

Direct from Main Street

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Oregon Small Business Views
on Credit and Lending



Main Street Alliance of Oregon • Alliance for a Just Society

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Introduction

As the United States continues to experience the worst economic downturn since the Great Depression, small businesses are seeing their sources of credit dry up. Normally an economic engine, they now face severe setbacks in their role as job creators and sustainers. Given the key role of small businesses in our economy, their experiences should be of particular concern to policymakers.

This report shares the findings of a survey of Oregon small businesses, focusing on their experiences with credit and their reactions to one current proposal to support small business and economic growth: the creation of a state bank. This report contributes to the discussion of such a proposal by sharing the perspectives of Oregon's Main Street small businesses.

Key Findings

- More than half (54 percent) of surveyed small businesses expressed that they had felt the tightening of credit. Of these, 51 percent said they had decided not to seek a bank loan because they were discouraged.
- Two thirds (67 percent) of small business owners reporting problems with access to credit had delayed or canceled expansion plans in response.
- A strong majority of respondents (67 percent) believe elected officials have not done enough to support small businesses and economic recovery.
- An even stronger majority (75 percent) would support the creation of an Oregon state bank like North Dakota's.

Background

The Important Role of Small Businesses in the Economy

Small businesses represent a key force in the economy of the United States and in Oregon. As of September 2009, small businesses employed just over half of the country's private sector workforce. Services and small-scale manufacturing provided by small businesses have become an economic base on which local commerce rests, as they make up 99.7 percent of the employer firms in the U.S.¹

Looking at 2006 pre-recession data, the National Community Reinvestment Coalition (NCRC) found that lending to small businesses increased employment on a county level.² Looking at Community Reinvestment Act (CRA) funding, communities where small businesses had increased levels of CRA-based lending correlated with higher levels of employment. By focusing on county-level change, this research illustrates the strong impact of local lending on community employment.

However, small businesses continue to face challenges to spurring the economy. A U.S. Congress Joint Economic Committee (JEC) national study notes that, as we came out of the deepest levels of recession, large establishments increased hiring levels in mid-2009, while small business employment continued to decline into early 2010 and remained stagnant into mid-2010.³ Because small businesses represent a force for economic activity and employment, in order to promote economic recovery it is vital to understand what challenges they face in the current economic downturn.

The Credit Crunch Continues

Although big banks pledged in 2009 to increase lending to small businesses, few have come close to their goals and many continue to contribute to a climate where 41 percent of business owners feel they cannot get adequate credit.⁴ Well into the long climb out of recession, many small businesses have been left to seek alternatives or go without the support of credit for purchasing inventory and supplies, meeting payroll and hiring new employees, paying for marketing and publicity, and taking advantage of opportunities to expand.

When the recession hit, lenders began tightening credit standards and reported continued tightening into 2009.⁵ Large banks state they have begun lending again but that limited demand exists from creditworthy small businesses.⁶

However, many small businesses and small business advocates also believe that the banks continue to apply overly strict standards of creditworthiness.⁷ Furthermore, the initial tightening of credit appears to be self-reinforcing. According to National Small Business Association (NSBA) president Todd McCracken, “banks lowered existing credit lines of many small business customers, which in turn lowered their credit scores because they were left using a higher percentage of their available credit.”⁸

Finally, the clampdown on credit and the deterioration of credit terms may be depressing demand. Some portion of lowered demand is likely attributable to “discouraged borrowers” who would like credit but do not seek it out because they believe they will be denied.⁹ Similarly, some small businesses may be holding off from seeking loans or other forms of credit because credit has become more costly for them.¹⁰

High Costs of the Credit Crunch

Small businesses are paying a high price for the credit crunch. At the same time that banks restricted access to traditional loans, credit card issuers raised interest rates, increasing the costs of credit for small business owners and making that credit less reliable.¹¹ Many small business owners also have seen their credit card issuers change interest rates from fixed to variable, adding to the instability.¹² Meanwhile, the crash of the housing market has limited home refinancing as a source of credit.¹³

These costs have a ripple effect. Across the country, small business owners have stated that the lack of adequate credit has prevented them from hiring new staff as they had planned, leaving communities without needed jobs.¹⁴ Equally troubling, small businesses have reported that lack of available credit has damaged their ability to buy inventory sufficient to meet demand¹⁵ – suggesting that the credit crunch is interfering with the economic activity necessary for recovery.

