NFIB
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CONNECTICUT

TESTIMONY OF
NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)
BY
ANDY MARKOWSKI, CONNECTICUT STATE DIRECTOR
REGARDING
SB-1, AN ACT CONCERNING THE PRESERVATION AND CREATION OF JOBS IN CONNECTICUT
BEFORE THE
FINANCE, REVENUE & BONDING COMMITTEE
MARCH 1, 2010

A non-profit, non-partisan organization founded in 1943, NFIB is Connecticut's and the nation's leading small-business association. In Connecticut, NFIB represents thousands of members and their employees and membership is scattered across the state and ranges from sophisticated high technology enterprises to single-person "Mom & Pop" shops that operate in traditional ways. NFIB's mission is "*To promote and protect the right of its members to own, operate, and grow their businesses.*" On behalf of those small- and independent-job-providers in Connecticut, I thank the Committee for raising and hearing Senate Bill 1 and I offer the following comments:

NFIB/Connecticut supports the general concepts behind this bill as an attempt to assist struggling small businesses. We applaud the proponents' desires to help small businesses and the recognition that small businesses and entrepreneurs are indeed the engine that drives the state's economy. As state lawmakers work towards solutions to help turn the economy around and focus on helping small businesses, whether through this bill or other pending legislation, it should be noted that in addition to what many think of as a traditional small business, it's actually the "midsize" small and independent businesses that will lead us out of the recession (See attached Hartford Courant article).

SB-1 is certainly well-intentioned, however, NFIB/Connecticut members suggest that there are numerous additional and perhaps even more impactful measures that state government can take that will help small business, including, but not limited to: 1) Demonstrating fiscal responsibility and reducing state government spending; 2) Refraining from adding any more government mandates on business, small and large alike; 3) Ensuring that workplace freedom continues to thrive; 4) Enacting responsible reforms to the state's unemployment insurance compensation system to prevent or mitigate tax increases as result of the fund's insolvency; 5) Reducing the regulatory burden on small businesses in the state; 6) Focusing on positive healthcare reform measures that reduce costs and increase choice and competition; 7) Enacting *meaningful* tax relief for small businesses.

<u>Section 1: Temporary suspension of business entity tax for qualifying entities</u>

When the business entity tax was adopted in 2002, it was widely promoted as a short-term fix to a looming state budget deficit. Eight years later, despite enjoying record state budget surpluses, a robust budget reserve fund, and seemingly broad bi-partisan support for full repeal in the interim, this nuisance tax still exists. Small businesses, like many others, are facing difficult economic times and need a boost. Small businesses contribute an estimated 80% of new jobs to the state's economy, but unfortunately, this tax sends our small businesses the wrong message.

While $250 may not sound like a lot, this is a tax that disproportionately impacts small businesses. For a small business, that $250 could pay for an electric bill for a month, advertising or marketing costs or the cost to attend a trade show. To many small business owners, this tax represents one more form, one more tax and one more headache to owning and growing a small business in this state. Limited Liability Companies and other small business entities already pay a significant amount of taxes because they are subject to state and federal income taxes on any net income generated by the company as well as sales taxes, property taxes, licensing fees and registrations. For many small businesses, especially in these difficult economic times, the business entity tax is the straw that breaks the camel's back.

Permanently repealing, not merely temporarily suspending for only some entities, this nuisance tax on small businesses would be a step in the right direction towards improving small business confidence in state government and it would spotlight the state's commitment to small business growth. Completely eliminating the business entity tax is an important first step to improving the business climate for Connecticut's small businesses.

<u>Sections 2 & 3: Surcharge on TARP bonuses as a funding mechanism</u>

While NFIB/Connecticut members, like many American taxpayers, are concerned about the bonuses paid out by TARP recipient entities, small businesses can and do benefit from the economic activity generated from bonus recipients. It is not necessarily a bad thing in this economy for people to have additional money in their pocket, so-to-speak, to spend and invest in their communities. Bonus recipients spend money in local restaurants and retail establishments. They hire local contractors to landscape or remodel their homes. They patronize professional service firms, etc. Punishing those individuals who have rightfully earned bonuses from their employers sets bad precedent for all employees, including those who work for small businesses, and sends an economic chill through the state.

