Financing Small Business: Landscape and Policy Recommendations

January 2025

The U.S. Department of the Treasury's (Treasury) mission of promoting economic prosperity has made support for small businesses a longstanding priority of Treasury.[1] Treasury administers multiple programs that support small businesses and has provided historic funding to these programs during the Biden-Harris Administration. In addition, Treasury's Office of Financial Institutions Policy (OFIP) has been working to better understand the state of the small business finance market given recent changes in credit provisioning, including through hosting a public roundtable with a wide variety of stakeholders representing small businesses, regulators, advocates, and the financial sector, and leading various small business engagement events, in coordination with other Treasury offices.[2]

Over the past several years, changes in the economy and technology have shifted how capital providers serve the small business community. These changes have particularly impacted businesses owned by members of underserved communities, including tribal members, women, and people of color.[3] Beyond traditional bank loans, non-traditional sources of financing, including from financial technology companies (fintechs), venture capital, and private equity, have played a larger role in financing than in earlier periods. Recently, the use of embedded financing, artificial intelligence and machine learning has changed the landscape of small business finance. This brief examines small business financing in light of recent technological changes and summarizes key findings about barriers facing small businesses. This brief also makes recommendations to foster a competitive and inclusive marketplace for small business capital.

Key findings:

- Many small business owners expressed difficulty in obtaining information about, or comparing, financial products, especially those with variable repayment terms, interest rates, fees, or financing arrangements, including merchant cash advances, factoring, or equity financing, which may contribute to a less competitive market;

---

[1] Small businesses are generally defined by the U.S. Small Business Administration (SBA) as independent businesses with fewer than 500 employees or with annual revenue below a certain level. 13 C.F.R. § 121.201. However, many sources define small business differently. For instance, other federal programs may use different definitions of small business, with SBA approval. 13 C.F.R. § 121.903. Capital providers often use different internal definitions. FEDERAL DEPOSIT INSURANCE CORPORATION, 2024 FDIC SMALL BUSINESS LENDING SURVEY (2024), https://www.fdic.gov/system/files/2024-09/small-business-lending-survey-2024-full.pdf.

[2] The roundtable and this note were led by Deputy Assistant Secretary Jeanette Quick, University of California Berkeley Law Professor Manisha Padi on detail to OFIP, Liang Jensen, and Detailee Casey Laxton as well as staff from the Office of Tribal and Native Affairs, Office of Consumer Policy, Office of Community and Economic Development, Office of Capital Access, Equity Hub, and the CDFI Fund.

[3] Underserved business owners experienced higher job loss during the COVID-19 pandemic and received less support from federal programs like the Paycheck Protection Program (PPP). *See* Jeanette Quick, "Minority owned businesses face an unequal recovery," THE HILL (Sept. 11, 2021), https://thehill.com/opinion/finance/571824-minority-owned-businesses-face-an-unequal-recovery-an-underfunded-federal/. "Underserved communities" include inner cities and rural areas and may include populations such as minorities, women, veterans, tribal groups, and others. *See* SBA, *Council on Underserved Communities*, https://www.sba.gov/about-sba/organization/sba-initiatives/council-underserved-communities.

- Over the last decade, large banks have tightened credit standards and originated fewer loans,[4] while fintechs have originated more loans to small businesses;
- Community banks and mission-driven lenders, including Community Development Financial Institutions (CDFIs), and targeted funding programs, including the State Small Business Credit Initiative (SSBCI), have made a meaningful impact in providing capital to underserved populations but may not fill remaining gaps in capital access; and
- Underserved business owners can face unique challenges, including limited connection to small business capital sources, lack of personal resources, and cultural barriers to accessing financial services.

Treasury recommends that:

- Policymakers continue to engage with industry stakeholders to evaluate the need for additional small business financing and discuss how to expand access to fill gaps;
- Capital providers consider how to deepen small business access to capital, including through leveraging government programs (such as Small Business Administration (SBA) programs), within prudent risk management standards;
- Policymakers, including legislators and regulators, conduct research and analysis to determine whether small business capital providers would benefit from more uniform product disclosures across product types that include information such as APR and fee disclosures, enabling more ready comparison and stronger competition;
- Capital providers consider voluntarily developing uniform disclosures with understandable terms for small businesses, including information about repayment terms and fees;
- Government agencies strengthen coordination with each other (including state and federal financial regulators, Commerce, Treasury, SBA, and others) to foster a robust and inclusive financial system, which includes access to small business financing, and develop coordinated resources for small business owners; and
- Regulators continue to coordinate their approach to emerging technologies, such as AI, including promoting consistent and robust standards for financial institutions deploying new technology.[5]

1. Small Business Capital Needs

The small business loan market in the United States is valued at over $1.4 trillion.[6] In the past five years, new small business formation has surged by 50%, with a record 430,000 new business applications each month in 2024 and creating 70% of net new jobs.[7] Small businesses play an important role in the economy, accounting for more than 43% of the U.S. GDP and 40% of private sector payroll.[8] Despite

[4] Large banks are defined as those with total domestic assets over $10 billion. Dustyn DeSpain and Jordan Pandolfo, *New Small Business Lending Declines as Credit Standards Continue to Tighten*, Federal Reserve Bank of Kansas City (Sept. 27, 2024), https://www.kansascityfed.org/surveys/small-business-lending-survey/new-small-business-lending-declines-as-credit-standards-continue-to-tighten/.

