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Statement of  
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Chairman, Board of Governors of the Federal Reserve System,  
before the  
Select Committee on Small Business  
of the  
United States Senate

March 17, 1967

I appreciate your invitation to participate in these hearings. In undertaking an assessment of the over-all position of small independent enterprises in the national economy, you have tackled a job that is far from easy. Perhaps I can help by sharing with you some thoughts about the part that small business plays in our economy, the role of monetary policy in fostering a general prosperity in which we all can share, the special credit needs of small business concerns, and the appropriate principles for evaluating Government programs intended to assist in meeting these needs.

I hardly need to remind this Committee that when we speak of "small business" we are speaking of practically all the businesses in the country. Only 14 per cent of our nonfarm businesses have sales of over \$100,000 a year. Only 13 per cent have earnings of over \$10,000 a year. Only 16 per cent are even corporations; three-fourths are sole proprietorships and the rest are partnerships. Even among corporations, all but 16 per cent have annual sales of less than \$500,000 and, compared with the billion dollar corporations on which attention is so often focused, \$500,000 is not very large.

There are many ways of measuring the size of a business other than by its sales or earnings--number of employees, position in its industry, geographic scope of its operations--but no matter

how you measure size, the vast bulk of our millions of businesses would be considered small. No one can seriously question that their well-being should concern us all.

But the economic contribution that small businesses make does not rest on a precise measure of how many of them there are, how many workers they employ, or how many billions of dollars they add to GNP, or how many new products or processes they have developed. It is enough to recognize that their contribution is very real, that in many important types of business activity the small unit is no less efficient--and frequently is more efficient--than larger units, and that our technological and material progress has been advanced by the inventions and innovations of individuals initially working alone. The person who prefers to be his own boss deserves the opportunity to do so, and a fair chance to make a success of it.

In our free society, the responsibility of government, as I understand it, is not to order the lives of people but to provide a climate of opportunity that will encourage them to apply their energy, enterprise, and ingenuity to bettering the lot of themselves, their families, and their communities, and thus to promote the welfare of the country as a whole.

That general responsibility is one in which the Federal Reserve System shares. The direct responsibility of the System, at all times, is to provide monetary and credit conditions that

will encourage orderly expansion in business and employment and safeguard the value of our dollar at home and its strength in international markets. By so doing, the Federal Reserve can make an important contribution to improving the living standards of our people as a whole--though it cannot achieve that result alone since its powers are limited to credit matters, and business and employment do not live on credit alone.

The System is concerned primarily with making money as useful a mechanism as it can be for helping men freely to make their own decisions and choices in the marketplaces that serve as the cornerstone of our competitive, private enterprise economy. Making money useful in that sense necessarily requires maintaining confidence in the dollar itself as well as in the integrity and efficiency of the banking system.

Because we are the custodians of the greater part of the reserves the commercial banks are required to maintain, and because we can, in large measure, alter the volume of both total and required reserves, we can exert considerable influence over the readiness with which the banks will extend credit. The soundness of bank credit, as well as the efficient functioning of our market system, depends to a large extent on the Federal Reserve's decisions with respect to what it should do about the reserve position of the banking system from time to time.

The instruments for accomplishing this include (a) changes in the proportion of deposits banks must hold as reserves, as in the case of the recent reduction in requirements against time and savings deposits, (b) changes in the price we charge to member banks for borrowing reserve funds, as when the "discount rate" is changed, and (c) purchases and sales of Government securities in the open market. If we buy Government securities, we add to bank reserves, in effect substituting Federal Reserve credit for private credit that had been extended to the Government and freeing private funds for other purposes, thereby making credit easier to obtain. If we sell, the opposite effect is produced.

The instruments we use to influence the willingness and ability of banks to extend credit operate generally and indirectly. Except for the authority to control the downpayment requirements on purchases of securities traded on stock exchanges, the Federal Reserve has no power to control the specific terms of a transaction between a bank and a borrower. We cannot require the allocation of bank funds to specific borrowers or classes of borrowers. Ours is a most general influence on the cost and availability of credit, used to create a general financial environment conducive to steady development of the nation's resources at a pace that avoids both inflationary excesses and periods of underutilization of resources.

It is in this context of how the Federal Reserve can influence credit conditions that we turn to the access that small business has to credit flows. Even in a healthy growing economy, small businesses--especially relatively new small businesses--may face problems which they are less able than older, larger concerns to handle. A serious and important one is obtaining intermediate and long-term credit and equity capital.

Surveys of business concerns which the Federal Reserve conducted in 1959 and 1960 confirmed the widely accepted view that the small-business financing gap was for these kinds of more or less permanent funds. Two surveys were conducted, each requesting information on financing experience in a single year. One covered about 3,000 manufacturing corporations and the other about 8,500 unincorporated retailers.

Both surveys indicated that small concerns were much more successful in meeting their needs for short-term credit than in obtaining longer-term credit or equity capital. In manufacturing, for example, about three-fourths of the small companies that reported a need for short-term credit were able to obtain such funds in amounts and on terms they regarded as satisfactory. But only one-third of the small companies needing long-term credit, and only one-tenth of those needing equity capital, obtained it on a satisfactory basis.

