EMPOWERING EMPLOYEE OWNED BUSINESSES AND COOPERATIVES THROUGH ACCESS TO CAPITAL

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

HEARING HELD
SEPTEMBER 30, 2021

Small Business Committee Document Number 117–034
Available via the GPO Website: www.govinfo.gov

U.S. GOVERNMENT PUBLISHING OFFICE
45–635 WASHINGTON : 2021

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EMPOWERING EMPLOYEE OWNED BUSINESSES AND COOPERATIVES THROUGH ACCESS TO CAPITAL

THURSDAY, SEPTEMBER 30, 2021

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 9:59 a.m., in Room 2360, Rayburn House Office Building, Hon. Nydia M. Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Davids, Phillips, Bourdeaux, Carter, Chu, Evans, Delgado, Houlahan, Mr. Kim, Craig, Luetkemeyer, Williams, Hagedorn, Stauber, Meuser, Tenney, Garbarino, Ms. Young Kim, Van Duyne, Donalds, and Salazar.

Chairwoman VELÁZQUEZ. Good morning. I call this hearing to order.

Without objection, the Chair is authorized to declare a recess at any time.

I would like to begin by noting some important requirements. Standing House and Committee rules and practice will continue to apply during hybrid proceedings. All Members are reminded that they are expected to adhere to the standing rules, including decorum.

House regulations require Members to be visible through a video connection throughout the proceeding, so please keep your cameras on. Also, please remember to remain muted until you are recognized to minimize background noise.

If you have to participate in another proceeding, please exit this one and log back in later.

In the event a Member encounters technical issues that prevent them from being recognized for their questioning, I will move to the next available Member of the same party, and I will recognize that Member at the next appropriate time slot, provided they have returned to the proceeding.

For those Members and staff physically present in the committee room today, in accordance with the attending physician's most recent guidance, all Members and staff who attend this hybrid hearing in person will be required to wear masks in the hearing room. Furthermore, all Members and staff who have not been fully vaccinated must also maintain 6-foot social distancing from others. With that said, Members will be allowed to briefly remove their masks if they have been recognized to speak.

The COVID crisis dealt a severe blow to American workers. In 2020, the pandemic raised unemployment rates, halted wage growth, and lowered employee satisfaction with their jobs. This shock occurred as the labor force was already contending with rising income and wealth inequality and growing uncertainty surrounding retirement security.

The Small Business Committee serves as the voice of small firms in Washington. This includes the employees that help power these businesses, as well as entrepreneurs that start them.

One such proven solution to alleviating the problems facing these workers is through the employee-owned business model, which takes various forms, but has a united principle that the interest of the employees and owners are aligned.

Today, I would like to focus on two of the most prominent types of employee-owned businesses: the Employee Stock Ownership Plan, also known as ESOP, and cooperatives. ESOPs and cooperatives create a link between the fortune of employees and the performance of the companies they work for. As revenues and profits rise, employs are compensated, helping to create a culture of ownership in the enterprise. This model helps to raise wages, promote job preservation, and increase worker benefits.

Employee-owned entities are also more resilient than their peers in the face of crisis. For example, a study by the Employee Ownership Foundation found that during the COVID crisis, ESOP firms retained more jobs, maintained standard hours and salaries, and provided protective measures at higher rates than typical firms.

Given the long list of benefits associated with employee-owned businesses, Congress must explore ways to facilitate and encourage the formation of these enterprises. Though employee-owned companies have become more prominent over the years, they continue to face unique obstacles. For example, co-ops have an especially hard time accessing capital through the SBA 7(a) loan program. They are locked out of the 7(a) due to their requirement of a personal guarantee from anyone who owns 20 percent or greater share of a business.

Congress took steps to address this issue by passing legislation I sponsored in 2018. The main street Employee Ownership Act sought to lower barriers to accessing capital and allow more employee-owned firms to participate in SBA programs. Unfortunately, the SBA failed to follow congressional intent and declined to propose alternatives for co-ops to secure a loan without a personal guarantee.

That is why as part of our Committee's title of the Build Back Better Act, we provided $500 million in funding for a cooperative lending pilot within 7(a) without the requirement of a personal or entity guarantee.

Today, I look forward to examining the potential impact of the cooperative lending pilot program and exploring other ways that Congress can help employee-owned businesses.

I look forward to hearing from our witnesses today about the benefits of employee ownership, the challenges these firms face, and what this committee can do to help.

I now would like to yield to Ranking Member Mr. Luetkemeyer for his opening statement.

Mr. LUETKEMEYER. Thank you, Madam Chair.

I would like to begin by addressing what is happening a few floors below us at the House Financial Services Committee this very morning. Financial Services Committee will be hearing from, of all people, Treasury Secretary Janet Yellen.

Although I am glad that Secretary Yellen has finally found her way to one of our House committees, I must address yet again that it has now been over 150 days since the Secretary has defied her legal duty to testify before our committee, the Small Business Committee, on COVID-19 relief for small businesses. Simply put, Secretary Yellen continues to break the law, and my colleagues on the other side refuse to hold her accountable.

The Paycheck Protection Program was created with two agencies spearheading the efforts: Department of Treasury and the Small Business Administration. With nearly $800 billion in assistance flowing through the program, it was one of the most important small business relief programs to assist and save the nation's smallest companies and their most important asset, their employees, in history.

It is clear that while Secretary Yellen flouts her statutory responsibility to the program, she is also ignoring American small businesses. This blatant disregard for main street USA appears to be a pattern within the Biden administration. Take, for example, the Biden tax hikes that are currently making their way through Congress, without Republican input. Increases to the corporate tax rate, increases to the individual rates, and the increases to the capital gains rate will all crush our country's small businesses.

While small businesses continue to recover from COVID-19, they are being impacted by supply chain issues, skyrocketing inflation, and a major labor shortage. And this administration's response to all these issues is to increase taxes. All the while, the Treasury Secretary continues to turn her back on our nation's smallest firms, which is her statutory duty, by the way.

Madam Chair, last week, I sent you a letter requesting that we subpoena her to testify. I look forward to working with you on next steps in order to conduct a hearing with the Treasury Secretary and the SBA Administrator as soon as possible.

Now, today's hearing and topic are important. Employee-owned businesses are a viable option for many small businesses, especially with owners aging and planning next steps. However, I think it is necessary to also discuss some of the recent policy proposals put forth by my colleagues and how these proposals will impact small businesses' access to capital.

Early in the month, this Committee met to examine the small business provisions within the Democrats' partisan, reckless, socialist spending spree. Not surprisingly, we saw numerous provisions that disregard responsible lending standards. Chief among these changes were language to create a direct lending option at SBA. This path that the Democrats are taking toward a one-lender model is extremely concerning.

A few weeks prior to the creation of this direct lending tool, the Biden administration's SBA threatened lenders with audits if they didn't join with the newly created Direct Forgiveness Portal. These are dangerous trends for many reasons.

Existing public-private lending guarantee partnership harnesses the efficiencies of competition to deliver assistance to small businesses. As we all know, the federal government doesn't face competition. Importantly, private sector lenders also bring their own fraud protection oversight to the table. In fact, we have a case study right before us that examines SBA's direct lending model.

The Economic Injury Disaster Loan program, which was activated at the onset of the pandemic, has underperformed compared to the private lender-driven PPP program. EIDL continues to be slow and cumbersome, and the SBA's lack of response and communication on loan questions has been frustrating and unacceptable.

When it comes to fraud, report after report from the SBA's Inspector General and others have highlighted that the program is layered with massive amounts of potential fraudulent loan activity. And, unfortunately, the fraud numbers continue to rise.

It is important to note that we know all these problems are associated with direct lending. Yet my colleagues are continuing down this path. We also know the pitfalls of waiving the personal guarantee on loans moving forward. And this absolutely blows my mind. SBA in its own words said of the personal guarantee, this requirement is to ensure that SB adequately mitigates the risk to the loan program and ultimately to the taxpayer. And yet they won't do away with it.

My Republican colleagues and I will not sit quietly and allow more taxpayer dollars to be exposed to fraud, waste, and abuse through the SBA's programs. Underwriting standards should not and cannot be reduced. These are vital topics that this Committee should examine thoroughly. I look forward to exploring many of these topics today with our witnesses.

I came across a discussion yesterday with somebody and I made the comment that entrepreneurship is strong but next economy is on the way. Ladies and gentlemen, if we want to grow this economy, we have to protect the small businesses, the entrepreneurs of this country, to be able to grow our next economy.

Madam Chair, thank you for the hearing. And I yield back.

Chairwoman VELÁZQUEZ. Thank you, Mr. Luetkemeyer. The gentleman yields back.

I would like to take a moment to explain how this hearing will proceed. Each witness will have 5 minutes to provide a statement and each Committee Member will have 5 minutes for questions. Please ensure that your microphone is on when you begin speaking and that you return to mute when finished.

With that, I would like to introduce our witnesses.

Our first witness is Mr. R.L. Condra. Mr. Condra is the Senior Vice President of government relations for the National Cooperative Bank, a national financial institution dedicated to providing banking solutions for cooperatives and their Members. He also serves on the board of CooperationWorks!, a national network of organizations focused on co-op development.

Prior to joining the private sector, Mr. Condra worked as a Senate professional staffer.

Thank you for joining us today, Mr. Condra.

Our second witness is Ms. Tatia Cooper, President of Home Care Associates of Pennsylvania, a worker-owned cooperative based in

Philadelphia providing in-home respite and senior care. Home Care Associates got started in 1992, in partnership with another home care co-op based in the Bronx, New York, a testament to the power of co-ops helping each other start up and expand.

Welcome, and thank you for joining us today, Ms. Cooper.

Our third witness is Mr. Gary Shorman, the Chairman and Chief Development Officer of Eagle Communications, a 100 percent employee-owned ESOP, based in Hays, Kansas. Eagle Communications started the self-conversion process in 1998 and became majority owned by its employees in 2002. They have been 100 percent employee-owned since 2012.

Thank you for joining us today, Mr. Shorman.

The Ranking Member, Mr. Luetkemeyer, will now introduce our final witness.

Mr. LUETKEMEYER. Thank you, Madam Chair.

Ms. Frazier is the president and chief executive officer of the Bank of Charles Town in Charles Town, West Virginia, and a leading official with the Independent Community Bankers of America, ICBA.

Community banks have played a significant role in assisting and rescuing small businesses during the COVID-19 pandemic. Beyond this emergency period, community banks, which are known for their focus on relationship banking, serve our nation's small businesses consistently day in and day out. Across our vast country, community banks provide access to capital financial assistance to entrepreneurs and small businesses as they strive to offer the best products and services to their customers. Their dedication to customer service and serving our communities honestly and responsibility cannot be matched.

Ms. Frazier, welcome. Welcome back to the Committee. We thank you for joining us again to represent the nation's smallest banks. We are also grateful for you attending in person. Thank you very much.

And, with that, Madam Chair, I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Thank you witnesses for being here today.

Mr. Condra, you are recognized for 5 minutes.

STATEMENTS OF MR. R.L. CONDRA, SENIOR VICE PRESIDENT, NATIONAL COOPERATIVE BANK, ARLINGTON, VA; MS. TATIA COOPER, PRESIDENT, HOME CARE ASSOCIATES, PHILADELPHIA, PA; MR. GARY SHORMAN, CHAIRMAN AND CHIEF DEVELOPMENT OFFICER, EAGLE COMMUNICATIONS, HAYS, KS; AND MS. ALICE FRAZIER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANK OF CHARLES TOWN, CHARLES TOWN, WV, TESTIFYING ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

STATEMENT OF R.L. CONDRA

Mr. CONDRA. Good morning, Chairwoman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee.

I had the honor of testifying on this issue last year. I would like to thank the Committee's continuing interest regarding the Small Business Administration's inability to provide cooperative businesses access to its lending programs. I would also like to thank the Committee for its vision to create a cooperative pilot program that will provide much needed capital and build institutional knowledge of this business model within the agency.

Is there anything more gratifying than becoming a small business owner? During the pandemic, haven't we learn how essential grocery stores are to our communities? Unfortunately, the SBA, the federal agency that oversees small business assistance and growth, continues to block cooperative businesses and their tens of thousands of jobs from being created.

To be clear, cooperative businesses should have the same opportunities, service, and financial products as other SBA borrowers.

There are over 65,000 cooperatives in the U.S., and the top 100 generated $226 billion in annual revenue in 2020. Some notable cooperatives include REI, Ace Hardware, Ocean Spray, Land O'Lakes, and Congressional Federal Credit Union. In the last decade, the number of worker cooperatives have doubled and have become a preferred business option for young people, women, minorities.

According to the 2019 Worker Cooperative Economic Census, 50 percent of owners of worker co-ops are Latino and African American, and women make up 60 percent of the workforce. Additionally, over 160 food cooperatives have opened during this time, creating over 4,200 jobs. Last year, startup food cooperatives have opened in Colorado, Nebraska, Virginia, Ohio, Pennsylvania, and New York. All this progress has occurred without the SBA's assistance.

The SBA has amended its outdated eligibility regulations to include cooperatives, but continues to block these businesses from accessing its programs with its own federal version of a catch-22. Now technically eligible, co-op businesses must meet the agency's personal guarantee requirement, which states that any owner of 20 percent of the business must sign a personal guarantee for a loan.

Due to its unique business structure, a co-op is just not able to meet the check-the-box personal guarantee requirement the SBA requires. For example, if a custodial worker cooperative in New York City is owned equally by 10 women, which owner of one-tenth of the business signs the personal guarantee? If a food cooperative has 5,000 Member owners, which customer signs over their house to cover the other 4,999 customers?

A cooperative borrower does have skin in the game. They raise money through Member shares and Member loans that should secure financial and equity obligations that lenders require.

In 2018, Congress attempted to level the playing field for cooperatives by passing the main street Employee Ownership Act, championed by Chairwoman Velázquez and Senator Gillibrand. We were greatly disappointed to learn the SBA did not provide practical alternatives for loans, as required by law. Essentially, the SBA ignored congressional direction and the needs of business owners and consumers.

My employer, the National Cooperative Bank, has provided loans of more than $2 billion to cooperatives and independent retailers, including over $77 million to food cooperatives. Per our loan policies, we do not require a personal guarantee for consumer and worker cooperative loans.

Along with the private sector, there is federal precedent for not requiring personal guarantees to cooperatives. The Department of Agriculture does not require personal guarantees for loans to cooperatives, but most startups are in urban areas. Ironically, even SBA does not require personal guarantees for loans to Employee Stock Ownership Plans, known as ESOPs, that have a similar structure as worker cooperatives.

So why is there a need for a cooperative pilot program? The sector caught a break when Congress removed the personal guarantee requirement in the CARES Act for all EIDL and PPP business loans, thus giving cooperatives access to federal funding during the pandemic. Although, this Committee had to include specific billing which for cooperative businesses to become eligible for the COVID relief programs.

Using the SBA reported numbers, the National Cooperative Business Association estimates that over 2,500 cooperatives received COVID-relief loans totaling $1.2 billion in funding that saved over 93,000 jobs.

Chairwoman Velázquez, let me personally thank you and the Committee for helping these businesses and workers during one of the most difficult times of our country. Please be aware that the same co-op businesses that received COVID relief funding are still not able to access the SBA's existing loan programs.

Now, especially in Black and Brown communities, entrepreneurs are turning to the cooperative model as an opportunity to own a business or meet the grocery needs in their neighborhoods, many of which are food deserts. In 2015, Pastor Reginald Flynn of Flint, Michigan, wanted to start a food cooperative due to the grocery chain closures in his community. Pastor Flynn was unable to obtain financial support from the SBA. Six years later, he has raised $7.6 million and now has over 900 Member owners. With the help of a $1.25 million grant from the State of Michigan, the food cooperative has finally started to break ground. This is a success——

Yes, ma'am.

Chairwoman VELÁZQUEZ. Yes. Time expired.

Mr. CONDRA. Thank you.

Chairwoman VELÁZQUEZ. You could—during the question and answer period, you could expand——

Mr. CONDRA. Thank you.

Chairwoman VELÁZQUEZ.—on the issue that you feel that you haven't been able to discuss.

Ms. Cooper, you are now recognized for 5 minutes.

STATEMENT OF TATIA COOPER

Ms. COOPER. Good morning, Chairman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee. Thank you for the opportunity to speak today and share Home Care Associates' story, and discuss the need to address access to capital challenges for cooperative businesses.

Home Care Associates of Philadelphia is a small business that is owned, controlled, and governed by its employees. HCA is the only—HCA is, you know, Home Care Associates, and I will refer to it as HCA throughout.

HCA is the only healthcare cooperative in the State of Pennsylvania, and it is one of 500 cooperatives in the United States. Lack of access to capital, including Small Business Administration loan guarantees, is the central reason as to why so few of these businesses exist.

HCA currently employs 124 full-time employees and 12 part-time employees. Although these past few years have been extremely difficult, we are looking forward to celebrating our 30th year in business in 2022.

Around 1990, founders of a larger co-op, as Chairwoman Velázquez pointed out, founders of a larger cooperative in the Bronx, New York, set out to find money to replicate the model elsewhere in the United States. At the time, Philadelphia made sense because of its large population of elderly and disabled citizens in need of quality care and because of the number of individuals living in poverty in need of a quality job.

HCA's mission is to provide high-quality home care services to those who are elderly, chronically ill, or living with disabilities, and to provide quality jobs where workers embrace opportunities to learn and grow as Members of the healthcare team. They contribute greatly to the participatory culture and earn competitive wages and benefits, while building a profitable worker-owned company.

