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Small Business Checkpoint

Why are small business card balances rising?

15 November 2023

Key takeaways

- Small business credit card balances are rising. The average balance has now exceeded 2019 levels, and businesses with annual revenue above $1 million are seeing the fastest increase, according to Bank of America internal data. While the initial rise was likely due to increased spending, over the last year credit card spending has been largely flat, while balances continue to rise.
- This suggests to us that more small businesses are not paying the full balance and are using credit cards as a source of financing. While this points to financial stress for certain firms, the overall loan-to-net worth ratio for small businesses remains at historically low levels.
- Looking at spending trends in October, total payments per small business client increased by 1.1% year-over-year (YoY), a rebound from September. Within sectors, we see relative strength in payments growth for construction. Despite signs that non-residential construction spending has started to moderate, residential construction spending is now showing signs of rebound.

Small Business Checkpoint is a regular publication from Bank of America Institute. It aims to provide a real-time assessment of small business spending activities and financial well-being, leveraging the depth and breadth of Bank of America's proprietary data. Such data is not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial condition or performance of Bank of America

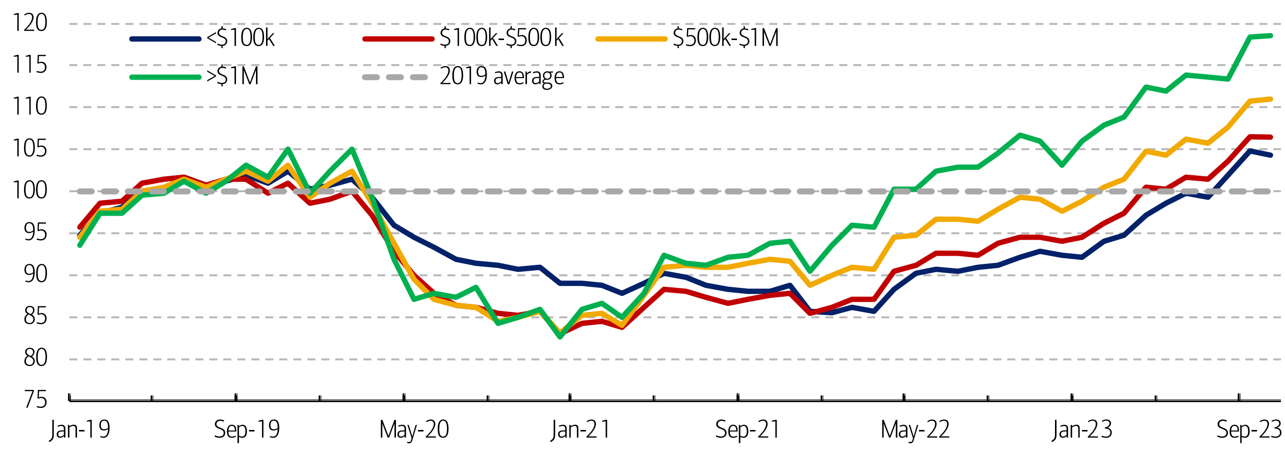
Small business credit card balances exceed 2019 levels

In the latest widely followed quarterly Household Debt and Credit Report from the New York Fed, household credit card balances reached a record high of $1.08 trillion in 3Q 2023. However, the data shed little light on small business credit cards, which play a critical role in smaller firms' daily operations. Bank of America internal data can provide that insight.

As Exhibit 1 shows, the average Bank of America small business credit card balance has been rising steadily since 2021 and has now exceeded the 2019 average. That said, the degree of increase varies across business revenue tiers. For those small businesses with annual revenue greater than $1 million, the average credit card balance as of October 2023 was 18% higher than its 2019 average, the largest increase across revenue tiers. On the flip side, for the smallest firms, those with annual revenue less than $100k, the latest credit card balances were just 4% higher than 2019 levels.

Exhibit 1: Average small business credit card balance by business annual revenue tiers, according to Bank of America internal data (index, 2019 annual average=100 for each revenue tier, non-seasonally adjusted, end of month balances)

Higher revenue tier small businesses have seen a faster rise in credit card balances over the last two years



Source: Bank of America internal data

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Should we worry about higher business credit card balances? First, it is important to understand that small business credit cards serve two functions: a means of transacting and a source of financing. In the former, credit card balances rise as businesses spend more on credit cards but generally businesses pay these balances off before their cycle due date. In other words, although balances are rising, they don't necessarily carry interest charges. However, in the case of balances that are not fully paid by their cycle date and, therefore, start to accrue interest, credit cards become a source of financing to small businesses.

