The Business of America Is Small Businesses

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As the economic recovery continues at a moderate pace, large corporations are sporting large cash balances and solid balance sheets, while corporate profits are approaching pre-recession highs. Overall, large corporations demonstrated great resiliency and an ability to expeditiously adapt during "The Great Recession." So at this juncture in the economic cycle, more focus needs to be placed on small businesses. Back in 1925, Calvin Coolidge, the 30th U.S. President quipped, "After all, the chief business of the American people is business." Perhaps, today, the chief business of America is *small* business.

Recent media attention has focused on the crises in Japan, the Middle East, and Europe, all of which could potentially dampen the U.S. economic recovery. However, more focus on small businesses is necessary to sustain this economic recovery for Americans. According to the *Kiplinger Letter*, "One factor contributing to less than robust post-recession economic growth is that small businesses are not providing their usual contributions to job gains. Small businesses generally employ approximately half the workforce and account for two-thirds of new hiring. Tight standards on home equity loans have precluded a widely used financing method for small companies, making it difficult for them to expand even if prospects are good."[1] The sustainability of the economic recovery will depend a great deal on the fate of small businesses, which in turn, depend a great deal upon community banks for small business lending.

Enacted into law as part of the Small Business Jobs Act of 2010 (the Jobs Act), the Small Business Lending Fund (SBLF) is a $30 billion fund that encourages lending to small businesses by providing tier 1 capital to qualified community banks with assets of less than $10 billion. The SBLF is designed to support community banks, community development loan funds, and small business, offering incentives for community banks to increase their lending to small businesses.[2] The program is not available to banks that are currently under another Treasury funding program and will require such program to be extinguished in order to receive SBLF funding. While banks will be able to refinance TARP CPP funding with lower cost funding, the smaller banks that benefitted from Community Development Capital Initiative (CDCI) funding up to 5% of their risk-weighted assets may not benefit from the SBLF, since the 2% interest rate

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[1] Forecasts for Management Decision Making, *The Kiplinger Letter*, March 25, 2011, Vol. 88, No. 12.
[2] U.S. Department of the Treasury Resource Center, http://www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx.

is fixed for eight years and is not predicated on any increased small business lending requirements.

A community bank considering participation in the SBLF should evaluate the risks and rewards of the program. The rewards are attractive if the participating community bank increases its lending to small businesses. The initial dividend rate will be 5%, at most. But if a bank's small business lending increases by 10% or more, then the rate will fall to as low as 1%. Banks that increase their lending by amounts less than 10% can benefit from rates set between 2% and 4%. However, if qualifying business loans do not increase in the first two years, the rate will increase to 7%. In addition, an exit strategy is necessary, because the rate will increase to 9% if the bank has not already repaid the SBLF funding within four and one-half years of receipt.

Community banks should also consider small business loan demand. The trade association, SMC Business Council, released its survey of Pennsylvania small business owners on March 28, 2011, which shows that business leaders are optimistic but still cautious about the future: "Small business owners showed increased optimism through their expectations for same or slightly increasing sales and profit margins. Fifty-six percent expected revenues to grow, while 30% believed that revenues would remain level, and 14% expected revenue declines. However, only 33% planned on making capital acquisitions."[3]

The National Small Business Association's (NSBA's) *2010 Year-End Economic Report* was consistent with the SMC Business Council's survey: "The NSBA revealed that there was significant growth in the number of small businesses reporting an increase in revenues from 26 percent in July to 39 percent in December. Similar trends in net profits were noted during the same time period. In addition, 54 percent of the respondent small business owners were projecting an increase in revenues over the coming 12 months."[4]

The community bank should also consider small business loan supply. The current Federal Reserve "Senior Loan Officer Opinion Survey" (January 2010) determined that approximately 10 percent of large banks eased their lending standards to small businesses. [5] However, the survey revealed that all banks eased lending standards significantly more for large companies than small. This may present strong opportunities for community banks to serve a niche in small business lending.

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[3] *Pennsylvania Small Business Survey*, SMC Business Council, March 28, 2011.
[4] *2010 Year-End Economic Report*, National Small Business Association.
[5] "The January 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices," http://www.federalreserve.gov/boarddocs/snloansurvey/201002/default.htm.

In addition to considering lending strategy and loan supply and demand, community bankers must evaluate the potential need for additional resources to conform to SBLF reporting requirements. For instance, it may not be cost-effective if additional employees are required to report and monitor qualifying small business loans to ensure compliance with the SBLF requirements.

Additionally, the risk of a bank being unable to make its SBLF dividend payment must be considered. A bank holding company (BHC) is required to downstream at least 90 percent of the SBLF funds received into its bank, which could present challenges to the BHC when its subsidiary bank's net income is not sufficient to fund the dividends. SR Letter 09-4, *Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at BHCs*, provides guidance for management to follow when dividends could have a negative impact on the financial condition of the institution. The BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that meets the criteria in SR Letter 09-4. Failure to do so could result in a supervisory finding that the organization is operating in an unsafe and unsound manner.

When historians analyze Calvin Coolidge's words, they debate what he meant in his statement about the business of America. Some believe that he placed too much emphasis on business and wealth, while others believe that he emphasized that wealth was fine—as long as it was put to good use.[6] Overall, the SBLF fund, if used appropriately, is a program that will benefit both community banks and small businesses. Community banks will have the opportunity to expand their markets at a relatively low cost of capital, and small businesses will be lent much-needed capital to help them grow and innovate. In order for this program to be successful, it will be important that the rules are not changed midstream, community banks assess the risks and rewards of the program, and participants make a good faith effort to legitimately get the SBLF money in the hands of qualified small businesses.

[6] Bittinger, Cyndy, "The Business of America is Business?," http://www.calvin-coolidge.org/html/the_business_of_america_is_bus.html.