Statement for the Record

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Subcommittee on Economic Growth, Tax, and Capital Access

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Chair Davids, Ranking Member Meuser, and Members of the Subcommittee, thank you for inviting me to testify at this important hearing.

My name is Wes Hampp, and I am a Co-founder and a Managing Partner at Holleway Capital Partners ("Holleway"). Holleway is a Small Business Investment Company ("SBIC") founded in 2018 by my partner Holly Huels and me that focuses on supporting the growth of small manufacturing businesses. While we are technically a first-time fund, the two founding practitioners each have been in the SBIC program for over 20 years and have built their careers investing in American small businesses. My partner Holly was the first woman chairperson of our trade association, the Small Business Investor Alliance (SBIA), and Holleway is one of the small but growing number of SBICs co-founded by a woman.

After working inside of larger institutions for 20+ years, Holly and I decided the time was right to take an entrepreneurial path, using our SBIC experience, investment knowledge, and track record to start a new Midwest-based fund. I am excited to talk about our business model and the SBIC program, which has allowed our team to stay focused on providing capital to small businesses in the manufacturing sector and navigating them through growth and increased employment, including during the ongoing COVID-19 pandemic.

My testimony provides fuller details about these key points I want to highlight regarding supply chain resiliency and the role of small manufacturers:

- COVID-19 exposed several key weaknesses in U.S. supply chains that need to be addressed in order to reduce our over-reliance on foreign goods to produce the critical products we need.
- The SBIC program is a vital source of patient capital (particularly equity capital) for small businesses to help them grow and create jobs.

<u>Holleway's Investment Strategy and Criteria</u>

Holleway is headquartered in St. Louis, MO with an office in Kansas City, KS. We focus on investing in small manufacturers and distributors of industrial products in the middle of the country, including the Midwest, Plains, Rocky Mountains, and the South.

Over the last 25 years, the principals of Holleway have invested in over 50 companies, with the vast majority of investments in small manufacturing concerns. We have retained or created thousands of jobs over our careers, many in smaller communities throughout the Greater Midwest. We have lived through several economic downturns, including the Great Recession, and now we can add a global pandemic to our library of investment experiences.

Some examples of recent small business investments include a manufacturer of wildland firefighting equipment and apparatus based in Arvada, CO, an industrial electronics manufacturer based in Detroit, MI and an overhead door distribution and installation company based in San Antonio, TX. All of our companies were impacted by COVID and have experienced international and domestic supply chain issues.

<u>SBIC Program Overview</u>

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 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]

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.[2] SBICs completed $630 million in financings to small businesses in December 2020, which was a 25 percent jump from $500 million in December 2019.[3]

At the end of fiscal year 2020, the SBIC program included more than 300 licensed funds.[4] 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.[5]

A recent 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.[6] The program is also structured so that the private capital is in first-loss position. This is an added safeguard to protect taxpayer dollars. Because of this structure, the SBIC program has operated at zero subsidy for over twenty years. A recent study on the SBIC program by the American Action Forum called it "one of the most successful public-private partnerships in U.S. history."[7]

Weaknesses in U.S. Supply Chains

Over-Reliance on Foreign Supply Chains and the Need to Invest in American Manufacturing

The COVID-19 pandemic exposed glaring weaknesses in U.S. supply chains and the need to have more domestic manufacturing. 60 years ago, the United States was the manufacturing engine of the world, but in 2020, we were unable to make adequate supplies of paper masks. A year after the pandemic, there are still mass shortages of simple manufactured products, like wood fence posts, as well as advanced computer processing chips. Manufacturing competitiveness and innovation does not happen in a vacuum or happen on demand. The entire manufacturing ecosystem needs to be supported because innovation comes from doing and not by government or corporate command. We need policies that focus on supporting manufacturing with an emphasis on small business investment. Tomorrow's large and advanced manufacturers are small businesses today.

