



# Beyond the Trends

Understanding the Commercial Economy

Spring 2024

### About this report

Beyond the Trends is a quarterly report written by Experian Business Information Services. The report offers a unique view of the small business economy based on what we see in the data. With up to date information on over 33 million active businesses and how they perform from a credit standpoint. Experian will share insights and commentary on how economic conditions, public policy, and other factors might shape future small business performance.



### Ready for springtime growth

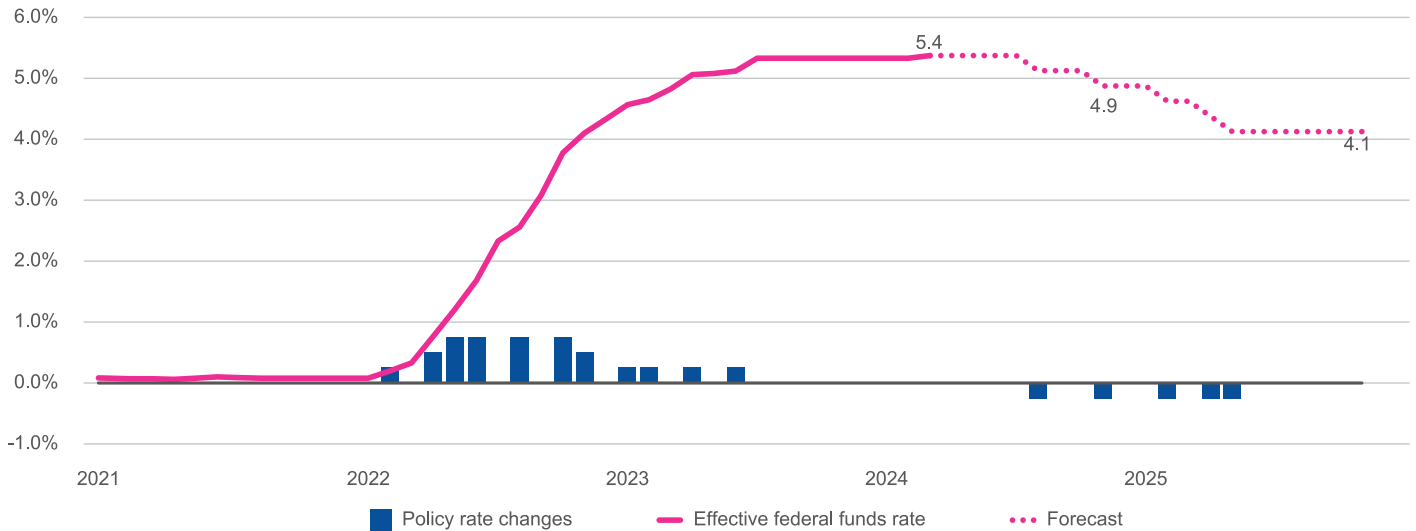
**U.S. Small Business is ready to expand?** Imagine you are a small business owner sitting at your kitchen table surveying your business's successes and failures as you review the prior year. Last year was a year synonymous with the word "Anxious." Talk of recession was thick in the air, but your customers were still buying. Your costs had risen, but you worked hard not to pass those on. When you finally had to, your customers paid, and you were surprised. The economy in 2023 outperformed expectations, with only the continued rise in the cost of everything weighing heavily on your mind. As a business owner you look at 2024 with the same anxious eye. The economy in general is strong but inflation is hanging on and not appearing to budge. Finding a loan at a comfortable rate and knowing your customers will continue to spend to support your business is tricky. You are ready to grow but are the signals clear enough to take the ideas from the kitchen table to the bank?

### Support for U.S. Small Businesses

Let's look at how my small business is viewed from a macroeconomic perspective and how the U.S. works to create an environment fertile for growth. Small businesses contribute greatly to the U.S. economy. The Small Business Administration (SBA) promotes small companies as a crucial component of the U.S. economy, highlighting their significant role in job creation and economic activity. According to the SBA, there are approximately 33.2 million small businesses in the United States, constituting 99.9% of all U.S. businesses. These small businesses create two-thirds of all new jobs and 44% of the U.S. economic activity. Programs and policies introduced or expanded by the SBA have substantially supported small businesses, including increased access to capital. These efforts represent a concerted push to bolster small businesses, ensuring they have the resources to sustain and grow, thereby contributing to their improved longevity and resilience in the face of economic challenges.

The Federal Reserve has been focused on two big targets: inflation and employment stability. These are keys in what we have traditionally considered a healthy economy. The Federal Reserve's mission focuses primarily on promoting maximum employment, stable prices, and moderate long-term interest rates, often called the "dual mandate". The Federal Reserve has been pulling levers to promote fertility by promoting maximum employment to create conditions that achieve an elevated level of U.S. employment across regions. They are committed and goaled to adjust monetary policy to foster economic conditions conducive to job creation. Finding ways to stabilize prices across industries, with the Federal Reserve aiming to keep inflation near 2% as represented in the Personal Consumption Expenditures (PCE), keeps the economy warm enough to grow but not so hot to drive customer prices to an unsustainable level. In 2024, adjusting interest rates and conducting open market operations have been central to their strategy to manage inflation levels and expectations.

