SPRING 2019

FINANCING MAIN STREET:

THE STATE OF BUSINESS FINANCING IN AMERICA

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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EXECUTIVE SUMMARY

After a challenging decade that included a financial meltdown, recession, and a historically slow recovery, American businesses are reporting that their ability to access capital is steadily improving, and generally they are optimistic about their expected performance over the next 12 months. This improvement is a welcome development, given the difficulties Main Street businesses had raising capital in the years immediately following the financial crisis.

In order to promote sustainable economic growth, our financial system must be as vibrant and diverse as the businesses it serves: A small business with one location may require the services of a local community bank that understands the neighborhood, while a large multinational company relies on the expertise of a global bank. In addition to traditional bank lending, the U.S. capital markets play a critical role in providing debt and equity financing to American businesses.

A key component of a strong financial system is a regulatory structure that promotes economic growth. Unfortunately, the post-2008 financial crisis regulatory response imposed enormous costs on the economy while doing little to fundamentally reform the U.S. financial regulatory system. As a result, Main Street businesses found it more difficult to access the capital they needed to innovate, grow, and hire new employees.

While businesses report steady improvements in capital access, they view a few specific regulations on the financial system as continuing to present a barrier to growth. Businesses are also more concerned about the future performance of the overall economy than they are about their own performance.

The U.S. Chamber of Commerce surveyed more than 300 corporate finance professionals about their core financial services needs and the direct or indirect impact that financial regulation has had on their ability to access short- and long-term capital. We asked them about products they use, services they rely on, and the number of financial institutions they typically use for various transactions. We also asked them how they see their company as well as the broader economy performing over the next 12 months.

This report and survey are intended to help policymakers better understand the ongoing impacts that financial regulation has on the broader economy and to inform regulatory reform efforts that are currently underway.

STATE OF BUSINESS FINANCING

THE DIFFERENT FINANCING NEEDS OF MAIN STREET BUSINESSES

American businesses rely on the U.S. financial system for a variety of needs, including:

- Cash management
- Obtaining short-term credit/issuing commercial paper
- Obtaining long-term loans
- Equity financing
- Issuing long-term debt
- Trade financing
- Derivatives transactions

Because of their specific needs, companies often rely on more than one financial institution to offer them different services or products.

- Most businesses use one to three financial institutions to help finance most of their activities.
- Many businesses have reduced or substituted the number of financial institutions used since 2016 due to the impact financial regulation has had on consolidation and the ability of banks to provide certain services.
- Businesses are more likely to use four or more financial institutions for derivatives transactions, issuing debt, obtaining long-term loans, and trade financing than any other service.

THE ONGOING IMPACT OF REGULATION ON MAIN STREET

Lingering effects of the post-financial crisis regulatory response in the U.S. and abroad continue to present a challenge to American businesses. Bank capital charges in particular are cited as an impediment to capital access.

- Of companies, ***82%*** report taking some action as a result of changes to banking regulations, up from 61% in 2013 and 79% in 2016.
- Of businesses, ***45%*** report absorbing the higher costs of banking services and loans, while 28% report increasing prices for customers as a result of financial regulation.
- Of businesses, ***27%*** report substituting or reducing the number of financial institutions that provide services to them.
- Of companies, ***66%*** report that increased bank capital charges have led to increased costs or other challenges, up from 50% in 2016.
- Of companies, ***63%*** support federal regulators recalibrating capital requirements for large banks when lending money to small businesses.

BUSINESSES REPORT MARGINAL IMPROVEMENTS, BUT ISSUES REMAIN

Businesses report improvements across virtually all aspects of their financing needs; however, the ability to both raise and invest short-term capital has improved the most. Raising equity remains a challenge for a considerable number of businesses.

- Of businesses, ***58%*** report that their ability to manage their cash operations has improved.
- Of companies, ***45%*** say their ability to obtain short-term credit has improved, while another 31% report no change.
- Of companies, nearly ***20%*** say that it has gotten more difficult to raise equity from public and private markets.

