

Banking and SME Financing in the United States

A Working Paper by Charles Ou, Ph.D.,
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Background

Commercial banks have been the leading supplier of debt capital to small firms in the United States. With the increasing availability of small business lending statistics and of research on the topic, it becomes possible to provide an overview of the small business loan markets in the United States, as well as an evaluation of the impact of major developments on the cost and availability of loans to small businesses.

The paper begins with a brief discussion of the market—the borrowers, lenders, and market organization—followed by a discussion of major developments in U.S. financial markets and the banking industry. Topics discussed include innovations in information technology and in financial modeling and financial products, as well as banking consolidation and the growth of interstate banking. The implications of increased competition in small business loan markets as evidenced by the emergence of a nationwide market for credit lines and business credit cards, and the entry of regional and national banks and bank holding companies (BHCs) into local markets are discussed.

Overall Findings

Loan markets for most small business borrowers in the United States have become more competitive over the past decade, evidenced by the emergence of a nationwide market for credit lines and credit cards and the entry of large regional banks in local markets. However, the impact of increased competition on the cost of funds to small firms, as indicated by the rate spreads between small business rates and the rates paid by the banks' best prime customers, is more difficult to assess because of data limitations.

Highlights

- With more than 6,000 banks and BHCs serving millions of small business owners, the small business loan markets in the United States are made up of hundreds or even thousands of submarkets varying in size and borrower characteristics. Many of these markets are segmented, with various degrees of intermarket connection in the flows of funds.
- Competition in different submarkets also varies significantly—from highly competitive credit card markets for small businesses at the national level, to fairly competitive markets in major urban centers, to markets with very limited competition in remote rural areas and/or for specific ethnic groups.
- The emergence of a nationwide market for small business credit lines and credit cards over the past decade is a significant development in small business financing. The number of small business loans outstanding (loans under \$100,000) increased from about 5 million in 1995 to 14 million in 2004, compared with much smaller increases in larger small business loans, up from 1 million in 1995 to 1.7 million in 2004. Most of the increases came from 15 to 20 multi-billion-dollar banks and BHCs; they accounted for more than 50 percent of the number of loans under \$100,000 outstanding. Fourteen banks/BHCs have extended business loans in more than 40 states, according to the 2003 database of information submitted by banks as required by the Community Reinvestment Act (CRA).
- The entry of large regional banks into local markets also increased market competition in local small business markets. In 2003, of 370 banks/BHCs that made larger small business loans (loans between \$100,000 and \$1 million) in more than one state, 34 have lending activities in more than 10 states.

- It is more difficult to study the impact of increased competition on interest rate spreads between small business loans and loans to the banks' best customers. The prime rate served as the proxy for the rates charged to banks' best customers in earlier years, but prime customers have generally been charged rates below prime since the 1990s. Information on the rate premium over the base (or the index) in the rate adjustment formula of loan agreements would be most useful to an understanding of this issue.

Scope and Methodology

The databases used for the analysis include Reports of Condition and Income (call reports), reports submitted under the requirements of the Community Reinvestment Act (CRA reports), and Statistical Release E.2—the Survey of Terms of Business Lending conducted quarterly by the Federal Reserve Board. Studies on small business lending using these databases, including, for example, the Office of Advocacy's annual banking studies (available at <http://www.sba.gov/advo/research/banking.html>), are reviewed and summarized. Time series statistics were generated for analysis of the trends in small business lending by 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

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at www.sba.gov/advo/research. Copies are available for purchase from:

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