

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

To: Members, Subcommittee on Contracting and Workforce, Committee on Small Business
From: Committee Staff
Date: March 10, 2014
Re: Subcommittee Hearing: *“Underserved Small Businesses: Providing Access to Federal Programs”*

On Tuesday, March 11, 2014, at 11:00 am at Queens College, Rosenthal Library, Room 230, 65-30 Kissena Blvd., Queens, NY, the Subcommittee on Contracting and Workforce of the Committee on Small Business will meet to examine factors that exist within underserved communities which limit access to federal programs. As small firms seek to propel economic growth and job creation, some segments of the small business community face substantial barriers to accessing federal programs and resources meant to aid them in this mission. During the hearing, association experts and local community members will present evidence on the various challenges facing underserved entrepreneurs, and representatives of the Small Business Administration (SBA) will discuss the steps the Administration is taking to assist underserved small business owners. Further, the hearing will consider the needs of underserved small firms and assess whether they are being met in areas such as contracting, financing, training, and international trade.

I. Introduction

In SBA’s FY 2014 Congressional Budget, a key strategic objective was strengthening outreach to underserved communities and underserved populations.¹ While there is technically no definition of an underserved community within SBA, “SBA broadly refers to underserved communities as the following: ... communities and populations that traditionally have faced barriers in accessing credit, capital and the other tools they need to start and grow businesses. These communities include inner cities and rural areas and may include populations such as women, minorities, veterans, tribal groups and others.”² As will be discussed below, SBA provides a variety of programs meant to promote entrepreneurship and small business growth.

Despite these programs and SBA’s recent objective, there are concerns as to whether underserved communities are receiving adequate access. According to SBA’s Office of Advocacy, between 2007 and 2012 the percentage of minority small business owners increased

¹ UNITED STATES SMALL BUSINESS ADMINISTRATION, FY 2014 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2012 ANNUAL PERFORMANCE REVIEW 64 (April 2013) [hereinafter SBA Budget].

² E-mail from Daniel Krupnick, Deputy Assistant Administrator for Congressional and Legislative Affairs, SBA, to Committee staff (Feb. 19, 2014, 3:32 p.m. EST) (on file with the Committee).

from 11.5 percent to 14.6 percent.³ Advocacy noted this increase is largely due to a shifting and more diverse United States population and workforce which is made up of more minorities.⁴ This shift nationally will continue as the population of children younger than five is close to becoming a majority-minority and the United States Census Bureau predicts the crossover to occur within the next few years, if this proportional growth continues.⁵ Additionally, in 2012 Asians were the nation's fastest-growing race or ethnic group.⁶ Given these factors, Congress must ensure that the SBA continues serving this burgeoning demographic of business owners.

II. SBA Programs

The SBA through its website, district offices, and entrepreneurial outreach partners, provides training opportunities and counseling services to help business owners become educated about how to run or grow a business. SBA focuses on three main components to do this: credit, counseling, and contracting. While the entirety of SBA's portfolio will not be discussed, in this memorandum below some of SBA's key credit, counseling, and contracting programs are highlighted.

a. SBA Credit Programs

Unlike large enterprises that can seek funds from commercial debt and equity markets, small businesses must rely on their own personal assets, retained earnings, and commercial banks for needed capital. For 60 years (since the July 1953 creation of the SBA during the Eisenhower Administration), the SBA has sought to fill gaps in the commercial debt and equity markets. The four major programs overseen by the SBA are the: 7(a) Guaranteed Loan Program (7(a)), Certified Development Company Loan Program, Small Business Investment Company Program, and the Microloan Program. In none of these programs does the SBA directly provide funds to small businesses; instead, the SBA guarantees the repayment of credit and equity issued by private-sector partners.⁷ While underserved small businesses may access either of these programs, the 7(a) program and Microloan program are most commonly utilized in underserved communities and therefore will be discussed in further detail below.

i. The 7(a) Loan Guarantee Program

The SBA's flagship financing program is the 7(a) Loan Guarantee Program, which guarantees a percentage of a loan from a participating lender in case of default by the borrowers, who are small business owners that cannot obtain credit elsewhere.⁸ The public policy rationale

³ JULES LITCHTENSTEIN, OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, DEMOGRAPHIC CHARACTERISTICS OF BUSINESS OWNERS I (Jan. 2014), *available at* <http://www.sba.gov/sites/default/files/Issue%20Brief%20-%20Business%20Owner%20Demographics.pdf>.

