

Small Business Administration

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THE SMALL BUSINESS ADMINISTRATION

By EDWARD SCHOEN, JR.*

The Small Business Administration has three major functions:

1. To help small business obtain adequate credit, at reasonable rates.
2. To help small business obtain a fair share of Government contracts.
3. To help small business by advice and counseling with respect to management and production problems.

DISASTER LENDING AUTHORITY

As many of the citizens of Maryland are aware, the SBA has a fourth function, which is a humanitarian duty. It is authorized to make loans — not grants — to owners of homes and businesses damaged or destroyed by natural disasters, such as hurricanes and floods, and is also empowered to make such loans to any small business concern located in an area where a drought is occurring.

ADMINISTRATIVE OBJECTIVE IS DECREASE OF GOVERNMENT IN BUSINESS

One of the primary objectives of the Eisenhower Administration is the encouragement of private enterprise and the decrease of Government business activities which may compete with private concerns. It is the belief of the Administration that individuals, doing for themselves, without interference, the jobs they alone can do best, will continue to generate prosperity and to produce more of the good things in life.

LEGISLATIVE CREATION OF THE SBA¹

On July 30, 1953, the Congress created the SBA, with the concurrence and approval of the President.² On July 31, 1955, the Congress extended the life of the Agency for another two years³ and amended the original Act by in-

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¹ 15 U. S. C. A. Secs. 631-651 [1956].

² C. 282, Title II, §§201-223, 67 Stat. 232-240.

³ C. 628, §13, 69 Stat. 551; 15 U. S. C. A. Sec. 650 [1956].

creasing and enlarging upon the lending limitations previously imposed.⁴ The expressed purpose of the SBA is to advise and assist small business in many ways and generally to serve as its champion.

DEFINITION OF A SMALL BUSINESS

A small business concern has been identified as one which is independently owned and operated and not dominant in its field. However, since other factors, relating to the type of industry or business, must also be considered, each applicant's eligibility for a business loan from the SBA is necessarily dependent upon the facts involved in his particular case, including such criteria as number of employees and annual volume of business.

LENDING LIMITATIONS

The SBA can make direct loans of not more than \$250,000 to individual small businesses and can share, up to that amount, in bank participation loans. Such credits may not have a maturity of more than ten years, with the exception of loans made for the purpose of constructing industrial facilities, which may be made for ten years plus such additional period as is estimated may be required to complete such construction. These loans are granted to enable small business concerns "to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense or essential civilian production or as may be necessary to insure a well-balanced national economy; and such loans may be made either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis."

GROUP CORPORATION LOANS

The above limitation of \$250,000 per loan does not apply to any loan extended to any corporation formed and capitalized by a group of small business concerns with resources provided by them for the purpose of establishing facilities in and through such corporation to produce or secure raw materials or supplies. In such cases, the loan limit shall

⁴ C. 628, §5, 69 Stat. 547, 15 U. S. C. A. Sec. 636 [1956].

be the sum of \$250,000, multiplied by the number of small businesses which have formed and capitalized the corporation. An example of such a corporation would be one established by a number of small manufacturers of cement products to build facilities for the production of raw cement, which would, in turn, be distributed to each of the small concerns for use in their finished products. If such a loan is for the purpose of constructing facilities, then it may have a maturity not in excess of 20 years, plus such additional time as may be required to complete the construction instead of the present 10 year maturity provided for other business loans. Interest on such loans has been fixed at the rate of 5% per annum.

LOANS MUST BE UNOBTAINABLE ELSEWHERE ON REASONABLE TERMS

Applications for financial assistance may be considered only where there is evidence that the desired credit is not otherwise available on reasonable terms; and no direct loan can be made if a bank participation can be secured. Furthermore, SBA will not make a loan if the proposed borrower can obtain the required funds, on reasonable terms, through the sale of stock or the disposal, at a fair price, of assets not needed in his business or not necessary to its healthy growth. Additionally, no financial assistance can be granted in cases where the personal credit or resources of the owner, partners, management or principal stockholders of the applicant can be utilized without undue hardship to any of these individuals.

The SBA will not make a loan which is to be used to refinance existing indebtedness that is already financed on reasonable terms. However, in many cases, a substantial portion of a proposed loan could be used to refinance, over a longer period, existing short-term obligations of an applicant.

