UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS

HEARING: "EXAMINING THE POST-RECESSION SMALL BUSINESS LENDING ENVIRONMENT"

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Thank you Chairman Rice, Ranking Member Chu and the Committee for inviting me to testify on this important topic. By way of background, I am currently Chairman and CEO of Dun & Bradstreet Credibility Corp. Dun & Bradstreet Credibility Corp. is the leading provider of credit building and credibility solutions for businesses. Dun & Bradstreet Credibility Corp. provides the only real business credit monitoring solution available to companies looking to monitor and impact their own business credit profile. Our leading credit monitoring products are used by hundreds of thousands of companies interested in helping protect their business reputation. Dun & Bradstreet Credibility Corp. additionally resells D&B solutions that help businesses gauge their potential risk by tracking the credit and creditworthiness of the companies with which they do business.

Dun & Bradstreet Credibility Corp. is headquartered in Los Angeles, CA with offices throughout North America.

Current State of the Economy

Across the United States, businesses are recovering from the recession. The US GDP is expanding and the stock market is performing well. Our proprietary data shows similar progress. In order to effectively analyze the marketplace, we divide businesses into four categories by size: micro (less than $500,000 in annual revenue), small (less than $5 million in annual revenue), medium ($5 million to $100 million in annual revenue) and large (over $100 million in annual revenue). Across each of these categories, businesses are doing well and we are seeing strong growth in annual revenues.

But when you look at the specific categories, an interesting trend emerges. It turns out that the smaller the business, paradoxically the better the performance. This is in contrast to what most people believe is happening. Yet, the numbers bear out the fact that the growth of sales are increasing the fastest in the smallest of businesses. The micro segment is performing best, followed by small, medium, and large. Small business growth is accelerating at a much faster pace than that of its larger counterparts. In 2013 alone, micro business revenue on average grew by 2.14% while small business revenue grew by 1.18%. Yet medium business revenue stayed relatively flat, losing 0.2% overall. The large businesses on average in our data decreased revenue by 1.56%.[1]

Current State of Job Growth

Despite the economic progress driven by business performance since the recession, the country has not recovered jobs at the same pace. Job growth, while improving, is slow by post-recession standards: The *New York Times* reported last year that percentage change in payroll, from business cycle trough to business cycle peak, averaged from all previous recessions, is 15%.[2] For the current recovery it is 2%. By contrast, in an average recovery, corporate profits rise 38 percent from trough to peak. In this recovery, they have risen 45 percent. We have better than average profitability and much, much lower than average job growth.

[1] Proprietary data is composed of D&B Credibility Corp. data, and various other sources compiled by D&B Credibility Corp. for the year 2013.
[2] Catherine Rampell, "Is This Really the Worst Economic Recovery Since the Depression?, *New York Times*, August 10, 2012.

Our proprietary data supports the conclusion that on average, job growth has been slow relative to other recessions. As with revenue growth, the lack of job growth is largely a tale of two economies. However, for job growth, it is the smallest businesses that are suffering, not thriving. Our data show that the rate of job growth is the lowest in the smallest business categories. In 2013, large businesses increased employment by 5.53%, medium-sized businesses increased employment by 0.93%, small businesses by 0.57%, and micro by only 0.44%.[3] It is a great paradox, an alarming problem, that even though small businesses are growing revenues at a faster pace, they are adding the fewest jobs.

Jobless Recovery is Due to Weak Hiring at the Small Business Level

Given that in past economic cycles, small businesses were the primary driver of employment growth, we can infer from our results that the disconnect between business success and job growth is one of the reasons for the "jobless recovery." When you dissect the data further and analyze revenues per employee, a proxy for productivity, the results bear out this conclusion. Employee productivity is rising at the fastest rate for the smallest businesses, as measured by sales growth per employee. From January to November 2013, micro businesses experienced 1.86% growth per employee, small businesses 0.75%, medium businesses -1.14%, and large businesses -6.72%.[4] (See attached figure.) The smaller the business, the greater the productivity gain on average per employee. Yet despite this gain in productivity, small businesses are not adding to their employment rosters at the same pace. Strong sales and greater productivity, without employment growth, yields a jobless recovery.

Small businesses not only employ almost half of the private sector, but they are also responsible for the lion's share of *new* jobs created. In the past 20 years, about two-thirds of all net new jobs were created by small businesses.[5] SBA data show that small businesses (those with 500 or less employees) amount to 99.7% of all businesses and employ 49.1% of private sector employment.[6] This means that small business job growth is critical after a recession.

