

Fourth-Quarter 2010 Small Business Survey

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Small Business Survey overview

New survey participants

About one-third of firms in the sample are new business contacts taking the survey for the first time. The median age among the new contacts is five years. The other two-thirds of the sample are preexisting contacts, which have a median age of 22. Of these, 81 percent took the survey in the third quarter.

Because of the changes in the distribution of the age of firms from the third to the fourth quarter, the survey results were evaluated two ways:

- Changes from the third quarter will be examined only among firms that participated in both quarters, thus controlling for any differences in the pool of survey takers.
- The survey results of “young firms” and “mature firms” will be compared to see if there are any significant differences in credit obtainment, reasons for borrowing, business outlook, etc.

Characteristics of the survey sample

In the fourth quarter, 277 firms took the survey.

The survey sample is over-weighted in terms of manufacturing. Manufacturing makes up 2 percent of total small firms in the Sixth District, but 12 percent of the fourth quarter survey sample are manufacturing firms. Real estate and construction firms remain a large portion of the sample, but are not significantly over weighted. Together they account for 29 percent of the sample compared to 23 percent of the small establishments in the Sixth Federal Reserve District according to data from the U.S. Census.

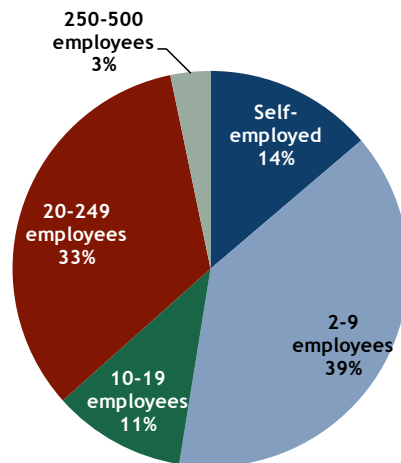
The sample remains skewed towards larger, more mature firms. Of the firms in the survey, 39 percent have between 2 and 9 employees. However, if you remove self-employed, they make up 45 percent compared to 70 percent of small firms in the sixth district. The median firm age is 17.

Most firms in the sample have annual revenues of less than \$1 million and 39 percent have annual revenues of less than \$500 thousand.

Credit obtainment for overall sample

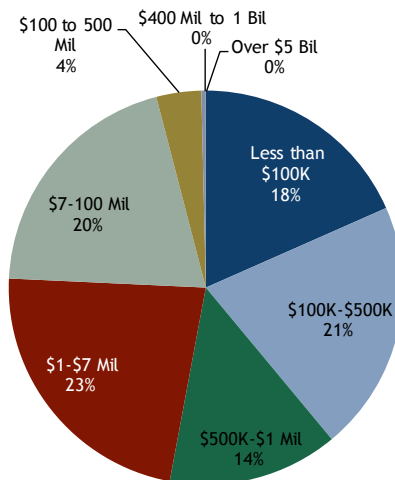
Of the 277 small firms in the Q4 survey, 97 applied for credit. Applying firms submitted 3.7 applications on average and had 29 percent of their overall financing need met in full. A further 29 percent indicated they received most of the amount requested.

Number of employees



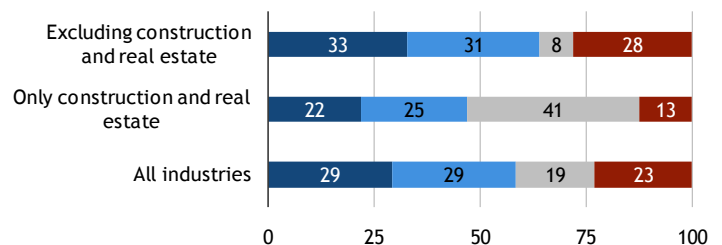
Source: Small Business Survey Q4 2010

Revenue



Source: Small Business Survey Q4 2010

Extent to which overall financing needs were met
% of firms



Source: Small Business Survey Q4 2010

- Received the full amount requested
- Received most of the amount requested
- Received substantially less than the amount requested
- Received none of the credit requested

Small Business Survey highlights

Summary of third quarter versus fourth quarter

The Q4 survey contained a mixture of signals regarding credit conditions. Construction and real estate firms continue to have more difficulty getting their financing needs met relative to other firms, but there is no significant change in firms' ability to access financing overall.

Credit conditions for repeat firms in the construction and real estate industries worsened in the fourth quarter. A smaller portion received the full amount or most of the amount of credit requested over all their applications for credit. A larger portion of credit applications were denied or refused by the borrower due to unfavorable credit terms.

There is one segment of the credit market where credit conditions seem to be improving. Credit approval at community banks and regional banks improved in both the third and fourth quarter. A greater portion of credit applications were fulfilled at community and regional banks among repeat firms in the sample not in the construction or real estate industry. This continues a trend among regional bank applications from earlier in 2010.

