Community Development Publication

Small Business Credit Survey
2019 Report on Employer Firms in Texas

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Overview and Key Findings

Small businesses are critical to the U.S. economy, representing 99.9 percent of all businesses in the country.[1] Small employer firms (hereafter "firms"), upon which this report is based, are responsible for two out of three net job gains nationally.[2] Therefore, monitoring challenges and opportunities associated with revenue, financing and hiring for these groups is essential to understanding the U.S. economy.

In 2017, the Federal Reserve Bank of Dallas joined a Federal Reserve System effort to survey small businesses across the country on an annual basis. This report is the second statewide report to come from this collaboration. It draws from the 2018 survey results, focusing on small employers in Texas. It further provides perspectives from community partners on addressing some of the challenges the survey reveals. Key findings include:

Texas firms are optimistic and want to grow

- Fifty-three percent of firms were profitable at the end of 2017, and 77 percent expect to increase revenues in the next year.
- Nearly half (49 percent) expect to increase their number of employees over the next 12 months.
- Most Texas firms (86 percent) prefer their business grow "larger" or "much larger."

A majority faced at least one financial challenge

- Sixty-two percent had a financial challenge, with 37 percent pointing to trouble paying operating expenses.
- Minority-owned firms continued to struggle at higher rates with credit availability than their nonminority-owned peers (37 percent versus 29 percent).
- Most firms used personal funds to address financing gaps. However, 27 percent made a late debt payment, up from 24 percent last year.
- Sixty-six percent of firms have outstanding debt. Women-owned firms are much less likely to hold more than $1 million (0.5 percent) in debt, compared with men-owned (12 percent) or equally owned firms (14 percent).
- Forty-two percent of firms applied for more financing in the survey period, and 42 percent of applicants received all financing for which they applied.

Most firms want to hire–and most have difficulty doing so

- Three-quarters of Texas firms attempted to hire in the survey period. Just 23 percent looked for candidates with a bachelor's degree or higher.
- For firms looking for candidates without bachelor's degrees, 38 percent said the search was somewhat difficult, and 28 percent said it was very difficult. For those searching for college graduates, 37 percent reported that it was somewhat difficult, and 27 percent said it was very difficult.
- To cope with hiring difficulties, Texas firms most often increased starting pay or restructured existing employee responsibilities.

Background

The data used here come from the Texas sample of the Small Business Credit Survey. The survey is a national sample of small businesses, or firms with fewer than 500 employees, aimed at providing insight into firms' financing and debt needs and experiences. In this effort, the Texas Small Business Development Centers (SBDCs) remain our largest partners, providing a majority of total responses from Texas participants.

The SBCS is designed to provide timely insights on financing needs and gaps in the country's small businesses. While many questions remain similar to the Texas Small Business Needs Assessment Poll, the SBCS illuminates how Texas businesses fit in the context of the nation and can provide more rigorous data on credit needs to inform policymakers, academics and small business owners.

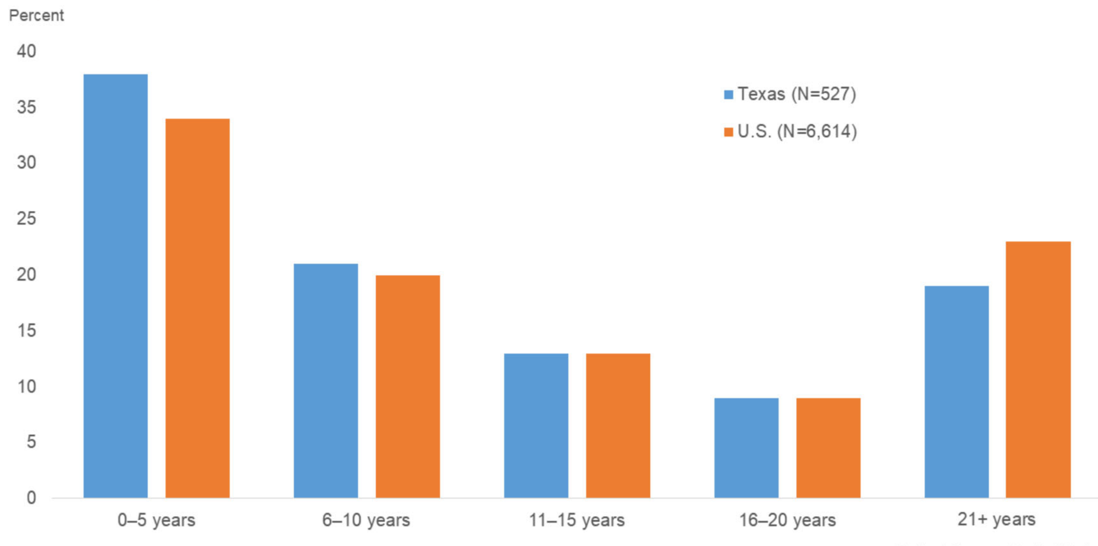
This report contains information on Texas firms that employ at least one person besides the business owner. The SBCS collects information on both employer and nonemployer firms. Because nonemployer firms are inherently different from employer firms, and we are interested in workforce and employee challenges, we look only at employer firms for this report. We also include insights from those on the ground—specifically, executive directors of SBDC regional offices.

The total number of Texas respondents for all small businesses in the 2018 survey was 1,146, with 527 of those being employer firms. The survey was fielded during the third and fourth quarters of 2018. For more information on methodology, see the appendix.

