

**SBA MANAGEMENT REVIEW: SMALL BUSINESS  
INVESTMENT COMPANY PROGRAM**

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**HEARING**

BEFORE THE

**COMMITTEE ON SMALL BUSINESS  
UNITED STATES  
HOUSE OF REPRESENTATIVES**

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

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## **SBA MANAGEMENT REVIEW: SMALL BUSINESS INVESTMENT COMPANY PROGRAM**

**THURSDAY, SEPTEMBER 26, 2019**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,

*Washington, DC.*

The committee met, pursuant to call, at 11:35 a.m., in Room 2360, Rayburn House Office Building. Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Finkenauer, Kim, Davids, Chu, Schneider, Veasey, Delgado, Craig, Chabot, Balderson, Hagedorn, Stauber, Burchett, and Joyce.

Also Present: Representative Bishop.

Chairwoman VELAZQUEZ. The committee will come to order.

I thank everyone for joining us this morning, and I want to especially thank the witnesses who have traveled from across the country to be here with us today.

Since 1958, the Small Business Investment Company program has been an integral part of the SBA's mission to provide small businesses with affordable capital and helping them create good paying jobs. The specific goal of the SBIC program is to fill the gap between the availability of venture capital and the needs of "high growth potential" small businesses in startups and early stage situations.

It achieves this purpose by partnering private and public investments in early stage and startup businesses. We need to look no further than companies like Apple, Tesla, and FedEx. They have all achieved what we hope for every small business—extraordinary growth and success. They each received early stage financing from SBICs.

One of the SBIC program's greatest strengths is its hands-off approach, giving fund managers the autonomy and flexibility to invest in almost any business sector they choose, from apparel to cutting edge technology. This freedom, coupled with sound investment strategies, has led to the program's bipartisan popularity and success.

In fiscal year 2018, SBA committed to guarantee \$2.5 billion in SBIC investments, and SBICs invested another \$3 billion from private capital for a total of \$5.5 billion in financing for 1,151 small businesses.

Though the SBIC program has helped increase the flow of affordable capital to worthy small companies, access to capital remains the number one priority for small firms across America. Congress can and should do more to ensure the program and its participants

can meet growing demand. This includes periodically conducting oversight to ensure the program is being administered as efficiently as possible.

Earlier this year, led by Ms. Chu, the House passed H.R. 116, which will strengthen the SBIC program by allowing banks and Federal savings associations to invest up to 15 percent of their holdings into SBICs. This increase in capital available to small businesses, at no cost to taxpayers, will provide entrepreneurs with enhanced opportunities to grow and expand their businesses and create good paying American job in the process.

However, we know that much more work needs to be done to fully optimize the rules governing the program. Over the past 2 years, I have heard consistent complaints from SBIC funds and other industry stakeholders about serious delays in licensing approvals. Reports in the press indicate that approvals that used to take 6 months are now taking a year to complete, or even longer. These delays are costing would-be participants to look outside the SBIC program for opportunities to deploy capital to small private equity space.

It is simply unacceptable for a federal government program to be operated so poorly that it becomes unattractive to potential participants.

Another priority is to ensure that venture capital and private equity in the SBIC is reflective of the diversity that exists across the nation in terms of demographics and geography. That includes having women and minorities in leadership positions as SBIC fund managers and making sure that women and minority-owned businesses, as well as businesses located in rural areas, are receiving the investments from SBICs.

On the first panel, I look forward to hearing from the Associate Administrator about how he has worked to address this concern and his plans to permanently fix these problems.

I also look forward to hearing from the second panel of industry participants and insiders about other challenges and ideas to continue optimizing the program and increasing participation.

Again, I want to thank the witnesses for being here, and I now yield to the Ranking Member, Mr. Chabot, for his opening statement.

Mr. CHABOT. Thank you, Madam Chair.

And before I begin my statement I wanted to quickly note that I unfortunately have to step away relatively early in this hearing because I have several other commitments that I have to address. I do apologize for that. I know this is a very important topic, and I fully support the chair in delving into these things, and I have full confidence that my colleagues on both sides of the aisle will ask the important and sometimes tough questions that are necessary.

Traditionally, small businesses, entrepreneurs, and startups are extremely flexible organizations. They adapt and bend as the market moves. They see opportunity and jump at the chance to capitalize. However, they are moving quicker and in a more nimble fashion than ever before. With the advancement of technology racing forward, innovators are sprinting to create the next great American product and service.

Yet, this Committee continues to hear that access to capital remains a top challenge for our Nation's smallest firms. Not only is it a challenge for the Nation's job creators, but often, it is also a roadblock that sometimes can't be bypassed. With options limited, Main Street businesses regularly turn to the SBA for financing assistance.

From my state of Ohio down to Florida, and from coast to coast, small businesses are participating in the SBA's programs to build, grow, and create jobs for our nation.

One option within the capital access toolbox at the SBA is the Small Business Investment Company Program, also known as the SBIC program. This program helps bridge the equity gap for small businesses by combining investment funds with small businesses. The SBIC program is a public-private partnership that has delivered results for America's small businesses and has helped launch some of the Nation's most prominent companies.

The SBA runs potential funds through an extensive licensing process to ensure that they are prepared to participate and work with small businesses. Over the years, this Committee has worked in a bipartisan manner to study the program and develop legislation to ensure that the program reaches small businesses that require its assistance.

Just last Congress, we passed legislation to increase the individual leverage limit within the program and to prioritize under licensed SBIC areas. Studying the program remains paramount and program performance will help Congress determine the next steps.

Just as Congress measure the efficiency and effectiveness of the program, the SBA must implement efficient and effective rules and regulations for program participants to follow. If program timelines diverge or if performance waivers further, examination is required to ensure the integrity of the program.

According to the SBA statistics, over 5,000 businesses have received SBIC funds in the last 5 years, all while operating on a zero-cost subsidy to the American taxpayer.

In fiscal year 2019, the SBA similarly did not request a subsidy as the fees that were built into the program were projected to cover its cost. We are eagerly awaiting end of fiscal year 2019 performance results as third quarter results have been mixed with the number of new licensees approved by the SBA on a downtrend and the dollar amount of the debenture leveraged commitments down significantly.

This hearing will allow members to learn more from the SBA about the program's performance metrics during the first panel, and how the program is impacting communities and neighborhoods from the participants that are testifying during the second panel. As with any capital access program that includes government participation, comprehensive oversight is required to safeguard American taxpayer dollars.

Although the witnesses will be formally introduced shortly, I wanted to quickly thank all of them for participating, especially Mr. Walt Rodgers from Family RV. Family RV's operations are in Colerain Township in Hamilton County, Ohio. For those of you who do not know, Colerain is in my district, and approximately 30 minutes by car or RV from downtown Cincinnati. They are a great

business, and we welcome them here today. And I know this hearing will generate a great conversation.

One final point I would make, Madam Chair, I would ask unanimous consent that our newest member who will be here shortly, I believe, Dan Bishop of North Carolina, will be able to join our dais. It is my understanding that it will be confirmed on the floor that he will be on our Committee, a member of our Committee. I would ask unanimous consent that he would be able to sit with us.

Chairwoman VELAZQUEZ. With no objection, so ordered.

Mr. CHABOT. Thank you very much.

And I will just mention a couple of quick things.

Dan Bishop won a very closely watched election just recently down in North Carolina's Ninth District. It was a relatively close race. He has been a member of the North Carolina Senate, the North Carolina House of Representatives. Like myself, he was a county commissioner. I was a county commissioner in Hamilton County that Cincinnati is located in. He was a Hamilton County commissioner in Mecklenburg County in the Charlotte, North Carolina area. Where my mom is from Charlotte, by the way. He is going to be a valuable addition to our Committee. He is also going to be serving on the Homeland Security Committee. So I think he is going to be a great addition to this Committee.

And at this time I yield back, Madam Chair.

Chairwoman VELAZQUEZ. The gentleman yields back.

And if committee members have an opening statement, we ask that they be submitted for the record.

I would like to take a minute to explain the timing rules. Each witness gets 5 minutes to testify and members get 5 minutes for questioning. There is a lighting system to assist you. The green light comes on when you begin, and the yellow light means there is 1 minute remaining. The red light comes on when you are out of time, and we ask that you stay within that timeframe to the best of your ability.

I would now like to introduce our only witness on today's first panel.

Our first witness is Mr. Joseph Shepard, the Associate Administrator for SBA's Office of Investment and Innovation. In this role, he is responsible for managing the SBIC program, as well as the Small Business Innovation Research and Small Business Technology Transfer programs. He has been in this role since his appointment in 2017. He previously held a position in the office during the George W. Bush administration.

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

**STATEMENT OF JOSEPH SHEPARD, ASSOCIATE ADMINISTRATOR, OFFICE OF INVESTMENT AND INNOVATION, UNITED STATES SMALL BUSINESS ADMINISTRATION**

Mr. SHEPARD. Thank you, Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee. Thank you for inviting me to testify today.

I appreciate the opportunity to talk about the SBA Small Business Investment Company program and the work of the Agency's Office of Investment, which has oversight responsibilities for the SBIC program.

The office was created by Congress in 1958 at a time when no private equity industry existed in the United States. The office was established to supplement private equity capital and long-term loan funds that are not available in adequate supply to small businesses.

Today, it has grown to a \$30 billion program with \$14.2 billion of that representing the SBA guaranteed portion.

So how is SBA managing that growth?

Since my arrival in 2017, we have focused on operational improvements in two significant areas—improving the Agency’s examinations process and improving our information technology systems. I have done this even as we have reduced processing times related to new license applications and reduced the number of denials relative to license applications.

We have been focused on improving the examination process and improving IT systems because those improvements will better position the Agency to advance the SBIC mandate into the future.

At the beginning of 2017, almost half of the licensed SBICs had not received a mandatory 2-year compliance examination as required by law. I am pleased to say that in just over a year we were able to get 100 percent compliance. We are now in the process of hiring and adding a new senior examiner position to maintain our progress.

With respect to IT, the infrastructure that supports our SBIC program is outdated and is in need of improvement. SBICs would certainly attest to the challenges of the current legacy system, that it is difficult and slow when required information is uploaded. We are now hiring an IT project manager, a position that the program has never had before.

Working with our Agency’s CIO, we have made great strides to modernize and improve our technology by taking steps to update the legacy system with a new software platform. This will better protect and secure the program’s financial data, as well as improve data entry, processing times associated with SBIC WEB data collection portal.

Another area of activity has been program outreach. Over the last 3 years, we have participated in close to 50 external engagements. Last month, I traveled to Arkansas and Oklahoma to promote the SBIC program in rural areas. The trip included meeting with Native American leadership, a first for the program.

Next, let me give you a snapshot of the SBIC program through numbers. There are just over 300 SBICs currently licensed by the SBA. Over the last 4 fiscal years, the program has been above 300 with a high of 315 in 2017. License approvals had been on a downward trend from 2013 through 2017, but significantly increased last year in 2018.

With regard to licensing times, the process has taken anywhere from 5 to 8 months over the last 5 years and is typically dependent on those seeking a new license versus a subsequent license. In comparison, similar private sector activity can take up to 24 months.

Something that our program office will continue to watch is liquidation numbers, which unfortunately increased from 2018 to 2019 with four SBIC licensees transferring to liquidation. When reviewing SBIC program participation and investment, we are fre-

quently asked for demographic information on SBICs and the small businesses that SBICs invest in. While the mission of the program is to supplement capital where it is not in adequate supply, the SBA and the SBIC program do not make decisions about which small businesses receive capital from SBICs.

SBA provides a license and provides a government guarantee on investment dollars, but it is the SBIC that decides where and how those dollars will be invested. Over the years, I know some in Congress have discussed providing statutory direction on where those investments should occur. That is a discussion we would look forward to having with you, your staff, and program participants to determine how better to supply capital in those areas in our Nation that do not have an adequate supply.

Let me also advise the Committee on implementation of legislation regarding licensing in under-licensed states, the Spurring Business and Communities Act. Recently, our office published guidance for potential applicants and the guidance is available on the SBA website.

I am proud of the SBIC program and the SBA team that works diligently to facilitate investment in America's small businesses, and I look forward to working with the Committee. And I want to thank you again for the opportunity to testify today.

Chairwoman VELÁZQUEZ. Thank you, Mr. Shepard.

I have consistently heard that the Office of Investment and Innovation is severely understaffed, and in your testimony before the Senate Small Business Committee you stated your office may need more people. Specifically, I am concerned with reports of needlessly long delays in approving licenses.

Who currently heads the Office of Licensing, and how does the number of employees in that office compare to when you took over in early 2017?

Mr. SHEPARD. I actually added two employees to the licensing office.

Chairwoman VELÁZQUEZ. When?

Mr. SHEPARD. After I took over. After I took over in 2017. So I have added—

Chairwoman VELÁZQUEZ. Who currently heads the Office of Licensing?

Mr. SHEPARD. We have an acting director in that capacity.

Chairwoman VELÁZQUEZ. How many employees did the Office of Investment and Innovation have when you first took office in early 2017, and how many are there now?

Mr. SHEPARD. Well, I can tell you that we are currently 91 percent staffed.

Chairwoman VELÁZQUEZ. Can you tell me how many were in the office in 2017 and how that number has changed?

Mr. SHEPARD. I would have to look at that number. I do not have that information.

Chairwoman VELÁZQUEZ. Will you please send this Committee the response to that question in writing?

Mr. SHEPARD. We have 76 now allocated.

Chairwoman VELÁZQUEZ. Okay. I just want to know—

Mr. SHEPARD. Seven that we are hiring.

Chairwoman VELÁZQUEZ.—how does that compare to.

Mr. SHEPARD. Very good.

Chairwoman VELAZQUEZ. I am holding an organizational chart here for your office and it shows that there are 69 full-time employees in your office, 5 vacancies, and 2 new positions. For the vacancies, how long have each of them been vacant?

Mr. SHEPARD. I would have to get that information.

Chairwoman VELAZQUEZ. And you will get back to us?

Mr. SHEPARD. Absolutely.

Chairwoman VELAZQUEZ. Just yesterday I looked on USAJobs myself to see how many job postings you have for your office and I found zero. How do you explain this after you testified before the Senate in June that you need more people? Why are those positions not on USAJobs?

Mr. SHEPARD. I am not sure about why. I can tell you of the 76 that we have allocated to the program, that we are in the process of interviewing seven.

Chairwoman VELAZQUEZ. Do you intend to fill the vacancies?

Mr. SHEPARD. We are in the process. We are in the process of interviewing now and hope to fill those in the next 60 to 90 days. Absolutely. We are in the process now.

Chairwoman VELAZQUEZ. Those vacancies have been vacant since when?

Mr. SHEPARD. That information I will have to get to the Committee.

Chairwoman VELAZQUEZ. How can we, as members of Congress, be assured that you are doing everything you can to have the appropriate staff when the positions are not even being posted publicly?

Mr. SHEPARD. Well, we, again, have 91 percent of the office is staffed.

Chairwoman VELAZQUEZ. I am not talking about the 91. I am talking about the fact that you went before the Senate Committee and you testified that you were in need, that you were understaffed. Since then, we checked online and you have no postings.

Mr. SHEPARD. I believe what may have happened is they were posted, the postings closed. I know that we vetted the resumes.

Chairwoman VELAZQUEZ. Okay.

Mr. SHEPARD. The certifications.

Chairwoman VELAZQUEZ. I only have 5 minutes.

Mr. SHEPARD. Now we are in the process—

Chairwoman VELAZQUEZ. Will you get back to us?

Mr. SHEPARD. Yes.

Chairwoman VELAZQUEZ. Mr. Shepard, in SBA's Congressional Budget justification for fiscal year 2020, it says that the SBA will complete an evaluation to determine how the SBIC examination process can be streamlined. Until 2017, SBIC license approvals commonly took 1 to 2 weeks. That was in 2017. In fiscal year 2017, they took on average 3 months, and some took 6 months to a year for approval. In fact, from 2010 to 2016, 26 licenses were approved per year, but from 2017 to 2019, only 16 were approved each year. Why the delay?

Mr. SHEPARD. I am not sure about those numbers and look forward to visiting with your staff more about them. I can tell you that when we looked at 2017 to 2019, in terms of average approval

time, it was 7.03 months average for approvals. When we go back and look at 2014 through 2016, that number is actually higher. It is 7.2. Downward trend since 2013, but in 2018, we had 25 licenses.

Chairwoman VELAZQUEZ. Let me ask you one last question because my time has expired.

I would like to stay on the topic of licensing. Is it true that your office is contracting out a large amount of that examination work instead of doing the work yourself?

Mr. SHEPARD. In licensing, we do not contract anything out other than FBI background checks with an interagency agreement. And we are seeking to—

Chairwoman VELAZQUEZ. Are you not contracting out examination work?

Mr. SHEPARD. With examinations and the Examination Office, which is a different office than the licensing, we do contract work out.

Chairwoman VELAZQUEZ. Will that explain the delays?

Mr. SHEPARD. When I arrived, as I mentioned in my opening testimony, a little over half of the SBICs had been examined, half had not been. And so we needed to surge to get to 100 percent statutory compliance. We required contracting to do that because we did not have the staff to do it.

Chairwoman VELAZQUEZ. My time has expired.

I now recognize the Ranking Member, Mr. Balderson, for 5 minutes.

Mr. Hagedorn is recognized for 5 minutes. Thank you.

Mr. HAGEDORN. Thank you, Madam Chair. I appreciate it.

Mr. Shepard, good to see you today.

So yeah, very important program, part of the SBA. I mean, you have these businesses, great business models, ideas. They want to expand. Just need a little bit of help with the capital. And so we appreciate the intent of the program, and all the people who are trying to get behind it and do the job.

I have heard similar things that the Chair brought up, that maybe there is some slow walking here or maybe not as much emphasis to our small businesses as they would like to see. I guess today they will have a chance to explain or talk a lot about that.

But just in a general sense, how long does it take for these licenses to come about, and from a process of a small business to receive any capital enhancements, generally when they start the process, how does it work and how long does it take?

Mr. SHEPARD. Well, the SBICs actually determine the investing to the small businesses. So how quickly that occurs is something between the SBIC and the small business concerned that receives the money.

Mr. HAGEDORN. There is no kind of historical data to kind of give some indication as to generally how long it takes, or just every situation is so different you cannot track it? Is that what you are telling me?

Mr. SHEPARD. I think there are differences about the due diligence required by an SBIC on a small business concern. Some are going to take longer than others. We will look into that information and be glad to sit down with you and share that.

Mr. HAGEDORN. I actually represent a rural district in Southern Minnesota, 21 counties, and the largest city, Rochester, home to the Mayo Clinic is 115,000, and from there, you know, lots of small communities. But great small businesses ideas, and folks are expanding in our rural communities every day. And I know some of them could use the assistance of the SBA and this program. And I think last year the President signed a bill. Actually, the Spurring Business and Communities Act, which if I understand, a good chunk of that is supposed to be devoted or directed to small business opportunity in the rural areas.

Do you have any update on how we are doing there? Have you seen an increase in small business activity that you contribute to in the rural areas?

Mr. SHEPARD. Absolutely. We have been very focused because of last year's memorandum of understanding between former Administrator McMahan and Sunny Perdue, the secretary of Agriculture. We began taking on conferences and having conferences, talking about rural investing. We have had several outreach events, some of them I mentioned in my testimony, where we have community development workshops where we talk about rural investing, the need for rural investing. We have done a couple of those in Oklahoma, Arkansas, North Carolina, Maine. We also bring in the other Federal agencies. We do that in partnership with USDA, talk about their Rural Business Investment Company program, in conjunction with the SBIC program. Talk about Community Reinvestment Act credits. We often in those workshops have the FDIC, the Federal Reserve, and the comptroller of the currency there, to talk about that activity and how the financial institutions that are in those areas can invest in small business companies, Small Business Investment Companies; that is a way to channel, deploy their capital into a Small Business Investment Company that can then invest in those demographic areas that are rural.

Mr. HAGEDORN. So in your opinion, the implementation of that act is on schedule or it is going well? I mean—

Mr. SHEPARD. Well, in terms of—

Mr. HAGEDORN. If I have had people tell me that they thought there was, again, a little bit of foot dragging, how would you respond to that?

Mr. SHEPARD. The act, obviously, has been passed and the guidance is on our website. And we have not received any applications for that but it is on the website, and the guidance is there and the applicants can—

Mr. HAGEDORN. Should we a little bit more proactive rather than waiting for them to come to you? I mean, is it not part of your job to go out there and make sure that folks understand what is available? And maybe me, too. I should get more involved and understand the law better so I can help our small businesses when we speak. But perhaps that is something I can gain from you or your organization down the road if that would be okay.

Mr. SHEPARD. Yes. And we bring that up every time we have a community development workshop. We talk about that.

Mr. HAGEDORN. Okay. Thank you. I yield back.

Chairwoman VELAZQUEZ. Thank you. The gentleman yields back.

Now we recognize the gentlelady from Iowa, Abby Finkenauer, Chair of the Subcommittee on Rural Development, Agriculture, Trade, and Entrepreneurship.

Ms. FINKENAUER. Thank you, Madam Chairwoman. And thank you, Mr. Shepard, for being here today.

We know that Small Business Investment Companies, SBICs program started in 1958. SBICs we know have invested billions across our country creating jobs and creating opportunity all over the country. And one of those SBICs known today actually as AAVIN, a private equity, has operated in my district in Cedar Rapids, Iowa, since the beginning of the program. Partnering with SBA has allowed AAVIN to make decades worth of investments that have strengthened our local and our national economy. The company has grown jobs in my district, whether by giving a boost to Happy Joe's Pizza, which I think most people in Eastern Iowa are very happy that they did, or supporting the development of local telecomm firms. The SBIC program has done a lot for places like Northeast Iowa. But its continued success depends on how well SBA runs the program. And current management is exactly what I am concerned about here today.

Let's take licensing, for example. SBA needs to efficiently issue licenses to investment companies so they can participate in the program, lend, and then also help our small businesses grow, obviously. But for the first 4 months of this fiscal year, the SBA did not issue a single license. I do not want the good work of SBICs and all that they do to actually be threatened simply because SBA seems to be asleep at the wheel in this regard.

I understand your office has actually failed to simply even provide reasons for why an application has been denied, and I am wondering today, what is one of the more common reasons of why these applications are denied and these licenses are denied, and then why have applicants not been given reasons in the first place?

Mr. SHEPARD. Thank you for the question.

I do want to correct the assertion that applicants are not given reasons, because they are. And they always are. And not only might they be given a reason by phone or by email about why a denial occurred, we also give them an opportunity to perhaps redo their investment plan so they can get an SBA license to operate an SBIC, because that is the intent of the program.

Ms. FINKENAUER. So what is a common reason?

Mr. SHEPARD. A common reason why a denial may occur? It could be maybe the investment plan is outside the regulations or the statute of what an SBIC should be investing in. So real estate, for example, the program does not do that. It does not do project management. So that could be an example of a reason.

Ms. FINKENAUER. Would this be why SBA for the first 4 months did not issue a single license? Did they all fall under that reason, or what is the reason that SBA has not issued a single license in the first 4 months of this year?

Mr. SHEPARD. Well, I can tell you that last year we issued 25. This year we are at 14. And we are continuing to work, before Monday, to do more.

Ms. FINKENAUER. So what is your plan to reduce—I am glad to hear before Monday you are planning to do more, but do you

have a plan moving forward here to reduce these delays in licensing approval?

Mr. SHEPARD. Well, as we look at the approval process as I mentioned in my testimony, 2017 through 2019, we are showing 7.03 average, better than the 2014 to 2016 average. And always want to be more efficient, more effective, and process as quickly as possible, balancing our stewardship responsibility in terms of risk, but always trying to improve and do better. One of the reasons why I added two more people to licensing was just for that reason, to license, to speed that up if possible.

Ms. FINKENAUER. Great. Well, it is very clear today but there are some tweaking that still needs to be done, making sure that folks are getting what they deserve and what they need to make these investments in our communities across the country and how important this program is. You know, we have a lot of work to do here and I want to make sure that we all take it very seriously and make sure again that folks get what they need and SBA is doing its job.

So thank you, Mr. Shepard, for being here today. And my time is expired.

Chairwoman VELÁZQUEZ. Well, we have 21 seconds, and I would like for you to yield to me.

Ms. FINKENAUER. I would love to yield to Madam Chair.

Chairwoman VELÁZQUEZ. The 7.3 is what? Is it per year? Is—

Mr. SHEPARD. 7.03 is an average from 2017 through 2019.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Now we recognize Dr. John Joyce from Pennsylvania, Ranking Member of the Subcommittee on Rural Development, Agriculture, Entrepreneurship, and Trade.

Mr. JOYCE. Mr. Shepard, thank you for being here.

Madam Chair, thank you for hosting this very important meeting.

Small businesses are the backbone to American industry. And in my home state of Pennsylvania, small businesses account for more than 99 percent of all the businesses. They have allowed us to achieve the sixth largest economy in the Nation, worth more than \$700 billion annually. However, in the underserved and rural communities, like those that I am proud to represent in South Central Pennsylvania, obtaining capital remains a common barrier to growth. By leveraging private dollars with Federal dollars, SBA's SBIC program increases the availability of long-term capital to small businesses which may not be as attractive to the traditional lenders.

Since 2019, SBICs have invested more than \$1.8 billion in 393 businesses across Pennsylvania, with over \$130 million invested in fiscal year 2018 alone. Pennsylvania's businesses have received financing from SBICs in 2016 that supported over 5,000 employees, and that number hopefully continues to grow today.

But I have concerns. This program demonstrates that, yes, there is public policy that can succeed when it aligns with the power in the private market. But I am concerned, as other members have addressed this as well today, Mr. Shepard, about the apparent delays in the licensing process that have been noted in SBA's man-

agement review. Our Chair and our Ranking Member, Mr. Chabot, discussed the downturn in the number of approvals of licenses, and obviously, the number of dollars that go with them.

It is not clear that we can justify why these numbers have decreased, and it is not an understanding that is something that is clear to me at this point from the dialogue and from the questioning from our Chair and from previous members.

Now, you did testify in the Senate Small Business, and they obviously asked you these same questions in their hearing with you in February. Were you able to follow up and provide them with the answers to these questions: (a) why we are seeing a decreased number of license approvals; and (b) what is your plan? How do we move forward? We, as members of the Small Business Committee, who take this challenge so seriously, what is the message that you were able to provide to the Senate subsequent to that hearing, please?

Mr. SHEPARD. We are in the process of getting answers back to the Senate, to answer your first question.

Chairwoman VELÁZQUEZ. That was in June?

Mr. SHEPARD. Yes, ma'am.

Chairwoman VELÁZQUEZ. How long is it going to take?

Mr. SHEPARD. I will have to check with our team and see where we are.

Chairwoman VELÁZQUEZ. No, you are in charge.

Mr. SHEPARD. Yes, ma'am.

Chairwoman VELÁZQUEZ. You are in charge of the program. It is your responsibility. You knew that you were coming before this committee, and you also knew that we were paying attention to your appearance before the Senate Committee. How could you come here and not be prepared to answer? I am sorry; I will give you more time.

Mr. JOYCE. Madam Chair, we are on the same page here. No apology is necessary.

We take this charge quite seriously. And this Committee shares those concerns.

Now, just for clarification, the Committee that you appeared for in the Senate was in February; correct?

Mr. SHEPARD. June.

Mr. JOYCE. In June, okay. So that meeting, and you are still preparing to answer those questions at this point in time? And we do not have any kind of ability to take this message of why there are so many delays in the licensing?

Mr. SHEPARD. The answers will be forthcoming.

But I want to correct the assertion about the licenses. I had mentioned in my opening testimony that there had been a downward trend from 2013, and that last year we had 25. So we had a good year last year, an upward tic. I mentioned that we are at 14 this year and aspiring to do more before the end of the fiscal year.

In terms of the comment about rural, we would welcome the opportunity to visit with Committee to talk about how we might be able to channel and get direction from the Committee through statute to put more money in rural areas.

Chairwoman VELÁZQUEZ. Dr. Joyce, would you yield for a second?

Mr. JOYCE. Yes, ma'am.

Chairwoman VELAZQUEZ. Of the 25, how many were repeat applicants?

Mr. SHEPARD. About half.

Chairwoman VELAZQUEZ. Okay.

Mr. JOYCE. Madam Chair—

Chairwoman VELAZQUEZ. Thank you for yielding.

Mr. JOYCE. Of course. Madam Chair, if I might just continue.

I think the message that I am going to ask you to take with you is that these loans, these licenses for rural, South Central Pennsylvania, for small businesses that cannot go and reach to traditional lenders, these are important. These are important for the growth of the people that we represent. This charge is taken quite seriously. I look forward to you to returning to us with those answers.

And at this point, Madam Chair, I yield.

Chairwoman VELAZQUEZ. The gentleman yields back. Thank you.

I now recognize the gentlelady, Ms. Davids, from Kansas, for 5 minutes.

Ms. DAVIDS. Thank you, Chairwoman.

Mr. Shepard, my hope was to talk with you about the diversity issues that we are seeing in women and minority-owned businesses' investments and how the SBIC program impacts those. I think I can just make a blanket statement that when investments are not being made, it disproportionately affects marginalized communities. And after the line of questioning that we have heard so far, a number of concerns have come up that I think I would like to just follow on.

One is when you testified before the Senate Committee and indicated that you were not sufficiently staffed, my question is if you are not advertising on USAJobs, how are you finding people? You said you are in the process of going through applicants. What is the other mechanism that you are using to find applicants?

Mr. SHEPARD. If I may, we did post on USAJobs. Those postings have closed and we are interviewing for those seven positions now. So it went on, came off, and now we are going through the interview process. USAJobs is the primary location that our Human Resources Department uses to advertise.

Ms. DAVIDS. Okay. That would have been a good response to the question about the USAJobs earlier.

So to follow on one of the lines of questioning from Ms. Finkenauer, the 4 months that you did not issue any licenses, have you evaluated what the impact of the failure of the program to issue licenses has had on the investments that would have taken place? And what the low number as compared to last year, what the impact of that is? Because the program is supposed to be helping spur investment and innovation, and if you are at half the number of licenses as you were last year, just over half, then how are you looking at the delta between last year and this year?

Mr. SHEPARD. Well, again, we did issue 25 last year. We are at 14 now, and we have more that we are processing currently this week.

Ms. DAVIDS. So we are in September.

Mr. SHEPARD. Right.

Ms. DAVIDS. How many more months are left in the timeframe that you are talking about? Is this the fiscal year or is this the calendar—

Mr. SHEPARD. Fiscal year is what I am talking about.

Ms. DAVIDS. So are you going to issue nine more licenses in the next 2 days?

Mr. SHEPARD. We are not going to issue nine more licenses in the next 2 days.

Ms. DAVIDS. Not nine?

Mr. SHEPARD. Maybe four, we hope.

Ms. DAVIDS. Okay. So are you planning on evaluating the negative impact on investments that, I mean, this body has allocated and started a program that has been successful and has helped a lot of businesses thrive. Have you looked at the negative impact that the failure to issue licenses is going to have? And if not, do you plan to?

Mr. SHEPARD. We issue licenses as quickly as possible. I mentioned the downward trend. I mentioned about what we did last year. Our licensing times are in a good place when you look at 2017 to 2019, and so we are doing—

Ms. DAVIDS. Can you explain to me what “in a good place” means?