Tighter lending standards continues to be a highly noted obstacle to credit, especially among construction and real estate firms. However, the portion of firms citing tighter lending standards as a credit obstacle declined slightly in the fourth quarter while the percent citing **no** obstacles to credit increased slightly among repeat firms in the sample.

The economic outlook of firms improved in the fourth quarter. Among the 163 firms that participated in the past two surveys, there was an increase in the net percent anticipating increases to sales, employees, and capital expenditures over the next six to twelve months.

Summary of young firms versus mature firms

Despite submitting more applications for credit, young firms in the survey received less credit overall than mature firms.

Most firms, young and mature, applied at banks. Young firms favored community banks and regional banks over large national banks to some extent, but were about as likely to receive credit from either one. Mature firms however, were more successful at community and regional banks.

Young firms had a more positive outlook than mature firms. They were more likely to say they were seeking credit to expand their business and larger net percents of young firms anticipated increases to employees, sales, and capital expenditures over the next six to twelve months.

About half of both young and mature firms said tighter lending standards were an obstacle to credit. Young firms were more likely to cite a variety of obstacles to credit likely correlated with lower credit worthiness including less than stellar credit score, high debt levels, loss of personal wealth/investment, and too few years of operations.

¹ We define small businesses as those with fewer than 500 employees.

Q3 versus Q4

Because of large changes to our survey sample, the comparison of Q3 to Q4 focuses solely on the 163 firms that participated in both surveys and, when applicable, the 33 firms that participated in both surveys *and* applied for credit both quarters.

Overall credit fulfillment

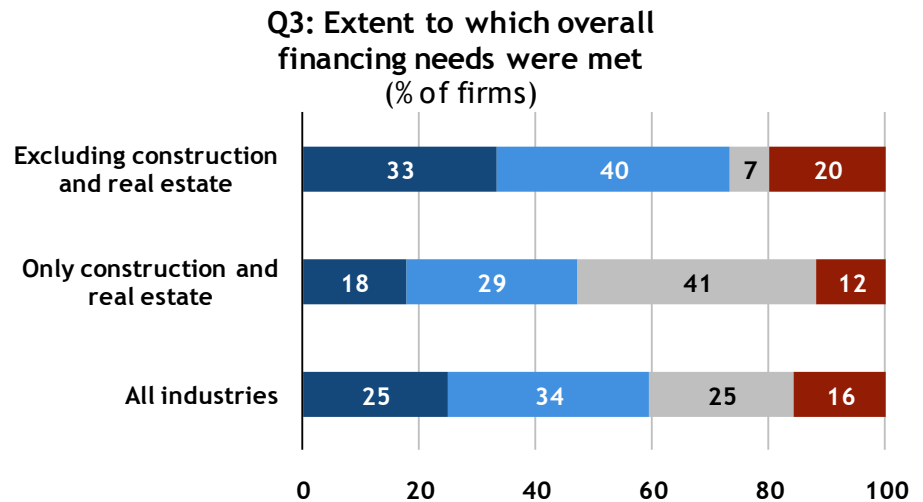
Among the 33 firms who participated in both survey and that applied for credit in both quarters, there was a slight decline the average amount of financing received. However, the difference in the sample averages from Q3 to Q4 was not statistically significant. The averages are computed by assigning a value between 1 to 4, where 1 equals none of the credit requested and 4 equals the full amount requested. On average, the third quarter sample received 2.7 and the fourth quarter sample received 2.5 amounts of credit.