Demographic Snapshot

The SBCS yielded 527 responses from Texas businesses with 1–499 full-time or part-time employees (hereafter 'firms'), the highest number across all states in the survey. Texas has a larger share, relative to national peers, of startups, or firms in their first five years of operation (*Chart 1*).

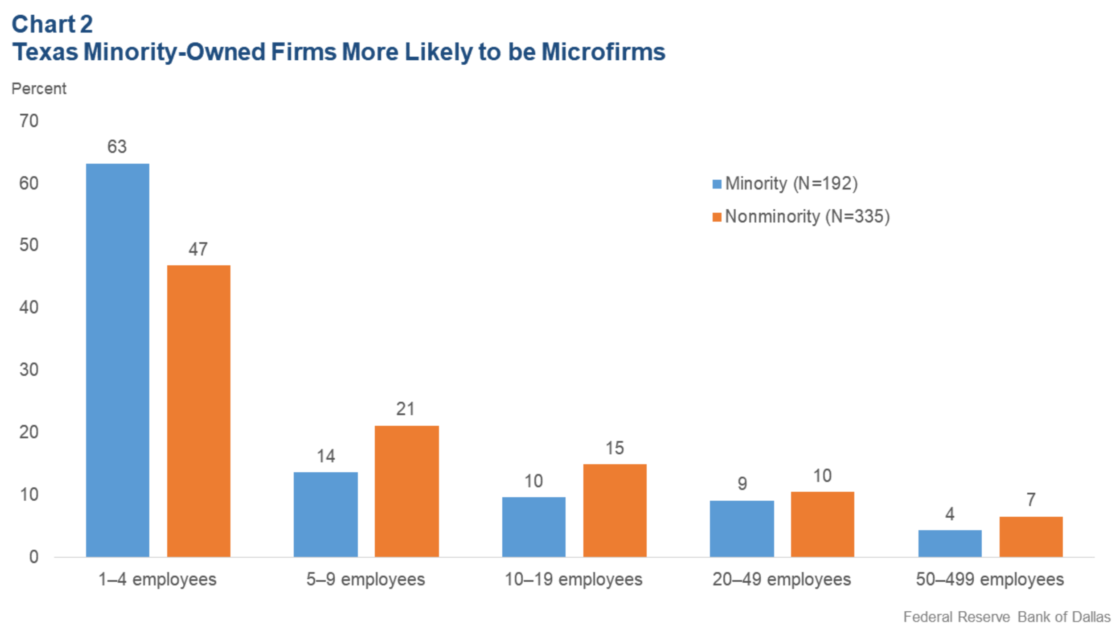
Chart 1
Texas Has Higher Share of Startups



Sixty-eight percent of firms in Texas reported revenues of $1 million or less, and just 4 percent had revenues of over $10 million. More than a quarter (28 percent) of Texas firms are minority-owned, a full 10 percentage points higher than the national average of 18 percent.[3] Texas also has a smaller share of firms owned by men than the nation (62 percent versus 65 percent), which means it has a slightly higher share of firms than the nation that are either owned by women or equally owned (38 percent versus 35 percent).

In terms of industry, according to Steve Lawrence, executive director of the Texas Gulf SBDC Network, entrepreneurs in Texas continue to launch traditional businesses but with a concentration in food and health care industries. "We've noticed an increasing interest in catering businesses, adult day care and elderly home health care services," he said. "There's also a growing interest in technology-related businesses, specifically in the development of mobile apps. In the Houston area, the creation of the 'Innovation Corridor,' the increase in co-working spaces, and new incubators are all fostering a start-up community in a variety of tech industries."

Regarding size, most businesses in Texas and the nation are microbusinesses (51 percent and 55 percent, respectively), those with fewer than five employees, including the business owner. Minority-owned firms are more likely to be microfirms than their nonminority counterparts (*Chart* 2). They are also significantly less likely to be at the next stage of employee growth (five to nine employees). Minority firm owners are more likely to have a master's, doctoral or other professional degree relative to their nonminority peers (36 percent versus 23 percent) and less likely to have a high school diploma or less (8 percent versus 13 percent).[4]



Performance

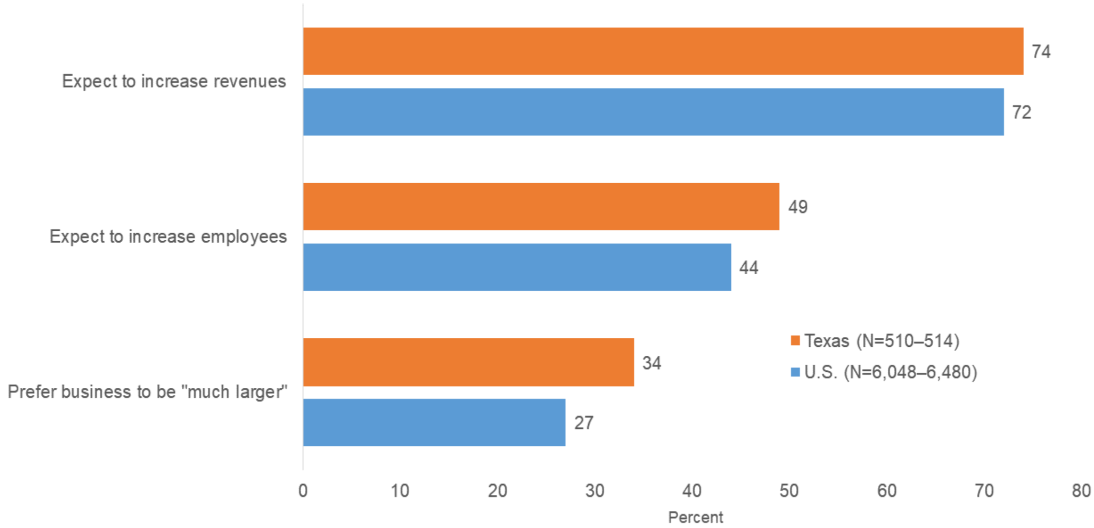
More than a third of Texas firms (34 percent) are considered growing, which means they met the following criteria for the past 12 months:

