

Trends in Small Business Lending

Federal Reserve Bank of Cleveland
Policy Summit
September 20, 2013

Small Business Lending: Conditions are Improving

Small Business Optimism Reaches Highest Level Since 2008

- *Wall Street Journal, August 20, 2013*

Small Business Credit Conditions Improve

- *Fox Business, August 27, 2013*

Looser Credit Boosts Small Business Optimism

- *American Banker, August 22, 2013*

Big Banks, Credit Unions Approve More Small Business Loans

- *Bloomberg Businessweek, August 6, 2013*

Or Are They?

Small Businesses Not Finding Much to Smile About

- Fox Business, August 13, 2013

Small Business Lending Might Not Be As Bright As Recent
Surveys Suggest *- Inc., August 9, 2013*

Small Business Lending Demand Decreased in July

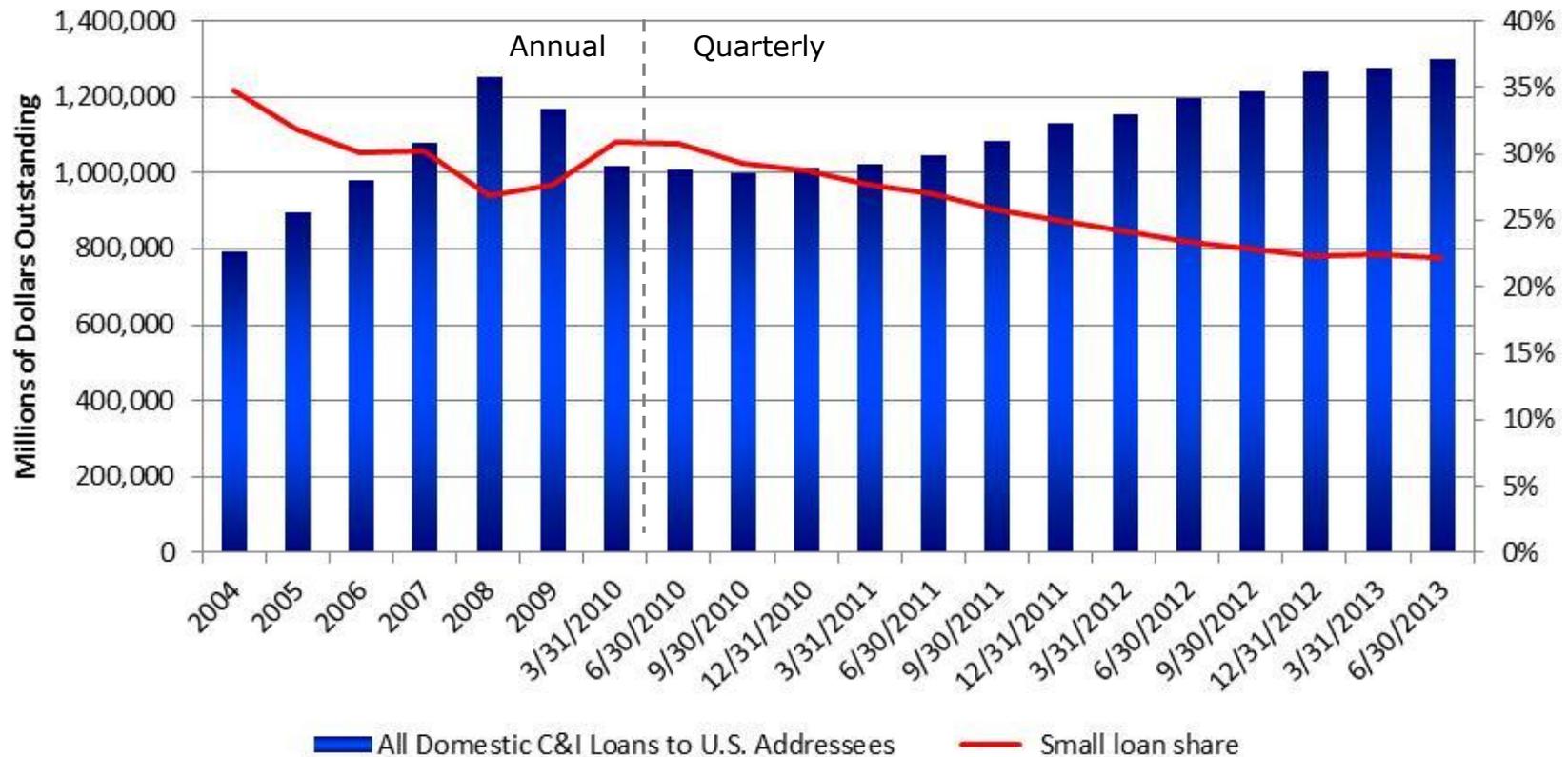
- San Francisco Chronicle, August 14, 2013