The challenge to raise cash to start our business was enormous. Like many other cooperatives, cooperative small businesses, HCA was not eligible to receive startup support from the U.S. Small Business Administration. Fortunately, and thanks to others who believed in our model and mission, including charitable trust foundations and founders of the Paraprofessional Healthcare Institute, HCA was able to secure the capital it needed to open its doors in 1992. However, I must mention that HCA was very fortunate in that there were other attempts to start other co-ops in cities that were not successful in raising capital.

At our 1-year anniversary, HCA established two different classes of stock: Class A shares were held by our investors, and class B shares were held by our workers. Worker owners would buy shares of the company for $500. Most of our owners do not have $500 of disposable income, so HCA lends the workers the $500, but they share no interest. The shares are then paid back with $35 deposit and a payroll deduction of $3 per week.

Upon making the deposit, each worker has one vote, can campaign for a seat on our board of directors, and is eligible to receive a financial share when the company is profitable. We are proud to share that all class A shares were donated back to the workers, making HCA now 100 percent worker owned.

Raising startup capital, though, was just the first of many challenges we faced. Eighty percent of the consumers that HCA serves are nursing home or Medicaid eligible, and most of HCA workers continue to be eligible for Medicaid.

Unlike many noncooperative businesses in the industry, HCA provides extensive training on both technical and soft skills we believe necessary to provide quality care. HCA relies on reimbursement from Medicaid to cover costs associated with training and employment.

In our efforts to provide a quality job, HCA remains committed to applying 70 percent of its revenue to worker salaries and benefits. Although we remain true to this goal, many of our workers and families continue to live below federal poverty levels. Low reimbursements contributing to low wages translates to caregivers who are eligible for Medicaid. This reality is not unique to Home Care Associates—home care cooperative. PHI reports that one in every six home care workers in the United States lives in poverty.

Since the onset of the global COVID-19 pandemic, our resources are quickly depleting. The expense of additional PPE to protect our workers to remain compliant fell squarely on the business. Fortunately, HCA did qualify for the first round of the Paycheck Protection Program to support sustaining jobs and salaries, but did not qualify for round two because we could not include increased operational expenses that contributed to our increased losses.

Although we have a strict PPE policy, many of our workers missed work, left work due to lack of access to childcare, or because they or someone in their family became sick with COVID-19.

The strain on our bottom line continues to be felt and we continue to struggle now to hire new workers as overtime has increased and the expense related to that increases.

Currently, HCA is struggling to find alternative sources of capital to support our efforts to sustain our business. Since early 2020, we have seen a decrease in employees willing to purchase shares to become worker owners. We are struggling to find ways to pay a living wage without sacrificing training and benefits, and we lack the financial support needed to widen our scope of services.

Like many in our industry, supply cannot meet the demand for service.

Chairwoman VELÁZQUEZ. Ms. Cooper?

Ms. COOPER. If we are to increase volume so that we may remain self-sufficient and continue to provide quality care, we must secure the capital needed to expand our scope of service, pay a living wage, provide training, and increase——

Chairwoman VELÁZQUEZ. Ms. Cooper, time has expired. During the question and answer period you will have time to revisit any issue you that you haven't discussed. Thank you so much.

And now, Mr. Shorman, you are recognized for 5 minutes.

STATEMENT OF GARY SHORMAN

Mr. SHORMAN. Thank you, Chairwoman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee. Wish I could be there in person.

I am Gary Shorman, Chairman of the Eagle Communications. We are a 100 percent employee-owned company doing business in Kansas, Nebraska, and Missouri, where we own and operate 31 local radio stations in local and small communities. In addition, Eagle has created digital and online learning divisions where we assist our local businesses.

I am also here representing The ESOP Association, a nationwide nonprofit representing over 3,000 ESOP companies and professionals.

I would like to state something right up front. ESOPs and employee ownership is not an experiment. They are proven, they are successful, and they are here to stay. It is time for the various agencies of the U.S. Government, including the Small Business Administration, to recognize this, and to treat ESOPs and employee-owned businesses as the successful, mature businesses that they are.

According to the most recent figures submitted to the U.S. Department of Labor, approximately 8.6 percent of the entire U.S. workforce has some ownership in an ESOP. That is more than 14 million American households.

In just a 10-year period of time, from 2008 to 2018, the Department of Labor reports that more than $1 trillion in retirement benefits have been paid to ESOP beneficiaries. Let me stay that again. More than $1 trillion.

In my written testimony, I have listed research showing the power of ESOPs, not only during the Great Recession, but also during the pandemic. ESOPs rebound much faster following economic downturns, and our company is a great example of that.

Despite of all the strengths, there remain far too many unnecessary obstacles for ESOP formation. To begin addressing those obstacles, Congress passed the main street Employee Ownership Act. I would like to speak to the two main goals of that legislation: access to capital through the Small Business Administration's 7(a) lending program and a desperate need for awareness initiatives.

During the pandemic, more than 70 percent of all ESOPs were successfully awarded Paycheck Protection Program loans through the SBA. That PPP program was administered through the SBA's 7(a) loan program and utilized the delegated lending authority program such that local SBA lenders could approve these time-sensitive loans.

However, in the first few days of the program, there was some initial confusion because despite the clear intent of Congress and the main street Act, the SBA does not allow loans to ESOP companies to be approved through delegated lending authority, instead requiring ESOP loans to be approved by staff in Washington. Fortunately, clarification was quickly given and ESOP PPP loans were allowed to be evaluated and granted by a local lender, just like every other PPP loan, as Congress intended.

We were one of those PPP beneficiaries. And it was a local familiarity that our lender had with our business that made it a streamlined and efficient process. Yet even though our local lender clear knows and understands our business and has evaluated and given us a PPP loan, if we were to apply for an SBA loan today, they could not approve it and would be required to forward our loan application to Washington where it might languish for weeks or even months.

To address these issues, the SBA must streamline lending for ESOPs. It is as intended by the main street Employee Ownership Act. We ask that the SBA be unambiguously directed to include ESOP loans in the preferred lending program. The experience of PPP program clearly demonstrates that local SBA approved lenders are fully capable of evaluating responsibly and lending to companies like ours.

In addition to lending, the programs—the main street Act also sought to significantly increase awareness within the privately held business community about ESOPs. Within the Act, the SBA was tasked with promoting awareness of ESOPs and employee ownership. Business owners must know the ESOP option exists and must be able to attain useful unbiased information. And to that end, be directed to have a centralized and specific office, such as the Office of Small Business Development Centers, with active public education and information effort about ESOPs. Further, we ask that the SBA undertake specific ESOP relegated educational training for regional SBA staff. We have been recently encouraged by public statements and support for employee ownership as articulated by SBA Administrator Guzman.

As you know, one of the biggest economic challenges ahead is the looming retirement of baby boomers, who own nearly 2.5 million businesses. It is known as the "Silver Tsunami," and this will be the largest transfer of business ownership over the shortest period of time in our nation's history. Many of those businesses have no succession plan. So time is of the awareness to raise all of the important issues regarding ESOPs for business owners.

And, finally, while I recognize this is outside the jurisdiction of this Committee, I would be remiss if I did not speak about what many of us in the ESOP community view as the biggest obstacle to the formation and expansion of ESOPs: it is the chilling effect of the U.S. Department of Labor. And I would recognize and would like to have a question on that later today.

I appreciate the time you have given me today to share any testimony, and look forward to your questions.

Ms. HOULAHAN. [Presiding.] Thank you, Mr. Shorman.

Ms. Frazier, you are now recognized for 5 minutes.

STATEMENT OF ALICE FRAZIER

Ms. FRAZIER. Good morning, Chairwoman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee. I am Alice P. Frazier, president and CEO of Bank of Charles Town, a community bank serving markets in West Virginia, Maryland, and Virginia. Today, I testify on behalf of the Independent Community Bankers of America, where I am Chair of the Policy Development Committee and a Member of the Board of Directors. And I thank you for the opportunity to testify.

Employee-owned and cooperative firms are important ownership models that deserve our support as lenders, business advisers, and policymakers. My bank currently lends to two co-op borrowers. Access to capital is critical to the success of small businesses of all ownership types. And in this regard, I will discuss the importance of preserving community bank SBA lending, which comes at zero cost to the taxpayer.

An experiment in SBA direct lending in which the agency has a poor track record would jeopardize access to the capital for small businesses. Community banks provide practical, real world business counseling, and networking opportunities, particularly for startups, in a way that can never be matched by SBA. We must not be sidelined in the critical task of creating access to capital. We are committed to working with this Committee and the SBA to ensure the 7(a) program is reaching the smallest borrowers.

Community banks account for 66 percent of 7(a) loans over the past 10 years. And my bank has been a SBA lender for over 40 years. The median loan size in our SBA portfolio is just under $100,000. We recently hired three highly experienced SBA lenders to place more of an emphasis on this product. The community bank-small business partnership goes well beyond a loan.

My bank is currently work with an African-American entrepreneur who has corporate experience but no experience in setting up a company. He lacks contacts with accountants and lawyers and other professionals that specialize in startups. And, unfortunately, as he has told me, African-American entrepreneurs are often disadvantaged in this sense. Mentorship is especially needed in minority business communities.

As we talked about his business plan, he asked for these connections, and we were happy to provide. We spent time walking him through different types of loans, eventually settling on a 7(a) line of credit, which we expect to grow quickly as his business ramps up.

The loan is really just one feature of a much broader partnership. Our experience in working with other small businesses gives us a unique ability to provide insights and counseling. I provide other examples of our small business relationships in my written statement.

Informed guidance, education, and borrower confidence building is our core value preposition. We stand by our partners and continue to provide guidance as the business grows and new opportunities arise or as they encounter setbacks and challenges.

I do not believe that the SBA direct lending could offer any remote substitute for a long-term relationship with a community bank. Employee ownership and cooperative ownership are models that make sense for many firms. Community banks support these firms, bringing the same commitment that they bring to any small business relationship. And I discuss my cooperative lending in my written statement.

We are willing to discuss alternative solutions to better accommodate co-ops and employee-owned firms. However, we caution against a broad waiver of guarantee requirement on all 7(a) loans.

SBA lending is not—direct lending is not the answer to capital access for small businesses of any ownership model. This experiment has been tried and failed, resulting in subsidy rates of 10 to 15 times higher than in loan guarantee programs, as noted in a recent Congressional Research Service report. What is more, as a locally based lender, we are able to root out fraud to which direct lending would surely be vulnerable.

I urge this Committee to reconsider the direct lending provisions included in the Build Back Better Act.

I thank you again for this opportunity to offer my perspective, and I am happy to answer any questions you may have.

Ms. HOULAHAN. Thank you, Ms. Frazier.

And thank you to all of our witnesses for being here today.

I will begin by recognizing myself for 5 minutes.

In June of this year, I formed the Stakeholder Capitalism Caucus with Representative Dean Phillips, who also sits here with me on the House Small Business Committee and who also shares an entrepreneurial background. We created the Stakeholder Capitalism Caucus in the wake of COVID-19's pandemic to engage Congress and business leaders on ways to reimagine the role of corporations to equitably benefit stakeholders and to lead to a more sustainable and prosperous economy.

With their unique business structures, ESOPs and cooperatives have demonstrated that employee-owned business models can produce higher wages and can promote job preservation for their workers during periods of economic distress, as well as invest more in their local communities than conventionally owned businesses can. While conventionally owned businesses may have outside stakeholders, the stakeholders of employee-owned businesses are, in fact, the workers themselves.

I would like to know if any of the panelists can address the ways in which your business models lend themselves to more equitable and sustainable conditions for your workers, as well as invest in your respective local communities in line with the ideal of stakeholder capitalism. And if it is okay, I would like to start with Mr. Shorman on that.

Mr. SHORMAN. I like that question. And, frankly, good to see you again.

When you take a look at what we do in our local communities, how important it is to have that connectivity in local communities, that is what we do with our radio stations, that is what we do with our businesses, is help them grow. And so when you ask that of being able to talk about that, over the last pandemic, that one that comes to mind, our ESOP, we did not layoff anyone, we did not furlough anyone. We kept everyone engaged. ESOP fought the same battles with everyone in dealing with the pandemic and being able to keep people at work and move them to the right place.

But the employee-ownership model adds a powerful advantage to local community business because it keeps things local. It keeps that business local. It keeps those who are the employee owners right in the middle of working to grow and working together to win for that company. And we have seen that in results of—not only of working our way out of the pandemic, but working during the pandemic of not having to do any layoffs or furloughs.

Thank you for that question.

Ms. HOULAHAN. You are welcome.

Ms. Cooper, would you have anything to contribute as well to that question? And hello to Philly.

Ms. COOPER. Hello. You know, I want to make sure I understood. It was a two-part question, correct, in that you asked about the contributions to the community, but also how we have kind of hung in there? Is that correct?

Ms. HOULAHAN. No. I am largely asking kind of what are the benefits, do you perceive, of co-ops and ESOPs to making sure that you are not only helping your shareholders, and in many cases coops and ESOPs the shareholders are the people, but also the community at large, potentially the environment, investors, all those kinds of things as well.

Ms. COOPER. Well, for us, I mean, clearly, we are a home care business, so we are serving residents of the Philadelphia area every day by providing direct care.

The one thing I wanted to say, which answers the question as we were wrapping up, is that, during this pandemic, with all of the challenges that we face in this industry, the advantage that we have as a cooperative is that, you know, our worker owners are not only committed to quality, but they are committed to their consumers. They are here because they want to be.

We know that worker owners stay longer, they work harder, they are far more committed to their consumers, decreasing the revolving door of direct care workers going in and out, ensuring that their consumers are safe, and making sure that they understand that they are representing the company, that they are going to benefit from both financially and in terms of having say in the direction of the company.

So we feel, as a cooperative, that that is our advantage in this industry, that because our workers are owners, they are more likely to stay, more likely to deliver quality care, more likely to contribute positively to the community by way of reducing hospital readmittances, accidents, incidents, and preventing illnesses.

Ms. HOULAHAN. Thank you, Ms. Cooper.

And, lastly, for Mr. Shorman again, what can we be doing more to promote businesses to transition to employee ownership? Many of you talked about the Silver Tsunami. Many people are trying to figure out what their transition, you know, exit strategies look like in this economy, because people are aging out of it, amongst other reasons. What can we be doing to improve the ideals of ESOPs and co-ops in the common vernacular?

Mr. SHORMAN. Well, this Committee is doing great work. We see that every day because we are on the streets working with——

Ms. HOULAHAN. I am afraid that I need to stop you, sir, because I ran out of time, and I need to go ahead and yield. My time has now expired.

The Ranking Member, Mr. Luetkemeyer, is now recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chair.

Ms. Frazier, thank you for joining us again today. And I want to start with you. Appreciate your testimony today. Like you, I am very concerned about the recent trends in SBA toward direct lending. You know, we are currently witnessing the devastation of direct lending through SBA's Economic Injury Disaster Loan program. And according to SBA's own inspector general, the program has a potential fraud rate of nearly 30 percent. Unbelievable.

And you rightly point out in your testimony, both in your written and verbal testimony, about the Congressional Research Service report that indicated that SBA, in the late nineties, stopped issuing direct business loans because the subsidy rate was 10 to 15 times higher than the subsidy rate for its loan guarantee program, which means that it was losing 10 to 15 times more money in direct lending than it was the loan guarantee program, which means it has no idea what it is doing when it comes to direct lending.

Your comment in there talks about—you are pointing to an example of where the bank actually caught somebody with an EIDL loan, a fraud attempt and caught them. So I would just appreciate you expanding on that a little bit more. This is a really, really big concern to me whenever we see that they are trying to actually propose more direct lending programs and empower the SBA even more whenever they can't handle what they have got right now.

Ms. FRAZIER. Thank you for that question. I am happy to expand on that.

I might begin with as a new banker, anyone that joins, the first thing they train you in preventing a bank robbery is look someone in the eye. And so there is a big value to that when you are getting ready to lend someone money. And if you are applying for a loan through a portal or through an opportunity where you really don't have to look anyone in the eye, the fraud is opportunity.

So to be able to visit a bank—or visit a business and talk and speak with the owners of the business, understand their dream and what they are doing, and really be able to evaluate how effective they are, helps evaluate the opportunity for the loan to be used well, successful, and in play.

So I think recently what we did experience, we had read about the fraud alert the SBA had issued on their website related to EIDL loans where they had distributed the money, and typically a borrower would come in and ask for all of the money in cash. We shared that with our branch managers. And one of them happened to have an instance where someone had come in and opened an account about 60 days prior, and had not really had any transactions in the account, very little for which would have been deemed a business account by far; had gotten two EIDL loan deposits 2 days apart and within 4 days came in wanting to take out what was equal to $20,000 out of the bank in cash.

Now, of course, we had shared that information. Our branch manager rightly so had reached out to operations. Ultimately, we returned that money because it was deemed not appropriate at that time. So the fraud is there, and so I liken it back to being able to look at folks.

Mr. LUETKEMEYER. As we have gone through this problem, the inspector general has pointed it out—the SBA's own inspector general has pointed it out, and indicates to us that he is trying to put in place some changes to the program to make it work better. SBA acknowledges that they are trying to put some things in place. But in the next breath, inspector general sits there and says, well, yeah, they are in—the changes are in place, but the employees don't follow the procedures. The employees don't follow the recommended changes. And as a result, the same things happen.

Have you experienced that, that they ignore the processes? Maybe you are not even going to be aware of the changes SBA has to go through to make this work, but just a comment from you.

Ms. FRAZIER. You know, I am not sure I could really speak effectively directly on that because I am not aware of the changes or how they operate internally.