Section 4: Establishment of a state run small business loan and loan guarantee fund

This section of the bill is certainly well intentioned and NFIB/Connecticut applauds the proponents for taking this initiative. Small businesses are concerned, however, that proposals such as this sometimes miss the mark and are often widely regarded as some type of "silver bullet" solution to what is a very complex problem. A survey released last Tuesday by the NFIB Research Foundation titled "Small Business Credit In A Deep Recession" (Executive Summary Attached), found that *51 percent of small-business owners reported a lack of sales as their greatest challenge. Only 8 percent cited a lack of loans. Many small-business owners say they're still grappling with a more basic problem: They don't have enough customers.*

Additionally, the problem is even more complex. The drop in home prices has made it harder for many small-business owners to qualify for loans because they can no longer pledge their homes as collateral, an extremely common approach for many small businesses.

The survey's findings show that while obtaining credit has become more difficult, declining sales and/or depressed real estate values typically lie at the base of credit problems. That means current small business problems will not be solved by simply focusing on lending issues. Lawmakers need to tackle weak demand and real estate.

Tackling weak demand requires growth in the economy and a stable state legislative environment in which small business owners can enjoy some sense of certainty without fear of the next mandate or tax hike. More liquidity in financial markets won't necessarily solve the problem. Weak demand will also not be cured by government spending initiatives.

Section 5: State bond issuance for small business assistance

Connecticut has one of the highest indebtedness in the country. Unfortunately, because revenues continue to drop, our percentage of debt in relation to how it funds the overall budget has increased. Recently, proposed bond projects have been canceled in order to comply with state law and prevent an even further downgrade of our bond rating. State government should follow the lead of many small business owners and should only be borrowing what it can afford to pay back.

In the past year, the small business optimism index hit the second lowest reading in the 35-year history of the NFIB Small Business Economic Trends survey. Small businesses in Connecticut are especially concerned about the impact of long-term state budget deficits, record state spending levels, and total bond indebtedness. Small business has led the Connecticut and the nation out of past recessions and is ready to lead the economic recovery again, but economic growth will be stalled if the General Assembly continues unchecked spending while increasing taxes and placing new mandates on Connecticut's job creators. Again, NFIB/Connecticut cautions that weak demand will not be cured by government spending or bonding initiatives, even if those initiatives are well-intentioned gestures aiming to help small business.

NFIB/Connecticut thanks the Committee for consideration of our comments.

Executive Summary

- Many policymakers misidentify the fundamental bases of small business problems, leading to promotion of faulty policy. The principal immediate economic problem for 51 percent of small employers remains slow or declining sales, six percentage points more citing the problem than one year ago. Uncertainty was identified by over one-fifth (22%) as theirs, followed by access to credit (8%) and falling real estate values (8%), virtually the same as last year. Even among owners who report they cannot get credit, twice as many cite poor sales as cite credit access.

- The percentage of small business owners holding a business loan or credit line each fell almost 20 percent in the last year, though the number of loans and lines outstanding per owner with at least one loan or line remained almost constant. The percentage holding a business credit card(s) fell by about 10 percent. Sixty-two (62) percent pay off their card balances monthly, leaving 38 percent using business cards as a source of credit.

- The financial institution extending a line of credit changed the terms/conditions of the line(s) during 2009 for 29 percent of small employers having at least one. About 10 percent with a business loan had the same experience as did 22 percent with a business credit card. The most frequent change was increased interest rates.

- Fifty-five (55) percent of small employers attempted to borrow in 2009; 45 percent did not, although five percent of owners, so-called discouraged borrowers, did not try because they did not think they could obtain credit.

