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STATEMENT OF SENATOR JOSEPH C. O'MAHONEY, CHAIRMAN OF THE TEMPORARY NATIONAL ECONOMIC COMMITTEE, ON THE FINANCIAL PROBLEM OF SMALL BUSINESS.

An unusually thorough-going study of the problem of small business prepared by the Investment Banking Section of the Securities and Exchange Commission for the Temporary National Economic Committee is being sent to the Government Printing Office for immediate printing. This report contains the results of more than a year's study in Washington and throughout the country by the staff of the Securities and Exchange Commission under instructions from the Temporary National Economic Committee. Regional surveys were made at Portland, Oregon; Seattle, Washington; Denver, Colorado; Houston, Texas; Detroit, Michigan; Scranton-Wilkes Barre, Pennsylvania, and Fall River, Massachusetts. In each of these cities representatives of small business were invited to make their needs known and the information secured through personal interviews with businessmen in each of these cities has been used in the preparation of the report.

The material which has been compiled contains an apparently complete diagnosis of the problem of small business. Entitled by its authors, "The Financial Problem of Small Business", it might well have been called, "Decentralization of Business and the Encouragement of Free, Private, Enterprise."

It is clear from this study that the principal obstacle to the prosperous development of small business is the difficulty experienced by small business men in securing venture capital with which to finance their operations. Two possibilities of meeting this need in a manner calculated to encourage both the establishment of new enterprises and the maintenance of old ones, the assets of which have been sapped by depression, are discussed in the report. Both of them, it is suggested, would have the effect of stimulating competition and of tending to reverse the trends which have resulted in a marked concentration of the "business population."

The first is the suggestion that local banks which, under present conditions, find it difficult if not impossible to make the sort of loans small business needs, should be encouraged to do so by some legislation under which loans of this character might be placed upon an insured basis. This device would be designed to promote the extension of needed credit which cannot now be secured because the assets which small business can offer are not as marketable as necessary to justify the ordinary commercial bank in accepting them as the basis for loans.

The second possibility which is discussed from the point of view of providing a new source of venture capital is the establishment of regional finance corporations under legislation which would enable the government to cooperate in the establishment of such institutions by the purchase of preferred stock while allowing private capital to supply, through the common stock, the real venture capital and to direct the management. This proposal, made sometime ago by Chairman Frank of the Securities and Exchange Commission,

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would, like the guarantee of loans, have the effect of providing government aid in a field which is not now served, without imposing any degree of government control upon the private enterprise to be fostered.

I have personally found the discussion of great interest because the whole study proceeds upon the theory that free, private enterprise should be stimulated and encouraged. Many States, including those of the West, which are now beyond the area of highly developed industry would be among the first to benefit from the stimulation and decentralization of enterprise and there is much material in this report which will be of great interest to business men in such areas. The highly populated areas will also fine it of interest because the continued prosperity of States in such a region depends upon the development of those other regions which are now being held back because small business is suffering a lack of capital and credit.

The statistical data which have been accumulated for this report indicate that there are now about 2,400,000 business units in the United States of which those which have assets of more than $5,000,000 each, though they constitute only about 1% of the "business population", employ most of the nation's workers. Of the 2,400,000 business units in the country, more than 90% have assets of less than $250,000 each. It is clear from the reading of this report that these small businesses constitute the most important segment of our national economy and that the thought of legislators and business men should be directed toward the solution of the problems of such enterprise.

This report has been prepared under the able direction of Mr. Peter R. Nehemkis, Jr., Special Counsel for the Securities and Exchange Commission, whose work has been particularly clear and effective. It consists of some 211 pages and is divided into two parts. Part 1 consists of a general analysis of the economic and financial aspects of small business. Part 2 consists of statistical data, field studies and certain special studies dealing with some of the newer types of finance institutions which have been specializing in the financing of small business.

It is unfortunate that several months will elapse before printed copies of the complete report will be available at the Government Printing Office. The TNEC, however, has several copies on file in the office of the Executive Secretary, 281 Apex Building, Washington, D. C. These may be examined by any interested individual.

A copy is also being filed in the general reading room of the Library of Congress for the convenience of the public.

The following is a brief summary of the report:

"Formerly local wealthy individuals were almost the sole source of equity capital for local enterprise, but the report shows that today group efforts appear to be replacing individual efforts in the supply of venture money. The growing practice by individuals of placing their savings with savings banks, life insurance companies, building and loan associations, or the purchase of stock in the great corporations, has tended to syphon off money which would otherwise be used for investment in local enterprise. The integration of a considerable part of local business into national organizations, which themselves finance their various dealers has made considerably more difficult the financing of the remaining independent local enterprises.

Investment banking appears to have played virtually no part in the financing of small business since the underwriting and marketing of securities — the traditional business of the investment bank — is geared almost exclusively to the requirements of large enterprise. The overwhelming preponderance of small business is unincorporated, consequently only a small sector at best can avail itself of investment banking machinery.

