Direct from Main Street

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Washington Small Business Views on Credit and Lending

Main Street Alliance of Washington • Alliance for a Just Society

Acknowledgments

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Introduction

As the United States continues to experience the worst economic downturn since the Great Depression, small businesses are seeing their sources of credit dry up. Normally an economic engine, small businesses now face severe challenges in their role as job creators and sustainers. Given the key role of small businesses in our economy, their experiences should be of particular concern to policymakers.

This report shares the findings of a survey of Washington small businesses, focusing on their experiences with credit and their reactions to one current proposal to support small businesses and economic growth: the creation of a state community investment bank. This report contributes to the discussion of such a proposal by sharing the perspectives of Washington's Main Street small businesses.

Key Findings

- More than half (56 percent) of surveyed small business owners reported some tightening of credit. Of these, half (52 percent) decided not to seek a bank loan because they were discouraged.
- Two thirds (68 percent) of small business owners experiencing difficulty accessing credit report that this has hurt their ability to make necessary investments in their business.
- A strong majority of respondents (69 percent) believe elected officials have not done enough to support small businesses and economic recovery.
- An even stronger majority (79 percent) would support the creation of a state community investment bank like North Dakota's.

Background

The Important Role of Small Businesses in the Economy

Small businesses represent a key force in the economy of the United States and in Washington. As of September 2009, small businesses employed just over half of the country's private sector workforce. Services and small-scale manufacturing provided by small businesses have become an economic base on which local commerce rests, as small businesses make up 99.7 percent of the employer firms in the U.S.[1]

In an analysis of 2006 pre-recession data, the National Community Reinvestment Coalition (NCRC) found that lending to small businesses increased employment on a county level.[2] Looking at Community Reinvestment Act (CRA) funding, communities where small businesses had increased levels of CRA-based lending correlated with higher levels of employment. By focusing on county-level change, this research illustrates the strong impact of local lending on community employment.

However, small businesses continue to face challenges to spurring the economy. A U.S. Congress Joint Economic Committee (JEC) national study notes that, as we came out of the deepest levels of recession, large establishments increased hiring levels in mid-2009, while small business employment continued to decline into early 2010 and remained stagnant into mid-2010.[3] Because small businesses represent a force for economic activity and employment, in order to promote economic recovery it is vital to understand what challenges they face in the current economic downturn.

The Credit Crunch Continues

Although big banks pledged in 2009 to increase lending to small businesses, few have come close to their goals and many continue to contribute to a climate where 41 percent of business owners feel they cannot get adequate credit.[4] Well into the long climb out of recession, many small businesses have been left to seek alternatives or go without the support of credit for purchasing inventory and supplies, meeting payroll and hiring new employees, paying for marketing and publicity, and taking advantage of opportunities to expand.

When the recession hit, lenders began tightening credit standards and reported continued tightening into 2009.[5] Large banks state they have begun lending again but that limited demand exists from creditworthy small businesses.[6]

However, many small businesses and small business advocates also believe that the banks continue to apply overly strict standards of creditworthiness.[7] Furthermore, the initial tightening of credit appears to be self-reinforcing. According to National Small Business Association (NSBA) president Todd McCracken, "banks lowered existing credit lines of many small business customers, which in turn lowered their credit scores because they were left using a higher percentage of their available credit." [8]

Finally, the clampdown on credit and the deterioration of credit terms may be depressing demand. Some portion of lowered demand is likely attributable to "discouraged borrowers" who would like credit but do not seek it out because they believe they will be denied.[9] Similarly, some small businesses may be holding off from seeking loans or other forms of credit because credit has become more costly for them.[10]

Debbie Taylor
President
Greater Granite Falls Chamber of Commerce

As the President of the Granite Falls Chamber of Commerce for the past two years, I have had the opportunity to be closely affiliated with many of the small businesses in our community. The struggle that they have endured financially has made it difficult for many to stay open and some businesses have actually closed their doors. The major obstacle is that these businesses have had nowhere to go to obtain capital to keep their businesses afloat.

