SECTION 2
Fundamentals

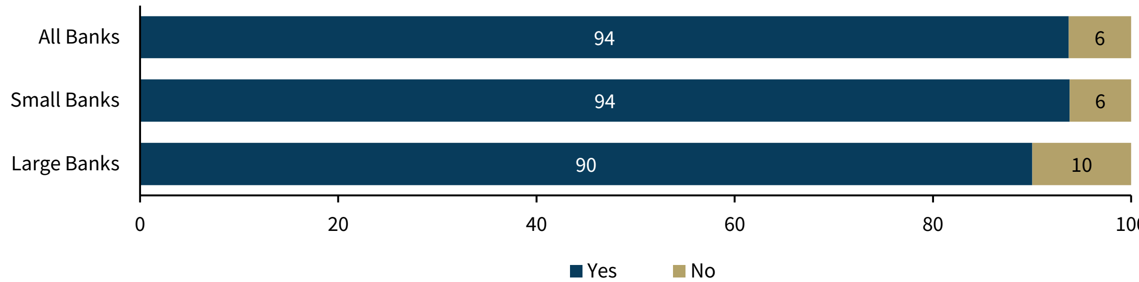
Almost all banks lend to small businesses; 94 percent of small banks and 90 percent of large banks reported making at least some small business loans in 2021 (Figure 2.1).[16]

2.1 Defining Small Businesses

While small and large banks are equally likely to report lending to small businesses, they may not define small businesses the same way. To provide insight into these differences, the 2022 SBLS asked banks whether their internal definition of small businesses uses two common financial measures: the gross annual revenue (GAR) and the aggregate loan exposure (ALE) of the businesses. Figure 2.2 shows that large banks are much more likely than small banks to use these measures to identify small business borrowers. Almost 60 percent of large banks use ALE and about half of large banks use GAR, compared with less than 16 percent of small banks that use either measure in their internal definition. This distinction likely reflects the need for large banks to direct customers and applications to specific units within the bank, while smaller banks may be more likely to consider all of the businesses they serve as small businesses. In the 2016 SBLS, almost 80 percent of small banks considered "largely all" of their commercial and industrial (C&I) lending to be to small businesses.[17]

Banks also use specific quantitative limits for these measures in their definition of small businesses. For banks that use ALE, $1 million or less is the most common limit, reported by about 8 percent of small banks and 33 percent of large banks (Figure 2.2). A significant portion of large banks (22 percent) define small businesses as having ALE between $1 million and $5 million, while only 2 percent of small banks do so. For banks that use GAR to identify small businesses, 14 percent of large banks and 11 percent of small banks use a limit of $1 million or less.[18] Only 4 percent of small banks use GAR greater than $1 million to identify a small business, compared with 37 percent of large banks. The notable differences in the use of GAR limits above $1 million between large and small banks may reflect differences in scale in

FIGURE 2.1
Percentage of Banks That Made Loans to Small Businesses in 2021, by Bank Size



Source: SBLS 2022 Question I.A1.
Note: Banks were asked about their lending in the 2021 calendar year. None of the differences shown here are significant at the 10 percent level.

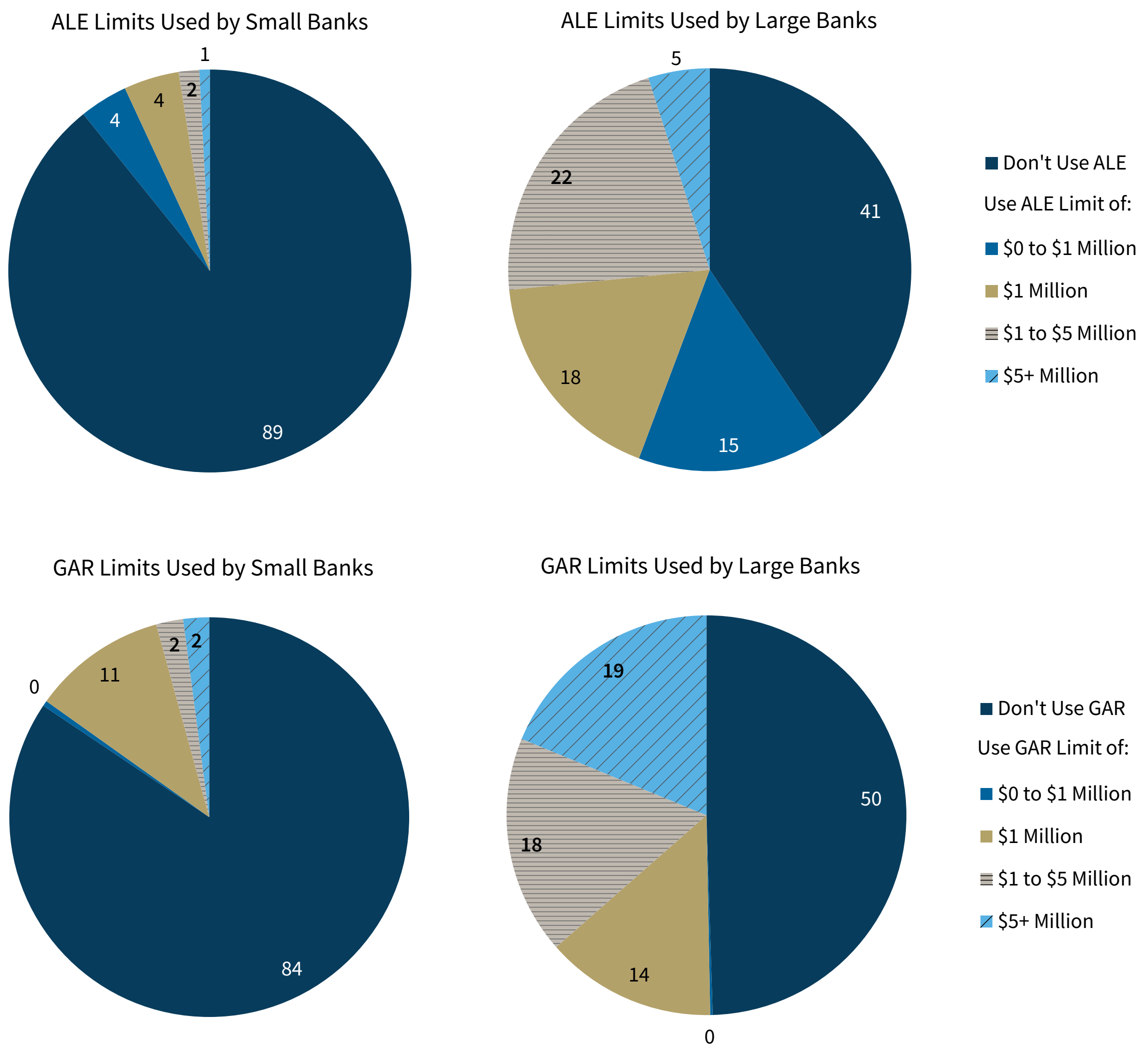
16 Subsequent analysis includes only banks that reported engaging in small business lending in Question I.A1. Thus, in all other analysis, the approximately 6 percent of banks responding "no" to that question are excluded from the calculations. For comparison, 95 percent of banks had at least some commercial and industrial (C&I) loans with an origination amount less than or equal to $1 million at the end of 2021.