## Federal Funds rate cuts in the distant future



Source: Federal Reserve Board of Governors

As they manage short-term interest rates and provide insights on future monetary policy changes, the Fed influences long-term interest rates to support economic conditions conducive to achieving its employment and inflation objectives. In 2024, the Federal Reserve has been actively monitoring economic indicators and making policy adjustments in response to evolving economic and financial stability.

## Transitioning market preparing for growth

What creates hesitation for growth for a small business? At my kitchen table it has always been costs and cashflow. These factors impact whether I am feeling comfortable enough to begin investing in my business versus holding capital for protection against a rainy day.

## What is holding back growth

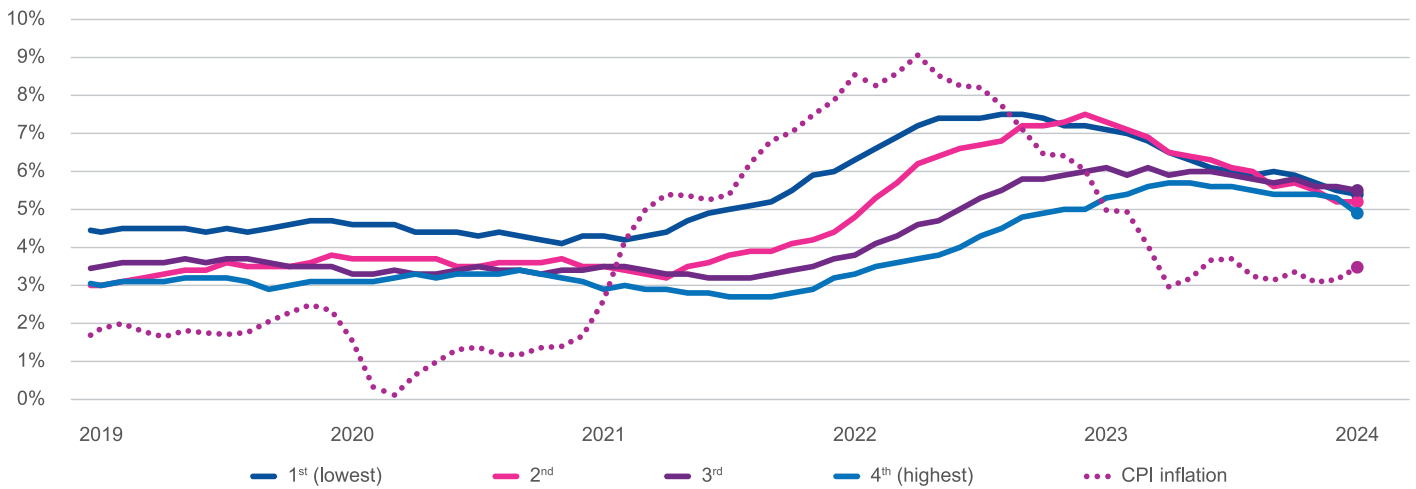
Small businesses face challenges that could hold back their willingness to grow in 2024.

**Economic Uncertainty and Financial Markets:** The potential for economic downturns affects everything from pricing strategies to overall business planning. According to a survey conducted by Bloomberg in 2023, the perceived probability that the United States would enter a recession in the following year was about 70%. The St. Louis Federal Reserve highlighted that by August 2023, professional forecasters estimated a 60% chance of a recession occurring within the next 12 months.

The concession on a prediction of recession dropped significantly in 2024 to around 25%. Small businesses, such as local retail stores, struggle with the unpredictability of economic shifts that affect their pricing and inventory strategies. For instance, Little Luxuries, a boutique gift shop in Madison, Wisconsin, must frequently adjust its product prices and stock levels in response to the fluctuating costs of imported goods, which are influenced by global currency dynamics. This type of dynamic pricing can impact customer engagement and limit a business’s ability to forecast cashflows for growth.

**Workforce Challenges:** Hiring and retaining talented employees is increasingly difficult due to competitive wages offered by larger companies and changing workforce expectations.

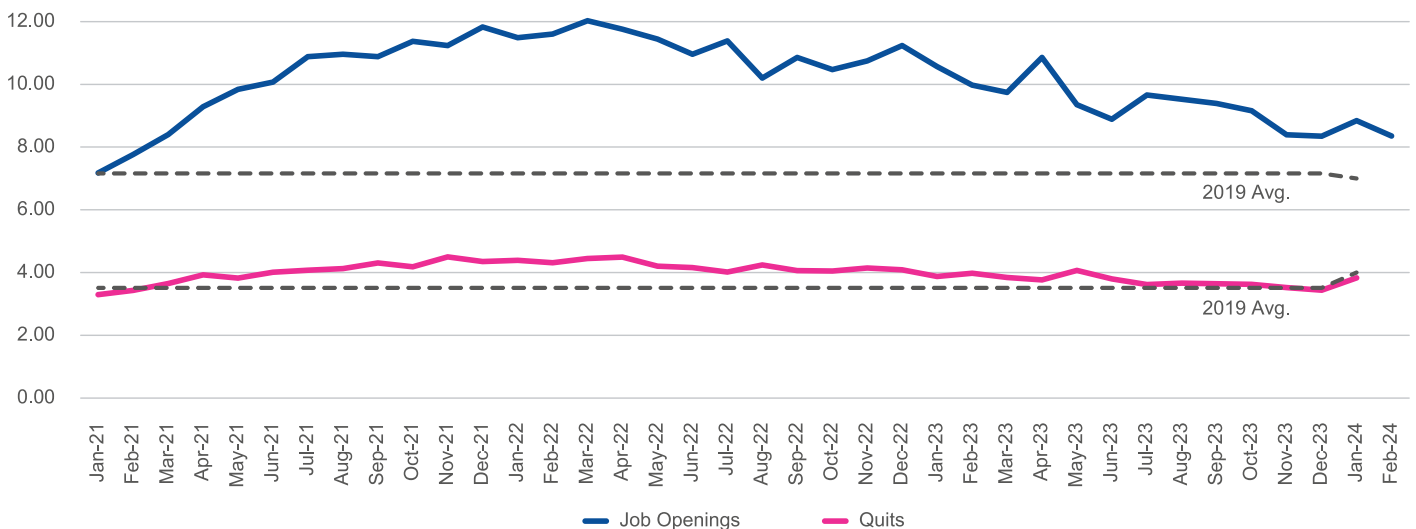
### Wage Growth by Income Quartile vs Inflation



