APPENDIX 36

LIST OF CONGRESSIONAL TESTIMONY

July 20, 2000

Aida Alvarez (SBA Administrator) Before the Senate Small Business Committee on SBA's Use of Technology: GAO Report

June 15, 2000

Gail McDonald: The National Ombudsman's 2000 Report to Congress - Building Small Business Agency Partnerships - Before the Subcommittee on Regulatory Reform and Paperwork Reduction Committee on Small Business, United States House of Representatives

May 16, 2000

Aida Alvarez on China Trade Impact on Small Business Before the Subcommittee on Tax, Finance & Exports Committee on Small Business, United States House of Representatives

March 1, 2000

Aida Alvarez Before the Small Business Committee, United States House of Representatives on SBA's Fiscal Year 2001 Budget Request and Reauthorization

February 29, 2000

Fred P. Hochberg (SBA Deputy Administrator) Before the House Small Business Subcommittee on Government Programs and Oversight on Loan Monitoring System (LMS)

May 26, 1999

Daniel O. Hill (SBA Assistant Administrator for Technology) Before the Committee on Small Business, U.S. House of Representatives on Electronic Commerce (E-Commerce)

Good Morning Mr. Chairman, Senator Kerry and members of the Committee. Thank you for inviting me to testify this morning. I am proud to be accompanied today by members of the U.S. Small Business Administration's management team. It is their hard work that makes SBA successful in meeting the needs of America's small businesses.

Record Small Business Growth and the Transformation of the SBA

The United States is enjoying one of the most robust economic growth periods in its history. More than 22 million new jobs have been created in the United States since 1992, we have the lowest unemployment and inflation rates in decades, and productivity gains from expanded use of technology have helped send the stock market to new highs. Corporate profits and individual wealth have increased, creating a Government surplus that was unthinkable a few years ago. Although not every segment of society has shared equally in the fruits of this prolonged economic expansion, the United States economy is arguably the most robust in the world, becoming more diversified, more global, and more technological.

The extraordinary economic growth over the past decade has been fueled in large part by growth in the small business sector. There are now more than 25 million small businesses in the United States, 5 million more than in 1990, and the most in the U.S. ever. In fact, almost a quarter of U.S. households own a business, are starting a business, or are investing in someone else's business.

According to research done by SBA's Office of Advocacy, small businesses --

- Represent 99 percent of all employers and 52 percent of the private workforce;
- Employ 38 percent of the private workers in the high technology field;
- Provide virtually all the net new jobs;
- Provide 51 percent of private sector output;
- Provide 35 percent of all Federal contract dollars;
- Represent 97 percent of all exporters, with the number of small business exporters doubling during the five year period from 1992 to 1997;
- And provide more than half of all innovations.

The SBA was created nearly 50 years ago to ensure a strong and vibrant small business sector. Many things have changed in the half-century, but our mission stays the same – to help small businesses start, grow and succeed. The Small Business Act states, "It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business....to maintain and strengthen the overall economy of the Nation." Congress understands that a vibrant small business sector is at the core of our economic growth and to the extent that SBA furthers this economic growth, its support of small business is in the best interest of every citizen.

The New SBA

SBA's workforce and the way we deliver programs have changed dramatically in the past decade, too. Since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time the number of our employees has decreased 22 percent.

Mr. Chairman, there are still places in America where small firms have not fully participated in the nation's phenomenal economic recovery. We are committed to helping these new markets gain access to our programs and services. As a "gap lender" that is addressing imperfections in the private market system, SBA has developed aggressive multi-year lending goals to guide our efforts. In addition, we will continue to work in partnership with major businesses, civic and trade associations, and local community groups to take advantage of their skills in reaching those small firms that need the most help. A big part of our mission will be to draw these groups into the mainstream of the American economy as envisioned in the Administration's new markets strategy.

Working closely with the Congress, SBA has recognized where the private sector could perform our tasks more efficiently, and has contracted out or delegated those activities. SBA is delegating greater authority than ever before to its lending partners. This transition permits greater use of staff for community outreach and greater attention to more complicated loan matters. Most importantly, according to our auditors, we are making the transition in a manner that is financially safe and sound.

Improved Financial Management

SBA received a clean opinion in its FY 1999 financial audit report, the highest rating an entity can receive. This was the fourth year in a row SBA attained this rating. SBA remains the only Federal credit agency to receive four clean opinions. As you know we completed our first asset sale last fall and enjoyed great success. We realized an estimated $90 million premium over what SBA would have received had we held the loans to maturity. On August 1 we will hold our second sale closely followed by a third in December 2000.

Additionally, since late FY 1997, SBA has taken the lead in the Federal government to begin the implementation of an enhanced internal control program using the Committee of Sponsoring Organizations of the Treadway Commission (COSO) guidelines. The COSO program provides for a more rigorous level of internal control awareness and processes than are currently required in the Federal Government. These guidelines also are used by commercial banks and other large financial organizations. SBA is well on its way to fully implementing these guidelines, and has committed to being fully COSO-certified by FY 2002 as part of its GPRA strategic plan.

We are emphasizing the importance of improved internal controls and program oversight. We are upgrading and modernizing our information systems, offering every small firm electronic access to our products and services to extend our outreach and offer more customer-driven assistance. And we are transforming our workforce to meet the challenges of the new knowledge-based economy.

We have laid out an aggressive agenda to improve our internal management in the President's FY 2001 budget. We requested $13 million for systems modernization to improve our lender oversight, risk management, and program evaluation activities; $7 million for information technology infrastructure support; and $4 million to train and transform our workforce. Funding these activities will help SBA address the challenges the General Accounting Office is reporting on today. Mr. Chairman, we need your help and that of the other members of the Committee in supporting our request for FY 2001.

It has been a period of astounding growth and change. And throughout, SBA, working with this Committee, has adapted its products, its services and its operations to contribute to the overall growth and vibrancy of the small business sector. The legislative structure of SBA's programs has changed significantly in the past decade. Dozens of changes in SBA's programs have passed the Congress and been signed into law.

Fair, Effective Oversight

Congress, the Executive Branch, and the American public are all looking for better ways to assess the effectiveness of government programs and the value added by our use of taxpayer resources. The Congress has passed several laws over the past decade to provide a framework for measuring results:

- in 1990, the Chief Financial Officer's Act;
- in 1992, the Credit Reform Act;
- in 1993, the Government Performance and Results Act;
- in 1996, the Clinger-Cohen Act and the Federal Financial Management Improvement Act;
- in 1997, PL.105-135, SBA's Reauthorization Act, calling for the completion of eight planning steps for SBA's Systems Modernization Initiative;
- in 1999, the Senate Governmental Affairs Committee, working together with GAO and the Government's Inspectors General, began monitoring high-risk areas and major management challenges of every federal agency.

Even before the commencement of the comprehensive assessment requested by you, Mr. Chairman, GAO was very active at our agency. Over the past year the GAO has conducted or is in the process of conducting 41 audits or reviews of SBA programs and processes. Beginning a year ago, in July of 1999, SBA began meeting with the GAO staff about Information Technology, and in August of 1999 about human capital and the 8(a) program. Currently, GAO has 20 open audits at SBA. During the last three fiscal years, GAO has completed roughly 10 times more audits of SBA per FTE than in the government as a whole. During this same period, GAO has completed roughly 25 times more audits of SBA per SBA's budget appropriation dollars than in the government as a whole.

Mr. Chairman, the audit activity at SBA is not without an impact on the staff and operations of our agency. Since August of last year, we have kept records of the documents requested for the comprehensive assessment. This is exclusive of the many audit activities underway by our agency's own Office of Inspector General (OIG) and the oversight reviews requested by the Senate's Committee on Governmental

Affairs and the House Government Reform Committee; by the Senate and House Small Business Committees; and by individual members of Congress.

Since last summer, SBA's senior managers and their staff – the same people responsible for running SBA's programs day-to-day and serving the public – have spent thousands of hours working on these audits. In the past year SBA has provided 799 documents to the GAO or 25,338 pages of material. In the past year alone SBA has spent approximately $180,000 providing information to the GAO.

Mr. Chairman, I believe in proper and prudent oversight. When I came before this Committee for my confirmation, I stressed my commitment to improving oversight at the SBA. During my tenure we created the Office of Lender Oversight and completed the first ever examination of all 14 Small Business Lending Companies. The second round of examinations is nearing completion. Prior to 1998 only three examinations had been conducted.

In FY 1998, SBA fully implemented a comprehensive Preferred Lenders Program (PLP) review process. All PLP lenders that made a loan in FY 1998 or 1999 have been reviewed. Currently, SBA is conducting its third round of reviews.

Because I feel so strongly that proper oversight is important, I met with GAO Comptroller General David Walker to discuss the comprehensive audit they were beginning. My senior staff – Deputy Administrator Fred Hochberg, Chief Operating Officer Kris Marcy, and Chief Financial Officer Joe Loddo – joined me at that meeting. Mr. Walker's senior staff was also present. We wanted to understand the scope of their planned body of work and the requirements for the compilation of data that would be required of SBA staff.

I believe the success of government programs needs to be measured at SBA in terms of SBA's mission, by the customers we serve, and our accomplishments. I also believe that oversight needs to be balanced and fair. The Government Performance and Results Act (GPRA) provides a framework for doing this. Let me share some of our accomplishments with you.

Accomplishments on Behalf of America's Small Businesses

- Since 1992, the SBA has helped almost 375,000 small businesses get more than $80 billion in loans, more than in the entire history of the agency before 1993. No other lender in this country - perhaps no other lender in the world - has been responsible for as much small business financing as the SBA has during that time.
- Since 1958, SBA's venture capital program has put almost $30 billion into the hands of small business owners to finance their growth. Well over half of that amount has been invested since 1992, in more than 13,000 businesses.
- Last year, the SBA approved $3.4 billion in loans to more than 12,000 minority-owned businesses, three times the amount approved in 1992. The $3.4 billion amounts to almost 28 percent of all SBA loan dollars last year, a record.
- Since 1992, the SBA has approved more than $18 billion in loans to nearly 80,000 minority-owned businesses, more than double the amount recorded

during the entire previous history of the Agency.

- We've reduced our staff level by 22 percent over the past decade, from just over 4,100 employees in 1990 to around 3,100 in 1999. At the same time, we've dramatically increased the size of our loan portfolio. In fact, from 1953 to 1993, SBA's portfolio grew to $25 billion. From 1993 through 1999, the portfolio nearly doubled-to about $50 billion.
- Since 1994, more than 140 new Small Business Investment Companies (SBICs) have been licensed with initial private capital exceeding $2 billion, more than the total private capital raised in the prior 35-year history of the program. Those SBICs participated in an estimated 53 percent of all institutional venture capital financing deals in the U.S. in FY 1999.
- In addition to financial assistance, SBA offers business development services to between 900,000 and 1 million small businesses each year through the Small Business Development Centers (SBDCs), SCORE, Women's Business Centers and others.
- At the beginning of the decade, the Internet as we know it did not exist. Today, SBA has an award winning website that offers entrepreneurs free online business planning and other valuable assistance. SBA's website receives over 9 million hits per week.
- SBA made more than 7,300 disaster business loans for more than $402 million. These loans have enabled businesses to rebuild, saving almost 35,200 jobs. In addition, SBA has made almost 29,000 home disaster loans for $534 million.
- SBA just conducted its first sale of business loans to the private sector, and realized an estimated $90 million premium over what SBA would have received had we held the loans to maturity.
- Our ongoing systems modernization initiative will completely overhaul our programmatic, financial and management systems, resulting in better data collection and greater ability to measure the impact of SBA's programs.
- SBA represents less than 5/100th of one percent of the federal budget and the yearly taxes paid by just one of our success stories, Intel, more than pays the costs of running the Agency's annual budget.

As we have noted above, SBA is a strong and vibrant advocate for America's small businesses. It is our mission and our goal to ensure that small businesses are provided the opportunity to fairly compete in our free market system. Our economy is growing and expanding like no other in history, while federal agencies are required to operate more efficiently. Therefore, it is imperative that SBA reinvent itself to ensure that America's small businesses are able to succeed. We are confident that SBA is properly undertaking reasonable and effective measures that ensure our mission, goals, and objectives in the 21st Century.

Now Mr. Chairman, I would like to address the specific program areas that I was invited to testify about.

The 8(a) Business Development Program

The History & Mission of the 8(a) Business Development Program

The 8(a) Business Development Program was created by the Congress to promote and assist socially and economically disadvantaged individuals in gaining access to the resources necessary to develop small businesses, and thereby improve their ability to compete on an equal basis in the mainstream of the American economy. SBA fulfills this mission through national programs that provide marketing, managerial, technical, and procurement assistance to eligible businesses that help them achieve their competitive potential. These programs are managed at the national level by the Office of Minority Enterprise Development, and delivered at the local level through our network of district offices and resource partners.

Under Section 8(a) of the Small Business Act, SBA provides access to sole source and limited competition Federal contract opportunities to eligible firms over a nine-year program participation term. Since the inception of the 8(a) program in 1968, approximately 511,000 contract actions worth approximately $82.2 billion have been made. While these figures represent a small percentage of total Federal procurement actions and dollars, they still represent significant success in including targeted businesses in the Federal market. This success has significantly enhanced participants' ability to compete in the commercial market.

Over its 31-year history, the 8(a) program has made it possible for many minority entrepreneurs to enter the Federal marketplace. The program is not a government "handout" or "giveaway." It is a means by which qualified businesses have provided goods and services that have met or exceeded market standards and agencies' needs.

Protecting and Strengthening the 8(a) Program

Pursuant to the 1995 Supreme Court decision Adarand v Pena, SBA has taken necessary and reasonable actions to ensure that the 8(a) business development program is narrowly tailored to the developmental needs of small disadvantaged businesses. In 1998, SBA issued regulatory changes to strengthen and improve the 8 (a) program. These changes act as a check and balance of business development opportunities, and therefore require SBA to monitor the contracting activity of 8(a) firms. For example, SBA regulations require a specific business mix formula for firms in the transitional stage of program activity, and provide for early graduation and sole source limitations for very successful firms.

At the same, SBA is reinventing how 8(a) firms receive contracting business development assistance. For example, SBA allows successful firms (either small or large) to "partner" with new 8(a) firms through a méntor-protegé relationship. The new regulations also increased small business access to federal contracting opportunities by making it easier for firms to affiliate and compete for large contracts. In addition, the changes provided for more equitable distribution of contracts by imposing stronger competitive mix requirements and restrictions on sole source contracts.