Of those small businesses, microbusinesses are particularly important to job growth. According to the Association for Enterprise Opportunity (AEO), 92% of all U.S. businesses are microbusinesses. Despite their size, the direct, indirect, and induced effects of these microbusinesses on employment amounted to 41.3 million jobs, or 31% of all private sector employment. "If one in three Main Street microbusinesses hired a single employee, the United States would be at full employment," the AEO reported in 2011 and reiterated in a new report last month.[7]

The Root Problem Is Access to Capital

We tend to equate job growth with business success but the reality is far more nuanced than that. Adding jobs is a capital investment, not a cash flow issue. Additional employees are hired for future

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[3] Proprietary data is composed of D&B Credibility Corp. data, and various other sources compiled by D&B Credibility Corp. for the year 2013.
[4] Proprietary data is composed of D&B Credibility Corp. data, and various other sources compiled by D&B Credibility Corp. for the year 2013.
[5] SBA Office of Advocacy Frequently Asked Questions, Published September 2012.
[6] SBA Small Business Profile, Published February 2013.
[7] "Bigger than You Think: The Economic Impact of Microbusiness in the United States," report by Association for Enterprise Opportunity (AEO), 2013.

growth, similarly to how business owners purchase computers, software, and other capital goods. Businesses may need to add jobs when revenues and profits rise but they cannot do so without a capital outlay.

For large businesses, the cost of employment is relatively low, so this point becomes largely academic. As revenues and profits rise, the largest businesses simply dip into their capital reserves to hire more people and grow their businesses. But small businesses do not have reserves significant enough to support new employment growth. It is a far bigger investment for a small business to hire an additional employee than for a larger business to do so. For microbusinesses, the situation is even more acute: adding a single employee to a microbusiness - where the average number of employees is 2.34[8] - would require increasing payroll by nearly 50%. For a small business to increase hiring, they need access to capital.

Today, access to capital for small businesses is a significant problem. The data we've collected with our partners at Pepperdine University show a large discrepancy in access to capital across business size. [9] (See attached figure). The largest businesses are able to secure financing with relative ease and on strong terms, including historically low interest rates – the United States Federal Funds Rate is currently 0.25% and the WSJ Prime Rate is 3.25%.[10]

As business size gets smaller, access to capital shrinks dramatically. 66% of small business owners indicate that the current business-financing environment is restricting growth opportunities for their businesses, while only 44% of medium sized businesses feel this way. 74.2% of small business owners feel it is difficult to raise new external debt financing, while only 45.3% of medium sized business owners feel this way.[11]

Our data show that 28% of micro, small, and medium sized businesses sought external financing in the past three months.[12] Of those, most (57.1%) sought a business bank loan.[13] The approval rates vary widely but the trend is consistent with our other data: 75% of medium-sized businesses who sought a bank loan were successful, as compared to 34% of small businesses and only 19% of microbusinesses.[14] Even alternative sources of capital that were once thought of as easy to acquire are becoming difficult for the smallest businesses in this environment. Of those business owners who attempted to acquire a business credit card, for example, in the past three months, only 51% of microbusinesses were successful, as compared to 62% of small businesses and 75% of medium-sized businesses.[15] It is alarming that almost half of all microbusinesses in our data were unable to secure a business credit card, traditionally one of the easiest sources of capital.

Instead, micro and small businesses are turning to their personal assets to grow: our survey showed that 46% of micro business owners transferred personal assets to the business over the past three months,

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[8] Glenn Muske, Michael Woods, Jane Swinney and Chia-Ling Khoo, "Small Businesses and the Community: Their Role and Importance Within a State's Economy," *Journal of Extension,* Vol 45 (1): February 2007.
[9] Joint survey with the Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013
[10] Interest rate obtained from http://www.bankrate.com/rates/interest-rates/prime-rate.aspx.
[11] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013
[12] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013, p20
[13] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013, p24
[14] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013, p23 plus Special PCA Index Survey Responses for Businesses with Annual Revenues Under $500K, p16.
[15] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013, p23 plus Special PCA Index Survey Responses for Businesses with Annual Revenues Under $500K, p16.

compared to 40% of small business owners and only 19.3% of medium business owners.[16] During the recession, these assets were largely frozen, but with the housing market recovering and personal debt expanding, this is a singular bright spot to the small business capital dilemma.

