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Chairwoman Van Duyne, Ranking Member Mfume, Members of the Subcommittee, thank you for inviting me to testify at today's hearing. By way of background, I am an Assistant Professor of Business Law at the University of Michigan's Stephen M. Ross School of Business and Co-Faculty Director of the University of Michigan's Center on Finance, Law & Policy. My research focuses on bank regulation. Prior to entering academia, I was an attorney at the Federal Reserve Board of Governors where, among other things, I worked on implementing the Dodd-Frank Act and the initial Basel III capital rule.

Small businesses are the lifeblood of the American economy. Indeed, small businesses create more than two-thirds of new jobs in the United States and account for almost half of U.S. GDP.[1] On a personal note, one of the things I love most about my hometown of Ann Arbor is the thriving community of small businesses like Zingerman's Deli and Argus Farm Stop that gives the city its unique college-town feel. In light of the essential role small businesses play in local communities and the national economy, it is critical that policymakers ensure that entrepreneurs have access to funding to establish and grow their companies.

I will make four points in my testimony today. First, regulations enacted after the 2008 financial crisis have helped to promote small business credit availability by enhancing the resilience of the banking system. Second, the Basel III Endgame capital rule proposed last year by the federal banking agencies will further bolster the banking system and will not impair small businesses' access to credit. Third, when small businesses experience difficulty obtaining bank financing, bank consolidation and lax merger oversight are often to blame, as larger and geographically distant banks typically do less small business lending than locally based community banks. Fourth, alternative sources of small business financing such as private equity and private credit may benefit certain small businesses, but they also pose potential risks and must be overseen accordingly. I expand on each of these points below.

I. <u>Post-2008 Bank Regulations Have Promoted Small Business Credit Availability</u>

The actions that Congress and the federal banking agencies took in response to the 2008 financial crisis to strengthen the banking system have helped ensure that small businesses can access credit throughout the economic cycle. The Dodd-Frank Act and Basel III capital rule substantially

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[1] *See* U.S. SMALL BUSINESS ADMINISTRATION OFFICE OF ADVOCACY, 2023 SMALL BUSINESS PROFILE, https://advocacy.sba.gov/wp-content/uploads/2023/11/2023-Small-Business-Economic-Profile-US.pdf (reporting that small businesses contributed a net increase of 4.9 million jobs, or 70 percent of the total net increase in employment between March 2021 and March 2022); *see also* Press Release, U.S. Small Business Administration Office of Advocacy, Small Businesses Generate 44 Percent of U.S. Economic Activity (Jan. 30, 2019), https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/.

increased banks' equity cushions. Collectively, these reforms have positioned banks to continue lending even under stressful economic conditions. Indeed, a substantial body of economic literature documents that better capitalized banks lend more during economic and financial stress, precisely when small businesses need credit the most.[2]

In fact, bank lending to small businesses has remained strong in the years since Dodd-Frank and Basel III were enacted. According to the Federal Reserve Board, bank loans to partnerships and proprietorships grew at a "robust" pace between 2012 and 2020.[3] Credit conditions for small business lending eased and small business loan spreads declined during the same time frame.[4] This experience confirms that strong capital requirements are consistent with long-term credit creation, economic expansion, and small business growth. Indeed, the period in which policymakers phased in new capital requirements coincided with the longest U.S. expansion on record.[5] The post-2008 financial reforms also prepared banks to support small businesses during the Covid pandemic, with the help of government initiatives like the Paycheck Protection Program (PPP).

Notably, local community banks play a critically important role in financing small businesses. Community banks have an advantage over other lenders when working with small businesses because of their geographic proximity and local knowledge.[6] Thus, community banks lend more than twice as much to small businesses as a share of their total assets compared to larger banks.[7] In addition, community banks approve a higher proportion of small business applicants, and small business owners report higher satisfaction when borrowing from a community bank compared to a larger bank or an online lender.[8] As a result, community banks punch above their weight in small business lending. According to FDIC data, community banks held 36 percent of all U.S. small business loans as of 2019, even though they accounted for just 15 percent of the banking industry's total loans.[9] That gap has likely widened due to community banks' outsized role in delivering PPP

[2] For example, one study concluded that "a country whose banks enter a crisis with a one percentage point higher capital ratio experiences 0.29 percentage points higher annual loan and 0.18 percentage points higher GDP growth in the following five years, compared to other countries." Basel Comm. on Banking Supervision, *The Costs and Benefits of Bank Capital—A Review of the Literature* 10 (Bank for Int'l Settlements, Working Paper No. 37, June 2019), https://www.bis.org/bcbs/publ/wp37.pdf.

