

Small business employment in the Fifth District and the impact of recessions

BY ROBERT H. SCHNORBUS

Small business firms are widely regarded as a key source of job growth and as largely recession-proof, but the current recession brought severe job losses even to relatively high-growth regions like the Fifth District. Of course, small businesses are constantly being created and destroyed both in and out of recessions, with job growth perhaps slowing during recessions, but rarely have small businesses as a category suffered net job losses.

The current recession, which continues to generate employment declines into 2010, is a notable exception to the historical pattern of uninterrupted small business job growth, with significant job losses occurring even in the high-growth services sector. While a clear picture of the severity of the recession in the Fifth District can be seen in the available data on government employment, data on the performance of small businesses at a regional level are limited.

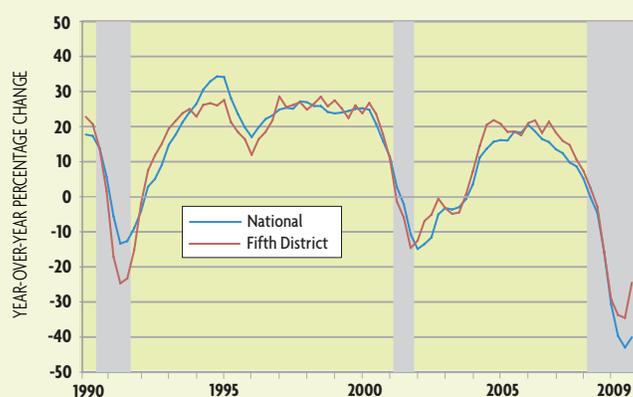
Fortunately, survey data of small business firms from the National Federation of Independent Businesses (NFIB) provide interesting insights into the problems small businesses faced during past recessions and, to some degree, how the surviving firms adjusted to such difficult times. Combined with the government data, this survey allows a close look at the performance of small business firms in the Fifth District during three recessionary periods over the last 20 years.

Defining a Small Business

Small businesses play a major role in job changes over any business cycle, but their exact definition often varies among studies. The Small Business Administration (SBA) defines a small business as any establishment with less than 500 workers. That casts a pretty large net across the labor market. By that definition, more than 99 percent of all establishments would be classified as a small business. It also means that more than 80 percent of all jobs in both the nation and the Fifth District are based in such establishments.

To match employment statistics by size of establishment as reported by the Bureau of Labor Statistics with survey-based data from the NFIB, three “size categories” can be defined for closer analysis. The first category, small business firms, is defined as establishments having less than 50 employees, which corresponds to more than 95 percent of all the firms in the NFIB survey. The second, medium business firms, is defined as establishments having 50 to 499 employees. The third, large business firms, is defined as establishments with 500 employees or more.

Figure 1: Employment Growth by Quarter



NOTE: The shaded areas correspond to recessions.

SOURCE: Bureau of Labor Statistics

Under this classification system, about 95 percent of all establishments in the District and the nation still fall into the small business category. However, in terms of employment, small and medium firms each normally account for roughly 40 percent of total employment, with large firms accounting for the remaining 20 percent. Finally, it should be noted that the government data used in this study are based on individual establishments (or locations of each plant or store in an area) rather than actual firms (or complete business entities).

Many firms are composed of more than one establishment. For example, Lowe’s is a single firm made up of many establishments (or store locations). However, the vast majority of small establishments are single-establishment firms with very few employees — the more common image of a “small business.” Thus, the terms establishment and firm are used interchangeably here, although some discrepancies do exist.

While the District composition of small firms is in broad terms similar to the nation, differences in both employment shares and their changes among firm-size categories over time should be noted. For example, the total employment share of small businesses in both the District and the nation has been rising over time, from roughly 39 percent in 1990 to 45 percent in 2009. In addition, heading into the recent recession the Fifth District had a slightly higher concentration of small businesses (45.3 percent) than the nation (43.8 percent) and a slightly lower concentration of large businesses (14.7 percent) than the nation (16.9 percent) —

the result of small businesses growing faster and large businesses tending to decline faster in the Fifth District than in the nation on average.

Yet the share of small business employment in goods-producing industries (which include construction, manufacturing, mining, and other natural resources industries) in 1990 was lower in the Fifth District (27.1 percent) than in the nation (30.4 percent). In 2007, however, the Fifth District's share was virtually equal to the nation's (37.5 percent). In contrast, the Fifth District's share of small business employment in the services sector, which includes such industries as health, education, financial, and other professional services, has always been slightly higher than the nation.

