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Small businesses hit by disaster often struggle with credit, too

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Small businesses that suffer losses from natural disasters tend to need smaller amounts of financing, they are more likely to seek it from online lenders or other nonbanks than regular businesses, and it's relatively hard for them to get what they need.

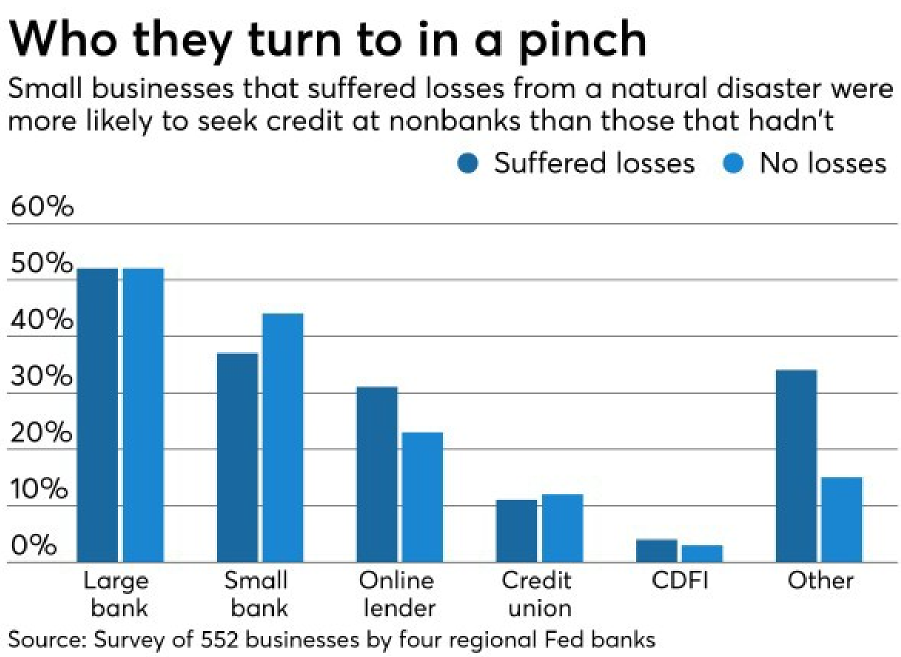
That is the conclusion of a report issued Tuesday by several regional Federal Reserve banks about the availability of credit to small firms in disaster-hit areas. The study tracked the credit-seeking experiences of businesses that suffered losses and those that did not to see how the two groups fared.

About half of the small businesses that sought financing after a calamity, regardless of whether they were damaged, filed applications with big banks. Unaffected businesses were more likely to apply to small banks for credit than their counterparts who had suffered financial losses (44% versus 37%).

More tellingly, businesses that suffered disaster-related losses were more likely to apply to online lenders for credit than those that had not (31% versus 23%). And damaged businesses were far more likely to tap other nonbank sources of credit (34% versus 15%) such as specialty lenders, friends or family, or nonprofits.

The amounts sought were relatively modest. Sixty-two percent of small businesses that experienced losses from natural disaster sought financing of $100,000 or less, the report said.

But the bar for success was high. The number of the companies that suffered losses that actually obtained all the financing they applied for was 34%, compared with 45% of those that had not suffered losses.



What the findings suggest is that those affected businesses were already financially vulnerable, independent of the calamity affecting their area, and that disasters tended to exacerbate those vulnerabilities. That could also be the reason they were more likely to tap other sources of funding, because they felt that traditional financial institutions might turn them down.

“This report shows that while small businesses experienced significant asset damages, their pain was doubly felt due to lost revenue and employment gains as well," Samuel Storey, community development senior research analyst at the Richmond Fed, said in a press release.

"Also, we found that certain communities are more vulnerable to experiencing natural disasters and suffering related losses,” he said. “By anticipating these disparities, financing sources can help address inequities in future recovery efforts.”

Natural disasters caused more than $300 billion of damage in the United States last year, and climate scientists do not anticipate that extreme climate events will abate anytime soon.

Researchers from the Federal Reserve banks of New York, Richmond, Dallas and San Francisco looked at small businesses in Federal Emergency Management Agency-designated zip codes last year and compared the financing and insurance needs among those that had suffered losses in storms and other disasters with those businesses that had not.

Small businesses that suffered losses in a disaster were more likely to need financing than their unaffected counterparts, with 48% of affected firms reporting that they had applied for credit in the prior 12 months, compared with 30% of unaffected firms. Yet, the researchers noted they did not necessarily apply for credit after a disaster, and their data could well include loan applications submitted before their market was struck by a hurricane, flood or earthquake.

That tracks closely with research that Ben Collier has conducted in partnership with the New York Fed. Collier, an assistant professor of risk management and insurance in the Fox School of Business at Temple University and a research fellow at the Wharton Risk Management and Decision Processes Center, looked at small businesses in New York one year after Hurricane Sandy.

He found that disasters can motivate some small businesses to apply for more credit after the fact, and that those businesses that were previously credit constrained are also less likely to be insured. Businesses that previously had greater access to credit before a disaster were less likely to suffer losses during a storm, he said.

Community banks can be proactive in helping their borrowers by tying more favorable loan terms to having insurance, as an example. “A lot of the motivation small businesses have in preparing for disasters, things like buying insurance, is related to their lender,” he said.

The authors of Tuesday’s report found that 40% of small businesses in affected zip codes had suffered losses from natural disasters, and they also looked at the demographics of businesses most hurt by natural disasters. Leisure and hospitality businesses and retail businesses were among the most likely to suffer, with 52% and 47% of those firms reporting losses, respectively.

Additionally, 54% of Hispanic-owned businesses suffered losses, compared with 40% of white-owned firms, 35% of black-owned firms and 27% of Asian-owned firms.