FULL COMMITTEE HEARING ON INCREASING ACCESS TO CAPITAL FOR SMALL BUSINESSES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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FULL COMMITTEE HEARING ON INCREASING ACCESS TO CAPITAL FOR SMALL BUSINESSES

Wednesday, February 11, 2009

U.S. House of Representatives,
Committee on Small Business,
Washington, DC.

The Committee met, pursuant to call, at 11:30 a.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Dahlkemper, Schrader, Michaud, Altmire, Clarke, Ellsworth, Halvorson, Graves, Fallin, and Luetkemeyer.

Also Present: Representative Moran.

Chairwoman Velázquez. Good morning. This hearing is now called to order. Whether we are talking about equity investment or traditional bank loans, access to capital has always been a major obstacle for small firms. Today that challenge is compounded.

According to a July survey by the Federal Reserve, 35 percent of domestic banks have tightened small business lending. Even loans through the SBA are down. For small firms, these declines are more than a simple setback. In fact, a lack of financing has forced many entrepreneurs to delay projects and put off investments. In some cases, it is limiting small firms' ability to create much needed jobs.

For small firms, access to capital is access to opportunity, and it is clear that small firms are in need of both. That is why the bill we are examining this afternoon delivers critical small business funding.

I would like to thank Representative Schrader, Chairman of the Subcommittee on Finance and Tax, for his leadership in moving this legislation forward. It is a bipartisan product, one that could not have come together without the work of eight different committee members, including two from the minority. Their efforts were instrumental in drafting a blueprint that accounts for every stage of the small business life cycle, from start-up to IPO.

The small business start-up stage is especially critical to our economy. That is because new firms generate jobs and revenue where there once were none. But of course, entrepreneurs cannot create new positions and paychecks out of thin air. Start-ups require significant capital to get off the ground.

Unfortunately, however, funding to these firms is declining. In the last quarter of 2008, it plunged $5.4 million. The legislation we are discussing today will stem from those drop-offs by providing critical, early-stage capital. It not only greases the wheels for equity investment, but also expands SBA's microloan program.

In doing so, it provides an additional $110 million for our smallest, most promising start-ups. Because small firms comprise 99.7 percent of all employer companies, that revision is more than an investment in small businesses. It is an investment in American job growth.

Small firms' funding needs begin in the start-up stage. But, as any small business owner will tell you, they certainly do not end there. Even established firms require periodic capital infusions, particularly when it comes to enhancing their ventures.

Today's legislation helps firms secure financing for new purchases. It also raises SBA loan guarantees, reducing risk for lenders. That is critical, because some banks are saying they will not loosen lending standards until the middle of 2010, and that is at the earliest.

For small firms that rely on loans, an eight-month waiting period could mean the end of their venture before it gets off the ground. That is why it is so important that we move forward with this legislation now. It will help small firms to purchase new equipment and inventory, and it would allow every business, regardless of industry, to hire new workers.

At a time when our economy is struggling, it only makes sense to stabilize the small business community. After all, it was small firms that sparked a recovery during the downturn of the mid 1990s. For this reason, we want to be sure that entrepreneurs have the resources to weather more than just an economic storm.

With important improvements to SBA's disaster loan program, we can protect the foundation of our economy, even in the event of catastrophe. Following a natural disaster, capital is nothing short of a necessity. But for many small firms, it is the only issue that matters at all, catastrophe or no catastrophe. In a hearing this Committee held last week, that fact became abundantly clear.

This past Wednesday, our Committee met to discuss the state of small firms in the housing sector. We expected the conversation to focus on items like Section 179 expensing and the First Time Home Buyer's Credit. As it turns out, our witnesses had another, more pressing issue in mind: access to capital.

One witness, despite owning a profitable venture, simply could not find a bank to finance his operations. As a result, his firm was forced to delay $1 million in contracts and ultimately lay off 10 workers.

I wish I could say his story was so unique. But the truth is this sort of thing is happening every day, and we cannot afford to continue down this road. That is why this legislation is so vital. It will ensure small firms have access to the capital they need to keep operations running and the opportunity they need to grow our economy.

With that, I would like to take this opportunity to thank all of the witnesses that are here today in advance for their testimony and will now yield to Ranking Member Mr. Graves for his opening statement.

Mr. GRAVES. Thank you, Madam Chair, for holding this important hearing to consider legislative changes to the SBA's capital access programs.

As I have mentioned before, access to credit and capital is critical to small businesses and to our American economy. During the past few years, we have seen the capital and credit markets fluctuate widely. Those changes are evident in the SBA Zone lending statistics.

In fiscal year, approximately 90,000 loans, worth over $14 billion, through the 7(a) lending program; in fiscal year 2009, those figures are 44,009 billion. Some might say that credit was too available in 2006 and 2007. Today the pendulum has swung completely in the opposite direction of credit and capital to unavailable.

Clearly the economy must find an appropriate middle ground. In an effort to navigate an appropriate middle course, the SBA capital access programs can play a vital role. Those programs can fill gaps where conventional commercial credit and capital markets are not supplying funds to small businesses.

Of course, those programs do no good if there are significant barriers to their utilization by lenders, investors, and small business owners. Bills being discussed today are designed to reduce impediments to their use by lenders, venture capitalists, and small businesses. This is a good start, and I hope to hear from our witnesses what additional changes are needed to unfreeze the capital and credit markets for small business owners.

I am generally supportive of the bills before us today. I still have some concerns about some of the legislative proposals. I recognize that additional expenditures may be necessary to fix programs that are currently not functioning, but given the current budgetary constraints, the cost of some of the initiatives remain troubling.

Furthermore, there may be some difficulties with implementation of some of the programs. I look forward to working with the Chairwoman and the rest of the Committee to resolve these issues in a bipartisan manner.

It is important to recognize that the legislative actions we take in this Committee are only a component of a broader strategy needed to revitalize the small business economy.

With over 25 million small businesses in this country, improving the capital access program of the SBA will not cure the credit and access ills through which the economy is suffering. It must recognize that overly restrictive regulatory policies must be corrected in order to swing the pendulum back to an appropriate middle ground for the country's capital and credit markets.

Congress must also not adopt policies that zap confidence in small business owners to invest in the growth of their enterprises. In position of additional costs, whether it is through cap and trade legislation or increased taxes to reformed health care, will reduce confidence in small businesses to take the economic risks needed to grow their enterprises.

If Congress takes an approach and approves access to capital and SBA programs, on one hand, and then turns around through increasing operating costs of small businesses, on the other hand, and Congress will have not accomplished a whole lot.

Again I want to thank the Chairwoman for holding this hearing and our witnesses for being here today. I know you have taken time out of your busy schedules and in some cases traveled a long way. We appreciate that very much.

Chairwoman VELÁZQUEZ. Does any member wish to be recognized for the purpose of making an opening statement?

[No response.]

Chairwoman VELÁZQUEZ. Okay. So it is my pleasure to introduce Mr. Martin Sabarsky. He is the Chief Financial Officer and Chief Operating Officer of HR BioPetroleum, a renewable energy technology company located in San Diego, California.

Mr. Sabarsky is testifying today on behalf of Biotechnology Industry Organization. BIO is the world's largest biotechnology organization, with more than 1,200 members.

Welcome.

STATEMENT OF MARTIN SABARSKY

Mr. SABARSKY. Good morning, Good morning Chairwoman Velázquez, Ranking Member Graves, members of the Committee, Committee staff, ladies and gentlemen. My name is Martin Sabarsky, and I am the Chief Financial and Operating Officer of HR BioPetroleum, a Hawaii-based biotechnology company focused on developing algae-based products such as next generation biofuels.

I am privileged to be here on behalf of the Biotechnology Industry Organization, representing more than 1,200 member companies and nonprofit institutions in all 50 states that are involved in health care as well as agricultural, environmental, and industrial biotechnology.

I am here to convey our strong support of the Small Business Early-Stage Investment Act of 2009. As indicated in my testimony submitted for the record, this bill addresses a longstanding problem in the biotechnology industry in which venture capital firms have become increasingly reluctant to fund promising early-stage research beyond the basic research stage and before the revenue generation stage.

In the biotech industry, we refer to this phase as the Valley of Death, which sounds perhaps melodramatic but is a real dynamic that has been exacerbated greatly since the onset of the financial crisis last year.

At the same time, advancing science through the Valley of Death has never been more important as we strive to create a Twenty-First Century economy, create new jobs, become more energy-independent, and develop promising biotech therapies, all of which are critical priorities.

Part of the challenge in developing innovative new biotech technologies and products is that it is extremely time and capital-intensive. The substantial costs and time lines involved in drug development are well-known. Perhaps less well-known, however, is that the pre-commercial development of advanced biofuel technologies is also a capital and time-intensive process and is estimated to cost anywhere from $100 to $300 million and take 5 to 10 years. My company, HR BioPetroleum, is but one small business in the emerging biofuels industry that has the potential to benefit from this important legislation.

Studies have shown that successful development in America of biofuels, such as biodiesel from algae, could result in the equivalent of 7.9 million barrels of oil being produced per day by 2050, virtually eliminating our need for gasoline.

The widespread use of biofuels could also reduce greenhouse gas emissions by 1.7 billion tons per year, equal to more than 80 percent of transportation-related emissions in 2002.

The benefits are clear. The early-stage research is promising. But, as we sit here today, the private equity capital to make new investments to drive these programs forward aggressively is largely sitting on the sidelines.

In fact, in a recent press release, the National Venture Capital Association reported that venture funds raised in the third quarter of 2009 are at a 15-year low. Investments in clean technology companies, such as my own, were down 48 percent in the first quarter of 2009 alone.

My presently unsuccessful attempts to raise private equity financing for HR BioPetroleum over the past 12 months, despite a promising technology and significant corporate achievements, are instructive.

By 2005, despite having no venture capital funding, my company had successful demonstrated a proprietary process to grow algae at an industrial scale in Hawaii. Based on these positive results in 2007, we were able to successfully enter into an industry-leading joint venture with Royal Dutch Shell called Cellana, the initial focus of which is to build and operate a new facility in Hawaii to demonstrate the economics of integrated algae production and algal oil production.

In 2008, in large part on the strength of this joint venture, we signed memoranda of understanding with Hawaiian Electric, Maui Electric, and Alexander and Baldwin to develop a commercial algae facility on Maui. Despite these accomplishments, however, we were unable to complete a private equity financing that fell through a year ago this month as a direct result of the current financial crisis.

Our subsequent attempts to attract additional venture capital investment have not yet borne fruit, due, I believe, to venture funds becoming even more hesitant to take technology risks within my industry at the same time that many of their traditional funding sources have backed off or backed out of venture investing.

R&D programs through our Cellana joint venture continue, however, but most of our industry peers are not so fortunate. Many have less than 12 months of cash. And some have had to discontinue operations entirely. Hence, this pending legislation is even more critical to addressing the structurally inadequate funding environment that exists today and has for some time.

Other complementary programs, such as the loan guaranty and grant programs through the Department of Energy and Department of Agriculture, are important adjuncts to this pending legislation, but these programs are simply not available to small businesses that don't already have the sufficient equity capital to satisfy the mandated cost-share or minimum equity requirements.

This is a real Gordian Knot that can only be cut by providing additional equity capital to address this problem. as the pending bill would provide.

In closing, to ensure that the U.S. remains the world leader in biotechnology research and development, investment in early-stage biotechnology companies needs to be fostered. BIO believes that providing incentives for additional investment in small biotechnology companies is the most effective approach for SBA to support these high-risk, high-reward companies.

Thank you all for the opportunity to talk to you today about HR BioPetroleum and the promise of biofuels as well as how the Small Business Early-Stage Investment Act of 2009 could provide critical investment dollars required to develop biotech products that will benefit the public. I look forward to addressing any questions you may have.

[The prepared statement of Mr. Sabarsky is included in the appendix.]

Chairwoman VELÁZQUEZ. Right on target by 12 seconds.

[Laughter.]

Chairwoman VELÁZQUEZ. Thank you.

Our next witness is Dr. Thomas Zimmerman. He is the Director of Osteopathic Medical Education and the Program Director of Osteopathic Family Medicine Residency, South Nassau Communities Hospital. Dr. Zimmerman is testifying today on behalf of the American Osteopathic Association, which represents more than 67,000 osteopathic physicians.

Welcome.

STATEMENT OF THOMAS ZIMMERMAN

Mr. ZIMMERMAN. Thank you.

Chairwoman Velázquez, Ranking Member Graves, and members of the Committee, thank you for the opportunity to testify before you today. As an osteopathic physician Board-certified in family medicine, a health information technologies consultant, and a member of the American Osteopathic Association, I have witnessed firsthand the challenges facing our nation's physicians as pressure mounts for these practices to implement HIT systems in the coming years.

Clearly, the incentives offered through the HITECH Act beginning in 2011 and the subsequent threat of penalties beginning in 2015 are expected to encourage many physicians to adopt electronic medical record systems.

However, from my experience and that of most research, I find that the biggest stumbling block to EMR implementation for many physician practices is financing. For this reason, we wish to express our strong support for H.R. 3014, the Health Information Financing Act of 2009.

The AOA represents 67,000 osteopathic physicians across the country. Our profession is unique in its focus on primary care, with approximately 60 percent of osteopathic physicians entering this field, the vast majority of whom practice in community-based settings.

However, inequities in our current Medicare payment system have resulted in onerous financial burdens for these physicians, whose practices generally operate with one to six employees. While our members are eager to adopt more streamlined administrative and clinical systems, narrow profit margins and high overhead hinder investments in new innovations, such as health information technology.

Many of these systems require a considerable amount of capital to purchase. The average cost to install an EMR system is $32,000 per physician according to an MGMA study. Other studies have placed this cost much higher.

The funds provided in the American Recovery and Reinvestment Act earlier this year offer financial incentives that will facilitate the implementation of these systems. Because these incentives come on the back end, however, smaller practices are at a significant disadvantage.

Under current law, we believe that the bulk of stimulus funds are likely to flow toward hospitals and larger specialized practices, ultimately making the rich richer while small practices work to build up the funds and infrastructure necessary to qualify.

With the time line established through ARRA, it is our belief that only a small minority of small physician practices will qualify for the 2011 bonus. Additional government support, including the loan program in your legislation, would level the playing field, enabling and encouraging many more small practices to implement EMR systems.

As you well know, the economic crisis in this country has hit small businesses particularly hard. Solo and small practices in the past often turned to home equity loans to fund business investments. With the current credit crunch, access to these loans is also severely limited.

H.R. 3014 would grant physicians access to private lenders through guarantees issued by the SBA. We support the targeted nature of your proposal, which directs funds toward the specific equipment, training, and maintenance services necessary for our practices to meet the guidelines set forth by the Department of Health and Human Services.

The AOA recognizes the promise of increased productivity, prevention of medical errors, reduction in health care costs, increased administrative efficiencies, decreased paperwork, and expanded access to affordable care offered by HIT. However, these benefits cannot be achieved until physician practices have clear guidelines from CMS as to the standards to ensure interoperability across systems.

We expect these guidelines and the definition of meaningful use to be published by the year's end. But with just 12 months to purchase and implement a qualifying system, we believe that this time line is overly aggressive and inadvertently favors large institutions.

The administrative costs associated with the adoption of HIT systems also present an obstacle for small practices. The initial transition period involves considerable time for both the physician and support staff, who may require outside training and consultants.

During this time physicians often decrease patient load by up to 25 percent for several months. These increased training expenses combined with decreased revenue creates a formidable cash flow problem that many small practices may not be able to accommodate. The loan program in this legislation accounts for these factors by allowing the funds to be applied towards extra administrative costs.

Ms. Chairwoman, your legislation paves the way for small practices to join larger institutions in implementing HIT systems that will improve the delivery of care across the spectrum of health care.

We commend you on your recognition of the challenges facing our members and the sound policy you set forth in H.R. 3014. On behalf of the AOA and my colleagues, thank you for your efforts. And we look forward to working with you and your colleagues throughout this promising period of transition.

[The prepared statement of Mr. Zimmerman is included in the appendix.]

Chairwoman VELÁZQUEZ. Very good. On time. Thank you, Dr. Zimmerman.

Our next witness is Mr. Ryan Fochler. He is the President and owner of Dog Paws n' Cat Claws Pet Care, a small business located in Arlington, Virginia. Mr. Fochler is testifying today on behalf of Corporation for Enterprise Development. CFED is a leading public policy advocate that helps federal, state, and private sector leaders move the nation towards a more equitable and inclusive economy.

Welcome.

STATEMENT OF RYAN FOCHLER

Mr. FOCHLER. Thank you very much, Chairwoman Velázquez, Ranking Member Graves, and the entire Committee for inviting me here today to provide this important testimony about the SBA microloan program and H.R. 3737.

My name is Ryan Fochler. And in 2004, I became the owner of Dog Paws 'n Cat Claws Pet Care in Arlington, Virginia. As you all know, small businesses are the backbone to our economy.

Dog Paws 'n Cat Claws employs 30 employees in the D.C. metro area. And we provide services for more than 1,800 clients and their pets, including home visits when they are out of town or away at work. We also house a 7,000 square foot doggie day care facility located in Arlington.

The pet industry accounts for more than $43 billion a year in economic activity and experienced a growth rate of more than 5.5 percent, despite the recession. And it continues to show no signs of slowing down. In fact, it continues to expand across multiple industries.

For example: car companies now offer a full line of dealer-installed pet accessories, new airline companies have taken off with the sole purpose of transporting animals in pressure and temperature-controlled cabins, and many chain hotels have adopted pet-friendly policies, which is why you may be asking yourself, if the pet industry is so fantastic, why is Ryan here? To answer that question, because despite a credit score of more than 720 and an average growth in sales of 168 percent over the first 3 years of my stewardship, Dog Paws would not be here where it is today without the SBA microloan program.

In recognition of that fact, I am also here to thank this Committee for their work on improving the microloan program and to make suggestions for future changes to the program so that that it can continue to help entrepreneurs like myself.

I am very excited about some of the changes proposed in H.R. 3737, including improving borrower education; opening the door to more flexible, responsible microloan products; expanding eligibility requirements to increase the presence of microloan intermediaries across the country; and increasing the amount of money that an intermediary can borrow from SBA in order to reach more small businesses.

I know that there are many more entrepreneurs like myself that were told no by banks every single day. All of these factors will contribute to making another entrepreneur's microloan experience even more positive than mine, which came at a crucial time for my business.

In 2007, because of our constant growth, I felt it was time to pursue my larger dream of the company to expand beyond dog walking and create a holistic training, day care, boarding, grooming and retail facility for people and their pets in my community.

In December of 2007, I was pre-approved for an SBA express loan from Provident Bank, which gave me the green light to finalize our space and move forward with opening our store. Within two months, our retail store was experiencing both commercial and media success. We have been nationally recognized as a green retail establishment.

Unfortunately, shortly thereafter, the credit crisis hit in full force. To be specific, despite having never made a delinquent payment, our available credit was slashed from over $56,000 to approximately $1,000 without warning. I felt sick to my stomach. We had grown from at that point 7 employees to over 20 at that point.

This severe and in my opinion unwarranted reduction in my credit made it nearly impossible for us to order new product for our retail store. It also created a horrible domino effect. The drastic lowering of my credit lines resulted in a much higher debt to available credit ratio. Now, instead of using about 50 percent of our available credit, we were at 90 percent of our available credit, which made us look like much riskier to banks.

My credit has since taken a nosedive, not because bills weren't paid but because I was told, "You have been a good customer up until this point, but there is no guarantee that you will be in the future."

I spent the next three weeks visiting what I felt was every single bank in the D.C. metro area. I was turned down time and time again by large and small banks alike. Many of the loan officers that I met with sympathized with my situation and told me that I had easily qualified before the financial crisis. But with the decline in my credit score, I could not get a loan from banks themselves that probably received bailout funding.

This is when I learned about the SBA microloan program and the Latino Economic Development Corporation. They took a look at our books, our history, year-over-year sales, and employment growth, our 100 percent positive credit card payments, and lent us $20,000 in working capital.

I also got something else from LEDC: quality, in-depth technical assistance for my business. Banks give loans and send payment invoices. Micro lenders like LEDC do much more.

LEDC, with all of their technical support, set Dog Paws up for success. They have ongoing one-on-one support, group events and training. They think of us when they meet new business owners and potential clients.

Because of the over 100 hours of technical assistance I have received from the microloan program at LEDC, I am a better businessman, and my company is continuing to grow at a sustainable rate.

Despite the tremendous help that we received from LEDC, Dog Paws continues to seek capital we need to reopen our retail center. We have approximately 1,000 square feet of empty space that current employees, like my manager, who was laid off from Fannie Mae, and potential employees, who were laid off from Bank of America, could go to work right away.

But without the availability of the SBA microloan program and SBA lending programs, Dog Paws 'n Cat Claws would not exist as it does today. We would most likely have not been able to create 23 new jobs over the past year and a half. We would not be trying to figure out a way to get our retail center reopened to create more full and part-time jobs. We would not be able to outsource new trainers, groomers, consignment stores, et cetera.

Before I finish, I want to suggest a few more changes to the microloan program that I know will help entrepreneurs down the road. By increasing the microloan program to $50,000 to run a successful small business, especially a retail business, larger amounts of capital are essential for ordering product. Do whatever you can to continue expanding this program. Believe me, the need is out there.

Microloan Intermediaries like LEDC do not have the marketing and advertising muscle that banks and even credit unions have. If they did, I certainly would have knocked on their doors earlier.

Small businesses are currently acting as a backstop for the economy and the bailout. Despite the limited available credit, many of us are still finding ways to grow. We are somehow managing to create jobs while companies that are subsidized by the government or even received bailout funds continue to lay off employees.

Thank you for this opportunity to testify here today. I look forward to answering any questions that you may have.

[The prepared statement of Mr. Fochler is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Fochler.

Our next witness is Mr. Matthew Shay. He is the CEO of the International Franchise Association, one of our nation's largest business associations, with more than 10,000 members.

IFA represents members in every aspect of the franchise community and across the nation.

STATEMENT OF MATTHEW SHAY

Mr. SHAY. Chairwoman Velázquez, thank you very much for the introduction and Ranking Member Graves, members of the Committee. It is a pleasure to be here today to applaud your efforts to restore the access of credit for small businesses and, in particular, to urge our strong support for the Small Business Credit Expansion and Loan Market Stabilization Act.

I am Matt Shay, President and CEO of the IFA, headquartered here in Washington, and very privileged to represent our 1,200 member companies who create small businesses across this country.

And you have got my written remarks. And so, rather than go into detail on those, what I would like to do is just try to make three points with you and emphasize those: first, that, no matter what you have heard, the credit crisis affecting small business and franchise businesses, in particular, is severe and becoming acute and more so every day; secondly, that the extraordinary nature of this crisis in our view requires the Congress, the administration, and the SBA to take extraordinary measures.

And, third, and I think maybe most importantly, we feel very strongly that a renewed emphasis on access to credit for small business and the facilitation of loans for small business can help lead our nation back into a period of sustainable economic recovery and, to put a fine point on that, to create jobs. And I think that that is what we all are most concerned about today, is the creation of jobs. And we really believe that a renewed emphasis on access to loans for small business will help us achieve that.

We think franchising is a particularly apt prism through which to look at the impact of the credit crisis on the small business community. There are franchise businesses operating in virtually every sector of small business. And because of the nature of the way in which small business franchises are regulated, the way they register at the federal and state level, the way information is reported to the franchisors, it is much easier to monitor and analyze the impact of this credit crisis on franchise businesses generally than it is on independent businesses in particular.

Our research and the experience that we have with the PricewaterhouseCoopers, who have conducted a number of research projects for us demonstrate that there are more than 900,000 franchise businesses operating in the United States today. Those businesses create jobs for 21 million Americans and generate more than $2.5 trillion of total economic output. And to put that in perspective, that is 15 percent of the private sector workforce and 12 percent of total GDP, or total economic output. So it is a significant and growing component of the nation's economy.

Further, we have been able to demonstrate through this research that over the last five or six years, franchise businesses have outperformed non-franchise businesses operating in similar industries. So franchise business is a more efficient way to create jobs to invest capital and ultimately to drive growth in our economy.

Over the last several years, franchise businesses grew by 40 percent, when non-franchise businesses in the same sector grew at approximately 25 percent. So we know that investing in a franchise business, providing capital and access to credit for those businesses, has a huge positive impact on job creation.

The experience that our members have is that lending has essentially ceased. All the companies that were lending to franchise businesses, CIT, Wells Fargo, GE Capital, are basically out of this market now. And it's also our experience that there are thousands of deals literally sitting on the sidelines: entrepreneurs that have signed contracts that have paid franchise fees who are unable to access capital they need to start those businesses.

We would make four basic suggestions to the Committee about things you could do that would be very beneficial to our members and we think the small businesses generally.

First, increasing the guaranteed loan amount from $2 million to $5 million would have an immediate impact on the ability of franchisees to grow and create jobs.

Secondly, adopting a market-based approach to the loan pricing for SBA loans we think would help supply and demand, find a proper equilibrium, which we don't think exists today. There is over-demand and under-supply, and we think that is because there is disincentive created by the policy decision to set rates at a certain level.

Third, we believe there are some things that can be done in terms of regulations we could adopt that would put emphasis back on making loans available to small business start-ups through the 7(a) program, as opposed to other ways in which this program has been utilized over the past year. We think, in particular, refinancing of real estate has artificially indicated that there is a heavy usage here when the money is not really going where it needs to go, which we think, really, are the small business start-ups.

And then, fourth and finally, we think the audit standards are creating a level of uncertainty for lenders that are creating some disincentives for them in terms of their ability to rely on the guarantee that an SBA loan will, in fact, be backed up should things not work out the way we all hope they do.

So we applaud the Committee's efforts. We appreciate the things you are doing. And we stand ready to work with you to adopt these changes. Thank you very much.

[The prepared statement of Mr. Shay is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Shay.

Our next witness is Ms. Zola Finch. She is the Director of Finance of RMI CDC, a small business-certified development corporation based in Jefferson City, Missouri.

Ms. Finch is testifying today on behalf of the National Association of Development Companies, the leading trade association of certified development companies, which administer the SBA 504 CDC program.

Welcome.

STATEMENT OF ZOLA FINCH

Ms. FINCH. Thank you.

My name is Zola Finch. And I am past Chair of NADCO. I am pleased to provide a statement today about the Committee's proposal to improve access to capital by small businesses.

I would like to thank Chairwoman Velázquez, Ranking Member Graves, and the entire Committee for their continued support of the CDC industry and the 504 program. The Committee has worked closely with SBA and our industry to ensure the availability of this program to small businesses for many years.

First, I would like to discuss the need to reduce the cost of the 504 program. SBA has informed us that its 2010 budget increases the cost of the 504 program by 38.9 basis points. This is due to at least two factors in the SBA's econometric subsidy model. The first factor is the national unemployment rate, and the second factor is the forecast of the 504 default rate.