17 FDIC (2018).

18 During this period, banks with total assets of more than $1.322 billion were generally obligated under the Community Reinvestment Act to make regulatory filings with data on aggregated C&I lending to businesses with GAR less than $1 million, which may contribute to an increased salience for that limit.

FIGURE 2.2

Percentage of Banks That Used Certain Financial Measures to Define Small Businesses, by Bank Size



Source: SBLS 2022 Questions I.A3, I.A4, I.A5, and I.A6.
Note: The financial measures are "Aggregate Loan Exposure" (ALE) and "Gross Annual Revenue" (GAR).
Results may not sum to 100 percent due to rounding.

which large banks are disproportionately more likely to have small business customers with GAR well above $1 million.

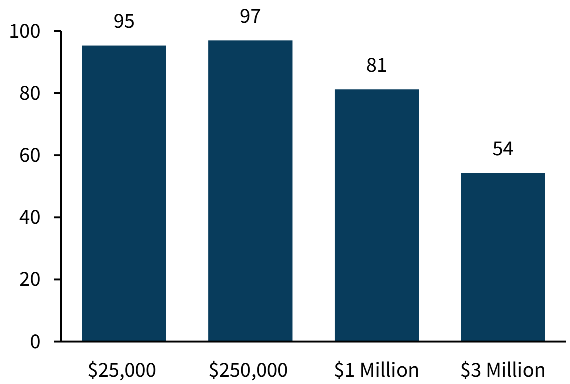
In line with the wide range in financial limits by which banks define small businesses, the sizes of loans banks make to small businesses also vary. Regulators have long used loan size to classify small business lending. But as shown in FDIC (2018), the FDIC's report on the 2016 SBLS, this approach may lead to misstatements of small business lending.[19] Small loans do not necessarily go to small businesses, and small businesses do not necessarily take out small loans. To evaluate banks' willingness to make large loans to small businesses, the 2022 survey asked banks whether they would typically make a loan for four amounts: $25,000, $250,000, $1 million, and $3 million.

[19] This history notably includes the use of C&I lending with amounts at origination up to $1 million as a measure of small business lending in bank Call Reports and for Community Reinvestment Act evaluations. For more, see Goldston and Lee (2020).

Unsurprisingly, nearly all banks make loans of $25,000 and $250,000 to businesses their bank considers small (Figure 2.3). As loan size increases, the share of banks typically making such loans to small businesses decreases. Even so, 81 percent of banks regularly make loans of about $1 million and 54 percent regularly make loans of about $3 million. These findings indicate that the majority of banks regularly make loans to small businesses of $1 million or more and that these loans meet the wide-ranging credit needs of small firms. The findings also reinforce the idea that using loan limits to define small business lending could fail to capture the full extent of bank small business lending.

FIGURE 2.3

Percentage of Banks That Made Small Business Loans of Specific Sizes



Source: SBLS 2022 Question I.C2.
Note: Banks were asked whether, in their normal course of business, they made loans of this approximate size to small businesses.

