Written testimony of
Brett Palmer, President, Small Business Investor Alliance (SBIA)

for the
U.S. House Small Business Committee
hearing entitled

"Fueling America's Future: How Investment Empowers Small Business Growth"

2360 Rayburn Building at 10:00AM

April 2, 2025

SMALL BUSINESS INVESTOR ALLIANCE

The Small Business Investor Alliance

SBIA was formed in 1958 to represent Small Business Investment Companies, the original American venture capital and private equity funds. As the small business investing market grew more complex, so did SBIA. SBIA now includes Small Business Investment Companies (SBICs), Rural Business Investment Companies (RBICs), Business Development Companies (BDCs), conventional private equity funds, private debt funds and other funds investing in American private small businesses. We also represent the institutional investors (e.g. community banks, university endowments, pension funds) who invest into these small private funds. Our association's purpose is to represent the entire lower middle market investing ecosystem, both General Partner and Limited Partner. As such, our public policy goals are balanced and focused on maintaining a robust, healthy, and competitive market for investing in American businesses.

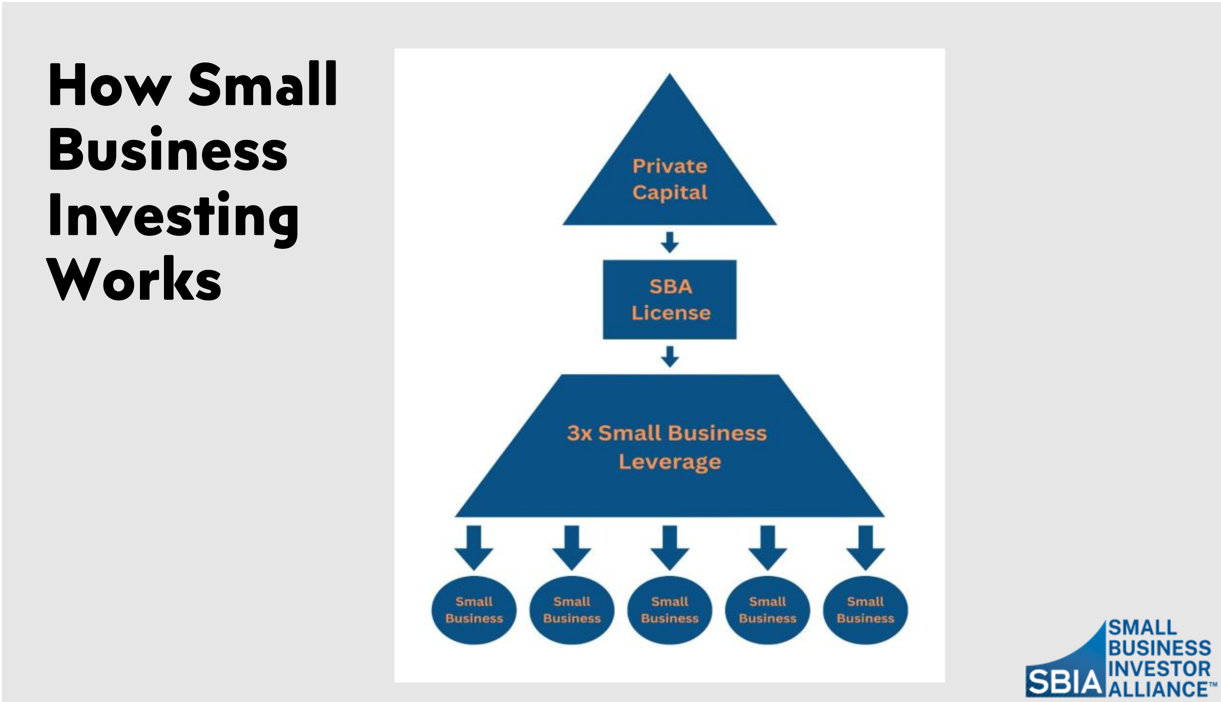
Private Capital Markets, Private Equity, and Venture Capital 101

The American capital markets are the envy of the world. Our capital markets are one of our greatest advantages in the highly competitive global economy. Our public markets are well known, with stock prices of very large businesses readily available and often at the top of the news. In contrast, private equity, private credit, and venture capital are far less understood, but arguably of equal or greater importance because they empower entrepreneurs to unleash innovation and growth. Private capital markets are critically important to small businesses in scaling up and becoming regionally, nationally, and globally competitive.