With both of these factors being impacted by the current recession but their real effect is expected to be short-lived, we ask the Committee's support of an appropriation sufficient to offset this fee increase for the next two years.

Small businesses are finally returning to a growth mode, which means improved cash flow, but why use that to pay increased program fees? We request this to be taken up as soon as possible in order to eliminate the impact of the subsidy fee increase on our borrowers for F.Y. 2010. It does not seem right in this economy to provide small businesses feverly from the stimulus bill in February of 2009 and turn around and increase their cost of borrowing in October of that same year.

The Committee has worked hard to enhance the 504 program to put more fixed asset financing and working capital in the hands of small businesses hard pressed by this recession. With that, it is clear that many small businesses either need access to larger guaranteed loan amounts or have already used up their allocated maximum for 504 under the current law.

The current restrictions can be addressed first in three ways. First, increase the maximum 504 loan amount beyond its current limit of $1.5 million; second, allow a borrower to maximize their use of both 504 and 7(a) loan limits; and, third, eliminate the regulation that restricts business owners with higher net worths from participating in 504 projects.

The Committee has recognized the need to reduce loan losses with more effort devoted to loan liquidations and recoveries. At Congress' direction several years ago, SBA created a new regulation that enabled taking advantage of the recovery expertise within the CDC industry. Many CDCs already perform such tasks for the loan programs they administer. They have simply not been given the ability and freedom by the SBA to do this on a broad scale for 504. NADCO believes that losses can be reduced if CDCs are allowed to perform recoveries in these settlements of loan guarantees of 504 projects.

The Committee has created other program changes to reduce losses. Under the proposed field, you will make the program more flexible by allowing higher owner equity injections, which will reduce the high cost of first mortgages.

Second, use of the PCLP program may be expanded by making the pilot amortization program permanent for calculations of the PCLP reserves.

And, third, the Committee will improve servicing of defaulted 504 loans by directing the administration to continue loan accounting for default through its own highly automated central servicing agent. This will result in much improved loan servicing by providing better information to the CDC's handling those loan defaults.

Finally, the Committee is addressing the need to make the SBA programs more relevant and productive. Loan volume for both 504 and 7(a) programs has improved slightly since passage of the Stimulus Act, but many of those benefits have not yet been implemented by SBA. Both programs are down over 40 percent from levels two years ago.

The 504 program is over 20 years old with an environment of restrictive and overbearing regulations, which has evolved within the federal bureaucracy. With this new administration and the fresh thinking under senior policy-makers, NADCO sees an opportunity to break out of the old program structure and establishment. We see the chance to work with this new leadership team and with the new Congress to expand the 504 program benefits to more borrowers.

NADCO believes that the first step in this process of expanding and enhancing the 504 program is to clarify the structure of CDCs that deliver the program and ensure an enhanced level of service by the CDCs. The Committee has developed several program changes that will increase the focus of the CDC industry on community development through our nonprofit organizations in the future.

Working together, we must be more creative and flexible in servicing the needs of not only existing small businesses but also in providing financing to new industries. We must tear down the walls of arcane, irrelevant, and restrictive regulations that create unnecessary barriers to reaching the industries of the Twenty-First Century economy.

SBA has become one of the largest economic development agencies in the federal government. By leveraging its guarantee authority using lending partners, SBA has directly assisted the creation of over 5 million jobs through more than $200 billion in 504 first mortgages, 504 debentures, and 7(a) bank loans. Very few agencies can claim this kind of record and accomplishment and impact on our economy.

But, like any maturing organization, SBA has to reevaluate its products to serve the changing needs of small businesses. NADCO urges Congress to collaborate with the new SBA management with farsighted market-driven lenders to eliminate those overly restrictive regulations and create the financing and economic development program so vital to America's future in a competitive world.

Small businesses that are agile and forward-thinking will lead us out of this recession. Let's help them to do it now. And by working together, we can put America back to work. Thank you.

[The prepared statement of Ms. Finch is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Finch.

Mr. Sabarsky, the proposed small business early-stage investment program has a specific focus on delivering capital to small businesses in some of the most capital-intensive industries, like biotech, clean energy, and life science. Can you discuss some of the policy justification for the program focused on these industries?

Mr. SABARSKY. Yes. Thank you, Madam Chairwoman.

So I think this is a sort of two-part question. The first answer to the question gets to the policy justifications for the targeted industries, as specified in the pending legislation. Particularly when it comes to biotechnology, clean technology, I think you see possibly the greatest combination of need for capital, especially in the current crisis that we are facing, as well as the potential for subsequent investment and job creation coming in from the combination of the public sector and private sector funding, which I am assuming and hoping will be available once sufficient risk is taken out of the biofuels development and biotech development processes.

I think, in particular, talking about the biotech industry, this program would leverage America's existing strengths in technology generally and biotech, in particular, as we move to an increasingly knowledge-based economy here in the Twenty-First Century.

It also in the case of biofuels would have the impact of bringing manufacturing and energy production into the U.S. and away from other parts of the world, whether it is OPEC countries or others, that may not be so friendly. So from an energy security standpoint, I think that has value as well.

Now, there is also a question about why target small businesses, early-stage companies. I think Congress and the administration and prior Congresses have indicated through things like the stimulus bill, through preexisting grants and loan guaranty programs, renewable fuel standards, and other regulations and tax policy a strong national priority for developing biofuels, alternative energy of renewable technologies, energy technologies generally. And so there is already a serious policy commitment at the national level to support the advanced biofuel industries that I am working on.

Once that is done, though, one has to ask the question, are small businesses able to compete on a level playing field for some of the larger dollars that are really necessary to field a large demonstration facility to prove the economics of biofuels production as one example?

And right now what we are seeing through DOE and DOA programs, be they the grant programs or the loan guaranty programs, is small companies simply can't play in that environment because you can't even get an application together that satisfies DOE's or DOA's requirements based on out-of-pocket expenditures that are required, which are substantial, sometimes mid to high six figures.

But the most important impediment is that you can't show the 20 to 50 percent cost share required on the grant side or the minimum equity required on the guaranty side to actually field your plant should you get the award.

Chairwoman VELÁZQUEZ. Mr. Sabarsky, can you tell us what is the average return on equity for early-stage—

Mr. SABARSKY. Early-stage investment?

Chairwoman VELÁZQUEZ. Yes.

Mr. SABARSKY. Well, and maybe the panel coming next would be more appropriate. I am not a venture capitalist. I do not play one on TV. But as I talk with them, they talk about a 25 to 40 percent year over year that they target. And this is obviously a very high return to indicate that there is a high risk. And, as the venture capitalists will tell you, out of every 10 investments, maybe 1 or

2 will actually produce a 10x return to their investment, which helps to take care of the ones that don't return anything or you basically get back your money and that is it.

Chairwoman VELÁZQUEZ. Okay. Thanks.

Mr. Shay, in your testimony, you emphasized the continued need for credit, especially among start-up businesses. Do you believe that lenders overemphasize more profitable loans, like loans to establish businesses with larger, greater needs, credit needs? Do these larger loans contribute to the credit shortage for start-ups that we are seeing at this point?

Mr. SHAY. Well, I certainly think in a competitive marketplace, capital hopefully, being agnostic, is going to go where it can, where it believes it is going to get the greatest return. So as the sources for loans to small businesses have dried up, the existing capital is either sitting on the sidelines or it is going to other places, larger loans.

There is a segment of our membership, about 400 member companies, that have investment levels, start-up investment levels, of between three-quarters of a million dollars and $2 million. Given the current loan limits on an SBA guaranteed loan of $2 million, those franchise investors essentially hit the limit with their first store.

So for the people that are trying to expand to multi-unit status two or three stores, which is really what they need in order to be profitable in many cases, the challenge that those people face—and that is really the sweet spot, those 400 that have those size businesses—they have exhausted the possibility of financing and capital with the first store.

So yes, we see a big challenge. And, you know, I can't point fingers at what is creating the real bottleneck. Is the capital going somewhere else, bigger loans or not? But we would not consider a loan of $750,000 to $2 million to be an extremely large loan. That is a very competitive loan for a small business. And it is tough to find.

Chairwoman VELÁZQUEZ. It is less risky for a bank to lend to other, more established businesses than going and lending to start-ups.

Mr. SHAY. Right. And certainly our view is that a franchise fits that category of an established business because you have got a track record and a history. And, again, not wanting to distinguish between franchise businesses and a typical independent start-up because we think all independent businesses are great. We just happen to favor the franchise model.

But yes. There is no question, though, that lenders, bankers, nonbank lenders look at a franchise. And when they see a business plan developed by a franchise system, that gives some comfort that there is going to be sort of some full faith and credit there, as opposed to someone that walks in off the street and doesn't have that experience or doesn't have those kinds of resources at their disposal.

Chairwoman VELÁZQUEZ. Thank you.

Dr. Zimmerman, the proposed health IT loan program, would you say that the proposed health IT loan program be duplicative of the

SBA's existing loan programs or are there factors that distinguish this program?

Mr. ZIMMERMAN. No. I don't believe that the proposed legislation does duplicate existing resources through the SBA. With the proposed legislation, the fact that there is up to a three-year deferment on the payment of interest before the payback begins decreases the cost of this loan greatly and makes it a lot more attractive for small practices to consider implementing the HIT technology.

A lot of these cost savings sided with electronic medical record systems, even in the federal Stimulus Act, come from savings and not actual revenue. So it is very important to see reductions in cost at the front end and not saying, "Well, ten years from now, this is how much money you will save." The physician is a business. And they need to see what the difference in the overhead, my cost right now, out of pocket is going to be. So no, I don't believe it is duplicative.

Chairwoman VELÁZQUEZ. We hear that the cost for implementing IT will be like $100,000 per practice. Do you know what will be the cost savings once the IT has been implemented?

Mr. ZIMMERMAN. A lot of times it depends on how well the practice is actually running with the EMR system. And a lot of it has to do with how well the practice has been run before the system is implemented. If they have a good paper system, if it is an efficient office, they will see a lot more savings and increased revenue with the EMR system.

I believe some studies cite anywhere between $10,000 to $20,000 per physician in cost savings. And if you look at the average cost of an implementation, a lot of times that comes out to about a six to eight-year period before you have a return on investment depending on the size and cost of the system.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Fochler, in the proposed legislation or the draft legislation that we have before us, we are allowing for the SBA to use the surplus to reduce the cost of loans for borrowers in the microloan program. The microloan program has been criticized for the interest rate, the high interest rate the borrowers pay.

Would this put more money into the hands of small businesses, like yours?

Mr. FOCHLER. Yes. I think anything to improve the microloan program, especially, you know, it is much higher interest rates, but at the same time, it is more competitive than credit cards. And at least it is accessible, even though it is limited.

So I think it definitely could improve and ultimately get more money into the hands of small business owners that are struggling to grow. Even though we seem to find ways to do it, it is just very stunted growth. Anything could definitely be a huge improvement to helping the microloan program.

Chairwoman VELÁZQUEZ. Thank you.

I have more questions. And I will come back at the second round. So now we will recognize Mr. Graves.

Mr. GRAVES. Thank you, Madam Chair.

Mr. Shay kind of answered my question to an extent. But I am on the Ag Committee. And the USDA has a guaranteed loan program with limits up to $25 million. My question is, you know, should the capital access programs in the SBA be modified to higher limits?

And, as I stated, you already kind of answered that, but I would like to get an answer from all of you on that. Obviously the limits are much different under the SBA. And I would be very curious how much that would help.

Mr. SABARSKY. Thank you, Congressman.

So the limits are important for folks in the early-stage biotechnology industry. Though I think the structure of the loan guarantees or grants through the Department of Energy or Department of Agriculture are the bigger issue, that would be helpful to increase the limits.

I think the main benefit that I would like to see as a separate proposal perhaps that we could talk about later would be the ability to bootstrap a grant or award such that you wouldn't have to demonstrate your ability to come in with a minimum equity or the cost share components until after you have been awarded the dollars for the innovation for the ability to deploy technology that is considered to be important and then go out and raise the private dollars required to do that.

Right now it is a catch-22. And it literally is keeping companies like mine out of the prices altogether versus other larger companies that may be dabbling in the science that we are doing or much smaller companies that are earlier-stage even than we may have gotten lucky with the funding shortly before the crisis that we are in right now.

And I am not sure that that is the way the Congress intended the selection process for these programs to work. I think they assumed a well-functioning capital market, which capital markets are anything but well-functioning at the moment. That is my perspective.

Mr. GRAVES. Mr. Zimmerman?

Mr. ZIMMERMAN. Thank you.

For the sake of physician practices, I believe that the current limits are adequate. If you take into consideration for anywhere from a 3 to 6-physician practice, the average cost of an implementation might run between $120,000 to $250,000, I think the limits are adequate to help incentivize action.

If you look at hospitals, on the other hand, their costs will obviously be much, much higher. But that is out of the realm of 3014.

Mr. GRAVES. Mr. Fochler?

Mr. FOCHLER. Yes. I think Mr. Shay made a great point. We are a small business looking to expand and grow. We have a lot of communities that have asked us to open up our store in some of the new developments that are out there. But I have personally hit my cap. I can't go back to get any more loans because the microloan has lent me all the money they can at this point. So Mr. Shay made a great point.

Yes, we do need to work with our business model to grow, sustain, to increase more jobs. You know, we are stuck exactly where Mr. Shay said. So the increase will be tremendous.

Mr. GRAVES. Go ahead, Ms. Finch.

Ms. FINCH. Under the 504 loan program, yes, an increase in the guaranteed amount would be tremendous because within the CDC industry, we have multiple borrowers. And they come to us. And they have done a 504 with us. And they want to do another location and do a real estate deal in another location. And they have maxed out.

So we would be able to do multiple deals under 504 or, as Mr. Shay stated, if you are a franchise and you have got a big storefront, you have maxed out on 504, you cannot do another storefront under 504 under the limitations.

And, even with a manufacturing company at $4 million, you know, another location, they are maxed out at $4 million. And we are unable to help them with 504. So the increase in the guaranteed loan amount would be very, very helpful under 504.

Mr. SHAY. Mr. Graves, could I just elaborate?

Mr. GRAVES. Yes, absolutely.

Mr. SHAY. Just one further thought on that. I mentioned earlier the study that we did with PricewaterhouseCoopers that analyzed the economic impact of franchise businesses in this country and those 400 that have the investment levels of $750,000 to $2 million.

We did some more analysis of the kind of growth rates that those companies experienced in the last decade. And it was six, seven, eight percent growth per year. And if we could get 5 percent growth going even for the companies of this size, our estimates are that over the next 12 to 18 months, we would create more than 600,000 new jobs just by making that capital available to the people that hit the cap at $2 million.

So when I said in my earlier remarks that from our perspective, the most important aspect of increasing the loan guarantee amount is the job creation aspect, that is really our view, that if we can get access flowing to these companies and we grow 16,000 or 18,000 new businesses and they employ 15 to 20 people apiece, all of which are pretty conservative estimates based on past experience, that is well over half a million new jobs created out of this sector of the economy just from increasing the amount from 2 million to 5 million.

Chairwoman VELÁZQUEZ. Ms. Dahlkemper?

Ms. DAHLKEMPER. Thank you, Madam Chair. Thank you to the experts here on the panel for coming today and joining us and giving us your guidance and expertise.

Dr. Zimmerman, yes, I have a question for you regarding the HIT loans. If you could expand a little bit more on the three-year deferment period and how you think that will be important for smaller practices going forward?

And if you have any thoughts or evidence on what you think will be the financial return when you implement that and how you can use that, then, of course, to repay the loan? I mean, do you think there will be that savings that is necessary with this three-year deferment to be able to then repay the loan?

Mr. ZIMMERMAN. I think so because if you look at most implementations, it takes about 6 to 12 months before the practice starts to get back up to the original level of productivity. So if you figure in a year of that decreased productivity getting back to baseline and then beyond that starting to generate more revenue, whether it be through cost savings and decreased cost of transcription, ability to see more patients per day, increase efficiencies in the office, decrease staff costs, by that point, by the second and third year, you are starting to generate more income, which would be able to start to pay off the cost of the loan.

So for that three-year period to have a free, you know, a no-cost source of capital where you are not paying interest, I think that would be very beneficial for the practice.

Ms. DAHLKEMPER. So the three-year time period you think is adequate—

Mr. ZIMMERMAN. I think so.

Ms. DAHLKEMPER. —in terms of being able to get the returns that you need?

Mr. ZIMMERMAN. Yes.

Ms. DAHLKEMPER. Okay. Thank you.

Mr. Sabarsky, yes, I wanted to ask you if you could elaborate maybe on why you believe the conventional markets are not meeting the needs currently for early-stage and high-growth business as yours. What do you see is the biggest hurdle at this point?

Mr. SABARSKY. Well, the biggest hurdle right now beyond just the lack of—it's a question of, why are the dollars not there, even though the dollars are there for later-stage investment?

This is a phenomenon that we of the biotechnology industry have seen for the better part of 20 years. We have also seen it, frankly, with the pharmaceutical companies, who would prefer to pay more for later-stage products that have less risk.

So on the curve of risk and return, at least the pharma companies had decided to pay more for less risk. I think the challenge right now as I interface with venture capitals—and there is a panel coming up next—is the venture capitalists that I have talked to seem to want to have the same type of return, but they are less willing to take the risk.

And the challenge that I face is that folks on the angel investing side, the sort of high net worth individuals, friends and family, have a very limited ability to invest maybe single-digit millions, $2 to $4 million, really, at most. And traditionally venture capitalists picked up the slack until more mature private equity has then come in. And so there is a sort of stair step.

It is interesting as part of the financial crisis, this dynamic has been exacerbated. And I don't have great rationale to explain why venture capitalists have changed their models. I have a couple of venture capitalists actually telling me that they are shifting their model to actually invest in public securities, so not even private securities. So that may be something that other panelists could speak to.

It is a mystery to me why this is the case, but it is a continuation of a dynamic that we have observed for some time now, Congresswoman.

Ms. DAHLKEMPER. Thank you. Thank you. I appreciate that.

I yield back.

Chairwoman VELÁZQUEZ. Ms. Fallin?

Ms. FALLIN. Thank you, Madam Chairman. I appreciate all of you coming today and giving testimony. We certainly want to do all that we can to help your businesses grow and create access to capital. I have a couple of questions.

We keep hearing about banks and the money that is available to be lent to the small businesses. And even this week, there were numerous reports of a lack of available credit and capital.

Can you tell us why you think there is a disconnect between the assertations that credit is available while still small businesses claim they cannot get the credit and the available credit is being slashed? Can you tell us what some of those barriers are and if you are seeing that in your individual industries?

Mr. SABARSKY. Congresswoman, I will sort of defer to the rest of the panelists here. In the biotech industry, especially at the small business level, generally it is not available. So it is all equity financing. But the other businesses here clearly could be benefited by the financing. So I will yield to them.

Mr. ZIMMERMAN. Thank you.

From my experience from informal research with banking personnel and physicians, they find it increasingly hard to qualify for any funding in the past, where having a credit score of 720 or above meant you got a very good rate, now it means the difference between getting a loan at all or not.

I have heard of several physicians who have had accounts with banks where they have had $2 or $3 million in savings with that bank or different funds. And in the past, where the bank would say when the physician would ask for a line of credit or a letter of credit, it would be a matter of just the procedure of printing out the letter, at this point now they are saying, "No. I don't think we can do that at this time." And there is no rhyme or reason. I am not an economist, but on the street, this is what people are experiencing.

Ms. FALLIN. Okay. Thank you.

Go ahead.

Mr. FOCHLER. Thank you.

Yes. I actually firsthand dealt with some of this in my testimony, as I mentioned, going into multiple banks in the D.C. metro area, you know, with a credit score of above 720.

A lot of them have gone. They aren't even looking at our growth rate. They aren't considering that. It is mainly based on I have to come up with the amount of equity to match the loan that I need. If I was in that position, I probably wouldn't be at that bank in the first place if I had that kind of available equity.

So that is the really challenging part for us is even the—what is really frustrating is when I work with some of these branches, the branch manager is actually very surprised I get turned down.

At an average growth of over 168 percent since I have been the owner per year, to not have that in consideration is very frustrating. And this year we are even showing a higher growth than that at this point. And still I could be growing, creating much more jobs. So it is frustrating to hear that there is available credit. But I am not seeing it firsthand.

Thank you.

Mr. SHAY. In the franchise context, I think the experience has been that, whereas, the loan officers over the recent history kind of held the decision-making authority over which loans got made and didn't get made, the pendulum has swung in the direction of the underwriters. And so the underwriting and the loan restrictions that go along with these loans I think from our perspective are driving the decision.

And, you know, you can't blame the banks. And certainly we don't for the position they are in between shareholders and regulators saying, "Don't make bad loans" and the business community saying, "We need access to credit." But, for example, the loans that were available to franchises several years ago, 18 months ago, for a relatively more modest equity up front, 20 percent equity maybe or in some cases plus or minus, now those loans are available at 50 percent equity. So the restrictions are very significant. And they are just not available.

I mentioned to Ranking Member Graves, the other Ranking Member Graves, earlier—

(Laughter.)

Mr. SHAY. —that we had a visit with the CEO of one of our member companies here doing the rounds in the last several months. And his situation is he has got 2,000 franchise licenses sold, contracts signed, franchise fees paid. And those 2,000 franchisees are unable to obtain the financing necessary to open those stores. And this is a well-known franchise system.

So, even for the well-known, well-established systems, if it is a problem when Wells Fargo and CIT and GE Capital and the others are just completely out of the franchise space, then we are really in a difficult position.

Ms. FALLIN. Okay. Thank you.

Anything you want to say?

Ms. FINCH. Sure. Within the 504 industry, last year our total loan volume was down, you know, 30 or 40 percent. And even though the bank only has to do 50 percent of a project with the 504 behind it, they did not even want to pursue that. So the credit was that type.

Within the last two to three months, we are seeing where banks are starting to at least entertain doing 504s and doing 50 percent mortgages along with us to where during the month, just a few weeks of October, we have seen an uptake of about 10 percent from where we were up from last year. So the banks are starting to get a little more comfortable at least doing a 504 with a 50 percent mortgage. So there is a slight uptake.

Ms. FALLIN. That is some good news.

Ms. FINCH. Some.

Ms. FALLIN. Well, thank you very much. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Michaud?

Mr. MICHAUD. Thank you very much, Madam Chair, Mr. Ranking Member, for having this hearing on increased access to capital for small businesses.

I have talked to a lot of small businesses back in my home State of Maine. They, too, have a problem with accessing capital with the credit crunch. I know the financial stimulus package is supposed to help with the credit, allowing businesses to be able to get the financing they need.

I have also talked to actually many credit unions, who actually have capital money or money that they would actually like to lend small businesses. But, unfortunately, there is an arbitrary limit set on credit unions of what they can lend for businesses.

My question to each of you is, would you be supportive if Congress actually increased that or removed that arbitrary limit so credit unions actually can allow access to capital for small businesses?

Mr. SABARSKY. Congressman, I will start over here. And I guess I will answer more as a member of the San Diego County Credit Union. I would be supportive, even though it would put our capital at risk, mainly because we understand that without access to capital, local, regional, national development just is stunted and, therefore, everything that flows from that, lack of job creation, as we see here, the local business, and all of the dollars that don't go to employees, don't go to everybody that those employees then would hire.

And so I think we are strongly supportive of that, even though as a business, it would be unavailable to me. I still think that as members of the broader community, we are very supportive of that.

Mr. ZIMMERMAN. I think any measure to increase availability of lower-cost loans would be of great advantage to physicians, especially graduating residents from residency programs as they might go out to start up their own private practices. Most times the credit unions do provide more economical sources of capital. So I would support that.

Mr. FOCHLER. Also as a member of a credit union, I would support it as well. I feel like also with the credit unions, sometimes I have been able to get a little bit more support, a little bit more technical assistance. I feel like they are there to really go above and beyond that I haven't seen from some of the major banks. So I think that would be phenomenal to do something like that.

Mr. SHAY. Without weighing in on the position that might be taken by the credit unions and their members, notwithstanding those that are here today, I think our folks certainly would be supportive of anything that we could do that would give access to more credit. So this is one of those things that can be achieved. I don't think any of our people would argue with it.

Ms. FINCH. If it is going to help the small business industry.

Mr. MICHAUD. Well, thank you very much for answering that question. And also thank you for your testimony today because this a very important issue when small businesses are the backbone of our economy. And I think we have got to do everything that we have to do to make sure that they survive and thrive and grow. And that's why I thought it was amazing that artificial limit is set in statute. And we ought to definitely look at that. So thank you for your response.

I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Madam Chair.

Yes, I often think of our Ranking Member as the phantom. That is our nickname for him. Now you see him. Now you don't. Now we see him. But thank all of you for being here today.

I am rather curious. I know that we are talking about access to capital here. And one of the things that I think is important as we evaluate some of the SBA programs here is our access to those as well.

What percentage of your members or do you have an idea of the participation that you have by your membership in SBA programs and how successful it has been? We can start with Mr. Sabarsky.

Mr. SABARSKY. Sure. Thank you, Congressman.

I think, in particular, the SBIR program the Committee must be well-aware of is probably the most used in the biotechnology and pharmaceutical industry. I think that has been a very successful program.

I think the only issue, if you will, that we might have with it is that the dollar limits obviously tap out fairly early in the process for anything that is considered capital-intensive. But it is an excellent method to develop initial proof of concept and get you at least to the beginning phases of what we call the Valley of Death.

Mr. LUETKEMEYER. Can you give me an idea, do you have an idea of the percentage of your members' participation? And if so, is it going up as a result of the lack of access to capital? Are you seeing more participation as a result of the constriction by the standard credit markets?

Mr. SABARSKY. And we could follow up with BIO staff later. I suspect it is a very high percentage. Probably when you consider the small business segment of the larger biotechnology industry, it is probably north of 50 percent. They tend to be fully funded. Sometimes you even get overhead as well. So they both get the research done and help keep the lights on.

So I think they are very important programs and would strongly support their continuation and even expansion beyond the current limits under current law.

Mr. LUETKEMEYER. Very good. Thank you.

Dr. Zimmerman?

Mr. ZIMMERMAN. Thank you.

I am actually not aware of the AOA's membership's actual involvement in the SBA program, but my understanding with this proposed legislation, it would greatly increase the access to those guaranteed loan programs.

Mr. LUETKEMEYER. Okay. Perfect.

Mr. Fochler?

Mr. FOCHLER. My experience with some of the business-to-business groups that I am with, I don't know the exact percentage, but I also don't know of any other small business that doesn't have a loan somehow tied to the Small Business Administration. So I would say I don't know the percentage, but it is extremely high. Every loan that we do have is somehow tied to a Small Business Administration loan.

Mr. LUETKEMEYER. Okay. Have you seen an increase in the request or utilization of SBA loans as a result of the restriction that we are having right now?

