Testimony of Cynthia Kay
Owner & President

Cynthia Kay and Company Media Production

On behalf of the National Small Business Association

National Small Business Association®

House Committee on Small Business Hearing:

"Building an Opportunity Economy: The State of Small Business and Entrepreneurship"

March 4, 2015

Good afternoon. My thanks to Chairman Chabot, Ranking Member Velazquez and the members of the Small Business Committee for inviting me to testify today on the health and vibrancy of the American economy, and challenges that small businesses like mine face as it pertains to the creation, sustainability, and future growth of our businesses.

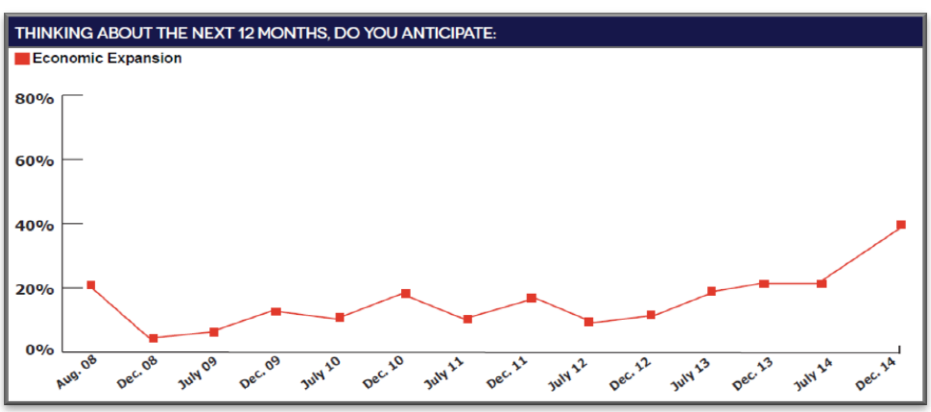
My name is Cynthia Kay and I am President of Cynthia Kay and Company based in Grand Rapids, Michigan. CK and CO is a full-service media production and corporate communications consulting company. The company is a certified Women's Business Enterprise. While we are truly a small business, with a full-time staff of eight, we are the production company of choice for a number of global companies, such as Herman Miller, Siemens Industry, Wiley Publishing as well as many non-profits. I also come from a family of small-business owners. My father co-owned a small dry-cleaning business. My sister and her husband own a boutique rental company in Raleigh, North Carolina and my brother is an attorney.

I am proud to be here representing not only my company, but also the National Small Business Association (NSBA)—the nation's first small-business advocacy organization. NSBA is a uniquely member-driven and staunchly nonpartisan organization—where I currently serve as Vice Chair of Advocacy. I also served as chair of the Small Business Association of Michigan, one of NSBA's regional affiliates in 2010-2011. One of the things that I believe NSBA does brilliantly is to conduct surveys to provide data that really give a snapshot of the current issues facing small business and long term trending data.

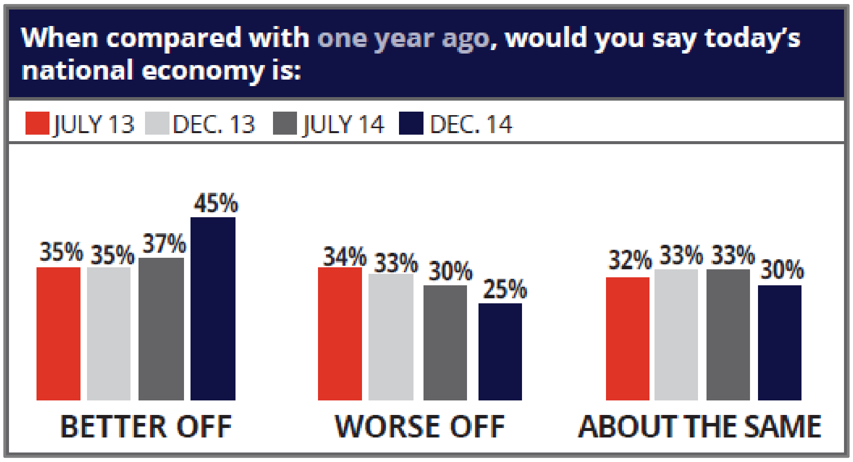
NSBA has members in all sectors and industries of the U.S. economy from retail to trade to technology—our members are as diverse as the economy that they fuel. Small employers comprise 99.7 percent of all employer firms in the U.S. One in two workers in the private workforce run or work for a small business, and one in four individuals in the total U.S. population is part of the small-business community. Those are certainly impressive figures.

