

Getting Credit For Business

Strategies to Expand Access to
Credit for Small Businesses

June, 2003

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MASSACHUSETTS COMMUNITY & BANKING COUNCIL

The Massachusetts Community & Banking Council (MCBC) thanks the following members of MCBC's Economic Development Committee for their assistance in the preparation of this report: Louis Corapi of Fleet First Community Bank, Martha Sloan Felch of Sovereign Bank, DeAnna Green of the Massachusetts Association of CDCs, Keith Hunt of the City of Boston's Office of Business Development, Pete Kaznoski of Easter Bank, Julia Reade of the Federal Reserve Bank of Boston, Esther Schlorholtz of Boston Private Bank & Trust Company and Kathleen Tullberg of MCBC.

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INTRODUCTION

In March 2003, the Massachusetts Community & Banking Council, the Massachusetts Association of Community Development Corporation's Community Business Network and the Federal Reserve Bank of Boston sponsored "Getting Credit for Business," a forum on strategies to increase access to credit for small businesses. The forum included panel presentations by bankers and representatives of small business assistance organizations and agencies (see Appendix B) and was attended by nearly 70 bankers, technical assistance providers, public officials, bank regulators and small business owners. The purpose of the forum was to help bankers, technical assistance providers, public officials and small business owners better understand the hurdles facing small business owners looking for credit, to identify steps that bankers and community organizations can take to help overcome those hurdles and to encourage more dialogue and stronger relationships between bankers and community-based assistance organization to help small businesses succeed and grow.

This report is intended to share the experience and findings of that meeting with other lenders, business assistance providers and small business owners.

BACKGROUND

Massachusetts Community & Banking Council

The Massachusetts Community & Banking Council (MCBC) was established in 1990 as a collaborative effort between community and banking representatives to encourage community investment in low- and moderate-income and minority neighborhoods. MCBC strives to promote a better understanding of the credit and financial needs in those neighborhoods and to provide information, assistance and direction to banks and community groups in addressing those needs.

MCBC's Economic Development Committee, which includes bankers and city, state, community, non-profit and business representatives (see Appendix A for list of members), works to identify ways to leverage public and private resources to support business growth and development. In October 2002, MCBC published its fourth annual study of small business lending patterns in Boston and neighboring communities. More than 250 copies of *Patterns of Small Business Lending in Greater Boston, 1998-2001* were distributed to bankers, community organizations and public officials.

MCBC Report

Patterns of Small Business Lending in Greater Boston, 1998-2001 analyzed lending data for 2001 and provided comparisons to 1998-2000 lending data¹. The report focused on lending to small business located in lower-income and minority area and, in particular, to lending to very small firms with \$1 million or less in annual revenues.

The report's findings showed some good news:

- Despite a weakening economy in 2001, lending to small businesses in low- and moderate-income areas in Greater Boston remained strong demonstrating continued access to credit in traditionally underserved areas.
- The lending rate (measured in thousands of dollars per 100 firms) in the city of Boston's low-income census tracts increased to 94.4% of the city's overall rate (as compared to 69.5% in 2000).
- The lending rate in the Boston Metropolitan Statistical Area's (MSA) low-income census tracts increased to 98.3% of the MSA's overall rate in 2000 (as compared to 81.4% in 2000).²

Although refinancings of existing loans have traditionally been reported as new loans, renewals of loans or lines of credit – a much more common form of small business lending – were not reported prior to 2001. When loan renewals are included, Massachusetts banks increased their market share of lending to small businesses in 2001.

However, the report's finding also raised some questions:

- There continued to be differences in lending rates³ in low- and moderate-income and minority areas. The rate of lending to very small firms in the city of Boston in 2001 was lowest in moderate-income census tracts and highest in upper-income census tracts. The rate of lending was lowest in minority and mixed areas and highest in white neighborhoods.
- There continued to exist a considerable variation in lending rates in Boston's neighborhoods in 2001. Lending rates in some neighborhoods were as much as four times higher than other neighborhoods.

¹ Copies of the full report are available from MCBC at 617 244-0271.