Mr. FOCHLER. It is hard to tell. I mean, I can't even request any more because I have used what I can. So it is not even an option for me to go back and even request anything else. So I am just at that point where I can't request anything.

Mr. LUETKEMEYER. Okay. Very fine.

Mr. Shay?

Mr. SHAY. I can't give you specifics on how much it has increased, but clearly among our membership, the usage of SBA loans has increased dramatically because the other sources are essentially all gone now. So as these private lenders have disappeared or pulled back from the market, there really isn't anywhere else to go for many of these companies.

I know the SBA can track what portion of the loan portfolio is related to a franchise business. And I suspect that we could also extract through our research partner information related to the number of franchise companies that use SBA loans and what that incident is.

But there is no question, just even anecdotally, that that number has increased dramatically over the course of the last year, just because those other sources are no longer there.

Mr. LUETKEMEYER. Very good.

Ms. Finch?

Ms. FINCH. Well, since I am here representing NADCO of 200 members plus and we administer the 504 and deliver the 504 loan program, we are all very successful at that.

[Laughter.]

Mr. LUETKEMEYER. A fairly good answer from you.

Ms. FINCH. However, as you will know, our loan volume is down due to decrease by our lending partners working with us and the access to capital for small businesses, but we are all very successful.

Mr. LUETKEMEYER. Thank you.

I will yield back my time. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Halvorson?

Ms. HALVORSON. Thank you, Madam Chairman. And thank you all so much for being here.

I just think that this is very important because everywhere I go, the first thing I hear from every business person I talk to, no matter where I go, is access to credit and access to capital from whatever business person I am talking to. My husband and I own two businesses. And everybody I know owns something. And they can't get credit.

You know, Mr. Shay, you talk about the fact that you say that the 7(a) loan program should go from 2 million to 5 million. Is that what you say? I don't disagree. I know I am sponsor of the bill to increase it from 2 to 3 million. It is a start.

However, the people who are opponents of that say that the SBA would have to take on too much risk and then now we are giving, you know, maybe big business too much opportunity to get into having a small business. Then we are taking away from what this truly is for.

What do you say to that?

Mr. SHAY. Well, our perspective is that when you are talking about a loan amount of 750 to 2 million—and I reference that a couple of times—we have got 400 members that fit in that category. And those people are out creating jobs.

And, to the Chairwoman's point, there are businesses that operate with a business plan and a recognized trademark and a brand name. So the risk is relatively less when compared to a pure start-up business.

Our focus is on creating jobs for the economy. And we think that if this is a demonstrable way in which we can do that, that it would be—"irresponsible" is maybe too strong a term, but if there is an opportunity here for job creation, that we should do it.

And if there are outrageous numbers of failures for some reason, then we can revisit the issue. But in the short term, these businesses really have nowhere else to go. And the SBA is a lender of last resort. And so we want to get people back to work and get the economy moving. And we think this is a responsible way to try to do that.

Ms. HALVORSON. Thank you.

Because it is something that we are all still talking about. So I encourage the input. And I am still getting plenty because I don't disagree with you.

Ms. Finch, could you help me clarify? You were saying that together we can fix some of this bureaucracy within the clarification of some of the paperwork. I know you used the words that we need to be "creative and flexible" and that it is too "arcane and restrictive." But I didn't hear what we need to do.

So if you could help me just answer some of the things of what we need to do with being creative and flexible and not so arcane and restrictive.

Ms. FINCH. Well, the paperwork under a 504 loan has increased from this size to this size over the last 20 years. One of the things that is restrictive is that we look at net worth and profit after tax. And those figures could be increased to allow more—and they are still small—would still allow more small businesses into our program. That could be increased definitely.

Personal resources test is something that I think can be viewed. That is a new regulation that had come into play about three or four years ago. And people that have large net worths or have accumulated money over the years are penalized from using our program basically because they have larger liquid assets. So that could be either done away with or some sort of limitation possibly, but that could easily be done away with.

It is the little things that have crept into our program that have made it much more difficult for small businesses to become eligible.

Ms. HALVORSON. Okay. And just so you know, this administration has a great technology department. And because of so many of us who want to decrease bureaucracy, we have now created—and if any of you out there have done FASFA forms for student aid, I used to do three a year. And they are very awful.

Now they will be done almost with the click of one click. So we are hoping that with a lot of your input, we will be able to do the same thing with this. We have the technology we need to use these experts that we have in this administration to do that.

So I look forward to working with all of you on that.

Ms. FINCH. Great. Thank you.

Ms. HALVORSON. Thank you.

I yield back, Madam Chairman, unless, sir, you have something to add? Please? Go ahead.

Mr. FOCHLER. I just wanted to say, too, from my experience with some of these requests of raising some of the limits, doing some research and development on the microloan programs, I mean, it is really phenomenal the way they give extra technical support to make it a lot less risky. They teach us.

As Mr. Shay was saying, a lot of the franchises out there, they are still small business owners. They are taking a lot less risk, but at the same time we could all use some extra technical assistance. And these microloan programs are I think a great system to kind of take a look at for increasing some of these other programs as well.

Ms. HALVORSON. I absolutely agree. And we need to find that happy medium. So thank you all so much for everything.

I yield back, Madam Chairman.

Chairwoman VELÁZQUEZ. Mr. Schrader?

Mr. SCHRADER. Thank you all for your generally positive comments on the new Investment and Financing Act of 2009. Hopefully this is a beginning. And certainly while we would like to do more, we are constrained, like many businesses, in terms of how much money we can actually spend at any given point in time. So a lot of your suggestions I think fall on very receptive ears. And hopefully going forward and as, Lord willing, our economy recovers, we will be able to make some additional investments.

I was interested a little bit in, Mr. Shay, your comments about the real estate portion of what SBA is doing and how that we may be overemphasizing that, on one hand, and maybe the market interest rates might be more. Can you elaborate on that a little?

And then I would like Ms. Finch's response to that if that is okay.

Mr. SHAY. Sure. And I don't want to pick any fights with anybody, but one of the things that we think would make sense to put the emphasis where it ought to be in terms of the 7(a) program would be to look at the amortization periods and say, for example, a loan that is going to amortize over a period of 15 years or longer, that there ought to be borrower fees associated with that and for a loan that is going to amortize over a period of 15 years or less—I guess it can't be 15 years or more but split the difference. For the shorter-term amortizing loans, we ought to reduce lender fees for those.

I mean, the goal ought to be to create incentives for the money to go to the places that are really going to help start-up businesses, as opposed to a longer-term amortization. And a small business is not a 30-year amortization or an 18-year amortization. A small business is a start-up if they need an injection of capital for 18 months or 12 months or 2 years or something like that.

So whatever we can do to sort of reset some of things that would emphasize or create incentives for the capital to flow to the start-up side, from our perspective, that makes sense.

Now, obviously other people will have other perspectives for totally legitimate reasons, but that is our view of one way in which you might do that.

In terms of the market rate on the interest charges—and I am not sure if you were alluding to that as well. I mentioned that. It is in our written submission. In that area, clearly from what everyone here has said, I think, the demand for access to capital exceeds the current supply or if not the supply—and I think maybe it doesn't exceed the supply because we know the balance sheets look pretty healthy in a lot of places, but it exceeds willingness to lend.

And so the question is not so much how we create more supply. The question is how we create incentives to lend. And incentives to lend, back to the observation that capital is agnostic, I mean, capital will go where it is going to achieve the greatest return on investment.

And so if there are lenders out there that look at opportunities to make loans and say, "If it is an SBA loan, I can earn six and a quarter. And if it is a loan somewhere else, I can earn eight or nine percent," then they are not going to do an SBA loan. And we can't blame them for that.

So our view would be if there is an opportunity to strike more of a balance there between the interests of lenders and borrowers, recognizing this is a government agency and—

Mr. SCHRADER. You have got some borrowers that are actually lending at eight percent? I don't have many in my area, but I appreciate.

Mr. SHAY. Yes. I think that in some places, it happens. And Ryan talked about that. It is still better than a credit card. So, I mean, if you are really desperate for capital and you have got a great idea, you will pay whatever you have to pay. And I think a lot of lenders don't want to do deals at six percent if they can do a better deal somewhere else.

Mr. SCHRADER. Ms. Finch, comment?

Ms. FINCH. When the American Recovery Act was passed and the money was available to pay fees under our program, it did increase our loan activity. It was a real incentive for businesses who maybe stepped back and were thinking twice about expansion, saw this as an incentive of, well, maybe this is a good time to expand because I can have the savings on the up-front fees. So they would go ahead and do their expansion. I feel that is money well spent.

As I stated in my testimony, though, beginning October 1, our subsidy rate went from zero to 389. I think that increase in fees is going to eat away at small business' cash flow that if they were to apply for a 504 loan, if that fee were to be paid for and that would be a savings to them, that that would be also another incentive for them to use the SBA 504 program.

So I think there are ways to use money smartly and more effectively, more cost-effectively, to help give an incentive to small businesses to use our types of programs.

One thing I will also mention is under 504, if you are a small business start-up, you are required to put in 15 percent. Otherwise, under 504, you could get in for 10 percent if you are an existing business.

That is a requirement, and I believe that is statutory. So if that barrier were taken away and it was more of a credit decision as to who should put in 10 percent and who should put in 15 percent, that barrier being taken away could help be a stimulus to small business expansions and start-ups.

Mr. SCHRADER. Thank you both very much.

I yield back.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Finch, correct me if I am wrong, but I think you mentioned that since October, your lending partners have increased lending activities by ten percent?

Ms. FINCH. In my particular—

Chairwoman VELÁZQUEZ. Yes.

Ms. FINCH. In my state, yes.

Chairwoman VELÁZQUEZ. I am glad to hear that. However, many analysts have voiced concern that a collapse in commercial real estate is yet to come. And the focus of CDC's 504 is basically financing on real estate projects.

So does the proposed legislation contain the necessary tools to control rise in costs and address the potential for increased losses in the program?

Ms. FINCH. I believe it does in that it also, then, gives CDCs the ability to try and recover on their 504 loans. We have the authority, but we don't have policies, procedures in place for us to be able to do that on our own.

And CDCs have been doing this in many other programs that they administer. So by giving us the ability to try and recover, liquidate and recover, on our own loans, I think that is a very important aspect.

Living in Missouri, I know what my market is. I know how to liquidate a property and try and maximize my recoveries. And right now we are partnering with the SBA in doing that. But I think if we were given the ability to have more freedom to do that, I think that is going to be very helpful.

Chairwoman VELÁZQUEZ. Okay. Thank you.

Mr. Graves? You don't. So let me take this opportunity again to thank you all. And you are all excused. Thank you.

Ms. FINCH. Thank you.

Chairwoman VELÁZQUEZ. I will ask the members of the second panel to please come forward

Mr. SCHRADER. [presiding] I would like to welcome the second panel to the Committee here today, look forward to your testimony. And we will start with Mr. Sekula.

Mark Sekula is the Senior Vice President of Business Services of the Randolph-Brooks Federal Credit Union, one of our nation's leading credit unions, serving more than 300,000 members, many of whom have served in our armed forces, I understand.

Mr. Sekula is testifying on behalf of the National Association of Federal Credit Unions, the leading trade group for our nation's federal credit unions.

Welcome.

STATEMENT OF MARK SEKULA

Mr. SEKULA. Thank you.

Good afternoon, Chairman Ranking Member Graves, and members of the Committee. My name is Mark Sekula, and I am testifying today on behalf of the National Association of Federal Credit

Unions, NAFCU. I serve as the Senior Vice President for Business Services for Randolph-Brooks Federal Credit Union, headquartered in San Antonio, Texas.

This June Randolph-Brooks Federal Credit Union was recognized by SBA Administrator Karen Mills as the SBA 2009 credit union lender of the year. We were also ranked as the fifth largest SBA patriot express lender in the United States with year-to-date volume for 2009 with 133 loans for approximately $8 million. Randolph-Brooks is also ranked as the number one SBA lender in the 55 counties in our SBA district for 2009.

Randolph-Brooks started its business program only five years ago. And today we have over 16,000 business accounts. We only started SBA lending a little over two and a half years ago, at the request of our members. And we currently have 414 loans for about $20 million. We grew 13 million of that from 2008 to 2009 as businesses turn to us for credit after losing other sources.

Through fiscal year 2009, which for the SBA runs from October to September, we generated 153 loans, for 8.9 million, and helped create 396 jobs and retain 799 employees.

It is also widely recognized that credit unions did not cause the current economic downturn. However, we believe we can be an important part of the solution. Credit unions have fared well in the current environment and, as a result, may have capital available.

Surveys of NAFCU member credit unions have shown that many are seeing increased demand for mortgage and auto loans as other lenders leave the market. A number of small businesses who have lost important lines of credit from other lenders are turning to credit unions for capital that they need.

Many small business owners are members of credit unions around the country and rely on our services to help make their small businesses successful. Our nation's credit unions stand ready to help in this time of crisis and, unlike other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents credit unions from doing more for America's small business community.

The current economic crisis has demonstrated the need to have capital available to help our nation's small businesses, especially in troubling times. Many credit unions have the capital other lenders cannot provide but are hamstrung by this arbitrary limitation. It is with this in mind that NAFCU strongly supports the passage of H.R. 3380, the Promoting Lending to America's Small Business Act of 2009.

Introduced by Representatives Kanjorski and Royce, this important piece of legislation would raise the member business lending cap to 25 percent while also allowing credit unions to supply much needed capital to under-served areas, which have been among the hardest hit during the economic downturn.

NAFCU strongly supports the reintroduction of the Credit Union Small Business Lending Act, which was first introduced by Chair Velázquez in the 110th Congress. We also support the legislation currently before the Committee, H.R. 3723, the Small Business Credit Expansion and Loan Market Stabilization Act of 2009. We believe that this legislation takes important steps toward improving the SBA and its 7(a) loan programs and will help credit unions do more with the SBA.

When I cover this bill in more detail in my written testimony, an important aspect of this legislation is a continuation of the program started under the American Recovery and Reinvestment Act of 2009, including a continuation of the 90 percent guarantee on SBA loans and the lower fee structure. The continued guarantee is particularly helpful for credit unions as the guaranteed portion of the SBA loans does not count against the arbitrary member business lending cap.

We also applaud the provisions that would assist small lenders that do not participate in the preferred lender program and that would have the SBA provide training to smaller lenders.

Finally, we believe the capital backstop program established in this bill could be an important tool in allowing credit unions to get capital to small businesses in a time of need as the SBA would handle much of the administrative work in such a circumstance.

In conclusion, the current economic crisis is having an impact on America's credit unions, but we continue to provide excellent service to our members. Credit unions stand ready to help our nation and our nation's small businesses recover from the current economic downturn. Legislation, such as H.R. 3723 and the Promoting Lending to America's Small Businesses Act, H.R. 3380, would aid credit unions in their efforts to help our nation's small businesses.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.

[The prepared statement of Mr. Sekula is included in the appendix.]

Mr. SCHRADER. Thank you very much.

Let's go to Ms. Carolyn Galiette, Senior Managing Director of Ironwood Capital located in Avon, Connecticut. Ms. Galiette is testifying today on behalf of the National Association for Small Business Investment Companies, one of the oldest organizations of venture capitalists in the world and leading trade organization for small business investment companies.

STATEMENT OF CAROLYN GALIETTE

Ms. GALIETTE. Thank you, Representative Schrader, Representative Graves, and members of the Committee. Thank you for the opportunity to appear before you today. Your dedication to the small business community is appreciated by all of the small business investment companies that I represent and by all of the small businesses that we support.

My name is Carolyn Galiette. I am a senior managing director and co-founder of Ironwood Capital, an investment management firm located in Avon, Connecticut. Over the past eight years, Ironwood Capital has become a staunch supporter of the SBIC program. We manage three SBICs, the first of which was licensed on September 7th, 2001 and the third of which was licensed in June of 2007.

We, like many other SBICs, have managed through turbulent times but have remained steadfastly focused on the objectives of the SBIC program to provide patient capital, operating advice, and market experience to eligible small businesses to generate a return for our limited partners through the success of these small businesses and be thoughtful stewards of the taxpayers' money, which lends capital to our funds.

We fill a capital need that is unmet by other financial institutions, including banks which provide SBA-guaranteed loans. To date we have invested in 53 small businesses in places ranging from Moline, Illinois to Winterville, North Carolina and to Brooklyn, New York. We also travel to invest in smaller cities, such as Hockley, Texas; Fitzgerald, Georgia; and Middleburg, Pennsylvania, places that are often overlooked by other capital providers.

Our partnership with the SBA has enabled our portfolio companies to create approximately 4,500 jobs and to increase revenues in these companies by over 50 percent on average. Moreover, we have accomplished all of this while making 50 percent of our investments in companies owned and managed by women and minorities and businesses located in and employing residents of low and moderate-income communities. We have provided capital where larger, more established financing sources would not, some of which are the very lenders and investors who recently received TARP financing.

The SBIC Debenture program is an incredible resource for small businesses and the taxpayer. This program is truly market-driven and operates at a zero subsidy rate, requiring no appropriations. Unfortunately, despite the efficiency of the SBIC credit facility, the program is dramatically under-used, due in large measure to the cumbersome and time-consuming process of obtaining a license and operating within the guidelines of the program. Fiscal year 2009 used only about 20 percent of the program's $3 billion in capacity, denying domestic small businesses over $2 billion in growth capital.

The SBIC Modernization and Improvement Act creates a streamlined licensing process that enables well-performing SBICs to establish follow-on funds in a timely manner, thereby avoiding a waiting period of one year or more that currently plagues the process. In fact, it took us 11 months to get our second fund license, 9 months to get our third fund license, and another 7 months on top of that to complete the FBI checks.

At the same time, the proposed legislation retains the rigorous underwriting process currently in place for new managers. Moreover, by increasing the borrowing ceiling on families of funds in good standing, the bill creates the ability to keep successful SBIC operators in the program.

Without these changes, these growth constraints will, unfortunately, preclude our next fund from being an SBIC, a prospect that disappoints me and an outcome which will likely affect many of our similarly successful peers. It would be a terrible waste to push aside fund managers, who have proven to be experts at empowering and in growing small business.

The bill needs a few technical adjustments, but otherwise it is a very solid piece of legislation whose passage we consider to be time-critical. Because it enhances a successful existing program, it could be implemented expeditiously and actually be utilized to deploy needed capital to small businesses early in 2010.

I strongly encourage all of you to move this bill forward as quickly as possible. Similarly, the Small Business Early-Stage Investment Act addresses a critical need for small business equity capital.

We believe several technical changes should be included in order to ensure the long-term success of this new program. These improvements include the licensing by SBA of early-stage program participants and the broadening of the program, to include industries, such as manufacturing and industrial technology, industries which lie beyond the Silicon Valley companies that will likely constitute the current focus of the bill.

In addition, there are a number of other provisions that have served the SBA well, which we advocate should be added to this program. We seek legislation that benefits not only our members but, equally importantly, policies that benefit the U.S. taxpayer and the small businesses we serve because without all of these constituents, we cannot succeed.

The SBIC program marries individual entrepreneurship with government assistance in a way that is productive for all and which is absolutely crucial to our nation's economic growth.

Thank you for the opportunity to speak to you today and your support of small business.

[The prepared statement of Ms. Galiette is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Galiette.

Our next witness is Mr. Michael Menzies. He is the—oh, I am sorry. I am sorry. Suzette Dutch—I am sorry—is the Managing Partner with Triathlon Medical Venture Partners in Cincinnati, Ohio. This is a venture-based venture capital firm that invests exclusively in the life sciences.

Ms. Dutch is testifying today on behalf of National Venture Capital Association, which represents the U.S. venture capital industry, with more than 450 member firms.

STATEMENT OF SUZETTE DUTCH

Ms. DUTCH. Thank you, Chairman Velázquez, Ranking Member Graves, and members of the Committee. My name is Suzette Dutch, and I am co-founder and Managing Partner with Triathlon Medical Ventures, an SBIC based in the Midwest that invests exclusively in life science funds.

By virtue of our regional presence and $105 million in capital funding, we are one of the leading sources of early-stage life science investment in the Midwest.

In addition to having been a venture investor since 1987, I am also a member of the National Venture Capital Association. And it is my privilege to be here today on behalf of the venture capital industry to support the Small Business Early-Stage Investment Act of 2009.

We believe this bill presents a tremendous opportunity to fund more of the most promising small businesses in our country. The venture industry has consistently supported the notion that significant value can be created when government and the private sector work together. The intent of this program appears to do that and to be beneficial to regions of the country that today are underserved in terms of access to capital.

There have traditionally been limited funding sources for ventures which carry significant entrepreneurial and technological risk. The current economic climate makes even traditional institutional investors slow their commitments to this asset class and makes the need for public collaboration more critical to these engines of future economic prosperity.

Given the risk of failure and the lack of collateral in their early years, these start-up companies are not able to qualify for traditional commercial loans, nor are they appropriate for the SBA's Debenture Program as the long time until profitability prevents them being able to support a current interest payment portion.

Appropriately, the expertise to select and nurture these investments keeps other alternative providers, such as buyout shops and hedge funds, away and leaves it to venture capitalists to fund these companies. The program would bolster the country's ability to offer promising companies a better chance to grow and thrive at a time when we need more jobs and stronger economic growth.

Implementing this program through established venture firms recognizes that intelligent investing and measured risk taking requires more than money, requires expertise and guidance from professionals who understand the industry's competition and strategic landscape into which these start-ups are operating and who have the networks of relationships to assist the companies as they grow.

While venture capital is a national industry with venture-backed companies in every state, there is a concentration on the coasts. This program, as structured, will benefit other parts of the country where this is needed.

For example, in Ohio, where my firm is headquartered, venture capitalists invested $39 million in 17 companies in the first half of '09 compared to $3.4 billion invested in 476 California companies during the same time period.

Ohio, as well as other states in our Midwest geographic footprint, has the entrepreneurs, university labs, and leading medical institutions that drive venture investment. It is capital we lack. And the opportunity to be part of this program and support local companies would be welcomed by firms like mine that have access to a great many more ideas than we can fund on our own.

The bill is currently proposed as an excellent start by offering the right incentives to the right stakeholders, by requiring privately managed companies to have capital commitments from nonfederal sources.

There is an intrinsic vetting that occurs, assuring the SBA a level of comfort that the applicant already has the support of accredited investors. Limiting the grant to 100 million for a single fund supports the appropriate diversification, protecting the government's interest as well as facilitating syndication.

The focus on early-stage investing in a diversity of industries channels government funding where it has historically been the most successful and where the gap is greatest between academic grant funding and expansion funding.

As we move through the legislative process, there are a few considerations we think will maximize the success of the program. First, venture capital funds have a ten-year life. And, therefore, we recommend the language be amended to permit drawdowns of capital over the life of the fund for follow-on investment and payment of expenses. This would make the language more consistent with industry norms and could be tempered with a restriction on new investments or a maximum percentage that could be drawn down after the first five years.

Another area of potential concern is the requirement that distributions be made to all investors in the form of cash without the option of distributing freely tradeable public stock. Recognizing IPOs are often a form of financing, rather than a liquidity event, this prevents other investors from achieving potential up-side and post-IPO stock appreciation and may make them reluctant to commit to funds.

With these changes, we strongly support this program. And I look forward to answering any questions.

[The prepared statement of Ms. Dutch is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Dutch.

Our next witness, Mr. Michael Menzies, is the President and CEO of Easton Bank and Trust Company in Easton, Maryland. Easton Bank is a state-chartered community bank with $150 million in assets. Mr. Menzies is also Chairman of the Independent Community Bankers of America. ICBA has nearly 5,000 members representing more than 20,000 locations nationwide.

Welcome.

STATEMENT OF MICHAEL MENZIES

Mr. MENZIES. Thank you, Chairwoman Velázquez and Ranking Member Graves, members of the Committee. It is my honor to represent the 5,000 community bank members of the Independent Community Bankers of America.

With many of the largest firms stumbling and the unemployment rate reaching ten percent, the viability of the small business sector is more important than ever. The SBA loan programs were created to assist our nation's entrepreneurs. ICBA appreciates the Committee's support of robust SBA loan programs and proposals to make them even better.

Community banks like mine specialize in small business relationship lending. For their size, community banks are enormous small business lenders. While community banks represent about 12 percent of all banking assets, they make 31 percent of the dollar amount of all small business loans of less than a million dollars. Notably, half of all small business loans under $100,000 are made by community banks.

The headlines have been full of reports of the giant mega lenders that took on huge risks and stumbled. Community banks represent the other side of this financial story. Despite the dominance in the media about a credit crunch, community banks are alive and well and lending. In fact, small banks of a billion dollars in asset size or less were the only segment to show an increase in their net loans and leases in the last FDIC quarterly data.

The ICBA was pleased with the ARRA stimulus enacted in February, which contained several ICBA-backed tax relief and SBA reform measures. Specifically, the major SBA loan program enhancements enacted are all helping many small businesses ride out this deep recession. And we support the extension of the key incentives for the SBA 7(a) and 504 lending programs.

At my bank I have made use of both the first-time home buyer tax credit and the SBA ARC loan program. ICBA applauds the Small Business Committee's legislation to extend the beneficial SBA enhancements included in the stimulus package, such as extending the SBA fee reductions and higher guarantee levels, expanding the ARC loans programs to apply to existing SBA loans, increasing the maximum loan amount to $50,000, and streamlining loan paperwork, making permanent the SBA secondary market facility authority.

ICBA believes the key to best meeting small business capital needs is to have diversity in SBA lending options. The SBA should be there to meet the needs of both large and small SBA loan program users.

Before this financial crisis hit, nearly 60 percent of all SBA loans were concentrated in just 10 banks. This is unacceptable because there are more than 8,000 community banks nationwide that can support a large number of SBA loans in total if community banks are able to access SBA loans more easily. In other words, we don't want an SBA with a one size fits all cookie cutter approach that only the biggest volume SBA lenders can use.

To help encourage more lenders to extend SBA loans to small businesses, we support making the community express program permanent, supporting a small lender outreach program, establishing a permanent rural lender program, and creating a national lender training program.

ICBA appreciates the Small Business Committee's support for the SBA programs and especially for proposing a robust authorization level. Specifically, we support $17.5 billion in 7(a) program authority, increasing the SBA 7(a) loan limit from $2 million to $3 million—that is enough—allowing alternative loan size standards for determining eligible small business borrowers.

We support the Committee's work. Thank you for all of your efforts in getting the credit needs of small businesses satisfied throughout America. I would be thrilled to answer any questions you may have.

[The prepared statement of Mr. Menzies is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Menzies.

Our next witness is Mr. Cass Johnson. He is the CEO of the National Council of Textile Organizations. The National Council of Textile Organizations represents the entire spectrum of the textile industry.

Welcome.

STATEMENT OF CASS JOHNSON

Mr. JOHNSON. Thank you.

Good afternoon, Chairman Velázquez, Ranking Member Graves, and members of the Committee. My name is Cass Johnson. I am the President of the National Council of Textile Organizations.