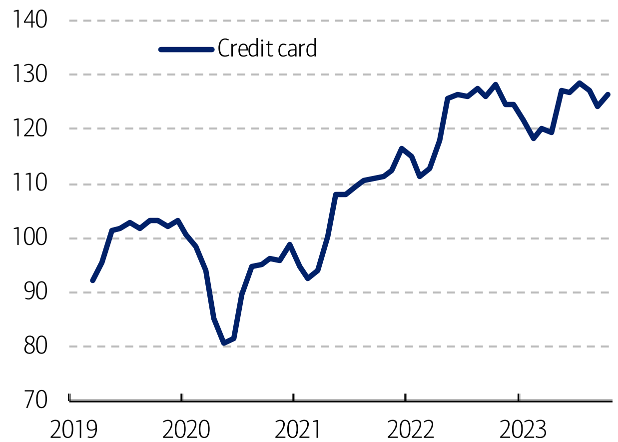
So, which of these factors explain the rise of balances? In our view, in 2021 and 1H 2022, increased spending largely explains the rise in balances. However, over the last year or so, credit card spending has been largely flat (except for the seasonal dip in February 2023), while balances have continued to rise (Exhibit 2). This suggests to us that more small businesses are using credit cards as source of financing this year with an increasing portion of balances carrying interest.

While this implies that some small businesses are starting to feel financial pressure, there are two positive factors to consider. First, the increase in credit balances since 2019 was lower than inflation during the same period across all revenue tiers. In September 2023, the Consumer Price Index (CPI) was 20% higher than the 2019 average. Accordingly, inflation-adjusted balances remain below pre-pandemic levels, even for small businesses with annual revenue greater than $1 million, whose balances increased by 18%.

Second, small business net worth has surged during the last few years, meaning that even with the rise in credit card debt, the ratio of debt to net worth remains at historically low levels. This can be seen in Exhibit 3, which shows the ratio between total bank loans, including credit card loans, and net worth for nonfinancial noncorporate businesses - most of which are small businesses.

Exhibit 2: Credit card spending per small business client (index, 2019 average =100, 3-month moving average, non-seasonally adjusted)

Over the last year or so, small business credit card spending has largely been flat



Source: Bank of America internal data

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Exhibit 3: Ratio of bank loans to net worth for nonfinancial noncorporate businesses (%, quarterly data through 2Q 2023)

Ratio of bank loans to net worth for nonfinancial noncorporate businesses remains low by historical standards

Source: Federal Reserve. Note: nonfinancial noncorporate businesses include sole proprietorships and limited partnerships, which are mostly small businesses.

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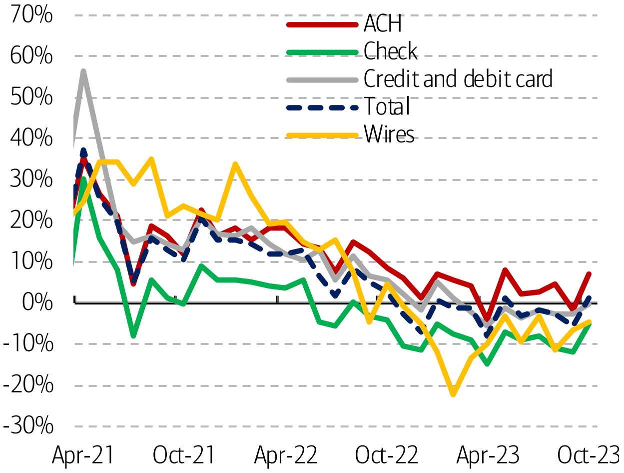
Total payments rebounded in October as expected

Looking at spending trends in October, total payments per small business client increased by 1.1% year-over-year (YoY), a rebound from the -5.6% YoY in September (Exhibit 4). The rebound came as expected because as we noted in last month's publication, with the prior month ending on a weekend, transaction processing for the last day of September was pushed into October. If we smooth out this calendar issue and look at the combined period of September and October, total payments per small business client were down 2% relative to the same time a year ago.

Among the major components, Automated Clearing House (ACH) showed the largest increase, up 7.0% YoY in October. This is the second-highest small business spending growth rate for this component in 2023. Part of the rebound in ACH payments was due to an increase in payroll spending. As Exhibit 5 shows, payroll payments per client were up 1.2% YoY on a three-month average basis in October, up from the -0.5% YoY in the prior month. As mentioned last month, we are seeing signs of small business hiring growth outpacing that of larger businesses in recent months.

