



ANALYSIS-Credit seen drying up for U.S. small business

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UNITED STATES - By Nick Carey

CHICAGO (Reuters) - As losses mount at American banks and the pain of the credit crisis spreads from housing and finance to the broader economy, many small companies complain it is increasingly difficult to obtain loans.

Tighter credit could not only help to push the United States into recession, but prolong the downturn as ideas for new businesses get stymied once entrepreneurs sit down with local bank managers, small business representatives warn.

"In recent weeks we've seen banks becoming more cautious and the pace of lending has slowed considerably," said Weldon Gibson, a consultant at the Lamar University Small Business Development Center in Texas. "They are demanding higher credit scores and want more collateral before lending."

Small businesses are a linchpin of the U.S. economy because they form the backbone of the country's jobs market and are crucial for job creation. According to U.S. Census Bureau data, in 2002 the United States had 112 million paid employees. About 56.4 million of them, or just more than 50 percent, worked at companies with fewer than 500 employees.

In the wake of the U.S. housing crisis and the shock waves this has sent through the financial sector, evidence has mounted that, as well as facing the strains of a weak economy and the pain of high fuel costs, many small companies face a tough time getting loans.

"If you have a great credit score, a solid business plan and a bank that hasn't been burned by the housing crisis, then you should be able to get a loan," said George Cloutier, chief executive of Orlando, Florida-based American Management Services Inc, a small business consultant.

"If you don't have good credit or your bank made some bad choices in the property boom, you'll be told to look elsewhere."

The screws have tightened even more on small companies seeking loans as the financial sector has been rocked in recent weeks, culminating in the takeover by

regulators of mortgage lender **IndyMac Bancorp** (nyse: IMBPR - news - people) Inc and a government rescue plan for mortgage finance giants **Fannie Mae** (nyse: FNM - news - people) and **Freddie Mac** (nyse: FRE - news - people) .

"From what bankers have told me, this (tougher approach to loans) is because they are under much greater scrutiny from regulators after the excesses of recent years," Lamar University's Gibson said.

CONSERVATIVE APPROACH

According to a quarterly U.S. Federal Reserve survey of senior loan officers in April, 52 percent of respondents said they had tightened lending standards for companies with annual sales of less than \$50 million, up from 30 percent in January.

According to the U.S. Small Business Administration, for the year up to July 11, about 10 percent fewer 7(a) loans were issued than in the same period in 2007. These are the SBA's most popular loans and -- with a government guarantee covering up to 85 percent -- low risk for lenders.

"Our loan volumes reflect the condition of the overall economy," said SBA spokeswoman Christine Mangi. "Credit is tightening and there is less demand for small business loans."

For the past four years, Dee Smith of Charlotte, Michigan, has run a small construction company that "flipped" homes -- buying, renovating and selling homes at a profit -- as well as a bed & breakfast guest house and a small consulting business. Up until this spring, he flipped five or six houses a year.

But when he approached his local bank in April asking for a mortgage loan covering 77 percent of a \$175,000 home purchase, he was told the bank's new limit was 75 percent and his application was rejected.

"Although I have been with the same bank for many years and have run all my loans through them, I was told times have changed and they couldn't give me the loan I wanted," Smith said. "They got burned by the housing crisis and the rules of the game have changed."

Smith has closed his construction company until further notice. The guest house and consulting company remain open as they can be run for the foreseeable future without any loans.

[According to data provided by Sageworks Inc, a financial information business that compiles information on private companies, its private sector index of more than 100,000 companies showed the sector's interest](#)

coverage ratio fell to 7.2 percent on June 30 from 8.1 percent on May 29. The lower the ratio, the greater a company's debt expense burden.

This data suggests either higher debt levels or that companies are paying more to service their debt.

In April, the Discover Business Watch poll found that 73 percent of business owners who extend lines of credit to customers had received delayed payments or requests to delay payments, up from 64 percent last September.

"It appears small businesses are under pressure at both ends," said Ryan Scully, director of Discover's business credit card. "They are finding it harder to get credit while doing everything they can to ease conditions for their customers."

But not everyone agrees credit is harder to come by for small businesses. Earlier this month, a National Federation of Independent Business poll showed "no evidence of credit problems has appeared on Main Street. It is a Wall Street issue."

But the NFIB seems to be in a minority.

"In the past few weeks, we haven't seen further deterioration of credit conditions, but they are certainly not improving either," said Todd McCracken, head of the National Small Business Association.

McCracken said that, with so much uncertainty over the U.S. economy, many small companies are "shelving expansion plans and are less likely to be looking for credit. Things would be a lot worse if there were a lot more business owners out there in need of loans."

"My main concern at this point is what happens when the economy starts to pick up and thousands of companies need credit, fast," he added. "If banks aren't ready to lend them money, that could really stifle any recovery." (Editing by Andre Grenon)