- Increased revenues.[5]
- Increase in number of employees.[6]
- Plan to increase or maintain employees.[7]

This is up from 30 percent in last year's findings. Interestingly, though, while 59 percent of firms were profitable at the end of 2016, the share dropped to 53 percent at the end of 2017. In fact, 28 percent of Texas firms reported ending 2017 at a loss, a statistically significantly higher share than the national average of 24 percent.

Still, optimism and growth goals are not in short supply in the Lone Star state. A majority of Texas firms were profitable in 2017, and a large share (74 percent) reported expecting to increase revenues in the coming 12 months (*Chart* 3).[8] Nearly half (49 percent) expected to increase their number of employees in the next 12 months. And when asked about their preference for the future size of their business, 86 percent of Texas business owners wanted to expand. More than a third (34 percent) indicated they would like to be "much larger" than current operations, a significant difference from the nation's 27 percent, as shown in Chart 3.

Chart 3
Texas Firms Optimistic About Future



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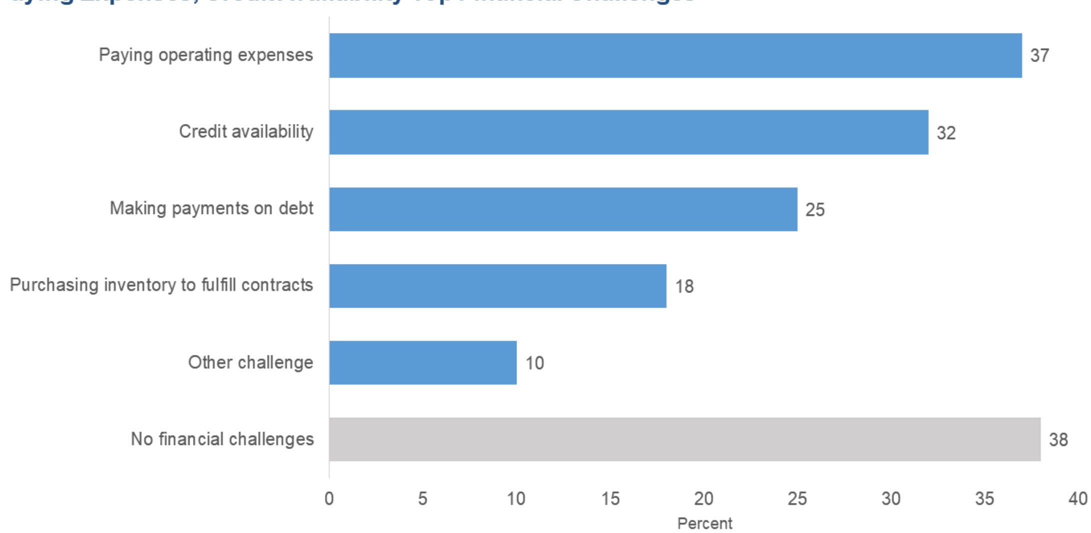
Sometimes, rapid growth can come with challenges. Al Salgado, executive director of the Southwest SBDC network, said, "Planning for growth can mitigate risks associated with growing too fast. Businesses owners who grow their firms at a healthy pace understand and plan for the dynamics of their cash flow, they explore the firms' capacity to deliver an increased level of products, and they communicate in advance with their lender to explore possible funding mechanisms such as a line of credit or loan." These tactics can help firms expand at a sustainable pace.

Financial Challenges

Sixty-two percent of Texas firms experienced at least one financial challenge, a decrease of 2 percentage points from last year's report. For those who did have a challenge, the rankings are similar to the previous report (*Chart 4*). However, at nearly one-third (32 percent), a larger share of respondents reported issues with credit availability than prior findings (29 percent).

Chart 4
Paying Expenses, Credit Availability Top Financial Challenges



NOTE: Respondents could select more than one option. N=515.

