

## Credit Conditions (Finally) Normalizing for U.S. Small Businesses

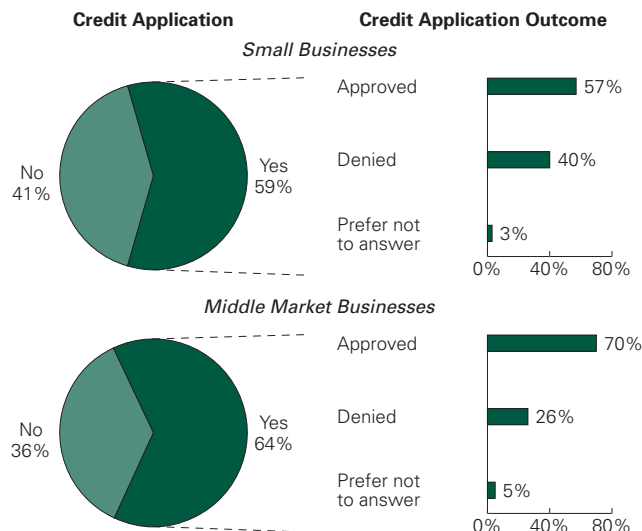
April 2011

New research from Greenwich Associates suggests credit conditions in the United States are finally starting to return towards “normal” and — for the first time since the start of the global financial crisis — the share of small businesses reporting success in landing bank loans is returning to historic averages.

The banking crisis and the onset of a global recession in 2008–2009 dried up the flow of bank loans to middle market companies and small businesses alike. Credit conditions started to improve in 2010 — but mainly for the strongest and most creditworthy middle market firms. Among small businesses and weaker middle market companies, bank lending activity remained depressed. The reasons: 1) lingering balance sheet issues and new capital requirements caused banks to limit their overall lending capacity and keep lending standards tough, and 2) continued uncertainty about the strength of the economic recovery caused businesses to put off expansion plans, limiting their need for external funding of any type.

The results of a March 2011 Greenwich Market Pulse suggest that the improvement in credit conditions experienced by top middle market companies in the first half of 2010 began extending into the lower ranks of the middle market and into the small business segment as the year progressed. “By the first quarter of 2011, loan demand and actual borrowing activity among small businesses and all middle market companies is recovering actively — and conditions now appear to be reverting

### Credit Rate of Approval in Past 12 Months

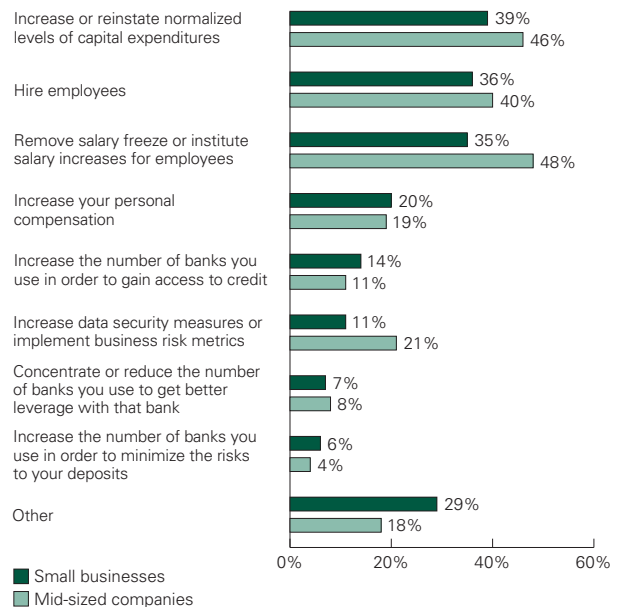


Note: Based on responses from 271 small business respondents and 235 mid-sized business respondents in 2011. Source: Greenwich Market Pulse v40

### Cap-Ex and Hiring Plans Show Signs of Optimism

With financial markets and the economy stabilizing, almost 40% of small business and 46% of middle market companies plan to increase or reinstate normal levels of capital expenditures. Those findings represent an important signal of recovery, in light of the fact that 73% of middle market companies and 69% of small businesses reduced or entirely eliminated capital expenditures during 2008 and 2009. In yet another promising sign for the U.S. economy, 40% of middle market companies and 36% of small businesses say they have plans to hire new employees now that the financial markets appear to be returning to more normal footing.

