

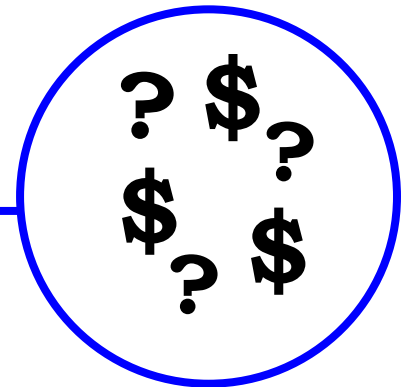
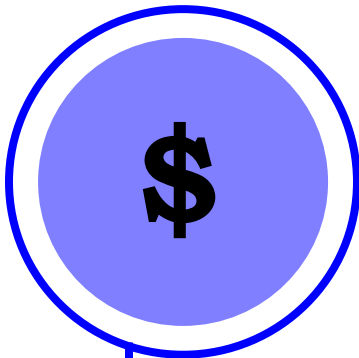
Final Report

Understanding Small Business Needs and Capital Access Barriers in Northern Lower Michigan

**Michigan State University
Center for Community and Economic Development
University Outreach and Engagement**

Project Team

J. D. Snyder
Rex LaMore
Steve Miller
Robert Griffore
John Schweitzer
Paul B.A. Holland
John Melcher



March 31, 2011

Supported, in part, with a grant from the
U.S. Department of Agriculture
Rural Business Enterprise Grant (RBEG) Program

Disclaimer

This report was prepared by the Michigan State University Center for Community and Economic Development under U.S. Department of Agriculture contract number 26-033-386900598. The statements, findings, conclusions, and recommendations are those of the authors and do not necessarily reflect the views of the U.S. Department of Agriculture.

© 2011 Michigan State University Board of Trustees, All Rights Reserved

Table of Contents

Executive Summary	ES-1
I. Overview/Introduction	1
II. Project Methodology	7
1. Literature Review	7
2. Analysis of FDIC Call Report Data	7
3. Design of the Lender Questionnaire and Survey	8
4. Design of the Small Business Questionnaire and Survey	10
5. Description of Data Analysis Methods	11
6. Webinar (Virtual Workshop) and Other Feedback on Study	12
III. Literature Review	13
IV. FDIC Commercial and Industrial Loan Data and Lenders’ Perceptions of Small Business Loan Conditions in Northern Lower Michigan	15
1. 2007-2010 FDIC Reports of Condition and Income (Call Report) Data	15
2. Survey of Commercial Bank Loan Officers: Perceptions of Capital Access Conditions	22
V. Small Businesses’ Capital Needs and Their Access to Capital	27
VI. Differences in Capital Access between Young and Mature Small Businesses	34
VII. Differences in Outcomes of Small Business Bank Loan Applications by Company Size	38
VIII. Barriers to Capital Access and Potential Solutions	40
IX. Small Business and Lender Perceptions of USDA and SBA Loan Programs	46
X. Project Findings	57
1. Small Business Capital Needs and Purposes	57
2. Lenders’ Loan Portfolio Management	59
3. Integrating Capital Needs with Loan Portfolio Management	60
XI. Policy Implications	62
XII. Conclusion	68
Annotated Bibliography	70
XIII. Appendices	
1. Key Informants and Interview Dates	A-1
2. Populations of Northern Lower Michigan Counties	A-2

3. Employment in Northern Lower Michigan by North American Industry Classification System (NAICS) Categories	A-3
4. Banking Intensity by Counties in Northern Lower Michigan	A-4
5. Lender Capital Access Survey Questionnaire	A-5
6. Small Business Capital Access Survey Questionnaire	A-10
7. Lender Perception Survey Data Tables	A-18
8. Small Business Perception Survey Data Tables	A-20
9. Young and Mature Company Cross Tabulation Survey Data Tables	A-23
10. Bank Loan Outcome Survey Data Tables	A-24
11. SBA and USDA Programs Survey Data Tables (Small Business & Lender Perceptions)	A-25
12. Michigan Small Business and Technology Development Centers (SBTDCs) Contact Information	A-31
13. Non-Employer Establishments in Northern Lower Michigan by County	A-32

List of Figures

Figure 1. Northern Lower Michigan Study Region	4
FDIC Call Report Data	
Figure 2. Average Commercial and Industrial (C&I) Loans	17
Figure 3. Average C&I Loan Charge-offs	18
Figure 4. Average C&I Loan Recoveries	18
Figure 5. Average C&I Loans Past Due or Nonaccruing	19
Figure 6. Changes in Regional Small Business C&I Lending	20
Figure 7. Average Number of Small Business C&I Loans	21
Figure 8. Amount Outstanding of Small Business C&I Loans	21
Lender Perceptions of Capital Access	
Figure 9. Availability of Lending Capital	23
Figure 10. Total Lending Portfolio Performance	24
Figure 11. Current Lending Standards	25
Figure 12. Purpose of Loan Requests	26
Figure 13. Future Small Business Lending	26
Small Business Perceptions of Capital Needs and Barriers to Access	
Figure 14. Current Financial Situation	28
Figure 15. Future Performance	28
Figure 16. Obstacles to Business Growth	29
Figure 17. Current Loan Standards	30
Figure 18. Future Capital Need	30
Figure 19. Future Capital Availability	30
Figure 20. Purpose of Future Capital	31
Figure 21. Lack of Capital a Problem	32
Figure 22. Impact of Lack of Capital	33
Figure 23. Applications of Additional Capital	33
Differences in Capital Access between Young and Mature Small Businesses	
Figure 24. Company Size by Average Number of Employees	34
Figure 25. Company Size by Average Annual Revenue	34

Figure 26. Current Financial Situation	35
Figure 27. Lack of Capital a Problem	36
Figure 28. Impact of Lack of Capital	36
Figure 29. Applications of Additional Capital	37
Different Outcomes of Small Business Bank Loan Applications by Company Size	
Figure 30. Bank Loan Outcomes	38
Figure 31. Bank Loan Outcomes by Average Number of Employees	38
Figure 32. Bank Loan Outcomes by Average Annual Revenue	38
Figure 33. Lack of Capital a Problem by Bank Loan Outcome	39
Small Business and Lender Perceptions of USDA and SBA Loan Programs	
Figure 34. Barriers to Capital Access and Potential Solutions	45
Figure 35. USDA Loan Applications*	46
Figure 36. Knowledge of USDA Programs*	47
Figure 37. Source of USDA Knowledge*	48
Figure 38. Actions to Improve USDA Programs*	48
Figure 39. Success of USDA Loan/Grant Programs**	49
Figure 40. Actions to Improve USDA Programs**	50
Figure 41. SBA Loan Applications*	51
Figure 42. SBA Loan Outcomes*	51
Figure 43. Reasons for SBA Loan Denial*	52
Figure 44. Knowledge of SBA Programs*	52
Figure 45. Source of SBA Knowledge*	53
Figure 46. Actions to Improve SBA Programs*	54
Figure 47. Success of SBA Loan Programs**	55
Figure 48. Actions to Improve SBA Programs**	56

* Small Business survey.

** Lender survey.

Executive Summary

Introduction

The Michigan State University Center for Community and Economic Development (CCED) project team sought to identify small business capital needs and the barriers to capital access in Northern Lower Michigan in a research project supported by a U.S. Department of Agriculture Rural Business Enterprise Grant (RBEG). The study was conducted in late 2010. CCED had earlier identified insufficient access to capital as a major obstacle to economic recovery and future business growth in its study titled *Investment 101: Capital Access and Investment Strategies in Northern Michigan and the Eastern Upper Peninsula*, funded in part with a U.S. Economic Development Administration grant. However, the CCED team wanted to develop a more complete and nuanced understanding of small business capital access conditions in rural Northern Lower Michigan. The team believed a more complete understanding of these conditions could lead lenders, small businesses, and policy makers to take actions to improve small business capital access.

Methodology

CCED assembled a multi-disciplinary Michigan State University project team to conduct the study. The project team designed two online questionnaires to survey small business owners and financial lenders, respectively, to identify gaps in capital access and related issues. Eight key informant interviews were conducted in August and September, 2010 to provide qualitative data and context for the development of the survey questionnaires. The project team also conducted a comprehensive review of the literature on small business capital access. Each questionnaire was uploaded to the SurveyMonkey Web site. The project team contacted local Chambers of Commerce and economic development agencies in the 21-county Northern Lower Michigan study region to assist dissemination of the URL link to each survey questionnaire on the SurveyMonkey Web site. Sixty-two (62) small business owners and 13 financial lenders participated in the surveys. The project team used the analytical capacity of the SurveyMonkey Web site to produce frequency and cross-tabulation analyses of the small business and lender survey data. The project team also analyzed FDIC Call Reports submitted by banks based in the region. On February 3, 2010, the project team conducted a webinar (virtual workshop) with representatives of the Michigan Small Business and Technology Development Centers, Federal Reserve Bank Chicago Region (Detroit Branch), and Northern Initiatives to obtain feedback on the draft Final Report.

Study Findings

Based on analysis of the project survey data, the project team organized the study findings into three principal areas:

I. Small Business Capital Needs and Purposes

- Most small businesses have found a lack of capital to be a problem and a barrier to future growth, yet remain optimistic about their future growth.
- A frequent consequence of a lack of capital is the inability of companies to grow or expand their operations.
- If capital were more available to companies, greater job creation would result.
- Lack of capital is a particularly pervasive problem for young companies that have fewer resources and less financial flexibility with which to endure the Great Recession and its lingering aftermath.
- Young companies more frequently than mature companies indicated they would hire additional employees if they were able to obtain capital.

II. Lenders' Loan Portfolio Management

- The Great Recession severely curbed cash flows so that otherwise creditworthy borrowers have found it difficult to meet lenders' standard loan benchmarks.
- Bank regulators may be relying on loan benchmarks that are too tough for small businesses to meet coming out of the recession and a still tentative economic recovery.
- Business owners often lack sufficient financial records, like financial statements that are more detailed than income tax returns, when applying for financing.

III. Integrating Capital Needs with Loan Portfolio Management

- Lenders, held by strict regulatory and internal portfolio standards, generally remain hesitant to lend to companies that would pose acceptable risks in any other economic environment.
- Business owners are often frustrated by what they see as insurmountable paperwork barriers to qualify for a bank loan and are often unprepared to meet lenders' expectations.

Policy Implications

Based on these findings, the project team urges action to address seven policy implications:

1. **Develop Reasonable Cash Flow and Capital Reserve Lending Requirements Consistent with Business Conditions in 2011 and Beyond.** It seems appropriate to question whether current lending standards are properly aligned with current economic realities. It is plausible that current cash flow and capital reserve requirements are more consistent with the unusually high GDP growth rates in the 1990s and bubble economics of the early 2000s than current economic conditions. A new set of regulatory lenses calibrated to these new economic realities of 2011 and beyond is arguably needed.
2. **Greater Regulatory Flexibility Needed in Supervising Community (Regional) Bank Loan Portfolios.** A multi-tiered regulatory approach to systemic risk would afford community banks the flexibility they need to make loans that they are currently restricted from making. As these community banks have immediate knowledge of their clients and local markets, it seems reasonable for them to have a greater range of discretion in making credit decisions. One regulatory approach would be to establish different portfolio risk metrics for multi-state banks, single-state banks, and community (regional) banks, respectively.
3. **Streamline the USDA and SBA Loan Application Processes.** Efforts to reduce the “shoe-leather costs” associated with USDA and SBA-backed loan applications are strongly desired and are important to creating an environment which unleashes entrepreneurial talent and job creation.
4. **Create a State Loan Fund.** Viable approaches exist to create a state loan fund or bank. Pooling public assets or pooling philanthropic foundation and public monies together could be used to create a public/private loan guarantee program that would promote Michigan economic development objectives.
5. **Effective Mobilization and Deployment of Small Business Loan Application Assistance.** Michigan should launch a concerted effort to enhance the visibility of public and private small business service providers. This effort could reduce loan transaction costs for both small businesses and commercial lenders. Effective deployment of business assistance resources is every bit as important as developing the resources in the first place.

6. **Build an Entrepreneurial Michigan.** Develop curricula at university, community college, and high-school levels that encourage creativity, problem-solving, and collaborative skills to prepare students to become entrepreneurs or entrepreneurially-minded workers. It is clearly insufficient to prepare students for entry to a traditional twentieth century workplace that no longer exists.
7. **Networking the Path to Business Innovation and Market Success.** State and local civic leaders can encourage networks by hosting annual entrepreneurship awards, providing meeting space, networking with other regional networks, and a wide range of other creative actions to support entrepreneurs, including those that open up paths to export markets.

Conclusion

It is vital for state, regional, and local agencies to take strategic actions that support greater capital access by small businesses because they power the engines that move our economy forward. Small businesses are the primary source of new jobs. Small businesses consistently rank difficulty in obtaining capital as a significant growth impediment. In essence, access to capital is the lifeline of small businesses and fundamental to future job growth. In general, far greater emphasis is needed in the region and state on issues related to the development and encouragement of small businesses and entrepreneurs.

I. Overview/Introduction

The MSU Center for Community and Economic Development (CCED) has served economically-distressed communities since 1969 by providing effective technical assistance and innovative research to improve economic conditions in those underserved urban and rural communities. With the advent of the new millennium and recognizing the fundamental transformation of the state's traditional manufacturing economy, CCED has promoted collaborative regional economic development strategies to position communities for success in the global knowledge economy.

As one part of CCED's award-winning, 21-month long U.S. EDA-funded project¹ that concluded July 31, 2010, the CCED project team published a White Paper titled *Investment 101: Capital Access and Investment Strategies in Northern Michigan and the Eastern Upper Peninsula* (May 2010). Based on eight key informant interviews,² insufficient capital access was identified as a major barrier to economic recovery and future development in the region. It was recognized that more research on capital access conditions would provide a more complete and nuanced understanding of these conditions in the region.

CCED's research also revealed that a relatively robust number of capital sources in addition to commercial lenders are available through regional and local revolving loan funds and USDA and SBA programs. In addition, Small Business and Technology Development Centers (SBTDCs) provide valuable business assistance services. But our preliminary field research also indicated that entrepreneurs and small businesses were either unwilling to seek out those sources or were unaware of them. Furthermore, while information on the "supply side" (commercial lenders) exists in federal data and reports, information on the "demand side" (small businesses at a local scale) is much less readily

¹ The MSU Center for Community and Economic Development was a finalist for the national University Economic Development Association's 2010 Excellence in Economic Development and Public Policy Research Award.

² See Appendix 1 for key Informant names and interview dates.

available. The preliminary identification of these “disconnects,” or gaps, provided the major impetus to conduct research to ascertain small business capital needs and to understand the conditions associated with capital access.

Based on federal and other data, small businesses and entrepreneurs have continued to find stalled credit markets for the most part since the financial meltdown in Fall, 2008. This snag in capital access has been detrimental to economic growth and recovery across the state; communities and families suffer. In a speech 14 months ago (December 8, 2009), President Obama recognized the need “to address the continuing struggle of small businesses to get loans they need to start up and grow.” At the time, he proposed waiving fees and increasing guarantees for SBA-backed loans as well as mobilizing Troubled Asset Relief Program (TARP) funds to facilitate lending to small businesses. The need for action became so acute over the course of the next 10 months that Congress, in spite of its seemingly intractable partisan differences, came together and passed the Small Business Jobs Act in September, 2010.

There is a powerful rationale for seeking to understand small business capital access conditions. To achieve a fully-realized economic recovery with the creation of a sufficient number of jobs to adequately support Michigan families and communities, entrepreneurial drivers must be unleashed. One key to unleashing creative entrepreneurs and growing their enterprises in rural communities is to free up access to investment capital. Effective deployment of this capital will give traction to innovative enterprises that will take risks, and compete and thrive in regional, national, and global markets. This strategic entrepreneurial development will create jobs needed by rural communities, one-by-one and two-by-two. Some will go on to become major enterprises with tens or even hundreds of jobs.

1. Introduction to Our Current Project

Economic development leaders in Michigan must push the envelope for regional rural development that is informed by a keen understanding of capital conditions on the ground here in the state and the competitive implications of the 21st century global economy for the state and its regions. At the core of innovative regional development is the understanding that strategic deployment of investment capital is critical to supporting entrepreneurial capacity to create new jobs and wealth.

To address rural capital access issues effectively, an empirical analysis of current entrepreneurial needs for capital in northern Lower Michigan on one hand and investment capital resources and services on the other was proposed to the USDA Rural Development Michigan Office and subsequently funded under the Rural Business Enterprise Grant (RBEG) program in July 2010.

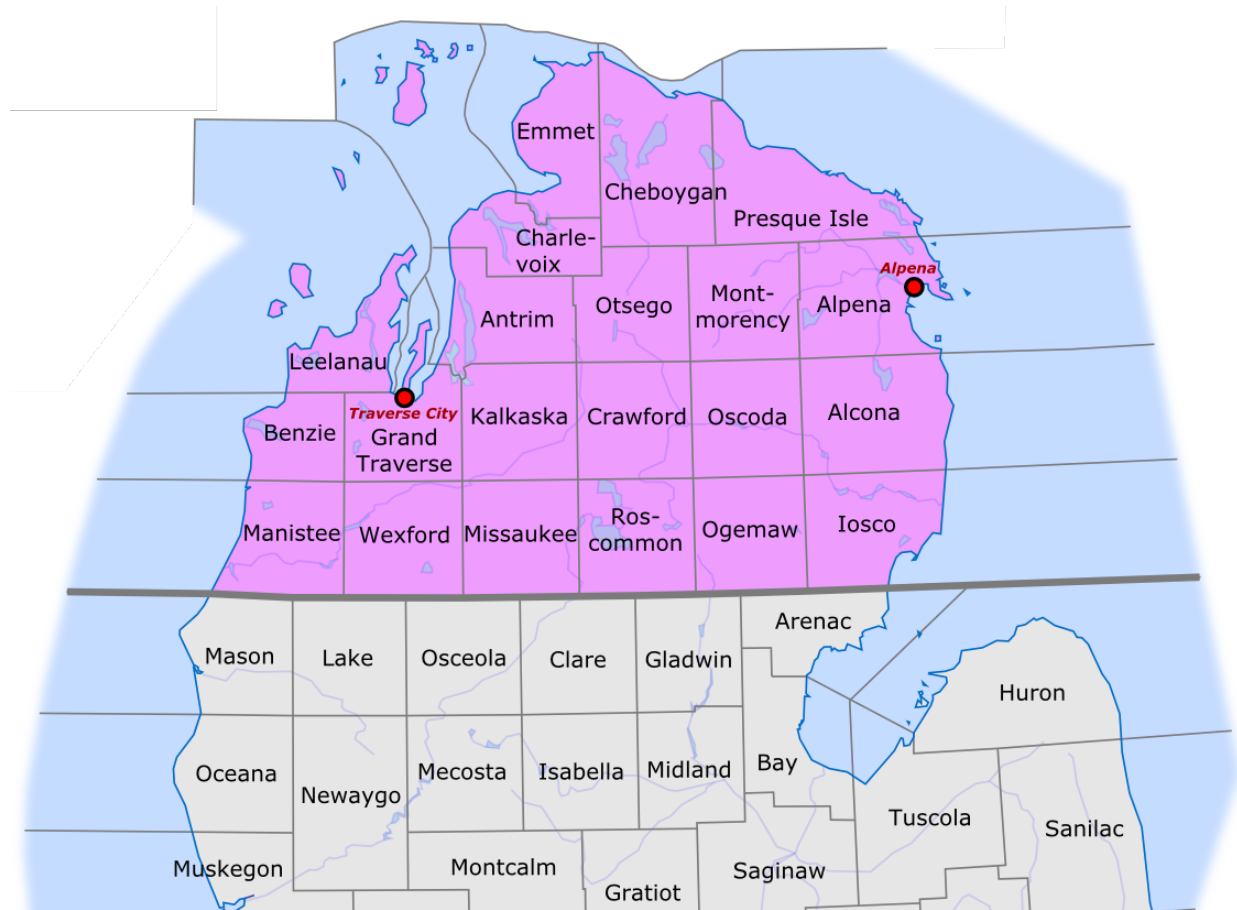
CCED brought together a multi-disciplinary MSU project team that designed two survey questionnaires and an analytical framework to produce policy-relevant data and findings that identify gaps and needs in small business capital access. The project commenced with six key informant interviews conducted in late summer, 2010 to inform the survey design and analytical framework.

Federal Response to Clogged Credit Markets

In September, 2010, the President signed the Small Business Jobs Act that, among other things, more than doubled the maximum amounts of SBA 7(a) and 504 loans from \$2 million to \$5 million (and increased 504 manufacturing-related loans from \$4 million to \$5.5 million); created a new \$30 billion Small Business Lending Fund to provide capital to small banks to increase small business lending; and \$15 billion for a new State Small Business Credit Initiative that will strengthen state small business programs that leverage private-sector lenders to extend additional credit. Governor Rick Snyder announced January 14, 2011 that Michigan will receive \$79.1 million through this initiative. Finally under the Small Business Jobs Act, the maximum amount for SBA Express loans will be increased from \$350,000 to \$1 million, providing greater access to working capital loans that small businesses can use to purchase new inventory and expand sales.

Our analysis is intended to help guide the future development of strategic technical assistance and appropriate training to increase successful rural lending and economic development in rural underserved areas in the 21 northern Lower Michigan counties that comprise our study region.³

Figure 1:
Northern Lower Michigan Study Region
(21 counties in magenta)



Our analysis is, we believe, critical to a nuanced understanding of current conditions affecting small business capital access that can be used to support positive steps to re-stabilize and re-energize Michigan’s regional and local rural economies. These economies remain highly vulnerable to a range of

³ See Appendices 2-4 for demographic, employment, and county banking intensity data, respectively, for the Northern Lower Michigan study region.

steep challenges associated with the escalating transformation of the global economy and the lingering fallout from the Great Recession.

There can be no doubt about the vital role of investment capital in the recovery of small businesses from the devastating impacts of the Great Recession and succeeding in the 21st century global economy. Capital is needed to bring innovative products and processes to the market and position companies to take advantage of innovative niche markets and enter or expand exporting markets. We believe economic development leaders must understand the precise nature of the current conditions associated with capital access to get their policies right. It is imperative that state and regional economic leaders have as much data and information as possible to equip them with the knowledge and understanding to provide capital and credit in the most effective ways achievable to re-start the state's economic engines.

This final report on research funded by a USDA Rural Business Enterprise Grant (RBEG) and conducted by the MSU CCED project team over the past eight months consists of 11 sections in addition to this overview/introduction and an extensive set of appendices. Our narrative starts with a description of our project methodology and literature review. We then present analyses of lenders' perceptions of small business loan conditions in the context of data from community bank FDIC call reports followed by our analysis of small businesses' perceptions of their access to capital. Based on trends and patterns identified in our analysis of the survey data, we describe the differences in capital access between young and mature businesses; the range of outcomes of small business commercial loan applications; the barriers to capital access and potential solutions; and the perceptions of businesses and lenders of USDA and SBA loan programs. Finally, we present a brief set of findings that focuses on three areas: one, small business loan needs and purposes; two, lenders' loan portfolio management; and three, the development of a preliminary framework for effectively understanding how to integrate small business

capital needs with prudent portfolio management. Based on our analysis and findings, policy implications are suggested and a brief conclusion follows.

II. Project Methodology

The project methodology consisted of six principal elements: one, a review of relevant and recent literature on small business capital access and related issues, including macroeconomic analyses and monetary policy analyses; two, an analysis of FDIC Call Report data submitted by lenders headquartered in the region for the years 2007-2010; three, an online survey of lenders in the Northern Lower Michigan study region using a questionnaire specifically designed for this project by our project team; four, an online survey of small businesses in the Northern Lower Michigan study region using a questionnaire also specifically designed for this project by our project team; five, quantitative and qualitative analyses of the data generated from the two surveys; and six, a webinar (virtual workshop) was conducted with lending experts in the region to obtain feedback on the preliminary draft report.

1. Literature Review

A review of current, relevant literature on rural small business capital access and related issues was conducted that resulted in a bibliography consisting of 56 annotated citations and 13 citations of relevant expert testimony and statements.

2. Analysis of FDIC Call Report Data

To monitor the compliance of member banks with federal banking regulations, the Federal Deposit Insurance Corporation (FDIC) requires that quarterly *Consolidated Reports of Condition and Income*, referred to as Call Reports, be submitted to the Federal Financial Institutions Examination Council (FFIEC).⁴ Third quarter Call Reports for the past four years (2007-2010) were downloaded for the 15 commercial banks headquartered in the Northern Lower Michigan study region. Third quarter Call Reports were analyzed because these reports include annual small business commercial and industrial loan data. Small business commercial and industrial (C&I) loans are defined by the FDIC as

⁴ Call Reports are available on the FFIEC website at <https://cdr.ffiec.gov/public/>.

those with original loan amounts of less than \$1 million. Fortunately for our purposes here, the third quarter Call Report data was also the most current that was available for our analysis.

3. Design of the Lender Questionnaire and Survey

The project team designed and pre-tested a 33-question survey instrument⁵ to elicit responses from commercial and other lenders regarding their perceptions of financial and capital access conditions in the study region. After receiving final approval of the confidential questionnaire from the Michigan State University Institutional Review Board November 14, 2010, the project team uploaded the instrument to SurveyMonkey.com and received a unique URL for the questionnaire.

To assist dissemination of the URL for the online lender questionnaire, the project team enlisted the assistance of the Michigan Banking Association (MBA). In late November 2010, the MBA distributed the URL link to the lender questionnaire as part of its customary email member communications. A story about the project was also published in the September 2010 issue of the *Michigan Banker* magazine. The project team also invited the managers of five revolving loan funds in the study region (by email and phone) to participate in the online survey, including the managers of the:

- Target Alpena Revolving Loan Fund
- Great Lakes Energy Revolving Loan Fund
- Northern Shores Loan Fund
- Northern Initiatives Business Loans and
- Grand Traverse County EDC Revolving Loan Fund

The project team identified 15 commercial banks headquartered in the Northern Lower Michigan study region with the assistance of the Federal Reserve Bank of Chicago-Detroit Branch and information from the Federal Deposit Insurance Corporation (FDIC) Web site that include:

⁵ See Appendix 5 for a sample of the Lender Capital Access Questionnaire.

- Alden State Bank
- Bank of Alpena
- Central State Bank
- Charlevoix State Bank
- Citizens National Bank of Cheboygan
- First Community Bank
- Firstbank—West Branch
- Honor Bank
- Huron Community Bank
- Huron National Bank
- Northwestern Bank
- State Savings Bank—Frankfort
- The Bank of Northern Michigan
- Traverse City State Bank
- West Michigan Bank & Trust

Bank officials with management level knowledge of their bank’s commercial lending practices and performance were identified at each of the 15 community banks through phone interviews with bank representatives. The project team emailed these commercial loan officers in late November with phone follow-ups to invite their participation in the online lender survey. Follow-up email and phone contacts were made in early December to prompt participation. The *Michigan Banker* magazine also included the URL link to the online questionnaire on its Web site.

