Small Business Credit

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

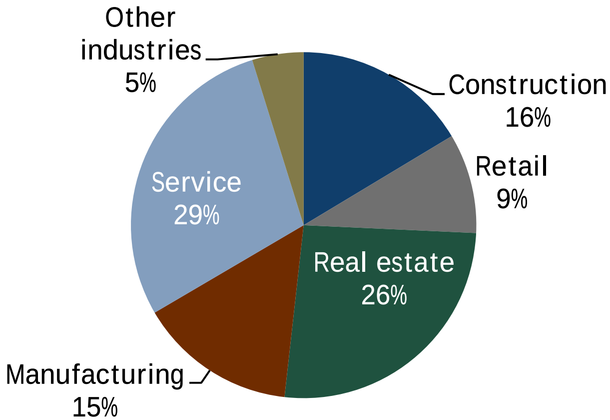
April 2010

FEDERAL RESERVE BANK of ATLANTA

Survey Participants

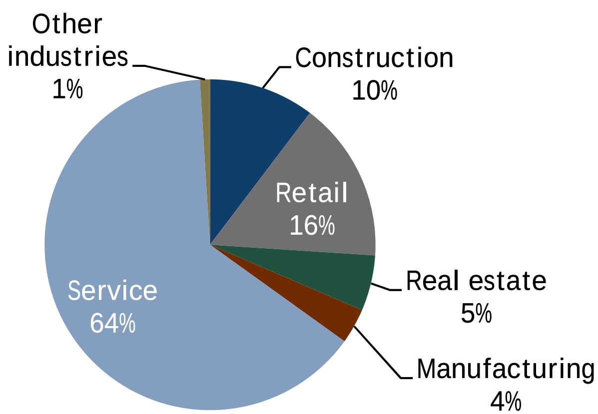
Industry distribution of small business survey participants

n=311 firms



Sixth district industry distribution

n=1,162,406 firms



Source: County Business Patterns, U.S. Census

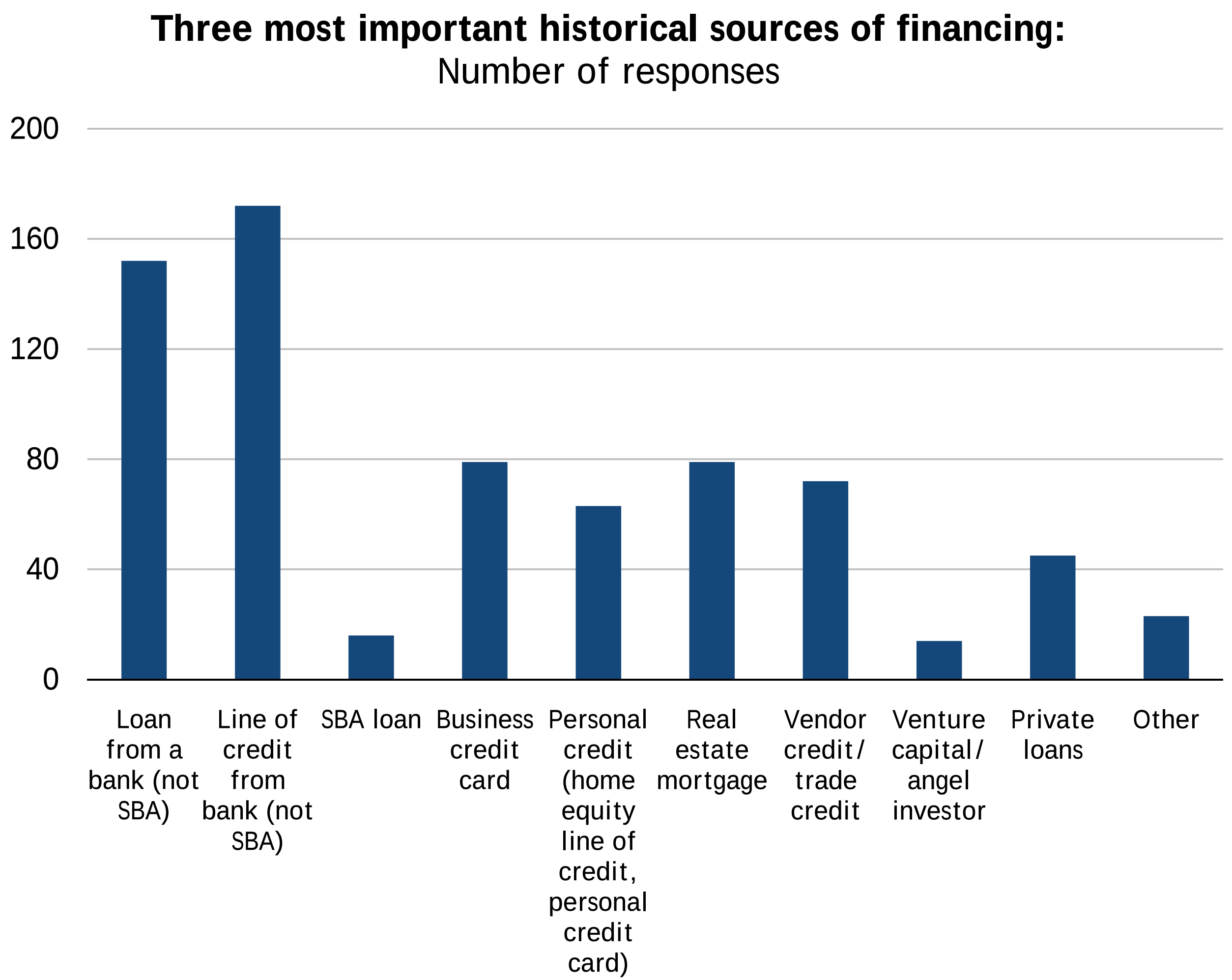
- In April 2010, the Federal Reserve Bank of Atlanta's Regional Economic Intelligence Network (REIN) e-mailed approximately 700 small business contacts an invitation to participate in an online survey. The Atlanta Fed supplemented this outreach with other participants contacted via local chambers of commerce. In total, 311 firms responded.

