SMALL BUSINESS

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The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks

by Diana Hancock, Joe Peek, and James A. Wilcox;
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Substantial financial deregulation and financial innovation in recent years have changed banking. The resulting consolidation of banking and improvements in technology have had important effects on small business lending, with large bank holding companies (BHCs) playing a larger role in such lending.

In contrast to previous studies that focused on the small business lending at smaller banks, the report focuses on non-credit card lending at the 50 largest bank holding companies. The largest BHCs have come to represent ever larger shares of U.S. banking assets. In addition, their rapid pace of acquisitions and mergers seems likely to continue. These developments make it particularly important to better understand the effects of bank growth and the changing organizational structure of the largest BHCs on small business lending.

The study documents recent trends in small business lending at the largest BHCs. It then provides an analysis of the effects of the recent consolidation in the banking industry on small business lending. The analysis makes key distinctions that are generally missing from the literature and estimates of small business lending. First, it distinguishes between (1) originations and purchases of small business loans and (2) the more typically used stocks of small business loans held on bank balance sheets. It then looks to see whether views about the credit available to small businesses might be influenced by the choice of the measure of lending. Second, it distinguishes between acquisitions of banks (and BHCs) and mergers of banks (and BHCs). To date, little is known about the effects on small business lending of consolidation within a BHC (the combining of bank charters through mergers), as opposed to the effects of consolidation into a BHC (the change of ownership through acquisitions). By distinguishing mergers of within-BHC banks from bank acquisitions by a BHC, the report estimates whether small business lending is affected differently by shifts in the organizational structure of BHCs than by changes in the ownership of banks. Third, it distinguishes between the effects of internal and external growth of the largest BHCs.

Overall Findings

The results suggest that, in general, larger BHCs tend to do less small business lending. That masks some important distinctions: small business lending can be affected quite differently by the way in which a BHC becomes larger and the extent to which the BHCs consolidate their bank subsidiaries. The results hint that banks that are acquired, but not placed under the more direct control that accompanies a formal merger, may do about the same amount of small business lending as prior to the acquisition. In contrast, the merging of bank charters within the BHC seems more likely to reduce small business lending.

Highlights

- Small business lending at a BHC tends to be smaller (relative to its total business loans) the larger the BHC is. This pattern holds regardless of whether

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small business lending is measured by the change in bank holdings or by the sum of originations plus purchases of small business loans.

- Small business lending declined significantly across each of the various dependent variables and loan sizes. Thus, both internal growth (as captured by the acquisition-adjusted specification) and total growth (which is the sum of internal growth plus acquisition-based growth) tend to reduce small business lending for each loan size category. The similarity of the estimated coefficients based on acquisition-adjusted data to those based on actual data suggests that internal growth has about the same effect on small business lending as external growth.
- Given the size and extent of the internal and external growth of a BHC, the more concentrated the assets become in its larger banks, through either internal growth or through mergers of its bank subsidiaries, the less small business lending the BHC does.
- In addition to the pure size effect, the organizational form of a BHC has important effects on small business lending. When BHCs acquire and thus change the ownership of banks—but do not merge them with their other banks (or with each other)—small business lending is little affected. In contrast, as BHCs merge bank subsidiaries and otherwise shift assets into their larger banks, their small business lending declines. Thus, the centralization, or increased concentration, of command and control of assets matters more than a change in ownership of a bank.

Methodology

The authors use annual data for 1997 to 2002, which incorporates data for small business lending during the 2001 national recession and the 2002 recovery. They use data for the 50 largest U.S. bank holding companies, as measured by their domestic bank assets as of mid-2002. They construct and analyze both conventional and novel data for banks, aggregated to the bank holding company level, and for their small business lending. When summing up assets and lending of individual BHCs, they exclude small banks, credit card banks, limited purpose banks, wholesale banks, and some other institutions. They use a number of sources for their data, including (1) the Consolidated Reports of Condition and Income (call reports) for balance sheet and income data for individual banks; (2) the Community Reinvestment Act (CRA) reports for (gross) originations and purchases of business loans; (3) the Federal Reserve Board's National Information Center (NIC) data for financial structure information; and, (4) the Federal Reserve's Survey of Terms of Bank Lending (STBL) for information on loan characteristics.

The authors use both actual and acquisition-adjusted data for each BHC. Actual BHC data are the sum of the data for the BHC's bank subsidiaries in a given year. Changes in these data reflect internal growth, as opposed to growth via acquisition.

They adjusted most variables for the scale of total business lending a BHC had been doing. In general, they explained measures of flows of small business lending with the overall size of a BHC (as measured by its total bank assets), a measure of how much of that size was attributable to acquisitions, and a measure of the degree to which a BHC's total bank assets were concentrated in a few large banks.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at **advocacy@sba.gov** or (202) 205-6533.

Ordering Information

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