In 1998, SBA took a major step in improving the program by delegating 8(a) contracting authority to substantially all Federal acquisition agencies. This allowed SBA to eliminate any unnecessary time-consuming district office intervention in the acquisition process. By streamlining the 8(a) contracting process, we have made the program more timely and efficient, increasing its attractiveness as a contracting vehicle for procuring agencies.

While these changes to the 8(a) program were significant, other changes in Federal procurement environment have made it easier for contracting officials to buy goods and services more quickly and efficiently under a variety of new acquisition mechanisms. Procurement reform has transformed the Federal government's $200 billion a year acquisition system and dramatically changed the way the government buys its goods and services. In today's dynamic procurement environment, as agencies downsize due to budget cuts and streamline procurement processes, we have seen an increase in contract bundling and the use of Multiple Award Contracts, Government-Wide Acquisition Contracts (GWACs), Federal Supply Schedules, and credit card purchases. Before I discuss the steps we are taking to increase opportunities for 8(a) firms, let me place levels of 8(a) contracting activity in perspective.

The total value of Federal procurements has been relatively stable over the last decade, increasing from $191.2 billion in FY 1990, to $198.8 billion in FY 1999. In the same period, 8(a) contract awards increased 81.5%, from $3.4 billion to $6.2 billion. In relative terms, 8(a) awards increased from 1.8 % of total procurements in FY 1990, to 3.1% in 1999. In the post acquisition reform environment, the impact of changes in the marketplace upon 8(a) firms becomes clear. For example, 8(a) awards declined from $6.4 billion or 3.2% of total procurements of $197.6 billion in FY 1996, to $6.2 billion, or 3.1% of total procurements in FY 1999.

We believe that providing contract assistance is an essential component of the business development services that we provide to 8(a) firms. The GAO survey confirms this in finding that 86 percent of the firms joined the program to obtain 8(a) contracts, while 22 percent joined to learn more about management.

The SBA is taking steps to further improve the 8(a) program in order to increase contracting opportunities for 8(a) firms. In June, SBA entered into a Memorandum of Understanding with the General Services Administration (GSA) that allows for blanket acceptance of the GSA's Multiple Award Schedules Program under the 8(a) program. This blanket acceptance provides for a streamlined approach for agencies to award orders to 8(a) firms under the schedules program. Agencies will also be allowed to take credit for orders to 8(a) firms towards their 8(a) goals. This action, and others like it, will increase 8(a) firms' access to opportunities in Federal procurement.

We are aggressively marketing the 8(a) mentor-protégé program. Through this program, 8(a) firms can enter into strategic alliances that enable them to compete more successfully for larger requirements than they could on their own. To date, we have approved 60 méntor-protegé agreements that will provide contracting opportunities for 8(a) firms.

In addition to improving the 8(a) program, we are simplifying the application process. Specifically, we are developing a combined 8(a)/small disadvantaged business (SDB) application to make it easier for firms to apply for the 8(a) and small disadvantaged business programs. We plan to automate the application and include a decision support module that will allow for approval on-line over the Internet. This will be implemented in accordance with a strategic information technology plan for our procurement assistance programs that we are now developing, as noted previously.

Tracking Assistance Provided to 8(a) Firms

The GAO report states that SBA remains unable to track technical assistance provided to firms. SBA developed and pilot tested a Business Assessment Tool (BAT) in 1998 and 1999. The BAT is a software tool that includes a series of questions to help district offices assess the technical assistance requirements of 8(a) firms in the developmental stage. We are now assessing the outcome of the pilot test to determine if the tool should be used to determine business development requirements, and to track the assistance provided to 8(a) firms. There is no question on the part of GAO or SBA that we must make significant improvements in this area.

SBA is embarking on an agency-wide systems modernization initiative to re-engineer its business processes to better service its customers. We have begun the planning for the re-engineering of the systems that support the 8(a) program, including the need to develop a system to track the assistance provided to our 8(a) firms. This is part of Phase III, which addresses entrepreneurial development and procurement assistance.

Measuring Program Performance

The GAO notes that SBA changed its program performance goals for the 8(a) program in its FY 2001 Annual Performance Plan to focus more on the business development. The GAO audit indicates that this is an output rather than an outcome measure and is weaker than the previous measure. Up until the current performance plan, SBA measured 8(a) program success solely in terms of the number of 8(a) firms that continued business operation 3 years after leaving the program. It should be understood that 15 U.S.C. § 636(j)(16)(B)(iii) requires that we include such information in an annual report to Congress. This requirement is codified in SBA's regulations at 13 C.F.R 124.603. It is notable that in our FY 2000 Annual Performance Plan we had established a goal of 50% for this measure. In fact, we realized a success rate of 52% for firms exiting the program in the period FY 1997 - FY 1999, and a rate of 63% for firms exiting the program in FY 1999. By statute and regulation, we must continue to collect and report this information.

With our FY 2001 Annual Performance Plan we have strengthened, not diluted, the tools by which we judge 8(a) program success. We have added a second measure to focus on business development. We also define program success as the number of 8 (a) firms that complete the 9-year program term and receive business development assistance, including both management and contracting assistance. The two measures, one dictated by statute and regulations, the other included in our Annual Performance Plan, when taken together, will help us better assess the overall 8(a) program performance.

Reassess Use of 7(j) Funding

Under section 7(j) Management and Technical Assistance Program, SBA provides management and technical assistance to socially and economically disadvantaged individuals and businesses, both 8(a) and non-8 (a); in areas of high unemployment or in areas with a high concentration of low-income individuals. Participants in the 8 (a) program comprise the largest percentage of 7(j) program users. SBA awards cooperative agreements to both public and private organizations for the delivery of program services.

As indicated in the GAO report, funding for the 7(j) program, our primary source of funding for technical assistance and training of 8(a) firms, has decreased significantly over the last 10 years. The funding from fiscal years 1990 through 1995 averaged approximately $8.4 million per year. From fiscal years 1996 through 1999, funding for 7(j) averaged about $2.8 million per year, well below SBA's budget request. Because of the decreased funding, we have been unable to provide technical assistance and training to many 8(a) firms.

The majority of the funding has been used to support our Executive Education Program, which services only a limited number of program participants. We agree that we should enhance the training component of the 7(j) program to focus on both management and contracting assistance. However, due to budget constraints, we have been unable to provide a broad spectrum of tailored management and technical assistance to 8(a) firms. For example, we have been unable to implement a program that would provide year round training to more 8(a) participants.

We agree with the GAO that continuous assessment of the needs of 8(a) program participants is essential to determining what types of management and technical assistance we offer under 7(j) authority. When the GAO review began, SBA was designing a survey instrument for the 8(a) program that would be administered to our district office managers and 8(a) program staff and to 8(a) firms. Due to budget constraints, we elected to delay issuance of our survey to 8(a) firms. However, during the next fiscal year, we will reconsider this survey to help us assess the deployment of 7(j) resources. We are not satisfied with our efforts in this area and agree with GAO that much more needs to be done.

Information Technology Management at SBA

For more than four years, even with lean budgets and the compelling urgency of the national Year 2000 conversion effort, SBA has been steadily on the path to modernizing its information technology systems and decision support processes. While much remains to be done, the Agency has been busy and productive in the information technology arena.

Since Systems Modernization is so critical to SBA's success over the next several years, I would like to expand on this subject for a moment. Systems modernization is a key success factor for SBA in the 21st century—an agency that delivers sophisticated, efficient, and cost-effective services to small business customers and to SBA's lending and other resource partners. The SBA vision statement reflects the commitment to provide:

- Cross-functional products and delivery systems;

- Customer-oriented programs to resource partners;
- An agency without barriers providing products to customers 24 hours per day, 7 days per week, from various sources; and
- A highly trained and motivated staff.

In order to implement this modernization plan, the SBA is committed to investing the necessary resources into the development of improved business processes and supporting information technology (IT) systems. As part of this objective, SBA is determined to manage itself to the highest industry standards for internal controls, risk management, and oversight.

To achieve these standards, SBA has embarked upon a multi-year systems modernization project, called the SMI. SBA has elected to divide SMI into three overlapping phases:

- Phase I -- Loan monitoring and lender oversight
- Phase II -- Financial management and disaster lending
- Phase III -- Government contracting, business development administrative systems, Small Business Investment Companies (SBIC), and Surety Guarantee Systems.

To effectively manage this complex transition, and ensure that the resources this effort will take are properly planned and controlled, SBA has been working to improve its IT investment management and control processes, in accordance with the Clinger-Cohen Act. The Agency established its IT capital planning review body, the Business Technology Investment Council (BTIC) in May 1997, shortly after passage of the Clinger-Cohen Act. The Council, chaired by SBA's Chief Information Officer, is comprised of the Deputy Administrator, the Chief Operating Officer, Chief Financial Officer, the General Counsel, SBA's Chief Acquisition Officer, all four Associate Deputy Administrators and two District Directors. The Council has met regularly since then and is now playing an active role in reviewing proposed IT projects and controlling costs by insisting on the necessary levels of planning before making investments. We recently provided additional contract resources in this area to fully document our IT investment management and control processes.

We appreciate GAO's time and effort in reviewing our management of IT and we believe that their recommendations will help us continue to develop our capabilities in this area.

GAO examined SBA's overall management of information technology (IT) in five key areas: IT Investment Management, IT Architecture, IT Software Development & Acquisition, Information Security and IT Human Capital Management. After commenting on the first draft of their report, SBA largely concurred with GAO's findings and recommendations.

Since late 1996 Congress, GAO and OMB have focused attention on how agencies manage and control their major investments in information technology. The Clinger-Cohen Act of 1996 set new requirements for agencies to follow in this area. SBA has been adapting to these new rules, but not at the rate we hoped to achieve. Year 2000 conversion, for example, had to be a priority effort for much of 1998 and 1999, and resource constraints have also held us back.

Overall, GAO acknowledged that SBA's intentions are good and that we have a good understanding of what needs to be done to sustain and improve our management of information technology. Our internal policies, procedures and enforcement tools need to be formally established. It is these administrative and documentation functions that have been most affected by resource constraints within the Agency at large.

IT Investment Management

Investment management is an integrated approach that provides for the management of IT projects and investments over their entire life-cycle. The investment management process requires that agencies address three key functions: how projects are selected, how they are controlled for cost and performance, and how they are evaluated afterward to assess their relative success. GAO determined that while SBA understands these processes and has made some progress in the selection and control areas, the Agency needs to establish policies and procedures that fully spell out how SBA will *select, control and evaluate* its major IT investments. In some of the projects GAO reviewed, earlier analysis was needed to show the costs, benefits and risks of proposed projects and their alternatives.

SBA awarded a contract in June to Booz Allen & Hamilton, a firm with recognized expertise in this area, to help us document and institutionalize our IT capital planning process. The contractor will also conduct training for SBA program managers in IT capital planning principles. We will have our internal IT capital planning process fully documented by December 2000.

SBA is treating its most significant IT investments, the Systems Modernization Initiative (SMI), which includes the Loan Monitoring System, as a model of how IT capital planning and implementation should be conducted within the Agency. All SMI projects are fully documented in accordance with SBA's new System Development Methodology, acquisition planning is performed for each. Investment control reports are provided to the BTIC at each meeting.

To date, the Agency has spent over $2 million supporting the necessary planning and project management activities related to SMI. We believe that these early investments will help minimize risk and ensure the soundness of our SMI projects as they continue into development and operations.

Information Technology Architecture (ITA)

An IT Architecture is a complex "blueprint" that defines the relationships among an organization's business processes, data needs and information systems. The ITA is not static; it evolves over time and guides how the Agency buys and develops IT systems according to technical industry standards, and maintains alignment between systems and the agency's missions. GAO acknowledged that SBA had developed its ITA, but recommended that we establish procedures to ensure that our ITA is properly maintained and developed over time.

SBA has developed its ITA based on an accepted industry model. GAO has indicated that SBA's ITA meets current standards and that we are one of only a few agencies of our size to have developed an ITA. From GAO's report:

> *"...SBA has made progress with its target IT Architecture by describing its core business processes, describing data maintenance and data usage, identifying standards that support information transfer and processing, and establishing guidelines to migrate current applications to the planned environment."*

SBA will implement full ITA maintenance on October 1, 2000. Key features will cover "change management" to ensure compatibility between systems, and security standards encompassing hardware, software and communications.

We have also hired a Quality Assurance Manager and will be selecting an IT Architecture Manager by August 15, 2000.

To help ensure the operational future of the systems we are planning for development, we will use the technical evolution path described in our IT Architecture to develop our IT office automation initiative, the "seat management" proposal.

IT Software Development and Acquisition

To provide the software to support its operations, agencies have two choices: they can develop software using their own staff or they can acquire software and services through contractors. Because SBA is a smaller agency, we should be perfecting our skills as a software *acquisition* agency, rather than a software *development* organization. To manage software acquisition processes, agencies need to establish policies and procedures and assign responsibilities for how they will do this technically demanding work. To be successful, an agency needs specialized and well-defined software acquisition processes, with supporting methods and standards that define its particular rules. Key processes that must be covered to be successful include requirements management, project planning, acquisition planning and contract management, project tracking and oversight, quality assurance, and configuration management. GAO recommended that SBA complete its Systems Development Methodology (SDM) -- which will be our repository for many of these technical requirements-- and establish and enforce solid procedures for developing and acquiring software through under federal contracting methods.

The most commonly acknowledged standard for assessing an organization's software management capability is the Software Engineering Institute's Capability Maturity Model developed at Carnegie-Mellon University. Under this model organizations can judge the maturity of their processes and understand the key processes they need to develop to attain the next higher capability level. There are five of these "CMM" capability levels and SBA, like most agencies is at the first level (CMM Level 1). Our goal is to attain CMM Level 2 – which means our key software rules and processes are fully documented and repeatable—within two years.

SBA's Inspector General has audited the SDM, found it to meet current standards, and requested only minor changes. The proposed SDM is now being used on a daily basis to govern software processes in the proposed Loan Monitoring System project.

The OCIO is committed to attaining Level 2 of the Software Engineering Institute's Capability Maturity Model for Organizations (SEI-CMM Level 2) by Fiscal Year 2002, resources permitting. Achieving a SEI-CMM Level 2 rating requires a well-planned and sustained investment in time, budget, staff and training over 2 to 3 years.

