# EXECUTIVE SUMMARY

The survival and growth of small businesses depends on access to credit, and banks are the most common source of external credit for small firms. Nonetheless, very little comprehensive information is available about how small business lending is conducted by banks. Given the current consolidation trend in U.S. banking, it is essential to understand the practices that banks use to meet the needs of small businesses, and how these practices differ between banks of different sizes. In particular, the continued decline in the number of small banks and of bank branches (for banks of all sizes) may have significant negative effects on U.S. small businesses.

To fill this information gap, the Federal Deposit Insurance Corporation (FDIC) conducted the nationally representative Small Business Lending Survey (SBLS). High-quality data on the small business lending practices of U.S. banks were collected in 2016 and 2017. Approximately 1,200 banks responded to the survey—over one-sixth of all banks in the nation—yielding a 60 percent survey sample response rate. The survey design allows researchers to make inferences about the U.S. banking industry as a whole, as well as to draw distinctions between small and large banks.

At present, few surveys of bank small business lending exist, and none covers the range of topics captured by the SBLS. Further, most existing surveys cover only small banks and do not allow for comparisons between small and large banks, as the SBLS does. (This report defines banks with less than $10 billion in assets as small, and banks with at least $10 billion in assets as large.)

The SBLS collected information on banks' entire volume of commercial and industrial (C&I) lending by firm size and by residential real estate collateral, which enables the FDIC to provide direct evidence that small business lending by banks is currently understated. The findings of the survey show that the best available proxy for small business C&I lending substantially understates the amount of lending extended by banks to small businesses, especially by small banks.

In addition, the data collected by the SBLS confirm that small banks are indeed more likely to rely on relationship lending practices, while large banks are more likely to use transactional methods. Yet the results reveal that small business lending at all banks, regardless of bank size, is characterized by a core set of practices centering on local personal interactions. Thus, the survey's unique combination of findings provides depth and nuance to the current knowledge of small business lending.

The following detailed results support the conclusions of this report.

## Banks Lend More to Small Businesses Than Is Currently Measured

### The C&I Loan-Size Proxy Understates Lending in at Least Two Ways

- The best available measure of small business lending is a proxy based on loan size, but many loans made to small businesses are above the loan-size limit used ($1 million). For banks with between $1 billion and $10 billion in assets, over a fifth of their C&I lending above $1 million was made to businesses with under $1 million in revenue.
- The proxy also fails to capture small business lending secured by residential real estate. Yet 6 percent of lending by small banks for commercial and industrial purposes was secured by 1- to 4-family residential properties.

### Conservative Extrapolations Show Substantial Understatement of Lending

- In 2015, small business C&I lending in the U.S. banking industry was understated by at least 12 percent ($37 billion).
- Small business C&I lending by small banks was understated by at least 29 percent.

## A Core Set of Small Business Lending Practices Are Used By Banks of All Sizes

### Relationships Are Important

- Both small and large banks most frequently cite relationships and personal attention as their top competitive advantages.
- Large majorities of both small and large banks are typically willing to grant exceptions to their underwriting policies based on existing loan and depositor relationships.

### Practices Are High-Touch and Staff-Intensive

- Majorities of both small and large banks use high-touch, staff-intensive practices to maintain and generate small business lending relationships, and customer referrals are a focus for both sizes of banks.
- Small banks are more likely to focus on community involvement and personal attention, while large banks focus more on professional referrals and their own branch network.

### Small Business Lending Primarily Occurs Locally

- A large majority of small banks define their small business lending trade areas locally, as do a substantial share of large banks.
- Almost all banks accept applications at branches; both sizes, but especially large banks, also accept applications during staff visits and over telephone calls.
- Very few small or large banks accept small business loan applications online.

### Competition Is Focused on Local Banks

- Banks typically view a local bank of similar size as their most important competitor.
- Local banks of other sizes are also often considered to be frequent competitors, but nonlocal banks are rarely viewed as such.
- Credit unions and FinTech firms are emerging as competitors, but are not currently top competitors.

### The Same Products and Underwriting Criteria are Generally Used

- The majority of both small and large banks offer a similar set of loan products, including lines of credit, letters of credit, and term loans.
- Small and large banks largely use similar underwriting criteria.
- Small and large banks typically accept the same types of collateral.

## Small Banks are Relationship Lenders, Competitive in the Small Business Lending Market

### Small Banks Are More Flexible in Characterizing Small Businesses and Engaging with Start-Ups

- Small banks use a diverse array of concepts to describe their small business customers, including qualitative attributes such as owner characteristics (e.g., “wears many hats”) and localness of the business (e.g., “involved in community”).
- Small banks evaluate a wide variety of additional criteria to qualify start-ups for loans, including evaluating owner characteristics (e.g., “education” or “experience in industry”).

### Small Banks Are Perceived As Relational, Attentive, and Fast

- Small banks are more than three times as likely as large banks to be considered by competitors as having advantages in customer service.
- Small banks are almost four times as likely as large banks to be considered by competitors as being faster at making loans.

### Local Small Banks Are Considered Top Competitors by Banks of Both Sizes

- Majorities of both small and large banks consider a local small bank with $1 to $10 billion in assets as one of their top three competitors, and about one-fifth of both sizes of banks consider such a bank to be their number one competitor.
- A third of large banks even consider one of the smallest local banks, those with $1 billion or less in assets, as a top three competitor for small business lending.

### Large Banks Are Perceived to Be Convenient and Cheaper

- Large banks are more likely to be considered by competitors to have an advantage in providing convenience, particularly by having broad branch networks.
- Large banks are more likely to be considered by competitors to have an advantage in pricing, particularly in their ability to offer lower interest rates.

## Large Banks Are More Transactional, with Perceived Advantages in Convenience and Pricing

### Large Banks Use Quantifiable Metrics to Characterize Small Businesses and Look for Guarantees When Lending to Start-Ups

- Large banks use only a small number of quantifiable terms to describe their small business customers—in particular, firm revenue/sales or loan size. Four-fifths of large banks cite revenue/sales.
- The vast majority of large banks use additional criteria in lending to start-ups, citing a few specific ones; four-fifths of all large banks look for additional guarantees from new businesses, particularly SBA guarantees.

### Large Banks Are More Likely to Use Transactional Practices

- The majority of large banks use formal limits to define small businesses, and they require minimum loan amounts. Large banks are more than four times as likely as small banks to evaluate business credit scores in underwriting.
- Large banks are more than three times as likely as small banks to offer credit cards, and more than seven times as likely to use standardized small business loan products.