



Small business credit still a problem:

Expanding credit union member lending authority a much-needed first step

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Table of Contents

Introduction	3
The Small Business Credit Crunch	3
A Piece of the Solution: Expanded Credit Union Member Business Lending	4
A Proposal with No Downside	5
Conclusion	6
Contributors	7

Introduction

American small businesses create 65 percent of all net new jobs and employ roughly half of all workers in the private sector.¹ According to the Kauffman Foundation, businesses founded between 1970 and 2000 (some of which grew into large businesses during those years) provided *all* net private sector job growth during that timeframe.²

During recovery phases in particular, these new jobs prove essential to American economic growth and prosperity. Increased hiring is the first sure sign of an economic recovery. Given that increased hiring must include hiring by small businesses, any public policy that impedes small businesses' ability to grow and hire can be considered a problem for the economy as a whole. To create jobs small businesses need dependable access to credit. They often can't get it.

This paper reviews challenges smaller enterprises face in obtaining credit, and outlines potential benefits that one proposal—a modest change in the regulations governing credit unions—could have in providing much needed access to small business credit. It describes how this proposed legislation would free up \$13 billion in capital and create 140,000 jobs at no cost to taxpayers, and then reviews its likely consequences.

The Small Business Credit Crunch

The current situation is straightforward: Small business owners agree that access to credit is a problem. Small Business Majority's opinion polling reveals 90 percent of small business owners believe the availability of credit is a problem, and three in five say it is harder to get a loan now than it was four years ago. Many small business owners are now turning to credit cards for help financing: 52 percent report they have used credit cards to finance their own business.³

Data collected by government and private sources bears out this widespread sentiment. Thompson Reuters/Paynet Small Business Lending Index, the most commonly used index of small business credit accessibility, fell five out of the previous six months. Most recently, it rose by 3 percent, after declining 5 percent in June. Nonetheless, the index still remains well below both its benchmark year of 2005 and its 2007 all-time high.⁴ Likewise, measures of national loan volume compiled by the Federal Reserve Bank of Cleveland show that loans typically going to small businesses (loans less than \$1 million) have not yet recovered to pre-recession levels of 2007.⁵ Although lending levels have increased slightly, the Federal Deposit Insurance Corporation's own loan data shows that lending to smaller businesses overall hit a 10-year low in 2011.⁶ Even though we have seen some preliminary signs of hope of this year, there are structural impediments that stand in the way of a full rebound: much small business bank lending comes from newly formed banks that lend to smaller enterprises as a way of building a loan portfolio in the first place. And new institutions are not being created. FDIC has not chartered a single new savings institution since 2009 or a single commercial bank since 2010.⁷ Between the mid-1990s and 2007, the FDIC would charter more than 100 commercial banks and a handful of savings institutions in a typical year.⁸

¹ Small Business Administration office of Advocacy. "Facts About Small Business," <http://web.sba.gov/faqs/faqIndexAll.cfm?areaid=24>

² Kauffman Foundation. "Entrepreneurship and the Economy," http://www.kauffman.org/uploadedfiles/factsheet/entrep_and_economy_fast_facts.pdf

³ Small Business Majority, American Sustainable Business Council and Main Street Alliance. "Opinion Survey: Small Business Owner Opinions on Access to Credit and Proposals to Boost the Economy," January 26, 2012, http://www.smallbusinessmajority.org/small-business-research/access-to-credit/access-to-credit_opinion-poll.php

⁴ Thomas Reuters Paynet. "Small Business Lending Index, June 2012 Update," http://thomsonreuters.com/content/financial/pdf/i_and_a/indices/small_business_lending_index_06012.pdf

⁵ Matthew Koepke and James B. Thomson. "Small Business Lending Continues to Struggle," Federal Reserve Bank of Cleveland, June, 2011, <http://www.clevelandfed.org/research/trends/2011/0711/01finmar.cfm>

⁶ Federal Deposit Insurance Corporation. "Reports of Condition and Income 2012," http://www2.fdic.gov/Call_TFR_Rpts/

⁷ See Federal Deposit Insurance Corporation. "Historical Statistics on Banking: Commercial Banks, Changes in Numbers of Institutions, FDIC Insured Commercial Banks," <http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=10> and "Historical Statistics

