California Association for Micro Enterprise Opportunity

Written Testimony of

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"Small but Mighty: A Review of the SBA's Microloan Program"

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Chair Kim and Ranking Member Hern, members of the Subcommittee, my name is Carolina Martinez and I appreciate the opportunity to testify on behalf of the California Association for Microenterprise Opportunity (CAMEO). CAMEO is California's statewide micro-business network made up of over 220 organizations, agencies, and individuals dedicated to furthering micro-business development in California. We expand resources and build capacity for our member organizations that provide entrepreneurs with small and micro-business financing such as loans and credit, technical assistance and business management training. Annually, CAMEO members serve about 21,000 very small businesses in California with training, business and credit assistance and loans. These firms – largely start-ups with less than five employees – support or create 37,000 new jobs in California and generate a total of $1.5 billion in economic activity.

Congressional investment in micro-business development matters: 88% of small businesses that receive business development services are still in business after five years. This compares to an overall five-year business success rate of less than 50 percent. Businesses that receive training tend to have average annual revenues that are 38 percent higher than those that do not. Business ownership is also a means to increase income and generate wealth. In underserved communities – whether urban or rural – microbusinesses are creating jobs and uplifting their communities.

The SBA reports that micro-businesses play a critical role in new hiring, and were responsible for more than one in 10 private-sector job gains from 2010 to 2016; however, this requires focusing on supporting entrepreneurs and providing them with critical capital, counseling, and business assistance. Thus, the topic of today's hearing, an overview of the SBA Microloan Program, is one that is of great importance for CAMEO.

The SBA Microloan Program offers small businesses loans of up to $50,000 from not-for-profit lending intermediaries, which, in turn, lend to small businesses. It also provides marketing, management, and technical assistance to microloan borrowers, including women, low-income, veteran, and minority entrepreneurs. In Fiscal Year 2018, Microloan intermediaries provided 5,459 microloans totaling $76.8 million. The average size of a microloan through the program was just over $14,000.[1] Historically, small businesses have struggled to obtain access to sufficient capital and credit to enable them to lead job growth.[2] The struggle can be even greater for startups and micro-businesses.

Take for example, Mirna Aracely Garcia who was born in Guatemala. She came to the United States in 2000 and eventually opened a party supply store in downtown Los Angeles, simultaneously working a separate job for three years while the business started. After running into cash flow issues and unable to obtain capital from traditional banks, Mirna went to the SBA district office to seek help with financing. SBA referred her to Valley Economic Development Center (VEDC), a CAMEO member, where she was able to obtain a $50,000 SBA loan. She received counseling and training through the Women's Business Center and experienced an increase in sales, helping her overcome cash flow issues. As a result of the loan, she was also able to become a distributer, now fulfilling orders not only nationwide, but also internationally.

Maria Palacio is a fifth generation Colombian coffee farmer who started her U.S.-based coffee roasting business to help farmers get a fair price for their coffee. Maria secured a contract with Facebook to provide coffee for their campus cafeterias; however, she needed a loan to purchase the beans to fulfill the contract. Since Maria's company Progeny Coffee was a start-up, local banks could not make that loan. Maria turned to Working Solutions, another CAMEO member, who lent her $25,000 loan with SBA funds to help her purchase inventory at this critical moment of business development. Working Solutions has also provided Maria with technical assistance to help manage her exponential growth. Over the

[1] CRS Report: The Microloan Program.
[2] CRS Report: Small Business: Access to Capital and Job Creation.

last three years, Progeny has grown from $10,000 in revenue per year to over $1 million in revenue.

To address challenges faced by small businesses, Congress authorized the SBA Microloan Program as a five-year pilot program in 1991.[3] While the program was made permanent in 1997, in the twenty-one years since its reauthorization, the rules of the program have vastly remained the same while the lending landscape has changed. However, Congress has taken some action in the past. Two bills were introduced in the 115th Congress to address this issue.

The Microloan Modernization Act (S. 526) was introduced by Senator Deb Fischer (R-NE) and a companion bill, H.R. 2056, was introduced by Representative Stephanie Murphy (D-FL). The bills sought to eliminate the 25/75 rule as it pertained to pre-loan technical assistance and the use of third party contractors, as well as increase the cap on microloans to intermediaries from $5 to $6 million. It also included an SBA study of microenterprise participation and a GAO study on SBA oversight of intermediaries. H.R. 2056 passed in the House in July 2017 with amended language on the 25/75 rule, changing the limit to 50 percent for both pre-loan technical assistance and third-party contractors. The Senate Small Business Committee passed S. 526 in March 2018, with amendments mirroring the language from H.R. 2056.

While these changes were helpful, it is time for Congress to further modernize the Microloan Program. CAMEO offers the following four suggestions: (1) eliminate the 50/50 rule, (2) amend the 1/55th rule to provide greater flexibility, (3) provide access to Microloan data, and (4) increase support for Microloan funding.