NSBA Year-End Economic Survey Results

As a business owner for the past 27 years, I have experienced first-hand a number of economic downturns, none more difficult than the past one. The good news is that business is booming for my company and I am not alone. The NSBA's recently released 2014 Year-End Economic Report shows that today's economic outlook for America's small-business owners is better than it has been in quite some time. And, today more small-business owners anticipate economic expansion in the coming year than have at any point in the last seven years.



When asked to compare today's economy with one year ago, 45 percent, up from 37 percent just six months ago, say it is better—that is the highest this indicator has been since we started asking the question. Although, there is a noted improvement on small-business owners' economic outlook, we are still not out of the woods yet and the majority of small firms still expect a flat or recessionary economy in the coming year.



Of course, small businesses like mine still face significant challenges, and despite the gains in economic outlook, the report found little change over the last six months when it comes to small-business owners' confidence about the future of their own business as well as job growth.

I had the opportunity to participate with business owners from across the country in the NSBA Small Business Congress held earlier this month in Phoenix, Arizona. After lengthy debate and voting by our members, NSBA unveiled its Top-10 priorities for the 114th Congress and the number one priority for small firms is ensuring corporate-only tax reform includes some kind of workable solution for the millions of pass-through small businesses. In the interest of transparency you should know that my company is a C-Corporation, but so many of my suppliers and fellow business owners are S-Corporations.

Taxation of Pass-through Entities

As I mentioned, most small businesses that I work with are sole proprietorships, subchapter S corporations or limited liability companies. Most of the remainder are partnerships (either limited or general). There also are some business trusts. All of these businesses (83 percent, according to NSBA data) pay taxes on their business at the personal income level, or are so-called "pass-through" entities that are subject to individual tax rates – not corporate tax rates. It should come as no surprise then that according to NSBA data income taxes are consistently ranked the most burdensome administratively, while payroll taxes were ranked the most burdensome financially, by small firms.

Some small businesses—such as mine—are C corporations that are subject to the corporate income tax, but these are a relatively small percentage and a large portion of these companies' net income before compensating the owners' is usually consumed by paying the owners' salary. This salary is also subject to the individual tax rates as, of course, are any dividends paid by the corporation to its shareholders. Thus, even for small C corporations, individual tax rates are key.

Broad reform of the entire tax code is necessary, not just for corporate entities. Allowing the smallest businesses to pay a much higher tax on their business income than a multinational, multi-billion corporations undercuts any semblance of fairness. Many proposals have called for reducing the corporate tax rate while eliminating various business deductions and credits, which—if not examined more closely—sounds like a fine plan. However, many pass-through entities, small businesses, utilize these tax benefits that would be on the chopping block. So now many of my suppliers would be facing the same, high tax rate on their business income, and would no longer be eligible to take advantage of some important tax credits and/or deductions. The result is a tax increase on these firms while large corporations would be given a tax cut.

I firmly believe that addressing just one piece of the puzzle—such as corporate tax reform—will only lead to even greater complexity and a massive tipping of the scales in favor of the nation's largest companies at the expense of small businesses.

Imposing higher tax rates on small firms will stymie any growth from what is widely recognized as the source of much of the economic growth and dynamism in the U.S. economy: small business. For the overwhelming majority of small businesses, individual marginal tax rates are much more important than corporate marginal tax rates. Since small businesses disproportionately contribute to job creation, raising individual marginal tax rates can be expected to have a disproportionate negative impact on job creation. It is this kind of shortsightedness that has made the IRS a major foe of small firms and why so many of us support broad tax reform.

If Congress overhauls the tax system by dramatically broadening the base —cutting the breaks that litter the tax code—and lowering rates, we would see real economic growth and raise revenues.