Ultimately, however, small businesses require business loans to succeed. Access to capital worsened significantly during the recession, but only for small businesses. Banks actually *increased* large business loans (defined by the FDIC as loans over $1 million) by 23% from 2007 (pre-recession) to 2012 (post-recession). During the same time period, they decreased small business loans (defined by the FDIC as loans $1 million and under) by 14%.[17]

External data show that banks and other traditional sources are trying to increase their small business lending, but even here, this lending is geared mostly to the larger "small" businesses. Many big banks now consider a small business as having up to $20 million in revenues, and evidence suggests that they are lending to those businesses with revenues closer to $20 million than $1 million or less. The average SBA backed 7(a) loan in 2012 was $337,730. This is much more than the average microbusiness would require and likely greater than the needs of many smaller businesses. In fact, *Forbes* reported this year that one firm who surveyed their small businesses seeking loans found that 59% of them were looking for a loan amount of $50,000 or less.[18]

Even definitions of small business have changed. The problem of defining a small business is not a new one: the War Mobilization and Reconversion Act of 1944 defined a small business as either "employing 250 wage earners or less" or having "sales volumes, quantities of materials consumed, capital investments, or any other criteria which are reasonably attributable to small plants rather than medium- or large-sized plants."[19] The SBA's size standards were changed as recently as July 2013, when it increased the average annual revenue size standard from $7 million to $35.5 million for 25 industries.[20] This encourages banks and other lenders to lend to larger firms, despite the need from the smallest segment of our business economy.

Without capital, small business will not be in a position to increase employment. This explains why our data shows that even though small businesses have increasing revenues and remain optimistic, they are still not adding jobs. Jobs require capital but it is the largest businesses that are having the easiest time financing growth, while the smallest businesses have much less access. As a result, we are investing in the least productive sector of our economy, which is yielding weak job growth. Improving small business access to capital would make the most positive economic impact.

Solving the Problem: Reduce Lending Risks to and for SMBs

The good news is that the problem is relatively clear: small business need access to capital in order to increase job growth. The solution, of course, is somewhat illusory. Previous attempts have focused on lowering interest rates but that is not the solution. Banks do not focus primarily on interest rate

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[16] Pepperdine Capital Access Index Survey Responses, Fourth Quarter 2013, p27 plus Special PCA Index Survey Responses for Businesses with Annual Revenues Under $500K, p20.

[17] Federal Deposit Insurance Corporation, Statistics on Depository Institutions, June 2007 through June 2012.

[18] Ty Kiisel, "65 Percent Isn't Enough and Job Creation is Suffocating," *Forbes*, August 13,2013.

[19] Robert Jay Dilger, "Small Business Size Standards: A Historical Analysis of Contemporary Issues," Congressional Research Service, June 20, 2013.

[20] Jack Fitzpatrick, "SBA Revises Small Business Size Standards," *USA Today*, June 21, 2013.

reductions in making lending decisions; they pass these costs on to businesses. Businesses in turn are not as focused as we might think on rates. We do not hear businesses complaining about high interest rates. In fact, many smaller businesses end up turning to alternative lending sources with very high rates and very high satisfaction. The solution, instead, lies with reducing risk, from both the lending side and the borrowing side.

