Mid-Size Banks and Government Backed Lending: Serving Communities and Businesses Most in Need of Credit?

The extensive research literature review in this report suggests that smaller banks specialize in making loans to small businesses. To test this proposition, this chapter looked at the lending activities of mid-size lenders with revenues between $250 million and $1 billion. The sample used in this chapter contained the lending records of 123 mid-size banks and thrifts headquartered in Appalachia that had 1,120 branches.[9] It would be desirable to scrutinize the lending activities of even smaller banks, however, banks with assets of less than $250 million do not report small business loans per the requirements of the Community Reinvestment Act (CRA) regulations.

In addition to describing the lending patterns of small banks, this chapter examines the lending patterns of loans with government-backing. The Small Business Administration (SBA) provided NCRC with data on government-backed lending on a county level for the year 2003, which is also the year for the CRA small business lending data analyzed in this study. The data presented in this chapter reflects the lending activity of the major SBA program, the SBA 7(a) program. The SBA web page describes the 7(a) program as the primary business loan program designed to provide access to credit for small businesses who "might not be eligible for business loans through normal lending channels." The 7(a) loans can be used for most purposes ranging from working capital, equipment, land and building acquisition, and debt refinancing. SBA 7(a) loans have a typical duration of 10 years for working capital and up to 25 years for fixed assets. Traditional banks and thrifts make the 7(a) loans while the SBA issues the loan guarantees.[10]

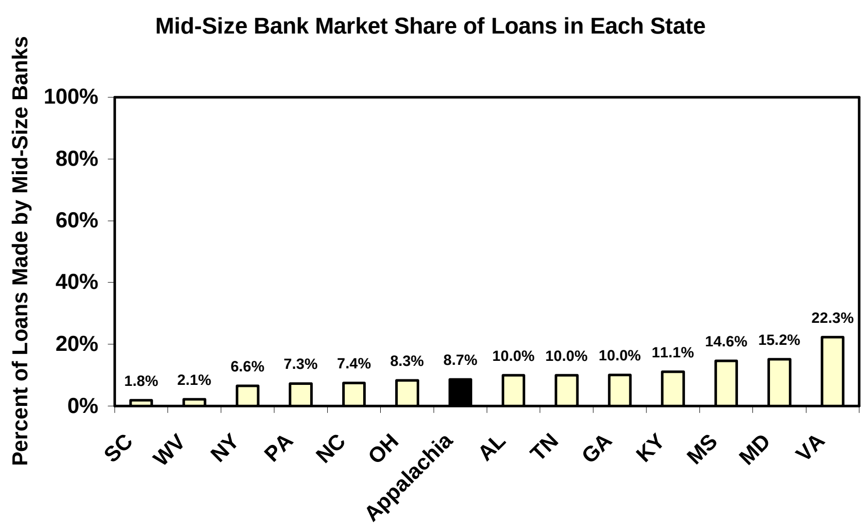
[9] NCRC identified the mid-size banks and thrifts headquarted in Appalachia by using the FDIC database *Statistics on Depository Institutions* available via http://www2.fdic.gov/sdi/index.asp. The CRA small business lending data of these institutions was then used to tabulate their lending levels by county.
[10] See description of the SBA 7(a) program on http://www.sba.gov/financing/sbaloan/snapshot.html. Last visited on May 6, 2006.

Mid-Size Banks

While it may appear that mid-size banks had a small role in the lending market, their presence was larger in non-metropolitan counties, distressed counties, and in counties with high numbers of minorities. Mid-size banks therefore had an important role in serving the hardest to reach small businesses in Appalachia.

In the Appalachian region, the mid-size banks issued 45,887 of the 530,309 CRA-reported small business loans during 2003. The mid-size bank market share of loans was 8.7% (see Appendix Table 19 and Figure 11). In other words, mid-size banks issued 8.7% of all loans in Appalachia. Mid-size banks exceeded their overall Appalachian market share in the Appalachian portion of seven states: Alabama, Georgia, Kentucky, Maryland, Mississippi, Tennessee, and Virginia. They had high market shares of 15.2% of the loans in Maryland and 22.3% of the loans in Virginia. Their lowest market share was in South Carolina (of 1.8%*)*.

