

INTUIT FUTURE OF SMALL BUSINESS REPORT

RESEARCH ROUND TABLE: SMALL BUSINESS CREDIT OUTLOOK

SMALL BUSINESS CREDIT: IT'S A CRUNCH, NOT A CRISIS

Credit remains available to fuel small business dreams, if you know where to look – and how to qualify.

America needs small businesses. And small businesses need credit – to start, to grow, to innovate. Credit is more than just a way to pay bills. It gets them through seasonal slow periods. It pays for expansion. And, as we found in our previous report, it is used to amplify innovation through pursuing new opportunities or investing in new ideas, methods or markets. It's more than a tool for today's survival. It's the key to tomorrow's success.

With some of the world's largest companies lining up to receive tens of billions of dollars in federal bailouts, businesses along Main Street USA – often considered the backbone of the American economy – are scrambling to obtain credit.

We recently interviewed those with the most at stake: small business owners who are seeking credit and financial industry executives who can provide it. While large financial institutions have dramatically cut their small business lending activities, we found that smaller lenders – typically community banks and credit unions – were still actively providing small business credit and credit services.

To explore this further, Emergent Research and Intuit's financial institutions division, Digital Insight, invited about two dozen leaders from small and mid-sized financial institutions to several round-table discussions on the current trends in small business lending. Our purpose: to better understand how smaller lenders see the small business credit market.

The discussions revealed that:

- **Have money, will lend:** Most of the smaller lenders represented at the discussions are actively and even aggressively seeking to provide credit and credit services to small businesses. Several mentioned they expect 2009 to be a record year for small business lending at their financial institution.
- **Lending standards remain high:** Smaller lenders are conservative lenders. Credit qualification standards at most of the banks represented aren't any more rigorous now than in the past, but small businesses take note: These institutions have stringent underwriting criteria for granting credit.
- **Unsecured credit disappearing:** Small business access to cheap, uncollateralized credit – especially through consumer credit cards – is being cut. Small businesses that rely on unsecured loans and consumer credit cards will see reduced access to credit.
- **Small Business Administration loans – a mixed view:** Lenders differ on the value of offering SBA loans. Some find it lucrative; others see it a drain on their business. Small businesses looking for an SBA loan through a bank or credit union need to find institutions participating in the SBA loan program.

SMALL BUSINESS CREDIT AVAILABLE TO QUALIFIED BORROWERS

Community banks and credit unions are keen on lending to qualified small businesses. Unlike most large banks, these lenders traditionally steered clear of the creative financial products that now burden much of the financial services industry with large losses and toxic assets. Because of this, these smaller banks have the assets and balance sheet resources to continue lending.

To qualify, borrowers face a detailed review of their assets, liabilities and business plans. Existing businesses with positive cash flows get preferred status. So do companies that offer tangible assets as collateral.

This scrutiny isn't new, participants said. But what has changed is the competitive landscape for loans. Consumer credit is becoming harder to obtain. Larger banks are either withdrawing from the small business market or offering fewer lending options. Faced with fewer choices, small businesses are increasingly turning to community banks and credit unions as a key source for loans. At the same time, borrowers must adjust and lower their expectations back to the years before the credit boom. They need to think more strategically about assets and cash flow projections when speaking to lenders.

This may be tough for small businesses with fewer than five employees, including sole proprietorships. Most will find it difficult to meet the traditional asset and cash flow-based lending requirements and will need to develop a relationship with their banker to determine ways to qualify for credit.

COMMUNITY BANKS, CREDIT UNIONS DIVIDED ON OFFERING SBA LOANS

Round-table participants are divided on the value of SBA loans within their portfolio. Some feel that the SBA loan program requirements, lending process and related efforts are too burdensome. The added costs and effort deter these institutions from actively promoting SBA loans.

A smaller subset views SBA loans more favorably. Looking beyond the added effort, they see SBA lending as an opportunity, fulfilling a need that other financial institutions rejected. These banks and credit unions established processes and procedures to handle the added requirements of SBA loans.

In some cases, these smaller institutions outsource the logistics to third parties who specialize in SBA loans. Member Business Lending, for example, is a credit union service organization that helps some 30 credit union members sell and administer SBA loans. This allows community banks and credit unions the ability to provide SBA small business loans efficiently and profitably.

Therefore, small businesses looking for SBA loans should identify financial institutions that actively support those loan programs.

SMALL BUSINESSES CAUGHT IN CONSUMER CREDIT PINCH

Many small businesses rely heavily on consumer credit – including personal credit cards and home equity loans – to bankroll day-to-day operations. Lured by lower qualifying standards and fees, small businesses now owe roughly \$150 billion on consumer credit cards.

But the lure is fading. The same factors that make conventional loans more difficult to obtain are forcing lenders to lower their exposure to consumer credit card risk. They're slashing credit limits, raising interest rates and making it harder to qualify for credit cards.

Similarly, small businesses are finding it tougher to use home equity loans as an easy source of quick cash. More stringent refinancing requirements and decreasing home values make this option far less available.

WHAT THIS MEANS FOR SMALL BUSINESSES

Credit markets, frozen in the fall of 2008, are thawing in 2009. Community banks and credit unions can be an excellent and accessible source of credit for small businesses who meet their lending criteria. They want the business and are ready to lend. Businesses that can demonstrate the ability to manage assets and cash flow will find credit is still available, although not unlimited.

Credit is available for small businesses able to secure loans with collateral, a solid cash flow, or both. Community banks and credit unions see the small business segment as an important part of their portfolio, even as larger banks retreat from this market. These local lenders are uniquely able to work with small business owners – to hear their growth plans, develop a relationship, and respond to their business plans.

But smaller lenders can't do it themselves. They simply don't have the asset base to replace the large lenders. So even with community banks and credit unions looking to expand small business lending, small business credit availability will remain tight.

Even with smaller lenders ready to extend credit, the reality is that the smallest of small businesses – those with five employees or less – often will not qualify on paper for business credit from these institutions. They'll be hampered by a lack of operating histories, positive cash flows or collateral. Instead, these personal and micro businesses will need to rely more heavily on relationships with their bankers or look elsewhere for credit.

Improved credit access – and knowing how to get it – will help drive small business growth and U.S. economic recovery. And that credit will support today's small business innovators and give birth to those in the future.

This research round table is part of the broader Intuit Future of Small Business project. This research and related materials are available at www.intuit.com/futureofsmallbusiness

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