



Bipartisan Policy Center

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Before the
United States House Committee on Financial Services
Subcommittee on Consumer Protection and Financial Institutions

Hearing on
“Small Businesses, Big Impact: Ensuring Small and Minority-Owned Businesses Share in the Economic Recovery”

February 17, 2022

Chairman Perlmutter, Ranking Member Luetkemeyer, and distinguished Members of the Committee: I am delighted to participate in today’s discussion about small businesses and economic recovery. My name is Dane Stangler, and I am director of strategic initiatives at the Bipartisan Policy Center, a non-profit organization that combines the best ideas from both parties to promote health, security, and opportunity Americans. BPC drives principled and politically viable policy solutions through the power of rigorous analysis and painstaking negotiation. As part of our work, we’re collaborating with a wide variety of partners to help ensure that more businesses are started by more Americans in more parts of the country. Support for small business and entrepreneurship has historically been bipartisan and we hope that additional actions taken by this Committee and the full Congress are similarly bipartisan.

I hope this discussion leaves you with the following takeaways:

- 1) The pandemic’s negative effects on many small businesses have persisted.
- 2) Government relief and assistance helped many remain afloat and get ready for recovery.
- 3) Full recovery and growth for small and young companies will require private financing and investment. Policymakers can best help by encouraging and supporting private sector innovations that expand access to capital for small and young companies.
- 4) Women entrepreneurs and business owners of color, in particular, benefit from a variety of private sector financing options. Many innovations in the space are directed at helping expand access to capital for these traditionally underserved populations.
- 5) As this Committee and the entire Congress look to ensure that all types of small businesses share in economic recovery, we encourage policymakers to promote innovation, leverage existing streams of federal spending, improve coordination, and reduce regulatory burdens.

It’s no secret that small businesses of all types were hit hard during COVID-19. In the early months of the pandemic, tens of thousands closed permanently. Millions more were hurt by economic uncertainty, government shutdowns, and shifts in consumer demand. The federal government responded with speed and scale. Through the Paycheck Protection Program (PPP) and COVID Economic Injury Disaster Loan

(EIDL) program, around \$1 trillion in assistance was disbursed to small businesses. Additional emergency funds came from state and local governments and private sources.

The negative effects of the pandemic have persisted for many small businesses. In mid-January, amidst the Omicron surge, nearly 40 percent of small businesses still didn't expect resumption of "normal" business for at least six months.¹

Yet small business owners and entrepreneurs are inherently forward-looking. In the latest national survey by the Goldman Sachs *10,000 Small Businesses Voices* program, released in January, nearly three-quarters of respondents said they were optimistic about the financial trajectory of their business in 2022.² In the most recent installment of the Census Bureau's Small Business Pulse Survey, in mid-January, hiring and increasing sales were identified by small businesses as their top needs. A year earlier, small businesses had said their top need was obtaining financial assistance.³

Optimism is also evident in record levels of new business formation, which has surged since the summer of 2020. Overall, new business applications filed with the government were 53 percent higher in 2021 than in 2019. Among what the Census Bureau deems to be likely employer businesses, 2021 levels were 37 percent higher than 2019.⁴ There is some evidence, too, that a greater share of these new businesses are being started by women and Black Americans compared to before the pandemic.⁵

Small businesses are looking to recover; new businesses are ready to grow. Policymakers can help by supporting the provision of private financing and investment for these businesses and encouraging private sector innovations that expand access to capital for small and young companies. Pandemic-era relief efforts such as PPP and COVID EIDL have lapsed. Many of the small business owners and entrepreneurs we talk to praise those programs for helping their company survive the pandemic. Now, public policy needs to continue transitioning away from emergency assistance toward support for private capital and credit markets.

Small Business Capital and Credit

It's important to keep in mind that external sources of capital and credit are not always the first option for small businesses and entrepreneurs when they seek to start, sustain, or expand their company. In any given year, less than half of small businesses seek external financing.⁶ Even in response to the financial challenges posed by the pandemic, small businesses and entrepreneurs were more likely to use personal funds, cut staff or hours, and seek out grants before they turned to external credit sources.⁷ Nevertheless, external financing is often necessary, especially for business growth.

The overall small business lending market is large. In 2019, for example, depository institutions extended over \$600 billion to small businesses—this includes loans, lines of credit, and credit cards.⁸ Small businesses and entrepreneurs also use home equity loans and personal credit cards for financing. They seek funds from alternative sources such as online lenders and finance companies.

Prior to the pandemic, the world of small business lending had been transformed by the rapid expansion of online lenders and other fintech companies. The share of small businesses applying for a loan, line of credit, or cash advance at an online lender rose from 24 percent in 2017 to 33 percent in 2019.⁹ Other sources of nonbank private credit for small businesses have also grown considerably.¹⁰ Access to credit through online lenders comes at a cost, however, in the form of higher interest rates and shorter loan terms.

