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ENABLING SUCCESS: EXAMINING THE COMPETITIVE LANDSCAPE FOR SMALL BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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ENABLING SUCCESS: EXAMINING THE COMPETITIVE LANDSCAPE FOR SMALL BUSINESSES

TUESDAY, SEPTEMBER 13, 2023

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:03 a.m., in Room 2360, Rayburn House Office Building, Hon. Dan Meuser [chairman of the Subcommittee] presiding.

Present: Representatives Meuser, Williams, Alford, Landsman, and Davids.

Chairman MEUSER. Well, good morning. I appreciate you all being here. The hearing this morning on Enabling Success: Examining the Competitive Landscape for Small Business will come to order.

I greatly appreciate our witnesses for being here and making the trip. And certainly, good morning to everyone, my colleagues on both sides.

So we will delve into today the critical issue of how regulatory decisions, particularly by the Federal Reserve, are impacting our nation's small businesses, which as we all know are the backbone of our communities and the strength of your economy. Small businesses are already navigating a maze of challenges, inflation, regulatory costs, access to capital to name just a few. And the last thing our small businesses need is additional roadblocks, particularly from institutions like the Fed that limit their access to capital and ability to succeed.

Take for instance the important issue of interest deductibility. To address inflation brought on by excessively high levels of spending, the Fed has raised interest rates to a 2 decade high and small businesses are capped at the relief that they can receive. The current cap on interest rates are 30 percent of adjustable taxable income really unfairly penalizes small businesses that utilize large capital expenditures to grow their business and hire employees. This hampers domestic investment but also erodes the global competitiveness of U.S. businesses.

The Joint Committee on Taxation estimate in its first year this change will have approximately $10 billion in fiscal cost for American businesses. Most developed businesses do not place such con-

straints on their companies. Putting this onto American entrepreneurs creates a disadvantage.

The Federal Reserve also, despite its own data in the Beige Book and the Senior Loan Officer Opinion Survey is in the process of implementing stricter capital standards on banks known as the Basel III endgame proposal.

Now, the proposal will require banks to keep more money on the sidelines where it will not be utilized to fulfill the lending needs of particularly small businesses. This move will exacerbate the already tightening capital access problem for small business. If banks have to hold back on lending due to these requirements, it is, again, small businesses that will suffer.

So larger financial institutions may be able to mostly absorb these regulatory shocks; not so much for small business. What happens when a business needs to replace crucial equipment or repair damages urgently and cannot very simply access affordable capital.

These are not theoretical concerns. They are real issues that can close the doors of our small businesses, impacting the lives and livelihoods of everyday Americans. Due to this proposal, banks will have less flexibility than ever and again, small businesses will receive the brunt of the lending pullback.

We do have a duty on this Committee to address the problems facing small businesses. Simple measures like restoring the 163J interest deductible and reconsidering the Basel III endgame can go a long way in ensuring we do not add to the problems.

Despite the headwinds of inflation and turbulent economic landscape our small businesses are fighting to thrive. Let's not allow misguided proposals to tie their hands.

I look forward to hearing the insights of our witnesses today on all of these topics.

Before concluding my remarks I would like to enter into the record three separate surveys of small businesses conducted by the National Federation of Independent Businesses, otherwise known as FIB and NFIB, Goldman Sachs 10,000 Small Business Voices and the Small Business Entrepreneurship Council on detailing the difficulties of small businesses are facing accessing capital. Thank you.

I now yield to our Ranking Member, Mr. Landsman.

Mr. LANDSMAN. Thank you, Mr. Chair. Thank you all for being here. This is a very important hearing and discussion about helping our small businesses with the regulatory landscape but also as the Chair mentioned, some of the tax issues that our small businesses are dealing with. So I am echoing some of his remarks but, you know, over the last several years our small businesses have faced compounding crises from the initial COVID shock to the ongoing repercussions involving the labor market and supply chain issues, the competitive landscape for these businesses has been a whirlwind.

Over the past 2 years, however, we have seen an unprecedented growth in small business startup activity. In 2021 and 2022, over 10 million people filed applications to start new businesses, and small firms are almost entirely responsible for the strong labor market we see today. An economic landscape in which the only constant is change, it is our job as policymakers to give these firms

some semblance of stability and certainty. By making policy decisions that allow small businesses to gain their footing, we can enable their success by creating the ability to plan long term and have confidence in their decision-making.

Unfortunately, the policy environment is far from a sure thing. Right now we are facing several changes to tax policy that undermines small businesses' competitiveness and the potential for financial market instability as we saw with Silicon Valley and signature banks. To create more certainty, it is time to take stock and explore how we can stabilize this landscape for small business.

Let me start by discussing the lending environment, and this is where I believe there is real bipartisan support. Over the last few years we have seen the quickest rise in interest rates in our nation's history to combat the ongoing issue of inflation. While this helped to stabilize prices, it has pushed the cost of capital for businesses out of reach for many of our small businesses. With the prime rate of over 8 percent, the small business loans rates upwards of 15 percent, the ability to deduct interest payments is more important than ever.

Now, some of our small businesses are exempt from these deduction limitations but others are not and this is an area where Congress can act to make sure that interest payments are deductible for all of our small businesses. I am very eager to work with my colleagues to ensure that our small businesses have tax policies that reflect how they operate.

Tax relief for businesses should also be paired with tax relief for workers and families. That is why I believe we should be expanding, extending the Child Tax Credit which managed to cut child poverty in half. Many of you saw that child poverty is up again because this has gone away. This makes a big difference for our small businesses as they look to attract and retain workers.

It is crucial that we improve the resilience and stability of the financial system on behalf of small businesses. Doing so increases the competitive landscape of our main streets businesses and allows them to do what they do best, which is create jobs and invest in our local communities.

I thank all the witnesses for joining us today and look forward to a very productive discussion.

I yield back.

Chairman MEUSER. Our first witness here with us today is Mr. James Chung. Pleasure to have you with us. Mr. Chung is a franchisee and CEO of Atlas, located in Pasadena, California. Mr. Chung began his franchising journey into the great Commonwealth of Pennsylvania, Pittsburgh. He now owns and operates 33 Jimmy John's across four states including a number of stores in Pittsburgh, Pennsylvania. In addition to serving as the CEO of Atlas, Mr. Chung was the CEO of Bacix, an administration organization that provides HR, payroll, financial services for franchises and professional organizations. He also currently serves on the Board of Nano Bank, among the fastest growing banks in the nation. Mr. Chung is a graduate of the University of Southern California where he earned a degree in economics. I am glad to see that is being put to good use. I was an economics major and wondered what I was going to do with it as well.

Mr. CHUNG. Here we are.

Chairman MEUSER. Here we are.

Mr. Chung, thank you for joining us today, and we look forward to today's conversation.

Our next witness with us today is Ms. Holly Wade. Ms. Wade is the executive director of the NFIB Research Center here in Washington, D.C. Ms. Wade has over 19 years of experience conducting research on the small business sector focusing on economic conditions, business operations, and public policy issues impacting small businesses. In addition to her role at the NFIB, Ms. Wade is a Member of the Board of Directors of the Global Interdependent Center and a former Member of the National Association for Business Economics where she is the current Co-Chair of the Small Business Roundtable. She is a frequent media spokesperson on the small business economy and related policy issues. Ms. Wade is a graduate of the University of Washington where she earned her Bachelor of Arts in Political Science and Sociology. Thank you, Ms. Wade for joining us today, and we look forward to your testimony.

I now recognize my friend, the Ranking Member from Ohio, Mr. Landsman, to introduce our last witness.

Mr. LANDSMAN. Thank you, Mr. Chair.

Our last witness today is Professor Kathryn Judge. Professor judge is the Harvey J. Goldschmid Professor of Law at Columbia Law School. Her research on financial markets and regulation has been published in top law journals and she has won accolades from academic peers and from the industry. She served as a clerk for Judge Richard Posner and Supreme Court Justice Stephen Breyer. She is a graduate of Stanford Law and Wesleyan University. Last year she published the book Direct: The Rise of the Middle Man Economy and the Power of Going to the Source.

Thank you, Professor Judge, and we look forward to hearing your testimony. I yield back.

Chairman MEUSER. Thank you. The gentleman yields.

And we have some esteemed witnesses. So we appreciate it and we want to get right to it.

Before we begin, I would like to remind you all that your oral testimony is restricted to 5 minutes. If you see the light turn red in front of you it means your 5 minutes have concluded and you should wrap up your testimony so I do not have to rap this too hard.

We now recognize Mr. Chung for your 5 minute opening remarks.

STATEMENTS OF JAMES CHUNG, FRANCHISEE, CEO, ATLAS; HOLLY WADE, EXECUTIVE DIRECTOR OF THE NFIB RESEARCH CENTER, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; KATHRYN JUDGE, HARVEY J. GOLDSCHMID PROFESSOR OF LAW, COLUMBIA LAW SCHOOL

STATEMENT OF JAMES CHUNG

Mr. CHUNG. Thank you, Chairman.

Chairman Meuser, Ranking Member Landsman, and Members of the Subcommittee, thank you for the opportunity to appear before

you today to share my perspective on the competitive landscape for small businesses in America.

I appear before you on behalf of myself and International Franchise Association, otherwise known as the IFA. The IFA comprised of franchise companies in over 300 different industries who support nearly 8.4 million direct jobs. I have experienced firsthand the remarkable impact that a franchise business can have on local economies and communities, including job creation, workforce development, and economic growth.

While attending the University of Southern California, I was expected to continue my family's medical legacy and study medicine. However, I made the decision to break from my family tradition and chase my entrepreneurial dreams. Lacking support and business knowledge, I decided to pursue a venture that would allow me to develop a business within an already thriving brand. Therefore, I created a business plan that redefined how wireless carriers, such as T-Mobile and their retail partners supported one another.

Through the program, I was able to develop T-Mobile retail locations throughout California. Once I hit my 10-year anniversary in 2018, I made the tough decision to exit wireless retail. I enjoyed and flourished in an environment where I was in business for myself, but not by myself, and it gave me the skills necessary to build my confidence.

After T-Mobile, I made the decision to invest in Jimmy John's, another well-known brand that built a reputation for their tenacious culture, fresh baked bread, and delicious sandwiches. Jimmy John's informed me they needed more stores in Pittsburgh, and although I knew nothing about the market, or food for that matter, I was confident that I could make it happen with the support of the franchise. To further my chances, I partnered with a mentor of mine, Tony Gressak. His experience as the VP of Cheesecake Factory Bakery and a Vietnam vet would prove to be invaluable.

After receiving my first SBA loan, I signed up to open a Jimmy John's in Pittsburgh. My team and I hit the ground running and before we knew it we had opened four more in Pittsburgh and earned the rights to open 24 more in California.

Unfortunately, the stores in California opened producing half of the sales we expected. We bared down, close underperforming stores while acquiring cash-flowing franchisees in other states and started to turn the corner.

The day we became profitable, shelter in place mandates were announced. I was sure this was the end. But thankfully, our government had the foresight and grace to provide programs that restaurants relied upon to make it through the numerous COVID shutdowns and restrictions. Because of the grit of my team and their devotion to our vision, we are now on the path to owning and operating 100 Jimmy John's across six states that would employ more than 2,000 employees.

Entrepreneurs cannot leave their teetering businesses to engage and participate consistently in regulatory and political matters. However, the current political climate is making it too difficult, litigious, and expensive to operate. I am deeply concerned that the American dream is being threatened by the current political landscape.

One headwind is an aspect of tax policy. The limitation on the deductibility of interest imposed by the expiration of a provision in the Tax Cuts and Jobs Act hinders small business growth, and at the beginning of last year it got worse. Prio to January 1, 2022, business interest expense deductions were limited by Section 163J to 30 percent of their earnings before interest, tax, depreciation, amortization, otherwise known as EBITDA. Interest deductions are now limited to 30 percent of earnings before interest and tax, otherwise known as EBIT, a much stricter limitation, especially for businesses with a lot of depreciable equipment such as restaurants. This change, combined with rising interest rates, is proving to make incremental investments by small businesses much more expensive. On average, a restaurant affected by change could see a threefold increase in its incremental tax burden facing both higher interest rates and higher tax rates.

Restaurants famously offer entry level jobs with high upper mobility. In fact, one in three Americans begin their jobs or their careers in a restaurant. Most of my managers and district managers started as simple delivery drivers.

The EBITDA based interest limitation would allow us to keep creating jobs and open this opportunity for countless more Americans.

I am consistently hearing from franchisees who want to delay restaurant openings because of the cost of funds. This is hurting job creation in America.

Fortunately, there is a bipartisan legislation, H.R. 2788, to permanently preserve the EBITDA standard and ensure that the Tax Code does not penalize job creating investments. In addition, H.R. 3398, the Build It in America Act includes retroactive extensions through 2025, and was approved by the Ways and Means Committee earlier this year.

I would urge Congress to take either of these approaches to address this critical issue as soon as possible but certainly before the end of 2023.

Finally, I would like to highlight an issue that has potential to completely dismantle the franchise business model. Any day now, the NLRB is planning to issue the final rule on joint employer standard that would reverse its course back to the harmful 2015 version. This rule will take away the equity and independence of franchise small business owners and will put their success and livelihoods, including mine, in jeopardy. Franchisers will move to hire numerous attorneys to oversee employment issues across the network of independently owned franchises where the franchisor has no control. Ultimately, the additional cost to the franchisor will translate into additional cost to independent owners like me.

Additionally, the increased scrutiny by the franchisor would put into question accountability regarding the success of the franchise which would make the franchise model untenable.

Mr. Chairman, thank you for your invitation to speak on behalf of small business owners everywhere. I look forward to any questions you may have. Thank you.

Chairman MEUSER. Thank you, Mr. Chung. I provided some leeway so I will do the same for our other witness.

Yeah, Washington time tends to be extended. California time I understand might be as well but we are going to try to stay within the limits.

Mr. CHUNG. Thank you, Chairman.

Chairman MEUSER. Ms. Holly Wade, your testimony, please. Thank you.

STATEMENT OF HOLLY WADE

Ms. WADE. Good morning, Chairman Meuser, Ranking Member Landsman, and Members of the Subcommittee. My name is Holly Wade. I am the executive director of the NFIB Research Center.

NFIB is the nation's leading small business advocacy organization, advocating on behalf of nearly 300,000 small business owner Members in Washington, D.C., and all 50 states. NFIB's mission is to promote and protect the right of our Members to own, operate, and grow their business.

Small businesses appreciate the invitation to discuss opportunities for Congress to create an environment for small businesses to grow and flourish. Small businesses continue to face economic headwinds, including stubbornly high inflation, supply chain disruptions, and pervasive workforce shortages. These headwinds all affect the competitive landscape for small businesses.

Small business owners' ability to grow and successfully operate their business are also constrained by unprecedented growth of burdensome regulations and red tape under the administration and the looming expiration of the 20 percent Small Business Deduction (also known as Section 199A) at the end of 2025.

Small businesses face many challenges. Many of these challenges are familiar to small business owners but others are quite new, namely inflation and rising interest rates. NFIB Research Center's August Banking Survey found that the cost of credit is small business owners' biggest financial concern. According to the survey, small businesses' access to credit is currently not a major problem, which is consistent with the findings of NFIB's monthly Small Business Economic Trends Survey. The Banking Survey found most small business owners are generally satisfied with their ability to borrow, however, increased cost of financing is a problem. In fact, 58 percent of those owners accessing credit in the last 3 months reported interest rates a significant issue.

The increasing cost of financing associated with high interest rates is a growing concern for many small business owners. If interest rate costs continue to increase, more small business owners will be priced out of traditional financing options.

Unfortunately, small businesses face many other significant economic headwinds in addition to rising interest rates. One of the biggest concerns for small businesses is the expiration of the 20 percent Small Business Deduction (Section 199A) at the end of 2025. Without Congressional action, millions of small businesses across the country face a massive tax increase. This looming tax increase threatens the ability of small business owners to plan and grow operations, as nearly half of small business owners (48 percent) reported the uncertainty of expiring tax provisions is impacting their current or future business plans.

It will also reduce their primary source of financing, business earnings. Small business owners' primary source of financing for their business are profits, and a tax increase will directly impact that source at a time when access to credit is more costly.

Additionally, the historic regulatory burdens and red tape of the administration are another significant problem facing small businesses. Since 2021, the Biden administration has imposed more than $403 billion in regulatory costs and added more than 233 million hours in paperwork burdens for businesses. These unprecedented burdens are crushing small businesses and there does not appear to be a regulatory slowdown in sight. Regulations are not only costly but require small business owners to allocate valuable time of themselves and often their employees to understand and implement the regulations.

On January 1, 2024, one of the most expansive small business regulations in history will go into effect. This substantial new reporting requirement, known as beneficial ownership information reporting, will affect 32.6 million small business owners in the first year and 5 to 6 million small businesses each year thereafter. The cost of this regulation is a staggering $22.7 billion in the first year, and $5.6 billion per year moving forward. Failure to file completed and updated reports could result in civil penalties up to $10,000 and criminal penalties of up to 2 years in prison. In total, this burdensome regulation smothers the smallest small businesses in America with more than $73 billion in compliance costs, and it only applies to small businesses with 20 or fewer employees and $5 million or less in annual revenue.

Small businesses need certainty to successfully invest, grow, and operate their business. Congress can help mitigate the many economic challenges facing small businesses by providing relief from burdensome regulations and eliminating the threat of tax increases.

I appreciate your time and attention to these concerns, and thank you for the opportunity to testify today.

Chairman MEUSER. Thank you, Ms. Wade. We appreciate your testimony very much.

Now, Ms. Kathryn Judge for your testimony. Thank you for your opening statement.

STATEMENT OF KATHRYN JUDGE

Ms. JUDGE. Thank you, Chairman Meuser, Ranking Member Landsman, Members of the Subcommittee. It is a great pleasure to be here today to be able to address two topics that are close to my heart. One is how to build a healthy banking system that is capable of supporting businesses in good times and bad. And second, how to make sure small businesses have access to the financing they need to survive and thrive. I am going to focus my opening remarks on three key points.

First, the proposal known as Basel III endgame reforms are an important step in efforts to promote a more resilient banking system and a healthier economy.

Two, the proposed reforms should enhance the ability of small businesses to access financing during periods of distress when they

often most need it, while likely having limited adverse effect on their ability to access capital at other times.

And three, small businesses do face very real challenges, including with respect to their ability to access outside financing on reasonable terms and more can and should be done to help in that regard.

First, I will do Basel II endgame. What we are really talking about here is a host of different reforms that are largely designed to enhance the accuracy and transparency with respect to how the largest and most complex banks in the country calculate their risk exposures for regulatory purposes.

For example, the reforms introduce more standardization and reduce the ability of banks to rely on internal models for assessing risk. Sheila Behr, Republican Chair of the FDIC during the 2008 financial crisis recently explained in a Financial Times piece supporting the reforms. The so-called internal ratings based system failed spectacularly during the 2008 financial crisis. This is just one of many different ways that the proposed reforms are efforts to learn the lessons of the past and build a more resilient system.

Second, the proposed reforms are not intentioned with a very important aim of helping small businesses. First, we can see this by looking at where the reforms actually have bite. The great majority of the reforms are really focused on the largest, most complex banking organizations. By contrast, they will have no impact on community banks. And this matters because traditionally it is the smaller community banks that have done the best job really helping to support small businesses. We can look at the Federal Reserve surveys and our resources and we know small businesses still say they have a better experience when they are borrowing from a smaller bank, and they have a higher likelihood of actually getting at least some of the financing they need, whether it is a loan or credit line when they are going to a small bank as opposed to a large bank. And again, the community banks that are the vital lifeline for credit for small businesses are not going to be at all affected by these reforms.

Just as importantly, the proposed reforms could actually really help small businesses. Research shows that one of the most important impacts of having a better capitalized banking system is that banks remain more willing and more able to lend after a financial crisis. And this is doubly helpful for small businesses.

First, it is great news for small businesses because it means they are more likely to be able to access credit after a crisis sets in when they most need credit and it is otherwise hardest to obtain.

But second, the research also shows that you have a significantly shorter and shallower recession. And actually great research by the NFIB really looked at what small businesses, how much they struggled after 2008. And if you look like years after that, there was research from 2012 showing that the uncertainty and the lingering effects of the recession continued to adversely impact small businesses, and it is going to make those types of deep recessions after crises less likely.

Third, the title of the hearing captures exactly what is needed: enabling success, examining the competitive landscape for small businesses. Right now small businesses do not face a level playing

field. They have a harder time accessing financing. They have to pay more for that financing. And they face a host of disadvantages in other ways as well.

And again, there are two different ways to try to help this out. One, you level the playing field from the top down. So you use the full suite of tools that are available, that Congress has given to regulators through competition policy to try to make sure that the largest companies are not abusing the power that they have.

But second, we can also think about really innovative ways to try to from the bottom up address some of the frictions and the challenges that small businesses face. And again here, a lot of those opportunities lie in helping to support that nexus between small businesses and small banks that often have received the most relationship lending. They did a good job with things like the Paycheck Protection Program, which my fellow witness referred to as a really critical component of how Congress really helped small businesses get through the challenges of the pandemic, so I would love to see Congress do more in those regards. There are a lot of opportunities that exist, but allowing the largest, most complex banks to game the system and not have regulations that adequately reflect the risk that they pose the entire economy is not going to be the best way of achieving that aim.

Chairman MEUSER. Thank you, Ms. Judge, very much.

Before we begin our questioning from our Members I will now recognize the Chairman of the Full Committee, Mr. Roger Williams from Texas, for his opening statement.

Thank you, Chairman Williams for participating with us today.

Mr. WILLIAMS. Thank you. And good morning.

I would like to start off by thanking Chairman Meuser for holding this hearing and thank all of you for the witnesses for being here today.

I am a franchisee holder. I am a car dealer in Texas and small business owner.

There is no doubt small businesses are the backbone of our communities and the engines of our economy. Entrepreneurs have faced many challenges over the past few years from labor shortages to crippling inflation, yet still prevail while our nation's job creators have faced and overcome countless hurdles as the Committee has heard prior, access to capital has remained a top concern for small business owners.

In order for a business to get off the ground, small businesses must invest their time and financial resources. This means taking out a loan and accruing interest. Currently, interest deductibility is capped and this cap may very well impact the number of investments a company decides to make.

To make matters worse, in the current state of our economy we are raising interest rates at record rates, at record numbers. With access to capital being the top issue for our nation's small business owners, the introduction of the new Basel III rule would be disastrous for our primary job creators, and if implemented, this rule would make it more costly to give out small business loans.

So despite tough times right now, small businesses are still finding ways to thrive because that is what we do, just as they always do and can. This Committee is focused on making sure our nation's

small businesses have a fighting chance at success, and I am glad we are going to be looking at these issues today.

So lastly, I ask unanimous consent to submit a letter for the record from the National Association of Manufacturers, regarding interest deductibility.

So thank you again to Chairman Meuser, and I yield back.

Chairman MEUSER. The Chairman yields back. Thank you, again, very, very much.

And now we will move to Member questions under the 5-minute rule. And I recognize myself for 5 minutes.

So we have got some interesting views, some interesting experiences. We hope to all benefit by that.

Mr. Chung, I would like to begin with you. You offered a lot of information there. I think your story is not atypical of a small business and growth and setbacks and whether it is mistakes or not there are setbacks and I know that very well from my 20-plus years in small business and perhaps into the larger business world.

So let's just talk a little bit about some of the challenges; right? I mean, Goldman Sachs, 10,000 Small Businesses Voices put out that 70 percent of small businesses have difficulty accessing capital. Of course, NFIB offers the same. States that only 19 percent of small businesses have adequate access to capital. The concern of the lack of predictability in taxes moving forward, i.e., costs on small business is a concern from 20 percent small business deduction to R&D to the interest deduction to the bonus depreciation. So the list goes on of what changes could occur and the type of preparation. Small businesses. And we need to address that. Where are the small business advocates here in the U.S. Congress? And we need to act vigorously in that way for you.

So that on top of the regulations that you mentioned, Ms. Wade.

So Mr. Chung, those lack of certainty, the challenges, the interest deductibility, access to capital, expand a little bit further. What are the things that are of concern to you that can be the difference between your growth, more employment, being built to last, and survival?

Mr. CHUNG. Thank you for the question, Chairman.

I think you guys hit it on the head. The first thing is predictability. We are in an everchanging environment where when we go to work with a bank when they are underwriting any requests for access to capital, the unpredictability causes or makes it difficult for the bank to consistently underwrite our business.

In terms of specifically what we are discussing today in regards to the deductibility with interest rates, it would further reduce ultimately cashflow, for any type of cashflow analysis for underwriting.

Another issue that came to mind as one of my fellow witnesses was discussing some of the programs that were rolled out during COVID is also the EIDL loans. A lot of these small businesses have EIDL loans sitting on their balance sheets as well. These EIDL loans are taken into consideration by the banks and are becoming difficult for these businesses (1) to pay off, and also to reach or to access additional capital due to the balance sheets holding these EIDL loans.

Chairman MEUSER. Thank you.

Mr. CHUNG. I yield back.

Chairman MEUSER. Yeah, I appreciate that.

So NFIB, of course, you mentioned, Ms. Wade, a number of concerns. Is access to capital something that comes up often? And as well, I would like to just ask you both and get to Ms. Judge as well. When you are dealing with these costs, when you are dealing with this lack of predictability, when you are dealing with the inability to invest more in capital investments so you can grow your business, your profitability will decrease due to the added costs and such and the lack of growth. Revenues will be mixed. Your margins will be squeezed. But also your tax revenues are squeezed. It is one thing that I think government does not recognize enough. Are you finding that your sales might be going up but your margins are tighter?

Mr. CHUNG. Margins are definitely tighter for a multitude of reasons. You know, our businesses right now are in a vice. We are facing actually a multifront battle. One is the tax increases that we are facing. Two is the deductibility we are facing. Three is, well, ultimately the rising cost of funds. And four is the rising cost of labor. So we are fighting a multifront battle right now and we are trying to find ground that we can win on. And it has been very difficult.

Chairman MEUSER. I want to address one thing with Ms. Judge. It was interesting how you related to the Basel III. Now, our concern is that the number of small businesses seeking loans from the larger banks, over $100 billion that would be affected by the Basel III will overflow into the smaller banks because there simply is not enough capital to go around, if you will, and creating more competition perhaps for the banks but a more challenging market for the small businesses, and as well at higher costs. So that will happen. So yes, it might benefit actually in the short-term the community banks but it will not in my view anyway, and you can respond to that afterwards, I am over my time, create the type of environment for access to capital that we want for small businesses.

And by the way, after the '08 financial collapse, capital requirements were raised significantly at that time. Basel III is asking for as much as a 20 percent increase, 19 percent to be exact. That is excessive. I yield back.

And I now recognize the Ranking Member for 5 minutes for his questions.

Mr. LANDSMAN. Thank you, Mr. Chair.

So let's stay with you, Ms. Judge. Many opponents of the financial regulation blame greater regulation for the continued consolidation of the banking sector. We talked a little bit about this already. Can you discuss how deregulation has created this wave of mergers that have taken place and taken over much of the community banking? This is really a question about consolidation and the impact it is having on lending and what can be done to revitalize community banking that encourages more small business lending?

Ms. JUDGE. It is precisely the right question to ask. And we have seen an incredible wave of consolidation that has now been in place for over 40 years. We went from having more than 16,000 community-oriented financial institutions that were really focused on serving businesses and families in their communities, to having

massive consolidation. So we have now fewer than 4,000 community banks depending on how you are measuring. And more importantly, a disproportionate share of the banking assets are really held in the top four or top six banks depending on how you look at it that engage in a whole variety of different activities, many of which have little to do with lending or supporting even the domestic economy. And so the core question going forward is how do we make sure we continue to have a robust community banking system?

And so when we look historically, actually, the highest rate of consolidation was during the late 1980s and really throughout the 1990s where we had a significant period of deregulation. The last couple of years where there was an effort to build in a more robust system we actually saw a much slower rate of consolidation among the banks and kind of more viability for the community banks.

So the question gets at the core issue which is what does the structure of the banking system look like? And what does that tell us about who they are really going to serve? And it was actually during the periods of deregulation that we saw changes in the structure that reduced the orientation to really serving the needs of small businesses and communities.

Mr. LANDSMAN. You mentioned that at one point it 16,000 institutions, banks, now four. So is it fair to say that the consolidation has, you know, reduced the number of lenders by, what is that, I mean——

Ms. JUDGE. Yeah. They were shrinking and they were growing at the same time because we did have a new entry for a while and we have had more credit unions. But it has reduced it by a massive fraction. And again, it has also changed dramatically the composition of the banks that are in the market.

