

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

MEMORANDUM

TO: Members, Subcommittee on Economic Growth, Tax, and Capital Access
FROM: Sharice Davids, Chairwoman
DATE: October 27, 2021
RE: Subcommittee Hybrid Hearing: “A Review of the SBIC Program”

The Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access will meet for a hybrid hearing titled, “A Review of the SBIC Program.” The hearing is scheduled to begin at **10:00 A.M. on Wednesday, October 27, 2021 in person in Room 2360 of the Rayburn House Office Building, and virtually via the Zoom platform.** The hearing will educate Members about the Small Business Administration’s (SBA) Small Business Investment Company (SBIC) program, which is designed to provide debt and equity financing to high-growth small businesses lacking access to adequate capital from traditional sources. Members will have an opportunity to discuss recent proposals to target SBIC funds to underrepresented businesses and critical sectors, as well as ways to improve investor diversity in the program. The witnesses will be:

Panel

- Ms. Holly Huels, Founder and Managing Partner, Holleway Capital Partners, LLC, St. Louis, MO
- Mr. Carl Kopfinger, Senior Vice President, TD Bank, Philadelphia, PA
- Ms. Carmen Palafox, Partner, MiLA Capital, Chatsworth, CA
- Mr. John Mickelson, Managing Partner, Midwest Growth Partners, West Des Moines, IA

Background

SBA administers programs to support small businesses, including investment programs designed to provide high-growth small businesses with access to financial capital and research and development funds to develop commercially viable innovations.¹ Authorized by the Small Business Investment Act in 1958,² the SBIC program 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.

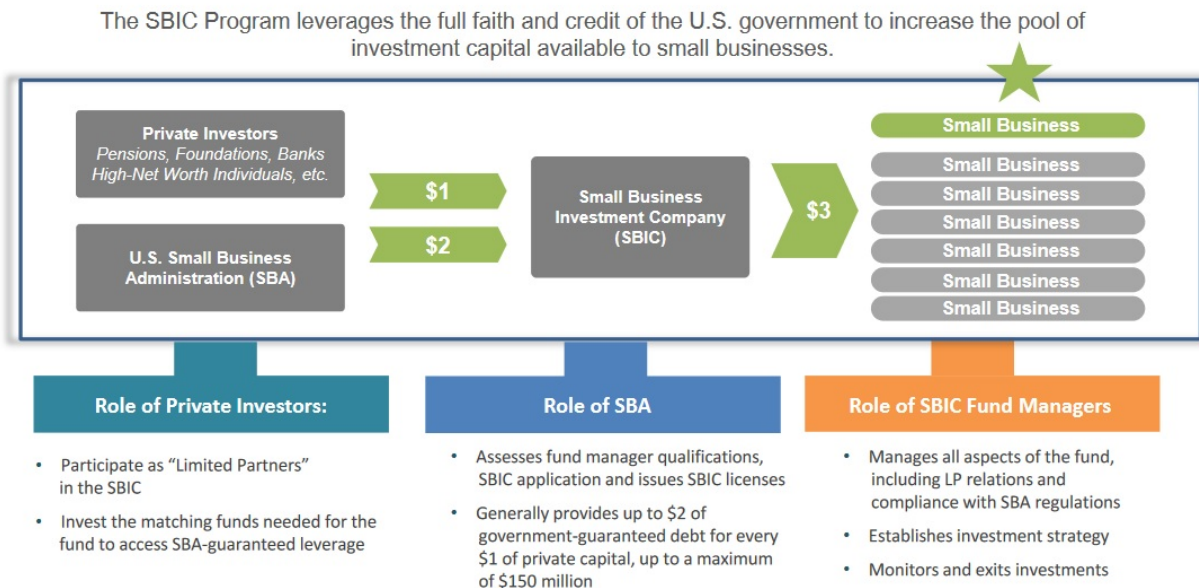
Program Overview

Under the SBIC program, SBA partners with privately owned and managed SBICs licensed by SBA to provide financing to small, high-growth companies with private capital raised by the SBIC

¹ U.S. Small Bus. Admin., Off. of Investment and Innovation, <https://www.sba.gov/offices/headquarters/ooi>.

