EXECUTIVE SUMMARY

Banks have historically played a key role in supporting small businesses, which in 2023 accounted for 99.9 percent of all firms, 46.4 percent of private sector employment, and 43.5 percent of gross domestic product in the United States.[2] Banks sustain the health and growth of small businesses by providing them with credit and other financial services.[3] The Federal Deposit Insurance Corporation's (FDIC's) report on the 2016 Small Business Lending Survey (FDIC 2018) found that banks almost universally emphasize a relationship-oriented approach to lending that is high-touch and staff-intensive. However, recent advances in technology have the potential to increase the prevalence of more transactional types of lending. Further, ongoing consolidation in the banking industry and increasing competition for small business lending from credit unions and other nonbanks may change the practices and comparative advantages of banks. These trends raise questions about how the evolving role of banks may affect small businesses' access to credit.

To improve our understanding of how the banking industry has adjusted to these changes, the FDIC conducted the nationally representative 2022 Small Business Lending Survey (SBLS). From a sample size of 2,000, about 1,300 banks—more than a quarter of all banks in the nation—responded, yielding a 68 percent survey response rate. Due to its size, nationally representative survey design, and high response rate, the SBLS is the only survey that allows researchers to make inferences about small business lending in the U.S. banking industry and to explore and highlight key differences within the industry, such as the differences between small and large banks. (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 2022 survey asked banks about their small business lending process, including their use of technology, their procedures for underwriting and approving loans, their geographic market and competition for small business borrowers, and their practices for developing relationships. It delved deeper into areas covered in the 2016 survey to better understand the fundamentals of the bank approach to small business lending and to gauge how lending practices vary within the industry. Several new topics probed how recent industry and economic changes have affected small business lending by banks.

The 2022 SBLS asked banks to consider their lending to borrowers that meet the bank's internal definition of a small business and to consider a wide range of lending to small businesses, including owner-occupied commercial real estate and traditional commercial and industrial loans. This approach captured small business lending that may be missed by other well-known regulatory or conventional definitions.

Overall, the 2022 survey finds that technology has not replaced the relationship-oriented and staff-intensive nature of small business lending that is focused locally around branches. However, small and large banks continue to manage the risks of lending to small businesses differently for smaller loans, with small banks relying on soft information gathered through relationships to a greater extent than large banks do.[4]

Most banks lend to small businesses and retain the risk

Almost all banks participate in small business lending, which commonly includes loans of at least $1 million.

- Nearly all banks make loans up to $1 million to small businesses.
- Half of banks make loans up to $3 million to small businesses.

2 U.S. Small Business Administration, Office of Advocacy, Frequently Asked Questions, March 2023.
3 On the advantages of banks relative to other external credit options, see Udell (2008) and Beck, Demirgüç-Kunt, and Maksimovic (2005).
4 For a discussion of "hard" versus "soft" information, see "Relationship and Transactional Lending" in Section 1.

Banks generally retain the risk of the small business loans they make.

- About one in five small banks and one in three large banks sold a small business loan on the secondary market.
- Small business loans with a risk-limiting government guarantee, such as the guarantee provided by the Small Business Administration (SBA), are a significant part of lending for only a small minority of banks.
- Among the top factors that limited additional bank participation in SBA lending is that a bank's customers qualified for traditional credit products.

Approval structures are fairly flat and approval times are generally fast, especially for small and simple loans

Approval structures are typically flat, with executives and board members often directly involved at small banks.

- Almost all banks give signature authority on small loans to first-level decision-makers.
- Nearly three in four banks have at most three levels of approval, even for larger and more complex-loans.
- At small banks, approval for larger loans often involves the bank's executive officers or the board of directors.

Approval times are fast, especially for small loans at large banks.

- Three in ten banks, including more than half of large banks, can approve a small and simple loan within one business day.
- Three in four banks can approve a small and simple loan within five business days.
- Three in four banks approve their typical loan within ten business days.

Technology has not replaced staff-intensive and relationship-oriented practices

About half of banks were using or considering using FinTech in their small business lending process.

- In 2022, three in ten banks used FinTech within their lending process and an additional two in ten were discussing or developing its use.
- Banks most commonly use FinTech to help with regulatory compliance and for steps taken after loan approval, such as closing, performance and servicing, and portfolio analytics.
- Large banks are somewhat more likely than small banks to use FinTech, but the greater difference is in the breadth of use across the lending process.

Banks emphasize in-person and high-touch practices for developing relationships.

- The vast majority of banks engage in high-touch practices and believe these practices to be crucial for generating and maintaining relationships.
- Banks emphasize relationships even when the banks differ in size, underwriting practices, and FinTech usage.

