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A smarter way for government to create jobs

SBA program leverages private money, avoids taxpayer risk

By Michael K. Wyatt and James C. Howard

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In his Sept. 8 speech on jobs, President Barack Obama repeated the conventional wisdom that small businesses create most new jobs. Like a lot of conventional wisdom, this does not fully capture the real dynamics of the situation. A 2010 article published by three University of Maryland economists led by John Haltiwanger revealed that when they controlled data for the age of a company, there was no indication that small companies outperformed large companies in creating new jobs. The key factor was age: new start-up companies were the vehicle for generating new jobs.

Most people feel that the government can and should encourage employment creation during an economic downturn, but most also agree that government is the last party that should be directly involved in selecting winners and losers. The current furor over the Solyndra loan losses adds an exclamation point to this position.

Fortunately, an existing federal program channels federal guarantees into start-up companies that are selected by experienced private investors. The Small Business Administration (SBA) established the Small Business Investment Company (SBIC) program in 1958. The aim was to supplement the money raised by private investors with funds loaned to the SBICs they are managing. One critical attraction of the program is that virtually no taxpayer money is involved. The money provided with the assistance of the SBA comes from debentures (a kind of bond) sold to private investors with an SBA guarantee.

Thus, the private equity money raised by the SBIC management team is leveraged by loans from private parties backed by the government guarantee (often providing \$2 of SBA-guaranteed loans for every \$1 of private equity). Managers of the SBICs need to apply to the SBA for a license, and they must demonstrate the knowledge and experience to select start-up ventures with the greatest chance of survival. The SBA monitors investment performance with periodic audits of the SBICs and, in many cases, with an assessment of fund performance conducted by independent contractors.

The SBIC program has provided part of the initial funding for Apple, Federal Express, Staples, Costco, Outback Steakhouse, Callaway Golf and Whole Foods Market. Losses on the SBA guarantee have totaled less than 20 percent of the amounts guaranteed, and these losses have been more than offset by fees charged by the SBA to the SBICs. No clear figures are available on the corporate taxes paid by

portfolio companies or on the individual income taxes paid by portfolio company employees, but the National Association of Small Business Investment Companies states that SBIC investments in 2010 helped to create or maintain more than 46,130 jobs.

The current economic downturn provides justification enough for utilizing whatever options are available to generate new jobs. However, the current situation may present new challenges that are not responsive to Keynesian "pump-priming" strategies. Overlaying this employment need is the fear that the technology of this century is introducing a different dynamic from that of the past century.

During the 20th century, many technological advances (automobiles, appliances, TV, radio, computers, airplanes, etc.) were responsible for creating innumerable employment opportunities, especially for blue-collar workers. The opposite seems to be happening in the 21st century. The advances in communications and transportation technologies over the past few decades have enabled companies to outsource numerous manufacturing and customer service jobs. In the domestic arena, technology has had an adverse impact on jobs, as demonstrated by the introduction of automated teller machines, email, E-ZPass, self check-out grocery aisles, e-tailing, etc. IBM's Watson computer initially demonstrated its skills on "Jeopardy," but now WellPoint health insurance is utilizing Watson to apply artificial intelligence capabilities to the processing of medical insurance claims.

With both cyclical and secular trends putting a drag on the employment situation, it is imperative that the country encourage those programs that have demonstrated a clear record of generating new employment opportunities. The SBIC approach is a clear winner.

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