United States General Accounting Office

GAO

Report to the Committee on Small Business, U.S. Senate

September 1996

SMALL BUSINESS

A Comparison of SBA's 7(a) Loans and Borrowers With Other Loans and Borrowers

G A O
75 years
1921 - 1996

GAO/RCED-96-222

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and Economic Development Division

B-272560

September 20, 1996

The Honorable Christopher S. Bond
Chairman
The Honorable Dale Bumpers
Ranking Minority Member
Committee on Small Business
United States Senate

The U.S. Small Business Administration's (SBA) General Business Loan Program—referred to as the "7(a)" program—is the agency's primary vehicle for providing small businesses with access to credit. With a few exceptions, SBA does not lend money directly under the program, but rather guarantees up to 80 percent of each loan made by private lenders to small firms.[1] This report responds to your request that we provide information on the role that the 7(a) program plays in small business financing. Specifically, you asked that we provide information on (1) how the characteristics—sizes, interest rates, and maturities—of 7(a) loans compare with those of small businesses that did not involve a guarantee from SBA and (2) how the characteristics of 7(a) borrowers compare with small business borrowers that did not obtain 7(a) loans. In addition, you asked that we provide information on reasons underlying private lenders' decisions to participate or not participate in the 7(a) program.

While this report compares 7(a) loans and borrowers with non-7(a) loans (loans that do not carry a guarantee from SBA) and borrowers to the extent practicable, for some factors the available data do not allow for a direct comparison. Data referred to as "non-7(a)" are from a subsample of data from a 1994 survey of small businesses by the Federal Reserve Board of Governors.[2] These survey data are representative of small businesses that applied for and received credit in the last 3 years (generally, 1991 to 1993). For information that our subsample did not include—on loans' sizes, maturities, and interest rates—we used information on commercial and industrial and other loans of $1 million or less. (Available research suggests that loans of $1 million or less, most of which are not guaranteed under the 7(a) program, are typically made to small businesses.) For simplicity, we speak of "small business loans in general" when discussing

[1]SBA has limited legislative authority to make direct loans to borrowers who are unable to obtain loans from other lenders, but no funds have been appropriated for this purpose since fiscal year 1995.

[2]The Survey, cosponsored by SBA and the Federal Reserve, collected data from 5,356 firms selected to provide a representative sample of all U.S. small businesses. We obtained a subsample of data on 1,811 firms that applied for and received credit within the past 3 years. Details about the Survey are in app. V.

these data describing sizes, maturities, and interest rates. Limitations on the comparability of the data are provided where appropriate in the report, and appendix V provides a detailed description of our methodology and data sources.

Results in Brief

Among the small business loans outstanding as of June 30, 1995, 7(a) loans tended to be larger than small business loans in general. For example, almost 60 percent of the number of outstanding 7(a) loans were for original amounts of more than $100,000, while about 18 percent of the number of small business loans in general were of this size. Furthermore, 7(a) loans were more likely to be term loans rather than loans under lines of credit,[3] and to have longer maturities and higher interest rates than small business loans in general.

Like most small business borrowers that did not have 7(a) loans, most 7(a) borrowers were organized as a corporation (rather than a sole proprietorship or partnership) and were in the service or retail sectors of the economy. Also, 7(a) borrowers had about the same average number of employees as non-7(a) borrowers but were likely to have fewer sales and assets and more likely to be new businesses. The largest percentage of 7(a) borrowers were located in the Pacific region, and the largest percentage of non-7(a) borrowers were in the East North Central region. Small businesses with 7(a) loans and those with non-7(a) loans tended to be primarily owned by males. Finally, small businesses with 7(a) loans were somewhat more likely to be owned by members of minority groups than were those with non-7(a) loans.

Many of the 38 participating lenders we interviewed said that the 7(a) program enabled them to offer loans to new businesses and to businesses that have less equity and to make loans with longer maturities than would otherwise be the case. Among the reasons for not offering 7(a) loans cited by the 23 nonparticipating lenders we interviewed were that their company did not focus on small businesses, SBA's loan requirements were too extensive and time-consuming, and they did not perceive any demand for 7(a) loans.

[3]Borrowers who receive term loans typically receive a lump sum amount and are then required to make monthly payments of principal and interest. Under a line of credit, a borrower is allowed to draw down funds as needed up to a specified limit; a drawdown is recognized as a loan and is subject to specified rate and maturity terms.

Background

Authorized under section 7(a) of the Small Business Act (15 U.S.C. 636(a)), the 7(a) program is the largest of SBA's programs for providing capital to small businesses. In fiscal year 1995, SBA approved about 56,000 7(a) loans totaling approximately $8.3 billion.[4] As of June 30, 1995, SBA's 7(a) loan portfolio was composed of 140,517 loans with outstanding balances totaling $23.5 billion.

SBA receives budget authority each fiscal year to cover the expected federal cost of the loans approved during the year. Federal costs are incurred when borrowers of guaranteed loans default and SBA recovers less than the total amount due. SBA also incurs administrative costs for the program. Program costs are offset in part by fees paid by both borrowers and lenders.[5]

To obtain a 7(a) loan guarantee, a lender must document that the prospective borrower was unable to obtain financing under reasonable terms and conditions through normal business channels. The borrower may use the loan proceeds to establish a new business or to assist in the operation, acquisition, or expansion of an existing business. The borrower repays the loan and associated fees through payments to the lender.

SBA's 7(a) loans represent a relatively small percentage of banks' overall lending to small businesses and an even smaller percentage of financing from all known sources. As of June 30, 1995, 7(a) loans accounted for only about 6.7 percent of the estimated total dollar amount of outstanding small business loans of $1 million or less originated by U.S. commercial banks and insured savings institutions.[6] Furthermore, 7(a) loans represent an even smaller proportion of small business credit obtained from all known sources, including finance and leasing companies.

[4]SBA's appropriation for the 7(a) program for fiscal year 1995 was $7.8 billion. The total amount of loans approved under the program may be higher than the amount appropriated in a given fiscal year because some loans are cancelled or reduced during the same year in which they are approved, thereby allowing SBA to reuse the guaranty authority. SBA actually "obligated" approximately $7.8 billion in guarantees made under the program as of the end of fiscal year 1995.

[5]For historical information on the program over the last 10 years, see Trends in SBA's 7(a) Program (GAO/RCED-96-158R, June 10, 1996).

[6]This analysis refers to loans recorded by lenders as commercial and industrial loans or "nonfarm nonresidential" mortgage loans.

Characteristics of 7(a) and Other Small Business Loans

Our comparison of 7(a) and other loans of $1 million or less showed the following:

- As of June 30, 1995, 59.4 percent of the number of outstanding 7(a) loans had original amounts over $100,000, compared with 17.9 percent for the number of small business loans in general. Moreover, about 88.9 percent of SBA's 7(a) loan dollars were used to make loans over $100,000, compared with 69.2 percent for small business loans in general. However, in recent years there has been an increasing percentage in the number of 7 (a) loans under $100,000 and in the loan dollars for loans of this size.
- About 2.1 percent of the number of 7(a) loans were under lines of credit, compared with about 51.5 percent of the number of non-7(a) loans.[7]
- The average maturities for 7(a) loans were longer than those for small business loans in general. For example, among variable-rate loans between $100,000 and $499,999, the average maturity for the 7(a) loans exceeded the average maturity for small business loans in general in each quarter of fiscal years 1991 through 1995. In fiscal year 1995, the average maturity for these 7(a) loans ranged from a low of 13.3 years to a high of 13.9 years; for the small business loans in general, the average maturity was 3.3 years in each quarter. Similar patterns held for fixed-rate 7(a) and general small business loans in the same category, and for both variable-and fixed-rate 7(a) and general small business loans of less than $100,000 for fiscal years 1991 through 1995.
- For most quarters of fiscal years 1991 through 1995, the average interest rates for 7(a) loans exceeded those for small business loans in general in the following categories: variable-rate loans of less than $100,000 and between $100,000 and $499,999 and fixed-rate loans between $100,000 and $499,999. An exception to this pattern was fixed-rate loans under $100,000, for which the interest rates for general small business loans exceeded those for 7(a) loans over most quarters during the period.

Additional details about the characteristics of 7(a) and other loans are in appendix II.

Characteristics of 7(a) and Non-7(a) Borrowers

Data show that 7(a) borrowers are similar to their non-7(a) counterparts in terms of their businesses' organizational form, the economic sector they are a part of, their geographic distribution, the average number of employees, and the gender of the primary owner(s). The 7(a) and non-7(a)

[7]According to a study performed by a small business trade organization, term loans in general are not more likely to have higher interest rates than loans drawn under lines of credit, all else being equal. It is more difficult to generalize about differences in maturities between term loans and loans drawn under lines of credit.

borrowers differ somewhat in terms of their average sales and assets, the ethnicity of the primary owners, and the likelihood of being a new business.

More specifically, for borrowers whose loans were $1 million or less we found the following:

- In both groups, most businesses were organized as corporations. Among 7(a) borrowers, 56.8 percent were organized as corporations; 34.6 percent were organized as sole proprietorships; and 8.6 percent were organized as partnerships. Among non-7(a) borrowers, 59.9 percent were organized as corporations; 30.7 percent were sole proprietorships; and about 9.4 percent were partnerships. These patterns were generally similar across census regions.
- While SBA did not distinguish between full-time and part-time employees, the overall mean number of employees was similar for 7(a) and non-7(a) borrowers. The mean number of employees of 7(a) borrowers was 16.4. In comparison, the mean number of full-time employees of non-7(a) borrowers was 13.1, and the mean number of full- and part-time employees combined was 16.8.
- Both 7(a) and non-7(a) borrowers with fewer employees were likely to be sole proprietorships; as the number of employees increased, businesses were more likely to be organized as corporations. We found this pattern to be consistent across regions.
- Most 7(a) and non-7(a) borrowers were primarily engaged in services and retail trade. These two categories accounted for 30.9 percent and 29.3 percent, respectively, of the 7(a) businesses, and 28.4 percent and 21.1 percent, respectively, of the non-7(a) businesses. Other areas of business that large percentages of both groups indicated as their primary areas included construction, manufacturing, and wholesale trade. Generally, we found similar patterns across regions.
- About 86.1 percent and about 82.9 percent of 7(a) and non-7(a) businesses, respectively, were male-owned. In recent years, however, the percentage of 7(a) businesses owned by females has increased, from about 13.2 percent in fiscal year 1991 to about 24.3 percent in fiscal year 1995. We do not have comparable data on non-7(a) businesses over this time period.
- About 86.5 percent of the 7(a) businesses were owned by nonminorities, and about 13.5 percent were owned by minorities. For the non-7(a) businesses, ownership was 91.8 percent nonminority and 8.2 percent minority.

- We estimate that 7(a) borrowers with loans serviced in Little Rock, Arkansas, and Fresno, California, had fewer sales and assets than non-7(a) borrowers.[8] These 7(a) borrowers had estimated annual average sales of between $958,266 and $1,203,763; in comparison, data from the National Survey of Small Business Finances show estimated annual average sales of $2,148,677 for non-7(a) borrowers. Similarly, the estimated average value of the assets of the 7(a) borrowers was between $434,167 and $542,111, compared with the estimated average assets of $1,094,827 for non-7(a) borrowers, as shown by the Survey.
- The greatest percentage of 7(a) borrowers were located in the Pacific (21.2 percent), West North Central (13.9 percent), and West South Central (12.6 percent) census regions. The greatest percentage of non-7(a) firms were located in the East North Central (18.5 percent), South Atlantic (15.5 percent), and Pacific (14.6 percent) regions.
- A larger percentage of the 7(a) firms were characterized as new businesses than were non-7(a) firms—22.1 percent versus 0.4 percent, respectively.

Additional details about the characteristics of 7(a) and non-7(a) borrowers are in appendix III.

Reasons Underlying Lenders' Decisions to Participate or Not Participate

We interviewed 61 lenders to determine the underlying reason(s) for their participation or nonparticipation in the 7(a) program. We interviewed 21 lenders selected from among lenders that account for a relatively high volume of 7(a) loans and 17 lenders selected because they make a relatively low volume of 7(a) loans. We also interviewed 23 nonparticipating lenders. Details about the interviews and the lenders' responses are in appendix IV.

Most of the high-volume lenders cited as primary reasons for participating in the 7(a) program the abilities to offer loans to new businesses, to make longer-maturity loans, and to offer loans to businesses that have less equity. However, 15 of the 21 high-volume lenders indicated that the increase in program fees might cause them to reduce their participation.[9] Seven of the 21 high-volume lenders also indicated that they might reduce

[8]Currently, SBA is in the process of centralizing all of its commercial 7(a) loan servicing at two locations—Little Rock, Ark., and Fresno, Cal. At the time of our review, these two service centers accounted for about 39 percent of the number of 7(a) loans approved in fiscal year 1993.

[9]The Small Business Lending Enhancement Act of 1995 provides for an increase in the guaranty fee based on the guaranteed portion of the loan. The act also provides for an annual fee for all SBA-guaranteed loans on the basis of their size; lenders are required to pay this fee and cannot pass it on to the borrower.

their participation in the 7(a) program if the guaranty percentage (that is, the portion of each loan that SBA guarantees, currently limited to 80 percent) continues to decrease. Three of the 21 indicated that their participation may decrease if funding for the program remains uncertain.

Most of the 17 low-volume lenders indicated that offering loans to businesses that have less equity and offering loans to new businesses were principal reasons for their participation in the program. In addition, 9 of the 17 low-volume lenders cited the following as factors that might cause them to increase their participation in the program: a reduction in program fees, a reduction in paperwork and documentation requirements, an increase in the demand for loans, an increase in the guaranty percentage, and obtaining "preferred lender" status.[10]

The 23 nonparticipating lenders cited the following as reasons why they did not participate in the program: They have a different business focus (i.e., they are not oriented to small businesses); SBA's loan documentation requirements are too extensive and time-consuming; they do not perceive a demand for 7(a) loans; they lack experience with the 7(a) program; and the loan terms would not be favorable to their borrowers.

Agency Comments

We provided a draft of this report to SBA for its review and comment. We met with SBA officials, including the Director, Office of Loan Programs, Office of Financial Assistance, who generally agreed with the facts presented in the report. They also suggested clarifying certain aspects of the report and making minor changes to make the report more technically accurate. We incorporated SBA's comments into the report where appropriate.

To respond to your request, we obtained information from SBA's management information database on the characteristics of 7(a) loans approved in fiscal years 1991 through 1995. We also used the database to obtain information on certain characteristics of 7(a) borrowers. We obtained information on borrowers' sales and assets from paper files at SBA's service centers in Little Rock, Arkansas, and Fresno, California. For data on small business loans in general, we used information from the Federal Reserve Board of Governors' statistical releases and information

[10]Preferred lenders have the authority to attach a guarantee from SBA with no credit review by the agency. SBA does review borrowers' applications submitted by preferred lenders for eligibility before issuing a loan identification number. Preferred lender status is conferred on lenders on the basis of their expertise and experience in making SBA loans and their performance record.

provided by the Federal Deposit Insurance Corporation. When they were available, we obtained data on non-7(a) loans and borrowers from the National Survey of Small Business Finances.