Today in Small Business: Loan Demand Declines

- New York Times, August 15, 2013

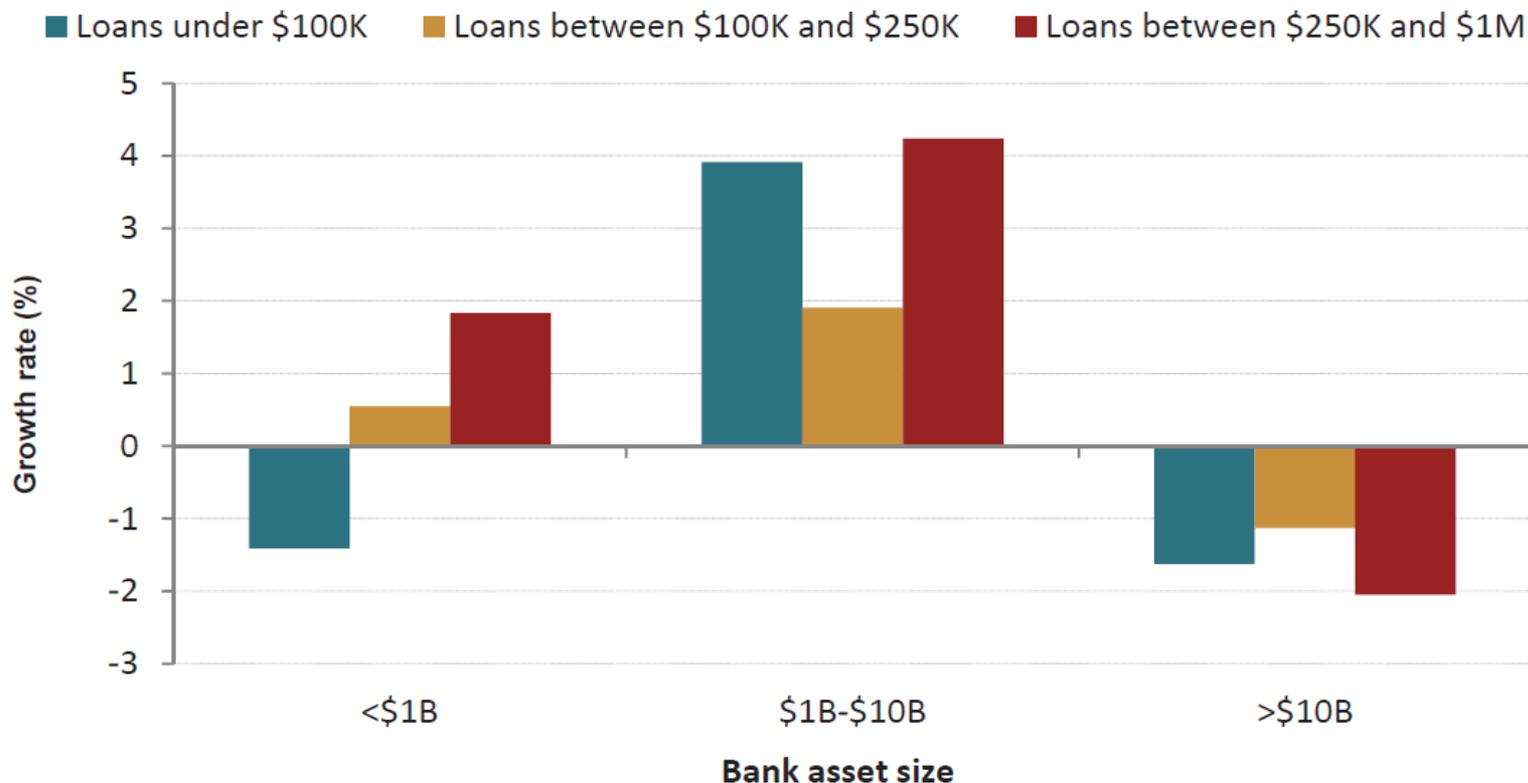
A Look at the Data: Trends in C&I Lending