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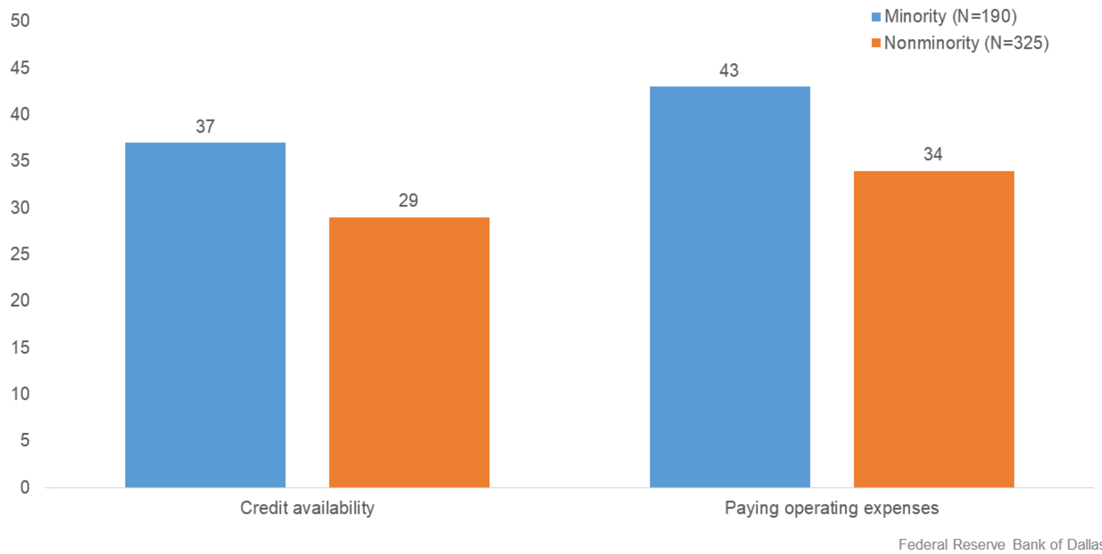
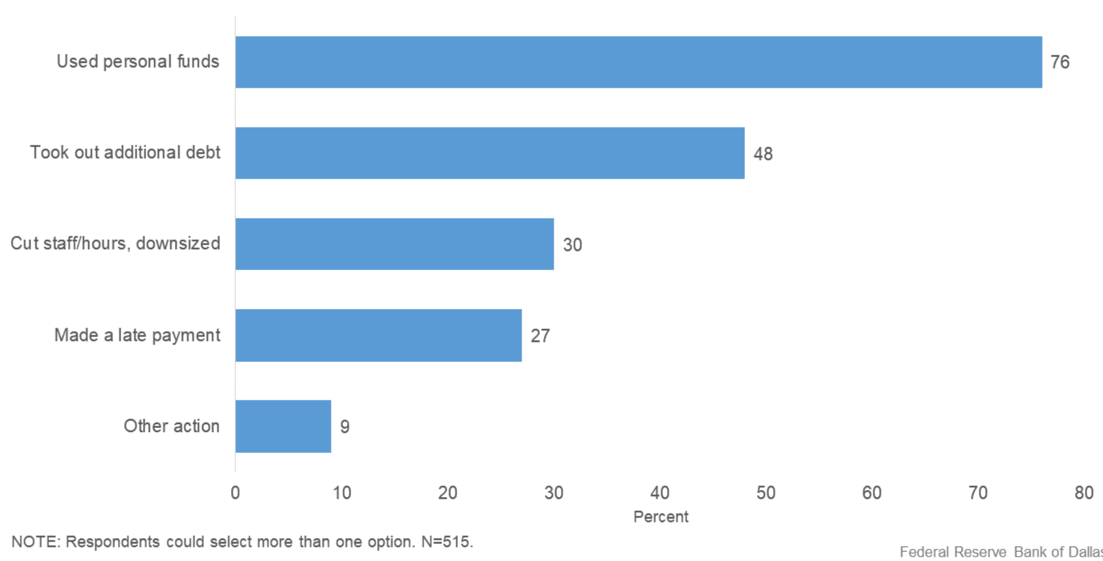
As in previous years of research on this topic, this year's findings indicate that minority-owned firms struggle more with credit access. As Chart 5 shows, 37 percent of minority-owned firms reported struggling with credit availability compared with 29 percent of their nonminority counterparts. This 8-percentage-point gap is significant but is half of last year's gap of 16 percentage points. This year, minority firms also appear more likely to struggle with paying operating expenses than their nonminority peers, although the differences on this measure are not statistically significant.

Chart 5
Minority-Owned Firms Struggle with Credit and Operating Expenses



The majority of firms that experienced a financial challenge used personal funds to address the situation, regardless of demographic (*Chart 6*). Nearly half took on additional debt while 30 percent cut staff or downsized operations. More than a quarter (27 percent), though, made a late payment on money owed, up from 24 percent from the previous findings. Late payments can have an adverse effect on a firm's ability to obtain future financing, so this should be monitored. As Mark Langford, executive director of the North Texas SBDC network said, "Managing cash flow is critical to the survival of any business ... . This can be done with a simple spreadsheet or a robust accounting system and must take seasonality, collection time and changing costs into account." He noted that service providers like the SBDCs can help with this aspect, with education and guidance. "It can be a daunting task to many business owners," said Langford, "but the consequences of not knowing this information can mean the difference between success and failure."

Chart 6
Most Texas Firms Use Personal Funds to Address Financial Challenge

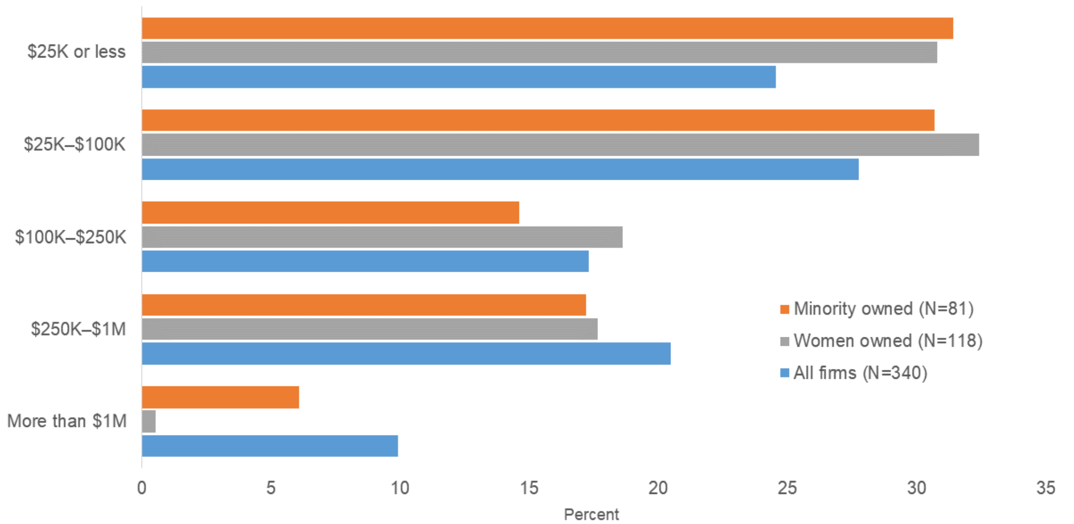


NOTE: Respondents could select more than one option. N=515.

