The original documents are located in Box 39, folder "Transition Reports (1977) - Small Business Administration (3)" of the John Marsh Files at the Gerald R. Ford Presidential Library.

U.S. Small Business Administration
Washington

OFFICE OF THE DEPUTY ADMINISTRATOR

December 17, 1976

Honorable John O. Marsh, Jr.
Counsellor to the President
The White House
Washington, D.C. 20500

Dear John:

I am attaching a pile of transition issues that we have been supplying our transition officer as per your request of November 16th.

Sincerely,

Louis

Louis F. Laun

Enclosures

ISSUE #1

STATEMENT OF THE ISSUE

The 8(a) Program -- should it be expanded, kept the same, eliminated, or changed? Are there other routes to the same goal?

DEPARTMENT POSITION

The Procurement Assistance Department strongly supports the program, asks for its expansion, and believes there are no workable options. A more detailed explanation of their position and recommendations is attached.

AGENCY POSITION

Short term: Support the continuation and modest expansion of the program. At the same time, work to improve administration and eliminate the major weaknesses, such as (1) frequent inability to provide contract continuity; (2) provision of more financial and management guidance; (3) improved regulations to eliminate problems of sponsorship and management contracts; (4) improved criteria for acceptance of firms as 8(a) participants; (5) more involvement of the major prime contractors in SBA's subcontracting programs in contracts for the socially or economically disadvantaged.

Longer term: Do an in-depth study of the program using outside resources and addressing the cost/effectiveness of the program and alternatives. Included in this should be a study of what the goals should be: (jobs? graduation of viable firms? improved balance sheets and income accounts?) Hold growth to modest levels until this is completed, as it has a heavy impact on SBA budget and personnel.

OTHER OPTIONS

(1) Use cost plus contracts to eliminate the chance for loss on the contracts. (But cost plus does not prepare a firm for competition in our competitive system.)

(2) Submerge the 8(a) program into a broader procurement marketing program to involve firms more in the private sector buying sector and to encourage more socially or economically disadvantaged participation in set-aside programs.

(3) Eliminate the program entirely and replace it with an incentive program to encourage private companies to create new minority small businesses, with Federal assistance, to provide goods and services needed in the public and private sector.

CONGRESSIONAL ATTITUDE

It is believed that both Houses of Congress support the expansion of the 8(a) Program, but a heavy amount of Congressional mail contains criticisms of the program and several Congressmen are opposed to it entirely.

ACTION FORCING DATES

None

LAW INVOLVED

Public Law 85-536 of the Small Business Act, as amended.

Position of the Associate Administrator for Procurement Assistance and the Director, Office of Business Development:

The vital nature of the 8(a) Business Development Program to the objective of increasing the successful participation of the disadvantaged Minority community in the mainstream of business activities in our economy cannot be minimized. The Program is the most efficient and promising method of accomplishing that objective. It is the only Federal program offering preferential treatment to Minority-owned small businesses in the procurement area. It has been utilized by three separate administrations as the primary vehicle to perform a socio-economic function of national scope and concern. It has been tested in the courts and upheld.

The program is considered to be dynamic in its present configuration and concept. It has achieved maturity over the past eight years of operation, developing from an experiment in the utilization of Federal procurement for the purpose of providing jobs and job training for the unemployed and increasing the number of Minority-owned firms participating in the economy, to a viable program to develop competitive small business concerns owned by eligible disadvantaged persons.

The AA/PA is committed to the Program as not only being necessary, but vital to the aspirations of the disadvantaged community. The program should be pursued vigorously with active efforts to improve both its size and scope.

In furtherance of this position the AA/PA recommends:

Expansion of the 8(a) Business Development Program by (1), increasing the volume and dollar amount of Government contracting support for the program as recommended below, (2), improving SBA's delivery of services and assistance to approved 8(a) companies as recommended below, (3), increasing the number of approved companies to the level supportable by available SBA resources and contract opportunities.

Providing SBA with statutory authority to enter into contracts with other Government agencies and to subcontract the performance of those contracts with small, profit-oriented, business concerns owned and controlled by eligible socially or economically disadvantaged persons. At the present time SBA has only administrative authority to do this under Section 8(a) /15 USC 637(a)/ of the Small Business Act.

Providing the Office of Business Development, SBA, with budget and staff adequate to deliver the services and assistance required in the effective development of that number of 8(a) companies that can be provided with appropriate contracting opportunities. The number of companies that can be effectively developed at any given time is a function of the available SBA resources and the number and volume of contracting opportunities offered for support of the 8(a) Program. That number is estimated at 1350 based upon SBA's present business development budget and staff.

Mandating through Executive Order that the Federal procuring agencies:

> Increasing the overall share of agency procurements awarded through prime contracts with small businesses through improved "break-out" procedures and through small business set-asides.
>
> Increase the volume and dollar value of contract opportunities offered to SBA for support of the 8(a) Program.
>
> Provide technical and management services and assistance to SBA and 8(a) subcontractors as required and when requested by SBA.

ISSUE #2

STATEMENT OF THE ISSUE

Should the thrust of SBA's loan programs tend more in the guaranteed or in the direct lending directions?

DEPARTMENT POSITION

In our opinion, the thrust should emphatically tend more to the guaranty direction. While true of nearly all programs, (physical disaster being the primary exception), the biggest impact is related to the 7(a) business loan program.

First, our basic legislation has always made clear that we do not compete with banks in small business lending. That is, the statute clearly states that we may not make a direct loan if a participation loan is available. Secondly, our losses are much lower for the guaranty program than the direct. From inception of the 7(a) program through June 30, 1976, our losses for direct loans were 6.51 percent actual, 7.79 percent ultimate; in the guaranty area, losses were 2.69 percent actual, 5.3 percent ultimate.

For many years SBA has attempted to attract the banks into the guaranty program, a thrust which received great impetus with the issuance of the report of President Kennedy's Committee on Federal Credit Programs in 1963, which recommended that all Federal loan programs should be oriented toward the guaranty approach. We are presently experimenting with an accelerated guaranty program in order to speed up our delivery system, both to banks and the small business borrower; experience to date has been limited and we are closely monitoring progress before making a final determination as to whether to include more banks than at present.

While the Congress has in recent years indicated that the Agency should be making more direct loans, and in fact has appropriated more funds for this purpose, it has never cut our budget for guaranty loans. In FY 77, for example, the Congress set a budget level of $195 million for 7(a) direct loans, and $2.0 billion for guranteed.

While we strongly believe in a modest direct loan level for those small firms unable to obtain direct bank loans, or a bank loan with the SBA guaranty, we equally believe that the Agency should use the private sector to the fullest extent by stressing the guaranty direction.

AGENCY POSITION

The Agency strongly favors emphasizing the guarantee approach. This maximizes Agency outreach (8,500 banks -- 15,000 + locations) rather than just 95 offices, cuts costs to government -- both personnel and interest rate, and involves the small business sector in the private sector.

In addition, subsidized low interest loan programs in the general business 7(a) category create market inequities and discriminate against other small business which must pay higher private sector, SBIC, or 7(a) guarantee interest rates.

OTHER OPTIONS

None offered.

CONGRESSIONAL ATTITUDE

See "Department Position," above.

ACTION FORCING DATES

None.

LAW INVOLVED

Small Business Act; Small Business Investment Act.

ISSUE #3

STATEMENT OF THE ISSUE

Should the components of Minority Business Enterprise throughout the government be consolidated in one department or agency?

DEPARTMENT POSITION

The Associate Administrator for Minority Small Business believes all Federal components of minority business development should be consolidated into his department in SBA. He also supports placing women in the MSB category.

AGENCY POSITION

The Agency supports the Interagency Report on Federal Minority Business Development Programs (copy attached). It has many recommendations aimed at avoiding duplication of effort. It calls for SBA having full responsibility for its socially or economically disadvantaged programs in financial, procurement, and management assistance. This includes EOL loan programs, MESBICs, the 8(a) procurement program.

With regard to management and technical assistance, SBA will supplement its resources with OMBE's contractors when feasible, subject to agreements between Commerce and SBA. All 10 regions have signed such agreements.

With regard to procurement assistance, SBA will be responsible for providing assistance to Federal agencies and contractors about opportunities to increase awards to minority businesses.

Commerce will, working with the Interagency Council (on which the SBA Administrator or Deputy sit as Vice Chairman), have the responsibility for stimulating other Federal agencies about programs in general and will have responsibility for mobilizing non-Federal organizations.

The Department of Commerce and SBA have also each assigned full time staff (Andy Canellas of SBA) to review programs, recommend objectives, evaluate effectiveness, and study alternatives.

The AA/MSB at SBA will, in conjunction with appropriate SBA Central Office Management Board members, develop objectives, priorities, policy, and budget proposals for SBA's programs for the socially or economically disadvantaged. The Associate Administrator for Operations will have responsibilities for taking field actions relative to these programs, and this authority delegates to the Regional Directors, each of whom has an AA/MSB, and to the District Directors.

A fuller description of the above is contained in the Interagency Report. SBA feels that a lot of reorganization without long study could stop activities in their tracks for some time.

With regard to women in business, SBA maintains that women as a class are not to be classified as socially or economically disadvantaged and that the AA/MSB would have no responsibility for women as a class. There is an Advocate for Women in Business and Consumer Affairs handling this area, and she reports to the Assistant Administrator for Advocacy and Public Communications.

OTHER OPTIONS

(1) Consolidate SBA programs with OMBE programs under the Department of Commerce.

(2) Maintain separate OMBE and SBA programs, but change organizational arrangements of those programs within Commerce and SBA.

(3) Establish a new, comprehensive, minority business program in SBA (or in Commerce) to replace the existing programs.

(4) Consolidate direct Federal assistance for minority business development in SBA; redirect OMBE program to stimulate private sector action to promote minority business development.

(5) Stop still -- and thoroughly review where the government has come in minority business development since 1963, what the benefit-cost has been, and where the government should go to achieve new goals in the next four years for its citizens.

CONGRESSIONAL ATTITUDE

A widely varying group of bills, supporting various kinds of organizational change, have been placed in the hopper over the years. Some favor strengthening OMBE as the lead agency. Some favor strengthening SBA. Some favor setting up a separate agency. While nearly everyone ritualistically wants "changes for the better", there is not consensus on what these changes should be. (SBA is opposed to most of the thrust of these bills, which are listed below.)

ACTION FORCING DATES

None on the legislative side; only OMB-imposed deadlines for carrying out Interagency Report recommendations on the administrative/executive side.

LAW INVOLVED

SBA legislation, including P.L. 93-386 concerning establishment of AA/MSB in August, 1974, referred to above.

WHEN LAW EXPIRES

Not applicable to SBA; OMBE exists only under Executive Order 11625. (A new Executive Order on Minority Business Development is now being written at OMB to replace E.O. 11625).

WHAT LEGISLATION IS BEING PROPOSED

S. 3427: Senators Brooke-Javits, May 13, 1976.

S. 2617: Senator Johnston, November 5, 1975.

H.R. 12741: Rep. Mitchell, March 23, 1976.

Series of Proposed Bills from Black Caucus.

PRECISE NATURE OF LEGISLATION

S. 3427 and H.R. 12741 would amend the Small Business Act to expand assistance to minority small business concerns (and/or socially and economically disadvantaged persons), to provide statutory standards for contracting and subcontracting for such concerns, and to create a Commission on Federal Assistance to Minority Enterprise.

S. 2617 would establish an Office for Minority Business Development and Assistance in the Department of Commerce, under an Assistant Secretary.

The other projected bills from the "Black Caucus" members are aimed at "a more effective program in the Executive Branch for minority economic development."

POSITION OF CONGRESSIONAL COMMITTEES AND THEIR STAFFS

Generally, in favor of better control and accountability for minority enterprise programs to avoid overlap and duplication. Some favor consolidation in SBA to achieve this.

Interagency Report

on the

FEDERAL MINORITY BUSINESS DEVELOPMENT PROGRAMS

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

In cooperation with:
DEPARTMENT OF COMMERCE
SMALL BUSINESS ADMINISTRATION

March 1976

Report on the Federal Minority Business Development Programs

Introduction

This report summarizes the findings and recommendations of several recent studies made of the Federal minority business development programs. It also summarizes recommendations for future actions to be taken to improve the effectiveness of the programs.

The findings and recommendations of this report should be considered in the context of the total Federal minority enterprise effort. For purposes of this report, it is useful to consider the minority enterprise effort in three main parts, as follows:

1. The Federal programs which are designed specifically to provide assistance to socially or economically disadvantaged individuals to help them establish successful businesses. These programs have been focused on those individuals who are unlikely to be able to compete with the broader spectrum of small businesses without such assistance. The specific programs in this category are the Economic Opportunity Loan (EOL) program, the 8(a) procurement program, the MESBIC financial assistance program, related Small Business Administration (SBA) management and technical assistance and related OMBE management and technical assistance efforts. These programs account for the bulk of the Federal spending focused on minority business development.

2. The efforts of all Federal agencies to help minority businesses participate in the benefits of established Federal programs and to become suppliers or contractors to the Government. These efforts include identification of Federal procurement opportunities for minority firms, and assuring that minority firms have opportunities to compete successfully for available loan and grant programs.

3. Programs to encourage and support the non-Federal sector, including States, cities, private firms, universities, and individuals, to assist in the development of minority-owned enterprises.

This report is primarily concerned with the programs in the first category, i.e., those direct assistance programs for the socially or economically disadvantaged. The bulk of the problems identified relate to this first category, and most of the recommendations for action are focused on these programs. There are some suggestions for improvements in the efforts in the other two areas. In particular, it is believed that further steps should be taken to help increase non-Federal minority enterprise activities.

Although this report contains criticisms of certain Federal minority enterprise programs, it is premised on the belief that the goals of these programs are significant and valid. The purpose is to help make these activities more effective. It also should be understood that many of the programs have made impressive gains in the last five years. Particularly impressive are the gains in the second program category, as most Federal agencies have greatly increased the participation of minority-owned businesses as contractors and recipients of loans and grants.

This report does not reassess or challenge the need for the various types of assistance provided by the Federal programs. The various forms of direct and indirect Federal assistance now available to minority business are important and should be continued and improved.

I. Evaluation of Program Impact

Since the beginning of the management and technical assistance program by the Office of Minority Business Enterprise (OMBE) in 1971, there has been a strong interest in measuring the impact of Federal efforts to assist minority business development. Executive Order 11625 of October 1971, specifically listed as one of the functions of the Secretary of Commerce:

> "to evaluate the impact of Federal support in achieving the objectives established by this order."

Evaluation of program impact has proven to be an extremely difficult task. Extensive efforts have been made by OMBE, SBA and the Office of Management and Budget (OMB) during the past four years to develop a useful method of determining the impact of these programs. Some progress has been made, but the current knowledge of program impact is not adequate to permit the most effective management of the programs. We believe further progress can be made, and recommendations for these next steps are discussed below. It should be recognized, however, that it may not be feasible to accurately determine the cause and effect relationship between Federal assistance efforts and the status of minority-owned businesses in this country. Clearly, Federal activities can and should represent only a small part of the ingredients that account for the success of a business, and other economic and social factors can completely overshadow the influence of Federal assistance.

Data available relating to the impact of Federal minority enterprise programs can be divided into two principal categories:

- Census or other general data on the status of minority-owned businesses, including information on numbers of firms, gross receipts, employees, geographic distribution, and type of business; and

. Data on the level of assistance provided through Federal programs, such as amount of procurement awards, number and value of loans, and number of firms receiving management or technical assistance.

The most comprehensive general data are contained in the Special Reports on Minority-Owned Businesses issued by the Bureau of the Census. The most recent survey was made in 1972 and the results were published during the past year. This provides a comparison with data from the 1969 survey. The findings of this survey are summarized in Attachment A. The survey shows, for example, that there was a 20% increase in the number of black-owned firms from 1969 to 1972, and a 60% increase in the gross receipts of black-owned firms during that period. The survey reflects the significant advances made by minority-owned firms, but it does not provide any measure of the influence of Federal programs on that advancement.

Data on the level of Federal assistance for minority enterprise are contained in the annual reports by the Department of Commerce. These data show impressive increases in the amount of contract awards, loans and other assistance provided to minority-owned businesses. For example, the value of total Federal procurement awards to minorities has increased from $12.7 million in 1969 to $701 million in 1974. These increases are summarized in Attachment B. This information on Federal assistance, however, does not tell us how these programs affected the number and viability of minority-owned businesses. Theoretically, all of the businesses assisted by these programs could have failed within a year after receiving the assistance, and this would not be reflected in this data.

What is missing in these impact evaluations is the link between the Federal input and the actual status of minority businesses. Many attempts have been made to provide this missing data through evaluations of individual Federal assistance efforts. These studies have been conducted by the agencies, GAO, private organizations and congressional committees. Many of these studies will be discussed in more detail later in this report, but none of them has been successful in providing facts regarding the impact of the programs. Some studies claim a major positive impact, while others argue that there has been little impact or maybe even a negative impact. But none of the studies has been able to provide the necessary empirical data to support the conclusions. This is <u>not</u> because the evaluation studies were poorly done. Rather, it reflects other basic problems, including:

. The lack of consensus on what should be measured, e.g., numbers of firms, profitability, employment levels, gross receipts, etc. This reflects the lack of a common understanding in the past regarding the objectives of the program.

. The lack of adequate knowledge of the factors that lead to success or failure of minority-owned businesses, and the relative importance of each.

- The lack of information on the economic condition of the firms that are assisted, over a useful period of time.

- The lack of information on the type and amount of Federal assistance which is provided by the several Federal programs to an individual firm.

Recognizing the lack of a common understanding of the objectives of the programs, an effort was undertaken to define the objectives more clearly. A consensus was reached by SBA, Commerce and OMB on a qualitative statement of the objectives. A discussion of the considerations and conclusions of this effort is included in Attachment C. That effort concluded that the Federal minority enterprise programs should:

- Help eliminate discriminatory actions against minorities which prevent or inhibit minorities' participation in private enterprise; and

- Increase minority ownership of private businesses which can operate on a profitable basis without continued special Federal assistance, resulting in increased income levels and asset ownership by minorities.

The agencies have not yet defined quantifiable objectives, e.g., how much minority ownership of successful businesses can or should be increased. Also, the agencies have not yet determined the specific means of measuring progress toward the objectives. There is general agreement, however, that just the numbers of new businesses started or numbers of businesses assisted are not adequate measures, and that efforts have to be made to measure effectiveness in terms of the increase in business income and asset ownership of minorities as a result of the Federal assistance.

Both Commerce and SBA have undertaken some studies of the factors that lead to the success or failure of minority businesses, but a much better understanding of these factors is needed. The preliminary results of these studies are summarized in Attachment D. It is necessary to improve this knowledge and put it to work to help measure the impact of Federal assistance and to help determine how the Federal assistance efforts can be improved.

There also is general agreement that there is a need to improve information on the progress of individual minority firms after assistance has been provided. This is necessary to determine the need for additional assistance as well as to gain a better knowledge of the impact of the assistance.

There is inadequate information exchange among the various Federal programs regarding the assistance being provided to an individual firm. Such information is essential to determine the role of Federal assistance in helping a firm, as well as to effectively manage the allocation of the Federal assistance.

Actions Recommended

1. The Department of Commerce and the Small Business Administration will jointly undertake an effort to establish useful, quantifiable, objectives for the Federal minority enterprise effort, both long-term and short-term. This will include analysis of alternative approaches and specific quantified objectives.

2. SBA and Commerce will work together to improve the knowledge of the most important factors in the success of minority firms and, where feasible, measure the impact of Federal assistance on these factors.

3. SBA and Commerce will jointly establish a comprehensive system for evaluating the impact of the Federal assistance activities. The system will include:

   . A process to obtain information on the progress of individual minority firms receiving assistance, in ways that will avoid or minimize the reporting burden on the firms; and

   . A system for obtaining data on all Federal assistance provided to particular minority firms.

II. Results of Evaluations of Individual Programs

Although the evaluations of the individual assistance programs do not conclusively show the impact of these programs, or clearly show the way for improving the Federal effort, several of the studies identify fairly obvious weaknesses in the programs and suggest actions to reduce these problems. In several cases there is a fairly broad consensus that such changes are likely to improve the programs, with a minimum risk that the changes would be detrimental. These problems and suggested improvements are summarized below under the three major categories of assistance.

A. Financial Assistance

The problems, and possible improvements in these programs, are discussed in more detail in Attachment E.

Problems

. Loans have in the past frequently been provided to firms which have very little chance of success. This is reflected in a high loss rate on the loans. But more importantly, it can lead to a worsened economic status for the minorities involved, as their investments are lost in businesses which were undertaken with Federal assistance and encouragement.

- Financial assistance has frequently been provided to minority firms without assuring that other types of needed assistance (such as procurement and management assistance) will be made available. There presently are inadequate management systems to assure that the complementary pieces of Federal assistance required to give a firm a reasonable chance of success will all be available to a firm.

- The present ceiling of $50,000 on SBA's Economic Opportunity Loan program does not allow adequate flexibility to provide the amount of financing needed to give firms a reasonable chance of success. Studies indicate that inadequate financing is a primary cause of failure for small firms.

- There is relatively little equity capital available for minority firms. The Federal programs primarily provide debt capital, with relatively little flexibility in repayment. Even the MESBIC program, which was intended primarily to provide equity financing, has had difficulty making equity investments.

Actions Recommended

1. SBA will establish improved criteria for acceptance of applications for EOL loans or loan guarantees, to help assure that loans are provided only to those firms with a reasonable chance of success. The results of SBA and Commerce studies of the factors leading to success or failure of businesses will be used to help develop these improved criteria.

2. SBA will improve its management system to assure that EOL financial assistance is provided only in conjunction with market or management assistance in those cases where such additional assistance is considered to be necessary.

3. The Administration will request the Congress to increase the ceiling on the amount of an SBA EOL loan, from $50,000 to $100,000.

4. The SBA will analyze alternative means of improving the MESBIC program to make more equity capital available to minority firms. This will include the alternative of focusing efforts on developing a relatively few large MESBICs, rather than supporting more small organizations. SBA also will establish an operational system for providing management assistance to firms receiving financial assistance from MESBICs.

B. Procurement Assistance

The problems and suggested improvements in these programs, are discussed in more detail in Attachment F.

Problems

- While substantial progress has been made in this area in the past 18 months, the protected procurement awards under the 8(a) authority have in the past frequently been made to firms with little chance of ever being able to compete in an unprotected market. Also the nature of some of the 8(a) procurements has not been helpful in preparing the firms to compete in an unprotected market.

- 8(a) procurement awards have been provided to firms without assurance that other types of needed assistance, such as financial and management assistance, will be made available to provide a reasonable chance of success. There has not been a management system adequate to assure the coordination of the needed assistance.

- Inadequate attention has been given to opportunities to use minority firms as subcontractors to Federal prime contractors. There has not been a concerted effort to assure that major prime contractors implement effective "affirmative action" programs to obtain minority owned firms as subcontractors.

- Although substantial efforts have been made to encourage and help develop non-Federal markets for minority firms, this has received relatively low priority in the total Federal effort. Ultimately, if the minority business development programs are to be successful, it will be necessary to reduce the reliance of minority firms on the Federal markets. This is an immediate concern in regard to the 8(a) program, in which many participants have not been able to develop non-Federal markets as an alternative.

Actions Recommended

1. SBA will continue its efforts to establish improved criteria for acceptance of firms as 8(a) participants, to focus the program on those firms which have a reasonable chance of being able to compete successfully for markets without special assistance, after participation in the 8(a) program.

2. SBA will continue its policy of providing 8(a) procurement assistance only in conjunction with management or financial assistance in those cases where such additional assistance is considered to be necessary, and it will establish a management system to assure effective implementation of this policy.

3. Commerce will study the issue of greater use of minority subcontractors on Federal prime contracts and develop specific proposals for an affirmative action program in this area, to be considered by the Interagency Council on Minority Business Enterprise.

4. The Department of Commerce will study and develop proposals for increasing its efforts to identify or establish non-Federal markets for minority firms.

C. Management and Technical Assistance

The problems, and suggested improvements in these programs, are discussed in more detail in Attachment G.

Problems

- The management and technical assistance efforts of SBA and Commerce have been expanded and improved substantially during the past five years. These programs have not been adequately coordinated, however, with other Federal minority business assistance programs to help assure that individual firms receive the types of assistance needed to provide a reasonable chance of success. Adequate management assistance frequently has not been available to help firms which are participating in the 8(a) program or receiving financial assistance. Also, the level of management assistance for a firm frequently has been inadequate to make a significant difference in the chances of success for the firm.

- The SBA and Commerce have not developed adequate criteria or management systems to target their management assistance efforts to those cases which will help develop profitable businesses which will be able to prosper without continued Federal assistance. Much of the assistance resources have been devoted to trying to save firms that are terminal cases, rather than targeting efforts to try to establish businesses which will be able to compete without continued assistance.