Mr. LUETKEMEYER. That is interesting. And, to me, the template for how this can actually work is the PPP program standpoint to the banks who have a know-your-customer law in place; and, actually, as you said, have to look the customer in the eye, make sure that those folks are who they say they are, and that they are a real business, a real person; their address and phone numbers, their signatures and Social Security number, all that matches up. Where when you do this virtually, there is a lot of this that doesn't take place.

So, to me, I would like for you to just elaborate just a little bit in my last 20 seconds here.

Ms. FRAZIER. You know, even through the PPP process or loan requests we received through our online portal, we would take the time to either visit their place of business, make sure we reached out and contacted them; had ways to validate it beyond just a complete virtual experience. And I think that puts us at a lot of risk if everything is virtual.

Mr. LUETKEMEYER. I appreciate your comments this morning. And I think that we actually have a template in place which shows how we can fix the problems at SBA. We just have to make sure we do it right.

Thank you very much for your testimony.

Ms. HOULAHAN. The gentleman's time has expired. And the gentleman yields back.

The gentleman, Representative Dean Phillips, Chairman of the Subcommittee on Oversight, Investigations, and Regulations, is now recognized for 5 minutes.

Mr. PHILLIPS. Thank you, Madam Chair. And greetings to our witnesses and colleagues.

My great-grandfather Jay Phillips started as a newspaper boy in Manitowoc, Wisconsin, in 1912, and created a business that became very successful over many years. He used to tell me that owners act differently than employees. They reuse paper clips and they turn off the lights when they leave the office. And he believed that business was a means to an end, and the end wasn't accumulating as much capital and wealth as possible, rather sharing as much as possible.

And in 1941, he created the Phillips bonus and profit sharing plan, a copy of which I have here in my hand. And he wrote in it: Unfortunately, the great majority of the people in this country never achieve the degree of financial independence which permits them to live out their lives without help from others. I believed, and still do, that the time to help people solve this problem is during the prime of their life and not when they become objects of charity.

When he introduced this plan in 1941, the top 1 percent of Americans controlled about 30 percent of wealth in America. Eighty years later, that number is 40 percent and growing.

I think we can all agree, Democrats and Republicans, that ownership is the best example, broad ownership in capitalism. We do not need a revolution in capitalism, rather evolution. And in my estimation, that is employee stock ownership programs.

So my question, starting with you, Ms. Cooper, is, you know, why are there not more ESOPs in America? And what can we here in Congress do to incentivize and encourage and promote and, hopefully, see national benefits from employees owning more businesses in America?

Ms. COOPER. I don't know if I can answer why there aren't more in the country. But I can tell you that, you know, in Philadelphia, in Pennsylvania, we work to—the same way Cooperative Home Care Associates supported us in replicating that model, we are supporting others in replicating the model, and trying to in healthcare, you know, really make the connection between ownership and quality of care. We know that in this country we are having an issue with delivering care.

You know, we talk about the Silver Tsunami and the number of people that, you know, are still living independently but may need some assistance and are beginning to need some assistance, and how there aren't just enough people out there. One of the things that we worry about the most in this industry is fraud and abuse and neglect.

Well, we know that when someone is an owner, they take a lot of pride in the level of care that they are delivering. And they take the work, you know, very seriously. They understand how important it is to make sure quality is delivered and to protect those from fraud, neglect, and abuse. And this is something that all of our workers have in common and they buy into. And I think it is necessary in order to create opportunities for quality care, continuity of care, and to protect our seniors, and people living with disabilities.

In healthcare, to me, it makes sense that a cooperative or a worker-owned model contributes to solving the problem in numerous ways, not just in, you know, the delivery of quality care and the—what ownership means as they are delivering quality care, but also in the ability to participate in a culture where you then contribute to the direction of the company and can talk about what it means to have a quality job and how those two are connected.

So for us it is about not only——

Mr. PHILLIPS. Ms. Cooper, in the spirit of allowing a couple of others to speak too, if I might just move to Mr. Condra for comments on what we might do here in Congress to promote employee ownership across the nation.

Mr. CONDRA. Thank you. The number one issue is access to capital. If you go to a conference, if you talk to cooperative developers, it is need to access to capital.

The USDA has the business and industry program that does not require this personal guarantee blockage for cooperatives. If they were able to make loans to businesses outside of rural areas and urban areas, we wouldn't be here today. But, unfortunately, they can only make loans to rural areas, and the SBA continues to block access to capital to cooperatives. And the fact is, for banks to do startups, we need credit enhancements. We need the 7(a) guarantee type of guarantee to continue to grow these businesses.

Mr. PHILLIPS. I appreciate it. I just have 10 seconds left. Just to inspire my colleagues on both sides of the aisle, to pursue what should be very unifying, which is to expand ownership in the United States as we try to inspire compassion to capitalism.

With that, Madam Chair, I yield back.

Ms. HOULAHAN. Thank you. The gentleman yields back.

The gentleman, Representative Roger Williams, the Vice Ranking Member of the Committee, is now recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Madam Chair. And I want to thank all the witnesses for joining us today.

And in full disclosure, I am a small business owner myself for 51 years, and I haven't had a day in my life in 51 years I haven't owed a community bank money. And they are very important to me. And I want to also say to the bankers, congratulations on the way you handled the PPP. It was well done.

In the last year and a half, we have observed how community financial institutions are better equipped to handle small business lending than the federal government. In the early days of the pandemic, the private sector was deputized to help deliver business serving loans quickly to American small businesses through the Paycheck Protection Program. They were a leading force, and successfully executed one of the most successful emergency lending programs in country's history. And on the contrary, the SBA's rollout of the Shuttered Venues Operation Grant program, or SVOG, took over 7 months before they delivered their first dollars, and was inefficient and lacked transparency.

So, nonetheless, Democrats are still proposing a direct lending option under the SBA's 7(a) loan program that will cut off the private sector financial institution's role. And they are the ones who give service. And to meet the immediate needs of our community small businesses, we need to get the private sector more involved, not less.

So, Ms. Frazier, can you speak more on how cutting the private sector's lending role from the 7(a) loan program, like Democrats have proposed, would have affected community banks and small businesses alike?

Ms. FRAZIER. Thank you for that question. You know, business lending is just not as simple as it is with consumer lending. There is a lot of nuances to business lending that you have to take in consideration. It is, what is the business model? How is the financial reporting? What is the leader like? Are they going to be successful? Do they have a plan that can work, a location, et cetera? All of these things play in the factor of making a decision on a loan, not just completing an application and submitting financial information. And, oftentimes, the financial information, you need to talk with the business owner to understand what is there.

So without that sort of relationship building and understanding that goes on in a community bank with the small businesses, I am concerned that the direct lending would really not be as effective as it could be for that. And with the story that I shared, oftentimes the small businesses, the entrepreneurs, they don't understand the different types of loans that they can use to help their business grow or the purpose of them. And direct lending might limit that opportunity or probably will limit that opportunity overall.

Mr. WILLIAMS. A relationship with your banker is much better than a relationship with the government.

Ms. FRAZIER. Most would say yes.

Mr. WILLIAMS. Community banks are an integral part of main street America. They provide access to capital, financial services—as I said, they have me for 51 years—with personalized relationships to the small business they serve. The government must not impose excessive regulations on banks that will make them less competitive and less struggling to compete with larger financial institutions.

Small businesses depend on community banks for their knowledge around the needs of local communities, and this direct relationship better positions community and regional banks to assist small business an reinvest local dollars back into the communities they are a part of to create more jobs.

So, Ms. Frazier, how are small businesses affected when a local community banks closes? And how can Congress ensure that community financial institutions can remain competitive against their larger, multinational counterparts?

Ms. FRAZIER. Thank you for recognizing how communities are affected when community banks are closed or are faced with challenges that prevent them from staying independent and involved in the community. Oftentimes, what exits first is the community dollars that are vested in the local nonprofits, the different civic organizations, et cetera, that really need the involvement of the community banks overall.

But then talk about the small businesses, those relationships that we build, we invest in, we help. The businesses network with each other because we know we have the conversations with each, and we know what someone is looking for and who can help solve that problem for them.

So I believe what you can do is continue to keep us involved in programs like the SBA, collaborate with us so that we can make those guidelines easier for people to access the capital that is needed to continue to grow.

Mr. WILLIAMS. Community banks now know firsthand the importance of main street America having access to capital. So I have got a little time here. Let me just go right to the question, Ms. Frazier. Small businesses continue recovering from the COVID-19 pandemic. Can you tell me, and quickly, in your opinion, what the impact of higher taxes and new costly compliance regulations would be on both small business and the banks?

Ms. FRAZIER. Right now, what we see is our small businesses continue to struggle to find employees, to be able to make additional revenues and profits. So if we added additional taxes, I think it would be very harmful.

Mr. WILLIAMS. Cutting taxes is always good.

Ms. FRAZIER. For business, yes.

Mr. WILLIAMS. Thank you for your testimony.

Ms. HOULAHAN. The gentleman's time has expired.

The gentlewoman, Representative Sharice Davids, Chairwoman of the Subcommittee on Economic Growth, and Tax, and Capital Access, is now recognized for 5 minutes.

Ms. DAVIDS. Thank you, Chairwoman. And thanks to our witnesses for joining us here today. I am really glad that we are getting the chance to hold this hearing.

You know, employee-owned businesses certainly have an impressive track record of higher employee retention, pay, and have definitely proven to be more resilient during economic downturns. So, you know, I think that this conversation is important.

You know, as these companies still might struggle with access to capital, even with the SBA programs, I think it is important for us to constantly evaluate how we can be helpful. You know, and that is why I supported—I have supported legislation like the promotion and expansion of private employee ownership. We have to do a better job with our marketing here—Promotion and Expansion of Private Employee Ownership Act.

You know, I think bills like this, you know, we are talking about expanding tax incentives, federal assistance for ESOPs to encourage small businesses to use this business model.

And, you know, I was also glad that we got the chance to put out from this Committee our portion of the Build Back Better Act, which would include $500 million for a pilot program for cooperatives and ESOPs to receive SBA loans without a personal or entity guarantee.

And, you know, I am proud to support this kind of legislation, because this is the stuff that benefits stability for companies and provides their employees and customers—employee owners and customers during critical times. You know, we are in some, like, very uncertain economic times.

And, with that, I definitely want to make sure that I talk to Mr. Shorman, a fellow Kansan here. Thanks for joining us. I was hoping to hear you talk a little bit about employee-owned businesses, specifically, you know, how ESOPs and such have been more resilient during the economic downturn. And then, you know, maybe how the resiliency maybe correlates with higher retirement savings and that sort of thing.

Mr. SHORMAN. Well, first off, I look forward to meeting you in person, Representative Davids, sometime when we are in Kansas City to be able to meet up and do that.

But our company, we started in 1998 with our ESOP, and you have seen the growth of wealth for our employee owners. We had that with a recent transaction. We saw that, how that paid off for employee owners as they built the company, and that is the story.

And I grew up on a family farm, and you worked together to build something so at the end of the day, everybody has, I guess, a part of the pie and the ability to really focus on what they want to do. We have seen that in our business.

As far as being able to figure out how to make it easy for companies to do ESOPs, that is a challenge, because you can set up a 401(k), and you have clear rules for making that happen, but an ESOP is more complicated than that. And what this Committee is doing to kind of simplify that, looking for ways to find easier access, looking to your community bank to make that happen, and secondly, being able to get clear regulatory guidance, and that is one of the biggest challenges. The DOL has perpetuated an absence of formal regulatory guidance. And so being able to have clear guidance would allow companies to jump in and be able to share that model.

Because in local communities, owners, and we see them every day, owners that are running these smaller businesses don't have a big team of executives that can go to D.C. and do that, but they do have a team of people who can work with the local bank to grow that business. And being able to keep that business local versus selling to another big corporation or something like that is so very important, especially in Kansas. And we have so many of those local business owners that want to transition to something else. We would just like it to be an ESOP.

Ms. DAVIDS. Yeah. I appreciate that. And, definitely, I will continue to figure out ways to be supportive from the Small Business Committee, and would be open to further conversations about how we might work with the Department of Labor, you know, to clarify some regulatory—the guidelines.

Mr. SHORMAN. We would appreciate that. Thank you.

Ms. DAVIDS. I appreciate all of you taking the time to join us, and I yield back.

Chairwoman VELÁZQUEZ. [Presiding.] The gentlelady yields back.

Now we recognize the gentleman from Minnesota, Mr. Hagedorn, Ranking Member of the Subcommittee on Underserved, Agricultural, and Rural Business Development, for 5 minutes.

Mr. HAGEDORN. Thank you, Madam Chair. Thank you. I appreciate the opportunity. It is nice of you to hold this hearing.

And I am somebody who has been a pretty strong supporter of employee-owned businesses and co-ops. Visited many across our district, talked to a lot of employees who seem to appreciate the opportunity to kind of build their own future, you know, grow their own retirement, have some control of it, feel like they are part of it. And it is amazing, the millions and millions of Americans who are in the workforce that are participating. So it is, I think, a big success and something we should continue to see what we can do to foster and certainly not put any impediments in there.

I would ask Mr. Shorman; you seem to be a strong advocate. Perhaps you could just let everyone know a little bit more about why it is such an opportunity for not just business owners to convert this way but for the employees.

Mr. SHORMAN. If you look at it—and thank you. You look at it from an employee standpoint. You can work for a company your entire career, and at the end of your career maybe have some sort of 401(k) or maybe a government retirement. You work for an employee-owned company, and we have seen that happen where the employees have worked for a company 20 years, and they end up retiring, but they have a nest egg that they are able to do things that they want to do. You can't do that in a regular company. But as an employee owner, you participate day in, day out in the growth and success of the company, and we see that in the success, and that also means that success stays in the local community.

And our company is based locally. We have to have strong local businesses. So to see them being able to transition into an ESOP and take their company, keep it local and share that ownership, that is a powerful way to do business, especially in small markets, small communities across our country.

Mr. HAGEDORN. It is just an excellent option. Obviously, nobody has to do it. People buy into it, and the employees, like I said, that I have spoken with have been very, very pleased.

So I think this Committee is very, very fortunate to have somebody like our Ranking Member, Mr. Luetkemeyer, who has a background in community banking, and he brings up some very good points. I mean, if we are—if the SBA wants to take some of these things over and expand their portfolio, boy, there has been some problems there, a lot of waste, fraud and abuse, as he said. We don't need any more of that, and we need a little bit more customer service.

I think Congressman Williams hit it right. Who is going to be there for the customer more than the community bank or the people in the community, invested in the community, who already have them as customers, or a big government bureaucracy or a big corporate bureaucracy? I am one Republican certainly never stands up and advocates for the big banks. I think the community banks have been hit hard.

What do you think? Don't you think you are in a much better position to deliver those services maybe than others and do it in a way that is going to protect the taxpayers?

Ms. FRAZIER. Thank you. I completely agree with what you say. We live in the communities we serve. We see our business leaders at church. We see them in the grocery stores. We see them out shopping, at the soccer games, et cetera, so we are involved in the community with them side by side. It is just not a faceless application. It is just not a faceless business. We know when their businesses are thriving and we know when they are struggling, and we do what we can to help. So I think community banks are the partners and really what help make communities thrive.

Mr. HAGEDORN. Thank you. Now, the majority wants to take a bunch of money that is created by capitalism—and I would say capitalism is always compassionate, because without producing wealth, you have no wealth in order to help people. So—and they want take a bunch of money and say, look, we are going to help you here. What they fail to talk about is how the other part of their bill is going to raise taxes and how their other agenda is going to increase regulations and how part of both agendas, both in this bill and across the board, is going to drive up the cost of energy needlessly and make it less reliable.

And, lastly, who knows about trade? We haven't seen much from the administration on that. And then fiscal policy, we see what is going on with inflation. It is just going to be spurred more.

You know, those things, those good government or bad government policies are way more important than government handing out money in order to have capital in this case. You can destroy businesses. You can give them all the money in the world, but if you are going to have policies that will destroy them, what difference does it make?

And I think a lot of businesses across our country need to reflect on this, and a lot of employees, that we are in a crossroads. And a lot of these policies that are coming out of Washington on the other side stand to destroy them and put them out of business forever, businesses that have been around for generations.

So while I appreciate the need for capital, and we will do what we can in order to help people, I do not appreciate the philosophy and the policies of the Democrat Party overall on this bill.

Thank you.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now I recognize myself for 5 minutes.

Mr. Condra, the USDA Business and Industry Loan Program does not require a personal guarantee from cooperatives. Instead, USDA requires co-op Members to sign a covenant to withhold profit distribution until the agency loan is paid in full. Could this work for the SBA loans to co-ops in place of a personal guarantee?

Mr. CONDRA. This could—this could work. This could work. And, also, if we sat in a room, we could think of all kinds of alternative ideas that the main street Act encourages SBA to do.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Frazier, the number of 7(a) loans made under $150,000 decreased by 44 percent over the past decade. The decline is even more troubling for 7(a) loans below $50,000, which decreased by 59 percent over the last 5 years. The average 7(a) loan size has also more than doubled in that time. In fiscal year 2012, it was just over $340,000. As of September 2017, the average loan size this fiscal year is over $687,000.

Many people will say smaller loans, those under $150,000, are not profitable, so traditional lenders are not making those loans. So what do you say to small businesses who are seeking loans of under $150,000? What do you say to them?

