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Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

MEMORANDUM

To:	Members, Subcommittee on Economic Growth, Tax, and Capital Access
From:	Sharice Davids, Chairwoman
Date:	April 29, 2021
Re:	Subcommittee on Economic Growth, Tax, and Capital Access Hearing: "Supply Chain Resiliency and the Role of Small Manufacturers"

The Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access will meet for a remote hearing titled "Supply Chain Resiliency and the Role of Small Manufacturers." The hearing is scheduled to begin at **1:00 P.M. on Thursday, April 29, 2021 virtually via the Zoom platform (information to be provided)**.

The COVID-19 pandemic exposed many weaknesses in the supply chains relied on by small businesses, especially small manufacturers. As the economy continues to recover, Congress must take steps to maximize supply chain resiliency for future economic disruptions. The hearing will allow Members to examine the impact the COVID-19 pandemic had on supply chains for small businesses, especially those in the manufacturing industry. The hearing will also discuss the challenges small manufacturers expect to face in the post-COVID economy, and the role of the U.S. Small Business Administration (SBA) lending and investment programs.

Panel:

- Mr. Claudio Dente, President, DenTec Safety Specialists, Lenexa, KS;
- Mr. Wes Hampp, Co-Founder and Managing Partner, Holleway Capital Partners, LLC, Overland Park, KS;
- Ms. Kimberly Glas, President and CEO, National Council of Textile Organizations, Washington, DC; and
- Mr. David Taylor, President and CEO, Pennsylvania Manufacturers' Association, Harrisburg, PA

Background

The COVID-19 pandemic exposed many weaknesses in global supply chains, especially those relied on by small businesses. Economic shutdowns to slow the spread of the virus caused shortages in nearly every industry including medical supplies, clothing, electronic components, and agriculture. A vast shortage in personal protective equipment (PPE), such as masks, gowns, and gloves, forced medical professionals on the front lines fighting the pandemic to improvise with

garbage bags as gowns and coffee filters as masks.[1] Nearly 80 percent of U.S. businesses experienced a disruption in their supply chain due to the pandemic, with small businesses operating on thin margins facing particularly difficult challenges.[2]

As a result of increasing globalization, supply chains have become vastly complex, and can vary significantly from product to product. Small businesses are particularly vulnerable to supply chain disruptions, as they typically have limited inventory and depend on lower costs from overseas suppliers. However, they can also be an important part of ensuring a resilient supply chain. Small firms are often more nimble than large companies and can adapt quickly to adjusting market conditions by finding different suppliers rapidly. Small firms with strong awareness of supply and demand flows, bottlenecks, interconnections, and interdependencies are better prepared for future economic disruptions, such as that caused by the COVID-19 pandemic, and also have the ability to adapt their business models to meet new demands. They can also help source goods locally for government contracts, and quickly shift their manufacturing, distribution, and sales capacity to fit community needs, such as distillers making hand sanitizer, or small manufacturers making PPE.

Current Issues

Manufacturing Sector Adapting to COVID-19

The overall manufacturing sector could take longer than five years to recover to pre-crisis GDP levels, depending on the economic impact of the COVID-19 pandemic.[3] For example, factories will need to adapt to address the operational challenges of meeting health and sanitation requirements.[4] To protect workers, manufacturing floors may need to be reconfigured to allow physical distance between workers.[5] Further, factories may also consider experimenting with a "pod" system, assigning operators to fewer machines but giving them greater responsibility for tasks within their work areas.[6] Such a system can reduce contact with staff and equipment outside the pod.[7] Both modified physical infrastructure and optimized operating procedures limiting the number of individuals each worker must interact with will help meet physical distancing guidelines.[8] In many cases, workers will also require additional PPE and regular health testing, including temperature checks prior to entering the building.[9]

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[1] Sophia Ankel, *Photos Show How Shortages are Forcing Doctors and Nurses to Improvise Coronavirus PPE from Snorkel Masks, Pool Noodles, and Trash Bags*, BUSINESS INSIDER, (Apr. 23, 2020), https://www.businessinsider.com/photos-show-doctors-nurses-improvising-due-to-lack-of-ppe-2020-4#but-these-measures-dont-always-work-several-nurses-in-the-uk-who-were-forced-to-wear-trash-bags-during-their-shifts-tested-positive-for-the-virus-while-one-nurse-in-new-york-died-3.