² 15 U.S.C. § 681 *et seq.*

(regulatory capital) and with funds (leverage) the SBIC borrows at favorable rates because SBA guarantees the debenture (loan obligation). SBICs provide capital to small businesses in various ways, including by purchasing equity securities and convertible debt securities, making loans, and providing a guarantee of monetary obligations to other creditors.³



Source: Small Business Administration

Program Statistics

From the inception of the SBIC program to December 31, 2020, SBICs have invested approximately \$108.3 billion in approximately 186,412 financings to small businesses.⁴ As of September 30, 2021, there were 307 licensed SBICs in operation (including 235 debenture SBICs and 56 bank-owned, non-leveraged SBICs).⁵ As of September 30, 2021, SBA had a guarantee on an outstanding unpaid principal balance of \$10.9 billion in SBIC debentures and outstanding commitments on \$4.2 billion in SBIC debentures.⁶ As of September 30, 2021, the SBIC program had invested or committed about \$34.2 billion in small businesses, with SBA’s share of capital at risk about \$14.6 billion.⁷

In FY 2020, SBICs made 2,533 financings to 1,063 small businesses (262 of which are owned by women, veterans, or minorities, or are located in low- and moderate-income areas), with an average

³ 13 CFR § 107.800; 13 CFR § 107.810; 13 CFR § 107.815; 13 CFR § 107.820.
⁴ U.S. Small Bus. Admin., *Offering Circular, \$1,095,675,000, Guaranteed 1.667% Debenture, Participation Certificates, Series SBIC 2021-10 A*, (Mar. 6, 2021), p. 9, <https://www.sba.gov/sites/default/files/2021-03/SBIC%202021-10A%20Offering%20Circular%20%28SBA%20Website%29-508.pdf>.
⁵ U.S. Small Bus. Admin., *Small Business Investment Company (SBIC) Program Overview Report as of September 30, 2021*, (Oct. 15, 2021), <https://www.sba.gov/document/report-small-business-investment-company-sbic-program-overview-report-september-30-2021> [hereinafter “SBIC FY21 program data”].
⁶ SBIC FY21 program data, *supra* note 5.
⁷ SBIC FY21 program data, *supra* note 5.

financing amount of \$1,928,504.⁸ In FY 2020, SBIC funds were used primarily for operating capital (43.1%) and acquiring an existing business (37.4%).⁹ Other uses included refinancing or refunding debt (5.6%), research and development (2.1%), purchasing machinery or equipment (1.5%), marketing activities (1.3%), new building or plant construction (0.6%), plant modernization (0.4%), and other uses (8%).¹⁰

In FY 2020, SBA's Office of Investment and Innovation (OII) licensed 26 new SBICs, an improvement over the FY 2019 total of 18.¹¹ In FY 2021, OII licensed 32 new SBICs, exceeding the total new licensees from the previous fiscal year.¹²

Financing to Underrepresented Groups

Diversity has long been an issue in the SBIC program. In 2007, SBA acknowledged at a hearing in this Committee that “women and minority participation [in the SBIC program] is low.”¹³ Further, in 2009 the Small Business Investor Alliance (SBIA) testified that SBA's SBIC licensing process “has done an abysmal job at attracting and licensing funds led by women and minorities.”¹⁴ The program's diversity numbers have not improved since 2007. In FY 2020, SBICs made about 5% of their total financing to minority-owned small businesses, totaling approximately \$244 million.¹⁵ Additionally, in FY 2020, SBICs made about 3% of total financings to women-owned small businesses and about 1% of total financings to veteran-owned small businesses.¹⁶

Library of Congress Report on Diversity Within the SBIC Program

In 2015, SBA contracted with the Federal Research Division (FRD) of the Library of Congress to conduct an independent evaluation of the SBIC program. FRD enlisted the aid of two experienced scholars with experience in financial markets to perform the research. The researchers prepared and issued three reports: one on diversity within the program, another on the program's role in small business job creation, and the final on the program's role in financing small businesses. The FRD report on diversity within the SBIC program noted that SBICs have better racial and gender diversity in leadership positions compared to the private equity (PE) community.¹⁷ In addition, they found that racially diverse SBICs make more investments in minority-led and minority-owned portfolio companies, as well as in women-led and women-owned businesses than non-racially

⁸ Congressional Research Service, *SBA Small Business Investment Company Program*, R41456, (Sep. 3, 2021) [hereinafter “CRS R41456”]; see also, U.S. Small Bus. Admin., *FY2022 Congressional Budget Justification and FY2020 Annual Performance Report*, p. 37 (2021).

⁹ CRS R41456, *supra* note 8.

¹⁰ CRS R41456, *supra* note 8.

¹¹ SBIC FY21 program data, *supra* note 5.

¹² SBIC FY21 program data, *supra* note 5.

¹³ *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs: Hearing Before the H. Comm. on Small Business*, 110th Cong. (2007) (statement of Hon. Steven C. Preston, Administrator, U.S. Small Business Administration).

¹⁴ *Full Committee Hearing on Increasing Access to Capital for Small Businesses: Hearing Before the H. Comm. on Small Business*, 111th Cong. (2009) (statement of Carolyn C. Galiette, Senior Managing Director, Ironwood Capital).

¹⁵ CRS R41456, *supra* note 8.

¹⁶ CRS R41456, *supra* note 8.