The project team also emailed local and regional economic development agencies requesting assistance in disseminating the URL link to their local commercial bank contacts, including:

- Traverse Bay Economic Development Corporation
- Target Alpena Development Corporation
- Northern Lakes Economic Alliance
- Otsego County Economic Alliance
- Cheboygan County Economic Development Corporation
- Manistee County Alliance for Economic Success
- Roscommon County Economic Development Corporation
- Ogemaw County Economic Development Corporation
- Northern Initiatives

The online lender survey was conducted November 29 to December 22, 2010. On January 5, 2011, thirteen completed responses were downloaded and exported into Microsoft Excel for analysis.

4. Design of the Small Business Questionnaire and Survey

The project team designed and pre-tested the small business capital access questionnaire in early Fall 2010 to survey small business owners and managers in the region.⁶ The online survey instrument consisted of up to 75 questions with the exact number of questions depending on specific responses to survey questions that incorporated skip-logic.⁷ That is, negative responses to certain questions necessitated skipping succeeding questions compared to positive responses to those questions necessitating the answering of those succeeding questions. Final internal university approval for the use of the confidential small business questionnaire was received from the Michigan State University Institutional Review Board November 1.

To assist the dissemination of the URL link to the online small business questionnaire, the project team contacted 13 local Chambers of Commerce in early November by phone and identified specific contacts to help distribute information about the small business questionnaire. These local chambers included the following:

⁶ The average number of employees at companies responding to our 2010 survey was 35 with an average annual revenue of \$1,589,726 (2009). The maximum reported number of employees was 200 and the maximum reported annual revenue was \$8,500,000.

⁷ See Appendix 6 for a sample of the Small Business Capital Access Survey Questionnaire.

- Alpena Area
- Boyne Area
- Cadillac Area
- Charlevoix Area
- Cheboygan Area
- East Jordan
- Gaylord Area
- Grayling Regional
- Manistee Area
- Petoskey Regional
- Rogers City
- Traverse City Area
- West Branch Area

The project team followed up with Chamber contacts to describe the scope and purpose of the project and requested their assistance in disseminating the URL link to their members and 11 indicated they would provide the URL link to their members in customary email communications. The project team also requested the assistance of Future/Innovation Research Strategy Team (F/IRST)⁸ members in disseminating information about the online small business questionnaire link.

The online small business survey was conducted from November 5 to December 3, 2010. A total of 69 responses were collected; however, seven responses were blank and deleted from the dataset. A total of 62 responses were exported into Microsoft Excel for analysis.⁹

5. Description of Data Analysis Methods

The project team used the analytical capacity of the SurveyMonkey Web site to produce frequency and cross-tabulation data. After collecting the responses from the two online surveys, the project team analyzed the data using both quantitative and qualitative methods to identify and measure lenders' and borrowers' perceptions of small business capital access in Northern Lower Michigan; discern significant trends in current and anticipated loan activity; and mine in-depth observations described by survey respondents in open-ended questions.

⁸ This advisory team was established as part of the 2008-10 Northern Michigan Eastern UP Knowledge Economy Strategies project.

⁹ The small business survey sample included 11 small business respondents located in counties outside of the Northern Michigan study region. Three of these small businesses are located in rural counties near the study area; eight are located in counties from across the state.

In the data analysis, the project team focused on the perceptions of small businesses and lenders regarding past, present, and future conditions of capital access in the Northern Lower Michigan study region and their use and assessments of SBA and USDA loan programs. The project team probed the data for salient results by conducting numerous cross-tabulations to identify significant trends and patterns. For example, cross tabulations of company age with various attributes of financial health, current capital access, and future uses of capital produced statistical evidence of the correlation between company age and the types of business activities that would ensue from acquiring capital. Other cross-tabulations revealed correlations between the outcomes of bank loan applications with company size.

The project team categorized responses to open-ended questions from both the small business and lender surveys according to the frequency of similar responses. The most frequently indicated responses were incorporated into the overall analyses, adding depth, and augmenting the quantitative analysis. Several qualitative responses provided specific suggestions to improve small businesses' capital access.

6. Webinar (Virtual Workshop) and Other Feedback on Study

On February 3, 2010, the project team conducted a webinar (or virtual workshop) with state USDA Rural Development Director Jim Turner in which three representatives of the Michigan Small Business and Technology Development Centers (SBTDCs), two representatives of the Northern Lakes Economic Alliance (NLEA), and representatives of the Federal Reserve Bank Chicago Region (Detroit Branch), Small Business Association of Michigan (SBAM), and Northern Initiatives provided feedback on the preliminary draft Final Report.¹⁰ In addition, Deb Markley of RUPRI and George Erickcek of the Upjohn Institute reviewed the draft Final Report in various stages and provided valuable feedback.

¹⁰ Carol Lopucki, Chris Wendel, Joel Schultz of the SBTDCs; Andy Hayes and Tom Erhart of NLEA; Jack Frost of Northern Initiatives; Martin LaVelle of the Chicago Region Federal Reserve Bank (Detroit Branch); and Michael Rodgers of SBAM.

III. Literature Review

A review of the relevant literature was conducted from which the project team compiled a bibliography consisting of 56 annotated citations and 13 citations of relevant expert testimony and statements (see the Annotated Bibliography at the end of this report). Most of the relevant literature has been published since 2000. All of the expert testimony and statements are from 2009-2010. The literature in this time frame corresponds to the seismic shift in the rural economy as part of the national and global economic downturn since 2007 and in the financial sector first with the dizzying deregulation of the 1990s and then the financial meltdown in 2008. This section highlights some of the most relevant works to this study.

In Brophy and Mourtada's (1999) seminal paper on the economic transition of rural America, they describe the now classic life cycle of a growing business and the development of the venture capital market that has focused primarily on the coasts. The authors then present a framework for the development of a community-centered entrepreneurial cluster and action components, including support of entrepreneurship at the core of the community development system; identification of business opportunities; business models which facilitate capital acquisition; technical and business training for entrepreneurs; organization of equity-capital and debt-financing networks; and providing vehicles for investment harvesting (e.g., IPOs). The authors conclude that the usual binary categorization of urban/rural misses the subtle effects of urbanization in rural areas where population clusters may offer potential for market-driven entrepreneurial economic development. This important observation corresponds to the dynamics of the population concentration along the coast of Northwest Michigan from Traverse City to Harbor Springs.

Keeton (2003) describes the important role played by community banks in the financial system of the U.S. economy. They complement the role of large banks by specializing in relationship banking and

providing credit to small businesses—a sector that is arguably underserved by large banks. In addition, community banks serve customers in rural areas and small metropolitan areas that are not served by large banks. Community banks are important lenders in the farm economy, and they serve the retail deposit needs of many depositors. Although the number of community banks will continue to decline because of merger activity, they will continue to play an important role for the foreseeable future.

Cocciarelli (2010) et al. explore capital access issues in the smaller-scale agricultural sector and also sought to learn from “hybrid” organizations that have bridged the relationship and knowledge gaps between willing farmers and lenders. These organizations share three key assets: 1) access to capital and land; 2) specific product assistance; and 3) farmer networking. They are all challenged by 1) the stress on lending from the Great Recession; 2) securing funding for operations and re-lending; and 3) finding qualified technical assistance providers for farmers in the small-scale sector. Practice recommendations include developing “pro formas” or templates for projections, capital needs, marketing strategies for farmers, and training them how to use these resources. By advancing the economic viability of small-scale operations, challenges associated with job creation, corporate consolidation, rural revitalization, and promoting an entrepreneurial culture can be successfully met. These practice recommendations anticipate salient findings made in this research project.

IV. FDIC Commercial and Industrial (C&I) Loan Data and Lenders' Perceptions of Small Business Loan Conditions in Northern Lower Michigan

To understand small business loan conditions from the perspective of lenders in the region, the project team used two data sources. First, the project team examined Consolidated Reports of Condition and Income (also known as Call Reports) submitted by 15 banks headquartered in Northern Lower Michigan to identify the general trends of commercial and industrial (C&I) lending in the region. Second, the project team conducted an online survey of commercial bank loan officers at those banks and representatives of five revolving loan funds using a questionnaire specifically designed for this project.

1. 2007-2010 FDIC Reports of Condition and Income (Call Report) Data

To monitor the compliance of member banks with federal banking regulations, the Federal Deposit Insurance Corporation (FDIC) requires lenders to submit quarterly *Consolidated Reports of Condition and Income* (FDIC Call Reports) to the Federal Financial Institutions Examination Council (FFIEC). Call Reports for four years (2007-2010) were downloaded for the 15 commercial banks headquartered in the Northern Lower Michigan study region. Third quarter Call Reports were used because they include annual small business C&I loan data, the focus of our study. Small business commercial and industrial (C&I) loans are defined by FDIC as those with original loan amounts of less than \$1 million, although it is understood that small businesses not infrequently obtain loans in amounts greater than \$1 million. Fortunately for our purposes here, the third quarter data was also the most current data that was available as we conducted our analysis.¹¹

Data from national banks and regional banks headquartered outside of the study region that have branches in the study region was excluded because these banks file their Call Reports for the entire geographic scope of their operations that reach beyond the study region. The Call Report data

¹¹ We note that Call Report data for the fourth quarter were released February 24, 2011, too late for use in our study.

described below, then, is intended to provide an overview of the commercial and industrial lending patterns of community banks headquartered in Northern Lower Michigan.

In the next three subsections, our discussion of all sizes of commercial and industrial (C&I) loans consists of a general overview; a brief summary of loan charge-offs and recoveries; and a short review of past-due and non-accruing loans. The fourth subsection focuses on an analysis of small business C&I loans in the region.

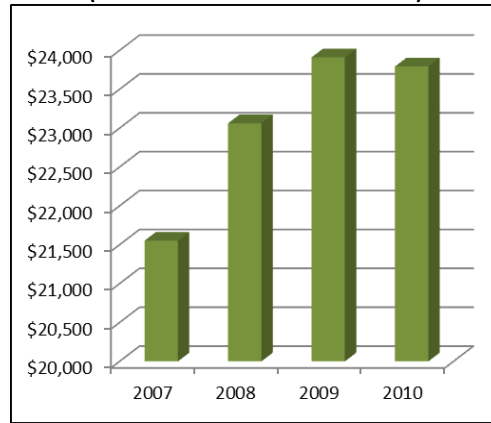
Overall, C&I loans made by the 15 banks headquartered in the region between 2007 and 2010 increased. However, the number of loans charged-off increased while the number of loan recoveries substantially decreased. For small business loans, these regional banks made fewer loans of less than \$250,000, while making more loans of more than \$250,000. Thus, we see a trend moving away from making loans with smaller amounts and toward loans with larger amounts. This trend may be a consequence of banks shifting their lending portfolio to reduce risks associated with smaller loans and reducing per loan administrative costs in response to the fallout from the Great Recession.

Amounts of Commercial and Industrial (C&I) Loans in the Region

For all C&I loans made by the 15 lenders headquartered in the Northern Lower Michigan study region, the total amount was \$323,289,000 in 2007 and \$356,898,000 in 2010, a gain of \$33,609,000, or just over a 10% increase. The average C&I loan portfolio for these 15 banks was \$21,553,000 in 2007 and \$23,793,000 in 2010, for a moderate increase of 10.4% over the three year period (see Figure 2). This increase in C&I lending, however, has not been directed to small businesses in the region. While the number and outstanding amounts of C&I loans to small businesses with original amounts between \$250,001 and \$1,000,000 increased slightly, the number and amounts outstanding of loans with original amounts less than \$250,000 decreased significantly as will be described below. Overall commercial and

industrial lending may be recovering, but capital access for small businesses in the region remains stunted.

Figure 2: Average C&I Loans
(amounts in thousands of dollars)



Charge-offs and Recoveries of Commercial and Industrial Loans

A charge-off refers to a loan that is unlikely to be collected, a determination that is usually made after six months of non-payment. A charge-off designation does not free a debtor of the obligation to pay back the loan. A loan recovery refers to the circumstance of a debtor resuming payments on a formerly charged-off loan.

In 2007, a total of \$310,000 in C&I loans were charged-off by the 15 regional banks in Northern Michigan; and the amount of charge-offs more than tripled to \$1,478,000 in 2010. During this time, the amount of recoveries on charged-off accounts dwindled from \$158,000 in 2007 to \$44,000 in 2010. The average amount per bank of C&I loans charged-off was \$21,000 in 2007 that nearly quintupled to \$99,000 in 2010 after peaking at nearly \$140,000 in 2010 as shown in Figure 3.

Average per bank recoveries of C&I loan charge-offs was \$11,000 in 2007 and \$3,000 in 2010, a decrease of 72.2% (see Figure 4). In essence, community banks could expect to recover about 50% of their non-performing C&I loans in 2007 and about 3% in 2010. Such growth in non-performing loans and the

accompanying drop in loan recoveries illustrate the elevated risks of lending in an environment defined by the Great Recession and the subsequent tepid economic recovery we are currently in.

Figure 3: Average C&I Loan Charge-offs
(amounts in thousands of dollars)

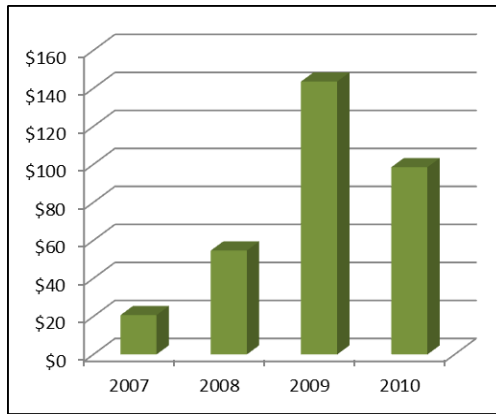
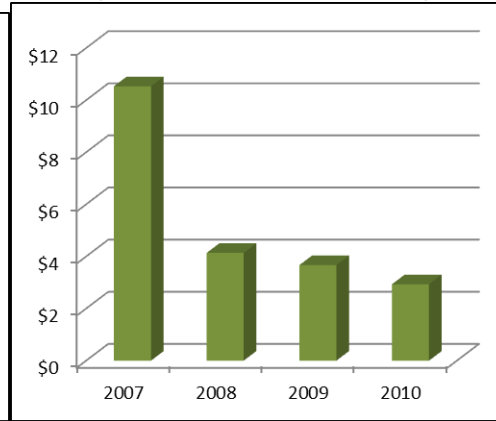


Figure 4: Average C&I Loan Recoveries
(amounts in thousands of dollars)



Past Due and Nonaccruing Commercial and Industrial Loans

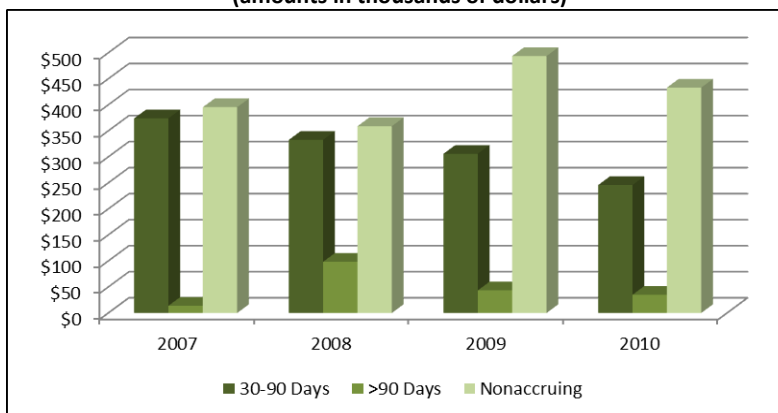
Past due loans are accounts that are delinquent more than 30 days. In extreme cases of delinquency, repayment of interest on past due loans may not be expected. Such loans are classified as non-accruing loans for which interest is no longer added to the loan principal.

In 2007, the 15 community banks in the region reported \$5,608,000 in loans 30-89 days past due. Delinquent accounts actually declined to \$3,686,000 in 2010. However, for loans 90 days (or more) past due, the amount more than doubled from \$208,000 in 2007 to \$525,000 in 2010. The data shows that the length of time for delinquent loans has been increasing, with the number of loans less than 90 days past due decreasing and the number of loans more than 90 days past due increasing dramatically. In addition, the total amount of non-accruing C&I loan amounts in 2007 was \$5,931,000 and increased to \$6,494,000 in 2010.

On average, a bank held about \$374,000 in past due loans (30-89 days) in 2007 and \$246,000 in 2010, a decrease of 34.3%. For C&I loans past due 90 days or more, the average was \$14,000 in 2007 and

\$35,000 in 2010, a jump of 152.4%. The average of non-accruing C&I loans was \$395,000 in 2007 and \$433,000 in 2010, a modest increase of 9.5% (see Figure 5).

Figure 5: Average C&I Loan Past Due or Nonaccruing
(amounts in thousands of dollars)



Number and Outstanding Amounts of Small Business C&I Loans

Call Reports published for the third quarter each year provide data for small business commercial and industrial loans, defined by the Federal Financial Institutions Examination Council (FFIEC) as those loans with original loan amounts (the loan principal) of less than \$1 million.¹² Small business loans are further subdivided into three categories with original loan amounts of: 1) less than \$100,000; 2) \$100,000-\$250,000; and 3) \$250,001- \$1,000,000. The number and outstanding amounts of small business loans in Northern Lower Michigan are described below.

The total number of active small business loans in the region was 4,390 in 2007 and 3,712 in 2010, a decline of 15.4%. These loans may include delinquent accounts. Decreases in the number of loans can result from the repayment of the principal, a charge-off, or transfer of ownership of the loan from the bank to another intermediary. The total outstanding amount of these loans was \$261,876,000 in 2007 and \$250,117,000 in 2010, a decline of 4.5% (see Figure 6).

¹² The classification of these C&I loans as “loans to small businesses” is based on FDIC Call Report terminology; specifically, schedule RC-C, part II, item 4.

Figure 6: Changes in Regional Small Business C&I Lending

	2007	2010	% Change
Number of Loans			
<\$100,000	3,397	2,733	-19.55
\$100,001-\$250,000	645	581	-9.92
\$250,001-\$1,000,000	348	398	14.37
	4,390	3,712	-15.44
Loan Amount Outstanding			
<\$100,000	\$76,544,000	\$62,438,000	-18.43
\$100,001-\$250,000	\$71,620,000	\$62,668,000	-12.50
\$250,001-\$1,000,000	\$113,712,000	\$125,011,000	9.94
	\$261,876,000	\$250,117,000	-4.49

The total number of small business C&I loans with original amounts less than \$100,000 was 3,397 in 2007 but declined by 20% to 2,733 in 2010. In addition, the total outstanding balance of these loans decreased by just under 20% from \$76,544,000 in 2007 to \$62,438,000 in 2010. The average number of loans for community banks in the region was 226 with an average outstanding balance of \$5,103,000 in 2007. In 2010, the average number of loans slid to 195 with a distinctly smaller average outstanding balance of \$4,460,000.

Similarly, the total number of mid-range small business C&I loans (original amounts of \$100,000-\$250,000) was 645 in 2007 but slipped to 581 in 2010, about a 10% decline. The total outstanding balances of these loans decreased by just over 12% from \$71,620,000 in 2007 to \$62,668,000 in 2010. Community banks in the region held an average of 43 such loans in 2007 with an average outstanding portfolio balance of \$4,775,000. In 2010, the average number of loans at 42 remained virtually flat with a modest decline in the average outstanding amount at \$4,476,000.

However, the total number of high-end small business C&I loans (original amounts of \$250,000-\$1,000,000) experienced a healthy increase from 348 in 2007 to 398 in 2010. The total outstanding amount of these loans increased from \$113,712,000 in 2007 to \$125,011,000 in 2010. While the

number of these larger C&I loans increased by about 15%, the total value of the loans increased by just over 9%. On average, the community banks in the region carried 23 of these C&I loans in 2007 with an average outstanding amount of \$7,581,000 (see Figure 7). In 2010, the average per bank for high-end small business loans increased to 28 loans with a total outstanding balance of \$8,929,000, an increase of \$1,348,000, or 17.8%. At first blush, this increase in high-end loans seems incongruous (see Figure 8).

Figure 7: Average Number of Small Business C&I Loans

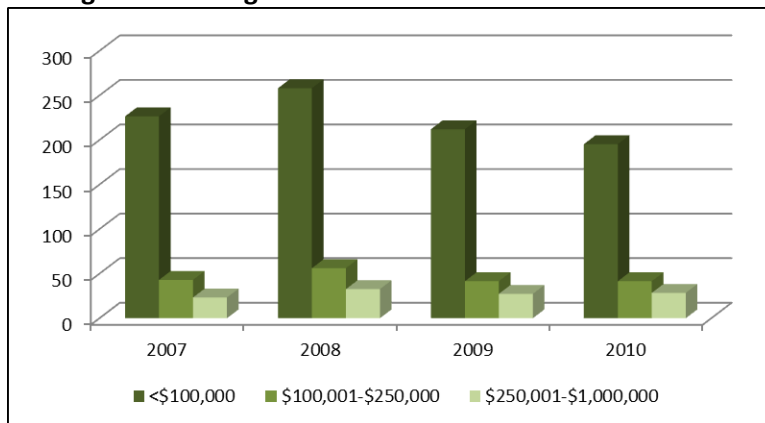
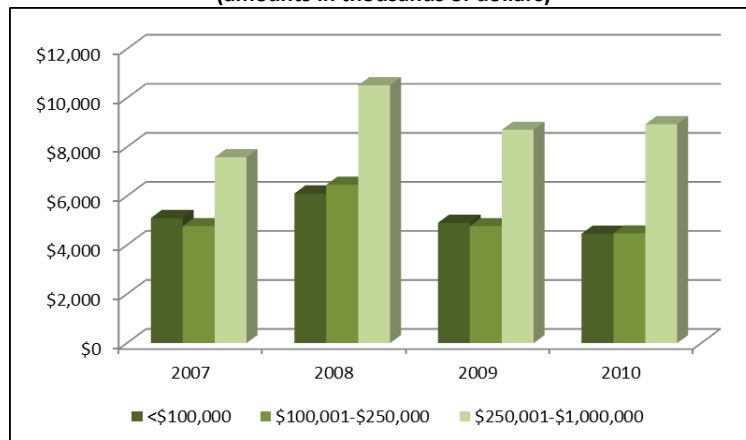


Figure 8: Average Outstanding Amount of Small Business C&I Loans (amounts in thousands of dollars)



However, this data may highlight the effects of the greater risks associated with bank lending during the massive economic downturn. Why? We infer that community banks in the region shifted risk and the implicit costs of loan processing by expanding their larger loans while contracting the volume of their smaller loans with generally lower margins. While the data suggests that banks are curtailing small

business loans in the lower range, other factors must be considered. For one thing, the decrease in small business loan activity may be attributed in some part to the reduced demand for small business loans caused by the economic downturn. In an attempt to untangle the factors causing the decline in small business lending, the project team conducted a survey of lenders in the region to generate primary data on their perceptions of the small business capital market.

2. Survey of Commercial Bank Loan Officers: Perceptions of Small Business Capital Access Conditions

The project team designed the lender questionnaire to elicit responses characterizing current regional economic conditions with the objective of better understanding the factors that underlie the data collected in the FDIC Call Reports. The project team contacted commercial loan officials from the 15 community banks headquartered in the Northern Michigan region and the directors of five regional revolving loan funds to invite their participation in the online lender survey.¹³ The online lender survey was conducted November 29-December 22, 2010 and 13 responses were collected. Our analysis is presented below.

Characterizing Regional Economic Conditions

Open-ended responses indicate a high level of uncertainty about the direction of the economy. Depressed economic conditions and chronic high unemployment have tripped tourism-related expenditures that are vital to the regional economy. In addition, depressed regional conditions have resulted from choked capital markets reducing the number of small business loans on one hand and stunted small business demand for capital on the other. Nevertheless, most respondents anticipate improvement in the regional economy or at least in some economic sectors. The problem remains with

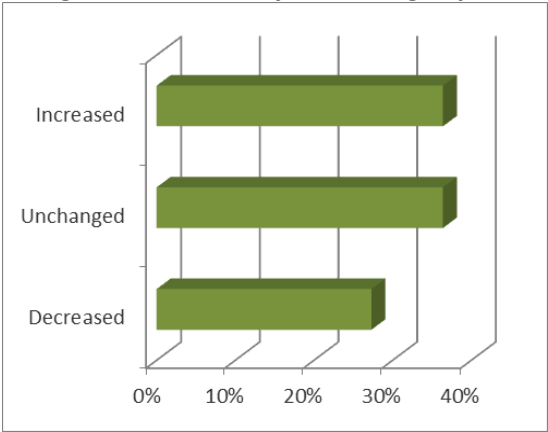
¹³ See Appendix 7 for a complete set of tables used in our analysis of lender survey data.

those small businesses that may be positioned to benefit from growth in their sectors finding their access to capital restricted because of lenders’ concerns with the overall trajectory of the economy.

Availability of Lending Capital

Most loan officers tend to believe that the availability of lending capital has increased over the past year. Indeed, nearly 73% indicated the availability of capital has remained the same (36.4%) or increased (36.4%). Only 27.3% of lenders indicated the availability of lending capital had decreased (see Figure 9). Our survey findings appear to parallel Call Report data for the last 12 months.

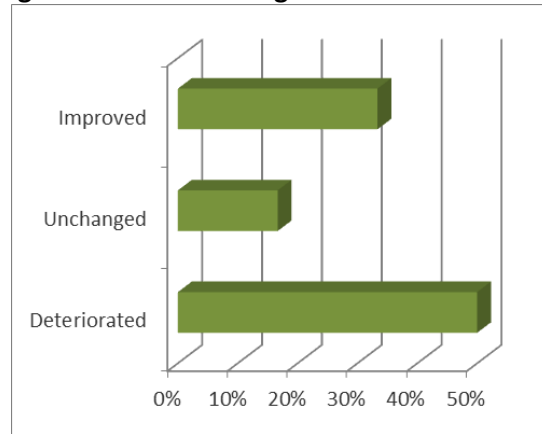
Figure 9: Availability of Lending Capital



Lending Portfolio Performance

In describing the performance of their own institutions’ overall lending portfolio during the past 12 months, lenders were divided between seeing it as having deteriorated or having improved. Specifically, about 50% indicated their loan portfolio performance had deteriorated while 33.3% indicated it had improved and 16.7% that it had remained unchanged (see Figure 10). Factors contributing to these differences in lenders’ perceptions of their loan portfolios are not altogether clear. However, loan portfolio performance certainly varies according to different approaches and outlooks of different lenders, among other things, based on information from our key informant interviews.

Figure 10: Total Lending Portfolio Performance



Respondents were further asked about their highest performing loan segments. Over half indicated lines of credit were the most profitable and a minority indicated SBA or term loans for capital and real estate. Respondents were then asked to identify those lending segments that performed best. Most commonly mentioned were real estate mortgages, followed by small businesses and commercial borrowers.

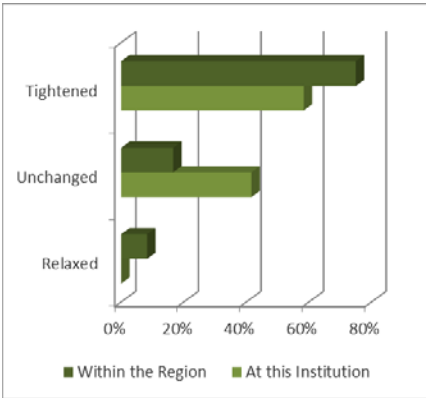
Current Lending Standards in the Region

It is interesting to note that lenders' perceptions of the recent changes in small business lending standards differ depending on whether they are asked about the region's banking industry or the standards of their own institutions. While 75% indicated that industry standards have tightened in the region, only 58.3% believed that standards had tightened at their own institutions. Moreover, 41.7% indicated their own institutions' standards have remained unchanged but only 16.7% indicated the same was true industry-wide for the region. Only 8.3% of those surveyed indicated that lending standards at their institutions have relaxed while not a single loan official indicated standards had relaxed in the region (see Figure 11).

