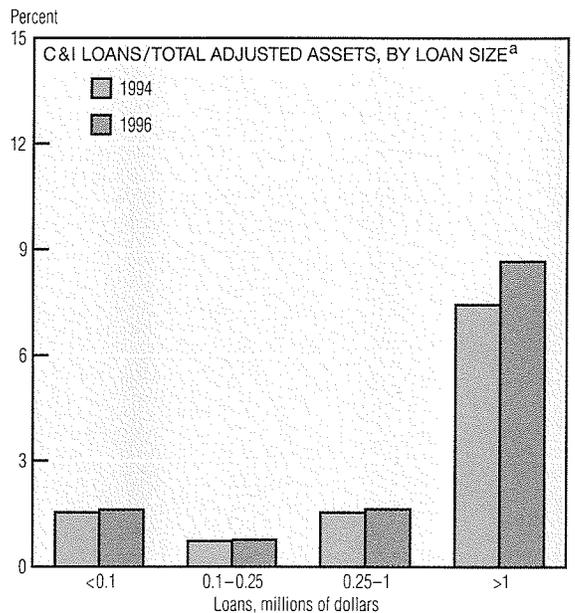
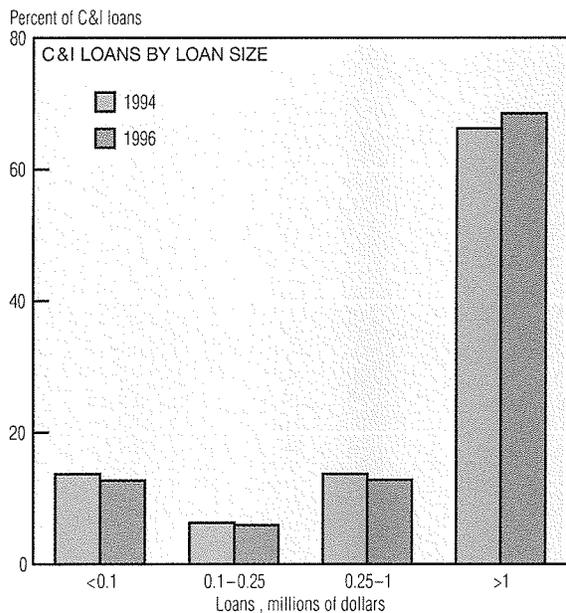
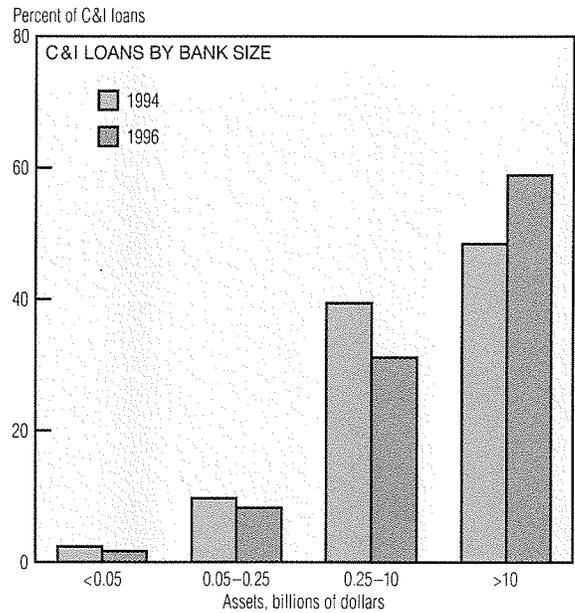
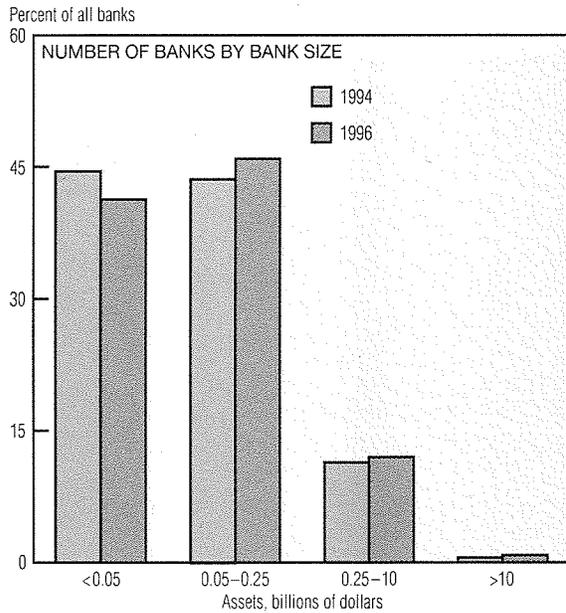


Banking Consolidation and Small Business Lending



a. Total adjusted assets equals total assets plus reserves allocated against transfer risk and loan and lease losses.
 SOURCE: Board of Governors of the Federal Reserve System, Call Report RC-C, part II.