The Sensitivity of District Small Business Firms to Past Recessions

To evaluate the severity of the current recession on small business firms, two recessions since 1990 — both comparatively mild by historical standards — are examined. The first recession began in the early 1990s (that is, from the third quarter of 1990 to the first quarter of 1991), when real GDP (in constant dollars) fell by 1.4 percent over the course of the recession. The second recession began in the early 2000s (that is, from the first quarter of 2001 to the fourth quarter of 2001), when GDP remained virtually flat.

In both recessions, employment declines in the Fifth District (from peak to trough on a seasonally adjusted basis) lasted slightly longer than in the nation as a whole, even though only employment in the first recession experienced a significantly deeper decline in the Fifth District (-2.5 percent) than in the nation (1.3 percent). Both experienced employment declines of about 2 percent during the second recession. Otherwise, Fifth District employment closely tracked the pattern of national employment growth on a year-over-year basis (see figure 1).

Since the available data on employment by size categories are limited to just the first quarter of every year since 1990, the two recessions described above can best be captured by measuring employment changes over the time periods from 1990 to 1992 and 2001 to 2003 (see table). While total employment declined during these recessionary periods, the pattern of job changes by firm size supports the claim that small firms were a key source of job growth even during recessions. For example, during both the 1990 to 1992 and 2001 to 2003 periods, small business employment increased, while both medium and large firms absorbed all the job losses, resulting in a net decline in total jobs. To be sure, some of these job losses, especially among large firms, represented structural changes as well as cyclical declines.

In contrast, the trends for small firms gained not only from new business startups but also from medi-

um firms becoming small firms due to job losses and from displaced workers at large firms starting their own small businesses. Such factors may overstate the underlying strength of small businesses during recessions. However, since churning of jobs at the small business level occurs throughout the business cycle and is a normal part of the process of employment change, small business employment gains during recession go far beyond these two limiting factors. Thus, it seems safe to conclude that small businesses in aggregate were still the center of substantial job gains during these earlier recessions.

Perhaps not too surprisingly, the experience of small firms was not uniform across the goods and services sectors; indeed, all of the job gains that occurred during the recessionary periods were concentrated among service-producing firms. For example, small business employment in the Fifth District's goods-producing sector declined 8.6 percent in the 1990-1992 period, which was almost as much as the total decline in employment over the period and substantially larger than the decline of small business employment for that sector nationally. Indeed, it was the decline in goods-producing small businesses that accounted for the fact that total employment in the Fifth District declined substantially more than the nation. In the 2001 to 2003 recessionary period small business employment in the Fifth District's goods-producing sector declined by only 1.7 percent, far less than in the previous recession and much more in line with the national experience.

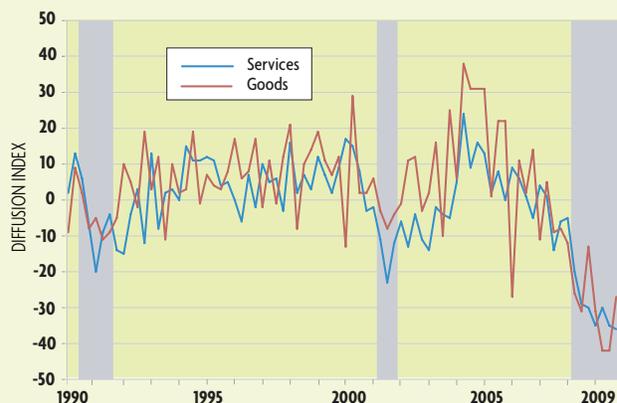
Employment Growth by Establishment Size During Recessionary Periods

