Annual Survey

Activity at professional services firms up, expected to continue

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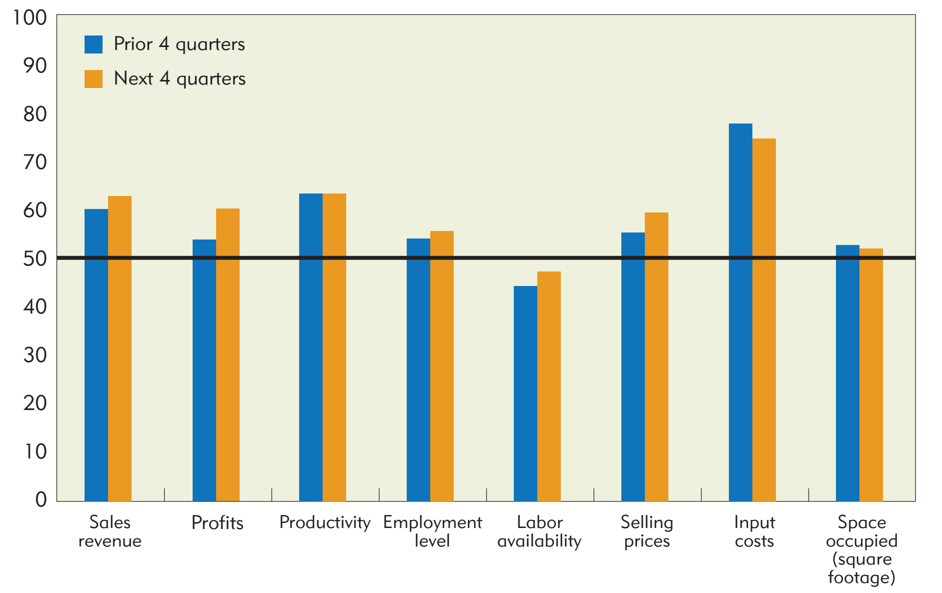
Accountants, engineers, graphic designers, market researchers, management consultants and other professional services providers had a decent year based on the annual survey of professional services firms conducted by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development.

Over the past four quarters, professional services firms experienced solid growth, with increased sales and productivity (see chart). Slightly more firms reported higher profits than lower profits, as higher selling prices and volumes were partially offset by higher input costs and increased employment. Firms reported that labor availability was reduced, access to bank credit increased slightly and space usage was relatively flat. The outlook for the next four quarters is upbeat, as more respondents expect increases rather than decreases in sales prices and revenue, along with employment, productivity and profits. More employers expect their state's economy to pick up rather than slow down over the next four quarters.

Professional business services firms expect to expand

(Above 50 indicates expansion; below 50 indicates contraction*)



* Percent of respondents indicating increase plus half indicating no change

Source: Federal Reserve Bank of Minneapolis; Minnesota Department of Employment and Economic Development

Many services firms expanded over the past year. Forty-eight percent of firms reported increased sales versus 27 percent reporting decreases. This is consistent with the predictions made in last year's survey, in which 48 percent expected increased sales revenue and 16 percent expected decreases. This year's sales revenue increases were partially reflected by higher selling prices (26 percent said up and 10 percent said down) and additional employment (25 percent added employees and 17 percent reduced employees).

Overall profits increased slightly, with 41 percent of firms seeing higher profits compared with 35 percent reporting lower profits. Besides higher sales revenue, productivity also helped profits, as 37 percent reported more efficient operations, while 11 percent reported decreased productivity. Factors hindering profits included higher input costs, cited by 57 percent of respondents, while just 4 percent reported lower input costs. Compensation also increased: Wages per worker increased 2.4 percent over the past year, and benefits increased by an average of 2.1 percent. Available financing increased slightly over the past three months: 12 percent of respondents reported improved access to bank credit, while 9 percent reported more difficult access.

The services industry should continue to grow over the next year. Sales and profit increases are expected by 47 percent and 41 percent of respondents (respectively), compared with 19 percent and 22 percent (respectively) expecting decreases. More than half of respondents also anticipate higher input costs compared with just 4 percent expecting lower input costs. More firms expect selling prices to increase than decrease (28 percent and 10 percent) and productivity to improve (35 percent) rather than decline (9 percent). Wages and benefits for the coming year are expected to rise about 2 percent. Employment is expected to rise at 24 percent of the firms and drop at 11 percent.

When asked about the Affordable Care Act's effect on the employment mix, 13 percent reported that they already have shifted to more part-time workers, while 10 percent are planning a similar shift during the next two years. But more than three-quarters of respondents expected no shift to more part-time workers.

The firms expect their state economies to expand as well: 45 percent expect increased overall employment, while 12 percent expect to see falling employment in their state. As well, 43 percent of firms expect higher consumer spending. While corporate profits are expected to increase, 56 percent also expect higher inflation, with only 2 percent believing that inflation will decrease. f

Banks paring back their branches

It has taken some time for the ball to start rolling the other way, but banks across the country and Ninth District are slowly pulling back on branches. Call it "too small to bail."

The total number of Ninth District bank branches rose steadily from 2001 to 2006—increasing by nearly 25 percent—before plateauing during the recession. Branches saw some gains and losses over the next several years, but still rose on net from 2006 to the fourth quarter of 2009, to 3,027 branches. But since then, the Ninth District has officially lost about 70 branches (more on this in a bit; the actual number is likely higher).

The Upper Peninsula of Michigan has seen the biggest loss of branches, but the trend started well before the recession. Branches there peaked in 2004 at 172 and were down to 139 by the end of 2009. By the fourth quarter of last year, the U.P. had lost another six branches. Minnesota has shed 35 bank branches, but from a much larger base of more than 1,400 branches. Other district states (including northwestern Wisconsin, the only portion technically in the Ninth District) lost only a small handful of branches—even booming North Dakota saw branches drop by a half dozen over this period.

The outlier, with caveats, was Montana, which officially saw the number of branches rise by nine, or almost 3 percent since the end of 2009. However, at least part of this bump appears to come from full-fledged banks getting converted by a parent company to branch status. Last year, for example, Glacier Bancorp, one of the largest bank holding companies in that state, consolidated 11 bank subsidiaries—five of them in Montana—into a single commercial bank, effectively converting previously independent banks into branches; nothing else changed except the regulatory designation of the building.

At the same time, Montana is still something of an outlier in terms of total "banking service locations"—in essence, the number of banks plus branches. Montana saw a net-zero change from 2009 to 2012, while every other district state saw a decline of banking locations of between six (in the U.P.) and 72 (Minnesota).

For more information on the health of Ninth District banks, see the Minneapolis Fed's Banking Conditions website, which is updated quarterly.

—Ronald A. Wirtz

Economist Jason Schmidt contributed to this article.