[3] *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., AVAILABILITY OF CREDIT TO SMALL BUSINESSES 11-12 (2022), https://www.federalreserve.gov/publications/files/sbfreport2022.pdf.

[4] *See id.* at 15.

[5] *See* David John Marotta, *Longest Economic Expansion in United States History*, FORBES (Jan. 21, 2020), https://www.forbes.com/sites/davidmarotta/2020/01/21/longest-economic-expansion-in-united-states-history/.

[6] *See* FED. DEPOSIT INS. CORP., COMMUNITY BANKING STUDY, at 1-1 (2012) ("Community banks tend to be relationship lenders, characterized by local ownership, local control, and local decision making.").

[7] *See* AVAILABILITY OF CREDIT TO SMALL BUSINESSES, *supra* note 3, at 37 ("[T]he average banking organization with $1 billion or less in total assets held over 13 percent of its portfolio as small business loans in June 2021. In contrast … the largest organizations—those with assets greater than $10 billion—held approximately 6 percent of their assets as such loans.").

[8] *See* FED. RSRV. BANKS, 2023 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY 19 (2023), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2023/2023_sbcs-employer-firms.pdf (reporting that small banks approved 82 percent of small business loan applicants, compared to 71 percent for online lenders and 68 percent for large banks); *see also id.* at 21 (documenting that small businesses that were approved for financing reported an 81 percent satisfaction rate with small bank lenders, compared to 68 percent for large bank lenders and 48 percent for online lenders).

[9] *See* FED. DEPOSIT INS. CORP., COMMUNITY BANKING STUDY, *supra* note 6 at 4-7 (2020).

loans to small businesses during the Covid pandemic.[10] In sum, local community banks are responsible for much of the resilience in small business financing.

II. The Basel III Endgame Rule Will Not Impair Small Businesses' Access to Credit

Contrary to a popular misconception, the pending Basel III Endgame reforms will not threaten small businesses' access to credit. The Basel III Endgame rule, which the federal banking agencies proposed in July 2023, marks the culmination of the United States' implementation of the international framework for strengthening the banking system in response to the 2008 financial crisis.[11] The rule also begins to correct the regulatory weaknesses exposed in 2023 by three of the four largest bank failures in U.S. history. Like the initial Basel III rule that preceded it, the Basel III Endgame proposal will enhance banks' resilience and ensure that they are able to continue lending to small businesses throughout the economic cycle.

In addition to the general principle that bank capital promotes long-term credit availability, there are two specific reasons why Basel III Endgame will not impair banks' small business lending. First, the Basel III Endgame proposal applies to only the 37 largest banking organizations with more than $100 billion in assets.[12] As noted above, these banks focus far less on small business lending than local community banks. The Basel III Endgame proposal does not apply to the nation's 4,600 community and mid-sized banks, many of which specialize in relationship lending. Thus, finalization of the Basel III Endgame rule will not change the capital framework governing the community and mid-sized banks that fuel the small business economy. In fact, Basel III Endgame could help level the competitive playing field for smaller banks by ensuring that the largest banking organizations maintain capital levels commensurate with their risks.

