Small Business Credit

Federal Reserve Bank of Atlanta
Regional Economic Information Network (REIN)

Q2 2010

FEDERAL RESERVE BANK *of* ATLANTA

Two Small Business Surveys

Survey #1: Survey of Small Business Owners

- The survey was distributed to small business owners in the Sixth District[1] through the Federal Reserve Bank of Atlanta's Regional Economic Information Network (REIN).
- Completing the survey were 432 firms.

Survey #2: Survey of Small Business Service Providers

- The survey was distributed to small business service providers in the Sixth District.
- Because the survey of small business owners is skewed towards old and large firms, we narrowed the survey of small business service providers where at least 60% of their clients are less than four years old and have fewer than 20 employees. This action limited the sample to 57 small business service providers.
- Most of the 57 small business service providers surveyed are small business development centers. Together, these providers assisted more than 20,000 young small businesses in the past year.

[1] The Sixth District includes Alabama, Florida, and Georgia and portions of Louisiana, Mississippi, and Tennessee.

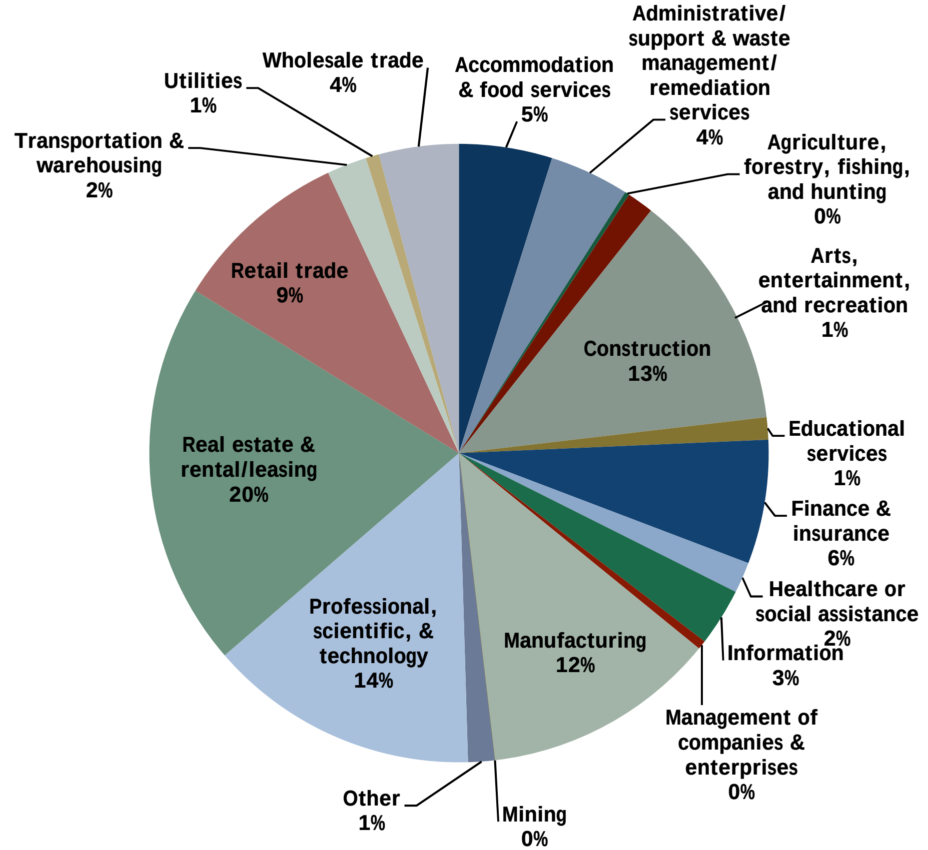
Two Small Business Surveys

Except where otherwise noted, the results in this report reflect the Survey of Small Business Owners.

Survey Sample Compared to Sixth District

- The distribution of industries in the survey does not differ much from the Sixth District as a whole.[1] However, survey participants were more likely to be real estate firms (20% of firms in the survey vs. 10% of firms in the Sixth District) and manufacturing firms (12% vs. 2%). Additionally, there was a smaller share of healthcare firms (2% vs. 8%) compared to the rest of the Sixth District.
- In terms of number of employees and revenues, the businesses of survey participants were larger on average compared to the Sixth District.
- When asked about number of employees, 40% of survey participants reported being self-employed or having fewer than 10 employees. This is quite skewed towards larger firms, as 94% of small firms in the Sixth District are self-employed or have fewer than 10 employees.

Small business survey participation by sector
(n=432 firms)



[1] According to 2007 County Business Patterns data from the U.S. Census Bureau.

Q2 Small Business Owner Survey Highlights

- The percent of applications for credit that were denied decreased significantly from the Q1 survey (40% in Q1 vs. 14% in Q2). However, the percent of loans declined by the applicant due to unfavorable credit terms increased significantly (4% in Q1 vs. 34% in Q2).

- While **40% of credit applications** received all or most of the amount requested, **60% of firms** in the survey received the full or most of the amount requested when adding together all of their applications for credit.

- Anticipated changes in future sales and capital investment have moderated from Q1. The net percent of firms anticipating an increase in sales or capital investment (vs. a decrease) was lower but remained positive in the Q2 survey.

- Real estate and construction firms reported more successful applications in Q2 than in Q1; their average financing index rose from 3.04 to 3.34. This increase may be the result of differences in the sample of real estate and construction firms responding in Q2 vs. Q1 or the geographic distribution of responding firms rather than an aggregate upward trend in lending to this sector. However, examining only construction firms that responded and sought credit in both Q1 and Q2 surveys, and thus controlling for unobserved firm characteristics, these firms did indeed have more successful applications on average in Q2 (average financing index increased from 3.2 to 3.5).

Q2 Small Business Owner Survey Highlights

cont.

- The average financing received among all other repeat firms increased from 3.6 to 3.7. This finding is consistent with the results of the latest Federal Reserve Senior Loan Officer Survey, suggesting that credit was easier to obtain in Q2 than in Q1—for the first time since late 2006, the net number of institutions easing credit standards on commercial and industrial loans to small firms was positive.

- Being denied or refusing credit in the Q1 survey did not have much of an impact on a firm's decision to apply again in Q2. Of the 30 firms who were denied or refused credit at least once in Q1 and who appeared in our Q2 survey, only 2 reportedly did not seek financing in Q2 ONLY because they thought lenders would not approve or unfavorable credit terms would be offered.