[5] U.S. Department of Treasury, Artificial Intelligence in Financial Services (Dec. 2024), https://home.treasury.gov/system/files/136/Artificial-Intelligence-in-Financial-Services.pdf.

[6] Consumer Financial Protection Bureau, Key dimensions of the small business lending landscape (May 10, 2017), https://www.consumerfinance.gov/data-research/research-reports/key-dimensions-small-business-lending-landscape/.

[7] Eric Van Nostrand, *Small Business and Entrepreneurship in the Post-COVID Expansion*, U.S. Department of the Treasury (Sept. 3, 2024), https://home.treasury.gov/news/featured-stories/small-business-and-entrepreneurship-in-the-post-covid-expansion.

[8] Office of Advocacy, U.S. Small Business Administration, *Frequently Asked Questions About Small Business* (July 2024), https://advocacy.sba.gov/wp-content/uploads/2024/12/Frequently-Asked-Questions-About-Small-Business_2024-508.pdf.

this, more than three quarters of the small businesses surveyed are concerned about access to capital.[9] A third of small businesses reported in the surveys that making payments on debt is a challenge due to higher costs of financing.[10] The majority of small business owners have reported financial hardship due to higher prices on goods, services, and wages.[11] Credit standards for small business owners remain tighter than before the pandemic, despite trends towards easing in the last few quarters.[12]

Multiple federal agencies provide direct or indirect funding or loan guarantees to support small businesses.[13] Treasury operates several programs that support small business finance and access to credit through tax policy or intermediaries, including the SSBCI and the Emergency Capital Investment Program (ECIP). It engages on small business capital access through the Office of Capital Access (OCA), Office of Community and Economic Development (OCED), and CDFI Fund.[14] These programs have had significant impact on small businesses. For example, the SSBCI program supported $3.1 billion in new financing for small businesses since its renewal in 2022.[15] Since its inception, the CDFI Fund has completed 28 rounds of financial assistance and technical assistance awards totaling over $3.4 billion.[16] CDFI Program Award Recipients have reported originating loans or investments of nearly $300 billion since 2010.[17] Many other government programs across agencies support small businesses, each of which have significant impacts.[18]

The important work done by federal grant and guarantee programs serves only part of the overall needs of small business owners.[19] This note is not intended to focus on the efficacy of small business-related programs internal or external to Treasury, but rather focuses on the small business financing provided by private capital providers. OFIP has also explored several related topics that have touched on small business finance, including recently publishing a request for information on the use of artificial intelligence (AI) in financial services, which sought information about how AI is deployed in small business loan underwriting, as well as convening a roundtable on tribal finance, which included questions about small business capital access in tribal communities.

---

[9] Goldman Sachs, *Glass Half Full: Small Business Owners Optimistic About 2024 Despite Challenging Business, Lending Environment* (Jan. 31, 2024), https://www.goldmansachs.com/community-impact/10000-small-businesses-voices/insights/glass-half-full.

[10] *Id.*; FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2023 SMALL BUSINESS CREDIT SURVEY at 5 (Mar. 7, 2024), https://doi.org/10.55350/sbcs-20240307.

[11] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS *supra* note 10, at 4.

[12] Van Nostrand *supra* note 7.

[13] BRETT THEODOS ET AL., URBAN INSTITUTE, FEDERAL SMALL BUSINESS SUPPORTS (Feb. 12, 2024), https://www.urban.org/research/publication/federal-small-business-supports.

[14] COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND, U.S. DEPARTMENT OF THE TREASURY, ANNUAL REPORT FISCAL YEAR 2024 (Dec. 31, 2024), https://www.cdfifund.gov/sites/cdfi/files/2024-12/CDFI_Fund_FY_2024_Annual_Report_FINAL.pdf (CDFI Fund Report).

[15] STATE SMALL BUSINESS CREDIT INITIATIVE, U.S. DEPARTMENT OF TREASURY, SSBCI ANNUAL REPORT 2022-2023 (Nov. 2024), https://home.treasury.gov/news/press-releases/jy2728.

[16] CDFI Fund Report *supra* note 14.

[17] CDFI Fund Report *supra* note 14.

[18] For example, the SBA administers several programs including loan guarantees, investment funds, and disaster relief funds that are generally offered to the public by traditional financial institutions. Other agencies with a significant focus on small business include the U.S. Department of Commerce, especially their Minority Business Development Agency (MBDA) and Economic Development Agency (EDA), as well as the U.S. Department of Agriculture's Farm Credit Program, among others. Across state and federal governments, small businesses receive procurement preferences that provide additional opportunities.

[19] FEDERAL RESERVE BANKS, 2023 REPORT ON NONEMPLOYER FIRMS: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY (May 31, 2023), https://doi.org/10.55350/sbcs-20230531.

Funding challenges are particularly problematic for underserved business owners.[20] A large academic literature has demonstrated that underserved business owners are disproportionately denied financing, despite having similar risk profiles as those who successfully obtained financing.[21] Women- and minority-owned small businesses continue to be denied funding at higher rates than male- and white-owned businesses, respectively.[22] Using personal credit or savings is common for business owners, but can result in significant disparities due to gaps in credit scores across race, gender, and other demographic lines.[23] Equity financing is harder to access for underserved business owners, due in part to exclusion from networks including potential investors.[24] Taken together, the evidence suggests that all small businesses, and underserved business owners in particular, have significant unmet need for financing.

