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EXPORT FINANCE

**The Small Business
Administration's Role in
Meeting Small Business Needs**

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General Government Division



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EXPORT FINANCE: THE SMALL BUSINESS ADMINISTRATION'S
ROLE IN MEETING SMALL BUSINESS NEEDS

SUMMARY OF STATEMENT BY JAYETTA Z. HECKER, DIRECTOR
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The Small Business Administration (SBA) will be challenged to try to continue to meet export finance needs of small- and medium-sized businesses while adjusting to the lower federal funding levels currently being projected for the coming fiscal year. GAO's testimony focuses on SBA's Export Working Capital Program (EWCP), discussing the past use of the program, key improvements made since 1993, projected current use of the program, and options to help reduce the potential impact of reduced federal funding.

In response to the needs of U.S. exporters for working capital loans that commercial lenders were unwilling to supply without federal guarantees, SBA, with congressional support, developed the Export Revolving Line of Credit program (now known as EWCP) in 1980. However, the program was little used until 1990, according to a 1992 GAO report. A total of 161 loan guarantees, worth about \$45 million, were approved between fiscal years 1983 and 1990. In fiscal years 1991 through 1994, the annual number and value of working capital loans that SBA guaranteed remained stable, averaging 80 loans worth about \$28 million per year.

Responding to legislation in October 1992 regarding the fragmentation of federal export promotion efforts and to recommendations made by the interagency Trade Promotion and Coordinating Committee (TPCC) that was established by that legislation, SBA made changes to its EWCP. SBA addressed three particular TPCC recommendations: (1) SBA has worked with the U.S. Export-Import Bank (Eximbank) to streamline and standardize its working capital programs; (2) SBA has supported "one-stop shops," or U.S. Export Assistance Centers, by assigning 11 staff to the four pilot centers that are to provide a single point of contact for potential U.S. exporters; and (3) SBA has established cofinancing agreements with a few states, which have given the states added ability to grant more loan guarantees.

GAO projects that because of SBA's efforts, it is likely that SBA will guarantee about 164 working capital loans, totaling almost \$55 million, for fiscal year 1995. SBA expects an even greater use of the program than GAO estimates.

Because Congress is assessing the need for continued funding of federal loan guarantee programs, GAO identified four possible approaches to help reduce the potential adverse impact of decreasing the funds available for EWCP. These options included (1) lowering the guarantee coverage, (2) increasing guarantee fees, (3) leveraging resources by using its funding as an incentive to create new state export financing opportunities, and (4) consolidating SBA's EWCP into the Eximbank's Working Capital Guarantee program.



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the Small Business Administration (SBA) and its efforts to meet the export finance needs of smaller businesses while adjusting its operations to the possibility of reduced federal funding levels.

My testimony will address exporter and Trade Promotion and Coordinating Committee (TPCC)¹ concerns regarding the limited extent of export financing available to small- and medium-sized businesses and how SBA has responded to this issue. It will focus on SBA's Export Working Capital Program² (formerly known as the Export Revolving Line of Credit program), highlighting the past use of the program, key improvements made to the program, projected current use of the program, and options to help minimize the negative impact on the program's goal of expanding exports caused by a reduction in the credit subsidy appropriation.

My remarks today are based on our reports issued in the past few years covering various aspects of SBA's export promotion and export finance programs. They also draw upon observations made during an ongoing assignment that focuses on implementing the TPCC concept of one-stop shops, or U.S. Export Assistance Centers (USEAC).

LIMITED EXPORT FINANCING

Following a debt crisis in developing countries during the early 1980s, U.S. banks sought to reduce their international debt by limiting their participation in the trade finance area. The TPCC Working Group on Trade Finance observed in a 1991 study that the availability of private trade finance fell well short of demand.

According to a 1993 TPCC report,³ U.S. exporters maintained that one of the greatest obstacles to increased U.S. exports is inadequate working capital financing to support a company's desire to begin exporting. It also noted that small-, medium-sized, and inexperienced exporters tended to rely on banks for external debt financing to a greater extent than large businesses. The TPCC report states that commercial lenders generally were unwilling to offer export finance services of the type that was most frequently

¹TPCC is an interagency group responsible for developing and coordinating U.S. export promotion programs.

²SBA's Export Working Capital Program (EWCP) seeks to expand U.S. exports by encouraging lenders to make working capital loans to U.S. companies for export-related production and marketing activities. Exporters must be domiciled in the United States, although businesses owned by foreign nationals or foreign entities may be eligible for the program.

