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Small businesses feeling credit crunch

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(01-21) 10:43 PST -- In the past two years, business partners Anamika Khanna and Tim Volkema have taken out \$700,000 in loans guaranteed by the Small Business Administration, matched this with \$300,000 of their own assets and opened two restaurants that now employ 30 people.

At their first Kasa Indian Eatery in San Francisco's Castro neighborhood, Khanna, a former attorney, reflected on how differently she feels in her current role as executive chef.

"When you work for someone else it feels like the economy is something that happens to you," said Khanna, whose husband, Suresh, is a Google executive and silent partner in the enterprise. "This way I feel like I am influencing my surroundings, not just with the people we employ but with our vendors."

Small firms, defined as those with fewer than 500 employees, created about 14.5 million jobs from 1993 through 2008, or nearly two-thirds of the net payroll growth in the United States during that period, according to SBA research.

As the nation tries to recoup the 7 million jobs lost in this recession, the collective hiring power of small firms is a hoped-for engine of recovery.

But small-business groups say banks have cut lending to Main Street. With this in mind Congress last year sweetened a popular SBA loan guarantee program.

Among other things, lawmakers increased to 90 percent, from the prior 75 percent, the amount of the loan the government would guarantee. Congress also subsidized the fees, ranging from 2 percent to 3.5 percent, that borrowers had paid for this backing, which reduced lender risk and thus induced banks to lend to them.

With these extras due to phase out by the end of February, Congress is mulling whether to extend these stimulus measures until the end of September at a cost of about \$350 million - a move backers hail as a proven job creator but which critics lament as deficit spending for marginal loans.

For Khanna and Volkema the SBA guarantee, which was 75 percent for their first loan, was essential in persuading Katherine Zinsser, senior vice president at Bank of San Francisco, to take a risk on borrowers with great corporate credentials - Volkema, for instance, had been brand manager for Kraft Foods' Grey Poupon line - but had little restaurant experience.

By the time the partners were ready to open a second Eatery on San Francisco's Union Street, Zinsser said the risks were less because they had demonstrated a successful start at their first locale. The 90 percent guarantee then in effect made the decision easier for the bank while the fee waiver made the expansion less costly for the borrowers, she said.

Big SBA help

Volkema said access to SBA capital was essential to launching the second location last month. "The fastest way for a restaurant to add jobs is to open another one," he said.

Tony Wilkinson, president of the National Association of Government Guaranteed Lenders - the financial institutions that make SBA-backed loans - said conventional credit remains so tight that extending the 2009 enhancements is necessary.

"Small businesses can't create jobs without access to credit," he said.

But Veronique de Rugy, a research fellow at the free-market Mercatus Center at George Mason University, said SBA-backed loans account for less than 2 percent of small-business lending, making them irrelevant to the larger economy and a moral hazard insofar as the guarantees encourage lending to marginal borrowers.

"Even (President) Obama has said that the mentality of easy money is one of our problems, so how is more of what put us into this situation going to improve things?" she said.

In addition to extending last year's enhancements, Congress is considering boosting the current \$1.5 million limit that SBA can guarantee, said Scot Cunningham, a small-business lender at Mechanics Bank.

Depending on how high lawmakers make that limit - there is talk of a \$3 million to \$5 million cap - SBA-backed loans could become alternatives for Cryotech International, a San Jose firm that develops liquid nitrogen systems for a variety of industrial cooling.

Company President Gary Sandercock said when he established his \$2.7 million line of credit in 2007, five banks bid for his account, but his sales have slumped

during the recession, making his firm less attractive. Now he worries about getting the line renewed when it expires in April.

"The hype is that banks are helping small businesses, and I think that is a crock," he said.

Pendulum has swung

Drew White of the North Carolina firm Sageworks, which analyzes small-business data from thousands of firms nationwide, said the credit pendulum has swung from too easy to too tight.

"It may take short-term government action to fix an acute problem," White said, acknowledging that it can prove difficult to scale back programs before they become entitlements.