S. HRG. 109–512

REAUTHORIZATION OF SMALL BUSINESS ADMINISTRATION FINANCING AND ENTREPRENEURIAL DEVELOPMENT PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

APRIL 26, 2006

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.access.gpo.gov/congress/senate

U.S. GOVERNMENT PRINTING OFFICE

28-334 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
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REAUTHORIZATION OF SMALL BUSINESS ADMINISTRATION FINANCING AND ENTREPRENEURIAL DEVELOPMENT PROGRAMS

WEDNESDAY, APRIL 26, 2006

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP,
Washington, D.C.

The Committee met, pursuant to notice, at 10:35 a.m., in room SR–428A, Russell Senate Office Building, the Honorable Olympia J. Snowe (Chair of the Committee) presiding.

Present: Senators Snowe, Thune, Isakson, and Levin.

OPENING STATEMENT OF THE HONORABLE OLYMPIA J. SNOWE, CHAIR, SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MAINE

Chair SNOWE. Good morning. The hearing will come to order on the reauthorization of the Small Business Administration's financing and economic development programs.

I want to say that my colleague Senator Kerry was going to be here today, but he had a personal commitment that detained him. He just wanted to express the fact that he very much wanted to be here today and regrets that he was unable to do so.

Administrator Barreto, I noticed the smile on your face today. Is it perhaps because this is your last hearing before this Committee?

[Laughter.]

Chair SNOWE. Well, I want to thank you very much for being here today as we examine the SBA's priorities and responsibilities and goals for the future. As this may be your last appearance, I want to extend my personal appreciation, on behalf of the Committee as well, to you for your service to this country.

As you prepare to move on from your position as the second-longest serving administrator since the SBA was created by President Eisenhower and Congress in 1953, you have very been a strong voice for small businesses and for the Small Business Administration. You have served the President and our Nation exceptionally well in leading this vital agency.

You have been a very strong voice for small businesses in America. We truly appreciate the service that you have rendered to our country, and I just want to wish you very best wishes for your future endeavors.

Mr. BARRETO. Thank you very much, Senator.

Chair SNOWE. Thank you, Administrator.

Indeed, today, when we look at the entrepreneurial spirit of our 25 million small businesses, it dates back to our Nation's founding. Small businesses are the cornerstones of economic growth and job creation, representing 99 percent of all employers, creating nearly ¾ of all net new jobs, and employing over 50 percent of the private sector workforce.

From family firms to software development, small businesses are the foundation of our economy and the linchpin for the innovation that moves our country forward. Americans who assume the risks and responsibilities inherent in owning and operating a business deserve our praise, admiration, and unwavering support.

The Small Business Administration plays a vital role in the economic growth and well-being of our Nation by providing entrepreneurs with the capital they need to start and grow small businesses. SBA's programs have had a tremendous return on investment, helping to create or retain over 5.3 million jobs since 1999.

In 2005, SBA programs disbursed record-breaking totals of loans to small businesses both in numbers of loans and total dollars provided to small businesses. During the last fiscal year, the SBA guaranteed over $24 billion in loans and venture capital for small businesses, the highest level of capital ever provided.

I have long sought to expand the power and reach of the SBA's financial and business development tools, which are used by millions of aspiring entrepreneurs and small businesses across the United States. We must continue to strengthen the core SBA programs because they have proven invaluable in aiding the efforts and dreams of America's entrepreneurs.

I am committed to supporting our Nation's small business community by increasing its access to capital. For entrepreneurs and other aspiring small business owners, a self-evident truth since the founding of our country is that it takes money to make money. We are here today to make that goal a little easier for all Americans.

The SBA's entrepreneurial development programs demonstrate how Congress can play a positive role in enhancing private sector financing for startup companies. SBA loan investment programs have produced success story after success story, which include assisting the founders of Intel, Staples, Federal Express, Outback Steakhouse, Ben & Jerry's, Calloway Golf, as well as thousands of other successful businesses.

My plan is to build upon these successes and to capitalize on the reauthorization process to make the SBA's programs even more effective. Today marks the beginning of this process. The Committee will conduct hearings, examine the oral and written testimony, and evaluate the performance of SBA programs. I hope that this reauthorization process will lead to a renewed SBA that is wholly dedicated to fostering small business ownership in America.

The reauthorization process began with three of the bills that I have introduced. The first is the Small Business Lending Improvement Act that streamlines the process to help small businesses obtain the capital they require to compete. It brings fundamental and long-awaited reforms to the operation of the Preferred Lender Program.

Rather than mandate 71 separate applications, the PLP program lenders would only be required to complete one application. This would create a national Preferred Lenders Program that will remedy the inefficiencies in the cost of applying for PLP status in each district.

Currently, in the 7(a) program, a small business's eligibility to receive a loan is determined by a confusing multi-page chart that has different size standards for every industry. This chart is nothing more than a bureaucratic impediment, and this bill will address that particular problem.

The second bill reforms and enhances the Small Business Investment Company Program. SBICs use their own capital, combined with funds borrowed from other private investors and supported by an SBA guaranty, to make equity and debt investments in qualifying small businesses. The structure of the program is unique and has been a model for similar public/private partnerships around the world.

This bill creates a new SBIC program that would be a zero subsidy program with no Federal appropriations necessary that would also provide financing to small businesses. Additionally, the new program would prevent financial losses to the Government by increasing its share of SBICs' profits.

The third bill is the Local Development Business Loan Program Act, which improves the 504 program by streamlining the lending process and providing small businesses with greater opportunities to obtain affordable financing. The statutory purpose of the 504 program is to create new jobs and strengthen the local impact of the 504 loan program.

To reflect that, the legislation that I have introduced, along with many other changes, renames the 504 program the Local Development Business Loan Program. This new name will help borrowers understand the intent, and many of the small business owners have told the Committee that the name "504 program" was neither clear nor indicative of the program's purposes.

I plan to advance these bills and move toward a successful rejuvenation of the SBA. That goal includes rejecting any attempts to eliminate the SBA's Micro Loan Program, which provides loans up to $35,000 and technical assistance to new and growing small businesses. This relatively inexpensive program helps entrepreneurs start and grow small businesses throughout our Nation.

In my own State of Maine, almost 90 loans have been made in the program over the last 2 years for a total of over a million dollars. It has a proven record of helping small businesses that could not otherwise get financing, and yet the administration regrettably proposes to eliminate this crucial source of small business growth.

Today, I want to make clear this Committee's opposition to the SBA's plan to charge additional fees on small businesses in the 7(a), 504, and SBIC programs. As I have already described, these are highly successful programs. None receive appropriations to subsidize its loans.

Now the administration proposes to increase fees on small businesses to raise $7 million in revenue, which will be used for SBA's administrative costs. Increasing fees paid by small businesses is not the way in which to reduce the budget. These small businesses are already paying fees and taxes to fund the agency. Let us not make it more costly for them to access financing.

I believe that the Congress must do everything possible to sustain economic growth and job creation. The American economy requires a strong and vibrant Small Business Administration. Toward that end, this Committee is here to help the Administrator and the agency to improve SBA's programs in any conceivable and possible way.

Finally, while today's hearing is dedicated to the entrepreneurial development and finance programs, rather than the disaster program, I still remain deeply troubled by the SBA's Gulf Coast recovery efforts. I am particularly concerned as to whether or not the SBA has adequately planned for a new hurricane season, which begins in just a month.

I strongly urge the SBA and all Federal employees to work to rebuild the area, to redouble their efforts, and obviously, we will make an assessment of the progress that has been made to date and what has been done, what further needs to be done, and also whether or not the agency has a comprehensive approach to address any future disaster response.

[The prepared statement of Senator Snowe follows:]

Senator Olympia J. Snowe
Chair, Senate Committee on Small Business and Entrepreneurship
Hearing on the "Reauthorization of SBA Financing and Economic Development Programs"
April 26, 2006

Opening Statement

Good morning, and welcome to today's hearing on the reauthorization of the Small Business Administration's financing and economic development programs.

I want to thank you, Administrator Barreto, for being here today as we examine SBA priorities, responsibilities and goals for the future. And as this may be your last appearance before this Committee – and I'm certain you'll miss us! – I *also* want to extend my appreciation to you for your service to America.

As you prepare to move on from your position as the second-longest serving Administrator since the SBA was created by President Eisenhower and Congress in 1953, you have been a strong voice for our small businesses – and have served the President and our nation well in leading this vital agency. So again, Hector, I appreciate your commitment to the success of America's small businesses, and I wish you well as you undertake new challenges.

Indeed, the entrepreneurial spirit of our 25 million small businesses dates back to our nation's founding. Small businesses are the cornerstone of economic growth and job creation, representing 99 percent of all employers,

creating nearly three-quarters of all net new jobs, and employing over 50 percent of the private-sector workforce.

From family farms to software development, small businesses are the foundation of our economy and the lynchpin for the innovation that moves our country forward. Americans who assume the risks and responsibilities inherent in owning and operating a business deserve our praise, admiration and unwavering support.

The Small Business Administration plays a vital role in the economic growth and well-being of our nation by providing entrepreneurs with the capital they need to start and grow small businesses. The SBA and its programs have had a tremendous return on investment, helping to create or retain over 5.3 million jobs since 1999.

In 2005, SBA programs disbursed record-breaking totals of loans to small businesses, both in the number of loans and total dollar value provided to small businesses. During the last fiscal year, the SBA guaranteed over $24 billion in loans and venture capital for small businesses, the highest level of capital ever provided.

The SBA's successful record of achievement - also in Fiscal Year 2005 alone - includes:

*** Approving over 89,000 business loans through the 7(a) and 504 lending programs;**

*** Funding 74,307 7(a) program loans to small businesses for a total of more than $14 billion;**

*** Saving $6.6 billion through implementation of the Regulatory Flexibility Act;**

*** A doubling of small business lending since 2001, with nearly a third of SBA-backed loans being made to minority-owned small businesses;**

*** Assisting 37,000 small businesses with procurement and government contracting;**

*** Counseling 1.25 million entrepreneurs through the agency's Small Business Development Centers, Business Information Centers, SCORE and Women's Business Centers.**

I have long fought to expand the power and reach of the SBA's financial and business development tools, which are used by millions of aspiring entrepreneurs and small businesses across the United States. We must continue to strengthen the core SBA programs because they have proven invaluable in aiding the efforts and dreams of America's entrepreneurs.

I am committed to supporting our nation's small business community by increasing its access to capital. For entrepreneurs and other aspiring small business owners, a self-evident truth since the founding of our country is that it takes money to make money. We're here today to make that goal a little easier for all Americans.

The SBA's entrepreneurial development programs demonstrate how Congress can play a positive role in enhancing private-sector financing for start-up companies. SBA loan and investment programs have produced

success story after success story, which include assisting the founders of Intel, Staples, Federal Express, Outback Steakhouse, Ben & Jerry's, Callaway Golf, as well as thousands of other successful businesses.

My plan is to build upon these successes and to capitalize on the reauthorization process to make the SBA's progress even more effective. Today marks the beginning of this process. The Committee will conduct hearings, examine the oral and written testimony, and evaluate the performance of SBA programs. I hope that this reauthorization process will lead to a renewed SBA that is wholly dedicated to fostering small business ownership in America.

The reauthorization process began with three bills I introduced. The first, the Small Business Lending Improvement Act, S. 1803, streamlines the process that helps small businesses obtain the capital they require to compete. It brings fundamental and long-awaited reforms to the operation of the Preferred Lenders Program. Rather than mandate 71 separate applications, the PLP program lenders would only be required to complete one application. This would create a "National Preferred Lenders Program" that will remedy the inefficiencies and cost of applying for PLP status in each district.

Currently, in the 7(a) program a small business' eligibility to receive a loan is determined by a confusing multi-page chart that has different size standards for every industry. This chart is nothing more than a bureaucratic impediment, and this bill would fix that problem.

The second bill reforms and enhances the Small Business Investment Companies (SBIC) program. SBICs use their own capital, combined with funds borrowed from other private investors and supported by an SBA

guarantee, to make equity and debt investments in qualifying small businesses. The structure of the program is unique and has been a model for similar public-private partnerships around the world.

This bill creates a new SBIC program that would be a "zero-subsidy" program - with no Federal appropriations necessary - that would provide financing to small businesses. Additionally, the new program would prevent financial losses to the government by increasing its share of SBICs' profits.

The third bill, the "Local Development Business Loan Program Act," improves the 504 program by streamlining the lending process and providing small businesses with greater opportunities to obtain affordable financing. The statutory purpose of the 504 loan program is to create new jobs and strengthen the local impact of the 504 loan program. To reflect that, the bill, along with many other changes, re-names the 504 program the "Local Development Business Loan Program." This new name will help borrowers understand the intent of the program; many small business owners have told the Committee that the name "504 program" was neither clear nor indicative of the program's purposes.

I plan to advance these bills and move toward a successful rejuvenation of the SBA. That goal includes rejecting any attempt to eliminate the SBA's Microloan Program, which provides loans of up to $35,000 and technical assistance to new and growing small businesses. This relatively inexpensive program helps entrepreneurs start and grow small businesses throughout our nation. In my own State of Maine, almost 90 loans have been made in the program over the last two years, for a total of over $1 million. It has a proven record of helping small businesses that could not get any other financing, and, yet, the Administration proposes to eliminate this crucial source of small

business growth.

Today, I want to make clear this Committee's opposition to the SBA's plan to charge additional fees on small businesses in the 7(a), 504, and SBIC programs. As I've already described, these are highly successful programs. None receive appropriations to subsidize its loans. Now, the Administration proposes to increase fees on small businesses to raise $7 million in revenue, which will be used for the SBA's administrative costs. Increasing fees paid by small businesses is not the way to reduce the budget. These small businesses are already paying fees and taxes to fund the Agency. Let's not make it more costly for them to get financing.

I believe that Congress must do everything possible to sustain economic growth and job creation. The American economy needs a strong and vibrant Small Business Administration. This Committee is here to help the SBA Administrator improve SBA programs in any way possible.

Finally, while today's hearing is dedicated to the entrepreneurial development and finance programs rather than the Disaster Program, I remain deeply troubled by the SBA's Gulf Coast recovery efforts. I am particularly concerned as to whether the SBA has adequately planned for the new hurricane season, which begins in just over one month. I strongly urge the SBA and all Federal employees working to rebuild the area to redouble their efforts. The Committee will conduct another hearing as soon as possible to improve the SBA's response to destructive hurricanes and help its leadership avoid the same mistakes that have hurt Gulf coast residents and small business owners over the last eight months. I now recognize Ranking Member Kerry for his opening statement.

With that, I will recognize Senator Levin.

OPENING STATEMENT OF HON. CARL LEVIN, A UNITED STATES SENATOR FROM MICHIGAN

Senator LEVIN. Madam Chair, thank you for calling this hearing, and thank you for your ongoing strong commitment to the SBA and its programs and your determination that we build on those programs and that we resist efforts to cut back those programs or to weaken those programs.

I want to focus, Madam Chair, on just one program today, given the time restraints that we have. Basically, I want to urge the SBA to work with you and our Ranking Member and other Members of this Committee to revive the SBIC Participating Securities Program, which has been, unfortunately, dropped, and which has provided so many important investments to small businesses across this country that would otherwise not have been available to them.

This program provides small businesses with venture capital by investing in promising small companies in exchange for stock in those companies. This type of venture capital or equity investment is known as "patient capital." It gives companies the time, typically 5 years or more, to get established before having to give investors a return on their investment.

This program, this SBA Participating Securities Program, fills some important needs that are not met by other venture capital funds. The SBIC Participating Securities Program makes equity investments in smaller amounts, between $1 million to $5 million, a size geared more to small business needs. It makes investments in areas of the country that are less likely to be served by non-SBIC venture funds. It serves a more diverse segment of small businesses than non-SBIC venture funds, including investing in manufacturing sectors.

Unfortunately, this very wonderful program has been shut down for the past 18 months since the administration ruled that under the Federal Credit Reform Act that it must be considered as equity by OMB and, therefore, requires an annual appropriation.

Now, workable solutions have been identified to modify the program so it can be scored at a zero subsidy. So far, the administration has not been willing to accept these solutions and has instead said that the program is not necessary.

Well, I hope that the administration will reconsider their position and make a serious effort to find a workable solution to restart the Participating Securities SBIC Program so that important venture capital investments can flow again to the small businesses that depend upon them for growth, expansion, and job creation.

Finally, I also would hope that an amendment of mine that previously passed the Senate to create the Small Business Intermediary Lending Pilot Program will be included in our authorization bill for the SBA again, Madam Chair, and would ask relative to my major point here that the following documents be included in the hearing record—the Participating Securities SBIC portfolio companies in Michigan and their investments.

Chair SNOWE. Without objection, so ordered.

[The documents follow:]

State of Michigan

FY 2001 - 2005 SBIC Program Statistics

All SBIC Investments

Year	Transactions	Investment $
2001	85	$65,125,732
2002	35	$24,151,044
2003	93	$26,689,552
2004	61	$34,137,201
2005	62	$38,762,993
Totals	336	$188,866,522

Participating Securities SBIC Investments

Year	Transactions	Investment $
2001	42	$28,778,836
2002	26	$14,434,436
2003	72	$16,841,989
2004	49	$13,170,201
2005	33	$24,216,723
Totals	222	$97,442,185

PS SBIC Portfolio Companies in MICHIGAN

Following are a few of the Michigan-based companies that have received financing from Participating Security Small Business Investment Companies since FY 1995.

Arbortext, Ann Arbor, provides enterprise publishing software that enables organizations to create and automatically publish large amounts of information, such as technical manuals, pharmaceutical product information, legal information, and software documentation. Enterprises around the world use the company's software to publish in multiple languages to multiple audiences in multiple hardcopy and electronic output formats. Arbortext's software is installed at over 1,400 organizations worldwide.

- *SBIC Investment: $ 3,491,810*

Ardesta, LLC, Ann Arbor, is the leader in bringing Small Tech products to the global marketplace. The company develops and acquires world-class intellectual property; creates and invests in young product companies; provides business and technical resources to support these companies; and develops industry-building resources.

- *SBIC Investment: $ 1,567,835*

Colorbök (pronounced "Colorbook"), Dexter, is a leading creator, marketer, and distributor of stationery, gift, scrapbooking, memory, toy, and craft products for children of all ages. The products are available to a wide range of specialty stores and chain stores in the U.S. and internationally.

- *SBIC Investment: $ 3,320,000*

Emerald BioAgriculture Corporation, Lansing, is a leader in the emerging field of bioagriculture—the use of biological and biochemical agents to improve crop yields, enhance quality, combat disease, and fight pests. Emerald Bio is devoted to the development of natural, environmentally responsible alternatives to chemical-based agricultural practices.

- *SBIC Investment: $ 950,000*

Fulcrum Composites Inc., Midland, is a technology and processing company dedicated to providing solutions to structural problems through the development and application of thermoplastic composites. Through a unique thermoplastic pultrusion process Fulcrum technology offers the combination of high mechanical properties with excellent toughness and damage tolerance for structural applications.

- *SBIC Investment: $ 350,000*

HandyLab, Inc., Ann Arbor, is dedicated to the development and manufacture of novel clinical diagnostic testing products. HandyLab's proprietary products will reduce the time, cost, and complexity of performing infectious disease and other testing while simultaneously improving the quality of results.

- *SBIC Investment: $ 4,892,350*

Montonix, Inc., Ann Arbor, is a leading supplier of tool and process monitoring solutions serving the worldwide automotive, aerospace, and machine tool industries.

- *SBIC Investment: $ 2,400,000*

Nematron Corporation, Ann Arbor, has been setting the standard for PC-based control and operator interface since the birth of the industry. Nematron introduced the first industrial control computers and the first Windows-based real-time control software, and it holds numerous patents on advanced control and information system components.

- *SBIC Investment: $ 4,430,000*

Solidica, Ann Arbor, is an advanced materials and manufacturing technology company that specializes in novel applications of additive fabrication. The company's patented *Ultrasonic Consolidation* (UC) technology and *Form-ation* fabrication system represent the first, proven direct-to-metal aluminum system made commercially available to the manufacturing community.

- *SBIC Investment: $ 3,226,500*

Senator LEVIN. Again, I thank you for convening this hearing and for your tenacity in support of SBA and its programs. I join you in welcoming the administrator, Mr. Barreto, and thanking him for his, I guess, almost record-setting tenure at SBA. I guess you are No. 2 and try harder.

[Laughter.]

Senator LEVIN. Thank you.

Chair SNOWE. Thank you, Senator Levin.

[The prepared statement of Senator Levin follows:]

Statement of Senator Carl Levin
Committee on Small Business and Entrepreneurship
Hearing on The Reauthorization of SBA's Finance and Entrepreneurial Development Programs
April 26, 2006

I urge the SBA to work with the Chair and Ranking Member Kerry and other members of this Committee to revive the SBIC Participating Securities program which has been unfortunately dropped. This program provides small businesses with venture capital by investing in promising small companies in exchange for stock in those companies. This type of venture capital or equity investment is known as "patient capital" that gives companies time, typically five years or more, to get established before having to give investors a return on their investment.

SBA's Participating Securities program fills some important needs not met by other venture capital funds. This is because the SBIC Participating Securities program:

- makes equity investments in smaller amounts, between $1-$5 million, a size geared more to small business needs;
- makes investments in areas of the country that are less likely to be served by non-SBIC venture funds, including in the Midwest;
- serves a more diverse segment of small businesses than non-SBIC venture funds, including investing in manufacturing sectors.

Unfortunately, this useful program has been shut down for the past 18 months since the

Administration ruled that under the Federal Credit Reform Act (FCRA) its must be considered as equity by OMB and therefore requires an annual appropriation.

Workable solutions have been identified to modify the program so that it can be scored at a zero subsidy. So far the Administration has not been willing to accept these solutions and has instead said the program is not necessary. I hope the Administration will reconsider its position and make a serious effort to find a workable solution to restart the Participating Securities SBIC program so that important venture capital investments can flow again to the small businesses that depend upon them for growth, expansion and job creation.

I also hope that an amendment of mine that previously passed the Senate to create the Small Business Intermediary Lending Pilot Program will be included in the Committee's reauthorization bill.

I ask that the following documents be included in the hearing record:

- Participating Securities SBIC Portfolio Companies in Michigan and their investments

Senator Isakson, do you have any comments?

OPENING STATEMENT OF THE HONORABLE JOHNNY ISAKSON, A UNITED STATES SENATOR FROM GEORGIA

Senator ISAKSON. Thank you, Madam Chairman.

I will waive any opening statement, except to thank you for your leadership and to thank Administrator Barreto for his service at the SBA. I understand he will be going to greener pastures or other pastures. Being a small businessman, they look green, but they aren't always green. I remember that.

Thank you for all you have done. I appreciate your leadership at the SBA and I look forward to your testimony.

Chair SNOWE. Thank you.

You may proceed. Thank you.

STATEMENT OF THE HONORABLE HECTOR V. BARRETO, ADMINISTRATOR, UNITED STATES SMALL BUSINESS ADMINISTRATION

Mr. BARRETO. Thank you very much.

First, let me start by saying I am truly grateful for the comments that have been made, and I appreciate very much the support that I have received from the Chair and from this Committee.

Chair Snowe and Senator Isakson, thank you for inviting me to testify on reauthorization of the Small Business Administration and its program. Over the past 4 years, SBA has dramatically increased its services to the small business community, providing billions in funding for small business and increasing Government contract amounts awarded to small businesses to an all-time high. Those are examples of what the SBA has accomplished while, at the same time, showing fiscal restraint and responsibility.

Our reauthorization proposal reflects our commitment to continuing that success. In general, the administration proposes a few technical changes, the repeal of duplicative or unused programs, and a 3-year reauthorization of SBA programs. Legislation has been proposed to improve oversight and penalties to harmonize the status for clarity.

However, SBA has proposed several significant items that I will discuss in detail. First, the administrative fees for loans over a million dollars. SBA has proposed an administrative fee for loans over $1 million, which would affect only a small percentage of loans, and that would offset $7 million in the loan-making costs. The fee proposal would apply to the 7(a), the 504, and the SBIC debenture programs.

With regards to the secondary market fee, SBA has proposed the authority to impose a secondary market fee to cover future costs of the "prompt payment" guaranty under Section 5(g) of the Small Business Act. SBA does not anticipate charging this fee in either fiscal years 2007 or 2008. However, this authority will enable SBA to cover the future subsidy cost of the guaranty.

With regards to the CDC review fee and the 504 program, SBA has proposed a conforming change for the 504 program, authorizing a fee to offset the cost of examinations and oversight. This same authority already exists in the 7(a) program.

With regards to disaster loans, as I testified several weeks ago, SBA is proposing a change in disaster loans. Absent legislative action, the cost of disaster loans will rise 20 percent in fiscal year 2007. This is largely due to the rising interest rates, a factor that SBA cannot control.

The proposal would continue to offer deeply subsidized interest rate for the first 5 years of a disaster loan and then adjust the rate to a Treasury security-based rate, still well below a market rate.

SBA is also exploring changes to our delivery system. The Office of Disaster Assistance has done an outstanding job approving nearly $9 billion in loans and processing over 300,000 applications.

Nevertheless, we can always strive to do better. We must do better.

SBA issued a request for information to solicit suggestions from the private sector on how the SBA can better respond, particularly in extraordinary disasters like Hurricane Katrina.

With regards to legislative proposals, Madam Chair, SBA has reviewed certain pending Senate legislation. Unfortunately, we have not had a chance to review all of the bills. I would like to summarize our comments about several of the bills. Of course, we will be happy to work with this Committee on the details.

With regards to S. 1603, 7(a), SBA has reviewed your bill, Madam Chair, and we have the following comments. SBA supports the proposed National Preferred Lenders Program. We have been working on a similar model through administrative efforts. This will relieve our lending partners, who often operate in several States, of the burden of duplicative applications.

SBA also has no significant objection to an increase in the authorization level of the 7(a) program. With zero subsidy, the program has the potential for growth, and such an increase may be prudent.

SBA also has no opposition to applying the alternative size standard to 7(a) loans, as proposed in S. 1603. This has been used successfully in the 504 and SBIC program for several years.

SBA has some concerns regarding the proposal to increase the gross loan amount to $3 million. The administration has striven to expand the use of the 7(a) program by smaller borrowers, increasing our loans under $200,000 dramatically. At the same time, while loans over $1 million are a small percentage of the 7(a) portfolio, roughly about 3 percent, they represent 20 percent of the dollar volume.

Some argue that lower loan sizes have a negative effect on recovery rates and reduced fee income. That argument cuts both ways. An increase in large loans creates an equivalent potential for a negative effect. It requires far fewer larger defaults to create a significant increase in our losses.

SBA still has only limited information on the performance of larger loans in our portfolio. More study and analysis should be done. With more experience with the performance of large loans, we can determine the feasibility of increasing the gross loan amount.

With regards to S. 2162 with the CDCs, SBA is generally supportive of S. 2162 and its goals. It provides a helpful definition of certified development companies, or the CDC's, and clarification of the local development aspect of the program.

SBA supports authorizing CDCs to liquidate loans or to use an approved contractor. This will provide more efficient liquidation actions and assist SBA in portfolio management. We look forward to working with the Committee to clarify and define some of the details.

However, SBA is concerned with permitting persons to hold directorships on the boards of CDCs in different areas. As S. 2162 emphasizes, this is a local development program, and SBA believes that CDC directors should participate locally. SBA would also like a clarification on the application of Section 7 regarding public policy goals.

Finally, SBA has reservations about the provision permitting refinancing. SBA is concerned that refinancing of existing SBA loans with new SBA loans, which is currently prohibited, would be allowed under this provision.

S. 1923, the SBICs, SBA has also reviewed S. 1923. We agree with the Congressional Budget Office that this legislation would be a debt program under Federal Credit Reform Act. We also agree with the CBO that it would have a significant subsidy rate. SBA has not created a subsidy model for the proposed program, but we believe the CBO estimated rate of 20 percent to 25 percent is reasonable.

In order to achieve the zero subsidy rate specified in the legislation, the program would require significant upfront fees. Restricting the program to one tier of leverage would reduce the subsidy rate, but we cannot accurately estimate that effect.

Finally, the administration believes that there is a significant amount of private sector equity financing available. For example, VentureExpert reports that in 2003 through 2005 over $9.5 billion was placed in investments for fiscal year 2003 through 2005 in that $500,000 to $5 million range.

Madam Chair, thank you again for inviting me to testify. Obviously, SBA's reauthorization covers the full spectrum of our many responsibilities, and I have only touched on a few points. I look forward to your questions. Again, thank you very much for your support and your passionate advocacy on behalf of small business.

[The prepared statement of Mr. Barreto follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

Testimony of
the Honorable Hector V. Barreto
Administrator, US Small Business Administration
Reauthorization of SBA programs
United States Senate
Committee on Small Business and Entrepreneurship
April 26, 2006

Chair Snowe, Ranking Member Kerry, Senators, thank you for inviting me to testify on the reauthorization of the Small Business Administration and its programs. Over the past four years SBA has dramatically increased its services to the small business community. Our loan programs have provided billions in additional funding for small businesses, and government contracts awarded to small businesses have steadily increased since 2001 to an all-time high. These are examples of what the SBA has accomplished since 2001 while, at the same time, showing fiscal restraint and responsibility. Our current reauthorization proposal reflects our commitment to continuing that success.

In general, the Administration proposes a few technical changes, the repeal of duplicative, unused or unnecessary programs, and a simple three year reauthorization of SBA programs with steady increases in the authorization levels for SBA's financial programs.

Legislation has been proposed to improve oversight and penalties for criminal acts, and to harmonize various statutes for clarity and consistency. However, SBA has proposed several more significant items that I would like to discuss in detail.

Administrative Fees for Loans over $1 Million

SBA has proposed an administrative fee for loans over $1 million which would affect only a small percentage of loans and would offset $7 million in loan-making costs.

The Administration believes that a small business with the ability to take on a $1 million loan should have the ability to cover this fee, which can be financed over the life of the loan. This fee proposal would apply to the 7(a), 504 and SBIC debenture programs.

Secondary Market Fee
SBA has proposed legislative language giving the SBA the authority to impose a secondary market fee in order to cover anticipated future costs of the "prompt payment" guaranty under section 5(g) of the Small Business Act.

SBA does not anticipate charging this fee in either fiscal years 2007 or 2008. However, this authority will enable SBA to cover the future subsidy cost of the guaranty without altering the pooling program in the secondary market.

Adjustments to the structure of secondary market pools have helped SBA cover the costs of the guaranty, but that is not a long term solution, and frequent changes create difficulties in the assembly and sale of loans in the secondary market.

CDC Review Fee/504 Program
SBA has proposed a conforming change for the 504, specifically a proposal to cover program oversight costs. The charge would authorize a fee designed solely to offset the costs of examinations, reviews and other lender oversight activities. This same statutory authority already exists in the 7(a) program.

Disaster Loans
As I testified at the budget hearing several weeks ago SBA is proposing an alteration in the structure of disaster loans. Absent legislative action the cost of disaster loans are expected to rise by 20 percent in fiscal year 2007. This is largely attributable to rising interest rates, a factor that SBA cannot control.

This proposal would continue to offer the current deeply- subsidized interest rate for the first five years when the disaster victim need the subsidy the most, and thereafter adjust the rate to that of an equivalent Treasury security determined at the time of loan closing, still a below market rate.

SBA is also exploring various changes to our delivery system for disaster loans. SBA's Office of Disaster Assistance has done an outstanding job in fiscal year 2006 approving nearly $9 billion in overall disaster loans and processing over 300,000 applications twice as fast as we had during the Northridge earthquake.

Nevertheless, we can always strive to do better. With that in mind SBA has issued a Request for Information (RFI) to solicit suggestions from the private sector on how SBA can better deliver its services, particularly in extraordinary-disaster situations like Hurricane Katrina.

We are also proposing to allow Small Business Development Centers (SBDCs) to utilize existing portability grants to offer educational assistance to small businesses during major disasters. Extending Economic Injury Disaster Loans to qualifying Nonprofit organizations is also included in the proposal.

<u>Legislative Proposals</u>
Madame Chair, as your staff requested SBA has reviewed certain pending Senate legislation. Unfortunately, we have not had the opportunity to review all the bills that have been introduced. I would like to summarize our questions, concerns and comments about several of the pending bills, although of course we will be happy to work with the committee on the details.

<u>S. 1603/ 7(a)</u>
SBA has reviewed your bill Madame Chair, and we have the following comments. SBA supports the proposed National Preferred Lenders program. We have been working on a similar model through administrative efforts, but we would welcome enactment of statutory authority. This provision will relieve our lending partners, who often operate in several states, of the burden of duplicative applications and approvals. SBA also has no significant objection to an increase in the authorization level of the 7(a) program. With the implementation of zero subsidy, the program has the potential for growth and such an increase may be prudent.

SBA also has no opposition to applying the alternative size standard to 7(a) loans as proposed in S.1603. This standard has been used in the 504 and SBIC programs for several years, and is often a useful alternative to applying the NAICS codes.

SBA has some concerns regarding the proposal to increase the gross loan amount from $2 million to $3 million. As you know, the Administration has striven to expand the use of the 7(a) program by smaller borrowers, increasing our loans under $200,000, and particularly our loans under $50,000 dramatically. At the same time, while loans over $1 million make up a small percentage of the 7(a) portfolio (roughly three percent), they represent twenty percent of loan dollar volume.

