SECTION 1
Introduction

Small businesses are a vital part of the U.S. economy. In 2023, there were more than 33 million small businesses in the United States, accounting for 99.9 percent of all firms, 46.4 percent of private sector employment, and 43.5 percent of gross domestic product.[5] The survival and growth of small businesses depends on access to credit, and banks are a primary source of credit to small firms. Results from a 2022 Federal Reserve survey show that banks provided financial services to 87 percent of small firms and remain their most common source of credit among financial service providers.[6] This is likely because of banks' expertise in judging the creditworthiness of small businesses even when such businesses lack standard evidence of their quality.[7] Yet despite the importance of banks to small businesses and the importance of small businesses to the economy, comprehensive information about bank small business lending remains scarce.[8]

Understanding the fundamentals of bank small business lending can help regulatory agencies, policymakers, academics, and other stakeholders better gauge both how changes in the economy affect small businesses' access to credit and how banks may better meet the credit needs of small firms.

To advance this understanding, the Federal Deposit Insurance Corporation (FDIC) conducted the Small Business Lending Survey (SBLS) in 2016 and in 2022 to collect high-quality data on small business lending practices for a large, nationally representative sample of U.S. banks.

The 2022 survey, conducted between June 2022 and January 2023, built on the success of the 2016 survey, which helped identify several areas for further analysis. For example, the 2022 survey delved more deeply into the lending practices of banks to highlight the many broad similarities across the industry in lending to small businesses and to capture important differences. The 2022 survey also covered new topics that reflect industry and economic changes since the 2016 survey, perhaps most notably those due to the COVID-19 pandemic (see "Impact of the Pandemic on Survey Results" box in this section).

As discussed in Section 2, banks vary substantially in how they distinguish small businesses and in the products they offer to small firms. So a key decision when discussing small business lending is how to define it. To allow for lending that may be missed by well-known regulatory or conventional definitions, the 2022 survey took a less-specific approach than the 2016 survey, which focused on commercial and industrial lending. Specifically, the 2022 survey asked banks to consider all borrowers that meet the bank's internal definition of a small business. Similarly, the 2022 survey asked banks to consider a wide range of potential lending, including owner-occupied real estate as well as traditional commercial and industrial loans.[9] In certain cases, however, the survey directed banks to consider only certain types of lending, generally excluding credit card lending and lending through the Paycheck Protection Program.

A more inclusive definition of small business lending facilitates comparisons between small and large banks (in this report, small banks are those with less than $10 billion in assets and large banks are those with at least $10 billion in assets). While parts of the small business lending process can look remarkably similar across all banks, there remain some key differences as banks increase the scale

[5] U.S. Small Business Administration, Office of Advocacy, Frequently Asked Questions, March 2023.

[6] The report contains findings from a survey of firms with between 1 and 499 employees. Of firms seeking credit, 43 percent had applied to a large bank (at least $10 billion in deposits) and 30 percent to a small bank. Online lenders were the next largest lender type with 22 percent. See Federal Reserve Banks (March 2023).

[7] On the advantages of banks relative to other external credit options, see Udell (2008) and Beck, Demirgüç-Kunt, and Maksimovic (2005).

[8] On the importance of small businesses to the economy, see Alon, Berger, and Hackney (2018).

[9] For additional details on the definition of *business purpose lending* used in the survey see Key Terms.

of their operations (see Section 2 and Section 3). Understanding these differences is critical given the trends in the banking industry since the Great Recession.

One such trend is bank consolidation. Consolidation has dramatically affected the structure of the banking industry and contributed to a sharp decline in the number and asset share of small banks. Between 2008 and 2023, the number of small banks in the United States declined almost 46 percent and their share of total assets in the industry decreased 7 percent. However, small banks have long held an outsized role in lending to small businesses. At the end of 2023, small banks held nearly 42 percent of small commercial and industrial and commercial real estate loans to businesses despite holding only 15 percent of industry assets.[10]

The results of the 2016 SBLS—found in FDIC (2018)—and the consensus in academic research agree that small and large banks differ in the types of information on which they base lending decisions (see "Relationship and Transactional Lending" box in this section). The implication is that the continued decline in the number of small banks could have significant adverse effects on access to credit for small businesses and threaten a key strength of the U.S. economy. This concern is most acute for firms that have relatively less quantifiable evidence of their creditworthiness—for example, start-ups. This report highlights differences in the practices of small and large banks and considers implications for how consolidation might affect the provision of credit by the banking industry.

