Statement
of
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Committee on Small Business
Subcommittee on Tax and Finance

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"Legislative Proposals to Reform the SBA's Capital Access Programs"

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 reforming SBA's Capital Access programs. My name is Steve Swartzman. I am a partner at C3 Capital, which manages two Small Business Investment Companies (SBICs) located in Kansas City, Missouri.

We appreciate this Committee's continued commitment to keeping SBICs as an important part of the Congressional agenda. As the champions of small business, we are asking this Committee and SBA to emphasize the SBIC program and fully utilize its potential. As someone who works closely with small businesses every day, I can tell you that the country needs this program, particularly at a time like this. NASBIC and its members ask you to reform the SBIC program to help today's small businesses become tomorrow's icons of the American economy. We specifically ask that as the SBA is being reauthorized that these reforms be included.

SBIC Program Overview

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

I co-founded C3 Capital where we manage two SBIC funds. Since 2003, we have invested $137 million in 33 small businesses, which have created many thousands of jobs and promoted economic development in communities throughout the country. Our investments have included: American Apparel, where we were the first institutional investor in a company that became the largest domestic apparel manufacturer in the U.S. and which grew retail stores from eight at the time of our investment to over 200 stores worldwide today (one of the fastest retail rollouts in American history); Electronic Transaction Consultants, a software developer and integrator that has grown into one of the most successful and innovative companies in its field, deploying the country's first electronic only toll road in the U.S. and providing the software that manages toll roads in the cities of Chicago, Dallas, and Houston; and a wide variety of niche manufacturing, services and distribution businesses throughout the U.S.

Need to Reform and Utilize the SBIC Program

Recently, NASBIC's Chairwoman of the Board testified that despite having a 50 year record of successfully growing American small businesses and providing over $55 billion of financing to over 106,000 U.S. based businesses, the SBIC program is being underutilized. This underutilization is leaving billions of dollars unused that would otherwise be invested in domestic small businesses. When both credit and investment has evaporated, it does not make sense to leave an effective small business tool unused, particularly because the SBIC Debenture program fully pays for itself. Because of its stability and partnership with SBA, the SBIC program is countercyclical and is one of the few programs that remains available to U.S. small businesses when other financing sources have dried up, as they have over the past year.

American small businesses and taxpayers need the SBIC program to live up to its potential. Without reform, we expect that over the next four years there will be about $10 billion of available SBIC capital that will not be invested in domestic small businesses. This opportunity cost is tragic because the cost to the taxpayer for providing the $10 billion in investments via the SBIC Debenture program is effectively zero. The SBIC debenture program pays for itself with fees and carries no subsidy rate. Zero cost to promote $10 billion of investments in small businesses is the kind of deal that taxpayers can respect.

Thankfully, this Committee is working on legislation to fix the problem. While there is not a single major problem with the SBIC program, there are a number of issues that are limiting utilization. We encourage you to include all of these issues in any legislation

Keeping Successful Small Business Investors

One of the bitter ironies for small businesses is that successful SBICs have been pushed or "graduated" out of the program. It is simply bad public policy to have disincentives for your best small business investment companies to continue operating. There should be incentives for good funds to continue to partner with SBA and to make all of their investments in domestic small businesses. Keeping successful SBICs in the program will ensure that there is ever more capital available for small businesses and that we are not losing some of the best small business experts.

Expedited Relicensing

Currently the licensing process at SBA is slow, opaque and subjective. It is the number one complaint of SBICs. For example, despite the success of our first SBIC fund, getting a second license took over a year, countless hours of paperwork, and expensive legal bills. Legislation should provide a transparent process, with clear standards, and a reasonable timeline for applicants. If a fund has already been fully vetted, licensed by the SBA at least once, proven itself successful financially, complied with federal regulations, passed annual examinations by federal regulators, and wants to continue to invest in small businesses, then it should be able to receive a new SBIC license quickly. To ensure continued taxpayer protection, new background checks and proof of private capital raised should be the only updates needed. Funds that are capitally impaired, have major regulatory problems, or that are unable to raise private funds should not be able to get an expedited repeat license. Further, the Administrator should have the authority to put the brakes on any application that she or he thought posed a risk to the taxpayer. Without a better relicensing system the amount of capital available for small business investment will continue to wither.

An expedited licensing procedure would have four positive benefits. First, it would provide more capital to domestic small businesses because there would be a greater number of SBICs. Second, it would create a strong incentive for existing SBICs with established track records and a wealth of investment experience to stay in the program. Third, it would allow the very limited resources allocated to the licensing division at SBA to focus its efforts on vetting new funds, with which SBA does not yet have a long-standing relationship. Fourth, it would create a strong incentive to remain in full regulatory compliance.

Letting Funds Grow to Provide More Capital

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

The individual fund limits are adequate, thanks to the increases included in the stimulus bill. The increase in the family of funds limit that was included in the stimulus bill was urgently needed and it met that urgent need. We appreciate this Committee's efforts to include these important provisions in the bill. However, if we are truly to keep the best funds in the program and to provide billions in capital to small businesses, then we need to allow a continuum of investment funds. With a higher leverage limit and expedited relicensing, a successful fund could have a series of SBIC funds that run the 10 year life cycle of the funds. One fund could be winding down, another could be at peak, and another could just be ramping up. Under this scenario, good SBICs can constantly be providing funds to small businesses without having to "graduate out" and suffer for success by hitting a leverage-limit ceiling. Funds that were in distress would not be eligible for new leverage or expedited re-licensing.

Providing Capital to Veterans

Under the current SBIC program there are a number of incentives that apply to investments in low and moderate income areas (LMI). SBICs invest in many LMI and other underserved areas, not because of a mandate, but because they are good investments for the SBIC and for the taxpayer. One incentive that has been discussed is to allow investments in veteran-owned or run companies to count towards the LMI calculations. This would be a market-based incentive for investing in those who have served this nation.

Prevent Regulatory Disincentives to Becoming an SBIC

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 and cost for being an SBIC. For example, 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 than the SEC's standards. Adding SEC regulation would only add cost – not taxpayer protection. SBICs, which are by their nature are small in size and cater to the lower and middle markets, pose no systemic risk and should not be punished for the past sins of a few unrelated mega funds. Adding duplicative and expensive regulation to SBICs would discourage funds from becoming SBICs and thereby drive capital away from small businesses.

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

Small Business Desperately Needs Equity Investment

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

The SBA previously had an effective tool that was exceptionally successful at using the private market to steer equity investments into domestic small businesses, with 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, the program invested over $13 billion in small businesses, created over 385,000 new jobs and saved hundreds of thousands more. While almost 70% of venture capital dollars go to high tech and life science industries, 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% of its capital 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 to small businesses 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 roadblock 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.

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

Renewable Energy

There is a great deal of interest in renewable energy and other technologies. While SBICs invest in small businesses across almost all industry sectors, SBICs are not yet able to utilize the energy debenture that was passed by Congress in 2007 because SBA has not produced any regulations to implement them. We would encourage Congress to act to ensure SBA makes these tools available. We would also ask that a technical correction be made to make the energy saving debenture available to all the SBICs, and not just the 11 licensed since last year. Further, 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, reforms, and new options need to be put in place quickly.

Bank Investments in SBICs

Banks are important investors in many SBICs. Banks receive excellent returns on their investments and many also get CRA credits. 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. 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.

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 incentivize 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% of regulatory capitol. Some of these rejected funds were from states that do not have any resident SBICs.

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 could 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**
MH	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**