Construction and real estate

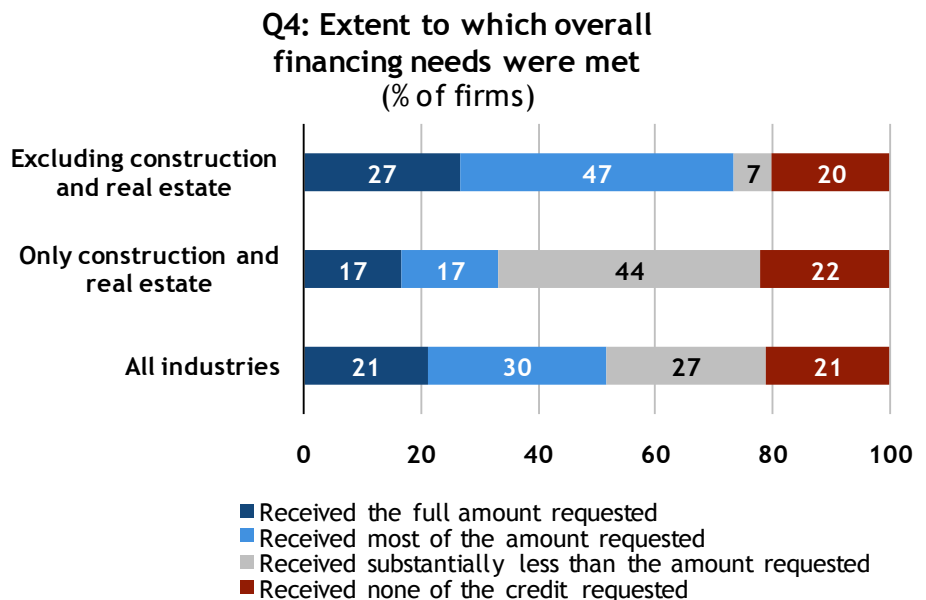
The amount of credit received by construction and real estate (CRE) firms declined in Q4 among the firms that participated in the past two surveys and that applied for credit. When asked to what extent their overall financing needs were met across all their applications for credit in Q3 2010, 12 percent indicated they received none of the credit requested. When the same question was asked to the same sample in Q4, 22 percent indicated they received none of the credit requested. Further, both of the firms that received no credit in Q3 also reported receiving no credit in Q4. The portion that received the full or most of the amount requested also declined, falling from 47 percent in the Q3 to 34 percent in Q4.

Excluding construction and real estate

The amount of credit received by firms not in the construction or real estate industry was essentially unchanged from Q3 to Q4. Slightly more firms received most of the amount requested while slightly fewer received the full amount requested, but the portion receiving either the full or most of the amount requested remained essentially unchanged.



Note: 33 firms in Q4 and Q3 that applied (Q3 responses)



Note: 33 firms in Q4 and Q3 that applied (Q4 responses)

Q3 versus Q4

Applications for credit

Again, looking at only the 33 firms that participated in both the Q3 and Q4 surveys and that applied for credit, the following changes occurred:

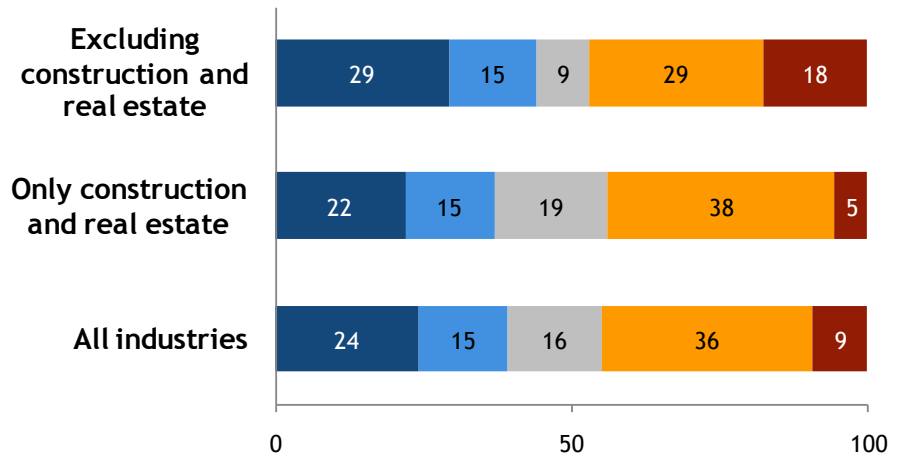
On average, the group of 33 submitted more applications for credit. In the third quarter, the group submitted 3.2 applications on average compared to an average of 3.7 applications in Q4.

The channels of financing firms used were more diverse in Q4, with a larger portion applying to credit unions, credit card companies, Internet banks, community development financing institutions, and nonbank financing companies.

In both quarters, there were about the same number of applications for credit at community and regional banks as large national banks, and in both quarters a much larger percent of applications were approved at the community and regional banks.

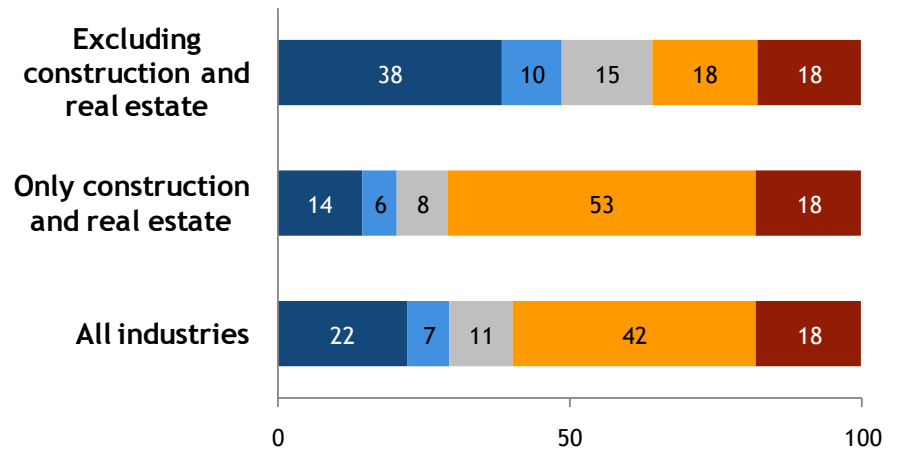
Firms applying at both large national banks and community banks were also more likely to obtain credit at community and regional banks in Q4. For example, among the 10 firms that did not receive a line of credit from a community or regional bank, eight applied for a line of credit at a large national bank and only one received credit there. However, among the 12 that did not receive a line of credit at a large national bank, 11 applied for a line of credit from a community or regional bank, and four received credit there.