I think this is the third time I have had the opportunity to testify before your Committee. May I just say that you always tackle important subjects. We really appreciate it. You shine a light where many committees, for some reason, dare not go. I just want to thank you for that.

The U.S. textile industry is the third largest exporter of textile products in the world. We export over $16 billion in goods to other nations. In that export context, I would like to touch briefly on a new topic, the availability of export financing for small businesses.

As the last 12 months have shown, we truly live and compete in a global economy. Credit is an essential ingredient in that economy. And access to credit, particularly credit for export, has become a new and major competitive issue for our industry and for other sectors.

During the financial crisis, Asian governments and banks reacted swiftly to ensure that export credit was not only available and plentiful. In April, China announced a textile revitalization plan that extended increased textile export subsidies and new credit lines and guarantees to its small and medium-sized textile companies.

In August, Pakistan announced it was eliminating taxes on all textile exports and would be granting comprehensive insurance for all textile exporters. And yesterday, India announced that all textile exporters would now get a two percent rebate on their credit costs from the Indian government.

Unfortunately, in regards to export credit availability here, the opposite has been the case. Our industry's access to export credit has been significantly reduced. As U.S. government institutions, U.S. banks, regional banks, and private insurers have deemed the $25 billion textile and apparel trade between the United States and the NAFTA, CAFTA Andean region to now be risky and, as a result, have hiked fees, reduced credit, and withdrawing guarantees and insurance.

To illustrate the problem, imports of finished apparel from Asia have dropped by ten percent this year. That is about the drop in U.S. consumption. However, within the CAFTA, NAFTA Andean region, imports are down by 22 percent. Accordingly, U.S. textile exporters have seen their exports decline by 24 percent. It will come as no surprise to hear, then, that our sector has been forced to lay off more than 50,000 workers since December of last year.

When we surveyed our members as to why U.S. exports were in decline to the region, they universally responded that credit has been significantly curtailed to their customers in the region.

We also learned that our mills are increasingly being asked to extend credit to apparel customers overseas who used to have their own credit and that they are being asked to do so sometimes without normal private insurance or government guarantees that used to be in place. And while this has been occurring, U.S. mills have been squeezed by their own banks.

We have instituted new fees, requirements, and standards for extending credit to them. To make matters worse, Ex-Im Bank has sharply reduced its activity for textile and apparel trade in the Western Hemisphere and, according to our members and importers, guarantees almost no trade, none of that $25 billion trade, in the region. As you can see, the entire credit chain for textile and apparel accomplished in the Western Hemisphere is under strain.

NCTO, the National Cotton Council and our members, have been examining programs in the SBA and the Ex-Im Bank in order to determine how best to restore credit availability.

We have determined that with a few updates, the SBA's export working capital program could provide an essential assist during these difficult times. These modifications concern the size of the loans being guaranteed and the limit on the size of the companies that can access guarantees. These two components need to be updated so that textile companies and other manufacturing exporters can take advantage of the programs.

Regarding the size of the companies, we are asking that the size limitations for companies in NAICS code 313, which covers all manufacturers, be standardized at 1,250 employees. A number of NAICS numbers have limits as high as 1,500, but our companies, for instance, have limits at 500. This will automatically open new export opportunities for small and medium-sized enterprises in the United States and provide access to almost all textile exporters.

Regarding the loan amount, we recommend a new export capital program be created outside of the 7(a) program. We suggest that the SBA set loan amounts at 5 million, 10 million, and 15 million that tie risk to the amount borrowed. The terms of the loan would be from 12 to 18 months and use standard SBA terms and interest rates. The guarantee level would be dependent on loan size.

In closing, our industry has solid export opportunities in the CAFTA and NAFTA regions and has helped create a platform that today accounts for $25 billion in exports and employs over 1 million workers region-wide.

However, faced by the reduction in export financing and well-capitalized competitors in Asia, we desperately need more financing and access to more financing options. We believe the SBA ca play an important role. And we urge the Committee to consider these two important modifications.

Thank you very much.

[The prepared statement of Mr. Johnson is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Johnson.

Mr. Sekula and Mr. Menzies, can you tell me what is the average loan size of 7(a) loan programs that you have made in the last two, three years?

Mr. SEKULA. Yes, Madam Chairman.

We have only been in the SBA lending arena for two and a half years. So we are relatively new into this. But since our inception, our average SBA loan size for 7(a) is $48,000.

Chairwoman VELÁZQUEZ. Forty-eight?

Mr. SEKULA. Yes, ma'am.

Chairwoman VELÁZQUEZ. Mr. Menzies?

Mr. MENZIES. Chairwoman, I don't have an average, if you will, but the range of loans that we have made has been from about $25,000 up to about $700,000. So I can think of a loan that is 235,000, but that would be the range of loans.

Chairwoman VELÁZQUEZ. Okay. Some in the previous panel that we had and some advocates are asking for an increasing of the maximum size on the 7(a) loans by as much as 2 and a half of the current size to 5 million, from 2.5.

Have you seen any real demand for loans this large from small businesses or if this is something that is more likely to benefit large banks that took TARP money?

Mr. MENZIES. We have not seen loan demand and I have no knowledge of member banks that have seen loan demand at that $5 million level. Our belief would be that $3 million should be more than adequate.

Mr. SEKULA. Yes, ma'am. Our position is pretty much the same. We have not seen an increase in loan demand for those sizes of loans. So we feel that the amount at this point would be adequate at this point in time, but we are relatively, again, new into this.

Chairwoman VELÁZQUEZ. Okay. Ms. Galiette, by most accounts, the need for investment has grown steadily over the past decade and is currently higher than at any time in the past. However, for years, the investing capacity in the SBIC program has gone unused.

Will the changes in the proposed legislation enable the SBIC program to grow and meet the need for capital?

Ms. GALIETTE. I think so. I feel that one of the challenges for the SBIC program, it's the front end and the back end. The front end, the licensing process is so time-consuming and cumbersome that good managers are turned away. And at the back end, once you have raised a fund, we have raised our first, our second, and now our third fund, we are going to be forced out of the program because once you have achieved success, you become too big for the cap.

It is not that any individual fund is larger nor is it that we are funding larger businesses than we have historically, but the average life of a fund is ten years. And so most successful fund managers are going to be managing three funds. You are going to have your newest fund; your fund that has basically hit the fourth year, which is almost the conclusion of the five-year investment period; and then your oldest fund, which is in its seventh or eighth year, which is almost fully harvested but isn't quite harvested. And in order to survive and keep capital moving out to communities and small businesses, you need to raise that next fund.

And so what happens is the funds are forced out of the program. They raise their next fund, a much larger fund because of the economies of raising funds, raising capital is also very difficult. So when you are forced to raise all of your capital from private investors, you are going to tend to raise a larger fund and invest in larger businesses because it is a lot of work to invest in small businesses.

Making a $2 million loan is in many cases more work than making a $20 million loan because those companies, they need the technical assistance, they need our expertise, they don't know how to work with the banks, they don't know how to increase lines of credit. And we spend a lot of time on that, which the larger mezzanine lenders don't have to do.

Chairwoman VELÁZQUEZ. All right. Would you say that the proposed language on the expediting relicensing program is crafted in a way that protects SBA?

Ms. GALIETTE. I believe it is. I think that clearly you need to be a proven manager. You need to have had a couple of exits. I think it is three exits in the proposal. You need to have a business plan that is substantially similar to your prize business plans and the same core group of investment managers so you can't have changed your focus or your team. And there is always a provision for the administrator, for whatever reason, to reject that licensee if there are extenuating circumstances.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Sekula, could the proposed capital backstop program containing this legislation have helped credit unions deliver more financing to small firms?

Mr. SEKULA. Yes, Madam Chairwoman. I think that the backstop would help us more small—at least from the credit union perspective, it would allow more smaller credit unions to be able to get in and start offering funds easier. And then, of course, with the continuation of the SBA doing a lot of the administrative work, then there is not the burden of trying to hire and get, obtain staff, and retain staff because from a credit union perspective, we have to have two years required member business lending training before you can become a business loan officer. So this will allow those who don't have that current staff on hand to be able to do that and capitalize on what the SBA backstop program would offer.

Chairwoman VELÁZQUEZ. Ms. Dutch, the proposed small business early-stage investment program will permit participating investment companies to repay the SBA funds at the same time as other investors when the company exits its investment. What are the advantages of this repayment structure?

Ms. DUTCH. Madam Chairwoman, I think that that is critical. As I mentioned, we were a participating securities SBIC. And, in fact, as we looked at that program, I think the difficulty with that was that it did not participate in the up side.

And what private investors and institutional investors have learned in the venture capital is that when we look across venture capital performance, the top tier way compensates. And the multiples that they earn compensate. And by capping the up side and not participating the same way that the private investors do, both in terms of timing and in participating in the full up side, their economics were sort of doomed to failure.

And so I think by aligning, the venture capital industry has shown over time that it is an attractive asset class. And that makes sense.

Chairwoman VELÁZQUEZ. Thanks.

Mr. Menzies, a frequent criticism of the ARC loan program was that these loans were burdensome for lenders to make. What are some ways that the paperwork burden for ARC loans could be reduced while keeping the loan safe for banks like yours?

Mr. MENZIES. Chairwoman Velázquez, community banks make relationship decisions. They are not in the production business. We don't use computers to credit score and simulate the repayment of a loan and run it through a big production model.

So one vehicle would be to allow community banks to use their standard C's of credit, character, capacity, capital, collateral, coverage, and conditions, and make those judgments the way they make judgments and feed them into the SBA program without the level of paperwork that is currently required in the ARC program.

Another clear benefit of this program would be to expand some of the definition of the use of the program. If I understand it correctly, it can be used to fund payments, if you will, but there are situations where individuals in small businesses have used their working capital to make payments. They have depleted their working capital to make those payments.

And that working capital needs to be restored at the favorable terms that are available in the ARC program. That would be extremely beneficiary if that was incorporated in this legislation.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Graves?

Mr. GRAVES. Thank you, Madam Chair.

I just have one question for Mr. Johnson. I think you kind of already answered it, but I wanted to reiterate. Should we have a greater emphasis on expanding capital and credit to manufacturers and, for that matter, any business that is going to improve the trade deficit?

Mr. JOHNSON. Absolutely. And what we are seeing is because of access to credit being reduced, the exports we should be making, we are not able to make. And, therefore, the deficit is increasing. And the proposals, the modifications we have proposed I think would help a lot. Our information is that manufacturers because the program size and the size of the companies simply are not availing themselves of these opportunities.

Our industry is certainly looking for a way to restore credit and would employ this program vigorously.

Mr. GRAVES. Thank you.

Chairwoman VELÁZQUEZ. Mr. Schrader?

Mr. SCHRADER. Thank you, Madam Chair.

Mr. Sekula, there has been a lot of discussion. You guys beat the drum pretty good on increasing the small business loan amounts for the credit unions. And considering that a lot of the banking community, at least large banks, aren't loaning at all has a lot of cache, at least with me.

I am interested in symmetrics. I mean, what assurances do we have that if we give this authority, that there will be an increase in small business lending beyond what you are already doing? And how would we gauge that? I mean, given the change, what increase in small business lending, what percentage increase in your portfolio or the credit unions across the country would we expect to see?

Mr. SEKULA. Well, unfortunately, I can't speak on behalf of all the credit unions of what their growth will be across the country. I can talk about some of what we have experienced over the near term.

For instance, when TARP went into place within 6 months after that, credit union member business lending increased 18 percent while lending with other financial institutions had dropped on the business side.

From Randolph-Brooks' perspective, we have been doing SBA lending for two and a half years. And our SBA lending from August of '08 to August '09 increased 107 percent. So the demands are there, but there are also barriers to entry.

And some of the things that you have addressed in this are by removing the preferred lender status so that more SBA loans can be granted is going to be a plus, the backstop deal with opportunities for preferred lenders to buy those loans.

But we also have to get past the issues that credit unions have with the arbitrary cap that was placed back from the Credit Union Membership Access Act, back from 1998. Prior to 1998, credit unions did not have a cap in place. During the Credit Union Membership Access Act, they asked Treasury to do a study on that and found that credit unions had no—there were no economic or safety and soundness reasons to necessarily support that.

They also found in that study that the credit union delinquency and charge-off as compared in the member business lending arena were much lower than those of other financial institutions. And those numbers still hold true today in regards to performance for member business lending portfolio.

I feel from my perspective that by removing some of these barriers, these entry to barriers for credit unions to get in and play who do have the capital to be able to lend, that credit unions will help.

I'm not leading to create an illusion that credit unions are going to save small businesses and take care of all of their lending needs. It has to be a cumulative effort of all financial services getting in place to be able to provide those services. But I think credit unions can't.

Mr. SCHRADER. And you would be willing to work with the Committee on metrics, like most small businesses would?

Mr. SEKULA. Yes, sir.

Mr. SCHRADER. Mr. Menzies? Excuse me if I got that—

Mr. MENZIES. Menzies.

Mr. SCHRADER. Menzies. I apologize.

A little off topic, I think related here, I have been a little concerned with the FDIC director's recent announcements trying to recapitalize their money. They are talking about making banks pay three years in advance what their normal dues would be.

Could you comment—I guess I would be interested in the credit unions' response on that, too—comment on what that is going to do to the ability or inclination of banks to lend money in these very difficult times?

Mr. MENZIES. Absolutely, Representative. I would like to make two comments, if I may, which is that I think it would be healthy for the nation to give credit unions unrestricted access to commercial lending and remove their 12 and a quarter percent cap, provide them an opportunity to be taxed and to pay towards the trillion-dollar federal deficit, provide them an opportunity to be part of the community reinvestment program, and offer them the opportunity to be regulated safety and soundness-wise the same way that community banks are. It would be a great opportunity for the nation. Taxing, CRA seems—

Mr. SCHRADER. If you could my question because I am running out of time?

Mr. MENZIES. Okay. And the answer to your question about recapitalizing the fund, it's a long, frankly, issue. We know that there are $42 billion in the fund right now. Thirty-two billion have been dedicated for reserves. Ten billion is left in capital.

The prepayment strategy is a strategy that is somewhat helpful to banks because we are allowed to put that prepaid premium on the balance sheet of the bank and amortize it over a three-year period of time.

The inequity of that solution is that all of us know that the $6 trillion of liabilities of the largest banks of the land are de facto guaranteed under too big to fail. And the previous special assessment was created by defining it as assets minus capital, which appropriately assessed those de factor insured liabilities. And that is the negative, if you will, of the prepayment of the deposit insurance premium.

Mr. SCHRADER. Just real quick because, again, I am running out of time—I apologize.

Mr. MENZIES. No problem.

Mr. SCHRADER. With the prepayment, are most banks going to be lending more or lending less given the changes in their balance sheet?

Mr. MENZIES. It absolutely will restrict the ability of banks to lend. In the case of my bank, $750,000 would be our prepaid insurance premium. That will come out of liquidity.

Mr. SCHRADER. Yes.

Mr. MENZIES. And that will be not available for lending. Yes, sir. That is your point. And that is an accurate point.

Mr. SCHRADER. I would like the Committee to look at that sometime perhaps. Thank you very much. I yield back.

Chairwoman VELÁZQUEZ. Ms. Halvorson?

Ms. HALVORSON. Thank you, Madam Chair. And thank you, panelists, for being here. Thank you, Mr. Johnson, for acknowledging the fact that we take on the hard issues because it is something that we have no choice to do. This is something that, no matter where we go, this is the first question we get from our businesses: how do we get access to capital and how do we get these things done.

I introduced the House Resolution 3723, which does take the 7(a) loan from 2 million to 3 million and increases the ARC loan from 35 to 50 because I believe that we take a good program. We want to increase it.

I am glad that the Chairman asked about the average 7(a) loan because, even though we wanted to make it better, we do acknowledge that, even though people want to make it even bigger, the average loans aren't anywhere near what people say that they should be.

What we are trying to accomplish with this legislation is an increase in lenders to participate in this 7(a). And I often hear small business owners in my district say that they can't find bankers that are going to offer these 7(a) loans, especially in my rural part of my district.

So, even in this legislation that I have, we are seeking to address this program or these problems by creating a real lender outreach program. And I know that the small bank outreach program is going to seek to increase the 7(a) participation among credit unions and community banks.

So I guess my question is—and before I ask my question, I also want to say that I have banks in my district that don't want to offer the ARC loans because they are saying that they're afraid that if a person defaults on the ARC loan that the SBA is not reimbursing them or it's very difficult to get the reimbursement, even though they're guaranteed at 100 percent.

So I would like anybody on the panel that would like to answer that if you are having trouble getting reimbursed from the SBA if there are any defaults. But, actually, I want anybody and Mr. Menzies or Mr. Sekula to discuss how you think what we could specifically do to increase the participation of people in banks and credit unions using this 7(a) program.

So if we could start with Mr. Sekula?

Mr. SEKULA. Well, as I mentioned earlier, I think for entry into the 7(a) program from the credit union perspective, only less than 3 percent of credit unions out of close to 8,000 credit unions are participating and offering SBA loans.

It is a very small percentage, but the average credit union size is only $92 million, as compared to the bank average size, it is probably close to $1.6-1.7 billion. So, as a result, their resources are very limited into that.

And so some of the stipulations that are put in place in H.R. 3723 will remove some of those by deferred lending steps or hoops that you have to jump through in order to become a preferred lender in order to offer it in 7(a) loans.

In addition to that, as I mentioned earlier, removing the cap of the 12.25 percent will provide some opportunity for that to take place as well as increasing the cap limit for member business loan qualification of 50,000 to 150,000.

And I really think that without them having to add additional staff that is going to be a drain on resources as they can work through the SBA program, that we will find more credit unions participate in the 7(a) programs.

Ms. HALVORSON. And, Mr. Menzies? I just want you to know everywhere I travel in my district, I say the community bankers did not get us into this mess. We love our community bankers. And, please, if you would like to add to how we increase participation?

Mr. MENZIES. God bless you, Representative.

Ms. HALVORSON. I do, everywhere I go.

Mr. MENZIES. As I mentioned in my testimony, supporting a small lender outreach program is very important. Education is important. I get an e-mail every week from our local SBA office. Mr. Knox sends me an e-mail and educates us on what is going on. I think education really is the key.

I have also heard, have not experienced or witnessed or personally seen examples of the SBA not paying on guarantees, but I have heard the same thing of a technical default in the loan documents existing and having trouble getting paid but personally haven't experienced that.

I think training is the issue and training loan officers. Loan officers like to do deals. They like to get things done. And when you bring in this infrastructure of new documents and new process and new procedure, lenders are inclined to say, you know, "I would rather it go this path and this path."

Ms. HALVORSON. So are you saying education—

Mr. MENZIES. Education.

Ms. HALVORSON. —is a primary barrier from banks and credit unions?

Mr. MENZIES. I think it is the primary opportunity. I think good lenders allow the SBA to be one tool in their bag of tricks. And they always consider the SBA solution as a piece of the whole solution. Rarely is it the total solution anyhow. Training banks and lenders on how to access and use the SBA in my opinion is a great opportunity.

Ms. HALVORSON. Great. Thank you. Thank you.

I yield back.

Chairwoman VELÁZQUEZ. Mr. Graves, any other questions?

[No response.]

Chairwoman VELÁZQUEZ. Well, let me take this opportunity to thank all of you. I think this Committee, we are listening. And we read the papers. We watch the news on TV. We hear the stories going on about the jobless economy and the fact that one of the obstacles that you are facing right now is the lack of access to capital. And so through this proposed legislation, we are trying to address some of the impediments that exist. And I want to take this opportunity to really thank all of you for being here today.

I ask unanimous consent that members will have five days to submit a statement and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned. Thank you.

[Whereupon, at 2:00 p.m., the foregoing matter was concluded.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

SAM GRAVES, MISSOURI
RANKING MEMBER

Congress of the United States

U.S. House of Representatives
Committee on Small Business
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STATEMENT
Of the
Honorable Nydia M. Velázquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: *"Increasing Access to Capital for Small Businesses"*
Wednesday, October 14, 2009

Whether we're talking about equity investment or traditional bank loans, access to capital has always been a major obstacle for small firms. Today, that challenge is compounded. According to a July survey by the Federal Reserve, 35% of domestic banks have tightened small business lending. Even loans through the SBA are down. For small firms, these declines are more than a simple setback. In fact, a lack of financing has forced many entrepreneurs to delay projects and put off investments. In some cases, it is limiting small firms' ability to create much needed jobs.

For small firms, access to capital is access to opportunity, and it's clear that small firms are in need of both. That's why the bill we're examining this afternoon delivers critical small business funding. I'd like to thank Representative Schrader, Chairman of the Subcommittee on Finance and Tax, for his leadership in moving the legislation forward. It is a bipartisan product, one that could not have come together without the work of 8 different committee members—including 2 from the minority. Their efforts were instrumental in drafting a blueprint that accounts for every stage of the small business life cycle—from startup to IPO.

The small business startup stage is especially critical to our economy. That's because new firms generate jobs and revenue where there once were none. But of course, entrepreneurs can't create new positions and paychecks out of thin air—startups require significant capital to get off the ground. Unfortunately, however, funding to these firms is declining. In the last quarter of 2008, it plunged $5.4 million. The legislation we're discussing today will stem those drop-offs by providing critical, early-stage capital. It not only greases the wheels for equity investment, but also expands SBA's microloan program. In doing so, it provides an additional $110 million to our smallest, most promising startups. Because small firms comprise 99.7% of all employer companies, that revision is more than an investment in small businesses—it is an investment in American job growth.

Small firms' funding needs begin in the startup stage. But, as any small business owner will tell you, they certainly don't end there. Even established firms require periodic capital infusions—particularly when it comes to enhancing their ventures. Today's legislation helps firms secure financing for new purchases. It also raises SBA loan guarantees, reducing risk for lenders. That's critical, because some banks are saying they won't loosen lending standards until the middle of 2010—and that's at the earliest.

For small firms that rely on loans, an 8-month waiting period might as well be a death sentence. That's why it's so important that we move forward with this legislation now. It will help small firms to purchase new equipment and inventory, and it will allow every business—regardless of industry—to hire new workers.

At a time when our economy is struggling, it only makes sense to stabilize the small business community. After all, it was small firms that sparked a recovery during the downturn of the mid 1990's. For this reason, we want to be sure that entrepreneurs have the resources to weather more than just an economic storm. With important improvements to SBA's disaster loan program, we can protect the foundation of our economy—even in the event of catastrophe. Following a natural disaster, capital is nothing short of a necessity. But for many small firms, it is the only issue that matters at all—catastrophe or no catastrophe. In a hearing this committee held last week, that fact became abundantly clear.

This past Wednesday, our committee met to discuss the state of small firms in the housing sector. We expected the conversation to focus on items like Section 179 expensing and the First Time Home Buyer's Credit. As it turns out, our witnesses had another, more pressing issue in mind—access to capital. One witness, despite owning a profitable venture, simply could not find a bank to finance his operations. As a result, his firm was forced to delay $1 million in contracts and, ultimately, lay off 10 workers. I wish I could say his story was unique. But the truth is, this sort of thing is happening everyday, and we cannot afford to continue down this road. That's why this legislation is so vital. It will ensure small firms have access to the capital they need to keep operations running, and the opportunity they need to grow our economy.

U.S. HOUSE OF REPRESENTATIVES
SMALL BUSINESS COMMITTEE REPUBLICANS
REPRESENTATIVE SAM GRAVES, RANKING MEMBER

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Opening Statement for Hearing on
Increasing Access to Capital for Small Business
Sam Graves
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC
October 14, 2009

I would like to thank the Chairwoman for holding this important hearing to consider legislative changes in the Small Business Administration's capital access programs. As I have mentioned before, access to credit and capital is critical to small businesses and the American economy.

During the past few years we have seen the capital and credit markets fluctuate wildly. Those changes are evident in the SBA's own lending statistics. In fiscal year 2007, the agency made approximately 90,000 loans worth about $14 billion through its 7(a) lending program. In fiscal year 2009, those figures are 44,000 and $9 billion. Some might say that credit was too available in 2006 and 2007. Today, the pendulum has swung completely in the opposite direction with credit and capital too unavailable. Clearly, the economy must find an appropriate middle ground.

In an effort to navigate an appropriate middle course, the SBA capital access programs can play a vital role. Those programs can fill gaps where conventional commercial credit and capital markets are not supplying funds to small businesses. Of course, those programs do no good if there are significant barriers to their utilization by lenders, investors, and small business owners.

The bills being discussed today are designed to reduce impediments to their use by lenders, venture capitalists, and small businesses. This is a good start and I hope to hear from our witnesses what additional changes are needed to unfreeze the capital and credit markets for small business owners.

While I am generally supportive of the bills before us today, I still have some concerns about some of the legislative proposals. I recognize that additional expenditures may be necessary to fix programs that are currently not functioning but given the current budgetary constraints, the costs of some of the initiatives remain troubling. Furthermore, there may be some difficulties with implementation of some of the programs. I look forward to working with the Chairwoman and the rest of the Committee to resolve these issues in a bipartisan manner.

It is important to recognize that the legislative actions we take in this Committee are only a component of a broader strategy needed to revitalize the small business economy. With 25 million small businesses in this country, improving the capital access program of the SBA will not cure the credit and capital access ills through which the economy is suffering. We must recognize that overly restrictive regulatory policies must be corrected in order to swing the pendulum back to an appropriate middle ground for the country's capital and credit markets.

Congress also must not adopt policies that sap confidence of small business owners to invest in the growth of their enterprises. Imposition of additional costs, whether it is through cap and trade legislation or increased taxes to reform health care, will reduce confidence in small businesses to take the economic risks needed to grow their enterprises. If Congress takes an approach that improves access to capital in SBA programs on one hand, and then takes away through increasing operating costs of small businesses on the other, Congress will not have accomplished anything.

Again, I would like to thank the Chairwoman for holding this hearing, the witnesses for taking time out of their busy schedules to provide us with valuable input, and yield back the balance of my time.

BIOTECHNOLOGY INDUSTRY ORGANIZATION

HEARING TESTIMONY

MARTIN SABARSKY, JD, MBA

CHIEF FINANCIAL OFFICER & CHIEF OPERATING OFFICER

HR BIOPETROLEUM, INC.

ON BEHALF OF THE

BIOTECHNOLOGY INDUSTRY ORGANIZATION (BIO)

BEFORE THE HOUSE SMALL BUSINESS COMMITTEE

"INCREASING ACCESS TO CAPITAL FOR SMALL BUSINESSES"

October 14, 2009

Good morning Chairwoman Velázquez, Ranking Member Graves, Members of the Committee, the Staff of the Committee, ladies and gentlemen. My name is Martin Sabarsky, and I am the Chief Financial Officer and Chief Operating Officer of HR BioPetroleum, Inc., a Hawaii-based biotechnology company focused on developing algae-based products such as next-generation biofuels. I am privileged to be here on behalf of the Biotechnology Industry Organization representing more than 1,200 member companies, academic institutions, state biotechnology centers and related organizations in all 50 states that are involved in healthcare, agricultural biotechnology, environmental biotechnology, and industrial biotechnology.

