Field Hearing on "Bridging the Gap – Increasing Access to Venture Capital for Small Businesses"
U.S. House Small Business Committee
Subcommittee on Economic Growth, Tax & Capital Access
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On behalf of the Small Business Investor Alliance
www.SBIA.org

Good morning Congressman Knight, Ranking Member Chu, and Members of the House Small Business Subcommittee on Economic Growth, Tax & Capital Access.

Thank you for holding this hearing today to examine ways to increase access to capital for small businesses. My name is Jeri Harman, and I am the Managing Partner & CEO of Avante Mezzanine Partners, an investment firm and Small Business Investment Company (SBIC) based in Los Angeles. I am also the Chair-Elect of the Board of Governors of the Small Business Investor Alliance (SBIA).

I am here on behalf of SBIA, the premier organization of lower middle market private equity funds, debt funds, and investors. SBIA members provide vital capital to growing small and medium sized businesses nationwide, resulting in job creation and economic growth. SBIA is also the primary voice of the SBIC industry. While many SBIA members traditionally do not provide venture capital, i.e. equity capital for start-ups or early stage companies, our members are significant sources of capital for small and growing companies and fill a critical gap that exists in the lower middle market.

About Avante Mezzanine Partners

Avante Mezzanine Partners provides debt and equity for high quality, lower middle market businesses that generate at least $3 million in cash flow. Avante invests between $5 million and $25 million of capital in the form of unitranche or one-stop debt as well as traditional subordinated debt and minority equity. Avante works with private equity and independent sponsors in buyout transactions, as well as with entrepreneurs and owners to finance recapitalizations, refinancings, acquisitions and growth.

Avante is somewhat unique in our industry, given the diverse leadership and ownership of our fund. Three out of our five investment partners are women, making it one of the only majority women-led and owned private equity funds in the nation. And four out of five are women and minorities or both.

Prior to founding Avante, I started-up and led Los Angeles offices for two multi-billion publically traded private equity and mezzanine investment funds - American Capital and more recently Allied Capital, where I was also a member of Allied's Investment Committee. Earlier career highlights include various senior level positions with Prudential Capital.

As the next Chair of the Board of Governors of the Small Business Investor Alliance, I will be leading an annual gathering of limited partners and general partners, including SBICs, at the National Summit for Middle Market Funds later this year. SBIA provides a platform for senior executives in the industry to agree on best practices – these best practices are good for small businesses and good for investors. In addition to my role as Chair-Elect at SBIA, I serve as a Steering Committee Member of the Private Equity Women Investor Network (PEWIN) and as the Co-Chair of the Association for Corporate Growth (ACG) – Los Angeles Business Conference.

I feel honored to have been recognized as one of the top women in the private equity industry. In 2013, the National Association of Women Business Owners (NAWBO) Los Angeles inducted me into the Hall of Fame. In 2015, I was named one of the Most Influential Private Equity Investors in Los Angeles by the Los Angeles Business Journal. In January of this year I was on the cover of Mergers & Acquisitions magazine and named one of the Most Influential Women in Mid-Market M&A.

According to March 2016 data compiled by Preqin, senior female women accounted for 10.5 percent of all employees in private equity firms across North America. These statistics indicate that we have a significant amount of work to do to improve diversity in the executive ranks at private equity funds. With increasing attention to this issue, more senior women as role models, continuing changes in firms' cultures and openness to flexible work arrangements, I am hopeful we can increase our pipeline and retention of talented women in private equity.

As Chair-Elect of SBIA, it is a goal of mine to increase diversity at regional events, provide new opportunities for women to network with one another, and include new content aimed at women in private equity. For example, as part of SBIA's regional and national events, SBIA has organized the Women Investors Networking Luncheon, an exclusive networking event for senior-level women fund managers, limited partners and investment bankers. Our first Women Investors Networking Luncheon was in May 2014, and we have hosted the luncheon at every subsequent regional and national event. These opportunities provide a platform for women to discuss how to make private equity more diverse and how to find and invest in companies that are led by women and minority entrepreneurs.

As private equity becomes more diverse this should result in better returns to shareholders as well as support job growth. Two recent reports support that gender diversity has a positive impact on performance at corporations. A study by McKinsey & Company[1] found that companies in the top quartile for gender diversity are 15 percent more likely to outperform their respective national industry medians. The study also found that companies in the bottom quartile for gender and ethnic diversity are less likely to achieve above average financial returns. A study by MSCI indicates that companies with strong female leadership generated a return on equity of 10.1% per year versus 7.4% for those without strong female leadership.[2]

SBICs Provide a Critical Source of Capital for Small Businesses

The SBIC program was created by the Small Business Investment Act of 1958 to "improve and stimulate the national economy…by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply."[3]

Avante Mezzanine was licensed for our second SBIC in 2015. This fund has $250 million in assets under management and we started investing in companies with this fund in late 2015. Our first

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[1] http://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters

[2] Women on Boards: Global Trends in Gender Diversity, MSCI. https://www.msci.com/www/blog-posts/women-on-boards-global-trends/0263383649

[3] Public Law 85-699, as amended

SBIC consisted of $218 million in assets under management and we are proud to have invested in 20 companies across the country.