[2] Jack Keough, *Pandemic has Caused Supply Chain Disruptions for 80% of U.S. Businesses*, INDUSTRIAL DISTRIBUTION, (Jun. 11, 2020), https://www.inddist.com/supply-chain/article/21131454/keough-pandemic-has-caused-supply-chain-disruptions-for-80-of-us-businesses.

[3] André Dua et al., *US small-business recovery after the COVID-19 crisis*, MCKINSEY & CO. PUBLIC SECTOR PRACTICE, (Jul. 2020), https://www.mckinsey.com/industries/public-and-social-sector/our-insights/us-small-business-recovery-after-the-covid-19-crisis.

[4] *Id*.

[5] *Id*.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] *Id*.

The most effective way for small businesses to meet new hygiene and safety expectations is to design effective contactless experiences.[10] However, for many firms, adopting the new technology facilitating contactless experiences will require significant changes.[11] In manufacturing, the scale of the necessary digital shift is massive.[12] Between 40 and 50 percent of U.S. manufacturing assets will require upgrading for digital readiness, and the transition may come sooner now that COVID-19 has disrupted the sector.[13] Additionally, other technological investments, such as digital training courses for workers, digital floor walks, and performance-management tools to reduce in-person check-ins, may become necessary.[14] Because smaller, lower-tier supplier businesses are the least technologically enabled today, much of the potential gains from digital adoption in the manufacturing sector lies with them.[15]

Access to Capital for Small Manufacturers

For small manufacturers, the portion of working capital tied up in inventory often adds up to 20 percent of sales.[16] Many also have the added cost of servicing debt as they tend to rely heavily on financing for their investment and working-capital needs—and indebtedness is high.[17] McKinsey's survey of more than 1,000 small businesses suggests the cost of debt service is, on average, 30 percent of revenue for small manufacturers, 11 percentage points higher than for more financially resilient industries, such as high-skilled professional, scientific, and technical services.[18]

With respect to accessing capital, small manufacturers are uniquely challenged compared with their larger counterparts.[19] This was made worse in the COVID-19 era by the need to adapt to rapidly changing supply chains and meet new hygiene and safety expectations for employees.[20] With greater challenges investing in equipment and facility upgrades, small and medium-size manufacturing companies have about 40 percent lower productivity relative to large businesses.[21] Operational modifications are costly—particularly when significant changes to a factory layout are required—and small firms have limited cash on hand to invest in such changes.[22] For those unable to fund necessary safety modifications immediately, operating at partial capacity, which carries its own cash-flow implications, may be the only viable option.[23] Among small manufacturers, two decades of revenue growth at roughly one-fifth the pace of larger manufacturers make smaller businesses less attractive than larger ones to investors.[24] Without

[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*

capital inflow, small manufacturers will find it difficult to fund the upgrades needed to bring their production lines into the modern era of tech-enabled manufacturing.[25]

SBA Capital Access options for small manufacturers

SBA offers numerous programs intended to ease access to capital for small businesses. Manufacturing represents a considerable portion of three SBA capital access/investment programs: the 7(a) Loan Guaranty Program, the 504/CDC Loan Guaranty Program, and the Small Business Investment Company (SBIC) Program.

7(a) Loan Guaranty Program

The 7(a) loan guaranty program, administered by SBA's Office of Capital Access, is SBA's flagship loan product. These loans are made by SBA lending partners (mostly banks and credit unions but also some other financial institutions) and partially guaranteed by SBA.[26] 7(a) loan proceeds may be used for fixed assets (real estate and equipment), working capital, financing start-ups, purchasing an existing business, and for other limited purposes.[27] The maximum loan amount is $5 million.[28] Loan maturity is between 5 and 7 years for working capital, and up to 25 years for equipment and real estate.[29] For all other purposes, the maximum term is 10 years.[30] The current guaranty rate is 85 percent for loans of $150,000 or less and 75 percent for loans greater than $150,000 (up to a maximum guaranty of $3.75 million – 75 percent of $5 million).[31] Lenders are allowed to charge borrowers a reasonable fixed interest rate or, with SBA's approval, a variable interest rate.[32] The 7(a) program has several specialized programs that offer streamlined and expedited loan procedures for particular groups of borrowers, including the SBA Express program (for loans of $350,000 or less), the Export Express program (for loans of up to $500,000 for entering or expanding an existing export market), and the Community Advantage pilot program (for loans of $250,000 or less), which is designed to target mission-based lenders and small businesses in traditionally underserved communities.[33]