Sources: Bureau of Labor Statistics and Experian Economic Strategy Group

Small businesses often struggle to meet salary demands, which affects their ability to attract and retain skilled workers. Small businesses across various sectors are experiencing difficulties in hiring and retention. Sunny Side Daycare in San Francisco, California, for example, has had trouble attracting qualified staff due to the competitive wages offered by larger corporations and public institutions, forcing them to enhance their employment packages to retain employees. The environment is improving as the labor market cools.

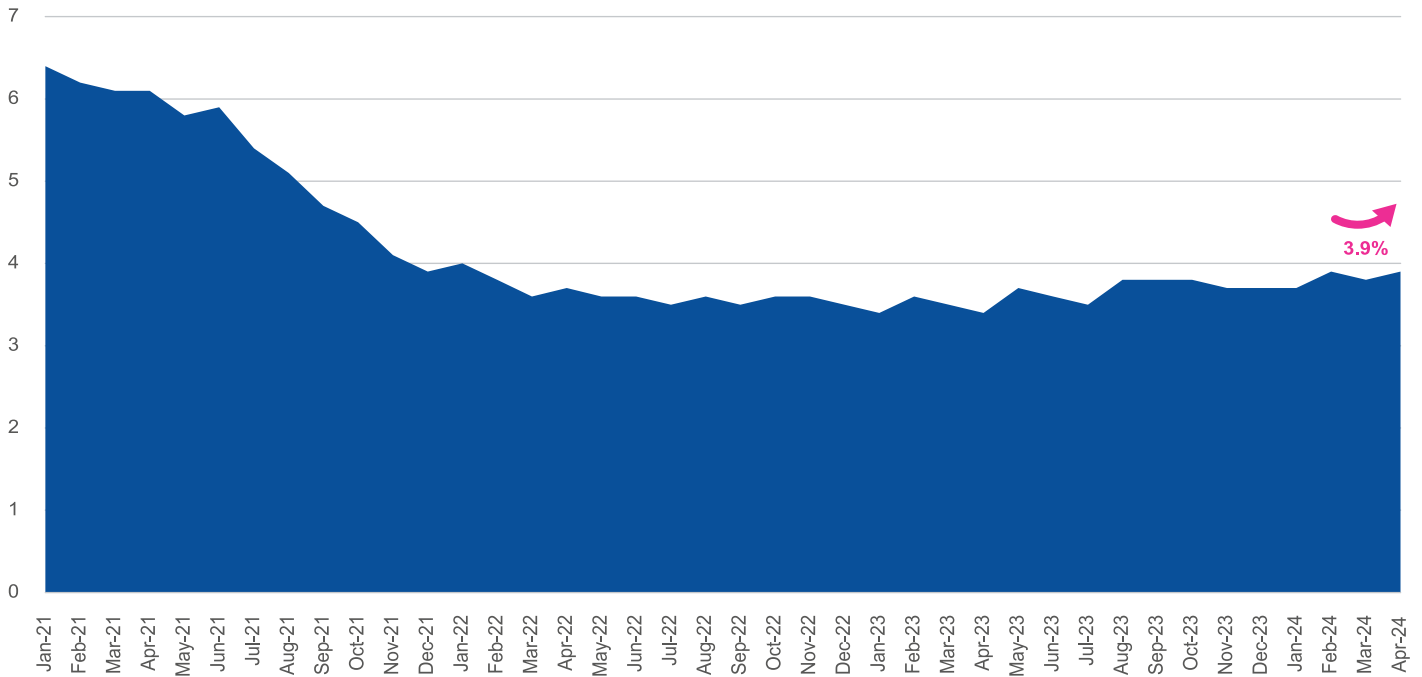
### Monthly Job Openings and Quits (Millions)



Sources: U.S. Bureau of Labor Statistics

The U.S. labor market is still strong, but wage growth will slow. This transition will provide relief to small business operational costs. U.S. unemployment steadily below 4% means consumers can work and spend steadily, placing upward pressure on inflation.

