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INVESTING IN SMALL BUSINESSES: THE SBIC PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURE, ENERGY, AND TRADE

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

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INVESTING IN SMALL BUSINESSES: THE SBIC PROGRAM

TUESDAY, NOVEMBER 7, 2017

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON AGRICULTURE, ENERGY, AND TRADE,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:03 a.m., in Room 2360, Rayburn House Office Building, Hon. Rod Blum [chairman of the Subcommittee] presiding.

Present: Representatives Blum, Chabot, Luetkemeyer, Comer, Bacon, Schneider, and Lawson.

Chairman BLUM. Good morning. Thank you all for being here with us today. I call this hearing to order.

Despite a downward trending unemployment rate and increasing signs of business optimism, small firms continue to face a rigid lending environment. Capital for the nation's small businesses, entrepreneurs, and startups is the difference between a Main Street company in my home State of Iowa turning on their lights or closing up operations for good. It could be the difference between making payroll and letting a great employee go. And I have been there and had to do that, so truer words cannot be spoken.

While large companies finance their projects through debt and equity markets, small companies regularly utilize traditional bank lending to finance their endeavors. As a way to inject more equity into the small business ecosystem to address the gap in long-term financing, the SBA created the Small Business Investment Company program, also known as the SBIC program, in 1958.

SBICs are for-profit entities that manage investment funds, but are licensed and regulated by the SBA. Through this unique structure, investors apply to receive an SBIC license which provides the ability to leverage private dollars with federal dollars for investments in high-growth small businesses.

This program is what we are here to talk about today.

This Committee has actively been studying the SBIC program for years. We examined two SBIC bills in the spring, one looking at the individual leverage limit and a second that looked at the threshold level in which a financial institution can invest in the SBIC. This program continues to be a topic of interest for this Committee.

Today, we will hear from SBIC participants that can share with us how this program is operating on the ground and how it impacts communities around the nation.

I am looking forward to hearing more about the role SBA plays in this program as well. From the issuance of leverage to the licensing process, it is important to know how SBA interacts with the SBICs.

Like many of SBA's financial programs, where the federal government has a role, robust and thorough Congressional oversight is required to ensure taxpayer money is safeguarded and protected. This Committee strives to create an environment where small businesses can flourish, and this program fits into that formula.

I appreciate all of the witnesses being here today. I look forward to your testimony.

And I now yield to Ranking Member Schneider for his opening remarks.

Mr. SCHNEIDER. Thank you, Chairman Blum. Thank you for calling this hearing. And I want to thank the witnesses for joining us today.

Access to capital is essential for every business, but especially for smaller ones. Without it, most firms cannot make improvements, expand, or hire qualified works that they need to succeed.

In 1958, Congress recognized the gap in the financial markets for long-term funding for growth-oriented small businesses and created the Small Business Investment Company Program. SBICs are privately owned and managed investment funds, licensed by the SBA, that use their own capital plus SBA guaranteed funds to make investments in small businesses.

The SBIC program helps fill the gap in the capital markets for businesses that have outgrown the SBA's flagship 7(a) loan guarantee program but remain too small or high risk for the private equity industry.

The key to the program's success is leveraging federal funds to expand the amount of private capital invested in promising small firms.

SBA provides funding to qualified SBICs with expertise in certain sectors of the economy. SBICs then use their own funds and leverage from SBA to invest in these small businesses. Their actions have facilitated over 3 million jobs total and nearly $6 billion per year of investment in domestic small employers. To date, small business investment companies have assisted thousands of high-growth businesses, providing over $100 billion in capital.

In this Congress, the House passed two pieces of legislation from this Committee that expand the SBIC program. The Small Business Investment Opportunity Act of 2017 increases the cap for the SBIC that manages just one company from $150 million to $175 million. And the Investing in Main Street Act of 2017 increases the percentage of capital and surplus banks and federal and savings associations can invest in an SBIC. Both measures seek to increase the flow of much-needed capital to small businesses.

Despite these efforts, more work needs to be done, in particular to diversify the program. Greater access for women and minority-owned funds would, in turn, increase the dollars flowing to women and minority-owned small businesses. Similarly, additional efforts to invest in rural small businesses could spur economic growth in these areas.

During today's hearing, I look forward to hearing from our witnesses on how we facilitate investment in our nation's entrepreneurs and small businesses. And I thank them in advance for their testimony.

Thank you, and I yield back.

Chairman BLUM. Thank you, Mr. Schneider.

I would like to explain the timing. You may all be aware of how the lights work, but if not, I would like to take a second to explain that.

You will have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, at the end of 5 minutes, it will turn red. And I ask that you try to adhere to that time limit.

Also, if Committee members have an opening statement prepared, I ask that they be submitted for the record.

And now I would like to introduce our distinguished panelists there.

Our first witness is Brett Palmer. Mr. Palmer is the President of the Small Businesses Investor Alliance, also known as SBIA, an association that has a focus on the SBIC programs.

We need a few more acronyms here, don't we?

With over 9 years at SBIA, Mr. Palmer is well-versed in the intricacies of the program. His previous experience includes time on Capitol Hill and at the U.S. Department of Commerce.

I appreciate you being here with us today.

Our next witness is Thies Kolln. Mr. Kolln is a Partner at AAVIN Private Equity in my home district of Cedar Rapids, Iowa.

Go Hawks.

Mr. Kolln has spent approximately 15 years at AAVIN, which focuses on late-stage and expansion-stage financing. Prior to AAVIN, Mr. Kolln spent time working for the Boston Consulting Group in Chicago and on the startup management team at Orbitz. He has also practiced corporate law at Kirkland & Ellis in Chicago.

Thank you for joining us today. It is always great to hear the perspective of a fellow Iowan.

Our next witness is Michael Painter. Mr. Painter is Cofounder and the Managing Partner at Plexus Capital in Raleigh, North Carolina, where they focus on middle market business. Prior to cofounding Plexus Capital, he worked for RBC Bank and investment firms in both New York and North Carolina.

It is a pleasure to have you with us today, Mr. Painter.

And I yield now to Ranking Member Schneider to introduce the remaining witness.

Mr. SCHNEIDER. Thank you.

It is my honor to introduce Mr. Mark Walsh, the Managing Director of Ruxton Ventures here in Washington, a Washington-based private equity firm that invests in technology, media, and education companies.

Prior to this position, Mr. Walsh served as SBA Associate Administrator for the Office of Investment and Innovation. In this role, he oversaw all SBIC, SBIR, Accelerator, Incubator, and other growth activities at SBA and was appointed to key committees at the Securities and Exchange Commission and Department of the Treasury.

Before his government service, he had a 30-year career in technology, media, venture capital, and angel investing. Mr. Walsh is a graduate of Union College and received his MBA from Harvard.

Welcome, Mr. Walsh.

Chairman BLUM. Thank you, Mr. Schneider.

I appreciate all of our witnesses being here today.

Mr. Palmer, you are recognized for 5 minutes. You may begin.

STATEMENTS OF MR. BRETT PALMER, PRESIDENT, SMALL BUSINESS INVESTOR ALLIANCE, WASHINGTON, DC; MR. THIES KOLLN, PARTNER, AAVIN PRIVATE EQUITY, CEDAR RAPIDS, IA; MR. MICHAEL PAINTER, MANAGING PARTNER, PLEXUS CAPITAL, RALEIGH, NC; AND MR. MARK L. WALSH, MANAGING DIRECTOR, RUXTON VENTURES, CHEVY CHASE, MD

STATEMENT OF BRETT PALMER

Mr. PALMER. Thank you.

My name is Brett Palmer. I am president of the Small Business Investor Alliance. I would like to thank the chairman, Ranking Member Schneider, and Congressman Lawson for being here today, and the rest of the members of the Subcommittee and the staff. Thank you for giving us the opportunity to share what we know about the SBIC program and small business investing and to answer your questions about it.

The SBIA is a trade association of small business investors that includes the SBIC industry. The goal of the SBIA is to promote a healthy ecosystem system for small business investing, one that benefits both small businesses and their investors and thereby promoting economic growth and job creation.

Small business investment companies have been around since 1958, and what was true in the 1950s will always be true: Small businesses need external, patient capital to grow and thrive and it is really hard to access that type of capital.

Debenture and non-levered SBICs have increased the amount of small business investment capital, with almost $6 billion invested in fiscal year 2016, the last year of which we have full data. All SBIC investments must be used for domestic small businesses with at least 25 percent going to even smaller enterprises.

SBICs invest across a broad range of industries and across a broad range of geographies. And actually I think Congressman Lawson's district runs from the northern part of Florida, and Mr. Kolln here actually, I think, is looking at an investment that would connect that corridor from Tallahassee to Jacksonville.

I will let you talk about that.

It is common to see investments in manufacturing in low and moderate income areas via SBICs. And this industry and geographic spread is important, because SBICs are often the first institutional capital into small businesses, which benefit from their capital but also from their professional help in scaling up their business, professionalizing themselves, and building up boards.

The program is having the best and lowest loss rate in its 59-year history, which is important, because taxpayer protection is the highest priority for the SBIC industry. There is currently unprecedented private sector interest in getting capital into small businesses via SBIC funds, and the private sector is the leading critical component to making the program work effectively. It is a market-driven program.

A recent Library of Congress study found that SBIC-backed businesses created 3 million new jobs over the course of their study and 6.5 million jobs. That is a period that included the Great Recession and the tech bubble busting.

The study was performed with researchers from Duke's and Pepperdine's business school and they found that debenture-backed SBICs created, on average, about 125 new jobs and non-levered, more equity-oriented SBIC investors created over 530 new jobs per small business receiving investment, which is pretty big numbers. Those are not uniform across every small business but the average.

Between these two types of investments, over 7 percent of net new jobs in the United States came from SBIC-backed businesses. That is an extraordinary number for a little known program, but that is what the program is supposed to do.

These quiet successes were achieved while the debenture program was one of the only major SBA programs that was able to maintain a zero subsidy rate, which matters. Again, this covers the period of the Great Recession and the tech bubble bursting for the debenture program. And with the help of Congress and the SBA, there has been significant operation reforms made over the past 8 years or so and have been producing the positive results that you have sought.

With this program having a great track record, there are always areas for improvement that could be made both by the private sector, on our side, as well from the government, because there are many more communities that would benefit from having access to this type of capital. With private capital investment at record highs, we would like to see that spread across more of the country, to more communities, to more businesses, across more sectors, because there has been good stuff that has occurred, but more certainly can and should be done.

And with that, I would like to take a moment to thank the Committee for passing those two bills that were mentioned before. They are simple, commonsense bills that will help get more capital out there to these worthy small businesses.

And with that, thank you for your time.

Chairman BLUM. Thank you, Mr. Palmer.

Mr. Kolln, you are recognized for 5 minutes.

STATEMENT OF THIES KOLLN

Mr. KOLLN. Thank you. Thank you, Chairman Blum, Ranking Member Schneider, and Member Lawson, for the opportunity to testify here today and for holding this hearing.

Access to capital is a tremendously important issue for small businesses across the country, and the SBIC program effectively helps to resolve that issue. I am eager to provide you with my perspective as an SBIC fund manager and also a past member of the SBIA board.

My name is Thies Kolln, and I am a partner of AAVIN Private Equity, a private equity firm based in the heart of the Midwest.

Our central office is in Cedar Rapids, Iowa. We have, at the time, two regional offices, in Madison, Wisconsin, and in Kansas City, and cover our Midwest footprint through those. I joined AAVIN in 2002, so I have been there for 15 years now, and it was a return to my home city of Cedar Rapids.

At AAVIN we stay true to our roots by focusing on helping small regionally based businesses grow. We specialize in late-stage and expansion-stage financings, and we partner with strong management teams that seek long-term business growth. Our focus is on smaller investment opportunities, and they are concentrated mostly in the upper Midwest States, such as Iowa and surrounding States, although we do invest nationally.

And as Brett mentioned, we have one company now that we invested in about a year ago THAT is based in Jacksonville and recently acquired another company to help it expand into Tallahassee. So we are covering the northern Florida market with that. It is a company that does precast concrete for road expansions and culverts and wastewater management mainly.

We have extensive private equity experience. There are seven members of our investment team. We have made investments in over 300 companies throughout our careers. Through our firm's history, just in Iowa, we have helped deploy $34 million in capital that helped create or sustain over 6,000 jobs. Those numbers may not mean a lot in a place like Manhattan, but they do for Iowa. These investments produce great growth for small businesses, as well as returns for our investment partners, which includes repayment in full to SBA and the American taxpayer.

I have got some more detail in my written testimony, but I will outline a little bit about the SBIC program. It has a rigorous licensing process for prospective funds, which ensures taxpayer protection and safeguards the program's reputation. One requirement for licensing is that management teams have extensive prior investment experience and good investment track records.

We meet that demand. Our firm's experience dates back to the start of the SBIC program in 1959, and we have basically over 40 years of continuous SBIC management experience in our firm.

Repeat licensing like this is a good thing as it demonstrates to prospective small business partners our previous fund successes, our commitment to serving this undercapitalized market, and demonstrates to the taxpayer that we are good stewards of tax dollars. We have a history of on-time payments to SBA and overall compliance, with clean examinations without findings.

We strongly support the SBIC program because it provides the opportunities to supplement our capital with up to two times more capital to deploy to small businesses to support their growth.

Given the increase in concentration of capital among large funds and institutions, it is difficult to find capital with a dedicated strategy of investing in small businesses and in small funds. And it is questionable whether many of the small funds like AAVIN could even continue to fund small businesses if it were not for the SBIC program.

We are often the first providers of institutional capital into small businesses. We help professionalize small businesses and make sure they have fundamentally solid operations and partner with strong management teams to do so.

I will give a little bit of a history or a little bit of some stories about some of our investments. We have made over 26 investments in Iowa. Our most recent was just completed last month in Happy Joe's Pizza & Ice Cream.

I am sure you are familiar with that, Mr. Blum.

Chairman BLUM. Absolutely.

Mr. KOLLN. It is a family-run pizza parlor chain that was founded in 1972. It has 54 locations across Iowa and other Midwestern States. We have already hired additional people to help it on a growth strategy and are right now looking at additional locations to grow out the operations.

Chairman BLUM. [Inaudible]

Mr. KOLLN. He is still involved in it, yes. He is part of the management team now. Well, Joe is retired. His son Larry is still involved.

So that is just an example of our investing in Iowa. And without the SBIC program we would not have had our successful history of deploying growth capital to American small business. The SBIC program has effectively helped us leverage our private capital that we are able to raise and invest in small businesses.

Thank you for holding this hearing. And I encourage the Committee and this Congress to continue to fully support the program so it may expand, support more domestic small businesses, and create even more American jobs. I look forward to answering any questions you may have.

Chairman BLUM. Thank you, Mr. Kolln. Let the record reflect that Happy Joe's Pizza has some pretty darn good taco pizza. Love it.

Mr. Painter, you are now recognized for 5 minutes.

STATEMENT OF MICHAEL PAINTER

Mr. PAINTER. Thank you, Chairman Blum, Ranking Member Schneider, and Mr. Lawson for having us here today.

So I have been involved in the SBIC program for over 20 years. My partners and I used to work at a small regional bank in North Carolina called Centura Bank, and we had a fund that served to provide the growth capital that went beyond what the traditional bank could provide. And in 2004 we have been out on our own and formed our first independent SBIC, and we have now invested in 87 companies that employ collectively thousands of people.

So we have made a big impact, and we are one example of many SBIC managers across the country who are making similar impacts.

My message today is really about three things. One, this is the most impactful and best example of a public-private partnership that I know of. Second, it is a program that supports a perpetually underserved area of the market. And third, it is impacting real lives. It is easy to talk about our program and our business in numbers and returns. It is ultimately about real people, real companies, real communities, and impacting lives and families.

As far as a program, public-private partnership that makes sense, I think the key here that I know you all understand, but I hope more people on the Committee and in Congress understand, is that all of the dollars that we raise from the private markets are at risk first, ahead of any Federal guarantees. That is a critical part of the program and why it has been so successful.

So in our case, we have 56 banks, 130 individuals, 18 family offices, and 9 institutions that have invested $475 million with us. That all is there protecting Federal guarantees. So our dollars would be lost first, before the Federal guarantees would be hit. So that is a big differentiator in the public-private partnership world.

I also think you have a staff that has been there for a long time that is driven by the purpose of the program. They are motivated by the purpose and the impact of the program, which is measurable and meaningful. And we have 50 years-plus of success in this program. So I don't know of any other public-private partnership that has had that level of success.

We also support a perpetually underserved area of the market. There are over 100,000 small businesses in the United States that have $10-$100 million in sales. Roughly half of those are owned by somebody over the age of 40.

So you have this big portion of the market, roughly $2 trillion of value, that has to transition to the next generation of owner-operators. Public companies have ready access to the public markets to effect those transitions each and every day. The private markets don't have that luxury, particularly at the small end of the market.

I have been in this market for 20-plus years. It is perpetually underserved. You have fund managers that come into our market, they have success, and they go up market, because it is easier to do 10 deals and grow by doing 10 bigger deals than it is to do 10 deals, then 20 deals. It takes a lot of fixed cost. We look at 100 opportunities to invest in 1.

So to really provide capital to small businesses, you have to be committed to building a real business and putting infrastructure in place, and that is not possible without the SBA program.

And back to the real driver of this. We do impact real lives. And I think telling stories about those lives is a good way to visualize it for me. We have got a company, design shop, in Orlando, Florida. This is Doug and Sherri Hughes, husband and wife, started this company in 2000, and they serve the trade show market. So they help companies prepare the materials they need for trade shows and they now employ 50 people.

So husband and wife, 2000, start a business that now employs 50 people, impacting their families, not just those 50 people, and their community.

Another example is Huseby in Charlotte, started by Scott Huseby. He is a third-generation court reporter, comes from a long line of court reporters. Saw a need to professionalize this industry. He now employees 50 people at Huseby, and, more importantly, he engages with over 1,800 court reporters across the country to provide a steadier flow of business to people all over the country.

So I look forward to taking questions about the program. I care a lot about the program and about the purpose. It is an impactful program. And I think the more stories that get out there about the people behind it, the more support there will be for it.

Thank you for having us.

Chairman BLUM. Thank you, Mr. Painter.

I now recognize Mr. Walsh, a former venture capitalist, for 5 minutes.

STATEMENT OF MARK L. WALSH

Mr. WALSH. Thank you.

Good morning. My name is Mark Walsh. And from late 2015 until January 19 of this year, I ran the Office of Investment and Innovation, OII, or as we call it, Oy, at the SBA here in Washington, D.C. My area oversaw, as was said, all SBIC, SBIR, and Incubator, Accelerator programs. It was my first job in government.

Before that, for 35 years or more, I had a career in technology, the internet, and media with senior or C-Suite positions at a wide variety of companies, including America Online, GE, HBO, VerticalNet, and more.

For the last 17 years, I have been an active angel investor and venture investor for a wide variety of startups and have served on the board of directors for many of those companies and other high-growth venture-backed entities. I have also served as chairman of the Bipartisan Policy Center here in Washington, D.C., the best think tank in town, in my personal opinion.

The SBIC program is one of the most innovative, financially successful, and well-structured government programs in existence, period, close quote. But I left the program almost 10 months ago, and some recollections and remembrances are dimmed by time. Also, my opinions are my own and are not meant to reflect anyone else's or any other agenda.

As was said, the SBIC program takes low-interest debt and provides it to professionally managed domestic venture capital and private equity funds. These funds need an SBIC license to get the investment.

The license application and approval process is super rigorous and helps avoid mismanaged or ill-targeted funds from receiving taxpayer dollars.

Further, a licensee reports all significant investment activities to the OII on a regular quarterly basis, and there are annual on-site inspections by OII trained teammates.

In short, OII is as vigilant an investor as any in the private market, if not more so. However, as we all know, investment entails risk, so OII also has a trained team of workout experts who help funds that ran array of financial health and, in some cases, assumed ownership and control of failed funds and disposed of the assets at admirable salvage valuations. But make no mistake: The amount of unrecoverable investment was minuscule and was the envy of the private sector.

The SBIC program is a fabulous example of a public-private partnership, as was mentioned by my colleagues. My colleagues in the organization and teammates were as motivated, talented, and professional as any I have worked with in my private sector career. Some of them are here today. And I enjoyed my all-too-short stint immensely.

But I was asked here to address some ways to improve the SBIC program. Nothing is perfect, and there are a few areas I would like to address if I were still in charge.

Number one, outreach. We made extraordinary progress during my time in discovering new funds and new types of funds and in meeting and engaging more diverse fund managers—gender, demographic, geographic, and market-focused diversity—more than prior efforts. This happened because my teammates and I made it a priority, and I would encourage the Committee to make sure the program pursues that with vigor.

Second, promote and award certain types of funds. Impact funds, which are aimed at social, environmental, educational, or institutional improvement, as opposed to pure profit, are important. The program should be more able to encourage impact funds with lower interest rates, more attractive payback options, or even faster application processing.

And speaking of that, number three, streamlining the license process. I am sure you guys would agree that. The amount of paperwork expected of a license applicant and license holder is heavy. OII and the program should continue their efforts to use available technologies to streamline these processes.

Fourth, equity ownership. OII should have the ability to receive a small amount of equity in the companies its capital invest in. SBICs have held debt stakes in many iconic companies. For instance, an SBIC in 1977 held over 4 percent ownership in a small technology company called Apple. Imagine if we had that 4 percent ownership stake today. OII should continue efforts to create ownership upside for American taxpayers through this program with equity ownership.

