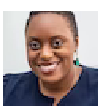
THIRD WAY

REPORT *Published March 22, 2023 • 12 minute read*

A Lawmaker's Guide to Reauthorizing the Small Business Act



Imani Augustus
Director of the Alliance for Entrepreneurial Equity
@__ImaniMA

Takeaways

As we approach the 70th anniversary of the US Small Business Administration, we examine several ways Congress should reauthorize the Small Business Act to ensure it brings modern solutions to modern problems. Specifically, we lay out a series of ideas that would boost the availability of small loans, diversify access to investment capital, reduce barriers to federal contracting, promote entrepreneurial development, and streamline oversight and accountability.

The US Small Business Administration (SBA) is having its platinum anniversary this summer. The coming milestone deserves celebration, but it also has small businesses and policymakers alike asking how the agency should prepare for the needs of the next seven decades. Last Congress, Chairman Ben Cardin of the Senate Small Business Committee introduced legislation to reauthorize and modernize many of SBA's core programs. Republicans in the House introduced a separate bill to fortify accountability and oversight at the agency. As both chambers prepare to build upon those efforts, we recommend a series of policies to enhance the SBA's important work and specifically meet businesses' needs in underserved communities.

Boost the availability of small loans.

The demand for smaller dollar loans is rising, especially among newly formed businesses owned by people of color and entrepreneurs in rural areas. For example, during the pandemic, most loans to businesses were under $150,000. [1] Yet, among this need, minority-owned firms are far more likely to be shut out of financing. [2] In rural areas, borrowers depend on a dwindling number of physical bank branches and have less access to online banking options. [3] Almost 70% of loans in the agency's flagship 7(a) loan program are under $350,000—highlighting the significant demand for loans at this level. [4]

For businesses facing a credit gap, SBA's lending programs are critical. But the Agency can do more to respond to capital needs by improving the availability of small-principal loans. Here's how Congress can help:

- **Authorize direct lending.** Congress should consider leveraging the SBA's existing 7(a) loan program as a vehicle for new direct lending to entrepreneurs looking for smaller-dollar loans. In 2020, two-thirds of Black and Hispanic business borrowers sought financing for less than $100,000. [5] Loans this size do not accumulate sufficient interest and fees to make the costs of underwriting worth the risk for traditional lending institutions. More direct government intervention on this lower-dollar end of the capital marketplace, particularly in high-demand industries, would fill a critical need in underserved communities.

- **Make the Community Advantage Loan Program permanent.** The program, launched as a pilot in 2011 to support underserved markets, provides capital to businesses with loans that are capped at $350,000. The program also keeps the interest rates and collateral requirements in check, making the loans more affordable for strapped companies. Making the program permanent, as proposed in Senator Cardin's 2022 bill, could give new lenders enough certainty to add this option to their credit offerings and make small loan financing more accessible for businesses. The SBA is also seeking to make its Community Advantage program participants a permanent part of its 7(a) lending community through new rulemaking. [6]

- **Eliminate or reduce fees on small 7(a) loans.** For many years, the SBA Administrator has exercised discretion over adjusting certain fees when the 7(a) program generates enough revenue to cover new loan guarantees. When the Administrator authorizes a reduction in fees, it allows small businesses to take home more of the financial support they need. In a notice released last September, the SBA extended fee waivers on loans up to $500,000. [7] Congress should look for ways to permanently reduce or eliminate fees for small-dollar borrowers while preserving the integrity of the 7(a) program and the Administrator's flexibility.

Diversify access to investment capital.

Patient capital in equity investments allows businesses to increase capacity, hire workers, and grow without being saddled with debt. Alternatives to debt financing, like those offered through the SBA's Small Business Investment Company (SBIC) Program, supply capital to scalable companies in their growth phase. Last month, AEE looked at the SBIC Program and found barriers within the program that keep investors of color and minority business owners from fully benefiting. [8] Further, the concentration of the traditional venture capital market along the coasts means rural businesses are often overlooked for equity financing opportunities as well.

Here's how Congress can fix this:

- **Revive and reinvent the Venture SBIC program.** Though fund managers aim to get growth capital to promising new companies, institutional investors are not writing checks as freely as they were even a few months ago. [9] Now could be the time to revive a 30-year-old program that enabled SBA to back equity investments through "Participating Securities SBICs." The program was shut down after regulations and structural flaws fueled speculative portfolios that failed when the Dot Com bubble burst in 2000. By correcting those statutory errors with modern portfolio theory and prudent regulatory controls, Congress can empower the SBA to become a limited partner in targeted investment funds once more.