2. Trends in Small Business Financing

Capital providers that originate the majority of small business loans include large banks, small banks and fintech companies, as well as credit unions, CDFIs, and other small institutions.[25] Nearly 45% of small businesses with employees report seeking loans from large banks, compared to 37% from nonbank lenders and 28% from small banks.[26] One-third of small businesses with employees seek funding outside loans, including personal savings, personal credit, investments from friends and family, and equity financing.[27] New startup firms rely heavily on private savings, bank loans, and personal credit, with only 0.5% turning to external equity financing such as venture capital.[28]

Banks originate the majority of small business loans.[29] Traditionally, they provide installment loans, lines of credit, and other standard loan products based on the business owner's personal creditworthiness and

---

[20] *See Building Opportunity: Addressing the Financial Barriers to Minority- and Women-Owned Businesses' Involvement in Infrastructure Projects, Hearing Before the House Financial Services Subcommittee on Diversity and Inclusion*, 117th Congress (Feb. 3, 2022) (statement of Jeanette Quick, Head of Compliance and Public Policy, Gusto), https://www.congress.gov/117/meeting/house/114374/witnesses/HHRG-117-BA13-Wstate-QuickJ-20220203.pdf.

[21] *See, e.g.*, David G. Blanchflower, Phillip B. Levine & David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85 THE REVIEW OF ECONOMICS AND STATISTICS 4 (2003), https://doi.org/10.1162/003465303772815835; Lloyd Blanchard, Bo Zhao & John Yinger, *Do Lenders Discriminate Against Minority and Woman Entrepreneurs?*, 63 JOURNAL OF URBAN ECONOMICS 2 (2008), https://doi.org/10.1016/j.jue.2007.03.001; Loren Henderson, Cedric Herring, Hayward Derrick Horton & Melvin Thomas, *Credit Where Credit is Due?: Race, Gender, and Discrimination in the Credit Scores of Business Startups*, 42 THE REVIEW OF BLACK POLITICAL ECONOMY 4 (2015), https://doi.org/10.1007/s12114-015-9215-4; Sterling A. Bone, Glenn L. Christensen, Jerome D. Williams, Stella Adams, Anneliese Lederer & Paul C. Lubin, *Detecting Discrimination in Small Business Lending*, (Huntsman School of Business, Utah State University, Paper 366, 2017), https://digitalcommons.usu.edu/manage_facpub/366/; Michael Ewens, *Chapter 6 - Gender and Race in Entrepreneurial Finance, in* 1 HANDBOOK OF THE ECONOMICS OF CORPORATE FINANCE 239-296 (B. Espen Eckbo, Gordon M. Phillips, Morten Sorensen eds., 2023), https://doi.org/10.1016/bs.hecf.2023.02.006; S. T. Howell, T. Kuchler, D. Snitkof, J. Stroebel, & J. Wong, *Lender Automation and Racial Disparities in Credit Access*, 79 THE JOURNAL OF FINANCE 2 (2024).

[22] FEDERAL RESERVE BANKS, 2023 REPORT ON STARTUP FIRMS OWNED BY PEOPLE OF COLOR: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY (June 16, 2023), https://www.fedsmallbusiness.org/reports/survey/2023/2023-report-on-startup-firms-owned-by-people-of-color; FEDERAL RESERVE BANKS, 2024 FIRMS IN FOCUS CHARTBOOKS ON SMALL BUSINESS DATA (May 31, 2024), https://www.fedsmallbusiness.org/reports/survey/2024/2024-small-business-data-chartbooks.

[23] Julia Fonseca and Jialan Wang, *How Much do Small Businesses Rely on Personal Credit* (2022), https://files.consumerfinance.gov/f/documents/cfpb_2022-research-conference_session-6_fonseca-wang_paper.pdf.

[24] Johan Cassel et al., *Racial Diversity in Private Capital Fundraising* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4222385.

[25] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS *supra* note 10, at 12.

[26] *Id.*

[27] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS *supra* note 10, at 21.

[28] Victor Hwang, Sameeksha Desai, & Ross Baird, *Access to Capital for Entrepreneurs: Removing Barriers*, EWING MARION KAUFFMAN FOUNDATION (April 2019), https://www.kauffman.org/wp-content/uploads/2019/12/CapitalReport_042519.pdf.

[29] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.

on the business' assets and profitability.[30] Banks have tightened credit standards in recent years.[31] Non-bank capital providers, including fintechs, have participated more actively in small business lending over the past fifteen years, both directly and through bank partnerships.[32] As bank originations have decreased, fintechs have replaced only part of that lending.[33]

More than a third of small businesses report applying for funding from a non-bank financial institution.[34] These include standalone non-bank lenders, as well as lenders who offer loans as supplements to other core services such as commerce, payroll, human resources management, banking, payment, marketing or logistics.[35] Some non-bank capital providers offer sales-based financing products, which include merchant cash advances, factoring, and invoice financing, and may utilize collections technology that automatically debits part of the business owner's receivables.[36]

High risk, low credit score business owners, as well as those from underserved groups, are most likely to apply for non-bank funding.[37] Of small business owners with low credit scores, for example, 60% reported applying for financing from an online non-bank lender, while only 13% of those with high credit scores did so.[38] Only 20% of men-owned businesses applied for funding through an online non-bank lender, while 33% of women-owned businesses did so. Finally, 44% of Hispanic business owners applied for an online loan, compared to 21% of white business owners. Although banks and non-banks operate differently, research has shown that higher non-bank participation in a market means banks do less small business lending in that market.[39] Borrowers report that non-bank loans appear to be more expensive than bank loans, but potentially easier to access, although comparisons across financing options are hindered by a lack of standardized metrics.[40]

