



NASBIC
America's Small Business Partners

**Statement
of
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Suite 750
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Before The

**United States House of Representatives
Committee on Small Business
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Madam Chair, Ranking Member and Members of the Committee:

Thank you for the opportunity to appear today to offer the National Association of Small Business Investment Companies' (NASBIC) views on the important issue of how to lay the groundwork for economic recovery by expanding small business access to capital. My name is Holly Huels and I am the Senior Vice President of Capital For Business (CFB) in St. Louis, MO. I am also Chairwoman of the NASBIC's Board of Governors.

While much of the attention has been paid to General Motors, AIG, and other ailing behemoths, the plight of millions of small business owners and entrepreneurs has not received the same media attention. We appreciate this Committee's continued commitment to small businesses and efforts to keep small businesses as part of the Congressional agenda. We particularly appreciate the reforms that were incorporated into the Recovery Act. Your actions have helped many of our small business partners.

CFB is a private equity firm focused on providing capital to small businesses with proven management teams and a high potential for growth. Founded fifty years ago as one of the first SBICs, we have invested in over 80 companies across a wide range of industries including consumer, commercial, distribution, manufacturing, and service companies throughout the U.S. CFB's goal is long-term growth and the creation of value by bringing unique financial, operational, and industry expertise to help management teams grow their businesses. We do not purchase companies with the intention of reducing employees or selling off key assets in order to realize short-term profits. We invest, in cooperation with exceptional management teams, to improve companies and increase long-term shareholder value for all investors.

CFB has invested in companies from Pennsylvania to California. Today much of our portfolio is in the Central U.S. The difficult economy has impacted our current 20 portfolio companies just as most companies in America have been affected. Revenues and profits have declined. However, CFB as well as most SBIC investors take a long-term view toward investing in U.S.-based companies. We have continued to support our investments by working with our management teams and commercial banks and providing additional capital from our own funds, when appropriate. Many of our companies are not currently growing due to the difficult economy. However, over CFB's long history, our portfolio investments have typically grown, increasing their employee base and paid taxes.

Over this 50 year period, the SBIC program has provided over \$55 billion of financing to over 106,000 U.S. based businesses. While these are large numbers, I assure you the program is underutilized. The U.S. credit markets have experienced a significant contraction, especially to small companies. SBIC financing is the one program available to U.S. small business that remains available when other financing sources have retracted.

SBICs are private equity funds that invest exclusively in domestic small businesses. While the bigger names in the private equity and venture world invest globally, SBICs invest locally in the main street businesses that employ your constituents. Many of SBA's greatest success stories – Federal Express, Intel, Outback Steakhouses, Whole Foods, Apple, Quiznos, and PeopleSoft – received their early funding from SBICs. SBICs are the right partnership for policy makers and the private sector to work together to end this recession, grow the economy, and create jobs.

Since 1958, the SBIC program has been a successful, market-driven collaboration. The program design is simple and effective: debenture SBIC fund managers raise private capital for investment in small businesses and are able to enhance these investments by borrowing money periodically from SBA. Currently the SBIC Debenture program has the capacity to facilitate investments of about \$4 billion dollars a year into America's job creators. However, only about \$1.5 billion dollars a year is currently being facilitated by the SBIC program. Over the next four years that is an opportunity cost of

approximately \$10 billion dollars – 100% of which would otherwise be invested in job creating domestic small businesses. This is particularly troublesome because the existing SBIC Debenture program fully pays for itself and often returns a profit to the government. For example, the SBIC Debenture program has returned over \$340 million dollars to SBA in excess of the costs of running the program and this number does not include any of the increased tax revenues from the small businesses that benefitted from the program. As the champions of small business, we are asking this Committee and SBA to emphasize the SBIC program and fully utilize its potential. Please reform the program to help today's small businesses become tomorrow's icons of the American economy.

