

Bank Lending to Rural vs Urban Firms in the United States Before, During, and After the Great Financial Crisis

By Rebel A. Cole, Krähenbühl Consulting, Delray Beach, FL. 71 pages.
 Under contract number SBAHQ-17-M-0108.

April 2020

No. 449

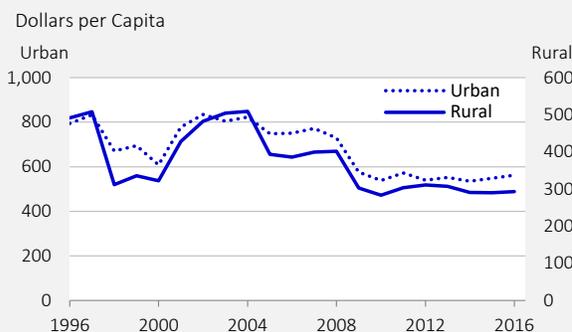
Given the constant evolution of the banking sector over the past two decades, it is worth understanding how banks lend money to meet the credit needs of small businesses in urban and rural areas. This study examines the patterns in bank lending to small businesses in urban and rural areas before, during, and after the financial crisis of 2008–2010. This study is a continuation in a series of research on bank lending to small firms funded by the Office of Advocacy, with the most recent published in 2018.¹

Key Findings

Small business loan originations differ by Census tracts, with loan originations lower in rural Census tracts than in urban Census tracts. Rural firms have poorer access to bank credit than their urban counterparts in terms of both the amount and number of loans, a trend that deteriorated rather than improved during the post-crisis period from 2011–2016.

Loan origination amounts in rural areas were generally smaller than in urban areas, and the rural trend in loan originations was similar to that in urban areas (Figure 1). Originations per capita in both urban and rural areas dropped by more than 40 percent during the crisis years. From 2010 to

Figure 1. Average SBL Originations per Capita in Amounts \$100,000 - \$1 million in Urban vs. Rural Areas



Source: *Bank Lending to Rural vs. Urban Firms in the U.S. Before, During, and After the Great Financial Crisis* by Rebel Cole. U.S. Small Business Administration, Office of Advocacy, 2020.

2016, originations per capita in urban areas partially recovered, but there has been almost no recovery in rural areas.

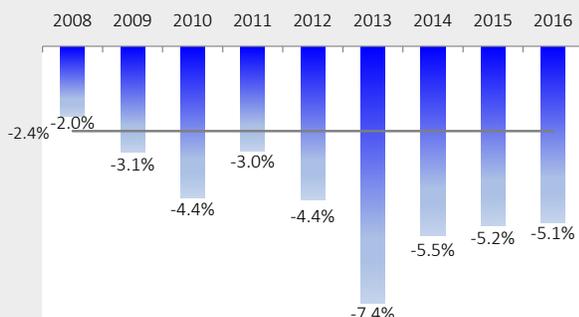
Originations peaked in 2007 for both urban and rural areas, at \$282.6 billion and \$36.6 billion respectively. Post-2000 originations were at their lowest in 2010 at \$170 billion, a 47 percent decline from the 2007 peak. Smaller loans less than \$100,000 experienced a steeper decline of 63 percent compared to 34 percent for loans in larger loan sizes. Figure 2 shows that originations of loans less than \$100,000 in rural areas were 2 percent to 7 percent lower than in urban areas from 2008–2016.

¹ Rebel Cole, “How Did Bank Lending to Small Business in the United States Fare After the Financial Crisis?” U.S. Small Business Administration, Office of Advocacy, 2018.

In both urban and rural areas, the percentage declines from 2007 to 2010 are almost identical to national declines. Total loan amounts rebounded to some extent by 2016, but remained 29 percent below the 2007 peak at only \$226 billion. Loan originations under \$100,000 remained at 43 percent below peak, whereas larger size loans were 19 percent below the peak.

The recovery in urban areas is almost identical to the nation's in general, but originations in rural areas remain 41 percent below the 2007 amount. Rural loan originations peaked in 2003 and bottomed out in 2014, four years later than in urban areas.

Figure 2. Differences between Rural versus Urban Area Loan Originations Under \$100,000



Source: *Bank Lending to Rural vs. Urban Firms in the U.S. Before, During, and After the Great Financial Crisis* by Rebel Cole. U.S. Small Business Administration, Office of Advocacy, 2020.

The multivariate analysis reveals strong differences in the recovery by loan size. Post-crisis, originations of loans from \$250,000 – \$1 million have been stronger in rural areas than in urban areas, while originations of smaller loans have been much weaker in rural areas relative to urban areas.

