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**TESTIMONY FROM**

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**HOUSE COMMITTEE ON SMALL BUSINESS  
SUBCOMMITTEE ON INVESTIGATIONS AND  
OVERSIGHT**

**Hearing:**

*"Access to Capital for Small Businesses"*

**May 17, 2010**

**Pittsburgh, Pennsylvania**

Good morning. My name is Marilyn Landis and I am the owner of Basic Business Concepts, Inc. a consulting and financial management company providing CFO level services to small businesses throughout the United States, with concentrations in Pennsylvania and Ohio. I am also the 2009 SBA National Financial Services Champion.

I would like to thank Chairman Altmire for holding this very timely hearing and for inviting me to be a part of it.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country—marketing, originating and underwriting SBA loans—and have continued working with my clients on securing SBA loans as well as myriad other sources of capital. After 38 years of working with small business, the one thing I can tell you without hesitation is that it's tough out there. Small-business owners face many obstacles in trying to garner capital—obstacles that illustrate the very significant need for and importance of the SBA's lending programs.

### **Small-Business Challenges in Financing**

Many small and startup businesses lack the assets necessary for a traditional bank loan. In 2010 these are the businesses who have burned through their savings, their reserves and even their retirement accounts to meet their obligations. They have scaled down to the new reality – found new customers – shuttered unprofitable lines – added new divisions with better sales prospects and margins. In sort – we did all the right, responsible things. We are here, receiving orders and unable to secure working capital. Smaller loans are generally less-profitable for banks, and typically have a higher default rate. The increased usage of personal credit ratings for business owners further exacerbates the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks, fewer character-based loans, and more difficulty for the small-business owner.

One of the biggest barriers to small-business financing is debt secured by equity in fixed assets. Many small-business owners do not have the kind of equity required by banks to acquire a sizeable loan. This gap in debt-equity financing primarily hinders both startup businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership (if the entrepreneur owns a home) rarely meets the equity

requirements for receiving a larger commercial loan. The small-business owner seeking to expand his or her business or hire additional employees faces the same equity challenges. The balance sheets for most small businesses, especially in today's economy, are not composed of significant fixed assets – buildings and heavy equipment. Especially significant, in light of the emerging commercial real estate crises, even the fixed assets the business does own are likely devalued. The old adage, “You’ve got to have money to make money” has morphed into “You’ve got to have equity to get money”—which just does not make sense – especially today.

A new capital issue has come to the forefront for small businesses, and that is the increased reliance on credit cards. Many small-business owners were forced to turn to credit cards as their primary source of working capital in the early years of this decade when a multitude of banks tightened their lending standards. In fact, only 20 percent of the respondents to a 2006 National Small Business Association (NSBA) membership survey relied on traditional bank loans as their primary source of financing. Eleven percent exclusively used credit cards to finance their business operations. The high interest rates typical of most credit cards continue to adversely impact U.S. small businesses. In December of 2009 78% of the respondents to a NSBA survey reported that they had been impacted by the “credit crunch”, causing 47% not to expand their business.

Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan request. Rapidly growing businesses, like mine, that are not traditional brick and mortar, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit card accounts. As such these loans are subject to credit card regulations which permit significantly higher and more volatile rates and payment structures. Rapidly growing service and technology companies do not want to rely on credit card debt—they are forced to.

### **SBA Loan Programs**

Banking practices that restricted access to capital were a key catalyst in the creation of the SBA's flagship 7(a) loan program. The goal, under the generally-accepted premise that small-business growth is a good thing, was to encourage greater lending to smaller, potentially riskier clients. As you can see, however, imperfections within the market still exist and SBA loan programs are as important now as ever.

While Congress should be pleased that the small-business provisions of the *American Recovery and Reinvestment Act*, specifically the temporary elimination of the upfront borrower fees and the increased guarantee, have had a positive effect on the lending programs at the U.S. Small Business Administration (SBA), they hardly were a panacea. In Fiscal Year 2009, the SBA approved 44,221 7(a) loans. This represents 36 percent fewer loans than in FY 2008 and 56 percent fewer loans than in FY 2007. The total dollar amount of these loans also plummeted—by about \$3.4 billion—to \$9.3 billion.

