Small Business Finance

Office of Advocacy
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Advocacy: the voice of small business in government

Frequently Asked Questions

What are the current conditions for small businesses seeking capital?

Borrowing conditions for small businesses have been gradually improving. Commercial banks have eased their lending conditions and terms, though it's still relatively tight compared to pre-recession conditions. Surveys from mid-2013 indicate that the portion of small businesses having difficulty obtaining credit has declined on net (Figure 1).[1] Approval rates for small business loans increased at credit unions, as well as at large banks (those with $10 billion or more in assets). All told, small business borrowing amounted to about $1 trillion in 2013—$585 billion in business loans outstanding, $422 billion in credit from finance companies, and the rest from a mix of sources (Figure 2).[2] The answer to a related question, what share of small businesses default on their loans, is unknown.[3]

How are small businesses financed?

Small businesses are a very diverse group (ranging from zero to 499 employees), and as a result, their financing needs vary greatly. Startups depend about equally on the owners' cash injections and bank credit,[4] and the most common sources of startup dollars are owners' and relatives' savings. Two studies give quite different answers to the question of how much startup capital a business needs. The Wells Fargo Small Business Index study found that the average small business owner uses about $10,000 as startup capital.[5] The Kauffman Firm Survey, which consists mostly of high-tech firms, found that startup capital averages $80,000 a year, and it consists of debt and equity. However, about one-third of new nonemployer firms and 12 percent of employer firms use no startup capital at all.[6]

For established businesses, owner investment and bank credit are the two most widely used kinds of financing. Young firms rely heavily on external debt, receiving about three-quarters of their funds from banks via loans, credit cards, and lines of credit (Figure 3). Most small business financing comes from business and personal loans; outside equity, such as angel investment and venture capital, amounts to only 6 percent of young firms' financing.[7] Capital requirements vary widely, and a significant number of established businesses use no outside financing.[8]

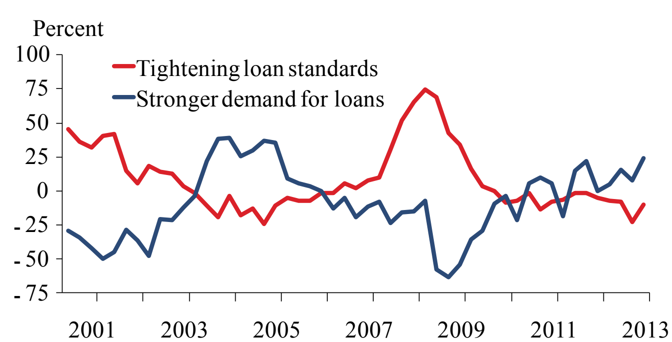
How much do small businesses rely upon credit cards?

Small businesses use credit cards extensively, but they only account for a small portion of total small business capital. Roughly 7 percent of all startup capital is derived from credit cards (personal and business credit cards).[9] A recent report by the National Small Business Association shows credit cards as the third most popular financing choice, after retained earnings and bank loans.[10]

What are the main reasons small businesses seek financing?

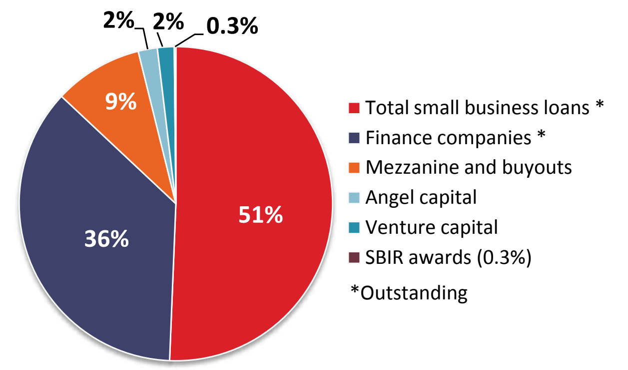
Small businesses borrow for four principal reasons: 1) starting a business, 2) purchasing inventory, 3) expanding the business, and 4) strengthening the firm. Firms choose different means of financing depending on the intended purpose.

Figure 1. Small Business Bank Lending



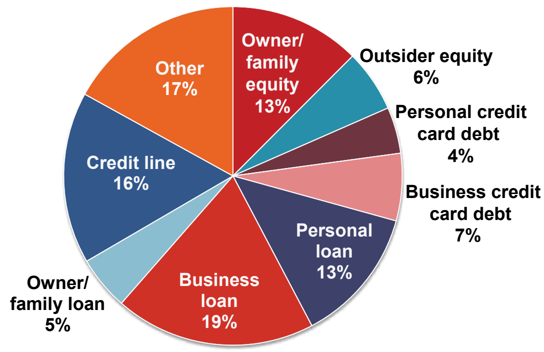
Note: Change in percentage of respondents from the previous period.
Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the Federal Reserve Board Senior Loan Officer Survey, October 2013.

Figure 2. Share of Financing by Category, 2012



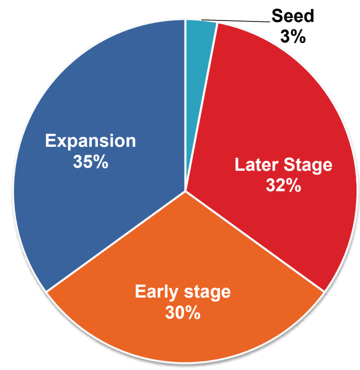
Note: Total small business loans are defined as all loans outstanding under $1 million, including SBA loans. Finance company lending consists of all business receivables outstanding. Note that with dollar amounts being outstanding, the figures are greater than annual small business financing.