### Planned Actions in the Post-Financial Crisis 2011



Note: Based on responses from 271 small business respondents and 235 mid-sized business respondents in 2011. Source: Greenwich Market Pulse v40

back to something resembling pre-crisis norms,” explains Greenwich Associates consultant Don Raftery.

About 60% of the small businesses participating have applied for credit in the past 12 months. Of those that applied, about 60% were approved. By way of comparison, about 64% of the middle market companies applied for credit last year; approximately 70% of applicants were approved.

“Both loan demand and application approval rates are always higher among middle market companies, which are better established and generally rank as much stronger candidates than small businesses,” says Greenwich Associates

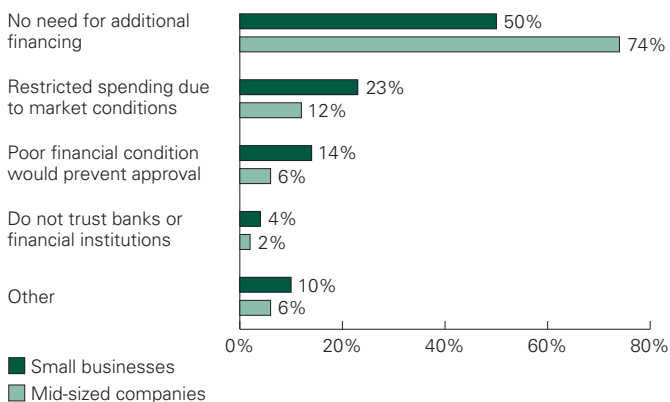
consultant Pete Garrison. “But for the first time in at least two years, the numbers for small business — both in terms of the approval rate and the overall share of small businesses borrowing — are in line with historic averages.”

### Surge in Loan Demand

The steady increase in the share of small businesses applying for loans over the past three quarters represents a strong vote of confidence in both bank credit markets and in the economic recovery. The results of the Greenwich Market Pulse study show that the share of small businesses applying for a loan nearly tripled from approximately 5% in Q3 2010 to 15% in Q4 2010, and then almost doubled again to 29% in Q1 2011. That final share of 29% actually exceeds the share of middle market companies that applied for bank credit in Q1 2011. In that quarter, 27% of middle market companies applied for bank loans, up from 16% in Q4 2010 and 9% in Q2 2010.

“It’s possible that the late spring and early summer of 2010 will be seen as the trough of the small business credit cycle,” says Greenwich Associates consultant Larry Baily. “At that point, few small businesses had enough confidence in the economy to be thinking about expansion, and among those that were, many had written off bank loans as a source of funding after repeated denials. Small businesses were turning to credit cards and personal loans for working capital. The new research results suggest that from that point forward, the share of small businesses applying for bank loans started increasing rapidly.”

### Reasons Companies Did Not Apply for Credit in Past Year



Note: Based on responses from 110 small business respondents and 84 mid-sized business respondents in 2011. Source: Greenwich Market Pulse v40

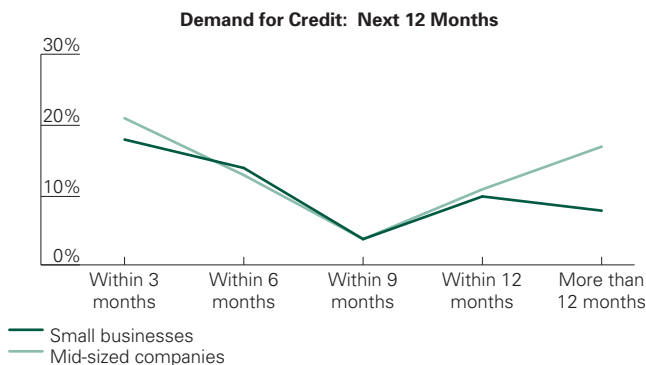
Among small businesses that opted not to apply for bank credit, half say they had no need for additional funding and another 23% say they did not apply for credit because they were actively restricting spending due to continued unfavorable conditions in financial markets. These results seem to indicate that most small businesses that did not apply for bank credit last year put off applying because they were unwilling to borrow money to fund expansion

