NSBA
National Small Business Association®

America's small business advocate

ISSUE BRIEF

Bank Examiners and Small Biz Credit Scores

Small businesses should not suffer because of banks' overreliance on credit scores

NSBA has warned repeatedly over the last several years that limitations on small businesses' ability to garner capital will continue to hinder broad U.S. economic growth. Using NSBA data from as far back as 1993, there is a clear correlation to a small-business owner's ability to hire and his/her ability to get financing. Despite this, small businesses' ability to get capital has diminished significantly over the last four years.

The prospect of getting financed as a small business—even in a growing economy—is very difficult simply due to the fact that many small businesses lack the assets necessary for a traditional bank loan, making them a riskier lending option for banks.

The ongoing credit crunch has put many small-business owners in an unfortunate situation vis-à-vis their credit scores and a birds-eye view of their finances. The arbitrary dropping of credit limits and calling in of loans, the decreasing value of homes—for which a good number of entrepreneurs utilize to finance their small business—and a banking community that has grown so risk-averse that only the most financially sound small business can qualify for financing have all contributed to lending gridlock.

Because small firms are so closely tied to the financial well-being of the owner, any kind of negative mark on the owners FICO score can spell disaster. This is particularly problematic given the widespread cutting of credit lines or reducing credit-card limits for reasons unconnected to the operations of the actual business or entrepreneur in question. Having a credit line cut or credit-card limit reduced means that the affected small-business owner suddenly is using more of his or her available credit, which reduces their credit score. Thirty percent of a FICO score is based on credit utilization rates.

If the affected small-business owners needs access to additional credit and seeks out a new credit line or credit card, it also negatively affects his credit score. This might not be such a problem, if banks were not overly reliant on the personal credit scores of small-businesses owners when it comes to making small-business loans. This is especially true of large banks.

It is also important to note that, while the banks themselves have stepped farther and farther away from making small-business loans based on more than just a FICO score—so-called "character loans"—banking regulators also are playing a roll. There exists extreme pressure, even despite high-ranking officials making statements to the contrary, on banks by their examiners to only make loans that are deemed extremely sound. Based on such restrictive qualifiers, few small-business loans can pass muster.

NSBA urges Congress to enact legislation to address the problem many small-business owners face with banks' overreliance on credit scores, and urges regulators to seek alternative methods of evaluating the soundness of loans when it comes to small businesses