

DOES CREDIT COMPETITION AFFECT SMALL-FIRM FINANCE?

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ABSTRACT

Relaxation of geographical restrictions on bank expansion was ‘completed’ in 1997 when Federal legislation permitted banks and bank holding companies to expand across state lines. This legislation, however, allowed states the right to erect road blocks to branch expansion. We show that these differences in states’ branching restrictions affect credit supply. In states more open to branching, small firms borrow at interest rates 80 to 100 basis points lower than firms operating in less open states. Firms in open states also are more likely to borrow from banks. These results cannot be explained by states’ choices about how tightly to restrict branching. Despite this evidence that interstate branch openness expands credit supply, we find *no effect* of variation in state restrictions on branching on the amount that small firms borrow.

