FEDERAL RESERVE SYSTEM COMMUNITY DEVELOPMENT RESEARCH CONFERENCE
RESILIENCE & REBUILDING FOR LOW-INCOME COMMUNITIES:
RESEARCH TO INFORM POLICY AND PRACTICE
APRIL 11–12, 2013

"Information Externalities and Small Business Lending by Banks: A Comparison of Urban and Rural Counties in the U.S."

Presenter: Stephan Weiler, Colorado State University

Stephan Weiler is a professor of economics and research associate dean in the College of Liberal Arts at Colorado State University. From 2004 through 2006, he was assistant vice president and economist at the Federal Reserve's Center for the Study of Rural America and led the center's applied research work. The center was the focal point in the Federal Reserve System for rural and regional development issues, providing cutting-edge research perspectives to private, public, and nonprofit decision makers. His research, comprising nearly 100 articles, book chapters, and policy papers, has spanned a variety of development and labor market issues in Africa, Appalachia, Europe, and the American West. Weiler's current work focuses on regional economic growth and development, particularly in rural and inner-city areas, combining theoretical, empirical, and policy analyses on topics such as information, innovation, industrial restructuring, land use, public/private partnerships, immigration, entrepreneurship, and the environment. He received his BA with honors in economics and MA in development economics from Stanford University, and his PhD in economics from the University of California–Berkeley, where he studied with eventual 2001 Nobel Laureate George Akerlof.

Coauthors: Ronnie Phillips, Colorado State University; Natalia Kravchenko, Philip Morris International

Summary and Findings: It is widely recognized that small business is not only an important source of employment but is the genesis of virtually all successful large enterprises. Given their size and characteristic opaqueness, small and medium enterprises (SMEs) tend to be more financially constrained than large firms because of the lack of access to external financing from both banks and capital markets. Though building a relationship provides the loan officer more information about the individual entrepreneur, there are other factors that can influence the success or failure of an enterprise. We divide the entrepreneurial information available to bank loan officers into three segments: information about competition in the local banking market, information about success and failures of other SMEs in the local market, and information about how well other banks are performing in the local market. The primary purpose of our paper is to find proxies for this entrepreneurial information and to gauge its impact on bank lending in a geographical area. We then test to see how our proxies for this information impact the dollar volume of small business lending. Our analysis uses county level data as the geographical area and controls for general economic conditions such as the level of income and the endowments of human capital. The paper confirms the importance of entrepreneurial information in influencing the level of SME lending by banks.

Implications for Policy and Practice: The findings of this paper help clarify the role of bank size, lending competition, and information on community banks' propensity to lend to small businesses. Both bankers and policymakers hopefully will find these results useful when considering how to support small business financing, regional entrepreneurship, and job growth.