

ECONOMICS MADE EASY



# A Journalism Workshop

## The State of Small Business Lending

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THE FEDERAL RESERVE BANK OF RICHMOND

RICHMOND ■ BALTIMORE ■ CHARLOTTE



## The news story

“After 10 years in the liquor business and four children, Mr. Tessier had decided he wanted to switch to a more family-friendly business. At least that is what he thought until he tried to get financing.... He assumed he was a better candidate for a loan with \$300,000 in the bank, \$9,000 monthly income from the sale of his liquor store and a credit score around 800. But Mr. Tessier said the lenders told him they had tightened policies and were willing to finance only the equipment for a five-year term. ‘I was just shocked at how tough it was.’” *(New York Times, 6/10)*





## Some Definitions

- What qualifies as a small business?
  - Small businesses are *generally* defined as firms with fewer than 500 employees.
  - Firms with fewer than 500 employees represent 99.9 percent of the total number of businesses.
- What qualifies as a small business loan?
  - Any business loan of \$1 million or less reported by financial institutions on Schedule RC-C, Part II (call report)
    - C&I loans, CRE loans, agricultural loans (< \$500,000)
  - Small business credit cards
  - SBA loan products: 7a, 504, and microloans
    - A small percentage of total small business loans





# Small Business Credit Demand

- Increased demand from existing and start-up businesses
  - Cash flow issues
  - Long-term unemployment has created a lot of entrepreneurs.
  - Banks are a primary or significant source of credit.
    - 45% of respondents use bank loans (NSBA 2009).
    - 59% use credit cards (NSBA 2009).
  - People can no longer rely on the 3 F's.
  - Small businesses are seeking out new banks and applying for different types of products.
    - 52% of respondents approached two or more banks for a new line of credit (NFIB 2009).





# Small Business Credit Demand

- Decreased demand from existing businesses
  - Businesses are not seeking credit because of uncertainty:
    - Health care legislation
    - Economic conditions
  - “Banks need to lend money just as grocery stores need to sell fruit. It is our business model. Nobody is knocking at our door.”
    - Small businesses tend to borrow locally. The median distance between business and lender was 11 miles (2003 Survey of Small Business Finances).
    - Trend may be turning in certain areas (e.g., Maryland event 9/29)
  - Discouraged borrowers
    - 11% in 2009 (NFIB survey)



# Small Business Optimism Index

Based on Ten Survey Indicators  
*(Seasonally Adjusted 1986=100)*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>2005</b>	103.7	103.7	102.5	99.8	100.8	100.8	101.1	100.9	100.0	103.7	101.2	101.4
<b>2006</b>	101.1	101.5	98.0	100.1	98.5	96.7	98.1	95.9	99.4	100.7	99.7	96.5
<b>2007</b>	98.9	98.2	97.3	96.8	97.2	96.0	97.6	96.3	97.3	96.2	94.4	94.6
<b>2008</b>	91.8	92.9	89.6	91.5	89.3	89.2	88.2	91.1	92.9	87.5	87.8	85.2
<b>2009</b>	84.1	82.6	81.0	86.8	88.9	87.9	86.5	88.6	88.8	89.1	88.3	88.0
<b>2010</b>	89.3	88.0	86.8	90.6	92.2	89.0	88.1	88.8				

Source: National Federation of Independent Businesses, Small Business Economic Trends, Sep. 2010



# Small Business Expansion Outlook

Percent Next Three Months “Good Time to Expand”  
*(Seasonally Adjusted)*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>2005</b>	23	24	19	18	18	22	20	21	19	22	20	21
<b>2006</b>	20	20	19	18	18	13	16	13	18	20	17	17
<b>2007</b>	17	18	12	12	12	13	16	12	14	14	13	14
<b>2008</b>	9	8	5	6	4	4	6	6	11	5	7	7
<b>2009</b>	6	3	1	4	5	4	5	5	9	7	8	7
<b>2010</b>	5	4	2	4	5	6	5	4				

Source: National Federation of Independent Businesses, Small Business Economic Trends, Sep. 2010