Private equity is a very broad category of capital providers who are commonly misunderstood and often misrepresented. The truth is, investing by private equity is a powerful force for good. Private equity is a driver of job creation, innovation, and expanding prosperity to the people and places that are not yet fully benefiting from our system of free enterprise. The profits from private equity fund the retirement security of millions of pensioners and provide the scholarship money used to provide educational access to a new generation of college students. These private equity investments are commonly made in areas of the country that are otherwise passed over or passed by. Most of our member funds are located in Little Rock, Indianapolis, Buffalo, Omaha, Kansas City, and many other places that far from Wall Street or Silicon Valley. Regardless of investing style, private equity investors in small and medium-sized businesses make money by helping the businesses grow and succeed. The idea that private equity funds make money by having businesses fail is just not true.

How Private Equity Works

To put it in the simplest of terms, private equity and venture funds are investment vehicles that pool capital (largely from institutional investors like pensions and endowments) and then invest in businesses that are not publicly traded to help them grow.



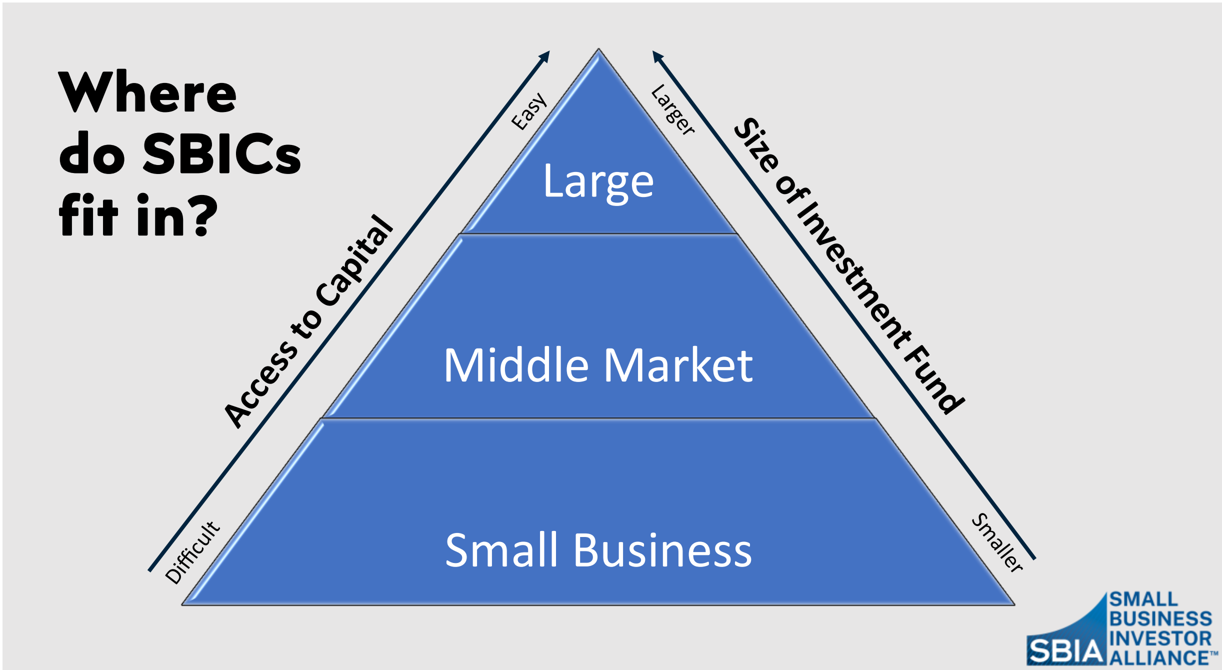
Private equity helps business grow by not only providing critical, patient capital that conventional banks cannot, but also by helping the smaller business learn how to grow and make big leaps forward that they otherwise would not have been able to achieve on their own. The only way to be a successful private equity fund in the lower and middle market is to find smaller businesses and help them grow into bigger, better businesses.