1. <u>Eliminate the 50/50 Rule</u>

The Microloan Program has specific eligibility standards and operating requirements for lenders and borrowers. For example, the Microloan Technical Assistance program previously required that 25% of the technical assistance given to the entrepreneur by the lender be

[3] P.L. 105-135.

provided pre-loan and 75% post-loan. In 2018, the Congress changed these percentages from 25/75 to 50/50.

The Consolidated Appropriations Act of 2018 relaxed the requirement on Microloan intermediaries that prohibited them from spending more than 25% of their technical assistance grant funds on prospective borrowers and more than 25% of those grant funds on contracts with third parties to provide technical assistance. The law increased those percentages to 50%.[4] Additionally, the National Defense Authorization Act for Fiscal Year 2019, among other provisions, increased the Microloan program's aggregate loan limit for intermediaries after their first year of participation in the program from $5 million to $6 million.[5]

While the relaxed requirement on technical assistance grant funds is a welcome change, the microloan industry has long advocated for this percentage to be lifted altogether, as every business is unique. CAMEO supports elimination of the prohibition on percentage of funds to be used on pre- and post-loan technical assistance.

2. Amend the 1/55th Requirement to Provide Greater Flexibility

During the first six months of each Fiscal Year, at least $800,000 or 1/55th of available loan funds, whichever is less, is made available for loans to Intermediaries in each state. The 1/55th of available loan funds is divided equally among all states. The percentage is determined by dividing the value of all funds currently appropriated in the current fiscal year for lending, which may be only a partial budget if operating under a continuing resolution, under the Microloan Program by 55.[6] In its Fiscal Year 2019 Congressional Budget Justification, SBA asked for authority to eliminate the 1/55th rule, stating that this prohibition restricts availability of capital for small businesses regardless of the size of the state or the needs of the small business community.

[4] P.L. 115-141
[5] P.L. 115-232
[6] *Supra* n. 1.

Because loan amounts are small under a continuing resolution, the 1/55th rule leads microlenders to wait to request loans from SBA until the Microloan program is fully funded. Consequently, intermediaries receive all of their capital through this program in the latter six months of the Fiscal Year, as opposed to the first. Further, because all states are treated equally, states like California, New Jersey, and Texas end up with significantly less than what they need while small states end up with more than what they need.

While this rule is a leftover requirement from the pilot program, this no longer seems like an efficient way to distribute funds. We support the elimination of the 1/55th rule. Additionally, we would support the flexibility of having a reserve fund for SBA to deploy capital throughout the year in the event of a lapse in appropriations that results in a continuing resolution.

3. Provide Access to Microloan Data

In order to provide a better understanding of the needs of the program, SBA should make publicly available data on borrowers who use the Microloan Program, similar to the data available for the 7(a) loan program. Supporters of the program would benefit from having access to data on information such as geographical location, loan amount, interest rate, term, and NAICS Code, just to name a few. Requiring individuals to file a Freedom of Information Act (FOIA) request in order to obtain such information is time consuming and laborious.

4. Increase Support for Microloan Funding

An important part of success of the Microloan Program is robust funding. We appreciate this Committee's history of strong bipartisan support for this program. The Microloan Program's administrative costs are funded through the SBA's salaries and expenses and business loan administration accounts. Further, each year the SBA receives an appropriation for credit subsidies for its direct lending through the Microloan program. In Fiscal Year 2019, SBA was expected to support around $42 million in lending to intermediaries.[7] In addition, an appropriation of $31 million was allotted for technical assistance. CAMEO requests that this program grow to continue to be an important source of affordable capital for underserved communities, and will advocate for a 10 percent increase in the program.

Only two-thirds of small businesses survive two years in business, and half of all businesses do not survive five years.[8] According to the Annual Member Survey conducted by Friends of the Microloan Program, small businesses financed through the SBA Microloan Program have significantly higher rates of success.[9] Microbusinesses are an important part of California's economy and the SBA Microoan is an important tool on making sure that our underserved entrepreneurs succeed.

In closing, I am compelled to mention the major change in the small business lending landscape – the exponential rise of online lending. In 2015, the volume of online lenders was five times that of SBA lending and growing at an increasing rate. The access to fast money comes at a price, in many cases, a price too high for many small businesses. Last year, California became the first state to pass a transparency in small business lending bill to protect entrepreneurs from predatory lending, SB 1235. CAMEO believes that the access to capital issue has moved beyond access to 'appropriateness' of capital, i.e., capital that is affordable for the small business, is something that the small business can pay back and will help it grow, not force it into bankruptcy. We support a federal truth-in-lending bill and would welcome this committee's inquiry into the feasibility of such a bill.

Thank you for inviting me to testify here today. I look forward to answering any questions you may have.

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[7] SBA FY19 Congressional Budget Justification Report (2018).

[8] United States Department of Labor, Bureau of Statistics, Business Employment Dynamics, available at https://www.bls.gov/bdm/entrepreneurship.htm.

[9] Friends of the SBA Microloan Program, 2018 Report on the SBA Microloan Program, available at http://www.rapoza.org/wp-content/uploads/2018/10/SBA-Micro-Report-write-up-final.pdf.