Fifth, more private sector partnerships. During my stint, teammates and I created a wonderful board diversity initiative called ONBoard, the Open Network for Board Diversity, with a partner, LinkedIn, the professional social network. There are many innovative private sector companies who would be partners in new opportunities that OII should be freer to pursue.

And, lastly, networking opportunities between funds and companies. OII is a natural clearinghouse for a wide variety of data it collects about its funds and the companies that it invests in, as you heard from my colleagues to my left. It should have, in my opinion, more open access to the data for industry observers, companies, funds, and analysts.

To conclude, there are improvements and opportunities that I could detail beyond that, but these are some that I saw that had great potential when I was at the agency.

And lastly, let me also mention the SBIA, or Small Business Investor Alliance. They are the industry association focused on the SBIC marketplace, as you heard Brett Palmer, their CEO, testify a moment ago. Their staff, management, members, and board were very helpful to me as I learned the program, and they were great partners for our initiatives. I can't thank them enough for their productive role in the ongoing success of the SBIC program.

Thank you for inviting me today. And now I and my colleagues are ready to help with any questions and comments you may have.

Chairman BLUM. Thank you, Mr. Walsh.

Due to Ranking Member Schneider's tight time schedule, I will reserve my time until the end. And I will now recognize Mr. Schneider for 5 minutes of questions.

Mr. SCHNEIDER. Thank you.

And, again, I want to thank all of the witnesses for being here and sharing your experience and your perspectives on a program that clearly is making a difference in communities across the country, in particular in the heartland, and we need to continue to do that.

I just want to take the opportunity to touch on one issue. I think one added value of the SBIC program is the leverage it provides, the ability to work with public-private partnership. But I know from experience, I know from your submitted testimony, that there are many other added-value aspects to this. For example, the involvement of the SBIC lenders with the portfolio companies. I would like to open it up and have you touch on some of those additional benefits that are provided to your portfolio companies.

Mr. PALMER. Let me start.

It is important, because this isn't just money. You are getting actual expertise. And I hear it all time from our members. We actually have recently partnered with Ohio State, their business school. There is something called the National Center for the Middle Market that GE Capital funded to train their portfolio companies. Well, GE Capital got broken up and went six ways to Sunday around the world. It got complicated. But they still had this training platform there.

We have now partnered with Ohio State, and actually today one of these trainings sessions is going on, where portfolio companies of SBICs are able to attend, and it is a platform for training them how to scale up their business, how to attract talent, how to retain talent, how to really grow their business and scale up in a professional, organized way. And that is something that we are doing and in a really concise, organized, dedicated feature just for SBIC-backed businesses. And that is going well. That is one example of one of the things that we are doing.

Mr. PAINTER. I think that is a really important example. The small businesses we invest in, they don't need to invent new strategy. I mean, they know how to run their business, they know how to manufacture their product or deliver their service.

What they haven't done before is scale that business. So they need tools to learn how to do that. It is basic stuff, basic blocking and tackling. We actually have four of our operating company professionals at the Ohio State event this week, and we have two of our internal people there so that we can help learn ourselves better how to train our other companies.

And that is one thing we are focused on, is we have right now one full-time operating partner, so somebody who has run a small business that is now working with four of our companies to help them with their growth and putting in the frameworks that are needed to help grow a business. And we are committed to growing that platform.

That is a key point, that it is not money. The money is important. That is the driver of us coming in. But we also have to provide more value than just dollars to make an impact.

Mr. SCHNEIDER. Mr. Kolln.

Mr. KOLLN. And we are, as a small fund, and even by SBIC standards a small fund, we are almost always the first institutional capital, the first, other than family money, that has been in the businesses that we invest in. Sometimes they have never even had a bank loan before.

So it really is the first kind of outside capital, outside advisors, outside board members that they take on in these businesses, and it is a big step toward professionalizing them. And one of the key things we do is help them add the management talent and complete the management team that is there to help run and grow the business.

Mr. SCHNEIDER. Mr. Walsh, as you go, as you give your answer, also touch on how to try to expand the outreach to more minorities and women-owned businesses.

Mr. WALSH. Fair enough. If I just might say, if you read the press, it seems like all this money is going to, like, hip companies in Silicon Valley and for the next Snapchat or whatever. But, in fact, the gentlemen to my left and the men and women who work with them are on the front line of entrepreneurship. These are first-time investors in the lunch bucket companies that make this Nation great. These are companies that aren't that sexy in many cases, but they are the people and the places that employ people sustainably. So that is my answer to the first part.

To the second part of your question, it really ended up being just going out there and shaking the tin cup. I mean, my colleagues and I, during my stint, literally went to every conference, every gathering, ads in newsletters, met folks like the men to my left and other men and women, and just tried to reach out to gender and racially diverse fund management. And more importantly, tried to exhort and encourage those funds to find companies that were owned and operated by diverse management teams.

And a final point. This ONBoard initiative that I mentioned was a way to get diverse directors into those private companies, because a lot of times these companies had a board of directors that all the last name, because they are a family-owned company. So when they were trying to expand the expertise of their board of directors, we would tell them to search our area on LinkedIn for the resumes of domain expertise people with diverse backgrounds and gender diverse and racially diverse elements to bring those people on the boards of directors.

Mr. SCHNEIDER. I think that is important. Oftentimes, these companies have their board meetings when they shave. And so it is important to expand that.

Mr. PALMER. Actually, one thing I would like to add to that, Mr. Schneider, if it is all right, is we have tried very hard to do that, and there is more to be done. Over the course of 9 years, our chair of the board, four of our nine chairs of the board, are women. In the private equity industry that is unheard of. That is not 50 percent, but it is progress. There is some more to be done.

And Mark, who did a fantastic job when he was running the program, did push that, and more can be done. I think one of the barriers, too, as far as the fund manager side is new funds coming in, it is a risk to go through this regulatory process that really is the size of a telephone book with hundreds of thousands of dollars of expense. You want to make sure you can get through it.

And so it is reputational risk, it is personal financial risk. Having some clarity as far as what that is and getting that streamlined would really benefit getting a broader range of gender, race, and geography from where we don't have it now.

Mr. SCHNEIDER. Great. Thank you. And my time has long expired, but thank you for your answers.

I yield back.

Chairman BLUM. Thank you, Mr. Schneider.

I will now recognize myself for 5 minutes.

Mr. Walsh, I did the mental math. I think 4 percent of Apple today would be about $40 billion that we would have.

Mr. WALSH. I think a tad less, but it is a heck of a lot of money, Mr. Chairman.

Chairman BLUM. I will take a tad of 40 billion.

Mr. Palmer, I think you mentioned in your testimony that we are experiencing our best loss rates ever. What are those loss rates? I was on a billion-dollar bank board for 15 years and I was Chairman of the Director's Credit Committee. So if our loan loss ratio ever got really low, sometimes we would ask: Are we taking enough risk or taking enough chances in loaning money?

Could you address both?

Mr. PALMER. That is an excellent question.

The losses are the lowest, and the program has run at zero subsidy for a long time, and that is good, ever since Congress reformed that back in the 1990s. It is a mark of industry pride that has been able to maintain that zero subsidy, we want to take that case.

The measure that shows up as far as the losses is annual charge. The SBA charges a fee on the leverage as a calculation to offset what they think the loss history has been. It is now down to 22 basis points on top of the leverage.

Frankly, there is a little bit of industry concern that that maybe is too low, one, from a loss side; but, two, also making sure—look, everyone likes low fees, but we want to make sure we are maintaining that zero subsidy rate.

And so that 22 basis points which is calculated is low, and that is fine, but that is assuming that things are going to keep going the way they are now, which is great guns. So maybe we want to take a look at relooking at that fee and maybe setting a floor on that fee so that there is always enough of a cushion in the future to maintain a zero subsidy rate.

But the investments themselves, because of the private capital being the first loss position, you have to lose all your own money first before the taxpayer money is exposed, which is different from 7(a) and 504. It really does align things in a good way as far as making good decisions and makes it hard to lose money. It is not that it is not possible. You can do it. People have risen to that challenge.

Chairman BLUM. Including the federal government.

Mr. PALMER. Including the Federal Government.

Quite, frankly, this is a case study in the Federal Government working. And that doesn't get much attention too often. But this really—it really is.

And so the loss rates are very low. They could do more risk, frankly. One of the things that they did was cleaning up the licensing program to minimize risk in 2008—2009, 2010, really, which was really helpful in filling this massive capital void that existed back then.

But at the same time, we ought to be taking a look smaller funds. It is harder to get a big fund in a smaller State, Rocky Mountain West and others, and the smaller funds are riskier. So maybe the program does need to look at allowing some smaller funds to more rural areas, smaller cities, to facilitate their market where a $200 million fund might be too big.

But having funds in Boise or in Portland or in Colorado, there are no SBIC funds in Colorado. I mean, that is a pretty big State. There are investments there. But we need to get more smaller funds out to some of these smaller cities and smaller towns across the country.

Chairman BLUM. Thank you.

Mr. Kolln, a lot of Members on this Committee represent rural areas. I am one of them. You are from my district. Can you talk to me a little bit about the challenges, if there are unique challenges, I assume so, in rural district, rural lending, rural startups versus urban areas?

Mr. KOLLN. The biggest challenges in rural areas are just that you don't have the concentration of companies. You don't have as many companies. You don't have as many managers to hire to start companies and to help grow companies. So it is really the challenges are finding businesses, finding enough businesses to make a fund work.

And that is why, as Mr. Palmer mentioned, we run a smaller fund. And I think you have to be willing to run smaller funds. And the SBIC program is a great way to do that to be able to invest in these smaller areas.

But the challenges are finding the businesses and finding talent and to help the companies grow.

Chairman BLUM. Thank you. My time is about expired. I have more questions, so I will do it in a second round of questioning.

I would now like to recognize the Ranking Member of the Subcommittee on Health and Technology, my colleague from Florida, Mr. Lawson, for 5 minutes.

Mr. LAWSON. Thank you very much, Mr. Chairman.

And thank you all for being here.

And I am real happy to see the collaboration between Tallahassee and Jacksonville. It is quite interesting. Districts separated by 200 miles.

But recently, in the last couple of months, we have had women-owned businesses before the Committee, and minorities, women before the Committee. And the staff has told us that women-owned businesses are the fastest growing businesses in America. But each one of those groups came in, and they complained about access to capital.

And I was wondering, just listening to the testimony this morning, it would appear that there must be some other factors involved other than the business people coming in saying they need access to capital, how they had to go to uncles, aunt, grandparents, and so forth. I thought maybe you could share some light on why this exists.

And I will tell you the reason why. In 1978, when I left coaching at Florida State, and I spent some time in Iowa, University of Iowa, needing just $10,000, and going from place to place trying to get those $10,000 to go into business. That was 39 years ago. Today, I don't think that should be an issue for most people, even though I was able to eventually get it.

And so what is going on? I don't want to talk too much because I got some other questions to ask. But what is going on about access to capital for women and minorities today, Mr. Palmer?

Mr. PALMER. There are challenges for all small businesses. They are particularly acute for women and minorities, no question about it. And if you look at the numbers, that bears it out.

It varies on a number of ways. The SBA, I am not an expert in all of SBA's program, but you are talking about $10,000-type sizes, they have a micro loan program that serves that. That is sort of below the scale of where the SBICs are. Most of the SBICs are generally investing in businesses with a million dollars or more. So, I mean, every small business would love a million dollars or more. But some of them can't absorb it yet.

I think some of it is not knowing who to reach out to, sort of the human circles associated with this. And this goes to Mark's comment about reaching out. Reaching out to a broader array of small businesses in communities. The SBA needs to get out there. The fund managers need to get out there and do more.

There was actually a hearing on the Senate side on this issue a couple weeks ago, and one of the things they mentioned, which is a true problem, which is if a small business is women owned or minority owned, in many cases they can lose that classification if they get institutional investment into them, which doesn't help them. Many of them are accessing government contracts and things, and most of the investments aren't in government-contract related businesses.

But that is an unintended consequence for accepting outside capital that is designed to help them to fulfill a capital access gap, and now they are being sort of hurt by it. So there is some tweaks that could be made to address some issues like that.

Does that change the underlying issue? No. I think the biggest thing is just getting out there and beating the bushes, more to Mark's statement. And Mark has really been committed to this, to do more of it.

The chair of our board, her fund, by design, invests more than half of her fund, it is called Ironwood Capital in Connecticut, in women and minority and low income areas. So it can be and is done, but it isn't done universally.

Mr. LAWSON. And Mr. Walsh, you stated that in Washington, D.C., you say that this is one of the best advocates for businesses and stuff, than anyplace else.

How did this compare with—and I know I don't have much time—but minority and women-owned business access to capital that you observe on the research that you all are involved in?

Mr. WALSH. Well, it is one of these questions that is always worth pursuing as vigorously as possible, because it is not only a question, it is a mandate. It is a proven fact that corporations that have diverse boards of directors, gender and racial diversity, perform better, their stock price performs better than companies that don't. So to not have a diverse board of directors and a diverse outlook is actually hurting your shareholders.

But to get to access to capital, investors look at risk. They look at the risk of where they are going to put their dollars and what the outcome will be. And the challenge that we saw in SBIC, to some extent, but also the SBA, for these women-owned businesses and minority-owned businesses, is that they needed to be better, bluntly, at describing their risk and their ability to scale up. Because an investor wants to see a company that will scale up and increase in size, have more employees, grow revenue.

So the SBA has done a good job, but I think we can never rest on any laurels in helping those companies build their business plan, describe what they do, and help make the case to investors that they can grow and scale, because otherwise why would they would take investment and why would an investor write a check?

So there are some women-owned venture capital firms, there are some minority-aimed venture capital firms that chase deals that are—companies that are run by minorities or women management teams. I think we can never have enough of those, and I think the SBIC program actually encourages more of those than currently exist, and that is why the public-public partnership element is so key.

Mr. LAWSON. Okay. With that, Mr. Chairman, I yield back.

Chairman BLUM. Thank you, Mr. Lawson.

What kind of a year is Florida State basketball going to have this year?

Mr. LAWSON. They should be great. We didn't do well right now in football, but I am looking forward to them doing better this year.

Chairman BLUM. Thank you very much.

I would now like to recognize my colleague from Kentucky, Mr. Comer, for 5 minutes.

Mr. COMER. Well, thank you, Mr. Chairman.

My first question is for Mr. Painter. Are the regulations that SBA has in place to oversee the SBIC program working? And are they sufficient for the size of the program?

Mr. PAINTER. So I think if you go back to 2009, there were roughly 315 SBICs. Today there are roughly 315 SBICs. And there has been a shift in terms of the number of debenture SBICs.

I do think there is adequate oversight. I think there are some fixes that can be made with us working with SBA on some just practical changes in the licensing process and oversight process where you have some well-intentioned standard operating procedures that have unintended impacts.

As an example, we close roughly one new investment per month. And just because of the way licensing is set up, we would have been in perpetual standstill and not able to get licensed if we didn't get a special waiver in the licensing process, because when you make a new investment, you have to refile your application. So by definition, we would have just been perpetually filing every month.

Some I think there are some commonsense changes that can be made within the standard operating procedures that can really help improve the efficiency and oversight.

Mr. COMER. Okay.

Mr. Walsh, you described the licensing process and the amount of paperwork as being heavy. Are there improvements that can be made in the program to address the concern and the bureaucracy?

Mr. WALSH. So as I mentioned in my testimony, it was my first job in government, and I was shocked, shocked, I tell you, to find that there is a lot of paperwork in government.

Mr. COMER. Me too.

Mr. WALSH. So it is said.

I think the organization has made progress in allowing these documents to be digital so that the access is able to be granted to specific sets of the applicant and other parts of the SBIC team. So digitizing all the documents actually is step A.

Step B is making those documents standardized across various elements. I mean, you just heard an example where a fund is asked to start the cycle over every single time.

So I know this sounds maybe too simplistic, but having what they call data rooms, where digital access to the types of data and having the actual forms that you fill out be digitized, so you can fill them out online, track them online, you the applicant, and then the folks at the SBIC program, that, I think, would go a long, long way to shrinking the amount of time and effort and paperwork to getting approved.

Mr. COMER. So how does the SBA interact with the SBICs with respect to the licensing process? Beyond licensing, how do they work together?

Mr. WALSH. Well, the licensing process can take anywhere from 3 to more than 3 months. It is typically around 8 or 9 months, I think, was the average when I was there, to get approved. Then the fund has access to our capital. Every month or, as was mentioned, every quarter, they put a full report out of what they have done. And then at least once every 2 years, typically every year, we have an on-site visit by one of our analysts, physically visit the offices and make sure they are for real.

I think our oversight is about as good as anybody in the private sector. You heard earlier, I am not sure if you were in the room, about the loss ratio being so low. I think that the teammates that I had when I was there were about as careful as I have ever seen, and I spent a lot of time in the private sector.

So I am not sure it needs a lot of tweaking. In fact, I think we might even see gearing back a little bit because the loss ratio is so low.

Mr. COMER. Okay. Thank you.

Mr. Chairman, I yield back.

Chairman BLUM. Thank you, Mr. Comer.

I now like to recognize the Vice Chairman of the full Committee, my colleague from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Great to be with you.

I am just kind of curious. I am kind of familiar with SBICs, but I was reading here in some of the information about it that SBIC invests in established businesses using a debenture SBIC to fund expansion.

Can you explain that, how that works?

Mr. PALMER. Sure.

Mr. LUETKEMEYER. Debenture is not a loan. It is more like a security.

Mr. PALMER. Yeah. Well, the way the program works, the leverage is at the fund level. So the SBIC raises, say, just make the numbers easy, $50 million. It goes through a licensing process. It then can access this credit facility through the Federal Home Loan Bank of Chicago, a temporary basis. And then every 6 months they take all of this credit facility, all the money, all the obligations that have made to the credit facility, they get pulled together, securitized, and sold into a trust, and the government guarantees that. And that is where those debenture are.

The form the capital goes to the actual small business can go in several—can come in several different varieties. It can be straight equity, it can be debt, it can be convertible debt, it can be all sorts of all different structures in there, some of which are recourse, some of which are not. But that is the basic gist of the debenture.

Mr. LUETKEMEYER. Because you are taking, really, a first dollar in in a lot of risky investments here, what kind of loss ratio do you experience with SBICs?

Mr. PALMER. The way it is structured, unlike the 7(a) and the 504 program where there is a loss sharing in the first dollar loss, all the private capital is lost before the taxpayer money is exposed, and there is ongoing review of the portfolio both on a quarterly basis as well as on an every investment basis as well as on an annual basis to make sure that if the fund is going sideways the SBA does have the capacity to cut off further access to leverage or if there is regulatory noncompliance.

So the losses are very, very minimal. And actually the program is actually run to zero subsidiary because of the fees associated with the program since the late 1990s when Congress reformed all the SBA programs. It is actually the lowest loss ratio they have had in the 59-year history of the program.

And there is an annual charge that they add to the SBA charges on the leverage that is now only down to 22 basis points. The historical low on that was 28 basis points, and the historical norm is closer to 70 basis points. So it is really, really low, maybe even too low of a loss rate.

Mr. LUETKEMEYER. Well, that was going to be my next question, is I see here with Mr. Kolln, he says something about AAVIN received between 500 and 1,000 inquiries a year, yet only finances roughly four to six small businesses a year. So if we don't experience any losses, are we really taking any chances? And we only have four out of six of 1,000 inquiries that are financed.

Can you explain that to me?

Mr. KOLLN. Well, I think that is due to two things. One is we get a lot of inquiries. A lot of them are not necessarily ones that match what we are trying to do.

Mr. LUETKEMEYER. What are you trying to do?

Mr. KOLLN. Or what we can do. They may be looking for a lot more money than we can provide. Or they may be—there are some businesses, if they are looking for not enough, too small an amount of money, it becomes difficult for us to do. Or the company doesn't have the growth prospects that we are looking for.

So we can't invest in every business that comes our way, and we physically only have so many partners and so much time. And once we get involved in the businesses, we are very involved with the management teams and counseling them and working with them. So we are just limited in the amount of businesses that we can invest in.

Mr. PALMER. And just so I was clear on that, I was talking about the loss to the taxpayer. That doesn't mean, necessarily, it is private sector losses. I mean, there are losses, too, where businesses are invested in and there is private capital that is lost.

So, yes, that does happen and it is common. It is not pervasive, obviously, but it certainly does happen regularly.

Mr. PAINTER. Well, the average loss rate at the fund level would be you are going to lose on roughly 5 to 10 percent of what you invest in. So not lose all of it, but on 5 to 10 percent of what you invest in, you will have some amount of loss on that.

Mr. KOLLN. And that is consistent with our experience as well.

Mr. LUETKEMEYER. Mr. Kolln, you are advancing funds here. Are you taking an active management role in these countries or an equity part in these companies, or are you just like a bank, just loaning money to them and kind of watching them from the sidelines?

Mr. KOLLN. It is typically a combination of debt and equity. And we are always involved at kind of an active board level with the companies. So we are not day-to-day operators. We back and partner with management teams. But we are active board members helping them with strategy, financing, treasury functions, and kind of overall——

Mr. LUETKEMEYER. You are like a venture capitalist where you will have somebody on the board?

Mr. KOLLN. Yes.

Mr. LUETKEMEYER. Okay. Very good.

