SBA Small Business Investment Company Program

Robert Jay Dilger
Senior Specialist in American National Government

Oscar R. Gonzales
Analyst in Economic Development Policy

January 10, 2011

Congressional Research Service
7-5700
www.crs.gov
R41456

CRS Report for Congress
Prepared for Members and Committees of Congress
c11173008

Summary

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs to enhance small business access to capital; programs to increase small business opportunities in federal contracting; direct loans for businesses, homeowners, and renters to assist their recovery from natural disasters; and access to entrepreneurial education to assist with business formation and expansion. It also administers the Small Business Investment Company (SBIC) Program. Authorized by P.L. 85-699, the Small Business Investment Act of 1958, as amended, the SBIC program enhances small business access to venture capital by stimulating and supplementing "the flow of private equity capital and long term loan funds which small business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply." Facilitating the flow of capital to small businesses to stimulate the national economy was, and remains, the SBIC program's primary objective.

The SBA does not make direct investments in small businesses. It works with 307 privately owned and managed SBICs licensed by the SBA to provide financing to small businesses with private capital the SBIC has raised and with funds the SBIC borrows at favorable rates because the SBA guarantees the debenture (loan obligation).

SBICs pursue investments in a broad range of industries, geographies, and stage of investment. Some SBICs specialize in a particular field or industry in which their management has expertise, while others invest more generally. Most SBICs concentrate on a particular stage of investment (i.e., start-up, expansion, or turnaround) and identify a geographic area in which to focus.

The SBIC program currently has invested about $15.0 billion in small businesses, with about $8.7 billion raised from private capital and $6.3 billion guaranteed by the SBA. In FY2010, the SBA guaranteed $931 million in SBIC small business investments, and SBICs provided another $1.1 billion in investments from private capital, for a total of more than $2.0 billion in financing for 1,331 small businesses.

Congressional interest in the SBIC program has increased in recent years primarily because it is viewed as a means to stimulate economic activity, create jobs, and assist in the national economic recovery. However, there are disagreements concerning whether the program should target additional assistance to startup and early-stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation.

This report examines the SBIC program's structure and operation, focusing on SBIC eligibility requirements, investment activity, and program statistics. It also examines legislation considered during the 111th Congress, including H.R. 3854, the Small Business Financing and Investment Act of 2009, H.R. 5554, the Small Business Assistance and Relief Act of 2010, and P.L. 111-240, the Small Business Jobs Act of 2010, which address the following SBIC-related issues: (1) the targeting of additional assistance to startup and early-stage small businesses, (2) the SBA's management of the program's financial risk and its processing of SBIC applications, and (3) whether the program's financing levels are appropriate given the nation's current economic circumstances.

Contents

SBIC Program Overview 1
SBIC Types 2
SBIC Eligibility Requirements 2
SBIC Application Process 4
SBIC Investment Activity 5
SBIC Investments in Small Businesses 5
SBA Investments 7
Leverage 7
Debentures 8
Participating Securities 9
Reporting Requirements 11
SBIC Program Statistics 12
Total Financing 12
Financing to Specific Demographic Groups 14
Financing By State 16
Financing By Industry 17
Legislative Activity 19
Legislation to Target Additional Assistance to Startup and Early-Stage Small Businesses 19
Discussion 20
Legislation to Require Expedited SBIC Licensing Procedures 21
Discussion 22
Legislation to Increase SBIC Financing Levels 23
Discussion 24
Concluding Observations 25

Tables

Table 1. SBIC Financing, FY2005-FY2010 14
Table 2. SBIC Financing, Minority-Owned Small Businesses, FY2010 15
Table 3. SBIC Financing, By State, FY2010 17
Table 4. SBIC Financing, By Industry, FY2010 18

Appendixes

Appendix. Small Business Eligibility Requirements and Application Process 27

Contacts

Author Contact Information 29

SBIC Program Overview

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs to enhance small business access to capital; programs to increase small business opportunities in federal contracting; direct loans for businesses, homeowners, and renters to assist their recovery from natural disasters; and access to entrepreneurial education to assist with business formation and expansion.[1] It also administers the Small Business Investment Company (SBIC) Program. Authorized by P.L. 85-699, the Small Business Investment Act of 1958, as amended, the SBIC program enhances small business access to venture capital by stimulating and supplementing "the flow of private equity capital and long term loan funds which small business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply."[2]

The SBIC program was created to address concerns raised in a Federal Reserve Board report to Congress that concluded that a gap existed in the capital markets for long-term funding for growth-oriented small businesses. The report noted that the SBA's loan programs were "limited to providing short-term and intermediate-term credit when such loans are unavailable from private institutions," and the SBA "did not provide equity financing."[3] Equity financing (or equity capital) is money raised by a company in exchange for a share of ownership in the business. Ownership is represented by owning shares of stock outright or having the right to convert other financial instruments into stock. Equity financing allows a business to obtain funds without incurring debt, or without having to repay a specific amount of money at a particular time. The Federal Reserve Board's report concluded that there was a need for a federal government program to "stimulate the availability of capital funds to small business" to assist them in gaining access to long-term financing and equity financing.[4] Facilitating the flow of capital to small businesses to stimulate the national economy was, and remains, the SBIC program's primary objective.

The SBA does not make direct investments in small businesses. It works with 307 privately owned and managed SBICs licensed by the SBA to provide financing to small businesses with private capital the SBIC has raised and with funds the SBIC borrows at favorable rates because the SBA guarantees the debenture (loan obligation).

Congressional interest in the SBIC program has increased in recent years primarily because it is viewed as another means to stimulate economic activity, create jobs, and assist in the national economic recovery. However, there are disagreements concerning whether the program should target additional assistance to startup and early-stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation.

---

[1] U.S. Small Business Administration, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, p. 1.

[2] 15 U.S.C. § 661.

[3] U.S. Congress, House Committee on Banking and Currency, *Small Business Investment Act of 1958*, report to accompany S.3651, 85th Cong., 2nd sess., June 30, 1958, H.Rept. 85-2060 (Washington: GPO, 1958), pp. 4, 5.

[4] Ibid., p. 5.

This report examines the structure and operation of the SBIC program, focusing on SBIC eligibility requirements, investment activity, and program statistics. It also examines legislation, including H.R. 3854, the Small Business Financing and Investment Act of 2009, H.R. 5554, the Small Business Assistance and Relief Act of 2010, and P.L. 111-240, the Small Business Jobs Act of 2010, which address the following SBIC-related issues: (1) the targeting of additional assistance to startup and early-stage small businesses, (2) the SBA's management of the program's financial risk and its processing of SBIC applications, and (3) whether the program's financing levels are appropriate given the nation's current economic circumstances.

SBIC Types

There are two types of SBICs. Investment companies licensed under Section 301(c) of the Small Business Investment Act of 1958, as amended, are referred to as original, or regular, SBICs. Investment companies licensed under Section 301(d) of the act, called Specialized Small Business Investment Companies (SSBICs), focus on providing financing to small business entrepreneurs "whose participation in the free enterprise system is hampered because of social or economic disadvantage."[5] Section 301(d) was repealed by P.L. 104-208, the Omnibus Consolidated Appropriations Act, 1997 (Title II of Division D, the Small Business Programs Improvement Act of 1996). As a result, no new SSBIC licenses have been issued since October 1, 1996. However, existing SSBICs were "grandfathered" in and remain in operation.

With few exceptions, SBICs and SSBICs are subject to the same eligibility requirements and operating rules and regulations. Therefore, the SBIC name is usually used to refer to both SBICs and SSBICs simultaneously.

In addition, regular SBICs are also distinguished by the nature of their financings. As will be discussed, there are debenture SBICs, participating securities SBICs, and bank-owned, non-leveraged SBICs. Debentures are debt obligations issued by SBICs and held or guaranteed by the SBA.[6] Participating securities are redeemable, preferred, equity-type securities, often in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings.[7]

SBIC Eligibility Requirements

An SBIC can be organized in any state, as either a corporation, limited partnership (LP), or a limited liability company (LLCs must be organized under Delaware law). Most SBICs are owned by relatively small groups of local investors, although many are partially owned, and some are wholly owned (47 of 307), by commercial banks.[8] A few SBICs are corporations with publicly traded stock.[9]

---

[5] P.L. 92-595, the Small Business Investment Act Amendments of 1972.

[6] 13 CFR § 107.50.

[7] Ibid.

[8] Commercial banks may invest up to 5% of their capital and surplus to partially or wholly own an SBIC. Bank investments in an SBIC are presumed by federal regulatory agencies to be a "qualified investment" for Community Reinvestment Act purposes. See P.L. 90-104, the Small Business Act Amendments of 1967; The Board of Governors (continued...)

The two primary criteria for licensure as an SBIC are having qualified management and sufficient private capital. The SBA reviews and approves prospective SBIC's management teams based upon their professional capabilities and character. Specifically, the SBA examines the SBIC's management team looking for

- substantive and relevant principal investment experience;
- realized track record of superior returns, based on an overall evaluation of appropriate quantitative performance measures;
- evidence of a strong rate of business proposals and investment offers (deal flow) in the investment area proposed for the new fund;
- a cohesive management team, with complementary skills and history of working together;
- managerial, operational, or technical experience that can add value at the portfolio company level; and
- a demonstrated ability to manage cash flows so as to provide assurance the SBA will be repaid on a timely basis.[10]

Debenture SBICs are required to have a minimum private capital investment of $5 million (called regulatory capital).[11] The SBA has discretion to license an applicant with regulatory capital of $3 million if the applicant has satisfied all licensing standards and requirements, has a viable business plan reasonably projecting profitable operations, and has a reasonable timetable for achieving regulatory capital of at least $5 million.[12] At least 30% of the debenture SBIC's regulatory and leverageable capital must come from three people unaffiliated with the fund's management and with each other.[13] Also, no more than 33% of the SBIC's regulatory capital can come from state or local government entities.[14]

Participating securities SBICs must have regulatory capital of $10 million. The SBA has discretion to require less than $10 million in regulatory capital if the licensee can demonstrate that it can be financially viable over the long term with a lower amount. In this circumstance, the regulatory amount required can not be lower than $5 million.[15] At least 30% of the participating securities SBIC's regulatory and leverageable capital must come from three people unaffiliated

(...continued)

of the Federal Reserve Board, "Small Business Investment Companies," 33 *Federal Register* 6967, May 9, 1968; and U.S. Small Business Administration, "Small Business Investment Companies (SBICs)," *Small Business Notes*, Washington, DC, 2009, http://www.smallbusinessnotes.com/financing/sbic.html.

