



Session on **Small Business Lending**

Discussion by

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Four Very Interesting Papers – Individually and Collectively

- **Did Bank Small Business Lending (SBL) in the U.S. Recover After the Financial Crisis?**
 - **Rebel Cole**
- **How Important are Local Community Banks to SBL? Evidence from Mergers and Acquisitions**
 - **Julapa Jagtiani and Raman Quinn Maingi**
- **Remote Competition and SBL: Evidence from SBA Lending**
 - **Wenhua Di and Nathaniel Pattison**
- **Similarities and Differences in SBL Between Small and Large Banks: Findings from the Small Business Lending Survey**
 - **Yan Lee**





My Discussion

- **Time does not permit a granular discussion/critique of each paper, so I will ...**
- **Focus on the connectivity among these papers**
 - Key findings on the changing role of community banks
- **Cast these findings in the context of the academic literature on the role of community banks**
- **Discuss the implications of these findings including:**
 - Limitations on the conclusions we can draw from them
 - Shortcomings in U.S. data on small business access to finance
 - The need to consider “lending channels”





The Connections

- All four papers directly or indirectly address the role of community banking and/or how that role is changing
 - With particular emphasis on the shrinking of the community banking sector
 - since 2008 the number dropped by 1/3 (Lee)
 - and assets dropped by 14% (Lee)
- The papers cover a number of aspects of this issue
 - Differences in SBL between large and small banks (Cole, Lee, Jagtiani and Maingi)
 - Changes in SBL (Cole, Jagtiani and Maingi)
 - The role of distance and remote lending (Di and Pattison, Lee)
 - The role of nonbank and nontraditional lenders (Di and Pattison, Lee)





Why Do We Care?

- The short answer: *small business access to credit*
- Somewhat longer answer: community banks may be special
 - They may be the “true” relationship lenders
 - If so, the decline in community banking could lead to a “funding gap” for small businesses
- The papers in this session are associated with key policy questions
 - Are community banks indeed special?
 - Has the decline in community banking led to a funding gap?
 - Did the financial crisis exacerbate the funding gap?





One Serious Problem: U.S. Data

We're playing with one hand tied behind our back!

- Hindered by the *unexceptional* nature of US data, particularly relative to Europe





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 - Bank survey data in Central and Eastern Europe that distinguishes among relationship vs. transactions-based banks
 - The EBRD/EBC BEPS I and II data (2007 and 2010)
 - See Beck, Degryse, De Haas and van Horen (*JFE* 2018)





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The Lee (2018)
survey data now
fills this gap





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 - All loans from all banks, and information on loan applications





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 - Extensive firm survey data, e.g., the Eurozone SAFE survey
 - Biannual firm survey with information on the firm, demand for credit, and credit outcomes (similar to discontinued SSBF) starting from the beginning of the crisis in Eurozone countries





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 - Biannual firm survey with information on the firm, demand for credit, and credit outcomes (similar to discontinued SSBF) starting from the beginning of the crisis in Eurozone countries
- Together, these European data can be used to identify demand vs. supply, nonbank sources of finance, relationship banks, and control for firm level characteristics.





The Good News

- Despite data limitations, these papers offer important insights into the changing role of community banking, including that ...
 - Small banks “focus more intensely on relationship lending” (Lee)
 - Post-crisis bank SBL still depressed (Cole)
 - Post crisis lending at large banks has disproportionately gone to large businesses (Cole)
 - Bank M&A has caused a decline in SBL in target counties (Jagtiani and Maingi)
 - Remote lenders can play a powerful role in the SBA market associated with improved access to SBA financing (Di and Pattison)





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But, the evidence is more nuanced (see later comments)





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A key result in paper
(along with new findings
on the precipitous decline
in SBL during the crisis)





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**Suggests limits to
large bank SBL**





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 - Bank M&A has caused a decline in SBL in target counties (Jagtiani and Maingi)
 - Remote lenders can play a role in maintaining SBL in rural areas with improved access to SBL

Key contribution: Identifying negative impact on SBL via bank M&A distinguishing between home and remote counties





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Importance of “non-traditional” SBL





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- Despite data limitations, these papers point into the changing role of community banking, including that ...

Consistent with a loss of small business access to finance

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Key feature: *post crisis data*





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Consistent with mitigating external effects





The Issue of Data (cont.)

- But, what is the *net* effect on small business access to finance? Has it decreased? This is difficult to answer because:
 - Call report data substantially underestimates SBL as per [Lee \(2018\)](#).
 - Arguably, it's even worse than that: For purposes of the SBA 7(a) Loan Guarantee Program used in [Di and Pattison \(2018\)](#), the maximum loan is \$5,000,000 – that is way above the \$1,000,000 Call Report threshold.
 - This underestimation problem affects [Jagtiani and Maingi \(2018\)](#) and the Call Report findings in [Cole \(2018\)](#).
 - The stock of loans used in all three empirical papers is an outcome of supply and demand for credit, not just supply. This limits our ability to pin down supply effects.
 - Finally, without firm level data on all sources of finance, the results in the three empirical papers need to be viewed as suggestive, but not definitive, in terms of the overall access to finance.