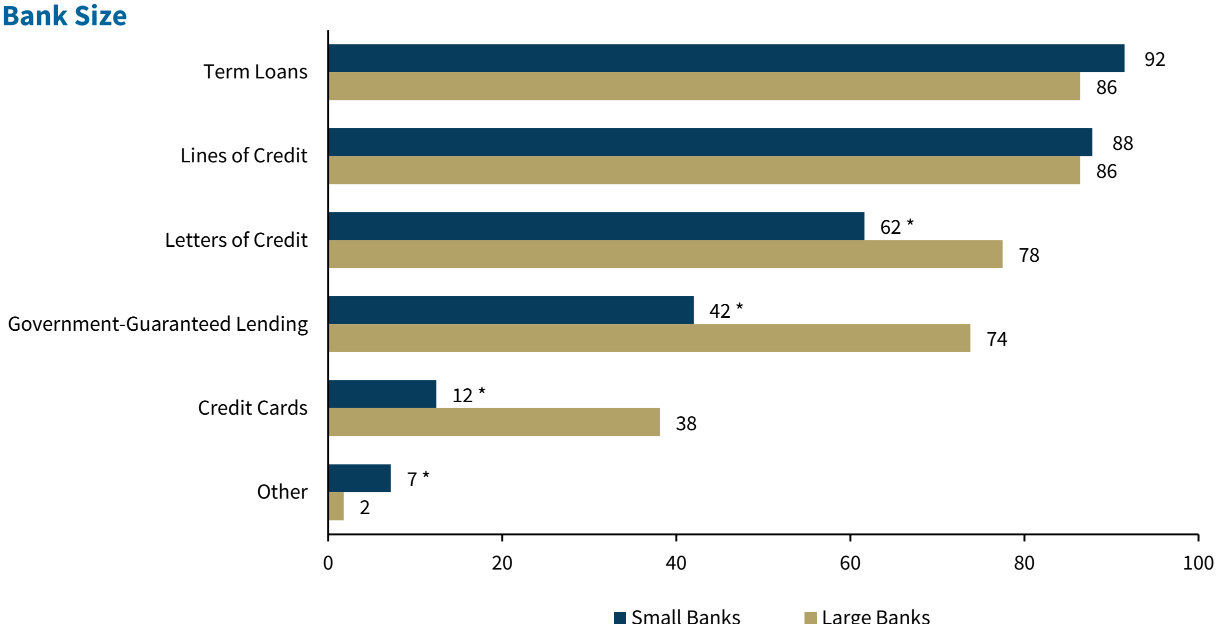
2.2 Small Business Lending Products

Banks offer several types of lending products to serve the needs of their small business customers. The survey asked banks whether they originated loans to small business customers using any of the following five general product types: credit cards, government-guaranteed lending, letters of credit, lines of credit, and term loans.

The survey finds that large banks are more likely than small banks to offer a greater array of products to small business customers (Figure 2.4). Virtually all banks offer term loans and lines of credit, but small banks are less likely than large banks to offer other loan products. For example, about three-quarters of large banks offer letters of credit and government-guaranteed loans, compared with 62 percent of small banks that offer letters of credit and 42 percent

FIGURE 2.4

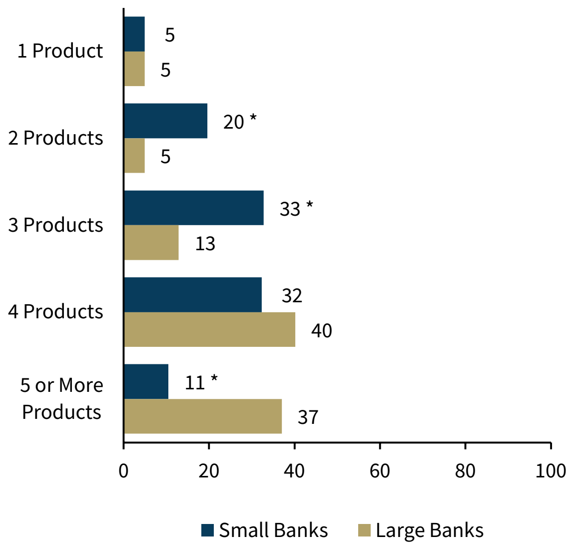
Percentage of Banks That Offered Specific Types of Lending Products to Small Businesses, by Bank Size



Source: SBLS 2022 Question SN4.
Note: Credit cards refer to lending in which the bank issues and holds the portfolio.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 2.5

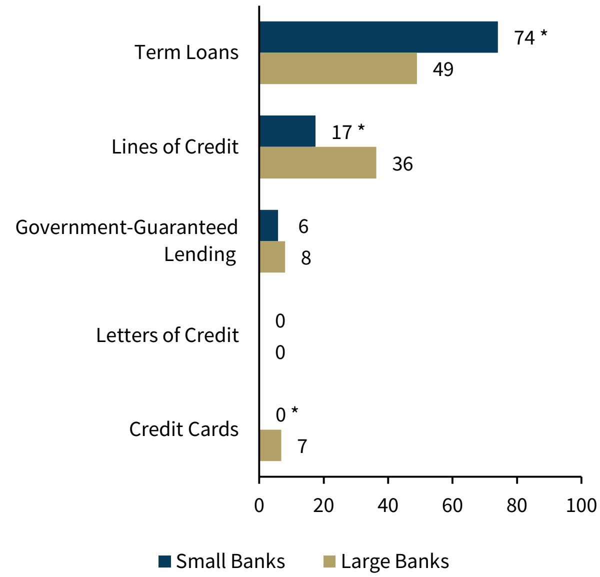
Percentage of Banks That Offered a Certain Number of Small Business Lending Products, by Bank Size



Source: SBLS 2022 Question SN4.
Note: The average number of products offered to small business borrowers is approximately three. Results may not sum to 100 percent due to rounding.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 2.6

Percentage of Banks Citing Each Small Business Lending Product as Their Top Dollar Product, by Bank Size



Source: SBLS 2022 Question SN5.
Note: Top dollar product is defined as bank's highest ranked product by dollar volume of originations among product types the bank originated to small business borrowers. The "other product" answer option is omitted. Credit cards refer to lending in which the bank issues and holds the portfolio.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

that offer government-guaranteed loans. Offering a credit card managed from the bank's own portfolio is relatively rare for small banks (12 percent) but relatively common for large banks (38 percent).