Small businesses use other forms of financing beyond business debt. The most common source of alternate funding is personal savings or credit cards.[41] Relatively few small business owners can access external equity financing such as venture capital.[42] Regardless of financing choices, small business

---

[30] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.
[31] Rohit Arora, *As Bank Lending Falls, Business Borrowers Turn to Alternative Lenders*, FORBES.COM (Aug. 26, 2023), https://www.forbes.com/sites/rohitarora/2023/08/26/as-bank-lending-falls-business--borrowers-turn-to-alternative-lenders/.
[32] *Id.*; FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS *supra* note 10. Other notable participants in the small business market include credit unions, who have increased their participation in the small business loan market but originate relatively few loans compared to banks and fintechs. *See* NATIONAL CREDIT UNION ADMINISTRATION, FINANCIAL PERFORMANCE REPORT (2024), https://fpr.ncua.gov/.
[33] Tetyana Balyuk et al., *What is Fueling FinTech Lending? The Role of Banking Market Structure* (June 27, 2022), https://ssrn.com/abstract=3633907.
[34] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.
[35] Karen Mills, FINTECH, SMALL BUSINESS & THE AMERICAN DREAM, 2nd Edition (2024).
[36] CONSUMER FINANCIAL PROTECTION BUREAU, *Small Business Lending Rule FAQs: Covered Credit Transactions, Question 3,* https://www.consumerfinance.gov/compliance/compliance-resources/small-business-lending-resources/small-business-lending-collection-and-reporting-requirements/small-business-lending-rule-faqs/.
[37] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.
[38] Low credit score is defined as personal credit score below 620 and business credit scores below 49, while high credit score is defined as personal credit score above 720 or high business credit scores above 80. *See* FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.
[39] Jacelly Cespedes, et al., *Branching Out Inequality: The Impact of Credit Equality Policies* (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4702125.
[40] OFFICE OF ADVOCACY, SMALL BUSINESS ADMINISTRATION, *Interest Rates and Non-Bank Lending to Small Businesses* (Aug. 2017), https://advocacy.sba.gov/wp-content/uploads/2017/08/Interestratesissuebrief508compliant.pdf; FEDERAL RESERVE BANK OF CLEVELAND, *Research [in] Brief: Fintech Lending Expands Small Businesses' Options* (July 8, 2020), https://www.clevelandfed.org/publications/research-in-brief/2020/rib-20200709-fintech-lending.
[41] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.
[42] OFFICE OF ADVOCACY *supra* note 8.

survival and profitability is far from guaranteed. More than half of businesses shut down within five years.[43] Even businesses with significant revenue face financial challenges due to economic fluctuations.[44]

Still, small business ownership is an important pathway to asset and wealth building, especially for underserved business owners.[45] Among the subset of business owners labeled self-employed workers, who work for profit in their own unincorporated businesses, women made up 43% of the total in July 2024, higher than the past 20 years.[46] Since 2019, the share of self-employed workers who are non-white has increased by 3.7 percentage points, suggesting that business owners are now more diverse than in the past.[47] Many of these new businesses serve the economic needs of underserved business owners caring for dependents.[48] As noted above, funding challenges are particularly problematic for underserved business owners and these business owners have significant unmet need for financing.

3. Barriers to Capital Access

Based on Treasury's outreach to stakeholders and further research, we have classified barriers to capital access into categories below.

A. Information gaps

One of the largest issues identified by stakeholders are gaps in business owners' information about financing structure, terms, and risks, and in capital providers' knowledge of small business creditworthiness. Regulators also reported limited information about the small business market.

i. Business owners' information gaps

Small business owners who are seeking financing and capital often are confronted with financing arrangements with complex repayment features such as variable repayment schedules which can change significantly over time. Other examples of complex financial structures include interest-only loans that offer low payments of interest up front but require the entire principal to be repaid at maturity and sales-based financing arrangements that automatically collect payments as a fraction of a business' receivables. Unlike consumer loans, which are subject to standardized disclosures such as in the Truth in Lending Act, there are no standardized terms or disclosures making the comparison of products across different lenders and loan types difficult. Business owners often rely on informal advice as a way to fill knowledge gaps. Underserved business owners with smaller networks may not have access to informal information sources, resulting in disparate outcomes.

Beyond financing information, business owners are often unprepared to navigate the requirements to obtain financing and require technical assistance to produce a business plan, report profit and losses, and properly document assets to capital providers. Stakeholders reported that community banks and credit unions often perform outreach and develop relationships with business owners to provide this assistance.

---

[43] U.S. CHAMBER OF COMMERCE, SMALL BUSINESS STATISTICS (last updated July 24, 2024), https://www.chamberofcommerce.org/small-business-statistics/.

[44] William C. Dunkelberg and Holly Wade, *Small Business Economic Trends*, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES (Nov. 2024), https://www.nfib.com/surveys/small-business-economic-trends/; U.S. CHAMBER OF COMMERCE, *Small Business Index* (2024), https://www.uschamber.com/sbindex/uploads/2024_Q3_assets/SBI_2024_Q3.pdf.

[45] *See, e.g.*, Brett Theodos and Dennis Su, *Small Business Ownership and Finance: A Landscape Scan of the Historical Underpinnings of Current Conditions*, URBAN INSTITUTE (Mar. 2023), https://www.urban.org/sites/default/files/2023-03/Small%20Business%20Ownership%20and%20Finance.pdf.