Small Business Investment Companies (SBICs)

SBICs are an American success story and example of a successful federal public policy that aligns the power of private markets with the public interest of job creation and economic growth. 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.[1]

SBICs operate in what is commonly called "the lower middle market." The small businesses that compose the lower middle market are employer firms, typically with $5-$150 million in annual revenues. Not every lower middle market business will be eligible for SBIC investment, they still must meet the size standards set by Congress and the SBA for the program. SBICs typically invest in businesses just entering the lower end of the middle market and in small businesses with growth potential to enter the middle middle market ($150-$500 million revenue/annually). Very few of these growing companies want to become publicly-traded companies and very few will ever have an IPO.

[1] Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.



SBICs invest exclusively in domestic small businesses, creating jobs and empowering U.S. small businesses to compete in our economy. 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. While these are recognized companies globally, many more small businesses backed by SBICs have grown from smaller businesses into robust, sustainable mid-sized businesses.

100% support for American Small Businesses

SBICs must invest in U.S. small businesses, which are defined as having the following:

- Tangible net worth of less than $24 million and average net income after Federal income taxes for the preceding two completed years of less than $8 million.
- Or, the industry size standard covering the industry in which the applicant is primarily engaged.

At least 25% of an SBIC's financings must be in smaller enterprises, defined as having the following:

- Net worth less than $6 million and average net income after Federal income taxes for the preceding two years of less than $2 million.
- Or, the size standard for the industry in which it is primarily engaged.

SBICs may not invest in, with certain exceptions, any of the following:

- Passive businesses
- Real estate businesses
- Project financing
- Farm land purchases
- Businesses contrary to public interest
- Foreign investments

SBIA SMALL BUSINESS INVESTOR ALLIANCE™

Small businesses that are experiencing a generational transfer warrant special mention because private equity, and SBICs in particular, play a critical role in successfully managing these changes. Most small businesses are “lifestyle businesses” that provide a fulfilling career and support a family, but the business will end when the owner ceases working. But there are also a large number of businesses that are meant to continue on past their founder’s time and many of these founders are aging. There are hundreds of thousands of successful businesses, commonly small businesses, that were founded by baby boomers or post-baby boomers, whose owners need to retire and whose business still has its brightest days ahead. In many of these businesses the founder/owner does not have a child who is willing or able to take over this business. Without a buyer, often a private equity fund or a management team backed by a private equity fund, many of these otherwise successful small businesses will simply shut down – harming their employees, the economy, and their communities.

When these businesses facing generational transfer are sold to an SBIC or private equity fund these businesses grow. The new owners are investing for the longer term –in new equipment, new technologies, new products, and new employees. These businesses innovate like a startup but do so with the critical advantage of a proven business model. It is common for the family or founder of the business to retain a minority ownership stake in the business and therefore participate in the ongoing success of the now growing business. The failure rate of these investments is low and the growth rate (both profit and employment) is high.

Impact of SBICs

SBICs are a critical part of the small business capital markets. SBICs investments are overwhelmingly the first institutional capital to ever be deployed into the small business they are backing. Further, once SBIC capital is invested into a small business then the small business is often able to access more conventional bank capital. SBICs are only able to make a profit by successfully growing small businesses.

