Commercial Lending Distance and Historically Underserved Areas

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Introduction (1)

Small business credit access is a policy priority.

Economic rationale:

➢ Severe asymmetric information problems – historically used bank-borrower relationships used to mitigate.
➢ Large, centralized banks poor relationship lenders – area demographic information may be quality proxy.
➢ Problems may be especially acute for firms operating in historically underserved areas.

However, small business credit markets may be in the early stages of transformation.
➢ Greater reliance on hard information (credit scoring).

Introduction (2)

Prior research:

➢ Small business credit scoring introduced and now widely used.
➢ Small business credit scoring may reduce information gaps and/or underwriting costs.
➢ Small business credit scoring associated with increased lending, especially out-of-market.
➢ Increased small business borrower-lender distance.

We study recent commercial lending distance trends with a special focus on borrowers located in historically underserved areas.

Data

Large sample of SBA guaranteed loans: 1984-2001
- ➢ 27,000 loans; 5,000 banks.
- ➢ Not strictly representative sample.

Borrower Information: location, SIC, corporate structure, number of employees, and firm age.

Lender Information: location, SBA certification level.

Loan Information: size, maturity, guarantee %, low-doc.

Calculate "as the crow flies" borrower-lender distance; relate to borrower, lender, and loan characteristics and borrower census tract information.

