Guest commentary I Small Business Administration can expand small businesses' access to capital

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Small businesses are drivers of new ideas, new employment and new economic growth. In the current economic environment, recently enacted changes to the U.S. Small Business Administration lending program — needed for many years — are even more critical to improving opportunities for small businesses.

Banks and their regulators are understandably more cautious in today's environment. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they examine. This means that some higher-risk projects that might have been funded when the economy was stronger may not find funding today.

We sometimes hear from individual businesses and developers that banks are not lending money. While overall bank lending continues to grow, that does not mean much to an individual borrower having difficulty obtaining financing.

In many of these individual cases, however, it appears that the primary reason for not receiving funding was either that the borrower's financial condition was vulnerable (perhaps weakened by local economic conditions), or the borrower expected to borrow money at pre-2008 terms when the risk of lending was considerably lower and funds available for lending were more accessible.

Even with the economy faltering, banks continue to lend. This is, in fact, in sharp contrast to the lending trends during other recessions. History shows that during a recession, several forces typically combine to reduce the volume of loans outstanding: Loan demand declines as businesses experience slowdowns; financial shocks make it hard to repay existing loans; and banks tighten lending standards as regulators caution banks about lending in this environment.

During the current recession, business loans have expanded by 12 percent and consumer loans by 9 percent. In contrast, for the previous six recessions, median business loans declined by 0.7 percent and consumer loans by 5.1 percent.

It is almost certain that loan demand — including the demand for SBA loans — will continue to decline in this economy, and there is evidence that the volume of traditional bank credit is now marginally declining. However, as the economy starts to grow again and loan demand increases, the ability of banks to meet these needs will be stunted if adequate capital is not available to back increased lending.

Unfortunately, the SBA program has been struggling. SBA fiscal year 2008 loan volume figures showed a 30 percent decline year-over-year in the flagship 7(a) loan guarantee program. Fiscal year 2009 figures will show a similar reduction. In addition to the bad economy, the decline is also due to SBA programs becoming too costly and difficult to access.

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But now the lending environment has the potential to improve as recent legislation creates more opportunities for small businesses and lenders. The Committee on Small Business has consistently worked to maintain the integrity of the 7(a) program, and we applaud its efforts on the American Recovery and Reinvestment Act to enact the small business provisions.

Already, the SBA is making progress to implement these provisions, and the ABA believes the changes will create more opportunities for small businesses.

First, SBA has made $375 million available to make access much easier for the two most popular lending programs. The act temporarily increases the guarantees to up to 90 percent on SBA's 7(a) loan program, which will give banks the increased confidence needed to extend credit during the recession. It also temporarily eliminates fees for borrowers on 7(a) loans and eliminated fees for both borrowers and lenders on the SBA-504 Certified Development Company loans.

According to SBA Administrator Karen Mills' testimony to the Senate Small Business Committee in May, average weekly loan volume was up 28 percent in the 7(a) program and 22 percent in the 504 program immediately following the act's passage. Bank participation had also increased.

Second, the SBA expanded eligibility to small businesses in the 7(a) program by applying the broader standard used in the 504 program. Now businesses will be able to qualify with a net worth up to $8.5 million and an average net income under $3 million (after taxes) for the preceding two fiscal years. This means an additional 70,000 small businesses will be eligible to participate.

Third, a whole new category of loan will be available through America's Recovery Capital program. The ARC program provides funding of up to $35,000 for six months to help small businesses facing short-term cash flow difficulties. Interest-free to the borrower, these loans are 100 percent guaranteed by the SBA. In addition, the loans have no fees and repayment does not begin until 12 months following final disbursement.

With this assistance, many businesses will be able to get on their feet.

To make it easier for banks to take advantage of these opportunities, the SBA needs to work with trade associations like the ABA to develop loan programs that are attractive to lenders of all sizes, especially community bankers.

The United States has more than 8,000 banks, but only 2,500 participate in SBA's 7(a) loan guaranty program. More community banks would participate if a regular guaranty was offered for a loan of $150,000 or less. The ARC loan program may fit this bill.

In conclusion, when the SBA's human resources are put in place for implementation, these initiatives and new programs launched by the administration and by Congress have great potential to help thousands of small businesses succeed.

Michael McGannon, a senior executive vice president and chief lending officer of Country Club Bank in Kansas City, recently testified on behalf of the American Bankers Association before the U.S. House Committee on Small Business. Here are excerpts from his testimony.