[9] U.S. Small Business Administration, "For SBIC Applicants," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/forsbicapp/INV_APPLICATION_PROCESS.html.

[10] Ibid.

[11] 13 CFR § 107.210.

[12] Ibid.

[13] 13 CFR § 107.150.

[14] 13 CFR § 107.230.

[15] 13 CFR § 107.210.

with the fund's management and with each other.[16] Also, no more than 33% of the SBIC's regulatory capital can come from state or local government entities.[17]

The eligibility requirements for small businesses requesting financial assistance from an SBIC is described in the **Appendix**.

SBIC Application Process

Applying for an SBIC license is a multi-step process, beginning with the submission of the SBA Management Assessment Questionnaire (MAQ). It includes, among others, questions concerning

- the fund's legal name, and the name and addresses of its principals and control persons;
- the fund's finances and expenses;
- the management team's professional experience;
- the fund's expected investing focus (e.g., will the fund be primarily a sole investor, lead investor, or co-investor; its anticipated percentage of investments in technology, life sciences, health care, manufacturing, distribution, service, consumer products and retail, or other industries; and its anticipated percentage of investments by business life cycle—seed, early stage, expansion, later stage, change of control, or turnaround);
- the geographic areas where the investments are expected to be made;
- the anticipated holding periods for investments;
- the types and characteristics of the securities that will be used to make investments; and
- the extent to which "special groups of businesses" will be targeted for investment, such as "ethnic groups, women, rural, inner city, etc."[18]

After receiving the firm's application a member of the SBA's Program Development Office reviews the MAQ, assesses the investment company's proposal in light of the program's minimum requirements and management qualifications, performs initial due diligence including making reference telephone calls, and prepares a written recommendation to the SBA's Investment Division's Investment Committee (composed of senior members of the Division).

If, after reviewing the MAQ and the SBA's Program Development Office's evaluation, the Investment Committee concludes, by majority vote at a regularly scheduled meeting, that the investment company's management team may be qualified for a license, the investment company's management team is invited to the SBA's headquarters in Washington, DC, for an interview. If, following the interview, the Investment Committee votes to proceed, the investment

[16] 13 CFR § 107.150.

[17] 13 CFR § 107.230.

[18] U.S. Small Business Administration, "SBIC Management Assessment Questionnaire and License Application: Form 2181," Washington, DC, p. 21, http://www.sba.gov/sites/default/files/inv_sba_form_2181.pdf.

team is provided a "Green Light" letter, formally inviting the investment team to file a license application, along with a filing fee of $10,000, plus an additional $5,000 for partnerships or LLC SBICs. If the license is approved, all SBIC principals must complete the SBA's SBIC Regulations training classes. On average, obtaining an SBIC license takes about six months from the time of the initial submission of the MAQ to issuance of the license.[19]

The application process for small businesses requesting financial assistance from an SBIC is described in the **Appendix**.

SBIC Investment Activity

SBIC Investments in Small Businesses

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);[20]
- 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;[21]
- purchasing debt securities from small businesses, which may be convertible into, or have rights to purchase, equity in the small business;[22] and
- subject to limitations, providing small businesses a guarantee of their monetary obligations to creditors not associated with the SBIC.[23]

SBICs are subject to statutory and regulatory restrictions concerning the nature of their approved investments. For example, SBICs are not allowed to

- directly or indirectly provide financing to any of their associates (e.g., officers, directors, and employees);[24]
- control, either directly or indirectly, any small business on a permanent basis;[25]

[19] U.S. Small Business Administration, "For SBIC Applicants," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/forsbicapp/INV_APPLICATION_PROCESS.html; and U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the authors, September 21, 2100.

[20] 13 CFR § 107.800. The SBIC is not allowed to become a general partner in any unincorporated business or become jointly or severally liable for any obligations of an unincorporated business.

[21] 13 CFR § 107.810; and 13 CFR § 107.840.

[22] 13 CFR § 107.815. Debt securities are instruments evidencing a loan with an option or any other right to acquire equity securities in a small business or its affiliates, or a loan which by its terms is convertible into an equity position, or a loan with a right to receive royalties that are excluded form the cost of money.

[23] 13 CFR § 107.820.

[24] 13 CFR § 107.730.

[25] 13 CFR § 107.865. The period of time that an SBIC can exercise control over a small business for purposes connected with its investment through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or otherwise, is "limited to the seventh anniversary of the date on which such control was initially acquired, or any earlier date specified by the terms of any investment agreement." With the SBA's (continued...)

- invest, without SBA approval, more than specified percentages of its private (regulatory) capital in securities, commitments, or guarantees in any one small business (e.g., SBICs are not allowed to invest more than 30% of their private capital in any one small business if their investment plan includes two or more tiers of SBA leverage); [26]
- invest in farm land, unimproved land, or any small business classified under Major Group 65 (Real Estate) of the Standard Industrial Classification (SIC) Manual, with the exception of title abstract companies, real estate agents, brokers, and managers;[27]
- provide funds for small businesses whose primary business activity involves directly or indirectly providing funds to others, purchasing debt obligations, factoring, or leasing equipment on a long-term basis with no provision for maintenance or repair;[28] or
- provide funds to a small business if the funds will be used substantially for a foreign operation.[29]

The SBA also regulates the interest rates and fees SBICs are allowed to charge small businesses on loans, debt securities, and equity financing.[30]

In 1999, the SBA introduced the low and moderate income investments (LMI) initiative to encourage SBICs to invest in small businesses located in inner cities and rural areas "that have a severe shortages of equity capital" because investments in those areas "often are of a type that will not have the potential for yielding returns that are high enough to justify the use of

(...continued)

prior written approval, an SBIC "may retain control for such additional period as may be reasonably necessary to complete divestiture of control or to ensure the financial stability of the portfolio company."

[26] A tier of SBA leverage equals the amount of the SBIC's private (regulatory) capital. SBICs approved for less than two tiers of SBA leverage must not invest more than 20% of its private capital in any one small business if the SBIC's plan contemplates one tier of leverage and no more than 25% of its private capital if its plan contemplates 1.5 tiers of leverage. See 13 CFR § 107.740; and U.S. Small Business Administration, "American Recovery and Investment Act of 2009: Implementation of SBIC Program Changes," letter from Harry Haskins, Acting Associate Administrator for Investment, to All Small Business Investment Companies (SBICs) and Applicants, Washington, DC, May 4, 2009, p. 2, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_rcvry_act_sbic_changes.pdf.

[27] 13 CFR § 107.720.

[28] Ibid.

[29] Ibid. SBICs may provide venture capital financing to "disadvantaged concerns" engaged in relending or reinvesting activities (except agricultural credit companies and banking and savings and loan institutions not insured by a federal agency). Without SBA approval, these financings, at the end of the fiscal year, may not exceed the SBIC's regulatory capital. A disadvantaged concern is defined as a small business that is at least 50% owned, controlled, and managed, on a day-to-day basis, by a person or persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

[30] The SBA has a general interest rate ceiling of 19% for a loan and 14% for a debt security, with provisions for a higher interest rate under specified circumstances. See 13 CFR § 107.855. SBICs are allowed to collect a nonrefundable application fee of no more than 1% of the amount of financing requested from a small business to review its financing application, a closing fee of no more than 2% of the amount of financing requested from a small business concern for a loan, charged no earlier than the date of the first disbursement, and a closing fee of no more than 4% of the amount of financing requested from a small business concern for a debt security or equity security financing, charged no earlier than the date of the first disbursement. SBICs are also allowed to charge a small business for reasonable out-of-pocket expenses, other than management expenses incurred to process the small business's financing application. See 13 CFR § 107.860.

participating securities."[31] This ongoing initiative provides incentives to SBICs that invest in small businesses that have at least 50% of its employees or tangible assets located in a low-to-moderate income area (LMI Zone) or have at least 35% of its full-time employees with their primary residence in an LMI Zone.[32] For example, unlike regular SBIC debentures that typically have a 10-year maturity, LMI debentures are available in two maturities, for five years and 10 years, plus the stub period. The stub period is the time between the debenture's issuance date and the next March 1 or September 1. The stub period allows all LMI Debentures to have common March 1 or September 1 maturity dates to simplify administration of the program.

In addition, LMI debentures are issued at a discount so that the proceeds the SBIC receives for the sale of the debenture are reduced by (1) the debenture's interest costs for the first five years, plus the stub period; (2) the SBA's annual fee for the debenture's first five years, plus the stub period; and (3) the SBA's 2% leverage fee. As a result, these interest costs and fees are effectively deferred, freeing SBICs from the requirement to make interest payments on LMI debentures, or pay the SBA's annual fees on LMI debentures, for the first five years of the debenture, plus the stub period between the debenture's issuance date and the next March 1 or September 1.[33]

In FY2010, SBICs made 569 financings to small businesses located in a LMI Zone, totaling $444.5 million—about 22% of the total amount financed.[34]

SBA Investments

Leverage

A licensed SBIC in good standing, with a demonstrated need for funds, may apply to the SBA for financial assistance (called leverage) of up to 300% of its private capital. However, most SBICs are approved for a maximum of 200% of its private capital and no fund management team may exceed the allowable maximum amount of leverage, currently $150 million per SBIC and $225 million for two or more licenses under common control.[35] SBICs licensed on or after October 1, 2009, may elect to have a maximum leverage amount of $175 million per SBIC and $250 million

[31] U.S. Small Business Administration, "Small Business Investment Companies," 64 *Federal Register* 52645, September 30, 1999.