Ms. FRAZIER. Thank you. And there is no way we can refute the numbers. I can only share with you my experience working with our customers. Oftentimes what we see is the expenses of starting a business are higher today than they were maybe 2, 3, 4 years ago. And so the loans that we have done to help startups, either a tenant up fit—and in my testimony I talk about a baseball coaching facility where we helped them up fit a tenant facility, and it is really nothing more than a warehouse, and they have got some nets, but the cost of doing so is expensive.

Chairwoman VELÁZQUEZ. Yes. Ms. Frazier, you know, one of our commitments is to make sure that small businesses have access to affordable capital. When you look at the overall portfolio of loans that have been made, the numbers speak for themselves. We need to look at alternative options of affordable loans, and this is one of them. It has worked for the USDA. I do not understand why it cannot work here.

Mr. Condra, the small business title of the Build Back Better Act, which was approved by this Committee in early September, provided $500 million for a cooperative lending pilot that would waive SBA personal or entity guarantee for co-ops. Will this new pilot program improve co-ops' access to 7(a) loans?

Mr. CONDRA. And what a great compromise with this Committee, with Congress, and the SBA and the private sector. As you know, we continue to discuss and work with SBA on these issues, but they just will not budge on the requirements, even though we have provided examples after examples of why it is not working.

An example, like in my testimony, the pastor raised $7 million. Apparently, that is not enough money to secure an SBA loan that they still require him to, I guess, use his used car as collateral over $7 million. So it will completely open up the gates for this industry, for the food/grocery industry, and the worker co-op industry.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Shorman, the main street Employee Ownership Act allows 7(a) preferred lenders to process ESOP loans under their delegated authority to streamline the process for small firms. Unfortunately, SBA's rule implementing the law says that those loans cannot be processed under delegated authority.

How did the ESOP community respond to SBA's position which contradicts the clear language of the statute?

Mr. SHORMAN. Well, I think this Committee has it right. I mean, trying to get—the direct contact with local community bankers is not a shortcut, but it is a way to get something done that is not happening today. So the Committee is right on target with what they are doing. And I think more of what we are talking about today is just saying, hey, this is what has to be done. ESOPs should be eligible for SBA loans through the local lending authority.

Chairwoman VELÁZQUEZ. Thank you. My time has expired.

Now we recognize the gentleman from Minnesota, Mr. Stauber, for 5 minutes.

Mr. STAUBER. Thank you, Madam Chair.

And I just have a few comments. You know, an employee stock ownership plan, an ESOP, is a wonderful employment structure for a small business. ESOPs allow their workers the ability to obtain ownership in the company where they are employed, really complementing the way small businesses normally operate. With over 6,500 ESOP companies nationwide, I am proud to say that over 250 of them are in my great State of Minnesota.

With that being said, I am worried about ESOPs and how they might fare under this administration's tax plan, specifically under the proposed capital gains tax increase. When ESOPs distribute actual shares of company stock rather than pay out the value of the shares in cash, the employee pays income tax at ordinary tax rates on the value of company contributions to the plan, plus capital gains tax on appreciation and share value when they choose to sell their shares.

We can sit here and talk all day about the access to capital, but it seems to me that none of it will make a difference if, on the back end, individual employees are stuck paying higher taxes.

A capital gains tax increase severely diminishes the incentives that normally draw individuals into ESOPs. When they look at getting into or potentially getting into an ESOP and they find that they are going to be paying more taxes, that is a disincentive. We have to encourage entrepreneurship and encourage people to invest in their companies and become part of the ESOPs.

Despite this administration's claims, this current reconciliation bill will cost something. It will cost the livelihood of small business owners. It will hurt the middle class with tax hikes and increase the taxes on middle-income ESOP participants. We can do better by allowing our small businesses and those participating in ESOPs to keep more of their hard-earned money.

And, Madam Chair, I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Pennsylvania, Mr. Evans, for 5 minutes.

Mr. EVANS. Thank you, Madam Chair.

Madam Chair, first, I would like to welcome Ms. Cooper. And I am very happy to have the president of a woman-owned work cooperative located in my district on this panel. But I am also proud of this Committee and the Chairwoman's work to mark up and pass out of Committee $25 billion to help entrepreneurs in the

Building Back Better. This includes $500 million for a pilot program for workers and consumer cooperatives. This will provide loan guarantees to eligible small business cooperatives, including short- and long-term working capital.

Ms. Cooper, how would this pilot program help Homewood Care and its workers?

Ms. COOPER. Currently, you know, we were able, as I mentioned, to get the money we needed for startup, but currently, we are really struggling to expand our services. And in this current environment with, you know, the pandemic and us not being eligible for the second—not having been eligible for the second round of PPP, a loan from the Small Business Administration would help us to expand our services, keep our employees employed, but also survive some of the changes that are going on in this particular industry.

So, you know, right now, we are clawing to, you know, stay alive in this industry. We know that there are changes that we need to make in order to remain competitive. So, yeah, it would help us to continue to stay in business. It would help us to secure our future, to increase volume, to sustain jobs.

Mr. EVANS. One last question, Ms. Cooper, I want to ask. What is your secret of bringing this together? I know it is difficult. It has been very a very difficult time, but I am interested in the personal aspect of seeking and pulling things together, you know, you driving to do this.

Ms. COOPER. You know, my—I will try not to be—I am a talker; I will try not to be too long-winded. But my thesis statement in college was the working poor. And I am very much committed to people who go to work every day, who work hard to care for others, who fill a gap that is desperately needed to fill, who are still struggling to make ends meet.

So for us, that is what drives me, my commitment to them. And I know, you know, how important the work is that they are doing but also the pride that they have in being owners.

The secret is that, that the worker ownership model creates a culture in which people are proud to be here, proud to do the work that they do. We are fully transparent as it comes to financials and every other aspect of the business. The board is primarily direct care workers. So, you know, the secret really is the culture. The secret is the cooperative. The secret is the fact that when we send someone to someone's home, they can say, I am the owner of the company and I am going to make sure that you get the quality care that you deserve.

Mr. EVANS. Thank you, Ms. Cooper.

And I yield back, Madam Chair. Thank you for the opportunity. Thank you.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Pennsylvania, Mr. Meuser, for 5 minutes, Ranking Member of the Subcommittee on Economic Growth, Tax, and Capital Access.

Mr. MEUSER. Thank you, Madam Chair. Thank you very much. I appreciate it.

It is an interesting hearing. We certainly all want responsible, reasonable risk, that is, access to capital available to new entrepreneurs, current businesses, those businesses that are simply trying to grow and expand. And you know what? Especially in some areas where we need it most. I have many very stressed cities in my district that I would love to see them have better access to capital, of course, more efficient and accessible.

Now, the cooperative formula that exists with the community banks and the SBA can definitely be improved, but as we saw with the PPP versus the EIDL, they were quite different, right, in the outcomes. One had—one was effective. One was unbelievably useful. One—you can't even go anywhere in a chamber meeting without those saying, hey, thank you for that PPP; it was everything to us.

And then the EIDL, which was strictly run by the SBA—and I appreciate the SBA. They were very helpful to us during the crisis and all, but it was—it is high levels of fraud, right. So that is a clear sign that that is not likely the best formula. The cooperative between the community banks and the SBA shows to be a better formula.

Now, it can be improved, right? I mean, you know, the whole PG requirement, the personal guarantee being mandatory as opposed to maybe only being needed when assets and collateral don't stack up for the loan to be made; be definitely made more efficient, as Ms. Frazier and I were speaking about earlier. But without the cooperative effort, we can see there is real serious fraud, okay. And this isn't just fraud from some large stockholders. This is the taxpayers. And it is our responsibility to make sure that doesn't happen. And some of the conversation going here, we are going to open ourselves up to that.

Now, if you don't have a personal guarantee, or a PG, there is a likelihood, right, how the economy works, that the competitive interest rates may be higher, more collateral requirements, perhaps less loans, right. So there is some unintended consequences that come with that, but that can be reviewed and be worked out as happens. But why the leadership of the Biden administration for SBA seems to want to centralize the authority within the SBA is something, frankly, we should be very wary of.

You know, just quickly on the ESOP idea, you know, I know many businesses that were ESOPs. Some did well; some did terrible. You know, it is a big payday for the owners, by the way. And then loans are made, and if that doesn't work out, there is a lot of false hope, and wishes and dreams can tumble down pretty fast. So every business has to do what is best for itself, what is in its interests. Many companies have options. Many companies have partial ESOPs. Many companies have stock ownership plans, right, and good retirement plans. So, now, why would those companies be—not receive the same level of SBA resources and plans that an ESOP would receive? So I have got a problem there.

So, Ms. Frazier, let me ask you, then, related to the PPP. Do you believe that that went relatively efficient? And as well, if it weren't with your—some of the community banks' oversight and credit criteria, understanding and knowledge of many of the customers, of course, how much different would it have been than what we have seen occur?

Ms. FRAZIER. Thank you for that question. Boy, that would— a lot of speculation that it would be largely very different, but I do believe the community banks were able to step up and really address the concerns of the small business borrowers and address their needs and work hand-in-hand with them to get to it.

I suspect if that program to have been a direct type of program, it might not have been enacted as quickly and efficiently. The dollars may not have been able to be distributed to the small businesses as quickly and their being able to survive, because it took a lot of hands and a lot of dedication and commitment to make that work.

Mr. MEUSER. I agree. We can't put billions of dollars of taxpayer money at risk.

So I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Louisiana, Mr. Carter, for 5 minutes.

Mr. Carter, you are muted.

Mr. CARTER. Thank you, Madam Chair. Greatly appreciate the opportunity.

My question: Mr. Shorman, in my district, a large number of small business owners are first-generation business owners, women and/or Black. With the additional struggles facing these communities in accessing and maintaining capital, how do we make sure that we know about ESOPs and other opportunities that employee-owned business models have as an option?

Mr. SHORMAN. I think one of the things we talked earlier is that is one of the directives in the Act is to be able to make sure education is out there. Everybody knows you can sell to an outsider, you can transfer to your family, or you can just go out of business. But being able to have that fourth option of transferring the business to your employees is so important to be able to tell that story. And if we can do that through the resources, whether it be through the SBA and training them to say, here is another option for you, that just makes so much sense.

And too many times I talk to employers who are—in fact, one was in my office the other day looking to transition their company. The ESOP was something completely foreign to them. And so I tell the story about what is going on. We need to do that more and more. We need to put that story on steroids, because those 2.5 million tsunami out there who are transitioning their business need another option, and employee ownership is one of them.

Mr. CARTER. So what more can be done to raise awareness about the benefits regarding ESOPs and other employee-owned business models? We know they are there; many people don't know. What can we be doing on our end specifically to educate minority and women-owned businesses, in your estimation?

Mr. SHORMAN. Well, when somebody comes in, make sure the SBA understands the importance and the value of that as well, and that goes through training programs for SBA employees that are in the field. That goes to making sure that the ease and access to the system is there which you are working on to be able to find ways for employee-owned companies to access the SBA, and then that local community banker that is sitting over there. And I appreciate the comments earlier of how that local community banker is connected to the community.

And while the person who is selling the business has a legacy there, that local community banker knows who is involved and who is a part of that company. That can't happen on a national level in Washington, D.C. It can happen if the SBA is required to allow and look at loans from employee-owned companies and helping them set that up as well.

Mr. CARTER. Mr. Shorman, I understand that Eagle Communications began the ESOP conversion process in 1998. It became majority owned by employees in 2002, and 100 percent employees owned in 2012. In your experience to ESOP conversions, what is the biggest obstacle you have seen in your company's struggle to overcome and convert into an ESOP?

Mr. SHORMAN. Well, the biggest struggle out there is making sure there is clarity of regulations. And the DOL has really been—has really not put out clear guidance for that. And so when we went through the process, we involved the best professionals so that we were doing it right to get the job done, but we are a bigger company. And at one point, we had 400 employee owners. We now have just under 200.

And when you take that, you have to have a clarity of regulations so that even the smallest companies understand what they need to do to set up an employee-owned company and make that happen, without worrying about regulatory issues that may come and haunt them later on. We need clarity through the DOL to make that happen.

We need to have a good path for economic value to be able to get loans through the SBA, and then have that resource of tools so that there is educational tools, like The ESOP Association, to be able to help them get through the process and manage that and then have a successful ESOP, because that is the goal, to have successful companies that stay local and build their local communities.

Mr. CARTER. And, finally, as my time winds down, if there were—if there was one thing that you could ask of this Committee that would aid other small businesses out there that have not—that either don't know about ESOPs, have not had the opportunity to utilize ESOPs, or what could we do as this committee to make your life and any other small business owners better or easier to access these resources?

Mr. SHORMAN. Well, I think this Committee can, in very specific terms, say that ESOP loans are available through the SBA, because that would trigger a whole new effect. Right now, that is not an option. I had a PPP loan. It worked great, and our local banker did it. A local banker can do the same thing with other local businesses there to be able to take and make that money available so that an ESOP can be created. But somehow it gets lost in the translation from the Committee to the SBA. So say, this is what we want to have happen, and get it done.

Mr. CARTER. Thank you. I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now the gentlelady from New York, Ms. Tenney, is recognized for 5 minutes.

Ms. TENNEY. Thank you, Chairman Velázquez and Ranking Member Luetkemeyer, and for holding this meeting. It is of great interest to me as a small business owner. Our company is celebrating our 75th year in business this year. But let's talk about a little bit of reality today.

A lot of capital that is investment capital is highly concentrated by geography, tend to be centered around big business hubs, urban areas, like Boston, New York City, San Francisco, and leaves behind much of the country, including my fairly rural and suburban district. It also tends to flow disproportionately into high-tech industries and not into the manufacturing sector that are more capital intensive; obviously, great for creating jobs too because they are more labor intensive; a lot more diversity in providing labor across all sectors. And those tend to be really beneficial in my community where the industrial revolution was founded.

But in the absence of these opportunities in these rural areas, and particularly in our area, as many of them have been forced to shut down partly due to lack of capital and also due to what has happened last year in upstate New York. My solution is to invite all of you to co-sponsor—and some of you have, I appreciate it—the American Innovation and Manufacturing Act. This bipartisan legislation will allow the federal government to work with the private sector to ensure these underserved areas, and especially manufacturers who create things, are not left behind by today's unequal landscape. Also, it does not—it does so with strong safeguards. We have put a lot of safeguards in place by protecting taxpayer funds. And I think with this type of innovation, we can bring back good, middle-class careers and by bring good-paying jobs across all sectors.

And I wanted to point to one thing. I wanted to ask Ms. Frazier a question. When we get to this direct lending and creating, you know, we are all for ESOPs and, you know, employee-owned businesses, that is a great option, and to opening up the lending process. Something in Ms. Frazier's testimony really struck my eye. And while we try to give more direct lending authority to the SBA, she says in her testimony: While the SBA has the authority to make direct loans, the exception disaster loans and micro loan program intermediaries, it has not exercised this authority since 1998. The SBA indicated that it stopped issuing direct business loans primarily because the subsidy rate was 10 to 15 times higher than the subsidy rate for its loan guarantee programs.

And I can tell you, as a small business owner, there is nothing worse than killing entrepreneurship, innovation, and growth in industry than providing government subsidies and picking winners and losers over other—in the marketplace. And I have been the victim of having competitors in the marketplace with government subsidies. And we have been lucky to survive in some cases, but many businesses cannot afford this unfair advantage.

And so I wanted to direct my first question to Ms. Frazier, and I reference this as well, but let me—if you could just tell me a little bit about 7(a) loans and tell us a bit about your business plan and how to properly use a bank loan to fund their business. You also guide them through funding and options. Do you think that this partnership with a local bank or investment partner provides an irreplaceable value to a business and increases its potential for success? I know you are going to say yes, but I want to you to give me some more reasons why, because if it weren't for small community banks, we wouldn't even be in business today.

And thank you for your great testimony. I think it is really important. And if you could address real quickly what the subsidy issue that I referenced in your testimony, that would be great and just clarify that.

Ms. FRAZIER. Thank you. Maybe I can start a little bit with the stories about how we help people and how we engage with the borrowers—or the potential business borrowers. We spend time with them in really figuring out what do they need. Because oftentimes, as I mentioned, they think they need a term loan, something that is paid out over 5 years, but maybe they need short-term working capital, or maybe they need to buy equipment and they don't know how to pay for it, or they don't know how much they can afford to repay.

So the time our bankers spend with those businesses really educating towards what the options are, and then in sharing with them how, maybe as they are starting out, they don't have the capital to really go a conventional route, and how we can use that with SBA to subsidize for them. And through PPP.

And, actually, we have been in existence for 150 years, so serving the rural communities has been very important to us. What we found is, is there is a great need for the 7(a) programs out in the communities, and we felt it was our responsibility to dig in deeper and made those investments.

If you think about the 10 to 15 times increase subsidy rate, I would suggest that——

Chairwoman VELÁZQUEZ. Time has expired.

Ms. FRAZIER. Okay. Thank you.

Ms. TENNEY. Thank you so much. Maybe we can revisit this. Thanks.

Chairwoman VELÁZQUEZ. Thank you.

Now we recognize the gentlelady from California, Ms. Chu, for 5 minutes.

Ms. CHU. Mr. Shorman, in addition——

Chairwoman VELÁZQUEZ. Ms. Chu, you are muted.

Ms. CHU. Mr. Shorman?

Mr. SHORMAN. Hi there.

Ms. CHU. Hi. In addition to being a Member of the Small Business Committee, I sit on the House Ways and Means Committee which has jurisdiction over issues affecting ESOPs. I am particularly interested in the way the Tax Code discourages business owners from agreeing to ESOP conversions, and most importantly, how we can fix this.