Some have argued that lower loan sizes may have a negative effect on recovery rates and that they reduce fee income, but that argument cuts both ways. A substantial increase in large loans creates an equivalent potential for a negative effect on program performance. It requires far fewer large loan defaults to create a significant increase in losses.

Compared to smaller loans, SBA has only limited information on the performance of larger loans in our portfolio, and until a few years ago there were very few such loans. SBA believes more study and analysis must be done, and once we have more experience with the performance of loans over $1 million we can determine the feasibility of further increasing the loan amount for the 7(a) program.

<u>S. 2162/CDCs</u>
SBA is generally supportive of S.2162 and its goals. It provides helpful statutory language regarding the definition of a Certified Development Company (CDC), and clarification of the local development aspect of this program.

SBA supports the provision that authorizes CDCs to liquidate their own loans or to use the services of an approved outside contractor. This will provide more efficient and timely liquidation actions and will assist SBA in portfolio management. We look forward to working with the Committee to clarify and define some of the details.
However, SBA is concerned with the provision permitting persons to hold multiple directorships on the boards of CDCs in different areas. This language will tend to dilute the local aspect of the program. As S.2162 emphasizes, this is a local development program and SBA believes CDC directors should participate on a local basis.

SBA would also like to seek clarification on the application of Section 7 of S.2162 regarding the combination of public policy goals. SBA is concerned how the combination could or should be applied across different goals.

Finally, SBA has reservations about the provision permitting refinancing of certain amounts. SBA is concerned that refinancing of existing SBA loans with new SBA loans, which is currently prohibited, would be allowed under this provision.

<u>S. 1923/SBICs</u>
SBA has also reviewed S. 1923. While we tend to agree with the Congressional Budget Office (CBO) that this legislation would be considered a debt program covered by the Federal Credit Reform Act, we also agree with CBO that it would have a significant subsidy rate. While we have not created a subsidy model for the program proposed by S. 1923, we believe the CBO estimate that places the rate of about 20 percent to 25 percent is probable.

In order to achieve the zero subsidy rate specified in the legislation, the program would require significant upfront fees. SBA has not been able to analyze the effect on the subsidy rate that restricting the program to one tier of leverage would produce. We believe that it would reduce the subsidy rate, but without a new subsidy model we can not accurately estimate the effect. Creating a model would require significant time, and we received your inquiry only the week before last.

Furthermore, the Administration believes that there is significant private sector equity financing available. VentureExpert, using Moneytree data for FYs 2003 through 2005, reports that over $9.5 billion was placed in investments ranging from $500,000 to $5,000,000.

Madame Chair, thank you again for inviting me to testify. Obviously, SBA's reauthorization covers the full spectrum of our many responsibilities and I have only touched on a few points. I look forward to your questions.

Chair SNOWE. Thank you, Administrator Barreto, and I appreciate your testimony here this morning.

First, on the disaster situation, because I know that there are several issues that are pending. One of which, of course, is the necessity of having additional funding through the supplemental. I understand that the disaster loans would basically be gone by the date May 19th. Is that true?

Mr. BARRETO. Well, we are looking at that very closely. We had a meeting on this yesterday, and we are fine right now. Obviously, we want to work with the Committees to get that supplemental approved. We think that that is very important. It is important for a lot of reasons. We are measuring this every single day.

You know, the number, the date, the actual date could change a little bit depending on the size of the loans that we are seeing right now. As you know, we have processed now well over in excess—I want to say 93 percent—of all of the applications. I think we are down to about 25,000 applications. Of course, we have had some stragglers come in because of the extensions of the due date.

We believe that we are going to be good until probably the third week, maybe the last few days of May. It is critically important for us to get that supplemental approved. Obviously, we will be reporting back to this Committee on a daily basis as to where we are on that.

Chair SNOWE. Well, I appreciate it because that will be an ambitious schedule, given the standards of Congress with respect to supplementals.

Mr. BARRETO. Sure.

Chair SNOWE. We are beginning that debate, obviously, this week here in the U.S. Senate. Do you have a plan in the event this is not passed by the end of May for any——

Mr. BARRETO. Sure.

Chair SNOWE. You know, because that is going to be critical in the final analysis if all of the funding has been depleted.

Mr. BARRETO. Right now, we are estimating—and again, this number could go up. We are estimating that we have 25 days of lending left, 25 days of lending ability left. Of course, that depends on the activity.

One of the things that we have mentioned is we are not going to stop processing these loans. We are going to be underwriting these loans. We are going to be processing these loans. We will not stop.

The key issue here is that if on the 27th day we get the supplemental, or the 28th day, and we have been processing those loans, we can fund those loans immediately. Of course, we will continue to be in very close coordination and communication not only with this Committee, but with our Appropriations Committee to make sure that we can get that done as soon as possible.

Chair SNOWE. You mentioned that 93 percent of the applications have been processed. Yet only about 13 percent of the money has been disbursed. Why the disparity?

Mr. BARRETO. Well, in actuality, we have partially or fully disbursed approximately 40 percent of the loans that have been approved. When you talk about the net dollars that have been disbursed there are two reasons for the disparity.

One is, as you know, that most of these loans are construction loans. Those loans are drawn down as construction is completed. We believe that a very important number to us is the number of loans that have been approved and that have been partially or fully disbursed, and I have said that number is closer to 40 percent.

The other thing is, and you have probably seen some of this in the media, there are folks now that have been approved for loans that still have not made a final determination of whether they are going to take that loan. There are still—and we have all talked about this for many months now—a lot of very difficult conditions on the ground of whether or not certain areas will be rebuilt and whether businesses can make a go of it with as much as 50 percent of the population still gone, difficulty in finding workers for their businesses, difficulty in finding contractors and building materials for these businesses.

There are a lot of decisions that are still in flux. One of the biggest challenges is, as we have said before, is that we still have many of these folks that have been approved for loans spread out over 40 different States. They are still determining if they take the loan, how do they come back? Do they come back just with one of the family members while the rest of the family stays behind?

A lot of very challenging decisions. We are doing everything that we can from our standpoint to get that money out as soon as possible. We are in constant contact with those borrowers who have been approved about what they want to do. Of course, you know that we also give them, once they are approved, 60 days to make a determination.

Chair SNOWE. Do you have enough personnel——

Mr. BARRETO. We do.

Chair SNOWE [continuing]. For verification offices?

Mr. BARRETO. I have re-allocated some of the folks that we had, you know? As we have gone through this process—you know, the processing, the underwriting, the inspection—wherever possible, we have moved more people into the closing aspect. We are continually bringing on more people with the specialization for doing closing types of activities.

Chair SNOWE. OK. With respect to the Small Business Investment Company Program, the SBICs, and I know you referred to it and the concerns about maintaining zero subsidy. You know, the administration back in 2005 had provided a $4 billion authorization for this program, and now we are down to not even agreeing to any authorization.

How do we go from $4 billion to $0 and say that the participating securities dimension of the SBICs is non-essential, when, frankly, I find it of value because it really does help in many instances to bolster the manufacturing sector of our economy, which we desperately need. Otherwise, this capital would otherwise not be available to so many industries. It plays a pivotal role.

I understand about the problems of the past and the years in which they experienced losses because of the downturn in the stock market. You obviously have to lessen the risk. That is why my legislation moved toward a zero subsidy, which, in that case, obviously it doesn't represent a cost to the Government, but also provides the available capital that is essential that I think we need.

Mr. BARRETO. Well, first of all, let me say that we agree with you wholeheartedly that the SBIC program has been an important program to small business. It has accomplished some great things. I am not sure that we have ever said that it was unnecessary or unimportant because we believe that it is. Of course, we are very proud of some of the incredible success stories.

Of course, we also want to state emphatically that we still have a venture capital program. It is the debenture program that we have, and we are still honoring all of the commitments that we have made on the Participating Securities Program.

Our challenge has been and remains how can we get to a completely self-sustaining program? This is a challenge that we still have with the losses that the program has taken. We know right now that we have experienced $2.4 billion in losses. We also know that we have $3.6 billion in potential exposure. We know that some of that is going to turn into losses.

One of our biggest responsibilities that we have is to make sure that we balance the program, that we manage the program, that we try to minimize any additional losses in the future. One of the things that we are concerned about, is the fact that if we are not able to get the zero subsidy, this program is not going to be competitive.

The upfront fees that would be required—as you know, the CBO has already come back and said that they believe that the cost of the program will be anywhere from 20 percent to 25 percent. We believe that that is probably an accurate figure from the experience that we have had before.

What we want to continue doing, what we will do is continue working with you and the industry to come up with a solution. We haven't been able to come up with something that we feel is workable to make this program completely self-sustaining, to make it competitive in the marketplace, and to deal not only with the losses that we have already experienced, but with the losses that we know that we may have in the future.

Chair SNOWE. Well, do you think this program is necessary? If you do, what would you propose as another means of providing this particular part of it?

Mr. BARRETO. Sure. Well, a couple of things. One is, as I mentioned, that we do have a venture capital program. We still have an SBIC program. We are still making venture capital investments through our debenture venture capital program.

The other thing that we mentioned is—and it wasn't always this way—we now know that there are other participants in the marketplace. I mentioned a statistic that there was $10 billion that went to these kinds of venture capital investments to companies between that $500,000 and $5 million investment range.

I guess what I am saying is that before it may not have been this way. There is capital available in the marketplace for small businesses that are interested in that kind of investment.

Again, from our standpoint, we just want to make sure—you know, it has always been presented as a self-sustaining program, a zero subsidy program, which wasn't going to cost the taxpayers anything. Well, it has already cost the taxpayers $2.4 billion. We have got $3.6 billion still sitting out there.

I think it would be irresponsible for us to come if we didn't have a good solution. We haven't given up on this. We want to continue working toward that end. We just haven't been able to figure a way to get there.

Chair SNOWE. Well, the Tuck School of Business at Dartmouth last year conducted a study on the SBIC program and indicated that it really did serve a very important niche in the marketplace. Especially in several ways, one of which was to address capital financing in underserved areas. I do think it is crucial that we work through this.

Mr. BARRETO. Sure.

Chair SNOWE. To make sure that it is there, especially for the small manufacturer that we are losing. Those are basically the sort of mom and pop operations in rural America. I know that is true in my State.

Mr. BARRETO. Sure.

Chair SNOWE. We are losing so many important industries. Are we going to see a retrenchment of rural areas and underserved areas in America because we are unwilling to take those risks so that they have the available capital to succeed? And they very well could.

I have seen a lot of small industries in my State right now, what they are doing in the global marketplace on a small basis is creating a niche. We need to help them.

We want to go to a zero subsidy on this question, but I think we have got to figure it out. I hope that you will share your analysis to suggest whether this program isn't necessary or what we can do to get to the zero subsidy in a way that gives a comfort level to the administration.

Mr. BARRETO. OK.

Chair SNOWE. Senator Isakson.

Senator ISAKSON. Thank you, Madam Chair.

In your testimony, I think I heard you say that the agency had approved $9 billion in disaster loans in applicants from 40 States?

Mr. BARRETO. No. Well, yes. I want to preface this. We are responding to—those $9 billion and most of that is Katrina-related. You are talking about Louisiana, Mississippi, Alabama. Most of it is in Louisiana.

What I said is a lot of the residents, former residents of Louisiana, are spread over 40 different States. That is one of the things that has been really challenging for us, trying to close these loans and set up appointments with folks that aren't in the State anymore.

It is one of the things the Chair asked me—what one of the challenges are in making sure that these monies are disbursed. Because we have approved the money. It is available immediately subject to closing. We haven't disbursed all of it. We have disbursed about 40 percent of the loans that we have approved, partially or fully. There are a lot of folks spread all across the country that still haven't decided what to do.

Senator ISAKSON. Yes. A lot of them are in Georgia, which begs the question now to justify my ignorance on the subject. Of the disaster loans that you are approving that are Katrina-related, are they limited to investments in Alabama, Mississippi, and Louisiana?

Mr. BARRETO. That is a very good question, Senator. Sometimes, and we do this kind of on a case-by-case basis, somebody who is approved for—remember, what started it was they had a business or a home in the affected disaster area. OK, that is the first requirement. You have got to be in the declared disaster area.

Once they go through that process, some of the times they will come back to us and say, "You know what, I am not going to be able to rebuild in my area." They have decided that they are not rebuilding in that area or, "My business isn't sustainable anymore. I depended on a large traffic flow. Fifty percent of the people are gone. What I would like to do is take that money and invest it in a different area."

In the past, that has also been problematic because sometimes local officials will say, "Look, we don't want any money that is approved for businesses or homes in our area going anywhere else." Sometimes there have been prohibitions from doing that. We look at that on a case-by-case basis.

I don't believe that we have received a lot of those requests so far, but I would be happy to investigate that.

Senator ISAKSON. Well, I may be totally off here, but I think sometime in the past, we also had some fraud problems when people applied for the deeply discounted disaster loans based on a disaster that they ended up really not being hurt in. They were just trying to take advantage of the program. Is that not correct?

Mr. BARRETO. Yes. That is absolutely correct. There has been some writing about this. The *New York Times* has written a story about this, and there has been some other writing.

We have found instances of that. Not to assume any mal intent, but sometimes what will happen is people don't know what a declared disaster area is. They will apply for a loan, and then we will go back to them and say, "You know what, your property is not in the declared disaster area. You are not eligible for a loan."

We have had instances like that already. Those loans are immediately withdrawn. That is part of that whole, when you look at the funnel, 400,000 applications at the top, that is what came in. So far, what has been approved is about 130,000 of them.

There are a lot of reasons why the rest of the folks didn't get approved. Sometimes because of what you just said. Sometimes it is because they didn't want a loan in the first place. They actually wanted a FEMA grant, and they had to go through our process and get turned down before they could go to FEMA for the grant.

Senator ISAKSON. Last question on that subject. If an applicant is approved, and they determine they are not going back to Louisiana or Mississippi because of a drop in population or not rebuilding the area or whatever, is it going to be a case-by-case basis as to whether or not the money can go with them somewhere else?

Mr. BARRETO. That has been our practice. A case-by-case basis unless something happens to change our authority. That has happened in the past, where a legislator from a particular State will say, "I don't want any disaster money leaving my State."

By the way, we saw this a little bit in New York after 9/11, where a lot of the elected officials were very concerned not about them necessarily leaving the State, but just leaving the area. In other words you were a business that was by the World Trade Center. You had 100,000 people walking past your front door. They are not there anymore. So you decide to move to one of the other boroughs. We saw that after 9/11.

So, yes, right now, on a case-by-case basis unless anything has changed to our authority.

Senator ISAKSON. Thank you.

Chair SNOWE. Senator Thune.

OPENING STATEMENT OF THE HONORABLE JOHN THUNE, A UNITED STATES SENATOR FROM SOUTH DAKOTA

Senator THUNE. Thank you, Madam Chair.

I commend you for holding this hearing on SBA's financing programs. With the reauthorization upon us, it is fitting that as committee of jurisdiction that we review the programs that strengthen our Nation's small businesses.

I would also like to take this opportunity to congratulate and thank Administrator Barreto for his service at the SBA.

Mr. BARRETO. Thank you very much, Senator.

Senator THUNE. You have served as administrator since President Bush took office. During that time, America's small businesses have had a strong and faithful advocate. Thanks to your leadership, our small businesses have better access to capital, and improved Federal procurement opportunities. Your presence at the agency will be sorely missed.

I want to wish you all the best in your future endeavors and thank you again for your service to our country and to America's small businesses.

Mr. BARRETO. Thank you very much, Senator.

Senator THUNE. I would like to address my brief remarks this morning to one of the major issues confronting the Committee, and that is whether SBA's equity financing program should continue.

In 1994, Congress rightly determined the financing needs of startup or early stage companies in States like South Dakota were simply not being met by traditional venture capital firms. Accordingly, the Congress enacted the Participating Security Program within the Small Business Investment Corporation. This program is designed to provide patient risk capital to main street manufacturing and other underserved businesses.

Since that time, over $10 billion has been invested in these types of companies and with the deal sizes ranging from about half a million dollars to $3 million.

Now, while traditional venture capital firms are flush with cash to invest, they continue to focus on deals over $10 million and with more mature, sophisticated companies. The Participating Security Program has helped to fill that gap. Unfortunately, the program has suffered like the rest of the economy after the effects of the dot.com bubble burst and the attacks of 9/11. Some now believe that it would be best to abandon the program.

For the past 18 months, no new licenses have been granted in the Participating Security Program. This hiatus is unacceptable and could have negative economic consequences down the road, which is why I am pleased to co-sponsor Senate bill 1923, a bill to revive and restructure the Participating Security Program.

I am concerned that if we fail to act on S. 1923, a vital source of venture capital to smaller firms will be lost. Companies like Bright Planet Corporation, located in Sioux Falls, South Dakota, a leader of deep Web research, and J.M. Precision, Inc., a manufacturing company located in Madison, South Dakota, have both received SBIC investments slightly over a million dollars. Thanks to this program, an infusion of capital has come into South Dakota, resulting in economic growth and job creation.

It is my hope that the Administration can work with the Committee and find a workable compromise that meets the needs of private investors and protects the interests of the taxpayers. I believe this can be achieved if realistic economic assumptions are used when calculating the program subsidy rate.

In summary, the imperfections in the venture capital markets that caused Congress to act on 10 years ago continue to persist, especially in the middle of the country. We must not let this public/private partnership that has provided billions of dollars in equity investments in small businesses wither away.

I look forward to working with the Chair and other Committee Members to enact legislation that reduces SBA's risks and maintains the needed incentives to attract private investors.

Administrator Barreto, I would, as I mentioned earlier, I want to follow up with just a question, if I could?

Mr. BARRETO. Yes, sir.

Senator THUNE. I believe that this is a program that we need to keep functioning in some form. You mentioned in your testimony that you believe there is a good chance the reform program would require a subsidy even though the legislation aims for it not to have one.

I guess my question is, do you believe there is a compromise out there that is more likely to carry a zero subsidy, and would the administration support that sort of a compromise?

Mr. BARRETO. Well, as I mentioned before, we are very open and interested in finding a solution. If we can find that solution—and I have to be very frank with you. We haven't seen a proposal yet that gets us to completely zero subsidy without any cost to the taxpayers, or a program that would be attractive to future participants in the SBIC program because of what would probably be required—some very, very large upfront fees.

In fact, in conversations that we have had with folks trying to encourage them to be more involved in the venture capital program in the past, many times folks said to us, "Look, if the fees go up too high or if you are going to tack on a big subsidy rate onto this that is going to affect us, there is no way that we can participate in this program."

Our job really is to balance both of those concerns. How are you able to have a Participating Securities Program that functions well, that does not experience the kind of losses that we have had for most of the program's existence, and that it protects the American taxpayer going forward?

We can't do anything about all of the investments that didn't work out for us before the $2.4 billion that we already have on the books and the exposure that we have on $3.6 billion more. Can't do anything about that.

We need to be able to continue managing the program that we have. Obviously, we are honoring the commitments that we have made. Those participating securities funds that we currently have can still draw down on capital. We are going to honor all of those.

Our big challenge is going forward. We haven't come up with a formula to do that, and we are more than willing to continue working with you, the Chair, this Committee, the industry, to keep working on that. We will be the first ones to take that proposal, a workable proposal and go back and really enroll the administration to it.

Nobody has said that the program is unnecessary or that it should go away or that it hasn't done good things. Our challenge is just to find a way for us to be responsible with both of our responsibilities not only to the small businesses that need this capital, but also to the American taxpayer who funds these programs.

Senator THUNE. I appreciate that. Madam Chair, look forward to working with you and Members of the Committee and with the agency.

There are those out there, I think, who are involved in this area. Regarding the debt financing piece of this, the SBA has done a terrific job filling that. I also believe that there, as I mentioned, companies like some of these small companies in my State that have benefited from the equity investment that has come to the program. I understand and hear what you are saying about making sure we do this in a fiscally responsible way, but I hope that we can continue the dialog and work constructively to try and find that solution.

It does seem, I think, that much of what is fueling the growth in the economy are these types of small businesses, and I realize that there have been some experiences after 9/11 and with the dot-com bubble bursting that have created some issues out there. It certainly seems that this is something that we ought to try to figure out a way to continue to maintain as a resource that is available to small businesses in this country.

I thank you for your testimony again, for your great service to the agency, to the small businesses in this country. Thank you.

Mr. BARRETO. Thank you very much, Senator.

Chair SNOWE. Thank you, Senator Thune. I'm looking forward to working with you on that particular question.

Hopefully, the administration can share with us some financial data to help us to examine some of these issues so that we can get to a point of solving this problem with the SBICs because it does provide significant venture capital to areas that otherwise would just—companies and areas that otherwise would not be served with access to this type of funding.

It really is important to support our economic base in underserved and rural areas similar to what Senator Thune is speaking of in his State of South Dakota, similar to Maine. These areas are part of the country that need that access to $500,000 to $5 million, whatever. It really is absolutely vital. It is a lifeline.

Mr. BARRETO. We completely agree, and I mean this sincerely. We will work in earnest with this Committee to come up with viable solutions.

I did want to mention one thing, that we have been working on a Rural Business Investment Company Program. That was something that was part of the Farm Bill. It is a Department of Agriculture program, but we have been asked to put that program together because of our prior expertise.

That is exactly what those funds will be used for—for small businesses in rural areas. And I am not saying that that will solve all of the necessity for venture capital. I just want to say that that is another tool that we may be able to depend on in the future.

Chair SNOWE. Well, it just seems to me, though, that under the SBA, wouldn't it be better to consolidate these issues? It creates a lot of confusion.

It seems to me it is simpler, more streamlined to incorporate, build upon the programs that have already been working to some extent. I understand the losses that have occurred. We obviously have to address those risks, but somehow try to maintain the zero subsidy feature of this important dimension to the SBICs.

I think that is what essentially it is all about. We have got to strive to do that because, otherwise, I just think it serves to create a lot of confusion. It is great to have another program, but I think we ought to build on this program if it is at all possible. We need to just work it through if we can.

Mr. BARRETO. OK.

Chair SNOWE. Just a couple of more issues here. On the fees for the 7(a), the 504, for example, and as well as the SBIC, of course, you are recommending additional fees for these programs. They are already zero subsidy programs. Now the administration is proposing new fees for any loans more than a million dollars.

That is going to create, I think, some financial difficulties for companies who are trying to have access to this capital. Now we are charging them fees for a zero subsidy program, and there is a wide variance in the fees.

There is 7(a), where the increase would be $623 per loan, to the 504, it would be up to $11,000 for a loan of the maximum $10 million allowed under the program. Then, under the SBIC, as you mentioned, an average of $45,360.

They are already paying for the loan guaranty costs. Now we find we are going to add additional costs. Exactly what is the purpose?

I know you are saying to cover the administrative fees. I think that, ultimately, you are going to reduce—we are already talking about an industry that already is sensitive. Otherwise, they are not going through the conventional lending process. They are going through SBA.

Now you are adding additional fees. It just creates an element of risk for their economic future survival.

Mr. BARRETO. Yes. I believe that we might have referenced this in our prior testimony on the budget. I want to first state that we are talking about 3 percent of the portfolio right now. That is the only loans that we are doing over a million dollars in the 7(a) portfolio.

The other thing is, is that as we have looked at it, the differential in the payment here is pretty negligible. You are talking about something like $14 a month difference on the 7(a) side. I think $31 difference on the 504 side on the million dollar-plus loans.

This is something to help offset some of the administrative costs, some of the additional costs on us to provide these loans. I mentioned also that these loans also take up more than 20 percent of the dollars of the portfolio.

When we have talked to our lenders and when we have talked to small businesses, their key priority is that there be enough lending authority in the program. Of course, we have good news about that. Next year, we will have a total of $25 billion of lending authority should our budget proposal pass.

They also want to make sure that there are no caps on the loans. We have had to put caps on the loans in the past. Now that we are at zero subsidy, we don't have to do that anymore because we are not subject to the appropriation, and we don't run out of funds the way that we used to.

The lenders are saying to us, "Look, we need a continuous program. That program can't even be shut down for one day because we dedicate millions of dollars to SBA lending, and we have thousands of employees." That is what they have told us are their main priorities.

This differential in the payment is not significant enough to prevent these kinds of loans being made. The other thing is that many of the small businesses that are able to get million dollar loans have more capacity. They have other options. Small business people are very discerning purchasers. If they feel that a loan program doesn't serve them, they have other options. They have other opportunities, especially at that million-dollar range.

We have asked for this slight increase in fee to offset what is becoming increasing administrative costs for us to provide the loan, and we think that it is a fair compromise, if you will, and will afford us the ability to be able to provide a healthy program for years to come.

Chair SNOWE. Do you have data that would demonstrate that this will not be a problem for companies? I mean that this would be a negligible impact? Is there any basis for making that because, obviously, this is going to be something that would be a departure and a new approach.

Mr. BARRETO. Sure. Well, some of the data that we have is the anecdotal data of business people and lenders telling us this. In other words, what they basically say is, "Look, $14 a month on a million dollar loan is not going to prevent us from taking the loan if we need it." It is still competitive. In some cases, it makes the best sense for us.

If they felt differently, they would probably choose another option. Remember, small businesses that can qualify for a million dollars are usually your businesses that have been around for a while, have a good track record, have more capacity and, because of that, have more options.

Chair SNOWE. Well, I know one of the witnesses in the second panel would say on, for example, the 504 program, that it raised about $300 million in excess fees.

Mr. BARRETO. Well, the 504 program, we are very happy and excited with the progress in that program. We have had a banner 2 years.

You remember that a couple of years ago, we were doing about $2.5 billion in those loans. Last year, we did $5 billion. We may surpass $5 billion this year. We have budget authority next year for $7.5 billion. That program is up 30 percent this year.

I mean——

Chair SNOWE. Why do we need to raise additional fees in the 504 then?

Mr. BARRETO. Again, what I think has happened——

Chair SNOWE. If they are already very successful and obviously raising $300 million more——

Mr. BARRETO. Remember what we said is that what we are doing here is offsetting the cost of being able to provide this great program slightly on the administrative side. It is not going to be anything that is going to affect the zero subsidy. One of the reasons that we feel that that program and the 7(a) program are successful is simply because we can offer it at a zero subsidy.

Chair SNOWE. The same is true with respect to the SBA's proposal to increase interest rates for disaster loans. Here again, we are changing the requirements for disaster loans. Instead of having a fixed rate over the 8-year period, whatever, they are now going to cap it after the first 5 years.

This is going to create some serious problems for people who are at a very vulnerable stage in their lives and requiring disaster loans. Why are we changing their provisions?

Mr. BARRETO. Well, the primary reason that we are doing that is because—and this is not something that we have control over. Interest rates have been going up over the last couple of years. We have all seen it, and people that are refinancing their properties have seen it. The interest rates have gone up.

That interest rate increase has created a $41 million deficit for the SBA. For us not to offer some kind of a solution, and I am not saying that this is a popular solution. What we basically have done is we have tried to again balance this. We have said, "Look, for the first 5 years of a disaster, those are the critical years, we are going to continue to subsidize that interest rate, deep subsidy."

After 5 years, after people are back on their feet, businesses are going well again—values have started to come back—what we would like to propose is that that interest rate track a Treasury instrument which will still be below market rates.

One of the things that we found out when we went back and looked at our disaster loan portfolio is that we, right now, have a pretty good number of people that prepay their loans in those first 5 years. Something like 25 percent of borrowers prepay those loans.

Chair SNOWE. In the first 5 years?

Mr. BARRETO. During the first 5 years.

Chair SNOWE. How many use the 8 percent or the 4 percent? How many in each of those categories?

Mr. BARRETO. Well, most of those loans are at the 4 percent. We have very few of those loans that really go into that higher interest rate because of the credit elsewhere test. Most of the loans, like 90-plus percent of the loans, are in that lower interest rate.

The reason that we are proposing this is, again, we know and we have to be responsible, especially when we are in front of this Committee, is to tell you what our reality is. Our reality is, is that we are dealing with higher interest rates the way that everybody else is. That the net effect of those interest rates will be a $41 million gap.

The way that we propose to offset that is to present this proposal to allow interest rates after 5 years, after those first critical 5 years, to trend up with Treasury instruments, which, again, will be below market interest rates. It will still be a better situation than they could have gotten on their own, if they could even get a loan from——

Chair SNOWE. Well, what are you estimating that the Treasury rates will be at that point, do you know? What will you get, if you say it is going to be much below. Obviously, you have a basis for making that statement.

Mr. BARRETO. Well, I am saying that, as you know, interest rates go up and down. It could be lower than what we see today.

Chair SNOWE. Well, I know. But what are you estimating? Obviously, you would surmise that it is going to do better. I would assume that that is true generally. It may well do better, I don't know. How would you know, based on the 8 percent or the 4 percent currently?

Mr. BARRETO. Remember, it is going to track with a U.S. Treasury instrument, which is always going to be lower than what a market interest rate is going to be because the market interest rate will add on the fees and the profit that private lenders have to earn.

It will still be lower than what we are going to be seeing. The private sector is not going to make loans less than what the Treasury rate is.

Chair SNOWE. You are incorporating another element of risk in that point for people who are very vulnerable. You know, economically. They are already facing significant challenges. They have lost a lot, and now having to take out an additional loan. They have already had losses. Perhaps their insurance doesn't cover all of those losses.

Now getting out to an additional loan. Now after that 5 years, you are saying, "Well, it is going to leave it open to the market," really, basically what the Treasury is——

Mr. BARRETO. It will track up to a Treasury instrument.

Chair SNOWE. It is just, OK, you are incurring something. Whether or not you decide you are going to have a variable interest rate on your mortgage or have a fixed rate. It is that whole uncertainty that you can't predict, especially for those disaster victims.

We are not talking about just in general. We are talking about people who have already been exposed financially and are taking on additional debt, who may have incurred other debt, and that way they can't be repaid through insurance. It is a combination of things.

Mr. BARRETO. One of the items that will mitigate some of that uncertainty is the fact that at closing, they will know what that Treasury rate is going to be. In other words, they will be able to make their decision knowing what that interest rate would be after that 5 years.

As we have already said, the Treasury rate is always going to be below the market interest rate. Again, we see this for any disaster. We have a lot of people, even to this day, saying, "I don't want a loan. I already got a loan. I don't want a loan."

If the only chance that I have for rebuilding my home or my business is a long-term disaster loan from the SBA, then I at least want it to be better than what I could get in the private market, if I could get it in the private market. This will still accomplish that.

Chair SNOWE. OK. Finally, on the micro loans. My last question is I notice its the third consecutive year the SBA administration has proposed eliminating the Micro Loan Program. It has been extremely valuable to my State, but I know in other parts of the country as well.

It is hard for me to understand because these are the startups that most certainly need to depend upon this type of program that has proven to be very effective and valuable. What is the problem with it?

Mr. BARRETO. There is no problem. Micro loans, as I go around the country and talk to people, the whole concept of micro loans, doing smaller loans. Helping startup businesses. Helping the emerging markets. People are very, very passionate about that, as I am.

I think that we never say and we don't say here that micro loans are unimportant, that we shouldn't have micro loans, that people, those folks that are in those communities don't deserve to have these kinds of micro credits. We agree with that 100 percent.

What we are saying, and maybe we are not saying it very well. Obviously, I haven't said it very well the last 3 years, and I am not confident that I will be able to say it any better here. The SBA's Micro Loan Program is a very small program that touches very few small businesses.

I am not saying that the small businesses that it touches in Maine, in rural communities, and places around the country aren't important. They are important. For us, it is a little over 2,000 of those loans every single year.

What I am saying is that SBA has gone through a radical transformation over those 4 years. We now do 60,000 small loans, small loans like those micro loans, under $35,000. We do them in our flagship loan program. We do them in the 7(a) portfolio. A third of those loans go to minorities. Many of those loans go to women, and they go all around this country.

What we have also said is that we know that SBA now is not the only provider of a Micro Loan Program. We know because we have investigated. There are 400 private sector micro lenders spread across the United States who offer micro loans much less expensively than the SBA program.

We have also said that we don't feel that we are as effective or as cost efficient as we should be on that program because that program literally costs us about a dollar for every dollar that we loan out.

What we have said is micro loans are important. There are a lot of micro lending going on there. SBA does small loans now where it never used to. When I first joined the SBA, the average size SBA loan was almost a quarter of a million dollars. Average size loan now is about mid-150's. The reason for that is that so many more of those small loans happen.

Sixty percent of the SBA portfolio now is in the SBA Express Program. The SBA Express Program was a pilot program who never had that kind of traction. I want to be clear that I am not saying that micro loans are bad. I think micro loans are good. I am just saying that SBA's Micro Loan Program really doesn't have the reach or the breadth that it would need to to be an effective national program.

I know that this Committee has disagreed with that, and we respect this Committee's decision over the last couple of years. We continue to implement the Micro Loan Program. If Congress decides that we will implement this program next year, we will. We shall.

Chair SNOWE. Well, I appreciate that because, obviously, there is a lot of support, including I think many Members of this Committee, most certainly. In fact, it has demonstrated its effectiveness and success. I know I can speak in Maine, where more than 90 loans have been made. Otherwise, companies who have no previous history cannot have access to this type of financing, and they have been very successful.