Mr. LANDSMAN. Then this gets at the Chairman's question. The smaller banks, as you mentioned, provide the bulk of lending to small businesses in their area. And there is concerned that the new proposed regulation may impact these small banks. Can you explain how this proposed regulation will have a limited impact on small banks? You talked a little bit about it in your testimony but if you can expand a little bit more.

Ms. JUDGE. Of course. So the regulations really only kick in for banks that have at least $100 billion in assets and their insured subsidiaries. The only exception to that is for slightly smaller banks that engage in a lot of trading activity. So it is not the banks that are actually focused on lending; it is the banks that are focused on trading that might be caught that are slightly smaller. And disproportionately, the real impact is going to be found among the most global and systematically important institutions. And again, they do provide important services and it is not going to stop them from being able to provide loans to small businesses, loans to businesses of all size. But instead it is going to recalibrate, for example, how their GSIB surcharge, the surcharge they face because of the threat they pose to the rest of the economy gets calculated in ways that better calibrate the risks that they are actually posing.

Mr. LANDSMAN. So as I understand it, this will, or at least your testimony is that the regulations will probably increase the

lending done by these community banks. I mean, more and more folks are going to look to community banks for loans. What will that do to the cost of capital. I am just trying to get at the Chairman's question.

Ms. JUDGE. Yeah. So getting to the Chairman's question, I think one of the ways we can try to get at it is, well, let's look at what happened the last time we really increased capital requirements. As the Chairman accurately noted, we really did increase capital requirements after 2007 and 2008. We realized they had been too low. So if you look at some of the key years, the 2013 through the 2016-2017 period which is when the post Dodd-Frank reforms were actually implemented and where you look statistically bank capital levels were actually going out, if you look at my written comments, a couple of economist have done a really nice job of saying, well, what actually happened to credit access during that period of time? Credit access remained robust and the banking system played more of a role in providing that credit.

Mr. LANDSMAN. Thank you.

I yield back.

Chairman MEUSER. Okay. The gentleman yields back.

I now recognize the Chairman of the Full Committee, Mr. Williams, from the Great State of Texas, for 5 minutes of questions.

Mr. WILLIAMS. Thank you, Mr. Chairman.

As we have discussed at length today, earlier this year the Federal Reserve unveiled the Basel III proposal that changes capital requirements for financial institutions. These proposed changes will dramatically affect the banking community, and there is concern that the revisions will have broad impacts on small businesses' ability to access reliable credit and increase overall borrowing costs.

So small businesses that rely heavily on loans and credit lines from the banks of all sizes in order to sustain and expand their operations. Implementing additional regulatory capital requirements will slow economic growth and "hinder financial institutions" ability to lend and quite frankly make it easier maybe on banks not to make loans as to make loans.

So Ms. Wade, how will lending access to capital affect the small business community?

Ms. WADE. Certainly. So small businesses rely on the flexibility, a "one size fits all" regulation or regulatory environment. It also includes the banking industry. Well, certainly it impacts small firms' ability to access credit.

One of the areas of concern is also the added paperwork burden and the process by which they are applying for credit and that the process is being lengthened, the amount of paperwork being required is increasing, and all of this affects small business owners' ability to access credit.

Mr. WILLIAMS. No question. They find themselves hiring more compliance officers than officers to do business.

Now, when businesses get to keep more of their hard-earned money they reinvest it into their business, employees, and the broader community. Excessive taxation prevents all the positive things from happening.

The interest deductibility tax provision is a perfect example of making it harder for business owners to make strategic decisions when they are forced to treat interest as a business expense.

So Mr. Chung, can you talk about some of the things that you have been able to do for your employees or with the strategic investments when you were able to keep more of your profits instead of sending them to Washinton in taxes never to be seen again?

Mr. CHUNG. Sure. And thank you for the question.

One of my mantras is "People over profits." And my team knows that. And so the profits that we generate in the company, we reinvest within the team and within the business.

One of the programs we are currently evaluating right now is an EAP program which will give our staff access to mental health programs. However, one thing we have to take into consideration or the reason we have not rolled out the program as of yet is simply because of the uncertainty with the tax provisions that are under discussion today.

Mr. WILLIAMS. Okay. The government does not understand if we make money we do not save money; we spend money. And that is why we need this.

As a small business owner for over 52 years I can tell you that the Biden administration is completely out of touch with Main Street America. Inflation is at a record high. Supply chain disruptions leaving stores helves empty. Worker shortages that are hindering business operations, and the constant threat of tax hikes coming from democrats in Washington have business owners concerned that they will not be able to compete in the future.

So yet this administration, the Biden administration, continues to create new and unnecessary regulations which overwhelm businesses with more red tape and administrative burdens. We cannot except small business owners whose resources are already stretched thin to handle increased costs and manhours that have come with increased regulations and businesses are already working within tight margins and compliance costs can be their tipping point.

So Ms. Wade, while we have time left, how have NFIB Members been dealing with the massive web of new regulations coming out of the Biden administration?

Ms. WADE. Certainly. It has been a huge challenge for small business owners to navigate the new regulatory system that they are required to comply with. And a lot of this is the time that is required for the owner but also their employees. And oftentimes, their most valuable employees to divert time into figuring out how to comply and what they need to do to adjust business operation. And time is one of the most valuable resources of a small business owner and it is very limited these days, especially in light of the labor shortage that many are having to deal with.

So the regulatory environment, it is costly in a number of ways. The dollar amount but also the time that is devoted towards compliance and understanding what they need to do.

Mr. WILLIAMS. Well, the fact of the matter is—let the competition work and let the consumer drive it, not the federal government.

So I appreciate you being here. And with that I yield back.

Chairman MEUSER. The Chairman of the Full Committee yields back.

I now recognize Representative Davids from Kansas for 5 minutes.

Ms. DAVIDS. Thank you, Chairman Meuser. And thank you to you and to Ranking Member Landsman for holding the hearing today.

Tax and capital access policy absolutely have a major impact not just on small business owners' ability to make money but their ability to hire, upgrade their company, and enhance their products as well.

As financial regulations change and provisions from the Tax Cuts and Jobs Act expire it is definitely important for our community to understand how the nation's small businesses are going to be impacted. It is also important that we do that in a bipartisan way to continue supporting the financial stability of these small businesses.

I have met with a lot of small businesses, with Chambers of Commerce, and others in the greater Kansas City Metro area which is where the Kansas 3rd District is. And certainly I have heard a lot about the uncertain tax landscape facing many business owners right now. Some of the provisions that would specifically have a significant impact on main street companies include, we have heard a bit about it already today, the decrease in the accelerated deduction rate for major purchases, how the adjusted taxable income is calculated, and then also changes that small businesses are going to be facing with the deduction of research and development expenses.

So there have been a number of us working on this. I have been working with my Republican colleagues, particularly Tracy Mann, who sits on this Committee as well, who serves on the Small Business Committee as a whole, to try to figure out how we can help address some of these uncertainties. And I know small businesses are out there trying to figure out ways to get capital, to hire new folks, and you know, some of what you guys have been saying has really been resonating today.

So I wanted to ask a question of everyone. I am curious what effects specifically we can expect for small businesses when it comes to the tax provisions from the Tax Cuts and Jobs Act that are about to expire.

Mr. Chung, I would very much like to hear from you first about what specifically you are anticipating with those expirations.

Mr. CHUNG. Thank you for the question.

To be clear, you are asking in terms of our strategic growth what are we anticipating or what are we forecasting?

Ms. DAVIDS. Yeah. And I think specifically when we think about some of the Tax Cuts and Jobs Act provisions that are going to expire, what does that impact look like to you and how are you anticipating navigating that if Congress is unable to address that?

Mr. CHUNG. Sure. Well, I will put it in real-world decisions. And real-world decisions would be simply we were looking to build 30 more stores over the next 5 years. We have now trimmed that down to five stores. And that is going to be spread over 5 years

until we understand what the landscape looks like, which ultimately is a difference in about 500 jobs.

As I was explaining to another Member of the Committee as well, we will also be looking at when and how we roll out various programs for our employees, such as the EAP program. Because of the constraints with budgets we will probably push that back until we have some definition hereinto.

With that I yield back.

Ms. DAVIDS. Thank you.

Ms. Wade, do you have——

Ms. WADE. Yeah. So one of the biggest factors again is their primary source of financing and reinvesting in their business's profits. And so a huge tax hike for many small business owners when this, if it expires, it will impact their ability to grow their business and use those dollars to finance their business.

One of the areas that I also think is going to be really important are a lot of, especially the smaller businesses are not going to be aware of the expiration and this huge tax hike that they are going to have to absorb. And so it will be a shock for them to have a larger tax liability at the end of the year that they were not anticipating. So the uncertainty element I think is very critical in understanding how this is going to impact small firms and their inability to plan going forward. But it will certainly limit their ability to invest in their business.

Ms. DAVIDS. Thank you.

I am short on time so I will yield back. Thank you, Chairman.

Chairman MEUSER. Thank you, Representative Davids, very much for your questions. And thanks again to our testifiers.

I now recognize the fact that we are going to—what I think we are going to do is pursuant to Committee rules, we are going to do a second round for those who would like to participate at any length of time under 5 minutes.

So to our Members, if you have one or two questions or if you want to utilize your entirety of your 5 minutes, you are free to do so.

I will start with myself. And I will recognize myself for 5 minutes.

So Mr. Chung, I want to come back to you. You mentioned you were planning on 30 stores if it was a more vibrant economy and you saw the returns and opportunities in a brighter manner. What would you like to see that would create such a brighter outlook for you from a tax regulation, access to capital standpoint?

Mr. CHUNG. Thank you for the question, Chairman.

In regards to the deductibility standpoint, EBIDTA would still be the status quo for considering what portion of interest was deductible. That is how it was previously and that is what we might need to maintain.

In regards to access to capital, we do need a vibrant economy that does provide access to capital, simple underwriting at various levels, whether it be large institutional banks or smaller community banks. So access to capital, stability in terms of the tax provisions, and keeping the status quo.

Chairman MEUSER. Has your bank or banks and the bank that you are a board member of, do you find that the so-called banking

crisis from a few months ago had any systematic effect on smaller community banks?

Mr. CHUNG. Absolutely. In regards to deposits, we saw deposits vacate some of the smaller community banks and be consolidated into larger banks which caused many banks to make tough decisions one way or the other. A very strategic conditions one way or the other.

Chairman MEUSER. Okay. Yeah. I mean, we saw some of that initially throughout my district, for instance, and banks that I speak with. But it seems that it has kind of balanced out. However, since those deposits have been lost, those assets have been lost, making loans from community banks to our small businesses, that much more selective; right? I mean, they will certainly be more diligent for secure loans and perhaps because the opportunity is there, where there is great demand, prices go up. And so they can loan at higher costs, higher interest rates even above and beyond where the Fed has gone with the Fed rate. So that will happen. I mean, that is happening with automobiles and it is certainly having an effect on where we had a boom in automobiles. I mean, and now it is at 7, 8 percent interest rates. People are turning away from it. Our housing market is really being struck hard in that manner.

So here we had a bailout. We will call it that of three banks. We had a special assessment to make up for the $44 billion when the bailout occurred. So that is a whole another story that larger banks are going to be facing. Interest rates due to inflation and the causes of inflation are relatively obvious. But the continued increase in energy costs, gasoline is $4 a gallon. I mean, and such. So the interest rates. Now we throw in there the increased capital requirements. So there is a squeeze that will be taking place. We have 19 percent, Ms. Wade, your Members, access to capital is something that is at the top of the list particularly lately. And so the idea of having capital requirement increases on banks to me just adds a significant burden or additional obstacle for accessing such capital. So they are going to be turning nontraditional lenders where that is not as regulated and usually with higher penalties for missing payments and all.

So Ms. Wade, why do you not comment on what your Members think of a tighter lending environment.

Ms. WADE. Certainly. Well, they are currently facing a lot of headwinds and challenges. And a lot of that is related to cost increases in business operations. So the inflationary pressures that they are experiencing right now, if there are additional costs related to financing that is just another part or a piece of absorbing higher costs in operating their business that they will have to navigate.

Chairman MEUSER. Right.

Ms. WADE. And all of this makes it very challenging and difficult for a small business owner to navigate, first, because the business owner is the one who is having to make all these decisions themselves generally speaking. So any increase in costs on the financing front will certainly be a factor in their ability to operate their business effectively.

Chairman MEUSER. Right. And banks over $100 billion need to tighten up by 19 percent. Okay? That is not a small amount. It will clearly drive those looking for such business loans to the smaller banks who will then be more selective and be able to charge stronger fees, so creating more competition, which tends to be good, but when we are advocating for small business, and small banks are small businesses, that competition, increased demand increases prices. And more selective; right? Banks will have the opportunity to be that much more selective in who they extend loans to which again might be good but not so much for our small businesses. And simply, less opportunity.

And Ms. Judge, later on perhaps you want to comment on that but I am over my time and I yield back.

I will now yield to the Ranking Member, Mr. Landsman.

Mr. LANDSMAN. Thank you, Mr. Chair.

Ms. Judge, just a couple of questions.

The Basel III has been, you know, implemented in other countries. Can you just talk a little bit about what that has looked like? And then I am going to ask the questions and then just hand it over time.

One is what the experience has been in other countries.

Number two is a little bit more focused on these regional banks. So Ohio is home to three regional banks, Fifth Third, Huntington, and Key Bank, who as a result of the proposal will largely face the same capital standards as global systemic banks. So from what I can see, we have got this ecosystem in Ohio that is one to envy. So what changes would you suggest for the proposed rule that could avoid any negative impacts from the current draft as it relates to the regional banks?

So one, it has been implemented globally. Wha have we seen?

Two, you know, as I am looking out for our regional banks, advice in terms of proposed changes.

Ms. JUDGE. Both great questions. I will take them in opposite order. And again, I think the ecosystem in Ohio is wind envy. I mean, I think you have a robust set of different size banks and I think that is critical to providing a whole variety of services to different types of businesses.

I actually think a lot of the reforms are meant to maintain the health of that ecosystem over time. So if you think about what California is going through right now, there are areas of California where the two biggest regional banks imploded precisely in an environment where credit standards are already tightening and access to credit is becoming more strict and more expensive. And so right when they need it they are dealing with like the greatest disruptions.

So part of what they are really doing through all of the different reform proposals, all of which are implemented very incrementally over time, many of them not taking into full effect for 5 years, others on a 3-year timeframe. 1:07:04xx allow banks to use the capital they already have, to use their accrued earnings so that there is no disruption even among necessarily what large banks are doing. Certainly, not what regional banks are doing to be able to become stable and resilient. So we do not have huge losses to deposit 1:07:19xx, but also so the banks continue to be there so they can

continue to service the small businesses and the other businesses. So I would say when you are taking a longer term perspective, I think the real aim here is to maintain that healthy ecosystem and not have the unexpected disruptions that create uncertainty and fear for small businesses and for others that has been a concern running throughout the hearing.

And with respect to other countries, they have not implemented, and it actually really goes to the process through which the standards were promulgated. These are standards that came out of discussions as part of the Basel Committee. And part of what is really interesting there is it is an effort among different jurisdictions that say let's really learn what is the best thing that we can do. And yes, the U.S. has a huge voice there. Europe also has a huge voice there. Europe is actually more reliant on small- and mid-size enterprises. They are a bigger part of the economy and they are more reliant on banks. And so these were standards that through years of research and testing were decided to be like these are the best overall standards that we can come up with to try to balance out the need for resilience while also wanting to make sure the banks have the freedom that they need to be able to really make loans in good times and bad and to support the real economy.

So I think what we have really seen is there is actually no easy answers in terms of impact but on a whole it looks like it has been able to be completely consistent with ongoing and important support for businesses.

Mr. LANDSMAN. And you have got a minute left.

On the regional banks as I am thinking about them, are there proposed changes to the rule that you would offer? And this could be just generally speaking. It does not have to apply just to regional banks.

Ms. JUDGE. No. I think the real key is going to be what is the timeframe for implementation because it is true as has been alluded to numerous times, you do not want to tighten expectations during periods of distress. But you also do not want to not adopt the rules that are actually going to have the healthiest banking system possible. I think right now there is probably adequate leeway and I bet on calls where a lot of bank analysts have said that given the timeframe there is the ability for the market to absorb the type of changes that lie ahead. That being said, you do want to make sure that you are not doing this in a way that could adversely impact lending. It does not seem likely but I think paying close attention to that is going to be important.

Mr. LANDSMAN. Thank you very much. And I yield back.

Chairman MEUSER. The Ranking Member yields back.

I now recognize Representative Alford from Missouri for 5 minutes.

Mr. ALFORD. Thank you, Mr. Chairman. I appreciate it. And thank you to the witnesses for being here today.

A very important hearing for our Subcommittee. I have said it before, and I am going to say it again that America's greatest economy in my lifetime really under President Trump thanks to the Tax Cuts and Jobs Act. A record number of small businesses were opening. The American dream was in reach for many more people than now. A crucial component for small businesses is capital and

access to capital has been a challenge for a lot of people. This is especially true for the rural small business community in Missouri's 4th Congressional District. Simply put, we have banking deserts there. I have seen it firsthand. In our Small Business Committee hearing earlier, I was proud to have a rural small business owner sitting where you are now. Her name is Jennifer Cassaday. She testified about starting up her business and financial resources, they just were not available to her when she was first starting out. So she had to turn to family for financial support. By the way, she has a great business thriving right now but it could have been a lot different. She could have had help from financial resources.

Unfortunately, the landscape for small businesses continually worsens as we see the TCJ provisions expiring and supervisors making borrowing more difficult and less affordable. The latest from Basel III will increase capital requirements and therefore tighten lending during a time that small businesses need it the most in America.

Ms. Wade, thank you for being here today. You note in your testimony that H.R. 4721, the Main Street Tax Certainty Act will provide relief and tax certainty to small businesses. This bill would make permanent a provision in the TCJA that helps small businesses. I am a proud cosponsor of this bill.

You also mention that regulatory burdens and red tape from the Biden administration and using the SBA Offices of Advocacy, you touch on that. Can you expand on that? Just how important is H.R. 4721?

Ms. WADE. It is incredibly important for the ability of small business owners to continue to operate and grow their business. They are under some really challenging headwinds right now with inflation and worker shortage and all of that. And having some certainty that their taxes will not increase in a couple years will go a long way to allow them the room to grow and operate their business. The Tax Cuts and Jobs Act was a huge help for small business owners to retain more of their profits to then use those profits to invest in their business. And that was where we saw, you know, some huge optimism that we track in our Small Business Economic Trend Survey, and small business owners, you know, felt confident going forward that they would be able to maintain business operations and even grow their business if they found the opportunity. But those expirations of those key provisions, especially the 20 percent small business deduction that they are able to benefit from now will be a huge tax increase for them if it does expire and will impair their ability to reinvest in their business and grow.

Mr. ALFORD. You also talked about the cost of borrowing, the concern of small business owners. Can you talk about how the cost of financing can really inhibit small business growth? And also talk about in the minute 20 that we have left, what does this mean for people wanting to start a business, much less those who are already committed their family's time and treasure to get a business going in America?

Ms. WADE. Absolutely. So the increased cost of financing will be another hurdle that they will have to absorb those cost increases. But then also, you know, having to figure out whether it is worth

the increased financing costs to purchase that new equipment or purchase that other building and whether that return on investment is worth it in this higher interest rate environment. And so the cost of financing is going to impact their decisions on how to grow and expand their business or reinvest in their business.

For those starting out, capital is paramount. And so their inability to afford financing if available to them to start a business is a huge hurdle for those who want to bring their ideas and creativity to the marketplace. In starting a business, financing will be a crucial role in that.

Mr. ALFORD. Ms. Wade, thank you. And I yield back.

Chairman MEUSER. The gentleman yields back.

Well, I think that concludes our hearing. I would like to thank our witnesses for your testimony and for certainly making the trip and appearing before us today.

Without objection, Members have 5 legislative days to submit additional materials and written questions for the witnesses to the Chair which will be forwarded to the witnesses. I ask the witnesses to please respond promptly.

If there is no further business, without objection, this Committee is adjourned.

[Whereupon, at 11:11 a.m., the Subcommittee was adjourned.]

APPENDIX



JAMES CHUNG

FRANCHISEE/OWNER
JIMMY JOHN'S

TESTIMONY BEFORE THE HOUSE SMALL BUSINESS SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS

HEARING ON "*Enabling Success: Examining the Competitive Landscape for Small Businesses*"

September 13, 2023

Chairman Meuser, Ranking Member Landsman and members of the Subcommittee, thank you for the opportunity to appear before you today to share my perspective on the competitive landscape for small businesses.

I appear before you on behalf of myself and the members of the International Franchise Association (IFA). IFA is the world's oldest and largest organization representing franchising worldwide. For over 60 years, IFA has worked through its government relations, public policy, media relations and educational programs to advocate for the protection, promotion and enhancement of franchising and the approximately 790,000 franchise establishments that support nearly 8.4 million direct jobs, $825.4 billion of economic output for the U.S. economy, and almost 3 percent of the Gross Domestic Product (GDP). IFA members include franchise companies in over 300 different industries, individual franchisees, and companies that support franchising in marketing, technology solutions, development and operations.

I have experienced firsthand the remarkable impact that franchised businesses can have on local economies and communities, including their ability to create jobs, develop a skilled workforce, and foster economic growth.

I graduated from USC in 2005 and come from a legacy family that helped establish the USC School of Dentistry. It was expected I return to USC for medical school and carry on the family tradition, however, I found myself spending more hours writing more business plans than I did in hospitals. Therefore, I decided to break from the family tradition and chase my entrepreneurial dreams without any support.

Looking back on it now, I am amazed I was brave enough to develop and pitch a business plan that detailed changing the relationship between wireless carriers and retailers. Shockingly, T-Mobile endorsed the plan which laid the foundation for what is known as the TPR-I program. This program defines T-Mobile's main distribution channel through private retailers today. As one of the founders of the program, I was fortunate to participate in it after my partner and I raised $60k to open the first T-Mobile TPR-I retail location in Fullerton, California.

Over ten years, we grew from 2 locations to 40, from San Luis Obispo to San Diego. I owe our growth and success to our team. We had an extremely strong culture. When we walked into events with our team leaders, the entire crowd would start chanting our company name and cheering us on. The development and management of our company culture was the result of our commitment to our team over profit.

Once we hit our 10-year anniversary, T-Mobile started to change the program so my partners and I decided it was our time to exit. It was one of the hardest decisions I had ever made, but we sold in 2018. After selling, I made the decision to venture into food and began researching many different concepts before choosing Jimmy John's as the next venture. Having started one successful business, I thought that being in business "for myself, but not by myself," sounded pretty good.

I picked Jimmy John's because of the culture, love for quality ingredients, fresh baked bread, and speed. Also, because I love sandwiches. To me, a sandwich is the perfect meal. After setting my sights on Jimmy John's, I opened my first store in Pittsburgh, Pennsylvania. After receiving an SBA loan, for the next year, I flew back and forth from California to Pennsylvania while sleeping at the store and working day and night to learn the business. My team and I hit the ground running, and before we knew it, we had gained the knowledge necessary to open 4 more in Pittsburgh and the rights to open 24 in California – which was almost the beginning of the end.

We were overly confident and began opening stores at a rapid pace in California. Some months we were opening two at a time with blind faith that we had the skills to make it work. Unfortunately, we underestimated how competitive California was and the stores opened at half the sales volume we were expecting. At the time, we thought we were too deep to adjust the trajectory of the business and the ship would sink. Bank commitments had been made, leases signed, debt had been taken on, and personal guarantees all over the place. I had no family and was willing to take on the burden of turning the company around.

I will never forget, I called a bankruptcy attorney, since I was sure that the end was imminent. He told me, "James: First, you couldn't afford me. Second, all those stories you hear about people going bankrupt and hiding money elsewhere are not true. They will come and take all your assets. The best thing to do is, take the money from the sale of your T-Mobile's, invest in yourself, and turn around the company." So that's what I did.

Looking at the numbers, I could see the business was on the upward trend, but needed time. So, I came up with a Hail Mary. Buy cash-flowing businesses to offset the losses in California and dig in with the team to run lean while keeping the faith. We called every Jimmy John's franchisee in the entire system to ask if they would be interested in selling. If someone was even the slightest bit interested, I was on the next flight to see them.

Slowly but surely, after making several minor acquisitions and after closing 14 stores in California, we started to become profitable. On the day Tom Hanks announced he had COVID we had turned California into the fastest growing market for Jimmy John's in the Nation and I was on my last few hundred bucks. I was sure this moment was the end of the Jimmy John's story for me as all the COVID mandates continued to rollout. But thankfully, our government had the foresight and grace to provide programs that most restaurants relied on to make it through.

As things stabilized, we continued inching forward and making progress. Because of the strength of my team and their devotion to our vision, we are now on a path to owning and operating 100 Jimmy John's in 6 states.

Entrepreneurs are unsung heroes. There are not enough of us to make our voice heard against the masses and we cannot leave our teetering business to engage in playing a consistent active role in regulatory matters.

Yet, most businesses are small businesses. If it were not for the passion I have for creating and building while providing the income for people to support their families and dreams, I would not recommend for anyone to become an entrepreneur. The current political climate is making it too difficult, litigious, and expensive to operate. People expect a return on the investment of their time and money - when the investment no longer matches the return, people move on to other things. In this case, that means people stop establishing businesses or innovating which, for me, is what the American Dream is all about.

The Unique Franchise Business Format

Franchising is perhaps the most important business growth strategy in American history. The first franchises started in the colonies by Ben Franklin, and over the centuries, this system has served as a core American model of opportunity and entrepreneurism. In 1731, Ben Franklin entered into a partnership with Thomas Whitemarsh, who franchised his printing business – *The Pennsylvania Gazette*. Later, Whitemarsh would introduce the first "franchised" newspaper of South Carolina, the *South Carolina Gazette*.

Franchising has contributed to robust job creation and provided foundational skills development for small business owners and workers. Today, there are more than 790,000 franchise establishments, which support nearly 8.4 million jobs[1]. Many people, when they think of franchising, focus first on the law. While the law is certainly important, it is not the central thing to understand about franchising. At its core, franchising is about the relationship that the franchisor has with its franchisees—how the franchisor supports its franchisees, the franchisor's brand value and how the franchisee meets its obligations to deliver the products and services to the system's brand standards.

Franchising is often confused with "big business" when it is in fact the exact opposite. A franchise is first a local business, distinguished from other local businesses because it licenses the branding and operational processes of a franchisor while operating independently in a defined market. The local owner, or franchisee, is responsible for hiring staff, organizing schedules, managing payroll, and all daily operational tasks as well as local sales and marketing. The value of franchising lies in a strategic balance in the relationship between a franchisor and franchisee: the independence of a franchisee to manage its day-to-day operations and connections with its employees, consumers and the local community balanced with the franchise system giving aspiring small business owners a head start toward becoming their own boss, with a proven business model that can set up new business owners for success and easier access to lines of credit than a traditional business.

The value of franchising is supported by empirical data. A recent study by Oxford Economics found that franchising offers a path to entrepreneurship for all Americans, but especially for minorities and women. Around 26% of franchises are owned by people of color, compared with 17% of independent businesses generally. In addition, franchising offers the opportunity for business ownership that would not otherwise be available, especially to women, people of color, and veterans. Franchised businesses also perform better and provide better pay and benefits than their non-franchised counterparts. On average, franchises report sales 1.8 times as large and provide 2.3 times as many jobs as non-franchised businesses. Sales and jobs in franchised businesses exceed non-franchised businesses across all demographic cuts, including gender and race. For example, Black-owned franchised firms generate 2.2 times as much in sales compared to Black-owned non-franchised businesses, on average[2].

Despite how it is often characterized, franchising is not an industry. Franchising is a business growth model used *within* nearly every industry. More than 300 different sectors are represented in franchising, and franchised companies offer a huge range of products and services from lodging to fitness, home services to health care, plumbing, pest control, restaurants, security, and lawn care.

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[1] Franchiseeconomy.com (2021).

[2] The Value of Franchising. Oxford Economics

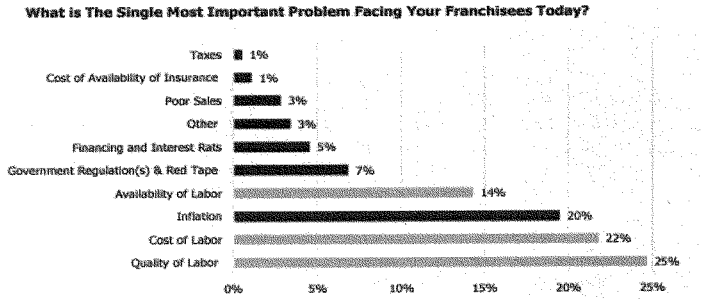
Further, despite popular misconceptions, franchising consists of far more than merely the "fast food" industry. In fact, 63% of companies that franchise are not in the food services at all, and 83% are not in fast food.[3] As you can see in the graphic below, there are far more local (50% of all franchised brands) and regional brands (34% of all franchised brands) whose names you might not recognize than the fast food giants that garner the most attention.