While not a cure-all for the credit crunch, the temporary elimination of the upfront borrower fees and the increased guarantee for SBA loans have been instrumental in a recent uptick in SBA lending. The SBA claims that the \$500 million appropriated for these provisions since February 2009 has supported more than \$20 billion in lending to small businesses across the country and has led to an increase to its average weekly loan volume of almost 90 percent. The provisions also have helped entice nearly 1,100 institutions back to the SBA's lending programs. This is extremely noteworthy, as hundreds of banks had quit participating in those programs over the last decade.

Given this tremendous success, it is vital that Congress immediately extend these provisions through all of 2010 on a reliable, sustainable basis that the lenders can build strong origination and compliance programs around. The fact that SBA volume has mirrored the availability of this program confirms the lender's need for the increased liquidity it affords.

#### Increase Maximum Allowable SBA Loan Sizes

I also support increasing the maximum loan sizes for 7(a) and 504 loans, as called for *H.R. 4302*, the *Small Business Job Creation and Access to Capital Act*. While many entrepreneurs would be delighted with a \$50,000 or \$100,000 loan, a sizable number of larger small firms require loans in excess of the current limits. Unfortunately, it is difficult to obtain small-business loans in the \$1.5-\$5.5 million range—according such loans an SBA guarantee would greatly expand their availability.

Although the House already has approved legislation (*H.R. 3854*, the *Small Business Financing and Investment Act of 2009*) that would increase the maximum sizes for SBA's 7(a) and 504 loans, NSBA contends a larger increase should be enacted. NSBA also believes that these enhancements should contain a commensurate increase to the statutory maximum guaranteed portion of SBA 7(a) loans.

NSBA is not alone in this belief. Increasing the SBA's maximum loan sizes, with a commensurate increase to the maximum guaranteed portion, is supported by the administration of President Barack Obama, the chair and ranking member of the Senate Committee on Small Business and Entrepreneurship and a bipartisan collection of their colleagues, and dozens of organizations, representing millions of small-business owners in every industry sector. Inexplicably, however, *H.R. 3854* fails to provide this increase.

It is important to note that the Congressional Budget Office has scored *H.R. 4302*, the *Small Business Job Creation and Access to Capital Act*, at zero. In other words, this is a simple step that would help numerous small firms around the country and cost nothing.

#### Legislative Changes to the SBA Program

SBA programs have served a key role in making capital available to small businesses. The use of the SBA programs have enabled lenders to meet the needs of their borrowers with the SBA guarantee to mitigate the reach outside their normal criteria. The SBA has made changes to the Standard Operating Procedures (SOP) to meet both the need for increased credit quality and increased flexibility in order to meet current access to capital needs. There are necessary changes, however, that cannot be made solely through the SOP. These changes must be made legislatively. I would like to recommend the following procedural changes. First, permit borrowers to pledge additional collateral for a refinance, for example real estate, in order to secure a longer term/lower payment in order to improve cash flow. Currently the law does not permit calculating a SBA loan term based on the underlying collateral. Second, permit the SBA to work with lenders to support loans advanced against projected sales. This could be accomplished in more than one way. If the lender and the borrower agree to a projected sales plan that rebuilds the business, the lender would receive a reduced SBA guarantee for the first year, to assure both lender and borrower are committed to the viability of the projections. If the borrower makes all payments for the first year, the bank would receive an increase in the guarantee amount to the full amount available under the SBA program. A second way to support loans for projected sales is to raise the rate cap on the SBA CapLine program. These programs, which finance purchase orders and contracts, are by their nature more costly for the lender to offer. An increased rate cap would permit the lenders to participate in this program at a interest rate level that is commiserate with their

requirements for profitability and still meet the borrowers need for affordable financing. A legislative change is also required in order to open the SBA's very practical international line of credit program to domestic receivables. Currently this program can only be used for international sales.