I am here to convey our support of the Small Business Early-Stage Investment Act of 2009, as it addresses a persistent problem in the biotechnology industry that has dramatically worsened in the past year. Over the past two decades, even in more "normal" financial times, the private equity and capital markets have increasingly failed to fund promising, early-stage scientific research beyond the basic research stage and before the revenue-generation stage, primarily because it is viewed as too high-risk relative to other investment opportunities. This critical phase of investment is often referred to as the "Valley of Death" within the biotechnology industry, given the potential for companies and technologies at this stage of their existence literally to die for lack of sufficient funding. This dynamic has been exacerbated greatly since the onset of the current financial crisis in the fall of 2008. Advancing science through the Valley of Death has never been more important than it is right now as we strive to create a 21st century economy, create new businesses and jobs, become more energy independent, transition to a low-carbon economy, and develop promising biotech treatments and therapies, all of which will benefit our citizens, and all of which will assist the United States in maintaining and even enhancing its reputation as a world-leader in developing cutting-edge technologies and the premier place to start and expand business to do so.

As but one example of a company and technology within the emerging biofuels industry that has the potential to benefit from this important legislation, HR BioPetroleum's renewable energy technology utilizes the most productive plants on earth – marine microalgae – to produce feedstocks for biofuels and other valuable products. Our technology leverages the photosynthetic power and rapid growth characteristics of microalgae to convert sunlight and carbon dioxide from industrial sources into inexpensive oils for conversion into biofuels and proteins and sugars for other products such as animal feed. Studies have shown that successful development in America of biofuels such as cellulosic ethanol and biodiesel from algae could result in the equivalent of 7.9 million barrels of oil being produced per day by 2050 – virtually eliminating our need for gasoline. The widespread use of biofuels could also reduce greenhouse gas emissions by 1.7 billion tons per year, equal to more than 80% of transportation-related emissions in 2002. Providing incentives for investments in technologies such as ours is critical not only to developing new businesses and jobs but to meeting one of our nation's top priorities - increased energy independence and security.

The economic downturn that has now lasted over a year has been especially devastating to small biotechnology companies and their ability to raise the capital required to develop their science beyond proof-of-concept into technologies available to the public. A recent joint study by BIO and Thompson Reuters found that the economic downturn has forced over 80% of biotech investors to change their investment approaches. In fact, from September 2008 through July 2009, over 40 life science biotechnology companies have shelved promising drug development programs in a number of therapeutic areas, including Alzheimer's, Multiple Sclerosis, Avian Flu, diabetes and various cancers due to limited ability to raise capital funds. Despite the very significant amount of new federal dollars being put into the grant or loan guarantee pipeline by this Congress and the previous Congress, investments in clean technology companies, such as my own, were down 48% the first quarter of 2009 (New York Times; April 1, 2009) and saw another 9% decrease from the second to the third quarter (WSJ; October 2, 2009). The most recent figures released this past Monday by the National Venture Capital Association and Thompson Reuters show that venture capital funds raised during the third quarter of 2009 are at a 15-year low. (The Hill, October 12, 2009). In addition, within the nascent algae industry, of which HR BioPetroleum is a member, one company that previously was funded by venture capital firms, and whose scientific founder was featured last year in Time Magazine for their promising technology, had to close its doors due to the inability to raise additional capital from either their previous funders or from new funding sources in the private equity market. This dramatic decline of investment within the early-stage segment of the biotechnology industry in general, and the industrial biotechnology / clean technology industry in particular, jeopardizes America's competitive edge and risks delaying or deferring our ability to create a robust 21st global economy.

Part of the challenge in developing innovative new biotech technologies and products is that it is an extremely time and capital-intensive process. Even in a positive economic environment, many biotech discoveries languish in the labs due to the difficulty in raising capital for advancing early-stage research and development programs for which there is promising data but significant remaining technological and market risks. Development of biotech-based treatments and therapies takes, on average, 8 to 12 years to bring a product to market and costs between $800 million and $1.2 billion. The pre-commercial and commercial development of biofuel technologies is an equally capital and time-intensive process given the significant research and development, engineering, and construction and operational expenses involved in developing and deploying pilot-scale, demonstration-scale, and, ultimately, commercial-scale facilities that have acceptable economics and have been approved by all regulatory agencies. Pre-commercial development of algae-based biofuels processes is estimated to cost anywhere from $100 to $300 million, and commercial-scale deployment will require hundreds of millions of dollars to billions of dollars depending on the size of the facilities.

In the case of my company, HR BioPetroleum, by 2007 we had successfully demonstrated an efficient process to grow algae at industrial scale in a pilot plant on the Big Island of Hawaii. This attracted Royal Dutch Shell, a world leader in biofuels within the energy industry, and we entered into a significant, industry-leading joint venture, called Cellana. The main short-term goal of our Cellana joint venture is to build and operate a new algae production facility in Hawaii to demonstrate the economics of integrated algae production and algal oil extraction processes. The main mid- to long-term goal is to optimize this technology package to permit large-scale commercialization within the next 5 to 10 years. Based in part on the strength of my company's technologies and its validating joint venture with Shell, we signed a memorandum of understanding with Hawaiian Electric Co., Maui Electric Co., and Alexander & Baldwin for a commercial algae facility to be located on the island of Maui, next to the power plant located there. This commercial algae facility would represent one of the more significant investments in Hawaii and one of the most significant non-hotel employers on the island of Maui, should we successfully develop the technologies and obtain the required funding to construct and operate this facility. Despite these advantages and accomplishments, a private equity financing that was on the cusp of closing fell through shortly after the beginning of the current financial crisis in September 2008, when the private equity firm shifted its investment strategy in response to the financial crisis. Our subsequent attempts to attract additional venture capital / private equity investment to continue development in the midst of the continuing financial crisis have thus far failed, with several venture capital and private equity funding sources openly telling us that their investment model had shifted to a more risk-averse model of investing in only a subset of their existing portfolio company investments or investing in later-stage or even public companies. Among the firms we contacted, few were even open to considering new investments in firms like mine, or within the biofuels industry generally, or even within the broader biotech industry, given the perceived and actual technology risk, coupled with a general lack of availability of new sources of capital from the "traditional" sources of private equity funding, such as university endowments and high-net-worth individuals and families. Even fewer firms we contacted in the fourth quarter of 2008 and the first quarter of 2009 engaged beyond preliminary discussions. At the moment, we have ceased reaching out to the venture capital / private equity community until signs of activity / interest can be seen. Our Cellana joint venture with Shell continues to operate, so as new positive developments occur with our commercial process development we can still potentially attract venture capital / private equity investment some time in the future. Most of our peers in the algae-based biofuels sector or the broader biotechnology industry, however, are not as fortunate as my company, and many have less than 12- or even 6-months of remaining cash to fund their programs or to survive as a company. Hence, this pending legislation is even more critical to addressing the inadequate funding environment that exists today and could persist for a significant time to come, and in particular could help early-stage, small biotechnology companies traverse the pernicious Valley of Death stages of their development.

Beyond the specific example of my company that I just shared with you, spurring investments in small, early-stage biotechnology companies will also spur job creation in the broader economy. In fact, a recent report by BIO Economic Research Associations (February, 2009) calculated that approximately 400,000 jobs would be directly created by the advanced biofuels industry, with total employment creation in the U.S. reaching 1.9 million jobs. They also estimated that direct economic output, including capital investment, research and development, technology royalties, processing operations, feedstock production and biofuels distribution, would be $5.5 billion in 2012, rising to $113 billion by 2030.

Traditional small business loans provided by the Small Business Administration simply do not work for early-stage biotechnology companies due to their high-risk nature, lengthy development times, large capital requirements for pre-commercial development, and aversion of equity investors towards early-stage companies with any significant debt. In many important respects, debt is just not a suitable or available source of capital for companies in the biotechnology industry, which traditionally have been financed entirely by equity capital until they have made it through the Valley of Death and are at a much later stage of development. The House Small Business Early-Stage Investment Act of 2009 would create a program at the SBA that would stimulate growth in small, early-stage, technology-based companies such as HR BioPetroleum These funds could also serve to bolster regional venture capital funds that are often key players in the early rounds of venture financing.

Other complementary programs, such as the loan guarantee programs, large grant programs, and tax incentives available through agencies such as the Department of Energy and Department of Agriculture are important adjuncts to the pending legislation, but these programs are simply not available to small businesses in the biotechnology or biofuel arenas that don't already have the sufficient equity capital to satisfy the cost-share requirements or the minimum equity requirements that must be demonstrated in the application phase of these programs. It is a sad reality that, unless the biofuels-related grant and loan guarantee programs are modified to reflect the lack of significant new funding within the biofuels industry, only those large, diversified companies with excess cash reserves or small companies who already have been funded can even apply for the significant federal dollars that are becoming available through the recent stimulus bill or other federal programs. In many cases, as I believe is the case with my company, HR BioPetroleum, small businesses that require new or additional equity investors to pursue DOE grants or loan guarantees may have the more innovative technologies despite their current lack of capital. This is a real Gordian Knot that can only be cut by providing additional equity capital to address this problem.

In closing, it is clear to me, as I hope it is clear to the Committee and this Congress, that small, early-stage biotechnology companies have enormous potential to benefit the economy, improve public health, and increase our nation's energy independence and security, among other significant benefits. To ensure that the United States remains the world leader in biotechnology research and development, investment in these biotechnology companies needs to be fostered. BIO believes that providing incentives for additional investment in small biotechnology companies is the most effective approach for SBA to support these high-risk, high-reward companies. This will provide a mechanism for SBA to address the needs of small, early-stage biotechnology companies that have heretofore been largely unable to utilize SBA's finance programs or the other funding mechanisms within the federal government.

Thank you for the opportunity to talk to you about HR BioPetroleum and the promise of advanced biofuels as well as how programs such as the Small Business Early-Stage Investment Act of 2009 could serve to provide incentives for increasing the availability of much needed investment dollars required to develop commercially available biotechnology products and processes that will benefit the public.

AMERICAN OSTEOPATHIC ASSOCIATION

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Statement of
Thomas G. Zimmerman, D.O.
American Osteopathic Association

Presented to the
Committee on Small Business
U.S. House of Representatives
October 14, 2009

Chairwoman Velazquez, Ranking Member Graves, and members of the Committee, thank you for the opportunity to testify before you today. As an osteopathic physician board-certified in family medicine, a health information technologies consultant, and a member of the American Osteopathic Association, I have witnessed first hand the challenges facing our nation's physicians as pressure mounts for these practices to implement HIT systems in the coming years. Clearly, the incentives offered through the HITECH Act beginning in 2011 and the subsequent threat of penalties beginning in 2015 are expected to encourage many physicians to adopt electronic medical record systems. However, from my experience and that of most research, I find that the biggest stumbling block to EMR implementation for many physician practices is financing. For this reason, we wish to express our strong support for H.R. 3014, the "Health Information Financing Act of 2009."

The AOA represents 67,000 osteopathic physicians across the country. Our profession is unique in its focus on primary care, with approximately 60% of osteopathic physicians entering this field, the vast majority of whom practice in community-based settings. However, inequities in our current Medicare payment system have resulted in onerous financial burdens for these physicians, whose practices generally operate with one to six employees. While our members are eager to adopt more streamlined administrative and clinical systems, narrow profit margins and high overhead hinder investments in new innovations and health information technology. Many of these systems require a considerable amount of capital to purchase: the average cost to install an EMR system is $32,000 per physician (according to an MGMA study)[1]. Other studies have placed this cost much higher.

The funds provided in the American Recovery and Reinvestment Act earlier this year offer financial incentives that will facilitate the implementation of these systems. Because these incentives come on the back-end however, smaller practices are at a significant disadvantage. Under current law, we believe that the bulk of stimulus funds are likely to flow toward hospitals and larger specialized practices, ultimately making the rich richer while small practices work to build up the funds and infrastructure necessary to qualify. With the timeline established through ARRA, it is our belief that only a small minority of small physician practices will qualify for the 2011 bonus. Additional government support including the loan program in your legislation would level the playing field, enabling and encouraging many more small practices to implement electronic medical record systems.

As you well know, the economic crisis in this country has hit small businesses particularly hard. Solo and small practices in the past often turned to home equity loans to fund business investments. With the current credit crunch access to these loans are also severely limited. H.R. 3014 would grant physicians access to private lenders through guarantees issued by the Small Business Administration. We support the targeted nature of your proposal, which directs funds toward the specific equipment, training and maintenance services necessary for our practices to meet the guidelines set forth by the Department of Health and Human Services.

The AOA recognizes the promise of increased productivity, prevention of medical errors, reductions in health care costs, increased administrative efficiencies, decreased paperwork, and expanded access to affordable care offered by HIT. However, these benefits cannot be achieved until physician practices have clear guidelines from CMS as to the standards to ensure interoperability across systems. We expect these guidelines and the definition of "meaningful use" to be published by the year's end, but with just twelve months to purchase and implement a qualifying system we believe that this timeline is overly aggressive and inadvertently favors large institutions.

The administrative costs associated with the adoption of HIT systems also present an obstacle for small practices. The initial transition period involves considerable time for both the physician and support staff, who may require outside training and consultants. During this time physicians often decrease patient load by up to 25% for several months. These increased training expenses combined with decreased revenue creates a formidable cash flow problem that many small practices may not be able to accommodate. The loan program in this legislation accounts for these factors by allowing funds to be applied toward extra administrative costs.

Ms. Chairwoman, your legislation paves the way for small practices to join larger institutions in implementing HIT systems that will improve the delivery of care across the spectrum of health care. We commend you on your recognition of the challenges facing our members and the sound policy you set forth in H.R. 3014. On behalf of the AOA and my colleagues, thank you for your efforts and we look forward to working with you and your colleagues on the Committee throughout this promising period of transition.

[1] MGMA Center for Research. Assessing Adoption of Health Information Technology, 2005.

Written Tesitmony of

Ryan P. Fochler

Owner & President of Dog Paws 'n Cat Claws Pet Care, Inc.

Submitted to the House Committee on Small Business

Hearing on *"Access to Capital for America's Small Businesses"*

October 14, 2009

2360 Rayburnn House Office Building

Thank you very much Chairwoman Velazquez, Ranking Member Graves, and the entire Committee for inviting me here today to provide this important testimony about the SBA Microloan Program and H.R. 3737.

My name is Ryan Fochler, and in 2004 I became the owner of Dog Paws 'n Cat Claws Pet Care in Arlington, VA. As you all know, small businesses are the backbone of our economy. Dog Paws 'n Cat Claws employs 3 independent contractors, 24 part-time employees, and 3 full-time staff in the Washington, DC and Northern Virginia area. We provide services for more than 1800 clients and their pets, including home visits when people are out of town or away at work. We also house a 7,000 square foot "doggie daycare" facility located in Arlington, VA.

The Pet industry accounts for $43.2 billion per year in economic activity, and experienced a growth rate of more than 5.5% despite the recession[1]. And it shows no signs of slowing down. In fact, it continues to expand across multiple industries. For example: car companies now offer a full line of dealer installed pet accessories, new airline companies have taken off with the sole purpose of transporting animals in pressure and temperature controlled cabins, and many chain hotels are adopting pet friendly policies.

Which is why you may be asking yourself: if everything is so "woof-tastic" in the Pet industry, why is Ryan here?

To answer that question: I am here because despite a credit score of 720, and an exponential growth in sales of 168% over the first three years under my stewardship, Dog Paws would not be where it is today without the SBA Microloan Program.

In recognition of that fact, I am also here to thank this Committee for their work on improving the Microloan Program and to make suggestions for future changes to the program so that it can continue to help entrepreneurs like me. I am very excited about some of the changes proposed in H.R. 3737, including:

- Improving borrower education by allowing Intermediaries to allocate a greater percentage of grant dollars towards training and outsourced technical assistance.
- Opening the door to more flexible, responsible microloan products.
- Expanding eligibility requirements to increase the presence of Microloan Intermediaries across the country.
- Increasing the amount of money that an Intermediary can borrow from SBA, in order to reach more small businesses. I know that there are many more entrepreneurs out there who, like me, are told "no" by banks every single day.

All of these factors will contribute to making another entrepreneur's Microloan experience even more positive than mine, which came at a crucial time for my business.

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[1] American Pet Products Association

In 2007, because of our quick growth, I felt it was time to pursue my larger dream for the company: to expand beyond dog walking and create a holistic training, boarding, daycare, grooming and retail facility for people and their pets in my community. In December of 2007, I was pre-approved for a SBA 7(a) loan by Provident Bank, which gave me the green light to finalize our space and move forward with opening our store. Within two months, our retail store was experiencing both commercial success. We have even received national recognition as a "green" retail establishment[2].

Unfortunately, shortly thereafter, the credit crisis hit in full force. To be specific, despite having never made a delinquent payment, our lines of credit went from $56,000 to less than $1,000 without warning. I felt sick to my stomach; we had grown from seven employees to twenty at that point.

This severe and, in my opinion, unwarranted reduction in credit made it nearly impossible for us to re-order new product for our retail store. It also created a horrible domino effect: the drastic lowering of our credit lines resulted in a much higher debt-to-available credit ratio for our business. Now, instead of using about 50% of our available credit, we were at 90%-- which made us look like a much riskier bet to banks and other credit card companies. My credit has since taken a nosedive not because bills weren't paid on time but because, as I was told, "You have been a good customer up until now, but there is no guarantee that you will be so in the future."

I spent the next three weeks visiting what felt like every single bank in the Washington, D.C. region. I was turned down time and again by large and small banks alike. Many of the loan officers that I met with sympathized with my situation and told me that I would have easily qualified before the financial crisis. But with the declined of my credit score, I could not get a loan from banks that themselves probably received bailout funding.

That is when I learned about the SBA Microloan Program and the Latino Economic Development Corporation (LEDC). They took a look at our books, our history of year-over-year sales and employment growth, our 100% positive credit card payments, and lent us $10,000 in working capital.

I also got something else from LEDC: quality, in-depth technical assistance for my business. Banks give loans and send payment invoices; microlenders like LEDC do that and much more. LEDC, with all of their technical support, set Dog Paws up for success. They have ongoing one-on-one support, group events and trainings, and they think of us when they meet new business owners. Because of the over 100 hours of technical assistance I received from Microloan Program at LEDC, I am a better businessman and my company is continuing to grow at a sustainable rate.

Despite the tremendous help that we received from LEDC, Dog Paws continues to seek the capital we need to re-open our retail store. We have approximately 1,000 square feet of empty space that employees-- like my manager, who was recently laid-off from Fannie

[2] Pet Product News International, August 2008

Mae-- and potential employees-- some of whom were recently laid off from Bank of America-- could go to work in right away.

But without the availability of the SBA Microloan Program and other SBA lending programs, Dog Paws 'n Cat Claws would not exsist as it does today. We would most likely would not have been able to create 23 new jobs over the past year and a half. We would not be trying to figure out how to get our retail center re-opened to create more full and part-time jobs. We would not be able to outsource new trainers, groomers, and consignment stores.

Before I finish, I want to suggest a few more changes to the Microloan Program that I know will help entrepreneurs down the road:

- Increase the maximum Microloan to $50,000. To run a successful small business—especially a retail business—larger amounts of capital are essential for ordering product.
- Do whatever you can to continue expanding this program. Believe me, the need is out there. Microloan Intermediaries like LEDC do not have the marketing and advertising muscle that banks and even credit unions have; if they did, I certainly would have knocked on their door sooner.

Small businesses are currently acting as a backstop for the economy. Despite the limited availability of credit, many of us sare still finding ways to grow. We are somehow managing to create jobs while companies that are subsidized by the government or that have received bailout funds continue to lay off employees. I hope that my testimony helps you to understand how important the SBA Microloan Program is for small businesses, and why this program should not only be kept alive, but expanded as much as possible.

Thank you again for the opportunity to testify here today. I look forward to answering any questions that you may have.

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IFA Franchising

Statement of
Matthew R. Shay
President & CEO, International Franchise Association
United States House of Representatives
Committee on Small Business

October 14, 2009

Good afternoon Chairwoman Velázquez, Ranking Member Graves and members of the committee. My name is Matthew Shay. I am President and CEO of the International Franchise Association (IFA), and I am grateful to have the opportunity to speak to you today about the credit crisis facing small business entrepreneurs and the need for legislation such as the Small Business Credit Expansion and Loan Markets Stabilization Act. During my statement, I will make three key points:

1. The current credit crisis is becoming increasingly more dire for small businesses;
2. The depth of this crisis calls for extraordinary action, and Congress should support changes to SBA programs including increasing the maximum SBA loan limits to $5 million to accommodate the needs of more small businesses; and,
3. A renewed emphasis on loan programs for small business start-ups, expansions and acquisitions will promote faster job creation and lead to a stronger recovery.

The legislation currently before this committee provides a foundation for addressing these goals. There are several additional steps that can be taken to strengthen this proposal. Making SBA lending programs work better for entrepreneurs seeking capital to open, acquire or expand a business will allow the economy to recover faster and provide the necessary bridge to a functioning commercial lending market once the recovery is complete. In many ways, franchised businesses are an excellent

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way to understand what is happening to small businesses during the current recession. Franchising is found in almost every sector that small businesses operate, and it is a clearly defined subset that is more easily tracked and analyzed.

As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted by PricewaterhouseCoopers for the IFA Educational Foundation, there are more than 900,000 franchised establishments in the U.S., providing 21 million American jobs and generating $2.3 trillion in economic output. The business methods, training and support franchise systems provide to their franchisees together with improved access to credit will result in faster and more sustainable job creation.

Under normal circumstances, small businesses can tap financing from a number of different sources, including national and community banks as well as many non-bank lenders. Typically, the SBA loan programs are not the first stop for an entrepreneur, but they serve an essential function as a lender of last resort for business owners who cannot find appropriate financing in the commercial marketplace. During this recession, however, most commercial lenders have dramatically curbed their willingness to assume risk. Prior to 2009, the top small business lenders for franchising were GE Capital and CIT. GE Capital is no longer lending and we all have read about the ongoing struggles at CIT to stay afloat. Some credit might be available at smaller institutions, but the restrictive terms and delays that entrepreneurs are encountering can be staggering. Moreover, many lenders that could now be serving the small business marketplace are not participating in SBA lending programs because they either may lack expertise or they may find the SBA's requirements too burdensome.

Franchised businesses play an important role in the economic health of the U.S. economy, and they are poised to help lead the economy on the path to recovery. IFA Educational Foundation reports show that the franchise industry consistently outperforms the non-franchised business sector, creating more jobs and economic activity in local communities across the country. Released in February, 2008, *Volume 2 of the Economic Impact of Franchised Businesses*, for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses.

The findings of a 2009 study, *Small Business Lending Matrix and Analysis*, prepared by FRANdata for the IFA Educational Foundation, demonstrate that meaningful economic recovery and job creation can start with small business lending. In fact, the study determined that for every $1 million in new small business lending, the franchise business sector would create 34.1 sustainable jobs and generate $3.6 million in economic output.

Earlier this year, Congress and the new Administration worked quickly to address the current economic crisis. The stimulus plan authorized spending of nearly $800 billion, including more than $650 million to support small business lending. The recovery bill made important changes to SBA programs such as a temporary increase in the loan guarantee from 75 percent up to a maximum of 90 percent, and the bill suspended loan fees for borrowers that can add up to 3.75 percent to the cost of a loan. These were crucial first steps, and we would strongly urge you to act to ensure that these temporary provisions are available through 2010.

So far, the 7(a) and 504 loan programs have supported $11.3 billion in lending since the Recovery Act was signed, but there is significant demand for more lending that has not been satisfied. The franchise business community believes that there are several important steps that Congress should consider to make it easier for entrepreneurs to access capital and create jobs. Most importantly, Congress should increase the standard 7(a) maximum loan limit from $2 million to $5 million and increase the maximum guarantee amount proportionately. The economic downturn has resulted in borrowers having less collateral due to declining home values and reduced investment and savings accounts. Increasing the loan limit will allow more individuals and businesses to take advantage of the 7(a) program, expanding the job creation potential of the program.

A majority of franchised businesses in the United States today are operated by multi-unit owners. Growth beyond the first unit is not just an aspiration for many entrepreneurs in franchising; it is an essential part of helping ensure that their business will reach a level of scalability and sustainability. Businesses that cannot reach a certain level of scalability naturally find it more challenging to survive.

There are over 400 different franchise brands in the United States that have an average initial investment requirement of $750,000 to $2,000,000 per unit. For these franchised small businesses, an entrepreneur reaches the SBA's current loan limit by the time they want to build the second or third store. In the past, the policy of lower loan limits may have ensured that SBA programs assisted only the smallest of small businesses, while businesses reaching a larger scale of operation could reasonably be expected to find financing from many places other than SBA backed loans. In the current credit crunch, however, other commercial financing options may not be available, and the lower loan limits are now operating as a restriction to success for many small business owners. Similarly, lower loan limits are restricting the true job creation potential of our economy.

There are approximately 325,000 franchised businesses in the United States owned by "multi-unit" small business franchisees. Our studies show that these multi-unit operators will be the most successful over time. Fifteen percent of all small business franchisees in the United States own between two and five units, and this category of franchise ownership is the fastest growing. If these businesses can grow at the five percent annual rate that we saw between 2001 and 2005, franchising will grow 16,250 new businesses per year. These new businesses will create 243,750 to 325,000 jobs (assuming 15-20 direct jobs per store) plus an additional 245,000 to 325,000 indirect jobs. Therefore, we believe that a larger loan limit will enable some of these franchise small business owners to expand into new markets and help the U.S. create between 450,000 to 650,000 new jobs within the next 12 to 18 months.

We urge this Committee to consider examining a market-based loan pricing model for SBA loan programs. In this crisis, the real issue for many small business borrowers is basic availability of start-up capital rather than the cost of capital. Between January 2008 and September 2009, the SBA loan interest rate cap dropped from 9.75 percent to 6 percent. During that same time period, the rate premiums that business lenders offering conventional loans required increased dramatically for those lenders willing to provide conventional business loans. While conventional lending is market driven, SBA lending can be influenced by policy. The highest business risk category—start-ups—are the most credit starved. While a continued 90 percent guarantee certainly helps, further inducement in the form of market based rates or rate buy-downs is necessary to open credit to this group. We understand this is a politically challenging issue; however, we consider this to be a major policy breakdown that is contributing to the credit crisis while undermining economic stimulus efforts.