The larger scale of operations at large banks, as shown in Figure 2.4, likely increases the probability of these banks offering a particular loan product. Government-guaranteed loans, for example, allow banks to effectively manage risk for smaller-dollar lending or to use secondary markets to generate a relatively quick return on capital. But this type of lending often requires significant investments in specialized staff, which may be cost prohibitive at smaller scales of operation (see Sections 2.4, 2.5, and 7.2). Other factors may also contribute to the differences in the types of small business loans small and large banks offer. For example, credit card lending tends to rely heavily on credit scores and other types of hard information, which more closely aligns with the underwriting practices used by large banks (see Section 3.5).

Although large banks are more likely to offer a greater array of loan products to small business customers, the vast majority of banks, large and small, offer more than one product (Figure 2.5). The average number of products originated across all banks is three, but this statistic masks substantial differences between small and large banks.[20] Most large banks (77 percent) originate loans in at least four of the different product types, compared with less than half of small banks (43 percent). However, a broader product offering does not necessarily translate into more flexibility in small business lending. Greater flexibility is a competitive advantage more typically associated with small banks (see Section 6.3).

Small and large banks also differ in what they consider their top lending product. Figure 2.6 shows the percentage of small and large banks indicating whether a product was their top product

[20] Average number of products originated across banks is computed using the mean number of product types that banks reported they originate in response to Question SN4.

as measured by dollar volume of originations. While most banks offer term loans and lines of credit, term loans are the top product for 74 percent of small banks and 49 percent of large banks. Lines of credit are the top product for 36 percent of large banks but only 17 percent of small banks. A relatively small share of banks—6 percent of small banks and 8 percent of large banks—report government-guaranteed loans as their top product. Notably, 7 percent of large banks indicate their top product to small businesses by volume is credit cards, while hardly any small banks report the same.

For multiple parts of the survey, the questions focused on the bank's "focal lending product," which refers to the bank's top loan product other than credit cards or government-guaranteed lending. This approach avoids mixing results from common loan products with those from specialized and qualitatively different products. Results were analogous to those for the top product overall (Figure 2.7). Term loans are the most common focal lending product overall and for both small and large banks, although large banks are more likely than small banks to report lines of credit as their focal lending product.

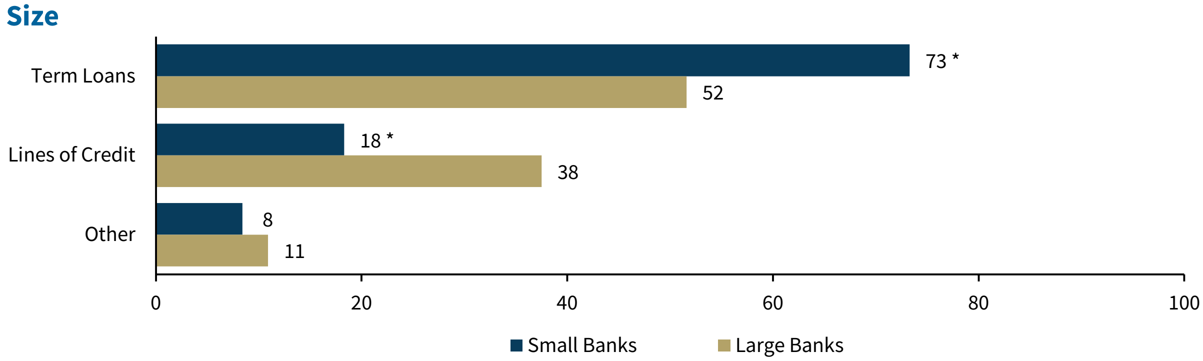
2.3 Primary Use of Loans by Type

The survey asked banks to report the primary use of their focal lending product for loans of four sizes: $25,000 (small loans), $250,000 (medium loans), and $1 million or $3 million (large loans).[21]

The survey finds that small term loans of $25,000 are most commonly used for equipment (65 percent), while large term loans of $1 million or $3 million are mainly used for owner-occupied commercial real estate (CRE) (81 percent) (Figure 2.8). Medium term loans are used roughly evenly for equipment (36 percent) and CRE (42 percent). Lines of credit are more often used for liquidity purposes, with working capital, inventory, and funding of accounts receivable making up the bulk of the uses for all sizes of loans. A quarter of banks report using large lines of credit for owner-occupied CRE.

