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Comments on Small Business Credit Conditions Before the House Banking and Financial Services Committee Thursday, November 12, 2009

My name is Charlie Owens and I am the State Director for the National Federation of Independent Business, an organization providing legislative advocacy for Michigan small businesses owners.

I thank the Chairman and members of the committee for the opportunity to discuss an issue of concern to small business and an issue that is also relevant to Michigan's economic health and viability.

That issue concerns the credit needs of Michigan's small to medium size businesses and how those needs are being met by Michigan's smaller community banks. NFIB research has indicated that in almost all cases (94%), the principal financial institution used by a small business to obtain credit is a bank.[1] Forty-one (41) percent of small businesses use a small bank (assets of $1 billion or less) with over 15 percent using very small banks (assets under $100 million). Thirty-eight (38) percent of the owners use very large banks (assets over $10 billion).[1] To quickly summarize that data, more than fifty-six (56) percent of small businesses use smaller community banks for their credit needs.

Availability of credit is critical to the survival and growth of Michigan small business and the survival and growth of Michigan small business has never been more important to Michigan than now. Small community banks in Michigan are a key source of that credit. If small community banks are limited in their ability to provide the credit needed by small business, this creates an environment of uncertainty in the small business community.

Job creation statistics from the Small Business Administration have demonstrated that small and medium size businesses are the "shock absorber" whenever the economy hits a bumpy road.[2] Certainly we can agree that the road in Michigan has been bumpy. It is imperative that small business has the credit tools it needs to help Michigan retain and grow jobs during these difficult times.

Uncertainty in credit conditions for small business can have an immediate and negative impact on the ability and willingness of small business to expand and create jobs. If small businesses perceive that credit availability is diminishing, a contraction of activity will occur that will have a cascading effect through the economy. In the end, this trend becomes a self-fulfilling prophecy. As small businesses put off expansion plans and cut back on hiring in response to diminishing credit availability, other small businesses that are affected by those decisions do the same. We are talking here about viable businesses with strong balance sheets taking on a "bunker mentality" and halting or slowing down planned increases in expansion.

Is this occurring in Michigan? In our testimony here almost a year ago, we said that we were concerned that it was beginning and if action was not taken, the scenario previously described would begin to play out. Our comments at that time were mostly anecdotal because statistical data usually used to quantify such trends lags by as much as 60 to 90 days and it was early in the trend line of the financial meltdown. However, since that time we have been able to quantify some of those concerns and they referenced here:[3]

Vendor Financing:

An example of such borrowing is a contractor purchasing a pick-up truck from a GM dealer, the sale being financed through GM's finance company, GMAC.

- 69 percent procured all they needed and on satisfactory terms (Q#6A1).
- Another 4 percent got the credit they wanted, but the terms did not satisfy them.
- 22 percent who tried to obtain financing through a vendor could not get it.

Vendor financing proved the type of credit more accessible than any of the credit forms examined.

Loans from Financial Institutions:

Of those small businesses that attempted to obtain a business loan from a financial institution in the period since September 1, 2008:

- 38 percent proved successful, both in terms of obtaining the loan and obtaining it with satisfactory conditions.
- 7 percent obtained a loan, but they were not satisfied with its conditions.
- 52 percent of applicants did not get the loan. This rejection rate appears much higher than would have been the case just a few months ago as is shown in the detailed research.

Lines of Credit:

Lines of credit, not including credit cards, have become a very important source of financing for large numbers of smaller firms. Of small businesses that attempted to obtain a line of credit:

- Only 21 percent were successful and satisfied with the amount and terms.
- Another 9 percent obtained a new line, but were not satisfied with either the amount or the terms or both.

- The overwhelming majority (69%) of small business owners and managers who tried could not establish a new credit line.

Trade Credit:

Trade credit is often an important aspect of a business-to-business relationship, substituting firm financing for short-term bank credit or other more formal arrangements. It allows one business to call another and have product shipped immediately or a service performed as needed with payment made subsequently, typically at the end of a month, but at times over an extended period. Small business owners, therefore, often find themselves in a position of giving and receiving trade credit.

- Forty-six (46) percent see no change in trade credit availability between late last summer and the present.
- Thirty (30) percent judge availability to be reduced (tighter).

As a result, while trade credit continues to flow, it is another form of credit more difficult to obtain in the present than just a few months ago.

Conclusion:

We also know is what our members are telling us. In conversations with members on this subject we are hearing that existing credit lines are being tightened, customary loan provisions are becoming more restrictive on renewal and new loans are becoming more difficult to negotiate.

I would conclude by commending the members of this committee for looking into this issue and we look forward to working with you in developing solutions to address the problem.

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[1] Bank Competition, NFIB Research Foundation. Volume 5, Issue 8, 2005, ISSN - 1534-8326, Jonathan A. Scott and William C. Dunkelberg, Temple University. http://www.411sbfacts.com/sbpoll.php?POLLID=0043&KT_back=1

[2]Released at the International Council for Small Business 2008 World Conference by Zoltan Acs, the study High-Impact Firms: Gazelles Revisited, (http://www.sba.gov/advo/research/rs328tot.pdf) defines high-impact firms as those whose sales have at least doubled over a four-year period and which have an employment "growth quantifier" (the firm's absolute change in employment multiplied by the percent change) of two or more.

[2] "How many jobs did small business create in Michigan?" SBA Fiscal 2007 Annual Report, page 16. http://www.sba.gov/idc/groups/public/documents/mi_detroit/mi_2007annualrpt.pdf

[3] Small Business Credit Access Volume 8, Issue 7, 2008 ISSN - 1534-8326 William J. Dennis, Jr. NFIB Research Foundation http://www.411sbfacts.com/sbpoll-about.php?POLLID=0071