Access to Capital and Credit for Small Businesses in Appalachia

Presented by
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Appalachian Regional Commission
at
Federal Reserve Bank of Cleveland
2007 Community Development Policy Summit
Cleveland, OH
Access to Capital and Credit for Small Businesses in Appalachia

ARC commissioned a study by National Community Reinvestment Coalition to examine access to capital and credit in the Appalachian Region.

Examined a range of issues, including:

- Impact of bank consolidation, relationship and transactional lending, credit scoring, role of bank branches, discrimination, and the impact of CRA on access to capital & credit.
- Released in April, 2007
Appalachian Region

- 13 States
- 410 counties
- 200,471 sq. miles
- 23 million people
- $680 billion GRP
By the mid 20th century, Appalachia had become “a region apart—geographically and statistically.”

– PARC report, 1964

- One of three Appalachians lived in poverty, 50 percent higher than the national average.

- Unemployment was 40 percent higher than the national average.

- Between 1950 and 1960, net migration data showed a population loss in the region of more than two million people.

- The high school dropout rate in Appalachia exceeded 50 percent.
Distressed Counties in Appalachia

Distressed counties: Distressed counties:
150% or more US unemployment rate
150% or more US poverty rate
67% or less per US capita income
County Economic Status, Fiscal Year 2007

Economic Status

- Distressed (78)
- At-Risk (78)
- Transitional (221)
- Competitive (26)
- Attainment (7)
Measures of Progress in Access to Capital and Credit

- Appalachia compares favorably to Nation on key indicators of lending.
- Appalachia also is similar to the nation in its business demographics.
- Appalachia has significant infrastructure for lending.
- Despite progress, significant credit gaps remain and need to be addressed.
Lending Infrastructure in Appalachia

- An evolving lending infrastructure which has enhanced access to credit, albeit with gaps.
- 227 banks with $500 billion in assets.
- These banks made $5.4 billion in CRA community development loans and investments over the 2.5 years period examined.
- 100 Community Development Financial Institutions including CDFIs, ARC Revolving Loan Funds.
Appalachia Compares Favorably to Nation in Key Indicators

- Small business loan-to-deposit ratio for Appalachia was 7% versus 5.2% for nation
  - 35% higher in Appalachia.
- Banks in Appalachia provided 57.5 small business loans per branch in non-metro counties.
- Nationally banks provided 53.2 loans per branch in non-metro counties.
## Lending by Minority Population Share in Counties: Appalachia vs. Nation

<table>
<thead>
<tr>
<th>Minority Population</th>
<th># of counties*</th>
<th># SB Loans/#SB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minority Pop 0-20%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appalachia</td>
<td>371</td>
<td>39.4%</td>
</tr>
<tr>
<td>Nation</td>
<td>2,100</td>
<td>41.8%</td>
</tr>
<tr>
<td>Minority Pop 20-50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appalachia</td>
<td>41</td>
<td>51.4%</td>
</tr>
<tr>
<td>Nation</td>
<td>831</td>
<td>42.4%</td>
</tr>
<tr>
<td>Minority Pop &gt;50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appalachia</td>
<td>6</td>
<td>53.6%</td>
</tr>
<tr>
<td>Nation</td>
<td>263</td>
<td>40.2%</td>
</tr>
</tbody>
</table>

* Includes Virginia Independent Cities
Similarities in Lending Trends: Appalachia and Nation

Percent of Small Businesses Receiving Loans

- Appalachia: 41.4%
- Nation: 41.7%
Within Appalachia, Differences in Access to Credit

- Differences by State.
- Differences in Metro and Non-Metro Counties.
- Differences by Size of Business
  - Just 28% of businesses with less than $1 million in revenues received loans.
- Less Access in Distressed Counties:
  - 32% of businesses in distressed counties;
  - vs. 42% in non-distressed counties receive loans.
Differences by State in Credit Access

Percent of Small Businesses Receiving Loans

KY: 32%  
WV: 33%  
PA: 34%  
NY: 38%  
OH: 38%  
VA: 40%  
Appalachia: 41%  
TN: 44%  
SC: 45%  
GA: 47%  
NC: 48%  
MD: 49%  
AL: 56%  
MS: 58%
Lending in Distressed & Non-Distressed Counties