Overall then, lenders believe lending standards at their own institutions have relaxed more than the standards used by other lenders across the region. Perceiving that lending standards have tightened

in the region is not surprising, given widespread acknowledgement of regulatory restrictions tightening credit channels. What is interesting, however, is the favorable bias with which lenders perceive the standards at their own institutions. This bias may be attributable to the reasonableness with which we all tend to view our own actions given the extensive access we have to our own rationales.

Figure 11: Current Lending Standards



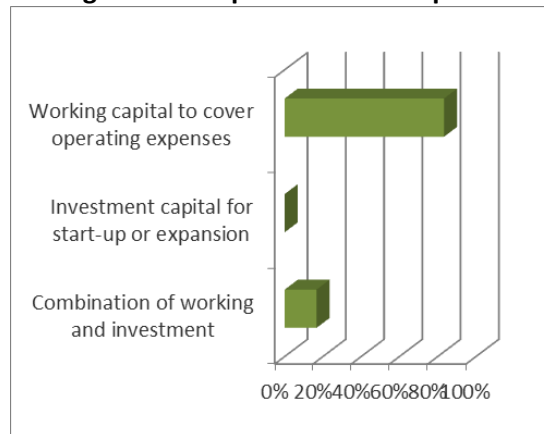
Respondents were further asked to describe their institution’s primary underwriting criteria. Nearly all emphasized collateral as a primary metric used in assessing business loan applications followed by actual and expected cash flows to cover current and new debt. Several made mention of credit history and reference to industry growth. When asked about common issues that impede approval, lack of collateral was most commonly indicated. Others included lack of business acumen and follow-through by businesses and insufficient cash flows. Lenders pointed out that small business owners often lack sufficient financial records to document cash flows and are unrealistic about pro forma cash flows. When asked about steps to take to overcome these impediments, a minority of respondents indicated they take additional time to educate borrowers, but most indicated they refer borrowers to CPAs, Small Business and Technology Development Centers (SBTDCs), or SBA counselors.

Purpose of Loan Requests

Most lenders (83%) agree that small business loan applications are primarily for working capital to cover current operating expenses rather than for investment capital for expansion or start-ups (see

Figure 12). In fact, none of the survey respondents indicated their loan requests were for investments in business expansion or start-ups. This result is in sharp contrast to our survey of small businesses, who asserted their pursuit of loans is primarily for expansion. The results of our small business survey are described in the next section.

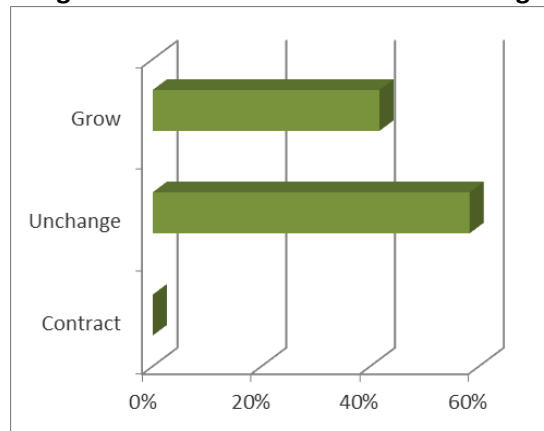
Figure 12: Purpose of Loan Requests



Future Small Business Lending

Finally, commercial loan officers were asked about expected levels of lending over the next twelve months: 41.7% indicated they expected growth in small business lending at their institutions, while 58.3% expect it would remain unchanged (Figure 13). None of the lenders expected small business lending to contract at their institutions. Overall then, our data strongly suggests expectations of greater small business lending activity in the next 12 months (i.e., 2011).

Figure 13: Future Small Business Lending



V. Small Businesses' Capital Needs and Their Access to Capital

In this section, we describe the results of our online survey of small businesses on their capital needs and access to capital. The survey was conducted November 2010. The survey generated data on small businesses' current financial situations; their expected future performance; perceptions of loan standards; and perceived barriers to small business growth in the future. Then drilling deeper, we review survey data on anticipated future capital needs, perceived future availability of capital as well as the purpose of future capital, lack of capital as a problem, impact of the lack of capital, and potential applications of additional capital.¹⁴ The data was generated from 62 surveyed respondents who completed the survey questionnaire designed specifically for this project.

The overall pattern of responses clearly reflects the perception that small businesses lack adequate access to capital. However, respondents also indicated they have a resounding optimism about future economic growth in Northern Lower Michigan. Whether this optimism exemplifies 'irrational exuberance' or is justified by underlying trends of growth and expansion cannot be answered definitively by our current research. This question, however, certainly suggests an area for future research. It is interesting to note that the Thompson/Reuters University of Michigan consumer sentiment index in February 2011 showed a majority of consumers believing that business conditions had improved over the past year for the first time in six years. (However, 39% say business conditions are worse.)¹⁵

Current Financial Situation and Expected Future Performance

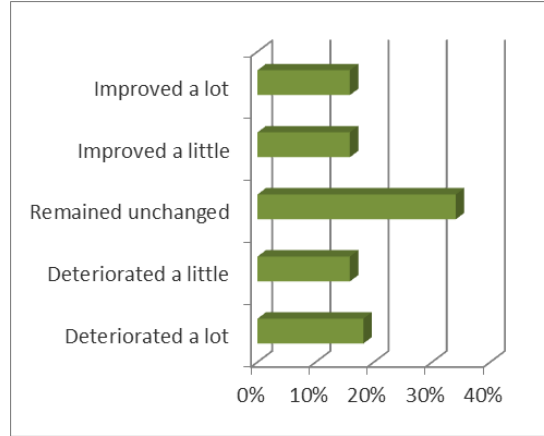
When asked about their companies' financial situation changing over the past 12 months, 34.1% indicated their situation had deteriorated a little or a lot and an equal percentage indicated their financial situation had remained unchanged. It had improved either a little or a lot for 15.9% each. All

¹⁴ See Appendix 8 for a complete set of tables used for the analysis of small business survey data presented in this report.

¹⁵ Floyd Norris, "Many See Economy Improving, but Not for Them," *New York Times*, February 19, 2011, p. B-3.

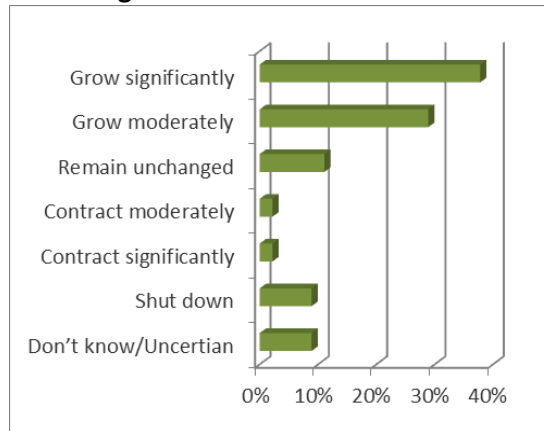
things told, the picture was a mix about evenly divided between deterioration, staying the same, and improvement.

Figure 14: Current Financial Situation



Regarding their expectations of future company performance over the next three years, 66.7% indicated they were optimistic with 37.8% expecting significant growth and 28.9% expecting moderate growth. Only 4.4% expect to contract either moderately or significantly. However, 8.9% expect to shut down.

Figure 15: Future Performance



Obstacles to Small Business Growth in Northern Michigan

When asked to rank nine obstacles to the future growth of their companies on a 1 to 5 scale (with 1 corresponding to “not an obstacle” and 5 to a “major obstacle”), 50% indicated their ability to obtain capital was a major obstacle (see Figure 16). A combined 85.5% indicated that the ability to obtain capital posed some obstacle to their future growth and only 14.5% responding that the ability to

obtain capital was not an obstacle. Access to capital is clearly a major barrier to small business growth in Northern Michigan.

Lack of confidence in the future of the economy also posed a considerable barrier to growth, with 85.5% of companies indicating a lack of confidence in the state’s economic future. And 80.4% indicated a lack in confidence in the national or global economy was at least a moderate, if not larger, obstacle to future growth. State and local regulations proved at least a moderate, or larger, obstacle for 58.7% of small businesses, while 62.3% indicated that federal regulations were at least a moderate obstacle to future growth.

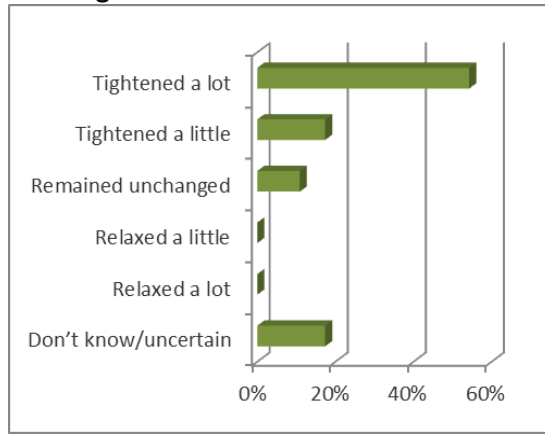
**Figure 16: Obstacles to Business Growth
(1 to 5 scale)**

Potential Obstacles	Not an obstacle	Moderate obstacle	Major obstacle	Rating Average		
Ability to obtain capital	14.6%	2.1%	16.7%	16.7%	50.0%	3.85
Lack of confidence in state’s economic future	12.5%	2.1%	27.1%	31.3%	27.1%	3.58
Lack of confidence in national/global economic future	13.0%	6.5%	23.9%	30.4%	26.1%	3.50
State and local regulations	15.2%	26.1%	15.2%	19.6%	23.9%	3.11
Federal regulations	20.0%	17.8%	26.7%	8.9%	26.7%	3.04
Generating new sales	19.1%	12.8%	36.2%	19.1%	12.8%	2.94
Existing debt load	41.3%	10.9%	19.6%	8.7%	19.6%	2.54
Ability to hire qualified workers	39.6%	10.4%	25.0%	16.7%	8.3%	2.44
Ability to create new products or services	68.1%	10.6%	17.0%	2.1%	2.1%	1.60

Perceptions of Loan Standards, Anticipated Future Capital Needs, and Future Capital Availability

Based on their knowledge and experience, 54.3% of companies indicated that commercial lenders’ loan standards have tightened a lot over the past 12 months and 17.4% responded they tightened a little. Only 10.9% indicated standards had remained unchanged, but not a single company indicated that lending standards had relaxed (either a little or a lot). Finally, 17.4% indicated they didn’t know or were uncertain (see Figure 17).

Figure 17: Current Loan Standards



Notwithstanding this perception of tightening loan standards, 70.8% anticipated their companies will need to obtain additional capital in the next two years. Only 12.5% indicated their companies would not need additional capital (see Figure 18). This represents a distinct gap between anticipated capital need and expected capital access.

Small businesses generally expect the lack of available capital will remain a problem over the next 12 months: 18.8% expect capital availability to greatly worsen and 8.3% expect it will worsen somewhat; 33.3% expect it to remain unchanged. Only 22.9% of companies expect it to somewhat improve and 8.3% expect it to improve greatly. We might regard this as sluggish optimism (see Figure 19).

Figure 18: Future Capital Need

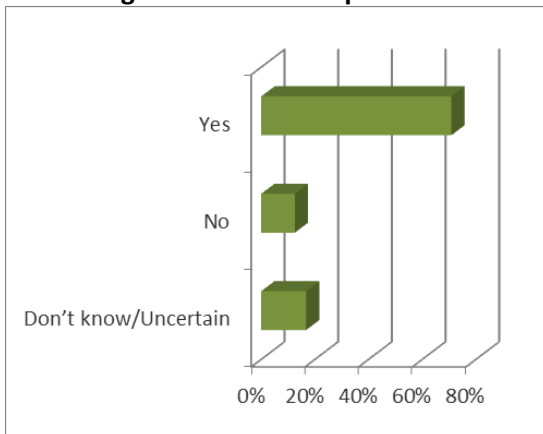
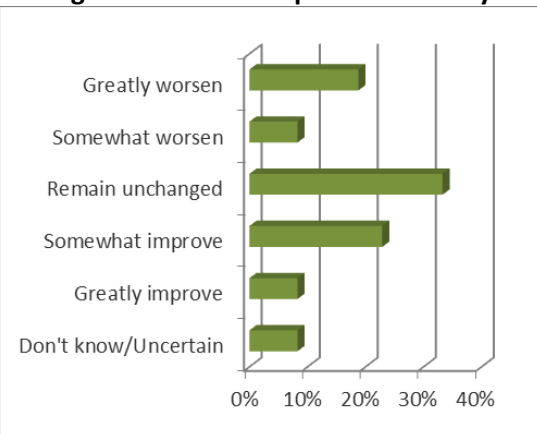


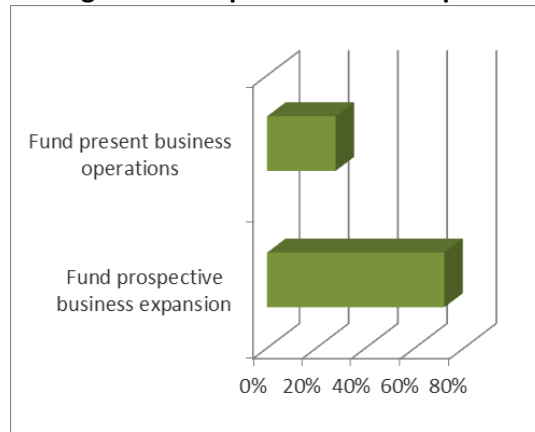
Figure 19: Future Capital Availability



Purpose of Future Capital

Asked what their companies intended to finance with additional capital, 72.1% indicated they would use the capital to fund business expansion (i.e., investment capital) and 27.9% indicated they would fund current business expenses (i.e., working capital) [see Figure 20]. These responses stand in sharp contrast to those responses from financial lenders who indicated working capital was the major use for loan capital. This difference may be the result of small businesses and lenders referring to the same thing using opposite terms. For example, a small business might refer to using a loan to purchase inventory as investment capital while a lender views this as working capital.

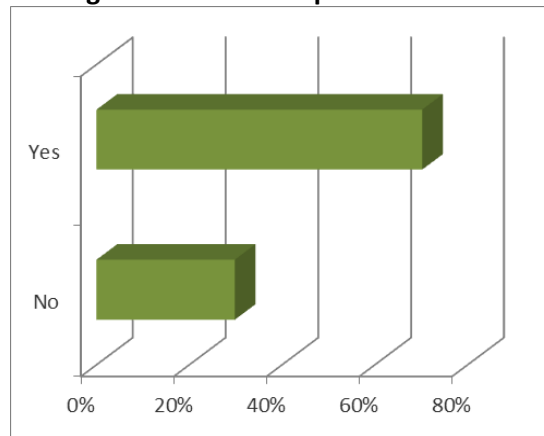
Figure 20: Purpose of Future Capital



Lack of Capital as Problem, Impact of Lack of Capital, and Potential Applications of Additional Capital

When directly queried about whether a lack of financial capital has been a problem for their companies, 70.2% indicated it has been a problem, with 29.8% indicating it had not been a problem (see Figure 21).

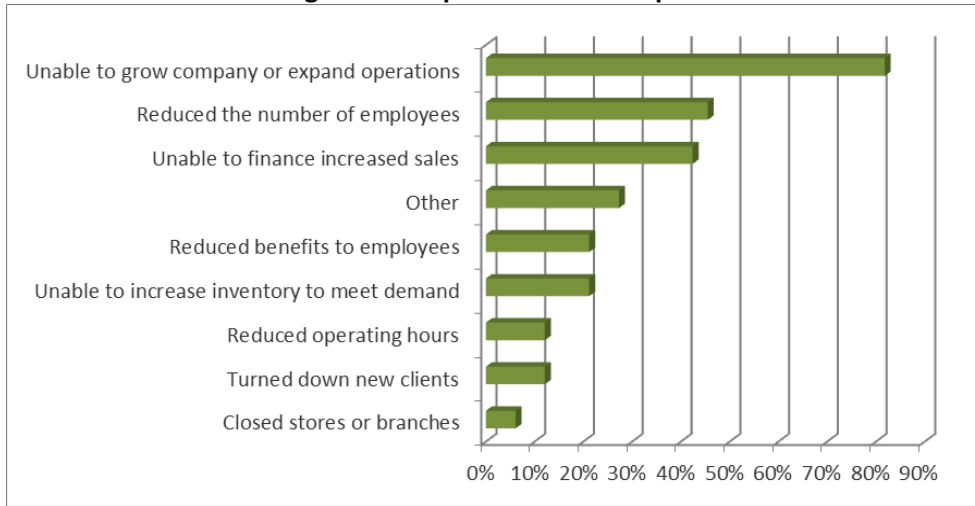
Figure 21: Lack of Capital a Problem



When respondents indicated a lack of capital had been a problem,¹⁶ a list of eight potential impacts resulting from the lack of capital was displayed for respondents to choose from (respondents could also describe other impact in an open-ended question): 81.8% indicated they were unable to grow their companies or expand their operations; 45.5% had to lay off employees. And 42.4% of companies were unable to finance increased sales (see Figure 22). In the relevant open-ended question, 27.3% of respondents provided more detailed explanations of the impact of the lack of capital, ranging from premature retirement and delayed startup to unsuccessful acquisitions and declaring bankruptcy.

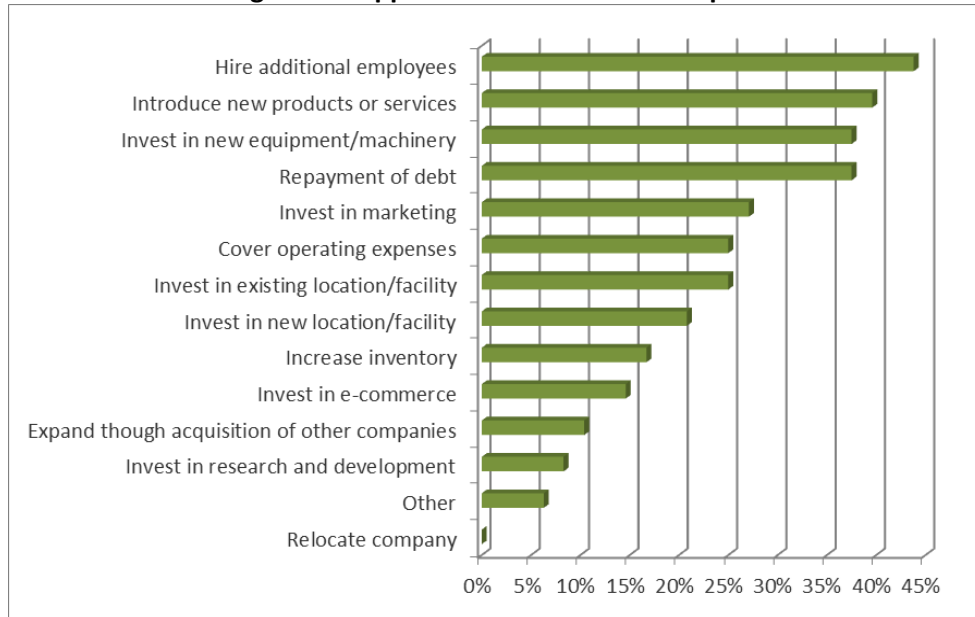
¹⁶ Using the design capacity of SurveyMonkey, the project team applied skip-logic to question #22 that asks whether the lack of financial capital had been a problem for the respondent. If it had been a problem, then question #23 appeared asking what the impact of that problem had been. If the lack of capital was not a problem, then the respondent skipped to question #24 regarding the application of additional capital if capital were available.

Figure 22: Impact of Lack of Capital



Asked to identify the first three actions they would take if their company were able to obtain additional capital in the future, 43.8% indicated they would hire additional employees and 39.6% indicated they would introduce new products or services. Investing in new equipment or machinery was indicated by 37.5% with the same percentage indicating they would repay existing debt (see Figure 23).

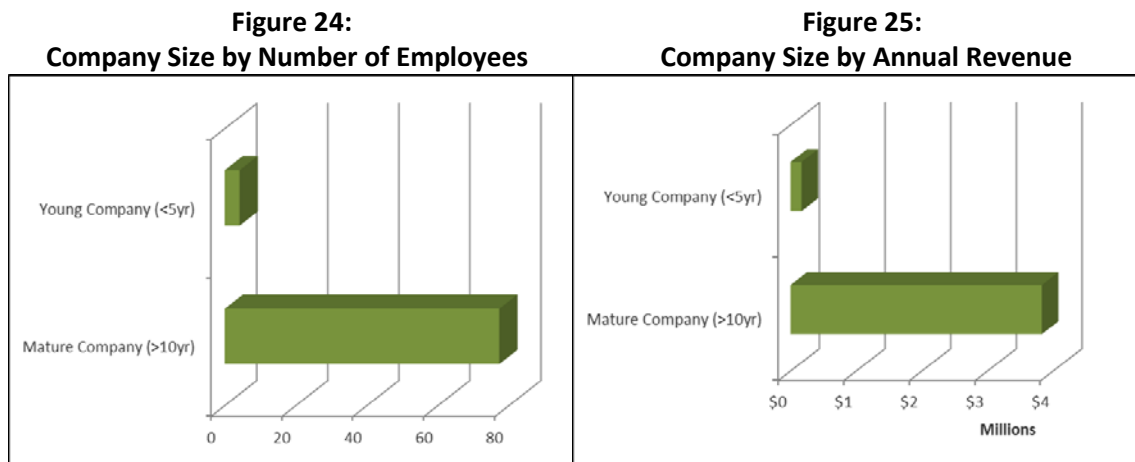
Figure 23: Applications of Additional Capital



VI. Differences in Capital Access between Young and Mature Small Businesses

The project team sought to ascertain whether direct correlations exist between access to capital and the size of the company.¹⁷ As open-ended questions were used in the small business survey questionnaire to elicit data on the number of employees and annual company revenues to provide precise values for each company, it was not possible to cross-tabulate these responses with responses to other questions. To get around this conundrum, the project team used company age as a proxy for company size, based on the assumption that small businesses over time tend to grow (or they cease to exist). That is, older companies tend to be larger in size than young companies (see Figure 24).

Small businesses were classified by the project team as “young” companies, those in operation less than 5 years, or “mature” companies, those in operation more than 10 years. By using the age of a company as a proxy for the size of a company size, the project team was able to compare data on capital access with the age/size characteristics of small businesses. In our sample, the average number of employees at young companies was 4.2 compared to 77.3 at mature companies. For annual revenues, young companies reported an average of \$167,343 and mature companies reported an average of \$3,828,095 (see Figure 25)

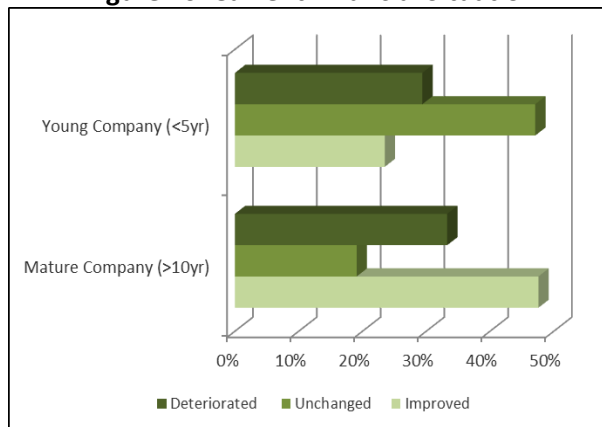


¹⁷ See Appendix 9 for a complete set of tables used for the cross tabulation analyses of young and mature companies presented in this report.

Our data analysis, then, supports the general notion that small businesses tend to grow over time (if they continue to operate). The younger a company is, the fewer the number of employees and the lower the revenues. The more mature a company is, the larger the number of employees and the greater the revenues. Given the strong correlation between company age and company size, we investigated how company age is related to financial condition and whether the differences in a company's access to capital is related to company age.

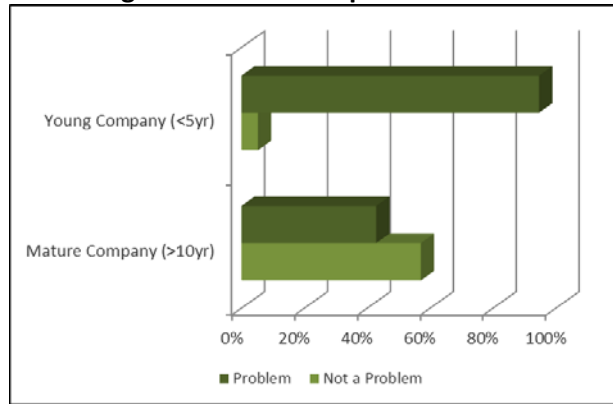
In describing their companies' financial situation over the past 12 months, 47.1% of young companies indicated their financial situation had remained unchanged; 29.4% indicated it had deteriorated. For only 23.5%, it had improved. For mature companies, 47.6% indicated their financial situation had actually improved; 33.3% indicated it had deteriorated; and 19.1% indicated it had remained the same (see Figure 26). **Mature companies, then, were twice as likely as young companies to report having experienced financial improvement in the past 12 months.**

Figure 26: Current Financial Situation



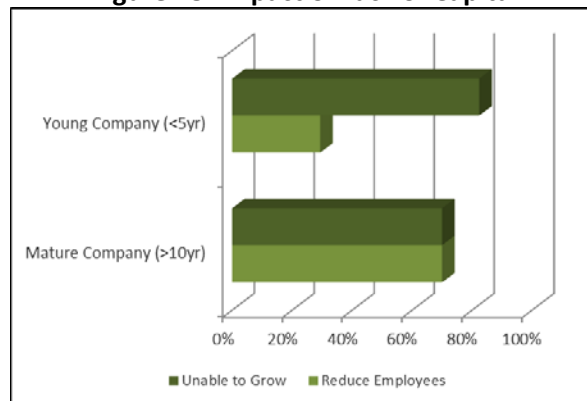
As to whether a lack of financial capital has been a problem, 94.7% of young companies indicated that it has indeed been a problem. In comparison, less than half (42.9%) of mature companies indicated that lack of capital has been a problem (see Figure 27). So again, there is a dramatic divergence between the ability of young and mature small businesses to access financial capital.

Figure 27: Lack of Capital a Problem



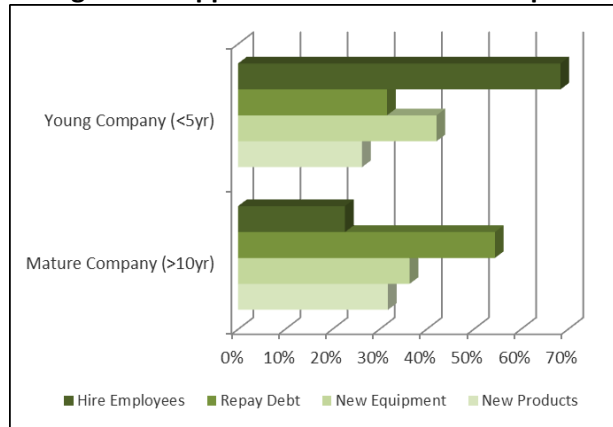
Companies indicating that lack of capital was a problem were then asked about the impacts: 82.4% of young companies indicated they were unable to grow their companies or expand operations, and 29.4% indicated they had to reduce the number of employees. For mature companies, 70% indicated they had been unable to grow or expand and 70% indicated they had reduced the number of employees (see Figure 28).

