Preparing your business for the economic upswing

Understanding business behavior for portfolio growth
Current signs point to economic recovery, but as was true during the recession, multiple factors will determine how individual businesses behave. In spite of this uncertainty, forward-thinking creditors need to be prepared should the recent economic uptick blossom into full-blown growth.

In this report, Experian® examines the metrics that illuminate why businesses have been impacted differently by the recession. In particular, the report will examine opportunities for creditors with small to medium-sized businesses, which traditionally have been harder to identify. As Experian's data shows, even within the most adversely impacted industries, there are segments that have remained relatively healthy. Understanding how industry type, region and business size can be factored into a more accurate assessment of the marketplace is crucial when considering opportunities for portfolio growth.

**Key business activity trends**

To better understand key business health trends, Experian monitored a sample of businesses (almost 80 percent of the sample included businesses with fewer than 25 employees), specifically examining the credit relationship between those businesses and their financial institutions. Two key measures of the health of business activity are new credit account opening rates and account closing rates.

Chart 1 shows that new credit accounts decreased through Q1 2009 as the financial crisis intensified and lending tightened. However, this rate started to increase in Q2 2009, after four consecutive quarters of decline. While this represented a positive sign, it is important to note that the trend had not yet stabilized, as it again headed lower in Q4 2009.

An examination of commercial account closing rates in Q4 2008 showed a large spike that corresponds with the peak of the credit crunch. As of Q4 2009, the closing rate had stabilized back to below 4 percent.

**National average rate of business credit account openings and closings**

![Chart 1](image-url)
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Have we turned the corner?
While it is difficult to gauge whether the economy has in fact begun to rebound, there are clear indications of improvement. Chart 2 shows that the average outstanding balance increased by more than $1,000 during a one-year period starting in Q1 2008. By Q3 2009, there was a dramatic increase in activity and borrowing; average balances nearly doubled, rising to more than $7,000. Hopefully, these indicators point to greater small-business activity and a return to growth. Coupled with healthier new account open rates, as described above, this data may be a sign that financial institutions have started to lend again.

Quarterly charge-off rates increased dramatically from Q3 2008 to Q2 2009, going from 0.26 percent to almost 1.2 percent, a 360 percent increase. In all likelihood, this signifies the period after banks had closed accounts for high-risk businesses and those balances were being charged off. Charge-offs then dropped below 0.8 percent, which coincides with credit account balances spiking in Q3 2009.

With these numbers, Experian is seeing a reversal from its previous study, which showed financial institution lending was shrinking rapidly in late 2008. As a result, suppliers were becoming credit grantors, providing trade credit to business partners to keep them afloat by extending payments. However, a recent analysis of Experian’s manufacturing trade contributors showed that the trend toward extended payments has significantly declined. When this information is combined with the observations made above, it appears small businesses have reverted back to bank lending to supplement cash flow in meeting trade obligations.

National average business credit account balance and charge-off rates

Business credit health index
To gain a clearer picture of the credit health for businesses during the study period, Experian developed a composite index that utilized various measures, such as account opening and closing rates, balance activity, payment behaviors and charge-off rates, to examine the health of businesses by various segments, including industry type, business size and geographic distribution.
Chart 3 details credit health by industry. The segments in green were ranked higher than average (more healthy), those in yellow were average, and those in red were lower than average (less healthy). Looking at the primary industry sectors, indicated in bold, Experian’s data shows that manufacturing and wholesale trade have the best financial credit health, which reflects early signs of economic improvement. Conversely, retail trade and real estate remain less healthy as consumer spending lags and unemployment and the mortgage crisis continue to affect home sales.

The second dimension Experian examined was business size. Chart 4 shows that large and medium-sized businesses are the most healthy, small businesses show average health, and very small businesses are less healthy. This data can be explained by the tightening of credit availability and lower consumer spending, resulting in large and medium-sized businesses stretching payments and the smallest businesses, which lack similar resources, quickly finding themselves in trouble.