There are two principal explanations given for the popularity of franchising as a method of distribution. One is that it "was developed in response to the massive amounts of capital required to establish and operate a national or international network of uniform product or service vendors, as demanded by an increasingly mobile consuming public."[4] The other is that franchising is usually undertaken in situations where the franchisee is physically removed from the franchisor, giving autonomy to the franchisee to run their own day-to-day business operations. These two motivations are consistent with a business model in which the licensing and protection of the trademark rests with the franchisor, and the capital investment and direct management of day-to-day operations of each franchise unit are the responsibility of the franchisee who owns, and receives the net profits from, its individually owned franchise unit.

It is typical in franchising that a franchisor will license, among other things, the use of its name, its products or services, and its operational processes and systems to its franchisees. The turnkey nature of operating a franchised business is why I and so many of my fellow franchisees purchased a franchise. Franchisees look to the franchisor to protect the trade names, trademarks and service marks (collectively the "Marks") and brand by establishing and enforcing standards on all franchisees in a system. Such standards are essential for protection of franchisees' equity in their businesses and consumers of the brand. These standards allow franchisors to maintain the uniformity and quality of product and service offerings and, in doing so, to protect their Marks, the goodwill associated with those Marks, and most importantly, consumer confidence in the Marks and brand. Because a core principle of franchising is the collective use by franchisees and franchisors of Marks that represent the source and quality of their goods and services to the consuming public, action taken to control the uniformity and quality of product and service offerings under those Marks is not merely an essential element of franchising, it is an explicit requirement of federal trademark law under the Lanham Act.

Staffing challenges

As I mentioned earlier, I am working day in and day out to grow my business, but there are headwinds. One of those is the ongoing difficulty of finding staff.



According to the U.S. Bureau of Labor Statistics (BLS), the unemployment rate edged down to 3.5%, one of the lowest in history. Demand for labor far exceeded the supply, resulting in a wage growth of 9.0% in 2022. The wage growth tapered down in the fourth quarter of 2022 to 6.4%. ADP Research projects wage growth in 2023 of approximately 3%, which is higher than pre-pandemic norms. Quality and cost of workforce remains the biggest challenge for almost all franchised businesses. According to the IFA/FRANdata 2023 labor survey of franchisors and franchise portfolio companies, 81% of franchised brands experienced constrained growth due to labor challenges, a continuation from 2022. Nearly identical to last year, 87% of franchisees have had difficulty filling in positions for unskilled labor, skilled labor, or both (88% in 2022).

In 2023, the franchise labor market is even more competitive than it was in 2022. According to the IFA/FRANdata 2023 labor study, 85% of the franchisors surveyed reported an increase in store-level wages in the past six months, and 43% of franchised businesses reported benefit increases. Almost 60% of the franchisors surveyed anticipate an increase in labor wages in the next six months. FRANdata expects that the rebalancing of the labor market will likely take some time, and franchisees will continue to face labor related challenges at least in the first half of 2023.

Tax Policy and the Deductibility of Interest

Another headwind is a particular aspect of tax policy – the limitation on the deductibility of interest imposed by the expiration of a provision in the Tax Cuts and Jobs Act. While I understand the rationale for wanting to discourage undue leverage, for small businesses, it hinders our growth, and at the beginning of last year, it got worse.

Prior to January 1, 2022, businesses' interest expense deductions were limited by section 163(j) to 30% of their earnings before interest, tax, depreciation, and amortization (EBITDA). Interest deductions are now limited to 30% of earnings before interest and tax (EBIT) – a stricter limitation. This change, combined with rising interest rates, is proving to make incremental investments by small businesses much more expensive.

On average, a restaurant affected by the change could see a three-fold increase in its incremental tax burden, facing both higher interest rates when financing improvements and a very high tax rate.

Restaurants famously offer low barrier to entry jobs with high upward mobility potential. One in three Americans begins their career in a restaurant. The EBITDA-based interest limitation would allow us to keep creating jobs and open this opportunity for countless more Americans seeking flexible entry-level positions.

In the Jimmy John's system, we're constantly hearing from franchisees who want to delay remodels or new restaurant openings because they'll be penalized by the tax code for their growth. This is hurting not only restaurant job creation, but jobs in construction, contracting, supply chain, etc.

According to an EY study, the permanent stricter EBIT-based interest expense limitation before market adjustment would cost **467,000 U.S. jobs, $23.4B in lost wages, and $43.8B in GDP over 10 years.** Two dozen OECD countries have earnings-based limitation. We are *the only country* with EBIT-based limitation; the others all include depreciation and amortization.

Reps. Adrian Smith (R-NE), Joe Morelle (D-NY), Kevin Hern (R-TX) and Brad Schneider (D-IL) have introduced bi-partisan legislation (H.R. 2788) to permanently preserve the EBITDA standard and

ensure that the tax code does not penalize job-creating investments. In addition, H.R. 3938, the Build It in America Act includes a retroactive extension through 2025 and was approved by the Ways & Means Committee earlier this year.

I would urge Congress to take either of these approaches to addressing this critical issue as soon as possible, but certainly before the end of 2023.

SBA Lending

I started my first Jimmy John's location with an SBA loan, and the SBA's lending programs and the access to capital they provide are a big part of the franchise success story. About 20% of SBA lending goes to franchising. In 2022, about 7,000 loans were approved in the 7(a) and 504 programs representing more than $5 billion of loan volume and supporting more than 100,000 jobs.

Earlier this year, the SBA finalized a number of changes to its affiliation rules, including elimination of the concept of affiliation by control, which also resulted in elimination of the Franchise Directory.

The IFA supports efforts to streamline government-supported lending programs and recognizes this was the intent of eliminating the principle of affiliation by control in the SBA size standards, which in the case of a franchise is currently based on franchise agreements. Those determinations required, by their very nature, subjective assessments of contract language. As such, consistency of those determinations, delays in approvals created by occasionally lengthy reviews, and the back and forth with franchisors to reach acceptable agreement language all were impediments to franchisees being able to access the capital they needed to grow. We commend the SBA's desire to address these issues and believe this is a good effort to do so.

However, as part of the affiliation review and use of the Franchise Directory, the SBA conducted an eligibility review, an effort to help lenders from an efficiency standpoint. Unlike other businesses, in franchising there is a set of agreements between a franchisor and the small business franchisees who borrow using SBA-guaranteed loans. In essence, it is a one-to-many review. One-time eligibility review decisions eliminate the need for each lender to review the sometimes lengthy and complicated agreements to assess eligibility. Importantly for franchisors, such reviews avoided the problem encountered years ago where they got inconsistent and often conflicting decisions and requirements from various lenders.

IFA's understanding of the affiliation change now shifts this burden to lenders. This shift may create an inefficiency that will put many franchise brands at a disadvantage. IFA is particularly concerned about access to capital for emerging brands (of which there are hundreds each year) and smaller, regional brands. Will a community bank be willing to make a loan to a franchisee associated with a brand that requires the banker to wade through multiple franchise documents to determine eligibility? Most franchise loans are relatively small, averaging under $400,000. The economics for lenders doing only one or a few franchise loans may drive them away from franchise lending completely.

Now that this rule is final, we will have to wait and see how lenders react, absent action from Congress. We appreciate the Committee's interest in and oversight of these changes and would be happy to be a resource as it considers what, if any, action to take.

Joint Employer

Finally, I would like to highlight an issue that has the potential to completely undermine the franchise business model. Any day now, the National Labor Relations Board (NLRB) is planning to issue a final rule on a joint employer standard that would reverse its course back to the harmful 2015 version.

The NLRB's proposal largely reestablishes the broad Obama-era standard of joint employment, under which one company may be deemed the joint employer of a second company's employees not only where it directly or immediately exercises control over the second company's workforce, but where the first company's putative control is indirect, or even simply reserved but not ever actually exercised. This puts franchisors at risk of being sued for things they never did and had no power to stop. Moreover, it risks wiping away the equity that I have spent my life and career building in my businesses and ultimately makes me a middle manager of my brand. The joint employer standard created by the NLRB in 2015 led to a nearly doubling of litigation against franchised businesses, cost franchising $33 billion per year, and preventing the creation of 376,000 new jobs in the four ensuing years. Small businesses will not survive a similar consequence in the current labor market.

The NLRB's proposed changes to the joint employer rule will take away the equity and independence of franchise small business owners and would put their success and livelihoods, including mine, in jeopardy. Franchisors will naturally move to hire numerous attorneys to oversee employment issues and claims across its network of independently owned franchised businesses over which the franchisor has no control. Ultimately, the additional costs to the franchisor would translate into additional costs to independent owners like me, and that would make the franchise business model untenable.

In fact, research released last week by Oxford Economics based on a July 2023 survey of franchisees shows that franchise owners are bracing for more harm from the new NLRB joint employer rule as it injects uncertainty in the franchisor-franchisee relationship and threatens standards enforcement across franchise systems. Overall, 43% of franchisee respondents expected a change in the franchisor/franchisee relationship as a consequence of the NLRB's joint employer rule, although there is uncertainty among franchisees regarding the responses from franchisors. Approximately 20% of respondents expected franchisors to increase control over their operations while another 20% expected franchisors to distance and reduce operations and compliance support.

Approximately 40% of franchisees did not know what to expect, and the remaining 20% expected no change. This uncertainty about franchisor responses to the new joint employer rule brings with it significant concern among franchisees, with 74% of franchisees expressed a high level of concern at the prospect of increased franchisor control, and 55% a high level of concern with reduced franchisor support.

The Oxford Economics report is also expected to identify increased costs for franchisees as a result of responses by franchisors to mitigate risk under the new joint employer rule. These include the heightened risk of litigation (i.e., 70% of franchisees expected increased litigation) and increases in legal and advisory fees, as well as higher insurance and operations costs. Meanwhile, the new rule may reduce the attractiveness to being a franchisee with respect to operating an independent business and lead to fewer franchises (i.e, 66% of franchisee respondents expected

the new standard to raise barriers to entry into franchising).

This report confirms that franchisees have significant concerns about their ability to do business if the NLRB moves forward with its proposed joint employer rule. A majority of franchisees are highly concerned about both increased franchisor control and decreased franchisor support, demonstrating that franchising currently has the right balance in the franchisor-franchisee relationship. Unnecessary, expanded joint employer liability will hurt franchised businesses – just as it did in 2015.

I urge Congress to reject this unnecessary and over-reaching rule via the Congressional Review Act.

Mr. Chairman, thank you again for the opportunity to testify. I am happy to answer any questions you may have.

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS



Statement for the Record of Holly Wade
Executive Director, Small Business Research Center

United States House of Representatives
Subcommittee on Economic Growth, Tax and Capital Access

Enabling Success: Examining the Competitive Landscape for Small Businesses

September 13, 2023

National Federation of Independent Business
555 12th Street NW, Suite 1001
Washington, DC 20004

Good afternoon, Chairman Meuser, Ranking Member Landsman, and members of the House Economic Growth, Tax, and Capital Access Subcommittee. My name is Holly Wade; I am the Executive Director of the Research Center at the National Federation of Independent Business (NFIB).

NFIB is the nation's leading small business advocacy organization, advocating on behalf of nearly 300,000 small business owner members in Washington, D.C. and all 50 state capitals. NFIB's mission is to promote and protect the right of our members to own, operate, and grow their businesses.

Small businesses appreciate the opportunity to discuss opportunities for Congress to create an environment for small businesses to grow and flourish. Small businesses continue to face economic headwinds including stubbornly high inflation, supply chain disruption, and pervasive workforce shortages.[1] These headwinds all affect the competitive landscape for small businesses.

Small business owners' ability to grow and successfully operate their business are also constrained by unprecedented growth of burdensome regulations and red tape under the Biden Administration and the looming expiration of the 20% Small Business Deduction (also known as Section 199A) at the end of 2025.

Small businesses face many challenges. Many of these challenges are familiar to small business owners but others are new, namely inflation and rising interest rates. NFIB Research Center's August Banking Survey found that the cost of credit is small business owners' biggest financing concern. According to the survey, small business owners' access to credit is currently not a major problem, which is consistent with the findings of NFIB's monthly survey. The Banking Survey found most small business owners are generally satisfied with their ability to borrow, however, increased cost of financing is a problem.[2] In fact, 58% of those owners accessing credit in the last three months reported interest rates a significant issue.

The increasing cost of financing associated with high interest rates is a growing concern for many small business owners. If interest rate costs continue to increase, more small businesses will be priced out of traditional financing options.

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[1] William C. Dunkelberg and Holly Wade, *NFIB Small Business Economic Trends*, NFIB Research Center, July 2023, https://strgnfibcom.blob.core.windows.net/nfibcom/SBET-July-2023.pdf.

[2] Holly Wade and Maddi Oldstone, *Banking Survey Part II*, August 2023, NFIB Research Center, https://strgnfibcom.blob.core.windows.net/nfibcom/Banking-Survey-2023-Part-II.pdf.

Unfortunately, small businesses face many other significant economic headwinds in addition to rising interest rates. One of the biggest concerns for small businesses is the expiration of the 20% Small Business Deduction (Section 199A) at the end of 2025. Without Congressional action, millions of small businesses across the country face a massive tax increase. This looming tax increase threatens the ability of small businesses to plan and grow their operations, as nearly half of small business owners (48%) reported the uncertainty of expiring tax provisions is impacting their current or future business plans.[3] It will also reduce their primary source of financing, business earnings. Small business owners' primary source of financing for their business are profits and a tax increase will directly impact that source at a time when access to credit is more costly.

Additionally, the historic regulatory burdens and red tape from the Biden Administration are another significant problem facing small businesses. Since 2021, the Biden Administration has imposed more than $403 billion in regulatory costs and added almost 233 million hours of paperwork burdens on businesses.[4] These unprecedented burdens are crushing small businesses and there does not appear to be a regulatory slowdown in sight. Regulations are not only costly but require small business owners to allocate valuable time of themselves and often their employees to understand and implement the regulations.

For instance, one proposed rule by the Securities and Exchange Commission (SEC) would require public companies to report the greenhouse gas emissions of the private companies with which they do business. Through the rule, millions of private, small businesses would fall under the SEC's regulatory authority. However, the SEC estimated that only 1,004 small entities would be affected by the proposed rules.[5]

Moreover, on January 1, 2024, one of the most expansive small business regulations in history will go into effect. This substantial new reporting requirement, known as beneficial ownership information reporting, will affect 32.6 million small businesses in the first year and five to six million small businesses each year thereafter.[6] The cost of this regulation is a staggering $22.7 billion in its

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[3] *NFIB Tax Survey*, NFIB Research Center 2021, https://assets.nfib.com/nfibcom/NFIB-Tax-Survey-Full-Report.pdf.

[4] Dan Goldbeck, *Digital Asset Tax Rule Drives Moderately Busy Week: August 28 – September 1*, American Action Forum, September 5, 2023, https://www.americanactionforum.org/week-in-regulation/digital-asset-tax-rule-drives-moderately-busy-week-august-28-september-1/.

[5] 87 *Fed. Reg.* 21462, col. 3, https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf.

[6] *Comments were submitted saying that FinCEN underestimated the compliance costs, which NFIB agrees.* See: *Comments of James Richards, Principal of RegTech Consulting LLC, FinCEN's Proposed Beneficial Ownership Information Reporting Form*, FinCEN, January 18, 2023, https://www.regulations.gov/comment/FINCEN-2023-0002-0003.

first year and $5.6 billion per year moving forward.[7] Failure to file completed and updated reports could result in civil penalties up to $10,000 and criminal penalties of up to 2 years in prison. In total, this burdensome regulation smothers the smallest businesses in America with more than $73 billion in compliance costs and it only applies to small businesses with 20 or fewer employees and $5 million or less in annual revenue. In NFIB's August Banking Survey, 90% of small business owners were not at all familiar with this new requirement that is effective in less than four months.[8]

These unprecedented burdens and the threat of tax increases underscore the need for Congress to provide relief for small businesses, especially in the current economic environment of high inflation and financing costs. Congress should consider the following proposals:

1. ***Provide Tax Certainty for Small Businesses:*** *Permanently extend the 20% Small Business Deduction by passing H.R. 4721, the Main Street Tax Certainty Act. Providing small businesses with long-term tax certainty will allow owners to invest and grow their operations.*

2. ***Provide Paperwork Relief:*** *Do not enact additional reporting requirements or mandates that would restrict financing or increase burdens on small businesses. Consider reducing the paperwork burden on small business owners, many of whom handle compliance and paperwork burdens themselves.*

3. ***Provide Relief from Burdensome Regulations and Red Tape:*** *Enforce laws like the Regulatory Flexibility Act to consider and minimize the impact of rules on small businesses. Congress could impose statutory penalties on agencies for failing to conduct retrospective reviews, require the Small Business Administration (SBA) Office of Advocacy to certify the economic analyses of agencies, require agencies to consider the indirect or downstream effects of rules, require agencies to meet with a panel of affected small business owners before promulgating rules or require agencies to publish less burdensome alternative rules for small businesses.*

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[7] *Beneficial Ownership Information Reporting Requirements*, Final Rule, Financial Crimes Enforcement Network, September 30, 2022, https://www.regulations.gov/document/FINCEN-2021-0005-0461.

[8] Holly Wade and Maddi Oldstone, *Banking Survey Part II*, August 2023, NFIB Research Center, https://strgnfibcom.blob.core.windows.net/nfibcom/Banking-Survey-2023-Part-II.pdf.

4. ***Increase Competition and Choice in Healthcare:*** *Empower employers and individuals to make healthcare decisions based on what is in their best interests. Enact policies that promote competition and transparency in healthcare markets.*

Small businesses need certainty to successfully invest, grow, and operate their business. Congress can help mitigate the many economic challenges facing small businesses by providing relief from burdensome regulations and eliminating the threat of tax increases. I appreciate your time and attention to these concerns. Thank you for the opportunity to testify today on behalf of small businesses.

Written Testimony of Kathryn Judge,
Harvey J. Goldschmidt Professor of Law and Vice Dean for Intellectual Life,
Columbia Law School

before the U.S. House of Representatives Committee on Small Business,
Subcommittee on Subcommittee on Economic Growth, Tax, and Capital Access

Topic: Enabling Success: Examining the Competitive Landscape for Small Businesses

September 13, 2023

Chairman Meuser, Ranking Member Landsman, and Members of the Subcommittee:

Thank you for the opportunity to be here today. Small businesses are the backbone of the U.S. economy and I appreciate the opportunity to discuss how—and how not—to ensure that small businesses in this country have access to the capital they need to survive and thrive. I will focus my written remarks on the impact the reform proposals issued by the Federal Reserve, Federal Deposit Insurance Corporation and Comptroller of the Currency commonly referred to as the Basel III endgame reforms[1] and a simultaneous proposal from the Federal Reserve to revise the methodology for calculating the capital surcharge for global systemically important banking organizations (collectively, the "Proposed Reforms").[2]

The overarching message is that the Proposed Reforms will enhance the resilience of the banking system, making it more likely that large banking organizations will remain healthy and capable of supporting businesses and families in good times and bad. The Proposed Reforms are thus fully consistent with the important aim of enhancing the ability of small businesses to access outside financing. It is true that many small businesses face difficulties obtaining as much funding as they could use, and I will close by touching on these challenges and opportunities. Allowing the largest banks in the country to remain inadequately capitalized is not the answer.

I. Why Capital

Capital regulation is the cornerstone of banking regulation in the United States and abroad, and for very good reason. Capital refers to how banks fund themselves—how much equity relative to debt they use to fund their lending and other activities. In general, banks and banking organizations use far less equity, and far more debt, than other types of businesses. There are some good reasons for this. For example, much of the debt that banks issue takes the form of deposits, which are socially useful. But there are also drawbacks to banks being so reliant on debt. The biggest one is that as a bank's reliance on debt goes up, so does the probability that

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[1] Department of Treasury: Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity (Notice of Proposed Rulemaking, July 27, 2023), *available at*: https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-basel-iii-20230727.pdf ("Basel III Endgame Proposal").

[2] Board of Governors of the Federal Reserve, Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (Notice of Proposed Rulemaking, July 27, 2023), *available at*: https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-gsib-20230727.pdf ("GSIB Surcharge Proposal".

it will fail. This is particularly bad news when it comes to large banks, as the failure of a large bank can undermine faith in the health of other banks and impede the functioning of the broader financial system. The good news is that the more capital a bank uses to fund its activities, the more capacity the bank has to absorb losses. Better capitalized banks are less likely to fail. This is a core reason that capital is so central to bank regulation.

A distinct advantage of regulating capital regulation is that a well-capitalized bank can absorb losses irrespective of the cause. As recent experience makes all too clear, all kinds of shocks can hit the economy in ways that impact bank health. If a pandemic sweeps the globe, causing many businesses shutter and unemployment to spike, capital can help banks absorb the losses that might result. If that pandemic contributes to a permanent shift in where people live and work, leading to significant declines in the value of office buildings and certain other real estate and higher defaults on loans backed by those properties, capital helps. If a deep recession takes hold, and rising unemployment, declining home values and corporate distress reduces the capacity of all sorts of borrowers to repay their loans, capital helps. If interest rates go up rapidly, leading to declines in the value of Treasuries, mortgage-backed securities, mortgages and other fixed-interest credit instruments, capital helps. In all of these instances and more, having additional capital enables banks to absorb more losses and remain solvent. In a world where no one can predict the future, this is very useful.

A related reason capital plays such a central role in bank regulation is that it creates better incentives for bank shareholders and bank leadership.[3] Bank shareholders, like all shareholders, have unlimited upside, but only limited downside. This can cause them to favor excessive risk-taking. For most companies, the potential for skewed shareholder incentives is kept in check by creditors that demand additional compensation when asked to assume a higher risk of default. This mechanism is imperfect even for nonfinancial companies, but it provides much less of a check with banks. All too often, allowing a bank to fail, and allowing depositors and other creditors to bear the losses they have contractually agreed to bear, can have adverse collateral consequences, such as triggering runs on other banks. As a result, as happened in 2008 and again in 2023, the government sometimes intervenes to protect depositors and other creditors. While such interventions are sometimes warranted to limit the damage that ensues, the expectation of such interventions changes the incentives of bank creditors. The combination of explicit and implicit government backstops thus preclude holders of bank debt from imposing the type of discipline typically imposed by creditors of nonbank companies.

Again, capital helps to address these challenges. When a bank is well capitalized, bank shareholders have more skin in the game. The asymmetry between the upside gains and possible downside losses is reduced. This reduces the inclination of bank shareholders and leadership toward excessive risk taking, and makes it more likely that banks will be managed in a way that promotes real value creation.

More broadly, a well-capitalized banking system is a more resilient banking system. A system-wide capital shortfall was a significant factor exacerbating the 2007-2009 financial crises and the recession that followed. Financial crises hurt businesses and families. After that crisis, the rate of small business creation went down and stayed depressed for more than a decade.

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[3] For an overview of the relevant research, including a discussion of how capital requirements reduce the risk-seeking propensity of bank shareholders, see Anjan V. Thakor, Bank Capital and Financial Stability: An Economic Trade-Off or a Faustian Bargain? 6 *Annu. Rev. Financ. Econ.* 185 (2014).

Enhancing the capacity of the banking system to weather shocks can go a long way in reducing the long-term costs that crises can inflict.

II. Capital requirements and lending

The relationship between capital requirements and lending is the source much confusion and contestation. To make progress on this question, we can start by looking at what actually happened as Congress and regulators required banks to hold more capital pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and banks responded by increasing their use of capital. Economists Stephen Cecchetti and Kermit Schoenholtz, co-authors of the influential textbook *Money, Banking and Financial Markets*, now in its sixth edition, compiled data on how banks' changing capital affected lending. Looking at the period between 2013 and 2019, they found that during the early years, when bank capital levels were going up, the rate of overall credit availability remained robust—and that the portion of credit provided by banks, as opposed to nonbanks not subject to the new rules, actually went up.

This analysis suggests that banks made more loans even as they increased capital.[4] Based on their analysis of the data, Cecchetti and Schoenholtz conclude: "To be as clear as we can possibly be, higher capital requirements have not hurt banks, they have not hurt borrowers, and, if there was any macroeconomic impact, it was probably offset by monetary and fiscal policy. In other words, it is difficult to find any social costs associated with increasing capital requirements and improving the resilience of the financial system."[5]

Another lesson from the data available is that better capitalized banks extend more credit during downturns—precisely when small businesses need it most. Not all credit is created equal. During boom times, credit is often easy to obtain, and sometimes too easy to obtain. Boom times can inflate asset prices, contributing to excessive extensions of credit on overly favorable terms. The opposite is true when a boom goes bust. It is often during and after financial crises that businesses often most need capital in order to survive, and it is during such periods that the loans extended are most beneficial for the broader economy. Nonetheless, that is often when it is hardest for small businesses and others to access the credit they need.

Research shows that well capitalized banks are more willing and able to extend credit during these challenging times—benefitting businesses and the economy. For example, a work stream organized by the Basel Committee on Banking Supervision reviewed the literature on the costs and benefits of capital requirements, coupled with its own analysis of the impact of such requirements. They found that "a country whose banks enter a crisis with a one percentage point higher capital ratio experiences 0.29 percentage points higher annual loan and 0.18 percentage points higher GDP growth in the following five years, compared to other countries."[6] This finding was consistent with other research suggesting that the greatest benefit of capital

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[4] Stephen G. Cecchetti & Kermit L. Schoenholtz, Setting Bank Capital Requirements, *Money and Banking Blog*, October 12, 2020, *available at* www.moneyandbanking.com/commentary/2020/10/11/setting-bank-capital-requirements

[5] *Id.*

[6] Basel Committee on Banking Supervision, The costs and benefits of bank capital – a review of the literature (BIS Working Paper 37, June 2019), *available at* https://www.bis.org/bcbs/publ/wp37.pdf, at 10.

requirements may be to lessen the adverse impact of financial crises by positioning banks to lend more after a crisis strikes.

More generally, based on their own analysis and the literature, the Basel Committee on Banking Supervision work stream concluded that higher capital requirements can "significantly lower the cost of a crisis by sustaining bank lending during the resulting recession. In addition, in normal times, bank capital does not seem to be negatively correlated with loan growth."[7]

None of this is to deny that at some point, capital requirements can impede bank lending. There is an extensive albeit far from conclusive body of literature trying to assess the tradeoffs at play between the impact of capital and other bank regulatory requirements in good times and bad. Nonetheless, the overall picture that emerges from the research is that capital requirements in the range proposed will help banks do more lending during periods of distress, when businesses and the economy stand to benefit the most. This is consistent with the assessment of the Federal Reserve, Comptroller of the Currency and FDIC with respect to the impact of the proposed Basel III endgame reforms: "Although a slight reduction in bank lending could result from the increase in capital requirements, the economic cost of this reduction would be more than offset by the expected economic benefits associated with the increased resiliency of the financial system."[8]

There are also more specific reasons to expect that the Proposed Reforms will not adversely impact credit access for small businesses. Rather than providing a detailed overview of the Proposed Reforms (which run over 1,000 pages), I will focus on two features: (1) the types of banks most impacted by the Proposed Reforms; and (2) the types of banking activities most impacted by the proposed reforms.

The United States is fortunate to have a diverse banking sector, with a range of different types of banks that specialize in serving different types of businesses and other clients. This includes a robust set of community financial institutions and other community banks and smaller regional banks that continue to prioritize relationship lending. Smaller banks have long played, and continue to play, an outsized role in small business lending. In 2021, for example, community banks held just 13 percent of the banking system's assets and 17 percent of its loans, yet they also held 40 percent of outstanding small business loans.[9] This is a smaller figure than it used to be, but it reflects the persistent and positive relationship between small banks and local, small business lending.