# Supply of Small Business Loans

- Challenges finding credit-worthy businesses
  - Lending to small businesses is often considered riskier and costlier than lending to larger firms.
    - Smaller loans
    - Higher failure rate of firms
    - Impacted more by business cycles
    - Difficulty determining creditworthiness of applicants (no public information, no general standards, often no solid financial information)
  - Given economic conditions, all businesses are relatively riskier.
    - Insufficient income and cash flow





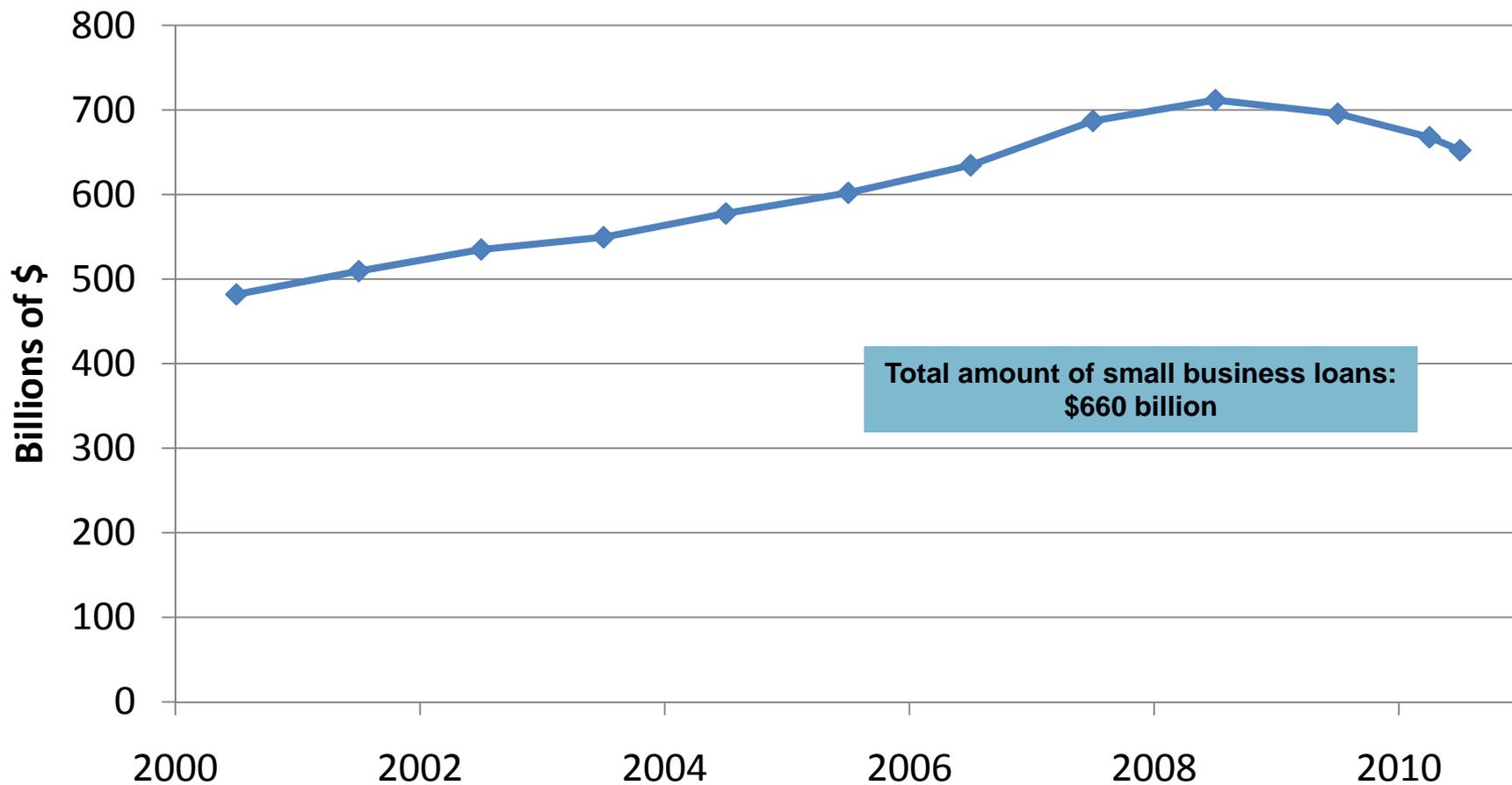
# Supply of Small Business Loans

- Traditional equity sources (home, 401K, friends, credit card) are severely limited and collateral has depreciated.
  - 45% of total dollar amount of small business loans in 2003 were collateralized by some type of real estate asset (Board survey) .
  - 29% of small businesses use a second mortgage as collateral for a business loan (NSBA 2009).
- New start-ups often don't have fleshed out business plans.
- Small businesses are unable or unwilling to provide paperwork and follow the lending process.