While we did not independently verify the accuracy or test the reliability of the data from SBA or the Federal Reserve Board of Governors, we performed tests to check the internal consistency of the data and compared them with the data reported in SBA's and the Federal Reserve's documents. We worked closely with agency officials to ensure our proper interpretation of the data, but we did not attempt to determine the reasons for observed similarities and differences between the 7(a) and non-7(a) loans and borrowers.

In addition, we interviewed lenders that participated in the 7(a) program and other lenders that did not. We also interviewed officials of SBA; the Federal Reserve; and several industry groups, including the National Federation of Independent Business, the National Association of Government Guaranteed Lenders, National Small Business United, and the American Bankers Association. Details on our methodology are in appendix V. We conducted our work between December 1995 and July 1996 in accordance with generally accepted government auditing standards.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days after the date of this letter. At that time, we will provide copies to the Administrator of SBA, the Chairman of the Federal Reserve Board of Governors, appropriate congressional committees, and other interested parties. We will also make copies available to others upon request.

Should you or your staff have any questions, you can reach me at (202) 512-7631. Major contributors to this report are listed in appendix VI.

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Contents

Abbreviations

FDIC	Federal Deposit Insurance Corporation
GAO	General Accounting Office
NSSBF	National Survey of Small Business Finances
SBA	Small Business Administration
SIC	standard industrial classification

Background

Small firms continue to be recognized as key job creators and innovators in the U.S. economy. According to the Small Business Administration's (SBA) Office of Advocacy, there are approximately 22.1 million nonfarm businesses in the United States, of which about 99 percent are considered small.[1] Small businesses employ 53 percent of the private workforce, contribute 47 percent of all sales in the country, and are responsible for 50 percent of the private gross domestic product. Moreover, small businesses dominate certain industries, such as restaurants, medical and dental facilities, and counseling and rehabilitation services. Between December 1994 and December 1995, employment in industries dominated by small businesses increased 2.7 percent, generating 1.25 million new jobs, or 75 percent of the total number of new jobs created.

Small Business Financing

Despite their recognized importance as a generator of economic activity, small businesses face burdens that limit their potential. During the recent 1995 White House Conference on Small Business, most participants indicated that access to credit and capital is a major barrier to entry and growth.

Unlike large firms, which have access to capital and financing from sources such as the stock, bond, and commercial paper markets, small firms rely to a greater extent on commercial banks for their financing needs. However, small firms often lack the collateral needed to secure conventional commercial loans.

SBA's 7(a) Loan Guaranty Program

In the 1930s, 1940s, and early 1950s, the Department of Commerce, the Federal Reserve Board, and others conducted independent studies of small business financing. These studies concluded that, in comparison to large businesses, small and medium-sized businesses faced a serious credit gap because their access to equity and bond markets was limited and banks were generally reluctant to lend them money on a long-term basis. Section 7(a) of the Small Business Act, as amended, (15 U.S.C. 636(a)) authorized SBA to make direct loans or to guarantee loans made by private lenders to small businesses. The 7(a) program enables repayment terms and collateral requirements that better fit the borrowers' needs than might be obtainable under usual bank policy and transfers the major risk of borrowers' default from the private lender to SBA.

[1]Generally, the size of small businesses is determined by their respective industries and may be based on either the number of employees or average sales over the last 3 years.

Since SBA's inception in 1953, the agency has provided financial assistance totaling more than $167 billion to more than 1.2 million businesses. In fiscal year 1995, the SBA approved about 56,000 7(a) loans for a total of about $8.3 billion.[2] The 7(a) loan guaranty program is the agency's primary small business financing initiative.

SBA operates approximately 30 subprograms under the overall 7(a) umbrella. Most of these subprograms guarantee loans for fixed terms, but a small percentage of SBA's guarantees are for loans made under lines of credit. SBA's 7(a) guaranteed term loans are typically used to finance things such as the purchase of a new business, the expansion of an existing business, or capital improvements. Loans made under lines of credit may serve a variety of purposes, and, in the commercial market, typically have maturities of less than a year.

SBA receives budget authority each fiscal year to cover the expected federal cost of the loans approved during the year. Federal costs are incurred when borrowers of guaranteed loans default and SBA recovers less than the total amount due. (In the event of a default, SBA purchases the agreed-upon share of the unpaid balance of the loan.) SBA also incurs administrative costs for the program. Program costs are offset in part by fees paid by both borrowers and lenders.

SBA's 7(a) loans represent a relatively small percentage of overall bank lending to small businesses and an even smaller percentage of financing from all known sources. According to information provided by SBA and the Federal Deposit Insurance Corporation (FDIC), as of June 30, 1995, 7(a) loans accounted for only about 6.7 percent of the estimated dollar amount of outstanding small business loans of $1 million or less originated by U.S. commercial banks and insured savings institutions.[3] Moreover, according to SBA's Office of Advocacy, 7(a) loans represent a much smaller proportion of overall small business financing because, in addition to bank loans, small businesses obtain financing through a variety of other means, including finance companies, leases, and home equity loans. Also, some banks may make small business loans through credit cards or other forms

[2]SBA's appropriation for the 7(a) program for fiscal year 1995 was $7.8 billion. The total amount of loans approved under the program may be higher than the amount appropriated in a given fiscal year because some loans are cancelled or reduced during the same year in which they are approved, thereby allowing SBA to reuse the guaranty authority. SBA actually "obligated" approximately $7.8 billion in guarantees made under the program as of the end of fiscal year 1995.

[3]SBA provided information on outstanding 7(a) loans. The remainder is based on information obtained from FDIC that was filed by U.S. commercial banks in Consolidated Reports of Condition and Income (Call Reports) and filed by insured savings institutions in Thrift Financial Reports. Both reports contain information on estimates of the number and amount of outstanding small business loans.

of consumer credit, which are generally not included in estimates of small business lending.

General Economic Conditions During the Period of Our Study, Fiscal Years 1991-95

Commercial and industrial lending activity provides a measure of business borrowing from banks. In late 1990—the beginning of the time period during which the loans we examined were made—the economy had entered a recession. Growth in commercial and industrial loans made by banks had slowed, and in 1991 there was an actual decline in commercial and industrial loan activity. Interest rates fell in 1991 and 1992. In particular, the prime rate, a key indicator of rates charged to commercial borrowers by banks, fell to 6 percent by the middle of 1992 and remained at that level until early 1994, although the prime rate remained high by historical standards when compared to other interest rates. Also, interest rate spreads (over the prime rate) on large business loans were small and getting smaller when compared to spreads on small business loans. Toward the end of the time period we examined, interest rates, including the prime rate, increased and the general level of economic activity increased as the economy emerged from the recession.

Characteristics of 7(a) and Non-7(a) Small Business Loans

Compared with small business loans in general, 7(a) loans tended to be larger. Moreover, a greater proportion of SBA's 7(a) loan dollars were for larger loans. However, in recent years there has been an increasing percentage in the number of 7 (a) loans under $100,000 and in the loan dollars for loans of this size. Also, SBA 7(a) loans were more likely to be term loans, whereas non-7(a) loans were more likely to be loans drawn down under lines of credit. Finally, compared with small business loans in general, 7(a) loans were more likely to have longer maturities and higher interest rates.[1]

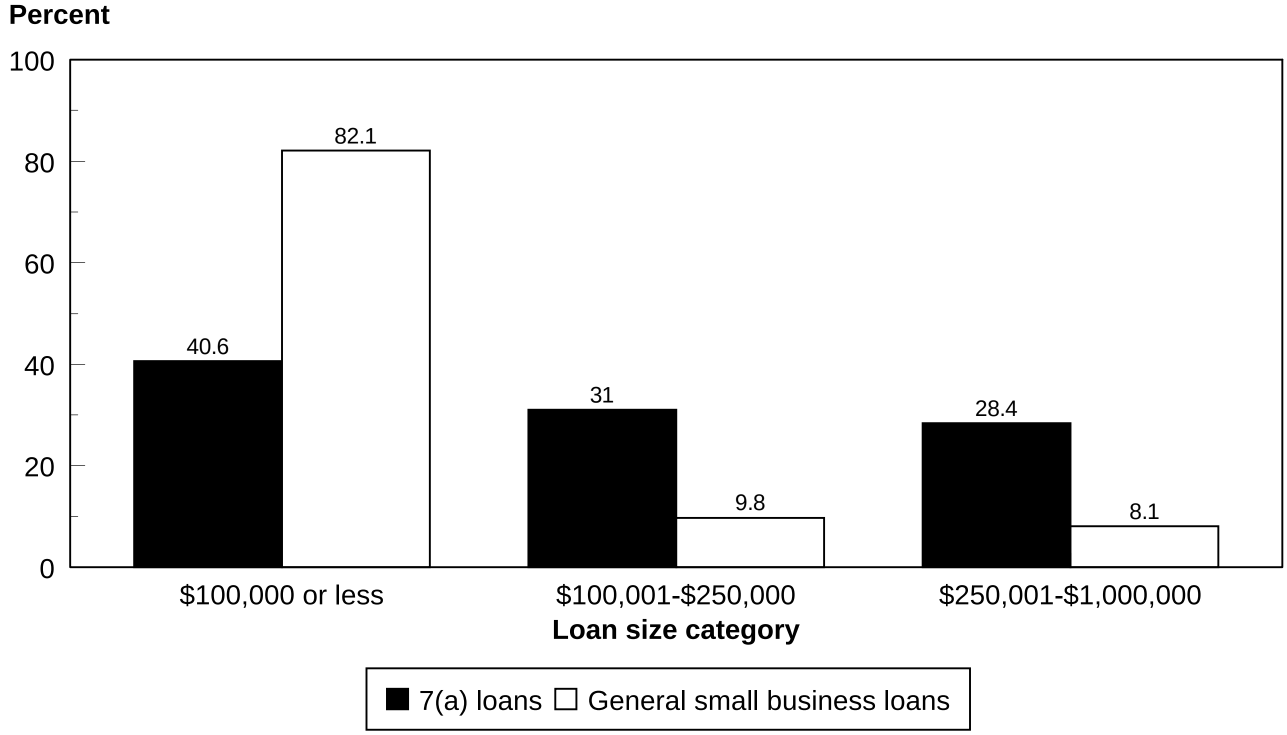
7(a) Loans Were More Likely to Be Larger

As shown in figure II.1, a comparison of data on the number of outstanding 7(a) loans and available information on the number of outstanding general small business loans shows that a greater percentage of outstanding 7(a) loans tended to be larger loans.[2] For example, 59.4 percent of the 7(a) loans were greater than $100,000, compared to 17.9 percent of the general small business loans.

[1]See app. V for a detailed description of our data and methodology. We used a subset of SBA's data on 7(a) loans spanning fiscal year 1991 through fiscal year 1993 to compare to the data from the National Survey of Small Business Finances.

[2]The data on outstanding loans represent loans that were for original amounts of $1 million or less and that still had outstanding balances as of June 30, 1995.

Figure II.1: Percentage of Outstanding 7(a) and General Small Business Loans, by Size of Loan, as of June 30, 1995



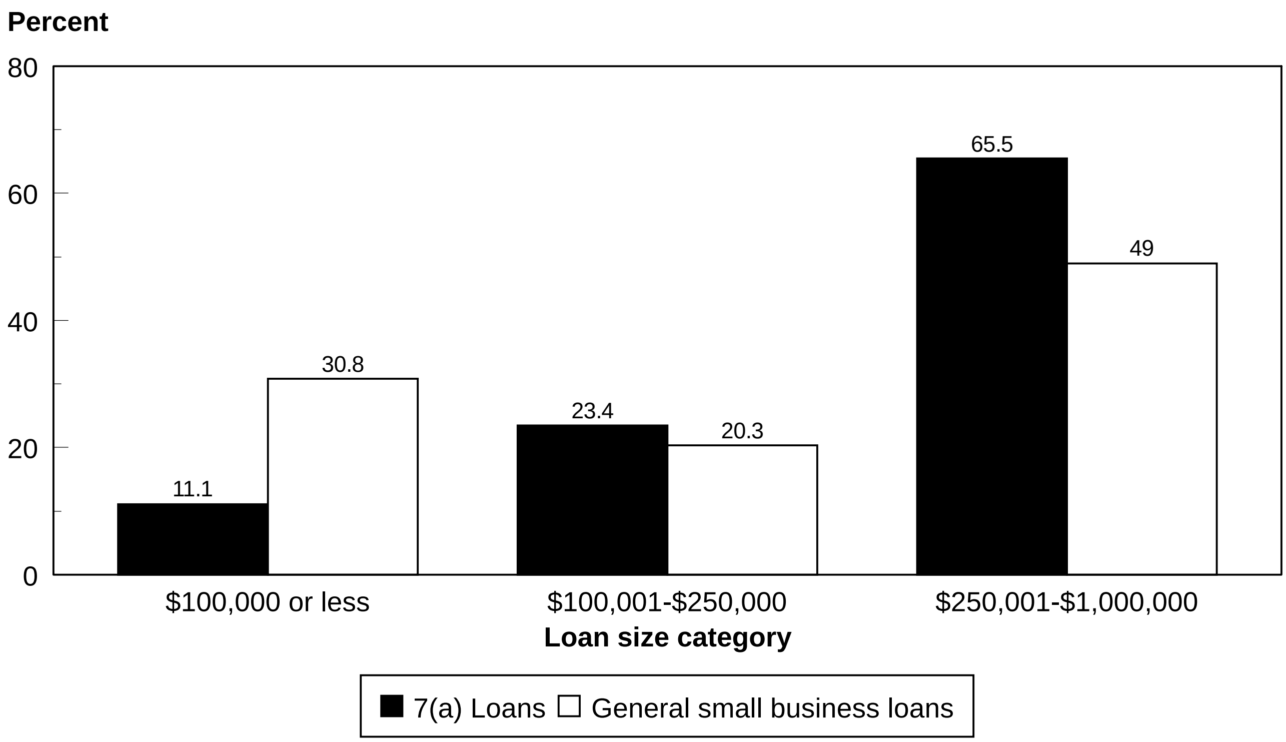
Note: The total number of 7(a) loans was 140,517, and the total number of general small business loans was 6,247,380.

Source: GAO's analysis of SBA's and FDIC's data.

7(a) Loan Dollars Were More Likely to Represent Larger Loans

For outstanding loans with original amounts of $1 million or less as of June 30, 1995, a greater proportion of SBA's lending has gone for loans with larger original amounts, compared with lending to small businesses in general reported by commercial banks and insured savings institutions. As illustrated in figure II.2, 65.5 percent ($15.4 billion) of the 7(a) loan dollars represented loans with original amounts ranging from $250,001 to $1,000,000, compared to 49.0 percent ($171.4 billion) of the general small business loan dollars.