The small business credit survey conducted by the Federal Reserve shows that small businesses also report having a much better experience when they borrow from a small bank than when they seek financing from a large bank or a nonbank, such as a fintech lender.[10] Community and other smaller banks also often have a different business model than the largest banks, focusing more on relationships and relationship lending. Research shows that relationship

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[7] *Id.* at 11.
[8] Basel III Endgame Proposal at 489.
[9] FED. RSRV. BANK OF KAN. CITY, COMMUNITY BANKS CONTINUE TO PLAY A PIVOTAL ROLE FOR SMALL BUSINESSES (2021), https://www.kansascityfed.org/Banking/documents/8441/Oct142021_CommunityBankingBulletinHighlight.pdf.
[10] FED. RSRV. BANKS, 2023 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY 7 (2023) *available at* https://www.fedsmallbusiness.org/survey/2023/report-on-employer-firms.

lending can be helpful to both banks and the businesses they serve, and can play a particularly important role in increasing the amount of credit available to small businesses.[11]

Yet the Proposed Reforms do not target small or even midsized banks. Instead, they are focused on strengthening the health of very large banking organizations, those with at least $100 billion in assets, and much of the impact would fall on the largest, more complex banks. As the accurately summarized in the press release accompanying the Proposed Reforms: "Community banks would not be impacted by this proposal."[12] In short, the types of banks that do the best job providing credit to small businesses are not the banks that will be affected by the Proposed Reforms.

Yet another reason not to worry about the impact of the Proposed Reforms on small business lending is that they do not contemplate an across-the-board increase in capital requirements even for the affected banking organizations. Instead, many of the Proposed Reforms are efforts to strengthen how banks assess the risks that arise from activities than extending credit and to introduce more standardization in how banks assess a range of risks.

For example, the Proposed Reforms tackle the challenge of trying to ensure banking organizations are adequately capturing the risks associated with trading. It requires that, as a default, all banking organizations subject to market risk requirements use the standardized measure for market risk. It does still allow banks to use a models-based measure, but it requires that all uses of internal models be subject to supervisory approval at the trading-desk level and introduces additional controls. These types of reforms should enhance the risk sensitivity and calibration of market risk capital requirements, and make it more likely that banks can only use internal models when they are adequately robust to capture the relevant risks. Similarly, the Proposed Reforms would improve the risk sensitivity of the GSIB surcharge to better capture the systemic footprint and potential threat posed by a banking organization. Such reforms should reduce opportunities for gamesmanship and do a better job of deterring banks from altering their activities or footprint in ways that could threaten systemic stability.

In general, the Proposed Reforms introduce more transparency and consistency into the regulatory framework. They are the byproduct of years of effort, both internationally and in the United States, to assess just how best to promote the health of the banking sector and the broader economy that it supports. Small businesses would be among the many beneficiaries of the more robust, accountable regime embodied in the Proposed Reforms.

III. Small Business Access to Credit

There may be little reason to worry about the impact of the Proposed Reforms on small business lending, but there are good reasons to be concerned about the ability of small businesses to access the credit they need to grow during good times and make it through the tough times.

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[11] *E.g.*, Vitaly M. Bord, Victoria Ivashina & Ryan D. Taliaferro, Large banks and small firm lending, 48 Journal of Financial Intermediation, Volume 48, October 2021,
Mitchell A. Petersen & Raghuram G. Rajan, The Benefits of Lending Relationships: Evidence from Small Business Data, The Journal of Finance, Vol. 49, No. 1 (Mar., 1994), pp. 3-37;

[12] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency, Joint Press Release: Agencies request comment on proposed rules to strengthen capital requirements for large banks, July 27, 2023,
https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.

According to the Federal Reserve's 2023 Small Business Credit Survey, only 17 percent of the businesses surveyed reported their financial condition as either "very good" or "excellent," whereas 57 percent viewed their financial condition as either "poor" or fair."[13] More than a quarter identified credit availability as a challenge in the preceding year, and just over half of the small businesses that sought funding or a credit line in the preceding year received all of the financing they sought.[14]

There are some bright spots. Overall, more small businesses sought outside financing in the past year than in the preceding two years, and more firms had those applications approved. Dealings with small banks also proved to be a bright spot along many dimensions Applicants at small banks were not only most satisfied with their experience, as already noted, they were also most likely to receive at least partial approval—with more than four out of every five applicants obtaining at least some of the financing sought—and applicants at small banks reported fewer challenges than small businesses who sought financing from an alternative source.[15]

Strikingly, however, even though small businesses had more access to outside, nongovernment financing in 2022 than they enjoyed in the preceding year, how small businesses fund themselves has not returned to pre-pandemic trends. Back in 2019, 62 percent of all small businesses had obtained funding from a financial institution or other lender in the preceding five years, making outside loans the more common source of financing for small businesses.[16] In 2022, that figure was just 51 percent—placing financial institutions and other lenders behind (1) an owner's personal savings, family or friends (66%, up from 56% in 2019) and (2) government programs (55%) as a source of funding that the business had used during the preceding five years.[17] This decline in outside financing could reflect ways that the government's response to the pandemic may have inadvertently greased financing for large companies without providing any commensurate boost for small businesses.

At first glance, the government did far more to support small businesses than large in its response to Covid-19.[18] Through the Paycheck Protection Program (PPP), for example, the government provided significant financial support for small businesses, and nothing comparable was instituted for most large businesses. But zooming out to look at how the myriad pandemic-era programs affected incentives to extend credit and invest in the infrastructure needed to provide and monitor such credit extensions reveals a very different picture.

PPP, understandably, largely functioned as a grant program. The banks and other financial intermediaries through which the funds flowed were not asked to play any role screening the creditworthiness of the small businesses to whom funds were extended. And so long as the program's terms were followed, the government guaranteed that the amounts so extended would be repaid in full. As a result, the design of PPP did little to provide banks or other financial intermediaries any incentive to make investments in the type of information production required

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[13] FED. RSRV. BANKS, 2023 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY 2 (2023) *available at* https://www.fedsmallbusiness.org/survey/2023/report-on-employer-firms.
[14] *Id.* at ii, 7.
[15] *Id.* at 19-22
[16] *Id.* at 9.
[17] *Id.*
[18] For more on these dynamics, see Todd Baker, Kathryn Judge & Aaron Klein, *Credit, Crises and Infrastructure: The Differing Fates of Large and Small Businesses*, 102 B.U. L. REV. 1353 (2022) and sources cited therein.

to underwrite loans or credit lines. Nor did it meaningfully change the perceived risks associated with making loans to small businesses.

Shift the focus to large businesses and the picture looks very different. With few exceptions, most large companies did not receive any direct financial aid from the government. Instead, much of the support for large businesses came via innovative lending facilities designed by the Treasury Department and the Federal Reserve pursuant to the Fed's authority to make loans to nonbanks during "unusual and exigent circumstances," bolstered by special provisions in the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act).[19] The legal and logistical constraints associated with this type of lending, combined with other dynamics then at play, resulted in a secondary credit program that significantly reduced the liquidity risk associated with corporate bonds, syndicated loans and other credit instruments of the type that can only be used by the largest companies. This not only made it easier for large companies to borrow during the height of the pandemic, but also changed perceptions of the risks associated with such lending long after the threat receded. Although the Federal Reserve worked hard to launch a Main Street Lending Program, that program largely targeted pretty big companies, not small ones, and its impact was far more muted. This was not the result of any apparent intent to favor large businesses, but instead a reflection of the mismatch between the types of programs that the Fed could readily institute and the mechanisms through which credit typically flows to small businesses.

Putting these pieces together, although Congress provided far more funding to small businesses than large ones, the aggregate mix of the government programs instituted did far more to grease the wheels on the extension of credit to the largest companies, companies that already have a much easier time accessing outside financing than small businesses. Although far from intentional, the net effect of these interventions was a reminder of the inequities that already exist when small and large companies seek financing, and just how much more might appropriately be done to try to support small businesses.

Although it is beyond the scope of this hearing, I would be happy to discuss ways that Congress and regulators may seek to do more to support access to financing for small businesses. Given what we know about the credit environment small businesses face, and the experience of small businesses seeking outside financing, such efforts are most likely to have the greatest impact when implemented in ways that encourage relationships between small businesses and community financial institutions and other smaller banks.

Thank you again for the opportunity to engage on the Proposed Reforms and small business financing. Capital regulation, like bank regulation generally, is a process that requires ongoing diligence to succeed. The Proposed Reforms should enhance the health of the largest banking organizations and the resilience of the financial system. In so doing, the Proposed Reforms should bolster the long-term health of small businesses and the economy of which they are a part.

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[19] Pub. L. 116–136 (2020).

Engine

Subcommittee on Economic Growth, Tax, and Capital Access Hearing: "Enabling Success: Examining the Competitive Landscape for Small Businesses" - Engine's Statement

September 19, 2023

House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C., 20510

Dear Chairman Landsman, Chairwoman Meuser, and members of the House Subcommittee on Economic Growth, Tax, and Capital Access of the House Committee on Small Business,

Thank you for convening a hearing last week covering the competitive landscape for small businesses and startups. Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues. Equitable access to capital for startup founders is a core tenet of Engine's work, and we are grateful for the opportunity to provide our feedback on the struggles and successes of entrepreneurs in our network.

Access to capital is one of the most critical barriers startups face when launching. Most startups launch with a limited amount of funding, often scarcely put together from a mix of personal loans and family savings. The average seed stage startup only has roughly $55,000 a month in resources, which, after payroll and expenses, leaves little room to cover extras.[1] Given these limited resources and time constraints, capital access issues can be a huge burden on startups. Improved and more equitable access to capital is crucial to create a brighter economic outlook for startups and promote further innovation.

Access to credit is one component of the capital landscape and is crucial for the growth of startup enterprises. Without access to credit, startups would encounter challenges in conducting basic operation activities, from accessing the essential resources required for inventory acquisition, to staff recruitment, to investment in marketing and advertising. Moreover, credit access can be the financial means to purchase technology and equipment, which in turn can enhance operational efficiency and productivity for the company.

The availability of credit empowers startups to secure loans from banks or alternative lenders, enabling the acquisition of materials or services that would otherwise be costly. This strategy

[1] Engine, *Engine Releases Report On The State Of The Startup Ecosystem*, https://www.engine.is/news/engine-releases-report-on-the-health-of-the-startup-ecosystem

helps maintain lower overhead costs and supports the continuous growth of their enterprise.[2] Furthermore, credit access allows startups to establish a track record of financial responsibility. Many lenders consider a business credit score of 75 as "acceptable" making it harder for those with a lower score to receive a loan.[3] By demonstrating their ability to manage funds and repay debts, startups foster credibility with lenders. As a result, this streamlines their access to larger loan amounts in the future. Most importantly, credit access allows businesses to readily secure loans from financial institutions instead of waiting for customer payments, effectively averting potential cash flow challenges that could lead to severe financial turmoil.[4]

Policymakers must continue to improve the regulatory environment in which startups operate to raise capital.[5] Dramatically increased capital requirements for banks, especially smaller banks, for example, may create a more challenging environment for small banks to operate—and they are already on the decline.[6] It may make it difficult for startups to gain access to capital and also hinder smaller banks' ability to extend loans. While larger banks impose stricter criteria when extending loans or lines of credit, smaller banks tend to cultivate more intimate connections with their customers, simplifying the process for startups to access essential banking services. Smaller banks may display greater willingness to engage clients who might appear too risky to larger institutions, and their quick decision-making often appeals to startups. Moreover, these smaller banks frequently have the flexibility to customize their offerings, such as offering specialized industry advice and assisting in building professional networks, to meet their clients' specific needs.[7] According to the Independent Community Bankers of America, "In stark contrast to the nation's largest banks, community banks operate under an entirely different business model—one that's based locally and is relationship focused. As small businesses themselves, local community banks take pride in serving the unique needs of their customers and communities."[8] Especially for rural businesses and startups, these increased capital requirements among smaller banks may make it even more difficult to raise capital for their business.

As was mentioned by members of this subcommittee, policymakers can take action, particularly in the tax space to support the startup ecosystem. For example, policymakers can address the current lending conditions by enabling interest payments to be tax-deductible for all

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[2] Intrepid Executive Group, *The Importance of Financing for Startups,*
https://www.intrepidexecutivegroup.com/blog/the-importance-of-financing-for-startups/
[3] U.S. Small Business Administration, *10 Stats That Explain Why Business Credit is Important for Small Business,*
https://www.sba.gov/blog/10-stats-explain-why-business-credit-important-small-business
[4] Faster Capital, *The Importance of Credit for Startups,*
https://fastercapital.com/content/The-importance-of-credit-for-startups.html#:~:text=Access%20to%20credit%20is%20essential%20for%20startup%20companies%20because%20it,invest%20in%20marketing%20and%20advertising.
[5] Engine, *Startup Policy Agenda 2023 - Capital Access,*
https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/63dd2e301ff9d014aaea0bee/1675439664886/Startup+Policy+Agenda+2023+Capital+Access.pdf
[6] *Small U.S. Banks See Record Drop in Deposits after SVB Collapse* (Mar. 25, 2023),
https://www.cnn.com/2023/03/25/business/small-us-bank-deposit-decline/index.html.
[7] Engine, *SVB: What Happened, How the Fallout Impacts Startups, What Policymakers can do Next,*
https://www.engine.is/news/category/what-policymakers-need-to-know-about-the-svb-collapse-and-startup-fallout
[8] ICBA, *Silicon Valley Bank and the Nation's Largest Banks Are Not Community Banks,*
https://www.icba.org/newsroom/news-and-articles/2023/03/13/icba-silicon-valley-bank-and-the-nation-s-largest-banks-are-not-community-banks

startups. And as Rep. Landsman suggested, Congress can look beyond direct business benefits to how we can better support workers and families, which will in turn help founders, would-be founders, and their employees. Passing a permanently expanded child tax credit is one option—which will reduce child poverty, enable working parents to remain in the workplace and work more hours, and would in particular, support women founders.[9] It is crucial for policymakers to take an all-of-the above approach to improve the capital landscape for startups while also easing other barriers to entrepreneurship.

Thank you once again for your commitment to examining the barriers faced by current startup owners and exploring how Congress can better support them. Engine is happy to serve as a resource for the committee as you continue this critical work.

Sincerely,

Engine Advocacy
700 Pennsylvania Ave SE
Washington, D.C., 20003

[9] See letter from women founders and ecosystem leaders in support of an expanded child tax credit: https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/65035de9a09d8f4381dc46e1/1694719465665/Final+-+Women+Founder+CTC+letter+%281%29.pdf

10,000 small businesses VOICES

FOR IMMEDIATE RELEASE: September 12, 2023
Contact: Abbey Collins, abbey.collins@gs.com

New Survey Data: Small Business Owners Raise Alarms Over Difficulty Accessing Capital

84% of Respondents Fear Federal Reserve's New Bank Capital Requirements Will Worsen Credit Access Challenges

New York, Sept. 12, 2023 – America's small business owners are struggling to access capital needed to operate and grow their businesses, as interest rates rise, and banks continue to tighten lending standards. The Federal Reserve's Basel III Endgame proposal would make matters even worse. These are two of the key findings from Goldman Sachs *10,000 Small Businesses Voices* survey of 1,556 small business owners.

Of the small business owners who have applied for a new business loan over the past year (28%), 70% reported it was difficult to access capital. In contrast, 61% of loan applicants in the April 2023 Goldman Sachs *10,000 Small Businesses Voices* survey said it was difficult to access capital in the prior three months. Seventy-six percent say difficulty accessing affordable capital has negatively impacted their business and 73% say rising interest rates are having a negative impact on their business.

As the Federal Reserve is seeking public comment on its Basel III Endgame proposal, 84% of small businesses are concerned that the proposal will negatively impact their ability to access capital in an already difficult market. In July 2023, the Federal Reserve proposed a rule that will require large banks to further increase the amount of capital they hold.

"Small business owners are hanging on by a thread, but the thread is getting increasingly thin as capital is becoming more difficult and more expensive to access, meaning many businesses are having to halt growth plans and consider cost cutting measures," **said Jessica Johnson-Cope, CEO & President of Johnson Security Bureau and Chair of the National Leadership Council for *10,000 Small Businesses Voices*.** "Small business owners appreciate the work of Congress to examine the impacts of the Federal Reserve's Basel III Endgame as we are concerned the proposal will only worsen the ability of many small businesses to access capital."

A variety of policymakers, organizations and banks have publicly stated that higher capital requirements will lead to reduced lending and credit access for households and consumers. Some notable comments include:

> *"Such a significant increase in capital standards will lead to reduced credit availability for all types of lending and undermine economic growth."* – **Letter from National Housing Conference, NAACP, National Urban League, Mortgage Bankers Association and National Association of Realtors**

> *"We must recognize that, at some point, well-intended actions to improve financial resiliency can undermine the indispensable role banks play in providing financial intermediation. In my view, the Basel III proposal crosses that line. I am concerned that today's Basel III proposal will increase the cost of credit and impede market*

functioning without clear benefits to the resiliency of the financial system."– **Federal Reserve Board Governor Waller**

Other key data points from the survey include:

- 68% of small business owners have outstanding business loans or lines of credit.
  - Of these, 58% have a fixed interest rate, while 42% have a variable interest rate.
  - 63% of those with outstanding loans or lines of credit say rising interest rates have impacted their ability to service their existing debt obligations.
  - 68% of those with outstanding loans or lines of credit say they would not be able to maintain current operations or grow their business without their business loan or line of credit.

This data is based on a survey of 1,556 Goldman Sachs *10,000 Small Businesses* participants conducted from August 29-September 7, 2023.

For more information, please visit, https://www.goldmansachs.com/citizenship/10000-small-businesses/US/voices/.

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About *10,000 Small Businesses Voices*
Goldman Sachs *10,000 Small Businesses Voices*, which in April marked its three-year anniversary, builds on *10KSB* and organizes program participants to advocate for policies that matter to them. Learn more at www.gs.com/10ksb-voices

About Goldman Sachs *10,000 Small Businesses*
Goldman Sachs *10,000 Small Businesses* is an investment to help entrepreneurs create jobs and economic opportunity by providing a comprehensive business education program and access to capital and business support services. To date, *10,000 Small Businesses* has served over 14,000 small businesses across the United States. The program has reached businesses from all 50 states, Puerto Rico, and Washington, D.C. Learn more at www.gs.com/10ksb.

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NATIONAL ASSOCIATION OF Manufacturers

Statement for the Record

National Association of Manufacturers
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HOUSE COMMITTEE ON SMALL BUSINESS'S SUBCOMMITTEE ON GROWTH, TAX AND CAPITAL ACCESS HEARING

"ENABLING SUCCESS: EXAMINING THE COMPETITIVE LANDSCAPE FOR SMALL BUSINESSES"

Sept. 13, 2023



Statement for the Record

House Committee on Small Business
Subcommittee on Growth, Tax, and Capital Access Hearing
"Enabling Success: Examining the Competitive Landscape for Small Businesses"

Sept.13, 2023

The National Association of Manufacturers appreciates the opportunity to submit written comments for the record as part of the House Committee on Small Business's Subcommittee on Growth, Tax, and Capital Access hearing on "Enabling Success: Examining the Competitive Landscape for Small Businesses."

The NAM is the largest manufacturing association in the United States, representing large and small manufacturers in every industrial sector and in all 50 states. Manufacturing employs nearly 13 million men and women, contributes $2.91 trillion to the U.S. economy annually, pays workers over 18% more than the average for all businesses and has one of the largest sectoral multipliers in the economy. Taken alone, manufacturing in the United States would be the eighth-largest economy in the world.

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Small manufacturers are the heart of the manufacturing industry in America, forming the backbone of their communities, creating jobs and driving economic growth. Nearly 75% of manufacturers have fewer than 20 employees, and 93.1% have fewer than 100 employees. Given the importance of small manufacturers to the strength of the U.S. economy, a competitive tax code that supports small businesses is critical.

The Tax Cuts and Jobs Act included many key reforms necessary to boost manufacturing in America: a lower, more competitive corporate tax rate, a reduced tax burden on pass-through income, incentives for investment in capital equipment and estate tax relief. Following the passage of the TCJA in 2017, manufacturers responded by hiring more workers, increasing wages and benefits and investing in their businesses and communities.

Consider the following:

- Manufacturers created 263,000 jobs in 2018, the best year for manufacturing job creation in the previous 21 years.
- Wages for production workers rose 3.4% year-over-year in March and April of 2018 (at the time, the highest since February 2003).
- Manufacturing capital expenditures increased 4.5% and 5.7% in 2018 and 2019, respectively.

Unfortunately, several harmful tax changes have recently gone into effect.

Manufacturing is a capital-intensive industry and many manufacturers borrow funds to finance their growth however at the beginning of 2022, a stricter interest deductibility limitation went into effect, increasing the cost of financing critical investments in machinery and equipment.

The maximum interest deduction under Section 163(j) of the tax code is now limited to 30% of a company's earnings before interest and tax, a significant change from the standard in place prior to 2022, which was based on earnings before interest, tax, depreciation and amortization. By excluding depreciation and amortization, the EBIT-based limitation makes it more expensive for capital-intensive companies to finance critical purchases, grow their businesses and hire new workers. This stricter

limitation effectively acts as a tax on investment and has a disproportionate impact on manufacturers given that long-lived manufacturing investment can generate significant depreciation and amortization. Moreover, this limitation has gone into effect at a time when the cost of capital itself has increased due to rising interest rates.

The EBIT standard also makes the U.S. a global outlier and directly harms the competitiveness of manufacturers in the U.S. Of the more than 30 OECD countries with an earnings-based interest limitation, the U.S. is the only one that employs an EBIT standard.

Failing to reverse this harmful change could cost the U.S. economy 467,000 jobs and reduce U.S. GDP by $43.8 billion.[1] These job losses will be felt across the country, as the breadth and depth of manufacturing supply chains and the spillover effects of this tax increase will ensure that small and medium-sized businesses are affected directly.

With debt financing playing an important role in manufacturing growth, the NAM encourages members of the committee to support the expeditious passage of H.R. 2788, the American Investment in Manufacturing (AIM) Act, bipartisan legislation introduced by Reps. Adrian Smith (R-NE) and Joe Morelle (D-NY) that would permanently preserve the EBITDA standard for interest deductibility.

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As Congress acts to reverse the damaging limitation on interest deductibility discussed above, two additional changes are necessary to protect manufacturing jobs.

Manufacturers in the United States drive more innovation than any other sector, performing 55% of private-sector research and development in the U.S. In 2021 alone, manufacturers spent nearly $350 billion on R&D. Research is the lifeblood of manufacturing: new products, new materials and new processes help propel manufacturing in America forward. Unless Congress acts, manufacturers' ability to innovate and create new products, technologies and lifesaving medicines will be harmed.

Since 1954, the tax code has recognized the important role of R&D in creating jobs and spurring innovation by providing a critical incentive for investments in R&D. Specifically, the tax code has allowed businesses to immediately deduct 100% of their R&D expenses in the same year in which they are incurred. However, as of Jan. 1, 2022, businesses have been required to amortize these expenses (deducting them over a period of years), making R&D more costly to conduct in the U.S. This change has been particularly harmful for small businesses, which account for about 15% of all private-sector R&D investments.[2]

Coming at a time of increasingly fierce global competition for research dollars, this policy—if not reversed—will hurt jobs, innovation and competitiveness. According to a recent economic analysis, the U.S. economy would lose 263,382 jobs and experience a GDP reduction of $82.39 billion in 2023, with the manufacturing industry projected to lose nearly 60,000 jobs, if the harmful R&D amortization policy is not reversed quickly.[3] For small manufacturers, the impact is especially onerous because the tax change took effect in 2022, creating unexpectedly higher tax bills during the 2023 filing season and significantly reducing the amount of capital available to reinvest into these businesses.

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[1] "Economic Impact of a Stricter 163(j) Interest Expense Limitation," EY (September 2022). *Available at* https://documents.nam.org/tax/nam_interest_deductibility_study.pdf.

[2] National Center for Science and Engineering Statistics, National Science Foundation, InfoBrief, NSF 22-343, Oct. 4, 2022, https://ncses.nsf.gov/pubs/nsf22343

[3] "New Data: Taxing R&D Will Cost U.S. More Than 260,000 Jobs Next Year If Congress Doesn't Act," National Association of Manufacturers (Dec. 16, 2022). Available at https://www.nam.org/new-data-taxing-rd-will-cost-u-smore-than-260000-jobs-nextyear-if-congress-doesnt-act-19948/.

Unless Congress acts, the U.S. will remain just one of two developed countries with an amortization requirement for R&D expensing (the other being Belgium). Meanwhile, China, which has made no secret of its ambition to become the world leader in advanced manufacturing, provides a 200% deduction for R&D expenses for manufacturers. In fact, 17 countries, including 10 OECD countries, provide for recovery of more than 100% of eligible R&D expenses.[4]

For these reasons, the NAM strongly encourages members of the committee to support expeditious passage of H.R. 2673, the American Innovation and R&D Competitiveness Act, bipartisan legislation introduced by Reps. Ron Estes (R-KS) and John Larson (D-CT) that would repeal the R&D amortization provision, so that manufacturers in the U.S. can continue leading the world in innovation, growing the economy and creating well-paying jobs.

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For the past several decades, the tax code has provided businesses with varying degrees of first-year expensing (i.e., accelerated depreciation). A 100% deduction for the purchase of equipment and machinery in the tax year purchased was in place from 2017 through 2022. This critical incentive decreases a company's tax bill in the year of purchase and frees up cash for that purchase. For capital intensive industries like manufacturing, where the latest technology is key to production, this kind of support can be vital, especially among smaller manufacturers with tighter margins.

According to recent analysis by the nonpartisan Joint Committee on Taxation, manufacturers led all sectors in the use of expensing by a wide margin.[5] Unfortunately, the 100% level of full expensing began to phase out this year and will be eliminated completely by 2027. If this occurs, it will become costlier for manufacturers to undertake job-creating investments, make it more difficult to strengthen domestic supply chains and harm the ability of manufacturers to compete effectively on a global scale. The NAM thanks Chairman Arrington for introducing H.R. 2406, the Accelerate Long-Term Investment Growth Now (ALIGN) Act, which would make permanent the ability to fully expense new investments. Manufacturers urge committee members to support its passage.

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After decades of advocating for a pro-growth, competitive tax code, manufacturers in America kept their promises following the enactment of the TCJA by raising wages and benefits, hiring more workers and investing in their communities. Tax policy plays a critical role in the ability of manufacturers to thrive in the United States and effectively compete in a global economy, and the NAM urges members of the committee to support a competitive tax regime that allows manufacturing in America to continue to grow.

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[4] "Tax Incentives for R&D and Innovation," OECD. Available at https://stip.oecd.org/innotax/.
[5] "Tax Incentives for Domestic Manufacturing," Joint Committee on Taxation (March 12, 2021). Available at https://www.jct.gov/publications/2021/jcx-15-21/.



NFIB RESEARCH CENTER

BANKING SURVEY

Part II

August 2023

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This report is a follow-up to the banking survey NFIB released in April 2023, one month after the banking failures and one year into the Federal Reserve's rate hikes. Small business owners were again asked about their financing activities and their experience in accessing credit. The health of the financial system is essential to small business operations, and this report offers insight into how well it is serving their small business clients.

In 1983 there were 14,469 independent banks; today only 4,136 remain according to the FDIC. The number of branches available has also declined as well from its peak in 2010[1] but not as much as the number of independent banks. That matters! Consider the extreme case, one bank has merged all other banks into one. There are many branches. You apply for a loan and are turned down. Where do you go? Every bank is the same bank; your rejection is on file at every branch. No competition to enforce critical evaluations of your application, just a "one and done" deal. Increasing concentration in financial markets is not conducive to innovation, risk taking, and good market pricing (competition) for the loan risks that banks undertake. The decline in bank competition and banking disruptions are of concern. These issues have the potential to significantly disrupt and negatively impact the small business economy. This survey helps assess their impact on small businesses.

Bank (branch) location is important to small firms. Forty-two percent of small business owners (or someone from their business) visit their bank in-person more than once per week. Another 35% visit their bank several times a month and 15% a few times a year. Only 8% reported using the internet or phone for their banking needs.

Sixty-four percent of small business owners use a small or regional bank. Eighteen percent use a large bank (Chase, Citi, Bank of America, Wells Fargo, Capital One, U.S. Bank, etc.) and 16% use a medium bank (PNC, Fifth-Third, Bank of the West, KeyBank, HSCB, Schwab, etc.). Three percent reported other, and none reported using an online bank (SOFI, LiveOak, etc.).

Twenty-one percent borrowed or tried to borrow from a bank or credit union in the last three months, 3% from another type of lender, and 2% from an internet lender. Of those borrowing, 32% were very satisfied with the amount and terms offered for the financing received. Another 33% were mostly satisfied and 19% were moderately satisfied. Seventeen percent of small business owners reported they were not satisfied. Banks have differing lending criteria, industry and regional foci. This provides those who are turned down or not offered expected credit terms or conditions the opportunity to shop their application to different, competing banks. Three-quarters of small business owners did not borrow or try to borrow money for business purposes in the last three months, nearly the same as in April 2023.