Current State of the Market

Small Business Access to Capital

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

NASBIC polled its members and found that 100% of the respondents reported that they had experienced banks pulling or reducing senior lines of credit for investments that normally would have no difficulty. 75% of the respondents reported less subordinated debt available for small businesses. One of the most respected publications for the lower and middle markets, GF Data Resources, recently reported that we “are now in the throes of a dramatic slow down in non-distressed private equity sponsored buyout activity.”¹ However, unlike the rest of the market, SBICs are still investing in small businesses. SBICs have provided approximately \$1.3 billion to small businesses in 2009. These funds were invested in over 1900 transactions in 1068 companies. The average amount of investment in each company is slightly over \$1 million. These may sound like small numbers by Washington standards, but to small businesses every one of these dollars is a very big deal. The SBIC Debenture program expands access to critical capital to the nation's small businesses. This effort is hindered by the relatively low number of licensed SBICs. Imagine what could be done if the program were running anywhere near full capacity.

For seed and early stage companies the situation is even worse. Early stage and equity investing for small business has largely dried up. The SBA previously had an effective tool that was exceptionally successful at using the private market to steer equity investments into domestic small businesses with the taxpayer money enhancing the effect. The SBIC Participating Securities program needed reforming, but instead of being reformed, it was deactivated and now lies dormant. While it lasted, this program had an Internal Rate of Return of almost 11%, invested over \$13 billion in small businesses, created over 385,000 new jobs and saved hundreds of thousands more. While almost 70% of venture capital dollars go to high tech and life science industries, this program invested heavily in small business manufacturing. More than half of VC investments are made in California and Massachusetts, but the SBIC program invested more than 70% in other states that are often starved for investment capital. SBICs are still a source of capital for early stage companies, investing in almost 300 so far this year, but there has been over a 30% decline since the mothballing of SBA's equity option.

Meanwhile the debenture program provided over \$800 million over the same period. The demise of an early stage and equity option from SBICs has contributed to the dearth of early stage capital and is a road block to our economic recovery. These SBICs were the most reliable source of equity capital for U.S. small businesses dealing with the fallout of the recession that began in 2000. All venture capital investments fell 83% between 2000 and 2003 according to Venture Economics. SBIC investments during that period—a total of \$5.25 billion—fell just 23%. A recent survey by the National Association of Seed and Venture Funds found that over 90% of early stage entrepreneurial companies, some of the nation's best job creators, are having serious difficulty raising follow on capital.

¹ GF Data Resources May 2009

Unfortunately for America's small businesses, the demand for SBIC capital is increasing at a time when the SBIC program is at its nadir. Last year only six SBIC funds were licensed. This is down by over 90% from the peak of over 60 a year in the late 1990s. Licensing in the 1990's took only a few months. In contrast, last year many SBIC licensees had to wait over a year. Without new SBIC licenses, small businesses are being denied funds that could be providing growth capital. The good news is that in FY 2009 SBA has licensed nine SBICs – a 50% increase from the nadir of 2008 – with SBA openly trying to get licensing waiting periods down to four months. This is a good start, but a better target would be 30 to 40 new funds a year.

New Capital for SBICs Means More Capital for Small Businesses

There is a dramatic uptick in the number of funds that are interested in becoming SBICs. With fewer limited partners investing in private equity, limited partners feeling the stress of the market downturn, and institutional investors holding onto capital, the SBIC program can be a win-win-win for private equity funds, small businesses, and policy makers. SBIC informational seminars were recently held by some of our industry partners in New York, Chicago, and Charlotte and with attendance so large that some rooms had to be expanded. As interest in the program grows, more of these seminars are being planned across the country.

NASBIC partners with SBA to provide regulation training for applicants to the SBIC program. The next class was expanded twice and is sold out. Our next class is scheduled for October and is nearly sold out. The private equity world is taking a fresh look at the SBIC program. We urge Congress and the Administration to seize the opportunity to bring in new partners and dramatically increase the investment capital available for small business. Now is the time for Congress and the Administration to fully utilize the SBIC program.