Figure 11



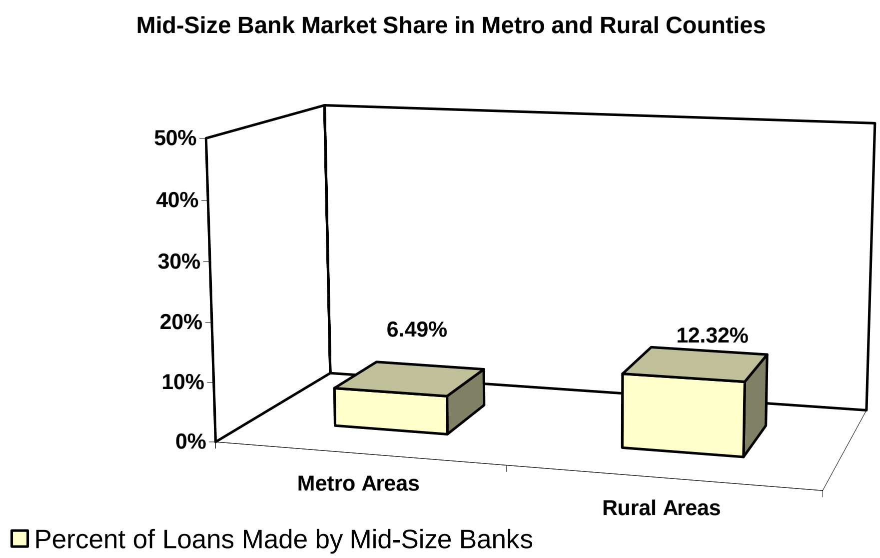
Source: Appendix Table 19 – column *Mid-size Banks' Market Share*

The states in which the mid-size bank market share of loans was high were also states in which their market share of deposits and branches was also high as displayed in Appendix Table 20. For example, in Maryland, the high mid-size bank market share of loans appeared to be correlated with a high market share of deposits (37.7%) and branches

(39.7%). A similar relationship between relatively high mid-size bank loan, deposit, and branch market share was present in Virginia and Mississippi. As suggested by the literature, mid-size banks' success in Appalachian lending markets hinges on their branches and deposit gathering activity. This is evidence of relationship lending featuring direct contact with and in-depth knowledge of small businesses utilizing mid-size bank branches.

Mid-size banks had a market niche in serving small businesses in non-metropolitan counties. The mid-size bank market share of loans was higher in NonMSA counties versus MSA counties. Mid-size banks made 12.3% of loans in NonMSA counties but just 6.5% of loans in MSA counties. Map 4 and Figure 12 below show mid-size bank market share in MSA and NonMSA counties in Appalachia. The mid-size bank market ratio was higher for NonMSA counties than for MSA counties in all Appalachian states but Maryland, South Carolina, Virginia, and West Virginia. In Ohio, for example, mid-size banks had a market share in NonMSA counties of 13.9% of all loans while their market share in MSA counties was just 1.2% of all loans. Likewise, in Alabama the mid-size bank market share was 16.1% in NonMSA counties but just 8.3% in MSA counties.