⁴ *Id.*

⁵ UNITED STATES CENSUS BUREAU, ASIANS FASTEST-GROWING RACE OR ETHNIC GROUP IN 2012, CENSUS BUREAU REPORTS (June 2013), *available at* <http://www.census.gov/newsroom/releases/archives/population/cb13-112.html>.

⁶ *Id.*

⁷ The textual explanation constitutes an oversimplification of these four programs but suffices for the purposes of this memo.

⁸ 15 U.S.C. § 636(a)(1)(A).

for risking taxpayer dollars in this way is that the government should aid small businesses in obtaining access to long-term capital.⁹

In the 7(a) program, loans are not made directly by the SBA; rather, commercial lenders underwrite, issue and service the loan to a small business. The size of the government guarantee varies depending on the size of the loan, with loans under \$150,000 receiving a guarantee of 85 percent and loans exceeding \$150,000 receiving a 75 percent guarantee. The maximum loan amount is \$5 million, and interest rates vary depending on the size of the loan.

According to SBA, in FY 2012 over 44,000 loans totaling \$15.2 billion were approved; which supported over 443,000 jobs and assisted approximately 39,000 small businesses.¹⁰ Additionally, “loans under \$350,000, which SBA encourages because they often reach underserved markets, made up the bulk of the lending activity in FY 2012 with almost 33,000 approved.”¹¹

ii. Microloans

To obtain a bank loan, many lenders require the business to prove a track record of success before they are willing to provide funding. The SBA’s Microloan Program is designed to assist startup small businesses, which cannot yet prove that their business can be successful, by providing low-dollar loans to businesses that traditionally cannot receive financing through a bank or credit card company.¹²

The SBA does not make Microloans directly to a small business. Rather, the SBA makes a loan to a non-profit called a microloan intermediary.¹³ The intermediary then makes loans of up to \$50,000 to small business borrowers.¹⁴ Unlike the 7(a) loan guarantee program, the SBA requires that intermediaries provide education and training to its borrowers. The intermediaries can provide such training or contract with another enterprise to provide training and counseling. In FY 2012, the “Microloan program approved \$23.9 million in loans to 42 intermediaries.”¹⁵

b. SBA Counseling Programs

Another critical SBA mission is to provide counseling and training for entrepreneurs and small business owners looking to start or expand their business. SBA-supported education programs leverage state government and private resources to provide a wide array of services to both prospective and established business owners at no cost to the business owner. These training opportunities include courses on topics such as how to start a business, how to obtain capital, how to contract with the federal government, and how to sustain and grow a business. SBA’s authorized entrepreneurial development programs are designed as partnerships whereby

⁹ *Id.* at § 631.

¹⁰ SBA Budget, *supra* note 1, at 35.

¹¹ *Id.*

¹² 15 U.S.C. § 636(m).

¹³ *Id.* at § 636(m)(1)(B).

¹⁴ *Id.* at § 636(m)(1)(B)(iii), as amended by § 1113 of the Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2508.

¹⁵ SBA Budget, *supra* note 1, at 69.

SBA provides grants, often with matching requirements, to Small Business Development Centers (SBDCs), Women's Business Centers, Veterans Business Centers, and SCORE chapters.¹⁶ Due to the variations in programs, the two largest SBA entrepreneurial development programs will be discussed in further detail below.

i. Small Business Development Centers¹⁷

SBDCs educate entrepreneurs on finance, marketing, production, organization, engineering, and technical problems as they pertain to running small businesses. Additional assistance is available to those seeking counseling with international trade issues, procurement assistance, venture capital formation, and rural development. The primary SBDC or grantee directs a network of smaller centers throughout a state in order to make their services available to a broad range of small business owners. The SBA is responsible for contributing up to fifty percent of operating funds with the remaining funds coming from a variety of contributors, including state governments, foundation grants, state and local chambers of commerce, and public and private universities. In FY 2012, SBDC conducted business consulting for 212,475 clients, training sessions for 336,279 attendees, and other forms of assistance for over 500,000 small businesses and aspiring entrepreneurs.¹⁸ SBDC clients received 2.8 million total hours of consulting and training services in FY 2012.¹⁹ Further, nationwide in FY 2012, 45 percent of SBDC business consulting clients were women, 22 percent minorities, and 8 percent veterans.²⁰ Additionally, in FY2012 nationwide 43 percent of SBDC training clients were women, 15 percent minorities, and 6 percent veterans.²¹