Financing and Debt

According to survey results, most firms in Texas (64 percent) are funded primarily from their retained business earnings. Although just 14 percent report external financing as the primary funding source, 66 percent of firms do have outstanding debt of some type. Minority-owned and women-owned firms appear more likely to hold smaller levels of debt (*Chart 7*). In fact, just half of a percent of women-owned firms hold more than $1 million in debt, a far smaller share than either men-owned (12 percent) or equally owned (14 percent) firms.

Chart 7
Amount of Debt Outstanding by Firm Ownership



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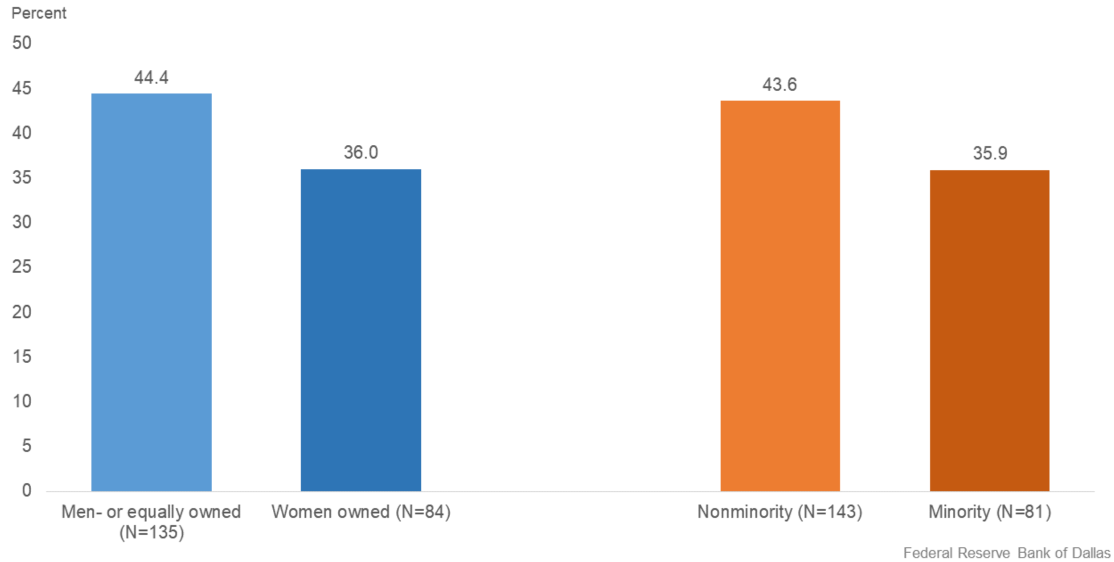
Among all Texas firms, 42 percent reported applying for financing in the past 12 months.[9] The majority of applicants (67 percent) applied with the goal of expanding their business or pursuing a new opportunity. This is significantly higher than the national average of 56 percent, suggesting that Texas firms are more likely to be looking to expand.

Among those who applied, 42 percent received all financing for which they asked. This is down from the reported 50 percent a year ago. However, the share reporting receiving none of the requested financing remained the same, at 21 percent, indicating that there has been a larger share of owners this survey period whose request was partially fulfilled. Still, this means that an additional 8 percent of applicants may have had unmet financing needs in this survey period.

Differences in success of full financing exist by firm ownership demographic. Women-owned firms as well as minority-owned firms are less likely to receive the total amount requested (*Chart 8*).