### Small Business Lending Fund

Approximately 40% of small businesses say they have never heard of the Small Business Lending Fund (SBLF), which was established as part of the Small Business Jobs Act in 2010. The SBLF allocated \$30 billion in capital to community banks in an effort to spur small business lending. “All told, about 85% of small businesses say they’ve either never heard of the SBLF or they don’t have specific knowledge about the fund,” says Don Raftery. “Because the program is structured to decrease the costs of capital for community banks as they increase the pace of their small business lending, participating banks have a strong incentive to find creditworthy borrowers. Small business owners should talk to the banks in their area to see if they can benefit from this federal program.”

amid uncertain economic prospects. “However, that conclusion is largely undermined by the fact that 80% of small businesses that did not apply for bank credit last year due to the poor financial condition of their company say they would have applied if they thought they’d be approved,” says Pete Garrison.

### Future Demand for Credit



Note: Based on responses from 271 small business respondents and 235 mid-sized business respondents in 2011, 47% of small businesses and 33% of mid-sized companies will make decisions about borrowing based on market conditions or their company’s financial condition. Source: Greenwich Market Pulse v40

Looking ahead, approximately one-third of small businesses and middle-market companies expect to apply for bank credit in the next six months, including 18% of small businesses and 21% of middle market companies that plan to seek out funding in the coming quarter. Other companies remain uncertain: 47% of small businesses and one-third of middle market companies say they’re putting off any decisions about whether and when to apply for bank credit until they get a clearer picture of market conditions and their own companies’ performance.

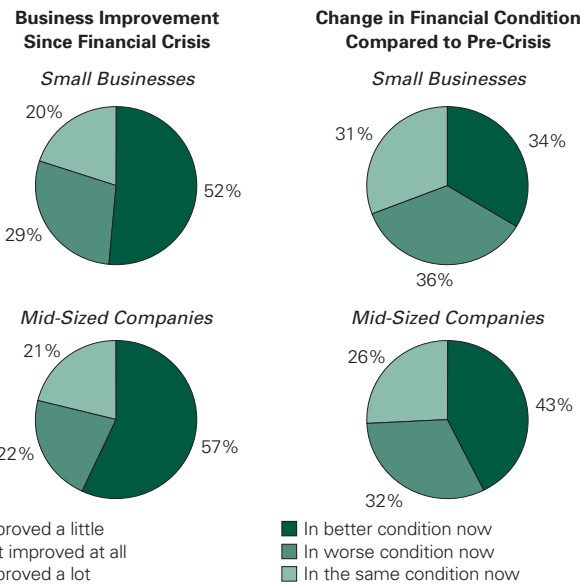
### Financial Crisis: Consequences and Recovery

Of course, the fact that bank loan approval rates are finally recovering will be small consolation to the roughly 40% of small businesses that have been denied credit in the past year. “Getting turned down for a loan is always a challenging and frustrating experience, but at this point in the credit cycle, the consequences of an application denial can be devastating — even fatal,” notes Don

Rafferty. “For most of these companies, bank loans have been out of reach for two years or longer. For some companies, the turnaround in conditions will come too late.”

Indeed, although the recovery in financial markets is starting to improve prospects for U.S. companies, a significant share of small businesses and middle market firms are still suffering. About 71% of small businesses and 78% of middle market companies say their businesses have improved since the worst days of the financial crisis, but 29% of small businesses and 22% of middle market companies say they have seen absolutely no recovery in their businesses. In terms of financial effects, a solid 43% of middle market companies and 33% of small businesses say their companies are in better financial shape now than they were prior to the crisis. But nearly a third of middle market companies and 36% of small businesses say their companies are in worse shape now than before the economic downturn.