Map 3
Small Business Loans per 100 Non-Farm Businesses, 2003

Loans per 100 Businesses
- Dark gray: 41.4 Loans or greater
- Light gray: Less than 41.4 Loans
- Red: Distressed County

100 Miles

1 N
Lending by Income Group of Census Tract

Percent of Small Businesses Receiving Loans by Income Category of Census Tract

- 41.40% for All Census Tracts
- 35.39% for LMI Census Tracts
Lending to Smallest Business in Low/Mod Census Tracts

Percent of Small Businesses Receiving Loans in Low- and Moderate- Income Census Tracts

- All Businesses: 35.39%
- Businesses with Revenues <$1 million: 23.63%
Role of Branches: More Branches Means More Loans

<table>
<thead>
<tr>
<th></th>
<th># Branches - All Lenders</th>
<th>Total #SB Loans - All Lenders</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Median # Branches = 11</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below median - total</td>
<td>1,324</td>
<td>66,834</td>
</tr>
<tr>
<td>Median</td>
<td>6</td>
<td>235</td>
</tr>
<tr>
<td>Above median - total</td>
<td>7,020</td>
<td>463,475</td>
</tr>
<tr>
<td>Median</td>
<td>22</td>
<td>1,287</td>
</tr>
</tbody>
</table>
Influence of Credit Scores on Lending Levels

- Higher the score (lower the risk), the higher the number of loans in a county
- Distribution of scores not much different by distress or metropolitan status of county
- Mid-size bank lending levels do not vary by differences in credit scores
Role of Mid-Size Banks

- Higher Market Share in Rural & Distressed Counties
- Relationship Lending not influenced by credit scores

### Mid-Size Bank Market Share in Metro and Rural Counties

<table>
<thead>
<tr>
<th></th>
<th>Metro Areas</th>
<th>Rural Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent</td>
<td>6.49%</td>
<td>12.32%</td>
</tr>
</tbody>
</table>

0% | 5% | 10% | 15% | 20% | 25% | 30% | 35% | 40% | 45% | 50%
Role of SBA Lending

- SBA Lending has small overall market share
- Higher market share in rural counties than metro counties.
- Not as successful in reaching minorities as non-SBA backed lending.
  - Particularly African-Americans;
  - May reflect the relatively high non-SBA lending to minorities which may reduce demand for SBA lending by minorities in Appalachia.
Regression Analysis of Small Business Lending in Appalachian Counties 2003

Three models for different dependent variables:
1. lending by all lenders of all asset sizes reporting CRA small business loan data,
2. lending by mid-size banks with assets between $250 million and $1 billion, and
3. SBA lending.

These models were developed to analyze the impact on lending of county level demographic & economic factors as well as:
- the influence of bank concentration;
- credit scoring;
- the number bank branches, and other factors.
<table>
<thead>
<tr>
<th>Explanatory Variables</th>
<th>Estimated Coefficients</th>
<th>t-score*</th>
<th>Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>5.1486</td>
<td>20.5293</td>
<td>Intercept</td>
</tr>
<tr>
<td>Distressed/Non-distressed</td>
<td>-0.3346</td>
<td>-3.4016</td>
<td>Distressed/Non-distressed</td>
</tr>
<tr>
<td>MSA/Non-MSA</td>
<td>0.1519</td>
<td>1.7807</td>
<td>MSA/Non-MSA</td>
</tr>
<tr>
<td>% Black</td>
<td>0.8410</td>
<td>2.7637</td>
<td>% Black</td>
</tr>
<tr>
<td>% Hispanic</td>
<td>5.7996</td>
<td>2.8862</td>
<td>% Hispanic</td>
</tr>
<tr>
<td>Median Household Income</td>
<td>0.0000</td>
<td>6.2512</td>
<td>Median Household Income</td>
</tr>
<tr>
<td>Number of Branches</td>
<td>0.0133</td>
<td>12.3197</td>
<td>Number of Branches</td>
</tr>
<tr>
<td>HHI, ICB + THRIFT @50%, COUNTY LEVEL</td>
<td>-0.0002</td>
<td>-11.9881</td>
<td>HHI, ICB + THRIFT @50%, COUNTY LEVEL</td>
</tr>
<tr>
<td>Personal Income Growth</td>
<td>0.5733</td>
<td>1.4023</td>
<td>Personal Income Growth</td>
</tr>
<tr>
<td>Credit Score (Low Risk) 1</td>
<td>0.2083</td>
<td>2.9515</td>
<td>Credit Score (Low Risk) 1</td>
</tr>
<tr>
<td>Credit Score (small risk) 2</td>
<td>-0.0869</td>
<td>-1.3258</td>
<td>Credit Score (small risk) 2</td>
</tr>
<tr>
<td>Credit Score (medium risk) 3</td>
<td>-0.0675</td>
<td>-0.9786</td>
<td>Credit Score (medium risk) 3</td>
</tr>
<tr>
<td>Firm Size (1-4 employees) 1</td>
<td>0.0029</td>
<td>0.0431</td>
<td>Firm Size (1-4 employees) 1</td>
</tr>
<tr>
<td>Firm Size (5-9 employees) 2</td>
<td>0.0830</td>
<td>1.1474</td>
<td>Firm Size (5-9 employees) 2</td>
</tr>
<tr>
<td>Firm Size (10-19 employees) 3</td>
<td>0.2136</td>
<td>2.8075</td>
<td>Firm Size (10-19 employees) 3</td>
</tr>
</tbody>
</table>