- All participating firms are based in the Sixth District. Relative to the population of firms in the Sixth District, the survey includes fewer firms (as a percentage) in retail and service industries—including education, arts, recreation, food service, and professional services. Consequently, our survey sample over-weights real estate, construction, and manufacturing. Due to the particular stresses in the real estate sector, we present results both including and excluding these firms to illustrate the robustness of the results.

- Overall, 51% of participating firms have fewer than 20 employees, 28% have annual revenue less than $500K, and 90% have been in business for longer than five years.

- **Note:** This survey is not a stratified random sample and thus is not to be interpreted as a statistical representation of small business credit usage by firms in the Sixth District or the nation. Rather the results should be viewed as suggestive and analyzed with awareness of potential methodological biases.

Historical Sources of Financing



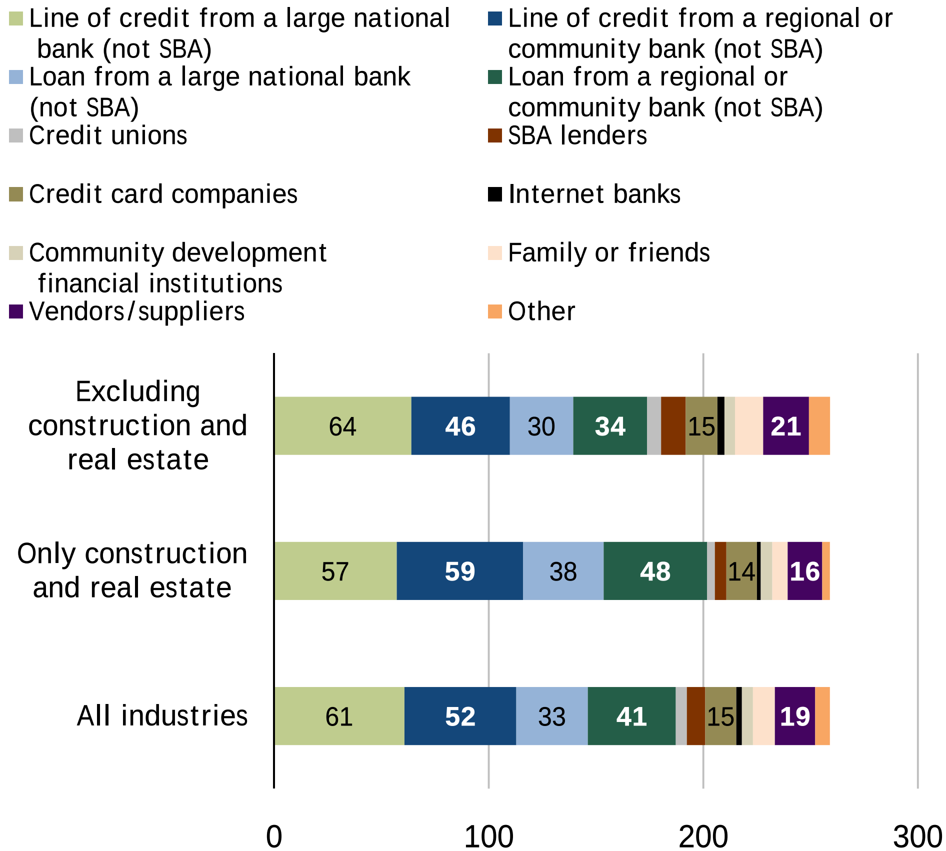
- When asked to report their three most important sources of credit or financing, roughly half of survey participants cite bank loans and lines of credit (49% and 55%, respectively).