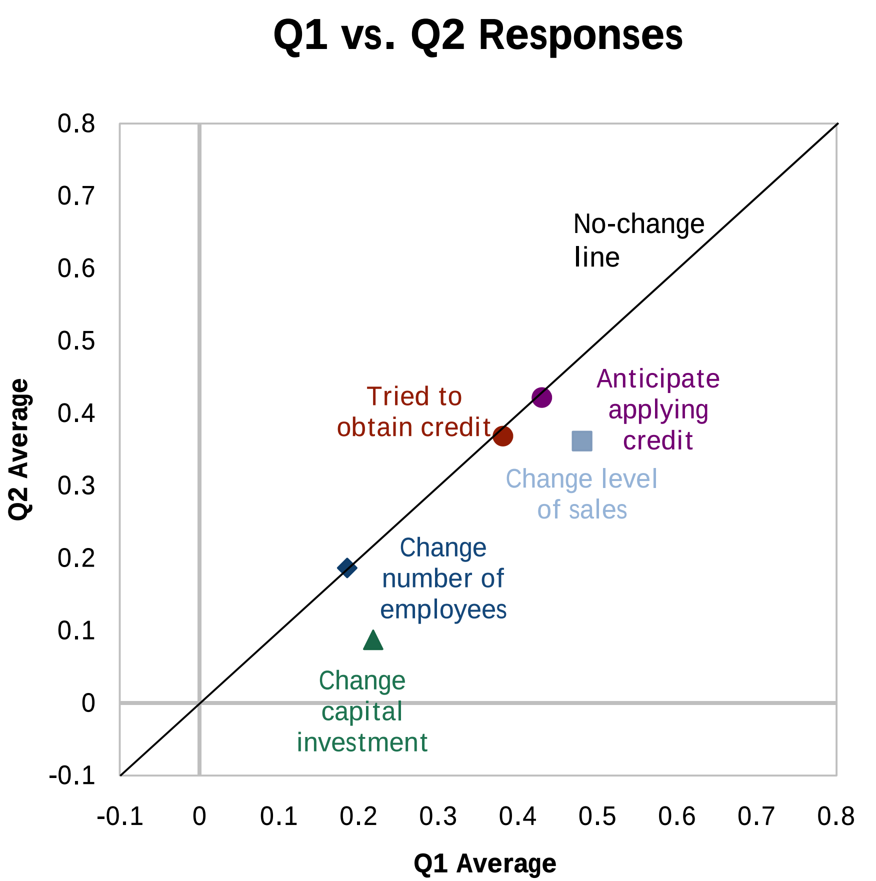
- However, there is a relation between discouraged borrowers and businesses that tended to rely on real estate for funding. In the Q2 survey, 44 firms did not seek credit ONLY because they expected denial or that unfavorable credit terms would be offered.

Q2 Small Business Owner Survey Highlights
cont.

- Seventeen (39%) reportedly will not seek credit again for the same reasons. These 17 were more likely to have historically relied on personal credit (home equity line of credit, personal credit card) and more likely to be a real estate or construction firm than the sample as a whole.

- Among this group of 44 discouraged borrowers, those who historically relied on personally credit and were in the real estate or construction industries were much more likely to be discouraged from borrowing in the future. 82% of the real estate and construction firms that historically relied on personal credit indicated they do NOT anticipate seeking credit in the next six months compared to 31% of remaining respondents in the group (this includes firms in industries other than real estate & construction and real estate & construction firms who did not historically rely on personal credit).