Second, most of the capital increase in the Basel III Endgame proposal is associated with large banks' trading and fee-generating business lines, not their lending activities. In fact, the proposed rule would retain the existing credit risk-weight applicable to large banks' small business loans. Under currently applicable standardized capital rules, large banks apply a 100 percent risk-weight to small business loans, and they would continue to apply a 100 percent risk-weight to small business loans after finalization of the Basel III Endgame proposal.[13] Since the Basel III Endgame proposal would increase large banks' capital requirements for trading and fee-generating businesses, the rule could encourage these banks to place a relatively greater emphasis on small business lending as they optimize their balance sheets to focus on less capital intensive activities. Moreover, large banking organizations are subject to the banking agencies' recently finalized Community Reinvestment Act (CRA) rule, which will incentivize such banks to increase their small business lending in underserved and low- and moderate-income areas.[14]

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[10] *See* Margaret Hanrahan & Angela Hinton, *The Importance of Community Banks in Paycheck Protection Program Lending*, 14 FDIC Q., no. 4, 2020, at 31-36.

[11] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64028 (proposed Sept. 18, 2023) [hereinafter Proposed Rule].

[12] *See id.* at 64168.

[13] *Compare* 12 C.F.R. § 217.32(f)(1) (applying a 100 percent risk weight to corporate exposures under the currently applicable standardized capital rules), *with* Proposed Rule, *supra* note 11, at 64054 (applying a 100 percent risk weight to non-publicly traded corporate exposures under the Basel III Endgame proposal).

[14] *See* Community Reinvestment Act, 89 Fed. Reg. 6574 (Feb. 1, 2024).

III. **Bank Consolidation Has Harmed Small Business Credit Availability**

Although bank regulation has not impaired small businesses' access to credit, some small businesses still are unable to obtain the financing they need to survive and grow.[15] When creditworthy small businesses have trouble obtaining bank financing, bank consolidation and lax merger oversight are often to blame. Accordingly, policymakers should strengthen guardrails around bank mergers to prevent excessive consolidation and ensure that small businesses can continue to access the credit they need to thrive.

The U.S. banking system has experienced dramatic consolidation over the past century. More than thirty thousand banks operated in the United States during the 1920s. Today, fewer than one in six remain.[16] U.S. financial conglomerates are now bigger than ever, with the six largest bank holding companies (BHCs) controlling more assets than all other BHCs combined.[17] Community banks—which, as noted above, tend to specialize in relationship lending to small businesses—have borne the brunt of this consolidation trend, with more than 7,500 community banks merged out of existence between 1984 and 2011 alone.[18]

Regrettably, small businesses suffer when banks consolidate, as acquired banks reorient their lending toward larger, out-of-market borrowers. Numerous empirical studies have documented a reduction in small business lending associated with bank mergers.[19] As a result, when banks merge, fewer small businesses are formed.[20] For small businesses that are able to obtain loans following a bank merger, credit becomes more expensive, average loan size declines, and nonprice loan terms—such as collateral requirements—become more onerous.[21] Researchers at the Federal Reserve Bank of Philadelphia have documented why small businesses are hurt when community banks disappear via merger: large acquiring banks divert small business lending from their targets'

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[15] According to Federal Reserve data, only 76 percent of small businesses that applied for lines of credit and 66 percent that applied for business loans in 2022 were at least partially approved. *See* 2023 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2022 SMALL BUSINESS CREDIT SURVEY, *supra* note 8, at 17.

[16] There were 4,614 commercial banks and savings institutions in the United States as of the third quarter of 2023. *See* *Quarterly Banking Profile: Third Quarter 2023*, 17 FDIC Q. 4, 10 (2023).

[17] *See* Jeremy C. Kress, *Reviving Bank Antitrust*, 72 DUKE L.J. 520, 522 (2022).

[18] *See* FED. DEPOSIT INS. CORP., COMMUNITY BANKING STUDY, *supra* note 6 at II.