LOANS MUST PLACE BUSINESSES ON SOUND FINANCIAL BASIS

The SBA is firmly opposed to loans which will not place the applicant on a sound financial basis, but will result, instead, only in providing temporary relief. The SBA's loan policy prohibits financial assistance which would be used solely to pay off a creditor or creditors of the applicant who are inadequately secured or to bail out a creditor who is likely to sustain a loss.

Furthermore, in all cases involving closely held enterprises, the Agency endeavors to obtain the personal guaranty of the owners, partners, management or principal stockholders of the applicant. Inasmuch as the loan will obviously benefit those persons, it is not felt that such a requirement is unreasonable; and applicants generally are agreeable to such terms.

Thus, it will be seen that the SBA is endeavoring to carry out the objective of the National Administration by preventing the lending of taxpayers' money in any instance in which private capital may be obtained and should be used.

CREDIT REQUIREMENTS

The law creating the Small Business Administration provided that loans made by it should be of such sound value or so secured as reasonably to assure repayment. In view of that language, the Agency feels that a proposed borrower's earnings should be sufficient to repay the loan without strain. In other words, the only credits which SBA considers to be of "sound value" are those in which the past records and future prospects of the applicant furnish reasonable assurance of his ability to repay the desired loan from the profits of his business. If that construction of the law were not adopted, there would undoubtedly be many instances in which financial assistance would be granted with advance knowledge that foreclosure and liquidation of the business would probably be necessary in order to enforce collection of the indebtedness. Obviously, such a course of action would be a disservice to the applicant.

However, the Agency has also taken the position that an applicant should offer collateral which would be adequate to secure the desired loan in the event some unforeseen difficulties or circumstances were to result in inability to repay the credit from earnings. Accordingly a general policy has been adopted which requires the pledge of collateral having a loan or forced sale value approximately equal, at least, to the amount of the requested financial assistance. In certain exceptional cases, where the applicant's past earnings record and overall financial condition are unusually good, the SBA's security demands are sometimes realistically adapted to meet the particular situation presented.

Except in cases where field warehousing can be arranged or State statutes permit blanket liens, the SBA is generally

unable to accept inventory as collateral because of the impossibility of maintaining adequate control over it. Of course, inventory may be used to supplement fixed assets collateral. Under certain conditions, sound receivables, appropriately assigned, may be pledged as security for a loan. However, an applicant should always have an adequate capital investment in his business, because credit can never be a complete substitute for capital.

SBA - BANK PARTICIPATION LOAN PROGRAMS

Under what conditions do banks recommend SBA participation loans to their customers? In cases where an applicant requires a credit for a longer term than that which can be handled by his bank or where the amount of the required financing exceeds its lending limitations, a bank may suggest the advisability of a participation loan. In other instances, the portfolio of the bank may be filled with respect to the desired type of loan. Many times a participation loan may be used for capital improvements, while the bank is able to continue inventory and similar working capital financing.

LIMITED LOAN PARTICIPATION PLAN

Recently, in order to provide financial assistance to additional worthy small business concerns, the SBA has inaugurated its Limited Loan Participation Plan. This new program is being conducted in cooperation with the private banks of the nation.

Loans made under this Plan are designed especially to open up a brand new line of government aid to small business. It will particularly help small retailers, wholesale distributors, repair shops, restaurants, dry cleaning and other service establishments, although other types of businesses are also eligible for such loans. As a rule, small concerns in these fields have very little in the way of tangible collateral which they can pledge for a loan. However, they often have a good earnings record, competent management, and a creditable record with local banks. They are frequently in need of term loans to finance modernization, expansion, additional inventories and for other purposes.

Under this Plan, the Small Business Administration will participate with a bank in a loan to a small concern up to a maximum of \$15,000 or 75% of the total amount of the loan, whichever is the lesser. Generally, the participating bank's share in the loan must represent additional exposure

of the bank equal to not less than 25% of the total loan. However, short-term loans to the applicant, which have been outstanding no more than six months, or loans made for a longer term on which repayments have been made promptly as scheduled, may be substituted for the new money requirement or included in computing the bank's participation in the loan. In either case, the bank's share in the loan must be equal, at least, to the outstanding loan to be refunded with a part of the new loan, or 25% of the full loan, whichever is the larger.