Access to Credit and Capital

Even in the best of times, access to capital is one of the largest impediments facing America's small businesses, hindering both aspiring and thriving entrepreneurs. In fact, the small-business members of NSBA consistently identify access to credit and capital as one of the top issues impacting their firms.

When I started my business, the only way to get a loan was to sign a personal guarantee using the equity in my house. I did that several times over the years to obtain capital. This perennial problem is only exacerbated during troubled economic periods, such as those many businesses are still experiencing today. In fact, over the last seven years, one-in-three small firms on average cannot access adequate financing for their business.

One of the biggest barriers to small-business financing is requiring debt be secured by equity in fixed assets. Many small and startup businesses lack the kind of equity necessary for traditional bank loans. This gap in debt-equity financing especially hinders startup and growing businesses, as these entrepreneurs typically do not have the assets necessary to acquire sizeable loans.

When my sister and her husband wanted to buy their business they also encountered these type of difficulties, even though they are highly educated and had great work history. Our family and my business ended up financing their startup. While this was many years ago, and things have improved slightly, you should know small businesses still see the lack of available capital among their top challenges. This comes at a time when small businesses believe the economy is improving and they are willing to take on additional debt in the form of financing. Without financing, we cannot expand our businesses and hire more employees.

If capital availability is a problem for your business, what is the effect on your operations?

	DEC. 2014	JULY 2014	DEC. 2013	JULY 2013
Unable to grow business or expand operations	34%	33%	36%	36%
Unable to finance increased sales	18%	15%	17%	18%
Reduced the number of employees	16%	18%	20%	20%
Unable to increase inventory to meet demand	13%	10%	11%	10%
Reduced benefits to employees	11%	12%	13%	14%
Other (please specify)	3%	2%	3%	3%
Closed stores or branches	1%	3%	3%	4%
Not a problem / No effects	56%	57%	54%	50%

Another barrier to capital for small businesses is that banks too often shy away from the small-business community. Smaller loans generally are less-profitable for banks and typically have higher default rates. Additionally, the proper valuation and credit worthiness of small businesses are notoriously difficult to determine. Ongoing bank consolidation has led to fewer community banks and fewer character-based loans which has limited small businesses in getting financing. In fact, small-business loans have steadily been declining: in 1995, small loans represented 40 percent of bank loan dollars but today it is only 23 percent.

What types of financing has your company used within the past 12 months to meet your capital needs?