It is vital that our community banks be able to provide funds for our small businesses. Community banks have been long-time supporters of small businesses, and, without them, we may see even more dissolve. I encourage any program that will help lend a hand to our community banks so that they can filter the capital that small businesses need to keep their doors open. Our towns, cities, counties, and states cannot survive without the people who work so hard every day to provide basic services for their local communities.

High Costs of the Credit Crunch

Small businesses are paying a high price for the credit crunch. At the same time that banks restricted access to traditional loans, credit card issuers raised interest rates, increasing the costs of credit for small business owners and making that credit less reliable.[11] Many small business owners also have seen their credit card issuers change interest rates from fixed to variable, adding to the instability.[12] Meanwhile, the crash of the housing market has limited home refinancing as a source of credit.[13]

These costs have a ripple effect. Across the country, small business owners have stated that the lack of adequate credit has prevented them from hiring new staff as they had planned, leaving communities without needed jobs.[14] Equally troubling, small businesses have reported that lack of available credit has damaged their ability to buy inventory sufficient to meet demand [15] – suggesting that the credit crunch is interfering with the economic activity necessary for recovery.

Recent Federal Legislation to Support Small Businesses and Economic Recovery

In September 2010, President Barack Obama signed into law H.R. 5297, the Small Business Jobs Act of 2010.[16] Among other things, this new legislation will increase the availability of and funding for Small Business Administration (SBA) loans and provides federal financial support for small business lending by community banks.[17] It also contains tax deductions and other tax-related measures to reduce business expenses. This federal legislation represents a step forward. At the same time, state policymakers are looking at ongoing state solutions that would support the small business sector and economic growth in Washington.

The Bank of North Dakota and the Proposal to Create a State Community Investment Bank

One such proposal is the creation of a state community investment bank, such as the one now in place in North Dakota. The Bank of North Dakota was created in 1919 in response to tight credit markets that were threatening the viability of the state's agricultural sector,[18] a situation similar to the credit crunch now experienced by small business.

Looking toward its 100th year, the bank is an important player in that state's economy, partnering with more than 100 other financial institutions to spur economic activity.[19] During the worst days of the recession, North Dakota was not hit as hard as many other states in terms of unemployment and other consequences of the downturn, prompting considerable interest in the model it presents. [20] The bank receives deposits from public agencies and uses that money to promote local economic development.[21] Community bankers in North Dakota credit the state community investment bank with assisting local development projects, while they have greater difficulty finding support from other lenders.[22]

Key among the bank's activities is its support for small business lending. It engages in this lending primarily in collaboration with other financial institutions, supporting their loans to small businesses. This participation lending involves either providing funds to increase the size of loans, buying down interest rates, or offering loan guarantees.[23] Compared to similar states, lending has been more robust in North Dakota, with small- and medium-sized banks registering more loans per capita and higher loan-to-asset ratios over the past five years.[24]

By collaborating with other lenders, the Bank of North Dakota supports and helps stabilize the state's banking market, which has a higher number of bank offices per capita and less market concentration than in comparable states.[25] The Bank of North Dakota's presence alongside local banks has been described as producing "a 'crowding in' effect – keeping [those banks] liquid, lending to local businesses, and fueling economic growth,"[26] at a time when larger institutions have closed off to providing credit.

The Bank of North Dakota also plays a role in reinvesting public funds in North Dakota. In addition to funding local economic development, the bank runs a profit and typically directs over 70 percent of its earnings back into the state general fund. It delivered $30 million in 2009, one of the toughest years on economic record.[27] This contributed to North Dakota being one of only four states to avoid a revenue shortfall in 2010 and the only state to avoid one in the past two years[28] – a time when other state and local governments are slashing funding for schools, clinics, libraries, and other key public functions.[29]

Joe Fugere
Tutta Bella
Neapolitan Pizzeria
Seattle

Reinvigorating small business lending from community banks is essential to allow small businesses to grow, create jobs, and build the economy. As a small business owner, I know this firsthand. I am the owner of Tutta Bella Neapolitan Pizzerias. The first Tutta Bella opened in 2004. Thankfully, the restaurant was successful and propelled me to open two additional locations, both funded by loans from a large commercial bank.