**Total Commercial and Industrial Lending
and share of loans under \$1 million**



Source: FDIC

Small Business Loan Growth from 2011 to 2012



As of March 11, 2013

Financial data is based on regulatory filings by commercial and savings banks.

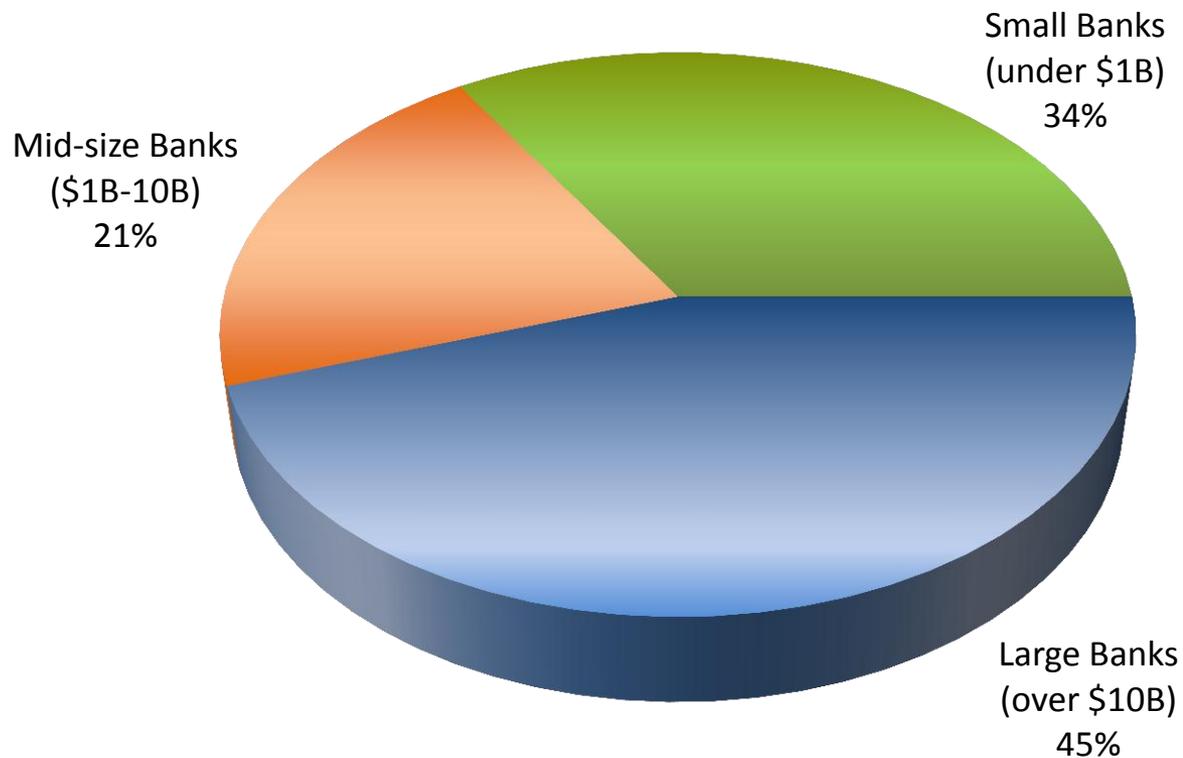
Loans secured by nonfarm, nonresidential properties and commercial and industrial loans to U.S. addresses with original amounts of \$1 million or less.

