U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF ADVOCACY

REGULATION • RESEARCH • OUTREACH

SMALL BUSINESS FINANCE

Frequently Asked Questions

1. Why do small businesses seek financing?

Small businesses borrow for four principal reasons: to start a business, purchase inventory, expand a business, and strengthen the firm's financial foundation. Firms choose different means of financing depending on the intended purpose. Small businesses' financing options typically fall into two categories: debt and equity. Other unconventional sources can also play a critical role in meeting a firm's financial needs.

2. How large is the small business financing market?

Small business accounts for a significant amount of all business borrowing. Bank loans going to small businesses totaled almost $600 billion in 2015. Small businesses also draw from other sources, such as finance companies, angel capital, and venture capital. While the percentage of these funds that go to small businesses is unknown, the total funding from these sources accounted for $593 billion in 2015 (Figure 1). Additional sources of small business finance include personal savings, personal and business credit cards, online lending platforms, loans from family and friends, and home equity.

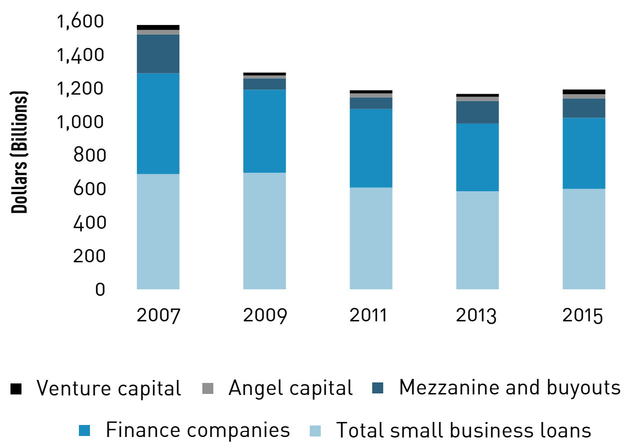
3. What percentage of small businesses use financing?

According to the National Small Business Association, 73% of small firms used financing in the last 12 months. Small business financing needs vary greatly. About one-quarter use no financing, and for others, the lack of capital causes difficulties growing the business, financing future sales, and keeping adequate inventory.[1]

4. How are new businesses financed?

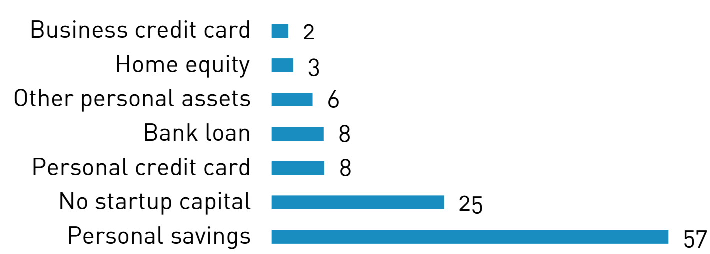
Startups make heavy use of personal equity and traditional debt, with over half using their own personal savings (Figure 2). Census Bureau data show that employers made greater use of financing than did nonemployers, but also continue to rely on personal savings. Roughly 30% of new nonemployer firms and 7% of employer firms used no startup capital.

Figure 1. Financing by Category



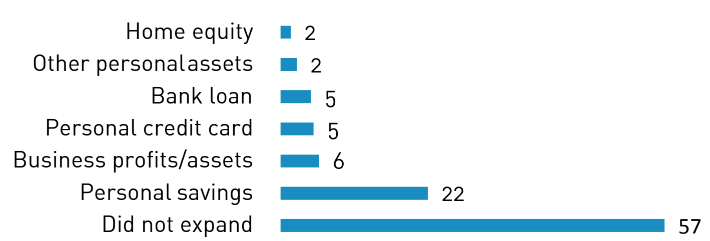
Total small business loans = all loans outstanding under $1 million.
Finance company lending = all business receivables outstanding.
Finance company: any nonbank financial institution that supplies credit or lease financing to American households and businesses.
Buyout: the purchase of a controlling interest of a company by an outside investor or management team.
Mezzanine: a layer of financing that has intermediate priority (seniority) in the capital structure of a company.
Source: Federal Deposit Insurance Corporation (small business loans); Federal Reserve G20 Survey (finance company lending); National Venture Capital Association, 2016 Yearbook (mezzanine, buyouts, and venture capital); Center for Venture Research, University of New Hampshire (angel capital).