[19] *See* Steven G. Craig & Pauline Hardee, *The Impact of Bank Consolidation on Small Business Credit Availability*, 31 J. BANKING & FIN. 1237, 1248–58 (2007); Paola Sapienza, *The Effects of Banking Mergers on Loan Contracts*, 68 J. FIN. 329, 354 (2002); Allen N. Berger, Anthony Saunders, Joseph M. Scalise & Gregory F. Udell, *The Effects of Bank Mergers and Acquisitions on Small Business Lending*, 50 J. FIN. ECON. 187, 217, 218 tbl.5 (1998) (finding a reduction in small business lending following mergers between acquirers with more than $1 billion in assets and targets with more than $100 million in assets); Itamar Drechsler, Alexi Savov & Philipp Schnabl, *The Deposits Channel of Monetary Policy*, 132 Q.J. ECON. 1819, 1859 (2017); Katherine Samolyk & Christopher A. Richardson, *Bank Consolidation and Small Business Lending Within Local Markets* 4 (Fed. Deposit Ins. Corp., Working Paper No. 2003-02, 2003), https://www.fdic.gov/bank/analytical/working/wp03-02.pdf.

[20] *See* Bill Francis et al., *Bank Consolidation and New Business Formation*, 32 J. BANKING & FIN. 1598, 1603-09 (2008).

[21] *See* Mark J. Garmaise & Tobias J. Moskowitz, *Bank Mergers and Crime: The Real and Social Effects of Credit Market Competition*, 61 J. FIN. 495, 515 (2006) (concluding that bank mergers between 1995 and 1997 significantly increased the cost of commercial credit and decreased loan size); Sapienza, *supra* note 19, at 354 (finding that acquisitions by large banks increase the cost of credit for small businesses); Jonathan A. Scott & William C. Dunkelberg, *Bank Mergers and Small Firm Financing*, 35 J. MONEY, CREDIT & BANKING 999, 1012 (2003) (documenting more onerous nonprice terms in small business loan contracts following bank mergers).

communities to the acquirers' communities, leaving the targets' communities worse off.[22] Since larger banks tend to favor larger borrowers, bank mergers hasten the consolidation of the national economy and create barriers to entry for new entrepreneurs.[23]

Despite the harmful effects bank mergers have on small businesses, policymakers have done little to stem the tide of bank consolidation. Between 2006 and 2019, the Federal Reserve approved more than 3,500 bank merger applications without denying a single one.[24] The Department of Justice (DOJ) last sued to block an anticompetitive bank merger in the 1980s.[25] Although agency staffers sometimes encourage banks to withdraw problematic merger proposals, acquisitions of community banks are often reviewed under streamlined procedures and receive only cursory evaluation. In particular, the agencies rarely conduct a rigorous evaluation of how a merger would affect the "convenience and needs of the community to be served," including the consequences of the merger for small business credit availability.[26]

Cracking down on excessive bank consolidation is one of the most powerful steps policymakers could take to preserve small businesses' access to credit. In 2021, President Biden's Executive Order on Promoting Competition in the American Economy encouraged the federal banking agencies and the DOJ to "adopt a plan for the revitalization of merger oversight under the Bank Merger Act and Bank Holding Company Act."[27] The agencies' progress to date has been slow, yet there have been encouraging signs. Last year Assistant Attorney General Jonathan Kanter laid out his vision for modernizing bank merger review in light of changes in the banking sector since the DOJ last issued bank merger guidelines in 1995.[28] The federal banking agencies should build on this momentum and update their bank merger policies accordingly. Strengthening bank merger oversight is particularly important considering Capital One's recently announced plan to acquire Discover Financial, which could have significant impacts on small businesses, both as business credit cardholders and as merchants that must pay fees to access credit and debit card payment networks.

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[22] *See* Julapa Jagtiani & Raman Quinn Maingi, *How Important Are Local Community Banks to Small Business Lending? Evidence from Mergers and Acquisitions* 18–20 (Fed. Rsrv. Bank of Phila., Working Paper No. 18-18, 2018), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2018/wp18-18.pdf.

[23] *See* Nicola Cetorelli & Philip E. Strahan, *Finance as a Barrier to Entry: Bank Competition and Industry Structure in Local U.S. Markets*, 61 J. FIN. 437, 437 (2006) ("The empirical evidence . . . strongly supports the idea that in markets with concentrated banking, potential entrants face greater difficulty gaining access to credit than in markets in which banking is more competitive."); *id.* at 438 ("[W]e find that more vigorous banking competition . . . is associated both with more firms in operation and with a smaller average firm size.").

