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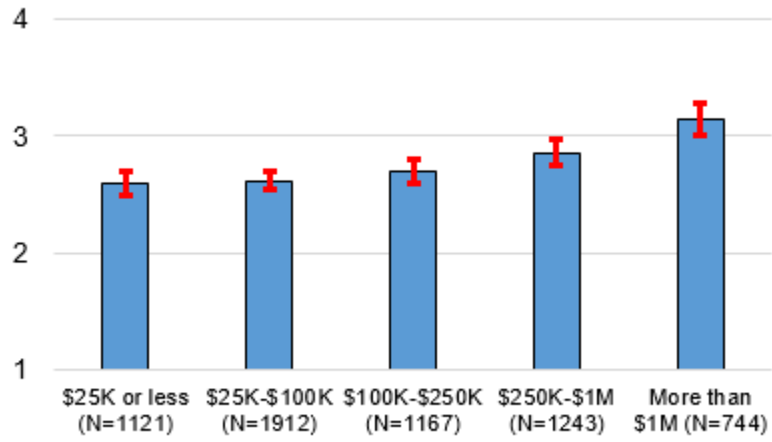
Are Small Loans Hard to Find? Evidence from the Federal Reserve Banks' Small Business Survey

The Federal Reserve Banks recently released results from the nationwide 2016 Small Business Survey, which asks firms with 500 or fewer employees about business and financing conditions. One key finding is just how small the financing needs of many businesses are. One-fifth of small businesses that applied for financing in the prior 12 months were seeking $25,000 or less. A further 35 percent were seeking between $25,001 and $100,000.

The data also show that firms seeking relatively small amounts of financing (up to $100,000) receive a significantly smaller fraction of their funding than firms who applied for more than $250,000. Chart 1 shows the weighted average of the share of financing received by the amount the firm was seeking.

Chart 1
Financing Received by Amount Sought
Weighted average (1=none and 4=all)



Note: The range specificed by the red line is the 95 percent credibillity interval around the mean.
Source: 2016 Federal Reserve Banks' Small Business Survey

So what explains this variation in financing attainment across the amount requested? We've heard reports from small business owners that smaller loans are relatively more difficult to obtain, especially from traditional banks. One often-cited rationale is that the administrative burden associated with originating and managing a small loan is often just not worth the bank's time. However, this notion is not entirely consistent with data on the current holdings of small business loans on the balance sheets of banks. As of June 2015, loans of less than $100,000 made up about 92 percent of the number of business loans under $1 million.

So it seems originating a loan for less than $100,000 is not uncommon for a bank after all. So why, then, do business owners say that smaller loans are more difficult to get? Using data from the 2016 Small Business Survey, we can investigate the reason for this apparent disconnect.

Much can be explained by looking at the characteristics of those who borrow small amounts versus large amounts. Firms seeking $25,000 or less are more likely to be high credit risk and younger, have fewer employees, and have smaller revenues than firms applying for more than $250,000. The table below summarizes the differences:

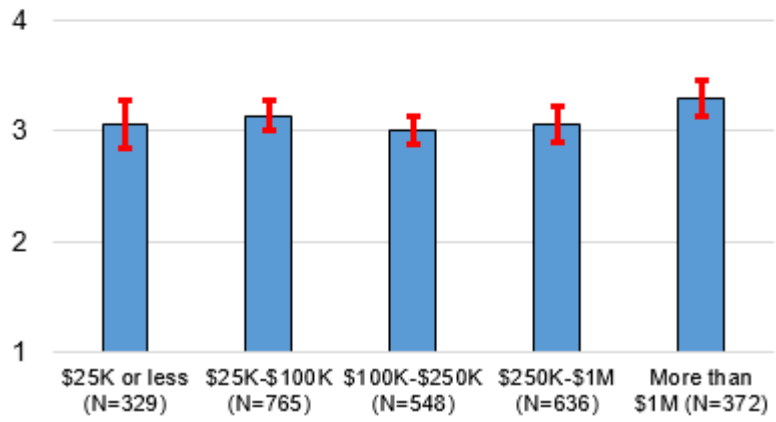
Share of firms	Firms seeking ≤$25K	Firms seeking $25K–$100K	Firms seeking >$250K
Medium or high credit risk	58%	50%	27%
Less than three years old	34%	25%	17%
1–4 employees	75%	54%	25%
$100K or less in annual revenues	41%	23%	10%

Note: Credit score is self-reported. If the firm uses both personal and business credit scores when seeking financing, the highest risk rating is used. Medium or high credit risk is a 1-79 business score or less than 720 personal score.

Source: 2016 Federal Reserve Banks' Small Business Survey

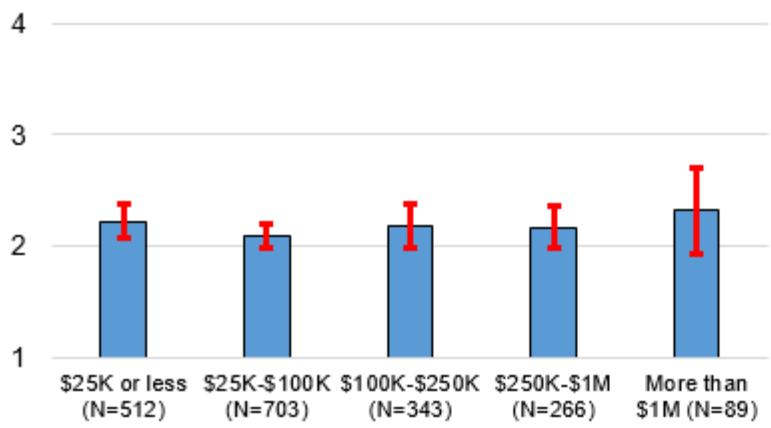
Of particular importance is the credit risk associated with the firm. Controlling for differences in this factor, it turns out that smaller amounts of financing are not more difficult to obtain. Charts 2 and 3 show the weighted average share of financing received by amount sought for low credit risk firms and for middle to high credit risk firms separately.

Chart 2
Financing Received by Amount Sought Among Low Credit Risk Firms
Weighted average (1=none and 4=all)



Note: The range specificed by the red line is the 95 percent credibillity interval around the mean.
Source: 2016 Federal Reserve Banks' Small Business Survey

Chart 3
Financing Received by Amount Sought Among Medium or High Credit Risk Firms
Weighted average (1=none and 4=all)



Note: The range specificed by the red line is the 95 percent credibillity interval around the mean.
Source: 2016 Federal Reserve Banks' Small Business Survey

As charts 2 and 3 demonstrate, low credit risk firms are able to obtain a similar share of the amount requested, regardless of how much they applied for. The same is true for higher risk firms. We also see that medium and high risk firms get less of their financing needs met than low credit risk firms that apply for similar amounts.

From this evidence, it seems that credit approval has more to do with the attributes of the firm than the amount of financing for which the firm applied. These results also highlight the potential importance of alternatives to traditional bank financing so that riskier entrepreneurs—including important contributors to the dynamism of the economy such as startups—have somewhere to turn. A later *macroblog* post will explore how low and high credit risk firms use financing differently, including where they apply and where they receive funding.

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