Figure II.2: Percentage of Outstanding 7(a) and General Small Business Loan Dollars, by Size of Loan, as of June 30, 1995

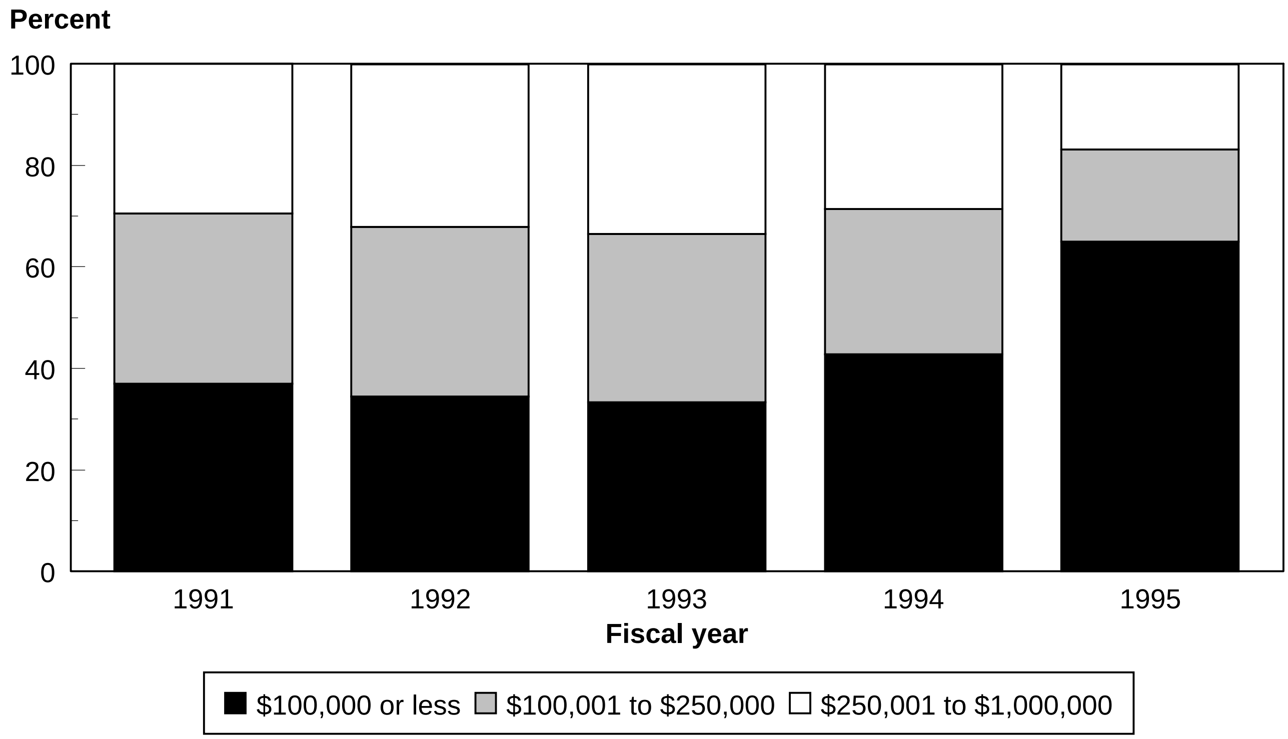


Note: The total amount for 7(a) loans was $23.5 billion, and the total amount for general small business loans was $350.0 billion.

Source: GAO's analysis of SBA's and FDIC's data.

Although, for outstanding loans, the largest proportion of 7(a) loan dollars has gone towards loans between $250,001 and $1 million, over the last 5 years the largest percentage of 7(a) loans have been for $100,000 or less. As shown in figure II.3, between fiscal year 1991 and fiscal year 1995, the percentage of approved 7(a) loans with amounts of $100,000 or less increased overall from 37.0 to 65.0 percent.

Figure II.3: Percentage of Approved 7(a) Loans, by Size of Loan, Fiscal Years 1991-95

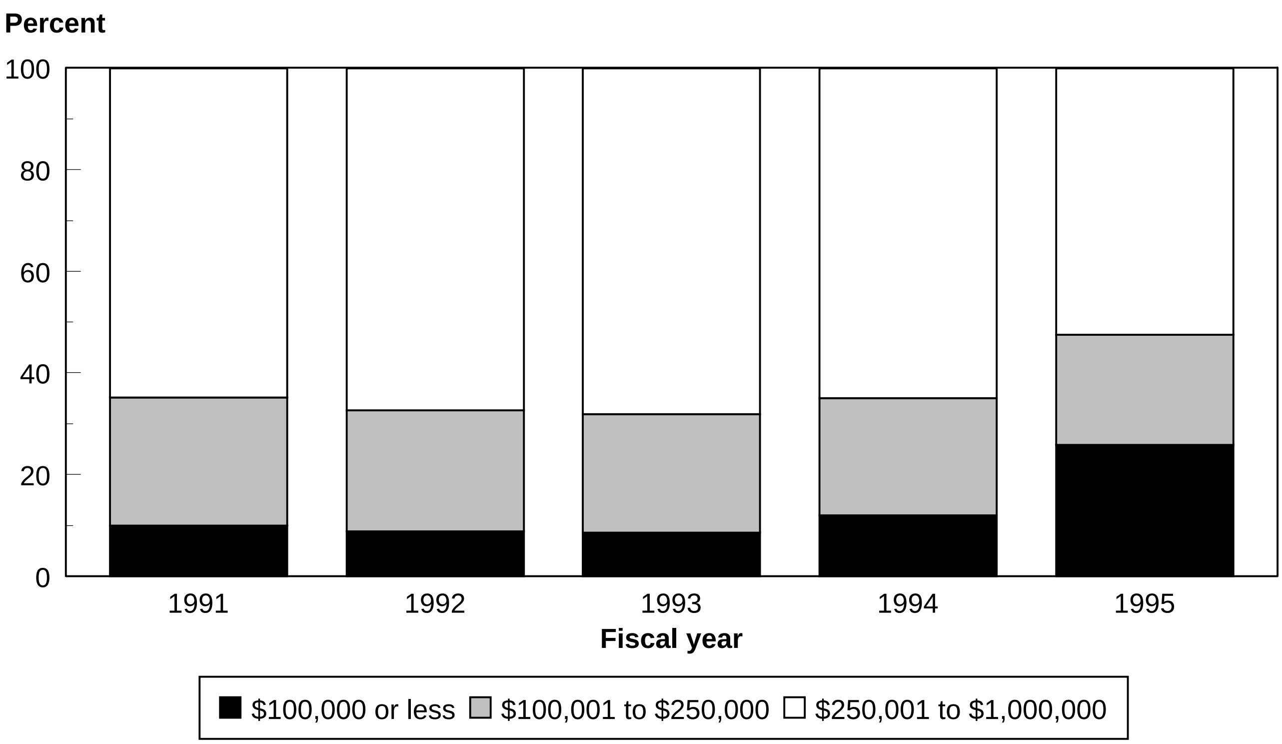


Note: The total number of approved 7(a) loans of $1 million or less was 18,535 in fiscal year 1991; 23,561 in fiscal year 1992; 25,879 in fiscal year 1993; 35, 121 in fiscal year 1994; and 54,173 in fiscal year 1995.

Source: GAO's analysis of SBA's data.

Over the last 5 years, the trends for approved loan dollars are similar to those for the number of loans. As figure II.4 shows, between fiscal year 1991 and fiscal year 1995, the percentage of approved 7(a) loan dollars in loans of $100,000 or less increased overall from 9.9 to 25.8 percent.

Figure II.4: Percentage of Approved 7(a) Loan Dollars, by Size of Loan, Fiscal Years 1991-95



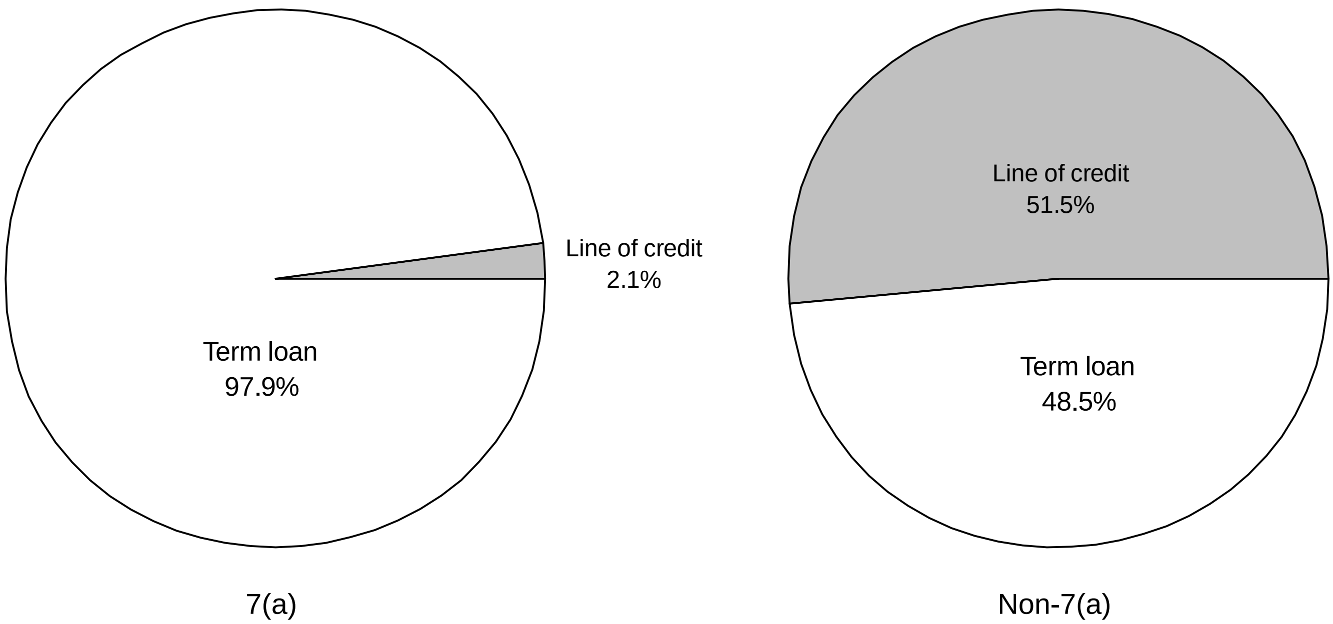
Note: The total amount of approved 7(a) loans of $1 million or less was $4.1 billion for fiscal year 1991; $5.6 billion for fiscal year 1992; $6.3 billion for fiscal year 1993; $7.5 billion for fiscal year 1994; and $7.8 billion for fiscal year 1995.

Source: GAO's analysis of SBA's data.

SBA 7(a) Loans Were More Likely to Be Term Loans

A comparison of 7(a) and non-7(a) data shows that 7(a) loans were more likely to be term loans, whereas non-7(a) loans were more likely to be under lines of credit. As shown in figure II.5, a smaller percentage of the number of 7(a) loans were under lines of credit (2.1 percent), when compared with the number of non-7(a) loans (51.5 percent).

Figure II.5: Percentage of 7(a) and Non-7(a) Loans That Were Under Lines of Credit and That Were Term Loans



Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

The percentage of 7(a) loans of $1 million or less under lines of credit was 1.4 percent in fiscal year 1991, 1.3 percent in fiscal year 1992, 3.2 percent in fiscal year 1993, 3.6 percent in fiscal year 1994, and 0.9 percent in fiscal year 1995.

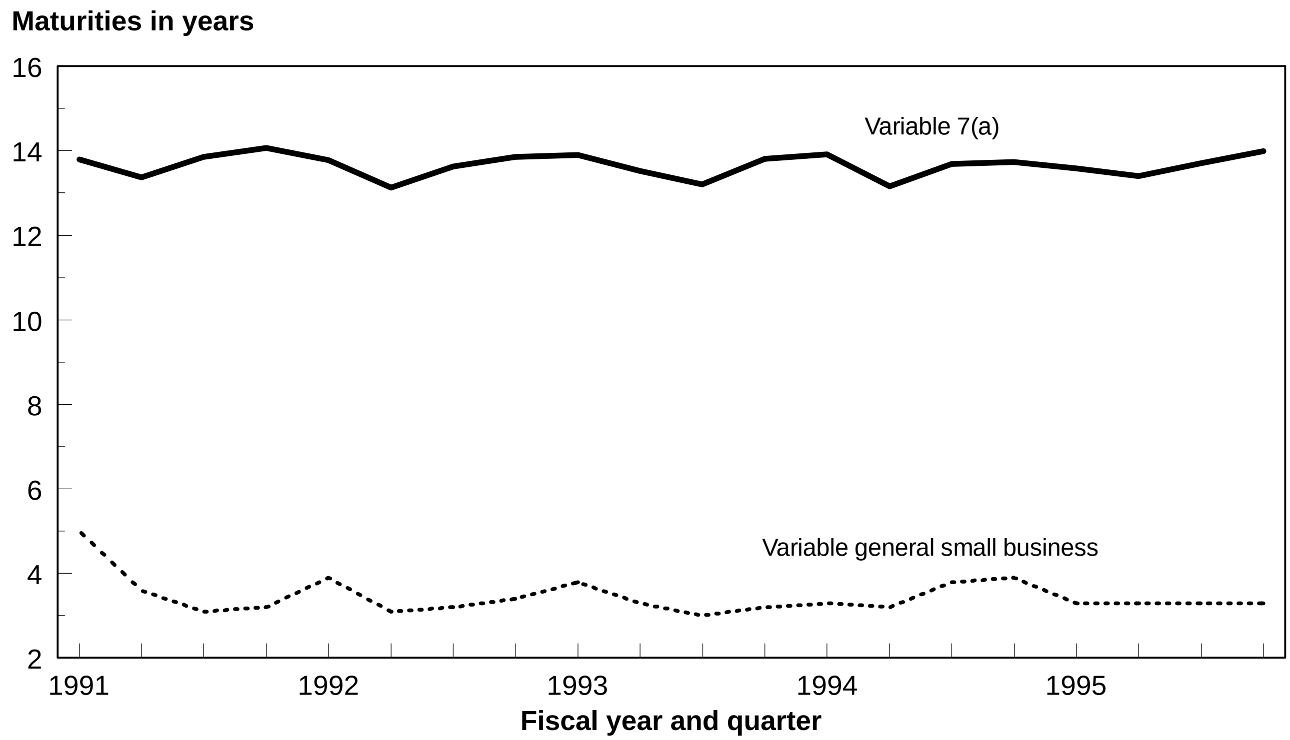
Maturities and Interest Rates for 7(a) Loans Often Exceeded Those for General Small Business Loans

A comparison of data from SBA and data published quarterly by the Federal Reserve Board of Governors shows that between fiscal year 1991 and fiscal year 1995, 7(a) loans had longer maturities and often had higher interest rates than small business loans in general.[3] Among loans with maturities of 1 year or more, general small business loans were more likely to have variable rather than fixed interest rates. Loans under $100,000 were more evenly split between having fixed and variable rates.

[3]We focused our analysis on two categories—loans of less than $100,000 and loans between $100,000 and $499,999—because together they account for 90.5 percent of SBA's 7(a) loans.