I see my time has expired. Thank you, Mr. Chairman.

Chairman BLUM. Thank you, Mr. Luetkemeyer.

The Chairman of our full Committee just arrived.

Would the Chairman like to question? I can give you a couple minutes if you will like.

Mr. CHABOT. I will see.

Chairman BLUM. We will begin now our second round of questioning, and I would like to recognize my colleague from Florida, Mr. Lawson.

Mr. LAWSON. Okay. Thank you, Mr. Chairman.

I don't have any data in front of me, as a former business person, but if I were to guess, I would think that the financing rate for minority-owned firms is low because of the application process and a lack of technical assistance that is provided to these firms.

Can you all provide your thoughts on the assessment and if there is a need for technical assistance, not only in the application process, but throughout the entire process of becoming an SBIC?

Mr. PALMER. There are two different issues there. One is getting minority fund managers. And one of the challenges with getting more minority fund managers, and this applies to women too, is to get an SBIC license, you have to have basically been in a private equity fund before, and so you are sort of cycling from the same pool. And to get beyond and a more diverse range of fund managers, it is tough with the way that it is set up right now.

So technical assistance isn't necessarily going to help that. It will help a little bit as far as that there is greater surety in getting to the licensing process, but you are still drawing from a fairly small pool, as opposed to doing some things to recognize professional experience people have, either on the banking side or on the investment banking side, to get more fund managers in that are diverse.

On the actual businesses accessing the capital, that is a little bit all over the place. Some technical assistance there, getting them steered to the right places, whether it be a conventional bank loan, a micro loan, whether they need equity investment and other matters.

A number of years ago, I was doing one of these sort of Shark Tank-type things and helping small businesses. And there was a minority-owned business there that was looking for a couple million dollars. It was a third-generation business. And people were saying, "Oh, I would take this amount of your business," and that sort of thing.

And I went to the guy afterwards and said, "Don't give up a dime of your business. You don't need to give up a single drop of equity to get what you need to do. Don't lose control of your business. Here are 5 or 6 people you can talk to that can give you the capital you are needing for looking at your loan, that you need."

That is what that person needed. And frankly, it would have been bad had it been—he would have been taken to the cleaners if he had just gone with what people were sort of throwing out. Now, that is not how the actual transactions get done.

But, yes, there is more education needed and more understanding of how to access the right type of capital at the right time of your business' development. And we try to do more of that, and we probably can do more.

Mr. PAINTER. And it is a complex issue that I don't have the answer for. But I know for me personally, I have three daughters, and I know my oldest daughter asked me 3 years ago, we were talking about work, and I said, "Well, would you ever want to come into my industry?" And she said, "Well, I didn't know that was possible," because all she sees are men, and mostly white men, in my industry.

So I think for that what we have struggled at Plexus is when we are doing hiring process is to get diverse pools of candidates that we can interview. And we are now working on education programs with colleges so that people know that it is an opportunity.

I think another really important point is there is a treasure trove of data at SBA. And there is a group of really smart people in the education arena that would love to analyze that for public policy purposes and they can dig into issues like that. It is such a complex issue that without getting the best brains around the world to focus on it, I don't know that we can solve it.

So I would really encourage consideration of figuring out a way to unlock that data and allow people from the educational world and policy world to analyze the data so we can solve problems like that. And the data is there. It is just a matter of somehow unlocking it and having access to it.

Mr. LAWSON. Okay. And I have less than a minute, but I want to ask you a question because it is a big issue.

How does tax reform help small businesses?

Mr. PALMER. It helps a lot. I mean, the more small businesses can understand a tax code, use it efficiently, the more money they can keep to reinvest in their businesses, the better off they are.

The bill was just released last week, everyone is still going through the details, but our current tax system is Byzantine and antigrowth. And a reform that gets to a lower tax rate, that is simpler and pro-growth would be, I think, universally accepted and supported.

Mr. PAINTER. I think it is important, too, just the certainty around it. Again, taking it to the human level, when we go to board meetings and we are sitting in Orlando, Florida, with Design Shop, and you have people there that have real money, real parts of their lives at risk and they are being asked to make decisions about future spending, it is very difficult to do that with uncertainty about where taxes are headed. And if you give them clarity on a reduction in taxes, then they become more comfortable spending that money for growth.

Mr. LAWSON. Okay. Mr. Chairman, I yield back.

Chairman BLUM. That was a great question. Thank you, Mr. Lawson.

I now recognize myself for 5 minutes.

Mr. Walsh, I am intrigued by your background. I am a private sector guy myself. And this is my first gig, if you will, in government. And you are a private sector guy, served a couple years in government. Why did you serve in government?

Mr. WALSH. I knew my two predecessors in this job, knew them well from the private sector. In fact, I hired and worked with my direct predecessor. He told me this is the greatest hidden secret in the Federal Government. This was effectively the venture capital firm—or sometimes called the vulture capital firm—the venture capital firm of the U.S. Government. It was an incredible program. It was exciting to meet the type of people involved. And in fact, at the end you actually saw real impact in real people's lives with investment that made a difference in companies that matter to our Nation.

So not to get out the flag and salute it, but I thought if there was ever a place in the Federal Government where it would map against my background, and I could hopefully add some value, and I would see the outcomes being so fruitful, this was the place.

Final point. I told any lovely spouse that in the job everything I was hoping to see in government I saw times 10, and everything I was hoping not to see in government I saw times 10. So it was very, very eye opening to see all the great things that were happening.

And sometimes, as we have heard some of the testimony today, reflecting some of the grinding wheels of Government made it a little tougher than it would have been. But overall, it was aimed—I did it because it mapped against my background, to your point, I saw the outcomes being so positive. And, again, I wouldn't trade any minute in that job. I loved every single bit of it.

Chairman BLUM. As a private sector person, what kind of a grade would you give the SBA overall?

Mr. WALSH. The SBA or the SBIC program?

Chairman BLUM. Well, both.

Mr. WALSH. Okay.

Chairman BLUM. Both.

Mr. WALSH. I give the SBIC program an A minus. I think it needs some improvement.

The SBA program—boy, am I going to regret this, but thank you for putting me on the spot, sir—I think the SBA program is a B minus. And mean no disrespect to my professional colleagues at it. I think the SBA program, the other parts that we talk about, I think they need some improvement and some outcome improvements.

I think the SBIC is the shining—and I am biased—I think the SBIC, SBIR, and Accelerator programs are the shining jewel in the SBA family.

Chairman BLUM. Thank you. Do you grade on a curve?

Mr. WALSH. What is the best answer to give you, Mr. Chairman, to that?

Chairman BLUM. Thank you for being frank.

Mr. Palmer, I looked in your testimony, the distribution of SBIC, financing dollars by industry. Number one was manufacturing. Good to see. Good to see. We can use more of that in this country.

I was surprised by healthcare was one of the lower percentages as far as industry segment that is invested in. Can you talk about that? I mean, healthcare is a very dynamic and growing part of our economy, and I am just a little surprised.

Mr. PALMER. It is. And I was surprised by that, too. The numbers are what the numbers are.

We just gave an award for portfolio company of the year to a company in Tennessee. It was healthcare company that provided urgent care centers throughout Tennessee and I think in a couple in Kentucky, too, this little entity that went from 7 employees to 500 employees providing medical care where there wasn't any before.

So we certainly have some, and some great ones. But it is relatively low, and I don't fully know why that is. But a lot of it on the manufacturing side is generational transfer, where the founders are retiring and their management team is buying out the owner and reinventing the business. That is why there is a large number of manufacturing and applying new technologies. But on healthcare, I think Thies has something to add there, but I don't know.

Chairman BLUM. Mr. Kolln?

Mr. KOLLN. I think part of it is looking at the companies and the size of companies that SBICs are investing in, and we are investing in smaller companies. Healthcare is such a large industry that has huge, huge companies in it, and those companies, there aren't as many small businesses necessarily involved in it. And there are a lot of—there are just, pure numbers-wise, I think a lot more small manufacturing and service businesses out there. So the businesses that we as SBICs tend to focus on and invest in skew differently maybe than the economy as a whole.

Mr. PAINTER. Right. It is a much more developed industry on the medical side. It is a much more developed system for access to capital relative to manufacturing and service.

Chairman BLUM. I have got quite a few questions, so I guess your answers to this one would have to be brief. But I would like to hear from each one of you.

Give me what you think is the state of small business in America today. What is the health, the healthiness of small business in this country today?

We understand, to tag on to Mr. Lawson's great question, we understand that tax reform is going to help. We understand regulatory relief helps. We understand reducing uncertainty helps. We also understand a robust and growing economy helps. I get that.

But what is the state of small business today? Try to be somewhat brief.

Mr. PALMER. Sure, I will be quick. I think, summed up in a word, I think there is optimism. I mean, I think there really is a lot of hope that the government is actually working with them and some of the shackles are going to come off on regulatory and tax.

So when I am traveling the country and talking to folks, what I am hearing is a lot of optimism. There is always a certain level of business uncertainty. Business uncertainty business people can deal with. Political and regulatory uncertainty, they can't. So I think optimism is what I hear the most.

Chairman BLUM. Mr. Kolln.

Mr. KOLLN. I would second that, too. You stole my word, Brett. I think on the whole there is optimism. It is always tempered with caution. But I think we see businesses more eager to invest and grow now than they have been for a number of years, I think.

Chairman BLUM. Mr. Painter.

Mr. PAINTER. There is undoubtedly no better place to start and own a small business than the United States of America. That is why I love doing what I do. I don't know what the future looks like, but I know that you have resilient people focused on growing small businesses with an employee base that is a meaningful percentage of our economy. And we have plenty of things we can work on and get better with SBA and on our own, at individual funds, but it is healthy and it is thriving like it always has and like it always will.

Chairman BLUM. Mr. Walsh.

Mr. WALSH. People are pumped up. It is cheaper to start a business today because of technology and other tactics and tools than ever before. And you can start businesses cheaper in places that normally didn't used to have businesses.

So I think we have had sort of from cautious optimism, on the other end of the scale. I think people are really, really maximally pumped up. This is the place, it is cheaper to do, and there are tools and tactics and money available to help you grow.

Chairman BLUM. If I can just follow up on that. I find it interesting. Uncertainty, I agree, is one of the biggest impediments to expanding a business. You know what the rules of the game are going to be tomorrow, how you prepare for it, correct? What has changed as far as uncertainty to cause this optimism? What has changed to cause the optimism?

I mean, healthcare, I guess one could say, is probably we are more uncertain than ever on what is going to happen as far as healthcare goes. I am just curious——

Mr. WALSH. Yeah. If I can toss a thought out. In the last couple of decades, back in the day, if you left a large company which used to have a pension and a very secure environment, the old days of corporate environment, if you left to start a business and it failed, your record, your career was besmirched, right?

Today, in fact, failure is not a sign of a negative tint or hue of your career. In fact, failure for many investors is a sign of education. You learn a lot from failing.

So I think there is an element of risk that today's workers are able to have a higher appetite for, because it doesn't take as much money to start a business and you are not kind of ruining your career arch by trying it and having it not work out.

So the uncertainty of the capital structure, the uncertainty of your cost structure, the uncertainty of your tax structure, I think those are slowly getting better. But the uncertainty about your career is also something that has kind of, I think, been taken care of and made more positive.

Chairman BLUM. Anyone else on that?

Mr. PAINTER. I just think there is always going to be uncertainty. There is always risk in small business. So just simplifying the Tax Code so that people know the environment they are operating in, and the less complex we can make it so you don't have to hire teams of tax attorneys to help you figure out how you need to operate, the better.

Mr. KOLLN. And part of it is just the spirit of small business owners. Small business owners are optimists by nature. You don't start a small business and look to grow a small business if you are not optimistic about yourself and about your company in the future. So that is what is great about our industry and who we get to work with, is that there is a natural optimism there, and I think people in small business tend to try to see the future is bright.

Chairman BLUM. Speaking of not having as much of a fear of failure, I think it was Mr. Painter, in someone's testimony they mentioned out of 100 companies looked at, 1 qualifies for financing.

Tell me about the other 99. In general, I know each one is unique, but why don't they qualify? What are the problems with the other 99?

Mr. PAINTER. Right. So I think the best way to describe it would be is, if you think about the very mature market where public companies have access to all types of capital, you have hundreds of suppliers of capital that all have a different focus. They find their niches and they focus on it and they dominate it.

At the small end of the market, there are so many gaps. So when I go in to meet with a company I don't understand—there is probably 50 percent of them where we just don't understand enough about what they do to be able to take that risk. So I can't know everything about every industry.

So that is one piece. We have to focus in certain areas so that we can ultimately protect taxpayer dollars and also deliver a return to our investors.

Then you have companies that don't have the proper accounting files, that we have issues that come up all the time around accounting and we will think we are looking at numbers of X, then we find out it is X times 50 percent.

So there are just a lot of things that have to happen to close one transaction.

Chairman BLUM. Anyone else on that?

Mr. KOLLN. Yeah. I think of the 100 down to 1, I think the first 80 of the 99, it is just not a fit. As Mr. Painter said, they are either looking for a different type of capital than we are able to provide, they are looking for much more capital, much less capital, they are looking for more risky capital than what we are providing, or they are looking for more like a bank loan type of capital. So it is not a fit.

And then the other 20, it is either something peculiar to the company or just sometimes you just can't come to a deal. And it is just making a deal and sometimes it works and sometimes it doesn't.

Mr. PALMER. And just to be clear.

Chairman BLUM. Mr. Palmer?

Mr. PALMER. It is not that those 99 don't ever get funded. They might get funding from other sources. They just might be barking up the wrong tree and need to get to the right tree. So there is some of that, which also matters.

But, again, the approach, the preparation that people have—and this goes to Congressman Lawson's point earlier of the training—when you are approaching a professional firm for institutional investment, what is it you need to explain. You need to have a board, you need to have your books looked at internally, with a real hard look, you know, what is it you really want to do with your business.

And that isn't always sort of lined up coming in before they are approached. And so if you don't have your ducks in a row going in, your chance of success coming out are lower.

Chairman BLUM. When I am asked about—and this will be my last question—when I am asked about the health of small business, I often talk about a three-legged stool.

And the legs being, one, the economy in general. I always say small businesses don't worry about taxes if they are not making any money. So they need revenues and they need to make a profit, first and foremost. So an expanding, robust economy is so important to small businesses.

Second is the regulatory relief, which we are seeing now, because regulations really hit small businesses to a greater extent than large businesses.

And thirdly, tax, tax relief, if they do make a profit, so they can keep more of their business, capital in their business.

Am I forgetting anything there? Is it a four-legged stool, five-legged stool? What is also important?

Mr. WALSH. I would add people. I think access to folks where your business is located that are trained, that are motivated, that you can motivate through your salary or your bonus or your equity structure, and retaining those people.

I think something you have seen recently really pop up, certainly in Silicon Valley and some of the other sort of hotter places for startups, is the loyalty, that people are changing jobs rapidly.

So discovering, recruiting, training, and keeping people. I think what I would add, what I would suggest is a fourth leg.

Chairman BLUM. Anyone else? It is a good point.

Does anyone else up here have any further questions?

Mr. LAWSON. Mr. Chairman, I just want to state one thing, if I could.

Chairman BLUM. Mr. Lawson, you are recognized.

Mr. LAWSON. In Florida, they require the businesses to pay the intangible tax. But what I noticed, and I brought up to the legislature back then, it cost them more for the CPA than what the tax was, you know.

And so I filed a bill, and some people didn't quite understand, to up the amount, limit of the intangible tax beyond $25,000. Because I was doing it myself and I had to pay the CPA all this stuff, fill out all these papers, and so forth, and the fee was not as much as it was to pay the CPA, you know.

So I can understand exactly what you are saying, Mr. Walsh. But it was incredible what you have to pay the CPA just to do the intangible tax.

That is all I want to say, Mr. Chairman.

Chairman BLUM. Thank you, Mr. Lawson.

Once again I would like to thank everyone, especially our panelists, for being here today. I believe it is extremely important to hear from those working on the ground, on the front lines with these programs that we care so deeply about.

And as we continue to examine many of the SBA's programs, your comments will be most helpful. You play an important role in the ability of small businesses to grow and create jobs, so I appreciate you all taking time out of your schedule to be here with us today.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 11:18 a.m., the Subcommittee was adjourned.]

APPENDIX

Statement for the Record

By Brett Palmer
President, Small Business Investor Alliance

Hearing Entitled "Investing in Small Businesses: The SBIC Program"

The House Committee on Small Business
Subcommittee on Agriculture, Energy, and Trade

November 7, 2017

Chairman Blum, Ranking Member Schneider, and Members of the Subcommittee, thank you for the opportunity to testify today and for holding this hearing, "Investing in Small Businesses: The SBIC Program." SBIA's members are proud of their role in creating small business jobs and are thankful to Congress and the Small Business Administration (SBA) for supporting American small businesses.

The Small Business Investment Company (SBIC) Program, administered by the Small Business Administration (SBA), has broad support because the core features of the program address fundamental problems in the small business economy:

- We need more small business investment;
- We need to create more jobs here in the United States;
- We need to support jobs domestically and not outsource and offshore our economic dynamism;
- We need more investment in domestic manufacturing;
- We need to be very frugal and wise with the taxpayers' money and trust; and
- We need the government to serve Americans and their interests and not work against them.

SBIA thanks the members of the Committee for supporting small business investment and job creation by unanimously voting through the Committee—and then unanimously through the full House—the Small Business Investment Opportunity Act and the Investing in Main Street Act. If we are able to get these bills through the Senate, then more small businesses will be able to access growth capital.

My testimony is broken into three parts. The first section explains how the program works and why it has been so successful growing small businesses and creating American jobs. The second section covers common questions about the SBIC program. The concluding section covers some of the issues that would benefit small businesses if improved. I have also attached a recent non-partisan Library of Congress study on the extraordinary record of SBIC job creation; a small sample set of small businesses that have received investment in districts represented by members of this committee; and a state-by-state table of SBIC investment from 2012-2016.

The Small Business Investment Company Program Overview

It seems that only bad news gets attention, which does not make it easy for SBICs to get attention because SBICs are an American success story. For example, in 2016 SBIC invested a record amount, nearly $6 billion, in American small businesses. The program is having the best (lowest) loss rates in its 59-year history. There is currently unprecedented private sector interest in getting capital to small businesses via investment in SBIC funds. A recent Library of Congress study found that SBIC-backed businesses created 3 million new jobs and supported an additional 6.5 million jobs from 1995-2014 (a period that included the Great Recession and the tech bubble recession). These quiet successes were achieved while being the only major SBA program that was able to maintain its zero-subsidy rate - even through the Great Recession and Financial Crisis. With the help of Congress and SBA, SBICs have seen significant operational reforms to the program that have been producing positive results for the American small business economy.

SBICs are highly regulated private funds that invest exclusively in domestic small businesses. At least 25% of an SBIC's investments must be made in "Smaller Enterprises." (Smaller Enterprise are smaller than the SBA's normal small business standards.) SBA currently licenses two types of SBICs: non-levered SBICs and Debenture (levered) SBICs. Both forms of SBICs invest in growing domestic small businesses, with non-levered SBICs tending to provide more equity capital and Debenture SBICs tending to provide more debt capital.

SBIC leverage significantly increases the amount of money invested into the small business economy. The private capital forms the foundation of an SBIC fund. SBICs raise capital from accredited investors and institutional investors (pension funds, university endowments, banks, etc.). After the SBIC applicant raises private capital, the SBA applies a rigorous licensing regime. If the SBIC applicant meets the legal and performance criteria, then an SBIC license is issued. Once licensed, an SBIC is permitted to access a line of credit (SBIC debenture leverage) to increase the amount of capital available for investment. For example, an SBIC may raise $50m in private capital and then, after licensure, may access up to an additional $100 million line of credit, which combines for a total of $150 million. The leverage is provided at a zero-subsidy rate and is eventually paid back in full (plus interest and fees). All of this capital is to be invested in domestic small businesses and may not be used for "offshoring," relending, project, finance, or for purposes that are not in the public interest. Unlike many government programs, the private capital is in first-loss position, which means the private investors lose their money before the taxpayer is exposed to risk of loss. This is an important taxpayer safeguard and a key reason why the SBIC program has been able to maintain its zero-subsidy rate. The program is effective and distinct because the private sector leads with its capital and investment expertise and then SBIC leverage follows to augment the impact of the private investment. It is a mark of SBIC industry pride that the program continued to maintain its zero-subsidy throughout the Great Recession.

- Since 1958, SBICs have invested over $80 billion in hundreds of thousands of small businesses.
- In FY 2016, SBICs invested $5.99 billion in businesses that employ approximately 122,000 workers across the U.S.
- For FY 2016, 313 SBICs were operating across the United States, which is a similar number as were operating 10 years ago. These SBICs managed $27.8 billion in committed capital resources.
- Of the 1,210 U.S. small businesses that received SBIC financing in FY2016, 28% were located in Low-to-Moderate Income (LMI) areas of the country.
- The SBIC program has operated at a zero-subsidy rate since Congress mandated a zero subsidy in the late 1990s.
- A 2017 study by the Library of Congress found that the average small business backed by a Debenture (leveraged) SBIC Fund created approximately 125 new jobs and non-levered funds created an additional 530 new jobs.
- Levered funds tend to provide more debt capital and non-levered funds tend to provide more equity capital.
- From 1995-2014 SBIC-backed small businesses created over 3 million new jobs and supported an additional 6.5 million jobs – all of which were in the United States.
- Many icons of American industry were once small business that received critical growth capital from SBICs including: Apple Computer, Intel, Buffalo Wild Wings, Build-A-Bear Workshop, Callaway Golf, Costco, Federal Express, Gymboree, Jenny Craig, Restoration Hardware, and Staples.