Renewable Energy

There is a lot of interest in renewable energy and other technologies. While SBICs invest in small business across almost all industry sectors, SBICs are not yet able to utilize the "energy debenture" that was passed by Congress. We do not yet know if the energy debenture will be successful in expanding small business investment in these areas, but until SBA implements this new debenture we do not know what the effect will be on these small businesses of the future. Some major market participants are actively reviewing ideas for a new debenture model to promote energy efficiencies. With your help, SBICs can make sure that the green economy will be open to innovative small businesses and not just the biggest multinationals. These regulations need to be put in place quickly and more green investing options should be authorized.

Bank Investments in SBICs

Banks are important investors in many SBICs. Banks receive excellent returns on their investments and many also get CRA credit. However, since the passage of Gramm-Leach-Bliley the number of bank SBICs and amounts invested in SBICs has dropped dramatically. Currently, banks are under intense pressure to maintain or increase capital reserves so the outlook for bank investments is not promising. As more pressure is being placed on banks to get capital out to small businesses, the SBIC program should be an attractive public policy option for both banks and policymakers.

Laying the Groundwork for Economic Recovery

The SBIC program must be used to its full potential. Small businesses need growth capital and they need it now. Capital for small businesses must not be a handout or bailout. The program should be market driven and protective of the taxpayer's money and trust. To achieve its full potential the SBIC program must attract and accept only qualified partners. Policymakers should remove barriers to entry and create

incentives to partake in this socially conscious form of investing that provides profits for investors and jobs for Americans.

Maximizing the Impact by Keeping Successful SBICs in the Program

Proven and successful SBICs are often “graduated out” of the program because the relicensing process is too slow and cumbersome and the leverage limits for “family of funds” becomes constraining. The loss of these established funds must be stopped. The program benefits from keeping funds that have developed expertise in the small business sector. To correct this problem we recommend that SBA create an “expedited relicensing process.”

Every three years any licensed SBIC should be automatically eligible for a new additional license subject to the following restrictions: the SBIC must be financially sound, have no major negative audit findings, have no major examination findings, have 2/3 of the same management team, and be in regulatory compliance. To be granted an expedited relicense, the SBIC must have a new background check, proof of private capital raised, pay all appropriate fees and submit a declaration that their new business model is similar to their previous model. Successful SBIC management teams are well known to SBA and there is no taxpayer protection added by an expensive, duplicative, and year long process. New or troubled funds should not be eligible for expedited relicenses.

If we are to keep successful SBIC funds in the program, raising the leverage limit for a family of funds is also very important. The normal life cycle of a single SBIC fund is ten years with a maximum \$150 million leverage limit. With expedited relicensing a new license could be granted every three years and therefore higher leverage limits will be needed to accommodate the capital needs of multiple funds. Under this scenario for a family of SBIC funds, one fund might be just getting started with \$50 million in leverage. A second fund might be at its investment peak with \$150 million in leverage. A third fund might be winding down with \$75 million in leverage outstanding. The current limit of \$225 million was a dramatic improvement for successful repeat funds, particularly in this time of economic crisis. However, if we are to truly lay the groundwork for keeping more successful funds in the system then even the current family of funds limit should be increased or eliminated.

There is one option that could release large amounts of capital nearly immediately - extending the investment period for current SBICs. Many successful SBICs are in the wind down phase, but do not have to be. If existing, successful SBICs were allowed to extend their investment period by two years and access the program’s leverage, then many more small businesses could be funded within a matter of days or weeks. There would be no increased risk to the taxpayer because only successful and currently licensed funds could access the extended investment period. Small businesses need capital now and are not served by an arbitrary investment period that cuts off the best SBICs when they are needed most.

A National SBIC Program

The SBIC program provides capital in areas of the country often overlooked by the rest of the private equity and venture capital community. Despite this fact, there are areas of the country that need more SBIC coverage. A concerted effort should be made to publicize this program and to welcome new licensees, particularly from the western United States. Policymakers should also make it easier to raise capital for SBICs by allowing a higher percentage of capital to come from state sources. There are a number of funds that have attempted to become SBICs who were either delayed or rejected for an SBIC license because of the current state limit of 33%.