Chart 8
Share Receiving Full Amount of Financing Sought, by Ownership

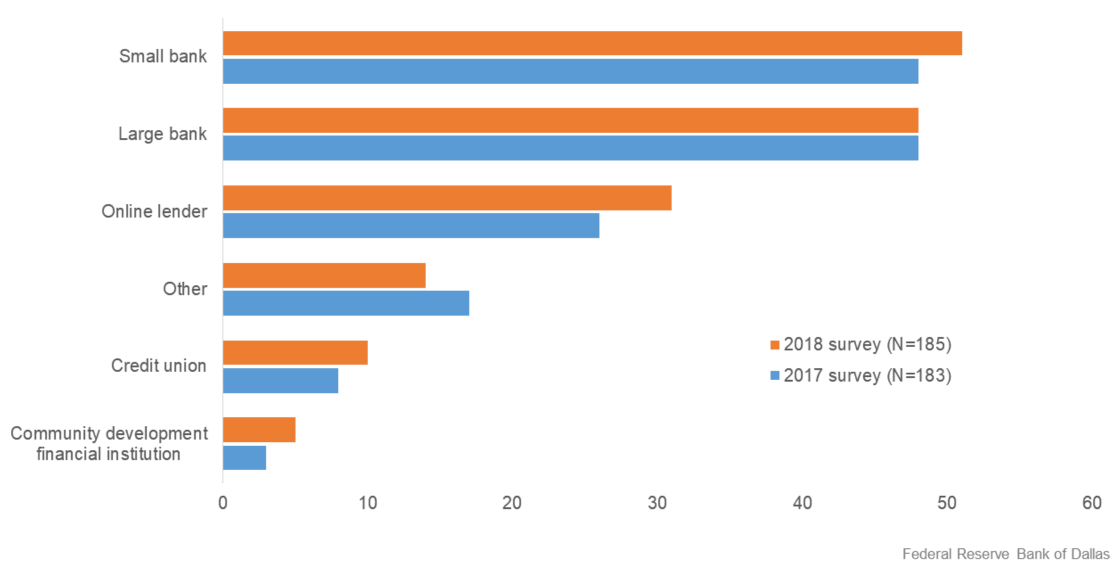


Among those who did not receive any of the financing they requested, respondents pointed to insufficient credit history and having too much current debt as top reasons for rejection. However, responses varied once again by ownership demographic. While 35 percent of firms overall indicated issues with too much current debt held, just 8 percent of minority-owned firms pointed to that issue. Both women-owned and minority-owned firms reported more issues with collateral than the average.

Interestingly, although just 28 percent of Texas firms pointed to low credit scores as being behind credit denial, at a national level, 36 percent of firms did. Insufficient credit history, while ranking at the top for Texas firms, came in fourth place nationally.

Financing applicants in Texas most frequently sought a loan or line of credit (88 percent). Among those, most reported applying to small banks, up a few percentage points from the 2017 survey period (*Chart 9*). Online lenders also saw an uptick, from 26 percent in the last report to 31 percent this year. Application rates at credit unions also increased, from 8 percent to 10 percent.

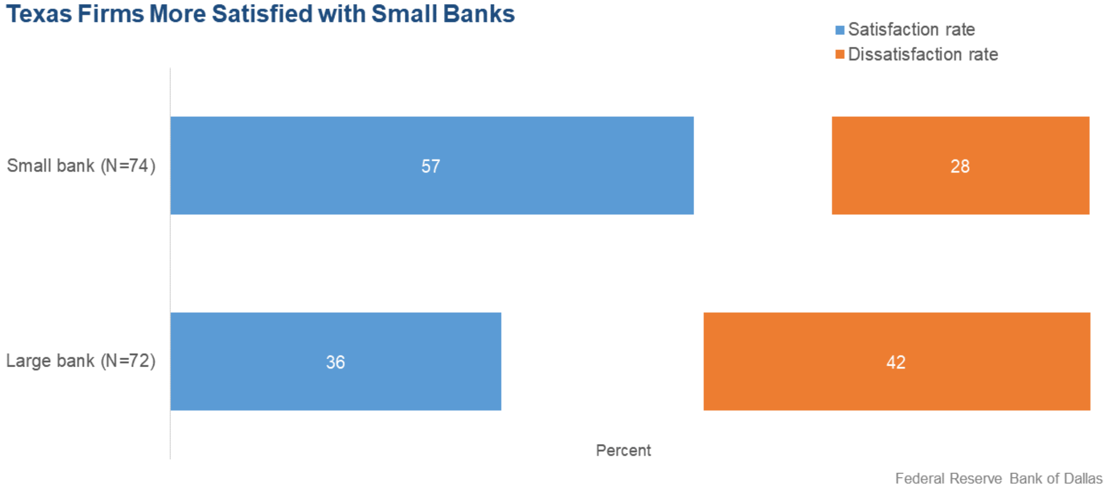
Chart 9
Applications Increase to Small Banks, Online Lenders



Higher shares of women-owned firms and minority-owned firms reported applying to online lenders: 35 percent, and 38 percent, respectively.

Small and large banks both have high enough sample sizes to take a look at applicant satisfaction rates. Overall, small banks have higher satisfaction and lower dissatisfaction rates than large banks (*Chart 10*). The top challenges reported with large banks were difficult application processes, high interest rates and long waits for a loan decision.

Chart 10
Texas Firms More Satisfied with Small Banks

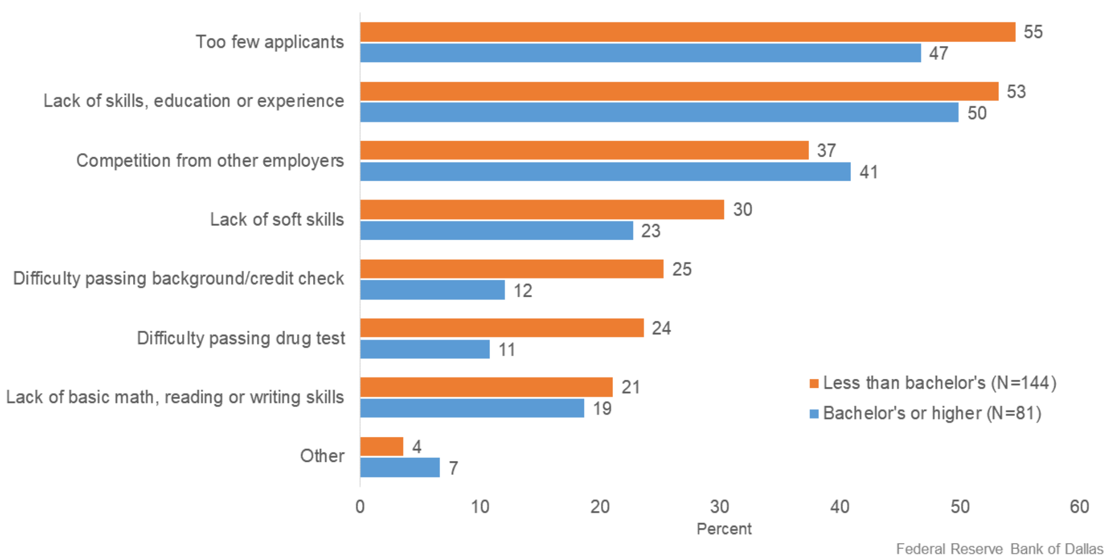


Employment and Hiring

Three-quarters of Texas firms attempted to hire in the 2018 survey period, up from 71 percent the previous period. The vast majority (77 percent) of open positions did not require a bachelor's degree. Reported rates of difficulty in finding these employees are similar for both bachelor's positions and non-bachelor's positions, where 27 percent and 28 percent, respectively, of firms rated the search process as "very difficult."