[32] U.S. Small Business Administration, "Small Business Investment Companies," 64 *Federal Register* 52641-52646, September 30, 1999. LMIs Zones are areas located in a HUBZone, an Urban Empowerment Zone or Urban Enterprise Community designated by the Secretary of the U.S. Department of Housing and Urban Development, a Rural Empowerment Zone or Rural Enterprise Community as designated by the Secretary of the U.S. Department of Agriculture, an area of low income or moderate income as recognized by the Federal Financial Institutions Examination Council, or a county with persistent poverty as classified by the U.S. Department of Agriculture's Economic Research Service. See 13 CFR § 107.50.

[33] U.S. Small Business Administration, "For SBICs: Background Information on Low or Moderate Income(LMI) Debentures," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/forsbic/inv_backgroundinfo.html.

[34] U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Summary of SBIC Program Financing," Washington, DC.

[35] 13 CFR § 107.1120; 13 CFR § 107.1150; and U.S. Small Business Administration, "American Recovery and Investment Act of 2009: Implementation of SBIC Program Changes," letter from Harry Haskins, Acting Associate Administrator for Investment, to All Small Business Investment Companies (SBICs) and Applicants, Washington, DC, May 4, 2009, p. 1, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_rcvry_act_sbic_changes.pdf.

for two or more licenses under common control if it has invested at least 50% of its financings in low-income geographic areas and certifies that at least 50% of its future investments will be in low-income geographic areas.[36]

The SBIC's application for SBA financial assistance is to secure the "SBA's conditional commitment to reserve a specific amount of leverage" for the SBIC's future use.[37] If the application is approved, the SBIC draws down the leverage as it makes financial commitments. Leverage is provided through the issuance of either SBA-guaranteed debentures or SBA-guaranteed participating securities.

Debentures

Debenture SBICs obtain leverage by issuing SBA-guaranteed debentures. The SBA pools these debentures and sells SBA-guaranteed debenture participation certificates, representing an undivided interest in the pool, to investors through periodic public offerings.[38] SBA-guaranteed debenture participation certificates can have a term of up to 15 years, although currently only one outstanding SBA-guaranteed debenture participation certificate has a term exceeding 10 years and all recent public offerings have specified a term of 10 years.[39] SBA-guaranteed debentures provide for semi-annual interest payments and a lump sum principal payment to investors at maturity.[40] SBICs are allowed to prepay SBA-guaranteed debentures without penalty. However, a SBA-guaranteed debenture must be prepaid in whole and not in part, and can only be prepaid on a semi-annual payment date. The debenture's coupon (interest) rate is determined by market conditions and the interest rate of 10-year treasury securities at the time of the sale.[41] Also, as mentioned previously, LMI debentures are available in two maturities, for five years and 10 years (plus the stub period).

Because the SBA guarantees the debenture, investors are more likely to purchase the SBIC's debenture participation certificate as opposed to others available on the market. They are also more likely to accept a lower coupon (interest) rate than what would be expected without the SBA's guarantee.[42] As a result, the SBIC's access to venture capital is enhanced, and its cost of

[36] 13 CFR § 107.1150.

[37] 13 CFR § 107.1100.

[38] The SBA is required by statute to issue guarantees "at periodic intervals of not less than every 12 months and shall do so at such shorter intervals as it deems appropriate, taking into consideration the amount and number of such guarantees or trust certificates." See 15 U.S.C. § 687m.

[39] U.S. Small Business Administration, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," Washington, DC, p. 11, http://www.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-ps-2009-10a-831641ep6.pdf.

[40] U.S. Small Business Administration, "Small Business Investment Companies (SBICs)," *Small Business Notes*, Washington, DC, 2009, http://www.smallbusinessnotes.com/financing/sbic.html; and U.S. Small Business Administration, "For SBIC Applicants," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/forsbicapp/INV_APPLICATION_PROCESS.html.

[41] Ibid.; 13 CFR § 107.50; and 13 CFR § 107.1150.

[42] The coupon (interest) rate on SBA debentures is based on the 10-year Treasury rate (adjusted to the nearest 1/8th of one percent) plus a market-driven spread, currently about 70-80 basis points. See 13 CFR § 107.50; and U.S. Small Business Administration, "SBIC Program: FAQs," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/faq/index.html. The coupon rate for the most recent sale of a SBA debenture participating certificate, which took place on March 24, 2010, was 4.108%. U.S. Small Business Administration, "Offering Circular, Guaranteed 4.108% Debenture Participation Certificates, Series SBIC 2010-10 A," Washington, DC, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-2010-10-a-831641es0.pdf.

raising additional financial resources is reduced. Because debenture SBICs make semi-annual interest payments to investors, they tend to focus their investments on mid- and later-stage small businesses that have positive cash flow and are seeking capital for expansion.[43]

The SBA operates the SBIC debenture program on a zero-subsidy basis. To recoup its expenses, the SBA requires the SBIC to pay a 3% origination fee for each debenture issued (1% at commitment and 2% at draw), an annual fee on the leverage drawn which is fixed at the time of the leverage commitment, and other administrative and underwriting fees which are adjusted annually.[44]

Participating Securities

P.L. 102-366, the Small Business Credit and Business Opportunity Enhancement Act of 1992 (Title IV, the Small Business Equity Enhancement Act of 1992), authorized the SBA to guarantee participating securities. Participating securities are redeemable, preferred, equity-type securities issued by SBICs in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings.

In 1994, the SBA established the SBIC Participating Securities Program (SBIC PSP) to encourage the formation of participating securities SBICs which would make equity investments in startup and early stage small businesses. The SBA created the program to fill a perceived investment gap created by the SBIC debenture program's focus on mid- and later-stage small businesses. As will be discussed, the SBIC PSP lost more than $2.7 billion during the early 2000s. In 2004, the SBA began an ongoing process to end the program. However, in recent years, congressional interest in either revising the program or starting a new program modeled on certain aspects of the SBIC PSP to assist startup and early-stage small businesses has increased.[45]

Participating securities SBICs obtained leverage by issuing SBA-guaranteed participating securities. The SBA pooled these participating securities and sold SBA-guaranteed participating securities certificates, representing an undivided interest in the pool, to investors through periodic public offerings. The SBA's regulations allow these certificates to have a term of up to 15 years, but all recent public offerings have specified a term of 10 years.

There have been 35 public offerings of SBA-guaranteed participating securities certificates since the start of the participating securities program, amounting to just under $10.3 billion. The final

---

[43] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 11; and U.S. Small Business Administration, "SBIC Program: FAQs," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/faq/index.html.

[44] 13 CFR § 107.1130; and 13 CFR § 107.1210.

[45] U.S. Congress, House Committee on Small Business, *Subcommittee Markup of Legislation Affecting the SBA Capital Access Programs*, 111th Cong., 1st sess., October 8, 2009, House Small Business Committee Document No. 111-050 (Washington: GPO, 2009), pp. 7, 10, 11, 187-194; U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), pp. 1, 2, 40, 98; and U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), pp. 3, 4, 10-12.

SBA-guaranteed participating securities certificate, for $332 million, had a term of 10 years and was offered to investors on February 19, 2009.[46]

SBIC participating securities certificates provide for quarterly payments to investors from dividends on preferred stock, interest on an income bond, or a priority return on a preferred limited partnership equal to a specified interest rate on the principal amount and a lump sum principal payment at maturity. The participating securities SBIC is obligated to make these quarterly payments "only to the extent it has sufficient profits available to make such payments."[47] If it is unable to make any required payment, the SBA will make the payment on behalf of the SBIC. Because startup and early-stage small businesses often are not initially profitable, the SBA included language in its participating securities' offering circulars that it "anticipates that it will be called upon routinely to make such … payments for the SBICs in the early years of the lives of such SBICs" and that it "expects to be reimbursed [by the SBIC] any amounts paid … under its guarantee over the life of a participating security."[48]

Because the SBA guaranteed the certificate, investors were more likely to purchase the SBIC's participating securities certificate as opposed to others available on the market. They were also more likely to accept a lower payment rate than what would be expected without the SBA's guarantee.[49]

In addition, participating securities SBICs are more likely than debenture SBICs to finance startup and early-stage small businesses because the SBA is willing to make the SBIC's required quarterly payments to investors, at least during the early years of the investment. Because participating securities SBICs are not required to make these quarterly payments, they are encouraged to focus on the small business's long-term prospects for growth and profitability, rather than on its prospects for having immediate positive cash-flow.[50]

In 2004, the SBA projected losses of more than $2.7 billion in the SBIC PSP, primarily because investments in technology startup and early-stage small businesses lost much of their stock value during the early 2000s. Consequently, on October 1, 2004, the SBA ceased issuing new licenses and new leverage for participating securities SBICs, effectively beginning the process of ending the SBIC PSP.[51] The SBA continued to honor its existing commitments to participating securities

[46] 13 CFR § 107.1500; and U.S. Small Business Administration, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," Washington, DC, pp. 7, 14, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-ps-2009-10a-831641ep6.pdf.

[47] U.S. Small Business Administration, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," Washington, DC, p. 2, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-ps-2009-10a-831641ep6.pdf.