Mr. SHEPARD. Well, when we compare 2017 to 2019 with the 7.03 average license time compared to the 3 year period prior, 2014 and 2016, we have beat that. So from a processing standpoint, we have done a better job than from 2014 through 2016.

Ms. DAVIDS. You have done a better job of processing but not actually licensing?

Mr. SHEPARD. Those are actually—

Ms. DAVIDS. You have done a better job of denying licenses?

Mr. SHEPARD. No. Actually, our denials are better. We have done fewer denials in that 2017 to 2019 period. But to clarify my point, we have actually licensed quicker. So applicants that have come in received an SBA license to operate an SBIC, that is what I am referring to when I mentioned the 7.3 number.

Ms. DAVIDS. Okay. So I have another question I am going to submit in writing.

But can you tell me what the consequence is? I saw that you have previously had leadership positions in venture capital, investment banking, private equity, investment fund management. Can you tell me what happens usually in the private sector when you fail to perform at the same level that was previously performed at in terms of investments?

Mr. SHEPARD. Well—

Ms. DAVIDS. What would happen if you showed up and talked to your private equity investors and said we normally invest in 25 companies but this year we only did 14?

Mr. SHEPARD. I think it would be a good idea to visit with the staff about capital formation, which we do not control. We can only process the applicants that come in to the program. So that is part of what I am trying to convey is that we do not control capital formation. We do not control the formation of the SBICs. We can encourage it, but ultimately, they have to raise the capital and they have to come in. And they do come in.

Ms. DAVIDS. Okay. I have gone over my time but that is the second time that you have put the onus of responsibility for this solely on your staff. And that to me is questionable leadership. And we will follow up with additional questions in writing.

I yield back.

Mr. SHEPARD. And if I may, the staff is doing a wonderful job. I am really talking about capital formation that takes place in the marketplace that is beyond the SBA's control.

Chairwoman VELAZQUEZ. Time has expired. The gentlelady yields back.

Now we recognize Mr. Balderson, from Ohio, Ranking Member of the Subcommittee on Innovation and Workforce Development for 5 minutes.

Mr. BALDERSON. Thank you, Madam Chair.

Good morning, Mr. Shepard. Overall, how is the performance of the program today compared to 5 years ago?

Mr. SHEPARD. We have had the challenges that I have mentioned with technology, which we have improved. We had the challenges with the examinations, which we have taken to 100 percent. Five years ago we were not examining at the level that we are now with 100 percent compliance. So we have improved in the areas of technology. We have improved in the areas of—I have mentioned licensing approval time several times. Our denials are down. We deny fewer. So IT improvements, licensing improvements, and with our modernization efforts, and especially examinations, it has improved drastically from not examining, which is a statutory requirement in the Small Business Investment Act. What I inherited was about half had not been. Now we are at 100 percent, much better there.

Mr. BALDERSON. Is there more risk today than there was 5 years ago?

Mr. SHEPARD. In terms of size, there is more, certainly more capital at risk, \$4.2 billion of SBA guarantees. So if you look at the amount of capital that is in the marketplace with the program with the guarantee, that could be one argument that there is more risk.

Mr. BALDERSON. So if the performance is good, then why the downturn? I mean, some of the performances you have stated and you answered one of the questions I have asked. If it is good, what is the downturn?

Mr. SHEPARD. In terms of licensing activity?

Mr. BALDERSON. Yes. Yes.

Mr. SHEPARD. The 2013 through 2017, sometimes explaining what happened in 2013, to 2014, to 2015, to 2016, constriction in the private equity industry, fewer people coming in. Again, we can only process applications that come in to the SBA. Why there were fewer from 2013 and why that downward trend occurred, we do not know the answer to that. Again, we can only process those applications that come in to the SBA.

Mr. BALDERSON. So now, are the applicants up or down?

Mr. SHEPARD. Well, last year we had 25. The previous year had been the downward trend.

Mr. BALDERSON. Okay.

Mr. SHEPARD. So up when comparing that downward trend to last year.

Mr. BALDERSON. Okay. In your testimony, you discussed many of the challenges faced by small business investors. You go on and talk about the risk that creates for the American taxpayer.

All right. Second panel. All right. So I am going off what the Ranking Member had here.

Madam Chair, I yield back my remaining time.

Chairwoman VELAZQUEZ. Okay. The gentleman yields back.

The gentlelady from California, Ms. Chu, Chairwoman of the Subcommittee on Investigations, Oversight, and Regulations, is recognized for 5 minutes.

Ms. CHU. Mr. Shepard, I want to recognize the success of the SBIC program, which is amongst the oldest at SBA. This program would help countless small businesses to secure capital and financing that they otherwise could not access through traditional private equity firms and is responsible for millions of new and sustained jobs at minimal cost to the government, and it is a priority for both Democrats and Republicans in Congress because it is so successful. That is why I have a bill, H.R. 116, which would increase capital for SBICs, and it was passed at the House at the beginning of the Congress and is currently waiting consideration in the Senate which would allow banks to invest up to 15 percent of their capital and surplus into one or more SBICs subject to the approval of the appropriate Federal bank regulators. And that is an increase from the current allowed percentage of 5 percent.

However, I believe that the SBA is not taking this program seriously. And one reason for the downturn in approvals could be the lack of outreach to potential SBIC applicants. The Small Business Investment Alliance has criticized your department for failing to effectively conduct outreach to prospective SBIC applicants. For example, they cite that at a recent event in New York, you attracted only one audience member. And in May 2019, they reported that you held an outreach event in Maine and disinvited the state's only licensed SBIC from attending.

So I would like to ask you, Mr. Shepard, about why there is this lack of outreach to potential applicants. I mean, we know that the SBA struggled to attract more women and minority-led SBICs, but we know that SBICs make more investments in minority and women-owned small businesses than their counterparts. Why this lack of outreach, and what are you going to do about it?

Mr. SHEPARD. Well, I had mentioned in my opening testimony that the last 3 years we have actually had 50 engagements, external engagements. We talk about women and minorities. We talk about rural. We talk about the SBIC program. We talk about the need for the program.

Ms. CHU. Mr. Shepard, you said 50. Do you have the attendance figures for them? Because we talk about one person attending.

Mr. SHEPARD. I can get those for the Committee in terms of attendance.

Ms. CHU. I mean, you can hold all these events but there could be no actual outreach to people. So nobody is attending.

Mr. SHEPARD. Well, the intent is to outreach, is to inform, is to educate, and that is the intent of having these engagements, the close to 50 we have had the last 3 years.

Ms. CHU. Well, I would like to follow up with other lack of classes that you are supposed to be holding. SBA's standard operating procedures require SBIC licensees to attend an SBIC regulations class but your office has reportedly not held or scheduled any in-person regulation classes since November 2019. The SBA website, however, still states that this training takes place several times per year in Washington, D.C. Why has there not been an in-person training session held in nearly a year?

Mr. SHEPARD. Well, let me first say that no one has been held back or denied leverage or a license because of that. That provision is being waived currently by the program office. We are discussing a new model and a new way to do it, an online certification. We do not think it makes a lot of sense of the staff to have to have a 1-day training seminar and have people come in to Washington, D.C. to do that. So going into fiscal year 2020, the intent is to and will be to have an online certification for that and revise the provision accordingly.

Ms. CHU. Well, you should make it clear in your standard operating procedures if that is what you are doing.

I would like to address another issue, which is that you have voiced some concern that SBIC programs have grown too quickly and left the taxpayer overexposed with \$14.2 billion in capital guaranteed by the SBA. But actually, SBA leverage is provided to SBICs at a zero subsidy rate and is eventually paid back in full to the government. And in fact, if an SBIC's portfolio loses money, private investors' capital must be completely exhausted before the SBA guaranteed capital is impacted. And so while the SBA can guarantee up to \$175 million per SBIC, the program actually operates at zero subsidy and does not require any congressional appropriations. In fact, the program even managed to maintain its zero subsidy rate throughout the Great Recession.

My time has run out, but let me say that it is false to say that the SBIC program has grown too quickly and is leaving the taxpayer overexposed.

Mr. SHEPARD. May I respond?

The context in which that statement may have been made may have been in regard to the subsidy model. And in 1992, a subsidy model was put in place to oversee the SBIC program it had \$900 million in SBA guarantees. My comments were it has been 27 years. We are using the same subsidy model. It has grown from \$900 million to \$14.2 billion in SBA guarantees. The Federal Credit Reform Act came out in 1992. Again, using the same model, let's revise the model to make sure that taxpayer losses do not occur. So that is the intent.

Chairwoman VELÁZQUEZ. Time has expired. The gentlelady yields back.

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

Mr. HERN. Thank you, Madam Chairwoman.

It is really good to be here today as a small business owner and business man, job creator for over 34 years. This is near and dear to my heart. As the Chairwoman said, I also Chair the Subcommittee, Ranking Member on the Subcommittee on Growth, Tax,

and Capital Access. Access and capital is very important. And so for that I am very supportive of what the SBIC is and what it is about but I am also very concerned about the lack of utilization.

The Chairwoman mentioned and asked you the question of how many of the 25 were new applicants and you said about half for last year. So of the 14, let's get clarity on that. Of the 14, how many of those are new for this year?

Mr. SHEPARD. I do not have the exact statistics on that but can get it to the Committee.

Mr. HERN. So let me ask a question you might know. So what is your office budget? How much is the budget that supports you and your office, your staff?

Mr. SHEPARD. \$1.8 million.

Mr. HERN. So you have got a \$1.8 million budget and you cannot know the makeup of only 14 applications that 70 something people are processing this year. And like my colleague from Kansas said, asked you the question, you are going to try to hit that number this fiscal year which closes on Monday, try to make up the difference between 25 and 14?

Mr. SHEPARD. On the 14 number, Congressman, four are first-time applicants and 10 are subsequent applicants.

Mr. HERN. So I would say with 70 office folks working, analysts or whatever they care called, folks in your office, you processed four new applications this year?

Mr. SHEPARD. Actually, 14.

Mr. HERN. Of the 14?

Mr. SHEPARD. That is where we are currently today.

Mr. HERN. Right, but 10 of those are repeats.

Mr. SHEPARD. Ten are repeats.

Mr. HERN. So it is pretty easy to figure out if they are performing or not, so I would think that process is not the same as somebody that is coming in brand new that you are trying to do the examination on. So only four had a complete examination done, I would assume because you are monitoring these performances along the way; is that correct?

Mr. SHEPARD. It is. And we are staying within that 5 to 8 month application licensing process time that I mentioned earlier.

Mr. HERN. So I am going to borrow some data from the Senate Small Business hearing that said that the normal approval rate is roughly 20 percent but now it is 11 percent.

Do those numbers mean anything to you?

Mr. SHEPARD. I would have to check those numbers. I am not sure about those figures.

Mr. HERN. I would have thought that after the Senate Small Business Committee that you would probably be really tuned up to really defend yourself when you came here but it does not appear that. We are kind of getting the same responses that the Senate got. So I guess for once, we are all being treated equally and we are getting the same information as the Senate and the House together.

Mr. SHEPARD. And Congressman, if I may.

Mr. HERN. Sure.

Mr. SHEPARD. In terms of annual, the denials that have occurred in 2017 through 2019, we only had 5.28 denials per year on

average. The previous 3-year period it was a larger number. From 2014 through 2016 it was 8.96 denials per year. So I am not sure if that is what we are getting at, but I am certainly happy to get with your staff and with this Committee and provide that information for more clarity.

Mr. HERN. So let me ask this question. How do you attribute, or what do you attribute to the reason for the lack of utilization of this program? You said it is not your people and I appreciate that. So if it is not your people, the program is the same, the economy is growing, is it lack of leadership? I mean, what is it exactly?

Mr. SHEPARD. Well, you are asking about—

Mr. HERN. I mean, I am not asking you to self-incriminate, but there is not a whole lot in business. Things kind of stop at the top.

Mr. SHEPARD. Thank you for that question. You are asking about the decline from 2013 through 2017 that occurred. We would like to study that more. We have got in our budget to do to study.

Mr. HERN. Can I stop you? Because I am going to run out of time here. But going from 25 to 14, you do not have to go back very far to see that you are performing at about a 50 percent rate from one year over the next. Does that not concern you at all?

Mr. SHEPARD. Well, we can only process the applicants that are in the licensing queue. We cannot control the number of applicants that—

Mr. HERN. Does it not concern you that if you have got zero, so you just, I mean, we are okay with just spending taxpayer money? I mean, that is why people dislike Washington, D.C. There is zero accountability, and that is what we are trying to do is provide oversight. What the Senate asked you to do is provide information back. We are asking almost identical questions that the Senate asked in June, you know, some 3 months ago. I cannot imagine if you are not doing any applications really what you are doing a whole lot of, so I would think that you could respond very quickly. And here we are. We are getting the same responses they go. And so I guess we will wait in perpetuity for the answers, but I know the Chairwoman is pretty passionate about this, and I doubt that she is going to let you go very long.

Mr. SHEPARD. Well—

Mr. HERN. My time is expired, Madam Chairwoman.

Chairwoman VELAZQUEZ. The gentleman yields back. Thank you.

Mr. SHEPARD. If I may?

Chairwoman VELAZQUEZ. No, the time has expired.

I now recognize Mr. Stauber, from Minnesota, Ranking Member of the Subcommittee on Contracting and Infrastructure for 5 minutes.

Mr. STAUBER. Thank you very much, Madam Chair. And I really appreciate the opportunity to speak and you holding this.

Mr. Shepard, I am not going to pile on but I will tell you that I, too, am a business owner for 30 years. If the success rate my brothers and I had in our small sporting goods store in Duluth, Minnesota, if we operated at your efficiency, we would have been out of business a long time ago.

So I will tell you this. I think you know that small business is the engine of our economy. And when you do not support them the

way we have asked you to, it is a detriment to Main Street America and Main Street Minnesota. The economy is going good. We have people, we have in particular women that want to get into small business. It is an opportunity to live the American dream. And I am just going to say that this member of Congress is extremely disappointed in what is happening in this program, and it needs to be fixed. And I do not think you have a lot of time to fix it.

Thank you, Madam Chair.

Chairwoman VELAZQUEZ. The gentleman yields back.

Let me take this opportunity to welcome Mr. Bishop, from North Carolina, to the Committee.

Mr. BISHOP. Thank you, Madam Chairman. I am delighted to be with you and I am learning already.

Chairwoman VELAZQUEZ. Okay. Thank you.

Mr. Shepard, thank you very much for taking time to walk us through our many questions. You know that you have to get back to us—

Mr. SHEPARD. Correct.

Chairwoman VELAZQUEZ.—with some of the responses that you were unable to provide today. And I hope you will get back to us by end of business next Friday. I am sure we will stay in touch on this issue in the coming months, and you are now excused.

We will now take a moment while we get our next panel settled. Thank you.

Mr. SHEPARD. Thank you. And always welcome the opportunity to come before you and your staff and program participants. Thank you.

[Recess]

Chairwoman VELAZQUEZ. Welcome to our witnesses on today's second panel. I will take a minute to introduce each of you before you give your testimony.

Our first witness today is Mr. Brett Palmer, President of the Small Business Investor Alliance. In this role he works to foster a healthy environment for small business investing and a strong and profitable lower middle market. Mr. Palmer served in the executive branch as a presidential appointee in the Commerce Department as Assistant Secretary for Legislative Affairs and as the previous Deputy Assistant Secretary for Trade Legislation. He holds a history degree from Davidson College. Welcome.

Our second witness is Dr. John Paglia. Mr. Paglia is the Senior Associate Dean of Academic Affairs and a professor of finance at Pepperdine University. A recognized expert on the topic of small business financing, Dr. Paglia has delivered over 50 presentations, including over a dozen keynote addresses. He was awarded in 2016 with a consultancy contract with the Library of Congress Federal Research Division as a private equity and venture capital expert to conduct research on the economic impacts of the SBA's SBIC program. Welcome, sir.

Our next witness is Ms. Ronda Penn, the Chief Financial Officer of Plexus Capital, located in Raleigh, North Carolina. She has 17 years of experience in public accounting with Dixon Hughes Goodman, LLP, where she served as an audit partner with a primary focus on private equity funds. Ms. Penn also has specialized knowl-

edge with private equity funds, which include regulatory reporting and investment accounting related to small business investment companies. She is a graduate of the University of North Carolina at Greensboro, where she earned a Master of Science in Accounting. Welcome.

Our next witness is Mr. Walt Rodgers, who was supposed to be introduced by the Ranking Member but I believe he is now in the Judiciary Committee. Mr. Rodgers is Chief Executive Officer of the Family RV Group, with multiple locations throughout southwestern Ohio and across five states. Family RV opened its doors in 1968 as Corian RV. Today, Family RV is a wide-encompassing dealership that also sells parts and accessories. Mr. Rodgers joined the company this past February but has a long history of leadership roles with numerous companies. You are welcome, sir.

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

**STATEMENTS OF BRETT PALMER, PRESIDENT, SMALL BUSINESS INVESTOR ALLIANCE; JOHN PAGLIA, PROFESSOR OF FINANCE, GRAZIADIO BUSINESS SCHOOL-PEPPERDINE UNIVERSITY; RONDA PENN, CHIEF FINANCIAL OFFICER, PLEXUS CAPITAL; WALT RODGERS, CHIEF EXECUTIVE OFFICER, FAMILY RV**

**STATEMENT OF BRETT PALMER**

Mr. PALMER. Thank you very much, Madam Chairwoman.

Chairman Velázquez, members of the Committee, thank you very much for holding this hearing.

My name is Brett Palmer. I am president of the Small Business Investor Alliance, the trade association that represents small business investors and Small Business Investment Companies in particular. We appreciate you having this hearing.

Small Business Investment Companies, commonly called SBICs, are highly regulated, private equity and venture capital funds that invest exclusively in domestic small businesses. They invest across the country to states and places that are often passed by or passed over. They provide long-term capital and cannot be used to offshore jobs. The debt leverage that the SBICs can access has maintained a zero subsidy for decades, including through the financial crisis and the Great Recession.

And these are not just my assertions, they are the law. They come from SBA data, and they have been documented by independent research. One of the researchers is to my right and a former teacher of mine.

I think everyone can agree that the following facts and findings by those independent researchers are pretty impressive, that SBIC-backed businesses created over 3 million net new jobs. That is a lot of jobs. The cost to the taxpayer to create these job was about \$35 for each new job created. That is a fantastic return on investment. SBIC capital is spread much more evenly across the United States and is not concentrated in the money hubs of Silicon Valley or Wall Street. SBICs get money to where it is needed.

The majority of SBIC funds invest in traditionally undeserved regions of the United States, particularly Kansas, Minnesota, Nebraska, North Dakota, South Dakota, the Upper Midwest, Ala-

bama, Kentucky, Mississippi, Tennessee. These are not the bastions of capital but there are a lot of Americans there and there are a lot of small businesses. It is a great opportunity.

And it has been touched only a very little, but manufacturing matters. And SBICs invest heavily in manufacturing. SBICs have been found to invest in all seven major industrial sectors. This is a national program with national benefits. I think if you asked everyone on this Committee, and I think you have heard some of that day, every member and every member of Congress, and every one of your constituents, they would all agree that we need more small business investment and not less. And the Trump administration Congress clearly want more small businesses growing, particularly manufacturing and particularly in ways that keep jobs here in the United States and not offshored.

Now, the second part of my testimony makes me distinctly uncomfortable because I do not like having to say this but the truth is what is going on is a bit bizarre, that the only person who we are not sure supports these goals is the person paid by the taxpayer to promote small business investment. His actions and record run completely counter to the statutory mandate of the program and to the small business agenda. His management model could be summarized as linger, languish, and fester. This does not benefit anyone, particularly small businesses. The testimony given by the SBA this morning, which is all of a page and a half, half of which is hello, how are you, and not a lot of substance, compared to—it is kind of pathetic—compared to our testimony which is kind of a catalogue of incompetence. I mean, you do not normally see congressional testimony the size of a small phone book. But we have to document it because the record is clear and the record is true and the record is not pretty.

The licensing for new small business funds is down 46 percent for the first 3 quarters of this year. Leverage reserved, a leading indicator for future small business investments, is down 39 percent and it is on pace to be down 50 percent for the year. That represents billions of dollars of small business investment that just will not happen.

You heard some statistics today, they are a little bit odd, from the previous witness, about how in 2018 they licensed 25 funds. Well, that is true because the previous year he stopped licensing. So if you suddenly jam up the pipe and then suddenly you get a pop at the end, hey, are you not doing great? Not so much.

In 2017, for example, there were 15 funds licensed. I think the number of 11 of those were licensed before he got there on January 20th. The remaining four were from the following 8-1/2 months. And so the idea that it popped up to 25, we are doing great, that is not so great. Fourteen licenses with 2 or 3 days left in the fiscal year is not an impressive number. He has spent significant funds, maybe wasted, we do not know, on contractors, while refusing to hire mission-critical positions and managers. And frankly, I think you heard some misleading testimony earlier. Yes, there were two people added to the licensing team, but they were taken from the program development team. The program development team is in charge of recruiting new funds, particularly women and minorities. So you take away from one, you move it to the other and you say

you added two. And by the way, in the process you undercut the ability of bringing in new funds to undeserved areas and undeserved people. That to me is not a recipe for success.

He also touched on all the efforts and time spent on IT. Yes, the SBA's IT is in need of improvement and we have been for a long time advocating for updating that. But a lot of money has been spent, there has been no progress made, and instead of things getting better, earlier this summer the entire SBA regulatory reporting system collapsed. And in that collapse they lost a whole lot of regulatory data. SBIC funds had to go reenter the data once it was opened, and once it was opened they could do it but that was thousands of man-hours and a lot of money. That is just not how a financial regulatory system should work. So if you spent all the last 2-1/2 years trying to upgrade your IT and spending taxpayer money to do it, should it not be getting better?

The mismanagement is creating unnecessary risk to the taxpayer while harming capital access. That is not the way it is supposed to go. Further, the associate administrator repeatedly blocked congressional requests from Republicans and Democrats, House and Senate, for a taxpayer funded study on the impact of the SBIC program. Why was Congress and the public denied access to the report for over 2 years? Was it because the Library of Congress said the study is working and living up to the statutory mandate? The report he hid from you was released only when we used the Freedom of Information Act to pry it loose. This is another example that this is not just mismanagement, it is hostility. And there is a lot more I can say and a lot more I will. I welcome your questions and your comments but we are begging you to get the leadership of this office to allow the program to work. So thank you very much.

Chairwoman VELAZQUEZ. Thank you, Mr. Palmer.

Mr. Paglia, you are recognized for 5 minutes.

#### **STATEMENT OF JOHN PAGLIA**

Mr. PAGLIA. Dear Chairwoman Velázquez, Ranking Member, and members of the Committee on Small Business. My name is John Paglia. Thank you for the opportunity to testify before you today.

Sound deployment of capital in the U.S. is central for promoting economic growth, and I am grateful for the opportunity to speak to you on this important topic. I grew up in a household where my parents owned and operated small businesses, so this topic is very personal. I also worked closely with small businesses as a CPA, business appraiser, consultant, advisor and corporate director. At Pepperdine University, where I am a professor of Finance and senior associate dean at the Graziadio School of Business, I co-founded our Pepperdine Private Capital Markets Project in 2007, which provides lenders, investors, and the businesses that depend on them with critical data to make optimal investment and financing decisions. As part of this research, I also co-led the launch of our Pepperdine Private Capital Access Index, a quarterly economic indicator designed to measure the demand for, activity, and health of the private capital markets.

I would like to share three key observations revealed in our most recent Pepperdine Private Capital Access Index Survey based on data collected from July 18, 2019 to August 2, 2019.

First, 56 percent of small business owners surveyed indicated it is difficult to raise new equity financing. Fifty-nine percent indicated it is difficult to raise new debt financing.

Second, 60 percent of small business owners say the current business financing environment is restricting growth opportunities for their businesses. Fifty-four percent indicated it is restricting their ability to hire new employees.

Third, 39 percent of businesses are planning to raise funding in the next 6 months. If unsuccessful, 68 percent cite slower business growth, and 46 percent indicate they would have to reduce their number of employees.

So the consequences of small businesses not obtaining capital and financing timely are potentially severe and detrimental to overall economic health.

One such program that has demonstrated success providing much needed small business funding is the Small Business Administration's SBIC program. Fairly recently, during 2015 to 2017, I had the honor and privilege of working with co-author professor David Robinson at Duke University and the Federal Research Division of the Library of Congress to produce three research papers studying the SBIC program. Our research addressed the general topics of diversity and inclusion, job creation, and SBIC's fit into the broader financing landscape.

Based on our analysis, we concluded that the SBIC program has demonstrated relative strength with respect to diversity and inclusion, success on the job creation front, SBIC-backed companies created nearly 3 million jobs from 1995 to 2014, and a more balanced funding distribution in the small business financing landscape across company sizes, industries, and geographies.

But there remains work to be done. Small businesses could benefit by having more capital available, as well as expedited access to funding, especially as needs arise and their capital structures change. Finding ways to achieve faster and more efficient capital deployment would increase their chances of success and serve to further job creation and economic growth.

Small business financing and capital formation would also benefit greatly with increased transparency and robust educational programming. Small businesses have at best a moderate understanding of how to efficiently and effectively navigate the financing and capital markets to get the money they need.

Accordingly, when small businesses need financing and capital, some freeze and choose not to pursue, or spend lots of time chasing opportunities that are not a good fit. If they do pursue funding, their mindset is do I qualify for funding versus a larger company mindset of what is the price of funding?

In summary, despite the successes of various programs, including the SBIC program, small businesses continue to struggle to find the financing and capital they need to grow and hire new employees. Reducing frictions in the system, increasing transparency and educational opportunities, and increasing the amount of capital

available would serve to further strengthen the foundation for economic growth.

Thank you again for the opportunity to share these points. I am happy to answer any questions and address comments. Thank you. Chairwoman VELAZQUEZ. Thank you.

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

#### STATEMENT OF RONDA PENN

Ms. PENN. Madam Chair and members of the Committee, thank you for holding this hearing, and thank you for asking me to testify.

I am Rhonda Penn, and I am the chief financial officer for Plexus Capital. Plexus Capital is a small, North Carolina-based company, and we are helping small businesses in the United States do big things. I am excited to talk to you about the program today that has allowed our team to stay focused on supporting perpetually undeserved small businesses.

My team at Plexus has managed SBICs for 22 years and witnessed the success of the program. I have personally worked with multiple SBICs and the SBA staff for more than 24 years. The sole purpose of the SBIC program is to provide capital to small businesses.

Plexus invests in Main Street America small businesses across all industries. We are currently operating our fourth SBIC fund. It is a \$400 million fund, and we are over 80 percent invested at this time.

We have a good working relationship with our analyst, Raoul Rodriguez at the SBA. We speak often. He genuinely cares about the program and he works hard. He offers advice on how we can improve, and I am happy to do the favor and give it back to him.

Together with the SBA, Plexus has invested \$1 billion in 108 small businesses. We consider the SBA our partner and our largest investor. Our profit capital investors include banks, individuals, family offices, and institutions. We have raised \$475 million of private capital. And this is key as to why this program is unlike any other public-private partnership as far as I know. In other programs, public money is put at risk alongside private money or ahead.

But the SBIC program is unique in that it operates at a zero cost to taxpayers, and we, along with our partners, put our capital at risk first.

But the real story of the SBIC program is about people, jobs, and communities behind the businesses that we support. Often we are measured based on financial metrics, but the driver behind every return we generate includes real people with families impacting their communities like the 26 employees at Plexus capital and the thousands of employees at the 108 small businesses that we support.

I will share with you just a few stats about the investments at Plexus. More than 80 percent of Plexus investments are in smaller concerns. The SBA defines a smaller concern as a business that has less than \$6 million in net worth and less than \$2 million in average 2 years of net income. More than 20 percent of Plexus investments have been in low to moderate income zones. More than 40

percent of Plexus investments are businesses owned by minorities and veterans. Overall, revenue growth for all Plexus investments has increased by more than 30 percent over the life of the investments, and jobs have grown by almost 30 percent during that time.

So I have talked about the importance of the program, how it impacts people and communities. I just want to speak briefly about the future of the SBIC program.

There are approximately 100,000 small businesses with sales between \$10 and \$100 million. Roughly 50 percent are owned by baby boomers. The continuity of these businesses and the millions of jobs in these businesses are dependent upon the successful transition of the estimated \$2 trillion of ownership to the next generation of owner-operators. These small businesses need the SBIC program.

To conclude, the SBIC program is a vital source of capital to small businesses. It is a prime example of how the Federal Government and private sector can work together to grow the economy and create jobs. I am thankful to this Committee for your support of the program. Plexus stands committed to pursue opportunities to strengthen the program with you. Thank you.

Chairwoman VELAZQUEZ. Thank you, Ms. Penn.

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

#### **STATEMENT OF WALT RODGERS**

Mr. RODGERS. Madam Chair, congressmen and congresswomen, it is an honor to be here today testifying in front of the Committee.

My name is Walt Rodgers. I am the CEO of Family RV Group, formerly Colerain RV. Founded in 1968 by the Jung family, Colerain RV started as a small, family-owned RV dealership in Cincinnati, Ohio, with little more than 10 campers for inventory. Today, just over 50 years from those humble roots, the company has expanded to include dealerships throughout Ohio, Kentucky, Indiana, Tennessee, and Georgia. Given the unique nature of our business, the patient and flexible capital from our SBIC partners Northcreek, Spring, and Resolute, has been instrumental in facilitating and expediting this growth.

Before proceeding about the impact of the SBIC program, I would like to provide a little bit more detail about the history of the Family RV Group. In the late 1960s, Charles and Lolly Jung decided to undertake the challenge of opening an RV dealership. With only a few campers on a lot and a sign on a small home, Colerain RV was born in a northern suburb of Cincinnati. The bootstrap effort instilled a focus on family and customer service and still remains a core value of our company today.

By 1975, Colerain expanded to nearly 100 vehicle operations with brands including Mallard, Thunderbird, and StarCraft trailers. Over the next 20-plus years, not only did the company's stock expand, so, too, did the impact and influence of the Jung family.

In 1988, Chuck Jung joined the family business to help his parents operate and grow operations. Shortly thereafter, Chuck was followed by his brother Steve and the two siblings led the company through another period of growth and success. The company relocated to its current 12-acre Cincinnati facility in 1996, and given the rapid growth, brought on Wade Stepp, an operating partner and owner with extensive industry knowledge in the early 2000s.

Wade, Chuck, and Steve made the decision of the next decade to focus on geographic expansion, acquiring single store locations in Dayton, Columbus, and Indianapolis, Indiana. By 2015, the company started looking for the next growth avenue. The addition of three new facilities began to strain the infrastructure, and rather than continue growing slowly in location by location, management realized the need to acquire not only additional talent and resources to support these operations, but also the opportunity to expedite growth through larger and more frequent acquisition activities.

This impasse led to the transaction that involved Northcreek, Spring, and Resolute in January of 2016. Kidd and Company, a Connecticut-based private equity firm led the transaction providing and arranging capital to recapitalize the business, refinance Colerain's existing debt, increase cash needed for working capital, and acquire assets of Northside RV in Lexington, Kentucky. Given the many uses of capital and overall need, debt was required to properly finance the company while maintaining the flexibility needed to pursue growth opportunities beyond Northside. However, as an RV dealership, the main source of bank financing is floorplan debt, which allows companies like ours and automobile dealerships to pursue the expensive inventory essential for our stores and showroom. It can often be difficult to find other lenders that are willing to provide additional debt alongside or below such a facility.