- **Equip diverse emerging managers.** Research shows that diverse-owned businesses are funded at much higher rates when underrepresented communities are part of the investment class. But application costs and regulatory burdens ensure that less-experienced, first-time applicants face challenges in becoming licensed SBICs. By establishing a new category of SBIC managers and pairing them with more experienced participants, as proposed in Senator Cardin's SBA Reauthorization bill, we can narrow knowledge gaps and build a more robust pipeline of diverse investors within the program.

- **Lengthen the repayment window.** Under the current program, investors must start repaying interest on SBA leverage immediately. This tends to drive capital toward matured businesses with significant cash flow and cuts out promising startups that typically operate pre-revenue for many years. To address this challenge, the Biden-Harris Administration has proposed the formation of "Accrual SBICs" that could defer interest and principal repayments until after a ten-year maturity date. This will encourage investors to dedicate more of their portfolio to long-term equity investments in younger, smaller businesses.

Reduce barriers to federal contracting opportunities.

The federal government is the largest customer in the world, but minority-owned and women-owned businesses often get shut out. As AEE pointed out last year, minority-owned small businesses only got 9.4% of contract dollars and women-owned small businesses a meager 4.9%.[10] SBA's 8(a) Business Development Program is one tool designed to get diverse entrepreneurs contract-ready. But businesses still encounter problems. For example, admission into the program is prohibitively competitive. In 2021, only 610 firms were approved for participation and less than 5,000 businesses were active in the program.[11] Once in the program, keeping up is difficult. Only 35% of companies successfully graduate.[12] And some businesses have reported exceptional difficulty securing clients after losing their 8(a) eligibility.

The SBA's contracting programs can play a crucial role in diversifying the government's available pool of suppliers if Congress can make the following improvements:

- **Count online retail purchases toward contracting goals.** E-commerce has created new channels for government agencies and prime contractors to acquire goods and services through small businesses. However, current law governing federal contracting goals prohibits agencies from receiving credit for their online purchases with small and disadvantaged businesses. Legislation to allow business done through online marketplaces could help agencies reach federally-mandated goals and provide greater access to contracts for underrepresented communities.

- **Implement anti-bundling policies.** Bundling contracts from multiple agencies and placing large orders may sound like cost-saving efficiency, but it unintentionally leaves fewer opportunities for smaller manufacturers. The practice is called "category management." And it makes it harder for women- and minority-owned businesses to break into sectors where they are unrepresented.[13]

- **Provide more transitional and post-graduation support.** A study found that within 10 years of graduating from the 8(a) program, more than 60% of businesses are no longer bidding on or winning federal prime contracts. [14] When the company no longer qualifies for 8(a) set-asides, customers aren't necessarily there to fill the gap. Congress needs to ensure there is more of a ramp for businesses to establish relationships that endure beyond the program. Senator Cardin addresses this in his bill by lengthening the 8(a) program to 10 years.

- **Protect set-aside programs from abuse.** The Women-Owned Small Business (WOSB) program is intended to give eligible companies greater access to contracting opportunities. But for almost 10 years, the SBA has faced challenges in establishing procedures to ensure only eligible firms receive set-aside contracts. In 2022, the SBA Office of Inspector General found that the Agency had established a WOSB certification process but did not require any documentation to ensure businesses met size standards or that women were majority owners of the business. SBA must create an environment for eligibility to be verified before awards are disbursed. [15]

Promote entrepreneurial development programs.

Expert assistance, mentorship, and counseling are essential services that the SBA provides through its Office of Entrepreneurial Development. The largest of SBA's resource partners, the Small Business Development Center Program, offers free or low-cost advice to businesses on marketing, accounting, international trade, technology transfer, and energy conservation. [16] However, these services only benefit companies that know where to look. Currently, SBDCs aren't allowed to use their federal award for marketing. And one-in-five small businesses still lack access to an SBA service center. [17]

To help SBA's resource partners strengthen relationships with businesses in the community, Congress should:

- **Extend the Community Navigator Pilot Program.** The Community Navigator program (CNPP) was piloted in 2021 to help the SBA close resource gaps in underserved minority and rural communities. Navigators are serving a diverse group of small businesses. According to SBA data, 40% of clients served by CNPP are Black, 30% are Hispanic, and 10% are Asian. And eight-in-ten businesses served fall into underrepresented categories based on race, ethnicity, gender, and veteran status. SBA's other entrepreneurial development programs are not as successful in reaching these communities. The success of the pilot is building up demand that risks engulfing organizations should the program be allowed to expire this fall.

- **Improve data collection by resource partners.** Unlike in the Navigators program, where business clients have overwhelmingly shared demographic information with participating organizations, far fewer businesses indicate this level of trust with SBA's other resource partners. Only 30% of clients served by SBA's SCORE, Women's Business Center, and Small Business Development Center programs elected to share demographic information, compared to 78% of clients served by Navigators. Congress must encourage SBA's resource partners to submit metrics that will allow legislators to evaluate the success and efficacy of their services to rural and disadvantaged businesses.