[48] Ibid., pp. 2, 3. Also, see U.S. Congress, House Committee on Small Business, *Private Equity for Small Firms: The Importance of the Participating Securities Program*, 109th Cong., 1st sess., April 13, 2005, Serial No. 109-10 (Washington: GPO, 2005), p. 5.

[49] The coupon rate for most recent sale of a SBA guaranteed participating securities participation certificate, which took place on February 25, 2010, was 4.727%. U.S. Small Business Administration, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," Washington, DC, p. 1, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-ps-2009-10a-831641ep6.pdf.

[50] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 11; and U.S. Small Business Administration, "SBIC Program: FAQs," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/faq/index.html.

[51] U.S. Congress, House Committee on Small Business, *Private Equity for Small Firms: The Importance of the* (continued...)

SBICs and they were allowed to continue operations. However, they were required to comply with special rules concerning minimum capital, liquidity, non-SBA borrowing, and equity investing.[52] As mentioned previously, the final SBA-guaranteed participating securities participation certificate was offered to investors on February 19, 2009.[53]

At the end of FY2010, the SBA had a guarantee on the outstanding unpaid principal balance of $3.4 billion in SBIC debentures, $2.9 billion in SBIC participating securities, and $14.2 million in SSBIC financings.[54]

Reporting Requirements

Once licensed, each SBIC is required to file with the SBA an annual financial report which includes an audit by an SBA-approved independent public accountant. SBICs are also subject to annual onsite regulatory compliance examinations.[55] SBICs are also required to provide the SBA:

- a portfolio financing report within 30 days of the closing date for each financing of a small business;[56]
- the value of its loans and investments within 90 days of the end of the fiscal year in the case of annual valuations, and within 30 days following the close of other reporting periods;[57]
- any material adverse changes in valuations at least quarterly (within 30 days following the close of the quarter);[58] and

(...continued)

Participating Securities Program, 109th Cong., 1st sess., April 13, 2005, Serial No. 109-10 (Washington: GPO, 2005), p. 5, 33; and U.S. Small Business Administration, "SBIC Program: FAQs," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/faq/index.html.

[52] 13 CFR § 107.1500. SBICs that wish to be eligible to issue participating securities must have regulatory capital of at least $10 million unless it can demonstrate to the SBA's satisfaction that it can be financially viable over the long-term with a lower amount, but not less than $5 million. See 13 CFR § 107.210. They must also maintain sufficient liquidity to avoid a condition of "Liquidity Impairment," defined as a liquidity ratio (total current funds available divided by total current funds required) of less than 1.2. See 13 CFR § 107.1505. The only type of debt, other than leverage, SBICs that have applied to issue participating securities or have outstanding participating securities are permitted to incur is temporary debt. Temporary debt is defined as short-term borrowings from a regulated financial institution, a regulated credit company, or a non-regulated lender approved by the SBA for the purpose of maintaining the SBIC's operating liquidity or providing funds for a particular financing of a small business. The total outstanding borrowings, not including leverage, can not exceed 50% of the SBIC's leveraged capital and all such borrowings must be fully paid off for at least 30 consecutive days during the SBIC's fiscal year so that it has no outstanding third-party debt for 30 days. See 13 CFR § 107.570. SBICs issuing participating securities are required to invest an amount equal to the original issue price of such securities solely in equity capital investments (e.g., common or preferred stock, limited partnership interests, options, warrants, or similar equity instruments). See 13 CFR § 107.1505.

[53] U.S. Small Business Administration, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," Washington, DC, p. 7, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_sbic-ps-2009-10a-831641ep6.pdf.

[54] U.S. Small Business Administration, Investment Division, "SBIC Program Overview," Washington, DC, October 13, 2010, p. 1, http://www.nasbic.org/resource/resmgr/Docs/SBIC_Stats_Oct._13.pdf.

[55] 13 CFR § 107.630; and 13 CFR § 107.690.

[56] 13 CFR § 107.640.

[57] 13 CFR § 107.650.

[58] Ibid.

- copies of reports provided to investors, documents filed with the Securities and Exchange Commission, and documents pertaining to litigation or other legal proceedings, including criminal charges against any person who was required by the SBA complete a personal history statement in connection with the SBIC's license.[59]

SBIC Program Statistics

There are 307 licensed SBICs in operation (140 debenture SBICs, 107 participating securities SBICs, 47 bank-owned/non-leveraged SBICs, and 13 SSBICs).[60] In FY2010, 218 SBICs provided at least one new financing to a small business.[61]

The number of licensed SBICs has declined in recent years, with most of the decline due to the planned phase-out of participating securities SBICs and SSBICs.[62] For example, in FY2006, there were 396 licensed SBICs (132 debenture SBICs, 173 participating securities SBICs, 67 bank-owned/non-leveraged SBICs, and 24 SSBICs).[63]

Overall, SBICs pursue investments in a broad range of industries, geographies, and stage of investment. Some individual SBICs specialize in a particular field or industry in which their management has expertise, while others invest more generally. Most SBICs concentrate on a particular stage of investment (i.e., start-up, expansion, or turnaround) and identify a geographic area in which to focus.

Total Financing

Since its inception, the SBIC program has provided more than $57.6 billion in financial assistance to more than 107,000 small firms.[64] As mentioned previously, at the end of FY2010, the SBA had a guarantee on the outstanding unpaid principal balance of $3.4 billion in SBIC debentures, $2.9

[59] 13 CFR § 107.660.

[60] U.S. Small Business Administration, Investment Division, "SBIC Program Overview," Washington, DC, October 13, 2010, p. 1, http://www.nasbic.org/resource/resmgr/Docs/SBIC_Stats_Oct._13.pdf.

[61] U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Form of Business, Pre-Financing Information, and Licensing Activity Levels," Washington, DC.

[62] In recent years, the SBA has made it a goal to increase the number of new SBIC licenses issued each year. In FY2008, the SBA issued six new SBIC licenses (five to debenture SBICs and one to a bank-owned/non-leveraged SBIC). In FY2009, the SBA issued 11 new SBIC licenses (eight to debenture SBICs and three to bank-owned/non-leveraged SBICs). In FY2010, the SBA issued 23 new SBIC licenses (21 to debenture SBICs and 2 to bank-owned/non-leveraged SBICs). See U.S. Small Business Administration, Investment Division, "SBIC Program Overview," Washington, DC, October 13, 2010, p. 2, http://www.nasbic.org/resource/resmgr/Docs/SBIC_Stats_Oct._13.pdf.

[63] Ibid., p. 1.

[64] U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the author, October 20, 2010; U.S. Small Business Administration, Press Office, "SBA Growth Capital Program Provides Record $1.59 Billion in Financing for Small Businesses in FY10," October 14, 2010, http://www.sba.gov/content/sba-growth-capital-program-provides-record-159-billion-financing-small-businesses-fy10. The SBA has a selected list of firms that have received SBIC financing, including Apple Computer, Compaq Computer, Costco Wholesale Corporation, FedEx, Intel, Jenny Craig, Inc., Outback Steakhouse, Sports Authority, Staples, and Sun Microsystems, on its website. See U.S. Small Business Administration, "Investment Division," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/INV_SUCCESS_STORIES.html.

billion in SBIC participating securities, and $14.2 million in SSBIC financings.[65] All together, the SBIC program currently has invested about $15.0 billion in small businesses, with about $8.7 billion raised from private capital and $6.3 billion guaranteed by the SBA.[66]

In FY2010, SBICs made 2,455 financings (including 43 financings by SSBICs). The average financing amount was $833,862 ($1,080,295 for debenture SBICs, $420,613 for participating securities SBICs, $838,478 for bank-owned/non-leveraged SBICs, and $68,585 for SSBICs).[67] The funds were used primarily for operating capital (93.3%). Other uses were for research and development (2.8%), to acquire an existing business (1.6%), plant modernization (0.6%), purchasing equipment (0.4%), refinancing or refunding debt (0.3%), marketing activities (0.2%), a new building or plant construction (0.1%), and other uses (0.7%).[68]

As shown in **Table 1**, the SBA's leverage increased each fiscal year from FY2005 to FY2008, peaking at just over $1.0 billion, declined in FY2009 to $787 million, and increased to $931 million in FY2010. In addition, SBICs provided total investments of more than $2.0 billion in FY2010 ($931 million in SBA leverage and $1.1 billion from private capital), about $1.85 billion in FY2009 ($787 in SBA leverage and $1.06 billion from private capital) and $2.2 billion in FY2008 ($1.0 billion in SBA leverage and $1.2 billion from private capital).[69]

The SBA has had congressional authorization to issue up to $3 billion in SBIC leverage each year since 2005. For comparative purposes, private venture capital firms invested $18.3 billion in 2,916 companies in 2009, and, based on their activity during the first three quarters of 2010, are on pace to invest $21 billion in about 3,100 companies in 2010.[70]

The SBA has indicated that one of its goals is "to enhance program acceptance in the marketplace and increase the number of funds licensed and the amount of leverage issued so as to improve capital access for small businesses."[71]

---

[65] U.S. Small Business Administration, Investment Division, "SBIC Program Overview," Washington, DC, October 13, 2010, p. 1, http://www.nasbic.org/resource/resmgr/Docs/SBIC_Stats_Oct._13.pdf.

[66] Ibid.

[67] U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Summary of SBIC Program Financing," Washington, DC.

[68] U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Use of Proceeds by the Financed Businesses," Washington, DC.

[69] U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the author, October 20, 2010; U.S. Small Business Administration, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, pp. 19, 51; and U.S. Small Business Administration, "FY2010 Congressional Budget Justification," Washington, DC, 2009, pp. 17, 42.