Since there is not likely to be any change in the types of institutions lending, it is important to note that most existing classes of lenders are not particularly eager to provide these smaller loans. Surveys of business investors and loan underwriters reveal a relatively healthy market for large business loans and investments, combined with an unwillingness to make loans to or investments in small businesses.⁹ In all, researchers at Pepperdine University found only 17 percent of enterprises seeking loans under \$5 million actually secured them.¹⁰ The news was even more grim for small businesses: only 6 percent of investments funded loans of less than \$1 million, often considered the metric for “small” business lending.¹¹ An August 2012 survey by the Federal Reserve Bank of New York, (which, notably, included firms as small as two people) found only 13 percent received the amount of credit they sought.¹² This data all substantiates the idea that the capital small businesses are seeking greatly outweighs what’s being made available to them.

There have been governmental efforts to address this lack of credit, but there is still much work to be done. The bipartisan Small Business Lending Fund provided more than \$4 billion to 332 community banks and community development loan funds in hopes that they would lend to small businesses. Likewise, the Small Business Administration has backed record numbers of loans (worth more than \$30 billion in 2011). However, this increase has not fully made up for a decrease in non-SBA lending, and likely displaced at least some lending that would have happened without the SBA.¹³ As a result of this problem, increasing numbers of businesses have turned to non-bank options altogether, such as “factoring” (selling receivables) and trying to survive without loans at all.¹⁴

The bottom line is simple: America’s small businesses face a credit crisis that changes in public policy to date have not remedied. While it is not desirable that all small businesses get credit—lenders must maintain prudent underwriting standards—a healthy small business economy requires greater access to capital than now exists. As the economy continues to struggle, it behooves policy makers to consider every reasonable approach to resolving the small business credit crunch.

A Piece of the Solution: Expanded Credit Union Member Business Lending

Given the significant unmet demand for small business credit, it appears unlikely that any single public policy could, by itself, solve the small business credit crunch. Nonetheless, one policy that has received significant bipartisan support in the current Congress appears to have real promise: expanding credit unions’ ability to lend to their own members.

The proposal before Congress would allow credit unions—member owned, democratically run cooperatives that provide financial services—to lend as much as 27.5 percent of their assets, up from the 12.25 percent allowed under current law.¹⁵ This proposal meets the needs of small business: it would

on Banking: Commercial Banks, Changes in Numbers of Institutions, FDIC Insured Savings Institutions, United States and Other Areas,” <http://www2.fdic.gov/hsob/HSOBRpt.asp>

⁸ Ibid.

⁹ John Paglia, *Pepperdine Private Capital Markets Project Survey Report 2011-2012*, Pepperdine School of Business and Management, 63.

¹⁰ Ibid, 61.

¹¹ Ibid.

¹² Federal Reserve Bank of New York. “New York Fed Survey Provides Insight into Regional Small Business Credit Environment,” August 14, 2012, http://www.newyorkfed.org/newsevents/news/regional_outreach/2012/an120813.html

¹³ Small Business Administration. “All Time SBA Loan Volume in Fiscal Year 2011,” <http://www.sba.gov/community/blogs/official-sba-news-and-views/open-business/all-time-sba-loan-volume-record-fiscal-year>

¹⁴ KC Ifeanyi. “New Rules of Getting a Small Business Loan,” *Inc.* June 29, 2011.

¹⁵ The bill is the Credit Union Small Business Jobs Bill or Credit Union Small Business Lending Enhancement Act: S. 2231 and H.R. 1418.

create a significant number of jobs, has no direct cost to taxpayers and brings willing capital together with businesses that want it. Not surprisingly, small businesses support this proposal by more than 2:1 ratio.¹⁶

This bill would free up roughly \$13 billion in capital at no cost to taxpayers.¹⁷ Since the average credit union loan is quite small—\$219,000—credit union lending will fill the exact voids where credit from other sources is in shortest supply.¹⁸ Outstanding loan volume currently stands at about \$590 billion, according to the Small Business Administration.

By itself, the proposal does not solve the small business credit crunch.¹⁹ But it makes a meaningful difference—perhaps bigger than that of the Small Business Lending Fund—and does so in a free market way.

