

THE BROOKINGS INSTITUTION

CAN AMERICA GETS ITS ENTREPRENEURIAL GROOVE BACK?

A DISCUSSION ABOUT PRIVATE CAPITAL'S ROLE IN THE ECONOMY

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**Closing Keynote: How to Bridge the Cultural Divide Between
Entrepreneurs and Policymakers**

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P R O C E E D I N G S

MR. LERNER: So, let me -- we're doing a little software upgrade here. I'll just tell you I have the honor of introducing Karen Mills. She is, as you all know, the administrator of the Small Business Administration.

Prior to running SBA, she served as the president of a private equity group called MMP Group, and prior that, the director -- founding partner and director of Solera Capital, whose primary focus was in investing in women-owned businesses.

She's got many honors including her alma mater and my employer, Harvard Business School. So, assuming the technology is ready --

SPEAKER: It's not.

MR. LERNER: It's not. Okay.

SPEAKER: We had this earlier problem, but we have a back-up plan.

MR. LERNER: We've got a back-up plan. This reminds me of some of the technological difficulties we encountered in our day. Our previous dean at Harvard Business School didn't like to invest in computers. He used to be a forest ranger, so we kept on upgrading the software, layer after layer, until one time trying to do an Excel spreadsheet and the little old IBM XD that we had caught fire, started smoking. (Laughter)

In any case, this looks more promising. In fact, it looks really good.

Without further ado, thanks again.

MS. MILLS: That was impressively done. Thank you very much.

Well, thank you for the kind introduction and I am quite delighted to be here. The first thing I have to say is happy National Entrepreneurship Week and National Entrepreneurship Month. The President proclaimed this National Entrepreneurship Month, but -- is Bob still here? Bob Litan? -- yup, you, at Kauffman, have declared this and led the charge and really initiated National Entrepreneurship Week, so thank you.

I come, as Josh was saying, from the private sector, so -- and from the world that has been discussed this morning, and I'm particularly glad to be here at Brookings because it was through Brookings that I started my slippery slope into the current job. I was involved in the great state of Maine, where I live, in some economic development and job creation clusters, and Brookings came and I ended up writing a paper on clusters for Brookings, came on the transition team, and now have the great pleasure of leading the Small Business Administration.

I want to talk today about three things: the sort of subtitle -- the title here is "Entrepreneurship and Creating Small Business Jobs," the subtitle is "Where have the jobs gone and how are we going to get them back?" And I want to tell you a little bit about some of the specifics we've been able to do at the SBA, articulating some of this public-private partnerships that were discussed today, and then most importantly, going forward, what are these strategies? What are the strategies for being on the 40-yard line, working in partnership between the federal government and the private sector, particularly in this

industry, so that we can do more job creation and drive more entrepreneurship and more innovation?

So, first, the facts about small business. Half of the people who work for this company -- for this country, work in this country, own or work for a small business. So, half the jobs are either people who are involved in running and owning the business or working for the business, and 65 percent of the net job creation comes from small business.

Now, about 28 million, this number goes up and down, small business, only about 6 million of them actually have employees. So, we're going to talk about the force of small business, both the high-growth entrepreneur sector and the Main Street small businesses and what they have experienced in this economic downturn.

If you look at what happened in the recession, small businesses just got crushed and they haven't recovered yet, so the red line is the small businesses, 62 percent of the net job loss came from the small businesses, and things have gotten better but they started dipping back down, particularly in the summer, with that lack of business confidence -- there was a crisis of confidence really across the country in the middle of the summer and small businesses really have yet to recover.

If you look at where in the small business world those job losses came, 32 percent of them came from the smallest businesses. If you look at the whole dip was about 7.7 million jobs, 137 down to about 130 million jobs, and 2.5 million of those came from small employers, 1 to 19 employees.

So, these are both new and starting businesses, growth businesses, and, importantly, they're also Main Street small businesses and we know that these are the firms that really drive job creation.