We want to encourage startup entrepreneurs. We will obviously proceed, and hopefully, we can work with you. I think that there is no question it will be restored in the reauthorization. I appreciate it.

Well, thank you, Mr. Barreto. Thank you again for your service.

Mr. BARRETO. Thank you very much, Chairman Snowe.

Chair SNOWE. Thank you.

Mr. BARRETO. I want you to know that I will always remain committed to the small business community, and if there is ever anything that I can do for you or for this Committee, it would be my honor.

Thank you very much for the opportunity to serve.

Chair SNOWE. Well, thank you. No, thank you. Thank you for your service, and we wish you well in the future.

Thank you. We applaud your leadership. Thank you.

OK. The second panel will begin with Harry Alford. Mr. Alford is the present chief executive officer of the National Black Chamber of Commerce, a nonprofit, nonpartisan organization dedicated to the economic empowerment of African-American communities.

Secondly, we have Jim Baird from the Bay Area Development Company. Bay Area specializes in providing 504 financing to small and mid-sized companies throughout northern California.

Next is Jim Maxwell, the manager of Granite State Economic Development Company/New England Small Business Finance, which is a certified development company. It is one of the fastest-growing certified development companies. It has played a leading role in doubling SBA 504 loan assistance to Maine small businesses.

Mark Morrissette, who will testify on behalf of North Atlantic Capital, an SBIC in Maine. Mr. Morrissette's capacity is managing director. He works to identify promising small businesses in which to invest in order to help them grow and prosper.

We welcome each and every one of you. If you can summarize your statements in 5 minutes, and I know there may be some votes at 12 o'clock or so. We will proceed and get to questions.

Thank you very much for being here and for your patience today.

Mr. Alford, we will begin with you. Thank you.

STATEMENT OF HARRY C. ALFORD, PRESIDENT AND CEO, THE NATIONAL BLACK CHAMBER OF COMMERCE

Mr. ALFORD. Madam Chair, Mr. Ranking Member, and other distinguished Members of the Senate Committee on Small Business and Entrepreneurship, thank you for inviting the National Black Chamber of Commerce to speak before you today regarding the reauthorization of the Small Business Administration credit and counseling programs.

We are faced with challenges in this global economy, and it must be emphasized that small business will continue to be the life blood for economic growth and job creation within this great Nation of ours.

According to records for SBA lending comparing fiscal year 2001 to fiscal year 2005, African-American participation has not been growing at any appreciable rate. The share of 7(a) loans remained constant at 3 percent. 504 loans were also constant at 2 percent, while the number of micro loans fell from 21 percent to 18 percent.

In terms of dollar volume, 7(a) loans rose from 4 percent to 7 percent. 504 loans remained constant at 2 percent, while micro loans fell from 29 percent to 21 percent. As the black population in this Nation is 13 percent, the participation levels for the 7(a) and 504 programs are, frankly, anemic.

With the "low doc" program being canceled, the future growth for these programs is suspect, and that should give us all cause for concern.

According to the U.S. Census Bureau, the number of African-American businesses between 1997 and 2002 grew at a rate of 45 percent in numbers and 23 percent in volume. This is the fastest-growing segment in the Nation. The demand for capital access in the African-American community is going to surge, and it is important that the SBA vehicles for capital access gain in exposure and utilization within the targeted community.

We are excited that this Committee has generated some bills to address the above predicament. S. 2595 improves the SBA 504 loan program. One aspect is increasing the lending limits for businesses that are owned by veterans, minorities, and women.

In this global economy, our Members are growing and meeting a new and broader customer base, which means more equipment, infrastructure, et cetera. We encourage the entire Senate to support this legislation.

Another key bill coming out of the Committee is S. 2594, which improves the 7(a) lending program. One key component is the establishment of the Office of Minority Small Business Development in the SBA with an annual budget and requirements to monitor the outcome of SBA's programs and ensure the SBA's State offices have money to market to minorities.

While this has relevance to the lending side of the SBA, it is established to address the need in all of SBA's programs—i.e., credit, counseling, and contracting—to reach more minorities. This office needs this broader jurisdiction, funding to back it, and more access and autonomy than the current minority offices at the SBA that focus on contracting.

The timing of S. 2594 is appropriate as African-American businesses grow at record numbers and are creating a great demand for more counseling as well as lending possibilities.

We are very pleased that our Nation's business schools are starting to understand the need to teach entrepreneurship as opposed to readying students for the corporate world. Business schools, such as that of Syracuse University, require students to form an active business as a requirement for graduation.

Historically Black Colleges and Universities have recognized the importance of entrepreneurship also. This is why the NBCC is quite excited about S. 2586, or the Minority Entrepreneurship and Innovation Pilot Program. This program is relevant to counseling and entrepreneurial development. It will fund HBCUs and other minority-populated institutions up to $1 million each for 2 years to establish entrepreneur development programs, and there will be 24 awards granted.

If this bill becomes legislation, we will partner with various institutions and compete for these grants. We could create a strong resource pool for business incubation and equip our future leaders with skill sets that ready them for this very competitive world. Such new entrepreneurs will become job creators with their innovation and acumen.

The number of field workers, boots on the ground, for the SBA has been greatly reduced over the years. When the Federal marketplace was nearly half the size it is now, there were 73 procurement center representatives. Today, there are only 58. Likewise, the number of commercial marketing representatives has been decreased to only 34.

We need more of these representatives to provide more counseling to the fast-growing number of our businesses. Also we need more representatives who provide full-time service, not the sharing of additional duties. In essence, it is imperative that we have a very strong SBA and equipped to provide the demands of a fast-growing small business population.

In sum, we support all of these efforts that will enhance the opportunities for lending and counseling. Our Nation is enjoying appreciable growth in small business creation, and that growth must be met with programs that will ensure development through improving skill sets and providing "fuel," i.e., capital, for entrepreneurs.

Thank you, Madam.

[The prepared statement of Mr. Alford follows:]

CONGRESSIONAL TESTIMONY

APRIL 26, 2006

Presented to:

United States Senate

Committee on Small Business & Entrepreneurship

Honorable Olympia J. Snowe, Chair
Honorable John F. Kerry, Ranking Member

Presented by:

Harry C. Alford
President/CEO
National Black Chamber of Commerce, Inc.

1350 Connecticut Ave. NW, Suite 405
Washington, DC 20036

Harry C. Alford
President/CEO
National Black Chamber of Commerce, Inc.

Madame Chair, Mr. Ranking Member and other distinguished members of the Senate Committee on Small Business & Entrepreneurship thank you for inviting the National Black Chamber of Commerce to speak before you today regarding the Reauthorization of the Small Business Administration credit and counseling programs. We are faced with challenges in this global economy and it must be emphasized that small business will continue to be the lifeblood for economic growth and job creation within this great nation of ours.

According to records for SBA lending comparing Fiscal Year 01 to Fiscal Year 05, African American participation has not been growing at any appreciable rate. The share of 7a loans remained constant at 3%. 504 loans were also constant at 2% while the number of Micro loans fell from 21% to 18%. In terms of dollar volume, 7a loans rose from 4% to 7%. 504 loans remained constant at 2%. While Micro loans fell from 29% to 21%. As the Black population in this nation is 13% the participation levels for the 7a and 504 programs are frankly anemic. With the "Low Doc" program being cancelled the future growth for these programs is suspect and that should give us all cause for concern.

According to the US Census Bureau, the number of African American businesses between 1997 and 2002 grew at a rate of 45% in numbers and 23% in dollar volume. This is the fastest growing segment in the nation. The demand for capital access in the African American community is going to surge and it is important that the SBA vehicles for capital access gain in exposure and utilization within this targeted community.

We are excited that this Committee has generated some bills to address the above predicament. S.2595 improves the SBA 504 loan program. One aspect is increasing the lending limits for businesses that are owned by veterans, minorities and women. In this global economy our members are growing and meeting a new and broader customer base which means more equipment, infrastructure, etc. We encourage the entire Senate to support this legislation.

Another key bill coming out of this Committee is S.2594, which improves the 7a lending program. One key component is the establishment of an Office of Minority Small Business Development in the SBA with an annual budget and requirements to monitor the outcome of SBA's programs and ensure the SBA's state offices have money to market to minorities. While this office has relevance to the lending side of the SBA, it is established to address the need in all of SBA's programs, i.e. credit, counseling and contracting – to reach more minorities. This office needs this broader jurisdiction, funding to back it and more access and autonomy than the current minority offices at the SBA that focus on contracting. The timing for S.2594 is appropriate as African American businesses grow at record numbers and are creating a great demand for more consulting as well as lending possibilities.

We are very pleased that our nation's business schools are starting to understand the need to teach entrepreneurship as opposed to readying students for the corporate world. Business schools such as that of Syracuse University require students to form an active business as a requirement for graduation. Historically Black Colleges and Universities have recognized the importance of entrepreneurship also. This is why the NBCC is quite excited about S.2586, or the "Minority Entrepreneurship and Innovation Pilot Program". This program is relevant to counseling and entrepreneurial development. It will fund HBCU's and other minority populated institutions up to $1 million each for two years to establish entrepreneur development programs and there will be 24 awards granted.

If this bill becomes legislation we will partner with various institutions and compete for these grants. We could create a strong resource pool for business incubation and equip our future leaders with skill sets that ready them for this very competitive world. Such new entrepreneurs will become job creators with their innovation and acumen.

The number of field workers (boots on the ground) for the SBA has been greatly reduced over the years. When the federal marketplace was nearly half the size as it is now, there were 73 Procurement Center Representatives. Today there are only 58. Likewise, the number of Commercial Marketing Representatives has been decreased to only 34. We need more of these representatives to provide more counseling to the fast growing number of our businesses. Also, we need more representatives who provide full time service not the sharing of additional duties. In essence, it is imperative that we have a very strong SBA ready and equipped to provide the demands of a fast growing small business population.

In sum, we support all efforts that will enhance the opportunities for lending and counseling. Our nation is enjoying appreciable growth in small business creation and that growth must be met with programs that will ensure development through improving skill sets and providing "fuel", i.e. capital for our entrepreneurs. We have recognized three bills coming out of your committee and pledge full support in your efforts to make these bills become reality. Any other bills that complement the aforementioned or will create other avenues for lending opportunities and provide needed counseling to our new businesses will, likewise, be supported by the NBCC. This great nation can survive by way of a strong economy. The past has shown us that the key component to a strong economy is small business growth. Your task is vital to us all and we pray that you are successful.

Thank you for this opportunity to come before you today. We have 160 chapters throughout this nation and please consider each and every one a resource for your constituents and a valuable asset to your communities. Also, we can make contact with over 100,000 business owners within 3 hours. We have great challenges such as energy prices and the enormous rebuilding tasks in the Gulf Region. Together, we can meet these challenges and prevail.

Chair SNOWE. Thank you, Mr. Alford.
Mr. Baird.

STATEMENT OF JAMES BAIRD, EXECUTIVE DIRECTOR AND CEO, BAY AREA DEVELOPMENT COMPANY, WALNUT CREEK, CALIFORNIA

Mr. BAIRD. Thank you.

Good morning. I am Jim Baird, the executive director of the Bay Area Development Company from the San Francisco Bay area. As one of the original CDCs in the 504 program, I am here to represent our CDC and to provide the perspective of an experienced CDC operating out in the field.

I would like to thank the Chair and the Committee for giving me the opportunity to provide my remarks on the SBA 504 program. Moreover, I would personally like to thank the leadership of this Committee for continually and steadfastly championing small business issues, including those of the 504 program, and for introducing legislation that, for the first time in 25 years, would define in statute the specific legislative framework as to how our industry should best be structured and best operate.

Bay Area Development Company was founded in 1981. In the last 25 years, we have provided assistance to over 1,100 entrepreneurs, representing SBA 504 funds of over $600 million, which is leveraged to over $1.8 billion in total private sector funds and investment. That activity has resulted in our clients creating over 12,000 jobs during that period of time.

In addition to our 504 economic development activities, in the last 5 years, our CDC has provided our communities with well over a quarter of a million dollars of economic development, sponsorships, and grants to a host of community development organizations. We also donate hundreds of hours each year serving on the boards and advising and assisting those organizations.

The SBA 504 program is operating in an environment of great change, including the introduction of universal statewide and multi-state competition and nationwide centralized processing of 504 loans.

The question has been asked is, is change good or bad for the 504 program? My opinion is that, to date, change has been very good.

The year-to-year growth in the 2.5 years since these changes were first implemented are between 20 percent and 30 percent in numbers of loans and dollars of program assistance, and that I believe it is developing 504 capacity in areas that are historically underserved, including regions and States that are now beginning to develop 504 capacity that didn't previously have it. The initial results, in short, are more loans for more businesses in more communities.

The change also has potential pitfalls. We need to be aware that it could cause CDCs to do badly structured projects, which would result in higher losses and higher rates for businesses. It could cause CDCs to neglect their economic development responsibilities.

Also we need to keep in mind the challenges of growth and success, and this includes the need to continue to maintain adequate staffing of the centralized processing and servicing centers so that we will have a workable turnaround time for our loan applicants, so that we can maximize recoveries on SBA defaulted loans, and in order for the SBA to have the resources to oversee a substantially larger program.

There have been issues raised about CDCs as nonprofits, and there are several points I would like to make on this as I believe that CDCs and their nonprofit role is not well or widely understood.

Basically, as nonprofit corporations, CDCs are mission driven, and this is critical to the role of CDCs in three different ways. The first is that, as nonprofit corporations, we are able to provide 504 at an extraordinarily low cost to the Nation's small businesses.

The second is that CDCs play a critical role in balancing the interests of the small businesses, the Small Business Administration, and the community on each and every project. CDCs' boards, staff, loan committees, et cetera, all serve to provide the internal guidance and local knowledge and input that is necessary to operate in this manner. This is absolutely critical to the success of the 504 program, and my question would be if CDCs, as nonprofits, didn't do that, who could?

The third point is that CDCs, as I mentioned before, significantly re-invest in their communities as set forth by the SBA and by Congress. It is basically the combination of these three major characteristics—being low-cost service providers; as being able to effectively balance the interests of small businesses, the SBA, and the local community needs; and in implementing significant non-504 economic development—that represents the true hidden value of CDCs.

With that, I will conclude my remarks and, again, would just like to thank you for the honor of being able to testify before you. I hope that we are able to work closely together in the furtherment of your legislative package.

[The prepared statement of Mr. Baird follows:]

STATEMENT

by

Bay Area Development Company

on

The Small Business Administration

504 Loan Guaranty Program, Reauthorization & Other Program Issues

Submitted to the

COMMITTEE ON SMALL BUSINESS & ENTREPRENURSHIP UNITED STATES SENATE

by

Mr. James Baird
Executive Director & CEO
Bay Area Development Company
Walnut Creek, California
April 26, 2006

I am Jim Baird, Executive Director of Bay Area Development Company of Walnut Creek, California. As one of the original CDCs in the program, I am here to represent our CDC and to provide the perspective of an experienced CDC operating in the field.

I would like to thank Chairperson Snowe, Ranking Minority Member Kerry and the entire Committee for giving me the opportunity to provide remarks on the SBA's 504 program to the Senate Small Business & Entrepreneurship Committee. Moreover, I would like to personally thank the leadership and the committee for steadfastly championing small business issues, including those of the 504 program, and for introducing legislation that, for the 1st time in 25 years would define in statute the specific legislative framework as to how the our industry should be best structured and how the 504 program best operate.

Bay Area Development Company was founded in 1981 and operates in Northern California with a focus on the greater San Francisco Bay Area. In its 25 years of operation, our CDC has provided over $600 million of 504 financing to over 1,100 companies resulting in over $1.8 Billion in total direct investment and in the creation and retention of over 12,000 jobs.

In addition to our 504 economic development activities, in the last four years, our CDC has provided our communities with over $240,000 of economic development sponsorships and community development grants, and we donate hundreds of hours each year serving on boards for organizations as diverse as The East Bay Leadership Foundation, Oakland Children's Hospital, The Alameda County SBDC, and the California Environmental Redevelopment Fund. A copy of our CDC's FY2005 Annual Report has been provided along with my testimony.

504 in an Environment of Change

Our industry is operating in an environment of great change. In addition to significant changes in the economy, in the lending environment, and in interest rates, over the last 2 years, every CDC in the 504 industry has experienced the implementation of universal statewide, and multi-state competition, and the advent of nationwide centralized processing of all 504 loan originations.

I thank the Leadership, Members and staff of the Committee for recognizing the implications of these significant changes, and the resultant need to provide a more definitive legislative framework for the optimal implementation and growth of the CDC industry and the 504 program for the long term benefit of America's small businesses and communities.

Is Change Good or Bad for 504?

To date, the recent changes in 504 have been very good for our industry in general. It has created a significant surge in 504 volume and has resulted in regions and entire states that had been historically underserved by 504to begin to develop 504 capacity. Nationally 504 loan volume has increased by an average of about 20% in numbers of loans and 30% in $ of loans per year from FY 2002 thru FY 2005. Results for the current fiscal year indicate continuing substantial growth, in short: more loans for more small businesses, and more economic development for our communities.

Change has been good for the 504 program, but it also has its pitfalls. For example, significantly increased competition could cause some CDCs to do inappropriately structured lending which would result in higher losses and ultimately higher interest rates for our borrowers. Increased competition may cause some CDCs to neglect their responsibilities as local economic development organizations or could cause some CDCs to focus only on the largest potential markets, to the disbenefit of underserved small businesses in rural America or urban core areas.

There are also the challenges that program growth and success bring, including a need to insure that the centralized processing and servicing centers have adequate staff to produce workable turnaround times for small business applicants, to maximize recoveries on defaulted loans, and insuring that the Agency has adequate resources to effectively oversee a substantially larger program.

Given the issues above, it is my hope that the legislation that the committee is currently working on will move forward and will result in maximizing the effectiveness of both the CDC industry and the 504 program in the communities we serve.

The Value of CDCs as Non-Profit Economic Development Lenders

As non-profit economic development lenders, CDCs provide unique benefits to small businesses, to the SBA and the communities we serve that are not always understood or appreciated.

While for-profit lenders have a responsibility to maximize return to their shareholders, CDCs have a responsibility to maximize return to small businesses and the communities we serve. This mission driven versus profit driven approach has resulted in substantial value to the economic development of our communities over the last several decades.

There are several areas where this added value is often overlooked that are critical to a non-profit CDC's role in providing economic development through the SBA 504 program.

1. **CDCs, as non-profits, are able to provide the 504 and other programs at an extraordinarily low cost to the nations small businesses.**
The non-profit structure of CDCs allows us to deliver the 504 at a cost significantly lower than those that would be required by for-profit SBA lenders. For example, it has been estimated that on a comparable $1 million small business real estate financing, a CDC makes total fee income of less than 1/5th of what a for-profit lender requires. The beneficiaries of this low cost are the small businesses we assist and the communities that benefit from their growth in terms of jobs and investment.

2. As organizations created and primarily regulated by the SBA, non-profit CDCs play a critical role in **balancing the interests of Small Businesses, the SBA and the Community** on every transaction undertaken. CDCs are required by SBA to have an active and knowledgeable staff, board of directors and loan committee to insure that the CDC has appropriate internal guidance and controls and local knowledge, to operate proactively, but also responsibly. CDCs are not disinterested third parties, but partners to the SBA in all their programs, providing support and expertise that represent an important component of the SBA infrastructure at the local and regional level.

3. Also very important is that, as non-profits, **CDCs reinvest in their communities in order to fully meet the economic development mission that Congress and the SBA have charged them with**. Clearly, the top economic development priority of most CDC is making 504 loans in a proactive and professional manner to diverse populations throughout all areas of each CDC's market. However, CDCs must also ensure that their resources and expertise are available and utilized by the communities they serve based on each community's distinct needs. This is often accomplished by implementing non-504 economic and community development activities in all of the regions or states in which they are active 504 lenders.

Although CDCs have many other jobs to do in implementing 504, my opinion is that **it is the combination of these three critical roles** as: 1) A lowest cost service provider; 2) An intermediary that can successfully balance the interests of small businesses and the SBA; and 3) Commitment to a significant economic development mission, **that together represent the hidden value of the CDC of the CDC industry that is not realized or accounted for, and that demonstrates the incredible return provided by these mission-driven organizations.**

Other Program and Industry Issues
In addition to the issues above, I would like to submit comments on the following overall program and industry issues:

A. SBA's proposed 504 authorization for FY 2007

The Administration proposes an authorization ceiling of $7.5 billion for FY 2007, which is the same as the current FY 2006 ceiling. With 504 program demand by small businesses growing at a rate of over 30% year-to-date, our industry believes we will end this fiscal year with usage at almost $7.0 billion.

We expect 504 program demand to continue at a high level well into FY 2007 as CDCs and banks team-up to use 504 to offer their clients the best financing for their needs. However, the Administration request would provide only about 7% growth. I believe this to be insufficient to meet expected demand for this loan program.

As the Committee knows, the 504 program has been at "zero subsidy" since 1997. This means that there is no cost or appropriation to the taxpayer for the program. It is fully paid for by user and lender fees. In fact, budget information provided by SBA reveals that the 504 program has actually provided excess fees paid into the U. S. Treasury over about $300 million since going off budget in FY 1997.

Given this, I urge the Committee to increase the loan authority for FY 2007 to ensure that small businesses are not turned away from SBA or 504. Our industry suggests $8.5 billion in loan authority, which is $1 billion more than the Administration proposed budget.

B. The Proposed New Loan Fees

The Administration proposes that a completely new user fee be added to the 504 program, and to the two other largest financing programs of the Agency for FY 2007. The fee would be levied on all 504 loans that exceed $1 million, which SBA estimates would impact at least 15% of our program's borrowers. The fee would is projected to be 11 basis points of the guaranteed 504 second mortgage loan amount, according to SBA sources. While not specified who would pay this fee, we believe that the small business borrowers would absorb its cost through either cash payments to SBA or increased fee costs for their loans.

Our industry has two concerns about this fee proposal:

First, it will be a new burden on thousands of small businesses that will increase the cost of their loans in both the 504 and 7a programs. It will likely dampen demand for 504 and possibly 7a loans, and thus decrease the availability of capital and job creation for many small businesses.

Second, such a new fee opens the door to unlimited increases in this revenue to SBA. It could lead to substantial growth in fees to cover all sorts of new agency expenditures. It could lead to the entire loan administration process being "off budget", and therefore it may no longer under the full and necessary oversight of Congress. As a result, our industry and I urge the Committee reject this new fee.

C. Loan Defaults and Liquidation

504 is a loan guarantee program for which the primary operating costs are the losses incurred from any defaulted loans. However, with all projected loan losses covered by fees paid by the small business borrower, our first mortgage lender, and by CDCs, the program already operates at a "zero subsidy.

SBA has recently spent considerable time and resources dealing with the 7(a) program loan defaults, and created a centralized liquidation center in Herndon, Virginia, solely for the processing of 7(a) defaults. While we applaud those efforts, unfortunately, they haven't been matched or even approached, as it relates to 504 liquidation support.

The long awaited SBA regulation on 504 liquidation was recently published for public and industry comments. In the proposed regulation, SBA rejected a recommendation by our industry to make participation in the liquidation of its defaulted loans mandatory for all CDCs. We believe that it is critical to maximize CDC participation in the liquidation process in order to maximize Agency recoveries, particularly in view of the huge across the board staffing cuts at the SBA District Offices, that previously handled liquidations.

In addition, our industry has not been able to obtain current data on the status of loan defaults for the past three years. This level of totally unnecessary secrecy could undermine all of Congress's long term work to create and improve this program, and our industry's work with the Agency to make so many program improvements over the 504 program's 25 year history.

Failure to improve the liquidation and recovery efforts for 504 defaulted loans will result in totally unnecessary increased fees for future 504 small business borrowers for years to come.

For these reasons, I ask the Committee to pass the provisions of both Senator Snowe's and Senator Kerry's bills that require SBA to make needed changes to its proposed liquidation regulation.

Conclusion

Through 504, SBA provides the largest and most successful dedicated economic development program the Federal government has today. Its real value to America is significant, and far beyond the statistics of numbers and dollars of lending done each year. The jobs and community development 504 creates and the business growth it fosters, benefits employees, business owners, their communities, and government at all levels.

Our industry would be honored to be able to continue working with the Committee to complete a comprehensive 504 bill that will make the program more attractive to and less costly to our small business borrowers.

I hope that the committee to continue their work in them, and believe that passage by the Senate, and then their adoption into the law of the land will insure that 504 will be able to accomplish so much more, now and well into the future. .

Again, I thank the Leadership, Committee Members and Committee staff for its tireless work in support of SBA and the 504 program and look forward to another successful year of creating more jobs and assisting in the community development of our Nation.

Chair SNOWE. Thank you, Mr. Baird. Appreciate that.
Mr. Maxwell, welcome.

STATEMENT OF JAMES A. MAXWELL, 504 STATEMENT MANAGER, GRANITE STATE ECONOMIC DEVELOPMENT CORPORATION/NEW ENGLAND BUSINESS FINANCE

Mr. MAXWELL. Madame Chair, thank you for inviting me today to talk about the 504 program.

My name is Jim Maxwell. I have been a hands-on 503/504 practitioner for 25 years, starting in 1981 with the city of St. Louis. I have been active in CDC management and underwriting, loan processing, credit underwriting for that period of time.

I am currently the State 504 manager for Maine. The Granite State Certified Development Company/New England Business Finance, which came in as a local expansion area, local economic area in 2003, and it went statewide in 2004. Has now become one of the region's fastest-growing certified development companies.

After being started in 1982, Granite State Development Corporation expanded statewide in New Hampshire in 1987, and again, we became statewide in Maine in 2004. We are now in seven counties in the State of Massachusetts as a local expansion area.

We have assisted 1,700 companies, providing about $600 million of SBA 504 financing and leveraging that with about $975 million of bank participation. On a per capita basis, we are the highest per capita lender in the SBA 504 program in the Nation.

We are a rural area. Most of the towns that we deal with are 5,000 people or less. Our debenture size is probably on the smaller end of the portfolio, and we have a currency rate of about 96.5 percent. We are, at this point with the expansions, doing about one of every three deals in the New England region.

Our mission has been and we are responsible for this delivery of this very powerful program. The program came about by the formation of local development companies under the Small Business Act, and we believe that not only in the spirit and practice, we perform that duty every day. We talk to bankers, small businesses, chambers of commerce. We are there. We are kissing babies. We are doing everything that we have to do to get out there and talk to people about what needs to be done.

As you know in the State of Maine, you can wake up in the morning to have a meeting. You can drive 8 hours and still not be there. As I was telling your staff before, I could have driven to Washington faster than I could have gone to Presque Isle from where I live.

We are local, and our deals are smaller. Our companies are smaller. The needs of our companies are terrific, but we still need access to financing, and we get out and do that on a regular basis.

I would just concur with what Jim had to say about the size of the program. I think we are doing a great job. I think that the changes with centralized processing have been terrific. It is a standardized program, a national program. We know what we are doing when we get there. They know what they are doing when they get our package. The turnaround time has been great.

I think another important strategy has been the creation of local economic areas and multi-state expansions. I think that bringing expertise into areas, especially areas in our part of the country where it is very rural. When I was with the city of Boston, I could walk 5 minutes and make all the loans I wanted to. Now I have to drive 3, 4, and 5 hours. We deliver those into those States that are underserved.

I will say that there are a number of things in your legislation that I consider to be very positive. I think the legislation that includes liquidation, finally bringing that down to the CDC level is a great thing. We have more control. I think we will have a higher recovery.

I think that assistance to low-income areas is a public policy goal. We have had that in the State of Maine every day, every week. I know I was talking last week about one of the mills had closed. We create low-income areas when mills close, and we need to find ways to help those companies.

I like the combination of the 504 and the 7(a) because some companies start with a 7(a), and then they need money to build or buy a facility. If they are maxed out on 7(a) exposure, then we can't help them.

Refinancing I think is a good thing. I think that it can be done reasonably, and I think that it is a positive step to assist companies and also helps our collateral position and helps access funds, more funds at a lower interest rate.

I am against any fees that are unfounded. I think as you were saying earlier today, I think we need to see why we need higher fees. I am against fees.

Use of excess funds in the area. I think your legislation was right on with the proposal. I think it is terrific.

Loan committee participation. It helps make a CDC operate more efficiently. Aggregate accounting is another one of those that just make sense proposals.

Again, I thank you. I am proud to be from the State that you represent, and I will be more than happy to answer any questions.

[The prepared statement of Mr. Maxwell follows:]

Committee on Small Business and Entrepreneurship
United States Senate

"Reauthorization of Small Business Administration Programs"
April 26, 2006

Written Testimony
Of

James A. Maxwell
504 State Manager
Granite State Economic Development Corporation/
New England Business Finance

Introduction

Madame Chair, Ranking Member Kerry, and members of the Committee, thank you for inviting me here today to provide my testimony regarding the Local Development Company Program or, as it is more commonly called, the SBA 504 Loan Program. My name is Jim Maxwell and I have been a hands-on SBA 503/504 Loan Program practitioner since 1981. Over the last 25 years I have been active in Certified Development Company (CDC) management, marketing, loan structuring, credit underwriting and documentation. Currently, I am Maine's 504 State Manager for Granite State Economic Development Corporation which does business as New England Business Finance in Maine and Massachusetts. We are the region's leading SBA 504 Certified Development Company and, currently, the nation's 7th most active 504 lender.

Our Certified Development Company

Granite State was originally certified in 1982 in three New Hampshire counties and then expanded statewide in 1987. In 2003, when positive SBA regulatory changes created Local Economic Areas (LEA) and statewide certifications, Granite State Economic Development Corporation (GSDC) d/b/a as New England Business Finance expanded into Maine. Although our CDC was new to Maine, I had been working with one of the regional development companies and was responsible for more that 80% of the state's 504 Loan production since the early 1990s. At the same time, Granite State received the Small Business Administration's permission to include the northern tier (3 counties) of Massachusetts as a Local Economic Area. Since 2003, Granite State d/b/a New England Business Finance in Maine (a statewide CDC) and Massachusetts (an LEA) have become the region's fastest growing local development company. Earlier this month, Granite State Economic Development Corporation/New England Business Finance received approval from the SBA to expand (through the LEA process) into seven counties in Vermont. As in New Hampshire, we have local offices with professional staffs in Maine and Massachusetts. Within 60 days, we will open a new, professionally staffed Vermont office.

Our 504 Loan Portfolio

Granite State Economic Development Corporation/New England Business Finance, like hundreds of CDCs working on a local, regional or statewide basis, is proud to have assisted thousands of small businesses in accessing the capital they need to expand and create jobs. Since 1982, we have provided loan approvals to 1,738 companies for $608 million in 504 debentures while participating banks have provided an additional $975 million as the first mortgage/first secured lender. Within the next two months Maine's New England Business Finance is on pace to reach the one hundred 504 Loan threshold since certification. On a portfolio-wide basis, Granite State's assisted companies have created and retained approximately 15,000 jobs. On a per capita basis, we have been the most active CDC in the country since 1992 and we continue to be New England's most active 504 lender. Of the 17 active CDCs in New England, Granite State accounts for 30% of the total 504 activity. Our portfolio has a Currency Rate of 96.5% and consists of start-up (4.0%) and existing (96.0%) businesses. Our portfolio companies come from nine major industry groups with the highest sector concentration in Service (26%), Manufacturing (14%), Hospitality (12%) and Professional (11%). Our active loan portfolio includes participation with 35 New England banks. Each month we reach out to dozens of lenders, small businesses and economic development professionals to keep them informed about the benefits of the SBA 504 Loan Program.

Local Development is Working

As with our colleagues at hundreds of CDCs across the country, our mission and responsibility is to deliver this powerful federal financing program to small businesses in our local communities. The Small Business Administration's (SBA's) 504 Loan Program has its roots in the Small Business Investment Act of 1958, a law that authorized the formation of "local development companies" to be "principally composed of and controlled by persons residing... in the locality". Those local development companies were, and still remain, a major catalyst for small businesses needing to access fixed asset financing. In that regard, the local development companies (now called Certified Development Companies or CDCs) have served the law's purpose of bringing together local banks, chambers of commerce representatives and government officials to focus on local community development. Each year, Granite State Economic Development Corporation/New England Business Finance works closely with at least 100 state, county, city and town economic development professionals to accomplish our "community's" goal to assist local businesses and create jobs.

Today, the 504 program is an important mechanism for providing fixed asset financing to the nation's business community. For FYE September 30, 2005 the 504 Loan Program assisted more than 9,000 small businesses by providing approximately $5.1 billion of SBA debenture loans while leveraging at least $6.5 billion in conventional bank loans. In FYE 2005, the 504 Loan Program experienced a 10.1% increase in the number of small businesses loans approved and a 26.5% increase in the amount of debenture funding accessed by expanding companies. Certified Development Companies are now economic development organizations that support growth in regions that range from a single county in one state to a multi-state region. Over the past 25 years our industry has matured and gained the trust of both SBA and Congress to implement and manage a multi-billion dollar industry. Each successive year, the CDC industry has proven that it can adhere to strict ethical and financial regulations while effectively delivering a powerful economic development program to our country's businesses.