### Changes in Business and Financial Condition



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### Shifting Relationships

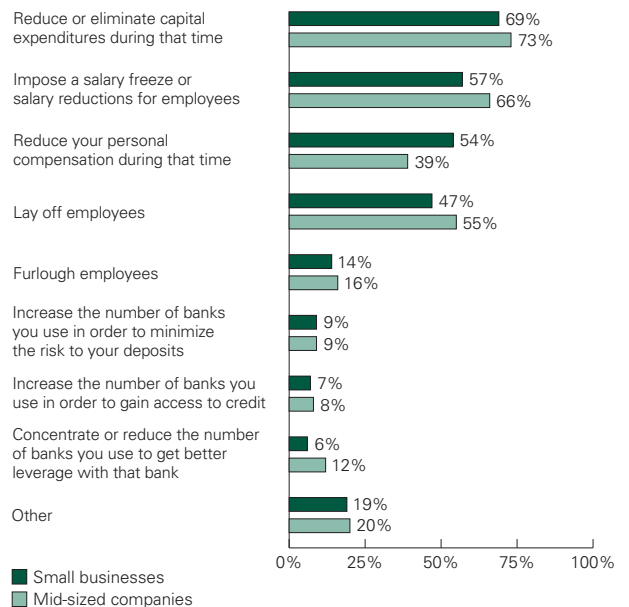
Fewer than 5% of small businesses and middle market companies say a distrust of banks prompted them to steer clear of bank credit markets last year. That share seems surprisingly low in light of hits taken by bank reputations in this segment in 2008 and 2009. “During the crisis, our research showed a complete breakdown in relationships between small businesses and many middle-market companies and their banks,” says Pete Garrison. “Companies that couldn’t get bank credit felt abandoned, and stronger companies that could get credit felt many banks were gouging them on price.”

There is one possible explanation as to why companies do not seem to be holding grudges against their banks: Many

### Business Owners Feel the Pain

Almost 55% of small business owners reduced their personal compensation in response to the financial crisis of 2008 and 2009. “People tend to overlook the significant personal costs that the recession had on small business owners, in terms of both reduced compensation and the accumulation of personal debt,” says Greenwich Associates consultant David Fox. “Our data suggest that most small business owners took a personal hit to their own compensation before laying off employees — a step that was taken by 47% of U.S. small businesses during the difficult stretch from 2008 to 2009.”

### Actions Taken in the Height of the Financial Crisis 2008–2009



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small businesses and middle market companies that were displeased with the treatment they received from their banks during the crisis are no longer clients. According to the Greenwich Market Pulse results, about half the small businesses and middle market companies that obtained bank credit over the past year borrowed from a lender outside the top 20 banks in the United States. The movement of some small businesses and middle market companies to regional and community banks last year reflects a trend: As the nation’s biggest banks recapitalized and adjusted their business models for the post-crisis era, they reassessed how they were committing their balance sheets. These large banks often did not work to retain dissatisfied small business and middle market banking customers, and in some cases banks actually severed relationships. “At the same time, some creditworthy small businesses and middle market companies probably took the opportunity to shift their business to smaller banks they see as providing better and more reliable service,” says Greenwich Associates consultant Duncan Banfield.

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*Greenwich Associates consultants Duncan Banfield, Don Raftery, Pete Garrison, Larry Baily, Marc Harrison, and David Fox advise on banking in the United States.*

### **Methodology**

*The Greenwich Market Pulse is an ongoing research series that addresses the most important and timely issues facing small (\$1 million–\$10 million) and mid-sized (\$10 million–\$500 million) company executives and their banking relationships in the United States. The current Greenwich Market Pulse was conducted during February 2011 and included participation from 506 companies. The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or*

*endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and review for presentation purposes in order to produce the final results.*

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