And one last major chart on the macro picture, these are births and deaths, so this underlines some of the points that were made earlier. There's a big gap, an unusually big gap, that occurred in births and deaths. Failures just accelerated and births just stopped. Now, the two -- the gap is getting back together, but there's still a gap and we are not at the level of new business creation that we need to be. And that's really illustrated by this, one of, I think, the most powerful charts on small business job creation. We are down 100,000 new starts. Our economy, day-in, day-out, year-in, year-out, in the past, even in recessions, has created about 600,000 new businesses every year. And now we're down to 500,000.

So, this has the impact -- I know there's a lot of talk about is it new firms, is it young firms, is it entrepreneurs -- but we know that this number, according to McKinsey, and I think the team that did this actually was here in the room, this drop in 100,000 new starts is likely to have accounted for about 1.8 million of the 7 million gap -- 1.8 million.

So, why are these new firms not starting? Maybe the failures are tapering off, but we're not starting the new firms.

So, switching gears for a second, with that background, what's the SBA's role? What does an agency like the Small Business Administration do in this environment? We came in in October 2008, we had seen just a credit

crunch. We come in around the beginning of 2009 and what do we do? It's our job to fill the gap, particularly in capital, and many of you probably don't know what the SBA does. We have a portfolio of \$90 billion of loan guaranties and we are partnered with about 5,000 of the 7,000 banks that are out there. We tend -- we usually are guaranteeing these loans as opposed to making them directly, so, public-private partnership, big public-private partnership.

And we have a big role in the area of private capital. We run about 150 Small Business Investment Companies, SBIC, we have about a \$3 billion annual authority to put money into those SBICs and right now we have about \$11 billion outstanding capital in those companies. They perform very well and provide a pretty good return for taxpayers. They are zero subsidy. Zero subsidy, so no current cost to taxpayers because, of course, the companies do well and pay for the losses.

So, this brings us to what have we been doing with this portfolio at the SBA? And coming back to the current crisis, when the recession hit in October 2008, the credit markets, for small businesses, just froze. You can see that right here we're still down \$100 billion in credit to small business.

Small businesses were lucky if they were able to keep their lines of credit. I was traveling all around the country. They'd say, I need a loan to save my business. Good businesses had their credit lines pulled. And if you look at what was happening in the credit standards, they were tightening for a very long period of time. This is the net percent of credit officers that said that they were tightening that quarter.

So, they're tightening, tightening -- 75 percent of them said they were tightening at some point. Now it's gone positive, that means a net 9 percent say they're loosening. But that means there's a lot still tightening and only a net 9 percent are loosening.

So, we are working very hard on this. I am partnered with the FDIC. Sheila Bair and I spend a lot of time on this issue and with the Fed trying to tell banks that the credit standards that were set on small business, the guidance, needs to be executed at the regional levels, that it can't -- the pendulum can't swing so far that good credits are not getting funded.

What did we do at the SBA at this period of time? Well, we stepped into the gap because, remember, we give a guaranty, a government guaranty, which helps a bank make a loan that they would not otherwise have made. If you're a small business and you can get credit from the marketplace, then the market is working. Why should taxpayers subsidize your business? But if you're a good business and you cannot get credit elsewhere, that's where the SBA steps in.

Well, I'm pleased to give you our report card because we just had the biggest year ever in SBA history, we had a record year. We did \$30 billion in loan guaranties in this fiscal year just ended and you can see in the background that gray line is our actual monthly volumes. It goes up and down, up and down because the first thing that happened is we're in 2008, credit markets drop in '09, the bottom just falls out, we come in with the Recovery Act, we raise our guaranties to 90 percent, we reduce and eliminate the fees, and our volume

comes roaring back. So, this is a great example about being on the 40-yard line, as I heard was discussed earlier. We were there with a government guaranty program, pretty good bang for the taxpayer buck, only cost us about \$1 billion+ to do \$30 billion in loan guaranties, and 5 times Congress came back and renewed this program, 5 times, ending in the Small Business Jobs Act about a year ago last fall, and we had the biggest quarter ever and were able to really deliver this record year.

So, we're very happy that we're on track now to be above the levels of credit delivery that we were even in 2008.