Recent SBA Strategies are Working

Since 2003, the SBA has implemented two very important strategies to improve the 504 program. First, the centralization of 504 loan processing in Sacramento, California has standardized the way in which SBA 504 rules and policies are applied nationally. Second, the creation of Local Economic Areas and multi-state areas of operation have allowed CDCs to reach out to its expanded "local" market area as a logical geographic extension of CDC services. Our industry has embraced these SBA strategies as evidenced by positive growth in the number of businesses assisted and the amounted of funding accessed. For example, in fiscal year 2003, the 504 Program provided approximately $3.1 billion in 504 funding to small businesses while in the current fiscal year 504 funding is projected to reach the $6.0 billion level. Over the years, the Certified Development Companies have consistently met the demands for continued loan growth challenge while maintaining ethical and professional management practices. In return, the SBA has bestowed on CDCs more authority to process, approve, close and service small business loans. The CDCs have earned the trust of the SBA, Congress and small business.

Proposed SBA 504 Legislation

If good things come in small packages, then great things come in the legislation proposed by Senator Snowe in S2162. Beyond the increased reauthorized funding levels for 2007 and 2008, the proposed 504 legislation contains language that provides both clarification and enhancement to a number of important components of the regulations. I would like to share with you my position as a SBA 504 Loan Program practitioner on a number of the sections contained within the proposed legislation.

Liquidation

Since the program's inception in 1980, the primary functions of a CDC were to market, underwrite, close and service loans. For a considerable period, delinquent 504 loans were turned over to the SBA for foreclosure and liquidation. As the industry began to mature, many CDCs became increasingly involved in both the workout and liquidation of 504 loans. With the recent introduction of proposed regulations on liquidation by SBA, it is clear that CDCs will be given full liquidation responsibility for their 504 portfolio. I support the transfer of the liquidation function to CDCs and believe our industry will be effective in maximizing loan recoveries. However, I believe it is important to note that this function is often time-consuming, complex and costly. Since most CDCs are non-profit, economic development organizations, their revenue sources and cost structure are not sufficient to cover the added costs of loan workout and liquidation. Furthermore, some in our industry will be on a learning curve and will need the option to contract out this function until such time as they have developed their own in-house expertise.

The proposed legislation, in my opinion, allows for each of these objectives. It allows CDCs directly, or under contract to qualified third parties to perform the foreclosure and liquidation function. The legislation also permits CDCs to be both reimbursed for expenses and compensated for results based on a percentage of the net amount recovered.

Additional Equity Injection

The proposed legislation takes a significant step forward in meeting the spirit of our economic development program while maintaining good underwriting practices. Requiring a higher equity injection for "single purpose" and "new business" loan projects is an accepted credit practice in lending. But using equity funds in excess of required levels to reduce the 504 loan has the effect of limiting the borrower's access to a long-term, fixed rate of interest while maintaining a higher level of first mortgage bank debt. By allowing the borrower to use excess equity funds to reduce the first mortgage lender's loan provides the borrower with a lower, more predictable debt service while improving the SBA's collateral position by reducing the amount of first mortgage debt. The current regulations are confusing to both small businesses and our lending partners.

Low-Income Areas

The inclusion of assistance to small businesses located in "low-income areas" as a Public Policy Goal validates what most program practitioners have been focusing on for decades. When I started with the prior 503 Loan Program in downtown St. Louis in 1981, we used the program to attract businesses back to our city, back into our vacant buildings along the Mississippi River so that our low-income population would have access to jobs and a decent wage. Over the last 25 years, as the location of "low-income" populations has shifted and our economy has changed, so has the need for our 504 Loan Program. Every month in Maine we learn that a major paper mill, clothing manufacturer or other major employer has shutdown or shifted production to another country. Overnight, good paying jobs are gone and a new group of "low-income" Mainers has emerged. Other states and other cities have their own sad job-loss stories. Declaring assistance to businesses located in "low-income areas" as a 504 Program goal sends a clear message to companies and citizens that we are here to help – if, when and where needed.

Goal Combination

Every CDC is mandated to qualify every SBA 504 Loan Program project for eligibility based on the facts associated with the owners, the type of business and the project components. From time-to-time, a worthy small business does not meet either our program's job creation threshold or public policy goals and we are unable to provide assistance. The proposed legislation allowing individuals who, in the aggregate, own at least 51% of the small business applicant and who qualify under one or more of the program's public policy goals will provide more program access for otherwise good and worthy companies.

Maximum 504 and 7(A) Eligibility

Often good companies that have grown with assistance under the 7(A) Program may need a 504 loan to purchase or construct a new facility or to acquire equipment. Under current regulations, once the borrower reaches the maximum eligible funding in one program, it is ineligible to receive assistance from the other SBA program. The result is that many companies are forced to invest scarce working capital into fixed asset expansion projects to overcome the lack of 504 funds available due to fund eligibility restrictions. The effect of the current regulation is an impairment to an otherwise strong borrower. This proposed enhancement in the regulations is one of those "it just makes sense" changes.

Refinancing

One of the only things growing faster than the SBA 504 Loan Program is the cost to construct a new building. In recent years, more CDC applicants are deciding to expand their current building (rather than construct a new facility) and, typically, the mortgage used to acquire the property has an outstanding balance. Under the 7(A) program, refinancing is an eligible project cost as long as there is a 20% "cash flow benefit" (either through increased loan term or reduced interest rate) to the borrower. Under current 504 regulations, refinancing is not an eligible "project cost" although a bank's existing first mortgage can be combined with the bank's new 504 mortgage. In those instances when the bank's existing and new mortgages are combined, the SBA 504 debenture loan is then subordinated to the new combined bank first mortgage. Over the years this has been a good "work around" solution to address the "no refinance" eligibility issue by actually allowing a refinance but without using SBA 504 funds. This practice has been an acceptable solution but it is does not provide the best result. The effect of the current regulation is to "push" the SBA 504 debenture further back on the collateral with no real economic benefit to the borrower. The proposed regulation to allow for the inclusion of an existing mortgage as an eligible project cost (as long as the existing indebtedness does not exceed one-half of the project costs of the expansion) is another "it just makes sense" solution. With the proposed change, the small business can access more funding at a lower fixed interest rate while the SBA reduces the amount of bank debt in front of the debenture on the project collateral.

Fees

Over the years it has been the responsibility of the CDC staffer to deliver the news about our program's "new" fees or "higher" fees and sometimes (but rarely) "lower" fees to our lending partners and our 504 borrowers. In the case of the third party lender participation fee (equal to 0.5% of the bank's first mortgage or secured loan), the CDC has had to change the explanation to lenders and borrowers depending on SBA policy at the time. At first, when lenders could not "pass on" the half point fee to borrower, they would either increase their bank's commitment fee or the interest rate on the loan. When SBA policy changed to allow the bank to charge the borrower for the participation fee, the borrower considered this a "higher" out-of-pocket cost to use the program. Some CDCs, like Granite State Economic Development Corporation/New England Business Finance, decided to pay half of the bank's participation fee as part of its marketing and outreach strategy to attract both lenders and borrowers to the 504 program. The proposed regulation to eliminate the "Participation Fee" and increase the "Development Company Fee" by 0.06% will further reduce the barrier to the program access for banks and borrowers. Since Granite State Economic Development Corporation/New England Business Finance has already been absorbing half of the participation fee at loan closing, the real impact of the fee shift to our CDC is not as dramatic. Historically, any 504 Program regulation or policy change that has reduced cost to the bank or borrower has correspondingly increased loan activity and access to the program.

Use of Excess Funds

Our CDC is a non-profit organization whose mission is to provide access to long-term, fixed interest rate financing for worthy small businesses seeking to expand and create jobs in our local areas. Like most CDCs, our organization is made up of individuals who live in each of the states we serve. The geography of New England allows for an interesting twist on the perception of "local". In the current year, New England Business Finance has processed several 504 loans in Aroostook County (known in Maine as "The County"). "The County" is a 5 to 6 hour drive from Portland, Maine but it is considered and treated as our "local" area. We interact with our "County" bankers, borrowers and other economic development professionals on a weekly, if not a daily, basis. In the amount of time it takes to drive to Aroostook County, I can traverse 4 states to be in New York City, have lunch, and be headed back to Maine. From Maine, I can travel 14 miles south through New Hampshire into Massachusetts in less than an hour. Many Maine residents work in Massachusetts and New Hampshire. Many New Hampshire companies have branches or satellite operations in Maine and Massachusetts. The definition of "local development" gets blurred in the description. Often a company that we assist in New Hampshire or Maine will create jobs for residents from other states that we serve. Historically, our organization has re-invested program-derived funds to improve operations, to fund the logical expansion of our CDC into contiguous "local development" areas and to use state-generated funds to further support local economic development activities in each state that we operate. As a regulated non-profit certified development company we must meet strict non-profit IRS guidelines, prepare Audited Financial Statements for SBA review and meet all SBA regulations. The inclusion of the "Use of Excess Funds" section of the proposed regulations re-affirms what has been the "best" practice of Granite State Development Corporation/New England Business Finance and other CDCs since certification.

Loan Committee Participation

A number of regulations governing the 504 program, some recent and some written more than a generation ago, have constrained program growth. These regulations have discouraged CDCs from providing financing to small businesses by requiring productive CDCs to establish redundant bureaucracies when they cross state lines. The proposed legislation takes a giant step forward by allowing multi-state CDCs to have a single loan committee with required participation by at least one member from the state in which the loan is made. For multi-state CDCs, the consolidation into a single loan committee will allow the CDC to operate more efficiently without diminishing the critical loan review process.

Aggregate Accounting

The old regulations never contemplated that there would be LEAs or multi-state operations. Current multi-state CDC policies have resulted in an inefficient, wasteful utilization of limited CDC resources for the small number of CDCs operating on a multi-state basis. As stated previously in my testimony, both the IRS and the SBA require CDCs to meet strict compliance guidelines and regulations. The proposed regulations allowing for aggregate accounting for multi-state CDCs is substantially more efficient and will not impair the ability of the SBA to provide CDC oversight or to audit 504 Loan Program activities. Again, this is one of those "it just makes sense" enhancements to the regulations.

Closing Observations

Over the last 25 years, I have spent a great deal of time personally and professionally agonizing over what would make this great economic development program even better. Through the intervening years, I have experienced regulations that have been good for the program and those that have presented challenges. The proposed legislation is some of the best, if not the best, work done to date to clarify certain sections of the law while providing enhancements that are timely, efficient and forward looking. Although I have chosen to discuss certain specific sections of the legislation, I support the proposed legislation in its entirety.

Madame Chair, Ranking Member Kerry, and members of the Committee, I want to thank you for allowing me to share my thoughts on this significant legislation that will allow economic development professionals like me to do a better job of helping our clients, America's Small Businesses, in accessing the capital they need to expand and create jobs.

Chair SNOWE. Thank you very much, Jim.

Mr. Morrissette, welcome, too. Thank you.

STATEMENT OF MARK MORRISSETTE, MANAGING DIRECTOR, NORTH ATLANTIC CAPITAL

Mr. MORRISSETTE. Thank you. Thank you very much, Senator Snowe.

It is an honor to be here from Falmouth, Maine, today, and I appreciate the chance to have the opportunity to appear before the Committee to present our views on the issues pertaining to the SBIC program.

The SBIC program has been a major success since its 1958 inception in providing venture financing so critical to growing U.S. small businesses that are not likely to find financing from other sources. As you noted in your opening remarks, the program has been a model for governments around the world.

Today, the SBIC program is at a crossroads. The decisions made by this Committee this year will determine the face of the SBIC program for years to come. The question the Committee must answer is will there be an SBIC program that provides equity capital for early stage and growth financing? My oral testimony will focus on that issue.

The administration says "no" when asked this question. The administration says there is no demonstrated need for an equity program and that it is not aware of any studies on the issue. The administration says the Government guaranteed loan programs, among them the debenture SBIC program, are sufficient to meet all venture capital needs of U.S. small businesses.

That position ignores the 2005 Tuck School of Business at Dartmouth College study on the equity capital gap faced by small businesses. It ignores the 2005 House testimony by Susan Preston, an expert on angel investing, and it ignores the testimony of Daniel O'Connell, the director of the University of Illinois Golder Center for Private Equity.

It ignores the views of the National Venture Capital Association, whose members have no interest in a government program that impedes in their own areas. The only fact that the administration cites is data from a PriceWaterhouseCooper study, saying that there was $9.5 billion of investments made in the years 2003 through 2005 in the $500,000 to $5 million range.

That is the range that is addressed by the Participating Securities SBIC Program. That fact is not offered as a statement for what the market need is. It is just a fact.

If we explore that fact a little further, we find SBIC participating security investments in that range actually totaled $4.1 billion for the same 3-year period. That $4.1 billion is included in the $9.5 billion. It is 43 percent of the investment capital in the target range during the period.

We think it is clear that eliminating 43 percent of the equity financing available to small companies is something that will have a negative impact on the economy and on the creation of jobs. True, certain high-tech companies and certain buzz industries and certain geographies will always attract a certain amount of investment capital. The main street companies, the small manufacturing businesses, the businesses located in diverse geographic areas like Maine all depend on that 43 percent of capital that the administration believes is unnecessary to America's well-being.

Whether the administration is right or wrong is what this Committee must decide. If you decide the administration is right, there is nothing more to do. The Participating Security Program will ramp down quickly over the next few years to zero equity investments.

However, if you decide the administration is wrong, there is work to be done, and we stand ready to help however we can. S. 1923 is a good bill, and NASBIC supports it. The bill rebalances the interests of all stakeholders in the current Participating Securities Program in a manner that will ensure the continuation of the SBIC equity capital investments in U.S. small businesses at no cost to the taxpayers.

I would like to end my testimony by speaking of costs and benefits. The administration continually raises the issues of cost when discussing the Participating Securities Program, claiming that its current negative cash position of approximately $2 billion will end up a program loss when the books are finally closed on the program 7 or 8 years from now.

The fact is we don't know if that is true or not. After all, for the first 6 years of the program, the administration was running a positive cash position in the program. What we do know is that a lot of money was invested by the Participating Securities Program in the 3 years leading up to the market crash and recession of 2000. It is not surprising a lot of that money was lost.

However, the need to support small businesses did not end with the crash. To the contrary, it became more important to the country, as always depending on the small business sector to lead the country out of recession.

In that regard, the Participating Security Program was a shining example. During the critical early recovery years of 2000 to 2003, all venture capital investments fell by 83 percent. The participating securities investments fell by just 23 percent. The Participating Security Program was more active and more effective when small businesses needed it most.

In fact, the $10.8 billion in participating securities investments made since the program's 1994 inception have led to the creation of an estimated 300,000 new jobs and $51 billion in revenue for the small businesses that were financed.

While no one wants to see the SBA lose money—we lose money when they lose money—these gains cited more than offset the current costs. We hope the Committee will focus on these positive facts when considering S. 1923. The mission has not changed, and the need is still there.

We look forward to working with you to make sure the SBIC program continues as a program that makes a very positive difference for growing U.S. small businesses in search of scarce equity capital.

Thank you again.

[The prepared statement of Mr. Morrissette follows:]

NASBIC
America's Small Business Partners

Statement
of
Mark Morrissette

Managing Director
North Atlantic Capital
&
Member of the Board of Governors
of the
National Association
of
Small Business Investment Companies

Before The

United States Senate
Committee on Small Business & Entrepreneurship

April 26, 2006

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Madam Chair, Senator Kerry, and members of the Committee:

I appreciate the opportunity to testify today on behalf of the National Association of Small Business Investment Companies (NASBIC) regarding the Small Business Investment Company (SBIC) program in general and S. 1923 in particular. NASBIC is the professional association dedicated to representing the interests of all licensed SBICs. We hope our views are helpful to the Committee as you consider the issues we will address today.

By way of background, I am the Managing Director of North Atlantic Capital in Portland, ME. I am also a member of the Board of Governors of NASBIC and serve as President of NASBIC's northeast regional association. A more complete statement of my background is attached.

North Atlantic Capital manages two Participating Security SBICs focused on providing equity capital to Northeast businesses that require growth capital in the $2 million to $5 million range. We pride ourselves on our ability to provide unique services to the small business we fund. For example, every year we take all of our CEOs to a leading business school for management and leadership training. In addition, we offer tactical and strategic consulting services to our companies to help them grow to a new level. All of these services are provided free of charge to the small businesses—our objective is to help them grow and prosper. A good example of one of our investments is Diamond Phoenix Corporation of Lewiston, ME, a leader in providing integrated material handling equipment, software, and control technology for order fulfillment systems. We first invested in the company in 1998 and have invested a total of $4.0 million over seven years. I am pleased to say that our investments have been instrumental in helping the company grow to its current size—120 employees—and to weather the recent recession. In just the past year, revenues have nearly doubled, and profitability has soared. Diamond Phoenix has eight offices in eight different states as well as an office in London, England.

By way of background, there are currently 403 active SBICs: 178 Participating Security SBICs (designed to provide equity capital to U.S. small businesses); 128 Debenture SBICs (designed primarily to provide subordinated debt financing to small firms); 72 unleveraged bank SBICs (a subset of SBICs substantially reduced in importance since the passage of the Gramm-Leach-Bliley Act in 1999); and 25 SSBICs (100% minority focused debt providers "grandfathered" under the provisions of the 1996 legislation that closed the program to new licensees). By far the most important SBICs in terms of dollars invested in small businesses are the Participating Security SBICs and the Debenture SBICs. Of the $2.9 billion invested by SBICs in 2,299 small businesses in FY 2005, Participating Security SBICs invested $1.6 billion (55%) and Debenture SBICs invested $1.1 billion (38%). Together they accounted 93% of all dollars invested. Bank SBICs accounted for slightly over 6% of dollars invested and SSBICs accounted for the remaining 1% of the total. Participating Security and Debenture SBICs are on track to invest similar amounts in FY 2006; Bank SBICs and SSBICs will likely invest less than last year. Additional information about the SBIC program is attached as an appendix to this testimony.

Although I will address all major SBIC issues, my focus today will be on S. 1923, the "Small Business Investment and Growth Act of 2005." We appreciate the growing support for the bill and believe its passage would correct structural issues related to the Federal Credit Reform Act and program performance that have caused the effect lapse of the Participating Security program.

A. The Status of the Debenture SBIC Program

1. The Debenture SBIC program is very stable at present. It enjoys the strong support of both the Administration and Congress. The 128 active Debenture SBICs manage a total of $4.9 billion in total committed capital resources. There were 11 new Debenture funds licensed in FY 2005 and SBA anticipates licensing as many as 15 new Debenture SBICs this fiscal year, FY 2006. The subsidy rate remains at "zero" and has required almost no adjustment in fees or interest paid by Debenture funds over the past two years to maintain that rate. Given the situation with respect to the Participating Security program, the Debenture SBIC program has represented the only real opportunity to increase the impact of the SBIC program with respect to future investments in U.S. small businesses.

2. The Administration has proposed $3 billion in new leverage availability for the Debenture SBIC program in its FY 2007 budget submission. Based on current and projected usage, that will meet the needs of existing and new Debenture SBICs through the end of FY 2007. NASBIC supports the Administration's proposal for FY 2007 Debenture leverage availability.

3. Where we part company with the Administration is on its proposal to charge Debenture SBICs substantial fees to subsidize SBA administrative costs. The proposal is vague and even SBA has been unable to tell us the particulars of the Administration's proposal. For example, the budget submission states that a 0.64% fee would be charged on all "loans" over $1.0 million. SBA has subsequently said that the fee would apply to "commitments." Commitments are not loans. However, if the proposed fee were to apply to all commitments (it being difficult to believe the Administration would allow SBICs to divide all their commitments in to sub-$1.0 million pieces), an averaged size Debenture fund would pay approximately $256,000 in fees over the life of the fund. That is a significant amount.

4. Such a change would very unfair to existing SBICs. When they raised money to start their funds, their investors knew there would be a subsidy rate risk and a credit risk. However, they were not told there would be a risk that the SBIC would have to fund part of the administrative cost structure of SBA—in a way that would also increase the SBIC's credit risk. This is different from the 7(a) and 504 programs (with substantially lower proposed fees) where each new loan stands on its own and a borrower can decide whether or not to enter into the transaction at the time the loan is considered. With the SBIC program, the borrower (the SBIC) is locked into an SBA-approved business plan that will run at least 10 years. To unilaterally add a major new category of cost in the middle of the game is unfair at best and a breach of contract at worst.

5. Such a change would also have a substantial negative impact on the formation of new funds. Since fund managers can have no impact on SBA's administrative budget, the change would introduce a substantial variable cost that cannot be controlled by fund managers. Few investors would be willing to risk million of dollars in a deal with open-ended costs (SBA says they want to pass all fully loaded administrative costs on to the borrowers) that cannot be quantified. The proposed fees would reduce substantially the

number of fund managers and investors who would be willing to apply for a new Debenture license. Small businesses would suffer accordingly. NASBIC strongly opposes the Administration's fee proposal.

B. The Status of the Participating Security SBIC Program

1. The Participating Security SBIC program has been closed to new licensees for two years; the last new funds were licensed in FY 2004. The program will ramp out of existence if no legislative action is taken to save or restructure the program.

2. The need for the Participating Security program has been confirmed by several independent sources over the past 18 months. The Center for Private Equity and Entrepreneurship at Dartmouth's Tuck School of Business confirmed the need in a study dated July 9, 2005. Daniel O'Connell, the director of the Golder Center for Private Equity within the College of Business at the University of Illinois confirmed the need for the program in testimony before the House Small Business Committee on April 13, 2005. Susan Preston, an expert on angel investing and Entrepreneur-in-Residence at the Ewing Marion Kauffman Foundation confirmed the need for the program at that same hearing, as did two CEO's of SBIC-financed small businesses. Finally, the National Venture Capital Association confirmed the need for the program in its September 9, 2004 letter to President Bush. I will submit copies of these documents for the hearing record.

3. Faced with this evidence of need for a program that stimulates equity investments in small businesses that are not served by the non-SBIC venture capital industry, the Bush Administration has elected to ignore it; to pretend it does not exist. The Administration has said "there is no demonstrated need" for such a program, that they are aware of no studies that support the need, and that SBA loan programs are sufficient to meet any existing small business venture capital needs. It will be for this Committee to make the ultimate determination as to whether or not the Administration's position is correct.

4. Assuming a need for the program to stimulate equity investments in U.S. small businesses, the question becomes how to restart the flow of capital. No new Participating Security licenses have been issued since FY 2004 for two primary reasons. First and foremost, the Administration has made the determination that the implementing legislation for the program does not meet the requirements of the Federal Credit Reform Act (FCRA) for a credit subsidy program eligible for credit scoring that offsets current costs with estimated future revenues. Without that qualification, an appropriation equal to 100% of any desired program level would be required on an annual basis. Clearly that would be a non-starter for the Participating Security program, or any SBA finance program. The second reason is that an unacceptably high subsidy rate would apply to any new Participating Security leverage even if the program met the requirements of the FCRA—a rate attributable to both structural defects in the program and losses attributable to the recent recession.

5. The reason given by the Administration for the non-qualification with FCRA was that the Administration considers Participating Securities "equity" securities, notwithstanding the

fact that the Administration requires Participating Security SBIC to carry those securities on their financial statements as Debt. Qualifying FCRA securities must be "debt" securities. Thus, for the past two years the industry and the House and Senate committees on small business have tried to design legislation that would pass muster with the Administration's definition of "debt" securities and adjust the "economics" of the program so as to merit a "zero" subsidy rate. The most recent efforts are represented by H.R. 3429 introduced by Mr. Manzullo and S. 1923 introduced by Senator Snowe last year and now pending in the Senate with several co-sponsors. We believe the Administration had agreed that both bills meet the requirements of the Federal Credit Reform Act for the purposes of being eligible for credit scoring in the appropriations process.

6. However, meeting the requirements of the Federal Credit Reform Act is only the first hurdle. The legislation must score at a "zero" subsidy rate to have any chance of being a meaningful program in terms of economic impact. SBA's 504 and 7(a) loan programs and the Debenture SBIC program carry zero subsidy rates and NASBIC supports this requirement for any legislation that would restart an equity investment program. By its terms, S. 1923 would require that fees authorized by the legislation be adjusted annually to maintain a zero subsidy rate.

7. Based on preliminary indications from the Administration, the Administration seems unlikely to score S. 1923 at a zero subsidy rate for the purposes of FY 2007. We believe that scoring is based on unrealistically conservative estimates as to the likely performance of funds that might be licensed if S. 1923 were enacted.

8. However, in order to reach a zero subsidy rate, NASBIC recommends the following change in S. 1923: amend what would be §321(b)(6)—regarding the maximum leverage that would be available to Participating Debenture SBIC—to limit such maximum leverage to 100 percent of the leverageable private capital of a licensed company. Reducing the maximum leverage from 200% to 100% would not only reduce total dollar's guaranteed by SBA for any one Participating Debenture SBIC, but would reduce the risk of loss substantially by reducing the maximum debt-to-equity ratio from 2:1 to 1:1. Such a change should be more than enough to reduce the subsidy rate to zero under any reasonable set of scoring assumptions.

9. NASBIC has one other recommended change to S. 1923: amend what would be §321(a)(6)(A)(i) of the bill to provide that any accrued interest due on leverage that has not been paid previously be paid on the "seventh anniversary of the issuance of the debenture" rather than on the "fifth anniversary" as provided at present. A deferral period seven years is what is reasonably required to enable Participating Debenture SBICs to make early stage investments in start-up and other very young small businesses. Early stage equity capital is the scarcest form of equity capital and we believe the SBIC program should help address that need. We do not believe the change should have a major impact on the subsidy rate. The bill still requires accrued interest to be paid whenever the SBIC has any gross receipts as defined in the bill, whether or not within the interest deferral period and irrespective of profitability. In addition, SBA's rights with

respect to any capital impairment make it unlikely that an SBIC would be able to draw substantial leverage if not performing within the limits set by SBA.

10. To conclude my remarks on S. 1923, NASBIC believes that the legislation is the right approach to restarting the flow of equity venture capital to U.S. small businesses through the SBIC program. We believe the changes we have suggested will improve the bill while at the same time reducing risk of loss to the government. We look forward to working with the Committee and the Administration in the coming weeks to fashion a final bill that will meet the needs of all stakeholders in the program.

C. Additional NASBIC Proposals For The SBA Reauthorization Bill

NASBIC will submit suggested legislative language for each of the following proposals:

1. An extension of the time for the exercise of Participating Security commitments sold to Participating Security SBICs in the years FY 2002, 2003, and 2004 to solve a very serious "commitment expiration" problem for existing Participating Security SBICs.

2. An amendment of §306(a) of the Small Business Investment Act of 1958 to correct what we believe are the unintended results of the formula for calculating the maximum percent of its total capital, including all leverage, that an SBIC can invest in a single small business. The existing formula yield differing percentages depending on the leverage ratio. NASBIC's proposed amendment would create a formula that would be consistent in its application to all SBICs, irrespective of leverage ratios.

3. An amendment of §303(g)(12) of the Small Business Investment Act of 1958 to clarify the rules that apply to distribution of publicly traded, marketable securities held by Participating Security SBICs due to successful portfolio company public stock offerings. The clarification would correct the current situation which has seen SBA unilaterally change the rules applicable to such distribution to the detriment of the program.

4. An amendment of §303(d) of the Small Business Investment Act to require that the Administrator require each licensee, as a condition of an application for leverage, to certify in writing that not less than 25% of the licensee's aggregate dollar amount of financings will be provide to smaller enterprises. This would replace the current requirement that a base of 20% be invested in smaller businesses plus 100% of investments made with leverage in excess of $90 million. The change would simplify record keeping and administration while increasing the across-the-board requirements for all leveraged SBICs.

In conclusion, thank you for your consideration of our views regarding the current status of the SBIC program and our suggestions for legislative changes that would improve the program and its ability to serve U.S. small businesses across America. We look forward to working with the Committee during the months ahead to further develop our ideas with the hope that they might be included in reauthorization legislation to be passed this year.

The U.S. Small Business Investment Company Program

- The U.S. Small Business Investment Company (SBIC) program was created by Congress in 1958 to help small U.S. businesses meet their requirements for growth and operating capital not available through banks or other private capital sources. Small companies often require financing in the critical $250,000 to $5 million range in the form of either subordinated loans not made by banks or equity investments not generally available from non-SBIC private equity firms. SBICs fill that gap—supporting thousands of U.S. small businesses each year.

- The SBIC program is a unique partnership between the public and private sectors. SBICs are private equity funds that invest in U.S. small businesses that meet size and operational criteria set by the federal government. SBICs are licensed and regulated by the U.S. Small Business Administration (SBA), but privately managed by private sector management teams whose qualifications and business plans are approved in advance in a rigorous licensing process. Minimum capital required to start an SBIC—$5.0 million—must come from qualified private investors. Additional capital—as much as three times the private capital—is then potentially available to each SBIC through SBA by sale of SBA-guaranteed securities on an "as needed" basis to support fund investments and expenses. The private capital is at risk in its entirety before any taxpayer money is at risk, and SBA examines SBICs regularly to ensure their financial soundness and regulatory compliance.

- Since its beginning in 1958, the SBIC program has provided approximately $46 billion of long-term debt and equity capital to more than 99,000 small U.S. companies, with $2.9 billion invested in 2,299 small U.S. companies in FY 2005 alone. Many well-known U.S. companies received early financing from SBICs, including Intel, Apple Computer, Callaway Golf, JetBlue Airways, Whole Foods Market, Palm Computing, Staples, Quiznos, Federal Express, Outback Steakhouse, Costco, Mothers Work, and Build-A-Bear Workshop. Eleven of the top 100 companies on the latest *Inc. 500* list of America's fastest-growing private companies received SBIC financing (November 2005), as did eight of the top 100 "Hot Growth Companies for 2005" featured in *BusinessWeek* (June 6, 2005), three of the nine members of *BusinessWeek*'s "Hot Growth Hall of Fame," and six of *Fortune* magazine's "100 Best Companies to Work For" (January 23, 2006).

- More than 40% of all SBIC investment dollars in FY 2005 went to companies that had been in business only three years or less at the time of the investments. SBICs are a crucial source of capital during those difficult early years.

- Small businesses receiving SBIC financing in FY 2005 employed approximately 218,000 individuals—an average of 95 employees per company—at the time they received the SBIC financing. The median number of employees in SBIC-financed companies was 34.

- SBICs play an important role in financing local businesses in states and geographic regions not generally served by non-SBIC private equity firms. Of the 2,299 U.S. small businesses that received FY 2005 SBIC financing, 23% were located in government-designated Low- and Moderate Income (LMI) areas of the country. Those LMI-district companies received $543 million (19%) of the total $2.9 billion invested by SBICs in FY 2005.

- SBICs are playing a vital role in our continuing economic recovery from the last recession—especially in the manufacturing sector. Of the $2.9 billion in SBIC investments in FY 2005, 30% were made in hard-pressed small U.S. manufacturing companies. For the period FY 2001 through FY 2005, SBIC investments in small manufacturing companies totaled $4.3 billion.

Mark Morrissette

Mark Morrissette is Managing Director of North Atlantic Capital of Portland, ME. North Atlantic Capital is a venture capital firm led by a team with nearly 50 years of combined investment experience. The firm invests in established and growing companies in the eastern United States with a preference for the Northeast and mid-Atlantic regions. North Atlantic's primary investment focus is on companies using technologies to deliver products and services to their customers. Since 1986, North Atlantic has raised and managed three partnerships (two of them Participating Security Small Business Investment Companies) totaling over $160 million of committed capital, has invested in more than 57 businesses, and has generated consistent and strong returns for its investors.

Mr. Morrissette has been in the venture capital industry since 1995 and serves as a Director for several North Atlantic Capital portfolio companies. He is a member of the Board of governors of the National Association of Small Business Investment Companies and President of that organization's northeast regional association. Prior to joining North Atlantic Capital in 2000, he worked at Advent International in Boston, and in consulting at CSC Index in Cambridge, MA. He earned a BA from Dartmouth College and an MBA from Harvard Business School.

Chair SNOWE. Thank you. I want to thank you all. I appreciate it very much.

First, since Senator Kerry was unable to attend this hearing today, I would like to include his entire statement without objection in the record.

[The prepared statement of Senator Kerry follows:]

Statement of Senator John F. Kerry

Hearing – Small Business Reauthorization

April 26, 2006

Madam Chair, thank you for holding this reauthorization hearing today to review the Small Business Administration's (SBA) credit and entrepreneurial development programs. I'd also like to welcome and thank Administrator Barreto and our witnesses for taking time to be here today to share their perspectives.

I am disappointed that we will not have the opportunity to hear testimony from small businesses about the importance of the SBA's entrepreneurial development programs. Several individuals and organizations will be submitting testimony for the record, and I look forward to reading their statements. It is important to stress that the Committee's decision to limit witnesses at this hearing should in no way be interpreted to mean that we will be devoting any less energy or resources to strengthening and improving the SBA's entrepreneurial development programs. I am convinced of the value of these programs, and I am determined to make sure this Committee, and Congress as a whole, supports these programs during reauthorization.

Madame Chair, like you, this is not the first reauthorization that I have been involved with in this Committee. Reauthorization is a great opportunity for Congress to examine programs, to work with the small business groups, SBA's partners and the SBA to ensure that they serve their intended purpose. And that purpose is to make the dream of a small business a reality to those who might not be eligible for business loans through conventional lending, those who don't have an MBA but need some management counseling, or those who need help cutting through red tape to get government contracts.