MIDDLE MARKET COMPANIES ARE PARTICULARLY IMPACTED

Middle market companies report unique challenges to accessing credit relative to their smaller or larger counterparts. These issues include challenges with obtaining loans as well as costs related to audit inspections and derivatives transactions.

Of middle market companies that stated they have been impacted by financial regulation:

- ***42%*** believe financial regulation has negatively impacted their ability to access capital.
- ***31%*** (versus 20% of large companies) say Public Company Accounting Oversight Board (PCAOB) audit standards have a negative impact on them.
- ***29%*** say that margin requirements for derivatives transactions has negatively impacted their operations.

INTRODUCTION

The past decade has been one of the most challenging periods for Main Street businesses in recent memory. The financial crisis of 2008, the ensuing recession, and a long period of lackluster growth made it harder for businesses to start, expand, or hire new workers. Businesses of all sizes were impacted during this period, as was just about every industry in the U.S. economy.

Compounding the problem was the significant and oftentimes disjointed regulatory response to the 2008 financial crisis. Regulators in the U.S. and abroad set about implementing hundreds of new regulations for the financial system, many of which were unsupported by economic analysis and unrelated to the causes of the financial crisis. As a result, it has become more difficult for financial institutions of all sizes to meet the needs of their customers: American businesses.

Main Street businesses rely on a diverse and vibrant financial system to provide them the capital they need to grow and innovate. When financial institutions are restricted in their ability to support business, the overall economy and the ability of people to find work suffers. Unfortunately, banks and other financial services providers have had to cease offering certain products or servicing certain markets due to cumbersome and misguided regulation.

The U.S. Chamber conducted surveys of corporate treasurers in 2013 and 2016 to better understand how Main Street uses the financial system and to measure the impact that financial regulation was having on the overall economy.

These surveys found that rules intended to increase financial stability actually made it more difficult for nonfinancial businesses to access capital and that businesses had a negative view overall of how recently implemented regulations would affect their long-term performance.

The Chamber's 2019 survey—completed by over 300 corporate finance professionals at companies of all sizes—found that businesses have generally become more optimistic over the past two years regarding their prospects and ability to access capital. For example, 62% of companies expect their financial performance to improve over the next year, while 76% report that their ability to obtain short-term credit has either remained the same or improved recently.

It is likely no coincidence that this increase in optimism has coincided with recent regulatory reform efforts to lessen some of the unintended consequences of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and other rules put in place in the wake of the crisis. Regulators have focused on improving the transparency surrounding regulation, while the "tone at the top" at regulatory agencies has shifted decidedly to be more constructive and deliberate in all facets of regulation, such as embracing robust cost-benefit analysis.

Congress has also addressed some of the areas where regulation has missed the mark. The Economic Growth, Regulatory Relief, and Consumer Protection Act (signed into law in May 2018) requires more appropriate tailoring of regulation based on a financial institution's size and includes a number of other provisions that, if implemented properly, should further improve the environment for business financing. Additionally, Congress is currently considering legislation that would build on the success of the 2012 Jumpstart

Our Business Startups (JOBS) Act in order to help companies raise equity through public and private channels.

Businesses continue to emphasize the importance of a diverse financial system to help them meet their needs. Of businesses, 91% say it is important for their bank to offer a wide spectrum of services, while nearly three-quarters prioritize banks that specialize in specific products. Mobile payments especially, along with artificial intelligence and other technological developments, are expected to play an increasing role in the relationship between financial services firms and Main Street businesses.

However, certain aspects of business financing remain a challenge. For example, bank capital charges are specifically cited as the one regulatory change that has increased costs for businesses over the past two years. The Dodd-Frank Act and the Basel III capital regime mandate that financial institutions maintain higher levels of capital. A capital surcharge on globally systemically important banks (G-SIB surcharge) is one example of a mandate that was intended in part to promote financial stability but in reality has made it harder for banks to lend to businesses and assist with activities such as trade financing.