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 - Finally, without firm level data on all sources of finance, the results in the three empirical papers need to be viewed as suggestive, but not definitive, in terms of the overall access to finance.
 - **This issue is exacerbated by significant changes in non-traditional credit markets such as the emergence of credit unions and FinTech.**





We're Still Lacking Info on "Lending Channels"

- **The concept of lending channels builds on the concept of lending technologies**
 - **Lending technology:**
 - A combination of screening mechanisms, contract structures, and monitoring strategies (Berger and Udell 2002)
 - **Lending channel:**
 - A two-dimensional concept defined as a lending technology offered by a particular type of creditor (Taketa and Udell 2007)





U.S. Lending Technologies

Relationship Lending
Financial Statement Lending
Asset-Based Lending
Factoring
Equipment Lending
Leasing
Real Estate-Based Lending
Small Bus. Credit Scoring
Crowd Funding
Trade Credit





U.S. Lending Technologies

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e.g., Gov't guarantees;
securitization





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**Lee (2018) survey
doesn't quite capture
lending technologies**





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Lending technologies not
simply loan products –
they capture an entire
underwriting process





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e.g., all three
associated with L/Cs

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U.S. Lending Channels

	Large Banks	Small Banks	Credit Unions	Large Commercial Finance Companies	Small Commercial Finance Companies	Internet	Corporations
Relationship Lending							
Financial Statement Lending							
Asset-Based Lending							
Factoring							
Equipment Lending							
Leasing							
Real Estate-Based Lending							
Small Bus. Credit Scoring							
Crowd Funding							
Trade Credit							





**Shrinking community
bank sector**

U.S. Lending Channels

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Relationship Lending							
Financial Statement Lending							
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Factoring							
Equipment Lending							
Leasing							
Real Estate-Based Lending							
Small Bus. Credit Scoring							
Crowd Funding							
Trade Credit							





U.S. Lending Channels

The channel of
most concern

	Large Banks	Small Banks	Credit Unions	Large Commercial Finance Companies	Small Commercial Finance Companies	Internet	Corporations
Relationship Lending	Grey	Orange	Green	Grey	Grey	Grey	Grey
Financial Statement Lending	Green	Orange	Green	Grey	Grey	Grey	Grey
Asset-Based Lending	Green	Orange	Grey	Green	Green	Grey	Grey
Factoring	Green	Orange	Grey	Green	Green	Grey	Grey
Equipment Lending	Green	Orange	Green	Green	Green	Grey	Grey
Leasing	Green	Orange	Green	Green	Green	Grey	Grey
Real Estate-Based Lending	Green	Orange	Green	Grey	Grey	Grey	Grey
Small Bus. Credit Scoring	Green	Grey	Grey	Grey	Grey	Grey	Grey
Crowd Funding	Green	Grey	Grey	Grey	Grey	Green	Grey
Trade Credit	Grey	Grey	Grey	Grey	Grey	Grey	Green





U.S. Lending Channels

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Relationship Lending							
Financial Statement Lending							
Asset-Based Lending							
Factoring							
Equipment Lending							
Leasing							
Real Estate-Based Lending							
Small Bus. Credit Scoring							
Special Financing							

Have these other lending channels expanded to offset the disappearance of small banks?





Discussed in Cole (2018)

U.S. Lending Channels

	Large Banks	Small Banks	Credit Unions	Large Commercial Finance Companies	Small Commercial Finance Companies	Internet	Corporations
Relationship Lending							
Financial Statement Lending							
Asset-Based Lending							
Factoring							
Equipment Lending							
Leasing							
Real Estate-Based Lending							
Small Bus. Credit Scoring							
Special Financing							

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Factoring							
Equipment Lending							
Leasing							
Real Estate-Based Lending							
Small Bus. Credit Scoring							
Crowd Funding							
Trade Credit							

Also, what about the SBA guarantee “credit multiplier”?





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Small Bus. Credit Scoring							
Crowd Funding							
Trade Credit							

Also, what about the SBA guarantee “credit multiplier”?



Can we control for external effects via the changes in SBA 7(a) guaranteed loans – particularly on the SOLD portion?
See Di and Pattison (2018)





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Small Bus. Credit Scoring							
Crowd Funding							

My main point here: Good firm-level data would significantly help us in estimating these offsetting external effects, and thus help estimating the overall effect on small business access to finance.





Conclusions

- These papers highlight and significantly deepen our understanding of the shrinking community banking sector.
- They tell us much about the impact of this phenomenon on commercial bank SBL and in doing so:
 - raise significant policy issues
- Nevertheless, the overall effect on small business access to finance is still an unsettled issue, in part, due to data limitations in the U.S.