Recent Federal Legislation to Support Small Businesses and Economic Recovery

In September 2010, President Barack Obama signed into law H.R. 5297, the Small Business Jobs Act of 2010.¹⁶ Among other things, this new legislation will increase the availability of and funding for Small Business Administration (SBA) loans and provides federal financial support for small business lending by community banks.¹⁷ It also contains tax deductions and other tax-related measures to reduce business expenses. This federal legislation represents a step forward. At the same time, state policymakers are looking at ongoing state solutions that would support the small business sector and economic growth in Oregon.

The Bank of North Dakota and the Proposal to Create a State Bank

One proposal is the creation of a state bank, such as the one now in place in North Dakota. The Bank of North Dakota was created in 1919 in response to tight credit markets that were threatening the viability of the state's agricultural sector,¹⁸ a situation similar to the credit crunch now experienced by small business.

Looking toward its 100th year, the bank is an important player in that state's economy, partnering with more than 100 other financial institutions to spur economic activity.¹⁹ During the worst days of the recession, North Dakota was not hit as hard as many other states in terms of unemployment and other consequences of the recession, prompting considerable interest in the model it presents.²⁰

The bank receives deposits from public agencies and uses that money to promote local economic development.²¹ Community bankers in North Dakota credit the state bank with assisting local development projects, while they have greater difficulty finding support from other lenders.²²

Key among the bank's activities is its support for small business lending. It engages in this lending primarily in collaboration with other financial institutions, supporting their loans to small businesses. This participation lending involves either providing funds to increase the size of loans, buying down interest rates, or offering loan guarantees.²³

Compared to similar states, lending has been more robust in North Dakota, with small- and medium-sized banks registering more loans per capita and higher loan-to-asset ratios over the past five years.²⁴

By collaborating with other lenders, the Bank of North Dakota supports and helps stabilize the state's banking market, which has a higher number of bank offices per capita and less market concentration than in comparable states.²⁵ The Bank of North Dakota's presence alongside local banks has been described as producing "a 'crowding in' effect – keeping [those banks] liquid, lending to local businesses, and fueling economic growth,"²⁶ at a time when larger institutions have closed off to providing credit.

The Bank of North Dakota also plays a role in reinvesting public funds in North Dakota. In addition to funding local economic development, the bank runs a profit and typically directs over 70 percent of its earnings back into the state general fund. It delivered \$30 million in 2009, one of the toughest years on economic record.²⁷ This contributed to North Dakota being one of only four states to avoid a revenue shortfall in 2010 and the only state to avoid one in the past two years²⁸ – a time when other state and local governments are slashing funding for schools, clinics, libraries, and other key public functions.²⁹



Rhonda Ealy Strictly Organic Coffee Co. Bend

My husband, Richard Stephensen, and I opened Strictly Organic Coffee Company almost 12 years ago, with the goal of providing fresh sustainable coffee products in a sustainable manner. We wanted to enrich the lives of our customers by allowing them to make environmental and socially conscious choices. Until the credit crunch and recession hit, my business was growing by leaps and bounds. I'd hired lots of staff and had become a national coffee wholesaler. My business is still very successful, but we've had to scale back, mainly due to all the problems we've had with credit.

We've been hit by the credit crunch in a couple of ways – being turned down for a bank loan, and having our American Express card spending limit decreased drastically, even though Strictly Organic was in excellent standing with Amex and had been paying off the balance completely every month. With this loss of credit, I've had to cut administrative staff, forego upgrading equipment, and halt the growth of my business.

Now my husband and I are doing most of the managing of our two stores ourselves, which was previously the work of four people. In fact, if I were able to access the credit needed, instead of cutting jobs, I could potentially add up to five jobs in the Bend area. It may not be much, but that's five more Oregonians earning a paycheck and putting money back into our economy.

I want to continue to provide a quality product, and create jobs for our community, but with current lending restrictions, it might not be possible long term. There must be a better solution that will help free up credit for small businesses like mine and others across Oregon that are the economic engine of our state. In the end, I want to see our local banks possess the ability to invest back into our communities with Oregon money. I am urging the state legislature to look at this issue and put Main Street back on stable footing.