[46] Van Nostrand *supra* note 7.

[47] *Id.*

[48] *See* Testimony of Jeanette Quick *supra* note 20.

Stakeholders suggested that they have experienced fewer instances of outreach and technical assistance from large banks, consistent with large banks' self reported hesitancy to meet with potential borrowers.[49] These patterns are consistent with evidence that large banks have lower approval rates for small business loan applications than small banks, despite being the primary recipients of loan applications from underserved business owners[50]

ii. Capital providers' information gaps

Capital providers incorporate different sources of information when making financing decisions. Large banks rely primarily on hard information, such as personal credit scores, bank statements, and asset value, when making lending decisions.[51] They incorporate soft information, such as management skills, company strategy, and borrower behavior, in their lending decisions less frequently than smaller banks.[52] This may create a barrier in access to the largest sources of financing for business owners with positive cash flow in their venture but low personal credit scores.[53] Stakeholders reported that this can creates barriers for new ventures and less formalized businesses that may not have the same credit history.

In contrast, fintechs utilize a mix of hard and soft information at a large scale by using statistical techniques to assess creditworthiness, but they do not fill the gaps left by declining bank lending and tightened bank credit standards.[54] Stakeholders reported that new financial technologies have diversified the market for small business capital, though they may also introduce new risks.

Small banks can potentially serve business owners that have trouble finding high quality financing from large banks or fintechs.[55] According to research, they originate loans considering soft information, which can benefit underserved business owners that are unable to furnish hard information, such as credit scores.[56] Stakeholders reported that the benefits of soft information may have associated drawbacks, including errors in assessing creditworthiness or a focus on borrowers with a previous relationship with the lender.

iii. Government Agencies' information gaps

Roundtable participants noted that regulators and other government agencies may not have detailed information about small business financing made by financial institutions, which in turn may limit their ability to identify communities without access or to evaluate the small business market. Several federal agencies gather survey or data on small businesses lending, but there is not yet a comprehensive administrative dataset recording small business financing.[57] Some of the gap may be filled by the

[49] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.
[50] FEDERAL RESERVE BANKS, 2024 FIRMS IN FOCUS, *supra* note 21; FEDERAL RESERVE BANKS, 2022 REPORT ON FIRMS OWNED BY PEOPLE OF COLOR: BASED ON THE 2021 SMALL BUSINESS CREDIT SURVEY (2022), https://www.fedsmallbusiness.org/categories/race-and-ethnicity/2022-report-on-firms-owned-by-people-of-color.
[51] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.
[52] *Id.*
[53] Paul Calem et al., *Bridging the Gap: How Larger and Mid-sized Banks Power Small Businesses*, BANK POLICY INSTITUTE (July 21, 2023), https://bpi.com/bridging-the-gap-how-large-and-mid-sized-banks-power-small-businesses/.
[54] Balyuk et al., *supra* note 32.
[55] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.
[56] *Id.*
[57] The Fed Small Business Survey takes a comprehensive view of small business capital providers, while the FDIC Small Business Lending survey focuses on bank loans. *See* FED SMALL BUSINESS, https://www.fedsmallbusiness.org/ (last visited Dec. 12, 2024); FDIC SMALL BUSINESS LENDING SURVEY, https://www.fdic.gov/publications/fdics-small-business-lending-survey (last visited Dec. 12, 2024). Administrative data on small business lending includes data from the Community Reinvestment Act (CRA), but those records are only available for banks undergoing CRA examination in any given year and records limited information. *See* FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL: COMMUNITY REINVESTMENT ACT, https://www.ffiec.gov/cra/craproducts.htm (last visited Dec. 12, 2024). Bank call reports include several variables pertinent to

Consumer Financial Protection Bureau's (CFPB) rulemaking on small business lending data collection under Section 1071, which may facilitate a more comprehensive record of small business loan characteristics and may highlight which communities lack access to capital or identify patterns in the distribution of risk.[58] A variety of roundtable participants expressed their eagerness to utilize data collected pursuant to Section 1071 to identify further issues in the small business loan market. Additional data sources on small business continue to emerge. For instance, Treasury has begun discussions with regulators to add small business lending questions to existing surveys of market conditions. Currently, however, regulators often report reliance on imprecise estimates to assess the market for small business financing.

B. Tight credit standards

Bank lending to small businesses has been declining for several years.[59] Though non-bank lenders have made up part of the difference, business owners report a perception that financing is difficult to obtain. Nearly 40% of potential business loan applicants do not apply for financing.[60] More than 20% of loan applications are rejected, while a further 28% receive partial funding.[61]

Survey data shows that bank credit standards for small business loans have tightened over the last three years, reflecting larger trends in the commercial lending market.[62] The majority of banks report that the main consideration they use in evaluating applications is the business' financial position.[63] However, personal credit score and other factors contribute. Business owners that are unable to obtain bank financing often have one or more of these factors working against their approval. Some do qualify for sales-based financing, but stakeholders report that those products may be perceived as costly. Business owners often pay for business expenses on personal credit cards or take loans against personal assets, perpetuating the cycle of low credit access due to low personal credit scores.

C. High interest rates and fees

Business owners reported to Treasury that available financing had high associated interest rates and fees. Banks are often able to provide loans and lines of credit at interest rates below 10% in APR terms.[64] SBA loans, which target business owners who cannot obtain other forms of financing, are available at rates up to 16% interest.[65] Ultimately, many businesses turn to sales-based financing options which are estimated to charge over 25% and up to 200% in equivalent APR for loans.[66] Prices may be even higher for borrowers who access small business loans through brokers, who are paid on commission.