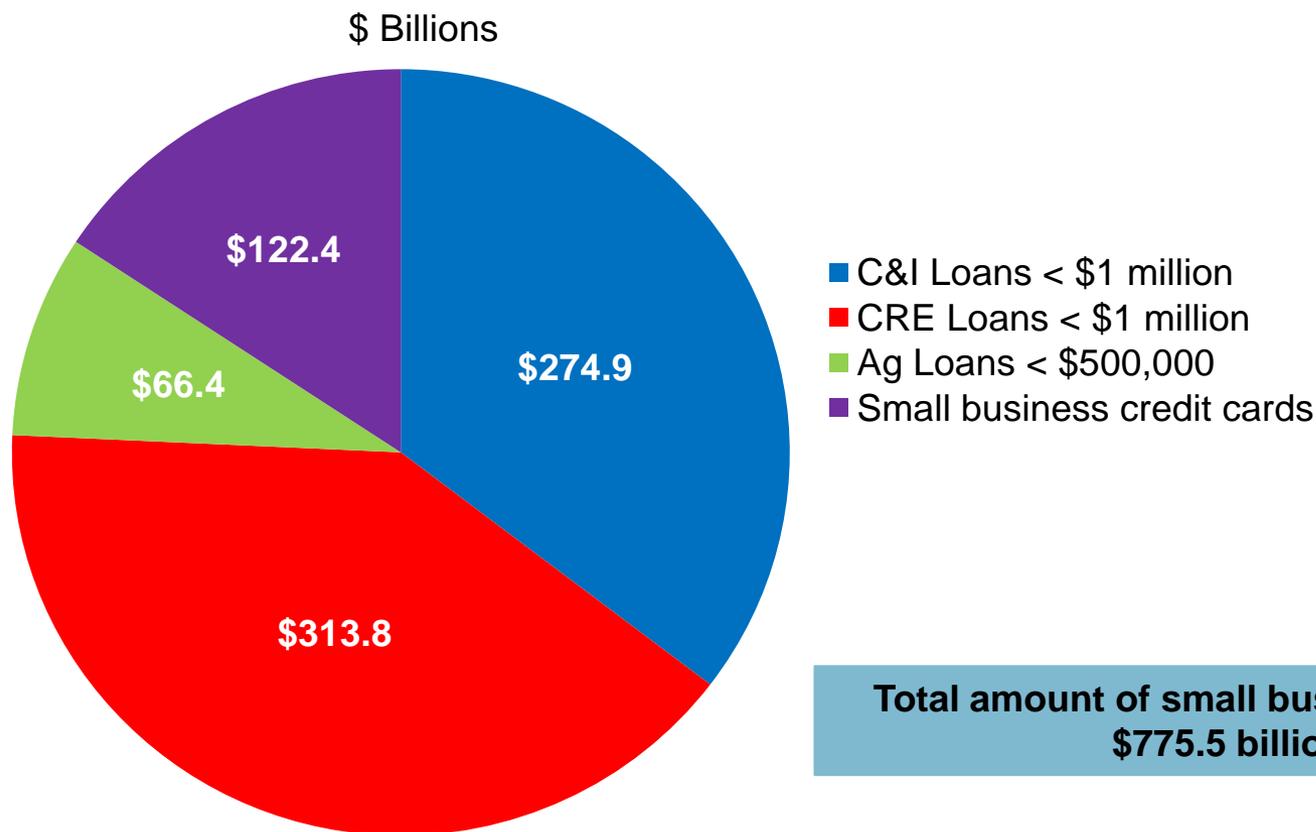
# Small Business Lending, 2000-2010



Source: Call report data, total small business loans outstanding