Currently, only C corporations can convert to an ESOP, but hardly any small businesses that organize as a corporation choose the C corp structure. Instead, most will elect to organize as an S corp because of the significant tax benefits for small businesses. Congress could choose to extend ESOP eligibility to S corporations in order to provide this option to more small businesses.

Could you talk about the impact that could have on encouraging more ESOP conversions?

Mr. SHORMAN. Well, it is going to open the door to a lot more ESOPs because, as you know, and you mentioned the 1042 benefit allows reinvestments of funds received from the sale of an asset without triggering a taxable event at that time. And a large portion of small businesses are sub S. Congress has made C corps eligible for that 1042 benefit, and S corporations are ineligible. So Congress could greatly incentivize the formation of new ESOPs by extending that same 1042 benefits that are given to C corps to S corporations.

And with many small businesses out there, and we talked about those 10—or 2.5 million baby boomers who have to decide what to do with their business. If they are an S corp, changing that and making it available for the 1042 benefit would greatly open the door to a lot more possibility for employee ownership.

Ms. CHU. Thank you. And let me ask you about another issue that owners face when they convert their business to an ESOP, and that is that often they can't meet the requirement to reinvest their proceeds within 1 year of the transaction. That is because ESOP conversions often take place over the course of many years because owners are paid in seller notes. This has created a situation where owners either miss out on the tax deferral that Congress created to incentivize ESOP conversions or they purchase 1042 securities that ultimately lose money but have a very, very long maturity.

So can you talk about how this 1-year window to reinvest proceeds impacts owners who decide to convert to an ESOP?

Mr. SHORMAN. That happened in our case, because we formed our ESOP in 1998, but it was 2012 before we could purchase all of that. And so there is that timeframe that takes place when a seller will actually loan money to the employees to be able to buy out that business.

So, really, what needs to happen, the law needs to be changed so that the taxable event takes place when the transaction is finished, when it is completed, including full repayment of the seller notes. Otherwise, it is a big penalty for that person who sells that first year who may not even have the proceeds from the sale because that is going to happen over a period of years later. So that is very important to take a look at and make happen.

Ms. CHU. Okay. And then there is a third issue. ESOP conversions are disincentivized because owners are so limited in what products they can reinvest in while keeping their tax deferral incentive. And, in fact, that is a big reason why so many owners are pushed into buying 1042 securities, which are complicated, expensive, and could end up costing them more money over the long run. And many small business owners who might contemplate an ESOP conversion are considering their retirement, but they can't use the proceeds to invest in a low-cost stable investment like an index fund.

So could you—can you explain how allowing owners to invest in mutual funds could make ESOP conversions more attractive?

Mr. SHORMAN. Well, I am a business owner/operator and not necessarily a tax accountant. But, nonetheless, when you look at it, you know, when you take your 1042 money, you want to have choices to put it into. Right now, those choices are very specific. If you could extend that to be able to do things like mutual funds as a qualified investment, that opens the door for more people to be and feel good about making that transaction, making employee ownership a possibility. And, frankly, by doing that, it would just remove another impediment for more employee-owned businesses.

Ms. CHU. Thank you. I yield back.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Now we recognize the gentleman from New York, Mr. Garbarino, for 5 minutes.

Mr. GARBARINO. Thank you, Chairwoman, and thank you to the Ranking Member, for putting this on. And thank you to our witnesses.

I have a question first for Ms. Frazier. In your testimony, you state that waiving the personal guarantee would reduce access to capital for firms. Why do you believe this is the case?

Ms. FRAZIER. Thank you for that question. I think we spoke about waiving the personal guarantee. Oftentimes that is the incentive to continue to ensure that payments are made, and the businesses run effectively to do that.

As regards to co-ops, we understand that those are very nuanced, and so that needs to be looked at differently, and we would like to collaborate for that specifically. But other loans, we really caution against waiving the personal guarantees.

Mr. GARBARINO. All right. Thank you very much.

Mr. Shorman, in your testimony, you have discussed the lenders' delegated authority. You even state that loans could take weeks or months if they weren't processed with delegated authority.

Why do you believe delegated authority is so important as opposed to loans being sent to the SBA?

Mr. SHORMAN. Well, Hays, Kansas, is a long way from Washington, D.C., and we would have to walk around a lot of streets in D.C. for even people to know where Hays, Kansas, is. So for us to apply for a loan that gets processed in Washington, D.C., in one of the big, massive offices there, we know the difference. We have seen that happen time and time again with things that we work on.

If I can walk across the street, have a good community banker that is interested in keeping us in business, keeping our community growing, and I can tell my story to that local banker, and they, in turn, are able—if they are able to process the PPP loan, as complicated and as quick as that all happened, they ought to be able to process an ESOP loan to be able to keep a company going or allow that transaction to happen within the ESOP community to grow ESOPs.

And so having that delegated authority, being able to transfer for ESOPs just like other businesses, I can't believe our local banker—Ms. Frazier may say something different here, but I can't believe our local banker wants to make loans that aren't going to work, that aren't going to keep that company in business.

So it would allow them and actually say, go do this versus saying maybe go do this—go do this and loan money to ESOPs. It can be a game changer for employee ownership for allowing those companies to have an option versus some of the others that aren't so good but having an option to keep that ownership local.

Mr. GARBARINO. I appreciate that answer, Mr. Shorman.

Ms. Frazier, did you want to respond to that, or did you have anything else you wanted to add to that—his statement or that question?

Ms. FRAZIER. I think there is nothing a local community bank enjoys more than help a business remain successful and operating.

Mr. GARBARINO. Oh, absolutely. We have a lot of community banks in New York, and I have worked with them in my previous—in my law practice, and they were very good at helping small businesses as well as homeowners and individuals. So I have nothing but respect for community banks.

I don't have any further questions. I yield back, Chairwoman.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentlelady from California, Ranking Member on the Subcommittee on Innovation, Entrepreneurship, and Workforce Development, Ms. Young Kim, for 5 minutes.

Ms. YOUNG KIM. Thank you, Chairwoman Velázquez. And I would like to thank the witnesses for being with us today.

You know, earlier this month, I had the opportunity to visit HdL Companies that was located in my district, in

Brea, California. HdL is a pioneer and leader of auditing operations and revenue solutions for public agencies, and it has around 150 employee owners. So I saw firsthand the value that ESOPs bring to our communities. And so I want to recognize how this ESOP structure serves as an important tool for businesses owners that are, you know, currently discussing and examining retirement. So in order to encourage this model to be adopted and encourage more employee ownership, as discussed already, I agree that we can offer more educational tools and clarity.

But as we discuss access to capital, I would like to ask Ms. Frazier, can you elaborate on how the personal guarantee allows community banks to mitigate credit risks and increase capital for firms? And then, can you also discuss how the SBA can make it easier for community banks and other lending institutions to provide capital for ESOPs and other employee-owned businesses without waiving the personal guarantee?

Ms. FRAZIER. Thank you. When you think about lending, there are oftentimes a lot of factors that go into it, not only what—on a business in particular, how the business is going to repay the debt, but what happens when the business has a stumble or things go awry for a period of time. And the banks, in a conventional way, and SBA in this way also, rely on the owner of the business to step in and make adjustments. And having that personal guarantee holds them to the line of that, and so it is very important.

There is five Cs of credit, and one of those is character. And part of that, putting your name on the bottom line of a loan saying I will guarantee it is a sign of character.

In speaking about—I think the more we could collaborate together and discuss, not only how can we look at the guidelines around the co-ops, but let's look at how we can also collaborate even more so to meet the needs of those small businesses and those small loans. Collaboration would be important.

Ms. YOUNG KIM. Thank you for your response.

You know, clearly—can you hear me?

Chairwoman VELÁZQUEZ. Yes.

Ms. YOUNG KIM. So we had a lot of discussion today about clearly banks and credit unions and community banks are much better equipped to service their communities than someone from afar in Washington. And as you stated, Ms. Frazier, direct lending through the SBA is not the answer to expanding access to capital for small businesses or women and minority entrepreneurs. I agree. The federal government does not have a good track record of being responsive nor having good communications with our constituents.

So can you elaborate on how community banks and lending institutions are better prepared to detect and prevent fraud than direct lending programs created by the government?

Ms. FRAZIER. Thank you. First of all, we are in the community, so we know the businesses. We know the business owners. Oftentimes, when new businesses are getting started up and those that are seeking capital that might be eligible for an SBA loan, we can visit them. We see them. And as mentioned earlier, there is nothing like laying eyes on someone as you are evaluating their ability to repay and their willingness to repay a loan. So I believe that value that we bring to the table of being feet on the street in the community helps prevent fraud in those areas.

Ms. YOUNG KIM. Thank you. You know, as a quick followup, can you talk about how—or what the tools, like the know your customer and the AML compliance, bring to the table in preventing and detecting fraud?

Ms. FRAZIER. Certainly. The documentation that we research and we bring to the table as far as even following up and making sure that they have a certificate of good standing in the State, all of those tools are pieces to validate that these are a credible business and has been established appropriately.

Ms. YOUNG KIM. Thank you very much. I really appreciate the interaction we had.

And I yield back my time.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Now we recognize the gentlelady from Texas, Ranking Member on the Subcommittee on Oversight, Investigations, and Regulations, Ms. Van Duyne, for 5 minutes.

Ms. VAN DUYNE. Thank you very much, Chairwoman Velázquez.

As this Committee has heard countless times, access to capital is essential for small businesses, but I can't help but think that a lot of the initiatives that are being put forward by the Democratic Congress are detrimental to the goals of our nation's small businesses. And this includes raising small business income taxes, capping the small business deduction, and raising capital gains and estate taxes. All of this comes while small businesses still can't fill their labor needs and our supply chains remain disrupted.

As we proceed with this hearing, it is important to underscore that it is not happening in a vacuum. There are very real harms Texas small businesses will face should the reconciliation package that Democrats are attempting to jam through become law. According to the Texas Public Policy Foundation, Texas businesses will lose $663 billion in investments, corporate tax hikes will cut wage growth by over 23 percent for employees, and international tax cuts will reduce full-time employment by 12,000 jobs. This is nothing of the $12,000 reduction in median family income or the exploding debt the average household will be expected to cover because of federal spending.

And, finally, I want to reiterate how disappointing it is to watch Secretary Yellen skirt her legal obligations to come before this Committee while small businesses in our community continue to fight to keep their doors open. I will continue to ask, but I really hope to see her before this Committee very soon.

I just have a couple of questions. Ms. Alice Frazier, thank you so much for being here today. I have significant concerns about how direct lending by the SBA. The SBA's latest effort, EIDL, had a large amount of potential fraud and the OIG reporting a possible fraud rate of up to 30 percent. Knowing this, can you tell us what the benefits are by including private lenders in small business loan process? And why do you think this administration is trying to cut private lenders out of the process?

Ms. FRAZIER. Thank you for the question. I am going to start at the end. And I am not sure that I can answer why I think that they are trying to cut it out of the process, but I would say that having the private lenders, the community banks, banks involved, this is what we have done. We have been doing it for years and years. It is a good process that works today. We work effectively with the SBA. And to change that process today, I am not sure even the business owners or those that would utilize it would understand how it would work. And given their current experiences with the programs, such as the EIDL, I am not sure they would trust it as well.

Ms. VAN DUYNE. Okay. Thank you. As you know, access to capital is crucial, but capital for business owners today isn't going as far as it used to. So prices for goods across the board are up. We have seen unprecedented number of cargo ships anchoring offshore at our ports and shuttering of supply chains. And this administration is planning to increase taxes on small businesses.

So, in your view, how do these challenges affect small business?

Ms. FRAZIER. Oh, they are affecting things greatly at this point in time. We have multiple committee-type meetings around in our different local areas where we bring small businesses together, and that takes up a good bit of the hour that we spend together. And I think to elaborate not only the challenges with labor but the challenges of the supply chain and the fears that they will have increased taxes has great concern for them.

Ms. VAN DUYNE. So you have talked to a number of businesses, I am sure, over the last year. Do you have any specific examples of how people who are either not as successful as they could have been because of some of these policies or ways that they are not currently investing because of threats of these policies?

Ms. FRAZIER. Oh, sure. I can tell you we have landscaping firms that are unable to hire enough people to do the jobs that they have actually been hired to do or contracted with. It might even be restaurants that have to close 2 days a week because they can't hire enough workers to remain open. The workers are overworked, or even in such that cost of the food has gone so great, they can't increase their prices enough.

One company that hires a number of workers that work remote said that they hired 200 workers over a 9-month period of time to retain 50. And so I think the——

Ms. VAN DUYNE. You said they hired 200 workers?

Ms. FRAZIER. Two hundred to retain 50 in that time period, and it is just the transient nature. The way that labor is working today has affected their business greatly.

Ms. VAN DUYNE. All right. I appreciate that very much.

I yield back.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Thank you again to our witnesses for joining us today. Your stories serve as a testament to the power of employee-owned businesses and all they offer the labor force.

If we generally want to help the American people build back better, we must promote policies to empower American workers. Employee-owned businesses merge ownership and employees' interests, helping to create a symbiotic relationship where everyone thrives. As ESOPs and cooperatives become more prominent, the American workforce will benefit.

I ask unanimous consent that Members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

If there is no further business to come before the Committee, we are adjourned.

[Whereupon, at 11:56 a.m., the committee was adjourned.]

APPENDIX

Testimony of R.L. Condra

Senior Vice President of Government Relations

National Cooperative Bank

House Committee on Small Business

Hearing on "Empowering Employee Owned Businesses and Cooperatives Through Access to Capital."

September 30, 2021

Testimony of R.L. Condra
Senior Vice President of Government Relations
National Cooperative Bank

Good morning Chairwoman Velázquez, Ranking Member Luetkemeyer and members of the Committee.

I had the honor of testifying on this issue last year and would like to thank the Committee's continuing interest regarding the Small Business Administration's inability to provide cooperative businesses access to its lending programs.

I would also like to thank the Committee for its vision to create a cooperative pilot program that will provide much needed capital and build institutional knowledge of this business model within the agency.

Is there anything more gratifying than becoming a small business owner? During the pandemic, haven't we learned how essential grocery stores are to our communities?

Unfortunately, the SBA, the federal agency that oversees small business assistance and growth continues to block cooperative businesses and their tens of thousands of jobs from being created. To be clear: cooperative businesses should have the same opportunities, service and financial products as other SBA borrowers.

There are over 65,000 cooperatives in the US and the top 100 generated $226 billion in annual revenue in 2020. Some notable cooperatives include REI, ACE Hardware, Ocean Spray, Land O'Lakes, and Congressional Federal Credit Union. It's not a new concept, Benjamin Franklin founded the first insurance cooperative in America which continues to operate today.

In the last decade, the number of worker cooperatives have doubled, and have become a preferred business option for young people, women and minorities. According to the 2019 Worker Cooperative Economic Census, 50% of owners of worker co-ops are Latino and African American, and women make-up 60% of the workforce.

Additionally, over 160 food cooperatives have opened during this time, creating over 4,200 jobs. Last year, start-up food cooperatives have opened in Colorado, Nebraska, Virginia, Ohio, Pennsylvania, and New York. All this progress has occurred without the SBA's assistance.

The SBA has amended its outdated eligibility regulations to include cooperatives but continues to block these businesses from accessing its programs with its own federal version of a Catch-22.

Now technically eligible, co-op businesses must meet the agency's personal guarantee requirement which states that any owner of 20 percent of the business must sign a personal guarantee for a loan. Due to its unique business structure, a co-op is just not able to meet the "check the box" personal guarantee requirement the SBA requires.

For example, if a custodial worker cooperative in New York City is owned equally by 10 women, which owner of 1/10th of the business signs the personal guarantee? If a food cooperative has 5,000 member-owners, which customer signs over their house to cover the other 4,999 customers?

A cooperative borrower does have "skin in the game." They raise money through member shares and member loans that should secure financial and equity obligations that lenders require.

In 2018, Congress attempted to level the playing field for cooperatives by passing the "Main Street Employee Ownership Act" championed by Chairwoman Velázquez and Senator Gillibrand.

We were greatly disappointed to learn the SBA did not provide practical alternatives for loans as required by law. Instead, the agency relied on its existing requirements that continue to keep cooperative businesses from much needed access to capital. Essentially, the SBA ignored Congressional direction and the needs of business owners and consumers.

My employer, the National Cooperative Bank, has provided loans of more than $2 billion to cooperatives and independent retailers including over $77 million to food cooperatives. Per our loan policies, we do not require a personal guarantee for consumer and worker cooperative loans.

Along with the private sector, there is federal precedent for not requiring personal guarantees to cooperatives. The Department of Agriculture does not require a personal guarantee for loans to cooperatives, but most start-ups are in urban areas. Ironically, even SBA does not require personal guarantees for loans to Employee Stock Ownership Plans, known as ESOPs, that have a similar structure as worker cooperatives.

Why is there a need for a cooperative pilot program?

The sector caught a break when Congress removed the personal guarantee requirement in the CARES Act for all EIDL and PPP business loans, thus giving cooperatives access to federal funding during the pandemic. Although, this Committee had to include specific bill language for cooperative businesses to become eligible for the Covid relief programs.

Using the SBA reported numbers, the National Cooperative Business Association estimates that over 2,500 cooperatives received Covid relief loans totaling $1.2 billion in funding that saved over 93,000 jobs.

Chairwoman Velázquez, let me personally thank you and the Committee for helping these businesses and workers during one of the most difficult times of our country. Please be aware that the same cooperative businesses that received covid relief funding are not able to access the SBA's existing loan programs.