³Toward a National Export Strategy, Trade Promotion Coordinating Committee (Washington, D.C.: Sept. 30, 1993).

sought by these exporters: pre-export, transaction-oriented financing (i.e., export working capital loans) for relatively small amounts. Lenders viewed this type of financing as too risky, labor intensive, and less profitable than other financial services. To persuade lenders to provide working capital loans to small- and medium-sized exporters, SBA, the U.S. Export-Import Bank (Eximbank), and various states have developed working capital guarantee programs. SBA developed its program pursuant to the Small Business Export Expansion Act of 1980 (P.L. 96-481, Oct. 21, 1980) to provide repayment guarantees to eligible lenders for secured loans that would not be made commercially without SBA's guarantee.

EWCP falls within the statutory authority of SBA's regular business loan program, known as the 7(a) program.⁴ There is no statutory limit on the proportion of 7(a) guarantees that may be EWCP guarantees. During fiscal year 1995 (through August 25, 1995), EWCP loans represented less than 1 percent of SBA's total 7(a) loan guarantee approvals.

LIMITED PAST USE OF SBA'S EWCP

As we reported in September 1992,⁵ historically, SBA's working capital program has been little utilized. Since 1980, when the program was first introduced, until 1990, there was little use of the program. Between fiscal years 1983 and 1990, SBA's export finance program approved 161 loan guarantees, which covered about \$45 million in loans. We also reported that the principal reasons for this low level of use included (1) insufficient training of the SBA loan officers in the techniques of applying the program, (2) inadequate marketing of the program to banks and the small business community, and (3) little interest in the program on the part of lenders due to the small average size of the loans and associated small profits likely to be realized.

In our 1992 report, we noted that SBA had recognized these and other program deficiencies and had made efforts to revise key features of the program. For example, SBA extended the maximum term of the loan guarantees from 18 months to 3 years. It also rewrote the guide that SBA staff, participating lenders, and small business exporters use for program applications. In fiscal year 1991 alone, SBA approved about \$26 million in guarantees under the

⁴This program is named after section 207(a) of the Small Business Act of 1953 (P.L. 163, July 30, 1953), which authorized it. Under the 7(a) program, SBA is to provide direct loans, or guarantee private lender loans to new or ongoing small businesses that have been unable to obtain other financing.

⁵See Export Promotion: Problems in the Small Business Administration's Programs (GAO/GGD-92-77, Sept. 2, 1992).

working capital program, more than one-half as much as had been approved during the previous 8 years of the program's existence. At the time, we reported that this heightened program activity reflected SBA's program improvements and that it suggested that a substantial unmet demand for the program had existed before the program revisions.

During an ongoing review, we have observed that the level of export working capital guarantees remained stable from fiscal year 1991 to fiscal year 1994. During this 4-year period, the annual number and value of working capital loans that SBA guaranteed averaged 80 loans per year covering about \$28 million in loans. The average export working capital guarantee was about \$350,000.

IMPROVEMENTS TO SBA'S EWCP

In October 1992, Congress passed legislation to address problems related to a federal export promotion effort that was fragmented among 10 agencies and lacked any governmentwide strategy or priorities. Title II of the Export Enhancement Act of 1992 (P.L. 102-429, Oct. 21, 1992) created an interagency mechanism through which the administration, working closely with Congress, might rationalize and strengthen federal export promotion efforts. This legislation codified the interagency TPCC and tasked it to issue a report by September 1993 containing a "governmentwide strategic plan for federal trade promotion efforts" and describing its implementation.

In its 1993 report⁶ TPCC recommended, among other things, that the federal government

- streamline the pre-export working capital guarantee programs of Eximbank and SBA to make the programs more customer focused and to take advantage of the agencies' comparative strengths,
- establish one-stop shops to provide local export communities a single point of contact for all federal export promotion and finance programs, and
- encourage qualified state/local export finance entities to enter into cofinancing arrangements in which risk is shared.

A high-level SBA official has stated that SBA fully supported the goals of the TPCC report, noting that the agency could play a vital role in achieving the TPCC goals, particularly as they related to small business. To this end, SBA has made diverse efforts to revitalize its EWCP and to increase the level of export financing that it supports.