While the investment trust presents important possibilities as a mechanism for providing equity capital to intermediate-sized business, it has seldom been used for that purpose. As now constituted the investment trust offers little promise as a financing medium to the small enterprise.

Traditionally, the commercial bank has been a major source of credit to local enterprise. The local bank was completely integrated into the life of its community; its management and ownership were in local hands; the business potentialities of its borrowers were known intimately. Frequently, the directors and principal stockholders were also themselves financially interested in local ventures. But with the advent of the depression of the 30's and the resulting credit strain upon the local banking system, the procedures for extending credits broke down.

Much of the small business enterprise on which local commercial and individual activity depends is not in a position to meet the existing lending standards of commercial banks. Commercial banks which are under direct public supervision, do not act without justification in restricting credit to small business. The position adopted by the commercial banker, that the funds at his disposal belong not to him but to his depositors, and, therefore, can be loaned only to individuals and enterprises whose assets and future prospects make repayment certain, is fundamental to sound banking practice, the report states. Under this responsibility, the business prospects of a considerable proportion of the smaller enterprises at any given time is not such as to warrant bank credit. The heart of the credit problem has been and continues to be that large group of small businessmen whose enterprises are not so firmly established and whose personal resources are not so great as to be able to satisfy the existing standards of commercial banking. The report traces the experience of the Federal Housing Administration, the Federal Reserve Banks and the Reconstruction Finance Corporation in endeavoring to fill up the void. It also deals with the newer financing agencies which have become the bankers for small business — the accounts finance companies, the factors, the personal loan companies and the trade creditor.

The report makes no specific recommendations. But evidence indicates that of the existing financial institutions, the investment trust or company appears to be the instrumentality the form of which is most suitable for providing equity capital to the incorporated sector of small business.

With respect to the provision of long and short-term credit, the report points out that credit is being successfully extended to small business, witness the phenomenal and profitable growth of the "retailers" of credit — the accounts finance company, the factor, the personal loan companies, etc. The successful experience of these lenders is due largely to their having developed such techniques and methods as "(a) pooling of risks; (b) routine procedures for appraisal, accounting, and servicing; and (c) establishment of schedules of charges appropriate to each class of risk as well as to individual risks. In other words, these 'retailers' of credit have been successful in financing small business because they have devised 'mortality tables' expressly designed for the financing of small business."

It is suggested that encouragement be given to the organization of additional finance and factoring companies "by encouraging the organization of additional finance and factoring companies of moderate size and a wider extension of the field of activity of the existing companies, coupled with some machinery for the coordination of their functions and activities in such a way as to reduce costs and to improve terms, the deficiency in credit facilities for small business might in part be remedied. Consideration should also be given to the desirability of providing insurance against losses sustained by such intermediary institutions either by an agency of government or by a corporation privately financed and expressly organized for that purpose."

While recognizing that the making of "capital" loans by commercial banks is open to serious question the report states that "the practice nevertheless, merits further thought in considering the entire problem of financing small business. If it is deemed advisable for the commercial bank to further extend its aid to small business in this direction, it must be recognized that facilities will have to be provided to protect the banks against the non-liquid and non-marketable character of the assets which they will be required to hold, as well as against the added risks involved. Consideration should be given to the advisability under suitable safeguards for the Federal Reserve Banks or the Reconstruction Finance Corporation assuming the role of guarantor on such loans. The basic principle for such an 'insurance' arrangement has already been embodied in a legislative proposal."

The report reviews certain of the measures which have already been proposed to Congress for the provision of more adequate long-term and intermediate credits for small business, such as Senator Mead's Bill which provides for the creation of an industrial loan corporation, which would utilize the existing machinery of the Federal Reserve System. Reference is also made to other proposals to overcome the deficiencies of the existing commercial bank system in supplying credits to small business such as the creation of a capital-credit banking system as a supplement to the existing banking structure. Commenting on this proposal, the report states, "those who have urged such proposals, believe that such a banking system is required not only for small and intermediate size businesses but for business as a whole since only through such banks can equity financing be provided."

The report also contains a discussion of the recent proposal by Chairman Jerome N. Frank of the Securities and Exchange Commission for the establishment of a system of regional finance companies. In conclusion the report states that "it cannot, however, be emphasized too strongly that merely to reduce the cost of credit or to make its supply more abundant will not solve all of the small business man's problems. Nor can we afford to overlook that, in addition to adequate capital and credit facilities, small business also requires that its operating efficiency and technical equipment be improved. Small business must, in order to survive, match the operating and developmental efficiencies which large business enjoys through its expert accounting, managerial, and operating techniques.

"Just as the credit and marketing problems of the farmer have been dealt with successfully because they have been delimited and special solutions developed for particular needs, so, too, the capital and credit problem of small business requires to be broken down into its component parts and special solutions found for its peculiar requirements."

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