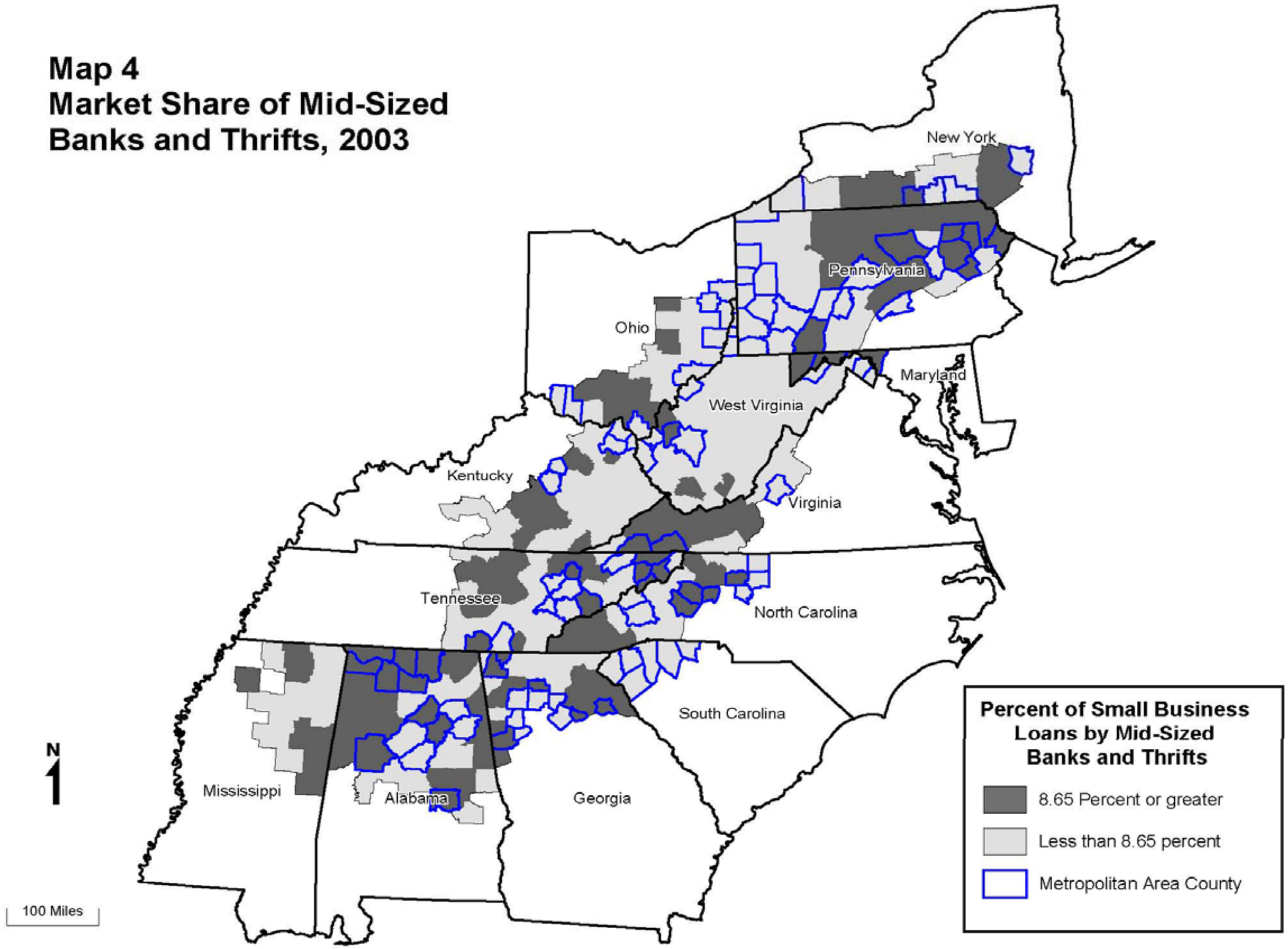
Figure 12



Source: Appendix Table 21 – column *Market Share %* and rows *Appalachia (MSA)* and *Appalachia (NonMSA)*