Figure 28: Impact of Lack of Capital



If young companies were able to obtain additional capital, 68.4% responded they would hire additional employees compared to just 22.7% of mature companies. Differences in company behavior corresponding to company size were also seen in 54.5% of mature companies indicating they would repay debt if they obtained additional capital, compared to only 31.6% of young companies (see Figure 29).

Figure 29: Applications of Additional Capital

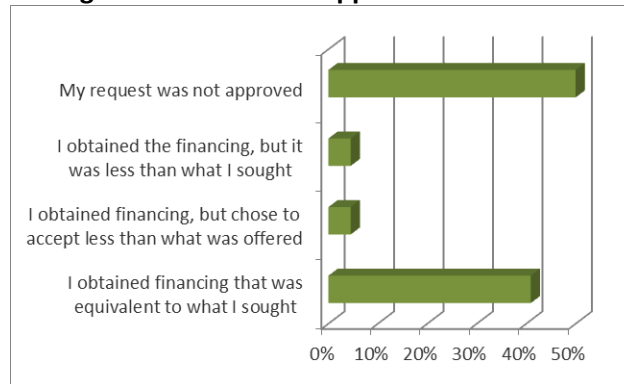


As the above analysis indicates, financial conditions of young companies have not improved to the same extent as those of mature companies over the past year and not surprisingly a lack of capital constitutes a dramatically greater problem for young companies. This pervasive lack of capital available to young companies has clearly had a detrimental impact on these companies and their communities by choking off potential hiring.

VII. Differences in Outcomes of Small Business Bank Loan Applications by Company Size

The project team compared the differences in outcomes of loan applications with the sizes of the businesses for those small businesses that had applied for a bank loan in the past year.¹⁸

Figure 30: Bank Loan Application Outcomes



In our small business survey, 50% were not approved and 40.9% obtained financing that was equivalent to what they sought (see Figure 30). For companies whose applications were not approved, the average number of employees was 11.6 compared to 35.4 at companies that obtained financing (Figure 31). The average annual revenue for companies whose applications for a bank loan were not approved was \$315,047 compared to \$2,412,377 for companies that obtained financing (Figure 32).

Figure 31: Loan Outcomes by Number of Employees

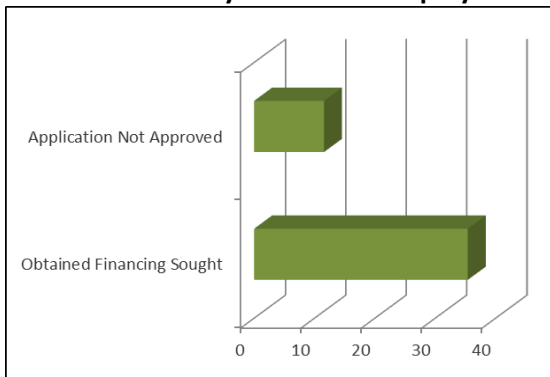
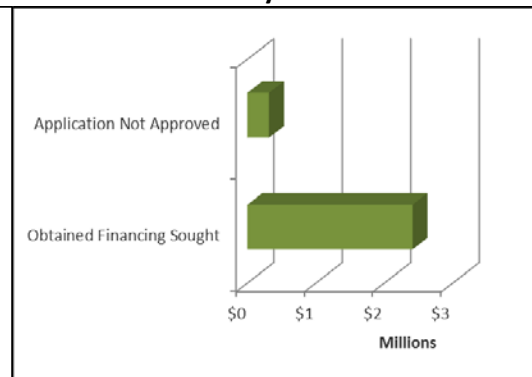


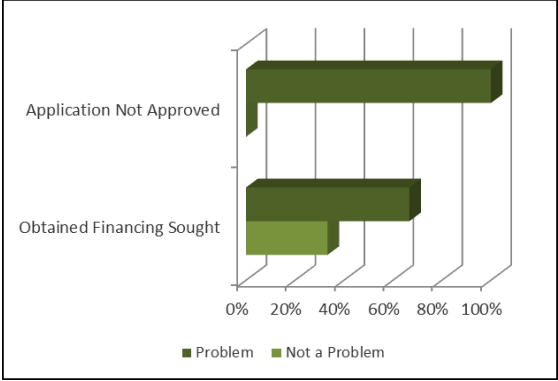
Figure 32: Loan Outcomes by Annual Revenue



¹⁸ See Appendix 10 for a complete set of tables used in the analysis of bank loan outcome data presented in this report.

Of those companies whose bank loan applications were not approved, all of them (100%) indicated a lack of financial capital has been a problem for their company. No surprise there. However, a surprising 66.7% of those companies that obtained financing also indicated that a lack of capital had been a problem (see Figure 33).

Figure 33: Lack of Capital a Problem by Bank Loan Outcome



This divergence in successful access to capital between young and mature companies suggests a significant and troubling trend in that start-up entrepreneurs and young businesses are clearly at a major disadvantage in obtaining bank loans. While this may not be a startling revelation about the difficulty start-ups and new businesses have in obtaining capital, it is no less troubling because it's not surprising.

VIII. Barriers to Capital Access and Potential Solutions

As described in the preceding sections, small businesses in Northern Lower Michigan face formidable barriers to obtaining capital. Not only do these barriers snag individual companies, they also threaten future economic growth in the region. To identify specific barriers, the project team used open-ended questions in both the lender and small business surveys that allowed respondents to provide qualitative data without the constraints of closed-ended questions. This qualitative data is described in the three subsections according to the lenders' perspective on capital access barriers and solutions; small businesses' perspective on capital access barriers and solutions; and potential solutions to barriers to capital access.

Principal barriers to small business capital access were identified in the lack of small businesses' financial knowledge for preparing adequate loan applications and lenders' lack of appreciation for the difficulties small businesses have had in overcoming the most severe economic downturn since the Great Depression. In developing a deeper understanding of the lenders' and small businesses' perspectives, the project team gleaned insights that suggest potential solutions for overcoming barriers to small business capital access.

1. Lenders' Perspective on Capital Access Barriers and Solutions

In making small business loans, lenders use underwriting standards that are governed by both regulatory oversight and internal risk management policies. Based on our survey, past positive (or adequate) cash flow coverage is the primary underwriting criterion used by lenders, followed by sufficient (or strong) collateral positions. Lenders also cited "good" credit history, industry sector, stable ownership, owner expertise, borrower equity, and "decent" net worth. In identifying obstacles to small business loan approvals, lenders pointed out applicants being "out of formula" with bank requirements,

including inadequate cash flow or collateral, insufficient equity, poor credit history, or being too highly leveraged and undercapitalized.

Several lenders also described applicants' "lack of business acumen," specifically their inability to provide "accurate and timely financial statements" and "quality financial information." They were also critical of applicants' impatience with the loan application process and their unwillingness to complete the entire application. Lenders also pointed to the applicants' inadequate understanding of cash flow requirements, lending standards, and "how the banks think" as obstacles.

To overcome these obstacles, lenders suggested that small businesses use government guarantees or enhancement programs, or add co-signers or provide stronger collateral. Other lenders might modify loan terms with longer amortizations or interest-only payments. Some refer applicants to professional financial advisors or public accountants for counseling and assistance in developing adequate business plans and successful loan applications. Many do not.

Lenders do not in general consider these barriers insurmountable. If applicants are amenable to guidance and counseling from available resources, they pointed out, these barriers can be overcome. Small business lending can also be improved, they suggested, through increasing government guarantees at limited costs and relaxing SBA lending guidelines, such as allowing refinancing of existing debt by the bank that currently holds the debt.

One lender discussed community bank regulation at some length and concluded that "community bankers know their customers and local economics very well and they are [in] the best position to judge whether or not a loan should be made" while regulators "want everything to be black and white and in reality most situations are gray." This lender cited instances of having to "decline loan requests to customers who have never missed a payment because their cash flow on paper may be short to cover the debt."

2. Small Businesses' Perspective on Capital Access Barriers and Solutions

Actions suggested by small businesses to improve capital access focus on three areas: one, the need to simplify the loan application process; two, the need for flexible criteria in evaluating loan applications; and three, the need to appreciate the difficult challenges small businesses face in the current economic environment.

Need to simplify the loan application process

The commercial loan application process can be onerous and uncertain for small businesses. They may lack sufficient financial records to document their financial condition and ability to repay a loan. It was suggested that lenders disclose the exact financial information they need from applicants and specify the information they will use in making credit decisions. One small business alluded to “ridiculous” applications that take far too much time to complete, regardless of the applicant’s credit history.

Other small businesses understand the need to cultivate “long-term relationships” with specific banks, or better yet specific bankers, and they encouraged lenders to actually work with small businesses. A pre-screening process for borrowers was recommended that would “point [the] applicant in the right direction before going through the entire process.”

Need for flexible criteria in evaluating loan applications

Inflexible financial criteria used in evaluating loan applications are regarded by small businesses as a major barrier to their access to capital. Several suggested relaxing cash flow requirements or considering factors other than cash flow. Other suggestions included:

- Encouraging lenders to allow higher collateralization as a primary criterion for evaluating loan applications;

- Considering future income resulting from business investment; and
- Permitting higher levels of risk in commercial lending.

Some business owners blamed overly strict banking regulations for preventing community banks from considering local business relationships in determining in making credit decisions.

Small businesses also advocated the use of incentives for locally-based businesses and offering small, low-interest loans for start-ups and existing businesses with sound business plans.

Need to appreciate small business challenges in the current economic environment

Small business owners implored lenders to “better understand small business issues” and “better understand what these businesses mean to the community.” They urged lenders to appreciate the difficult economic situation in the region and consider loans to “people who have good ideas for a business.” It was suggested that lenders are overly fixated on “the old rules about what makes a good investment” in a newly emerging economic reality. Some businesses lamented the unwillingness of lenders to take on risk to expand the regional economy. It was also asserted that banks need a “greater knowledge of available state/federal programs” and be “familiar with creative business financing forms.” Expressing frustration, one small business owner insisted that “they just need to be willing to take a little more risk—they are too scared I believe.”

3. Potential Solutions to Barriers to Capital Access

Based on a careful examination of the barriers identified by small businesses and lenders, the project team identified potential solutions (see Figure 34). Both commercial lenders and small business owners face critical barriers that block capital access. For commercial lenders, the loan application process is complicated by loan applicants with inadequate cash flow and/or collateral; loan applicants being unprepared and lacking sufficient financial information; and federal regulation of underwriting

standards that tend to exclude making loans based on client relationships and knowledge. Modifying loan terms and/or using enhancement programs can solve problems caused by inadequate cash flow or collateral. Educating applicants on the importance of sufficient financial recordkeeping could help applicants be better prepared for the application process. Finally, reforming the regulation of community banks would allow greater flexibility in applying underwriting standards.

For small businesses, they are faced with loan application processes that are often complex and confusing; inflexible loan criteria that ignore key financial factors that underscore their creditworthiness; and a lack of appreciation by lenders for small business economics and related issues. In order to make the loan application process less confusing, financial institutions could explicitly state their financial information requirements and disclose the relevant loan underwriting requirements. This transparency would help uncomplicate and expedite small business loan applications.

Emphasizing factors other than past cash flow, including smart business plans and solid market research, could also be an avenue to provide capital to small business owners who perhaps have not yet earned substantial profits. Finally, educating lenders about creative financing options, federal loan guarantee programs, and developments in rapidly-changing markets and conditions might also support greater capital access.

Figure 34: Barriers to Capital Access and Potential Solutions

Barriers to Capital Access and Potential Solutions			
Commercial Lenders		Small Business Owners	
Barriers	Solutions	Barriers	Solutions
1) Loan applicants with inadequate cash flow and/or collateral.	1) Modify loan terms and/or use enhancement programs.	1) Complex and confusing loan application process.	1) Clearly state financial information requirements.
2) Loan applicants being unprepared; lacking sufficient financial information.	2) Educate applicants on maintaining sufficient financial recordkeeping.	2) Inflexible loan criteria.	1a) Disclose underwriting criteria that will be used. 2) Consider more than past cash flow including business plans and market research.
3) Inability to make loans based on relationship knowledge because of federally-required underwriting standards.	3) Reform community banking regulations to allow greater flexibility in applying underwriting standards.	3) Lenders lack appreciation of small business economics and related issues.	3) Understand new market realities and enhance creative financing options.

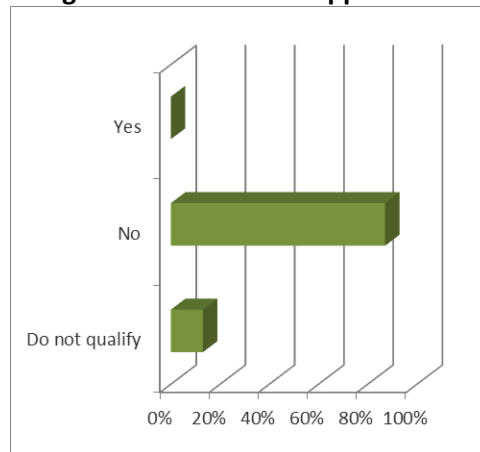
IX. Small Business and Lender Perceptions of USDA and SBA Loan Programs

Our small business and lender survey instruments each included questions about the use and effectiveness of U.S. Department of Agriculture (USDA) and U.S. Small Business Administration (SBA) loan programs.¹⁹ Both federal agencies provide guarantees for small business loans (in the case of USDA, only rural small businesses) that may or may not qualify for conventional C&I loans. The USDA, however, unlike the SBA, also offers grants in addition to offering small business loan guarantees. Our analyses of these responses are described below.

1. Small Business Perceptions of USDA Loan and Grant Programs

None of the surveyed companies indicated they had applied for USDA-guaranteed loans over the past year. However, 13% indicated they did not qualify for USDA-guaranteed loans (see Figure 35).

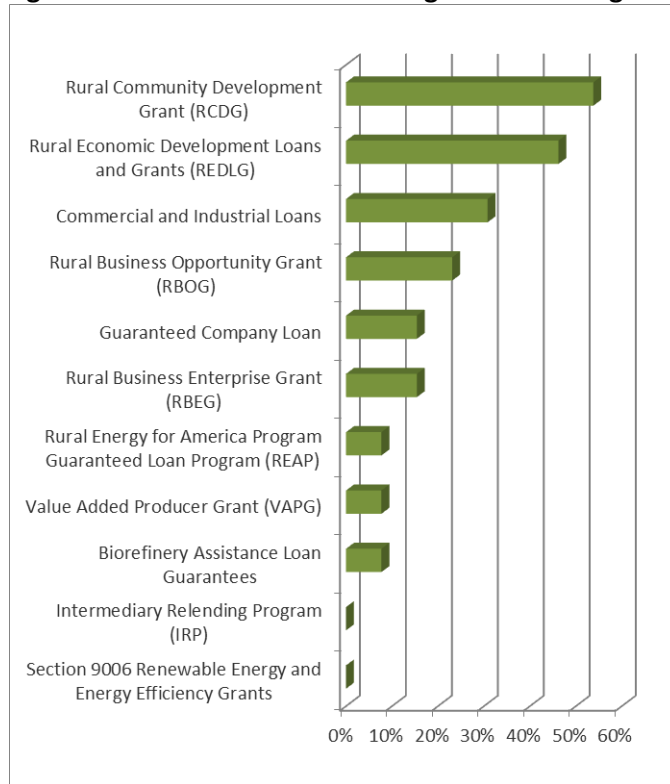
Figure 35: USDA Loan Applications



Questioned about their knowledge of USDA loan and grant programs, 53.8% identified Rural Community Development Grants; 46.2% Rural Economic Development Loans and Grants; and 30.8% USDA Commercial and Industrial Loans. Other programs were identified with less frequency, as shown in Figure 36.

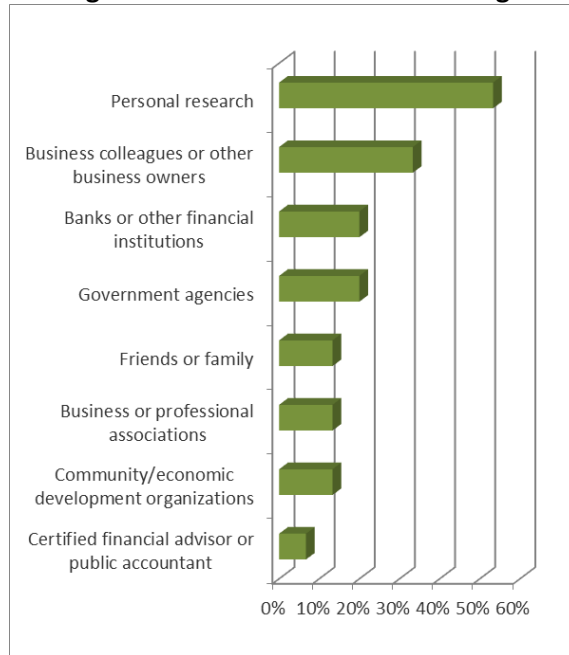
¹⁹ See Appendix 11 for a complete set of tables used for analysis of data on the perceptions of SBA and USDA programs presented in this report.

Figure 36: Small Business Knowledge of USDA Programs



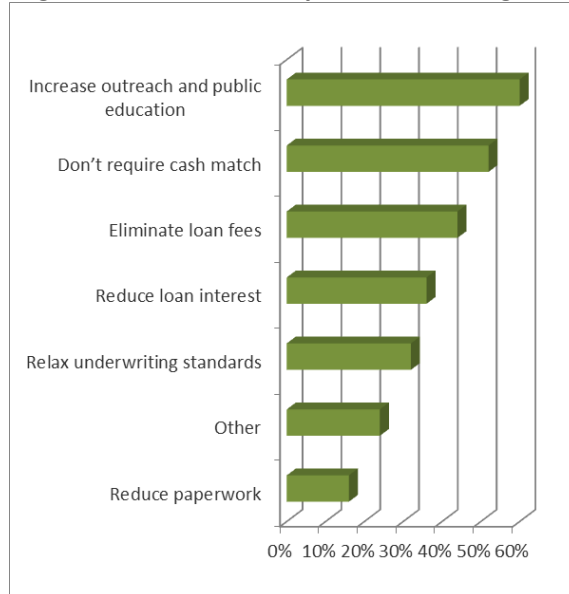
Asked how they became familiar with these USDA programs, the majority of business owners (53.5%) indicated personal research, followed by business colleagues or other business owners (33.3%). Only 20% indicated they learned of USDA programs from banks or other financial institutions (see Figure 37).

Figure 37: Source of USDA Knowledge



Finally, asked about actions to improve USDA loan and grant programs, about 60% of businesses suggested increasing outreach and public education; 52% not requiring cash match; 44% eliminating loan fees; and 36% reducing loan interest (Figure 38).

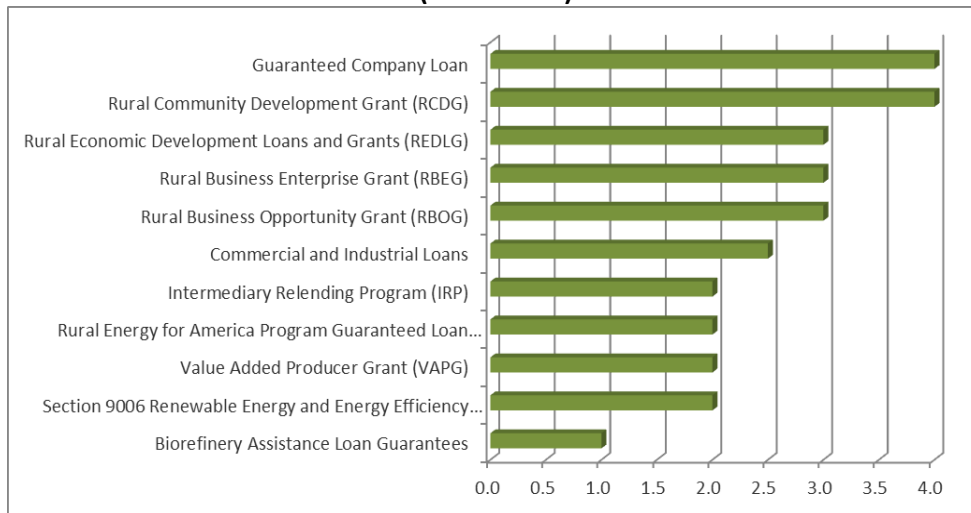
Figure 38: Actions to Improve USDA Programs



2. Lender Perceptions of USDA Loan and Grant Programs

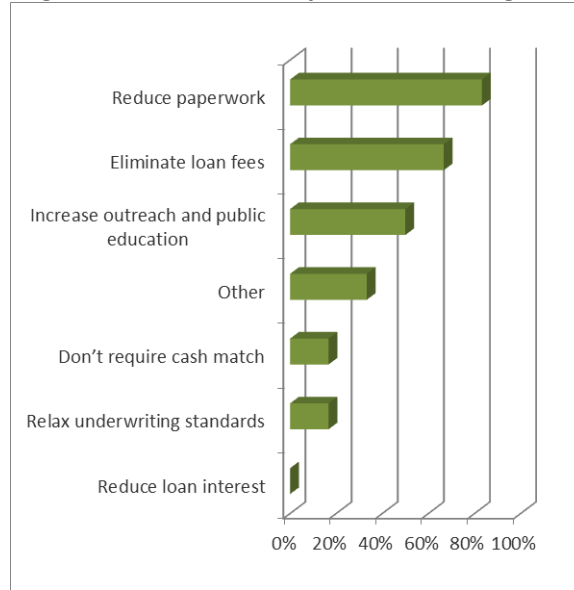
To understand the perspective of lenders on USDA programs, commercial loan officers were asked to rank USDA programs according to the level of success in providing financing to small businesses on a scale of 1 (“not successful”) to 5 (“very successful”). These rankings lack validity because the majority of lenders indicated they were not familiar with USDA programs.

**Figure 39: Success of USDA Loan/Grant Programs
(1 to 5 scale)**



In suggesting changes to improve USDA programs, lenders familiar with USDA programs overwhelmingly indicated reducing loan application paperwork (80%), followed by elimination of loan fees (64%) and increasing outreach and public education to increase the use of USDA programs (49%)[see Figure 40]. In an open-ended question, lenders were asked to further describe suggested changes. Allowing exception waivers for isolated situations and reducing capital requirements were suggested.

Figure 40: Actions to Improve USDA Programs

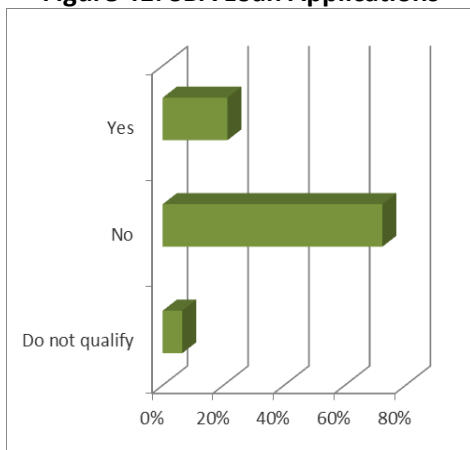


3. Small Business Perceptions of SBA Loan Programs

SBA loan programs are primarily intended to encourage banks to provide loan terms with longer repayment periods. Structuring loan terms in this way reduces the burden of higher periodic payments on small companies frequently faced with uncertain cash flows. SBA-guaranteed loans are not, however, designed to provide loan funds to high-risk businesses. As a guarantor, the SBA seeks to minimize its own exposure to claims and applies underwriting standards designed to protect against making bad loans.

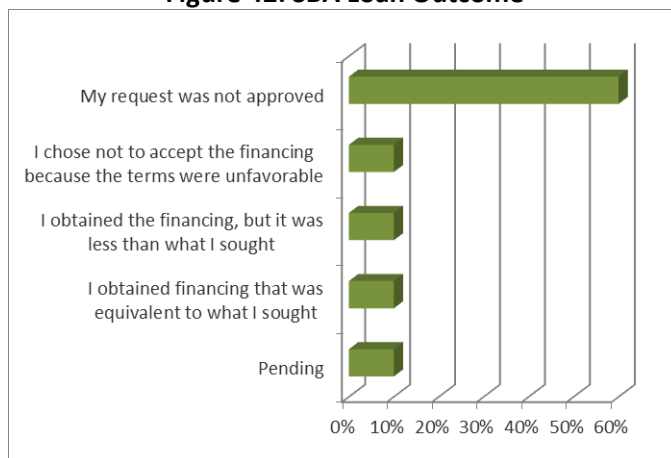
When asked whether their company had applied for an SBA loan in the past year, 21.3% of the surveyed businesses indicated they had while 6.4% discovered they did not qualify. 72.3% did not apply for such loans (see Figure 41). Thus, about one of every three businesses in our survey that qualified for SBA-backed loans sought such loans last year.

Figure 41: SBA Loan Applications



Of those that applied for SBA loans in the past year, 60% did not get their loans approved²⁰ (see Figure 42). Rejecting SBA financing because the terms were unfavorable was reported by 10% of companies as was obtaining financing that was less than they sought. However, the small number of responses was insufficient for drawing any substantive conclusions.

Figure 42: SBA Loan Outcome

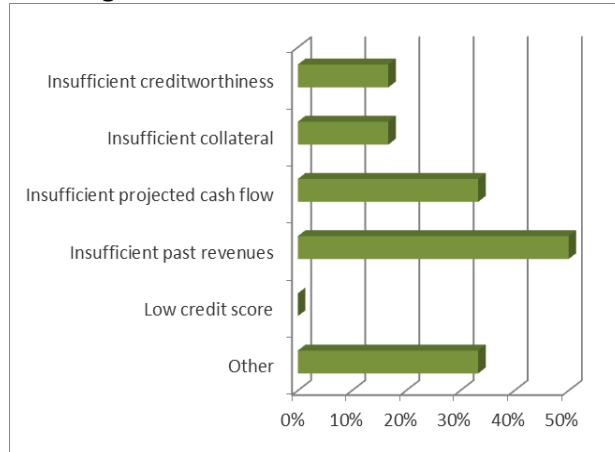


Those denied SBA loans were asked for the stated reason(s) given for the denial. Again, the small sample size precludes drawing any substantive conclusions. The most frequent response—50%—indicated insufficient past revenues. Insufficient projected cash flow was also widely reported (33.3%). Insufficient cash flows and collateral were also cited. Several respondents noted in their open-ended responses that lenders were unwilling to consider projected increases in cash flow and would only consider past

²⁰ It should be noted that the sample size of this group is very small and this analysis is not statistically precise.