² The Boston Metropolitan Statistical Area (1120) includes Suffolk County and parts of Bristol, Essex, Middlesex, Norfolk, Plymouth and Worcester counties in Massachusetts and part of Rockingham County in New Hampshire.

³ The measure used in the report is the lending rate to firms with annual revenues of \$1 million or less (referred to as very small firms) measured as thousands of dollars loaned per 100 firms.

- There also continued to exist a considerable variation in lending rates in the 27 cities and towns that surround Boston in 2001. Lending rates in some communities were more than triple those in other locations.
- Of the fifteen largest MSAs across the country, the Boston MSA ranked at or near the bottom in terms of lending to very small firms in 2001. The Boston MSA ranked eighth in terms of total population and eighth in terms of total number of very small firms. At the same time, the Boston MSA ranked twelfth in terms of the volume of loan dollars to very small firms and fifteenth in terms of the lending rate of loan dollars per 100 very small firms.

From these findings, the members of MCBC's Economic Development Committee concluded that we can do better in lending to small businesses. As a first step, the Committee proposed bringing together bankers, technical assistance providers and others to discuss the problems facing small business owners looking for credit and how they might work together more effectively to help address those problems. MCBC's March 2003 forum and this report are intended to help promote and expand dialogue and collaboration among bankers, intermediaries and small business owners to help those businesses succeed and grow.

EXPANDING ACCESS TO CREDIT

The first step in expanding access to credit for small businesses is to understand the role that banks and intermediaries play in the lending process and the hurdles facing small businesses looking for credit.

Understanding the Role of Banks and Intermediaries

Banks want to make loans to business customers, expand their market share and increase the potential for new business. Banks, however, are not all the same. Different banks have different market strategies, different products and different approaches to small businesses. Large banks generally offer a wide range of bank products and services and, for smaller loans, a credit-scored loan product that can offer small businesses a fast turnaround on their loan application. Smaller banks typically offer fewer products and services but can provide a one-on-one relationship with an account officer and less reliance on credit scoring, even for smaller loans.

Intermediaries are organizations that work to assist small business owners looking for bank credit. Intermediaries can offer (often at no cost) one-on-one technical assistance

and counseling (including, in some cases, post-loan counseling), provide education on issues such as accounting, taxation and marketing, and, in general, help small business owners to meet the standards required for a bank loan and to make more effective use of bank products and services. Intermediaries can include community development corporations, whose mission is to increase economic opportunity in their targeted neighborhoods; municipal business assistance programs; Small Business Development Centers and other not-for-profit organizations. Some intermediaries offer their services to all small businesses while others may focus on specific geographic areas and/or types of businesses, e.g. women-owned businesses and micro-businesses. Some intermediaries have, or have access to, loan funds that can provide very small loans and/or subordinated debt.

Understanding the Hurdles Facing Small Businesses Looking for Credit

Many small business owners are not familiar with bank lending procedures and with the information that bankers need to make a positive lending decision. Bankers often find the biggest gaps in:

- **Financial management skills/bookkeeping.** Bankers need to see adequate record-keeping in a format understandable to the lender, e.g. GAAP reporting basis or income tax reporting basis.
- **Credit issues.** Bankers often look to a business owner's personal credit history as an indication of how the borrower handles debt, as well as to the credit history of the business.
- **Taxes and liens.** Bankers see delinquent income, payroll, real estate or other taxes and/or liens as an early sign of cash flow problems and/or a character issue.
- **Collateral.** Bankers look for adequate collateral in the form of personal and/or business assets to ensure a source of funds for repayment. However, in many cases, collateral shortfalls can be overcome by certain credit enhancements.
- **Equity.** Many small businesses are undercapitalized. Bankers want to see retained earnings and cash flow adequate to cover business operations. Bankers will look at the business owner's personal investment as one indication of his/her commitment to the business.

Above all, bankers want to see information that demonstrates **business viability**, including years of operation, profitability, a stable cash flow, retention of capital and an ability to repay the loan. Start-up businesses generally face unique challenges in meeting these requirements.