Banks are reluctant to expand lending through the SBA programs. If banks were clamoring to participate in and make SBA loans, one might assume that the interest rates were an attractive inducement to lend. Today, the opposite is true. Borrowers are clamoring for loans, and banks are reluctant to provide them. The statutory rate sets an artificial price that is too low for the demand. Policymakers, economists and consumers all want small businesses to lead the recovery. Borrowers are not reporting that SBA loan interest rates are too high or restrictive—they are frustrated that they cannot obtain a loan—SBA or conventional. By addressing the pricing of SBA loans, Congress can deliver on its policy goals of improving access to credit for small businesses in order to lead the economy out of recession.

The IFA strongly recommends that this Committee look at new ways to stimulate small business lending so that funds are available specifically for business start-up and expansion. Much of the increase in SBA lending activity in 2009 has taken the form of refinancing real estate. We believe that this is not the intention of Congress when they enhanced the tools available to small businesses in the Recovery Act. We urge the Committee to consider a set of changes that would specifically promote loan guarantees for start-ups, expansions and acquisitions. To achieve this goal, we suggest that Congress consider re-instituting the borrower fees on all 7(a) loans with amortizations over 15 years while eliminating or reduce lender fees on all 7(a) loans with amortizations under 15 years, or alternatively, on true start-ups with all amortizations. This change would shift the focus of the 7(a) program back toward true business start-ups and expansions. Congress could also consider making the 90 percent guarantee permanent for all loans with amortizations under 15 years, and adding a 100 percent guarantee for first two years of a franchise start-up. For loans with amortizations over 15 years, we recommend that Congress restore the 75 percent guarantee.

We also support congressional efforts to improve SBA audit standards. At the same time that policymakers are encouraging banks to expand their small business lending during a weak economy, we cannot afford to undermine these efforts by creating an environment where banks are questioning the reliability of an SBA guarantee. Stories of loan guarantees revoked due to small errors continue to loom large in the minds of bankers, and we fear that lenders will remain hesitant to participate in all SBA programs unless they can be sure of the guarantee. This is especially true for the repurchase of existing SBA guaranteed loans that are repackaged on the secondary market. The committee heard earlier this year from the Independent Community Bankers of America, whose members report facing long waiting periods to hear from SBA and refusals to pay the guarantee. If the prevailing perception among lenders becomes a lack of faith in the SBA guarantee, then small business lending will decline further and these entrepreneurs will face a much greater challenge to be the engine of economic recovery. The SBA should work closely with these and other stakeholders to improve communication and develop clearly defined standards.

I want to again thank the members of the Committee for the opportunity to participate in today's important hearing on the Small Business Credit Expansion and Loan Markets Stabilization Act. The IFA looks forward to working with this Committee throughout the legislative process to ensure SBA's programs will work to help our country's small businesses lead us out of the recession.

Thank you.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program

Increasing Access to Capital for Small Businesses

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Zola Finch
Past Chair
NADCO Board of Directors
&
Vice President
RMI CDC

Jefferson City, MO.

October 14, 2009

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business about its bill, H.R. 3739, to improve access to capital by small businesses.

NADCO is a membership organization representing the Certified Development Companies (CDCs) responsible for the delivery of the SBA 504 program. We represent more than 260 CDCs and more than 200 affiliate members, who provided more than 95% of all SBA 504 financing to small businesses during 2008, as well as many other small business programs and services in their communities. CDCs are for the most part not-for-profit intermediaries with a statutory mission of community and economic development achieved through the delivery of the SBA 504 and other economic development programs and services customized to the needs of their respective communities.

NADCO's member CDCs work closely with SBA and our lending partners (generally banks and federal credit unions) to deliver what is certainly the largest and most successful federal economic development finance program in history (over two million jobs, $50 billion in authorized 504 loans and the leveraging of over $55 billion in private investment since 1986).

NADCO would like to thank Chairman Velazquez, Ranking Member Graves, and the entire Committee, for continued support of small business in America, the CDC industry and the 504 program. The Committee on Small Business has worked closely with SBA and our industry to ensure the availability of this valuable capital access program to small businesses for more than twenty years.

NADCO will provide comments today on the proposals we have submitted to improve the 504 program in order to increase access to long term capital for small businesses during and following this recession. Many of these proposals have been incorporated into the Bill, H. R. 3739, as introduced by Congressman Buchanan, marked up by the Subcommittee on Finance and Tax, and reported to this Committee last week. We will comment on just a few of the major changes in 504 that this bill would implement, and how these will increase the availability of long term capital for small businesses.

Reducing 504 Program Costs for Small Businesses:

The FY 2010 SBA budget increases the cost of access to the 504 program for small businesses by 38.9 basis points per annum. Further, with the nation's unemployment rate being a major factor in the SBA's "econometric" subsidy model, it is almost a certainty that the borrower fee for FY 2011 will also increase. For the average 504 borrower, this represents an increased interest cost of almost $50,000 for the life of their loan. For FY 2011, this figure may far more than double. These cost increases will hit our new borrowers just at the time our national economy needs these companies to expand, create jobs and help pull the country out of the recession. These fee increases will clearly negate the benefits of the benefits of the stimulus bill. We reduced the cost to borrowers in March 2009 and then SBA significantly increased the cost in October 2009, and with a high probability of an increase in costs again in October 2010.

Since FY 1997, the 504 program has been at zero subsidy; that is to say, fees paid by small business borrowers, CDCs and first mortgage lenders have covered the entire cost of the program. Until passage of the stimulus bill in February of this year, no taxpayer funds have been appropriated for the program in over ten years. While we have requested a more detailed discussion with SBA's subsidy experts, an analysis of the OMB Federal Credit Supplement reveals that SBA is projecting that loan defaults for 504 will increase from 3.5% for FY 09 to over 7.3% for FY 2010. Together with the unemployment rate increase, these two factors may well account for the majority of the fee increases over the next two years.

NADCO is concerned about this forecast of the program default rate. Surveys of our CDC membership and information on bank credit underwriting lead us to a very different conclusion than the SBA has drawn for this critical factor. In fact, both bank's AND SBA's own underwriting of 504 loans have become far more conservative during this recession. The "credit box" has become much tighter, and only the strongest small businesses are now qualifying for new loans. Further, with most businesses more carefully husbanding their cash, demand for fixed plant expansion is coming from only the stronger small businesses. Finally, appraisers have become much more conservative in their valuations of commercial real estate, making expansion capital of any kind much more difficult to obtain.

Combining all these factors, it is clear that the FY10 loans we make to small businesses may be among the best and most conservatively underwritten in the twenty-two year history of 504 lending. NADCO strongly believes that loan defaults for the 2010 loans will substantially <u>decline</u>, not go up, as now forecasted by SBA's subsidy modelers.

If nothing is done by Congress, the result will be identical to what occurred in FY 1997 when SBA grossly overestimated the defaults and cost thousands of small businesses millions in inflated guarantee fees. In FY 2010, we will see borrowers paying unnecessarily high program fees at the worst time: when they need access to affordable 504 loan capital so they can preserve their cash for working capital to undertake their company expansion and create jobs. With inflated guarantee fees for both FY 2010 and 2011, almost 20,000 small businesses will pay millions in extra fees to SBA over the entire twenty years of their 504 loans. The 504 program will become less and less effective for small businesses creating new jobs.

We ask the Committee to consider the impact of these increased guarantee fees on the very small businesses that are the job creators that will lead America out of this recession. NADCO believes that the only way to restore the fairness of this subsidy process is for Congress to step in and appropriate sufficient federal funds to offset these fees. We request this be taken up by Congress as soon as possible in order to negate the impact of this subsidy fee on our borrowers for FY 2010.

<u>Reaching Out to More Small Businesses With New Capital:</u>

Congress and the Obama administration have worked hard to put more fixed asset and working capital in the hands of small businesses hard pressed by this recession. Our industry thanks both the Congressional Small Business Committees for taking a leadership role by adding key programs to the stimulus bill earlier this year that are beginning to impact capital access and job creation.

However, our industry believes that more should be done quickly to have even more impact. Even as SBA worked to implement new programs and fee reductions created through the stimulus bill, the loan eligibility and underwriting policies set forth by SBA that are so critical to maximize the effectiveness of these programs were drifting towards more conservative interpretations on numerous issues. NADCO thanks the Committee for considering a number of recommendations to expand availability of 504 funding to more small businesses. These include:

<u>Increasing the maximum 504 loan size</u>: In order to reach more borrowers, the limit for a regular 504 loan is increased from $1.5 million to $3.0 million, and the limit for critical public policy loans goes

from \$2.0 million to \$4.0 million. Commercial real estate construction costs have increased substantially in the last five years, and these loan limit increases will keep up with these costs for small businesses. NADCO suggests an even higher new guarantee limit in order to enable successful small businesses to utilize 504 for multiple loan projects. These will create even more new jobs.

Increasing the 504 Alternative Size Standards: The Committee has recognized that an increase of the business size standards goes hand in hand with an increase in the maximum loan sizes. This will enable 504 to be used by small businesses with a higher net worth and a stronger balance sheet to reduce the risk of the 504 loan. These somewhat larger small businesses have generally created even more jobs.

Assisting businesses in low income areas: The benefits of the public policy loan limits will become available to small businesses located in low income areas, to include those that would be eligible for new markets tax credits. Many traditional lenders have moved away from making loans in these areas due to perceived added risk. More capital must flow to these small businesses that create jobs in areas of low income and extremely high unemployment. This is a core mission of the 504 program.

Combining the benefits of certain public policy goals: Small businesses owned jointly by minorities, women, or veterans (all now individually public policy qualified) will be able to qualify for a "combined" benefit if they own at least 51% of the business. This will enable many more small firms to obtain added capital.

Maximizing both 504 and 7(a) loan eligibility for a borrower: Small businesses typically need added working capital when building a new larger 504 project, yet this is frequently restricted under current SBA regulations. Especially important in this credit crisis, the bill will make more capital available for inventories, salaries and business operating expenses, in ADDITION to the funds for the building construction.

Uniform leasing policy: Small businesses should be able to lease out 50% of their space, whether it is newly constructed or an existing building, for both the 504 and 7(a) programs. This will actually reduce credit risk while providing added potential expansion space for these growing firms well into the future.

Acquisition of stock: Some small businesses being acquired by new owners will be allowed to make the fixed asset transfer through a stock sale, so long as the assets are 504 eligible.

Definition of "rural" areas: SBA continues to apply outdated population parameters to rural areas, which restricts 504 from assisting rural borrowers through the program's Congressional public policy loans. The bill will ensure that the more current USDA definitions of "rural" areas will be applied to SBA programs to increase the availability of capital in these areas.

Need for refinancing of existing debt: While the bill does not include this, our industry strongly recommends that the Committee consider NADCO's proposals to assist small businesses by including a temporary expansion of refinancing provisions. We are concerned about the potentially catastrophic damage to the nation's entrepreneurial sector as a result of the current capital markets and banking sector crisis. The commercial mortgage backed securities industry remains frozen and banks are failing, or failing to lend, in spite of historic efforts by this Congress and Administration to get these markets moving. One area where this is having very adverse effects is in situations where companies own their own buildings, but have financed these buildings with conventional financing which often has five-year call provisions. As the banks for these companies fail or substantially tighten their lending standards, performing loans to good companies are being called, causing historically good small businesses with performing loans to be put into foreclosure and causing jobs to be lost. Because of the CDC industry expertise in providing optimally structured fixed asset financing to small business, we believe 504 should be made available to refinance this badly structured conventional debt and save these good companies and the jobs they have created.

NADCO is also concerned that many small businesses that urgently need working capital to fund salaries, raw materials, inventories, and everyday expenses are being hamstrung by their inability to gain access to needed working capital from their substantial commercial real estate equity. This equity is locked up due to the current capital markets and banking crisis, with many banks simply unwilling to renew even good loans as federal and state regulators force major adjustments in bank balance sheets and loan portfolios. We believe that SBA and our industry can work together to craft means to assist in these situations and provide fresh capital to these small businesses, while retaining sufficient real estate collateral to protect the taxpayer. We urge Congress and SBA to work with NADCO to develop legislation to make regulations more flexible, especially during this recession in which businesses are collapsing due to lack of working capital, even as they sit on substantial real estate equity that they cannot access due to a crisis in the nation's capital markets.

<u>SBA implementation of ARRA 504 first mortgage secondary market guarantees</u>: SBA has yet to implement regulations to assist in re-establishing the secondary market for unguaranteed first mortgages issued by many community banks as part of 504 projects. We believe that this failure is constricting the use of 504 by many banks that have traditionally sold their first mortgages in order to maintain liquidity. We urge the Committee to direct SBA to immediately provide these guarantees.

<u>Controlling and Reducing Loan Losses for the 504 Program:</u>

Loan defaults and losses have increased for 504, as for all other commercial lending – both public and private – during this recession. NADCO believes it is imperative for changes to be made to control these losses in the future. We appreciate the Committee including the following recommendations:

<u>Expanding CDC responsibilities for loan liquidation and recovery</u>: SBA's limited liquidation staff is being overwhelmed with loan defaults, which is leading to higher loss rates for 504. In turn, this will result in higher subsidy costs and fees for future borrowers. Qualified CDCs should perform liquidation and recovery work, and SBA should simply compensate CDCs for staff liquidation work from the certain increased recovery amounts, as their own regulations require (which have not been funded by the Administration as directed by this Committee).

<u>Continuing collection and accounting for defaulted 504 loans</u>: Accounting for defaulted 504 loans, as well as new secondary work-out loans with borrowers, would be continued at the program's efficient and highly automated Central Servicing Agent. This will result in timely, accurate loan accounting and portfolio servicing, and enable CDCs to service these notes more rapidly and effectively. This will both reduce costs for SBA and increase overall recoveries from 504 defaults.

<u>Improving reserve requirements for Premier Certified Lender CDCs</u>: The pilot amortization program for calculation of PCLP loss reserves would be re-instated and made permanent. While this will reduce the cash reserve requirements for participating PCLP CDCs, it will attract more CDCs to this program

that enables both improved borrower service and reduced loan losses for SBA from defaulted 504 loans.

Making SBA Programs More Relevant and Productive:

Loan volume for both the 504 and 7(a) guarantee programs has improved since passage of the stimulus act, but many of those benefits are just now being implemented by the SBA. However, in spite of the stimulus bill, both programs are still down as much as 40% from their highest levels two years ago.

A substantial part of this volume loss is clearly due to this historic recession with small businesses pulling back on demand for long term capital. But part may also be due to SBA, and even our own lending industries, failing to fully respond in innovative new ways to the ever-changing needs of small business financing. As we have seen with our inability to convert equity to working capital, and the ever more conservative policies on loan programs, it is possible that SBA's programs are becoming less relevant as small businesses are pushed to find other, and often more expensive, means of funding their growth and job creation.

Each of these guarantee programs is over twenty years old, and an environment of restrictive and potentially unnecessary regulations has evolved within the Federal bureaucracy. With this new administration, and the fresh thinking from senior policymakers it is attracting, NADCO sees an opportunity to break out of some of the old program's structure and bureaucracy. We are encouraged by the opportunity to work with this new leadership team, and with the new Congress to expand the reach of the many benefits of both 504 and 7(a) to more borrowers with different capital needs in new and leading edge industries that will be the job creators for the next fifty years.

In order to begin a "re-thinking" of the program, its ability to serve small business, and an expansion of its benefits, NADCO believes that there must finally be established the organizational parameters and control guidelines for Certified Development Companies that deliver the 504 program to the nation. The very definitions of our industry and its financing services should not be left to the sometimes arbitrary evolution of regulations that are designed to control the "lowest common denominator" of the program.

NADCO has carefully evaluated the existing industry structure and concluded that there is a need for codification of key facets of the industry and key program components. The Committee's implementation of the following recommendations will firmly establish much needed operating guidelines for our industry without restricting the program creativity of SBA:

Affirming the Certified Development Company structure: Low cost program delivery is at the core of 504's benefits for small business borrowers. As SBA and our industry seek to grow the delivery organizations for 504, the program should continue to be delivered by not-for-profit, community-based organizations that are focused on economic development in their local areas. The Committee has created a series of enhancements that address this goal, and through codification, make it an absolute requirement for all new CDCs. Some of these recommendations mirror beneficial SBA rules, while others are new requirements that will maintain the advantages of today's low cost delivery of 504.

Establishing appropriate CDC management and ethical structure: With the recent corporate "implosions" in the financial services industries that led to many of the reasons for this credit crisis, NADCO strongly believes that there must be codified requirements for the ethical and service standards of the CDC industry. Our industry has a long history of focus on community benefits, rather than the profit goals of traditional private lenders. In order to maintain this focus, the Committee would implement changes to maintain these standards for the benefit of our future borrowers.

Improving Multi-state service by CDCs: Some of the current industry structure has evolved on a haphazard basis without careful consideration of small business needs in individual communities. "One size" does not fit all communities, and the expansion of CDC services must be carefully structured. The Committee would establish a series of changes to provide definitive guidance for the future.

Defining 504 Debenture issuance terms: The key component of the 504 program benefits is access to the capital markets for long term loan funding. Our low cost of debt is derived from the program's long term consistency of its funding security structure. Our funding security portfolio performance has led to investment attractiveness by a very broad segment of major corporate investors and financial institutions, based both in the U. S. and overseas. This belief in our consistent performance and portfolio structure has directly led to lower interest rates for many years. For example, in spite of this credit crisis, our October 2009 interest rate for our borrowers was the lowest in the twenty-three year history of 504. So even as Fortune 500 corporations are having trouble finding funds at ANY cost, the 504 program continues to function as the "window to Wall Street" for thousands of small businesses; providing funds on long terms and at the lowest possible cost. The Committee recognizes this and assures a clear definition of the 504 funding security for future borrowers.

CONCLUSIONS:

For many years, 504 has been an extremely cost effective capital access program for thousands of growing small businesses that are the core job creators of the American economy. The program was in such demand that for several years its growth rate exceeded 20% each year. As the country slid into recession, many small business owners decided they could not take a risk of continued growth of their firms, so they stopped borrowing all but the necessary working capital to maintain their existing operations.

It is the sense of both SBA and NADCO that "the dam is about to break". That is to say, many small businesses are concluding that an economic turnaround is beginning to happen. We can see it in the calls that CDCs are getting about 504. Our "pipeline" of loan projects is coming back. Perhaps it is stimulus working; maybe it is simply the upturn of the American business cycle, but it's there, and it's growing.

The 504 program is over twenty-two years old, in its basic form. But the need for long term capital has not changed in those years, and 504 remains as relevant and important as the day it came out. NADCO has not proposed a radical change of direction for 504, but an incremental update and upgrade of a very successful capital access program that for over ten years has cost the taxpayer nothing.

These changes will make 504 an improved source of capital at just the right time for our economy, as small businesses begin to ask for long term fixed asset and plant expansion funding. With these changes, and rapid implementation by SBA, 504 will be the right program at just the critical time for small businesses. We ask Congress to pass these recommendations, and work with SBA and our industry to help restore the American dream of business ownership and entrepreneurship.

Thank you for your support for the past twenty-two years. You are responsible for our success today!

NAFCU

Testimony of

Mark Sekula
Senior Vice President, Business Services
Randolph-Brooks Federal Credit Union

on Behalf of

The National Association of Federal Credit Unions

"Increasing Access to Capital for Small Businesses"

Before the

House Small Business Committee

United States House of Representatives

October 14, 2009

Introduction

Good afternoon, Chair Velazquez, Ranking Member Graves and members of the committee. My name is Mark Sekula and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the Senior Vice President, Business Services for Randolph-Brooks Federal Credit Union, headquartered in Live Oak, Texas.

NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU–member credit unions collectively account for approximately 65.4 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding access to capital for America's small businesses.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 92 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 7,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have grown steadily in membership and assets, but in relative terms, they make up a small portion of the financial services marketplace. Federally-insured credit unions have approximately $813.4 billion in assets as of year-end 2008. By contrast, Federal Deposit Insurance Corporation (FDIC) insured institutions held $13.9 trillion in assets and last year grew by an amount exceeding the total assets of credit unions. The average size of a federal credit union is $92.5 million, compared with $1.673 billion for banks. Over 3,200 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, at just 1.4 percent as of December 2008.

Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and the community. While credit unions may have grown, their relative size is still small compared with banks. Even the world's largest credit union, with $36.4 billion in assets, is dwarfed by the nation's biggest banks with trillions of dollars in assets.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) a decade ago. In the "findings" section of that law, Congress declared that "[t]he American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue[s] to fulfill this public purpose." This finding would no doubt be made today as well!

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Randolph-Brooks FCU and Business Lending

Earlier this year, Randolph-Brooks FCU was recognized by SBA Administrator Karen Mills as SBA's 2009 Credit Union Lender of the Year. We are also ranked as the 5th largest SBA Patriot Express Lender in the United States, year-to-date for 2009, with 133 loans totaling approximately $8 million. Randolph-Brooks FCU is also ranked as the number one SBA lender in the 55 counties in our SBA district for 2009.

Randolph-Brooks FCU started its business program only five years ago, and today we have over 16,000 business accounts. We only started SBA lending a little over 2 ½ years ago, at the request of our members, and we currently have 414 loans totaling $20 million. We grew $13 million of that from 2008 to 2009, as businesses turned to us for credit after losing other sources. Through fiscal year 2009 (which for the SBA runs from October to September), we generated 153 loans totaling $8.9 million, helped create 396 jobs, and retained 799 employees for businesses we loaned to.

Credit Unions in the Current Economic Environment

While credit unions have fared better than most financial institutions in these turbulent economic times, many have been impacted, through no fault of their own, by the current economic environment. In particular, the corporate credit union system has felt the biggest impact, and NCUA placed the two largest corporate credit unions, U.S. Central Federal Credit Union and Western Corporate Federal Credit Union, into conservatorship earlier this year. The passage and enactment of S. 896, *The Helping Families Save Their Homes Act of 2009,* and the temporary corporate credit union stabilization fund it created, provided important relief to natural-person credit unions in these challenging times.

It is also widely recognized by leaders on Capitol Hill and in the Administration that credit unions did not cause the current economic downturn. However, we believe we can be an important part of the solution. Credit unions have fared well in the current environment and, as a result, many have capital available. Surveys of NAFCU-member credit unions have shown that many are seeing increased demand for mortgage loans and auto loans as other lenders leave the market. A number of small businesses who have lost important lines of credit from other lenders are turning to credit unions for the capital that they need. However, more can still be done.

Our nation's small businesses represent 99.7 percent of all employer firms, employ half of all private sector employees, pay more than 45 percent of total U.S. private payroll, and have generated 60 to 80 percent of net new jobs annually over the last decade. Therefore, NAFCU believes the strength of the economy is strongly influenced by the health and well-being of America's small businesses. Many small business owners are members of credit unions around the country and rely on our services to help make their small businesses successful. Our nation's credit unions stand ready to help in this time of crisis and, unlike other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents credit unions from doing more for America's small business community.

The *Credit Union Membership Access Act* (CUMAA) established an arbitrary cap on credit union member business lending of 12.25% of assets in 1998. CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study, entitled "Credit Union Member Business Lending," in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." The same study also found that over 50 percent of credit union loans were made to businesses with assets under $100,000, and 45 percent of credit union business loans go to individuals with household incomes of less than $50,000.

The current economic crisis has demonstrated the need to have capital available to help our nation's small businesses. Many credit unions have the capital to provide small business with low-cost sources of funds that other lenders are not positioned to in this current environment, but are hamstrung by this arbitrary limitation. It is with this in mind that NAFCU strongly supports the passage of H.R. 3380, the *Promoting Lending to America's Small Business Act of 2009*. Introduced by Representatives Kanjorski and Royce, this important piece of legislation would raise the member business lending cap to 25% while also allowing credit unions to supply much needed capital to underserved areas, which have been among the hardest hit during the current economic downturn.

NAFCU also strongly supports the reintroduction of the *Credit Union Small Business Lending Act*, which was first introduced by Chair Velazquez in the 110th Congress. This bill would have exempted credit union participation in Small Business Administration (SBA) lending programs from the MBL limits currently in place. These particular programs are invaluable tools, helping many Americans to successfully start and run their own businesses.

By exempting credit union participation in these programs, small businesses throughout the nation will have greater access to capital at a time when it is needed most. While we believe SBA loans should permanently be exempted from counting against a credit union's MBL cap, we also support a continuation of the 90% guarantee on SBA loans. We view these changes which allow credit unions to do more to help our nation's small businesses as an important step to help our nation recover from the current economic downturn.

SBA Access to Capital Legislation

NAFCU applauds the work of the Finance and Tax Subcommittee in moving the SBA Capital Access package of bills forward. In particular, we applaud the introduction of H.R. 3723 by Representative Deborah Halvorson and urge the Committee to act on this bill in a timely manner. This legislation will improve the SBA 7(a) program, and help lenders get these needed funds to our small business members.

We would like to share some of our thoughts on key sections of this legislation that we support:

Section 2: would create a program (to be established within district offices) that would assist small lenders who do not participate in the preferred lenders program, to make Section 7(a) loans. This would allow credit unions to make 7(a) loans without the added hurdle of becoming a preferred lender.

Section 3: would establish a new division within the SBA that would focus on lending in rural areas. Under the program, the guarantee would be 90 percent on amounts up to $250,000, and applications, documentation and processing would be streamlined and abbreviated. We support this provision as well. We would ultimately prefer a 95-100% guarantee on all 7(a) loans up to $250,000, as the guaranteed portion of SBA loans do not count against the arbitrary credit union member business lending (MBL) cap.

Section 5: would permanently establish a sub-division of the 7(a) program geared toward increasing lending to veterans, and would provide for, among other things, a permanent 90% guarantee for such loans.

Section 7: would help establish a lender training program at SBA's 10 regional offices.

Section 11: would clarify the requirements for lending to cooperative businesses.

Section 12: would create a mechanism under which businesses can apply directly to the SBA and the SBA would essentially auction off the loans to the private sector as part of a capital backstop program. We believe such a mechanism can help credit unions get more involved with SBA lending, if they have the capital, by having the SBA tackle some of the up-front obstacles.

Section 15: would extend the temporary guarantees and the elimination of borrower fees until the end of 2011. We support this and even prefer permanency of the guarantees and a decrease in fees.

Section 16: authorizes the SBA to establish a one-page application for business stabilization loans (i.e. loans made under the stabilization act's small business lending program, which provides 100% guarantee on qualifying loans with a maximum of $35,000) and allows lenders to use them. We support this. To the extent that a credit union wants to provide these loans, the application process would be shorter (and could possibly lead to a faster approval process).

Section 17: would amend the definition of a small business loan that qualifies as an SBA loan under the stabilization program. The existing law excludes from the definition "loan guarantees (or loan guarantee commitments made) by the Administrator prior to the date of enactment of this [stabilization] Act." This legislation would remove the exclusion. It appears that this change would allow the SBA to reclassify certain loans that qualify as loans made under the stabilization program, thus providing the 100% guarantee, even if the 7(a) loan is made before the enactment of the stabilization act.

Section 18 and 19: increases the maximum amount that can be made under the stabilization act's program from $35,000 to $50,000, and extends it to 9/30/11. These changes would enable credit unions to provide more assistance and for a longer period of time.