- While participants also cite business credit cards, personal credit, and real estate mortgages, these are important for only 20–25% of responding firms. These sources were slightly more important for real estate and construction firms (27–39%).

- Vendor credit/trade credit, while not involving access to the traditional credit market per se, was also cited by 72 firms (23% of all participants).

Credit Market Applications in the Past Three Months

Channels of financing:
Percent of firms that sought credit
(all industries = 117)

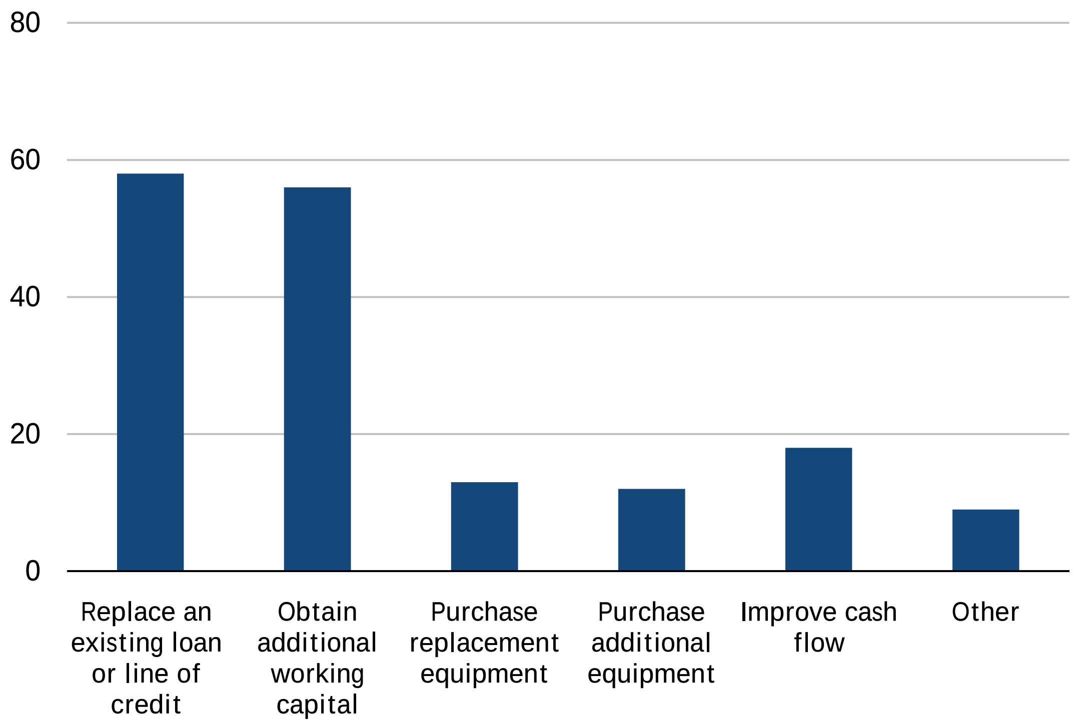


Notes: Percentages sum to >100 due to multiple responses. Firms were surveyed on the channels through which they sought credit but not on the number of applications within each channel.

- Overall, 117 firms (38%) reported seeking some source of credit in the past three months. Construction firms were the outliers here, with 61% (31 firms) seeking credit.
- On average, firms sought credit through 2.6 channels.
- Lines of credit, followed by loans, were accessed most often, echoing the pattern among historically important sources of credit. Construction and real estate firms applied to national and regional/community banks for lines of credit in roughly equal numbers, while the other industries accessed national banks more often. All industries, in contrast, applied for loans more often from regional and community banks than from national banks.