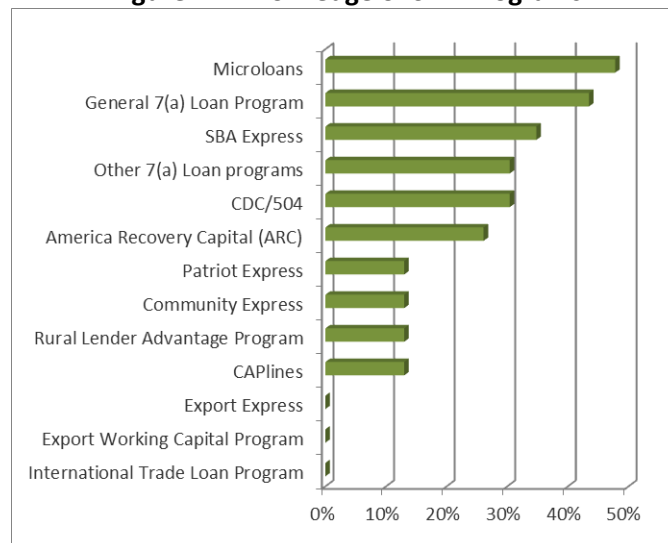
revenues. As the small sample size renders the implied distribution of responses imprecise, interpreting these results should be done with caution.

Figure 43: Reasons for SBA Loan Denial



Asked about their knowledge of specific SBA loan programs, the SBA Microloan was most frequently cited (47.8%) followed by the 7(a) Loan Guarantee Program (43.5%) and SBA Express Loan Program (34.8%). None of the respondents cited SBA export or international loan programs.

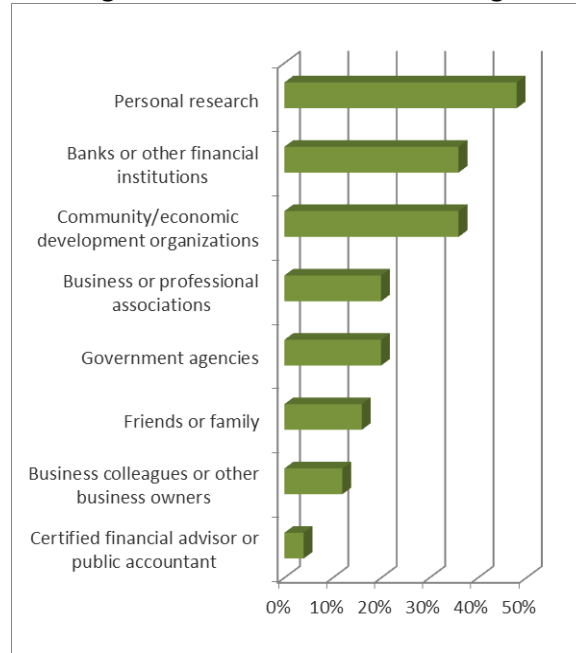
Figure 44: Knowledge of SBA Programs



Asked to indicate the source of their knowledge of SBA loan programs, most (48%) indicated personal research. Tied at 38% were banks and community/economic development organizations. Other sources

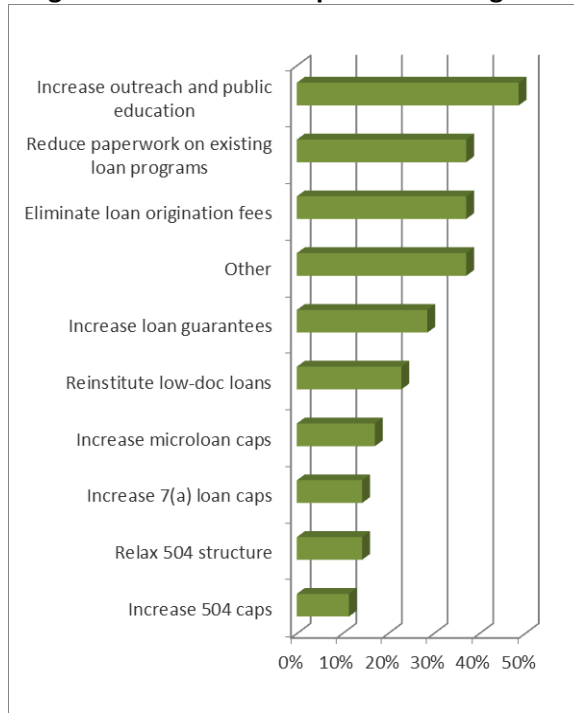
included business associations, government agencies, friends/family, colleagues, and accounting services (see Figure 45).

Figure 45: Source of SBA Knowledge



Finally, small businesses were asked to consider actions to improve the SBA loan process and allowed to select more than one. Expanding outreach and public education was the most frequently cited action (48.6%) followed by reducing paperwork (37.1%) and eliminating origination fees (37.1%). Other suggestions include increasing loan caps and relaxing the rigid 504 Fixed Asset Financing Program structure (see Figure 46). In responding to an open-ended question, other respondents suggested encouraging greater information and cooperation from local banks working with SBA programs and better preparing applicants on the cash flow conditions of start-up businesses.

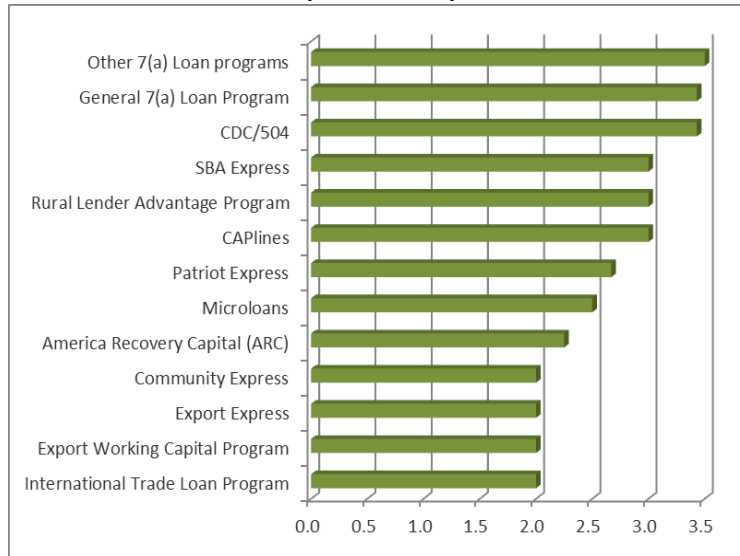
Figure 46: Actions to Improve SBA Programs



4. Lender Perceptions of SBA Loan Programs

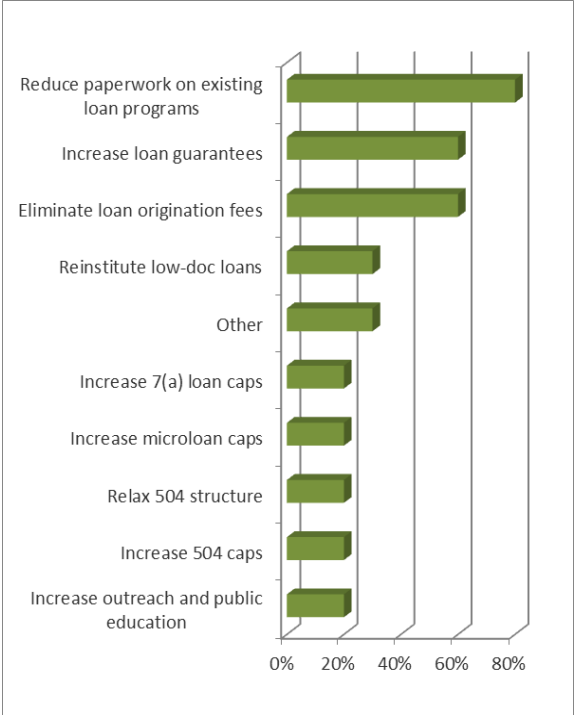
Commercial loan officers were also asked about SBA loan programs. Asked to rank the success of specific SBA loan programs in providing financing to small businesses on a scale of 1 (“not successful”) to 5 (“very successful”), they ranked “general 7(a)” and “other 7(a)” programs with a combined average of 3.47. CDC/504 programs were also ranked high (see Figure 47). However, it is again important to note that for each program ranked lower than SBA Express, the majority of loan officials did not use or have knowledge of these programs so very few ranked them at all.

**Figure 47: Success of SBA Loan Programs
(1 to 5 scale)**



Lenders suggested actions to improve SBA loan programs differing from those of small businesses. While small businesses ranked increased outreach and public education highest, loan officers ranked it last. However, both lenders and small businesses agreed on the need to reduce paperwork, with 80% of lenders suggesting this action. About 60% suggested the elimination of origination fees and the same percentage suggested an increase in loan guarantees (see Figure 48). Other suggestions to improve SBA loan programs include developing a program to guarantee small micro-enterprise notes; allowing all loans to originate through ETRAN (this was recently enacted under the Small Business Jobs Act of 2010); and reducing the overall burden of loan servicing.

Figure 48: Actions to Improve SBA Programs



X. Project Findings

The following findings are based on our analyses of quantitative and qualitative survey data and organized in three areas: 1) Small business capital needs and purposes, 2) Lenders' portfolio management, and 3) Integrating capital needs with loan portfolio management.

1. Small Business Capital Needs and Purposes

Our survey data strongly suggests that Northern Michigan business owners and entrepreneurs expect a bright economic future. They are optimistic about their companies' future prospects in spite of their generally gloomy perspectives on their companies' recent past economic performances; tightening of lending standards; the lack of available capital; a lack of confidence in the future economy; and a lack of confidence in the future availability of capital. In spite of these multiple down sides, most respondents expect their companies to grow. However, they also see their inability to obtain capital as a major barrier to their future growth, based in part on their perception that commercial lending standards have tightened drastically in the past twelve months.

To finance future growth, the vast majority of companies anticipate the need for additional capital. At the same time, however, a majority of companies lack confidence in capital becoming more available in the future. It is important to note that the need for additional capital to invest in business expansions and startups dwarfs the need for working capital to cover operating expenses, according to our survey data. Most companies have found a lack of capital to be a problem. The most frequent specific problem was the inability of companies to grow or expand their operations, especially for young companies. **Thus, one key finding is that greater job creation would result if capital were more available to young companies.**

The differential impact of the lack of capital on young and mature companies, respectively, is dramatic. The financial situation has been worse for young companies than for mature companies over the past 12

months (November 2009-October 2010). Mature companies are far more likely to have experienced improvement. The lack of capital, while problematic for most companies, has been a particularly pervasive problem among young companies. Mature companies, unlike young companies, are more likely to have reduced the number of employees in response to capital tightening. Moreover, mature companies are more likely than young companies to seek capital to restructure and repay existing debt. Young companies frequently indicated they would add new employees were they able to obtain additional capital.

These findings underscore the fundamental importance of improving small business capital access in Northern Lower Michigan and perhaps other similar regions. Small businesses and entrepreneurs are most likely to create new jobs in an uncertain economy, but they need capital to do so. While mature companies have weathered the Great Recession better and have enjoyed greater access to financial capital than young companies, it is young companies that are more likely to hire new workers. These findings correspond to the notion that more mature and larger companies have greater resources to weather the economic storm of the Great Recession and the tentative recovery. Being larger, they have greater flexibility in shifting costs, revenues, and assets to ward off the recessionary effects of short-term (and longer) disruptions in cash flows. Younger and smaller companies have less flexibility, given that they have fewer sources of revenue and fewer opportunities to cut costs. Their financial statements also show the negative impacts of cash flow interruptions more quickly than those of mature companies. Their financial lifelines are much shorter than those of mature companies.

Commercial banks were the most common source of financial capital for small businesses in the region. Of companies that applied for bank loans during the past twelve months, 50% were not approved for the financing they sought. Company size correlates to success in obtaining capital. Companies whose applications for bank loans were approved employed over three times the number of employees at

companies whose applications were not approved. The average annual revenue was over seven times greater (\$2,412,377 compared to \$315,047) for companies that were approved for bank loans compared to companies whose applications were denied. Lack of capital proved problematic for the majority of both companies that were approved (66.7%) as well as for those denied loans (100%).

2. Lenders' Loan Portfolio Management

In assessing FDIC Call Report data for the 15 banks based in Northern Michigan and from our online lender survey, two principal themes emerged in the context of decreased lending activity. The first is the obvious impact of the Great Recession and the current economic environment on borrowers' financial conditions that are subject to review by banks in reviewing loan applications. The second is the insufficient preparedness of applicants in pursuing small business loans from commercial banks. Each theme has distinct implications for policy-driven intervention.

The impact of the Great Recession on small businesses' financial conditions is twofold: reduced cash flows and eroded net equity. As banks (as well as USDA and SBA small business loan programs) use benchmarks that measure a company's ability to repay loans from the generation of new revenue, evidence of healthy cash flows is critical to obtaining a loan. However, the economic downturn has severely disrupted cash flows. It has been difficult for otherwise creditworthy borrowers to meet minimum standard benchmarks after their financial track records have been dented by the downturn. In addition, eroded cash flows further exacerbate the situation by reducing net equity, another key metric used by lenders in assessing creditworthiness.

Some lenders contend that small business loan programs and bank regulators are relying on financial benchmarks that are too tough for small businesses to meet as the economy struggles to emerge from the Great Recession. Less rigidity in applying regulatory standards to loan management could provide banks with greater ability to determine creditworthiness on metrics that are difficult to quantify like

long-term relationships with borrowers, knowledge of borrowers' circumstances, superior understanding of the local economy, and other similar factors.

Many lenders indicated that borrowers often approach banks without sufficient preparation to apply for a loan. Business owners often lack adequate financial records, such as annual financial reports or financial records more detailed than tax returns. Lenders also lament that many applicants base their ability to repay loans on unrealistically high expectations of future cash flows. While extensive resources are available to assist small businesses, lenders observe these resources are not fully used. Small businesses have access to a range of private and public resources that could help in developing business plans, financial records and pro forma statements, legal documents, and provide valuable business advice. Private resources include CPAs, attorneys, and others. Public resources include the Michigan Small Business and Technology Development Centers (SBTDCs),²¹ local economic development agencies, and community colleges or state university resources like MSU and MSU Extension.

3. Integrating Capital Needs with Loan Portfolio Management

Newly-elected Michigan Governor Rick Snyder has emphasized the need to invest in locally-grown businesses as a concerted state economic development strategy. At the same time, our survey of small businesses shows these businesses are sending distress signals because of the threat posed by the lack of capital access. Our research further indicates that bank lenders are willing to lend to small businesses. A disconnect, however, clearly exists between at least some borrowers and lenders. Lenders, constrained by strict regulatory and internal portfolio standards, hesitate to lend to companies that, in any other economic environment, would not pose unreasonable risks.

²¹ See Appendix 12 for Michigan Small Business and Technology Development Centers (SBTDCs) contact information.

A second issue evident from our research seems imminently manageable. Small businesses find lenders' information requirements difficult to meet. Business owners are often perplexed and distressed by what they see as insurmountable obstacles of paperwork to qualify for standard business loans. And in seeking government-guaranteed business loans, their distress only gets worse.

Thus, in spite of the public and private resources available to business owners throughout the region-- including the Small Business Technology and Development Centers, economic development agencies, accounting firms, and law firms—a disconnect remains between small business capital needs, business assistance resources, and successful loan applicants. A key question, then, is how to facilitate or build connections between small businesses and extensive business assistance sector in the state. By carefully considering our research and the literature on regional business support, clear policy implications emerge.

XI. Policy Implications

1. Develop Reasonable Cash Flow and Capital Reserve Lending Requirements Consistent with Business Conditions in 2011 and Beyond

The commercial banking sector may be using commercial and industrial loan assessment models that are inconsistent with current market realities. During the Great Recession, companies of all sizes suffered through severe cash flow problems for prolonged periods of time. Two of Michigan's automotive manufacturers declared bankruptcy. Small and medium businesses across the board were very hard hit. They were less likely than most large corporations to have sufficient capital reserves and the financial flexibility to respond to sudden disruptions in cash flow. In our two surveys, both lenders and borrowers expressed concern about cash flow and capital benchmarks used by lenders, as they were perceived as significant barriers to small business capital access.

It is understood that relaxing cash flow and capital requirements as a change in regulatory policy would be a complicated matter at multiple regulatory levels and for SBA and USDA loan guarantee programs. We further acknowledge that the issue of whether relaxing such standards would result in the banking industry taking on overly risky exposures has not been well-vetted. At the very least though, it seems appropriate to question whether current lending standards are aligned with the unusually high rates of GDP growth in the 1990s and bubble economics of the early 2000s at the expense of proper alignment with current economic realities. A new set of regulatory lenses calibrated to these new economic realities of 2011 and beyond is arguably needed.

2. Greater Regulatory Flexibility Needed in Supervising Community (Regional) Bank Loan Portfolios

Parallel to the discussion above, some lenders expressed concern that rigid standards for underwriting loans represent a barrier to small business commercial lending. A federal regulatory approach using a "one size fits all" approach to loan standards may be too rigid and constraining in some

markets. A regulatory policy seeking to provide protect the country from banks “too big to fail” may be misfiring when applied to community or regional lenders.

Although we recognize that fluid regulation is tantamount to no regulation at all and would lead to higher regulatory costs, a multi-tiered regulatory system could still be a viable option. Such a system would afford greater flexibility in capital markets by segmenting the commercial loan sector, and afford the community banking segment the flexibility to effectively respond to local market conditions. As these community banks have immediate knowledge of their clients and local markets, it seems reasonable for them to have a greater range of discretion. A multi-tier system might establish different portfolio risk metrics for multi-state banks, single-state banks, and community (regional) banks, respectively.

Since the banking deregulation of the 1990s, community banks have been held to the same Federal banking regulations as national banks. These regulations are designed to protect the public from major bank failures that pose systemic risk to the entire national banking system. However, these regulations impose restrictions on community (regional) banks that may unreasonably interfere with making loans based on their knowledge and relationships with local businesses. A community bank may determine that some small business loans are acceptable risks but Federal regulations forbid it. Given that community banks lack the same potential for systemic risk to the national banking system as do large national banks, community bank loan underwriting standards could be governed by an alternative set of more flexible regulatory standards. As with any regulatory changes, there would be a new set of differential risks: some institutions may have greater regulatory advantages compared to others; the potential exists for creating greater vulnerability of community banks to regional economic fluctuations; and other unintended consequences are likely to exist.

3. Streamline USDA and SBA Loan Application Processes

The need to streamline USDA and SBA paperwork requirements emerged as a predominant theme in the survey responses of business owners and managers. Both borrowers and lenders indicated the need to streamline SBA and USDA business loan application procedures. SBA has instituted streamlining procedures under its SBA Express programs, and survey respondents regard SBA Express favorably. Lenders, however, would like to see this program expanded to other types of SBA loans and further streamline all programs.²² In addition, borrowers already faced with what they consider formidable tasks associated with conventional loan applications must surmount a higher bar when pursuing SBA or USDA loans. Any efforts to reduce the “shoe-leather costs” associated with SBA and USDA-backed loan applications would be welcome and are arguably needed to create the right environment to unleash entrepreneurial talent and job creation in the region and state.

4. Create a State Loan Fund

Similar to SBA and USDA loan programs that neither incur costs nor realize profits, establishing a state-backed, revenue-neutral loan program to respond more effectively to the need for business formation and expansion and job creation should be considered. Its purposes could include focusing on small business lending; making patient capital available to start-ups; greater flexibility in collateral requirements; establishing reasonable criteria for start-up lending; using personal creditworthiness as a major factor in lending decisions for small businesses and start-ups; and other creative alternatives to conventional financing. Viable approaches include creating a state loan fund or development bank that could pool assets to promote state economic development objectives or pool philanthropic foundation

²² Two new SBA 7(a) loan guarantee programs (Small Loan Advantage & Community Advantage) became available February 15, 2011 to “preferred lenders” and “mission-focused” financial institutions, respectively. These programs will offer a streamlined application process to increase the number of smaller loans (up to \$250,000) to small businesses in underserved communities. Advantage loans will come with the regular SBA 7(a) government guarantee: 85% for loans up to \$150,000 and 75% for loans greater than \$150,000.

and public monies together to create a public/private loan guarantee program. Other options would likely emerge as discussions of this approach take shape and move forward.

5. Effective Mobilization and Deployment of Small Business Loan Application Assistance

Many borrowers are not well prepared for the rigors of applying for small business loans, based on our data from the small business and lender surveys. The loan application process requires a great deal of pre-application legwork and can be demanding, confusing, and frustrating. *The Guide to Starting a Small Business*, available on the state Web site (Michigan.gov), provides an extensive menu of public resources to assist those starting small businesses. In addition, the U.S. SBA sponsors a wide range of events, workshops, and programs that provide valuable business development and finance information across the state. The Small Business and Technology Development Centers (SBTDCs) located around the state provide excellent one-on-one assistance to small business owners.²³ Community colleges also offer credit and non-credit courses geared toward small businesses.

However, another key finding is these resources appear underutilized by Michigan's small businesses as evidenced in our survey data. Lenders described scenarios in which small businesses approach them with few financial records, no business plan, and unrealistic cash flow projections. At the same time, small businesses are critical of the complicated application process to obtain commercial financing. Although we believe that loan application processes do not pose insurmountable barriers (obviously there are small businesses that successfully obtain loans), that does not mean that formidable barriers do not exist, especially to those who are new to the game. Small businesses can be better prepared for making loan applications by consulting a host of publicly-sponsored business assistance programs and/or private business service providers.

²³ Michigan SBTDCs received an SBA grant of \$1,622,560 in February 2011 from funds provided by the 2010 Small Business Jobs Act to help entrepreneurs grow their businesses. Nine small business finance and strategy specialists will be hired by SBTDCs to provide no-cost counseling focusing on growth-phase (second stage) businesses and assist them in obtaining capital and credit, among other types of assistance.

Michigan should launch a concerted effort to increase the visibility of public and private service providers. Better use of these resources could reduce transaction costs incurred by both borrowers and commercial lenders. This low-cost approach could go a long way to opening up small business capital access in Michigan. And it's simply a matter of more effectively mobilizing the current small business support infrastructure already in place. Genuinely effective deployment of resources is every bit as important as developing the resources in the first place. Such deployment should be predicated on entrepreneurial and strategic considerations, not institutional silos or traditional agendas.

6. Build an Entrepreneurial Michigan

Curricula at university, community college, and high-school levels should be developed to encourage creativity and prepare students to become innovators and entrepreneurs. It's clearly insufficient to prepare students for entry into a traditional workplace that no longer exists. Recent research has shown that entrepreneurship is predicated more on learning than on any particular genetic trait. Although entrepreneurs often benefit from a specific set of specialized skills (e.g., writing computer codes or the know-how to manufacture wind turbines), other skills are also needed—leadership, organizational, marketing, communications, and financial management among others. Perhaps the most critical elements making up the entrepreneurial skill-set are the ability to spot and anticipate opportunities and to engage in creative problem-solving. As Peter Drucker pointed out in his seminal 1998 work titled *The Discipline of Innovation*, "(I)nnovation is work rather than genius." Entrepreneurial success occurs where opportunity and preparation meet.

7. Networking the Path to Business Innovation and Market Success

Research shows that innovation results from the exchange of ideas. Thus, the pivotal role of business networks and community interactions with entrepreneurs cannot be over-emphasized. These networks promote entrepreneurship through exchanging and sharing knowledge and ideas. Such

networks can be cultivated with little formal institutional encouragement; businesses already have a vested interest in learning from their peers and working collaboratively. These networks can meet regularly as mixers at local coffee shops, book stores, and community centers to discuss common issues, advance solutions, exchange ideas, and create partnerships to meet the collective and individual goals of its members. State and civic leaders can encourage such networks by hosting annual entrepreneurship awards, providing meeting space, networking with other regional networks, and a wide range of other creative actions, including those that open up paths to export markets. The importance of export markets to Michigan companies cannot be overemphasized. And at present, small and medium companies in Michigan (and most other states) are not fully taking advantage of these hugely-important market opportunities. For new entrepreneurs with innovative products to sell, thinking in terms of global markets should be a key part of their business plans.

XII. Conclusion

This is our second major paper on small business capital access issues in less than a year, the first being *Investment 101: Capital Access and Investment Strategies in Northern Michigan and the Eastern Upper Peninsula* published last May. Obviously our CCED team believes this is a vital area to understand as fully as possible based on accurate data and incisive analysis. Armed with research data and findings, policymakers can develop and implement strategic actions to support greater capital access by small businesses. As the engines that make our economy go, they are the primary source of new jobs—two of every three new jobs are created by small businesses. In essence, access to capital is the lifeline of small businesses. However, small businesses consistently rank difficulty in obtaining capital as a significant barrier to growth.

Our principal intent in pursuing this research is to stimulate constructive discussion of capital access and small business formation in Michigan that will lead to positive policy outcomes and economic prosperity. As the Obama administration at the federal level and the new Snyder administration at the state level have identified small business formation as key objectives for regional economic development strategies, the time is right to calibrate the policies surrounding what is arguably the most significant barrier to growing small businesses in the study region and across the state. We hope this paper will contribute to fruitful policy discussions that will result in actions to improve the state's business climate – ranked 47th on Forbes 2010 list of *Best States for Business and Careers*. We hope future changes will especially benefit young companies and start-up entrepreneurs who are the economic future of the region and the state.

Readers should be mindful of the limitations of this study. The geographic scope of the surveyed business owners and commercial lenders was limited to the northern 21 counties of Michigan's Lower

Peninsula. This is a predominantly rural region although it includes small cities like Traverse City, Alpena, Gaylord, Manistee, and others. The two surveys of small businesses and lenders, respectively, may or may not be representative of the entire state. No attempt was made to test the sample's representativeness of all businesses and financial institutions in the state. Moreover, commercial bank lenders participating in this study represent only those financial institutions operating solely in the study region. No effort was made to survey multi-state or multi-regional lenders. Our findings, however, appear not dissimilar from current discussions described in the literature.

Finally, other sources of capital exist that were not surveyed should be considered in discussions of policy options to address small business capital access. These include venture capitalists, community foundations and organizations, angel investors, and other institutions seeking to support local business formation and development through capital financing.

Additional research areas include generating data and information to investigate evidence associated with designing and evaluating initiatives to address the seven policy implications described in Section XI.

Annotated Bibliography

Alessandri, P. and A.G. Haldane. (2009). "Banking on the State." Presented at the Federal Reserve Bank of Chicago's *International Banking Conference on The International Financial Crisis: Have the Rules of Finance Changed?* Chicago, IL.

Over the past 800 years, the terms of trade between the state and the banks have decisively swung one way and then the other. For most of this time, the state relied on the deep pockets of the banks to finance periodic fiscal crises. But for at least the past century, the pendulum has swung back, with the state often needing to dig deep to keep crisis-prone banks afloat. Events of the past two years have tested the deep pockets of many national states even further. It has added even more momentum to this century-long pendulum swing. Reversing direction will not be easy. It is likely to require a financial sector reform effort every bit as radical as that which followed the Great Depression. It is an open question whether reform efforts to date, while slowing the swing, can bring about that change in direction.

Avery, R. B. & K. A. Samolyk. (2003). Bank Consolidation and Small Business Lending: The Role of Community Banks. *Journal of Financial Services Research*, 25(2-3), 291-325.

This paper examines how bank consolidation activity affected small business lending in local U.S. banking markets during two 3-year study periods, focusing on the role played by community banks in the process. In 1994–1997, consolidation activity involving big banks was found to be associated with lower loan growth, while community bank consolidations and a greater presence of community banks in the market were associated with higher loan growth. During 1997–2000, consolidation activity was either unrelated to small business loan growth or was associated with higher loan growth. In both periods, the share of small business lending funded by community banks rose, particularly in markets undergoing consolidation.