Despite my success, I was turned down for a loan from a big bank when I tried to open my fourth location. So I approached a local community bank where I could be on a first-name basis with the president and secured a loan to open a new location. Within a few weeks, the loan was approved, and on June 15, 2009, in the midst of what some have called economic Armageddon, I opened the fourth Tutta Bella – the most successful opening to date in terms of revenue and the number of customers served. This restaurant employs 50 people and has been welcomed and embraced by the community.

In August 2010, Tutta Bella was recognized nationally as the "Independent Pizzeria of the Year" by *Pizza Today* magazine. With more than 33,000 pizza restaurants across the country, it truly is an honor. Although it does make me question what's going on with the big banks. If a successful and growing business like Tutta Bella can't get financing from the big banks, who can?

I believe that tax revenue and fees should be directed to support local business growth by getting capital flowing to community banks. These community-based lenders provide affordable funding to thriving small businesses, which, in turn, nourish the path to economic recovery.

Methodology

Between October and December 2010, the Main Street Alliance of Washington conducted a survey of 107 small businesspeople around Washington, including the following locations: Arlington, Bellingham, Bothel, Brier, Dayton, Kennewick, Lakewood, Lynnwood, Marysville, Mill Creek, Olympia, Seattle, Snohomish, and Tacoma. Surveyors contacted respondents through door-to-door canvassing of visible storefronts within business districts and/or emails to business owners who previously had expressed interest in the Main Street Alliance of Washington and its activities.

Survey results are rounded to the nearest percentage point. In some cases, the combined tallies for a particular question may not sum to exactly 100 percent due to this rounding.

Findings

This survey questioned Main Street small business owners about their experiences with credit and about their perspectives on a proposal to create a state community investment bank.

Respondent Information

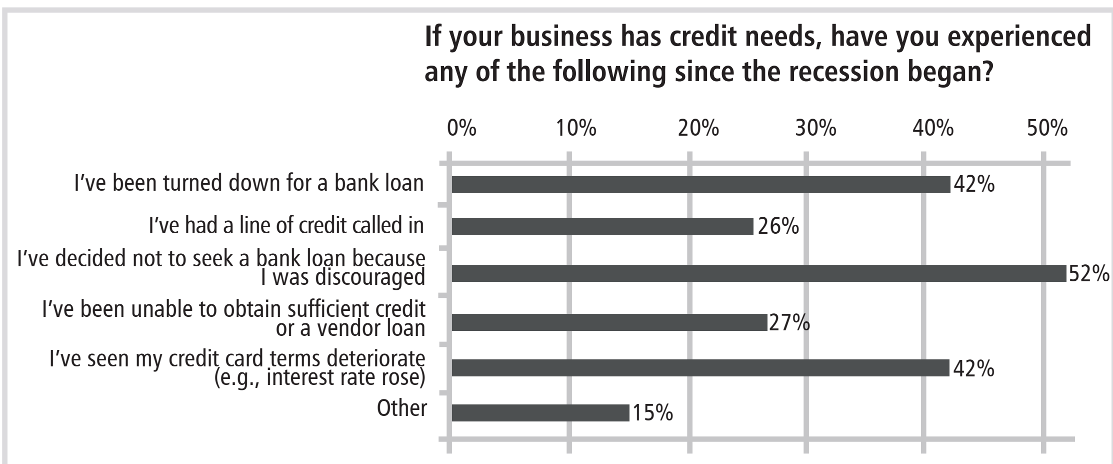
Respondents included small employers (66 percent) and self-employed business owners (44 percent). Forty-one percent employed one to five employees. Respondents represented a wide range of Main Street small businesses, including retail shops, restaurants and delis, real estate services, farmers, suppliers, personal and professional services, and others.