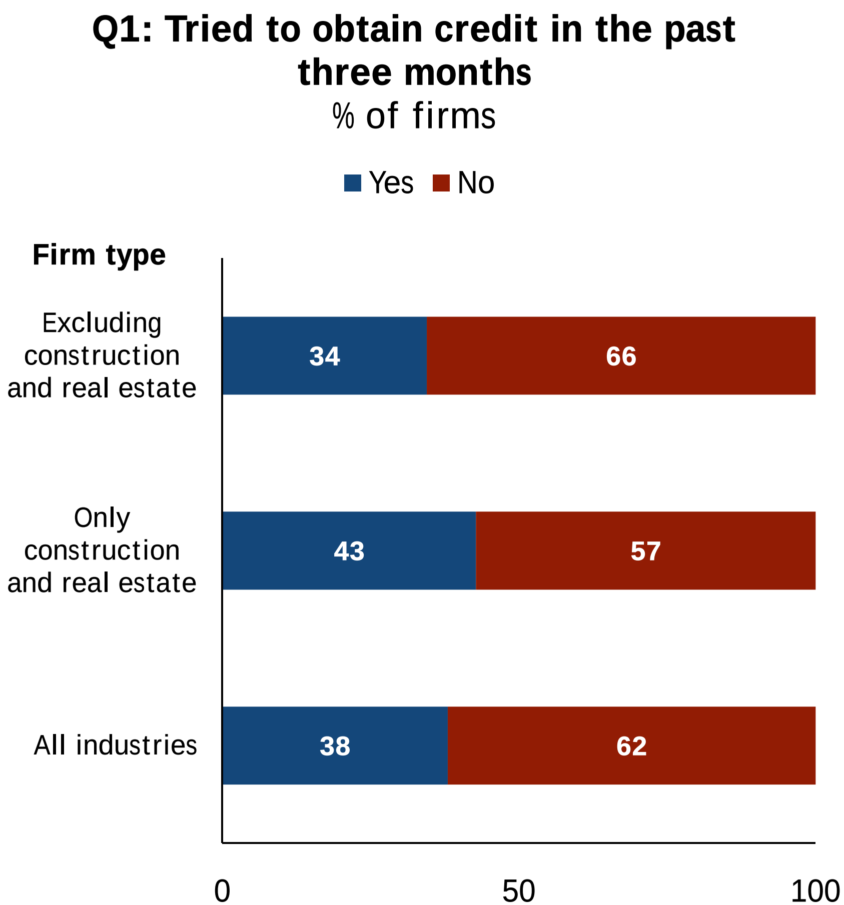
Overview of Responses in Q1 and Q2

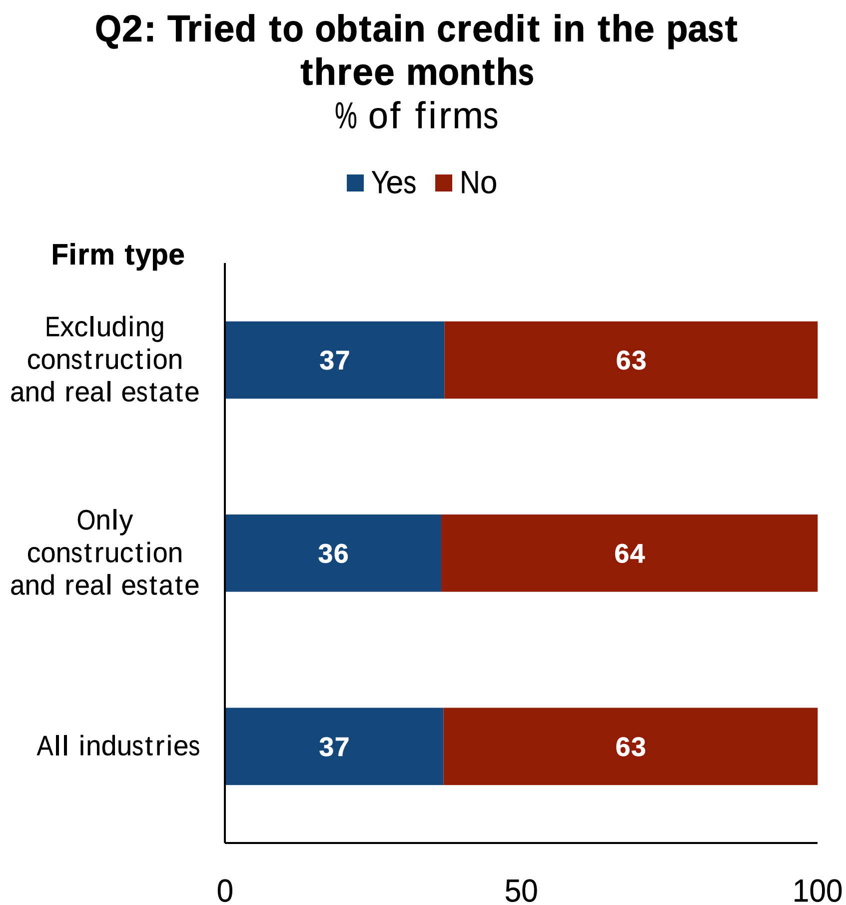


Notes: The "Change in sales/Employees/CapX" values' responses range from -1 to 1, where 1=*Increase*, 0=*No change*, and -1=*Decrease*. The "Tried to obtain/Anticipate applying" credit questions range from 0 to 1, with 1=*Tried/Anticipate applying* and 0= *Didn't try/Don't anticipate applying*.

- The **Q1 [Q2] Average** for "Tried to obtain credit" and "Anticipate applying credit" indicates the percent of firms in the Q1[Q2] survey that tried to obtain credit in the past thee months or that anticipate applying for credit in the next six months.
- The **Q1 [Q2] Average** for "Change number of employees/Sales/Capital investment" represents the percent of firms anticipating an increase in employees/sales/capital investment net of those anticipating a decrease.
- For example, in the Q2 survey, when firms were asked about their expectation of changes in the level of sales over the next six to twelve months, 55% said *Increase* and 18% said *Decrease*, resulting in a net of 36%. (See the note below the chart for more details.)
- Variables lying below the "No-change line" have deteriorated since the Q1 survey, while those above the line have improved.

Percent of Firms Accessing Credit: Q1 vs. Q2

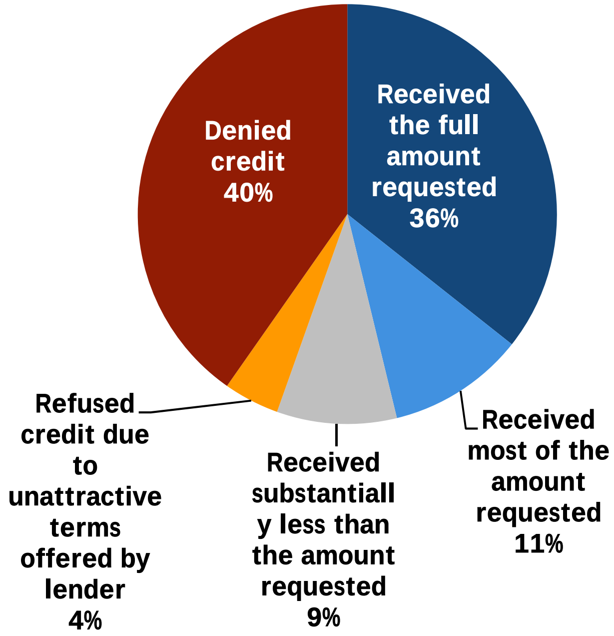




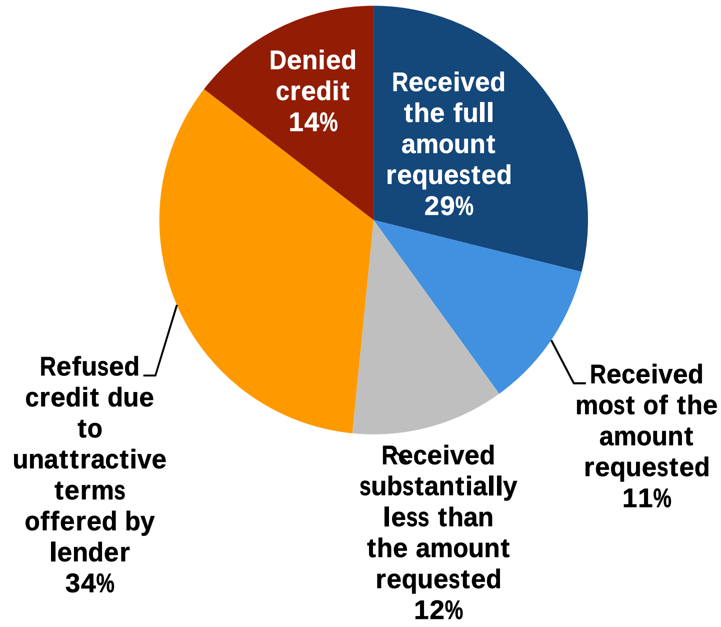
Applications for Credit: Q1 vs. Q2

- The denial rate for applications was much lower in Q2 compared to Q1: 14% versus 40%.
- However, many more offers of credit were refused by the borrower, suggesting more applications were being approved, just not at a price firms were willing to accept.