[70] National Venture Capital Association, "Venture Capital Investments Q3-2010 – MoneyTree Results, National Data," Arlington, VA, October 15, 2010, p. 3, http://www.nvca.org/.

[71] U.S. Small Business Administration, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, p. 52.

Table 1. SBIC Financing, FY2005-FY2010

($ in millions)

Year	SBA Leverage/Guarantee	# of Small Businesses Financed
FY2010	$931	1,331
FY2009	$787	1,481
FY2008	$1,029	1,905
FY2007	$707	2,057
FY2006	$477	1,488
FY2005	$355	1,559

Source: U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the author, October 20, 2010; U.S. Small Business Administration, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, pp. 19, 51; U.S. Small Business Administration, "FY2010 Congressional Budget Justification," Washington, DC, 2009, pp. 17, 41, 42; U.S. Small Business Administration, "Fiscal Year 2009 Congressional Submission and FY2007 Annual Performance Report," Washington, DC, 2008, pp. 25, 43; U.S. Small Business Administration, "FY 2008 Budget Request and Performance Plan," Washington, DC, 2007, pp. 23, 57; and U.S. Small Business Administration, "Performance and Financial Highlights, FY2007," Washington, DC, February 4, 2008, p. 4.

In 2008, the Urban Institute released an analysis comparing debenture SBIC investments made from 1997 to 2005 to private sector venture capital investments made during that time period in second stage business loans, third stage business loans, and bridge loans "because these investments are likely to be of the same character (debt with equity features) as those made by debenture SBICs."[72] The Urban Institute found that debenture SBIC investments accounted for more than 62% of all venture capital financings in second stage business loans, third stage business loans, and bridge loans in the United States during that time period. However, because the average amount of an SBIC debenture investment was much smaller than the industry average, SBIC debenture investments accounted for "only 8% of total dollars invested."[73]

Financing to Specific Demographic Groups

As shown in **Table 2**, in FY2010, SBICs made 123 financings (5.0% of all financings) amounting to $69.2 million (3.4% of the total amount of financings) to minority-owned and -controlled small businesses.

In addition, in FY2010, SBICs made 43 financings (1.8% of all financings) amounting to $2.1 million (1.4% of the total amount of financings) to women-owned small businesses, and 4 financings (0.2% of all financings) amounting to $1.6 million (0.1% of the total amount of financings) to veteran-owned small businesses.[74]

---

[72] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity, The Urban Institute , Washington, DC, January 2008, p. 3, http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[73] Ibid., p. 1.

[74] U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Demographics of Financed Businesses," Washington, DC.

Table 2. SBIC Financing, Minority-Owned Small Businesses, FY2010

Small Business Ownership Demographic	# of Financings	% of Financings	$ Amount of Financings	% of Total $ Amount of Financings
Black-Owned	40	1.6%	$36,865,781	1.8%
Subcontinent Asian-Owned	39	1.6%	$5,135,745	0.3%
Hispanic-Owned	26	1.1%	$5,402,931	0.3%
Asian Pacific-Owned	18	0.7%	$21,794,698	1.1%
Native American-Owned	0	0.0%	$0	0.0%
Subtotal	123	5.0%	$69,199,155	3.4%
Other (non-minority)	2,332	95.0%	$1,977,932,234	96.6%
Total—All Financings	2,455	100.0%	$2,047,131,389	100.0%

Source: U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Demographics of Financed Businesses.," Washington, DC.

Notes:: Ownership is defined as owning at least 50% of the small business.

Research concerning private venture capital investment in minority-owned or women-owned small businesses is limited. As a result, it is difficult to find the data necessary to compare the SBIC program's investment in minority-owned or women-owned small businesses to the private sector's investment in these firms.[75]

In 2007, the SBA acknowledged at a congressional hearing on the SBA's investment programs that "women and minority representation in [the SBIC program] is low" and has been low for many years.[76] The SBA reported at that time that it does not control the investments made by SBICs, but it has tried to increase women and minority representation in the SBIC program by reaching out to venture capital firms, trade organizations, and others to better understand why women and minority representation in the SBIC program is low, and by "finding debenture firms with minority representation on their investment committees and in senior management."[77] However, despite these efforts, in 2009, the National Association of Small Business Investment Companies (NASBIC) asserted at a congressional hearing on the SBA's capital access programs that the SBA's SBIC licensing process "has done an abysmal job at attracting and licensing funds led by women and minorities."[78]

S. 1831, the Small Business Venture Capital Act of 2009, introduced on October 21, 2009, and referred to the Senate Committee on Small Business and Entrepreneurship, would encourage SBIC investments in women-owned small businesses and socially and economically

[75] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity, The Urban Institute , Washington, DC, January 2008, pp. 2, 26, http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[76] U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs*, 110th Cong., 1st sess., September 6, 2007, Serial Number 110-44 (Washington: GPO, 2007), p. 15.

[77] Ibid.

[78] U.S. Congress, House Committee on Small Business, *Full Committee Hearing On Increasing Capital For Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), p. 89.

disadvantaged small business concerns by increasing the amount of leverage available to SBICs that invest at least 50% of their financings in small business concerns owned and controlled by women or socially and economically disadvantaged small business concerns.

Financing By State

As shown on **Table 3**, in FY2010, SBICs provided financing to small businesses located in 46 states, the District of Columbia, and Puerto Rico, with the most financings taking place in New York (455 financings amounting to $243.2 million) and California (422 financings amounting to $295.2 million).

The previously mentioned 2008 Urban Institute comparative analysis of debenture SBIC financing from 1997 to 2005 found that the dollar volume of investments from debenture SBICs was much more evenly distributed across the nation than from comparable private venture capital funds. For example, the Urban Institute found that California (45.8%) and Massachusetts (12.9%) received the largest share of the total dollar volume invested by private venture capital funds from 1997 to 2005. The two states accounted for more than half (58.7%) of the total dollar volume invested by private venture capital funds. In contrast, New York (18.7%) and California (11.1%) received the largest share of the total dollar volume invested by debenture SBICs from 1997 to 2005. The two states accounted for less than one-third (29.8%) of the total dollar volume invested by debenture SBICs. Also, the top 10 states in terms of their share of the total dollar volume invested accounted nearly 84% of the total invested by private venture capital funds, compared to 64% for debenture SBICs.[79]

Data concerning private sector venture capital fund investments during the third quarter of 2010 and the state-by-state distribution of SBIC financings shown on **Table 3** suggest that the Urban Institute's finding that SBICs investments were much more evenly distributed across the nation than private sector venture capital fund investments from 1997 to 2005 may continue to be the case today.[80] For example, California (46.0%) and Massachusetts (10.1%) received the largest share of the total dollar volume invested by private venture capital funds during the third quarter of 2010. The two states accounted for 56.1% of the total dollar volume invested by private venture capital funds. In contrast, California (14.4%) and New York (11.9%) received the largest share of the total dollar volume invested by SBICs during FY2010. The two states accounted for 26.3% of the total dollar volume invested by SBICs.

---

[79] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity, The Urban Institute , Washington, DC, January 2008, pp. 3, 18-24, http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[80] National Venture Capital Association, "Venture Capital Investments Q3-2010 – MoneyTree Results, Regional Data," Arlington, VA, October 15, 2010, p. 17, http://www.nvca.org/.

Table 3. SBIC Financing, By State, FY2010
($ in millions)

State	# of Financings	Amount of Financings	State	# of Financings	Amount of Financings
Alabama	5	$5.1	Montana	1	$0.1
Alaska	0	$0.0	Nebraska	1	$4.0
Arizona	23	$81.3	Nevada	11	$19.2
Arkansas	2	$1.0	New Hampshire	17	$6.9
California	422	$295.2	New Jersey	146	$104.0
Colorado	47	$26.2	New Mexico	5	$0.5
Connecticut	27	$21.3	New York	455	$243.2
Delaware	5	$0.7	North Carolina	61	$70.1
District of Columbia	8	$4.5	North Dakota	3	$8.1
Florida	97	$190.0	Ohio	47	$45.9
Georgia	40	$47.0	Oklahoma	4	$1.9
Hawaii	1	$6.9	Oregon	10	$8.9
Idaho	4	$0.4	Pennsylvania	101	$86.7
Illinois	86	$45.1	Puerto Rico	0	$0.0
Indiana	27	$8.4	Rhode Island	0	$0.0
Iowa	18	$5.4	South Carolina	19	$41.1
Kansas	18	$19.5	South Dakota	0	$0.0
Kentucky	12	$15.7	Tennessee	22	$31.7
Louisiana	5	$10.6	Texas	177	$211.1
Maine	3	$0.5	Utah	37	$23.3
Maryland	25	$13.4	Vermont	15	$20.9
Massachusetts	185	$121.5	Virginia	58	$60.6
Michigan	14	$26.7	Washington	64	$26.6
Minnesota	26	$17.3	West Virginia	11	$2.0
Mississippi	6	$4.3	Wisconsin	35	$25.5
Missouri	49	$37.4	Wyoming	0	$0.0
Total				2,455	$2,047.1

Source: U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: SBIC Program Financing by State," Washington, DC.

Financing By Industry

As shown on **Table 4**, in FY2010, SBIC financings were made in a variety of industries, led by investments in manufacturing; transportation and warehousing; professional, scientific, and technical services; and information.