> "As a retailer, we are not directly impacted by the financial regulations. However, if those regulations were increased, they would indirectly impact the company through the decreased availability of credit."
>
> ***– A Mid-Sized Company Financial Executive Survey Respondent***

Another finding from this year's survey is that middle market companies are disproportionately experiencing some of the negative consequences of regulation, making it more difficult for them to serve the communities and regions in which they operate. Issues faced by middle market companies go beyond regulations implemented in the wake of the 2008 crisis. For example, middle market companies are more likely to say that PCAOB audit standards negatively impact their ability to operate. While strong internal controls are critical for investor confidence and business performance, the Chamber has long been concerned that audit standards overseen by the PCAOB have not been scalable for small and midsize public companies.

Overall, businesses report that while there have been improvements in accessing short-term credit, their ability to raise long-term debt as well as equity has become more difficult. Companies are also more pessimistic about the overall economy than about their own performance: More than one-third expect the economy to worsen over the next 12 months, with interest rates and trade-related issues cited as the top two concerns.

The Chamber remains committed to advocating for policies that promote entrepreneurship, strengthen financial stability, and enhance economic growth. We hope this report helps policymakers understand the impact of regulation on business financing in order to better inform the regulatory process.

METHODOLOGY

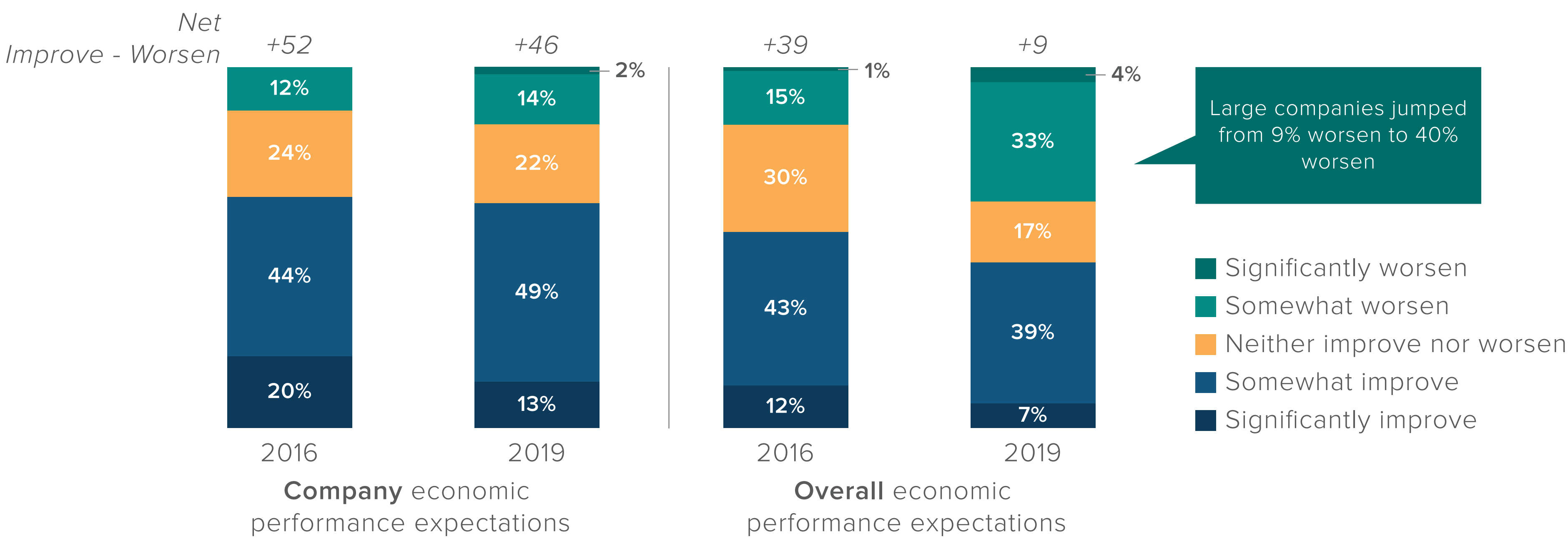
Brunswick Insight surveyed 318 executives with financial decision-making power (e.g., CFO, controller, treasurer) at both private and public companies across a variety of sectors, including healthcare, manufacturing, and technology. Further analysis was based on company size, where small companies are those with less than 250 employees, midsize companies are those with 250 to 999 employees, and large companies are those with 1,000 or more.