# Small Business Lending, 2010

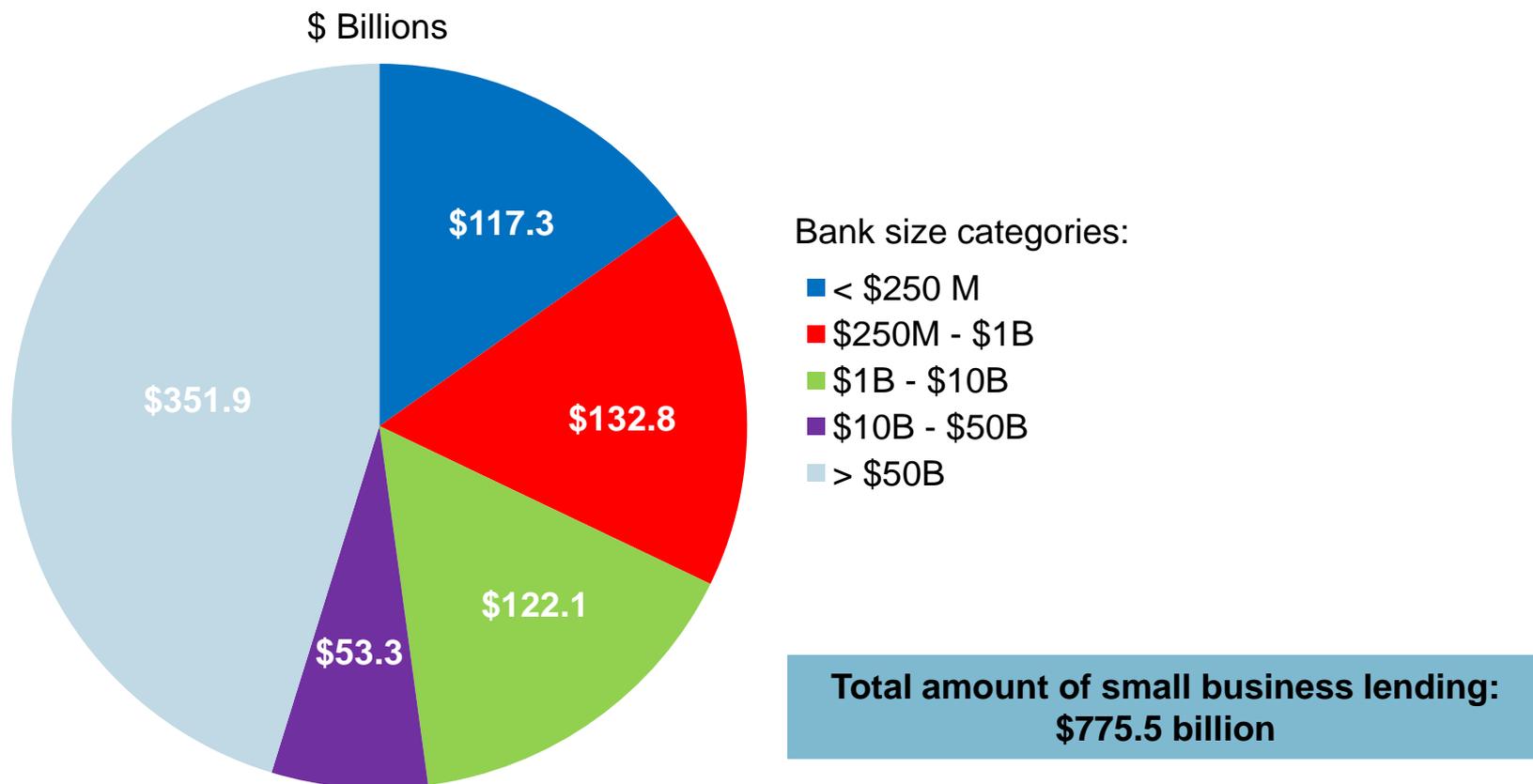


Sources: Reports of Condition and Income, March 2010; The Nilson Report, June 2010