Methodology

Between October and December 2010, the Main Street Alliance of Oregon and Friends of Family Farmers conducted a survey of 116 small businesspeople and small family farmers around Oregon, including the following locations: Ashland, Aumsville, Bend, Corbett, Corvallis, Eugene, Gardiner, Grants Pass, Gresham, Harbor, Hillsboro, Independence, Jacksonville, Junction City, Keizer, Lyons, Medford, Mehama, Merlin, Molalla, Monmouth, Newberg, Philomath, Portland, Salem, Stayton, Troutdale, and Woodburn. Surveyors contacted respondents through door-to-door canvassing of visible storefronts within business districts and/or emails to business owners who previously had expressed interest in the Main Street Alliance of Oregon and its activities or the activities of its partners.

Survey results are rounded to the nearest percentage point. In some cases, the combined tallies for a particular question may not sum to exactly 100 percent due to this rounding.

Findings

This survey questioned Main Street small business owners about their experiences with credit and about their perspectives on a proposal to create a state bank.

Respondent Information

Respondents included small employers (75 percent) and self-employed business owners (25 percent). Fifty-three percent of respondents employed one to five employees. Seven percent were farmers. Other respondents represented a wide range of Main Street businesses, including retail shops, health services, restaurants, personal and professional services, auto repair shops, and others.



Bill Allegri
Allegri Wine Shop &
Art Gallery
Gresham

My wife Kathy and I have been operating our wine shop and art gallery in downtown Gresham for 10-plus years. With our business we are committed to providing quality wines as well as displaying Kathy's well recognized fine art.

Fortunately, I'm not afraid my business will go under – we're still strong. But we've found it very difficult to expand as we'd like to. We'd love to provide better products and services for the residents of Gresham and surrounding areas, but the economic downturn makes this very difficult.

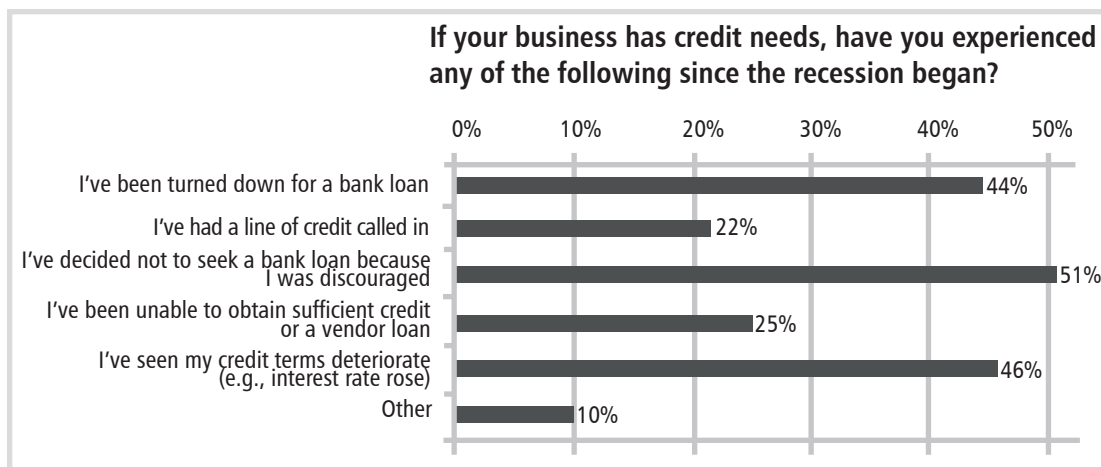
Within the past two years, we sought a bank loan. Unfortunately, we were turned down. This was disappointing, because it meant we had to do things for our business we wish we didn't have to do. We refinanced our home, sold a car, and held off plans to expand the business. On top of all that, we also haven't been able to acquire inventory we need for our business; we've experienced working capital interruptions; and we've delayed plans to add staff.

Our business, like other small businesses, is part of the backbone of our community. We're disappointed, frustrated and at times angry that elected officials – local, state and national – have not found ways to help small businesses in this economic crisis. We hope they decide to make small business a top priority during their next legislative sessions.