Another trend is the closure of bank branches. Between 2017 and 2022, the number of bank branches fell by 12 percent. Large banks reduced their total branch footprint by about 20 percent, while the number of small bank branches remained roughly stable.[11] The closure of nearby branches may reduce small businesses' access to credit and make it more difficult for banks to form and maintain relationships within local communities. The 2022 SBLS investigated how banks define their markets and what role branches play in their small business lending process (see Sections 5 and 6). Understanding the importance of branches in providing small business credit facilitates a better appreciation of how branch closures affect general credit access and highlights where closures are likely to have the greatest impact.

A third trend is the increased prevalence of financial technology, or FinTech, in small business lending. FinTech presents both an opportunity and a challenge, as banks may adopt new technologies to streamline their small business lending but may also face increased competition from nonbank FinTech firms (see Section 5). Further, the growing role for technological solutions may threaten or complement the traditional model of relationship-oriented lending (see Section 4). Similarly, the resulting flexibility or inflexibility of such systems could change the types of customers that obtain credit, including by expanding credit to new customers.

The SBLS helps address the question of how banks manage their small business lending in the context of these trends.

The SBLS is the only survey to provide nationally representative findings that reflect a broad view of the practices of the entire industry, including both small and large banks.[12] This level of detail can be gleaned from the survey results because of the size and representativeness of the sample, rigorous testing of the survey questions, and high response rate.[13] The 2022 survey had a sample response rate of

[10] All numbers are from bank Consolidated Reports of Condition and Income (Call Reports). Small loans to business are the outstanding balances as of December 31, 2023, on commercial and industrial and commercial real estate loans less than $1 million at origination.

[11] Numbers taken from Hinton, Hoffman, Kasper, and Lu (2023). The numbers conditional on bank size reflect merger-adjusted changes in the number of bank offices. The process of "merger-adjusting" accounts for differences that result from the effects of mergers.

[12] Few other surveys of small business lending survey banks. These other surveys cover fewer topics than the SBLS and often use non-representative samples of only small banks, which prevents comparisons between different-sized banks.

[13] For example, the survey samples a disproportionately high number of large banks, which is corrected in analysis through the use of statistical weighting of responses, resulting in findings that are nationally representative of U.S. banks (see Appendix A). The survey instrument was developed in consultation with experts at the U.S. Census Bureau and benefited from suggestions by approximately 50 banks of all sizes across the United States that provided feedback on draft versions of the survey through one-on-one interviews in 2021. The survey also benefited from comments by a panel of experts from academia and other government agencies (see Acknowledgments).

68 percent, with about 1,300 banks, or more than a quarter of all eligible banks, responding.[14]

Topics covered in the 2022 survey included banks' loan approval and underwriting processes, markets and competition, use of financial technology, and lending to start-up firms.[15] This report details results and findings from the 2022 survey responses. Generally the report focuses on the banking industry as a whole unless significant differences between groups of banks were observed.

Section 2 of the report covers the fundamentals of small business lending by banks, and Section 3 explains the underwriting and approval process for small business loans. Section 4 focuses on the use of FinTech in bank small business lending, specifically which banks use FinTech and how they incorporate it in small business lending. Section 5 considers how banks define their markets for small business lending, who their competitors are within those markets, and how competition has changed since the 2016 SBLS. Section 6 explores the practices that banks use to generate and maintain relationships with their small business customers and the competitive advantages of banks. Section 7 covers bank lending to start-ups.

RELATIONSHIP AND TRANSACTIONAL LENDING

The consensus explanation in academic research for the role of banks in small business lending is that banks have a unique ability to generate information that allows them to identify creditworthy small firms and, by extension, profitable small business loans.[a] Although banks are thought to use a variety of methods to identify high-quality small businesses, small and large banks are widely considered to hold distinct advantages in how they process information. As a result, small and large banks are expected to manage their small business lending programs differently.