# Small Business Lending by Bank Size



Sources: Reports of Condition and Income, March 2010; The Nilson Report, June 2010

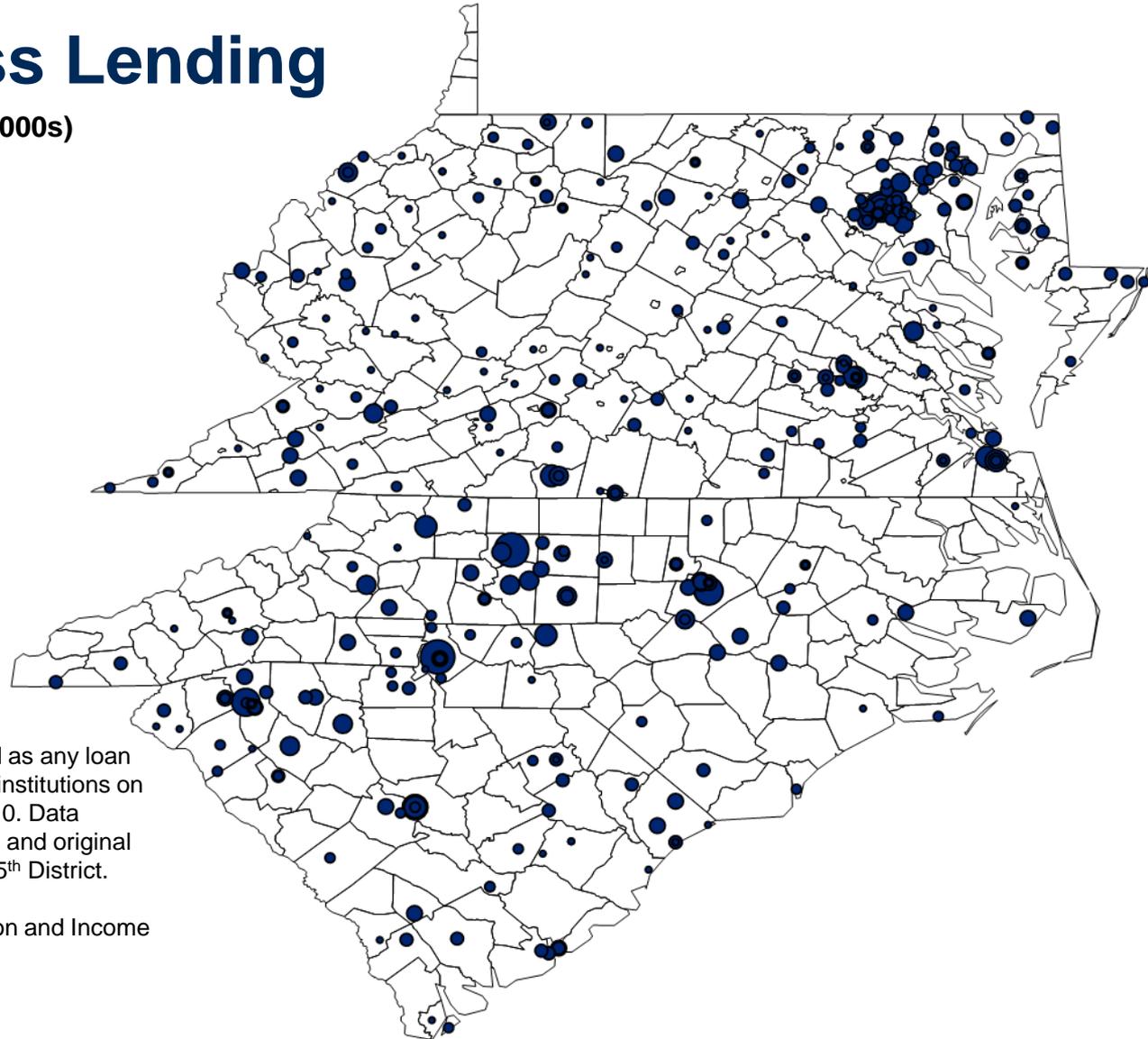




# Small Business Lending

Total Small Business Lending (\$000s)  
by Institution, March 2010

- 0 - 25,000
- 25,001 - 50,000
- 50,001 - 100,000
- 100,001 - 200,000
- 200,001 - 400,000
- 400,001 - 800,000
- 800,001 - 1,600,000
- 1,600,001 - 3,200,000
- 3,200,001 - 6,400,000
- 6,400,001 - 26,838,664