Historically, banks in the U.S. have been subject to myriad restrictions on their geographic expansion. At the beginning of the century, most states allowed banks to have only one office. In time, multi-office banks were permitted, provided that the offices were located within the institution's home state.

In the first half of the 1950s, banks attempted to expand their activities across state lines by developing bank holding companies

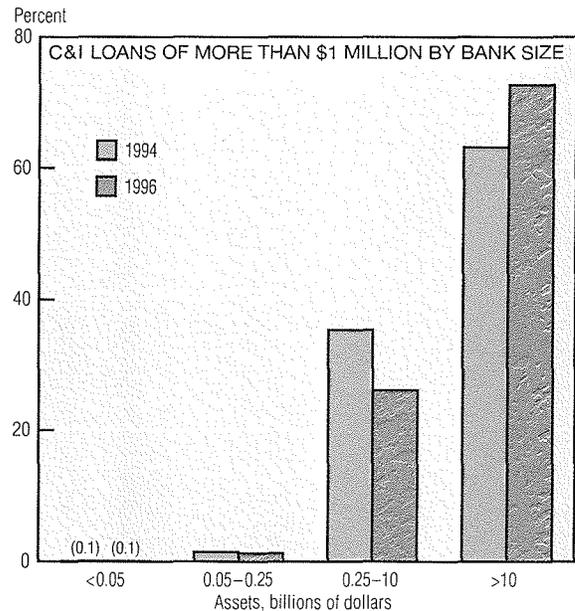
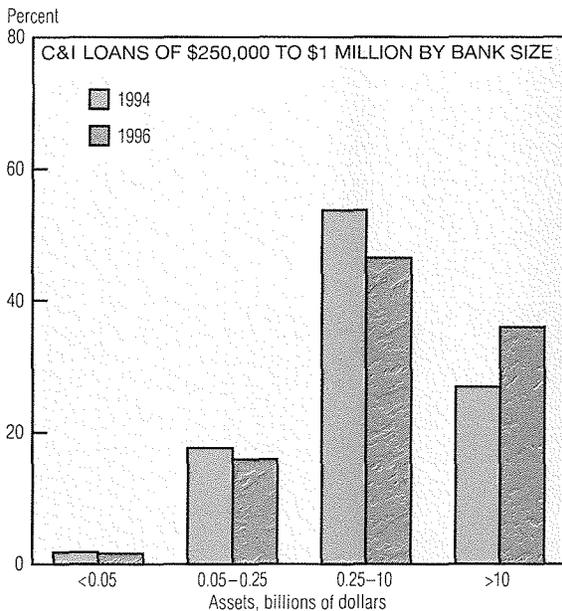
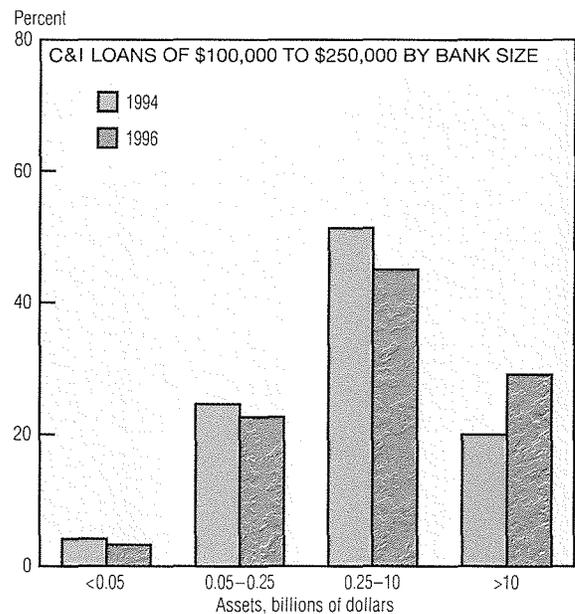
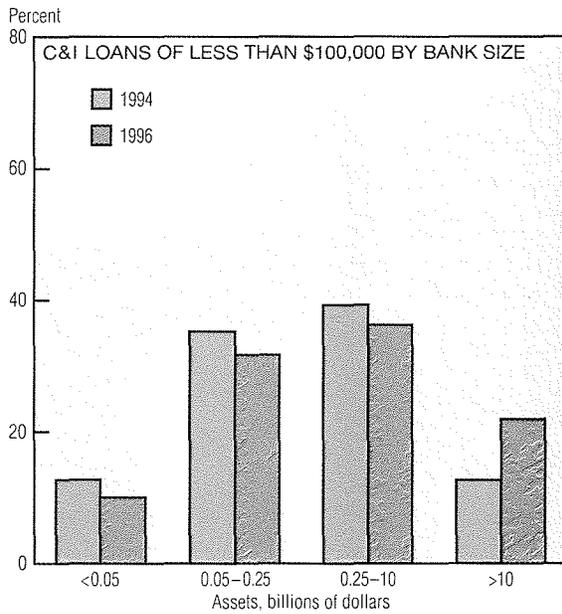
(BHCs) with banks located in various states. In 1956, the Douglas Amendment to the Bank Holding Company Act put a stop to this initiative by requiring BHCs to obtain authorization from the home state of an institution it wanted to acquire. At that time, states did not allow out-of-state-banks to acquire local firms.