Our letter to the appropriators, signed by every member of this Committee, sends a strong bipartisan message in support of adequate funding for many of the business loan and entrepreneurial development programs that we will be discussing today. As my colleagues know, this Committee has a history of working in a bipartisan way. No matter how controversial, we've generally managed to work through our differences and get the job at hand done. I hope that this tradition of bipartisanship continues as we work to reauthorize small business programs. I was very disappointed at how the Democrats were treated during final passage of the 2003 SBA reauthorization and I hope that history will not repeat itself. We worked in good faith to pass provisions that were important to both sides. Yet, a last-minute deal between House Republicans, Senate Republicans, and the Administration stripped out provisions that were unanimously approved by the Senate. The result was a mini-66-page reauthorization tacked onto an omnibus appropriations bill with many worthy provisions stripped out. Again, it is my sincere hope that we can return to the tradition of working together.

Chair Snowe, I think this is very possible as we share many of the same goals. We both oppose the Administration's proposal to impose unprecedented administrative fees on the 7(a), 504 and Small Business Investment Company (SBIC) programs. We both want to ensure the long-term success of Women's Business Centers through renewable, performance-based grants. And, we both want adequate program levels for key small business programs set to expire as demonstrated by the reauthorization bills we both have introduced.

And there are many problems we can tackle together. Unfortunately, our committee has heard loud and clear that the Certified Development Company (CDC) industry and the 504 loan program have experienced unprecedented structural changes, such as the shifting of all 504 loan processing, loan servicing and liquidation from 70 SBA district offices to one or two centers in the country. Both Senator Snowe and I have proposed that the SBA develop a schedule to compensate and provide an incentive to qualified CDCs that foreclose and liquidate defaulted loans.

While we may have different views on how to respond to the impact on the CDC industry of SBA adopted regulations a few years ago that allow for state-wide and multi-state CDC operations, I hope we can agree that transparency and accountability are always good. In response to concerns about the need to reinvigorate the local economic development focus of the 504 program, Senator Pryor and I have introduced legislation, S.2595, to not only reauthorize the 504 loan program at adequate authorization levels to prevent rationing and a shut down of the program, but to ensure that there are accountability measures as CDCs expand into contiguous states. I understand that this program was created a decade ago and will naturally change in response to demand and growth. But I want to make one thing clear - the 504 program was not created for CDCs to expand operations and simply create revenue from one state to another. Non-profit CDCs are more than lenders and should not act like for-profit banks. Our bill ensures that local communities continue to be the main focus of CDCs by requiring that the 25 members of their board and board of directors be residents of the area of operations and prohibits an individual from holding a position of control in more than one CDC. Our bill also ensures transparency by requiring an annual report on the use of excess funds and all economic development activities in every state in which the CDC operates. This report is not designed to be burdensome to CDCs. CDCs are already required to submit annual reports to the SBA. In fact, we didn't specify any requirements for the report. The 504 loan program is a public program and Congress and the public should be assured that funds are being used for local economic development.

The 504 program not only fosters local economic development but CDCs play an important role in building better communities. That is why I have been advocating for allowing CDCs to work with non-profit child care centers. To that end, I have reintroduced legislation which was in the Senate-passed reauthorization bill but did not make it into the final reauthorization bill the last time around – the Child Care Lending Pilot Act of 2006. The bill creates a three year pilot program to allow small non-profit child care providers to participate in the 504 program. This bill came out of a taskforce in my state of Massachusetts comprised of child care providers, lenders and state and federal policy makers in Massachusetts. It is my hope that this proposal to expand access to affordable child care will be adopted this time.

Another loan program that we will be hearing about today is the 7(a) loan program. Well-known successes like Winnebago and Ben & Jerry's are examples of the program's effectiveness. However, the availability of capital and credit still remains one of the most significant impediments to small business creation and growth, and it is the SBA that continues to serve as the principal "gap" lender to millions of small businesses in our nation. SBA's loan and investment programs are a bargain. For very little or nothing at all, taxpayers leverage their money to fuel the economy and help thousands of small businesses every year. In both the 504 and 7(a) programs, taxpayers don't spend a penny to lend or leverage investments because these programs are self-funded. Last year alone, almost 96,000 small businesses received $15 billion in 7(a) loans, creating or retaining an estimated 460,000 jobs.

Along with Senators Pryor and Landrieu, I have also introduced legislation reauthorizing the 7(a) loan program, S.2594. To ensure that we continue to have high enough authorization levels to manage the increasing demand, we propose to reauthorize the 7(a) program for three additional years at more than adequate levels and reduce fees to borrowers through a Kerry-Landrieu provision which passed as part of the CJS FY2006 appropriations bill. This bill also addresses an issue that has not been a focus of the SBA – that of access to loans for minority communities.

According to a recent study by the U.S. Chamber of Commerce and Business Loan Express, availability of capital remains a priority for all small businesses, but for Hispanics and African Americans, it is one of their top three concerns. Knowing of this need, I was deeply disappointed to see that although SBA's loan programs have increased lending overall, the figures surrounding the percentage of small business loans going to African-Americans, Hispanics, Asian Americans and women have not changed much since 2001. The administration claims that in FY2005, almost 30 percent of 7(a) loans and about 25 percent of 504 loans were made to minority groups.

However, according to the SBA's own data, since 2001, while numbers of 7(a) loans have gone up for African Americans, the dollars have remained at 3 percent of all money loaned. In the 504 program, loans to women have decreased from 19 percent in number to 15 percent, and dropped from 16 percent to14 percent in dollars. In the Microloan program, African Americans received 28 percent of the total number of microloans made in 2001 as compared to only 21 percent of the total number of loans made in 2005. Their microloan dollars have also decreased from $7.1 million to $5.7 million in 2005. Native Americans went from 2 percent of the total number of microloans made in 2001 to less than one percent -- a mere 0.93 percent -- in 2005.

These statistics are of great concern and demonstrate that the SBA has not been highly successful in playing an active role encouraging robust entrepreneurial activity and small business ownership amongst these minority groups. I know that just recently the SBA partnered with the California Hispanic Chambers of Commerce to strengthen and expand small business development in California through channeling information to Hispanic businesses under the Chambers umbrella. I think that's a step in the right direction but we need an office in the SBA to manage initiatives, such as this one and assure that they are carried out and that we continually seek new and innovative ways to break down the barriers to access in these minority communities.

This is why my colleagues and I are proposing the creation of an Office of Minority Small Business Development at the SBA in our legislation reauthorizing the 7(a) loan program. This office will be similar to offices devoted to business development among veterans and women and in rural areas. In charge of the office will be the Associate Administrator for Minority Small Business and Capital Ownership Development, under a new title with expanded authority and an annual budget to carry out its mission. Currently this position is limited to carrying out the policies and programs of SBA's contracting programs under 7(j) and 8(a). To make sure that minorities are getting a fair share of loan dollars, venture capital investments, counseling, and contracting, the bill expands the Office's authority and duties to work with and monitor the outcomes for programs under Capital Access, Entrepreneurial Development, and Government Contracting. It also requires the head of the Office to work with SBA's partners, trade associations and business groups to identify more effective ways to market to minority business owners, and to work with the head of Field Operations to ensure that district offices have staff and resources to market to minorities. This office is well over-due.

But to really get at this issue of minority entrepreneurship, we cannot just focus our outreach efforts on current minority businesses and entrepreneurs. We must target our youth. That is why I have introduced the Minority Entrepreneurship and Innovation Pilot Program of 2006, which establishes a grant program to be administered by the SBA to foster entrepreneurship among our best and brightest minority students. Competitive grants will be awarded to Historically Black Colleges and Universities, Tribal Colleges, and Hispanic-Serving Institutions to establish entrepreneurial curriculums at the undergraduate and graduate level focusing on business management and marketing; market analysis and competitive analysis; innovation and strategic planning; and other entrepreneurial needs as required by the surrounding community. The funds will also be used to place Small Business Development Centers on campuses for research; management and finance counseling; management training; and referral services.

I am proud of this legislation, and I am proud of the support it has received in the minority business community. It is a solid approach to addressing the need for more entrepreneurial development assistance within the minority community, something that this Administration has carefully avoided addressing.

Counseling and training are vital to all entrepreneurs. As we can see in the success of the Microloan program, it has one of the best track records of all lending programs and this success would not be possible without the technical assistance that is tied to it. Unfortunately, for the third year in a row, the President disagrees and is instead proposing to eliminate the Microloan Program and Microloan Technical Assistance program- the largest federal program solely dedicated to supporting the credit needs of very small businesses and self-employed entrepreneurs. SBA is claiming that the Microloan Program is more expensive than existing programs and that micro-entrepreneurs can be served through the 7(a) Community Express program. As for cost, the SBA still hasn't told us the default rate on the 7(a) Community Express loans, claiming that they haven't been around long enough to get a true comparison. Nevertheless, every member of this Committee signed a joint letter stating our strong support for this program, which I should add, has had only two total losses, and the program is a bargain on job creation, creating one job for every $1,800 loaned, compared to the SBA's other loan programs which create one job for every $33,000 loaned. Last year, Senator Bingaman and I reintroduced a bill, S.138, making the SBA Microloan Program more flexible to meet credit needs and more streamlined for making loans and providing management assistance. The bill also reauthorizes PRIME through 2007 and includes a provision which will expand PRIME with a separate $2 million authorization to provide direct, in-depth technical assistance and counseling to disadvantaged Native American small business owners. I hope these provisions can be included this time around.

Another program that has not gotten its due from the Administration is the New Markets Venture Capital Program. For the sixth year in a row, the Administration has requested zero funding for this venture capital program that goes to the areas most in need of investment. I feel strongly about this program because I introduced the legislation -- which passed in 2000 -- that established this program, based on the SBA's successful SBIC program, to create venture capital funds that target investment capital and business expertise into low-income areas to develop and expand local businesses that create jobs and alleviate economic distress. This program is set to expire this year and I will certainly advocate for its reauthorization. All the members of this Committee have gone on record with their support for this program in our joint appropriations letter.

Speaking of the SBIC program, it is disappointing to note that one of the two SBIC programs, the Participating Securities Program, has been shutdown for about 18 months because OMB assessed losses of $2 billion and determined that it didn't meet the Federal Credit Reform Act. Since then, the Administration has taken the position that the program is not needed, and that this capital market – deals of less than $5 million – is being met by the SBIC debenture program. This is of particular concern to me as these participating securities funds make investments in areas of the country that are not served by larger non-SBIC's venture funds. Seventy one percent of SBIC investment goes into states that traditionally receive limited venture capital. Overall, this program dates back to 1958, at a time when venture capital industry was non-existent. Today, we have Staples, Intel and Federal Express – all products of the SBIC program -- to remind us how valuable this program is to our communities in terms of job creation. In particular, since 1994, participating security investments have led to an estimated 300,000 new jobs. We need to find a solution to the issues facing the participating securities portion of this two fold program so that we continue to see this job creation in the areas where it's needed most.

Turning to the entrepreneurial development programs, quite frankly, I think that the concerns of the broader entrepreneurial development community will continue to be neglected as long as this Administration is making small business policy. We will continue to face an uphill battle for basic funding. I think this is wrong. My colleagues in the Senate – on both sides of the aisle – think this is wrong. We want to see small businesses succeed, we want to see these programs succeed, and we want to give the SBA the tools it needs for success. I think those are common goals that most members of Congress share. That is why it is so frustrating that we keep meeting resistance in these efforts. Time and again, the Senate has unanimously passed legislation to help small businesses only to see that legislation die in the House at the hands of the Administration and the House Republican leadership. We've seen it happen repeatedly with one of the SBA's most successful programs: the Women's Business Centers program.

This time, the Women's Business Center program must be a top priority. The WBCs have proven to be highly effective – counseling over 500,000 clients since 1989 – but they are struggling right now because language unanimously approved by the Senate in 2003 to reform the program was stripped out. That means we are still facing the same problems for the Women's Business Centers that we were facing *last* reauthorization. Existing Women's Business Centers have faced cuts since 2003 and that trend will continue unless we address the needs of this program *soon*.

The key element to reauthorizing the Women's Business Centers involves finding a solution to the issue of long-term funding to sustain these centers after their initial grant period expires. In 1999, I wrote legislation to solve this problem and passed it through Congress and got the Administration to support it. My legislation created a sustainability grant pilot program which expired in 2003. Then, recognizing the value that these sustainability grants had for the Women's Business Centers and the women-in-business community, Chair Snowe and I worked together to make that program permanent as part of the SBA's reauthorization. We passed that bill through the Senate *unanimously*. The Administration, however, was opposed and pushed to get these provisions stripped out of the SBA's reauthorization.

The Administration's alternative plan would cause great instability in the Women's Business Centers program. Because we know that many WBCs are not able to become self-sustaining after just five years in existence, the Administration's approach means that we will end up with a program that is essentially a five-year rotating grant fund for Women's Business Centers with new centers across the country being forced to close just five years later. If a Women's Business Center is forced to shut down, that federal investment and infrastructure is lost and must be recreated in a new center. Why wouldn't we want a more fiscally-responsible approach? That's what I support. That's what the Senate passed unanimously. That's what the Women's Business Centers support. The fact that our reauthorization plan was blocked last time around does not discourage me from fighting for this valuable program, and I hope it does not discourage others.

The Administration is proposing flat reauthorization levels for the Small Business Development Centers network. This is a program that serves more than a quarter million clients each year, and we want that number to continue growing. The Administration has been grossly under-funding the SBDC network for years, but this Committee has continuously pushed for more appropriations. It is my hope that we will do the same with regard to the authorization levels. With a proven network like the SBDCs, which brings in $2.66 in federal revenues for every dollar invested, increasing funding is a no-brainer.

I am pleased to see that the Administration is supportive of two ideas that our Committee proposed in the wake of Hurricane Katrina. First, the SBA has agreed that, in the event of a catastrophic disaster like Katrina, the SBDCs across the country should be able to send counselors to help in the recovery efforts. Second, the SBA has agreed to waive the cap on the portability grants to SBDCs affected by a catastrophic disaster.

I am particularly concerned about the SBA's language proposal that would give the SBA additional funding to monitor the SBDCs. The SBA would get this additional administrative funding no matter what happens to the SBDCs' grant funding. In fact, if the SBDCs were to receive the same funding in FY 2007 that they received in FY 2006, the grant money directed to the centers themselves would be cut to provide the SBA with more money to manage the program. The SBA wants to send more money to administrative functions, and less to small businesses. This is the wrong direction, and I will push to ensure that when Congress gives the SBDCs more money, that money is reaching small businesses.

The Administration is also heading in the wrong direction with its proposal to eliminate PRIME. PRIME is the only program targeted to entrepreneurs earning 150 percent of the poverty line or less. And, unlike other counseling programs such as the Microloan Technical Assistance program, PRIME's clients aren't ready for loans – either because their credit is not strong enough yet or because their business is not at that stage. We shouldn't repeal this program, and I'm frustrated that we're even discussing the idea. As a Committee, we always promote the idea of achieving the American dream through entrepreneurship. Time and again, the PRIME program has done just that, and with our support, it will continue to do so.

Finally, the Service Corps of Retired Executives, or SCORE, is also up for reauthorization. SCORE is a volunteer-based network that uses over 11,000 volunteers – and I don't think I can emphasize that word enough – to counsel and train entrepreneurs. They've had over 7 million clients since the program was created. SCORE has been level-funded for the past four years, but it still continues to produce impressive numbers that we, as a Committee, should be proud to support. I know I am. We should be acknowledging the success of SCORE, and its potential for reaching even more entrepreneurs, by increasing its reauthorizations levels this year.

Madame Chair, I am hopeful that this reauthorization period will not produce more of the same. I am hopeful that we will work in a bipartisan fashion to address the needs of America's small businesses. They deserve nothing less.

Chair SNOWE. Let me just—you heard the administrator here today, in some of the areas that he spoke to, and of course, on the SBICs, and you addressed some of those issues here today. What is your response to this whole question?

Mr. MORRISSETTE. Well, I think that the administration thinks that the debenture program is a venture program, and it is not. Debt lending is not the same thing as equity lending. I think that is one really key and important factor.

The other is, as I said in my testimony, they focus a lot on the fact that there was a large amount of money invested in this small size range. Those dollars count the SBIC funds that were invested, and most or something like 43 percent of the dollars invested were from SBICs.

I know from my own experience that the dollars that we have invested have brought in other venture capital funds as well. We have led investments that non-SBICs have come in and invested in, in businesses in small towns and in rural areas across the United States.

The equity programs, they also seem to want to focus on the fact that they can't find a way to make an equity program profitable. We wouldn't be in business if equity programs couldn't be profitable. I know they can be profitable. I am sure there is a way, and I think that S. 1923 is a very good step in that direction.

Chair SNOWE. I appreciate that.

Mr. Alford, you were talking about, excuse me, procurement center representatives. There used to be 73. We are now down to 58 at a time when the market for Federal contracts has doubled, more than doubled in size.

I know just from my own experience in Maine, where I have been working with these representatives to, for example, just on the "hub zone" program, to enhance the eligibility so that small businesses, especially in disadvantaged areas, can have more access to Federal contracts.

We have limited capacity, and it is that kind of financing and assistance that becomes so useful for businesses to participate in the $300 billion worth of Federal contracts that are issued on an annual basis.

What do you think are the implications of having fewer rather than more?

Mr. ALFORD. You won't find a more demoralized individual than a PCR rep. I have interviewed some. For their stress levels and the amount—I was in Los Angeles, and the guy literally broke into tears. It appeared he was just on the verge of a nervous breakdown because there were so many opportunities out there, but there is only 24 hours in a day.

I saw this coming back in the 1990's, when they started stripping it down. We need more people trained, qualified, to give counseling out there in the field. The SBA is just fading away.

The SBIC is fading away. It is gone in the black community. It is gone. It is funny in New Orleans, where we are using French money and Belgian money and Russian money for business loans. We have got Israeli money servicing the black churches in the Gulf. That is kind of sad.

Chair SNOWE. Yes, that is a sad commentary on where we are standing today.

Well, we know that SBA could have been on the front lines and showcasing, and it has been unfortunately all the problems that evolved. I appreciate what you are saying and sharing that sad story as well about a procurement representative having to feel so much stress.

I agree there is so much need out there and demand to be able to connect small businesses with Federal contracts. That is why I included in the Senate budget resolution an amendment increasing them to 100, and I am urging them to continue that in the Appropriations Committee as well. Hopefully, it will be part of the next year's budget. I will certainly make sure to make that happen.

I mean that is just one opportunity where you could make small businesses expand, create jobs, or retain the ones that they have and particularly in underserved areas that have been hard hit by closures.

Mr. ALFORD. Appreciate your concern.

Chair SNOWE. Also in New Orleans, I agree. I couldn't agree with you more. We are going to do everything we can to get to the heart of that problem because it is really regrettable and tragic that we have had so many difficulties in distributing these kind of funds so that you can rebuild the local economy, which is almost wholly dependent on small business.

Mr. ALFORD. Yes, ma'am.

Chair SNOWE. Mr. Baird and Mr. Maxwell, 504s. What do you think specifically the Committee should address in the reauthorization?

Mr. BAIRD. I think that there are a number of items in the draft legislation or the introduced legislation that have already been addressed, including raising the reauthorization level from what the administration had proposed to a level proposed by the Committee that is adequate to fund the program at a zero subsidy over the next 3 years, I believe.

I think also that you are exactly right in your description of the 504 program with a zero subsidy model. The administration is proposing to additionally fee the program at the same time that the subsidy model is estimated to be funding $300 million of surplus into the Treasury, and I think that opposition to those fees is essential and not just for the current proposed fees at the current level.

Moreover, I would be concerned about what happens next year and the year after that and the other programs.

I also think that the legislation has included a critical aspect of mandating CDC participation in liquidations. I think that CDCs, many of them have the resources or all of them could hire the resources to much more effectively deal with defaults and maximize recoveries, and I think those are just critical.

Chair SNOWE. Appreciate that.

Mr. Maxwell.

Mr. MAXWELL. Well, I second many of the things that Jim just addressed. Again, being a practitioner, I am the guy who is sitting across the table from somebody when I tell them about a new fee or they ask me to explain what it is for. Sometimes I kind of get lost in the description.

I think that this is a zero subsidy program. I think that the fees are high enough right now. If somebody can explain to me reasonably why they should be higher and I can explain it to them because, ultimately, it is the small business that pays them.

I think access to financing to a great extent, I know that the administrator talked about over a million dollars. In our State, to have somebody invest over a million dollars, we have to pull them from the South some place and blindfold them to come up. I think that having more fees at whatever level is not a good thing. Especially if it is to fund some staffing-related issue at the SBA, it just doesn't make any sense to me.

Additionally, I echo liquidation. Liquidation is an important aspect of our job. We are responsible for doing everything else in this program with the oversight of the SBA. We think we do that very well. We do it very ethically.

On the other side, when it comes to the times when we have a 96.5 percent currency rate in our portfolio, we have had a couple of clunkers in there. It would have been a lot easier for us to do the liquidation than to have it go through some out of area process.

Those are the couple of things that I focus on.

Chair SNOWE. I appreciate that. Well, I think, in your testimony you indicated that SBA had raised $300 million more in fees, in excess fees, as a matter of fact. I don't know why they would move in a direction to increase those fees or to now impose fees in programs that otherwise wasn't the case.

I agree, you know? I think that it is going to have, I think, an adverse impact at a precarious time in our own economy. For those who otherwise wouldn't have access to financing and incurring another additional cost of doing business. They have overestimated, obviously, the default rate by charging these fees if they have raised more than $300 million.

We will obviously get to the heart of all that, but I think my intent is clear, and hopefully, we will get a majority to agree as well on many of these questions that I think are so important.

I appreciate your testimony. I wish I could spend more time with you. Again, I do want to thank you for your patience. Also, and most especially, in working through this reauthorization process to make sure that we continue to get your input and insights as to how best to craft some of these provisions.

I have laid out some markers with respect to my provisions and bills, but we certainly want to get your input as we move forward in trying to shape the best legislation possible for the future and making sure that it is going to suit small businesses and actually bolster small business at a time we desperately need it.

To help, that you were mentioning Mr. Alford, down in New Orleans in the disaster areas, that we really need to step up to the plate here and get this done and get it done right. It should have been done a while back. We are going to continue to fight that effort.

Again, I want to thank all of you for your patience and your time and your contributions. Thank you very much. Thank you.

The record for this hearing will remain open for an additional 2 weeks until noon on May 10th. In addition, any written questions for the administrator must be submitted to the Committee by noon on April 28th. We will forward them to Mr. Barreto for written responses.

Again, thank you for this hearing. This Committee hearing has adjourned.

[Whereupon, at 12:14 p.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Remarks
Senator Christopher S. Bond
Hearing on the SBA Reauthorization Act of 2006
Senate Committee on Small Business & Entrepreneurship
April 26, 2006

Thank you, Chairwoman Snowe, for allowing me to say a few words regarding the reauthorization of the Small Business Administration Act of 2006. I know that you and your staff are working very hard to complete a comprehensive bill. I commend you on your efforts with this challenging process.

First, I congratulate Mr. Barreto, who is testifying before us today. Mr. Barreto is leaving the Small Business Administration after almost five years as its Administrator to become the head of The Latino Coalition. It has been a pleasure working with you sir. Even through some difficult times, you have always given the SBA and the American public your best. I wish you good luck in your new venture.

Chairwoman Snowe, I appreciate your help, and others on this Committee, by working to include the reauthorization of SBIR as part of the final SBA package. It is my sincere hope that upon reauthorizing the SBIR program we can work together to ensure that small, biotech firms with venture capital backing be allowed to participate in the program as they have in the past. I understand that our next hearing in May will allow us to discuss this specific SBIR issue in detail.

The reauthorization of the SBA provides Congress the opportunity to review the Agency's programs and the chance to improve and refine them. In addition, small businesses benefit from reauthorization through stability in strengthening the lending programs and the greater access to capital it provides. I look forward to continuing working with Senator Snowe in fighting for the small business community. Thank you for allowing me to share my thoughts with you today.

Statement for the Record
The Honorable Norm Coleman

Committee on Small Business & Entrepreneurship
Hearing on the Reauthorization of the Small Business Administration
April 26, 2006

Thank you Madame Chair.

I commend you for your steadfast leadership for small businesses and thank you for holding this important first hearing on the reauthorization of the Small Business Administration. This reauthorization hearing on SBA's financing and entrepreneurial development programs provides us with an important opportunity to examine the effectiveness of these programs.

As a former mayor and a member of the Small Business Committee, I understand and appreciate the importance of small businesses for our economy. Without question, America's economic future is tied to the growth of small businesses. When I was Mayor of St. Paul, I witnessed first-hand the important role small businesses played in helping to revitalize the city through job creation and business formation and expansion.

Given that small businesses are the job engine of our economy, I believe it is critically important that we continue to provide the necessary support for the SBA to effectively carry out its mission while at the same time ensuring that the SBA serves as a strong steward of taxpayers' money. On this latter point, I applaud the SBA's ongoing effort to operate its major programs more efficiently. Nevertheless, as the SBA is serving more small businesses we need to make sure that appropriations are commensurate with the work undertaken by the SBA.

Large and small SBA financing programs provide critical support for our small businesses. On a regular basis I hear from my constituents about how SBA programs have helped make a difference for their small businesses.

One such program is the 7(a), which has increased significantly in the past few years especially with respect to supporting minority and women-owned businesses. Although I am pleased at the successful expansion of the 7(a) program, it is important to ensure that it also effectively serves our rural communities and that we do not put in place a fee structure that could very well undermine the program.

Another critical albeit smaller program is the micro loan program. As with my other colleagues on this committee, I am a strong believer in the concept of microlending. This program has been effective here at home and serves those small businesses that may not otherwise be able to obtain financing either through private means or through other SBA programs. It is this sort of program we are touting around the world as an important and proven economic development tool. It would be wrong for this program to be eliminated as the Administration proposes. This program deserves to be reauthorized and I support the Chair's efforts to do so.

Madame Chair, I conclude by saying that I look forward to working with you and the rest of my colleagues on the committee as we embark on this reauthorization process.

From: Harry C. Alford [halford@nationalbcc.org]

Sent: Friday, May 12, 2006 3:26 PM

To: Lawrence, Lena (Small-Business)

Cc: Kay DeBow

Subject: Questions for Harry Alford, National Black Chamber of Commerce

- In August, 2003, SBA Administrator Hector Barreto signed a Memorandum of Understanding with the National Black Chamber of Commerce. It included targeting Black owned businesses for increased lending and procurement opportunities. We are happy with our relationship with the SBA and encourage our local chapters to work with the local SBA offices.
- No, the SBA's staffing is at a critical shortage. This needs to be improved.
- Our people who do not live in large urban areas get little attention. An example is Tennessee. Our chapters in Memphis and Nashville have no complaints about the SBA while the chapters in Chattanooga, Jackson and Bolivar claim that there is no activity with the SBA. There isn't enough staffing to cover the entire nation just certain select markets. Another roadblock is the attitude of banking officials. If they do not have the local SBA selling them on being aggressive, they won't be.
- It has been our experience that venture capitalists spend the most energy in certain markets such as New York, Chicago, DC, Los Angeles. Our business owners in downstate Illinois, Mississippi, North Carolina, Missouri and other places that do not have a major US urban center are out of the "loop". Where does that business in Dayton, OH go to interact with a venture capitalist? He certainly won't find him in Dayton.
- It is my understanding that there is no presence at all in Black communities. There are no Black SBIC's nor any that target minority business, let alone African American businesses.
- Yes, indeed! The lack of diversity in the program is directly correlated to the lack of diversity in the portfolios.
- Formulating Black SBIC's would be a good start. Also, we feel the timing is right to form and/or recruit venture capital firms from members of the National Football League, National Basketball Association, etc. This would naturally generate much participation from the African American investors (NFL and NBA are predominantly Black) who would have an interest in serving a Black business population.

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May 10, 2006

Mr. Weston J. Coulam, Staff Director
Committee On Small Business & Entrepreneurship
United States Senate
Washington D. C., 20510

Dear Mr. Coulam:

Thank you for the opportunity to appear before the Committee and thank you for the follow-up questions requesting my thoughts on how the 504 program does and should operate.

It was an honor to appear before the Committee and I hope the attached information will be useful to you.

Please contact me at any time if you have additional questions, or if I can be of assistance in any way.

Thank you,

Sincerely,

James R. Baird,
Executive Director

Reauthorization Hearing Follow-up CDC Questions:

1. You run what is apparently a very successful CDC. What differentiates you, as a lender, from a bank?

There are a large number of critical differences that substantially differentiate CDCs from the banks we work with.

Profit vs. Non-Profit
First, banks are for profit corporations. As such, their role is to generate maximum profits and returns to shareholders and to maximize the growth of their organizations in order to maximize the value of their stock. CDCs are non-profit corporations. We have no shareholders who need dividends and we don't need to maximize profits or hit specific returns on investments. However, to adequately service our markets, CDCs do need to generate adequate funds in order to operate and to grow.

A Difference of Mission
A second major difference is in our respective missions. The mission of banks is to maximize profits and to provide capital to businesses and individuals in order to maximize profits. The primary mission of a CDC is to implement locally-based economic development, both with the SBA 504 program and with the many other programs that CDCs deliver. One mark of our effectiveness is numbers of companies assisted and dollars of financing provided. However our main measure of progress is in terms of jobs created, communities revitalized, and underserved populations that get 504 loans. The difference in mission is why CDCs use available funds to run microloan programs, help subsidize SBDCs, to develop incubators, and do many other programs (most at substantial losses), instead of opening a second or third office in the same city. In addition, the focused mission of CDCs enable them to provide consistency in 504 delivery, particularly during downturns, while banks move in and out of products and markets, including those of SBA and 504.

The CDC's Role in 504
CDCs play three critical roles in implementing the 504 program that banks are absolutely not structured to accomplish. The first of these is that **CDCs, as SBA-regulated non-profits, are able to provide 504 financing to the nations small businesses at an extraordinarily low cost, far below what would be required by banks or other for-profit lenders.** It has been estimated that on a comparable small business real estate financing, a CDC makes total fee income of less than $1/5^{th}$ of what a bank or for-profit lender requires. This does not mean that banks are somehow bad. Banks are by far the largest suppliers of credit to our nation's small and large businesses and its consumers, and that is how it should be. They are also our partners in 504 and we could not implement this program without their valued participation. It is just that in order to do their job, they need to generate a return that is far beyond that needed by a CDC participating in the 504 program. The beneficiaries of 504's low cost are the small businesses we assist and the communities that benefit from their growth in terms of jobs created and new investment.

A second and critical role is that **CDCs serve as the hub of each 504 project**, providing coordination and expertise to bridge the gap between the small business concern, the bank and the SBA on every project. Many of the banks we work with are not active 7a lenders SBA expertise, and the business and the bank need a CDC to guide them though the entire process. Many of the banks we work with on 504 projects are active 7a lenders and have significant SBA lending expertise. But even then, it is critical that the CDC is able to coordinate and guide the process to insure the project is done in accordance with all of the 504 guidelines. There are also very important projects, typically in urban core areas or very rural areas, wherein the CDC will coordinate and arrange other sources of local or state government or private funds in order to fill financing gaps and to best structure the project in everyone's interest. It is my understanding that in addition to delivering 504, more than 75% of CDCs also provide other sources of capital to small business. In multiple funding sourced 504 projects, it is the CDC and not the Bank that does the extra work to get the additional funding, and without this, typically the project would not happen.

Perhaps most important, CDCs **effectively balance the interests of the small businesses, the SBA and their communities in every project they finance**. This is absolutely critical in effectively implementing 504 as a non-subsidized, low-loss, and low-cost economic development program. **It is the combination of their non-profit status, SBA oversight, being mission-driven, extremely efficient (low cost) and the locally-based nature of CDCs that totally differentiate them from banks** and that have enabled 504 to flourish.

2. Would it be burdensome for industry members to annually report to SBA what their economic development activities are in each state that they operate?

My opinion is that CDCs should be proud of both the 504 and the non-504 economic development they accomplish each year. As you have seen by our CDC's Annual Economic Development Report I had submitted to the Committee along with my testimony (copy attached), we are proud of our 504 and non-504 economic development and we go to great lengths to tell our CDC's story to all of our strategic partners and stakeholders, such as our banking community, the public and private sector development professionals in our marketplace, etc.

It is also important that CDCs retain the local accountability that is part of the overall system that keeps them on track and on mission. It is my opinion that reporting on the economic development activities in each area (including states) in which CDCs operate should be a critical part of a CDC's job. Although our CDC operates in only one state, I would think that reporting on local economic development activities would be particularly important when crossing state lines for the optimal operation of any CDC.

That being said, it also needs to be said that, in spite of the many positive changes the SBA has made in the administration of the 504 program, we have at times been hindered by having our affairs micromanaged by the Agency to the disbenefit of not only the CDCs, but particularly to the additional companies we could instead be helping. It is my hope that any new reporting procedures required by this statute have a clear and stated legislative intent not to be needlessly lengthy or burdensome in any way.

