SBA Office of Advocacy
www.sba.gov/advo

Small Business Research Summary

Advocacy: the voice of small business in government

May 2005 No. 257

Availability of Financing to Small Firms Using the Survey of Small Business Finances

by Karlyn Mitchell and Douglas K. Pearce
Raleigh, NC 2004. 68 pp., under contract no. SBAHQ-03-Q-0016

Purpose

The small business sector is of interest to policymakers not only because of the important role it plays in the U.S. economy, but also because of the avenue to advancement small business ownership represents, in particular for ethnic minorities and women. Critical to small businesses' success is the availability of financing for both capital acquisition and working capital purposes. Much of this financing takes the form of credit extended by commercial banks and nonbank lenders.

This study investigates possible restricted access to credit for minority- and women-owned businesses by focusing on two types of credit—"relationship loans" (lines of credit) and "transaction loans" (commercial mortgages, motor vehicle loans, equipment loans, capital leases, and other loans)—from two types of creditors: commercial banks and nonbank lenders. The disaggregated approach is feasible because of a rich new data set, the 1998 Survey of Small Business Finances

Overall Findings

The results imply that minority small business owners face some restrictions in access to credit. These restrictions do not appear to be uniform across loan or lender type.

Highlights

• By disaggregating outstanding loans by loan type and lender type, the research finds that ethnic minority firm owners are more likely to have transaction loans from nonbanks and less likely to have bank loans of any kind.

• Consistent with past studies, researchers found that African-American and Hispanic firm owners face significantly greater loan denial probabilities than white male firm owners on both relationship bank loans and transaction bank loans. New evidence in this study hints that discrimination may be specific to particular segments of the loan market rather than a general problem.

• Researchers found that lenders do not artificially restrict the credit-market access of female and Asian firm owners.

• This study breaks new ground by suggesting that preferential lending practices characterize the granting of transaction loans to a significantly greater degree than the granting of relationship loans.

Methodology

The researchers postulated that evidence of preferential lending practices, if any, may be discernible in the patterns of outstanding loans and of loan application denials; and in the average characteristics of firm owners whose loan applications are approved. Econometric models used by previous researchers were adapted to study patterns in outstanding loans and loan application denials and to investigate the possibility of preferential lending practices in the granting of relationship and transaction loans by commercial bank and nonbank lenders. The researchers developed five testable hypotheses for outstanding loans and four for loan application denials.

To test the possibility that preferential lending may take the form of lenders requiring women and minority firm owners to meet a higher standard to

This *Small Business Research Summary* (ISSN 1076-8904) summarizes one of a series of research papers prepared under contracts issued by the U.S. Small Business Administration's Office of Advocacy. The opinions and recommendations of the authors of this study do not necessarily reflect official policies of the SBA or other agencies of the U.S. government. For more information, write to the Office of Advocacy at 409 Third Street S.W., Washington, DC 20416, or visit the office's Internet site at *www.sba.gov/advo*.

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

obtain a loan, they developed a testable hypothesis concerning the average characteristics of white male, women, and minority firm owners whose loan applications lenders had accepted.

Data from the 1998 Survey of Small Business Finances were used. The researchers examined the raw data on outstanding loans, loan applications, and loan denials for evidence of preferential lending. They identified variables to use in estimating the econometric models and examined the characteristics of these data.

They estimated probit models of the probability that a firm owner has an outstanding loan as well as models of the probability of having a loan application denied. Because firm owners must apply for loans before they can be approved or denied, they also presented loan denial models estimated jointly with loan application models, so as to reduce the possibility of "selection bias." They used both the probit and jointly estimated loan denial models to develop predicted loan denial probabilities for firm owners with given characteristics.

Finally, they used t-tests to compare the average characteristics of white male and minority firm owners whose loan applications were approved.

The final report was peer reviewed consistent with the Office of Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at advocacy@sba.gov or (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract to the U.S. Small Business Administration's Office of Advocacy are available at *www.sba.gov/advo/research.* Copies are also available from:

National Technical Information Service
U.S. Department of Commerce
5285 Port Royal Road
Springfield, VA 22161
(800) 553-6847 or (703) 605-6000
(703) 487-4639 (TDD)
www.ntis.gov
NTIS order number: PB2005-105510
Pricing information:
Paper copy and CD-ROM, A04 ($31.50)
Microfiche, A01 ($14.00)
CD-ROM, A00 ($18.95)
Electronic download, A00 ($8.95)

To receive email notices of new Advocacy research, press releases, regulatory communications, and publications, including the latest issue of *The Small Business Advocate* newsletter, visit *http://web.sba.gov/list* and subscribe to the appropriate Listserv.