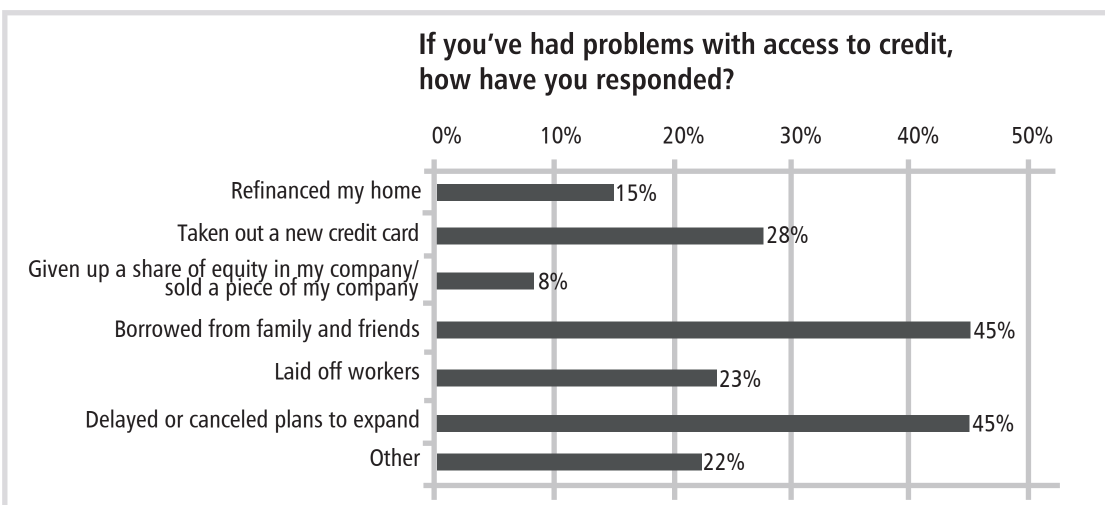
Experiences with Credit

The survey asked small business owners about their experiences with credit. More than half (56%) of surveyed small business owners reported feeling some tightening of credit. Of these, 52 percent reported that, since the recession began, they had decided not to seek a bank loan due to being discouraged. Forty-two percent had been turned down for a bank loan, while the same percentage of respondents saw their credit card terms deteriorate. Twenty-seven percent were unable to obtain sufficient trade credit or a vendor loan, and 26 percent experienced a line of credit being called in.

Small business owners experiencing difficulty accessing credit responded in a variety of ways. Nearly half (45 percent) delayed or canceled plans to expand; the same share borrowed from families or friends. This was followed by 28 percent that took out new credit cards and 23 percent that laid off workers. Additional responses by surveyed businesses include reducing one's own pay, cashing out retirement savings, and cutting staff hours, among others.

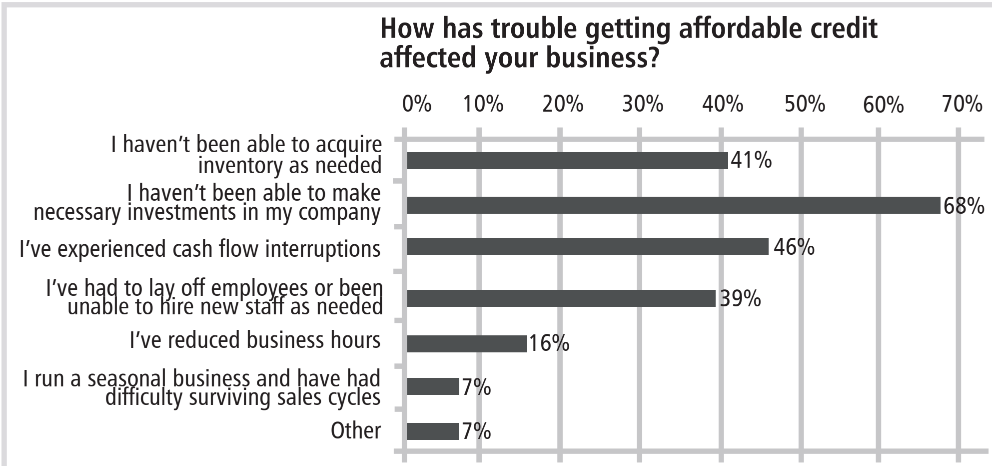
Small business owners reported a variety of effects from their difficulty obtaining credit. Sixty-eight percent have been unable to make necessary investments in their companies (such as equipment purchases, marketing, or expanding the physical plant). Almost half (46 percent) reported experiencing cash flow interruptions, followed by 41 percent who were unable to acquire needed inventory and 39 percent that had to lay off staff or were unable to hire new staff as needed.