Growth rate represents the change in aggregate loans held on the balance sheet at the end of 2012 compared to the end of 2011.

Source: SNL Financial



Share of Small Loans by Bank Size in 2012



Source: SNL Financial

Why the Confusion?

- What is a “small business”?
 - The Small Business Administration defines small businesses as those with fewer than 500 employees for most industries.
 - Other definitions:
 - The Affordable Care Act uses a threshold of 50 employees to qualify as a small business.
 - For its small business reporting, the U.S. Bureau of Labor Statistics divides large and small firms at 250 employees.
- With such a wide range of firms classified together as *small businesses*, the conflicting reports are not unexpected.

Small Lending Is Declining: Multiple Factors at Play

- Supply of Small Business Credit
- Demand for Loans
- Ongoing Impact of the Great Recession
- Regulatory Issues
- Industry Consolidation

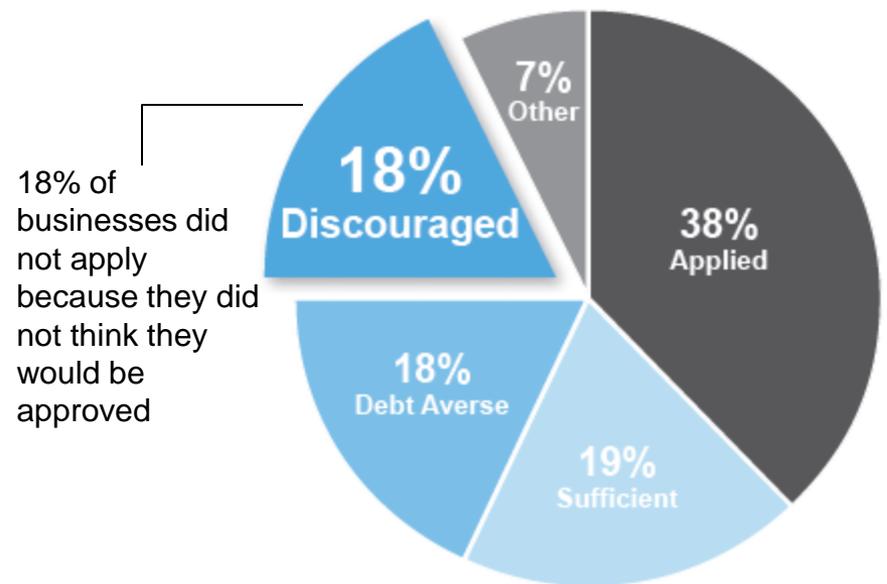
Constraints on Credit Supply

- While many banks express an increased interest in C&I lending, some banks report that small business loans (especially loans under \$250K) are less profitable and more time-intensive.
 - Increased competition in the financial industry has led banks to focus on their most profitable loans.
- Small business loans are less attractive because they are difficult to automate and securitize.
- Home value declines have limited the viability of home equity financing options for small businesses.

Many Small Businesses are Not Seeking Credit

- The National Federation of Independent Businesses (NFIB) reports that 49 percent of the respondents to their most recent survey said they were not looking to borrow.
- Some businesses say they are “discouraged” by reports that credit to small businesses is not available, and therefore do not apply for loans.
- A 2013 Wells Fargo/Gallup survey revealed that 36% of business owners expect credit will be difficult to get in the next 12 months.