The credit union proposal will not require any public resources. It's a simple deregulatory legislation that can be implemented at no cost to the taxpayer. And, it doesn't require any person or institution to do anything they do not already want to do. Credit unions that don't see it in their member interest to increase lending to small businesses aren't obligated to do so. But the overwhelming evidence is that credit unions have billions of dollars to lend, and because of current restrictive laws, they can't: credit union business lending has grown markedly in recent years and all of the major credit unions and credit union trade associations support increased member business lending.²⁰

A Proposal with No Downside

This proposal, which would help create small business jobs, has no real downside. It would not decrease the stability of credit unions and would not displace a significant amount of existing bank lending.

Historically, credit union small business lending has proven to be safe. Credit unions had no caps on their ability to lend to businesses prior to 1998 and they currently have a loan delinquency rate 20 percent lower than that of banks.²¹ The proposed legislation will ensure this fiscal soundness continues. It will be backed by the oversight of the National Credit Union Administration, an independent federal agency that charters and supervises federal credit unions. Only well-capitalized, experienced credit unions that meet a number of ongoing tests would be qualified to increase their small business lending.

There's no evidence that raising the credit union business lending cap would significantly displace bank lending or, as a banking trade group puts it, allow credit unions to "cherry pick" loans.²² If credit unions wanted to "cherry pick" loans from banks, they would be doing it already. The reason they aren't is because a greatly disproportionate share of credit union member business lending—now and in the foreseeable future—takes place in highly specialized categories such as taxicab medallions and agriculture, where banks and others have shown little inclination to make loans of any kind.²³

That said, allowing credit unions to make more business loans would mean more competition for banks. Some loans that banks would make money on would also make good business sense for credit unions, and

¹⁶ Small Business Majority, American Sustainable Business Council and Main Street Alliance. "Opinion Survey: Small Business Owner Opinions on Access to Credit and Proposals to Boost the Economy," January 26, 2012,

http://www.smallbusinessmajority.org/small-business-research/access-to-credit/access-to-credit_opinion-poll.php

¹⁷ Credit Union National Association. "Credit Union Small Business Jobs Bill," <http://www.cuna.org/download/mb/mb/mbtps.pdf>

¹⁸ Ibid.

¹⁹ Victoria Williams. *Quarterly Lending Bulletin*, Small Business Lending, First Quarter 2012, Small Business Administration, http://www.sba.gov/sites/default/files/SBL_2012Q1.pdf

²⁰ See e.g. Adam Belz. "Credit Unions Growing Commercial Lending Business," in *USA Today*. July 7, 2011.

²¹ Lydia Coal. "Where Delinquency Rates Really Stand," Creditunions.com, March 12, 2012, <http://www.creditunions.com/where-delinquency-rates-really-stand/>

²² Independent Community Bankers Association. "Expanded Business-Lending Cap Risky, Controversial Among Credit Unions," <http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=129239>

²³ Eli Lehrer. "Taxicab Medallions and Heirloom Tomatoes to the Rescue: How Expanding Credit Union Lending Can Help Small Businesses Survive the Credit Crunch," The Competitive Enterprise Institute, September 18, 2007,

<http://cei.org/sites/default/files/Eli%20Lehrer%20-%20Taxicab%20Medallions%20and%20Heirloom%20Tomatoes%20to%20the%20Rescue.pdf>

therefore, banks should expect to compete with credit unions for some small business loans. For those interested in the welfare of banks alone—their management and stockholders—the lending proposal is easy to reject outright. On the other hand, this legislation would give small businesses a major advantage as they seek capital. Small businesses need this advantage: six in 10 of them have faced difficulty themselves when trying to obtain loans that would grow their businesses.²⁴ These entrepreneurs are our chief job creators, and therefore, promoting healthy competition among lenders can be seen as beneficial to the economy as a whole.

Conclusion

Small businesses face a real and ongoing credit crunch. Expanded credit union member business lending can help confront it—at no cost to taxpayers, with no increased risk to the public sector and without significantly displacing existing bank lending. While the size and scope of the credit union lending proposal is not big enough to solve the small business credit crunch by itself, raising credit unions' member business lending cap would nonetheless be a positive first step in addressing the national small business credit crisis.

²⁴ Small Business Majority, American Sustainable Business Council and Main Street Alliance. “Opinion Survey: Small Business Owner Opinions on Access to Credit and Proposals to Boost the Economy,” January 26, 2012, http://www.smallbusinessmajority.org/small-business-research/access-to-credit/access-to-credit_opinion-poll.php

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