How to Get Small Businesses Ready to Borrow

By Claudia Viek, American Banker, MAR 16, 2012

These days, banks complain there is little demand for loans and that small businesses are not creditworthy due to the effects of the recession, such as loss of home equity, reduced cash flow, etc.

The bankers may be right about this, but there are things they, along with regulators, can do to remedy the situation. In the process, they'd be helping to restart the engine of job growth in this country.

In my 25 years of experience, I have learned the first step to success for small start-up businesses is what I call business assistance. Organizations such as small business development centers, women's business centers, micro enterprise programs and community colleges provide training and services to a wide variety of entrepreneurs.

For young businesses to succeed, they first need business management tools, networks and coaching. Only after they have these things are they ready to take out loans.

For example, Jose and Josie Rodriguez own King City Tires in the southern Salinas Valley in California in a town of 12,000 residents. Their region is very distressed with an official unemployment rate of over 16% and a real rate closer to 30%. King City Tires found a niche servicing tractors in the fields, 24/7. It took two years of business counseling from El Pajaro Community Development Corp. for the Rodriguezes to qualify for a $1.5 million Small Business Administration loan to expand their business. Now they employ 16 full-time workers.

Nationwide, businesses that receive assistance have an 80% success rate as compared with the 50% to 80% mortality rate for small businesses overall. A forthcoming study by University of Virginia's Darden School of Business looked at borrowers who obtained loans from nonprofit, nonbank community development financial institutions. The study found that borrowers who received business technical assistance were 40% more successful than those who did not.

The U.S. is home to 25.5 million micro-businesses with five or fewer employees. That's 88% of the nation's businesses. These enterprises employ 31 million people. To stimulate job creation, policy makers must understand that start-ups create jobs on a net basis; that help for the very-small-business sector needs to be part of the conversation about job creation; and that business assistance needs to be a crucial part of the help for the very-small-business sector.

Unfortunately, the President's fiscal 2013 budget cuts funding for some business technical assistance programs and eliminates other programs altogether. We understand the pressures of deficit reduction mean cuts across the board in government services. Therefore, the private sector, and in particular financial institutions, should step up to provide financial support for these critical business assistance services, in the form of grants.

An increase in business training would help business owners retool their business model or improve their financial skills, thus improving the pipeline of loan-ready borrowers. Such actions would certainly improve the public's perception that banks care about small businesses.

What the financial services regulators – the Federal Reserve, the Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency – can do is to amend Community Reinvestment Act regulations to give the same credit to grants for business technical assistance programs as they do for capital investments. These regulatory changes would provide incentives to banks to direct more funding to those organizations in our communities that have proven effective in assisting start-ups and Main Street businesses to become loan-ready.

"[Technical assistance] support should get equal weighting for CRA regulatory compliance," Julius Robinson, the senior vice president for CRA at Union Bank of California, told me. "Lending money is one thing but if the capital is not put to proper use, economic development sputters and ultimately fails."

The Brookings Hamilton Project estimates that 11 million jobs need to be created until we return to a pre-recession level of unemployment. If we continue to add jobs at the current rate, we won't close the gap until 2020. To close the jobs gap more quickly, traditional financial institutions, the administration and our leaders, whether Democrat or Republican, need to recognize and support our greatest potential job creators – the small and very small businesses.

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