Technical assistance can often help business owners address these issues. In addition, technical assistance can help a business owner to develop a well-written business plan

that can provide assurances to the lender about the business's viability, current operations and future plans. Technical assistance providers can also help business owners with financial projections and on-going management issues.

Even with technical assistance, some small business owners still face difficulty in meeting bank requirements, including:

- **Credit scoring.** Credit-scored products were developed to respond to business' need for a fast decision, particularly on small loans. However, when a business owner's credit score is the only criteria used to approve or deny a loan, it can be a problem for owners with no credit history (or one limited to untracked categories such as utility payments), with a history of early financing on credit cards, in certain types of businesses (SIC codes) or with little personal wealth.
- **Cultural issues.** First generation Americans, first generation business owners and first generation participants in the formal economy are often unfamiliar with bank lending procedures, may not have adequate financial management practices, may be reluctant to provide financial information and/or may face language difficulties. Some minority business owners may not feel that banks want their business and/or that they can qualify for credit.
- **Small loans.** Some owners of small businesses need very small loans. For them, the only bank product available is often a credit-scored product, with its associated issues. As a result, some very small businesses do not believe that banks and, in particular, large banks want their business.
- **Access to bank decision-makers.** Small business owners often have regular contact with and are well-known by the branch manager in their bank. However, many branch managers have no input into the loan decision process and are not prepared to offer advice on alternative financing and/or the availability of local technical assistance providers.
- **Safety and soundness.** Bankers have internal and governmental regulatory requirements, e.g. portfolio concentrations, and underwriting standards which may influence their decision to lend to certain types of businesses.
- **Economic conditions.** Start-up businesses or businesses entering into a new market may face problems due to local or regional economic conditions that can influence a bank's decision to extend credit. Some retail or other types of small businesses may be particularly vulnerable to local economic changes.

STRATEGIES

Banks, intermediaries and small business owners can all take steps to help expand access to small businesses looking for credit. Not all of the strategies listed below will be appropriate for all financial institutions, all organizations and agencies or all business owners. Some have already adopted action steps similar to those proposed here. Some may not be feasible due to an organization's size or capacity. Several strategies represent long-term commitments, some are short-term projects. However, it is hoped that all financial institutions, business assistance organizations as well as others who play a role in assisting small businesses will use the strategies as a guide to identify ways in which they, individually and in partnership with others, can increase small business lending by more effectively serving the small business owners in their community.

For Financial Institutions

- **Hire and train branch and loan officers who are sensitive to the issues facing small business owners in the bank's market area.** Banks doing business in areas with growing ethnic populations, for example, can hire, support and promote bi-lingual and bi-cultural officers and/or can offer diversity and sensitivity training to include a greater emphasis on cultural issues and concerns.
- **Provide information to intermediaries on bank products and procedures.** Intermediaries are more likely to refer business customers to a specific bank if they are familiar with the bank's loan products and procedures.
- **Consider use of second look procedures to identify loans that could be made with credit enhancements.** Some banks successfully use a second-look process to identify loans that could be approved utilizing credit enhancements, subordinated financing and/or technical assistance. However, timing is an important issue for many small business owners. Timely action by the bank in recommending alternate products and/or technical assistance is, therefore, critical in meeting customer needs and in demonstrating the bank's understanding of those needs.
- **Provide training to branch staff on local business assistance programs, targeted and micro-loan programs.** To provide effective assistance, branch managers and other branch staff need to have information about local technical assistance providers, micro-loan programs and specialized loan products. Branch staff should also be trained on how to refer customers to business loan experts within the bank. Hand-out materials on bank products and procedures, special loan products and local assistance programs would be helpful.