Experiences with Credit

The survey asked small business owners about their experiences with credit. More than half (54 percent) of survey respondents expressed that they had felt the tightening of credit. Of these, 51 percent said they had decided not to seek a bank loan because they were discouraged. Forty-two percent saw their credit card terms deteriorate, while 41 percent said they had been turned down for a bank loan. Twenty-three percent were unable to obtain sufficient trade credit or a vendor loan, and one out of five had a line of credit called in. Other reported experiences included seeing an increase in the requirements for lines of credit, having lines of credit reduced, and having credit card limits reduced.

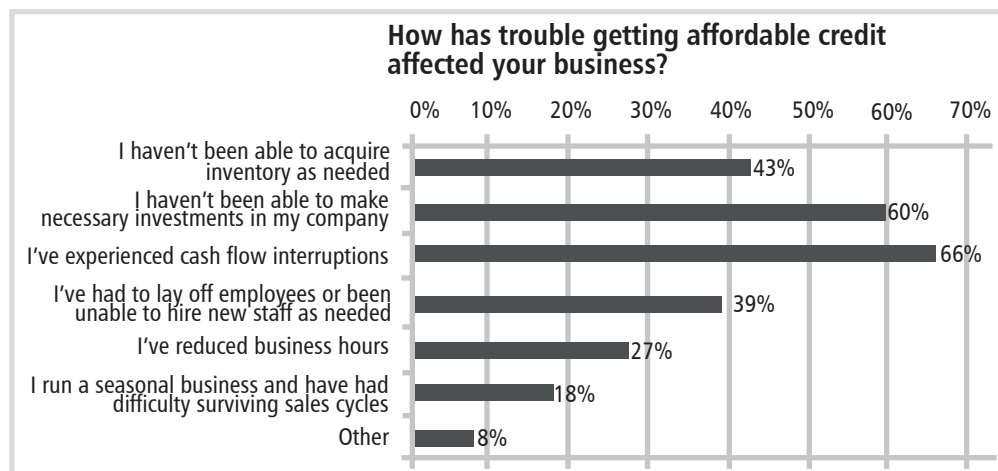
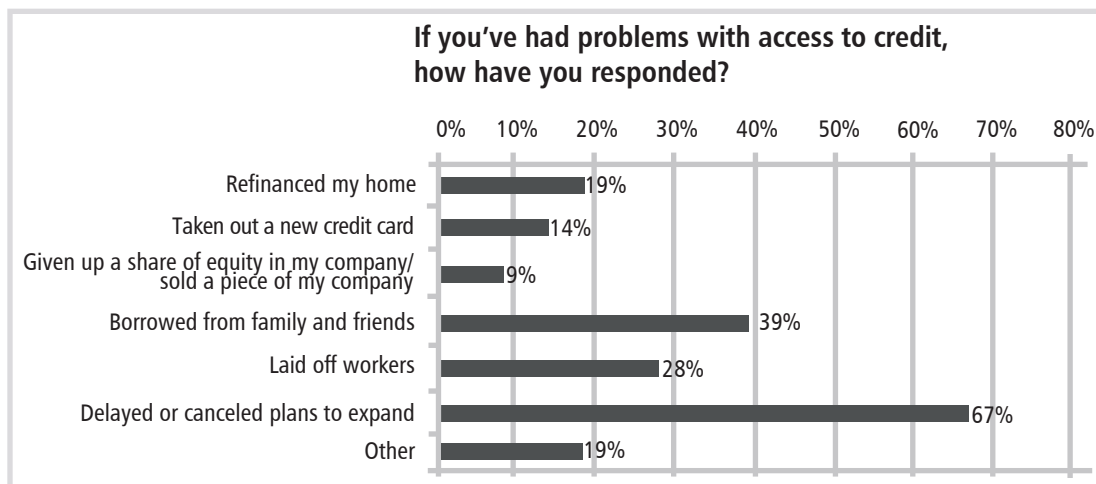
Small business owners experiencing difficulty accessing credit responded to this challenge in a variety of ways. Sixty-seven percent delayed or canceled plans to expand their business, 39 percent borrowed from family and friends, and more than a quarter (28 percent) laid off workers. Nineteen percent refinanced homes in response to credit access issues, while 14 percent took out a new credit card.