Despite the uniqueness of our situation, our SBIC partners were able to get comfortable with the transaction structure and business in general to provide the capital we needed. I truly believe that the distinct characteristics of the mezzanine debt provided by Northcreek, Spring, and Resolute, specifically the lack of amortization and willingness to be subordinated to the senior floor plan, provided the perfect solution for our needs and not only gave Colerain the necessary growth capital and flexibility, but allowed us to secure the initial floor plan facility and larger ones thereafter that may not have been possible with other capital providers.

That transaction in 2016 immediately impacted the growth of the company with the acquisition of Northside. The addition of this platform and its assets created the Family RV Group and immediately increased revenue to nearly \$120 million, while expanding the company's workforce from 130 to 180. With that acquisition, the group has completed another transaction, Dunlap RV, under the Family RV Group with locations in Nashville; Knoxville; Ringgold, Georgia; and Bowling Green, Kentucky. Though no direct capital was provided by our SBIC investors in this instance, the lack of amortization on their debt facilities allowed us to build cash on the balance sheet. By the time the Dunlap transaction needed to be financed, we had accumulated enough cash to fund the acquisition ourselves. Not only did this flexibility allow us to add Dunlap but also position and capitalize Family RV for further growth.

Today, Family RV is an over \$180 million business. It is continually looking to grow, improve, and support communities in which we operate. As I mentioned before, our business now employs some 300 American workers, more than twice that were employed in 2015.

When the Jungs opened their single location mom and pop shop in Cincinnati, they never—

Chairwoman VELAZQUEZ. Mr. Rodgers—

Mr. RODGERS.—I am sure they never envisioned that.

Chairwoman VELAZQUEZ. During the question and answer period you may be able to finish or add something that you feel strongly about.

Thank you to all of you for being here today.

Now I recognize myself for 5 minutes.

Mr. Palmer, since you have been at SBA for so many years, can you please discuss anything that you find that you need to say or react to Mr. Shepard's information provided to the committee regarding licensing delays and approval rates?

Mr. PALMER. It is regulatory roulette. I mean, you never know what you are going to get. They can move quickly when they feel like it. There was a fund that submitted their green light application in July, which is the early start of the process. My understanding is they were approved for license last week. It was about 40 days. Hey, that is great. The question earlier, if you are a repeat license, you should be able to move quickly. That is light speed. We have other repeat funds that are in good standing that have put their green light letter in which is the first start before you are even allowed to submit your license application that have had to wait over a year. I think some of the statistics are going down since 2013, well, 2013 was a spike year after the financial crisis because we were filling gaps. I mean, look at the overall trend. And there is going to be a normal fluctuation, a little up and down. I get that. But you cannot do all your homework the night before and expect to do it well. I mean, businesses have to have some consistency. So the idea that you have got 14 licenses through 363 days of the fiscal year and then in the last 2 days suddenly you are going to wake up and get it all done, that is not fair.

I think on the personnel side, there are mission critical positions. Regulation matters. Regulation is a taxpayer protection. You have three area chiefs that are managers and oversee the actual regulators. Two of those three are vacant and they have been vacant for a very long time. There are all these contractors being hired, all these studies are being done. To the best of my knowledge no one has ever seen the results of any of those studies, but no one is getting filled. I think the last employee to be added to the Office of Investment was in February of 2018. And that just does not work. That is creating risk where there is no need for it. The money has been appropriated. The FTEs are there. And I think, and I think this might be a question for the Committee, that a number of those FTEs have been actually ceded back to other parts of the agency. So I think if we want to get more diversity and more geography we have got to get the program working. I think the underlying core is right but just the management is not.

Chairwoman VELAZQUEZ. Thank you.

Dr. Paglia, we know that the SBIC program has historically struggled with attracting and licensing women-led and minority-led SBIC funds. Your report noted SBICs have better racial and gender diversity in leadership positions compared to the broader private equity community, and these diverse SBICs are more likely to in-

vest in low to moderate income regions of the country. Did you look at whether diverse fund managers have better investment returns than nondiverse managers? And if not, why?

Mr. PAGLIA. Yes, that is a good question. And so we did take a look at that question. We wanted to understand if there were any discernable return differences between diverse and nondiverse fund manager teams. And by looking at the years of 1995 to 2015, we examined that very question. We concluded that there was no statistically significant difference between fund returns among those two groups.

Chairwoman VELÁZQUEZ. Okay. Thank you.

Ms. Penn, in your written testimony you talk about financing small businesses owned by baby boomers who might be wishing to retire soon but want to preserve their independence as small businesses. How many of those financings have gone to small businesses that have converted to a co-op or other employee-owned business models?

Ms. PENN. Our fund does not work those types of transactions. We mostly are working with transactions moving to a strategic buyer. But Mr. Palmer may be able to speak on SBIC's others.

Mr. PALMER. Sure. I mean, there is a broad range of investing types. I do not know of any co-ops, but I can look into that. But ESOP transactions, which are related transactions, certainly a number of SBICs have done those. And I think there might be one or two that are even forming to specialize in that. But I need to look some more into the co-op action.

Chairwoman VELAZQUEZ. As a general matter, do you think SBA's capital access and investment programs should be more accessible to ESOP co-ops and employee-owned businesses?

Mr. PALMER. I think they should be more accessible to more small businesses and to reflect the diversity of structure and geography and industry sector as much as possible.

Chairwoman VELAZQUEZ. Mr. Rodgers, thank you. I am interested in hearing about how your business found its way to an SBIC fund, and how did you find the SBIC fund that made the investment in your business?

Mr. RODGERS. Sure. Thank you.

Well, originally, as I understand, the SBIC fund was referred to us through our PE firm, Kidd and Company. And it is probably important to talk about the fit and the impact of the fund. So in the space in which Family RV operates—

Chairwoman VELAZQUEZ. If you could be brief because my time has expired.

Mr. RODGERS. Certainly. So it is all about access to capital versus traditional banks. And banks are not comfortable with the floor plan arrangement typically in our industry, and there is more flexibility within the fund. And lastly, the bank loan mechanism with amortization is not as friendly to companies like Family RV as the fund is.

Chairwoman VELÁZQUEZ. Thank you.

Mr. RODGERS. Certainly.

Chairwoman VELAZQUEZ. Now, we recognize the gentleman from North Carolina, Mr. Bishop, for 5 minutes.

Mr. BISHOP. Thank you, Madam Chair. I appreciate the opportunity before I officially joined your Committee, but I certainly wanted to remain. I noticed that as I sat down that we had a witness from North Carolina. Thank you, Ms. Penn, for being here and learning about Plexus, which I was happy to do.

I was curious. I think I heard, I believe, during your testimony that you spoke highly about the relationship that you had with the reviewer at SBA that you work with. But I have also heard some disturbing things today, which are new to me. And I wondered if you had any insight about the approval issues that we are hearing about and delays. Is that something that Plexus experiences? And if not, do you have any ideas about why not?

Ms. PENN. I was speaking specifically about our relationship with our analyst who has worked with us for about 5 or 6 years. We have experienced more delays in recent years and we are working with the SBA to improve that. We have not been through the licensing process in recent years but we are now submitting a request for our fund five. And the procedure that Mr. Palmer spoke about earlier regarding there is a time period where you are requesting to submit an application. And we have been in that process for about 5 months right now, but Mr. Palmer may have more to add to that.

Mr. PALMER. Sure. So the relationship between the SBIC fund managers and the SBA is excellent among the career staff and in the senior leadership of the SBA. That is not the problem. It is not perfect but, hey, that is how regulators work, and we do the best we can.

The political leadership of the Office of Investment is just incompetent, and frankly, hostile to the successful operation of the program. And I do not say that lightly or with any comfort from me.

But on the licensing side, you do have these massive delays that are unnecessary, and some of them were I think misrepresented by the previous witness. Yes, it takes time to raise private capital. We are about to host a large private equity connection between fund managers, small business investors who are raising funds and institutional investors. There is massive interest in investing in the private into small businesses, you have SBICs. The problem that the institutional investors are having—banks, pension funds, endowments—is that there are not enough SBICs to put money into. That they are moving so slowly they have to go back to their own investment committees and say, hey, I have tried to put money into this but they have been sitting in the SBA's inbox or on somebody's desk for extended periods of time so I need to go back and get permission. They are actually cutting back on their allocations into small business because they cannot get it through the SBA. That is not what I think the goal of this Committee or the goal of the program is.

Mr. BISHOP. Thank you, sir.

And Ms. Penn, one follow up to that. Are you finding that in the North Carolina market that there is a great deal of additional potential for SBICs to be involved and that they are not forming because of these regulatory roadblocks?

Ms. PENN. So we, in addition to being in North Carolina, we work with and invest all across the country. It seems that demand

for capital is higher than ever and investors are seeking ways to invest their money. So right now I believe demand is as high as it has ever been.

Mr. PALMER. And one thing I would add to that is that North Carolina has an exceptionally healthy and robust SBIC market. There is certainly more to be formed but they are in Greensboro, they are in Raleigh, they are in Charlotte. There is one forming in Wilmington. You have got them all over the place. And frankly, the more, the better. And frankly, we would like to get more of them in other parts of the country as well, more in North Carolina, but also undeserved states.

Mr. BISHOP. The final question, if I may, again, for Ms. Penn, Mr. Shepard referred to a rural investing workshop in Carolina. Is that something that your company was aware of and participated in? Is that the sort of thing you would do? And if not, do you have any ideas about how that might be more effective for attracting folks in North Carolina and giving them ideas on how to proceed?

Ms. PENN. I was not and did not attend. I do believe that more education and more communication about the program would help it significantly. I am constantly surprised at how little people know about this program and what a great program it is.

Mr. BISHOP. Thank you, Madam Chair.

Mr. PALMER. Can I add one piece to that?

Mr. BISHOP. Yes, sir.

Mr. PALMER. That event was actually in North Carolina, I believe at UNC. It was attended, but it was so poorly attended because it was held the day after the National Conference of SBIC funds that was 700 miles away. And it is not something that the SBA did not know about. He was actually invited to be a speaker at that event. So to have it 700 miles away after you have just been in a big conference really minimizes the effectiveness of it. That is consistent.

Mr. BISHOP. Thank you, Madam Chair.

Chairwoman VELAZQUEZ. The gentleman's time has expired.

Now we recognize Ms. Davids from Kansas for 5 minutes.

Ms. DAVIDS. Thank you, Chairwoman.

So in light of the previous panel's testimony I am going to very briefly as one unanimous consent to submit testimony from Konza Valley Capital in Overland Park, which is in my district-based SBIC.

Chairwoman VELÁZQUEZ. Without objection, so ordered.

Ms. DAVIDS. And second would just like to say I am going to follow up with written questions, at least one written question to Mr. Palmer and then others if they would like to chime in related to leverageable capital. So Konza Valley Capital uses the Evergreen Fund structure which is maybe less used. So I want to delve in with the experts here about the reinvesting and that sort of thing. And I will do that with written questions to you all.

So I want to go off of the testimony we heard earlier from Mr. Shepard and then Mr. Palmer, some of the statements that you made earlier. I am really curious about the current waiver of classes related to regulations and compliance that SBICs have and that there have not been classes offered. Can you tell me a bit about—in his words he said that no one has been held back. I am less wor-

ried about—I am worried about all of it, but I am less worried in this moment about folks feeling held back and more about if this is going to cause problems for SBICs in the future because if this is the mechanism by which they learn to comply with the law and then if they potentially run afoul of that later, then whose fault is it really? So if you could speak to that. And Ms. Penn, as an SBIC who maybe is familiar with those classes, would love your input, too.

Mr. PALMER. Sure. It is a very complicated program. Complicated law, complicated regulations, complicated financing. And those classes have been held at least about once a quarter every year for decades. And we have helped organize them. They are incredibly helpful because you get to talk to the regulators who really understand it because this is complicated. These are very smart people, very educated people, but you want to get it right because if you do not you are breaking the law. It is very helpful. They just stopped, sort of went into the abyss last year. We have not been able to get any response from them. He mentioned that they are going to use taxpayer money to create an online regs class. We did that. We took the exact content that they have. We have built an online regs class. They know it. It is set to go live I think this week or next that does the exact same thing because they did not. So if they are going to do an online regs class and use taxpayer money to do it, stop.

I actually wrote a letter to the CFO to let them know that, to make sure that that was getting up there. It is very effective. It is very helpful. If we want to use new technology, hey, that is great, but do not reinvent the wheel with the taxpayer dime.

Ms. PENN. These regulation courses are instrumental to helping us know how to manage the SBICs. You can read the regs. They are complicated and hard to follow so these courses really help you understand so that you do not make decisions where you are breaking the law.

Ms. DAVIDS. Thank you.

And then the only thing I want to, the last thing I want to say is that I, as a first-term member of Congress, I wanted to be on this Committee because in the Kansas City Metro area and the Third District in Kansas where I have the honor of representing, the entrepreneurship is baked into the DNA of the place. So many of the programs that we hear about in this Committee are instrumental in small business growth and entrepreneurship in my community. And what I heard today was very alarming. And I also want to say that all the other times that I have been in here, the SBA programs are supported across the board, Republicans, Democrats, it does not matter. People know that small business is really important and that there are plenty of other programs in the SBA that I know are functioning well. And I have not up to this point heard anything that is a red flag or alarming like I did today. And I will just ask that all of you be open to me reaching out, our office reaching out to you to do follow up questions and do more insight into what is going on with this specific program.

Thank you. I yield back.

Chairwoman VELAZQUEZ. The gentlelady yields back.

Now the gentleman from Illinois, Mr. Schneider, is recognized for 5 minutes.

Mr. SCHNEIDER. Thank you, Madam Chairman. I want to thank the witnesses. And after the comments from my colleague from Kansas, you know, we should be here today celebrating the SBIC program. We should be honoring those small business entrepreneurs who take an idea and develop a business model, seek to get the capital to take that model to market, look to hire people to create the jobs that grow our economies. And having spent my career as a consultant working with family businesses, the clients and investments you all make, I understand the values these businesses bring. And I understand the power that a well-functioning SBIC program could actually provide in these communities. And the fact that we are falling short is a misuse of taxpayer money because we are not living up to the potential. But it is also hurting the growth of our economy.

Mr. Palmer, I want to turn to you first. I hear your frustration. I share your frustration. Two questions. How new is this phenomenon you are explaining or describing? And what would be the things that could most quickly change it and turn it in the other direction?

Mr. PALMER. Excellent questions one and all. Thank you very much.

There is always going to be frustration with regulations. That is normal. There is a normal level that is a reasonable level, and then we try to push and minimize but that is this. This really has been for 2-1/2 years been a mess. It started with day one of the political appointee taking over the program. I will mention that he ran the program at the end of the Bush administration when I was in the Bush administration, too. Not overlapping. But it was a disaster then but the clock ran out because he was only there for about 13 months. And if you look at the hearings from 2009, you see that documented. There was no reason for it then. It took years to undo the damage of that. It will take some time here, too. I think you need to change the management. I do not think you need to change the focus from the administration because they do care about small business. I do not think you need a change in Congress. They care about small business. They just need to be allowed to work. I think they need to hire some key people that they have not been allowed to hire in key management positions that they have money for. But I think you just need someone who is willing to let the staff do their job and do the regulation that they need. And we can disagree on different things at time but we are not trying to get someone to do their job.

Mr. SCHNEIDER. Ms. Penn, I am going to turn to you. You are on your fourth fund.

Ms. PENN. Yes, sir.

Mr. SCHNEIDER. You have been investing, I think you said, 108 investments focusing on the \$10 to \$100 million segment of the market. How critical to the growth of the communities you are investing in, the companies you were investing in to the communities that these operate in is speed of this access to capital, the ability to process, to review a proposal, process it quickly, and get the capital of these companies quickly, how important is speed on that?

Ms. PENN. Very. We are on our fourth fund. It is a \$400 million fund. It is over 80 percent invested. We need a fifth fund.

Mr. SCHNEIDER. Great. Thank you.

And Mr. Paglia, as you look at it, and you come at it from an academic standpoint. I know you are a CPA. I am the son of a CPA, so I have some appreciation by osmosis. But these companies are looking, they need people, they need funds. They need the ability to do that to grow. We can help that by investing in workforce development. We can help that by investing in programs like the SBIC program that is a public-private partnership. What do you see as the impact? What do you see as the opportunity?

Mr. PAGLIA. Well, I think there is a real opportunity in the early stage investment side of things. One of the reasons why this capital penetrates smaller segments of the marketplace is because of this public-private partnership, the leverage it has created for the funds. And so I think this sort of a model would work fairly well with younger companies that create a significant number of jobs. I also think that as you look at the dispersion of capital around the country, there are some geographic areas where the number of businesses per capital event is significantly higher than others. And that suggests there are some additional opportunities to deploy capital, to grow jobs, create healthier economies, and engage more of a diversity and inclusion application as well.

Mr. SCHNEIDER. All right. And thank you.

I am running out of time, but Mr. Rodgers, I do not want to leave you out. Family RV you described is a growing business, going into new markets. I know from experience that many of the RV dealers across our country are family-owned businesses. Started out with a similar story to your company. How many people do you employ now, today?

Mr. RODGERS. Today, just over 300.

Mr. SCHNEIDER. Okay. Starting from two people selling RVs on their lot.

Mr. RODGERS. That is right.

Mr. SCHNEIDER. That is the kind of example of companies that we are looking to invest in. And whether it is an RV business or a new technology business, a service business or a manufacturing business, we have the ability to grow our economy. Small businesses drive our economy. They create the jobs new. They strengthen our communities.

Madam Chairman, thank you for having this hearing. Thanks again to the witnesses for being here. We have got to get this right.

Chairwoman VELAZQUEZ. Thank you. The gentleman yields back.

I have one more question.

Mr. Paglia, since you have conducted research on the SBIC space and given the fact that this is a very important program, specifically a private-public partnership, what recommendations or suggestions can you suggest to make it better?

Mr. PAGLIA. Yes. Thanks for the opportunity to weigh in on that.

I do think that any time you can make programs run more efficiently and send the capital out, deploy the capital to those businesses that need it in a faster fashion, it is going to allow the econ-

omy to work and grow at a much faster rate. So I would just suggest that you take a very hard look at this program and the opportunities to extract efficiencies out of the current operating model and structure and then also supplement with some increased capital.

Chairwoman VELÁZQUEZ. Thank you.

Mr. PAGLIA. You are welcome.

Chairwoman VELÁZQUEZ. We want to thank all of the witnesses for taking time out of their schedule to be here with us today.

We have now heard about one of the federal government's most popular public-private partnership programs. It is an engine of small business job creation and has contributed to the growth of countless small businesses, some of whom have become the largest and most powerful companies in our economy. However, if we intend to continue enhancing access to affordable capital for small businesses, it is clear we must take a hard look at the SBIC program, especially the way it is currently being administered. We owe it to the entrepreneurs, as well as to the taxpayers at large, to ensure that these federally-backed finance programs are being run efficiently.

I look forward to working with my colleagues on both sides of the aisle to come up with bipartisan solutions to this issue.

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

Without objection, so ordered.

If there is no further business to come before the committee, we are adjourned. Thank you.

[Whereupon, at 1:26 p.m., the Committee was adjourned.]

**A P P E N D I X**



**Statement of Joseph Shepard  
Associate Administrator  
Office of Investment and Innovation  
U.S. Small Business Administration**

**before the  
House Committee on Small Business**

**Hearing on "SBA Management Review: Small Business  
Investment Company Program"**

**September 26, 2019**



**Statement of Joseph Shepard  
Associate Administrator  
U.S. Small Business Administration**

Chairwoman Velázquez, Ranking Member Chabot and members of the committee, thank you for inviting me here today to this hearing on, "SBA Management Review: Small Business Investment Company Program".

I am the Associate Administrator for the Office of Investment and Innovation at the SBA. I am honored to be at the SBA and to be here today with all of you.

Prior to the SBA, my business career has included leadership positions in consulting, investment banking, venture capital, private equity, and investment fund management for such organizations as KPMG, Texas Pacific Capital, Principal Financial Securities, Banc One Capital Markets, as well as a previous tenure in public service at the SBA.

The SBA's Office of Investment and Innovation has oversight responsibilities for three different programs, the Small Business Innovation Research (SBIR) program, the Small Business Technology Transfer (STTR) program, and the Small Business Investment Company (SBIC) program.

The SBA's Office of Investment was created by Congress through the Small Business Investment Act of 1958 to supplement private equity capital and long-term loan funds that were not available in adequate supply to small businesses.

The Office of Investment has managed the program for 61 years, during which a vibrant private equity industry has developed in the United States. The SBA does not provide capital directly to small businesses through the SBIC program. Instead, SBA provides taxpayer-backed, SBA-guarantees to SBICs that are licensed by the SBA. SBA provides 100% guarantees up to \$175 million to a single SBIC, and up to \$350 million to multiple SBICs under common control. SBICs use these SBA-guarantees and privately raised funds to independently provide capital to qualifying small businesses.

During the past 18 years, the SBIC program has grown significantly, and in FY 2018, surpassed \$30 billion in capital. The SBA-guaranteed portion of that amount increased 1.8 times from \$7.9 billion as of 09/30/2010 to \$14.2 billion as of 12/31/2016. Since my arrival in 2017, I have led improvement efforts to ensure the technology, examinations process, and risk management practices are appropriate for a program of this size and complexity. Many of these improvements have been generational in nature. The following is a summary of these activities, which are intended to improve the efficiency and effectiveness of the program.

Technology plays a key role in improving effectiveness and efficiency. During my tenure, I've focused on opportunities to leverage technological improvements to modernize the SBIC program's information technology infrastructure to streamline processes, increase security, and facilitate information sharing throughout the SBIC life cycle.

In September 2018, SBA awarded a contract for a state-of-the-art software system to assist SBA with managing and monitoring the SBIC program. SBA is currently focused on implementation and customization of this new system. Additionally, the legacy SBIC WEB system, which collects SBIC and SBIC portfolio company financial data, is being moved to the cloud to improve data entry and processing times. It will also be replaced by the new system.

In regard to examinations of SBICs, the Small Business Investment Act has a requirement that all SBICs are to be examined at least every 2 years. Examinations are critical to the oversight of the SBIC program and assist SBA with confirming that SBIC recipients of SBA-guaranteed leverage are complying with SBA regulations.

However, the number of SBIC examinations conducted by SBA had been declining since FY 2015 and examinations were taking twice as long as they took in FY 2013. This combination resulted in a steady decline in the number of SBIC examinations. As a result, SBA began FY 2017 with approximately 178 of all 313 SBICs (56.9%) in statutory compliance.

To remedy this situation, I implemented an immediate response to the problem through an intense focus on examinations. I'm pleased to announce that by July 2018 statutory compliance improved to 100%. SBA also recently concluded a program evaluation of the examinations process and will be reviewing the recommendations for implementation. Furthermore, SBA is adding examinations as an operating metric to monitor compliance performance in the future.

Finally, SBA is continuing to implement elements of the Office of Management and Budget's Circular Number A-129 regarding policies and procedures for managing Federal credit programs. In accordance with the Federal Credit Reform Act, SBA is improving cost estimation tools to better forecast program performance and is also building additional risk management capacity for the SBIC program.

In conclusion, thank you for your support of the Small Business Administration and the SBIC program. I look forward to working with this Committee to support America's small businesses.



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**Testimony of SBIA President Brett Palmer  
Before the U.S. House Small Business Committee**

**“SBA Management Review: Small Business Investment  
Company (SBIC) Program”**

**Thursday, September 26, 2019**

Prepared by:

**Brett Palmer**

President, Small Business Investor Alliance (SBIA)

Prepared on:

**September 24, 2019**

Dear Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee:

The Small Business Investor Alliance ("SBIA") is pleased to submit the following testimony about the U.S. Small Business Administration's Small Business Investment Company ("SBIC") Program." SBIA is the national association that has represented SBICs since their inception over 60 years ago.

SBICs are an American success story and are an example of a successful public policy that aligns the power of private market with the public interest of job creation and economic growth. SBICs invest exclusively in domestic small businesses to create job, empower American small businesses to grow and compete in a global economy, and support communities.

The SBIC program, like all government programs, should be regularly examined for effectiveness and for opportunities to make reforms to better serve the American people. We welcome Congressional oversight and review.

This testimony explains the SBIC program and the role it fills in aiding high growth small businesses and thereby job creation. We are disappointed that we must dedicate a large section of our testimony to the mismanagement plaguing the SBIC program – issues that are harming small businesses and creating unnecessary risks to the taxpayer. The following testimony documents many of these fully avoidable, man-made problems.

After well over two years, the Office of Investment and Innovation (OI) Associate Administrator's management style being applied to this otherwise successful small business program could be summarized with the phrase "linger, languish, and fester."

We are at the point that small business investors are unable to distinguish between what is mismanagement by the Associate Administrator and what is passive aggressive hostility to the successful operation of this otherwise successful small business program. Small business investors see a pattern of mismanagement by OI leadership using or warping the regulations not for good faith execution of the law and the benefit of small business, but instead to set up a near never-ending series of delays, roadblocks, and unnecessary costs at every step of the program. Every process with which the Associate Administrator is involved has become slowed, erratic, and unpredictable. When there is any regulatory or procedural question small business investors now are forced to assume that the most adverse interpretation is the likely outcome.

Small Business Investment Companies need and want regulation that is reasonable, clear, predictable, and maintains the alignment of interests between the private and public sectors.

In some cases, the SBIC processes work adequately and as they should, but in too many other cases random delays and unpredictable outcomes have been the growing norm. There are numerous, interdependent steps in the many SBIC processes. The regulatory steps that do not involve the Associate Administrator generally seem to be working adequately. Nearly all processes involving the Associate Administrator are delayed, commonly for exceedingly long periods of time. Since many processes have multiple steps, the delays build upon other delays and to the point of near programmatic dysfunction. Management of a \$30 billion-dollar federal program should not be so unpredictable and unsteady.

Small business investors have wasted significant time over the past two years trying to get OII leadership to simply execute the law in good faith. This wasted time and effort should otherwise have been spent finding more small businesses with growth potential and then helping them grow to their full potential. SBIA's members would prefer to be spending time and resources to identify ways to work with this Committee and Administration to better serve the public. For example, what policies can be improved to better fill the remaining gaps in capital access? How can we facilitate a more robust equity market for small businesses? Are there better ways to capitalize small businesses in underserved communities, both rural and urban? How can we make investments into veteran, women, or minority-owned businesses more commonplace? What changes should be made to ensure the taxpayer is fully protected under all economic conditions? These are issues where the private sector, Congress, and the SBA could have been working together. Instead, we are again before Congress asking that the leadership of the OII stop breaking what is otherwise a successful small business program and to simply allow the program work. There is no public benefit from the rampant delays, unpredictability, and lack of communication exhibited by the leadership of the OII.

Our testimony exposes, in many cases using SBA's own official data, the current management's dismal record. For example,

According to SBA's most recent data through three quarters of FY 2019:

- Licensing for SBIC Debenture funds is down 46%
- The number of Green Light Letters issued is down 42%
- The number of first time SBIC licensing applicants is down 83%
- The amount of leverage commitments issues (a leading indicator of future investment) is down 39%

It is worth noting that licensing numbers get the most attention because they are the most easily counted metric and are a clear indicator of future small business investment. However, there are many other areas where there are significant management problems that are mission critical but are not as widely reported or as easily quantifiable. For example, the OII has numerous critical management positions which are sitting vacant and preventing the SBIC program from operating properly, despite having the FTE's and the money appropriated to hire these key staff. The OII has also spent significant financial resources on outside contractors, particularly for computer systems – systems that previously worked, but which and now are collapsing. This testimony includes many other examples.

The SBIC program is a long-term investing platform and the successes for the past several years and the current year are lagging indicators. For example, the majority of licenses issued and the small businesses receiving capital are largely the results of previous OII management. The leading indicators are the result of the current leadership of the SBIC program and are trending very negatively. With the current program management of this otherwise successful small business program, the amount of small business investment is on a downward path where the future will have fewer small business funds with fewer small businesses able to access capital. The current mismanagement is also creating unnecessary risk to the taxpayer.

The President has spoken many times about his commitment to support American small businesses. He has placed an emphasis on manufacturing, on economic growth for underserved areas and people, and on not promoting offshoring of American jobs. These goals are widely shared by this Committee, this Congress, and your constituents. These goals are exactly what the SBIC program does, which is why the program has always had strong bipartisan support. This is a good program doing good work for the American people. It should be allowed to work.

SBIA appreciates the opportunity to present this testimony and looks forward to collaborating with the Committee in its work to ensure the SBIC program continues to benefit America's small businesses with access to the growth capital they need.

On behalf of the small business investors, I look forward to answering any questions you may have.

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## SBA Management Review: Small Business Investment Company Program

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*Prepared by the Small Business Investor Alliance (SBIA)  
September 24, 2019*

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	<b>Studies and Reports on the SBIC Program</b>	
	11. Paglia, J. and D.T. Robinson. (2017). <i>Measuring the Role of the SBIC Program in Financing Small Businesses: 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.</i> Access: <a href="https://www.sba.gov/sites/default/files/2019-08/SBA_SBIC_Financing_Small_Business.pdf">https://www.sba.gov/sites/default/files/2019-08/SBA_SBIC_Financing_Small_Business.pdf</a>	
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	14. U.S. Government Accountability Office. (2016). <i>Small Business Investment Companies: Characteristics and Investment Performance of Single and Multiple Licensees.</i> Access: <a href="https://www.gao.gov/products/GAO-16-107">https://www.gao.gov/products/GAO-16-107</a>	
	15. Office of the Comptroller of the Currency, U.S. Department of the Treasury. (2015). <i>Small Business Investment Companies: Investment Option for Banks.</i> Access: <a href="https://www.sbia.org/wp-content/uploads/2019/06/OCC-Paper-on-SBICs.pdf">https://www.sbia.org/wp-content/uploads/2019/06/OCC-Paper-on-SBICs.pdf</a>	

## Section One

Serious Mismanagement Issues and Hostility  
Undercutting the Success of the SBIC Program

- **SBIC Program Only Allowed to Work When There is Impending Oversight.** Without public review and Congressional oversight, the current leadership of the SBIC program will not let the SBIC program operate effectively or efficiently, but when there could be public scrutiny the program is allowed to work (albeit only until the threat of oversight wanes).
  - The first licenses for fiscal year 2019 were issued less than 24 hours before the SBA Administrator was scheduled to testify before the Senate Small Business Committee in February 2019.
  - For over two years, the Associate Administrator of OII blocked the release of a Library of Congress report on SBIC Financing of Small Businesses that was favorable to the program. Only after a Freedom of Information Act (FOIA) request by SBIA forced the Associate Administrator to release the report was Congress able to read it. Access to this report was repeatedly sought by this Committee and was repeatedly denied.
  - In the closing months of FY 2018 the rate of Debenture licenses issued dramatically accelerated in advance of the SBA Administrator speaking to a large gathering of small business investors. Shortly thereafter, the pace of licensing again returned to a crawl.
  - A SBIC license was only delivered to the applicant, who had been waiting months for the license documents, when OII was informed that the Administrator was going to be appearing with the home state Senator of the applicant.
  - After waiting for an extended period of time for an approved license to be sent, it was emailed an hour after a Senate office completed SBA's required paperwork before the SBA would talk to the Senate office about the reason for the delays.
  - Several Representatives had to intervene with SBA to get the OII to release the approved licenses of their constituents after months of delays.
  - The Associate Administrator refused to process the surrender of many licenses, some of which had been pending for ten months, until SBIA appealed to SBA leadership in advance of a Congressional hearing.
  - A number of SBIC applicants were approved for a "Greenlight Interview" in July 2019. However, the Associate Administrator would not make himself available to interview the applicants for over five months (i.e., late November 2019). Only after a letter was sent to Congress about these unreasonable delays were the interviews quickly rescheduled for a few weeks later.
  - The small business investing community expects that a number of the metrics for the SBIC program will noticeably improve just prior to this Congressional hearing – and only because of Congressional oversight. However, the small business investing community also expects that shortly after any Congressional oversight of the SBIC program, the current leadership of the Office of Investment and Innovation will quickly return the program to near dysfunction.
  - Senators and Representatives should not have to personally involve themselves in the SBA operations to get the leadership of the Office of Investment and Innovation to do his job.