By 1984, these restrictions had pushed the number of banks to a post-Depression high of about 14,500. Subsequent regulatory

changes liberalized restrictions on branching and mergers. As a result, the number of banks fell to approximately 9,500 by the end of 1996. Between June 1994 and June 1996 alone, the number of federally insured U.S. commercial banks decreased by more than 1,000, as small institutions merged with larger ones.

Consolidation may affect the banking industry's performance because banks of different size have different
(continued on next page)

Banking Consolidation and Small Business Lending (cont.)



SOURCE: Board of Governors of the Federal Reserve System, Call Report RC-C, part II.

ways of operating. In the past, larger commercial banks, which make most of the commercial and industrial (C&I) loans in the U.S., have devoted a lower share of their assets to small business lending than have smaller banks. This has caused some concern about the possible impact of consolidation on the availability of funding to small businesses. The reason is that consolidation is eliminating many small firms' traditional suppliers of credit—usually small, independent banks—by transferring

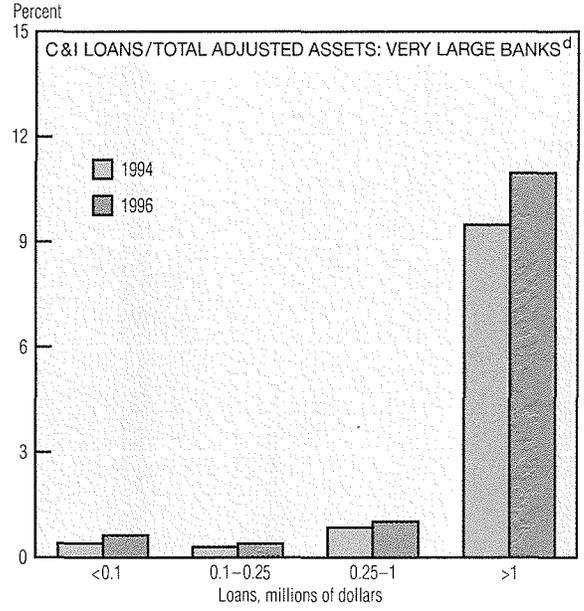
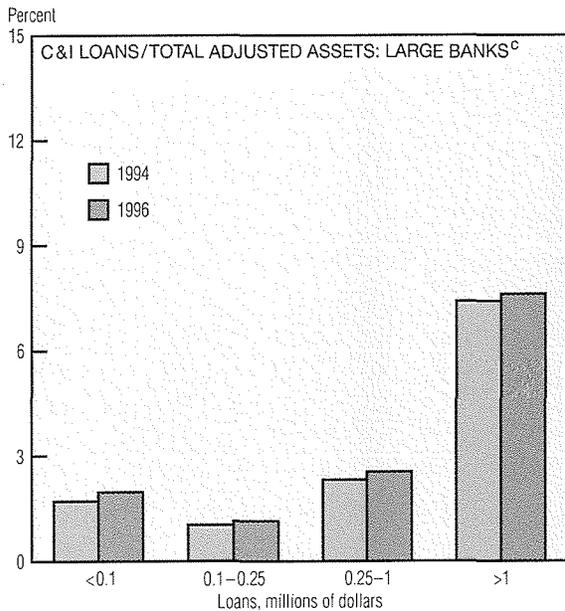
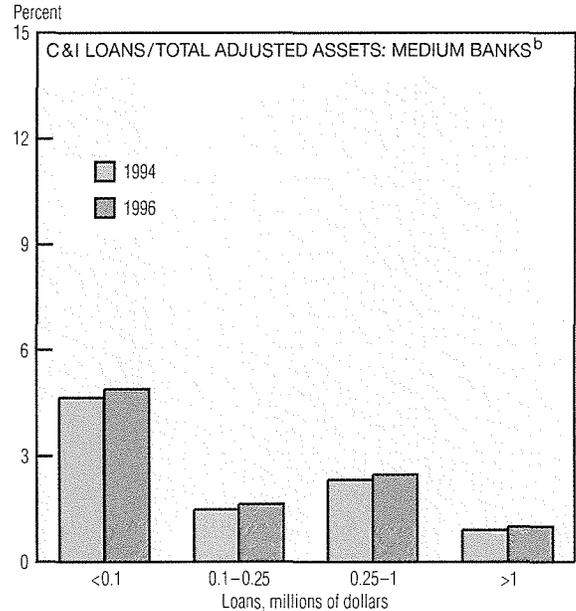
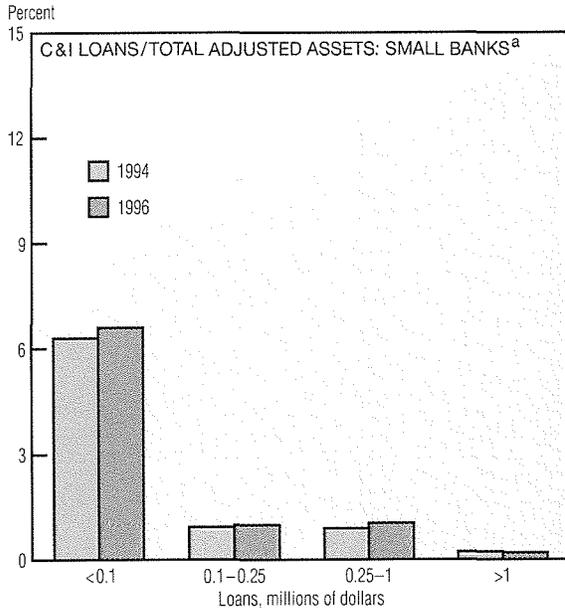
their assets to larger organizations. Whether the funding available to small firms shrinks depends crucially on whether banks' lending propensities remain the same after consolidation.

Until recently, research on banking consolidation's effect on small firm credit was hampered by a lack of appropriate data. This changed in June 1993, when Call Reports (statements of banks' condition and income) began to include information on small business loans.