As shown in figure II.6, the mean maturities for variable-rate 7(a) loans between $100,000 and $499,999 exceeded those for variable-rate general small business loans of the same size over fiscal years 1991 through 1995.[4]

Figure II.6: Mean Maturities for 7(a) and General Small Business Loans Between $100,000 and $499,999 With Variable Interest Rates, by Quarter, Fiscal Years 1991-95



The maturities for these loans were 1 year and over.

Source: GAO's analysis of SBA's data and the Federal Reserve Board of Governors' quarterly Survey of Terms of Bank Lending.

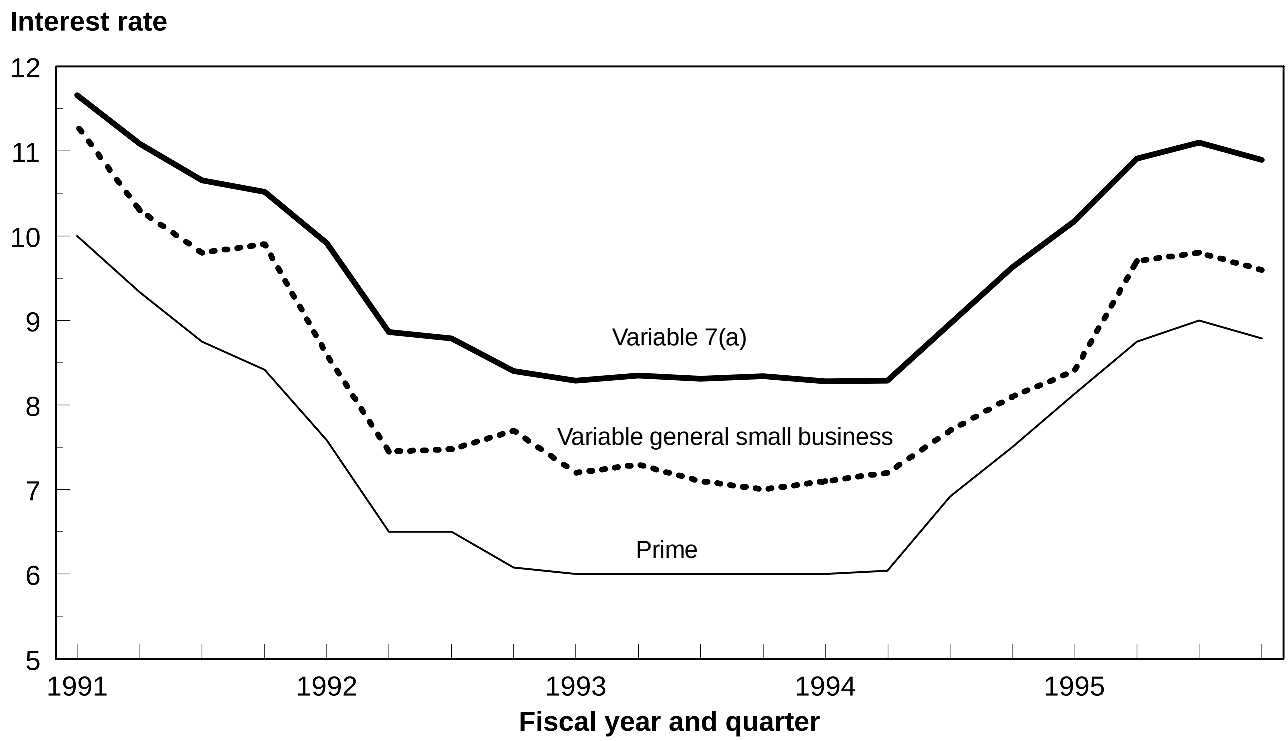
The same trend as shown in figure II.6 held for fixed-rate 7(a) and general small business loans in the same category and for both variable- and

[4]We compare 7(a) loans to general small business loans with maturities of one year or greater. We focused on this category of general bank loans because of the long-term nature of 7(a) loans, even though much bank lending to small business is for maturities of less than one year.

fixed-rate 7(a) and general small business loans of less than $100,000 over the same period.

As shown in figure II.7, the mean interest rates for variable-rate 7(a) loans between $100,000 and $499,999 exceeded those for variable-rate general small business loans of the same category over fiscal years 1991 through 1995. For loans under $100,000 with variable interest rates, the trend was similar.

Figure II.7: Mean Interest Rates for 7(a) and General Small Business Loans Between $100,000 and $499,999 With Variable Interest Rates, by Quarter, Fiscal Years 1991-95

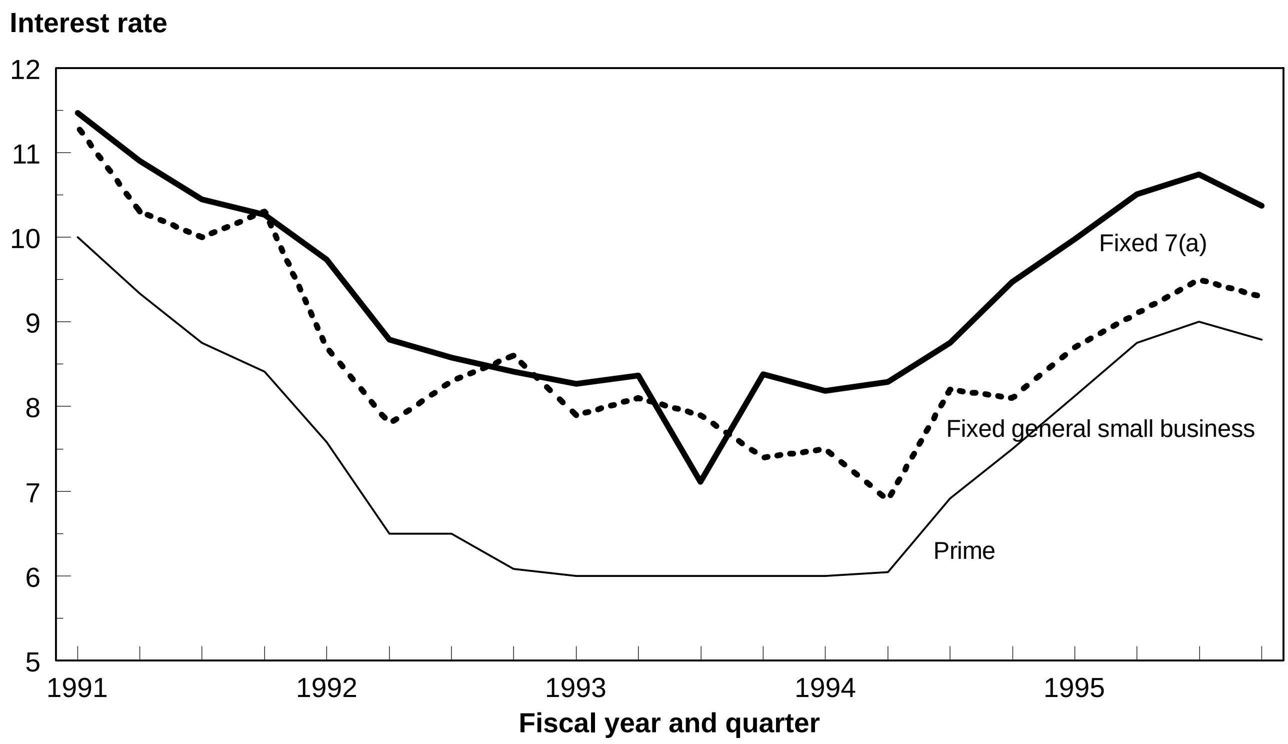


Note: The maturities for these loans were 1 year and over.

Source: GAO's analysis of SBA's data and the Federal Reserve Board of Governors' quarterly Survey of Terms of Bank Lending.

While the mean interest rates for variable-rate 7(a) loans exceeded those for general small business loans, this relationship did not always hold true for fixed-rate loans. As shown in figure II.8, for loans between $100,000 and $499,999, the mean fixed interest rates for 7(a) loans were not always higher than those for small business loans in general.

Figure II.8: Mean Interest Rates for 7(a) and General Small Business Loans Between $100,000 and $499,999 With Fixed Interest Rates, by Quarter, Fiscal Years 1991-95

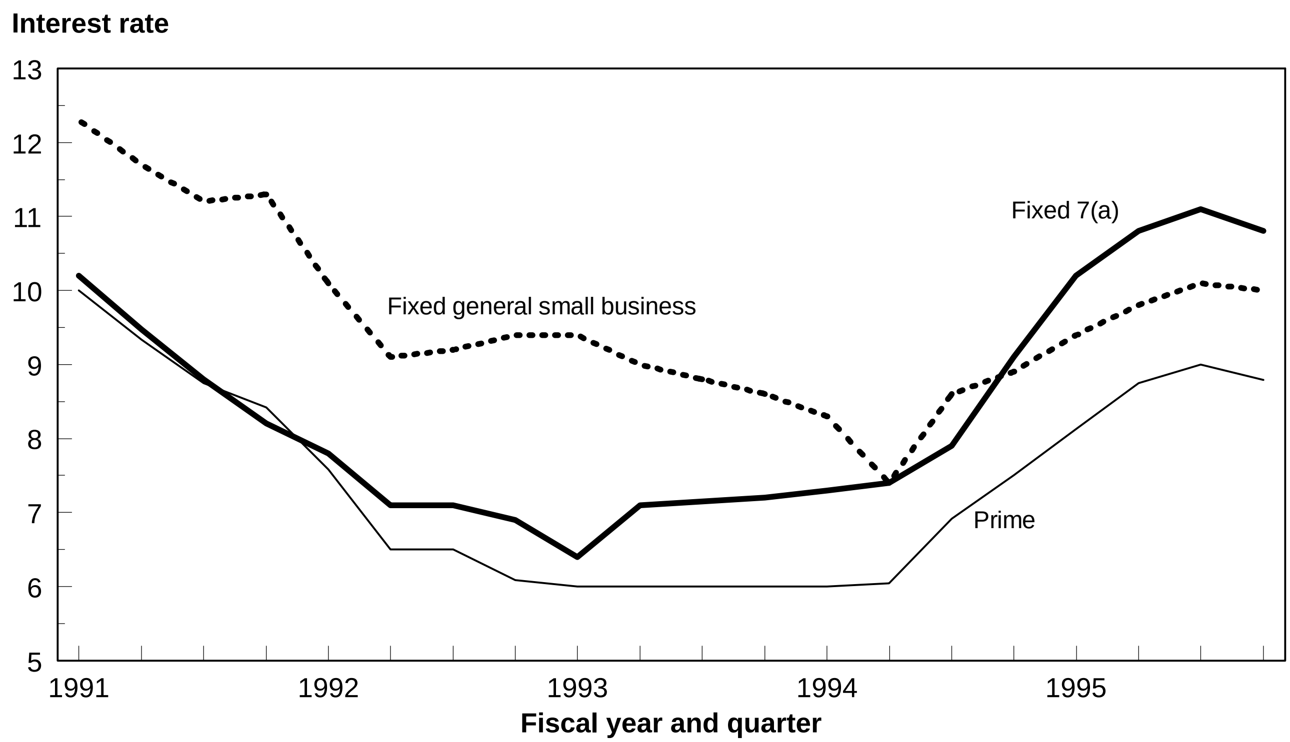


Note: The maturities for these loans were 1 year and over.

Source: GAO's analysis of SBA's data and the Federal Reserve Board of Governors' quarterly Survey of Terms of Bank Lending.

In contrast, for loans less than $100,000, the mean fixed interest rates for 7(a) loans were generally lower than those for small business loans in general, as shown in figure II.9.

Figure II.9: Mean Interest Rates for 7(a) and General Small Business Loans Less Than $100,000 With Fixed Interest Rates, by Quarter, Fiscal Years 1991-95



Note: The maturities for these loans were 1 year and over.

Source: GAO's analysis of SBA's data and the Federal Reserve Board of Governors' quarterly Survey of Terms of Bank Lending.

Characteristics of 7(a) and Non-7(a) Borrowers

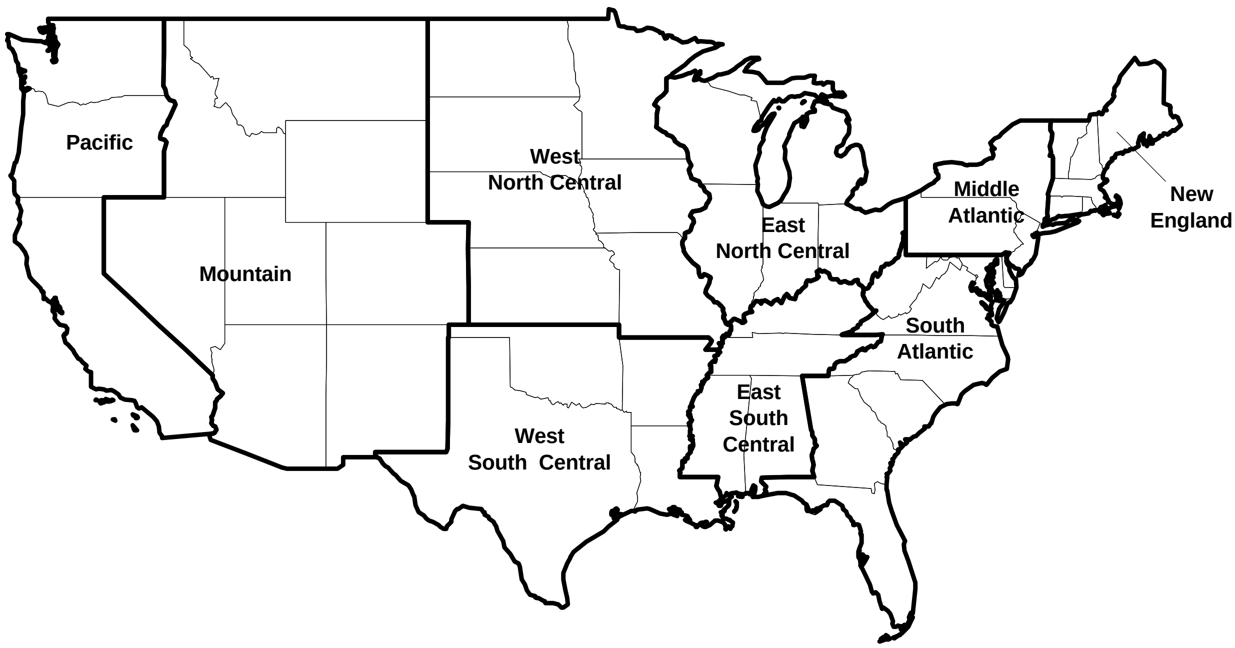
We observed similarities and differences across selected characteristics of 7(a) and non-7(a) borrowers. The 7(a) borrowers are similar to their non-7(a) counterparts in terms of their businesses' organizational form, the economic sector they are part of, the average number of employees, and the gender of the primary owner(s). The 7(a) and non-7(a) borrowers differ somewhat in terms of their average sales and assets, their geographic distribution, the ethnicity of the primary owners, and the likelihood of being a new business.[1]

Business Characteristics

The geographic distribution of 7(a) and non-7(a) borrowers across census regions appears to be somewhat different, as figure III.1 illustrates. For example, the three regions with the highest percentage of 7(a) loans were the Pacific, West North Central, and West South Central regions. In contrast, the top three regions for non-7(a) loans were the East North Central, South Atlantic, and Pacific regions.