- There has been frequent criticism that the skills of those providing management and technical assistance under Commerce and SBA programs have frequently not been suited to the needs of the minority businesses. There is continuing criticism that many of the assistance staff, both direct Federal employees as well as contractor employees, are not adequately trained or experienced to effectively assist minority firms. There also is criticism that the skills of the assistance staff often do not match the needs of the minority firms, e.g., complex solutions to relatively simple problems.

Actions Recommended

1. A management system will be established by SBA to assure that management and technical assistance are provided to firms, when such assistance is necessary in conjunction with SBA's financial or procurement assistance to provide the firms a reasonable chance of success. This system may use Commerce management assistance capabilities as agreed by the two agencies.

2. Criteria will be developed and applied by SBA and Commerce to determine which firms will receive available management and technical assistance, to help assure that this assistance is effective in helping businesses become independent of continued special Federal assistance.

3. An effort will be undertaken jointly by SBA and Commerce to determine the need to develop or revise standards regarding the capabilities of the management and technical assistance staffs, both direct Federal and contractor employees. If different standards are needed, these will be implemented by the agencies. This might include training programs as well as higher standards in the initial selection of employees for these positions.

III. Evaluation of Problems Which Are Broader Than The Individual Assistance Programs

It is generally accepted that participants in the programs to help the socially or economically disadvantaged have needs for assistance beyond that which is normally considered necessary for small businesses in general. In many cases, these firms need market, management and financial assistance in order to have a reasonable chance of success. If the firms did not need this extensive, comprehensive assistance, they could obtain assistance under the regular small business assistance programs of SBA. Because of this need for extraordinary assistance, there is the danger that the firms will become dependent on continued Federal assistance and not achieve the objective of becoming independent, profitable firms. Accordingly, it is essential that firms not be assisted under these programs unless it is possible to provide the type and amount of assistance needed to provide a reasonable chance that the firms will be able to "graduate" from the programs.

Problems

- With several different program managers, and no clear leadership responsibility, the programs have not always been focused on common long-range objectives. Since none of the programs by itself can assure successful Federal assistance for minorities, it is essential that the programs are all pulling together in the same direction. It is simply not feasible to have an effective effort with each program doing its own thing.

- Even if there are common program objectives, there are difficulties in assuring that the program pieces fit together to provide a "critical mass" of assistance toward any particular objective or for any specific business. Dispersal of resources in such small amounts that they do not help make the difference between success or failure of a firm, is a waste of resources. Presently, there is not a management system to help assure the minimum necessary concentration of resources.

- There is not now a capability to develop a total program plan for the minority business effort, or to determine the role of each program element in that plan. Accordingly, resource allocation decisions are made without the benefit of knowledge of whether there is a proper balance of resources among the various types of assistance. Under the present management arrangement, there is little flexibility to reallocate resources among the program elements during a fiscal year to meet changing needs. For example, there is no ability to reallocate funds budgeted for financial assistance to take care of special management assistance needs.

- There presently is no process to try to measure the progress or impact of the total Federal effort. The individual program elements themselves generally can only measure program input.

- The present program management arrangement tends to give priority to direct Federal assistance, either with Federal employees or through contractors. Lower priority is generally given to help in mobilizing the resources of State and local governments, businesses, trade associations and other private and public groups to get minority businesses into the mainstream of economic life of the country. Presently, these two parts of the total program are continuously in direct competition for the staff resources of the offices. The demands of the direct assistance programs invariably are more visible and immediate than those of the other programs, frequently resulting in insufficient staff attention to mobilizing non-Federal efforts.

Actions Recommended

The proposed actions for dealing with the problems are discussed in more detail in Attachment I. The recommendations are summarized below.

1. The Small Business Administration will have full responsibility for its socially or economically disadvantaged assistance programs, including the EOL loan program, the MESBIC program, the 8(a) procurement program, and related management and technical assistance activities. SBA will be responsible for assuring that these programs are managed as a comprehensive effort. Commerce may promote, or develop customers for, the EOL, MESBIC or 8(a) programs, pursuant to agreements between the two agencies.

2. SBA will be responsible for assuring adequate management and technical assistance for minority firms receiving SBA's financial or procurement assistance. To supplement its own management and technical assistance resources, SBA will use OMBE's management and technical assistance contractors when feasible. OMBE assistance will be provided pursuant to agreements between the two agencies, will not necessarily be restricted to the programs mentioned above, and will reflect OMBE's responsibility to reduce dependence on Federal assistance for minority enterprise.

3. SBA and Commerce will continue to provide management and technical assistance to minority firms which are not SBA's loan or procurement clients. The two agencies will establish operating agreements to coordinate the provision of such assistance.

4. Except as noted below, Commerce, working with the Interagency Council, will have the responsibility for stimulating Federal agencies to provide greater opportunities for minority firms to obtain the benefits of Federal agency programs. This will include encouraging agencies to establish goals for minority enterprise participation, and to initiate changes in programs, regulations, procedures, etc., to assure that minority businesses have an opportunity to participate in the Federal programs. In accordance with the policy guidance of the Interagency Council, the SBA will be responsible for providing assistance and advice to the Federal agencies and major Federal contractors regarding specific opportunities for increasing prime procurement and subcontract awards to minority businesses.

5. Commerce will be responsible for mobilizing minority business assistance efforts conducted by non-Federal organizations without continued Federal support. Commerce will give increased emphasis to the objective of developing effective alternatives to continued dependence on Federal assistance for minority enterprises.

6. Commerce will be responsible for developing an effective program to help minority firms become independent of SBA's special assistance programs, pursuant to an operating plan to be developed between SBA and Commerce. This plan will provide that Commerce will offer assistance to any of the EOL and 8(a) clients which either SBA or Commerce identify as in need of assistance in obtaining non-Federal markets, private financing, etc.

7. The Department of Commerce and the Small Business Administration will each assign full-time staff to work together to:

   - Recommend quantifiable long-term objectives for the total Federal minority business effort.
   - Review the annual program and budget proposals of the minority business assistance organizations to help assure that they are consistent with approved long-term objectives, and that there is a proper balance among the programs.
   - Review the coordination and cooperation efforts of the agencies to identify any problems, and to recommend solutions.
   - Oversee the development of a comprehensive process for measuring the impact of the Federal activities.
   - Evaluate the effectiveness of the Federal efforts and make recommendations for improvements.
   - Study alternative forms of Federal action to assist minority business development.

   These staff resources will report to the Office of the Secretary in Commerce and the Office of the Administrator in SBA. Such staff will not be part of the operational programs of the agencies, so they can devote their full attention to these high priority responsibilities. These two staffs will work together as a joint effort on all activities which affect programs of both agencies, and will develop consolidated reports and recommendations.

8. The Associate Administrator for Minority Small Business (AA/MSB) of SBA will have responsibility for developing objectives, priorities, policies and budget proposals, in conjunction with the other Associate and Assistant Administrators, for SBA's socially or economically disadvantaged assistance programs, including EOL, section 301(d) Licensee, 8(a), and related management and technical assistance. It will be the responsibility of the AA/MSB to assure that these programs are focused on common objectives, that the pieces of assistance fit together into a comprehensive effort and that resources are properly allocated among these programs. It will be the responsibility of this office to work with the other Associate and Assistant Administrators to help assure that the objectives, priorities, policies and budgets for these programs represent a coherent effort. The other SBA Associate Administrators will give full consideration to the recommendations of the AA/MSB in carrying out their responsibilities. If any disputes arise between the AA/MSB and the other Associate Administrators, they shall be resolved by the Deputy Administrator or the Administrator.

9. The AA/MSB of SBA will have responsibility for reviewing the implementation of the socially or economically disadvantaged assistance programs at the region and district levels, and to identify any problems with the delivery of this assistance in a coordinated and comprehensive manner. The AA/MSB will inform the Associate Administrator for Operations of any problems identified, and the latter will be responsible for taking corrective action through his field organization. If any disputes arise between the AA/MSB and the Associate Administrator for Operations, they will be resolved by the Deputy Administrator of the Administrator.

10. Each SBA Regional Office will assign responsibility to its Assistant Regional Director for Minority Small Business, to assure the effective implementation of the socially or economically disadvantaged assistance programs in the region. In each district and branch office, staff will be assigned responsibility for coordinating any assistance provided under the socially or economically disadvantaged assistance programs. These staff will be the principal point of contact for socially or economically disadvantaged individuals or firms dealing with the office, and will coordinate the provision of assistance to these individuals. These assigned "account executives" also will be responsible for following up with these businesses to identify problems and needs which may arise after assistance is provided. While firms are in SBA's 8(a) program, the responsible account executive will be provided by the field Office of Business Development staff. The account executives will be responsible for informing the District Director of any problems encountered with the individual program offices in carrying out their responsibilities.

IV. Implementation of Recommendations

It is planned that the recommendations of this report will be implemented in accordance with the following schedule:

April 15, 1976 - A revised Executive Order will be developed, to clarify the responsibilities of SBA and Commerce in accordance with the recommendations of this report.

April 30, 1976 - SBA and Commerce will complete Interagency Agreements regarding:

- Any Commerce support to be provided to SBA related to the EOL, MESBIC and 8(a) responsibilities of SBA;
- Coordination of management and technical assistance for firms other than SBA's loan and procurement clients; and
- Operating plans for efforts to develop non-Federal markets or financing for 8(a) and EOL clients.

April 30, 1976 - Commerce and SBA will complete plans for full-time staff to carry out the responsibilities of recommendation III.7.

May 15, 1976 - SBA will implement the revised internal management system to permit management of the EOL, MESBIC, 8(a) and related management and technical assistance in a comprehensive manner, to implement recommendations II.A.2, II.B.2, and III.8, 9 and 10.

July 15, 1976 - SBA, in cooperation with Commerce, will have established revised criteria for allocation of assistance under the EOL, MESBIC, 8(a) and management and technical assistance programs, to implement recommendations II.A.1, II.B.1, and II.C.2.

SBA and Commerce will complete plans for studies to improve the understanding of the factors leading to success and failure of minority businesses, in accordance with recommendation I.2.

The Administration will submit legislative proposals to Congress to increase the ceiling on EOL loans.

August 1, 1976 - Commerce will complete proposals for increasing stimulation of non-Federal efforts to assist minority business enterprise and to redirect resources for this purpose, in accordance with recommendations II.B.4 and III.5.

SBA will complete proposals for improving the effectiveness of the MESBIC program, in accordance with II.A.4.

Commerce and SBA will complete their analysis of standards for staffing for management and technical assistance programs, in accordance with II.C.3.

Attachment A

Summary Findings Of 1972 Survey Of Minority-Owned Business Enterprises

Background

The 1972 Survey of Minority-Owned Business is the second study in a series initiated in 1969. It provides basic economic data on businesses owned by blacks, persons of Spanish-American or Latin American ancestry, and persons of American-Indian, Asian, or other origin or descent. Data published from the survey cover number of firms, gross receipts, and number of paid employees distributed geographically by industry, size of firm and legal form of organization of firm.

The 1972 survey is presented in four reports. Publication dates are as follows:

Minority-Owned Businesses - Black	November 1974
Minority-Owned Businesses - Spanish	April 1975
Minority-Owned Businesses - Other	February 1975
Minority-Owned Businesses - Total	August 1975

Survey Findings:

- For the period 1969 to 1972, the number of minority-owned firms grew from 321,958 to 381, 935 or an increase of 19 percent. Gross receipts for these firms grew from $10.6 billion to $16.6 billion or an increase of 56 percent (Table A1 shows the distribution of business ownership by minority group).

Table A1

Comparison of Business Ownership by Minority Group 1969 and 1972

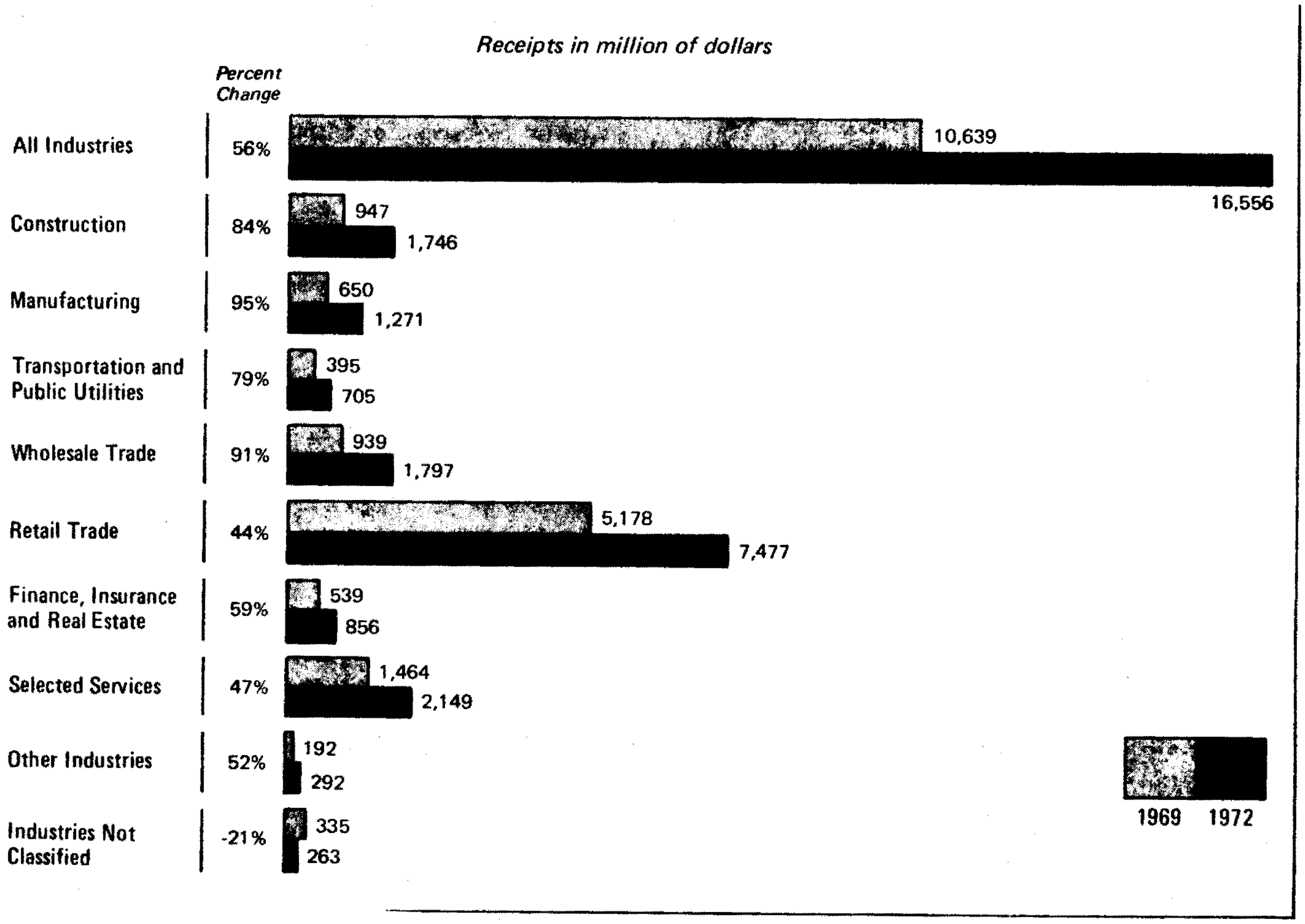
Minority	1972		1969		Percent change 1969 to 1972	
	Firms (number)	Receipts (million dollars)	Firms (number)	Receipts (million dollars)	Firms	Receipts
United States, total	381,935	16,556	321,958	10,639	19	56
Black	194,986	7,168	163,073	4,474	20	60
Spanish origin	120,108	5,306	100,212	3,360	20	58
Asian Americans, American Indians, and others	66,841	4,082	58,673	2,805	14	46

Source: Department of Commerce (Bureau of Census)

. During this same period, minority-owned businesses in the manufacturing industry experienced the greatest percentage increase (95 percent) in gross receipts, from $650 million in 1969 to $1,271 million in 1972. Those firms in the wholesale trade industry experienced an increase in receipts of 91 percent, with $939 million in 1969 and $1,797 million in 1972 (Figure A1 shows the distribution of receipts of minority-owned businesses by industry).

Figure A1

Receipts of Minority-Owned Businesses By Industry
1969 and 1972

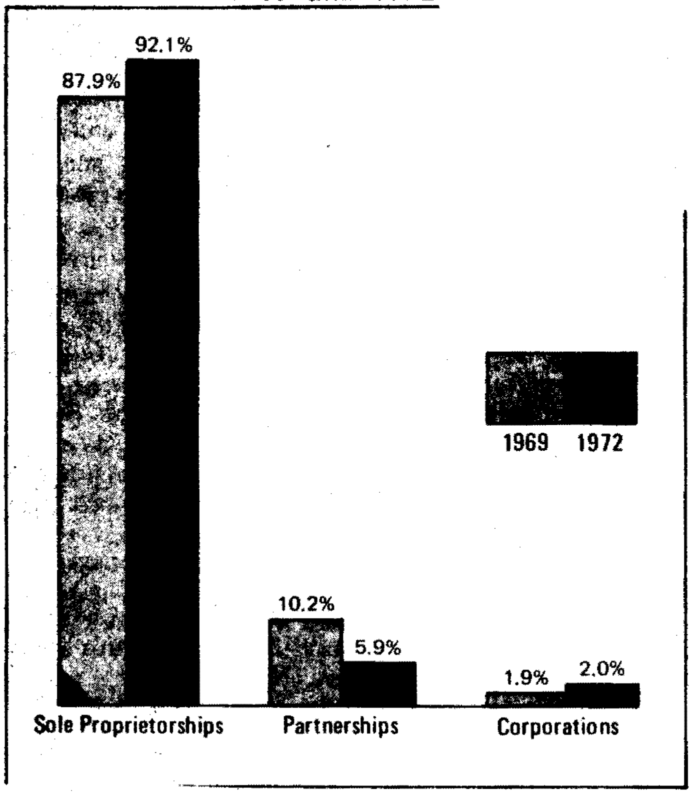


Source: Department of Commerce (Bureau of Census)

Figure A2

Percent Distribution of Minority-Owned Firms By Legal Form of Organization

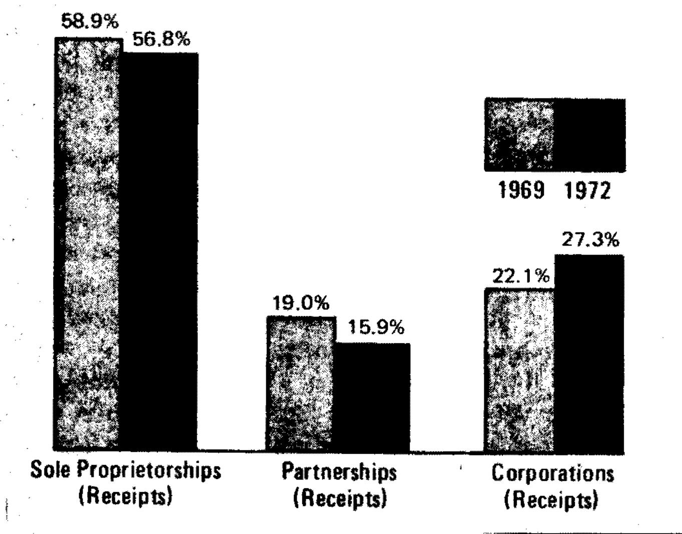
1969 and 1972



Source: Department of Commerce (Bureau of Census)

Figure A3

Percent Distribution of Receipts of Minority-Owned Firms by Legal Form of Organization



Attachment B

Summary of Federal Funds Obligated To Minority Business

The following data on the level of Federal assistance to minority business was compiled by OMBE and represents an update to those schedules provided in the report entitled "Progress of the Minority Business Enterprise Program 1973." This data reflects only input measures to Federal minority business programs and does not attempt to measure the impact of this assistance.

Figure 1 indicates that total Federal loans and guarantees to minority businesses have grown impressively from $197 million in 1970 to $509 million in 1973 or an increase of approximately 160 percent. SBA contribution to this total activity accounts for an average of 87 percent throughout the same period.

Figure 2 indicates that in 1973 Federal agencies and departments purchased more than $731 million in goods and services from minorities which is an increase of $700 million from 1970. Non-8(a) procurement has grown from $8 million in 1970 to $523 million in 1973.

A summary of Federal funds obligated to minority businesses for FY 1969-1974 is provided in Table 1.

The distribution of FY 1974 funding by Federal agency to minority businesses is provided in Table 2.

Figure 1

Federal Loans and Guarantees
By Fiscal Year

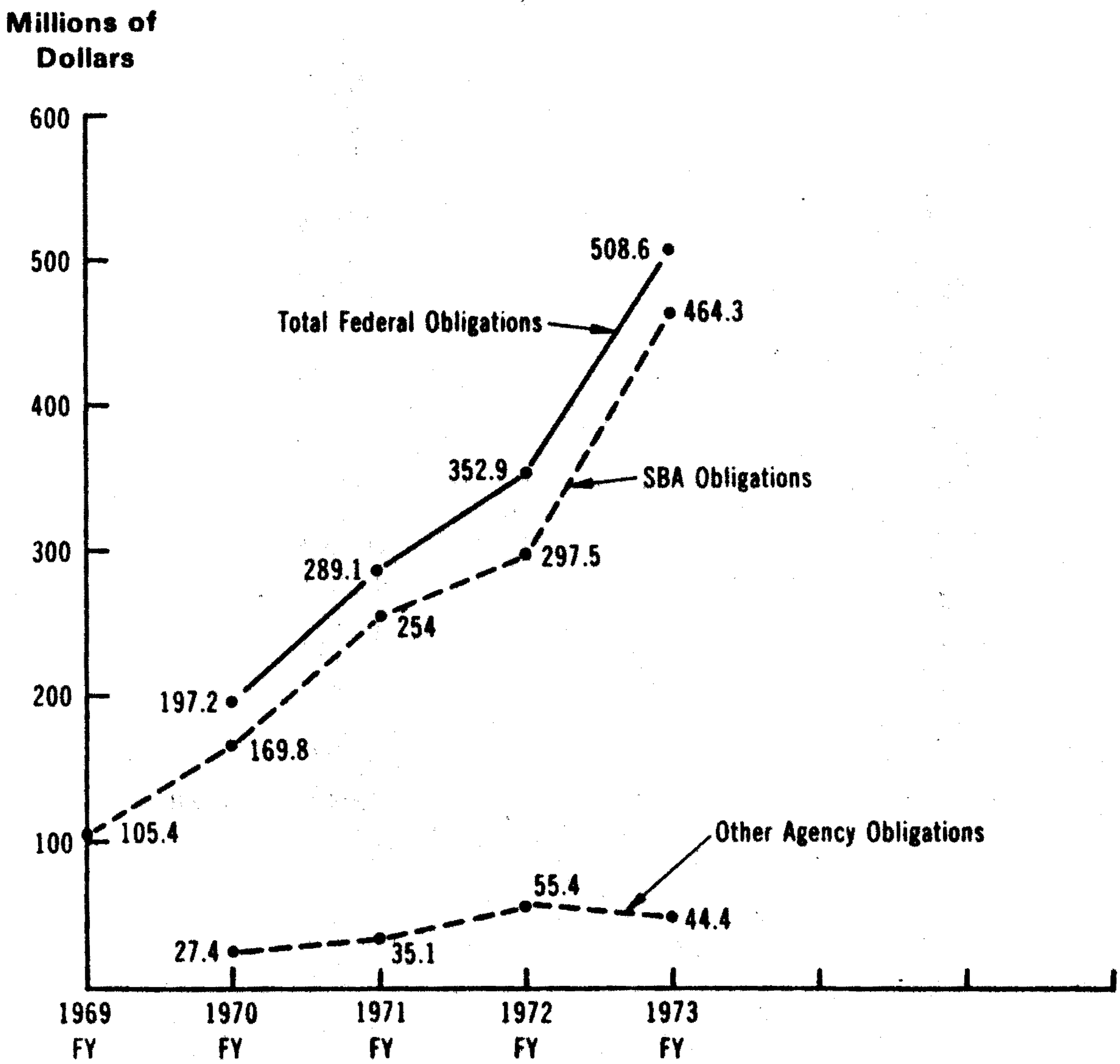


Figure 2

Federal Procurement By Fiscal Year

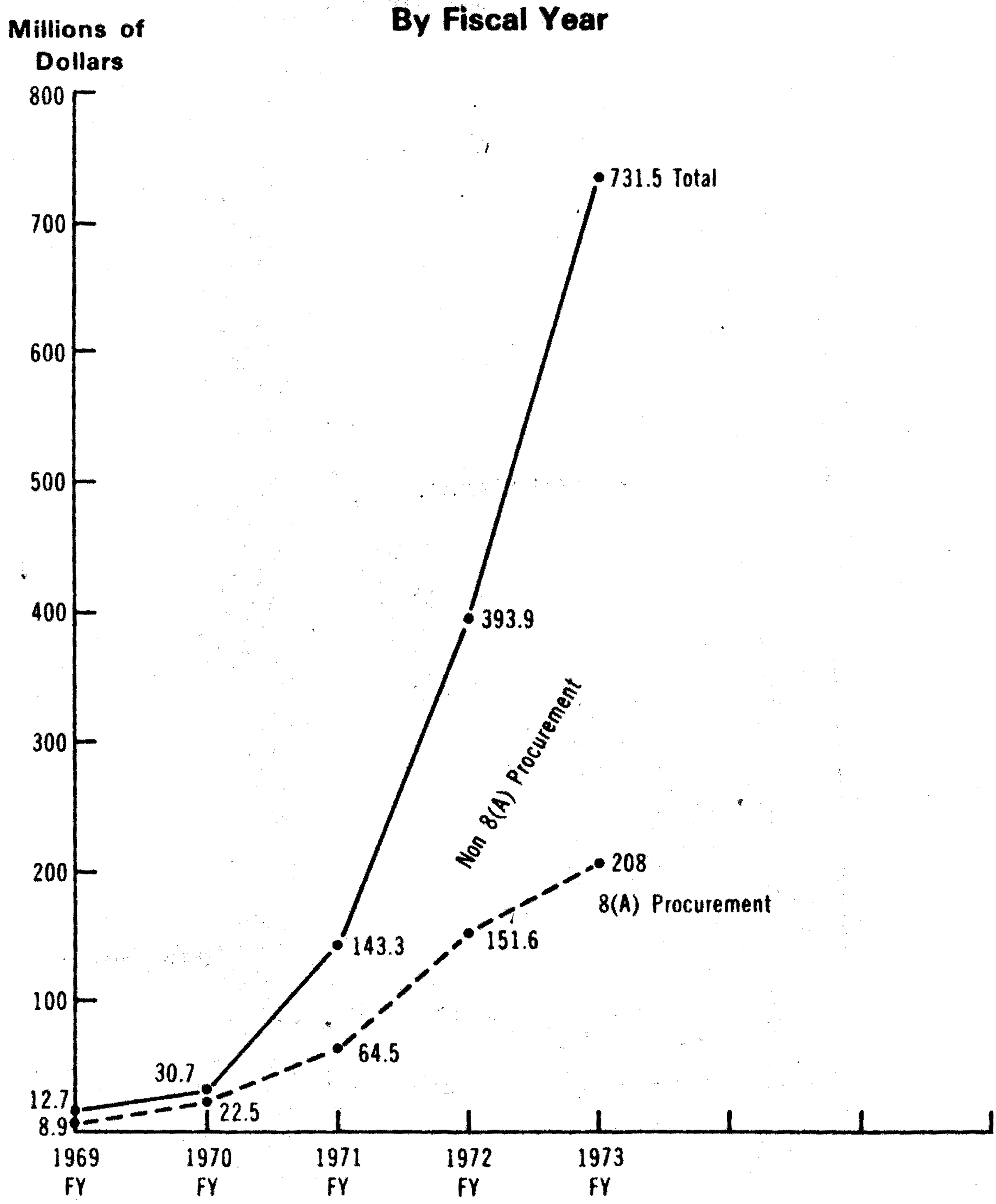


TABLE 1

Summary of Federal Funds Obligated to Minority Business Development Fiscal Years 1969-1974