Small banks are thought to hold an advantage in gathering and using "soft" information, defined as information that is difficult to quantify or transmit between individuals. Small banks obtain this information through direct, repeated interactions with prospective borrowers and through knowledge of the local community. Because small banks are usually closely held organizations with few managerial layers between bank owners and loan officers, the loan officer may be more motivated to gather and use soft information when deciding whether to grant a business loan.[b] Further, small banks are typically located in the communities they serve, which lowers the cost of forming a relationship with the firm and of gathering knowledge of the local market.[c] Small banks are therefore considered more flexible in meeting credit needs and better able to engage with small businesses on a case-by-case basis. For these reasons, small banks as a group are typically called relationship lenders.

Large banks are thought to take advantage of economies of scale to gather and use large amounts of quantifiable, or "hard," information about current and prospective borrowers. This reliance on hard information requires that bank management specify the types of data used as well as the metrics for determining small business quality, usually well before any business applies for a loan. Accordingly, the lending decisions of large banks are more likely than those of small banks to be based on the strength of financial variables.[d] Further, since the information used by large banks is quantifiable, it can be

[a] Udell (2008).
[b] Berger and Udell (2002).
[c] Berger and Udell (2002) and Stein (2002).
[d] Cole, Goldberg, and White (2004).

[14] For more on the methodology of the survey and response rates, see Appendix A.
[15] For an informational copy of the survey instrument, see Appendix B.

submitted and shared electronically, which may reduce the need for decision-makers in large banks to be in close proximity to the small business. This structure facilitates a high-volume small business lending model and is often called transactional lending.

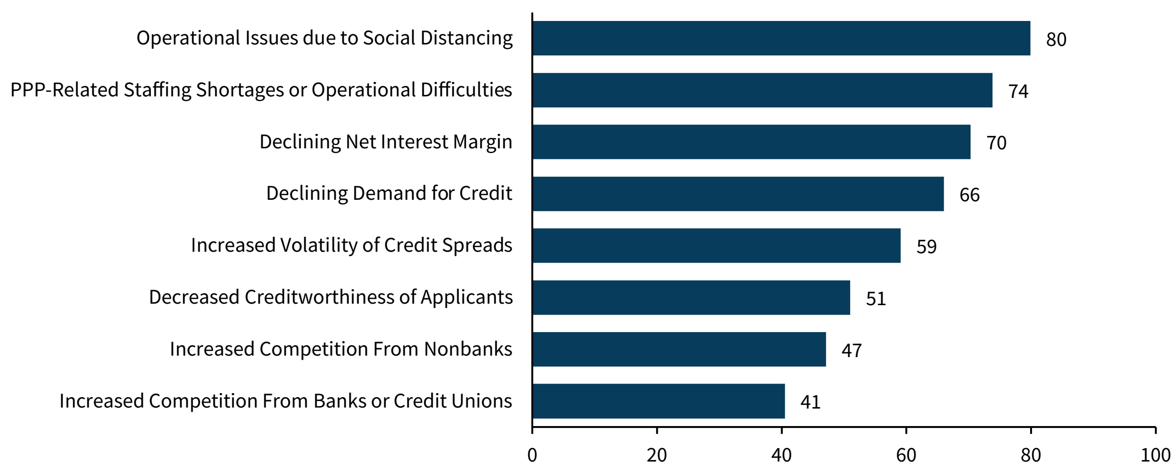
Simply because banks use different models to process loan information does not necessarily mean they will use different strategies to interact with current and prospective small business borrowers. As documented in the 2016 Small Business lending Survey report (FDIC 2018), a high-touch, staff-intensive approach to customer relationships does not necessarily mean that a bank incorporates or emphasizes soft information in its underwriting. Similarly, the adoption of consumer-facing technology such as mobile apps does not necessarily mean that banks use a more transactional approach for credit decisions, though they may incorporate data gathered through those interactions into their underwriting. Rather, certain effective practices in generating and maintaining relationships with small business customers are nearly universal in banking, even if banks differ in how those relationships factor into credit decision-making.

