Table of Contents

Executive summary 2
Experian/Moody’s Analytics Small Business Credit Index 3
Behind the numbers 4
Recent performance 4
Still a long way back 4
Regional pattern persists 6
Prolonged uncertainty from the shutdown 6
Small-business credit quality continues to improve as credit balances rise and delinquency rates fall

Executive summary

Small-business credit quality improved markedly in the third quarter, lifting the Experian/Moody’s Analytics Small Business Credit Index 2.3 points higher to 118.5 from an upwardly revised 116.2 (previously 111.7*) in the second quarter (see chart 1). The most recent index value is the highest since its inception and is an encouraging sign that small firms’ financial houses are finally starting to fall into order.

The index measures credit quality for firms with fewer than 100 workers and has trended upward for the past year. Credit balances expanded at their fastest pace in at least two years, and the delinquency rate has fallen consistently. Ten percent of outstanding small-business credit balances were past due in the third quarter, down 0.7 percentage point from a year ago and the smallest share since the recovery began.

The federal government shutdown in October took a bite out of small-business lending, according to the U.S. Small Business Administration (SBA), but loan volumes have already improved since the government reopened. Hence, it doesn’t look like the shutdown will greatly alter the small-business credit environment over the course of the fourth quarter.

Uncertainty poses a greater threat to small firms. The deal struck on Oct. 17 to fund the government and avert breaching the debt ceiling only funds the government until January and extends the debt ceiling through February. Consumer and business confidence will be tested as policymakers once again negotiate a budget and raise the debt ceiling in just a few months. Therefore, it wouldn’t be surprising if credit conditions for small businesses fail to improve further over the next couple of quarters.

*Recalibration of the index led to the larger-than-average revision.
Chart 1: Credit Quality Steadily Improves
Small Business Credit Index, 2011Q1 = 100

Experian/Moody’s Analytics Small Business Credit Index

Current quarter (2013 Q3): 118.5
Previous quarter (2013 Q2): 116.2
Behind the numbers

The rise in the Small Business Credit Index last quarter was supported by a strong increase in total credit outstanding, which rose at a double-digit pace in the third quarter (see chart 2). This is an indication that the small-business lending market is finally starting to thaw after credit markets froze during the recession. This is especially good news, since it could suggest more small firms have the confidence to borrow and expand. The 30- and 90-day delinquency rate buckets also ticked down 0.1 percentage point, offering a modest lift to the index.

The rise in credit balances is corroborated by responses from the Federal Reserve’s Senior Loan Officer Opinion Survey. The net share of banks loosening credit standards for small businesses has risen noticeably over the past year. Moreover, this has been met by a larger appetite for credit among small companies (see chart 3). The net percentage of banks reporting increased loan demand from small firms hit an eight-year high in the third quarter. The SBA also reports a healthy 17.9 percent rise in approved 7(a) loan balances in the fiscal year ended September 30 compared to 2012.

This is only part of the story, however. Financial lines of credit comprise only about 25 percent of the data used in the index. The other three-quarters is made up of nonfinancial trades. For example, a small law office may open an account at Staples for office supplies rather than take out a loan or obtain a credit card to fund those purchases. It may be that nonfinancial lenders are following banks’ lead and opening more accounts in search of revenues; the data certainly suggest that is the case.

Recent performance

The delinquency rate for small-business credit declined during the quarter and has been steadily declining since peaking in summer 2011. This has been accomplished in part by keeping labor costs in check.

Small-business employment dipped by 0.06 percent in October after essentially holding flat for the three months prior, according to the Intuit Small Business Employment Index that measures employment for companies with fewer than 20 workers (see chart 4). Though this represents only a subsample of businesses considered “small” by our definition, it serves as a decent rough proxy nonetheless. Small companies held their staffs steady amid rising policy uncertainty ahead of the shutdown and tepid consumer spending growth, but more job losses could be on the way if political uncertainty rises much more.

This is in line with the National Federation of Independent Businesses (NFIB) Small Business Survey, which also indicates small firms are in a holding pattern. Sentiment has barely budged since the summer, and a solid majority of respondents feel the economy will deteriorate over the next six months (see chart 5). Another parallel drawn between the Intuit and NFIB surveys is that earnings trends have been persistently negative for nearly all of 2013.