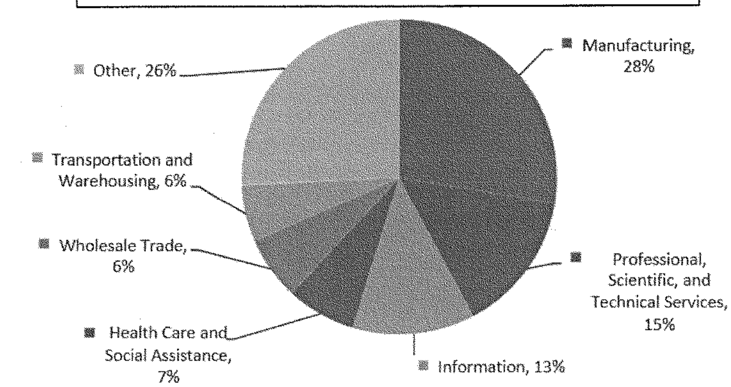
SBIC Frequently Asked Questions

How does the SBIC Program Help the Taxpayer and the American Public?
The SBIC Program helps the taxpayer by providing capital to growing small businesses that in turn hire more employees, invest in capital improvements, and generally grow the economy. A 2017 study by the Library of Congress found that one new job was created for every 35 dollars of taxpayers' money spent administering the program. (The leverage operates at zero subsidy, but there are still some administrative costs.) Correlation is not causation, but there is no doubt that the ability of successful small businesses to access growth capital empowers them to grow and hire more employees.

SBIC investments are made in areas of the country and in industry sectors that are commonly overlooked by conventional venture capital and private equity. The overwhelming percentage of venture capital is invested in Northern California and the New York to Boston corridor. While SBICs do invest in those areas, SBICs invest most of their capital in places other than this investment footprint. For example, 28% of SBIC investments are in areas certified as Low-Moderate Income. Even SBICs that are primarily located in population centers regularly invest well outside of their local area so the SBIC program helps move capital to underserved areas – both urban and rural.

SBIC investments are commonly made in industry sectors largely passed over by many conventional venture capital and private equity funds, including manufacturing and asset-light services businesses.

Distribution of SBIC Financing Dollars by Industry FY 2010-2014



** Numbers will not add to 100% due to rounding.*

Is the SBIC Program Effective?

- Yes. Multiple studies, including a 2017 Library of Congress study (attached) have found the SBIC program is very effective at supporting growing small businesses and creating jobs.
- It could be even more effective with broader benefits to more communities with modest reforms.

Is the SBIC Program an Efficient Use of Capital?

- Yes. It is one of the most efficient, job-creating programs within the government. According to a 2017 Library of Congress study, only $35 in administrative government costs were associated with creating each new job. There were only $11 in administrative costs for each additional job supported. Further, the fact that the SBIC Program's leverage has successfully sustained its zero subsidy for so long is a testament to its operational effectiveness and efficient use of capital.

Is SBIC Investing the Same as Bank Lending?

- No, SBIC investing and bank lending are very different.
- SBICs provide education, training, and professional guidance that banks generally do not provide.
- Banks are often only able to provide conventional lending to a small business *after* an SBIC has invested in a small business.
- SBICs provide long-term capital that empowers small businesses to survive and recover from the inevitable surprises that can happen in business.
- SBIC capital can be in the form of debt, equity, or both.
- Banks and SBICs collaborate, but offer different types of capital so they do not compete.

Does SBIC Investment Displace Conventional Bank Lending?

- No. Banks are partners, not competitors.
- Banks are often only able to provide capital after a business has received SBIC capital because the SBIC capital changes the capital structure of the business and thereby makes it more "bankable."
- Over 500 banks, ranging from small community banks to large banks, are investors in SBIC funds.
- Some banks own non-levered SBIC funds and other banks are forming their own internal SBIC units to provide equity capital that the banks cannot otherwise provide.
- If small businesses could access this capital from banks, then they would get bank loans because there are thousands of banks and conventional bank lending is less expensive.

	Bank	SBIC
Provide Debt	Yes	**Yes**
Provide Equity	No	**Yes**
Provide Convertible Debt	No	**Yes**
Provide Unitranche Capital	No	**Yes**
Can revoke capital on 30 to 60 day notice in the event small business hits a snag or if there is a macroeconomic disruption?	Generally, Yes	**No**
Are loans required to be fully collateralized?	Generally, Yes	**No**
Cash Flow Lending	Limited	**Yes**
Able to provide Capital to businesses that are not otherwise bankable	No	**Yes**
Commonly has a Formal Role on the Board of the Small Business	No	**Yes**
Provides Management Assistance to Help the Small Business Grow and Have Good Governance	No	**Yes**

Does the Government Own Any Part of these Small Businesses?

- No. The government does not invest in or own any portion of any small businesses.
- There was a time (1994-2004) when the government effectively participated in the ownership of some types of SBIC funds, and therefore the small businesses, but that program ceased licensing funds in 2004.

Is the Government a "Limited Partner" in SBIC Funds or Does It Own a Part of the SBIC Fund?

- No. The government manages access to and guarantees a private sector credit facility, but is not a "Limited Partner." The government is in a more advantaged position than the private sector limited partners.
- The SBA does not own an interest in SBICs or their portfolio companies.

- The SBA stopped being a "fund of funds" and stopped being a "Limited Partner" with the end of licensing funds where the government participated in the profits (and losses) in 2004.
- The SBA is a regulator and a guarantor of credit facility.

Can the 7a and 504 programs do what the SBIC program is doing?

	SBA 7a	**SBA 504**	**SBA SBIC**
Government (Taxpayer) Guarantee on Each Investment	Yes	Yes	**No**
Must the small business have collateral or a personal guarantee to loan against?	Yes	Yes	**No**

Does the Government Choose Which Small Businesses Receive Capital?
All SBIC investments are made entirely by the private sector via investing professionals without the government's involvement. Investments are made for real economic reasons. SBICs invest in growing small businesses and then notify the SBA which small businesses received capital after the investment has been made. There are size standards and other basic requirements and taxpayer protections that must be adhered to, but government involvement stops there. The program is successful at creating jobs and growing small businesses because it allows the private sector to find the businesses with the greatest growth potential and direct capital to them.

What Happens if an Investment Underperforms?
A single SBIC will invest in many different small businesses. Unlike the 7a and 504 programs, when a single investment underperforms or loses money, only private capital is lost, not taxpayer guaranteed capital (leverage). The profits from the other investments cover the losses from the isolated underperforming investment(s). If the profits from the other investments are inadequate to cover all the losses, then the private investors' capital is lost before taxpayer money is at risk. There is generally a large private capital cushion that would need to be burned through before the taxpayer guarantees would be realized. Even if the guarantees would be used, SBIC funds pay an annual fee on their leverage that is designed to offset losses and maintain the statutorily-required zero subsidy rate. SBA can cut off SBICs from accessing additional leverage or trigger an orderly liquidation process run. Even if a fund is ordered into orderly liquidation, it does not necessarily lose private capital or realize losses for the taxpayer.

What Built in Accountability Exists in the SBIC Program?
There is extensive accountability built into the program. Private capital being in first-loss position is a very effective accountability tool because there is no "gambling with other people's money." Private capital being in first-loss position is an important, built-in taxpayer safeguard. The SBA has reporting

obligations that ensure the SBA is fully apprised of the health of the fund, and the funds receive independent audits plus SBA examinations. The SBA can cut off underperforming SBICs from further leverage and can even require disgorgement if an investment does not meet the SBA's statutory and regulatory requirements. SBA can require an orderly wind down of the SBIC and limit compensation. In extreme cases, SBA can remove the fund managers.

Are Repeat Licensees a Good Thing?

Repeat licensees are exceptionally good for the small businesses and the taxpayer. Repeat SBICs specialize in small business investing, which is good for small business, the SBA, and ultimately the taxpayer. SBICs are only able to receive an additional license if their previous fund was a success and the private sector was willing to commit its own money first. The private sector leads, and only then can a license be issued. The market speaks before the SBA licenses. Keeping successful fund managers in the program and culling poor performers is one of the reasons the program has been so good at growing businesses and has been able to sustain its zero-subsidy rate. Congress recognized the importance of repeat licensees by raising the "family of funds limit" to allow more successful managers to continue to invest more money into more growing small businesses. The GAO studied this issue in 2016 and found repeat licensees were far less likely to be put into an orderly wind down than first time funds.

Is the SBIC Program Stress Tested and Sound?

The Great Recession and Financial Crisis were a real-life stress test. Unlike other SBA programs, the SBIC Debenture program was able to maintain its zero-subsidy rate. Further, many small businesses were able to survive the Great Recession because they were backed by SBICs. Banks were forced by their regulators to pull lines of credit from thousands of small businesses, which then failed. SBIC-backed small businesses benefitted from the longer-term capital provided by SBICs and had a much better chance of surviving.

Opportunities for Improvement

Licensing

Licensing is down over 40% (year over year) and has slowed considerably since January. This drop off was not caused by lack of private market interest in investing in SBICs. To the contrary, there is record institutional interest in investing in domestic small businesses via SBICs. As many polls have pointed out, small business optimism has been inspired by this Administration. In the face of this licensing slowdown, licensing staff have been loaned to disaster loan processing, which will further slow licensing. Fund managers, even repeat SBICs, are uncertain as to what is required for licensure or how long it will take. This is particularly foreboding to smaller funds and funds that are not in financial centers for whom taking the risk to form an SBIC is a very big personal, professional, and financial risk. This lower licensing rate is likely a leading indicator of reduced future investments in small businesses. To quantify what this slow down and confusion means, there is currently nearly $1 billion of private investment for small businesses that is in licensing limbo, and some private institutions have pulled out of investing in new Small Business Investment Companies.

The licensing process for repeat licenses, which the GAO recently studied and found to be much less risky, should be clear and relatively fast because these fund managers are well known to SBA and have a history of performance and compliance. However, the licensing process for all funds, even repeat SBICs has slowed. For example, to pass the "Green light" phase of the licensing process used to take two weeks but now requires a 4-6-month advance notice before filing the application, and then it will take several more months to get a decision. These new built-in delays do not apply to new fund investors with whom the SBA has no direct experience and has never regulated before. To be clear, new funds are experiencing all sorts of new delays too, but they are different delays. SBICs would like a return to a clearer, faster process so they can increase small business investment, which would seem very much in line with President Trump's pro-jobs, pro-small business, pro-manufacturing, America-first economic agenda.

Similarly, the Investment Division's committee process has become protracted for performing licensing interviews, licensing reviews, and approving leverage. The committee reviewing license applications used to meet regularly (often weekly), but now meets irregularly with meetings and interviews being rescheduled more often than occurring as scheduled. The committee chair has ceased the decades-long practice of actively participating and attending nearly all the interviews for licensure. Lack of consistent scheduling, attendance, and constructive engagement have added unnecessary delays. When the committees do meet, the agenda is commonly not followed and key decisions are regularly not made or repeatedly postponed. Additional delays have been caused by new internal policies that the committee performing interviews must now give a minimum of 28-day notice before internally scheduling a licensing interview, and the committee no longer is allowed to deliberate and decide immediately after the interview while the information is fresh in their minds. There is now a mandatory delay period before the matter can be discussed and decided, which runs counter to private sector best practices and creates more unnecessary delays. Even when licensed, actual documentation of being licensed is taking an additional several months. Scheduling delays are compounded by more and more scheduling delays. The industry has not seen delays of this magnitude since 2007-2008.

Licensing Recommendations

SBA should return to a more timely licensing process, particularly for repeat licensees whose tracks records are already very well-known and documented with the SBA. SBA should also return to having regularly scheduled meetings. Both the industry and the SBA would benefit from clearly articulated timelines and applicant feedback.

Finally, SBA should provide a more complete picture of what is happening in the licensing process by regularly reporting data that recognizes the numbers and timeframes for applications and similar regulatory requests that have been "set aside" or otherwise sit in procedural limbo and may not be showing up in the system now.

Examinations

SBICs are regularly examined by private, independent auditors. In addition to these conventional audits, SBA performs additional regulatory examinations. Delays in these examinations have significantly increased this year, particularly recently. For example, the year-over-year number of exams performed is down 35% as of SBA's most recent data release (June 30, 2017), and cycle times are up 33%. These numbers are worse for leveraged funds. From January 1, 2017 to June 30, 2017, examination cycle time for leveraged funds has increased from 10.8 months to 16.6 months. The delays in examinations do not mean the SBIC has never been examined before (they likely have many times), or that the SBA does not have insights about what is going on in the SBIC, because SBICs still file reports after every investment and provide detailed quarterly and annual reports to the SBA. SBICs have no control over when examinations take place, and yet SBICs are being frozen in licensing or in securing leverage commitments because the SBA has not performed a recent enough examination.

Examination Recommendations

SBA deserves credit for having recently contracted out some of their examinations. SBA recently made another positive reform by allowing SBA examiners to perform multiyear exams instead of doing multiple single-year exams. SBIA would also suggest that for SBICs with multiple licensees that examiners should try to examine all licenses at the same time to reduce disruption to the SBIC's operations and to reduce wasting SBA's travel budget and human resources. We encourage Congress to support SBA's efforts to get caught up with the examinations, and we ask that this Committee maintain its oversight role to make sure the examinations backlog is improving. Finally, SBA should recognize that SBICs have no control over the timing of their examinations and should not penalize SBICs for matters that are solely under SBA's control.

SBIC Program Transparency

SBIC data has become less transparent and more outdated. The 504 and 7a programs release their data weekly, but the SBIC program releases its data quarterly, and then holds the data back for nearly two months before releasing it. This data used to be released monthly in the first few days of the new month. Further, SBIC program data and reports have been removed from the SBA website.

SBIC Program Transparency Recommendations

The SBICs do not need weekly data like the 7a and 504 programs, but the program data should be made available in a timely fashion. SBIA believes this data should be released no later than two weeks after the reporting period ends with the reporting period being no less than quarterly. SBA should return to posting the information on the SBA website. SBA also should release the 2016 SBIC Program Annual Report that was completed at the beginning of FY 2017 but is still unpublished.

Informational Technology (IT)

SBA staff cannot serve the public as effectively as the public deserves without the tools to do the job efficiently. SBA deserves credit for undertaking an effort to make IT improvements, and SBIA asks Congress to support their modernization efforts.

Operations

The Investment Division's Operations section is run by experienced managers and frontline staff who regularly engage directly with SBIC fund managers as their primary regulatory contact. Many of these SBIC-Regulator contacts have become less constructive because the SBA staff are no longer clear about what they are allowed to do and what are the current policies or interpretations. This is not because they are not competent but because policies and practices are changing without advance notice to the SBICs or the staff. Without formal communication to them or the industry it is very difficult to provide informed regulatory guidance. This is currently happening with the proposed TechNote 7b, which has been proposed but not finalized. Despite not being finalized, it is being enforced much to the surprise of SBICs and some SBA staff.

Operations Recommendations
The Investment Division should provide clear polices and guidance to both SBA staff and SBICs with realistic timelines for completing tasks. Communication of changes before they go into effect would also be very helpful to both the SBA and the private sector. Finally, applying the rules with a greater degree of consistency and clarity would benefit both SBA and SBICs.

Conclusion
Thank you for considering the views of the SBIC industry. We thank you for your consideration of these matters. We also thank the SBA for their time and effort in working with SBICs to grow the small business economy. Without the support of the Congress, the SBA, and the private sector, this program would not be able to provide such a positive impact for the taxpayers.

I would welcome any question you may have for me.

SBIC Program
Financing to Businesses by State
Fiscal Year 2012 through Fiscal Year 2016
prepared: November 8, 2016

	FISCAL YEAR 2016			FISCAL YEAR 2015			FISCAL YEAR 2014			FISCAL YEAR 2013			FISCAL YEAR 2012		
State Name	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)
Alabama	8	7	71.4	9	3	21.6	7	6	42.1	11	4	47.6	5	3	34.2
Alaska	0	0	0.0	1	1	20.0	0	0	0	0	0	0	0	0	0
Arizona	79	26	95.5	57	24	82.8	33	21	84.7	19	11	30.7	14	11	27.7
Arkansas	5	2	6.5	28	5	57.6	11	1	2.8	9	3	10.3	10	2	2.4
California	483	192	1,041.3	438	196	1,016.3	297	151	765.7	194	113	457.2	247	137	480.1
Colorado	84	30	160.3	71	23	164.5	47	21	133.1	50	24	223.7	36	18	62.6
Connecticut	32	17	102.5	32	15	64.5	42	18	130.9	21	11	52.3	24	12	50.8
Delaware	9	3	20.3	5	2	27.0	5	5	9.4	5	2	6.5	7	2	1.4
District of Col.	5	3	6	0	0	0	1	1	0.3	2	1	0.5	9	5	15.6
Florida	176	62	418.5	217	74	476.6	136	52	335.1	63	37	181.3	100	44	179.2
Georgia	124	49	250.6	101	37	183.6	74	32	223.5	65	32	140.1	46	28	135.0
Guam	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Hawaii	0	0	0.0	1	1	0.5	3	1	1.6	0	0	0	1	1	2.5
Idaho	7	3	22.1	4	3	5.0	6	3	15.6	0	0	0	2	1	0.2
Illinois	222	70	386.0	172	52	244.5	118	49	252.2	101	70	188.6	108	68	189.9
Indiana	34	16	32.8	27	15	142.9	24	8	53.2	13	5	12.4	18	13	46.1
Iowa	4	3	18.6	1	1	1.8	6	3	23.4	6	3	17.2	9	6	20.4
Kansas	36	13	75.4	29	10	53.9	20	12	21.7	28	11	36.2	26	13	17.3
Kentucky	12	6	15.4	23	9	25.7	11	5	14.7	5	4	8.3	12	7	48.1
Louisiana	29	10	55.2	32	14	74.1	36	10	53.8	12	7	76.3	11	5	24.3
Maine	5	3	26.1	5	3	8.6	3	2	4.2	3	3	9.2	1	1	9.7
Maryland	36	12	61.3	32	17	126.5	18	12	33.4	23	12	23.6	15	10	52.5
Massachusetts	126	60	264.3	144	71	286.4	138	73	231.5	152	83	230.2	143	68	125.2
Michigan	44	21	107.7	83	36	254.4	18	12	82.1	31	21	95.8	24	18	80.0
Minnesota	83	29	145.3	55	26	165.7	54	26	166.3	32	18	66.0	35	20	110.3
Mississippi	22	3	21.5	7	2	6.4	2	2	23.4	0	0	0	17	14	1.7
Missouri	46	17	88.2	51	22	107.7	37	16	99.0	24	12	61.9	16	10	27.4
Montana	4	1	23.0	1	1	1.0	4	1	4.9	0	0	0	0	0	0
Nebraska	2	2	11.8	2	1	10.5	5	3	20.4	0	0	0	0	0	0
Nevada	12	2	16.7	16	4	53.5	6	3	29.6	1	1	0.3	2	2	0.8
New Hampshire	9	6	34.5	2	2	7.9	15	9	43.3	8	5	8.6	10	2	1.4
New Jersey	81	30	166.8	86	52	152.0	110	59	167.0	164	93	200.1	120	71	149.1
New Mexico	10	6	17.2	11	5	20.9	5	3	3.5	12	6	5.4	13	6	12.9
New York	247	123	373.1	183	108	329.0	236	139	506.1	283	211	366.6	226	172	261.8
North Carolina	114	40	164.5	140	41	198.8	137	49	271.5	61	30	110.0	33	22	96.4
North Dakota	16	4	15	0	0	0	0	0	0	5	2	4.3	1	1	1.5
Ohio	95	41	297.0	57	28	132.7	45	22	111.9	22	17	83.3	36	22	59.6
Oklahoma	32	12	52.1	40	15	65.2	31	9	36.7	12	3	13.4	20	4	15.6
Oregon	14	9	34.7	27	10	142.3	24	10	57.7	26	9	35.6	15	9	36.4
Pennsylvania	99	37	254.4	110	50	331.1	68	33	228.0	40	31	115.2	67	40	156.1
Puerto Rico	3	2	9	0	0	0	3	2	5.6	0	0	0	3	2	13.4
Rhode Island	4	2	15.7	6	2	6.1	6	3	10.6	10	3	23.0	3	3	4.0
South Carolina	36	16	98.4	14	7	38.5	33	13	73.2	13	9	20.6	16	7	10.9
South Dakota	2	1	0.4	2	1	8.5	9	3	30.4	3	3	14.6	0	0	0
Tennessee	44	19	100.2	43	20	73.6	41	21	137.5	45	18	65.4	36	15	78.1
Texas	273	107	527.4	269	108	701.9	237	85	538.2	136	70	262.9	182	111	348.6
Utah	57	34	90.8	71	40	125.4	39	21	129.5	34	18	34.9	72	31	39.2
Vermont	2	1	16.5	4	1	8.9	6	5	30.8	4	3	3.4	5	3	13.2
Virgin Islands	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Virginia	36	21	75.6	33	16	73.4	52	23	90.7	45	19	45.7	65	28	79.2
Washington	28	10	41.9	43	21	107.8	25	15	90.3	32	18	61.9	25	13	22.9
West Virginia	0	0	0.0	1	1	0.3	0	0	0	0	0	0	2	2	10.8
Wisconsin	29	17	78.0	29	14	79.0	25	12	63.0	21	12	47.1	19	11	70.8
Wyoming	2	1	4	0	0	0	0	0	0	0	0	0	0	0	0
	2,962	1,201	$5,991.7	2,815	1,210	$6,285.5	2,309	1,085	$5,464.6	1,846	1,068	$3,498.3	1,907	1,094	$3,227.4

