



Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

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Committee on Small Business

Hearing on

“Empowering Employee Owned Businesses and Cooperatives Through
Access to Capital”

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Chairwoman Velázquez, Ranking Member Luetkemeyer, and members of the Committee, I am Alice P. Frazier, President and CEO of the Bank of Charles Town headquartered in Charles Town, West Virginia. I testify today on behalf of the Independent Community Bankers of America where I am Chair of the Policy Development Committee and a Member of the Board of Directors.

Thank you for the opportunity to testify at today's hearing on "Empowering Employee-Owned Businesses and Cooperatives Through Access to Capital." These are important ownership models that deserve our support as lenders, business advisors, and policymakers. Many community banks use Employee Stock Ownership Plans (ESOPs) to give their employees an ownership stake in the bank. Some 800 banks have ESOPs, and a small number are 100 percent ESOP-owned.

Access to capital is critical to the success of small businesses of all ownership models. In this regard, I will discuss the importance of preserving community bank SBA lending and highlight the threat posed by proposals for direct 7(a) lending. An experiment in SBA direct lending, in which the agency has a poor track record, would be ill conceived and would jeopardize access to capital for small businesses. What's more, the community bank-small business partnership goes well beyond lending. Community banks provide practical, real world business counseling and networking opportunities, particularly for startups, in a way that can never be matched by SBA or any government agency. Community banks are invaluable to the 7(a) program. We are committed to working with this committee and the SBA to ensure the program is reaching the smallest borrowers. I will discuss this issue in more detail later in this statement.

Our Story

The Bank of Charles Town, or BCT, was founded in 1871 in Jefferson County, West Virginia by a group of 38 farmers, orchardists, and business leaders who believed a locally based bank would create an economic and stabilizing influence in Jefferson County. Thousands of community banks around the country were founded on that same vision. Today, BCT is a \$671 million asset community bank with 121 employees serving the Eastern Panhandle of West Virginia as well as Hagerstown, Maryland and Loudoun County, Virginia.

The Paycheck Protection Program Illustrates the Value of the SBA-Community Bank Partnership for Small Borrowers

Nowhere is the community bank commitment to small businesses more obvious than in our embrace of the Paycheck Protection Program. As you contemplate proposals for SBA direct lending, I ask you to consider this recent history. Community banks were simply indispensable to the success of the PPP, and their lending was weighted toward the smallest borrowers. Community bankers are not the people you want to sideline in the critical task of creating access to capital.

The PPP was a natural fit for the business model of community banks. We are small business lending specialists, and our strength is personal relationships in our communities and direct knowledge of local economic conditions. There are countless stories of small businesses in

desperate need that, unable to secure a PPP loan from a larger bank in a timely fashion, turned to a community bank where they were promptly and effectively served. Community bankers worked around-the-clock to meet a surge in demand for PPP loans from existing as well as new customers.

The data tells the story: Community banks were the predominant PPP lenders to local small businesses. Their 4.7 million PPP loans worth \$429 billion served 55.8 percent of all PPP recipients and accounted for nearly 60 percent of the program's total loan amount. These loans supported the retention of nearly 49 million jobs, accounting for over 58 percent of the program total. Moreover, community banks made nearly 87 percent of the PPP loans to minority-owned small businesses, 81 percent of the PPP loans to women-owned small business, and nearly 69 percent of the PPP loans to veteran-owned small businesses. I am proud that my industry stepped up to support the survival of these diverse businesses in a time of crisis.

My bank's PPP lending is typical of a community bank. In the first round, we made 557 loans with an aggregate value of nearly \$55 million. The average loan size was \$98,000. Eighty-five percent of these loans were under \$150,000, and 66 percent were under \$50,000.

In the second round, we made 411 loans with an aggregate value of over \$29 million. These loans were smaller than those made in the first round. The average loan size was \$71,000. Ninety-one percent of these loans were under \$150,000, and 71 percent were under 50,000. In other words, our PPP lending, typical of a community bank, disproportionately helped the smallest businesses.