Banks, both large and small, remain the primary external source of capital for small businesses and entrepreneurs when they seek it. And banks have sought to innovate to better compete with new and faster forms of credit. Many traditional banks invested heavily in technology to accelerate loan processing and others forged partnerships with fintechs, using the latter's technology to streamline loan applications and decisions.¹¹ Banks and nonbank lenders have not only incorporated technology to a greater extent in small business lending but also tested different sources of underwriting data.¹²

The expanding market for small business credit helps widen access for small business owners and entrepreneurs who have historically had difficulty obtaining funds through traditional sources. Online lenders, for example, are more likely to serve Black-owned businesses as well as small business borrowers that are medium and high credit risks.¹³ In PPP, online lenders were effective at reaching Black business owners as compared with other financial institutions.¹⁴ Meanwhile, financial entrepreneurs across the country have been testing and exploring new ways of deploying capital to small and young companies. This includes hybrid capital structures, different forms of revenue-based financing, and new investment models seeking to expand and diversify the pipeline of entrepreneurial finance.¹⁵

As this Committee and the entire Congress look to ensure that all types of small businesses share in economic recovery, we offer a few guidelines for policy action.

Encourage Innovation

Typically, when small businesses and entrepreneurs tap external sources of financing, they do so for the purposes of expansion, acquiring assets, or pursuing opportunities. (This changed, unsurprisingly, during the pandemic, when meeting operating expenses was the biggest reason for applying for financing.)¹⁶ Capital support for these growth-oriented activities is best supplied by the private sector.

Across the spectrum, the private sector is continually seeking new and different ways to get capital into the hands of small business owners and entrepreneurs. Innovation is occurring at all stages of capital provision, from origination and underwriting to capital structures and product design. Not all of that innovation will, or should, endure. But, the government should continue to follow the private sector's lead and encourage such innovation.

Leverage Existing Streams of Federal Spending

Through PPP, the federal government supported nearly \$800 billion in loans: 87 percent of the total loan value has been forgiven, in full or in part.¹⁷ For many small businesses, a PPP loan was the difference between closing or continuing, between retaining or firing employees. Yet now small businesses and entrepreneurs need sources of capital oriented toward growth. One way for the government to support that, rather than creating new spending, is to leverage existing federal funds. And the single biggest source of federal spending on small businesses is procurement.

In fiscal year 2020, the latest year for which data is available, there was \$560 billion in federal procurement spending that was "small business eligible." About \$145 billion of that was awarded to small business contractors. As we have highlighted in our work, the number of small businesses participating as contractors has declined dramatically in the last decade.¹⁸ Especially for women entrepreneurs and business owners of color, a key opportunity for growth is thus diminishing. In a forthcoming report, BPC will outline policy options for reversing these trends.

Improve Coordination of Existing Federal Resources

The federal government has scores of programs and offices devoted to helping small businesses and entrepreneurs. These exist in nearly every federal agency. Some offer support with capital formation, others provide technical assistance. Many of them are designed to help businesses from historically disadvantaged communities.

A common theme in our conversations with small businesses and agency officials is the lack of coordination among these programs. A lending support program, for example, might be more effective in helping underserved entrepreneurs if those entrepreneurs had technical assistance that helped get them “credit ready.” Policymakers should focus on maximizing the effectiveness of existing programs.

Reduce Regulatory Burdens

Regulatory safeguards exist for a reason. Banks, for example, must comply with a variety of requirements intended to prevent fraud, protect borrowers, and maintain trust. Those requirements come with costs, however. For banks, the transaction costs to make a \$50,000 loan to a small business are about the same as for a \$500,000 loan. Compliance costs scale up, not down. This helps explain why online and alternative lenders have expanded their share of small business lending so rapidly. They generally don’t face the same regulatory burdens as banks.

Lenders that participate in loan guarantee programs, get scored and graded by the government in ways similar to how they score small business borrowers. Making riskier loans—or loans that are at least perceived to be riskier—can damage that scoring. It may not be possible for the government to lower the costs for banks of making small dollar loans to small businesses. But policymakers should bear in mind that regulatory costs on lenders can get passed onto borrowers.

Help the Entrepreneurs

The current small business landscape in the United States is characterized by a juxtaposition. On one hand, millions of small businesses have yet to fully recover and don’t expect resumption of normal operations for months. They remain optimistic, but recovery has been slow. On the other, millions of Americans are pursuing opportunity through new businesses, most of which are and will remain small. They won’t all survive let alone succeed: about half of new businesses don’t exist after five years. Yet they represent attempts at entrepreneurial renewal.