COVID-19 exposed our massive overreliance on China's supply chain, not just for PPE and medical supplies, but also in nearly all industry sectors. When COVID-19 disrupted supply chains from China, we faced and still face massive disruptions at home. U.S. businesses compete successfully in a global economic environment and there are positive economic arguments for global supply chains, but the COVID-19 pandemic exposed an urgent need for supply chain diversification and more domestic manufacturing of all types of products to reduce our reliance on certain imports critical for public health and necessary to

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[1] Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.
[2] *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).
[3] Id.
[4] SBA – *SBIC Program Overview* at 2 (Sept. 30, 2020). Accessed Feb. 1, 2021 (unpublished).
[5] Id. SBA estimates jobs created or sustained using "The 1999 Arizona Venture Capital Impact Study" (confirmed by the DRI-WEFA study of 2001) whereby one (1) job is created for every $36,000 of SBIC investment (adjusted for inflation).
[6] 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>.
[7] Wade, The Small Business Investment Company Program: A Primer (March 2021) https://www.americanactionforum.org/insight/the-small-business-investment-company-program-a-primer/

sustain our economy. The nation that built its way out of World War II needs a manufacturing base that is robust and not hollowed out.

At Holleway, our portfolio companies do not source a large quantity of products from overseas suppliers, however, the products which they do source overseas have become more expensive, have longer lead times, and are seeing more quality issues. COVID-19's disruptions have illustrated the risk of reliance on overseas supply chains. While it may be cheaper to source products overseas, the pandemic illuminated a trade-off between costs and sourcing products from thousands of miles away.

Symbiosis of Small and Big Businesses – The Mismatched Recovery

Manufacturing is an ecosystem with small and large businesses interacting and mutually benefitting from each other. Large U.S. businesses contract with smaller domestic companies. Likewise, small businesses buy products and materials from large businesses. Small and large need each other to operate and are part of a mutually beneficial domestic supply chain. As a small business investor, we are focused on small manufacturers, but we know the critical role large companies play as both suppliers and customers for our small businesses. Both large and small need to be healthy.

Similar in nature to the global supply chain issues discussed, domestic supply chains are also in a state of chaos. Prices are rising, and lead times have been extended. In some cases, we are seeing prices rise 25% week to week, inputs simply not available for months instead of weeks, or in some cases not available at any price for the foreseeable future. Anecdotally, we hear this is generally COVID-19 related in a few ways. First, international supply chain issues. Second, some companies are actually seeing more COVID-related illness among the workers in the plants in 2021 than they did in 2020. Third, larger companies that supply products to our smaller manufacturing companies stopped making growth investments as COVID-19 hit last year, shuttered capacity in anticipation of a global recession, or even laid off employees given the uncertainty. As demand rebounded in late 2020 and so far in 2021, these larger suppliers are now struggling to hire and train employees to ramp up output and meet demand. As a result, prices are going up, and even after a year and at this stage of the recovery, lead times for some orders at our portfolio companies are 12 weeks or longer (which is at least *four times longer* than pre-pandemic), creating serious delays and disruptions.

It should be noted that the availability of financing through the Paycheck Protection Program (PPP) helped stabilize the financial uncertainty many small businesses faced in the early days of the pandemic. PPP loans/grants were a small business lifesaver that kept employees paid – but equally important – kept employees connected to their small business employers. Maintaining this connection helped many small businesses survive and left them in a position to quickly restart and recover because their workforce was intact. Without PPP, many small manufacturers we work with would have laid off employees and struggled to rehire in order to restart. However, the supply chain disruption was an unintended consequence of limiting PPP to small businesses. PPP allowed many small businesses to surge back, but many of their large company suppliers had lost their workforce and were/are unable to quickly restart and return to pre-pandemic production levels. Without the subsidy to make an anti-economic decision to keep paying their workforce during a prolonged economic stoppage, large businesses were forced to cut their workforce, which led to domestic supply chain disruptions and a severe reduction in productivity nationwide of the raw materials and upstream products that many of those small manufacturers needed. PPP was a smashing success for small businesses and employees of small businesses, but there was no similar tool available to upstream manufacturers.

