Is an SBIC right for you?

By David Ryan, Upton Financial Group, Inc.

Whether a business owner wants to acquire for growth or sell the company, a well-structured financial balance will be an important element in their success. So how can a business prepare for such opportunities?

Many business owners are aware of the Small Business Administration (SBA) loan programs in which local banks participate. Most are not aware, however, of the SBA's Small Business Investment Company (SBIC) Program. The SBIC program was created to help fill the gap between the availability of growth capital and the needs of small businesses. The SBA will grant an SBIC license and supplement capital raised from private investors with access to low-cost, government guaranteed non-recourse debt. The fund will generally be able to borrow two dollars for every dollar the fund has contributed from the SBA under the SBIC program. The SBA does not invest directly in small businesses; instead they rely on the licensed SBIC funds. These licensees are assessed by the SBA to ensure that they have the appropriate expertise and experience needed to make appropriate investments in qualified small businesses. An SBIC program is sometimes referred to as a public-private investment partnership since a licensee has their own money at risk in addition to the funds borrowed from the SBA.

With these two sources of capital, SBICs search across the United States for promising businesses in need of debt or equity financing. SBICs are similar to other investment funds in terms of how they operate and their pursuit of high returns. Unlike other funds, however, SBICs limit their investments to qualified "small" businesses as defined by SBA regulations: businesses with tangible net worth of less than $18 million and less than $6 million in net income over the previous two years at the time of investment. According to the SBA, Apple Computer, Whole Foods Market, Staples, Quiznos and Federal Express are just a few businesses to take advantage of early SBIC funding.

Since the program's inception in 1958, SBICs have been supplying equity capital, long-term loans and management assistance to qualifying small businesses. The SBIC program is a multi-billion dollar, government-sponsored investment fund created to bridge the gap between entrepreneurs' need for capital and traditional sources of financing. These funds will invest in businesses using loans or debt with equity features, or will make equity investments. The SBA does, however, put a number of restrictions on SBICs. SBICs are not allowed, for example, to grant loans related to a specific project (such as a large construction job), nor can they invest in real estate or any projects related to financing (such as banking). SBICs are also prohibited from investing in companies with more than 49 percent of their employees located outside the United States.

Since its establishment, the SBIC program has provided almost $60 billion of long-term debt and equity capital to more than 107,000 small U.S. companies. In 2010, $2.05 billion was invested in a total of 1,331 small U.S. companies (for an average of about $1.5 million per company) and in 2011, $2.83 billion was invested in 1,339 businesses (average of about $2.1 million per company). The current trend seems to indicate that SBIC funds are looking to advance $2.5 to 3 million or more, which could include a combination of management buyout, growth capital, and even restructuring the current balance sheet debt. [gl1]

In my experience, SBIC funds have most commonly been used for funding transfers of ownership through management buyouts, acquisition financing, or retirement of non-active owners. Funds can also be utilized as growth capital, with many SBICs still providing early-stage venture capital. The SBA website (sba.gov) offers a full listing of the country's SBICs, as well as their lending preferences and loan size. An additional resource for information on SBICs can be found through the Small Business Investor Alliance (www.sbia.org).

With approximately 338 SBICs and $17.4 billion in capital, this type of funding is a route that every small business owner and their advisors should explore when planning for additional growth capital, management buyout, acquisition, or recapitalization.

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