**Q3: Extent to which financing needs were met:
Percent of ALL applications**



33 firms in Q3 and Q4 that applied: Q3 responses

**Q4: Extent to which financing needs were met:
Percent of ALL applications**



33 firms in Q3 and Q4 that applied: Q4 responses

- Received the full amount requested
- Received most of the amount requested
- Received substantially less than the amount requested
- Refused credit due to unattractive terms offered by lender
- Denied credit

Q3 versus Q4

Construction and real estate

Compared to the third quarter, the portion of successful applications decreased at both large national banks and community and regional banks for firms in the construction and real estate industries.

Among this group of 18 firms, a larger portion of credit applications were turned down due to unattractive terms. At large national banks in the fourth quarter, 15 out of 22 applications for either a loan or line of credit (68 percent) were turned down and 13 out of 22 (60 percent) were turned down from community and regional banks. In the third quarter a smaller portion of applications were turned down due to unattractive terms. Half of applications were turned down at

large national banks and 26 percent were refused due to unattractive terms at regional and community banks.

Excluding construction and real estate

Compared to the third quarter, the portion of successful applications increased at both large national banks and community and regional banks for firms not in the construction or real estate industries.

Applications from firms not in the construction or real estate industry were more likely to be fulfilled at large national banks in Q4 among the group of 15. However, a greater portion of fulfilled applications were met with substantially less than the amount requested and thus, a smaller portion were met with the full or most of the amount requested.

At community and regional banks, not only were a smaller portion denied or refused by the borrower but a greater portion of applications were met with the full or most of the amount requested in the fourth quarter.

Q3 versus Q4

Reasons for borrowing

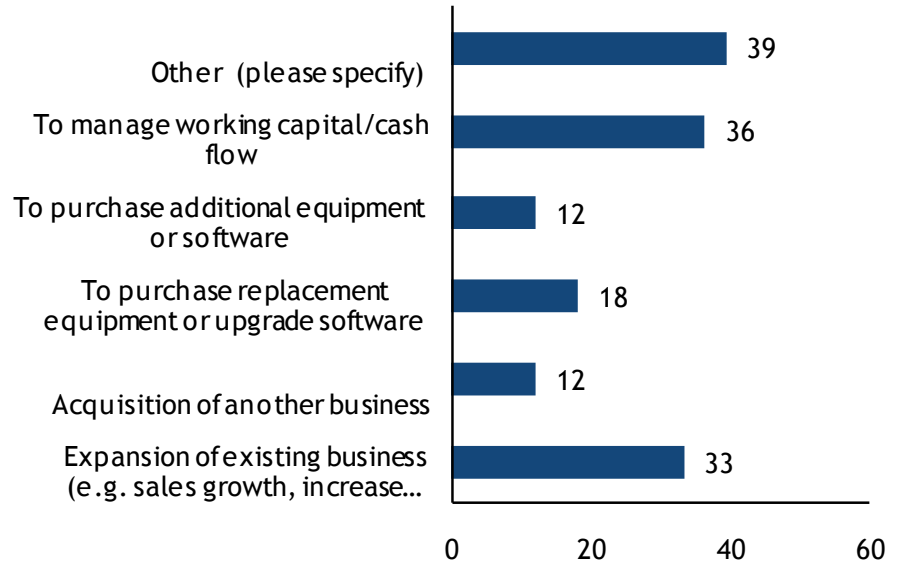
In both quarters, firms responding to why they were seeking credit gave similar reasons, most commonly selecting “expansion of business,” “manage working capital/cash flow” and “other.”

Among those saying “other,” most were real estate or construction firms seeking credit to purchase land or renovate homes or shopping centers.

The only notable difference in the reasons for borrowing among the 33 firms that sought credit in both quarters was “to purchase additional equipment/software,” which increased from 6 percent in Q3 to 12 percent in Q4.

