



**TESTIMONY FROM**

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**On behalf of the**

**NATIONAL SMALL BUSINESS ASSOCIATION**

**HOUSE COMMITTEE ON SMALL BUSINESS**

**Hearing:**

**“Increasing Access to Capital for Our Nation’s Small Businesses”**

**March 1, 2007**

Good morning. My name is Marilyn Landis and I am pleased to be here on behalf of the National Small Business Association. I would first like to thank Chairwoman Velazquez for holding this very important hearing and for being such a strong and outspoken advocate for increased access to capital opportunities for U.S. small businesses. I also would like to thank Ranking Member Chabot for his long-time support of entrepreneurs. The entrepreneurs of the National Small Business Association look forward to working with you on the House Small Business Committee. I also would like to thank both of you for sharing members of your staffs with us during our recent Small Business Congress. Let me assure you that they represented you very well.

I am proud to serve as the first vice chair for NSBA as we celebrate our 70th year of small-business advocacy, and continue our long-standing tradition of working in a nonpartisan manner to promote pro-small-business policies. In addition to my leadership role within NSBA, I am the owner of Basic Business Concepts, a consulting and financial management company serving small businesses primarily in Pennsylvania and Ohio.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country—marketing, originating and underwriting SBA loans—and have continued working with my clients on securing SBA loans as well as myriad other sources of capital. After 36 years of working with small business, the one thing I can tell you without hesitation is that it's tough out there. Small-business owners face many obstacles in trying to garner capital—obstacles that illustrate the very significant need for and importance of the SBA's lending programs.

### **Small-Business Challenges in Financing**

Many small and startup businesses lack the assets necessary for a traditional bank loan. Smaller loans are generally less-profitable for banks, and typically have a higher default rate. The increased usage of personal credit ratings for business owners further exacerbates the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks, fewer character-based loans, and more difficulty for the small-business owner.

One of the biggest barriers to small-business financing is debt secured by equity in fixed assets. Many small-business owners do not have the kind of equity required by banks to acquire a sizeable

loan. This gap in debt-equity financing primarily hinders both startup businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership (if the entrepreneur owns a home) rarely meets the equity requirements for receiving a larger commercial loan. The small-business owner seeking to expand his or her business or hire additional employees faces the same equity challenges. The old adage, “You’ve got to have money to make money” has morphed into “You’ve got to have equity to get money”—which just does not make sense.

A new capital issue has come to the forefront for small businesses, and that is the increased reliance on credit cards. Many small-business owners were forced to turn to credit cards as their primary source of working capital in the early years of this decade when a multitude of banks tightened their lending standards. In fact, only 20 percent of the respondents to a 2006 NSBA membership survey relied on traditional bank loans as their primary source of financing. Eleven percent exclusively used credit cards to finance their business operations. The high interest rates typical of most credit cards continue to adversely impact U.S. small businesses.

Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan request. Rapidly growing businesses, like mine, that are not traditional brick and mortar, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit card accounts. As such these loans are subject to credit card regulations which permit significantly higher and more volatile rates and payment structures. Rapidly growing service and technology companies do not want to rely on credit card debt—they are forced to.

In order to address the access to capital barriers that continue to hinder the economic development of the small businesses that form the backbone of the U.S. economy, NSBA supports the following banking reforms:

*Address the use of personal credit scores in processing loans*

Too many banks rely solely on the personal credit score of the business-owner and neglect to evaluate the owner’s business experience or the long-term viability of the business. Individuals with high credit scores and/or equity in a home can secure a loan, whereas an experienced entrepreneur cannot. Lower credit scores may only reflect the presence of both personal and business debt on the business owner’s credit report, not a poor payment

history. We firmly believe that, in time, the unintended consequence of the over-reliance on credit scoring and lack of emphasis on the actual viability of the business will increase small business defaults by over extending credit to the inexperienced and denying credit to viable, functioning businesses.

*Require greater transparency in credit-scoring and/or loan approval requirements*

While great strides have been made in regard to personal credit transparency and the finance worthiness of an individual, small-business financing remains cloudy at best.

*Allow small businesses to earn interest on their checking accounts*

Currently, large businesses have a significant advantage over small businesses in their ability to earn interest on their checking accounts. Most large banks have established “sweep” accounts which enable a business to set up a separate interest-bearing account into which the balance of their primary checking account can be transferred or “swept” up to 24 times per month. The transferring allows money to be placed into interest-bearing accounts at the close of business and then put back into the primary account at the next opening business day, providing for interest accrual overnight.

Due to the complexity of “sweep” accounts and the significant cost in administering them, these interest-bearing accounts are not an option for most small businesses. Chairwoman Velazquez has introduced legislation that would clarify and repeal certain regulations that have served to disadvantage small businesses in this regard. The legislation would enable small businesses to participate in these sweep-accounts and increase the allowable number of transfers per month while requiring that the fees for such transfers not be prohibitive to smaller accounts.

NSBA thanks Chairwoman Velazquez for reintroducing *The Business Checking Fairness Act of 2007 (H.R. 41)* and urges the full committee to support this important piece of legislation.