In our ongoing work, we have discussed with SBA officials their

⁶Toward a National Export Strategy.

efforts to revitalize EWCP. SBA has implemented many internal changes aimed at improving the EWCP's ability to facilitate more working capital loans. SBA issued comprehensive operating guidelines for administering EWCP, provided basic export finance training to almost 300 of its staff and resource partners (e.g., Small Business Development Center staff) developed more in-depth training on transaction lending⁷ for its trade finance specialists, and established specific EWCP goals for each of its 68 district offices.

In addition, SBA has made efforts to actively respond to each of the three TPCC recommendations previously noted.

SBA Has Made Efforts to Harmonize with Eximbank

The Eximbank and SBA have been working together to streamline and harmonize their working capital programs. Accordingly, they have standardized many features of their programs,⁸ including the application form, the initial application fee, the guarantee coverage, and the types of transactions covered.

Exporters may now use the same form when applying for either an Eximbank or SBA working capital loan. Although the size of the guarantee fees they charge vary, the initial application fee for either an Eximbank or an SBA guarantee is to be \$100. To standardize guarantee coverage, the Eximbank reduced its coverage from 100 percent of principal and interest to 90 percent, and SBA raised its 85-percent guarantee to 90 percent. Funds guaranteed under either agency's program may be used to support single transactions or multiple export transactions. Similarly, they may be used to acquire inventory and pay for direct manufacturing costs, or to purchase goods and services.

By agreement, SBA is generally to assist small companies that need a loan of \$833,333 or less (resulting in an SBA guarantee of \$750,000 or less), and the Eximbank is generally to serve companies that have credit needs above that amount.

SBA Has Supported One-stop Shops

In 1993, TPCC recommended the creation of four pilot USEACs. These one-stop shops were designed to test the feasibility and effectiveness of providing a single point of contact for the

⁷Transaction lending means financing to support specific transactions that, in most cases, are self-liquidating, as compared to SBA's more traditional asset-based financing in which SBA may provide loan guarantees to purchase equipment. That equipment is, in turn, used as collateral for the guaranteed loan.

⁸Effective October 1994.

fragmented federal export promotion and financing program. Specifically, TPCC intended for USEACs to more effectively integrate the trade network of the Department of Commerce, the export finance expertise and resources of the Eximbank, and the small business contacts and local presence of SBA into a seamless one-stop shop for export-ready firms.

Viewing the USEAC network as a key component for delivering and administering EWCP, SBA has taken an active role to support the centers. It assigned 11 staff to the four pilot USEACs and assumed the lead as site coordinator of the Long Beach, California, USEAC. While SBA officials noted that the implementation of the USEAC pilot was in some ways flawed (e.g., lacking unified goals), they viewed the centers as the best means of administering EWCP. As such, when TPCC later announced the planned openings of an additional 11 USEACs by the end of 1995,⁹ SBA established 11 new trade finance specialist positions to staff them.

Trade finance specialists assigned to USEACs are expected to spend 100 percent of their time administering and promoting SBA's working capital program. They are to guide borrowers in the EWCP application process and provide review and first approval¹⁰ of the working capital guarantees. They are also to spend a portion of their time networking with and recruiting local banks to participate in SBA's Preferred Lender Program.¹¹ To ensure that they are properly motivated, SBA has established EWCP goals for trade finance specialists it has assigned to each of the centers. For example, SBA staff located at the Long Beach USEAC have a goal of completing 22 working capital guarantees for the current fiscal year.

SBA Has Established Cofinancing Agreements

Recognizing that states such as California have specialized experience in export lending, SBA entered into a coguarantee agreement with the California Export Finance Office (CEFO) in January 1994. This interagency agreement provided a 50/50 matching guarantee for 90 percent of the principal of requested working

⁹As of August 1995, 5 of the additionally planned 11 USEACs had been opened.

¹⁰SBA requires that all loans be reviewed and approved by two different loan specialists. With the exception of the Long Beach USEAC, which has ability to complete both financial reviews in-house, USEACs are to send their EWCP loan packages to an SBA district office for the second approval.

¹¹Under the Preferred Lender Program, a lender and SBA enter into an agreement that allows the lender to approve loans and receive a guarantee from SBA without obtaining prior SBA approval.

capital loans. Guarantees under this agreement were not to exceed \$1.5 million,¹² or up to \$750,000 per agency per guarantee.

According to the Director of CEFO, the state conducts its loan analyses and completes its forms as usual, then sends the loan guarantee package to SBA trade finance specialists located at the Long Beach USEAC for approval. The loan package is also given to an SBA district office attorney for legal review and approval.