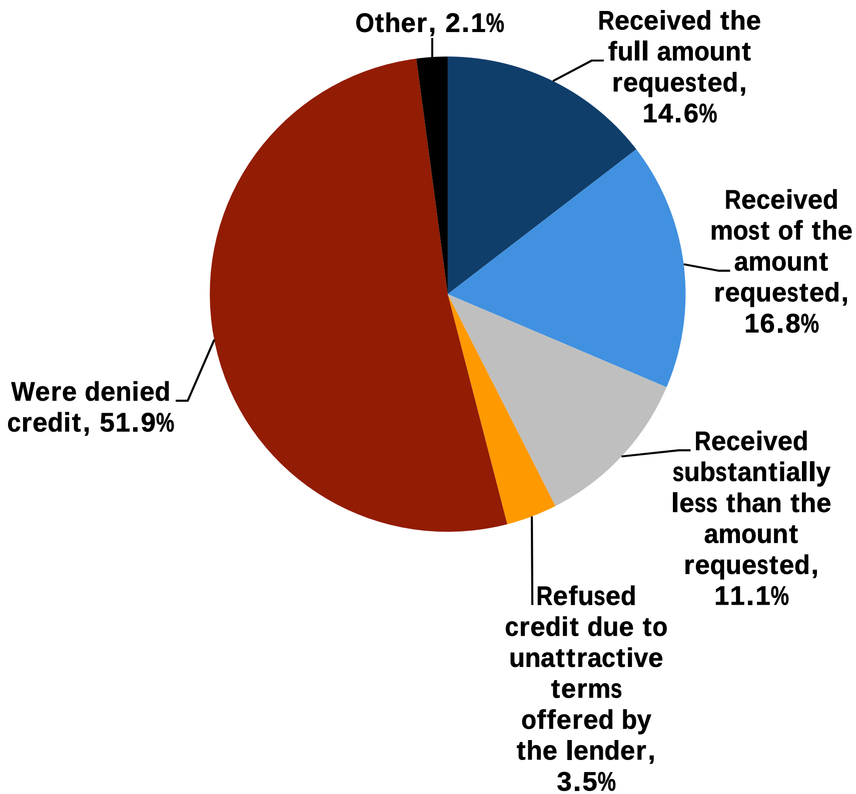
Q1: Degree to which credit applications were met
(303 applications by 117 firms)



Q2: Degree to which credit applications were met
(502 applications by 157 firms)



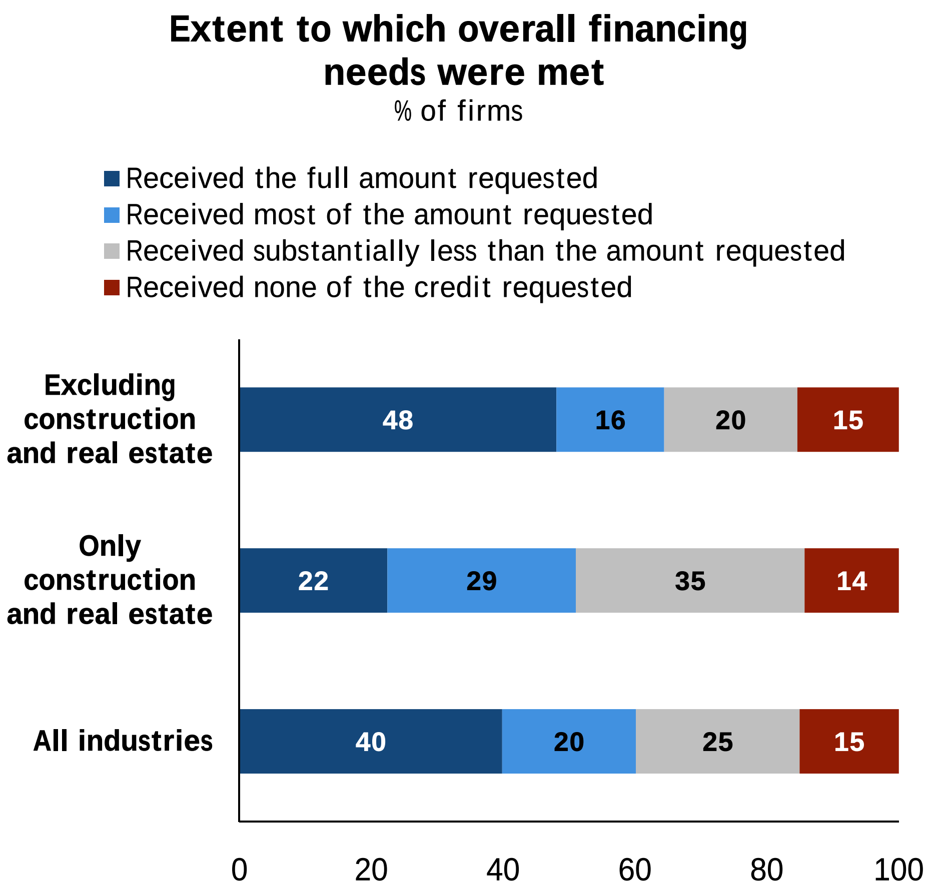
Applications for Credit by Young Firms



- Responses from service providers suggest that younger firms are experiencing higher denial rates of just over 50%.
- However, when combined with loans ultimately refused by the borrower, the percent is similar to that of small business owners.
- According to service providers, 55% of applications were denied or refused compared to 48% as reported by small business owners.

Note: The chart was derived using the responses of service providers and the number of small and young firms they assisted in the past year.
Source: Q2 Survey of Small Business Service Providers

Overall Financing Needs of Firms



- 60% of firms had their financing met substantially or in full.
- Over all applications of credit, approximately 51% of real estate and construction firms reported received all or most of the amount requested compared to 64% of all other firms.
- On average, real estate and construction firms tried slightly harder to obtain credit, applying through 3.9 channels compared to 2.9 channels for all other firms. The channels include loan from a large national bank, credit unions, SBA, vendors/ suppliers, credit card companies, and 7 others. The average number of credit applications among real estate and construction firms was also higher than the Q1 average of 2.6 applications.