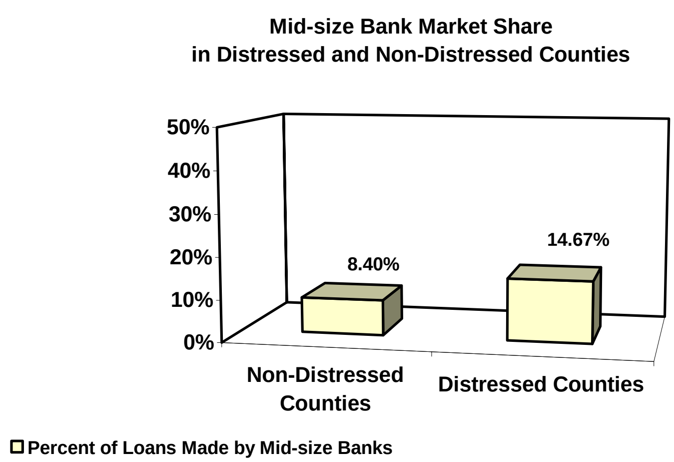
Mid-size banks also reached a higher percentage of small businesses in NonMSA counties than MSA counties. Mid-size banks issued loans to 5% of small businesses in NonMSA counties and 2.7% of small businesses located in MSA counties during 2003. The pattern of serving a higher percentage of small businesses in NonMSA counties held for 8 of the 13 Appalachian states. For instance, mid-size banks made loans to 7.3% of the small businesses in NonMSA counties in Georgia and 3.4% of the small businesses in MSA counties in the Peach state. Similarly, mid-size banks issued loans to 4% of the small businesses in NonMSA counties in Pennsylvania and 2% of the small businesses in the MSA counties in the Keystone state.

Map 4
Market Share of Mid-Sized Banks and Thrifts, 2003



Just as with non-metropolitan counties, mid-size banks had a larger presence in the lending market in distressed counties than in non-distressed counties (see Appendix Table 22). Mid-size banks had a market share of 14.7% of the loans in distressed counties and a market share of 8.4% in non-distressed counties (see Map 5 and Figure 13 for a pictorial display of mid-size bank market share in distressed and non-distressed counties). Interestingly, the mid-size bank median market share in non-distressed counties (4.6%) was higher than their median market share (1.8%) in distressed counties. Mid-size bank average market share in distressed and non-distressed counties did not differ by that much. The discrepancy between overall market share and median market share was probably explained by the dispersion of mid-size bank lending. While mid-size banks had a smaller median market share of loans in distressed counties than non-distressed counties, mid-size banks probably dispersed loans over a greater number of distressed counties than non-distressed counties in absolute terms or relative to other banks, enabling them to have an overall market share of loans that was larger in distressed than non-distressed counties.