[1] https://www.fdic.gov/resources/data-tools/

Over half (58%) of small business owners reported high interest rates as their largest complaint in accessing financing. Fourteen percent reported the amount of credit approved being too low as their largest complaint, and another 9% reported that the application, approval, or closing process was too slow. Seven percent reported too much paperwork, 6% reported that the repayment schedule was too short, and 3% reported collateral requirement was too big.

Small business owners who were not completely satisfied were asked to evaluate issues in their most recent experience accessing financing. Forty percent reported that interest rates were a significant issue. Almost a quarter (23%) reported it was a moderate issue and 13% a mild issue. Interest rates were not an issue for 23% of small business owners. Regarding collateral requirements, 16% reported it was a significant issue in the process of accessing credit, and another 16% reported it as a moderate issue. Fourteen percent reported it was a mild issue, and a little over half (55%) reported it was not an issue. Six percent reported that the repayment schedule was a significant issue, 15% a moderate issue, and 12% a mild issue. Sixty-eight percent of small business owners reported that the repayment schedule was not an issue. Thirteen percent reported that the paperwork requirements associated with accessing financing. was a significant issue. Another 13% reported a moderate it was a issue, and 16% reported it was a mild issue. Fifty-eight percent reported it was not an issue. The amount of approved credit was not an issue for 62% of small business owners. Thirteen percent reported it was a significant issue, 12% a moderate issue, and 13% a mild issue. Similarly, the application, approval, or closing process was not an issue for 60% of respondents. Fourteen percent reported that it was a significant issue, 12% a moderate issue, and 14% a mild issue. These issues, of varying importance, represent the "margins" on which borrowers can search for better terms at competing banks.

Small business owners who borrowed were also asked what their main purpose was for seeking financing. A third reported the main purpose was to meet operating and inventory expenses, 26% reported to replace capital assets or make repairs, 20% reported to expand their business, and 13% reported other. Refinance or pay down debt was the main financing purpose for 5% of owners.

Among those who borrowed, over half (56%) received a term loan. Thirty-seven percent received a line of credit, and none reported factoring. Seven percent reported none of the above. Of those who received a term loan, about half (51%) reported receiving a 3-5 year loan, and 19% reported a 6-10 year loan. Another 10% reported the term duration of their loans as longer than 10 years. Only 10% had a term loan duration of less than one year and 8% reported 1-2 years. Fifteen percent reported that their term loan was an adjustable-rate loan.

Among those who did not apply for financing in the last three months, 80% reported that the primary reason they did not was because they did not need financing. Three percent

reported that credit costs were too high, and 1% did not think their application would be approved. Another 1% reported that the application process was too difficult or confusing, and 2% cited other reasons.

Fifty-three percent of small business owners currently have a line of credit for business purposes. For about half (54%), the total credit limit is $100,000 or more. Four percent reported less than $10,000, 20% reported between $10,000-49,999, and 19% reported $50,000-99,999. Two percent did not know. The vast majority (85%) of small business owners with a line of credit have had it for over a year. Three percent reported they have had this line of credit for less than three months, 3% reported 3-6 months, and 6% reported 6-12 months. Two percent did not know.

The vast majority (80%) of business owners with a line of credit have not had their bank change the terms or conditions of that loan in the last three months. Three percent reported that their bank has reduced the amount of credit available in the last three months. One percent reported that additional collateral was required, and none reported that their bank shortened the time duration of the loan.

Small business owners' concerns over the health of their bank have eased significantly since last reported in April. Owners were asked in July how concerned they are about the health of the bank they use for business purposes in light of the recent bank failures. Over half (54%) were not at all concerned, a significant increase from when they were asked in April (31%). Four percent were very concerned, 13% were moderately concerned, and 29% slightly concerned. Seven percent of small business owners have reached out to their bank about concerns related to the most recent bank failures. Thirteen percent reported that their bank reached out to them, and 80% reported that they did not reach out to their bank and their bank did not reach out to them.

Small business owners are generally confident in the stability of their bank and therefore not seeking out alternative financial institutions. Ninety-seven percent of small business owners have not changed their primary financial institution that they use for business purposes in the last three months. Only 6% are considering changing their primary financial institution in the next three months. Eleven percent did not know.

When asked to characterize the current financial state of their business, 26% reported excellent. Almost half (45%) reported good and another 25% okay. Only 5% characterized the current financial state of their business as poor. Small business owners were also asked about the current state of their local economy. Just 3% reported excellent, while 33% reported good, and another 44% reported okay. One-in-five reported poor. When it comes to the national economy, small business owners have a dismal view of the current situation. Over half (58%) of owners assessed the current state of the national economy as poor. Only 1% reported excellent, 9% reported good, and 32% reported okay. As for when the U.S. economy will enter the next recession, just over half (52%) of small businesses

think the U.S. is already in a recession. Two percent think the next recession will start in the July to September 2023 period. Seventeen percent believe a recession will occur in the October to December 2023 period, 20% reported the January to June 2024 period, and 10% reported July 2024 or later.

Beginning January 1, 2024, a new federal regulation (commonly called "beneficial ownership") will require most businesses with 20 full-time employees or less to report information about their business and information about all owners with 25% or more ownership in the business to the U.S. Department of Treasury. How familiar are you with this new regulation?

The vast majority (90%) of small business owners are not at all familiar with this new federal regulation. Nine percent are somewhat familiar, and only 1% are very familiar. While most small business owners will be required to comply with the regulation, few owners currently know of its existence.

Methodology

This survey was conducted with a random sample of 20,000 NFIB members from NFIB's membership database of about 300,000 small business owners. The survey was conducted by email from July 20–26 , 2023. NFIB collected 646 responses.

Questionnaire

Q1. What size bank do you use for business purposes?
18% 1. Large (Chase, Citi, Bank of America, Wells Fargo, Capital One, U.S. Bank, etc.)
16% 2. Medium (PNC, Fifth-Third, Bank of the West, KeyBank, HSCB, Schwab, etc.)
64% 3. Small/Regional/Local
0% 4. Online bank (e.g., SOFI, LiveOak, etc.)
3% 5. Other
N= 645

If you answered "other,"please describe:

Q2. How often do you or someone from your business visit your bank?
42% 1. More than 1 time per week
35% 2. Several times a month
15% 3. A few times a year
8% 4. Use internet /phone
N= 643

Q3. Have you borrowed or tried to borrow money for business purposes in the last 3 months?
21% 1. Yes, from a bank or credit union
2% 2. Yes, from an internet lender
3% 3. Yes, from other type oflender
75% 4. No
N= 644

Q4. If you borrowed, were you satisfied with the amount and terms offered for the financing that you received?
32% 1. Very satisfied
33% 2. Mostly satisfied
19% 3. Moderately satisfied
17% 4. Not satisfied
N= 162

Q5. If you were not completely satisfied, please evaluate the following potential issues in your most recent experience accessing financing.

A. Interest rate
40% 1. Significant issue
23% 2. Moderate issue
13% 3. Mild issue
23% 4. No issue
N= 141

B. Collateral requirement
16% 1. Significant issue
16% 2. Moderate issue
14% 3. Mild issue
55% 4. No issue
N= 141

C. Repayment schedule
6% 1. Significant issue
15% 2. Moderate issue
12% 3. Mild issue
68% 4. No issue
N= 142

D. Paperwork requirement
13% 1. Significant issue
13% 2. Moderate issue
16% 3. Mild issue
58% 4. No issue
N= 142

E. Amount of approved credit
13% 1. Significant issue
12% 2. Moderate issue
13% 3. Mild issue
62% 4. No issue
N= 142

F. Application, approval, or closing process
14% 1. Significant issue
12% 2. Moderate issue
14% 3. Mild issue
60% 4. No issue
N= 141

Q6. If you were not completely satisfied, what was your largest complaint?
58% 1. Interest rate too high
3% 2. Collateral requirement too big
6% 3. Repayment schedule too short
7% 4. Too much paperwork
14% 5. Amount of credit approved too low

9% 6. Application, approval, or closing process too slow
3% 7. Other
N= 118

If you answered "Other, " please describe your largest complaint.

Q7. If you borrowed, what was the main purpose your business was seeking financing?
33% 1. Meet operating and inventory expenses
20% 2. Expand business
26% 3. Replace capital assets or make repairs
5% 4. Refinance or pay down debt
13% 5. Other
4% 6. Does not apply
N= 160

Q8. If you borrowed, what type of financing did you receive?
56% 1. Term Loan
37% 2. Line of Credit
0% 3. Factoring
7% 4. None of the above
N= 156

Q9. If you received a term loan, what was the duration of the loan?
10% 1. Less than 1 year
8% 2. 1-2 years
51% 3. 3-5 years
19% 4. 6-10 years
10% 5. Longer than 10 years
0% 6. I don't know
1% 7. Does not apply
N= 88

Q10. If you received a term loan, was it an adjustable-rate loan?
15% 1. Yes
55% 2. No
2% 3. I don't know
29% 4. Does not apply
N= 145

Q11. If your business did not apply for financing, what was the primary reason?
80% 1. Did not need financing
1% 2. Did not think application would be approved

3% 3. Credit cost was too high
1% 4. Application process was too difficult or confusing
2% 5. Other
13% 6. Does not apply
N= 475

Q12. Does your firm currently have a line of credit for business purposes?
53% 1. Yes
46% 2. No
1% 3. I don't know
0% 4. Does not apply
N= 571

Q13. What is the total credit limit of this credit line?
1% 1. Less than $5,000
3% 2. $5,000–9,999
12% 3. $10,000–29,999
8% 4. $30,000–49,999
19% 5. $50,000–99,999
54% 6. $100,000 or more
2% 7. I don't know
1% 8. Does not apply
N= 306

Q14. How long has your business had this line of credit?
3% 1. Less than 3 months
3% 2. 3–6 months
6% 3. 6–12 months
85% 4. Over a year
2% 5. I don't know
2% 6. Does not apply
N= 309

Q15. If you have a line of credit, has your bank changed the terms or conditions of that loan in the last 3 months?
3% 1. Yes, reduced the amount of credit available
0% 2. Yes, shortened the time duration of the loan
1% 3. Yes, additional collateral was required
80% 4. No, nothing has changed
11% 5. I don't know
5% 6. Does not apply
N= 307

Q16. How concerned are you about the health of the bank you use for business purposes in light of the recent bank failures (Silicon Valley Bank and Signature Bank)?
4% 1. Very concerned
13% 2. Moderately concerned
29% 3. Slightly concerned
54% 4. Not at all concerned
N= 594

Q17. Has someone from your bank reached out to you or have you reached out to your bank about concerns related to the most recent bank failures?
7% 1. Yes, I reached out to my bank
13% 2. Yes, my bank reached out to me
80% 3. No, neither
N= 602

Q18. Have you changed your primary financial institution that you use for business purposes in the last 3 months?
3% 1. Yes
97% 2. No
N= 608

Q19. Are you considering changing your primary financial institution in the next 3 months?
6% 1. Yes
83% 2. No
11% 3. I don't know
N= 605

Q20. How would you characterize the current financial state of your business?
26% 1. Excellent
45% 2. Good
25% 3. Okay
5% 4. Poor
N= 615

Q21. How would you characterize the current state of your local economy?
3% 1. Excellent
33% 2. Good
44% 3. Okay
20% 4. Poor
N= 615

Q22. How would you characterize the current state of the national economy?
1% 1. Excellent
9% 2. Good
32% 3. Okay
58% 4. Poor
N= 617

Q23. When do you think the next recession will start in the U.S.?
52% 1. The U.S. is already in a recession
2% 2. July–Sept. 2023
17% 3. Oct.–Dec. 2023
20% 4. Jan.–June 2024
10% 5. July 2024 or later
N= 577

Beginning January 1, 2024, a new federal regulation (commonly called "beneficial ownership") will require most businesses with 20 full-time employees or less to report information about the business and information about all owners with 25% or more ownership in the business to the U.S. Department of Treasury. How familiar are you with this new regulation?

Q24. How familiar are you with this new regulation?
90% 1. Not at all familiar
9% 2. Somewhat familiar
1% 3. Very familiar
N= 632

Q25. Which industry best describes your business?
17% 1. Construction
13% 2. Manufacturing
18% 3. Retail
30% 4. Services
8% 5. Finance, Real Estate, Insurance
3% 6. Wholesale
5% 7. Agriculture
4% 8. Transportation
2% 9. Other
N= 632

If you selected "other" for your industry, please describe:

Q26. How many full-time and part-time employees work at your business (not including owners)?

11% 1. No employees
56% 2. 1–9 employees
14% 3. 10–19 employees
12% 4. 20–49 employees
8% 5. 50 or more employees
N= 557

NFIB RESEARCH CENTER

SBE COUNCIL
Small Business & Entrepreneurship Council

Small Business Checkup Survey (Q3-2023)

TECHNOMETRICA
MARKET INTELLIGENCE

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Introduction

Background & Objectives

The SBE Council commissioned the study to gain insights from small business owners about current economic and business conditions and policy related issues.

Survey Sample

- ✓ **Online Survey Methodology**
- ✓ **Sample size - 535 completes**
  - TechnoMetrica used its network of panel partners for the sample.
- ✓ **Credibility interval - +/-4.3 percentage points**

Methodology



- ✓ **Survey Conducted**
  - August 23 – August 25, 2023
- ✓ **Median Length of Interview**
  - 9.45 minutes



- ✓ **Qualification Criteria**
  - Small business owners
  - Employee size = 2 to 99

Findings - Overview

Business Environment

- Most businesses believe the current business environment is generally positive. Specifically, 21% consider it excellent, 42% rate it as good, 25% find it average, and 13% feel it is poor or unacceptable.
- A significant portion (38%) anticipate worsening **economic** conditions in the next six months. In contrast, 22% expect conditions to improve, and 36% predict them to remain about the same.
- Nearly half (49%) expect their **business's financial position** to remain unchanged in the next six months. 36% anticipate improvement, while 12% foresee a worsening financial condition.
- On the matter of **federal policies** with regard to small businesses: 10% are very satisfied, and 39% are somewhat satisfied. 45% express dissatisfaction, with 24% being not very satisfied and 21% not at all satisfied.
- Inflation (57%), economic uncertainty (32%), recession/slowdown (32%), rising interest rates (22%), and high gas prices (21%) are the top 5 concerns for small businesses.
- Almost nine in ten (89%) express concerns about **inflation** over the next twelve months. Similarly, nearly nine in ten (86%) are concerned about an economic slowdown or **recession**.

Findings - Overview

- In describing the outlook on economy for the remainder of 2023, 61% say the economy will deteriorate, 20% say it will be stable, and 14% note it will improve.
- Small business owners say that inflation, rising interest rates, gasoline prices, energy and transportation costs, labor and benefit costs, and supply chain disruptions have had a negative impact on their businesses.

Labor Market and Employment:

- Two-thirds (66%) describe the current labor market as fair or poor. Regions in the South and West show stronger intent to increase employment. Nearly one-half (48%) of small businesses report that labor shortages and limited access to skilled labor are hampering operating capacity.

Credit and Capital Availability:

- Two-thirds (62%) rate credit availability as fair or poor, with 33% considering it excellent or good. Almost half (49%) believe the lack of credit or access to capital is hampering their operations.

Findings - Overview

Sales and Profitability in 2023:

- 52% report that their revenues have not kept pace with inflation, while 42% indicate their revenues have kept up. A majority (59%) are cutting expenses; travel, big-ticket items, new hiring, and marketing are the top categories facing the cut.
- One-thirds (35%) experienced decreased sales in 2023, with 40% noting increased sales and 23% reporting steady sales. Similarly, 42% reported decreased profitability, while 34% experienced improved profitability.
- Majority (53%) expect a stable **business** outlook for the rest of 2023. Meanwhile, 29% expect improvement, and 14% anticipate a deterioration. However, most are pessimistic about the **economy** for the rest of 2023.
- Nearly three-fourths (72%) are optimistic about their business's survival over the next two years. 26% rate their chances as excellent, 46% as good, and 22% as fair.

Findings Overview

President Biden

- Small business owners don't think highly of President Biden's performance on key issues.
- Combating *inflation* receives failing grades from 70%, while only 14% rate his efforts positively.
- Management of *government spending* is similarly unfavorable, with 63% giving low grades and only 16% offering high ratings.
- Over six in ten (62%) are dissatisfied with President Biden's *handling of the economy*, compared to 20% who rate him favorably.
- On *taxes*, 58% assign failing marks, while 15% view his performance positively.
- *U.S. competitiveness with China* sees 56% giving failing grades and just 18% rating him favorably.
- Over half (56%) give failing grades for Biden's *Immigration policy.* 21% give him good grades.
- 55% assign failing grades for his *Energy policy and costs*, while 22% give him good grades.
- Another 54% award failing grades for *Health insurance and healthcare costs,* while 22% give favorable ratings.

Findings Overview

President Biden (Continued)

- *Regulations* efforts are considered unsuccessful by 53%; 20% rate them favorably.
- Addressing the *labor shortage* earns dissatisfaction from 50%, but 23% are satisfied.
- *Access to capital and credit* receives positive grades from 18%, with 26% rating him as average and 50% giving failing grades.
- On the issue of *national security*, only 29% give Biden positive grades, while 47% rate him poorly.
- *Small business friendliness* is another concern, as 46% assign a failing grade and 25% rate him favorably.
- Overall, small business owners express significant dissatisfaction with Biden's performance, with 37% assigning an "F" and 20% a "D." Positive ratings are fewer, with only 6% giving an "A," 15% a "B," and 21% a "C."
- Two-thirds blame the Biden administration for rising gas prices. 40% state the administration is *very responsible*, and another 25% say it is *somewhat responsible*.

Findings Overview

Technology Platforms For Branding And Income Generation

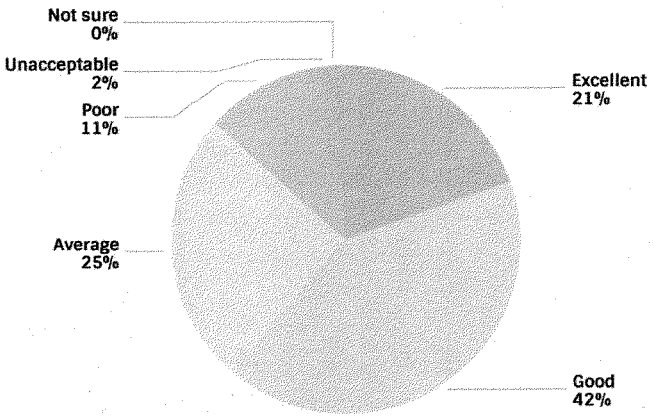
- Small business owners (59%) say Facebook is the most crucial platform for branding and income generation.
- Instagram, Amazon, and LinkedIn are also important platforms for branding and income generation.
- Small businesses also use other platforms like YouTube, TikTok, eBay, Twitter, Shopify, and Walmart.
- Social media and technology platforms contribute to 22% of total sales for surveyed small businesses.

Amazon's Role In Small Business Sales

- One in five (22%) of small businesses surveyed sell products on Amazon.
- Amazon accounts for 23% of total sales for its users.
- Amazon users also utilize their websites (69%) and social media platforms (64%) for sales.
- Small businesses utilize other tech platforms (41%), brick-and-mortar storefronts (35%), buy online, pick-up-in-store (BOPIS) (23%), and larger company platforms like Walmart (16%).
- Nearly 80% of small businesses relying on Amazon expect negative impacts from potential FTC action.
- Concerns include sales disruption (31%), employee layoffs (22%), loss of customer base (17%), potential business closure (16%), and increased sales/marketing costs (15%).

Detailed Findings

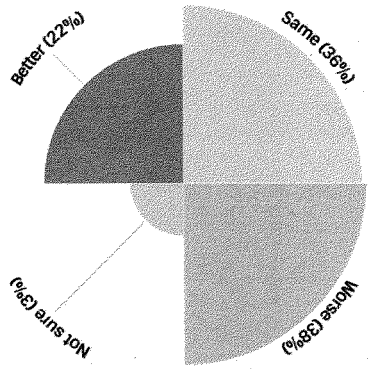
Most Businesses Believe The Current Business Environment Is Generally Positive



Q1. Generally speaking, how would you describe the current business environment?

- One in five, or 21%, say that the current business environment is *excellent*.
- Another two in five, or 42%, say it is *good*.
- But, one-fourth, 25%, rate the business environment as *average*.
- 13% think the business environment is *poor* or *unacceptable*.

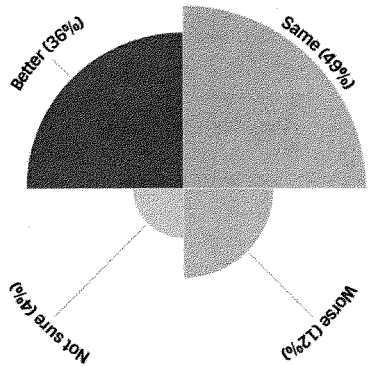
38% Anticipate Economic Conditions To Worsen In The Next Six Months



- A fifth (22%) expect the economic conditions in the country to be *better* in the next six months.
- However, two in five (38%) foresee the conditions *worsening*.
- More than a third (36%) predict that the conditions will remain *about the same*.

Q2. In the next six months, do you think that economic conditions in the country will be better, worse, or about the same as now?

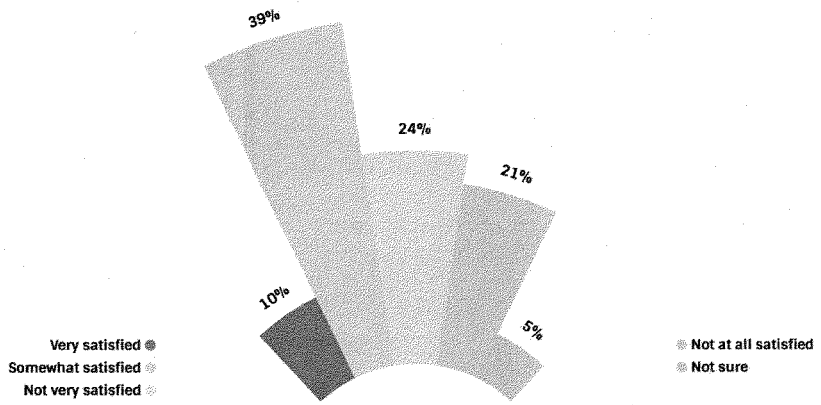
Nearly Half Anticipate Business Financial Position to Remain Unchanged



- One in three (36%) anticipates their business's financial position to be *better* in the next six months.
- Almost half (49%) foresee it remaining the *same*.
- However, 12% believe their business's financial condition will *worsen* in the near future.

Q3. In the next six months, do you think that your business's financial position will be better, worse, or about the same as now?

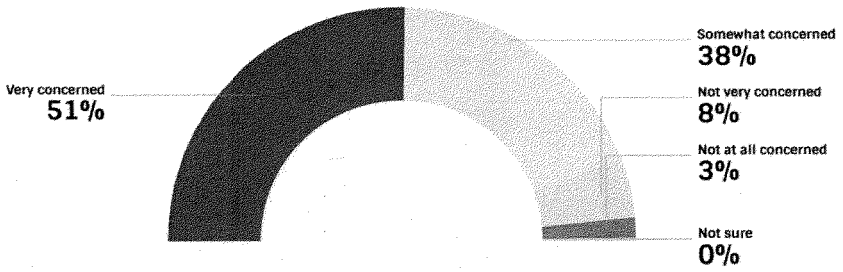
49% Are Satisfied With Current Federal Policies To Bolster Small Businesses; 45% Are Dissatisfied



Q4. How satisfied are you that the current federal policies serve as a catalyst to bolster the success of small businesses, nurture the expansion of startups, and facilitate the initiation of new businesses?

- Nearly half (49%) express *satisfaction* with current federal policies aimed at bolstering the success of small businesses – 10% are *very satisfied*, and 39% are *somewhat satisfied*.
- However, 45% are dissatisfied, with 24% being *not very satisfied* and 21% *not at all satisfied*.

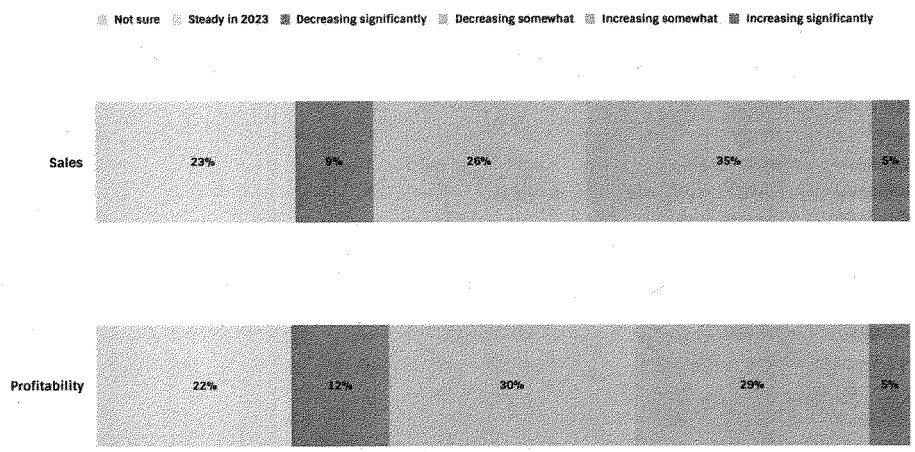
Almost Nine in Ten Express Concern About Inflation in the Next Twelve Months



Q5. How concerned are you about inflation in the United States over the next twelve months?

- Half of business owners (51%) are *very concerned* about inflation, while 38% are *somewhat concerned*.
- On the other hand, 11% express no concern.

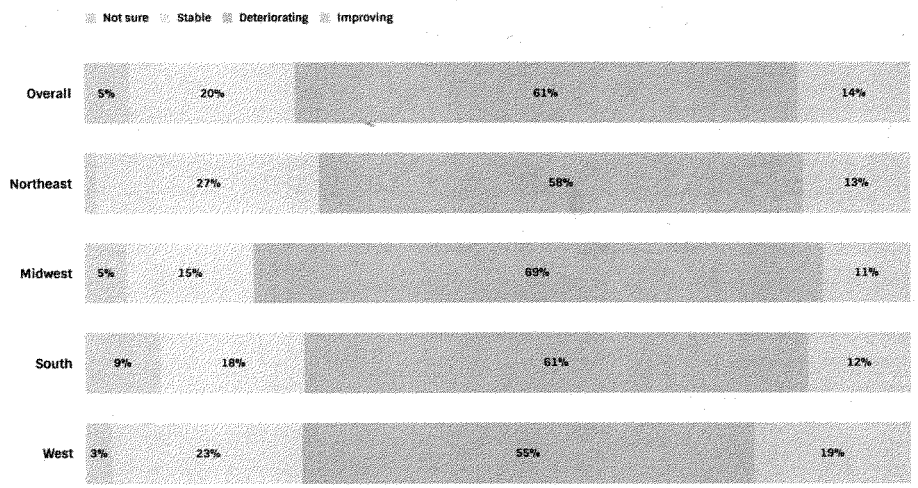
2023 Business Trends: Mixed Fortunes As 40% See Sales Increase, While Same Proportion Faces Profitability Dip



Q22: Thinking about 2023, how would you describe the following for your business?

- Four in (40%) noted *increased* sales, and another fifth (23%) reported *steady* sales in 2023.
- However, one-third (35%) reported a *decrease* in sales in 2023 – with 26% experiencing a somewhat decrease and another 9% experiencing a significant decrease.
- Only 34% saw *improved* profitability, while a fifth (22%) stated their profitability remained *steady* in 2023.
- Meanwhile, four in ten small businesses reported *decreased* profitability – with 30% experiencing a somewhat decrease and 12% a significant decrease.

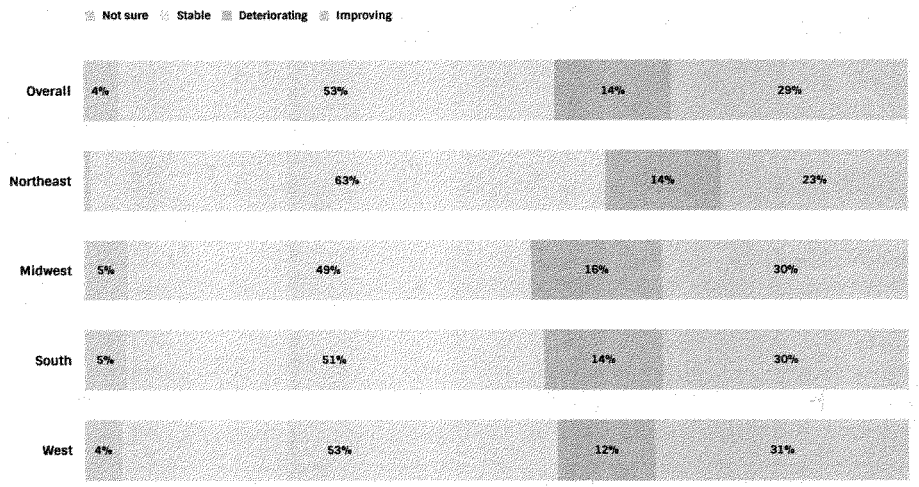
Majority of Small Businesses Hold Pessimistic Economic Outlook for the Remainder of 2023



Q24b: How would you describe the outlook for the remainder of 2023 for the Economy?