For instance, on a loan of \$15,000 and with an outstanding qualified loan of \$3,000 to the borrower by the bank, the maximum SBA participation would be \$11,250 and the bank's share would be \$3,750, of which \$3,000 would be the outstanding loan and \$750 would be new money. On the other hand, if the outstanding loan amounted to \$5,000, the SBA's participation would be \$10,000 and the bank's share would be \$5,000, with no new money involved. On a \$30,000 loan, the maximum SBA participation would be \$15,000 and the bank's share would be an equal amount, either new money or qualified outstanding loans, as outlined above.

PROCEDURES UNDER LIMITED LOAN PARTICIPATION PLAN

An application for a loan must be made directly to a bank, using SBA Form 4. An original and two copies of the application are required, together with any necessary supporting data. The bank then furnishes the nearest office of the SBA with the two copies of the form and other papers, together with a letter stating the proposed amount of bank participation and the bank's opinion of the character and ability of the applicant's management, future business prospects, repayment ability and recommended loan terms and conditions, including collateral requirements.

The SBA will take final action on the loan, based on the bank's recommendations and the data submitted. However, it will be the responsibility of the participating bank to obtain and determine the adequacy of collateral to be pledged. Security for such loans may include, but shall not be limited to, mortgages of real or personal property, assignment of accounts receivable or monies due on contracts, pledge of warehouse receipts, negative pledge agreements and corporate guarantees or personal endorsements. After approval, the loan will be disbursed and serviced by the participating bank.

Since the inception of the Limited Loan Participation Plan in January, 1956, 914 of such loans, aggregating \$13,416,896, were approved by the SBA through October, 1956.

SUCCESSFUL BORROWERS

What type of borrower has been most successful in obtaining loans from the SBA? Records of the Agency show that applicants who have been sponsored by their banks have received twice as many credits as those who applied for direct loans. Equally important, of course, are such factors as good management, a successful past earnings record, future prospects, and adequate collateral. Furthermore, a sound business should also show growth, rather than stagnation or retrogression.

The majority of all SBA loans have been made in participation with banks. Through October 31, 1956, the SBA had approved 4511 business loans, aggregating \$204,065,000. About three-fourths of such loans are now being made in participation with banks. This is more desirable because of the utilization of private, rather than public, funds.

LIMIT OF PARTICIPATION

Under the law, the SBA is authorized to take not more than 90% of a deferred participation loan. On deferred participations, the Agency agrees to purchase its share of the loan, at any time, upon the bank's request. The majority of share loans are made on a deferred basis; and it is felt that the Government will rarely be called upon to advance its portion of this type of loan. The SBA also makes immediate participation loans, in which case both the bank and the SBA lend their agreed shares at the time the loan is closed.

INTEREST RATES

In participation loans, the bank fixes the interest rate to be charged, which cannot be in excess of 6% per annum. Such rate is applicable to both the bank's share and the SBA's portion of the loan. The Agency's loan policy also established an interest rate of 6% per annum on direct loans. The purpose of that requirement was to avoid the possibility of Government business loans being made on a more attractive basis than can be obtained from private sources.

An exception to the above rate was permitted by the amendments to the Small Business Act of 1953, which became effective on July 31, 1955. Interest on loans made to group corporations for the construction of facilities has been fixed by the Loan Policy Board of the SBA at 5% per annum.

AUTHORITY DELEGATED TO REGIONAL DIRECTORS

Under the law, the Administrator of the SBA, or his delegates, have sole authority to approve or decline applications for loans. SBA regional directors have been empowered to approve, without reference to Washington, loans made under the Limited Loan Participation Plan and loans of not more than \$100,000 in instances where private banks have agreed to participate to the extent of not less than 25% of the loan, provided that at least one-half of the bank's participation represents new or additional credit advanced by the bank to the borrower. Regional Directors have also been authorized to make direct or regular participation loans of not more than \$20,000, without reference to Washington. In all other cases, the application is transmitted to Washington for final consideration and decision.

LOAN STATISTICS

It is true, of course, that most of the loans made by the SBA are for longer periods than those ordinarily preferred by commercial banks. Notwithstanding the fact that the SBA is authorized to make loans for as long as ten years, the average term of such loans has been about five years, and a large percentage are for four or five year periods. Since private banks are usually able to provide short-term credits in adequate amounts, the SBA's activity in connection with loans for less than two years is generally limited to those cases in which Government contract financing is involved. By size, the average of business loans approved has been \$42,800.