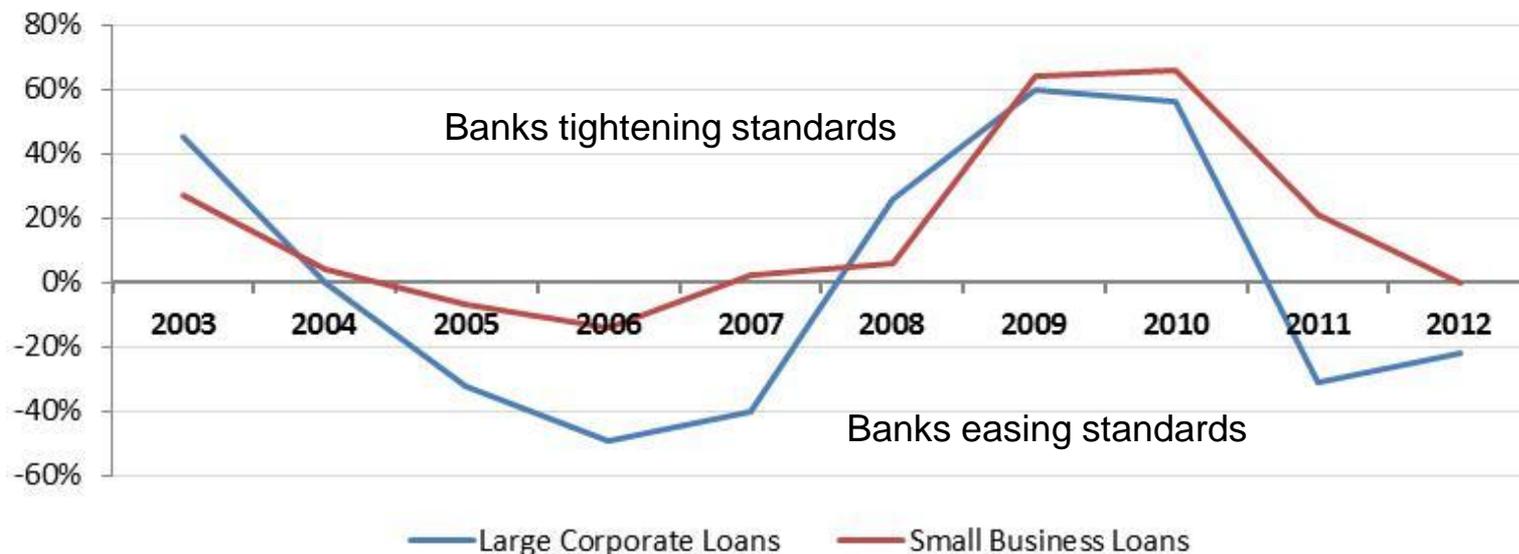
In 2012, did your business apply for new credit or to renew credit?



Source: Federal Reserve Bank of New York
Small Business Borrowers Poll, 2013

Lingering from the Recession: Tighter lending standards and weaker small business financials

Net Tightening of Lending Standards



Source: Office of the Comptroller of the Currency, Survey of Credit Underwriting Practices

- Lending standards remain tight.
- Collateral values have not fully recovered.
- Cash flow is an ongoing concern.