IMPACT OF THE PANDEMIC ON SURVEY RESULTS

The 2022 Small Business Lending Survey (SBLS) is a survey about the typical small business lending practices of banks. The COVID-19 pandemic changed the economic environment including during the survey period. In answering the survey questions, banks were encouraged to ignore temporary disruptions or changes to small business lending practices due to the pandemic. The ability of respondents to make these adjustments was a topic explored during virtual testing of survey questions with banks.[a] Banks responded to the survey in 2022, and some questions referred to lending activity in calendar year 2021; thus, all responses partially reflect the wide-ranging impact of the pandemic.

FIGURE 1.BOX1

Percentage of Banks That Faced Selected Challenges During the COVID-19 Pandemic

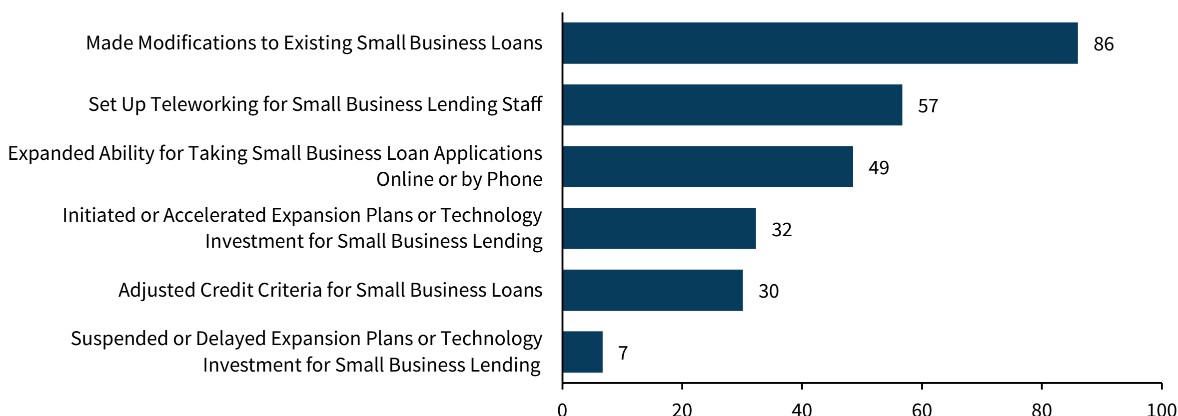


Source: SBLS 2022 Question III.A1.
Note: Results reflect a response of either “experienced somewhat” or "experienced as a serious problem" to question III.A1. "PPP" is the Paycheck Protection Program. This analysis includes only banks that reported engaging in small business lending in Question I.A1.

[a] For example, in most cases the survey asked banks to exclude pandemic-specific activity, such as Paycheck Protection Program (PPP) lending or competition based solely on PPP loans.

FIGURE 1.BOX2

Percentage of Banks That Took Specific Actions During the COVID-19 Pandemic



Source: SBLS 2022 Question III.A2.
Note: This analysis includes only banks that reported engaging in small business lending in Question I.A1.

The survey asked specific questions about banks' experiences during the pandemic to better understand the challenges and how banks responded to them. As shown in Figure 1.BOX1, banks reported confronting a range of issues during the pandemic. Unsurprisingly, the virus and social distancing measures challenged the traditional high-touch and in-person approach for interacting with small business customers: four in five banks reported operational difficulties due to social distancing. For 74 percent of banks, pandemic-related issues may have been compounded by implementation of the Paycheck Protection Program (PPP), which caused well-documented logistical and operational difficulties. Most banks also faced challenges with declining net interest margins, a decline in demand for traditional credit, and increased volatility of credit spreads.

The survey also documented actions banks took in response to these challenges. Ninety percent of banks reported participating in at least one round of PPP lending.[b] As shown in Figure 1.BOX2, 86 percent reported modifying some existing small business loans. About half of banks adopted or expanded methods of remote communication, such as allowing small business lending staff to telework (57 percent) and allowing customers to apply for loans online or by phone (49 percent). Notably, the majority of banks (70 percent) did not see a need to change their typical credit criteria or standards in response to market changes. While these adjustments had a large and potentially long-lasting impact on business practices, high-touch and in-person practices remain essential in small business lending (see Sections 5 and 6).

[b] Percentage of banks that participated in at least one round of PPP lending is computed using the percentage of banks that answered yes for either round in question III.A3.