[24] *See* Jeremy C. Kress, *Modernizing Bank Merger Review*, 37 YALE J. ON REGUL. 435, 456 (2020).

[25] *See id.* at 453.

[26] Both the Bank Merger Act and Bank Holding Company Act require the responsible federal agency to consider the "convenience and needs of the community to be served" when acting on a merger application. 12 U.S.C. §§ 1828(c)(5), 1842(c)(2).

[27] Exec. Order No. 14,036, 86 Fed. Reg. 36,987, 36,992 (July 14, 2021).

[28] Jonathan Kanter, Assistant Att'y Gen., Dep't of Just., Merger Enforcement Sixty Years After *Philadelphia National Bank* (June 20, 2023), https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-keynote-address-brookings-institution.

IV. Alternative Financing Sources May Benefit Some Small Businesses, But They Also Pose Potential Risks and Should Be Overseen Accordingly

In recent years, some small business owners have turned to alternative sources of financing—such as private equity, private credit, and venture capital—to fund their companies. When structured with appropriate guardrails, these alternative financing arrangements can create new pathways for small businesses to grow. For example, proponents of private credit assert that small businesses may experience quicker underwriting and more flexible covenants when borrowing from a private lender compared to a bank.[29] In addition, some small businesses may benefit from managerial expertise and strategic advice they receive from private equity investors.

However, policymakers and small business owners should approach private capital with caution, for at least two reasons. First, based on the minimal data available, private investors appear to focus on the types of businesses that already have access to capital. Thus, private markets may be ill-suited to reduce barriers to financing for underserved small businesses, including minority- and women-owned companies. Second, because private investors' interests are not necessarily aligned with those of other stakeholders, private capital may pose risks to small business owners, their employees, and their communities. I expand on both of these points below.

A. Private Capital May Not Reduce Barriers to Financing for Underserved Small Businesses

Although private markets are opaque, the little data that are available suggest that private equity, private credit, and venture capital may not be viable options for many small businesses in need of financing. In general, these private investors tend not to make the small-dollar investments that are essential to many proprietorships and partnerships. In addition, private capital flows disproportionately to White, male-owned companies in coastal cities. Thus, rather than reducing inequities in finance, private capital may perpetuate them.

As an initial matter, private market investors generally do not make small-dollar investments on which many small businesses rely. According to Federal Reserve data, small business loans by banks averaged between $71,000 and $167,500 in the third quarter of 2023.[30] By contrast, the average private credit loan exceeded $80 million in 2022.[31] Moreover, private equity made just 14 percent of its investments in companies with fewer than 10 employees in that same year.[32] These data suggest that private capital skews toward larger, established companies, rather than small businesses striving to get off the ground.

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[29] *See* EY, ECONOMIC CONTRIBUTION OF PRIVATE CREDIT TO THE US ECONOMY IN 2022, at ii (2023), https://www.investmentcouncil.org/wp-content/uploads/2023/10/EY-AIC-Private-credit-attributed-employment-report-09-28-2023-1.pdf (reporting the results of a survey commissioned by the American Investment Council).

[30] *See* Fed. Rsrv. Bank of Kan. City, *Small Business Lending Survey, Aggregate Survey Data*, https://www.kansascityfed.org/Research/documents/9943/Q3-2023-Aggregate-Data-PDF-Small-Business-Lending-Survey.pdf (reporting in Table A.3 more than 360,000 outstanding fixed-rate term loans among survey participants totaling $25.8 billion, for an average of approximately $71,000 and in Table A.6 more than 52,000 outstanding variable-rate term loans among survey participants totaling $8.8 billion, for an average of approximately $167,500).

[31] *See* Fang Cai & Sharjil Haque, *Private Credit: Characteristics and Risks*, FEDS NOTES (Feb. 23, 2024), https://www.federalreserve.gov/econres/notes/feds-notes/private-credit-characteristics-and-risks-20240223.html.

[32] *See* EY, ECONOMIC CONTRIBUTION OF THE US PRIVATE EQUITY SECTOR IN 2022, at 9 (2023), https://www.investmentcouncil.org/wp-content/uploads/2023/04/EY-AIC-PE-economic-contribution-report-FINAL-04-20-2023.pdf.