Conclusion

In conclusion, the current economic crisis is having an impact on America's credit unions, but they continue to provide excellent services to their members. Credit unions stand ready to help our nation and our nation's small businesses recover from the current economic downturn. Access to capital legislation currently before the Committee, such as H. R. 3723 and H.R. 3380, the Promoting Lending to America's Small Businesses Act, would aid credit unions in their efforts to help our nation's small businesses.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.

NASBIC
America's Small Business Partners

Statement
of
Carolyn Galiette

National Association of Small Business Investment Companies
Suite 750
1100 G Street, NW
Washington, DC 20005

Before The

United States House of Representatives
Committee on Small Business

October 14, 2009

Increasing Access to Capital for Small Business

Chairwoman Velázquez, Representative Graves, and Members of the Committee,

My name is Carolyn Galiette. I am a senior managing director and co-founder of Ironwood Capital, an investment management firm located in Avon, CT. I speak to you today on behalf of the National Association of Small Business Investment Companies (NASBIC) regarding H.R. 3740, the Small Business Investment Company Modernization and Improvement Act of 2009 and H.R. 3738, the Early Stage Investment Act of 2009. We strongly support the rapid passage of H.R. 3740 with a few technical changes. H.R. 3738 is an excellent model that closely mirrors the NASBIC proposal. If enacted, it will address a critical small business need. With a few technical corrections added it will be able to achieve its goals. We congratulate and thank Representatives Luetkemeyer and Nye for introducing these bills and the Committee for advancing them. NASBIC would welcome the chance to offer our expertise in order to improve and then pass these important small business resources.

SBIC Program Overview
SBICs are private equity funds that invest exclusively in American small businesses. SBICs raise private capital and then get licensed by the Small Business Administration. Once licensed, debenture SBICs can draw leverage and thereby multiply the amount of money available for investment in small businesses. SBA is paid back with interest and thus there is no net cost to the taxpayer for the SBIC **debenture program. Since this program's inception in 1958 over $55 billion has been invested in** American small businesses. Some of the bigger name employers that received early SBIC investments include: Intel, Callaway Golf, Outback Steakhouse, PeopleSoft, Staples, and Quiznos and hundreds of NASDAQ listed companies.

Over the past eight years, Ironwood Capital has become a staunch supporter of the Small Business Administration and the SBIC program because of the success we have seen the program achieve. We manage three SBICs, the first of which was licensed on September 7, 2001 and the third of which was licensed in August 2007. We, like many other SBICs, have managed through turbulent times but have remained steadfastly focused on the objectives of the SBIC program- to provide capital and advice to eligible small businesses, to generate a return for our limited partners through the success of these small businesses, and to be thoughtful stewards of the **taxpayers' money which lends capital to our funds.** We have raised market priced capital from institutional investors which support our investment thesis. We fill a capital need that is unmet by other financial institutions, including banks which provide SBA guaranteed loans. To date, we have invested in 53 small businesses in places ranging from Moline, IL to Winterville, NC and to Brooklyn, NY. We also travel to invest in smaller cities such as Hockley, TX, Fitzgerald, GA and Middleburg, PA, places that are often overlooked by other capital providers. Our partnership with the SBA has enabled our portfolio companies to create approximately 4500 jobs and to increase revenues in these companies by over 50 % on average. Moreover, we have accomplished all of this while making 50% of our investments in companies owned and managed by women and minorities and businesses located in or employing residents of low and moderate income communities. We have provided capital where larger, more established financing sources would not, some of which are the very lenders and investors who recently received TARP financing. *Despite the success of the SBIC program and of Ironwood Capital, if the program is not reformed we and many other funds that are bona fide experts in growing domestic small businesses will be forced to leave the program.*

H.R. 3740 SBIC Modernization and Improvement Act of 2009

The SBIC Debenture program is an incredible resource for small businesses and the tax payer. This program is truly market-driven and operates at a zero subsidy rate. As the Chairwoman of our Board, Holly Huels and later Steve Swartzman (both of Missouri) testified earlier this year, despite the efficiency of the SBIC credit facility, the program is dramatically underused. Fiscal year 2009 used

only about 20% of the SBA's $3 billion in capacity, denying domestic small businesses over $2 billion in SBA leverage and $1 billion in private growth capital. Today more than ever, the patient capital, market experience, and governance guidance that SBICs provide fill a capital chasm that threatens the ability of small businesses to emerge from the current recession. Congressional action is needed from you to realize improvements that are critical to providing capital to small business.

To correct this problem we proposed reauthorizing the program with a number of simple, but effective reforms:

Keep Successful SBICs in the Program by Fixing the Licensing Process
Currently the licensing process at SBA is slow, opaque and subjective. Licensing is the number one complaint of SBICs. Legislation should provide a transparent process, with clear standards, and a reasonable timeline for applicants.

The SBA often takes over a year to issue an SBIC license, even for successful SBICs that are seeking their second, third, or fourth license. Making repeat SBICs wait this long for a new license makes no sense. Further, it wastes SBA resources that should be used to review new funds that deserve more scrutiny, but for whom a one year licensing process is too long. For example, recently a successful SBIC fund applied for its fourth license. Despite its excellent record this SBIC waited over a year for its fourth license.

This bill would fix these problems while maintaining taxpayer protections.

Let SBICs Grow to Provide More Capital
Success is often rewarded by growth. Successful SBICs often start new funds that are larger than their previous fund. The problem is that successful funds can grow too large for the SBIC program. They still want to invest in the small business sector, but even the recently increased family of funds limit can effectively force out repeat funds as they become larger. These would-be repeat SBICs are solid investment vehicles with a wealth of experience and significant infrastructures that should be kept in the program. Again, we should not force funds out because of successful small business investing.

If we are truly to keep the best funds in the program and to provide billions in capital to small businesses, then we need to allow a continuum of investment funds. With a higher leverage limit and expedited relicensing, a successful fund could have a series of SBIC funds that run the 10 year life cycle of the funds. One fund could be winding down, another could be at peak, and another could just be ramping up. Under this scenario, good SBICs can constantly be providing funds to small businesses without having to graduate out and suffer for success by hitting a leverage-limit ceiling. Funds that were in distress would not be eligible for new leverage or expedited re-licensing.

It makes no sense to push successful funds out of the program because they have been too successful at growing small businesses. Raising the family of funds limit, combined with expedited relicensing, will ensure that proven small business experts stay in the program and provide more capital to small businesses.

This bill successfully addresses this issue.

Remove Unnecessary Barriers
H.R. 3740 fixes numerous technical issues that are individually modest, but collectively very burdensome. For example, there are a number of funds whose licensing was either seriously delayed or rejected outright because of the very low limit on state funds allowed in an SBIC. SBICs should not be penalized for partnering with their home states. Additionally, many high tech small businesses are denied access to growth capital because SBA does not allow Generally

Accepted Accounting Principles (GAAP) for a number of regulatory calculations.

This bill addresses this issue.

Increase Objectivity and Transparency to the Licensing Process for First Time SBICs
There is an obvious correlation between fewer SBIC licenses and less capital flowing to small businesses. The SBIC licensing process has been and continues to be in need of serious reform. The licensing process should have greater transparency for the applicant, objective criteria for licensure, an appellate mechanism, solid taxpayer protections and should not choke off the program. In FY 2008, only 6 licenses were issued – over a 90% decline from the peak of the 1990's. There has been modest improvement with 11 licenses in FY 2009. This number is low despite the fact that scores of quality funds, many repeat SBICs, are trying to get an SBIC license. The licensing process has done an abysmal job at attracting and licensing funds led by women and minorities. This lack of openness is compounded by the rigid application of subjective standards that effectively prohibit those whose experience is senior lending or investment banking from applying for an SBIC license

This bill addresses many of the transparency issues in licensing. Further language may be needed to open up the program to a more diverse set of fund managers.

Remove Regulatory Disincentives
SBICs compete in a free and open market as they invest in small business transactions. If the number of SBICs is to increase and thereby grow the amount of capital available for small businesses, then disincentives should not be placed on becoming an SBIC. For example, SBA currently limits the interest rates that SBICs earn if equity warrants are part of the investment package. SBA also limits enforcement of default rates. Both of these provisions need reforming **because they limit taxpayer protections for being paid back and risk the SBIC's bottom line** compared to non-SBICs. There should not be a penalty for partnering with SBA to invest exclusively in domestic small businesses. We would like to suggest a technical correction that would closely mirror existing regulations and therefore expedite implementation upon passage.

This bill successfully addresses many of these disincentives.

License more SBICs in Underserved Areas, like the Western U.S.
The SBIC program provides capital in areas of the country often overlooked by the rest of the private equity and venture capital community. Despite this fact, there are areas of the country that need more SBIC coverage. A concerted effort should be made to incentivize this program and to welcome new licensees, particularly from the western and less urban parts of the United States. Policymakers should also make it easier to raise capital for SBICs by allowing a higher percentage of capital to come from state sources.

This bill will allow greater resources to be used to bring new funds into the program including to underserved areas. SBA should use the opportunity created by this bill to license funds across the entire country, particularly in underserved areas.

H.R 3738 the Small Business Early Stage Investment Act

Small Business Desperately Needs Equity Investment
Capital for small business investment is in very tight supply, but demand is strong. In times of economic stress, small businesses must be nimble to take advantage of growth opportunities, but they need access to capital. Right now, seed and early stage investment has shriveled to exceptionally low levels. Growth and buy out capital is hard to come by. Senior lending by banks has pulled back dramatically.

The SBA previously had a tool that was successful at using the private market to steer equity investments into domestic small businesses. The program was excellent at getting equity capital to early stage businesses. While it lasted, the program invested over $13 billion in small businesses, created over 385,000 new jobs and saved hundreds of thousands more. While almost 70% of venture capital dollars go to high tech and life science industries, the SBA program successfully invested heavily in manufacturing all over the country. More than half of VC investments are made in California and Massachusetts, but the SBA program invested more than 70% of its capital in other states that are often starved for investment capital. However, the old equity program was structurally flawed and created a misalignment of interest between investors, the SBA and taxpayers. This bill shares the same risk and reward equally between the government and the investor, is structurally simpler and therefore promises to be a workable equity tool.

We are in a deep recession. This fact makes the availability of equity capital, or lack thereof, even **more important to America's small businesses. Equity capital is the foundation upon which any company is built. A company's ability to raise senior debt and lines of credit**—absolutely essential to business success—relates directly to its ability to raise equity capital. Congress and the Administration should review proposals that establish tools for SBICs to invest equity in a manner that protects the taxpayer and provides capital to worthy businesses. The SBIC platform, with its experienced SBA personnel and an established private sector network, is an excellent platform that could be used in conjunction with this bill to resuscitate private sector equity investing.

How to Improve the Bill

The structure of the bill mirrors very closely the NASBIC proposal for an efficient equity tool to address the drought in equity investing. NASBIC believes that an equity program needs to maintain strong taxpayer protections such as those adhered to in the SBIC program. There are still a number of issues, some technical and some substantive, that could be improved.

Ensure there is broad economic benefit by Opening the Program to Manufacturing and Other Industries Across the Country

Previous SBA tools successfully encouraged investment in areas consistently overlooked by venture capital and in industries overlooked by many Silicon Valley VCs. The bill in its current form is overly restrictive on the types of small businesses that are eligible for investment, limiting investment in such core sectors as manufacturing, industrial technologies, aviation, food production, and many others, particularly in the service industries. As written, the bill would likely limit the majority of investments to Silicon Valley and other areas of heavy venture capital density, where there is already a good deal of VC capital. In order to encourage economic and geographic diversity, the bill should be modified to provide capital to all areas and more industries in the country, particularly those commonly overlooked for equity investing.

Use 50 Years of SBIC Experience to Expedite and Improve Implementation

With over 50 years of experience of private capital partnering with the SBA, the law and regulations have established excellent taxpayer protections for its SBIC partnerships. Taxpayer funds need to be fully protected and therefore should only be handed over to funds that are have been properly vetted by SBA. This legislation recognizes that SBICs are already regulated specialists in small business investing. Holding an SBIC license is proof of having been vetted by SBA and should offer a faster track for grant approval. SBA should not limit currently licensed funds from participating.

This bill would benefit from adding reasonable regulations identical or similar to those already on the books including those regarding: investor diversification, management fees, investment, prohibitions on self dealing, etc. There are scores of taxpayer protections in SBA regulations that have been derived from lessons learned the hard way. New regulations and standards could be created, but that would take years. Rather than repeat the mistakes of the past, the taxpayer protections of the SBIC program should apply to this program.

Streamline the Qualification Process

SBA already has staff and processes specifically designed to screen for equity investing (which is one of the reasons that the debenture program licenses slowly). There is no point in reinventing the metaphorical wheel for licensing because doing so would delay implementation by years – small businesses cannot wait that long. Grant recipients should use the established licensing regime for equity investing. Established SBIC managers that have already been fully vetted and proven themselves, should therefore only have to have their business plan reviewed and should not have to revisit a process that repeats the process by which they received their license. The expedited relicensing process in H.R. 3740 would ensure that the program got off the ground very quickly.

Conclusion

In summary, both of these bills are major advancements in using market forces to provide critical capital to small businesses. The SBIC program marries individual entrepreneurship with government assistance in a way that is productive for all and which is absolutely crucial to our nation's economic growth. We believe that this legislation is imperative for US small business and that our input can improve the proposed legislation. We seek legislation that benefits not only our members but, equally importantly, policies that benefit the U.S. taxpayer and the small businesses we serve, because without all these constituents, we cannot succeed. These bills should be passed into law as quickly as possible

U.S. House of Representatives Committee on Small Business Hearing
October 14, 2009
"Increasing Access to Capital for Small Businesses"

Testimony of:
Suzette Dutch, Managing Partner
Triathlon Medical Venture Partners
Cincinnati, OH
On Behalf of the National Venture Capital Association

Introduction

Chairwoman Velazquez, Ranking Member Graves, and members of the Committee, my name is Suzette Dutch and I am a co-founder and managing partner with Triathlon Medical Venture Partners, a venture capital firm headquartered in Cincinnati, Ohio, with offices in Indianapolis, Louisville, Ann Arbor, and St. Louis. Triathlon is an SBIC that was licensed in 2004 with $60 million in SBA participating securities and $45 million in private institutional capital. We provide equity capital and business expertise to early and expansion stage companies with proprietary biomedical technology platforms or products addressing significant human healthcare needs. Our $105 million dollar fund has already repaid over $12 million of SBA's participating securities from 2 profitable exits. Our financial results place our performance in the top half of all venture funds of the same age using standard industry benchmarks.

By virtue of our regional presence and capital funding, Triathlon is one of the leading sources of early-stage life science investment capital in the Midwest. We make investments in early-stage opportunities, typically when there are only a few employees and a great idea. We will invest from $0.25 million to $5 million in the initial round and up to $8 million total per company in subsequent rounds as the company grows, reaches agreed upon milestones and requires additional capital. Triathlon has led 14 of its 17 investments. Syndication, which takes place when multiple venture firms come together to meet larger funding needs, is important to us and a necessity to provide our portfolio companies the capital, expertise, and networks they need to reach the finish line – returns to our investors in the form of an IPO or acquisition.

Our portfolio of 17 companies in life sciences includes 2 which were sold to market leaders in their respective fields. One of these companies, Renal Solutions, is a Pittsburgh headquartered company with technology that enables dialysis patients to be cost effectively and better treated in their homes. It was sold in 2007 to Fresenius the world leader in dialysis. Importantly the company headquarters remains in Pittsburgh operating as a separate subsidiary and cartridge manufacturing continues in Oklahoma as the acquirer recognized that innovation takes place in small companies. The majority of our 15 remaining companies are in the undercapitalized Midwest with 3 in Indiana, 2 in Ohio, and one each in Michigan, Missouri, Minnesota, Tennessee, and Kentucky. Endocyte, for example has clinical trials in ovarian and lung cancer underway and even before reaching the market employs 60 people in Indiana.

In addition to my responsibilities as a venture investor, I am also a member of the National Venture Capital Association (the NVCA) based in Arlington, Virginia. The NVCA represents the interests of more than 400 venture capital firms like ours in the United States which comprise more than 90 percent of the venture industry's capital under management.

It is my privilege to be here today on behalf of the venture capital industry to support the Small Business Early Stage Investment Act of 2009. We believe that this bill puts forth a tremendous opportunity to fund *more* of the most promising small businesses our country has to offer. The venture capital industry has consistently supported the notion that significant value can be created when the government and the private sector work together to bring new ideas and innovation to life. The intent of the Small Business Early Stage Investment (SBESI) program appears to do just that and promises to be particularly beneficial to regions of the country that today are underserved in terms of access to capital.

<u>The Importance of Early Stage Investment</u>

In 1962, a small early stage company based in Minneapolis with an idea for a battery-like device that would regulate a patient's heartbeat received $100,000 in venture capital investment. Eleven years later, in 1973, an entrepreneur had a concept that would allow packages to be sent across the country overnight. He received $10 million in seed money to bring that company to market. And, in 1987 a computer savvy young man obtained $17 million to start a hardware company in Austin, Texas. These small start-up businesses grew into Medtronic, FedEx and Dell Computer and are representative of thousands of companies that transformed their industries and their regions because they were funded and supported early on in their life cycle.

A commitment to investment in early stage companies has been a key differentiating factor in our country's ongoing economic leadership. The venture capital industry invests billions of dollars each year into innovative ideas that have the potential to grow into world class companies. Often these ideas are not even businesses yet, but reside in the minds of entrepreneurs, scientists or engineers. These individuals typically have the intellectual capacity and vision to do great things but lack the risk capital and business expertise to bring their concepts to life. At one time or another, every blue chip company in the United States was just an idea. In addition to the three examples above, companies such as Genentech, eBay, Google, Amgen, Intel and Starbucks were also once early stage start ups. In 2008, companies that were originally funded by venture capital accounted for 12.1 million employees and represented 21 percent of US GDP. And, according to StartUp Hire, there are currently more than 10,000 job openings at early stage start-ups across the United States. Investment in these companies is a proven job creator.

The venture industry supports the SBESI program on behalf of the next Amgen, Google or Starbucks. There have traditionally been limited funding sources for these ventures which carry significant entrepreneurial and technological risk. In the current economic climate even traditional institutional investors have slowed their commitments to the asset class making the need for public collaboration more critical to these engines of future economic prosperity. Given the probability of failure and the lack of collateral in their early years, these start-up companies are not able to qualify for traditional commercial loans. The long term nature of the investment required and the expertise to select and nurture these ideas typically keeps other alternative providers such as buyout shops and hedge funds away. Thus these entrepreneurs rely on bootstrapping, friends and family, angel investors, and venture capital firms for early stage funding. Some seek government grants which are incremental to private sector sources but not enough to go the distance to being financially viable, especially in sectors that require large amounts of capital such as life sciences and clean energy. The SBESI program would bolster the country's ability to offer promising companies a better chance to grow and thrive at a time when we need more jobs and stronger economic growth.

The choice to implement the SBESI program through established venture capital firms is a good one. It recognizes that intelligent investing and measured risk taking requires more than just capital. More money alone will not guarantee a favorable outcome. That money must come with expertise and guidance from professionals who understand the industries, competition and strategic landscape in which the start-ups are operating and who have the networks of relationships to assist these companies as they grow. Additionally the program must align interests of the companies' founders and management with the capital providers. Venture capital firms well understand how to structure investments to achieve this win-win outcome. Together, additional capital and this expertise are critical ingredients and will serve areas of the country such as mine very well.

Support for Promising Regions

While venture capital investment is a national industry and there are venture backed companies in every state, there is undoubtedly a concentration of funds in particular regions. Silicon Valley is the dominant region for both venture capital firms and the companies in which our industry invests. Other well funded areas include Boston, New York, Austin and San Diego. Here there are long established venture capital funds with support from the institutional investor community making billions of dollars in investment each year. Other areas such as the Pacific Northwest, the Southwest and Mid Atlantic region have shown promising growth in the last several years. Still there remain other parts of the country where the SBESI program would do tremendous good.

For example in Ohio, where my firm is headquartered, venture capitalists invested $39 million in 17 companies in the first half of 2009 compared to the $3.4 billion which was invested in 476 California companies during the same time period. Ohio – as well as other states in our geographic footprint such as Missouri, Indiana, Michigan and Kentucky– is not lacking energized entrepreneurs, robust university labs, leading medical institutions or other factors that drive venture investment. We, for the most part, are lacking dollars to invest. The opportunity to apply for and receive SBESI funds to invest in local companies would be welcome by my firm and others like mine that have access to more great ideas than we can fund on our own.

Key Factors for Success

The Bill as it is currently proposed is an excellent start to offering the right incentives to the right stakeholders. By requiring privately managed investment companies to have capital commitments from non-federal sources that are at least equal to the amount of the grant request, the Bill puts in place an inherent vetting system and offers the SBA a level of comfort that the fund applicant already has the support of accredited investors. Limiting the grant to $100 million for any single investment fund will support investment in multiple funds providing appropriate diversification for the government and participation by a larger number of funds to allow for syndication. The focus on early stage investment opportunities channels government funding where it has historically been the most successful, in the nascent years of a start-up company as well as where the gap is greatest – between academic grant funding and expansion funding.

We also applaud the diversity of industry sectors to which the SBESI program would apply. By including information technology, life sciences and clean technology, the bill guarantees that the program will be in a position to impact the most promising and fastest growing industries in the country. Not only do these industries create high value jobs and revenues, but they are also poised to bring the next wave of innovation in medical care, climate sustainability and information delivery to Americans, keeping our country competitive and improving our quality of life.

As we move through the legislative process, there are details that we believe deserve further consideration in order to maximize the success of the program. For instance, the bill currently states that the SBESI fund would be required to be drawn down within five years. Although most venture capital funds draw down capital for new investments within the first five years, most venture capital funds have a ten year life, plus two or three one-year extensions if necessary for an orderly liquidation. This permits those funds to draw down capital for follow-on rounds of investment in existing companies after the initial 5-year investment period, allowing them to support their portfolio companies throughout their life cycle, and to draw down capital to pay expenses as they come due. Without this flexibility, venture capital funds would be prohibited from making follow-on investments or from paying expenses during the life of the fund. Additionally, non-federal investors would have opportunities for follow-on investment that the SBA would not, which is not contemplated under the language of the legislation. We would recommend that the language be amended to permit draw downs of capital to be made for investment in new companies only during the fund's first five years, but to also allow draw downs of capital to be made for follow on investments or for payment of expenses in the later years of the fund. This language would be more consistent with industry norms and could be tempered with a maximum percentage that could be drawn after the first five years.

Another area of potential concern is the requirement that distributions be made to all investors only in the form of cash, without the option for distribution in the form of freely tradable public stock. In the private sector, most fund agreements allow a firm to distribute freely tradeable public stock in the wake of an IPO, recognizing than an IPO is often another form of financing a company's growth and not a liquidity event. By requiring that ALL investors, even non-federal investors, receive only cash distributions, the bill prevents those investors from sharing in the potential upside from post-IPO stock appreciation. This requirement may dissuade outside investors from committing to the fund. An alternative would be for distributions of freely tradeable public stock to be permissible. In this case, the SBA could immediately sell any stock distributed to it and receive cash, but outside investors could act in their own interest and, if they prefer, hold the stock prior to selling.

Lastly, the bill states that "funds from the SBESI program will only be given to highly qualified investment funds with experienced managers that have a proven track record of returning a profit to its investors." While this language is at face value extremely reasonable, it could become problematic for managers whose funds have not yet matured or were part of a troubling vintage year. Profitability of a venture fund is often not realized for 10-15 years. As an example, funds being evaluated during the current economic crisis may ultimately be profitable but today have yet to realize any return. Thus, the current snapshot may not reflect the manager's true ability. We suggest the language be amended to reflect a manager's performance as it relates to an established industry benchmark as opposed to pure profitability.

Conclusion

On behalf of the venture capital industry, we appreciate the efforts by this committee to support entrepreneurs by offering additional funding through the SBESI program. We support this legislation as it takes into account the realities of start up investing and allows the government to participate as a third party investor in an effective and efficient manner. This bill also fills an important gap left by the closed participating securities program by financing the types of businesses we finance, namely those whose long road to profitability can not support a current interest payment required by the SBA's debenture program. By having SBA and private limited partners get their returns at the same time and at the same level, this program is structured in a way that can eventually become self-sustaining.

The SBESI program is poised to support regions of the country that today are underserved and have less access to risk capital than areas heavily populated with venture capital firms and venture-backed companies. The opportunity is significant. One only has to see what companies such as Dell and Medtronic did for Austin and Minneapolis to understand how important it is to nurture these start-ups in their earliest phases. I remain bullish on the prospects for the region surrounding Ohio, Missouri, Michigan, Kentucky, and Indiana to grow more companies from the ground up under this program and we at Triathlon have demonstrated that belief by locating our fully staffed offices in those states.

We look forward to working with Congress and the SBA to address the nuances we described which will maximize the appeal of the program to venture capital firms and their limited partners. I am happy to answer any questions.

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

R. Michael S. Menzies, Sr.
President and CEO, Easton Bank and Trust Company
Easton, Maryland

On behalf of the
Independent Community Bankers of America

Before the

United States House of Representatives
Committee on Small Business

Hearing on

"Increasing Access to Capital for Small Businesses"

October 14, 2009
Washington, D.C.

Chairwoman Velazquez, Ranking Member Graves, Members of the Committee, my name is Michael Menzies. I am the President and CEO of Easton Bank and Trust Company in Easton, Maryland and the Chairman of the Independent Community Bankers of America[1]. Easton Bank is a state-chartered community bank with $150 million in assets. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on the Small Business Administration lending programs.

Summary of Testimony

- The weak economy and challenging credit markets for many small businesses warrants stable and workable SBA loan programs.
- Community banks are prolific small business lenders and many rely on robust SBA lending programs to supply long-term capital to small businesses. ICBA applauds the Small Business Committee's legislative initiatives that support and strengthen the vital SBA 7(a) and 504 loan programs.
- Beneficial SBA lending incentives included in the American Recovery and Reinvestment Act (ARRA) have helped jumpstart SBA lending.
- ICBA recommends and supports a strong SBA rural lender program, increasing the 7(a) loan limit to $3 million, improving SBA's guarantee reimbursements, a national lender training program, and the use of alternative business size standards advanced by the Committee.
- Small business access to credit is critical for a strong economic recovery. Therefore, unduly burdensome and overly aggressive bank exams and onerous new regulations on community banks must be avoided to support small business lending and economic strength.

Small Business and Community Banks Key to Recovery
America's small businesses are critical to supporting our economic recovery. Small businesses represent 99% of all employer firms and employ half of the private sector workers. The more than 26 million small businesses in the U.S. have created the bulk of

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

new jobs over the past decade. With many of the largest firms stumbling and the unemployment rate reaching 10 percent, the viability of the small business sector is more important than ever. The Small Business Administration's loan programs exist to assist our Nation's entrepreneurs. ICBA appreciates the Committee's support of robust SBA loan programs and proposals to make them even better.