- **Undercutting the Implementation of Chairman Rubio's "Spurring Business in Communities Act"**

A new law sponsored by Chairman Rubio and Rep. McMorris-Rogers requires SBA to prioritize licensing small business investment funds in underserved states and regions. The Associate Administrator's response to this law has been to gut the staff charged with fulfilling this statutory mandate.

- The Program Development team had four (4) FTE's prior to the law being signed. This team was responsible for outreach to underserved areas and to educate the small business investing community about how to amplify small business investment by accessing this program.
- Since the law's enactment, the Associate Administrator has reassigned the people on the team and reduced it to one person: The Director of Program Development. The program's data tells the story. Instead of increasing licensing in underserved states, the number of applicants entering the licensing pipeline has dropped precipitously. Rather than growing the program, it appears that the Associate Administrator's model for achieving small business investor parity between the states is apparently to stunt SBIC growth for all the states.
- OII finally released guidance on the implementation of this Act on September 10, 2019, with no public notice.

Figure 1:

**Program Development and Licensing Activity Applicant Initial Review/Program  
Development SBA Data through June 30, 2019**

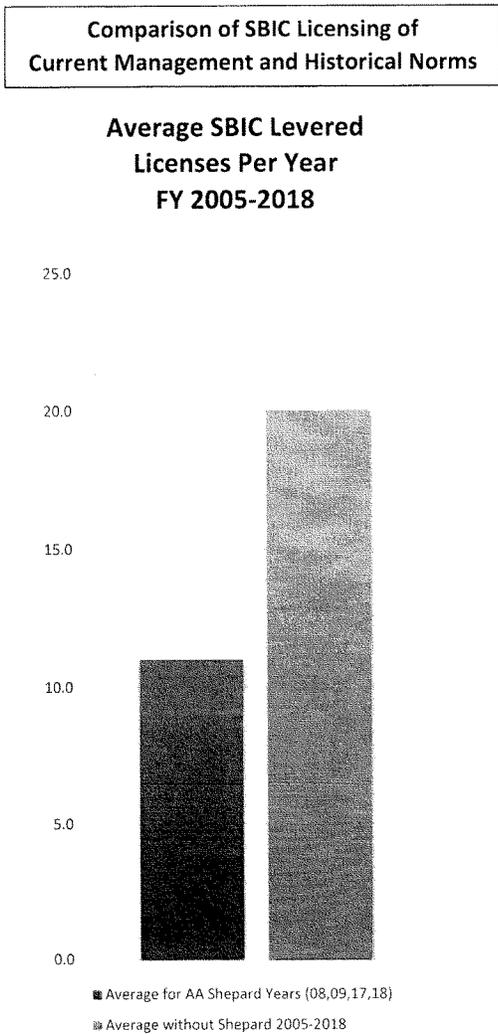
SBA'S REPORTED DATA AS OF 6/30/2019							YEAR OVER YEAR CHANGE 6/30/2018 VS 6/30/2019
FY 2015	FY 2016	FY 2017	FY 2018 (FIRST FULL FY WITH AA SHEPARD)	FY 2019 (HALF FY THRU 3/31/2019)	FY 2019 (THRU 6/30/19)		
Total Received During FY	48	57	55	39	11	23	(18%)
1 <sup>st</sup> Time SBIC Applicants	24	30	27	17	5	8	(33%)
Subsequent Fund Applicant	24	27	28	22	6	15	(6%)
Processed in FY	44	50	52	41	9	17	(39%)
Green Light Letters Issued	25	32	31	28	7	11	(42%)

- **Faux-Outreach to the Small Business Investor Community.** Under the Associate Administrator's management, taxpayer money has been spent on outreach that has been poorly handled and, at best, is ineffective and has built a paper trail of faux outreach:
  - The Associate Administrator was so disorganized and late in organizing an "outreach" event in New York that there were only eight attendees – four from SBA and three were asked by SBA to be there on the SBA's panel – one independent attendee.
  - On October 17, 2018, the Associate Administrator held an SBIC rural investing outreach seminar the morning after the SBIC community's annual event which took place over 700 hundred miles away, ensuring minimal participation from SBICs who want to invest in rural areas.
  - On May 21, 2019, the Associate Administrator held an SBIC event in Maine. The only SBIC in Maine was disinvented by SBA from attending.
  - There is no meaningful follow up from OII for their "outreach" events.

- The OIG held three SBIC “Listening Sessions” in 2018. Taxpayers funded mediators to facilitate discussions that have been held for decades directly between SBA and the private sector without intermediaries. There has been no follow up or improvements stemming from these sessions. The private sector put a good deal of effort in preparing constructive input to SBA, but it appears that these events created a paper record of engagement without any outcome or improvement.
- The Associate Administrator will not participate in any forum where he has not pre-screened all the questions and removed any substantive questions. This approach has been received poorly by small business investors, the institutional investors that provide the provide capital into SBICs, and those considering forming a new SBIC fund. Further, because of the hollowing out of the Program Development Team, there is effectively no follow up to the outreach that has occurred, ensuring minimal positive impact.
- **Refusal to Share with Congress Taxpayer Funded Reports on the SBIC Program.** The taxpayers paid for three (3) in-depth studies of the SBIC program by the Library of Congress in conjunction with academics from Duke and Pepperdine University’s business schools. Two of these studies were released during the prior Administration.
  - The final Library of Congress study on the impact of the SBIC program on the health of the private small business capital market was blocked for over two years from release by the Associate Administrator, despite being completed in July 2017.
  - The House and Senate Small Business Committees asked for this completed report, but the Associate Administrator blocked the sharing of the report with the Congress. As the Committee is reauthorizing the SBIC program it is owed full access to all studies on the SBIC program so it can make informed decisions. Further, it is unclear how a single office in an executive branch agency is able to block Congress’ own Library of Congress from sharing its research with the authorizing committees of the House and Senate.
  - It is also worth noting that the Senate Small Business Committee submitted numerous questions for the record to the SBA about the SBIC program following a February 2019 hearing with then-SBA Administrator McMahon. Seven months later, it appears the SBA has still not responded with answers to all the Senate Committee’s questions about the SBIC program.
  - The Associate Administrator has also blocked the release of the SBA’s annual reports for the SBIC program for FY 2015 and FY 2016, which are both completed. There are no annual reports expected for FY 2017 or FY 2018.
  - The SBA has hired dozens of contractors to do studies and work on projects related to the SBIC program. While some of them may be value-producing work, none of these studies have been shared with the public or the committees. The authorizing and appropriating committees are owed the knowledge of what these contractors are being hired to do, what are their results, and how much money is being spent.

- **License Surrenders.** SBICs have a finite life of about 10-12 years. As the SBIC fund winds down it pays off all money owed to the SBA, including fees and leverage. Once the SBA is fully paid off, then the SBIC surrenders its license and ceases to be an SBIC. Prior to the current management, a surrender was a pro forma exercise which was uniformly accepted and processed in a matter of days.
  - Under the current OII management, SBICs have been forced to wait as long as 10 months for the Associate Administrator to approve license surrenders.
  - During these periods of unreasonable administrative delays, forms must be filed, examinations may be required, and as a result SBICs are bearing unnecessary costs; their other active SBICs also can face unnecessary delays or barriers to reserving leverage for prospective investments or advancing an application for a new SBIC licenses.
  - There is no statutory or regulatory reason for these excessive periods of inaction by the Associate Administrator. (See SBIA letters dated April 18, 2019, and May 8, 2019, to the SBA regarding this issue in the appendix to this testimony.)
- **Receiving License After Approval.** By statute and regulations, until SBICs have a license in their possession either digital or paper from the SBA, they are not legally licensed and very restricted in their ability to invest in small businesses. Applicants for an SBIC license go through a rigorous, multi-step vetting process. The last vetting is performed by the SBA's "Agency Committee". Prior to current management, the period from approval by the Agency Committee to receiving a license number commonly ranged from 0 to 10 business days. The period to receive a license number now can take months. There is no reasonable justification for these delays. These delays appear to be caused by several actions/inactions by the Associate Administrator.
  - The Associate Administrator sometimes will not send a license until he has found time on his calendar to personally call the applicant to tell them that they have been licensed. This can take over a month to receive this unnecessary call. In some cases, funds have received a call that they were licensed and then were unsure if they were able to legally operate because they did not receive anything in writing for a very long time. A phone call is not a license to operate a multimillion-dollar fund.
  - An additional source of delays is the inability of the Associate Administrator to submit the paperwork with all the approvals for processing in a timely manner. SBICs and SBA staff have expressed concerns about backdating of documents, and these concerns may be worthy of further investigation.
  - Finally, on numerous occasions it has taken the direct intervention by Members of Congress for the Associate Administrator to release the approved licenses, after extensive delays. (See SBIA letters in the appendix to this testimony dated August 10, 2018, February 7, 2019, and February 27, 2019, to SBA and to the Committee regarding these delays.)

Figure 2:



- **Green Light Letters.** The first major step in the licensing process is receiving a “Green Light” letter inviting the applicant to apply for a SBIC license subject to meeting or exceeding several SBA-determined criteria.
  - For existing SBIC funds forming a new small business fund, the Green Light process used to take several weeks because the SBA already has detailed performance and regulatory information about the applicant. This process can now take over a year.
  - The Associate Administrator has inserted a series of new unnecessary delays that have severely slowed the formation of more SBIC funds. For example, repeat funds seeking subsequent licenses face unnecessary hurdles and delays despite the SBIC having been in the program for years and the SBA having extensive knowledge of their operations. Repeat SBIC funds are subject to examination delays that can exceed those experienced by first time applicants. Repeat funds must travel to Washington to be re-interviewed at the sole scheduling discretion of the Associate Administrator, which can add months of delay. Prior to the current Associate Administrator, decisions on “Green Lights” would occur shortly after any interview. It now can take several months after the interview to receive the “Green Light” decision.
  - A number of SBIC applicants were approved for a “Greenlight Interview” in July 2019. However, the Associate Administrator would not make himself available for over five months (Late November 2019). Only after a letter was sent to Congress about these unreasonable delays were the interviews rescheduled for July and August 2019.
  - The current Associate Administrator is not only wasting taxpayer money and small business investors’ time with these Green Light delays for repeat small business investors, but these new practices are absorbing finite resources that should be deployed to expand the program such as fulfilling the *Spurring Business in Communities Act*, which was signed by President Trump. By statute SBA should be directing its energies to adding more small business investment companies in more parts of the country to gain more small business investment parity.

Figure 3:

SBA'S REPORTED DATA AS OF 6/30/2019 <i>(in millions)</i>						YEAR OVER YEAR CHANGE
	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019 THRU 6/30/2019	6/30/2018 VS 6/30/2019
Green Light Letters Issued	25	31	32	28	11	(42%)

- **Examinations as a Delaying Tool, not as Compliance Tool.** By statute, SBA must examine SBIC funds for regulatory compliance. These examinations are in addition to the normal independent audits performed annually on SBIC funds.
  - Beginning with the current Associate Administrator the examinations process has been used as a tool to insert delays into nearly every core SBIC operation (e.g., licensing, accessing leverage, normal regulatory approvals, surrendering licenses).
  - It is critical to note that the delays that have been created are not because examinations found a violation, but because: 1) the Associate Administrator created new arbitrary timelines completely outside the control of the SBICs; 2) SBA could not schedule an examination in a timely fashion (SBICs have no control over when these exams occur); 3) SBA could not finalize the examination in a timely fashion; 4) The SBA was unable or unwilling to transmit the results to the fund; or 5) the Associate Administrator has inserted himself into the examinations process and the release of the examination to the SBICs adding further delays. Examinations should be used to monitor regulatory compliance.
  - The Associate Administrator has repeatedly misrepresented the issue by accusing SBICs of not being in compliance for examinations. The timing issues and the processing of examinations are solely under the Associate Administrator's control.
  - Even after completing examinations, it now can take up to nine months or longer for SBA to share the examination report with the SBICs, during which time the SBIC is frozen regulatorily and unable to reserve investment leverage or submit a license application.
  - The precipitous drop off in leverage reserved (a measure of future small business investing) and in funds forming is in part due to the misuse of the examination regime. According to SBA's most recent year-to-date data, there has been a 39% drop in the amount of leverage issued/reserved - \$958 million. If OII continues to stifle SBICs from reserving leverage for the rest of the fiscal year, the results will be a reduction in leverage issued of just over \$1.3 billion, indicating a reduction in future small business investment by about \$1.8 billion (assuming 2:1 leverage ratio).

Figure 4:

**Debenture Leverage Issued – SBA Data as of June 30, 2019**

SBA'S REPORTED DATA AS OF 6/30/2019 <i>(in millions)</i>	FY 2019					YEAR OVER
	FY 2015	FY 2016	FY 2017	FY 2018	PARTIAL THRU 6/30/2019	YEAR CHANGE 6/30/2018 VS 6/30/2019
Leverage Commitments Issued	\$2,553	\$2,514	\$1,960	\$2,522	\$958	(39%)

- **Licensing Interviews.** Applicants for an SBIC license, even repeat SBICs, are being required to come to Washington for a personal interview with the Associate Administrator. Applicants are very willing to come in for interviews; however, the Associate Administrator commonly will not schedule the required interview for months – adding unnecessary delay on top of the other delays.
- The SBIC licensing process is a complicated legal process that is alien to most small business investors. They are experts in growing small businesses, not navigating the federal regulatory gauntlet. As is their right, small business investors use legal/regulatory counsel to help them prepare their applications and to serve as a translator to better understand the government's questions and statements.
  - In some cases, the Associate Administrator has asked to meet privately with applicants without counsel or other SBA staff present, which is not only inappropriate but effectively an offer that applicants cannot refuse without risking additional delays and an adverse decision by the Associate Administrator.
  - The Associate Administrator asks for post-interview materials after almost all interviews, much of which were already in the application, but in a different form. This causes an additional delay.
- **Timing of Regulatory Responses.** Many regulatory decisions are time sensitive with serious ramifications for small businesses, their employees, and the SBICs. SBA must make an informed decision so that SBICs can know how they are allowed to help small businesses. But, instead of making timely informed decisions, matters involving the Associated Administrator are often delayed creating impossible situations for the SBIC and their portfolio companies.
  - For example, SBICs have been faced with the choice of adhering to regulatory timelines or saving a small business and the jobs it provides because the leadership of OII has been unable to decide when to approve a regulatory request in a reasonable time.
- **Refusal to Allow the Office of Investment to Fulfill its Mission by Refusing to Hire.** The Office of Investment and Innovation oversees nearly \$30 billion dollars of domestic investment with approximately 88 staff positions. For more than two years, this office has been operating without nearly 20% of its workforce with approximately 17 vacant positions because the Associate Administrator will not approve filling the vacant positions. Many of these positions are mission critical, senior management positions.
  - Vacancies in these positions are causing significant increases in risk to the taxpayer.
  - Some of the vacant leadership positions include: Deputy Associate Administrator (the most senior career management position in the office, Director of Licensing, and two Operations Chiefs (there are only 3 total Operations Chiefs and these staff oversee the regulation and operations of \$30 billion dollars).
  - OII may have given these vacant FTE's to other parts of SBA, hindering the ability to fill needed positions once competent management is installed.
- **Inability to Execute Basic Program Operations.** According to the SBA's published Standard Operating Procedures, an applicant for an SBIC license will not be issued a license until after the management team has attended an SBIC Regulations class taught by the SBA. For decades, these classes have been

held at least once a quarter and sometimes more often. However, the SBA has not held or scheduled any SBIC Regulations classes in 2019. The last SBIC Regulations Class was held on November 29, 2018.

- The OII, at the direction of the Associate Administrator, has provided conflicting and inconsistent guidance as to why SBA is not able to hold these classes and what the plan is going forward.
- To the private sector this appears to be one more step in the SBIC process that has collapsed due to mismanagement.
- The SBIA has built an online training platform to replace the class being withheld by the SBA.
- **Inability or Unwillingness to Communicate Effectively with the SBIC Licensees**. Communication is critical in a complicated, highly regulated program like the SBIC program. The communications from OII are minimal and often not informative.
  - For example, the OII informed SBICs that because of the January 2019 shutdown it would delay by one month the due date for certain required filings. However, shortly before the original deadline some funds were informed that the delay was revoked, and they must file their forms by the original deadline. But, shortly after this revocation and without explanation, OII disabled for an extended period the computer systems that allowed SBICs to file their required forms. This made it nearly impossible to comply with these moving deadlines. There was no communication about OII taking the computer system down or when it would reopen. Once the computer system was finally opened up, SBA directed SBICs to wake up and log in at 3:00 am in the morning to access SBA's computer system. The extension date was for a Sunday, initially leaving SBICs unclear as to whether the real deadline was the previous Friday or the following Monday.
- **Data Problems – Collapse of SBIC-Web**
  - As the Associate Administrator testified in June, making changes in information technology systems has been one of his top priorities for the past 2.5 years. This summer, the SBIC Web system, which is the portal by which all financial/regulatory filings are submitted, crashed at the end of the third quarter filing period, causing serious delays, costs, and a loss of regulatory data. SBA eventually extended the filing deadline for 30 days, but by then, the system had been completely inoperable for nearly two weeks, and many funds had incurred significant costs. The SBIC-Web was scheduled to be moved to a faster, more stable cloud-based platform instead of staying on older, internal SBA servers, but that upgrade was blocked by the leadership of the OII. Shortly thereafter, the platform collapsed and regulatory data and filings were lost.

## Section Two SBIC Program Overview

- The 61-year-old SBIC program is a market-driven platform that serves an important public purpose of facilitating and amplifying private investment into domestic small businesses. President Eisenhower, as the former Allied Commander in World War II, recognized that America had won World War II and would be competing to win the Cold War with the dynamism of American industry and our system of free enterprise as strategic allies. Eisenhower signed the Small Business Investment Act of 1958 and created the SBIC program in part to help ensure that the United States would continue to be a dynamic economy and industrial leader.
- Congress declared in its original authorizing legislation that the SBIC program should “stimulate and supplement the flow of private equity capital and long-term loan funds which small business concerns need for the sound financing of their business operations” while also stimulating the national economy and job growth.<sup>1</sup>
- As of June 30, 2019— three quarters through the fiscal year—the SBIC program included more than 300 licensed funds, representing approximately \$30 billion in small business investment capital. Over the last five fiscal years, SBICs have invested \$5-6 billion annually in over 1,100 small businesses.<sup>2</sup> Companies that in their early stages received SBIC investments and have subsequently grown into icons of American industry include Federal Express, Apple, Intel, and Callaway Golf. Many more small businesses backed by SBICs have grown from smaller businesses into robust, sustainable mid-sized businesses that bring prosperity and employment to communities across the country.
- SBICs are federally regulated, privately-owned and managed investment funds that invest exclusively in domestic small business. SBICs, primarily formed as limited partnerships, provide long-term loans, equity, or debt-equity investments along with management assistance to small businesses across a range of sectors, geographic locations, and stages of growth. Some SBICs specialize in an industry sector while others invest more broadly. There are various forms of SBICs:
  - *Leveraged (Debenture) SBICs* increase the amount of capital available for domestic small business investing by accessing the SBIC credit facility. SBIC leverage is borrowed at the fund level, not at the small business level.
  - *Non-leveraged SBICs* do not seek or receive SBA leverage. Non-levered funds can provide debt or equity or both. They are able to provide more equity to small businesses than levered (debenture) SBIC funds because they do not need to make interest payments on SBIC leverage. Banks commonly invest some of the Institutional Capital into these funds. These funds have no taxpayer risk.

<sup>1</sup> Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958), 15 U.S.C. 661.

<sup>2</sup> SBIC Program Overview, U.S. Small Business Administration (March 31, 2019). The number of licenses are inflated because SBA is not reporting a significant number of licenses that have been submitted for surrender or are inactive.

- Bank-Owned SBICs are fully owned or funded by a single bank. Like other non-levered SBIC funds, they do not access leverage and have no taxpayer risk. Like other non-levered SBICs, these bank-owned SBICs can provide debt or equity. Since these SBICs are unlevered, they are able to provide more equity because they do not have interest payments to make on SBIC leverage.
- Most SBICs are Levered (Debenture). These levered SBICs invest private capital that is amplified by access to an SBA-backed credit facility using the Federal Home Loan Bank system. This permits individual SBICs to multiply paid-in private capital up to three-times or up to \$175 million, whichever is less. The maximum leverage for an SBIC family of funds (a group that hold multiple SBIC licenses) is currently \$350 million. Three times leverage is the statutory limit, which is rarely used and which the SBA will only permit under unusual circumstances. Most levered SBIC funds lever private capital one to two times their private capital.
  - For example, an SBIC may raise \$87.5 million in private capital and then, after licensure, may access up to an additional \$175 million line of credit (SBA leverage), which combines for a total of \$262.5 million – a very large boost in the small business economy. The leverage is provided at a zero-subsidy rate (no appropriation necessary to fund up to \$4 Billion a year in SBIC leverage) and is eventually paid back in full to the SBA (plus interest and fees).
- Unlike many government programs, the SBIC private capital is in first-loss position, meaning private investors lose their money before the taxpayer is exposed to risk of loss. In practice there is generally a 33-50% private asset coverage of the leverage. This is an important taxpayer safeguard and a key reason why the SBIC program has been able to maintain its zero-subsidy rate. SBICs are also very different from the SBA's other capital programs because of the Portfolio Effect of the SBICs. A loss in a single small business investment does not have to expose the taxpayer to a loss – no individual small business investments are guaranteed by the taxpayer. Losses in a single investment can be backfilled by the profits of other small businesses in the portfolio. In the other SBA programs (504 and 7a), the government guarantees the performance of each loan to each individual small business and shares first loss position with the private sector (offset by fees).
  - The SBIC 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. The government does not pick winners and losers, private investors guide capital to the companies with the best potential.
  - It is a mark of SBIC industry pride that the program maintained its zero-subsidy throughout the Great Recession. It is important to SBICs that this zero-subsidy rate be protected by prudent regulatory policies and good program management.
  - This successful alignment of private markets with public goals where private capital leads and the SBA-leverage follows provides SBICs a deeper capital pool from which to make equity and debt investments in qualifying small businesses.

- A recent independent study prepared for the Library of Congress found that SBIC-backed small businesses created almost 3 million new jobs and supported an additional 6.5 million jobs over the 20-year period of their study.<sup>3</sup>
- Another independent Library of Congress study found that “the SBIC program is not only widely diversified by industry sector and geographic subregion but varies from non-SBIC private equity on key dimensions concerning the companies, industries, and regions receiving investments.”<sup>4</sup>
- Every one of the jobs created by each of those small businesses was a gain to the communities where they are located and to the broader regions from where they drew employees and to whom they provided goods and services. These businesses and jobs continue on, succeeding independently of SBICs after the investment is completed. These small businesses are not “propped up” or subsidized.
- These investments are in real companies with real staying power and real growth potential.

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<sup>3</sup> Paglia and Robinson, Measuring the Role of the SBIC Program in Small Business Job Creation, Report for the Library of Congress, at 4 (January 2017) <[https://www.sba.gov/sites/default/files/articles/SBA\\_SBIC\\_Jobs\\_Report.pdf](https://www.sba.gov/sites/default/files/articles/SBA_SBIC_Jobs_Report.pdf)>.

<sup>4</sup> Paglia, J. and D.T. Robinson. (2017). Measuring the Role of the SBIC Program in Financing Small Businesses: 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.

## SBIC Frequently Asked Questions

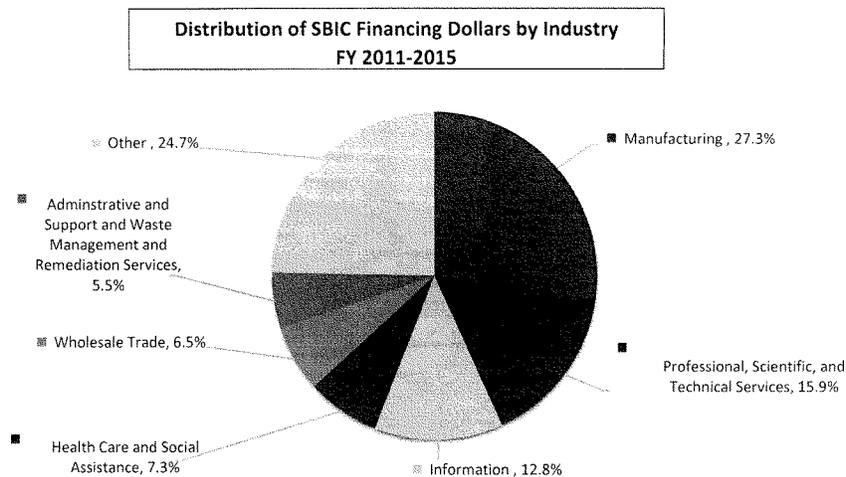
### *How does the SBIC Program Help the Taxpayer and the American Public?*

- 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 1 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, from 2014-2018, 22% of SBIC investments were 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.

Figure 3:



*\* Numbers will not add to 100% due to rounding.  
(Chart Source: U.S. Small Business Administration (SBA), The Small Business Investment Company Program (SBIC): Annual Report; Fiscal Year 2015 (unpublished manuscript, July 13, 2017).)*

***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.
- With modest reforms, it could be even more effective, with broader benefits to more communities.
- There are additional studies completed by the Library of Congress that were supposed to be released in 2017 but have yet to be released by the SBA.

***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 average administrative government costs were associated with creating each new job. There were only \$11 in average administrative costs for each job created or sustained.<sup>5</sup> Further, the fact that the SBIC program's leverage has successfully maintained its zero subsidy for so long is a testament to its operational effectiveness and efficient use of capital.

<sup>5</sup> Paglia and Robinson, *supra* note 4, at 2.

***Is SBIC Investing the Same as Bank Lending?***

- No. SBIC investing and bank lending are very different.
- SBICs provide education, training, and professional guidance to their portfolio companies 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 to SBICs.
- 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, they would get bank loans because there are thousands of banks and conventional bank lending is less expensive.
- The Library of Congress completed a SBIC study in 2017 (that SBA is still blocking the release of) is expected to report that:
  1. SBICs spread capital in a more dispersed manner across the country than conventional venture capital and private equity.
    - a. The SBIC program provides funds for deals that are more widely geographically distributed than by the broader fund community.
    - b. There is a lower concentration of SBIC capital on the west coast.
    - c. More of SBIC funds go to underserved regions in the north and south.
    - d. SBICs deploy funds towards different sectors differently than other private sector funding.
    - e. SBICs are generally deploy their largest concentration of dollars towards the business-to-business sector. SBICs are also less likely to invest in sectors targeted by other types of financing.
    - f. Sectors with high capital requirements, like energy and healthcare are likely to have lower coverage by SBICs.
  2. SBICs investment supports companies less likely to be considered by traditional private equity investors.
    - a. SBICs invest in companies that are less profitable than those invested by traditional growth capital and debt funds of similar fund size.
    - b. SBICs are investing in companies that might look unattractive from the point of view of a traditional private equity investor, either because a company operates in a less profitable sector or because the small business faces risks not attractive to other investors.

Figure 4:

## Comparison of Conventional Bank Lending and SBICs

	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 these funds 15 years ago (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 far more advantaged position than the private sector limited partners because the SBA leverage must be repaid before private investors are repaid.
- 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 (last licensed in 2004).
- The SBA is a regulator and a guarantor of the SBIC leverage credit facility.

Figure 5: Can the 7a and 504 programs do what the SBIC program is doing?

	SBA 7a	SBA 504	SBA SBIC
Government (Taxpayer) guarantee on each individual 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 direct involvement.
- Investments are made by the private sector 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 loan programs, when a single investment underperforms or loses money, only private capital is lost, not taxpayer guaranteed capital (leverage). The profits from the other portfolio investments cover the losses from the isolated underperforming investment(s). If the profits from the other portfolio investments are inadequate to cover all the losses, then the private investors' capital is lost before taxpayer money is at risk. There normally a large private capital cushion that would need to be exhausted 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.
- The "annual charge" is a fee on leverage used to prevent taxpayer losses and to maintain the zero subsidy on the program. The current Annual Charge is the lowest rate in the 60+ years of the program because SBICs have done such a good job at investing and protecting the taxpayer. However, SBIA has for some time flagged this record low Annual Charge as worthy of cautious review because at some point investment losses will revert to something closer to the historical norm and SBICs want to make sure the taxpayer is protected for the long term.

***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 on-site 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 SBIC fund managers’ 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 businesses, the SBA, and ultimately the taxpayer.
- SBICs are only able to receive an additional license if their previous SBIC 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 placed by SBA 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.

***What can under-licensed states do to get more SBIC small business investment?***

- In general, smaller states that are difficult to reach tend to attract less investment, but investments are still made in those states and more can be done to improve their attractiveness.
- First, since investing in small business is very much dependent on personal relationships, we need to build more of those relationships in under-licensed states. These relationships commonly start with relationships with banks. Getting banks to invest in SBICs would not only provide solid returns to the banks, but it would also create a connection between SBICs and the small businesses served by the local banks.

- Banks in under-licensed states can form their own SBIC fund. These bank-owned, non-levered SBICs can use their extensive networks to provide equity to small businesses and create relationships with both the bank for senior lending and other SBICs for subordinated debt access.
- SBA needs to make the licensing process more consistent because newer, smaller small business investment funds are easily scared off by regulatory uncertainty.
- SBA needs to make it less painful and less expensive to start and run smaller small business investment funds outside of the major money center cities.
- Finally, investment bankers, business brokers, and small business owners themselves can reach out to SBICs and start the business relationship.