Moreover, private capital may not be readily available to small businesses in underserved areas. One study found that the top ten metropolitan areas—including Silicon Valley, New York, Los Angeles, and Boston—accounted for more than three-quarters of all venture capital investment across the United States.[33] Similarly, businesses in coastal states receive a significant majority of private equity investment.[34] This geographic bias is consistent with the distribution of private investment funds themselves, which tend to be concentrated in coastal areas.[35]

In addition, women and minority entrepreneurs receive very little funding from private investors. For example, female-founded companies accounted for only two percent of all venture capital investment in 2022.[36] Black entrepreneurs similarly receive less than two percent of all venture capital investments each year.[37] Again, these findings track a lack of diversity in private investment firms themselves. As the *Wall Street Journal* reported, firms that are at least 50 percent minority- or women-owned hold just 2 percent of private credit assets, 3 percent of private equity assets, and 6 percent of venture capital assets.[38]

To be sure, these inequities in private capital are directionally consistent with biases documented in the traditional banking sector.[39] However, barriers to financing for underserved businesses may be even more severe in the private market because the CRA's statutory imperative to invest in low- and moderate-income areas does not apply to private credit, private equity, or venture capital.

B. Private Capital May Pose Risks to Small Businesses, Employees, and Communities

Although private capital may benefit certain small businesses, it can also pose potential risks. Since a private fund's primary goal is to maximize returns for its partners, its interests may not necessarily be aligned with those of other stakeholders in a small business. Thus, a private investor may structure its financial commitment in a way, or encourage a management strategy, that is disadvantageous for a small business' owners, its employees, and its community. Accordingly, small business owners and policymakers alike should approach private capital with requisite caution.

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[33] *See* Richard Florida, *A Closer Look at the Geography of Venture Capital in the U.S.*, BLOOMBERG (Feb. 23, 2016), https://www.bloomberg.com/news/articles/2016-02-23/the-geography-of-venture-capital-in-the-u-s.

[34] *See* Joyce Guevarra et al., *Private Equity Most Active in Coastal States Across All US Regions*, S&P GLOBAL MKT. INTEL. (Oct. 16, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/private-equity-most-active-in-coastal-states-across-all-us-regions-77698269.

[35] *See* Henry Chen, Paul A. Gompers, Anna Kovner & Josh Lerner, *Buy Local? The Geography of Successful and Unsuccessful Venture Capital Expansion* (Nat'l Bureau of Econ. Rsch., Working Paper No. 15102, 2009), https://www.nber.org/system/files/working_papers/w15102/w15102.pdf.

[36] *See US VC Female Founders Dashboard*, PITCHBOOK (Mar. 7, 2024), https://pitchbook.com/news/articles/the-vc-female-founders-dashboard.

[37] *See* Gabrielle Fonrouge, *Venture Capital for Black Entrepreneurs Plummeted 45% in 2022, Data Shows*, CNBC (Feb. 2, 2023), https://www.cnbc.com/2023/02/02/venture-capital-black-founders-plummeted.html.

[38] *See* Maria Armental, *Private Credit's Rising Tide Fails to Lift Women- and Minority-Owned Firms*, WALL ST. J. (Nov. 29, 2023), https://www.wsj.com/articles/private-credits-rising-tide-fails-to-lift-women-and-minority-owned-firms-2b569919.

[39] *See, e.g.*, Maura L. Scott et al., *Revealing and Mitigating Racial Bias and Discrimination in Financial Services*, J. MKTG. RSCH. (forthcoming), https://journals.sagepub.com/doi/full/10.1177/00222437231176470.