- **Consider using alternative forms of credit (e.g. rent payments, utility payments) for applicants with no credit history.** For years, mortgage lenders have been willing to accept alternative payments (e.g. rent and utility payments) as a demonstration of good credit performance for borrowers with no formal credit history. Small business lenders can use similar measures to evaluate a borrower's character and ability to handle debt.
- **Provide denied applicants with clear information on reasons for denial, steps necessary to correct problems and local business assistance programs that can provide the assistance they need.** Banks can provide encouragement to small business owners by providing clear information on why a loan was denied and what steps can be taken to allow the loan request to be approved.
- **Establish partnerships with local intermediaries to link credit with technical assistance.** Some banks have developed successful partnerships with community-based organizations that link, and fund, technical assistance for small business owners as a condition of the loan. Such programs can provide a win-win situation: the small business owner gets the loan that he/she needs and the assistance to more effectively manage his/her business and the bank gets the assurance that the technical assistance provider will provide continuing assistance.
- **Provide financial support for technical assistance programs.** Many technical assistance programs are now facing substantial cuts in state and local funding. Increased financial support from banks and other local businesses is critical to maintaining the availability and quality of these technical assistance programs. For banks, their support can be a good investment that can help current and future bank customers succeed and grow.
- **Participate in local loan pools for small and/or subordinated loans.** For many banks, loan pools offer a way to assist small businesses looking for very small loans and/or subordinated loans. Typically, participating banks pool their funds, thereby spreading the risk, and, in some cases, oversee the program through their participation on a loan committee. Bankers can also serve on advisory committees.
- **Consider new loan products tailored to meet the needs of local business owners.** For some small business owners, standardized loan products do not meet their needs. Banks can do more to learn about the special needs of local small business owners and to consider loan products and procedures that respond to those needs.

For Intermediaries

- **Provide information to banks on training programs, levels of assistance.** To make appropriate referrals, banks need to know about the scope and level of

assistance available to their bank customers. Written information on counseling and one-on-one technical assistance, workshops, and language capabilities can be used by banks for internal training and/or distribution to business customers.

- **Involve local bankers in discussions about small business credit issues.** Intermediaries can serve as effective go-betweens to help bankers better understand the perceptions, problems and needs of local small business owners. Intermediaries can host meetings with bankers in their offices and/or work with chambers of commerce, boards of trade, Main Streets programs or other local organizations to open discussions. An important by-product: fostering personal relationships that can make customer referrals easier.
- **Provide post-loan counseling.** Banks often do not have the time or the manpower to follow-up and monitor all of their small business loans. Post-loan counseling can help protect business clients and position the organizations as an ally and partner with the bank.
- **Expand outreach and publicity on current assistance programs.** Local bankers, business, neighborhood and political leaders (all potential supporters) and, most importantly, small business owners need to know about the intermediaries in their areas, what they do and how businesses can use their services. Intermediaries can use neighborhood newspapers to highlight success stories (and generate visibility for business customers). They can also use local business and neighborhood meetings to promote upcoming workshops and events. Outreach and publicity can generate new clients and political and funding support.
- **Expand and diversify funding for business assistance programs.** Reductions in state and local funding require all community-based organizations to look for new funding sources. Intermediaries can identify banks and other local businesses that have a stake in a strong, stable business community and ask for their help. Intermediaries can also develop collaborations with local businesses and other technical assistance providers to make the most effective and cost-effective use of available resources.
- **Maintain the quality of the technical assistance provided.** For referrals and for financial support, banks need to know that their customers will be well-served. Local businesses need to know that they can have confidence in the assistance being provided.
- **Develop and maintain an appropriate referral strategy.** Intermediaries need to thoroughly prepare business owners before approaching a bank. Be realistic about what is possible. Intermediaries may need to shop around for the right bank and/or identify other funding sources.