IT Security

Information security covers the ways an organization protects its computer supported resources and assets. Such protection -- which is largely the outgrowth of technical tools and organizational practices -- ensures the integrity, confidentiality, and availability of the data and systems within an organization. Integrity ensures that data have not been altered or destroyed unless authorized. Confidentiality means that information is not made available or disclosed to unauthorized sources. Availability means that data will be accessible or usable upon demand by those with authorization. Key IT security processes include risk assessment, user awareness, controls, evaluation, and central management. GAO recommended that SBA finalize its IT security policies and procedures, and establish regular risk assessments of our key systems.

SBA understands how important IT security is, and how critical it will become in the future as we enter the era of e-government. We have increased our resources for IT security by hiring five additional internal staff, and we've allocated over $800,000 in additional contractor support to conduct needed security reviews. Our IT security reviews are prioritized and we have accomplished 4 of the 5 most critical reviews.

We are developing comprehensive disaster recovery plans for the Agency and have a prototype recovery plan that will be in place for each SBA office nationwide by December 1, 2000.

To raise IT security consciousness, we have developed a self-paced security

awareness training course based on NIST (National Institute of Standards and Technology) guidelines. We will make this training available to all employees on the Agency's Intranet in early September.

Our revised and updated IT security SOP has been issued and posted on SBA's internal web site. Mandatory security reviews will be included for all projects that are developed under our new IT capital planning and investment control procedures.

IT Human Capital Management

The concept of human capital centers on viewing people as assets whose value to an organization can be enhanced through investment, thereby increasing the performance capability of the organization and its value to customers and other stakeholders. IT human capital management is a particular concern right now in the federal sector because of the pervasive competition among all public and private organizations for skilled IT persons. GAO recommended we establish a process for identifying SBA's IT knowledge and skills requirements, update that information periodically, and develop workforce plans to acquire, develop and maintain these critical IT skills to fill known gaps.

We are developing the specifications for a contract that we expect to award within the next 30 days to perform the specialized, repeatable IT skills survey to support Clinger-Cohen Act requirements. It will cover managers, dedicated IT staff and IT support staff in all SBA offices.

Under SBA's workforce transformation project we are also planning a measured re-organization of our OCIO organization to achieve the functions that GAO has recommended we strengthen.

We also plan to add an IT skills assessment factor in the IT capital planning and investment control processes we are developing.

For FY 2001, our CIO has developed a training request that aims to fill the most urgent of our skills gaps, and which will better prepare us to manage the systems that are under development.

We appreciate the work GAO has done with us and the recommendations they have developed. We also understand that the overall effort to improve the management of information technology at SBA will demand a commitment of resources and effort over many months. We intend to make that commitment and achieve consistently better performance in this critical arena, since no agency can lay claim to superior performance on behalf of the public unless it manages information technology consistently and well.

SBA Human Capital

In the past two and one-half years, SBA has discussed the content and format of the SBA Five Year Strategic Plan with staff from Congressional committees, Office of Management and Budget (OMB), Government Accounting Office (GAO), small business and our own Small Business Administration (SBA) staff. The result is a comprehensive shared vision of small business goals that are: outcome oriented, more clearly linked to our strategies and the activities, and linked to the management challenges. This effort has established two overarching strategic goals which encompass four modernization strategies:

Shared Vision

<u>Strategic Goals</u>

- Help small businesses succeed, particularly the New Markets segments, through fair and equitable access to (1) capital and credit, (2) Government contracts, (3) business development, and (4) serve as a voice for small

businesses; and
- Help Americans recover from natural disaster, through needed capital and credit.

Modernization Strategies

- Ensure effective internal control and oversight, both internally and externally
- Modernize Information Systems
- Expand use of e-commerce
- Transform SBA's workforce into the 21st century –

The strategy of transforming the SBA has begun by transitioning its employees from making and servicing loans to primarily reaching out to new markets and overseeing its private sector partners. Second, SBA has begun to take steps for better managing its human capital activities, such as undertaking workforce planning activities, including developing competency models and related training for some core functions and realigning and deploying staff. However, more remains to be done. We do need to continue and complete our processes that include:

- Conserve and Reinvest in Human Capital – developing a succession plan for senior leaders and reinstating candidate development programs for these leaders
- Right Size the Organization - estimating the number of employees who will be needed with certain skills
- Train as We Go – ensure that employees receive adequate training to perform their jobs well.

Changes at SBA

Historically, SBA has provided four types of service to the small business community: credit/capital assistance (including disaster lending), procurement and government contracting help, business development, and advocacy. Today, these products and services continue, but, in addition, the Agency functions as a voice for small business in the face of macro-economic changes and globalization of markets. Most importantly, SBA continues ensuring fairness and equity of access for ALL small business.

Therefore, SBA has changed the way it delivers services, centralizing processing while decentralizing customer relations. Responding to the Administration's initiative to "work better and cost less," the SBA has already made large strides to modernize the agency through several initiatives including, centralization, asset sales, privatization, partnerships, and automation. In order to implement these initiatives, SBA is transforming the emphasis in business operations to outreach, marketing, management and oversight of partnerships, outsourcing and privatization efforts. This new direction, which more closely mirrors the lending operations in the private sector, requires the transformation of human resources to new areas of business.

The traditional methods of doing business within the Small Business Administration are also undergoing change. A new technology infrastructure is being implemented to facilitate the rapid exchange of information related to most aspects of our business. The systems modernization efforts underway will radically change the way we conduct business in the future as the need for processing and filing of paper is reduced. This evolution of modernization requires changes to employee tasks and will provide new opportunities for employees to expand their skills and capabilities.

The introduction of changes in business practices necessarily brings numerous changes in the requirements for personal skill sets. We find the new functions generally require a different emphasis on skill needed by personnel currently involved in the business. Many of our employees find that they are already performing some of the new functions. The Agency is committed to assisting everyone during this period of transformation and has worked in partnership with the Union to develop our Work Force Transformation (WFT) Strategy.

Focus of SBA Work Force Transformation Efforts

SBA has actively engaged all levels of management and supervision in the development and execution of its comprehensive WFT Strategy. Embarking on a seven step process, SBA's staff in Headquarters, the Centers, the Districts, and the Disaster area offices are involved.

The conservation and enhancement of our human capital remains the primary goal as we move forward improving the quality of our services and growing the size of the small business community.

Many government organizations are reviewing their human capital strategies, including the GAO. In many respects, SBA is similar to GAO (e.g., size, reduction in staff resources over a relatively short time frame, customer driven). SBA's WFT effort is also at approximately the same stage as GAO's. We, therefore, will continue to work with GAO's senior human capital experts as we go through this transformation process.

Mr. Chairman, I have described the many accomplishments of my agency. Like the Comptroller General, I agree that our human capital is our greatest asset and the one in which we must invest more and more resources.

I appreciate the opportunity to describe our progress, and appreciate all the assistance and guidance GAO' senior experts have provided. I look forward to continued progress for America's small business owners – with GAO's assistance and that of this Committee.

STATEMENT OF

GAIL MCDONALD

SMALL BUSINESS AND AGRICULTURE REGULATORY ENFORCEMENT OMBUDSMAN

OFFICE OF THE NATIONAL OMBUDSMAN

U.S. SMALL BUSINESS ADMINISTRATION

THE NATIONAL OMBUDSMAN'S 2000 REPORT TO CONGRESS

BUILDING SMALL BUSINESS–AGENCY PARTNERSHIPS

BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM AND PAPERWORK REDUCTION

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

JUNE 15, 2000

Good morning, Chairwoman Kelly, Congressman Pascrell and Members of the Subcommittee. Thank you for inviting me here today to share with you some observations from the National Ombudsman's 2000 Report to Congress.

I am Gail McDonald, the Small Business and Agriculture Regulatory Enforcement 'National' Ombudsman appointed by SBA Administrator Aida Alvarez this past February. Although my official capacity as the National Ombudsman began in the midst of finalizing the 2000 Report to Congress, my ten years of experience in both the Federal government and working with small business allows me to address the findings in the 2000 report. Certainly, my years in my family's own small businesses have helped me appreciate first-hand some of the regulatory concerns of small businesses.

In my position as National Ombudsman, I am ably assisted by 50 small business owners who make up the regional Small Business Regulatory Fairness (RegFair) Boards. I want to thank the RegFair Board Members who were able to attend today's hearing as well as those who could not. Each RegFair Board Member has made significant personal and professional sacrifices to serve and has provided invaluable advice, program guidance, and small business outreach assistance. Together we can offer the Subcommittee our plans and ideas for the future of the Office of the National Ombudsman.

I understand, Congresswoman Kelly, that you and Members of the Subcommittee have been very helpful to the Office of the National Ombudsman in the past by encouraging agencies to implement the requirements of the Small Business Regulatory Enforcement and Fairness Act (SBREFA). I appreciate your past support and look forward to working with you.

The Year 2000 Report to Congress, *Building Small Business–Agency Partnerships*, provides Congress and the Administration a thorough review of the efforts of the National Ombudsman and the RegFair Boards. In the interest of keeping my remarks brief, I would like to ask that the Executive Summary of the Year 2000 Report be submitted for the record. I could certainly spend all day sharing with you the content of the report, but today I would like to talk about what we've *done* in the context of what we're *doing*.

The good news is the tide is turning on the regulatory climate that has far too long plagued our country's small business owners. Step by step – or maybe I should say, one RegFair hearing at a time – our program and others are building bridges to change the way Federal regulatory enforcement officials view small business compliance and, in some cases, change the way small businesses view Federal regulations.

Federal agency enforcement officials are becoming more sensitive to the impact of what they see as simple regulations, but small businesses see as one more costly requirement that diverts attention from day-to-day operations. The results have been productive partnerships between small businesses and Federal regulatory agencies that produce model projects, which we encourage others to utilize all over the country. For example the Environmental Protection Agency (EPA) joined the Office of National Ombudsman and the Denver Area FabricCare Association in developing a user-friendly compliance guidebook for dry cleaners. The Occupational Safety and Health Administration (OSHA) has worked cooperatively with the housing construction industry to develop an easy to use compliance flipbook. Some Saturday, you may go into a Home Deport as I did recently and observe an OSHA safety workshop for contractors and do-it-yourselfers.

Through SBA's Office of the National Ombudsman and the Regulatory Fairness Boards, small business owners are:

- voicing their regulatory enforcement concerns;
- exercising their First Amendment right, which allows them to communicate with Federal agencies without fear of retaliation and obtain responses that address their concerns and constructive suggestions;
- holding Federal agencies accountable with timely, independent, and high-level agency responses to their regulatory enforcement and compliance concerns; and
- changing agency and government-wide enforcement and compliance

polices.

The 2000 Report demonstrates how these partnerships have improved agency enforcement practices, heightened the impact of small business feedback, enabled the development of innovative enforcement and compliance solutions, and enhanced the impact of RegFair Board efforts.

But we still have work to do. Based on the recommendations of small businesses and agencies, the National Ombudsman has prioritized four goals:

1. Encourage increased small business feedback
2. Promote greater agency accountability
3. Develop more small business—agency communication; and
4. Foster creative partnerships between small business and Federal regulatory agencies.

These four goals are the foundation on which all partners will build a regulatory enforcement environment that is fairer and friendlier to small businesses and will ultimately result in greater regulatory compliance and small business prosperity.

The Year 2000 Report to Congress demonstrates that together we are making progress on our shared goals. And we will continue to build upon the successes we have achieved.

One of the ways we intend to do this is through our partners. The Administration, Congress, small businesses, trade associations, and Federal agencies agree that Federal resources are better spent helping small businesses comply with the law, rather than taking punitive action against them. So we work together "to get the word out."

Members of Congress can help by including RegFair information cards and SBREFA brochures in their mailings to small business constituents or as handouts in district offices and at small business speaking engagements.

Trade associations are helping by using their publications and e-mail networks to market the regulatory fairness program to state and local affiliates as well as to their members. We have an Association of the Month (AOM) program, where we work with national small business associations to develop joint regulatory fairness marketing and outreach agreements helping us to reach a broader spectrum of small business, sector by sector. This year, in response to RegFair Board Member suggestions, we will inaugurate regional associations of the month to learn more about regional small business concerns and reach those companies that we do not reach through the national AOM program.

Federal agency representatives help tremendously by participating in the RegFair hearings. The small business feedback details the positive and negative aspects of Federal regulatory enforcement activities and provides agencies with innovative suggestions on how agencies may better serve their small business customers while meeting their regulatory missions.

Also, you will see in the 2000 Report that more high-level, independent agency officials are responding to the comments and testimony small business owners provide the National Ombudsman and the RegFair Boards.

Several Federal agencies, such as the Equal Employment Opportunity Commission (EEOC), Occupational Safety and Health Administration (OSHA), Customs, and Internal Revenue Service (IRS) have initiated new small business outreach programs to learn about small business enforcement concerns and to make their enforcement and compliance environments fairer and friendlier. And some agencies are participating in small business-agency task forces, established cooperatively with trade associations to address long-standing industry enforcement or compliance issues.

My appointment to the Office of the National Ombudsman brought about very significant changes for the program. Administrator Alvarez recognized that one person should be dedicated to the position of the National Ombudsman and that person should be located at SBA headquarters, where 'she' could make 'her' presence felt within the Administration on a daily basis.

Since I joined SBA, I have managed to reach out to agency officials at the Securities Exchange Commission (SEC), Federal Aviation Administration (FAA), Immigration, Customs, OSHA, IRS, EPA and the Departments of Interior, Education, Agriculture, Veterans Affairs, Commerce, and Transportation... and of course, SBA. The responses have been very positive. The commitments I have received to build effective partnerships through SBREFA and to implement the National Ombudsman's Annual Recommendations prove that the time was right to move the office to Washington. We've learned that to get the greatest impact from small business feedback we need to work directly with the highest-level agency enforcement officials. Now that we have a physical presence in the Nation's Capitol we will make our partnerships more effective for small businesses.

The Office of the National Ombudsman continues to reach out to small business owners, listen to their concerns and compliments, assist them in resolving important regulatory issues and offer them unique opportunities to influence and even reshape Federal regulatory activities. Small business feedback provides the Office of the National Ombudsman the information needed to gauge and analyze national and regional small business regulatory enforcement and compliance issues and make Federal regulatory agency officials aware of small business concerns. Perhaps most importantly, I think the Office of the National Ombudsman helps close the loop on Federal agency accountability by allowing me to report to you, Members of Congress.