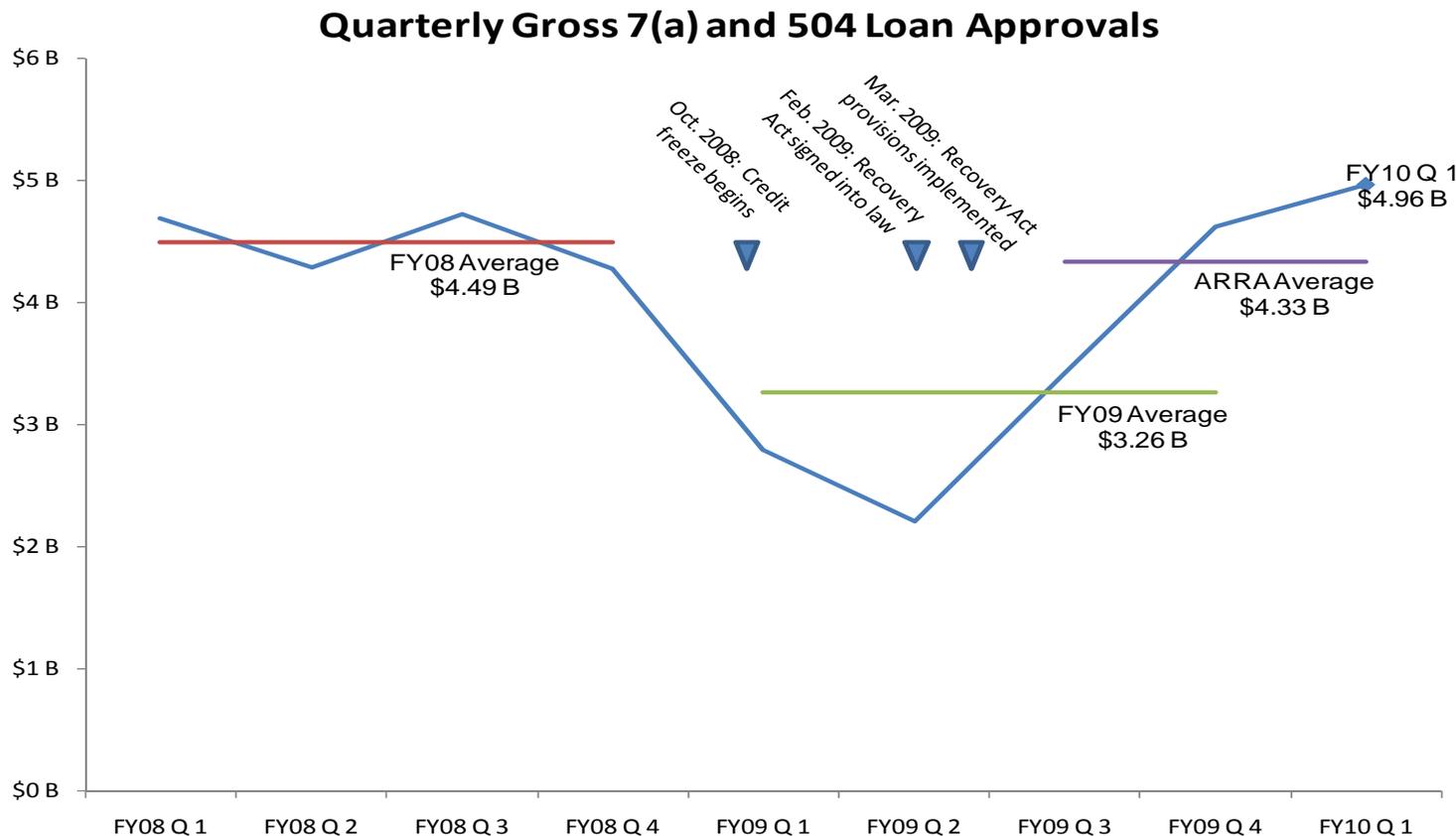


Notes: Small Business Loans are defined as any loan less than \$1 million reported by financial institutions on Schedule RC-C Schedule 2 in March 2010. Data reported are all current outstanding loans and original amount of loan for 356 institutions in the 5<sup>th</sup> District.

Source: Consolidated Reports of Condition and Income (Call Reports)



# SBA Lending, FY 2007-2010



Note: Total loan volume equals the sum of all 7(a) and 504 loans.

Source: Small Business Administration





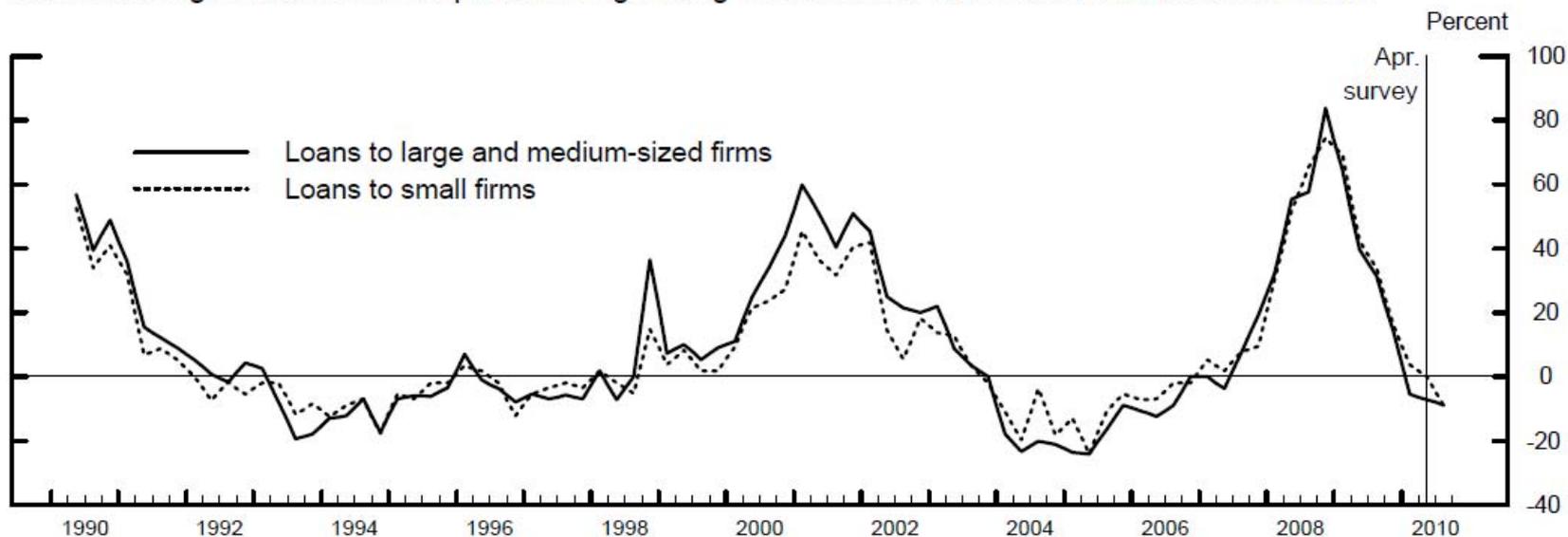
# Supply of Small Business Loans

- Regulator issues
  - Lenders complying with their own policy guidelines (not tightening)
    - Review of sectors with high concentration of outstanding/problem loans (e.g., retail, construction)
    - Regulators advise on guidelines, but they are created by banks
  - Regulators put in place commercial real estate guidance (thresholds)
  - Examiners do not review small business loans; they fall outside sampling technique
  - Interagency guidance to banks and examiners to encourage lending to creditworthy small businesses
    - Extensive training programs for bank examiners