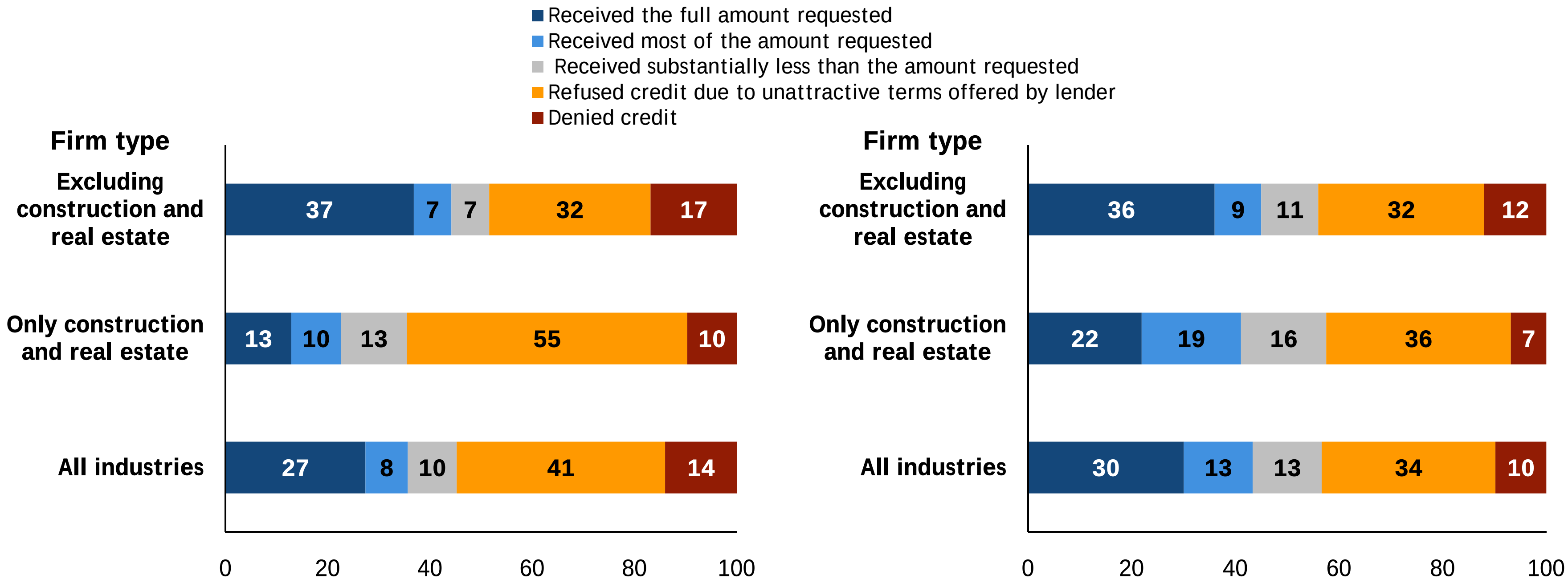
Note: This question was not asked in the Q1 survey.

Large Banks vs. Community/Regional Banks

- Financing from large national banks was reportedly more difficult to obtain compared to regional or community banks, especially for real estate and construction firms.
- 41% of applications from real estate and construction firms were met fully or with most of the amount requested at community or regional banks compared to only 23% at large national banks.

Extent to which you were able to meet your financing needs– Large national bank (loan and line of credit)
% of applications (all industries=157 applications)

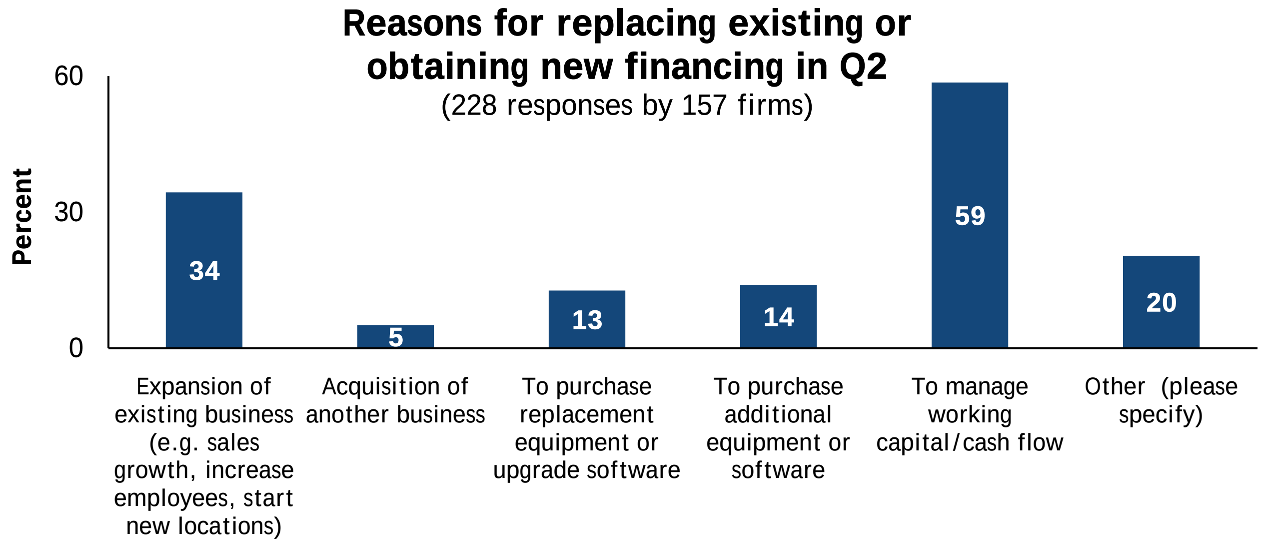
Extent to which you were able to meet your financing needs– Community or regional bank (loan and line of credit)
% of applications (all industries=173 applications)