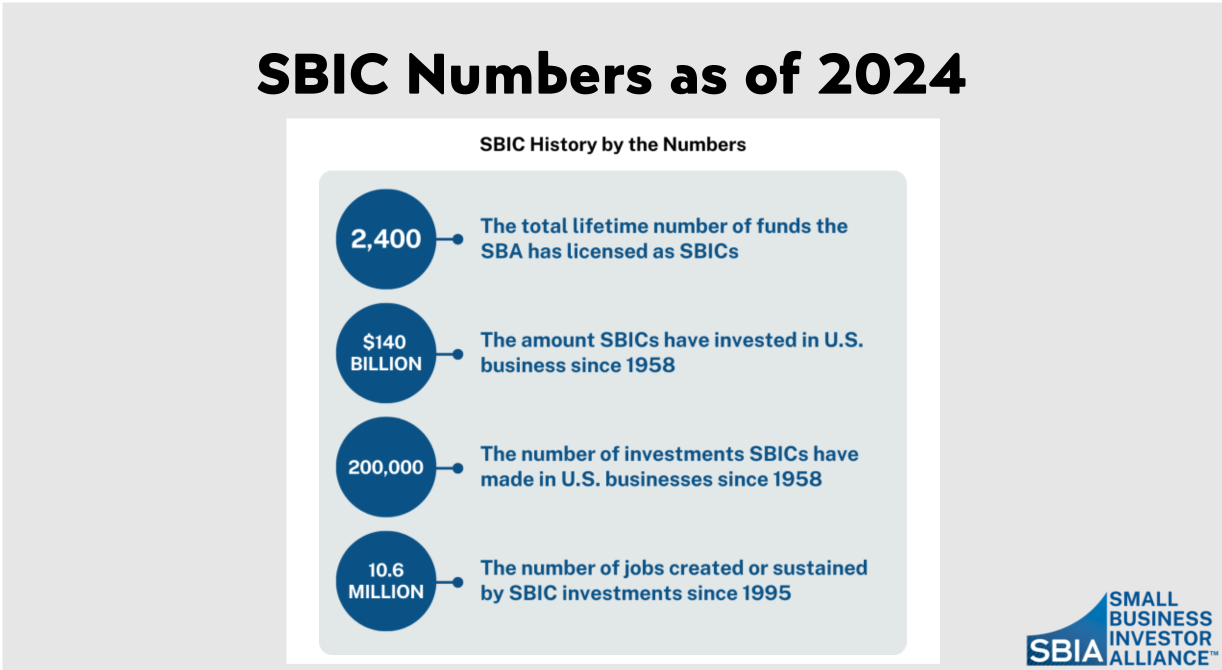
Since inception, 2,400 SBICs have made over 198,000 investments in U.S. small businesses totaling $140 billion. These investments are in real companies with real staying power and real growth potential.

In FY2024, the capital committed to U.S. small businesses from licensed SBIC funds was nearly $47 billion, a record level over 50 percent higher than five years ago.[2] Nearly one in four investments, moreover, were made in underserved small businesses.[3] During 2024, the SBIC program had 318 active funds[4].

[2] Small Business Administration, *Small Business Investment Company (SBIC) Program Overview Report for FY2024* (last visited March 11, 2025)

[3] The Office of Investment and Innovation reports financing information based on data collected on the SBA Form 1031. The term "Underserved" and represents women-owned, minority-owned, and veteran-owned small businesses or small businesses who are located in a low-to-moderate (LMI) income area.

[4] Id.



[5]

SBIC Structure

Most SBICs are levered (debenture) funds, which means those funds are authorized to borrow money from a federally authorized credit facility using the Federal Home Loan Bank system. It is critical to note that unlike other SBA programs, the investments made by the SBICs have zero investor guarantee. All private capital can be lost with a bad investment – the private sector is fully exposed to risk with the SBA leverage protected by the private capital. Access to this SBA/Federal leverage permits individual SBICs to multiply paid-in private capital up to two times capital or $175 million, whichever is less. Almost all SBIC Funds have a finite term, with an investing period of 5 years and then a harvesting period of another 5 years. As such, SBICs commonly have several SBIC funds that are in different parts of their investing/harvesting life cycles (investing, harvesting, and then forming their next fund). The maximum leverage for an SBIC family of funds (a group that holds multiple SBIC licenses) is currently $350 million. Leverage is provided at a **zero-subsidy rate**, with no annual appropriations necessary to fund up to $6 billion a year (FY25 Continuing Resolution), which is eventually paid back in full to the SBA with interest and fees. (*See Appendix for the typical lifecycle of a traditional SBIC*).