The Coronavirus Aid, Relief, Economic Security (CARES) Act[34] temporarily increased the SBAExpress loan limit from $350,000 to $1 million. The Economic Aid Act[35] extended the temporary increase in the SBAExpress loan limit from $350,000 to $1 million (reverting to $500,000 on October 1, 2021), increased the SBAExpress guaranty rate for loans of $350,000 or less from 50 percent to 75 percent in FY2021, waived the SBA's fees for the 7(a) and 504/CDC loan guaranty programs in FY2021, and increased the 7(a) program's guaranty rate from 85 percent

[25] *Id.*
[26] Congressional Research Service, *Small Business Administration 7(a) Loan Guaranty Program*, RL41146 (Feb. 25, 2021).
[27] *Id.*
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] P.L. 116-136.
[35] P.L. 116-260.

for loans of $150,000 or less and 75 percent for loans greater than $150,000 (up to a maximum guaranty of $3.75 million—75 percent of $5 million) to 90 percent in FY2021.

In FY2020, SBA approved 42,302 7(a) loans totaling over $22.5 billion.[36] Manufacturers received 3,054 of those loans (7.2 percent), totaling approximately $2 billion (9 percent).[37]

504/CDC Loan Guaranty Program

The 504/CDC loan guaranty program, also administered by SBA's Office of Capital Access, is delivered by Certified Development Companies (CDCs), which are private, nonprofit corporations established to contribute to the economic development within their local communities.[38] Each CDC has its own geographic territory.[39] The program provides long-term, fixed-rate loans for major fixed assets such as land, structures, machinery, and equipment.[40] 504/CDC loan proceeds cannot be used for working capital, inventory, or repaying debt.[41] Under the program, a commercial lender (typically a bank or credit union) provides up to 50 percent of the financing, which is secured by a senior lien.[42] The CDC's loan of up to 40 percent is secured by a junior lien.[43] The SBA backs the CDC with a guaranteed debenture.[44] The small business must contribute at least 10 percent as equity.[45] To participate in the program, small businesses cannot exceed $15 million in tangible net worth and cannot have average net income of more than $5 million for two full fiscal years before the date of application.[46] Also, CDCs must intend to create or retain one job for every $75,000 of the debenture ($120,000 for small manufacturers) or meet an alternative job creation standard if they meet any one of 15 community or public policy goals (one of which includes assisting manufacturing firms).[47]

The Economic Aid Act[48] modified 504/CDC refinancing regulations to expand borrower access to the refinancing program and create reciprocity for refinancing under the 7(a) and 504/CDC programs, and temporarily authorized SBA, through September 30, 2023, to establish a 504/CDC Express Loan program to expedite the approval of 504/CDC loans that do not exceed $500,000.

[36] U.S. Small Bus. Admin., *Weekly Approvals Report with data as of 09/30 for each FY*, (Sep. 30, 2020), https://www.sba.gov/sites/default/files/2020-10/WebsiteReport_asof_20200930-508.pdf.
[37] U.S. Small Bus. Admin. Office Capital Access, *FOIA Frequently Requested Records: 2010-Present SBA 7a Loan Data*, (Feb. 24, 2021), https://data.sba.gov/dataset/2010-present-sba-7a-loan-data.
[38] Congressional Research Service, *Small Business Administration: A Primer on Programs and Funding*, RL33243 (Mar. 18, 2021).
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] P.L. 116-260.