Sample of Small Businesses Invested in by Small Business Investment Companies

Member	State	District	Small Business	Business Description	SBIC Fund
Chairman Steve Chabot	OH	1	Colerain RV	Recreational vehicle retailer	NorthCreek Mezzanine
			Exposition Services LLC (d/b/a Fern Exposition)	Service contractor for events	NorthCreek Mezzanine
Rep. Steve King	IA	4	NutriQuest	Agricultural products producer and researcher	Capital Alignment Partners
Rep. Dave Brat	VA	7	Home Care Delivered	Medical supplies delivery	Tecum
			eServicesLLC	Natural gas logistics, trading, and marketing	Plexus
			ncgCARE	Behavioral healthcare provider	NewSpring Capital
Rep. Steve Knight	CA	25	Pharmaceutic Litho & Label Co.	Pharmaceutical labeling	Ironwood Capital
Rep. Trent Kelly	MS	1	Winston Plywood & Veneer	Plywood mill and products manufacturer	GarMark Partners
Rep. Rod Blum	IA	1	RuffaloCODY	Enrollment and fundraising management for higher education and nonprofits	AAVIN
			Happy Joe's Pizza and Ice Cream	Pizza parlor chain	AAVIN
			Henderson Products, Inc.	Municipal snow and ice control equipment manufacturer	Eagle Private Capital
Rep. Jennifer González-Colón	PR		EDIC College	For-profit higher education institution	Renovus Capital
Rep. Don Bacon	NE	2	PRIMUS Sterilizer Company, LLC	Sterilizer equipment manufacturer	Blue Sage Capital
Rep. Brian Fitzpatrick	PA	8	Lynn Electronics	Data and Telecommunications products manufacturer	NewSpring Capital
			Atlantic Diagnostic Labs	Microbiology, chemistry, toxicology, immunology, and virology testing lab	NewSpring Capital
			MPD Holdings	Chemical manufacturing	Plexus Capital
Rep. Roger Marshall	KS	1	PRIMUS Sterilizer Company, LLC	Sterilizer equipment manufacturer	Blue Sage Capital
			KBK Industries	Fiberglass reinforced plastic tank supplier and oil recovery specialist	Main Street Capital
Rep. Ralph Norman	SC	5	Sunbelt Thread & Packaging Inc	Packaging material and automated packaging provider	Kian Capital
Rep. Dwight Evans	PA	2	City Taphouse	Restaurant chain	Balance Point Capital
			Saxbys Coffee	Coffee chain	Plexus Capital
			Cellucap Manufacturing	Disposable, protective safety apparel manufacturer	NewSpring
Rep. Stephanie Murphy	FL	7	Avant Healthcare	Registered nurse staffing agency	LFE Capital
			American In-Home Care	Senior home health care	Kian Capital
			DesignShop Services	Custom trade show exhibits and displays fabricator	Plexus Capital
			Girard Environmental Services	Commercial landscaping and maintenance	NorthCreek Mezzanine
			Florida Autism Center	Autism therapy and behavioral development centers	Resolute Capital Partners
Rep. Al Lawson	FL	5	BP Express	Intermodal transportation services	Tecum Capital
			Florachem Holdings	Pine, citrus, and plant-based chemical goods producer	Plexus Capital
			TrueNet Communications	Telecommunications service provider	Eagle Private Capital
Rep. Alma Adams	NC	12	Reagents, Inc.	Laboratory chemicals and chemical solution provider	Tecum Capital
			SPATCO Energy Solutions	Liquid energy handling equipment provider	Kian Capital
			Agility Recovery Solutions, Inc.	Business disaster recovery consultancy	Plexus Capital

			Huseby Inc.	Global litigation support services	Plexus Capital
			TITAN Technology Partners	Global cloud hosting and managed services	Plexus Capital
			Carolina Beverage Group	Contract filler for national and international beverage brands	Plexus Capital
Rep. Brad Schneider	IL	10	Spire Hospitality	Property management	Kian Capital
			Sayers Technology	Technology solutions consultancy	Merion Partners

Small Business Success Stories with the Help of Small Business Investment Companies

NutriQuest, Mason City, IA

NutriQuest, founded in 2007, is a manufacturer and researcher of nutritional and non-nutritional products, services, and technologies for the agriculture industry. NutriQuest's portfolio offers research-based feed additives, probiotics, protein technologies, nutritional quality and value monitoring services, water quality products, and humane euthanasia technology, among others that improve production performance for the agriculture industry at the best costs possible.

In March 2015, Capital Alignment Partners, based out of Nashville, TN and Newport Beach, CA, invested in NutriQuest to finance the purchase of the company by NutriQuest's management team. When Capital Alignment Partners made the investment, NutriQuest had employees numbering in the low 30s. Today, the business employees over 50 people.

NutriQuest has a customer base of over 4 million sows in the United States and is growing in the both the U.S. and international poultry and ruminant sectors.

Happy Joe's Pizza and Ice Cream, Bettendorf, IA, with numerous locations

Happy Joe's is a family-run chain pizza parlor that was founded in 1972 in the Village of East Davenport, IA, with a loan provided by the Small Business Administration. The company provides franchise opportunities and is philanthropically active in its communities with Happy Joe's Kids Foundation, which strives to meet the needs of children with development disabilities and delays and special needs. Today, in addition to a multitude of pizzas including their famous Taco Pizza, Happy Joe's offers pastas, sandwiches, salads, and ice cream, among a variety of other foods, all in a family-friendly setting.

In October 2016, Cedar Rapids, Iowa-based private investment group AAVIN served as the financial investment partner for developing a new ownership model for Happy Joe's. This new ownership model will enable the company to expand their locations, create more jobs, and acquire other regional pizza chains to do the same.

As of today, Happy Joe's has 50 stores across seven states, including Iowa, Missouri, Illinois, Wisconsin, Minnesota, North Dakota, and even Arizona.

Henderson Products, Inc., Manchester, IA

Henderson Products, Inc., was founded in 1946 in Cedar Rapids, IA as a manufacturer of agricultural attachments and spreading equipment. Later in 1958, Henderson moved to Manchester, IA. All of Henderson's products are manufactured in their 175,000 square foot facility in Manchester.

In 2009, Eagle Private Capital, based out of St. Louis, MO, made an investment in Henderson to facilitate further growth. When Eagle invested in Henderson, it was a leading manufacturer and up-fitter of heavy-duty truck equipment used by municipalities for snow removal and ice control.

Eagle partnered with Cameron Holdings, a St. Louis-based family office investor focused on acquiring, building and operating middle-market manufacturing, industrial service and value-added distribution companies across a broad range of end markets, to grow Henderson. Cameron purchased Henderson, and Eagle made an investment of debt and equity.

At the time of Eagle's investment, Henderson employed 225 people. Around the time of Eagle's exit in 2013, Henderson created 95 jobs and grew its revenue by over 15%.

Florachem, Jacksonville, FL

Florachem was founded in 1988 by Steve McAllister, who had spent more than 10 years working for a large chemical company. During his time at that company, McAllister established relationships to supply U.S-based small businesses with specialty chemicals used in manufacturing processes. These specialty chemicals include aroma chemicals and essential oils to provide fragrance and flavor.

In the years following Florachem's founding, Plexus Capital, based out of Charlotte, NC and Raleigh, NC, made an investment to grow the company. At the time of the investment, Florachem had 16 employees that served more than 200 small manufacturing customers across the United States. Plexus exited Florachem in 2007 and today the company has more employees with additional locations now including Newark, NJ, Springfield, MO, and Mission, TX that serve distribution partners in over 20 countries.

Spire Hospitality, Deerfield, IL

Spire Hospitality is a full service third-party hospitality management company with more than 5,870 keys under management across 20 hotels operating under a variety of well-known domestic hotel brands.

Spire began in 1980 as Lane Hospitality, and quickly gained prominence as outstanding owners and operators of quality hospitality real estate assets. This success and experience empowered the company to continue growing into the strong company it is today. In 2012, AWH Partners, a NY-based real estate investment firm with its own extensive background in the real estate and hospitality industries, acquired Lane Hospitality. This new company was then rebranded as Spire Hospitality.

In December 2015, Kian Capital, based out of Charlotte, NC and Atlanta, GA, made an investment to finance recapitalization of the company and provide growth capital. This investment is continuing to spur the growth initiatives Spire strategized, including creating more jobs and expanding services.

LIBRARY OF CONGRESS

Measuring the Role of the SBIC Program in Small Business Job Creation

A Report Prepared by the Federal Research Division, Library of Congress under an Interagency Agreement with the Office of Investment and Innovation, U.S. Small Business Administration

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1948 – 2017

PREFACE

The U.S. Small Business Administration (SBA) oversees the Small Business Investment Company (SBIC) Program, which provides an alternative source of financing for small businesses lacking access to adequate capital from traditional sources, such as banks and credit unions. Since the program's inception in 1958 through December 2015, SBICs have deployed US$80.5 billion in capital (two-thirds from the private sector) into approximately 172,800 financings.[1]

The goal of this report is to contribute to a deeper understanding of the role that the SBIC Program has played in creating and sustaining jobs in the small business sector using data collected exclusively by the SBA under the SBIC Program. The report addresses key questions concerning the number of jobs created and/or sustained by the program.

The SBA's Office of Investment and Innovation (OII) contracted with the Federal Research Division (FRD) of the Library of Congress for an independent evaluation of the SBIC Program. FRD provides customized research and analytical services on domestic and international topics to agencies of the U.S. government, the government of the District of Columbia, and authorized federal contractors on a cost-recovery basis.

FRD enlisted the aid of two experienced scholars with particular expertise in financial markets to perform this research:

- Dr. John Paglia is a professor of finance at Pepperdine University's Graziadio School of Business and Management, and founding executive director of the Peate Institute for Entrepreneurship. Dr. Paglia also founded and directed the Pepperdine Private Capital Markets Project, which examines the demand for capital by and financing success rates for business owners. The project also examines investments by private equity groups, venture capital firms, and mezzanine funds (among more than a dozen other types of financing), including activity in the lower-middle market, which is defined as the market segment containing businesses with between US$5 million and US$100 million in annual revenues.

[1] U.S. Small Business Administration (SBA), *Offering Circular: Guaranteed 2.507% Debenture Participation Certificate, Series SBIC 2016-10 A*, March 14, 2016, 7, https://www.sba.gov/sites/default/files/SBIC_2016-10A-cusip-831641-FF7.pdf.

- Dr. David T. Robinson, a professor of finance and the J. Rex Fuqua Distinguished Professor of International Management at Duke University and a research associate at the National Bureau of Economic Research. Dr. Robinson has published several papers in the fields of entrepreneurial finance, venture capital, and private equity, and has conducted a number of studies that analyze the conditions and performance of the financial sector serving young and small businesses, both on the equity side and on the debt side.

The analysis in this report is based on 1995–2014 SBIC data from SBA Portfolio Financing Report (SBA Form 1031) filings, which are submitted by SBICs within 30 days of closing on a financing, and SBA Annual Financial Report (SBA Form 468) filings, which are audited and submitted by SBICs annually. The authors used personal interviews, surveys, and external data sources to augment and validate the data where possible to build the fullest picture possible of the investment behavior of SBIC funds.

This report represents an independent analysis by FRD and the authors, who have sought to adhere to accepted standards of scholarly objectivity. It should not be construed as an expression of an official U.S. government position, policy, or decision.

The SBA makes no representation as to the analysis or calculations performed by the Library of Congress or its employees or contractors and reported in this study. The SBA has not verified the analysis or calculations performed in this study. This study was conducted by third parties not affiliated with the SBA and is intended to be independent from the SBA.

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OVERVIEW OF FINDINGS

One of the core missions of the U.S. Small Business Administration (SBA) is to help Americans start, grow, and build their own businesses. The SBA's Small Business Investment Company (SBIC) loan program assists in these efforts by harnessing "the talent of professional investment fund managers to identify and finance promising small businesses."[2] These small businesses support jobs across a diverse set of industries, including manufacturing, transportation, and technology. For this reason, the SBA approached the Library of Congress's Federal Research Division (FRD) to assess the following about the jobs created and/or sustained by the SBICs and portfolio companies participating in the program:

- How many jobs have been created by companies that received funding from SBICs?
- How many jobs have been sustained by companies that received funding from SBICs?
- How did the rates of job creation vary according to the type of SBIC that provided the funding?
- How many jobs have been created or sustained per dollar of SBIC financing?
- What have been the government administrative costs associated with the jobs created or sustained?

Statistical analysis of the SBA's data concerning SBICs has yielded the following answers to these questions:

- The SBIC-funded small businesses in the sample used in this report created almost 3 million jobs during the sample period (October 1995–December 2014). This figure is based on observations from 11,681 SBIC-funded firms.
- The SBIC-funded small businesses in the sample used in this report created or sustained almost 9.5 million jobs during the sample period. *Jobs created or sustained* is an expanded scope of job creation that includes not just the jobs that were added after a firm received SBIC funding, but also those jobs that were maintained in these businesses during the time the companies received such funding.
- Companies funded by non-leveraged SBICs (those that are licensed with the intent of never issuing leverage, which include bank-owned SBICs) created the most number of jobs during the sample period, at 530 jobs per firm on average. Businesses funded by SBICs in the SBA's participating securities program created the second highest, at 438

[2] SBA, *The Small Business Investment Company (SBIC) Program Overview*, last updated February 24, 2016, https://www.sba.gov/sites/default/files/files/SBIC_Program_Executive_Summary_2016.pdf.

jobs per firm. Debenture-funded companies created an average of 125 jobs per firm, while businesses financed through the specialized SBIC (SSBIC) created an average of 22 jobs per firm. On average, employment in small businesses funded by these SBIC programs grew by 45.6 percent.

- On average, one new job was created for every US$14,458 of funding invested through the SBIC Program, while an average of one job was created or sustained for every US$4,525 invested. Restricting the analysis to only those firms financed through active licensees, the authors found that one new job was created for every US$16,340 invested, and one job was created or sustained for every US$4,603 of SBIC funding.

- Between 1999 and 2015, the net government administrative cost[3] was about US$0.0024 per dollar of funding deployed, or US$2,400 of government administrative cost for every US$1 million of capital deployed. This, in turn, means that the average administrative cost was approximately US$35 per job created, and about US$11 per job created or sustained.

These findings indicate that SBIC-funded small businesses are a robust source of job creation in the U.S. economy. Yet, the averages reported above mask a tremendous amount of firm-level heterogeneity in job creation.

While the findings in this report show that SBIC-funded small businesses are an important source of job creation, the authors must acknowledge several important caveats and inherent limitations in this analysis. Because the SBIC data only track firms during the time that they are receiving SBIC funding, it is possible that these businesses change their employment patterns after those funds go away. This could result in an over- or under-counting of the current employment numbers in these companies. The authors also do not know the total amount of capital that these businesses received from other sources—funding from banks and other capital providers could be important for many portfolio companies. The SBA only began tracking the size of the round or deal in which the SBIC participated as part of its financing form in 2013, so that they could better understand the contribution to the total financing by SBICs. Based on the analysis, the authors found that, on average, SBICs contributed around 40 percent of the total financing received in each financing round or deal since the SBA started tracking this figure.

[3] SBA provided administrative costs on the SBIC program from its program overviews. Administrative costs include the direct costs from the operating budget, including contracts, compensation and benefits, but may not include agency wide costs, such as rent and telecommunications and indirect costs. SBA also provided the administrative fees it collected to offset its administrative costs. The net government administrative cost was calculated by subtracting administrative fees from the administrative direct costs identified in its program overview.

A small number of SBIC-funded companies grow to become important job creators, but most do not. Indeed, this finding comports with broader patterns of employment in the small-business sector. A growing body of economics research has stressed that most small businesses do not create jobs; instead, most analysis suggests that a relatively small number of firms is responsible for a relatively large fraction of overall job growth.[4]

Finally, at a conceptual level, it is difficult, if not impossible, to know what employment in these companies would have looked like in the absence of SBIC funding. Thus, it is hard to attach a causal interpretation to the numbers presented here. The statistics on how many dollars were required to create a job should be interpreted with these caveats in mind.

[4] For example, see Erik Hurst and Benjamin Wild Pugsley, "What Do Small Businesses Do?" (NBER Working Paper 17041, National Bureau of Economic Research [NBER], Cambridge, MA, 2011), http://www.nber.org/papers/w17041.pdf; John C. Haltiwanger, Ron S. Jarmin, and Javier Miranda, "Who Creates Jobs? Small vs. Large vs. Young" (NBER Working Paper 16300, NBER, Cambridge, MA, 2012), http://www.nber.org/papers/w16300.pdf; and Manuel Adelino, Song Ma, and David T. Robinson, "Firm Age, Investment Opportunities and Job Creation" (NBER Working Paper 19845, NBER, Cambridge, MA, forthcoming).

BACKGROUND ON THE SBIC PROGRAM

Description of SBICs

The SBA was established in 1953 to promote the development of small businesses by providing "loans, loan guarantees, contracts, counseling sessions and other forms of assistance." The organization's authorizing legislation was the Small Business Act, which created the agency to "aid, counsel, assist and protect, insofar as possible, the interests of small business concerns." In 1958, the Small Business Investment Act created the SBIC Program, under which the SBA "licensed, regulated and helped provide funds for privately owned and operated venture capital investment firms."[5] The U.S. government designed the program to provide debt and equity financing to high-risk small businesses lacking access to adequate capital from traditional sources.[6] Since the program's inception in 1958 through December 2015, SBICs have deployed US$80.5 billion in capital (two-thirds from the private sector) into approximately 172,800 financings.[7]

How SBICs Work

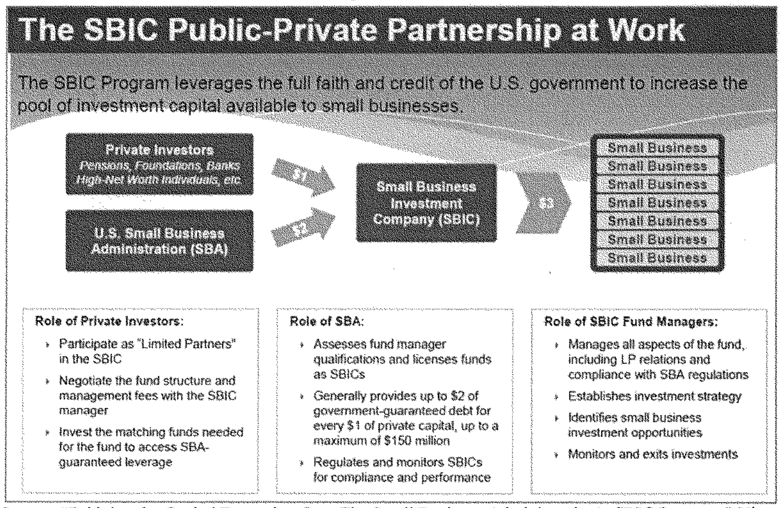
Fund managers submit applications to the SBA for licenses to operate SBICs, which typically combine equity investments from private investors—such as pensions, foundations, banks, and high-net-worth individuals—with government-guaranteed debt financing from the SBA. In the process, SBICs leverage their equity capital, resulting in a capital structure (debt-plus-equity financing) that reduces the weighted average cost of capital and boosts returns on equity. The U.S. Congress permits the SBA to guarantee leverage, known as debentures, which are issued to SBICs for up to three times the amount of private equity (although in most cases the limit is set at twice this amount).

The SBIC, typically formed as a limited partnership, invests in a portfolio of small businesses. When formed as a limited partnership, an SBIC—itself a limited partnership—has a general partner that manages the operations of the fund and limited partners who are passive investors. As the investments play out and the SBIC winds down, it repays its debt to the SBA and shares

[5] SBA, "History," accessed April 7, 2016, https://www.sba.gov/about-sba/what-we-do/history.
[6] SBA, *The Small Business Investment Company (SBIC) Program Overview*.
[7] SBA, *Offering Circular: Guaranteed 2.507% Debenture Participation Certificate*, 7.

its profits with the investors (see fig. 1).[8] See Appendix II for a full description of the SBIC life cycle.

Figure 1. SBIC Public-Private Partnership



Source: "Bridging the Capital Formation Gap: The Small Business Administration's SBIC Program," Vimeo video, 57:07, from the Association for Corporate Growth, April 12, 2016, https://vimeo.com/162594659.