November, 1974

Category	Fiscal Year 1969	Fiscal Year 1970	Fiscal Year 1971	Fiscal Year 1972	Fiscal Year 1973	Fiscal Year 1974	Cumulative Total
Financial Grants, loans and Loan Guarantees by Federal Agencies.	$200,000,000	$315,236,045	$434,019,716	$472,617,473	$670,185,569	$585,157,168	$2,677,215,971
8(a) Procurement by Federal Agencies	8,884,141	21,814,292	67,770,506	142,319,905	207,954,732	272,141,414	725,893,373
Direct and Subcontract Procurement by Federal Agencies	3,792,365	8,220,042	77,863,045	242,254,264	523,516,566	429,224,781	1,284,871,063
Total	212,856,506	345,270,379	579,653,267	857,191,642	1,401,656,867	1,286,523,363	4,687,980,407

TABLE 2

Summary of Federal Funding for Minority Business Development Fiscal Year 1974 (July 1, 1973 - June 30, 1974)

Agency	8(a) Procurement	Direct and Subcontract Procurement [1]	Loans and Loan Guarantees	Grants	Total
ACTION	$ 173,289	$ 30,000	—	—	$ 203,289
Department of Agriculture	2,592,150	—	—	—	2,592,150
Atomic Energy Commission	917,592	8,000,000	—	—	8,917,592
Department of Commerce	2,916,263	46,000,666	$ 500,000	$31,318,851	80,735,780
Department of Defense	144,130,949	79,371,000	—	—	223,501,949
Equal Employment Opportunity Commission	1,554,686	309,000	—	—	1,863,686
Environmental Protection Agency	2,595,683	10,700,000	—	—	13,295,683
General Services Administration	41,498,624	5,729,000	—	—	47,227,624
Department of Health, Education & Welfare	20,205,075	23,746,000	—	—	43,951,075
Department of Housing & Urban Development	2,281,643	139,752,876	—	9,259,000	151,293,519
Department of Interior	1,228,571	74,260,000	—	—	75,488,571
Department of Labor	3,719,768	10,592,000	—	—	14,311,768
National Aeronautic & Space Administration	11,796,765	7,880,000	—	—	19,676,765
Office of Economic Opportunity	693,336	162,039	—	37,679,317	38,534,692
Postal Service	218,694	—	—	—	218,694
Redevelopment Land Agency	596,209	761,200	—	—	1,357,409
Small Business Administration	1,343,673	225,000	506,400,000	—	507,968,673
Department of State (A.I.D.)	664,623	7,209,000	—	—	7,873,623
Department of Transportation	16,522,712	1,556,000	—	—	18,078,712
Department of Treasury (IRS)	165,346	62,000	—	—	227,346
Veterans Administration	15,163,727	12,879,000	—	—	28,042,727
Department of Justice	836,382	—	—	—	836,382
National Weather Service	39,355	—	—	—	39,355
Civil Service Commission	30,901	—	—	—	30,901
Executive Office of President	229,398	—	—	—	229,398
General Accounting Office	26,000	—	—	—	26,000
Total	$272,141,414	$429,224,781	$506,900,000	$78,257,168	$1,286,523,363

[1] Subcontract procurement includes that portion of a Government prime contract awarded to a non-minority firm that is in turn subcontracted to a minority firm.

Attachment C

Goals To Be Pursued Through Minority Business Development Programs

The current minority business development assistance programs have developed and grown, primarily during the last six years, without a clear common understanding of the overall goals of the programs or the appropriate means of measuring program impact.

This lack of a clear definition of program goals and objectives makes it difficult or impossible to make reasonable resource allocation decisions or improve program management.

What Are We Trying To Achieve?

A review of the statements of goals and objectives for the current programs, and discussions with policy officials interested in these programs, made it clear that there was not a consensus on goals.

Based on the review and discussions, the following possible program goals were analyzed:

1. Eliminate discriminatory actions against minorities which prevent or inhibit minorities' participation in private enterprise.

2. Increase minority ownership of private businesses which can operate on a profitable basis without continued Federal assistance, to help increase the income levels and asset ownership of minorities.

3. Close the gap between the majority and minority population in terms of numbers of businesses owned.

4. Close the gap between the majority and minority population in terms of income and assets from participation in private enterprise.

5. Assist minorities to obtain a major financial stake in businesses in predominantly minority communities, to increase the interest and pride of minorities in their communities.

Analysis of Validity of These Goals

1. Help eliminate discriminatory actions against minorities which prevent or inhibit minorities' participation in private enterprise.

This goal obviously implies that there has been discrimination against minorities which has limited their participation in private enterprise. Although it is not possible to draw firm cause and effect relationships, there is substantial indication that discrimination has existed and frequently continues to exist. The following data also leads to the assumption that discrimination has prevented minority participation in private enterprise.

- In 1969, minorities comprised approximately 17 percent of the total population but controlled only 4.3 percent of the total number of businesses in the United States.

- Gross receipts for these minority-owned businesses were only 10.6 billion dollars, or about 0.7 percent of the total receipts for all United States businesses.

- Minority-owned businesses accounted for only 0.3 percent of all business assets in the United States in 1971. The combined assets of all minority-owned banks and insurance companies is less than 0.2 percent of the industry total.

Few will disagree that it should be a national and Federal goal to remove this discrimination against minorities. It has been a principal policy of this Administration to help eliminate such discrimination. The real questions regarding this goal are not whether it should be a goal, but rather what can the Federal Government do toward achieving it, and how do we measure progress toward the goal?

In order to maximize the effectiveness of any Federal efforts to eliminate discrimination against minorities participating in private enterprise, it would be desirable to know the relative significance of the various discriminatory barriers. For example, are any of the following factors of substantially greater significance than the others: (1) the lack of minorities receiving business education; (2) the lack of experience in decision making positions as employees in business; (3) the inability to obtain adequate financing; (4) the inability of minorities to obtain prime business locations; or (5) discrimination by suppliers, customers or clients.

It has been noted that pursuing this goal should not be entirely the responsibility of minority business development agencies such as SBA and OMBE. It is correct that all agencies, and particularly EEOC and Justice, should be concerned with such discriminatory practices. But agencies with the responsibility for assisting minority business development should be responsible for helping to assure that enforcement agencies are giving adequate attention to areas of discrimination that are particularly significant for business success. Also, the "promotion" agencies should be concerned with identifying and implementing effective positive efforts (as opposed to enforcement efforts) to reduce or overcome discrimination that adversely impacts business success.

The effectiveness of Federal efforts to eliminate discrimination cannot be accurately measured by changes in the amount of minority participation in private enterprise. The amount of actual participation will depend on factors other than current discrimination, such as interest of minorities in entering business; education and experience of minorities in business management; and rate of economic growth. The inability to identify accurate measures of progress toward this goal, however, should not be a reason to reject this as a Federal goal. Since it is not feasible to measure progress in reducing discrimination, the best substitute is to measure the expected or desired results of reducing discrimination.

It is important not to select measures of results which will provide the wrong incentives to program officials. The measures should not encourage an input orientation or provide incentives to focus on quantity rather than quality.

Progress toward this goal might result in important social and political benefits for minorities, but such benefits cannot be meaningfully measured. It is felt that the most important results would be improvements in economic conditions, which in turn will lead to social and political benefits. Therefore, it is proposed that progress toward this goal be measured in economic terms, i.e., successful businesses with increased incomes and asset ownership by minorities.

2. Increase minority ownership of private businesses which can operate on a profitable basis without continued special Federal assistance, to help increase income levels and asset ownership of minorities.

The problem of relatively low income levels among minorities was one of the principal forces behind the initiation of Federal minority business development programs.

If the goal is to increase income levels of minorities, any Federal assistance toward such a goal should be provided only if it is determined that the particular activity will indeed have a good chance of increasing income for minorities.

When a minority individual is employed, he almost always receives economic benefits which exceed those of the unemployed. Participation in business, on the other hand, does not necessarily result in benefits to the participant which exceed those to the non-participant. Business failure can wipe out any savings that the individual may have had, subject him to humiliation in the community, result in a loss of dignity and pride, and lead to alienation from the "establishment."

The high failure rate among new businesses (in excess of 50 percent within the first two years) makes it clear that the chances of such economic and social failure of businesses are high. There is no apparent rationale to give special assistance to minorities to help them start business failures. Therefore, a program to improve the economic condition of minorities should focus on increasing minority participation in successful, i.e., profitable, businesses.

Because of the need to focus on creating successful businesses, the programs should not let immediate social or other considerations result in assistance to businesses which have poor chances of success. The assistance should be directed to stimulating minority participation in businesses which will provide the maximum economic benefits to minorities, regardless of geographic location or social status.

Consequently, minority participation in business should be encouraged where the chances of success (profitable businesses with maximum benefits to minorities) are the best, and would not be limited to predominantly minority communities.

Because it is often very difficult to establish or maintain successful businesses in low income minority communities, the emphasis on success may mean that much of the minority business development assistance would be provided to businesses outside of low income minority communities. This does not mean that there should be no efforts to stimulate minority business development in low income minority communities. Some businesses, particularly those which do not rely on the local market, may have a good chance of success in low income minority communities.

Minority business development in low income minority communities might also be undertaken as part of a broader community economic development program for low income areas.

Experience with economic development and adjustment programs to alleviate community poverty problems makes it quite clear that a minority business development program by itself is likely to have little impact on alleviating these problems. Successful efforts require the best possible combination of public facilities and services, investments by established minority and non-minority businesses, as well as a strong community interest in success. There is some indication that an active role by minorities in business ownership and investment in the community can help build that strong community commitment to success.

Without the proper comprehensive community effort, however, minority-owned businesses which rely on the local market are likely to have a very short life expectancy in low-income communities.

Minority business development should not, therefore, be pursued in isolation as a means of overcoming community unemployment or poverty problems. It should be one of a set of tools used to stimulate community economic development.

3. Close the gap between the majority and minority population in terms of numbers of businesses owned.

This goal has considerable superficial appeal, but it doesn't stand up under close scrutiny.

First, as discussed earlier, business ownership is not necessarily by itself a desirable state of affairs. A non-competitive business, or one that is only marginally profitable, may be an economic burden for its owners. Secondly, a very large number of marginal businesses may provide less economic, social and political benefits to minorities than a few large successful firms.

A serious problem with this as a goal is that it tends to pressure program people to emphasize numbers rather than real benefits to minorities. It provides incentives to lure minorities into business ownership even if they have little chance of success. It provides incentives to emphasize businesses that are easy to enter rather than those that are harder to enter but have higher chances of success.

A reduction in the gap in numbers of businesses owned might be one measure used to determine progress in reducing discrimination against minorities, but it must be tempered by an evaluation of the economic benefits flowing to minorities from such participation.

4. Close the gap between the majority and minority population in terms of income and assets from participation in private enterprise.

This goal is generally consistent with goals number 1 and 2, but acceptance of this as a goal has some problems.

First, the "gap" is now so wide that it would take several decades, at a minimum, to make a substantial reduction in the gap with the amount of resources that could reasonably be expected to be available. At this time, it is not feasible to make reasonable estimates of when this gap should be achieved.

Second, elimination of the numerical gap is not the real goal, but only a reflection of the progress made by minorities. If minorities attained essentially the same income levels as non-minorities, and were not discriminated against in entering or succeeding in business, there would be no fundamental reason for closing any "gap" that might exist in terms of income from business ownership.

5. Assist minorities to obtain a major financial stake in businesses in predominantly minority communities, to increase the interest and pride of minorities in their communities.

The problem with this goal is that businesses operating in minority communities frequently have a competitive disadvantage due to higher operating costs (insurance, theft, etc.) and predominantly low income customers. Special Federal programs to entice minorities into businesses in minority communities may be contrary to the goal of increasing income levels of minorities from participation in private enterprise. Such a goal may result in pressures to establish minority-owned businesses in ghettos regardless of the chances of success of the businesses. This could lead to a loss of financial benefits to those businessmen as well as further alienation of minority community residents.

Summary

In summary, the overall goals of the Federal minority business development programs should be to:

1. Help eliminate discriminatory actions against minorities which prevent or inhibit minorities' participation in private enterprise.

2. Increase minority ownership of private businesses which can operate profitably without continued special Federal assistance, to help increase income levels and asset ownership of minorities. In regard to this goal, special stimulation of minority-owned businesses in poverty communities should be undertaken only as part of broader efforts to overcome the poverty problems of the communities.

A reduction in the gap between the majority and minority population in terms of numbers of businesses owned, or increasing minorities' financial stake in their communities, may result from pursuing the above goals, but would not be pursued as goals themselves.

The measures of progress toward the two selected goals would be the same for both goals, i.e., the amount of the increase in income and asset ownership of minorities as a result of participation in private enterprise. This raises the question of why distinguish between the two goals. The principal reasons for distinguishing between the two goals is to clarify that the Federal effort should be more than just to remove discrimination; it should help minorities improve their economic condition by helping them overcome disadvantages which may result from past discrimination. The distinction also is important to make it clear that the Federal effort should not focus only on special assistance to overcome disadvantages; it should continue to do whatever is feasible to end discrimination so that minorities will eventually be able to compete in the private enterprise system without any Federal assistance.

Attachment D

Studies Of Factors That Lead To Success Or Failure of Minority Business

The following studies have been made regarding the success or failure of minority businesses which have been recipients of Federal assistance. Therefore, the results of these studies may not be representative of all minority businesses nationally.

Why Some Minority Business Enterprises Fail and Others Do Not: A Statistical Analysis (Completed in 1973 by Sharon B. Lockwood on a contract funded by OMBE.)

Purpose of Study

To determine which characteristics of minority business entrepreneurs are most highly correlated with business failure or non-failure. Thirty-three characteristics on minority entrepreneurs were analyzed and data was collected on over 5,000 recipients of SBA loan assistance for the period 1968-1971.

Study Conclusions

The result of the study was to identify the following important factors on the viability of minority business:

- Management Experience

  The owner's years of management experience has the most important impact on the outcome of the enterprise. Entrepreneurs with less than four years of management experience were very likely to fail.

- Amount of Collateral Possessed

  The second important factor on the viability of the minority firm is the amount of collateral (i.e., value of business plant, equipment, and land) held by the owner. Entrepreneurs holding less than $3,500 when they apply for a loan have a higher probability of failure than those holding more than this amount.

- Year In Which SBA Loan Was Made

  The study was inconclusive as to why this factor was so important. It was speculated that an SBA change in 1971 to make loan approval criteria more flexible to provide assistance to minorities may have adversely affected the failure rate of the minority loan recipient.

- Age Of The Business When The Loan Was Made

  This factor indicated that minority businesses with less than an average age of four years have a higher probability of failure than businesses with an age of over four years.

- Number Of Employees In The Business

  This factor indicated that businesses with more than three employees experienced higher survival rate than those with less than that number of employees.

Study Limitations

A primary limitation of this study is that minority enterpreneurs were studied in a vacuum, without reference to equivalent information on non-minority entrepreneurs. Without this equivalent information, it cannot be determined if the causes of minority business failure are unique to minority entrepreneurs or are common to all entrepreneurs.

Study of Minority Borrowers And Firms Prior And Subsequent To SBA Assistance
(Completed in 1974 by Office of Program Planning and Evaluation, SBA)

Purpose of Study

To identify minority borrower characteristics and to determine which of these characteristics or other factors appeared to have the greatest influence on the viability of the loan recipient. A random sample of 600 minority loan recipients for the period 1968 to 1970 was analyzed.

Study Conclusions

The following are summary conclusions:

- Fifty-seven percent of all firms studied appeared capable of continuing business operations.

- Fifty percent of firms in the general business community discontinued within two years of start-up, while it was found that 53 percent of SBA minority borrowers studied either discontinued or were expected to discontinue their new business within the first two years of operation.

- The managerial characteristic which appeared to have the greatest effect on success and failure is previous business decision-making experience. Thirty-six percent of borrowers with such experience discontinued or were expected to cease operations, compared to 59 percent for those lacking this background.

- The business factors which appear to have the greatest relationship to success and failure are:
  - -- Type of industry;
  - -- Business location; and
  - -- Pre-loan operating and financial history of the business.
- Significant differences in the extent of success and failure of minority business are evident:
  - -- Firms operating prior to receiving SBA loans were more viable than new business start-ups.
  - -- Firms obtaining SBA guaranteed loans were more viable than firms financially assisted by direct SBA loans.

Study Recommendations

. Loan Recipients With Known or High Potential Problems

Recommendation: Establish systematic follow-up of borrowers with characteristics highly related to business failure, particularly within the vulnerable two year period after financing. This action should produce the framework for more effective and timely assistance.

. Approval of Direct Loans

Recommendation: Decide whether grossly disproportionate rates of business discontinuance between direct and guaranteed loan recipients are warranted. If not, criteria for approving direct loans should be strengthened.

. Previous Decision-Making Experience

Recommendation: Require that loan approval procedures include evidence that consideration has been given to probable survival problems of prospective borrowers who lack previous business decision-making experience. In all such cases pre-loan counseling should be provided.

. Pre-loan Consideration of Identified Management Weaknesses

Recommendation: Revise loan approval criteria to assure consideration of any specific management deficiencies identified during the loan-making process. Where such weaknesses are found, require a realistic plan to alleviate the deficiencies as a condition of loan approval.

. Borrower Submissions of Required Financial Reports

Recommendation: Review and strengthen operating practices for obtaining post-loan periodic financial statements. This action is essential in order to provide SBA with timely information to help solve current and emerging problems and to foster the viability of borrower firms.

Study Limitations

The study sample of SBA minority loan recipients was too small (five percent) to be fully representative of all SBA minority borrowers.

Attachment E

Financial Assistance Programs for Minority Businesses

The focus of this review is on the major debt and equity financing programs for minority businesses within the Small Business Administration, i.e. the Economic Opportunity Loan Program and the MESBIC Program.

I. Economic Opportunity Loan (EOL) Program

A. Program Background

The EOL Program was established by Title IV of the Economic Opportunity Act of 1964. Title IV as originally enacted placed jurisdiction of the program under the Director of the Office of Economic Opportunity. However, Section 401 of the Economic Opportunity Amendments of 1966 transferred the responsibility for the EOL Program to the Administrator of SBA. Authority for this program was included in the Small Business Act by Public Law 93-386, of August 23, 1974.

The principal purpose of the EOL Program as presented in SBA regulations is as follows:

> "To make funds available on reasonable terms and maturities to small business concerns located in areas with high proportions of unemployment or to small business concerns owned by or to be established by persons with low incomes. Particular emphasis is placed on assisting low-income individuals who due to social or economic disadvantage have been denied the opportunity to acquire adequate business financing through normal lending channels on reasonable terms."

Loans under this program were limited to $25,000 until 1972 when the maximum loan ceiling was changed to $50,000. The maximum maturity on EOL loans is 15 years and the interest rate is set at cost of money to the Treasury plus such additional charges to cover administrative costs of the program (currently direct EOL loans are at 8.38% and guarantee EOL loans are at 10.75%).

From the start of the program in 1974 through the end of 1974, 46,109 EOL loans for $683.4 million were approved. In FY 1974, 6,290 laons for $109 million were made. The average size of EOL loans has increased from $12,142 in 1965 to $19,318 in 1974. The loss rate of the EOL Program has been reported at 30 percent of total loan disbursement which is by far the highest loss rate of all SBA loan programs.

B. Program Evaluations

1. SBA Review of Economic Opportunity Loan Program

SBA has an ongoing annual review of the EOL Program. The SBA review focuses on descriptive analysis rather than on EOL program impact.

The following are some of the findings of the SBA review:
...Location of EOL Borrowers
--72 percent of the EOL loans were made to borrowers located in urban areas.

...Income Characteristics and Minority Groups
--The median income of EOL recipients in FY 74 was $7,456 per year.

--71 percent of the FY 74 EOL loans were made to members of minority groups. The distribution of EOL assistance by minority group is as follows: Black, 45%; Spanish American, 28%; Puerto Rican, 17%; other, 10%

...Type of Business
--48 percent of the FY 74 EOL loans were made to firms in the retail trade industry, and 25 percent to firms in the services industry.

...New or Existing Businesses
--61 percent of the FY 74 EOL loans were made to existing firms.

...Direct versus Guaranteed EOL Loans
--For FY 74, $64 million in direct EOL loans was approved and bank loans of $45 million were guaranteed.

2. "Proposal for New Priorities in SBA's Minority Lending Programs" (Bates/Bradford Report)

This unpublished report was presented at the March 1975 White House meeting on Minority Business by Dr. Timothy Bates (Asst. Professor of Economics, University of Vermont) and Dr. William D. Bradford (Asst. Professor of Finance, Stanford University).

- Focus of Study

The Bates/Bradford report focuses on a random number of black-owned businesses (555) in Boston, New York and Chicago which had received either direct or guaranteed EOL assistance during the years 1967 through 1970. Extensive information on financial variables, loan term, loan repayment status and other items was collected from the SBA district offices.

- Summary Study Conclusions

... At the end of November 1973, over 54 percent of the sampled black business EOL borrowers were either 1) delinquent 60 days and over regarding loan repayment, 2) in process of liquidation, or 3) closed out and charged off by SBA as uncollectable loans.

... The incidence of delinquency among black recipients of SBA EOL loans (64 percent) is far greater than the frequency of delinquency found among black borrowers under other SBA loan programs (42 percent).

... Using discriminant analysis on information which was available to loan officers at the time the loan approval decisions were made, it was concluded that most of the business failures among black EOL borrowers were predictable; they were therefore avoidable.

... EOL loans often perpetuate rather than alleviate poverty because the availability of capital at relatively low rates of interest has encouraged many wage earners to enter businesses that are not viable. The result of failing in business are defaulting on an EOL loan places severe hardship on unsuccessful entrepreneurs.