## Appendices

Letters Submitted; Studies and Reports; and  
SBIC Data

**Small Business Investment Company (SBIC) Program Overview**  
as of June 30, 2019

<b>PROGRAM COMPOSITION</b>					
<b>Program Composition of Operating SBICs</b>					
	<b>FY End 2015</b>	<b>FY End 2016</b>	<b>FY End 2017</b>	<b>FY End 2018</b>	<b>As of 06/30/19</b>
<b>Total Number of Licensees</b>	<b>303</b>	<b>313</b>	<b>315</b>	<b>305</b>	<b>302</b>
Debenture	205	216	227	227	225
Participating Security	46	41	33	25	22
Bank-Owned/Non-Leveraged	43	47	47	47	49
Specialized SBICs	9	9	8	6	6
<b>Private Capital of Operating SBICs by Fund Type (\$ in millions)</b>					
<b>a. Regulatory Private Capital</b>	<b>\$12,995.0</b>	<b>\$14,115.3</b>	<b>\$ 15,014.7</b>	<b>\$15,808.2</b>	<b>\$16,332.4</b>
Debenture	10,414.2	11,357.7	12,259.3	13,252.8	13,366.8
Participating Security	887.8	716.8	504.6	352.3	327.5
Other	1,693.0	2,040.8	2,250.8	2,203.1	2,638.1
<b>b. Leverageable Private Capital</b>	<b>\$ 7,930.5</b>	<b>\$ 8,897.0</b>	<b>\$9,565.2</b>	<b>\$10,015.0</b>	<b>\$10,221.7</b>
Debenture	6,413.4	7,309.8	7,974.6	8,533.4	8,633.1
Participating Security	684.7	571.7	383.5	262.5	237.8
Other	832.4	1,015.5	1,207.1	1,219.1	1,350.8
<b>c. Unfunded Private Commitments</b>	<b>\$5,064.5</b>	<b>\$ 5,218.2</b>	<b>\$5,449.7</b>	<b>\$ 5,793.1</b>	<b>\$6,110.6</b>
Debenture	4,000.8	4,047.9	4,284.8	4,719.4	4,733.7
Participating Security	203.1	145.0	121.2	89.8	89.7
Other	860.6	1,025.3	1,043.7	983.9	1,287.2
<b>Leverage from SBA of Operating SBICs by Fund Type (\$ in millions)</b>					
<b>d. SBA Capital at Risk (e+f)</b>	<b>\$12,351.2</b>	<b>\$13,696.7</b>	<b>\$13,996.4</b>	<b>\$14,280.7</b>	<b>\$14,242.8</b>
Debenture	11,883.6	13,356.3	13,810.2	14,203.4	14,193.8
Participating Security	392.6	249.5	96.8	18.0	5.8
Other	75.0	90.9	89.4	59.3	43.2
<b>e. Outstanding SBA Leverage</b>	<b>\$ 9,157.2</b>	<b>\$10,330.4</b>	<b>\$10,708.9</b>	<b>\$10,860.5</b>	<b>\$11,308.9</b>
Debenture	8,712.0	10,010.8	10,525.3	10,785.8	11,262.5
Participating Security	384.6	244.6	96.8	18.0	5.8
Other	60.6	75.0	86.8	56.7	40.6
<b>f. Outstanding SBA Commitments</b>	<b>\$ 3,194.0</b>	<b>\$3,366.3</b>	<b>\$3,287.6</b>	<b>\$3,420.2</b>	<b>\$2,933.9</b>
Debenture	3,171.6	3,345.5	3,285.0	3,417.6	2,931.3
Participating Security	8.0	4.9	0.0	0.0	0.0
Other	14.4	15.9	2.6	2.6	2.6
<b>g. Unreimbursed Prioritized Payments</b>	<b>\$142.2</b>	<b>\$113.1</b>	<b>\$55.5</b>	<b>\$0.1</b>	<b>\$0.0</b>
<b>Combined Private Capital and SBA Capital at Risk of Operating SBICs (\$ in millions)</b>					
<b>h. Total Capital at Risk (a+d)</b>	<b>\$25,346.2</b>	<b>\$27,812.0</b>	<b>\$29,011.1</b>	<b>\$30,088.9</b>	<b>\$30,575.2</b>
Debenture	22,297.8	24,714.0	26,069.5	27,456.2	27,560.6
Participating Security	1,280.4	966.3	601.4	370.3	333.3
Other	1,768.0	2,131.7	2,340.2	2,262.4	2,681.3

**Small Business Investment Company (SBIC) Program Overview**  
as of June 30, 2019

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Program Composition in Liquidation (\$ in Millions)					
	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19
<b>Total Number of Licensees</b>	115	104	97	87	87
Participating Security	81	76	72	66	65
Other	34	28	25	21	22
<b>Leverage Balance</b>	\$959.2	\$810.5	\$671.7	\$413.1	\$411.6
Participating Security	697.5	571.1	451.8	257.1	249.3
Other	261.7	239.4	219.9	156.0	162.3
Program Funding (\$ in millions)					
<b>Debtenture Authorization (\$ in Millions)</b>	\$4,000.0	\$4,000.0	\$4,000.0	\$4,000.0	\$4,000.0
<i>Annual Charge</i>	0.742%	0.672%	0.347%	0.222%	0.094%
<i>Average Debtenture Pooled Interest Rate</i>	2.68%	2.29%	2.70%	3.35%	N/A

ECONOMIC IMPACT: SBIC FINANCINGS TO SMALL BUSINESS REPORTED *						
Total SBIC Program						
	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/19
<b>Financing Amount Reported (\$ in millions)</b>	\$6,285.5	\$5,991.7	\$5,727.3	\$5,502.6	\$4,321.3	7%
<b>Type of Financing (\$ in millions)</b>						
Straight Debt	3,810.5	3,791.7	3,720.2	3,543.0	2,578.1	(0%)
Debt with Equity Features	1,351.2	1,157.1	859.8	807.3	607.6	1%
Equity Only	1,123.8	1,042.9	1,147.4	1,152.2	1,135.6	35%
<b>Number of Companies Financed</b>	1,210	1,201	1,077	1,151	950	5%
<b>Special Competitive Opportunity Gap</b>	288	332	308	315	233	(3%)
Businesses Located in LMI Areas*	229	284	262	265	197	(6%)
Women, Minority, Veteran Owned*	73	61	68	66	46	10%
<b>Number of Jobs Created or Sustained**</b>	129,749	122,382	112,865	106,021	82,064	5%
Debtenture SBICs						
<b>Financing Amount Reported (\$ in millions)</b>	\$5,939.6	\$5,653.8	\$5,353.8	\$5,159.0	\$4,011.0	6%
<b>Type of Financing (\$ in millions)</b>						
Straight Debt	3,701.8	3,665.5	3,617.6	3,422.1	2,495.3	(0%)
Debt with Equity Features	1,265.9	1,110.6	835.4	791.8	587.6	(1%)
Equity Only	971.9	877.7	900.9	945.0	928.1	33%
<b>Number of Companies Financed</b>	1,010	986	904	940	801	9%
<b>Special Competitive Opportunity Gap</b>	226	260	245	238	190	7%
Businesses Located in LMI Areas*	182	232	212	206	162	3%
Women, Minority, Veteran Owned Businesses*	51	35	47	39	36	33%

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**Number of Jobs Created or Sustained\*\***      122,608    115,481    105,505    99,400    76,171    4%

**Non-Leveraged, Bank-Owned, and Specialized SBICs**

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/18
<b>Financing Amount Reported (\$ in millions)</b>	\$300.1	\$307.0	\$357.7	\$328.0	\$300.8	35%
Type of Financing (\$ in millions)						
Straight Debt	98.8	116.5	94.1	111.9	76.3	5%
Debt with Equity Features	72.6	38.2	23.4	13.4	18.5	91%
Equity Only	128.8	152.3	240.1	202.6	206	47%
<b>Number of Companies Financed</b>	<b>147</b>	<b>203</b>	<b>189</b>	<b>236</b>	<b>171</b>	<b>(6%)</b>
<b>Special Competitive Opportunity Gap</b>	<b>48</b>	<b>70</b>	<b>67</b>	<b>84</b>	<b>48</b>	<b>(26%)</b>
Businesses Located in LMI Areas*	34	50	54	66	40	(27%)
Women, Minority, Veteran Owned*	21	26	22	27	10	(33%)
<b>Number of Jobs Created or Sustained**</b>	<b>6,196</b>	<b>6,271</b>	<b>7,048</b>	<b>6,319</b>	<b>5,712</b>	<b>33%</b>

**Participating Security SBICs**

<b>Financing Amount Reported (\$ in millions)</b>	\$46.8	\$30.9	\$15.8	\$15.7	\$9.5	(13%)
Type of Financing (\$ in millions)						
Straight Debt	9.9	9.7	8.6	9.0	6.5	12%
Debt with Equity Features	12.8	8.3	0.9	2.0	1.5	200%
Equity Only	24.1	12.9	6.3	4.6	1.5	(67%)
<b>Number of Companies Financed</b>	<b>53</b>	<b>40</b>	<b>23</b>	<b>15</b>	<b>10</b>	<b>(23%)</b>
<b>Special Competitive Opportunity Gap</b>	<b>14</b>	<b>9</b>	<b>6</b>	<b>3</b>	<b>1</b>	<b>(67%)</b>
Businesses Located in LMI Areas*	13	9	6	3	1	(67%)
Women, Minority, Veteran Owned*	1	0	0	0	0	0%
<b>Number of Jobs Created or Sustained**</b>	<b>945</b>	<b>630</b>	<b>312</b>	<b>302</b>	<b>182</b>	<b>(14%)</b>

\* The Office of Investment and Innovation reports financing information based on data collected on the SBA Form 1031. Information is aggregated, by fiscal year, based on the date of the submission of the form and not on the date of the financing to the small business.

\*\* SBA estimates jobs created or sustained using "The 1999 Arizona Venture Capital Impact Study" (confirmed by the DRI-WEFA study of 2001) indicating that 1 job is created for every \$36,000 of SBIC Program investment (adjusted for inflation).

**PROGRAM OFFICE ACTIVITIES**

**New Licensees**

<b>New Licensees by Fund Type</b>	<b>25</b>	<b>21</b>	<b>15</b>	<b>25</b>	<b>10</b>	<b>(38%)</b>
Debenture	22	17	11	21	7	(46%)
Bank-Owned/Non-Leveraged	3	4	4	4	3	0%
<b>Initial Private Capital (\$ in millions)</b>	<b>\$1,236.4</b>	<b>\$1,188.0</b>	<b>\$831.7</b>	<b>\$1,224.1</b>	<b>\$761.3</b>	<b>(9%)</b>
Debenture	1,204.1	893.0	656.5	1,137.9	513.8	(32%)
Bank-Owned/Non-Leveraged	32.3	295.0	175.2	86.2	247.5	205%

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Licensing Pipeline *						
	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19	Chg. from 06/30/18
<b>Total in Pipeline</b>	37	49	62	53	55	(7%)
In Applicant Review/Program Development	13	20	22	20	26	18%
In Capital Raising	14	22	26	23	21	(5%)
In Licensing	10	7	14	10	8	(47%)

Program Development and Licensing Activity **						
Applicant Initial Review/Program Development						
<b>Received during FY</b>	48	57	55	39	23	(18%)
1st Time SBIC Applicants	24	30	27	17	8	(33%)
Subsequent Fund Applicants	24	27	28	22	15	(6%)
<b>Processed in FY</b>	44	50	52	41	17	(39%)
<b>Green Light Letters Issued</b>	25	32	31	28	11	(42%)
<i>% of Processed Receiving Green Light</i>	57%	64%	60%	68%	65%	(4%)
1st Time SBIC Applicants	11	10	18	10	5	(38%)
Subsequent Fund Applicants	14	22	13	18	6	(45%)
Number Denied -- 1st Time and Subsequent	17	15	15	7	3	(40%)
Number Withdrawn -- 1st Time and Subsequent	2	3	6	6	3	(25%)
Capital Raising Completed/Terminated						
<b>Green Light Letters Expired/Other Licensing Applications Submitted</b>	10	0	5	7	4	0%
Total, Capital Raising Completed/Terminated	25	24	22	24	8	(58%)
<i>% in Capital Raising Completed/Terminated Submitting Applications</i>	35%	24%	27%	31%	12%	(48%)
	71%	100%	81%	77%	67%	(19%)

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**Licensing \*\*\***

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/18
<b>Received during FY</b>	<b>25</b>	<b>24</b>	<b>22</b>	<b>24</b>	<b>8</b>	<b>(58%)</b>
1st Time SBIC Applicants	15	2	9	8	1	(83%)
Subsequent Fund Applicants	10	22	13	16	7	(46%)
Otherwise Resolved During FY	7	6	0	3	1	(50%)
<b>FY Number of New Licensees</b>	<b>25</b>	<b>21</b>	<b>15</b>	<b>25</b>	<b>10</b>	<b>(38%)</b>
1st Time SBIC Applicants	12	8	1	11	4	(33%)
Subsequent Fund Applicants	13	13	14	14	6	(40%)
Average Months to Process	8.4	5.8	5.1	8.2	7.8	3%

\* Oil re-evaluated the data collection in the Office of Program Development. Consequently, the content of Licensing Pipeline, for previous years, was updated and therefore may not be consistent with previously issued Program Overview reports.

\*\* Oil identified several historical data discrepancies. Consequently, the content of Program Development and Licensing Activity, for previous years, was updated and therefore may not be consistent with previously issued Program Overview reports.

\*\*\* FY2019 Licensing data has been adjusted for the lapse in appropriations.

**Leverage Activities in Operations****Debenture Leverage**

Commitments Issued	\$2,553.0	\$2,514.3	\$1,959.8	\$2,521.9	\$958.2	(39%)
Draws	\$2,337.4	\$2,157.6	\$1,901.8	\$2,118.7	\$1,394.5	(14%)
Redemptions (Pre-Paid and at Maturity)	\$806.1	\$807.8	\$1,372.0	\$1,893.5	\$920.2	25%
Transfers to Liquidation	\$ 26.5	\$38.6	\$42.4	\$0.0	\$13.7	100%
% of Beginning Leverage Transferred	<1%	<1%	<1%	0%	0.10%	100%

**Participating Securities Leverage**

Prioritized Payments (PP) Advanced	\$28.4	\$15.5	\$8.9	\$3.3	\$0.3	(90%)
<b>SBA Distributions</b>	<b>\$201.6</b>	<b>\$137.4</b>	<b>\$73.1</b>	<b>\$56.6</b>	<b>\$12.1</b>	<b>(69%)</b>
Prioritized Payments	\$24.8	\$13.1	\$1.8	\$4.0	\$0.0	(100%)
Adjustments and Annual Fees	\$3.7	\$4.0	\$0.4	\$17.0	\$0.0	(100%)
Profit Participation	\$13.3	\$5.1	\$11.3	\$13.6	\$1.1	(91%)
PS Redemptions--Operating SBICs	\$159.8	\$115.2	\$59.6	\$21.9	\$11.0	(40%)
Transfers to Liquidation	\$109.2	\$22.8	\$49.3	\$51.7	\$1.2	(98%)
% of Beginning Leverage Transferred	18%	7%	25%	60%	10%	(83%)
Prioritized Payments at Transfer	\$42.8	\$11.1	\$49.6	\$59.2	\$0.3	(99%)

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<b>SBIC Examination Activities</b>						
	<b>FY End 2015</b>	<b>FY End 2016</b>	<b>FY End 2017</b>	<b>FY End 2018</b>	<b>as of 06/30/19</b>	<b>Chg. from 06/30/18</b>
<b>Exam Reports issued</b>	222	186	167	177	97	15%
Exam Cycle (months)	12.7	13.0	16.3	17.3	16.7	(7%)
% of Reports with Major Findings	19%	19%	17%	24%	15%	(44%)
<b>Licensees with Leverage</b>	173	137	126	139	74	19%
Exam Cycle (months)	11.2	11.5	15.4	16.9	15.6	42%
% of Reports with Major Findings	21%	19%	19%	26%	18%	(38%)
<b>Licensees without Leverage</b>	49	49	41	38	23	5%
Exam Cycle (months)	18.1	17.1	19.2	18.8	20.1	1%
% of Reports with Major Findings	8%	18%	12%	16%	5%	(78%)
<b>Surrenders and Transfers to Liquidation</b>						
<b>SBIC License Surrenders</b>	13	7	7	31	11	(58%)
Debenture	4	3	0	21	10	(38%)
Participating Security	4	4	3	5	1	(80%)
Bank-Owned/Non-Leveraged	5	0	4	4	0	(100%)
Specialized SBICs	0	0	0	1	0	(100%)
<b>SBIC Licensee Transfers to Liquidation</b>	3	2	6	4	2	(50%)
Debenture and Specialized SBICs	0	1	1	1	1	0%
Participating Security	3	1	5	3	1	(67%)
<b>Activities in the Office of Liquidation</b>						
<b>Participating Security Leverage</b>						
<b>Total Leverage Collections</b>	<b>\$170.7</b>	<b>\$98.6</b>	<b>\$118.4</b>	<b>\$200.0</b>	<b>\$10.2</b>	<b>(91%)</b>
Collections as % of Beginning Leverage	22%	14%	21%	44%	4%	(85%)
Leverage Write-offs	\$34.4	\$52.5	\$51.4	\$89.9	(\$0.7)	(104%)
Prioritized Payments Collections	\$14.1	\$2.7	\$0.4	\$50.7	\$0.8	(88%)
Prioritized Payments Write-offs	\$55.9	\$15.7	\$14.0	\$14.6	\$0	0%
<b>Debenture Leverage</b>						
<b>Total Leverage Collections</b>	<b>\$83.6</b>	<b>\$54.0</b>	<b>\$37.8</b>	<b>\$9.2</b>	<b>\$7.4</b>	<b>(77%)</b>
Collections as % of Beginning Leverage	24%	21%	16%	4%	5%	(67%)
Leverage Write-offs	\$36.0	\$7.1	\$24.7	\$12.7	\$0.0	(100%)

SBIC Program  
 Financing to Businesses by State  
 Fiscal Year 2014 through Fiscal Year 2018

State Name	FISCAL YEAR 2018			FISCAL YEAR 2017			FISCAL YEAR 2016			FISCAL YEAR 2015			FISCAL YEAR 2014		
	# of Financing	# of Businesses	Amount of Financing (\$M)	# of Financing	# of Businesses	Amount of Financing (\$M)	# of Financing	# of Businesses	Amount of Financing (\$M)	# of Financing	# of Businesses	Amount of Financing (\$M)	# of Financing	# of Businesses	Amount of Financing (\$M)
Alabama	1	1	9.8	5	4	17.3	8	7	71.4	9	3	21.8	7	6	42.1
Alaska	4	1	1.7	4	1	14.4	0	0	0.0	1	1	20.0	0	0	0
Arizona	56	29	96.6	62	18	188.5	79	25	95.5	57	24	82.8	33	21	64.7
Arkansas	13	5	53.4	11	6	24.6	5	2	8.5	28	5	57.8	11	1	2.8
California	392	175	1,049.1	447	189	985.5	493	192	1,041.3	438	198	1,015.3	297	151	785.7
Colorado	74	30	121.8	71	28	158.7	84	30	160.3	71	23	154.5	47	21	133.1
Connecticut	26	15	35.4	22	8	26.9	33	17	102.5	32	15	54.5	42	18	130.9
Delaware	3	2	2.4	4	3	18.6	9	3	20.3	5	2	27.0	5	5	9.4
District of Col.	7	5	14.7	3	2	2.0	5	3	8.0	0	0	0	1	1	0.3
Florida	154	63	256.5	202	70	417.8	176	62	418.5	217	74	478.8	138	52	335.1
Georgia	61	28	147.2	87	28	163.2	124	49	250.6	101	37	185.8	74	32	223.5
Hawaii	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Idaho	8	4	35.3	7	5	9.3	7	3	22.1	4	3	5.9	4	3	15.8
Illinois	64	66	341.8	184	46	288.1	222	79	386.0	173	53	244.6	118	49	232.1
Indiana	45	16	26.7	50	16	104.3	34	16	32.8	27	15	142.3	24	8	53.2
Iowa	4	2	4.1	5	2	16.0	4	3	18.9	1	1	1.8	6	3	23.4
Kansas	30	16	58.0	25	9	20.5	36	13	75.4	26	10	53.9	20	12	21.7
Kentucky	6	5	28.7	8	5	48.3	12	8	15.4	23	9	25.7	11	5	14.7
Louisiana	18	8	104.1	20	8	55.3	29	10	55.2	32	14	74.1	26	10	53.8
Maine	12	7	34.1	6	3	18.8	5	3	28.1	5	3	8.8	3	2	4.2
Maryland	42	11	57.0	38	16	76.0	36	12	91.3	32	17	126.5	19	12	33.4
Massachusetts	105	53	258.5	96	51	229.1	120	60	264.3	144	71	289.4	138	73	321.5
Michigan	72	28	116.8	59	20	123.7	44	21	107.7	83	36	254.4	18	12	32.1
Minnesota	69	28	92.7	124	30	185.2	83	29	145.3	54	28	165.7	54	26	166.3
Mississippi	7	4	26.4	17	3	17.9	22	3	21.5	7	2	8.4	2	2	23.4
Missouri	91	23	108.9	83	24	85.7	46	17	88.2	51	22	107.7	37	16	86.6
Montana	14	3	23.4	11	2	12.4	4	1	23.0	1	1	1.0	4	1	4.9
Nebraska	11	6	52.7	11	5	37.7	2	2	11.8	2	1	10.5	5	3	20.4
Nevada	7	4	23.3	6	3	1.3	12	2	16.7	16	4	53.9	6	3	26.0
New Hampshire	9	6	25.5	13	5	26.3	9	6	34.5	2	2	7.9	15	8	43.3
New Jersey	111	48	241.8	87	37	206.7	81	30	199.8	86	52	152.0	110	59	167.0
New Mexico	4	2	2.2	9	3	15.3	10	5	17.2	11	5	20.8	5	3	3.5
New York	233	124	482.6	178	94	389.9	247	123	373.1	183	108	329.0	236	139	506.1
North Carolina	72	28	138.5	84	36	167.3	114	40	164.5	140	41	198.8	137	49	271.8
North Dakota	21	2	10.3	18	4	12.9	16	4	15.0	0	0	0	0	0	0
Ohio	97	48	135.9	61	29	111.5	65	41	297.0	57	28	132.7	45	22	111.9
Oklahoma	27	8	29.8	22	10	27.8	32	12	52.1	40	15	85.2	31	5	36.7
Oregon	40	18	118.7	19	11	44.5	14	8	34.7	27	10	142.3	24	10	57.7
Pennsylvania	72	31	130.0	134	40	312.3	89	37	254.4	110	50	331.1	86	35	228.0
Rhode Island	3	2	2.8	1	1	1.5	3	2	9.0	9	0	0	3	2	4.6
Rhode Island	9	2	10.0	3	2	1.1	4	2	15.7	6	2	6.1	6	3	10.8
South Carolina	18	10	53.6	49	10	46.0	36	16	88.4	14	7	38.5	33	12	73.2
South Dakota	3	2	20.0	0	0	0	2	1	0.4	2	1	6.5	9	3	30.4
Tennessee	48	23	123.2	50	25	124.7	44	19	100.2	45	20	73.8	41	21	137.6
Texas	276	89	427.6	253	94	484.1	273	107	527.4	289	108	701.8	237	85	538.2
Utah	49	31	75.8	43	23	61.3	37	34	90.8	71	40	129.4	39	21	123.4
Vermont	2	1	3.0	1	1	3.1	2	1	16.5	4	1	8.8	8	5	30.8
Virgin Islands	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Virginia	47	19	72.1	37	21	153.8	36	21	75.8	33	16	73.4	53	23	80.7
Washington	33	10	37.4	41	12	79.7	28	10	41.9	43	21	107.8	28	15	80.3
West Virginia	0	0	0	0	0	0	0	0	0	1	1	0.3	0	0	0
Wisconsin	37	15	91.3	32	14	105.3	29	17	78.0	29	14	79.0	25	12	63.0
Wyoming	1	1	0	0	0	0	2	1	4	0	0	0	0	0	0
TOTAL	2,711	1,151	\$5,602.6	2,779	1,077	\$5,727.3	2,962	1,201	\$5,991.7	2,815	1,210	\$6,285.5	2,309	1,086	\$5,464.9



September 13, 2019

The Honorable Marco Rubio  
 Chairman  
 U.S. Senate Committee on Small Business  
 & Entrepreneurship  
 428A Russell Senate Office Building  
 Washington, DC 20515

The Honorable Ben Cardin  
 Ranking Member  
 U.S. Senate Committee on Small Business  
 & Entrepreneurship  
 428A Russell Senate Office Building  
 Washington, DC 20515

RE: SBIC Program 3<sup>rd</sup> Quarter FY2019 Data

Dear Chairman Rubio, Ranking Member Cardin, and Members of the Committee:

We thank you for holding the June 26<sup>th</sup> hearing entitled "Reauthorization of SBA's Small Business Investment Company Program." The Committee took a serious look at the Office of Investment and Innovation's (OII) management of the SBIC program. With several months having passed, we would like to share with Congress some updates on the program since the hearing.

In mid-August, SBA finally released the SBIC program data for the first three quarters of the fiscal year:

- Total new SBIC license issuance (for Levered and Non-levered funds) is down 38% compared to the comparable three quarters of the previous fiscal year.
- Licensure of Levered SBIC funds are down 46% year over year.
- Green Light letters issued, the first step in advancing in the licensing process, were down 42%, meaning that significantly fewer funds are being given the go-ahead to pursue an SBIC license.
- Debenture commitments are a leading indicator of future small business investments. SBA reports new commitments issued are down 39%. As of June 30, 2019, SBA had issued \$958.2 million in debenture leverage commitments and, if this rate continues, then SBA is on pace to issue \$1.286 billion in debenture commitments for FY 2019. This would be a decline of nearly 50% from FY 2018.
- SBA reports that zero dollars of SBIC debentures have been written off in the Office of Liquidation. This is a strong testament to the health of the economics of the program and further evidence that it should be strengthened instead of choked off.

The Associate Administrator for OII has not filled the management or general staff vacancies that Senators questioned him about during the June hearing. The Deputy Associate Administrator position remains vacant as does the Director of Licensing. The Office of Program Development, charged with helping SBICs form in underserved parts of the country, has been reduced to one employee. In addition, two of the three Operations Managers (aka "Area Chief" positions) remain vacant, and several new analyst vacancies have arisen with the departure of other career staff since the hearing. Rather than fill positions, it appears that FTE's have been removed from

this division and ceded to other parts of the SBA. The OII has not filled a staff vacancy since February 2018.

As the Associate Administrator testified in June, making changes in information technology systems has been one of his top priorities for the past 2.5 years. This summer, the SBIC Web system, which is the portal by which all financial/regulatory filings are submitted, crashed at the end of the third quarter filing period, causing serious delays, costs, and a loss of regulatory data. SBA eventually extended the filing deadline for 30 days, but by then, the system had been completely inoperable for nearly two weeks, and many funds had incurred significant costs. It should be noted that the SBIC Web was recommended to be moved to a more stable cloud-based platform instead of staying on older, internal SBA servers, but that upgrade was blocked by the leadership of the OII.

For several years, the Associate Administrator has blocked multiple requests by Members of Congress and the private sector to release a completed Library of Congress study entitled, "Measuring the Role of the SBIC Program in Financing Small Businesses." In August, using the Freedom of Information Act, SBIA was able to force the release of the study that had been denied to Congress and the public. The researchers, professors from top business schools, had access to SBA's confidential internal data on SBICs and their investments. It says a great deal about the leadership of the Office of Investment that he would try to hide from Congress and the public independent information like the following:

- *"the authors found that the SBIC program is not only widely diversified by industry sector and geographic subregion, but varies from non-SBIC private equity funding on key dimensions concerning the companies, industries, and regions receiving investments."* (p. 1)
- *"SBICs invest in companies that are smaller than those funded by traditional private equity sources of similar size and investment focus."* (p. 2)
- *"SBIC investments fund different sectors than the rest of the private equity universe."* (p. 2)
- *"SBIC investments spread capital in a more dispersed manner across the country than traditional investors.*
  - *"the majority of SBIC funds invest in traditionally underserved regions of the United States, particularly Kansas, Minnesota, Nebraska, North Dakota, and South Dakota in the northern Midwest, and Alabama, Kentucky, Mississippi, and Tennessee in the South."* (p. 2)
  - *"...SBICs have higher capital distribution ratios among small businesses and distribute capital more evenly among nine geographic subregions."* (p. 2)
- *"Based on this data, SBICs reflect a broader and more consistent geographic presence than private capital funds on all three counts measured: total number of deals, relative concentration across subregions, and business population per deal ratio."* (p. 40)
- *"SBIC funds contributed capital in all seven major industrial sectors during the sample period."* (page 41)

- *“SBIC investment capital is spread much more evenly across the United States; much less is concentrated in the traditional hubs of private equity investment activity like the Pacific subregion, which is home to Silicon Valley. The authors’ analysis of the geographic dispersion of investments revealed that SBIC funds contributed capital in all four geographic regions and nine subregions of the United States.” (pp. 41-2)*

We thank you for your support in increasing access to capital for American small businesses. We look forward to working with you to strengthen this job-creating program to expand prosperity across a broader swath of the country and to more Americans.

Sincerely,



Brett Palmer  
President  
Small Business Investor Alliance

CC: Senate Small Business Committee  
House Small Business Committee  
Senate Appropriations Committee  
House Appropriations Committee



August 15, 2019

Office of the Ombudsman  
 U.S. Small Business Administration  
 409 3<sup>rd</sup> Street SW  
 Washington, DC 20416

**Re: SBIA Testimony and Report for SBA's National Regulatory Fairness Hearing**

The Small Business Investor Alliance ("SBIA") offers the following report about the Small Business Investment Company ("SBIC") program as our testimony for SBA's National Regulatory Fairness Hearing. This report was also recently submitted to Congress to inform them of what is happening to the SBIC program. SBIA is the national association that has represented the Small Business Investing Companies since their inception over 60 years ago.

Most Small Business Investment Companies are themselves small businesses. It is not uncommon for SBICs to have 3-5 employees. For decades SBICs have been an American success story and are an example of a successful public policy that aligns the power of private market with the public interest of job creation and economic growth. SBICs invest exclusively in domestic small businesses, creating jobs and empowering American small businesses to compete in a global economy.

Given the mission of SBA, the fact that most SBICs are small businesses, and that SBICs help thousands of small businesses grow, it is out of a deep sense of exasperation that we must seek the aid of the SBA's Ombudsman to get the SBA's Office of Investment to cease the hostile regulatory treatment by the leadership of the Office of Investment and Innovation toward small business investors. Our testimony includes a lengthy section (Section 3) documenting a sampling of the mismanagement that is currently plaguing the SBIC program and thereby harming small businesses and creating unnecessary risks to the taxpayer. SBICs now have come to expect that every regulatory question that arises will likely have an adverse outcome or inexplicable extended delays. For example:

- Delays in receiving completed examination results have created hardships for many SBIC funds, in advancing in the licensing process or accessing capital. There are SBICs who whose regulatory examinations were completed and paid for (by the SBIC) in October 2019, but who still do not have the results of their exams. These SBA exams are so delayed that the new exams have already begun without knowing the outcome of the prior years.
- SBIC must do regulatory reporting through the "SBIC-Web" system. A system failure that occurred at the end of the 2<sup>nd</sup> quarter resulted in SBA losing data for many funds who had already spent hundreds of work hours completing their filings. SBICs must now waste their time and money completing this work. SBICs were already spending over \$100,000 dollars a year on complying with SBA regulations and these data losses will increase those costs.
- SBIC funds going through the "green light" licensing approval process have faced lengthy administrative delays simply because the Associate Administrator refused to schedule meetings or interviews in a timely manner.

