JOBS DEPENDENT ON SMALL AND MEDIUM SIZED FIRMS

The ADP national employment report has received a lot of flack over the years for not being as accurate a predictor of the monthly change in non-farm payrolls as many investors would like. Last week was no exception. The ADP predicted 157,000 new private sector jobs for June, while the actual tally came in at a meager 57,000. However, if we pull the lens back and look at both series’ on a 3-month trend basis, they become kissing cousins. And, the trend relationship holds even looking at ADP data prior to revisions that align it with payrolls data. Market participants may deem this of little value, since the ADP report is largely relied upon as a near-term predictor of the monthly payrolls report that is released two days later. However, the trend relationship can help us assess the degree to which small and medium sized enterprises (SMEs) are engaged in this recovery cycle. That’s because, unlike the non-farm payrolls report, the ADP report breaks out private sector payrolls into three firm-size buckets – those with 1-49 employees, those with 50-499 employees, and those with 500+ employees. The first two categories constitute SMEs, and the lackluster performance on the payrolls front has often been attributed to SMEs not being engaged in this recovery cycle. We reviewed this notion in detail in a previous report.

We’ve always had to rely on the Business Dynamics Employment (BED) report for a relatively accurate tally of SME firm employment behavior in the past. But this report is incredibly lagged – by nine months to be exact. The most updated data is for the third quarter of 2010. Fortunately, this is where the ADP report can help bridge the gap. The above graph shows a tight trend relationship between the ADP job figures for SMEs and that of the BED statistics. If this relationship remained in tact, it suggests that SMEs were largely responsible for the nearly 1.4 million private payroll jobs created in the past nine months. The share looks to have definitely increased from roughly 60% in the latest BED data. This would be consistent with historical behavior in which SMEs have accounted for roughly three-quarters of the new jobs during economic recoveries. The difference in this cycle, however, was the SMEs were later in getting to the party (if we can call it that). And, we’re seeing job growth that is roughly 2 percentage points slower than the last two recovery cycles, which were already on the weak side.

Although SMEs look to have reinstated their status as key drivers of job growth, it is a shadow of its former self. A poor sales environment has been a key impediment sighted for dreary job demand by these employers. Although it is not realistic to expect a strong rebound in sales, the recovery in the second half of this year should at least face less drag from high gasoline prices and supplier chain disruptions. Ultimately, the findings circle back to the notion that if this economic recovery is going to gain momentum, SMEs will have to be at the center of it.

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