Accessible version

BANK OF AMERICA INSTITUTE

BANK OF AMERICA

Small Business Checkpoint

Rising rents take a bite out of profits

17 November 2022

Key takeaways

- Small businesses are facing rising operational costs including from rent payments which have surged. In October, the average rent payment per client was up 16% year-over-year (YoY), over 20% higher than in January 2019. This, together with other inflation pressures, has led to a profit squeeze, with small business account inflow-to-outflow ratio slowing since early 2022.
- To tackle these inflationary pressures, small businesses have increased borrowing. Business credit cards have been a popular choice of funding, with elevated spending per client growth at 16% YoY in October. This stands in contrast to debit card spending per client, which has slowed meaningfully over the past few months.
- But some relief can be found in moderating wage inflation, particularly in the restaurant industry. Restaurants' payroll payments grew at a similar pace to overall payroll payments in October, after leading by nearly 10 percentage points on a YoY basis earlier in the year.

Small Business Checkpoint is a regular publication from the 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 conditions or performance of Bank of America.

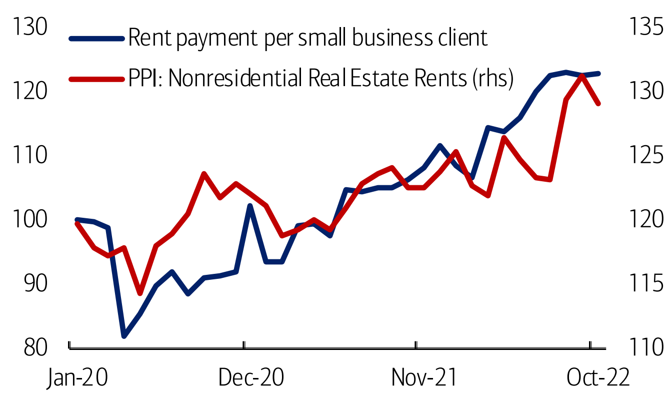
Small businesses squeezed by higher rents

In 2020, when many small businesses were shut down or had reduced traffic, support from schemes like the Paycheck Protection Program (PPP) and the eviction moratoriums provided temporary relief of operational costs. However, as COVID-related fiscal support has faded and prices have surged following the reopening, small business owners are now facing skyrocketing rents, amid other inflationary pressures. A recent Bloomberg article suggested that more than a third of US small businesses couldn't pay all their rent in October, according to survey data from Alignable, a small business network.

To quantify impact from higher rents, we turn to Bank of America internal data, focusing on small businesses that pay rent out of their Bank of America accounts through ACH (automated clearing houses). The average rent payment per small business client was up 16% YoY in October, over 20% higher than the January 2019 level. As Exhibit 1 shows, rent payments per client closely track the nonresidential real estate rents component of the Producer Price Index (PPI), suggesting the increase is largely due to inflation rather than small businesses upgrading to bigger or better spaces.

Exhibit 1: Monthly small business rent payments (index, Jan 2020=100) and Producer Price Index for commercial rents

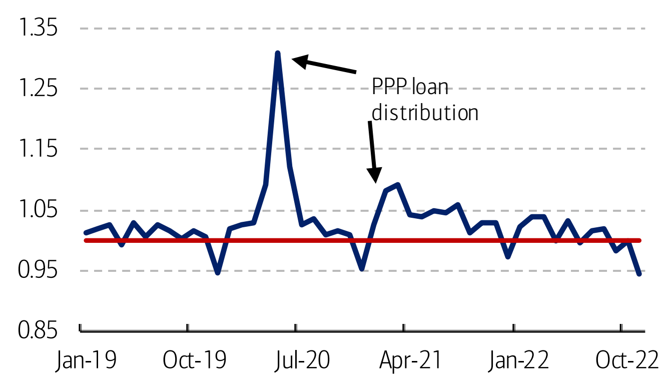
Average rent payment per small business client was up 16% YoY in October



Source: Bank of America internal data, Bureau of Labor Statistics for PPI data

Exhibit 2: Inflow to outflow ratio for small businesses, based on Bank of America internal data (monthly, 1+ = inflow greater than outflow)

The inflow to outflow ratio for small businesses moderated this year



Source: Bank of America internal data. PPP = Paycheck Protection Program. Note: inflow to outflow ratio is based on small business checking and savings accounts at Bank of America

Some small businesses also pay commercial mortgages for their premises. Bank of America data shows that the average mortgage payment per small business client was up 6% YoY (3-month rolling average) in October, or 8% above the level in January 2019. Note that mortgage payments by Bank of America small business customers include payments through ACH to financial institutions that may include Bank of America. Together, rent and mortgage payments account for over 7% of the total payments (total payments consist of ACH, card, wires, checks, cash and peer-to-business) of these small businesses. Therefore a meaningful increase in such rent/mortgage payments could mean a big increase in operational costs and a further squeeze on profit margins.

