SMALL BUSINESS LENDING DURING THE FINANCIAL CRISIS: THE IMPACT ON BUSINESSES IN URBAN MINORITY COMMUNITIES (SUMMARY)

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SUMMARY

SMALL BUSINESS LENDING DURING THE FINANCIAL CRISIS:
THE IMPACT ON BUSINESSES IN URBAN MINORITY COMMUNITIES

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Principal Topic and Method

Do banks redline urban minority communities? While redlining per se has disappeared in recent decades, the view that financial institutions are averse to lending in minority neighborhoods persists. Regarding bank lending to small businesses specifically, scattered evidence of varying quality supports the hypothesis of such lending aversion, but this evidence is dated and not comprehensive (see, for example, Bates, 2011; Immergluck, 2004). Examining firms located in metropolitan areas, we have analyzed Kauffman Firm Survey (KFS) data, contrasting the outcomes of loan applications submitted to financial institutions by small firms located in minority neighborhoods to those of businesses in predominantly nonminority areas. KFS data currently provide the only nationally representative database containing firm-specific information on geographic location as well as dollar amounts and sources of debt capital actually being used by small firms. The KFS data track small businesses starting operations in 2004 and their particular strength is inclusion of annual follow-up information on new capital raised by individual firms in the years subsequent to startup.

Results and Implications

We have investigated the specific hypothesis of tightening credit standards affecting firms located in minority communities disproportionately, relative to cohort firms in other urban geographic areas. In fact, bank loan approval rates among small-firm applicants located in minority neighborhoods did fall disproportionately in 2009 and 2010 relative to earlier years; our analysis attempts to disentangle the effects of tightening loan approval criteria from declining applicant credit quality. While our findings demonstrate that lending criteria did tighten in 2009 and 2010 -- relative to the 2 preceding years -- this tightening was across-the-board and not disproportionate in minority neighborhoods. Additionally, our findings demonstrate that financial institutions during 2007-2010 appeared to be more sensitive to the credit needs of minority-owned firms when these small businesses were in fact located in minority communities, in comparison to those located in nonminority areas. Controlling statistically for credit risk factors, the minority-ownership trait was not a significant determinant of loan application approval likelihood within the minority neighborhood geographic context; the minority ownership characteristic, in contrast, was a strong negative predictor of loan approval when the applicant firm was located in urban geographic areas outside of minority communities. While the spirit of equal treatment implicit in the Community Reinvestment Act (CRA) may indeed be benefitting minority business borrowers operating in minority neighborhoods, the practice of treating loan applicants in a color-blind fashion appears to apply primarily to high net-worth minority owners and it was apparent throughout the rest of metropolitan America.

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