## United States Unemployment Rate

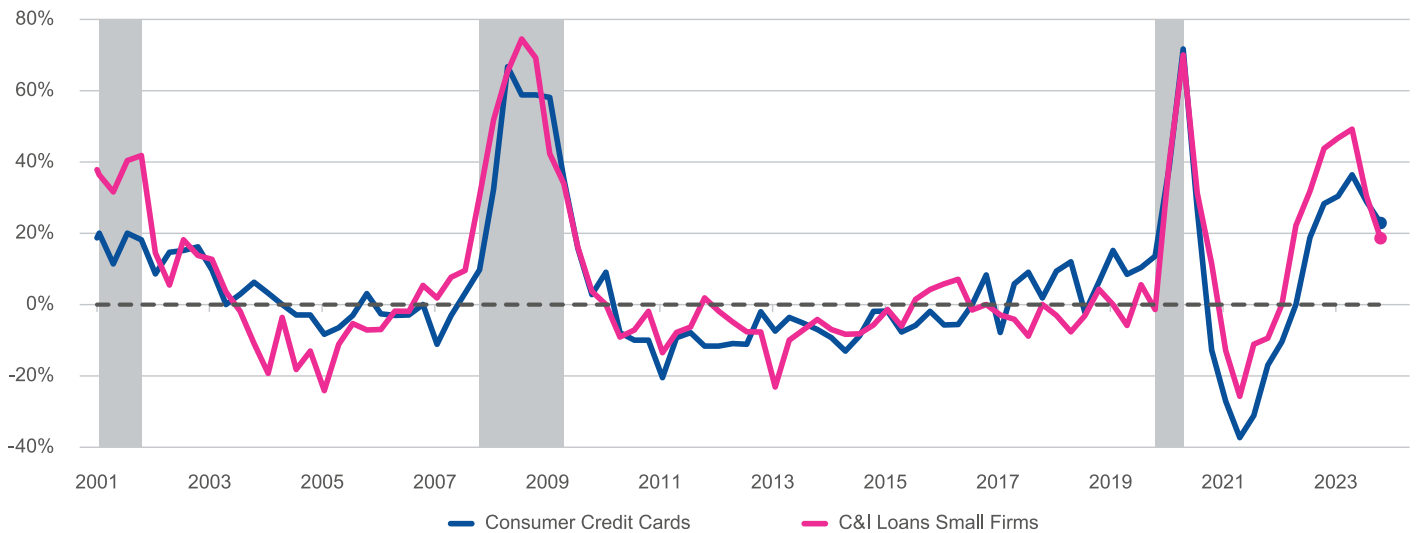


Source: U.S. Bureau of Labor Statistics

**Inflation and Rising Costs:** Inflation remains a significant challenge, eroding profit margins and increasing operational costs. Small businesses need to raise prices or cut expenses to manage these higher costs. Rising inflation significantly impacts small businesses like craft microbrewers in Boulder, Colorado. They have reported a sharp increase in the cost of raw materials such as hops and barley, as well as energy costs, leading them to increase the prices of their craft beers to maintain a sustainable margin. Rising cost has been the top concern for small business owners in the past 24 months surpassing labor as the number one concern. If you cannot afford the raw materials to create your products you will likely not survive as a business.

**Access to Capital:** The tightening of credit conditions and the rise in interest rates have made it increasingly difficult for small businesses to secure the necessary funding.

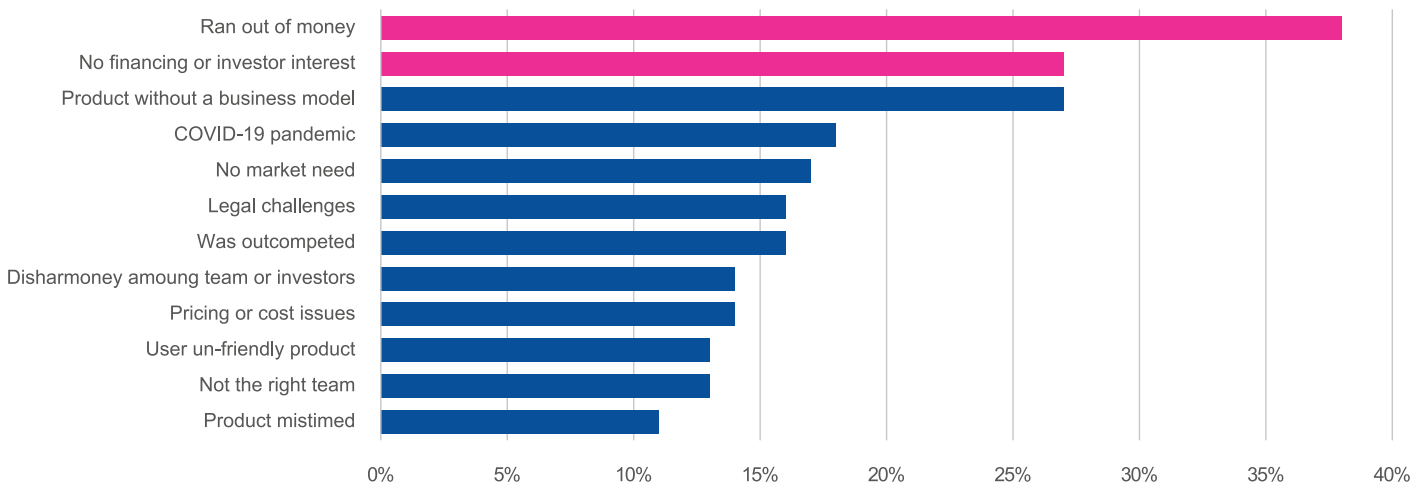
### Net % of Banks Tightening Lending Standards



Sources: Federal Reserve and Experian Economic Strategy Group

The recent failures of regional banks like Silicon Valley Bank and Signature Bank have particularly impacted small businesses that relied on these institutions for their banking needs. These closures have strained the small business lending environment, making it more challenging for businesses to access the capital needed for growth and sustainability. The closure of some regional banks has exacerbated this issue, particularly affecting those who relied on these banks for funding. Tighter lending conditions have affected small businesses' ability to expand.

