

# **Business Services Firms Are Cautiously Optimistic About The Coming Year**

Minnesota business service firms are hopeful about the coming year, despite some concerns. Inflation remains high due to continued labor-market tightness and growing wage pressures, resulting in tighter credit policies. However, supply chain disruptions are receding, the search for workers is easing, and inflation is subsiding.

These results come from a random sample of Minnesota businesses service firms conducted in May and June 2023, by the Minnesota Department of Employment and Economic Development and the Federal Reserve Bank of Minneapolis.

**Business Services Firms: Previous Year**
Minnesota business services firms experienced mixed economic conditions in the past year. There was a modest growth in sales revenue (diffusion index of 57, indicating expansion) and productivity (diffusion index of 55, also expansion) (see Chart 1). However, labor availability faced contraction: 53% of respondents indicated unchanged levels while 42% specified a decrease (see Table 1), resulting in a diffusion index of 32 (contraction). Business services firms also faced inflation: 62% of respondents indicated increased input cost with a diffusion index of 80 (expansion).

\* Above 50 indicates expansion, below 50, contraction.

**Business Services Firms: The Coming Year**
Minnesota business services firms are cautiously optimistic about the next four quarters with modest expansion in some metrics, even for labor availability. The diffusion index for this metric (41), indicates contraction but it is an improvement from the index in 2022 (32), suggesting modest optimism (see Chart 2). However, it comes with a cost. To attract workers, 53% of respondents anticipate increasing wages by at least 3%. See Table 1.

\* Above 50 indicates expansion, below 50, contraction.

**Outlook On The State Economy: Next Year**Minnesota business services firms are also cautiously optimistic about the overall economy for next year, despite some concerns. About 56% expect constant employment levels, with a diffusion index of 52, indicating subdued expansion. See Table 1.
Although respondents anticipate inflation with a diffusion index of 79, it is significantly lower than the index from the previous year (93), suggesting timid optimism about slowing inflation. See Table 1. Respondents are concerned about consumer spending with a diffusion index of 40 (contraction). See Table 1.

A question about credit conditions revealed that business experienced difficulties in the past year. The percentage of respondents that did not experience changes (53%) was significantly down compared to the previous year (80%). About 35% reported higher interest rates and 20% experienced decreased capital expenses. Additionally, 9% indicated difficulties accessing credit. See Table 1.

The survey also inquired about the impact of inflation compared to 2022. About 65% of respondents indicated that the cost of utilities and materials or inputs cost are worse. However, rent remained mostly stable with 66% of participants reporting unchanged levels. On the upside, only a third expressed that supply change disruptions were worse and, in fact, 14% reported improved conditions. See Table 1.

**Table 1: Minnesota 2023 Business Services Firms Condition Survey Results1**

| **Business indicators in the last year** | **Up** | **Same** | **Down** | **Diffusion index 2023(2)** | **Diffusion index 2022(2)** |
| --- | --- | --- | --- | --- | --- |
| Sales revenue | 43% | 27% | 31% | 57 | 60 |
| Profits | 36% | 26% | 39% | 49 | 50 |
| Productivity | 30% | 50% | 21% | 55 | 53 |
| Employment level | 14% | 67% | 19% | 48 | 49 |
| Labor availability | 5% | 53% | 42% | 32 | 34 |
| Selling prices | 48% | 44% | 9% | 70 | 72 |
| Input costs | 62% | 35% | 2% | 80 | 84 |
| Space occupied (square footage)Exports (sales for foreign clients) | 6%3% | 87%93% | 7%4% | 5050 | 5249 |

| Labor indicators in the last year | Decrease | 0% | 1-2% | 3-5% | 6-9% | >10% |
| --- | --- | --- | --- | --- | --- | --- |
| Wages per worker | 5% | 25% | 8% | 26% | 17% | 19% |
| Benefits per worker | 3% | 50% | 9% | 14% | 15% | 10% |

| Expected business indicators during next year | Up | Same | Down | Diffusion index 2023(2) | Diffusion index 2022(2) |
| --- | --- | --- | --- | --- | --- |
| Sales revenue | 36% | 43% | 21% | 58 | 58 |
| Profits | 28% | 44% | 27% | 50 | 51 |
| Productivity | 24% | 64% | 11% | 56 | 55 |
| Employment level | 16% | 72% | 12% | 52 | 55 |
| Labor availability | 7% | 68% | 25% | 41 | 36 |
| Selling pricesInput costs | 37%55% | 57%41% | 6%3% | 6676 | 6684 |
| Space occupied (square footage) | 4% | 90% | 6% | 49 | 51 |
| Exports (sales for foreign clients) | 2% | 96% | 2% | 50 | 51 |