Despite some duplication in the review process by SBA and CEFO, the cofinancing arrangement represents an example of a cooperative agreement that can be mutually beneficial. This arrangement allows CEFO to benefit from having access to guarantee funds from SBA that are in addition to CEFO's own funds. Also, CEFO may now be able to support the larger transaction needs of small- and medium-sized exporters. In the meantime, SBA may capitalize on CEFO's extensive export finance expertise and reach out to a greater number of small- and medium-sized exporters.

Since January 1994, SBA and CEFO have coguaranteed 11 loans, totaling \$8.3 million. While on the surface the number of loans appears low, both federal and state officials view the agreement as a success. The Director of CEFO viewed the coguarantee agreement as a success, noting the state's added ability to grant more guarantees by tapping into federal resources. SBA officials also considered the agency's coguarantee agreement with CEFO to be a success and stated that SBA has recently established similar arrangements with Kansas and Florida. They also noted that SBA planned to further expand the coguarantee program to include other states that have expressed an interest in the program and have developed an effective export finance program.

FISCAL YEAR 1995 PROJECTIONS
INDICATE EXPANDED PROGRAM USE

Although it is still premature to assess the full effects of the Eximbank's and SBA's harmonization efforts as well as other internal changes made by SBA, initial results indicate a greater use of EWCP. An SBA official suggested that the agency will guarantee about 240 loans by the end of the fiscal year--over three times as many loans as those guaranteed during the prior fiscal year. This estimate was calculated by adding the number of preliminary commitments and the number of applications (i.e., pending approval, in process, or newly submitted) outstanding to the actual number of approved guarantees.

However, our projection, based on a straight extrapolation of 11 months of actual data, estimates that SBA will guarantee about 164 working capital loans, totaling almost \$55 million, for fiscal year

¹²Loans under this agreement were not to exceed \$1.67 million.

1995. Although this projection is lower than SBA's, it represents a marked increase from the prior years, double the number of loans guaranteed by SBA during fiscal year 1994.

While the volume of loans has increased during the past fiscal year, we believe it is still too early to judge SBA's efforts to restructure and improve EWCP as well as the overall effectiveness of the program. Information on the extent of defaults that may be associated with these loans is still limited. Also, an SBA official pointed out that the agency's ability to fully implement its EWCP delivery system was based on the implementation of the USEAC network which, at the time, was still scheduled to open another six centers before the end of the calendar year.

OPTIONS TO HELP REDUCE THE ADVERSE
IMPACT OF A DECREASED CREDIT SUBSIDY

In the current budget environment, Congress is carefully assessing the need for continued funding for all federal programs, including federal credit programs. The assessment of credit programs includes various SBA-administered programs such as EWCP. We understand that reducing the agency's overall credit subsidy program for the 7(a) program is currently under consideration, and I will discuss four suggested approaches we identified to help reduce the potential adverse impact of lower federal funding on the program's goal of increased exports: (1) lowering the guarantee coverage, (2) increasing the fees charged, (3) better leveraging of resources, and (4) consolidating SBA's EWCP into the Eximbank's programs.

- **Lowering the guarantee coverage.** The first approach involves lowering SBA's guarantee coverage to about 70 to 75 percent to help decrease the credit subsidy cost of any given loan receiving an SBA guarantee. This approach would permit a larger number of guarantees to be made than otherwise would be the case with the reduced appropriation, if lending banks are willing to assume the additional risk and exporters are willing to pay potentially higher rates. This approach may work for SBA's overall 7(a) program for which a large number of banks participate. However, this approach may have a negative impact on SBA's EWCP, which does not have the benefit of as extensive a pool of banks to finance export loans as is available to its domestic programs. Reducing the guarantee coverage would create greater risk for participating lending institutions, thereby making these export finance loans less attractive to them. This, in turn, could further diminish the already limited pool of banks willing to engage in providing export working capital loans to small companies. Thus, the actual result of reducing the guarantee coverage could be a decrease in the use of EWCP beyond what would happen from just cutting the current subsidy appropriation.

Also, effective this fiscal year, SBA increased its guarantee coverage for export working capital loans from 85 percent to 90 percent to be consistent with the Eximbank's level of coverage. Decreasing the guarantee coverage would run counter to this congressionally approved harmonization effort and to other efforts designed to encourage greater private sector participation in export financing.