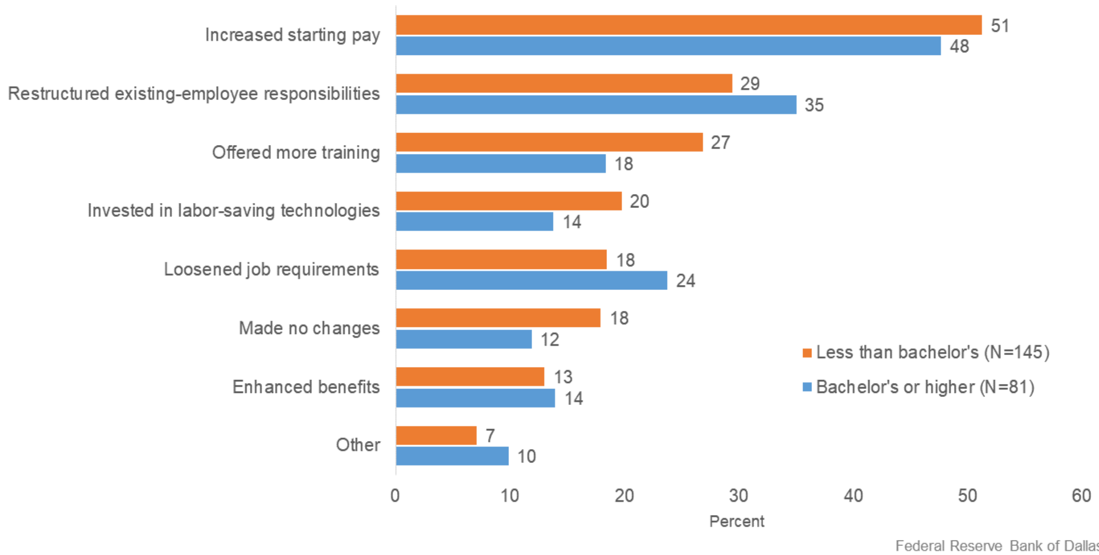
Digging in deeper to specific hiring challenges, Chart 11 indicates that the top two challenges for firms attempting to hire are the same for jobs requiring a bachelor's degree and those without the requirement. However, while a shortage of applicants is first for non-college-degree jobs, for positions requiring a four-year degree, the shortage is second to a lack of job-specific skills or education. The biggest differences between the two job types are difficulty passing a background check or passing a drug test; in both hiring challenges, about a quarter of firms not looking for a college graduate report struggling, compared with just around 12 percent of firms looking for college graduates.

Chart 11
Hiring Challenges by Job Type



Coping with these hiring barriers most often led firms to increase starting pay, particularly for those seeking to fill jobs that did not require a degree (*Chart 12*). This seems to fit with attempts to increase the low number of applicants, the top barrier found in Chart 11. Twenty-seven percent of firms with positions not requiring a bachelor's also offered more training to existing staff, and 20 percent not requiring a degree invested more dollars into technology that would save labor. Compared with firms hiring non-college-graduates, firms seeking four-year-degree holders were more likely to restructure responsibilities for their existing employees (35 percent) and loosen requirements for their open positions (24 percent).

Chart 12
Changes Made from Hiring Difficulties



For firms looking to hire, Judy Wilhelm, Northwest Texas SBDC network executive director, had some advice:

> The small business owner may look to the local university or vocational school to accept an intern that could be trained with the intent of joining the company upon graduation. Your local workforce agency can help identify various talent that fits your company vision prior to your time spent searching. Review your technology status to determine if upgrades to your current technology system would allow for a more efficient operation and more available candidates with the skill set to accomplish your goals. A clear position description prior to posting or distributing information will assist in eliminating unqualified candidates while attracting those who might otherwise be overlooked. When interviewing, today's small business owner must be willing to invest in training or retraining. When interviewing potential candidates, look for the passion, desire to learn and willingness to grow with your company.

Closing Thoughts

The large contribution of small employer firms to the overall economy—in Texas, but also nationally—suggests an imperative to study the changes and trends of their successes and challenges. According to findings discussed here, Texas firms are, on average, optimistic about future business performance and growth potential, despite the fact that the majority are experiencing at least one financial challenge. More than one-third of firms report struggling to pay operating expenses, while 32 percent report issues with credit availability. Minority-owned firms are more likely to have trouble with these two issues than those that are not minority owned. A majority of Texas firms have outstanding debt, and a sizeable portion (42 percent) of firms applied for additional financing. Women-owned firms and minority-owned firms had lower rates of being granted the full amount of financing requested, a finding which is in line with prior reports. This year, most firms applied to small banks for financing, and those that did tended to find the experience more satisfactory than those that applied to large banks. Regarding employees, 75 percent of firms tried to hire in the prior 12 months, most with some amount of difficulty. Increasing starting pay and restructuring the responsibilities of existing employees were both common tactics for dealing with these challenges.