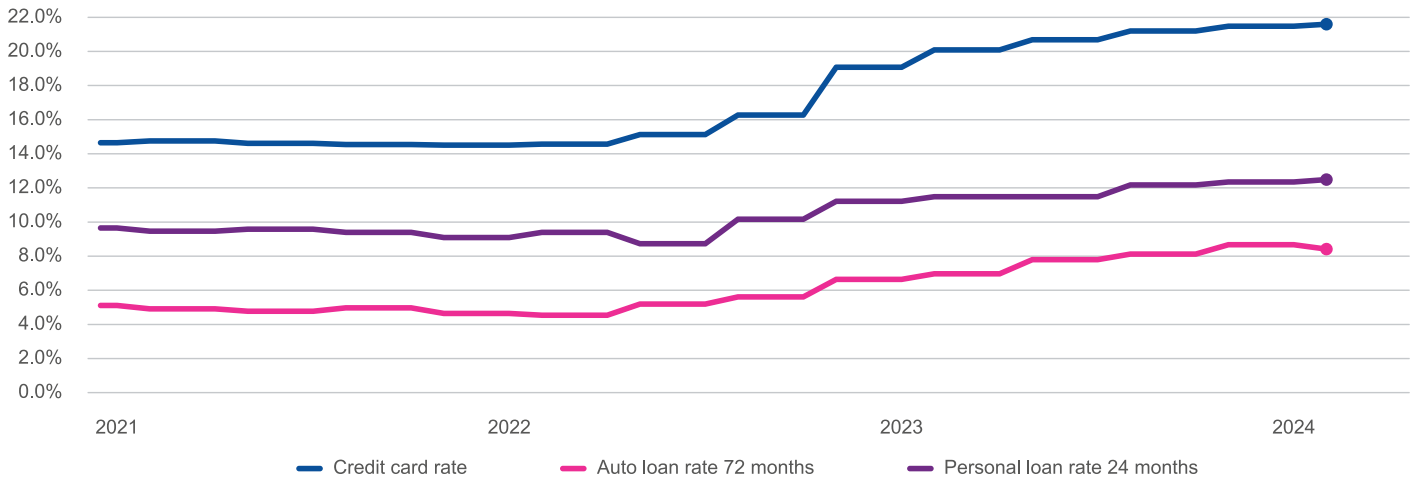
### Top Reasons Startups Fail



Source: Oberlo

Green Leaf Gardening, a landscaping company in Orlando, Florida, faced challenges securing a loan for new equipment due to stricter banking regulations and rising interest rates, which impacted its operational capacity and growth potential.

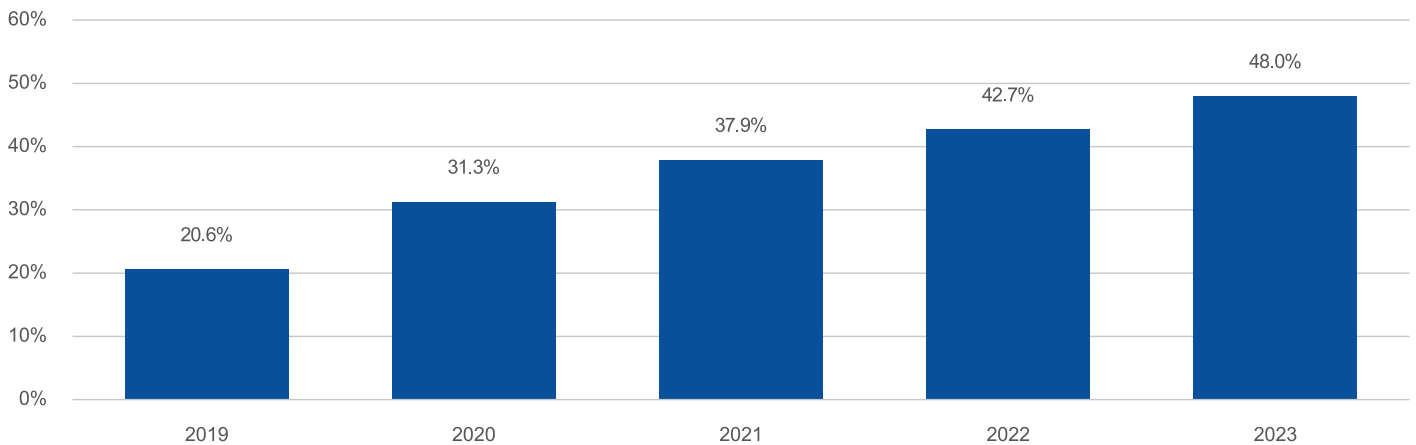
### Interest Rates by Product



Sources: Federal Reserve and Experian Economic Strategy Group

These rising rates on the financial products they utilize to maintain and grow their businesses make operating more expensive. The differentiated rise in interest rates across commercial products will make lower cost products more attractive and others cost prohibitive. Limited supply of funding is a leading cause of new businesses failing in the first 5 years of operation.