Reason for Seeking Credit in the Past Three Months

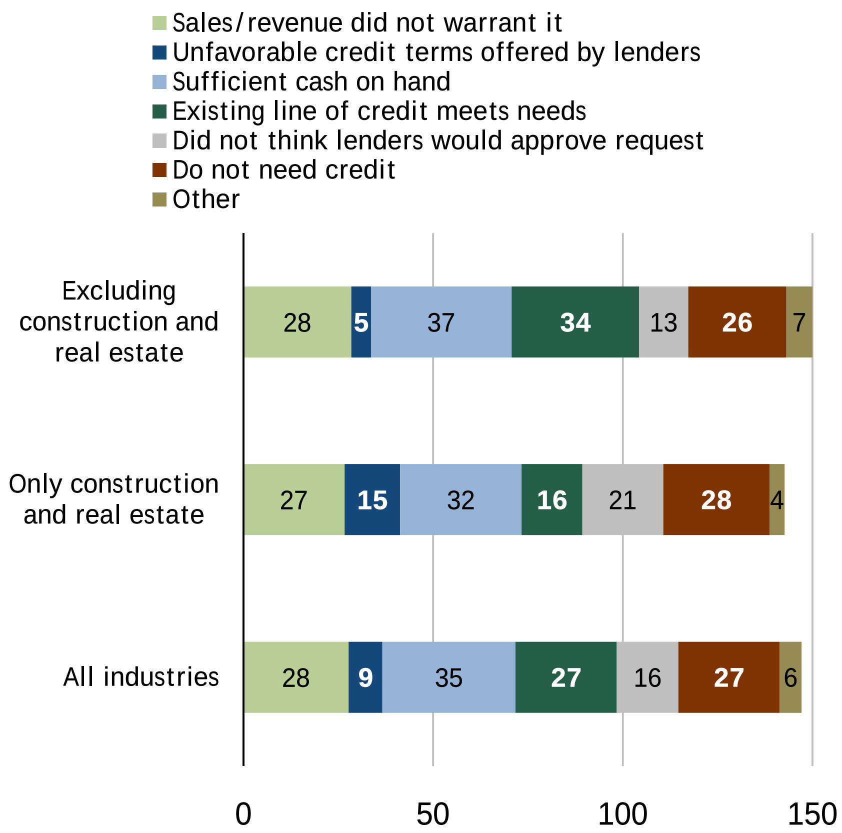
Reasons for seeking credit: Number of responses
(n=117)



- 50% of firms that sought credit in the past three months indicated that their applications were motivated by refinancing needs.
- 48% cited the need to generate additional working capital. This response was highly correlated with a need to improve cash flow.
- 19% of all firms and 44% of manufacturing firms planned to use the credit to purchase new or replacement equipment.
- Among the “other” uses, two firms cited a desire to expand or acquire a business and four planned to purchase real estate.

Reasons for Not Seeking Credit

Reasons for NOT seeking credit:
Percent of firms
(all industries = 191 firms)

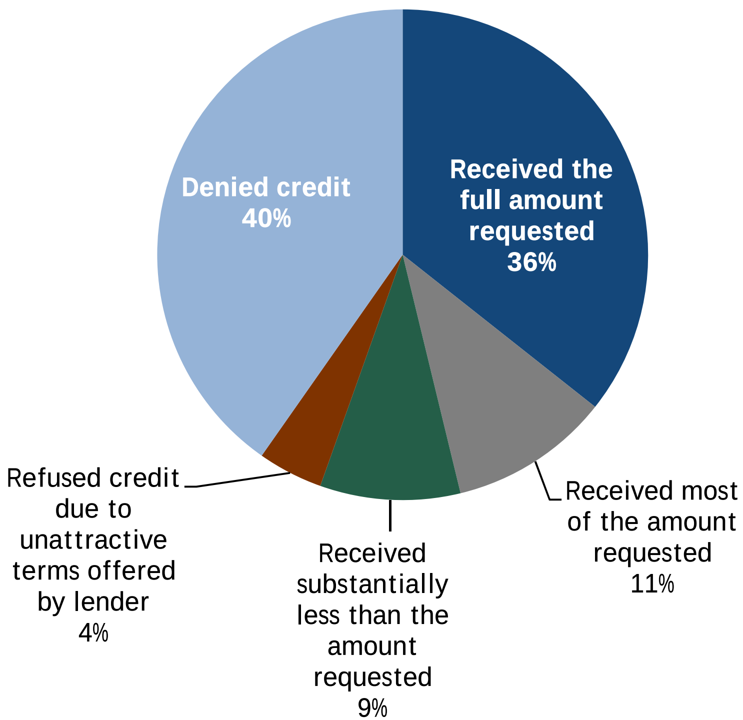


Note: Percentages sum to >100 due to multiple responses.