- A pessimistic sentiment prevails across all regions.
- While the Midwest (69%) has the highest level of pessimism, the West has the lowest (55%).
- Meanwhile, 14% of businesses hold an *optimistic* outlook, and an additional 20% expect a stable economy for the remainder of 2023.

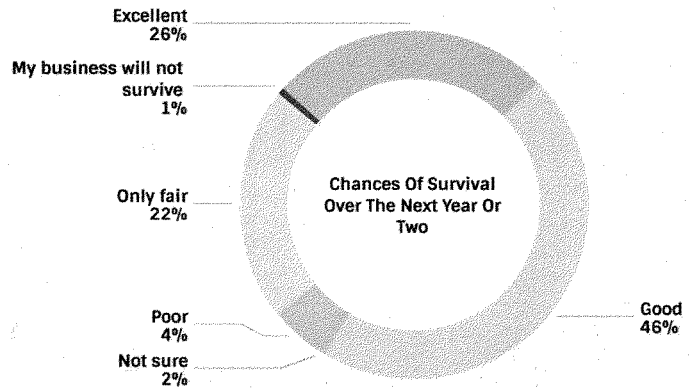
Most Small Businesses Anticipate a Stable Business Outlook for the Remainder of 2023



Q24a: How would you describe the outlook for the remainder of 2023 for your business?

- The sentiment of stability is shared across all regions.
- Half (53%) of small business owners describe the outlook for their businesses for the remainder of 2023 as *stable*.
- Meanwhile, 29% expect *improvement*, and 14% anticipate a *deterioration*.

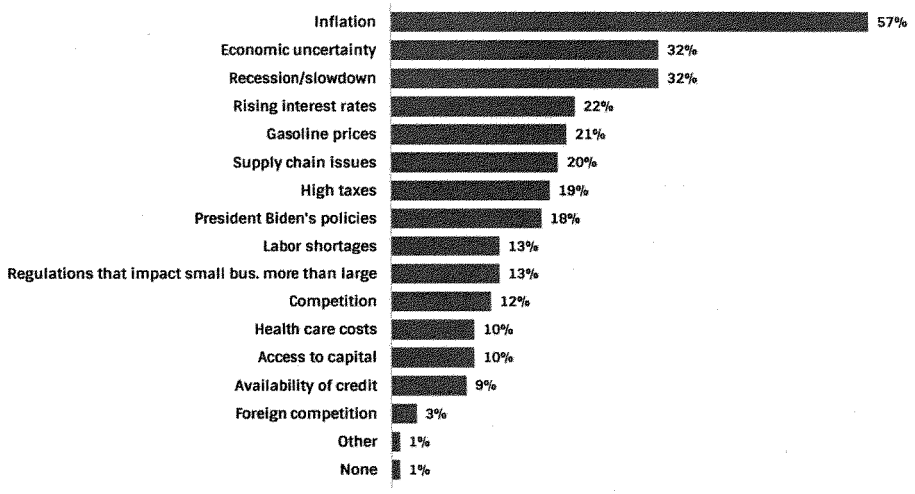
Nearly Three-Fourths Are Optimistic About Their Survival In The Next Two Years



Q23. How would you describe your business's chances of survival over the next year or two?

- Small businesses are optimistic about their survival in the coming two years.
- 26% rate their chances as *excellent* and 46% as *good*.
- However, one-fourth (22%) say their odds are only *fair*.
- A handful (4%) see their chances of surviving the present business conditions as *poor*.
- One percent said their business will not survive.

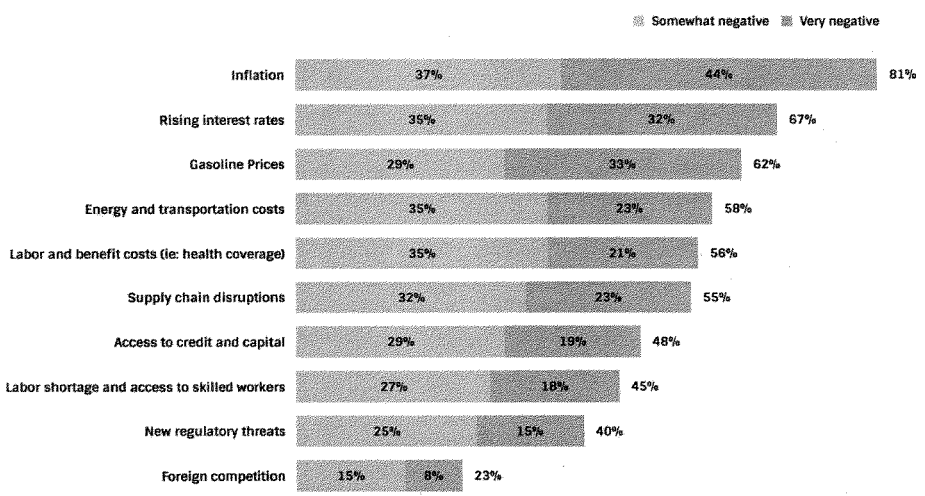
The Top-3 Economic Issues Facing Small Businesses Are Inflation, Economic Uncertainty, And Recession



Q7. What are the top-3 economic issues facing your business?

- From a list of 15 options, small business owners chose their top 3 issues: *Inflation* (57%) took the lead as the primary economic concern, followed by *Economic uncertainty* (32%) and *Recession* (32%).
- The second tier of concerns included *Rising interest rates* (22%), *Gasoline prices* (21%), and *Supply chain issues* (20%).

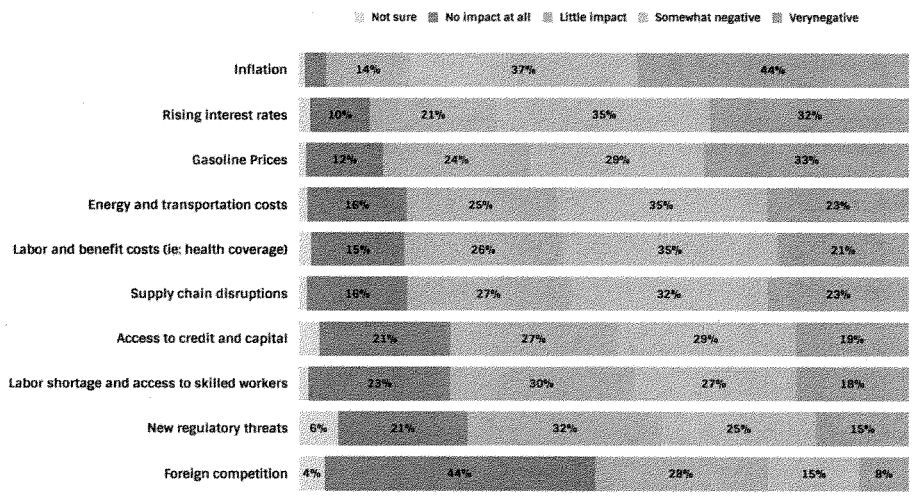
Inflation, Rising Interest Rates, Gasoline Prices, And More Take A Toll on Businesses



Q10. What is the impact of the following on your business?

- Out of the ten listed factors, a majority of small business owners identified six as having a negative impact on their businesses: *Inflation*, *Rising interest rates*, *Gasoline prices*, *Energy and transportation costs*, *Labor and benefit costs*, and *Supply chain disruptions*.
- Over eight in ten, or 81%, stated that *inflation* had a negative impact on their businesses, with 44% describing it as *very negative* and another 37% as *somewhat negative*.
- *Rising interest rates* held the second spot at 67%, closely followed by *Gasoline prices* at 62%.

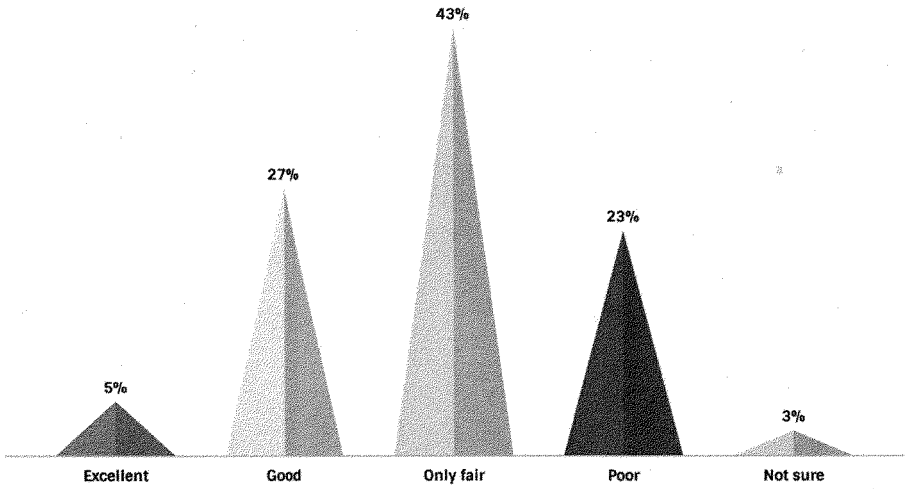
Negative Impact



Q: What is the impact of the following on your business?

- More than one-half (58%) of small businesses complain that *energy and transportation costs* have negatively impacted their businesses.
- Meanwhile, 56% reported that *labor and benefit costs (i.e., health coverage)* are a burden.
- Another 55% state that *supply chain disruptions* have negatively impacted their businesses.
- Under one-half reported a negative impact from *access to credit and capital* (48%), *labor shortages* (45%), *new regulatory threats* (40%), and *foreign competition* (23%).

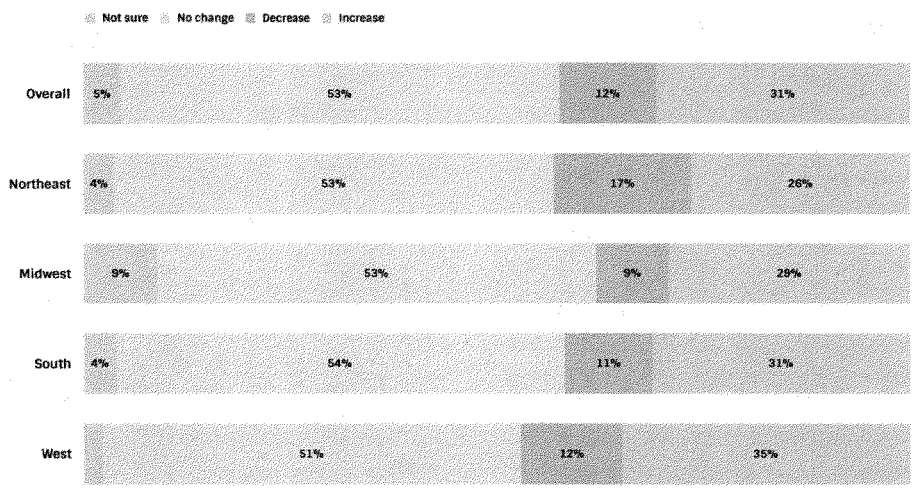
Two-Thirds Rate The Current Labor Market As Fair Or Poor



Q11. How would you describe the current labor market in terms of how easy it is to find the people you need?

- Two-thirds describe the current labor market as *only fair* or *poor* (66%) – with 43% considering it *only fair* and 23% rating it as *poor*.
- In contrast, one-third (32%) say it is *excellent* or *good*, including 5% who consider it *excellent* and 27% who rate it as *good*.

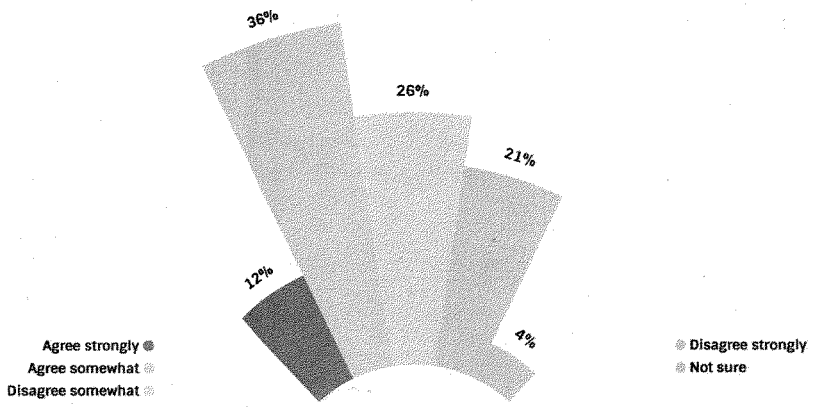
Small Businesses In The South And West Lead In Intent To Increase Employment



Q12: Do you expect to increase or decrease the number of people working for you over the next six months?

- Regionally, 26% of businesses in the Northeast, 29% in the Midwest, 31% in the South, and 35% in the West plan to *increase* employment.
- Meanwhile, 17% in the Northeast, 9% in the Midwest, 11% in the South, and 12% in the West plan to *decrease* employment.

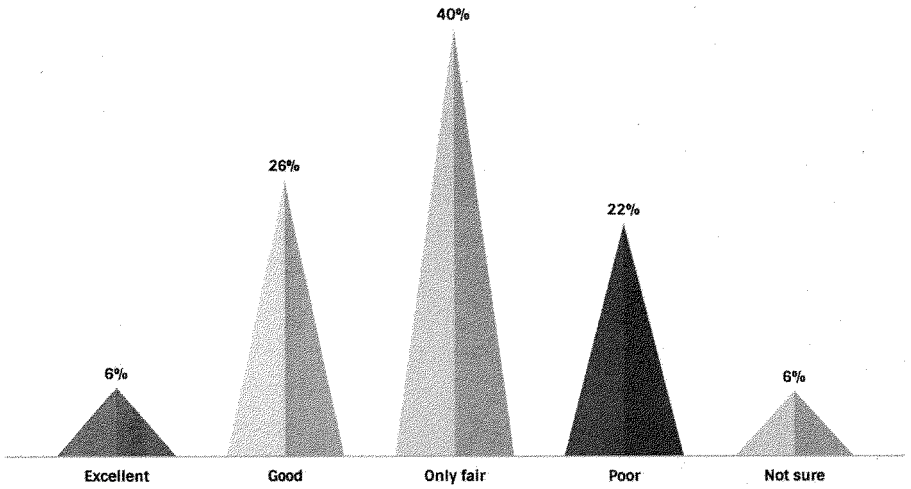
Nearly Half Of Small Businesses Report Labor Shortages And Limited Access To Skilled Labor Hamper Operating Capacity



Q13. Please indicate how much you agree or disagree with the statement. A labor shortage and access to skilled labor is hampering my company's operating capacity.

- Nearly half (48%) report that labor shortages are hampering their operating capacity, with 12% *strongly agreeing* and 36% *agreeing somewhat*.
- Meanwhile, 47% believe that labor shortages have not impacted their operating capacity.

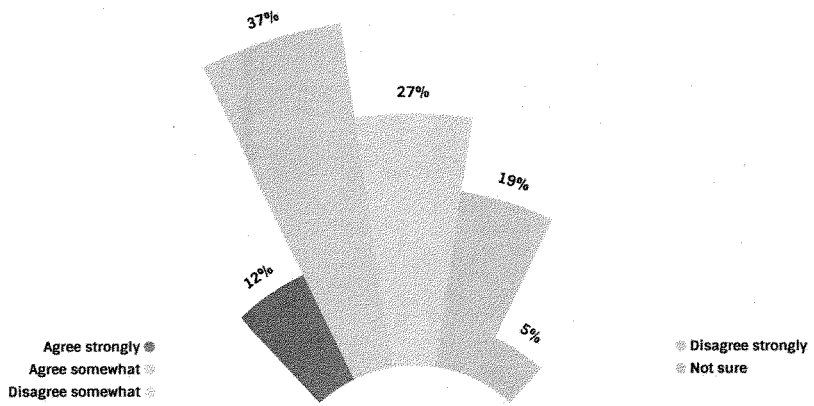
Nearly Two-Thirds Rate The Availability Of Credit Or Capital As Fair Or Poor



Q15. How would you describe the availability of credit or capital these days?

- Three in five (62%) are experiencing the effects of a credit squeeze.
- Among them, 40% describe credit availability as *only fair*, and 22% say it is *poor*.
- However, one-third rate it as *excellent* or *good*, with 6% considering it *excellent* and 26% marking it as *good*.

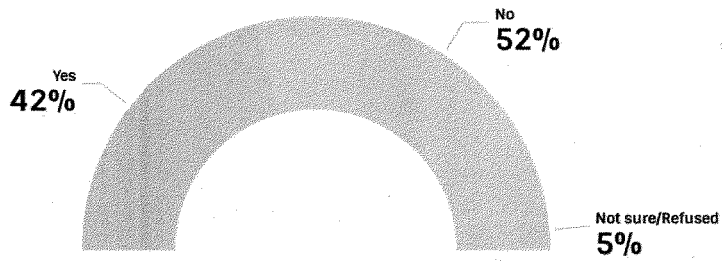
Half Of Small Businesses State Lack Of Credit Or Access To Capital Is Hampering Operating Capacity



Q16. Please indicate how much you agree or disagree with the statement. The lack of available credit or access to capital via lending and other sources is hampering my company's operating capacity.

- Nearly half of small businesses (49%) are feeling the effects of a credit squeeze.
- 12% *strongly agree* that the lack of credit is hampering their operating capacity, while 37% *agree somewhat*.
- However, 46% disagree that credit is hampering operating capacity, with 19% *strongly disagreeing* and 27% *disagreeing somewhat*.

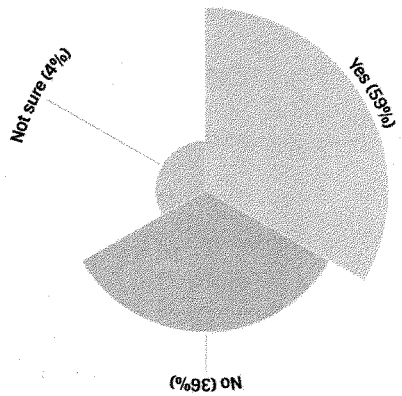
Most Say Revenues Have Not Kept Pace With Inflation



Q18. Have your revenues kept pace with inflation?

- 52% report that their revenues *have not* kept pace with inflation.
- 42% report that their revenues *have kept pace* with inflation.

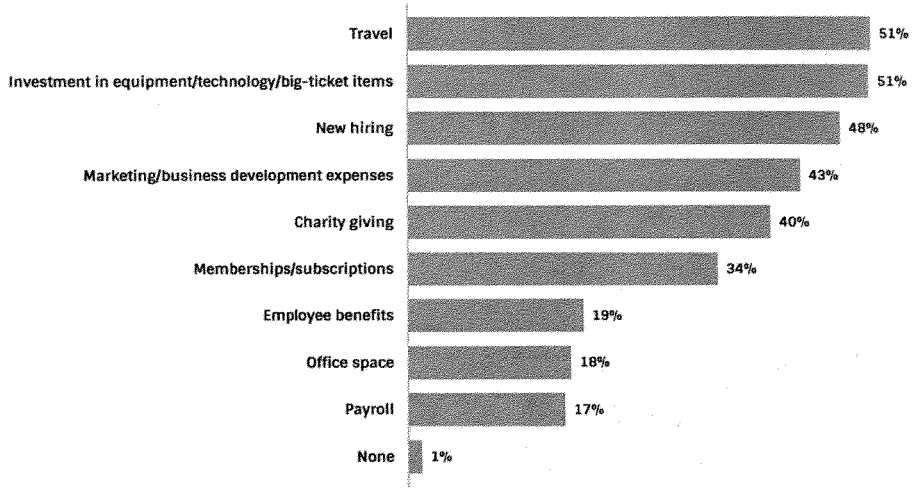
Slashing Spending Is Common Among Small Businesses



Q19. Due to the higher costs for raw materials, labor, and other inputs, are you cutting back on your business spending or not?

- Most small businesses have been careful with their resources in this environment. In fact, 59% are cutting expenses.
- However, 36% report they *have not cut* spending despite increased raw material and labor costs.

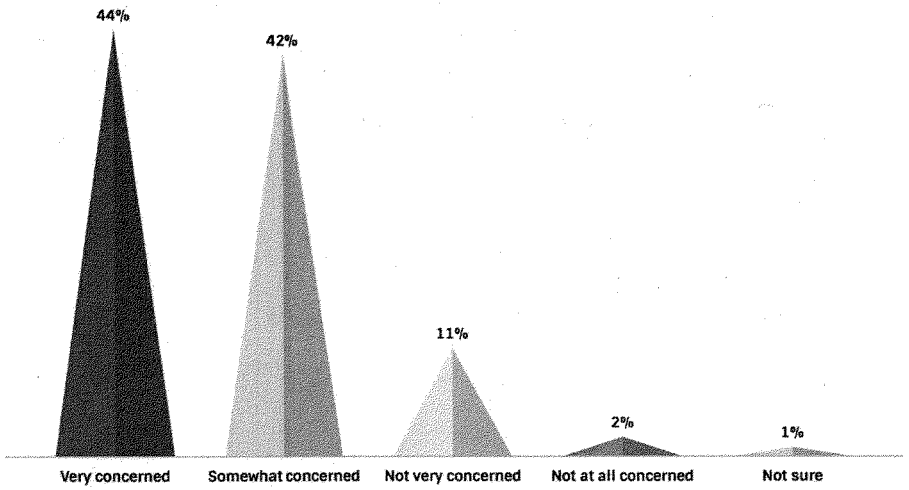
Travel, Big-Ticket Items, New Hiring, And Marketing Are Top Categories For Cutbacks



Q20. Which of the following activities have you cut back? Base=Those who have cut (n=311)

- Travel (51%), Big ticket items (51%), New hiring (48%), and Marketing (26%) are top areas of reduced spending.
- Charity giving (40%) and Memberships/subscriptions (34%) are also getting cut.

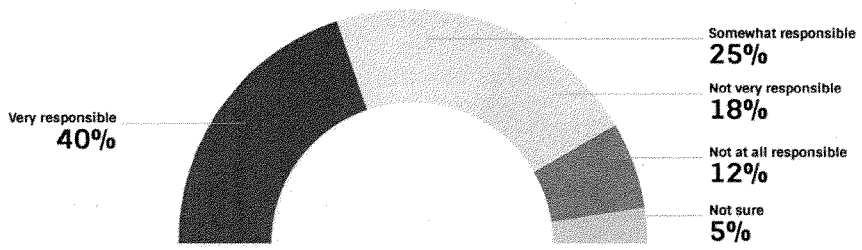
Nearly Nine In Ten Concerned About Economic Slowdown/Recession



Q6. How concerned are you about an economic slowdown/recession in the United States over the next twelve months??

- Small businesses are worried about a slowdown/recession.
- 44% are *very concerned*, and another 42% are *somewhat concerned*.
- Only a handful (13%) are *not* concerned.

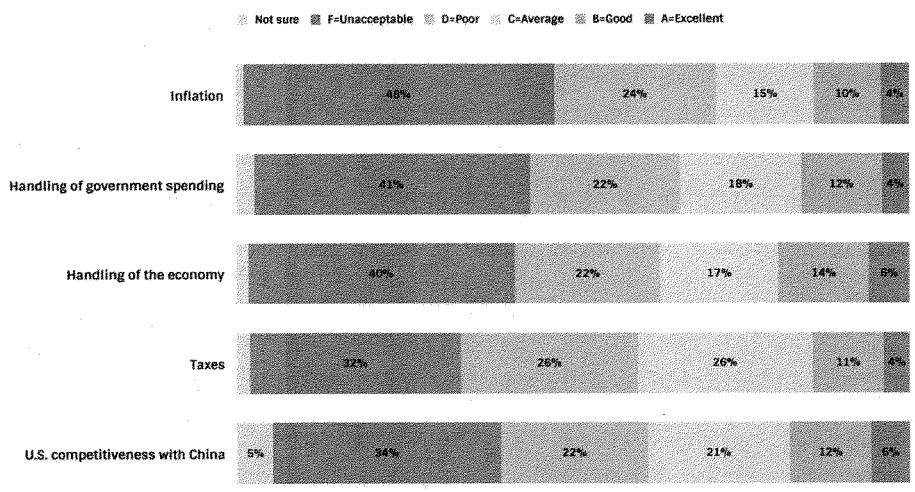
Two-Thirds Blame The Biden Administration For Rising Gas Prices



Q25. How responsible is the Biden administration for rising gas prices?

- 65% *blame* the Biden administration for rising gas prices.
- 40% state the administration is *very responsible*, and another 25% say it is *somewhat responsible*.
- However, 30% does not hold the current government responsible for the high prices.

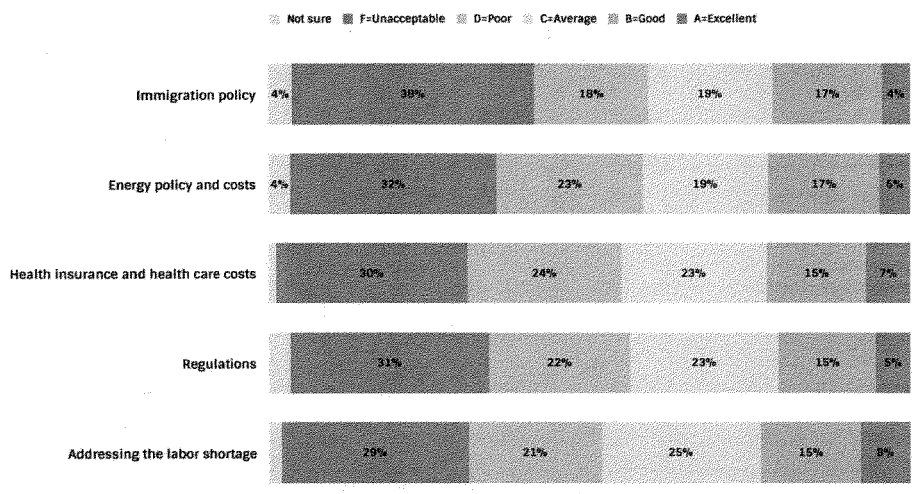
Most Small Businesses Give President Biden 'D' or 'F' on 10 of 13 Tested Issues



Q9: Please rate President Joe Biden's PERFORMANCE SO FAR in handling the following issues.

- A staggering 70% give the President failing grades for combating *inflation*, while only 14% give him good grades.
- Similarly, 63% give low grades for his management of *government spending*, whereas 16% rate him highly.
- Another 62% are dissatisfied with Biden's *handling of the economy*, with only 20% giving him favorable ratings.
- In the area of *taxes*, over half (58%) give him failing marks, while 15% view his performance positively.
- Furthermore, 56% assign failing grades to the President's approach to U.S. competitiveness with China, while 18% rate him favorably in this aspect.

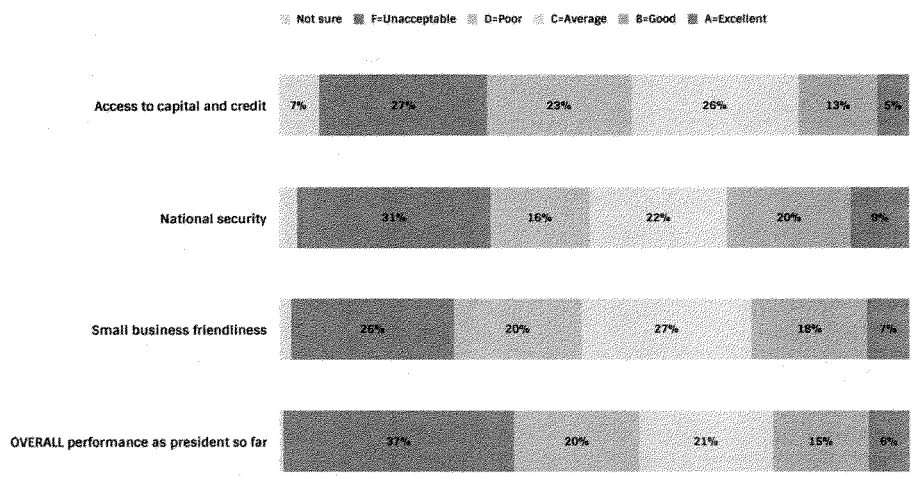
Biden Receives Positive Ratings For Just One Out Of 13 Tested Issues From More Than One-fourth



Q9: Please rate President Joe Biden's PERFORMANCE SO FAR in handling the following issues.