For Small Business Owners

- **Take advantage of educational and training resources available in your community.** The responsibility for getting and using technical assistance and education programs to strengthen business operations and to build management (including financial management) skills ultimately lies with each individual business owner. Entrepreneurs can check with city agencies, local community development corporations and on the Internet for the assistance that best meets their needs (see Appendix C).
- **Establish and maintain a good credit and payment history.** Every business owner should get a copy of his/her credit report. If there are errors, they should be corrected. If there are late payments problems, business owners should be prepared to explain why they happened and what is being done to prevent future delinquencies. If necessary, an owner should seek credit counseling. Business owners also need to ensure that all income, payroll, real estate and other taxes and bills are paid on time.
- **Enlist your branch manager as an advocate for your credit request.** Not all branch managers are small business lending experts. But, even if they are not, small business owners can enlist their help. Business owners should keep their branch manager informed about their business and any plans to apply for credit. Ask the branch manager to identify a business lender. Meet with the lender early in the process to learn as much as possible about the bank's loan products and procedures, information on lending options and/or other assistance.
- **Develop and use a strong business plan.** A good business plan tells a banker that a business owner knows how his/her business is doing, where it is going and how it is going get there. A good business plan can demonstrate performance against goals. A good business plan can inspire confidence in a banker contemplating a loan request. Know what your bank is looking for to demonstrate business viability.
- **Ask for only what you need and what you can afford to repay.** Commercial credit requests are project-specific and need to be justified by the purpose of the loan. For example, if a business needs money for relocation and leasehold improvements, the request should show how the funds will be used and how the funds will increase the sales volume of the business. This sources and uses information will also need to show an ability to repay the amount being requested.

Appendix A

MCBC Economic Development Committee

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Danielle Bailey, Planning & Development Department, City of Newton
Alix Cantave, Boston LISC
Jennifer Capuano, Chelsea Center for Recycling & Economic Development
Louis Corapi, Fleet First Community Bank
Stephen Costello, Bank of Canton
Andrea Daskalakis, Massachusetts Housing Investment Corporation
Erika Eurkus, ACCION
Martha Sloan Felch, Sovereign Bank
Patricia Ford, Urban Edge
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Brenda Jovenich, Citizens Bank
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Margaret Somer, UMass Boston Small Business Development Center (SBDC)
Kathleen Tullberg, Massachusetts Community & Banking Council
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* Co-chairs

Appendix B

Getting Credit for Business
March 25, 2003
Federal Reserve Bank of Boston

Panel Presentation

Moderator:

Anthony Silva, New England Business Editor, WBZ Newsradio 1030 and WBZ-TV 4

Panel Members:

Tony Barros, President, Hyde-Jackson Business Association

Louis Corapi, Director, Small Business Lending, Fleet First Community Bank

Martha Felch, Director, Specialty Banking, Sovereign Bank

Keith Hunt, Assistant Director, Office of Business Development, City of Boston

Pete Kaznoski, Vice President, Small Business Lending, Eastern Bank

Douglas Ling, Executive Director, Asian CDC; Co-Chair, Community Business Network

Kevin Winn, Director of Lending & Technical Assistance, Nuestra Comunidad Development Corporation

Tom Young, Vice President, Boston Private Bank & Trust Company

Appendix C

Greater Boston Business Resources

Bankers, intermediaries and small business owners can all benefit from knowing more about and sharing information on the assistance that is available to local small business owners. MCBC is grateful to the UMass Boston Small Business Development Center for sharing their list of business resources.

ACCION (formerly Working Capital)

56 Roland Street, Suite 300

Boston MA 02129

Phone: 617 625-7080

www.accionusa.org

Provides small business loans to entrepreneurs who cannot access traditional sources of credit

Boston Business Information Center

10 Causeway Street

Boston MA 02222-1093

Phone: 617 565-5615

www.cityofboston.gov

Located at the SBA Boston District Office, provides a business resource library, market research, computer access, business planning and financial spreadsheet software

Business Loan & Equity Fund

Urban Edge

2010 Columbus Avenue

Roxbury MA 02119

Phone: 617 983-3500, extension 318

www.urbanedge.org

Developed and managed by Urban edge for a collaborative of Boston CDCs, the Fund makes loans to and equity investments in existing new local minority business enterprises

City of Boston
Office of Business Development
26 Court Street
Boston MA 02108
Phone: 617 635-2000

www.cityofboston.gov/dnd/OBD

Provides entrepreneurs and existing businesses in Boston's neighborhoods access to financial and technical resources, including the following programs and services:

- Boston Main Streets – a neighborhood-based commercial revitalization program
- Commercial Real Estate Development – loans through HUD CDBG and Section 109/Economic Development programs
- Partners with Non-Profits – Matching grants to non-profits to enhance facilities
- Business Assistance Center – technical assistance grants to businesses, located at 2201 Washington Street, Roxbury MA 02119. Phone: 617 9889-9100
- *Boston Business Resource Guide*, available on-line – provides information on starting a business, regulations and licensing requirements, technical assistance and financing

CDFC/Urban Initiative Fund
100 City Hall Plaza, 3rd Floor
Boston MA 02108
Phone: 617 523-6262

www.cdfc-uif.org

Business loans for minority firms

Center for Women & Enterprise
1135 Tremont Street, Suite 480
Boston MA 021102
Phone: 617 536-0700

www.cweboston.org

Education and training programs for women-owned firms

Commonwealth Corporation
The Schrafft Center
529 Main Street
Boston MA 02109
Phone: 617 727-8158

www.cbwl.org

Training and support for entrepreneurs. The Economic Stabilization Trust provides financing for manufacturers

Commonwealth Institute
69 Newbury Street, 5th Floor
Boston MA 02116
Phone 617 859-0080

www.commonwealthinstitute.org

Education, training, networking for high-growth, women-owned firms

Community Business Network
c/o Massachusetts Association of CDCs
99 Chauncy Street, 5th Floor
Boston MA 02111
Phone: 617 426-0303

www.cdc-cbn.org

A collaboration of 12 community development corporations supporting the creation and growth of small businesses in Boston's neighborhoods

Consumer Credit Counseling Service
8 Winter Street, 19th Floor
Boston MA 02108
Phone: 617 426-6644

www.cccsintl.org

Dorchester Bay EDC Loan Fund
594 Columbia Road, Suite 302
Boston MA 02125
Phone: 617 825-4200

www.dbedc.com

Loans for neighborhood businesses

Economic Justice Project – Free Legal Clinics
294 Washington Street, Suite 443
Boston MA 02108
Phone: 617 988-0606

e-mail: jfeldman@lawyerscom.org

Free business law clinics and business legal services

Hale and Dorr Legal Services Center
132 Boylston Street
Jamaica Plain MA 02130
Phone: 617 522-3003

www.haledorr.com

Free business legal services

JVS Neighborhood Business Builders

105 Chauncy Street

Boston MA 02111

Phone: 617 451-3354

www.jvs-boston.org

Business loans, technical assistance and training for home-based and smaller firms

Nuestra Comunidad Development Corporation

56 Warren Street

Suite 200

Roxbury MA 02119

Phone: 617 989-1205

www.nuestracdc.org

Small business technical assistance and financing to purchase commercial buildings in Roxbury and Dorchester

Pioneer Institute

Center for Urban Entrepreneurship

85 Devonshire Street, 8th Floor

Boston MA 02109

www.pioneerinstitute.org

Business Regulations and Licensing Requirements Guide for Entrepreneurs in selected cities available on-line at

www.pioneerinstitute.org/entre/guide/entre_guide.cfm

Quincy 2000

1250 Hancock Street, Suite 802N

Quincy MA 02169

Phone: 617 847-1454

www.quincy2000.org

Business and economic development planning; business loan funds

Service Corps of Retired Executives

10 Causeway Street

Boston MA 02222-1093

Phone: 617 565-5591

www.score.org

Retired executives consult with start-up and early stage firms

Small Business Development Center & Minority Business Center

UMass/Boston

100 Morrissey Boulevard M-5-403

Boston MA 02125

www.sbdc.umb.edu

One-on-one counseling and low-cost workshops to prospective and existing small businesses

State Office of Minority & Women Business Assistance

10 Park Plaza, Suite 3720

Boston MA 02119

Phone: 617 727-8692, extension 195

www.state.ma.us/somwba

Certification and education programs for minority and women-owned businesses

U.S. Small Business Administration

O'Neil Federal Building

10 Causeway Street, Room 265

Boston MA 02222

Phone: 617 565-5590

www.sba.gov

Financial, technical and management assistance for business owners