The competitive advantages of banks reflect their investments in staff and local communities.

- Banks perceive their primary competitive advantages to be customer service, relationships with customers, and speed of service.
- Both small and large banks use a relationship-oriented approach based on customer service and cultivating relationships and describe the approach as a key competitive edge.

Outside of credit cards, automated lending remains uncommon in the industry and is used almost exclusively for smaller loans.

- One in ten banks have a credit-scoring system that can partially or fully automate the underwriting of some non-credit-card lending.

- Less than one in thirty banks use a credit-scoring system to auto-approve loans, and less than one in one hundred banks will auto-approve a loan of $250,000.

Lending is largely local and focused around branch locations

The small business borrowers of a bank are generally located close to the bank's branch locations.

- About one-third of banks report that the general location of their small business borrowers is within 20 miles of a branch, and two-thirds of banks report the general location is within 60 miles.
- About four in five banks define their geographic market for small business lending based on their branch footprint and, on average, their market extends 40 miles from their branch locations.
- This reported market distance is largely independent of size, top lending product, and technology use.

Branches and on-site visits are key conduits for small business credit.

- Banks use and highly value branch locations and on-site visits as ways to generate and maintain small business lending relationships.
- While remote communication methods such as email, file transfer, and video conference are ubiquitous, they often supplement rather than replace in-person interaction.
- Very few banks allow borrowers to complete a loan application entirely through an online portal.

The primary factors limiting the extent of geographic markets relate to competitive pressures and the challenges of maintaining relationships.

- The most commonly cited factor limiting banks' markets is that borrowers outside their market prefer to borrow from closer banks.
- A majority of banks identify operational issues related to maintaining relationships and gathering information about the small business borrower as limiting their market.
- Banks operating in more-competitive areas report a geographic market that is, on average, nine miles smaller than banks operating in less-competitive areas.
- Alternative explanations such as technological investment, asset size, and underwriting practices rarely explain differences in market size.

Banks typically compete with similarly sized or smaller local banks, though competition with nonbanks seems to be increasing

Banks generally compete with banks of a similar or smaller size.

- More than nine in ten banks compete often with another bank for small business lending.
- Relatively few small banks compete often with large banks.
- Conversely, most large banks compete often with banks of all sizes.

Banks rarely compete intensively with banks that do not have a branch presence in their market.

- The majority of banks only compete often with banks that have a branch presence in their market, while one in five banks compete often with local and non-local banks.
- Banks are more likely to compete with a non-local bank when the competitor bank is large.

Competition with credit unions and other nonbanks seems to have increased.

- The majority of banks at least occasionally compete with credit unions and other nonbanks, and regular competition with credit unions and FinTechs seems more common than in 2016.
- Small banks are more likely to compete with credit unions, while large banks are more likely to compete with FinTech lenders, credit card issuers, and other financing companies.
- Banks cite pricing as the primary advantage of credit unions, while banks cite customer-facing technology, convenience, and speed of service as competitive advantages for FinTechs.

There are key differences between small and large banks in small business lending

Compared to large banks, small banks generally use more soft information in their underwriting process.

- Small banks are more likely than large banks to use a wide variety of soft information, especially loan officer assessments, when evaluating loan applications.
- Nine in ten small banks, but only four in ten large banks, have loan decision-makers meet with applicants.

Most large banks make smaller loans using techniques that emphasize information from credit bureaus rather than more qualitative factors.

- The majority of large banks, compared with only one in ten small banks, view credit bureau information as the most important aspect of a small loan.
- A substantial minority of large banks have credit-scoring systems that allow them to automatically approve small loans based entirely on hard information.

Small banks are perceived by other banks as more flexible and able to lend to marginal borrowers. Large banks are more likely than small banks to make small loans without collateral.

- Small banks have perceived advantages in lending flexibility, such as flexibility in pricing or loan structure, in collateral requirements, and in their willingness to accept alternative forms of documentation.
- Small banks also have perceived advantages in lending to marginal borrowers or those who lack documentation, which may include start-ups.
- Large banks may be better at serving small businesses that lack collateral, as large banks are more likely to make loans of $25,000 or less without requiring collateral.

To manage the risk of lending to start-ups, large banks more often rely on government guarantees, while small banks more often use soft information gleaned from meeting with applicants.

- Six in ten large banks that are SBA lenders lend to start-ups, compared with only a quarter of non-SBA lender large banks.
- Small banks are more likely than large banks to use the information they gain from meetings with applicants to make start-up loans.
- Overall, small banks are somewhat more likely than large banks to lend to start-ups.