*Eliminate the credit card industry’s universal default practice*

Starting in 2000, credit card issuers began increasing a credit card holder’s interest rate if the cardholder was late on an unrelated payment to a different credit card, a utility company, or a mortgage lender, to name a few. This practice, known as “universal default,”

raised eyebrows and in 2004, the Office of the Comptroller of the Currency (OCC) issued a guidance to banks urging them to disclose this practice in promotional materials. This guidance, which included language warning of the risks of using a universal default policy, was successful in motivating the six largest U.S. credit card issuers to cease the practice.

According to a new report by the Government Accountability Office (GAO), however, three of the 28 most popular cards still employ a universal default policy. This GAO report also found that four other of the most-popular 28 cards are seeking to reinstate universal default, but are trying to do so under the auspices of a “change-in-terms”, which unlike the automatic increase previously done with universal default can require prior notification.

Due to small business’ reliance on personal credit cards, this practice is creating undue pressure on many small-business owners whose personal and professional finances are tied together. NSBA urges Congress to codify language preventing banks and credit card issuers from using universal default increases on credit cards unrelated to a particular late payment.

### **SBA Loan Programs**

First, I would like to state for the record that NSBA is very pleased to be working with the new administrator of the SBA, Steven Preston. Administrator Preston who attended NSBA’s recent Small Business Congress, is truly a breath of fresh air within SBA; and while we may not always agree with him, Mr. Preston’s openness and willingness to work with a range of small business groups is to be commended.

Banking practices that restricted access to capital were a key catalyst in the creation of the SBA’s flagship 7(a) loan program. The goal, under the generally-accepted premise that small-business growth is a good thing, was to encourage greater lending to smaller, potentially riskier clients. As you can see, however, imperfections within the market still exist and SBA loan programs are as important now as ever.

#### *7(a) Loan Guarantee Program*

As everyone in this room can attest, the 7(a) loan program has had a bumpy ride over the past five years. The program has faced loan caps, a complete shutdown, and a zeroed-out budget. The 7(a) loan program is now running on a zero subsidy, which requires no appropriations but has led to increased fees on lenders and borrowers. NSBA has worked with Chairwoman Velazquez and her

staff in the past two years to push for funding, only to have the measure taken out in conference committee negotiations.

While some have argued that the zero subsidy and lack of appropriations has led to stability in the program, we would argue that stability and funding the 7(a) program are not mutually exclusive. For the record, I am confident that the program can be stable and receive appropriations at the same time. Hindering the 7(a) program and placing the financial burden on small-business owners because Congress has been unable to enact appropriations measure is simply unfair.

When the program first went to a zero-subsidy rate in FY 2005, lenders and borrowers were hit twice by increased fees. The new subsidy rate requires higher fees, and the expiration of PL 107-100 required a 100-percent increase in guarantee fees for loans less than \$150,000, and a 20-percent increase in guarantee fees for loans between \$150,000 and \$700,000. Additionally, all annual service fees increased from .25 percent to .5 percent. The interest rates are now at their statutorily highest allowable level.

While the number of loans being made has steadily increased, both loan volume and loan size has decreased since the new subsidy rate went into effect. According to statements from the SBA, 7(a) loan volume decreased in FY 2006 to \$13.46 billion from \$14 billion in FY 2005. Additionally, the loan size has decreased from \$157,459 in FY 2005 to \$148,767 in FY 2006. The average 7(a) loan size in FY 2000 was \$240,437. This represents a 61-percent decrease in loan size in only six years.

Perhaps the most worrisome numbers, however, are the number of banks involved in the 7(a) program. Higher fees are not only pushing business borrowers toward credit card reliance, they are driving banks out of the program. At first glance, it appears that there has been a moderate decrease in the number of lenders participating in the 7(a) loan program. This does not seem particularly alarming, as it could be explained by bank consolidation or a number of other issues. When you dig deeper, however, you discover that the number of lenders registered that actually made at least ONE loan in FY 2001 was 5,228, and that by FY 2005 the number had decreased dramatically, almost 50 percent, to 2,751.

The SBA has made a concerted effort to expand its operations, and we support the goal of broadening SBA's reach—but not at any cost. The decreasing loan size and number of participating banks is worrying, and could be signaling systematic shortcomings. The shriveling loan size is

particularly troublesome as smaller loans do not typically create as many jobs as large loans. Since smaller loans generally present less risk for banks anyway, it would appear intuitive that the SBA should focus on increasing incentives to banks to make large loans. Shrinking bank participation could mean that because of bank consolidation, large corporate banks are distributing the bulk of loans or it could mean that the administrative costs of the program are too great for many banks. Sadly, whatever the explanation, the burden of diminished bank participation will most likely fall on the already overloaded shoulders of America's entrepreneurs, especially rural entrepreneurs.

NSBA continues to urge Congress to fully fund the 7(a) program, which remains the largest source of public or private small-business financing in the country—providing 30 percent of all long-term small business lending. The 7(a) program is not only important, however, it is effective. For every \$33,000 spent in the 7(a) program, one job is created or retained. The merits of the 7(a) program are too great for Congress to continue to ignore.