Accrual Debentures and Reinvestor SBICs

SBA has relatively new additional tools to fill more types of capital access gaps in the market: Accrual and Reinvestor SBICs. Accrual SBICs are leveraged funds but interest accrues and is paid back by the SBIC at the end of the 10-year debenture period to better align with the cash flows of long-term, equity-oriented funds. Equity investments allow small businesses to retain their liquid capital for both growth and working capital. Reinvestor SBICs are a subset of Accrual SBICs for the express purpose of

[5] Jobs are a sum of findings from Library of Congress report entitled "Measuring the Role of the SBIC Program in Small Business Job Creation" from 1995-2014 and data from SBA SBIC annual reports 2014-2024.

reinvesting in a portfolio of smaller investment funds to increase the geographic reach of the SBIC program. Reinvestor SBICs are in a category commonly referred to in the investing industry as "funds-of-funds". Reinvestor funds are a market-driven developmental league to provide more capital to a next generation of emerging small business investors.

SBIC Critical Technologies Initiative

The SBIC Critical Technologies Initiative is a partnership between SBA and the Department of Defense (DOD) to increase investments in a broad range of small businesses that operate in critical national security industries and supply chains. These small businesses are not necessarily government contractors, but are in key industries we need to develop domestically. SBA and DOD have identified gaps in the credit markets for high-tech startups and small businesses that could produce the technology needed for future national security efforts.

License Type	Investment Strategy	Details
Standard SBIC	Private Credit, Structure Equity or Mezzanine	• Uses Standard Debenture • Eligible for up to 2 tiers of leverage • $175M for one fund or $350M for family of funds
Accrual SBIC	Venture, Growth or Buyout	• Uses Accrual Debenture • Eligible for up to 1.25 tiers of leverage • $175M cap for one fund, $350M for family of funds
Non-Leveraged SBIC	Benefits of an SBIC license, without SBA leverage	• No funding from SBA • Typically established and owned by a bank • Provides financial institutions with opportunities to receive Community Reinvestment Act credit and a limited exemption from the Volker Act
Reinvestor SBIC	Fund-of-Funds	• Uses Accrual Debentures • Must invest ≥ 50% of capital in private funds • Eligible for up to 2x tiers of leverage • $175M cap for one fund, $350M for family of funds
Critical Technologies SBIC	Heavy focus on National Security and Defense	• Can be Standard or Accrual • Must invest 60% in Critical Technologies • Partnership with DoD • Critical to National Security

State of Small Business Access to Capital

For small businesses, access to capital is a distinguishing feature that often determines success or failure. It is noteworthy that access to capital often is the single highest concern for growing small businesses. It is much more difficult for smaller businesses to access long term patient capital than it is for medium-sized or larger businesses.

Traditionally, community and regional banks generally help finance businesses that have assets to borrow against. Even when banks can provide capital, they generally cannot provide equity or many of the flexible types of capital that growing small businesses need. Unfortunately, smaller and more rural businesses have even more difficultly accessing traditional sources of capital, particularly if there is any equity in the transaction. Also, many small businesses do not have adequate assets to access the amount of bank loans that they need. Smaller businesses are seen as too risky for most banks and larger financial institutions. Equity and subordinated debt provided by SBICs, RBICs, and other PE/VC funds enable small businesses to access bank loans that otherwise would be unavailable.

Additionally, smaller businesses need hands-on help to manage growth while some need help to navigate changes in the competitive landscape. Some family-owned small businesses need help to transfer ownership when the original founders are ready to retire but want to maintain the business as a going concern. This is the kind of help that SBIC funds can provide.

SBIA Policy Recommendations

While the SBIC program has shown record growth over the past 15 years, there are policies this committee can consider to expand access to capital in unserved geographies, ensure the SBICs remain on par with rising inflation, and provide the Office of Investment and Innovation with the resources necessary to administer the program.