Figure 1

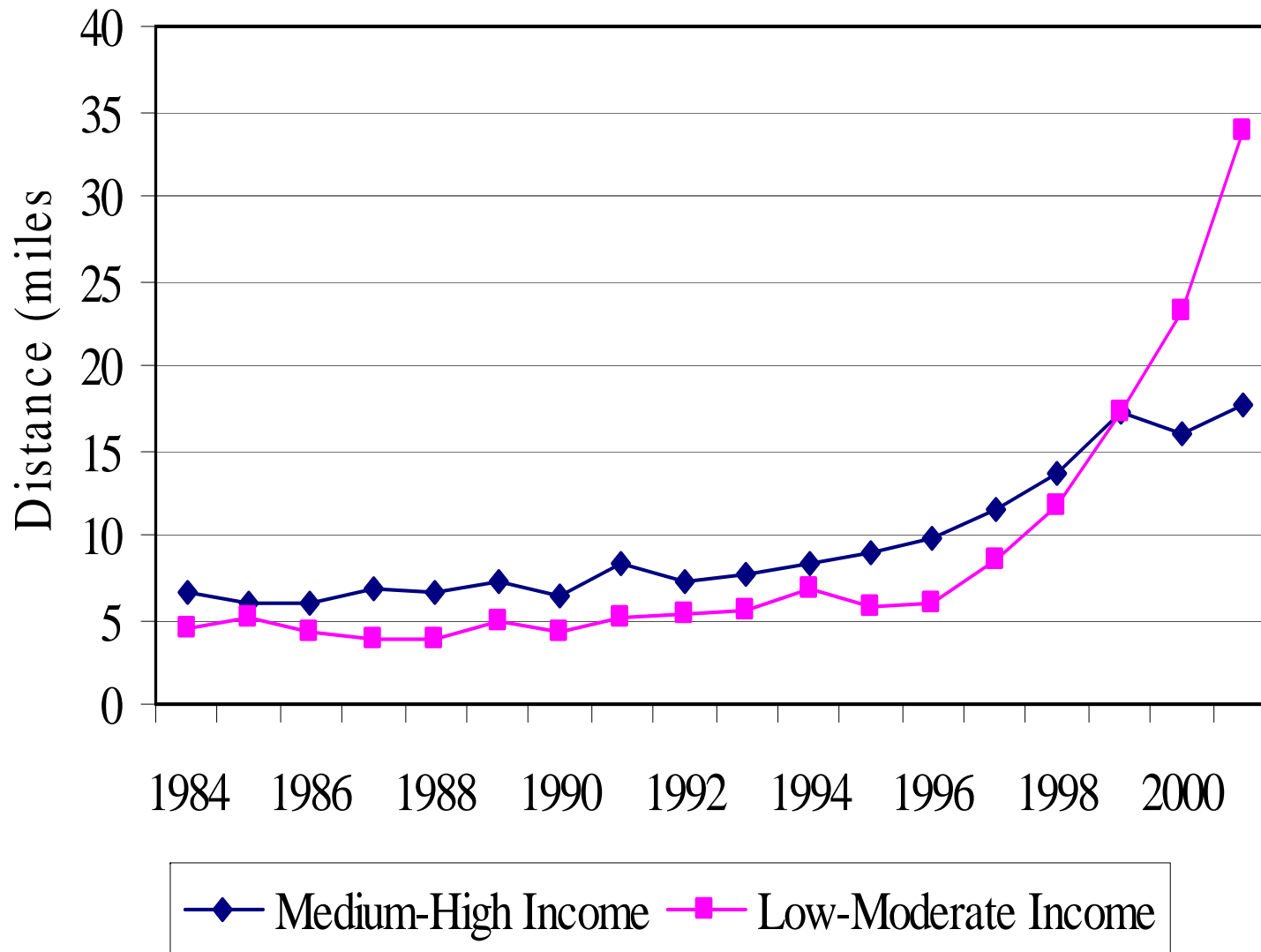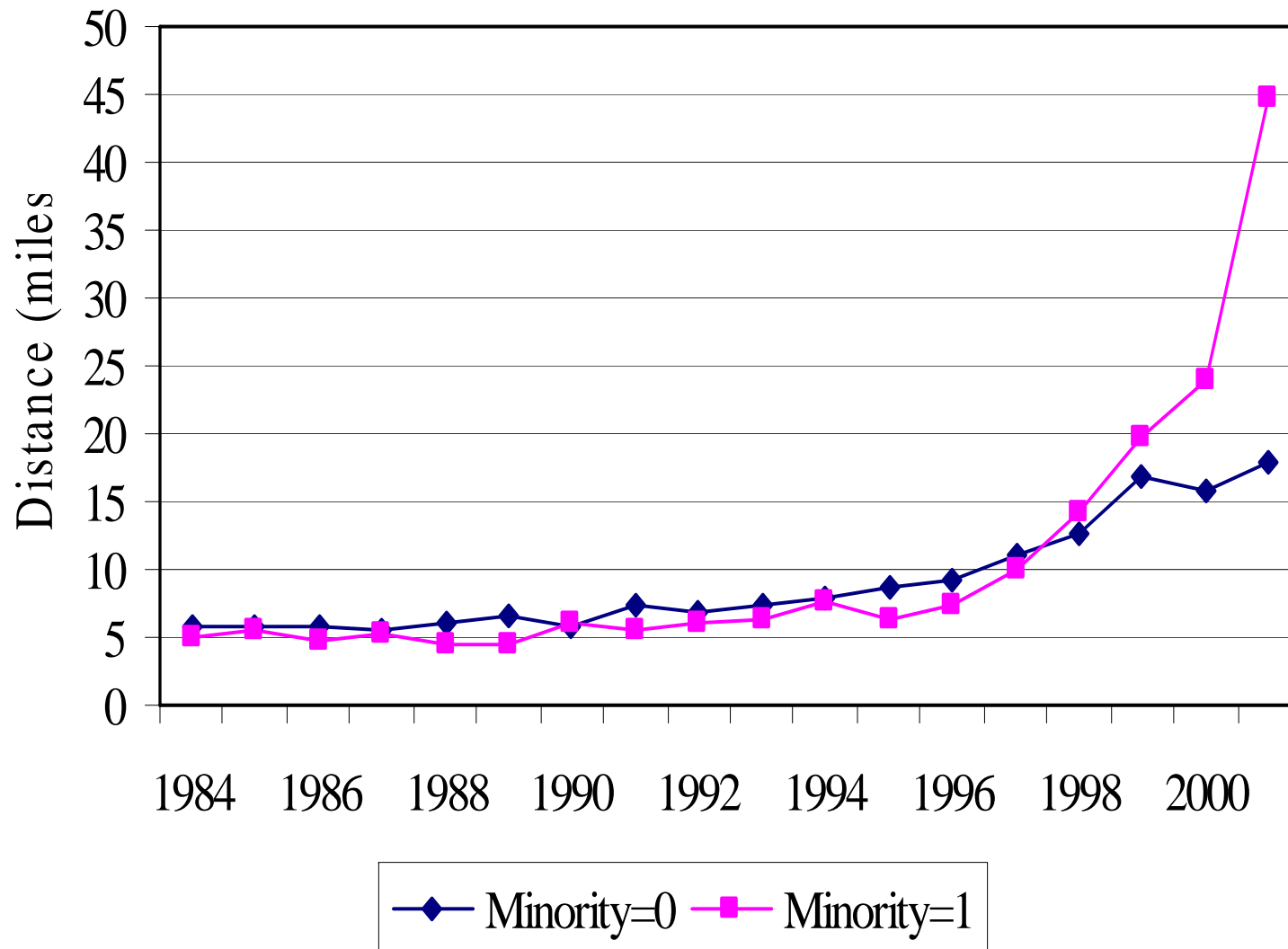Median Borrower-Lender Distance, by Tract Income

