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Small Business Research Summary

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The Increasing Importance of Credit Unions in Small Business Lending

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Purpose

Over the last decade the banking industry has undergone changes in its business lending to small firms, and the number of banks in the United States has declined continuously. Over this period, small businesses relied heavily on banks for their financing needs. In fact, the last Survey of Small Business Finances by the Federal Reserve Board showed that while almost two-thirds of small businesses obtain their financing from banks, small firms have increased their use of thrift institutions and credit unions. In the last two years, small business lending by banks has declined because of tight lending standards and a weak economy. With that in mind, the report looks at the impact of credit unions on small business lending, examining in particular whether credit unions are picking up the slack in small business lending by the banking sector.

To examine the effects of credit union lending, the researcher uses econometric techniques to estimate whether and how much credit unions might offset reductions in business lending at banks. The first hypothesis tested is that credit unions, taken together, have tended to do more business lending when banks as a whole have reduced their business lending. The second hypothesis is that state by state, credit union business lending rose in response to reductions in bank supply of business loans.

Overall Findings

The results suggest that, even during the financial crisis, credit unions may have provided some extra business lending in response to the reductions in bank business lending. While credit unions partly offset changes in business lending by banks, the findings also show that these effects have not been consistent over time. To the extent that increased credit union supply of business credit has and will offset reductions in bank loan supply, credit unions can help small businesses and reduce the cyclicality of their local economies.

Highlights

- To the extent that reductions are offset, banking consolidation would have less deleterious effects on small business lending than if credit unions were not in a position to lend to small firms.
- The study found, as expected, that bank business lending was largely unaffected by changes in credit unions' business lending.
- The regression estimates at the state and national levels produced different responses of credit unions' business lending to a positive shock to bank business lending. For example, at the national level, the estimates show that credit unions changed their business lending in the same direction banks did; that is, when banks increased or decreased their business lending, credit unions did the same. At the state level, the estimates indicate that credit union business lending served as a partial offset to changes in bank business lending—as banks reduced their business lending, firms found that they could obtain loans from credit unions.
- The study also suggests that the extent of the credit union offset to bank business lending often varied considerably across regions. The estimates show that credit union offsets to bank business lending were pronounced in the South and Midwest regions of the United States.
- The results from the North and West indicate that rather than offsetting bank lending, credit union

business lending may have accentuated shocks to bank business lending.
- Analysis shows that during the 2000-2002 and 2008-2009 recessions, credit unions offset declines in business lending, but not during the recessionary period of 1990-1991.
- The result was unclear as to whether credit union offsets have grown, while compelling evidence showed that credit unions offset more of the fluctuations in business loans at small banks than at larger banks.

Scope and Methodology

The researcher constructed and analyzed Call Report data for banks and credit unions, aggregated to the national and state levels, for business lending to businesses of all sizes. The variables used in the analysis describe the changes in small business lending markets, and estimate how much decline, if any, in business lending is offset by the increase in small business lending by credit unions. The researcher tested two hypotheses using annual state-level data and national aggregate data for the period 1986 to 2010 for banks and credit unions. Excluded from the analysis were data for three states: Alaska, Delaware, and Wyoming.

The focus of the research method is to estimate (1) the impulse response functions that show how much business lending at credit unions responded to an increase in business lending at banks, and (2) the effects of changes in bank business lending on business lending by credit unions.

The study provided analysis for four regions using the regional classification used by the Bureau of Labor Statistics, and also provided estimates on recessionary and expansionary periods, which were grouped into five subperiods using vector autoregressions (VAR).

To estimate the effects of business lending by credit unions and banks on one another, vector autoregressions were used. Bank data were obtained from Federal Reserve Call Reports, while comparable data for credit unions were obtained from the National Credit Union Administration (NCUA) Call Reports.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research by email at **advocacy@sba.gov** or by phone at (202) 205-6533.

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