- In terms of *immigration policy*, 21% assign him good grades, 19% rate him as average, and 56% give failing grades.
- When it comes to *energy policy and costs*, one in five (22%) give good grades, while over half (55%) give failing grades.
- For *Health Insurance and healthcare costs*, only 22% rate Biden positively, in contrast to the 54% who give him failing grades.
- Meanwhile, 53% grade his *regulations* efforts unsuccessful, with 20% awarding passing marks.
- Regarding *addressing the labor shortage*, half (50%) express dissatisfaction, while 23% give good grades in this area.

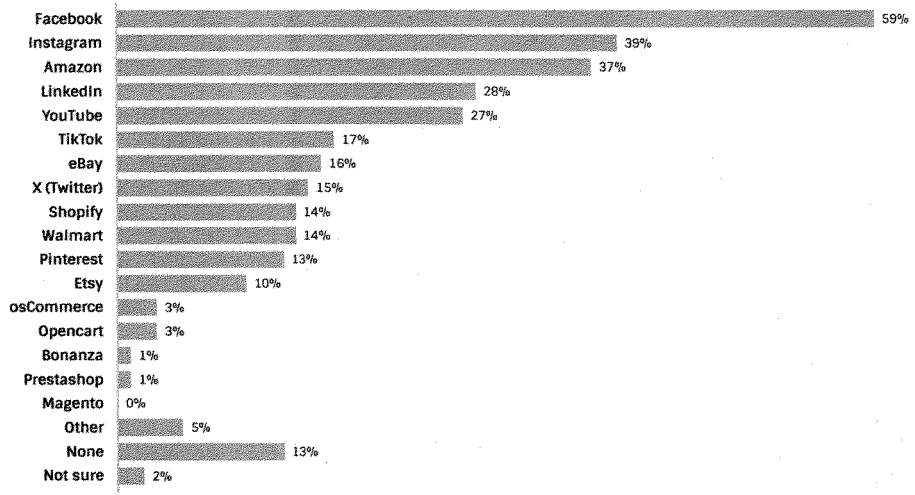
57% Grade Biden's Overall Performance A "D" Or "F"



Q9: Please rate President Joe Biden's PERFORMANCE SO FAR in handling the following issues.

- One in six (18%) assign him good grades for *access to capital and credit*, 26% rate him as average, and 50% give failing grades.
- When it comes to *national security*, only 29% give Biden positive grades, while 47% rate him poorly.
- Nearly half, or 46%, give Biden a failing grade for small business friendliness, whereas 25% award him good grades in this domain.
- Many small business owners express dissatisfaction with the President's performance; 37% give him an "F" and 20% rate him a "D." In contrast, only 6% give him an "A," 15% a "B," and 21% a "C."

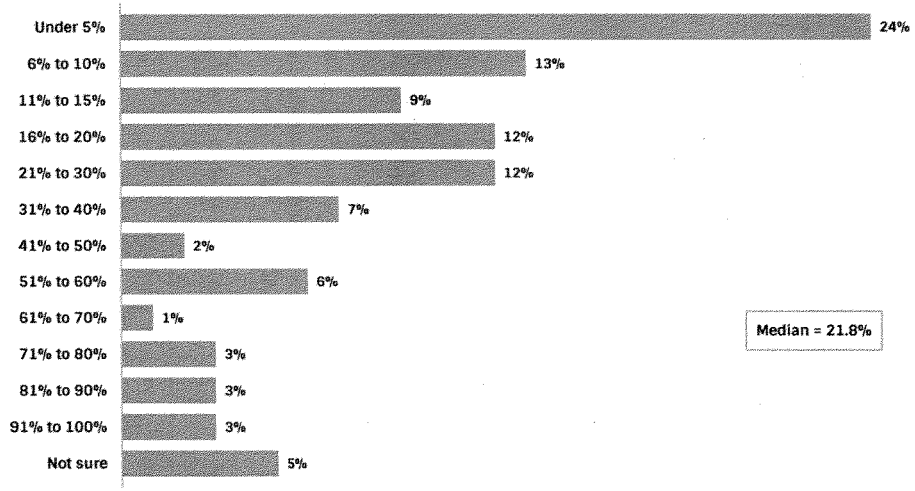
Facebook, Instagram, And Amazon Are The Most Popular Platforms



TE1. Which social media and technology platforms are most important to your company's branding and income generation?

- Nearly six out of ten (59%) identified Facebook as their most important social media and technology platform for branding and income generation.
- Instagram (39%), Amazon (37%), and LinkedIn (28%) fell in the next tier of most important platforms.
- Other important platforms include YouTube (27%), TikTok (17%), eBay (16%), X (Twitter) (15%) followed by Shopify and Walmart (14%).

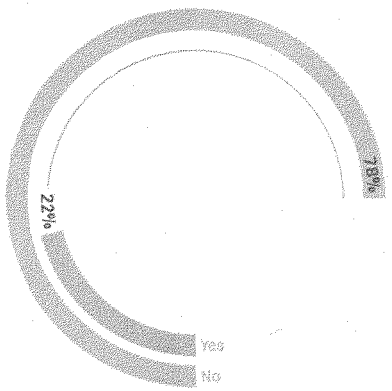
Social Media And Technology Platforms Account For 22% Of Sales



TE2. What percentage of your sales is derived from social media and technology platforms?

- More than one in three (37%) reported that their sales using social media platforms are 10% or less.
- One in five (21%) stated that social media platforms are responsible for 11% to 20% of their sales.
- Another one in five (21%) said that social media platforms account for 21% to 50% of their sales.
- One in six businesses (16%) stated that social media platforms are responsible for over half of their sales.

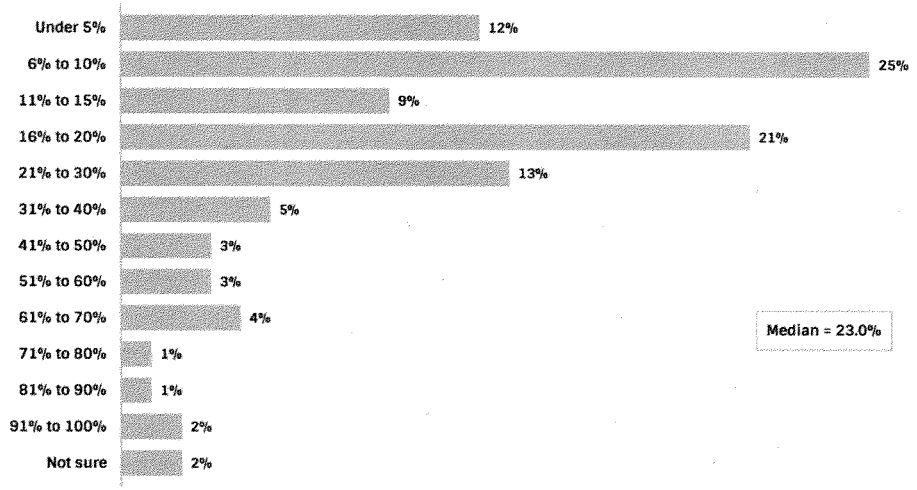
22% Of Small Businesses Utilize Amazon To Sell Their Products



TE3. Does your company use Amazon to sell products or goods?

- More than one in five (22%) said they sell their products and goods on Amazon.

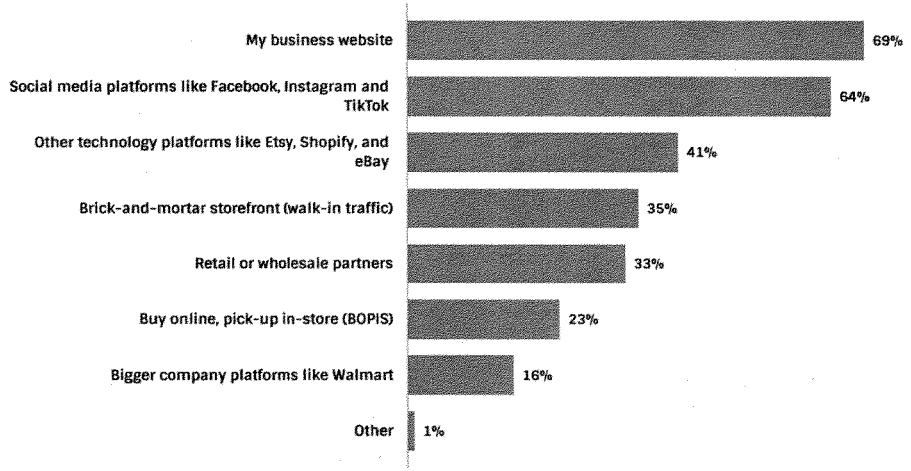
Amazon Contributes To 23% Of Total Sales For Its Users



TE3. What percentage of your sales is generated via the Amazon website?, Base=126 businesses who sell on Amazon.

- More than one in three (37%) reported that their Amazon sales accounted for 10% or less of their total sales.
- Nearly a third (30%) stated that Amazon is responsible for 11% to 20% of their total sales.
- Over a fifth (21%) said that Amazon accounts for 21% to 50% of their total sales.
- One in ten businesses (11%) mentioned that Amazon is responsible for over half of their total sales.

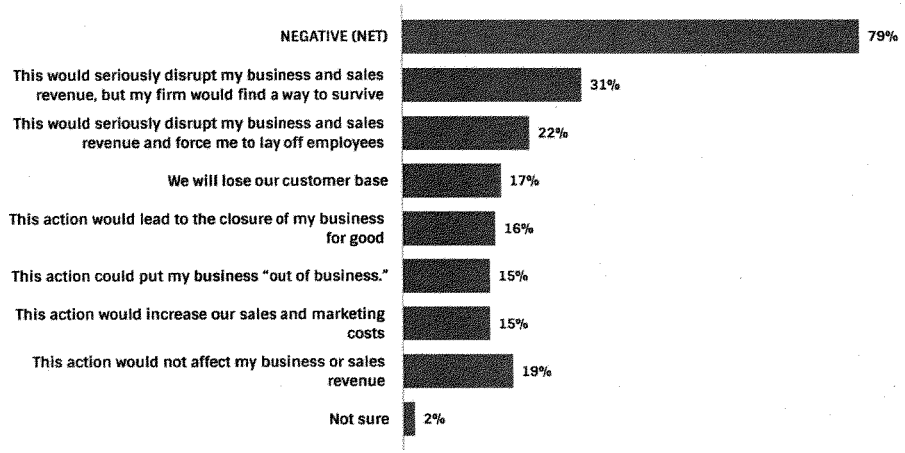
Amazon Users Also Sell Using Their Business Websites And Other Social Media And Technology Platforms



TE4. What other methods does your business use besides Amazon to generate sales? (Please select all that apply), Base=126 businesses who sell on Amazon.

- Two-thirds of Amazon users utilize their websites (69%) and social media platforms (64%) to generate sales.
- Four in ten (41%) use other tech platforms such as Etsy, Shopify, and eBay.
- One-third (35%) engage brick-and-mortar storefront and retail/wholesale partners (33%) to generate sales.
- Over a fifth (23%) use buy online, pick-up-in-store (BOPIS) to sell products.
- One in six (16%) utilize larger company platforms like Walmart for their sales.

Nearly 80% Anticipate Negative Impact From Potential FTC Action On Amazon

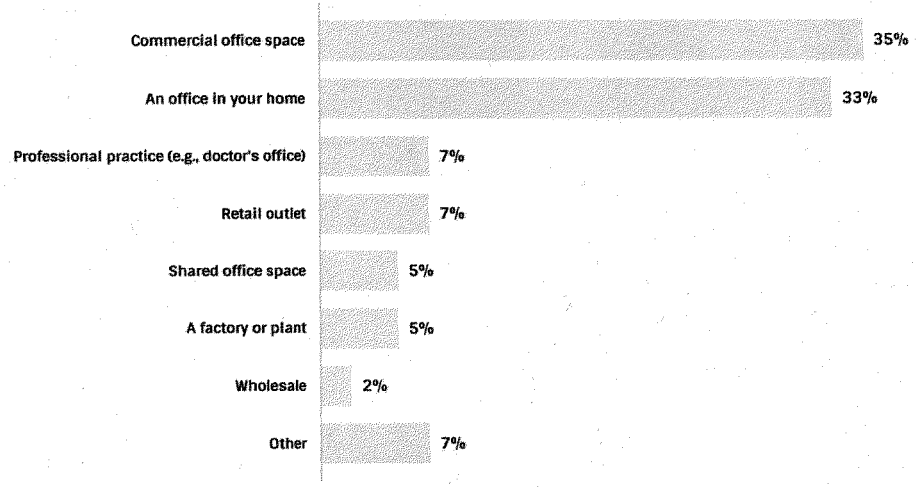


TE5. The FTC is considering antitrust action against Amazon, which could lead to either breaking up the company or ending the company's practice of permitting small third-party sellers to use and access the Amazon marketplace. How would such changes affect your small business? (Please select all that apply). Base=126 businesses who sell on Amazon.

- The potential FTC action will negatively impact almost 80% of businesses that rely on Amazon for generating sales.
- Around one-third (31%) anticipate sales disruption but express their determination to find ways to survive.
- One-fifth (22%) believe the FTC action could result in employee layoffs.
- Seventeen percent (17%) fear losing their customer base.
- Additionally, 16% have concerns about their business permanently closing due to such actions.
- Meanwhile, 15% stated that the FTC action would increase their sales and marketing costs.
- One in five (19%) said the action would not affect their business or sales revenue.

Firmographics

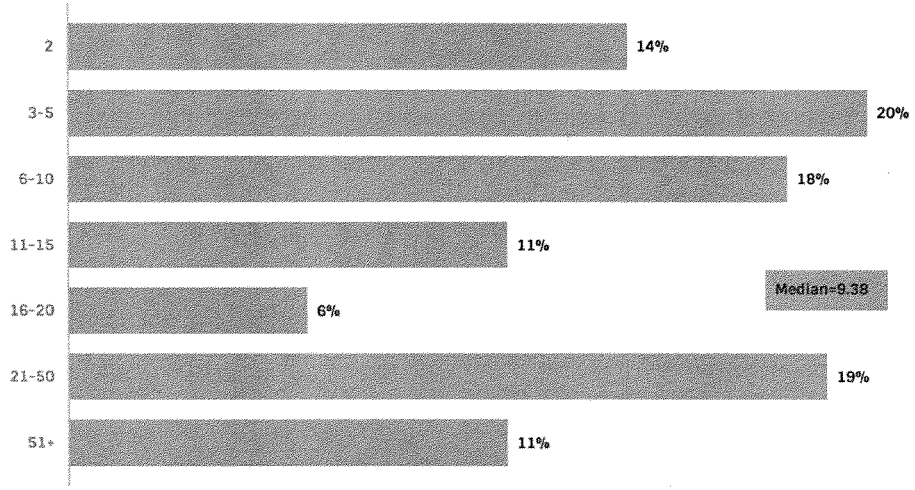
Business Location



F5. Which of the following best describes your business location?

- Over one-third, 35%, had *commercial office space*.
- Another third, 33%, of the small businesses were run from a *home office*.
- 7% owned a *professional practice.*
- 7% had *retail outlets*.
- 5% operated from a *shared office space.*
- 5% was based out of *factories* and 2% from *wholesale space*.

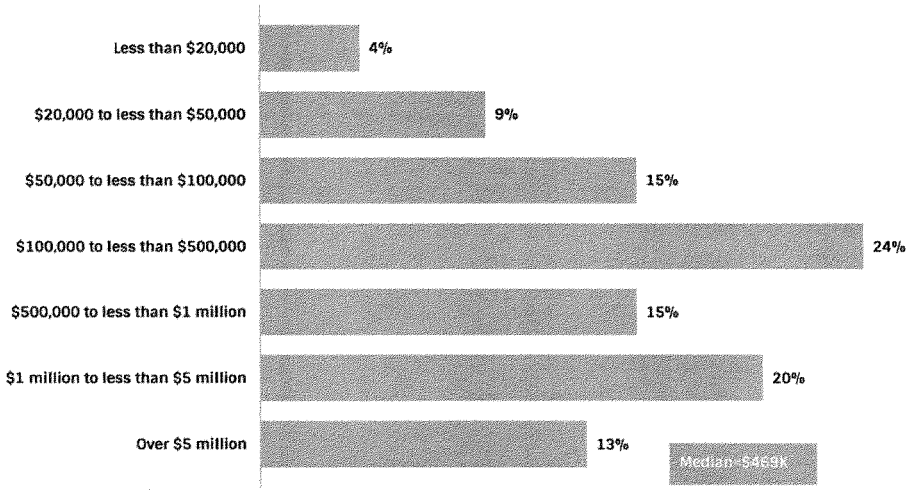
Employee Size



S1. Including yourself how many people are currently employed by your business?

- The median number of employees on payroll in the small businesses surveyed is 9.39.
- Over one-third, 34%, of the establishments had fewer than five employees. 14% had two employees, and another 20% had 3-5 employees.
- About a fifth, 18%, had 6-10 persons on the payroll.
- A little more than a sixth, 17%, had 11-20 employees.
- 30% had more than 21 employees.

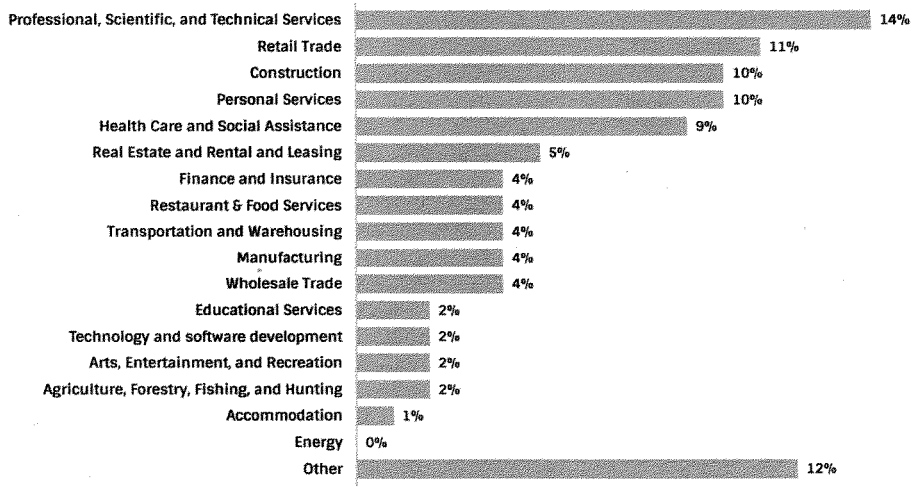
Business Revenue 2022



F2. What was your company's approximate revenue for 2022?

- The *median earnings* of surveyed small businesses in 2022 stood at $469K.
- About one in ten of the businesses (13%) earned less than $50K.
- Another 15% made between $50K to $100K, and almost a quarter (24%) made between $100K-$500K.
- 15% generated revenue between $500K and $1 million.
- One third 33% earned more than $1 million last year.

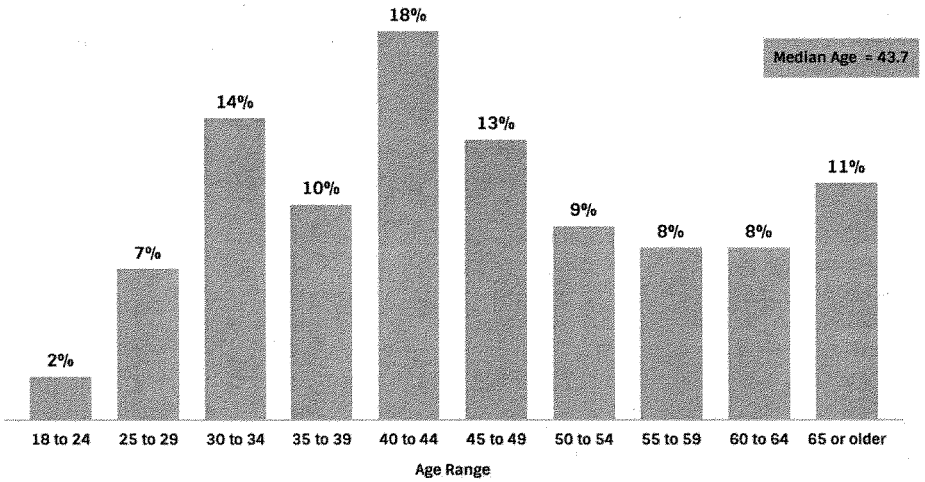
Primary Business



F3. Which of the following best describes the primary business of your company?

- The largest segment ofsmall businesses, 14%, fell under Professional, Scientific, and Technical Services.
- Retail Trade made up 11%, Construction 10%, and Personal Services 10%.
- Healthcare had 9%.
- Six other categories ranged from 4% to 5%.
- 12% of the establishments came under other sectors of business activity.

Age Of Respondent



D2. What is your age?

- The *median age* of the entrepreneur was found to be 43.7 years.
- Nearly a quarter, 24%, were in their 30s and 31% were in their 40s.
- Less than a fifth (17%) were between 50 and 59 years old.
- Nearly one-fifth, or 19%, were 60 or older.
- 9% belonged to the under-30 age bracket.

Gender

54%
Male



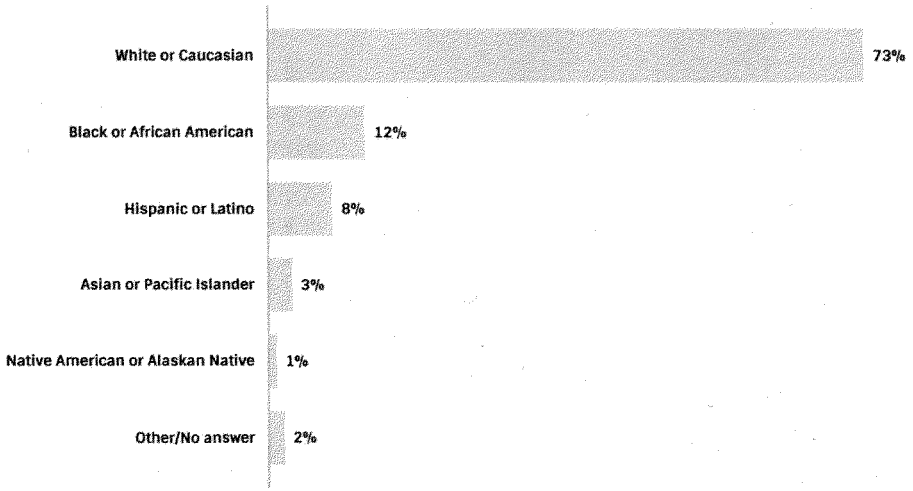
46%
Female



D1. Your Gender

- By gender, the survey was nearly *equally split* between male(54%) and female (46%) business owners.

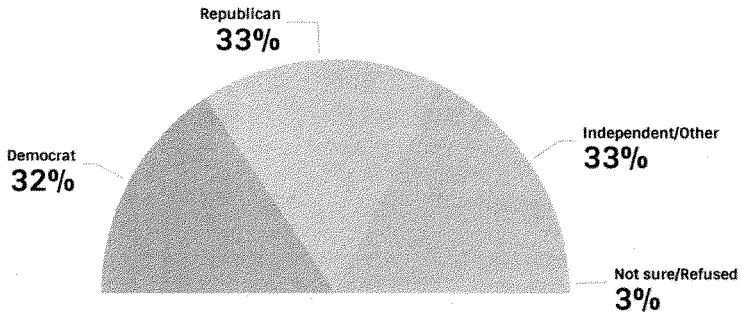
Race/Ethnicity



D3. Which of the following best describes you?

- A majority, 73%, of small business owners were White or Caucasian.
- 12% were African American or of black ethnicity.
- 8% identified as Hispanic/Latino.
- 3% belonged to an Asian or Pacific Islander community.
- Only 1% came from Native American or Alaskan backgrounds.
- 2% did not divulge their race/ethnicity.

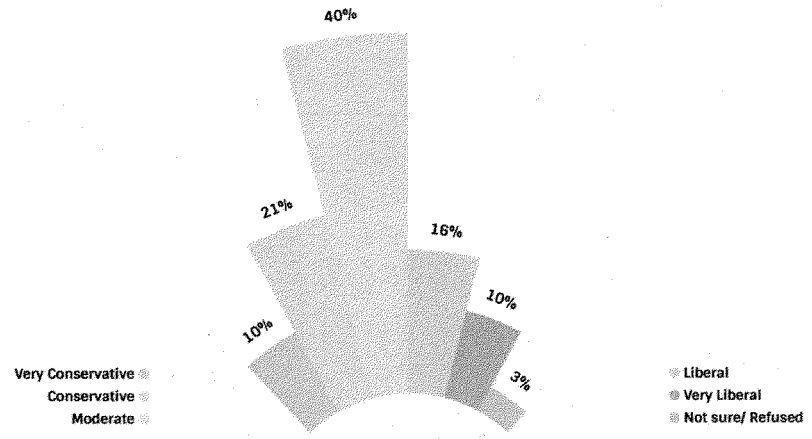
Party Affiliation



- Republicans and Independents/Others comprised two-thirds of the respondents at 33% each.
- 32% identified as Democrats.
- 3% did not divulge their party affiliation.

D9. In politics, do you consider yourself to be a Democrat, a Republican, an Independent, or something else?

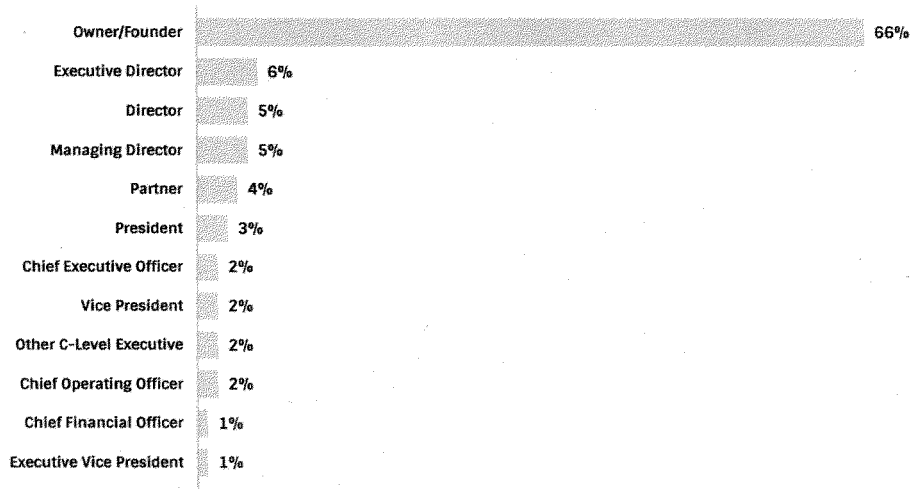
Ideology



AD1. Ideology

- A plurality, 40%, identified as Moderate.
- Roughly a third (31%) said they were Conservative; one in 10 or 10% identified as *very Conservative* and another 21% as *Conservative*.
- A fourth 26%, considered themselves Liberal. 16% identified as *Liberal*, and 10% as *very Liberal*.

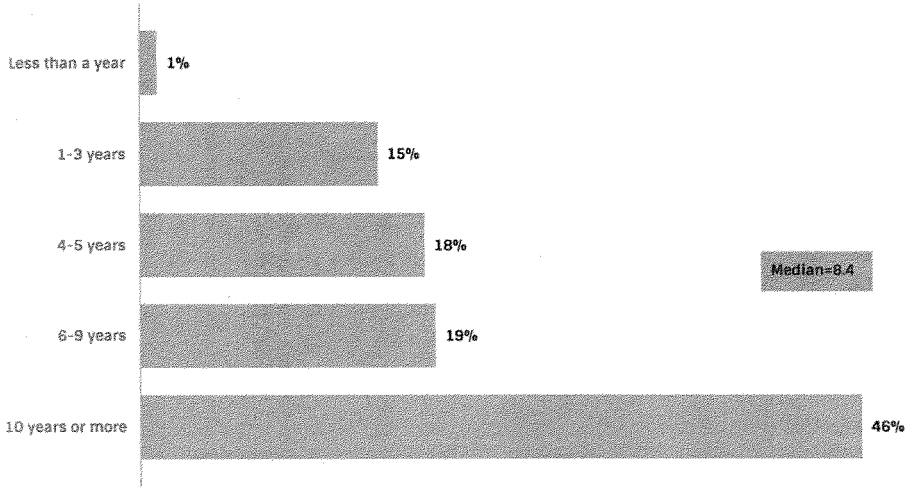
Job Title



F4. What is your job title?