Figure 2. Top Sources of Startup Capital (Percent)



Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

Figure 3. Top Sources of Expansion Capital (Percent)



Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

5. How do existing businesses finance expansion?

Existing businesses use similar financing vehicles as startups to finance expansion. Personal savings are the most common source of expansion finance, followed by reinvestment of business profits (Figure 3). The percentage of firms using expansion capital is much smaller compared with those starting new businesses.

6. How much capital do startups need?

Small businesses' startup capital needs vary, and employer firms tend to use more than nonemployers. More than 43% of employer firms used over $25,000 in startup capital compared to only 12% of nonemployer firms (Table 1). A relatively large percentage of both employers and nonemployer businesses used a small amount of startup financing (less than $5,000), and a sizeable share of both used no startup capital.

7. How much debt do small businesses carry?

63% of all small employer businesses have some debt. The amount of debt that a business carries varies with size and age. Three-quarters of firms with 50 or more employees carry debt, compared with 60% of firms with fewer than 10 employees. Younger firms tend to carry far less debt than their older counterparts (Figure 4).

8. How important is credit card financing to small firms?

Credit cards are used extensively, but they represent only a small portion of total finance. A recent report by the National Small Business Association shows that credit cards were one of the top three sources of short-term capital used by small businesses.[2] However, the Census Bureau finds them to be of lesser importance for startup and expansion capital (Figures 2 and 3).

9. How are veteran-owned ventures financed?

Veteran-owned businesses are similar to other businesses in their use of credit for startup and expansion. For example, for firm expansion, 4.5% of veterans used personal credit cards and 4.3% used bank loans; the comparable figures for all firms were 5% and 4.5%.

10. How are women-owned ventures financed?

Women are more likely than men to start businesses without seeking financing (Table 2). Female business owners, like their male counterparts, largely depend on personal finances, but they are only half as likely as men to obtain business loans from banks. This may put women-owned businesses at a disadvantage since an early relationship with a bank may be critical for future business financing. Businesses that are equally owned by men and women are more likely to use credit cards, and far more likely to put up personal assets as a source of financing (for instance, home equity).

Table 1. Amount of Capital Needed to Start a Business (Percent of Firms)

	Firms with Employees	Nonemployer firms
Less than $5,000	22.5	39.5
$10,000 to $24,999	14.2	7.1
$50,000 to $99,999	11.5	2.8
$250,000 to $999,999	7.3	1.8

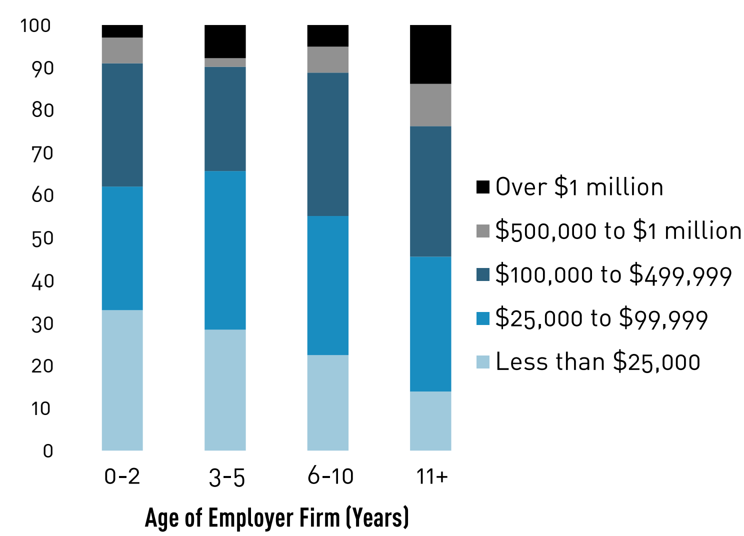
Note: Figures recalculated to account for "don't know" responses. Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

Table 2. Type of Financing Used by Male-, Female-, and Equally-Owned Startups (Percent of Firms)

	Male-owned	Female-owned	Equally male and female-owned
Personal savings	59.0	51.3	67.8
Bank loan	8.5	3.6	14.6
Personal credit card	7.4	7.3	9.4
Other personal assets	5.8	4.5	10.3
Home equity	3.0	2.1	7.2
Business credit card	2.5	1.9	3.5
None used	21.9	34.3	11.2

Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

Figure 4. Employer Firm Debt by Age (Percent)



Source: 2015 Small Business Credit Survey: Employer Firms, Federal Reserve Banks, 2016.