Not all of these small businesses can fit into a single public policy framework. A business with 10 employees that is 20 years old is different from a business with 10 employees that is two years old. Their capital needs differ as do their operational challenges. Ensuring that small and minority-owned businesses share in the economic recovery will require policymakers to recognize these differences and tailor policy accordingly.

Chairman Perlmutter, Ranking Member Luetkemeyer, I want to thank you for convening this important hearing. America’s small businesses and entrepreneurs are the backbone of our economy and with your continued leadership and bipartisan collaboration, our nation’s small businesses can continue to thrive as we emerge from the pandemic. I look forward to your questions.

¹ U.S. Census Bureau, Small Business Pulse Survey, accessed February 11, 2022, available at: <https://portal.census.gov/pulse/data/>.

² Goldman Sachs *10,000 Small Businesses Voices*, “Survey: Small Businesses on the Brink,” January 24, 2022, available at: <https://www.goldmansachs.com/citizenship/10000-small-businesses/US/infographics/small->

[businesses-on-the-brink/index.html](#). Disclosure: Goldman Sachs *10,000 Small Businesses Voices* supports BPC's work on small business policy.

³ U.S. Census Bureau, Small Business Pulse Survey, accessed February 11, 2022, available at:

<https://portal.census.gov/pulse/data/>.

⁴ U.S. Census Bureau, Business Formation Statistics, available at: <https://www.census.gov/econ/bfs/index.html>.

⁵ GoDaddy, "Venture Forward Report," Winter 2021, available at: https://www.godaddy.com/ventureforward/wp-content/uploads/2021/12/VF-Winter-2021-Report_20211207-1.pdf.

⁶ Federal Reserve Banks, "Small Business Credit Survey: 2021 Report on Employer Firms," February 2021, available at: <https://www.fedsmallbusiness.org/survey>.

⁷ Federal Reserve Banks, "Small Business Credit Survey: 2021 Report on Employer Firms," February 2021, available at: <https://www.fedsmallbusiness.org/survey>.

⁸ Office of Advocacy, Small Business Administration, "Small Business Lending in the United States, 2019," September 2020, available at: <https://cdn.advocacy.sba.gov/wp-content/uploads/2020/09/10092858/Report-2019-Small-Business-Lending-Report.pdf>.

⁹ Federal Reserve Banks, *Small Business Credit Survey*, multiple years, available at:

<https://www.fedsmallbusiness.org/survey>.

¹⁰ American Investment Council, "Private Credit: Investing in Main Street," March 2021, available at: <https://www.investmentcouncil.org/wp-content/uploads/private-credit-investing-in-main-street.pdf>. Disclosure:

The American Investment Council is a financial supporter of BPC.

¹¹ Karen Mills, *Fintech, Small Business & the American Dream* (Palgrave Macmillan, 2018).

¹² FinRegLab, "The Use of Cash-Flow Data in Underwriting Credit: Small Business Spotlight," September 2019, available at: <https://finreglab.org/wp-content/uploads/2019/09/FinRegLab-Small-Business-Spotlight-Report.pdf>.

¹³ Federal Reserve Banks, "Small Business Credit Survey: 2021 Report on Firms Owned by People of Color," April 15, 2021, available at: <https://www.fedsmallbusiness.org/survey>.

¹⁴ Sabrina Howell, Theresa Kuchler, David Snitkof, Johannes Stroebel, and Jun Wong, "Racial Disparities in Access to Small Business Credit: Evidence from the Paycheck Protection Program," National Bureau of Economic Research, Working Paper 29364, October 2021, available at: <https://www.nber.org/papers/w29364>. See also Government Accountability Office, "Paycheck Protection Program: Program Changes Increased Lending to the Smallest Businesses and in Underserved Locations," September 2021, available at: <https://www.gao.gov/assets/gao-21-601.pdf>.

¹⁵ See, e.g., Philip Gaskin and Ross Baird, "Access to Capital for Entrepreneurs: Removing Barriers | 2021 Update," Kauffman Foundation, available at: https://www.kauffman.org/wp-content/uploads/2021/10/kauffman_capital_report_2021_update.pdf.

¹⁶ Federal Reserve Banks, "Small Business Credit Survey: 2021 Report on Employer Firms," February 2021, available at: <https://www.fedsmallbusiness.org/survey>.

¹⁷ Small Business Administration, "Forgiveness Platform Lender Submission Metrics," February 6, 2022, available at: <https://www.sba.gov/document/report-2022-ppp-forgiveness-platform-lender-submission-metrics-reports>.

¹⁸ Dane Stangler, "Supporting Small Business and Strengthening the Economy Through Procurement Reform," Bipartisan Policy Center, June 22, 2021, available at: <https://bipartisanpolicy.org/report/supporting-small-business-and-strengthening-the-economy-through-procurement-reform/>.