On April 15, 2021, the House of Representatives passed the 504 Modernization and Small Manufacturer Enhancement Act of 2021,[49] which among other things, increases the maximum loan size for manufacturers from $5.5 million to $6.5 million, provides decreased project costs for small manufacturers, eases the job creation or retention requirements for small manufacturers, and requires coordination with SBA District Offices to provide entrepreneurial development assistance and training to manufacturing small businesses.

In FY2020, SBA approved 7,119 504/CDC loans totaling over $5.8 billion.[50] Manufacturers received 802 of those loans (11.3 percent), totaling approximately $832 million (14.2 percent).[51]

Small Business Investment Company (SBIC) Program

The SBIC program, administered by SBA's Office of Investment and Innovation, is designed to enhance small business access to venture capital by stimulating and supplementing the flow of private equity capital and long-term loan funds.[52] SBA partners with privately owned and managed SBICs licensed by SBA to provide financing to small businesses with private capital raised by the SBIC (regulatory capital) and with funds (leverage) the SBIC borrows at favorable rates because SBA guarantees the debenture (loan obligation).[53] SBICs provide equity capital to small businesses in various ways, including by:

- Purchasing small business equity securities (e.g., stock, stock options, warrants, limited partnership interests, membership interests in a limited liability company, or joint venture interests);
- Making loans to small businesses, either independently or in cooperation with other private or public lenders, that have a maturity of no more than 20 years;
- Purchasing debt securities from small businesses, which may be convertible into, or have rights to purchase, equity in the small business; and
- Providing small businesses, subject to limitations, a guarantee of their monetary obligations to creditors not associated with the SBIC.[54]

In FY2020, SBICs made 2,533 financings to 1,063 small businesses.[55] The average financing amount was $1,928,504.[56] SBA has not published SBIC investments broken down by industry in recent fiscal years.[57] The most recent publicly available data breaking down SBIC investments by

[49] 504 Modernization and Small Manufacturer Enhancement Act of 2021, H.R. 1490, 117th Cong. (2021).
[50] U.S. Small Bus. Admin., *Weekly Approvals Report with data as of 09/30 for each FY*, (Sep. 30, 2020), https://www.sba.gov/sites/default/files/2020-10/WebsiteReport_asof_20200930-508.pdf.
[51] U.S. Small Bus. Admin. Office of Capital Access, *FOIA Frequently Requested Records: 1991-Present SBA 504 Loan Data*, (Feb. 24, 2021), https://data.sba.gov/dataset/1991-present-sba-504-loan-data.
[52] Congressional Research Service, *SBA Small Business Investment Company Program*, R41456, (Feb. 19, 2021).
[53] *Id.*
[54] *Id.*
[55] *Id.*
[56] *Id.*
[57] *See* Gregory W. Brown et al., *Filling the U.S. Small Business Funding Gap*, p. 9, UNIVERSITY OF NORTH CAROLINA INSTITUTE FOR PRIVATE CAPITAL, (Feb. 2020), https://uncipc.org/wp-content/uploads/2020/02/FundingGap_02042020.pdf ("Unfortunately, we do not have data from the SBA for [2014-2018] by industry or by business ownership type.").

industry is from FY2011-15, showing that during that period, 27.3 percent ($5.8 billion) of SBIC financing dollars ($21.3 billion) went to small firms in the manufacturing industry, for an annual average of $1.16 billion.[58]

Conclusion

The COVID-19 pandemic exposed many weaknesses in global supply chains. Small manufacturers were especially hurt by the interruptions caused by COVID-19, made worse by the challenges they've historically faced in accessing affordable, long-term capital. SBA offers numerous loan and investment programs (7(a) loan program, 504/CDC loan program, and SBIC program) intended to improve access to capital for small businesses. These programs can be useful for small manufacturers in adapting to the post-COVID economy, especially in making the upgrades needed to help meet new safety and hygiene expectations.

[58] John Paglia & David T. Robinson, Fed. Res. Div.-Libr. of Congress, *Measuring the Role of the SBIC Program in Financing Small Businesses*, (Jul. 2017), https://www.sba.gov/sites/default/files/2019-08/SBA_SBIC_Financing_Small_Business.pdf.