Reasons for borrowing Percent

(50 responses by 33 firms)



33 Firms in Q4 & Q3 that applied, Q4 Responses

Discouraged borrowers

Among the 163 firms that took both Q3 and Q4 surveys, about the same portion were “discouraged borrowers.” That is, when the firms responded to why they did not borrow, 11 out of 103 (or 11 percent) not borrowing said they did not borrow *only* because they believed unfavorable credit terms would be offered or lenders would not approve their request.

In Q3, 8 percent of these firms not borrowing were “discouraged borrowers” by this measure.

The vast majority of those not obtaining any credit (out of the entire sample of 277) are not discouraged from reapplying. Of firms that received no credit, 86 percent anticipate applying for credit again in the next six months.

	Q3 (%) (n=163)	Q4 (%) (n=163)
Discouraged borrowers	8	11
Tighter lending practices	48	45
No recent credit obstacles	35	41
Tried to obtain credit	39	33
Anticipate applying for credit	43	45

Q3 versus Q4

Obstacles to credit

Despite a slightly larger portion of discouraged borrowers in Q4, fewer firms in the group of 163 cited “tighter lending practices” and more cited “no recent obstacles.”

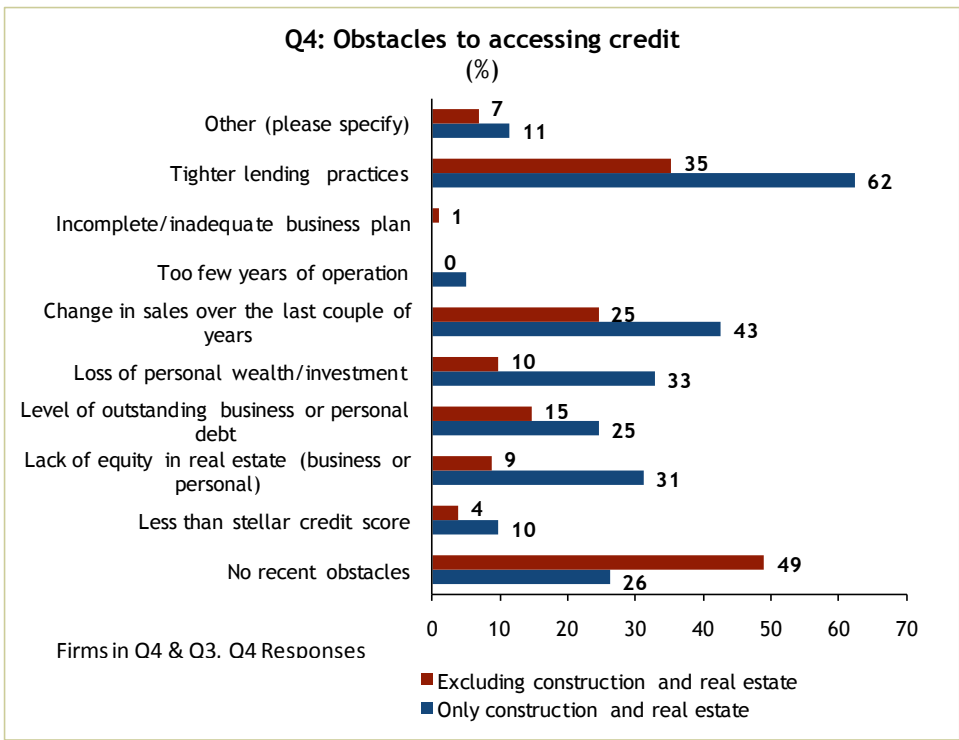
This mixture of signals suggests that credit conditions were not perceived to have changed much for the group as a whole. However, the fact that a greater portion of credit applications were fulfilled at community and

regional banks specifically in both the Q3 and Q4 for firms not in the construction or real estate industry suggests positive change is occurring at least in some places.

Obstacles to credit: As seen from the firms that received no credit

Out of the entire sample of 277, 97 firms sought credit in Q4; 74 received at least some credit while 22 received no credit over all their credit applications.

The firms that received no credit across all of their credit applications were more likely to cite tighter lending practices as an obstacle to credit but were also more likely to cite a variety of firm-related economic factors likely hampering their ability to obtain credit. The table below notes the differences; the largest differences are bolded.