The previously mentioned 2008 Urban Institute comparative analysis of SBIC financings from 1997 to 2005 found that "SBIC financing is less concentrated by industry than financing from private venture capital firms" and "total financings by SBICs are much less likely to be in high-tech industries" than comparable private sector venture capital investment firms.[81] The Urban Institute found that unlike SBICs, "the value of investments by private venture capital firms is predominately directed towards information and finance," with computer and Internet firms receiving roughly half of all private sector investments.[82]

Table 4. SBIC Financing, By Industry, FY2010

Industry	# of Financings	% of Financings	$ Amount of Financings	% of $ Amount of Financings
Manufacturing	739	30.1%	$527,277,437	25.8%
Transportation and Warehousing	421	17.2%	$217,787,008	10.6%
Professional, Scientific, and Technical Services	333	13.6%	$232,320,253	11.3%
Information	332	13.5%	$236,968,531	11.6%
Wholesale Trade	86	3.5%	$130,427,351	6.4%
Administrative and Support and Waste Management	84	3.4%	$112,767,605	5.5%
Retail Trade	83	3.4%	$71,012,876	3.5%
Accommodation and Food Services	64	2.6%	$29,759,323	1.5%
Health Care and Social Assistance	59	2.4%	$188,706,225	9.2%
Real Estate and Rental Leasing	52	2.1%	$55,785,086	2.7%
Construction	46	1.9%	$39,610,816	1.9%
Finance and Insurance	40	1.6%	$43,746,936	2.1%
Educational Services	18	0.7%	$109,899,891	5.4%
Arts, Entertainment and Recreation	11	0.5%	$2,933,006	0.1%
Mining	5	0.2%	$1,071,239	0.1%
Other Industries	82	3.3%	$47,057,806	2.3%
Total	2,455	100.0%	$2,047,131,389	100.0%

Source: U.S. Small Business Administration, "SBIC Program Financing to Small Businesses – Fiscal Year 2010: Industrial Classification of the Financed Businesses," Washington, DC.

81 Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity, The Urban Institute , Washington, DC, January 2008, pp. 3, 11-17, http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

82 Ibid., p. 11.

Legislative Activity

P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), included provisions designed to increase the amount of leverage issued under the SBIC program by increasing the maximum amount of leverage available to an individual SBIC to 300% of its private capital, or $150 million, whichever is less; and by increasing the maximum amount of leverage available for two or more licenses under common control to $225 million.[83] It also encouraged SBIC investment in smaller enterprises by requiring SBICs licensed on or after the date of its enactment (February 17, 2009) to certify that at least 25% of all future financing dollars are invested in smaller enterprises. ARRA defined smaller enterprises as firms having either a net worth of no more than $6 million and average after-tax net income for the preceding two years of no more than $2 million, or meeting the SBA's size standard for its industry classification.[84]

ARRA also encouraged SBIC investments in low-income areas by allowing SBICs licensed on or after October 1, 2009, to elect to have a maximum leverage amount of $175 million per SBIC and $250 million for two or more licenses under common control if it has invested at least 50% of its financings in low-income geographic areas and certifies that at least 50% of its future investments will be in low-income geographic areas.[85]

Congress also considered several bills during the 111th Congress that were designed to address several other SBIC-related issues, including (1) the targeting of additional assistance to startup and early-stage small businesses, (2) the SBA's management of the program's financial risk and its processing of SBIC license applications, and (3) whether the program's financing levels are appropriate given the nation's current economic circumstances.

Legislation to Target Additional Assistance to Startup and Early-Stage Small Businesses

As mentioned previously, congressional interest in the SBIC program has increased in recent years primarily because it is viewed as a means to stimulate economic activity, create jobs, and assist in the national economic recovery. However, there are disagreements concerning whether the program should target additional assistance to startup and early-stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation.

Advocates of targeting additional assistance to startup and early-stage small businesses argue that the SBA's participating securities program was created to fill a perceived investment gap resulting from the SBA's debenture program's focus on mid- and later-stage small businesses. Because the SBA is no longer providing new licenses or leverage for participating securities

[83] 13 CFR § 107.1120; 13 CFR § 107.1150; and U.S. Small Business Administration, "American Recovery and Investment Act of 2009: Implementation of SBIC Program Changes," letter from Harry Haskins, Acting Associate Administrator for Investment, to All Small Business Investment Companies (SBICs) and Applicants, Washington, DC, May 4, 2009, p. 1, http://archive.sba.gov/idc/groups/public/documents/sba_program_office/inv_rcvry_act_sbic_changes.pdf.

[84] 13 CFR § 107.1150; and 13 CFR § 107.710.

[85] 13 CFR § 107.1150.

SBICs, they have introduced legislation to create a new SBA program that would focus on the investment needs of startup and early-stage small businesses.

For example, during the 111th Congress the House passed, by a vote of 241-182, H.R. 5297, the Small Business Jobs and Credit Act of 2010. It would have authorized a $1 billion Small Business Early-Stage Investment Program.[86] The proposed program, which was not included in the final version of the bill, which became P.L. 111-240, the Small Business Jobs Act of 2010, would have provided equity investment financing of up to $100 million in matching funds to each participating investment company. It would have required participating investment companies to invest in small businesses, with at least 50% of the financing in early-stage small businesses, defined as not having "gross annual sales revenues exceeding $15 million in any of the previous three years."[87] The proposed program emphasized venture capital investments in start-up companies operating in nine targeted industries.[88]

P.L. 111-240, which was signed into law by President Obama on September 27, 2010, did not include legislative language authorizing a Small Business Early-Stage Investment Program.[89] Instead, it authorizes a three-year Intermediary Lending Pilot Program to provide direct loans to not more than 20 eligible nonprofit lending intermediaries each year, totaling not more than $20 million and $1 million per intermediary. The intermediaries, in turn, can make loans to new or growing small businesses, not to exceed $200,000 per business.[90]

Discussion

Advocates of the Small Business Early-Stage Investment Program and other efforts to encourage capital investment in startup and early-stage small businesses argue that, given the SBA's elimination of the SBIC participating securities program, it is necessary to "fill the gaps in the SBA's existing array of capital access programs, particularly in the provision of capital to early-stage small businesses in capital-intensive industries," because early-stage small businesses "have historically encountered the greatest difficulties in accessing credit."[91] Advocates assert that (1) "these inherent limitations have only been aggravated by the economic downturn;" (2) "venture capital financing and investments in early-stage businesses has stagnated since the last quarter of

[86] Representative Edward Perlmutter, "Providing for Further Consideration of H.R. 5297, Small Business Jobs and Credit Act of 2010, Roll No. 368," *Congressional Record*, daily edition, vol. 156, no. 91 (June 17, 2010), pp. H4608, H4609.

[87] H.R. 5297, the Small Business Lending Fund Act of 2010, Sec. 399L. Definitions.

[88] Ibid. The nine targeted industries are: agricultural technology, energy technology, environmental technology, life science, information technology, digital media, clean technology, defense technology, and photonics technology. A similar $200 million Small Business Early-Stage Investment Program was included in H.R. 3854, the Small Business Financing and Investment Act of 2009, which was passed by the House on October 29, 2009, by a vote of 389-32. It is awaiting action in the Senate.

[89] Senator Al Franken, "Small Business Lending Fund Act of 2010," Rollcall Vote No. 237 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158.

[90] P.L. 111-240, the Small Business Jobs Act of 2010, Sec. 1131. Small Business Intermediary Lending Pilot Program.

[91] H.Rept. 111-315, to accompany H.R. 3854, the Small Business Financing and Investment Act of 2009, p. 2. For the arguments presented by various organizations advocating the program see U.S. Congress, House Committee on Small Business, *Subcommittee on Finance and Tax Hearing on Legislative Proposals to Reform the SBA's Capital Access Programs*, 111th Cong., 1st sess., July 23, 2009, House Small Business Committee Document No. 111-039 (Washington: GPO, 2009), pp. 10-12, 60-67; and U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Access to Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), pp. 33-35, 50-54, 63-69, 86-99.

2008"; (3) "as a result, the gap for investment in early-stage and capital-intensive small businesses has grown wider"; and (4) "this critical component of the small business community has continued to be underserved by existing government programs."[92] They also argue that "according to SBA studies, the total unmet need for early-stage equity financing for small businesses is about $60 billion annually."[93]

Opponents argue that the Small Business Early-Stage Investment Program "will pile unnecessary risk or costs onto taxpayers at a time when we're dealing with record debt and unsustainable deficit spending."[94] They also argue that the program is untested, that the availability of federal funding is likely to encourage risky investments, and the legislation requires "only 50% of the funding … to be invested" in early-stage small businesses.[95]

Legislation to Require Expedited SBIC Licensing Procedures

In 2003, the SBA's Office of the Inspector General (OIG) reported that "an ongoing audit of SBIC oversight indicates that policies and procedures in the Investment Division do not limit financial risk."[96] In October 2004, the SBA's OIG issued seven recommendations to reduce the likelihood of the SBA facing large, unanticipated losses in the SBIC program such as those experienced following the collapse of technology-based stock values in 2000 and 2001.[97] Three of the recommendations concerned the SBA's measurement and oversight of potential SBIC program costs and four of the recommendations concerned the oversight and liquidation of financially troubled SBICs.[98]

At that time, the SBA's OIG included the SBA's financial oversight of the SBIC program in its annual list of the most serious management and performance challenges facing the SBA, and indicated that the SBIC program would remain on the list until the recommendations were implemented.[99] In 2009, the SBA's OIG reported that the SBA had adequately addressed five of its seven recommendations.[100] In 2010, the SBA's OIG reported that the SBA had adequately

[92] H.Rept. 111-315, to accompany H.R. 3854, the Small Business Financing and Investment Act of 2009, p. 3.

[93] Ibid., p. 20.

[94] Representative Sam Graves, "Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, vol. 156, no. 90 (June 16, 2010), p. H4516.

[95] Ibid; and Representative Jeff Flake, "Small Business Early-Stage Investment Act of 2009," House debate, *Congressional Record*, vol. 155, no. 171 (November 18, 2009), p. H13083.

