

## A Damaging Disconnect Between Banks and Corporate Borrowers

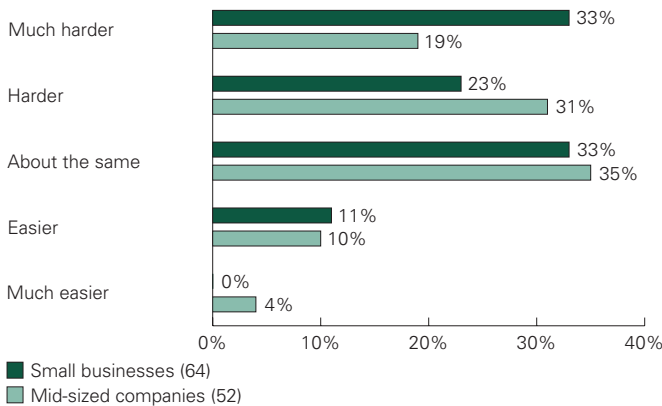
April 2010

Even as the start of an economic recovery provides a boost to U.S. businesses, many small and medium-sized companies are finding that their improving financials still fall short of banks' newly rigorous credit standards.

That finding, from the results of a new Greenwich Market Pulse survey, helps explain why U.S. companies say it is harder to obtain credit now than it was a year ago in the depths of the economic and market crisis. Approximately 55% of U.S. small businesses say it has been harder to secure credit so far in 2010 than it was during the same period last year — including one-third saying it has been “much harder.” Half of mid-sized companies agree that it has become more difficult to secure credit.

Greenwich Associates tracks U.S. corporate credit conditions through the Greenwich Credit Availability Index. The Index score, which is based on the results of quarterly surveys of more than 500 small and mid-sized businesses, reflects a net calculation of the number of businesses that see credit conditions improving versus those reporting deterioration. Although the Index has been mired in negative territory since the second half of 2007, it began to climb in the direction of a positive reading at the end of the second quarter of 2009 for mid-sized companies and at the start of the third quarter for small businesses. “That rebound has stalled in 2010,” notes Greenwich Associates consultant Chris McDonnell.

### Perception of Current Credit Availability vs. Last Year

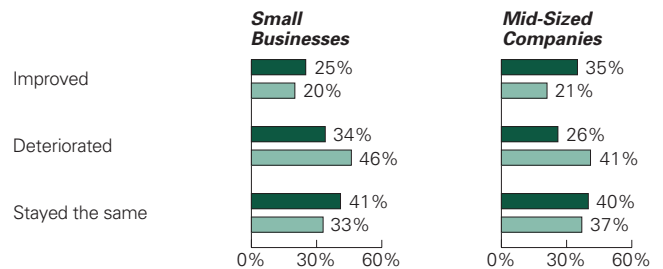


Note: Number of respondents shown in parentheses.  
Source: Greenwich Market Pulse v36

### Optimism Builds About Economy and Business Prospects

The continued lack of access to credit is especially frustrating for owners and executives of small and mid-sized companies who are increasingly optimistic about the economy and say the financial condition of their own businesses are improving. Companies in both groups were neutral about whether the economic conditions were improving or deteriorating as recently as the start of the fourth quarter of last year. Optimism is surging in both camps so far in 2010, with mid-sized companies especially bullish about the direction of the U.S. economy.

### Reported Change in Financial Condition Over the Past Year



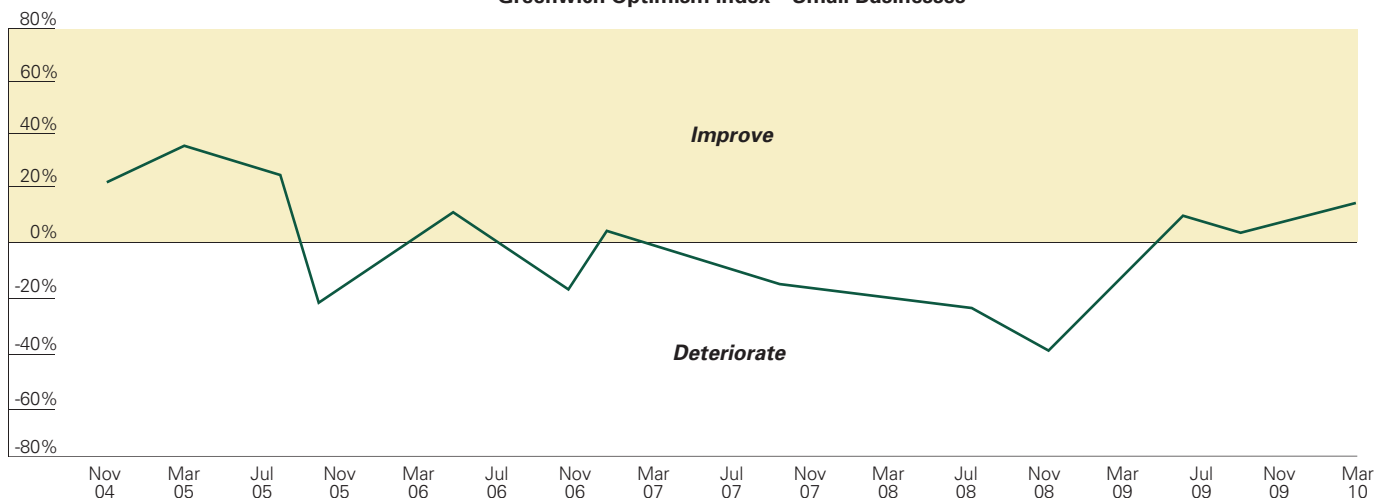
■ March 2010 (131 small businesses, 110 mid-sized companies)  
■ January 2009 (237 small businesses, 513 mid-sized companies)