Obstacles to credit	Firms who received no credit (%) (n=22)	Firms who received at least some credit (n=74)
No obstacles	0	27
Less than stellar credit score	36	7
Lack of equity in real estate	32	22
Level of outstanding business or personal debt	23	27
Loss of personal wealth/investment	32	15
Change in sales over the last couple of years	41	32
Too few years of operation	14	8
Incomplete/inadequate business plan	0	0
Tighter lending standards	86	64
Other	23	16

Q3 versus Q4

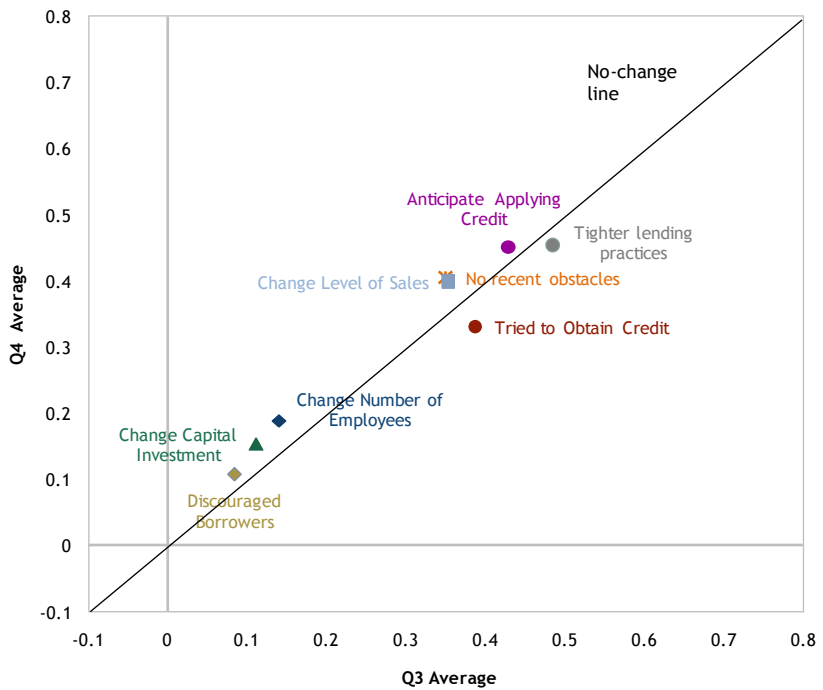
While the survey results don't suggest much change in credit conditions from Q3 to Q4, improvements in small business sentiment are apparent.

Among the 163 firms that took the survey in both quarters, there was a positive change in the net percent of firms anticipating increases to number of employees, sales, and capital expenditures. The net percent is calculated as the percent of firms anticipating an increase minus the percent of firms anticipating a decrease. The changes are plotted on the chart and included in the table.

The other data plotted are the percent saying yes to a specific question in Q3 compared to Q4. For example, the data point "tried to obtain credit" plots the 39 percent that tried to obtain credit in Q3 on the x-axis and the 33 percent that tried to obtain credit in Q4 on the y-axis.

Q3 vs. Q4 Responses

163 Repeat Respondents



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

Net percent anticipating increases to	Q3 (%) (n=163)	Q4 (%) (n=163)
Employees	14	19
Sales	35	40
Capital expenditures	11	15

Young firms versus mature firms

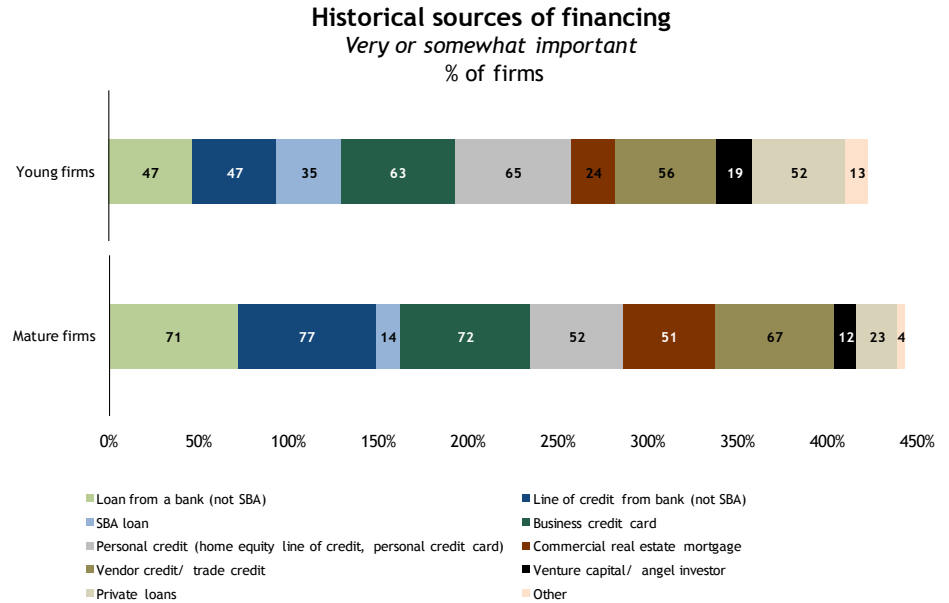
About one-third of the sample for the Q4 survey were new business contacts taking the survey for the first time. The median age among the new contacts is 5 years old.