Especially in Black and Brown communities, entrepreneurs are turning to the cooperative model as an opportunity to own a business or meet the grocery needs in their neighborhoods, many of which are food deserts.

In 2015, Pastor Reginald Flynn of Flint, Michigan, wanted to start a food cooperative due to the grocery chain closures in his community. Pastor Flynn was unable to obtain financial support from the SBA. Six years later, he has raised $7.6 million and now has over 900 member-owners. With the help of a $1.25 million grant from the state of Michigan, the food cooperative has finally started to break ground.

This is a success story on resilience and commitment to a community, but truth be told, access to an SBA loan would have allowed them to break ground years earlier. No small business should have to wait six years to achieve their dream.

I look forward to answering your questions. Thank you.

Testimony of Tatia Cooper

President/CEO

Home Care Associates of Philadelphia

House Committee on Small Business

Hearing on "Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital"

September 30, 2021

HomeCare Associates
A worker-owned company

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Chairwoman Velazquez, Ranking Member Luetkemeyer and members of the committee, thank you for the opportunity to speak today to share Home Care Associates' story and discuss the need to address access to capital challenges for cooperative businesses.

Cooperatives exist and thrive across all sectors of our economy. Worker cooperatives, like Home Care Associates, are small businesses that are owned, controlled, and governed by the employees. There are fewer than 500 worker cooperatives in the United States. Lack of access to capital—and importantly, lack of access to U.S. Small Business Administration loan guarantees—is a central reason for there being so few of these businesses. Home Care Associates (HCA) is a Home Care cooperative located in Philadelphia, Pennsylvania. We currently employ 124 FTE and 12 PTE. Although the past few years have been extremely difficult, our worker-owners are looking forward to celebrating our 30th anniversary in this industry in 2022.

Discussion of starting a worker co-op in Philadelphia began in 1990. The founders of a larger cooperative established in 1985, Cooperative Home Care Associates (CHCA), located in the Bronx, NY set out to find money to replicate the model elsewhere in the United States. Philadelphia made sense, at the time, because of its large population of older and disabled citizens in need of quality Home Care and because of the number of individuals, living in poverty, in need of a quality job.

Like CHCA, our mission is:

1. To provide reliable, high quality home care services for those who are elderly, chronically ill, or living with disabilities;
2. To provide a quality job that includes a living wage, benefits and paid time off while building a profitable worker-owned company;

3. To give workers opportunities to learn and grow as members of the health care team.

At its inception, because of the cooperative structure, HCA was not eligible to receive start up support from the U.S. Small Business Administration, like many other cooperative small businesses. The challenge of raising capital to begin business was enormous. Thanks to the support of others who believed in the mission such as The Paraprofessional Healthcare Institute, individual philanthropist, charitable trust, and foundations, HCA was able to secure the capital needed to open its doors in 1992. However, many other home care cooperatives have not had this opportunity from charitable foundations and have struggled enormously to raise the capital needed to start this in-demand business.

One year after the start of business, HCA established two different classes of stock. Class A shares, held by investors in the business and class B shares, held by HCA workers. In 2019, all class A shares were donated to the company making HCA 100% worker owned.

Workers-owners buy a share of the company for $500. Most of our owners do not have $500 of disposable income. The purchase of the share is made with a $35.00 deposit and a payroll deduction of $3 per week. Upon making the deposit, each owner has one vote, can campaign for a seat on the Board of Directors and is eligible to receive a financial share when the company is profitable.

Raising startup capital was the first of many challenges HCA would face. 80% of the Consumers we serve are nursing home and Medicaid eligible, while more than 75% of our workers/caregivers also remain eligible for Medicaid. We rely on reimbursement from Medicaid to cover cost associated with training and employment.

Unlike many non-cooperative businesses in this industry, HCA provides an extensive training on topics we believe are necessary to providing quality care. Examples of technical and soft skills topics include emergency preparedness, safely lifting and transferring, assessing home and environmental safety, first aid including CPR, diversity, problem solving and care coordination.

In our efforts to provide a quality job, HCA remains committed to the goal of applying 70% of its revenue to worker salaries and benefits. Although we remain true to this goal, many of our workers and their families continue to live below 150% of federal poverty levels. This low wage translates to caregivers who are also eligible for Medicaid. This reality is not unique to home care cooperative. According to PHI, a national research non-profit, one in every six home care workers in the United States lives in poverty.

Since the onset of the global COVID-19 pandemic, we have been faced with new challenges that are quickly depleting our resources. Examples include the expense of purchasing Personal Protective Equipment (PPE) to protect our workers and remain compliant. These costs fell squarely on the business. Fortunately, we were able to qualify for the first round of Paycheck Protection Program loans to support sustaining jobs and salaries but did not qualify for round two because we could not include increased operational expenses that contributed to increased losses. Although we have a strict PPE policy at work, many of our workers missed work because of a lack of childcare or because they were diagnosed with COVID-19. This forced us to place more pressure on existing workers, which increased overtime expenses. The demand for workers increased while recruitment of new workers in our field was nonexistent. This strain on our bottom line continues to be felt today. We continue to struggle to hire new workers.

As was the case in 1992, HCA finds itself seeking alternative sources of capital to support our efforts to sustain our business. Since early 2020, we have seen a decrease in employees willing to purchase shares to become worker-owners, we are struggling to find ways to pay a competitive wage without sacrificing training and benefits, and we lack financial support to widen our scope of services. This is extremely frustrating because demand for home care services continues to increase. Like many in our industry, supply cannot meet the demands for service. If we are to increase volume so that we can remain self-sufficient and provide quality care, we must secure the capital needed to expand our scope of service, pay a competitive wage, offer benefits, and increase worker participation. Securing funds in this environment is proving to be more challenging.

Unfortunately, as a cooperative, we continue to be unable to access the affordable, safe capital offered by the U.S. Small Business Administration. Current SBA regulations require a borrower provide a personal guarantee to properly secure the loan. This provision is not only counter to the cooperative business model, in which our worker-owners operate on the basis of one member, one vote, but would also be impossible for any one worker to put forward. That is, no single worker has a home, another business, or other asset that could be put 'on the line' to fulfill SBA's current requirements. This is despite our cooperative operating for nearly 30 years, in which our workers and our business has demonstrated having skin in the game and our continued commitment to our community.

For these reasons, HCA supports the proposed Cooperative Lending Pilot Program included in the Build Back Better Act. This program would provide equal opportunity to cooperative small businesses as businesses with other ownership structures. Equal access to affordable capital would allow co-ops like HCA the opportunity to grow to meet the increasing demand for home care services and create employee-ownership opportunity to more caregivers.

Thank you for the opportunity to speak today and I look forward to your questions.

Written House Testimony for Mr. Gary Shorman
Committee on Small Business, U.S. House of Representatives
September 30, 2021

Thank you, Chairwoman Velazquez, Ranking Member Luetkemeyer, and members of the committee.

I'm Gary Shorman, Chairman of Eagle Communications, a 100% employee-owned company doing business in Kansas, Nebraska and Missouri where we own and operate 31 radio stations that focus on local news, sports, and weather. In addition, Eagle has Creative, Digital, and online learning divisions where we assist our customers in their creative production and online learning initiatives and needs. Eagle employs more than 170 employees who share in the ownership of the company through their Employee Stock Ownership plan, or ESOP.

I am also here representing The ESOP Association where I serve on the Board of Directors, and served as Board Chairman from 2019 until this past spring. The ESOP Association is a nationwide non-profit representing over 3,000 companies and professionals throughout the nation and whose purpose is to protect and grow employee stock ownership plans.

I would like to state something clearly right up front: ESOPs and employee ownership are NOT an experiment. They are proven. They are successful. And they are here to stay. It is time for the various agencies of the U.S. government, including the Small Business Administration, to recognize this and to treat ESOPs and employee owned businesses as the successful, mature businesses that they are.

According to the most recent figures submitted to the U.S. Department of Labor, approximately 8.6 percent of the entire U.S. workforce has some ownership in an ESOP—*more than 14 million American households*.

ESOPs were first codified by the U.S. Congress as part of the Employee Retirement Income Security Act of 1974. Since that time, their value to the retirement security of American workers, their contributions to our economy, and their resiliency in difficult times have been proven over and over.

In just a ten year period of time, from 2008 to 2018, the Department of Labor reports that more than one trillion dollars in retirement benefits have been paid to ESOP beneficiaries. *Let me say that again – more than a trillion dollars in the last ten years.*

To put an even finer point on it, Social Security in 2018 paid a total of $894 billion in benefits nationwide to America's retirees. In that same year, ESOPs paid $126 billion to their retirees.

Research conducted by Rutgers University in 2009 following the great recession and again in 2020 during the COVID pandemic clearly demonstrated the resiliency and the benefit of ESOPs to local economies and job security. During the pandemic, the Rutgers research showed that ESOPs were 3.2 times more likely to retain staff, were significantly less likely to cut employee hours and pay, and were more likely to provide personal protective equipment or allow work-from-home arrangements for safety. Coming out of the Pandemic, ESOPs are once again proving what was learned following the 2008 recession: ESOPs maintained employment, they helped anchor local economies, and they are rebounding much faster following an economic downturn.

Despite all of these strengths, and their deep roots within our local economies and business communities, there remain far too many unnecessary obstacles to new ESOP formation or expansion of existing ESOPs.

To begin addressing those obstacles, Congress passed the Main Street Employee Ownership Act in 2017. I would like to speak to two main goals of that legislation – access to capital through the Small Business Administration's 7(a) lending program and a desperate need for public and stakeholder awareness initiatives.

During the pandemic more than 70% of all ESOPs were successfully awarded Paycheck Protection Program, or PPP loans through the SBA. As you are all aware, the PPP program was administered through the SBA's 7(a) loan program and utilized the delegated lending authority program such that local SBA lenders could approve these time sensitive loans. However, in the first few days of the program, there was some initial confusion at many of these local lending facilities because, despite the clear intent of Congress in the Main Street Act, the SBA does not allow loans to ESOP companies to be approved through delegated lending authority, instead requiring ESOP loans to be approved by staff in Washington.

Fortunately, clarification was quickly given and ESOP PPP loans were allowed to be evaluated and granted by local lenders just like every other PPP loan as Congress intended. Our company was one of those PPP beneficiaries and it was the local familiarity that our lender had with our business that made it a streamlined and efficient process. Yet, even though our local lender clearly knows and understands our business, has evaluated and given us a PPP loan, if we were to apply for an SBA loan today, they could not approve it and would be required to forward our application to Washington, where it might languish for weeks or months.

To start addressing lending shortages, the SBA must streamline lending for ESOPs, as intended by the Main Street Employee Ownership Act. The Delegated Lending Program decentralizes loan decision making and results in faster loans, and it clearly was Congress' intent to make loans for ESOPs easier and faster by using it.

We ask that the SBA be unambiguously directed to include ESOP loans in the Preferred Lending Program. The experience of the PPP program clearly and unequivocally demonstrates that lending to ESOPs does not require special treatment and local, SBA approved lenders are fully capable of evaluating and responsibly lending to our companies.

In addition to the lending programs, the Main Street Act also sought to significantly increase awareness within the privately held business community about ESOPs. Within the Act, the SBA was tasked with promoting awareness of ESOPs and employee ownership. The ESOP Association knows that some on the front lines of the agency already take this task seriously, but they are too few and lack adequate support, structure, and resourcing from senior management within the agency. We have been recently encouraged by public statements and support for employee ownership articulated by SBA Administrator Guzman. However, much more can and should be done to rapidly increase awareness.

Business owners must know the ESOP option exists, and must be able to obtain useful, unbiased information. To that end, we ask that the SBA be directed to resource a specific, centralized office —such as the Office of Small Business Development Centers—with active public education and information efforts about ESOPs. Further, we ask that the SBA undertake specific ESOP related educational training for regional SBA staff.

As you know, one of the biggest economic challenges ahead is the looming retirement in the next 10 years of baby boomers who own nearly 2.5 million small businesses. Known as the "Silver Tsunami," this will be the largest transfer of business ownership over the shortest period of time in our nation's history. Even more concerning, is that the Wilmington Trust has estimated that nearly 60% of these businesses currently have no succession plan.[1] These businesses, and their nearly 25 million employees, face difficult futures if plans and supportive policies are not adopted. Time is of the essence to raise awareness of ESOPs as an option for business owners seeking to exit.

Finally, while I recognize this is a matter outside of the jurisdiction of this Committee, I would be remiss if I did not speak about what many of us in the ESOP community view as the biggest obstacle to the formation and expansion of ESOPs: the chilling effect of the U.S. Department of Labor.

DOL has perpetuated an absence of formal regulatory guidance, while simultaneously pursuing a litigious approach to oversight. The effect has been a deep chill on the formation of new ESOPs.

Every year, hundreds of business owners who want to learn about ESOPs attend educational events hosted by The ESOP Association. Yet once exposed to the lack of clear regulatory guidance from the Department of Labor, many turn away out of fear that some unknowable misstep will invite never-ending DOL scrutiny.

Those fears are not unfounded.

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[1] https://www.cnbc.com/2019/12/10/as-baby-boomers-retire-main-street-could-face-a-tsunami-of-change.html

Today, more than 47 years after ESOPs were established with the passage of ERISA, the Department of Labor has *yet* to finish its rulemaking process. They started. They nearly finished in 1988. But they never issued final regulations.

Instead of issuing clear regulation, the Labor Department has practiced regulation by litigation, pursuing ESOP companies in a series of one-off cases that sometimes drag on for years, and often do not ever reach a formal end or resolution. The result: ESOP companies have been left to interpret a patchwork of settlement agreements or decisions that sometimes were predicated on such unique circumstances they provided little or no generally applicable guidance at all.

Operating without clear guidance is a risk ESOP companies should not be forced to bear; it is a risk that adversely affects the entire industry offering legal, accounting, and other professional services and that are instrumental in helping companies form new ESOPs; it is a risk that negatively affects the wealth and security of the 14 million employee owners DOL has been tasked with protecting.

It is a risk our nation cannot afford if we hope to survive the gathering wave of the Silver Tsunami.

The direct cost to the ESOP community of the DOL's regulatory inaction has been enormous: Companies embroiled in Labor Department actions have been forced to scale back investments, acquisitions, and other wealth building efforts to pay for the legal and administrative costs of fighting these claims. Those who lost most were the employee owners who failed to realize the greatest gains possible from their shares of company stock.

Further, the Labor Department's success rate in these cases has been extremely low, leading one to question this investment of time and energy.

The indirect cost of the Labor Department's actions is even higher: By adding undue risk to the process of forming and running an ESOP, the agency is discouraging companies from becoming employee owned. This does not benefit employees, and it denies our economy of potential buyers of businesses at a time when we will need them most.

The Labor Department must stop its policy of regulation by litigation and instead provide the clear guidance necessary so that ESOP companies, Boards, and trustees may operate their ESOP trusts in the manner consistent with clearly defined rules.

But here is the travesty: It is impossible to prove how many American workers have lost the opportunity to become employee owners as a result of this chilling effect. And due to the rapidly escalating retirements of baby boomer business owners, there is urgency to reduce the chilling effect this lack of regulatory clarity is causing.

A solution can start very simply: Congress should require DOL to define one thing: what constitutes "adequate consideration" when an ESOP trustee values the price to be paid for shares of company stock.

Ambiguity over what is adequate consideration has been at the heart of many DOL actions, and it is our belief this ambiguity has depressed the legitimate efforts of businesses to launch ESOPs while complying with the law.

Congress has made clear, through legislation such as the Main Street Employee Ownership Act, that it wishes to encourage the formation of ESOPs. For that to happen, the

Labor Department must fulfill its mission and provide clear regulations that good corporate citizens can follow when selling their companies to their employees.

This one simple piece of guidance could be a game changer for new employee ownership.

Thank you for the privilege of sharing my testimony today. I look forward to answering any questions you have.

Testimony of

Alice P. Frazier

President and Chief Executive Officer

Bank of Charles Town

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives

Committee on Small Business

Hearing on

“Empowering Employee Owned Businesses and Cooperatives Through Access to Capital”

September 30, 2021

Washington, D.C.

Chairwoman Velázquez, Ranking Member Luetkemeyer, and members of the Committee, I am Alice P. Frazier, President and CEO of the Bank of Charles Town headquartered in Charles Town, West Virginia. I testify today on behalf of the Independent Community Bankers of America where I am Chair of the Policy Development Committee and a Member of the Board of Directors.

Thank you for the opportunity to testify at today's hearing on "Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital." These are important ownership models that deserve our support as lenders, business advisors, and policymakers. Many community banks use Employee Stock Ownership Plans (ESOPs) to give their employees an ownership stake in the bank. Some 800 banks have ESOPs, and a small number are 100 percent ESOP-owned.

Access to capital is critical to the success of small businesses of all ownership models. In this regard, I will discuss the importance of preserving community bank SBA lending and highlight the threat posed by proposals for direct 7(a) lending. An experiment in SBA direct lending, in which the agency has a poor track record, would be ill conceived and would jeopardize access to capital for small businesses. What's more, the community bank-small business partnership goes well beyond lending. Community banks provide practical, real world business counseling and networking opportunities, particularly for startups, in a way that can never be matched by SBA or any government agency. Community banks are invaluable to the 7(a) program. We are committed to working with this committee and the SBA to ensure the program is reaching the smallest borrowers. I will discuss this issue in more detail later in this statement.

Our Story

The Bank of Charles Town, or BCT, was founded in 1871 in Jefferson County, West Virginia by a group of 38 farmers, orchardists, and business leaders who believed a locally based bank would create an economic and stabilizing influence in Jefferson County. Thousands of community banks around the country were founded on that same vision. Today, BCT is a $671 million asset community bank with 121 employees serving the Eastern Panhandle of West Virginia as well as Hagerstown, Maryland and Loudoun County, Virginia.