### **Small Business Research and Development**

Increasing the amount of federal research and development invested in U.S. small businesses is an important access to capital goal. Small technology firms with less than 500 employees now employ 54.8 percent of all scientists and engineers in U.S. industrial research and development. Yet, these nearly 6,000 scientists and engineers are able to obtain only 4.3 percent of extramural government research and development dollars. This must change. NSBA urges Congress to build upon the successes of the Small Businesses Innovation Research (SBIR) program—which has delivered more than 50,000 technology patents and is now doing so at the rate of seven patents a day—during SBIR's reauthorization process and to increase the percentage of agencies' research and development funds reserved for small businesses

### **Small Business Lending Fund**

NSBA is generally supportive of President Obama's proposal to create a Small Business Lending Fund, aimed at increasing community banks' small-business lending. NSBA has advocated using TARP funds to improve small-business owners' access to capital for more than a year.

Although programmatic specifics are not yet clear, the plan appears to address community banks' concerns with previous proposals and has earned the industry's strong support. Of course, NSBA would not oppose arming the proposal with lending requirements—or strong disincentives for community banks to receive the capital infusion but not increase their small-business lending—rather than only incentives, but further delay is not an option.

### **Small Business Credit Card Reform**

I also urge Congress and this committee to address two additional aspects of the credit-card industry that urgently need reform: (1) the absence of explicit protections for small-business cards, and (2) the secretive and unfair interchange system.

[The Small Business Credit Card Act of 2009 \(H.R. 3457\)](#)

The largest loophole in the *Credit CARD Act* was the absence of explicit protection for small-business owners who use their card(s) for business purposes. Since the legislation amended the *Truth in Lending Act (TILA)*—which, except for a few provisions, does not apply to business cards—its protections were limited to consumer credit cards. Although the credit cards of many—if not most—small-business owners are based on the individual owner’s personal credit history, it is conceivable that issuers could legally consider them exempt from the law’s vital protections.

*TILA* defines a “consumer” as a “natural person who seeks or acquires goods, services, or money for personal, family, household use other than for the purchase of real property.” While a small-business owner who opens a personal credit-card account and uses it occasionally for business should be covered under *TILA*, it is far from clear that this legislation would protect a small-business owner who used his card exclusively or even primarily for business purposes. Eighty-six percent of the respondents to NSBA’s credit-card survey reported using their consumer or business credit-cards primarily or exclusively for business purposes.

Although in the past, issuers appear largely to have kept most of their cards in compliance with *TILA*, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small-business cards. An unintended consequence the *Credit CARD Act* is that it could provide just such an incentive.

Thankfully, legislation has been introduced that would correct this oversight and extend equal protection to the cards used by small-business owners with 50 or fewer employees. The *Small Business Credit Card Act of 2009 (H.R. 3457)*—introduced by Reps. Nita Lowey (D-N.Y.), Michael Michaud (D-Maine), Thomas Perriello (D-Va.), and Don Young (R-Alaska)—also contains an “opt-out” provision, so that small-business owners who did not want their cards protected in such a manner can choose to keep any current agreements.

*H.R. 3457* is supported by a diverse range of small-business organizations and consumer groups—from U.S. PIRG to the Consumer Federation of America to the Associated General Contractors of America to the Hispanic, Black, and Women’s Chambers of Commerce—and I respectfully request that this committee consider this bipartisan, common-sense legislation as soon as possible.

### The Credit Card Interchange Fees Act (H.R. 2382)

Interchange is the fee paid by a merchant's bank every time a credit or debit card is used to pay for a good or service to the bank that issued the consumer's credit card. The fees—which vary depending on the type and size of the merchant's business, the way the transaction is processed, and the specific kind of card used—are set by Visa and MasterCard and the issuing banks and are not subject to negotiation. As much as \$2 of every \$100 in credit or debit card receipts goes to the card issuers, which inflates the cost of nearly everything consumers buy—since merchants are prohibited from surcharging the customers who use the most high-fee cards. It is important to note, especially as states across the U.S. raise their state sales taxes to meet budgetary shortfalls, that these interchange fees are based on the *total* transaction amount, including taxes.