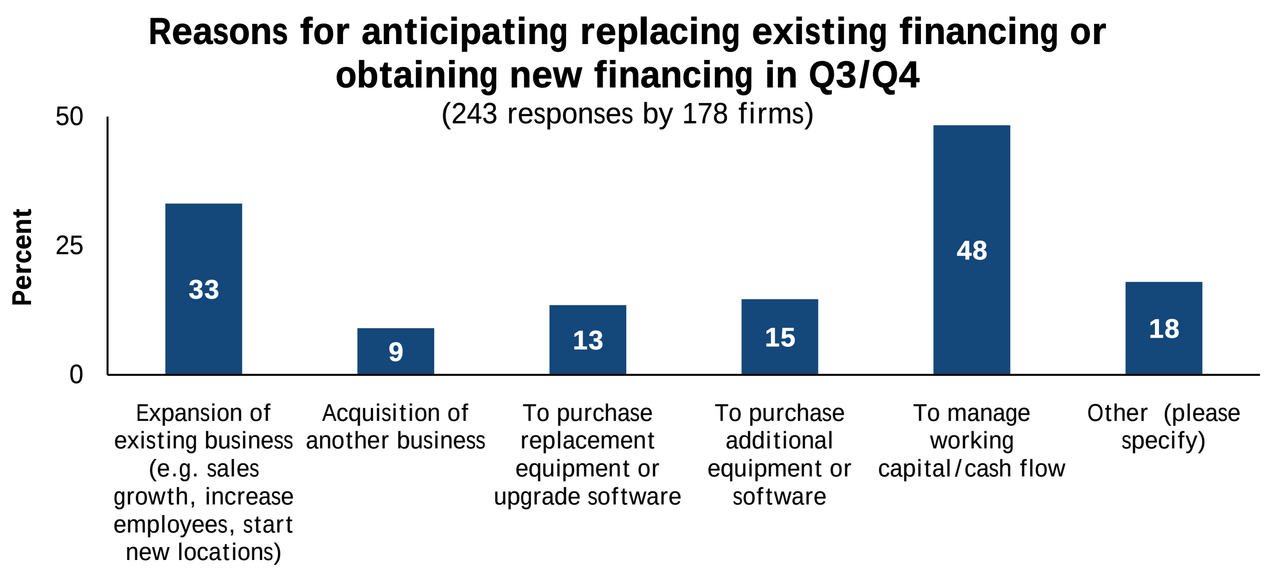


Uses of Financing

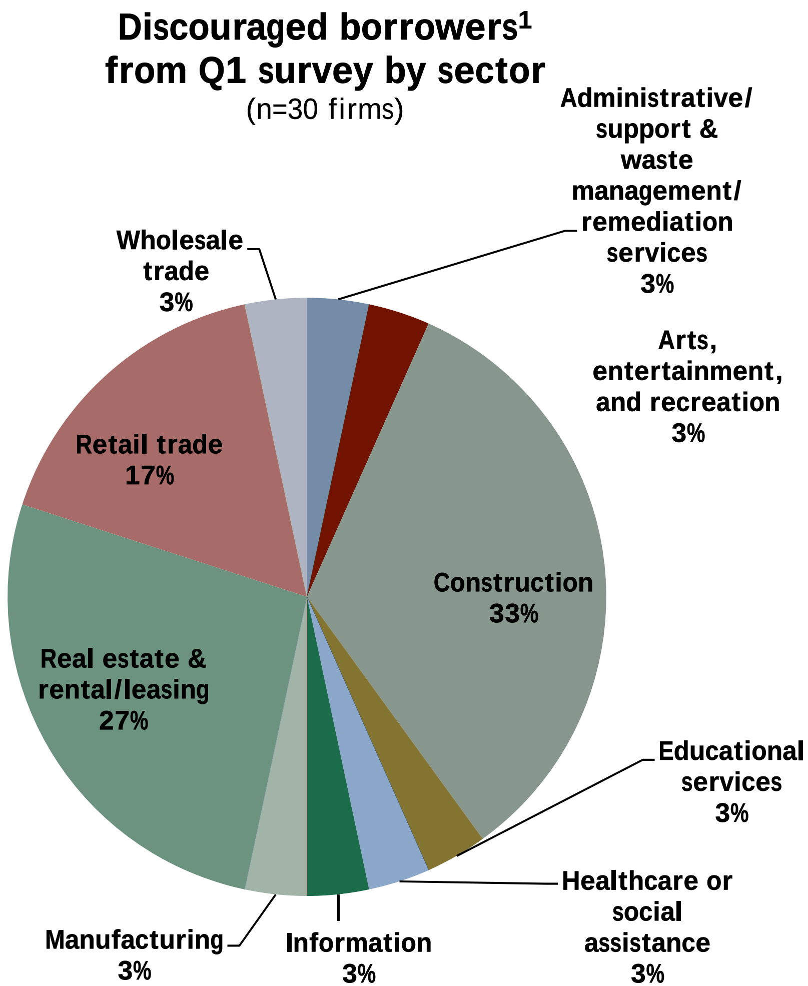
- 20% of firms sought credit to either replace existing or purchase new equipment and software, compared to 19% in Q1.

- Reasons for planning to seek financing in Q3/Q4 remained essentially unchanged. In Q1, 37% of respondents said they planned to seek financing in the next six months to expand their business and 49% said to manage working capital, compared to 33% and 48% in Q2.





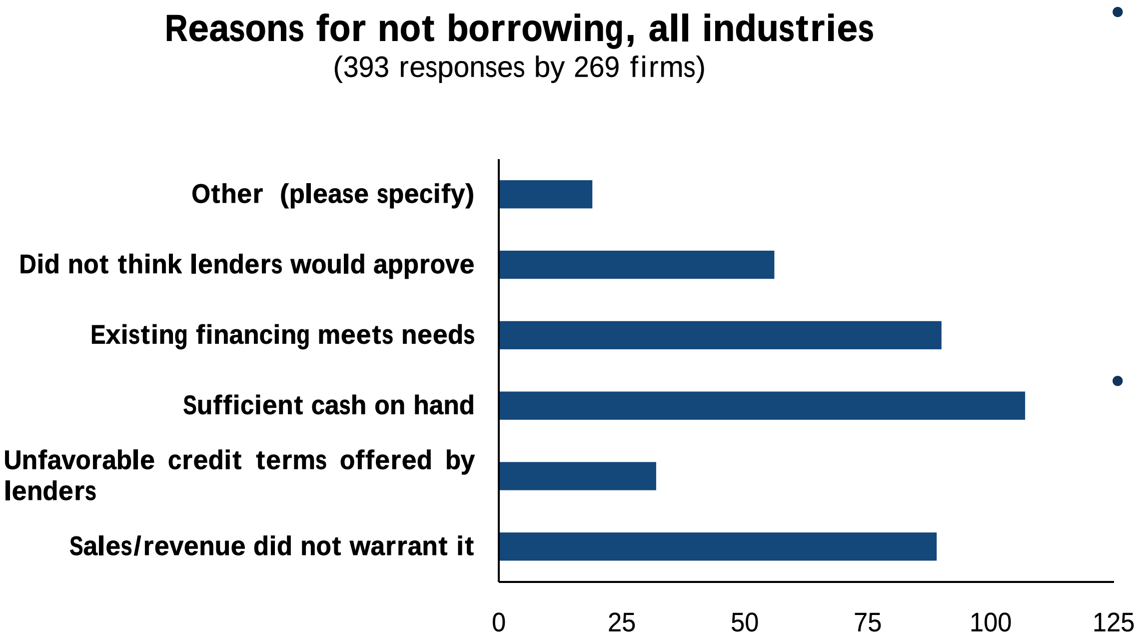
Discouraged Borrowers?



