

PA House of Representatives Republican Policy Committee,
Job Creation Policy Team
August 11, 2011

Public Hearing on “Cost of Doing Business in PA”

I want to thank the Republican Policy Committee for taking the time to convene this discussion.

I am Marilyn D. Landis, President & CEO of Basic Business Concepts, Inc. I founded the company in 2001 to provide CFO level services to small businesses that don't have a CFO. Headquartered in Pittsburgh, we currently have five offices in four states – Pennsylvania, Ohio, New England and California - and clients in more than eight states. Before starting my own business I spent 30 years as a commercial lender- the last seven of which working for three of the largest SBA lenders in the country. In 2009 I was the SBA National Financial Services Champion.

I actively advocate for small businesses. I am a past chair of the National Small Business Association (NSBA) – the nation's oldest small business advocacy association - representing 150,000 small businesses nationwide. Representing NSBA I have testified before the US House and the Senate numerous times. I have also participated in several national credit crunch summits over the last two years. I serve under the National Ombudsman on the National Regulatory Fairness Board. Regionally I am the immediate past chair of SMC Business Councils.

This hearing was convened to address the cost of doing business in Pennsylvania. One of the ways to mitigate the necessary costs of doing business – taxes, regulations and workforce development – is for businesses to have the necessary capital. Since 1993 – when NSBA started tracking this data – their economic survey (1) has shown a direct correlation between access to capital and job growth. When capital flows more freely, small businesses add new jobs.

Micro or very small businesses represent more than 80% of all business in the U.S. Last year, more Americans became entrepreneurs than any time in the last 15 years. If one in three microenterprises hired a single employee, the U.S. would be at full employment. (2) Put another way, small employers comprise 99.7% of all employers nationally. Firms with fewer than 50 workers employ slightly more than a quarter of the national workforce. Expand that to the SBA definition of a small business – less than 500 employees – and small business accounts for about half of all economic activity (3)

So, what does half the economy think? 88% expect a flat or recessionary economy in the coming year (1). But – 64% are confident about the future of their business. What is the PA equivalent? 875,000 PA business owners are bracing for an anti-growth environment - flat or recessionary (4). But 637,000 are confident in their business. 55% are growing or see growth opportunity in the next year (1) – that's 547,000 businesses in PA who are looking for resources to grow.

What are their growth strategies? Only 10% plan to expand operations and/or facilities (1) – that means only 10% will need state programs like PIDA or MELF! In fact, growth requiring additional buildings or equipment didn't even make the top four growth strategies. The top growth strategies will require working capital. 22% reported employment gains in the last 12 months. 29% will hire new employees. 43% will increase employee compensation.

22% of small businesses surveyed reported lack of available capital as their biggest challenge (1) – that translates to 219,000 Pa businesses. Many businesses lost credit because of their industry, geographic location or asset value decline – even if the fundamentals of their business itself were strong. (5) 36% of the respondents to NSBA’s survey last month said they were unable to secure adequate credit. In PA that translates to 358,000 businesses. In PA 23% of small businesses are employers (3) – that means 82,000 employers were unable to secure adequate credit. How have these business responded to the lack of capital? 18% were forced to reduce their number of employees. 10% were unable to increase inventory. 18% were unable to finance increased sales. 36% were unable to grow or expand – remember the top growth strategies need working capital not loans to acquire buildings and equipment. (1)

Business owners rank access to capital as the most important issue facing privately held companies (7). Access to capital has always been tough for small business – we don’t have capital markets to raise equity or sell commercial paper – we only have debt. This is especially true for the largest segment of businesses in our modern economy – technology and service companies. These are companies who need cash for payroll and innovation – not commercial real estate. These companies, therefore, have never had the collateral traditional lenders look for – real estate equity or heavy equipment. For these companies what was tough has become almost impossible. In March of last year The Wall Street Journal commented on the small business lending outlook, “...the local banks they [small business] depend on – [are] worried about borrowers’ financial strength, scrutinized by regulators and slammed by souring real-estate loans – might not be willing or able to provide the credit they need....The stakes are particularly high for community banks, which tend to be much more active in commercial real estate than their counterparts. This has been further exacerbated by community banking’s underwriting response to regulatory pressure – a continued reliance on collateral – primarily real estate.

Remember – 64% of small businesses are confident about their future. Based on numerous studies – Federal Reserve, Pepperdine University and others – their greatest need for capital is for working capital loans under \$250,000. These businesses need capital to create jobs – they have orders in hand but lack “bankable collateral”. In most cases they collected their receivables, sold their inventory, used their cash to re-tool, sold non-operating assets, saw their real estate values decline – in short, simply don’t have the traditional collateral banks require. But – they have real contracts – solid orders – in hand. They are ready to purchase raw materials, hire workers back – but lack the capital to move forward.

Federal programs – like the SBA aren’t meeting small business’s need for working capital. Other than two new programs – available only in limited locations to traditionally underserved markets (in PA available only in Philadelphia) – the SBA programs are geared to real estate and heavy equipment. SBA also requires a bank resource partner. SBA lending by the number is up – but look closely and the volume is driven by commercial real estate refinancing. And even those limited federal programs that offer working capital set the job count per loan dollars too high to be realistic for businesses with less than 100 employees.