Another area -- and I'll come back to where the gaps still are, but I just want to move to an area of great interest in this room, which is, so what's happening in the more patient capital, the earlier stage capital? Nothing good. Nothing good for our small businesses. There was a decline in venture capital fundraising, there was a decline in the amount of capital going out. Fundraising is down 131 percent. It's down \$17 billion. And venture capital investments into companies, down 31 percent. So, all of that patient capital disappears and the valley of death gets wider.

So, as the federal partners, what do we do about it? Well, remember our Small Business Investment Companies. What we did is ramp up that program. We have \$3 billion of authorization and less than a third of it was being used every year. What we did in this last year was significantly increase our commitments through our SBICs, both the money into the SBICs and the money out of those SBICs into the marketplace. And this is -- the \$26 billion is a

record year for us. You can see how much is us and how much is the private commitment.

So, once again, an operating public-private partnership, these are investment funds run by investment professionals, so government is not making the decisions, but we are providing the support so that we get more funding out into these marketplaces.

How are we able to do that? Well, we did what everybody has been asking us to do in this Administration and the President has committed to do, we reduced the complexity without creating more risk. We took our licensing times down almost 15 months to 5-1/2 months and we licensed 22 new funds and we have very high applications from women-run funds and minority-run funds.

So, that's what's going on in the SBA of today, in answer to the gap.

So, then the question is, well, what are we going to do next? What are we going to do going forward? Because the problem is not solved. And this is where I want to come down to talking about three kinds of small business. We used to talk about two, but I've added some thoughts about supply chain, and you heard some great discussion about supply chain just in the previous panel, but we're going to talk about Main Street small business, what they're facing, we're going to talk about high growth-high impact small business that many of you fund, and we're going to talk about small businesses, particularly manufacturing businesses, in the supply chain.

First off, what's happening on Main Street? And the answer is, there's still a gap. Even though we are back up above our 2009 levels, there is a gap in small-dollar loans, under \$250,000, particularly under \$150,000, and there is a gap in underserved markets. So, even though minority-owned businesses are growing faster than ever, as are women-owned businesses, we are not getting the capital into these markets and they're not getting access and opportunity, and therefore, unemployment rates are high. Some of these are Main Street businesses -- restaurant opens, restaurant closes, failure rate; new restaurant doesn't open, new dry cleaner doesn't open, auto dealer, not open in some of these underserved communities. So, we've really got some work to do.

What are we doing? Well, there's a series of things that we're doing that involve more dollars and more doors. We've got a whole scheme of things but I'll just talk about a couple. We simplified our programs for small dollar loans. Too much paperwork, right? Too much cost to make a small dollar loan. We took our paperwork down.

I actually had this conversation. I delivered over at the White House, because they had a question on this, the stack of paper that was required before our change and the stack of paper that was required after our change. We're trying to use more of the bank's own paperwork and allow us less complexity, more streamlining, without increasing the risk.

We're also strengthening our micro loans, and then I particularly want to talk about this last thing. Just recently the Vice President and I went and announced that 13 of the largest banks, including Bank of America, Wells Fargo,

JPMorgan Chase, have committed an additional incremental \$20 billion into these markets, small business loans with particular emphasis on small loans in underserved communities. And that's another public-private partnership that is going to drive more capital where it needs to be.

And if you look at the whole range of equity, we are operating -- and we're not the only ones. Down at the bottom you'll see we have a great partnership with Tom Vilsack, the Secretary of Agriculture, using all of the rural development loan programs in the same context, but all the way from equity in our SBICs through the micro lenders, CDFIs is a Treasury program where we are now allowing them access to our 7A loan product. So, partnerships all across the federal government on access to capital and partnerships with the private sector as well.

So, that's the theme for us going forward and the idea is to make this network more seamless and easier to navigate for this small business and for the entrepreneur.

What else are we doing? Well, the second group I want to talk about are the high growth entrepreneurs, the ones that, by a lot of arguments, create lots of the jobs, maybe all the jobs. What are we doing for them? Well, there's a problem because entrepreneurship rates are down, and I think once again this is Kauffman data, but it's not a good trend. If you think that entrepreneurship is one of America's greatest assets, what are we going to do with this trend? We have to make sure that more people get access and opportunity to start their own business all across all of the various entrepreneurial

groups in America, and so we have a series of things that we're doing.