- **Allow for marketing and promotional activities at SBDCs.** Under current law, centers must raise funds to market their products to businesses in the community. Congress should increase appropriations for SBDCs and update the Small Business Act to allow centers to budget a portion of their federal award for marketing services to reach more disadvantaged businesses. Congress should also require SBA to study how it can reallocate its 900 SBDC service locations to serve a broader geography.

Streamline oversight and accountability.

During the pandemic, the SBA encountered unprecedented oversight challenges. The scale of its relief operation, the break-neck pace at which programs had to be implemented, and a heavy reliance on its lending partners created cracks in the agency's otherwise strong defenses. In December, the Select Committee on the Coronavirus Crisis found that the earliest days of the pandemic were marred by substantial fraud and abuse of funds within both the EIDL and PPP programs. [18] To their credit, new leadership at SBA had already investigated and penalized the culprits upon the report's release. [19] This new leadership also established SBA's Fraud Risk Management Board to serve as "the designated anti-fraud entity responsible for oversight and coordination of the agency's fraud risk prevention, detection, and response activities." [20] In FY21 alone, SBA's Office of Inspector General (OIG) investigations resulted in over 130 convictions and $4.3 billion of monetary savings and recoveries. [21]

To be sure, SBA's core programs were established under vastly different circumstances, and it is important not to conflate the fraud discovered in the economic relief programs with SBA's tried and true capital programs. Still, some will want to see the SBA doing more to claw back federal dollars lost to waste, fraud, and abuse. Here's what Congress can do to help:

- **Give clear guidance to lending partners.** Right now, the SBA doesn't have direct lending authority, so it relies heavily on its approved lending partners to ensure its programs operate with a high level of integrity. Clear, specific, and sufficient guidance would help lenders effectively track and address fraud across SBA's programs. [22]

- **Increase staff to handle new servicing needs.** Before the pandemic, the SBA serviced about 260,000 outstanding EIDL loans across its three disaster loan centers. Now, that number is close to four million—over 15 times its pre-pandemic disaster loan portfolio. According to an Inspector General report, "SBA does not have the staff or infrastructure to manage this volume." [23] Given the sophistication of the Agency's services and the impact it has in serving small businesses, Congress should provide long-term resources for SBA to ramp up their hiring efforts across all its programs.

Conclusion

In the last seven decades, the SBA has grown to play an outsized role in our economy and in the lives of millions of business owners across the country. In order to serve the businesses that will be born and endure over the next 70 years, Congress must equip the SBA to meet new demands for capital, contracts, and counseling while protecting against bad actors and increasingly difficult challenges. By taking these steps, the SBA will secure the opportunity for all people to generate wealth, create jobs, and grow our economy through entrepreneurship.

TOPICS

WORKFORCE & TRAINING 121 | 21ST CENTURY JOBS 68 | POVERTY/MOBILITY 34

ENDNOTES

1. "Paycheck Protection Program (PPP) Results Summary." *US Small Business Administration.* 19 July 2020, https://www.sba.gov/sites/default/files/2020-07/PPP%20Results%20-%20Sunday%20FINAL.pdf. Accessed March 15, 2023.

2. Board of Governors of the Federal Reserve System (U.S). "Small Business Credit Survey (SBCS): 2022 Report on Firms Owned by People of Color." Fed Small Business. https://www.fedsmallbusiness.org/survey/2022/2022-report-on-firms-owned-by-people-of-color. Accessed March 15, 2023.

3. Consumer Financial Protection Bureau. "Data Spotlight: Challenges in Rural Banking." April 2022, https://files.consumerfinance.gov/f/documents/cfpb_data-spotlight_challenges-in-rural-banking_2022-04.pdf, page 8. Accessed March 15, 2023.

4. "Weekly Approvals Report with data as of 12/30 for each FY" *US Small Business Administration*. 30 December 2022. https://www.sba.gov/sites/default/files/2023-01/WebsiteReport_asof_20221230.pdf. Accessed March 15, 2023.

5. Board of Governors of the Federal Reserve System (U.S). "Small Business Credit Survey (SBCS): 2021 Report on Firms Owned by People of Color." Fed Small Business. https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color. Accessed March 15, 2023.

6. US Small Business Administration. "Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization." *Federal Register*. 7 November 2022. https://www.federalregister.gov/documents/2022/11/07/2022-23597/small-business-lending-company-sblc-moratorium-rescission-and-removal-of-the-requirement-for-a-loan. Accessed March 15, 2023.

7. "SBA Information Notice Regarding 7(a) Fees for FY2023." *US Small Business Administration.* September 2022, https://www.sba.gov/sites/default/files/2022-09/5000-836123%28R%29.pdf. Accessed March 15, 2023.