The tide is turning -- small businesses are beginning to see improvement in the regulatory enforcement and compliance environment. While few agencies achieve the highest ratings in our report, most are working aggressively to implement the National Ombudsman's Annual Recommendations to Congress and generally improve their enforcement and compliance policies and practices. Those who aren't, we will work with more closely.

Federal agencies no longer feel they are the only ones with concerns about such issues as waste, fraud, and abuse, or on environmental protection or workers' safety. Together, small businesses and Federal agencies are learning to appreciate each other's contributions towards addressing these issues and building a strong healthy economy. An economy based on a constructive compliance and enforcement environment built on partnerships.

Thank you, again, for inviting me here today. This concludes my testimony, and I will be happy to answer any questions you may have.

STATEMENT OF

AIDA ALVAREZ

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

CHINA TRADE IMPACT ON SMALL BUSINESS

BEFORE THE

SUBCOMMITTEE ON TAX, FINANCE & EXPORTS

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 16, 2000

Mr. Chairman, Ranking Member McCarthy and distinguished members, thank you for inviting me to testify today concerning America's small businesses and trade with China. As this Subcommittee is well aware, the interests of small business are often overshadowed by other matters in issues of national importance, such as the China trade debate. But, as this Committee knows well, small business is big business when it comes to international trade. Some may disagree on how best to handle our bilateral trade relationship with China, but I commend all the members of this Subcommittee for recognizing how important the China market is to small business.

Small business is playing an increasingly important role in our international trade efforts. In just five years, the number of small business exporters doubled—from 112,000 in 1992 to 202,000 in 1997. The most recent export profile prepared by the Department of Commerce also shows that small business represents:

- 97 percent of all exporters
- one-third of the dollar value for all exports, up from 26 percent in 1987 (the value of small business exports has increased over 300 percent over the past five years)

- the most dynamic portions of the export economy – technology, services, and e-commerce transactions.

The benefits of trade are reflected in that fact that small businesses exporters are:

- 20 percent more productive than their non-exporting counterparts
- experience 20 percent greater job growth
- pay wages that are 15 percent higher on average, and
- provide benefits that are 11 percent higher on average

But the most promising facts about small business trade are that today about two-thirds of small business exporters are exporting to only one country, and less than 1 percent of the nation's 25 million small businesses are actually involved in trade. Consider the possibilities if we increased this by just one percentage point.

What about U.S. small business and China?

- China is the 10th largest export market for U.S. small businesses
- small business accounts for 82 percent of all U.S. exporters and 35 percent of all U.S. exports to China by value, and
- from 1992-1997, the number of small businesses that export to China increased 141 percent

To illustrate how American small businesses are competing and winning in China's marketplace today, I would like to mention just a couple of examples.

Veris, Inc., is a 20-person, Colorado-based manufacturer of flow sensors for various applications. Exports make up 50 percent of Veris' sales, with China its biggest overseas market. Veris' sensors are being used in Beijing to monitor the city's water supply, and in Hong Kong to monitor combustion air at a coal fired plant that supplies one-third of Hong Kong's power.

Triastoria Trading & Consulting Company, based in New Jersey, sells oil and gas equipment. Exports to China account for around 80 percent of the firm's sales, with a dollar value of more than $2 million. The firm employs 13 people, 10 of whom are salespeople in China.

Even though we can cite many small business success stories in China, that does not mean everything has been smooth sailing. What we hear from our small businesses is that there are continuing problems with a lack of published rules, high tariffs, requirements to have expensive local partners and requirements to obtain multiple import and business licenses.

Given the size of China's market and the complaints we have heard, the question today is whether granting Permanent Normal Trade Relations (PNTR) would benefit U.S. small businesses. I have been on the road discussing this with small business owners, and the clear consensus is that PNTR would be a win for U.S. small business. By granting PNTR, the U.S. government will enable small businesses to benefit from the many significant trade liberalization commitments that China has made in its bid to join the World Trade Organization (WTO). We believe that small business stands to make even larger gains than large companies because, unlike large firms like Boeing who have had a long-standing presence in China and the ability to deal directly with the government, small businesses historically have not had that type of clout. With the Chinese government lowering barriers and opening up to more "business to business" contact, we expect that the opportunities for American small businesses will expand dramatically.

Let me highlight just a few of the key aspects of the PNTR agreement that will help U.S. small business. Under the agreement, China will:

- lower average industrial tariffs of interest to the United States from 24.6 percent to 9.4 percent by 2005
- lower information technology tariffs from 13.3 percent to 0 by 2005—a real key given the large growth in the number of small businesses involved in information technologies
- lower tariffs on key agricultural products from 31.5 percent to an average of 14.5 percent by 2004—this is important to those small businesses that sell processed foods and other value-added agricultural products
- eliminate the export subsidies that it provides to its industries in various sectors
- eliminate quotas and quantitative restrictions by 2005 (most are eliminated by 2002)
- eliminate the required use of Chinese-government approved "middlemen" to sell products in China. U.S. companies will have the right to import and export, and to have their own distribution networks in China to sell U.S.-made products directly to customers in China. This will allow U.S. companies to oversee commission agents' services, franchising services, transportation, wholesaling, repairs, and retailing of their products.
- allow professionals and service providers to operate within China in accordance with WTO standards—a real benefit to small business since many of our accounting, law, and engineering firms doing business in China are, after all, small businesses
- conform its standards and inspection procedures to WTO norms—a major benefit to small businesses that cannot afford to hire legions of foreign specialists to unearth the rules

- simplify and make uniform customs and licensing procedures—a move that will reduce paperwork costs for small businesses significantly, and

- expand its obligation to protect intellectual property while at the same time providing injured parties access to China's courts and the WTO dispute settlement system

We have looked at the PNTR issue closely. Because China will enter the WTO regardless of what action the United States takes, our assessment is that we gain nothing by withholding PNTR from China. To do so would waste the critical market opening gains negotiated by Ambassador Barshefsky. The loss would be doubly painful if we cede those gains to other countries.

The agreement moves China in the direction of reform, locking-in an economic reform process that has faced mounting difficulties and formidable domestic opponents. We should not underestimate the difficulty for China in implementing these reforms and overcoming constituencies opposed to them. Granting PNTR is our chance to support those in China who seek to advance the type of market-oriented economic reforms we have been pressing China to adopt, while enabling American small businesses to capitalize on the substantial trade liberalization commitments China has made.

Thank you for the opportunity to appear here today. I would be happy to answer any questions.

STATEMENT OF

AIDA ALVAREZ

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

SBA'S FISCAL YEAR 2001 BUDGET REQUEST

AND REAUTHORIZATION

BEFORE THE

SMALL BUSINESS COMMITTEE

UNITED STATES

HOUSE OF REPRESENTATIVES

MARCH 1, 2000

Mr. Chairman, Ranking Member Velazquez, and Members of the Committee, thank you for inviting me here today. I am very proud to present the U.S. Small Business Administration's (SBA) budget request for Fiscal Year 2001.

For small businesses and for the SBA, this is a great budget. It represents an unprecedented investment in the talent, drive, and entrepreneurial spirit of Americans. It recognizes the vital role small business plays in our economic growth and vitality. And, it delivers results at a fiscally prudent cost to the taxpayers.

A Decade of Success

There are now more than 25 million small businesses in the United States, five million more than in 1990, and the most ever in the United States.

Over the last decade, business ownership has grown even more rapidly for Hispanics, African-Americans, Asians, and for women. Hispanic-owned firms have increased 232 percent, African American-owned firms by 108 percent, and Asian-American and Pacific Islander-owned firms by 180 percent.

The number of women-owned firms has almost doubled to an estimated 8.5 million in the last 10 years. Women now own about one-third of all firms and employ 24 million people. These companies generated $3.1 trillion in revenue in 1997, more than triple the amount from a decade earlier.

And, small firms remain the job creators – they have produced a majority of the 20 million new jobs created between 1993 and 1998.

It has been a period of astounding growth and change. And throughout, SBA, working with this committee, has adapted its products and services to contribute to the overall growth and vibrancy of the small business sector. Further, we have focused our help more clearly on those who need it the most. Our training, financing, technical assistance, and contracting opportunity programs are tools used to help build economic development in distressed inner city and rural communities.

SBA partners with the private sector to help fill the gaps that prevent people from owning their own business and that impede our nation's overall economic progress. To succeed we must fill gaps in both financial access and skills training, often at the same time.

Our lending policies have facilitated a dramatic expansion in the scope of private lending to small businesses. Programs like SBA Express, Low Doc, and Preferred 7 (a) Lenders have fueled the growth by giving our lending partners greater responsibility and by simplifying the loan approval process for smaller and non-traditional loans.

SBA guaranteed 50,000 loans in FY 1999—loans that would not have been made without our support. Approximately a third of our 7(a) loans in FY 1999 went to start-up firms less than 24 months old. That is filling a gap. Since 1992, we have doubled our lending to African-Americans and Hispanic-Americans, while tripling our lending to women.

We also play a significant role in the availability of equity capital. In 1999, Small Business Investment Companies (SBICs) averaged less than $1 million per investment, while other venture capital firms averaged $6.2 million. In 1999, SBICs accounted for 53 percent of all institutional venture capital transactions in the United States.

In the area of procurement, small businesses achieved a 22.4 percent share of total Federal procurement. We were pleased to launch the Historically Underutilized Business Zone (HUBZone) Program. I am happy to report that nearly 900 businesses are now qualified as HUBZone firms.

SBA's Office of Advocacy worked to show agencies how their regulations could accomplish their policy objectives without placing an undue burden on small businesses. The Office's efforts save small businesses literally billions of dollars. Our budget proposes increasing funding for Advocacy's research and database to $1.5 million, $400,000 more than FY 2000.

To assist families and businesses hit by disasters, we approved 36,000 loans for a little more than $900 million in 1999. Our loans enabled firms to continue their business and retain 35,000 jobs.

Mr. Chairman, preparing to testify before you today gave me the opportunity to review the truly enormous changes that have taken place at the SBA. SBA is a great story of reinvention, about which this committee should be very proud. Now, we must continue to build on successful strategies and successes of the past to help small businesses meet the challenges of the future.

SBA requests funding of $1.06 billion for FY 2001. This budget will allow us to guarantee a record level of small business loans, finance record levels of venture capital, and support record levels of business development, technical assistance, and innovation. It gives us the resources to help create jobs and economic development in places the current economic expansion hasn't yet reached. It supports our continuing efforts to transform the SBA into a 21st century leading edge institution.

Finally, it fully supports our commitment to assist families and businesses recently hit by disasters. Mr. Chairman, we request full funding to allow us to provide $871 million in low cost loans for disaster victims.

New Markets

In his State of the Union address, President Clinton repeated his belief that more must be done to extend the benefits of today's economy to our inner cities, poor rural areas, and Native American reservations. He thanked Speaker Hastert for his bipartisan effort to achieve this common goal. We hope we all can come to an agreement soon that includes our New Markets Venture Capital proposal so we can start to put our FY 2000 appropriation to work. Mr. Chairman and Ranking Member Velazquez, my staff and I are pleased to be working with you to make this happen.

This budget includes several proposals designed to make investment capital available to newer, smaller firms.

We request $21.6 million in budget authority to support a $150 million program level, and an additional $30 million for technical assistance for the New Markets Venture Capital program. Smaller size equity investment plus technical assistance are key to the long-term success of New Markets firms.

The cost of the program, which we calculated using the most conservative assumptions, will go down as we develop experience with the program. The long-term benefits are impressive.

Right now, there are virtually no institutional sources of equity-type capital in these distressed communities. Nationwide, the community development venture capital industry consists of essentially 25 firms with about $157 million under management. Only 14 of these funds are capitalized at $5 million or more—the absolute minimum for economic viability.

Our own analysis of these community development venture capital companies indicates that one direct job is created for each $10,000-$15,000 equity investment. On this basis, $51.7 million should generate between 13,300 and 20,000 direct jobs at a cost of between $2,600 and $4,000 each. If the indirect jobs are included, the cost is even less. We believe that this investment in New Markets will ultimately pay off in a big way.

SBA is requesting funding for other New Markets initiatives as well.

At the close of the last session of Congress you passed, and the President signed, a law establishing the Program for Investment in Micro-Entrepreneurs (PRIME). This program provides much needed technical assistance to very low-income entrepreneurs to improve their capacity to succeed in business. We request $15 million in budget authority for PRIME. In addition to serving the micro-enterprise industry generally, PRIME will perfectly complement our overall micro strategy.

In addition, we are making every effort to expand the reach of our existing Microloan program. We request $5.37 million to support $60 million in Microloans, along with $45 million for Microloan technical assistance.

We request $6.6 million for SBA's BusinessLINC program, which encourages large businesses to work with small business owners as technical advisors and mentors—especially in America's rural areas and inner cities.

We began accepting HUBZone applications last March. As demand increased we added staff and are now up to nearly 900 certified HUBZone companies in 47 states. We request $5 million to integrate this program into our field structure, and broaden our outreach and oversight efforts to help this program meet its full potential. This compares to $2 million appropriated in FY 2000.

To better serve Native American communities and to honor the federal government's trust responsibility to tribes, the President's budget overall includes an increase of $1.2 billion over FY 2000 for key new and existing programs assisting Native Americans and Indian reservations.

Mr. Chairman, one of every three Native Americans live in poverty. On some reservations, between 40 percent and 60 percent of the population is unemployed. Fifty-three percent of Indian homes on reservations do not have a telephone.

We want to tap into the entrepreneurial drive within the Native American community. SBA's budget proposes $5.75 million ($3 million for Native American SBDCs, $1.25 million for reservation-based BusinessLINC, and $1.5 million for TBICs) to provide access to business development assistance that recognizes the cultural differences and specific needs of this country's Native American entrepreneurs.

Access to Capital

The SBA is filling critical gaps in the marketplace and helping those who have not shared in the tremendous economic growth of the past several years. Smaller loans are out there – but they are still hard to get. If you are from a distressed urban or rural area, if your business is newer, if you are smaller, if you lack sufficient equity, or an established track record, you are more likely to be turned down by a commercial lender. This is the gap that we fill and the unique value that we bring to businesses.