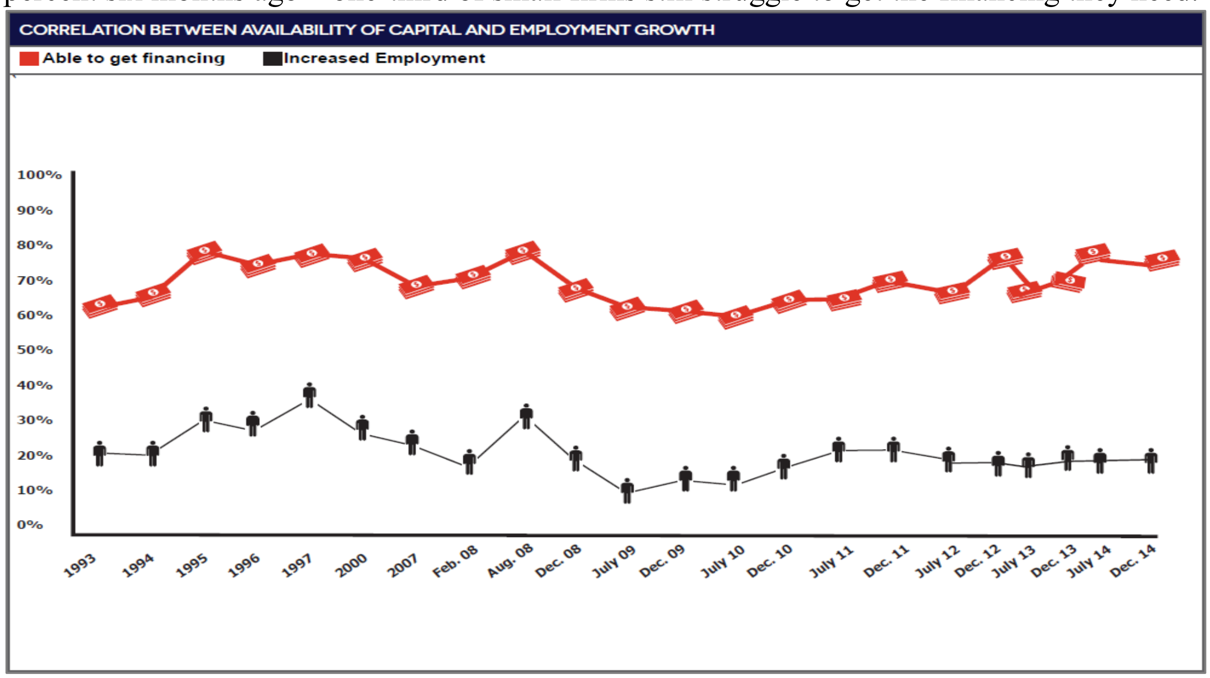
	DEC. 2014	JULY 2014	DEC. 2013	JULY 2013
Credit cards	36%	30%	33%	31%
Earnings of the business	35%	32%	34%	35%
Used no financing	27%	28%	27%	30%
Community Bank Loan	20%	19%	19%	18%
Vendor credit	19%	15%	17%	16%
Private loan (friends or family)	18%	17%	17%	17%
Large Bank Loan	17%	19%	20%	13%
Leasing	6%	6%	6%	5%
Other	5%	5%	5%	5%
Credit Union Loan	4%	2%	3%	2%
Small Business Administration (SBA) loan	3%	4%	3%	5%
Selling/pledging accounts receivable	3%	2%	2%	2%
Private placement of debt	2%	2%	3%	2%
Venture capital/Angel investors	2%	n/a	n/a	n/a
Online or non-bank lender	1%	1%	1%	n/a
State/Regional Loan and Incentive Programs	1%	1%	1%	1%
Crowdfunding	1%	1%	0%	n/a
Private placement of stock	1%	2%	1%	1%
Public issuance of stock	0%	0%	0%	0%

When asked how the absence of capital is negatively impacting their business, there was a concerning trend whereby more small-business owners report a lack of financing is hindering their ability to finance increased sales or increase inventory to meet demand. Nearly one-in-five small firms cannot meet increased sales demand due to an inability to garner financing.

While insufficient access to capital has long been a lament in the small-business community, the current capital vacuum has created a new predicament for small-business owners: Use credit cards or bust. When asked what kind of financing their company used, there was a notable jump among small firms that rely both on credit cards and earnings of the business. These two are the most quickly accessed forms of financing which could indicate newer businesses seeking financing as well as new opportunities for existing businesses that may not have the track record required by other financing tools.

Among those surveyed, there are a handful of other contributing factors to the increase in credit card usage as well, including: a five-percentage-point increase among firms who report there was an increase on their line of credit or credit card in the last six months; a drop among small firms who say the terms of their credit cards worsened in the past six months; and the average interest rate dropped from 13.94 percent in July 2014 to 13.05 percent today.

According to NSBA data from as far back as 1993, there is a clear correlation to a small-business owner's ability to hire and his/her ability to get financing. Although the number of firms that report being affected by the credit crunch continues to drop—down to 61 percent from 66 percent six months ago—one-third of small firms still struggle to get the financing they need.



Capital is the lifeblood of small business and without it, the heart of America's economy—its millions of small businesses—stands poised to fail.

Tax Extender Permanency

In recent years, Congress has enacted dozens of important tax provisions for small businesses to encourage job creation, investment, research and international competitiveness. However, due to budgetary and political restraints, too many of these provisions were enacted on a temporary basis, requiring repeated extensions and creating layers upon layers of complexity and instability rendering any kind of reasonable tax planning nearly impossible for small business. Now, however, these provisions have been expired since the end of last year and by Congress continuing to further delay there extensions, it punishes our work, investment, risk-taking and entrepreneurship. Absent comprehensive tax reform, extending and making permanent important business tax provisions has long been on NSBA's priority list.