Many of you heard about Startup America. Startup America is a partnership with Steve Case and a whole set of private companies who are going to try to work on many of these parts of entrepreneurship.

I like to divide -- we divide things into three buckets at the SBA around access to capital, around counseling and mentoring that we think is equally important to giving somebody the capital is giving them the advice to accelerate their business, and then this third area you just heard talked about, what are we doing to drive innovation all across the administration? You heard quite a bit about that.

But I'll just point out a couple of these things. Michael Klein talked this morning about the SBIC Impact Fund and he helped us with Dow and we were able to partner with Dow in Michigan and the State of Michigan, the pension fund there, and create an impact fund just for an area which had been very hard hit, but has a lot of potential for entrepreneurial companies.

We also -- you heard about the crowd funding and many other things we're doing on access to capital with the SEC. We are working across the Administration on allowing small businesses to raise money in a broader way, to relax some of the SEC regulations and make them appropriate to small business, and Mary Schapiro has been a very good partner to small business in that endeavor.

On the counseling side, we are very excited about something called an entrepreneurial mentor core that we've been piloting, and this has to do

with the fact that, as once again shown by Kauffman folks, accelerating entrepreneurs with networks, with advice, with mentorship, is equally as important as the capital, and we are looking to expand that once again with private sector partners. There are many, many folks between Goldman Sachs and Blackstone and others who have stepped into this space, all the partners in Startup America are very interested, and we are trying to orchestrate this network. We actually funded the first piece of it in clean tech.

And then we have a whole series of things that we are doing -- oh, I want to mention student loan deferment. You may have heard the President talk and Arnie Duncan talk about what we are doing on student loans. Well, it turns out that the income-based deferment on student loans applies to budding entrepreneurs.

So, this is something, once again, we can do without new congressional authority or money, it's within the current authority. But we are promoting to young entrepreneurs that they can defer their student loans under this arrangement if they decide to become entrepreneurs and they're, of course, not getting a lot of income at the time.

We have a whole series of things we do around innovation. We run the SBIR program. Many successful companies have come out of that program. Actually, 25 percent of *R&D Magazine's* top 100 innovations were SBIR funded. It's \$2.5 billion. So, how do we make this more accessible? Well, the first thing we did is we created a website where you can go to one place and get 11 agency solicitations. That wasn't hard but hadn't been done before, so all

across these various activities we are working to deliver more access and more opportunity to money that already is in the system, that doesn't add to the federal budget, and that drives innovation.

Patent reform, as you know, just passed and this federal lab commercialization is something being driven by the Department of Commerce and Energy. There's enormous innovation in the federal labs and this is a whole set of programs to help pull it out.

So, I think one of the things we talked about in these public-private partnerships, all of these either involve or have the potential to increasingly involve a public-private partnership with, you know, the federal government squarely participating because we can bring enormous activity and enormous leverage just within these current program and still remain, as I said, on the 40-yard line, but driving down the field.

The last area I want to talk about is supply chain. Now, we've kind of added this as another kind of small business and you heard why earlier, but one of the reasons I like it is I come from a manufacturing heritage. That's really, you know, most of the businesses I bought for all those years were plastic injection molders and metal stamping and food processors and I'm a big believer in American manufacturing. And as I go all around the country, I see that we have opportunity in small manufacturing, but it needs some help right now.

You can see the hit that manufacturing took, 2.7 million jobs lost, but, you know, we're starting to add jobs in manufacturing, so we're on a good trend, and the question is, how can we accelerate that trend? The reason we

want to, it's not just because I love manufacturing. It's because the multiplier on manufacturing, as you see from the first bar in the bar chart, is the highest. Every dollar that you invest in manufacturing has the highest multiplier in terms of benefit for the economy.