	United States				Fifth District			
	Under 50 Employees	50-499 Employees	Over 500 Employees	Total Employees	Under 50 Employees	50-499 Employees	Over 500 Employees	Total Employees
Total Nonfarm								
1990-92	6.0%	-3.5%	-14.6%	-2.3%	5.5%	-6.0%	-13.7%	-3.2%
2001-03	1.3%	-4.6%	-9.1%	-3.0%	2.3%	-4.4%	-11.0%	-2.7%
2008-09	-2.5%	-6.3%	-5.7%	-4.5%	-2.7%	-6.6%	-4.0%	4.4%
Goods Producing								
1990-92	-5.4%	-7.7%	-11.5%	-8.1%	-8.6%	-7.5%	-11.0%	-8.9%
2001-03	-2.2%	-10.8%	-17.8%	-9.6%	-1.7%	-10.1%	-21.7%	-10.5%
2008-09	-7.6%	-12.1%	-11.6%	-10.4%	-9.8%	-12.4%	-10.3%	-11.0%
Services								
1990-92	9.1%	-1.7%	-16.1%	-0.2%	9.3%	-5.3%	-15.1%	-0.5%
2001-03	2.1%	-2.5%	-5.7%	-1.0%	3.2%	-2.6%	-5.9%	-0.3%
2008-09	-1.5%	-4.6%	-3.9%	-3.1%	-1.3%	-5.4%	-1.9%	-3.0%
Education/Health Services								
1990-92	15.4%	6.4%	4.1%	8.2%	17.0%	8.2%	10.6%	11.8%
2001-03	6.8%	6.5%	7.1%	6.8%	6.5%	8.9%	7.5%	7.7%
2008-09	1.5%	2.8%	2.7%	2.3%	2.8%	2.6%	2.1%	2.5%
Leisure/Hospital Services								
1990-92	17.2%	-11.1%	-31.2%	-0.4%	6.2%	-10.6%	—	0.1%
2001-03	5.3%	0.5%	-13.5%	1.6%	4.1%	-0.1%	—	2.7%
2008-09	-0.6%	-4.7%	-9.9%	-2.8%	-1.0%	-5.0%	—	-2.4%
Professional/Business Services								
1990-92	8.3%	4.3%	-9.2%	2.9%	9.0%	3.4%	-11.7%	2.4%
2001-03	2.7%	-7.2%	-13.7%	-5.0%	5.0%	-5.8%	-15.1%	-3.3%
2008-09	-0.5%	-8.3%	-10.2%	-5.5%	-0.1%	-7.8%	-4.3%	-4.1%

NOTE: Growth rates are based on first-quarter employment levels of each year indicated.

SOURCE: Business Employment Dynamics, Bureau of Labor Statistics

Figure 2: Small Business Sales
(Last Three Months vs. Prior Three Months)



NOTE: The shaded areas correspond to recessions.
SOURCES: National Federation of Independent Business; Richmond Fed

In sharp contrast, small services businesses in the Fifth District had an unbroken chain of job gains through both recessionary periods. It should be noted that both medium and large services firms in the District suffered significant job losses — though far less severe than their counterparts among goods-producing firms nationally. The impact of the economic shift to an increasingly service-based economy in the Fifth District is clearly reflected in the strong employment growth during both recessions among some of that sector's major growth centers, such as education/health, leisure/hospitality, and professional/other business services industries. Indeed, employment tended to increase in all three size categories during these recessions, indicating the breadth of the job growth strength that these firms have experienced. That is, until the current recession.

Small Business Experience During the Current Recession

In comparison to the two earlier recessions, employment declines in the current recession have been deeper and more pervasive both nationally and in the Fifth District. Indeed, not only did GDP in this recession decline more than twice as much as the earlier recessions, but job declines to date also have been far steeper than in the past (and that assumes that no further job losses occurred after the fourth quarter of 2009).

For example, from the first quarter of 2008 to the first quarter of 2009, total employment in the District declined by at least a third more than either the 1990 to 1992 or 2001 to 2003 recessionary periods, and that decline occurred in only half the time (four quarters). While medium and large firms still accounted for the bulk of the job losses, small firms in this recession lost more jobs than they created for the first

time during a recessionary period (and probably for the first time in many decades). Employment declines were registered nearly everywhere in the Fifth District — only the District of Columbia registered a modest increase.

Perhaps what really distinguishes the current recession is the fact that service-producing firms in the Fifth District lost jobs even among small firms (with only Virginia and Maryland managing modest gains, most likely due to the influence of employment growth sustained by gains in the District of Columbia). The employment decline among small firms was relatively small, with medium firms accounting for the largest decline in jobs. However, even among some of the strongest services industries, such as professional services and leisure/hospitality industries, small firms in the Fifth District experienced net job losses for the first time ever. Only small firms in the education/health services industries were able to buck the trend and continued to add jobs in this downturn.