SBIA thanks Members of the Committee for supporting H.R. 754, the Investing in Main Street Act

During the first weeks of the 119th Congress, the House unanimously passed H.R. 754, the Investing in Main Street Act.[6] The bill has passed the House of Representatives the last five Congresses.

The bill, introduced by Reps. Judy Chu (CA-28), Andrew Garbarino (NY-2), LaMonica McIver (NJ-10), and Brad Finstad (MN-1) would rectify a historical disconnect between banking law and small business investment law and allow a bank or federal savings association to invest up to 15% of their capital and surplus in SBICs, while still subject to the approval of the bank regulator if above 5%. This would dramatically increase the amount of private capital in the SBIC program, which will then be deployed to domestic small businesses, at no cost to taxpayers.

SBIA strongly supports passage of H.R. 2066, the Investing in All of America Act

SBIA strongly urges Congress to consider and pass H.R. 2066, the Investing in All of America Act, to increase access to capital through the SBIC program. This bipartisan legislation, introduced by Reps. Meuser and Scholten, will encourage private capital investments in the parts of America that are often overlooked, including small manufacturers. SBIA wants to thank Reps. Meuser and Scholten for their leadership.

Last Congress, the Committee made meaningful improvements to the bill, including an adjustment to how college and university investments are treated which will unlock significant new investment into SBICs to the benefit of both students and small businesses. That bill passed the House unanimously last year.

This year's version of the bill makes one additional, and very important, improvement to make investments in small manufacturers eligible for bonus leverage. The new SBA Administrator has made U.S. manufacturing a top priority for SBA, and we believe the new Investing in All of America Act will fulfill that goal.

---

[6] Actions - H.R.754 - 119th Congress (2025-2026): Investing in Main Street Act of 2025 | Congress.gov | Library of Congress

The Investing in All of America Act reforms the Small Business Investment Company program at SBA to encourage private capital investment in underserved areas and industries with the following benefits:

- No new spending.
- No new mandates.
- No subsidies.
- 100% of investment is in American small businesses.
- Encourages investment in Low-income and Rural Areas.
- Encourages investment in domestic manufacturing and critical technologies.
- Inflation adjustment allows the program to remain competitive as prices rise.
- Market-led and market-driven.

The Investing in All of America Act would streamline the current bonus leverage provisions to make them simple and straightforward, with no need for new appropriation for implementation as drafted. Specifically, the bill provides SBICs with bonus leverage to invest in rural, low-come, manufacturing, or national security-focused businesses. SBA already captures zip codes and NAICS codes of the small businesses financed. Simply adding check boxes and drop-down menus on the Form 1031 (Form 1031 must be completed by SBICs and submitted to SBA for every financing made to a small business. It includes details of the financing and information on the small business) for "rural", "low-income", and "critical technology" captures the remaining data needed to exclude the cost basis of the investment when calculating an SBIC's outstanding leverage.

The legislation would also adjust the leverage commitment levels by a factor of inflation from the last time they were adjusted in statute and make annual adjustments thereafter. This ensures successful SBICs do not grow out of the program and can continue assisting job-creating small businesses across the country for years to come.

The SBIC program had an inflation adjuster for many years prior to raising the caps in emergency legislation (ARRA) during the Great Recession. However, the leverage caps have not been adjusted since 2015 for single licensees and 2018 for a family of funds. In that time, inflation has risen nearly 30%. In the face of current and future inflationary pressure, reinstating the inflation adjuster is necessary to ensure the program's investment power remains consistent with the broader markets and small businesses can continue to receive the capital they need.