Regulatory Considerations

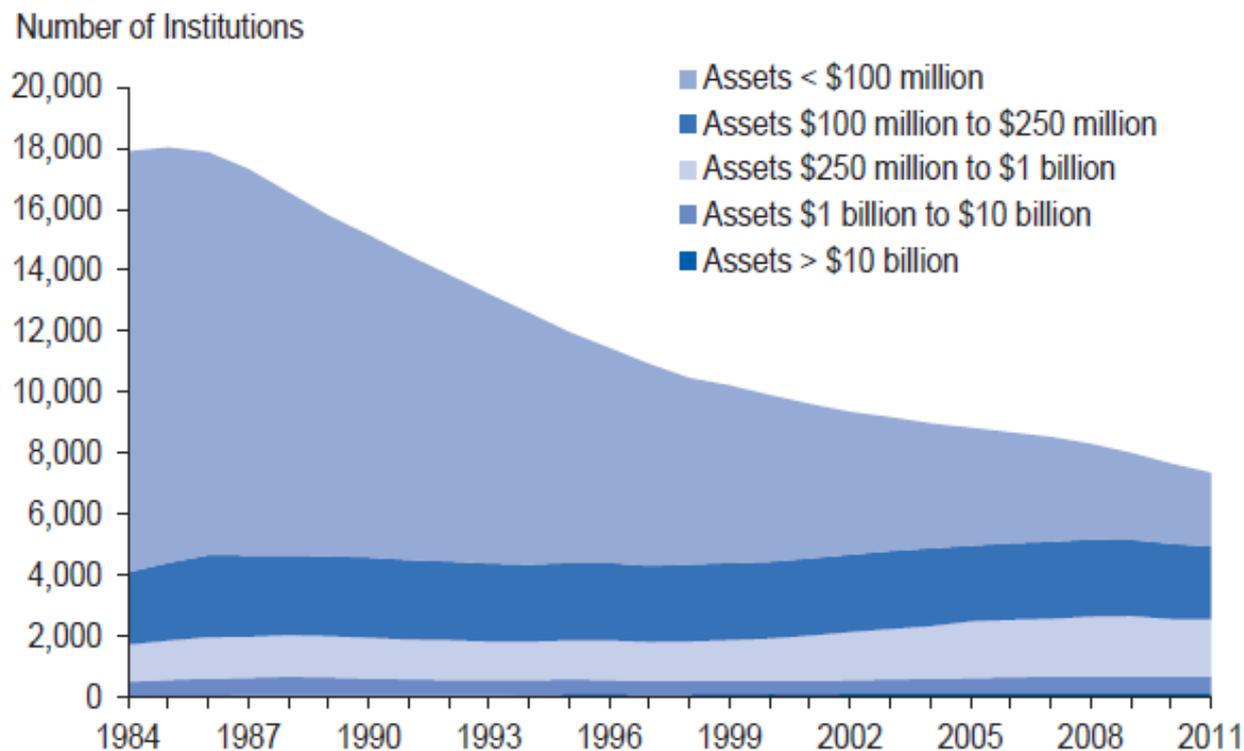
- Since the crisis, bankers have reported that bank examiners have discouraged lending to certain types of small businesses.

Regulatory agencies issued guidance on small business borrowing:

"Regulators are mindful of the harmful economic effects of an excessive tightening of credit availability in a downturn and are working through outreach and communication with the industry and supervisory staff to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound small business borrowers."

- Increased vigilance by regulators has led to a decline in "relationship banking". Loans that were previously made based on the strength and duration of relationships may be subject to additional terms, or not made at all.

Consolidation in the banking industry has led to a reduction in the number of small banks



Source: FDIC.

- In 2011, banks with assets of \$250 million or less accounted for only 4.0 percent of all banking assets. However, they held 13.7 percent of all small business loans and 13.9 percent of business microloans.

Why It Matters:

Employment and Business Dynamism

- Small businesses account for nearly half of private sector jobs in the U.S.
- Research shows that the *churn* of firms and jobs is important for the productivity and health of our economy.
 - The rate of new business formation has declined. New businesses now represent fewer than 35 percent of all businesses, down from over 40 percent in the 1990s and 50 percent in the 1980s.

For Policymakers: No easy answers

- A multi-faceted problem requires a multi-faceted solution. Addressing one driver of the lending decline will not reverse the trends.
- The Federal Reserve continues to focus on and elevate this issue.
- Market-based solutions are becoming more available, and policymakers should ensure that alternatives to traditional bank lending are accessible and safe.