Policy Implications

The results of this study suggest that inadequate access to financing disproportionately affects rural small businesses. These issues became even more pronounced during, and especially after, the financial crisis of 2008–2010. The study suggests several policy approaches to address the imbalance.

- Incentivize banks. Regulators and policymakers should incentivize banks to originate more small business loans in rural and other less served areas, such as low-income and minority areas. One option currently

discussed is to count such loans as “community development loans” when evaluating a bank’s CRA rating. This would seem an especially promising avenue for the “big four” banks that control almost half of the assets in the industry.

- Reduce underwriting burden on banks that make small business loans in terms of documentation for exam classification purposes. During the 1991 – 1993 credit crisis “low-doc” loans were moderately successful.
- Encourage nonbank lenders. Encourage the growth of small business lending by non-bank lenders. Recent considerations of raising small business lending limits of credit unions are one such action.
- Support the FinTech industry. Policymakers and regulators should be careful not to hinder the nascent Fintech industry, whose small business lending portfolio is growing at triple digit rates. There are calls to more strictly regulate firms in this industry, which may prevent these firms from serving as a viable alternative to bank lenders.

Discussion

U.S. banks play an integral role as traditional credit suppliers to small businesses. Banks are especially important in rural areas where small community banks may be the only source of credit available to small firms.

The findings in this report suggest that patterns in small business lending in rural areas tend to differ from that of the nation. The recovery was not uniform across regions and loan sizes. For instance, the bottom in loan originations for small business loans in rural areas occurred four years after that of urban areas; likewise, rural areas had their peak earlier. The analysis reveals strong differences in the recovery by loan size with larger size loans stronger in rural areas than urban areas post-crisis.

The results suggest that banks reporting under the CRA are extending fewer smaller loans and more larger loans in rural areas. It is unclear whether the decline is caused by fewer banks or by the largest banks moving away from the small business loan market. Also, other providers of credit to small firms in rural areas such as credit unions and

other nontraditional lenders are not captured in the analysis.

Scope and Methodology

This study uses data from several publicly available sources. The primary source is the Federal Financial Institutions Examination Council's Community Reinvestment Act (CRA) database. The CRA regulations require financial institutions with an asset threshold of \$1 billion or more to report their lending to small businesses. These institutions are required to report the flow of new loans on both the number and amount of business loans of \$1 million or less and loans made to firms with less than \$1 million in revenues. The study covers all CRA data available through 2016.

The data contains information by state, MSA, county, and Census tract. Identification by Census tract enables merging of the CRA data with Census demographic data to identify urban and rural areas. The "rural" category includes areas outside of a Metropolitan Statistical Area. The FFIEC Census data is augmented with data from the 2016 five-year estimates from the Census's American Community Survey. The author uses 1990, 2000, and 2010 Census data and 2016 American Community Survey data to linearly interpolate annual observations for each control variable.

The study uses both univariate and multivariate tests on the data. Specifically, a variation of the "difference-in-difference" methodology is used to analyze differences in lending by banks in urban and rural areas. Consistent with the Office of Advocacy's data quality guidelines, this report was peer reviewed. More information on the process can be obtained by contacting the director of economic research by email at advocacy@sba.gov or by phone at (202) 205-6533.

Related Research

Part of the Office of Advocacy's statutory mission includes researching small business access to capital:

- "[Small Business Lending in the United States, 2017](#)" Office of Advocacy, January 2020. This report examines small business lending patterns using FDIC data, and finds that small banks devoted larger shares of

their assets to small business loans, while large banks issued a higher total volume of small business loans.

- "[Spotlight on Community Bank Lending](#)" Daniel Brown, September 2019. This fact sheet examines trends and provides an overview of community banks, a critical source of capital for small businesses.
- "[Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms](#)" Alicia Robb, February 2018. This report examines racial and ethnic differences in the financing patterns, access to capital, and credit market experiences of U.S. employer firms.
- "[How Did Bank Lending to Small Business in the United States Fare After the Financial Crisis?](#)" Rebel Cole, January 2018. This report assesses changes in bank lending to small businesses after the financial crisis, and the differences in lending behavior between large and small banks.

READ THE FULL REPORT ONLINE

This report is available on the Office of Advocacy's webpage at <https://advocacy.sba.gov>. To stay informed of Advocacy's research, visit <https://advocacy.sba.gov/connect>. By selecting the Small Business Regulation & Research category, you can choose to receive email notices of Advocacy research, regulatory communications, or The Small Business Advocate newsletter.