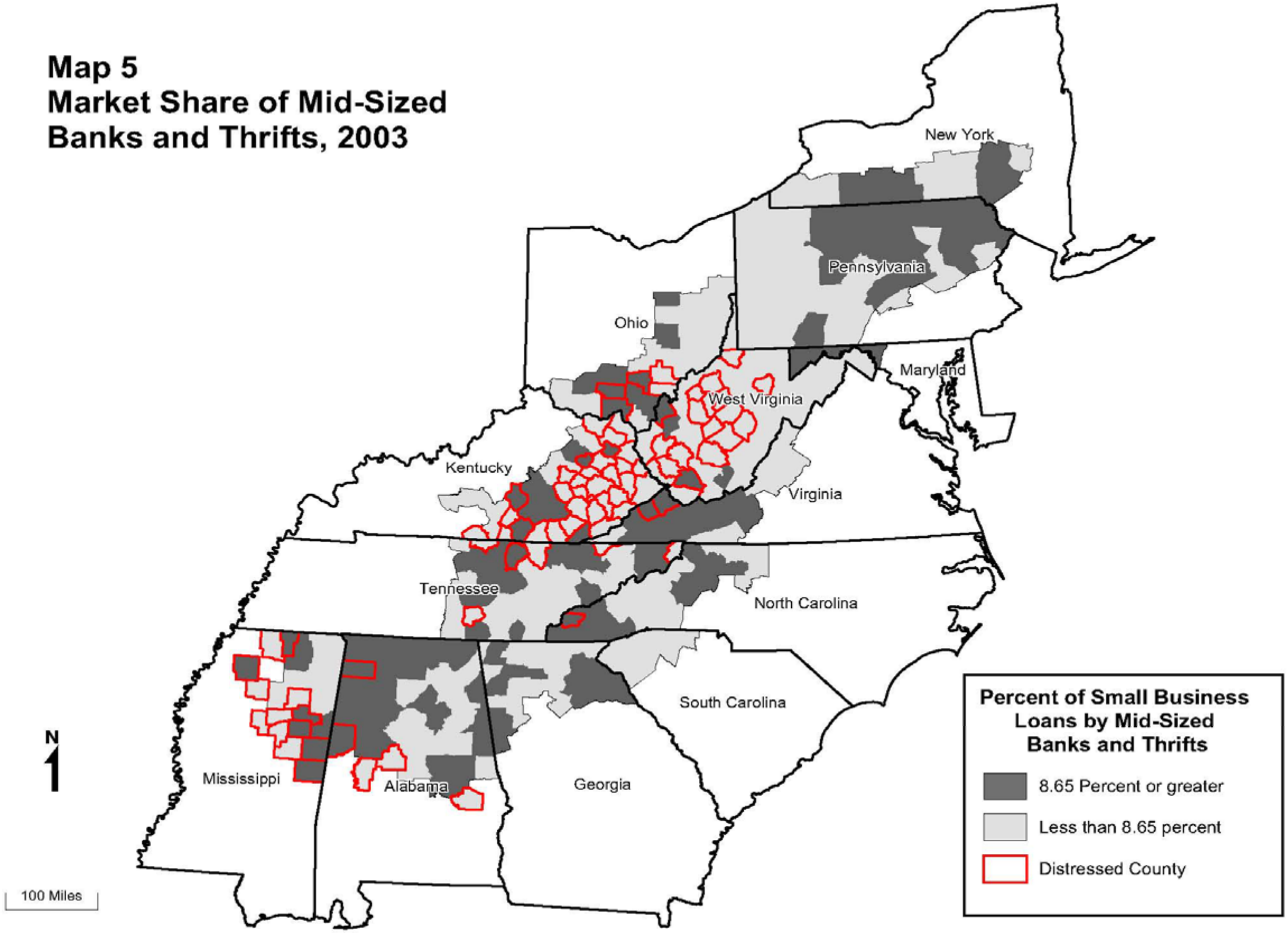
Figure 13



Source: Appendix Table 22 – column *Mid-size Banks' Market Share, number of loans* and rows *Total- Non-distressed* and *Total-Distressed*

Likewise, the percent of small businesses receiving loans from mid-size banks in distressed areas (4.7%) was higher than the percent of small businesses located in non-distressed areas (3.5%). This statistic reinforces the finding that mid-size banks concentrated their lending in distressed counties relative to non-distressed counties.

Map 5
Market Share of Mid-Sized Banks and Thrifts, 2003



Mid-size banks appeared to be particularly active in counties with more than 50% minorities (see Appendix Table 23). The market share of loans made by mid-size banks in substantially minority counties (minority level >50%) was 28.6% whereas in counties with less than 20% minorities, mid-size banks issued less than 10% of all small business loans. The mid-size bank median market share of 10.7% in substantially minority counties was also much higher than the mid-size bank median market share of 4.2% in counties with less than 20% minorities. In contrast, mid-size banks had their lowest overall market share of 6.7% in counties with between 20% to 50% minorities.

The analysis in this chapter supports the thesis that mid-size banks were particularly responsive to the credit needs of small businesses. Overall mid-size bank market share of loans was greater in NonMSA counties than MSA counties, in distressed counties than non-distressed counties, and in substantially minority counties than non-minority counties. Some of the data were not completely consistent with the thesis that mid-size banks had a niche in traditionally underserved markets. For example, median mid-size bank market share was lower in distressed than non-distressed counties. But overall mid-size bank market share in distressed counties was larger in non-distressed counties, most likely due to a greater dispersion of mid-size bank loans in distressed than non-distressed counties. In addition, while mid-size bank market share was particularly high in counties with more than 50 percent minorities, it was lower in counties with 20 to 50 percent minorities than in counties with less than 20 percent minorities. Mid-size banks in Appalachia were more successful overall in serving non-metropolitan and/or distressed counties than they were in serving counties with a moderate to heavy minority population (between 20 to 50 percent minorities).