Of course, the true purpose and value of the PPP is job preservation in an unprecedented economic crisis. BCT's first-round PPP lending has saved just over 4,000 jobs and the second round supported 2,877 jobs. This is an enormously positive impact in the small communities we serve and has staved off outright collapse. I know that other community banks have had similar results.

Community Banks and 7(a) Lending

The 7(a) program is invaluable in allowing us to support local small businesses that would not otherwise qualify for conventional credit. Community banks account for 66 percent of 7(a) loans between 2010 and 2021, meeting the needs of the smallest borrowers. BCT has been an SBA lender since 1978. Our SBA portfolio includes 24 open loans for \$5.2 million. The median loan size is just under \$100,000. In May of 2021, BCT hired three highly experienced SBA lenders to place more of an emphasis on this product. BCT, like other community banks, is committed to meeting demand for SBA loans, including smaller loans, in the markets we serve.

Access to Capital for Employee-Owned and Cooperative Firms

Employee ownership, partial or complete, and cooperative ownership are models that make sense for many firms in certain industries. The owners, be they employees or customers, enjoy tax benefits. Importantly, an ownership stake aligns employee or customer interest with the prosperity of the firm, which spurs productivity. As noted above, some 800 community banks have ESOPs. For these banks, ESOPs are an important source of capital and liquidity, help them remain independent, and aid with succession planning.

Like any other business, an employee-owned or cooperative firm must make financial projections, pay salaries and expenses, market their services, and operate in a competitive environment. Like all firms, they must have access to capital to ensure their success, pay wages, and provide services in their communities. These business forms don't have the option of outside investor capital. They rely on employee or member contributions and operational income to generate capital, supplemented by loans from banks and other sources. Community banks support these firms through lending, deposit taking, and other banking services. BCT currently has a lending relationship with two cooperatives, an apartment building in Arlington, Virginia, and Southern States, a retail agricultural cooperative that sells fertilizer, seed, and other farm inputs. We bring the same commitment to these borrowers that we bring to any small business relationship.

Solutions Are Needed to Permit Full Access to the 7(a) Program for Cooperative and ESOP Businesses

ICBA opposes any broad waiver of the requirement that a borrower personally guarantee a 7(a) loan. Such a broad-based waiver would increase risk for the lender and for taxpayers. A loan without a personal guarantee from someone might as well be an unsecured loan. While we are willing to discuss alternative solutions to better accommodate co-ops and employee-owned firms, a full waiver is unacceptable and would reduce access to capital for these firms.

We appreciate this committee's interest in access to capital for employee-owned and cooperative businesses. Let's be clear that direct lending is a threat to capital access for these businesses because it would sideline community banks and the partnership they bring to the lending experience.

SBA Direct Lending Has a Poor Track Record and Is Costly for Taxpayers

As I've discussed, SBA direct lending is not the answer to capital access for small business, whether they are employee-owned, cooperatives, investor-owned, or some hybrid model. SBA has been tried and has failed. I ask you to consider the finding of a [recent Congressional Research Service report](#):

The SBA has authority to make direct loans but, with the exception of disaster loans and loans to Microloan program intermediaries, has not exercised that authority since 1998. ***The SBA indicated that it stopped issuing direct business loans primarily because the***

subsidy rate was “10 to 15 times higher” than the subsidy rate for its loan guaranty programs.

The SBA retreated from direct lending as an ill-conceived experiment. Congress must not repeat this mistake. The recent Economic Injury Disaster Loan (EIDL) program, an SBA direct loan program, has been rife with fraud and poorly executed. Congress should heed this warning before creating a direct 7(a) program.

The involvement of banks is critical to reducing fraud. My bank, for example, recently detected and prevented a case of EIDL fraud. An alert branch employee flagged a transaction in which a client who had opened an account only 60 days ago received two government payments, coded similarly to EIDL loans, totaling \$20,000, and wanted to withdraw the total in cash. The employee had seen a recent fraud alert from the SBA which described just such a scenario. We stopped the transaction and returned the funds to the SBA.

Community bankers know their customers. They know the difference between a legitimate business and a fake business set up to perpetrate fraud because they meet with business owners, visit their businesses, and see their operations. The SBA is not on the ground in local markets and cannot assess borrowers firsthand. This distance from the borrower makes direct lending vulnerable to fraud.