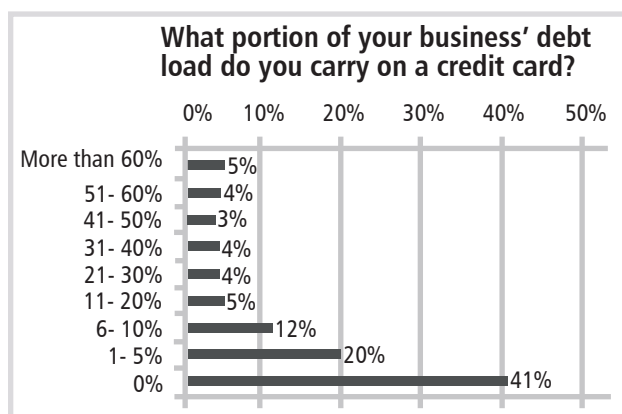
Additional responses reported by surveyed businesses include cashing out retirement and other personal savings, borrowing from a personal credit card, working without pay and downsizing the business.

Small business owners reported a variety of effects from the difficulty of obtaining credit. Sixty-six percent have experienced cash flow interruptions, 60 percent have been unable to make necessary

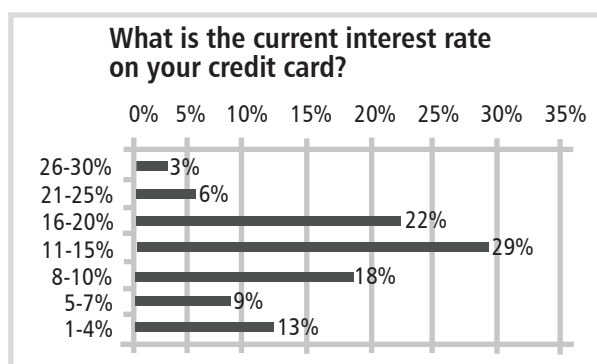
investments in their company (such as marketing, equipment, or other capital purchases), and 43 percent have been unable to acquire inventory as needed. More than a third (39 percent) reported having to lay off employees or being unable to hire new staff as needed, while more than a quarter (27 percent) reduced business hours. Another 18 percent were seasonal businesses that reported difficulty surviving sales cycles.



A number of responding businesses believe they would have been able to create additional jobs had they not encountered credit problems. More than half of respondents (53 percent) believe they would have been able to hire between one and five new employees. An additional nine percent felt they would have been able to create between six and 10 additional jobs. In total, 55 small businesses estimated that they would have been able to create additional jobs had they had access to sufficient credit.



The survey also questioned small businesses about their experiences with credit cards. Many participating small business owners have avoided relying on credit cards, with 41 percent of respondents reporting that they carried none of their business debt on a credit card. For those who did, the portions of debt carried on a credit card ranged from one to five percent (20 percent of respondents) to more than 60 percent (five percent of respondents).



For those respondents reporting use of a credit card, interest rates ranged from a rate of one to four percent (13 percent of respondents) to a rate between 26 and 30 percent (three percent). The largest portion of those reporting credit card interest rates report rates between 11 and 15 percent (29 percent of respondents), followed by 16 to 20 percent (22 percent of respondents).



Barbara McLean
The One Stop
Sustainability Shop
Portland

My daughter and I opened our store about a year ago with a vision that manufacturers and consumers can

participate in an economy that is both environmentally sensitive and socially just. We try to assess the lifecycle of the products we sell, making sure they are made of renewable or recycled materials in a non-toxic, non-polluting way and can be recycled or re-used when worn out.

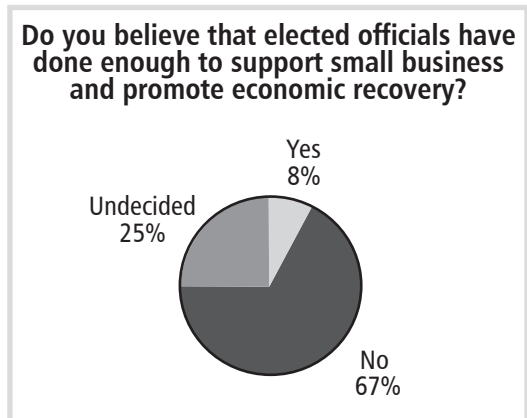
Like all new businesses, we had start-up costs. We went to our local bank, and we were told we needed to be in business for two years before they could provide us with a loan. But how can you start a small business without being able to get start-up funding? Because of this, I decided to take a risk, and use a home equity loan on my house. Without this money, I couldn't have gotten my business off the ground.