Forty-one percent of surveyed businesses believe they would have been able to create additional jobs had they not encountered credit problems, with 52 percent of those believing they would have been able to create between one and five jobs, respectively.

In total, of the 107 businesses surveyed, 44 believe they could have created additional jobs if they'd had sufficient credit. Those 44 businesses report that, with sufficient credit, they could have created a combined 191 to 385 or more jobs, an average range of 1.8 to 3.6 additional jobs per business surveyed.



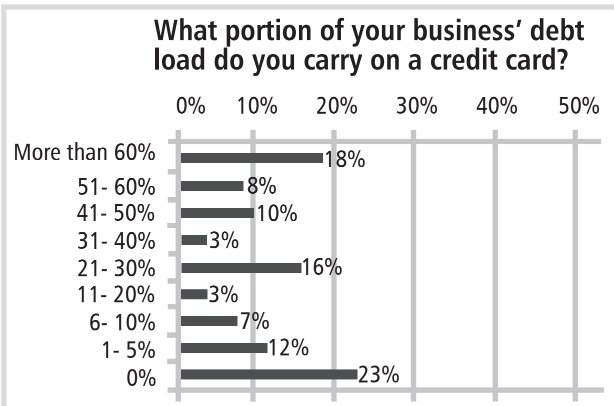
Lorraine Read
Uppercase Books
Snohomish

I've been the owner of Uppercase Books for the last four years, but it has been a landmark and successful business in Snohomish for the last 13 years. I love interacting with customers, getting to know them, and helping them find good books. Helping people find the book they want is remarkably easier when I have a bigger inventory. Recently, I sought to extend a line of credit with my bank to increase the new book inventory for the holiday season.

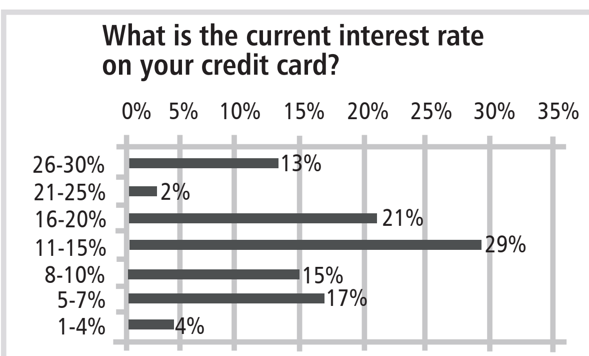
I was hoping to get a Small Business Administration (SBA) Bridge Loan, which was a zero-interest loan created by President Obama to support viable small businesses through these economic hard times. But you had to get the loan through the primary financial institution used by your business – in my case, a big national bank. However, the big bank I use didn't offer SBA bridge loans. I then tried to extend my existing line of credit, but the bank wouldn't extend the credit, because, in general, they see small business as a risky investment during the recession. This line of credit would help my established business maximize on new book sales.

As a result, I wasn't able to buy as many books as I've needed, which absolutely affects my bottom line. Local and community banks have the capacity to get to know you and your business and provide credit when it makes sense. I think small business owners like me would benefit from having a bank in Washington, like North Dakota's state community investment bank, that supports local and community banks lending to small businesses.

The survey also questioned small businesses about their experiences with credit cards. Many participating small business owners have avoided relying on credit cards, with 23 percent of respondents stating that they carry none of their business debt on a credit card. For those who did, the portion of debt ranged from one to five percent (12 percent of respondents) to more than 60 percent (18 percent of respondents).



For those respondents reporting use of a credit card, interest rates ranged from a rate of one to four percent (four percent of respondents) to a rate between 26 and 30 percent (13 percent). The largest portion had rates between 11 and 15 percent (29 percent of respondents), followed by 16 to 20 percent (21 percent of respondents).



