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Small Business Research Summary

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Bank Liquidity Pressures and the Availability of Bank Credit to Small Firms: Was the 2007-2009 Credit Crisis Different?

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Purpose

Small firms continue to have difficulty gaining access to capital. Because of their size, these firms typically have little or no collateral. As relatively young firms, they lack an extensive history from which future firm performance can be extrapolated. For these and other reasons they have virtually no access to external funds from national markets such as through the issuance of commercial paper, bonds, or publicly traded equity. Thus, they tend to be "bank dependent."

Consequently, small firms are more sensitive to tightening monetary policy or bank liquidity pressures. The recent financial crisis and dysfunction of the short-term funding market have placed a squeeze on credit markets used by small businesses. This study examines the role of bank liquidity in determining bank lending behavior, including its effect on banks' limited ability to fund asset portfolios in short-term credit markets and its impact on credit availability to small firms. The study estimates how much and how differently banks responded to small business lending based on bank health and aggregate economic conditions over the 1996-2010 period.

Overall Findings

The study found that during the financial crisis, bank holdings of liquid assets became an important factor for bank lending; generally, this sensitivity persisted during the immediate post-crisis period. The evidence also suggests that healthier banks tended to shy away from small commercial and industrial (C&I) and small commercial real estate (CRE) loans.

Highlights

- Banks with more liquid assets tend to have larger changes in both small C&I and small CRE loans relative to total assets, but tend to have smaller changes in the shares of small C&I and CRE loans relative to total C&I loans, and small CRE loans relative to total CRE loans, suggesting that more liquid banks are willing to increase small C&I loans, and even more willing to increase large C&I loans.
- For small CRE loans, as for small C&I lending, higher liquid assets tended to encourage small CRE lending, but encouraged large CRE lending even more.
- For the smallest category of both C&I and CRE loans ($100,000 or less), higher liquid assets encouraged such lending relative to total assets, but not relative to total loans, and tended to reduce the changes in both small C&I and small CRE loans relative to total C&I and total CRE loans, respectively.
- The results for the smallest category of C&I loans of $100,000 or less are similar to those for loans of $1 million or less, with only a few notable differences. For example, the evidence suggests that better capitalized banks tend to shift their mix of C&I loans away from the smaller loans of $100,000 or less, even in the absence of evidence of a movement away from small business loans.
- Several interesting patterns emerged for changes in the small loan shares. A general rebalancing effect is apparent for both small C&I and CRE loans in their shares relative to both total assets and total loans. That rebalancing appears to be primarily at the expense of large, not small loans.

- The study finds that unused loan commitments tended to become less important, and did not appear to play a role in the relative composition of small versus large C&I and CRE loans, other than as a temporary increase in C&I loan commitments during the crisis. To the extent that unused C&I loan commitments positively affected the change in small C&I loans relative to total assets and total loans, they did not appear to do so at the expense of large C&I loans.

Scope and Methodology

The researchers use annual data for 1996 to 2010, which incorporates data for the last two recessionary periods, to investigate the determinants of aggregate lending, as well as the changes in the availability of credit to small firms. The data used in this study come from two sources; the Consolidated Reports of Condition and Income (Call Reports) and the National Information Center database (NIC). To investigate the determinants of aggregate lending and the changes in bank characteristics, the researchers exclude foreign-owned banks, credit card banks, banks with a value of credit card loans to total loans exceeding 50 percent, banks with loan-to-asset ratios of less than 5 percent, de novo bank observations for the first two years of a bank's life, and merger observations. They construct and analyze bank data at the individual bank level for small commercial and industrial (C&I) and commercial real estate (CRE) loans. The regression model estimates the statistical significance of the critical variables as well as the magnitude of the impacts for each variable..

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