Labor Shortages

The biggest challenge facing our small business portfolio and across the small business space is labor supply. These small manufacturers are unable to find employees to fill the open positions, which is hindering growth. This issue is more acute for unskilled/entry level positions, but it is a challenge for skilled labor as well. In some cases, our companies have raised the starting wages 20%, and yet open positions remain unfilled. Increased unemployment insurance payments appear to have created a disincentive for labor to return to the workplace. Whether this is a result of current unemployment policy or just not enough workers in this country, this is a material issue for the long-term viability of manufacturing in the US.

I should note that in addition to good salaries, we prioritize the health and safety of our employees. From the outset of the pandemic, Holleway did everything we could to provide PPE for our portfolio's employees and did our best to maintain social distancing in order to keep people working. We made sure people were sent home and isolated for the required amount of time, with pay, if they were exposed to COVID-19 or tested positive.

Solutions to Supply Chain Challenges in Manufacturing

1. **Ensuring that Small Businesses Have Access to Patient Capital (with a Particular Focus on Equity Capital)**.

Access to long term "patient" capital is critical for domestic small businesses in order to keep the U.S. competitive and strengthen supply chains. Businesses that have long term capital are far more likely to be able to adapt to changing markets and to survive economic downturns.

Since SBICs invest exclusively in domestic companies (and heavily in the manufacturing sector) and are largely prevented from offshoring because they may not pursue a strategy that increases domestic unemployment , they are an excellent vehicle to get capital to small manufacturers. SBIC also are unique in that instead of concentrating their investments in the metro areas, SBICs invest in all geographic regions of the country – big cities and small towns, big states and small states. Congress and the Administration should support policies that reward and encourage SBIC investments and not do anything to hinder the program's success, such as:

- timely appointment of a leader for SBA's Office of Investment and Innovation ("OII") – the position has been open for over 6 months – to supplement the strong career leadership already present within OII
- providing adequate staffing (SBIC frontline regulators are managing over 45 SBICs per regulator when they are supposed to manage about 10 – a 4.5X staffing overload),
- licensing more small SBIC funds in underserved geographies,
- continuing to streamline the SBIC licensing process (particularly for repeat licensees),
- providing adequate resources for the SBA OII's Information Technology (no one in the private sector would be managing $33 Billion with an Excel spreadsheet and an Access database),
- encouraging SBA to get comfortable with more equity-oriented investing,
- removing unintentional barriers to inclusivity by having more clear, objective licensing standards and by making decisions based on the official record; and
- releasing an SBIA annual report with industry sector, geographic region, and performance data.

Congress and the Administration should also support more equity investing in U.S. small businesses like manufacturing because it encourages long-term, patient capital investments in those companies that otherwise rely on debt financing. Debt financing requires interest payments, which takes money out of the business, but equity financing lets businesses use all their available cash to grow the business in exchange for equity ownership. The SBIC program is more debt-oriented, with less emphasis on equity investing. Congress should provide more tools to allow for more equity investments.

2. **Pro-Small Business Tax Policy - Capital Gains Taxes**

Congress should write tax policies that encourage, not discourage, long-term investing in America's small businesses and small manufacturers. Doubling the capital gains rate for anyone with an annual income over a million dollars would be a major setback for entrepreneurs or those that are considering starting a small business, particularly a manufacturer. Small business owners build their small business over years (and in some cases the majority of their lifetime), and they typically get to sell that investment once. When they sell their business, they take the money and either retire or start a new business. Manufacturing has significant start-up costs and often expensive machinery. When an entrepreneur sells their business, they are commonly going to have more than $1 million in income for that year – and it may be all the money they may have to live on for the rest of their life. Unlike government employees, most small business owners do not have pensions, and many have the eventual sale of their business as nearly all of their retirement plan. Before Congress doubles the capital gains rate, I would implore you to consider what doing so would do to small businesses and small manufacturers, because the story that $1 million income makes a person "rich" ignores the irregular, and probably one time, in a person's life that this may occur.