[1]See app. V for a detailed description of our data and methodology. We used a subset of SBA's data on 7(a) loans spanning fiscal year 1991 through fiscal year 1993 to compare to the data from the National Survey of Small Business Finances.

Figure III.1: Percentage of 7(a) and Non-7(a) Borrowers, by Census Region

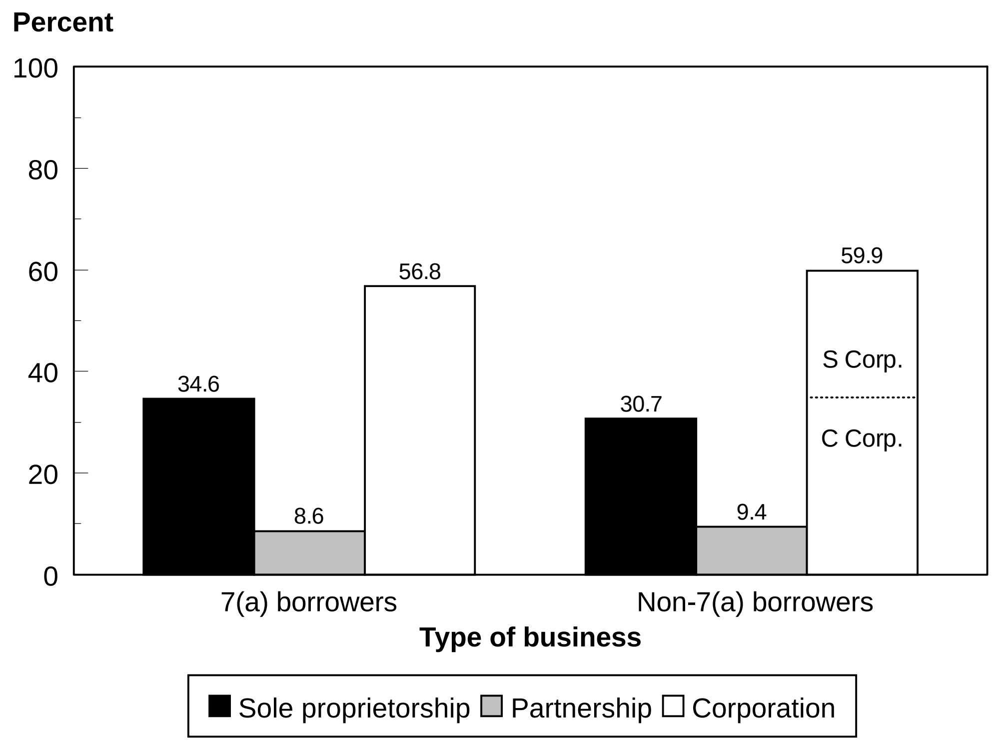


Region	7(a) loans	Non-7(a) loans
East North Central	9.8	18.5
East South Central	5.3	6.3
Middle Atlantic	10.4	11.8
Mountain	10.0	6.6
New England	7.0	5.6
Pacific	21.2	14.6
South Atlantic	9.9	15.5
West North Central	13.9	10.6
West South Central	12.6	10.4

Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

A comparison of data on 7(a) borrowers and non-7(a) borrowers shows little difference in the form of business ownership—sole proprietorship, partnership, or corporation. Most 7(a) and non-7(a) businesses were organized as corporations, as shown in figure III.2. In general, we found these patterns to be similar across census regions.

Figure III.2: Percentage of 7(a) and Non-7(a) Borrowers, by Business Organization



Note: The percentage of non-7(a) borrowers that were organized as corporations contains both S Corporations (24.9 percent) and C Corporations (34.9 percent). See footnote 10, app. V, for a discussion of these types of corporations.

Source: GAO's analysis of SBA's and the Federal Reserve Board of Governor's data.

The average number of employees was similar for 7(a) borrowers and non-7(a) borrowers. Specifically, the mean number of employees in 7(a) firms was 16.4. In comparison, the mean number of full-time employees in non-7(a) firms was 13.1, and the mean number of full- and part-time employees combined was 16.8.[2] In addition, as shown in table III.1, the percentage of firms with various numbers of employees was similar for 7(a) and non-7(a) borrowers. We found these patterns were consistent across regions.

Table III.1: Percentage of 7(a) and Non-7(a) Firms, by Number of Employees

Number of employees	1	2-4	5-9	10-19	20-49	50-99	100-499
7(a) firms	11.0	26.8	23.1	18.9	14.6	4.2	1.5
Non-7(a) firms							
Full-time employees	18.6	35.4	18.8	12.0	9.2	3.3	2.6
Full- and part-time employees	8.7	32.6	25.2	14.3	11.8	4.3	3.1

Note: According to SBA, a 7(a) firm cannot have zero employees, so for consistency we eliminated zero values from the data on non-7(a) firms. We also eliminated firms with 500 or more employees from SBA's data on 7(a) firms for consistency with the data from the National Survey of Small Business Finances (NSSBF).

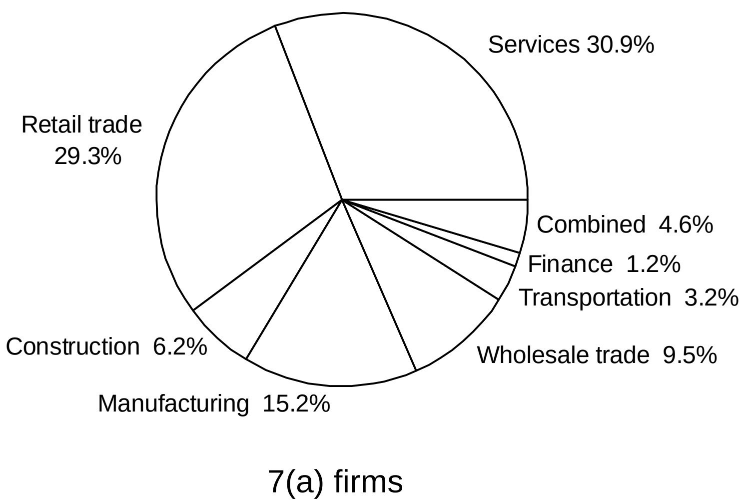
Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

In addition to finding similarities between the two groups based on separate overall comparisons of the form of business organization and number of employees, we also found similarities between the two groups when these characteristics were analyzed together. We found that both 7(a) and non-7(a) firms with fewer employees were likely to be sole proprietorships; and, as the number of employees increased, firms were more likely to be organized as corporations. For example, 51.3 percent of 7(a) firms with two to four employees were sole proprietorships, and 36.5 percent were corporations. For 7(a) firms with 100 or more employees, 7.1 percent were sole proprietorships, and 88.7 percent were corporations. We found a similar pattern for non-7(a) firms.

A comparison based on firms' standard industrial classification (SIC) division shows similarities. As shown in figure III.3, overall the largest concentration of 7(a) and non-7(a) firms were primarily engaged in services and retail trade. Other areas that large percentages of both groups indicated as their primary area of business activity included construction, manufacturing, and wholesale trade. Generally, we found similar patterns across regions.

[2]SBA's data included the number of employees as provided to the lender by the borrower at the time of loan approval. Data from the National Survey of Small Business Finances included separate data elements on full-time and part-time employees. We based our comparisons on (1) the number of full-time employees and (2) the sum of full- and part-time employees.

Figure III.3: Percentage of 7(a) and Non-7(a) Firms, by Primary Area of Business Activity



Note: The “Combined” category includes firms in agriculture, mining, and public administration and “nonclassifiable” establishments (4.4 percent of 7(a) borrowers and 1.0 percent of non-7(a) borrowers). It also contains all SIC codes unassigned to any category (0.2 percent of 7(a) borrowers and 9.7 percent of non-7(a) borrowers).

Source: GAO’s analysis of SBA’s and the Federal Reserve Board of Governors’ data.

A comparison of data collected from SBA’s files in Fresno, California, and Little Rock, Arkansas, with similar information from the NSSBF shows that the sales and assets of 7(a) and non-7(a) firms appear to be different. The estimated average annual sales for 7(a) borrowers was $1,081,014, compared to $2,148,677 for non-7(a) borrowers. Some of the observed difference in these estimates may be due to sampling error.[3]

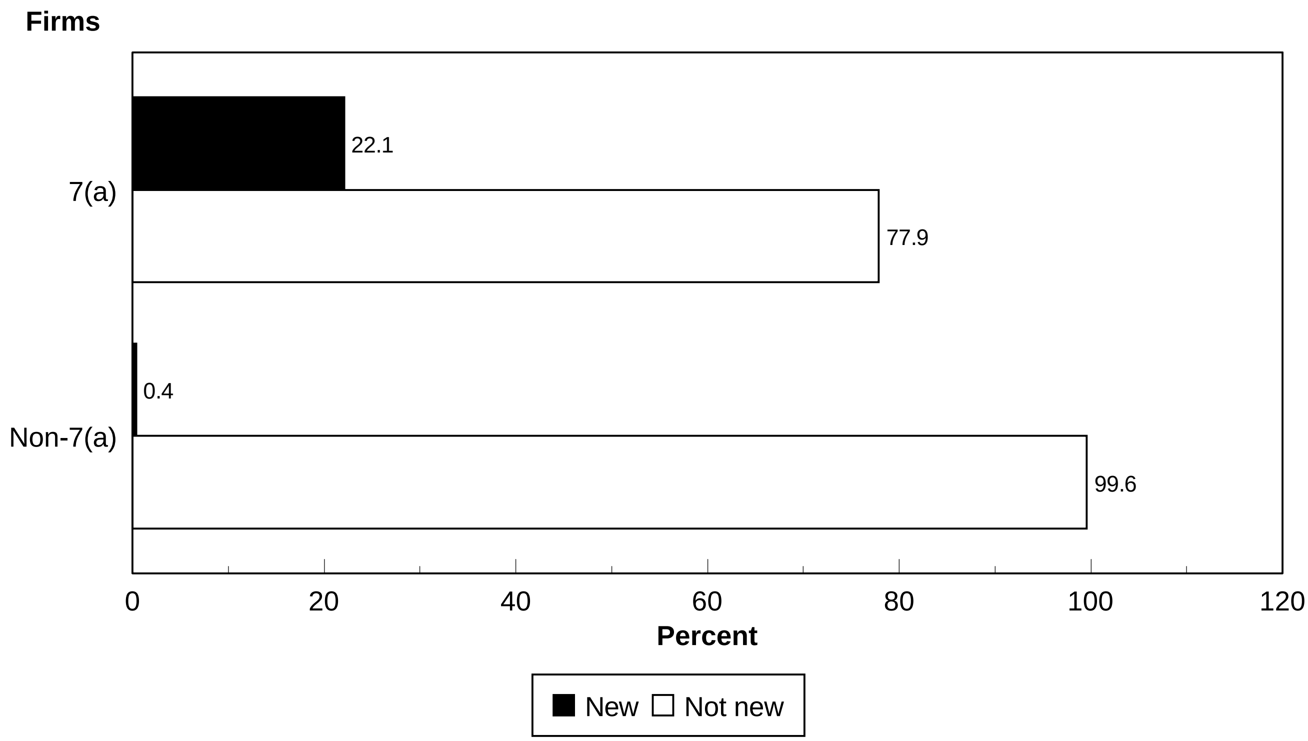
[3]At the 95-percent confidence level, the lower and upper bounds for the estimate of the average annual sales for SBA’s 7(a) borrowers at Little Rock and Fresno are $958,266 and $1,203,763. For the NSSBF’s estimate of the average annual sales for non-7(a) borrowers, we were unable to compute the sampling error because the survey methodology report had not been finalized within the time of our review.

Similarly, the estimated average assets of the 7(a) borrowers was $488,139, compared to $1,094,827 for non-7(a) borrowers. Similarly, some of the observed difference in these estimates may be due to sampling error.[4]

As shown in figure III.4, a larger percentage of 7(a) firms than non-7(a) firms were new businesses.

[4]At the 95-percent confidence level, the lower and upper bounds for the estimate of the average assets of SBA's 7(a) borrowers at Little Rock and Fresno are $434,167 and $542,111. Again, we were unable to compute the sampling error for the NSSBF's estimate of the average assets for non-7(a) borrowers because the survey methodology report had not been finalized during the time of our review.

Figure III.4: Percentage of 7(a) and Non-7(a) Firms, by Status as a New Business



Note: SBA defines a new business as one no older than 180 days (or 6 months). The NSSBF's data were recoded to indicate a new firm as one that is no older than 1 year. According to Financial Services Used by Small Businesses: Evidence From the 1993 National Survey of Small Business Finances, 15.3 percent of all firms are less than 5 years old.

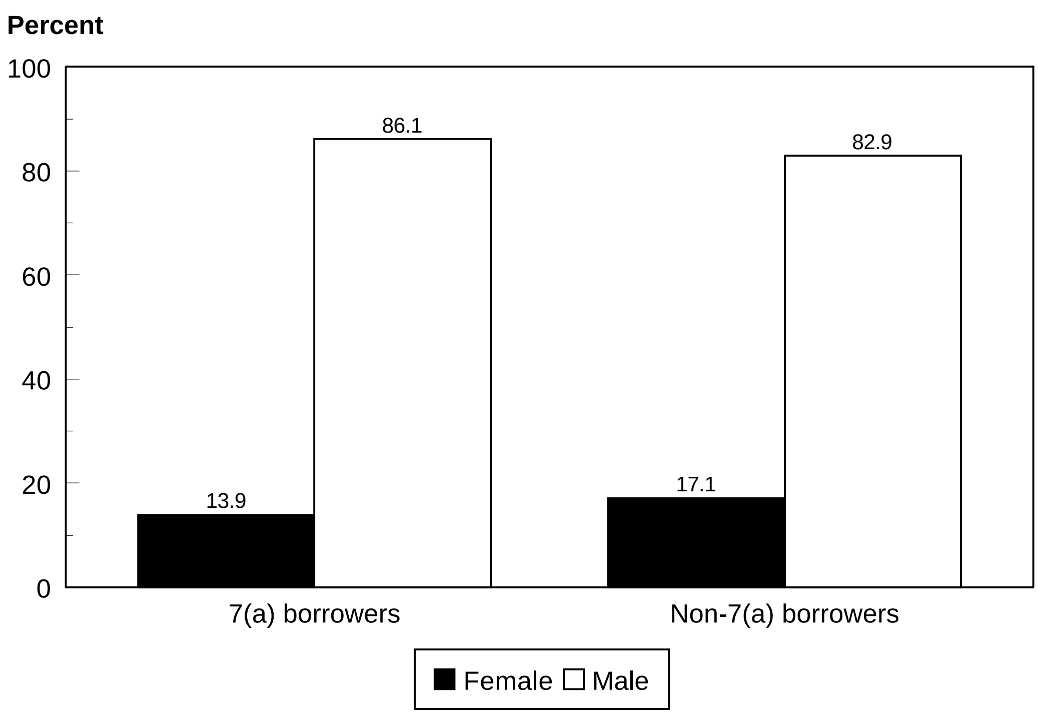
Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

Characteristics of Owners

As shown in figure III.5, overall about 86.1 percent of the 7(a) firms were male-owned, and 82.9 percent of the non-7(a) firms were male-owned.[5]

[5]Both SBA and the NSSBF define the primary ownership to be female if more than 50 percent of the firm is owned by one or more women.