| Expected labor indicators during next year | Decrease | 0 | 1-2% | 3-5% | 6-9% | >10% |
| --- | --- | --- | --- | --- | --- | --- |
| Wages per worker | 5% | 34% | 9% | 35% | 11% | 7% |
| Benefits per worker | 3% | 50% | 11% | 22% | 9% | 6% |

| Outlook on the following state economic indicators during the next year  | Up | Same | Down | Diffusion index 2023(2) | Diffusion index 2022(2) |
| --- | --- | --- | --- | --- | --- |
| Employment | 24% | 56% | 20% | 52 | 53 |
| Consumer spending | 19% | 41% | 40% | 40 | 39 |
| Inflation | 65% | 28% | 8% | 79 | 93 |
| Corporate profits | 25% | 39% | 37% | 45 | 38 |
| Mergers and acquisitions | 23% | 53% | 14% | 60 | 33 |

| Have changes inin credit conditionsin the last 4 quartersaffected your firm? | Higher Interest rates | No Changes | Increased Hiring | IncreasedCapital Expenditures | DecreasedHiring | Decreased Capital Expend. | NoDiff.accessing credit | Difficultiesaccessing credit |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Percent | 35% | 53% | 7% | 6% | 11% | 20% | 21% | 9% |

1) Based on responses from 229 Minnesota business service firms, for a response rate of 19.0%. Percentages might not add to 100% due to rounding.
(2) A diffusion index greater than 50 indicates expansion, lower than 50 indicates contraction.
Prepared by the Economic Analysis Unit, Minnesota Department of Employment and Economic Development, June 2023.

**Sources of Inflation Pressure Compared to The Previous Year**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Compared to 2022, how the following source of inflation pressure changed?** | **Worse** | **Same** | **Better** | **Not applicable** |
| Wages | 48% | 41% | 5% | 6% |
| Benefits | 40% | 49% | 3% | 9% |
| Rent | 23% | 66% | 0% | 11% |
| Utilities’ cost | 65% | 29% | 0% | 6% |
| Transportation cost | 54% | 29% | 3% | 15% |
| Administrative cost | 46% | 49% | 1% | 5% |
| Technology cost | 63% | 33% | 1% | 3% |
| Materials or other input cost | 65% | 26% | 1% | 8% |
| Supply change disruptions | 36% | 33% | 14% | 18% |
| Falling demand for your companies’ services |  25% | 47% | 16% | 13% |
| Inability to acquire/repair property/equipment | 18% | 45% | 6% | 31% |
| Other | 11% | 21% | 0% | 68% |

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**Business Ownership**Beginning in 2022, DEED began asking questions about business ownership demographics in the business conditions surveys. Responses showed that Minnesota business services firms remain overwhelmingly white and non-Hispanic owned. Non-white or Hispanic-owned business owners represented only 5% of the state’s business services firms but 18% of Minnesota’s population. Women represented 28% of firms but 50% of the state’s population.



Note: Percentages do not add to 100% due to multiple choice selection.

Respondents were asked to provide additional comments. Several participants indicated concerns with high taxes, labor availability and cost, inflation and recovering sales. One participant provided a comment about embracing technology change to increase growth. Sample comments are included *verbatim* below:

Labor Availability and Cost
*“Business owners in this small town are aging and want to retire. I can’t find anyone to take over my business. Account[ant]s, CPA professionals don’t want to move [to] or stay in small towns. But there is a need for their services.”*

*“Labor is more expensive due to [the] economy, while productivity is not increasing…likely also related to stress/mental health issues fueled by the economy and still covid burn out.”*

*“Our revenue is up only because we raised prices to keep up with inflationary pressures. We need to offer higher salaries in order to retain the talent [...]. We have to limit the amount of new business we take on, even though the demand is there, because it is difficult to find qualified employees to do the work.”*

Inflation
*[…] The cost of living has gone [up] more than my company’s ability to raise wages has. This effectively means that even with a modest raise, my employees have still taken a pay cut.”*

Recovering Sales
*“Sales were non-existent in 2020. Slow ramp up in 2020-2021, this year is close to “normal” but still below 2019.”*

Technology Change

*“Our business meetings have moved to the internet. Our international business has grown because we have placed our services on the internet. The nature of everything we do has changed because of the Internet.*