3. What efforts does your CDC undertake to reach underserved populations?

Our CDC has undertaken a number of initiatives to insure this. I would want to preface my response by saying that our CDC is not unusual in these activities as the vast majority of CDCs have numerous ways to implement non-504 economic development and many CDCs have programs substantially beyond the scope of our non-504 efforts.

First, our original territory, the 9-county greater San Francisco Bay Area, was served by approximately ten CDCs. The competition between these CDCs within this large but limited area required that CDCs go deep into their communities to reach as many eligible applicants as possible. Over the years this resulted in a region that was very highly serviced by 504 on a per-capita basis, including traditionally underserved populations. So in our case, competition alone, assisted in more fully penetrating underserved markets.

Second, we market to, participate with or belong to organizations that have a large representation or clientele comprised of underserved populations. Examples of such organizations would include ethnic chambers of commerce, professional associations that focus on women and/or minority-owned companies, SBDCs, etc.

With a large percentage of Hispanic and Spanish-speaking population of business owners in our area, we were the first CDC in the country to develop a Spanish-language website wholly dedicated to marketing and presenting the 504 program. Our CDC's website, www.bayarea504.com, including the Spanish language section was awarded the best website in the industry by Nadco in 2003.

In addition to the above, our economic development grants and sponsorships generally focus on organizations that are dedicated to creating economic opportunity for traditionally underserved and low-income youth from our CDCs overall area of operation. . Detailed and specific examples of programs we are significantly involved with can be found at www.EBLF.org and www.facesforthefuture.org . The above activities have resulted in our 504 portfolio having significant representation from traditionally underserved populations including 23.6% minority-owned companies, 19% women-owned companies, and 31.5% of our projects being located in recognized low and moderate income neighborhoods.

4. I have heard the concern expressed that some CDCs are really for profit entities parading as not for profit entities. Do you agree or disagree, and if so, why?

As one of the original practitioners in the 503 and then 504 industries, I would categorically say that if the contention above is true, it is in fact true only for a very small minority of industry participants. Most of what became the CDC industry had, prior to the advent of 504, or even 503, been directly involved in implementing non-504 economic development as the core of their non-profit organizations' mission. I deeply believe that most CDCs have held to their appropriate missions as non-profit economic development organizations.

However, I also know that the opening of statewide competition and multi-state expansion, coupled with the SBA's initiative to provide many more loans to many more small businesses has put major pressure on our industry. It has caused some CDCs to de-emphasize their non-504 programs, in favor of using most or all of their assets to promote the 504 program. I would assume the CDC annual report process would enable SBA to collect and monitor this information and determine its impact, and take actions accordingly.

The second effect of these changes is that it may have caused some CDCs to loosen their underwriting standards. I don't know how effective different CDCs have been in maintaining their underwriting standards, however I would assume that a combination of getting regular feedback on lending quality from the Centralized Processing Center in Sacramento and the careful monitoring of default and recovery rates on 504 loans would provide a clear indication as to any deterioration in loan quality.

As I had indicated in my response to SBA on the ANPR process of several years ago, SBA already has policies, rules and regulations on the books that give them broad and sweeping powers to discipline CDCs that are out of compliance. Sanctions for violating regulations or even policy can include suspension or even revocation of a CDC's license, suspension or revocation of their loan servicing income, etc. etc.

It is critical, that SBA have the resources and systematically gather information on program portfolio performance and on the specifics of non-504 economic development activities. This should be reported to Congress and to other appropriate parties on and annual basis. It is also critical that when details of any specific abuse of policy or regulation occur, that SBA fully enforce the rules they already have in place, as opposed to declining enforcement and then making more rules. To do that later has the effect of saddling the entire industry with additional bureaucracy, rather than dealing directly with the problem.

If, in fact, one or more CDCs are acting like for profit entities and, therefore are not properly fulfilling the roles detailed above that are critical to the success of 504, then my opinion is that the SBA needs to fully enforce the rules they already have on the books in order to stop that kind of behavior. No alternative action could send a clearer or more effective message to any marginal players in our industry, and no other action would be better for our industry and the optimal implementation of the 504 program.

Answers of Mark Morrissette To Questions Posed By Senator John F. Kerry

May 10, 2006

1. Question concerning SBIC investments in minority owned businesses.

I preface my answer to this question with the caveat that North Atlantic is "colorblind" and "gender blind" with respect to its investment policies and procedures. We actively seek the best possible businesses and entrepreneurs to invest in irrespective of the ethnicity or gender of either the ownership or management of those companies. It is my belief that the same can be said of all SBICs other than Specialized SBICs, which are required to invest solely in minority owned businesses. That said, I believe the following considerations are important to any discussion of minority business venture capital financing, as they are for all such financing:

a. **Is the business seeking capital a growth opportunity that should attract venture capital?**

Many businesses, including minority businesses, may represent good opportunities for their owners yet may not represent good opportunities for venture capital investors—most likely because the projected return to the venture capital investors, including SBICs, over a period of four to six years will not be great enough to satisfy the returns the venture capital management team is trying to secure to satisfy the expectations of its private investors.

b. If the business is one that might represent an attractive investment for a venture capital fund, how does the venture capital fund learn about that opportunity?

An individual venture capital professional might read short summaries of the business plans of as many as two small thousand businesses, from which he or she may ultimately, after substantial due diligence, select two to three to invest in during any given 12-month period. A small business, including a minority small business, representing an excellent investment opportunity that does not have its business plan summary among those that are reviewed stands no chance of receiving financing from the particular fund involved.

c. Simply sending a business plan to a venture capital fund is generally not enough to get a small business financed, whether or not it is minority owned.

As indicated above, there are generally thousands of business plans available to venture capital professions for their review. What makes one opportunity more attractive than another in the important initial screening process generally relates to the following: (1) the apparent fit between the opportunity and the investment profile of the fund involved; (2) the quality of the plan detailing the opportunity; (3) the apparent quality and experience (subject to verification) of the management team that would implement the business plan; and (4) whether or not the plan comes from a trusted referral source—e.g., a banker, accountant, attorney, investor, entrepreneur, or other individual whose business judgment the venture capital fund has reason to trust.

d. **SBA provides details related to drafting business plans—including examples of business plans—on its Internet site.**

Many other organizations around the country also provide help or instruction when it comes to drafting business plans. There in no excuse for a small business seeking financing to have an inadequate business plan in terms of the necessary elements that should be addressed in the plan. Whether the substance is sufficient is another issue, but the plan itself should be complete in terms of formal content.

e. **The primary distinguishing characteristics between businesses, including minority businesses, seeking capital are the quality and experience of the small businesses' management teams and the networks they have developed to help introduce them to venture funds, including SBICs, which might be interested in the opportunities they represent.**

Targeted SBA outreach, whether through new or existing SBA support programs, on the importance of quality management teams and effective networks in securing venture financing might improve the ability of minority owned small businesses to secure venture capital financing, including SBIC financing.

2. **Question regarding impact of SBA's proposed new fess on Debenture SBIC loans.**

a. It is difficult to answer the question regarding impact until we know the specific details of the proposal. For example, we understand that SBA says that over 90% of Debenture loans are covered. We do not know how SBA arrived at that percentage. Does it mean leverage draws or specific loans to small businesses? Also, will SBICs be able to pass any fees they pay on to small businesses they lend to or not? Until we have the specifics of the proposal we cannot give an impact statement that is completely accurate.

b. What can be said with certainty is that the proposal is very unfair to existing Debenture SBICs. When they raised money to start their funds, the private investors knew there would be a subsidy rate risk and an investment risk. However, there was never any indication that there would be a risk that SBICs would have to fund part of the administrative cost structure of SBA. This is different from the 7(a) and 504 programs where each new loan stands on its own and the borrower can decide whether or not to enter into the transaction at the time the loan is considered. With the SBIC program, the SBIC is the primary borrower and is locked into an SBA approved business plan that will run at least 10 years. To unilaterally add a new category of cost in the middle of that period is unfair at best and a breach of contract at worst.

c. Increasing the expenses of SBICs that cannot be passed on increases the risk of failure for those SBICs. Likewise, increasing the expenses of small businesses if the fees can be passed on increases the risk of failure of the small businesses. The amounts involved are significant and, therefore, the risk of significant negative impact is significant. For example, we had been told previously that 90% of Debenture loans to SBICs would be covered. If each covered loan would bear $45,000 in new fees, the average SBIC (one with $20 million in private capital and $40 million in Debenture leverage) would pay $1,620,000 in the new fees over its projected 10-year life.

d. The question states that SBA's position is that all borrowers who can qualify for a loan of $1,000,000 or more can afford to pay an extra 4.5% in new upfront fees. That is simply not true. Not every borrower who can afford to borrow $1,000,000 can afford to pay an additional $45,000, particularly at the time the loan is made. Each individual borrower is unique and the financial facts and circumstances of each borrower at the time a substantial fee is imposed control whether or not that new fee is "affordable."

3. Question regarding a "zero" subsidy rate for the Participating Security program.

a. NASBIC believes that a zero subsidy rate must be achieved in an equity focused SBIC program, whether a Participating Security or Participating Debenture program, that meets the requirements of the Federal Credit Reform Act in order for the program to have a meaningful economic impact in terms of investments in U.S. small businesses. With all SBA finance programs now operating at "zero" subsidy rates and the Congress intent on finding ways to control mounting deficits, it seems unreasonable to assume another approach might be viable.

b. NASBIC cannot determine what fees must be imposed to reach a "zero" subsidy rate because OMB and CBO control the performance modeling that is used to arrive at an answer to the question and industry experts are not permitted to participate in the process. Of paramount importance in such modeling is the use of reasonable performance assumptions for the SBICs that would be licensed to make equity investments. Reasonable performance assumptions should be developed by looking at private equity return data across a timeline of at least 20 years. Using such data ensures that performance assumptions used for modeling purposes are not unreasonably skewed either positively or negatively by the impact of any single economic period, such as that of 2000-2003.

c. It is axiomatic that SBIC program user fees make the program more expensive for private investors and increase the risk that they might lose some or all of their capital. Like OMB and CBO, private investors do their own performance modeling to decide whether or not to invest in the SBIC program and they will not invest in the program if the fees and other program costs exceed a certain level. Since different investors will have different views concerning "how much is too much," it is difficult to stipulate as to the outside limit—especially when "fees" are made up of up-front costs, interest add-ons, and SBA's profit share. NASBIC is more than happy to share with the Senator, the Committee, and the Administration the modeling NASBIC does to project how the combination of those elements might impact any given investor's decision on whether or not to invest in an SBIC.

Testimony of Mark A. Redding Before The House Committee on Small Business

April 13, 2005

Chairman Manzullo, Ranking Member Velázquez, and Members of the Committee:

I appreciate the invitation to testify at the hearing of the Committee on Small Business of the United States House of Representatives. This hearing, to address the challenges facing small businesses needing equity because of the shutdown in the Participating Securities Program, is of great importance to me. My name is Mark A. Redding. I am currently the Chief Executive Officer of Banner Service Corporation in Carol Stream, Illinois. Banner is a manufacturing company with about sixty employees engaged in the precision processing sector of the steel bar industry. While small in comparison to the total steel industry, Banner is a leader in its chosen field of precision centerless bar grinding. We service the needs of the machining, automobile, metal service center, and selected original equipment, industries.

My professional background, since 1974, has been in the metal products industry. For the past thirty years I have worked exclusively in the machining, grinding, foundry, and machinery making industries. From an entry level position as a production control analyst, on to plant management, sales management, Chief Operating Officer, Group Vice President, and eventually twice a Chief Executive Officer, I have been engaged in both large and small firms. I have had the opportunity to be in a private ownership position in three of those firms. Most recently I was able to lead the effort that resulted in the purchase of Banner Service Corporation from its founding family, some forty-plus years after its original inception. Two licensed SBIC private equity firms, Prism Capital and Alpha Capital Partners joined with me to make that purchase and subsequent revitalization of Banner Service Corporation possible.

To more fully understand the importance of these issues, I would like to more fully describe Banner. To know this business, its history, past success, decline, and recent revitalization is, in my opinion, of great relevance to the subjects being discussed in this hearing. Banner was formed by the Jack Sneeden family in 1961. In the beginning it was mostly a small, metal distributor focused upon serving small metal bar users. Over a period of many years, Banner transformed itself from metal bar distributor to a turnkey provider of precision straightened, ground, and polished bar products. During the course of its history it expanded many times, added additional equipment and created new jobs. In the mid to late nineties, it eventually outgrew its facility and began to look for a new home. In cooperation with a Chicago-area real estate developer, it was able to secure a new building that was designed specifically for its intended business. In late 1997, as the U.S. economy blossomed, Banner relocated to this 74,000 square foot facility, ideal for its functionality, but at a significantly higher cost. Many new efficiencies were realized as a result of this expenditure and Banner was blessed with business that resulted in sales revenue of over $26,000,000 in 1997. However, there would be trouble ahead for Banner and its new scale. Much of that growth was based upon making bars to be further manufactured into component parts for office products such as computer printers. From the late 1990's until the early 2000's, most of the demand for these bars evaporated as the office products sector moved offshore. In addition, the recession of this period impacted many other sectors of Banner's traditional clients and the result was a serious decline in Banner's revenues. By mid-2003, at the time I came upon Banner, its sales revenue had declined to an annualized pace of less than 17 million dollars. This was considerably less than what it would take to support its new facility. The then owner considered many options to deal with these conditions. Eventually, liquidation studies were conducted with the possible intent of simply ceasing to operate. Fortunately for the company and its employees, the ultimate result was a sale of the business to our group, led by me but heavily supported by Prism Capital and Alpha Capital Partners. Portions of the funds from Prism and Alpha used to support this purchase were provided by the Participating Securities Program.

The transaction to buy Banner from the Sneeden family occurred over the approximate time frame of May 2003 to September 2003. The early part of that period saw me working on dual fronts to negotiate with Mr. Sneeden on the terms of the sale, while also attempting to raise equity capital to anchor the financial structure and consummate the purchase. Armed with a Letter of Intent signed by Sneeden, the seller, I searched the financial community to attract equity investors to combine with capital of my own. The private equity investors are well established and well known in the Chicago market. I contacted firms such as Wynnchurch Capital Ltd., Cambridge Capital Partners, P.S. Capital Partners LLC, Cedar Creek Partners, LLC, High Street Capital, Tangram Partners, Inc. and others. However there was a very low level of interest in participating in this transaction. That low level of interest was in spite of my promise to not only invest my own personal capital in the venture, but also my full-time leadership as Chief Executive Officer. While I believe my considerable related experience was valued, the market for deals of this nature and size was very limited—limited because of the lingering recession, because of the reluctance of banks to extend debt financing, and because of the small size of the deal. It is commonly acknowledged in the traditional private equity community that small transactions are nearly as much cost and trouble as large ones, yet have considerably less upside. By June of 2003, I had found little solid support among equity investors for the Banner transaction and my window of opportunity described by my letter of intent was closing. It was at that time that I was fortunate enough to contact Steve Vivian of Prism Capital Mr. Vivian showed initial interest in the opportunity and frequently visited the company with me. He learned, firsthand, what the conditions at the company were. After developing more specific interest, we both met with Andrew Kalnow of Alpha Capital Partners to enlist his support and interest in joining with us. After careful and considerable investigation, Alpha Capital committed to investing equity capital to get this small but worthy transaction completed.

On September 3, 2003, the closing of sale occurred. What happened thereafter was and remains a wonderful success story. I would like to detail that success and offer my opinions as to why it has unfolded that way. During what remained, post closing, of the 2003 calendar year, Banner was able to make a profit and have a positive cash flow. Due to a firm financial structure, anchored by our SBIC equity investors, we had the time to carefully reposition the business and its intent. During the full year that followed

(2004) Banner was able to survive and thrive in an improving steel industry marketplace. By year end of 2004 Banner was able to regrow its sales revenue back to over $24,000,000 and more than double its free cash flow. We met every one of our debt financing repayments, increased our employment, added new products, and invested new money in new equipment. By year end Banner had purchased and installed a Twin Grip centerless grinding production line that cost in excess of $600,000. That investment arrived just in time to serve a strong 2005 demand for Banner's product and service offering. That investment provided work for machine riggers, electricians, plumbers, truck drivers, and others. Four new permanent jobs have resulted.

Further, this transaction, supported by SBICs Prism and Alpha, has created a new "class" of ownership at Banner. As part of the investor agreements developed by Prism, Alpha, and myself, four long-term employees of Banner became eligible to participate in Banner Holding Company's Management Common Unit Plan. This included one gentleman in excess of sixty years of age and one woman over fifty-five years of age. This plan also provides for future key members of Banner's management team to qualify for ownership if their contribution to Banner's future success warrants it.

In summary, as a result of the new ownership cooperation between Alpha, Prism and me, new life has been given to Banner Service Corporation. However, it is my opinion that much of the foundation underlying this success was the Participating Securities program and its cooperation with the small business community through SBIC licensees like Prism and Alpha.

Could it have happened without that specific source of equity capital? Perhaps, but when you consider the real alternatives, at that time, I doubt it. Let me explain why.

The Banner business was in decline, as I have already stated. The debt financing available without substantial equity investment was restrictive, nervous, and in short supply. A very basic tenet here is that equity investment was and continues to be a must for these transactions. Could there have been an alternative equity source to the SBIC licensed private equity? Perhaps, but unlikely. Traditional private equity does not seem to "like" small, basic manufacturing. In fact, it often does not like the Midwest as a region for reasons that are sometimes one and the same. Traditional equity investors often do not want this kind of small deal size or have the appetite for equity amounts needed to prevent the risk of excessive leverage. The desire for too much leverage would likely have prevented the Banner transaction from getting the debt financing required, especially when considering the lending environment at that time, the economic conditions and the company's recent decline. Prism and Alpha were prepared to commit sufficient equity capital to offset severe lender covenants that could have come into being if Banner had not been able to turn itself around quickly. What about so-called "angel" investors or high net worth individual investors? Perhaps, but undesirable to me due to future dependability and long term motives and purpose. The benefits of equity investment supported by the Participating Security Program were many when applied to the Banner transaction: patient, knowledgeable investors such as Prism and Alpha, the constancy of purpose of their SBIC license and use of that equity capital, and the focus on small business deal size. It is my conclusion that the Banner story would be very different without the Participating Security Program. We will never know for sure. However, we do know that because of it, a viable small business, formerly in decline, is back growing, spending capital on business expansion, increasing employment, and regenerating itself after 44 years in business. Furthermore, that regeneration is in a responsive, niche business that will not be outsourced overseas. The nature of Banner's business model does not lend itself to long distance supply routes or long lead times. As a result of the equity financing provided by the Participating Security Program through Prism and Alpha, Banner has attracted strong senior management comprised not only of myself, but others we have been able to attract. It is further supported by an experienced Board of Directors where members of both Prism and Alpha serve. Together we plan further acquisitions in an industry many others do not care about or trouble themselves with. With help from the SBIC Participating Security Program, there could be many more stories like Banner. I sincerely hope there will be. Please consider us and those other small businesses when you consider the future of the Participating Securities program.

Thank you. It has been a privilege to participate in this process.

Mark A. Redding

Mr. Redding is the CEO of Banner Service Corporation, having acquired the company on September 4, 2003. Banner is now owned by Mr. Redding, Prism Opportunity Fund, and Alpha Capital Partners. Mr. Redding is leading a new, high-growth period for Banner and intends to make several acquisitions in the near future. The strategy of this steel processing consolidation venture will include highly responsive customer service, lean manufacturing and an aggressive sales force coverage model.

From January 2000 until November 2001, Mr. Redding was President and CEO of General Automotive Manufacturing in Franklin, Wisconsin. His efforts there were focused on repositioning the company to a high production, repetitive manufacturing environment. This involved establishing the driving force of the company as production capability and changing the culture to one of performance based thinking and employee involvement. He also guided the company through a major restructuring, streamlining the manufacturing floor and implementing a new organization structure. The company intended to build a new facility in South Carolina to be operational in October 2002. This was a result of a new, large-scale supply contract negotiated by Mr. Redding with Siemens Diesel Systems Technology. General Automotive's focus area became precision machined components for the diesel engine and diesel fuel system market. Its customers are Caterpillar, Cummins, Siemens, Bosche Corp., Mercury Marine, and others.

Prior to joining General Automotive Manufacturing, Mr. Redding was group Vice President of Beloit Corporation, Mill Pro Services. He assumed the position in early 1996 after accepting the appointment from Tom Englesman, President of Beloit. Beloit Mill Pro Services was a group within Beloit Corporation comprised of approximately sixteen sites and 2,200 people. It focused on the service, spare parts and marketing functions for all Beloit Divisions and was a global business. Sales revenue for 1997 for Mill Pro Services exceeded a half a billion dollars with record profits exceeding one hundred million dollars. Mr. Redding was the original Group Vice President responsible for formulating and structuring this unified group from the previously disparate, seven individual groups, which were located within separate Beloit entities. In addition to the operating structure, a completely new financial and marketing structure was formed to develop, implement and measure the new B2000 Mill Pro Services strategy.

From 1992 until late 1995, Mr. Redding was the Vice President and General Manager of Beloit Corporation's J&L Fiber Services. This Waukesha, Wisconsin based firm was acquired by Beloit from its founders in 1992.

Prior to the acquisition of J&L by Beloit Corporation in 1992, Mr. Redding was President of J&L and Executive Vice President of the Corporation. He was among the early key employees, joining the company in 1974 as Foundry Manager. In 1976 he became Vice President, Gartland Foundries and in 1979 he left the Gartland operation to become National Sales Manager for J&L, becoming President in 1982. During this period Mr. Redding became a minority shareholder in the company with significant holdings. Mr. Redding was an early proponent of J&L's international efforts and traveled and worked extensively in more than fifteen countries on behalf of the program. Prior to joining J&L, he was employed by Brunswick Corporation, Libertyville, Illinois.

Mr. Redding is a graduate of the University of Chicago Management Development Program (1985) and is a past director of Panel Products International Corporation of Beaverton, Oregon and Custom Products Corporation of Menomonee Falls, Wisconsin. Mr. Redding was also a longtime board member of the American Paper Machinery Association, Washington D.C., and served as the organization's President in 1997-1998.

TESTIMONY BEFORE THE HOUSE SMALL BUSINESS COMMITTEE
APRIL 13, 2005
SBIC INVESTMENT AND US SMALL BUSINESS DEVELOPMENT
DR REDMOND CLARK, PRESIDENT
METALFORMING CONTROLS CORPORATION

My name is Redmond Clark. I am a resident of the State of Illinois, and I am president of Metalforming Controls Corporation, which is a venture-funded startup firm serving the metal stamping and die-making industries in North America. Our company sells a stamping press control system that allows metal forming operations to make stamped metal parts faster with fewer defects and less wear on the production line. Perhaps more importantly, our technology allows less expensive forming of high strength, lightweight steel that will reduce the weight of cars and trucks. That reduction in weight will not compromise the safety of the passengers, but it will reduce the fuel requirements of the US vehicle fleet. In doing so, our equipment will help to reduce the US dependency on foreign oil suppliers. Using US Department of Energy calculations, this technology could help to reduce US oil and gasoline consumption by almost one billion gallons of fuel annually.

Before I was the president of Metalforming Controls, I was president and CEO of the TDJ Group, which was and is a specialty chemicals manufacturer located in the Chicago area. This company has been an industry leader in the development, manufacture and sale of chemicals used to safely remove and detoxify lead paint from steel and masonry surfaces throughout North America. Lead paint is a significant threat to health of our children and the cleanliness of our drinking water. To date, company technologies have been used to clean more than 100,000,000 million square feet of lead painted surfaces, including such structures as the Seattle Space Needle, The Indianapolis 500 Speedway, the launch platforms for the Space Shuttle, and the hulls of the Trident Missile Submarine Fleet. In addition, this company has detoxified and/or recycled almost 1,000,000 tons of industrial hazardous waste.

I am here before your committee today to discuss the viability of the SBIC Program, and I am here to advise the committee as to whether the program should be funded in the upcoming federal budget for the 2007 fiscal year. Why is my testimony relevant to that issue? Simply put, those two companies that I managed would not be here today if SBIC funding had not provided the startup and/or turnaround capital required to make those companies successful. SBIC-backed funds provided a material portion of the money used during both company startups, and those funds attracted the rest of the investment dollars that got each company up, running and profitable.

THE CAPITAL LANDSCAPE FOR STARTUPS

I have spent the past 22 years working in the startup and growth company environment. During that period, I have raised almost $50,000,000 in capital invested into the businesses that I managed. During those 25 years, I have personally seen three trends that should be noted by this committee: institutional and private venture capital has increased dramatically, capital availability has clustered on either end of the investment spectrum (Seed, Later Stage), and capital sources are clustered on the coasts.

As investors recognized the opportunities in venture investment, there was a steady increase in the dollars allocated for investment in growth companies (See Table 1).

Table 1: The Growth of Institutional Venture Investment in the US

	VC Investment ($ Billions)	Seed Investment ($Billions)	Seed Investment Percentage
1995	8.2	1.3	16.1
1996	11.5	1.5	13.2
1997	14.9	1.3	8.9
1998	21.4	1.8	8.5
1999	54.6	3.3	6.1
2000	105.9	3	2.8
2001	41	0.7	1.7
2002	21.6	0.3	1.3
2003	18.9	0.4	2
2004	20.9	0.3	1.7

Source: National Association of Seed and Venture Funds

In the past decade, venture fund investment has almost tripled in size to more than $20 Billion. With that kind of growth, it would appear that the venture capital community would eventually catch up with any demands for startup and growth capital. Unfortunately, a second industry trend ran in parallel with the growth in capital investment: the venture capital industry invested larger amounts of those dollars in later stage companies. The reasons behind the trend include lower risk, shorter investment timeframes, and limited high quality investment managers. Whatever the cause, the effects are obvious: the absolute dollars invested in early stage companies fell by more than 75% while total investment expanded by 250%. Early stage companies are having more trouble finding funds necessary to support startup activities.

Angel capital has received a lot of attention as a partial solution to this growing problem. Private investors have allocated meaningful amounts of money to support the startup effort, but even though the numbers of angel investors and angel organizations have grown dramatically, and estimates of the dollars available for investment exceed those of the venture capital community, there is still a hole in the availability of early stage capital. Historically, angel capital may cover early startup costs, but these angels typically do not have the ability and the willingness to follow-through with concentrated additional investment that precedes venture fund or bank investment.

This creates a funding gap for growing ventures in need of debt and/or equity investment. This is a space that has been occupied by a number of first stage funds, including SBIC-backed venture funds.

The third trend worth noting is the location of capital sources. As outlined in Table 2, the vast majority of venture funding is found on the west coast and in the Northeastern US.

Table 2: Geographic Sources of Venture Capital in the US: 1994 - 2004

STATE	NO OF DEALS	$ INVESTED ($Billions)	% OF TOTAL VENTURE INVEST.
CA	14381	133	41.8
MA	4175	33	10.4
IL	872	7	2.2
MO	235	2	0.7
TN	275	2	0.6
IN	101	0.6	0.3
KY	93	0.5	0.3
KS	76	0.5	0.1
NE	29	0.2	0.1
MI	28	0.3	0.1
AK	26	0.1	0.1

Source: National Association of Seed and Venture Funds

This table indicates that more than 50% of the venture investment over the last decade occurred in two coastal states: CA and MA. This table also shows that there are large areas of the US where venture capital is very hard to find.

CHALLENGES IN RAISING STARTUP CAPITAL

I have raised venture capital and angel capital on the east coast and in the Midwest. In the last two venture-funded companies I managed, these companies attempted to raise approximately $1,000,000 - $2,000,000 each in order to cover startup and growth related expenses. In the first case – The TDJ Group, a 1989 chemical management startup – we received our first backing from Moreamerica, a Cedar Rapids, Iowa SBIC fund formed in 1959. No first stage money was found in Chicago, Minneapolis or St Louis. Through the support of Moreamerica and an Iowa-based, state-run venture fund, the additional funding requirements for the company were ultimately obtained from a small, east coast fund. Without the capital and support of the SBIC organization, the TDJ Group would not have existed.

My most recent company – Metaldforming Controls – sought $2,000,000 from venture investors in the greater Chicago area. The bulk of the funding necessary to start the company came from AAVIN Venture Fund in Cedar Rapids, Iowa. This fund is also an SBIC-backed investment fund. Through their leadership, we were able to bring in money from the State of Illinois and a new angel fund that started operations during the first year of our own operations. When a second round of funding was required to grow the business, the SBIC-backed fund continued in a leadership role, while the angels declined further investment.

Without SBIC investment, these companies would not have survived. Although they are not huge, they have generated more than $50,000,000 in sales, millions in taxable profits, more than $10,000,000 in payroll and income taxes, and directly or indirectly employed more than 50 people. Those companies detoxified and/or or recycled almost 1,000,000 tons of industrial or toxic waste. Those companies are making significant headway in reducing oil consumption and greenhouse gas emissions. Without SBIC involvement, these numbers would be zero.

CONCLUDING THOUGHTS

If my experience is a guide, I can offer the following thoughts about SBIC-backed investment funds;

- The SBIC supports a national availability of venture capital. Those funds are available to competent investment fund managers in any state.
- A significant number of SBIC – backed funds seem to be biased towards seed and first stage investment, with median investments in the $500,000 to $1,500,000 range, roughly double that of the angel community. That figure does not include follow-on investments by those funds. This covers a large portion of the funding gap referenced in this testimony
- SBIC investment in small to medium sized funds ($10 – 25 Million dollars) exceeds $800,000,000 annually (Source, SBIC 2003 report), which is a major fraction of the seed/first stage dollars invested by the entire venture capital industry each year.
- SBIC – backed funds are found in all 50 states
- Their geographic diversity often places licensees in markets where capital availability is a critical limit to the success of startups. If I may offer an analogy, the professional baseball leagues do not find all of their talent in a handful of states. The same is true for entrepreneurs and the businesses they run. The SBIC has made my companies a reality in spite of the locations of the businesses.
- The entire venture capital community has passed through periods of better and worse performance, because that industry is subject to business cycles too. The total investment in the venture capital industry is still increasing, even after the effects of the industry bust after the bubble. Recent SBIC performance is not necessarily a guide to future performance, as long as the program works to fund competent managers and business concepts.

We are beginning to understand how important small companies are to the strength of the US economy. We already know that unavailable risk capital is a significant limit to growth for most startup firms, and we know that well run SBIC licensees can provide that capital to promising startups. It would seem imprudent to cut back or terminate such a program, especially as we see global competition in almost every corner of our economy. Thoughtful investment of SBIC venture capital during business evolution fuels technology change, economic growth and competitive advantage.

Testimony of Daniel W. O'Connell before the House Small Business Committee
April 13, 2005

Chairman Manzullo, Ranking Member Velazquez, and Members of the Committee

Thank you very much for this opportunity to testify at the hearing of the Committee on Small Business of the United States House of Representatives regarding the importance of the participating securities program. My name is Daniel W. O'Connell. I am currently the director of the Stanley C. Golder Center for Private Equity studies in the College of Business at the University of Illinois at Urbana-Champaign. This Center, through a combination of education, research and outreach initiatives, focuses on the issues, roles and impact that the private equity community has in supporting new and growing businesses, as well as in the recapitalization and restructuring of existing enterprises.

More than thirty years ago, I was introduced to the venture capital industry when, as a summer intern in 1973 at the then First National Bank of Chicago, I was asked explore whether or not the Trust Department should be involved in the venture capital industry, and if so, how. In my subsequent white paper, I argued that it should, and presented a strategy by which it might proceed. After graduation in 1974, I returned to the Trust Department, and, eventually, served as the venture capital asset class manager executing the strategy I had recommended. During the five years of my leadership, our team made more than fifty investments into both venture capital funds and individual companies. In 1984 I left First Chicago to co-found Alpha Capital, which was one of the first licensed partnership-form SBIC's. My partner and I formed Alpha in order to take advantage of an opportunity we perceived to serve the needs of small and early stage companies in the Midwest. During my time with Alpha, I was a NASBIC governor, and in the early 1990's, I had the honor to serve on a committee whose work ultimately led to the creation of the participating securities program. In 1993 I left Alpha to join Allstate's private equity unit, a group which, I believe, at the time of my arrival was the largest venture capital pool between the coasts. Upon Allstate's departure from the private equity business at the end of 1999, I joined Capital for Business, an SBIC focusing on buyouts and expansion financings of primarily smaller Midwest-based manufacturing businesses. Over the years, I have been all around the venture table, acting at various times as a general partner, a limited partner and an investor in a wide range of private equity situations.

These past thirty years have been a time of incredible expansion for our industry. Dollars under management, dollars invested, companies created, number and types of limited partner investors, number of investment professionals, and the size and character of supporting infrastructure have all grown dramatically.

Testimony of Daniel W. O'Connell before the House Small Business Committee
April 13, 2005

During this period there has also been a huge broadening of investment strategies. At First Chicago we felt we were ahead of our time because we preferred to refer to what we did as the deployment of "risk" or "development" capital, not just "venture" capital. Today, private equity, broadly defined, includes a broad spectrum of possible investments, ranging from angel and earliest stage start ups through and including huge international multi-billion dollar buyouts.