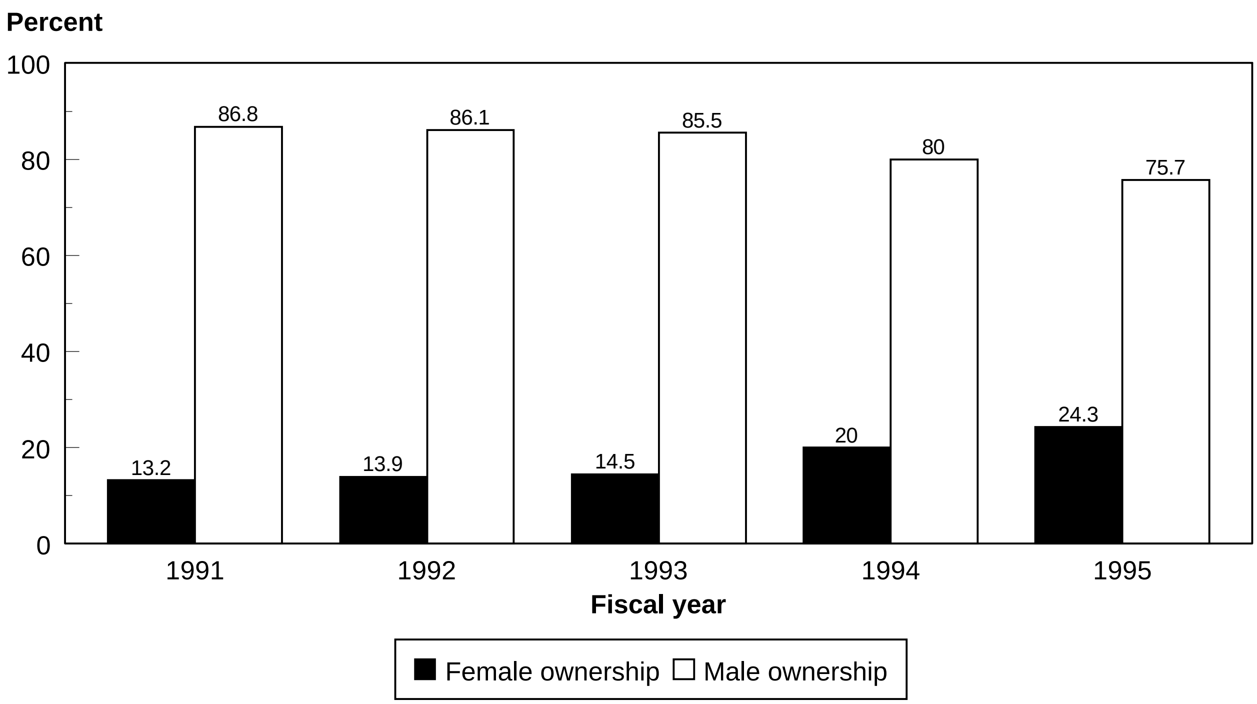
Figure III.5: Percentage of 7(a) and Non-7(a) Firms, by Gender of Primary Owner



Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

In the past several years, however, the percentage of 7(a) firms owned by females has increased, from about 13.2 percent in fiscal year 1991 to about 24.3 percent in fiscal year 1995, as indicated in figure III.6.

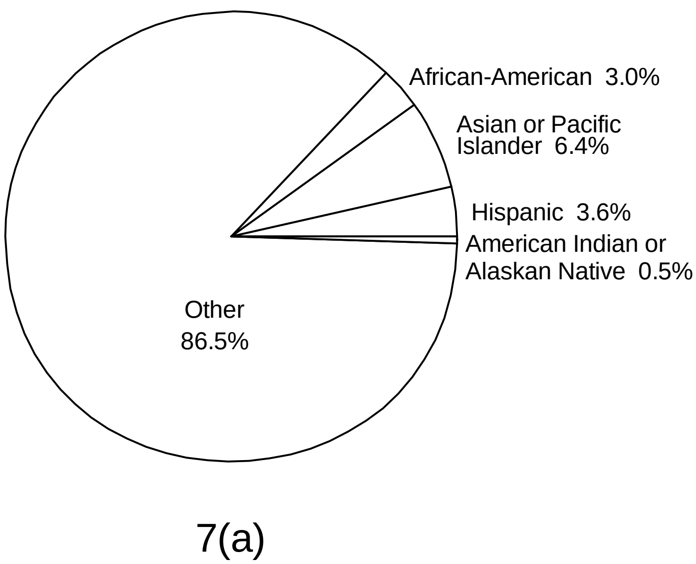
Figure III.6: Percentage of 7(a) Firms, by Gender of Primary Owner, Fiscal Years 1991-95



Source: GAO's analysis of SBA's data.

As shown in figure III.7, overall 13.5 percent of 7(a) and 8.2 percent of non-7(a) business owners were minorities.

Figure III.7: Percentage of 7(a) and Non-7(a) Firms, by Borrowers' Ethnic Category



Note: There is no overlap between any of these ethnic categories. The Hispanic category incudes all persons of Hispanic descent, regardless of race. For example, the Hispanic category could include African-Americans, Asians or Pacific Islanders, and others. All persons not of Hispanic descent are divided among the remaining categories. These non-Hispanic categories may underrepresent the percentage of firms owned by these groups.

Source: GAO's analysis of SBA's and the Federal Reserve Board of Governors' data.

Reasons Underlying Lenders' Decisions to Participate or Not to Participate

We interviewed representatives for 61 lenders to determine the reasons underlying their participation or nonparticipation in SBA's 7(a) program.[1] In 1995, 21 of these lenders made a relatively high number of 7(a) loans, 17 made only a few 7(a) loans, and 23 did not participate in the program.[2] As shown in figure IV.1, these lenders were located primarily in California, Florida, Illinois, New York, and Texas—states with large numbers of 7(a) loans.

[1]The titles of the lender representatives we talked to included Presidents, Senior Vice-Presidents, Assistant Vice-Presidents, and Commercial Loan Officers. According to SBA officials, the reasons given by the lender representatives could vary depending upon their position in the organization. For example, a high-ranking representative might cite different reasons from those given by a lower-ranking representative.

[2]See app. V for a detailed description of the method we used to select these lenders. In brief, the high-volume and low-volume lenders were chosen from among lenders with the highest and lowest number of loans, respectively, in fiscal year 1995. Some of the 23 lenders that did not participate in SBA's 7(a) loan program in 1995 subsequently participated in 1996.

Figure IV.1: Location of Lenders Contacted by GAO

Note: Symbols appear in the state in which lenders are located but do not represent actual locations within the state.

Factors Contributing to High-Volume Lenders' Decisions to Participate

As shown in table IV.1, the most frequently cited factors contributing to a very great or great extent to lenders' participation in the 7(a) program were the ability to offer (1) loans to new start-up businesses or businesses without established borrowing histories and (2) loans with longer maturities. Also important was the ability to make loans to businesses with less equity than that required for non-7(a) loans.

Table IV.1: Factors Contributing to 21 High-Volume Lenders' Decisions to Participate in the 7(a) Loan Program

	Number of times factor was cited				
Factor	Very great extent	Great extent	Moderate extent	Some extent	Little or no extent
Ability to offer loans to new start-up businesses or businesses without established borrowing histories	9	9	2	1	0
Ability to offer longer-maturity loans	11	6	4	0	0
Ability to offer loans to businesses with less equity	8	8	5	0	0
Ability to make loans to types of businesses for which the bank does not generally make conventional loans	5	6	5	4	1
Ability to sell SBA loans in the secondary market	7	3	1	1	9
Ability to make larger loans than regulated lending limits[a] permit	6	3	2	0	10
Ability to offer more favorable interest rates	1	1	9	3	7
Ability to pledge the SBA-guaranteed portion of a loan as security for public funds or as collateral	0	1	4	1	15

[a]The guaranteed portion of a 7(a) loan does not count against a bank's legal lending limit, which is imposed by legislation.

Describing one of the most frequently cited factors, one lender representative said the 7(a) program enables the bank to make loans for business start-ups and expansions to borrowers that do not have the cash flow necessary to qualify for conventional loans. He said without the 7(a) program, these small business owners would not be able to obtain credit.

Describing another factor, another lender representative said the 7(a) program allows the bank to provide borrowers longer loan terms and is very important because many borrowers would not be able to repay loans with shorter terms. A longer term allows a small business owner to repay the loan without depleting his working capital, which, the lender representative explained, is the lifeline of the small business. Otherwise, keeping the note current could cause the small business to go out of business eventually. A different lender representative said that because banks typically make short-term loans, the flexibility to structure long-term SBA loans is advantageous to the bank and borrowers.

The ability to offer loans to businesses that have less equity than that required for non-7(a) loans was the third most frequently cited factor contributing to lenders' participation in the 7(a) program. A lender representative said that banks do not like to make conventional loans to small businesses because they quite often lack equity. Overall, 12 lender representatives said the program allowed the bank to extend credit to borrowers that would not be able to obtain a loan through the bank's conventional lending practices.

While many lender representatives were positive about the 7(a) loan program, some expressed concerns. For example, one high-volume lender representative said banks are becoming polarized regarding 7(a) lending; either they participate in the program and make a lot of loans, or they make none at all. This representative added that it is costly for a bank to get started in the program, but once in place, the program can be profitable for the bank. He believes it would be advantageous for the program to have more selective lenders participating because loan defaults would be lower. He further stated that nonbank lenders such as finance companies have an unfair competitive advantage over banks in making 7(a) loans because banks spend a great deal of time and money complying with bank regulations and paying premiums and oversight fees to FDIC and the Office of the Comptroller of the Currency. Furthermore, he said the bank must pay for a full-time compliance officer who ensures that the bank is conforming to applicable regulations. Because their cost structure is lower, the nonbank lenders can offer more competitive rates for 7(a) loans.

Factors That Might Cause High-Volume Lenders to Reduce Participation

Of the 21 high-volume lenders, 18 said there were one or more factors that might cause their participation in the program to decrease. The most frequently cited factor was the increase in the fees associated with the program, cited by 15 lender representatives. Some of these lender representatives believe the increase in the guaranty fee[3] made the program

[3]The Small Business Lending Enhancement Act of 1995 provides for an increase in the guaranty fee based on the guaranteed portion of the loans. The act preserves a 2-percent guaranty fee for 7(a) loans with a guaranteed portion of $80,000 or less; for larger loans, the fee will be on a blended scale as follows: (1) 3 percent of the guaranteed portion of a loan that is over $100,000 and up to $250,000; (2) 3.5 percent of the guaranteed portion of a loan that is over $250,000 and up to $500,000; and (3) 3.875 percent of the guaranteed portion of a loan that is over $500,000.

expensive for potential borrowers (because the lenders pass the fee on to them). Other lender representatives said the introduction of the 50-basis-point fee[4] made the program less profitable for the bank. One lender representative said the increased guaranty fee was bordering on "exorbitant," making the product not well received by potential borrowers. Two lender representatives said the number of 7(a) loans their banks have made this year is down approximately 70 percent from a year ago because of the increase in the guaranty fee. One of these representatives added that the higher fee had caused borrowers to become uninterested in the program. Five lender representatives said that if the fees continue to increase, it may not be profitable for their banks to participate in the program. Another lender representative was concerned that the increase in the guaranty fee will impair the quality of SBA's portfolio. He said that only the high-risk borrowers will be willing to pay the increased fee, which will ultimately result in higher defaults.

According to one lender representative, the 50-basis-point fee that the bank must pay SBA causes the bank to make smaller SBA loans. He said it may be appropriate to charge lenders 50 basis points on loans that banks sell in the secondary market, but he believed it was inappropriate for SBA to assess the fee on 7(a) loans that are not sold in the secondary market.

Another factor that, according to some high-volume lenders, could cause them to reduce their participation is the reduction in the percentage of a loan that the government can guarantee.[5] Seven lender representatives cited this factor. For example, one lender representative said that if the government's guaranty percentage continues to go down, his bank may curb its participation in the program because its underwriting policies will not allow it to accept more risk. Another representative said that reducing the guaranty percentage ties up the bank's capital.

A third factor, which was cited by three lender representatives, was uncertainty about the program's funding. One lender representative said that the program's funding has become too political and that the bank does not know if SBA will continue to exist. With all the volatility

[4]A basis point is one one-hundredth (1/100) of 1 percent. The Small Business Lending Enhancement Act of 1995 provides for a 50-basis-point ongoing fee for all SBA-guaranteed loans. Lenders are required to pay this fee and cannot pass it on to the borrower. Prior to this, SBA was authorized to charge a 40-basis-point fee on loans sold in the secondary market.

[5]Since October 13, 1995, the maximum allowable guaranty percentage has been 80 percent on loans of $100,000 or less and 75 percent of all other loans not to exceed $750,000, unless otherwise authorized by statute for a specific loan program. Prior to this, the maximum guaranty percentage was 90 percent on loans of $155,000 or less and 85 percent on loans over $155,000, except loans made by preferred lenders, which carried a maximum guarantee of 70 percent.

surrounding SBA, he said, it is very difficult for the bank to plan for lending backed by the agency. Another lender representative said it is difficult for the bank to devote substantial resources to SBA programs that may or may not receive funding each year. One lender representative seemed to summarize these concerns when he said that it had been a "rocky" couple of years for the 7(a) program, with the increase in fees and the government shutdown in the first quarter of fiscal year 1996. He said that with such events, the bank has difficulty maintaining momentum in the program and that many potential customers lose interest because of the volatility.

Finally, one lender representative said she is noticing that customer demand for 7(a) loans is slowing down at her bank. She said this may be due to the increase in competition among banks to make loans. According to her, some banks have loosened their credit underwriting requirements and are making riskier loans—loans that would have been made only with a government guarantee a year ago.

Factors Contributing to Low-Volume Lenders' Decisions to Participate

The most frequently cited factors contributing to a very great or great extent to the 17 low-volume lenders' decisions to participate in the program were the ability to offer (1) loans to businesses that have less equity than that required for non-7(a) loans and (2) loans to new start-up businesses or businesses without established borrowing histories, as shown in table IV.2. For example, one lender representative said that his bank primarily uses the 7(a) program for small business owners who lack equity and for businesses just getting started. Seven lender representatives that made a low volume of 7(a) loans said the program allows them to make credit available to those who would not be able to obtain a loan otherwise.