FIGURE 2.7

Percentage of Banks Citing Each Focal Lending Product as Their Top Dollar Product, by Bank Size

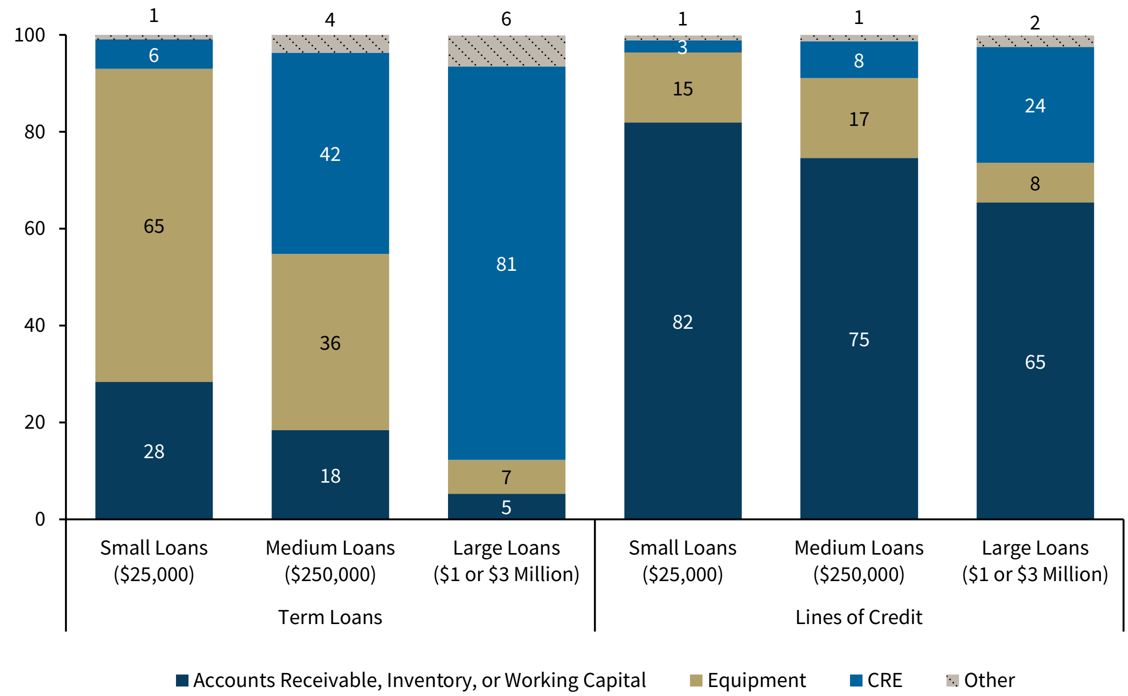


Source: SBLS 2022 Question SN5.
Note: This figure shows the focal product for questions keyed to a specific product. The focal product is the bank's highest ranked product by dollar volume of originations among product types the bank originated to small business borrowers, excluding credit cards and government-guaranteed lending (see Appendix A for more information). Results may not sum to 100 percent due to rounding.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

[21] Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Responses for $1 million and $3 million loans are combined to form the "large loans" category.

FIGURE 2.8

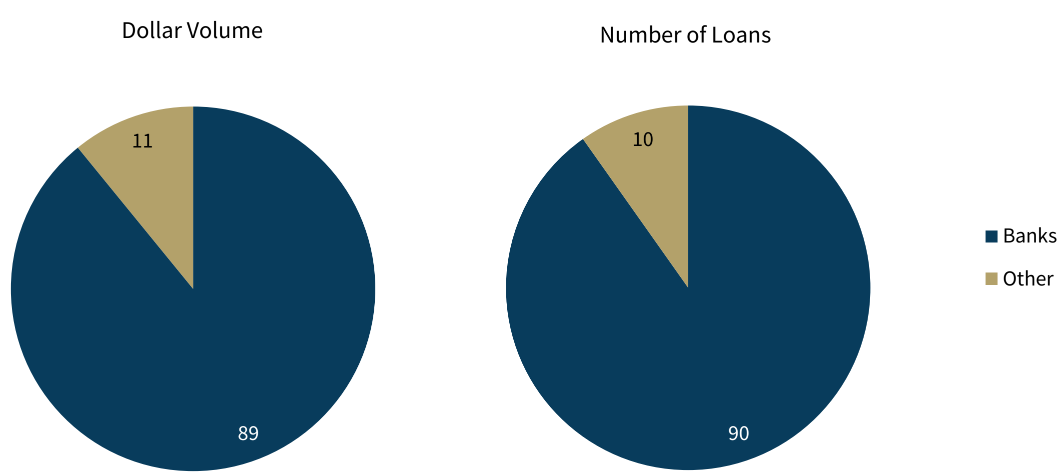
Percentage of Banks Citing Each Loan Purpose as Most Common, by Product Type and Loan Size



Source: SBLS 2022 Questions IC.3, IC.9, IC.15, and IC.21.
Note: Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information). Results may not sum to 100 percent due to rounding.

FIGURE 2.9

Percentage of SBA 7(a) Loans Originated in 2021, by Type of Institution



Source: SBA 7(a) data.
Note: “SBA” is the Small Business Administration, which administers several programs that facilitate lending to qualifying small businesses. SBA 7(a) loans are originations from the SBA’s largest program that offers a partial guarantee of the loan principal.

2.4 Government-Guaranteed Lending

Government-guaranteed lending refers to loans in which a government entity agrees to cover a portion of the loss if the borrower defaults. Typically, these guarantees help encourage or expand credit in targeted communities. Guaranteed loan programs play a dominant role in the consumer credit market for residential mortgages, where most loans are eligible for a form of guarantee from a government or quasi-government agency. In contrast to the residential mortgage market, the overall volume of government-guaranteed lending remains a small part of small business lending.[22]

The most prominent guaranteed loan program in the U.S. small business lending market is the Small Business Administration (SBA) 7(a) Loan Program. The 7(a) program offers a guarantee, typically for 50 to 85 percent of the loan principal, as long as the loan meets certain criteria.[23] The SBA administers the program through approved lenders that take the application and help underwrite and fund the loan.