Table 3. Type of Financing Used by Minority Startups (Percent of Firms)

	Hispanic	African American	Asian	Non-minority
Personal savings	55.4	54.8	61.7	57.2
Personal credit card	8.5	8.9	7.6	7.3
Bank loan	3.6	3.2	7.0	8.1
Other personal assets	4.7	4.9	5.9	6.0
Home equity	2.7	1.9	4.6	3.1
Business credit card	2.2	2.1	2.4	2.4
None used	27.6	29.2	18.8	25.0

Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

11. How are minority-owned ventures financed?

Minority-owned firms are far less likely to use a bank loan to start their businesses, and instead use personal credit cards (Table 3). This heavier-than-average reliance on credit cards can negatively affect a business; it may displace establishing a personal relationship with a bank, which is often the source of less costly financing that is tailored to a business's needs.

12. How often are businesses denied loans or new credit?

The Census Bureau reports that only 1% of businesses that wanted to expand or make capital improvements were unable to do so because of lack of funding. However, other studies indicate that credit denial rates may be much higher. The Kauffman Foundation found that nearly 20% of credit applicants in their business survey were denied. When businesses do receive new credit, they often do not receive the full amount applied for. According to the Federal Reserve, 82% of small employer firms were approved for financing, but only 50% received the full amount requested. Further, businesses are often discouraged from applying for additional credit due to an expectation that they will be turned down. The Federal Reserve found that 16% of small businesses felt discouraged from seeking additional credit or financing.[3] Minority- and women-owned businesses are disproportionately more likely to be in this discouraged group than their nonminority or male counterparts.[4]

13. How have small businesses fared since the Great Recession?

Small businesses credit conditions have improved since the end of the downturn, but small business lending has yet to return to pre-crisis levels (Figure 5). Financing approval rates have increased, but small firms with poor credit histories still face difficulties obtaining financing through traditional sources. However, numerous online lending platforms have emerged to help fill the credit market deficit during the downturn. Small firms now have more financing options available to them, and the number of small firms that report being able to access adequate capital is at an eight-year high.[5]

14. What is the default rate for small business loans?

The Small Business Default Indices (SBDI), which measures small business loan defaults, is at an all-time low of less than 2%, compared with a peak of roughly 6% in 2009.[6]

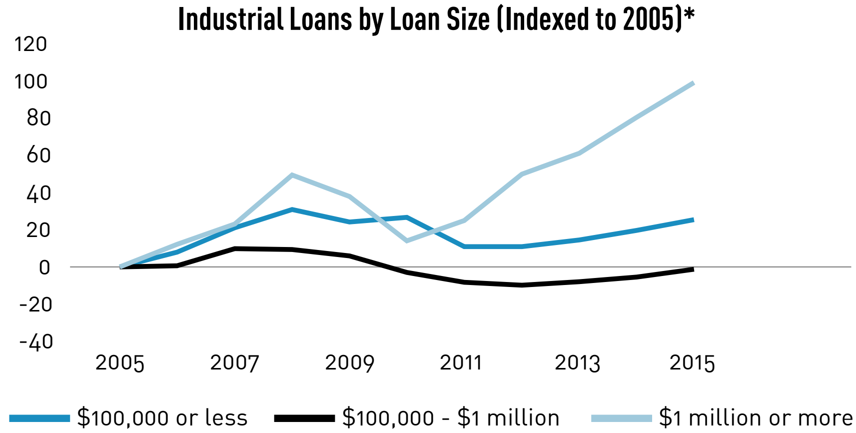
15. What are online lending platforms?

Online lending, also termed "marketplace lending," generally includes any internet platform that connects lenders and borrowers. Borrowers may be individuals or businesses, and lenders include both institutional lenders and—in the case of crowdfunding—individual (retail) investors. "Crowdfunding" denotes the pooling of capital from multiple retail investors (Figure 6). Peer-to-peer lending is a form of crowdfunding in which an individual borrower receives a personal loan. Peer-to-business lending, another form of crowdfunding, allows the funding of business loans through these platforms. In 2014, an estimated $8.6 billion in loans were financed through online lending platforms, an amount larger than all previous years combined.[7]