SBICs allow small businesses to access patient capital – capital that cannot be called back at a moment's notice. This capital is available for helping businesses survive and thrive in the face of the unexpected bumps in the road. The importance of SBIC capital was abundantly clear in the financial crisis and the recession that followed. While most financial institutions were cutting off capital to small businesses and recalling loans, SBICs were throttling up and filling the capital void. Demand for capital from SBICs has grown dramatically since the financial crisis and continues to grow. This growth is not driven by government directive, but by the market needs of small businesses and the opportunities being recognized by private investors.

It is important to note that the SBIC program has facilitated record amounts of private capital into SBICs and, in turn, into the small business economy. For example, according to the SBIC Program Overview[4] provided by the SBA, from 2012 to 2015 SBICs have deployed $18.4 billion to 4,457 companies nationwide. The SBA data also indicates that during the time period between 2012 and 2015, SBIC financings created or retained 385,274 jobs. As of December 31, 2015, there was a total of $25.9 billion in assets under management, a record amount for the SBIC Program. Currently, there are 300 SBICs across the country, in all corners of the country, from Portland, Maine, to Portland, Oregon, and Miami, Florida to Los Angeles, California.[5]

SBIA Supports Enhancements to the SBIC Program

The SBIA appreciates the constant stream of communication between Small Business Administration leadership and staff and the Board Members and staff of the SBIA. This open dialogue has helped the SBA and SBIC industry work together to find common ground on many improvements to the SBIC Program.

We also appreciate the work of the Committee over the past several years to improve SBIC operations and increase leverage available to SBICs. While the SBIC program has grown steadily, there are additional actions the SBA and the Committee can take to strengthen the program, and expand the pool of SBIC investors. These actions will increase the number of SBIC funds, increase the attractiveness of the program to existing SBIC investors, and increase the amount of capital that can be deployed to American small businesses.

The SBIC Act Should Be Adjusted to Encourage More Bank Investment in SBICs

The SBIC program is in a unique position to attract investment from banking institutions. Since prior to the repeal of the Glass-Steagall Act in 1999, SBICs have been encouraged as a strong investment for banks, allowing them to expand their lending activities beyond what the bank itself could engage in. Bank investments in SBICs are actively encouraged by bank regulators through the Community Reinvestment Act (CRA). Bank investments in SBICs receive CRA credit due to the public welfare benefit that they provide, including lending to small businesses, particularly

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[4] SBIC Program Overview, https://c.ymcdn.com/sites/sbia.site-ym.com/resource/resmgr/Docs/SBICProgramOverview_-_Q12016.pdf
[5] https://www.sba.gov/sbic/financing-your-small-business/directory-sbic-licensees

minority, women and veteran-owned businesses, but also to economically disadvantaged and rural areas that generally see little capital investment. Since the passage of Dodd-Frank, and the institution of the Volcker Rule framework, SBICs have once again become very attractive vehicles for banks. Small businesses seeking capital from SBICs have greatly benefitted from this interest, as more SBIC funds will form and more capital can be deployed out of the program as new banks decide to invest in SBICs.

Unfortunately, many banks and savings institutions that have an interest in increasing the amount of their investments in SBICs, are unable to invest more than 5% of the capital and surplus of the institution due to a provision in the Small Business Investment Act of 1958 (SBIC Act).[6] However, depending on the type of charter of the banking institution, some banks are permitted to invest up to 15% of their capital and surplus in SBICs[7], with bank regulator approval. A number of SBIA's bank members are currently at the cap and wish to invest more than 5% of their capital and surplus in SBICs, and are not permitted to do so. An adjustment to the SBIC Act, which has been discussed with members of the Committee, could remove this barrier, and ensure SBICs can continue to grow the amount of investment from banking institutions. I encourage the Committee to study this issue closely and adopt legislation that would raise the percentage that banks are permitted to invest under the SBIC Act, to match that permitted by their respective banking regulators.