So, we have put it in our head to do a series of things to help small manufacturers, particularly if they get into supply chains, because we know when they get into the supply chain they get more sales and more profits and hire more people.

So, these are a series of things that we are doing around small business and supply chain. We have a new financing product. I did say I was the only person, I thought, who was an SBA administrator who had ever had an asset-based loan, and we have just redesigned our asset-based lending product to have significantly less paperwork and be able to fund lots of these small manufacturers.

We also are partnered with the Department of Labor and the White House in something called Skills for America's Future, which is training for manufacturing. And I was out with the National Association of Manufacturers, so this is really a bipartisan effort, in Minnesota, to kick off the Skills program for precision manufacturing. We have all of these C&C machines, we don't have C&C operators. So, we need to make sure we build those skills.

And then we have a whole set of revenue generating and I will tell you my absolute favorite. How many of you know that the President announced about two months ago that the federal government is going to pay all of its small

business contractors in 15 days? Right? And I say this sometimes to a bunch of folks who are not small business-oriented and then say it to a crowd of small business people, the small business people all just break out and go wild because they know, you know. And others say, well, they were going to get it in 30 days, what's the big deal if they get it in 15? This is a permanent infusion of working capital and cash into a small business and they all know it.

So, this actually has gone out to the agencies and they have until this month to figure out how they're going to pay their small businesses in 15 days. Once again, this is the kind of thing that we can do right at this moment to do what is absolutely the most important -- there's \$100 billion of small business contracts every year. They're all going to get paid in 15 days, not 30 days.

So, these are the kinds of things that -- and this is -- I have to tell you, this is the President's -- one of the President's favorites and he can explain to you why it's good for small business and the cash flow.

We have some other things as well, including a big focus on small business exports that's been accelerating, and a very strong public-private partnership led by IBM on a portal to connect suppliers to some of the largest companies. And it's been Citigroup, IBM, Pfizer, Bank of America all signed up to do some of their purchases through this portal.

So, this is another way we can drive revenue into the hands of small businesses.

So, just to conclude a little bit, these are the gross jobs numbers. The small business ones look kind of like this. They don't have that little red

bump, but they lag, the data lags. That's something we could do, we could get data sooner on small business. But we still have not created enough jobs, still are in this area where we have to push on every lever that we have. And we're not going to wait for Congress. We're going to move ahead with the budgets we have, with the authority that we have, to drive capital, to drive tools, to drive help into the hands of these small businesses.

I was in Pittsburgh with the Jobs Council and with the President recently and he talked about entrepreneurship and he said, "The story of America's success is written by American entrepreneurs, men and women who took a chance on a dream and turned that dream into a business and somehow changed the world." This is right after Steve Jobs died.

You know, I'm somebody who grew up in a family of entrepreneurs. My grandfather came to this country, started a business. I grew up with that notion that what you do is you come here and you build a business, and that those are the dreams that we have to support, even as we come out of one the toughest recessions that this country has ever seen. So, it's up to you and to me and to all of us in these public-private partnerships to make sure that these dreams can come true and that we can build a prosperous and entrepreneurial America.

Thanks very much. (Applause)

MR. LERNER: Thanks so much. Do we have time? I think we have five minutes or so for some questions?

MS. MILLS: Absolutely. I'd be happy to take some questions. I'm

going from here to film a promo for Small Business Saturday, which means I get to go shopping. I hope all of you will take a moment to consider where you will shop on the Saturday after Thanksgiving and maybe find a small business in your town and help them with some revenue.

MR. LERNER: So, let me start with the first question. People are either bashful or still processing all the information that you're getting.

How much do you see there being, essentially, a model in all the kind of activity in terms of incubator -- we talked earlier about why combinator, incubators, seed venture funds and so forth, which is clearly very narrowly focused today on Silicon Valley and social media companies. Is there, though, some sort of learning that we can take out of this that might in some way be able to be harnessed to help the greater mass of small businesses out there in the U.S. more generally beyond the sort of narrow confines of Silicon Valley and social media?