Artranetta Gray
Artradina's Thriftique
Seattle

After years of collecting vintage, I founded Artradina's Thriftique in 2008. I started my business with $1,200 to open shop, but I had a community effort behind me. I went to friends, family, and church to see what they wanted to donate to my business. Three years later, Artradina's has grown to a successful vintage shop in Seattle.

I started my business without a loan to build capacity. I wanted one, but the business climate wasn't good at the time. If I'd had an affordable business loan when I started, I could have hired people to help me expand.

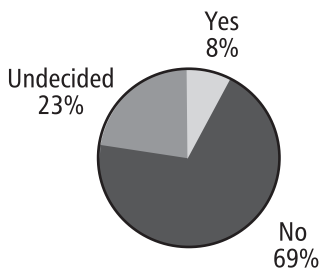
Right now, I want to take my business to the next level, advertise, expand to a larger location, expand my inventory, and hire a few employees. I believe in strong small business communities, but we, as a community, need to support small businesses to help them grow. That's why I support using our taxes and fees to support community and local banks giving loans to small businesses.

Small Business Perspectives on a Washington Community Investment Bank

In addition to questioning small businesses about their experiences with credit, the survey asked respondents about their perspectives on government action and the state community investment bank proposal.

When asked whether elected officials have done enough to support small businesses or promote economic recovery, 69 percent of respondents said no. Another 23 percent were undecided.

Do you believe that elected officials have done enough to support small business and promote economic recovery?

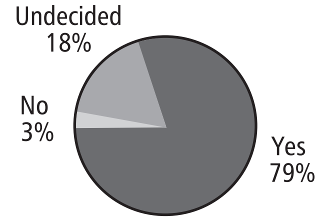


The survey also asked small businesses about their views on a state community investment bank. Specifically, it asked:

> The state of North Dakota has a state bank that supports small business lending by providing matching funds for loans to commercial banks. The state bank of North Dakota has been credited with maintaining the flow of credit to small businesses, as well as increasing revenue for the state. Would you support the creation of such a bank in your state?

Seventy-nine percent of respondents said they would support such a bank, with 18 percent remaining undecided and three percent opposing.

Would you support the creation of such a bank [like the Bank of North Dakota] in your state?

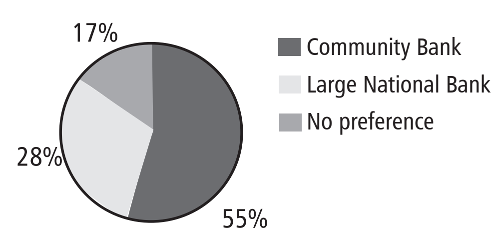


Small Business Owners' Banking Preferences

Finally, the survey asked small business owners whether they preferred banking with a large, national bank or a community or local bank. More than half of respondents (55 percent) preferred banking with a community bank, compared to 28 percent that prefer banking with a large national bank, and 17 percent expressing no preference.

The survey then asked respondents to compare community and large banks. Large portions of respondents said that local or community banks invest more in the neighborhood or area where the respondent's business is located (98 percent), have better customer service (87 percent), and provide credit more affordably (83 percent). Seventy-five percent responded that community banks have provided more credit for their business, compared to 25 percent that responded that large national banks have provided more credit. When it came to offering more options, 54 percent said that community or local banks offer more options; 46 percent responded that large national banks offer more options.

Do you prefer banking with a large national bank or a community or local bank?



Conclusion

Small businesses continue to suffer the effects of the economic downturn, undermining recovery for entire communities and the state as a whole. Main Street small business owners who participated in this survey are feeling the credit crunch in a variety of ways.

A majority believe that elected officials have not yet done enough to promote small business and economic recovery. Additionally, a strong majority support one proposal to increase small business lending: the creation of a Washington state community investment bank.

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The Main Street Alliance of Washington is a coalition of more than 2,000 small businesses across Washington state. We work strategically to provide small businesses a voice on the most pressing public policy issues of our time. Our advocacy promotes vibrant businesses and healthy communities, and fosters leadership development of socially responsible business leaders.

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The Alliance for a Just Society convenes community and racial justice organizations nationwide on critical public policy issues, providing research and policy analysis and fostering public conversation.

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