The Paycheck Protection Program Illustrates the Value of the SBA-Community Bank Partnership for Small Borrowers

Nowhere is the community bank commitment to small businesses more obvious than in our embrace of the Paycheck Protection Program. As you contemplate proposals for SBA direct lending, I ask you to consider this recent history. Community banks were simply indispensable to the success of the PPP, and their lending was weighted toward the smallest borrowers. Community bankers are not the people you want to sideline in the critical task of creating access to capital.

The PPP was a natural fit for the business model of community banks. We are small business lending specialists, and our strength is personal relationships in our communities and direct knowledge of local economic conditions. There are countless stories of small businesses in desperate need that, unable to secure a PPP loan from a larger bank in a timely fashion, turned to a community bank where they were promptly and effectively served. Community bankers worked around-the-clock to meet a surge in demand for PPP loans from existing as well as new customers.

The data tells the story: Community banks were the predominant PPP lenders to local small businesses. Their 4.7 million PPP loans worth $429 billion served 55.8 percent of all PPP recipients and accounted for nearly 60 percent of the program's total loan amount. These loans supported the retention of nearly 49 million jobs, accounting for over 58 percent of the program total. Moreover, community banks made nearly 87 percent of the PPP loans to minority-owned small businesses, 81 percent of the PPP loans to women-owned small business, and nearly 69 percent of the PPP loans to veteran-owned small businesses. I am proud that my industry stepped up to support the survival of these diverse businesses in a time of crisis.

My bank's PPP lending is typical of a community bank. In the first round, we made 557 loans with an aggregate value of nearly $55 million. The average loan size was $98,000. Eighty-five percent of these loans were under $150,000, and 66 percent were under $50,000.

In the second round, we made 411 loans with an aggregate value of over $29 million. These loans were smaller than those made in the first round. The average loan size was $71,000. Ninety-one percent of these loans were under $150,000, and 71 percent were under 50,000. In other words, our PPP lending, typical of a community bank, disproportionately helped the smallest businesses.

Of course, the true purpose and value of the PPP is job preservation in an unprecedented economic crisis. BCT's first-round PPP lending has saved just over 4,000 jobs and the second round supported 2,877 jobs. This is an enormously positive impact in the small communities we serve and has staved off outright collapse. I know that other community banks have had similar results.

Community Banks and 7(a) Lending

The 7(a) program is invaluable in allowing us to support local small businesses that would not otherwise qualify for conventional credit. Community banks account for 66 percent of 7(a) loans between 2010 and 2021, meeting the needs of the smallest borrowers. BCT has been an SBA lender since 1978. Our SBA portfolio includes 24 open loans for $5.2 million. The median loan size is just under $100,000. In May of 2021, BCT hired three highly experienced SBA lenders to place more of an emphasis on this product. BCT, like other community banks, is committed to meeting demand for SBA loans, including smaller loans, in the markets we serve.

Access to Capital for Employee-Owned and Cooperative Firms

Employee ownership, partial or complete, and cooperative ownership are models that make sense for many firms in certain industries. The owners, be they employees or customers, enjoy tax benefits. Importantly, an ownership stake aligns employee or customer interest with the prosperity of the firm, which spurs productivity. As noted above, some 800 community banks have ESOPs. For these banks, ESOPs are an important source of capital and liquidity, help them remain independent, and aid with succession planning.

Like any other business, an employee-owned or cooperative firm must make financial projections, pay salaries and expenses, market their services, and operate in a competitive environment. Like all firms, they must have access to capital to ensure their success, pay wages, and provide services in their communities. These business forms don't have the option of outside investor capital. They rely on employee or member contributions and operational income to generate capital, supplemented by loans from banks and other sources. Community banks support these firms through lending, deposit taking, and other banking services. BCT currently has a lending relationship with two cooperatives, an apartment building in Arlington, Virginia, and Southern States, a retail agricultural cooperative that sells fertilizer, seed, and other farm inputs. We bring the same commitment to these borrowers that we bring to any small business relationship.

Solutions Are Needed to Permit Full Access to the 7(a) Program for Cooperative and ESOP Businesses

ICBA opposes any broad waiver of the requirement that a borrower personally guarantee a 7(a) loan. Such a broad-based waiver would increase risk for the lender and for taxpayers. A loan without a personal guarantee from someone might as well be an unsecured loan. While we are willing to discuss alternative solutions to better accommodate co-ops and employee-owned firms, a full waiver is unacceptable and would reduce access to capital for these firms.

We appreciate this committee's interest in access to capital for employee-owned and cooperative businesses. Let's be clear that direct lending is a threat to capital access for these businesses because it would sideline community banks and the partnership they bring to the lending experience.

SBA Direct Lending Has a Poor Track Record and Is Costly for Taxpayers

As I've discussed, SBA direct lending is not the answer to capital access for small business, whether they are employee-owned, cooperatives, investor-owned, or some hybrid model. SBA has been tried and has failed. I ask you to consider the finding of a recent Congressional Research Service report:

> The SBA has authority to make direct loans but, with the exception of disaster loans and loans to Microloan program intermediaries, has not exercised that authority since 1998. ***The SBA indicated that it stopped issuing direct business loans primarily because the***

<u>subsidy rate was "10 to 15 times higher" than the subsidy rate for its loan guaranty programs</u>.

The SBA retreated from direct lending as an ill-conceived experiment. Congress must not repeat this mistake. The recent Economic Injury Disaster Loan (EIDL) program, an SBA direct loan program, has been rife with fraud and poorly executed. Congress should heed this warning before creating a direct 7(a) program.

The involvement of banks is critical to reducing fraud. My bank, for example, recently detected and prevented a case of EIDL fraud. An alert branch employee flagged a transaction in which a client who had opened an account only 60 days ago received two government payments, coded similarly to EIDL loans, totaling $20,000, and wanted to withdraw the total in cash. The employee had seen a recent fraud alert from the SBA which described just such a scenario. We stopped the transaction and returned the funds to the SBA.

Community bankers know their customers. They know the difference between a legitimate business and a fake business set up to perpetrate fraud because they meet with business owners, visit their businesses, and see their operations. The SBA is not on the ground in local markets and cannot assess borrowers firsthand. This distance from the borrower makes direct lending vulnerable to fraud.

Direct lending is a poor and costly alternative to private sector lending and would reach fewer borrowers. Today, there is a strong network of community banks, Community Development Financial Institutions, and other lenders already in place to meet demand for small business borrowers.

Lenders Are What Make the 7(a) Program Successful

I would like to share some stories from my bank to highlight that the community bank-small business partnership goes well beyond lending.

My bank is currently working with an African American entrepreneur who has a lot of corporate business experience but no experience in setting up a new company. For example, he has no contacts with accountants and other professionals that specialize in startup businesses. Sadly, it is too often true that African American entrepreneurs are disadvantaged in this sense. They are often the first in their family to start a business and don't have the benefit of a parent or family member to mentor them in the critical, initial phase. Mentorship is especially needed in minority communities.

As we talked with this entrepreneur about his business plan, he asked for those connections as well as how to properly use the bank loan to fund his business. We spent time walking him through different types of loans, such as a line of credit versus term loan, and what would work for him. Working together, we decided on a $125,000 SBA 7(a) line of credit initially, which we expect to grow quickly as the business ramps up. The loan is really just one feature of a much broader business partnership.

Without this type of partnership, an entrepreneur is left to muddle through. As a dedicated community bank partner, we connect an entrepreneur to resources in the community – accountants, lawyers, and other professionals – he or she needs to succeed. Our experience in working with other small businesses gives us a unique ability to provide insights and counseling to startups. We are invested in their success, and we have the experience and knowledge to help bring it about.

This is the added value a community bank brings to a lending relationship. We see it time and again. We provided a $150,000 SBA loan to a baseball performance academy for tenant improvements and equipment. The client was borrowing money for first time in order to move into their own space after relying on "boot strap" funding for the previous five years. They were worried about their capacity to repay, but we walked them through a number of business scenarios to help them understand and give them the confidence they needed to take the loan.

Recently, a woman-owned coffee shop had an opportunity to expand to a second location by purchasing an existing business and building. While her first coffee shop was doing well on its own, the source for a down payment was limited. The best solution for her was an SBA Express loan. We worked closely with the entrepreneur, the seller, and the broker to structure the purchase and sale agreement to allow for the use of the SBA Express program to support her credit needs. We take great satisfaction in visiting her thriving new location.

This type of informed guidance, education, and confidence building is what community bank specialize in. We listen to their dreams, build trust, and celebrate their wins. Our role doesn't end when the loan closes. We stand by them and continue to provide guidance as the business grows and new opportunities become available, or as they encounter setbacks and challenges. Lending relationships typically begin with a smaller loan of less than $150,000. As a borrower grows their business, they need more credit to support that growth. Cutting off community bank access to these small initial loans would deprive the borrower of a long-term lender partnership to support their growth. A startup must establish a solid foundation from the beginning to support future expansion. This is where a community bank is irreplaceable.

I do not believe that SBA direct lending could offer any remote substitute for a long-term relationship with a local community bank.

PPP Lending Displaced 7(a) Lending in 2020

Proponents of SBA direct lending cite data showing a decline in 7(a) lending in 2020. This data is misleading. Small business 7(a) loans were displaced by PPP loans and small business borrowing needs were met during this critical period. As PPP has come to a close, the SBA has already guaranteed a record $30.1 billion in lending in fiscal year 2021, with financing for the

7(a) program funded by user fees. The most recent NFIB survey of small business owners found that just two percent of owners said that their credit needs were unmet.

Bank and other private sector lender underwriting, relationship-based business guidance and expertise are what make the 7(a) program successful. They have direct ties to their communities, knowledge of local economic conditions and expertise honed over generations that cannot be duplicated by the SBA. Displacing these lenders would be a grievous error.

ICBA will continue working with policymakers to maximize the effectiveness of the 7(a) program for the small businesses they serve.

Conclusion

Thank you again for convening today's hearing and for the opportunity to offer the community bank perspective on access to capital for small businesses of all ownership models.

I'm happy to answer any questions you may have.

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Committee on Small Business

Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital

Capital Impact Partners Comments

October 22, 2021

On behalf of Capital Impact Partners, I am pleased to submit written testimony on "Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital" to the Committee on Small Business.

Capital Impact Partners is a national, nonprofit Community Development Financial Institution (CDFI) that is dedicated to creating new opportunities in places where options are limited. Our mission is to transform underserved low-income communities into healthy, sustainable communities by making strategic, high-impact investments that create and maintain quality jobs while delivering essential products and services to residents.

Capital Impact Partners has a long and successful track record of supporting cooperative businesses. Since our founding in 1984, we have provided over $250 million to more than 200 cooperative businesses that serve low-income people and communities. Our work with cooperatives is a key component of our broader efforts to ensure that low-income communities have access to quality health care and education, healthy foods, and affordable housing.

We believe that worker cooperatives are a critical tool for wealth creation, quality jobs, and reinvestment in the historically disinvested communities where we work. The 2019 "State of the Sector" report recently released by the US Federation of Worker Cooperatives highlights that worker-owners are 60% people of color and 62% women. Worker-owners make an average of $19.67 per hour, well above the minimum wage in every state. Even more compelling is the fact that the average patronage refund (or profit sharing) per worker-owner is $8,241- this wealth would not exist without ownership in the company.

In an effort to grow worker co-ops nationwide, Capital Impact Partners is involved in the Workers to Owners Collaborative, a national group convened by the Democracy at Work Institute focused on creating a sustainable ecosystem. We were very enthusiastic about the passage of the Main Street Employee Ownership Act spearheaded by Chairwoman Velazquez. With the impending sale of millions of small businesses owned by baby boomers, there is a huge opportunity to grow worker co-op conversions to scale with a focus on equity and low-income communities. In order to quantify this opportunity, Capital Impact released a publication in 2018 entitled "Co-op Conversions at Scale" which demonstrated a solid market opportunity for transactions over $800,000 in target geographies and sectors in addition to recommendations for the field.

In October of 2018, Capital Impact Partners organized a national convening around financing worker co-op conversions to engage more mission-focused financial instructions and ultimately increase the number of capital providers in the ecosystem. "Financing the Preservation of Legacy Businesses" was held in New York City with over 70 attendees from financial institutions (CDFIs, credit unions, and local banks) learning about the conversions ecosystem, underwriting, risk, business valuation, and technical assistance. The keynote speaker was Chairwoman Nydia Velazquez who highlighted the impact of employee owned businesses on her district and the potential for national impact. There was also a representative from Senator Kirsten Gillibrand's office who led a lunch discussion on future policy initiatives and the implementation of the Main Street Employee Ownership Act. This event demonstrated that there is a new cohort of financial institutions that are eager to finance worker cooperative conversions and are motivated by the opportunities created by the Main Street Employee Ownership Act.

Capital Impact Partners also supports the growth of the worker co-op ecosystem through our annual Co-op Innovation Award grant. This award supports innovative and replicable strategies for expanding cooperatives in communities of color and/or historically disinvested communities. The 17 grantees have leveraged their combined $515,000 in grants to leverage more than $6.3 million in additional funding from foundations, investors, and government.

This year, we are proud to announce financing our first worker co-op conversion with long-time partner the Cooperative Fund of New England. This proud new cooperative, Ward Lumber, is another example of the power of worker co-op conversion to maintain and augment wealth and stability within communities. Ward Lumber is a 130-year-old business in New York, employing more than 40 workers. This is an important transaction, not only for the workers themselves, but because the ripple effect of this business closing would have been felt throughout the local economy for years to come. We also developed a new loan product for worker co-op conversions to institutionalize and increase our lending to worker co-ops conversions.

After many years of ecosystem development, we are excited to see the number of cooperative development projects growing but we know that unlocking government support and funding is critical for scale, as demonstrated by USDA investment in the growth of the rural electric and agricultural cooperative sectors in the U.S.

While Capital Impact Partners is very excited about the potential for scale, the SBA personal guarantee requirement creates an unnecessary barrier to lending. Capital Impact Partners has never required a personal guarantee from a cooperative borrower; we do not believe that one member should have to use their home or personal assets as collateral for the co-op as a whole. This is particularly prohibitive to low-wage workers in industries that have seen growth in worker ownership in recent years including home care, childcare, professional services, and retail.

The cooperative sector has been working for years with the SBA to implement practical alternatives to the personal guarantee and we were hopeful that the Main Street Employee Ownership Act would be a catalyst for change. The Department of Agriculture's Business and Industry loan program does not require a personal guarantee and Capital Impact has been able to utilize this program to finance food cooperatives. Resolving the SBA loan guarantee issues is even more critical to our organization now that we have combined forces with an SBA lender who is eager to work together to finance cooperative businesses.

In 2021, Capital Impact Partners and CDC Small Business Finance announced a new alliance to ensure that traditional and mainstream financial systems are equitably serving Black, Hispanic, and Indigenous communities to drive solutions that support economic mobility and wealth creation. Leveraging our 80 years of combined experience, nearly $3 billion in assets, and strong ties to both large financial institutions and community-based organizations, Capital Impact Partners and CDC Small Business Finance, the nation's leading mission-based small business lender, are now formally operating as one to lead a national strategy designed to address critical legacy issues facing communities. As the largest SBA 504 lender in the nation the last 20 years and largest Community Advantage lender, CDC Small Business Finance is excited to participate in the pilot program. The

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integration with Capital Impact Partners makes them particularly poised to be a leader in deploying this program and working with the Administration in providing feedback for its continued improvement.

Capital Impact Partners and CDC Small Business Finance are very enthusiastic about the proposed $500 million pilot program for worker and consumer cooperatives to access SBA loan products without the requirement of a personal or entity guarantee. SBA guarantees are a critical tool for enabling new and low wealth business owners to access credit to start and grow businesses. However, most cooperatives cannot access this tool because of the personal guarantee requirement. If this personal guarantee requirement were modified to enable cooperatives to access SBA guarantees, it could unlock hundreds of millions of dollars to help start and grow cooperatively owned businesses.

Through our years of underwriting small business cooperatives, Capital Impact Partners has developed an in-depth understanding of the cooperative ownership structure. Our strong track record of lending to cooperatives demonstrates that these businesses often are more successful, impactful, and resilient than traditional businesses. Capital Impact Partners appreciates the Committee on Small Business supporting cooperative businesses and their ongoing attention to removing barriers that would increase financial resources and promote growth of the model.

Alison Powers

Manager, Cooperative and Community Initiatives

Credit Union National Association
CUNA

Jim Nussle
President & CEO
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99 M Street SE
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Washington, D.C. 20003-3799

September 30, 2021

The Honorable Nydia M. Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Velázquez and Ranking Member Luetkemeyer,

On behalf of America's credit unions, I am writing regarding the hearing entitled, "Empowering Employee Owned Businesses and Cooperatives Through Access to Capital." The Credit Union National Association (CUNA) represents America's credit unions and their more than 120 million members.

Credit unions recognize that financial inclusion and access to capital are critical to ensuring the survival of many of our nation's most vulnerable small businesses. As not-for-profit, consumer-owned financial cooperatives credit unions have a laser-focus on our mission of financial inclusion and serving our members.

One of the most important things that Congress could do to promote financial inclusion and help small businesses would be to ensure that federal law permits all federal credit unions to serve underserved areas. Under current law, only multiple common bond credit unions are eligible to add underserved areas to their field of membership. In addition, credit unions are also arbitrarily restricted in the amount of business lending that they can provide to 12.25 percent of assets. Lifting that cap would ensure small businesses would be able to access the capital they need.