SBA 7(a) Loan Program

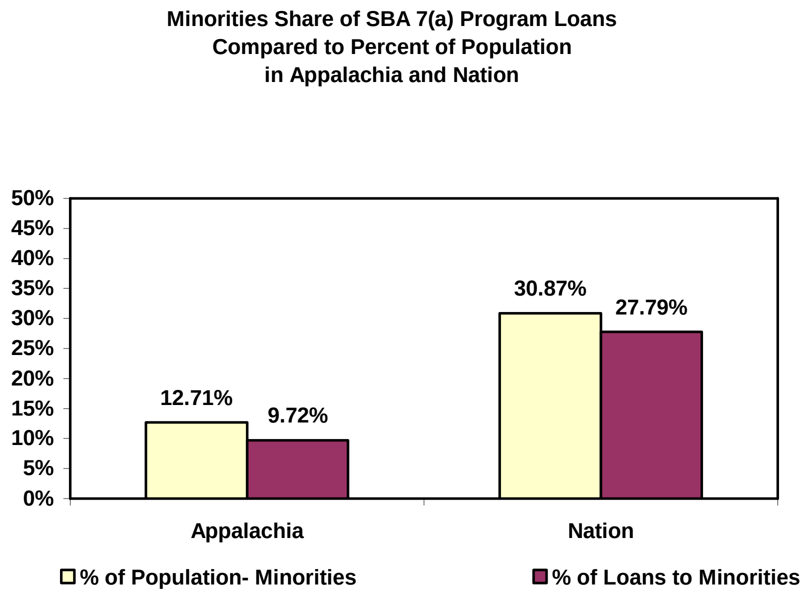
The SBA loan program had a small presence in the Appalachian and national lending market. Overall in Appalachia, the 7(a) program had not succeeded in penetrating the minority small business loan market. One possible explanation was that Appalachian banks active in the minority community are not heavy users of the 7(a) program. In contrast to its performance in minority markets, the data suggests that the SBA program had succeeded in penetrating non-metropolitan counties.

Appendix Table 24 shows that the SBA 7(a) program accounted for 4,260 loans in Appalachia during 2003, or just 0.8% of all loans in the region. Interestingly, the SBA market share of loan dollars was higher than their market share when considering the number of loans. The SBA loan program accounted for 2.4% of the loan dollars issued in Appalachia during 2003. The higher SBA market share when considering loan dollars was probably due to credit card lending driving down the average dollar amount for non-government backed loans.

SBA-guaranteed lending did not appear to have a regional pattern. The SBA market share was not concentrated in any particular sub-region in Appalachia during 2003. The highest number of SBA-guaranteed loans (2,620 loans) was in Pennsylvania and the lowest was in Virginia (28 loans). After Pennsylvania, the next highest totals for SBA-guaranteed lending occurred in Georgia (372 loans), West Virginia (207 loans), and New York (200 loans). The states with the lowest totals besides Virginia were Maryland (35 loans), Mississippi (49 loans), and Kentucky (66 loans).

The SBA program did not quite reach minorities in proportion to their population in Appalachia or the nation. While the SBA program did well in serving Asian businesses, it had the most difficulty in serving African-Americans in proportion to the African-American population. In the Appalachian region, 9.7% of the SBA 7(a) program loans in 2003 were made to minorities while minorities constituted 12.7% of population. Across the country, 27.8% of the SBA-guaranteed loans served minorities, but minorities constituted 31% of the population (see Figure 14).