SBICs enable SBA-guaranteed leverage up to two times the amount of private capital, subject to caps of US$150 million and US$350 million for, respectively, individual funds and families of funds.[9] As a result, SBIC business licensees are subject to various investment criteria. The most important criterion is that SBICs must invest in small businesses, which the SBA defines (solely for the purpose of the SBIC Program) as those having less than US$19.5 million in tangible net worth and an average net income for the preceding two years of less than US$6.5 million. The SBA also counts small businesses that comply with the agency's size standards in terms of the

[8] SBA, *The Small Business Investment Company (SBIC) Program Overview.*
[9] SBA, *The Small Business Investment Company (SBIC) Program Overview.*

number of employees or average annual receipts, as calibrated according to industry.[10] These standards are set out in the North American Industry Classification System (NAICS).[11]

The SBIC Program is a particularly attractive investment target for the banking industry for two reasons. First, it is exempt from the Volcker Rule, a provision of the Dodd-Frank Wall Street Reform and Investor Protection Act that prohibits banks from owning hedge or private equity funds.[12] Second, investments in SBICs may qualify for Community Reinvestment Act credits since they are presumed to promote the economic development of all members of a community, including residents of low- and moderate-income neighborhoods.[13] Increased bank participation in the SBIC Program in recent years has steadied investment demand, according to *American Banker* magazine.[14]

Currently Active SBICs

As of September 30, 2015—the end of the U.S. government fiscal year (FY)—there were 303 licensed SBICs, of which:

- 205 belonged to the ongoing debenture program (generally with a focus on later-stage, mezzanine, and buyout investments using primarily debt and hybrid financing),[15]
- 46 belonged to the discontinued participating securities program (with a high percentage of early-stage investments using equity financing),
- 43 were non-leveraged (generally with a focus on early-stage and later-stage equity investments), and
- 9 belonged to the discontinued SSBIC program (with a focus on minority-, women-, and veteran-owned businesses using primarily loans).[16]

[10] Compliance with Size Standards as a Condition of Assistance, 13 C.F.R. § 107.700 (2009); What Size Standards are Applicable to Financial Assistance Programs?, 13 C.F.R. § 121.301 (2016).
[11] SBA, "Summary of Size Standards by Industry Standard," last updated February 26, 2016, https://www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/summary-size-standards-industry-sector.
[12] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5535 (January 31, 2014).
[13] Federal Deposit Insurance Corporation, "Interagency Questions and Answers Regarding Community Reinvestment," last updated April 20, 2014, https://www.fdic.gov/regulations/laws/rules/2000-6750.html.
[14] Shane Kite, "SBIC Revival: Why Interest from Banks is Way Up, As the Volcker Rule Looms," *American Banker*, April 28, 2014, http://www.americanbanker.com/magazine/124_04/sbic-revival-why-interest-from-banks-is-way-up-as-the-volcker-rule-looms-1066822-1.html.
[15] Five SBICs in this group have an early-stage focus.
[16] SBA, *Small Business Investment Company (SBIC) Program Overview as of September 30, 2015*, accessed September 30, 2016, https://www.sba.gov/sites/default/files/files/WebSBICProgramOverview_September2015.pdf.

For a more detailed explanation of these SBIC programs, see the glossary in Appendix I.

Costs of the SBIC Program

Since the beginning of FY 2000 (October 1, 1999), the SBA has operated the debenture SBIC Program at zero subsidy. The agency accomplishes this by charging SBICs 3 percent up-front fees and annual fees on the leverage balances. The SBA formulates these fees each year, spreading the costs of riskier strategies, such as early-stage investments, across the investment portfolio. As of September 30, 2015, the total amount of private capital and SBA capital at risk in the SBIC Program was approximately US$25.3 billion.[17]

Previous Findings on Job Creation by the SBIC Program

The first of SBA's three strategic objectives, as outlined in its FY 2014-18 Strategic Plan, is Strategic Objective 1: "Growing Businesses and Creating Jobs"[18] (The other two were meeting the needs of small businesses and serving as their voice). Given the primacy of job creation to the SBA, it is important to examine how well the agency is doing in this critical area.

Underpinning the SBA's current claims regarding job creation is the *1999 Arizona Venture Capital Impact Study*, which was conducted by the Zermatt Group. This study concluded that US$122.2 million of venture capital invested in Arizona businesses in 1997 would generate a company revenue total of about US$800 million through 2002. Therefore, every dollar of venture capital investment resulted in US$6.54 in revenue returns over a five-year period. In addition, the investment led to the creation of 3,400 jobs.[19] The ratio of investment (US$122.2 million) to jobs (3,400) was US$36,000.

Relying on the Arizona study, the SBA publishes estimates of the numbers of jobs created or sustained by the SBIC Program at the end of each fiscal year explicitly based on the assumption that "[one] job is created for every US$36,000 of . . . investment (adjusted for inflation)." However, it is not advisable to extrapolate from this metric: It is dated, geographically limited to one state, and focused only on venture capital, which excludes the SBA's late-stage investment

[17] SBA, *Small Business Investment Company (SBIC) Program Overview as of September 30, 2015.*
[18] SBA, "SBA Strategic Plan, Fiscal Years 2014–2018,", https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_2014_-2018_Strategic_Plan-1.pdf.
[19] Justin M. Cook and Sean M. Nevins, *1999 Arizona Venture Capital Impact Study* (n. p.: Zermatt Group, 1999).

efforts. Nevertheless, as of the end of FY 2015, the SBA claimed on this basis that the SBIC Program had created or was sustaining 129,749 jobs—a 15 percent improvement from the previous year.[20]

In 2012, researchers affiliated with the U.S. Census Bureau's Center for Economic Studies and George Mason University published a study designed to establish whether "SBA loans create jobs."[21] However, it should be noted that the study assessed the impact of other SBA loan programs—specifically, 7(a) loan programs for small businesses and 504 loans for certified development companies—than the SBIC program of interest here.[22] The study examined matching samples of SBA loan recipients and all U.S. employers from 1976 to 2010 with similar "firm age, industry . . . pre-loan size," and employment history characteristics. The resulting job creation metric was much more modest than the one for the *1999 Arizona Venture Capital Impact Study*, although the two studies are not comparable. The researchers found "little or no impact of loan receipt [on jobs] *per se*, but an increase of about 5.4 jobs for each million dollars of loans."[23]

This study is designed to explore the role that the SBIC Program plays in small business job creation based on the most recent data from the SBA's Office of Investment and Innovation (OII).

MEASURING THE ROLE OF THE SBIC PROGRAM IN SMALL BUSINESS JOB CREATION

Methodology

The SBA's OII, which manages the SBIC Program, provided FRD with its data on SBIC fund managers and portfolio companies in which SBIC funds were invested. The authors restricted

[20] SBA, *Small Business Investment Company (SBIC) Program Overview as of September 30, 2015.*
[21] J. David Brown and John S. Earle, "Do SBA Loans Create Jobs? Estimates from Universal Panel Data and Longitudinal Matching Methods" (CES Working Paper 12-27, Center for Economic Studies, U.S. Census Bureau, U.S. Department of Commerce, Washington, DC, 2012), http://www2.census.gov/ces/wp/2012/CES-WP-12-27.pdf.
[22] According to the SBA, "certified development companies (CDCs) are nonprofit corporations certified and regulated by the [agency], that work with participating lenders to provide financing to small businesses" ("CDC/504 Loan Program: Find a CDC," accessed April 29, 2016, https://www.sba.gov/loans-grants/see-what-sba-offers/sba-loan-programs/real-estate-equipment-loans-cdc-504/cdc-504-loan-program-find-cdc). However, the SBA has clarified that CDCs are generally, but not exclusively, nonprofit corporations.
[23] Brown and Earle, "Do SBA Loans Create Jobs?," abstract, 14.

their attention to data from October 1995 through December 2014. This data was shared "AS IS" with FRD; that is, as it was reported by SBIC managers to the SBA. The SBA makes no representation or warranty, express or implied, with respect to the content, completeness, or accuracy of the information provided.[24]

The SBIC data provided by OII included information collected from SBA Portfolio Financing Report (SBA Form 1031) and SBA Annual Financial Report (SBA Form 468) filings. The one-page Portfolio Financing Report contains financial and demographic data on small businesses prior to their receipt of capital support through the SBIC Program. The 22-page Annual Financial Report contains annual financials for each SBIC, including employment data on the loans and investments for each year they participate in the program. Schedule 8 of the annual report contains employment and any other general data on the portfolio companies. Copies of both the Portfolio Financing Report and Schedule 8 of the Annual Financial Report are provided in Appendices III and IV. The complete forms can also be found online at: https://www.sba.gov/sbic/sbic-resource-library/forms.

Number of Portfolio Companies Used in This Analysis

OII uses the SBA Portfolio Financing Report (SBA Form 1031) to assess various characteristics of small businesses, including employment, *before* their financing events. It uses the SBA Annual Financial Report (SBA Form 468) to assess changes in those companies *while* they participate in the SBIC Program.

To ensure that the analysis was based on the most accurate data possible, the authors excluded the data from portfolio companies that did not submit a Portfolio Financing Report, and only used data from October 1995 to December 2014. The authors also excluded financings that were related to the purchase of taxi medallions by excluding all portfolio companies in NAICS code 48531—these taxi financings were performed primarily by two or three SBICs but skew the measurement of job creation. The resulting data include over 11,500 portfolio companies that received investments from the various funds participating in the SBIC Program (see table 1).

[24] FRD employees and contractors signed confidentiality agreements, which stipulated they would not "publish, divulge, disclose, or make known in any manner" SBIC data.

Table 1. Number of Portfolio Companies Receiving Funding from SBIC Funds

Type of SBIC Fund	Number of Companies
Non-Leveraged	1,788
Debenture	5,596
Participating Securities	2,926
Specialized	1,371
Total	11,681

Occasionally, some portfolio companies may receive funding from different types of SBIC funds. For example, a company may receive financing from both a non-leveraged SBIC and an SBIC licensed through the debenture program. In such instances, that firm would be counted twice—once under each SBIC fund category. However, such instances are extremely uncommon; the analysis presented here is unaffected by excluding such firms.

Measuring Job Creation

For each portfolio company, an initial employment figure was established by recording the earliest available employment number reported on either the SBA Portfolio Financing Report (SBA Form 1031) or the SBA Annual Financial Report (SBA Form 468). Similarly, the last available employment figure was recorded as the final headcount for each firm.

If the employment data were missing from the first record of an individual portfolio company, the authors took the value from the next record, if available; otherwise, they set the initial headcount as equal to the final headcount in order to obtain a conservative measure of job creation. Similarly, if the final headcount was missing, they took the value from the penultimate record if it was available. These imputations expanded the available data but did not materially affect the calculations that were performed in the analysis.

These calculations gave rise to two distinct measures of job creation: jobs created and jobs created or sustained. The latter—jobs created or sustained—was computed by recording the final headcount for each company. The former—jobs created—was obtained by taking the difference between the final and initial employment figures listed for each company. This is a conservative measure of job creation inasmuch as a great many firms reported maximum employment levels that exceeded the final employment tally that was recorded. In that sense, job growth that was transient was not included in the calculation. Additionally, this figure does not account for jobs that were created or sustained indirectly.

In terms of interpretation, these two measures—jobs created and jobs created or sustained—are at the extreme ends of the job creation spectrum. On one end, jobs created is the appropriate measure of job creation under the assumption that the initial headcount for each portfolio company would have been sustained in the absence of SBIC funding: in that case, only the incremental employment reflects actual job creation. On the other end, if one were to assume that none of the jobs in the firm would have remained were it not for the SBIC funding that the firm received, then jobs created or sustained is a more appropriate measure of job creation because, in addition to the incremental employment, it also includes the jobs that were not shed over time. Accordingly, jobs created and jobs created or sustained can be interpreted as bounds on the amount of job creation that has occurred as a result of the SBIC Program. The facts at hand may place any specific case somewhere between these two poles, but they provide reasonable bounds on the amount of job creation that has occurred.

Measuring Total Investment

To arrive at a measure of the number of dollars invested per job created, this analysis also tracked the amount of SBIC funding that each portfolio company received. The SBA Portfolio Financing Report (SBA Form 1031) records the amount of debt, equity, and hybrid securities that each firm receives at each financing event. To construct the financing measures, the authors summed the total amounts of each type of funding that the individual companies received. Because this analysis did not attempt to compare individual SBICs with one another in terms of how many jobs were created, the authors aggregated data across SBIC funds in instances where multiple funds invested in the same portfolio company.

Measuring the Employment Impact of Investments

The final step of the analysis measures the employment impact of the SBIC investments by computing the ratio of the total dollars invested by the number of jobs created. Because most firms start small and stay small, though some do add many jobs, the analysis is aggregated down to the level of each SBIC investment program. This allows for a comprehensive picture of the role the overall SBIC Program plays in small business job creation.

MEASURING THE EMPLOYMENT IMPACT OF THE SBIC PROGRAM

Measuring Job Creation in SBIC-Funded Portfolio Companies

Table 2 reports the aggregated employment figures for SBIC-funded portfolio companies. The total initial employment in the sample was almost 6.5 million workers across 11,681 firms over a period of nearly 20 years. Summing up the last recorded employment count for all of the firms in the data yields a total of 9,457,965 jobs, which implies that a total number of 2,960,177 jobs were created between October 1995 and December 2014.

Table 2. Total Job Creation in SBIC-Funded Portfolio Companies

Type of SBIC Fund	Number of Companies	Total Employment			
		Initial	Final	Jobs Created	Jobs Created or Sustained
Non-Leveraged	1,788	1,517,224	2,465,657	948,433	2,465,657
Debenture	5,596	3,049,361	3,748,951	699,590	3,748,951
Participating Securities	2,926	1,860,879	3,142,195	1,281,316	3,142,195
Specialized	1,371	70,324	101,162	30,838	101,162
Total	**11,681**	**6,497,788**	**9,457,965**	**2,960,177**	**9,457,965**

Breaking the employment data out across the different types of SBIC funds shows a tremendous amount of variation in the numbers of jobs created and jobs created or sustained. For example, the participating securities program was responsible for funding businesses with the highest number of total jobs created (1,281,316), followed by non-leveraged funds (948,433), and then by debenture funds, whose portfolio companies created 699,590 jobs. Debenture-funded portfolio companies created or sustained the most number of jobs (over 3.7 million), with portfolio companies funded through the participating securities program coming in second at slightly over 3.1 million jobs. Non-leveraged SBIC funds created or sustained almost 2.5 million jobs during this period. Relative to the other SBIC programs, firms funded by the specialized program were associated with only modest aggregate employment.

One reason why the total employment figures across the programs differ is that the average firm size varies across the program types. This can be seen in table 3. While an average of 253 jobs were created and 810 jobs were created or sustained per firm, there was significant variation across the groups. Businesses financed by non-leveraged SBICs were the largest in terms of final employment, with 1,379 jobs created or sustained on average. Firms financed by SBICs from the participating securities program were the second largest, at 1,074 jobs created or sustained on average. Companies financed through the debenture program were a little bigger than half this size, at 670 jobs created or sustained on average, while firms financed through the specialized program were small by comparison.

Table 3. Jobs Created per SBIC-Funded Portfolio Company

Type of SBIC Fund	Number of Companies	Jobs per Company		Job Creation Rate
		Created	Created or Sustained	
Non-Leveraged	1,788	530	1,379	0.63
Debenture	5,596	125	670	0.23
Participating Securities	2,926	438	1,074	0.69
Specialized	1,371	22	74	0.44
Total/Average	**11,681**	**253**	**810**	**0.46**

The programs also differ in terms of the average numbers of jobs created and created or sustained. The final column of table 3 divides the number of jobs created by the initial head count to report a job creation rate. The non-leveraged and participating securities programs created the most number of jobs per job sustained, at over 0.6 jobs created per initial job, while the average across the whole sample was about one-half job created per initial job. The reasons for the differences in job creation may be attributed to the type of financings provided by each of these different funds. The next section considers the types of financings provided by these different SBICs.

Measuring Total Investment in SBIC-Funded Portfolio Companies

Table 4 shows that the portfolio companies in the sample across all SBIC programs accounted for a financing total of almost US$43 billion from October 1995–December 2014. Slightly over US$17 billion (40 percent) of that funding came through the debenture program. SBICs in the non-leveraged and participating securities programs each accounted for around US$12 billion (30 percent) of financing. The specialized program was small in comparison—$774 million (1.8 percent).

Table 4. Total Dollars Invested by Type of Fund and Security

Type of SBIC Fund	Number of Companies	Total Invested Overall by Security Type (in US$ millions)			
		Debt	Debt/Equity	Equity	Total
Non-Leveraged	1,788	$739	$2,274	$9,422	$12,435
Debenture	5,596	$7,311	$6,263	$3,607	$17,181
Participating Securities	2,926	$817	$2,280	$9,311	$12,408
Specialized	1,371	$487	$160	$127	$774
Total	**11,681**	**$9,355**	**$10,976**	**$22,468**	**$42,799**

The fact that the amounts of debt and equity vary according to the type of fund is a reflection of the different investment strategies commonly used by funds in each program. Not surprisingly, for example, the vast majority of financing provided through the debenture program is either debt or a hybrid of debt and equity—for example, mezzanine debt with warrants attached. The numbers also reflect the fact that, occasionally, funds operating under different programs may invest in the same portfolio company.

As shown in the table above, over 75 percent of the non-leveraged and participating securities financing dollars were in the form of equity, while less than 21 percent of the debenture and specialized financing dollars were through equity. These types of SBICs also showed the highest job creation rates, which is a reflection of the natural tendency for equity investments to be more common among higher risk, higher growth companies, while debt investments are more common among lower risk, lower growth companies.

Measuring the Employment Impact of SBIC Funding

Table 5 provides a calculation of the ratio of SBIC financings to jobs created and jobs created or sustained. The bottom row of the table shows that, across the board, SBIC programs invested a total of approximately US$14,500 per job created, while a little over US$4,500 was invested per job created or sustained.

Table 5. Ratio of SBIC Dollars Invested to Jobs Created and Jobs Created or Sustained by Type of Fund

Type of SBIC Fund	Number of Companies	Ratio: Total SBIC Financing per Job[25]	
		Jobs Created	Jobs Created or Sustained
Non-Leveraged	1,788	$13,112	$5,043
Debenture	5,596	$24,559	$4,583
Participating Securities	2,926	$9,684	$3,949
Specialized	1,371	$25,108	$7,654
Total/Average	**11,681**	**$14,458**	**$4,525**

As with the earlier analyses, there is substantial variation in these dollars-per-job-created figures depending on the type of fund. Firms funded through the non-leveraged program, for example, created jobs at a rate of around US$13,000 in SBIC financing per job created, while companies funded through the debenture program created jobs at a rate of approximately US$25,000 of SBIC financing per job created.

The programs also rank differently in terms of the dollars invested per job created or sustained, largely because the average firm size varies across the program types. For instance, portfolio companies financed through the non-leveraged program come in at an average of around US$5,000 in SBIC financing per job created or sustained, while businesses financed through the specialized program created or sustained jobs at a rate of over US$7,600 per job.

As a final step, the authors investigated whether there have been important changes over time in the ratio of financing dollars per job created or sustained. To do this, they restricted attention to only those firms financed by active licensees. Limiting the sample in this way allowed them to consider whether the costs have changed over time. The sample breakdown for firms financed by active licensees is in table 6.

[25] This figure only represents SBIC financing dollars per job. As noted previously, the authors do not know the total amount of capital that these businesses received from other sources—funding from banks and other capital providers could be important for many portfolio companies. The SBA only began tracking the size of the round or deal in which the SBIC participated as part of its financing form in 2013, so that they could better understand the contribution to the total financing by SBICs. Based on analyzing this data, the authors found that, on average, SBICs contributed around 40 percent of the total financing received in each financing round since the SBA started tracking this figure. Using a 40 percent contribution, the total financing dollars from all sources per job would be $36,145 per job created and $11,313 per job created or sustained.

Table 6. Number of Portfolio Companies Receiving Funding from Active SBIC Licensees

Type of SBIC Fund	Number of Companies
Non-Leveraged	390
Debenture	2,041
Participating Securities	548
Specialized	199
Total	**3,178**

Lastly, table 7, which highlights the ratio of total SBIC financings to the numbers of jobs created and jobs created or sustained by fund type among active licensees, shows higher average financing dollars per job than the overall analysis. This is particularly the case among firms financed through the debenture program, which shows an average cost of just over US$33,000 per job created and around US$5,200 per job created or sustained. It is important to recognize this because table 7 restricts attention to active licensees only, where there is a preponderance of newer investments, many of which may not have had sufficient time to grow. These numbers should be interpreted with that caveat in mind.

Table 7. Ratio of Total SBIC Financings to Jobs Created and Jobs Created or Sustained by Type of Fund for Active SBICs

Type of SBIC Fund	Number of Companies	Ratio: Total Financing to Jobs	
		Created	Created or Sustained
Non-Leveraged	390	$11,214	$4,616
Debenture	2,041	$33,646	$5,203
Participating Securities	548	$5,801	$3,081
Specialized	199	$661,031	$7,106
Total/Average	**3,178**	**$16,340**	**$4,603**

MEASURING THE GOVERNMENT COST OF THE SBIC PROGRAM

It is important to recognize that the calculations presented above relate program dollars invested to jobs created and jobs created or sustained, not the taxpayer costs associated with these jobs. The taxpayer costs of these jobs is the net administrative costs of the SBIC Program (the gross administrative costs less the licensing and examination fees) minus the incremental tax revenue generated by firms and individuals that would not have been generated in the absence of the program.

As table 8 demonstrates, the taxpayer costs associated with these programs is small relative to the amount of dollars deployed. Indeed, the SBA has operated the debenture SBIC Program at zero subsidy since FY 2000. Overall, the SBIC Program provided US$57.2 billion of financing dollars between 1999 and 2015 for a net administrative cost of approximately US$138 million, or roughly one penny of net administrative costs for every US$4 deployed.