### Failure Rates of Businesses that started in 2018

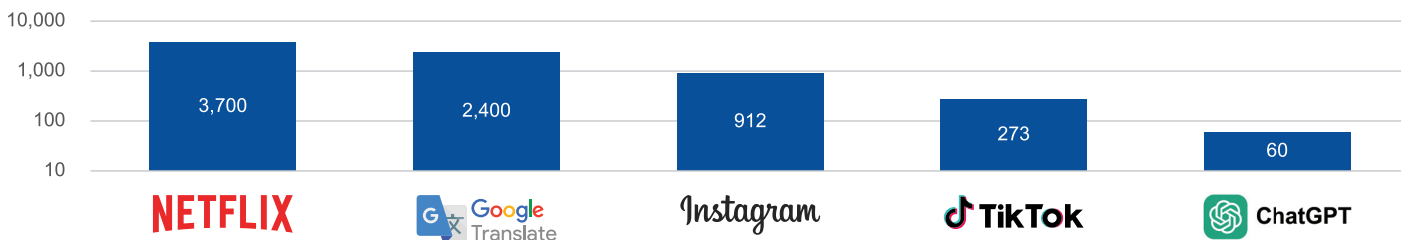


Source: Oberlo

The failure rate dropped during the pandemic as small businesses had access to a broad swath of low/no cost funding options, but funding will be more expensive in 2024. Bankruptcies are rising, but that new velocity in Chapter 11 filings does not include many small and micro mom and pop shops that just close their doors because of cash flow challenges.

**Adapting to Technological Changes:** The rapid pace of technological change requires small businesses to update their operations continuously, integrating innovative technologies like A.I. and digital marketing strategies to stay competitive.

## Time it took companies to reach 100 million users (days)



Sources: McKinsey Digital: "The economic potential of generative AI: The next productivity frontier"; Global X ETFs

Embracing innovative technologies is crucial for staying competitive. Great Lakes Independent Book Sellers Association, in Ann Arbor, Michigan, has leveraged AI-driven analytics to understand customer preferences better and optimize inventory, enhancing customer satisfaction and sales efficiency. It has transitioned its decision making away from human staff and now relies on cutting edge artificial intelligence to better serve its customers.

**Supply Chain Disruptions:** Ongoing supply chain issues continue to impact small businesses, making it challenging to maintain consistent operations and meet customer demands. Ongoing supply chain issues continue to challenge small businesses, particularly those dependent on overseas suppliers. Zesty Kitchen, a small kitchen supplies retailer in Austin, Texas, has started sourcing more products from domestic manufacturers to avoid delays and ensure they can meet customer demand more reliably.

Addressing these challenges requires strategic planning, leveraging technology, and seeking alternative funding and supply chain solutions to mitigate the impacts of these widespread concerns. Diverse challenges across sectors exist, and small businesses are adopting innovative approaches to navigate these issues effectively. These strategies highlight the resilience and adaptability of small businesses facing an ever-evolving economic landscape.

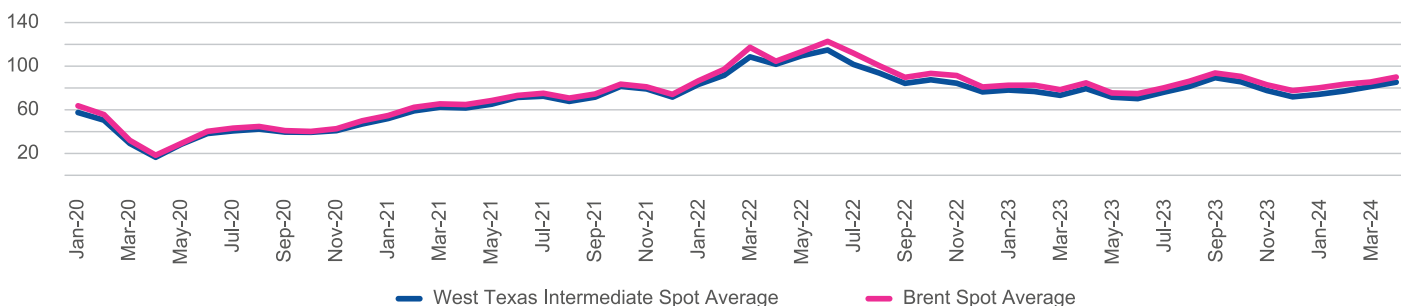
## What else are we watching

Two stories to follow in 2024 that will have an impact on small businesses are energy prices and commercial real-estate. The direct and indirect impacts of volatility will be noticeable in the coming year.

## Oil

Oil prices have significant implications for small businesses in the U.S., particularly for operational costs and consumer spending.