Yet while the industry has expanded dramatically, it remains fundamentally "granular". That is, there exists a immense matrix of possible investment strategies described across multiple dimensions: size of investment, size of company, stage of company, industry, geography, level of ownership, character and degree of investor involvement, to name a few. And while the dollars under management have grown substantially, over the years many of these dollars have flowed into a relatively few, established private equity groups. The resulting competition for the remaining available dollars encourages general partners to identify niches in which they feel they can compete more successfully. I can only see this trend toward specialization continuing. The best private equity managers recognize that they are in a business. As such, they identify an attractive and defensible opportunity, create a strategy and plan, and assemble a team and the resources to capture the opportunity. It was, and still is, true that successful execution of a private equity group's business strategy requires an underlying match of its human and financial capital to the needs of its chosen niche.

Over these years we have endured several venture cycles in which I have seen it, at one end, incredibly difficult for good investors to raise money and, at the other, incredibly tempting to compromise one's discipline and strengths in order to make investments in overheated, very challenging markets. Always, but especially in between these two extremes, there can be something almost magical that occurs when all the elements of a good investment come together to create, sustain or grow worthy businesses.

So what do these have to do with the participating securities program? In my experience at Alpha, it was conspicuous to those of us using SBA debentures that there was a problem when we wanted to invest in situations characterized by high risk, high growth and potentially high returns; i.e. venture or growth companies. From one perspective, it made little sense for an SBIC to **borrow** money – which implies some sort of reasonable expectations as to timing and probability of collection – to make an investment in a company that by its stage and character made such expectations unpredictable or unrealistic. Those companies required **equity**. There was a fundamental mismatch between our source of funds (SBA debentures) and our uses of those funds (equity investments). Did we make those investments anyway? Yes, we did, but in less than optimal ways. We tolerated more risks at the fund level; we acquired notes from our portfolio companies, and over funded the equity piece in a company investment in order to mitigate some of these risks. In my opinion, the participating securities program was intended to provide a better match between the nature of the funds (i.e. long-term, patient, equity-like dollars) provided to the SBIC and the realistic dynamics of the businesses into which the SBIC would invest.

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April 13, 2005

So, is there still a need today for this kind of program? Absolutely. If anything, the increasing specialization of our business suggests an even greater need. From my experience, SBIC's fill important pieces of the private equity matrix. They tend to be more geographically focused, and in regions under served by other sources. Because they have learned how to prosper from exits other than the public market, they are more comfortable with smaller businesses, and with businesses in industries (like manufacturing) or niches of a size that typically do not represent IPO potential. And because SBIC's manage smaller pools of dollars, they tend to make smaller investments, on average. Once in an investment, SBIC principals often deal with value creation needs somewhat different than those of traditional vc's. For example, at CFB we felt a significant element that we brought to the table was our ability to take a small, owner operated business to the next level by developing in place management, judiciously adding to the team over time, and refining or putting into place the financial and managerial controls, processes and disciplines necessary for growth. Could and do traditional venture funds and the larger buyout groups make these kinds of investments? Yes, from time to time they do. But only when it is easy for them to do so. It is just not time or dollar efficient for them to aggressively make the kinds of investments that an SBIC was formed to do.

Regarding how the program might be more effective going forward, I wish I had more specific knowledge so I could make tighter suggestions. In any case, I would like to make a couple of observations. First, I believe it is absolutely critical that there be a match between a private equity fund's sources of capital and its uses as seen in the investments it intends to make. On any private equity fund's balance sheet, there is largely sweat equity brought to the table by the managing principals, risk capital (equity) from the fund's limited partners, and, if used, somewhere in between might appear dollars from the SBA. If you expect the SBIC managers to make relatively high risk, low liquidity, long term, but potentially high return, i.e. equity, type investments, then the SBA dollars that might be used should patient, long term, and risk tolerant.

In any company situation seeking funds from a diverse set of players, there are pricing and term issues. So it will be here. To be successful, all parties to the transaction must feel there is a fair and reasonable sharing of risks and rewards, and that there is reasonable oversight and controls consistent with a player's position in the transaction.

When I look at the SBA itself, my experience would suggest several things. First, because of the risks and illiquidity involved, it is essential that any pool of private equity investments be broadly diversified, both by character (industry, stage, etc.) and over time. Second, there is a need to be patient. Interim results – good or bad – can be very misleading in the private equity business. It is only when you have finally and completely exited an investment that you are able to determine its success. A rush to decision in the middle of the investment process nearly always results in suboptimization over the long run. Both of these issues are portfolio management challenges which are best met by having a staff of experienced professionals. And to build and keep such a staff, it would appear to me, requires a long term commitment to the SBA itself.

Finally, if we in the industry are going to ask for patience and flexibility from our backers, we must do everything we can to earn and sustain their trust. It is thus incumbent upon us to rigorously adhere to the highest management and ethical standards, and to accumulate and share appropriate information that shows the continuing value of our efforts.

In conclusion, thank you, again, for this opportunity to share my experience and thoughts. I truly believe that there is a continuing need for SBIC's that lever their private capital with equity-like SBA dollars. I also believe that the SBA has been a productive and valuable partner. And while there are certainly things that can and should be changed, the goal of having a program to support the creation and support of America's small businesses is worth the effort.

At this time I would be pleased to address any questions the Committee might have.

Testimony of Daniel W. O'Connell before the House Small Business Committee
April 13, 2005

Biography
Daniel W. O'Connell

Mr. O'Connell joined the College of Business at the University of Illinois at Urbana Champaign in 2005 with nearly 30 years of venture capital and small business investing experience. He serves as the director of the recently established Stanley C. Golder Center. Through a combination of education, research and outreach initiatives, the Center focuses its programs on the issues, roles and impact that the private equity community has in supporting new and growing businesses, as well as in the recapitalization and restructuring of existing enterprises.

Before joining the University, Dan served for five years as a senior vice president of Capital for Business, a licensed SBIC and the private equity affiliate of Commerce Bankshares of St. Louis. With approximately $100 million under management, Capital for Business focuses on buyouts and expansion capital opportunities primarily in Midwest middle market manufacturing businesses. Dan established and led CFB's Chicago office. Before joining CFB, for seven years Dan served as a director in Allstate's Private Equity Group, which until 1999 had been one of the country's largest and most active venture and private equity investors. Prior to joining Allstate in1993, Dan was a general partner for Alpha Capital Venture Partners, a private venture capital partnership and SBIC located in Chicago, and focusing on investment opportunities in the Midwest. And prior to co-founding Alpha in 1984, Dan was a Vice President of The First National Bank of Chicago and for five years head of First Chicago Investment Advisors' venture capital activities. His responsibilities there included directing the growth and operation of a substantial pooled investment vehicle making venture capital investments for the benefit of pension and profit sharing funds.

Mr. O'Connell has been actively involved with closely held businesses, venture capital investments and venture partnerships since 1975. He has served on numerous boards of directors and partnership advisory committees. He currently sits on the Board of Directors for LWG and Pegasus Research, and on the Board of Advisors for Aavin Equity Partners. He is also a Director of the Illinois Venture Capital Association, and he is a past Governor of NASBIC, where for two years he served as Chairman of its Education Committee.

Mr. O'Connell received his B.S. with High Honors from the University of Illinois, an M. S. in Accounting with Distinction from DePaul University, and an MBA from Harvard University.

Statement
of
Susan L. Preston

Before The
United States House of Representatives
Committee on Small Business

April 13, 2005

Chairman Manzullo, Ranking Member Velázquez and Members of the Committee:

A. Introduction

Thank you for inviting me to testify regarding the Administration's FY 2006 budget proposal for the Small Business Investment Company (SBIC) program. To provide context for my testimony, I provide a brief summary of my background and expertise and attach a more complete resume for the Committee's information. My testimony reflects my expertise and knowledge of the private equity market, in particular angel investing.

For approximately 5 years, I have been an Entrepreneur-in-Residence (E-in-R) with the Ewing Marion Kauffman Foundation, an internationally recognized foundation dedicated to the advancement of entrepreneurship in the United States. One of the most critical issues for entrepreneurs is the availability of financing for creation, development and growth of a business venture. As an E-in-R for Kauffman Foundation and in several other capacities, I have focused much of my professional efforts on the subject of angel financing of entrepreneurial ventures: understanding that economically vibrant communities are created through the support of entrepreneurial endeavors.

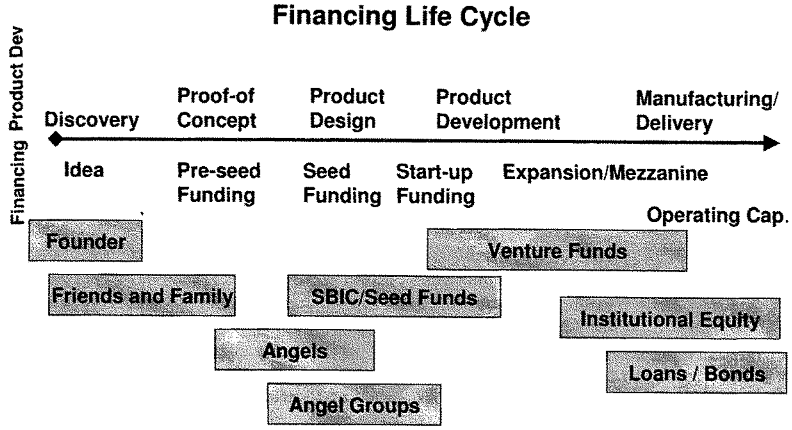
My activities specifically relating to angel investing are numerous and broad-reaching including:

1. Author of *"Angel Investment Groups, Networks and Funds: A Guidebook to Developing the Right Angel Organization for Your Community*", a comprehensive guidebook on the establishment and operation of angel investment groups.
2. Contributing author to *"State of the Art: An Executive Briefing on the Cutting-Edge Practices in American Angel Investing"*.
3. Author of numerous articles on private equity financing, particularly angel investing and angel organizations.
4. Member of the Advisory Board, Treasurer and one of the founding members of Angel Capital Association (ACA), a professional alliance of angel organizations.
5. Frequent speaker and instructor on private equity financing, including at: ACA North American Summits, State Science and Technology Institute (SSTI) conferences, National Association for Seed and Venture Funds (NASVF) annual conferences, Organization for Economic Cooperation and Development (OECD) double ministerial conferences, Governors' Conference on Economic Development, Industry Canada, State of Wisconsin and many others.
6. Profiled in Inc. Magazine and other local and national publications on angel investing, private equity financing and women's entrepreneurship.
7. Founder of Seraph Capital Forum, an all-women's angel investment group in the Seattle, Washington area.
8. Co-chair for two consecutive years for the Early Stage Investment Forum, the premier investment event in the Pacific Northwest

B. The Funding Gap

The development of any entrepreneurial venture requires funding at various stages of development. As Graph 1 below depicts, the source of funding varies with development of a company's product or services.

Graph 1: Financing Life Cycle



As will be discussed in this testimony and supported by facts from MoneyTree™Survey, National Venture Capital Association, Center for Venture Research, Dow Jones Venture One and other sources, venture capital is no longer a realistic source of financing for the critical seed and start-up phases of a company's development – creating a funding gap for which entrepreneurs must seek other sources of funding. Historically, the funding gap between investments made by friends and family and the point at which companies could obtain venture capital financing was between $500,000 and $2 million in invested capital. However, with venture capitalists moving further up the funding chain with fewer and fewer investments early in a company's development, a second funding gap has emerged between $2 million and $5 million.[1] Table 1 illustrates these funding gaps:

TABLE 1

Stage	**Pre-Seed**	**Seed/Start-Up**		**Early**	**Later**
Source	Founders, Friends and Family	Individual Angels	**Funding Gaps: 1. Between $500,000 and $2,000,000; 2. Between $2,000,000 and $5,000,000**	Venture Funds	
Investment	$25,000 to $100,000	$100,000 to $500,000		$2,000,000/$5,000,000 and up	

[1] Source: Sohl and Sommer, *Angel Investment Activity: Bracing for the Downdraft,* 2002 Babson Conference

MoneyTree™Survey[2] statistics amplify the loss of venture capital in the seed/start-up stage of entrepreneurial company development. In fact, as shown in Table 2 below, in the last 6 years, the amount invested in the seed/start-up stage by venture capitalists has decreased by nearly 90%, and the percentage of funding dollars has decreased by 72%.

TABLE 2
VC Seed and Start-Up Financings[3,4]

1999	$3.3 billion	809 deals
	6.1%*	14.4%**
2000	$3.0 billion	672 deals
	2.9%	8.3%
2001	$767 million	251 deals
	1.9%	5.4%
2002	$352 million	155 deals
	1.7%	5.1%
2003	$385 million	193 deals
	2.0%	6.1%
2004	$346 million	171 deals
	1.7%	5.9%

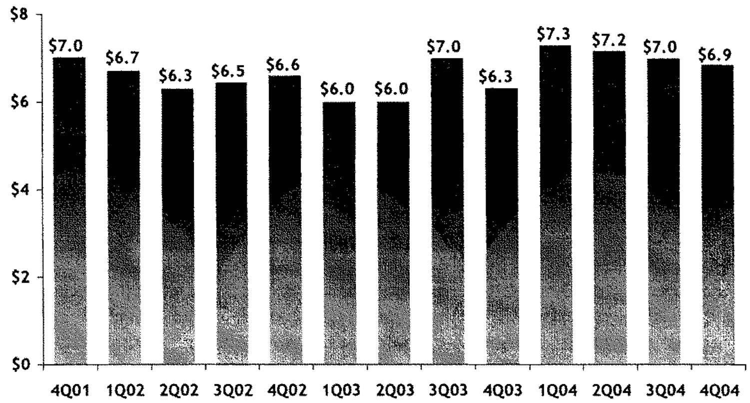
*Percentage of total dollars invested by venture capitalists in seed/start-up ventures
**Percentage of total deals by venture capitalists in seed/stat-up ventures

The reasons for this alarming and precipitous drop in funding are multi-faceted. First, since the bust, venture capitalists have been re-investing in their portfolio companies, rather than new investments. Second, because of the size of venture capital funds, often several hundred million dollars, it is not cost-effective for venture capitalists to go through the often arduous task of due diligence and then ongoing investment stewardship for a $2 to $5 million deal, than the historical median investment of $6 to $7.5 million.

Graph 2 below shows the median amount invested by venture capitalist in each round of financing. Clearly, few companies require $7 million in the seed/start-up phase of development.

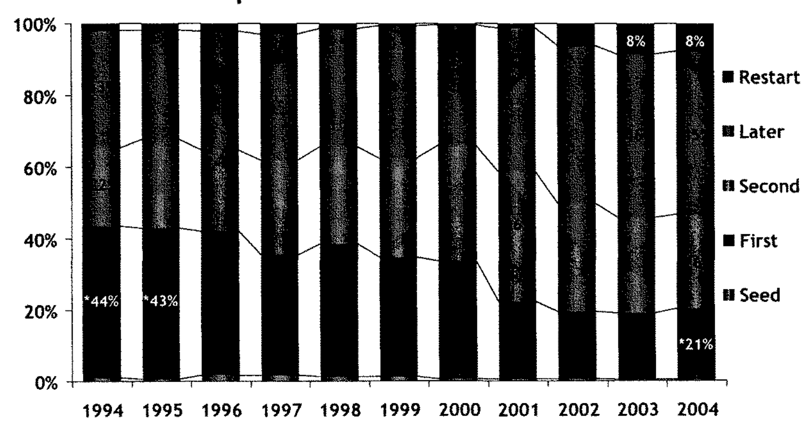
[2] PricewaterhouseCoopers/Thomson Venture Economics/National Venture Capital Association
[3] Source: MoneyTree™Survey
[4] Definition of "seed/start-up" under MoneyTree™Survey: "The initial stage. The company has a concept or product under development, but is probably not fully operational. Usually in existence less than 18 months. "

Graph 2[5]
Median Amount Invested Per Venture Capital Financing Round



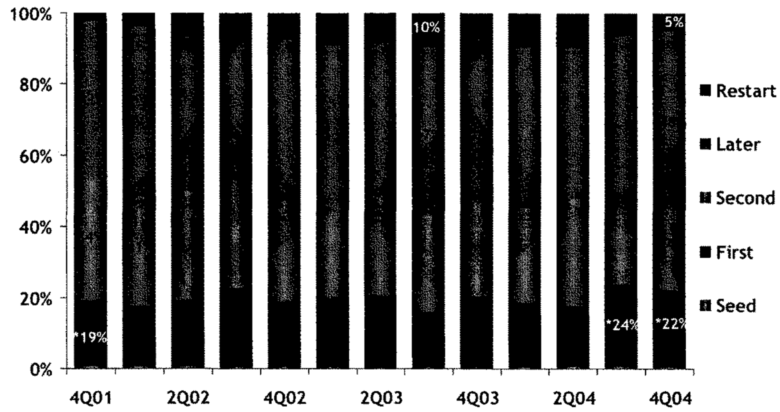
Finally, investing in later stage companies provides venture capitalists with operational history, evidence of market acceptance and sales performance information, theoretically reducing the investment risk. Graphs 3 and 4 below show venture capitalists' strong preference for later stage investments, both in terms of total dollars invested and number of investments.

Graph 3[6]
Most Venture Capital Dollars Directed at 2nd & Later Rounds



[5] Source: Dow Jones VentureOne/Ernst &Young
[6] Source: Dow Jones VentureOne/Ernst &Young

Graph 4[7]
Venture Capital Allocation to Later Rounds Continues



C. Angel Investments

Angel investors have proven themselves to be an integral part of the capital market, particularly for funding seed/start-up companies. The term "angel" originated in the early 1900s and referred to investors who made risky investments to support Broadway theatrical productions. Today, the term "angel" refers to high net worth individuals, or "accredited investors," who typically invest in and support start-up companies in their early stages of growth. In addition to the value provided by early funding, angel investors are typically experienced professionals who can offer wisdom and guidance to the entrepreneur and who have the patience to allow time for normal company maturation. With few exceptions, angels invest on a regional basis, being interested in personal relationships with companies and employees, as well as in giving back to their communities.

In the financial world today, angel investors are a critical and essential part of a healthy economy. Experts estimate that, on a cumulative basis, the level of investments made by angels over the last 30 years has been double that of investments made by venture capitalists.[8] The Center for Venture Research at the Whittmore School of Business and Economics at the University of New Hampshire estimates that angel **investments for 2004 were approximately $22.5 billion in 48,000 deals**, compared to $18.1 billion in 42,000 deals in 2003, representing a 24% increase in deals. These investments were made by an estimated 225,000 active angel investors. The majority of the 48,000 deals in 2004 were in the seed/start-up phase of entrepreneurial company development.

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[7] Source: Dow Jones VentureOne/Ernst &Young

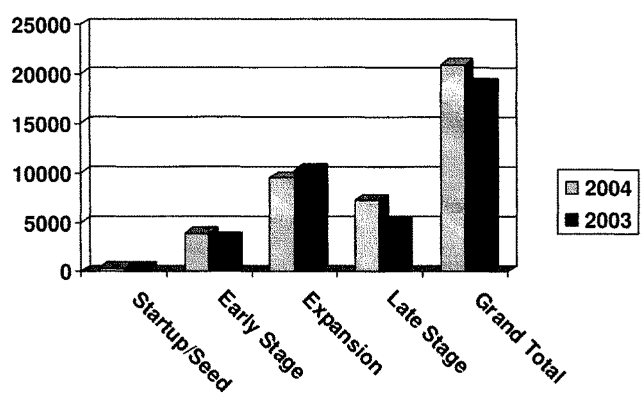
[8] According to statistics published by the National Venture Capital Association and the Center for Venture Research, University of New Hampshire

Therefore, angel investors can be defined as individuals who:

- Provide early-stage investment dollars
- Typically invest smaller dollar amounts per investment, with average investments of $25,000 to $250,000 per deal
- Invest their own wealth, with a clear expectation of financial reward
- Make their own investment decisions, in contrast to venture capital funds which are a passive investment process for the limited partners
- Provide valuable mentor or advisor services to companies as many are successful entrepreneurs with wisdom and expertise to offer the entrepreneur
- Have a sense of community involvement and social responsibility
- Have a tolerance for loss of entire investment
- Help fill part of the funding gap left by venture capitalists

In contrast, **venture capitalists invested less than angels in 2004 in dollars and in considerably fewer deals: $20.9 billion in 2,876 deals**. (Venture capitalists invested $18.9 billion in 2003.) Graph 5 below further emphasizes previously stated statistics and reflects the focus of venture capitalists on late stage company development rather than seed/start-up, with the 2004 increase in venture capital investments largely due to late stage investments, an increase to $7.2 billion in 2004 from $4.9 billion in 2003.

Graph 5
Venture Capital Investments by Stage of Development[9]
($s in Millions)



MoneyTree™Survey defines the various stages of investment as:

1. Seed/Start-Up Stage: The initial stage. The company has a concept or product under development, but is probably not fully operational. Usually in existence less than 18 months.
2. Early Stage: The company has a product or service in testing or pilot production. In some cases, the product may be commercially available. May or may not be generating revenues. Usually in business less than three years.

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[9] Source: MoneyTree™Survey

3. Expansion Stage: Product or service is in production and commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit. Usually in business more than three years.
4. Later Stage: Product or service is widely available. Company is generating on-going revenue; probably positive cash flow. More likely to be, but not necessarily profitable. May include spin-outs of operating divisions of existing private companies and established private companies.

The combination of late stage investment focus, sizable investment amount median and reinvestment into portfolio companies should convince anyone that venture capitalists are not a realistic source of funding for the corner-stone of innovation and creativity in the United States: the entrepreneurial venture.

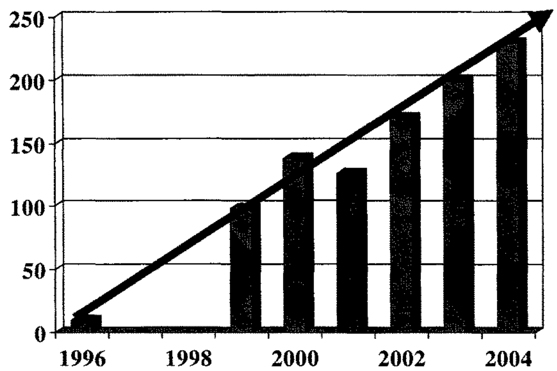
D. Angel Organizations

As stated earlier, Kauffman Foundation's mission is advancement of entrepreneurship in the United States. The founder understood the vital importance of entrepreneurs to the creation of healthy, vibrant economies. Unfortunately, one of the fundamental issues for entrepreneurs is the availability of adequate financing, particularly at the critical seed/start-up stages of company development. In recognition of this issue, Kauffman Foundation has focused much attention and resources in developing programs to support the availability of funding for young entrepreneurial ventures, most recently in support and promotion of angel investing and angel organizations.

An important part of the definition that separates angel groups from other investment vehicles is the active participation of angel group members in the investment of their own capital. From this definition of active investment of one's own capital, an angel group is then a group of angel investors investing through a member-directed investment process. The actual investment direction process may vary considerably, but all members have input either through their individual decision to invest or as a member of the group to invest part of the group's fund. Angel organizations can be everything from an informal group of individuals who conduct cooperative due diligence to a group with paid management and committed investment funds. Angel investment groups provide several advantages for individual angel investors including: 1. Quality deal flow; 2. Greater investment clout from combined dollars; 3. Opportunity to bridge the funding gap; 4. Collective due diligence; 5. Formal and informal investment education; and, of course, 6. Group social benefits.

Because of these advantages, we have seen a definitive increase in the establishment of angel investment groups in the United States. Graph 7 below depicts this recent extraordinary rise in angel organizations:

Graph 7[10]
Growth of Angel Organizations



Approximately three years ago, I, along with others at Kauffman Foundation became involved in what were initially small, semi-formal, meetings of representatives of angel groups. The attendees' strong expression of interest for a more formal, structured mechanism for angel organizations to meet and share best practices, information and experiences, led to Kauffman Foundation creating Angel Capital Association (ACA), a professional alliance of angel organizations. ACA is still a program of Kauffman Foundation, but will soon file for independent corporate recognition and will be seeking independent 501(c)(3) and 501(c)(6) status. The primary objective of the 501(c)(3) entity will be to conduct research on the angel investing market and educate individuals and the public on angel investing and angel organizations. The 501(c)(6) will be the angel organization trade association, with commensurate member and public benefits.

The recognition of the importance of angel investing is reflected in the estimated amounts invested by angel investors in 2004, $22.5 billion, as well as in the remarkable success of ACA. ACA began accepting group membership in March 2004 and at the time of the second North American ACA Summit in April 2005, 85 angel groups had been accepted for membership, including provisional groups (forming angel groups). This second ACA Summit attracted approximately 150 attendees with a keen and focused interest in furthering understanding angel investing and angel organizations.

All indications point toward continued growth and success for ACA. One of the important reasons for this anticipated positive future is the nascent character of angel investing – so new many are still hesitant to refer to angel investing as an actual industry. As such, the "terms and conditions" of angel investing are far from set. Just a few years ago, angel investors were considered unsophisticated, often taking common stock in return for their investment, failing to conduct adequate due diligence and investing at highly inflated valuations. Through several recent angel investing educational programs, as well as through the valuable angel group summits, angels are becoming "professionals" at investing.

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[10] Source: Center for Venture Research

But as with the development of any industry, numerous variables exist in investment models and organizational structures, which raise issues of sustainability. Angel investing and angel organizations as an investment vehicle can be equated to the venture capital industry 25 years ago. Currently, several legal and operational structures exist for angel groups, with no certainty of which model will provide positive return on investment (ROI) or if these factors even affect ROI. Additionally, the angel industry has differing opinions on fundamental terms and establishment of professional standards. Therefore, the continued presence of angel investing as a vital part of supporting the growth of entrepreneurial companies particularly at the seed/start-up stage will depend on several variables. As yet, no one has created a crystal ball which will assure the future of angel capital as an adequate and effective resource for the funding gap. Nor should any intelligent economy rely on one source to meet these critical economic needs, just as companies would not single source a crucial part of the product.

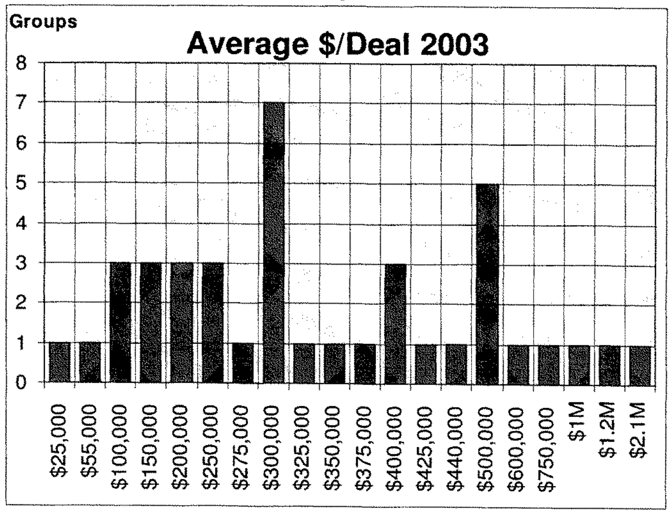
In addition to those issues being discussed and addressed through the ACA, equally important to angel investing, in any form, include critical factors as the availability of follow-on financing, patience in return on investments, an understanding of cyclic and often unpredictable nature of the investment industry and education of existing and potential angel investors. These factors emphasize the nascent qualities of angel investing and the importance of diversified financial resources.

E. Funding Gap Still Exists

One of the most critical issues for angel investors is the availability of follow-on funding. Some angel groups are beginning to reserve funds for follow-on round needs; however, few entrepreneurial funding needs can be met by angel investors alone, even through angel groups. This is particularly true for the second funding gap - $2 million to $5 million – left by the venture capitalists essentially abandoning seed/start-up funding rounds. As such, another source of funding must be available for this funding gap, specifically the SBIC program.

Even in these early stages of development, ACA has already conducted research on its member angel organizations. One particularly interesting and important statistic for the current discussion related to the continued funding of the SBIC program, is the average investment size of ACA group members. Graph 8 below shows the results of a recent survey of ACA angel group members, showing that the average investment amount per round for a group is between $100,000 and $500.000.

Graph 8



By these statistics, an individual angel group cannot meet the larger early stage investment needs of entrepreneurial companies, particularly the larger $2 to $5 million funding gap. Angel groups are only beginning to discuss deal collaborations or syndications and the likelihood of collaborations occurring and to what degree is uncertain at this time. This uncertainty is amplified by the fact that angels typically invest within their own community and most angel groups still leave investment decisions up to individual members. This combination of factors makes reliance on angels to fill the funding gap a risky bet and currently a long shot at best.

Because angel investing is a new industry, the ability to create substantial funding leverage is still developing. Therefore, to rely on angel investors and angel groups to fill the funding gap of $2 to $5 million is short-sighted and unrealistic and the numbers bear out this statement. Without the SBIC program, entrepreneurial ventures have lost an essential and critical component of early stage financing.

F. Policy Implications

One of the most troublesome consequences of the loss of the SBIC program is the further widening of the chasm between the middle and upper class. Without a vital funding source at the early stages of a company's development, only those with the financial capability to self-fund entrepreneurial endeavors, the upper class, will have the ability to drive a company through these initial stages of growth. Lower and middle class entrepreneurs with innovative products and creative business models will not have the financial resources to start businesses or grow to a point of possible sustainability. This is especially true for minority and women entrepreneurs.

G. Conclusion

Early stage investing must be patient money as the time period for realizing a return can often be several years. In addition, we have recently gone through an economic depression, partly due to unrealistic and poorly thought-through investments, which has resulted in significant losses. Therefore, any recent losses incurred by the SBIC program are similar to those experienced by all other participants in the investment community, including venture capitalists and angel investors. Despite these recent losses, the number of angel organizations continues to grow as does the amount of angel investing. Angels understand that we must continue to support entrepreneurial endeavors and strong returns can be achieved through these investments. This is no different than the economic cycles every investment segment experiences at some point in its lifespan. But if investors abandon each segment during a downturn, we would have few investment options today.

Far more good ideas exist than dollars to fund them and we must continue to support all sources of funding that enable the support of aspiring entrepreneurs at each stage of development from idea to viable company. As the Kauffman Foundation recognizes, entrepreneurs are the key to local and national economic wealth.

May 8, 2006

Ladies and Gentlemen:

The Ford Motor Minority Dealers Association (FMMDA) is an automobile trade association representing 325 franchised ethnic minority new car dealers across the United States. FMMDA members are primarily engaged in the retail sale of new and used Ford Brand vehicles. Further, FMMDA members are also engaged in automotive service, repair and parts sales.

Last month there was a subcommittee hearing where Senate Bill S.1603 was discussed. We applaud your efforts on changing the Alternative Size Standard. However, we also feel that the size standard for new car automobile dealers should be reevaluated as well.

The current new car dealer automobile North American Industrial Classification System (NAICS) 441110 use sales of $25.6 million or less to define a new car dealer as a small business. The current sales limitation does not allow many of the new car dealers and minority dealers in particular to take advantage of the loan programs administered by the SBA. We need to have the sales limit increased where more "Small" new car dealers can take advantage of the services offered by the SBA. If we continue to use new car sales, the sales limit needs to be raised from $25.6 to $49.5 million. New car sales vary in retail sticker price from $12,250 to $170,000. Therefore unit sales may not be the best indicator. However, a cleaner criterion may be using number of employees as a basis for determining a small new car dealer. Further, Car prices continue to rise. For example if a dealership's average retail price for a new car sold is $20,000 and the dealership sold 1000 new cars the dealership would have gross sales of $20,000,000 for the year. If the retail price increased by 5% due to the manufacturer's cost and the units sold stayed the same, the dealership would have increased its gross sales by $1,000,000 but not necessarily the dealership's profit. Moreover, if the trend continues for 6 years the dealership would surpass the sales threshold that defines a small new car dealership. Meaning, the business cannot take advantage of the programs that were put into place for small new car dealerships.

It is very rare to see a dealership with less than 100 employees with functional management positions throughout the organization. For example, many dealerships under 100 normally don't have a Vice President of Human Resources or even a Human Resource manager. The functions are mostly carried out among various people within the dealership. Further, within a dealership the trend is positions are becoming more specialized which forces the dealership to hire more people which increases its fixed operation and not necessarily its new car sales

Summary
Issues/Concerns/Problems

- The current new car dealer automobile North American Industrial Classification System (NAICS) 441110 uses sales of $25.6 million or less to define a new car dealer as a small business.
- The current sales limitation does not allow many of the new car dealers and minority dealers in particular to take advantage of the loan programs administered by the SBA.

- Gross receipts are not the best indicator of whether a dealership is large or small.
- Car prices continue to rise requiring the SBA to make frequent adjustment to its sale limitation.

Solutions

- The sales limit needs to be raised from $25.6 to $49.5 million.
- Or, a more appropriate criterion would be using number of employees (100) as a basis for determining a small new car dealer.

Regards,

A.V. Fleming
Executive Director

ASSOCIATION FOR ENTERPRISE OPPORTUNITY

May 10, 2006

Committee on Small Business and Entrepreneurship
428A Russell Senate Office Building
United States Senate
Washington, D.C. 20519

Chair Snowe, Ranking Member Kerry and Members of the Committee:

Thank you for the opportunity to submit written comments pertaining to the April 26 hearing on "Reauthorization of Small Business Administration Financing and Entrepreneurial Development Programs." My name is Zulma Bianca, and I am the Interim Executive Director of the Association for Enterprise Opportunity (AEO), the national trade and membership association for microenterprise development in the United States. The vast majority of AEO's membership consists of microenterprise practitioner agencies, including over half of all Microloan Intermediaries, PRIME grantees, and Women's Business Centers.