- Forty (40) percent of small business owners attempting to borrow in 2009 had all of their credit needs met; 10 percent had most of their needs met; 21 percent had some of their needs met; and, 23 percent had none of their credit needs met. The current level of borrowing success is significantly lower than in the mid-2000s when up to 90 percent had their most recent credit request approved.

- In 2009, about 20 percent of small employers attempted to obtain each of the following types of credit: vendor loans, credit lines, renewal of credit lines, business loans, and business credit cards. The least difficult to obtain was a credit card (73% successful); the most difficult was a new line of credit (38% successful).

- The best predictors of success in meeting credit needs were: higher credit scores, customers of banks with less than $100 billion in assets, more properties collateralized for business purposes, and fewer second mortgages held. Owners of larger small firms, older businesses, and businesses located in states with relatively few home foreclosures are also frequently good predictors of success in obtaining certain types of credit.

- Overwhelmingly, the most common planned purpose of credit rejected was to fill cash flow needs. Though many prospective borrowers had multiple planned purposes for rejected credit, about one in three sought at least some money to replace plant, equipment and vehicles with a non-mutually exclusive third intending to invest in additional plant, etc.

- Falling real estate values (residential and commercial) severely limit small business owner capacity to borrow and strains currently outstanding credit relationships. Ninety-five (95) percent of small employers own real estate, including a primary residence, the business premises (commercial), or investment real estate that is neither of the two. Twenty (20) percent hold one or more mortgages on real estate that finances other business assets and 11 percent use real estate as collateral for business purposes. A non-mutually exclusive 20 percent hold a second mortgage on a property. Thirteen (13) percent report at least one property upside down.

- Broad and deep real estate ownership is a major reason why small businesses have not yet begun to recover, why larger businesses have been able to recover more quickly than small businesses, and why this recession is different, at least for small business owners, from recent ones.

www.courant.com/business/hc-creditsidebar.artfeb14,0,1690438.story

ECONOMY

Midsize Companies Key To Economic Recovery

By MARA LEE

The Hartford Courant

February 14, 2010

Small businesses will be the first to chip away at high unemployment.

But it won't be at the mom-and-pop shops or other under-10-employee businesses, no matter politicians' fondness for photo ops there.

It's companies with millions in revenue, with 50 to 499 employees, that are the economic engine of recovery.

In January, a nationwide payroll survey showed companies with more than 500 workers cut 19,000 jobs. Businesses with fewer than 50 workers cut 12,000 jobs. Only those with 50 to 499 workers hired more than they laid off, and they hired 9,000 people.

Those companies in the middle — still small enough to qualify for federal loan guarantees to small business — have usually been considered attractive to banks. But as the Great Recession took hold, that changed.

With policymakers focused on them, the definition of what is a small business matters all the more. And it may surprise many people who think of a small business as an independent shop, a start-up firm or a couple of accountants in a second-story office.

The U.S. Small Business Administration defines "small" differently depending on the industry. Construction contractors, for example, can have sales of up to $14 million a year. Manufacturers can have as many as 500 employees. A department store can have sales of $27 million.

In good times, it was start-ups and micro- businesses that came to Donna Wertenbach, CEO of Community Economic Development Fund. The fund, which made more than $4 million in loans in 2009, is a Meriden nonprofit that lends to low- and moderate- income entrepreneurs, as well as small businesses in distressed towns and cities.

"The purpose of CEDF is to serve small businesses who cannot get credit from banks," she said.

In 2009, Wertenbach suddenly saw an influx of larger small businesses. The banks that fund her agency called her last year, saying they weren't willing or able to help those firms as their sales plummeted. They'd say, Werternbach recounted, "Can you catch them, stabilize them?"

Wertenbach, whose agency has a higher risk tolerance than banks, said there were "hundreds and hundreds and hundreds" of businesses like this in Connecticut in 2009, whose credit lines were pulled, whose credit card limits were cut, or whose credit card rates were jacked up, and, with revenues dropping, they couldn't make payroll.

"I had the saddest conversations with people," she said.

But most of the time, she couldn't help them.