Business credit health by industry

<table>
<thead>
<tr>
<th>Rank</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Public administration</td>
</tr>
<tr>
<td>2</td>
<td>Mining</td>
</tr>
<tr>
<td>3</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>4</td>
<td>Wholesale trade</td>
</tr>
<tr>
<td>5</td>
<td>Services</td>
</tr>
<tr>
<td>6</td>
<td>Construction</td>
</tr>
<tr>
<td>7</td>
<td>Agriculture, forestry and fishing</td>
</tr>
<tr>
<td>8</td>
<td>Transportation and public utilities</td>
</tr>
<tr>
<td>9</td>
<td>Retail trade</td>
</tr>
<tr>
<td>10</td>
<td>Finance, insurance and real estate</td>
</tr>
</tbody>
</table>

Chart 3

Business health by business size

<table>
<thead>
<tr>
<th>Rank</th>
<th>Business size</th>
<th>Employee size</th>
<th>Percentage of sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Medium</td>
<td>26–1,000</td>
<td>23%</td>
</tr>
<tr>
<td>2</td>
<td>Large</td>
<td>1,000+</td>
<td>1%</td>
</tr>
<tr>
<td>3</td>
<td>Small</td>
<td>6–25</td>
<td>14%</td>
</tr>
<tr>
<td>4</td>
<td>Micro</td>
<td>1–5</td>
<td>62%</td>
</tr>
</tbody>
</table>

Chart 4
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The third dimension examined is credit health by geographic region. In Chart 5, the West Coast and the Southeast are least healthy, reflecting the significant impact of high unemployment rates and the related mortgage meltdown on businesses in those regions. The regions in the middle of the country are the healthiest, which suggests the recession has had less impact on businesses there.

A review of the results over the two-year study period highlights the fact that not all businesses were affected equally. Simply looking at a one-dimensional view provides some insight into business risk, but it does not give sufficient information to formulate a business strategy for targeted growth. A multidimensional view of business health is far more effective at identifying risk-worthy lending opportunities.

Average financial credit health segmented by region

A closer look by industry type and business size

A review of geographic segmentation alone shows that the Great Lakes region (Region 5) is healthier than other areas in the country and, as such, may be an area of opportunity for business growth strategy.

To illustrate the importance of taking a multidimensional view of risk factors, Experian focused on the retail industry (Chart 6), which ranks as the second-worst in terms of health. Given this region’s standing, it is no surprise that an examination of industry segmentation shows that retailing in the Great Lakes region was less
healthy than other industries. This suggests that creditors should take a cautious approach to these businesses and not jump in, which could be suggested if only geographical segmentation were examined. However, drilling down deeper and segmenting by business size shows that medium-sized retail firms were in the healthiest category.

Financial credit health for the retail industry

![Chart 6](image)

**How one of the best-performing industries is faring**

Quite the opposite of the retail industry, manufacturing has been one of the best-performing industries nationwide. Looking more closely by region, Chart 7 shows that businesses in the Southeast displayed below-average health among all industries, including manufacturing. Yet, when segmented by size, this region had above-average health for both large and medium-sized businesses.

In the chart below, Region 3 shows above-average health when considering the geographical well-being of all industries but only average health when focusing on manufacturing. This difference can be attributed to the impact of microbusinesses, which fared less well. So, while manufacturing is clearly one of the best-performing industries, the segmentation results show that growth opportunities must be evaluated carefully.
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The examples of the retail and manufacturing industries illustrate the importance of using more variables in segmenting a study in order to gain more granular results. In this way, creditors can achieve an enhanced view of the marketplace.

Financial credit health for the manufacturing industry

Conclusion

As credit grantors prepare for small-business portfolio growth, there will be a shift from the defensive positioning of the past several years to a growth mode. As the portfolio growth strategy accelerates, competitive posturing for new business will intensify. Experian has demonstrated that identifying which industries, regions and business sizes are the healthiest will be key in developing effective business strategies that enable profitable portfolio growth. As the economic landscape improves, those organizations that rely on analytics to further segment prospects will be well-positioned for higher-quality growth and greater success in today’s complex business climate.
Methodology
The data referred to in this study was sourced from Experian’s Small Business Credit Share™ program. The study focused on small business, with almost 80 percent of the sample measuring businesses with fewer than 25 employees. Businesses examined had a credit relationship with a financial institution, and the health of business credit was examined using a proprietary index developed from those relationships. The study relied on data from Q1 2008 through Q4 2009.

Experian analyses and studies
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