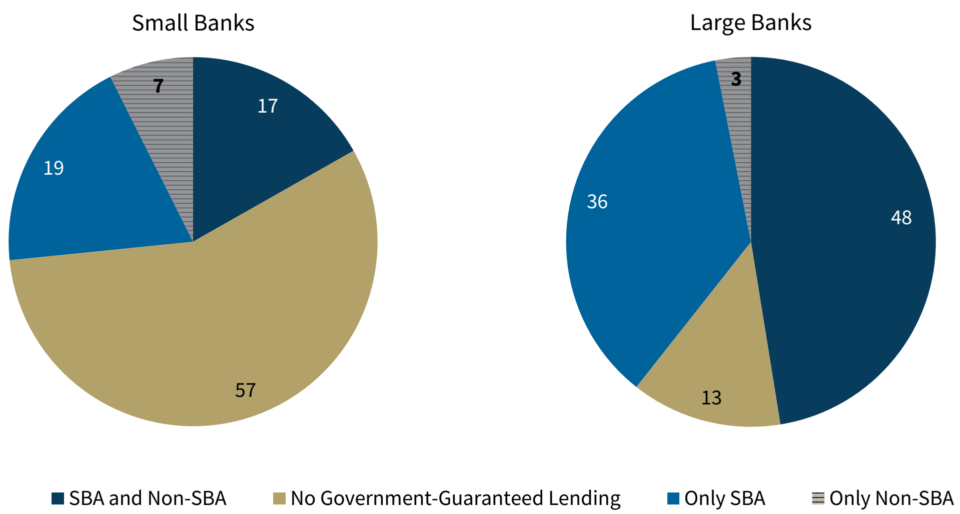
As a mainstay of the financial system, banks serve as a primary intermediary for administering government-guaranteed small business loan programs. In 2021, banks originated 89 percent of 7(a) loans by dollar volume and 90 percent by number of loans (Figure 2.9).[24]

While banks are central to the SBA program, less is known about how such programs fit into a bank's overall lending operations. Thus, the survey included several questions that explore how banks incorporate government-guaranteed loan products into their small business lending.

To gauge the prevalence of bank participation in government-guaranteed lending, the survey asked banks whether they originated loans through any program offering a government guarantee.[25] As

FIGURE 2.10

Percentage of Banks Originating Government-Guaranteed Loans, by Type of Loan and Bank Size



Source: SBLS 2022 Questions SN2A, SN2B, and III.B1.
Note: "SBA" is the Small Business Administration, which administers several programs that facilitate lending to qualifying small businesses. Results may not sum to 100 percent due to rounding.

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22 Gopal and Schnabl (2022) estimate that SBA lending accounted for about 8 percent of all C&I lending in 2016.
23 Most notably, the SBA requires a 7(a) borrower to be unable to obtain reasonably priced credit from a traditional source.
24 Author calculations from SBA data on the 7(a) program.
25 This analysis restricts the answers to government-guarantee programs other than the Paycheck Protection Program (PPP). The 2022 survey asked specific questions about banks' participation in the PPP, and the results from these questions can be found in Section 1. The timeframe for the question is calendar year 2021. Given the prominence of the SBA in the small business market, the survey separately asked banks about their lending through SBA and non-SBA programs.

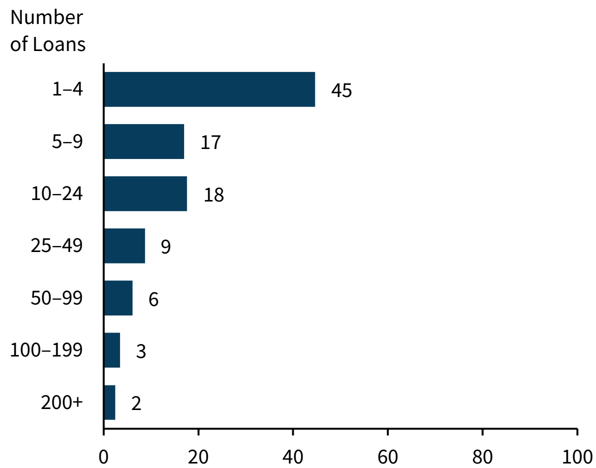
shown in Figure 2.10, fewer than half of small banks participate in government-guarantee loan programs that target small business borrowers, while nearly all large banks do. About 43 percent of small banks and 87 percent of large banks participate in at least some government-guaranteed lending. SBA programs are the most popular small business government-guaranteed program banks use, with 36 percent of small banks and 84 percent of large banks participating. Bank participation in only a non-SBA guarantee program is comparatively rare (7 percent of small banks and 3 percent of large banks).

The majority of banks (62 percent) that made SBA 7(a) loans in 2021 made fewer than 10 such loans, and only 2 percent of banks made more than 200 7(a) loans (Figure 2.11). These results are consistent with the relatively small number of banks that cite government-guaranteed loans as their primary small business loan product (Figure 2.6). Further, these results suggest that banks can use the SBA program to supplement their regular lending or as a mainstay product, and participation does not seem to be inherently limited to large banks due to economies of scale.

To understand the reasons driving the differences in participation in guaranteed lending, the survey asked banks about factors that limit their involvement in the SBA 7(a) program, including concerns about compliance, operating and staffing costs, and lack of need. The relatively high cost of participation, in terms of obtaining required expertise and personnel, and a lack of perceived need are the most common factors limiting participation (Figure 2.12). About half of small banks (48 percent) and 20 percent of large banks cite difficulty obtaining the required expertise and personnel to start or expand their SBA program. A similar share of small banks (48 percent) and a third of large banks report that applicants qualify for other loan products and do not need an SBA guarantee. Relatively less common concerns are compliance with origination and servicing guidelines and start-up or administrative costs of participation.