Still a long way back

The performance of small firms, which is more tightly tethered to demand for specialty goods and services, has been weaker than that of larger businesses since the recovery officially began in June 2009. The U.S. recovery has proceeded in fits and starts, sideling consumer spending on these types of items to a great extent.

The housing collapse decimated the construction industry, taking builder firms, which typically employ fewer than 100 workers, down with it. Only now, more than six years after the bottom gave out on the housing market, are construction firms’ fortunes changing for the better. With the housing recovery firmly in place, orders for new homes and renovations to existing ones are rebounding.

Notwithstanding recent momentum, both residential and nonresidential building companies have a long way back. The Intuit Small Business Revenue Index reveals that revenues fell by a disproportionately large amount for small construction firms in the wake of the housing bust and have trailed other industries throughout the recovery (see chart 6). Moreover, balance sheets at small construction companies remain weak: The share of past-due balances owed to creditors by construction firms with fewer than 100 workers rests at 17.4 percent, well above the 10 percent average for all industries.

The good news is that construction-company revenues are climbing back steadily, which should begin to show up as stronger credit quality over the next few quarters.
Chart 2: Delinquency Rate Hits New Low

Outstanding credit, % change year ago
Delinquency rate %

Sources: Experian, Moody’s Analytics

Chart 3: Small-Business Credit Market Thaws Out

Net % of banks reporting...

Looser credit for small firms
Higher demand for loans from small firms

Sources: FRB: Senior Loan Officer Opinion Survey, Moody’s Analytics

Chart 4: Small Firms Start to Shed Workers

Intuit Small Business Employment Index, % change, <20 workers

Sources: Intuit, Moody’s Analytics

Chart 5: Companies Still Leery of the Future

NFIB small business optimism index

Sources: NFIB, Moody’s Analytics

Chart 6: Builders’ Cash Flows Choked Off

Intuit Small Business Revenue Index, Jan 2005 = 100

Sources: Intuit, Moody’s Analytics
Regional pattern persists

The regional credit divide inherent thus far in the recovery remains intact. The credit profiles of small companies in the West remain substantially stronger than those in the eastern portion of the country (see chart 7). This is and has been particularly true in the Mountain West. For instance, past-due balances in Utah comprise a mere 1.1 percent of all balances, and Idahoan small firms boast a similarly low 2.2 percent delinquency rate.

Small companies in Florida have continually shown the weakest credit performance in the nation, with a quarter of all balances being paid beyond contracted terms. The real-estate bust was especially harsh in Florida, and overdevelopment led to a severe residential-property supply overhang that quickly lowered house prices. The drop in home values was exacerbated by a foreclosure rate that ballooned and still remains nearly four times the national average. In the end, house prices were nearly halved and are still struggling to gain ground.

This has meant a long and painful six years for Florida construction companies. Small businesses let go of more workers proportionally, many of whom were builders, than elsewhere in the country. Construction employment in Florida dropped 50 percent between 2007 and 2011 and has hardly made any headway since. For context, U.S. construction employment fell by about 30 percent over that time period.

An overwhelming amount of construction companies are small businesses and a peek into the credit quality of small Florida builders sheds some light on the extent to which they are hurting. Almost 30 percent of balances owed by small construction firms are being paid late in the Sunshine State, much higher than the U.S. average of 17.4 percent and about seven times higher than the share of delinquent balances owed by construction companies in Utah. Worse, nearly all of the overdue balances are more than 99 days late.

In fact, a number of industries in Florida are paying late, and this is especially apparent when comparing small Florida companies to their counterparts in Utah and Idaho (see chart 8).

On the bright side, variations in credit quality across the nation have narrowed over the past year, a sign that small companies in the East are making headway at a sufficient pace to catch up to their better-performing peers in the West.