SBIA appreciates the opportunity to present these comments and looks forward to collaborating with the Ombudsman to strengthen the SBIC program and to ensure America's small businesses and the communities they serve have access to the capital they need. On behalf of the small business investors, I look forward to answering any questions you may have.

Sincerely,



Brett Palmer  
President  
Small Business Investor Alliance



May 8, 2019

Joseph Shepard  
 Associate Administrator  
 Small Business Administration  
 403 3<sup>rd</sup> Street SW  
 Washington, DC 20024

Dear Associate Administrator Shepard,

As the person responsible for managing the Small Business Investment Company (SBIC) program, the small business investors feel the need to raise another important issue with you.

As you know, SBIC funds are licensed and regulated by your office, the Office of Investment and Innovation (OII). SBICs have a finite life and are entitled to surrender their license once all SBIC leverage has been paid back. SBIC funds that were never leveraged are able to surrender their licenses at any time. There are more than a dozen SBIC licenses that have paid back all leverage and submitted their licenses for surrender. Some of these surrenders were submitted well over nine months ago, yet they await your acceptance of the surrender. These are unreasonable administrative delays that serve no purpose in helping small businesses, creating jobs, protecting the taxpayer, or benefitting the investors into the SBIC. To the contrary, these arbitrary, capricious, and inexplicable delays add costs to both the taxpayer and the SBIC fund manager, reduce returns to limited partners, and display another general breakdown in the basic operating abilities of the OII. These would-be-surrendered licenses are still accruing not only direct administrative and examination costs, but SBA may also demand exams on these winding down SBICs to delay the processing of new applications or accessing leverage for their other younger active SBIC funds.

The success of this small business program is dependent on basic functions of the program operating in a reasonable and dependable manner, which they are not doing. The inability of SBIC funds to exit the program adds to the current chilling effect on small business investors considering forming a new SBIC fund. It is important to note there are more small business investors trying to surrender their licenses than have been new SBICs licenses issued this fiscal year.

As the trade association representing SBIC funds and their limited partners, we formally ask:

- That you immediately process all license surrenders that have been submitted;
- OII have the surrender documents include an accurate date as to when the surrender was signed and approved by SBA (no backdating);
- OII provide email or other written confirmation to the SBIC of the surrender and the date of approval for the surrender; and
- On a going forward basis, OII process all license surrenders within a two week period.



The small business investors have numerous other concerns about the mismanagement of the SBIC program, but this issue is an issue that can be fully addressed in minutes. Please do so.

Sincerely,

A handwritten signature in cursive script that reads "Brett Palmer".

Brett Palmer  
President



April 18, 2019

The Honorable Christopher Pilkerton  
 Acting Administrator and General Counsel  
 Small Business Administration  
 403 3<sup>rd</sup> Street SW  
 Washington, DC 20024

Dear Acting Administrator Pilkerton:

The Small Business Investor Alliance (SBIA) is the trade association representing small business investors, the Small Business Investment Companies (SBIC), and limited partners investing via SBICs. As the new Acting Administrator of the Small Business Administration, we would like to draw your attention to the management of the Small Business Investment Company program which is now under your oversight.

The SBIC program is a proven job-creating program driven by the private sector and enhanced by the SBA via leverage. When allowed to function properly the SBIC program increases the capital available to growing small businesses. The SBIC program has not been allowed to function properly since the appointment of Joseph Shepard to run the Office of Investment and Innovation (OII). Through the first two quarters of FY 2019, some of the effects of mismanagement of the SBIC program have been clear and quantifiable. Below is a sampling of the performance through the first half of FY 2019:

- OII has one of the worst SBIC licensing rates in decades (only 4 licenses issued and received).
  - Only 2 SBIC Debenture funds received a license through the first half of the fiscal year.
    - Both licenses delivered immediately prior to Congressional Oversight hearing
  - Only 2 non-levered SBIC funds received a license through the first half of the fiscal year.
    - 1 license delivered immediately prior to Congressional Oversight hearing
  - Only 1 new SBIC platform was licensed (1 of the 2 non-levered funds) through the first half of the fiscal year.
    - License delivered immediately after Congressional inquiry into status of license.
    - No new levered SBIC platforms licensed
- More than 3 times as many SBICs surrendered their licenses than received a license.
  - 14 licenses have been submitted for surrender through the first half of FY 2019.
  - These license surrenders are in legal limbo because they have been pending on Associate Administrator Shepard's desk for up to 6 months, despite having fully paid off all of their leverage to the SBA. There is no justification for these unreasonable administrative delays.



- OII only issued \$690 million in leverage commitments to SBICs.
  - OII is currently on pace to have a 45% decrease (over \$1 Billion less) in SBIC leverage commitments for FY 2019 – down from \$2.5 Billion in FY 2018.
  - This represents billions of dollars in reduced future small business investments.
- No SBIC program data was released until March 30, 2019 - six months after beginning the fiscal year.
  - OII was once able to release this data monthly.
  - The 7a and 504 programs release data weekly or biweekly.
- There have been no SBIC regulations classes held so far this calendar year and there are currently none scheduled for the rest of the year.
  - The last SBIC Regulations class was held in November 2018.
  - SBA requires applicants for SBIC licenses to receive regulations training before being licensed.
  - SBIA has been asking for dates for SBIC regulations classes since the summer of 2018.
  - Outside of force majeure disruptions, it is extremely unusual to go at least a quarter without a regulations class – and it is unheard of that SBA has gone so long without a class. There is no precedent for having zero classes scheduled for the entire calendar year.
  - SBIA is in the final stages of building an online SBIC regulations training (at no expense to the taxpayer).
- OII's budget requests additional funding to study the SBIC program, but still has not released reports that were completed in 2017 and for which the taxpayer has already funded the research.
  - Releasing completed reports and studies before performing duplicative studies would prevent wasting additional taxpayer funds.
- OII's budget request seeks additional funding for 11 new FTE's for risk management.
  - OII has created new additional risks to the program because its leadership has not posted or filled existing, prolonged vacancies in mission critical positions despite having authorities and funding to do so.

I would like to meet with you to discuss how small business investors and SBA can work together to get the SBIC program working again so we can return the focus toward helping small businesses access growth capital.

Sincerely,

A handwritten signature in black ink that reads "Brett Palmer". The signature is fluid and cursive, with the first name "Brett" and last name "Palmer" clearly distinguishable.

Brett Palmer  
President



February 27, 2019

The Honorable Marco Rubio  
 Chairman  
 U.S. Senate Committee on Small Business  
 & Entrepreneurship  
 428A Russell Senate Office Building  
 Washington, DC 20515

The Honorable Ben Cardin  
 Ranking Member  
 U.S. Senate Committee on Small Business  
 & Entrepreneurship  
 428A Russell Senate Office Building  
 Washington, DC 20515

Dear Chairman Rubio, Ranking Member Cardin, and Members of the Committee:

Thank you for asking questions about the Small Business Investment Company (SBIC) program during the recent oversight hearing of the SBA. When allowed to function, the SBIC program is a powerful catalyst for small business growth and job creation. As a 2017 Library of Congress study revealed, SBIC-backed small businesses created over 3 million new jobs and supported over 6 million more jobs. As the voice of small business investors, we feel it is important to clarify the record of what has been happening with the SBIC program.

Despite strong, pro-small business policies of the broader Trump Administration and the professionalism and dedication of the SBA career staff, for two years there have been serious problems with the management of the SBIC program. Until the day before this hearing, over four months into FY 2019 and through more than one third of the fiscal year, SBA had issued zero SBIC licenses. Less than 24 hours before this oversight hearing, the Office of Investment and Innovation (OII) finally released the first SBIC licenses of the fiscal year. All three licenses were approved by SBA's Agency Committee on November 16, 2018, but the leadership of OII was unable or unwilling to release the SBIC licenses until hours before the Committee's oversight hearing. Until 2017 releasing licenses would have taken 1 to 2 weeks. SBICs are not allowed to operate until they possess the license.

For the past two years, the SBIC program has suffered from ongoing problems that are clearly seen in the licensing process but are also manifest in nearly all facets of the SBIC Program. Where the OII leadership has inserted itself into any SBIC processes, each step of those processes has slowed to near paralysis and the outcomes are at best uncertain. As the association representing small business investors, we have been informing the OII and leadership of the SBA of these emerging problems from very early on, but the problems and the primary cause of these problems persist.

The Chairman asked a good question about SBIC licensing. The SBA Administrator answered honestly with what normally would be the textbook answer of what is supposed to happen. However, it is clear that the information being given to the Administrator, which was then passed on to the Committee in good faith, does not reflect the complete picture. SBIA hopes that this chart will inform the Committee and the leadership of SBA as to what is really happening from the private sector perspective. While it is true that SBIC licensing in FY 2018 increased relative to FY 2017, it is also true FY17 was one of the worst licensing periods in nearly a decade. Licensing was working well in FY 2017 until the Associate Administrator was appointed to oversee the OII.

Licensing returned to near average in 2018, but this too is misleading because given the underperformance and backlog of FY 2017 applicants, the number of licenses should have been much higher in FY 2018. To be clear, time to fundraise is not the reason for the slowdown in licensure, particularly for the funds licensed in FY 2019. SBIA agrees with SBA that technology improvements are needed and will improve some of these issues, but technology alone will not fix the primary cause of the problems at the Office of Investment and Innovation.

	FY 2010-2016	Feb. 1, 2017-Feb. 10, 2019	FY 2019 (SBICs licensed from Oct 1, 2018 through date of Hearing Feb. 13, 2019)
<b>Time for Greenlight Approval for Repeat Funds</b>	Commonly 0.5 Months	Commonly up to 6 Months	Average of 7.25 Months (100% repeat SBICs)
<b>Time to Receive License After Approval by Agency Committee</b>	Commonly 1-2 Weeks	Commonly 1 - 2 Months (sometime more)	3 months
<b>Annual Pace of funds licensed per year</b>	26.4 Licenses Per Year Average (Fewest 21 and highest 34 per year)	Averaging 16 Licenses Per Year for the last 24 months <ul style="list-style-type: none"> <li>• 7 in FY17 (excludes licenses issued by previous Administration in FY 2017)</li> <li>• 25 in FY 2018 (repeat and new SBICs)</li> </ul>	On pace for 9 to 12 licenses (No new platforms licensed as of date of hearing)
<b>Average Time for Licensure</b>	6.6 Months (185 first-time and repeat funds)	SBA reported numbers for FY 2017 are 5.1 months – this number is misleading because more than 50% of licenses issued were issued in a timely manner by the previous Administration (further, this data excludes SBA-caused delays) (includes new and repeat funds)  8.7 Months for FY 2018 (includes new and repeat funds and <i>excludes SBA-caused delays that are omitted from SBA's reported data</i> )  Zero SBICs Licensed from Oct. 1, 2018 through Feb 10, 2019	9.7 months (100% repeat SBICs, which should be much faster to analyze than first time funds)

Source of data 2009-2018 SBA, Source of FY 2019 SBIA (OII appears to have ceased releasing SBIC data for FY 2019)

Licensing is only one area where OII's leadership has broken the efficient and successful operation of this small business investing program. The leadership of the OII has created new uncertainty and delays at every step of the entire SBIC process from pre-licensure to operations to examinations and even to surrendering of licenses. Each of the new delays builds upon the preceding delays. Adding to the delays is the fact that the OII has numerous critical career director, manager, and chief positions that have been vacant for extremely long periods of time, but there has been no attempt by the leadership of the OII to post these open positions for replacement. Attached to this letter is a sample of the private sector's concerns that were submitted to the SBA in the summer of 2018. SBIA has also highlighted these problems in Congressional testimony to the House Small Business Committee with the hope that SBA would address the problem with OII's leadership. This small business program needs your oversight to return it to a fully functional resource for small businesses.

We encourage the Committee and the leadership of the SBA to review these concerns and address them as warranted. This is a program regulating over \$30 Billion in small business investment capital, and it needs competent leadership. As an industry, small business investors want to be working collaboratively with Congress and the SBA to get more SBICs in underserved areas, more equity-oriented SBICs, more investments in rural areas, more women fund managers, more veteran fund managers, and more small businesses growing. Instead our energy must be spent begging SBA to get the most basic functions of the OII to work. The SBIA looks forward to working with Congress and the SBA to better serve and empower growing small businesses with an efficient and functional SBIC program.

Sincerely,



Brett Palmer  
President  
Small Business Investor Alliance

cc U.S. Senate Committee on Small Business & Entrepreneurship  
U.S. Senate Committee on Appropriations  
U.S. House Committee on Small Business  
U.S. House Committee on Appropriations  
SBA Administrator Linda McMahon



February 7, 2019

Mr. Joseph Shepard  
Associate Administrator  
Office of Investment and Innovation  
U.S. Small Business Administration  
409 3<sup>rd</sup> Street SW  
Washington, DC 20416

Dear Associate Administrator Shepard:

As the appointee leading the Office of Investment and Innovation (OI), your responsibilities include overseeing and executing the Small Business Investment Company (SBIC) program. SBIA again requests you take corrective action to address what appears to the small business investing community to be another breakdown of the SBIC program, particularly the delays with the delivery of licenses.

Today, over four months into the new fiscal year, only one SBIC license has been issued and received by an applicant. This license was issued last week despite being approved by the Agency Committee on November 16, 2018. This single new license is a non-levered SBIC. With more than a third of the fiscal year completed, not a single levered SBIC license has been issued and delivered. This inability to license any levered SBIC funds is confounding because there are several SBIC applicants that also completed SBA's entire licensing process and were approved by the Agency Committee on November 16, 2018. These would-be-SBICs are in limbo and are currently not able to operate and invest in small businesses until SBA issues the licenses.

It is important to also put on the record that the single license issued and the several would-be-licenses-in-limbo are all repeat SBICs with well-established, successful track records in the program. These applicants are extremely well-known to the SBA. Not a single license has been issued to a new SBIC platform in FY 2019. Our industry wants to see more small business investment with more women, more minorities, and more veterans running SBICs. Our industry wants to see more SBIC funds licensed in more geographies – under licensed states and underinvested areas. Our industry wants to see more SBIC funds investing in a broader array of investments in a broader mix of small businesses. How can SBA expect any investing professional, but particularly new entrants to the program who are women, minorities, veterans, or investors from new areas, to take the entrepreneurial risk of forming an SBIC fund when even established and successful SBIC funds are facing unpredictable delays and are struggling to be licensed? Even longtime institutional investors in SBICs, who know the program well, are worried about deploying capital into SBICs that are entering the licensing process because many aspects of the program are now unpredictable and slower than ever.

The government shutdown is not a meaningful cause of these licensing delays. The licenses-in-limbo were approved by the Agency Committee on November 16, 2018. The government did not shut down until December 23, 2018. These licenses should have been issued well before the shutdown. The government reopened on January 25<sup>th</sup>, almost two weeks ago and still there are approved applicants without an SBIC license.

The private sector is having difficulty making sense of the delays. Applicants and their investors can only sit and wait. The civil servants in the Office of Investment and Innovation are not the cause of these licensing delays. By all accounts the civil servants appear to be doing their work professionally and with a sense of purpose. The Agency Committee, composed of both political appointees and civil servants, appears to have done their job and approved applicants for SBIC licenses months ago.

Other parts of the Trump Administration have done an excellent job in promoting small businesses, reducing taxes on small businesses, reducing regulations on small business, and prioritizing capital access to small businesses. The SBIC program is completely in line with the President's goals of supporting small businesses, promoting investment in domestic companies, and promoting hiring American workers and limiting offshoring of jobs. The SBIA wants to partner with and support this Administration to aid growing small businesses, but the SBIC program must be allowed to function.

On behalf of the small business investing community, the SBIA asks that OII ends these delays and release to the applicants all approved licenses. OII should also prevent these delays from happening in the future. Further, we ask that the SBIC program's other operational issues, not just licensing, be righted so the program can become reliable again. Small businesses, their employees, the private sector investors into SBICs, and SBA's SBIC partners expect a functional Office of Investment and Innovation. SBIA stands ready to assist you in this undertaking in any way that we can.

Sincerely,



Brett Palmer  
President  
Small Business Investor Alliance

CC: Pradeep Belur  
Chris Pilkerton  
Bill Manger  
Nina Levine  
Tim Gribben



August 10, 2018

Joseph Shepard  
Associate Administrator  
Office of Investment and Innovation  
Small Business Administration  
409 3rd Street SW, Suite 6300  
Washington, D.C. 20416

Re: Industry Comments on Reducing Regulatory Burden

Dear Associate Administrator Shepard:

For 60 years, the Small Business Investor Alliance (SBIA) has been the trade association that serves as the collective voice of the Small Business Investment Company (SBIC) industry. SBIA's membership includes both GPs and LPs in the SBIC program. This membership ensures that our SBIC policy proposals are solid, balanced, and aligned with promoting a healthy capital market for small businesses.

Debenture and non-levered SBICs are highly-regulated private funds that serve the important public purpose of facilitating private investment into domestic small businesses. Core to the success of the program is that investments are market-driven and not government-chosen. A 2017 Library of Congress study found that SBIC-backed businesses created 3 million net new jobs and supported an additional 6.5 million jobs from 1995-2014 (a period of 20 fiscal years that included the Great Recession and the tech bubble recession). The underlying economics of the SBIC program are sound: for years it has maintained its zero subsidy, and for several years it has been operating at or near the lowest loss rates in the 60-year history of the program.

On August 15, 2017, SBA published in the Federal Register a request for public comment entitled "Reducing Unnecessary Regulatory Burden." The request was issued in accordance with three executive orders aimed at reducing regulatory burdens. Executive Order 13771 was issued by President Trump on January 30, 2017 and has the goal of reducing regulatory costs by eliminating two regulations for every new regulation that is issued. Executive Order 13777, issued by President Trump on February 24, 2017, aims to—among other things—repeal, replace, or modify regulations that "eliminate jobs, or inhibit job creation; are outdated, unnecessary, or ineffective; impose costs that exceed benefits;" and "create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies." Executive Order 13563, issued by President Obama on January 11, 2011, requires agencies to propose regulations whose benefits are justified by their costs and to issue the least burdensome regulations possible. In November 2017, SBIA submitted a comment letter in response to the August 2017 request from SBA. SBIA stands by that letter and would like to see those recommendations implemented. We submit the comments below as additional items that would make the SBIC program operate more efficiently.

President Trump deserves credit for his pro-small business efforts to reduce regulations and taxes. Further, SBIA is supportive of the goals laid out in the President's executive orders and appreciates the opportunity to comment on ways to reduce unnecessary regulatory burdens. SBICs embody SBA's goal "to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation," while instituting strong taxpayer protections. SBICs are proof that these goals can coexist, and we welcome the opportunity to offer suggestions to extend and enhance that record.

The recommendations contained below are all in line with the goals of the executive orders issued by Presidents Trump and Obama and applying them would ease burdens on small business investors and help unleash more capital to domestic small businesses in a more efficient manner.

In preparation for the SBA's regulatory review, SBICs and Limited Partners (LPs) were surveyed about the regulations and, equally important, the SBA's real-world application of the regulations. Many of our LPs participated in a conference call to help us further flesh out our comments to reflect their views. SBIA staff also spoke to many more SBICs, LPs, lawyers, and accountants to ensure we were capturing and communicating critical issues. The survey produced results based on a very large sample size of all actively investing SBIC license holders. Fund managers who hold over 100 active SBIC licenses completed the survey as did LPs who have investments in a similarly large number of SBIC funds. The survey encompassed the four main regulatory aspects of the SBIC program: licensing, operations, examinations, and forms.

This comment letter includes some of the findings of the survey. For the sake of brevity, we are including only comments which received overwhelming consensus from the SBIC industry and which are appropriate for this specific comment letter. It is important to note that a number of SBICs had serious concerns about responding to the survey out of an explicitly stated fear that SBA would trace back their responses and retaliate against them if SBA was able to identify fund managers who had raised concerns about the regulations or how they were being applied. As such, SBIA will only be describing the results of the survey and not be releasing the survey or any other information that could be tied back to any specific person, group, or SBIC fund.

#### **Overall Regulatory Challenges**

The Debenture and non-levered SBICs have been successfully operating for decades under regulations that have barely changed. Most of the regulations are time-tested and reasonable. While the regulations have been adequate to the task, with the passage of time, personnel, and management philosophies, a review and update of the regulations and their applications are appropriate. Our survey documented a significant number of regulations, policies, and practices that are unnecessary, outdated, burdensome, conflicting with other law, and hindering job creation. By an overwhelming margin in our survey, respondents noted that the biggest challenge facing the SBIC program is uncertainty about the management of the program and confusion about the current leadership's vision for the operation of the program, not the regulations. Not only was this the answer to the specific question about the biggest challenge facing the SBIC program, it also showed up in the "word cloud" of responses to the survey. Words like "confusion," "delays," and "uncertainty" were some of the most common concerns. Words like "clarity," "timelines,"

“consistency,” “standards,” and “communication” were some of the most common in the questions where suggestions for improvement were sought. SBIA applauds SBA’s efforts to clean up and modernize the regulations, but we also strongly encourage SBA to focus on fixing the delays, uncertainties, and other execution problems that may continue long after any written word of regulation is changed. LPs described it this way:

[It is now] about 20 months into the Administration and the leadership of the SBIC program has not articulated what they want to accomplish with the Small Business Investment Company program.

Improved regulations are welcome, but how the leadership of the SBIC program implements the regulations has a far bigger effect on how effective SBICs are allowed to be.

LPs choose between competing investments every day. If the leadership of the SBIC program makes it difficult to invest in SBICs and for SBICs to operate, then we can redirect our investments away from SBICs and small business and into other investments.

### **SBIC Licensing**

SBIC licensing is core to the program because without a license, no investments can be made into small businesses. SBA has an extraordinary group of public servants doing the best they can to fulfill the demands of their jobs. They are at the front lines of both taxpayer protections and small business access to capital. The SBICs and LPs are concerned that licensing is understaffed and that the staff does not have the adequate technological resources needed to perform at their full potential. LPs in particular see the SBIC licensing team as disciplined professionals who complement the private sector’s efforts to vet and approve fund managers. Further, there are a number of regulatory and policy improvements that can make licensing clearer, faster, and better for both applicants and the SBA.

#### Green Light letters

SBIA’s members believe that the SBA’s Green Light letter process should lay out the specific targets that the applicant must reach to be licensed. SBA should honor their letter and license applicants who meet the standards set therein, provided that no new material adverse information develops during the review of the license application. If SBA’s expectations are clear, quantifiable, and written, then there is greater transparency and less regulatory frustration for both sides. Clear standards must be communicated from the Agency Committee to make this happen. Also, LPs commit to GPs and their business model. SBA forcing changes to the business model that was approved for the Green Light, by significantly reducing leverage late in the process, is not fair to LPs or GPs.

Agency Committee

The survey shows there is overwhelming confusion or doubt about the value that the Agency Committee brings to the licensing process. The Agency Committee was created under the Administration of President Bill Clinton to get more political appointees involved in SBIC licensing. The Agency Committee makes decisions without many of its members having ever met an SBIC fund manager, without any members ever meeting the applicant whose fate they are deciding, without clearly documenting and communicating their expectations and standards to the Office of Investment, and without ever communicating their expectations and standards to the small business investing community. By the time applicants reach the Agency Committee for their consideration, hundreds of thousands of dollars and up to two years may have been spent forming the SBIC, but these expenses and applicants' work going through the process is not necessarily valued or respected.

It should be noted that, according to SBA's Standard Operating Procedure (SOP), all issues must have been dealt with satisfactorily before being presented to the Agency Committee. So, if all the legal, financial, and other approvals have already been satisfied, then it is not clear what value this body adds to the process. SBA should either have the Agency Committee communicate their standards and expectations to the SBIC community, or it should reconsider what value this additional step adds to the process beyond more time and expense. Every member of the Agency Committee was invited to meet the SBIC industry at SBIA's 2018 Washington Fly-In, and none accepted the invitation. SBIA would welcome the chance to have members of the Agency Committee engage the SBICs and understand more about our market.

Licensing Decisions Based on Facts in the Record (13 CFR 107.305)

Licensing decisions by SBA should be based on the facts in the record that are discovered during the process of approving a fund. The licensing team in OII does excellent diligence, a very small amount of which must be kept confidential, but there is no documentation of how decisions are made or what facts were used to make determinations. Applicants should have the right to address or correct any issues, but they cannot do so if they do not have a chance to address and correct the record.

Specific Reason for Non-Approval with Opportunity for SBIC Applicants to Cure

SBIA's survey respondents believe that SBA should give applicants clear and specific reasons for non-approval with an opportunity to cure any issues that SBA raises. Not every applicant for a license is worthy of licensure, but some issues deemed worthy of non-approval by SBA can often be cured by the applicant. If applicants cure the issues, SBA should promptly reconsider the application and grant approval if all conditions are met. An applicant should not be turned down or prohibited from filing a formal application without a clear, meaningful, written explanation from the SBA and a good faith opportunity to fix any issues. The SBA should also recognize that some of the reasons SBICs are being delayed or prohibited from filing an application are 100% due to SBA's actions or inactions and are on matters over which the applicant has zero control (timing of exams, for example).

#### Clear Appellate Mechanism for Adverse Decisions

SBIA members also believe that a clear appellate process should exist for funds who receive an adverse regulatory decision, particularly, but not limited to, licensing.

#### Meaningful Fast-Track Licensing for Known, Repeat SBIC Applicants

SBIA members surveyed unanimously support a meaningful fast track licensing process for repeat SBICs. The GAO has studied the risks of first-time and repeat licensees and found that repeat SBICs are lower risk<sup>1</sup>. Repeat licensees (some of whom have been successfully operating SBICs for decades) are fundamentally less risky and more well-known to SBA than first time applicants. SBA is intimately aware of their investments and is very familiar with their management teams and investment strategies. Beyond a new FBI background check and review of new capital certificates, nothing is not already known to the SBA. If there are no material changes, the process should be significantly expedited.

Existing SBICs have the added burden of not being able to apply for a license until SBA's (recently broken) examinations process has run its course. Existing SBICs may already have had dozens of clean exams previously, but that is not considered. First-time licensees have never been examined and therefore do not face these unnecessary delays. Existing SBICs should not face delays or have limitations put on the amount of leverage they can access because of an examination process that is completely outside of their control. (Greater explanation of the issues surrounding the problems with examinations are covered later in this letter.)

Recognizing the inefficiencies created by the treatment of existing SBICs and how that removes resources from attracting and vetting new SBICs from across the country, the House and Senate Appropriations Committees' Financial Services and General Government appropriations bills for FY 2019 recommended a 60- to 90-day window for repeat licenses.

#### Transparency During the Licensing Process

SBIA members surveyed unanimously agreed that the licensing process should be more transparent, more predictable, and that applicants should know where they stand at all stages during the process. As one LP described it, "The inability to forecast licensing causes cash flow and allocation planning problems for many LPs." Further, an LP described the following:

SBA wants banks to finalize their commitments to SBICs before licensure, but banks investing in SBICs are being forced to withhold their commitments until after licensure because we don't have insight into the timing of the licensing process. Banking laws do not allow us to be put in the position of being held hostage to the SBA's uncertainties.

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<sup>1</sup> U.S. Government Accountability Office, *Small Business Investment Companies: Characteristics and Investment Performance of Single and Multiple Licensees*, GAO-16-107 (Washington, DC, 2016), 14-18.

Other SBIA members described the situation this way:

Institutional Investors need to plan allocations yearly. SBA's delays have caused us problems with planning our allocations. Further, we have been forced to go back to our investment committee to get renewed approvals or to rebalance our allocations because of SBA's actions and timing.

For those of us (LPs) that are publicly traded companies, this is a problem because we want to be transparent with our shareholders who hold us accountable for meeting the investing goals that we set.

Acknowledging Receipt of Materials and Accepting All Forms (Including Licensing Materials) Electronically without a "Wet Signature"

The requirement for a wet signature of licensing or regulatory materials is unnecessary, and the survey showed that removal of this requirement is overwhelmingly supported by SBIA members. With current technology, all required signatures can be collected safely and securely electronically. SBIA's membership recognizes that this is not a requirement that is peculiar to SBA. Accepting materials electronically will also address the issues/questions about when materials were received. The date SBA received regulatory or licensing requests should not be a question. This could easily be addressed with the use of virtual data rooms and other off-the-shelf technology, like email.

SBICs Should Receive Their Actual License within Two Weeks of Approval

SBICs need their license to operate and for their bank LPs to comply with banking law. Upon approval, SBICs should receive their actual license as soon as possible and definitely within two weeks. SBIC survey respondents overwhelmingly agreed on this point.

Recently, it has taken months to get a written confirmation of licensure. This time frame is arbitrary, expensive and challenging for the licensee, and does not benefit small businesses seeking capital. These delays are an added headache for bank LPs who need the letter to document compliance with banking laws. SBA should have a regulation providing SBICs with a timely confirmation of licensure. SBA should also publicly announce when funds are licensed and when licenses are surrendered.

SBICs Should Be Able to Maintain Their Licenses in Wind Down after Paying Down Their Leverage Below the \$5 Million-Dollar Threshold

When SBICs complete their life cycle, their fund size will eventually reduce to zero, but before they get to zero, they generally drop below the \$5 million minimal threshold that SBA requires. Surrendering the license can harm bank LPs because of the banks' allowance to invest in SBICs under the banking laws. Survey respondents feel that SBA should allow SBICs to hold onto their licenses as they wind down and should make regulatory changes to significantly reduce the cost of operating SBIC funds that are in wind down. At the final stages of a fund's life there is minimal fund income, so it is important that SBA reduce regulatory costs so as not to create an artificial incentive to surrender the license.

SBA's Model Limited Partnership Agreement (LPA) Should Be More Customizable

SBA has a fairly rigid model LPA. SBIA recognizes that the lawyers reviewing the SBIC LPA are severely under-resourced, which requires some level of standardization. It is very hard for an applicant to make changes to the LPA, even the "non-bold" language that is theoretically flexible. SBIA members surveyed believe that there should be more flexibility for General Partners (GP) and institutional Limited Partners (LP) to negotiate market terms for their LPAs. SBA should require LPA language that is necessary to fulfill its statutory mandate and provide the necessary protections to serve its role as a guarantor of a credit facility and as a regulator. Since SBA is a guarantor of a credit facility and not an LP, it should leave the non-statutory and non-credit related terms to the GPs and LPs to negotiate.

Affiliation

The SBA's affiliate rules need to be updated to ensure that investments with private equity funds are not inadvertently limited, survey respondents agreed. Some SBA regulations were written before related SEC regulations were written and now the SBA regulations need to be updated to reflect these changes. The lack of an exception from affiliation for portfolio companies that are owned by private equity funds that are exempt from registration under the Investment Company Act of 1940 because of Section 3(c)(7) only restricts or harms SBICs' investment activities. The exemptions from the Affiliates definition should be changed to expressly include 3(c)(7) funds. Many SBIC funds are affected by this regulation, and a simple fix would be to remove the current exception under 13 CFR 121.103(b)(5)(vi) and replace it with a reference to any "private fund" as defined by SEC Rule 203(m)-1, which includes any 3(c)(1) or 3(c)(7) fund.