Small companies report revenues largely under $500,000, and midsize company revenues largely fall between $1 and $99 million. Large companies on the other hand had revenues falling largely between $1 and $49 billion. A very large majority of those we spoke with have operations in the U.S., while some operate in regions such as Canada, Mexico, and Europe, among others. Half (48%) of the financial executives we spoke with work at companies with a debt rating of A or higher, including 53% of large companies.

Favorable Outlook for Company Despite Pessimism Toward Larger Economy

Expectations for overall company performance have held stable, though there has been a strong increase in negativity regarding financial executives' outlook toward the economy as a whole

Outlook over the Next 12 Months



STATE OF BUSINESS FINANCING

WHAT MAIN STREET NEEDS FROM THE FINANCIAL SYSTEM

Rapid technological transformation, the increasingly global nature of business, and a generational shift in the preferences of consumers have all served to change the landscape for American businesses. A strong financial system must reflect this dynamism in order to serve the needs of the 21st century economy.

Businesses have long relied on the financial system for traditional banking and lending products, but they increasingly rely on financial institutions to manage currency fluctuations, hedge risk through the use of derivatives, and raise large amounts of equity or debt. Unlike in other countries—where traditional bank lending remains the primary source of corporate finance—the U.S. capital markets play a critical role in helping companies meet both short- and long-term obligations.

As a result, companies often choose their financial institutions based on their own unique circumstances and financing needs. This year's survey found, for example, that local and community banks are the most effective partners when it comes to finding a lender that understands a particular local economy.

At the same time, businesses that operate across the country look to banks with a regional or national presence when they need specialization in certain products or access to a wide range of different services. And global banks—by a wide margin—are seen as the best option for helping businesses gain access to markets outside the U.S.

Put simply, banks of all sizes and geographies play a critical role in the U.S. economy and provide businesses with options for their financing needs.

Additionally, the rise of mobile payments, artificial intelligence, and distributed ledger technology all present unique opportunities for companies to grow and compete in the modern global economy. Most companies believe these technological advancements will only become more prominent in the years to come.

"Small businesses are driving the American economy, and if they can't get access to liquidity or credit, the economy is going to falter. It is a slippery slope if Congress doesn't step in and find ways to make it easier for business owners, especially small business owners, to access capital and liquidity."