... Blacks who borrow to purchase already existing established businesses (including franchises) have a greater chance of success than those borrowing to start new firms, even when the experience and financial attributes of the borrowers are taken into consideration. However, new firms tend to offer larger incremental employment to the community than can changes in ownership of already existing businesses.

... A significant amount (32 percent) of the black EOL borrowers forming new businesses are entering the traditional fields of black enterprise (barber shops, restaurants, laundry, shoe repair, food stores, and funeral parlors). Creating additional firms in these traditionally crowded lines of business could force more black firms to compete for shares of a market that is fixed in size. In this situation, SBA financing of new businesses might succeed in driving existing black entrepreneurs into bankruptcy.

- Study Recommendations

1. The Economic Opportunity Loan (EOL) Program should be appreciably diminished. The EOL program appears to be a device for perpetuating rather than alleviating poverty among low income, disadvantaged enterpreneurs.

2. The EOL lending philosophy should be altered. The SBA should deter its lending to enterpreneurs in the absence of reasonable repayment prospects.

3. Funds which presently support EOL loans should largely be reallocated to increase financing and other support available for the most capable minority entrepreneurs. Stronger firms offer greater incremental contributions to employment and output in inner city communities, where most minority enterprises are located.

4. SBA should generally avoid financing the creation of new firms in traditional lines of minority enterprise, such as barber shops, beauty parlors, funeral homes and so forth. Creating additional firms in these traditionally crowded lines of business leads, in many instances, to a destructive zero sum game in which SBA financed new firms succeed only by driving existing minority entrepreneurs into bankruptcy.

5. Potential entrepreneurs who wish to create new businesses should receive loans only when they have very strong business backgrounds. (Past income and years of managerial experience are the best background trait predictors of future business success.) Marginally qualified borrowers that receive SBA loans to create new firms are rarely successful and their loan default rates are extraordinarily high.

6. The success of SBA's minority enterprise lending efforts should be measured in terms of both 1) loan recipient business survival rate, and 2) loan recipients' incremental contribution to employment and output. Furthermore, future SBA loan approval decisions should be based upon these criteria.

3. "Limited Success of Federally Financed Minority Businesses in Three Cities"

This GAO report was completed in November, 1973 and addressed SBA assistance provided to minority business. For purposes of this section, only the GAO evaluation of SBA financial assistance is reviewed.

- Focus of the Study

This GAO report focused on 845 minority businesses receiving SBA loans disbursed by the Chicago, Los Angeles, and Washington, D.C. District Offices during fiscal years 1969 and 1970. The report reviewed the degree to which minority businesses financed by SBA through Operation Business Mainstream had been successful. Operation Business Mainstream was a concerted SBA effort to increase the number of minority-owned businesses using all elements of SBA programs including the 7(a) Business Loan Program, the EOL Program, the 8(a) Procurement Program and the 406 Management Assistance Program.

- Summary Study Conclusions

... Of the 845 minority-owned businesses receiving SBA loan assistance, GAO classified:

-- 232 (27 percent) as failures;
-- 213 (25 percent) having serious problems and probable failures;
-- 260 (32 percent) as probable successes; and
-- 140 (17 percent) as undeterminable.

... Those minority businesses with SBA guaranteed loans indicated a higher incidence of success (41%) than recipients of direct loan assistance (16%). Probable and actual failure rates were 42 percent for direct loan recipients.

... A comparison of size of loans indicated that those recipients of minority loans over $25,000 indicated a higher incidence of success (41%) than recipients of minority loans under $25,000 (25%).

... Seventy-four minority businesses had received two or more SBA loans and GAO classified them as 42 (56%) failures or probable failures, 13 (17%) probable successes, and 19 as undeterminable. Providing follow-on loan assistance to minority loan recipients appears to be of limited value by itself in improving the chances of business success.

... SBA and OMBE cited increases in the number of loans to minorities as a measure of success of the Federal effort to assist minority businesses. Such a measure gives no recognition to the fact that the Federal effort has a potential risk as well as a reward. This risk is that minorities, encouraged to go into business by SBA and OMBE, may fail and be left deeply in debt and worse off than before they received help.

- Study Recommendations

... To provide greater assurance that loans are made for minority businesses with reasonable prospects for success and thus reduce the current high rate of failure, GAO recommended that SBA develop loan approval criteria based on an assessment of owner and business characteristics related to business success and failure.

4. Report of House Select Committee on Small Business

Congress has frequently indicated concern with the high loss rate on the EOL program.

This congressional concern was spelled out by the House Select Committee on Small Business, in its "Final Report", dated December 30, 1974, as follows:

> "For several years, this Committee has expressed concern about the number and dollar volume of slow, trouble and liquidated economic opportunity loans resulting in substantial losses. Testimony at the oversight hearings in September 1973 and various SBA reports indicate that about one out of every three or four loans fall in one of the above categories.
>
> This Committee does not consider this percentage of trouble loans acceptable. The Small Business Act provides that no loans should be made without reasonable assurance of repayment. This loss ratio would indicate that many (EOL) loans are made without adequate investigation and, also, that stronger collection policies and procedures are needed as well as more substantial management and technical assistance to these borrowers."

5. House Subcommittee Report on Minority Enterprise and Allied Problems of Small Business

This report, prepared by the Subcommittee on SBA Oversight and Minority Enterprise, made the following conclusions and recommendations related to the EOL program.

... The present statutory ceiling ($50,000) on EOL's is not realistic in view of the inflationary characteristics of the present day economy.

... An SBA administrative decision to increase the guarantee percentage (from 90% to 100%) on EOL's secured through the bank gurantee program would greatly increase the availability of private sector resources to the minority business community.

... SBA loan programs have proven to be of extremely little value to American Indian business persons. SBA has not made an effort to isolate the business financial problems of the American Indian and adjust its programs accordingly.

- Report Recommendations

1. That SBA:

   ... Consider raising the guarantee limit on EOL guarantees from the current level of 90 percent to the allowed statutory rate of 100 percent.

   ... Make all appropriate efforts to increase the participation of American Indian business persons in all its loan programs.

2. That the Subcommittee on SBA and SBIC legislation of the House Committee on Small Business give consideration to legislation to increase the statutory ceiling on EOL's from the present $50,000 to at least $75,000.

C. Comments on the Above Conclusions and Recommendations

The SBA/Commerce/OMB review of the EOL program and the analysis of the independent evaluation reports have resulted in the following major conclusions:

1. There is general agreement that there is a need to establish a system for providing management and technical assistance to EOL borrowers as needed to provide a reasonable chance for success of the firms. SBA has a policy of providing a management assistance review for all EOL direct loan applications. SBA cannot, however, provide assurance that EOL borrowers receive the proper management assistance on a timely basis. The previously cited GAO report indicated that SBA management assistance was often provided to a business too late to have an effect on improving the status of the business or reversing a trend toward business failure. In many instances, the management assistance provided was not timely because inadequate loan servicing prevented the problems from being identified at an early date.

   OMBE-funded organizations provide management and technical assistance to EOL applicants, but this assistance has been primarily provided in the loan packaging stage. OMBE does not have information on the amount or impact of OMBE assistance to EOL borrowers.

2. Although EOL borrowers could qualify for assistance under the 8(a) procurement program, SBA does not have information on the amount and impact of 8(a) contracts on EOL borrowers. SBA cannot assure that an effort is made to obtain 8(a) procurement assistance for an EOL borrower in cases where such market assistance may be desirable.

3. There is a need to establish improved criteria for selection of EOL loan recipients, based on information regarding the factors leading to success and failure of firms. There appears to be a conflict between the desire to assist low income individuals under the EOL program and the finding that one of the most important factors in the viability of the minority firm is the amount of collateral held by the owner. It may be possible to partially overcome the problem of a lack of collateral by increasing the size of EOL loans. There is the danger, however, that low collateral requirements may reduce incentives for the owner to make the business a success and avoid the loss of collateral. There is a need to carefully study how the EOL requirements can be revised to continue to assist relatively low income individuals while increasing the chance that the assistance will not result in failure.

4. There is a need for greater flexibility in determining the size of EOL loans. The current $50,000 limit appears to contribute to the number of cases where inadequate financial assistance is provided.

5. It would not be appropriate to provide a 100% guarantee of bank loans under EOL. This would further reduce the banks' interest in assuring that the firms have a reasonable chance of success. A 1971 study showed that EOLs with a 100 percent guaranty have a far higher rate of defaults and purchase actions, bearing out the rationale for requiring a minimum level of bank exposure. Moreover, lending institutions having a financial interest in their borrowers may develop a relationship with those borrowers. Hopefully, this will provide an experience base which will allow participants in this program to move into the private sector exclusively for future financing.

II. <u>Minority Enterprise Small Business Investment Company (MESBIC) Program</u>

A. <u>Program Background</u>

The MESBIC Program was established by PL 92-595, the Small Business Investment Act Amendment of 1972, approved October 27, 1972. MESBIC's are privately owned, privately managed venture capital corporations. Chartered in their home state and licensed to operate on a national basis by the Small Business Administration, MESBIC's furnish the following four basic services for businesses which are owned 50% or more by socially or economically disadvantaged individuals:

1. Provide venture capital by purchasing an equity interest in the business. (Common and/or preferred stock).

2. Provide long-term capital by lending funds (normally subordinated to other creditors) to the business, often with warrants permitting the MESBIC to purchase an equity position.

3. Guarantee loans made by third parties to the business.

4. Provide general management and technical assistance to such businesses.

Inasmuch as venture capital is one of the major needs of disadvantaged entrepreneurs, MESBICs have been given the power by Congress to leverage their privately invested capital by selling long-term debentures and/or preferred stock to the SBA. For instance, MESBICs with $500,000 or more of capital and capital-surplus may sell up to three times this sum in debentures to the SBA, priced at the cost of capital to the U.S. Government. The resulting capital pool can be further leveraged by cooperative bank loan participation to provide approximately twenty times the MESBICs capital in equity and working capital to minority businesses.

A MESBIC is a modified form of the Small Business Investment Company (SBIC).

The differences are as follows:

1. The MESBIC investments are restricted to businesses which are at least 50 percent owned and managed by eligible minorities.

2. The MESBIC is supported by some organization or group, called a sponsor, that can provide capital operating funds and management assistance to the MESBIC and its portfolio companies.

3. A MESBIC can be licensed with minimum capital of $150,000, but SBA imposes the restriction that annual operating expenses in excess of eight percent of paid in capital cannot be withdrawn from the capital investment. Additional operating expenditures must be provided through other sources, usually involving the assistance of the sponsoring organization.

The first MESBIC was organized in 1969. It was not until the provisions of the amendments of 1972 to the Small Business Investment Act broadened the scope of the program and increased its leverage possibilities that the MESBIC concept became truly viable. In December 1975, there were 80 MESBICs with over $40 million in private capital and $42 million in Federal funds via preferred stock and/or debentures. SBA estimates that more than 1,500 minority small businesses have received direct and financial assistance through the MESBIC program.

B. Program Evaluations

1. "A Look at How the Small Business Administration's Investment Company program for Assisting Disadvantaged Businessmen is Working."

This GAO report was published on October 8, 1975, and addressed the operational problems of MESBICs and SBA administration of the MESBIC program.

This GAO report focused on ten MESBICs located in or near Chicago, San Francisco, Dallas and New Orleans. A review was made of MESBIC financial statements, accounting records, and files pertaining to investments made, rejected or being considered by the selected MESBIC. It also included examining SBA loan dockets and files pertaining to bank and SBA assistance provided to MESBICs.

- Summary Study Conclusions

... According to financial statements submitted to SBA during the year ended June 30, 1974, sixty-seven MESBIC's had total funds of $52 million, of which $23 million represented SBA funds. The MESBICs' investments in disadavantaged small businesses totaled only $17 million, or about 33 percent of available funds.

.... Despite SBA guidelines instructing that MESBICs should emphasize equity investments in minority enterprises, the GAO review of ten MESBICs showed that actual equity investments accounted for only 19 percent of the total amount of funds available for investment. The remaining MESBIC financings were made in the form of loans (65%) and debt securities (16%).

... Review of the ten MESBICs indicated that management fees for services provided to MESBIC clients tended to be unreasonable. For example, one investment company charges flat fees up to $25,000 for initial management and technical services. Another investment company charged four different minority small businesses 27 percent of profits before taxes as management fees. GAO concluded that these excessive management fees may burden the already disadvantaged small business.

... The MESBIC program lacks clear SBA policies and guidelines concerning the eligibility of potential clients. The lack of adequate eligibility criteria has inhibited the solicitation and development of investment prospects.

- Study Recommendations

1. SBA should establish policies and guidelines to assist MESBIC in assessing reasonable management fees.

2. SBA should develop guidelines that define specific factors MESBICs should consider in declaring persons eligible for program assistance.

3. SBA should improve management control over the MESBIC program by requiring that MESBICs provide more meaningful management reports.

2. "Federal Government Policy and Black Business Enterprise"

This book was written by Robert J. Yancy and published in 1974. Specific observations were made on the MESBIC program.

- Summary Conclusions

... The most severe problem facing MESBIC's is cash flow. MESBICs do not generate rapid income turnover because of low interest rates charged on loans and because of the extended periods before equity investments yield any dividends. However, the MESBIC may experience loss on investments, operating costs, and interest that it must pay on borrowed funds which can leave the MESBIC with a negative cash flow and depleted resources.

... In 1971, 34 MESBIC's participated in 270 financings involving total capital creation of $26 million. For 1972, 50 MESBIC's participated in 152 financings involving total capital creation of $16.8 million. The amount of MESBIC contribution to these financing activities decreased from $4.6 million in 1971 to $3 million. In other words, MESBIC contribution to new capital decreased by 35 percent while the total number of MESBIC's increased 34 percent.

....Criticism exists on the size of MESBIC's that are being encouraged to form. Addison Parris, in his book on the SBA observed that virtually all SBIC's which were successful were capitalized at $1 million or more and invested their funds in larger small businesses. Sixteen of the 34 MESBIC's licensed by the end of FY 1971 had less than $200,000 in capital and only one had $1 million or more in capital.

3. "Position Paper of the American Association of MESBICs"

This paper was presented by Roland Crump at the March 1975 White House Meeting on Minority Business.

- Conclusions of Position Paper

...A major problem in the MESBIC industry is the urgent need for effective managerial assistance program for our portfolio clients. The SBA 406 and SCORE/ACE programs and the OMBE BDO's are not designed to effectively give the proper assistance to MESBIC clients.

...A recent MESBIC survey indicates that the average MESBIC is capitalized at $475,000 and a full-time staff of three persons with an average overhead of $80,000. Additional resources are not currently available to allow MESBICs to provide in-house management assistance to clients.

...Another primary problem in the MESBIC program is the under-capitalization of MESBICs. Over 45 percent of existing MESBICs are privately capitalized $300,000 or less. Experience indicates that a $300,000 base is insufficient to allow a MESBIC to be an active investor in minority businesses. MESBICs tend to become quickly leveraged with SBA debt obligations which makes the viability of the MESBIC precariously dependent on the viability of its debt clients.

- Position Paper Recommendations

...MESBICs should be given direct financial assistance to hire the staff necessary to provide management assistance to clients.

...The leveraging ration for SBA preferred stock as it applies to venture capital investments be increased from 1:1 to 2:1, thereby giving the MESBICs 4:1 leveraging of private capital instead of the existing 3:1 ratio.

...OMBE cease from encouraging the formation of MESBICs capitalized at less than $500,000 - the ideal model depicts that MESBICs should have a capital base of not less than $1,000,000.

...SBA raise the floor of initial MESBIC capitalization for licensing to $500,000.

...The present MESBICs capitalized under $500,000 be given the same full rights and privileges as current MESBICs capitalized at $500,000 or more.

4. Joint OMBE/SBA Force on MESBICs

In February 1974, OMBE and SBA established a joint task force on MESBICs for the purpose of establishing program goals, proposing improvements in program policy, and coordinating interagency efforts to promote, license and regulate MESBICs.

A clear understanding was developed that SBA had the legislative mandate to license, regulate and fund MESBICs, and OMBE would promote the program in a manner which would encourage the expansion of the present licensees and the funding of new licensees. This dual interagency role in the MESBIC program has not contributed to a more effective program, but has developed significant interagency conflict on major MESBIC policy issues.

The MESBIC joint task force has not decreased this interagency conflict and in some instances has functioned as a mechanism for bringing the interagency conflict to a peak. Although specific OMBE/SBA work plans were developed for FY 1974 and FY 1975, few of the tasks were completed.

5. House Subcommittee Report on Minority Enterprise and Allied Problems of Small Business

- Report Conclusion:

...The Subcommittee estimates that well over 60 percent of the capital resources of MESBICs are not invested in the minority community but are held in cash and U.S. securities. MESBICs are relatively free to invest such funds in bank certificates of deposit, or in other securities with a higher interest rate than their Government financing. The Subcommittee believes that Federal funds should not lie idle in MESBIC bank accounts to the benefit of its investors while the minority community lacks venture capital.

...The Subcommittee also recommended that the SBA should continue and increase its efforts to attract large and majority businesses to participate in the establishment of MESBICs.

C. Comments on the Above Conclusions and Recommendations

1. There is a need to improve the effectiveness of the MESBIC program in providing equity capital to the socially or economically disadvantaged. Possible ways of doing this that should be considered are:

...Focus efforts on creating only large MESBICs which may have more financial flexibility.

... Modify regulations relating to the use of available funds for other than equity investments.

2. There is a need to improve the availability of management and technical assistance to firms assisted by MESBICs. This might be done through increasing the management assistance capabilities of the MESBICs themselves or by establishing a management system for providing the needed assistance from other available sources, including the SBA's 406 program and OMBE contractors.

Attachment F

Procurement Assistance

The Federal Government's special procurement assistance program for minority businesses is the SBA's 8(a) contract program. Through this program, the SBA assists minority and disadvantaged persons to obtain non-competitive negotiated contracts from various government agencies.

Other procurement assistance is offered under the authority of Title 41 of the Code of Federal Regulations which makes the head of each procuring activity in every agency responsible for setting up a minority procurement program and providing assistance to minority firms. Title 41 also requires that solicitations carry a section to inform potential respondents regarding the Federal policy to assist minority firms and to encourage the use of minority subcontractors by prime contractors. The Office of Minority Business Enterprise (OMBE) provides for additional procurement assistance through the National Purchasing Council. This group, which receives a grant from OMBE, consists of private sector business executives who seek to develop private procurement programs for minority business.

I. SBA 8(a) Contract Program

A. Program Background

Section 8(a) of the Small Business Act of 1953 authorizes the SBA to enter into procurement contracts with Federal agencies and to subcontract the work to small businesses. The original intent was to make certain that small businesses received contracts during wartime. However, the SBA never used its authority until 1968 when it was employed to develop jobs and training for minorities in the ghettos. Contracts were awarded to small firms willing to locate in or near the ghetto and provide jobs. The initial contracts went to manufacturing businesses.

Gradually the emphasis was changed from jobs, to business ownership, and the SBA began to use its 8(a) authority to assist minority-owned firms to develop and expand. Since 1969, the general goal of the 8(a) program has been to assist minority and economically/socially disadvantaged businesses develop and become competitive by providing non-competitive Federal contracts.

B. Program Evaluation

Much has been written about the SBA 8(a) program. Generally the criticisms have been failure of firms to develop under the program, lack of required management assistance, poor pricing assistance resulting in little profit or a loss, inability of the SBA to obtain from the procuring agencies the amount of contracts a firm requires for growth, and non-responsive and negative attitudes on the part of some of the SBA regional and field staff in dealing with minority business owners. However, the 8(a) program has awarded, through FY 1975, $1,059 million in subcontracts. Some firms have benefited from this program in terms of economic growth and increased viability.

There are two recently completed program evaluations of the SBA 8(a) program. The GAO study, "Questionable Effectiveness of the 8(a) Procurement Program", dated April 16, 1975, and the SBA "Evaluation of the 8(a) Contract Program", dated March 1974, both look at the impact and problems of the program.

Summary of Evaluation Findings & Recommendations

1. GAO April 1975 Study

a. Findings

Progress of 8(a) Firms

- SBA's success in helping disadvantaged firms to become self-sufficient and competitive has been minimal. From 1968 to August 1974, only 31 firms successfully completed the program.

- GAO evaluated the progress of 110 firms that had received at least 1 subcontract before December 31, 1970. These firms received over $81.4 million in 8(a) subcontracts.

- Of the 110 firms , 73 had not reached self-sufficiency. Twenty firms deteriorated financially, 27 went out of business, and the remaining 26 had either a slight financial improvement (but not enough to make the firm self-sufficient) or no change. Of the remaining 37 firms, 18 became self-sufficient and 19 were not classified because of insufficient information.

- A major reason for this lack of success was SBA's inability to control the supply of contracts from Federal agencies. Although applicants specify in business plans the amount of assistance they need each year to become self-sufficient, SBA cannot guarantee any level of assistance.

- SBA did not provide adequate assistance to the 20 firms that deteriorated financially or the 27 firms that went out of business. Sixteen of these 47 firms projected a need for $17.1 million of assistance, but SBA provided only $5.8 million in assistance.

- Fourteen of 19 officials at Federal agencies supplying contracts to SBA advised GAO that they could not forecast their procurement needs so they could not guarantee SBA any given level of contracts for the 8(a) program.

Extent and Effect of Sponsorships

- SBA encourages nondisadvantaged businesses (sponsors) to provide management services, training, and capital to 8(a) firms.

- Ineffective monitoring by SBA of the activities of sponsors coupled with the high degree of control exercised by sponsors over disadvantaged firms permits some sponsors to maintain their standing in the marketplace by using the 8(a) program. Eighty-nine firms accepted into the 8(a) program had part owners and/or sponsors who were nondisadvantaged. Of these firms, 77 received contracts amounting to about $132.5 million under the program.

Eligibility

- SBA requires that owners of applicant firms be socially or economically disadvantaged to be eligible for the 8(a) program.

- SBA has admitted applicants in the program on the basis of social disadvantage without documenting the reason the assistance is needed. SBA field offices should be required to document in writing the connection between an applicant's social or economic disadvantage and his inability to compete successfully in the business world.

Administration

- SBA emphasizes that the performance of 8(a) firms must be closely monitored, but it has not regularly done so. Therefore, SBA has not been able to identify the contractual and management assistance requirements of 8(a) firms or to promptly fulfill these requirements.

- Although SBA considers management assistance an important tool in correcting the deficiencies of 8(a) firms, it had not provided such assistance to about 52 percent of the firms GAO reviewed. Seven firms that requested management assistance did not receive it. Of the 88 firms that received management assistance, only 33 were satisfied with it.

- SBA has established goals for the 8(a) program in terms of the number and dollar amount of contracts awarded. GAO believes this is not a valid measure of effectiveness.

- For example, SBA has met its monetary goals, even though business plan projections were not met, in each of the last 3 fiscal years, but only 31 firms graduated from the program. A more appropriate goal would appear to be based on the desired number of successful program completions.

b. Recommendations

GAO suggested that the Administrator of SBA consider the following as means of improving the 8(a) program:

- Identify and evaluate potential courses of action which could be taken to alleviate SBA's lack of control over supply of contracts by considering alternatives such as (1) allocating more SBA resources for identifying and processing suitable 8(a) contracts and/or (2) reducing the number of firms in the 8(a) program.

- Provide firms with more assistance and guidance in developing sales.

- Establish a system to monitor (1) the extent to which sponsors control 8(a) firms and (2) the progress of the sponsor-controlled firms toward becoming self-sufficient.

- Develop criteria to define the extent to which sponsors can collect fees from 8(a) firms for service and other items.

- Evaluate each firm's need for management assistance and provide such assistance as required while they are in the program.

- Establish realistic goals for the 8(a) program that would include the number of successful program completions.

2. SBA March 1974 Evaluation

a. Findings

- There was an absence of complete business plans and other basis for documentation of decisions made in a significant number of cases. In even more cases, pertinent financial data was missing and apparently there was no effective system for insuring that required financial data was obtained.

- There was no system, in any region, which allowed specific identification of individuals who were directly responsible for the 8(a) program.

- There appeared to be a strong correlation between highly motivated owners with good education and management experience with sound financing and the 8(a) firm's ability to survive.

- The 8(a) program had a positive economic impact on 81.4% of the sampled firms. This was based on the fact that 81.4% of the respondents increased their number of employees after receiving an 8(a) contract. This surrogate measure was used due to lack of financial data on sales and profits.

- 8(a) contractors recognize their needs for management assistance and 68.2% of sampled firms indicated they had received SBA counseling.

- There was significant confusion among many SBA staff as to the goals of the 8(a) program - (e.g., who was disadvantaged -- what the assistance was intended to accomplish).

- The SBA field staff felt a need for greater emphasis on technical training and many felt unprepared for their job.

- Small business owners who had participated in the program felt that it failed to live up to expectations and that they did not receive the level of assistance they had expected.

b. Recommendations

- That the Office of Business Development of SBA initiate applicable procedures to insure that the decisions made and actions taken with regard to 8(a) contractors are fully documented, and that such records are adequately safeguarded.