Technological Updates and Modernization of SBA Processes Will Increase the Attractiveness of the SBIC Program

For many years, the SBA has provided important and helpful data to the industry, Congress and the public about the SBIC program through their "SBIC Program Overview." The SBIC Program Overview, up until October 2015, was provided monthly. The information provided in this report[8] includes, among other things: (1) information on the number of SBICs; (2) SBIC capital at risk; (3) the number of applicants going through the licensing process; (4) how long license applications are taking to clear the SBA's process; (5) information about how many companies received financing; (6) the number of jobs that were created and retained with that financing; (7) and the number of businesses located in LMI or women, minority and veteran owned that received financing from SBICs. The timeliness and frequency of this information is critical to ensure the SBIC program is running smoothly, particularly the licensing process. Investors or limited partners (LPs) in the program also rely on this data to get a sense of how long the licensing process is taking for funds in formation they are investing in. In addition, the data was a meaningful economic indicator on the small business sector, as well as an indicator of SBA's performance and activities. The SBIC Program Overview has only been released once since October 2015 (the end of FY 2015), while being released monthly beforehand.

In addition to the "SBIC Program Overview", SBA previously provided information about the names of companies that were financed by SBICs, at the state level, as well as the total amount of

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[6] Capital Requirements, Small Business Investment Act of 1958, Section 302(b).
[7] Banks holding a National Bank Charter, and regulated by the Office of the Comptroller of the Currency ("OCC") can make aggregate "public welfare investments" that do not exceed 15 percent of the bank's capital and surplus. SBICs qualify as public welfare investments. If making such an investment over 5 percent, OCC written approval must be received. *See* 12 CFR 24.4.
[8] Attached as Appendix A.

capital SBICs had invested in all fifty states. This data was extremely helpful to make sure the program was making an impact across the entire country, and to share with members of the Congress and the public about the companies in their region that were actively benefitting from the program. The SBA has not released this data to the public since 2013, while doing so for many years beforehand. We encourage the Committee to ensure the SBA resumes providing all of this necessary information on a monthly and timely basis that is not only critical for oversight of the program, but also critical for Congress, the public, and the industry to review.

SBIA also believes the SBA should embark on an initiative to utilize "virtual data rooms" provided by a private sector provider, and paid for by the SBIC. Updates should be made to technology to help share files, reports, contracts, and other information that is communicated between Small Business Investment Companies and the SBA. Virtual data rooms would make it easier to find these documents because they would be searchable and housed in one digital location. Virtual data rooms would also streamline the collection of data by SBA staff, removing redundant processes at the SBA and saving time and resources. SBA should allow for the use of existing off-the-shelf virtual data rooms to provide a communication vehicle for SBICs and the SBA in a single, secure location for all regulatory documents, submissions, requests, and communications. This approach will reduce costs for the SBA, as well as provide for storage of information in an easily-accessible format for the life of the SBIC.

In addition to the restoration of data provision by the SBA and suggested use of virtual data rooms, SBIA has a number of suggestions that can improve the licensing process for SBICs, in which the time from application until licensure has significantly crept up in the past few years, rising from 5.6 months in FY 2011 to 8.4 months at the end of FY 2015. In contrast, several years ago, the SBA set a goal to approve licenses in six months. SBA has taken some positive steps to improve the licensing structure, including folding together the teams that handle licensing and the management assessment questionnaire (MAQ) process, but more could be done to streamline the application process. This includes a number of recommendations of the House Appropriations Subcommittee on Financial Services & General Government, which requested the following in House Report 114-194, reported out of the full Committee on July 9, 2015:

> SBIC Program Licensing.--The Committee believes the SBA Investment Division should consider reorganizing the Small Business Investment Company (SBIC) licensing process and personnel to more efficiently use the resources allocated. In particular, SBA should: combine the licensing and Management Assessment Questionnaire (MAQ) staff; reduce the number of licensing committees and steps for all applicants; and create a meaningful fast track process for repeat licensees that takes no longer than six weeks, which will allow SBA to focus their resources on first funds and ensure that there is a written record of the decisions made by the Investment Division for applicants and any court that might review such licensing decisions.[9]

Making the changes suggested by the Appropriations Committee would be extremely helpful in eliminating the slowdown in license application approvals at the SBA, particularly by the

[9] H. Rept. 114-194, *Financial Services & Genera Government Appropriations Bill, 2016,* (July 9, 2015).

elimination of duplicative licensing committees and implementing a fast track process for second-time funds which have an established track record at the SBA. This meaningful fast track process for repeat licensees should not be longer than 45 days after an application is submitted to the SBA, which will allow SBA to focus their resources on first funds. There are a number of other suggestions which SBIA has communicated to SBA staff in the hopes of further streamlining processes, better utilizing staff resources and providing more transparency and consistency to the licensing process.

Conclusion

I am grateful to be part of the SBIC program and excited by the impact it has on capital access for small and middle market businesses. The SBIA looks forward to working with the Committee to continue to explore ways to increase access to the SBIC program for women and minority fund managers and expand the number of businesses that are receiving investments from SBICs. Thank you again for inviting me to testify, and I look forward to answering any questions that you have.