Long term capital gains are also a critical part of attracting and retaining talented leaders in growing small businesses. People that are key to the growth of a small business are commonly granted ownership incentives to come to work at and/or stay with the small businesses. Doubling the capital gains tax removes the benefit of sticking with a small business. If all the income is going to be taxed the same, then it is easier and less risky to work for a big business, get paid more, keep the same amount of after-tax take home pay, and not be personally vested in the business because the person will always be an employee and never an owner.

If capital gains taxes are raised, then there should be serious consideration given to investments in American small businesses, including manufacturers. We need more, not less, investment in American small businesses, particularly domestic manufacturing.

3. **Encourage Expanded Workforce Development for Skilled Trades.**

In addition, as a nation we should urge our leaders in government at all levels, business, and education to promote and provide opportunities for all interested persons to learn skilled trades by supporting apprenticeships and technical education.

As mentioned previously, our portfolio companies, and those of many others in the SBIC space, are struggling to find both skilled and unskilled workers, but skilled workers are extremely difficult to find. It is one of the biggest problems in the manufacturing sector, and it is holding back small business growth and national economic growth. A four-year college degree is not for everyone. People can make a good living in trades that support manufacturing and contribute to our country's economic success. Congress should support practical opportunities to encourage more young people to pursue this route out of high school to help fill these needs in manufacturing.

Conclusion

The U.S. is at a critical juncture, and our supply chains need to be strengthened in order for us to compete globally and meet our needs domestically. The SBIC program is perfectly situated to provide much needed capital to small manufacturers to help them lead the way in producing innovative products that continue to spur America's growth through the 21st century.

Thank you again for the opportunity to testify before the Subcommittee.

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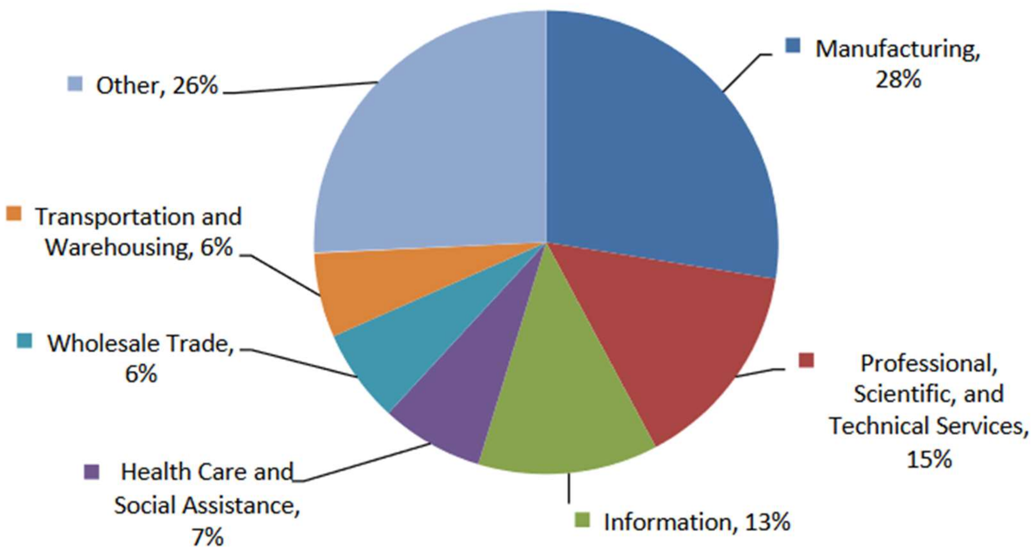
Distribution of SBIC Financing Dollars by Industry
FY 2010-2014
(SBA has not released updated data on this subject since 2016)

Exhibit 4-7: Distribution of SBIC Financing Dollars by Industry Reported FY 2010-2014
Total SBIC Financings = $17.1 Billion



** Numbers will not add to 100% due to rounding.*