- Of the 191 firms that did not seek credit in the past three months, 131 (69%) reported that they had sufficient cash on hand, did not have sales/revenues to warrant additional debt, or did not need credit.
- Consistent with the finding that refinancing was a significant motivator for seeking credit, 51 firms reported they did not seek credit because they had sufficient financing in place.
- Many fewer firms (19%) did not seek credit due to unfavorable terms or the anticipation of a denial. Overall, 9% expected unfavorable credit terms, and 16% did not anticipate approval. However, both of these responses were more common among construction and real estate firms (15% felt terms would be unfavorable, while 21% anticipated denial).

Extent to Which Financing Needs Were Met: Applications

Extent to which financing needs were met
(n=303 applications by 117 firms)

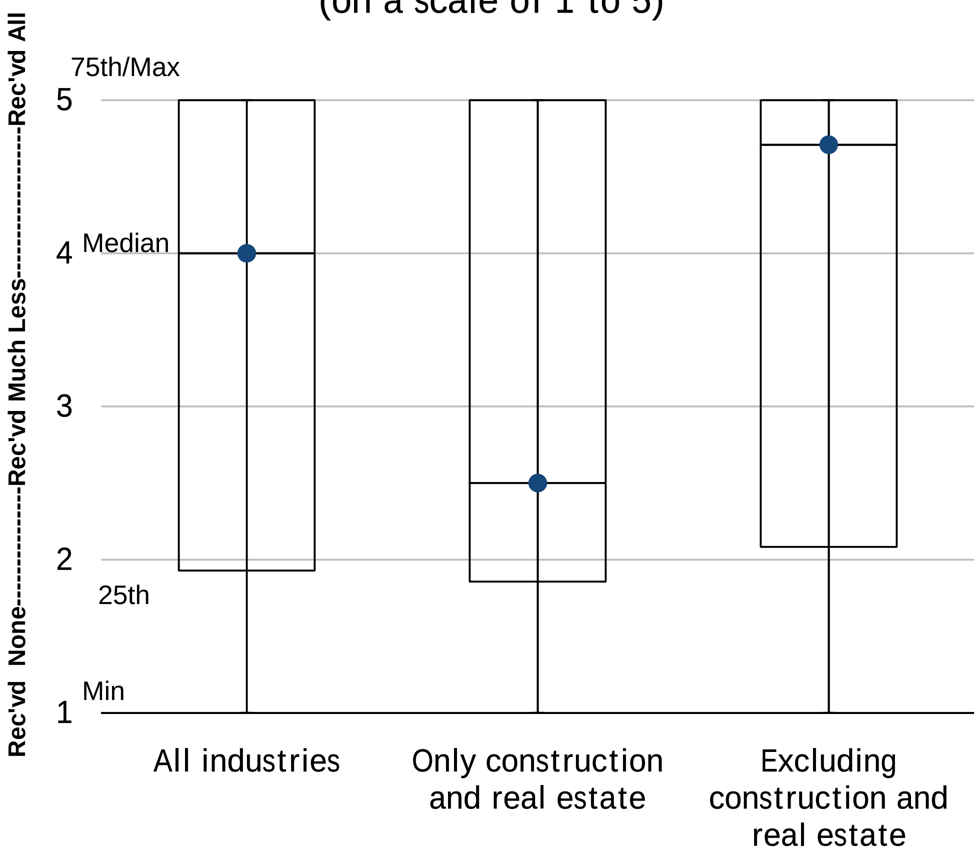


Note: Firms were surveyed on the channels through which they sought credit but not on the number of applications within each channel. "Applications" refers to seeking credit through a particular channel, such as a loan from a large national bank.