---

small commercial loans, but do not address non-bank capital providers. FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, Central Data Repository's Public Data Distribution (2024), https://cdr.ffiec.gov/public/ManageFacsimiles.aspx. The Small Business Administration has significant data related to administration of its programs but does not have a comprehensive dataset of small business financing outside of its programs.

[58] 12 C.F.R. § 1002.

[59] Dustyn DeSpain and Lauren Bennett, *Small Business Lending Demand Continues to Decline*, FEDERAL RESERVE BANK OF KANSAS CITY (Dec. 20, 2023) https://www.kansascityfed.org/surveys/small-business-lending-survey/small-business-lending-demand-continues-to-decline-december-2023/.

[60] FEDERAL RESERVE BANKS, 2024 REPORT ON EMPLOYER FIRMS, *supra* note 10.

[61] *Id.*

[62] DeSpain and Pandolfo *supra* note 4.

[63] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.

[64] Lindsay VanSomeren and Jordan Tarver, *Average Business Loan Rates: What Will You be Charged?* FORBES.COM (Oct. 11, 2024), https://www.forbes.com/advisor/business-loans/average-business-loan-rates/.

[65] *See* SMALL BUSINESS ADMINISTRATION, TERMS, CONDITIONS, AND ELIGIBILITY, https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility (last visited Dec. 12, 2024).

[66] *Id.*

In addition, capital providers report that higher interest rates and the costs of underwriting small business loans are factors that contribute to the higher pricing of small business loans, since each loan's risk has to be evaluated differently based on sector-specific information and highly varied forms of collateral. The cost of funding may also be high. Moreover, the high risk of small business failure means that loans must be priced higher or be over-collateralized to minimize the financial institution's expected losses. To pay these high interest rates, small business owners allocate a significant fraction of their revenue to service debt, limiting their ability to invest further in their business.

D. Imperfect match between business needs and financing structure

Business owners report difficulties in finding a financing structure that meets their needs. Traditional bank loans and lines of credit issued to businesses are structured to require repayment of interest on a strict schedule, followed by a repayment of principal at maturity. In contrast, sales-based financing requires a portion of revenue to be provided to the lender until principal and interest is repaid.

Each of these structures may best suit different types of businesses. Strict adherence to a repayment schedule may limit the success of business owners dealing with regular cash shortfalls or variation in revenue due to seasonality or other predictable fluctuations in demand. This is all the more important because most small business owners have less than three months of cash reserves on hand.[67] In contrast, highly variable repayment under a sales-based financing agreement can quickly deplete a business owner's incoming cash flows. Businesses in a growth phase may struggle without cash to invest in long term projects or expand their business. Those without other sources of financing may also lack operating capital needed for payroll or incidentals.

Considering the challenges with debt financing, small businesses may benefit from access to non-debt financing, including equity financing, angel investing, or venture capital. Business owners reported to Treasury that they perceive equity financing as limited primarily to high growth businesses, especially in the information technology sector, with high short term returns and exit potential.[68] The data shows that equity financing is disbursed primarily to businesses based in California, Massachusetts, and New York and disproportionately exclude underserved business owners.[69] Moreover, equity investors have moved away from startup financing and towards more mature businesses, further excluding the small businesses most in need of financing.[70] Stakeholders have observed, however, that traditional small businesses may provide unexplored opportunities for equity investment, while noting that equity investments may be challenging for most small businesses, which generally are not able to document very high growth potential with high certainty.[71]

E. Unique challenges facing underserved business owners

Many of the barriers to accessing capital discussed above apply to underserved business owners, just as they do to other small businesses. However, stakeholders emphasized some issues that disproportionately deterred underserved business owners from accessing capital.

---

[67] Perry Beeman, *Goldman Sachs: 40% of U.S. Small Businesses Don't Have Three Months of Savings*, MISSOURI INDEPENDENT (Sept. 8, 2021), https://missouriindependent.com/briefs/goldman-sachs-40-of-u-s-small-businesses-dont-have-three-months-of-savings/.
[68] This perception is consistent with patterns observed in empirical data. *See* Robert Carpenter and Bruce Petersen, *Capital Market Imperfections, High-Tech Investment, and New Equity Financing*, 112 THE ECONOMIC JOURNAL 477 (2002), https://academic.oup.com/ej/article-abstract/112/477/F54/5085300.
[69] Theodos and Su, *supra* note 45.
[70] *Id*.
[71] Dustin Betz, *Venture Capitalists Can Fund Traditional Small Businesses, Too. Here's How*, CRUNCHBASE NEWS (Aug. 9, 2021), https://news.crunchbase.com/startups/venture-capital-small-business-funding/.

Some stakeholders noted a lack of trust in capital providers by groups that were historically subject to discrimination or received products with abusive terms from these institutions. For example, Black communities that faced historical redlining, financial exclusion, and access to lower quality financial products for generations may not feel comfortable borrowing from those same institutions.[72] Community development organizations, CDFIs, minority depository institutions and similar institutions have played an important role in bolstering the confidence of underserved business owners, though gaps in trust remain.