Interchange fees originated in the 1960s as a way to cover the real cost of a credit-card transaction. Despite vast technological advancements, which have led to greatly diminished processing times and manpower requirements, interchange fees have more than tripled since 2001 alone. As Professor Adam Levitin, of Georgetown University Law Center, has noted, since “interchange is transaction-based revenue; the issuer doesn't incur the consumer's credit risk. That means that issuers can risk greater credit losses because they've already made a nice bit of money via interchange with virtually no risk. Not surprisingly, interchange has increased over the last decade from being about 13 percent of card issuer revenue to being 20 percent.” In total, Americans paid more than \$48 billion in interchange fees in 2008.

Visa and MasterCard force merchants to sign a contract when they decide to accept credit cards, agreeing to all current and future operating rules. Merchants rarely have seen these rules and are prohibited from disclosing their terms to consumers, preventing merchants from alerting their customers to the true cost of accepting credit and debit cards. Many argue that Visa and MasterCard, which control roughly 80 percent of the credit-card market, and their card network function like “price-fixing cartels,” operating in collusion and in violation of federal antitrust laws by using their market power to impose non-negotiable rates and terms on merchants.

The *Credit Card Interchange Fees Act (H.R. 2382)*—introduced by Reps. Peter Welch (D-Vt.) and Bill Shuster (R-Pa.)—directs the Federal Trade Commission (FTC) to fulfill a regulatory void and review the credit-card industry's interchange practices and rules. The bill also grants the FTC the

authority to prohibit any practices that it deems unfair, deceptive, or anticompetitive; and prohibits a number of practices that clearly meet this definition.

In an attempt to provide transparency to the system, *H.R. 2382* also would require the Federal Reserve to collect and disseminate information on interchange fees and the rules that currently govern the system. It also requires the Visa, MasterCard, and the rest of the credit-card industry to make their operating rules available to participating merchants and the public.

Believing that *H.R. 2382* provides critical transparency to the currently shrouded interchange rules and addresses some of the most egregiously unfair, deceptive, or anticompetitive practices of the industry, the National Small Business Association, Americans for Financial Reform and more than 20 additional national trade associations have urged Congress to adopt it.

With America's entrepreneurs—existent and, importantly, aspiring—suffering through a crippling credit crunch, it is high time that Congress provide U.S. small businesses with the credit-card protection they so desperately deserve—protection against practices already identified as “unfair” and “deceptive” by the U.S. Federal Reserve Board, the Office of Thrift Supervision at the U.S. Department of the Treasury, the National Credit Union Administration, and an overwhelming majority of the Congress.

If millions of new, small firms are going to be created during this recession—as they have been in previous recessions and economic downturns—then they largely are going to be financed through credit-cards, given the current lending environment. Although credit cards are an inherently expensive and volatile source of financing for entrepreneurs, they also are indispensable. Congress can and must ensure, however, that they are not allowed to function simply as a mechanism with which to siphon capital—through “unfair” and “deceptive” practices—from the backbone of the economy to the top 10 U.S. banks, which controlled 83 percent of the small business credit-card market (understood as their proportion of outstanding credit-card debt) in 2005.

The administration and Congress must fully support small businesses as the true centers of growth in the U.S. economy. Congress must recognize that the majority of small businesses in today's

economy are not fixed asset-intensive and should take the lead in ensuring that traditional financing practices and new credit-card policies do not restrict small business growth. I urge Congress to examine the benefits of reforming the current limitations placed on banks in lending to small business and fully supporting and funding existing SBA loan programs.

I thank you for your time and welcome any questions you may have.