- That SBA give priority attention to the need for systematic data collection - particularly financial data - on the experience of all of the minority business community reached by its programs as an ongoing part of the design, administration and evaluation of agency efforts. The need for comprehensive financial data on the minority business community is particularly critical because it is a universally accepted fact that such data do not currently exist.

- With specific regard to the 8(a) program, it was further recommended that OBD explore means to finance a Certified Public Accountant's audit for each firm annually. This would serve the dual purpose of identifying financial problems of the firm before they are "too far gone" and provide appropriate definitive financial information for SBA purposes.

- That OBD (and SBA) place greater emphasis on the improved work measurement procedures so as to improve budget justifications, operational planning, and work control and implementation. Basically, it was the consensus of the SBA study team that the OBD professional staff must be enlarged if the Agency's commitment to quality awards and appropriate followup is to be achieved.

- That the OBD Central Office, in conjunction with Operations, Administration and the regional offices, promote an orientation and information program (with appropriate feedback provisions) to insure that policy and procedure directives are being adequately interpreted and disseminated to all levels of field operations.

- That OBD take immediate steps to determine technical training needs of field staff and assist field offices to provide such training.

- That a policy statement be set forth, from the highest SBA level, re-emphasizing the importance of the 8(a) program and the need for its full support from all SBA components.

C. Discussion of Evaluations and Other Program Problems

The GAO evaluation report focused on the success of the 8(a) program in assisting firms to become self-sufficient, the role and misuse of non-minority sponsors, the criteria used for accepting companies into program, and the failure to provide adequate management assistance. It also reviewed several SBA administrative/management problems such as use of volume dollar goals rather than the number of self sufficient companies. Many of the problems which the GAO raised and documented had been identified earlier as potential and/or real failures in the 8(a) program. However, several of these problems deserve further comment.

The problems regarding successful completion of the 8(a) program appear to stem from SBA policy and not from the authorizing legislation. There are no criteria for determining when a firm has completed the program or should be terminated. Nor is there a time limit in which a firm can participate. The SBA policy of using 8(a) to help disadvantaged firms become viable implied the concept of program completion. In fact, until recently there has been no criteria nor administrative procedures to determine when a firm had completed the program.

The sponsor problem discussed by GAO is real, but does not appear to be serious. At the time of the GAO study, 89 of the 8(a) firms out of some 1800 to 2000 participants had non-minority sponsor arrangements. The SBA has been working on this and says the number of sponsors has dropped to about 50. The sponsor arrangement should not be totally dropped. If proper criteria for sponsor relationships are developed and the arrangements carefully monitored, sponsors can be a valuable source of technical and managerial assistance.

The GAO review of eligibility highlighted the problem that many SBA staff who are involved with the 8(a) program are not certain of its goals or the procedures. This probably was compounded by the overall uncertainty and lack of explicit goals for the entire Federal minority business program. The GAO questioned the fact that some firms which did not appear to need assistance, were in the program. This judgment is apparently based on the fact that some firms had positive net worth and profits. However, if a goal of the 8(a) program is business development (e.g., assisting firms to overcome racial/social barriers and reach their optimum potential) it is entirely proper to have businesses with positive net worth and profit. These firms would use 8(a) to expand through barriers that have kept them smaller than their potential. If on the other hand the only goal of 8(a) is to help new and unprofitable firms become profitable, then the GAO observation is legitimate. The problem appears to be that everyone involved with the minority business program has their own set of operational objectives for the program. This has lead to a wide range of problems from SBA staff use of different eligibility criteria to questionable evaluation, findings and conclusions.

The SBA evaluation, which was completed in March 1974, had some questionable findings.

The finding that 81.4% of the sampled 8(a) firms had positive economic impact is very dubious when it is considered that this percentage was based on the number indicating they had increased employment. First, an 8(a) contract of any size can easily require a firm to increase employment. However, if the contract price is not correct or if there are insufficient cost controls, this increased employment can lead directly to losses to the company. Secondly, if the company does not build a steady volume of business as a result of the 8(a) contract, most of the new employees will be laid off after the contract is completed. Thus, the benefit is very temporary. Since the economic goals of the 8(a) program, while not well defined, do focus on profits and net worth, and not on manpower development and jobs, the conclusion that the 8(a) program has had positive economic benefit is not valid.

The SBA evaluation did raise several issues which highlight additional problems. Although good statistical records may not be significant, the lack of individual business plans is. It is the business plan which is the basis for the SBA to determine how much procurement assistance a firm needs. It also provides the business goals by which to judge if a firm is succeeding through participation in the 8(a) program. The fact that such plans were missing eliminates the SBA's ability to objectively make these determinations. It might be hypothesized that these plans were missing because they were never prepared in some cases, and so poorly prepared in others as to be useless and, therefore, destroyed. It should be noted that many disadvantaged businesses have no resources nor competence to develop such plans. The SBA has no specific program component to assist the firm in preparing the plan.

The SBA has assumed the individual will get help from OMBE's Business Development Organizations or other private sources, but there is no formal procedure or coordinated effort to see that this happens. Thus, the potential 8(a) firm often did not develop an adequate business plan which is critical to its success in the 8(a) program.

The SBA evaluation also pointed out that it was unclear who was responsible for the 8(a) program, that there was confusion about the specific current objectives of the program, that there was confusion in district offices regarding administration procedures for 8(a), and that many staff believed they were not properly trained. These problems all reflect serious management problems which SBA is now trying to correct.

The Associate Administrator for Procurement is aware of the numerous criticisms of the 8(a) program and is taking steps (within his power) to correct them. A new Standard Operating Procedure for 8(a) has been developed. There is heavy emphasis on obtaining and updating business plans for participants. There is also increased attention to having firms complete the program with specific criteria and procedures for "graduating" firms. Business plans will be used as a basis for judging a firm's progress. Firms will be required to provide quarterly financial statements in order that SBA can monitor progress. Management and technical assistance will receive greater attention. There will be an 8(a) review committee composed of staff from the three SBA program components (procurement, management assistance, and finance) to review 8(a) participants. Where the need for other assistance is identified, the committee is supposed to see that it is provided.

D. Integration of SBA 8(a) With Other Programs

The ultimate success of minority business programs to assist new and expanding businesses develop and become competitively profitable in the marketplace is dependent on a wide range of assistance. Procurement (e.g., sales) is not, in most cases, sufficient. Dun and Bradstreet and other studies have indicated that the primary cause of failure of new business startups is lack of management capability and basic incompetence. Another major reason is insufficient working capital and/or too much debt financing. Therefore, the 8(a) program, while a major component, must be coordinated with the other programs to meet the general goals of the 8(a) and total program effort.

The SBA is instituting regional review committees to identify management assistance needs and provide the required assistance. However, the Office of Business Development (Procurement Assistance) has no operating control over the performance of these committees. Therefore, the actual success of this arrangement will depend on the Regional Director and his staff, and the ability of the central SBA office to monitor the workings of these committees.

There was little discussion or review in the evaluation of the problems 8(a) firms have because of poor financial positions. However, 8(a) firms frequently cannot effectively perform and receive the benefits of 8(a) contracts because their working capital position is too low or their debt service costs and debt-to-equity ratios are too high. The 8(a) staff supposedly screen 8(a) firms to insure they have adequate working capital. However, when they do discover that the firm's position is weak, they do not have a mechanism to correct it. They might seek to obtain an EOL direct loan or a 7(a) loan, but this is a separate financial assistance program. In addition, such loans will increase the debt servicing costs while providing working capital (loan must be for more than one year to provide working capital). The EOL and 7(a) loans are not typically used in such a way as to provide working capital. Banks usually require that the entire 7(a) loan be taken down at once, resulting in greater interest costs than is necessary, and, unless very carefully controlled, being spent for activities not associated with the expanded 8(a) sales. While the SBA has provisions for taking down direct loans as needed, these loan provisions are not typically used, perhaps with the exception of construction contracting.

The problem of high debt to equity, a common problem with new firms, is not addressed at all through the 8(a) program. Firms with too much debt must incur interest costs in excess of those associated with the industry's normal financial structure, causing them to be either non-competitive in price or to make low or no profit.

Since Federal Government procurement regulations do not allow recovering of interest expense in overhead allocations to Government contracts, the revenues from such contracts do not sufficiently cover the 8(a) firm's total operating costs. Thus, it is possible for a 8(a) firm's financial position to deteriorate even though it has an 8(a) contract. The real way to correct this problem is through infusions of equity. The only Federal minority business program that can assist in this area is the section 301(d) Licensee (MESBIC) program and there is no direct coordination with the 8(a) program.

The one other major financial problem that 8(a) firms encounter is the slow/delayed payments on 8(a) contracts. The 8(a) firm typically has a weak working capital position, is highly leveraged with debt and suffers cash flow problems. These problems are compounded when payment for work performed on 8(a) contracts is 60 to 90 days late. The firm must pay wages, withholding taxes, and other basic operating expenses within 15 to 30 days of incurring them. When the government is late in paying the invoice, the firm's financial position further deteriorates. The 8(a) program does not have a mechanism to help firms solve this financial problem. On a case-by-case basis, SBA staff will assist firms by persuading the agency's disbursing office to give high priority to 8(a) invoices, but there is no systematic method to give all 8(a) invoices special attention.

E. The Report of House Subcommittee on SBA Oversight and Minority Enterprise

a. Recommendations

- That the President consider issuing an Executive Order providing specific criteria for agencies to determine whether a particular procurement should be set aside for the 8(a) program, so that the greatest number of firms could participate in the program. The President should also instruct all agency heads of the importance of participating in the 8(a) program.

- That all Federal procuring agencies: (a) submit by January 1, 1976 a plan to promote fuller utilization of disadvantaged firms, particularly for contracts under $10,000; and (b) consider breaking large contracts into smaller contracts which disadvantaged firms can perform.

- That the SBA:

  (a) Provide 8(a) firms more management assistance in the area of developing commercial and competitive Government contracts;

(b) develop a directory of all minority and disadvantaged firms capable of performing government contracts and make it available to procuring agencies and private business;

(c) conduct a study of bonding problems;

(d) increase its portfolio of 8(a) firms;

(e) reevaluate its standards for eligibility;

(f) increase American Indian 8(a) participation; and

(g) continue its efforts to monitor 8(a) sponsorship.

- That the appropriate committees of Congress increase SBA resources for management and technical assistance and to provide staff for procurement center representatives.

- That the Subcommittee on SBA and SBIC Legislation of the House Committee on Small Business: (a) consider proposed legislation to increase the SBA statutory authority to establish 8(a) contracts; and (b) consider proposed legislation to raise the level of the Associate Administrator for Minority Small Business.

b. Discussion of Report Recommendations

Much of the Report of The House Subcommittee substantiated the evaluation study findings. The recommendations seek to correct the problems, but it appears that some additional actions are needed. First there is a need to overcome the organizational fragmentation, and develop a comprehensive program to effectively implement an 8(a) program. The suggested Presidential Executive Order, while restressing commitment, would not by itself provide the mechanisms to translate increased 8(a) procurements into expanded, profitable business.

The Subcommittee's interest in expanding 8(a) procurement is understandable. However, given the SBA's current problems of matching procurements with firms and vice versa, and providing the full range of assistance necessary to help the firms become profitable and competitive, increasing 8(a) awards could create further problems.

II. Title 41 - Code of Federal Regulations

Title 41, the affirmative action clause of the procurement regulations requires the head of each procuring activity to set up a minority business procurement program. In addition, on procurements exceeding $5,000, agencies are required to include a Utilization of Minority Business Enterprise section stating Government policy to provide opportunities to minorities. On procurements in excess of $500,000, there is a specific requirement for prime contractors to involve minority subcontractors.

There has been no program evaluation of Title 41. Most reviews, including the report of the House Subcommittee for SBA Oversight and Minority Enterprise, are critical of Title 41. The provisions of "Title 41 are totally inadequate to achieve the stated policy of the government to increase subcontracting opportunities...."*

Basically there is no enforcing mechanism or even a monitoring process to make Title 41 work. Therefore, where program managers or procurement officers have an interest, there has been some effort to implement Title 41. Generally, however, the regulation has not contributed to minority procurement.

The Subcommittee recommends strengthening Title 41 by requiring majority bidders to submit plans to accomplish the goals. This may work, but it could significantly increase procurement costs. It may be advisable that alternatives be explored before modifying Title 41.

III. The National Purchasing Council

The National Purchasing Council is an OMBE funded organization which started in May 1972. It is basically run by private business executives who volunteer their time to increase the procurements by private businesses from minority firms. Since its inception, it has reported that it has generated private sector sales of $682 million. For calender year 1974, it reported sales of $360 million and has a goal of $1 billion for FY 1977. It is also engaged in generating a computerized directory of minority firms on a national basis.

There has been no evaluation of the Council. If reported sales figures are correct, it has shown good potential. It is suggested that the Council's activities be carefully evaluated and that additional approaches be studied to find ways to further expand private markets for minority firms.

*Subcommittee Report "Minority Enterprise and Allied Problems of Small Business."

Attachment G

Evaluation of Federal Management and Technical Assistance to Minority Business

The following studies have been completed regarding the current Federal management and technical assistance programs which are directed toward minority enterpreneurs.

A. "Limited Success of Federally Financed Minority Businesses in Three Cities" (GAO Report)

This GAO report (completed in November, 1973) surveyed 845 minority-owned businesses receiving SBA loans disbursed by district offices in Chicago, Los Angeles and Washington during fiscal years 1969 and 1970.

- Study Conclusions

... Of 224 businesses which indicated a need for management assistance according to SBA records, only 50 percent (111 firms) actually had been provided with this assistance.

... When SBA management assistance was provided to solve business problems, it generally did not improve the business status or reverse a trend toward failure. Of the 111 minority firms which received SBA management assistance, 62 percent (69 firms) were classified as actual or probable failures.

... SBA management assistance is often provided to a business too late to have an effect on improving the status of the business or reversing a trend toward business failure. In many instances, the management assistance provided was not timely because inadequate loan servicing prevented the problems from being identified at an early date.

... Management assistance may not be effective when such business problems such as vandalism, owner fraud, or illness of owner are causes of business failure. Of 203 minority firms for which reasons for failure or probable failure could be identified, 136 firms had problems other than just a lack of management capability (i.e. downturn in economy, fraud by owner, etc.).

... OMBE funded organizations emphasized activities designed to place a minority in business (i.e. assistance in preloan activity). This practice of increased preloan assistance may result in the diffusion of management assistance resources. Management assistance may remain inadequate because it will not be directed toward solving business problems which develop after the minority enterpreneur has received financial or procurement assistance.

... OMBE has failed to adequately evaluate the activities of OMBE funded organizations before expanding its program of management assistance to determine whether the additional resources resulting from this expanded program will significantly resolve the management problems of minority entrepreneurs.

- Study Recommendations

... To improve the effectiveness of SBA management assistance to minority businessmen, GAO recommended that SBA:

--Place greater emphasis on identifying managerial deficiencies before loan approval and on making the acceptance of needed management assistance a condition of the loan.

--Require that managerial deficiencies be resolved before loan disbursement when short-term training can resolve the problem.

--Use loan servicing, whenever possible, to identify problems so that section 406 contractors may devote their time to solving problems.

--Require loan-servicing visits to all minority borrowers within the critical first 90 days after loan disbursement.

--Establish procedures to insure that the required initial loan-servicing visits are made and that subsequent visits are made as needed.

--Monitor and evaluate the adequacy of each participating bank's servicing of SBA-guaranteed loans to minorities and, when a bank's servicing is inadequate, assume the responsibility for servicing.

--Idenfity methods to engage volunteers more frequently in solving, rather than identifying, problems.

--Monitor and evaluate the effectiveness of the assistance provided by each section 406 contractor to remove ineffective contractors from the program.

... To improve the effectiveness of OMBE management assistance to minority businessmen, GAO recommended that OMBE:

--Adequately measure the success of local business development organizations (OMBE funded organizations) and identify methods of operation most closely related to the establishment of successful businesses.

--Coordinate OMBE management assistance activities with those of SBA to provide maximum benefit to minority entrepreneurs.

A. <u>"Management Assistance: An Evaluation of its Extent and Impact on Minority Owned Businesses" (SBA Report)</u>

This SBA report (completed in December, 1974) surveyed 262 minority loan recipients in four SBA districts (Chicago, Dallas, Los Angeles, and Washington) during fiscal years 1971-1973.

- <u>Study Conclusions</u>

... SBA management assistance is not significantly affecting the success rate of minority businesses.

... Forty-six percent of minority loan recipients rate SBA management assistance very poorly in terms of effectively assisting them to improve their business.

... Assistance provided in the SCORE/ACE and SBI program is too broad and of little use in solving the specific business problems of the minority entrepreneur.

... 406 assistance was considered to be the least helpful to the minority client, because 406 contractors prepared reports for use by SBA rather than the client and solutions to the business problems were often not addressed or implemented.

... The present SBA system for measuring the value of management assistance is based on numbers of counseling cases, workshops or calls handled. This system provides little, if any, information on the effectiveness of SBA management assistance and limits SBA's ability to improve the quality of this assistance to minority entrepreneurs.

- <u>Study Recommendations</u>

... 406 program funds should be redirected for providing SBA direct management assistance. This is considered a better use of Federal funds to assist minority business.

... SBI program should be used to assist smaller minority firms which have "non-crisis" problems. Specific implementation plans should be developed as an integral part of SBI assistance to minorities.

... SBA should improve the matching of qualified SCORE/ACE volunteers who have the expertise with a minority firm's given problem or line of business.

D. House Appropriations Committee Investigative Report on the Office of Minority Business Enterprise

This report was completed on March 10, 1975, by the Surveys and Investigations staff of the House Appropriations Committee. The investigation was to include a measure of effectiveness of this program, as well as data concerning arrearages on loans which OMBE assists businessmen in obtaining.

- Study Conclusions

... Proliferation of OMBE Funded Organizations in Certain Areas..

Although OMBE-funded organizations are located throughout the country, a heavy concentration of organizations exists in certain metropolitan areas. For example, 99 organizations (or 32 percent of the total) are located in Chicago, Los Angeles, New York City and Washington, D.C.

... Professional Inadequacies of OMBE Staff.

"Generalists" often lacking education or experience in business serve in "specialist" positions in finance, business education, construction contracting, and Government and private procurement. Lack of personnel qualifications rendered OMBE incapable of the expected level of assistance to funded organizations, minority businessmen, or others seeking OMBE assistance; this generated internal and external criticism.

...Failures in Performance

The performance of OMBE-funded organizations has fallen far short of planned goals in terms of business buy-outs, and expansion of existing businesses, and the OMBE performance management system adopted in June 1972 to measure performance, does not provide current, complete, or meaningful information on any return on investment in terms of sales, profits, and jobs created by the minority businesses assisted through the OMBE program. Moreover, statistical information, showing

OMBE accomplishments in other program areas is neither complete nor accurate. An example is the client data reporting system, which was designed to measure how well programs are proceeding in terms of actual results versus budgeted resources. It is considered to be nonresponsive and unworkable for its intended purpose.

... Inability to Assess Level of Success.

The number of minority businesses that are successful or have failed and the reasons for the success or failures is not known by OMBE. OMBE has attempted, unsuccessfully, through in-house studies and contracted effort to develop this information. As a result, OMBE is severely handicapped in proposing definitive plans and in implementing concrete actions to increase the effectiveness of its funded organizations. Additionally, OMBE does not make loans, but rather provides assistance to minority businessmen to help them obtain loans through its funded organizations. Generally, the loans made to minority businessmen are SBA-guaranteed and made through private sources. Neither SBA nor OMBE maintains separate records concerning the current conditions of loans (including arrearages) made to minority businesses assisted by OMBE.

... Problems With Management and Technical Assistance.

Management services and technical assistance (MSTA) is considered by OMBE to be a key factor in the ultimate success of a minority business. This assistance is required to be provided to minority businesses by the funded organizations under the terms of their contracts with OMBE. Actual assistance provided has been much less than anticipated and is predominantly oriented to the initial period of contact with the minority businesses, with little follow-on assistance after a firm begins operations. Employees of the funded organizations are considered to lack a depth of expertise in MSTA to provide this kind of assistance even if staffing and time were available. Furthermore, OMBE has not utilized the capabilities available within its own organizations. One of its funded organizations has pioneered a very successful approach to providing continuous MSTA to selected minority businesses. Despite the successful practices demonstrated by this firm, OMBE has not implemented any similar type program in any of its other funded organizations.

- Report Recommendations

... OMBE currently has too many funded organizations to be managed effectively and should refrain from creating more organizations. It should consolidate existing organizations by carefully screening the performance of these organizations to eliminate the marginal performers.

... Since OMBE exists because of the fiat of a Presidential Executive Order, attention should be given to phasing out OMBE altogether or reducing its activities to a small policy body working in conjunction with top officials of other agencies involved in the minority business enterprise program.

... OMBE be removed from Commerce and transferred to SBA or reestablished as an entirely new agency with a specific mandate and a professional staff to assist potential and existing businessmen directly without resorting to the mechanism in funded organizations.

... Serious consideration be given to defunding OMBE organizations and that other means be developed for utilizing the funds recouped so that potential or existing minority business will benefit more directly from the available funds.

E. <u>House Subcommittee Report on "Minority Enterprise and Allied Problems of Small Business"</u>

The Subcommittee made the following conclusions regarding the current management and technical assistance programs:

- "The subcommittee is at a loss to understand how the typical OMBE funded organization, comprised of only five professional people, can provide comprehensive services to approximately 60 client firms per 9-month period."

- "On the basis of the evidence considered by the subcommittee, it has been established that a great many professional personnel employed by OMBE do not have the requisite skills in economics, business acumen, or management to effectively administer the program."

The Subcommittee recommends that:

- The Secretary of Commerce conduct an investigation of the qualifications of those professional personnel employed in OMBE with a view to insure that all personnel have adequate economic skills, business acumen, or management capabilities.

F. <u>Results of Joint Commerce/SBA/OMB Review of These Programs</u>

There have been many improvements in the SBA and OMBE programs in the last couple years to deal with several of these problems. For example, SBA created the position of Assistant Regional Director for Management Assistance in each of its 10 regions, as well as assigning management assistance officers in 63 district offices. It also has taken several actions to increase the amount of assistance available and to work more closely with OMBE.

It is clear, however, that more needs to be done. There still has not been adequate assistance to all EOL borrowers and 8(a) contractors, and this may contribute to failures of businesses under both of those programs.

There also was concern that the amount of assistance provided frequently has not been adequate to make a difference between success and failure of a firm. This appears to be due to the very limited nature of much of the assistance, while many of the firms require sustained periods of assistance.

There was evidence that management and technical assistance has in the past been provided primarily to firms which are already in serious difficulty, rather than attempting to prevent such problems by earlier assistance. Also, it appears that much of the assistance provided has been on a first-come, first-served basis, without clear criteria for allocating the assistance resources.

It also was clear that SBA and OMBE still had not fully agreed on their roles in providing management and technical assistance. This has resulted in duplication, gaps and conflicts.

Attachment H

Problems of the Minority Business Programs Which Are Broader Than The Individual Programs

A large number of studies of the Federal minority business programs have identified fundamental problems with the programs which can be solved only by looking at the total Federal effort rather than focusing on the individual pieces.

1. Blueprint For The 70s

Many of these problems were identified in the early days of the expanded Federal effort, and many recommendations have been made to deal with the problems. The most extensive early discussion of these problems was included in the report of the President's Advisory Council on Minority Business Enterprise, titled Minority Enterprise and Expanded Ownership: Blueprint for the 70s. This report was published in June 1971, but many of its findings and conclusions are still relevant today.

A principal conclusion of the Council was as follows:

> A serious problem with all programs designed to assist minority enterprise has been a lack of an effective linking mechanism between the suppliers of resources (Federal agencies and private sector) and the demanders of resources, i.e., the minority enterpreneurs and community groups.

The Council stressed the need for a "comprehensive" minority enterprise development plan and a comprehensive delivery system. The report noted that "economic development requires the systematic relationship of a variety of financial and management programs." The Council concluded that the existing programs did not provide the needed comprehensive approach. The Council concluded that the delivery system "must... be capable of providing a one-stop...service where the individual entrepreneur can receive a total package without the necessity of going through a series of...officials to put the components together." The Council recommended that a single agency be established to assure a comprehensive Federal program.

2. GAO Report of November 1973 On "Limited Success of Federally Financed Minority Businesses In Three Cities"

This GAO study report is quite critical of the failure to tie together the pieces of Federal assistance needed to provide a firm a reasonable chance of success.

The GAO found that about 50% of the borrowers who needed management assistance received such assistance, and those firms that received it generally did not receive adequate assistance to make a difference in their chances for success.

The report also noted that few of the borrowers received any assistance in obtaining procurement, either Federal or non-Federal.