That said, CUNA strongly supports the *Expanding Financial Access for Underserved Communities Act,* which would allow all federal credit unions to add underserved areas to their field of membership and exempt business loans made by credit unions in low-income areas from the credit union member business lending cap. Furthermore, the legislation expands the definition of a low-income credit union to include any area that is more than 10 miles from the nearest branch of a financial institution.

Allowing credit unions to expand into underserved areas would advance communities throughout the nation by giving tens of millions of consumers access to member-owned financial services. As we have learned through the COVID-19 pandemic with stimulus checks and PPP, lack of access to financial services is a major problem that needs resolution. CUNA conservatively estimates that modest but meaningful reform of field-of membership (FOM) rules would produce first-year benefits for over one million consumers who now have no realistic, affordable options in the financial marketplace.[1]

Small businesses and communities around the country are suffering and need access to relief. As you continue your work to provide funding and resources to our small businesses, I would encourage you to support the *Expanding Financial Access for Underserved Communities Act* to ensure credit unions are able to fully serve their communities.

Sincerely,

Jim Nussle
President & CEO

REFORM THE SBA

BIGGER: MISSION, AUTHORITY & RESOURCES

October 11, 2021

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Charles Schumer
Majority Leader
U.S. Senate
Washington, D.C. 20510

The Honorable Kevin McCarthy
Republican Leader
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Ben Cardin, Chair
U.S. Senate Committee on Small Business
Washington, D.C. 20515

The Honorable Nydia Velasquez, Chair
U.S. House Committee on Small Business
Washington, D.C. 20515

Dear Leader Schumer, Speaker Pelosi, Leader McCarthy, and Chairs Cardin and Velazquez:

Recent letters from the Republican members of the House Committee on Small Business (October 1, 2021) and Republican Senators (October 6, 2021) advocated against an important provision of the House Reconciliation bill that would benefit new small business startups and microbusinesses regarding access to capital.

The nation is at a 40-year low in new business startups. A significant contributor to this serious economic problem is the lack of capital to start businesses and grow microbusinesses.

The Republican letters fail to address this problem or offer any meaningful solutions.

As the House GOP letter recognizes, private lenders use "prudent underwriting" when making a loan. These private lenders, according to the letter, "are in the business of ensuring dollars are secure."

This is not an entirely correct assessment. Private lenders are in the business to make a profit. That goal is appropriate and "prudent underwriting," or being risk averse, is a vehicle to achieve that goal.

This is the underlying problem with access to capital for new business startups. They are most often too risky for private lenders. Additionally, the average startup loan is around $10,000, far too unprofitable for private lenders even if the loan is successful.

Further contributing to the problem of startups accessing capital from private lenders is the fact that there are at least 68% fewer commercial banks today compared to 1980, according to the SBA Office of Advocacy. The St. Louis Federal Reserve Bank found that in 2014 there were 1,132 banking deserts in the country, 734 in rural areas.

It is these rural and underserved communities that are starving for access to capital to fuel entrepreneurship.

In March of this year, a number of national, state, and local business organizations launched a campaign to make recommendations to address the 40-year low in new business startups. One of the key issues addressed is access to capital.

The issue demands a solution that is not just doing more of the same. Trying to encourage private lenders to make small business loans they do not want to make, even with generous loan guarantees, is destined to not solve the problem.

The Senate Republican letter advocates for "expanding the lending pool in the 7(a) program to more lenders" to increase options for small businesses. While including more financial technology companies (FinTechs) in the traditional 7(a) programs might mean more private lenders, it does not guarantee more startup and micro loans in the underserved communities, nor the training and technical assistance needed to successfully grow small businesses.

Our campaign recommends that the Small Business Administration (SBA) have the authority and resources to make direct loans of up to $20,000 to new business startups and microbusinesses with a priority given to our nation's rural and underserved communities. In this way, the SBA would be addressing a critical access to capital need but would not be competing with private lenders, which have already shown their disinterest in this market.

The proposed House Reconciliation bill includes a section that authorizes the SBA to "originate and disburse direct loans, including through partnerships with third-parties, to small business concerns." The cap would be $150,000. However, the legislative language does not direct the loans to specific demographics.

It is this section that inspired the Republican letters opposing SBA direct lending and claim, without explanation, that such a program "will harm the very businesses the programs are meant to help" and "will "hurt the United States economy as a whole."

The letters' argument against the SBA making direct loans centers on potential fraud because private lenders would not be making the loans.

The letters point to the reported potential fraud in the SBA's Economic Injury Disaster Loan (EIDL), a program that is direct lending, as proof that the SBA's "lack of oversight controls" puts taxpayer dollars at risk compared to loans from private lenders participating in the federal Paycheck Protection Program (PPP) and the traditional SBA7(a) loan guarantee program.

However, private lenders have also experienced fraud and potential fraud with the PPP loans they have originated.

A December 2020 report by an SBA independent financial auditor identified "more than two million PPP loans worth $189 billion—more than one third of all PPP loans issued in that period—that 'are potentially not in conformance with the CARES Act and related legislation.'"

Just through April of this year the Justice Department had already criminally charged 209 individuals that were suspected of applying for about $445 million in PPP loans. Those charged had already received over half of these funds.

Earlier this year the House Select Committee on the Coronavirus Crisis launched an investigation into fraudulent PPP loans originated by FinTechs and their private lending partners. Committee Chairman James Clyburn wrote that he was "deeply troubled by recent reports alleging that financial technology lenders and their bank partners failed to adequately screen PPP loan application for fraud."

Regarding the "potentially fraudulent EIDL loans processed and advanced" by the SBA, Congress holds significant blame. The Project on Government Oversight explains:

> The CARES Act precluded the agency from exercising one important check on fraud in the Economic Injury Disaster Loan program. Normally, the agency can require loan applicants to fill out a form allowing the agency to verify their tax information with the Internal Revenue Service. "The disaster loan program's strongest internal control is the ability to receive directly from the IRS recent tax transcripts," wrote James Rivera, head of the SBA's Office of Disaster Assistance, last fall. But, he added, "the CARES Act removed that control," calling it a "pivotal change."

The experience of the first nine months of the CARES Act led both Congress and the Administration to take measures to address fraud and abuse in both PPP and EIDL. Certainly, more preventative measures can be taken.

Preventing fraud in any government program should be a high priority. However, citing fraud in the SBA PPP lending program as being less and thus more acceptable than the fraud in the EIDL program to justify not initiating a completely different and critically needed SBA small business lending program is not good policymaking.

The proper response to fraud is to have better fraud prevention controls in all lending programs—private and public.

Our campaign recommendations for the new SBA direct lending program reduces potential fraud, the risk to taxpayer money, and private-lender competition while increasing access to capital for small business startups and microbusinesses:

1. Cap the new SBA direct loans at $20,000 and use non-traditional underwriting criteria.
2. Require all SBA direct loan recipients to first receive technical assistance and training from SBA partner organizations before and during the loan.
3. Target the loans to small business startups and microbusiness.
4. Prioritize the loans to rural and underserved communities.

The House Republicans on the Committee on Small Business insists that "Federal government programs must provide aid and resources in a responsible, efficient, and prudent manner." Our recommendations meet these criteria for the new SBA direct lending program that is critical to addressing the nation's 40-year low in new business startups.

We hope that both Republicans and Democrats will support these recommendations and we look forward to engaging members of Congress individually and in hearings on the matter.

Sincerely,

Frank Knapp Jr.

Frank Knapp Jr.
Campaign Coordinator, Reform the SBA: BIGGER Mission, Authority and Resources
President & CEO, South Carolina Small Business Chamber of Commerce

Coalition Members:

American Independent Business Alliance
American Sustainable Business Council
Gullah Geechee Chamber of Commerce
Latin American Chamber of Commerce—Charlotte
Latino Communications Community Development Corporation
Local First Arizona
North Carolina Business Council
Sumter Black Chamber of Commerce
South Carolina Hispanic Chamber of Commerce
South Carolina Small Business Chamber of Commerce
Triad Local First
U.S. Green Chamber of Commerce

NCBA CLUSA
The National Cooperative Business Association • CLUSA International

Testimony of Doug O'Brien
President and CEO, National Cooperative Business Association CLUSA
House Committee on Small Business
Hearing on "Empowering Employee-owned Businesses and Cooperatives Through Access to Capital"

Chairwoman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee, thank you for the opportunity to provide written testimony for the hearing, "Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital."

The National Cooperative Business Association CLUSA International (NCBA CLUSA) is the apex trade association for cooperatives across all sectors of the U.S. economy, including worker cooperatives, consumer food cooperatives, and credit unions, all of which have an important role in the conversation of access to capital for cooperatives.

First, NCBA CLUSA would like to express our appreciation for the work of the House Small Business Committee—and especially that of Chairwoman Velázquez and her staff—in ensuring that cooperative businesses were eligible for the primary small business disaster relief programs in response to the COVID-19 pandemic through the CARES Act. Expressly including cooperatives in both the Economic Injury Disaster Loan and Grant program and the Paycheck Protection Program brought certainty to thousands of cooperative small businesses. Over 3,000 cooperatives accessed these programs, providing over $1.2 billion in direct assistance to maintain operations and make necessary adaptations to keep more than 1.2 million employees.

These programs also revealed the inconsistencies and lack of institutional knowledge of cooperative by the U.S. Small Business Administration. While ultimately resolved, dozens of cooperative businesses faced delays or undue denials in their applications because of lack of awareness as well as incompatible processes and forms for cooperatives to work with the agency. Excluding these disaster programs, NCBA CLUSA is aware of just one loan guarantee that SBA has administered to a cooperative business, which occurred in 2020.

One in three Americans is a member-owner of at least one cooperative business, but membership is unevenly distributed across types of cooperative and sectors of the economy. This is in large part due to the strength of policy support around each type. For example, 125 million member-owners access safe, affordable financial services through their local credit union. Products produced by farmer cooperatives are household names like Organic Valley, Cabot Creamery, Ocean Spray, and Sunkist. And more than 20 million households, businesses and schools receive electricity as member-owners of their electric cooperative. Despite the presence and success of cooperatives for more than 100 years in the United States, the U.S. Small Business Administration has failed to incorporate its products and services to include this business model.

The testimony from Home Care Associates of Philadelphia was unique in that it was a collaborative effort of philanthropic, charitable, and foundation funds. Notably, HCA cited that as a worker cooperative, the co-op was not able to access capital at SBA because no single member-owner owned at least 20 percent of the business. HCA and other cooperatives have indicated that it would be helpful to access traditional, affordable and safe forms of capital like the programs offered by SBA. Their cooperative structure should not prevent them from attaining that goal. This lack of access at SBA helps to demonstrate why, unlike other sectors, there are fewer than 500 worker cooperatives in the United States.

Worker cooperatives like HCA are the exact type of business that SBA should be reaching. Worker cooperative ownership creates paths to economic mobility that may otherwise be unattainable by a single aspiring entrepreneur. Cooperatives form primarily for one of three reasons:

- To address market failures where neither the private sector nor government provide a needed service
- To help small players gain parity with large investor-owned competitors
- To give consumers a deliberate choice of business to better meet their common needs and aspirations

Member-owners of cooperatives have 'skin in the game' both through personal financial investment in the business and a desire to ensure a long-term solution to one or more of the aforementioned challenges to improve quality of life. As a result, worker cooperatives enjoy five percent higher productivity levels than traditional businesses, are two-thirds more likely to succeed than the average business, offer higher pay and have more satisfied employees.

Cooperatives also enjoy lower worker turnover than average businesses by a margin of at least 35 percent. Many co-ops institute workforce development programs that help employees build new skillsets and continue to grow and innovate with the cooperative. As a member-owner, people also work with the co-op's finances and has a voice in governing the co-op's path forward.

The United States is in a unique moment where workers across the country are seeking to form cooperatives at rapidly increasing rates. It is critical that SBA provide a level playing field to cooperative start-ups. In addition to supporting start-up cooperatives, access to capital at SBA could also help to prevent thousands of small business closures as America's largest generation approaches retirement. In many cases, the employees that have helped build the success of the business over its lifetime are best positioned to become the next generation of owners.

This dynamic will be especially important as it relates to access to fresh, healthy foods in rural communities. Where many Mom and Pop grocery stores do not have a ready singular buyer, consumer ownership can help preserve this existing business and maintain access to fresh groceries. Consumer food co-ops have an excellent record of adapting to meet changing community need, sourcing more local products than traditional retail grocery stores, offering higher wages, and reinvesting more back into their communities.

In 2018, this committee led the effort to pass the bipartisan Main Street Employee Ownership Act that asked SBA to identify and recommend practical alternatives to the agency's underwriting criteria so that cooperatives could participate—notably, this centered on SBA's use of personal and entity guarantees. Unfortunately, SBA published a disappointing report to

Congress that failed to recommend any alternatives to allow cooperatives to participate in SBA programs.

For this reason, the Cooperative Lending Pilot Program included in the Build Back Better Act was welcomed news to the cooperative community. This program would require SBA to take the actions intended by the Main Street Employee Ownership Act by adopting loan guarantee criteria for cooperatives that does not include a personal or entity guarantee, while maintaining the security of taxpayer resources that are used to guarantee these loans.

It is our hope that SBA engages with cooperative stakeholders in standing up and carrying out this pilot program and, ultimately, find a long-term solution to incorporate cooperatives into each of the agency's capital access programs.

NCBA CLUSA appreciates the Committee's continued attention to this important issue. Cooperatives are a tested model for building a more resilient, inclusive, and sustainable economy, and will be an integral component to our nation's recovery from the economic impacts of the COVID-19 pandemic. We look forward to continuing to work closely with the Committee and SBA to help make dreams of entrepreneurship possible for more people through cooperatives.

REFORM THE SBA
BIGGER: MISSION, AUTHORITY & RESOURCES

BankThink
American Banker
October 8, 2021

Opinion: Direct loans from SBA are no threat to private lenders

By Frank Knapp Jr.

In March of this year a campaign was launched by numerous national, state, and local business organizations to address the country's 40-year low in new business startups. One of the recommendations was for the U.S. Small Business Administration to directly make startup and microloans of less than $20,000 in rural and underserved communities.

The House budget reconciliation package proposes to give the SBA the authority and resources to make this recommendation a reality, only with a $150,000 loan cap and no specified target areas.

The coalition members of our campaign, Reform the SBA: BIGGER Mission, Authority and Resources, are very supportive of this prospective SBA program, which would address access to capital, one of the most significant barriers to starting a small business, especially in rural and underserved communities that desperately need local entrepreneurship to grow their economies.

The Independent Community Bankers Association has voiced opposition to the proposed change to the SBA 7(a) program. The association's CEO, Rebeca Romero Rainey, said, "Establishing a direct lending program to compete with 7(a) private-sector experts would needlessly risk diminishing participation in the program while putting taxpayer dollars at risk."

As the head of a small-business advocacy organization, I agree that, generally, the government should not create programs that compete with the private sector.

However, the reality is that private lenders do not want to make small startup and microloans, especially in rural and underserved communities, and particularly to entrepreneurs of color and women. Such loans are viewed as too risky and not very profitable.

Add to this reluctance the fact that there are simply fewer private banking opportunities in rural and underserved areas.

The SBA Office of Advocacy reports that the number of commercial banks declined from 14,400 to 4,600 from 1980 through 2019, a 68% drop, due to consolidations and failures. In 2014, there were 1,132 banking 'deserts,' according to the St. Louis Federal Reserve Bank. More than half, 734, were in rural areas. Data from the Federal Deposit Insurance Corp. indicates that brick and mortar banking opportunities continued to decline in 2020 with over 3,300 branches closing nationally, three times as many as were opened.

Private lenders will argue that ATMs and technology make it less important to have a physical presence in underserved communities. Justin Hawkins, a region president for Wells Fargo, has said that branches are increasingly becoming "advice centers" as opposed to their former primary role as "transactional centers."

However, the Paycheck Protection Program exposed the fallacy of the rationalization that banks can serve customers in rural and underserved communities with minimal or no presence. They certainly didn't do this with minority small-business owners, who were largely left out of the PPP loans.

If these private lenders didn't make the essentially no-risk small business loans to entrepreneurs of color during this federal program, it is hard to understand their concern about SBA competition for traditional 7(a) loans in rural and underserved communities today.

The ICBA also raises the concern that "taxpayer dollars" are at risk with an SBA direct lending program because "private-sector experts" would not originate such loans.

While private lenders might want us to believe that they have benevolent concern for "taxpayer dollars," their primary goal is to make a profit. Not making small, risky loans is one way their "private-sector experts" achieve this goal. Recovering 80% or more of a failed loan through an SBA guarantee still results in a loss in both investment dollars and administrative efforts for the private lender.

But taking more risk with small-business loans is exactly what we need to lift our rural and underserved communities.

Traditional 7(a) loans are not getting this job done, whether they are originated by a private or nonprofit lender.

The nation's 40-year low in new business startups is a testament to the need for not just doing more of the same to address this small business crisis.

I hope that the ICBA will support our campaign recommendation that SBA direct lending be targeted to startups and microbusinesses in rural and underserved communities.

Private lenders' concern about competition will fade away and needy local communities will be in a better position to grow their economies from the bottom up thanks to the SBA direct lending.

Frank Knapp Jr., President and CEO, South Carolina Small Business Chamber of Commerce

https://www.americanbanker.com/opinion/direct-loans-from-sba-are-no-threat-to-private-lenders