## Dollars per barrel

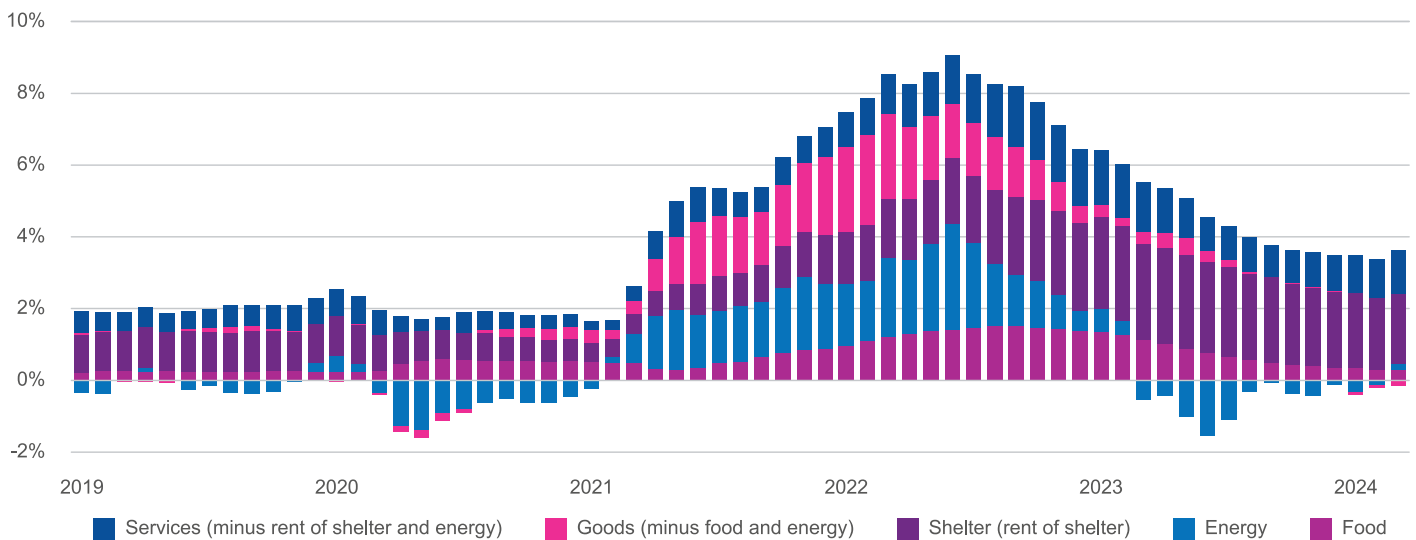


Source: <https://tradingeconomics.com/commodity>

How will fluctuations in the price of oil impact small businesses? Small businesses will see an increase in operational costs because they rely on transportation, like delivery services, who experience higher fuel costs directly due to oil price increases. When oil prices rise, gasoline prices follow, increasing costs for businesses with fleets or those that depend on shipping. These businesses may need to implement surcharges to cover these additional costs. U.S. regions will feel the impact of oil price changes differently due to variations in local access to oil refineries and state-specific taxes and policies, as seen in states like California and Oklahoma. Higher fuel prices can cause customers to reduce spending because the increase will deplete available disposable income, as a more significant portion of the budget is spent on essential expenses like gasoline. Reducing disposable cashflows leads to reduced spending on non-essential goods and services, impacting businesses that rely on discretionary small business and consumer spending.

Rising oil prices place upward price pressure on the economy driving prolonged inflation, eroding purchasing power, and slowing economic growth.

### Consumer Price Index: 12-Month % Change



Sources: Bureau of Economic Analysis Federal Reserve and author's assumptions, and Experian Economic Strategy Group

This inflation affects small businesses by increasing the cost of goods and services and potentially reducing consumer demand. Prolonged inflation often leads to a heightened risk of recession. The market is still looking for rate cuts later this year, but they will come modestly with little overall impact. During a slower economic cycle, consumer spending and business investments typically decrease, further challenging small businesses.

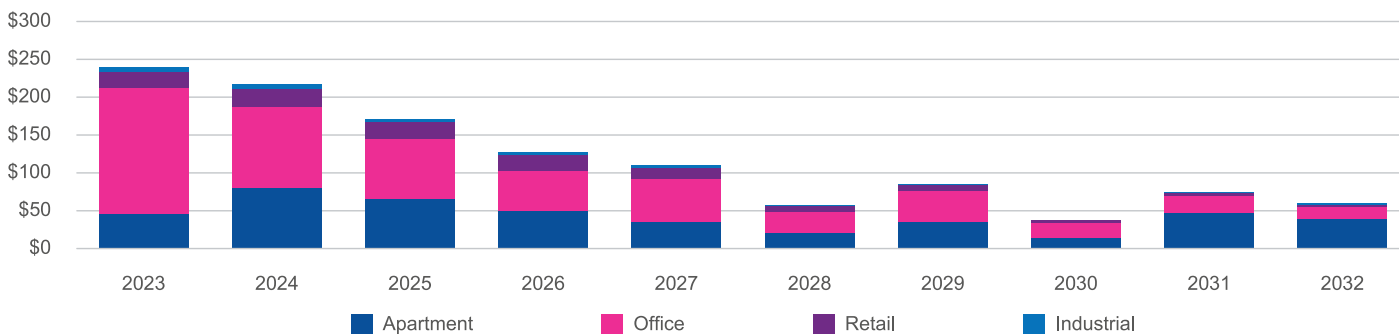
These underline the broad influence of oil prices on small businesses across various sectors of the U.S. economy. The U.S. Energy Information Administration estimates average retail gasoline prices will be around \$3.70 from April to September. This is below the \$4 a gallon price where consumer and small business usage and behaviors change significantly and can cause ripples across supporting transportation industries.

## Real-estate

Inflation in the **commercial real estate (CRE) sector** significantly impacts small businesses in the U.S. through several channels:

Commercial leases often include clauses allowing annual rent increases to align with inflation. When inflation is high, these increases can raise operating costs for small businesses that lease commercial spaces. In times of high inflation, like in recent years, these adjustments may not adequately cover the erosion of purchasing power, further straining small business finances.