We request $274 million to deliver more than $18 billion of credit, venture capital and technical assistance. The $18 billion compares to $16 billion in FY 2000. Our request includes:

- an $11.5 billion program level for the 7(a) loan program, up from $9.8 billion this year;
- a $3.75 billion program level for 504 loans—and we propose to lower the guarantee fee for the fourth year in a row.

To encourage more lenders to offer loans in smaller amounts, SBA proposes to raise the guaranty for 7(a) loans of $150,000 and less to 90 percent. Relatively high transaction costs and the loss of smaller rural and community lenders is shrinking the financing options available to smaller businesses. Our 90 percent guaranty will encourage more institutions to lend using our 7(a) product, making capital more available at a more competitive price, and expanding financing options for small business owners. We also propose to simplify the guaranty fee structure for all loans.

We request $26.2 million in budget authority to support $2.5 billion in venture capital in the Small Business Investment Company program. We expect this investment will attract an additional $1.25 billion in private capital to the smaller and newer end of the venture capital investment spectrum. With the $3.75 billion in new SBA leveraged funding, plus their on-hand private capital, we estimate the SBICs will be able to make $4.5 billion in investments in FY 2001.

I am pleased to report that since the SBIC participating security program's inception in 1995, the SBICs have returned over $131 million to the U.S. Treasury as the taxpayers' share of their profits.

To appreciate SBA's success in assisting small business, we need to step back and look at the bigger picture. Since 1992 SBA has backed more than $71 billion in small business loans and venture capital. That's more than in the previous 25 years combined!

Mr. Chairman, we plan to send our legislative package to you shortly and we look forward to working with you in the coming year to enact these changes.

Safety and Soundness

Coupled with our desire to sustain unprecedented growth and to penetrate new markets, Mr. Chairman, is our solid commitment to maintaining the financial safety and soundness of our portfolio. We are a financial institution with more than $50 billion in our portfolio. Just like financial institutions in the private sector we have the fiduciary responsibility to make our lending decisions wisely and guard our current investments carefully. Anything else would be a disservice to our borrowers and lenders, as well as the Federal taxpayer.

In FY 1999, Mr. Chairman, we instituted—for the first time—a safety and soundness examination program for the Agency's Small Business Lending Companies and examined all 14. We expect to complete our FY 2000 reviews in September. We established the Office of Lender Oversight and a Risk Management Committee. We completed our first full cycle of reviews for participants in the Agency's Preferred Lender Program (PLP). We expect to complete FY 2000 reviews by April.

In addition, we request $14.3 million to fund our Inspector General, to provide the necessary review, audit, and oversight of SBA's programs and services to the small business community. This compares to $11.5 million appropriated for FY 2000. The increase will allow the Inspector General to oversee areas identified as high priority by the Agency and Congress, such as loan monitoring and lender oversight.

Access to Training and Technical Assistance

SBA also fills gaps in the area of training and technical assistance, reaching out to new and non-traditional markets through our Small Business Development Centers, Service Corps of Retired Executives (SCORE) Women's Business Centers, One-Stop Capital shops, Tribal Business Information Centers (TBICs), and U.S. Export Assistance Centers. Our small business counseling and technical assistance programs provided help to more than a million entrepreneurs in FY 1999 alone—many of them are also loan customers.

For FY 2001, we propose full funding of $88 million for Small Business Development Centers (SBDCs), including $3 million to fund an SBDC network in Native American communities. In addition, we are pleased to be working with the SBDCs in considering ways to grow their non-government resources and extend their reach to even more small businesses.

To upgrade SCORE's computer network, allowing SCORE counselors to communicate better among themselves and with the SBA, we propose funding of $5 million—an increase of $1.5 million from this year.

SBA's Women's Business Centers have more than tripled in three years, going from 18 funded centers to 59 (including 25 new WBC's in FY 1999.) The budget includes $12 million, up from $9 million in FY 2000, to expand our network of Women's Business Centers even further. The request would widen our nationwide network to more than 80 sites. It is our hope to have at least one center in each state.

SBA requests $10 million to maintain our existing One Stop Capital Shops and to open new ones in empowerment zones across the country. These community-based outlets provide hands-on assistance to help businesses start, grow, and provide employment in these distressed areas.

In addition, this year our budget proposes $4 million for our veterans programs, compared to $615,000 appropriated in FY 2000. We owe our veterans the best service possible when they are interested in starting or expanding a small business. Our request will fund research and outreach efforts to help us better tailor our products to the particular needs of the veterans' community. It will also fund the National Veterans' Business Development Corporation, which was created by Congress last year to help improve access to small business development training and counseling for our Nation's veterans.

Promoting Procurement for Small Business

The Federal Government spends nearly $200 billion for goods and services each year. This is a tremendous marketplace for America's small businesses. SBA works with the major procuring departments to ensure that small businesses receive 23 percent of these Federal contracting dollars.

Mr. Chairman, it has become increasingly difficult to maintain the level of contracting opportunities for small businesses. Over the past 10 years we have seen agencies increasingly rely on contract bundling. Unfortunately, bundling tends to limit procurement opportunities available to small businesses.

To counter the effects of contract bundling we have been pleased to work with this committee on implementing the contract bundling provisions of the 1997 Small Business Reauthorization Act. We plan to issue a final rule later this year that will provide clear guidelines and procedures that we believe will curtail agencies practice of bundling contract requirements.

Small businesses, particularly minority-owned small businesses, often do not receive a fair share of government contracts. To help them become more competitive we are requesting $5 million for the 7(j) program. This program provides technical assistance and executive training to 8(a) firms and small businesses in areas of high unemployment or low-income. If we are to develop these minority-owned firms, we must provide targeted assistance to help them grow and build a broad-based business selling to both the public and private sectors.

Our research indicates that even after the firms in our Small Business Innovation Research Program have fully developed their products, they still lack the venture capital they need to market and fully commercialize those high quality technologies. Commercial venture funds typically are not interested in the types of investment opportunities SBIR firms present at that stage, referred to as phase III, of their development. We request $15 million in FY 2001 to fund the first-year of a three-year SBIR Phase III matching grant pilot program, designed to promote commercialization of the research and development (R&D) efforts by small high technology firms.

Modernization

SBA's workforce and the way we deliver programs have changed dramatically in the past decade, too. Since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time the number of our employees has decreased 22 percent.

We are devoting significant energy and resources toward improving our capacity to monitor our loan portfolio. SBA is building an early warning system of indicators and graduated enforcement remedies. We will soon have a new system in place that will enable us to better identify and manage portfolio risk and integrate SBA's system with those of private sector lenders.

Working closely with the Congress, SBA has recognized where the private sector could perform our tasks more efficiently, and has contracted out or delegated those activities. SBA is delegating greater authority than ever before to its lending partners. This transition permits greater use of staff for community outreach and greater attention to more complicated loan matters. Most importantly, according to our auditors, we are making the transition in a manner that is financially safe and sound. SBA received a clean opinion in its FY 1998 financial audit report, the highest rating an entity can receive. This was the third year in a row SBA attained this rating.

As you know we completed our first asset sale last fall and enjoyed great success. We realized an estimated $90 million premium over what SBA would have received had we held the loans to maturity. We plan a second sale in FY 2000 and are strategizing how to continue in FY 2001.

We are emphasizing the importance of improved internal controls and program oversight. We are upgrading and modernizing our information systems, offering every small firm electronic access to our products and services to extend our outreach and offer more customer-driven assistance. And we are transitioning our people to meet the challenges of the new knowledge-based economy.

We have laid out an aggressive agenda to improve our internal management. We request $13 million for systems modernization to improve our lender oversight, risk management, and program evaluation activities; $7 million for information technology infrastructure support; and $4 million to train and transition our workforce.

E-Commerce

SBA was among the first government agencies to create an on line presence. In the last seven years we have grown from no businesses served on the Internet to over 6 million small businesses served each week. We expect that number to double this year.

SBA's current activities include:

- Online Education, Training, and Counseling. The accessibility and affordability of the Internet offer businesses online counseling, distance learning, online classrooms, and web-based tutorials, e.g., SBA classroom, SCORE online.
- Access to Networks and Matchmaking. Increasingly, the new SBA is taking on the role of creating markets, fixing market imperfections where possible, and/or providing a platform for "buyers and suppliers" to connect and transcend the boundaries of time and distance. Some call this function electronic brokering, e.g., ACE-Net, PRO-Net, TradeNet, Tech-Net, HUBZones, Sub-Net, TM-Online, NewMarkets.
- One-Stop-On-Line-Shop for Government Information. SBA is providing anytime, anyplace access to Government information and services through its own web site and is developing and sponsoring cross-agency gateways and portals, e.g., *U.S. Business Advisor*, TradeNet's *Export Advisor*, Women's Online Business Center.

This unique movement has leveled the playing field for unprecedented numbers of entrepreneurs from every background who seek to own their own business. But as always in business, this potential is accompanied by risk. SBA's small business customers cannot afford to overlook or fail to take advantage of the opportunities created by new technologies. And if technology is going to revolutionize the way small companies do business, then SBA must increase its own digital dexterity and focus its assistance on helping firms compete in the new economy.

To respond, we are creating an electronic SBA, one that can serve as an example for bridging the "digital divide" and help small firms take advantage of the technological revolution.

The budget includes $5 million to ensure that we provide more of our services electronically, and to ensure that all small businesses are able to participate in the opportunities created by e-commerce. Building on the success of our Y2K outreach initiative, where 1,300 workshops were attended by about 1.5 million small businesses, we will now work with the Department of Commerce and the Department of Agriculture to reach out to entrepreneurs looking to get on-line. For those who are on-line, we will expand our training, offering virtual classes on topics such as building a website, conducting e-commerce on the Internet, marketing your business on-line, bidding electronically and catalogue sales.

Conclusion

SBA's budget is a key element of the President's plan to maintain today's unprecedented economic expansion. The Agency is confident that our flagship programs and services—credit and capital, business development and technical assistance, and procurement assistance—are some of the best forms of Federal assistance to broaden access to small business opportunities, and help sustain our strong economy. These programs also make SBA even more vital in this Administration's strategic focus on new markets areas.

I look forward to working with you and the Committee toward the implementation of this budget.

Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for inviting the U.S. Small Business Administration (SBA) to testify today about our planning for the implementation of our Loan Monitoring System (LMS). My name is Fred P. Hochberg and I am the Deputy Administrator at SBA. Joining me is Kris Marcy, the Chief Operating Officer, Lawrence E. Barrett, the Chief Information Officer, Charles Tansey, Associate Deputy Administrator for Capital Access, and Joe Loddo, the Chief Financial Officer. We are appearing on behalf of SBA Administrator, Aida Alvarez, whose schedule does not permit her being with you today.

Since we last testified on this topic in July 1998, SBA has made significant progress in leveraging our resources through the development of public-private sector lending partnerships and in designing our overall information technology systems. The Loan Monitoring System (LMS), however, remains the core of our modernization initiatives.

By way of background, the Loan Monitoring System is Phase I of a three-phase, multi-year overall systems modernization program. This is the subject of today's hearing. Phase II contains both the core accounting system and the disaster loan system. Phase II will allow us to produce timely financial statements and expedite the disbursement of disaster funds to people who need to start rebuilding their homes and businesses. Phase II is also critical to the LMS because the Agency must account for the loan portfolio in its financial statements and the LMS will service loans made in the disaster program. Phase III will modernize the systems used for the rest of the agency's programs.

We are truly excited by the benefits that this new technology will provide. Here is just a brief outline of some of the benefits that will be derived from the system:

For our lending partners:

- SBA compatibility with our lending partners by enabling seamless reporting, exchange of data, and fee management.
- Decreased risk of imprudent lending by a small group of lenders, thereby freeing resources for prudent lending partners.
- Shorter turnaround times, better service, electronic fund transfers, and simplified data collection.

For SBA:

- SBA personnel will finally have the analytical tools and real-time access to information required for appropriate business decisions.
- Electronic workflow will eliminate much of the paper, which will allow SBA personnel to focus on loan analysis, lender oversight and relationship management.
- Electronic loan files will be accessible "on-line" with appropriate safeguards eliminating the costs and delays involved with transferring paper from office to office.
- More accurate data will make back-end functions such as asset sales due diligence and subsidy rate calculations less onerous.

I want to thank you Mr. Chairman and the Members of the Subcommittee for your past support of our efforts and I ask for your continued assistance and support in the future.

SBA's MISSION

SBA provides capital to a unique niche in America's commercial market. Simply put, our legislative mandate is to serve as a gap lender, to ensure that those small businesses who do not have access to traditional means of capital in the commercial marketplace are able to get the funds necessary to start or grow their business.

Forces Creating Immediate Need for Modernization of the SBA's Key Processes and Technology

There are several important events which are forcing the Agency to prioritize the modernization of our core business and technology practices:

1. **Changes in governance and policy have led to an increased reliance on private sector lenders for delivery of SBA's programs.**
2. **Technological innovation is changing SBA's private sector partners' business practices.**
3. **The lending industry has undergone radical restructuring amid rapid growth and even more unanticipated changes may be on the horizon with the last year's passage of the Gramm-Leach banking law by Congress.**
4. **Declining SBA personnel levels.**
5. **The passage of Clinger-Cohen Act of 1996.**
6. **SBA's financing system does not comply with the posting rules contained in the Standard General Ledger, and SBA's loan accounting system does not adequately capture budgeting data in a manner that facilitates preparation of financial statements and reports.**
7. **The directives set forth in the 1997 SBA Reauthorization Act (PL 105-135).**

PRIVATIZATION OF SBA FUNCTIONS

In the not too distant past, SBA field offices reviewed the creditworthiness of each loan before guaranteeing it, and then serviced and liquidated each loan that went into default. Today, SBA has centralized many loan processing and servicing functions. The Agency's Preferred Lender Program (PLP), SBAExpress, and Premier Certified Lender Program (PCLP) delegates credit decisions and other loan making and servicing responsibilities to its most qualified lenders. SBA relies on the lenders' credit analysis and only reviews PLP and SBAExpress loans for eligibility. SBA also performs only a limited credit review on loans submitted under the LowDoc program. The LowDoc program allows lenders to submit a streamlined application for loans of up to $150,000 and to receive a response from SBA within 36 hours.