It was concluded that the existing management and technical assistance resources were inadequate relative to the numbers of loans made. There was an imbalance in the allocation of the available resources between these two types of assistance.

GAO recommended, among other things, that:

- OMBE coordinate its management assistance activities with those of SBA to provide maximum benefit to minority businessmen; and

- SBA establish goals, in conjunction with OMBE, in terms of the number of successful minority-owned businesses to be established through SBA's programs and establish an acceptable failure rate for minority loans.

3. Paper Presented By Henry T. Wilfong, Jr., of Los Angeles, at White House Meeting in March 1975

Pertinent portions of Mr. Wilfong's paper follow:

> "If I had to pick two words to best characterize efforts to date in the minority business area they would be disjointed and diffused. The effort has been poured out in every direction, in a disunited manner.
>
> Not only is such a course of action wasteful, it is ineffectual. We can ill afford either.
>
> Instead of using the diffuse 'shotgun' method, we need to use the compact 'rifle' approach. Instead of offering so little to so many we should offer more to fewer. In this manner we can create a viable base upon which to build, a base of rock rather than sand."

* * *

> "It is my firm belief that the current organizational arrangement is totally unacceptable."

4. Paper Presented By Theodore R. Turner of Amoco Venture Capital Company at White House Meeting in March 1975

Mr. Turner concluded that a serious problem with the minority assistance effort is that the programs are fragmented. "In our dealings with minority businessmen, we find many of them unaware or confused about where to go, who to see and what do do to obtain the necessary resources available through these agencies."

He recommended consolidating the programs to provide a one stop source to resolve financial, technical and marketing problems they may be encountering. "Since the Small Business Administration has within its agency established authorities, responsibilities and procedures for providing Financial Assistance, Managerial Assistance, and 8(a) Procurement Assistance, it is the logical agency to assume the management role of the Minority Enterprise Program."

5. House Subcommittee Report on "Minority Enterprise and Allied Problems of Small Business"

This report summarizes the testimony of several witnesses before the Subcommittee, draws conclusions from this testimony and provides recommendations for corrective actions.

The report notes testimony related to the organization of the minority enterprise programs.

- The National Economic Development Association recommended that one agency be granted full responsibility and authority for the programs.

- The Central Queens Community Corporation urged the Subcommittee to consider placing all minority enterprise programs within the SBA or creating a new independent agency.

The Subcommittee report found that: "The OMBE and SBA systems for providing management and technical assistance to minority business is, in substantial part, uncoordinated. Accordingly, there is a diffusion of effort and the precious resources of the Federal Government allocated for these purposes have not been utilized in a fashion yielding of maximum efficiency."

The report concluded, however, that: "The subcommittee considers a major reorganizational effort of minority enterprise programs to be an alternative of last resort. Reorganization would result in confusion, loss of time and, most importantly, a disruption of vitally needed services to the minority business community."

Rather than a major reorganization, the Subcommittee recommended that the agencies develop an interagency plan for joint coordination. "Areas of duplication and other problems should be isolated and defined, corrective alternative systems developed and evaluated, and a final proposed solution agreed upon."

The Subcommittee concluded that the internal minority enterprise program organization within the SBA is in need of major revision. The Subcommittee noted that "SBA's organizational structure is not attuned to the reality that, in fact, certain of its programs are utilized almost exclusively by minority business persons."

6. Stimulating Private Sector Assistance For Minority Enterprise

Several observers of the current programs have suggested that higher priority should be given to stimulating private sector markets for minority firms, and private sector sources of management and technical assistance.

A paper presented to the White House meeting in March 1975 by Fields, Freeman Associates, Inc. discusses the need to create larger markets in the private sector and decrease the current dependency of many minority businesses on government for financing and sales. This paper also suggests making greater use of the expertise of established businesses and trade associations to provide management and technical assistance.

A task force of minority businessmen, headed by Floyd McKissick, also urged greater efforts to involve the 1,000 largest corporate concerns in the minority enterprise effort. The task force concluded that: "Any plan for inclusion of minorities in the market economy must be accomplished with the full cooperation and support of the largest corporations. Those agencies responsible for minority enterprise development must develop new strategies and incentives for securing larger corporation involvement."

7. Problems As Viewed by the Small Business Administration

The Small Business Administration believes that there are problems with coordination between SBA and OMBE. The primary problem area is in management assistance. As OMBE shifted emphasis from loan packaging to management and technical assistance, it became obvious that SBA's management counseling services could be duplicative to a considerable degree, particularly in contract counseling services, if both SBA and OMBE were actually dispatching this aid. If SBA were to be clearly named as the dispatcher, these services would be additive and not duplicative. For this reason, Expanded Management Assistance for Minority Entrepreneurs (EMAME) was developed. EMAME is a joint pilot project with OMBE and ACTION with SBA taking the lead. The project has operated for nearly a year in Dallas, New York City, and Indianapolis, and has demonstrated that the resources of the participating agencies can be coordinated and effectively applied to small minority businesses. It has also demonstrated that extensive executive coordination is required to promote continuity of assistance and to eliminate duplicative delivery of assistance.

Other areas where inefficiency results from duplication, and may require reassignment of functions, are in the MESBIC, 8(a), and Minority Vendor Programs. Minority businesspeople would be far better served by these SBA programs if OMBE would limit itself to its original mission of "wholesale" marketing, as opposed to operational involvement without coordinating with the SBA department responsible for these programs. For example, in the MESBIC area, OMBE continually "oversells" and gets operationally involved with funding MESBICs, only to discover that there are not enough funds in SBA for projected leveraging.

8(a) "casework" by OMBE duplicates SBA functions. There is a need for OMBE's wholesale promotion with Federal agencies, but not for operational overlap.

SBA's Minority Vendor Program (MVP) is paralleled by the OMBE-funded National Purchasing Councils (NMPC). The Purchasing Councils can do a great service for minority business development by promotion of contracts from large industry to minority vendors. There seems to be an overlap in OMBE's having a computerized system (in the NMPC) more costly than SBA's, particularly since SBA's computerized MVP has already been operating for three years.

8. <u>Problems As Viewed by the Commerce Department</u>

Though considerable progress has been made in the past six years, the Federal minority enterprise effort is beset by problems which have had an adverse effect on both the quality and quantity of services provided minority businesses.

a. <u>SBA Internal Coordination</u>

The focus of the SBA minority enterprise program is in the Office of the Associate Administrator for Minority Enterprise. But, with the exception of the Minority Vendor Program, the Associate Administrator has budgetary and policy authority over none of the eight SBA minority business programs. The other programs are administered by line offices which are responsible for assistance to both majority and minority small businesses. The impact of this situation is significant: the lack of authority of the minority enterprise office impairs its ability to influence and coordinate the SBA line offices which control the agency's resources.

This creates additional difficulties for other agencies or individuals who seek access to those minority business program offices and resources but are referred instead to the SBA minority enterprise office.

b. OMBE/SBA Coordination

Recent experience with OMBE/SBA task forces shows that the problem of internal SBA fragmentation has reduced the ability of SBA and OMBE to coordinate their programs into a comprehensive assistance package. OMBE has been asked to deal with the SBA Associate Administrator for Minority Enterprise, but since the Associate Administrator is not in a position to coordinate internal SBA programs, he is not able to coordinate these internal programs with the OMBE program.

Some OMBE and SBA coordination efforts involving line officials in the regions have had significant success; e.g., the joint OMBE/SBA/ACTION pilot program in three cities.

c. Duplication in Outreach Functions

There is duplication in outreach efforts between the SBA minority enterprise representatives and the OMBE-funded organizations. This causes some confusion within the minority business community over where to obtain assistance, and within the private banking and corporate sector over who is responsible for the minority business program.

d. Duplication in Management and Technical Assistance

There is duplication between OMBE and SBA in the provision of management and technical assistance. SBA's $5 million 406 program is used primarily to contract with business assistance organizations to provide management and technical assistance to minority SBA loan clients and 8(a) firms. At the same time, OMBE spends approximately $42 million to fund business assistance organizations to provide management services and technical assistance to minority firms, many of which are those in SBA's loan portfolio or 8(a) program.

This duplication and multiple agency funding has created a number of serious problems: (1) fragmented responsibility and accountability; (2) unclear lines of supervision and contract administration; (3) dual reporting and bookkeeping by the contractor, thus limiting his services provided under contract; and (4) multiple expenditure of Federal staff resources.

Duplication also exists in OMBE and SBA public and private marketing and procurement efforts. This includes duplication in outreach, data collection and marketing efforts between SBA's 8(a) and minority vendors programs and OMBE's minority purchasing councils and other competitive marketing programs.

e. Lack of Effective Coordination Between the Various Federal Agencies With Minority Enterprise Programs

As it currently operates, the Federal minority enterprise effort has no common program goals, no common planning, program development and budgets. There is no comprehensive package of assistance and resources available. Neither the Federal Government nor the minority business community can be assured that a minority businessman that enters any one component of the total Federal program will benefit from the other components that are available.

9. Summary of the Problems

- With several different program managers, and no clear leadership responsibility, the programs have not always been focused on common long-range objectives. Since none of the programs by itself can assure successful Federal assistance for minorities, it is essential that the programs are all pulling together in the same direction.

- Even if there are common program objectives, there are difficulties in assuring that the program pieces fit together to provide a "critical mass" of assistance toward any particular objective or for any specific business. Dispersal of resources in such small amounts that it does not help make the difference between success or failure of a firm, is a waste of resources. Presently, there is not a management system to help assure the minimum necessary concentration of resources.

- There is not now a capability to develop a total program plan for the minority business effort, or to determine the role of each program element in that plan. Accordingly, resource allocation decisions are made without the benefit of knowledge of whether there is a proper balance of resources among the various types of assistance. Under the present management arrangement, there is little flexibility to reallocate resources among the program elements during a fiscal year to meet changing needs. For example, there is no ability to reallocate funds budgeted for financial assistance to take care of special management assistance needs. Also, there is no system to clearly identify such changing needs.

There presently is no process to try to measure the progress or impact of the total Federal effort. The individual program elements themselves generally can only measure program input. Under the present arrangements, it would be difficult to improve the measurement of the impact of the Federal effort.

The present program management arrangement tends to emphasize direct Federal assistance, either with Federal employees or through contractors. Lower priority is given to help in mobilizing the resources of State and local governments, businesses, trade associations and other private and public groups to get minority businesses into the mainstream of economic life of the country. Presently, these two parts of the total program are continuously in direct competition for the staff resources of the offices. The demands of the direct assistance programs invariably are more visible and immediate than those of the other programs, resulting in insufficient staff attention to mobilizing non-Federal efforts.

Attachment I

Proposals For Overcoming The Problems of the Current Program Fragmentation

A large number of options for organization changes and other actions have been considered. The White House meeting of March 1975 resulted in literally hundreds of suggestions and proposals for organization and program changes. Most of the proposals received included suggestions for reorganization to consolidate the programs. The primary alternatives suggested have been:

- Consolidate all the minority enterprise programs in OMBE;

- Consolidate all of the programs in SBA; and

- Establish a new independent agency to administer the programs.

There have been several other proposals for less sweeping organization changes, such as transferring the SBA procurement and management assistance activities to Commerce, or establishing a Commission to oversee and direct the two agencies. There also have been some who have strongly advised against a major reorganization on the basis that such changes would result in a disruption of vitally needed services to the minority business community.

These options have been studied and debated thoroughly during the past several months. Special attention was given to identifying possible solutions to the problems which would have little or no disruptive effect on the programs. We believe we have identified a series of actions that can be taken which could overcome many of the organizational problems and which should have little disruptive impact on the programs. We agree with the House Subcommittee Report that a major reorganization should be an alternative of last resort.

A. Responsibility For Direct Assistance Programs

It is most critical that an improved management system be established to manage the special direct assistance programs (socially or economically disadvantaged assistance) as a single, comprehensive effort. We see no way to significantly improve these programs without such a system.

It is proposed that this can be achieved by giving one agency the clear responsibility for this total effort.

SBA is considered to be the logical agency to have this responsibility. SBA already has the primary responsibility for most of these programs.

It has the experienced staff for managing the programs and a complete field office network to administer the assistance. SBA would be held fully accountable for the success or failure of these programs.

This clarification of responsibilities should permit SBA to establish meaningful and consistent criteria for acceptance of firms into the programs, provide a comprehensive package of assistance to firms in the programs, and to implement a meaningful strategy to "graduate" the firms from the programs.

This clarification also should have the benefits of:

- Ending conflicts between SBA and OMBE regarding the objectives and operating procedures of the 8(a) program, and help assure that firms are not pushed into the program unless resources are available to provide a reasonable chance of success.

- Ending conflicts between SBA and OMBE regarding the MESBIC program. Any OMBE promotion of MESBICs would be done pursuant to agreement with SBA, to end problems of promoting demand that cannot be met by SBA.

- Ending duplication and gaps between SBA and OMBE in providing management and technical assistance to 8(a), EOL and MESBIC firms.

This designation of agency responsibility can be accomplished without any major transfer of programs, and without major disruptions of assistance.

B. Responsibility For Opening Federal Programs to Minority Firms

1. Commerce, due to its experience with the OMBE and Interagency Council responsibilities, has knowledge of the broad range of Federal programs which might be of assistance to minority firms. Also, Commerce, in its role as advocate of the private enterprise system, has knowledge of Federal legislation and regulations that may be detrimental to minority firms. Accordingly, it is proposed that Commerce have responsibility for trying to assure that minority firms receive the benefits of Federal programs and to help prevent undesirable Federal legislation or regulations affecting minority firms.

   This responsibility will not include any operational or policy responsibilities for Commerce in the conduct of programs by other agencies. Commerce will focus on identifying opportunities for additional participation by minorities, suggesting policy or procedure changes to provide more access for minority businesses to the programs, encouraging goal-setting and evaluating progress by the agencies.

2. The SBA already has an extensive network throughout Government and the major Federal prime contractors to help identify specific opportunities for small businesses to obtain increased government procurement. Accordingly, it is proposed that SBA be given responsibility for providing assistance and advice to the Federal agencies and major Federal contractors regarding specific opportunities for increasing prime procurement and subcontract awards to minority businesses.

3. SBA is the primary Federal source of financial and management assistance to businesses, in addition to its socially and economically disadvantaged assistance programs. Accordingly, SBA should continue to have a special responsibility to assure that minority businesses receive all reasonable opportunities to share in the benefits of this assistance.

   These assignments also can be implemented without any significant disruptions of the assistance activities.

C. Responsibility For Encouraging Non-Federal Efforts Toward Minority Enterprise Development

Commerce, through OMBE, presently is conducting most of the Federal efforts to stimulate non-Federal sector assistance to minority firms. This includes programs with State and local governments, trade associations, and the National Minority Purchasing Council. It has the established relationships with industry, States and communities to pursue this effort. Also, Commerce would be able to more effectively pursue this objective without the competing demands of a direct Federal program.

It is proposed that Commerce be given clear responsibility for mobilizing minority business assistance efforts conducted by non-Federal organizations without continued Federal support.

OMBE should redirect available resources to give top priority to this objective.

OMBE's contractor resources should give high priority to helping firms gain or retain independence from special Federal assistance efforts. This would include help in developing non-Federal sources of management and technical assistance. Commerce would need to work closely with SBA in helping SBA assisted firms "graduate" from its program, and assist those firms to strengthen their independence after graduation. Commerce also would assist other minority firms which were capable of starting or expanding without participating in SBA's program.

D. Independent Review and Evaluation Staff

The two operating agencies will need a mechanism to help assure that their programs are complementary and coordinated.

It is proposed that both the Office of the Secretary of Commerce and the Office of the Administrator of SBA should have full time permanent staff to conduct studies and reviews and prepare recommendations for the agency heads regarding the minority enterprise programs. These staffs should be independent from the operating agencies, should work closely together, and prepare joint reports and recommendations on matters affecting both agencies.

It would be useful to have such an independent staff develop and recommend quantified long-term objectives for the programs. It could review proposed Commerce and SBA programs to assure consistency with those objectives. It also would be desirable to have such a staff conduct evaluations of the programs and consider better ways to provide assistance. In addition, it could be responsible for developing a comprehensive system to be used by the two agencies to measure program impact.

E. Improved SBA Organization Structure for Managing Its Socially and Economically Disadvantaged Assistance Programs

SBA cannot effectively assume the lead agency responsibility for these programs with its current structure for managing these activities. It is essential that it establish a management system which will give responsibility to one office to develop common objectives, policies and priorities for the socially and economically disadvantaged assistance programs of SBA. This office should have responsibility for assuring that these programs establish common criteria for acceptance of firms into the programs, and that the right mix of assistance is provided for a particular firm.

It is proposed that the Associate Administrator for Minority Small Business (AA/MSB) of SBA would have responsibility for developing objectives, priorities, policies and budget proposals, in conjunction with the other Associate and Assistant Administrators, for SBA's socially or economically disadvantaged assistance programs, including EOL, section 301(d) Licensee, 8(a), and related management assistance. It would be the responsibility of this office to work with the other Associate and Assistant Administrators to help assure that the objectives, priorities, policies and budgets for these programs represent a coherent, comprehensive effort. The other SBA Associate Administrators would give full consideration to the recommendations of the AA/MSB in carrying out their responsibilities. If any disputes arise between the AA/MSB and the other Associate Administrators, they would be resolved by the Deputy Administrator or the Administrator.

The AA/MSB of SBA would have responsibility for reviewing the implementation of the socially or economically disadvantaged assistance programs at the region and district levels, and to identify any problems with the delivery of this assistance in a coordinated and comprehensive manner. The AA/MSB would inform the Associate Administrator for Operations of any problems identified, and he would be responsible for taking corrective action through his field organization. If any disputes arise between the AA/MSB and the Associate Administrator for Operations, they would be resolved by the Deputy Administrator or the Administrator.

Each SBA Regional Office would assign responsibility to its Assistant Regional Director for Minority Small Business, to assure the effective implementation of the socially or economically disadvantaged assistance programs in the region. In each district and branch office, staff would be assigned responsibility for coordinating any assistance provided under the socially or economically disadvantaged assistance programs. These staff would be the principal point of contact for socially or economically disadvantaged individuals or firms dealing with the office, and would coordinate the provision of assistance to these individuals to assure that assistance is provided only in a comprehensive way. These assigned "account executives" also would be responsible for following up with these businesses to identify problems and needs which may arise after assistance is provided. The account executives would be responsible for informing the District Director of any problems encountered with the individual program offices in carrying out their responsibilities.

We believe that these several actions can provide the basis for overcoming the most serious problems with the minority enterprise programs, without major disruptions.

ISSUE #4

STATEMENT OF THE ISSUE

Should all small business lending programs be consolidated in one department or Agency?

DEPARTMENT POSITION

Most small business lending programs are in SBA at present. The notable exceptions are lending programs in FmHA and the Economic Development Administration of the Department of Commerce.

In the case of FmHA, under the Rural Development Act, that Agency is authorized to make loans to small commercial firms in rural areas, even though SBA also makes loans to small firms in such areas. Duplication is controlled to some extent by a memorandum of understanding between FmHA/SBA. The issue is further complicated by the passage in June 1976 of P.L. 94-305, which redefined "small business" in the Small Business Act to include small farmers. In our opinion all lending to commercial small firms, in rural or other areas, should be handled by one agency, SBA; and all lending to farmers should be handled by one Federal agency, FmHA.

As for EDA, we believe there would be little point in separating their very small volume of loans to small firms from their total of less than 100 loans per year to all sizes of business, which are made to those in economically depressed areas and those firms injured by imports. We are informed by EDA that that agency's average size loan is approximately $1 million, another indication that the number of loans to small firms is quite small. In many cases, too, EDA refers small business applicants to SBA for assistance under our regular business loan program.

AGENCY POSITION

The only real conflict is the problem of Agriculture making small business loans and SBA making agriculture loans.

Agriculture should get out of Small Business and SBA should get out of Agriculture.

OTHER OPTIONS

None offered.

CONGRESSIONAL ATTITUDE

The Congress (in particular the House of Representatives) was quite determined to force SBA into the making of loans to small farmers. There were heated battles in both Houses on the pros and cons, lasting for many months, and SBA consistently opposed the legislation. The Congress seemed to feel that SBA is more "responsive" than the Department of Agriculture in implementing legislation. No indication of Congressional attitude on EDA/SBA functions.

ACTION FORCING DATES

.None.

LAW INVOLVED

Small Business Act; Rural Development Act; various statutes authorizing FmHA lending programs.

ISSUE #5

STATEMENT OF THE ISSUE

In the face of budgetary constraints can volunteers be expanded in the government as a way to give small business additional assistance?

DEPARTMENT POSITION

The SBA's primary volunteer programs (SCORE/ACE), involving utilization of both retired and active executives, have the following primary objectives:

(a) To provide business management counseling and training to SBA's loan holders and other clients.

(b) To provide similar types of assistance to other small businesses contacting them through "outreach programs."

The problems facing small businesses today have increased tremendously in the last decade. Some of the new problems currently faced by small business are:

(a) Government regulations, such as OSHA, taxes and a myriad of pressures beyond the control of the small business owner now makes his/her life more complex.

(b) The economy is more volatile than it was ten years ago, and the line between recession and "good times" is more difficult to perceive.

(c) Mounting crime losses now stagger many small business owners.

(d) Space age technology applied to commercial problems by big business (that can access and use it) now is making the competitive environment much more difficult for small businesses who find it much more difficult to use federally funded research and development which they helped pay for.

(e) The evolving energy situation has more adversely impacted small business than any other segment of our economy.

(f) Small Business now is faced with the fast paced world of electronic data processing that outmodes the education and experience of many owners.

(g) Changes in the "money market" now have virtually dried up external sources of equity capital for small business owners; while they must continue to pay banks a premium (over the rate paid by large corporations) for borrowed capital.

SBA has been utilizing SCORE for the past twelve years. The membership has expanded from an initial 1,000 to over 6,500 today. ACE, started in 1969, has nearly 3,000 members.

Recognizing that 90 percent of business failures are due to lack of management competence, one of the primary objectives of the volunteer program has been to develop additional management assistance resources within manpower and budgetary constraints. With a limited expansion of SBA manpower, and continued development of the concept of increased self-administration, counseling and training activities can add significantly to aiding small business.

Plans for such enlargement and better self-administration by highly qualified volunteers with a life long experience in management is now underway:

1. Positive steps have been taken to develop "balanced" SCORE/ACE chapters so that each chapter recruits and retains volunteers with a full range of skills needed to meet the needs of the local community.

2. At the SBA district level, a selected SCORE volunteer will serve as the District SCORE Representative (DSR). The DSR works closely with the ADDMA to provide guidance to SCORE chapters within the district and maintain close cooperation with the Regional SCORE Representative. The DSR serves as a key communication link between chapters, the SCORE Association and SBA.

3. The National SCORE Council (NSC) is comprised of one representative from each of the ten SBA regions plus a chairperson. The NSC serves as the Board of Directors of the SCORE Association.

4. The SCORE Association is comprised of 305 individual chapters throughout the country.

5. A National SCORE Office is to be established in Washington, D.C. staffed by volunteers. The function of this office will be: to provide National SCORE/ACE Program support in many functions such as recruitment and training of volunteers; to provide National SCORE public relations and publicity; to develop concepts for chapter administrative functions; and, to develop programs of national priority such as energy cost reduction with other Federal agencies and private organizations for special SCORE/ACE participation.

The organizational structure described above provides the vehicle for the SBA to maintain maximum leverage of its resources both budgetary and manpower.

AGENCY POSITION

Strong support for the volunteer concept.

OTHER OPTIONS

Budgetary constraints limit the opportunity for higher cost management assistance resources.

CONGRESSIONAL ATTITUDE

Congress has continued to demonstrate a positive attitude in supporting the only SBA funded volunteer program - SCORE/ACE.

ACTION FORCING DATES

None.

WHEN LAW EXPIRES

Indefinitely.

WHAT LEGISLATION BEING PROPOSED

As a result of the administrative responsibility associated with the sole-sponsorship of the SCORE/ACE Program transferred from the ACTION Agency in July 1975, new legislation is in process which, when enacted, will replace the Executive Order now in effect.

POSITION OF CONGRESSIONAL COMMITTEES AND THEIR STAFFS

Attitude appears to be the same (positive) as that of the Congress.

ISSUE #6

STATEMENT OF THE ISSUE

Should the thrust of the Agency's guaranteed loan program be through more bank liaison or through a new group of non-bank lenders?

DEPARTMENT POSITION

The major source of guaranteed loans has been and will continue to be the nation's banks and SBA should continue efforts to improve its relations with, and to increase the participation of the banking community. SBA should also encourage participation by other regulated lenders such as savings and loan associations, credit unions and state development companies. Small business investment companies should be permitted to devote a portion of their capital (which would not be available for borrowing from SBA) to supporting guaranteed loans.