Table 8. Breakdown of SBIC Administrative Costs

Item	Amount
Total SBIC Financing Dollars	$57,229,853,052
Total SBIC Administrative Expenses	$185,080,017
Minus Licensing and Exam Fees	$46,727,000
Net Administrative Costs	$138,353,017
Net Administrative Costs per Financing Dollar	$0.0024

Source: SBA provided administrative costs on the SBIC program from its program overviews. Administrative costs include the direct costs from the operating budget, including contracts, compensation and benefits, but may not include agency wide costs, such as rent and telecommunications and indirect costs. SBA also provided the administrative fees it collected to offset its administrative costs. The net government administrative cost was calculated by subtracting administrative fees from the administrative direct costs identified in its program overview. Financing dollars were based on Form 1031 data.

Based on an average administrative cost of one cent per US$4 deployed, table 9 reports the administrative cost per job created and per job created or sustained. The taxpayer costs associated with these jobs is quite low.[26] The calculation reported in table 9 does not account for the fact that taxes are paid by both employees and the companies. At some level, the administrative costs per job reported here are offset even further by the income taxes paid by employees who would not otherwise be working, by companies that would not otherwise be generating profits, and by investors who would not otherwise be earning returns.

[26] The administrative costs for the participating securities program are substantially higher if the subsidy costs of the government leverage issued are included in the calculation. The SBA's fiscal year 2017 budget estimates these subsidy costs of government leverage at 26.3 cents per dollar, which implies a cost of 18.28 cents per dollar for the participating securities program. This raises the total administrative costs to US$1,771 per job created and US$771 per job created or sustained through the participating securities program. These subsidies do not impact the costs associated with the other SBIC investment programs.

Table 9. SBIC Administrative Costs per Job Created and Job Created or Sustained

Type of SBIC Fund	Number of Companies	Ratio: Total SBIC Financing per Job		Ratio: Administrative Cost per Job	
		Jobs Created	Jobs Created or Sustained	Jobs Created	Jobs Created or Sustained
Non-Leveraged	1,788	$13,112	$5,043	$31.70	$12.19
Debenture	5,596	$24,559	$4,583	$59.37	$11.08
Participating Securities	2,926	$9,684	$3,949	$23.41	$9.55
Specialized	1,371	$25,108	$7,654	$60.70	$18.50
Total/Average	**11,681**	**$14,458**	**$4,525**	**$34.95**	**$10.94**

CONCLUSION

Congress created the SBA's SBIC Program in 1958 and since the program's inception through December 2015, SBICs have deployed US$80.5 billion in capital (two-thirds from the private sector) into approximately 172,800 financings. This study has assessed the job creation that resulted from this investment activity.

The authors' analysis indicates that SBIC-funded small businesses created almost 3 million jobs during the sample period, which extended back to October 1995 and ran through December 2014. In addition, these SBIC-funded small businesses created or sustained almost 9.5 million jobs during this time.

Putting these jobs and financing figures together reveals that, on average, one new job was created for every US$14,458 of funding invested through the SBIC Program, while an average of one job was created or sustained for every US$4,525 invested. If attention is restricted to only those portfolio companies financed by active licensees, the ratios are one job created for every US$16,340 invested, and one job created or sustained for every US$4,603 invested. While these numbers are qualitatively similar, it is important to recognize that the time period covered by the active licensees is more heavily influenced by the Great Recession in the late 2000s than the overall sample.

These findings indicate that SBIC-funded small businesses are a robust source of job creation in the U.S. economy. Nevertheless, it is important to point out the limitations that are inherent in this type of analysis. Because the SBA's SBIC data only track firms during the time that they are receiving SBIC funding, it is possible that these businesses could grow or shrink after this funding ceases, which could result in job gains or losses that would go unmeasured by this analysis. In addition, the analysis presented here does not account for any potential funding that firms received from non-SBIC sources.

A more important shortcoming stems from the inherent difficulty in establishing causal interpretations to the numbers presented here. Because it is practically impossible to know what employment in these businesses would have looked like in the absence of SBIC funding, it is difficult to take a stand on whether the SBIC funding caused the job creation, or whether similar levels of job creation could have been achieved through alternative means of financing. Ultimately, questions of this nature go far beyond the scope of the current analysis.

These caveats notwithstanding, the analysis presented here, when compared to previous estimates for the private equity industry, suggests that the ratio of investments to jobs is at least as attractive in the SBIC Program as is found elsewhere in the private equity sector as a whole. Moreover, because the program operates at a relatively low administrative cost, the government costs per job created and per job created or sustained is easily outweighed by the tax revenues generated by the employment, profits, and returns of the firms that receive the investments.

APPENDIX I. GLOSSARY

Community Reinvestment Act

Enacted by Congress in 1977, the Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate.

Debenture

A corporate finance term that refers to a medium- to long-term debt instrument used by large companies to borrow money at a fixed rate of interest. For the purposes of the Small Business Investment Company (SBIC) Program, while authorized under the Small Business Investment Act to have a maximum term of 15 years, substantially all SBIC debentures are issued for a 10-year term.

Debt Financing

Financing based on debt instruments, such as bond issues or long-term notes payable.

Debt-Plus-Equity Financing

Financing based on debt instruments, such as bond issues or long-term notes payable, and equity, such as common stocks, preferred stocks, or retained earnings.

Dodd-Frank Wall Street Reform and Consumer Protection Act

Signed into law by President Barack Obama on July 21, 2010, this act is intended to promote the financial stability of the United States by improving accountability and transparency in the financial system, to protect American taxpayers by ending bailouts, and to protect consumers from abusive financial services practices, among other purposes.

Equity Capital/Financing

Money raised by a business in exchange for an ownership share of the company, by either owning shares of stock outright or having the right to convert other financial instruments into stock. Two key sources of equity capital for new and emerging businesses are angel investors and venture capital firms.

Hybrid Financing

Combined debt and equity financing.

Leverage

The ratio of a company's loan capital (debt) to the value of its common stock (equity).

Licensee

A private investment fund licensed as an SBIC by the U.S. Small Business Administration (SBA).

Limited Partnership

A partnership consisting of a general partner, who manages the business and has unlimited personal liability for the business's debts and obligations, and a limited partner, who has limited liability but cannot participate in the management of the business.

Lower-Middle Market

The market segment containing businesses with between US$5 million and US$10 million in annual revenues.

Mezzanine Financing

Mezzanine debt is used by companies that are cash-flow positive to fund further growth through expansion projects, acquisitions, recapitalizations, and management and leveraged buyouts. When mezzanine debt is used in conjunction with senior debt, it reduces the amount of equity required in the business. As equity is the most expensive form of capital, it is most cost effective to create a capital structure that secures the most funding, offers the lowest cost of capital, and maximizes return on equity.

North American Industry Classification System (NAICS)

The standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. economy.

Office of Investment and Innovation (OII)

The office within the SBA that operates the SBIC Program.

Portfolio Company

An entity in which a venture capital firm, buyout firm, holding company, or other investment fund invests. All of the companies currently backed by a private equity firm can be referred to as the firm's portfolio.

Private Equity/Capital

An asset class consisting of equity securities and debt in operating companies that are not publicly traded on a stock exchange. A private equity investment will generally be made by a private equity firm, a venture capital firm, or an angel investor.

Private Equity Fund

A collective investment scheme used to make investments in various equity (and, to a lesser extent, debt) securities according to one of the investment strategies associated with private equity.

SBA Annual Financial Report (SBA Form 468)

The OII uses the Annual Financial Report to assess changes in SBICs while they participate in the program. SBICs submit them quarterly and they are audited annually.

SBA Portfolio Financing Report (SBA Form 1031)

The OII uses the Portfolio Financing Report to assess various characteristics of small businesses before their financing events. SBICs submit the form within 30 days of the close of financing. This form contains portfolio concern financing and supplementary information that the SBA uses to evaluate an SBIC's investment activities and compliance with SBIC Program requirements. The agency also pools the information provided by individual SBICs on these forms to analyze the SBIC Program as a whole and the impact of SBIC financings on the growth of small businesses.

SBIC Funds (by Type)

Bank-owned: Bank-owned SBIC funds are typically non-leveraged financings. Banks sometimes prefer owning the SBICs themselves because doing so allows them to have more control over where the fund investments are made while avoiding the risks associated with leveraged financing. These SBICs generally focus on later-stage, mezzanine, and buyout investments using primarily debt and hybrid financing.

Debenture: Debenture SBICs generally focus on later-stage, mezzanine, and buyout investments using primarily debt and hybrid financing

Non-leveraged: Non-leveraged SBIC funds make up approximately 15 percent of the active SBICs. Generally focused on later-stage, mezzanine, and buyout investments using primarily debt and hybrid financing, their private capital is not supplemented with SBA-guaranteed debentures.

Participating Securities: The SBIC Program's participating securities effort was the SBA's original attempt to infuse funding into the venture capital industry. It began in 1994, in time to catch the dot-com wave, and was suspended in 2004, when the SBA stopped issuing new licenses. Under the program, the SBA matched up to twice the amount of private capital raised by a qualified firm. Some venture capital businesses, such as Triathlon, which raised its debut fund under the initial program, succeeded, but others foundered.

Specialized: The specialized SBIC program was authorized between 1969 and October 1996 to target "disadvantaged" businesses, meaning those that were at least 50 percent owned, controlled, and managed on a day-to-day basis by a person or persons whose participation in the free enterprise system was hampered because of social or economic disadvantages.

Small Business

A business with less than US$19.5 million in tangible net worth AND an average after-tax income for the preceding two years of less than US$6.5 million; OR, a business that qualifies as "small" under NAICS code standards (which are generally based on annual sales or the number of employees).

Venture Capital

Early-stage funding for startup companies that are high on risk but also high on potential. Venture capital is a type of equity financing that addresses the funding needs of entrepreneurial companies that—for reasons of size, assets, and stage of development—cannot seek capital from more traditional sources, such as public markets and banks. Venture capital investments are generally made as cash in exchange for stock shares and an active role in the invested company.

Volcker Rule

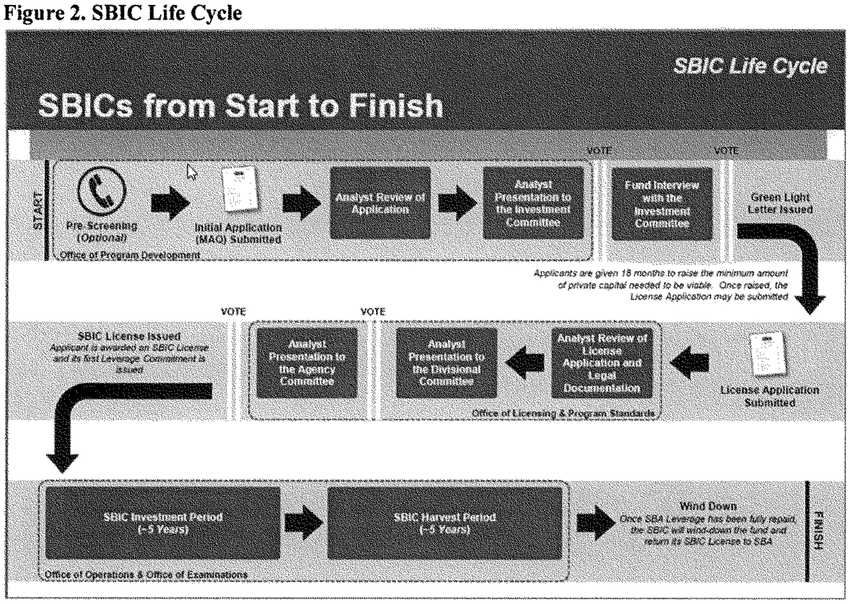
A section of the Dodd-Frank Act, originally proposed by American economist and former Federal Reserve Chairman Paul Volcker to restrict U.S. banks from making certain kinds of speculative investments that do not benefit their customers.

Note: These definitions were compiled from various sources, including websites and official documents of U.S. government organizations, such as the Federal Financial Institutions Examination Council, the U.S. Census Bureau, the U.S. Small Business Administration, and the White House; the websites of trade associations, such as the National Association of Investment Companies and the National Venture Capital Association; and trade platforms, such as *Crunch Base* and *Investopedia*.

APPENDIX II. SBIC LIFE CYCLE

The SBIC life cycle begins with an extensive application process. Following an optional pre-screening of applicants by telephone, the first required step in applying for an SBIC license is the submission of a management assessment questionnaire (MAQ). After the SBA's investment committee reviews the MAQ, the agency issues a green-light letter. It is only upon the receipt of this letter that an applicant may submit a formal license application. This application is subject to additional review by the SBA's Office of Licensing and Program Standards before an SBIC license is issued. Once licensed, and if eligible under SBA regulations, an SBIC may apply for a leverage commitment. The SBIC then goes through investment and harvest periods (where investments are later sold), each of which extends for approximately five years. When the leverage has been repaid, the SBIC winds down the fund and returns its license to SBA (see fig. 2).

Figure 2. SBIC Life Cycle



Source: "Bridging the Capital Formation Gap."

APPENDIX III. SBA PORTFOLIO FINANCING REPORT (SBA Form 1031)

OMB No. 3245-0078
Expiration Date 10/31/2017

U.S. Small Business Administration
Portfolio Financing Report

Name of Licensee________________________ License Number__________

Part A - Small Business Concern Data

1. Name of Small Business ________________________ 2. Employer Identification Number ____-__________
3. Street Address ________________________
4. City________________ 5. State______ 6. ZIP Code ________ 7. County ________________
8. Small Business FAX ________________ 9. Contact Person for FAX ________________
10. Date Business Established __/__/__ 11. Form of Business ____ 1) Corporation 2) Partnership 3) Proprietor 4) LLC
12a. NAICS Code ____________ Industry ________________________
12b. Energy Saving Qualified Investment? ____ If checked, was Energy Saving debenture used to finance investment? _____
13. Percentage of Small Concern (if any) Owned by: American Indian or Alaska Native: ____% Asian: ____%
Black or African American: ____% Hispanic or Latino: ____% Native Hawaiian or Other Pacific Islander: ____% White: ____%
14a. Percentage of Small Concern Owned by Women (if any) _____% 14b. Percentage Owned by Veterans (if any) _______%
15. CEO or President (may select one or more): Woman:____ American Indian or Alaska Native: ____ Asian: ____
Black or African American: ____ Hispanic or Latino: ____ Native Hawaiian or Other Pacific Islander: ____ White: ____

Part B - Prefinancing Information

16. Prefinancing Status: ____ (1) New Information (2) Previously Submitted (3) Acquired Business (4) New Business
17a. Stage of Company at Financing:______________ 17b. Technology developed with SBIR/STTR funding:__________
18. Small Business Concern's Pre-Money Valuation: ________________
19. Fiscal Year End Immediately Prior to Date of Financing (Month/Day/Year) _____/_____/_____
20. Gross Revenue for Prior Fiscal Year $____________ 21. After-Tax Profit or (Loss) for Prior Fiscal Year $__________
22. Income Taxes for Prior Fiscal Year: Federal $______________ State $______________ Local $______________
23. Net Worth $____________ 24. Number of Employees ________

Part C - Financing Information

25. a. Date of Financing ___/___/____ b. Date of Disbursement ___/___/____ 26. Did Licensee lead this investment? _____
27. Purpose of Financing (Percentage of Financing that will be used to support each category below. Percentages should total to 100%.)

a. Working Capital or Inventory Purchase	____	f. Acquisition of Machinery and Equipment	____
b. Plant Modernization or Leasehold Improvement	____	g. Land Acquisition or Dwelling Construction	____
c. Acquisition of All or Part of an Existing Business	____	h. Marketing Activities	____
d. Consolidation of Obligations or Non-SBIC Debt Refunding	____	i. Research and Development	____
e. New Building or Plant Construction	____	j. Other	____

28. Is this the first Financing of this Small Business by the Licensee? ______
29. Financing Instruments and Applicable Amounts (for participations, include Licensee's portion only):

Instrument	Amount	Initial Interest Rate(s)	% Actual Ownership
Loan Only	$________	________%	
Debt with Equity Features	$________	________%	
Equity Only	$________		________%
Total Licensee Financing	$________		

30. Total Size of Financing Round for Small Business Concern: ________________
31. Comments:

Part D - Transmission Verification Transmission Date ____/____/____

SBA Form 1031 (3/14) Previous Editions Obsolete

OMB No. 3245-0078
Expiration Date 10/31/2017

U.S. Small Business Administration

Portfolio Financing Report

Use of Information: SBA Form 1031 is to be completed only by small business investment companies (SBICs) licensed by the Small Business Administration (SBA). This form contains Portfolio Concern financing and supplementary information that SBA uses to evaluate an SBIC's investment activities and compliance with SBIC program requirements. SBA also pools information provided by individual SBICs to analyze the SBIC program as a whole and the impact of SBIC financings on the growth of small business.

Instructions for Submitting Completed Form: SBA Form 1031 must be completed and filed electronically in the SBIC-Web system. SBIC-Web requires an SBA-approved user account. Submit your account request to sbicwebsupport@sba.gov.

PLEASE NOTE: The estimated burden for completing this form is 12 minutes per response. You will not be required to respond to this information collection if a valid OMB approval number is not displayed. If you have questions or comments concerning this estimate or other aspects of this information collection, please contact the U.S. Small Business Administration, Chief, Administrative Information Branch, Washington, DC 20416 and/or SBA Desk Officer, Office of Management and Budget, New Executive Office Building, Room 10202, Washington, DC 20503.

PLEASE DO NOT SEND FORMS TO OMB.

APPENDIX IV. SBA ANNUAL FINANCIAL REPORT (SBA Form 468, Schedule 8)

SCHEDULE 8	Unaudited Portfolio Company Information AS OF	OMB Approval No. 3245-0063 Expiration Date 10/31/2017
Name of the Licensee:		License No.

Portfolio Company Name	Employer ID	% Own	% Vote	Cost at End of Period	Unrealized App (Dep)	Total Reported Value
		0%	0%	$0	$0	$0

General Portfolio Company Information

Business Description: NAICS:

Soybean farming, field and seed production

1st Date Invested: Overline?

Current Stage:

Exchange: Stock Symbol:

If original investment company's name changed, was acquired/merged, company name of original investment:

Address:

City/State:

Zip Code: LMI:

Other Comments:

Rounded to nearest $ **Portfolio Company Financial Information**

Fiscal Year End	Period 1	Period 2	Period 3
As Of Date			
Basis Period			
Revenues	$0	$0	$0
Gross Profit	$0	$0	$0
EBITDA	$0	$0	$0
Interest Charges	$0	$0	$0
Net Income	$0	$0	$0
Cashflow from Ops.	$0	$0	$0
Burn Rate	$0	$0	$0
Cash Balance	$0	$0	$0
Current Assets	$0	$0	$0
Fixed Assets	$0	$0	$0
Total Assets	$0	$0	$0
Current Liabilities	$0	$0	$0
Debt	$0	$0	$0
Total Liabilities	$0	$0	$0
EOY Equity Value (Market)	$0	$0	$0
EOY Enterprise Value	$0	$0	$0

Full-time employees : -

Federal Taxes Paid : $0 State Taxes Paid : $0

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In addition, the authors consulted relevant federal codes, laws, and regulations; U.S. government websites, such as those maintained by the Federal Deposit Insurance Corporation and the U.S. Small Business Administration; newspapers, such as the *Guardian*; and the websites of industry trade organizations, such as the National Association of Investment Companies and the National Venture Capital Association.

Statement for the Record

By Thies Kolln
Partner, AAVIN Private Equity

Hearing Entitled "Investing in Small Businesses: The SBIC Program"

The House Committee on Small Business
Subcommittee on Agriculture, Energy, and Trade

November 7, 2017

Chairman Blum, Ranking Member Schneider, and Members of the Subcommittee, thank you for the opportunity to testify today and for holding this hearing, "Investing in Small Business: The SBIC Program."

This hearing is important for highlighting the United States Small Business Administration's (SBA) Small Business Investment Company (SBIC) Small Business Investment Company (SBIC) Program and the impact it is having on growing domestic small businesses and creating American jobs. Access to capital is a tremendous issue for small businesses across the country. This program effectively resolves that issue. I am eager to provide you my perspective as an SBIC fund manager and past member of the Small Business Investor Alliance board.

My name is Thies Kolln. I am a partner of AAVIN Private Equity, a private equity firm based in the heart of the Midwest. Our central office is in Cedar Rapids, Iowa, but we also have regional offices in Kansas City, Missouri and Madison, Wisconsin. I joined AAVIN in 2002, and prior to joining the firm I practiced corporate law in Chicago, representing venture capital and private equity funds.

At AAVIN, we stay true to our roots by focusing on helping small, regionally-based businesses grow. We specialize in late-stage and expansion-stage financings, and we partner with strong management teams that seek long-term business growth. Our focus is on smaller investment opportunities—small businesses seeking financings less than $10 million, with most needing less than $5 million. Further, our activities are concentrated mostly in the upper Midwest, such as Iowa, which is an area of the country traditionally underserved by capital. We are also weighted toward small businesses in manufacturing and business services, but are diversified in other sectors such as healthcare, technology, and communications.

AAVIN has extensive private equity investment experience. The seven members of our investment team have made investments in over 300 companies and have held multiple operating roles.