Viewing Recessions from a Small Business Perspective

A recession takes its toll on small businesses in many ways. As sales fall, survival is often a scramble to cut costs and gain access to needed credit to keep the business running until the recovery starts. The deeper the recession and the longer the delay in recovery, the fewer small businesses can be expected to survive.

A quarterly survey of more than 2,000 of NFIB's members nationally and more than 100 in the Fifth District provides an opportunity to gain insight into how small businesses viewed business conditions during past recessions and what actions they took to keep their businesses running. The questions are subjective in nature. Respondents were asked whether a particular variable, such as sales or employment, increased or decreased over the previous quarter and whether they expected increases or decreases over the next three to six months. The result is a "diffusion index" that measures the difference between the percentage of firms reporting increases in production or planned hiring and the percentage of firms reporting decreases in those variables. This allows comparison of small business behavior in the previous recessions and the current one (see figures 2 and 3).

From the perspective of small businesses in the Fifth District, the recessions in the early 1990s and 2000s were fairly similar in both depth and duration, which is consistent with both recessions being relatively mild in terms of GDP declines. For example, in both recessionary periods the index measuring the net percent of firms experiencing sales declines over the past three months expanded, with the percent of firms reporting declines exceeding the percent of firms reporting increases by 15 to 20 percentage

QUICK FACT

The "diffusion index" measures the difference between the percentage of firms reporting increases in production or planned hiring and the percentage of firms reporting decreases.

points. The index did not return to positive territory — indicating more small businesses had expanding rather than contracting sales, a net expansion — until long after these recessions officially ended.

Other measures are not included in these figures. Credit problems for small businesses, for instance, only seemed to become a serious problem during the 1990 to 1992 recessionary period. Also, small business optimism dropped sharply as both recessions were approaching and then slowly recovered over the subsequent two years. Yet, consistent with the employment declines discussed above, the number of small businesses that planned to decrease their employment never exceeded the number planning to increase employment during either of these two recessions. (Only during the recessions in the mid-1970s and early 1980s did decreases ever exceed increases and then rarely for more than two quarters consecutively.)

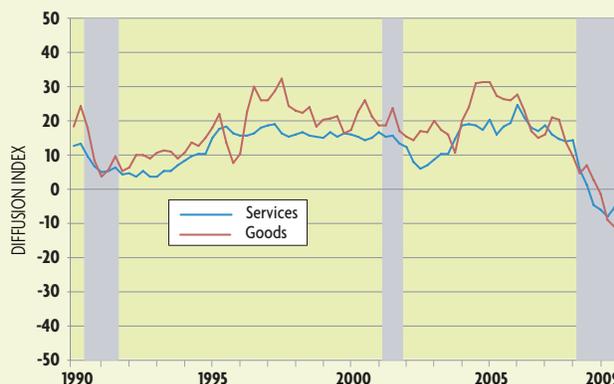
In both earlier recessions, small businesses took several years before they were back to planning net job increases at a pace comparable to the normal expansionary phase of the business cycle. In both recessions, however, the upward path toward recovery was clearly evident in the percent of firms that were planning to increase their hiring.

In sharp contrast to these two earlier recessions, the experience of small businesses in the Fifth District during the current recession, as reflected in survey responses, was by far the worst in the survey's history. For example, the index for change in sales declined by nearly twice as much as the two earlier recessions. Moreover, that decline continued for at least 10 quarters (until the end of 2009, the most currently available survey numbers, and quite likely continued to decline into 2010).

Indeed, the sales index suffered its worst decline on record by a significant margin, along as did such other measures as earnings, capital outlays, compensation, inventories, and prices — all reaching record lows. While credit problems never seemed to get as bad as during the “credit crunch” in the early 1980s, the index measuring the degree of problems obtaining credit followed a pattern similar to the early 1990s recession — starting well before the official recession began and by the end of 2009 falling farther than during that earlier recession. Not surprisingly, given the severity of general business conditions, small business optimism declined further than during any previous recession on record and, despite three quarters of recovery in 2009, was still little better than during the low point reached in the early 1980s.

The response to the deterioration in general business conditions was for the percent of small businesses planning to reduce hiring to exceed the percent planning to increase hiring for the first time since the early 1980s. Indeed, small

Figure 3: Job Hiring Plans by Quarter



NOTE: The shaded areas correspond to recessions.

SOURCES: National Federation of Independent Business; Richmond Fed

business in the Fifth District registered a net cut in planned job hiring in five of the last seven quarters for which data are available—the worst seven-quarter experience in the survey's history.