¹⁷ John Paglia & David T. Robinson, Fed. Res. Div.-Libr. of Congress, *Measuring the Representation of Women and Minorities in the SBIC Program* (Oct. 2016) https://www.sba.gov/sites/default/files/aboutsbaarticle/Measuring_the_Representation_of_Women_and_Minorities_in_the_SBIC_Program_2016_10.pdf (hereinafter “Paglia report”).

diverse SBICs.¹⁸ Notably, the researchers also found no evidence that gender-diverse or racially diverse SBICs perform better or worse than white-male-only-managed SBICs.¹⁹ Overall, the findings suggest that granting SBIC licenses to well-qualified gender-diverse and racially diverse funds increases the rates of investment into other women-led, women-owned, minority-led, minority-owned companies while also producing returns that are comparable to their non-diverse counterparts.²⁰ Taken together, the findings indicate that diverse populations are better served by and through a diverse team of fund managers.²¹

Current Issues

Build Back Better Act SBIC Provisions

On September 9, 2021, the House Small Business Committee approved the Small Business title of the Build Back Better Act. The package invests in a Venture Small Business Investment Company (VSBIC) subprogram within the SBIC program to provide patient capital to underserved markets and critical industries, such as infrastructure, manufacturing, clean energy, and childcare. It also invests in an Emerging Managers Program to pair less-experienced fund managers seeking their first SBIC license with highly experienced SBIC managers to provide guidance and advice. It invests in a “MicroCap” SBIC license allowing for less initial private sector investment to receive SBA leverage and requires a percentage of investments be made in underserved markets.

Micro-SBIC Legislation

On September 10, 2021, Rep. Chrissy Houlahan (D-PA) introduced H.R. 5225, the Micro-SBIC and Emerging Managers Program Act.²² The bill establishes a new license within the existing SBIC program for smaller funds that reduces management requirements to expand the pool of eligible fund managers. To improve fund manager diversity, the bill also establishes an Emerging Managers Program, similar to the one included in the Small Business title of the Build Back Better Act, through which less experienced managers and those with an emphasis on underrepresented markets can receive guidance and assistance from experienced fund managers. Studies have shown that granting SBIC licenses to well-qualified gender and racially diverse funds increase the rates of investment into underrepresented companies while also producing returns that are comparable to their non-diverse counterparts.²³ The Micro-SBIC license is intended to make it easier for less-experienced funds to access SBA leverage through the SBIC program with the goal to improve access to investment capital for diverse entrepreneurs. The bill is supported by small business advocates and program stakeholders, including SBIA.²⁴

Staffing Updates at SBA’s Office of Investment and Innovation

On August 18, 2021, SBA announced Ms. Bailey DeVries was appointed Associate Administrator (AA) for OII.²⁵ According to SBIA in testimony on June 9, 2021 before the Senate Committee on

¹⁸ Paglia report, *supra* note 17.

¹⁹ Paglia report, *supra* note 17.

²⁰ Paglia report, *supra* note 17.

²¹ Paglia report, *supra* note 17.

²² Micro-SBIC and Emerging Managers Program Act of 2021, H.R. 5225, 117th Cong.

²³ Paglia report, *supra* note 17.

²⁴ Small Business Investor Alliance, *SBIA Expresses Support for Rep. Houlahan’s “Micro-SBIC” bill*, Press Release, (Sep. 14, 2021), <https://www.sbia.org/news/sbia-expresses-support-for-rep-houlahans-micro-sbic-bill/>.

²⁵ U.S. Small Bus. Admin., *U.S. Small Business Administration Announces Key Staff*, Pres Release No. 21-71, (Aug. 18, 2021), <https://www.sba.gov/article/2021/aug/18/us-small-business-administration-announces-key-staff>.

Small Business and Entrepreneurship, the AA for OII was one of the last senior positions at SBA that remained vacant as of that time. Moreover, industry stakeholders testified that “staffing shortages in [OII] are severe and are not conducive to capital access or healthy oversight.”²⁶ According to the testimony, frontline SBIC regulators are currently regulating approximately 45 or more funds per operations analysts.²⁷ Analysts typically regulate only about 12 funds each due to the unique nature of each fund.²⁸

Conclusion

SBA’s SBIC program plays a unique role in the world of small business finance. It is a positive force in helping entrepreneurs grow their businesses and create jobs, and in making investment capital more broadly available across the country, serving geographic areas underserved by traditional private equity. This hearing will allow Members to learn more about the SBIC program as an engine of small business job creation, as well as recent proposals to modernize the program and make it more accessible for investors from underrepresented groups. It will also update Members on program management, and explore the concerns raised by program stakeholders regarding understaffing at OII.

²⁶ *Review of the Small Business Investment Company Program: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 117th Cong. (2021) (statement of Stacey R. Wittelsberger, Principal, Patriot Capital) [hereinafter “Wittelsberger testimony”].

²⁷ Wittelsberger testimony, *supra* note 26.

²⁸ Wittelsberger testimony, *supra* note 26.