- 60% of applications experienced a "successful" result, interpreted as the extension of some amount of credit (= full+most+substantially less +refused).
- A total of 122 applications (40%) were denied, but only 22 of the 117 firms that sought credit were denied on all applications they attempted. Thus, 81% of firms seeking credit received credit at some level.
- Of 41 manufacturing applications, 29 (71%) received the full amount requested and only 7% were denied. These firms are among the largest in our sample, in both number of employees and annual revenue.
- Construction and real estate applications experienced almost the same denial rate as all other industries (40% compared to 41%) but were less likely to receive all or most of the credit requested (39% versus 46% of applications). These industries also account for 11 of the 13 applications that firms refused due to unattractive terms.
- These figures do not measure the extent to which a firm may or may not have gotten its total financing needs met across all of its credit applications.

Extent to Which Financing Needs Were Met: Firms

Distribution of financing index across firms
(on a scale of 1 to 5)

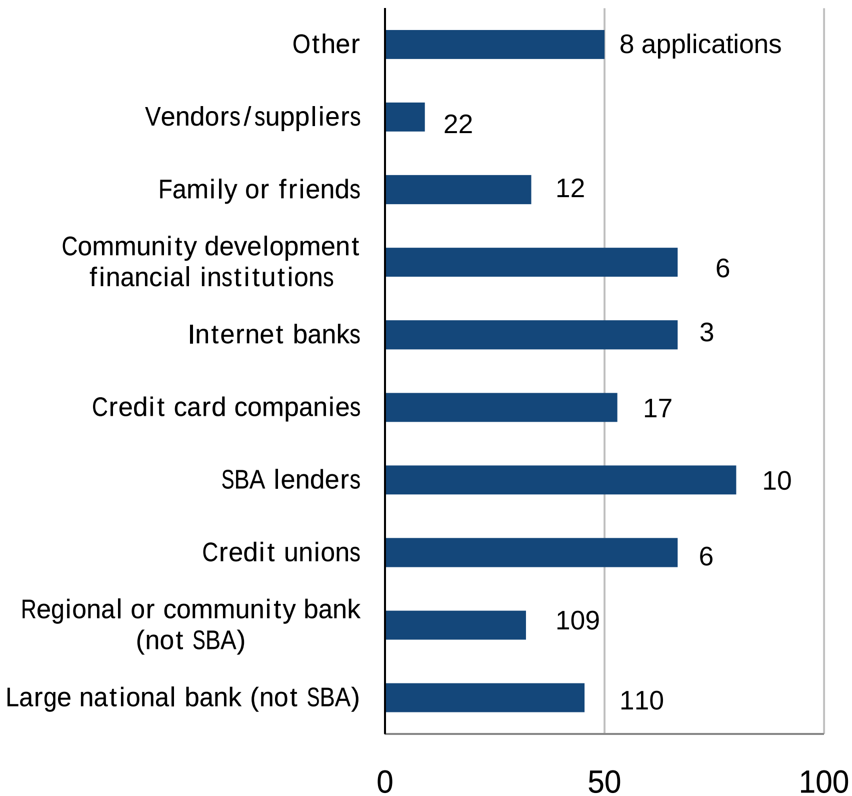


Notes: Each box plots: minimum, maximum, 25th, 50th and 75th percentiles.
1= firm was denied credit (=none), 2= firm refused credit due to terms, 3= firm received much less than the financing requested, 4= firm received most , 5= firm received all of the financing requested.

- For each of the 117 firms that sought credit in the past three months, the Financing Index is a weighted average of the outcome of the firm's credit channel applications (see the note below the chart for the weights).
- An index of 1 indicates a firm was turned down on all applications, while an index of 5 implies full financing on all applications.
- This chart illustrates the distribution of the Financing Index across firms.
- Overall, 50% of firms have an index level above 4, suggesting they received most or all financing. In contrast, within construction and real estate firms, 50% have an index level below 2.5.