One way to understand the pressure on profit margins is to look at the inflow-to-outflow ratio for small businesses checking and savings accounts. As Exhibit 2 shows, this ratio seems to have been on a slight downward trend since March and was at just 0.94 in October, the lowest reading since 2019 (Exhibit 2). Although part of the slowdown is related to the fading of stimulus and that October's data could be an outlier, a persistent downward trend would be a cause for concern. Similarly, small business sentiment survey from the National Federation of Independent Businesses (NFIB) showed that earnings trends are near historic lows: in October, a net 30% of respondents expected a decline in earnings in the current quarter.

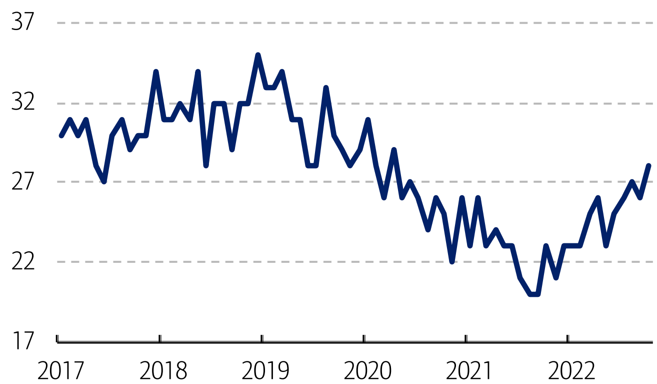
Reaching for the credit card to cope with price pressure

To tackle these inflationary pressures, small businesses have increasingly started to seek financing. According to the NFIB, 28% of small business survey respondents in October 2022 said that they borrowed at least once a quarter, up from 20% in September 2021 (Exhibit 3), though still below 2017-2019 levels.

Similarly, as we discussed last month (see Planning on sticking around), Bank of America survey data suggests business credit cards are a popular choice of funding. We see evidence of this in still-elevated credit card spending per client, which grew 16% YoY in October. This stands in contrast to debit card spending per client, which moderated meaningfully over the past month and actually slipped into negative territory (at -0.2%) on a %YoY basis (Exhibit 4). The caveat is that some small businesses may be able to fully pay off their credit card balance each month so the actual accumulation of credit card debt would be smaller than what spending growth rates suggest.

Exhibit 3: Percentage of small businesses borrowing at least once a quarter as of October 2022 (%)

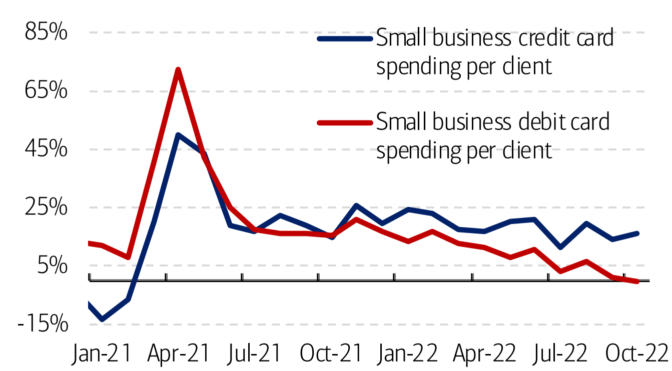
Share of small business survey respondents who said they borrowed at least once a quarter up from 20% in Sept 2021



Source: National Federation of Independent Businesses

Exhibit 4: Small business credit and debit card spending growth per client (monthly, %YoY)

Credit card spending per client grew 16% YoY in October compared with a 0.2% YoY contraction in debit card spending per client



Source: Bank of America internal data

Wage pressures easing, particularly for restaurants

The good news is that wage inflation seems to be moderating. As payroll payments account for nearly 20% of total small business payments, according to Bank of America data, slower wage growth could provide some relief to small businesses. Data from Bureau of Labor Statistics' (BLS) jobs report showed that average hourly earnings grew 4.7% YoY in October, down from the peak of 5.6% in March.

Looking by sector, restaurants saw the biggest moderation in wage growth to a still-elevated 7% YoY, but down from 14.9% in December 2021. As a result, payroll payments growth, based on Bank of America internal data, for restaurants and bars has also moderated: 13.6% YoY in October remains high but is down meaningfully from the peak of 38.8% in March this year (Exhibit 5). The growth is now in line with other sectors, and appears to be trending at similar rates to retail trade. Lodging payroll payments growth was strongest among the major sectors we track at 16% YoY, perhaps as hiring increases into the holiday season.