While SBA has had participation from a large percentage of the banks, few have more than 10 loans outstanding. Few banks devote resources and talent to SBA loans or actively seek such loans. There is a need for lenders specialized in small business lending as a supplement to the banking community for the establishment of small business lending companies which are associated or affiliated with other lenders, financial institutions, or similar firms such as insurance companies, finance companies, bank holding companies and small business investment companies. These lenders will require additional incentives in the form of fees to obtain an adequate return on capital.

Efforts to develop additional participation by small business lending companies require increases in the guaranty authority of the agency and increases in the personnel resources in SBA's financial assistance functions.

AGENCY POSITION

The major agency thrust should be through expanded bank participation rather than through non-bank lenders. We should license reputable non-bank lenders who apply, but should not set up separate fee schedules or strongly encourage this area. The improved secondary market should create more inducement for banks to make guaranteed loans.

OTHER OPTIONS

Concentrate effort on participation by banks and abandon the small business lending company approach. This makes SBA lending totally subject to the attitude of the banks and their willingness and ability to devote the necessary funds to guaranty lending.

Concentrate effort on participation by small business lending companies. Meeting the needs of the small business community would require a large number of SBLCs with the resultant need for resource allocation for regulation and supervision functions. Presently participating lenders might not welcome new competition.

CONGRESSIONAL ATTITUDE

Animosity to the question of additional fees to be borne by the small business.

ACTION FORCING DATES

None.

LAW INVOLVED

Section 7(a) of the Small Business Act permits SBA to participate with banks and other lending institutions.

ISSUE #7

STATEMENT OF THE ISSUE

Should the costs of the Agency's (1) guarantee; (2) direct loan programs above and beyond current program reserves be:

(a) absorbed by the taxpayers;
(b) passed to the program beneficiaries by making them self-sustaining?

DEPARTMENT POSITION

The Agency has no funded "reserve for losses," as such. There is a funded reservation of budget authority in the revolving fund of 15 percent of amounts disbursed by banks in the case of guaranteed loans.

The matter of a self-sustaining guaranty program for 7(a) loans has been under study and discussion with the Office of Management and Budget for some months, and no final decisions or conclusions have been reached. F&I believes that it is proper to move into the direction of a self-sustaining program in order to avoid excessive cost to the taxpayers, but that a completely self-sustaining effort would require higher fees unacceptable to small business borrowers or the Nation's banks, depending on where the burden fell.

There has been no study of a self-sustaining direct program; this could be undertaken, but it is our present belief that a completely self-sustaining direct program would also be unacceptable because of excessively high cost to the small business borrower. It has always been our belief that, because of the small business credit gap through the years, the Congress intended the business loan program to be subsidized to some extent (never in exact terms). This controversial matter needs more study both as to direct and guaranty lending.

AGENCY POSITION

SBA has two kinds of loan programs -- the general 7(a) guarantee business loan program and a large number of special guarantee and direct programs constructed to take care of special situations, such as impact of government action (the non-physical disaster loans), aid to the handicapped, EOL loans, 7(a) direct loans, etc.

SBA believes that the special programs should not be self-sustaining, but that the 7(a) guarantee programs should.

Small business' greatest need is for access to capital. Minor fees or slightly increased interest costs are of less concern to them than availability. With either direct or guaranteed loans the increased fees still would make term financing available at less cost to the small business than SBIC or other private sector sources.

Neither OMB nor the Congress has made the amounts of guaranteed money available that small business needs, and the number one reason for denying this supply is the cost to the government of the losses, all of which must be passed on to the taxpayers. Eliminate the losses, and more billions of dollars should be able to be supplied.

In the 7(a) guarantee program, with improved administration being made possible by the extra personnel in our FY 1976 and 1977 budgets and more hope for relief in FY 1978, a modest charge should do it adequately.

A thorough study of this is being made with OMB, and the cost/supply alternatives should be discussed in detail with the appropriate Congressional committees.

In the 7(a) direct loan program the <u>interest</u> subsidy should be eliminated to reduce costs to the taxpayer, but this program should not be self-sustaining with relation to losses.

In addition, a thorough investigation of the possibilities of credit insurance, rather than guarantees that require possible repurchase, should be made.

<u>OTHER OPTIONS</u>

A wide variety of methods could be used to approach self-sustaining:

(1) Increased management assistance and portfolio management to reduce losses.

(2) Stricter criteria for loan approval.

(3) Fees -- on the borrower or the bank.

(4) Differential interest charges to cover the gap.

<u>CONGRESSIONAL ATTITUDE</u>

The House Small Business Committee in 1974 stopped an SBA proposal to charge higher fees to small business borrowers under the non-bank lender program. It is believed that this attitude has changed and that modest fees would be allowed for this program.

However, it is to be expected that the Small Business Committee of the House and the Senate would strongly resist increased interest charges or fees to the borrower unless they could be sold on the idea that the increased supply of lower-cost-than-private-source capital would be more valuable to small business.

ACTION FORCING DATES

None

LAW INVOLVED

Small Business Act controls the interest rate charged on 7(a) direct loans. Interest rate limits allowed on guaranteed loans are set by SBA.

ISSUE #8

STATEMENT OF THE ISSUE

Should members of the Central Office Management Board have direct command authority over the field or should authority be centralized in an Office of Operations?

AGENCY POSITION

There are as many shades of opinion on this subject as there are members of the Management Board, with some members favoring abolishing the office and placing the field under the Deputy Administrator, some favoring direct order giving by each Central Office Management Board member, and some favoring the current concept of our office of Operations to exert command authority.

Some program departments feel that the current system reduces their ability to effectively develop and control programs, while others feel the system works.

The Agency position is that command authority over the field must be centralized in one Central Office entity. The vesting of this authority in each member of the Management Board would result in serious dilution and confusion of line management responsibility as well as a loss of organizational responsiveness in the delivery of the total SBA program in the field. It was tried in the past and didn't work. Regional Directors should have one person to whom they are immediately accountable. This should be an Associate Administrator for Operations and not the Deputy Administrator, as assigning the field to him would pin him down on delivery problems and inhibit his ability to assist the Administrator with overall policy formation and Agency management.

Discussion: Operations was established based on a recommendation by an independent task force. The task force recognized that the span of control of the Administrator was excessive.

Ideally, the Regional Directors, who are responsible for all field activity, should report directly to the Administrator. He is ultimately responsible for all Agency activity. However, the span of control of the SBA Administrator would be seriously overexpanded by such an extraordinary responsibility. He must of necessity delegate this authority. The options are to delegate command authority (line responsibility) over all field activity to:

(1) The Central Office Management Board.

(2) A General Manager for Field Operations.

Under the first option, each member of the Management Board would be able to exercise direct line authority over each Regional Director and each Regional Director would be responsible to every member of the Management Board.

The advantages of Option #1 are:

(1) It vests more direct authority in each member of the Management Board.

(2) Closer communciation between Central Office program divisions and field program efforts. No delay by going through Central Office and field line management where communications and directions are screened.

The disadvantages of this option are:

(1) Chaotic organizational structure.

Every program could be an operational entity in itself with program interests taking precedence over Agency interests or the welfare of the total small business constituency.

(2) Impossible for the field to determine priorities. Conflicting demands would lead to confusion.

(3) Role of regional management is undermined.

(4) No overall Agency control. Each program manager tends to focus on the operation of only his own program. Evaluation of overall field effort almost impossible.

The second option, that of having command authority over field activities delegated to the Associate Administrator for Operations, is the one presently employed by the SBA.

The advantages of a general manager for field operations are:

(1) Meaningful organization structure wherein the Administrator maintains complete control over field direction and priorities. Line of responsibility is clear.

(2) Field management is strengthened and held accountable. Field management problems, crises, and discipline are handled by one manager.

(3) Field responsibilities and authorities are clearly assigned and controlled. Evaluation is uniform and embraces total effort in relation to goals and priorities.

(4) New management initiatives and techniques are encouraged and implemented through a general management unit.

(5) Administration priorities are more quickly implemented and the overall Agency viewpoint can be better understood and accomplished by the field.

The disadvantages of Option #2 are:

(1) Extra Management Board position is necessitated.

(2) Program directives and communications to the field must go through field management and not directly from Central Office program to field program personnel.

ISSUE #9

STATEMENT OF THE ISSUE

Should a field size determination program be instituted and centrally controlled as to assure more uniform processing and determinations in handling authorizations, with some loss in time, or should decentralization continue?

Discussion:

Basis for Program: The ability to participate in SBA's preferential programs is limited to small business firms. Eligibility for such program participation is based on favorable size determinations made individually as statutorily provided for in Section 8(b)(6) of the Small Business Act.

The Basic Problem: An original size determination is made by the SBA field office within whose jurisdiction an applicant firm is headquartered. Unfortunately, however, little or no uniformity exists in the field for the processing of such determinations. While some regions retain authority for this function, others delegate the authority to district offices where the determinations may often be made by personnel assigned the function on an ad hoc basis and who are not particularly knowledgeable in size matters. This weakness, compounded further by the absence of both a requirement for regular management review and coordinated informational exchanges on policy interpretations, etc., has resulted in the use of research sources -- some adequate, some inadequate -- disparate between regions and often resulting in questionable determinations.

Main Impact on Procurement Programs: Inasmuch as SBA is totally controlling in processing loan applications and administering the Agency's lending program, the matter of size determinations has not posed any significant problem to that program. However, in our procurement program, SBA is not totally controlling because the time spent in the processing of a size determination impinges on the interest of the Contracting Agency to place its procurement under contract without delay. This is particularly true in the set-aside program where competition for an award is restricted to firms who certify themselves as smalls. If the size of the low bidder is challenged, the regulations permit the SBA field office only 10 working days from receipt of the protest to process the case and notify the Contracting Officer of its decision.

Importance of the Size Determination Program: In assuming responsibility for making size determinations, SBA not only can critically affect the on-going ability of an individual small business, but the future ability of small firms to continue to compete for the procurement of similar items on a set-aside basis. If poor decisions are made or undue delays are experienced in making size determinations, Contracting Agencies will be reluctant to cooperate in continuing to establish set-asides. Additionally, the number of cases referred to SBA for size determinations will be increasing. Not only is the number increasing on the basis of the prime contract set-aside program, but because subcontracting set-aside is a new and growing field, referrals from that aspect of the program can be expected to add to the Agency's workload.

DEPARTMENT POSITION

It is the position of the Department that a centralized Size Determination Program be established with a sufficient number of trained personnel to expeditiously process all size determinations and who would receive policy guidance and program direction from the Size Standards Division in Central Office. Such field specialists would be strategically located in those offices having most traffic in size standards but with the facility to also handle those areas not having sufficient volume to warrant separate specialists.

AGENCY POSITION

The Agency position favors centralized policy guidance and decentralized implementation in the interest of time per case. Additional staff must be assigned, and improved training and guidance must be implemented, if this is to take place.

OTHER OPTION

An alternative approach would be to have trained specialists strategically positioned as that suggested in the Department Position, but reporting to and receiving policy guidance from the regional directors as opposed to Central Office.

ISSUE #10

STATEMENT OF THE ISSUE

Should small business be exempt from the Renegotiation Act?

Discussion: The basic concept of the Renegotiation Act of 1951 is that contractors doing business with defense and defense related agencies of the Government are not entitled to reap an excessive profit on contracts which relate to the national interest and national security of our country. In determining what constitutes an excessive profit, the Renegotiation Board basically must consider and give favorable recognition to the efficiency of the contractor or subcontractor with regard to attainment of quantity and quality of production, reduction of costs, and economy in the use of materials, facilities, and manpower.

The Renegotiation Act, practically, allows excessive profits to be realized by defense contractors, not recoverable by the Renegotiation Board because of the process of renegotiation by aggregate sales. The Board permits contractors to average their profits on all renegotiable sales within a given year. As a result, a contractor can charge the Government high prices and reap profits on one contract or product line and, then, offset high profits with the lower returns on another contract or product line. The resulting average profit for the contractor may appear reasonable. It is apparent that this aspect of renegotiation is particularly advantageous for large corporations consisting of numerous divisions engaged in a variety of businesses. The high profits earned in some divisions can be averaged with low profits earned in other divisions, and thus escape renegotiation.

Recent studies have indicated that small businesses' relationships with the Renegotiation Board result in more small firms being surveyed relative to excess profits than large businesses.

It is extremely desirable to increase the entry of small business in the Government market for various reasons. One is that to the extent there is an increase in the number of viable and efficient firms competing for Government contracts, one must expect the cost of Government procurement to be reduced. Another is the establishment of a broad production base for defense. Given the desirability of increasing the number of smaller firms entering the Government market, care must be taken not to inhibit possible entry by these firms and to take proper account of the real costs of this entry and hence the proper evaluation of returns to the firm.

Small firms enter the Government procurement market with greater risk. This risk is attributed largely to the limited number of product lines that the small firms may produce. The consequences of financial losses associated with a single product line in a small firm are not likely to be comparable to consequences of losses from a single product line in a large firm. The difference is not marginal. For a small firm, the consequence may be the death of the firm, while this is not likely to be true for the larger firm. Also, when a small firm enters the Government market it foregoes opportunities in the commercial sector which may go beyond the Government contract period.

A small firm must be competitive price-wise and at the same time must be extremely efficient to obtain the necessary return commensurate with risk. As long as prices received by small business in a competitive market are reasonable compared to those received by big business and can produce a sufficient return to small business, national objectives are being met. One objective of national policy is to foster small business participation in Government procurements.

It would be inappropriate to compare profit rates between big and small businesses without considering the risk and uncertainty associated with entering the market. Further, related to this point, it would be inappropriate to limit the profitability of an efficient small business by comparing costs and profitability between small and big business for any particular contract. The small business when entering the Government market again is no doubt taking a greater risk. For any particular contract or production run, the profitability may be high or low. As a concomitant of this, for any given segment of time the small business has to be accorded higher profits to compensate for its additional risks described earlier, which are not undertaken by big business. The more important consequence is what is happening on the average over a considerable period of time. The entrepreneur must be concerned with maximizing the value of his firm. To do this, he must assess long-run profitability and consider present value of the firm in the light of probable developments in the market. This is possibly the more esoteric way of stating the need for the small entrepreneur to develop some form of a safety margin based on possible higher profits on some sales to defray losses which may take place as a result of other sales. If, over some reasonable time period, profits on the average tend to increase without any increase in risk or with a lowering of risk, the obvious consequence is entry of more firms into the market, assuming that the market is competitive.

Price competition may be said to exist if offers are solicited and (a) at least two responsible offerors respond, (b) who can satisfy the Government's requirements, and (c) independently contend for a contract (to be awarded to the responsive and responsible offeror submitting priced offers responsive to the expressed requirements of the solicitation).

Due to the limited number of product lines that a small firm may produce, its entrance into the Government marketplace is with greater risk. Entry into the Government market causes small firms to forego opportunities in the commercial sector which may go beyond the Government contract period. This same situation is not compelling on large business. Losses from a single product line may be the death of a small firm while this is not likely to be true for the larger firm. Small business must be competitive price-wise and at the same time just be sufficiently efficient to obtain the necessary return commensurate with risk.

DEPARTMENT POSITION

As declared in Section 2 of the Small Business Act, and reiterated in other provisions included therein, an objective of national policy is to foster small business participation in Government procurement. As suggested previously herein above, as long as prices received by small business in a competitive market can produce a sufficient return, there is certainly consistency with such national objectives. Cognizant of these objectives, which are supported by public law, the Department recommends that all small business concerns (by SBA definitions) entering into contracts with the United States Government, as the result of the price competition method of procurement, be exempt from the Renegotiation Act.

AGENCY POSITION

Agree with the Department Position.

OTHER OPTION

To conduct the renegotiation process by division and by major product line within a division and not furnish the offset of excess profit on one product line or within one division against a loss on another product line or within another division. Basing renegotiation on sales within a specified commodity grouping or product line should lead to more effective renegotiation and minimize the profits that are escaping renegotiation.

CONGRESSIONAL ATTITUDE

It is the understanding of this Department that Congress is vitally interested in eliminating the inequities that currently exist in the Regnegotiation Act.

ACTION FORCING DATES

It is anticipated that Congress will consider an extension of the Renegotiation Act in January 1977, along with H.R. 10680, a bill to amend the Renegotiation Act. Thus, it is essential that statutory changes exempting small business from renegotiation be presented in January for full consideration.

LAW INVOLVED

The Renegotiation Act of 1951. (50 U.S.C. app. 1211).

WHEN LAW EXPIRES

The Renegotiation Act expired on September 30, 1976. This is not unusual with respect to this Act. An extension may be enacted in early January.

WHAT LEGISLATION BEING PROPOSED

In commenting on H.R. 10680, SBA suggested that serious consideration be given to the granting of exempt status to certified small business concerns.

PRECISE NATURE OF THE LEGISLATION

As suggested by SBA in its comments on H.R. 10680, an exemption of a small business concern from renegotiation would follow a certification by SBA of such small business's status at the close of its fiscal year. This certification would precede a small business's filing with the Renegotiation Board.

POSITION OF CONGRESSIONAL COMMITTEES & THEIR STAFFS

It is believed that there is solid support for such an exemption.

ISSUE #11

STATEMENT OF THE ISSUE

Should SBA be the Surety of last resort and develop a direct Surety Bond Program or should the present guarantee approach be used?

DEPARTMENT POSITION

Under no conditions should SBA or any other Federal agency undertake direct bonding. For sound reasons, bonds are required by law on construction projects by Federal and other public bodies. Government at any level cannot make an objective third party judgment as to a contractor's ability to perform. Providing or selling bonds is a relatively simple procedure when compared to the duties of a surety in a default. To suggest that a bond provided by SBA in favor of GSA on a private contractor who defaults, requiring litigation or arbitration by the Department of Justice, would be absurd as well as financially stupid. The U.S. Treasury would pay all losses and costs. Surety bonds are not financial insurance policies.

Retention of the existing guarantee program is strongly advised. Reliance on the agency system of private sector insurance -- surety companies during the past five years have demonstrated that government and the private sector can fill a peculiar financial need with a high degree of efficiency.

AGENCY POSITION

Agree with Department Position.

OTHER OPTIONS

None. Unlike a loan applicant who has a variety of options, a bond applicant must provide a bond issued by a surety listed and qualified by the U.S. Treasury. Without SBA's guarantee, most sureties reject small bonds and/or small contractors.

LAW INVOLVED

P.L. 91-609, SBI Act of 1958.

PRECISE NATURE OF LEGISLATION

To guarantee up to 90 percent of loss if sustained by a surety on bid, payment or performance bonds on contracts up to $1.0 million.

POSITION OF CONGRESSIONAL COMMITTEES

Highly favorable. Completely understood by few. Confused with loan programs by most.

ISSUE # 12

STATEMENT OF THE ISSUE

Should SBA be in the business of extending its programs to the agricultural community or should it press for elimination or contraction of purely agricultural programs?

DEPARTMENT POSITION

In our opinion the SBA has no business in agricultural lending programs. P.L. 94-305 impacted on all of our many lending programs, including business and economic opportunity loans, disaster loans, and economic injury programs, as well as to equity and lending programs under the Small Business Investment Act. Agricultural lending is completely different from lending to commercial firms; there is a huge Government department (USDA) to handle lending to farmers, as well as the instrumentalities of the Farm Credit Administration which approve in excess of $15 billion in loans to farmers each year. We believe that, in those instances where FmHA cannot make loans (such as to corporations and aliens), their legislation should be expanded, not ours. SBA already has a constituency in excess of 9 million small firms; FmHA with its vast resources should be responsible for the nation's 3 million farmers. (Also see Issue 4).

Finally, as the Congress adds to our constituency through such Acts as P.L. 94-305, we are never given additional funds or personnel slots to carry out those functions. To continue to add to SBA functions without additional funds and personnel will lead to a calamitous condition of our portfolio in the future, we believe.

AGENCY POSITION

Agree with Department Position. We should get out.

OTHER OPTIONS

Introduce legislation to make farmers the constituency of FmHA.

CONGRESSIONAL ATTITUDE

See "Department Position" in Issue 4.

ACTION FORCING DATES

None

LAW INVOLVED

Small Business Act; various statutes relating to FmHA lending programs.

ISSUE #13

STATEMENT OF THE ISSUE

Should SBA be the direct source of pollution control financing for small business, or should such rather be assigned to EPA?

DEPARTMENT POSITION

SBA should continue to be the primary source of pollution control financing for small business. SBA presently has a water and an air pollution control loan program as well as a pollution control financing guarantee program. The latter program P.L. 94-305 was passed by congress, by a lopsided majority, on June 4, 1976.

The primary purpose of the EPA is to ensure the quality of the environment specifically through research and the enforcement of established emission control standards. As a regulatory agency, EPA would be put in a compromising position if required to perform a regulatory function as well as finance the facility to control what it is regulating.

More important, however, is the fact that small businesses have problems unique to them which the SBA through its mandate, proven expertise and its various programs, is and has been helping to overcome. Industry demand for the programs will increase as we approach the 1977 and 1983 EPA deadlines for compliance with emission standards.

Additionally, as presently structured, the EPA has no facility within its organization with capability, which the SBA has, to perform a loan and/or guarantee function.

Because EPA is mandated to regulate and ensure compliance with established industrial emission standards by all businesses, small and large, their position would be further compromised if required to finance small businesses pollution control needs without providing a similar program for large businesses. On the other hand SBA does not have that problem because of its mandate, established size standard rules and regulations, etc.

AGENCY POSITION

Agree with Department Position. SBA should handle.

OTHER OPTIONS

None.

LAW INVOLVED

P.L. 94-305 - Pollution Control Financing Guarantee Program.
Small Business Act Section 7(b)(5) - Air Pollution Loan Program.
Small Business Act Section 7(g)(1) - Water Pollution Loan Program.

POSITION OF CONGRESSIONAL COMMITTEES AND THEIR STAFFS

See Department Position.

ISSUE #14

STATEMENT OF THE ISSUE

Should SBA continue to be involved in disaster assistance, or should efforts be made to transfer it to another department of agency, or should our assistance be only extended to business borrowers?

DEPARTMENT POSITION

SBA has an extensive system of field offices, and over the years has developed considerable expertise in providing both home and business loan assistance to disaster victims.

P.L. 94-305, enacted June 4, 1976, required a study of the Disaster Loan Program delivery system. Because SBA has demonstrated the ability to effectively manage the disaster program, FDAA recommended that all disaster loan assistance, except farm production loans, be transferred to SBA (see Exhibit #1). SBA concurred with FDAA's recommendation (see Exhibit #2) and adopted said recommendation as the Agency's position, and the most effective, economical and efficient administration of disaster loan assistance.

SBA was created to provide assistance to the small business community. Since its inception, the Agency has provided loan assistance, as well as other type of assistance, to businesses throughout the United States. Without our assistance, small business concerns could not and would not prosper. As a result of several years of providing loan assistance, the Agency has become the expert, as far as Government is concerned, in loan making and loan servicing activities. The processing of disaster loans, whether home or business, is simply an extension of our capabilities in the field of financial assistance. Approximately 90 percent of all disaster loans are home loans and require only minimal loan making experience which already exists in abundance within the Agency. Therefore, it is our opinion that SBA should continue to make business and home disaster loans because it is more capable of doing so than any other Government agency.

AGENCY POSITION

Agree with Department Position.

Exhibit #1

RECOMMENDATION

It is recommended that Alternative 6 be adopted, on the basis that this alternative most nearly meets all of the concerns outlined in the Scope and Objectives portion of this study, as follows.

Implementation of the proposed alternative will rely on the skills and systems which have been developed by SBA over many years of disaster loan experience. While the agency does not engage in direct home and personal property loan operations in "normal" operations, it possesses, by far, the largest body of experience in the Federal Government in this area. Further, assumption of responsibility for on-farm loans of this type will add only marginally to the agency's total workload in this area.

Implementation of the proposal will consolidate under one agency responsibility for administration of this entire disaster loan class, thereby affording the advantages of standard application procedures and the equity of like benefits for the same loss.

Implementation of the proposal will not impose any additional extraordinary burden upon the current system. Management initiatives and the provision of additional resources have combined to alleviate a situation which gave rise to grave and legitimate concerns in the wake of Tropical Storm Agnes. While, as noted earlier, there is no assurance that any reasonable system designed will be able to cope adequately with any conceivable disaster situation, SBA is today in a greatly improved position to meet the requirements of all the programs which it administers.

By increasing the speed with which on-farm residents may receive home and personal property disaster loan assistance and by consolidation of this facet of Federal disaster assistance under one organization, implementation of this proposal holds the promise of an increase in both the efficiency and economy of the program.

SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Exhibit #2

E OF THE ADMINISTRATOR

NOV 1 8 1976

Honorable Thomas P. Dunne
Administrator
Federal Disaster Assistance Administration
Department of Housing and Urban Development
Room B-133
Washington, D.C. 20410

Dear Mr. Dunne:

We have reviewed the listing of disaster loan authorities, in accordance with Public Law 94-305, which you sent to us with your letter of November 1, 1976.

On balance, we agree with both the content and the recommendation that alternative 6 be adopted.