Because of the risks involved, I would prefer to transfer my home equity loan amount to a conventional business loan, but that doesn't seem possible at the moment. It is frustrating that the banks are doing little to help small businesses. There needs to be a better solution – many small, thriving businesses can and do have a great effect on local economies, but if they don't have enough capital they'll be forced to closed their doors, which I am determined will not happen to my business. I think it would be much more beneficial to provide small businesses with modest amounts of money in order to keep their doors open.

Small Business Perspectives on a State Bank

In addition to questioning small businesses about their experiences with credit, the survey asked respondents about their perspectives on government action and the state bank proposal.

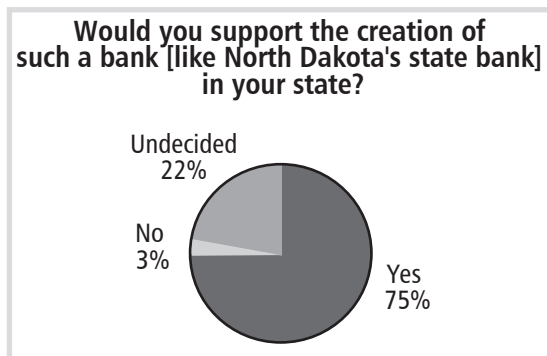
When asked whether elected officials have done enough to support small businesses and promote economic recovery, 67 percent of respondents said no. Another 25 percent were undecided.



The survey also asked small businesses about their views on a state bank. Specifically, it asked:

The state of North Dakota has a state bank that supports small business lending by providing matching funds for loans to commercial banks. The state bank of North Dakota has been credited with maintaining the flow of credit to small businesses, as well as increasing revenue for the state. Would you support the creation of such a bank in your state?

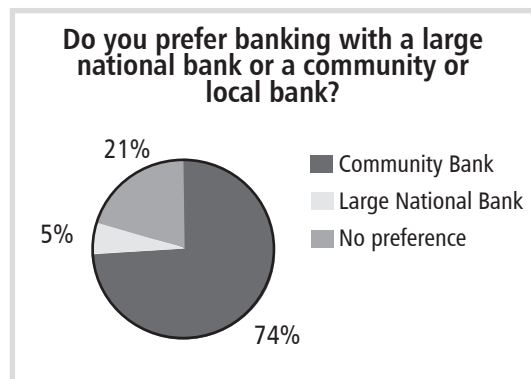
Three quarters of respondents said they would support such a bank, with 22 percent remaining undecided.



Small Business Owners' Banking Preferences

Finally, the survey asked small business owners whether they preferred banking with a large, national bank or a community or local bank. Almost three quarters of respondents (74 percent) preferred banking with a community bank, compared to five percent that prefer banking with a large national bank, and approximately one in five (21 percent) expressing no preference.

The survey then asked respondents the reasons for their preferences and asked them to compare community and large banks. Large portions of respondents said that local or community banks invest more in the neighborhood or area where the respondent's business is located (100 percent), have better customer service (96 percent), or provide credit more affordably (87 percent). Seventy-six percent responded that community banks have provided more credit for their business, compared to 24 percent that responded that large national banks have provided more credit. When it came to offering more options, 56 percent said that community or local banks offer more options; 44 percent responded that large national banks offer more options.



Conclusion

Small businesses continue to suffer the effects of the economic downturn, undermining recovery for entire communities and the state as a whole. Main Street small business owners who participated in this survey are feeling the credit crunch in a variety of ways that they believe have harmed their

businesses. A majority believe that elected officials have not yet done enough to promote small business and economic recovery. Additionally, a strong majority support one proposal to increase small business lending: the creation of a state bank for Oregon.

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The Main Street Alliance of Oregon creates opportunities for Oregon small business owners to speak for themselves to advance policies that are good for small businesses and the communities we serve.



Alliance for a Just Society brings together community-based and racial justice organizations from across the country.

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