*Highlighted - 5% level of significance
Significant Findings

- More bank branches result in more small business loans for banks of all sizes and for SBA 7(a)-guaranteed loans.
- Lower lending occurred in distressed counties than non-distressed counties.
- Counties with higher minorities population shares had higher lending levels.
- Mid-size bank lending on a county level was unaffected by the distribution of credit scores.
Additional Findings

- Lending by all banks was lower in counties with higher levels of concentration.
  - County-level bank concentration however did not impact mid-size bank lending.
- Lending by all banks was higher in counties with a higher portion of businesses with 10 to 19 employees.
  - Small businesses employment size did not affect mid-size bank lending.
- Findings suggest that SBA 7(a) program was focused on non-metro areas.
Analysis of Appalachian CRA Exams

The regulatory agency break down for the bank sample:

<table>
<thead>
<tr>
<th></th>
<th>All Banks</th>
<th>Small Banks</th>
<th>Large Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDIC</td>
<td>51.8%</td>
<td>57.7%</td>
<td>48.6%</td>
</tr>
<tr>
<td>FRB</td>
<td>15.0%</td>
<td>9.0%</td>
<td>18.3%</td>
</tr>
<tr>
<td>OCC</td>
<td>25.5%</td>
<td>25.6%</td>
<td>24.4%</td>
</tr>
<tr>
<td>OTS</td>
<td>7.7%</td>
<td>7.7%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Sample Size</td>
<td>220</td>
<td>78</td>
<td>142</td>
</tr>
</tbody>
</table>

Sample drawn from 2001-2005, with 90% from 2002-2004 period.
Role of CRA – Ratings Matter: $5.4 Billion in CD Financing

Median Community Development Investments by CRA Rating

<table>
<thead>
<tr>
<th>Rating</th>
<th>Median Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Needs to Improve</td>
<td>$84,995</td>
</tr>
<tr>
<td>Low Satisfactory</td>
<td>$858,388</td>
</tr>
<tr>
<td>High Satisfactory</td>
<td>$2,003,915</td>
</tr>
<tr>
<td>Outstanding</td>
<td>$17,250,000</td>
</tr>
</tbody>
</table>
More Community Development Financing by Metro Banks

Community Development Lending in Metro and Rural Areas
- Rural Areas, $264,387,608
- Metro Areas, $3,269,832,196

Community Development Investment in Metro and Rural Areas
- Rural Areas, $205,892,899
- Metro Areas, $1,696,854,929
CRA Community Development Financing: More Housing than Small Business

Community Development Loans by Purpose: Housing and Small Business

- Housing, $297,397,431
- Small Business, $117,271,479

Community Development Investments by Purpose: Housing and Small Business

- Housing, $807,413,830
- Small Business, $174,107,733
Key Findings & Implications

- **Consider incentives for developing more bank branches and growth of community banking.**
  - e.g. NY Banking Development District program.

- **Ensure continued efficacy of CRA**
  - integrity of mid-size exams & enhance small business data.

- **Increase capitalization and sustainability of Community Development Financial Institutions in region.**
  - Particularly development venture capital.

- **Conduct longitudinal research to assess the impact of CRA and further explore lending trends to distressed counties and minority communities.**