Community banks like mine specialize in small business relationship lending. Community banks stick with their local communities and small business customers in good times and in bad. We serve a vital role in small business lending and local economic activity not supported by Wall Street. For their size, community banks are enormous small business lenders. While community banks represent about 12% of all bank assets, they make 31% of the dollar amount of all small business loans less than $1 million. Notably, half of all small business loans under $100,000 are made by community banks.

Community-based banks form the building blocks of our nation's communities by providing small business capital and credit to all geographic regions of the country. They have played a vital role in the stability and growth of each of the fifty states by providing a decentralized source of capital and lending. This wide dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness, and stability of our entire financial system.

A Tale of Two Lenders

Mega-firms have stumbled and have dramatically cut small business lending. The headlines have been full of reports on the giant lenders like Bank of America, GMAC, GE Finance, and CIT that took on huge risks and stumbled. Community banks represent the other side of the financial story and credit market. Despite the dominance in the media about a "credit crunch" community banks are very much alive, well and willing to lend.

The truth is, community banks are open for business. Community banks, in general, rely more on local deposits to fund local lending so they don't rely heavily on Wall Street capital markets for funding. In fact, small banks of $1 billion in asset size or less were the only segment to show any increase in their net loans and leases in the latest quarterly FDIC data. Unlike the Wall Street mega-firms, community banks do not have to dramatically readjust our business model or lending practices.

Simply stated, community banks balance sheets are transparent and strong. That said, there are genuine credit market difficulties that continue to have real consequences across the entire financial and economic spectrum from Wall Street to Main Street.

Economic Recovery Package Important

The severe economic recession justified a sizable economic stimulus, including tax relief measures for individuals and small businesses. The ICBA was pleased the American Recovery and Reinvestment Act (ARRA) enacted in February contained several ICBA-backed tax relief and SBA reform measures to help boost small businesses. Specifically, the major SBA loan program enhancements enacted are all helping many small businesses ride out this deep recession and we support the extension of the key incentives for SBA 7(a) and 504 lending programs.

At my bank I have made use of both the first-time homebuyer tax credit and the SBA "ARC" loan program. These incentives have allowed me to best help my individual and small business customers and they are having a positive impact on the community.

ICBA Supports Extension of Key SBA Incentives in ARRA
ICBA applauds the Small Business Committee's legislation to extend the beneficial SBA enhancements included in ARRA. Specifically ICBA supports:

- Extending the SBA fee reductions through fiscal year 2011;
- Extending the higher guarantee levels through fiscal year 2011;
- Expanding the "ARC" loans programs to apply to existing SBA loans, increasing the maximum loan amount to $50,000, and streamlining loan paperwork; and,
- Making permanent the SBA secondary market facility authority.

If enacted, these measures would all help community banks expand their SBA lending to small businesses and would stimulate much-needed economic activity and job creation.

ICBA-Backed SBA Reforms
ICBA supports additional measures the Committee is proposing to enhance SBA lending. ICBA believes the key to best meeting small business capital needs is to have diversity in SBA lending options. The SBA should be able to meet the needs of both large and small SBA loan program users. This was ICBA's main objection to the SBA's elimination of the successful "LowDoc" program. It was used most often by banks that did a small number of loans and did not have the dedicated SBA loan expertise staff.

Because there are more than 8,000 community banks nationwide they can support a large number of SBA loans if community banks are more easily able to use SBA. In other words, we don't want an SBA with a one-size-fits all cookie cutter approach that only the biggest-volume SBA lenders can fully use. Before this financial crisis hit, nearly 60% of all SBA loans were concentrated in just ten banks. If we are concerned with supplying small businesses with a steady source of capital, the SBA needs to do a better job of embracing the more than 8,000 banks nationwide so all lenders can easily participate.

The Small Business Committee's Proposals Will Help
The ICBA is pleased with several of the Committee legislative proposals that will help diversify SBA programs and make them more community-bank friendly. Specifically ICBA supports:

- Making the community express program permanent;

- Supporting a small lender outreach program;
- Establishing a permanent rural lender program; and,
- Creating a national lender training program.

Many community banks do want to participate in SBA lending but are not part of the SBA preferred lender program (PLP) or have loan officers dedicated exclusively to SBA lending. While some smaller community banks may make only a few SBA loans, these SBA loan are critical to the local communities they serve. Therefore, the SBA should not loose sight of the relative importance of these community bank SBA loans and their economic importance to small communities throughout America. The Committee's efforts to provide flexibility and diversification in SBA loan programs will go a long way in allowing more community banks to supply capital to their local small business customers.

SBA Secondary Market

Several ICBA-backed programs have been launched to help unfreeze the secondary market for pools of SBA guaranteed loans, including the Term Asset-Backed Securities Loan Facility (TALF) and a new SBA secondary market facility. ICBA helped ensure the TALF program was available for purchasing SBA loans.

The ARRA legislation also promoted SBA secondary market assistance. However, success of the ARRA's SBA secondary market program has been hampered by the debate over potential additional fees to operate the program and has stalled its launch. ICBA recommends using the existing substantial funded budget authority to run the program in combination with user fees so as not to hamper the program with unworkable double fees. ICBA supports the Committee's legislative effort to address and enhance the SBA secondary market program to help ensure it is available as intended. While the frozen secondary market for SBA loans has begun to thaw and recover, ICBA believes with additional minor adjustments, the targeted secondary market programs at SBA can provide another reliable source to securitize SBA loans and keep more money flowing to small businesses.

Note on Overzealous Bank Regulation Hurting Small Business Lending

Even with greater fiscal and monetary stimulus and incentives for SBA lending, efforts by community banks to increase lending will be hamstrung if regulatory burdens are increased. Unfortunately pro-cyclical bank regulatory policies continue to jeopardize credit availability for many small businesses. ICBA believes the bank regulatory pendulum has swung too far and is crushing many community banks' ability to lend to deserving small businesses. Community banks did not cause the current financial crisis fostered by the missteps of the too-big-to-fail banks. Unfortunately, bank regulators are often applying crippling regulatory exams and policies across-the-board.

This examination environment is exacerbating the contraction in credit for small businesses, as community bankers must avoid making good loans for fear of examiner criticism, write-downs, and the resulting loss of income and capital. While it is expected and understandable that examiners will be more thorough and careful during a credit downturn, excessively tough exams that result in potentially unnecessary loss of earnings and capital can have a dramatic and adverse impact on the ability of community banks to provide small business loans and the ability to support economic growth. Lawmakers must be cautious so that that the missteps of a few large financial players do not foster costly new regulatory burdens on *all* financial institutions. This will likely cause banks to further tighten credit because of the increase in transaction costs for lenders and small businesses alike.

Additional SBA Proposal Support
ICBA believes SBA loans serve a unique role and deserve Congress' full support during this difficult economic environment. Lenders need to match short-term deposits with short-term small business loans. While the typical commercial small business loan has a maturity of one to three years, SBA 7(a) loan maturities average 12 or more years. Importantly, SBA lending allows longer loan terms up to 25 years. This lowers the entrepreneur's loan payments and frees up needed cash flow to start or grow the small business. As small businesses do their best to weather the current difficult economic climate, the longer loan term offered by an SBA loan is a huge help. ICBA appreciates the Small Business Committee's support for the SBA programs and especially for proposing a robust authorization level. Specifically ICBA recommends and supports:

- $17.5 billion in 7(a) program authority through fiscal year 2011;
- Increasing the SBA 7(a) loan limit from $2 million to $3 million; and
- Allowing alternative loan size standards for determining eligible small business borrowers.

Enacting these measures will support growing small business loan demand typical in the early economic recovery stage coming out of a recession.

In conclusion, the SBA loan programs are a success story where thousands of small businesses that otherwise would not have had access to capital are funded. The SBA program legislation and reforms advanced by the Committee will allow community banks to extend more SBA loans to meet the needs of small businesses. ICBA pledges to work with the Small Business Committee to ensure the nation's small businesses have the access to capital they need to invest, grow, and to provide jobs and economic growth. Thank you.

United States House of Representatives
Committee on Small Business

Cass Johnson, President

The National Council of Textile Organizations

NCTO
NATIONAL COUNCIL of TEXTILE ORGANIZATIONS

"Increasing Access to Capital for Small Business"

October 14, 2009
2360 Rayburn House Office Building
Washington D.C. 20515

Good afternoon Chairwoman Velazquez and members of the Committee, my name is Cass Johnson, I am the President of the National Council of Textile Organizations (NCTO). I am pleased to appear before you today to address this very important topic and will be pleased to share with you NCTO's perspectives on how this Committee can work to increase access to capital for small businesses. NCTO is a trade association representing the entire spectrum of the textile industry which includes fiber, yarn, fabrics, and industry suppliers. The textile sector, from fiber to finished garments, employs over 600,000 workers in the United States.

Importance of Manufacturing Jobs to the Entire Economy

Given the harsh economic environment, NCTO's member companies have gone to great lengths to ensure that their operations remain strong and that they are able to provide good-paying manufacturing jobs for U.S. workers and their families. Manufacturing jobs are a critical portion of the U.S. economy and the small business sector. A recent survey of U.S. public opinion found that 71 percent of the public believes that manufacturing should be a national priority.[1] The survey also found that in relationship to six other industries, manufacturing is the number one most important industry in maintaining a strong national economy. Other industries ranked behind manufacturing in the following order: technology, energy, healthcare, financial services, retail, and communications. Given the level of importance placed on the manufacturing sector, the U.S. government should be doing its utmost to ensure the sector is viable and able to put Americans back to work.

Unfortunately, the critical benefits that the U.S. manufacturing sector contributes to our economy have gotten short shrift for many years. Over five million manufacturing jobs, over one quarter of the manufacturing workforce, have been lost since 2001 and more than 1.1 million jobs have been lost during the last nine months. In the case of the textile industry, nearly 50,000 jobs have been lost since December 2008.

Manufacturing jobs are the highest paying, highest value added jobs in our economy. And, according to economists, manufacturing jobs support far more jobs in our economy than any other. Madame Chair, rebuilding a strong U.S. manufacturing base and creating new high paying, highly skilled manufacturing jobs is clearly essential in order for the U.S. economy to recover.

Role of the Small Business Administration (SBA) in Supporting Manufacturing Jobs

This committee, in working with the Small Business Administration (SBA), can make a real impact in aiding this nation's recovery. Small and medium sized manufacturers need access to credit, working capital and loan guarantees in order to manufacture

[1] 2009 Index of the Public Views on Manufacturing, National Association of Manufacturers.

products and engage in domestic and international commerce. These financing options play a pivotal role in the manufacturing sectors ability to produce goods and export those goods to customers outside the United States. According to the SBA, Office of Advocacy, small businesses are responsible for over 97 percent of all U.S. exports.

The U.S. textile industry is the world's third largest exporter of textile products, exporting over $16 billion in goods to other nations in 2008. However, without adequate financing options and government supported guarantees, our companies are now being shut out of the some of the largest and most important export markets. During the current downturn, securing adequate credit financing and short-term loan options have become a significant problem. This problem is getting more pronounced and is now threatening many parts of our industry.

I understand that the committee recently considered a broad package of bills that aimed to provide additional access and flexibility for small businesses to secure SBA guaranteed loans. On behalf of NCTO, I applaud the committee's efforts to expand small business opportunities. However, a significant issue, the ability of small businesses to access *financing for overseas exports,* was not addressed. Currently, the SBA is able to grant export working capital loans to small businesses through the Export Working Capital Loan Program. However because of outdated restrictions on loan limits and business size, this program is rarely utilized by domestic manufacturers.

I urge the committee to consider working with the SBA to update the Export Working Capital Loan Program so that small businesses, including manufacturers, are able to tap into government supported export financing. In addition, we urge the committee to focus specific attention to small and medium manufacturers' ability to guarantee credit so that they may engage in international commerce. Before I outline our proposed modifications, I'd like to outline the current problem that the industry is having with its export operations.

Review of U.S. Textile Credit Sourcing

Historically, U.S. mills shipped primarily to <u>domestic</u> customers on open terms, generally 30 to 60 days. Some companies utilized domestic factors and some had open terms and credit insurance. Credit for <u>exports</u> has generally been handled in a variety of ways: either against Letters of Credit (L/C); open terms with credit insurance; or in many cases factors. The terms were similar to those offered to the domestic customers, but sometimes included special shipments or orders which allowed for 90 day terms.

Over time, as the industry has become more export oriented, it has become more difficult for U.S. textile manufacturers to secure financing from private lending sources. When U.S. mills sales were largely domestic in origin, U.S. mills had various means of financing with domestic banks for raw material, work in process, finished goods and

A/R, and normally financing arrangements were granted annual renewal. For collateral, the lenders required real and personal property, inventory (raw and finished goods), A/R (domestic) and subordinating credit insurance policies. However, as the textile industry has come to rely more on exports, less credit is available because U.S. lenders will increasingly not allow foreign accounts receivable as collateral.

Impact of Financial Crisis and Resulting Loss of Export Credit Financing

U.S. textile mill credit problems have been dramatically increased by the financial crisis, beginning mid to late 2008. As the recession grew more pronounced, banks began cutting credit to U.S. mills either during the term, based on covenants in existing agreements, or upon renewal. On top of the tighter restrictions, factors pulled out of agreements to offer credit to many export customers. This exposed U.S. mills to greater risk, threatening the ability of the mills to function properly. In addition, credit insurers have cut back on A/R guarantees or even canceled customers. This action caused a backlash by banks that are no longer willing to extend credit to mills that traditionally have never had issues in securing credit financing.

As noted in the table below, U.S. textile exports to the Western Hemisphere preference areas and imports of apparel from these areas have been dramatically impacted. While sourcing decisions are the result of many factors, many NCTO members report that they have lost orders to the region because the cancellation of credit, insurance or guarantees in the region. Indeed, the Western Hemisphere countries have seen declines that are twice as great as their Asian competitors. Imports of apparel from Asia are down ten percent compared to a 22 percent decline for the Western Hemisphere. As the Western Hemisphere accounts for 75 percent of total U.S. exports, the 24 percent decline in U.S. textile exports is taking an enormous toll.

Reduced Export Credits Hurts U.S. Textile Exporters and Western Hemisphere Suppliers

	CAFTA/NAFTA/ANDEAN	
	Percentage Change	Dollar Change
Apparel Imports	-22%	- $1.9 billion
U.S. Textile Exports	-24%	-1.1 billion

The textile credit problems have been compounded by customers, domestic and foreign, who have begun to pay bills late. In particular, because of late payments from retailers, our apparel producing customers in the CAFTA region have come under severe financial stress. *This is where the SBA, working in concert with Ex-Im bank, could play a pivotal role in restoring fluidity to the textile and apparel supply chain.* The challenge that we are experiencing with Ex-Im is that it has pulled coverage because of late payments.

Foreign customers, in turn, have seen regional banks in Central America cut their credit lines in half and in some cases by even more. In part because U.S. banks have stopped extending credit to the Central American banks, U.S. mill customers are now asking U.S. mills to extend longer terms, sometimes as much as up to 150 days and to do so without Ex-Im coverage, factoring, or private credit insurance coverage. This is a burden that even large well capitalized firms would find hard to bear, much less small U.S. textile exporters.

Taking all the above into account, one can easily understand that smaller and midsize mills have been driven to the brink of failure. In addition, banks are now discounting the use of collateral to back credit terms and now are insisting on using cash flow as a basis for extending credit. For many companies, cash flow over the previous 12-months has been extremely weak, thus further reducing many textile companies ability to secure future export financing.

What small and midsize mills need now is access to capital in order to function normally and to have an adequate supply of raw material on hand in order to react quickly once orders are received. They also need credit in order to finance outstanding A/R, which have now grown because of the problem of slow payments and also because of the necessity to grant longer payment terms.

In addition to the credit needed to finance the A/R, textile companies need Ex-Im to get back to guaranteeing the A/R's for export orders since small and midsize companies are not able to carry credit risks. Ex-Im has the authority to do so today, but their choice today has been to restrict giving such guarantees.

Solutions

NCTO has been proactive in response to the credit crisis. We formed an *ad hoc* committee of member companies and representatives from the National Cotton Council and Cotton Council International to review the situation and determine what could be done to correct it. The group studied the array of programs available through SBA, Ex-Im Bank, and the U.S. Department of Agriculture's GSM program. Several of NCTO's members have utilized these programs in the past, so there was already a broad understanding of what was available. As I mentioned earlier in my testimony, during normal economic times, the industry relies most heavily on private sector financing, with these programs filling the gaps or providing much needed credit insurance.

However, with the sharp reduction in credit from private sources, two modifications are needed immediately to the SBA export financing programs in order for U.S. textile manufacturers to continue to shipping goods overseas.

Within the SBA programs, specifically the Export Working Capital Program, there are two requirements that automatically disqualify virtually every textile company and many other small manufacturers.

Proposed Modifications to Export Working Capital Program

The first requirement is the size of the loans being guaranteed. Even for small companies, credit needs can easily exceed the $2,000,000 cap. Overseas export orders are now much larger than they used to be and specialty products are higher value added.

We suggest creating a new loan program outside of the current 7(a) program. SBA could set three loan amounts at $5 million, $10 million and $15 million that tie risk to the amount borrowed. This would limit the cost of the program. The terms of the loan would be for 12 to 18 months and use standard SBA terms for interest rates. The guarantee level would depend upon the size of the loan. SBA could offer its normal 90 percent guarantee for loans under $5 million; the program could offer an 80 percent guarantee for loans from $5 million to $10 million, and 70 percent for loans ranging from $10 million to $15 million. For companies with multiple loans, the total borrowed could not exceed $ 25 million.

The second requirement limiting small and medium manufacturers' ability to take advantage of SBA programs is the limit on the size of the company. As you know, SBA allots size requirements by North American Industry Classification System codes. Textiles are classified in NAICS 313, Textile Mill Productions in NAICS 314, and Apparel in NAICS 315. The size limitations for companies in NAICS codes 31-33, which covers all manufacturers in every industry, should be raised from the current limit of 500 employees to 1,250.

Our study of SBA loan programs has revealed that the agency has already capped size standards at 1,000 or 1,500, so we do not believe this moves the SBA outside its current scope. Increasing the size limit for manufacturers would open significant new export opportunities for small and medium sized enterprises in the United States. To ensure that SBA is covering businesses with an established history, the program could require that program candidates have been in business for at least one year.

Finally, we would also strongly encourage SBA to continue its credit programs offered in conjunction with the Ex-Im Bank. Even though many of the limitations mentioned earlier are still a barrier preventing full access to these programs, we believe this has been a fruitful relationship that has benefited U.S. companies. Because of the loan limitations on SBA programs, this joint effort has expanded access to credit for some small businesses since it allows a higher overall credit limit

Conclusion

The need for credit has never been greater. We are seeing solid export opportunities in the NAFTA and CAFTA regions, but we are being forced to turn away business due to shortfalls of credit, credit guarantees, and working capital. We believe that the SBA can play an important role in opening up financing to companies and industries in need of alternative financing options. NCTO is committed to working with this committee, your Senate counterparts, and the SBA to accomplish this goal.

Chairwoman Velazquez, I'd like to thank you for the opportunity to appear before the committee and would be pleased to answer your questions.

Thank you.

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EDUCATION AND LABOR COMMITTEE

HOMELAND SECURITY COMMITTEE

SMALL BUSINESS COMMITTEE

Congress of the United States
House of Representatives
Washington, DC 20515-3211

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RURAL DEVELOPMENT ENTREPRENEURSHIP AND
TRADE SUBCOMMITTEE

Rep. Yvette Clarke
October 14, 2009
House Committee on Small Business
Access to Capital

<u>COMMENTS</u>

- Thank you Madame Chair, and thank you to our panelists for coming to discuss this important issue with us.
- In recent months thanks to the programs enacted by Congress and the Administration, small improvements in the credit environment have been made.
- However the general lending environment is still poor.
- This stifled lending environment is contributing to a 9.8% unemployment rate, as more businesses shed jobs or put off hiring because of an inability to access affordable credit.
- We should explore every avenue available. We should explore expanding direct lending. I have engaged in conversations with small businesses across the country and I am hearing that banks are simply not lending EVEN with the increased SBA guarantees.
- In addition we have heard that only a few banks in some of our highly populated metropolitan areas are participating in the ARC loan program.
- In any event more needs to be done and I am glad that we are engaging in this discussion. It is timely to say the least.
- Thank you Madame Chair.

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Written Testimony of

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Federal Policy Director, CFED

Submitted to the House Small Business Committee

Hearing on
"Access to Capital for America's Small Businesses"

October 14, 2009
2360 Rayburn House Office Building

Expanding Economic Opportunity

Thank you Congresswoman Velázquez, Ranking Member Graves and members of the Committee for the opportunity to submit written testimony on behalf of the Corporation for Enterprise Development (CFED) regarding H.R. 3737 and improvements to the SBA Microloan Program.

We also thank the Committee for working closely with us to produce the best bill possible. As you know, the majority of businesses in this country are small business which provide needed goods and services and jobs while stabilizing communities and promoting economic growth.

CFED is a nonpartisan national nonprofit organization that celebrates our 30th anniversary this year. We collaborate with diverse partners across the field of microenterprise, including the Association for Enterprise Opportunity, the Center for Rural Affairs, Aspen Institute's FIELD program, State Microenterprise Associations such as the Oregon Microenterprise Network, SBA Microloan Intermediaries and other microenterprise practitioners. CFED also chairs the Microenterprise Anti-Poverty Coalition (MAP), and is a leader in promoting the expansion of economic opportunity to include all people. We strongly believe that this will bring greater social equity, alleviate poverty and lead to a more sustainable and inclusive economy.

Our mission is to bring together community practice, public policy and private markets in new and effective ways. We combine the innovation of a think tank with the "on-the-ground" insight of practitioners to:

- Identify ideas that make the economy work for everyone. We focus on communities that have traditionally been excluded from or limited by the mainstream economy. We conduct rigorous research, seeking ideas that have potential for practical application.

- We also work with economic development practitioners to pilot programs and provide funding to design and modify effective strategies to be successful in different cultures, regions and economic conditions.

- Lastly, we develop and advocate for federal and state policies that move the nation toward a more equitable and inclusive economy. We publish reports, convene working groups and provide information to help partners participate in the policymaking process.

Along with homeownership and continuing education, CFED focuses on microenterprise as a key asset-building tool for low-income entrepreneurs. We strongly support the SBA Microloan Program, which provides capital, training and technical assistance to disadvantaged entrepreneurs.

We believe that H.R. 3737 is a solid bill that lays the groundwork for the expansion and improvement of the Microloan Program. Many of the reforms contained H.R. 3737 have been requested for years by Microloan Intermediaries. It is our hope that these provisions will allow the Microloan Program to meet the demand of microentrepreneurs who are shut out of the mainstream financial services industry.

First, we are pleased to see that the Committee has included language that allows Microloan Intermediaries to offer more flexible credit terms to entrepreneurs. This will allow Intermediaries to develop responsible financial products that meet the specific needs of their borrowers. This is especially true for entrepreneurs that provide seasonal services, and those whose business needs fluctuate according to other markers. For example, a home air conditioning repair service will typically experience a spike in demand during the hot summer months and might request a small revolving line of credit that would meet their cash flow needs more adequately than a three-year loan. Ultimately, our goal is for these entrepreneurs to benefit from responsible innovations in microlending.

We also agree with the Committee and the Administration that increased program participation is necessary to meet the needs of underserved low-income entrepreneurs. We welcome language that expands eligibility requirements for prospective Microloan Intermediaries, and believe that SBA should continue to exercise ultimate discretion to determine the experience necessary to become an Intermediary.

We are also pleased to see that the Committee recommends increasing the cap on borrowing by Intermediaries. Many of the highest-performing, most capable Intermediaries in the Microloan Program have met their loan limit, and are unable to make additional Microloans despite heavy demand. Increasing the cap from $3.5 million to $7 million will provide a much-needed injection of capital for these Intermediaries. We are very pleased to find that the Committee has incorporated CFED's suggestion to give SBA discretion to increase the cap further, to $10 million, for Intermediaries that meet certain criteria.

In addition, CFED applauds the inclusion of reporting requirements for the SBA Microloan Program. While we would like to see clarification and/or the elimination of the Technical Assistance reporting requirement (the data of which, for logistical reasons, may prove quite difficult to gather), we are encouraged at the prospect of hard, usable data to better inform policymaking around the Microloan Program.

Lastly, we are happy to see that H.R. 3737 proposes an increase in the percentage of technical assistance grants that may be used for providing information and technical assistance to prospective borrowers, as well as the increase in percentage that Microloan Intermediaries can use for third-party technical assistance.

Moving forward, we recommend that the Committee consider more extensive changes to the Microloan Program in the near future. These changes include:

- Lowering the loan loss reserve requirement: the required 15% loan loss reserve fund that Intermediaries must maintain results in unnecessary levels of passive capital. The SBA Microloan Program has made loans that no bank would dare take on, and yet has the lowest default rate of any SBA lending program, even as it operates without a guarantee. In fact, for FY 2009, the Microloan program is projected to have a default rate (net of recoveries) of 0.37 percent. Contrast that with the assumption for 7(a) at 3.42 %, or the CDC program at 1.79 %. While SBA regulations allow this requirement to be lowered to 10%, we are dismayed that this is the only SBA lending program that requires a loan loss reserve fund. This limitation forces the SBA to lower its risk on its best-performing program, even while it provides guarantees of 80% and higher through its other loan programs. Data collected by the Aspen Institute on 37 microenterprise lenders showed that in 2007, the median loan loss rate was 3.6%. The average loan loss rate was 5.8%, and only three of the 37 lenders had loss rates above 10%.

- Expansion of operations: the advent of highly capable, highly successful microlenders in the United States leads us to ask the SBA and the Committee to study closely whether it is time to eliminate the requirement that Intermediaries not be allowed to operate in more than one state. To this end, we believe that the Microloan Program can balance economies of scale with a sharp focus on community training and technical assistance needs. In fact, some microlenders already operate in more than one state, but this restriction means that they must use their Microloan dollars in some or part of the regions they serve. Permitting multi-state use of Microloan dollars will facilitate regional economic development, something that is much needed in many parts of the nation.

- Increasing the maximum Microloan from $35,000 to $50,000. This change only reflects the reality of the financial market: banks are reluctant, especially in today's economy, to make loans of this size. Banks simply consider the loans too small to be profitable.

We would again like to thank the Committee for the opportunity provide input and insight on H.R. 3737. CFED looks forward to continuing and strengthening our partnerships with Congress and the Administration to enable low-income entrepreneurs to start and grow businesses, and to achieve financial self-reliance in vibrant communities.

If the Members or the Committee have any questions, I can be reached at 202-408-9788.

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