Welcoming Banks to the SBIC Program

Banks are being asked to hold more capital while increasing lending and investment. Policy makers should encourage and incentivize banks for investing in SBICs. Banks get CRA credit for providing capital to SBICs, but this credit is sometimes done on a case by case basis. A strong public statement from bank regulators would provide an incentive to partner with SBICs. Moreover, if banks are welcomed and incentivized to become leveraged SBICs they could then triple the amount of capital they

invest in small businesses. This could be done in a way that does not cost the taxpayer while minimally reducing their regulatory capital.

Prevent Regulatory Disincentives to Becoming an SBIC

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

Following the scandals in several of the mega private equity funds, there have been calls to regulate private equity, including SBICs. SBICs are already highly regulated and screened to levels that the SEC has never matched and likely never will. Additional regulation by the SEC or other bodies would just increase the regulatory burden for being an SBIC. SBA's reporting requirements are already out of sync with GAAP and will be out of sync with the SEC too. SBA's requirements are stricter. Adding SEC regulation would only add cost – not taxpayer protection. SBICs and the entire lower and middle markets pose no systemic risk and should not be punished for the sins of a few scandalous mega funds.

Revive an Equity Focused Program

We are in a recession. This fact makes the availability of equity capital, or lack thereof, even more important to America's small businesses. Equity capital is the foundation upon which any company is built. A company's ability to raise senior debt and lines of credit—absolutely essential to business success—relates directly to its ability to raise equity capital. Congress and the Administration should review proposals that establish tools for SBICs to invest equity in a manner that protects the taxpayer and provides capital to worthy businesses.

Conclusion

American small business is the unsung workhorse of our economy. A fully utilized SBIC program can provide billions in capital to domestic small businesses that will create more jobs than any other part of the economy. The Recovery Act was projected to save or create four million jobs at a cost of nearly \$197,000 per job. It only costs between \$11,000 and \$33,000 to create a job via small business investment. If the existing SBIC program were fully utilized, it could create between 300,000 and 900,000 jobs over the next four years and do so at zero net cost to the taxpayer. Please reauthorize, reform, and expand this successful partnership of 51 years. Now more than ever, the economy and the American worker need this program to be fully utilized.