16. What is the current state of crowdfunding regulations?

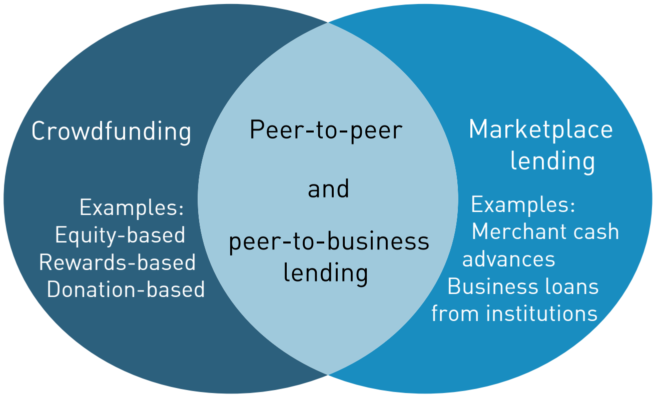
In 2015, the Securities and Exchange Commission adopted final rules to allow crowdfunding beginning on May 16, 2016. This regulation allows businesses to raise up to $1 million in debt or equity in a 12-month period from individual retail investors. Most notably, it requires less paperwork than some other similar capital-raising options, such as filing to become a public company. It is difficult to predict the effect of this rule on small firms'

Figure 5. Percent Change in Outstanding Commercial and Industrial Loans by Loan Size (Indexed to 2005)*



*Loans less than $1 million are considered to be small business loans.
Source: Federal Deposit Insurance Corporation.

Figure 6. Overview of Alternative Finance



Source: "Peer-to-Peer Lending: A Financing Alternative for Small Businesses," SBA Office of Advocacy, 2015.

access to capital. However, the increase in personal loan originations on peer-to-peer lending sites suggests that there is potential for the adoption of business crowdfunding in the United States.

17. How do interest rates differ on conventional and alternative financing?

Interest rates on small business lending products vary widely depending on the duration of the loan and the credit history of the borrower. Because of the nature of some alternative lending products, such as loan terms as short as four months, these products tend to have higher rates than traditional bank loans. Rates on commercial and industrial bank loans have remained below 5% since 2009. Personal credit cards tend to have much higher rates, at around 13%. Alternative loan products can have annual rates from 15% for a 36-month peer-to-peer loan and up to 45% for a four-month institutionally backed loan.[8]

18. What is the condition of the venture capital, angel, and IPO markets for small businesses?

Venture and angel capital are a relatively small part of business financing, making up less than 2% of their financing. (Angels are accredited investors who provide financial backing for small startups or entrepreneurs.) The average venture capital deal size has grown over the last five years to roughly $11.7 million, while the average angel investment is only $330,000.[9]

The IPO market has fallen to its lowest level since the Great Recession of 2008-2009. The IPO market continues to struggle to reach a healthy range of 250-350 deals per year, a level not seen since 2000.[10]

19. What role do SBA loans play in the small business credit market?

To some extent SBA loans act as a shock absorber in times when credit is tight by smoothing risk and offering additional capital access opportunities. For information on SBA loan programs, see www.sba.gov/category/navigation-structure/loans-grants/small-business-loans. For demographic information on SBA loan programs, visit www.sba.gov/about-sba/sba-newsroom/weekly-lending-report.

Endnotes

Note: The primary public data source used in this report is the U.S. Census Bureau's Survey of Business Owners 2012.

1, 2. 2015 Year-End Economic Report, National Small Business Association.

3. An Overview of the Kauffman Firm Survey: Results from 2011 Business Activities, by Alicia Robb and Joseph Farhat, Ewing Marion Kauffman Foundation, 2013; 2015 Small Business Credit Survey: Employer Firms, Federal Reserve Banks, 2016.

4. "Access to Capital for Women- and Minority-owned Businesses: Revisiting Key Variables," SBA Office of Advocacy, 2014.

5. 2015 Year-End Economic Report, National Small Business Association.

6. Small Business Credit Conditions Quarterly report, PayNet.com.

7. State of SME Finance in the United States in 2015, by Shahin Firoozmand, Philip Haxel, Euijin Jung, and Kati Suominen; Tradeupfund.com and NextTrade Group LLC, 2015.

8. "Peer-to-Peer Lending: A Financing Alternative for Small Businesses," SBA Office of Advocacy, 2015.

9. University of New Hampshire, Whittemore School of Business and Economics, Center for Venture Research. 2016 Yearbook, National Venture Capital Association.

10. IPO data compiled by Jay B. Ritter, University of Florida, https://site.warrington.ufl.edu/ritter/ipo-data.

The Office of Advocacy and Small Business Data

The SBA's Office of Advocacy was created by Congress in 1976. The office's mission includes conducting policy studies and economic research on issues of concern to small businesses. The office also publishes data on small firm characteristics and contributions. Our website, www.sba.gov/advocacy, contains numerous databases and links to other sources. Have more questions? Email us at advocacy@sba.gov.

SBA Office of Advocacy
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