As a media production company, tax extenders are of major significance to my business. You have heard the saying "lights, camera, action" well, all of that costs a great deal of money and the technology is constantly changing. The high-definition cameras we bought two years ago are no longer state-of-the art. Today 4K cameras are the new format and 3D graphics are being replaced by Cinema4D. We are constantly buying or updating equipment and the out-of-pocket expense is significant.

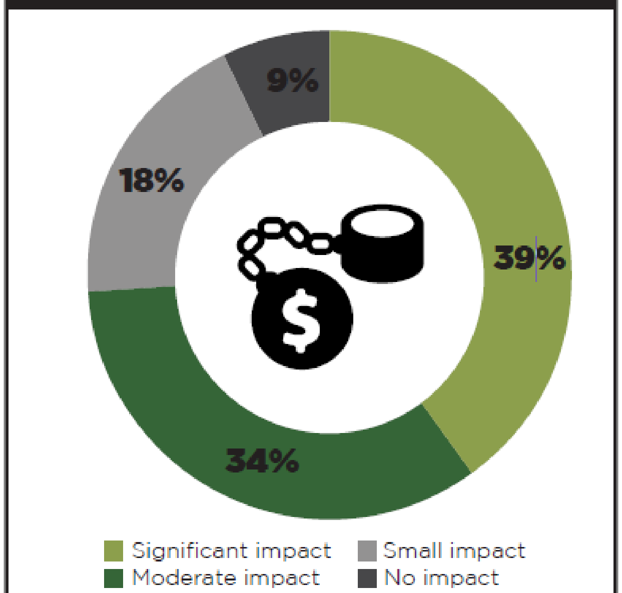
Which of the following deductions or credits do you take advantage of? (Check all that apply)

Sec. 179 expensing	34%
Home mortgage interest deduction	31%
Home office deduction	22%
Bonus depreciation	20%
15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and qualified retail improvements	13%
R&E (Also called R&D) credit	8%
Energy efficiency credits	5%
Start-up costs deduction	5%
Work Opportunity Tax Credit	3%
None of the Above*	27%
Other	4%

*The ongoing debate over the so-called "tax extenders" holds significant importance for small businesses as the majority, 73 percent, report utilizing some kind of tax benefit covered under the extenders umbrella.

In the past, we have been able to utilize Section 179 expensing. It is critically important for my company, as we invest in new equipment; we are able to deduct the cost of the asset in the year that we purchase it, especially since technological equipment needs updating sooner than the 5 to 7 years that it is required to be depreciated over. And this is not just affecting my company, more than one in three NSBA members, according to NSBA's 2014 Taxation Survey, take advantage of this break as it simplifies tax accounting, helps with cash flow and reduces the cost of capital.

How much of an impact would you say federal taxes have on the day-to-day operation of your business?



Now, even if I wanted to take advantage of Section 179 I can't because on Dec. 31, 2014 it expired, along with more than 55 other tax provisions commonly referred to as "tax extenders." The loss of some of these vital credits has and will negatively impact job creation, investment, research and international competitiveness. It's no wonder so many small firms, according to the aforementioned Taxation Survey, say federal taxes have a significant impact on the day-to-day operation of their business—and no wonder why so many small firms are beyond frustrated with the Tax Code.

Regulatory Reform

Often cited as one of the biggest challenges facing manufacturers and small businesses, coercive, combative, and expensive federal regulations hurt our economy as we spend countless hours trying to understand, interpret and comply with the overwhelming array of federal regulations.

Firms with fewer than 20 employees spend 36 percent more per employee than larger firms to comply with federal regulations at $10,585 per employee per year, according to the SBA Office of Advocacy.

Time and again, I hear from my small business clients and suppliers about their desire to have a more simplified approach to complying with federal regulations and their paperwork requirements. Yet, more often than not, small-business owners find themselves buried under mountains of paperwork when they could be helping their customers, hiring new employees and expanding their businesses.