What will differentiate PA from other states is the presence or absence of capital access programs available to small businesses. PA has 994,000 small businesses – most of who have orders but lack the capital to hire back employees, purchase the raw materials and do the work. These are businesses that burned through their savings, their reserves and even their retirement accounts to meet their obligations, scale down to the new reality – found new customers – shuttered unprofitable lines – added divisions

with better sales prospects and margins. In short – did all the right – responsible things – they are here, receiving orders and unable to secure working capital

I have seen what other states propose. These states are taking a hard look at what the state can do for their state's businesses. These states recognize the difference between subsidizing a declining business and funding assistance to a viable business with orders in hand. Pennsylvania businesses will be at a disadvantage if Pennsylvania doesn't recognize the need and step up to help the surviving small businesses fund the work they already have in hand.

What can the state of Pennsylvania do to help with access to capital? First – let me point out that SMC and its members are very aware of the financial stress the economy is already experiencing - Our Legislative Action Committee carefully looked at many options – the ones we propose today are those we feel have merit but not a significant state funded price tag.

Proposal number one - funding for small businesses awarded state contracts could be built into the process by modifying the payment schedule. Once a contract or purchase order is awarded to a qualified small business – if the state advanced the funds for the contractor to purchase the materials and meet the payroll to start that contract, then the contractor wouldn't need to borrow funds to pay for materials and labor while waiting to get paid by the state. When the contract is complete – if the state paid in full at completion – not 30 days later – the contractor would have the funds to start another job without debt. Normal 10% retainage would still apply – we're talking about the other 90% of the contract – no additional cost to the state – just a change in timing. The federal government has a limited mechanism for advances to contractors which is not widely utilized because of the stigma attached in the bidding process. The state must treat all bidders the same – whether or not they ask for the “on time payment option”.

Proposal number two – the state received \$29 million in federal funding made available by last year's federal stimulus bill. Per Scott Dunkelberger “we put the bulk of this money in the hands of local organizations”. This makes it even tougher for Pennsylvania businesses, where state economic development funds almost always require a 50% bank match (6) – if the banks aren't available - the funds aren't available to the small business. There are three components of the state's criteria – that if re-worked – could make this influx of federal money more accessible to the PA businesses that need it. One – re-think the job count per loan dollars. The reality, in this economy, one new job per \$25,000 in loan proceeds for example (6), doesn't cover the cost of one new employee – let alone materials. Re-define the [CDFI] definition of “underserved” markets to include otherwise viable businesses who are currently “underserved” due to the financial meltdown and subsequent recession. These are businesses who have the infra-structure, talent, experience and supply chains to immediately add jobs if they had the capital. Third, de-couple state economic development funds from the requirement that there be a matching bank capital component.

Proposal number three is already in place in The state of New York where working with community banks, national banks and international banks the state facilitated the formation of several pools of funds. Twenty six banks around the state agreed to pool \$7.5 million. Small businesses can apply for the loans - \$25K to \$150K – if they can prove they've been turned down for a loan by their primary lender. Banks, required to lend, and further required to meet CRA goals, are stymied by the inability to

find borrowers who meet their limited credit requirements at this time. Contributing to these pools of funds puts their money into loans. Non-profit economic development groups were contracted to originate, underwrite and service the loans made from these pools. The state of New York divided the loan pools into regions to facilitate the local administration of the funds by economic development groups who know their communities best. These funds are not for real estate loans or heavy equipment loans –the dollar amounts, therefore, do not need to be large. Even a good size small business may only need \$100,000 or less to execute on purchase orders or contracts they have – this is real business - that once funded and complete will generate cash to fund the next set of orders. These loans are seed money to prime the well – to get the flow of orders and work flowing again. Of note – the loan size is not tied to number of new employees

Proposal number four is patterned after Rhode Island. An innovative non-bank lender has successfully lent hundreds of millions of dollars to small businesses nationwide - \$25,000 to \$300,000. Because On-Deck is a not a bank – their cost of funds is higher than a bank – therefore their loan rates are higher. Rhode Island is looking at investing state pension funds into On-Deck at a guaranteed 8%. In return, On-Deck will lend funds to Rhode Island businesses at 10%. This definitely makes it advantageous to be a small business in Rhode Island.

Small businesses are the spark of innovation – the drivers of green technology – the employers in the community. Small business owners who have survived to this point need cash to execute the orders they have in hand.

There is a vast array of state programs – but in today’s reality, few are meeting the real – immediate needs of the business owner who is trying to re-grow their business.

Thank you for your time and interest. I would welcome any questions.

- (1) NSBA 2011 Mid-Year Economic Report
- (2) Association for Enterprise Opportunity May 2011
- (3) Tuscon Business Times August 1, 2011
- (4) SBA Office of Advocacy Small Business Profile: Pennsylvania 2008 Census data
- (5) John Tozzi, Bloomberg Businessweek February 24, 2011
- (6) DCED Small Business First Fund
- (7) Pepperdine University June 2011