Table IV.2: Factors Contributing to 17 Low-Volume Lenders' Decisions to Participate in the 7(a) Loan Program

	Number of times factor was cited				
Factor	Very great extent	Great extent	Moderate extent	Some extent	Little or no extent
Ability to offer loans to businesses with less equity	12	3	0	2	0
Ability to offer loans to new start-up businesses or businesses without established borrowing histories	11	2	3	0	1
Ability to offer longer-maturity loans	5	6	5	0	1
Ability to make loans to types of businesses for which the bank does not generally make conventional loans	3	8	4	2	0
Ability to sell SBA loans in the secondary market	3	2	3	1	8
Ability to make larger loans than regulated lending limits[a] permit	2	3	3	2	7
Ability to offer more favorable interest rates	1	3	4	5	4
Ability to pledge the SBA-guaranteed portion of a loan as security for public funds or as collateral	1	1	2	3	10

[a]The guaranteed portion of a 7(a) loan does not count against a bank's legal lending limit, which is imposed by legislation.

One low-volume lender representative said that his bank has a difficult time selling the 7(a) program to the community. Many potential borrowers tell the bank's loan officers that they do not want a 7(a) loan; the lender representative said that it appears many in the community view the program negatively. Another lender representative said that SBA changes the program with very little notice, which causes problems for the bank and its 7(a) customers. She said SBA could improve its communication with the lenders so that they do not prepare 7(a) loan packages only to find out later that the requirements have changed.

Factors That Might Cause the Low-Volume Lenders to Increase Participation

Of the 17 low-volume lenders we contacted, 9 cited factors that might cause their participation to increase. These factors were (1) a reduction in the fees associated with the program, (2) a reduction in the paperwork and documentation required for a 7(a) loan, (3) an increase in the demand for 7(a) loans, (4) an increase in the government's guaranty percentage, and (5) obtaining status as a preferred lender.[6]

Three of the lender representatives surveyed said that if the fees were reduced, participation might increase. For example, one lender representative said that the fees are becoming very cumbersome and that many potential 7(a) borrowers cannot afford them. Another lender representative said that SBA may be pricing itself out of the market with the increase in the guaranty fee because many potential customers are not willing to pay it.

A different lender representative said that if the 50-basis-point fee was eliminated, his bank would be inclined to participate in the program more. Two lender representatives indicated that a reduction in the paperwork and documentation requirements might cause their banks to increase participation. One explained that the program requires too much in terms of paperwork and documentation from potential borrowers, such as resumes.

Two lender representatives said an increase in the demand for 7(a) loans in their communities would cause their banks to increase participation in the program. One lender representative said that an increase in the government's guaranty percentage might cause her bank to increase participation. Finally, one lender representative said that his bank's participation would increase if it could obtain status as a preferred lender.

Principal Reasons for Lenders Not Participating in the Program

The 23 nonparticipating lenders we contacted provided the following principal reasons for not participating in SBA's 7(a) program:

- Lenders do not focus on small business lending. This was the most frequently cited reason for nonparticipation. Eight of the 23 lenders focused their efforts on consumer lending, such as residential mortgage, auto, boat, small unsecured, home improvement, home equity, and passbook savings loans. In addition, three of the lenders that do provide

[6]Under the Preferred Lenders Program, SBA delegates to its best private lenders the authority to approve a borrower's creditworthiness and service SBA-guaranteed loans. SBA retains the authority to determine a loan's eligibility.

small business lending said that they met their customers' credit needs by providing financing without SBA's guarantee.

- SBA's 7(a) loan-processing requirements are too extensive and time-consuming. Eight of the lender representatives surveyed believe that SBA has time-consuming loan-processing procedures. The representatives said that the 7(a) program requires a voluminous amount of documentation, which extends the processing time well beyond normal banking standards. One of the representatives indicated that his bank could process a conventional loan in 2 to 3 days, whereas he believes that it would take SBA anywhere from 30 to 60 days to process the same loan. He indicated that he could not offer 7(a) loans and compete in the marketplace if SBA's processing takes longer than his own bank's. Another lender representative, who recently made his bank's first 7(a) loan, described the program's paperwork as "horrendous and unbelievable." This representative said that it took him almost a year to close the loan and that he even had professional assistance with preparing all the paperwork. A different lender cited the following two examples of SBA's excessive paperwork requirements: (1) Every unmarried customer applying for a 7(a) loan must complete the child support verification forms,[7] and (2) lenders must obtain written verification from the Internal Revenue Service that all 7(a) loan applicants have filed their tax returns. He explained that this coordination with the Internal Revenue Service adds time to the loan process and that customers simply do not want to wait 5 to 6 months to have their loan approved. The lender maintained that all of SBA's paperwork requirements imply that banks do not know their customers and would make risky SBA loans.
- There is a lack of demand for small business loans. Seven of the representatives stated that they serve communities that do not have a lot of demand for small business or 7(a) loans. These seven lenders were located in rural, residential, farming, and tourist communities, which have had a limited number of new businesses start up. One lender representative believes that the lack of demand for small business or 7(a) loans at his bank stems from having to compete with 11 other financial institutions that have 17 branches in their 10,000-resident tourist community.
- The lender lacks experience with 7(a) loans. Seven of the representatives said they had no experience with 7(a) loans and had neither the staff nor the expertise to participate in the program. Moreover, these representatives did not have commercial loan departments and thus were not structured to participate in the program. One lender representative

[7] This is a legislatively mandated requirement pursuant to section 4(f) of the Small Business Act (P.L. 103-403, Oct. 22, 1994).

reported that his loan officers did not know anything about SBA loans or whom to contact at SBA to obtain this information. He also said that his loan officers were too busy to pursue the program because they had other duties and responsibilities that had higher priority. Another lender representative said that his bank refers customers who qualify for 7(a) loans to other lenders who are knowledgeable of SBA's loan-processing procedures and documentation.

- 7(a) loan terms are not favorable. Three of the representatives noted that the fees and interest rates for 7(a) loans are higher than the banks' own fees and rates for small business loans. In addition, one lender representative indicated that SBA's loan program is expensive for the borrowers because the bank passes the guaranty fee on to them. For example, this bank is just about to issue its first SBA 7(a) loan totaling $488,000; the borrower's fees for this loan are approximately $10,000.

Scope and Methodology

Our objectives required comparing a number of relevant characteristics for 7(a) loans and borrowers and non-7(a) loans and borrowers. Because we were not always able to obtain data specifically on non-7(a) loans, we used other available sources of data. We did not attempt to determine the reasons for similarities or differences between the 7(a) and non-7(a) loans and borrowers. This appendix provides a detailed description of our methodology. Each of our data sources is listed in table V.1 below and described in the following sections, including the major assumptions and limitations inherent in their use in this report. This appendix also describes our approach in identifying reasons affecting lenders' decisions to participate or not to participate in the 7(a) program.

Table V.1: Data Sources for Comparing 7(a), Non-7(a), and General Small Business Loans and Borrowers

Topic	7(a) data source	Comparison data source	Figures and tables using these data
Outstanding number and amount of 7(a) and general small business loans (as of June 30, 1995)	SBA's Office of Information Resources Management	Consolidated Reports of Condition and Income (Call Reports) and Thrift Financial Reports	Figures II.1 and II.2
7(a) and non-7(a) loans' characteristics	SBA's management information database	1993 National Survey of Small Business Finances (NSSBF)	Figures II.3 through II.5
7(a) and general small business loans' maturities and interest rates	SBA's management information database	Federal Reserve's Survey of Terms of Bank Lending, published quarterly	Figures II.6 through II.9
7(a) and non-7(a) borrowers' and firms' characteristics	SBA's management information database	NSSBF	Figures III.1 through III.7; table III.1
Sales and assets of 7(a) and non-7(a) firms	Sample of SBA's files located in loan servicing centers in Fresno, CA, and Little Rock, AK	NSSBF	Appendix III, discussion of business characteristics

Because these data sets covered different periods of time, we made adjustments to ensure that the various comparisons covered comparable time frames. For example, we used a subset of SBA's 7(a) data spanning fiscal year 1991 through fiscal year 1993 to compare to the data from the NSSBF. In addition, we converted the Federal Reserve's statistical releases from a calendar-year basis to a fiscal-year basis.

Although each of the sources in table V.1 provides information on small business loans, none is a perfect representation of the general population of small business loans. The sample from NSSBF is representative of only small businesses that applied for and received credit in the past 3 years, not the general population of small businesses. The data from Call Reports and Thrift Financial Reports are representative of only small commercial and industrial and commercial real estate loans outstanding on the books of depository institutions at a point in time. The Survey provides information on new commercial and industrial loans made by commercial banks, but not on outstanding loans; it also does not include real estate or other types of loans to businesses.

Outstanding Loans and Amounts as of June 30, 1995

Our data for outstanding small business loans in general, including both the number and amount of outstanding loans, are based on information reported annually by U.S. commercial banks and insured savings institutions to their appropriate bank regulator. These data are consolidated and maintained in a database at FDIC.[1] We used data reported as of June 30, 1995. The combined data are an estimate of commercial and industrial loans and nonfarm nonresidential loans extended to small businesses by U.S. commercial banks and savings institutions.[2] The number and amount of these loans are grouped by the following three size categories—"$100,000 or less,"[3] "$100,001 to $250,000," and "$250,001 to $1,000,000."[4] We requested that SBA provide the same type of information in the same size categories for the number and amount of outstanding 7(a) loans as of June 30, 1995.

Characteristics of Loans and Borrowers

Unless noted otherwise, the comparisons of 7(a) and non-7(a)[5] loans and borrowers were based on data obtained from two sources: (1) SBA's management information database (for information used to describe 7(a)

[1]U.S. depository institutions are required by federal law to file detailed information in quarterly Call Reports or Thrift Financial Reports. Beginning in June 1993, these institutions have been required to include in their June reports information on the outstanding number and amount of small business loans. For the purposes of the Call and Thrift reports, a small business loan is defined as a commercial and industrial loan or a nonfarm nonresidential loan for which the original amount was $1 million or less. "Original amount" is defined as the total amount of the loan at origination or, for loans made under lines of credit, the size of the line of credit or loan commitment when either was granted.

[2]Our data do not include loans secured by farmland or agricultural loans.

[3]Institutions filing Call and Thrift reports are not required to submit information on loans under $1,000. SBA's 7(a) data contained three loans under $1,000.

[4]Because these are small business loans in general, they include a small portion of 7(a) loans. For outstanding loans of $1 million or less as of June 30, 1995, 7(a) loan dollars accounted for about 6.7 percent of all commercial and industrial, and nonfarm nonresidential loans reported by U.S. commercial banks and insured savings institutions.

[5]The comparisons between 7(a) and non-7(a) are not restricted to SBA programs. For example, data describing non-7(a) could include loans under other SBA programs as well as conventional small business loans.

loans and borrowers) and (2) the NSSBF (for information used to describe non-7(a) loans and borrowers).

SBA provided us with 162,382 records from its management information system, which contained information on all loans approved in fiscal years 1991 through 1995. SBA's data included information on a small number of loans greater than $1 million (1,679 records). We eliminated these records from our analyses because the comparison data sets did not include loans over $1 million. This reduced the number of SBA's records to 160,703. The total number of records in our analysis of SBA's data was further reduced as noted below. SBA's data included information describing the loan—such as the state in which the money was to be used, the loan's approved amount and date, the subprogram,[6] the guaranteed proportion of the loan, the interest rate, and the maturity. The data also included information on the borrower and firm—such as the ethnicity and gender of the principal owner(s), the type of business organization, the number of employees, the standard industrial classification code (SIC), and the firm's status as new (less than 180 days old) or not.

Information from the NSSBF was used as a proxy for non-7(a) borrowers.[7] The NSSBF, which was cosponsored by the Federal Reserve Board of Governors and SBA, collected data through interviews conducted in 1994 and early 1995 with 5,356 firms that were selected to provide a representative sample of all small businesses in the United States.[8] The main purpose of the NSSBF was to provide information on the use of credit by small and minority-owned firms and to create a general-purpose database on the finances of such firms. Because of the time period of the data collection effort, the data were current as of 1993.

At the time of our study, data from the 1993 NSSBF had not yet been published, but the Federal Reserve Board of Governors provided us with preliminary data for 1,811 small businesses that applied for and obtained credit in the last 3 years. This group of small businesses constitutes a

[6]Under the 7(a) program, SBA operates a number of subprograms, such as those intended to assist companies engaged in exporting, firms seeking loans in amounts up to $100,000, and firms seeking lines of credit.

[7]According to Financial Services Used by Small Businesses: Evidence From the 1993 National Survey of Small Business Finances, 0.53 percent of small businesses indicated that the government was the supplier of their financial services. Federal Reserve staff noted that this percentage may understate the incidence of 7(a) loans because, among other reasons, some respondents may have been unaware that they received an SBA-guaranteed loan.

[8]The NSSBF initially selected 15,714 firms, of which 10,141 passed to the main questionnaire stage. Interviews were completed for 5,356 of the firms, or about 50 percent.

subset of the total set of sample respondents of 5,356 firms. The Federal Reserve provided the sampling weights for each of these cases to enable us to weight the observations to their population values. However, the data from the NSSBF were preliminary, and the methodology report for the survey had not been finalized at the time we performed our analyses. Consequently, we did not have the details of the design of the survey sample, the survey's implementation and response rates, and information regarding the handling of missing data. Because estimating the survey's sampling errors would have required making various assumptions, we therefore did not calculate the sampling errors associated with the NSSBF's data. The NSSBF's data were based on a sample, and a measurable precision is associated with each estimate, but without the sampling errors (described in more detail later), great care should be taken when comparing estimates for non-7(a) businesses and 7(a) businesses.

The differences in the data from these two sources had to be reconciled to facilitate comparisons. The adjustments are described below.

Geographic Information

The only geographic information in the NSSBF's data was the census region in which the firm was located.[9] The state listed in SBA's data was used to group the 7(a) data according to census regions. We excluded 3,434 records—for borrowers from Guam, Puerto Rico, and the Virgin Islands with loans of $1 million or less—from all analyses of SBA's data. This further reduced the overall number of SBA's records to 157,269.

Business Organization

SBA's data included three organizational types—individual (or sole proprietorship), partnership, and corporation. The NSSBF included four organization types—proprietorship, partnership, S corporation, and C

[9]The Bureau of Census organizes the 50 states into nine regions, as follows: (1) East North Central (composed of Ohio, Indiana, Illinois, Michigan, and Wisconsin), (2) East South Central (Kentucky, Tennessee, Alabama, and Mississippi), (3) Middle Atlantic (New York, New Jersey, and Pennsylvania), (4) Mountain (Montana, Idaho, Wyoming, Colorado, New Mexico, Arizona, Utah, and Nevada), (5) New England (Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut), (6) Pacific (Washington, Oregon, California, Alaska, and Hawaii), (7) South Atlantic (Delaware, Maryland, District of Columbia, Virginia, West Virginia, North Carolina, South Carolina, Georgia, and Florida), (8) West North Central (Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, and Kansas), and (9) West South Central (Arkansas, Louisiana, Oklahoma, and Texas).

corporation.[10] We combined the two types of corporations in the NSSBF's data to provide comparable information.