Exhibit 4: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)

In October, total payments per small business client were up 1.1% YoY



Source: Bank of America internal data

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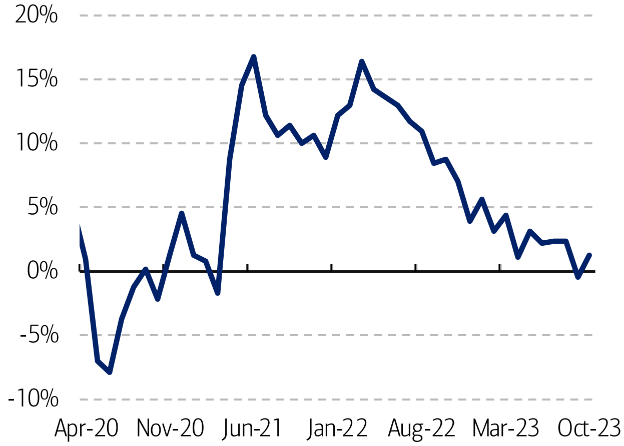
Exhibit 5: Payroll payment per small business client (%YoY, 3-month moving average)

Payroll payments per client were up 1.2% YoY on a three-month average basis in October, up from the -0.5% YoY in the prior month



Source: Bank of America internal data

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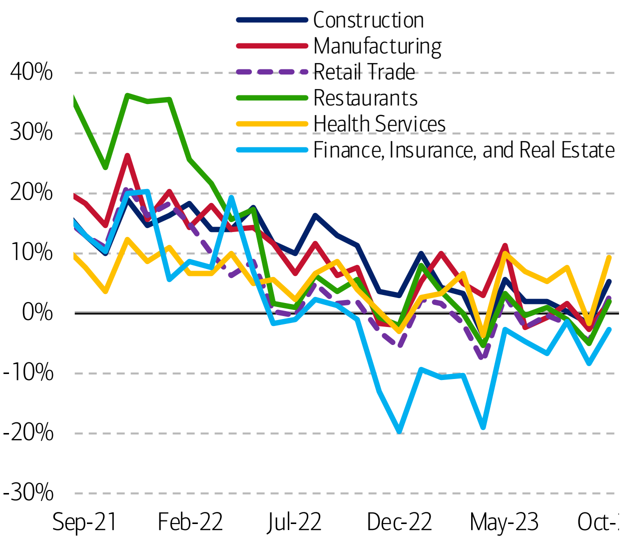
Within sectors, we continue to see relative strength in payments spending growth for health services and construction. The construction sector continues to be supported by a strong demand for building manufacturing plants, though it has cooled from the peak in 2Q of this year. In September, manufacturing construction spending was up 62% YoY, according to data from Census Bureau, still elevated but down from 82% YoY in May. The good news is, even though non-residential construction spending might have peaked according to Census Bureau data, residential construction is showing signs of rebound, which could continue to support the overall construction sector (Exhibit 7). And as we head into the holiday season, retail small business payments' growth was up 2.0% YoY in October, an improvement from the -4.7% in September.

Exhibit 6: Small business payments growth by select industries, according to Bank of America internal data (monthly, %YoY)

Healthcare companies have strongest small business payments growth compared to other sectors since June



Source: Bank of America internal data

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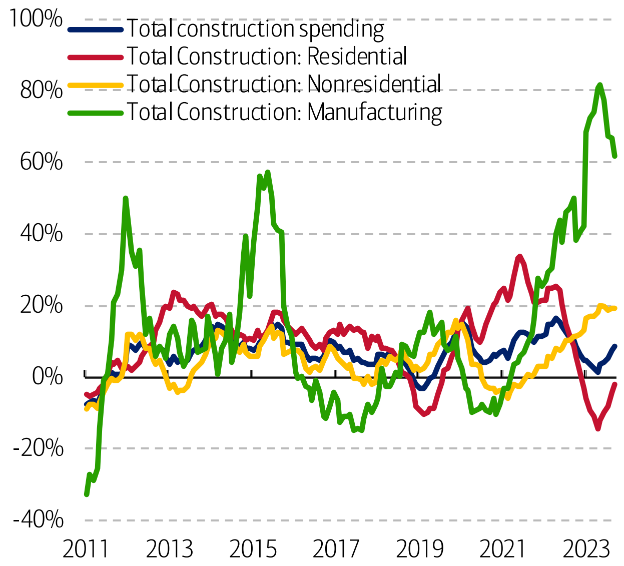
Exhibit 7: Construction spending: total and by type (%YoY)

Even though non-residential construction spending might have peaked, residential construction is showing signs of rebound



Source: Census Bureau

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Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on **aggregated and anonymized** selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Any **Small Business** payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and are generally defined as under $5mm in annual sales revenue.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Revenue tiers are determined by the combination of following factors: 1) stated revenue on small businesses credit or PPP applications, 2) actual account inflow into BofA Deposit Accounts, and 3) third party revenue estimation.

Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Additional information about the methodology used to aggregate the data is available upon request.

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