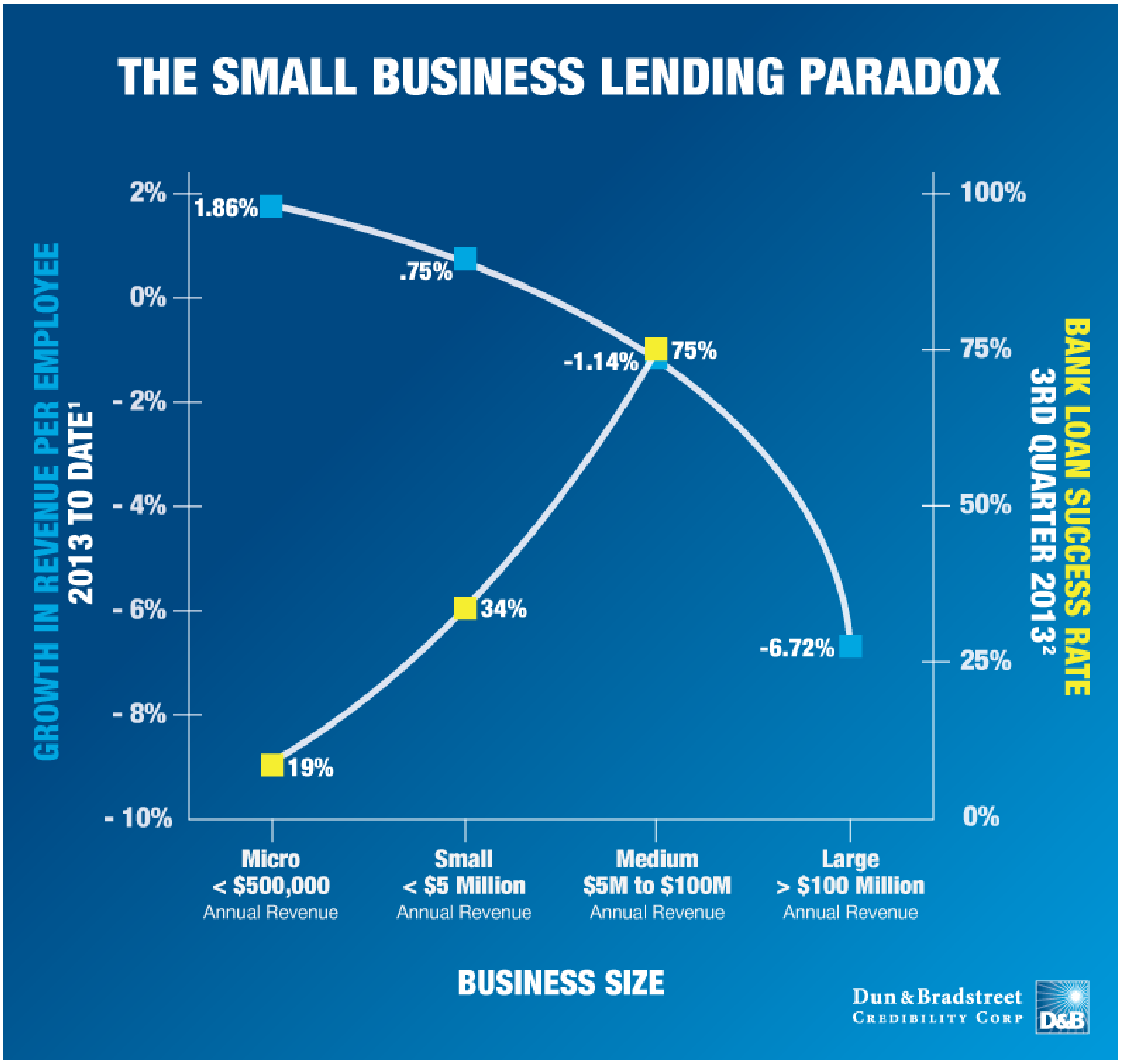
1. On the lending side, we've observed that banks are risk adverse. In general, the larger the business, the less likelihood of a complete loan default. Hence, banks tend to focus on lending to larger businesses. The government has tried to stem this trend with positive results by providing backstops through the Small Business Administration. The SBA currently guarantees 85% of the value of loans up to $150,000 and 75% of the value of loans of more than $150,000. While this has had a positive effect on small business lending, small business lending may benefit from having that distinction be focused, not on loan size, but on business size. For example, the SBA could guarantee 85% of the loan value for microbusinesses, 75% for small businesses, 50% for medium-sized businesses, and zero for larger companies. This would effectively tier the risk for banks and incentivize them to lend to the smallest and most productive businesses.

2. On the borrowing side, many small business owners are hesitant to take out loans with personal guarantees. The SBA, traditional banks, and even many alternative lenders require personal guarantees. For example, the SBA requires all owners of 20 percent or more of the equity in a business to offer a personal guarantee, and may even require liens on personal assets.[21] When banks require personal guarantees for a business loan, that loan is essentially the same as a personal loan. In effect, our economy has no concept of business loans for small businesses: we only offer personal loans. The most savvy of business owners know this and it is why our data shows that many owners avoid business loans in favor of easier and cheaper personal loans that carry the same risk. This policy is costing the economy growth and our nation jobs.

We believe strongly that helping small businesses access capital is vital to our nation's recovery, and we have made this one of our missions at Dun & Bradstreet Credibility Corp. We launched our Access to Capital initiative in an effort to foster business lending and educate small business owners on the many types of financing that may be available to them. We have held four successful events in the past year, and have helped thousands of small business owners sit down for one-on-one meetings with traditional and alternative lenders, resulting in tens of millions in loan originations. We are also a partner in the Clinton Global Initiative, where we have provided over $2.5 million in free products and services to small businesses across the country who are in need of our credit building solutions but cannot afford them.

The best solutions occur when government and the private sector work together. The government has already done a great deal for its part. For small businesses, the government can even further and profoundly influence the growth of revenues and jobs by reducing risk on both sides of the equation.

[21] 7(a) loan repayment terms from Sba.gov.



[1] Source: D&B Credibility Corp. proprietary data for the year 2013.

[2] Source: Joint survey by D&B Credibility Corp. and Pepperdine University, Capital Access Index Survey, Fourth Quarter 2013.