[96] U.S. Small Business Administration, Office of the Inspector General, "FY2003 Agency Management Challenges," Washington, DC, January 17, 2003, p. 30, http://archive.sba.gov/ig/onlinelibrary/tmc/index.html.

[97] U.S. Small Business Administration, Office of the Inspector General, "FY2005 Report on the Most Serious Management and Performance Challenges Facing the SBA," Washington, DC, October 15, 2004, p. 11, http://archive.sba.gov/idc/groups/public/documents/sba/oig_reports_tmc_fy05.pdf.

[98] U.S. Small Business Administration, Office of the Inspector General, "FY2005 Report on the Most Serious Management and Performance Challenges Facing the SBA," Washington, DC, October 15, 2004, p. 11, http://archive.sba.gov/idc/groups/public/documents/sba/oig_reports_tmc_fy05.pdf.

[99] The most recent Office of the Inspector General's annual reports on the most serious management and performance challenges facing the SBA are on-line at http://www.sba.gov/office-of-inspector-general/875 and an archive of reports since FY2000 can be viewed at http://archive.sba.gov/ig/onlinelibrary/tmc/index.html.

[100] U.S. Small Business Administration, Office of the Inspector General, "FY2010 Report on the Most Serious Management and Performance Challenges Facing the SBA," Washington, DC, October 16, 2009, p. 7, http://www.sba.gov/office-of-inspector-general/875/12354.

addressed the remaining recommendations and removed the SBIC program from its list of most serious management and performance challenges facing the SBA.[101]

The SBA is currently focusing its attention on improving the SBIC licensing process, which NASBIC has argued in recent congressional hearings is "the number one complaint of SBICs."[102] In FY2009, the SBA took, on average, 13.2 months to process an SBIC license. During the first half of FY2010, the SBA reduced that average processing time to 5.8 months.[103] NASBIC has argued that it should take the SBA no longer than six months, and preferably no longer than four months, to process an application for an SBIC license from a new applicant, and less time than that to process an application for an SBIC license from an existing SBIC.[104]

The SBA reported that it was able to reduce the SBIC licensing processing time in FY2010 by making licensing a priority for the SBA Investment Division, initiating a "Fast Track" licensing process for SBICs seeking a subsequent license, reducing the number of questions asked of SBICs seeking a subsequent license, incorporating timeliness standards in all SBA licensing analysts and supervisors' performance plans to further emphasize speed in processing applications, adding two new analysts to the SBA's licensing office to assist with the processing of applications, and adding another analyst to the SBA's program development office to assist with the review of applications prior to the actual filing of the application.[105] The SBA also reported that is continuing to identify additional processing changes to further "facilitate processing and reduce any redundancies in the process."[106]

Discussion

H.R. 3854, the Small Business Financing and Investment Act of 2009, included a provision requiring the SBA to develop expedited licensing procedures for experienced SBIC applicants. Specifically, the SBA would be required to approve an application for a new SBIC license within 60 days of its receipt if the applicant met a list of requirements, including having been in operation as a licensed SBIC for at least three years prior to the receipt of the request, having at least half of the principal managers of the applicant consist of at least two-thirds of the principal managers of a licensed SBIC, meeting specified minimum performance thresholds (such as having maintained six consecutive quarters of profitable net investment income and at least three exits from investments in small businesses that have realized profits from those respective

---

[101] U.S. Small Business Administration, Office of the Inspector General, "FY2011 Report on the Most Serious Management and Performance Challenges Facing the SBA," Washington, DC, October 15, 2010, p. 10, http://www.sba.gov/sites/default/files/oig_reports_tmc_fy11_0.pdf.

[102] U.S. Small Business Administration, "FY2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, p. 51; and U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Access to Capital for Small Businesses*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), p. 88.

[103] U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the authors, September 21, 2100.

[104] U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital* , 111th Cong., 1st sess., June 10, 2009, House Committee on Small Business Document No. 111-028 (Washington: GPO, 2009), pp. 10, 22, 23, 70.

[105] U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the authors, September 21, 2100.

[106] Ibid.

investments), and being in good standing.[107] The bill was passed by the House on October 29, 2009, by a vote of 389-32, and referred to the Senate for consideration.[108] On November 2, 2009, the bill was referred to the Senate Committee on Small Business and Entrepreneurship.

The House committee report accompanying H.R. 3854 argued that "the existing licensing process is perhaps the single-greatest impairment to the SBIC program."[109] The report also indicated that the SBA's licensing procedures for experienced SBICs needed to be revised because the SBA's "licensing and relicensing process has become so cumbersome that many successful SBICs leave the program rather than deal with the arduous and lengthy task of SBA licensing."[110]

H.R. 5554, the Small Business Assistance and Relief Act of 2010, included the same legislative language contained in H.R. 3854 providing for expedited licensing procedures for experienced SBIC applicants.[111] It was introduced on June 17, 2010, and referred to the House Committee on Small Business.[112]

Legislation to Increase SBIC Financing Levels

In FY2010, the SBA's leverage ($931 million) amounted to less than one-third (31.0%) of its authorized level of $3 billion.[113] NASBIC has characterized the SBIC program as "dramatically underused."[114] It has argued that the program's financing levels would increase if (1) the SBA further improved its licensing processing procedures to make them more timely and objective, (2) the percentage of SBIC regulatory capital allowed from state or local government entities was increased from its present maximum of 33%, and (3) the SBIC program's family of funds limit (currently $225 million for two or more licenses under common control) was increased to allow

[107] The bill defines good standing as being a licensed leveraged or non-leveraged SBIC actively operating on the date of the initial receipt of the application, having no principal manager found liable in a civil action for fraud if the SBA makes a reasonable determination based on evidence that such liability has a material adverse effect on the applicant's ability to perform required obligations required by a license, and having no principal manager under investigation by a governmental agency or authority, under indictment, or convicted of a felony for a violation of federal or state securities laws, fraud, or another criminal violation if such investigation, indictment, or conviction has a material adverse effect on the applicant's ability to perform obligations required by a license. See H.R. 3854, the Small Business Financing and Investment Act of 2009, Sec. 402. Expedited Licensing for Experienced Applicants.

[108] Representative Diana DeGette, "Roll No. 830," House vote on H.R. 3854, *Congressional Record*, daily edition, vol. 155, part 159 (October 29, 2009), pp. H12116, H12117.

[109] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 36.

[110] Ibid.

[111] H.R. 5554, the Small Business Assistance and Relief Act of 2010, Sec. 592. Expedited Licensing for Experienced Applicants.

[112] The bill was also referred to the House Committees on Ways and Means, Appropriations, Energy and Commerce, and Financial Services, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned.

[113] U.S. Small Business Administration, Office of Legislative Affairs, correspondence with the author, October 20, 2010.

[114] U.S. Congress, House Committee on Small Business, *Full Committee Hearing On Increasing Capital For Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), pp. 32, 87.

SBICs to have a series of investment funds in place, where, for example, "one fund could be winding down, another could be at peak, and another could just be ramping up."[115]

H.R. 3854 and H.R. 5554 would have encouraged greater utilization of the SBIC program by increasing the maximum percentage of SBIC regulatory capital allowed from state or local government entities from 33% to 45%.[116] Both measures would have also increased the SBIC program's family of funds limit from $225 million to $350 million; increased the SBIC program's limit of $250 million to $400 million for multiple funds under common control who are licensed after September 30, 2009, and invest 50% of their dollars in low income geographic areas; and increased the SBIC program's authorization level from $3 billion to $5.5 billion in FY2011.[117]

Discussion

One of the SBA's goals is to enhance the SBIC program's "acceptance in the marketplace and increase the number of funds licensed and the amount of leverage issued so as to improve capital access for small businesses."[118] The SBA has asserted that ARRA's changes to the SBIC program will help it to achieve this goal. ARRA increased the maximum leverage available to SBICs to up "to three times the private capital raised by the SBIC, or $150 million, whichever is less, and $225 million for multiple licensees under common control" and increased "the maximum leverage amounts to $175 million for single funds and $250 million for multiple funds under common control who are licensed after September 30, 2009, and invest 50% of their dollars in low income geographic areas."[119] The SBA has not requested a further increase in the SBIC program's leverage limits or an increase in the program's current authorization level of $3 billion.

Advocates of increasing the SBIC program's leverage limits and authorization level to achieve a greater utilization of the SBIC program argue that these actions are necessary to help fill a gap "in the SBA's array of capital access programs."[120] For example, NASBIC has argued that the demise of the SBIC participating securities program and the current "underutilization" of the SBIC debentures program is preventing many small firms from accessing the capital necessary to fully realize their economic potential and assist in the national economic recovery.[121] Others worry about the potential risk an expanded SBIC program has for the taxpayer, especially if investments

[115] U.S. Congress, House Committee on Small Business, *Full Committee Hearing On Increasing Capital For Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), pp. 88, 89.

[116] H.R. 3854, the Small Business Financing and Investment Act of 2009, Sec. 401. Increased Investment from States; and H.R. 5554, the Small Business Assistance and Relief Act of 2010, Sec. 591. Increased Investment from States.

[117] H.R. 3854, the Small Business Financing and Investment Act of 2009, Sec. 401. Increased Investment From States, Sec. 403. Revised Leverage Limitations For Successful SBICs, and Sec. 408. Program Levels; and H.R. 5554, the Small Business Assistance and Relief Act of 2010, Sec. 591. Increased Investment from States, Sec. 593. Revised Leverage Limitations for Successful SBICs, and Sec. 598. Program Levels.

[118] U.S. Small Business Administration, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," Washington, DC, 2010, p. 52.

[119] U.S. Small Business Administration, "SBA Project Plan, Section 505: SBIC Program Changes," Washington, DC, June 16, 2010, http://archive.sba.gov/idc/groups/public/documents/sba_homepage/sba_sbic_plan.pdf.