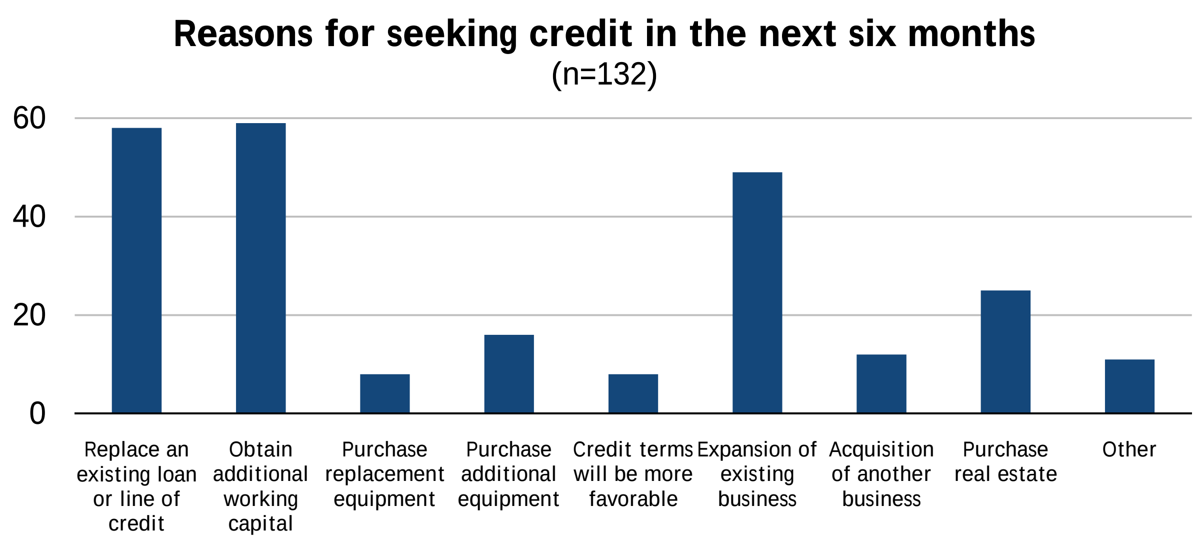
Denial Rates

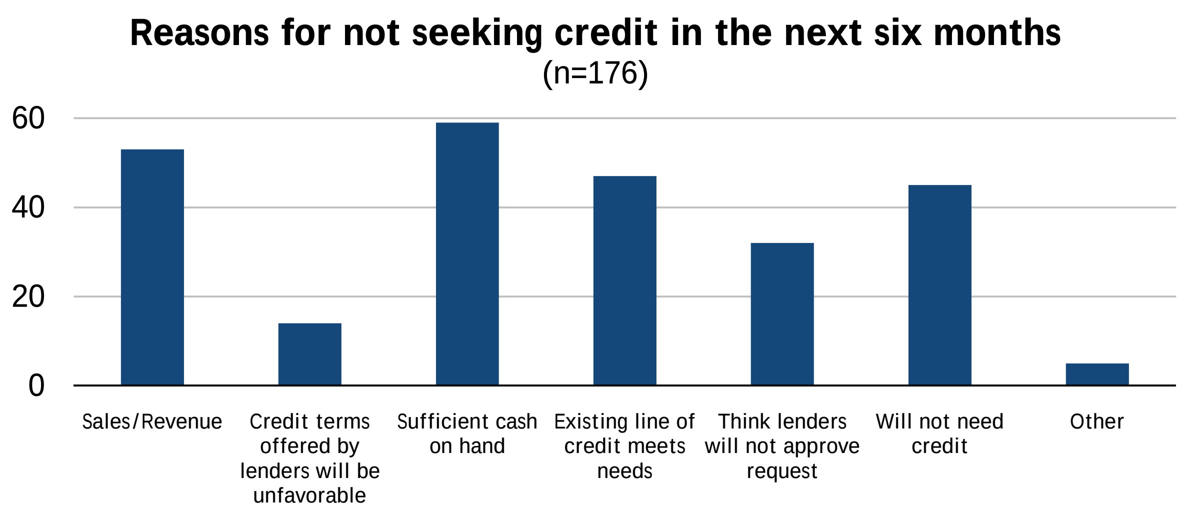
Denial rate by financing type:
Percent of firms applying to source



- Denial rates at large national banks were markedly higher than at regional/community banks (45% versus 32%).
- Construction and real estate applications were denied more often both at large national banks (53% versus 39% for all other industries) and at regional/community banks (35% versus 29%) .
- At large national banks, lines of credit exhibited lower denial rates than loans for industries outside of construction and real estate (31% for lines of credit versus 56% for loans). Line of credit applications at these banks were also more likely to receive the full amount requested (56% versus 33% for loans) for all industries.
- Many of the other categories received few applications, so their denial rates should be viewed cautiously. However, it is interesting to note that SBA lenders denied 8 of the 10 applications reported. Vendors and suppliers, on the other hand, denied only 2 of 22 requests.