# Loan Standards for C&I Loans by Firm Size

Net Percentage of Domestic Respondents Tightening Standards for Commercial and Industrial Loans



Source: Federal Reserve Senior Loan Officer Opinion Survey, July 2010

N = 80



# Availability of Small Business Loans

Net Percent (“Easier” Minus “Harder”)  
 Compared to Three Months Ago  
*(Regular Borrowers)*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2005	-4	-3	-3	-5	-5	-3	-4	-5	-3	-4	-6	-3
2006	-5	-5	-6	-4	-5	-5	-6	-8	-3	-6	-6	-6
2007	-5	-5	-7	-5	-6	-5	-5	-7	-9	-6	-7	-7
2008	-7	-5	-7	-9	-8	-7	-9	-10	-11	-9	-11	-12
2009	-13	-13	-12	-14	-16	-14	-15	-14	-14	-14	-15	-15
2010	-14	-12	-15	-14	-13	-13	-13	-12				

Source: National Federation of Independent Businesses, Small Business Economic Trends, Sep. 2010





# Evidence of Unmet Credit Demand

- National Small Business Association
  - 2010 mid-year national survey of small business members
  - N = 400 (relatively older firms)
  - 29% reported lack of capital as most significant challenge
  - 59% of respondents were able to access adequate financing, down from 78% two years ago.
- National Federation of Independent Businesses (NFIB)
  - 2009 national survey of small businesses (<250 employees)
  - N = 751
  - Greater concern about weak sales than inability to obtain credit
  - 55% of respondents applied for credit.
  - Of those, 50% of respondents were able to obtain “most” or “all” of the credit they sought.



# Small Business Credit Need Satisfaction

Percent of All Businesses Last Three Months Satisfied/  
 Percent of All Businesses Last Three Months Not Satisfied  
*(All Borrowers)*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>2005</b>	38/4	39/4	39/5	38/6	41/4	39/5	34/5	36/4	34/4	34/5	39/4	35/5
<b>2006</b>	36/4	37/6	36/6	38/5	38/5	39/5	38/4	44/4	34/4	36/7	34/4	36/5
<b>2007</b>	36/5	40/5	35/5	38/4	39/6	36/4	37/5	35/4	37/5	36/6	32/4	32/7
<b>2008</b>	34/5	35/4	32/6	34/5	34/7	35/5	32/7	35/6	33/6	31/6	31/7	32/6
<b>2009</b>	33/8	32/8	29/10	30/8	28/9	30/10	28/10	30/7	30/10	29/9	29/10	28/8
<b>2010</b>	27/11	29/9	29/11	28/9	28/8	25/10	27/9	27/9				

Source: National Federation of Independent Businesses, Small Business Economic Trends, Sep. 2010



## Looking Ahead

- The percentage of small businesses expecting credit conditions to get harder in next 3 months > those expecting it to get easier (net =14%) (NFIB 2010)
  - Highest is 16%; greater than either 1991 or 2001 recessions
- Highlights of the 2010 Small Business Jobs Act
  - Small Business Lending Fund: Provides \$30 billion to smaller community banks with low cost capital (as low as 1%) if they exceed 2009 small business lending levels
  - State Small Business Credit Initiative: Provides \$1.5 billion to states to finance small business lending programs
  - Extension of SBA Recovery Loan Provisions (\$14 billion)
  - Permanently increases SBA 7(a) and 504 limits: \$2M to \$5M
  - Additional eight new small business tax cuts



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