[120] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 3.

[121] U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, House Small Business Committee Document No. 111-051 (Washington: GPO, 2009), pp. 88-91.

are targeted at startup and early-stage small businesses which, by definition, have a more limited credit history and a higher risk for default than businesses that have established positive cash flow.

Concluding Observations

Some, including President Barack Obama, have agued that current economic conditions make it imperative that the SBA be provided additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs.[122] In their view, encouraging greater utilization of the SBIC program will increase small business access to capital, result in higher levels of job creation and retention, and promote economic growth. For example, the House Committee on Small Business report accompanying H.R. 3854 indicated that

> The SBA's lending and investment programs are intended to bridge the gap in financing that occurs when the private markets contract. Conventional wisdom would suggest that these programs would expand when the gap in private credit grows during times of economic stress. Unfortunately, that has not been the case in this economic downturn. A growing number of businesses have struggled to secure loans and other forms of capital through the SBA's lending and investment programs. Despite moderate improvements that can be attributed to the small business lending initiatives contained in ARRA, the conditions for small business credit have been slow to improve….
>
> If the declines in small business lending [are] to be halted, inherent deficiencies in the SBA's capital access programs must be addressed. The agency must have additional lending programs that are better suited to operate under conditions where lenders are under increased capital constraints and extremely sensitive to risk. Additionally, these programs must provide significant tangible benefits to small business borrowers that are struggling with lower revenues and greater uncertainty in the near-term. While the SBA's existing programs cannot meet these criteria, the changes implemented under H.R. 3854 [including enhancements to the SBIC program] will address these needs.[123]

Others worry about the potential risk an expanded SBIC program has for increasing the federal deficit. In their view, the best means to assist small business, promote economic growth, and create jobs is to reduce business taxes and exercise federal fiscal restraint.[124] For example, during floor debate on H.R. 3854 Representative Pete Sessions argued:

> This legislation … would offer some assistance to small business, but I believe there are more effective ways to assist them during the economic crisis. For instance, not growing the size of government just to give them, small business, a loan. We should be doing things to

[122] Representative Nydia Velázquez, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12074, H12075; Senator Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12910; and The White House, "Remarks by the President on Job Creation and Economic Growth," Washington, DC, December 8, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth.

[123] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, committee print, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 5.

[124] National Federation of Independent Business, "Payroll Tax Holiday," Washington, DC, http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49039/; and NFIB, "Government Spending," Washington, DC, http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49051/.

> improve small business by expensing, by permanently repealing the death tax, by extending tax relief, by improving regulatory reform, by not adding a cap-and-trade bill, and by … not … passing a health care bill which will diminish American jobs.[125]

As these quotations attest, congressional debate concerning the SBIC program has primarily involved assessments of the ability of small businesses to access capital from the private sector and evaluations of the program's risk, the effect of proposed changes on the program's risk, and the potential impact of the program's risk on the federal deficit. Empirical analysis of economic data can help inform debate concerning the ability of small businesses to access capital from the private sector and the extent of the program's risk, the affect of proposed changes on the program's risk, and the potential impact of the program's risk on the federal deficit. Additional data concerning SBIC investment impact on recipient job creation and firm survival might also prove useful. However, ultimately, these assessments are often secondary to personal value judgments concerning the federal government's role in promoting business, and the SBA's role in promoting small business.

[125] Representative Pete Sessions, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, part 159 (October 29, 2009), p. H12071.

Appendix. Small Business Eligibility Requirements and Application Process

Small Business Eligibility Requirements

Only businesses that meet the SBA's definition of "small" may participate in the SBIC program. They must meet either the SBA's size standard for the industry in which they are primarily engaged, or a separate financial size standard which has been established for the SBIC program. SBICs use the size standard that is most likely to qualify the company, typically the financial size standard for the SBIC program. It is currently set as a maximum net worth of no more than $18 million and average after-tax net income for the preceding two years of not more than $6 million.[126] All of the company's subsidiaries, parent companies, and affiliates are considered in determining if it meets the size standard.

In addition, since 1997, the SBA has required SBICs to set aside a specified percentage of their financing to "businesses at the lower end of the permitted size range," primarily because "the financial size standards applicable to the SBIC program are considerably higher than those used in other SBA programs."[127] For example, P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), amended those regulations to require SBICs licensed on or after the date of its enactment (February 17, 2009) to certify that at least 25% of their future financing is invested in smaller enterprises. A smaller enterprise is a company that, together with any affiliates, either has net worth of no more than $6 million and average after-tax net income for the preceding two years of no more than $2 million, or meets the SBA's size standard in the industry in which the applicant is primarily engaged.[128]

SBICs licensed before February 17, 2009, that have not received any SBA leverage commitments after February 17, 2009, must have at least 20% of its aggregate financing dollars (plus 100% for leverage commitments over $90 million) invested in smaller enterprises.

SBICs licensed before February 17, 2009, that have received a SBA leverage commitment after February 17, 2009, must meet the 20% threshold (plus 100% for leverage commitments over $90 million) for financing provided before the date of the first leverage commitment issued after February 17, 2009, and the 25% threshold for financing made on or after such date.[129]

SBICs are not allowed to invest in the following: other SBICs; finance and investment companies or finance-type leasing companies; unimproved real estate; companies with less than 51% of their assets and employees in the United States; passive or casual businesses (those not engaged in a regular and continuous business operation); or companies that will use the proceeds to acquire farmland.[130] In addition, SBICs may not provide funds for a small business whose primary

[126] 13 CFR § 107.700; 13 CFR § 107.710; 13 CFR § 301(c)(2); and 13 CFR § 301(c)(1).

[127] U.S. Small Business Administration, "Small Business Investment Companies ─ Leverage Eligibility and Portfolio Diversification Requirements," 74 *Federal Register* 33912, July 14, 2009.

[128] 13 CFR § 107.710.

[129] U.S. Small Business Administration, "Small Business Investment Companies ─ Leverage Eligibility and Portfolio Diversification Requirements," 74 *Federal Register* 33912, July 14, 2009.

[130] 13 CFR § 107.720.

business activity is deemed contrary to the public interest or if the funds will be used substantially for a foreign operation.[131]

Small Business Application Process

Small business owners interested in receiving SBIC financing can search for active SBICs using the SBA's SBIC directory.[132] It provides contact information for all licensed SBICs, sorted by state. It also includes the SBIC's preferred minimum and maximum financing size range, the type of capital provided (e.g., equity, mezzanine, subordinated debt, 1st and 2nd lien secured term, and preferred stock), funding stage preference (e.g., early stage, growing and expansion stage, and later stage), industry preference (e.g., business services, manufacturing, environmental services, and distribution), geographic preference (e.g., national, regional, or specific state or states), and a description of the firm's focus (e.g., equity capital to later stage companies for expansion and acquisition, targeting companies with revenues of at least $5 million and profitability at the time of financing).[133]

After locating a suitable SBIC, the small business owner presents the SBIC a business plan that addresses the business's operations, management, financial condition, and funding requirements. The typical business plan includes the following information:

- the name of the business as it appears on the official records of the state or community in which it operates;
- the city, county, and state of the principal location and any branch offices or facilities;
- the form of business organization and, if a corporation, the date and state of incorporation;
- a description of the business, including the principal products sold or services rendered;
- a history of the general development of the products or services during the past five years (or since inception);
- information about the relative importance of each principal product or service to the volume of the business and to its profits;
- a description of business's real and physical property and adaptability to other business ventures;
- a description of technical attributes of its products and facilities;
- detailed information about the business's customer base, including potential customers;
- a marketing survey or economic feasibility study;

[131] Ibid.

[132] U.S. Small Business Administration, "Small Business Investment Companies: Entrepreneurs Seeking Financing," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/esf/INV_DIRECTORY_SBIC.html.

[133] Ibid.

- a description of the distribution system for the business's products or services;
- a descriptive summary of the competitive conditions in the industry in which the business is engaged, including its competitive position relative to its largest and smallest competitors;
- a full explanation and summary of the business's pricing polices;
- brief resumes of the business's management personnel and principal owners, including their ages, education, and business experience;
- banking, business, and personal references for each member of management and for the principal owners;
- balance sheets and profit and loss statements for the last three fiscal years (or from inception);
- detailed projections of revenues, expenses, and net earnings for the coming year;
- a statement of the amount of funding requested and the time requirements for the funds;
- the reasons for the request for funds and a description of the proposed uses; and
- a description of the benefits the business expects to gain from the financing (e.g., expansion, improvement in financial position, expense reduction, and increase in efficiency).[134]

Because SBICs typically receive hundreds of business plans per year, the SBA recommends that small business owners seek a personal referral or introduction to the particular SBIC fund manager being targeted to increase "the likelihood that the business plan will be carefully considered."[135] According to NASBIC, "a thorough study an SBIC must undertake before it can make a final decision could take several weeks or longer."[136]

Author Contact Information

Robert Jay Dilger
Senior Specialist in American National Government
rdilger@crs.loc.gov, 7-3110

Oscar R. Gonzales
Analyst in Economic Development Policy
ogonzales@crs.loc.gov, 7-0764

[134] National Association of Small Business Investment Companies, "SBIC Financing: Step-by-Step," Washington, DC, http://www.nasbic.org/?page=SBIC_financing.

[135] U.S. Small Business Administration, "Small Business Investment Companies: Entrepreneurs Seeking Financing," Washington, DC, http://archive.sba.gov/aboutsba/sbaprograms/inv/esf/INV_DIRECTORY_SBIC.html.

[136] National Association of Small Business Investment Companies, "SBIC Financing: Step-by-Step," Washington, DC, http://www.nasbic.org/?page=SBIC_financing.