FINANCIAL SERVICES

All applications for loans must be filed and processed in the Regional or branch offices of the Agency throughout the country. The Baltimore Branch Office and Richmond, Virginia Regional Office, both of which serve Maryland, have financial and production specialists who are well qualified to advise and assist proposed borrowers and to

evaluate loan applications and assets offered as collateral. These specialists are able to furnish applicants with the necessary forms and give them proper instructions with respect to completion and execution. Accordingly, a proposed borrower will always expedite the processing of his application and save himself both time and expense if he will communicate with regional office representatives.

FINANCIAL COUNSELING

In addition to its lending activities, the SBA renders financial counseling services to small enterprises. Adhering to the primary objectives of the Eisenhower Administration and the requirements of the law, the SBA has consistently endeavored to suggest solutions not requiring the use of public funds, so as to promote private lending and avoid any semblance of competition with banks. Nevertheless, when the situation seemed to warrant such action, the SBA has not hesitated to proceed promptly, within the limitations of its authority, to make direct or participation loans. However, the recommendations and suggestions of the Agency in this respect have favored bank financing.

In some instances, after consideration of the loan applicant's overall financial position and needs, the SBA will conclude that a proposed borrower does not actually require the total amount of the requested credit. In such cases, the SBA will approve a loan in a reduced sum, which is adequate for the applicant's requirements and usually enables him to save interest by an earlier repayment of the financing.

DISASTER LOANS

As previously mentioned, the SBA makes disaster loans to owners of small businesses and homes which have been damaged or destroyed by hurricanes, floods or other natural catastrophes. The Administrator designates disaster areas, for loan purposes, on the basis of reports from field offices of the Agency, the American Red Cross, Federal Civil Defense Administration, and other qualified observers. Under certain conditions, the SBA can also make loans to any small business concern located in an area where a drought is occurring.

Applications for disaster loans from persons or firms in the area are considered on an individual basis. The purpose is to rehabilitate and replace, but not to put the borrower in a better condition than he was prior to the dis-

aster. Loans of this type are not required to meet the standards which are applicable to business loans. Interest on the SBA share of all disaster loans has been fixed at the rate of 3% per annum. Through October 31, 1956, the SBA had approved 4,707 disaster loans in the amount of some \$54,502,000 for catastrophe victims in all parts of the country.

PROCUREMENT, PRODUCTION AND MANAGEMENT ASSISTANCE

The financial assistance program of the SBA constitutes less than one-half of its efforts to aid small businesses. The Agency is also required to endeavor to obtain a fair share of Government contracts for small concerns. In this activity, it deals with many more firms than in its lending program.

AVAILABLE INFORMATION ON PROCUREMENT

The United States Government is the largest purchaser of goods and services in the world, entering into some 6,000,000 contracts a year for about thirty billion dollars. The SBA maintains representatives at some 36 major military procurement centers in an effort to have as many defense contracts as possible set aside for exclusive award to small firms.

The SBA publishes a U. S. Government Purchasing Directory and a U. S. Government Specifications Directory, which can be purchased at a cost of fifty cents and twenty-five cents, respectively, from any local office of the Department of Commerce or from the Superintendent of Documents at the Government Printing Office in Washington. All SBA field offices and SBA personnel in procurement centers have been furnished with copies of these directories.

In addition to a complete revision of the listing of items bought by the Government, and of the complementary list of purchasing offices which buy the items, SBA has included in the Purchasing Directory more information of help to small firms. For example, the latest edition contains a listing of military installations, by States, whose local purchases could prove a valuable source of orders for small businesses in their areas.

PROCUREMENT ACHIEVEMENTS

Under the cooperative SBA-Department of Defense Joint Determination Program, more than \$215,000,000 in

Government purchase orders was set aside for exclusive award to small businesses during the first four months of the present fiscal year. This represents an increase of more than \$91,000,000 over the small business set-asides for the period from July through October, 1955. During the entire fiscal year of 1956, which ended last June 30th, about \$498,000,000 in proposed Government purchases was reserved for award to small concerns.

During the first four months of the current fiscal year, the Agency's 40 field offices reported 37,632 instances of assistance to individual small firms in efforts to help them obtain an increased share of Government purchase orders. This aid to small businesses included 20,875 referrals of Government prime contract opportunities and 9,243 general procurement cases which were handled on a national basis.