ii. SCORE²²

The SCORE program is composed of a network of working and retired business executives and small business owners. Similar to SBDCs, this organization provides free, expert advice to both fledgling and seasoned small business owners. Small business owners receive this assistance through SCORE's website, chapter offices, SBA district offices, and other venues. In FY 2012, 348 SCORE chapters mentored 458,773 clients and offered over 10,000 local training workshops.²³ The program also provides more than 1,600 online counselors who aid small businesses that are unable to travel to an office for counseling.²⁴ Furthermore, according to SCORE's impact study, in FY 2013, 56 percent of their clients were women, 28 percent were minorities, and 12 percent were veterans.²⁵

c. SBA Contracting Programs

¹⁶ This again is an oversimplification of these programs but for purposes of this memo will suffice.

¹⁷ 15 U.S.C. § 648.

¹⁸ AMERICA'S SMALL BUSINESS DEVELOPMENT CENTER NETWORK, FY 2012 ECONOMIC IMPACT STUDY FLYER 1(2013), available at http://asbdc-us.org/About_Us/Impact_Flyer.pdf.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² 15 U.S.C. § 637(b)(1)(B).

²³ SBA Budget, *supra* note 1, at 50.

²⁴ *Id.*

²⁵ SCORE 2013 National Handout Draft - Attachment, Email from W. Kenneth Yancey, Jr., CEO, SCORE, to Committee staff (Feb. 24, 2014, 9:40 a.m. EST) (on file with the Committee).

SBA's final focus is on increasing federal contracting opportunities for small businesses. The federal government routinely spends approximately half a trillion dollars through prime contracts each year.²⁶ Given the sheer volume of dollars spent, this is a crucial market for small businesses as prime contractors and subcontractors. Congress has enacted six different contract programs overseen by the SBA's Office of Government Contracting and Business Development. Each of these programs has a statutory goal associated with it, relating to the percentage of prime contract dollars the government should award qualifying firms each year. These programs are the small business contracting program, Historically Underutilized Business Zone (HUBZone) program, Woman-Owned Small Business (WOSB) program, 8(a) Business Development (8(a)) program, Small Disadvantaged Business (SDB) programs, and the Service-Disabled Veteran-Owned Small Business (SDVOSB) program.²⁷ Three of these contracting programs which are frequently used in underserved communities will be addressed below.

i. The SDB and 8(a) Programs

SDBs are small businesses at least 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals.²⁸ Social disadvantage is presumed for members of designated groups, or may be established by a preponderance of the evidence for any other individual.²⁹ Economic disadvantage is defined as a net worth of less than \$750,000, after excluding the value of the individual's ownership interest in the small business and the value of the individual's equity in a primary personal residence.³⁰ A firm certifies as a SDB to either the procuring agency or to a third-party certifier, although all 8(a) firms are automatically considered SDBs.³¹ There is a statutory goal of awarding five percent of all prime contract and five percent of all subcontract dollars to SDBs.³²

The 8(a) program is an important subset of the SDB program. 8(a) firms are small businesses owned and controlled by socially and economically disadvantaged individuals who have applied for and been accepted into a nine-year business development program at SBA.³³ While the definition of social disadvantage is the same in the 8(a) program as it is in the SDB program, the definition of economic disadvantage is much stricter, with a \$250,000 cap on assets

²⁶ This number fluctuates and has recently been declining due to decreased government spending.

²⁷ For a comprehensive overview of each program, please see the Committee's report on Small Business Act Programs for Small Federal Contractors, available at http://smallbusiness.house.gov/uploadedfiles/small_business_act_programs_for_small_federal_contractors.pdf.

²⁸ 13 C.F.R. § 124.1002.

²⁹ There is a rebuttable presumption that "Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China (including Hong Kong), Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Fiji, Tonga, Kiribati, Tuvalu, or Nauru); Subcontinent Asian Americans (persons with origins from India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands or Nepal)" are socially disadvantaged. 13 C.F.R. § 124.103.