It is worth noting that labor shortages persist in the restaurant industry. As of October, BLS data suggests employment at restaurants was still 4.6% below the levels of February 2020 despite overall employment being 1% higher. This could suggest limited room for further moderation in restaurant wages.

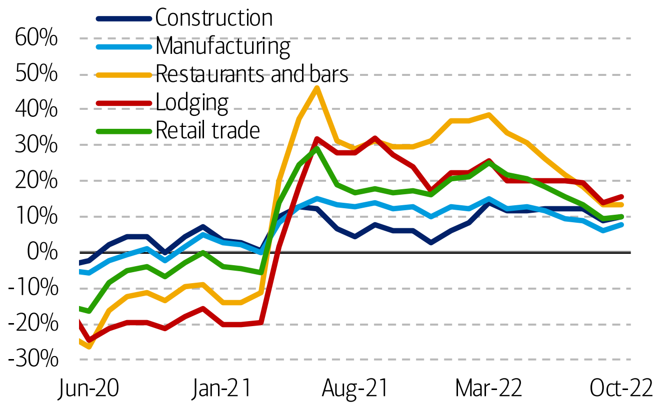
BANK OF AMERICA INSTITUTE

Elsewhere, small business payments data shows ACH and card payments remained fairly elevated in October, up 10% YoY and 8% YoY, respectively (Exhibit 6). ACH captures growth in bigger-ticket items, such as rent payments, car loans/leases, and payroll, which make up a significant portion of small business operating expenses.

On the flipside, both check and wire volumes per client contracted on a %YoY basis in October, down 2% YoY and 4% YoY, respectively. This could be further evidence of the shift from traditional payment methods to digital ones.

Exhibit 5: Growth in small business payroll payments for select industries (% YoY, 3-month moving average as of October)

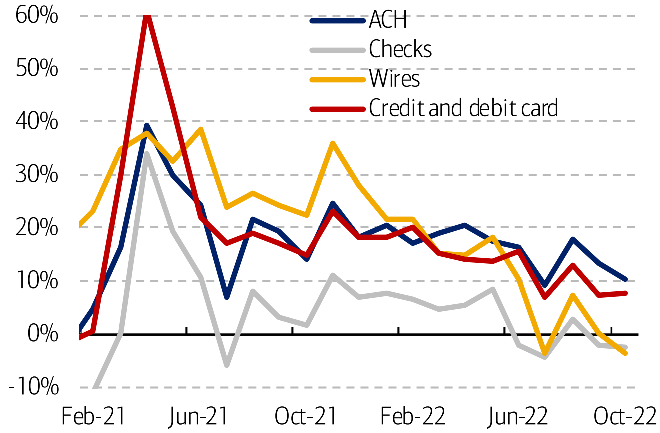
Payroll payments growth for restaurants and bars has moderated, and is now in line with growth in other sectors



Source: Bank of America internal data

Exhibit 6: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)

YoY% growth continues to moderate across all payment channels



Source: Bank of America internal data

Contributors

Anna Zhou

Economist, Bank of America Institute

Taylor Bowley

Analyst, Bank of America Institute

Sources

Patrick Williams

Senior Vice President, Digital Marketing

Kevin Burdette

Consumer Product Strategy Analyst, Consumer and Small Business

Carol Lee Mitchell

National Strategy & Segmentation Executive, Small Business

Julie Murphy

Small Business Analytics Executive, Digital and Marketing

Josh Long

Consumer Product Strategy Manager, Consumer and Small Business

Chris Wong

Head of Small Business Products, Consumer and Small Business

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 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.

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.

Disclosures

These materials have been prepared by the Bank of America Institute and are provided to you for general information purposes only. Such materials are not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial conditions or performance of Bank of America. The Bank of America Institute is a think tank dedicated to uncovering powerful insights that move business and society forward. Drawing on data and resources from across the bank and the world, the Institute delivers important, original perspectives on the economy, Environmental, Social and Governance (ESG) and global transformation. Unless otherwise specifically stated, any views or opinions expressed herein are solely those of the Bank of America Institute and any individual authors listed, and are not the product of the BofA Global Research department or any other department of Bank of America Corporation or its affiliates and/or subsidiaries (collectively Bank of America). The views in these materials may differ from the views and opinions expressed by the BofA Global Research department or other departments or divisions of Bank of America. Information has been obtained from sources believed to be reliable, but Bank of America does not warrant its completeness or accuracy. Views and estimates constitute our judgment as of the date of these materials and are subject to change without notice. The views expressed herein should not be construed as individual investment advice for any particular client and are not intended as recommendations of particular securities, financial instruments, strategies or banking services for a particular client. This material does not constitute an offer or an invitation by or on behalf of Bank of America to any person to buy or sell any security or financial instrument or engage in any banking service. Nothing in these materials constitutes investment, legal, accounting or tax advice.