Figure 3. Share of Small Business Financing Dollars for Young Firms



Note: Firms started in 2004, reporting 2008 financing and about one-third did not use capital in the year. Source: U.S. Small Business Administration, Office of Advocacy, from data provided by Kauffman Firm Survey

Figure 4. Percent of Venture Capital Investment by Stage, 2012



Source: Office of Advocacy, U.S. Small Business Administration from data provided by PricewaterhouseCoopers/National Venture Capital Association using Thomson Reuters data.

What share of small businesses use financing?

There are various answers to this question. The Kauffman Firm Survey shows that half to two-thirds of young firms use capital injections, which come mostly from owner investment or non-bank sources of funds. However, Census Bureau data indicate that less than half of existing firms use expansion financing.[11] Regardless of the total number, it is worth pointing out that financing is a critical need for a select group of firms, including many high-growth job creators. Not being able to obtain capital has profound implications for their ability to expand.[12]

What is the outlook for crowdfunding?

Provisions within the Jumpstart Our Business Startups (JOBS) Act of 2012 authorize the sale of stock by small businesses and startups over the Internet (crowdfunding). A small business will be able to collectively raise up to $1 million a year. However, crowdfunding will not be an available option for small businesses until the Securities and Exchange Commission issues final regulations. The rulemaking process is underway; draft rules were issued in fall 2013.

What are SBA loans?

SBA loans are government-backed loans available through commercial lenders who follow SBA guidelines. SBA works with lenders to provide a partial guarantee for loans, reducing lenders' risk, increasing small business lending, and helping expand small business economic activity. For information, see **www.sba.gov/category/navigation-structure/loans-grants**. The SBA does not make direct loans to small businesses, except for the disaster loan program, to repair physical and economic damage caused by a declared disaster. For details see **www.sba.gov/taxonomy/term/99**.

What is the condition of the angel and venture capital market?

Angels are accredited investors who are qualified based on federal securities law. The angel capital market continued on a gradual upward trend in 2012 after being down in 2008 and 2009. More importantly, the angel market has shifted its preference to later stage investments (Figure 4).[13] The venture capital market has remained relatively flat in both number of deals and investment dollars since the bubble burst in 1999-2001. However, 2012 had the highest percentage of seed and early-stage deal counts since the mid-1980s.[14] Venture capitalists have moved their focus to firms in the expansion phase.

What is the lending picture for ventures owned by women, veteran, minorities, and immigrants?

Women-owned businesses (just like their male counterparts) largely depend on personal finances; but women- and minority-owned firms are more likely to use credit cards for startups and expansion. Women are 30 percent more likely than males to start businesses without seeking financing, and only half as likely to obtain business loans from banks. Hispanic- and African-American owned firms are more likely than other business owners to rely on owner equity at startup. Veteran-owned businesses' use of credit for startup and expansion was similar to other businesses. For example 11 percent of veterans used credit cards and 8 percent used bank loans for expansions, while the figures were 13 percent and 9 percent, respectively, for all firms.[15]

The sources of startup capital used by immigrant businesses do not differ substantially from those used by non-immigrant firms.[16] However, their heavier-than-average reliance on credit cards negatively affects a business by displacing a personal relationship with a bank, which is often the source of less costly financing that is tailored to a business's needs.

Where can I obtain small business data on financing?

The Federal Reserve Bank of St. Louis's FRED (**http://research.stlouisfed.org/fred2**) and the federal government's Data.Gov (**www.data.gov**) track hundreds of finance indicators. However, much of the data is not related to small business. The Office of Advocacy maintains a list of major U.S. government data sources on small business (**www.sba.gov/sites/default/files/Small_Business_Data_Resources_8-13.pdf**), although only a few of these pertain to finance topics.

Notes

1 National Small Business Association, *2013 Mid-Year Economic Report,* **www.nsba.biz/wp-content/uploads/2013/08/2013-MY-Report.pdf**; National Federation of Independent Business.
2 Federal Deposit Insurance Corporation; Federal Reserve Board, Finance Companies G.20, **www.federalreserve.gov/releases/g20/current/g20.htm;** National Venture Capital Association.
3 Biz2Credit Small Business Lending Index report, **www.biz2credit.com**.
4 Alicia Robb et al., *An Overview of the Kauffman Firm Survey: Results from the 2004–2008 Data,* Kauffman Foundation, May 2010, **https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1606933**. Note that results based on the Kauffman Firm Survey are based on a sample pool of businesses that are larger than the national average.
5 Wells Fargo, press release dated August 15, 2006, **www.wellsfargo.com/press/20060815_Money**.
6 U.S. Census Bureau, Survey of Business Owners, 2007, **www.census.gov/econ/sbo**.
7 Alicia Robb, et al., *An Overview of the Kauffman Firm Survey*.
8 Census, Survey of Business Owners.
9 Alicia Robb, et al., *An Overview of the Kauffman Firm Survey*.
10 NSBA, *2013 Mid-Year Economic Report*.
11 Census, Survey of Business Owners.
12 See National Federation of Independent Business, *Small Business Economic Trends,* **www.nfib.com/research-foundation/small-business-economic-trends-sbet-archive.**
13 University of New Hampshire, Whittemore School of Business and Economics, Center for Venture Research.
14 National Venture Capital Association Yearbook 2013, **www.nvca.org/index.php?option=com_content&view=article&id=257&Itemid=103**.
15 Data on veteran-, woman- and minority-owned firms are from Census, Survey of Business Owners.
16 Robert Fairlie, *Immigrant Entrepreneurs and Small Business Owners, and their Access to Financial Capital.* U.S. Small Business Administration, Office of Advocacy, May 2012, **www.sba.gov/advocacy/7540/141841**.

About the Office of Advocacy

The SBA's Office of Advocacy was created by Congress in 1976. Part of 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. For further data and research information, visit Advocacy's website at **www.sba.gov/advocacy/847**.