³⁰ 13 C.F.R. § 124.1002(c).

³¹ *Id.* at § 124.1003.

³² 15 U.S.C. § 644(g)(1).

³³ 13 C.F.R. § 124.

outside of the business and primary residence, and a requirement that the individual demonstrate limited access to capital.³⁴ Participation in the 8(a) program provides important contracting preferences – sole-source contracts up to \$4 million (\$6.5 million for manufacturing contracts) are the preferred contracting method, although competitive 8(a) awards are allowed with the permission of the SBA.³⁵

In the 8(a) program, SBA is considered the prime contractor, and the 8(a) firm is its subcontractor, which requires agencies to negotiate awards with SBA.³⁶ However, since the 1990s, SBA has been entering into Memorandums of Understanding with agencies, allowing agencies to bypass SBA and award contracts directly to the 8(a) firms.³⁷ The 8(a) certification is processed by SBA, and annual reviews are required throughout the nine years to ensure a firm's continued eligibility.³⁸ In FY 2012, approximately 7,815 firms participated in the 8(a) program, and nearly 4,000 applications were received with 500 new companies entered into the 8(a) program.³⁹

ii. HUBZone Program

A HUBZone is a geographic area with high poverty or high unemployment, as defined through a complicated statutory framework.⁴⁰ HUBZone small business concerns are small businesses whose principal office is located in a HUBZone that are at least 51 percent owned by United States citizens, and which draw at least 35 percent of their employees from HUBZones.⁴¹ To certify as a HUBZone firm, a small business must apply on the SBA website, recertify every three years, certify through the System for Award Management,⁴² and qualify at the time of offer and the time of award.⁴³ There is a statutory goal of awarding 3 percent of all prime contract dollars and three percent of all subcontract dollars to HUBZone firms.⁴⁴ In FY 2012, there was

³⁴ *Id.* at § 124.104.

³⁵ *Id.* at § 124.506.

³⁶ 15 U.S.C. § 637(a).

³⁷ 13 C.F.R. § 124.508.

³⁸ *Id.* at § 124.201, 124.601.

³⁹ SBA Budget, *supra* note 1, at 71.

⁴⁰ HUBZones are defined as any areas in a qualified census tract, qualified nonmetropolitan county, within the external boundaries of an Indian reservation or an area subject to the Base Realignment and Closure Act (BRAC). 15 U.S.C. § 632(p). Qualified census tracts are tracts designated by the Department of Housing and Urban Development (HUD) in which either 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25 percent, but no more than 20 percent of a metropolitan statistical area may qualify. 26 U.S.C. § 42(d)(5)(B)(ii). Qualified nonmetropolitan counties are those in which the median household income is at less than 80 percent of the nonmetropolitan State median household income, the unemployment rate at least 140 percent of the average unemployment rate for the United States or for the State in which such county is located, whichever is less, or which is located in a difficult development area, as designated by HUD. 15 U.S.C. § 632(p).

⁴¹ 15 U.S.C. § 632(p)(5).

⁴² In the federal procurement arena, this is popularly abbreviated as SAM and referred to by that name. SAM is the official United States government system used for various federal procurement activities including where entities register their firm to do business with the government.

⁴³ 13 C.F.R. § 126.300.

⁴⁴ 15 U.S.C. § 644(g)(1).

an average of 5,600 HUBZone certified firms and SBA conducted 80 HUBZone boot camps to discuss the program with prospective applicants.⁴⁵

III. Conclusion

Small business growth is essential as the United States continues to struggle with high unemployment and seeks to regain economic momentum. Small businesses act as a catalyst for growth and between 1993 and 2011 accounted for more than half of net new jobs.⁴⁶ Thus, increasing opportunities for small businesses and ensuring access to federal programs discussed above can contribute to economic growth. As noted above, in FY 2014 SBA established a strategic objective to strengthen their outreach of SBA programs to underserved communities as this would stimulate job creation and economic growth. Despite this intention and SBA's recent objective, there are concerns as to whether underserved communities are receiving adequate access to these programs.

⁴⁵ SBA Budget, *supra* note 1, at 71.

⁴⁶ OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, FREQUENTLY ASKED QUESTIONS (Sept. 2012), available at http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf.