



# **Channeling Growth Capital to Small and Medium-Size Businesses**

**Global Conference 2010**

## **Channeling Growth Capital to Small and Medium-Size Businesses**

Wednesday, April 28, 2010; 6:30 - 7:45 AM

### **Moderator:**

Betsy Zeidman, Research Fellow and  
Director of the Center for Emerging Domestic Markets, Milken Institute

### **Speakers:**

John Bohn, Commissioner, California Public Utilities Commission

Wally Hunter, Managing Partner, EnerTech Capital Canada Ltd.

Rafael Pastor, Chairman and CEO, Vistage International

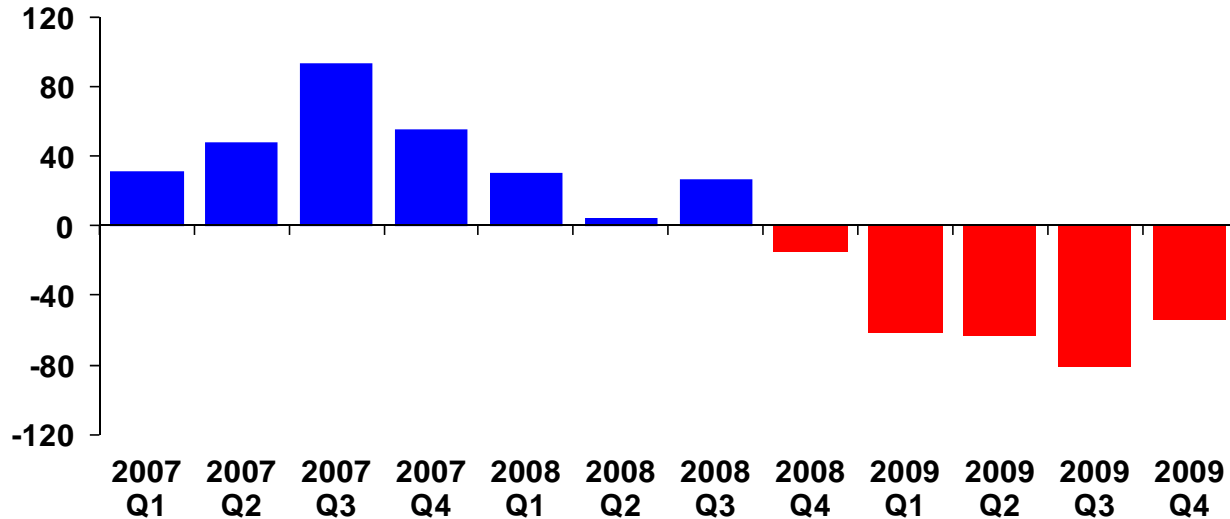
Stephen Watkins, Chairman and CEO, Entrex Inc.

# Industrial and commercial loans by all depository institutions declined in 2009



MILKEN INSTITUTE

Quarterly change, US\$ billions



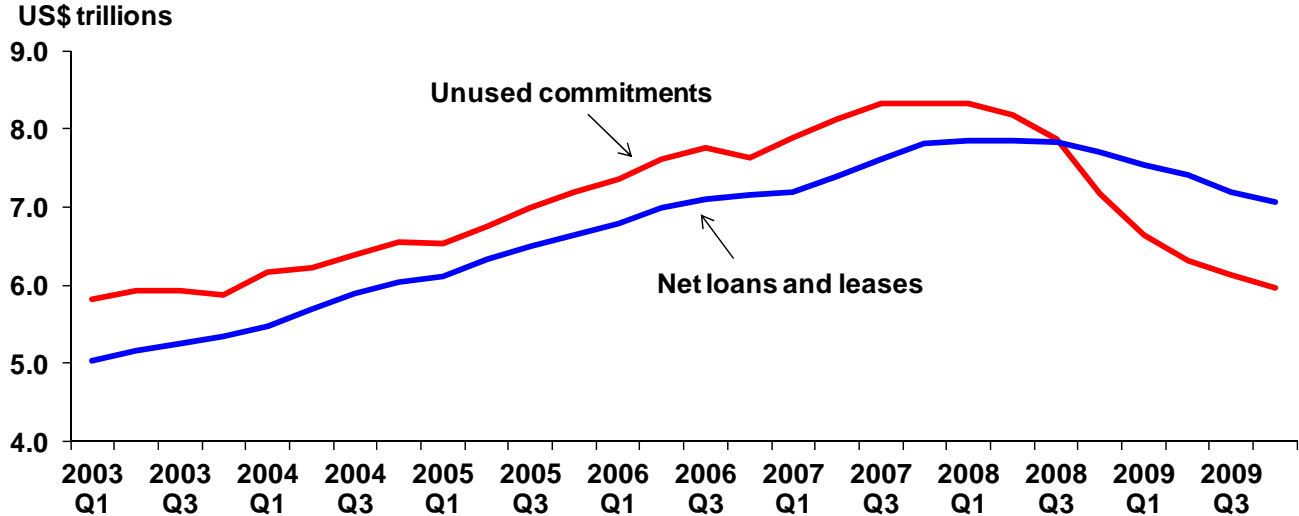
Source: FDIC.

# Bank lending continues to decline



MILKEN INSTITUTE

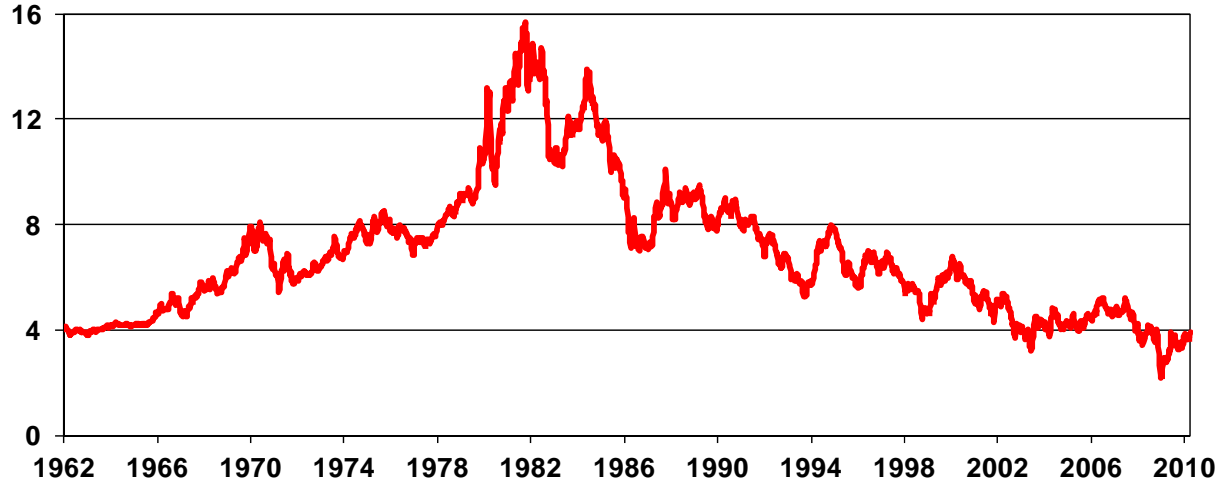
*Businesses and individuals draw upon existing credit lines*



Sources: FDIC, Milken Institute.

# Yield on the 10-year Treasury note is rebounding

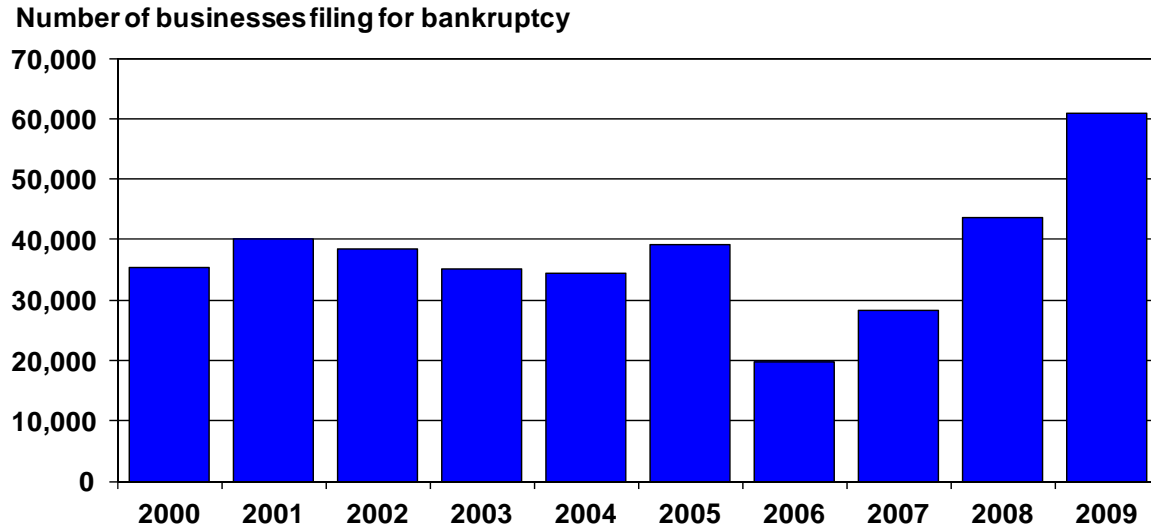
Yield on the 10-year Treasury note, percent



Source: Federal Reserve.



# More businesses in bankruptcy

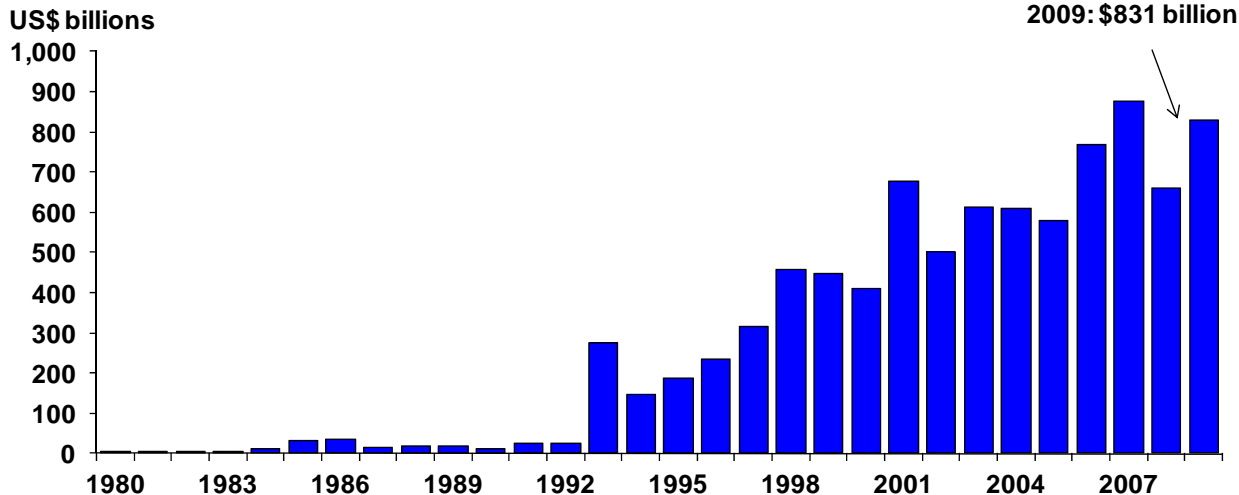


Source: U.S. Courts.

# U.S. companies raised \$831 billion from corporate bond issuance in 2009



MILKEN INSTITUTE



Source: Dealogic.

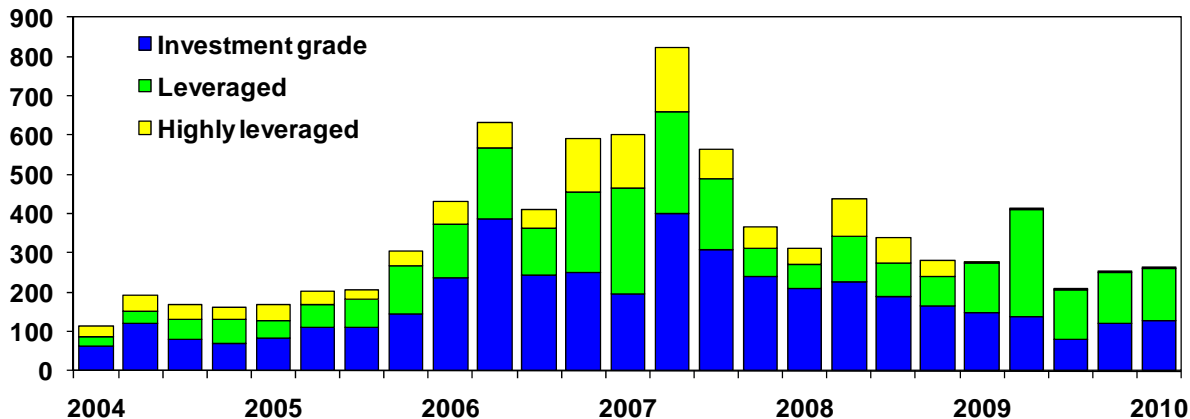
# Loan issuance in the United States

*Quarterly, Q1 2004 to Q1 2010*



MILKEN INSTITUTE

US\$ billions

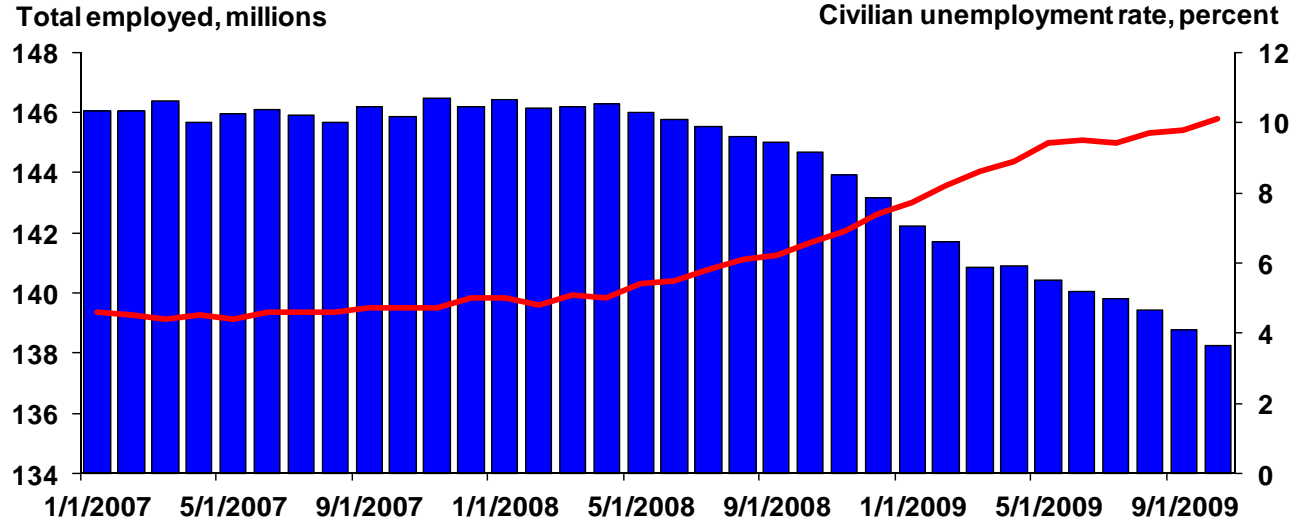


Source: Dealogic.





# Jobless recovery in the United States?

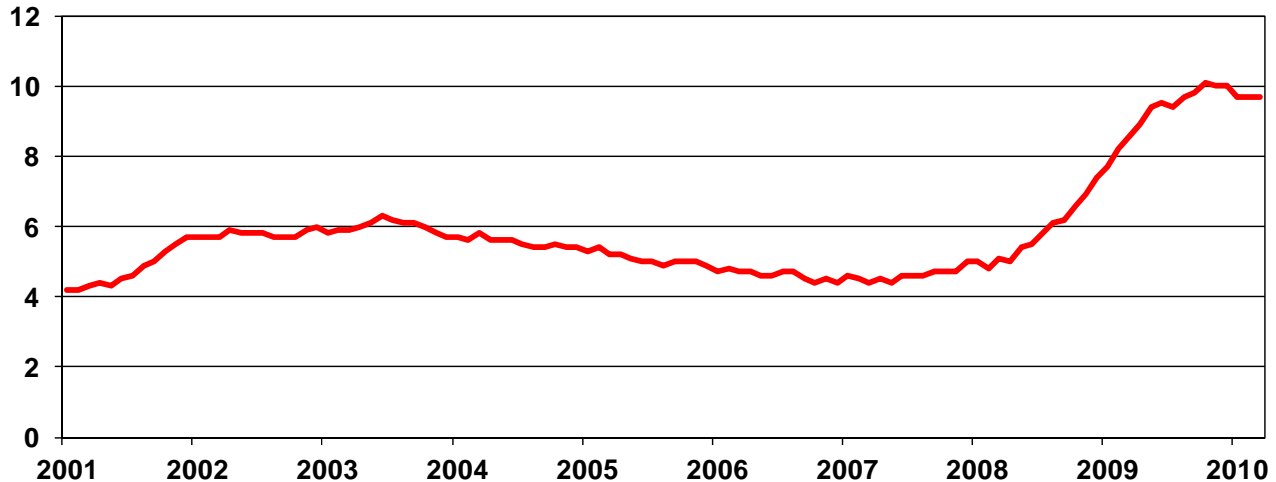


Source: Bureau of Labor Statistics.



# Unemployment rate still high

Unemployment rate, percent of labor force

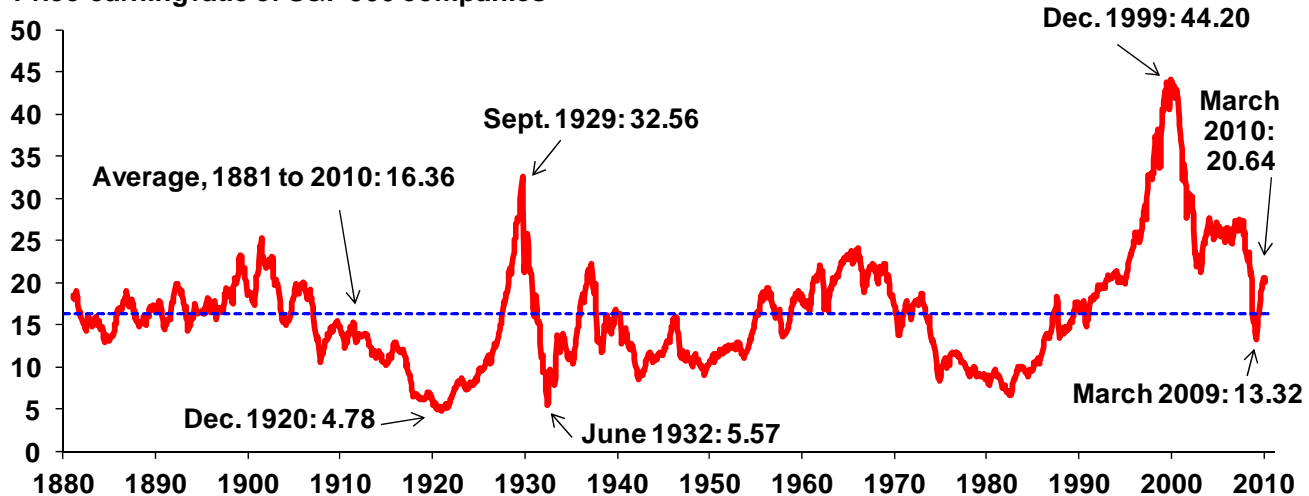


Source: Bureau of Labor Statistics.



# Long-term S&P 500 price-to-earning ratios

Price-earning ratio of S&P 500 companies

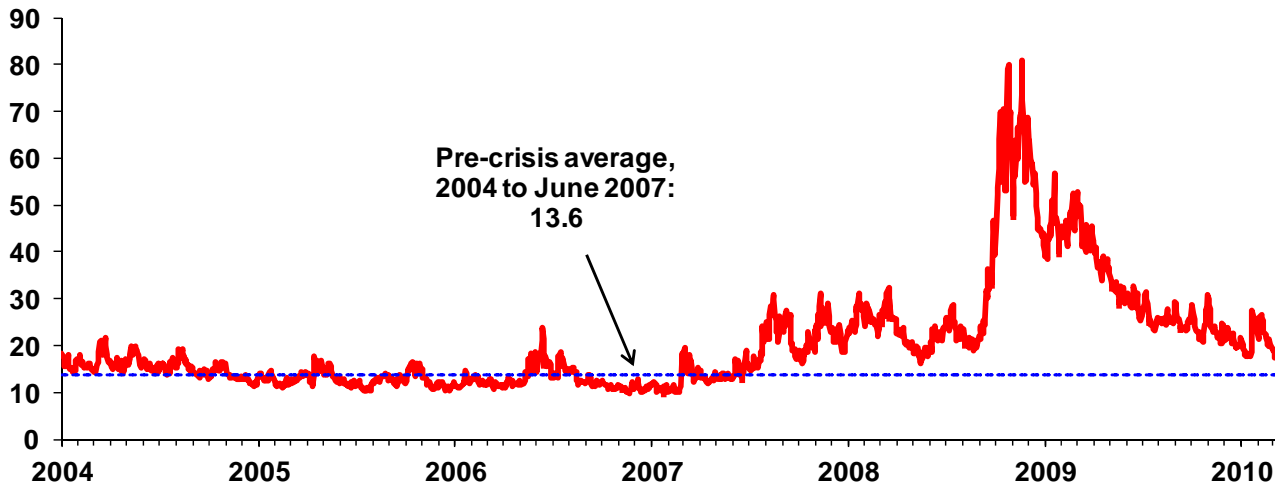


Source: Robert Shiller.



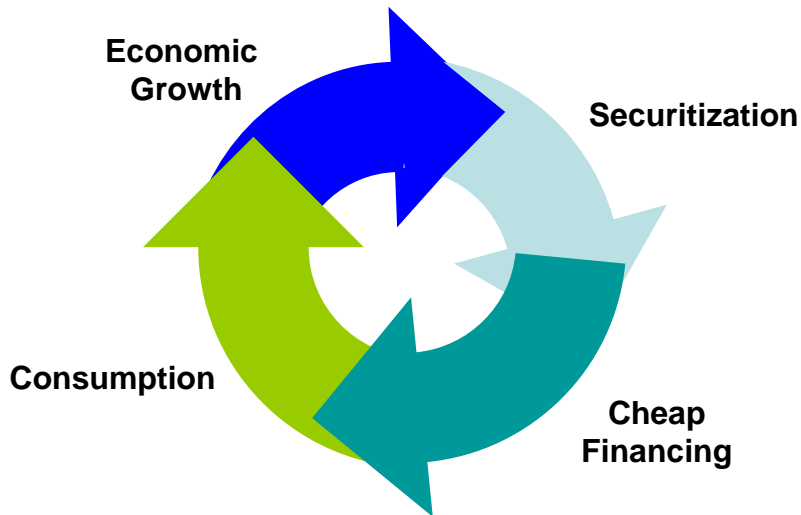
# Volatility: Still above pre-crisis level

Chicago Board Options Exchange Volatility Index (VIX)



Source: Bloomberg.

# Securitization contributed to economic growth by providing cheap financing and by stimulating consumption

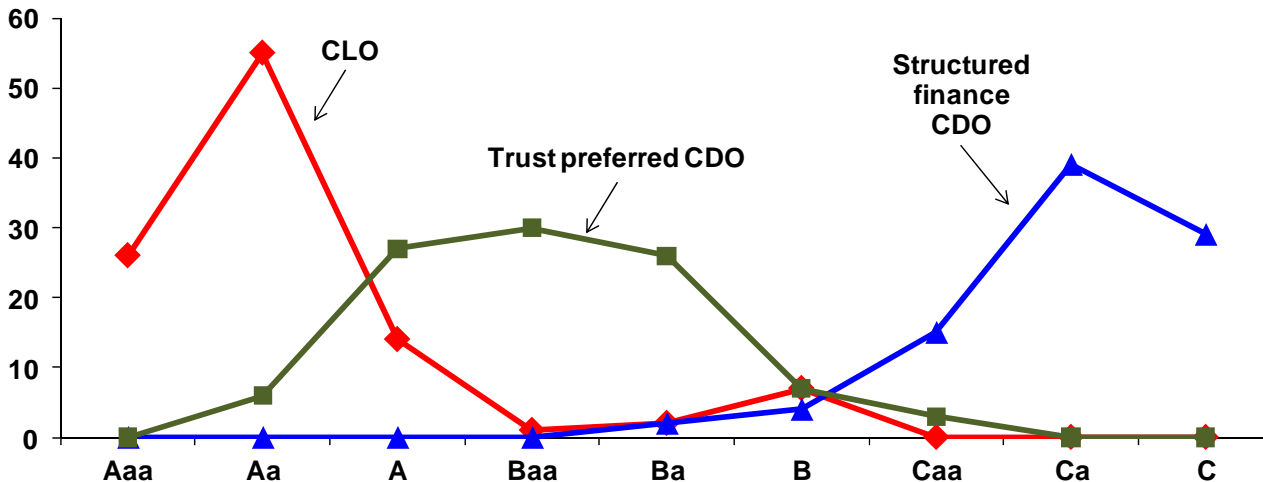


Source: Ares.



## Cash flow CLOs have maintained higher rating distinctions versus CDOs collateralized by trust preferreds and other asset-backed collateral

Percent of securities initially rated AAA



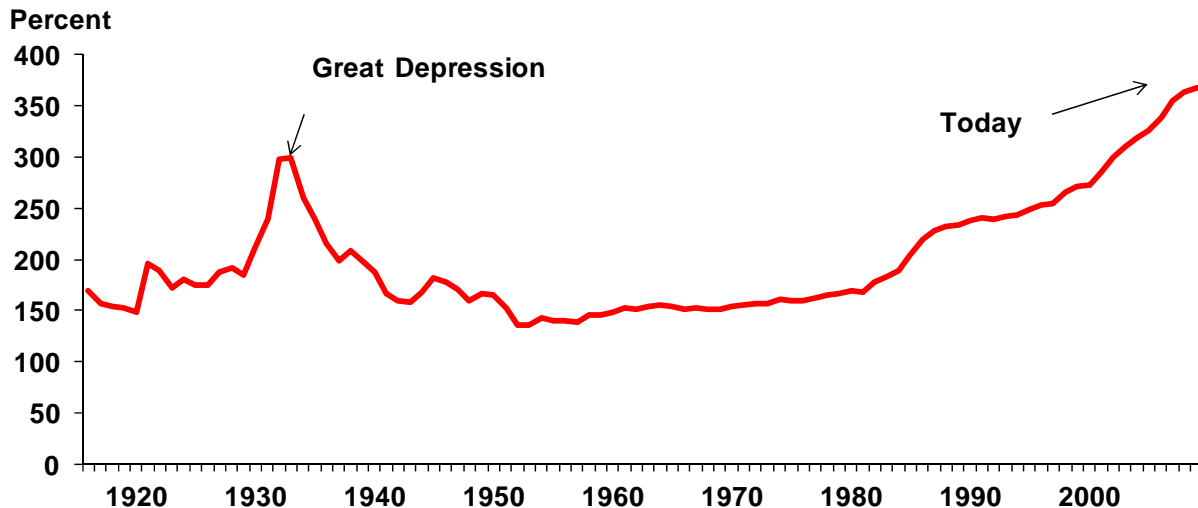
Sources: Wells Fargo, Moody's Investor's Service.

# Total credit market debt/US GDP

1916 to 2009



MILKEN INSTITUTE



Sources: Federal Reserve, *Historical Statistics of the United States*, Bureau of Labor Statistics, Milken Institute.

# A liquidity crisis



MILKEN INSTITUTE

## **Leveraged loan market:**

Minimal capital available to loan market from Hedge Funds, CLOs, Banks

## **Subprime:**

Defaults & losses lead to uncertainty & loss of confidence

## **SIVs & Conduits:**

Loss of confidence results in disappearance of short term funding/ABCP market forcing some SIVs holding LT portfolios into default and liquidations

A light blue octagon with a black border, containing the text "Liquidity Crisis".

## **Liquidity Crisis**

## **Hedge funds:**

Marked-to-market losses, conditions to equity withdrawals and liquidations

## **CLOs:**

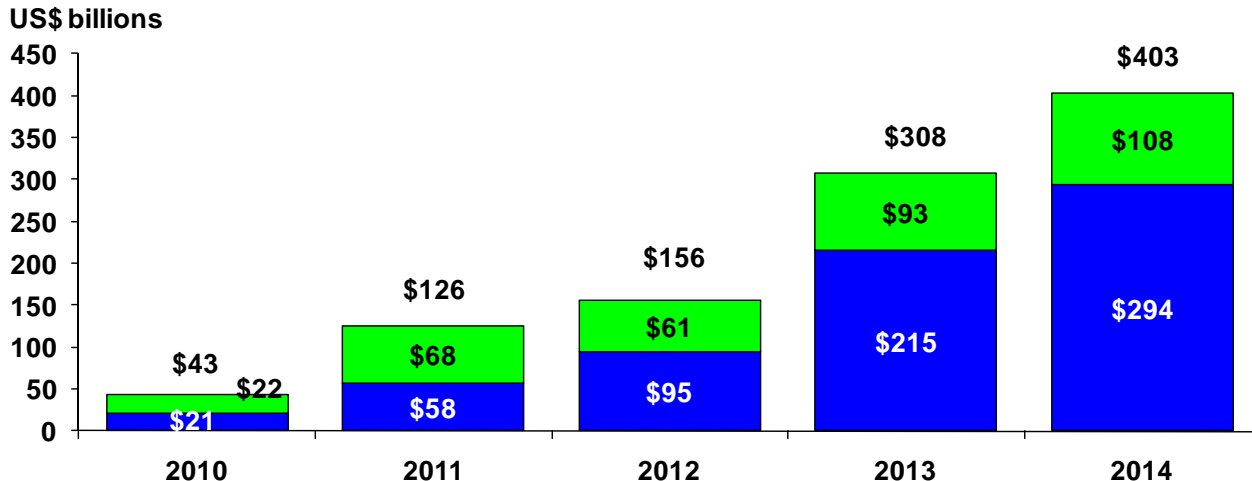
Bank warehousing lines frozen, AAA lender disappears, closes ABS market

## **Banks:**

Illiquidity and disappearance of lenders leads to overhang of loans on bank books causing markdowns and secondary price decline

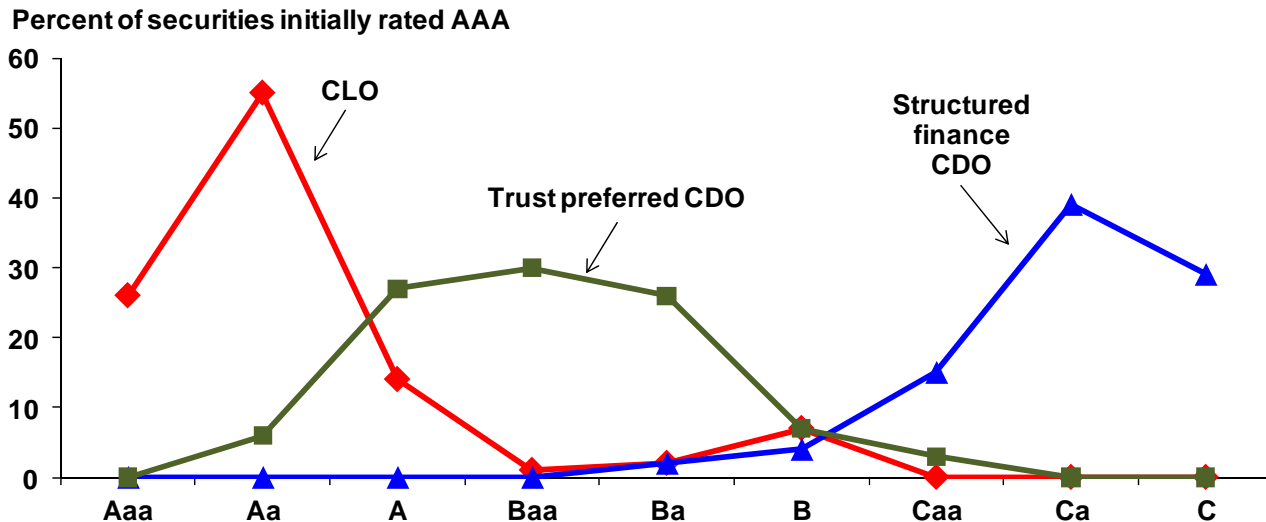


# Bank loan and high yield bonds maturing in the next five years



Sources: Credit Suisse Leveraged Loan Index, Merrill Lynch High Yield Master II Index, S&P LCD Quarterly Leveraging Lending Review.

# Cash flow CLOs have maintained higher rating distinctions versus CDOs collateralized by trust preferreds and other asset-backed collateral



Sources: Wells Fargo, Moody's Investor's Service.

# Differentiating CLOs versus CDOs

## CLOs – The Good

### ■ High quality product

- ▶ No AAA CLO has lost principal value
- ▶ More suitable leverage
- ▶ Ability to access underlying collateral

### ■ Contributor to lower cost of bank debt

- ▶ CLOs act like a “synthetic bank”
- ▶ Provides meaningful benefit to the U.S. economy

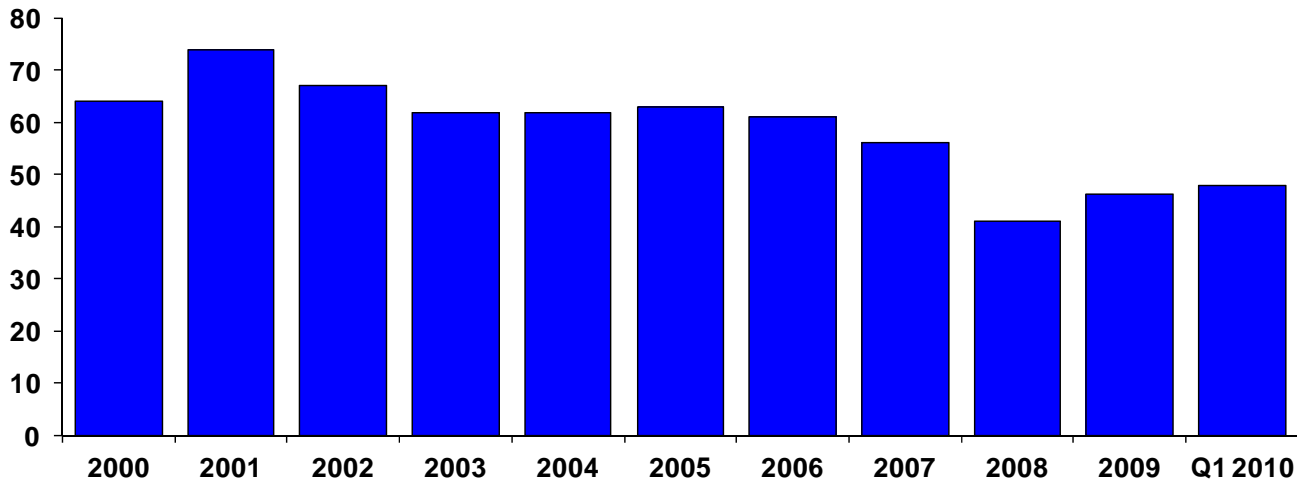
## CDOs – The Bad

### ■ Low quality product

- ▶ Ratings agency did not understand the correlation risks
- ▶ Imprudent leverage
- ▶ Impossible to access underlying collateral leading to decreased ability to fix systemic problems associated with the product
- ▶ Destroyed balance sheets of banks

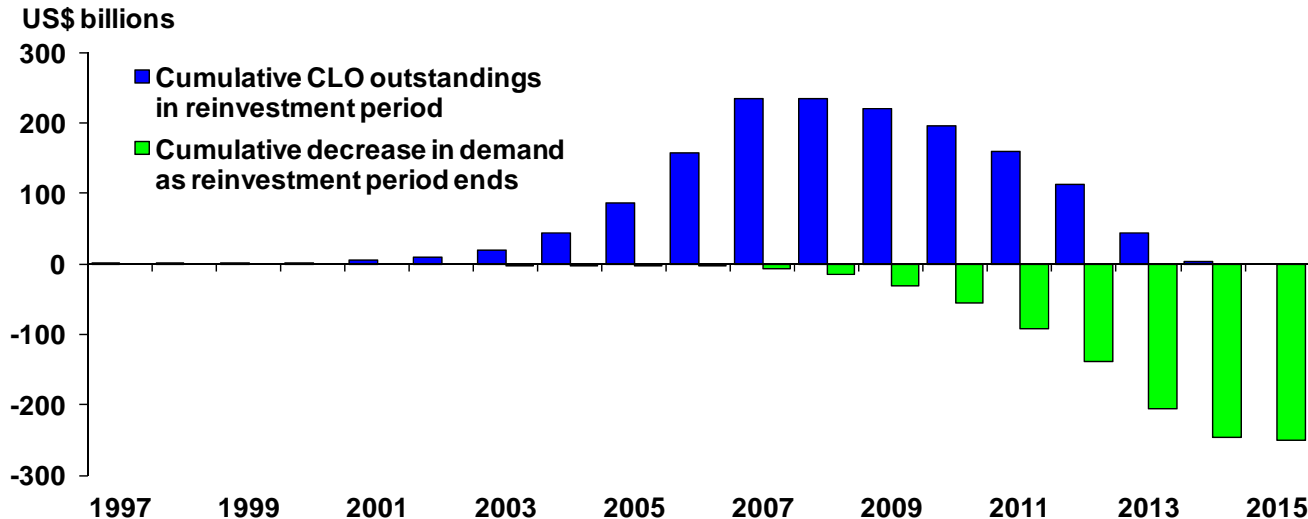
# CLOs purchased 60–70% of newly issued institutional loans from 2000–2007 vs. 45% in 2008–2009

Percent of newly issued institutional loans purchased by CLOs



Source: S&P LCD Quarterly Leveraged Lending Review.

# CLO outstanding reinvestment period



Source: S&P LCD Quarterly Leveraged Lending Review.

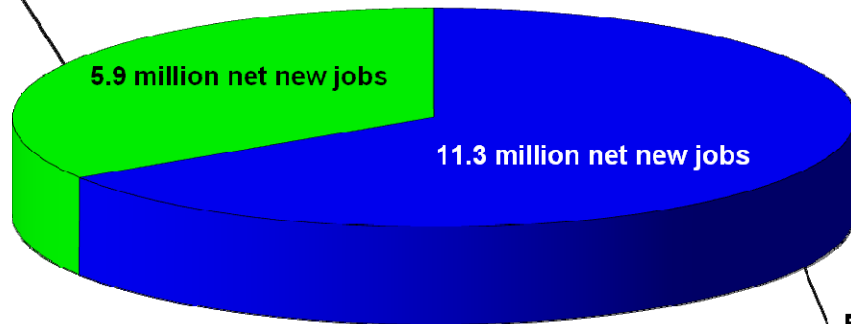
# Small businesses account for lion's share of private sector job growth



MILKEN INSTITUTE

**Net new private sector jobs  
1992Q3 - 2009Q2**

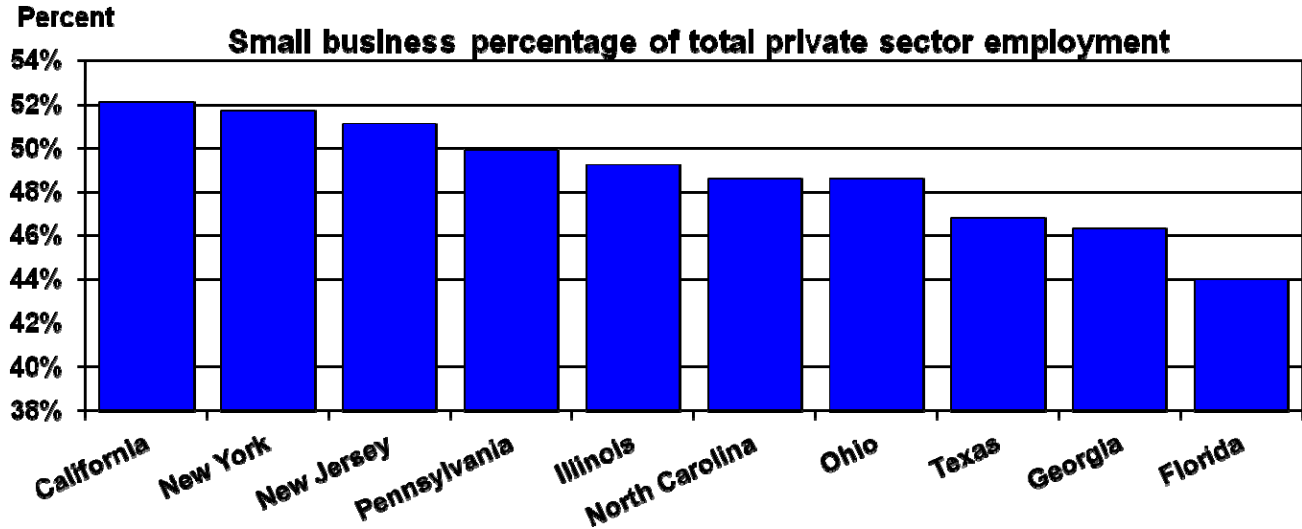
**Firms with 500 +  
employees  
34%**



**Firms with 1-499  
employees  
66%**

Source: BLS.

# Ten largest U.S. state economies all depend on small business job growth



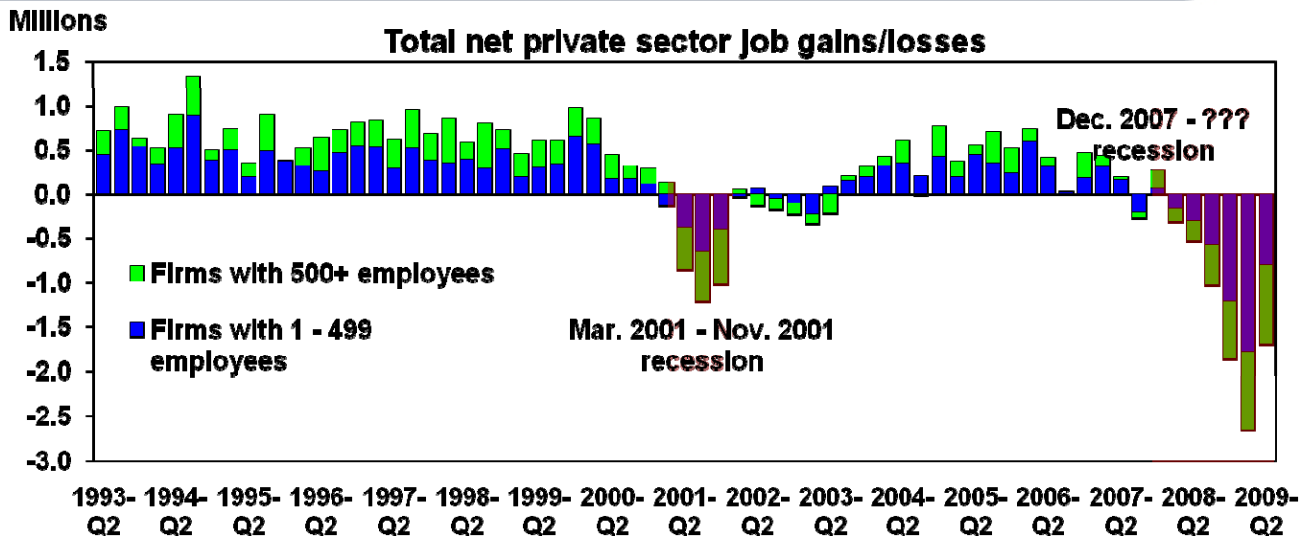
Source: SBA.

# Small business private sector job growth hit hard in current recession



MILKEN INSTITUTE

*Quarterly, 1993Q2 — 2009Q2*

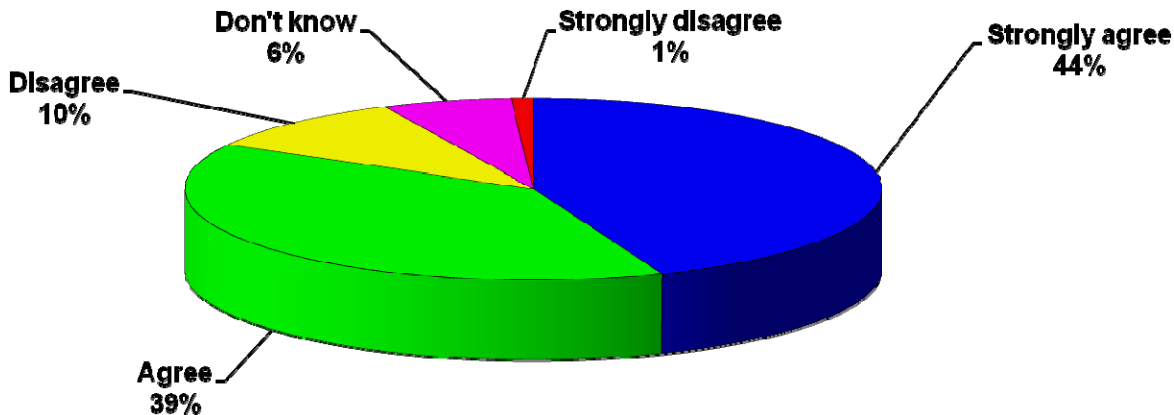


Sources: BLS, NBER.



# Small businesses believe they will lead the U.S. out of current recession

***'Small businesses will lead the U.S. out of the current economic doldrums'***



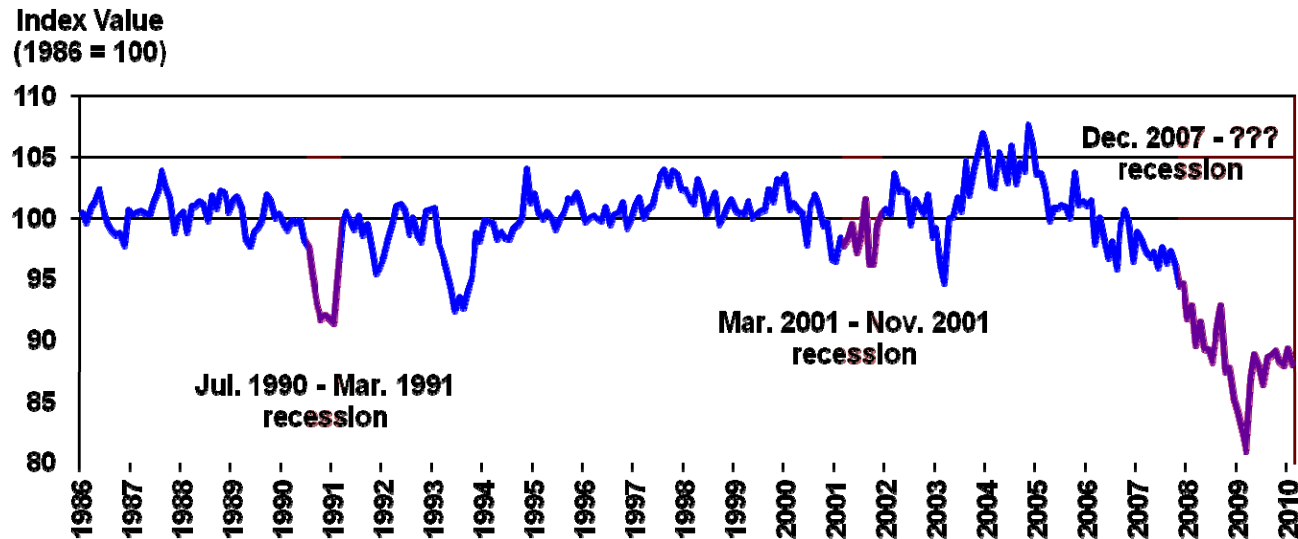
Sources: "U.S. Small Business Outlook 2010: Lessons Learned – A Case for Greater Optimism," CIT in association with Forbes Insights.

# Small business optimism index starting to rebound from March 2009 low



MILKEN INSTITUTE

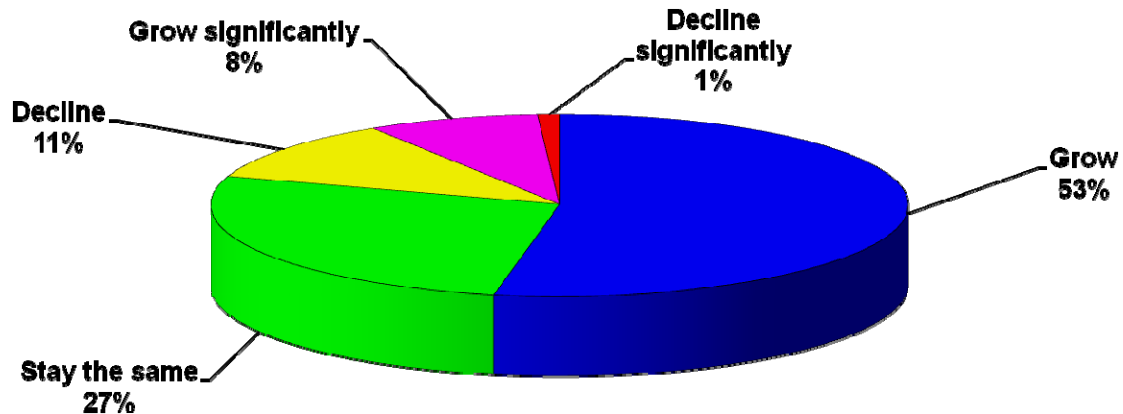
*Monthly, Jan. 1986 — Feb. 2010*



Sources: National Federation of Independent Business, Economy.com, NBER.

# Majority of small businesses are optimistic about revenue growth in 2010

**In 2010, do you expect your company's revenues to:**

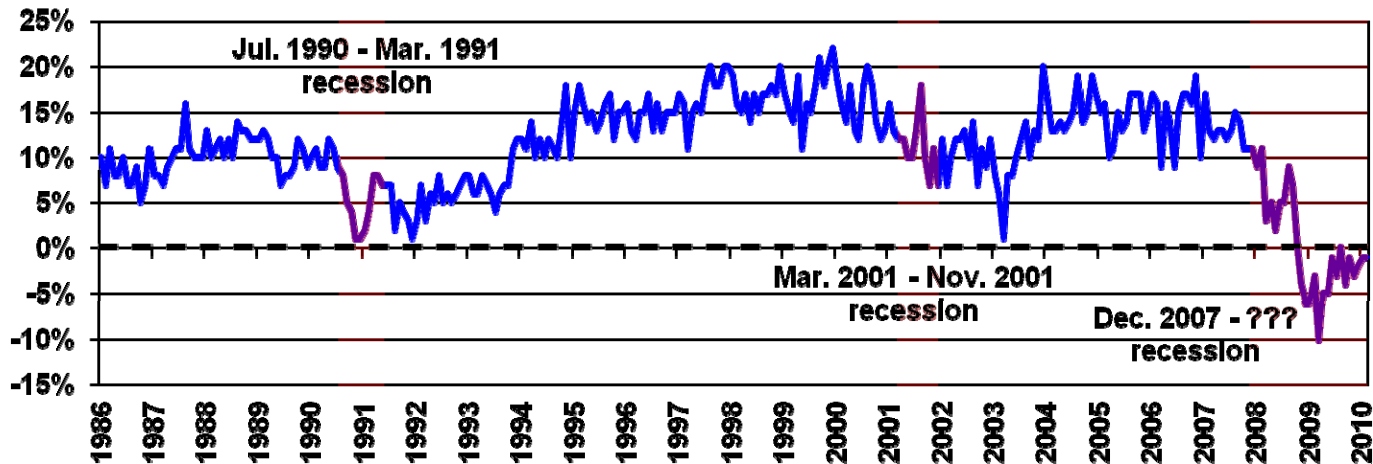


Sources: "U.S. Small Business Outlook 2010: Lessons Learned – A Case for Greater Optimism," CIT in association with Forbes Insights.

# Net percent of small business survey respondents planning to hire in next 3 months

Monthly, Jan. 1986 — Feb. 2010

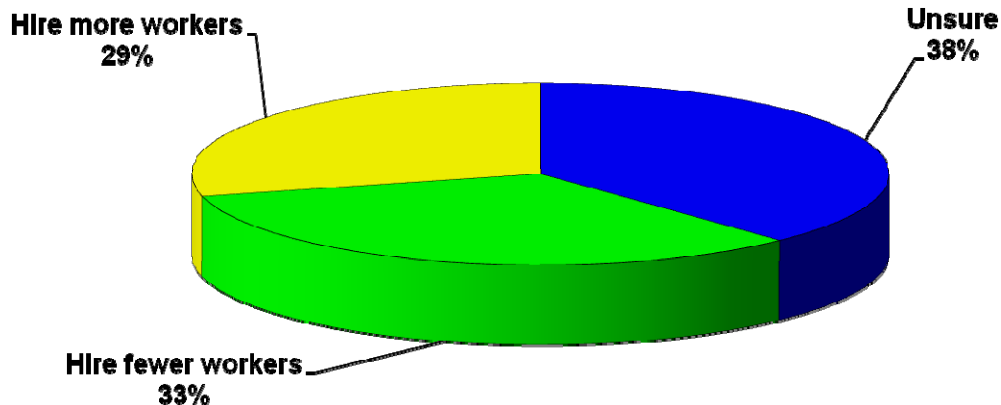
Net percent of respondents



Sources: National Federation of Independent Business, Economy.com, NBER.

# Small businesses still hesitant to ramp up staff levels

**In 2010, what are your company's plans with regards to hiring:**



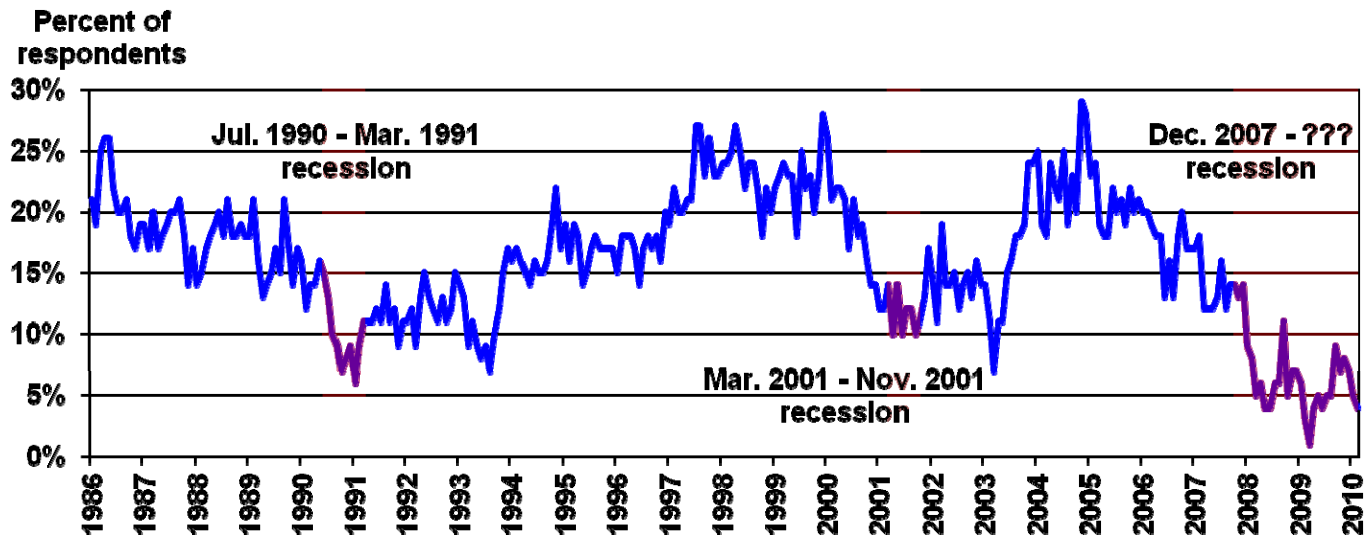
Sources: "U.S. Small Business Outlook 2010: Lessons Learned – A Case for Greater Optimism," CIT in association with Forbes Insights.

# Percent of small business survey respondents that believe now is a good time to expand

*Monthly, Jan. 1986 — Feb. 2010*



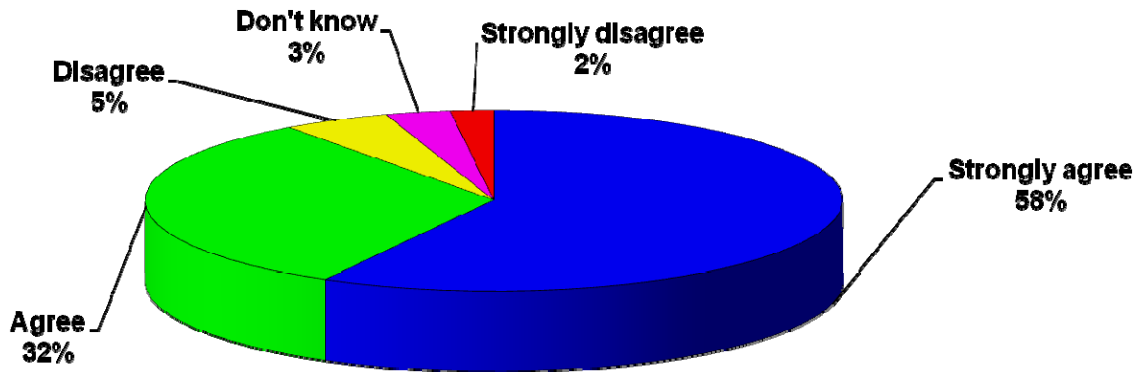
MILKEN INSTITUTE



Sources: National Federation of Independent Business, Economy.com, NBER.

# Small businesses feel left out of post-crisis recovery efforts

***'Current economic stimull do not benefit small businesses'***



Sources: "U.S. Small Business Outlook 2010: Lessons Learned – A Case for Greater Optimism," CIT in association with Forbes Insights.

# Small business owners understand the importance of planning, but few actually do it

*Percentage of survey respondents*



MILKEN INSTITUTE

- 85% agreed that the recession put additional pressure on their businesses to plan more effectively.
- 61% indicated they would spend more time on planning & budgets in **2010** than they did in **2009**.
- Only 44% indicated they had a strategy in place to guide growth during the coming recovery; 44% said they were working on a strategy while 11% didn't have a plan.

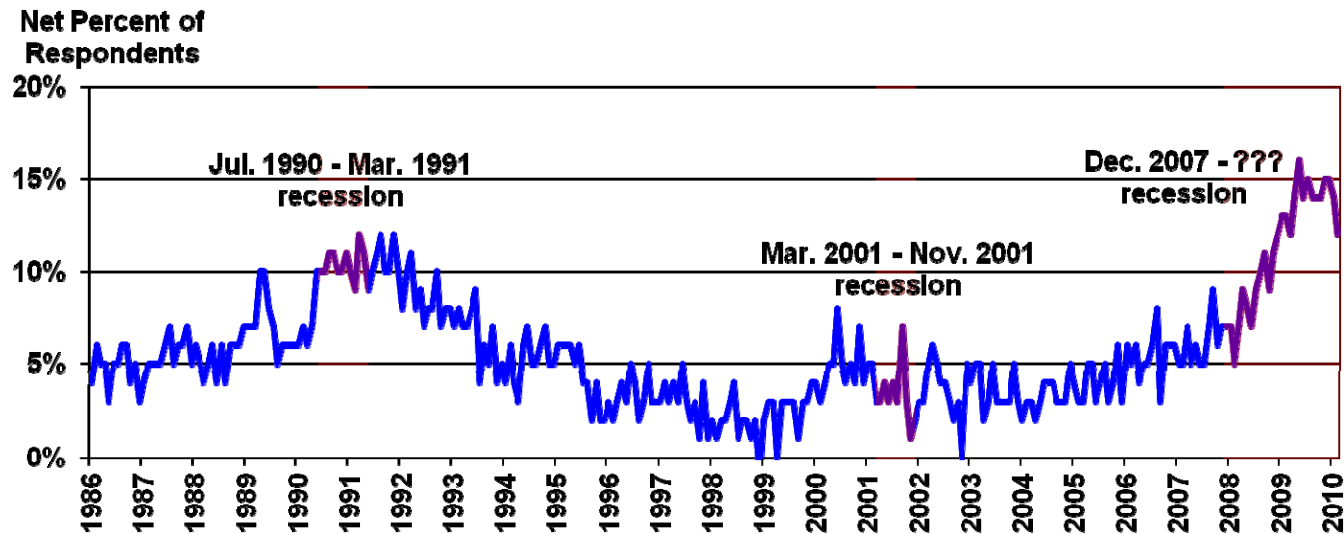


Sources: "U.S. Small Business Outlook 2010: Lessons Learned – A Case for Greater Optimism," CIT in association with Forbes Insights.



# Net percent of small business survey respondents with difficulties obtaining credit

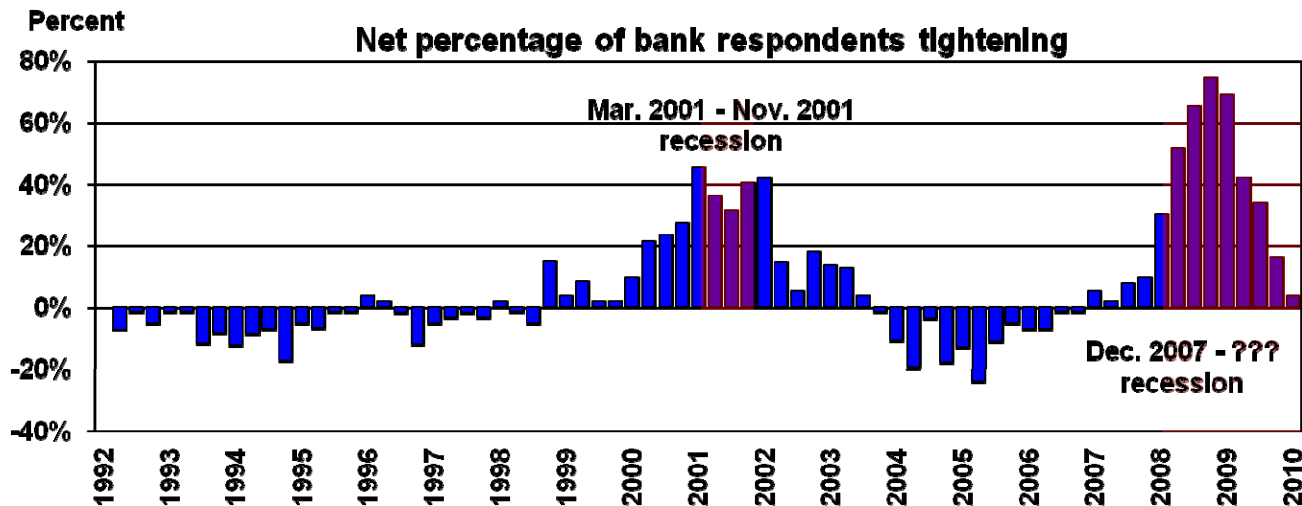
*Monthly, Jan. 1986 — Feb. 2010*



Sources: National Federation of Independent Business, Economy.com, NBER.

# Bank survey respondents tightening credit standards on C&I loans to small businesses

*Quarterly, 1992Q1 — 2010Q1*

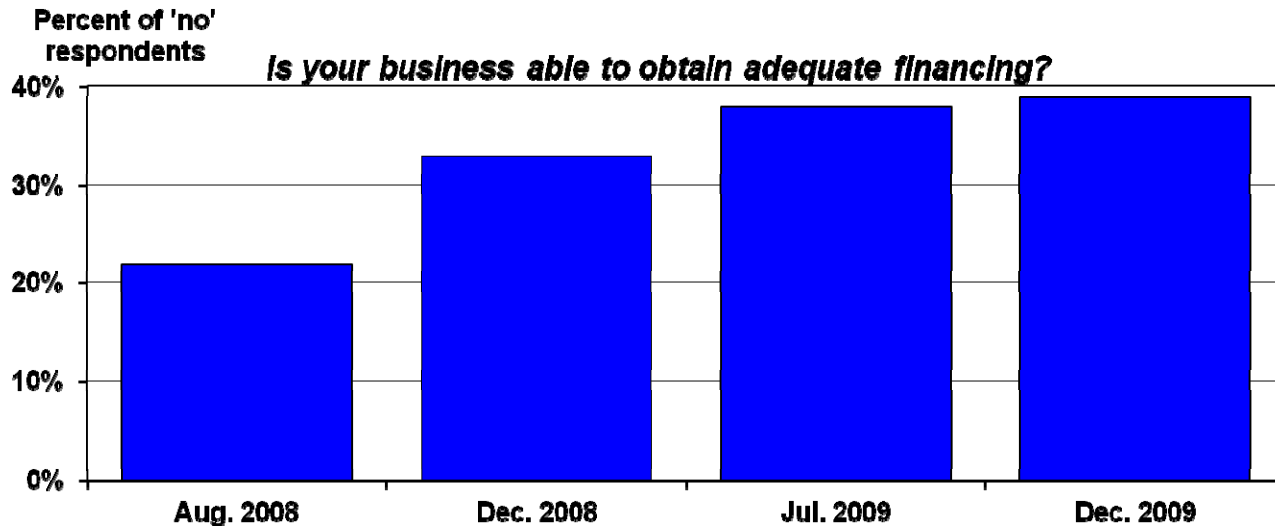


Sources: Federal Reserve Senior Loan Officer Survey on Bank Lending Practices, NBER.

# Small businesses increasingly unable to obtain adequate financing



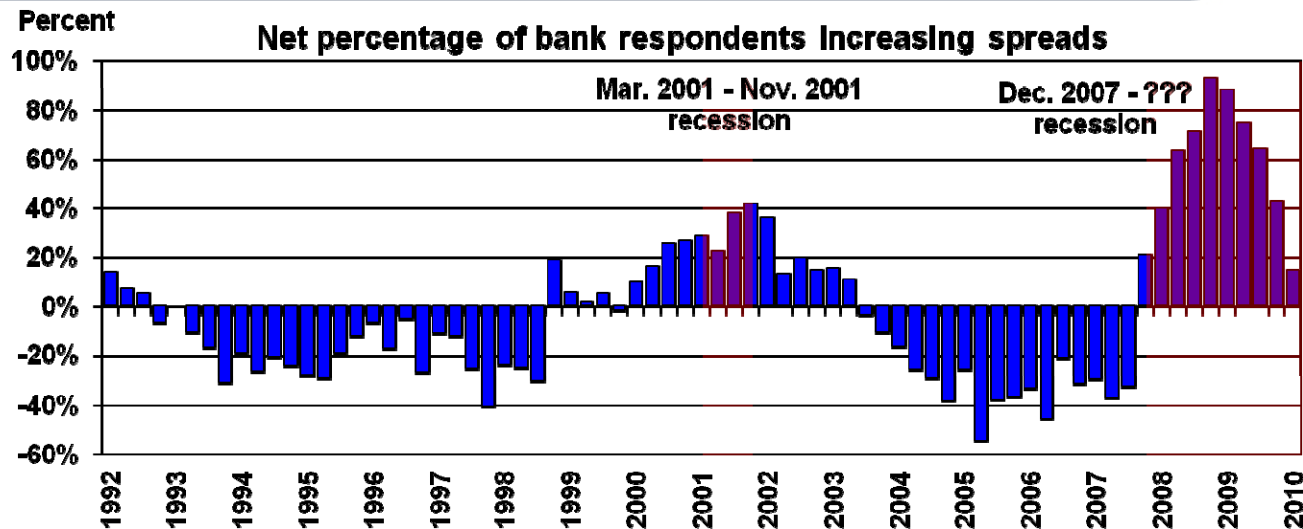
MILKEN INSTITUTE



Source: National Small Business Association Survey.

# Bank survey respondents increasing spreads of small business loan rates over cost of funding

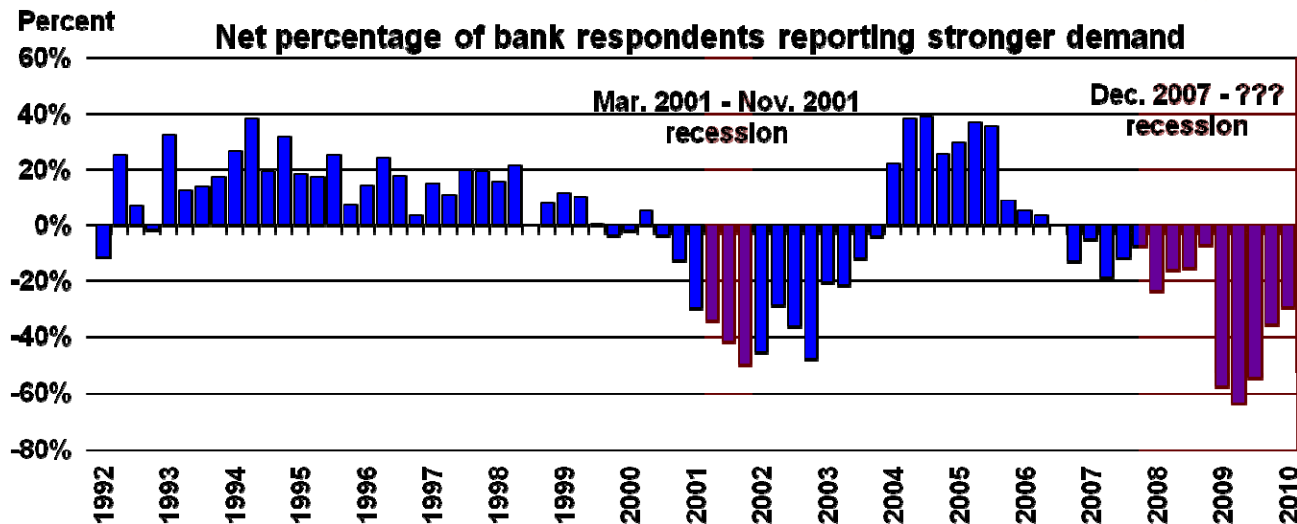
*Quarterly, 1992Q1 — 2010Q1*



Sources: Federal Reserve Senior Loan Officer Survey on Bank Lending Practices, NBER.

# Bank survey respondents indicate demand for small business C&I loans is down

*Quarterly, 1992Q1 — 2010Q1*



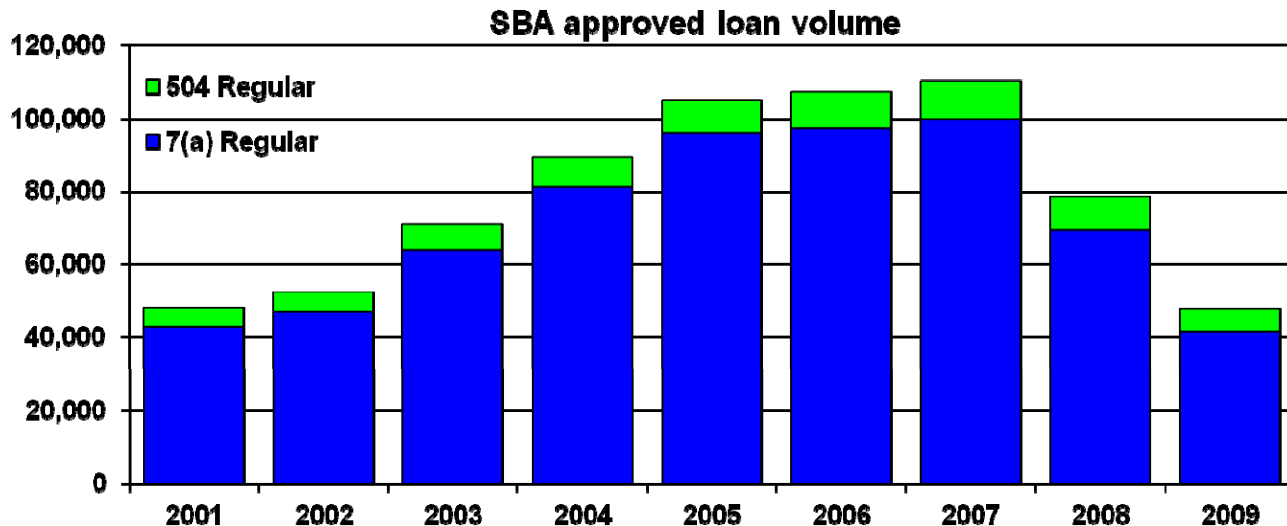
Sources: Federal Reserve Senior Loan Officer Survey on Bank Lending Practices, NBER.

# SBA loan volume down 57% since 2007

*Fiscal Year, 2001 — 2009*



MILKEN INSTITUTE



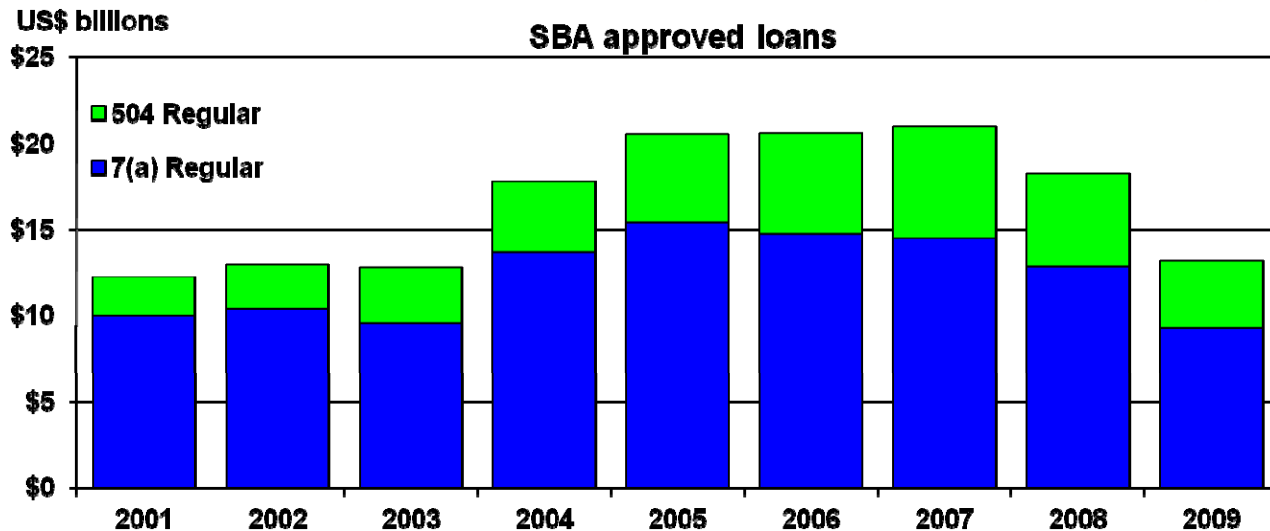
Source: SBA.

# SBA total loan value down 37% since 2007

*Fiscal Year, 2001 — 2009*



MILKEN INSTITUTE



Source: SBA.

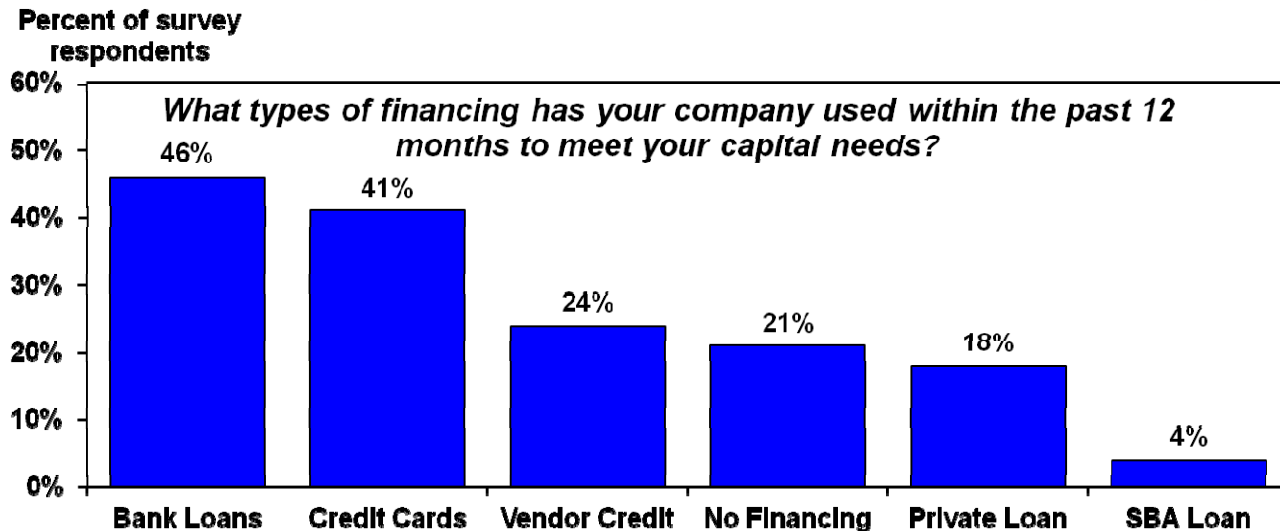
# Community banks are critical to small business lending in the U.S.

- Community banks account for 67% of outstanding small business loans and 62% of initial dollar amount
- There are roughly 8,000 community banks with more than 50,000 U.S. locations
- Community banks constitute 97% of all banks
- Of all U.S. banks, 91% have assets under \$1 billion and 36% have assets under \$100 million

Source: Independent Community Bankers of America.



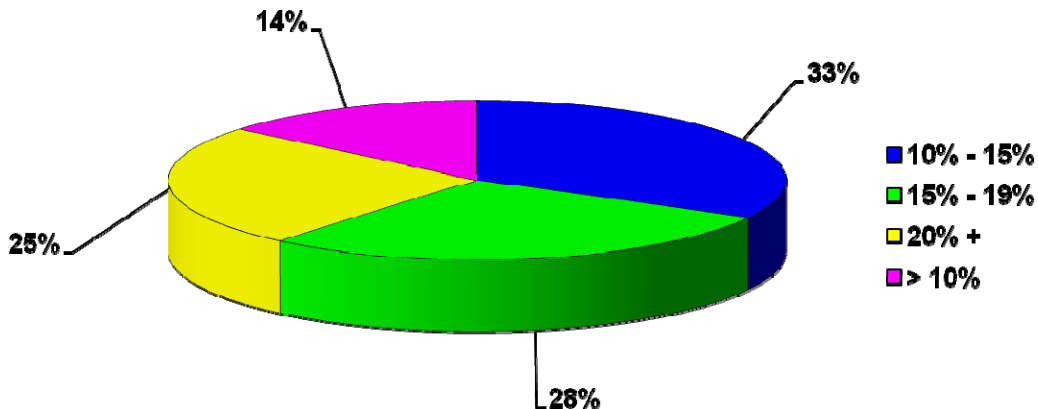
# Small businesses depend largely on bank loans and credit cards for financing



Source: National Small Business Association Survey (December 2009).

# Small businesses credit card terms typically exceed 10% interest rate

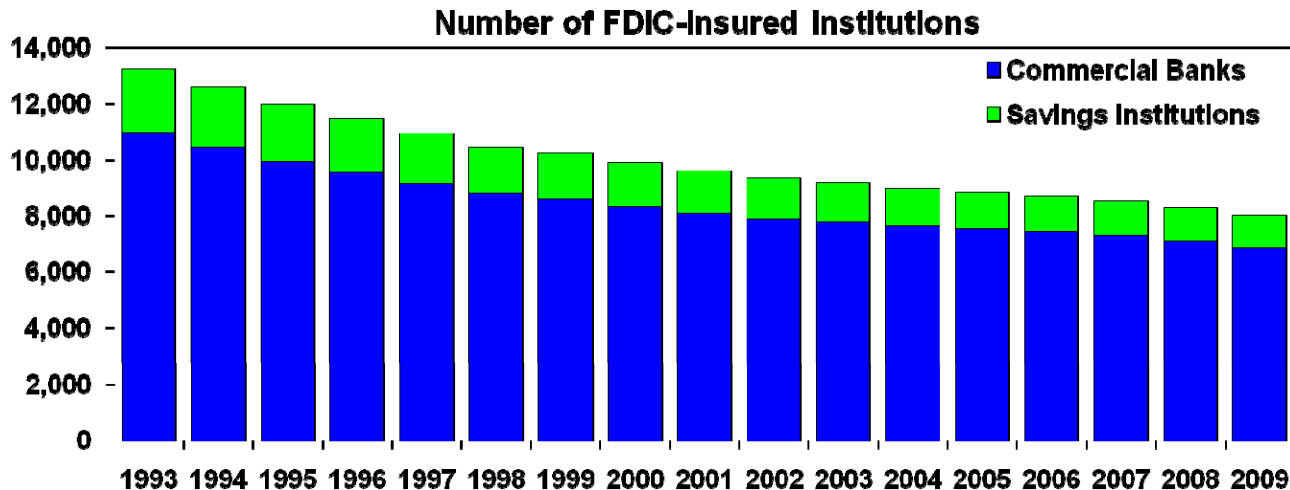
*What Is the approximate Interest rate you are charged on your primary credit card?*



Source: National Small Business Association Survey (December 2009).

# Banking industry has changed dramatically

*Annual, 1993 — 2009*



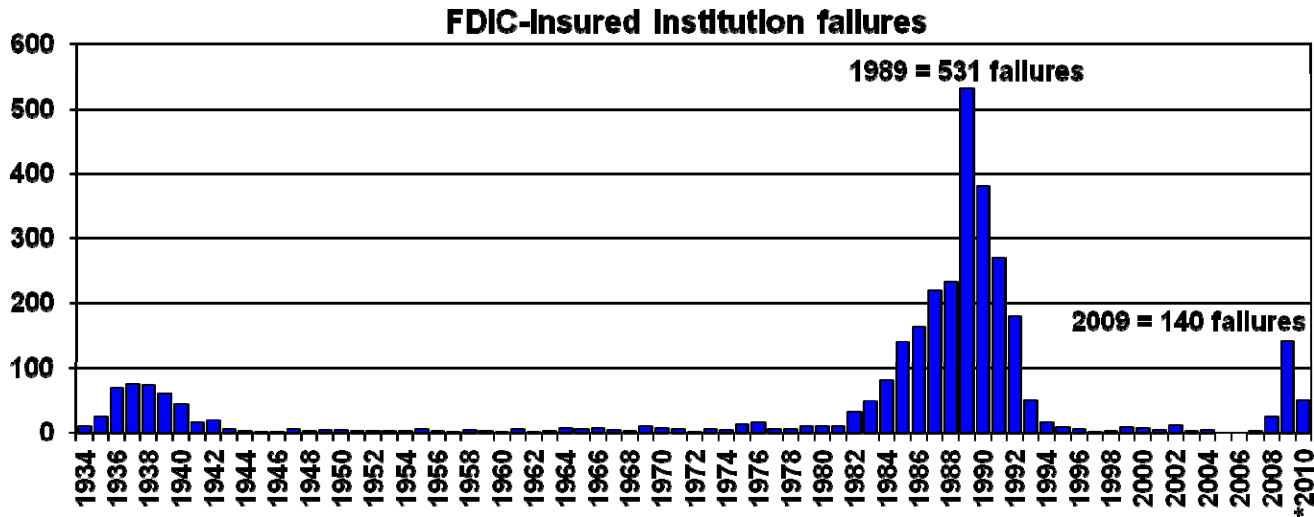
Source: FDIC.

# Bank failures reached 140 in 2009

*Annual, 1934 — \*2010*



MILKEN INSTITUTE



Source: FDIC.

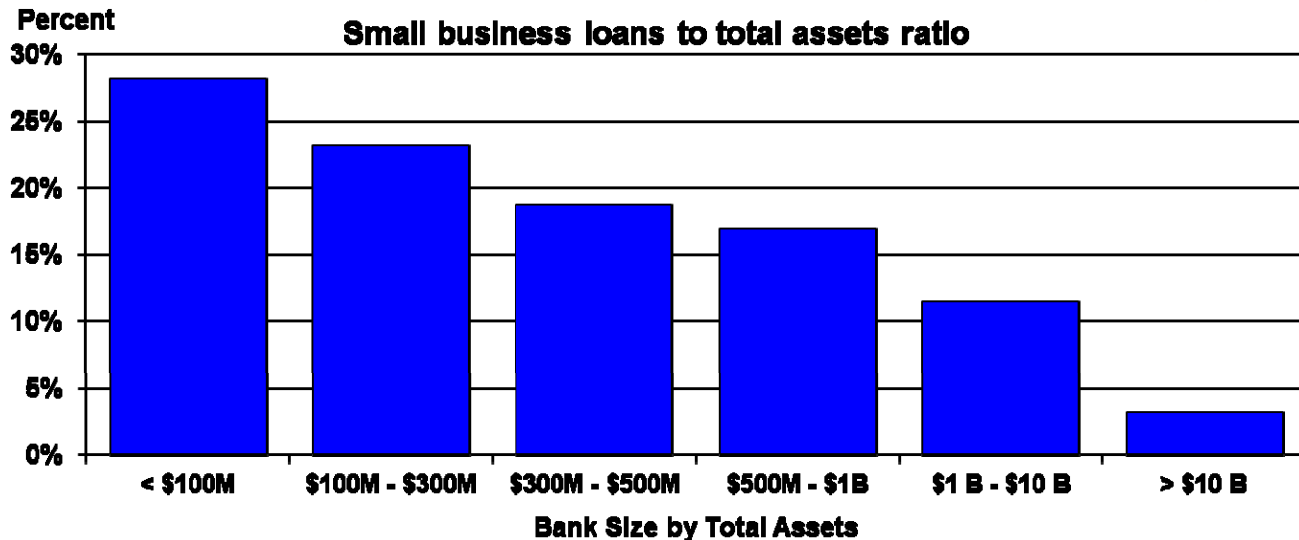
\*through April 16, 2010

# Small and medium sized banks commit larger share of assets to small business loans

YTD (12/31/2009)



MILKEN INSTITUTE



Source: FDIC.

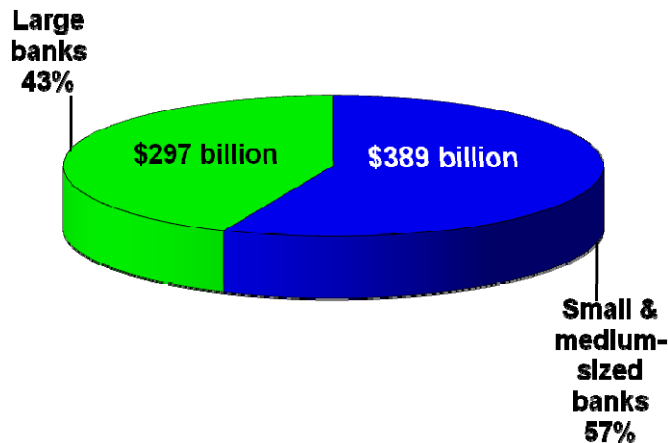
# Smaller banks account for 57% of small business loans with only 20% of industry assets



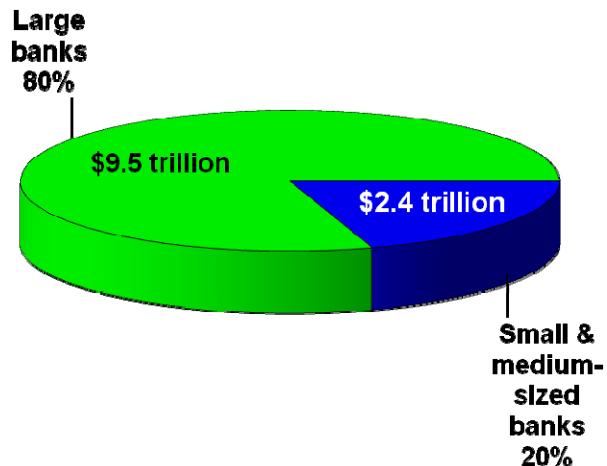
MILKEN INSTITUTE

YTD (12/31/2009)

## Small business loans outstanding



## Total bank assets

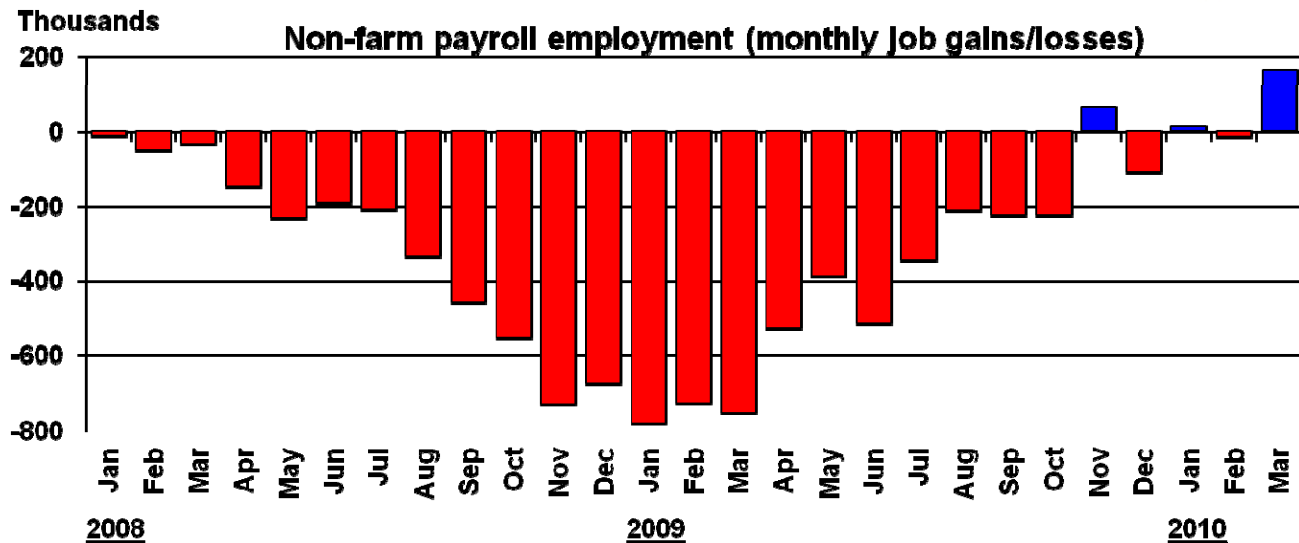


Source: FDIC.

Note: small & medium-sized banks defined as having less than \$10 billion in total assets

# U.S. economy beginning to add jobs

Monthly, Jan. 2008 – Mar. 2010



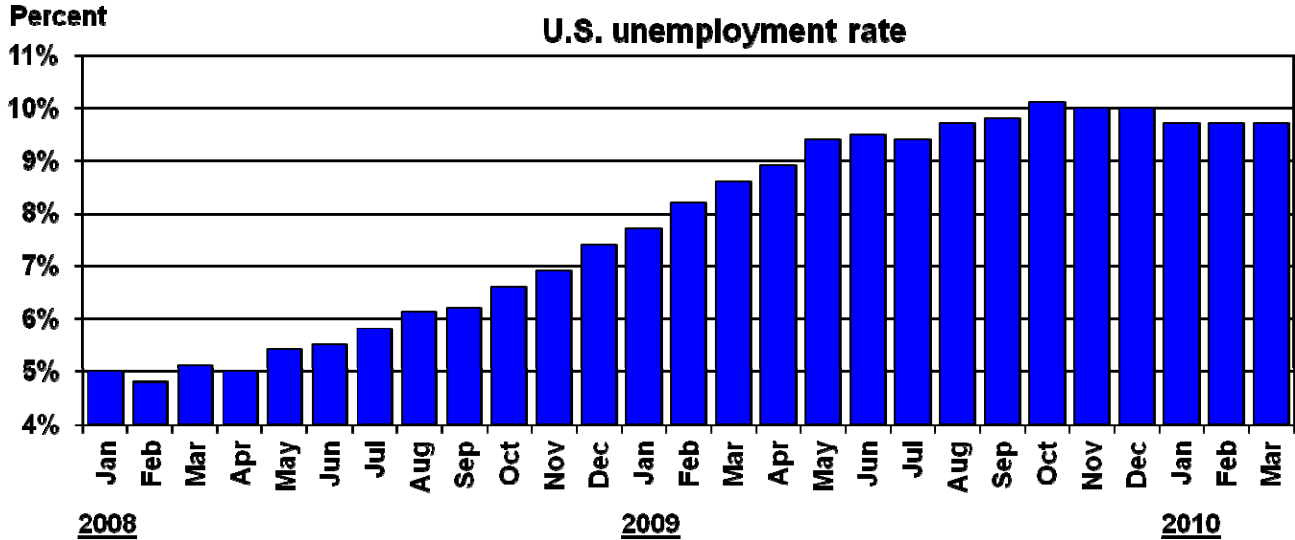
Source: BLS.

# U.S. unemployment rate improving

*Monthly, Jan. 2008 – Mar. 2010*



MILKEN INSTITUTE



Source: BLS.

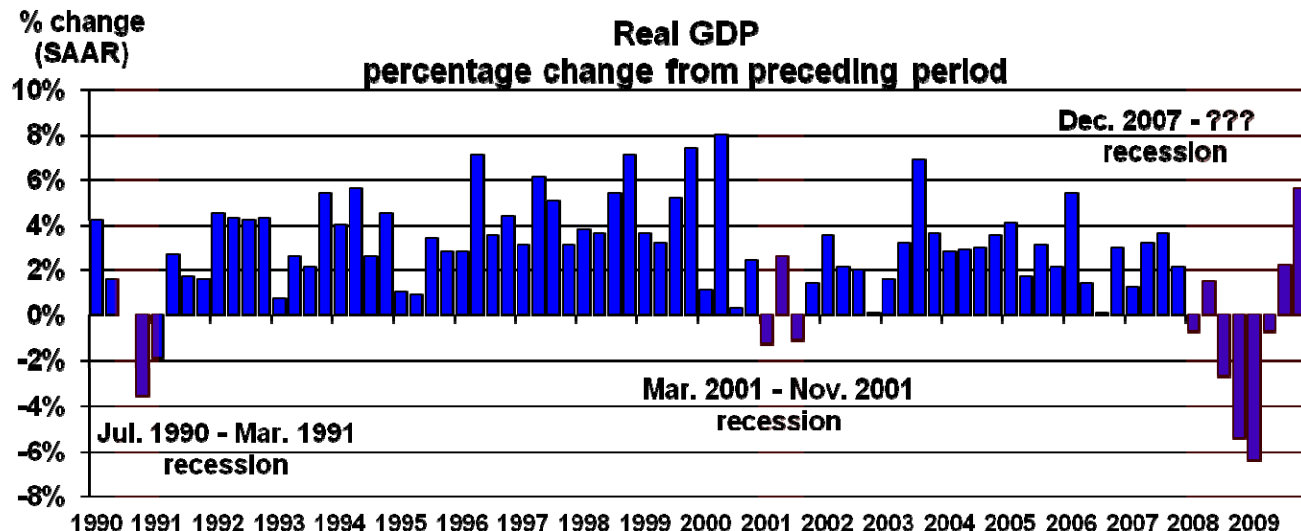


# U.S. real GDP expanding as economy recovers



MILKEN INSTITUTE

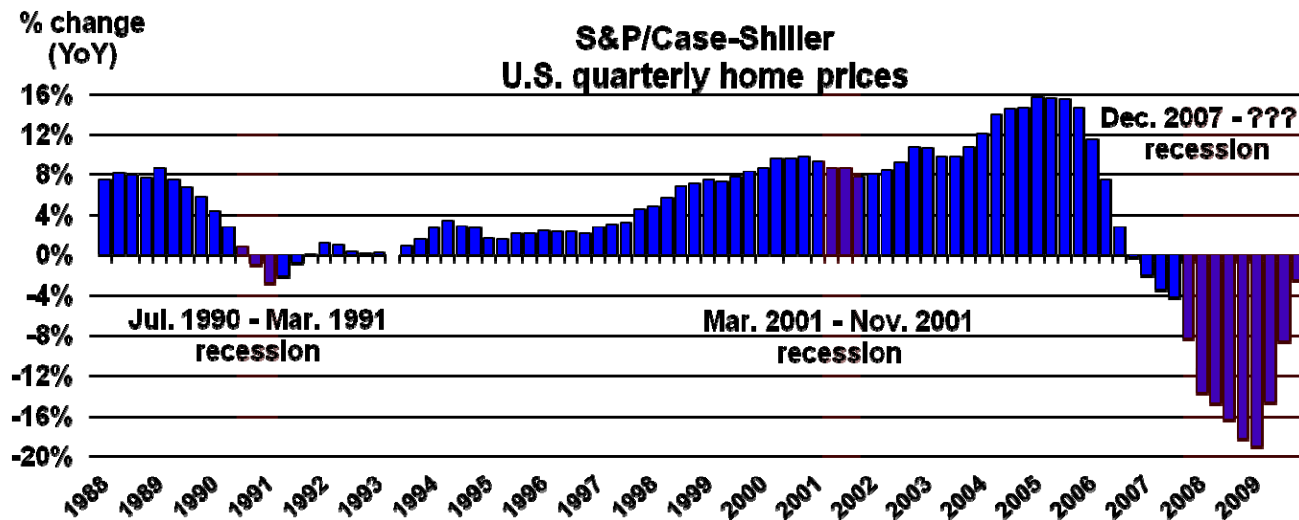
*Quarterly, 1990Q1 – 2009Q4*



Sources: BEA, NBER.

# Home prices may have touched bottom in 2009

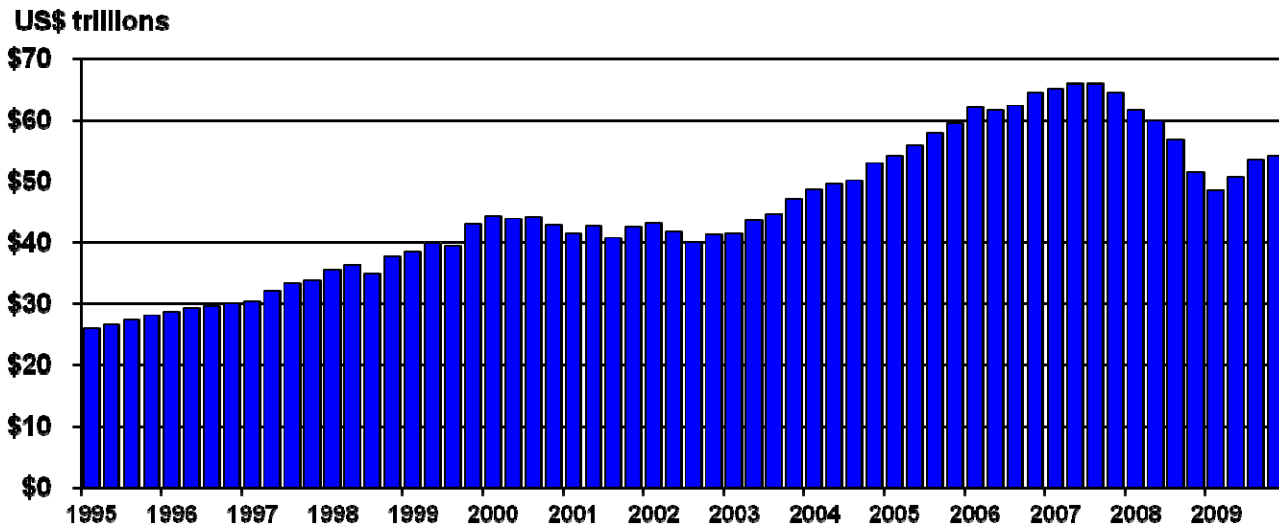
*Quarterly, 1988Q1 – 2009Q4*



Sources: S&P/FiServ, NBER.

# U.S. household net worth beginning to rise

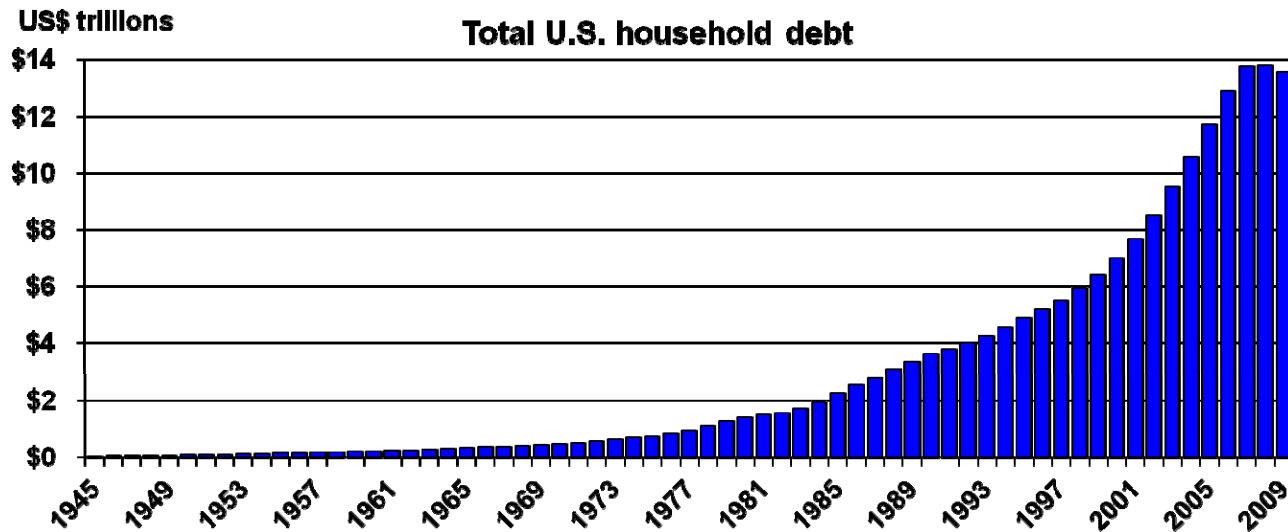
*Quarterly, 1995Q1 – 2009Q4*



Source: Federal Reserve.

# 2009: first time on record that total U.S. household debt fell year-over-year

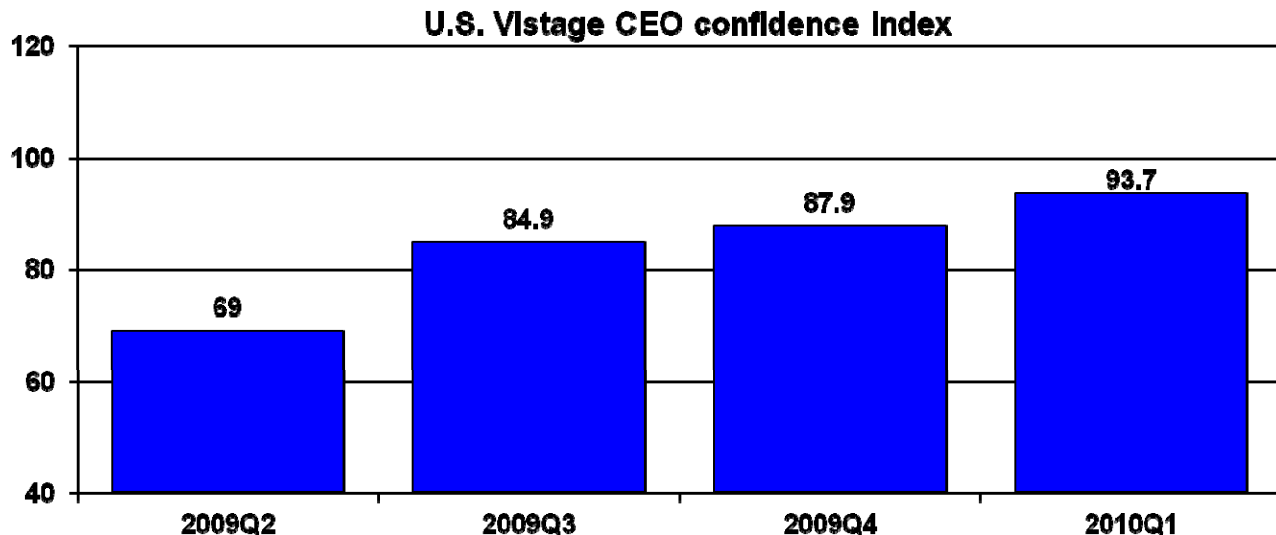
*Annual, 1945 – 2009*



Source: Federal Reserve.

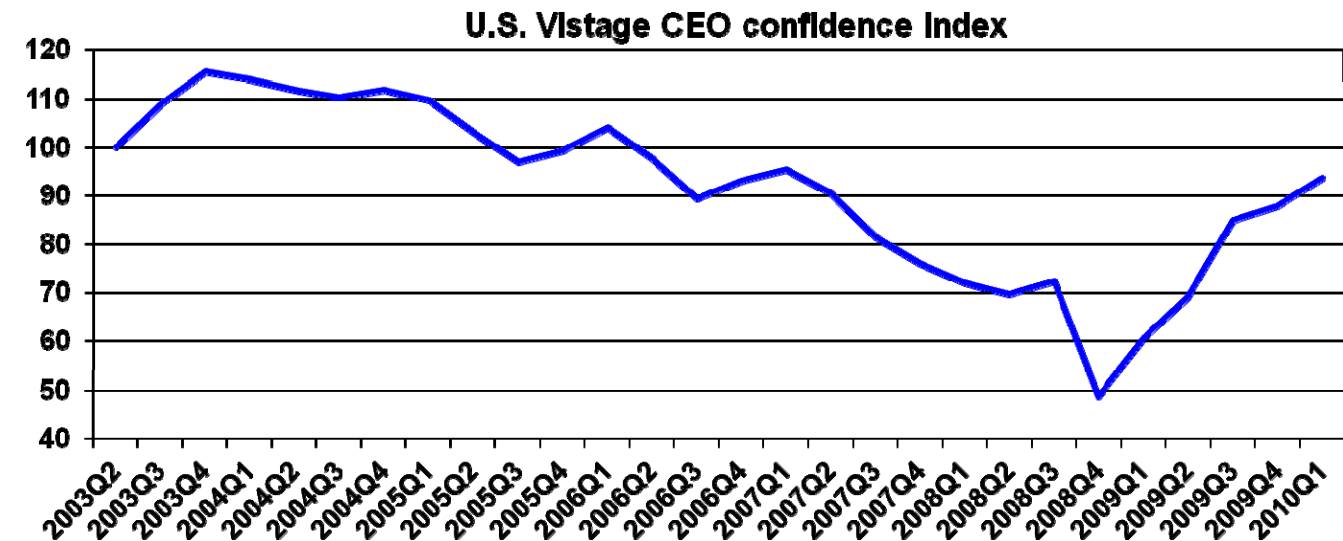
# U.S. Vistage CEO confidence index: last four quarters

*1,869 respondents*



Source: U.S. Vistage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# U.S. Vistage CEO confidence index: since 2003

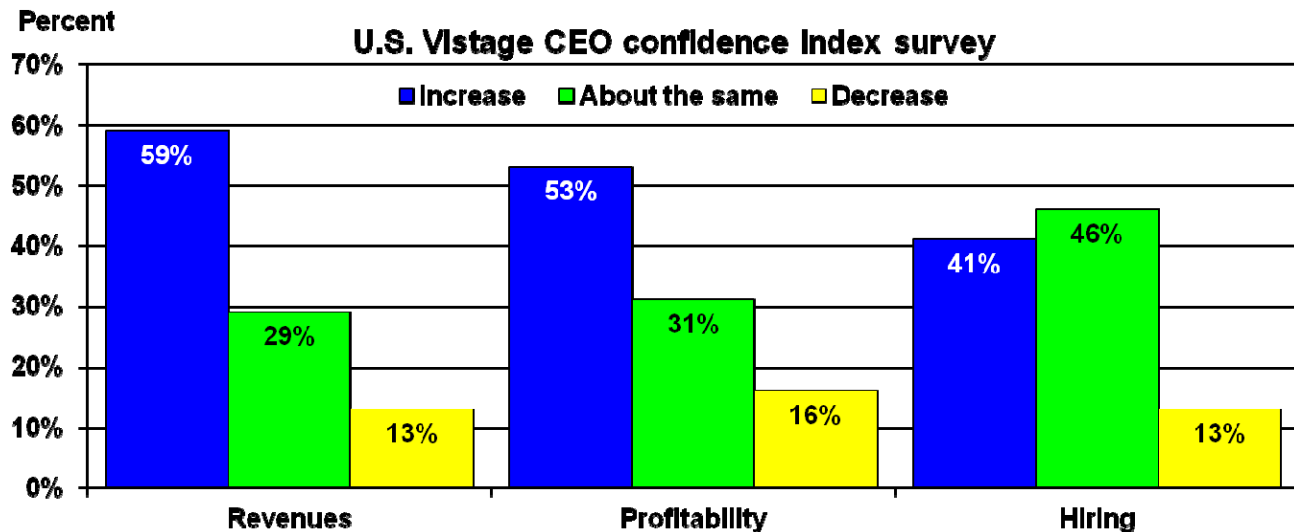


Source: U.S. Vistage CEO Confidence Index Survey.

# Changes in revenues, profitability and hiring: year ahead *1,869 respondents*



MILKEN INSTITUTE



Source: U.S. Vistage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# When will CEOs hire?

*1,869 respondents*



MILKEN INSTITUTE

When do you plan to increase your firm's total number of employees over the next 12 months?

- Q2 2010 (13%)
- Q3 2010 (12%)
- Q4 2010 (13%)
- Steadily over next 12 months (22%)
- I don't plan to increase (45%)

Source: U.S. Vantage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010



# Most significant business issues in 2010

*1,869 respondents*



MILKEN INSTITUTE

- Economic uncertainty (35%)
- Financial issues – cash flow, finances, profitability (18%)
- Growth – growing too slowly (14%)

Source: U.S. Vantage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# Biggest business challenges in 2010

*1,869 respondents*



MILKEN INSTITUTE

- Customer retention and/or generation (27%)
- Managing costs and/or cutting staff (18%)
- Cash, liquidity, receivables (17%)

Source: U.S. Vantage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# CEOs doing “more with less”

*1,869 respondents*



MILKEN INSTITUTE

- 86% of CEOs say they're having to do more with less and list leveraging employee productivity as their primary solution

Source: U.S. Vantage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# Entrepreneurship in America

*1,869 respondents*



MILKEN INSTITUTE

- 37% of CEOs believe entrepreneurship and business opportunities will be weaker in the U.S. in the next 3-5 years
- 38% say it will be stronger
- 25% see no change

Source: U.S. Vistage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# Q1 2010 Vistage CEO confidence index: international perspectives *1,869 respondents*



41% of CEOs say they are  
doing business  
internationally, with  
Europe topping the list.



69% of CEOs see China as  
the biggest threat to  
overtaking the United States  
as an economic superpower

Source: U.S. Vistage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010

# CEO views on Washington

*1,869 respondents*



MILKEN INSTITUTE

- 85% of CEOs do not believe Washington is listening to the needs of small to medium-sized business owners
- 65% of CEOs believe national health care legislation is bad for their business

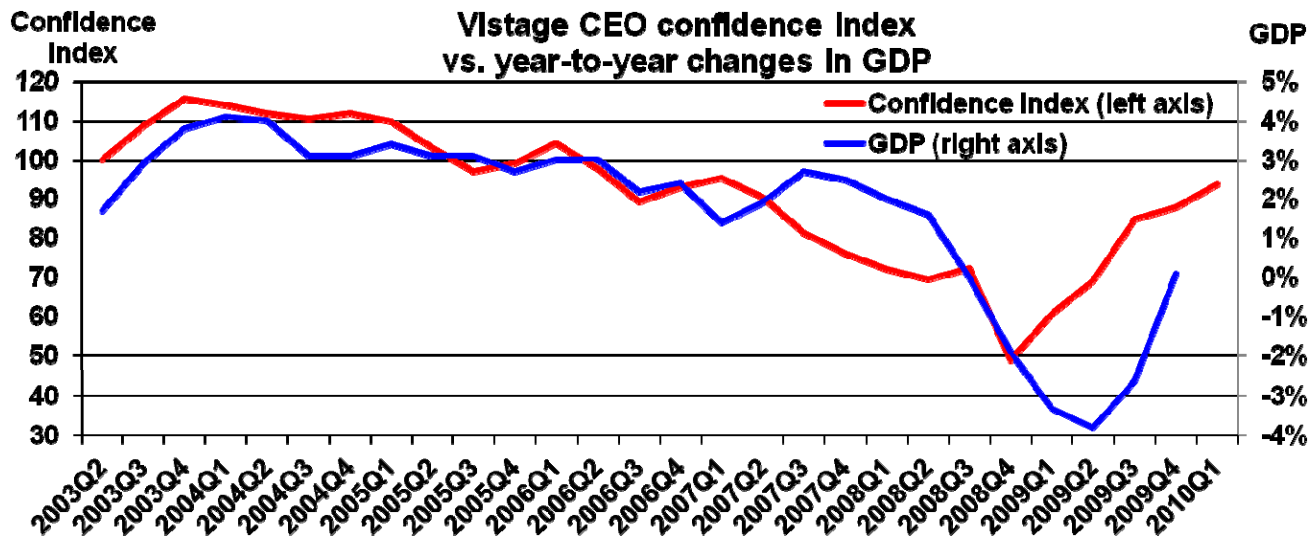
Source: U.S. Vantage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010



# The new business landscape: more with less

- **As we emerge from global recession**
  - What is the new normal for your business?
  - How do you adjust your business to:
    - the new normal?
    - do more with less?
- **The new paradigms**
  - Bigger (government expansion, corporate consolidation)
  - Smaller (budgets, workforces, consumer spending)
  - Broader (opportunities online and internationally)

# Vistage CEO confidence index vs. GDP: forecast of economy two quarters in advance



Source: U.S. Vistage CEO Confidence Index Survey.  
Dates: March 22 – April 2, 2010