In 1999, about 75 percent of all business loans were made by our lending partners with no or limited credit review by SBA. The lenders also service and liquidate those loans. In accordance with the direction of Congress, SBA has also out-sourced 30 percent (or about $1 billion) of disaster home loan servicing. This trend is expected to expand in the future. For instance, in FY 1999, SBA carried out its first asset sale of direct and purchased business loans. This is the ultimate privatization of SBA's servicing. The sale included 4,060 small business loans and realized $195 million in proceeds, which is $90 million more than the Federal government would have collected had it held the loans to maturity.

As delegation of the loan-making process continues, SBA's exposure on the loan guaranties becomes increasingly subject to the credit policies and actions of the participating lenders. In order to protect the taxpayer's interests, we must have a system that allows us to identify, understand, and respond to their behaviors so we can ensure the long-term viability of SBA's lending programs. The Small Business Reauthorization Act of 1997 also required the SBA to increase its role in lender oversight.

SBA's basic program management and accounting systems were designed 20 years ago for direct loan making and have not kept pace with program delivery or technology. The current system does not readily provide management type information, such as identifying lender behavior that deviates from industry norms or being able to determine the sensitivity of the portfolio to changes in the economy. This information is crucial to overall risk management and SBA's continued ability to prudently deliver access to capital.

Ultimately, the success of the SBA's efforts to leverage private sector resources is contingent on the development and use of a sophisticated lender oversight and loan monitoring system. We will refer to this effort as the Loan Monitoring System (or LMS) which constitutes Phase I of SBA's overall system modernization efforts.

WHAT THE FUTURE HOLDS FOR SBA

The Internet's vast potential as a consumer-banking forum is beginning to be realized. In 1998, 6.9 million households were banking online; and that number is expected to grow to 24.2 million by 2002. Thirty-nine of the nation's 100 largest consumer banks now offer Internet bill payment, up from 17 a year ago. And, Forrester Research projects that 40 billion dollars in loans will be originated online by 2001. These changes are also taking place in business banking and SBA's systems must become compatible with these industry innovations to enable seamless integration of SBA's programs with the internal mechanisms of our lending partners. We must be able to accommodate electronic transactions at the request of our lenders.

Another technological advancement impacting SBA and its business partners is the use of credit scoring. The private sector employs credit scoring to assist in making objective, standardized determinations on front-end risk on consumer loans, and increasingly on business loans. Recently, credit scoring models have increased in sophistication, allowing for a more in-depth, prospective analysis of borrowers who previously would have scored poorly.

By the summer of 2000, SBA will begin using customized credit scoring technology to expedite the decision-making workflow of its LowDoc centers. This approach was identified during the Benchmarks process, following a review of Freddie Mac's systems. Specifically, a loan guaranty request receiving a credit score in the low risk range, that is when the score indicates a high likelihood of repayment, the credit scoring process will replace one of the two

credit reviews now required for loan approval.

The use of credit scoring must be balanced. SBA will continue to proceed to develop credit scoring methodology tailored to the needs of its clients which can serve as an appropriate evaluation tool.

SIGNIFICANT CHANGES IN THE LENDING ENVIRONMENT

It should be noted that while large, high-volume lenders generate a significant portion of SBA's lending, smaller, less active lenders who tend to serve rural areas and economically disadvantaged areas still need to be served by SBA programs and services. For example, in FY 99, seventy-two percent of our lenders originated five or fewer loans. Continued bipolarization of lending activity between high-volume multi-state lenders and less-active lenders in smaller markets may exacerbate the gaps in lending and make it more difficult for SBA to ensure nationwide access to capital. At the same time that the SBA accommodates multi-state lenders by streamlining operations and processing, it must provide customized service to newer, smaller and more traditional lenders and their borrowers in local markets.

DECLINING PERSONNEL LEVELS

All of these changes have occurred while SBA's personnel levels have decreased. At the same time the number of our employees (excluding disaster staff) has decreased over 20%, lending has tripled to where SBA has a portfolio in excess of $50 billion today.

THE EIGHT REQUIREMENTS OF SECTION 233 OF The Small Business Reauthorization Act of 1997

In February 1997, SBA requested appropriations as part of its FY 1998 budget to begin replacing its outmoded legacy data systems and to make needed improvements in its loan monitoring capabilities. Congress appropriated $8 million for FY 1998, $8 million for FY 1999 and $8 million for FY 2000.

Section 233 of the Small Business Reauthorization Act of 1997 laid out a series of eight planning steps which were to be followed in designing the new loan monitoring system. During the past two years, the Agency has worked closely with your staff, staff of the Full House and Senate Small Business Committees, our appropriators and the General Accounting Office (GAO) in order to carry out these important planning steps.

In total SBA submitted twenty-eight deliverables to GAO for review. Many deliverables were ultimately revised to incorporate GAO's recommendations for improvements. SBA believes that the work done to fulfill these planning steps have laid the groundwork for a successful loan monitoring system and improved other aspects of the Agency's information technology program. What follows is a summary of our progress on each of the eight planning steps.

1. **Fully defining the system requirements using on-line, automated capabilities to the extent feasible.**

   Working with contractor help (Booz-Allen&Hamilton) and a forty-member team of senior SBA staff, SBA identified a number of improvements in our business processes. Requirements were identified for lender management, loan guaranty approval, risk management, portfolio management including asset sales and subsidy rate support, and Treasury cross-servicing. In addition, requirements were identified for data quality and information technology. These requirements are contained in a document entitled "SBA Systems Requirements for the Loan Monitoring System."

2. **Identifying all data inputs and outputs necessary for timely report generation.**

   SBA has completed the identification of all data inputs needed for the Loan Monitoring System. First, our contractor Data Networks developed a high level process chart which breaks down the system to three levels of functionality. Using this chart, as well as, the SBA 1995 Information Architecture Report, the draft Information Technology Architecture (ITA) "To Be"

   model, the BPR data elements groups, and data elements lists from SBA legacy systems, we documented the required LMS data inputs. Working with SBA staff from the Office of Capital Access, processing and service centers, field offices, and the OCIO, the contractor developed a logical (or conceptual) data model that depicts all of the data elements required as inputs to the LMS.

3. **Benchmark loan monitoring business processes and systems against comparable industry practices.**

   I will detail this later as I describe the system SBA plans to implement as a result of these planning steps.

4. **Determine data quality standards and control systems for ensuring information accuracy.**

   SBA took a two-step approach to completing the planning for ensuring that the LMS collects data that meets the needs of SBA management. First, Data Networks developed a Data Quality Guidance document that sets the goal of quality data in all SBA information systems. This guidance was used by the contractor to develop the Data Quality Management Plan to identify data quality standards and control systems for ensuring information accuracy for the LMS. The Plan identifies the activities SBA will undertake to ensure information accuracy including: development of business, data, and application architectures, physical data base design, data load and migration, testing focusing on data quality, and inspection and data configuration management during system operation. In addition, SBA also performed an analysis of the data quality issues it faces in its legacy systems. The Data Quality Plan focuses on ensuring that these kinds of quality issues are resolved and do not reoccur in our new system.

5. **Identify an acquisition strategy and work increments to completion.**

   We have completed an acquisition strategy for the Loan Monitoring System and have identified six phases of implementation of the reengineered work processes and associated technology improvements. On December 21, 1999, Administrator Alvarez approved the recommendations of the BPR and the implementation strategy in an SBA policy document entitled "Loan Monitoring System (LMS) Recommendations" following its review by senior SBA officials.

   Contracts will be used as management tools and will be structured to motivate contractors to manage the work effectively while satisfying all contract requirements, to identify performance problems early enough to take needed corrective actions

6. **Analyze the benefits and costs of alternatives and use to demonstrate the advantage of the final project.**

   Following finalization of the BPR recommendations, SBA conducted a cost/benefits analysis for implementing the reengineering. The analysis, contained in "The Business Case for the Reengineered Loan Monitoring System," clearly shows that the Loan Monitoring System is cost effective in comparison with the current system as well as major alternatives.

7. **Ensure that the proposed information system is consistent with the agency's information architecture.**

   The SBA has taken steps to ensure the proposed information system is consistent with the agency's information architecture. With EDS Corporation support, the SBA has developed a strategy to reconcile LMS (as well as other technology projects that are underway) with the Enterprise Information

Technology Architecture (ITA). The ultimate goal of this strategy is to effectively and efficiently align the use of information technology with strategic business and IT direction, while minimizing the impact of the SBA's evolution towards its target.

As an integral part of the Systems Development Methodology (SDM), phase reviews and checkpoints are identified and planned. SBA will use these checkpoint reviews as a means to verify and ensure compliance to the ITA. Because the LMS is currently in the initiation phase of the project, there are only two elements of the SBA ITA that LMS should be reconciled with, the Business Architecture, and the IT Direction.

8. **Estimate the cost to completion through identification of essential cost elements.**

SBA has estimated the LMS cost of completion through the identification of essential cost elements. SBA decided to structure the cost elements by SDM life-cycle phases. This approach allowed for focus on specific phases of the project life-cycle to better identify appropriate cost elements by purpose and outputs of each phase of the process. Assumptions were documented for each cost element. The cost elements were then summarized by life-cycle phase and categorized by type of cost.

BENCHMARK STUDY

As mentioned earlier, I will now go into detail about the results of the benchmark study and subsequent business process reengineering. Our office of the Chief Information Officer (OCIO), on behalf of the Capital Access/Financial Assistance Office, contracted with Booz-Allen &Hamilton to conduct a benchmark study in order to fulfill the requirements of the 1997 SBA Reauthorization Act. The purpose of "benchmarking was to identify the "best practices" of organizations that perform functions similar to those of the SBA.

Booz-Allen&Hamilton emphasized to SBA at the beginning of the benchmark study that some of the organizations examined have had significantly more resources available for the development of their systems and have spent several years in their development.

Booz-Allen&Hamilton also highlighted the fact that *none* of the organizations identified in the benchmark report perform precisely the same function as the SBA. Conventional lenders in the study do not have SBA's mission of providing financing to those who do not have access to credit on reasonable terms. The quasi-governmental entities we studied, like Freddie Mac and

Fannie Mae, are also significantly different from SBA because they are involved in housing rather than commercial loans. This is mainly due to our role as a gap lender, which I discussed earlier. Nevertheless, their systems provided good models for the SBA to use in developing the Loan Monitoring System.

Booz-Allen&Hamilton first examined the current processes of the Agency's loan programs to determine where improvements could be made. Their study concentrated on five functions: guaranty procedures, lender oversight, risk management, asset sales, and subsidy rate.

As expected, the study concluded that there are performance gaps in all of the five functional areas. Within the performance gaps, there was one underlying concern that affected each of the five areas, i.e., the inability of capturing and analyzing information which may result in an increased taxpayer's exposure to credit risk. Booz-Allen&Hamilton recommended that systems be developed that will obtain information at loan origination and then automatically and seamlessly transfer the information throughout the organization. The information captured directly from lenders at the inception of a guaranty will form the basis for all other future analysis. Loan performance data should also be gathered from lenders and analyzed to develop an understanding of loan-life behavior. The Risk Management function should use the captured information to determine the optimal underwriting criteria and portfolio exposure. The Lender Oversight function should use the captured information to analyze, and anticipate, lender behavior in order to ensure that lenders are acting in the best interests of the SBA. The Subsidy Rate Calculation function should use the captured information to predict more accurately the future cash flows of loans. The Asset Sales function should use the captured information to determine the optimal value for a portfolio of loans or guaranties. Each function is therefore dependent on receiving accurate, relevant, timely and consistent information on each guaranteed loan.

Commercial lenders and other organizations which exhibit the best practices are those who have systems and processes in place that allow functions to be integrated based on three key concepts: consistency of loan information, relevance of information collected, and the seamless integration of information and business processes. The LMS incorporates these key concepts.

It is important to note that SBA's benchmark efforts are dynamic. SBA continues to benchmark innovative business practices and information technology systems as they become available to ensure that potential business process improvement or commercial-off-the-shelf (COTS) technical solution is considered for its applicability to our Agency.

BUSINESS PROCESS REENGINEERING

SBA's Business Process Reengineering (BPR) project represents an important step in the Agency's modernization planning process. Booz-Allen & Hamilton, Inc. facilitated the BPR effort, with employees of their firm both guiding the work of the BPR teams and recording the teams' ideas. The BPR study was conducted from December 1998 through June 1999 with a forty-member team comprised of a cross section of SBA field and headquarters staff most knowledgeable about small business borrowers and SBA's responsibilities. The team recommended incorporating technology advances that were not even available five years ago. The members were specifically instructed not to be limited to the traditional, nor constrained by current organizational structure.

FEASIBILITY ANALYSIS

After the BPR, SBA followed the guidance of the General Accounting Office's (GAO's) Business Process Reengineering Assessment Guide and conducted a feasibility analysis of the BPR recommendations. The GAO guidance suggested that a feasibility study should balance the feasibility of each recommendation against the projected return on investment for the agency. To this end, a panel of program experts, who were not part of the BPR team, reviewed the 38 major BPR recommendations. Concurrently, the Associate Directors for Capital Access and Field Operations and their staffs along with the Chief Operating Officer analyzed and adjusted the recommendations to better reflect the agency's mission as a "gap lender." Of major concern was ensuring that the new system did not have a negative impact on potential borrowers most in need of assistance and on those lenders not yet ready to move to an all-automated environment. The original recommendations called for complete centralization of loan processing. This approach was *rejected because we could not ensure that the Agency's mission could adequately be served without some degree of local service.* Centralized processing may require a level of standardization that can cut out low-volume and new lenders. The team's other major risk concerns included the following:

- Increased delegation of authority to lenders must be counterbalanced with stronger lender oversight.
- The streamlining of underwriting could reduce the availability of information necessary to assess SBA's potential risk.
- Full centralization of servicing reduces the ability to provide hands-on assistance to borrowers who are viable, but having difficulty. It also reduces the ability to quickly respond to regional needs. One example would be the recent fuel oil crisis in New England.
- Centralization further removes the Agency from local knowledge. Commercial lending is very sensitive to local conditions, requirements of state law and associated litigation. Relations with local lenders, lenders new to SBA's programs, and lenders that specialize in serving new markets cannot be cultivated to the same degree in a highly centralized environment. In addition, training, oversight and market analysis are also more difficult.
- The manner in which a loan is processed and serviced has a direct influence on the kind of loans that are made. To the extent that SBA too closely mirrors the practices of commercial lenders, it runs the risk of reducing the value added to the small business sector.