Figure 14

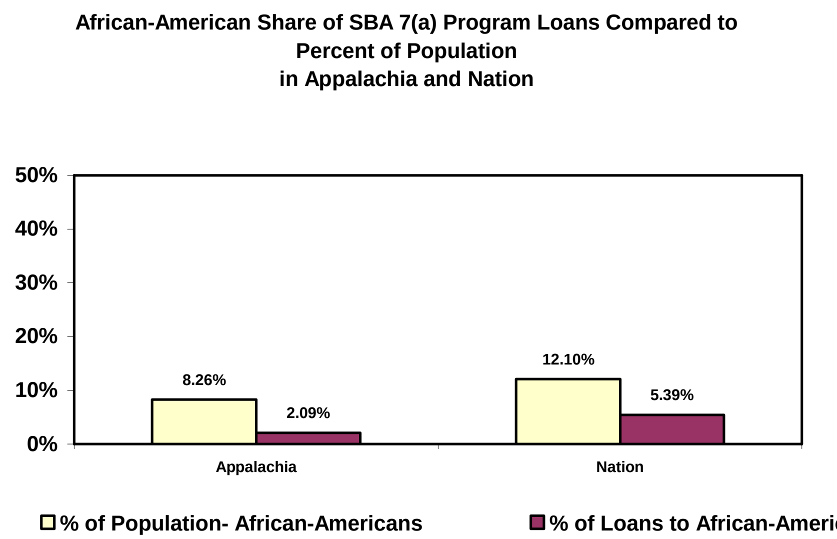


Source: Appendix Table 24 – columns *% Minority pop* and *% of loans, number* and rows *Total for Appalachia* and *Total for Nation*

The SBA program would have served an even lower level of minorities were it not for its success in reaching Asian-owned businesses. In Appalachia, Asians were less than 1% of the population, and 5.5% of the SBA 7(a) loans were issued to Asians. Likewise, Asians across the country enjoyed a greater percentage of SBA-guaranteed loans than their percentage of their population. Asians constituted 3.6% of the nation's population and received 13% of the SBA 7(a) loans during 2003.

The SBA program was not nearly as successful in serving African-Americans as Asians. The mismatch between the percent of small business loans and the percent of their population was particularly striking in Appalachia and across the country. In Appalachia, African-Americans were 8.3% of the population but received 2% of the SBA 7(a) loans during 2003. On a national level, African-Americans constituted 12.1% of the population but were issued just 5.4% of the SBA 7(a) loans (see Figure 15). The situation was similar for Hispanics, but Hispanics did not comprise a large portion of the population in Appalachia. Hispanics were 2.2% of the Appalachian population and received just 1.2% of the SBA-guaranteed loans. Across the country, Hispanics were 12.6% of the population and were issued just 8.3% of the SBA 7(a) loans.

Figure 15



Source: Appendix Table 24 – columns *% Afr-Amer pop* and *% of loans, number* and rows *Total for Appalachia* and *Total for Nation*

In the Appalachian portion of states with a considerable minority population, the disparities in SBA 7(a)-guaranteed lending to African-Americans were pronounced. For example, 21.4% of the population in Alabama was African-American but African-American businesses received just 4.4% of the SBA 7(a) loans during 2003. Similarly wide differences occurred in Mississippi, North Carolina, and South Carolina. In Georgia, the SBA 7(a) program exhibited a disparity in reaching Hispanics in proportion to their population. Almost 7% of Georgia's population was Hispanic, but Hispanic-owned businesses received 3% of the SBA 7(a) loans.

The performance of the SBA program in serving women-owned businesses in Appalachia matched its performance on a national level. In Appalachia, 20.3% of SBA-guaranteed loans in 2003 were made to women owned small businesses, which was very close to the nationwide indicator of 21.3%.