Still, it could get worse before it gets better for companies in the East. Many small businesses in the eastern half of the country are struggling amid high delinquency on their loans, yet the bankruptcy rates in many large eastern cities is quite low. Given relatively weaker growth projections for that portion of the country, these companies could end up filing for bankruptcy to get out from under their debt. If so, it’s possible that business filings could rise modestly in 2014, especially along the Eastern Seaboard where delinquency is highest.

Prolonged uncertainty from the shutdown

Moody’s Analytics estimates the 16-day partial federal government shutdown will lower real gross domestic product growth by a half of a percentage point in the fourth quarter on an annualized basis. Factoring this in, the forecast calls for growth to clock in at 2 percent annualized in the final quarter of 2013. The drag on growth will undoubtedly hurt small businesses, but quantifying the total impact is difficult.

One hard number that stands out is the volume of approved small-business loans through the SBA since Oct. 1, when the shutdown began. The SBA is a federal agency, meaning thousands of loans couldn’t be serviced during the federal blackout. Loan volumes to small companies in the first four weeks of October were down 35 percent compared to last year. However, the news may not be all that bad. The volume of approved loans was 55 percent below year-ago levels as of the week ending Oct. 18, just after the government reopened. This suggests the gap in loan disbursements could close by the end of the quarter and that the overall net impact to credit conditions will be minimized.

That said, other factors could likely weigh on small-business credit conditions as 2013 ends and 2014 begins. Washington’s 11th-hour deal to reopen the government will do little to jumpstart the recovery over the next few months, since a long-term fix is lacking.

Both the University of Michigan and Conference Board measures of consumer sentiment show the government shutdown and debt-ceiling standoff had a more malignant effect on consumers’ psyches than was expected in October. Confidence reeled as buyers indicated unease over
Chart 7: Regional Pattern Holds in Q3
Delinquency rate, $ volume

Sources: Experian, Moody’s Analytics

Chart 8: High Delinquency Across Industries in Florida
Delinquency rate, $ volume

Sources: Experian, Moody’s Analytics
their current situation and heightened pessimism over the economic outlook. The University of Michigan reading is the lowest since December of last year, when consumers were anticipating higher taxes associated with the fiscal cliff, and the Conference Board measure sank to its lowest level since April. Soft consumer sentiment is bad news for small retailers during their most important shopping season, and delinquency could rise modestly if buyers pull back on spending.

Any gain in the Small Business Credit Index this quarter will be extremely hard-won but not impossible. Small companies seem to be committed to improving their credit profiles, even at the risk of expanding more slowly. It looks as if small-business loan balances will recover after the kerfuffle in the midst of the shutdown. Slow consumer spending growth will make it tough for businesses to pay down delinquent debt. However, this has been the case for almost all of the recovery, and delinquency is at its lowest since early 2010. If anything, small companies will adjust their costs in order to keep making headway on debt.

Many of the same headwinds that could hold back improvement in the fourth quarter will persist into early 2014. Another budget standoff in January will be quickly followed by negotiations to raise the debt ceiling in February. Much like the recent episode, uncertainty will likely be an albatross on business activity. All told, the Small Business Credit Index is likely to see only modest improvements over the next couple of quarters until the thick cloud of uncertainty dissipates in Washington.
About the index

Experian joined forces with Moody’s Analytics, a leading independent provider of economic forecasting, to create a business index and detailed report that provides insight into the health of U.S. businesses. The Experian/Moody’s Analytics Small Business Credit Index is reported quarterly to show fluctuations in the market and discuss factors that are impacting the business economy.

About Experian’s Business Information Services

Experian’s Business Information Services is a leader in providing data and predictive insights to organizations, helping them mitigate risk and improve profitability. The company’s business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies. Experian provides market-leading tools that assist clients of all sizes in making real-time decisions, processing new applications, managing customer relationships and collecting on delinquent accounts. For more information about Experian’s advanced business-to-business products and services, visit www.experian.com/b2b.

About Moody’s Analytics

Moody’s Analytics, a unit of Moody’s Corporation, helps capital markets and credit risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By offering leading-edge software and advisory services, as well as the proprietary credit research produced by Moody’s Investors Service, Moody’s Analytics integrates and customizes its offerings to address specific business challenges. Further information is available at www.moodysanalytics.com.