U.S. Senate Committee on Small Business

Review of the Small Business Investment Company Program

Statement of

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On Behalf of the Small Business Investor Alliance ("SBIA")

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Chair Cardin, Ranking Member Paul, and Members of the Committee, thank you for inviting me to testify on behalf of the Small Business Investor Alliance ("SBIA") at this important oversight hearing.

My name is Stacey Wittelsberger. I am a principal with Patriot Capital, headquartered in Baltimore with offices in Chicago, Dallas, and Atlanta. Patriot Capital is an active member of the SBIA, a national association founded in 1958 that develops, supports, and advocates policies to promote a healthy small business investing market. SBIA's membership includes Small Business Investment Companies (SBICs), Rural Business Investment Companies (RBICs), Business Development Companies (BDCs), conventional venture and private equity funds, private debt funds, and other funds committed to investing in growing domestic private small businesses. These long-term, illiquid investments help small business owners grow their businesses from small to medium-sized businesses while increasing employment and opportunities for their communities.

Patriot Capital is a multi-strategy middle market investment manager that is a five-time licensee in the SBIC program. Our firm focuses on investment opportunities in small and medium-sized, privately-held companies with annual revenues as low as $10 million. We typically invest between $3 and $25 million in our portfolio companies. According to internal data from our three most recent funds, our portfolio of 84 small businesses, either current or exited, employs approximately 33,100 people, which represents a 27 percent increase in jobs from the time Patriot Capital made its initial investment in each company. Patriot Capital, like other SBICs, is a small business and we know first-hand the challenges that our portfolio companies face because of our team's extensive and diverse professional backgrounds.

My testimony will focus on these key points:

- The SBIC program, administered by the U.S. Small Business Administration ("SBA"), is largely working well but, as with any federal program, targeted improvements can help strengthen the program's ability to expand the benefits of free enterprise to more people and places. It is struggling from wholly inadequate technology tools and too few employees to do the job properly.

- The SBIC industry has a record of supporting female leaders, but the SBIC program could be improved to help grow a far more diverse pool of investment fund managers, skilled at helping domestic small businesses access capital.

- Small businesses need access to more of the most patient form of capital – equity. The SBIC program severely limits the amount of equity available to smaller businesses and would benefit from thoughtful tools to facilitate more access to this type of capital.

Targeted Improvements to the SBIC Program

SBICs are an American success story and an example of a successful federal public policy that aligns the power of private markets with the public interest of job creation and expanding economic growth and opportunity.

The SBIC program is a market-driven program that is one of the best, most cost-efficient job creating tools in the government.[1] SBICs have empowered small businesses to create millions of jobs across the country.

One such example of job creation is a Patriot Capital portfolio company that grew its employee base right in our home state of Maryland and was also a women-owned business. The company was a telecom manufacturing business called CSS Antenna. At the time of our investment in 2008 the Company employed approximately 40 individuals and endured a difficult time in the lull between the 3G and 4G technology development and rollout. Our capital allowed the business to maintain its operations during such uncertainty and be well positioned to support its customers when the 4G technology launched. CSS grew to 150 employees at the time of our exit from the investment in 2013.

During the pandemic, the SBA did an extraordinary job under extraordinary circumstances setting up and executing in a matter of weeks some of the largest government aid programs in American history. These massive emergency actions saved tens of millions of jobs and millions of small businesses.

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[1] An 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. The average administrative cost was approximately $35 per job created, and about $11 per job created or sustained." *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>*.

The Office of Investment and Innovation (OII) staff did an extraordinary job during the pandemic. With a deadly virus rapidly spreading, the economy seizing, mass shutdowns across the country, and a completely unplanned transition to entirely remote work with third-rate technology tools, the OII staff adapted quickly and actually improved performance and output. In 2020 during the pandemic, more than double the number of SBIC licenses were processed during the second half of the fiscal year than during the first half. Leverage was processed at a faster rate and exams were completely remotely. It was impressive and we are thankful for their efforts.

Administrator Guzman has inherited an agency that is operating an unprecedented number of new programs set up in an inconceivably short amount of time. The political leadership and career staff at SBA deserve recognition for their heroic efforts administering these rescue programs, especially given that the SBA continues to be chronically understaffed with an anemic technology budget and archaic technology tools.

As the pandemic ends, small businesses will need an effective SBA to provide the help they need to grow. In particular, the SBIC program needs an appointed leader to serve as Associate Administrator for the Office of Investment and Innovation. The Associate Administrator for the Office of Investment and Innovation is one of the last senior positions that remains vacant. Additionally, staffing shortages in the Office of Investment and Innovation are severe and are not conducive to capital access or healthy oversight. For example, frontline SBIC regulators typically monitor and regulate only about 10-12 SBIC funds per regulator because of the unique nature of each fund. Today, however, the SBA is so short-staffed that the ratio between Office of Investment and Innovation regulator and regulated SBIC is at an impossible level of 45 or more funds per operations analyst. Regulated entities do not normally ask for more regulators, but we are. We encourage Congress to provide the necessary resources, both human and technological, to ensure SBA is able to run this successful program and provide necessary oversight.

Expanding Opportunity with a New MicroCap SBIC License

As Congress and the Administration contemplate next steps to help small businesses emerge from the pandemic-induced economic slowdown, SBIA recommends modifying the existing SBIC investment program to fill ongoing market gaps, both geographic and demographic.

SBIA supports the creation of a MicroCap SBIC license to encourage formation of more small funds providing smaller dollar amounts in smaller geographic markets. A bipartisan bill introduced recently by

Senators Hickenlooper and Risch, *MicroCap Small Business Investing Act of 2021*, would do just that by creating a pathway to increase not only the breadth of participants in the program, but also the geographic reach of investment capital, especially to small businesses located in regions with limited capital access. The SBIA encourages the Senate to pass the Hickenlooper-Risch bill.