If this happpens, however, it must be recognized that SBA is a small agency, and would have difficulty handling, without extra resources, significant increased demand caused either by a major natural catastrophe or major liberalization of the existing law in the direction of "foregiveness" or lower interest rates.

Sincerely,

SIGNED BY MR. KOBELINSKI

Mitchell P. Kobelinski
Administrator

ISSUE #15

STATEMENT OF THE ISSUE

Should SBIC and MESBIC Regulations relating to "Idle Funds" be revised?

(In early 1976, Staff of the House Committee on Small Business expressed concern of MESBIC "idle funds," i.e., uninvested funds of the Licensee. It appeared from a superficial analysis of aggregate dollars that same $45 million were "idle" and not invested.

SBA's initial response was a proposed regulation to eliminate the first dollar leverage of MESBICs. (Published for comment March 1, 1976), The proposed regulation was withdrawn by SBA on June 17, 1976, due to overwhelming opposition by the industry and members of Congress.)

DEPARTMENT POSITION

Elimination of the First Dollar leverage is not the proper answer.

In the alternative, proposed "inactivity" regulations are now under consideration with the Agency. Even these proposals, however, have the potential problem of compelling MESBICs to more investments within a specified period of time, and conceivably forcing bad investments.

More analysis is required.

AGENCY POSITION

"Inactivity Regulations" are favored. Also a close watch by the SBIC examiners.

OTHER OPTIONS

1. Make no change, and recognize the uninvested funds of MESBICs as a necessary element of doing business for MESBICs. (See memo re AA/MSB, attached)

2. Develop other alternative approaches.

CONGRESSIONAL ATTITUDE

Original serious concern seems to have been mollified by testimony of MESBIC industry at Congressional Hearings.

ACTION FORCING DATES

None.

LAW INVOLVED:

Small Business Investment Act of 1958.

WHEN LAW EXPIRES

N/A

WHAT LEGISLATION PROPOSED

None.

PRECISE NATURE OF LEGISLATION

N/A

POSITION OF CONGRESSIONAL COMMITTEES AND THEIR STAFFS

See above.

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Date: December 7, 1976

Reply to Attn of: AA/MSB

Subject: Transition Issues

NO. 15 - Idle Funds in the MESBIC Industry: MSB Input to Main Paper

To: John T. Wettach
Associate Administrator
for Finance and Investment

On March 23, 1976, my position on this subject was articulated by memorandum to the Administrator. In that memorandum, I demonstrated that any reasonable analysis of the financial situation of the industry would show that no serious idle funds problem exists.

In addition, I am on record supporting the strengthening of SBA's ability to deal with inactive or slow-acting MESBICs. I still maintain that position and direct your attention to the referenced memorandum * where my complete statement on this subject can be reviewed.

C. Mack Higgins
Associate Administrator
for Minority Small Business

* Copy attached.

OPPC

Proposed Revision of §107.201, Part 107 -
Regulations for SBICs

Mitchell P. Kobelinski
Administrator

It has been brought to my attention by various sources that the viability of the 301(d) MESBIC industry is being challenged. The basis of the challenge to the existence of this industry is the level of so-called "idle funds." For some months now there have been rumblings inside and outside of SBA about "idle funds" and what those funds mean insofar as the viability of the industry is concerned.

In truth, I must admit that I paid little attention to such ridiculous comments. After all, who would be concerned about uninvested funds in the MESBIC industry when the unutilized funds in the Revenue Sharing Programs make such a larger target to attack among many others I am sure both of us can think of. However, the critics not only didn't go away, but they appear to have somehow acquired some allies inside of SBA who are willing to react not in a manner supportive of SBA's efforts in Minority Enterprise, but in a manner that is certain to bring more ridicule and criticism to an agency that is fighting hard at present to get back on track after the criticism, scandal and audits of 1973-1974.

The "idle funds" problem is raised by referring to aggregate industry data which, some critics say, show some $45 million, or approximately 54% of available funds, to be idle, or, as I prefer to say, uninvested. The problem is also raised on occasion by referring to a small number of MESBICS (approximately 6 to 7) which have had some difficulty in implementing their investment plans for various reasons. No further analysis was made of the status of the industry, yet there are many inside and outside of SBA, who have recommended drastic measures to solve a problem which, in fact, may not exist at all. Measures so drastic as to jeopardize the existence of the entire MESBIC industry.

Further analysis would have shown that from July, 75 to February, 76, SBA provided $21.7 million in leverage to the MESBIC industry. (The "idle funds" approximate $45 million). A reasonable man would be loath to include this $21.7 million in his calculation of idle funds. So, (from my point of view) let's analyze the MESBIC industry (composed of 81 members) from the standpoint that $45 million is erroneous. However, we can search a little deeper still, and identify idle funds according to the age of the MESBIC (See table 1). After doing this we would find that investing funds is essentially time-related. The older the MESBIC, the lower the "idle funds" ratio.

We would also find that leveraged MESBICs have, on the whole, less "idle funds" than un-leveraged MESBICs. Now, if we really got ambitious and dug a little deeper we would discover something quite significant. We would discover that venture capitalists and other financiers normally maintain 20-25% of their available capital in reserve, so they might be able to provide the appropriate servicing for their portfolio companies. Who would have thought that profit-oriented firms would do a thing like that? It really makes sense.

My last comments were not intended to be offensive, rather to point out how little analysis must have been done by critics on the status of the MESBIC industry. I am not in a position to know what the actual reserve for each MESBIC is, but SBA, as well as private sector expertise, will accept 25% of total assets. Using that as a guideline, Table No. I shows several categories which we would have to consider "over-invested".

The latest available data on the MESBIC industry are not sufficient to accurately calculate the total assets of the MESBIC industry. We can, however, based on SBA's formula for calculating total assets, assume that total assets would at least be equal to private capital plus leverage received, where applicable. Based on this assumption, the correct "idle funds" for the MESBIC industry is $7.8 million dollars. (See table 2). This "idle funds" ratio of 12.5% clearly indicates that, contrary to current belief, the MESBIC industry does not have a serious idle funds problem.

Again using the table in Attachment No. 1, we can see that, except in two instances, un-leveraged MESBICs have higher "idle funds" ratios than leveraged MESBICs. This statistic indicates that "idle funds" vary indirectly with leverage, so that the higher the leverage, the lower the idle funds. It becomes even more significant in relation to the proposed regulation to reduce "idle funds" by reducing the availablity of leverage. Industry statistics indicate that, ceteris paribus, idle funds levels would increase not decrease.

The concern which, to me, is more important than the level of idle funds is that of the industry's future. If the proposed regulation change is finalized, it will portend the death of the MESBIC industry. First, no new private capital could be raised, and secondly, such a decision would cause existing investors to back out of the program, thereby jeopardizing SBA's existing investment (taxpayer dollars) since the industry would be dead shortly. On the other hand, if we recognized the fact that the MESBIC industry is still in a growth stage and has just come through a most severe recession virtually in tact, we can see a very bright future ahead for this industry. A future that SBA should want to be a part of.

However, if there are those who are seriously concerned about MESBIC inactivity, let me suggest they look to the "inactivity reg" for their answer. Revision to make that regulation practical and workable is highly desirable. I would be glad to participate in such an effort as long as the attitude is positive and the objective is to strengthen and not weaken the MESBIC industry.

Also attached for your information is a copy of Rockwell International's Testimony of July, 1975 before the Sub-Committee on SBA Overnight and Minority Enterprise. I would direct your attention to the summarizing statement. SBA should take actions which reinforce this kind of commitment rather than those which turn such commitments off.

C. Neal Higgins
Associate Administrator
for Minority Small Business

TABLE I

Idle Funds as a Percentage of Capital or Capital plus Leverage by Age of MESBICs.

	LEVERAGE		
Age of MESBICs	No Leverage	Less Than or Equal to $1	Greater Than $1
60 months or over	27.2%	24.1%	10.8%
48 to 60 months	45.8%	12.4%	28.2%
36 to 48 months	28.2%	61.4%	30.2%
24 to 36 months	51.2%	73.1%	9.0%
12 to 24 months	99.3%	78.6%	9.6%
12 months or less	100.0%	99.0%	0
*Total	67.4%	47.1%	14.8%

*Totals includes MESBICs that have been licensed over 24 months.

TABLE II
(Dollars in Millions)

Total Assets of MESBICs	=	$84.0
Leverage from 7/1/74 to 2/29/76	=	$21.7
Idle Funds	=	$45.0

If we deduct $21.7 from $84.0 and $45.0 we get
-21.7 -21.7
$62.3 and $23.3 as our
totals for Total Assets and Idle funds respectively.

If 25% of total assets is accepted as reasonable as a reserve for continuing operations the idle cash or uninvested funds for the MESBIC industry would amount to $7.8 or 12.5% of total assets.

(a) 25% of $62.3=$15.5 - Accepted reserve for continuing operations (Calculation for 12.5%)

(b) $23.3-15.5=$7.8 excess of unvested funds over the reserve for continuing operations.

(c) $7.8=12.5% of $62.3

ISSUE #16

STATEMENT OF THE ISSUE

Should SBA concentrate its efforts toward assistance to "labor-intensive" businesses as a means of solving high unemployment or should its priorities be set by the needs of the businesses or other criteria?

DEPARTMENT POSITION

In our opinion, while it would be a sound policy to give a high priority to labor-intensive businesses as one means of solving high unemployment, it would not be sound to confine our loan-making in such an effort. As a matter of fact, an attempt to do just this was made in Fiscal Year 1966, and it met with instant and highly vocal opposition both in the Congress and the small business community. It could be argued, too, that we have no authority in our legislation to give assistance to some types of businesses, such as labor-intensive, and not to others who have only 1 or 2 employees.

However, the 502 community development program (small in relation to the regular business program), has been oriented toward helping labor-intensive businesses to provide a sounder economic base for an area. This is especially true in our new effort twoard assisting urban areas. It should be noted that the local development company program, since inception in 1958, has stimulated $1.2 billion of total financing, creating or preserving some 278,000 jobs.

AGENCY POSITION

Agree with Department Position.

OTHER OPTIONS

None offered.

CONGRESSIONAL ATTITUDE

Based on past efforts (see Department Position, above), we do not believe that the Congress would look favorably on our assisting only labor-intensive businesses, except in the 502 program, which we are expanding.

ACTION FORCING DATES

None.

LAW INVOLVED

Small Business Act; Small Business Investment Act.

ISSUE #17

STATEMENT OF THE ISSUE

Should SBA play a more vital role in the formulation of tax policy?

DEPARTMENT POSITION

SBA is the sole Federal agency that can speak for the small business community. As such, we should participate in the formulation of any Government policies that affect small business including tax policy. One way we do this is by input to two Treasury Small Business Committees. The IRS has established a Small Business Advisory Committee for tax matters and the Treasury Department itself has set up a Small Business Advisory Council with a Taxation Subcommittee. SBA was instrumental in the setting up of these committees and SBA personnel attend meetings and serve as ex-officio members. SBA also works with trade associations on their tax policy positions. This is a relatively recent phenomenon, and the Agency has only played even this small role for the past year. To fully play this role in tax policy formulation, SBA must develop improved capability to gauge the impact of proposed policies on the small business sector of the economy and on specific industries where there is a concentration of small firms. SBA also has access to the Economic Policy Board on tax policies.

AGENCY POSITION

Agree with Department Position.

OTHER OPTIONS

None offered.

CONGRESSIONAL ATTITUDE

Congress wants more SBA advocacy effort in this area.

ISSUE #18

STATEMENT OF THE ISSUE

Should certain small businesses, based on size and type of industry, be given special consideration in the enforcement of health, safety, environmental and other Federal regulations?

DEPARTMENT POSITION

As presently constituted, most Government regulations -- including those of OSHA and EPA -- were formulated from the input provided by the leading firms in specific industries. Consequently, the regs reflect the state of the art or level of technology present in these leading firms. Compliance efforts predicated on these regs thus put small firms at an immediate disadvantage, since small businesses tend to lag behind larger operations in keeping their plants up-to-date. In addition, compliance officers are encouraged to "go after" small firms in order to boost their quotas of firms visited and number of violations found, since smalls generally are unable to afford the delays in legal appeals of adverse decisions.

AGENCY POSITION

Enforcement activities should be geared toward enforcement of regulations that are realistic for a specific size and type of firm. A 2-tier set of regulations should be developed to establish health, safety, environmental, etc., standards that can be implemented by the firm at its existing level of technology.

Regulations such as Sections 503 and 504 of the Rehabilitation Act of 1973 should be waived for businesses under a certain size. For example, specialty businesses in old structures which employ few people, and usually cater to a select segment of the public, should either not be required to comply with the accessibility requirements of this Act or receive special help in meeting such requirements. In some instances, the increased cost of a street-level location or the need to modify the structure of an old building would be such that the business would not be able to afford the additional expense.

An example of regulation completely unrelated to effectuate its purpose which was published for comment were regulations by the Office of Federal Contract Compliance Programs, U.S. Department of Labor, which would require that "Affirmative Action Compliance Programs," (also known as "Affirmative Action Plans"), by Federal contractors be <u>printed</u>. All small businesses should be allowed to submit such requirements in any legible form.

OTHER OPTIONS

None offered.

U.S. Small Business Administration
Washington

OFFICE OF THE DEPUTY ADMINISTRATOR

December 17, 1976

Mr. William A. Keel
Carter Transition Team
Room 5470, HEW North
4th & Independence Avenue, S.W.
Washington, D.C.

Dear Bill

I am attaching Issues 8 and 24, and a letter relative to Issue 19 recommending that we drop this as a transition issue.

This completes our list. We will send along others as they come to mind.

Sincerely,

Louis F. Laun

Enclosures

cc: Ms. Pat Burr

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Date: DEC 15 1976
Reply to Attn of: GC

Subject: Transition Issue No. 19 - Transfer of Equal Credit Opportunity Act Compliance From FTC to SBA

To: Louis F. Laun
Deputy Administrator

We think this item is probably more of a nonissue than an issue. At best, it is premature given the newness of the enactment and its implementation.

AA/APC's comment is that there is no clear-cut justification. It may well be that the argument should be against transfer.

The Act assigns enforcement authority to several agencies to the extent that these agencies have principal regulatory responsibility over certain organizations (e.g., SBA over SBICs and Federal Reserve Board over certain banks). The FTC is given residual authority because of its other extensive responsibilities for trade regulation, responsibilities which extend to most, if not all, business organizations. SBA does not have as extensive an involvement; it probably only deals with only a small proportion of the small business population.

Accordingly, there is something to be said for the enforcement responsibility remaining with FTC, particularly in the interest of uniformity. We can continue to help in a small way to monitor those small businesses with which we have direct contact.

We recommend that this issue be dropped.

David M. F. Lambert
General Counsel

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ISSUE #20

STATEMENT OF THE ISSUE

Executive Order 11914 gives the Secretary of HEW authority to issue guidelines to other Federal agencies to assure nondiscrimination against the handicapped in programs receiving Federal financial assistance under Section 504 of the Rehabilitation Act of 1973. On July 16, 1976, in Volume 41, Number 138 of the Federal Register, HEW published its own proposed regulations. They have not been finalized. There is some indication that HEW will make its own regulations the guidelines for other Federal agencies.

The proposed regulations require the elimination of physical barriers for the handicapped. There will not be severe problems in prohibiting physical barriers in new structures. The proposed regulations would require that in all existing facilities physical barriers be removed in not more than 3 years.

(a) Should there be a size standard for small businesses eliminating them from this requirement?

(b) Should the Federal government offer small businesses special assistance in addition to that contained in Section 7(b)(5) of the Small Business Act in meeting the requirements of these regulations if they are finalized in the manner currently published?

DEPARTMENT POSITION

In regards to part (a) above, it is felt that size standards be set for small businesses currently housed in existing buildings to exempt businesses under a certain size based on annual gross income from the requirements of this Act. Requiring a marginal or small business struggling to gain a foothold in the business mainstream to incur additional financial burden by providing special facilities for the handicapped in an older building would be an undue burden. It is, therefore, suggested that Section 504 be amended to include this exemption.

If such a size standard is not adopted, special help such as tax incentives should be sought for small businesses required to modify existing structures or relocate because of the need to eliminate physical barriers for the handicapped.

AGENCY POSITION

Agree with Department Position.

ISSUE #21

STATEMENT OF THE ISSUE

Should the Office of Federal Contract Compliance of the Department of Labor attempt to effectuate a reassignment of contract compliance responsibility during a period of transition?

DEPARTMENT POSITION

No -- Most important is the fact that such a reassignment is not in keeping with the provisions of Section 303(a) of Executive Order 11246 which states in part: "Each administering department and agency shall be responsible for obtaining the compliance of such applicants with their undertakings under this Order." Therefore, in order for OFCCP to reassign this function legally, Executive Order 11246 would have to be amended. This has not been done. Further, reassignment of a function from one agency to another during a period of change would be counter-productive because of the uncertainty of the desires of incoming administration and its priorities.

AGENCY POSITION

Agree with Department Position.

ISSUE #22

STATEMENT OF THE ISSUE

Should union bargaining units be consolidated?

DEPARTMENT POSITION

In those bargaining units where recognition has been granted, AFGE is the predominant union. It is expected that, in the near future, this union will seek consolidation of all existing AFGE units into one unit. While there are disadvantages and advantages associated with such a consolidation, it is believed that working with one large unit rather than a number of smaller ones will make for ease of administration and will provide for a greater expertise on the part of both unions and management.

AGENCY POSITION

Undecided at present and awaiting a full presentation of the pros and cons. There is some indication that a consolidated contract could add administrative costs and increase the relative power of union relative to mangement, and if either of these are true consolidation should be resisted.

ISSUE #23

STATEMENT OF THE ISSUE

Should we make further appeals for authority for appointment of disaster loan making personnel to provide for longer periods of service?

DEPARTMENT POSITION

The question itself expresses a basic problem. Use of the term "loan making personnel" ignores the whole question of portfolio servicing. Lending to disaster victims is "romantic" and in the public eye, whereas servicing is never the subject of news headlines. Therefore servicing needs objective, strong support from within the Agency.

In past disaster activity, short-termed policy has cost SBA dearly. Knowledgeable people are lost, training in depth is not practical and efficiency is never at optimum. Undoubtedly, many loans have had to be charged off for lack of reasonable follow-up, on a timely basis by able personnel.

On February 24, 1976, the Civil Service Commission approved an amendment to Schedule A authority 213.3132(a) to increase the limitation on total service from two to four years in SBA's Disaster Loan Program. However, no more than two years may be spent on any one disaster, and no appointment may be made under the authority to positions involving long-term portfolio maintenance.

Initially, the "loan maker/loan servicer" ratio can easily be worked out. As disaster loans increase, peak and then fall off completely, personnel should be moved from one activity to the other. Accordingly, supervisors should be required to justify their total needs for financial personnel at regular intervals.

From a practical standpoint, the increase in total service to 4 years did not give us much relief. Under the previous 2-year rule, we were rather successful on an individual case basis in obtaining extensions beyond the 4-year limit recently granted.

In our request to the CSC for extension of the disaster authority, we also requested that disaster employees be eligible for reappointment so long as there is a six-month break in service between each four years of cumulative or continuing service. This request was not responded to by the Commission.

During the temporary crisis of a newly declared disaster, it is imperative that SBA react spontaneously to appoint individuals who possess superior qualifications, training, and dedication in order to provide the best possible support to disaster victims. Without the authority to further utilize those individuals who have completed four years of disaster service, we are losing our best source of candidates in order to assure that the position is being filled with the best qualified person.

Therefore, we are recommending that another appeal to the Civil Service Commission be made for approval to reappoint disaster employees who have completed four years of service as long as there has been a break in service of six months.

AGENCY POSITION

Agree with Department Position.

ISSUE #24

STATEMENT OF THE ISSUE

Congress continues to mandate new programs for SBA. No increases in personnel commensurate with these program increases have been granted in many years either by OMB or the Congress. This has affected the quality and efficiency of SBA service.

Should the Agency attempt to curtail programs drastically to improve quality of administration or make an all out appeal for major new personnel resources, or neither of these?

AGENCY POSITION

The Agency's response should not be to attempt to curtail programs drastically, although it should mount a cost effectiveness review of all programs to find specific areas where savings can be made. The Agency received additional permanent personnel in FY 1976 and FY 1977 and has asked for more relief in the FY 1978 budget. A continued strong attempt should be made in this area to continue this trend in FY 1979.

The permanent ceiling of the SBA as shown on the attached schedule has fluctuated from a ceiling of 4,360 (4,377 filled) to a low of 4,019 in 1972 and to the current 1977 ceiling of 4,434.

In 1968, when we had 4,373 filled positions, the loan portfolio was 101,773 loans valued at $2.1 billion. The current portfolio is 228,000 loans valued at over $7 billion SBA share. In addition to this tremendous increase in the loan portfolio, there have been about 19 new programs added to the SBA mission and Congress has added over 3 million new constituents by making farmers eligible for SBA programs.

If no personnel increases become available, we should selectively curtail programs done directly by SBA employees.

As maintenance of a vast portfolio of past loans uses more personnel than any other SBA activity, SBA should explore setting up some national credit insurance type program to replace existing guaranteed loan programs. Direct loan programs should not be expanded.

A separate collection and auctioning unit should be set up and modernized along the lines of commercial banks -- American Express and others.

Continued efforts should be made to involve volunteers and students from the private sector to extend the ability of the Agency to aid small business.

We should always try not to duplicate with our scarce resources programs available from the private sector.

In addition, and this may be more possible with the same party in charge of the Executive Branch and the Congress, an all out effort should be made to work with the committees in both houses during the legislative process so that the impact of new programs on personnel resources can be more thoroughly understood at that time.

SMALL BUSINESS ADMINISTRATION

YEAREND EMPLOYMENT

FISCAL YEAR	CEILING PERMANENT POSITIONS
1977	4,434
1976	4,339 1/
1975	4,200
1974	4,054
1973	4,200
1972	4,019
1971	4,100
1970	4,100
1969	4,250
1968	4,360

1/ 167 allowed to replace temporary disaster employees.

ISSUE #25

STATEMENT OF THE ISSUE

Should the Agency undertake a massive development of productivity/cost standards applicable to field offices and Central Office?

DEPARTMENT POSITION

Whether the Agency should undertake a massive project of development of productivity/cost standards is a matter that should have much discussion. The Agency should initiate efforts to establish productivity/cost standards at least on a selective basis as quickly as possible, however, the Agency should keep in mind that these standards should be useful for management purposes in addition to support budget requests for more people and more money. The Agency does need productivity/cost standards. However, we must be sure that we are proceeding cautiously to obtain useful standards and not just standards for standards sake.

AGENCY POSITION

The Agency recently abandoned the last of a number of attempts at establishing fixed workload standards and measuring productivity against those standards.

The cost of our output and the efficiency of our operations must be measured to assure proper management of SBA offices and programs, but this need not be a massive effort. We could be able to compute most of the needed information if the agency had a meaningful measure of where our employees are physically located and in what program efforts they are engaged. A revision of the time and attendance records would accomplish this. Office outputs are generally available now in existing reports. By having the computer compare the revised office T&As against office outputs, costs per output, either in dollars or manhours, can be readily determined.

If finer details on program productivity and cost are necessary they can be achieved by establishing an ongoing, automated, sampling procedure, the results of which can be used in conjunction with the above system.

The information on productivity and costs is essential but the massive development of standards is not and should be approached cautiously.

ISSUE #26

STATEMENT OF THE ISSUE

Should the Agency install an Organization and Management Department?

DEPARTMENT POSITION

Yes. The basis for the establishment of an Organization and Management shop is to develop and maintain a staff with the expertise to conduct in-depth management, organization, and work methods studies to assist management in work organization, manpower planning, employee utilization and procedures development. Many of these functions are being conducted now, with staff, line and supervisory employees, who have to develop methodologies as they go. In these cases, the employees are often not capable of producing a professional report in the required time frame, and in addition, once the project is over, their staff experience is not capitalized on. When task forces are not used, or staff employees with other specializations are not assigned to study methods and techniques, the problems may be left to fester, or the improvement may be lacking. In any case, the proper involvement of management analysts, with management sciences expertise, is essential to an Agency such as SBA with major program responsibilities that are dynamic and nationwide.

AGENCY POSITION

Agree in principal with the Department Position. A detailed position paper is in the process of being examined.

ISSUE #27

STATEMENT OF THE ISSUE

Even without additional personnel increases severe shortages of space exist in Central Office and many field offices. GSA appeals have not produced adequate relief. Should the new administration make an early attempt to reopen this whole issue with the new GSA management?

DEPARTMENT POSITION

Yes. We do feel that the new Administration should make an early attempt to reopen this whole space issue with the new GSA management.

Prior to the 15th of November 1976, this Agency had 60 active space requests for FY 1977 on file with GSA for action. As of this date, 15 actions have been completed, leaving a total of 45 which remain in various stages of completion. Of these 45, it should be noted, 23 involve leased space and 22 involve Federal space.

AGENCY POSITION

Agree with Department Position.