Barkley, David L. (1999). Policy Options for Equity Financing for Rural Entrepreneurs. *Equity for Rural America: From Wall Street to Main Street*, Federal Reserve Bank of Kansas City Conference. October 8-9, 1998, Denver, CO.

Rural entrepreneurs and small businesses have limited access to financing from venture capitalists. What are the reasons? This paper provides an overview of options for enhancing the availability of venture capital in rural areas drawing on the author's research for the Rural Policy Research Institute (RUPRI). He also discusses private venture capital funds and the impediments that discourage these funds from investing in rural areas and provides examples of public and private efforts to build rural equity capital institutions. He concludes with suggestions based on lessons learned from alternative, nontraditional venture capital programs and policy alternatives to promote the availability of equity capital in rural areas (see citation below).

Barkley, David L., Deborah M. Markley, David Freshwater, Julia Sass Rubin, and Ron Schaffer. (2001). Establishing Nontraditional Venture Capital Institutions: Lessons Learned. Part 1 of 4 of the Final Report. RUPRI Rural Equity Capital Initiative Study of Nontraditional Venture Capital Institutions.

This report reviews nontraditional venture capital institutions in the U.S., notably Kansas Venture Capital, Inc. and the Colorado Rural Seed Fund. KVC has invested in 30 companies and created or retained nearly 3,000 jobs. It repaid the original public investment of \$5 million. The Colorado Rural Seed Fund was unable to make successful investments in western Colorado, and by 1998, the fund value had dropped to \$100,000 from \$500,000. Differences between success and failure are not great: successful institutions generate sufficient deal flow for a profitable investment portfolio and appropriate management and portfolio structure are keys to success. Other

keys include rewarding management for growing the fund; insulating the institution from political agendas; and providing assistance to portfolio companies after investments are made. The other three parts of the final report include: Part 2) Nontraditional Venture Capital Institutions: Filling a Financial Market Gap that provides an overview of the venture capital (VC) industry, identifies impediments to VC investments in rural areas, and suggests roles for nontraditional VC in small market areas; Part 3) Establishing Nontraditional Venture Capital Institutions: The Decision-Making Process outlines a decision-making process for establishing nontraditional VC funds based on 23 case studies; and Part 4) Case Studies of Nontraditional Venture Capital Institutions provides detailing the 23 institutions in the study.

Berger, A. N. and G.F. Udell. (1994). Lines of Credit and Relationship Lending in Small Firm Finance. *Journal of Business*, 68(3), 351-381.

This article examines the role of relationship lending in small firm finance by examining price and nonprice terms of bank lines of credit extended to small firms. The focus on bank lines of credit allows the examination of a type of loan contract in which the bank-borrower relationship is likely to be an important mechanism for solving the asymmetric information problems associated with financing small enterprises. The authors find that borrowers with longer banking relationships pay lower interest rates and are less likely to pledge collateral. These results are consistent with theoretical arguments that relationship lending generates valuable information about borrower quality.

Berger, A. N. & G. F. Udell. (1998). The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle. *Journal of Banking & Finance*, 22(6-8), 613-673.

The authors examine the economics of financing small business in private equity and debt markets. Firms are viewed through a financial growth cycle paradigm in which different capital structures are optimal at different points in the cycle. We show the sources of small business finance, and how capital structure varies with firm size and age. The interconnectedness of small firm finance is discussed along with the impact of the macroeconomic environment. The authors also analyze a number of research and policy issues, review the literature, and suggest topics for future research.

Berger, A. N. & G. F. Udell. (2002). Small Business Credit Availability and Relationship Lending: The Importance of Bank Organizational Structure. *The Economic Journal*, 112(477), F32-F53.

This paper models the inner workings of relationship lending, the implications for bank organizational structure, and the effects of shocks to the economic environment on the availability of relationship credit to small businesses. Relationship lending depends on the accumulation over time by the loan officer of "soft" information. Because the loan officer is the repository of this soft information, agency problems are created throughout the organization that may best be resolved by structuring the bank as a small, closely-held organization with few managerial layers. The shocks analyzed include technological innovations, regulatory regime shifts, banking industry consolidation, and monetary policy shocks.

Berger, A. N., W. S. Frame & N. H. Miller (2005). Credit Scoring and the Availability, Price, and Risk of Small Business Credit. *Journal of Money, Credit, and Banking*, 37(2), 191-222.

It was found that small business credit scoring (SBCS) is associated with expanded quantities, higher averages prices, and greater average risk levels for small business credits under \$100,000, after controlling for bank size and other differences across banks. It was also found that: (1) bank-specific and industry learning curves are important; (2) SBCS effects differ for banks that adhere to "rules" versus "discretion" in using the technology; and (3) SBCS

effects differ for larger credits. The data do not support two alternative explanations of the main results under which the findings primarily represent statistical artifacts, rather than significant changes in lending behavior.

Berger, A. N., et al. (2005). Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks. *Journal of Financial Economics*, 76(2), 237-269.

Theories based on incomplete contracting suggest that small organizations have a comparative advantage in activities that make extensive use of “soft” information. The authors provide evidence consistent with small banks being better able to collect and act on soft information than large banks. In particular, large banks are less willing to lend to informationally “difficult” credits, such as firms with no financial records. Moreover, after controlling for the endogeneity of bank-firm matching, it was found that large banks lend at a greater distance, interact more impersonally with their borrowers, have shorter and less exclusive relationships, and do not alleviate credit constraints as effectively.

Berger, A. N., R. J. Rosen & G. F. Udell (2007). Does Market Size Structure Affect Competition? The Case of Small Business Lending. *Journal of Banking & Finance*, 31(1), 11-33.

Market size structure refers to the distribution of shares of different size classes of local market participants, where the sizes are inclusive of assets both within and outside the local market. This new measure of market structure was applied in two empirical analyses of the U.S. banking industry to address concerns regarding the effects of banking consolidation. Quantity analysis of the likelihood that small businesses borrow from large versus small banks and a small business loan price analysis that includes market size structure as well as conventional measures yield very different findings from most of the literature on bank size and small business lending. The results did not suggest a significant net advantage or disadvantage for large banks in small business lending overall, or in lending to informationally opaque small businesses in particular. The authors argue that the prior research that excluded market size structure may be misleading and offer some likely explanations of why their results differ.

Bernanke, B. S., et al. (2009). *The Economic Crisis and Community Development Finance: An Industry Assessment*. Federal Reserve Bank of San Francisco, Community Development Investment Center (Working Paper 2009-05). San Francisco, CA.

A major theme is that time is of the essence. Even before the current meltdown, the community development finance industry was stressed by years of federal cutbacks and a changing dynamic that made bank funding more difficult to obtain and more expensive. The paper recommends longer-term steps, such as establishing a fiduciary duty for all financial institutions to invest in “opportunity finance.” However, the authors agree that capital, liquidity, well-priced debt, and financing partners are needed now. Delay may well mean the infrastructure of community finance, especially for housing and particularly in hard-hit and rural areas, will die before help arrives.

Blumberg, B. F. & W.A. Letterie (2007). Business Starters and Credit Rationing. *Small Business Economics*, 30(2), 187-200.

This paper investigates which business starters experience credit rationing by simultaneously analyzing which business founders apply for credit and which are refused. The authors argue that credit denial depends largely on the entrepreneurs’ commitment and signals regarding the repayment of the loan and the success chances of the proposed business. An empirical analysis is based on a sample of 1140 potential business starters in the Dutch county South Limburg. Findings show that commitments drive the credit application and approval, while the

effects of signals are mixed. The findings also suggest that business founders have a pretty good idea regarding whether their applications will be honored or not.

Board of Governors of the Federal Reserve System. (2010). *The July 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices*. Washington, DC.

The results of the July survey indicated that a modest net fraction of domestic respondents had eased standards for lending to large and middle-market firms over the previous three months—the second consecutive survey showing such an easing. For the first time since 2006, banks reported having eased their lending standards on C&I loans to small firms. In particular, around one-fifth of large domestic banks reported having eased lending standards for small firms, which offset a net tightening of standards by a small fraction of other banks.

Boot, Arnoud W. A. (2000). Relationship Banking: What Do We Know? *Journal of Financial Intermediation*, 9(1), 7-25.

This paper briefly reviews the contemporary literature on relationship banking starting with a discussion of the *raison d'être* of banks in the context of the financial intermediation literature. From there we discuss how relationship banking fits into the core economic services provided by banks and point at its costs and benefits. This leads to an examination of the interrelationship between the competitive environment and relationship banking as well as a discussion of the empirical evidence.

Brophy, D. J. and Wassim Mourtada. (1999). "Equity Finance and the Economic Transition of Rural America: A New Framework for Private-Sector Initiatives and Positive Economic Public Policy." *Equity for Rural America: From Wall Street to Main Street*, Federal Reserve Bank of Kansas City Conference. October 8-9, 1998, Denver, CO.

This seminal paper on the economic transition of rural America describes the now classic life cycle of a growing business and the development of the venture capital market that has focused mainly on the coasts. The authors then present a framework for the development of a community-centered entrepreneurial cluster and action components, including support of entrepreneurship at the core of the community development system; identification of business opportunities; business models which facilitate capital acquisition; technical and business training for entrepreneurs; organization of equity-capital and debt-financing networks; and providing vehicles for investment harvesting (e.g., IPOs). The authors conclude that the usual binary categorization of urban/rural misses the subtle effects of urbanization in rural areas where population clusters may offer potential for market-driven entrepreneurial economic development.

Carter, D. A., J. E. McNulty & J.A. Verbrugge. (2004). Do Small Banks have an Advantage in Lending? An Examination of Risk-Adjusted Yields on Business Loans at Large and Small Banks. *Journal of Financial Services*, 25(2-3), 233-252.

Consolidation in the banking industry has sparked concern about the survival of small banks, particularly as it relates to the availability of credit to small businesses. However, if small banks have an advantage in processing credit information, compared to large banks, they should continue to survive in a competitive environment. Risk-adjusted commercial loan yields (gross yields less net charge-offs and the risk-free rate of return) at small and large banks for the period of 1996 through 2001 are evaluated. The primary finding is that, after controlling for market concentration, cost of funds, and a variety of other factors that might influence yields, smaller banks earn greater risk-adjusted yields than larger banks. This result suggests that small banks make better choices from the available small business loans and is consistent with the notion that these banks have an information advantage in evaluating credit.

Cocciarelli, Susan. (2009). *Financing Michigan's Sustainable Agriculture: The Availability and Accessibility of Capital for Beginning Farmers*. C.S. Mott Group for Sustainable Food Systems at Michigan State University. East Lansing, MI.

Recommendations include the expansion of asset building tools to build net worth of promising beginning farm enterprises, clarifying the link between production agriculture and economic development within the existing financial services industry, strategic linkages between beginning farmers and sources of capital investment, and exploration of new visions for capital deployments to scale up Michigan's good food economy.

Cocciarelli, Susan, Dorothy Suput and Ray Boshara. (July 2010). *Financing Farming in the U.S.: Opportunities to Improve the Financial and Business Environment for Small and Midsized Farms through Strategic Financing*. W.K. Kellogg Foundation Food and Community Program.

This report explores capital access issues in the smaller-scale agricultural sector and sought to learn from "hybrid" organizations that have bridged the relationship and knowledge gaps between willing farmers and lenders. These organizations share three key assets: 1) access to capital and land; 2) specific product assistance; and 3) farmer networking. They are all challenged by 1) the stress on lending from the Great Recession; 2) securing funding for operations and re-lending; and 3) finding qualified technical assistance providers for farmers in the small-scale sector. Practice recommendations include developing "pro formas" or templates for projections, capital needs, marketing strategies for farmers and training them how to use these resources. By advancing the economic viability of small-scale operations, challenges associated with job creation, corporate consolidation, rural revitalization, and promoting an entrepreneurial culture can be successfully met.

Cole, Rebel. (2010). *Bank Credit, Trade Credit or No Credit: Evidence from the Surveys of Small Business Finances*. SBA Office of Advocacy. Washington, DC.

This study investigates the availability of credit in at least two important ways. First, we provide the first rigorous analysis of the differences between small U.S. firms that do and do not use credit. Second, for those small U.S. firms that do participate in the credit markets, new evidence is provided about factors that determine their use of trade credit and bank credit, and whether these two types of credit are substitutes (Meltzer, 1960) or complements (Burkart and Ellingsen, 2004). The evidence strongly suggests that they are complements.

Congressional Oversight Panel. (2009). *Reviving Lending to Small Businesses and Families and the Impact of the TALF*. May Oversight Report. Washington, DC.

Keeping the credit markets open in a fair – and economically healthy – manner to small business and family borrowers ultimately demands a mix of policies that reflect the realities that borrowers face. The problem is circular: Until the economy improves borrowers will have a limit on the debt they can absorb and loan terms may tighten appropriately. The securitization markets can play a part in breaking that circle. But the Term Asset-Backed Securities Loan Facility (TALF) cannot be the primary means to stimulate credit for small business and family borrowing. Moreover, its shift of liability to the taxpayer remains an important policy issue and requires that the TALF operate in a carefully-monitored and fully-transparent way.

Tim Critchfield et al., (February 2005). "Community Banks: Their Recent Past, Current Performance, and Future Prospects." *FDIC Banking Review*.

Cowan, C. D. & A. M. Cowan. (2006). *A Survey Based Assessment of Financial Institution Use of Credit Scoring for Small Business Lending*. SBA Office of Advocacy, Small Business Research Summary (No. 283). Washington, DC.

While credit scoring has yet to become a primary instrument in small business loan underwriting for a majority of banks in the United States, there are indications that credit scoring may be providing more borrowing opportunities to small businesses. Although it does not appear that there is geographic expansion resulting from credit scoring, it does appear that there are significant increases in the importance of small business and micro business loans in the total lending portfolio subsequent to the adoption of credit scoring.

Dennis, William, J. (2010). *Small Business Credit in a Deep Recession*. NFIB Research Foundation. Washington, DC.

The immediate pressing credit issue appears to be credit lines. New lines are the most difficult form of credit to get and one-third of renewal applications are rejected. As trade credit becomes increasingly stretched, both on the giving and receiving ends, pressures on cash flow become intolerable. Lines could alleviate the problem for many. Yet, financing for cash flow purposes is the use of credit most frequently rejected. The problem for small business owners is a lack of alternatives. If a small employer is rejected for a loan to buy a new truck, it may be cost-ineffective to fix the vehicle, but fixing it may still be an alternative. If a small employer is rejected for a loan to purchase new inventory, sales will be hurt, but it is possible to carry on. Cash flow is different. A small employer can stretch paying bills while waiting for customers to pay him, or even dispose of assets. Yet, that can go on only so long. Without backup credit lines to bridge the temporary imbalance, the alternative is bleak.

DeYoung, Robert and D. Glennon & P. Nigro, P. (2006). *Borrower-Lender Distance, Credit Scoring, and the Performance of Small Business Loans*. FDIC Center for Financial Research (Working Paper No. 2006-04). Washington, DC.

The authors developed a theoretical model of decision-making under risk and uncertainty in which bank lenders have both imperfect information about loan applications and imperfect ability to make decisions based on that information. The authors tested the loan-default implications of the model for a large random sample of small business loans made by U.S. banks between 1984 and 2001 under the SBA 7(a) loan program. As predicted by their model, both borrower-lender distance and credit-scoring contribute to greater loan defaults. The former finding suggests that distance interferes with information collection and monitoring. The latter finding implies production efficiencies that encourage credit-scoring lenders to make riskier loans at the margin. However, the authors also found that credit-scoring dampens the harmful effects of distance, consistent with the conjecture that information generated by credit scoring models improves the ability of lenders to assess and price default risk.

DeYoung, Robert, and William C. Hunter and Gregory Udell. (Apr-June 2004). "The Past, Present, and Probable Future for Community Banks." Dordrecht: *Journal of Financial Services* Vol. 25, Issue 2/3, pg. 85.

The authors examine how deregulation, technological advances, and increased competition have affected the size and health of U.S. community banks and the quality and availability of banking products and services since the 1970s. They develop a simple theoretical framework to analyze how these changes have affected the competitive viability of community banks. Using empirical evidence, they conclude that regulatory and technological change has exposed community banks to intensified competition on one hand, but on the other, provides an opportunity for well-managed community banks to exploit their strategic position in the industry. Two of their key observations bear worth noting: 1) it's an open question as to whether credit scoring does a better job of risk assessment than human analysis and by how much; 2) an average \$60 billion large bank is about 100 times larger than a large community bank and 1200 times larger than the average small community bank.

Dunkelberg, W. C. & H. Wade. (2010). *NFIB Small Business Trends*. NFIB Research Foundation. Washington, DC.

A near record low 31 percent of all owners reported borrowing on a regular basis, which is then not surprising that reported and planned capital spending are at 35 year record low levels. Those looking for loans predominately are looking for cash flow support, not funds to expand or hire. A net 12 percent reported loans harder to get than in their last attempt, one point lower than July. Overall, 91 percent of the owners reported all their credit needs met or they did not want to borrow, unchanged from July. Only four percent cited financing as their top business problem. What businesses need are customers, giving them a reason to hire and make capital expenditures and borrow to support those activities. The percent of owners reporting higher interest rates on their most recent loan was six percent, while three percent reported lower rates. The net percent of owners expecting credit conditions to ease in the coming months was a seasonally adjusted negative 14 percent (more owners expect that it will be "harder" to arrange financing), unchanged from July. The Federal Reserve is holding rates at historically low levels, but this is not improving the outlook for the ease of financing expansion. Sales are needed, not just low rates.

Frame, W. S., A. Srinivasan & L. Woosley (2001). The Effect of Credit Scoring on Small-Business Lending. *Journal of Money, Credit, and Banking*, 33(3), 813-825.

This paper examines the effect of credit scoring on small-business lending for a sample of large U. S. banking organizations. The authors found that credit scoring is associated with an 8.4 percent increase in the portfolio share of small-business loans, or \$4 billion per institution. However, they fail to uncover any specific attributes of bank small-business credit-scoring programs that lead to this increased lending. The overall conclusion was that credit scoring lowers information costs between borrowers and lenders, thereby reducing the value of traditional, local bank lending relationships.

Galloway, Ian J. (2009). *Peer-to-Peer Lending and Community Development Finance*. Federal Reserve Bank of San Francisco, Community Development Investment Center (Working Paper 2009-06). San Francisco, CA.

Peer-to-peer (P2P) networks directly connect computer users online. Popular P2P platforms include eBay and Craigslist, for example, which have transformed the market for used consumer goods in recent years. Increasingly popular, however, are P2P lending sites that facilitate debt transactions by directly connecting borrowers and lenders on the Internet. In the summer of 2008, the Center for Community Development Investments assembled a working group of community development leaders, investors, and Prosper Marketplace, the largest P2P lending platform in the world, to discuss the potential community development implications of the innovation. This working paper documents this discussion and explores P2P lending in greater detail. Part I offers background on P2P and the state of the P2P lending industry; Part II outlines the potential community development finance implications of P2P; and Part III discusses the working group and next steps necessary to successfully marry P2P technology and community development finance.

Geithner, Timothy and Karen G. Mills. (November 18, 2009). Report to the President Small Business Financing Forum. U.S. Department of Treasury and U.S. Small Business Administration. Washington, DC.

Forum participants addressed areas that included expanding and improving SBA programs; using the Emergency Economic Stabilization Act (EESA) to support business lending; tax policy ideas to assist small businesses; supporting small business in underserved markets; expanding access to credit in rural areas; promoting innovation, exports, and manufacturing for small businesses; and increasing liquidity for lenders and addressing regulatory issues. Opening remarks were made by Treasury Secretary Tim Geithner and SBA Administrator Karen Mills, and Senator Mary Landrieu and Rep. Nydia Velazquez, the chairs of the Senate and House small business committees,

respectively. This forum formed a substantial part of the basis for the Small Business Jobs Act passed in September 2010.

Gorton, Gary. (2009). *Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007*. Presented at Federal Reserve Bank of Atlanta's 2009 Financial Markets Conference: Financial Innovation and Crisis. Atlanta, GA.

The "shadow banking system" at the heart of the current credit crisis is, in fact, a real banking system – and is vulnerable to a banking panic. Indeed, the events starting in August 2007 are a banking panic. A banking panic is a systemic event because the banking system cannot honor its obligations and is insolvent. Unlike the historical banking panics of the 19th and early 20th centuries, the current banking panic was a wholesale panic, not a retail panic. In the earlier episodes, depositors ran to their banks and demanded cash in exchange for their checking accounts. Unable to meet those demands, the banking system became insolvent. The current panic involved financial firms "running" on other financial firms by not renewing sale and repurchase agreements (repo) or increasing the repo margin ("haircut"), forcing massive deleveraging, and resulting in the banking system being insolvent. The earlier episodes have many features in common with the current crisis, and examination of history can help understand the current situation and guide thoughts about reform of bank regulation. New regulation can facilitate the functioning of the shadow banking system, making it less vulnerable to panic.

Gorton, G. & A. Metric. (2010). *Regulating the Shadow Banking System*. Working Paper.

The "shadow banking system" played a major role in the financial crisis, but was not a central focus of the recent Dodd-Frank legislation and thus remains largely unregulated. This paper proposes principles for the regulation of shadow banking and describes a specific proposal to implement those principles. We first document the rise of shadow banking over the last three decades, helped by regulatory and legal changes that gave advantages to the main institutions of shadow banking: money-market mutual funds to capture retail deposits from traditional banks, securitization to move assets of traditional banks off their balance sheets, and repurchase agreements ("repo") that facilitated the use of securitized bonds in financial transactions as a form of money. All of these features rely on an evolution of the bankruptcy code that allows securitized bonds to be used as a form of privately created money in large financial transactions, a usage that can have significant efficiency gains and would be costly to eliminate. History has demonstrated two successful methods for the regulation of privately created money: strict guidelines on collateral (used to stabilize national bank notes in the 19th century), and government-guaranteed insurance (used to stabilize demand deposits in the 20th century). The authors propose the use of strict rules on collateral for both securitization and repo as the best approach for shadow banking, with compliance required in order to enjoy the safe-harbor from bankruptcy.

Hardee, Polly. (2007). *A Two-Step Analysis of Standardized Versus Relationship Bank Lending to Small Firms*. SBA Office of Advocacy.

Small firms have very limited access to publicly-traded capital markets so they are largely dependent on commercial bank financing. This study addresses the question of adequate small firm credit through an examination of standardized versus relationship lending methods in both total bank credit as well as credit from the firm's primary bank. It examines the banking structure at both the local market and credit provider level by analyzing 1998 Small Business Finances Survey data and banking data. The end result is an analysis of total bank debt unlike previous studies focusing on one type of credit instrument. The adequacy of credit availability is investigated under the two different lending methods. Not surprisingly, relationship lending is extensively used by primary bank providers and competing bank sources used standardized lending techniques, e.g., credit scoring. No clear dominance of one method over the other related to credit availability was found.

Hein, S. E., T. W. Koch & S. S. MacDonald. (2005). On the Uniqueness of Community Banks. Federal Reserve Bank of Atlanta, *Economic Review*, First Quarter, 15-36.

Many observed differences between community banks and large commercial banks primarily occur because the former focus relatively more attention on relationship banking while the latter focus more on transactional banking. The authors emphasize differences in performance and risk bearing based on traditional transactional banking versus relationship banking and generally associate higher interest rate spreads and greater profitability per loan with relationship banking. As commercial banks grow in size, they appear to find it more difficult to maintain an effective relationship focus. Community banks concentrate their efforts on customers with personal loan and deposit relationships that are generally profitable and stable over time. It is this focus that better differentiates strong versus weaker performance.

Henley, Andrew. (2005). Job Creation by the Self-employed: The Roles of Entrepreneurial and Financial Capital. *Small Business Economics*, 25(2), 175-196.

The paper reports micro-econometric evidence on the factors that influence the ability of the small businesses to create employment. It uses data on self-employment from a British panel survey. In particular it investigates the contributions of financial and entrepreneurial capital to job creation. Housing wealth appears to be significantly associated with small business job creation. It appears to act as an important source of financial collateral. The parental background of the small business owner is also significantly associated with job creation. Successful entrepreneurs are more likely to have had self-employed parents, and in particular parents who employed others. Educational attainment, in particular at degree level, is also important. The preferred model incorporates individual random effects and the significance of these suggests the importance of unobserved latent entrepreneurial ability.

Kane, Tim. (July 2010). The Importance of Startups in Job Creation and Job Destruction. Kauffman Foundation Research Series: Firm Formation and Economic Growth.

Using Business Dynamics Statistics (BDS), the author contends that startups are the only sector contributing to job growth in the U.S. economy. Firms in their first year of existence add an average of 3 million jobs per year. During recessions, job creation at startups remains stable while net job losses at existing firms are highly sensitive to the business cycle. On balance, existing firms lose more jobs than they create, but after firm deaths are set aside, survivors create more net jobs than startups do.

Keeton, William. (2003). The Role of Community Banks in the U.S. Economy. Federal Reserve Bank of Kansas City, *Economic Review*, Second Quarter, 15-43.

Community banks play an important role in the financial system of the U.S. economy. They complement the role of large banks by specializing in relationship banking and providing credit to small businesses—a sector that is arguably underserved by large banks. In addition, community banks serve customers in rural areas and small metropolitan areas that are not served by large banks. Community banks are important lenders in the farm economy, and they serve the retail deposit needs of many depositors. Although the number of community banks will continue to decline because of merger activity, they will continue to play an important role for the foreseeable future.

Mach, T. L. & J. D. Wolken. (2006). Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances. *Federal Reserve Bulletin*, October, A167-A195.

Comparisons reveal some changes over time between small business finance surveys. The share of small businesses that are S corporations has risen at the expense of C corporations and proprietorships. Computer use, especially for Internet banking and online loan applications, increased markedly between 1998 and 2003. The payment of business expenses with credit cards, especially business credit cards, has grown substantially between surveys. The incidence of credit lines and vehicle loans has increased, while the incidence of capital leases declined somewhat. Since the 1987 survey, small businesses have increasingly used non-depository institutions to obtain some of their financial services. However, despite the growth in the use of non-depository sources—from 25 percent of firms in 1987 to 54 percent in 2003—commercial banks remained the dominant supplier of most financial services.

Markley, Deborah and David Barkley. (September, 2008). *Assessment of the Capital Market in Central Louisiana*. Regional Technology Strategies and the Rapides Foundation. Center for Rural Entrepreneurship.

An assessment of the capital market in the nine-parish region of central Louisiana, it provides an overview of the region's economy and capital market described by secondary data and insights about the region's capital market based on interviews with bankers, entrepreneurs, and service providers. Gaps in the region's capital market are identified and recommendations are made to address these gaps.

Martinez, J., R. R. Patin & D. W. McNeil. (2007). Viability of Community Banks in the Dallas Federal Reserve District: Evidence of Relationship and Transactional Orientation. *Journal of Applied Business Research*, 23(2), 93-100.

This paper examines the viability of community banks. The results indicate that larger community banks are more profitable and less susceptible to most forms of risk than smaller community banks. Evidence that smaller community banks are more relationship oriented and larger community banks are more transactional oriented is mixed. Smaller community banks have a lower cost of funding assets, perhaps as a result of a stronger relationship with depositors, but there is no evidence that their relationship with borrowers allows them to earn more interest income. The primary indication of a stronger transactional orientation by larger community banks is their ability to generate more non-interest income.

