Small Businesses and Lack of Access to Capital

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Thank you, Senator Collins and the rest of this committee, for the opportunity to appear here this afternoon.

A year and a half ago, Woodstock Institute published a report entitled *Dis-Credited: Disparate Access to Credit for Businesses in the Chicago Six County Region*, which examined small business loans made by banks and reported under the Community Reinvestment Act (CRA) between 2008 and 2012. The CRA reports cover all banks with assets over about $1.2 billion. In addition to the CRA small business loan data, I used data from the United States Postal Service to quantify the number of businesses in each census tract and data from the Bureau of the Census for the income and racial composition of the tracts. My testimony today will build on that report, updating it with CRA small business loan data from 2012 through 2014, and will be loaded with data to give you a clearer picture of the situation. Knowing that most people have a hard time keeping track of numbers, I prepared a handout with some charts and notes to help keep the numbers straight.

When I talk about loans this afternoon, it will be important for you to keep in mind that "loans" include traditional loans, lines of credit, and credit cards. So, if a business does not receive a "loan," it means that it does not even have a Capital One credit card that can be used to purchase office supplies at the local office store or a line of credit to manage cash flow. The upper limit of the loans in the data is $1 million, loans most likely going to smaller businesses, which means that these data are good indicators of the extent to which small businesses have access to capital from mainstream financial institutions.

The data I used in the *Dis-Credited* report showed that the number and amount of loans reported for the six county region had dropped by about a third between 2008 and 2010, and then started to increase slowly after that. Analysis of more recent data through 2014 shows that the total amount of loans reported for the region has increased by about 12 percent since the low point in 2010, but is still about 25 percent below the amount of loans made to businesses in the six county region in 2008. The data suggest to me that business credit remains tight in the Chicago region, much tighter than before the financial crisis, and the situation is improving very slowly. The data for the region seem to be consistent with the national data, as well. In other words, while my data analysis is focused on the six county region, the problem is not local. This is a problem in other places, including the rest of Illinois.

In the *Dis-Credited* report, and with the more recent data, I looked at how many loans were made to businesses in census tracts in the Chicago region aggregated by the income level of the tract, grouping them into the fairly standard categories of low-, moderate-, middle-, and upper-income. Low-income tracts have median family income that is less than 50 percent of the area median, or about $36,000 based on the more recent data. Moderate-income tracts have median family income between 50 and 80 percent of the area median, or between roughly $36,000 and $58,000. Middle-income is between 80 and 120 percent of the area median, or between roughly $58,000 and $87,000, and upper-income is over $87,000.

For the period between 2012 and 2014, an average of under 19 percent of businesses in low-income census tracts received loans, meaning that four out of five businesses in low-income census tracts did not receive credit from the banks reporting under CRA. The situation was a little better for businesses in moderate-income tracts, where an average of about 30 percent of businesses received loans, meaning that seven out of ten businesses did not receive credit. At the other end of the income groupings, 40 percent of businesses in middle-income tracts, and over 47 percent of businesses in upper-income tracts, received loans. This means that businesses in low-income census tracts were less than half as likely as businesses in middle- or upper-income tracts to receive loans from CRA-reporting banks (banks with assets of over about $1.2 billion).

Admittedly, not all businesses want or seek credit from banks, or seek in amounts that would be reported in the CRA data, but the difference between the percentage of businesses in low-income tracts receiving loans and the percentage of businesses in middle- or upper-income tracts receiving loans suggests that businesses in lower-income neighborhoods do not have the same level of access to capital from mainstream banks as businesses in more affluent neighborhoods.

The difference can also be seen by looking at the percent of businesses in the different income levels of census tracts, and then comparing those percentages with the percentage of loans received and the amount of loans. For example, about 6.7 percent of all businesses in the more recent data were in low-income census tracts. Those businesses received only about 3.2 percent of all loans, less than half as many as they might have if loans had been made in proportion to the number of businesses. By way of contrast, about 41.5 percent of all businesses were in upper-income census tracts, and they received 49.1 percent of all loans, over 18 percent more than if loans had been made in proportion to the number of businesses.

The impact of those differences is quite large. If loans had been made in proportion to the number of businesses in the census tracts, businesses in low- and moderate-income census tracts would have received nearly 35,000 more loans, amounting to over $1.34 billion in loans, lines of credit, and credit card limits, than they actually received from the banks reporting under the CRA between 2012 and 2014.

I also analyzed the data by the racial composition of the census tracts, grouping them into tracts that have a population that was less than 20-percent minority, between 20- and 50-percent minority, 50- to 80-percent minority, and 80-percent or more minority. As with the analysis of the income level groups, the racial composition aggregation shows the clear differences between census tracts that are predominantly minority and those that are mostly white. In census tracts that were 80-percent or more minority, an average of about 21 percent of businesses received a loan over the period from 2012 to 2014, meaning they were less than half as likely to receive loans as businesses in census tracts that were majority white.

As with the income level groups, the groups based on the racial composition of the census tract show marked differences between the percentage of businesses in the different groups of tracts and the percentage of loans they received. Businesses in tracts that were 80-percent or more minority make up 14.3 percent of all businesses in the data, for example, but they received only 7.6 percent of loans, over 47 percent fewer loans than if they had been received in proportion to the percentage of businesses. Businesses in tracts that were less than 20-percent minority make up 29.3 percent of businesses in the data, and they received 35.1 percent of all loans, which means they received just under 20 percent more loans than if loans had been made in proportion to the number of businesses.

If loans had been made in proportion to the number of businesses in the census tracts, businesses in majority minority census tracts would have received just over 34,000 more loans, amounting to over $1.26 billion in loans, lines of credit, and credit card limits, than they actually received from the banks reporting under CRA between 2012 and 2014.

If businesses do not have access to loans from banks, then they are probably going to resort to the same types of strategies as consumers who can't get small loans from banks; they are going to go to alternative lenders, some of whom offer access to capital on terms that seem predatory to me. We know about the 300-percent payday and auto title loans that are prevalent in the consumer lending field. Business lending has some of the same types of lenders that charge exorbitant fees and interest. At least in consumer lending, the interest rates on the predatory loans have to be clearly disclosed to the borrower so that he or she can have some basic information about the loan. That is not the case with business loans.

For example, I looked at one loan from OnDeck, a large online business or "marketplace" lender. For an $18,000 loan, the borrower had to make 252 payments of $97.86 every business day, defined as Monday through Friday, with the exception of Federal Reserve holidays. The borrower will pay back the $17,550 he or she received, the $450 origination fee that is rolled into the balance due, and $6,661 in interest over the life of the loan. The terms do not, without calculations that few people can make, let the borrower know that the loan will take a full year to repay with an effective interest rate of just under 70 percent.

Small businesses need access to safe and affordable capital, primarily from banks. The data suggest that small businesses in certain neighborhoods, those with lower incomes or higher percentages of minority residents, do not have access to capital from banks as readily as businesses in more affluent and whiter neighborhoods. Those businesses that obtain loans from largely unregulated, predatory, marketplace lenders often end up worse off than if they had not borrowed. Small business borrowers deserve to be treated fairly by lenders and brokers, and that includes having underwriting based on ability to repay the loan, and enough transparency so that business owners can understand the interest rate and fees, compare terms, and make an informed decision about whether to take the loan.

Thank you for your time and attention.