- Of the 30 firms that were denied or refused credit at least once in Q1, only two reportedly did not seek financing in Q2 only because they thought that lenders would not approve or that unfavorable credit terms would be offered. The remaining 28 cited both credit quality and anticipation of lender denial.
- Perhaps not surprisingly, almost all of the 30 firms were in the construction, real estate, or retail trade industries.

[1] Firms that were denied or refused credit in Q1 and that completed the Q2 survey

Discouraged Borrowers? *cont.*



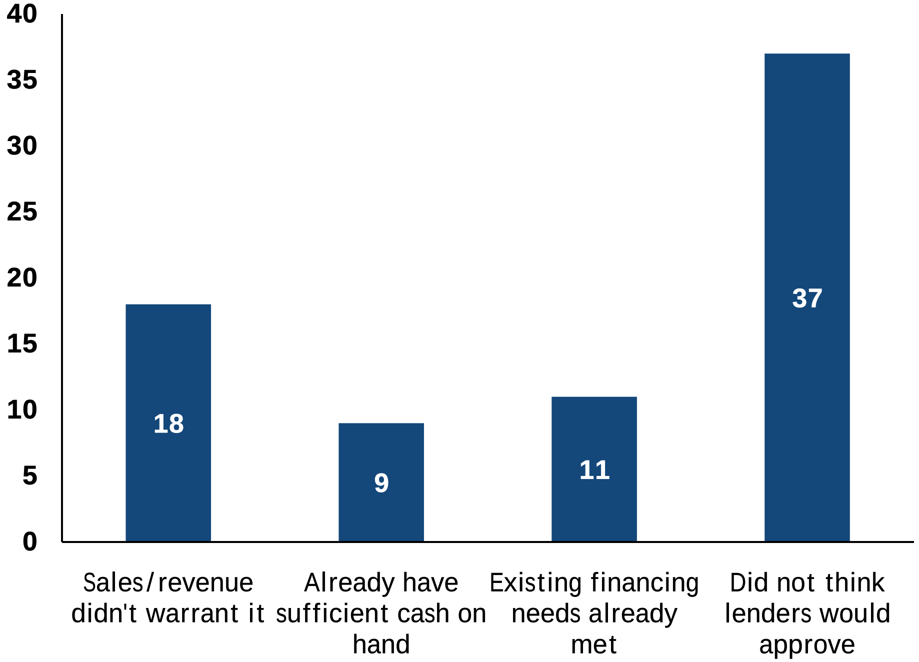
- 44 (16%) of firms that did not seek credit in Q2 cited ONLY supply-side reasons.[1] 17 of the 44 (39%) also cited ONLY supply-side reasons[1] for why they do not anticipate borrowing in Q3/Q4.

- These 17 firms were also more likely to be construction or real estate firms (53% compared to 32% of all respondents). They were more likely to have historically relied on personal credit,[2] with 88% citing personal credit as *Very* or *Somewhat* important compared to only 52% of all respondents.

1 *Unfavorable credit terms* and/or *Do not think lenders would approve* BUT NOT *Sales/revenue will not warrant it*, *Sufficient cash on hand*, or *Existing financing meets needs*
2 Home equity lines of credit, personal credit cards

Reasons Young Firms Are Not Seeking Credit

Main reasons firms did not try to obtain credit in the past three months according to small business service providers
(75 responses by 57 service providers)



- According to service providers, young firms have a higher tendency to not seek credit due to anticipation of denial.
- *Sufficient cash on hand* and **existing financing meets** needs were the least-cited reasons here but were the most cited reasons among small business owners, possibly a reflection of the fast-growing nature and smaller financial backstops of younger small businesses.