Direct lending is a poor and costly alternative to private sector lending and would reach fewer borrowers. Today, there is a strong network of community banks, Community Development Financial Institutions, and other lenders already in place to meet demand for small business borrowers.

Lenders Are What Make the 7(a) Program Successful

I would like to share some stories from my bank to highlight that the community bank-small business partnership goes well beyond lending.

My bank is currently working with an African American entrepreneur who has a lot of corporate business experience but no experience in setting up a new company. For example, he has no contacts with accountants and other professionals that specialize in startup businesses. Sadly, it is too often true that African American entrepreneurs are disadvantaged in this sense. They are often the first in their family to start a business and don't have the benefit of a parent or family member to mentor them in the critical, initial phase. Mentorship is especially needed in minority communities.

As we talked with this entrepreneur about his business plan, he asked for those connections as well as how to properly use the bank loan to fund his business. We spent time walking him through different types of loans, such as a line of credit versus term loan, and what would work for him. Working together, we decided on a \$125,000 SBA 7(a) line of credit initially, which we

expect to grow quickly as the business ramps up. The loan is really just one feature of a much broader business partnership.

Without this type of partnership, an entrepreneur is left to muddle through. As a dedicated community bank partner, we connect an entrepreneur to resources in the community – accountants, lawyers, and other professionals – he or she needs to succeed. Our experience in working with other small businesses gives us a unique ability to provide insights and counseling to startups. We are invested in their success, and we have the experience and knowledge to help bring it about.

This is the added value a community bank brings to a lending relationship. We see it time and again. We provided a \$150,000 SBA loan to a baseball performance academy for tenant improvements and equipment. The client was borrowing money for first time in order to move into their own space after relying on “boot strap” funding for the previous five years. They were worried about their capacity to repay, but we walked them through a number of business scenarios to help them understand and give them the confidence they needed to take the loan.

Recently, a woman-owned coffee shop had an opportunity to expand to a second location by purchasing an existing business and building. While her first coffee shop was doing well on its own, the source for a down payment was limited. The best solution for her was an SBA Express loan. We worked closely with the entrepreneur, the seller, and the broker to structure the purchase and sale agreement to allow for the use of the SBA Express program to support her credit needs. We take great satisfaction in visiting her thriving new location.

This type of informed guidance, education, and confidence building is what community bank specialize in. We listen to their dreams, build trust, and celebrate their wins. Our role doesn't end when the loan closes. We stand by them and continue to provide guidance as the business grows and new opportunities become available, or as they encounter setbacks and challenges. Lending relationships typically begin with a smaller loan of less than \$150,000. As a borrower grows their business, they need more credit to support that growth. Cutting off community bank access to these small initial loans would deprive the borrower of a long-term lender partnership to support their growth. A startup must establish a solid foundation from the beginning to support future expansion. This is where a community bank is irreplaceable.

I do not believe that SBA direct lending could offer any remote substitute for a long-term relationship with a local community bank.

PPP Lending Displaced 7(a) Lending in 2020

Proponents of SBA direct lending cite data showing a decline in 7(a) lending in 2020. This data is misleading. Small business 7(a) loans were displaced by PPP loans and small business borrowing needs were met during this critical period. As PPP has come to a close, the SBA has already guaranteed a record \$30.1 billion in lending in fiscal year 2021, with financing for the

7(a) program funded by user fees. The most recent NFIB survey of small business owners found that just two percent of owners said that their credit needs were unmet.

Bank and other private sector lender underwriting, relationship-based business guidance and expertise are what make the 7(a) program successful. They have direct ties to their communities, knowledge of local economic conditions and expertise honed over generations that cannot be duplicated by the SBA. Displacing these lenders would be a grievous error.

ICBA will continue working with policymakers to maximize the effectiveness of the 7(a) program for the small businesses they serve.

Conclusion

Thank you again for convening today's hearing and for the opportunity to offer the community bank perspective on access to capital for small businesses of all ownership models.

I'm happy to answer any questions you may have.