Available data confirm that the largest banks (those with assets above \$10 billion) are not major lenders to small firms. In 1994, for example, this group of depositories made less than 20% of C&I loans below \$100,000. By contrast, they made more than 60% of the loans above \$1 million. Between 1994 and 1996, the number of banks in this class increased, as did their share of C&I loans of all sizes. Note, however, that the greatest increase

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Banking Consolidation and Small Business Lending (cont.)



- a. Total assets of less than \$50 million.
- b. Total assets between \$50 million and \$250 million.
- c. Total assets between \$250 million and \$10 billion.
- d. Total assets of more than \$10 billion.

SOURCE: Board of Governors of the Federal Reserve System, Call Report RC-C, part II.

occurred in their share of loans below \$100,000.

The data also confirm that as the size of a bank increases, the proportion of its adjusted assets devoted to small C&I loans tends to shrink. The smallest banks (those with assets of less than \$50 million) devote approximately 6% of their adjusted assets to C&I loans of less than \$100,000, but only 0.2% to loans above \$1 million. The largest banks have exactly the opposite pattern. The fraction of

their assets devoted to those two lending classes is about 0.5% and 10%, respectively.

Research on consolidation's impact on small business lending is still in its early stages. So far, the results have been inconclusive on certain issues. For example, the evidence is mixed on whether mergers restrict lending to small businesses: The impact appears to depend on the size of the banks involved in the consolidation. It does appear, however, that mergers and acquisitions involving

small banks tend to boost small business lending.

Research on consolidation's impact on the overall availability of funding to small businesses is even more limited. The reason is that very little information exists about small firms' alternative sources of funding, which can include other financial arrangements (such as credit cards, residential mortgage loans, and auto loans) and nonbank sources (such as finance companies, trading partners, and venture capitalists).