Looking forward, as Texas firms continue to plan for new growth and opportunities, there are numerous resources available across the state. Microlenders such as LiftFund, PeopleFund and BCL of Texas can help with sources of debt outside of traditional banks. Local and statewide economic development offices, chambers of commerce and other groups can help make connections. Finally, organizations like Texas SBDC Network can provide one-on-one advisement for entrepreneurs as they navigate challenges in years to come.

Appendix: Methodology

Data for this report are derived from the national Small Business Credit Survey (SBCS) effort. Weights and imputations are used to create a nationally representative sample. The following methodology write-up is from the 2017 Report on Employer Firms, available at fedsmallbusiness.org.

Data Collection

The Small Business Credit Survey (SBCS) uses a convenience sample of establishments. Businesses are contacted by email through a diverse set of organizations that serve the small business community. Prior SBCS participants and small businesses on publicly available email lists are also contacted directly by the Federal Reserve Banks. The survey instrument is an online questionnaire that typically takes 6 to 12 minutes to complete, depending upon the intensity of a firm's search for financing. The questionnaire uses question branching and flows based upon responses to survey questions. For example, financing applicants receive a different line of questioning than nonapplicants. Therefore, the number of observations for each question varies by how many firms receive and complete a particular question.

Weighting

A sample for the SBCS is not selected randomly; thus, the SBCS may be subject to biases not present with surveys that do select firms randomly. For example, there are likely small employer firms not on our contact lists and this may lead to a noncoverage bias. To control for potential biases, the sample data are weighted so the weighted distribution of firms in the SBCS matches the distribution of the small (1 to 499 employees) firm population in the United States and Texas by number of employees, age, industry, geographic location (census division and urban or rural location), gender of owner(s), and race or ethnicity of owner(s). We first limit the sample in each year to only employer firms. We then post-stratify respondents by their firm characteristics. Using a statistical technique known as "raking," we compare the share of businesses in each category of each stratum (e.g., within the industry stratum, the share of firms in the sample that are manufacturers) to the share of small businesses in the nation that are in that category. As a result, underrepresented firms are up weighted and overrepresented businesses are down weighted. We iterate this process several times for each stratum in order to derive a sample weight for each respondent. This weighting methodology was developed in collaboration with the National Opinion Research Center (NORC) at the University of Chicago.

The data used for weighting come from data collected by the U.S. Census Bureau. We are unable to obtain exact estimates of the combined racial and ethnic ownership of small employer firms for each state, or at the national level. To derive these figures, we assume that the distribution of small employer firm owners' combined race and ethnicity is the same as that for all firms in a given state. Given that small employer firms represent 99.7 percent of businesses with paid employees, we expect these assumptions align relatively closely with the true population. In addition to the main weight, state- and Federal Reserve District-specific weights are created. While the same weighting methodology is employed, the variables used differ slightly from those used to create the main weight. Estimates for Federal Reserve Districts are calculated based on all small employer firms in any state that is at least partially within a District's boundary. Federal Reserve District-level weights are created for each district using the weighting process described above, but based on observations in the relevant states.

Race/Gender Imputation

Sixteen percent of respondents completed the survey but did not provide information on the gender, race, and/or the ethnicity of their business's owner(s). This information is needed to correct for differences between the sample and the population data. To avoid dropping these observations, a series of statistical models is used to attempt to impute the missing data. When the models are able to predict with an average accuracy of 80 percent in out-of-sample tests, the predicted values from the models are used for the missing data. When the model is less certain, those data are not imputed and the responses are dropped. After data are imputed, descriptive statistics of key survey questions with and without imputed data are compared to ensure stability of estimates. In the final sample, 13 percent of observations have imputed values for either the gender, race, or ethnicity of a firm's ownership. To impute for owners' race and ethnicity, a series of logistic regression models is used that incorporate a variety of firm characteristics, as well as demographic information on the business headquarter's zip code. First, a logistic regression model is used to predict if business owners are members of a minority group. Next, for firms classified as minority-owned, a logistic probability model is used to predict whether the majority of a business's owners are of Hispanic ethnicity. Finally, the race for the majority of business owners is imputed separately for Hispanic and non-Hispanic firms using a multinomial logistic probability model.

A similar process is used to impute for the gender of a business's ownership. First, a logistic model is used to predict if a business is primarily owned by men. Then, for firms not classified as men-owned, another model is used to predict if a business is owned by women or is equally owned.

Notes

1. United States Small Business Profile, Office of Advocacy, U.S. Small Business Administration, 2018.
2. Small Business Administration and Job Creation, Congressional Research Service, Dec. 20, 2018.
3. We use the term "minority owned" if the respondent reports that at least 51 percent of the company is owned by someone who identifies as black/African-American, Hispanic/Latino, Asian or Pacific Islander, Middle Eastern, American Indian/Alaskan native or other race. The term "minority owned" is used by the U.S. Small Business Administration, the Census Bureau and local business certification entities.
4. These educational differences are significant at the 90 percent credibility level, but they are not significant at the 95 percent level. When two values are not statistically different, this means that we cannot be certain that the difference is not just due to sheer chance of sampling. In this case, we are 90 percent certain these values are different but not 95 percent certain.
5. Approximately the second half of 2017 through the second half of 2018.
6. See note 5.
7. Expected change in the second half of 2018 through the second half of 2019.
8. See note 7.
9. See note 5.

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