For a small business, I have to have a lot of advisors. Just to give you a sample. I use an accounting firm, an insurance firm, a corporate lawyer, an HR lawyer. In the past, I used an environmental lawyer for issues with a building I wanted to buy. And the list goes on. It's not that I don't love lawyers, my brother is one, but each one of these resources is costing my company money and the time to deal with all of the regulations.

Personally, I think we tend to be an easy target since unlike big corporations—which have hordes of accountants, benefits coordinators, attorneys, personnel administrators, etc. at their disposal—small businesses often are at a loss to keep up with, implement, afford, or even understand the overwhelming regulatory and paperwork demands of the federal government.

Small business owners are smart people, but we often experience a hard time dealing with the complexity of ambiguous terms, intricate technical language and difficult sentences. The increased burden causes us to have trouble understanding the requirements. This forces us to spend more time trying to interpret the rules and ensure we are completing the forms accurately thus avoiding being fined by the agency for noncompliance. The best thing for small businesses is simplicity: simplicity in instructions, in requirements, in consequences and an overall reduction in the size of the paperwork and the time necessary to complete the forms.

While small-business owners agree compliance assistance is necessary, it also must be streamlined and put into plain-language. It is unrealistic for small businesses to comply if the only methods of communication are huge envelopes that are packed with books and pamphlets. Although small-business owners appreciate the efforts and hard work put into creating detailed instruction manuals, agency officials must consider the time it will take for the recipient to read through a 195- page instruction manual and decipher poorly organized, difficult to read forms that contain an abundance of technical terms. Most small-business owners do not have the training or experience to translate legalese and decipher the convoluted directions that accompany most government forms. Small-business owners are smart, entrepreneurial, creative and quick students. We are not, however, regulation specialists.

On behalf of NSBA, I would like to thank you, Chairman Chabot, for all your work in advancing the Small Business Regulatory Flexibility Improvements Act of 2015 (H.R. 527) earlier this year. This important piece of legislation strengthens the voice of small business in the federal rulemaking process and makes agencies fully quantify the impact of major rules by requiring federal agencies to consider indirect economic effects, in addition to direct effects, when writing regulations, guidance and policy statements. NSBA was pleased to support H.R. 527 as it improves transparency and ensures that agencies thoughtfully consider the impact of regulations on small businesses.

More can still be done and for this reason, NSBA played a critical role in developing the idea of a National Regulatory Budget—another 114th Congress priority—to bring much needed reform, transparency, and priority setting within the regulatory process. Reining in excessive regulations will provide a boost to, and certainty for entrepreneurs as we work to compete, expand and create jobs.

Cybersecurity

Given the increasingly commonplace occurrence of hacking and cyber-crimes, coupled with the fact that, over the past few years in a difficult economy, small-business owners are handling more of their firm's IT operations, cybersecurity is a growing concern for small business.

Has your business been the victim of a cyber-attack (i.e. computer virus, malware/spyware, website hack, credit card or banking hack or trojan, etc.)?

	DEC. 2014	2013
Yes	50%	44%
No	50%	56%

The Year-End Economic Report emphasizes the fact that in an increasingly technology-reliant global marketplace, cybersecurity issues and vulnerabilities can bring commerce to a screeching halt. What NSBA found is truly startling. Today, half of all small businesses report they have been the victim of a cyber-attack – up from 44 percent just two years ago. Among those who were targeted 68 percent report being a cyber-victim more than just once.

In fact, my company is included in that fifty-percent, as CK and CO has been the target of an attack. Hackers tried to get access to our corporate banking account. Fortunately, the attempt was foiled by our bank. But we continue to get phishing e-mails and other suspect communications. I am especially vigilant about cybersecurity because we serve larger, global customers. We have numerous non-disclosure and confidentiality agreements in place because we are creating video and other communications regarding new products they are launching and financial information they need to communicate to employees and stakeholders. This information in the wrong hands could be devastating to our customers.

Small-business owners are becoming increasingly tech savvy, but limited resources and knowledge still leave many vulnerable to cyber-threats. In 2013, cyber-attacks cost small businesses on average $8,699

Approximately how much did this cyber-attack cost your business?

