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RESEARCH SUMMARY

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The Effects of Interstate Banking on Small Business Lending

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Purpose

Small business borrowers traditionally have relied on banks to satisfy their credit needs. The consolidation wave that has been occurring in the banking industry raises concerns about reduced availability of credit to small businesses. Focusing on the period June 1993 through June 1995, a period of significant bank consolidation, the study investigates how bank acquisitions influence a banking organization's willingness to lend to a small firm.

The perception that large banks may not be responsive to the needs of small businesses is related to several developments, including : (1) loan size information, as reported by commercial lenders in accordance with the Federal Deposit Insurance Corporation Improvement Act of 1991, reveals that bank holdings of large business loans have grown more rapidly than small business loans; (2) small business loans have grown more rapidly at small banks compared with large banks; and (3) the portfolio share of small business loans tends to be inversely related to the size of institution.

The recent adoption of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 will most likely accelerate the ongoing consolidation in the banking industry. It is, therefore, especially important from a public policy standpoint to ascertain the impact of the acquisition of active small business lending banks by large interstate banks on the availability of loans to small business.

Scope and Methodology

Most of the data for this study are taken from two sources, the Consolidated Reports of Condition and Income (Call Reports) and the National Information Center (NIC) data base. Bank balance sheet and income statement information, as well as some bank structure information, is taken from the Call Reports. The NIC structure file is the primary source for the identification and dating of mergers, acquisitions, bank failures, and de novo bank entry.

The bank sample includes all FDIC-insured commercial and state-chartered savings banks in the United States for which complete data are available. The data set is organized by bank observations (rather than by merger-acquisition activities) for the sub-periods occurring between the three Call Reports containing the small business loan survey data: June 1993, June 1994, and June 1995. The Call Reports provide small business loan data for three size categories: loans of $100,000 or less, loans of more than $100,000 up to $250,000, and loans of more than $250,000 up to $1 million. To minimize problems with reporting errors, this study uses only the $250,000 or less and $1 million or less loan categories as the definitions of small business loans.

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The statistical estimation is based on a specification that attempts to explain the growth in a bank's small business loan portfolio, controlling for bank-specific characteristics, regional banking market characteristics, and regional economic activity. By including banks that made merger acquisitions, banks that had no merger activity, and banks that showed a change in ownership without merger during the sub-period in the same equation, it is possible to test for differences in the growth in small business loan portfolios across these bank categories.

Highlights

The primary findings of the study are:

- The bulk of the shrinkage in the number of banks has occurred among the smaller banks (those with less than $100 million in assets). De novo entry has offset little of this consolidation.
- The shrinkage in the number of banks has occurred across most Federal Reserve Districts. No simple pattern exists between the degree of shrinkage and the share of small banks in a district.
- The most prevalent type of merger involves the combination of two or more small banks . In roughly one-half of the mergers, the acquirer has a small business loan portfolio share greater than that of the target bank.
- In approximately one-half the mergers, the surviving bank increased its holdings of small business loans during the period immediately following the merger.
- The implications of a change in ownership without merger for small business lending seem to be sensitive to the relative degree of small business lending specialization of the acquired bank.
- In a merger situation, the degree to which the acquirer bank is committed to small business lending prior to merger, as well as the acquirer's asset size, are important determinants of the willingness of the surviving bank to lend to small businesses.

Summary

From a public policy standpoint, mergers are not unequivocally bad for the small business borrower. Subsequent to a merger, surviving banks tend to revert towards the acquirer's pre-merger small business loan activity.

If the acquirer is an active small business lender that has chosen to focus on relationship lending to smaller borrowers, the acquisition could increase the small business lending of the consolidated institution. If the acquirer has not focused on small business lending, the merger is more likely to reduce credit extended to small businesses from the consolidated institution.

While larger institutions do tend to have a smaller portfolio share of small business loans, large institutions that have focused on small business lending are likely to maintain that focus. Thus, when considering the implications of bank acquisitions on small business lending, the portfolio share of small business lending of the acquirer may be as important as the acquirer's size.

It is possible that in some geographic locations, consolidation will result in few, if any, banks with a small business focus. While small business lenders are likely to respond eventually to profitable lending opportunities in the area, some borrowers may be hurt during the transition, given the time it takes a small firm to establish a new lending relationship. This highlights both the need for antitrust authorities to consider small business credit in their competitive analysis for proposed mergers and the potential role for government programs to ease credit disruptions during the adjustment process.

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