McMullen, J. S., L. A. Plummer & Z. J. Acs. (2007). What is an Entrepreneurial Opportunity? *Small Business Economics*, 28(4), 273-283.

The nature and source of entrepreneurial opportunity are important issues for understanding how markets function and come into being. In addition to describing the forum held on the topic and summarizing the contributions of the articles that appear in the special issue, this article shares a number of lessons learned during the workshop and the editorial process. We explore three of the most important reasons for confusion about the opportunity construct: (1) the "objectivity" of opportunity; (2) the perceived importance of one particular individual in determining the direction of the social world; and (3) what distinguishes the sub-class of "entrepreneurial" opportunity from the broader category of opportunity in general. Finally, some directions for future research are suggested by illuminating important issues that emerged from a workshop but remain largely unanswered by the papers of this special issue on entrepreneurial opportunity.

Meyer, Laurence H. (1998). The present and future roles of banks in small business finance. *Journal of Banking and Finance*, 22, 1109-1116.

Appointed by President Clinton in 1993 to the Federal Reserve Board, Meyer addressed the 1998 New York University Conference on Small Business Finance on the role of banks in supplying credit to small businesses. He points out that commercial banks are the most important external source of credit for small firms and that small businesses use lenders that are close by for their banking services, including loans and credit. The bank-borrower relationship appears to be an efficient means for overcoming information and cost problems in small firm finance, and for allowing creditworthy small firms to finance sound projects that might otherwise go unfunded. As these relationships mature, banks typically reduce interest rates charged for loans and drop collateral requirements. He argues that the small business loan market was working well in spite of consolidation in the banking industry. He acknowledges that some borrowers will have to pay temporarily higher loan rates and collateral requirements in short-term switching costs, but that ongoing technological change in small business lending should help improve the efficiency of the process.

Michigan Economic Development Corporation. (2008). *Michigan Small Business Lending Study*. Lansing, MI.

The Study Team identified three market imperfections as stand-outs in Michigan: 1) insufficient risk pricing, pooling, and spreading mechanisms; 2) high information and transaction costs; and 3) insufficient market competition. While the Study Team saw some market prejudice toward Michigan given the current state of the economy, it was limited. Overall, the Study Team found lenders' consideration of the Michigan economy when making small businesses lending decisions to be appropriate and rational. Study found there are issues with small business lending in Michigan, but they are not issues caused by any market prejudice of banks. Instead, the problems stem from a lack of innovative risk reduction mechanisms for debt financing and a sub-optimal mix of financial institutions in the state. These issues, which are not unique to Michigan, have been faced and overcome by other states across the nation that have employed innovative programs.

MSU Center for Community and Economic Development. (2010). *Investment 101: Capital Access and Investment Strategies in Northern Michigan and the Eastern Upper Peninsula*. Northern Michigan and Eastern Upper Peninsula Knowledge Economy Strategies Project Co-Learning White Paper #6. Lansing, MI.

The topic of rural access to capital will remain extraordinarily important as regional stakeholders seek to adapt their rural economies to the transformative changes associated with the global knowledge economy and to take constructive steps to recover from the Great Recession—the worst economic catastrophe since the Great Depression of the 1930s. As a part of the Northern Michigan and Eastern Upper Peninsula Knowledge Economy Strategies project, research was conducted to identify funding sources and document gaps in access to investment capital markets; identify collaborative methods to leverage investment capital; and compile a directory of internet resources to help small businesses expand and further develop their markets. The greater the knowledge of the various types of investment capital, the more effective local and regional leaders and policy makers can be in developing effective economic development strategies. Investment strategies that identify, develop, and deploy social capital are critical to success in the global knowledge economy.

Michigan Venture Capital Association. (2009). *The Michigan Venture Capital Report*. Ann Arbor, MI.

Despite the economic woes of 2009, growth in Michigan's venture capital industry remained steady. During 2009, the national venture capital industry experienced a 9% decline from 2008 in the amount of venture capital under management. Michigan-based venture firms, on the other hand, had a 10% increase in the amount of capital under management, now at \$1.1 billion. The amount of capital raised among venture firms nationally declined by 63%. In 2009, four Michigan venture firms completed fund closings totaling \$163 million.

National Small Business Association. (2010). *2010 Mid-Year Economic Report*. Washington, DC.

The prospect of getting financed for a small business—even in a growing economy—is very difficult simply due to the fact that many small businesses lack the assets necessary for a traditional bank loan, making them a riskier lending option for banks. Unfortunately, the number of small businesses able to obtain adequate financing for their business has steadily decreased in the last few years. Today, only 59 percent of small businesses are able to obtain adequate financing for their business. That number has dropped from 78 percent in August 2008, 67 percent in December 2008, 62 percent in July 2009, and 61 percent in December 2009. Although a majority are able to secure financing, it cannot be glossed over that 41 percent—which translates into more than 12 million—of the nation’s small businesses are not able to get adequate financing.

Ou, Charles. (2005). *Banking Consolidation and Small Business Lending: A Review of Recent Research*. SBA Office of Advocacy (Working Paper). Washington, DC.

As long as small business lending is profitable, as it has been, there will be an adequate number of suppliers in the market to supply credit and financial services. Small business credit markets will remain vast, differentiated, and segmented. Community banks will remain an important participant in the small business markets as they continue to develop differentiated services (special relationships and localized expertise) that larger banks cannot provide. The entry of large banks into local markets contributes to the credit supply for small firms by bringing some segments of small business borrowing directly into the markets served by national lenders and by servicing others through participation in secondary markets.

Peek, J. & E. S. Rosengren. (1998). Bank Consolidation and Small Business Lending: It’s Not Just Bank Size that Matters. *Journal of Banking & Finance*, 22(6-8), 799-819.

The authors found that acquirers tend to recast the target in their own image, causing the small business loan portfolio share of the consolidated bank to converge toward the pre-merger portfolio share of the acquirer. However, concerns that this pattern will necessarily reduce bank small business lending may be overblown. First, most mergers are of two (or more) small banks. Second, acquirers are almost as likely to have larger as smaller shares of small business loans in their portfolios, compared to their targets. Finally, in roughly half the mergers, small business loans increase in the period immediately after the merger.

Peek, Joe. (2007). *The Value to Banks of Small Business Lending*. SBA Office of Advocacy, Small Business Research Summary (No. 301). Washington, DC.

The authors find that for commercial and industrial loans, small business lending does, in fact, add value to banking organizations overall. This evidence suggests that at least for small banks, the added revenue associated with relationship lending exceeds the added information costs associated with evaluating and monitoring small business commercial and industrial loans. Small business lending was found to be a profitable market niche for small publicly-traded banking organizations in the United States.

Reynolds, Paul. (2007). Start-up Funding: Expectations, Informal Support, and Accredited Investors. In *Entrepreneurship in the United States: The Future is Now* (pp. 121-150). New York, NY: Springer.

Money does not start a business, but businesses do not start without money. How much money is required? Where does it come from? This review of financial requirements by those in the start-up process, also discusses potential funding sources. The primary source of funding is, of course, the start-up team. There is consideration of other sources, including informal investors and formal channels. A special category of informal investors received additional attention, high net-worth individuals or “accredited investors.”

Reynolds, Paul D. (2005). Understanding Business Creation: Serendipity and Scope in Two Decades of Business Creation Studies. *Small Business Economics*, 24(4), 359-364.

Rubin, Julia S. (2009). *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?* Federal Reserve Bank of San Francisco, Community Development Investment Center (Working Paper 2009-01). San Francisco, CA.

The CDLF industry and its government and foundation funders must not lose sight of the ongoing importance of subsidy. Subsidy is necessary for the continual innovation and risk-taking that have enabled CDLFs to demonstrate repeatedly the financial viability of new products and markets. Subsidy also is necessary to enable CDLFs to maintain an in-depth knowledge of the low- and moderate-income communities they serve, a critical component of the CDFI model. The low- and moderate-income communities that CDLFs were designed to assist are facing an increasingly difficult environment. The U.S. poverty rate has grown since 2000, while funding of services for the country's neediest has shrunk. The current economic situation is likely to exacerbate both of these trends. Furthermore, many CDLF activities – such as the provision of micro-loans, nonprofit operating loans, extensive technical assistance, and pre-development financing — are not cost efficient. Without ongoing subsidies, CDLFs will be forced to abandon such activities, diminishing their ability to serve low-income communities.

Scott, J. A., W. C. Dunkelberg & W. J. Dennis. (2003). *Credit, Banks and Small Business—The New Century*. NFIB Research Foundation. Washington, DC.

This report presents the basic findings from the 2001 edition of *Credit, Banks and Small Business* with a focus on four issues. First, the impact of the continuing consolidation in the banking industry on small firms is analyzed, examining how consolidation has affected competition, the cost of services, and credit availability. Second, the sources of financing used by small business owners are examined with a detailed look at the role of credit cards as a source of financing operations and expansion. Third, the strength of banking relationships is explored by reviewing the services used and ratings of bank performance using characteristics important to small-business owners, with an emphasis on how bank size and market competition affects these results. Fourth, the availability, terms, and price of new credit extended are examined, again with an emphasis on differences by firm characteristics, bank size and merger experiences. The survey posed several questions about the use of new technologies like the Internet for conducting bank business and these findings are highlighted in each section.

Shane, Scott. (September 2008). The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures. Small Business Administration Office of Advocacy Working Paper.

The angel capital market is smaller than generally believed. Few companies are fit the angel financing model. Angel investments are smaller; less sophisticated; and include more debt than commonly thought. Companies receiving angel financing are more similar to typical startups. There is considerable confusion around angel definitions. Some researchers confound informal investors, friends and family who invest in startups, accredited and unaccredited angel investors, and individual and group investing.

Shane, Scott. (2009). Why Encouraging More People to Become Entrepreneurs in Bad Policy. *Small Business Economics*, 33(2), 141-149.

Policy makers often think that creating more start-up companies will transform depressed economic regions, generate innovation, and create jobs. This belief is flawed because the typical start-up is not innovative, creates few jobs, and generates little wealth. Getting economic growth and jobs creation from entrepreneurs is not a numbers game. It is about encouraging the formation of high quality, high growth companies. Policy makers should stop subsidizing the formation of the typical start-up and focus on the subset of businesses with growth potential.

While government officials will not be able to “pick winners,” they can identify start-ups with a low probability of generating jobs and enhancing economic growth. By eliminating incentives to create these low probability companies, policy makers can improve the average performance of new businesses.

Small Business Administration: Office of Advocacy. (2009). *Small Business and Micro Business Lending in the United States, for Data Years 2007-2008*. Washington, DC.

The health and growth of small businesses is critical and depends on knowing how lending institutions are meeting small firm credit needs and which lenders are investing in small businesses. This information not only helps small businesses save valuable time in shopping efficiently for credit; it also gives lending institutions information on the demand for and supply of small business credit and helps them learn about the competition in the markets in which they participate.

Smith, G., et al. (2009). *Collaborators or Competitors? Exploring the Relationships between Community Development Financial Institutions and Conventional Lenders in Small Business Finance*. Federal Reserve Bank of San Francisco, Community Development Investment Center (Working Paper 2009-02). San Francisco, CA.

A key finding from the case studies is the existence of a continuum of credit within which banks and CDFIs (typically non-depository loan funds) develop referral relationships that allow each to serve small businesses of varying credit-worthiness. Such collaborations can be mutually beneficial, but also problematic for CDFIs when mergers and acquisitions reduce the number of financial institutions active in the local market and disrupt relationships. Problems can also arise for CDFIs if banks require CDFIs to improve a bank’s bottom line as a condition of CDFI funding. A CDFI’s source of lending capital is also critical in determining the nature of the bank/CDFI relationship. In addition to competition for loans from aggressive, niche-oriented start-up banks, depository CDFIs compete with larger banks for consumer and small business deposits, their key source of lending capital. The study also considers the current credit tightening and economic downturn. It examines both the opportunities for CDFI as banks restrict their small business lending, and the potential impact the economic downturn on CDFI underwriting policies.

Strahan, P. E. & J. P. Weston. (1998). Small Business Lending and the Changing Structure of the Banking Industry. *Journal of Banking & Finance*, 22(6-8), 821-845.

This study investigates the relationship between bank lending to small businesses, banking company size and complexity, and bank consolidation. The authors consider two potential influences on small business lending associated with changes in the size distribution of the banking sector. On the one hand, organizational diseconomies may increase the costs of small business lending as the size and complexity of the banking company increases. On the other, size-related diversification may enhance lending to small businesses. The authors find first that small business loans per dollar of asset rises, then falls, with banking company size, while the level of small business lending rises monotonically with size. Second, consolidation among small banking companies serves to increase bank lending to small businesses, while other types of mergers or acquisitions have little effect. These findings are interpreted as consistent with the diversification hypothesis.

Testimony, Statements, Comments, and Remarks

Bernanke, Ben S. (2010). Remarks at the Meeting Addressing Financing Needs of Michigan’s Small Businesses. June 3, 2010. Detroit, Michigan.

Bernanke, Ben S. (2010). Remarks: *Restoring the Flow of Credit to Small Business*. Federal Reserve Meeting: “Addressing the Financial Needs of Small Business”. July 10, 2010. Washington, DC.

Calcutt, Scrub. (undated). *Did you get a taxpayer bailout? Neither did we.* Northwestern Bank. Traverse City, MI.

Cloutier, C.R. (2010). *Testimony on behalf of the Independent Community Bankers of America.* Financial Crisis Inquiry Commission. January 13, 2010. Washington, DC

Duke, Elizabeth A. (2010). "Small Business Credit: Next Steps." Remarks made at Federal Reserve Meeting Series: "Addressing the Financing Needs of Small Businesses." July 12, 2010. Washington, DC.

Jones, Andrew. (2010). Senate Subcommittee Hearing on Restoring Credit to Main Street: Proposals to Fix Small Business Borrowing and Lending Problems held March 2, 2010. Revised March 19, 2010.

Kus, Michael, A. (2009). *Testimony on behalf of the Michigan Association of Community Bankers.* U.S. House Financial Services Committee, Subcommittee on Oversight and Investigation. November 30, 2009. Southfield, MI.

Lowe, M. Anthony. (2009). Statement: *Credit Availability for Small Businesses.* U.S. House Financial Services Committee, Subcommittee on Oversight and Investigation. November 30, 2009. Southfield, MI.

Mills, Karen. (2010). Remarks on Strengthening the Lending Environment for America's Small Businesses. Federal Reserve Forum on Addressing the Financing Needs of Small Businesses. July 12, 2010. Washington, DC.

Sperling, Gene. (2010). Testimony on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." U.S. House Financial Services Committee. May 18, 2010. Washington, DC.

Stiglitz, Joseph E. (2009). Testimony: *The Challenge of Creating Jobs in the Aftermath of the "Great Recession."* U.S. Congress Joint Economic Committee Hearing. December 10, 2009. Washington, DC.

Tarullo, Daniel K. (2010). Comments on "Regulating the Shadow Banking System." Brookings Panel on Economic Activity. September 17, 2010. Washington, DC.

Appendices

Appendix 1. Key Informants and Dates Interviewed

Sandy Bloem, Economic Development Foundation, Grand Rapids, MI, August 18, 2010.

Tim Hall, Northwestern Bank, Gaylord, MI., August 20, 2010.

Wendy Wieland, Northern Lakes Economic Alliance, by phone, August 23, 2010.

Lori Meeder, Northern Initiatives, by phone, August 24, 2010.

Todd Gregory, Citizens Bank, Gaylord, MI., August 27, 2010.

Chris Wendel, Small Business and Technology Development Center, Northwest Region, Traverse City, Aug. 27, 2010.

Brian Braddock, Northern Lakes Economic Alliance & former CEO of a community bank, Petoskey, MI., Sept 3, 2010.

Don Coe, Black Star Farms, Traverse City, by phone, September 10, 2010.

Appendix 2. Populations of Northern Lower Michigan Counties

Populations of Northern Michigan Counties		
County	2009 Population	% of Region
Alcona	11,091	2.20
Alpena	29,289	5.81
Antrim	23,834	4.72
Benzie	17,227	3.41
Charlevoix	25,796	5.11
Cheboygan	26,106	5.17
Crawford	14,203	2.82
Emmet	33,649	6.67
Grand Traverse	86,333	17.11
Iosco	25,817	5.12
Kalkaska	16,891	3.35
Leelanau	21,899	4.34
Manistee	24,439	4.84
Missaukee	14,838	2.94
Montmorency	10,094	2.00
Ogemaw	21,234	4.21
Oscoda	8,707	1.73
Otsego	23,412	4.64
Presque Isle	13,436	2.66
Roscommon	24,682	4.89
Wexford	31,553	6.25
Regional TOTAL	504,530	100.00

SOURCE: 2009 U.S. Census Population Estimate.
 Retrieved November 15, 2010 from
http://factfinder.census.gov/servlet/SAFFPopulation?_submenuId=population_0&_sse=

Appendix 3. Employment in Northern Lower Michigan by North American Industry Classification System (NAICS) Categories

Employment in Northern Michigan by NAICS* Categories		
Classification	Employment	% of Total
Agriculture, Forestry, Fishing and Hunting [11]	1,969	1.41%
Mining, Quarrying, and Oil and Gas Extraction [21]	1,408	1.01%
Utilities [22]	770	0.55%
Construction [23]	8,067	5.78%
Manufacturing [31-33]	16,649	11.93%
Wholesale Trade [42]	3,504	2.51%
Retail Trade [44-45]	19,726	14.13%
Transportation and Warehousing [48-49]	2,470	1.77%
Information and Communications [51]	2,140	1.53%
Finance and Insurance [52]	4,181	3.00%
Real Estate and Rental and Leasing [53]	1,634	1.17%
Professional, Scientific, and Technical Services [54]	4,890	3.50%
Management of Companies and Enterprises [55]	315	0.23%
Administrative and Support and Waste Management and Remediation Services [56]	5,339	3.82%
Educational Services [61]	12,731	9.12%
Health Care and Social Assistance [62]	24,490	17.54%
Arts, Entertainment, and Recreation [71]	3,719	2.66%
Accommodation and Food Services [81]	20,809	14.91%
Other Services (except Public Administration) [92]	4,782	3.43%
Regional TOTAL	139,593	100.00%

SOURCE: U.S. Census, Local Employment Dynamics, QWI Online [NAICS], 2009 Q4. Retrieved December 01, 2010 from <http://lehd.did.census.gov/led/datatools/qwiapp.HTML>

*North American Industry Classification System

**Data reported under Worker Investment Act Classifications: Northeast Michigan Consortium and Northwest Michigan Council of Governments. Does not include Iosco, Ogemaw, & Roscommon Counties.

Appendix 4. Banking Intensity by Counties in Northern Lower Michigan

Banking Intensity by Northern Michigan County			
County	Number of Banks	2009 Population	Banks/1,000 Residents
Manistee	13	24,439	0.53
Emmet	17	33,649	0.51
Leelanau	10	21,899	0.46
Roscommon	11	24,682	0.45
Iosco	11	25,817	0.43
Ogemaw	9	21,234	0.42
Antrim	10	23,834	0.42
Grand Traverse	36	86,333	0.42
Benzie	7	17,227	0.41
Charlevoix	10	25,796	0.39
Wexford	11	31,553	0.35
Otsego	7	23,412	0.30
Presque Isle	4	13,436	0.30
Montmorency	3	10,094	0.30
Crawford	4	14,203	0.28
Alcona	3	11,091	0.27
Missaukee	4	14,838	0.27
Cheboygan	7	26,106	0.27
Alpena	7	29,289	0.24
Oscoda	2	8,707	0.23
Kalkaska	3	16,891	0.18
Regional TOTAL	189	504,530	0.37

SOURCE: FDIC "Offices and Branches of FDIC-insured Banks." Retrieved November 10, 2010 from <http://www2.fdic.gov/idasp/main.asp>.

SOURCE: 2009 U.S. Census Population Estimate. Retrieved November 15, 2010 from http://factfinder.census.gov/servlet/SAFFPopulation?_submenuId=population_0&_sse=on

Appendix 5. Lender Capital Access Survey Questionnaire

Lender Capital Access Survey Questionnaire Responses collected from November 29 to December 22, 2010

- 01. What is the name of this financial institution?**

- 02. How is the financial institution incorporated?**
____ National Bank
____ Community Bank
____ Credit Union
____ Savings & Loan
____ Revolving Loan Fund
- 03. What is the Federal RSSD-ID number of this financial institution? (if applicable)**

- 04. In what county is this branch of the financial institution located? (83-county drop down)**
- 05. Is small business lending the primary focus of the financial institution?**
____ Yes
____ No
- 06. Approximately what proportion of the financial institution's lending portfolio are loans to small business?**
____ <20%
____ 20%-40%
____ 41%-60%
____ 61%-80%
____ >80%
- 07. How has the proportion of loans to small businesses in the financial institution's lending portfolio changed in the past two years?**
____ Greatly increased
____ Somewhat increased
____ Remained unchanged
____ Somewhat decreased
____ Greatly decreased
- 08. During the past 12 months, which of the following describes the performance of the financial institution's overall lending portfolio:**
____ Improved a lot
____ Improved a little
____ Stayed about the same
____ Deteriorated a little
____ Deteriorated a lot

09. During the past 12 months, which of the following describes the availability of lending capital (deposits and interbank lending) for the financial institution:

- Greatly increased
- Somewhat increased
- Remained unchanged
- Somewhat decreased
- Greatly decreased

10. During the past 12 months, small business lending standards of most financial institutions within the region generally have:

- Tightened a lot
- Tightened a little
- Remained about the same
- Relaxed a little
- Relaxed a lot

11. During the past 12 months, the intensity of small business activity in Northern Michigan has:

- Grew significantly
- Grew moderately
- Stayed about the same
- Contracted moderately
- Contracted significantly

12. During the past 12 months, small business lending standards at this financial institution have:

- Tightened a lot
- Tightened a little
- Remained about the same
- Relaxed a little
- Relaxed a lot

13. How would you characterize the current local economic conditions within the region?

14. Over the next 12 months, do you expect the availability of lending capital (deposits and interbank lending) for the financial institution to:

- Greatly increase
- Somewhat increase
- Remain unchanged
- Somewhat decrease
- Greatly decrease
- Don't know/Uncertain

Please explain: _____

15. Over the next 12 months, do you expect the financial institution's level of small business lending to:

- Grow significantly
- Grow moderately

- Stay about the same
- Contract moderately
- Contract significantly
- Don't know/uncertain

Please explain: _____

16. Of the small business loan applications received by the financial institution, are the primary purposes of the loan requests for:

- Working capital to cover operating expenses
- Investment capital for start-up or expansion
- Other: _____

17. Does the financial institution offer any unique lending products for small businesses in the region?

- Yes
- No
- If yes, please specify: _____

18. What are the most popular small business lending products that the financial institution offers?

19. What are the most profitable sectors, in terms of lending, within the region?

20. Does the financial institution specialize in any specific business sector within the region?

- Yes
- No
- If yes, please specify: _____

21. What steps, if any, does the financial institution take to target and attract businesses from these sectors?

22. In the evaluation of risk associated with small business loans, what are the financial institution's primary underwriting criteria? (Please be as specific as possible)

23. Approximately what proportion of small business loans are secured by collateral?

- <20%
- 20%-40%
- 41%-60%
- 61%-80%
- >80%

24. How would you describe the level of preparedness of small business loan applicants within the region?

- Very well prepared

- ___ Moderately prepared
- ___ Somewhat prepared
- ___ Not prepared at all

25. What are common impediments to the approval of small business requests for loans?

26. What steps, if any, does the financial institution typically take to overcome these impediments to lending?

27. If these impediments are frequently insurmountable, what steps could be taken by the institution or public policymakers to mitigate them?

28. Please rank the following SBA loan programs the institution utilizes regarding their successfulness in expanding capital to small businesses? [randomize]

	N/A	1	2	3	4	5
General 7(a) Loan Program						
Other 7(a) Loan programs						
Patriot Express						
Community Express						
SBA Express						
Export Express						
Export Working Capital Program						
International Trade Loan Program						
Rural Lender Advantage Program						
CAPLines						
CDC/504						
Microloans						
America Recovery Capital (ARC)						

29. What criteria does the financial institution use in directing clients to an SBA-guaranteed loan rather than a conventional commercial loan?

30. What actions can the SBA take to improve small business access to capital? [randomize]

- ___ Reinstitute low-doc loans
- ___ Reduce paperwork on existing loan programs
- ___ Increase loan guarantees
- ___ Eliminate loan origination fees
- ___ Increase 7(a) loan caps
- ___ Increase microloan caps
- ___ Relax 504 structure
- ___ Increase 504 caps
- ___ Increase outreach and public education
- ___ Other: _____

31. Please rank the following USDA loan and grant programs the institution utilizes regarding their successfulness in expanding capital to small businesses? [randomize]

N/A
1
2
3
4
5

Commercial and Industrial Loans

Guaranteed Company Loan

Intermediary Relending Program (IRP)

Rural Economic Development Loans and Grants (REDLG)

Rural Energy for America Program Guaranteed Loan Program (REAP)

Value Added Producer Grant (VAPG)

Rural Business Enterprise Grant (RBEG)

Rural Business Opportunity Grant (RBOG)

Rural Community Development Grant (RCDG)

Biorefinery Assistance Loan Guarantees

Section 9006 Renewable Energy and Energy Efficiency Grants

32. What criteria does the financial institution use in directing clients to a USDA-guaranteed loan or grant rather than a conventional commercial loan?

33. What actions can the USDA take to improve small business access to capital? [randomize]

___ Don't require cash match

___ Reduce loan interest

___ Eliminate loan fees

___ Reduce paperwork

___ Relax underwriting standards

___ Increase outreach and public education

___ Other: _____

Appendix 6. Small Business Capital Access Survey Questionnaire

Small Business Capital Access Survey Questionnaire

Responses collected from November 05 to December 03, 2010

1. Indicate the industry sector your company best identifies with:

- Agriculture, Forestry, Fishing and Hunting
- Mining, Quarrying, and Oil and Gas Extraction
- Utilities
- Construction
- Manufacturing
- Wholesale Trade
- Retail Trade
- Transportation and Warehousing
- Information and Communications
- Finance and Insurance
- Real Estate and Rental and Leasing
- Professional, Scientific, and Technical Services
- Management of Companies and Enterprises
- Administrative and Support and Waste Management and Remediation Services
- Educational Services
- Health Care and Social Assistance
- Arts, Entertainment, and Recreation
- Accommodation and Food Services
- Other Services (except Public Administration)

2. Does your company operate as a franchise?

- Yes
- No

3. Is your company Michigan-owned and operated?

- Yes
- No

4. How is your company organized?

- Sole Proprietorship
- Partnership
- Limited Liability Partnership or Limited Partnership
- Limited Liability Company
- S-Corporation
- C-Corporation

5. In what county is your company or home office located? (83-county drop down)

(If your company home office is located outside of Michigan, select the county where most of your company's Michigan business is conducted.)