Despite these concerns, government-guaranteed lending plays an important role in small business lending. As noted in Section 7.2, large banks seem to use government-guaranteed loans to manage risk

FIGURE 2.11
Percentage of SBA-Lender Banks Reporting SBA 7(a) Loans Originated in 2021



Source: SBA 7(a) data.
Note: "SBA" is the Small Business Administration, which administers several programs that facilitate lending to qualifying small businesses. SBA 7(a) loans are originations from the SBA's largest program that offers a partial guarantee of the loan principal. Results include only those banks that made at least one SBA 7(a) loan in 2021, which is the calendar year and not the SBA's fiscal year.

when lending to applicants without a strong credit history. In fact, 37 percent of SBA originations in 2021 went to businesses two years old or less.[26]

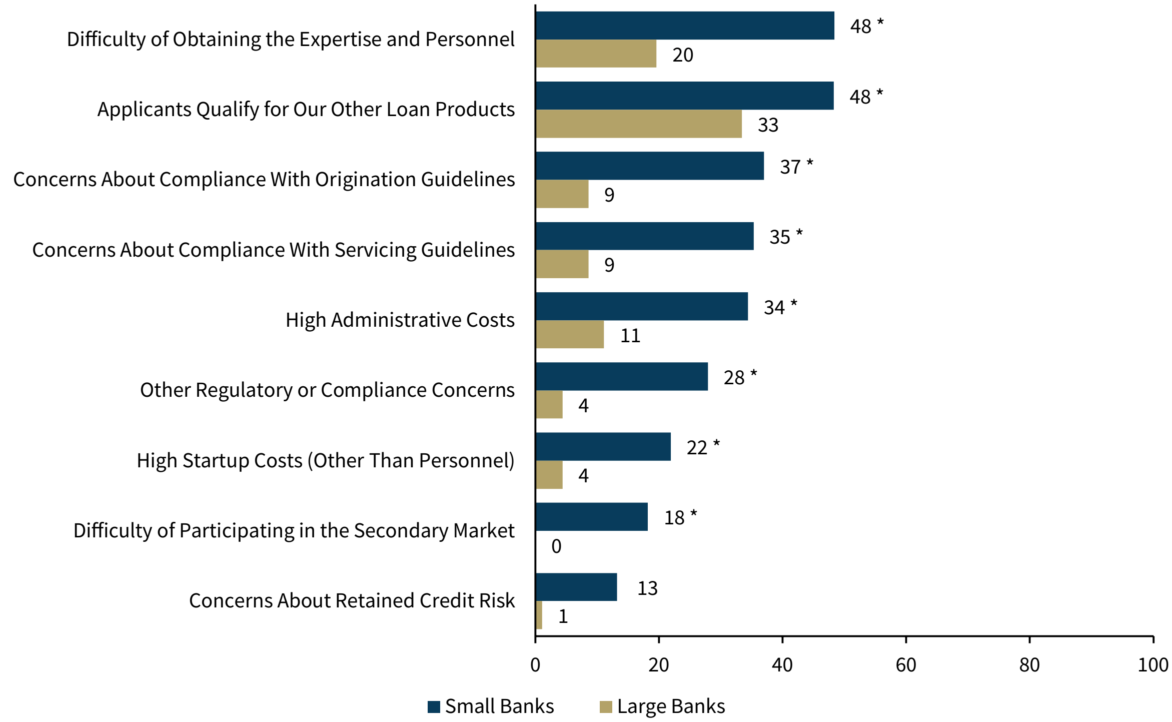
2.5 Sales of Small Business Loans

Another way banks can manage the credit risk of a small business loan portfolio is by participating in the secondary market for small business loans, where lenders can sell loans they originated, either individually or through securitization. A large secondary market for loans can quickly increase liquidity by allowing banks to recoup a portion of the principal and issue additional loans. The secondary market in residential mortgage financing is widely credited with expanding the availability of credit, principally through the participation of government-sponsored enterprises that support market functioning. Within small business lending, the most prominent secondary market is for the guaranteed portion of SBA 7(a) loans. The secondary market for traditional small business lending products is less centralized and difficult to quantify. Accordingly, the

[26] Author calculations from SBA data.

FIGURE 2.12

Percentage of Banks Listing Selected Factors as Limiting Their Participation in SBA Programs, by Bank Size



Source: SBLS 2022 Question III.B2.
Note: Question asked respondents to exclude the Paycheck Protection Program (PPP) when answering.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

survey asked whether banks had sold various types of loans with and without a government guarantee.