Second, underserved business owners stated that they often lack a network that can provide technical assistance, mentoring, or direct funding. For example, Black and Hispanic business owners have fewer potential investors in their personal networks, resulting in fewer opportunities for equity financing.[73] Moreover, underserved business owners often operate in "banking deserts" which limit their ability to form relationships with lenders or access financial services.[74]

Third, Native American business owners and businesses on tribal land noted that they face especially severe barriers to capital access. Native American business owners are often located in rural areas with few capital providers present.[75] Small business borrowers located on tribal land may struggle to access credit, including due to the perceived difficulty of capital providers to recover assets in case of default due to uncertainties in Tribal law or courts or limitations on collateral.[76] Native American business owners are also likely to operate in industries viewed by lenders as higher risk.

Fourth, underserved business owners may confront stereotypes when raising funding. For instance, Asian American, Native Hawaiian, and Pacific Islander (AANHPI) communities noted that they faced assumptions about their backgrounds when fundraising, including the "model minority myth" that supposes that AANHPI communities are self-reliant and that AANHPI business owners lack leadership skills.[77] Capital providers with similar backgrounds to underserved business owners may provide more funding for these groups.[78]

4. Policy Proposals

Proposal 1: Stakeholder Engagement on Access to Financing and Uniform Disclosures

Treasury recommends that policymakers and industry stakeholders continue to share information about the need for additional small business financing and how to best meet the capital needs of small businesses. If significant unmet need exists for financing, either across the market or for particular subgroups, policymakers should consider innovative efforts to matchcapital providers with small business through public-private partnerships, as well as how to ensure that government-sponsored programs are

[72] MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP (2017); KEEANGA-YAMAHTTA TAYLOR, RACE FOR PROFIT: HOW BANKS AND THE REAL ESTATE INDUSTRY UNDERMINED BLACK HOMEOWNERSHIP (2019).
[73] Cassel et al. *supra* note 24.
[74] FED COMMUNITIES, *Banking Deserts Dashboard* (Jan. 16, 2024), https://fedcommunities.org/data/banking-deserts-dashboard/.
[75] U.S. DEPARTMENT OF THE TREASURY, READOUT: U.S. DEPARTMENT OF THE TREASURY HOSTS ROUNDTABLE DISCUSSION ON HOW FINANCIAL INSTITUTIONS CAN SUPPORT TRIBAL NATIONS IN ACCESSING CAPITAL (Oct. 17, 2024), https://home.treasury.gov/news/press-releases/jy2656.
[76] OFFICE OF FINANCIAL INSTITUTIONS POLICY, U.S. DEPARTMENT OF THE TREASURY, FINANCIAL PRODUCTS AND SERVICES FOR NATIVE COMMUNITIES: LANDSCAPE AND POLICY RECOMMENDATIONS (Dec. 12, 2024), https://home.treasury.gov/system/files/136/Financial-Products-Services-Native-Communities.pdf.
[77] Nicol Zhou, et al. *Breaking Down Funding Barriers for Asian American and Pacific Islander Entrepreneurs*, BOSTON CONSULTING GROUP (Nov. 3, 2023), https://www.bcg.com/publications/2023/breaking-down-funding-barriers-for-aapi-owned-businesses.
[78] *Id.*

effective. In addition, capital providers could consider how to deepen small business access to capital, including through leveraging government programs (such as SBA programs), within prudent risk management standards.

Treasury recommends that policymakers, including legislators and regulators, conduct research and analysis to determine whether small business capital providers would benefit from more uniform product disclosures across product types that include information such as APR and fee disclosures, enabling more consumer protection, ready comparison, and stronger competition. Research could include engagement with capital providers and other industry stakeholders to study whether uniform disclosures across small business capital products – such as loans, merchant cash advances, sales-based financing, and other forms of small business capital – could help expand access to financing and better protect small business owners. Such disclosures could include minimum standards about the cost and terms of any financing, in a form that is comprehensible, clear, and conspicuous. Small business stakeholders reported that comparison of these financial products is challenging, and terms can often be hard to understand. More uniform and consistent disclosures may help address this issue. In recent years, eight states have enacted laws that would require certain commercial financing disclosures.[79] Evaluation of these state laws may contribute to understanding whether additional disclosure requirements would be warranted.

In addition, Treasury recommends that capital providers consider voluntarily developing uniform disclosures with understandable terms for small businesses, including information about repayment terms and fees. Treasury notes that the Responsible Business Lending Coalition developed a "Small Business Borrower Bill of Rights," which includes industry sector participants that have agreed to provide certain information to small business borrowers.[80] The Small Business Borrower Bill of Rights includes such rights as transparent pricing and terms, non-abusive products, responsible underwriting, fair treatment from brokers and lead generators, inclusive credit access, and fair collection practices.[81] This effort could serve as a model for other credit and equity providers to develop more uniform disclosures with clear and understandable terms for small businesses, including repayment terms and fee disclosures.[82] Multiple capital provider stakeholders expressed support for uniform disclosures across different types of financing, both to enhance competition and to attract creditworthy small business owners.

Treasury recommends that any uniform disclosure be designed carefully, in light of the well-studied challenges in creating effective disclosures.[83] In the past, agencies have utilized focus groups, individual interviews, lab experiments, and quantitative surveys to test designs.[84] Disclosures may also benefit from being supplemented by financial education and regulation.

Proposal 2: Foster Small Business Finance with Interagency Working Group

Treasury recommends that government agencies strengthen coordination with each other (including state and federal financial regulators, Commerce, Treasury, SBA, and others) to foster a robust and inclusive

---

[79] Stephen Ornstein, Josh Dhyani & CJ Blaney, *States Impose Commercial Financing Disclosure Requirements*, OF INTEREST CONSUMER FINANCE BLOG (Sept. 3, 2024), https://www.alstonconsumerfinance.com/states-impose-commercial-financing-disclosure-requirements/.