6. **How old is your company?**
 ___ <2 years ___ 2-5 years ___ 6-10 years ___ over 10 years
7. **Annual Revenue in:**
 2009: _____ 2008: _____ 2007: _____
 (If possible, state your Modified Gross Receipts (line 27 of the Michigan Company Tax form 4567))
8. **Gross margins in:**
 2009: _____ 2008: _____ 2007: _____
9. **Number of employees in:**
 2010: _____ 2009: _____ 2008: _____
10. **How many financial institutions did your company do business with in:**
 2010: _____ 2009: _____ 2008: _____
- 11a. **How many lines of credit does your company have?**

- 11b. **How has the number of lines of credit changed in the past twelve months?**
 ___ Increased
 ___ Decreased
 ___ Remained the same
- 12a. **How many outstanding loans does your company have?**

- 12b. **How has the number of outstanding loans changed in the past twelve months?**
 ___ Increased
 ___ Decreased
 ___ Remained the same
- 13a. **How many credit cards do you use for business purposes?**

- 13b. **How has the number of credit cards changed in the past twelve months?**
 ___ Increased
 ___ Decreased
 ___ Remained the same
14. **How has the economic environment affected your company's performance during the past twelve months?**
 ___ It improved a lot.
 ___ It improved a little.
 ___ It stayed about the same.
 ___ It deteriorated a little.
 ___ It deteriorated a lot.

15. In which areas of your company have you seen a significant-to-moderate increase in costs during the past twelve months? (Select all that apply) [randomize following list]

- Salaries
- Employee benefits
- Product inventory
- Marketing
- Materials/ supplies
- Taxes
- Rent/ lease
- Travel & entertainment
- Other: _____
- NO increases in any costs

16. Based on your knowledge and experience, during the past twelve months, have commercial lenders' loan standards have:

- Tightened a lot
- Tightened a little
- Remained about the same
- Relaxed a little
- Relaxed a lot
- Don't know/uncertain

17. During the past twelve months, has your company's financial situation has:

- Improved a lot
- Improved a little
- Stayed about the same
- Deteriorated a little
- Deteriorated a lot

18. Over the next three years, do you expect your company to:

- Grow significantly
- Grow moderately
- Stay about the same
- Contract moderately
- Contract significantly
- Shut down
- Don't know/uncertain

19. Please rate the following in terms of whether they are obstacles to the future growth of your company. [randomize following list]

	Not an obstacle	Moderate obstacle			Major obstacle
	1	2	3	4	5
Generating new sales	1	2	3	4	5
Ability to hire qualified workers	1	2	3	4	5
State and local regulations	1	2	3	4	5
Federal regulations	1	2	3	4	5
Lack of confidence in state's economic future	1	2	3	4	5

Lack of confidence in national/global economic future	1	2	3	4	5
Ability to create new products or services	1	2	3	4	5
Ability to obtain capital	1	2	3	4	5
Existing debt load	1	2	3	4	5
Other (please specify): _____	1	2	3	4	5

20. Over the next two years, do you anticipate your company will need to obtain additional capital?

- ___ Yes
- ___ No
- ___ Don't know/Uncertain

21. What purpose would your company intend to finance with additional capital?

- ___ Fund present business operations
- ___ Fund prospective business expansion
- ___ Other: _____

22. Has a lack of financial capital been a problem for your company?

- ___ Yes (go to Q.23)
- ___ No (skip Q.23 and go to Q.24)

23. What has been the impact of the lack of available capital on your company's operations? (Select all that apply) [randomize following list]

- ___ Unable to grow company or expand operations
- ___ Reduced the number of employees
- ___ Reduced benefits to employees
- ___ Unable to finance increased sales
- ___ Unable to increase inventory to meet demand
- ___ Closed stores or branches
- ___ Reduced operating hours
- ___ Turned down new clients
- ___ Other _____

24. If in the future you are able to obtain additional capital for your company, what are the first THREE actions you would take? [randomize following list]

- ___ Cover operating expenses
- ___ Hire additional employees
- ___ Invest in new equipment/machinery
- ___ Invest in existing location/facility
- ___ Invest in new location/facility
- ___ Increase inventory
- ___ Introduce new products or services
- ___ Invest in research and development
- ___ Invest in e-commerce
- ___ Invest in marketing
- ___ Repayment of debt
- ___ Relocate company

___ Expand through acquisition of other companies
___ Other: _____

25. Over the next twelve months, do you expect the availability of capital for your company to:

- ___ Greatly worsen
- ___ Somewhat worsen
- ___ Remain unchanged
- ___ Somewhat improve
- ___ Greatly improve
- ___ Don't know/Uncertain

26. When seeking information about issues related to financing your company, who or what do you turn to? (Select all that apply) [randomize following list]

- ___ Personal research (internet, trade publications, library, etc.)
- ___ Friends or family
- ___ Business colleagues or other business owners
- ___ Business or professional associations (Chamber, Farm Bureau, etc.)
- ___ Banks or other financial institutions
- ___ Certified financial advisor or public accountant
- ___ Community/economic development organizations (Target Alpena, Otsego County Economic Alliance, Northern Lakes Economic Alliance, Northern Initiatives, etc.)
- ___ Government agencies (local, regional, state, MEDC, SBA, USDA, etc.)
- ___ Other: _____

27. During the past twelve months, have you reinvested earnings back into your company?

- ___ Yes
- ___ No

28. During the past twelve months, did you apply for a new personal credit card or to seek to increase the limit on an existing personal credit card to use for business purposes?

- ___ Yes (go to __b)²⁴
- ___ No

29. During the past twelve months, did you apply for a new company credit card or to seek to increase the limit on an existing company credit card?

- ___ Yes (go to __b)
- ___ No

30. During the past twelve months, did you apply for a loan from a bank?

- ___ Yes (go to __b)
- ___ No

²⁴ If a small business had applied for a given type of financing, they were then asked about the outcome of that application. If they had not applied, they skipped to the next question about another type of financing. The question regarding the outcome of the application is represented below as “__b.” This outcome question was asked each time a small business responded that they had applied for a given type of financing.

- 31. During the past twelve months, did you apply for a loan from a credit union?**
 ___ Yes (go to __b)
 ___ No
- 32. During the past twelve months, did you apply for a new line of credit from a bank or to seek to increase an existing line of credit from a bank?**
 ___ Yes (go to __b)
 ___ No
- 33. During the past twelve months, did you apply for a new line of credit from a credit union or to seek to increase an existing line of credit from a credit union?**
 ___ Yes (go to __b)
 ___ No
- 34. What actions can be taken by commercial lenders to improve small business access to capital?**

- 35. During the past twelve months did you apply for a new line of credit from a vendor or supplier or to seek to increase an existing line of credit from a vendor or supplier?**
 ___ Yes (go to __b)
 ___ No
- 36. During the past twelve months, did you seek a loan from friends or family members?**
 ___ Yes (go to __b)
 ___ No
- 37. During the past twelve months, did you seek financing through venture or angel capital?**
 ___ Yes (go to __b)
 ___ No
- 38. During the past twelve months, did you seek financing by factoring accounts receivable?**
 ___ Yes (go to __b)
 ___ No
- 39. During the past twelve months, did you seek financing through capital leasing?**
 ___ Yes (go to __b)
 ___ No
- 40. During the past twelve months, did you apply for a Small Business Administration (SBA) loan?**
 ___ Yes (go to __b)
 ___ No
- 41a. During the past twelve months, did you apply for a USDA loan?**
 ___ Yes (go to __b)
 ___ No

__b. What was the outcome of your most recent attempt to obtain this financing?

- My request was not approved (go to __c)²⁵
- I chose not to accept the financing because the terms were unfavorable
- I obtained the financing, but with unsatisfactory terms
- I obtained the financing, but it was less than what I sought
- I obtained financing, but chose to accept less than what was offered
- I obtained financing that was equivalent to what I sought
- Pending

__c. What reason(s) was cited for the denial of the financing you sought?

- Insufficient creditworthiness
- Insufficient collateral
- Insufficient projected cash flow
- Insufficient past revenues
- Low credit score
- Other: _____

42a. Which of the following SBA loan programs do you have knowledge of? [randomize]

- General 7(a) Loan Program
- Other 7(a) Loan programs
- Patriot Express
- Community Express
- SBA Express
- Export Express
- Export Working Capital Program
- International Trade Loan Program
- Rural Lender Advantage Program
- CAPLines
- CDC/504
- Microloans
- America Recovery Capital (ARC)

42b. How did you acquire knowledge of this SBA loan program? [randomize]

- Personal research (internet, trade publications, library, etc.)
- Friends or family
- Business colleagues or other business owners
- Business or professional associations (Chamber, Farm Bureau, etc.)
- Banks or other financial institutions
- Certified financial advisor or public accountant
- Community/economic development organizations (Target Alpena, Otsego County Economic Alliance, Northern Lakes Economic Alliance, Northern Initiatives, etc.)
- Government agencies (local, regional, state, MEDC, SBA, USDA, etc.)

²⁵ If the outcome of a small business application for a given type of financing was not approved, they were asked for the reason(s) cited for the denial. If they were not denied, they skipped to the next question about another type of financing. The question regarding the reason(s) cited for denial is represented as “__c.” This reason(s) cited question was asked each time a small business responded that they had been denied for a given type of financing.

___ Other: _____

42c. What actions can the SBA take to improve small business access to capital? [randomize]

- ___ Reinstitute low-doc loans
- ___ Reduce paperwork on existing loan programs
- ___ Increase loan guarantees
- ___ Eliminate loan origination fees
- ___ Increase 7(a) loan caps
- ___ Increase microloan caps
- ___ Relax 504 structure
- ___ Increase 504 caps
- ___ Increase outreach and public education
- ___ Other: _____

43a. Which of the following USDA loan or grant programs do you have knowledge of? [randomize]

- ___ Commercial and Industrial Loans
- ___ Guaranteed Company Loan
- ___ Intermediary Relending Program (IRP)
- ___ Rural Economic Development Loans and Grants (REDLG)
- ___ Rural Energy for America Program Guaranteed Loan Program (REAP)
- ___ Value Added Producer Grant (VAPG)
- ___ Rural Business Enterprise Grant (RBEG)
- ___ Rural Business Opportunity Grant (RBOG)
- ___ Rural Community Development Grant (RCDG)
- ___ Biorefinery Assistance Loan Guarantees
- ___ Section 9006 Renewable Energy and Energy Efficiency Grants

43b. How did you acquire knowledge of this(these) USDA loan or grant program(s)? [randomize]

- ___ Personal research (internet, trade publications, library, etc.)
- ___ Friends or family
- ___ Business colleagues or other business owners
- ___ Business or professional associations (Chamber, Farm Bureau, etc.)
- ___ Banks or other financial institutions
- ___ Certified financial advisor or public accountant
- ___ Community/economic development organizations (Target Alpena, Otsego County Economic Alliance, Northern Lakes Economic Alliance, Northern Initiatives, etc.)
- ___ Government agencies (local, regional, state, MEDC, SBA, USDA, etc.)
- ___ Other: _____

43c. What actions can the USDA take to improve small business access to capital? [randomize]

- ___ Don't require cash match
- ___ Reduce loan interest
- ___ Eliminate loan fees
- ___ Reduce paperwork (specify)
- ___ Relax underwriting standards
- ___ Increase outreach and public education
- ___ Other: _____

Appendix 7. Lender Perception Survey Data Tables

During the past 12 months, which of the following describes the availability of lending capital for the financial institution:	
	Response Percent
Increased	36.4%
Unchanged	36.4%
Decreased	27.3%

During the past 12 months, which of the following describes the performance of the financial institution's overall lending portfolio:	
	Response Percent
Improved	33.3%
Unchanged	16.7%
Deteriorated	50.0%

During the past 12 months, small business lending standards have:		
	Within the Region	At this Institution
Tightened	75.0%	58.3%
Unchanged	16.7%	41.7%
Relaxed	8.3%	0.0%

Of the small business loan applications received by the financial institution, are the primary purposes of the loan requests for:	
	Response Percent
Working capital to cover operating expenses	83.3%
Investment capital for start-up or expansion	0.0%
Combination of working and investment	16.7%

Over the next 12 months, do you expect the financial institution's level of small business lending to:	
	Response Percent
Grow	41.7%
Unchange	58.3%
Contract	0.0%

Appendix 8. Small Business Perception Survey Data Tables

During the past twelve months, has your company's financial situation:	
	Response Percent
Improved a lot	15.9%
Improved a little	15.9%
Remained unchanged	34.1%
Deteriorated a little	15.9%
Deteriorated a lot	18.2%

Over the next three years, do you expect your company to:	
	Response Percent
Grow significantly	37.8%
Grow moderately	28.9%
Remain unchanged	11.1%
Contract moderately	2.2%
Contract significantly	2.2%
Shut down	8.9%
Don't know/Uncertain	8.9%

Rate the following in terms of whether they are obstacles to the future growth of your company:						
Potential Obstacles	Not an obstacle	Moderate obstacle	Major obstacle	Rating Average		
Ability to obtain capital	14.6%	2.1%	16.7%	16.7%	50.0%	3.85
Lack of confidence in state's economic future	12.5%	2.1%	27.1%	31.3%	27.1%	3.58
Lack of confidence in national/global economic future	13.0%	6.5%	23.9%	30.4%	26.1%	3.50
State and local regulations	15.2%	26.1%	15.2%	19.6%	23.9%	3.11
Federal regulations	20.0%	17.8%	26.7%	8.9%	26.7%	3.04
Generating new sales	19.1%	12.8%	36.2%	19.1%	12.8%	2.94
Existing debt load	41.3%	10.9%	19.6%	8.7%	19.6%	2.54
Ability to hire qualified workers	39.6%	10.4%	25.0%	16.7%	8.3%	2.44
Ability to create new products or services	68.1%	10.6%	17.0%	2.1%	2.1%	1.60

Based on your knowledge and experience, during the past twelve months, have commercial lender's loan standards:

	Response Percent
Tightened a lot	54.3%
Tightened a little	17.4%
Remained unchanged	10.9%
Relaxed a little	0.0%
Relaxed a lot	0.0%
Don't know/uncertain	17.4%

Over the next two years, do you anticipate your company will need to obtain additional capital?

	Response Percent
Yes	70.8%
No	12.5%
Don't know/Uncertain	16.7%

Over the next twelve months, do you expect the availability of capital for your company to:

	Response Percent
Greatly worsen	18.8%
Somewhat worsen	8.3%
Remain unchanged	33.3%
Somewhat improve	22.9%
Greatly improve	8.3%
Don't know/Uncertain	8.3%

What purpose would your company intend to finance with additional capital?

	Response Percent
Fund present business operations	27.9%
Fund prospective business	72.1%

Has a lack of financial capital been a problem for your company?	
	Response Percent
Yes	70.2%
No	29.8%

What has been the impact of the lack of available capital on your company's operations? (Select all that apply)	
	Response Percent
Unable to grow company or expand operations	81.8%
Reduced the number of employees	45.5%
Unable to finance increased sales	42.4%
Other	27.3%
Reduced benefits to employees	21.2%
Unable to increase inventory to meet demand	21.2%
Reduced operating hours	12.1%
Turned down new clients	12.1%
Closed stores or branches	6.1%

If in the future you are able to obtain additional capital for your company, what are the first THREE actions you would take?	
	Response Percent
Hire additional employees	43.8%
Introduce new products or services	39.6%
Invest in new equipment/machinery	37.5%
Repayment of debt	37.5%
Invest in marketing	27.1%
Cover operating expenses	25.0%
Invest in existing location/facility	25.0%
Invest in new location/facility	20.8%
Increase inventory	16.7%
Invest in e-commerce	14.6%
Expand through acquisition of other companies	10.4%
Invest in research and development	8.3%
Other	6.3%
Relocate company	0.0%

Appendix 9. Young and Mature Company Cross Tabulation Survey Data Tables

Capital Accesibility by Age of Compnay				
	Relative Size			
	Number Employees (2010)	Annual Revenue (2009)		
Young Company (<5yr)	4.2	\$167,343		
Mature Company (>10yr)	77.3	\$3,828,095		
	Financial Situation			
	Deteriorated	Unchanged	Improved	
Young Company (<5yr)	29.4%	47.1%	23.5%	
Mature Company (>10yr)	33.3%	19.1%	47.6%	
	Lack of Capital			
	Problem	Not a Problem		
Young Company (<5yr)	94.7%	5.3%		
Mature Company (>10yr)	42.9%	57.1%		
	Impact of Lack of Capital			
	Unable to Grow	Reduce Employees		
Young Company (<5yr)	82.4%	29.4%		
Mature Company (>10yr)	70.0%	70.0%		
	If Capital, What Actions			
	Hire Employees	Repay Debt	New Equipment	New Products
Young Company (<5yr)	68.4%	31.6%	42.1%	26.3%
Mature Company (>10yr)	22.7%	54.5%	36.4%	31.8%

Appendix 10. Bank Loan Outcome Survey Data Tables

What was the outcome of your bank loan application?	
	Response Percent
My request was not approved	50.0%
I obtained the financing, but it was less than what I sought	4.5%
I obtained financing, but chose to accept less than what was offered	4.5%
I obtained financing that was equivalent to what I sought	40.9%

Capital Accesibility by Bank Loan Outcome		
	Relative Size	
	Number Employees	Annual Revenue
Application Not Approved	11.6	\$315,047
Obtained Financing Sought	35.4	\$2,412,377
	Lack of Capital	
	Problem	Not a Problem
Application Not Approved	100.0%	0.0%
Obtained Financing Sought	66.7%	33.3%

**Appendix 11. SBA and USDA Programs Survey Data Tables
(Small Business & Lender Perceptions)**

USDA Programs: Small Business Responses

During the past twelve months, did you apply for a USDA loan?	
	Response Percent
Yes	0.0%
No	87.0%
Do not qualify	13.0%

Which of the following USDA loan or grant programs do you have knowledge of? (Select all that apply)	
	Response Percent
Rural Community Development Grant (RCDG)	53.8%
Rural Economic Development Loans and Grants (REDLG)	46.2%
Commercial and Industrial Loans	30.8%
Rural Business Opportunity Grant (RBOG)	23.1%
Guaranteed Company Loan	15.4%
Rural Business Enterprise Grant (RBEG)	15.4%
Rural Energy for America Program Guaranteed Loan Program (REAP)	7.7%
Value Added Producer Grant (VAPG)	7.7%
Biorefinery Assistance Loan Guarantees	7.7%
Intermediary Relending Program (IRP)	0.0%
Section 9006 Renewable Energy and Energy Efficiency Grants	0.0%

How did you acquire knowledge of these USDA loan or grant programs? (Select all that apply)	
	Response Percent
Personal research	53.3%
Business colleagues or other business owners	33.3%
Banks or other financial institutions	20.0%
Government agencies	20.0%
Friends or family	13.3%
Business or professional associations	13.3%
Community/economic development organizations	13.3%
Certified financial advisor or public accountant	6.7%

What actions can the USDA take to improve small business access to capital? (Select all that apply)

	Response Percent
Increase outreach and public education	60.0%
Don't require cash match	52.0%
Eliminate loan fees	44.0%
Reduce loan interest	36.0%
Relax underwriting standards	32.0%
Other	24.0%
Reduce paperwork	16.0%

USDA Programs: Lender Responses

Please rank the following USDA loan and grant programs the institution utilizes regarding their successfulness in expanding capital to small businesses?							
	Not successful	Successful	Very Successful	N/A	Rating Average		
Guaranteed Company Loan	0.0%	0.0%	0.0%	16.7%	0.0%	83.3%	4.00
Rural Community Development Grant (RCDG)	0.0%	0.0%	0.0%	16.7%	0.0%	83.3%	4.00
Rural Economic Development Loans and Grants (REDLG)	0.0%	0.0%	16.7%	0.0%	0.0%	83.3%	3.00
Rural Business Enterprise Grant (RBEG)	0.0%	0.0%	16.7%	0.0%	0.0%	83.3%	3.00
Rural Business Opportunity Grant (RBOG)	0.0%	0.0%	16.7%	0.0%	0.0%	83.3%	3.00
Commercial and Industrial Loans	0.0%	25.0%	25.0%	0.0%	0.0%	50.0%	2.50
Intermediary Relending Program (IRP)	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00
Rural Energy for America Program Guaranteed Loan Program	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00
Value Added Producer Grant (VAPG)	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00
Section 9006 Renewable Energy and Energy Efficiency Grants	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00
Biorefinery Assistance Loan Guarantees	16.7%	0.0%	0.0%	0.0%	0.0%	83.3%	1.00

What actions can the USDA take to improve small business access to capital? (Select all that apply)

	Response Percent
Reduce paperwork	83.3%
Eliminate loan fees	66.7%
Increase outreach and public education	50.0%
Other	33.3%
Don't require cash match	16.7%
Relax underwriting standards	16.7%
Reduce loan interest	0.0%

SBA Programs: Small Business Responses

During the past twelve months, did you apply for a SBA loan?	
	Response Percent
Yes	21.3%
No	72.3%
Do not qualify	6.4%

What was the outcome of your most recent attempt to obtain a SBA loan?	
	Response Percent
My request was not approved	60.0%
I chose not to accept the financing because the terms were unfavorable	10.0%
I obtained the financing, but it was less than what I sought	10.0%
I obtained financing that was equivalent to what I sought	10.0%
Pending	10.0%

What reason(s) was cited for the denial of the financing you sought?	
	Response Percent
Insufficient creditworthiness	16.7%
Insufficient collateral	16.7%
Insufficient projected cash flow	33.3%
Insufficient past revenues	50.0%
Low credit score	0.0%
Other	33.3%

Which of the following SBA loan programs do you have knowledge of? (Select all that apply)	
	Response Percent
Microloans	47.8%
General 7(a) Loan Program	43.5%
SBA Express	34.8%
Other 7(a) Loan programs	30.4%
CDC/504	30.4%
America Recovery Capital (ARC)	26.1%
Patriot Express	13.0%
Community Express	13.0%
Rural Lender Advantage Program	13.0%
CAPLines	13.0%
Export Express	0.0%
Export Working Capital Program	0.0%
International Trade Loan Program	0.0%

How did you acquire knowledge of these SBA loan programs? (Select all that apply)	
	Response Percent
Personal research	48.0%
Banks or other financial institutions	36.0%
Community/economic development organizations	36.0%
Business or professional associations	20.0%
Government agencies	20.0%
Friends or family	16.0%
Business colleagues or other business owners	12.0%
Certified financial advisor or public accountant	4.0%

What actions can the SBA take to improve small business access to capital? (Select all that apply)	
	Response Percent
Increase outreach and public education	48.6%
Reduce paperwork on existing loan programs	37.1%
Eliminate loan origination fees	37.1%
Other	37.1%
Increase loan guarantees	28.6%
Reinstitute low-doc loans	22.9%
Increase microloan caps	17.1%
Increase 7(a) loan caps	14.3%
Relax 504 structure	14.3%
Increase 504 caps	11.4%

SBA Programs: Lender Responses

Rank the following SBA loan programs the institution utilizes regarding their successfulness in expanding capital to small businesses?							
	Not successful	Successful	Very successful	N/A	Rating Average		
Other 7(a) Loan programs	0.0%	14.3%	14.3%	14.3%	14.3%	42.9%	3.50
General 7(a) Loan Program	11.1%	0.0%	33.3%	11.1%	22.2%	22.2%	3.43
CDC/504	0.0%	10.0%	40.0%	0.0%	20.0%	30.0%	3.43
SBA Express	11.1%	11.1%	22.2%	11.1%	11.1%	33.3%	3.00
Rural Lender Advantage Program	0.0%	0.0%	28.6%	0.0%	0.0%	71.4%	3.00
CAPlines	0.0%	0.0%	16.7%	0.0%	0.0%	83.3%	3.00
Patriot Express	0.0%	14.3%	28.6%	0.0%	0.0%	57.1%	2.67
Microloans	0.0%	14.3%	14.3%	0.0%	0.0%	71.4%	2.50
America Recovery Capital (ARC)	11.1%	11.1%	22.2%	0.0%	0.0%	55.6%	2.25
Community Express	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00
Export Express	0.0%	14.3%	0.0%	0.0%	0.0%	85.7%	2.00
Export Working Capital Program	0.0%	14.3%	0.0%	0.0%	0.0%	85.7%	2.00
International Trade Loan Program	0.0%	16.7%	0.0%	0.0%	0.0%	83.3%	2.00

What actions can the SBA take to improve small business access to capital? (Select all that apply)	
	Response Percent
Reduce paperwork on existing loan programs	80.0%
Increase loan guarantees	60.0%
Eliminate loan origination fees	60.0%
Reinstitute low-doc loans	30.0%
Other	30.0%
Increase 7(a) loan caps	20.0%
Increase microloan caps	20.0%
Relax 504 structure	20.0%
Increase 504 caps	20.0%
Increase outreach and public education	20.0%

Appendix 12. Michigan Small Business and Technology Development Centers (SBTDCs) Contact Information

Michigan Small Business and Technology Development Centers		
Center	Phone	Web Address
SBTDC State Headquarters	(616) 331-7480	http://www.misbtdc.org
Upper Peninsula Region	(906) 789-0558	http://www.misbtdc.org/region1
Northwest Michigan Region	(231) 922-3780	http://www.misbtdc.org/region2
Northeast Michigan Region	(800) 562-4808 Ext.237	http://www.misbtdc.org/region3
Mid Michigan Region	(989) 386-6630	http://www.misbtdc.org/region4
Great Lakes Bay Region	(989) 686-9597	http://www.misbtdc.org/region5
Genesee/Lapeer Region	(810) 762-9660	http://www.misbtdc.org/region6
West Michigan Region	(616) 331-7370	http://www.misbtdc.org/region7
Capitol Region	(517) 483-1921	http://www.misbtdc.org/region8
Southeast Michigan Region	(734) 487-0355	http://www.misbtdc.org/region9
Macomb/St. Clair Region	(586) 469-5118	http://www.misbtdc.org/region10
Southwest Michigan Region	(269) 387-6004	http://www.misbtdc.org/region11
Greater Washtenaw Region	(734) 547-9170	http://www.misbtdc.org/region12

Appendix 13. Non-Employer Establishments in Northern Lower Michigan by County

Non-Employer Establishments in Northern Michigan			
County	Population	Non-Employer Estb.	Estb/Pop
Alcona	11,600	751	65
Alpena	29,700	1,978	66.6
Antrim	24,200	2,100	86.6
Benzie	17,500	1,783	102
Charlevoix	26,100	2,472	94.6
Cheboygan	26,700	2,089	78.2
Crawford	14,500	955	65.7
Emmet	33,400	3,220	96.5
Grand Traverse	85,400	8,422	98.6
Iosco	26,200	1,572	60
Kalkaska	17,100	1,340	78.3
Leelanau	21,800	2,676	122.6
Manistee	24,700	1,823	73.7
Missaukee	15,000	1,170	78.1
Montmorency	10,300	739	71.6
Ogemaw	21,200	1,419	66.8
Oscoda	8,900	630	70.6
Otsego	24,200	2,101	87
Presque Isle	13,800	937	67.8
Roscommon	25,400	1,659	65.3
Wexford	31,700	2,405	75.8
Regional TOTAL	509,400	42241	79.59

SOURCE: 2008 U.S. Census Nonemployer Statistics. Retrieved January 15th, 2011 from <http://www.census.gov/econ/nonemployer/index.html>

For further information, contact:

Michigan State University
Center for Community and Economic Development
1615 E. Michigan Avenue
Lansing, MI 48912
Tel: 517-353-9555
Fax: 517-884-6489
knowledgeplanning.org