Note: Number of respondents shown in parentheses.  
Source: Greenwich Market Pulse v32, v36

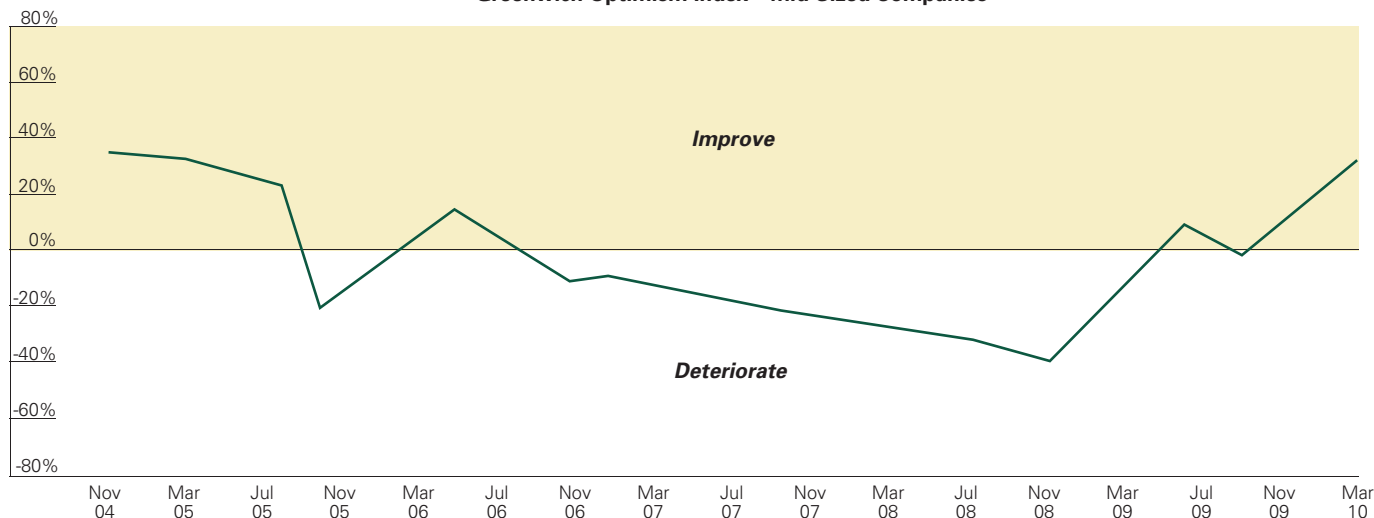
Companies see the economic recovery as having a strong stabilizing impact on their own businesses. The graphic above illustrates how respondents assessed the change in their companies' financials over the past year, showing results from the most recent survey and research conducted in July of last year. Among small businesses, the proportion reporting that their financial condition had deteriorated over the past 12 months declined to approximately one-third in 2010 from 46% in July 2009, while the share reporting financial improvement increased to one quarter from 20% and the share reporting no change jumped to 41% from 33%. The shift was even more dramatic among mid-sized companies, among which the share reporting deterioration in their financial condition dropped to 26% in 2010 from 41% in 2009, while the proportion reporting improvement rose to 35% from 21%.

## Small Businesses and Mid-Sized Companies are Increasingly Optimistic About the State of the U.S. Economy

Greenwich Optimism Index – Small Businesses



Greenwich Optimism Index – Mid-Sized Companies



Note: The Greenwich Optimism Index is the net score of companies who feel that the economy will improve versus deteriorate. Based on the results of quarterly surveys of more than 500 small businesses and mid-sized companies. Source: Greenwich Market Pulse v36

### A Disconnect Between Banks and Borrowers

Although these results suggest the worst might be in the past for small businesses and mid-sized companies, owners and executives of these companies also see evidence of a troublesome disconnect: Despite the rebound in the economy — not to mention significant support from government in the form of monetary and fiscal stimulus — banks are not picking up the pace of lending. Only 24% of small businesses and 22% of mid-sized companies borrowed money over the past three months, shares that were down from the 27% and 29% reported respectively in January of this year, and down significantly from the 46% of small businesses and 40% of mid-sized businesses that reported borrowing in September 2009.