Small Business Expectations for 2010

By any measure, the current recession has been one for the record books — at least for small businesses. And interestingly, despite widespread concerns about credit availability as the recession took on the characteristics of a global financial crisis, small businesses rated weak sales, not credit availability, as their most important problem by a wide margin. While credit availability may be tight, until sales begin to improve the need for small businesses to borrow may be limited. Yet, as the most recent quarter (fourth quarter of 2009) of hiring plans suggests, small businesses in the Fifth District seem to be gearing up to start hiring again.

Their expectations for the recovery in 2010 seem to be guarded, however. The index for expected sales (adjusted for inflation) barely turned positive at the end of 2009. So, while more and more small businesses are beginning to expect sales to increase, the number of firms that are still expecting decreases has continued to be substantial. Similarly, while small business optimism began to improve at the end of 2008, the level of optimism at the end of 2009 remained far below the lowest levels achieved in either the early 1990s or 2000s, suggesting that small businesses remain overwhelmingly pessimistic. Still, the fact that many indexes in the survey, including sales and business conditions, have turned positive is encouraging. Indeed, the most encouraging sign may be that the index of hiring plans turned slightly positive in the closing months of 2009, although again mostly in services industries. **RF**

State Data, Q3:09

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000s)	703.8	2,509.6	3,879.1	1,809.5	3,617.8	740.1
Q/Q Percent Change	0.2	-0.8	-1.0	-0.6	-0.8	-1.0
Y/Y Percent Change	-0.8	-3.4	-6.2	-5.9	-3.9	-3.0
Manufacturing Employment (000s)	1.4	116.5	437.7	209.2	235.1	49.3
Q/Q Percent Change	0.0	-2.0	-3.0	-2.4	-2.1	-3.4
Y/Y Percent Change	-10.6	-8.8	-14.8	-13.5	-10.8	-12.2
Professional/Business Services Employment (000s)	146.8	381.8	455.8	200.4	634.2	59.0
Q/Q Percent Change	-0.5	-0.6	-1.1	0.9	-0.5	-0.8
Y/Y Percent Change	-3.6	-4.0	-9.1	-9.2	-3.8	-3.3
Government Employment (000s)	246.5	493.2	711.1	349.8	695.1	150.3
Q/Q Percent Change	2.8	-0.2	-0.3	0.5	-1.0	-0.8
Y/Y Percent Change	4.2	0.8	0.4	1.2	-0.1	1.8
Civilian Labor Force (000s)	331.5	2,979.3	4,526.3	2,178.4	4,171.0	797.4
Q/Q Percent Change	0.1	-0.7	-0.6	-0.3	-0.5	-0.8
Y/Y Percent Change	-1.1	-1.6	-1.1	1.4	0.9	-1.1
Unemployment Rate (%)	10.8	7.2	10.9	12.1	6.9	8.6
Q2:09	9.7	7.0	10.9	11.7	6.8	7.8
Q3:08	6.9	4.6	6.5	7.2	4.0	4.3
Real Personal Income (\$Mil)	36,206.7	251,608.1	294,457.1	132,167.8	315,911.8	53,399.7
Q/Q Percent Change	-0.7	-0.5	-1.0	-0.9	-0.7	-1.4
Y/Y Percent Change	1.9	1.5	-0.7	-0.8	0.9	1.9
Building Permits	163	2,412	9,360	4,365	5,406	735
Q/Q Percent Change	365.7	-5.6	-5.7	6.7	-6.6	73.3
Y/Y Percent Change	7.2	-36.8	-35.8	-34.9	-14.3	-15.8
House Price Index (1980=100)	564.2	450.2	332.1	336.3	424.1	226.8
Q/Q Percent Change	-0.4	-2.2	-1.6	-2.5	-1.8	-1.6
Y/Y Percent Change	-3.8	-7.3	-2.0	-2.1	-3.9	-1.3
Sales of Existing Housing Units (000s)	9.2	75.2	146.8	74.0	126.4	29.2
Q/Q Percent Change	21.1	12.6	18.4	10.1	14.5	19.7
Y/Y Percent Change	27.8	15.3	-4.4	-7.5	2.9	14.1

NOTES:

Nonfarm Payroll Employment, thousands of jobs, seasonally adjusted (SA) except in MSAs; Bureau of Labor Statistics (BLS)/Haver Analytics, Manufacturing Employment, thousands of jobs, SA in all but DC and SC; BLS/Haver Analytics, Professional/Business Services Employment, thousands of jobs, SA in all but SC; BLS/Haver Analytics, Government Employment, thousands of jobs, SA; BLS/Haver Analytics, Civilian Labor Force, thousands of persons, SA; BLS/Haver Analytics, Unemployment Rate, percent, SA except in MSAs; BLS/Haver Analytics, Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics, Sales of Existing Housing Units, thousands of units, SA; National Association of Realtors®

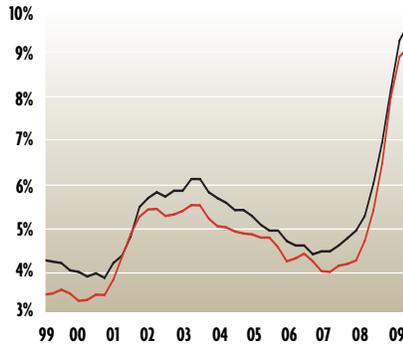
Nonfarm Employment

Change From Prior Year
First Quarter 1999 - Third Quarter 2009



Unemployment Rate

First Quarter 1999 - Third Quarter 2009



Real Personal Income

Change From Prior Year
First Quarter 1999 - Third Quarter 2009

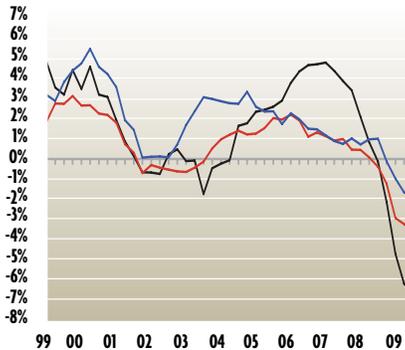


— Fifth District

— United States

Nonfarm Employment Metropolitan Areas

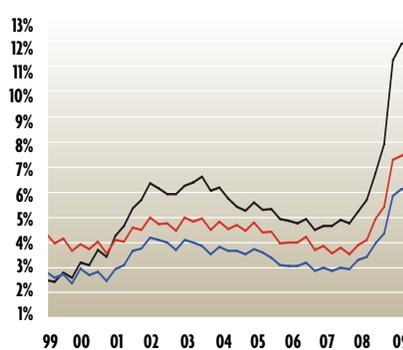
Change From Prior Year
First Quarter 1999 - Third Quarter 2009



— Charlotte — Baltimore — Washington

Unemployment Rate Metropolitan Areas

Change From Prior Year
First Quarter 1999 - Third Quarter 2009



— Charlotte — Baltimore — Washington

Building Permits

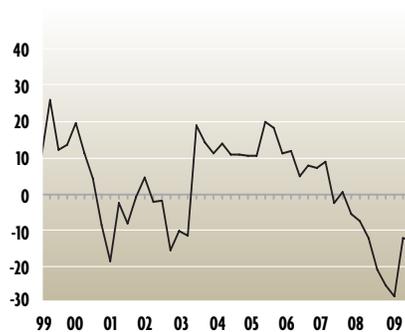
Change From Prior Year
First Quarter 1999 - Third Quarter 2009



— Fifth District — United States

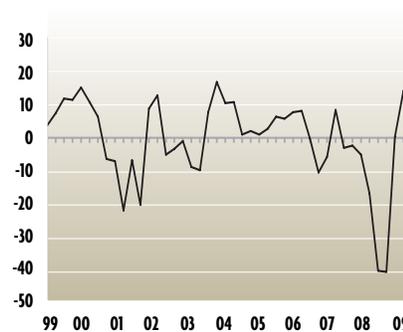
FRB—Richmond Services Revenues Index

First Quarter 1999 - Third Quarter 2009



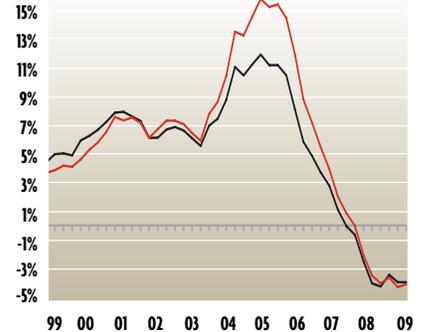
FRB—Richmond Manufacturing Composite Index

First Quarter 1999 - Third Quarter 2009



House Prices

Change From Prior Year
First Quarter 1999 - Third Quarter 2009



— Fifth District — United States

NOTES:

1) FRB-Richmond survey indexes are diffusion indexes representing the percentage of responding firms reporting increase minus the percentage reporting decrease. The manufacturing composite index is a weighted average of the shipments, new orders, and employment indexes.
2) Building permits and house prices are not seasonally adjusted; all other series are seasonally adjusted.