- A significant majority, 66%, went by the title of 'Owner' or 'Founder'.
- 6% identified as Executive Directors.
- 5% were Directors and 4% identified themselves as Managing Directors.
- 4% were Partners.

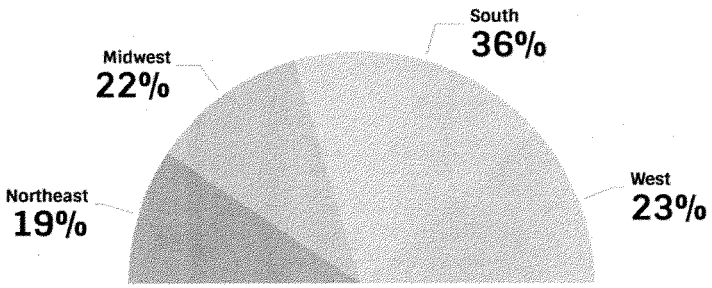
Year In Business



F1. How many years has your company been in business?

- The median age of the small businesses is a little more than **8 years**.
- 46% of the small businesses have been in operation for 10 years or more.
- One-sixth (16%) were started in the past three years.
- 18% were in operation for 4-5 years and 19% for 6-9 years.

Region



Reg: Region

- One-fifth operated in the Northeast (19%) and the Midwest (22%).
- Nearly a third, 36%, of the small businesses surveyed operated in the South.
- Close to a quarter were based in the West (23%).

Statement of the US Chamber of Commerce

ON: "Enabling Success: Examining the Competitive Landscape for Small Businesses"

TO: Subcommittee on Economic Growth, Tax, and Capital Access

BY: Bill Hulse, Senior Vice President, Center for Capital Markets Competitiveness, US Chamber of Commerce

DATE: September 13, 2023

Introduction

The U.S. Chamber of Commerce ("the Chamber") is dedicated to promoting, protecting, and defending America's free enterprise system. More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses but also those facing the broader business community.

The Chamber's Center for Capital Markets Competitiveness ("CCMC") seeks to advance America's global leadership in capital formation by supporting diverse capital markets that are the most fair, transparent, efficient, and innovative globally. CCMC advocates for American businesses to ensure that legislation and regulation strengthen our capital markets so that businesses—from the local flower shop to a multinational manufacturer—can mitigate risks, manage liquidity, access credit, and raise capital. Among other things, CCMC advocates for appropriate and balanced banking regulations that maintain financial stability while also allowing businesses of all sizes to obtain capital and credit to expand and succeed. Banks are vital intermediaries for all businesses seeking capital and credit.

CCMC regularly surveys corporate treasurers and other financial decision-makers at U.S. businesses to understand their economic outlook and their views on regulation. The survey provides an inside view of how financial regulation impacts small to large businesses and their ability to access capital and expand. Working with Teneo Research, CCMC surveyed 300 corporate finance executives including Treasurers, Deputy Treasurers, Controllers, Chief Financial Officers, and Chief Executive Officers (small businesses only). The survey data was collected between June 28, 2023, through July 27, 2023. While CCMC intends to make the results public soon, some initial findings are included in this statement, namely that the Basel III Endgame regulations, which would require covered banks to hold more capital, may come with considerable costs to their business customers on Main Street and could have a material impact on the U.S. economy.

Small Businesses & Economic Growth

The heart of America's economic strength is ignited by small businesses, which power innovation, create jobs, and build communities. While modest in size, these small businesses contribute substantially to our nation's economic might. Small business success is essential to our economy and to the livelihood of millions of Americans.

As of April 10, 2023, there are 33.2 million small businesses in America.[1] This accounts for 99.9% of all U.S. businesses.[2] These small businesses are the backbone

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1https://www.uschamber.com/small-business/state-of-small-business-now

of our economy, commanding a significant role in shaping our nation's gross domestic product. In 2019, small business output contributed to 44% of our nation's economic activity.[3] Since 2017, the number of small businesses has grown by 12.2%.[4] Collectively, these small businesses have a major role in shaping our nation's economic landscape.

Small businesses provide vital employment opportunities in every community across America. Small businesses are credited with creating almost two-thirds (63%) of the new jobs created from 1995 to 2021.[5] These small businesses also employ almost half (46%) of America's private sector workforce.[6] American small businesses create jobs that breathe life into local communities and help bolster America's workforce and economy.

America's small businesses are pivotal to driving innovation that catalyzes economic growth and help us build a competitive edge that allows us to compete globally. Today's small businesses produce more than 14 times as many patents as large businesses and universities and employ nearly 40% of America's scientists and engineers.[7] These enterprises help drive forward our economy by introducing new ideas, products, and services. The collective effort of small innovative businesses plays a crucial role in strengthening our economy and helping solidify America's position as a global innovation leader.

U.S. Chamber Survey of Corporate Treasurers Views on Financial Regulation

The Chamber has periodically conducted surveys of corporate treasurers to gauge the outlook and concerns of Main Street businesses in the United States and to assess the ways in which businesses—large and small and from every geographic region in the country—use the financial system to meet their needs. These surveys also examine how regulatory policy is impacting the ability of businesses to raise capital, manage their cash, and invest in long-term projects. The Chamber conducted previous surveys in 2013, 2016, and 2019. The Chamber will soon release the results

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[4] https://www.oberlo.com/statistics/number-of-small-business-in-the-us#:~:text=The%20increase%20in%20the%20number,percent%20from%202017%20to%202022.
[5] https://advocacy.sba.gov/2023/03/07/frequently-asked-questions-about-small-business-2023/#:~:text=From%201995%20to%202021%2C%20small,percent%20of%20private%20sector%20payroll.
[6] https://advocacy.sba.gov/2023/03/07/frequently-asked-questions-about-small-business-2023/#:~:text=Small%20businesses%20employ%2061.7%20million,percent%20of%20private%20sector%20payroll.
[7] https://www.sbc.senate.gov/public/index.cfm/innovationresearch

of its 2023 survey.[8] High-level findings have been adapted from the survey for inclusion in this statement.

This year's results again demonstrate that changes to financial regulations can inhibit the ability of companies to soundly manage their finances. Many businesses have been forced to take undesirable actions in response to costs imposed by certain regulations. And businesses expressed concern about pending regulations including the Basel III Endgame.

Businesses did not report they were overly concerned about the stability of individual banking organizations or the banking system, ranking this issue as number 8 out of 10 potential concerns.[9] This is notable given that the survey was conducted shortly after Silicon Valley Bank and Signature Bank were put into receivership in March 2023, which caused some volatility in the banking system. In fact, businesses ranked cyber risks and uncertainty resulting from new financial regulations as higher risks to the economy than the stability of the banking system.

A key principle regarding financial regulation is that many of the costs imposed on financial institutions by new rules are ultimately borne by the customers of those institutions, including Main Street businesses and other end users within the economy. This has been especially visible over the last decade, as rules stemming from the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act have taken effect, and as federal financial regulators have recently embarked on an increasingly aggressive regulatory agenda.

- A striking **87%** of businesses have been negatively impacted by cost increases resulting from financial regulation. This includes **46%** of companies that have delayed or cancelled planned investments or capital expenditures due to regulations, **40%** that have decreased the types of services offered to customers, and **49%** that have substituted or reduced the number of banks or financial institutions that provide services to them.
- **Over one-third** of businesses report that they have raised costs due to financial regulation, which indicates that certain financial regulations may actually be a driver of inflation throughout the economy, one of the top economic risks identified by businesses.
- While businesses across industries report they are negatively impacted by regulations, actions taken in response to certain rules vary by industry. For example, businesses in the retail sector are more likely to absorb higher costs

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[8] The survey data was collected between June 28 and July 27. We anticipate publishing the final report by October 1, 2023. Teneo Research conducted a national survey of 300 corporate finance executives (Treasurers, Deputy Treasurers, Controllers, CFOs, small business owners) that was fielded online and via mobile telephone. The credibility internal for this study is +/-5.7% at the 95% level of confidence.

[9] Survey Question: Over the next 12 months, what do you see as the most significant risks to your company? (Rank Answers): Taxes, Inflation, Interest Rates, Trade/tariffs, Cyber risks, geopolitical risks causing market fragmentation, dealing with uncertainty over new financial regulation, stability of individual banks or the overall banking system, restrictions on credit offers from banks and other lenders, transition from LIBOR and other IBORs to risk-free rates)

and feel exposed to greater financial risk because of regulation. Energy and mineral companies are more likely to reduce product or service offerings due to financial regulation, while manufacturers are more likely to be forced to pass on higher prices to customers. Only **13%** of retailers, **16%** of energy/mineral companies, and **17%** of manufacturers report that costs have not increased as a result of financial regulations.

Businesses express major concerns over pending changes to the Basel III capital and regulatory framework.

- **68%** of businesses say a net increase in capital requirements on banks could be damaging to their business.
- **77%** of businesses are concerned that investment grade private companies will be treated less favorably than investment grade public companies under the new Basel III framework.
- **53%** of businesses believe that the costs under Basel III related to interest rate swaps could make it more difficult to manage currency risk.
- The overwhelming majority of businesses also support treating banks equally when it comes to cross-border financial regulation, with **90%** saying that foreign banks operating in the U.S. should be treated the same as domestic banks, and that U.S. banks operating overseas should be treated the same as local banks operating in those markets.

These concerns regarding Basel III Endgame are even more heightened for small and medium-sized enterprises ("SMEs"): over **80%** are concerned about unfavorable treatment for investment grade private businesses, while **nearly three-fourths** of SMEs are concerned about the impact of higher capital requirements on their business.

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision ("BCBS"), established in 1974 by the central bank governors of the G10, serves an important role as an interlocutor among banking regulators around the globe. The BCBS helps to shape global banking standards and collaborates to establish guidelines for banking supervision, capital adequacy, and risk management. These guidelines developed by the BCBS can be informative for developing regulation in the U.S. and other countries' jurisdictions to help avoid regulatory fragmentation and a potential "race to the bottom." The standards agreed to by the BCBS are not part of a treaty, and while U.S. banking regulators – the Board of Governors of the Federal Reserve System ("Board"), Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") – participate in the standard setting process, they have no legal obligation to issue regulations that implement the standards.

The Federal Reserve Board's Holistic Capital Review & the Basel III Endgame Proposal

In Michael Barr's first public speech after he was confirmed as Vice Chair of Supervision of the Board, he announced that the Board would conduct a "holistic review" of bank capital standards that would inform potential changes to capital requirements, including the final implementation of the Basel III Endgame.[10] The Chamber sent a letter to the Vice Chair on May 3, 2023, advocating for transparency in the Board's holistic capital review and urging the Board to provide an opportunity for the public to examine its findings given our concern about what any material regulatory changes for banks could mean for the Main Street businesses that they serve. Importantly, the letter requested that the Board make available the data and methodology used to reach its findings before proposing a rule to implement any new capital standards. On July 27, 2023, U.S. banking regulators jointly issued the Basel III Endgame proposal in a regulation that would significantly increase capital requirements for U.S. banks without first making the results of the holistic capital review available to the public.[11]

U.S. banking regulators have not justified why the substantial capital increase contemplated in the proposed rule is necessary. In fact, Board members have expressed in recent years that a material increase in capital is not necessary to support the stability of the U.S. banking system or to faithfully implement the Basel III Endgame standards.

- Jerome Powell, Chair, stated during a recent hearing of the House Financial Service Committee hearing, *"I think the overall level of capital, particularly at the largest firms, is about right."*[12]
- Randy Quarles, former Vice Chair for Supervision, noted in a speech with his departing thoughts, *"What policymakers will need to do as they implement the Basel III reforms is determine whether adjustments to other parts of the capital framework are necessary to ensure that we do not unduly increase the level of required capital in the system."*[13]

This difference of opinion among Board members regarding whether current bank capital levels are sufficient or need to be increased warrants further examination of the data the Board is relying on in its issuance of the Basel III Endgame proposal. Had the information from Vice Chair Barr's holistic capital review been made publicly available, then third parties could independently analyze it and make those perspectives available to policymakers. Regrettably, neither the Board nor Vice Chair Barr have made that information publicly available, keeping it instead shrouded under a cloak of unnecessary secrecy.

The Basel III Endgame Proposed Rule

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[10] https://www.federalreserve.gov/newsevents/speech/barr20220907a.htm.
[11] E.g., https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.
[12] https://www.americanbanker.com/news/capital-levels-are-just-right-powell-tells-house-members
[13] https://www.federalreserve.gov/newsevents/speech/quarles20211202a.htm

U.S. banking regulators jointly issued the Basel III Endgame proposal on July 27, 2023. The rule, which is intended to implement the final Basel III capital framework developed by the BCBS, would revise the risk-based capital framework applicable to banking organizations with at least $100 billion in total assets and their depository institution subsidiaries and to banking organizations with significant trading activities. The proposed rule would increase capital requirements for most covered banking organizations and eliminate the ability to use internal models to calculate capital requirements for credit and operational risk. Instead, internal models would be replaced with standardized approaches. Additionally, the proposal includes an expanded risk-based approach with a new set of standardized requirements for calculating credit, operational, and market risk. Covered banking organizations must also include unrealized gains and losses on available-for-sale securities. If implemented, this proposal would require a material increase in capital for the 8 U.S. global systemically important banks, 22 larger and midsized U.S. bank holding companies, 10-12 U.S. intermediate holding companies of foreign banking organizations, and 7-10 other U.S. banking organizations.

Real-World Impacts on Main Street Companies of Increasing Bank Capital Requirements

The Basel III Endgame proposal will indirectly impose costs on Main Street companies in numerous ways given their dependence on a robust and vibrant banking system. Banks provide countless services to businesses ranging from payments and lending, cash management and investment advice, raising debt and equity from investors in the capital markets, accessing products to hedge market risks, and advising on the financial strategies to help businesses of all sizes grow and meet their full potential. If costs are imposed on banks through an increase in the capital they are required to hold, there is a high likelihood that they will have to cease providing certain services or pass at least some of the new costs on to their customers.

The following hypothetical scenarios illustrate how the Basel III Endgame proposal could impose new costs on businesses that depend on access to the banking system and capital markets.[14]

Credit Risk.

The Basel III Endgame proposal would replace internal-models-based capital requirements for credit and operational risk currently with new, risk-sensitive standardized requirements that would apply to all banking organizations with $100 billion or more in total assets. These "standardized" requirements mean banking

[14] These are only hypothetical examples and do not take into consideration how the Basel III Endgame proposal may impact individual banking organizations differently, how the banks may change their operations to comply with the regulation, or how different bank customers may be impacted given their relationship with an affected bank.

organizations are generally not permitted any discretion when determining credit risk and the capital they have to hold for an individual loan, including a loan to a business, regardless of their business model, risk profile or individual footprint. Instead, these loans will be subject to standardized risk-weights that may not accurately reflect the discrete credit risk of a borrower. This is above and beyond international Basel III Endgame standards which limit but still allow internal models.

- ***Commercial Loan.*** The Proposed Rule would require that, for a corporation to be eligible for a reduced credit-risk-capital requirement as "investment grade," the company or its parent must have securities outstanding on a public securities exchange. For example, this would mean that a company that is all-else-equal in terms of credit risk (demonstrated history of repayment, predictable cashflow, strong assets and manageable liabilities, etc.) a bank would have to subject any credit exposure to a higher capital surcharge. This higher capital surcharge to the bank would likely mean it has to reduce its credit exposure or offer less favorable terms to the private company than it would to an otherwise identical public company.

Operational Risk.

The Basel III Endgame proposal would replace the models-based advanced approaches for operational risks with a new set of standardized approaches. The operational risk capital requirements under the expanded risk-based approach would be based on a banking organization's business volume and historical losses. Sources of operational risk are those attributable to running the bank (e.g., management decisions, external events like litigation, failure of a critical system like a computer network).

The capital requirements are especially punitive to banks that offer products that rely on fee income (as opposed to interest income) that cannot be offset by a reduction in expenses. Therefore, the capital requirements somewhat perversely disincentive banks from diversifying their income streams to include products other than lending. A bank is subject to less operational risk exposure if it offers fewer products/services. Banks therefore may be incentivized to limit the availability of or increase the cost of products that use fee income.

- ***Initial Public Offerings.*** Businesses work with investment banks to help them access the public markets in order to expand the number of investors that are legally permitted to purchase their stock. Businesses can benefit from going public given it expands their investor base by selling shares to the general public. Expanding the potential demand for a stock can mean lowering the businesses' cost of capital. Investment banks charge fees to support businesses accessing the public markets to value the shares, market the shares, and cover the risk of carrying the shares on their balance sheet until sold to investors. The Basel III Endgame proposal may increase banks' fees, diminishing the benefit of the capital raise and potentially discouraging the startup from going public. The Basel III Endgame proposal may increase the cost of going public and therefore deprive investors of the ability to invest early in growing companies.

Market Risk Capital Requirements

The proposal also would replace the current market risk framework with a new standardized methodology for calculating risk-weighted assets for market risk and a new model-based methodology. The increase in capital requirements is most severe under this aspect of the proposal. Governor Waller pointed out in his dissent, *"It is not clear to me why our large banks should face a further roughly **70 percent** hike in market risk capital requirements, on top of the existing post-crisis requirements to address risks in the trading book, including market risk capital requirements plus the stress test."*[15] (emphasis added)

- ***Corporate Debt Issuance.*** Businesses depend on banks to provide liquidity in the market for corporate debt. A reduction in liquidity for corporate debt would mean borrowing costs for corporations would increase. If there are fewer banks willing to buy and sell corporate debt, the market will price in a "liquidity premium," which translates to an increased cost a bank will charge to hold the asset because there may be fewer buyers willing to purchase it at a future date. This is validated by research recently published by PwC ("Basel III Endgame: The Next Generation of Capital Requirements") finding, *"[t]o meet higher capital requirements, banks may reduce their trading inventories, thereby lowering market liquidity."*[16] In other words, if there are fewer market makers, the secondary market will become less liquid and will create concern with investors about their ability to buy or sell the bonds quickly and at a fair price.
- ***Interest Rate Risk.*** Businesses may be subject to financial risk due to changes in interest rates, especially if the changes are unexpected. One way to manage interest rate risk is through interest rate swaps, an agreement between two parties to exchange one stream of interest payments for another over a defined period. For example, life insurance companies are major investors in long-dated bonds with fixed interest rates because these assets are seen as low-risk and match the maturity of their long-dated liabilities.[17] If interest rates were to unexpectedly increase, the price of these bonds would decrease. To manage this risk, life insurance companies oftentimes pay a premium by purchasing a fixed-to-floating interest rate swap. With the proposed Basel III Endgame rules in place, that swap may be more costly to the business due to fewer banks offering the product or banks passing on additional cost of such activity to the business.
- ***Commodity Price Risk.*** Businesses may be subject to financial risk due to commodity price instability. For example, the margins of a regional airline or trucking company are dependent on the price of fuel. These types of companies purchase futures contracts to hedge the price of fuel (e.g., they pay today to have a guarantee they can purchase the fuel at the same price in the future). These types of contracts will become more expensive for banks to offer.

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[15] https://www.federalreserve.gov/newsevents/pressreleases/waller-statement-20230727.htm#:~:text=It%20is%20not%20clear%20to,requirements%20plus%20the%20stress%20test.

[16] https://www.pwc.com/us/en/industries/financial-services/library/basel-iii-and-banking.html

[17] https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/03/CCMC_InsurancePaper_v2.pdf

Inadequate Cost-Benefit Analysis

The "Impact and economic analysis" section of the Basel III Endgame proposal inadequately addresses the potential costs and benefits of the rulemaking. A cost-benefit analysis should not be an informal ledger of pros and cons, but rather a detailed and quantitative undertaking that measures how the regulatory proposal impacts covered entities and the markets in which they operate. Regrettably, the cost-benefit for the proposed rule fails to meet the bare minimum required for major rulemakings and especially for a rulemaking with such a significant impact on an individual sector and the overall economy.

Specifically, the agencies fail to adhere to numerous cost-benefit analysis requirements, including:

- **Executive Order 13563**. In reaffirming certain principles in President Clinton's Executive Order 12866 of 1993, Executive Order 12563 includes a provision that requires agencies promulgating rules to "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs."[18] The order goes on to provide that "each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible." Consistent with this approach, and despite its status as an independent regulatory agency, the Board, for example, has stated that it "continues to believe that [its] regulatory efforts should be designed to minimize regulatory burden consistent with the effective implementation of [its] statutory responsibilities."[19]
- **The Riegle Community Development and Regulatory Improvement Act ("Riegle Act")**. This law applies to all federal banking agencies defined by cross-reference in Section 4801 of the Riegle Act to include the OCC, FDIC, and Board. The Riegle Act mandates that *"[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and* ***customers of depository institutions****; and (2) the benefits of such regulations."*[20] (emphasis added)

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[18] Executive Order 13563—Improving Regulation and Regulatory Review (January 18, 2011). Found at: https://obamawhitehouse.archives.gov/the-press-office/2011/01/18/executive-order-13563-improvingregulation-and-regulatory-review 8 The White House proposed changes to Circular A-4 on April 26, 2023. The US Chamber of Commerce issued a statement expressing our objections (April 7, 2023), available at https://www.uschamber.com/regulations/u-s-chamber-opposes-changes-to-regulatory-cost-benefitanalysis-that-would-unleash-more-regulatory-overreach

[19] Letter from Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., to Cass Sunstein, Administrator, Office of Info. And Regulatory Affairs, Office of Mgmt. and Budget (Nov. 8, 2011), available at https://www.federalreserve.gov/foia/files/regulatory-burden-reduction-111115.pdf.

[20] 12 U.S.C. § 4802(a) (emphasis added).

The cost-benefit analysis in the proposal suffers from a strawman argument that is far from subtle: increasing capital requirements will make individual banks and the banking system more stable. No one disputes that capital is necessary to address any number of unexpected shocks an individual bank may occur and that banks may not be able to properly address those shocks with insufficient capital. But the regulatory agencies have failed to demonstrate through empirical analysis or otherwise why the current capital levels are inadequate, as discussed above.

Moreover, identifying a benefit is only an initial step of a proper cost-benefit analysis. The relevant question, rather, is what level of capital is *optimal* so that the marginal benefits (i.e., limiting the risk of bank failure or systemic risk) exceed the marginal costs (e.g., limiting, or increasing the cost, of the financial products/services a bank can make available to its customers). The Basel III Endgame proposal only provides a cursory and conclusory analysis of the costs of the proposal.

For example, the "Impact and economic analysis" section includes only sparse discussion of the attendant costs of the regulation. It mentions that the credit risk and operational risk frameworks could cause a *"slight reduction in bank lending"* (page 498) and *"small changes in loan portfolio allocations"* (page 498). And, the proposed market risk framework *"could also increase banking organizations' costs of engaging in market making activities"* (pg. 489). The economic impact assessment, similarly, only measures the estimated increase in capital required and does not attempt to measure that impact on lending and market making, despite issuing statements suggesting this would be minimal.

The "Impact and economic analysis" section also jumps to the conclusion that, *"While quantification of the economic costs and benefits of changes in bank capital is difficult and highly contingent on the assumptions made, current capital requirements in the United States are toward the low end of the range of optimal capital levels described in the existing literature. On balance, this literature concludes that there is room to increase capital requirements from their current levels while still yielding positive net benefits."* (Pages 496-497). The conclusion is based on academic literature that generally speaks to the optimal level of bank capital and is not specific to the proposed regulations. This academic literature is informative but cannot serve as the basis for the agencies' conclusion or as a substitute for the agencies' own quantitative analysis. The Board alone employs just over 400 Ph.D. economists[21], the OCC employs over 50 Ph.D. economists[22], and the FDIC employs approximately 25 Ph.D. economists[23]. But instead of relying on some portion of close to 500 Ph.D. economists fully capable of undertaking a comprehensive quantitative analysis in a significant rulemaking with a potentially major impact on the U.S. economy, it appears the agencies are simply citing academic research that fits their preconceived conclusion that the marginal benefits exceed the costs.

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[21] The Fed - Economists (federalreserve.gov)
[22] Meet Our Research Economists | OCC (treas.gov)
[23] FDIC: Center for Financial Research - Externally Published Research

Undermines Regulatory Tailoring under The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018

The Basel III Endgame proposal undermines bipartisan legislation enacted by Congress in 2018 that directs regulators to embrace a risk-sensitive approach applying to capital requirements and prudential standards. The Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") requires, among other things, that many regulatory requirements be tailored based on *"capital structure, riskiness, complexity, financial activities (including financial activities of subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate."* Senator Mike Crapo, the lead sponsor of the legislation, stated in a hearing after the legislation's enactment that, *"This law's primary purpose is to make targeted charges to simplify and improve the regulatory regime for community banks, credit unions, midsize banks and regional banks to promote economic growth."*[24]

The Chamber supported this legislation and the regulatory proposals that tailored the regulatory frameworks to which banking organizations in the U.S. are subject. In one statement, we noted, *"[t]his legislation will bring a long-awaited respite to Main Street businesses across America whose growth has been stifled in the post-crisis regulatory era. It's a commonsense solution brokered through collaboration and compromise that ensures businesses have access to the loans and other financial services they need to get off the ground, create jobs, and expand."*[25] We supported regulations finalized in 2019 that had the intended effect of tailoring regulations based on risk, and reduce unnecessary costs for businesses accessing the banking system, stating that, *"[t]he Chamber believes the Proposals will alleviate many of the financing concerns that have been raised by Main Street businesses with the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act and other regulatory initiatives in the wake of the 2008 financial crisis."*[26]

In 2019, the Board, OCC, and FDIC jointly issued tailoring rules embracing the regulatory tailoring as directed by the Economic Growth Act.[27] The rules establish a framework that sorts banking organizations with $100 billion or more in total assets into four different categories based on several factors, including asset size, cross-jurisdictional activity, reliance on short-term wholesale funding, nonbank assets, and off-balance sheet exposure.

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[24] https://www.banking.senate.gov/newsroom/majority/crapo-statement-at-hearing-on-implementation-of-the-economic-growth-regulatory-relief-and-consumer-protection-act-s-2155

[25] https://www.uschamber.com/regulations/us-chamber-president-praises-senate-passage-bank-relief-legislation

[26] http://www.centerforcapitalmarkets.com/wp-content/uploads/2019/01/1.22.19-Comments_ApplicabilityThresholds_OCC.Fed_.FDIC_.pdf?#

[27] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm#:~:text=The%20Federal%20Reserve%20Board%20on,largest%20and%20most%20complex%20banks

Banking organizations in a category with higher risks (e.g., larger asset size, more cross-jurisdictional activity) are subject to more prescriptive prudential regulation. The Basel III Endgame proposal, with little to no justification, moves to unwind work completed by the banking regulators just four years ago. Travis Hill, Vice Chairman of the FDIC, noted in his dissent that, *"[t]he Proposal undoes almost all of the tailoring of the capital framework for large banks, is a repudiation of the intent and spirit of [the Economic Growth Act]."*[28]

Undermining the regulatory tailoring required by the Economic Growth Act could reduce market competition and lead to further consolidation in the banking sector. The total number of banking organizations in the U.S. has steadily decreased, and regulatory thresholds have likely contributed to consolidation as banking organizations seek to achieve economies of scale. In her dissent, Board Governor Michelle Bowman stated, "*I am also concerned that today's proposal moves one step closer to eliminating the tailoring required by [the Economic Growth Act] from the prudential capital framework. The consequences of increasing capital requirements for all firms above $100 billion in assets may be to force smaller firms to merge or consolidate, to achieve the necessary economies of scale to comply with higher capital requirements. Ultimately, this may harm competition and reduce banking options in some geographic or product markets.*"

Conclusion

The Basel III Endgame proposal is not a *fait accompli* that must simply be adopted by regulatory agencies that participate in the Basel Committee on Banking Supervisions. U.S. banking regulators proposing to implement the standards must take into consideration the legal frameworks in which they operate, their congressional mandates, and the unique aspects of the banking system they regulate.

There is no dispute that capital is important to maintaining a healthy banking system, but policymakers must not only tailor capital requirements to the risks posed by varying types of banks but also consider the tradeoffs of additional capital requirements for such banks as well as their customers and the U.S. economy. These tradeoffs to higher capital can come in multiple forms, including making it more expensive for businesses to access the banking system and capital markets. Increasing costs on banks may cause them to limit what products and services they offer to businesses or cause them to increase the prices.

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[28] https://www.fdic.gov/news/speeches/2023/spjul2723b.html

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