AEO supports reauthorization of the Small Business Administration (SBA). We firmly believe that this reauthorization is, above all, a real opportunity to expand access to financing and technical assistance for small businesses across the country. Three of the programs administered by the SBA are of particular interest to AEO and its membership of over 450 microenterprise development organizations. We are strongly in favor of incorporating legislation provisions in the SBA reauthorization legislation which will further strengthen the Microloan Program, the Program for Investment in Microentrepreneurs (PRIME) and Women's Business Centers.

The Microloan and PRIME Programs are two essential federal funding sources for microenterprise development in the United States. However, the Administration has again proposed in its FY 2007 budget that these programs be terminated. This would effectively eliminate the only available sources of business assistance for thousands of underserved microentrepreneurs across the country. These programs serve a unique population of microentrepreneurs whose financing and business assistance needs would not otherwise be met since they do not meet the eligibility criteria set forth by other federal loan programs or traditional financial institutions. The Microloan and PRIME Programs have proven track records of assisting new and growing small businesses, and must be supported and funded by Congress. Accordingly, AEO is very grateful to the Small Business and Entrepreneurship Committee for sending a letter to the appropriators signed by every member of the Committee which expressed support and requested adequate funding for the SBA Microloan Program, PRIME, and Women's Business Centers.

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As the national organization representing the microenterprise industry, AEO respectfully submits for your consideration legislative changes listed to the Microloan and PRIME programs which have consistently enjoyed strong bipartisan support because of their effectiveness in providing access to capital and technical assistance to low- and moderate-income entrepreneurs across America. These proposed changes would provide more flexibility to microenterprise development organizations and, in certain cases, update the legislative language to be consistent with current SBA practices.

SBA Microloan Program

1. **7(m)(1)(B)(i)**: AEO recommends striking the words "short-term," as they preclude Intermediaries from providing more flexible loan instruments.

2. **7(m)(2)(B) Expansion of Intermediary eligibility requirements**: AEO recommends that this section read: "Has at least (a) 1 year of experience making microloans to startup, newly established, or growing small business concerns, OR (b) a full-time employee who has not less than 3 years experience making microloans to startup, newly established, or growing small business concerns, AND (c) has at least 1 year experience providing, as an integral part of its microloan program, intensive marketing, management, and technical assistance to its borrowers." The addition of (b) would allow organizations that add staff with extensive experience in microlending to be eligible to participate in the program, even if the organization itself has less than one year's experience in making microloans.

3. **7(m)(3)(F)(iii) Technical change:** This and all references to the number "$7,500" should be struck and "$10,000" inserted in its stead. This is a technical change that reflects the manner in which SBA has operated the Microloan Program.

4. **7(m)(4)(E)(i) Pre-loan Technical Assistance:** AEO recommends changing the percentage of an Intermediary's technical assistance grant that it can spend on "...providing information and technical assistance to small business concerns that are prospective borrowers" from 25% to 35%. Oftentimes, microentrepreneurs need training, financial education and guidance before they can become good borrowers. Increasing this percentage gives Intermediaries the opportunity to develop more borrowers.

5. **7(m)(4)(E)(ii) Outsourcing Technical Assistance:** AEO recommends changing the percentage of an Intermediary's technical assistance grant that it can spend on "...entering into third party contracts for the provision of technical assistance" from 25% to 35%. As with point 4 above, this would better allow Intermediaries to provide technical assistance and training to entrepreneurs that need it, before making loan capital available to them.

SBA Program for Investment in Microentrepreneurs (PRIME)

1. Administration of the PRIME program should be moved from under the Community Development Financial Institutions (CDFI) Fund to the SBA. Conference Report 106-434, Section 172 clearly defines SBA as the Administrator of the PRIME program.

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In addition, AEO would like to recommend that funding for the PRIME program be increased from the FY 2006 appropriation of $2 million back to its original funding level of $15 million. If the funding level for PRIME is restored to the amount that was authorized by Congress when the program was created, AEO would then recommend that the geographic scope of the program be restored to include all 50 states and U.S. territories. This would enable PRIME to achieve its full potential of assisting underserved microentrepreneurs throughout the country. Currently, microenterprise development organizations in only 15 states and the District of Columbia are eligible to participate in this program.

Most of the legislative changes that have been outlined above are included in S. 138, the SBA Microenterprise Improvements Act, which was introduced by Senator John Kerry and Senator Jeff Bingaman on January 24, 2005. AEO greatly appreciates the leadership of Senators Kerry and Bingaman in introducing legislation to strengthen the Microloan Program and reauthorize the PRIME program, and would like to express our strong support for this bill. It should be noted that these legislative changes were in the SBA reauthorization legislation that was passed by this committee and unanimously approved by the Senate in the 108th Congress. Unfortunately, most of these provisions were not included in the final SBA reauthorization legislation which was added to an omnibus appropriations bill that was passed by Congress. We are grateful to the Senate Small Business and Entrepreneurship Committee for its commitment to supporting small businesses across the country and are confident that it will again pass reauthorization legislation to rejuvenate the SBA and empower the programs it administers.

As the Committee is preparing to consider SBA reauthorization legislation, AEO believes this is an appropriate time to discuss the incorporation of legislative provisions pertaining to individuals with disabilities and federal microenterprise programs. While people with disabilities are not being excluded from these programs, neither are they being specifically targeted or explicitly mentioned as being eligible for receiving assistance. To date, there is no Microloan intermediary, PRIME grantee or Women's Business Centers which specifically focuses on assisting individuals with disabilities. This situation is the result of an unintentional oversight, and not one of purposeful exclusion. The goal of including legislative language on people with disabilities is to get the microenterprise programs to be more aware of and accessible to organizations that are working with such entrepreneurs, and not to create any new programs or special treatment for this segment of the population. AEO looks forward to working with the Committee on addressing this important issue.

As both chambers of Congress move forward with SBA reauthorization legislation, we would like to thank you in advance for ensuring that the concerns of SBA Microloan Intermediaries and the broader microenterprise industry are taken into consideration.

Sincerely,

Zulma Bianca

Zulma Bianca
Interim Executive Director

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ASSOCIATION OF
WOMEN'S BUSINESS CENTERS

STATEMENT
OF
THE ASSOCIATION OF WOMEN'S BUSINESS CENTERS

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April 26, 2006
U.S. SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

Background of The Association of Women's Business Centers

The Association of Women's Business Centers (AWBC) is a national not-for-profit organization representing women business owners and women's business centers. The AWBC was founded to support entrepreneurial development among women as a way to achieve self-sufficiency, to create wealth and to expand participation in community economic development through educational, training, technical assistance, mentoring, development and financing opportunities. The vision of AWBC is a world where economic justice, wealth and well-being are realized through the collective leadership and power of successful entrepreneurial women.

As an organizing force of women's business centers and women business owners, the mission of the AWBC is to develop and strengthen a global network of women's business centers to advance the growth and success of women business owners. The AWBC builds the capacity of women's business centers, develops public and private resources to support member centers and the women business owners that they serve, advocates on behalf of women's business centers and women business owners and otherwise promotes women's business development nationally and internationally.

History and Impact of the Women's Business Center Program

The Women's Business Center Program began as a demonstration program created by Congress in 1988 as a response to women's organizations that presented evidence to Congress that women continued to face discrimination in starting and running small businesses. A leveraged federal investment in women's economic development, the Women's Business Center Program, quickly demonstrated its value and has enjoyed consistent, widespread, bi-partisan support from Congress. Today, the Program has grown from four to 104 Centers.

Seminal research by the National Women's Business Council[1], the Center for Women's Business Research[2], the US Census Bureau[3]and the Association of Women's Business Centers[4] validate the breadth and depth of the women's entrepreneurial market in the United States. This body of research builds the quantitative and qualitative case that women in enterprise development are a strategic and visionary solution for economic improvement.

Composite data from these studies provide specific economic growth detail.

- As of 2004, there were 15.6 million majority-owned, privately held women-owned firms, 48% of which were privately held firms by women who employ 19.1 million workers.
- By 2004, women business owners employ a gender-balanced workforce, 52% women and 48% men.
- Aggregate sales in 2004 of the majority-owned, privately held women-owned firms totaled $2.5 trillion dollars.
- Between 1997 & 2004, privately held women firms diversified into all industries with the fastest growth in construction, transportation, communications, public utilities and agriculture.

Consistently, the AWBC and the network of WBC's are the training grounds for women's entrepreneurship in the US:

- Bin 2006, there are 104 WBC's throughout the United States as well as women business resource centers abroad that continue to train women.
- During the three years from 2001-2003, the businesses counseled by Women's Business Centers generated an estimated impact of $500 million in gross receipts on an investment of $37 million. Producing a staggering return on investment!
- Since 1989, U.S. Women's Business Centers have collectively served over 500,000 clients.
- The Women Business Centers in the United States annually train over 100,000 entrepreneurs. In 2003 alone, Women's Business Centers trained over 106,000 clients.
- Women's Business Centers have an average of 79 client visits per month, ranging as high as 350 clients per month. On average, centers serve just fewer than 950 clients annually.
- Demand for Women's Business Centers services is rising; 75% of centers noted an increase in monthly client visits in 2004.
- During 2001-2003, the number of women entrepreneurs served *nearly* doubled- a 91% increase.
- During 2001-2003, the number of new firms created by WBC's increased by 376%.
- Approximately 50% of Women's Business Centers are co-located with another organization; 38% are part of a local economic development organization.
- The average WBC budget is just under $750,000 but the median budget is $320,000.
- Women's Business Centers serve women of color at a rate far higher than their prevalence in the general population; 42% of clients served are women of color.
- WBC's serve an economically disadvantaged population; on average, Centers report that 67% of clients served are in a household income bracket of less than $50,000.
- Women's Business Centers produce entrepreneurs; 60% of clients assisted are currently leading a start-up business.

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[1] National Women's Business Council, *Analyzing the Economic Impact*, September 2004
[2] Center for Women's Business Research, 2003 and2004
[3] US Census Bureau, 2004
[4] The Center for Women's Leadership at Babson College and the Association of Women's Business Centers, *The Impact and Influence of Women's Business Centers in the United States*, April/June 2005

- WBC's continue to provide critical entrepreneurial support, technical assistance and access to finance and markets in a constrained financial and staffing resource environment.
- In a safe, comfortable, relationship-oriented setting, staffed primarily by other women, women's business centers succeed in attracting clients and delivering a valuable entrepreneurial learning experience.
- The success of these Women's Business Centers is clear as the majority of clients form businesses and maintain their connections to the Women's Business Centers, creating a cycle of business connection, mentoring, and value creation.

Current Outcomes: WBC's deliver on their promise:

- Between 45 and 60% of economically disadvantaged people entering the WBC program, were no longer in poverty a year or two later.
- Studies of micro-enterprise programs, such as the Women's Business Centers, produce a return to society of two dollars to every dollar invested over 1 to 5 years.
- The 2 to 1 ROI does not account for the additional economic benefits of increased taxes paid by entrepreneurs and their businesses.
- Although many microenterprises are self-employment businesses, many others hire 10 to 20 employees.
- In addition to the jobs these businesses are creating, the tax base is bolstered through increased personal income, retail sales, personal property and corporate taxes.

The Role of the SBA and WBC's in a Thriving Economy

In their brief history, Women's Business Centers have become a key SBA Resource Partner. They have been acknowledged as an integral component of the SBA's primary infrastructure, being highly effective and having established a well-developed infrastructure

The following recommendations and comments are designed to support and sustain the Women's Business Centers, affirming their demonstrated effectiveness as an essential source of assistance for women business owners and their role as a key element of the SBA's infrastructure.

1. Appropriations: The AWBC requests that funds be appropriated at the following levels: $16.5 million for 2007, $17 million for 2008, 17.5 million for 2009 and $18 million in 2010.

The President's budget recommends that the Women's Business Center program be funded at $11.88 million in FY2007. We appreciate the fact that the program was included in the President's budget. Nonetheless, we are deeply concerned about the proposed decreased level of funding and its effects on the WBC program.

The program experienced a decrease in funding last year of $500,000. With that exception, it had been funded at the same level for the past four years. Another year of decreased funding will mean a further reduction in funding for individual Centers. Quite apart from the effect of inflation and increasing costs of operation, new Centers have been added to the program, spreading even further the limited available resources. The result has been a significant and detrimental reduction in funding for individual centers. From a macro level, there are obvious inefficiencies: a higher number of program grants to manage, a higher number of programs having to fulfill the myriad administrative requirements that the SBA imposes upon each WBC; and, overall less client-driven activities and more administrative activities per dollar as the number of funded Centers increases while the total appropriation decreases. Currently, the program is so administratively intensive that as the amount of each cooperative agreement decreases, it becomes increasingly debatable as to whether or not it is worth an individual Center's time.

The AWBC is requesting that funds be appropriated consistent with current authorized levels and funding needs: $16.5 million for 2007, $17 million for 2008, 17.5 million for 2009 and $18 million in 2010. This is the level of funding needed in order to meet current commitments and possibly to continue to grow the program to meet unmet demand in areas currently not served by the program. This level of funding would also be more in alignment with the administrative requirements for each individual Center.

Even in times of fiscal restraint, we feel able to request full funding, because of the documented impact of the program. Funding for the Women's Business Centers is an investment in the country's small business economy. The returns are the businesses started, strengthened and expanded, the jobs sustained and created, and the income generated by the growing number of women owned businesses served by the program. As noted above, the National Women's Business Council issued a report in July 2004 entitled: Analyzing the Economic Impact of the Women's Business Center Program. The research drew on data from the SBA's Office of Women's Business Ownership from 2001, 2002, and 2003. Among other things, the report revealed that the WBCs generated a substantial economic impact. In 2003 alone, the WBCs generated $407 million in gross receipts, started 3,578 new businesses and created 6,493 new jobs. By any measure, this is a significant return on investment. The report also noted the long lead-time needed to develop a small business. In other words, we can look forward to even greater returns in the future from dollars invested to date.

Furthermore, changes to improve program efficiencies at the administrative level are needed –inside the SBA. Increasing efficiencies by streamlining operations at the "back office" level. The three entrepreneurial programs: WBC, SBDC, SCORE all have unique market niches and are seen to be different by clients, but efficiencies at the SBA administrative levels would further support the delivery of good work and services. **The AWBC is very interested is in being part of the solution and discussing strategies and plans for efficiency and improvements before 1.6% of the WBC funding is allocated to the SBA for costs associated with monitoring and oversight of the program.**

2. Renewability of Funding Stream (aka as sustainability of funds)- Investing in what works

There is no doubt that the investment of public funds in the Women's Business Center Program has generated a significant return that has benefited the country overall. In 2007, 52 WBC's will be considered "sustainability centers", receiving funding in years 6-10 of operations, and 32 WBCs will be considered "regular centers" receiving funding in years 1-5 of operations. YE 2007 is critical in crafting and mandating legislative policy and language that invest in programs that pragmatically and economically invest in America- programs such as the WBC program!

The structure of the Women's Business Center Program has also changed as it has grown. The Program was initially conceived as a demonstration with three-year funding and an expectation that Centers would graduate to other funding. In 1997, the Program was made permanent and funding was extended to cover a five-year period. In 1999, with the overwhelming support of Congress, the Program was changed again to incorporate a sustainability pilot program that allowed Centers to apply on a competitive basis for an additional five years of funding.

The creation of the Sustainability Pilot Program was the result of the recognition of several important points. The first is the importance of the Women's Business Centers in providing essential services to a significant and growing market of women who want to be business owners and who also want to be part of a program targeted to women. Secondly, it acknowledged the importance of the SBA's role as a funder. Not only does the SBA contribution provide an important foundation from which Centers can build, but the SBA brings credibility to the work of the Centers and its funding serves as a catalyst for raising the necessary matching funds. Finally, it acknowledges the value of the investment made in the existing Centers and the need to sustain the infrastructure so painstakingly constructed over the life of the program.

The Sustainability Centers have demonstrated their capacity to deliver the program in conformance with the program's goals and purposes. That means more than just delivering technical assistance and training; it also means that WBC's have developed the skills and expertise of their staff, that they have established solid reputations in their communities and that they have developed the relationships and partnerships needed to sustain their organizations over a long period of time. The importance of experience and longevity to a WBC's capacity and the likelihood of achieving significant economic impacts were also addressed in all the research findings. The researchers found a strong correlation between success and the length of operation of a Center. In these times of fiscal restraint, it is more important than ever to make each dollar invested count. Common sense and the research underscore the same conclusion: investing in the infrastructure of the WBC program, including those WBC's with proven track records and experience is an investment that is worth preserving.

In 1999 Congress overwhelmingly supported the creation of Sustainability Centers, e.g., enabling those Centers who had completed their first five years of funding to apply for renewal grants. Under the initial legislation, a funding allocation was established that was designed to ensure that appropriations would be distributed equitably among new, current and sustainability centers. The percentages were held constant over time while the authorization levels increased modestly to accommodate program growth.

Unfortunately, the level of funding has not increased, while the number of Centers eligible for sustainability funding has grown. The combination of the funding formula and flat funding, individual sustainability centers experienced budget cuts of between 57 and 62 percent the year before last. Some centers were compelled to close; others reduced staff and struggled to cut expenses. Regardless of the decisions that were made, the impact was a loss of skilled professional capacity and a reduction of services to the very entrepreneurs that invest in our communities nationwide.

Why do we care so much about the renewal of funding streams for performing women's business centers? In order to be funded as a sustainability center, a WBC has to have demonstrated its capacity to perform and its ability to meet the program's goals. The NWBC report also found that years in operation were highly correlated with success. In other words, the greatest return on investment is most likely to come from those Centers with the most experience. Further, positive economic impacts were generated through the efforts of Centers to respond effectively to the needs of their local markets and their targeted populations. As the report noted, this is a hallmark of program sophistication and integration, and a function of experience. Particularly in times of fiscal restraint, it is essential that the return on public investment be maximized. Clearly, support for the performing or sustainability centers is one way to achieve this critical objective.

The AWBC has long supported the idea of supporting WBCs that are successfully delivering on their performance commitments. We believe all performing WBC's, whether operating under sustainability status or not, should be able to compete for funding if they are indeed meeting performance commitments. After a great deal of effort, conversation and negotiation, the AWBC deeply regrets that 11 performing and highly successful WBC's were not allowed to compete for grant funding in 2005 due to a misguided interpretation and application of sustainability language. These 11 WBC's operated successfully throughout their tenure as SBA funded WBCs meeting the guidelines and expectations of the WBC program.

In the last Congress, legislation was passed in the Senate that would have created the opportunity for WBCs to apply for funding on a five-year cycle subject to performance. On the House side, there was legislation, which unfortunately did not pass, that included a provision for renewable funding. For all the reasons noted above, it is critical that this issue be addressed to provide a sound framework for the program going forward.

In the past, the SBA has expressed a preference for funding new Women's Business Centers as a strategy to encourage innovation and to ensure Women's Business Center services in currently underserved markets. The AWBC has always supported the establishment of new Centers and shares a vision of having a Women's Business Center within reasonable proximity of every woman who wants access to these services. **However, for all the reasons cited in this testimony, we do not support the establishment of new Centers at the expense of those who have demonstrated a capacity to deliver the program. It is important that we invest in what has been built and continue to strengthen what has already been tested and proven to be effective.**

3. Performance Criteria

The AWBC has long supported the development of performance criteria for the Women's Business Center Program with the goal of ensuring the delivery of the highest quality services possible. As previously noted, the AWBC has as one of its primary purposes building the capacity of the WBCs which it does through the delivery of training and technical assistance, the facilitation of mentoring relationships and the development of resources to support the work of the WBCs.

Two years ago, the SBA developed performance criteria for the WBCs, which have been shared with the Committee on Small Business. These criteria were used to determine levels of funding for the Sustainability Centers in allocating the FY2004 and FY2005 appropriations. Each Sustainability Center was graded on each criterion on a scale of 1-3 and the total score was used to slot the Center into one of three levels of funding. In order to understand how the criteria were applied so that it can support those Centers interested in improving their rankings, the AWBC has asked for information about the standards used in applying the criteria to the Centers. Unfortunately, the SBA has not been forthcoming with information about the standards that they used in determining their scores. Going forward, the AWBC hopes that the SBA will share this information so that we can continue to work together to build on the accomplishments of the program and achieve even higher levels of impact.

4. Authorization
The AWBC is deeply concerned about the proposed decrease in the authorization levels through 2010. The recommendation of decreasing the authorization levels will have a particularly deleterious effect on the WBC program. As a result of the decrease in appropriations and funding cuts across the board for Centers, we have already lost some Centers. If the authorization levels fall and appropriations fall in accordance with the authorized levels, the impressive economic growth that the WBC has demonstrated will surely be compromised. In a time of tight funding, we must prioritize programs that serve to drive our economy: the Women's Business Center Program has proven to do just that.

Association of Small Business Development Centers.

Statement of

Donald Wilson

President, Association of Small Business Development Centers

For the

United States Senate Committee on Small Business and Entrepreneurship

Hearing on the Reauthorization of Small Business Administration Financing and Entrepreneurial Development Programs

April 26, 2006

Chair Snowe, Ranking Member Kerry, and members of the Committee, I am Donald Wilson, President and CEO of the Association of Small Business Development Centers (ASBDC). ASBDC's members are the 63 State, Regional and Territorial Small Business Development Center (SBDC) programs comprising America's Small Business Development Center Network. SBDC programs are located in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam and American Samoa. The SBDC network is the Federal Government's largest small business management and technical assistance program, with more than 1,000 service centers nationwide, serving more clients than all other Federal small business management and technical assistance programs combined.

I appreciate the opportunity to submit this statement for the Committee's hearing on the Reauthorization of Small Business Administration Financing and Entrepreneurial Development Programs. My remarks will focus on the reauthorization of the national SBDC program.

Chair Snowe and Ranking Member Kerry, I would like to thank you and the members of the Committee, on behalf of ASBDC and the nearly 6,000 dedicated men and women who are a part of America's Small Business Development Center Network, for your strong support of our nation's Small Business Development Center network. You have been true champions of small business owners, aspiring entrepreneurs and the SBDCs that serve them.

Last year, you led the effort to secure desperately needed funding for America's SBDCs. With your leadership, the Senate passed the bi-partisan Snowe-Kerry-Vitter-Landrieu-Talent amendment to the FY 2006 S-S-J-C appropriations bill by a vote of 96-0. That amendment provided $110 million for the nationwide SBDC network, the amount needed to restore most SBDC programs to the capacity they had just a few years ago. Unfortunately, that figure was sharply reduced in conference.

This year, you led the successful effort to pass the bi-partisan Snowe-Kerry-Vitter-Coleman-Nelson (of Florida)-Landrieu-Lieberman-Levin amendment to the FY 2007 Budget Resolution, providing $110 million for America's SBDCs. And with your leadership, every member of the Senate Committee on Small Business and Entrepreneurship joined in a letter to the Chairman and Ranking Member of the C-J-S Appropriations Subcommittee in support of this funding for the nationwide SBDC network.

The members of this Committee, perhaps more so than others in Congress, are aware that small businesses represent 98 percent of all businesses and employ 50 percent of the nation's non-public workforce. You understand that small businesses are responsible for over two-thirds of net new jobs year in and year out. You understand that small businesses contribute over 40 percent of receipts to the Treasury, according to GAO. You understand that small business is big business in America.

What many may not know however, is that 60 percent of small business owners have a high school education or less based on the latest research by Dr. Paul Rogers. As a result, they have had little or no formal training in business management. They may have a wonderful skill set as a machinist or a cook, or an auto mechanic, or a dress maker or a carpenter. The list is endless. However, millions of ambitious, hardworking Americans start a business but quickly confront major issues such as financial management, inventory control, marketing issues, or human resource issues for which they are totally unequipped. Dun and Bradstreet has repeatedly reported that the major reason for small business failure is bad management decisions, not a lack of capital. The Small Business Committees of the Congress a little over 25 years ago recognized the enormous need for business management assistance for small business owners and aspiring business owners, and created America's SBDC network.

In-depth clients of the SBDC national program, that is those businesses or startup firms that received five hours of counseling or more, generated nearly 75,000 new jobs in 2004. Those clients attribute nearly 81,000 jobs saved to the assistance they received from their local SBDCs. This data is based on extensive research by Dr. James Chrisman of Mississippi State University, who has been studying the SBDC national program for roughly 20 years. What these statistics mean is that a new job is created by an SBDC in-depth client every seven minutes. $100,000 in new sales are generated by SBDC in-depth clients every nine minutes. $100,000 in new financing is obtained by SBDC in-depth clients every 20 minutes. SBDC in-depth clients create job growth at ten times the rate of the average U.S. business.

Based on Dr. Chrisman's research, SBDC in-depth clients directly generated $233,674,930 in new Federal revenues in 2004. This represents a return to the Federal Treasury of $2.66 for every Federal dollar invested in the SBDC national program. I think if anyone knew where he or she could get that type of return on their own money, they would readily make that investment.

The SBDC program is the Federal program of choice for most small business owners and aspiring business owners. SBDCs serve more clients than all other Federal management and technical assistance programs combined. Forty-one percent of our counseling clients are women and 43 percent of our training attendees are women. Thirty-one percent of our counseling clients are minorities and

21 per cent of our training attendees are minorities. Ten percent of our counseling clients are veterans. We understand that the real percentage of veteran clients is higher than that, but many veterans do not self-declare.

If we are to generate jobs for our nation's young people coming out of colleges and universities and high schools, we must stimulate job growth. The cost per job created by SBDC in-depth counseling clients, including Federal dollars and non-Federal dollars, is $2,439 per job. We would challenge this Committee, members of the Budget Committee or the Appropriations Committee to find many Federal jobs programs that could approximate that cost per job created. Most state economic development agencies consider $10,000 per job to be a successful program.

The fastest area of entrepreneurial growth is among women and minorities, an area where we have a demonstrated experience, expertise and success. SBDCs work with these under-served populations. SBDCs have specialized programs for minorities, women, veterans, people with disabilities, 8(a) firms, individuals in low or moderate income urban and rural areas and individuals in HUB Zones and Empowerment Zones. We believe we are doing a highly commendable job. And we know we could do so much more with adequate resources.

ASBDC is deeply concerned about the impact that call-ups of Guard and Reserve units are having on tens of thousands of small business owners. We believe the SBDC program can help assure that, when these young men and women return home, their businesses will still be viable.

In addition, the SBDCs have major responsibilities when a disaster, natural or manmade, occurs. Assisting small businesses in the wake of disasters is not new to Small Business Development Centers. The California SBDC played an important role in assisting small businesses following the Northridge earthquake in 1994. The North Dakota SBDC was a key player in 1997 when that state endured major flooding and devastation along the Red River. The North Carolina SBDC helped lead that state's recovery efforts following Hurricane Floyd in 2000, and more recently in responding to the destruction inflicted on Western North Carolina by Hurricane Ivan. The New York State Small Business Development Center network brought counselors from across the state into Manhattan in September, 2001, to address the needs of thousands of small businesses following the devastation and economic dislocation that occurred as a result of the terrorist attacks on the World Trade Center towers on 9-11.

The work of the New York State SBDC was recognized during Small Business Week in the Spring of 2002, when New York State SBDC State Director Jim King was awarded SBA's prestigious Phoenix Award. In the months following the terrorist attack, the New York State SBDC helped a total of 2,500 small businesses, which were able to secure more than $54 million in assistance. The Florida SBDC was a major player in responding to Hurricanes Charley, Frances, Ivan and Jeanne. The Economic Development Administration (EDA) at the U.S. Department of Commerce recognized the efforts of the Florida SBDC network when the EDA presented that agency's prestigious Excellence in Economic Development Award to the Florida Small Business Development Center Network, in the category of economic adjustment. Florida SBDC State Director Jerry Cartwright accepted the award on behalf of the Florida SBDC network at ceremonies last fall, here in Washington.

Last September, within less than a week after Hurricane Katrina hit the Gulf Coast, the Association of Small Business Development Centers trained over 150 SBDC counselors from across the nation in disaster response. The trainers were experienced SBDC personnel from states like New York, North

Carolina and Florida, who had been intimately involved during the last six years in responding to major natural or manmade disasters. Forty-four SBDC counselors from 15 states (including Maine and Massachusetts) traveled to Mississippi, Louisiana, and Alabama in October and November, to assist the SBDC networks in those devastated states. Why was outside assistance needed? Tens of thousands of small businesses had been gravely impacted. Also, the Mississippi SBDC network had three of its service centers destroyed by Hurricane Katrina. The Louisiana SBDC for weeks did not know where some of its counselors were or even if they were alive. Hundreds of local business owners in dire need were seeking to access SBDC services.

The ASBDC sought to provide loans from its own resources to those state networks. Corporate partners of the Association responded with incredible generosity. Intuit gave $50,000 each to the SBDC networks in Alabama, Louisiana and Mississippi. Federal Express gave $25,000 each to the Mississippi and Louisiana SBDC networks. Microsoft gave computers and printers. Others volunteered in-kind resources. Just recently, the Mississippi Small Business Development Center Network received the Mississippi U.S. Small Business Administration's Outstanding Contribution to Disaster Recovery Award.

Despite the overwhelming tasks facing the Louisiana and Mississippi SBDCs, no supplemental funds were requested by the Administration. We recognize that we are a program of modest size and that in the rush to address disasters, we might be easily overlooked. However, it is vitally important that, when supplemental funding requests for disaster relief are crafted by SBA, there be an understanding of the heightened demands on local SBDC capacity. Often the SBDC capacity has been diminished but the demands on that capacity have been increased exponentially. I am not aware of a single disaster in the last quarter century where SBA has included in its supplemental funding requests increased resources for the SBDC network in the disaster stricken area. Adequate supplemental funding for SBDCs to meet the demands placed on them should be a standard line item in any disaster supplemental funding request.

As it crafts the SBA reauthorization bill, the Committee needs to take into account the indispensable role that is played by Small Business Development Centers in assisting small businesses that have been adversely impacted in times of disaster. SBDC personnel should be viewed as critical responders when disasters strike. SBDC personnel often are more familiar than any other entity with the local small business economy and the various community resources available to assist small businesses. SBDC trained counselors have the skill sets and the experience to assist small business owners in reconstructing lost or destroyed business financial records, that are so necessary in making a successful filing for SBA loans and other financial assistance.

It is absolutely imperative that, when FEMA or other Federal agencies set up Disaster Recovery Centers (DRCs), SBDC personnel be included so that small business owners have a one-stop shop, not only to get loan applications, but also expert assistance to enhance the likelihood that the loan application will be approved the first time. Business disaster loan applicants who have had SBDC assistance have decidedly higher loan approval rates than those who do not. This has been demonstrated in North Carolina, New York and Florida. In many instances, SBDC personnel are welcomed into Disaster Recovery Centers. In other instances they are not. We believe that full participation of SBDC personnel at Disaster Recovery Centers should be standard operating procedure.

State and local governments, who in most instances are funding partners of state and local SBDC programs, expect SBDC personnel to play an integral part in helping small businesses to recover from a natural or manmade disaster. Unfortunately, FEMA and SBA personnel who come into the community from outside frequently do not recognize the critical role that SBDC counselors play, and are expected by state and local government to play, in helping disaster stricken small business owners to reconstruct financial records, access capital, and rebuild their businesses.

The ASBDC commends the SBA for including in its reauthorization proposals two changes that will strengthen the SBDC network's ability to assist small businesses in times of natural or man-made disasters. First, the SBA has proposed lifting the restriction on travel to disaster areas by out-of-state SBDC counselors. This proposal will greatly facilitate the nationwide SBDC network's efforts to send volunteer SBDC counselors from all across the nation to assist in a local SBDC's small business disaster recovery efforts. Second, the SBA has proposed to clarify that SBDC Portable Assistance grant funding can be made available in awards of more than $100,000 in extraordinary circumstances such as natural or man-made disasters. This proposal will allow SBDC Portable Assistance grant funding to be directed where it is most needed when the nation is struggling with a major disaster.

The ASBDC is concerned, however, by a provision in the SBA's reauthorization proposals that would increase the amount of SBDC grant funding that the SBA can use for administrative purposes. At a time when the SBA is proposing a reduction of $743,292 in the Congressional appropriation for SBDC grant funding, it seems inappropriate at best for the SBA to propose using even more of the scarce SBDC grant funding (intended for service delivery to small businesses and aspiring entrepreneurs) for administration. The ASBDC believes that the funding provided by Congress for the delivery of business counseling and training should be used to the maximum extent possible to deliver services to the small business community, and not to add to program administration.

The members of this Committee have historically been advocates for the SBDC national program on a bi-partisan basis. We ask that you remain advocates so that together we can reverse the decline in this remarkable program's capacity to serve our nation's entrepreneurs.

Chair Snowe and Ranking Member Kerry, we again thank you and the members of this Committee for all that you have done to ensure that small businesses, aspiring entrepreneurs, and the SBDCs that serve them have the resources they need. We appreciate your willingness to consider our views.