Figure 2

Median Borrower-Lender Distance, by Tract Race

Regression Analysis (1)

We relate borrower-lender distance (log miles) to:

➢ TIME:
  ➢ Continuous variable (Year = 0, …, T);
  ➢ Discrete annual dummies; and
  ➢ Discrete segments (Pre-/Post-1996).

➢ LMI: Indicates whether the borrower is located in a low-/moderate-income census tract.
➢ MINORITY: Indicates whether the borrower is located in a predominately minority census tract.
➢ Interactions of TIME, LMI, and MINORITY.

➢ Several control variables capturing borrower, lender, and loan characteristics at origination.

Regression Analysis (2)

Estimate three basic models using OLS; delineated by TIME specification.

 ➤ Several sub-specifications.

Use only the loans originated between 1992-2001.

➤ Figures 1 and 2 suggested little variation in distance over time between the mid-1980s and mid-1990s.

➤ Including data from earlier years provides little additional information for regressions.

➤ Structural underpinnings of the banking industry have been in flux for the past 25 years -- minimize impact of these changes.

Summary of Results (1)
Ln(Distance) = *f*(Time, LMI, Minority, Controls)

	Table 4	Table 5	Table 6
Time (Continuous)	Positive*		
Time (Dummies)		Positive*	
Time (Post-1996)			Positive*
LMI	Negative*	Negative*	Negative*
LMI*Time	Positive*	Mixed	Positive
Minority	Negative	Positive	Positive
Minority*Time	Positive*	Positive	Positive*

* Statistically significant at the 5 percent level.

Summary of Results (2)

Coefficient estimates for LMI are negative -- consistent with a "soft information effect" <u>not</u> "access to lenders effect".
  ➤ However, LMI*TIME is not generally important.

No general effect for MINORITY; except in some cases where LMI is excluded from regression.
  ➤ However, MINORITY*TIME is positive.

Our results are robust to excluding loans with the farthest distances (1% and 5% truncation).

Some evidence that credit-scoring may be playing a role in increased distances, especially for historically underserved areas. (Based on Loans < $100,000.)

Conclusion

We study evolution of small business borrower-lender distance using a sample of SBA loans.

➢ Special focus on historically underserved areas.

Consistent with prior research, we find that distance has increased.

➢ This is especially true for LMI and MINORITY areas – may be linked to credit scoring.

Findings consistent with increased competition – especially for borrowers located in historically underserved areas.