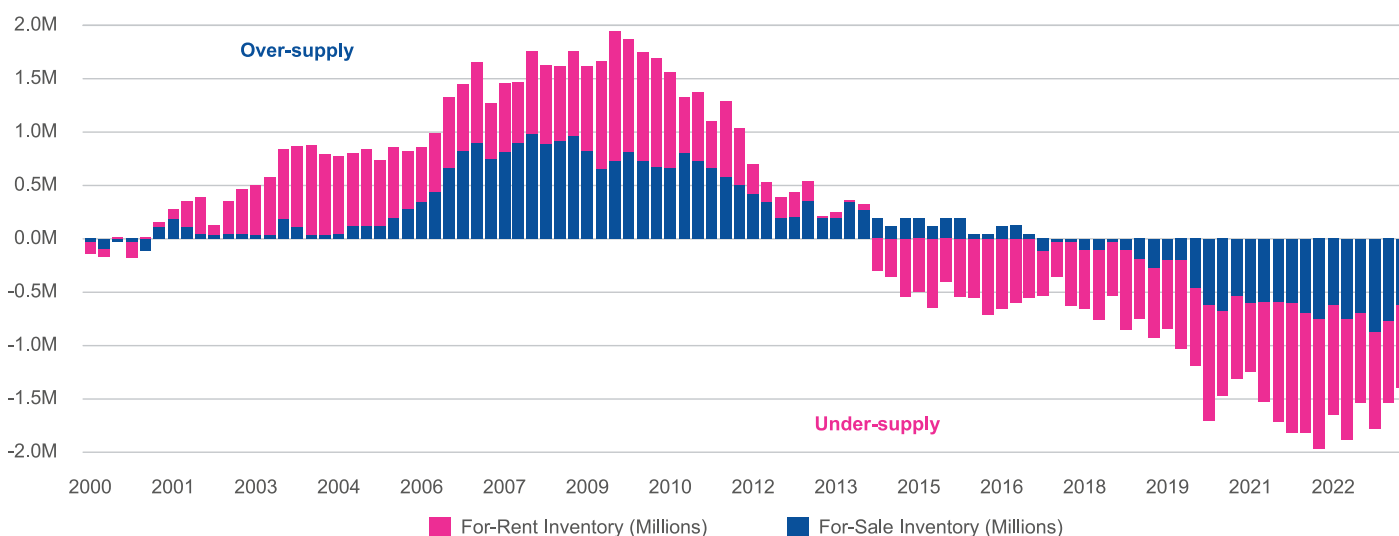
### High-Leverage Property Debt Maturing (\$B)



Sources: Freddie Mac, U.S. Census Bureau, Newmark Group Inc.

High inflation often leads to increased construction and property maintenance costs, which can discourage new projects and reduce the availability of commercial spaces, potentially driving up rents.

### Undersupply of properties creates upward pressure on price



Sources: Freddie Mac, U.S. Census Bureau, Newmark Group Inc.

Prolonged inflation can lead to higher property values, which while potentially beneficial for property owners, can increase rental costs for small businesses. Small businesses will face operational challenges as inflation influences various economic factors such as consumer spending, supply chain costs, and broader economic stability. These factors indirectly affect the viability and profitability of small businesses operating in commercial real estate environments. When small businesses change their demand patterns for storefront and need for employee space this will impact the investment landscape in CRE, affecting property yields and investment returns. Government policy changes can impact valuations as they respond to inflationary headwinds. For example, the Inflation Reduction Act impacted CRE by promoting investment in specific sectors like clean energy. These shifts can create opportunities and challenges for small businesses depending on their industry and location.

These factors combine to create a complex environment for small businesses operating in the commercial real estate market during periods of inflation. Each business's impact will vary based on its specific circumstances, including the terms of lease agreements, the nature of the business, and its location.

### How to look at 2024

This year is shaping up to be a year where we beat expectations. Consumers are spending and small businesses are managing cashflows. The U.S. labor market is expected to stay strong throughout the year, with unemployment expected to edge up slightly to 4%. Investors are buying into equities and bonds as they feel more optimistic about a year of growth in the U.S. Inflation is expected to be the number one challenge to spending in 2024. Costs will be higher than expected but customers will absorb those costs and continue to signal resilience.

The economy will be resilient, pressing back against the potential of a near term slowdown. The Federal Reserve will look for one to two rate cuts possible post-election.

The growth velocity will be moderate as small business owners consider stubborn inflation and prohibitive costs of funds and assets a barrier to investing in significant growth in 2024. That anxious feeling will still hold tightly to business strategies until the first rate cut signals "Go" to investment and lower costs.

As I sit at my kitchen table, this is what I consider when putting together a short and long-term strategy for growth in my small business. I am transforming my business with new GenAI tools to help differentiate and connect with my customers with a more targeted and engaging message. I feel comfortable in my cash position as I go into this solid economic year. **My excitement and optimism are pushing me to test the waters of expansion, and that's what entrepreneurship is all about, taking risks. Come on, the water's great, jump on in.**

#### About the author

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#### Brodie Oldham

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Brodie leads a team of statistical consultants, scientists, modelers, and engineers with diverse skills to provide clients with leading edge analytic-driven information solutions, services, and visualization of actionable insights. His is an industry expert, who speaks on behalf of Experian at industry conferences.



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