Ultimately, 30 of the 38 original major recommendations were adopted without change. The remaining eight were adopted with modifications to better meet our legislative mission as a gap lender. SBA will implement the actual recommendations issuing from these deliberations as part of Phase I of LMS development. The general themes of these 38 recommendations are:

- **We will become electronic with our lenders, pushing less paper and**

leveraging the tools we already have.
- **We will emphasize quality data and timeliness.**
- **We will meet the need for greater oversight to monitor lenders' strict adherence to data collection and performance standards.**
- **We will consistently enforce policies and regulations.**
- **We will proactively perform risk management.**
- **We will continue with asset sales and will strengthen our ability to do timely and accurate subsidy rate calculations.**

THE ITERATIVE APPROACH TO IMPLEMENTATION

Now I will briefly discuss our approach to implementation of the Loan Monitoring System (LMS). The technical term for the approach we have adopted is a "combination evolutionary incremental project structure." In layman's terms, we refer to our implementation method as the iterative approach.

The incremental or iterative model is characterized by acquisition, development, and deployment of capability through a number of clearly defined system "increments" that can stand on their own. The number, size and phasing of the "increments" for the LMS project were determined by the project team with significant input from SBA field representatives. Requirements for the LMS are documented both in Joint Financial Management Implementation Program (JFMIP) loan systems requirements and in the LMS Systems Requirements. The approach is evolutionary in that SBA will make use of prototypes whose full functionality may evolve over time. Testing a system built in smaller modules is also *less risky*. If something doesn't work as expected it can be fixed fairly quickly and less expensively.

The first iteration of the new LMS initially will have the greatest impact on the PLP and SBA LowDoc loan processing. The anticipated completion date for Iteration One is Summer 2000. In Iteration One:

- **We will establish a set of core data elements that we will collect on all loans.**

  The core set of data elements that have been identified is needed both for guaranty approval and throughout the life of the loan, including for risk management and lender oversight. Most of the best practice organizations reviewed during the benchmark practice standardized data collection followed by seamless and consistent use of the information for risk management. Freddie Mac uses its Loan Prospector® system to capture standard information directly from the lenders and move the information into the corporate computers. Bank of America uses the Merlin® system to capture standard information at its branch level, then uses the information to underwrite the loan and then transfers the information into the corporate loan accounting system.

- **The Internet will be the standard medium for submitting all applications.**

  Ultimately, SBA will fully leverage the Internet as a backbone for data submission. Freddie Mac has realized significant benefits by establishing their Loan Prospector® Internet based system as its standard medium for application data submission. In fact, Freddie Mac's participating lenders report that using Loan Prospector already is saving them $300 to $650 per loan.

- **PLP, SBAExpress, PCLP, SBALowDoc, and Community Express ultimately will be submitted electronically.**

  SBA will encourage electronic transfer of guaranty requests and servicing actions. However, to ensure access to SBA's programs by all small businesses, SBA will not turn down any transaction because of a lender's lack of electronic capability. We fully expect that, over time, lenders will move towards electronic-commerce and this issue will fade, however we intend to do what it takes to get capital to deserving small businesses. In the short term, SBA plans on accommodating lenders' varying levels of technical infrastructure and competency by establishing several automated data submission tracks. For example, highly automated lenders may use a file transfer via the Internet, whereas a less sophisticated lender may use Optical Character Recognition forms to fax an application to SBA. However, SBA will not turn a paper application away.

- **Establishment of performance standards against which lenders will be reviewed .**

  Lender performance standards will be established by a centralized lender oversight group. This is similar to what occurred at Freddie Mac and the Farm Credit Administration (FCA), where "best practice" lender performance standards were established by centralized lender groups.

- **Lenders will be held responsible for submitting complete and accurate information on loan applications.**

  This is ensured through a processing system that immediately screens out incomplete applications and identifies incomplete or invalid entries. The appropriate SBA field office will be notified of repeated deficiencies and rejections by lender so that they can undertake training.

- **Authority to make eligibility decision will be delegated to PLP lenders.**

  SBA will allow PLP lenders to sign an eligibility checklist and/or use an Internet automated eligibility tool and retain the results in their file as a substitute for the Agency's eligibility determination. Lenders will be held accountable for eligibility determinations as part of the lender review process. Upon full implementation, we expect PLP loans to be processed without SBA staff being involved in the processing. *However, SBA will have staff available to consult on complex eligibility issues.*

ITERATIONS 2-6

The following is a summary of the highlights of iterations 2-6:

Iteration 2: We will expand the electronic application process to include regular 7(a) and 504 loan programs. We will also test electronic loan files, digital signatures, and loan risk determinants.

- This will minimize paper flowing between SBA and its lenders and within SBA.
- Loan risk determinants will help SBA assess the risks associated with new loans and understand how the risks change over time.

Iteration 3: We will continue to automate the internal work flow and develop on-line reports for SBA staff and management.

- SBA staff and managers will have more accurate and timely information to make decisions.

Iteration 4: We will add proactive risk management tools, a new loan servicing system, and an on-line system for lenders to update loan status information.

- It will be easier for lenders to provide loan data to SBA.
- SBA will have analysis tools to perform proactive risk management of the portfolio.

Iteration 5: The system will include lender performance tracking and oversight.

- The system will provide lender performance information to our lender oversight function.

Iteration 6: We will complete the system with modules to support liquidation and litigation activities, enforcement of lender performance standards, and streamlined asset sales and subsidy rate calculations.

- The cost of asset sales will be reduced.
- Subsidy rate estimates will be more automated and require less data cleansing freeing resources to do more analysis.

OVERALL AGENCY COMMITMENT

SBA believes it has addressed most of GAO's recommendations regarding the management of this project that are not specifically referenced in the eight planning steps, but critical to Clinger Cohen based planning. Early in the process, GAO representatives suggested that SBA's modernization efforts and more specifically the Loan Monitoring System Project, were devoid of an official "champion." Since the last hearing on this subject in July 1998, SBA has designated Chief Operating Officer, Kris Marcy, as the senior-level official with overall responsibility, authority, and accountability for managing and coordinating the Agency's modernization projects. She works closely with our Chief Information Officer, Larry Barrett and our Chief Financial Officer Joe Loddo to ensure that the Clinger-Cohen mandates have been met and that critical tasks are completed on time and within budget. She also works closely with the Associate Deputy Administrator for Capital Access Charles Tansey and the Associate Administrator for Field Operations Robert Baskin to ensure that our program offices are well served by data improvements. We also want to ensure that the staff who will implement the LMS in the field are involved fully during the early stages of the project. In addition, Ms. Marcy and our program staff have held regular, in-depth briefings with GAO and your staff in November 1998, May and October 1999, to keep this Subcommittee fully abreast of our progress. Also, the Business Technology Investment Council, the SBA's Information Technology Investment process, has endorsed the Loan Monitoring System Project. This Council reviews, controls and evaluates all SBA systems projects.

Most importantly, SBA has established dynamic feedback mechanisms to analyze the concerns of its internal and external stakeholders and to proactively identify and define potential barriers of the modernization effort. Some examples include:

- In December of 1999, the agency began a series of ten regional training sessions to educate key field staff (District Directors, Deputy District Directors, Assistant District Directors for Economic Development) about business and system changes.
- The LMS Project team regularly briefs its primary 7(a) and 504 trade groups, the National Association of Government Guaranteed Lenders (NAGGL) and the National Association of Development Companies (NADCO), on proposed process and system changes. In addition, project leadership conducts monthly meetings with NAGGL and NADCO technical advisory representatives.
- An Internet (www.sba.gov/banking/modernization.html) and Intranet site is dedicated to the communication of modernization related issues. The sites include various two-way communication mechanisms for dynamic exchange of ideas between internal and external stakeholders.

NEXT STEPS

We are confident that we have carefully undertaken the planning necessary to ensure successful implementation. We are mindful of the mistakes that have caused other organizations to stumble. Using the incremental development approach, we will increase the likelihood of success by developing, testing, and implementing manageable pieces of the system. While we are mindful of possible risks, we are also aware of the greater risk of not proceeding. All of our planning has illuminated the exposure we currently face. As stewards of federal resources, our failure to proceed would be irresponsible and imprudent.

Thank you for inviting SBA to discuss with you the automated Loan Monitoring System and again we appreciate your continued support for this effort. We will be happy to answer any questions you might have.

Testimony of

Daniel O. Hill

Assistant Administrator for Technology

Before

Subcommittee on Government Programs and Oversight

Committee on Small Business

U.S. House of Representatives

May 27, 1999

Good morning, Mr. Chairman and members of the Subcommittee. Thank you for inviting me to appear before the Subcommittee on Government Programs and Oversight of the House Committee on Small Business to discuss the U.S. Small Business Administration's (SBA's) Small Business Innovation Research Program (SBIR) program. My name is Daniel O. Hill and I am the Assistant Administrator for the Office of Technology at the SBA. It has been my pleasure to manage the SBIR program for almost 4 years.

Numerous small businesses have been able to conduct successful research and development (R&D) through the SBIR program that they would not have been able to do alone. For example, before receiving a Department of Energy Phase II grant in 1991, the Atlantia Energy Corporation of Houston, Texas, constructed shallow water oil and gas drilling platforms. for about $2 million each. At the time, deep-water platforms built by others were so expensive ($500 million) that they were not economical to use for many small oil deposits. Atlantia used their SBIR grant to develop their new concept for deep-water platforms that would cost only $100 million.

Four hundred construction workers were employed to build two of the platforms for a previous customer. The firm has grown from 30 to 100 employees as a result of the SBIR program and has received 4 patents and one trademark.

In addition, because the U.S. government receives royalties from the oil production, the two new platforms will send $200 million to the U.S. Treasury from fields that were previously not economically recoverable. Atlantia said they probably would not have undertaken the project without the SBIR award.

Today I will first, further discuss the need for and success of the SBIR program, second, give a brief description of the basics of the SBIR program and third, explain the role of the SBA in such success.

The Success of the SBIR program

The SBIR program was created in 1982 with the following objectives: "to strengthen the role of the small, innovative firms in federally funded research and development, and to utilize federal research and development as a base for technological innovation to meet agency needs and to contribute to the growth and strength of the Nation's economy." I would like to elaborate on how the SBIR program meets these goals.

The SBIR program strengthens the small firm role in Federal R&D

By its design, the SBIR program strengthens the role of small innovative firms in Federally funded R&D. Since its first year of implementation, the SBIR program has grown to the point that it is now providing more than $1 billion a year to innovative small businesses. In spite of the effect of the SBIR program on Federal extramural R&D funding, small firms receive less than 5 percent of federal extramural R&D funding. This compares with about 47 percent going to large firms and more than 42 percent to universities and colleges (See Figure 1).

The SBIR program encourages Federal contracting with small innovative firms, which brings Federal spending more in line with the distribution of industrial R&D in the private sector. Small firms conduct more than 16 percent of the private sector R&D, yet they receive only 9 percent of the Federal R&D funds that go to private firms. The largest firms (those with 25,000+ employees), however, conduct about 46 percent of industrial R&D but they receive more than 80 percent of the federal R&D funds going to the industry.

Recent data from the National Science Foundation (NSF) provide evidence that the small business role in innovation and the economy is likely to increase in the future. As we know, our economy is increasingly knowledge-based, where future competitiveness is determined by the quality of the human resource base of technically trained and skilled personnel. NSF data show that this human resource base, the technical intellectual capital needed for future innovation, appears to be moving from large business to small business. A recent NSF study concludes that "the employment of full-time equivalent research and development (R&D) scientists and engineers rose almost twice as fast between 1995 and 1996 at small companies as at larger ones --18 percent versus 10 percent -- according to a 1997 national survey of R&D-performing firms." The data show this trend continuing from 1997 to 1998 with a 14 percent increase for small firms and only a 6 percent change for larger firms (See Figure 2).

Another NSF survey shows that as many recent college graduates with degrees in science or engineering are entering small firms as large firms, and that this amount far exceeds the number going into other institutions such as universities, non-profits, or government (See Figure 3). These data show that the SBIR program helps the Federal procurement process focus on a sector of the economy with a growing center of innovation capacity.

The SBIR program enables Federal agencies to meet their research needs

The ten Federal agencies in the SBIR program have very different research and development needs. Some seek the development of new products or processes to meet their program needs. Others focus more on building the research and science base in specific fields. The SBIR program has resulted in high quality research and development for the agencies. The flexibility in the program design has enabled agencies to manage their programs to effectively meet their specific mission objectives.

The SBIR program contributes to the growth and strength of the Nation's economy by increasing the commercialization of Federal R&D

Most evaluations of the SBIR program to date have focused on the success of participating firms in commercializing the results of their R&D.

- These reviews have documented the sales and additional R&D funds generated by SBIR firms. For example, a 1992 study by the General Accounting Office found that "the program is showing success in Phase III (commercialization) activity" and that SBIR expenditures of $956 million over 1984-1987 had generated $471 million in sales of new commercial products and $646 million in additional developmental funding as of July 1991.

- Studies by the Department of Defense in 1996 and the SBA in 1998, using the same methodology as GAO's and applying it to all SBIR agencies, found that the average Phase II SBIR project over 1984-1993 (funded at around $500,000) had generated $955,000 in sales and attracted about $625,000 in additional, non-SBIR funding as of 1998. The same study found that 55 percent of all respondents reported either sales or additional development funding or both.

- A Harvard University study found that SBIR awardees grew significantly faster—whether measured by sales or employment—than a matched set of firms over a ten-year period. The study found this to be true in geographic areas with considerable venture capital activity.

Analysts are quick to point out that any commercial success attributable to these projects adds value to the economy over and above the research they performed for the agency.

The SBIR program contributes to the growth and strength of the Nation's economy by stimulating innovation

By making R&D funds available to small innovative firms, the SBIR program takes advantage of an underutilized economic and social resource: the small, flexible, innovative firm willing to take the risk needed to transform a new idea into an innovation. The term "innovation" generally refers to the introduction into the marketplace of a new product, process or service.