8. Hawkins, Jazzelynn. "Four Ways to Modernize the SBA's Small Business Investment Company Program." *Alliance for Entrepreneurial Equity*. 15 February 2021. https://www.aeequity.org/product/four-ways-to-modernize-the-sbas-small-business-investment-company-program. Accessed March 15, 2023.

9. Jin, Berber. "Venture Fundraising Hits Nine-Year Low." *The Wall Street Journal.* 20 February 2023. https://www.wsj.com/articles/venture-fundraising-hits-nine-year-low-c2b4774. Accessed March 15, 2023.

10. McSwigan, Curran. "Shut Out: The Dearth of Opportunity for Minority Contracting." *Alliance for Entrepreneurial Equity.* 23 June 2022. https://www.aeequity.org/product/shut-out-the-dearth-of-opportunity-for-minority-contracting. Accessed March 15, 2023.

11. SBA's Business Development Assistance to 8(a) Program Participants." Small Business Administration Office of Inspector General. 14 February 2022. https://www.oversight.gov/sites/default/files/oig-reports/SBA/SBA-OIG-Report-22-08.pdf. Accessed March 15, 2023.

12. Lewis, Ron. "How to Successful Graduate from the SBA 8(a) Program - Part 1." *At Work*. 3 January 2023. https://www.atworksys.com/blog/how-to-successfully-graduate-from-the-sba-8a-program-part-1. Accessed March 15, 2023.

13. McSwigan, Curran. "Shut Out: The Dearth of Opportunity for Minority Contracting." *Alliance for Entrepreneurial Equity*. 23 June 2022. https://www.aeequity.org/product/shut-out-the-dearth-of-opportunity-for-minority-contracting. Accessed March 15, 2023.

14. David Berteau and Amanda Swanson. "The Impact of 8(a) Graduation." *Naval Postgraduate School: Acquisition Research Program*. 30 March 2018. https://dair.nps.edu/bitstream/123456789/1602/1/SYM-AM-18-087.pdf. Accessed March 15, 2023.

15. Top Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2023." *US Small Business Administration Office of Inspector General.* 14 October 2022. https://www.sba.gov/sites/default/files/2022-10/SBA%20OIG%20Report%2023-01__0.pdf. Accessed March 15, 2023.

16. Robert Jay Dilger, Anthony Cilluffo, and Corinne Blackford. "Small Business Administration: A Primer on Programs and Funding." *Congressional Research Service*. 27 April 2022. https://crsreports.congress.gov/product/pdf/RL/RL33243. Page 23. Accessed March 15, 2023.

17. "Community Navigator Pilot Program: Frequently Asked Questions." *US Small Business Administration.* 28 October 2021. https://www.sba.gov/sites/default/files/2021-11/CNPP%20FAQs__Approved%5B90%5D__508.pdf. Accessed March 15, 2023.

18. "Preparing for and Preventing the Next Public Health Crisis: Lessons Learned from the Coronavirus Crisis." *Select Committee on the Coronavirus Crisis.* 9 December 2022. https://permanent.fdlp.gov/gpo190156/2022.12.09%20Preparing%20for%20and%20Preventing%20the%20Next%20Public%20Health%20Emergency.pdf. Accessed March 15, 2023.

19. "U.S. Small Business Administration Statement on the House Select Subcommittee on the Coronavirus Crisis Report Concerning Fraud in the Paycheck Protection Program" *US Small Business Administration*. 8 December 2022. https://www.sba.gov/article/2022/dec/08/us-small-business-administration-statement-house-select-subcommittee-coronavirus-crisis-report. Accessed March 15, 2023.

20. "Administrator Guzman Announces Expanded Efforts to Aggressively Crack Down on Bad Actors and Prevent Fraud in Programs." *US Small Business Administration.* 1 April 2022. https://www.sba.gov/article/2022/apr/01/administrator-guzman-announces-expanded-efforts-aggressively-crack-down-bad-actors-prevent-fraud. Accessed March 15, 2023.

21. Robert Jay Dilger and Ben Wilhelm. "SBA's Office of Inspector General: Overview, Impact, and Relationship with Congress." *Congressional Research Service.* 5 July 2022. https://crsreports.congress.gov/product/pdf/R/R44589. Accessed March 15, 2023.

22. "SBA's Handling of Potentially Fraudulent Paycheck Protection Program Loans." *Small Business Administration Office of Inspector General.* 26 May 2022. https://www.thirdway.org/infographic/race-wealth-and-retirement-across-the-united-states. Pages 8-10. Accessed March 15, 2023.

23. "Top Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2023." *US Small Business Administration Office of Inspector General.* 14 October 2022. https://www.sba.gov/sites/default/files/2022-10/SBA%20OIG%20Report%2023-01_0.pdf. Page 30-31. Accessed March 15, 2023.