#### *Microloan Program*

President George W. Bush's FY 2008 budget proposal includes a restructured and zeroed-out Microloan program. SBA Administrator Preston has stated that in keeping with the agency's efforts to run a more efficient agency, the goal is to fold the Microloan program in with the 7(a) loan program and have Small Business Development Centers assume the technical assistance responsibilities currently provided through the Microloan program. We do not believe this is in the best interests of the Microloan program or the aspiring entrepreneurs it strives to assist. A very important component of the Microloan program is the intensive, hands-on technical assistance it offers. This technical assistance is quite different from what is currently offered through the SBDC program, and given the continued flat-funding for SBDCs, it is both unfair and unrealistic to expect them to assume this new and different responsibility.

Although the incredibly low cost of the Microloan program makes it a tempting target during a budget crunch, this temptation must be resisted—the vital assistance provided by the Microloan program to the smallest and most vulnerable entrepreneurs in the country, oftentimes individuals who have been displaced, must be both ideologically and financially supported by Congress.

Access to capital for small companies that export is especially challenging. This is a particularly critical issue with the U.S. trade deficit at record levels. Exporters that cannot sell for cash need such financing, but the problems they encounter are: (1) asset-based lenders almost always reject

transactions in which the collateral is shipped to a foreign country, where it would be difficult to foreclose for nonpayment; and (2) foreign risks differ from domestic risks, requiring a lender to have staff with specialized training. In practice, lenders will occasionally take a chance on underwriting an export by a large company; but they almost never will on a small-company exporter—unless the transaction is backed up by a government guarantee or insurance policy. This is why small exporting companies in the U.S. depend so much on government guarantors like the Small Business Administration, the Export-Import Bank, and the Overseas Private Investment Corporation. (OPIC).

Each of these agencies offers reasons for small-business optimism. With a field staff of only 16 export-finance professionals and an agency-wide budget of only \$4.3 million, SBA's Office of International Trade financed more than \$2.1 billion in exports in FY06. This translates into about \$500 in export sales for each \$1 the taxpayers invested in this program—and these exports supported the creation of nearly 30,000 new, high-paying American jobs in FY06, the taxes from which more than covered the cost of the program.<sup>1</sup> *There is no better return on export promotion anywhere in the federal government.* The real question here is why a capital access and export financing program this successful—both in addressing the U.S. trade deficit and in helping small business—continues to be starved for funds. As recently as FY2000, the program had 22 export finance professionals in the field and a much larger travel budget to allow them to visit banks and exporters across the large territories they cover. Today, huge areas of the country—even those with critical needs, like the Gulf Coast—lack access to these export finance professionals and the economic development that they can provide.

Thanks to the work of Chairwoman Velazquez and others, Congress recently directed the Export-Import Bank to create a permanent small business division, staffed by underwriters dedicated solely to small business, and headed by a senior vice president answering directly to the Bank president. These and other recent changes at Ex-Im should help the Bank build on recent progress by its new president, James Lambright. In FY06, the Bank met the mandate requiring them to devote 20 percent of its financing dollars to small businesses. We thank Chairwoman Velazquez for her excellent work on this important capital access issue, and we encourage this Committee and the Financial Services Committee to commend Ex-Im Bank as it shows continuing progress in this area.

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<sup>1</sup> Based on the Department of Commerce index of 14,000 new jobs, paying 18% higher wages than non-trade-related jobs, per \$1 billion in exports, and IRS *Statistics of Income*.

The Overseas Private Investment Corporation (OPIC) is the federal government's most remarkable recent success story in financing small businesses in international trade. With the creation of its Small and Medium Enterprise Finance (SMEF) Department and the strong backing of the agency's current and former presidents (Dr. Peter Watson and Rob Mosbacher, Jr.), OPIC went from handling \$6 million in small-business financing in FY01 to handling over \$500 million in FY06. Today, it stands poised to do even more, through its new Enterprise Development Network that will delegate more front-end authority for small-business financing to commercial banks and brokers. OPIC is up for reauthorization this year, and it deserves the strong support of all in Congress that believe U.S. small business can play a vital role in international trade.

NSBA believes that increasing the amount of federal research and development invested in U.S. small businesses is another important access to capital goal. Small technology firms with less than 500 employees now employ 54.8 percent of all scientists and engineers in U.S. industrial research and development. Yet, these nearly 6,000 scientists and engineers are able to obtain only 4.3 percent of extramural government research and development dollars. This must change. NSBA urges Congress to build upon the successes of the Small Businesses Innovation Research (SBIR) program—which has delivered more than 50,000 technology patents and is now doing so at the rate of seven patents a day—during SBIR's reauthorization process and to increase the percentage of agencies' research and development funds reserved for small businesses

NSBA strongly encourages both the administration and Congress to fully support small businesses as the true centers of growth in the U.S. economy. Congress must recognize that the majority of small businesses in today's economy are not fixed asset-intensive and should take the lead in ensuring that traditional financing practices and new credit-card policies do not restrict small business growth. NSBA urges Congress to examine the benefits of reforming the current limitations placed on banks in lending to small business and fully supporting and funding existing SBA loan programs.

I thank you for your time and welcome any questions you may have.