Number of Employees

The number of employees in SBA's data is the number as provided by the prospective borrower at the time of loan approval. No specific guidance is given to elicit the number of full-time and/or part-time employees. According to SBA, the number of employees in SBA's data is required as part of the application recording process, so any zeros in this field should be treated as missing values. Therefore, we excluded 167 such values from any analysis of the number of employees.

The NSSBF's data included information on the number of full-time employees and the number of part-time employees. We chose to use two different numbers—(1) the number of full-time employees and (2) the sum of the number of full-time and part-time employees—in our comparison because of the lack of specificity in SBA's data. The NSSBF's data contained zero full-time employees in 3.9 percent of the cases, and no cases with zero once full- and part-time employees were combined. All cases specifying zero were eliminated in the analyses of the number of employees.

Standard Industrial Classification Codes

SBA's data included four-digit SIC codes, and the NSSBF's data included two-digit SIC codes. We used only the first two digits of SBA's SIC codes to ensure comparability. To facilitate our analysis of the SIC codes, we aggregated the two-digit codes into the divisions described in the Standard Industrial Classification Manual, 1987.[11] The divisions described in the Manual did not assign all possible two-digit SIC codes to a division. Because of this, our assignment of two-digit SIC codes to these divisions left some unassigned codes, which were grouped into an "Other" category.

[10]According to Financial Services Used by Small Businesses, from a legal and financial viewpoint, a sole proprietor and his or her company are one. The income of the company flows directly to the proprietor, and the proprietor is responsible for all liabilities of the company. A partnership is a legal relationship between two or more persons for the purpose of conducting business as joint principals. Income goes directly to the partners and is taxed only at the personal level. Like a sole proprietor, partners are responsible for the firm's liabilities. Two primary types of corporations exist: C and S. The income of a C corporation is subject to the corporate tax, whereas the income from an S corporation is not. However, the ownership of an S corporation carries several restrictions—such as those on the number of shareholders and on the number of different classes of stock—that do not apply to a C corporation. Hence the "S form" applies primarily for small businesses.

[11]The SIC code divisions are A for agriculture, forestry, and fishing; B for mining; C for construction; D for manufacturing; E for transportation, communications, electric, gas, and sanitary services; F for wholesale trade; G for retail trade; H for finance, insurance, and real estate; I for services; J for public administration; and K for nonclassifiable establishments.

The unassigned SIC codes constituted 0.2 percent of the 7(a) firms and 9.7 percent of the non-7(a) firms.

Ethnicity

SBA's data included the following categories: African-American, Puerto Rican, American Indian, Hispanic, Asian or Pacific Islander, Eskimo or Aleut, Undetermined,[12] White, and Multigroup.[13] There is no overlap between any of these ethnic categories. We excluded 102 records from any analysis of ethnicity because of missing information.

The NSSBF's data included two data fields related to race and ethnicity. The first field designated whether a firm's ownership was more than 50 percent Hispanic, less than 50 percent Hispanic, or exactly 50 percent Hispanic. The second designated what minority race(s) owned more than 50 percent of the firm—African-American, Asian or Pacific Islander, American Indian or Alaskan Native, and multiple or mixed. Skipping this field indicated that no minority race(s) owned more than 50 percent of the firm—in other words, that more than 50 percent of the firm was owned by Whites.

We recoded both data sets to provide comparable ethnic coding. We recoded SBA's data into the following categories: African-American, Hispanic (combining Puerto Rican and Hispanic), American Indian or Alaskan Native (combining American Indian and Eskimo or Aleut), Asian or Pacific Islander, Undetermined, White, and Multigroup. For consistency with our earlier report, we combined the last three groups into an "Other" category.[14]

We combined the NSSBF's data fields on race and ethnicity to create a new category. All records coded as 50 percent or greater Hispanic were assigned the new ethnic category "Hispanic," regardless of race. All records coded as less than 50 percent Hispanic were assigned new ethnic categories using the data describing race as follows: African-American, Asian or Pacific Islander, American Indian or Alaskan Native, Multigroup, and White.

[12]The "Undetermined" category constituted 1.4 percent of the 7(a) firms.

[13]The "Multigroup" designation applies only to minority enterprises in which at least 51 percent of the owners are from minority categories, but each individual minority category accounts for less than 51 percent. This group constituted 0.2 percent of the 7(a) firms.

[14]The data provided by SBA that we used for analysis in Trends in SBA's 7(a) Program (GAO/RCED-96-158, June 10, 1996) included an ethnic category of "Other," which combined three categories: White, Multigroup, and Undetermined. For consistency, we adopted the same grouping in the current report.

Gender

SBA's data included information on the gender of the principal owner. According to SBA, this field is used to identify businesses that are at least 51 percent owned by one or more women. The NSSBF's data had information designating whether more than 50 percent, less than 50 percent, or exactly 50 percent of the firm was owned by women. We combined the groups of less than 50-percent and exactly 50-percent female ownership to indicate that the firm did not have female ownership.

Line of Credit

SBA's data included a subprogram code. Because some of these involve providing lines of credit while others do not, we recoded this information to reflect whether or not the subprogram code related to a line of credit. The NSSBF's data included a variable that specified whether or not the firm had most recently applied for a line of credit.

Status as a New Business

SBA's data included information indicating whether or not the business was new, which SBA defines as being no older than 180 days (or 6 months). The NSSBF's data included information on the age of the firm in years; we considered a business as new if its age was 1 year or less.[15]

Loan Maturities and Interest Rates

SBA's management information data included information on fixed and variable interest rates and loan maturities in months, which we converted to years. We used the loan approval date to calculate the fiscal year and quarter in which each loan was approved. Using this information, we calculated mean values, weighted by the approval amounts, for the interest rates and maturities of fixed-rate and variable-rate loans. The maturities for 7(a) loans were under 1 year in 1.6 percent of the cases and 1 year and over in 98.4 percent of the cases. We eliminated 2,483 SBA loans with maturities under 1 year from the analyses of interest rates and maturities for comparability with the Survey of Terms of Bank Lending.

The subset of the NSSBF's data provided to us contained no information on interest rates and maturities. The NSSBF collected information on maturities and interest rates, but according to staff at the Federal Reserve, as of August 1996, the data had not been processed. For comparable information on small business loans in general, we used data from the Federal Reserve's statistical release Survey of Terms of Bank Lending for commercial and industrial loans made by commercial banks for each

[15]We attempted to recode the NSSBF's data using an age of 0.5 years or less as the definition of a new business, but 0.0 percent of the businesses were identified as new using this definition. Therefore, we increased the time period defining the age of a new business to 1 year or less.

quarter of fiscal year 1991 through fiscal year 1995.[16] We used this source for our comparison because it was the only available source of this type of data. Loans captured in the Survey could have been made to any size business. However, available research shows that small loans are likely to be to small businesses. Throughout the report, we refer to data from the Survey as describing general small business loans. We used information from the statistical releases—which cover 1 week in the middle month of each quarter—as a rough proxy for the quarter. This is a limitation that should be considered when reviewing our comparisons.

The Survey of Terms of Bank Lending provides information on loans with maturities of 1 year and over in three size categories under $1 million (less than $100,000,[17] between $100,000 and $499,999, and between $500,000 and $999,999). The percentages of 7(a) loans in these categories were 40.9, 49.5, and 9.5 percent, respectively. We focused our analysis on the first two categories because they accounted for 90.5 percent of 7(a) loans.[18] In general, commercial loans with maturities of 1 year and over are more likely to have variable rather than fixed interest rates.

Sales and Assets

Using SBA's management information data, we determined the portion of 7(a) loans approved in fiscal year 1993 that listed SBA's centralized commercial 7(a) loan-servicing centers in Little Rock, Arkansas, or Fresno, California, as the current loan-servicing office: 18.2 and 21.2 percent, respectively.[19] We collected the sales and assets data from the files of a random sample of loans stratified by the two locations. We sampled 375 out of 5,230 cases in Little Rock and 395 out of 6,097 cases in Fresno. We were unable to collect information on 28 and 34 of the selected cases in Little Rock and Fresno, respectively, primarily because the records were either missing or in use in other locations. Therefore, our results apply to an estimated universe of 4,826 loans at Little Rock and 5,572 loans at Fresno.

[16]Through the Survey of Terms of Bank Lending, the Federal Reserve Board of Governors collects data on gross loan extensions made during the first full business week in the middle month of each quarter by a sample of 340 commercial banks of all sizes. The sample data are used to estimate the terms of loans extended during that week at all insured commercial banks. The Survey notes that the estimated terms of bank lending are not intended for use in collecting the terms of loans extended over the entire quarter or residing in the portfolios of those banks.

[17]The Survey does not include information on loans under $1,000.

[18]The percentages of SBA's 7(a) loan dollars in these categories were 11.0, 56.3, and 32.7 percent, respectively. We focused our analysis on the number of loans rather than the loan dollars.

[19]Our sampling unit was loans, but Little Rock and Fresno accounted for 18.4 and 24.5 percent, respectively, of the loan dollars approved in fiscal year 1993.

Because we used a probability sample of loans to develop our estimates of the sales and assets of 7(a) firms whose loans were serviced at Little Rock and at Fresno, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. A sampling error indicates how closely we can reproduce from a sample the results that we would obtain if we were to take a complete count of the universe, using the same measurement methods. By adding the sampling error to and subtracting it from the estimate, we can develop upper and lower bounds for each estimate. The range is called a confidence interval. Sampling errors and confidence intervals are stated at a certain confidence level—in this case, 95 percent. For example, a confidence interval at the 95-percent confidence level means that in 95 out of 100 instances, the sampling procedure we used would produce a confidence interval containing the universe value we are estimating. The confidence intervals for our estimates are contained in footnotes 3 and 4 of appendix III.

The NSSBF's data contained 1992 sales and assets data for a sample of firms. The Federal Reserve Board of Governors' staff notified us that the NSSBF collected sales and assets data as they appeared on the firms' balance sheets on December 31, 1992, since some firms had not completed filing their 1993 tax forms at the time of the survey. Also, staff of the Federal Reserve notified us that the sales and assets data had not been edited for logical consistency at the time it was provided to us and should be used accordingly. In addition, the sampling error associated with each estimate made from this sample is not known. Therefore, great caution should be exercised when reviewing all comparisons of data on 7(a) and non-7(a) firms' sales and assets.

Selection of Lenders for Telephone Surveys

To obtain a range of views about participation in the 7(a) program, we identified lenders that had generated a high volume and a low volume of 7(a) loans and lenders that had not participated in the program.

High-Volume Lenders

Using the same data provided to us from its management information system, SBA determined the top 500 lenders, as indicated by the number of 7(a) loans approved by each lender in fiscal year 1995. SBA provided us with data on each of these 500 firms, including the name and address of the parent financial institution, as well as the number and amount of loans approved in fiscal years 1991 through 1995.

We randomly selected 40 financial institutions from the top 250 institutions on this list. Financial institutions were dropped from the sample if they were nonbank entities, were located outside the continental United States, no longer existed (because of mergers), or were no longer participating in the 7(a) program or if we could not obtain accurate telephone listings for them. Of the 40 lenders in our original random sample, 19 were dropped for these reasons. We conducted telephone interviews with the remaining 21 using a structured interview guide.

In developing our structured interview for the high-volume lenders, we obtained input from four lenders to determine factors that contribute to a lender's decision to participate in the 7(a) program. These lenders were identified by SBA's Dallas District Office as participating in the program. Prior to administering the structured interview guide, we pretested the instrument with three lenders, which we selected from the list of 500 high-volume lenders. Once pretesting was complete, we administered the structured interview to the 21 lenders: 3 in California, 1 in Colorado, 3 in Florida, 3 in Georgia, 1 in Illinois, 1 in Iowa, 1 in Mississippi, 1 in Montana, 1 in New Jersey, 1 in Pennsylvania, 1 in South Dakota, 2 in Texas, 1 in Vermont, and 1 in Virginia.

Low-Volume Lenders

Using data from SBA's management information system, we generated a list of the 1,000 lenders with the fewest 7(a) loans in fiscal year 1995. SBA provided us with the names and addresses of these 1,000 low-volume lenders.

Using this list, we selected a judgmental sample of 17 lenders from five states that are among the most active in the 7(a) program and that provided some geographic dispersion. The five states selected were California (which accounted for 13.2 percent of the 7(a) loans from fiscal year 1991 through fiscal year 1995), Texas (10.3 percent), New York (6.1 percent), Illinois (3.2 percent), and Florida (3.1 percent). We conducted telephone interviews with 17 lenders using a structured interview guide.

In developing our structured interview for the low-volume lenders, we obtained input from 5 of the 1,000 lenders to determine factors that contribute to a lender's decision to participate in the 7(a) program. Because the structured interview guide for the low-volume lenders was very similar to the guide for the high-volume lenders, we pretested the instrument with only one lender. Subsequently, we administered the structured interview guide to the 17 lenders: 3 in California, 3 in Texas, 3 in New York, 4 in Illinois, and 4 in Florida.

Nonparticipating Lenders

We also interviewed lenders that do not participate in the 7(a) program to determine the reasons underlying their lack of participation. We wanted these nonparticipating lenders to be located in the same five states—California, Texas, New York, Illinois, and Florida—that are active in the 7(a) program.

Comparing listings of lenders in the Spring 1995 Polk North American Directory of Financial Institutions and SBA's September 30, 1995, "Lender's Guaranty Loan Report," we identified nonparticipating lenders. We judgmentally selected 23 such lenders from the five states: 2 in California, 9 in Texas, 4 in New York, 4 in Illinois, and 4 in Florida.

We conducted telephone interviews with these 23 lenders and asked why they did not participate in the 7(a) program. We recorded their responses and then categorized them using content analysis.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

Lawrence J. Dyckman, Associate Director
David G. Wood, Assistant Director
Charles E. Wilson, Jr., Evaluator-in-Charge
Angela Crump-Volcy, Senior Evaluator
Judy K. Pagano, Senior Operations Research Analyst
SaraAnn W. Moessbauer, Senior Operations Research Analyst
Annette Wright, Senior Technical Specialist
Jonathan Bachman, Senior Social Science Analyst
Stephen M. Brown, Senior Economist

Dallas Office

Luis Escalante, Jr., Senior Evaluator
Sally S. Moino, Staff Evaluator

Office of the General Counsel

John T. McGrail, Senior Attorney

Related GAO Products

Trends in SBA's 7(a) Program (GAO/RCED-158R, June 10, 1996).

Small Business: Analysis of SBA's Preferred Lenders Program (GAO/RCED-92-124, May 15, 1992).

Small Business: Improving SBA Loan Collateral Liquidations Would Increase Recoveries (GAO/RCED-92-5, Dec. 19, 1991).

Small Business: Financial Condition of SBA's Business Loan Portfolio Is Improving (GAO/RCED-92-49, Dec. 3, 1991).

SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Market (GAO/RCED-83-96, Apr. 25, 1983).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

http://www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Correction Requested

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100