Most of those whose long-term financing needs remained unsatisfied had made no effort to obtain the funds. The reason they usually gave was that they felt the effort would be useless. We don't know why they felt this way. Perhaps they had tried before and had been unsuccessful. Perhaps they didn't know where to go for long-term funds. It is possible that some of them would have been successful in obtaining the long-term funds they needed, if they had been encouraged and assisted in seeking them. This suggests a need for aggressive educational programs--such as those since instituted by SBA--to make smaller entrepreneurs aware of the variety of financial resources available, and the kinds of records and operating experience needed to make use of these resources.

Of the relatively few small manufacturers that made an effort to obtain long-term funds, about two-thirds were completely satisfied with their long-term credit arrangements and half were completely satisfied with their new equity financing. Those that were successful tended to be older, more profitable, and stronger financially than those that were unsuccessful, but the differences were not striking. Other factors clearly contributed to successful financing.

A survey of business concerns, of course, cannot cover certain factors--such as lenders' evaluation of management

capabilities or of product potentials--that may be decisive in determining the extent to which financing needs are satisfied. Moreover, it is questionable whether any survey can take account of all the combinations of circumstances that enter into individual businessmen's evaluation of their financing needs or into their success in meeting them. In view of the diversity of financial and nonfinancial problems with which small businesses may be faced, statistical surveys which place large numbers of respondents into several broad categories may be less revealing than case studies of individual small businesses.

While we found the survey approach somewhat inadequate for describing the small-business long-term financing gap, I feel sure the gap existed when we ran the surveys; I am equally sure it still exists, though I hope it has narrowed.

Considering the importance of small business in our economy, it is appropriate for the Government to sponsor financial assistance programs for those creditworthy enterprises that cannot themselves obtain from private sources the financing which they need. But this assistance ought to follow sound principles of business and public finance. Such principles were enunciated in the 1963 report of President Kennedy's Committee on Federal Credit Programs, of which I was a member. They are worth repeating.

In general, the Committee concluded that any Federal program designed to provide financial assistance to private sectors



should work through the private credit markets to the fullest extent possible, by stimulating and supplementing the flow of private credit rather than competing with it or substituting for it. Thus, a Federal credit program could work with private lenders to develop new financing techniques that would better meet the needs of both lenders and borrowers. It could work with small businesses themselves to alleviate shortcomings that were unnecessarily handicapping their financing efforts.

A Government lending program should commit public credit to individual private businesses only when the need is clear, the likelihood of repayment is high, and funds are not available from private sources without some participation by the Government. In order to obtain maximum private participation and minimum commitment of public funds, the Committee recommended that Government guarantees of private loans be arranged wherever this is at all possible, with direct loans made only as a last resort.

To the extent that the small-business financing gap is in the equity capital area, Government participation in filling it should be at arms' length, but may appropriately take the form of assistance to a new type of financing institution. Here also the Committee recommended that maximum participation of private capital be sought, in order to avoid establishing new institutions

which would simply be conduits for channeling public funds to private businesses.

Another recommendation of the 1963 Committee report was that Federal credit programs should be regularly reviewed to see whether they were making progress toward accomplishing their goal, had already accomplished it, or showed no sign of ever being able to accomplish it.

Certainly this is an appropriate assignment with respect to the existing programs for small business. But it is also a difficult assignment. It is far from easy to judge how successful our present SBA financial assistance and SBIC programs have been thus far in closing the long-term credit and equity capital gap. Success can't be measured in terms of the number of loans and investments made, or the dollar amounts channeled to small business.

Federal small-business credit programs may be deemed successful when the innovations they introduce significantly increase the willingness and ability of private sources to make funds available to small business, when a significant proportion of the businesses they help are able to prosper and grow without repeated Governmental financial assistance, and when they are sufficiently flexible to meet the changing needs of small business.

The trouble with these standards is that they are difficult to apply, except after a prolonged period, to programs that focus on the provision of long-term funds. When a program is designed to help small businesses to obtain long-term loans or permanent capital, its benefits will be long-term ones and its shortcomings may also not become evident for some time.

This is especially the case with the Small Business Investment Company program. I am not discouraged by the fact that, as the Small Business Administrator indicated in his statement before this Committee, the program has not yet realized the potential Congress expected. The SBIC program provided for an entirely new type of institution, and no one could know in advance just what would be required to make it work.

Now that the program has been in operation for several years, it is possible to see why certain SBIC's have been able both to attract private capital and to invest their funds profitably while too many others have failed in one or both respects. The Small Business Administration has drawn up a promising new blueprint for a strengthened SBIC industry, but we should not expect it to show substantial results for some years. Time will be required for weak companies to grow stronger or be phased out of the industry and for SBIC's to take their place as seasoned financial institutions. The equity capital gap did not open up over night and it is not likely to be closed over night.

The fact that there are today strong, successful SBIC's to serve as a pattern for the rest of the industry indicates that the SBIC approach can be workable. The experience of recent years merits careful study, to bring out more clearly the characteristics of successful companies in this field as a guide to where future emphasis of Government sponsorship ought to be placed.

It is to such specifically-focused efforts as the SBIC program that one must look for solutions of the special problems of providing adequate long-term financing for small business. The instruments available to the Federal Reserve operate in a most general fashion to influence the cost and availability of credit to all borrowers. Our aim is to employ these general instruments in a manner that will help to bring about a financial climate conducive to sound economic expansion for business concerns of all sizes.