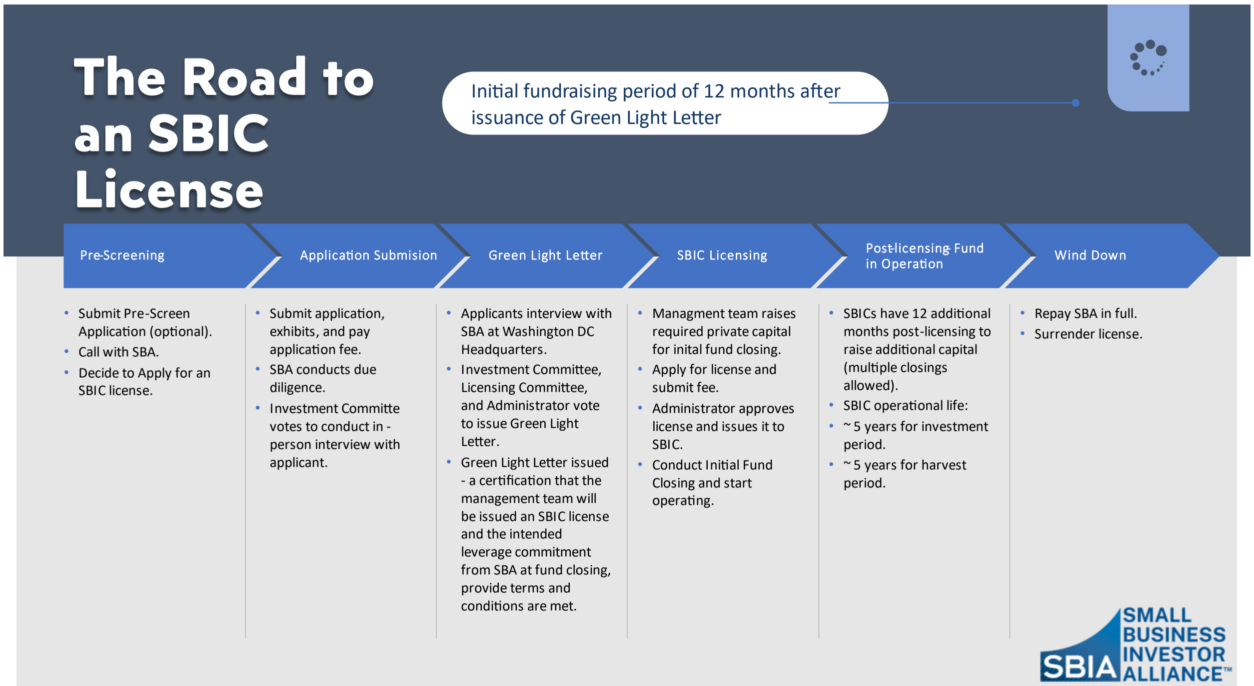
<u>SBIA urges Congress to ensure all fees charged to, and collected from, SBICs are used by OII exclusively to administer the SBIC program.</u>

The SBIC program has experienced significant growth recently. As mentioned previously, today there are nearly 320 licensed funds with combined SBA commitments and private capital exceeding $46 billion. There has also been record-setting interest from prospective and returning licensees. As of mid-March, the Office of Investment and Innovation indicated it had over 118 licenses applications in their queue with more coming in every day. To put that in perspective, the Agency issued just 26 licenses in all of FY2023.

Ensuring the fee revenues collected from SBICs by the Office of Investment and Innovation are used to provide the personnel and resources to process and manage the influx of new and existing licensees is critical.

SBIA thanks the Committee for holding this important hearing and looks forward to working with Members on bipartisan legislation that will increase capital access for all of America's small businesses.

APPENDIX I



Robust Fund Reporting, Examination, and Oversight Protect Taxpayers

Quarterly and annual financial report: SBIC Licensees must submit quarterly financial reports with respect to fund-level financials and portfolio company financings.

Portfolio financing report: For each financing of a small business, excluding guarantees, SBIC Licensees must submit a portfolio financing report within 30 days of the close of the quarter in which portfolio company financings occurred.

Examinations: The SBA Office of Investment and Innovation Examinations Division performs periodic remote and on-site examinations of SBICs every one to two years to monitor regulatory compliance with SBIC program statutory, regulatory and policy requirements. Examiners also ensure the accuracy of information SBICs submit to SBA.

SBIA SMALL BUSINESS INVESTOR ALLIANCE™