- **Increasing the fees charged.** Additional revenues realized through increased fees lower the credit subsidy cost of making loans. SBA guarantee fees have remained stable at 0.25 percent per year of the guaranteed amount¹³ and consistent with similar guarantees offered through its other programs. This fee was not made directly consistent with the Eximbank as part of the harmonization effort; under the Eximbank's Delegated Authority Program,¹⁴ the guarantee fee is 0.75 percent per annum of the loan amount for loans that do not exceed \$833,333 and mature in 6 months or less.¹⁵

According to SBA officials, the agency has chosen to keep fees at the current level to better service the small business community and to help keep export financing accessible to them. They acknowledged, however, that given the current budgetary environment, it may be time to consider increasing the fees charged. Keeping fees reasonable so as not to drive small businesses away from exporting will continue to be an important SBA consideration. One official suggested that standardizing fees with state programs, such as CEFO, that focus on smaller businesses as does SBA may be more appropriate. CEFO currently requires a 0.50 percent facility fee on the amount of the guarantee.

- **Better leveraging of resources.** SBA has already started to engage in leveraging strategies involving cooperative agreements with state entities, such as CEFO, and with private banks through its Preferred Lender Program. SBA may be able to further leverage its resources by using its funding as an incentive to create new state export financing initiatives or to enhance existing ones.

¹³The SBA fee is 0.25 percent of the guaranteed amount for loans that are 12 months or less. For loans that are guaranteed longer than 12 months, the fee is 2 percent of the guaranteed amount.

¹⁴Under the Eximbank's Delegated Authority Program, a lender and the Eximbank can enter into an agreement that allows the lender to approve loans and receive a guarantee from the Eximbank without having to submit individual applications to the Eximbank for approval.

¹⁵For loans that do not exceed \$833,333 and mature in 7 to 12 months, the fee is 1.5 percent per annum of the loan amount.

SBA could be a catalyst for change if some of its funds are provided as an incentive for states to increase their funding of export finance programs and if states choose to take advantage of such an incentive. In using SBA resources to provide matching federal funds, limited federal funding can be used as an inducement for states to assume a greater role in providing export finance assistance to small businesses.

SBA could provide states that do not have export working capital guarantee programs with matching funds to encourage them to establish such programs. For states with existing programs, SBA could match additional state dollars with federal dollars as long as the states are willing to increase their appropriation for working capital guarantees. For example, if a state currently appropriates \$10 million for export financing guarantees and increases its appropriation by an additional \$5 million knowing that SBA would match it with \$5 million in federal funds, this would result in \$20 million in total available guarantees rather than \$15 million--\$10 million from the state and \$5 million from SBA. In this way, additional state funds would be made available to provide more export financing assistance to small businesses in general and could help minimize the adverse impact of a reduced SBA credit subsidy.

-- **Consolidating SBA's EWCP into the Eximbank's programs.** In recommending that harmonization efforts be evaluated by the two agencies 1 year after their effective date (October 1994), it appears that TPCC may have recognized the potential inefficiencies of continuing both SBA and Eximbank involvement in providing export working capital assistance to small- and medium-sized exporters. Specifically, TPCC suggested that if harmonization efforts were deemed to be unsatisfactory, SBA's working capital program should be consolidated into the Eximbank's Working Capital Guarantee Program.

Despite this directive, TPCC has a limited basis for assessing the effectiveness of either agency's program. As of July 1995, criteria for making this assessment had not yet been developed, and, in the absence of such criteria, it is not clear how this assessment could be made. Among other considerations, such an assessment might be based on the amount of use each program has generated, the default rates encountered, the cost-effectiveness of each program, and the efficiency of the programs. According to a TPCC official, the SBA and Eximbank are currently developing the evaluation criteria with an overall assessment projected to be completed by December.

Consolidating the two programs may go further towards decreasing the possibility of overlapping responsibilities or duplicating operations than harmonization. It may also result in less confusion on behalf of small- or medium-sized exporters, who would only have to deal with one federal agency for export financing.

However, consolidating SBA's EWCP into the Eximbank's program would also present other issues for consideration. These issues include

- the extent to which banks participating in the Eximbank's Delegated Authority Program would be willing to meet the finance needs of smaller companies by providing export working capital loans that may be less than \$833,333 and
- the amount of budgetary authority that would need to be transferred, given the recent increase in use of SBA's EWCP.

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Mr. Chairman, this concludes my prepared statement. I would be pleased to try to answer any questions you or the Subcommittee may have.

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