MS. MILLS: Right. Well, we love -- you know, I love Silicon Valley, but I almost never go there, and, you know, I go to Memphis and to Ohio and to Minnesota and to Pennsylvania, West Virginia, and you know what I find is incredibly interesting innovation and entrepreneurial companies.

And unfortunately, what, all 90 percent of the venture capital goes to 3 states? So, we have to, and this is classically a gap, and I say to the folks who say, what's the role of government? I say, to fill the gap. And we have some tools, but they aren't actually enough. And so one of the things that we are working very hard on is to take this model that you just described and see how

we can take the incredible energy in these accelerators and the capital that people like Starbucks want to put out, and the success of the micro loan programs and the state run programs, and create more of a continuum, because right now the hardest thing for the small business owner is to find their way. They just can't navigate. They're so busy, you know, trying to stay alive and trying to take that next step, and very often they don't have a road map. So, we need to get them the road map, the business plan, the counseling, the advice, the network, and those are different for a Main Street business than for a high growth business.

So, we've come to, I think, that point where we've identified a lot of models. We do things that we can do like convene, and I'm looking forward to convening all the top accelerators and many of the folks that you saw. We try to weave them together to give them access to programs we know that work. So, one of the things we learned is don't reinvent the infrastructure. Don't invent a brand new program. Build on one that's successful now. So, we took our 7A program and under it we put community advantage allowing CDFIs access to 7A loans. We take our micro loan program and got more intermediaries into it.

So, more simplicity, more streamlining, building on those things that work, I think answers the question of what's the role of government is to come in and provide access and opportunity and the ability to navigate.

MS. NGUYEN: I'm Genie Nguyen with Voice of Vietnamese Americans. I work with many Asian Americans Chamber of Commerce, and I actually have two questions. First, many ethnic minorities, especially women, are

trying to establish -- save their current business, but they don't know enough about your programs.

I sit in different classes held by Fairfax County Small Business for Women and they taught us to go on the Net and borrow money from -- there's a network on the Net and they charge like 35 to 45 percent interest rate on it, and these women don't know any better. They don't require credit or anything and they just go in and apply and they get the money, but very high risk. So, I think there's a need to reach out there to these people who have limited knowledge of your program.

MR. LERNER: So, the real question is about the education and --

MS. NGUYEN: The education.

MR. LERNER: -- just the skill levels are so disparate in terms of stuff.

MS. NGUYEN: Right. And then the second part of it is, I have my husband, who is in an engineering network for Quest Diagnostics and recently they cut half of the staff, not (inaudible), so because they wanted to save their money and half of the jobs are being cut. So, how do you save the current business, the current jobs, while you're trying to build the new ones?

MS. MILLS: Right. So, the first piece of this is really, I think, one of our greatest challenges, which is the entrepreneurial fabric of this country is increasingly diverse and the traditional pathways are very, very limited, as we talked about, so we need to be in every community and people in the Hispanic community, in the Asian-American Chamber have said to me they have business

opportunities, particularly on the mom-and-pop side, but sometimes on the high-growth side. We need to have a door in that community that they can walk through and have that door, whether it's a community development financial institution, a micro lender, have that door open to the next door. And that's what we're working on.

And it's complicated because there are many, many, many diverse pieces of this, but what everybody has realized in this recession is that this group has to have access and opportunities, so we are doing it by redesigning our website, SBA.gov, so you can put in, I'm a woman-owned business, I'm a veteran-owned business, I want to export, and we will help you navigate to the federal government program that has that activity.

We're doing it even further with a one portal platform called Business USA, which is going to be up in under 90 days and we're doing it on the ground, by link leverage and aligning both private sector partners, chambers, and our program.

But my biggest challenge is, nobody knows, and if they think about the SBA they think about the SBA of three or four or five or eight years ago, which was too much paperwork, too much time. And we have transformed it. We now approve loans in 10 days. So, how do we make sure that nobody is going on and accessing inappropriate capital when perhaps they would be eligible for one of our programs?

MR. LERNER: Right. So, thank you very much for taking the time out.

MS. MILLS: Thank you. Really appreciate it. (Applause)

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Carleton J. Anderson, III

(Signature and Seal on File)

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