**Capitalizing an SBIC: Private and Regulatory, Institutional Capital**

LP Capital from Bona Fide "Funds of Funds" Should Be Recognized as Institutional Capital

There are a number of well-established, proven "Funds of Funds" whose investments in SBICs are not treated as institutional regulatory capital. This harms capital inflows into domestic small businesses and does not treat all significant LPs similarly. SBIA's survey revealed that well-known and established Funds of Funds who meet or exceed the qualifications to be an "institutional investor" should be treated as providers of institutional, regulatory capital. We recognize that a new Fund of Funds that might warrant scrutiny and a review, but there are top-tier, long establish, SEC-regulated Funds of Funds that are not treated as institutional capital. Further, fair treatment of the Funds of Funds model will allow new entities to form to provide professional investment opportunities to unique sources of capital that may need to be pooled to gain the benefits of scale, to access unique market expertise, or to find particularly SBIC characteristics (looking for SBICs that focus on rural areas, for example).

Pensions and Endowments from State-Chartered Universities Should Be Recognized as Private, Regulatory Capital Instead of as "Instrumentalities of the State." (Instrumentalities of the State May Not Qualify as Regulatory Capital.)

Recently, SBA has started treating endowments and pension funds from some universities as "instrumentalities of the states." This is not an accurate description of what they are. Further, this

treatment effectively blocks other endowment and pension funds from investing in an SBIC that has these investors. As one large LP described it, “SBIC investments are only a fraction of our multibillion dollar endowment’s overall capital. If SBA continues to make it difficult to invest in SBICs, then we can and will redirect our investments away from domestic small businesses to other investment opportunities.” This new interpretation of the regulations runs directly counter to the President’s goals for fostering domestic investment and small business job growth.

SBA Should Recognize LP Investments from Canada and Other Treaty Countries as Regulatory Capital

Under US law, investments from certain countries may not be discriminated against. Canada, Australia, and Mexico are three examples where this US law applies. Contrary to US law, SBA is not treating investments from these countries as regulatory, institutional capital. Survey respondents agreed that SBA’s regulations should be modified to reflect existing law. Creating barriers for our trading partners to empower domestic small businesses via SBICs appears to run counter to the President’s goals for job creation and more equitable treatment of American small businesses.

Transfer of LP Interests That Represent 10% or Less of an SBIC Fund Should Be Streamlined or Permitted without Prior SBA Approval

SBICs have Limited Partner Advisory Committees (LPACs). Survey respondents feel that if an SBIC has the approval of its LPAC, then it should be allowed to transfer smaller LP interests (10% or less of the committed capital). Existing restrictions are cumbersome and unnecessary.

Side Letters

Side letters are necessary documents for many LPs, particularly banks. Many banks have their own standard side letter to reflect their bank’s (banking) regulatory requirements. Side letters are extremely time consuming to the under-resourced legal staff because they are commonly treated as if each were *de novo*. SBIA’s survey found that side letters that have already been approved and used numerous times by LPs (commonly from bank LPs) should be presumed by SBA to be acceptable for future commitments. Alternatively, LPs should be able to get a standard side letter pre-approved once for use across multiple and future funds that they plan to invest in for a set period of time. SBIA’s LP Council could work with SBA to provide guidance and standards for these side letters.

**SBIC Operations**

Common Contact File/Resource to Prevent Multiple Requests for Information

Survey respondents said that SBA should have a common contact file/resource/customer relationship management system in place that will prevent SBA from asking for the same information that has previously been submitted – often many times or in many similar ways. Redundant requests of information are common, burdensome, and could be easily remedied. A system of this type could expedite processes at SBA significantly and reduce burdens for both SBICs and the SBA.

#### Addressing Regulatory Questions through a “No Action Letter” System

SBIA survey respondents overwhelmingly support the establishment of a no action letter system, modeled off that of the SEC, to help SBIC industry participants address good faith regulatory questions that may arise. SBIA believes this would help facilitate productive communication between industry participants and regulators and would provide an outlet to address questions and potential issues early. As appropriate, no action letters should also be shared with the SBIC community so there is clarity in the regulatory environment.

#### Conflicts of Interest (13 CFR 107.730)

The conflict of interest rules are being interpreted so narrowly that in some cases they are now harming LPs and GPs by preventing or terminally delaying legitimate small business investments. Similar to transfer of LP interests below a certain threshold, if the LPACs from two affiliated SBICs (often two successive SBIC funds, e.g., SBIC Fund 1 and SBIC Fund 2) both agree that an investment is appropriate, then it should be allowed. With LPAC approval, and when two SBIC entities are financing a small business under the same terms, this should be automatically approved and should not be viewed as a conflict of interest. SBIA survey respondents recommend that the regulations follow 13 CFR 107.730(d)(2) for conflicts of interest. The regulations should also provide automatic approval if all SBIC LPACs have been approved and the SBA has not made a determination within 30 days.

#### Overline Requests (13 CFR 107.740)

SBIA’s members recommended in the survey the establishment of clear, binding timelines within which SBA must make a determination on overline requests, or else the request should be deemed approved if the LPAC has already been approved of the investment. Such timelines will be helpful in reducing uncertainty and providing structure for industry participants. If SBA does not decide on an overline request within the time allotted (30 days), requests should be granted automatic approval. It should be noted that during the economic stresses of 2008, small businesses failed, and Americans lost their jobs because SBICs were not able to get timely approvals for follow-on SBIC investments from the SBA. The economy is solid now, but the regulations will need to be applied in tougher times, too. No American should lose their job because paperwork was pending for month after month at SBA.

Similarly, SBIA and its members overwhelmingly feel that the SBA should develop clear and binding timelines for processing all regulatory requests, not just overlines, to promote efficiency and certainty in the industry. SBA should create a list of regulations that will be deemed approved if SBA does not make a decision within a pre-determined amount of time.

#### Personnel Changes and Absences

By regulation, the SBA should provide SBICs with a formal notification when their analyst, examiner, etc. is reassigned or on extended leave. It is not uncommon that an analyst leaves the government, leaves SBA, goes on extended vacation, is out ill, or otherwise becomes unavailable. Often, no notice is given to the SBIC, and no information is given as to whom critical and time

sensitive requests should be submitted. In this scenario, SBICs could unknowingly submit time-sensitive regulatory requests to a person who is unable to receive the filing.

SBIA members surveyed believe that SBICs should be aware of whom they are supposed to communicate with at all times. SBIA hopes that informing SBICs of analyst changes will facilitate improved communication between SBA and the industry and contribute to the smooth functioning of regulatory processes. Further, the use of virtual data rooms and other off-the-shelf technologies commonly used in the private sector will make it easier for SBA staff to find information and records when assigned to a new SBIC.

#### Fund Expenses vs. Management Company Expenses

According to the survey, SBIA members feel that the allocation of an expense as either a fund expense or a management company expense should be negotiated between the private LPs and the GPs in the LPA. The expense allocation should not be decided solely via SBA regulation; rather, a negotiated decision made jointly by LPs and GPs in the LPA will allow for a mutually beneficial solution. It is appropriate that expense allocations should be included in the LPA which is shared with SBA.

#### Technological Modernization

Similarly, SBIA's members support the removal of regulations related to outdated technological requirements. Specifically, SBICs should no longer be required to maintain a fax machine at the primary office (13 CFR 107.504), as email and mobile communication systems provide faster, more reliable, and more ubiquitous forms of communication.

Additionally, to prevent fraud and protect market information, the SBIC industry participants responding to SBIA's regulatory survey agreed unanimously that the SBA should have a secure, encrypted mechanism for communicating sensitive materials and information such as leverage commitments and wiring instructions. Cybercrime is a growing problem across all industries, and SBICs, their LPs, and the SBA all should have more secure communications for the movement of large financial transactions than conventional email provides. It should be noted that the survey received comments about making sure any new communications system or portal not be too cumbersome, expensive, or limiting.

#### Recordkeeping

SBIA survey respondents recommend that SBICs be allowed to use a single safe to maintain the records for all affiliated SBICs. SBICs should also be allowed to keep records electronically in secure virtual data rooms or other secure cloud services.

#### Prepayment of Financing (13 CFR 107.830)

SBIA survey respondents also recommend that SBICs be allowed to put modest pre-payment limitations on the capital they invest in small businesses. Small businesses should be allowed to make prepayments, but reasonable limitations should be permitted. Every prepayment requires time and some expense by the SBIC. Being paid a penny (or a single dollar) is not reasonable. Perhaps prepayments of at least a certain percentage—5%, for example—would be reasonable.

#### SBIC Industry Data

SBA should return to publishing SBIC industry data on a regular, timely basis, according to the majority of survey respondents. The 7a and 504 programs release their data weekly. The SBIC program used to release the data monthly, and it would be released within a week of the month ending. Now SBA releases the data quarterly and waits an additional 6 weeks to release the data. LPs and GPs would benefit from having fresh, not stale, data. SBIC industry participants rely on up-to-date data to identify industry trends and remain informed as they make key decisions pertaining to their businesses. This data should be released monthly and within 5-10 business days of the end of the month.

#### Cost of Money

SBIA members believe that cost of money regulations should be made more flexible. Further, the definition of "default interest" should be revised to allow for increased charges without violating the Cost of Money. The definition of default should be expanded to be more consistent with the market and to not leave SBICs and the SBA in a disadvantaged position. SBICs should be allowed to be more proactive in taking necessary steps to address risks to investments.

#### Liquidations

SBIA members who were surveyed also overwhelmingly believe that an SBIC should be able to get out of "liquidations" and back into regular operations if the issues that caused them to be moved to liquidation are cured, and they otherwise would be able to operate as an SBIC. This is an unusual circumstance, but it should be addressed.

#### Debenture Pooling

SBIA survey respondents feel that the SBA should pool SBIC debentures four times a year (instead of the current two) and allow repayment four times a year (instead of the current two). Until about 10 years ago, SBA pooled four times a year (twice for Debenture SBICs and twice for the defunct Participating Securities program). SBICs may draw leverage and have to wait up to six months to know the interest rate on that leverage. SBICs also may be paid back from a small business and have millions of dollars sit idle for up to six months. If SBA were to keep the exact terms on the SBIC debentures, but pool/price four times a year instead of two, then SBICs would often have less timing/interest rate risk and would be able to pay back debentures sooner and reduce risk to SBA. This could be achieved without any change to the offerings other than adding summer and winter pooling/pricing dates.

#### OII Interaction with SBIC Fund Managers and Limited Partners

SBIA members would also like to see more engagement by OII leadership with the SBIC industry via SBIA. If there are regulations that are somehow preventing the OII leadership from attending industry gatherings, then those regulations should be changed. The leadership of OII has attended only one of the many SBIA industry events held since January 2017. These events are an opportunity to learn about what is happening in the market the SBA is regulating. Industry dialogue has been exclusively in closed, invite-only settings where the government chooses the participants;

in private, one-on-one meetings with LPs and GPs; or in settings where all questions are screened/chosen by SBA and all the answers are pre-scripted. This lack of engagement by SBA is not only an inefficient and ineffective way of having two-way communication, but it also raises doubts that market participants are being told the same information. As one LP put it, “The leadership of the SBIC program should be engaging the SBIA to work with SBICs and with LPs. Engagement should be regular and two-way.”

## **Examinations**

### Examination Reports

SBIA survey participants recommend that examination reports be provided to the SBIC within four weeks of a completed examination. Despite recent massive increases in examination fees, the examination process has recently become a choke point for the effective operation of the program. Currently, exams are being completed with the examiner verbally informing the SBIC that there were no findings, but the actual letter informing the SBIC of the results of their exam may not be given for up to six months later – awaiting approvals from higher ups at SBA. There is no justification for these delays in issuing the examination letters. This means that the SBIC may be blocked by SBA from reserving leverage or from submitting a licensing application for another entire year and exam cycle because their exam results are considered out of date and stale. It is also inappropriate for SBA to exclude from the licensing times report the amount of time SBA blocked SBICs from filing for a license due to SBA’s inability to produce an examinations letter.

It should be noted that licensed SBICs have been unable to invest because they have been waiting many months for the results of their examinations and therefore cannot purchase leverage. There is no reason SBICs are not given their results promptly after the examination. Further, the SBIC has begun misusing the existing regulations by applying a “must” standard to regulations that clearly state “should” regarding a fresh examination. Further, SBA’s delays in issuing exam reports prevent SBICs from responding to potential findings and resolving any outstanding concerns – meaning that they may get findings two consecutive years because SBA withheld that there was a finding, adding to SBICs’ expenses under the new higher fee regime. Timely exam results empower the SBICs to make needed changes prior to their next review.

Finally, it is critical to note that SBICs have absolutely zero control over when they receive an exam, but SBA is holding SBICs accountable for the timing of the exams by blocking their ability to file for a license or access leverage. Ultimately, both of these withholding actions hinder the ability of small businesses to access capital.

### Examinations for Multiple SBIC Licenses

The overwhelming number of survey respondents thought it best to have all licenses of an SBIC platform examined at the same time. It is not uncommon to have multiple licenses under common control examined at different times by different examiners. This is inefficient for both the SBIC and the SBA. Further, during examinations, many smaller SBICs are unable to continue their normal operations until the exam is complete, so spreading out the exams is particularly disruptive. Finally, having all licenses reviewed simultaneously by the same examiner will prevent getting

different results for the same practice inside the same SBIC group. However, simultaneous or sequential examinations should not be a reason for SBA delaying examinations in a way that could delay licensure, leverage, or other actions.

#### Examination Issues Shared with the Industry

There was overwhelming support in SBIA's member survey for the SBA to share an annual notice of the most common examination findings. Once a year, the SBA should share with the entire SBIC industry the most common negative findings from examinations. SBIA would be happy distribute this information and help the SBIC industry develop "best practices" to make regulatory violations far more rare. If GPs and LPs are informed of the most common errors, then GPs will have the opportunity to proactively review their practices to make sure they are in full compliance, and LPs will be able to consider these matters when interviewing funds for future investments. All parties will benefit from SBA sharing this information.

#### Examination of the Management Company

SBIA members also responded in the survey that examinations should be limited to the examination of the SBIC. SBA commonly examines things well outside of the scope of their legal and regulatory authority, specifically the management company contracted with SBICs. SBA should not conduct such examinations unless there is a specific, clear, and compelling reason to review the management company. Management companies regularly manage SBICs and non-SBIC vehicles, and the examiners confuse the two, causing SBIC regulations questions to be raised on entities that are not SBICs. SBA should clarify the regulations and SOP to make sure they are not wasting the time of SBA examiners and the money of SBICs by examining issues outside their legal mandate.

#### Choice of Accounting Method

SBICs should be given the option of using Generally Accepted Accounting Principles (GAAP) instead of statutory accounting at the time of licensure. Given the unique nature of leveraged SBICs, statutory accounting is needed while leverage is outstanding. Once leverage is paid off, SBICs should be allowed to reduce their operating expenses by going to GAAP.

#### Updating Forms

The survey received many comments that most SBA forms relating to the SBIC program are outdated, confusing, redundant, or overly cumbersome and require updating. SBIA's survey participants specifically identified Form 468 as confusing and difficult to read, with no opportunity to amend or correct investments that were entered erroneously. SBIC participants also identified Form 1031 as particularly dated, complicated, and in need of reform. SBA and SBIA should conduct a joint review of its SBIC forms to streamline and remove duplicative content.

The SBIC-Web system was always clunky, but recently it has become at times almost unworkable – with delays for each data entry being measured in seconds. With hundreds of entries required, it takes days and nights to enter the data. With the recent changes, SBIC-Web is also regularly unavailable to even access. Recently, SBA's use of technology has been getting worse, not better. SBA should allow SBICs to submit an Excel spreadsheet if SBIC-Web is not working.

SBIA thanks the Small Business Administration for its attention to SBIC regulatory issues and appreciates the opportunity to share feedback from the SBIC community. We look forward to a thoughtful and continued dialogue throughout the regulatory review process.

Sincerely,

A handwritten signature in black ink, appearing to read "Brett Palmer". The signature is fluid and cursive, with the first name "Brett" being more prominent than the last name "Palmer".

Brett Palmer  
President  
Small Business Investor Alliance



December 1, 2017

The Honorable Linda McMahon  
Administrator  
Small Business Administration  
Washington, DC 20416

Dear Administrator McMahon,

With the transition completed, fiscal year 2017 closed, and the calendar year coming to an end, I write you today to provide an update on the Small Business Investment Company (SBIC) program from the perspective of the small business investor community.

While no program is perfect, the SBIC program inherited by this Administration was operating well and had been for a very long time. SBICs were investing near record amounts in domestic small businesses, losses were at record lows, licenses were being processed in a timely manner, quality fund managers were being attracted to the program, jobs were being created, and there was record interest from institutional investors to provide capital to small businesses via SBICs. The program was working to benefit America's small businesses. With the increased small business optimism spurred by the election of President Trump and with your appointment to lead the Small Business Administration, SBICs were optimistic that they could be a constructive partner in translating that optimism into positive outcomes.

By the close of FY 2017, the optimism around the operation of the SBIC program has changed. Licensing for first time SBIC funds was down 92% year over year. Licensing for all Debenture SBICs funds (first time and repeat SBICs) was down 35%. This reduction in licensing appears less precipitous than it really was because the licensing numbers in FY 2017 included strong licensing results from the previous Administration. For example, through March 31 of this year total licensing was up 40% year over year, but then there was a change and licensing finished the fiscal year down 35%. The number and amount of investments by SBICs were down in FY 2017 as were the jobs created, but the actual amounts are not known because the SBA's Investment Division ceased releasing most SBIC data to the public. Some private institutional investors (e.g., endowments, banks, pension funds) that provide the bulk of the private capital into SBICs have become unnerved by the slow pace of the operations of the program, the unpredictability of licensing and operations, and the lack of constructive engagement by the political leadership of the Investment Division. Some of these institutional investors are now building in an additional four to six month waiting period for each stage of the licensing process, while others are completely stepping back from the SBIC program until there is new management of the program. The new management culture and practices are discouraging the best fund managers from being in the program and this will create an adverse selection problem and create unnecessary downside risk that previously did not exist. In sum, there is now a serious leadership problem at the Investment Division that has not existed since the nadir of the program during the period of mismanagement from 2007 through January of 2009.

The pro-small business regulatory reforms and performance of the 7a program are clear examples of what the Trump Administration, as good stewards of a small business program, is accomplishing. However, and in contrast to the successes of the 7a program, there is very deep and broad-based concern across the small business investor community about the management of the SBIC program. Given that this program was fully operational less than a year ago, there is still time to address the problem before the current situation is institutionalized. Given your unwavering commitment to American small businesses and your entrepreneurial and executive experience, I ask that you address the problem in the SBIC program before a stable, productive small business resource becomes neither stable nor productive.

The SBIC industry is committed to improving the nation by empowering small businesses and the SBIA would welcome the opportunity to work constructively with the SBA to make effective use of the Small Business Investment Company program.

Sincerely,

A handwritten signature in black ink that reads "Brett Palmer" with "P.S." written below it.

Brett Palmer  
President  
Small Business Investor Alliance

cc: The Honorable Althea Coetzee Leslie



Statement of John K. Paglia  
Professor of Finance and Senior Associate Dean  
Pepperdine Graziadio Business School

Before the

U.S. House of Representatives  
Committee on Small Business

Hearing on "SBA Management Review:  
Small Business Investment Company Program"

September 26, 2019

**Statement of John K. Paglia**  
**Professor of Finance and Senior Associate Dean**  
**Pepperdine Graziadio Business School**

Dear Chairwoman Velazquez, Ranking Member Chabot, and Members of the Committee on Small Business:

Thank you for the opportunity to testify before you today. Sound deployment of capital in the U.S. is central for promoting economic growth and I am grateful for the opportunity to speak to you on this important topic.

I grew up in a household where my parents owned and operated small businesses so this topic is very personal. I also worked closely with small businesses as a CPA, business appraiser, consultant, advisor and corporate director; and more recently through research studies leveraging the insights and observations I've accumulated over several decades. At Pepperdine University, where I am a Professor of Finance and Senior Associate Dean at the Graziadio School of Business, I co-founded our *Pepperdine Private Capital Markets Project* in 2007, which is the first simultaneous, comprehensive, and on-going investigation of the major private capital market segments. This research seeks to understand the true cost of private capital across market types and the investment expectations of privately-held business owners; providing lenders, investors, and the businesses that depend on them with critical data to make optimal investment and financing decisions and better determine where the opportunities to create lasting economic value may be realized. As part of this research, I also co-led the launch of our *Private Capital Access Index* – a quarterly economic indicator designed to measure the demand for, activity, and health of the private capital markets— in partnership with Dun and Bradstreet, and our *Market Pulse* report—a quarterly survey of market conditions for small businesses being sold— in partnership with the International Business Brokers Association and M&A Source. I also helped craft the vision for, and led the launch of, our *Dan and Coco Peate Institute for Entrepreneurship*. Furthermore, I was instrumental in launching our *Most Fundable Companies* initiative to help bridge the startup funding gap, and designed, led, and taught our 3-day *Certificate in Private Capital Markets* executive education program as well as our *Private Capital Markets* class.

Along the way, I've leveraged my unique direct experiences, insights, and knowledge to produce relevant research on startup companies and small businesses, including three research papers on the *Small Business Investment Company* (SBIC) program with co-author Professor David Robinson at Duke University. These were prepared by the Federal Research Division of the Library of Congress under an interagency agreement with the Small Business Administration's (SBA) Office of Investment and Innovation (OII). I'll speak to this research momentarily.

But before I do, it is important to note three points regarding small business's access to capital highlighted by the Pepperdine University studies, based on data collected from July 18 to Aug 2, 2019:

- **56% of small business owners surveyed indicate it is difficult to raise new external equity financing; 59% indicate it is difficult to raise new external debt financing.** When disaggregated between those with less than \$5M in revenues, 61% indicate difficulty raising equity; and 62% indicate difficulty raising debt. The \$5M - \$100M revenue group indicates 30% equity difficulty and 29% debt difficulty.<sup>1</sup>
- **60% of small business owners say the current business financing environment is restricting growth opportunities for their businesses; 54% indicate it is restricting their ability to hire new employees.** When disaggregated between those with less than \$5M in revenues, 64% indicate restrictions on growth and 57% indicate restrictions on hiring. The \$5M - \$100M group indicates 27% growth restriction and 25% hiring restriction.<sup>2</sup>
- **39% of businesses are planning to raise financing and/or capital in the next 6 months.<sup>3</sup> Of them 69% cite 'planned future growth or expansion' as one of the reasons.<sup>4</sup> In the presence of an unsuccessful raise, 68% cite 'slower business growth', 46% indicate they'd have to reduce their number of employees.<sup>5</sup>** Just 14% indicate that an unsuccessful financing and capital raising event would have no expected impact on growth, business size or hiring plans.

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<sup>1</sup> Pepperdine Private Capital Access Index, Third Quarter 2019, Craig Everett, page 29.

<sup>2</sup> Ibid, page 20.

<sup>3</sup> Ibid, page 37.

<sup>4</sup> Ibid, page 38.

<sup>5</sup> Ibid, page 57.

So the consequences of small businesses not obtaining capital and financing are potentially severe and detrimental to overall economic health. One such program that helps with capital deployment, especially in those segments where other private institutional capital isn't nearly as concentrated, is the SBA's SBIC program.

As mentioned previously, I had the opportunity to examine three main questions, along with my coauthor and with the support of the Library of Congress, using the SBA data: 1) Is the SBIC program diverse? 2) Does the SBIC program create jobs? 3) Where does the SBIC program fit into the broader financing landscape?

### 1. Measuring the Representation of Women and Minorities in the SBIC Program<sup>67</sup>

The goal of this report is to contribute to a growing body of knowledge about gender and racial diversity in the venture-capital (VC) and private-equity (PE) arenas.

Key findings included:

- ***SBIC funds are more gender diverse than the broader venture capital and private equity community (VCPE).*** Approximately 11.9% of SBICs had women on their investment teams vs. 7.9% for the broader VCPE community.
- ***Approximately 10.2% of SBIC funds have at least one ethnic or racial minority on their investment teams.*** While there are various racial diversity statistics for the population of businesses in the United States, there is no such data for the private equity universe specifically.
- ***Racially diverse SBICs make more investments in minority-led and minority-owned portfolio companies, as well as in women-led and women-owned businesses than non-racially diverse SBICs.*** Approximately 12% of the investments made by racially diverse SBICs are in companies led by minority CEOs; whereas the number for non-racially diverse SBICs is about

<sup>6</sup> Paglia and Robinson, Measuring the Representation of Woman and Minorities in the SBIC Program, October 2016.

[https://www.sba.gov/sites/default/files/aboutsbaarticle/Measuring\\_the\\_Representation\\_of\\_Women\\_and\\_Minorities\\_in\\_the\\_SBIC\\_Program\\_2016\\_10.pdf](https://www.sba.gov/sites/default/files/aboutsbaarticle/Measuring_the_Representation_of_Women_and_Minorities_in_the_SBIC_Program_2016_10.pdf)

<sup>7</sup> The analysis in this report is based on 1995–2015 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. OII provided supplemental demographic information on the SBIC funds for the years 2013–15.

5%. Similarly about 19% of the investments made by racially diverse SBICs are to companies that are at least partly owned by women or ethnic or racial minorities, while about 13 percent of the investments made by SBICs without racial diversity are to such businesses.

- ***Gender-diverse SBICs make more investments in women-led and women-owned portfolio companies than non-gender-diverse SBICs.*** Gender-diverse SBICs make two to three times more investments in portfolio companies with a female CEO than male-only SBICs. Approximately 10.3 percent of the investments made by gender-diverse SBICs are in female-led companies, while the corresponding figure for SBICs with no gender diversity is 3.4 percent.
- ***There is some evidence that racially diverse SBICs direct more capital to LMI communities.***

These conclusions suggest that diverse populations are better served by and through a diverse team of fund managers. A summary of these findings are located in the appendix.

## **2. Measuring the Role of the SBIC Program in Small Business Job Creation<sup>89</sup>**

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. The report addresses key questions concerning the number of jobs created and/or sustained by the program.

Key findings included:

- ***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

<sup>8</sup> Paglia and Robinson, Measuring the Role of the SBIC Program in Small Business Job Creation, January 2017. [https://www.sba.gov/sites/default/files/files/SBA\\_SBIC\\_Jobs\\_Report\\_0.pdf](https://www.sba.gov/sites/default/files/files/SBA_SBIC_Jobs_Report_0.pdf).

<sup>9</sup> 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.

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 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 \$14,458 of funding invested through the SBIC Program, while an average of one job was created or sustained for every \$4,525 invested.*** Restricting the analysis to only those firms financed through active licensees, we found that one new job was created for every \$16,340 invested, and one job was created or sustained for every \$4,603 of SBIC funding. Between 1999 and 2015, the net government administrative cost was about \$0.0024 per dollar of funding deployed, or \$2,400 of government administrative cost<sup>10</sup> for every \$1 million of capital deployed. This, in turn, means that the average administrative cost was approximately \$35 per job created, and about \$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.

### **3. Measuring the Role of the SBIC Program in Financing Small Businesses<sup>1112</sup>**

<sup>10</sup> 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.

<sup>11</sup> Paglia and Robinson, Measuring the Role of the SBIC Program in Financing Small Businesses. July 2017. <https://www.sba.gov/article/2019/aug/28/measuring-role-sbic-program-financing-small-businesses>.

<sup>12</sup> The analysis in this report is based on 1995–2015 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 goal of this report is to contribute to a deeper understanding of the role the SBIC program has played in providing financing to the small business sector. The report addresses key questions concerning the role the SBIC program plays in the overall financial industry.

- ***SBIC investments support companies that are less likely to be considered by private equity investors.*** SBICs invest in companies that are smaller than those funded by traditional private equity sources of similar size and investment focus. Because they are smaller, investing in these companies is typically less attractive to larger private equity investors.
- ***SBIC investments fund different sectors than the rest of the private equity universe.*** As a group, SBICs deployed the largest concentration of dollars—nearly half—to the B2B sector, more than double the share invested by the overall investment community. SBICs also invested considerably less in other sectors traditionally favored by the broader financial industry, including the B2C sector, which SBICs funded at half the rate of the overall investment community.
- ***SBIC investments spread capital in a more dispersed manner across the country than the rest of the private equity universe.*** The SBIC program funds deals that are more widely geographically distributed than the broader investment fund community, both in terms of the proportion of deals by region and the proportion of dollars invested by region. Displaying a far lower concentration of capital on the West Coast, the majority of SBIC funds invest in traditionally underserved regions of the United States, particularly Kansas, Minnesota, Nebraska, North Dakota, and South Dakota in the northern Midwest, and Alabama, Kentucky, Mississippi, and Tennessee in the South.

Altogether, these findings show the tangible value SBIC funds provide as a robust source of funding for small businesses in the U.S. economy. As compared to the broader financing landscape for small and mid-sized businesses—where over 35,000 deals were made and over \$1.5 trillion was invested—SBICs have higher capital distribution ratios among small businesses and distribute capital more evenly among nine geographic subregions.

Overall, based on our research, the SBIC program has demonstrated relative strength with respect to diversity and inclusion, success on the job creation front,

and a more balanced funding distribution in the small business financing landscape across company sizes, industries, and geographies.

I should point out that recent success is predicated on the fact that those ‘worthy’ small businesses are able to navigate the relatively opaque private capital markets successfully. ***Small business financing and capital formation would benefit greatly with increased transparency and robust educational programming.*** Small businesses have at best a moderate understanding of the types of financing and capital components available to them, the process to obtain funding, the “costs” of each type, advantages and disadvantages of each financing and capital type, how to qualify for financing and capital, which firms and entities to contact for funding, and success rates for each type. (See “*Small Business’s Level of Knowledge of Funding Components*” in appendix.) Accordingly, when small businesses need financing and capital, some ‘shy away’ from pursuit, or spend lots of time chasing opportunities that aren’t a good fit for their needs, operating characteristics, and firm profile. If they do pursue funding, their mindset is “do I qualify for funding?” versus a larger company mindset of “what is the price of funding?”

Because of this mindset and the relative lack of transparency and knowledge, small businesses make lots of mistakes when pursuing and selecting financing and capital types. In fact, according to a Pepperdine survey, across nineteen different financing and capital types, no greater than 60% of businesses that had an unsuccessful financing outcome feel the general financing and capital *type* is still a good fit for their business.<sup>13</sup> (See “*Confidence in Funding Category Fit after Unsuccessful Event*” in appendix for additional details.) This highlights the inefficiencies in the small company financing and capital markets and speaks to the need for increased transparency and education.

Of course, ***small businesses could also benefit by having greater capital availability and expedited access to financing and capital, especially as needs arise and their capital structures change.*** (See “*Prevalence of Funding Type by Revenue Size*” in appendix.) While due diligence is an important component of any investment opportunity review, and should be thorough, finding ways to achieve faster approvals of capital deployment would also serve to fuel job creation and economic growth. In the case of the SBIC program, having the ability to award

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<sup>13</sup> Pepperdine Private Capital Access Index, Second Quarter 2014, Craig Everett.

licenses faster – both for initial applicants as well as those who are seeking approvals for subsequent funds— would likely produce positive benefits for small businesses and serve to further contribute to economic growth.

In summary, small businesses continue to struggle to find the financing and capital they need to grow, especially in a timely and efficient manner. The SBIC program is in a position to further address funding challenges cited by ‘worthy’ small businesses in need of financing and capital to continue to grow, hire and retain employees, and to promote economic growth.

Thank you again for the opportunity to share these points. I’m happy to answer any questions and address comments.