The decline in corporate borrowing undoubtedly reflects a fall off in companies' demand for capital as they oper-

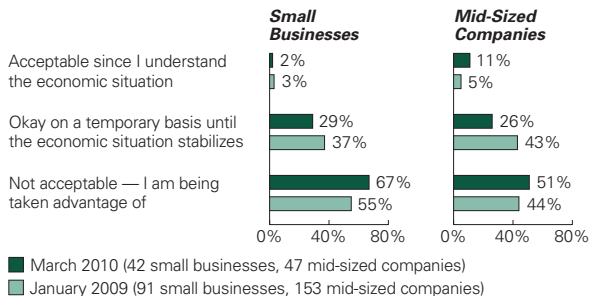
ate more conservatively through the recession. As the economic recovery proceeds, however, that demand should increase, perhaps even rapidly. As it does, companies looking to borrow are going to bump up against new bank lending standards. "This process is already playing out," explains Greenwich Associates consultant Jesse Neumyer. "Many small businesses and mid-sized companies feel like their businesses and future prospects are improving, but in reality, these companies' financials are just not strong enough to qualify under bank credit policies that are much stricter than those companies were used to before the crisis."

According to research conducted by the American Banker in the first quarter of 2010, almost three-quarters of U.S. banks tightened their credit standards over the past 12 months, including almost a quarter reporting that their

## Companies Losing Patience With Higher Fees and Rates

Two thirds of small businesses and 55% of mid-sized companies that have been hit with increases in interest rates or fees on their bank credit lines call the stepped-up charges “unacceptable” and believe their banks are taking advantage of them. “Both of those shares are up significantly since January 2009, indicating that companies are losing their patience with banks,” says Greenwich Associates consultant Don Raftery.

### Opinions About Paying More in Interest Rates or Banking Fees\*



Note: \*Excludes “Don’t know” responses. Number of respondents shown in parentheses. Source: Greenwich Market Pulse v30, v36

standards are now “significantly tighter.” These stricter standards are having a disproportionate impact on smaller companies, which are likely to be seen as less creditworthy than companies at the larger end of the middle-market category. “Thirty-six percent of the small businesses participating in our Market Pulse survey say they are using credit cards to meet their capital needs,” says Greenwich Associates consultant Steve Busby.

## Credit Recovery Will Start at Top End of Middle Market

In the most recent Greenwich Market Pulse, participating companies were asked to evaluate the top 15 U.S. commercial banks to indicate whether these banks were “stepping up to provide credit” or “not lending to an appropriate degree.” By aggregating the responses, a “net willingness to lend” score was calculated for each bank. The results were not pretty. Among small businesses, not a single U.S. bank received a positive score for willingness to lend, indicating that these companies do not think any bank is lending to an appropriate degree. Among mid-sized companies, a large majority of banks (11 of the 15 banks on the list) received either negative or neutral scores. Among both groups, national banks received the lowest scores for their willingness to lend.

However, four banks, including Wachovia/Wells Fargo, Regions Financial, National City/PNC, and Zions Bancorp, received positive scores from mid-market companies, indicating that in aggregate, a majority of their corporate clients see them as stepping up to extend credit.

“These results provide a glimpse at how the pick-up in bank lending will unfold and to some extent, is already playing out,” says Greenwich Associates consultant David Fox. “Banks that are still pressed for capital and reluctant to add risk to their loan portfolios will first increase the amount of capital available to larger companies with more reliable financials, meaning that the lending recovery will begin in the middle-market and then extend down to small businesses only gradually.”

Although it may come as cold comfort to small businesses and larger companies that find themselves cut off from bank credit, banks will resume lending at more “normal” levels —eventually. Since the start of the credit crisis, Greenwich Associates has repeatedly made the case that banks traditionally have been overly cautious and slow to resume lending in the early stages of an economic recovery. The results of the latest Greenwich Market Pulse suggest that things are no different this time. “Banks are beginning to recognize the huge opportunity that exists amid the risks in today’s market environment,” says Greenwich Associates consultant Pete Garrison. “Now is the point in the credit cycle when banks with the ability and willingness to lend can “win” a larger share of new business at competitive prices. With a smaller number of attractive deals available, the competitive pressures to succeed will be substantial.”

*Greenwich Associates consultants Chris McDonnell, Jesse Neumyer, Don Raftery, David Fox, and Pete Garrison advise on banking in the United States.*

## Methodology

*The Greenwich Market Pulse is a panel of approximately 30,000 financial decision-makers at small (\$1 million–\$10 million) and mid-sized (\$10 million–\$500 million) companies in the United States. The current survey was conducted from March 1–26, 2010 and included participation from 519 companies.*

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