SBIC Financings 2004 - 2009

State	\$ Fin. 2009	\$ Fin. 2008	\$ Fin. 2007	\$ Fin. 2006	\$ Fin. 2005	\$ Fin. 2004	Total \$ Financed 2004 to Present
AL	16,682	9,256,173	9,084,571	4,217,827	13,900,006	30,207,292	66,682,551
AK	0	0	0	0	0	0	0
AZ	34,233,277	60,834,429	30,249,147	41,756,290	24,741,694	29,235,389	221,050,226
AR	1,970,000	331,518	10,144,777	13,281,992	7,057,425	12,623,615	45,409,327
CA	133,410,976	347,448,553	408,174,810	456,952,045	487,038,915	608,630,860	2,441,656,159
CO	48,018,000	77,032,486	93,579,760	112,208,179	77,097,953	73,448,469	481,384,847
CT	19,807,846	47,496,128	38,643,462	81,834,822	46,167,518	49,889,435	283,839,211
DE	1,051,425	3,082,572	3,290,301	2,838,033	14,925,469	10,100,510	35,288,310
DC	1,286,257	12,354,065	749,815	2,112,500	9,199,404	7,431,663	33,133,704
FL	65,954,736	48,663,606	113,672,922	166,502,105	106,081,810	50,761,621	551,636,800
GA	21,680,087	64,992,086	75,400,958	54,279,480	89,465,544	97,935,960	403,754,115
HA	0	0	0	4,620,000	0	0	4,620,000
ID	150,000	6,106,029	10,040,000	550,000	6,894,802	891,346	24,632,177
IL	38,723,687	109,205,506	168,606,212	100,002,022	144,566,449	121,597,340	682,701,216
IN	17,195,591	57,380,088	33,556,133	31,284,392	30,495,242	10,419,756	180,331,202
IA	2,789,000	6,200,000	8,018,937	9,246,254	10,187,412	21,941,093	58,382,696
KS	3,311,000	21,249,878	27,393,333	21,039,245	8,821,068	3,644,988	85,459,512
KY	14,765,360	25,344,897	36,161,066	1,665,000	24,879,978	17,317,543	120,133,844
LA	12,946,962	8,852,878	8,844,411	18,844,289	26,884,982	11,004,500	87,378,022
ME	625,000	9,564,640	8,700,000	20,550,000	16,375,000	25,350,000	81,164,640
MD	13,116,317	48,271,099	51,677,197	89,662,842	53,500,990	60,699,195	316,927,640
MA	106,441,506	166,991,540	175,394,349	139,807,267	207,468,130	158,037,274	954,140,066
MI	31,952,378	34,882,568	47,389,763	50,520,778	38,762,993	34,137,201	237,645,681
MN	28,292,995	25,545,227	45,244,101	62,331,432	66,505,800	35,548,394	263,467,949
MS	608,294	14,185,403	2,161,208	4,486,500	11,150,861	9,101,500	41,693,766
MO	39,274,195	36,689,539	49,318,000	68,604,335	48,240,293	47,239,828	289,366,190
MT	500,000	495,000	1,305,000	123,000	0	0	2,423,000
NE	2,150,000	4,483,302	17,441,663	2,625,000	17,853,252	1,300,000	45,853,217
NV	9,646,793	12,187,996	18,488,000	14,859,948	9,539,805	5,270,000	69,992,542
NH	11,181,178	22,364,351	18,581,756	32,050,896	30,674,852	15,905,393	130,758,426
NJ	45,328,952	109,023,126	128,064,464	93,742,234	116,199,476	127,345,863	619,704,115
NM	297,706	3,703,120	9,400,595	11,468,225	18,347,988	9,761,741	52,979,375
NY	142,400,223	361,499,241	325,956,487	447,987,904	377,053,148	397,312,616	2,052,209,619
NC	38,067,960	80,512,684	69,606,180	67,940,758	46,466,092	38,282,741	340,876,415
ND	0	0	0	1,670,000	0	0	1,670,000
OH	21,790,551	31,936,167	40,360,705	75,817,454	47,962,311	38,044,078	255,911,266
OK	9,000,000	10,525,170	13,594,439	3,396,232	14,378,540	10,924,965	61,819,346
OR	2,000,437	6,491,767	36,234,991	36,815,319	22,538,250	35,873,604	139,954,368
PA	56,495,731	51,526,249	119,209,618	112,966,543	142,820,692	99,457,210	582,476,043
PR	1,260,000	807,500	727,600	5,791,028	13,664,736	3,295,000	25,545,864
RI	450,042	11,876,260	4,256,286	11,240,000	26,383,539	6,291,282	60,497,409
SC	21,994,248	28,073,788	14,733,056	47,546,022	28,999,250	16,403,600	157,749,964
SD	115,014	0	689,700	9,342,599	1,500,000	7,608,209	19,255,522
TN	15,125,607	38,449,479	57,392,395	39,305,762	70,134,322	49,725,786	270,133,351
TX	59,883,553	219,106,162	127,888,822	167,493,034	142,584,386	229,932,391	946,888,348

UT	40,239,533	33,588,481	26,631,312	38,577,559	37,765,890	48,496,900	225,299,675
VT	594,000	6,320,446	6,264,705	1,098,000	7,225,000	4,420,746	25,922,897
VA	49,435,504	56,596,756	48,399,139	34,162,186	61,252,683	67,259,349	317,105,617
WA	14,141,667	55,697,154	56,470,405	59,219,349	62,337,653	46,765,697	294,631,925
WV	37,500	10,415,118	1,894,173	2,664,878	4,177,611	13,276,867	32,466,147
WI	11,774,738	29,715,128	48,761,020	18,308,039	24,829,487	36,642,689	170,031,101
WY	0	0	0	1,833,336	0	0	1,833,336
	1,191,532,508	2,427,355,353	2,647,847,744	2,897,242,934	2,895,098,701	2,836,791,499	14,895,868,739