Appendix Table 25 illustrates that minority-owned businesses in Appalachia had greater access to SBA-guaranteed loans if they were located in MSA counties as opposed to NonMSA counties. Almost 29% of the SBA-guaranteed loans were issued to minorities in MSA counties but just 7% of the loans were issued to minorities in NonMSA counties in Appalachia during 2003. The difference for Asians was large. About 19% of the SBA 7(a) loans were issued to Asian-owned businesses in MSA counties and just 3.5% of the loans were received by Asian-owned businesses in NonMSA counties during 2003 in Appalachia. The difference in the portion for African-American businesses was also substantial; African-American businesses received 6.5% of the SBA 7(a) loans in MSA counties but just 1.5% in NonMSA counties.

In contrast to the SBA lending patterns to MSA and NonMSA counties, minority-owned businesses had about as much access to 7(a) loans in distressed as in non-distressed counties. In non-distressed counties, lenders using the SBA program issued 9.8% of guaranteed loans to minority-owned businesses. In distressed counties, lenders using the SBA program offered 8.4% of SBA-guaranteed loans to minority-owned businesses in Appalachia during 2003. The pattern was quite different across the country; minorities in distressed counties received a much higher portion of SBA loans than minority-owned businesses in non-distressed counties. This differential access was driven by the much higher percentage of Hispanic businesses in distressed counties receiving SBA 7(a) loans than Hispanic businesses in non-distressed counties across the country. Appalachia did not have a sizeable Hispanic population, and hence did not exhibit this lending pattern to Hispanics.

The SBA program was more successful in penetrating NonMSA counties than minority markets during 2003 in Appalachia. In NonMSA counties, the SBA 7(a) program achieved a market share of loans of 1% whereas in MSA counties its market share was .34%. Unlike the market share differences in MSA and NonMSA counties, the SBA program did not have a greater market share in distressed than non-distressed counties. In addition, other data indicate that the SBA 7(a) program may not be as successful in distressed counties as in non-distressed counties. Lenders using the program made 22.3 loans in distressed counties per 10,000 businesses and 68.3 loans per 10,000 businesses in non-distressed counties (see Table 4).

Table 4

SBA 7(a) Loans per 10,000 Businesses, 2003-2004

	Appalachia			all USA
	Distressed Counties	Non-distressed Counties	All	
All Loans	22.33	68.27	66.2	78.83
Minority owned businesses	1.17	7.57	7.28	21.62
Women owned	4.33	14.44	13.99	17.02

When considering SBA 7(a) loans per 10,000 businesses on a county level, the data suggest that the SBA program was not as successful in guaranteeing lending in Appalachia as it was across the country. In Appalachia, lenders using the 7(a) program issued 66.2 loans per 10,000 small businesses while they issued 78.9 loans per 10,000 small businesses across the country. In addition, lenders using the SBA 7(a) program issued just 7.3 loans to minority-owned businesses per 10,000 businesses in Appalachian counties but 21.6 loans to minority-owned businesses per 10,000 businesses in counties across the country. For women-owned small businesses, the ratios were 14 in Appalachia and 17 across the country.[11]

Conclusion

Mid-size banks generally performed according to expectations. Their lending was relatively concentrated in non-metropolitan counties and distressed counties in contrast to larger banks. They also had a greater market share in substantially minority counties with

[11] To generate the data for loans per 10,000 businesses, this report combined 2003 and 2004 SBA 7(a) loan data. Above the report used SBA 7(a) loan data for the year 2003 only.

populations that were more than 50% minority but had their smallest market share in counties with 20% to 50% minorities.

The SBA 7(a) program had a higher degree of success in serving small businesses in non-metropolitan counties than in counties with substantial minority populations. SBA-backed lending was not offered in proportion to the minority population in either the nation or Appalachia. SBA-guaranteed lending had a higher market presence in non-metropolitan counties than metropolitan counties. However, SBA-guaranteed lending served a smaller percentage of minority-owned businesses in non-metropolitan than metropolitan counties. The SBA program also did not guarantee as many loans per small businesses in Appalachia as it did across the country. In sum, it appears that mid-size banks were more consistently oriented towards traditionally underserved populations while the performance of the SBA 7(a) program was mixed in its success of reaching traditionally underserved markets.