While a private investor's incentives may sometimes be aligned with those of its portfolio companies, this is not necessarily the case. Private investors typically have a limited time horizon: the average holding period for a private equity investment and the average maturity of a private credit loan are both about five years.[40] As a result, private investors in small businesses may implement management strategies intended to generate short-term profits, rather than sustainable business growth. For example, private equity investors may liquidate a small business' assets, reduce long-term capital investments, load up the company with excessive debt, or pay out profligate dividends.[41] Similarly, private credit funds may charge inordinately high interest rates or insist on onerous covenants.[42] While these strategies may be detrimental to a small business' long-term prospects, they are often profitable for the private fund that exits the investment after just a few years.[43]

In addition to harming entrepreneurs, private investors' tactics can have adverse effects on small businesses' employees, communities, and other stakeholders. For example, private equity funds frequently terminate employees of portfolio companies in which they invest. One study found that private equity investment in the retail sector led to more than 1.3 million jobs lost in just ten years.[44] Private equity's aggressive cost-cutting strategies can also harm small business customers. At the extreme, private equity ownership has been estimated to be responsible for tens of thousands of deaths in critical industries such as healthcare and nursing homes.[45]

Policymakers could take several steps to mitigate the risks posed by private capital. For example, Congress could enact limits on portfolio companies' dividends to prevent private investment funds from extracting financial resources from the companies in which they invest.[46] Congress could likewise insist that private investment funds assume responsibility for the liabilities of their portfolio companies to better align the funds' incentives with those of the small businesses in which they invest.[47] Finally, policymakers should enhance transparency in private credit so that

[40] *See* Maria Amental, *Private-Equity Firms Pump Sales Opportunities for 2024*, WALL ST. J. (Feb. 15, 2024), https://www.wsj.com/articles/private-equity-firms-pump-sales-opportunities-for-2024-c0bd7eae (reporting that the average holding period for private equity-backed companies was 5.6 years in 2023); Cai & Haque, *supra* note 31 (reporting that the average maturity in private credit is generally around 5 years).
[41] *See* BRENDAN BALLOU, PLUNDER: PRIVATE EQUITY'S PLAN TO PILLAGE AMERICA (2023).
[42] *See* Cai & Haque, *supra* note 31 (reporting that credit spreads exceeded 650 basis points in 2023, nearly 250 basis points higher than leveraged loans); *see also* M. Shams Billah, *Private Credit Loan Transactions*, PRACTICAL GUIDANCE J. (Aug. 24, 2023), https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/private-credit-loan-transactions ("The extensive set of covenants in private credit loan transactions typically results in lenders having a greater say in the company's affairs…").
[43] *See, e.g.*, Brendan Ballou, *When Private-Equity Firms Bankrupt Their Own Companies*, THE ATLANTIC (May 1, 2023), https://www.theatlantic.com/ideas/archive/2023/05/private-equity-firms-bankruptcies-plunder-book/673896/.
[44] *See* PIRATE EQUITY: HOW WALL STREET FIRMS ARE PILLAGING AMERICAN RETAIL 4 (2019), https://united4respect.org/wp-content/uploads/2019/07/Pirate-Equity-How-Wall-Street-Firms-are-Pillaging-American-Retail-July-2019.pdf.
[45] *See, e.g.*, Atul Gupta et al., *Owner Incentives and Performance in Healthcare: Private Equity Investment in Nursing Homes* (Nat'l Bureau of Econ. Rsch., Working Paper No. 28474, 2021), https://www.nber.org/papers/w28474.
[46] *See* Stop Wall Street Looting Act, H.R. 5648, 117th Cong. (2022).
[47] *See id.*

prudential regulators like the Financial Stability Oversight Council can better monitor the market for emerging systemic risks.[48]

V. Conclusion

In sum, it is vitally important that policymakers ensure entrepreneurs have access to funding to establish and grow their companies. Since the 2008 financial crisis, new guardrails have helped promote small business credit availability by safeguarding the banking system. To foster small business financing in the future, policymakers should slow the rapid pace of bank consolidation to preserve community banks that play an essential role in funding small businesses. Although private capital can fill some gaps in small business financing when local community banks disappear, these alternative financing sources may perpetuate or exacerbate existing disparities and may pose risks to small businesses, their employees, and communities.

[48] *See* FIN. STABILITY OVERSIGHT COUNCIL, ANNUAL REPORT 2023, at 34 (2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf ("The level of opacity in private credit markets can make it challenging for regulators to assess the buildup of risks in the sector.").