Additionally, the Agency referred 2,234 subcontracting opportunities to small businesses, assisted 3,644 small concerns in the preparation of their bids on Government purchases and, in 1,636 cases, requested large prime contractors to consider subcontracting work to smaller firms.

NEW PRODUCT SUGGESTIONS

The SBA also aids small firms to increase their output through a diversified line of products. A program is in effect for the purpose of publicizing Government-owned inventions and patents which are available for licensing or sale. New processes and techniques are also explained through this program. Small Business concerns may receive, without cost, counsel and assistance in solving product research, development, and marketing problems, and in locating possible new products. This program is conducted by the field offices of the Agency.

TECHNICAL AIDS

The SBA also publishes management and technical aids to help small business owners solve particular problems or to keep them informed of current business practices and policies. These publications are also furnished by SBA field offices upon request, without cost. The Agency has published a series of booklets, collectively entitled, "The Small Business Management Series". Each of these, prepared by experts in the field, discusses in detail some phase of the operation of a small plant or business. Such management problems as costs, the importance of human relations, and others are covered in this helpful, inexpensive series. A

list of these publications may be obtained from any of the Agency's field offices; and the booklets themselves may be purchased from the local office of the Department of Commerce or the Superintendent of Documents in Washington.

Nor are retailers and distributors omitted. Another series provides management information for these important fields. Small Marketers Aid No. 1, "Records Management in Smaller Stores", Management Aid No. 2, "Adequate Production Control", and Management Aid No. 61, "How Good Records Aid Income Tax Reporting", among other publications of the SBA, should be particularly helpful to small concerns.

ACTIVITIES OF FIELD OFFICES

All of the many types of assistance mentioned above are readily available to small businessmen and their attorneys at the Baltimore and Richmond Offices of the SBA. The Baltimore Office is located at 307 Calvert Bldg., Fayette and St. Paul Streets, Baltimore, Maryland, and services the State of Maryland. The Richmond Office, located at 900 N. Lombardy Street, Richmond 20, Virginia, has jurisdiction over the region comprised of Maryland, Virginia, West Virginia, North Carolina and South Carolina. Financial and production specialists in those offices are very well equipped to help small concerns in many ways and are always happy to be of service in the solution of the various problems which are constantly confronting small businessmen.

FUTURE PLANS

The SBA is constantly endeavoring to find new ways and means of helping the small businessmen of the Nation, within the scope of its authority. Suggestions and recommendations for the improvement and extension of its assistance programs are always welcomed and given serious consideration. It is a service agency and it wants to improve its services to the small business community to the utmost.

In May, 1956, the President appointed a Cabinet Committee on Small Business, which made a progress report in August, 1956. In that report the Committee made recommendations for legislative and administrative changes to assist small firms, such as tax relief, a review and simplification of the purchasing procedures of the Government, clarification of the rules governing the availability of progress payments to Government contractors, strengthening

of the Anti-Trust laws, and a decrease in the paperwork required of businessmen by Government departments. The Committee is continuing its efforts to further the interests of the small business community.

In October, 1956, a meeting was arranged between representatives of leading life insurance companies and officials of the SBA. The conferees discussed in detail a proposal that insurance firms broaden their lending policies to aid small business owners, either independently or in cooperation with the SBA. The conference followed closely the increased activity of the SBA in the lending field and represented another step in the Agency's efforts to assist in making credit available for owners of small businesses.

It is the announced policy of the SBA to sell direct loans on its books at any time to banks which may be interested in purchasing them. Quite a few of such loans have already been sold to banks; and it is expected that a great many more direct loans will be transferred to the private banking system. Furthermore, the Agency hopes and anticipates that most of its participation loans will ultimately be taken over by local banks.

PROPER ROLE OF GOVERNMENT IN LENDING FIELD

In essence, the lending program of the SBA is rooted in the confident belief that the private banks of the country are doing a good job in providing the credit requirements of business. However, it is recognized that the proper role of the Government in this field is to assist in those areas where credit may be needed to promote and maintain a strong and expanding national economy. It cannot be emphasized too strongly that the SBA's lending programs are geared to active and most sincere cooperation with local banks in their own communities.

It is the considered opinion of the officials of the SBA that this is the principal way in which its program of financial assistance for small businesses can contribute to the maintenance of a prosperous economy, which will provide a healthy environment for small and large firms alike and opportunities for increased business and employment.