SOURCES:

Real Personal Income: Bureau of Economic Analysis/Haver Analytics.
Unemployment rate: LAUS Program, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Employment: CES Survey, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Building permits: U.S. Census Bureau, <http://www.census.gov>.
House prices: Federal Housing Finance Agency, <http://www.fhfa.gov>.

Metropolitan Area Data, Q3:09

	Washington, DC	Baltimore, MD	Hagerstown-Martinsburg, MD-WV
Nonfarm Employment (000s)	2,391.8	1,268.6	97.3
Q/Q Percent Change	-0.4	-1.0	-0.6
Y/Y Percent Change	-2.0	-3.6	-3.6
Unemployment Rate (%)	6.1	7.7	9.3
Q2:09	6.1	7.5	9.7
Q3:08	4.0	4.9	5.2
Building Permits	2,802	1,102	208
Q/Q Percent Change	-2.1	4.6	18.9
Y/Y Percent Change	-19.0	-32.0	-26.0
	Asheville, NC	Charlotte, NC	Durham, NC
Nonfarm Employment (000s)	165.5	798.9	280.6
Q/Q Percent Change	-1.2	-1.7	-1.8
Y/Y Percent Change	-6.0	-6.7	-3.5
Unemployment Rate (%)	8.7	12.0	8.0
Q2:09	9.2	11.9	7.9
Q3:08	5.2	6.8	5.2
Building Permits	304	1,994	398
Q/Q Percent Change	-6.2	-4.5	-34.3
Y/Y Percent Change	-37.1	-24.5	-26.6
	Greensboro-High Point, NC	Raleigh, NC	Wilmington, NC
Nonfarm Employment (000s)	339.2	495.8	138.4
Q/Q Percent Change	-1.5	-1.1	-2.1
Y/Y Percent Change	-7.1	-5.0	-5.9
Unemployment Rate (%)	11.5	8.8	9.8
Q2:09	11.6	8.8	9.9
Q3:08	6.9	5.2	5.9
Building Permits	550	1,332	584
Q/Q Percent Change	-17.8	-14.1	-25.5
Y/Y Percent Change	-19.0	-66.8	-39.6

	Winston-Salem, NC	Charleston, SC	Columbia, SC
Nonfarm Employment (000's)	206.7	282.8	344.3
Q/Q Percent Change	-1.0	-1.5	-0.9
Y/Y Percent Change	-4.9	-5.2	-5.1
Unemployment Rate (%)	10.0	9.7	9.3
Q2:09	10.2	9.4	9.1
Q3:08	6.3	6.2	6.5
Building Permits	329	887	811
Q/Q Percent Change	-22.0	-3.1	-5.9
Y/Y Percent Change	-6.8	-18.6	-41.0
	Greenville, SC	Richmond, VA	Roanoke, VA
Nonfarm Employment (000's)	292.0	598.1	153.4
Q/Q Percent Change	-1.4	-2.0	-1.9
Y/Y Percent Change	-7.3	-4.9	-5.3
Unemployment Rate (%)	10.4	7.8	7.4
Q2:09	10.2	7.9	7.5
Q3:08	6.4	4.5	4.1
Building Permits	397	974	117
Q/Q Percent Change	4.5	20.0	11.4
Y/Y Percent Change	-33.4	-13.7	-17.0
	Virginia Beach-Norfolk, VA	Charleston, WV	Huntington, WV
Nonfarm Employment (000s)	739.8	147.7	114.8
Q/Q Percent Change	-1.0	-1.2	-1.5
Y/Y Percent Change	-4.3	-3.5	-3.3
Unemployment Rate (%)	6.8	7.4	8.3
Q2:09	7.0	7.4	8.1
Q3:08	4.4	3.3	5.0
Building Permits	1,188	47	7
Q/Q Percent Change	-14.3	23.7	-22.2
Y/Y Percent Change	-8.7	-68.9	-12.5

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