Plans to Seek Credit in the Next Six Months

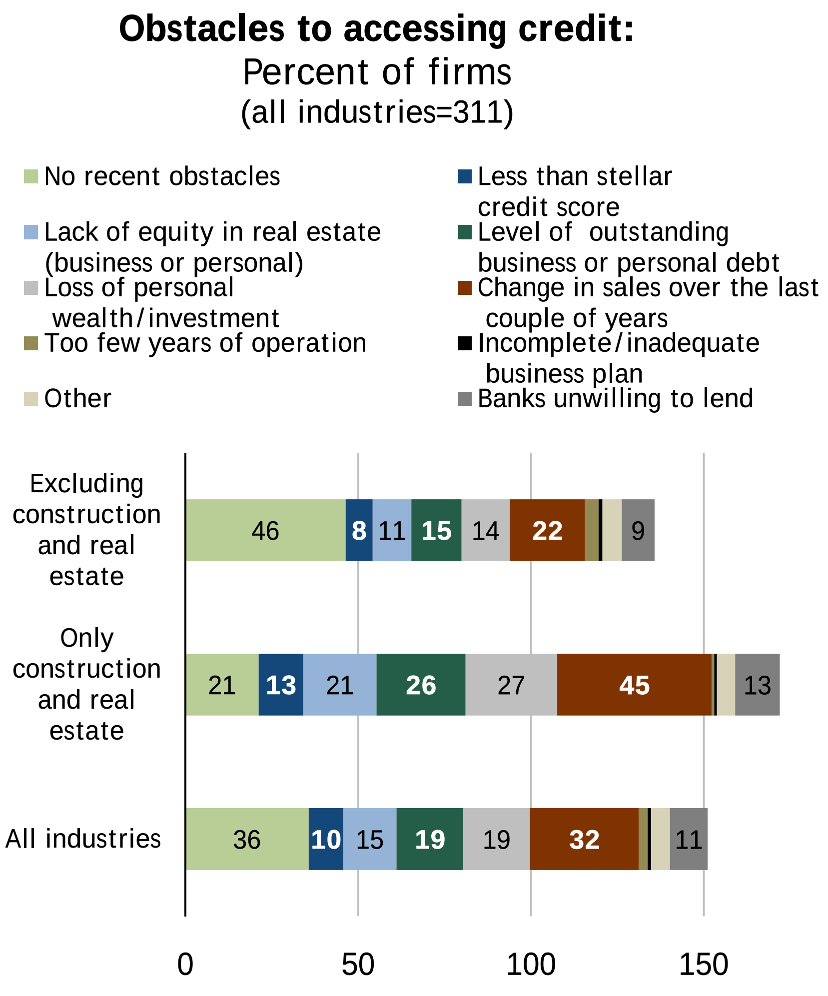




Note: Three firms did not indicate if they anticipated trying to obtain a loan or line of credit in the next six months.

- 42% of firms anticipate seeking credit in the form of a loan or line of credit in the next six months, including 51% of the 132 firms in construction and real estate.
- 61% of firms that applied for credit in the past three months anticipate applying again in the next six months, while 71% of the firms that did not apply also have no plans to do so.
- While refinancing remains a significant source of credit demand, additions to working capital (45%) and the expansion of business (37%) are also cited by a large percentage of respondents.
- Concern over the outlook for sales, sufficient cash on hand, and existing financing continue to be factors in the decision of firms not to seek credit in the future. Of those that will not seek credit, 18% of firms do not anticipate that their application will be approved, while 8% anticipate unattractive credit terms. Again, these concerns are more prevalent among construction and real estate firms.

Obstacles to Accessing Credit



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

- Overall, 36% of firms do not perceive any obstacles to accessing credit, though opinions differ across industries. 21% of construction and real estate firms versus 46% of firms in other industries do not perceive obstacles.
- Across all industries, the largest obstacle noted is the impact of the recession and housing market decline (which translate to a decline in sales over the past two years). Other obstacles reported address the quality of the credit application or lack of collateral (e.g. the level of personal/business debt, weak credit score, or lack of equity in real estate).
- Among the 40 firms denied credit at least once in the past three months, only 9 report that banks are an obstacle. Roughly 50% cite declining sales, level of outstanding debt, and a decline in personal wealth.