	DEC. 2014	2013
Average Estimated Cost	$20,751.97	$8,699.48
Average Money Stolen from Bank Account	$19,948.11	$6,927.50

per attack. Today, that number skyrocketed to $20,752 per attack. For those firms whose business banking accounts were hacked, the average losses were $19,948 today–up significantly from $6,927 in 2013. This huge jump in cost is likely due to the increased sophistication in phishing and hacking schemes as well as an improved economy that finds greater funds available in many small firms' bank accounts than was there just two years ago.

As small businesses become increasingly dependent on services and applications that connect to the internet, they also become a larger target for cybercriminals looking to exploit vulnerabilities to steal money and credit card credentials, intellectual property, personally identifiable information as well possibly destroy data and disrupt operations. The truth is, it is not a question of if a business will be the target of an attack; it is a question of when. For many small firms, a cybersecurity incident could lead to an entire network being down for many days until the full extent of the problem is known and then fixed. Several of the suppliers I work with would not be able to withstand the loss of income, or have insurance to help defray those costs or any liabilities that might occur as a result of the breach. A highly public breach could also damage the business's brand and lead to long-term loss of income.

Conclusion

Small businesses, despite a more positive overall economic outlook, continue to struggle with hiring and garnering quality, affordable capital. Not only are our elected officials not doing enough to improve the U.S. economic situation, oftentimes, they are causing economic stagnation by their inability or unwillingness to deal with serious issues facing the country and preoccupation with reelection.

Small businesses simply need the environment to grow and create jobs: economic stability; predictability, fairness and transparency in taxes and health care costs; common-sense regulations that don't unfairly disadvantage small firms; and lawmakers willing to tackle the major issues facing our country, and to do so together.

Looking ahead to the coming year, the Year End Economic Report finds the majority of small firms—60 percent—anticipate increases in revenue, and slightly fewer—54 percent—anticipate increases in profits, both number the highest percentages in the past seven years. Additionally, small-business owners are projecting modest growth in hiring and continued growth in employee compensation in the coming 12 months.

I began today by saying the economy has improved. It has. The phone is ringing for many small businesses like mine and there is pent up demand for products and services. As a small-business owner, I need to be able to focus my time and effort on "doing business" and meeting these needs. But, I and other owners can only do that if it gets easier and simpler. There is not a month that goes by that a potential small-business owner reaches out to me to ask advice about starting a new business. As I am sure you can tell I am direct. I tell them how great it is to be a small-business owner, but I also tell them about the significant challenges. Many decide to go back to work with a larger firm and not take the chance because they fear the burdensome regulations and the cost. These are potential small businesses that could help us continue the recovery and create new jobs.

Despite this overall vast improvement in outlook from existing small-business owners, we are facing a significant dearth of new start-ups. As our friends at Gallup point out, the rate of new firm births is being outpaced by firm deaths. Specifically, according to Gallup, 400,000 new businesses are being born annually nationwide, while 470,000 per year are dying. They go on to report that until 2008, startups outpaced business failures by about 100,000 per year. But in the past six years, that number suddenly turned upside down.

I have to believe that a good portion of this is due to the growing set of hurdles over which would-be entrepreneurs must jump: the inability to garner financing; the vast web of local, state and federal regulatory requirements; the massive local, state and federal tax burden; the growing cost of health care and new requirements on employers which are riddled with errors; the threat of lawsuit and liability in any number of areas, both from government and private citizens; the high cost of protecting your intellectual property; and the list goes on and on.

These are all areas where lawmakers can intervene and ease the burden on existing small firms and likely make entrepreneurship once again a sought-after life trajectory for many Americans who today are opting to work for someone other than themselves. I've been doing this for 27 years and it still keeps me awake at night – it is no wonder that people who have never done it before and looking at what they are up against walk away.

At NSBA, we stand ready to work with you in helping to ease these burdens with proactive solutions such as broad tax reform, the National Regulatory Budget and many other proposals that will make running a small business easier.

Again, I would like to thank Chairman Chabot and the members of the Small Business Committee for the opportunity to speak today. I would be happy to answer any questions you may have.