Through our firm's history, just in Iowa we have deployed $34 million in capital that helped create our sustain over 6,000 jobs. Those numbers may not mean a whole lot for a place like Manhattan, but they do for Iowa. These investments produced great growth for small businesses as well as returns for our investment partners, which includes repayment in full to the SBA and American taxpayer.

To provide technical insight into the SBIC Program, my testimony today will focus on three main areas: 1) AAVIN's involvement in, and strong support for, the SBIC Program; 2) AAVIN's investment process in small businesses through the SBIC Program; and 3) AAVIN's impact on growing domestic small businesses and creating American jobs through the SBIC Program.

SBIC Program Involvement

AAVIN has substantial historical involvement with the SBIC Program.

A hallmark of the SBIC Program is its rigorous licensing process for prospective SBIC funds, ensuring taxpayer protection and safeguarding the program's reputation. One requirement for licensing is that management team applicants have extensive prior investment experience and good investment track records. AAVIN meets that demand. Our firm's experience base dates back to the start of the SBIC Program in 1959. We have a long-term commitment to small business.

In its present-day iteration, AAVIN is currently on its second Debenture SBIC fund, which became licensed in 2015; however, our seven principals have successfully managed five prior SBICs, with over 40 years of continuous Debenture SBIC management. We have over 120 cumulative years of lending and mezzanine investing experience. Such repeats of licensure as an SBIC is a good thing, as it demonstrates to prospective small business partners our previous funds' successes; demonstrates our commitment to serving this undercapitalized market; and demonstrates to the taxpayer that we are good stewards of American tax dollars. Notably, we have a history of on-time payments to SBA and overall compliance, with clean examinations without findings.

AAVIN strongly supports the SBIC Program because it provides the opportunity to supplement our private capital with up to two times more capital to deploy to small businesses to support their growth. This augmented growth capital helps small businesses grow even more than AAVIN's private capital alone could. Given the increasing concentration of capital among large funds and institutions and the resulting difficulty in finding capital with a dedicated strategy of investing in small funds and small businesses, it is questionable whether many of the small funds like AAVIN could even continue to fund small businesses at all without the program. Importantly, our private capital—and any private capital of any other SBIC fund—is always in the first-loss position when making investments. So, despite being leveraged with capital other than our private capital, our interest is always in making sound investments knowing that our private capital, which includes significant personal investments by our management team, would be burned through by an underperforming investment before any taxpayer capital would lose even a dollar.

SBICs like AAVIN are usually providers of the first institutional capital into a small business. Because of this, the program is helping to professionalize small businesses, as SBICs ensure the business's operations are fundamentally solid along with their financials during the investment. This not only primes businesses for greater growth but also gives them greater long-term viability by strengthening their ability to response to changing economic cycles, management team transitions and other unforeseen events. AAVIN's investment process works to that end.

Investment Process

While the SBIC Program makes available additional capital to augment private capital, the actual act of investing in small businesses itself is, and always will be, incumbent upon the SBIC fund.

AAVIN's investment process not only protects the interests of the American taxpayer and the firm's own investment partners, but also that of the small businesses it partners with to grow.

AAVIN receives over 500 to 1000 inquiries annually for small business financings. Approximately 50 to 100 of those inquiries we whittle down through our preliminary diligence, then even further from there, eventually landing at approximately 4 to 6 financings actually being conducted through the fund annually.

Our deal flow is from significant proprietary sources that we have developed over 40 years by focusing on a consistent investment profile using our regional offices. Again, this informs our geographic investment preferences. Notable among those deal flow sources are local and regional banks, many of which are too small to be called on by other funds and which also cannot practically deploy their capital to small businesses without an SBIC.

Our investment underwriting is rigorous and credit-based. Characteristics of small businesses that we look for before investing in are a positive cash flow; financial ratios, such as total funded debt to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA); a complete management team with strong financial and operation leadership; a defensible market position; and ultimately a growth opportunity.

This is all to say that the rigorous licensing process and continuous ongoing oversight of funds that the SBA applies to the SBIC Program likewise applies to our processes in financing small businesses.

A typical transaction for AAVIN provides under $2 to 5 million in financing to a small business. This is mostly debt in the form of loans, but we usually take an equity stake in the small business in conjunction with the loan. We partner with the management teams and always make sure that management holds equity interests in the businesses they operate—active managers will usually own a greater stake in the business after our investment than before.

Following the initial investment, AAVIN, as generally the first institutional investor, supports the small business for anywhere between three to eight years before. In that time, we are repaying the SBA and providing returns to our investors.

We provide significant value over the life of our investments through active involvement with the respective small businesses. We provide assistance to our small business management teams in many areas including strategic planning, finance, marketing, recruiting, analyzing and closing acquisitions or divestitures, developing treasury strategies and assessing financial markets. These are the acts of professionalizing the small business I mentioned as a core outcome of the SBIC Program. To that end, we are truly partners with small businesses.

Impact on Small Businesses

Through the SBIC Program, AAVIN helps small businesses solve their need for capital, along with operating assistance that aids professionalization. The upper Midwest is traditionally lacking in alternative sources of capital, particularly for smaller businesses. Unlike other fund managers, AAVIN has not moved up-market to manage ever larger funds that no longer focus on small business investing. We have been able to keep our focus and strategy because of the continued availability of the SBIC program.

When it comes to securing growth capital, equity financing is often too expensive or unavailable for small businesses. To finance their continued growth through equity alone, small business owners would have to give up large amounts of control of their businesses, if they could even find such capital at all. Most private equity capital is focused either in specific regions and industries such as Silicon Valley IT or Boston area medical companies or in very large multibillion dollar funds that aren't set up to make small investments. Small businesses are also limited in their ability to get traditional bank loans, which are often limited to a portion of the assets the business has as collateral or the owners can provide through personal guarantees. The SBIC Program fills this gap by enabling a these businesses to access a more flexible source of debt that is focused on meeting their capital needs.

The small businesses AAVIN invests in through the SBIC Program may have many possible uses for capital, such as expansion by purchasing equipment or facilities, hiring additional employees to grow the business, acquiring other small businesses, or providing operating capital.

Because of our location and our firm's investing principles, we have a particular impact on small businesses in Iowa. In our firm's history, we have made 26 investments in Iowa small businesses, one as recently as the end of October in Happy Joe's Pizza & Ice Cream.

Happy Joe's is a family-run chain pizza parlor that was founded in 1972. The business also provides franchise opportunities and has 54 locations across Iowa and other states in the Midwest. We have an ambitious growth plan for this company and have already made new hires into the organization to carry this out. Our management team is currently looking for more space for our expanded operations, which will enable them to make additional hires. Our involvement with the business will help it to create a larger geographic footprint, expand its product offerings, and—most importantly—create more jobs.

Another example of our investment in small local businesses is RuffaloCODY, headquartered in Cedar Rapids, Iowa. RuffaloCODY provides fund raising, consulting, enrollment and donor based management services to non-profit organizations; primarily colleges and universities. The company manages on-campus fund raising campaigns and telefund campaigns, where RuffaloCODY hires students to perform the telemarketing process for its clients. RuffaloCODY is the market leader in fund raising services for non-profit organizations.

After an 8-year involvement that included a total investment of $3.25 million, AAVIN exited RuffaloCODY. AAVIN's investment helped the company grow from just over 100 to more than 500 permanent employees, build out new facilities in Cedar Rapids and provide thousands of students across the country with part-time work raising money for their colleges and universities. In 2014, the business announced it acquired another business, forming Ruffalo Noel Levitz, to better partner with colleges and nonprofit organizations to help them enroll their classes, graduate their students, and engage their donors. Our involvement with the company helped establish a foundation for their growth into what the business is today.

We are proud of these investments because of the impact the small businesses have on their communities by creating jobs and spurring the local economy, not least because we ourselves live in these communities.

Conclusion

But for the SBIC Program, AAVIN would not have its successful history of deploying growth capital to American small businesses, the backbone of our economy. The SBIC Program effectively helps us leverage the private capital we are able to raise for this purpose.

Conversely, but for the SBIC Program, American small business access to capital would be worse. Without the program, an enormous capital access gap would exist for small businesses that traditionally lack alternative capital sources for growth.

Thank you to the Subcommittee for holding this hearing on the SBA's SBIC Program and how it enables access to capital for small businesses. I encourage the Committee and this Congress to continuing fully supporting the program so that it may expand, support more domestic small businesses, and create even more American jobs. I look forward to answering any questions you may have.

Statement for the Record

By Michael Painter
Managing Partner, Plexus Capital, Raleigh, NC

Hearing Entitled, "Investing in Small Businesses: The SBIC Program"

The House Committee on Small Business
Subcommittee on Agriculture, Energy, and Trade

November 7, 2017

Chairman Blum, Ranking Member Schneider, and Members of the Subcommittee, thank you for holding this important hearing and for inviting me to testify.

My name is Michael Painter. I am Managing Partner of Plexus Capital—a North Carolina small business focused on supporting the growth of other small businesses throughout the United States. I am excited to talk about the Small Business Investment Company (SBIC) program, which has allowed our team to stay focused on supporting perpetually underserved small businesses since 1996.

Since graduating from the University of North Carolina at Chapel Hill in 1995, I have spent my career focused on providing capital to US-based businesses. My career began with a regional bank in North Carolina, Centura Bank, where our team received its first SBIC license in 1996 as part of a commitment to better support the capital needs of the bank's clients. From Centura Bank I went to Donaldson, Lufkin & Jenrette in New York and eventually made my way back to North Carolina to re-join my colleagues at Centura supporting small businesses through the bank's SBIC fund. The bank eventually sold to RBC Bank in 2000 and in 2004 our team joined together again to form Plexus Capital and successfully closed our first independent SBIC in 2005.

For over 20 years, members of our firm have managed SBICs and witnessed the program's success. Access to capital is one of the most important issues for small businesses nationwide, and for decades, this program has helped fill that void in a perpetually underserved area of the financial markets.

In 2013, we were honored to be awarded the SBIC of the Year by the U.S. Small Business Administration (SBA). At the time, SBA administrator Karen Mills stated that "Plexus Capital's hard work, innovative ideas and dedication" were factors in us receiving the award. We remain committed to those same values as we seek to invest in growing small businesses.

Investment Process and Criteria

At Plexus we have stayed focused for more than two decades on supporting small businesses. We provide low-cost capital that supports growth and helps support the necessary transition of primarily baby-boomer owned small businesses to the next generation of owner-operators. There are more than 100,000 small businesses with $10 – 100 million in sales and roughly 50% are owned by baby boomers. The continuity of these businesses and the millions of jobs they support are dependent on successfully transitioning the estimated $2 trillion of ownership to the next generation of owner-operators.

We are currently managing our fourth SBIC fund, and to date, have invested $710 million in 87 small businesses nationwide, successfully managing through all economic cycles. Plexus invests in main-street American small businesses across all industries – including manufacturing, service providers, retail and distribution companies. Below is a summary of our four SBIC funds that highlight the success of the small businesses we've partnered with:

<u>Plexus Fund I: $80 MM</u>
Closed in November 2005
10.5% net IRR
1.7x multiple through the Great Recession

<u>Plexus Fund II: $175 MM</u>
Closed in November 2009
21.8% net IRR
2.0x multiple

<u>Plexus Fund III: $300MM</u>
Closed in March 2013
$352 million deployed to-date

<u>Plexus Fund IV: $400 MM</u>
Closed in October 2016
$82 million deployed to date

Our growth has been driven by doing more of the same investments in small businesses. We invested in 28 small businesses through our first SBIC fund and expect to invest in 40 - 50 small businesses over the life of Plexus Fund IV. While many peers have found great success moving up market to serve larger companies, we have been intentional about staying focused on smaller businesses who have limited access to capital where we can make a meaningful impact on growth.

We review approximately 1,200 opportunities annually and ultimately invest in 12 - 15 small businesses. On average, we invest between $2 and $10 million and our capital allows owners to maintain significant ownership and control of the business. We are generally the first institutional partner of the small businesses we invest in and are committed to bringing value beyond the capital need. We have a full-time operating partner focused on supporting our small businesses in the development and execution of their growth plans, and we are committed to expanding this platform in 2018.

We have 56 banks, 130 individuals, 18 family offices and 9 institutions that have invested across our four funds with total private capital raised of more than $475 million. Their support is the key to why the SBIC program is unlike any other public-private partnership I know of - most programs have public money at risk alongside of (or ahead of) private money. Importantly, the SBIC program is unique and operates at zero cost to the taxpayer because we, along with our partners, put our capital at risk <u>first</u>. This not only provides obvious protection of taxpayer dollars, but also serves as private market validation of the quality of fund managers during the licensing process.

Licensing Process

The SBIC program's licensing process is rigorous—as it should be—to ensure protection of taxpayer dollars. To receive an SBIC license, the management teams of SBIC applicants must have stellar track records in investment management. As mentioned earlier, we are currently on our fourth SBIC fund. Throughout each subsequent licensure process, we have proven to SBA that we have the expertise to be trusted with taxpayer dollars.

We believe strongly that firms with demonstrable success should be encouraged to seek additional licenses. Historically firms who have had success with smaller businesses move up market, perpetuating the lack of capital for small businesses. The program's sole purpose is providing capital to small businesses where it otherwise may not be available - and what better avenue than existing funds with proven track records.

The regulations ensure all investments made by SBICs go to small businesses - irrespective of how long a manager has been in the program. Repeat funds in good standing are known entities that reduce the workload on limited resources at SBA, all while keeping much needed capital at the small end of the market.

How SBICs Are Impacting Communities

The people, jobs and communities behind the small businesses we support are the real story of the SBIC program. While we are often evaluated on financial metrics, the drivers of every return we generate are real people with families who are impacting their communities - including the now 25 Plexus employees and the thousands of employees with our 87 small business partners.

The following is a sample of the 87 small businesses we've partnered with and a brief summary of the people and stories behind them:

- Agility Recovery (Charlotte, NC): Agility provides disaster support services and supports small business across the United States by providing customers with fully-operable office space that is delivered within 24 to 48 hours from the declaration of a disaster. With the help of our growth investment, Agility more than doubled its employment base, growing from 57 to 119.

- Design Shop (Orlando, FL): Design Shop was founded in 2000 by a husband and wife, Doug and Sherri Hughes, and now has 50 employees on its payroll. Design Shop provides full-service support of trade show services for companies across the United States, and our capital is supporting continued growth.

- Florachem (Jacksonville, FL): Steve McAllister founded Florachem in 1988 after spending more than 10 years working for a large chemical company. He established relationships to supply US-based small businesses with specialty chemicals used in manufacturing processes. At the time of our growth investment, Florachem had 16 employees and served more than 200 small manufacturing customers across the United States.

- Huseby (Charlotte, NC): Huseby was founded in 1989 by Scott Huseby, a 3rd generation court reporter, to professionalize the court reporting industry. Scott comes from a long line of court reporters - including multiple grandparents, both parents, aunts, uncles and cousins. We were Huseby's first institutional partner, and we provided capital to continuing growing the business. In addition to the 50 full time employees at Huseby, they also work with a network of more than 1,800 court reporters across the country. Huseby provides a steady flow of work to professionals in what historically had been an unpredictable "Mom-and-Pop" industry.

- MPD (Trevose, PA): MPD was formed through the combination of Oak Bark Corporation, founded in 1973 by Bill Oakley and Jim Barker, and MPD, founded in 1978 by Dr. Jack Dickstein. The combined company employed 33 people at the time of our investment and grew to 57 employees. MPD manufactures specialty monomers and polymers used in industrial and commercial applications, primarily for use in medical devices.

- TITAN (Charlotte, NC): Founded in 1998 by Michael Vadini, TITAN employed 350 people supporting the technology needs of businesses across United States. The company had been funded primarily by friends and family and various individual investors prior to our investment. Our capital was used for growth that the initial investors didn't have the ability to fund.

Conclusion

The SBIC program is a vital source of capital for small businesses and is a prime example of how the federal government and the private sector can work together to grow the economy and create jobs. I am deeply thankful to the entire committee for its support of this successful program, and I encourage you to pursue ways to strengthen it so more capital can be directed to growing small businesses. Again, I thank the subcommittee for holding this hearing and for allowing me to testify. I welcome your questions.

Good Morning. My name is Mark Walsh, and I am pleased to join you today to discuss the Small Business Investment Company, or SBIC program. From late 2015 until January 19th of this year, I ran the Office of Investment and Innovation (OII), at the US Small Business Administration here in Washington D.C. My area oversaw all SBIC, SBIR (Small Business Innovation Research) and Incubator/Accelerator programs. I was a Presidential appointee. It was my first job in government. Before that I had a 35+ year career in technology, the internet, and media—with senior or C-Suite positions at a wide variety of companies, including AOL, GE, HBO, VerticalNet, and more.

Further, for the last 17 years, I have been an active "Angel" and venture investor in a wide variety of start-ups, and have served on the board of directors for many of those companies and other high-growth venture backed entities. I have also served as Chairman of the Bipartisan Policy Center here in DC. I have a BA from Union College in NY, and an MBA from Harvard.

I am happy to discuss the SBIC program, one of the most innovative, financially successful and well-structured government programs in existence. However, since I left the program almost 10 months ago, I hope the committee will forgive me if some of my recollections and remembrances are dimmed or made suspect by the passage of time. Also, my opinions are my own, and are not meant to reflect any one else's or any other agenda.

The SBIC program takes low-interest debt issued by a consortium of banks, backed by the SBA/OII, and provides it to professionally managed domestic Venture Capital and Private Equity funds. These VC and PE funds can only receive the non-dilutive debt investment from OII after being granted an SBIC License. The license application and approval process is extraordinarily rigorous, and creates an efficient "filter" for mismanaged or ill-targeted funds from receiving taxpayer dollars.

Further, a licensee is required to report all significant investment activities, sales of companies, additional Limited Partner investments, etc. to the OII on a regular quarterly basis, and there are annual on-site inspections by OII trained teammates to validate all the activities and efforts of the licensee. In short, OII is as vigilant an investor as any in the private market, if not more so. However, as we all know, investment entails risk, so OII also had a trained team of "workout" experts who helped funds that ran awry of financial health, and in some cases assumed ownership and control of failed funds and disposed of the assets at admirable salvage valuations. But, make no mistake, the amount of unrecoverable investment was miniscule, and was the envy of the private sector.

In short, the SBIC program was a fabulous example of a public/private partnership, and one I was proud to be part of. My colleagues and teammates, both career and political-appointees, were as motivated, talented and professional as any I have worked with in my career. I enjoyed my all-too-short stint immensely.

But, I was asked here today to address ways to improve the SBIC program. Nothing is perfect, and there are a few areas I would try to address if I were still in charge.

1) ***Outreach:*** We made extraordinary progress during my time in discovering new funds and new types of funds, and in meeting and engaging more diverse fund managers—gender, demographic, geographic and market-focused diversity—than many prior efforts. That happened because my teammates and I made it a priority. The SBIC program should hire and motivate more and more outreach teammates to reignite and continue that trend.

2) ***Promote and Reward certain types of Funds:*** "Impact Funds", (aimed at social, environmental, educational, or institutional improvement as opposed to pure profit) are wonderful entities. The SBIC program should be able to encourage them with lower interest rates, more attractive payback options, or faster application processing. Currently, they are not effectively treated any differently than other funds. Also, SBIC had a "Venture Fund" category, aimed at higher-risk start up investments, and those funds should also have better terms made available for them, as they are often structured to have less appetite for debt.

3) ***License Processing Streamlining/Reporting Requirement Streamlining:*** The amount of paperwork expected of a license applicant and license holder is heavy. OII and the Program should continue its efforts to use available technologies to streamline these processes. Some funds we tried to enroll and apply chose not to because the paperwork and processes were onerous and time consuming.

4) ***Equity Ownership:*** OII should have the ability to receive a very small amount of equity in the companies its capital invests in. The SBIC program, started in the 1950's, has held debt-stakes in a number of iconic companies. For instance, in 1977 it held over 4% ownership in a small technology company called Apple. Over the years, the program has had limited success in taking equity stakes, but I feel that OII should continue vigorous and energetic efforts to create some ownership "upside" for American taxpayers through this program with equity ownership versus only debt.

5) ***More Private-Sector Partnerships:*** During my stint, teammates and I created a wonderful board-diversity initiative called ONBoard (The Open Network for Board Diversity) with a partner, LinkedIn (the professional Social Network). There are a great number of innovative and productive private sector companies who would be wonderful partners in new and innovative opportunities. OII should be freer to pursue those.

6) ***Networking Opportunities between Funds and Companies:*** OII was not at liberty to cross pollinate its investment funds with each other. Companies looking for capital who called OII could not be told about PE or VC funds that might be looking to invest in them. OII is a natural clearinghouse for a wide variety of data it collects about its Funds, and it should

have more "Open Access" to the data for industry observers, companies, funds and analysts.

There are other improvements or opportunities I could detail, but these are some that I saw great potential in when I was at the Agency. I would encourage the Committee to work with OII and the SBA to promote these ideas, if the Committee finds them of value.

Before I conclude, let me also mention the SBIA, or Small Business Investor Alliance. They are the industry association focused on the SBIC marketplace. Their staff and management were extraordinarily helpful to me as I learned the program, and were invaluable partners for the initiatives me and my OII colleagues pursued. Their Board and members were truly the "best of the best", and I can't thank them enough for their productive role in the ongoing success of the SBIC program.

Thank you for inviting me today, and now I am ready to help with any questions or comments the Committee may have.

Mark L. Walsh