The large influx of new young firms into the survey allows for the comparison of young firms, which are defined here as firms less than 7 years old, and mature firms, defined as 7 years or older.

Of the 277 firms in the Q4 survey, 203 are mature firms, 62 are young firms, and 12 did not specify in what year they were established. These were left out of this analysis.

Historical sources of financing

As expected, the historical sources of financing for the young firms compared to mature firms are quite different. Most notably, young firms have relied less on loans and lines of credit from banks, more on SBA loans, and less on commercial real estate mortgages.



Note: The total percentage of respondents is greater than 100% due to multiple responses.
Source: Small Business Survey Q4 2010

Young firms versus mature firms

Credit sources

Forty percent of young firms and 34 percent of mature firms applied for credit in the three months leading up to the survey. On average, applying young firms submitted 4.8 credit applications compared to 3.5 among mature firms.

Almost all firms applying for credit, whether young or mature, went to a bank: 83 percent of young firms applied at a bank, and 92 percent of mature firms applied for credit at a bank.

Young firms were about as likely as mature firms to apply at community and regional banks, and only 1 out of 14 that applied at a large national bank did not also apply at a community or regional bank. However, 13 out of 45 mature firms applied at a large national bank and did not apply at a community or regional bank.

Young firms used a wider variety of financing channels. They were more likely to seek financing at credit unions, SBA lenders, credit card companies, community development financial institutions, family or friends, and nonbank financing companies.

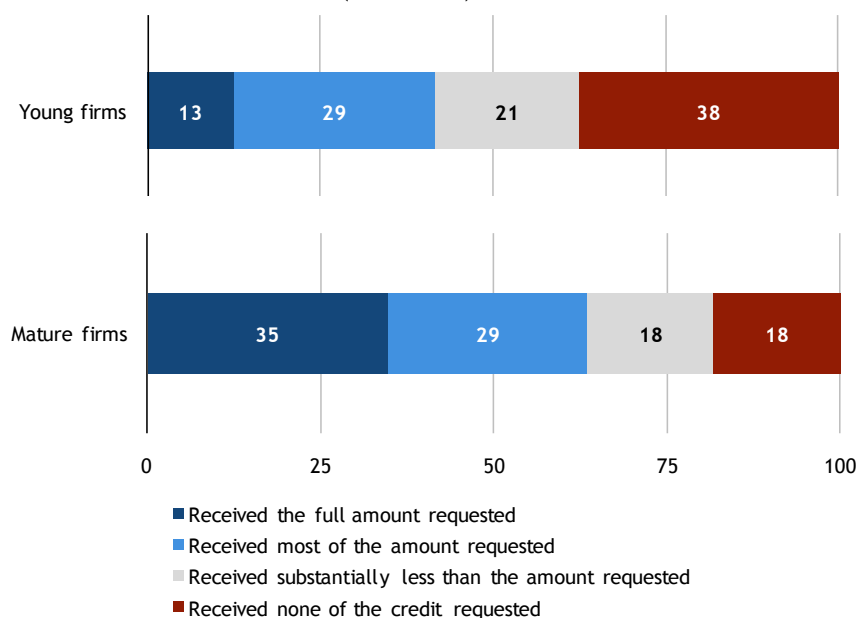
Credit success

Young firms received less credit on average than did mature firms. The difference was statistically significant at the 98-percent level.

On a scale of 1 to 4, where 1 indicates that a firm received no credit across all applications and 4 indicates that a firm received the full amount, young firms on average received 2.2 while mature firms received 2.8 amounts of credit.

It is difficult to say whether the effect was any different for firms in the construction and real estate industry because only three in the sample of young firms applied for credit.

Extent to which overall financing needs were met (% of firms)