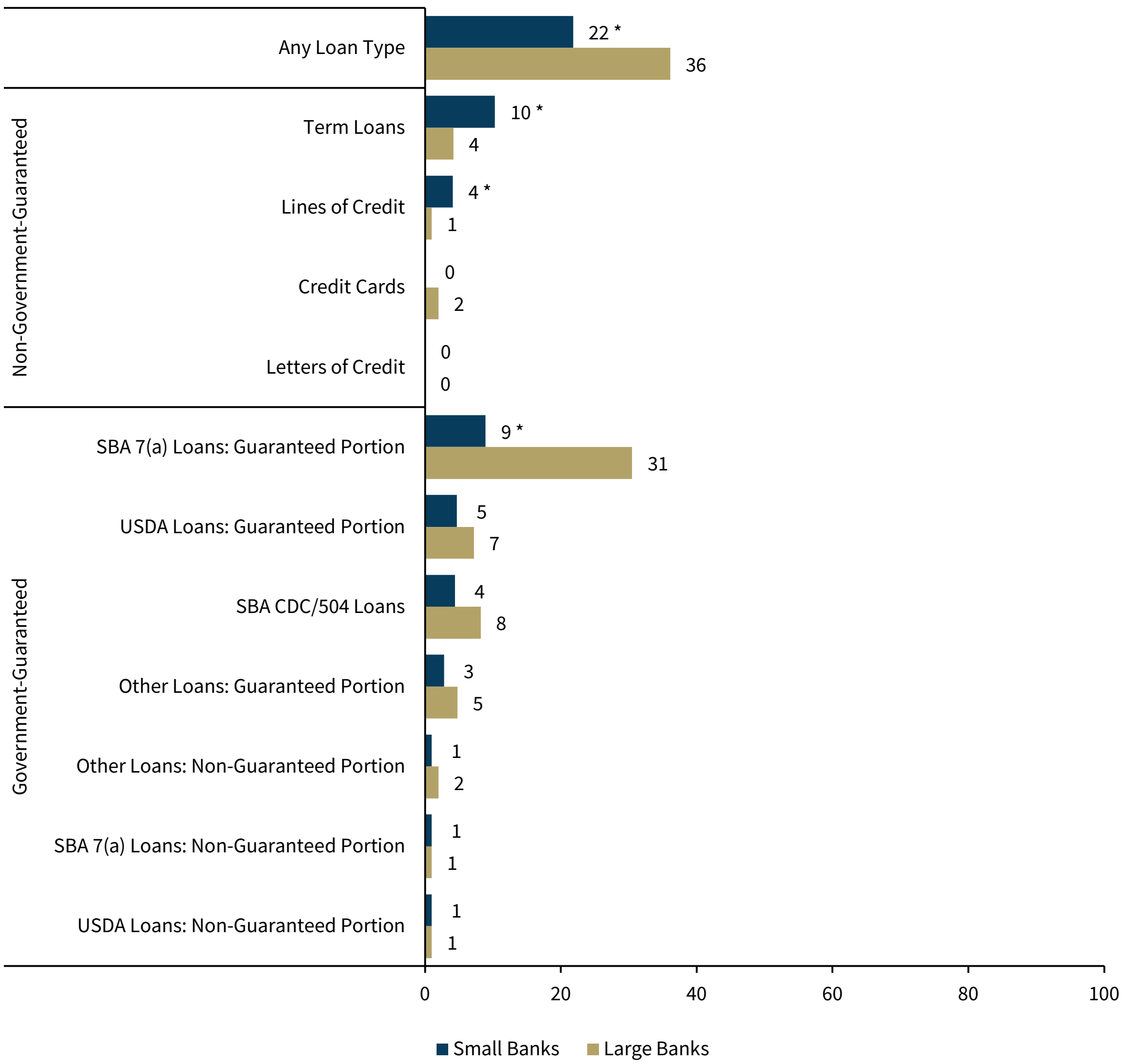
Most banks did not sell any portion of their loans in 2021. Only 22 percent of small banks and 36 percent of large banks sold at least one small business loan (Figure 2.13). The higher prevalence of sales among large banks likely reflects the fixed costs of participating in the secondary market and the greater likelihood of originating government-guaranteed loans, particularly SBA loans (see Section 2.2). These findings also suggest that, as in the residential mortgage market, government guarantees play an important role in the secondary market for small business loans. Almost all large banks and a significant share of small banks that sell loans sell a government-guaranteed portion. However, small banks are significantly more likely than large banks to sell traditional credit products, including term loans and lines of credit. Overall, these findings suggest a relatively modest role for the secondary market in small business lending.

2.6 Conclusion

Survey results show that almost all banks participate in small business lending, though not necessarily by offering the same products or providing the same services. Banks also define small businesses differently, with large banks more likely to use rigid definitions based on gross annual revenue or aggregate loan exposure. Banks commonly offer relatively large loans of $1 million or more to businesses they consider small, as well as smaller loans of $25,000 or less. Depending on the loan size and specific product, these loans might be used for equipment or owner-occupied commercial real estate (in the case of term loans), or for working capital or other liquidity purposes (in the case of lines of credit).

While banks originate the bulk of government-guaranteed small business loans, government-guaranteed lending and the secondary market do not make up a large share of most banks' small business lending. But government guarantees and the secondary market, especially in conjunction, can be an important part of banks' role in the small business lending market. The relatively limited role for government-guaranteed lending and secondary markets in small business lending underscores the unique expertise of banks in providing small business credit and may reflect the importance of soft information and relationships when evaluating loan applications from small businesses.

FIGURE 2.13
Percentage of Banks That Sold Specific Types of Small Business Loans, by Bank Size



Source: SBLS 2022 Question III.C1.
Note: Credit cards refer to lending in which the bank issues and holds the portfolio. "SBA" is the Small Business Administration, which administers several programs that facilitate lending to qualifying small businesses. SBA 7(a) loans are originations from the SBA's largest program that offers a partial guarantee of the loan principal. "SBA CDC/504" is the 504 loan program intermediated through Certified Development Companies (CDCs), which facilitates longer-term lending to qualifying small businesses. "USDA" is the United States Department of Agriculture, which administers several programs that facilitate lending to qualifying small businesses.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.