Studies and anecdotal evidence tell us that small firms have a number of advantages over large firms when it comes to innovation (greater flexibility, closer contact with customers and potential end users, greater willingness to engage in high risk R&D projects). These qualities have made small firms the leaders in industrial innovation, producing more innovations per employee and per dollar spent on R&D than larger firms. In fact, large corporations in innovation-intensive industries try to achieve some of the advantages of small firm organization through new business models using semi-autonomous research and business units. Further evidence of the advantage of small innovative firms is the important role being played by small start-up businesses in the development of emerging high-tech industries such as biotechnology and information technologies.

But the many advantages and efficiencies of small innovative firms are not fully realized in our economy because of the obstacles they naturally face in raising capital. Capital markets do not have the information needed to make sufficient investments in the high quality but risky small firm projects that can lead to significant and socially-beneficial innovations. The SBIR program funds those types of projects, by providing high-risk, patient capital that is not available in the market.

The impact of the SBIR program goes well beyond the outcomes of new product innovation and firm growth. At a recent symposium conducted by the National Academy of Sciences' Board on Science, Technology and Economic Policy, a team of researchers reported their findings from extensive case studies of SBIR recipients. At the day-long conference, the researchers reported finding a number of examples of start-up firms that said they would not have started their company at all if it had not been for the SBIR program. In one study it was reported that fully half of the firms surveyed said that the existence of the SBIR program influenced their decision to start the company.

In addition, a study has found that SBIR start-up firms have had the effect of encouraging colleagues to seek funding to start other firms. One-third of the firms in one case study said their SBIR experience had encouraged their colleagues to form their own innovation-oriented firms.

There are also other indirect benefits of the SBIR program to the recipient firm. These indirect benefits include increasing staff .skills, retaining or hiring valuable researchers, increasing the credibility and financial stability of the firm, enabling new collaborative arrangements with others and influencing other R&D activities of the firm.

The SBIR program: Background

The SBIR program was created by the Small Business Innovation Development Act of 1982 (P. L. 97-219). The SBIR program mandates that each Federal agency with an extramural R&D budget in excess of $100 million must designate a certain percentage of this budget for awards to small businesses. Currently, there are ten Federal agencies participating in the program (See Figure 4).

In the early years of the program, the SBIR set-aside percentage was 0.2% of an agency's extramural R&D budget in excess of $100 million with a legislated growth to 1.25% in 1987 that continued until 1992. On October 28, 1992, the program was reauthorized through the year 2000 and Congress maintained the growth rate by directing that the percentage grow each year to an eventual 2.5% in FY 1997, maintaining that level to the year 2000.

The Act established a three-phase structure:

- Phase I: Awards of up to $100,000 are funded for six months for research projects to evaluate the scientific and technical merit and feasibility of an idea.
- Phase II: Funds Phase I projects with the most potential to further develop the proposed idea. Phase II funding is for one or two years, and most awards are $750,000 or less.
- Phase III: No SBIR funds may be used in Phase III. Private sector investment and support brings an innovation to market, and, if appropriate, Phase III may involve follow-up production contracts issued by a Federal agency for future use by the government.

SBA's Role in the SBIR program

In order to ensure the success of the SBIR program, the SBA plays a vital policy leadership role by seeing that the interests of small businesses are protected. The SBA directs the implementation and execution of the SBIR program by undertaking the following key management and policy functions:

- Issues policy directives to the participating federal agencies with specific instructions on establishing and maintaining the SBIR program at their respective agencies;
- Chairs quarterly interagency program managers' meetings to discuss policy initiatives and directions as well as operational issues;
- Provides advisory opinions on specific project and policy issues;
- Approves solicitation schedules for SBIR projects;
- Issues pre-solicitation information to small businesses;

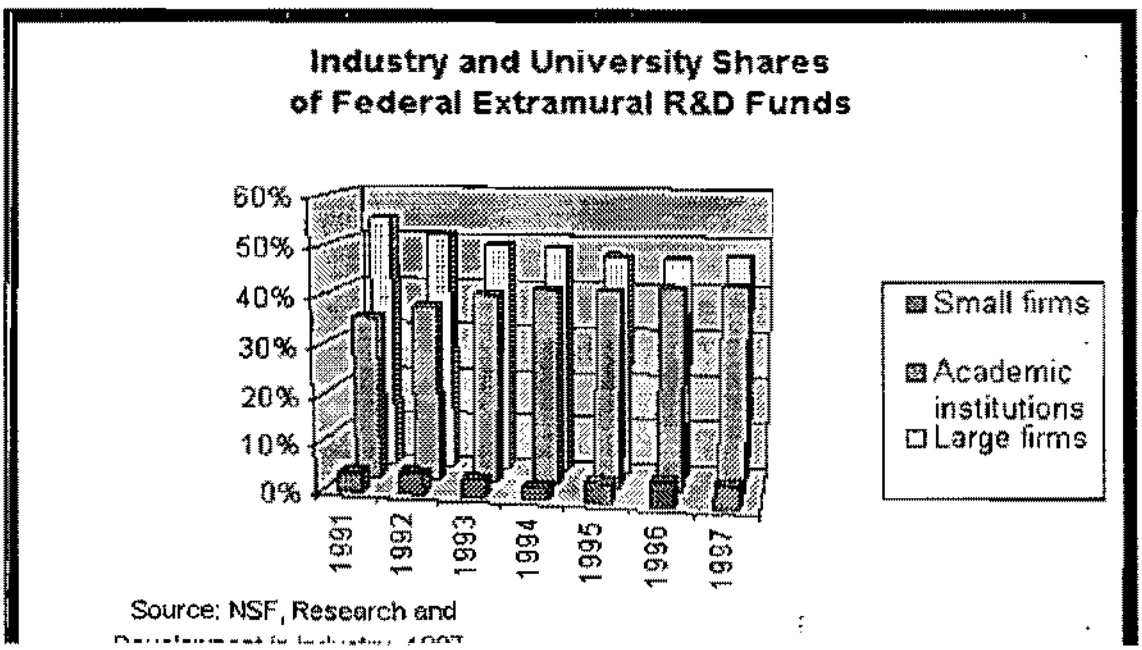
- Collects program data (See Figure 5) and reports annually to the Congress and the Administration; and
- Maintains a database of SBIR winners and conducts studies to determine the success of the program.

Conclusion

In summary, the SBIR program is working; it is achieving its congressionally mandated goals. A large part of the SBIR program's success is clearly due to the skill, dedication, and ingenuity of the program managers and other Federal and state officials administering the program. I would like to commend them for the terrific work they do. Equally important is the unique and flexible design of the program, which enables it to fill the needs of a diverse set of Federal agencies, and at the same time, reach a broad range of small businesses. Finally, credit must go to the small businesses themselves who have performed so well in the program.

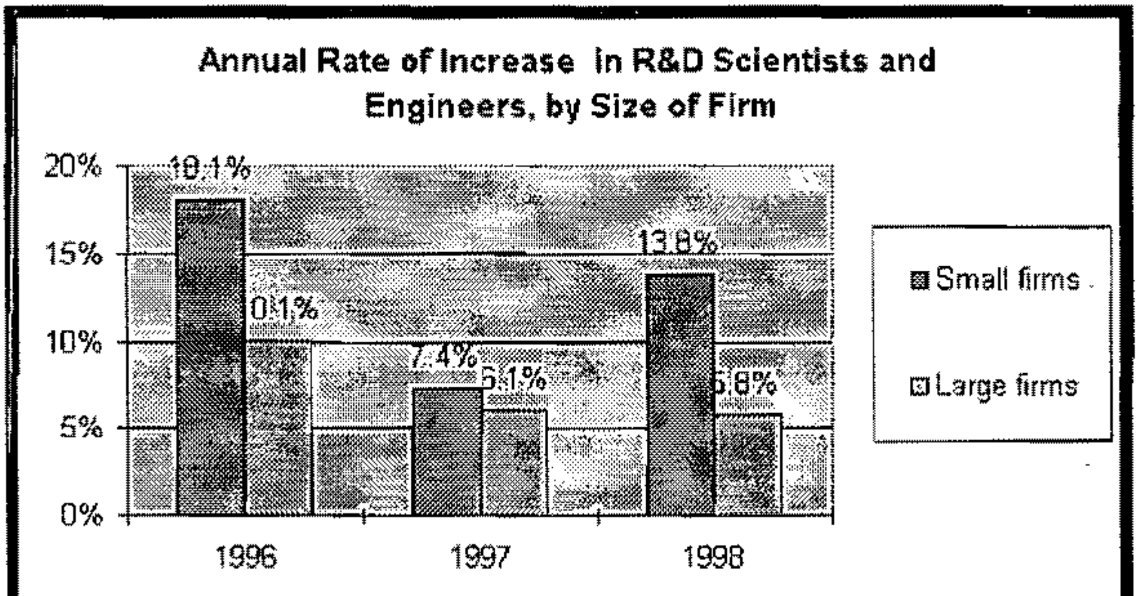
The SBIR program enables the Federal Government to keep pace with transformations in the economy while supporting a dynamic and innovative small business sector that will be the foundation of the economy of the 21^{st} Century. The SBA supports the continuance of this successful program. Thank you for inviting me to discuss the SBIR program with you. I will be happy to answer any questions you might have.

Figure 1



Development in Industry, 1997.

Figure 2



Source: NSF, Research and Development in Industry, 1997, Table A-52.

Figure 3

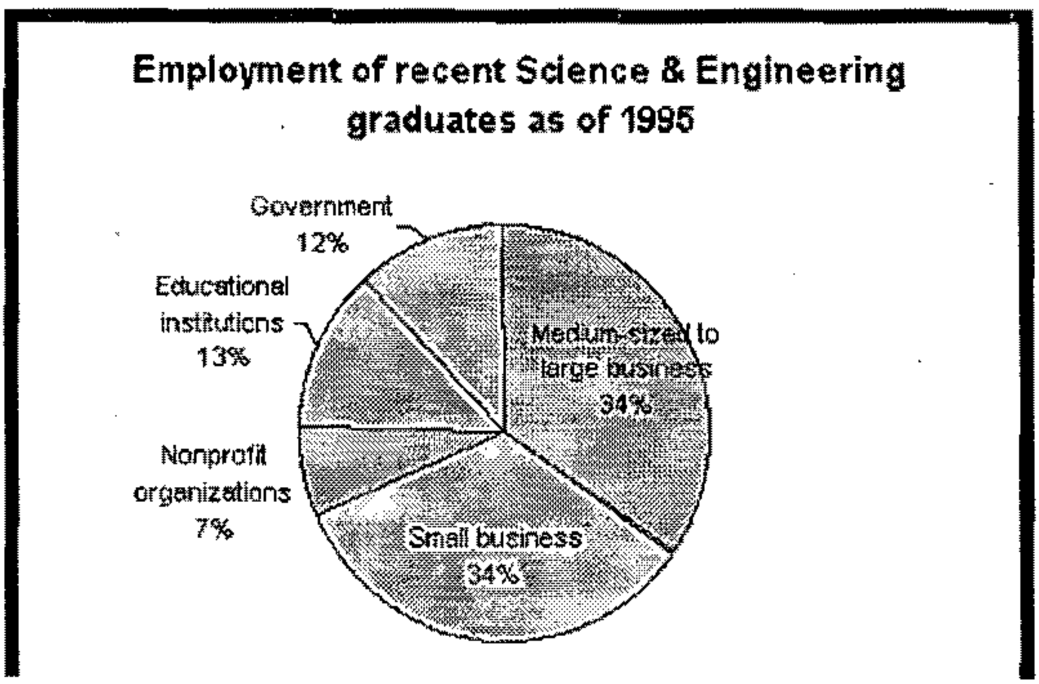


Figure 4

SBIR Agency Obligations

Fiscal Year 1997

(in thousands of dollars)

Department of Agriculture	10,020
Department of Commerce	7,330
Department of Defense	569,075
Department of Energy	74,872
Department of Transportation	8,370
Department of Education	4,470
Environmental Protection Agency	5,843
Health and Human Services	251,940
National Aeronautics and Space Administration	121,447
National Science Foundation	53,630
TOTAL	1,106,997

Figure 5

SBIR Awards

FY 1983 through FY 1998

	Number of SBIR Awards			Value of SBIR Awards (in millions of dollars)		
FY	Phase I	Phase II	Total	Phase I	Phase II	Total
83	686		686	44.5		44.5
84	999	338	1,337	48.0	60.4	108.4
85	1,397	407	1,804	69.1	130.0	199.1
86	1,945	564	2,509	98.5	199.4	297.9
87	2,189	768	2,957	109.6	240.9	350.5
88	2,013	711	2,724	101.9	248.9	389.1 *
89	2,137	749	2,886	107.7	321.7	431.9 *
90	2,346	837	3,183	118.1	341.8	460.7 *
91	2,553	788	3,341	127.9	335.9	483.1 *
92	2,559	916	3,475	127.9	371.2	508.4 *
93	2,898	1,141	4,039	154.0	490.7	698.0 *
94	3,102	928	4,030	220.4	473.6	717.6 *
95	3,085	1,263	4,348	232.2	601.9	834.5 *
96	2,841	1,191	4,032	228.9	645.8	916.3 *
97	3,371	1,404	4,775	227.6	789.1	1,106.9 *
98	3,022	1,320	4,342	262.3	804.4	1,066.7 (prelim.)

* includes award modifications

NSF, Research and Development in Industry, 1997, early release tables

NSF, Will Small Business Become the Nation's Leading Employer of Graduates with Bachelor's Degrees in Science & Engineering?, 99-322, 1999 p. 2.

NSF, Research and Development in Industry, 1997, early release tables, Table A-52.

NSF, Will Small Business Become the Nation's Leading Employer of Graduates with Bachelor's Degrees in Science & Engineering?, 99-322, 1999 p. 3.

Results of a Three-Year Commercialization Study of the SBIR Program, U.S. Small Business Administration, 1991, (SBA 90-00.147).

BRTRC, Commercialization Small Business Innovation Research, and special tabulations, Peter Cahill, BRTRC.

Josh Lerner, 1996. The Government as Venture Capitalist: The long-run Impacts of the SBIR Program, NBER Working Paper 5753, Cambridge, MA.

This was a common comment by the participants of the National Academy of Sciences' Board on Science, Technology, and Economic Policy, Symposium on The Small Business Innovation Research Program: A Review of Current Research, May 5th 1999, Washington, D.C.

The State of Small Business, 1994 Chapter 3; and The State of Small Business 1996, Chapter 5.

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David Audretch, presentation of research, NAS Symposium on SBIR, op. cit.

David Audretch, op. cit.