Source: Atlanta Fed Small Business Survey Q4 2010

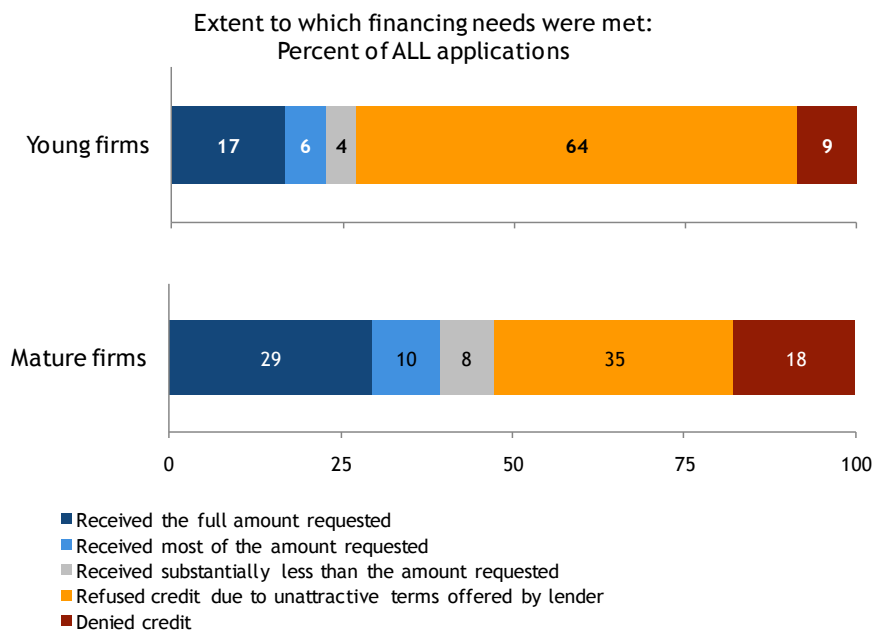
Young firms versus mature firms

Applications for credit

On average young firms received less financing than did mature firms, so the success rates of their applications does not come as much surprise. Almost two-thirds of all applications submitted by young firms ended with the firm refusing the offer due to unfavorable credit terms. Only 23 percent of applications from young firms were met with the full or most of the amount requested, while 39 percent of applications from mature firms were met with the full or most of the amount requested.

Success of applications at banks

Eighty-three percent of young firms and 92 percent of mature firms applied for either a loan or line of credit from a bank. Regardless of whether the application was made at a national or regional or community bank, young firms were not very successful at obtaining credit: 16 percent received the full or most of the amount requested from a community or regional bank compared to 21 percent from large national banks. However, the type of bank to which a mature firm applied however, made a big difference in the success of the application. Half the requests that mature firms made for loans and lines of credits to community and regional banks were met with the full or most of the amount requested compared to 30 percent of requests to large national banks.



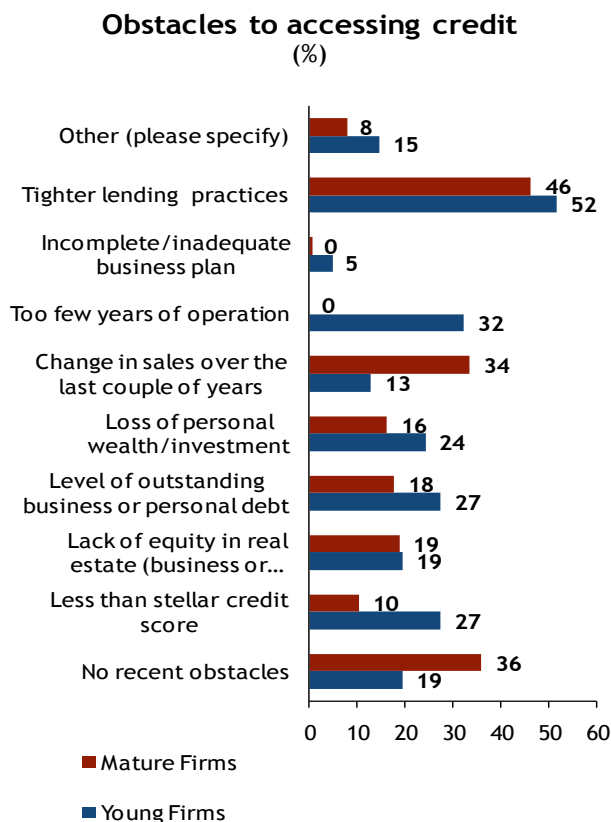
Young firms versus mature firms

Outlook

Young firms had a more positive outlook than mature firms. They were more likely to say they are seeking credit to expand their business; larger net percents of young firms anticipated increases to employees, sales, and capital expenditures over the next 6–12 months.

Compared to 33 percent of mature firms, 71 percent of young firms seeking credit were doing so to expand their business; for example, sales growth, increase employees, start new locations.

None of the young firms anticipated decreasing the number of employees in their firm over the next 6–12 months. The following table shows the net increases in employees, sales, and capital expenditures.



Creditworthiness

One explanation for the lower amount of credit received by young firms may be lower credit worthiness. Some quantitative indicators related to potential lower credit worthiness are the higher portion of young firms citing less than stellar credit score, debt levels, loss of personal wealth/investment, and too few years of operations as obstacles to accessing credit. Further, greater portions of young firms were looking to acquire new/additional financing which could be an indication that they do not have pre-existing credit histories with lenders.

Net % anticipating increases to	Young firms	Mature firms
Employees	57	27
Sales	89	48
Capital expenditures	53	16

By Ellyn Terry, senior economic research analyst in the research department at the Federal Reserve Bank of Atlanta