[80] *See* RESPONSIBLE BUSINESS LENDING COALITION, SMALL BUSINESS BORROWERS' BILL OF RIGHTS, http://www.borrowersbillofrights.org/bill-of-rights.html (last accessed Dec. 26, 2024).

[81] *Id.*

[82] *Id.*

[83] OMRI BEN-SHAHAR AND CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE (2014).

[84] Jeanne M. Hogarth and Ellen A. Merry, *Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing*, 97 FED. RESERVE BULLETIN 3 (Aug. 2011), https://www.federalreserve.gov/pubs/bulletin/2011/articles/designingdisclosures/default.htm.

financial system, which includes access to small business financing, and develop coordinated resources for small business owners. Stakeholders suggested that administrative agencies with interests in different aspects of small business finance would benefit from developing a working group to foster small business finance.[85] Several issues in this space would benefit from ongoing dialogue by all these agencies, including data gathering, oversight of underwriting and collection technologies, access to equity financing, and addressing deeper issues that cause barriers to capital access for underserved business owners.

First, the working group could leverage data on small businesses used by different agencies to better analyze trends and gaps across different financial market participants. Several data resources already exist, such as the Small Business Credit Survey led by a consortium of Federal Reserve banks[86] and SBA's loan data on its 7(a) and 504 programs.[87]

Second, Treasury also recommends that regulators continue to coordinate their approach to emerging technologies, such as AI, including promoting consistent and robust standards for financial institutions deploying new technology.[88] The working group could discuss and harmonize supervisory policy related to new financial technologies, especially the use of artificial intelligence and novel underwriting mechanisms.[89] Non-bank lenders have led the adoption of new technologies, but banks have also adopted new technology to remain competitive in the lending market.[90] Different types of technology may be viewed differently by financial regulators. For example, automated collections used in sales-based financing raise unique challenges, since these loans may appear to have a competitive interest rate but are often repaid more quickly than the disclosed term, which equates to much higher effective APR. Lenders who are concurrently offering borrowers other types of services may use proprietary data to underwrite loans and offer integration with other services. This can expand access to credit but may make it more difficult for small business owners to shop across lenders. Banks may also be hesitant to use certain technologies because of concerns that they may raise supervisory issues. Agencies could benefit from working together to study these technical issues and develop consistent policies.

Third, the group could design policies that would help banks originate more small business loans, targeted to the business owners most in need of financing. Several policies could help increase the volume of these loans. For example, agencies could work together to help small lenders access secondary markets and increase their liquidity, following examples established by the SBA.[91]

Fourth, the group could study the role financial institutions play in facilitating access to equity financing and non-debt forms of capital. Research shows that business owners are open to financing arrangements outside of debt, but that access is even more limited. Traditional equity financing options such as initial public offerings or private placements may need to be modified to provide access to small businesses. Creative forms of capital formation such as crowdfunding and cooperative ownership are understudied and may provide important opportunities for small businesses in need.

---

[85] Example agencies include the Fed, FDIC, OCC, NCUA, CFPB, SBA, MBDA, Treasury, state agencies, and other agencies.
[86] FED SMALL BUSINESS, https://www.fedsmallbusiness.org/about (last visited Dec. 12, 2024).
[87] OFFICE OF CAPITAL ACCESS, SMALL BUSINESS ADMINISTRATION, *7(a) & 504 FOIA* (July 2024), https://data.sba.gov/dataset/7-a-504-foia (last visited Dec. 12, 2024).
[88] U.S. Department of Treasury, ARTIFICIAL INTELLIGENCE IN FINANCIAL SERVICES, December 2024, https://home.treasury.gov/system/files/136/Artificial-Intelligence-in-Financial-Services.pdf.
[89] The risks and benefits of new technologies need careful consideration in order to be deployed safely and effectively. *See, e.g.*, Jeanette Quick, *Surviving the Winter*, DISCOURSE (Nov. 9, 2020), https://www.discoursemagazine.com/p/surviving-the-winter.
[90] FEDERAL DEPOSIT INSURANCE CORPORATION *supra* note 1.
[91] *See, e.g.*, SMALL BUSINESS ADMINISTRATION, *7(a) Secondary Market*, https://www.sba.gov/partners/lenders/7a-loan-program/7a-secondary-market (last visited January 9, 2025).

Fifth, the group could monitor disparities in access to capital for underserved business owners. Offices across multiple other agencies including Treasury's Office of Capital Access, SBA's counseling and mentorship programs, Department of Energy's Office of Energy Justice and Equity, Department of Transportation's Disadvantaged Business Enterprise Program, Minority Business Development Agency, and USDA Farm Service Agency's targeted funds, among others, are also focused on underserved entrepreneurs. Pooling data and research could shed light on the drivers of disparate access to capital. Agencies could also work together to combat discriminatory lending practices.

Conclusion

The market for small business financing is fraught with information asymmetries, high prices, limited supply, and challenges in matching business owners' needs with financing structure. These issues disproportionately exclude underserved businesses from access to capital, compounding the challenges they already face.

Considering stakeholder interviews and research, Treasury recommends that the policy recommendations stated in this paper – including additional research and analysis related to uniform product disclosures and continued coordination across government agencies – would strengthen the small business marketplace. In addition, Treasury urges capital providers to continue to evaluate how to deepen small business access to capital and whether to develop uniform disclosures to enable a more robust and competitive market.