Source: Q2 Survey of Small Business Service Providers

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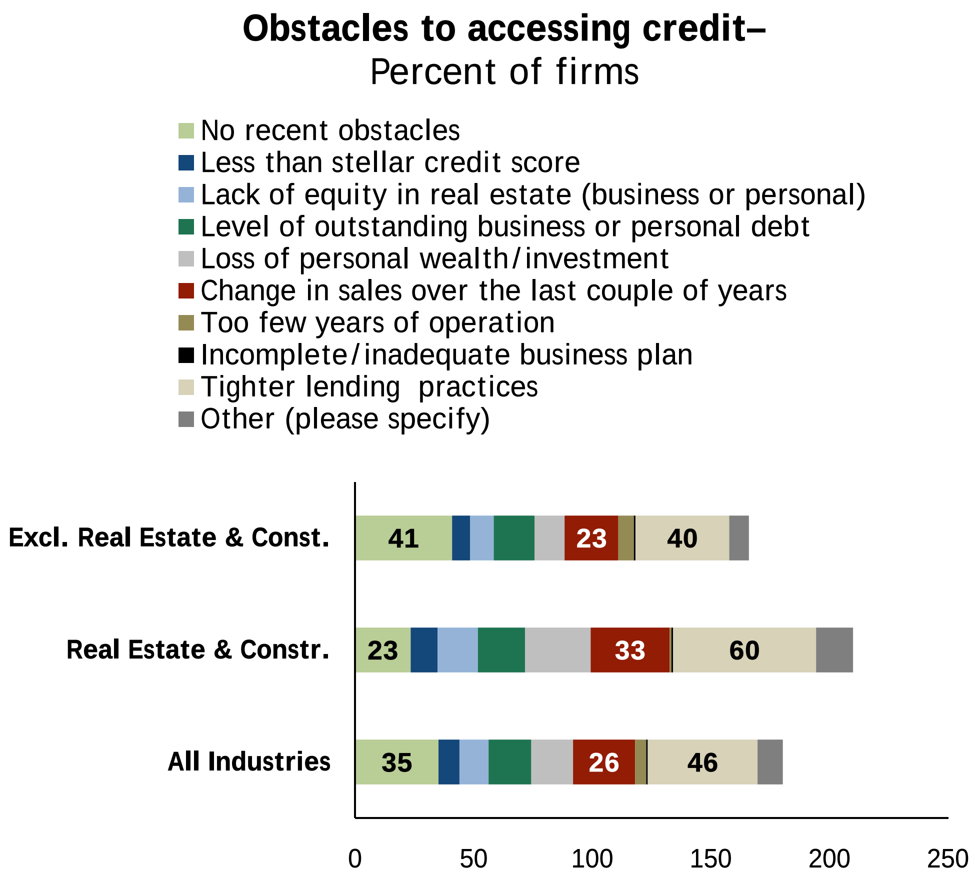
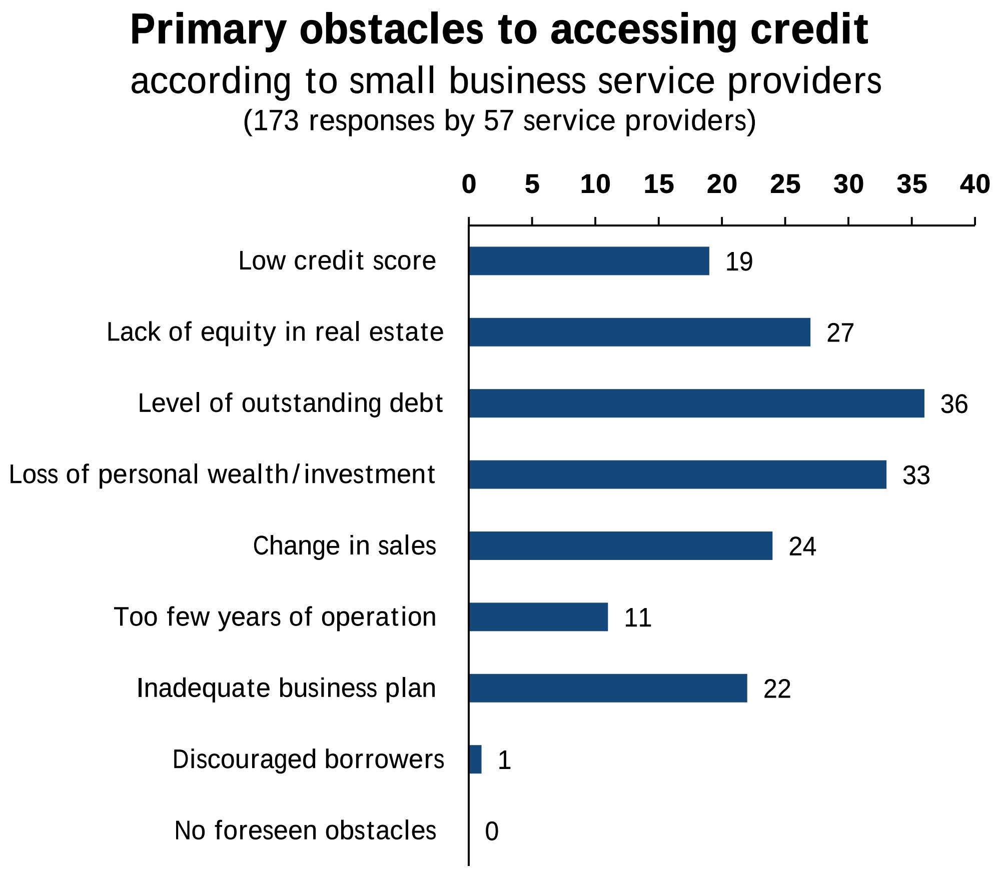
Obstacles to Accessing Credit



Note: Percentages sum to >100 due to multiple responses.

- 41% of firms outside of the real estate & construction sector see no recent obstacles to obtaining credit.
- Tighter lending practices are cited by 60% of real estate & constructions firms compared to 40% for all other firms.
- Of firms denied at least once, 73% cited "tighter lending standards" as an obstacle to credit.

Obstacles to Credit for Younger Firms



Source: Q2 Survey of Small Business Service Providers

- For firms less than four years old, loss of personal wealth—both general wealth and equity in personal real estate—are the primary obstacles to accessing credit.
- This is followed by *Change in sales*, *Low credit score*, *Inadequate business plan*, and *Level of outstanding debt*.
- The fact that no service providers said *No foreseen obstacles* could be an artifact of the survey, since they are answering on behalf of all the firms they service.

Optimists vs. Nonoptimists: Definitions

- Of all firms, 231 (55%)[1] expect an increase in sales over the next six months. For the sake of comparison, these are *optimists*.

- The remaining 192 firms (45%)[1] expect sales to remain the same or decline over the next six months. These are *nonoptimists*.

[1] Nine firms did not answer this particular question.

Optimists vs. Nonoptimists: Differences

- Firms in the sample that are less than five years old are much more likely to be optimists; all 12 firms less than a year old and the majority (63%) of firms one to five years old are optimists.
- Optimists are somewhat more likely to anticipate seeking credit in the next six months (45% vs.39% of non-optimists).
- Optimists were much more likely to have borrowed or to anticipate borrowing for the purpose of growing their business. 46% of optimists that recently sought credit did so to expand/acquire a business and 51% anticipate borrowing for these reasons, compared to 25% of nonoptimists who recently sought credit and 18% of nonoptimists who anticipate borrowing.
- Obstacles to accessing credit differed between the two groups, especially among real estate and construction firms.
- Real estate and construction firms in the nonoptimist group were much more likely to cite lack of equity in real estate (21% vs. 12%), change in sales over the last couple of years (41% vs. 25%), and tighter lending practices (67% vs. 54%) as obstacles to credit.

Obstacles to accessing credit—
Real estate and construction firms only