Sincerely,

John K. Paglia  
John.paglia@pepperdine.edu

# Appendix

### **John K. Paglia Bio**

#### **John K. Paglia, Ph.D., CFA, CPA**

Senior Associate Dean; Professor of Finance  
Pepperdine Graziadio Business School



Dr. John K. Paglia is senior associate dean for academic affairs and professor of finance at Pepperdine Graziadio Business School (PGBS). He is also an independent corporate director (board member) and audit committee chair for Simulations Plus Inc. (NASDAQ: SLP), and advisor to several startups. He previously served PGBS in a number of leadership roles over his near 20-year tenure at Pepperdine. Most recently, as inaugural executive director of the Dan and Coco Peate Institute for Entrepreneurship, he led pre-launch initiatives around entrepreneurial education, business incubation, and venture funding to ultimately help student entrepreneurs launch and accelerate their business ventures. He also served as associate dean for part-time (fully employed) programs, director of accreditation, chair of the accounting and finance department, and founding director of the Pepperdine Private Capital Markets Project.

A recognized expert on the topics of small business financing, business valuation, and financing and deal trends, Dr. Paglia has delivered over fifty presentations, including over a dozen keynote addresses, at key investment banking, private equity, accounting, small business, exit planning, and valuation events. He was also honored by the National Association of Certified Valuators and Analysts with the "Industry Titan" Award in 2016, the Alliance for Mergers & Acquisitions Advisors and Grant Thornton with a "Thought Leader of the Year Award" in 2012, and the Association for Corporate Growth with an "Excellence in M&A Award" in 2011. In 2016, he was also awarded with a consultancy contract with the Library of Congress Federal Research Division as a private equity and venture capital expert to conduct research on the economic impacts of the Small Business Administration's Small Business Investment Company (SBIC) private equity program. His research has been covered in The Wall Street Journal, CNBC, USA Today, Businessweek, TIME, Bloomberg, Reuters, Inc., Forbes, Entrepreneur, MSNBC, ABC News, Huffington Post, Crain's New York, The Los Angeles Times, The Washington Post, Financial Times, and The New York Times, among many others.

His research has been published in a number of journals including *Journal of Banking and Finance*, *Journal of Entrepreneurial Finance*, *Journal of Accounting and Finance*, *Journal of Business Valuation and Economic Loss Analysis*, *Business Valuation Review*, *The Value Examiner*, *Journal of Wealth Management*, *The RMA Journal*, *Graziadio Business Review*, and cited in Congressional testimony and SBA reports.

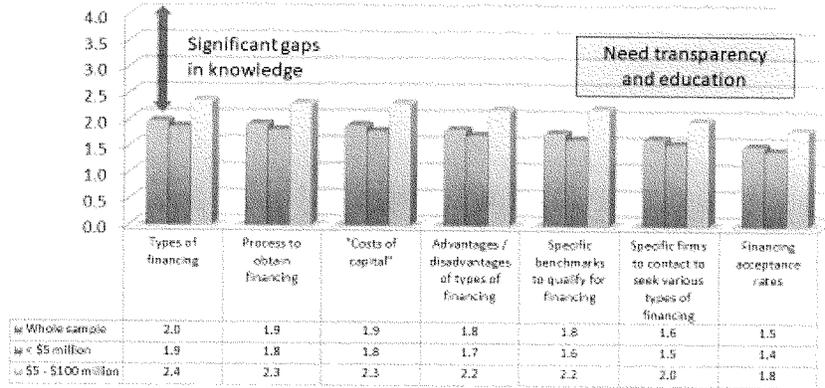
Dr. Paglia holds a Ph.D. in finance, an MBA, a B.S. in finance, and is a Certified Public Accountant and Chartered Financial Analyst.

**Summary Results Table: Measuring the Representation of Women and Minorities in the SBIC Program**

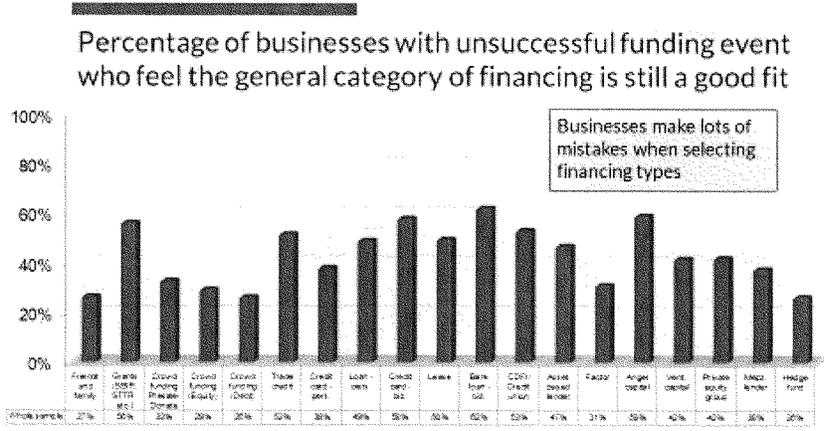
<b>Table 1. Summary of Findings on Diversity in the SBIC Program SBIC Fund Leadership Diversity:</b> How diverse are SBICs in terms of having women and/or ethnic or racial minorities in leadership positions compared to the broader private equity (PE) community?		
Type of diversity:	SBICs	Broader PE Community
Gender diversity	11.9%	7.9%
Racial diversity	10.2%	N/A
<b>Racially Diverse SBIC Investment Behavior:</b> Are racially diverse SBICs more likely to invest in diversely led or owned portfolio companies than non-racially diverse SBICs?		
If the portfolio company is:		
Woman-owned		Yes
Woman-led		Yes
Minority-owned		Yes
Minority-led		Yes
<b>Gender-Diverse SBIC Investment Behavior:</b> Are gender-diverse SBICs more likely to invest in diversely led or owned portfolio companies than non-gender-diverse SBICs?		
If the portfolio company is:		
Woman-owned		Yes
Woman-led		Yes
Minority-owned		No
Minority-led		No
<b>Return on Investment by Diversely Owned SBICs:</b> How do diverse SBICs compare in terms of investment performance to non-diverse SBICs?		
Gender-diverse SBICs		Similar
Racially diverse SBICs		Similar
<b>Diversely Owned SBIC Investment in LMIs:</b> Are diverse SBICs more likely to invest in LMI regions than non-diverse SBICs?		
Gender-diverse SBICs		No
Racially diverse SBICs		Yes

**Chart: Small Business's Level of Knowledge of Funding Components by Revenue Size**

*Business Level of Knowledge of Financing Components (Scale 0-4: None; Some; Moderate; Very; Completely)*

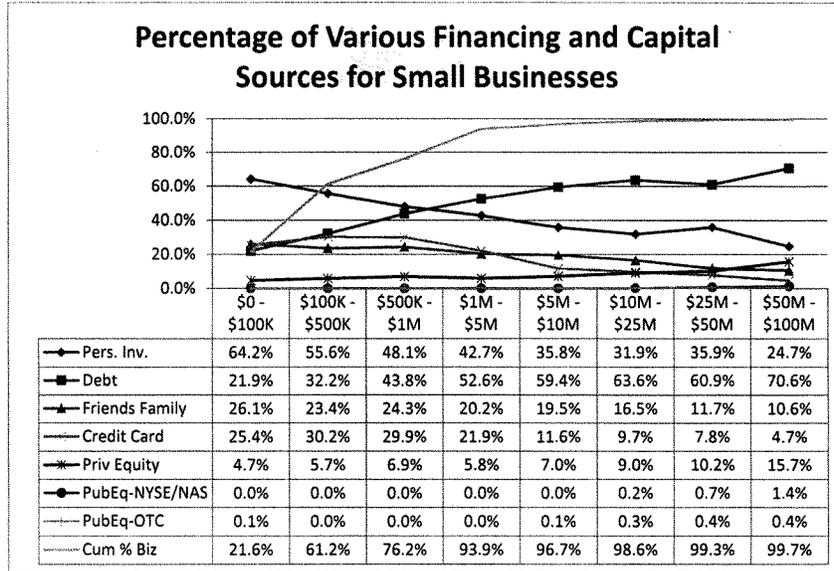


**Chart: Confidence in Funding Category Fit after Unsuccessful Event**



Source: Everett, Craig. *Response: Private Capital Index Survey Responses: Second Quarter 2014 Quarterly Report*. Malibu: Pepperdine University.

**Chart: Prevalence of Funding Type by Revenue Size**



Source: Pepperdine Private Capital Markets Project, Summer 2011

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Statement for the Record

By Ronda Penn  
Chief Financial Officer, Plexus Capital, Raleigh, NC

Hearing Entitled, "SBA Management Review: Small Business  
Investment Company Program"

The U. S. House Committee on Small Business

September 26, 2019

Chair Velázquez, Ranking Member Chabot, and Members of the Subcommittee, thank you for holding this important hearing and for inviting me to testify.

My name is Ronda Penn. I am Chief Financial Officer 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 Greensboro in 1996, I spent much of my career working closely with SBICs. My career began with a regional accounting firm in North Carolina, Dixon Hughes Goodman (DHG), where I focused on financial statement audits of SBICs and other small businesses for 17 years. I worked closely with multiple SBICs and SBIC staff during my career at DHG. I began working with Plexus Capital when it was formed and received its SBIC license in 2005 as the firm's audit partner and joined the team in 2012 as Chief Financial Officer.

The Plexus team received its first SBIC license in 1996 when working with Centura Bank as part of a commitment to better support the capital needs of the bank's clients. The bank eventually sold to RBC Bank in 2000 and in 2004 the team joined together to form Plexus Capital and successfully closed its first independent SBIC in 2005.

For over 22 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 \$1 billion in 108 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:

**Plexus Fund I: \$80 MM**

Closed in November 2005  
10.5% net IRR  
1.7x multiple through the Great Recession

**Plexus Fund II: \$175 MM**

Closed in November 2009  
21.8% net IRR  
2.0x multiple

**Plexus Fund III: \$300MM**

Closed in March 2013  
\$404 million deployed to-date

**Plexus Fund IV: \$400 MM**

Closed in October 2016  
\$325 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 2020.

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 first. 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 26 Plexus employees and the thousands of employees with our 108 small business partners.

Plexus has invested in underserved companies as follows:

- More than 80% of Plexus investments have been in companies defined by the SBA as “smaller concerns”
- More than 20% of Plexus investments have been in companies located in low to moderate income (LMI) zones
- More than 40% of Plexus investments have been in companies owned by minorities and veterans
- Overall revenue for all companies invested in by Plexus has increased by more than 30% over the duration of the investment
- Overall jobs have grown for all companies invested in by Plexus by more than 30% over the duration of the investment

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 the entire Plexus team is committed to working with you to pursue ways to strengthen it so more capital can be directed to growing small businesses. Again, I thank the Committee for holding this hearing and for allowing me to testify. I welcome your questions.



Congressman and congresswomen,

It is an honor to be here today testifying in front of the Committee. My name is Walt Rodgers, and I am currently the CEO of Family RV Group, formerly Colerain RV. Founded in 1968 by the Jung family, Colerain RV started as a small, family-owned RV dealership in Cincinnati with little more than 10 campers for inventory. Today, just over 50 years from those humble roots, the Company has expanded to include dealerships throughout Ohio, Kentucky, Indiana, Tennessee, and Georgia. Given the unique nature of our business, the patient and flexible capital from our SBIC partners – Northcreek, Spring, and Resolute – has been instrumental in facilitating and expediting this growth.

Before proceeding about the impact of the SBIC program, I would like to provide a little bit more detail about the history of Family RV Group. In the late 1960s, Charles and Lolly Jung decided to undertake the challenge of opening an RV dealership. With only a few campers on a lot and a sign on a shack-like house, Colerain RV was born in a northern suburb of Cincinnati, OH. This bootstrap effort instilled a focus on family and customer service that still remains a core value of the Company today.

By 1975, Colerain had expanded to a nearly 100 vehicle operation with brands including Mallard, Thunderbird and Starcraft trailers. Over the next 20+ years, not only did the Company's RV stock expand, so too did the impact and influence of the Jung family. In 1988, Chuck Jung joined the family business to help his parents operate and grow operations. Shortly thereafter, Chuck was followed by his brother Steve, and the two siblings led the Company through another period of growth and success.

The Company relocated to its current 12-acre Cincinnati facility in 1996 and given the rapid growth, brought on Wade Stepp, an operating partner and owner with extensive industry knowledge, in the early 2000s. Chuck, Steve and Wade made the decision over the next decade to focus on geographic expansion, acquiring single-store locations in Dayton, OH, Columbus, OH and Indianapolis, IN. By 2015, the Company started looking for its next growth avenue. The addition of 3 new facilities began to strain the overall Company infrastructure and rather than continue growing slowly and location-by-location, management realized the need to acquire not only additional talent and resources to support these expanded operations, but also the opportunity to expedite growth through larger and more frequent acquisition activities.

This impasse led to the transaction that involved Northcreek, Spring, and Resolute in January 2016. Kidd & Co., a Connecticut-based private equity firm, led the transaction, providing and arranging capital to recapitalize the business, refinance Colerain's existing debt, increase cash needed for working capital, and acquire the assets of Northside RV. Given the many uses of capital and overall need, debt was





required to properly finance the Company while maintaining the flexibility needed to pursue growth opportunities beyond Northside. However, as an RV dealership, the main source of bank financing is floorplan debt, which allows companies like ours and automobile dealerships to purchase the expensive inventory essential for our stores and showrooms. It can often be difficult to find other lenders that are willing to provide additional debt alongside or below such a facility. Despite the uniqueness of our situation, our SBIC partners were able to get comfortable with the transaction structure and business in general to provide the capital we needed. I truly believe that the distinct characteristics of the mezzanine debt provided by Northcreek, Spring and Resolute, specifically the lack of amortization and willingness to be subordinated to the senior floorplan, provided the perfect solution to our needs. It not only gave Colerain the necessary growth capital and flexibility, but allowed us to secure the initial floorplan facility, and larger ones thereafter, that may not have been possible with other capital providers.

That transaction in 2016 immediately impacted the growth of the Company with the acquisition of Northside RV. Northside, a Lexington, KY based RV dealership, was and is considered the number one dealership throughout the entire state of Kentucky. The addition of this platform and its assets created the Family RV Group, and immediately increased revenue to nearly \$120 million, while expanding the Company's workforce from approximately 130 employees to 180.

Since that acquisition, the Family RV Group has completed another transaction, adding Dunlap RV under the Family RV Group umbrella. Completed in 2017, Dunlap added an additional four dealership locations in Nashville, Knoxville, Ringgold, GA, and Bowling Green, KY. Though no direct capital was provided by our SBIC investors in this instance, the lack of amortization on their debt facilities allowed us to build cash on the balance sheet. By the time the Dunlap transaction needed to be financed, we had accumulated enough cash to fund the acquisition ourselves. Not only did this flexibility allow us to add Dunlap, but also positioned and capitalized Family RV to pursue further growth and potential expansion opportunities down the road.

Due to these acquisitions, the Company now has 9 total locations across 5 states and employs more than 300 people. It is also important to note that our stores are not located in "major" markets, such as New York or California, but rather serve smaller communities and cities in the Midwest and Southeastern United States. There are many private equity groups and financial institutions that may overlook businesses in Cincinnati, Dayton, Lexington, Bowling Green, or Knoxville because of a lack of geographical presence or focus on such areas of the country. However, the SBIC program and our SBIC partners have made a concerted effort to aid companies in these smaller markets not only effect ownership changes, but grow and improve, as is the case with Family RV Group.





Today, Family RV is an over \$180 million business that is continually looking to grow, improve and support the communities in which we operate. As I mentioned before, our business now employs some 300 American workers, more than twice what we employed in 2015, in smaller cities such as Dayton, OH and Bowling Green, KY, and is looking to add another 50+ to support our existing business and new initiatives. We more than doubled our floorplan facility from 2016 just last year and are continually seeking opportunities to expand our footprint and reach. The SBIC program and its affiliated investment companies have been critical in allowing us to accomplish all of these tasks and goals. Northcreek, Spring, and Resolute have all been extremely supportive along the way, not only with their patient and flexible capital, but with the general knowledge, insight and experience they have been able to provide.

When the Jungs opened their single-location, mom-and-pop shop in Cincinnati, I'm sure they never truly envisioned the Company becoming what it is today. However, just over 50 years later and with the help of investors such as Northcreek Mezzanine, Spring Capital Partners, Resolute Capital Partners, and Kidd & Co., Family RV Group has become a staple within the Midwestern and Southeastern RV communities.





Mr. Joseph Shepard  
Associate Administrator  
Office of Investment and Innovation  
Responses to House Small Business Committee  
Hearing on the SBIC Program

- 1) Question: Please clarify who currently heads the Office of Licensing, as it remains unclear following the hearing the identity of that official.

Answer: Mr. Arthur Spivey.

- 2) Question: How many employees did the Office of Investment and Innovation have when you first took over in 2017, and how many are there now?

Answer: (A) 72 employees. (B) 76 employees.

- 3) Question: For each of the five (5) vacancies listed in the organizational chart for the Office of Investment and Innovation, how long have they been vacant?

Answer: One position became vacant approximately four months ago, and another position became vacant approximately two months ago. The other three have vacant personnel in those positions but are listed as vacant until a permanent hire is made.

- 4) Question: If there are vacancies in the Office of Investment and Innovation, why are those vacancies not posted on USAJOBS.gov?

Answer: All vacancies were posted on USAJOBS.gov and have now closed for interested applicants, except one, which will be posted by October 31, 2019.

- 5) Question: In your testimony, you stated that there were vacancies in your Office for which you were presently interviewing. For those vacancies, how long have each been vacant?

Answer: In addition to those already addressed in question #3, there are two recently created positions.

- 6) Question: In your testimony, you stated that in the last three years, your Office conducted 50 external engagements with industry stakeholders. Please provide the Committee with attendance figures for each.

Answer: Since FY 2017, the Office of Investment has participated in over 50 external engagements. SBA served as a participant in many events and as a host in others. SBA did not record or measure attendance at all those events and is unable to confirm attendance figures. Examples of events that SBA hosted this fiscal year include interagency collaborative events in Maine, Oklahoma, and Arkansas. Attendance at those events were 45-50; 95-100; and 30-35. Any external event is viewed as an opportunity to educate and inform the public on the SBIC program, to encourage potential applicants, and through that, small business investment. We view our involvement as successful if any attendee comes away more knowledgeable about the program and might become a participant.

- 7) Question: The normal approval rate is 20 percent, now it's 11 percent - does that mean anything to you?

Answer: Approval of candidates receiving green light letters in FY 2019 was 77%. The current 3-year average (FY 2017 to FY 2019) for such approvals is 67%. The previous 3-year average (FY 2014 to FY 2016) for such approvals was 60%.

Approval of license applicants receiving a SBIC license in FY 2019 was 95%. The current 3-year average (FY 2017 to FY 2019) for such approvals is 94%. The previous 3-year average (FY 2014 to FY 2016) for such approvals was 82%.

**Question for Mr. Brett Palmer, President, Small Business Investor Alliance**

There's an SBIC fund called Konza Valley Capital, Inc., or KVCI, located in my district in Overland Park, Kansas, which has operated as a non-traditional "evergreen" fund. KVCI is calling for a change in the regulatory definition of what constitutes "leverageable capital," which would include funds from gains reinvested into new investments. Based on their testimony, it appears that this change would help evergreen funds like KVCI increase their available leverage, while not impacting the more traditional partnership models. Mr. Palmer, if the regulatory definition of "leverageable capital" included reinvested gains, could that help evergreen funds while not negatively impacting the rest of the funds? Is there any reason why this change couldn't be made?

**Answer:**

To the best of my knowledge, the SBA no longer licenses evergreen funds, and consequently, there are very few still in existence. A reasonable SBA would be able to look at the facts and make the appropriate adjustment to have the calculation reflect reality, but SBA has not allowed a reasonable path to make these adjustments or to get relicensed. This is another example of SBA's Office of Investment and Innovation (OII) creating expensive, time consuming barriers to providing capital to small businesses. A timely, inexpensive, and reasonable relicensing process would fix this problem that benefits no one, but that harms small business access to capital.

There are several reasonable fixes:

- The regulatory definition of "leverageable capital" could include reinvested gains for evergreen funds. This would not apply to finite life SBIC funds.
  - If SBA deemed it necessary, this change to the definition of leverageable capital could allow evergreen funds to access limited leverage (1x) on reinvested capital, not the full 2x that is currently available to finite life debenture funds. This would provide more capital for evergreen funds to deploy to domestic small businesses without letting them grow without limit.
- SBA could and should fix the licensing process to ensure that funds coming back for a repeat license (or to reconfigure an evergreen license) face a process that is clear, timely, less expensive, and far less uncertain.
- There may be other fixes, but this is an issue that should be addressed.

**Written Testimony Submitted to the House Small Business Committee****By Brian Lueger, Principal****Konza Valley Capital, Inc.****For a Hearing on September 26, 2019**

Konza Valley Capital, Inc. (KVCI) has been part of the SBIC program for more than 42 years (since 1977). During that time, we have invested in small businesses located throughout the country. Almost every individual in the country has very likely used or seen products made by companies that KVCI has helped and continues to help grow, if they have ever:

- Eaten a Pizza Hut pan pizza (produced the pans the pizzas were cooked in),
- Walked under a clear archway where you could see fish swimming above/around you,
- Seen the large backlit apple above an Apple store, or
- Watched news networks on election night point out specific county results on a large touchscreen (built metal components included in the touchscreen).

KVCI is submitting this testimony to (#1) let you know that the SBIC program is a success story, (#2) two different ways that SBIC funds are structured, (#3) identify an issue that is the result of this structuring difference, and (#4) provide a simple solution to help fix this issue.

**The SBIC Program Works**

The mission statement of the SBIC is “stimulating and supplementing the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing, growth, expansion and modernization their business operations.” A recent Library of Congress Report on SBIC Financing of Small Businesses (July 2017), helped show that the SBIC program was meeting its mission statement. The report’s authors drew from relevant business data from the SBA and other sources to conclude that SBICs have filled significant gaps in the market and that SBIC investments:

- Support companies that are less likely to be considered by private equity investors.
- Fund different sectors than the rest of the private equity universe.
- Spread capital in a more dispersed manner across the country than traditional investors.

Capital is the lifeline of businesses and especially small businesses that are looking to grow. KVCII is proud to have helped provide that lifeline over its 42 years in existence and as part of the SBIC program, which can be seen in terms of revenue and employee growth in just a few select locations where investments have been made (revenue in \$ millions):

	# of Companies	Starting Revenues	Ending or Current Revenues	%age Change	Starting # Employees	Ending or Current Employees	%age Change
Kansas City, KS	7	\$ 135.7	\$ 235.6	74%	550	809	47%
Denver, CO	1	149.2	2,986.7	1,902%	17	433	2,447%
Chicago, IL	1	9.0	14.3	58%	245	350	47%
Dubuque, IA	1	6.9	9.3	33%	22	50	127%
Alvarado, TX	1	11.6	15.4	32%	49	57	16%
Minneapolis, MN	1	11.6	14.0	21%	31	28	(10%)
Cincinnati, OH	1	9.6	11.8	23%	55	63	15%
Tulsa, OK	1	8.9	8.9	0%	46	49	7%
Knoxville, TN	1	22.8	32.1	41%	62	132	113%

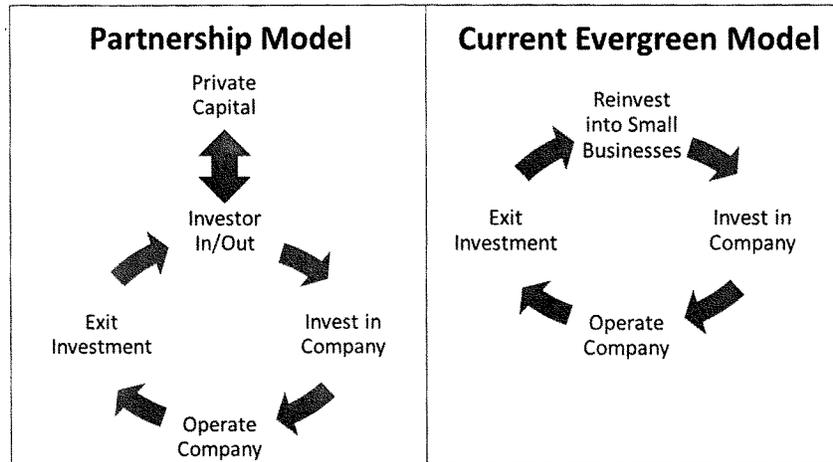
Over its 42 years of existence, KVCII has made investments in half the country (25 states) seen below.



Both the Library of Congress report and KVCII's results show that the SBIC program works and meets its stated mission statement. The best part of the program is that while Congress guarantees the debentures in case of default, *the cost to the U.S. taxpayer has been \$0 over the life of the program.* The SBIC program is a self-sustaining program that has resulted in an effective public/private partnership since its inception in 1958.

**SBIC Fund Structure**

As a SBIC with an evergreen license (a corporation), KVCI is structured slightly different than the majority of other SBICs (partnerships) that are in existence today. When the SBIC program started, most funds were licensed under the evergreen model. Today funds are almost exclusively, if not entirely, licensed under the partnership model. The difference in structures relates to the initial formation of each fund. Both structures effectively provide capital to small businesses. The primary difference between the evergreen and partnership models is what happens after a fund exits an investment in a portfolio company. This difference can be seen in the below graphic:



As can be seen above, the partnership model typically results in gains from the exit of investments being immediately returned to investors in the fund and then potentially invested later into a new fund to make new investments. Under the evergreen model that KVCI operates under, gains from the exit of investments are often reinvested into new companies. While the two models both result in investments, the way reinvestment occurs is slightly different, which impacts the amount of SBA leverage an SBIC can obtain under each model.

Over the life of the SBIC program, funds have navigated towards the partnership model in order to increase liquidity opportunities to outside investors and improve return to the managers of the fund. The downside to this model is that partnership funds have a limited lifespan, which can dictate the timeline that portfolio investments will need to be exited under. KVCI believes that the evergreen model allows the fund more patience in determining when to exit an investment as there is no timeline for exit, which can help increase return metrics. The downside to the evergreen fund is fewer liquidity opportunities for outside investors, especially if funds are continually reinvested into new opportunities. While the initial formation of both types of funds are different, both types of funds have been shown to be successful throughout the life of the SBIC program.

**Issue Resulting from Structure Difference**

As with any program (even successful programs such as the SBIC program), there are always enhancements that can be made to continue to modernize and improve the program. There are only three ways to increase the amount invested into companies in an SBIC portfolio:

- Raise capital,
- Borrow funds (primarily from the SBA debentures), and
- Reinvest gains/income from investments made.

Under current regulations, SBIC funds can receive 2x to 3x leverage of regulatory capital. Regulatory capital is primarily calculated based on capital initially raised. However, funds from gains reinvested into new investments (under the evergreen model) are not included in regulatory capital. This results in less leverage available to funds operating under the evergreen model. As can be seen below, the evergreen model receives approximately \$46.0 million less in available leverage than the partnership model (the below example utilizes KVCI's current investment, SBA leverage, and regulatory capital balances.)

Partnership Model			Current Evergreen Model		
<small>(in millions)</small>			<small>(in millions)</small>		
Cost of investments	\$50.0	Available	Cost of investments	\$50.0	
Leverage	<u>(17.0)</u>	<u>Leverage</u>	Leverage	<u>(17.0)</u>	
Private capital	33.0 x 2 =	66.0	Private capital	33.0	
			Regulatory capital	<u>(10.0) x 2 =</u>	20.0
			Reinvested capital	23.0 x 0 =	<u>-</u>
			Available Leverage		20.0

This issue can further be seen by the fact that despite KVCI almost *doubling* the amount invested (from 2010 to current) and *lowering* the amount of SBA debentures outstanding (\$1.5 million), SBA borrowing capacity has *declined* significantly by \$7.6 million (see below for actual values.)

	2010	6/30/19
Investments made by KVCI	\$25.6 million	\$50.3 million
SBA debentures outstanding	18.6 million	17.1 million
Private capital	7.0 million	33.2 million
Outside investor funds	7.0 million	7.9 million
Reinvested portfolio gains		25.3 million
Private capital	7.0 million	33.2 million
SBA debenture borrowing capacity	27.8 million	20.2 million

KVCI believes that an increase in investment with a corresponding decrease in outstanding debentures owed to the SBA should result in at least maintaining, if not increasing borrowing capacity. Unfortunately, that is not the case and borrowing capacity has declined based on the way that the debenture borrowing capacity is currently calculated.

**Simple Solution**

The SBIC program works, but unfortunately the math does not always make sense. KVCI is requesting an improvement to the program through a change in the regulations that would allow for an increase to the amount of leverage available for gains reinvested back into the portfolio. Below is the change KVCI is proposing to the definition of leverageable capital included in the regulations.

*Leverageable Capital* means the sum of:

(1) Regulatory Capital, excluding unfunded commitments, and

(2) The greater of \$0 or 50% times the total of the Financed investments made by the Licensee less:

(a) Leverage provided by the SBA, and

(b) Regulatory Capital, excluding unfunded commitments.

The impact of the proposed change can be seen in the below graphic.

<b>Current Available Leverage</b>				<b>Proposed Available Leverage</b>			
<i>(in millions)</i>				<i>(in millions)</i>			
Cost of investments	\$ 50.0			Cost of investments	\$ 50.0		
Leverage	(17.0)			Leverage	(17.0)		
Private capital	33.0			Private capital	33.0		
Regulatory capital	(10.0) x 2 =	20.0		Regulatory capital	(10.0) x 2 =	20.0	
Reinvested capital	23.0 x 0 =	-		Reinvested capital	23.0 x 1 =	23.0	
		<u>20.0</u>				<u>43.0</u>	
	Available Leverage		20.0		Available Leverage		43.0

As can be seen above, this change results in an increase to \$43.0 million in available leverage for an evergreen fund, which is still much less than the \$66.0 million of leverage available to a partnership fund. Under the evergreen model, the only way to make new investments without obtaining additional funding from outside investors is to have a successful investment that generates a *gain*. If a fund is unsuccessful and experiences losses, the fund would not have the ability to reinvest funds into a new investment and thereby not increase its borrowing capacity. Additionally, KVCI is not proposing a full 2x leverage on reinvested capital. The change to the definition of leverageable capital results in 1x leverage available to reinvested capital. While the SBA does not have the ability to “relicense” evergreen funds, the SBA does have the ability to deny additional leverage requests if the fund is not performing (even if the amount of available leverage is more than what is outstanding.)

While this change will primarily benefit evergreen funds such as KVCI, funds under both the partnership and evergreen models can benefit from this change. Both partnership and evergreen funds can make the decision to reinvest gains into new investments. This is likely to occur less frequently in the partnership model due to current partnership agreements; however, in times when successful funds are experiencing delays or a difficult time in the licensing process, the fund would have the ability to reinvest gains and qualify for additional leverage in the same manner that evergreen funds would be able to. While that may be difficult, it does provide an additional tool in the toolbox for partnership funds.

Conclusion

In summary, *the SBIC program is a successful program*, but KVIC believes there is an enhancement that can be made to improve the program. By making this enhancement, KVIC can continue to help fulfill the mission of the SBIC program and make investments to help grow and sustain small businesses.

Thank you for taking time to consider KVIC's proposed change.