The Hickenlooper-Risch bill would authorize the licensing of new, smaller funds within the existing parameters of the current SBIC program. The goal of the legislation is to expand the pool of qualifying fund managers in the SBIC program by providing broader access to talented, underrepresented, diverse people in potentially smaller geographies that currently have limited access to participating in this successful small business program, while directing much needed capital to smaller markets. If enacted, this legislation will seed a whole new generation of fund managers that will be more demographically and geographically, representing a far more characteristic swath of America.

While first-time funds may be higher risk, this proposal offers a way to manage that risk. Under the bill, fund managers who have a documented record of business experience relevant to the investing strategy being pursued would become eligible for a license to manage a smaller SBIC fund with access to much less SBA leverage than other SBICs. This maximum leverage ratio would be 1:1 (up to $25 million) relative to the private capital that the fund raises. This significantly lower leverage cap for MicroCap SBIC funds would lower taxpayer risk while increasing capital access.

It is critical that these new fund managers not only get a license, but they also are being set up to succeed. They are not being given a license and left to figure it all out themselves, with the potential for failure. To provide further safeguards and to promote successful investments, each fund will have two independent members of their investment committee who are or who have been licensed SBIC fund managers and who will help these first-time funds identify and structure their investments and to act as a sounding board for these investments once completed. In this advisory capacity, the independent investment committee members serve as mentors to the MicroCap SBIC fund managers. MicroCap SBIC funds are also required to invest at least 25 percent of their capital in a combination of the following: small businesses in underserved areas, low-to-moderate income areas, Qualified Opportunity Zones, and rural areas, or businesses in research & development and manufacturing.

This legislation would deliver a powerful addition to the SBIC program and thereby help domestic small businesses. We believe it would also encourage more diversity in the SBIC program while maintaining the successful market-driven SBIC model. The SBIA urges the Committee to support the proposal.

Bank Investment in SBICs

The SBIA also supports the *Investing in Main Street Act*, a bill introduced during the last Congress session by Senators Duckworth and Young, designed to increase bank investments in SBIC funds. The bill passed in the House by a vote of 403-2, but no action was taken in the Senate.

This proposed legislation would amend the Small Business Investment Act of 1958, which currently restricts SBICs from taking capital investments from banks that have more than five percent (5%) of their institution's capital and surplus invested in SBICs. Bank regulations currently permit these same banks to invest up to 15 percent of their capital and surplus (with regulatory approval) in SBICs.

This simple change would create symmetry between statute and bank regulation and would increase the amount of capital that banks can deploy into SBICs. Increasingly, SBIC funds are encountering smaller banks who have hit the five percent (5%) statutory cap but want to invest more in job creation that is a hallmark of the SBIC program.

Allow for More of the Most Patient Capital - Equity

All SBICs provide long-term patient capital. This longer-term strategy is an incredible advantage to small businesses in surviving the bumps, sometimes jarring bumps, that small businesses face. But SBA discourages equity strategies in large part because the SBA does not have tools tailored specifically for equity investing.

The SBIA supports empowering SBICs to provide more long-term patient capital in the form of equity investments than they are permitted to do today because equity capital is the most patient form of capital and can be the hardest for small businesses to access. Equity provides a capital infusion that, unlike debt, typically does not drain the cash a business is generating. This allows for more money to be reinvested into the business to fuel growth. Equity also allows for investing in earlier stage (younger and newer) businesses that are not yet generating significant revenue. When the SBA pivoted away from equity investing, the number of minority-owned business receiving capital plummeted due to the fact that younger businesses today tend to be composed of a more diverse demographic that is representative of their generation. Further, when the SBA moved away from equity investing, fewer funds were formed in smaller states and funds providing equity became very concentrated in a few areas.

The SBIC program would benefit from creation of equity investment tools to help small businesses outside of the three concentrated areas that receive 75 percent of the early-stage capital today. Equity investments mean no debt service for the fund or its portfolio company investments. This proposal would help create economic opportunity in parts of the country desperately undercapitalized and immediately begin creating jobs and domestic production in critical industries.

Conclusion

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.[2]

As of the first quarter of 2021, the SBIC program has grown to a combined SBA guaranteed and private capital program exceeding $33 billion, an increase of 19 percent since 2016 and the highest level ever in program history.[3] SBICs completed $630 million in financings to small businesses in the month of December 2020 alone, representing a 25 percent increase from only $500 million in the month of December 2019.[4] At the end of fiscal year 2020, the SBIC program included more than 300 licensed funds.[5] Over the last five fiscal years, on average, SBICs have invested nearly $6 billion annually in over 1,100 small businesses, creating or sustaining nearly 109,000 jobs annually.[6]

The SBIC program is well positioned to provide much needed capital to domestic small businesses, helping them lead the way in producing innovative products and services that will continue to spur America's growth through the 21st century. Patriot Capital is proud to be one of the growing numbers of SBIC licensees helping U.S. small businesses stimulate economic growth and create jobs.

Thank you again for the opportunity to testify on behalf of the SBIA.

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[2] Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.
[3] *An Update from SBA's Office of Investment and Innovation,* presentation to SBIA Outlook 2021 Virtual Conference at 2, https://www.sbia.org/wp-content/uploads/2021/02/SBIA-Outlook-SBA-Update-Presentation-HANDOUT-1.pdf (last visited Feb. 7, 2021).
[4] Id.
[5] SBA – *SBIC Program Overview* at 2 (Sept. 30, 2020). Accessed Feb. 1, 2021 (unpublished).
[6] Id.