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Credit crunch looms large for small business

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By Nick Carey - Analysis

CHICAGO (Reuters) - The credit crunch driven by the U.S. housing crisis appears to have hit another engine of the American economy -- small businesses.

After years of fast and loose lending, major banks have begun tightening standards for loans to small businesses -- often described as the backbone of the jobs market. That is making it harder to gain funding for anything from buying equipment to hiring new workers.

"We've been concerned about this for some time, but things are really beginning to deteriorate," said Todd McCracken, president of the National Small Business Association (NSBA).

Many small businesses are seen heading for trouble because they used home equity loans to fund their businesses during the housing boom, saddling themselves with too much debt in the process.

With home prices dropping, some small business owners are now left with properties worth less than the money they owe the banks.

"Businesses have taken on large amounts of debt over the past several years, which they are probably having trouble refinancing since banks are tightening their lending standards," said Carol Kaplan, a spokeswoman for the American Bankers Association (ABA).

A lot of small businesses are also seen likely to take on too much credit card debt that may ultimately push them under.

Marilyn Landis is president of Basic Business Concepts Inc (BBC), a Pittsburgh company that performs the tasks of a chief financial officer for small businesses that require more than a bookkeeper but do not yet need a full-time CFO.

She said a lot of small companies will suffer the consequences of Wall Street's lax lending practices.

"There are many companies out there that borrowed money against their homes without a solid business plan," she said. "I've had to turn down potential clients who are way out of their depth with debts."

Landis added she had been planning to expand into Michigan this year, but is going to "take a hard look at those plans given the current economic environment."

TIGHTER STANDARDS

According to the Federal Reserve's January Senior Loan Officer Opinion Survey -- which included 56 domestic banks and 23 foreign banking institutions -- 30.4 percent of respondents said they had "somewhat" tightened lending standards on commercial and industrial loans to small, medium-sized and large firms, up from only 5.3 percent a year earlier.

"That's a significant change," ABA's Kaplan said.

In the same survey, 30.9 percent of banks said they had seen "moderately" weaker loan demand from small firms, up from 21.4 percent a year earlier.

Not everyone agrees that small businesses are finding it harder to gain access to loans.

"There is no credit crunch on Main Street for small businesses. Period," said William Dunkelberg, chief economist of the National Federation of Independent Business (NFIB).

Regular monthly NFIB member surveys show little change in respondents' perceptions of how easy it is to obtain credit.

But Dunkelberg and the NFIB seem to be in a minority.

Alan Tonelson, research fellow at the U.S. Business and Industry Council said small manufacturers are especially reliant on bank financing since they have only modest profits to put toward growth and are thus more likely to suffer now.

"Margins throughout manufacturing have become so thin that reinvestable capital has dried up," he said, citing competition from Chinese producers.

"If they're still in business after all this, chances are they're extremely well run," he said.

Josh Frey, owner of Onsalepromos.com based in Washington, D.C., with a staff of six, said he had hoped to add about five employees annually for the next several years, plus find office space capable of accommodating up to 25 workers.

Frey approached his lender, a "huge" national bank which he declined to name, for a $250,000 credit extension.

"They wouldn't do the line of credit against the assets of the business," Frey said. The bank wanted his home, in which he has built up a lot of equity, as collateral.

Frey refused, wanting to keep personal and business finances separate.

"I got nothing because I wasn't willing to collateralize it with my house," Frey said.

With access to traditional loans limited small businesses are expected to turn to credit cards, which carry much higher interest rates.

The Fed's 2003 Survey of Small Business Finance -- conducted every five years -- found 48 percent of small companies used business credit cards, up from 34 percent in 1998.

BBC's Landis said she has used business credit cards to expand her operations and has noticed her rates rising, which her banks attribute to higher credit risk in the market.

"In the coming months we'll see a lot of companies hunkering down and choosing not to expand," she said. "Others will use credit cards to bail themselves out, which will push them further and further into debt."