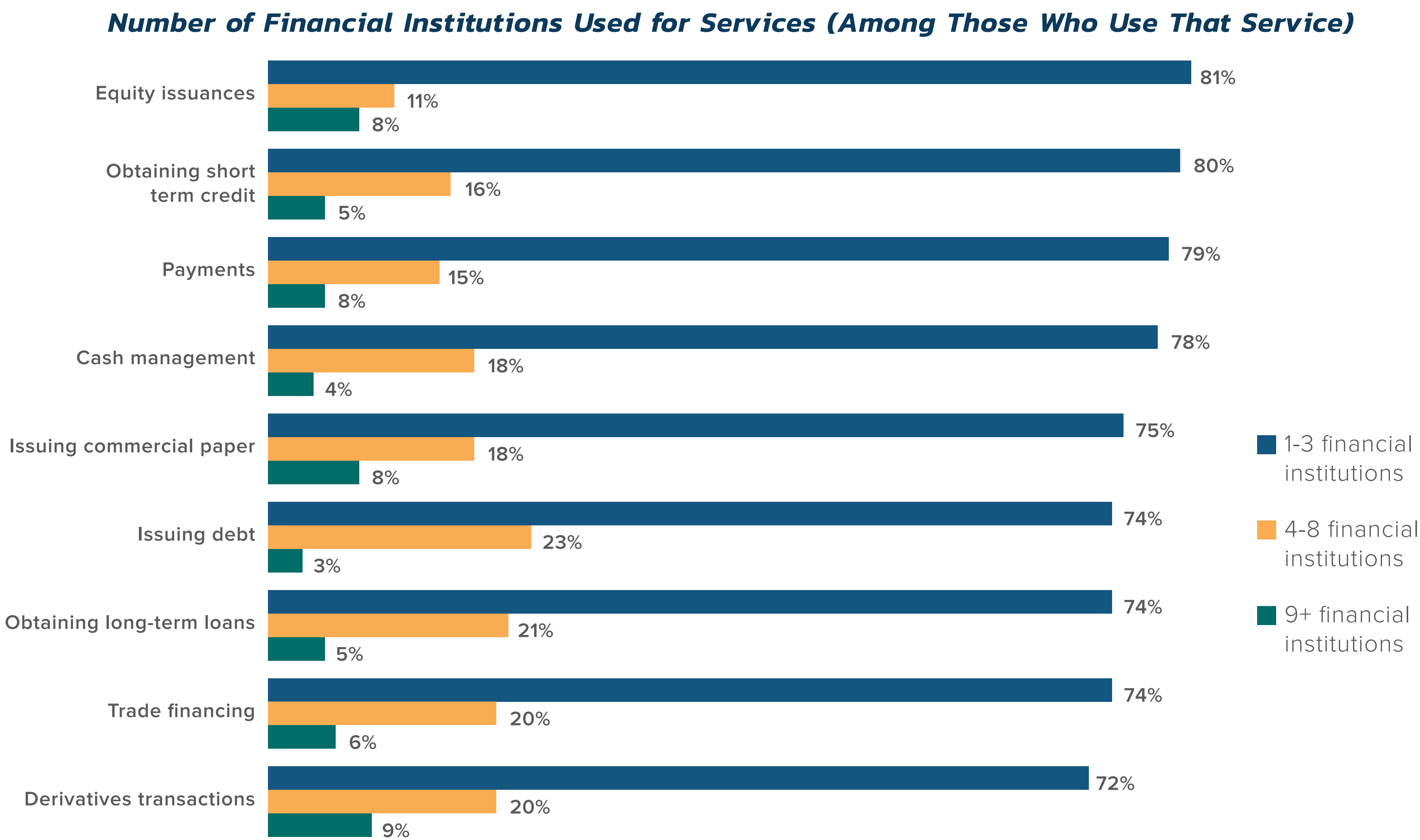
– A Large Company Financial Executive Survey Respondent

KEY FINDINGS:

- Most businesses use one to three financial institutions to help finance a wide array of activities. Over one-quarter have had to reduce or substitute the financial institutions they use since 2016 due to financial regulation.
- Businesses are most likely to use four or more financial institutions for certain activities, including issuing debt (23% of companies use between four and eight institutions), obtaining long-term loans (21%), trade financing (20%), and derivatives transactions (20%).
- "Ease of use" and competitive offerings are the top attributes that businesses look for in banks.
- Of businesses seeking a lender with a local or regional footprint, ***61%*** prefer a small local bank.
- Of businesses that want access to markets outside the U.S., ***66%*** prefer to use a global bank for trade financing and other needs.
- Of businesses, ***62%*** find that banks with a national or large regional footprint are efficient at offering a wide spectrum of services.
- Of businesses, ***70%*** believe that mobile payments will have an impact on company growth in the future, while 61% believe the same for artificial intelligence.

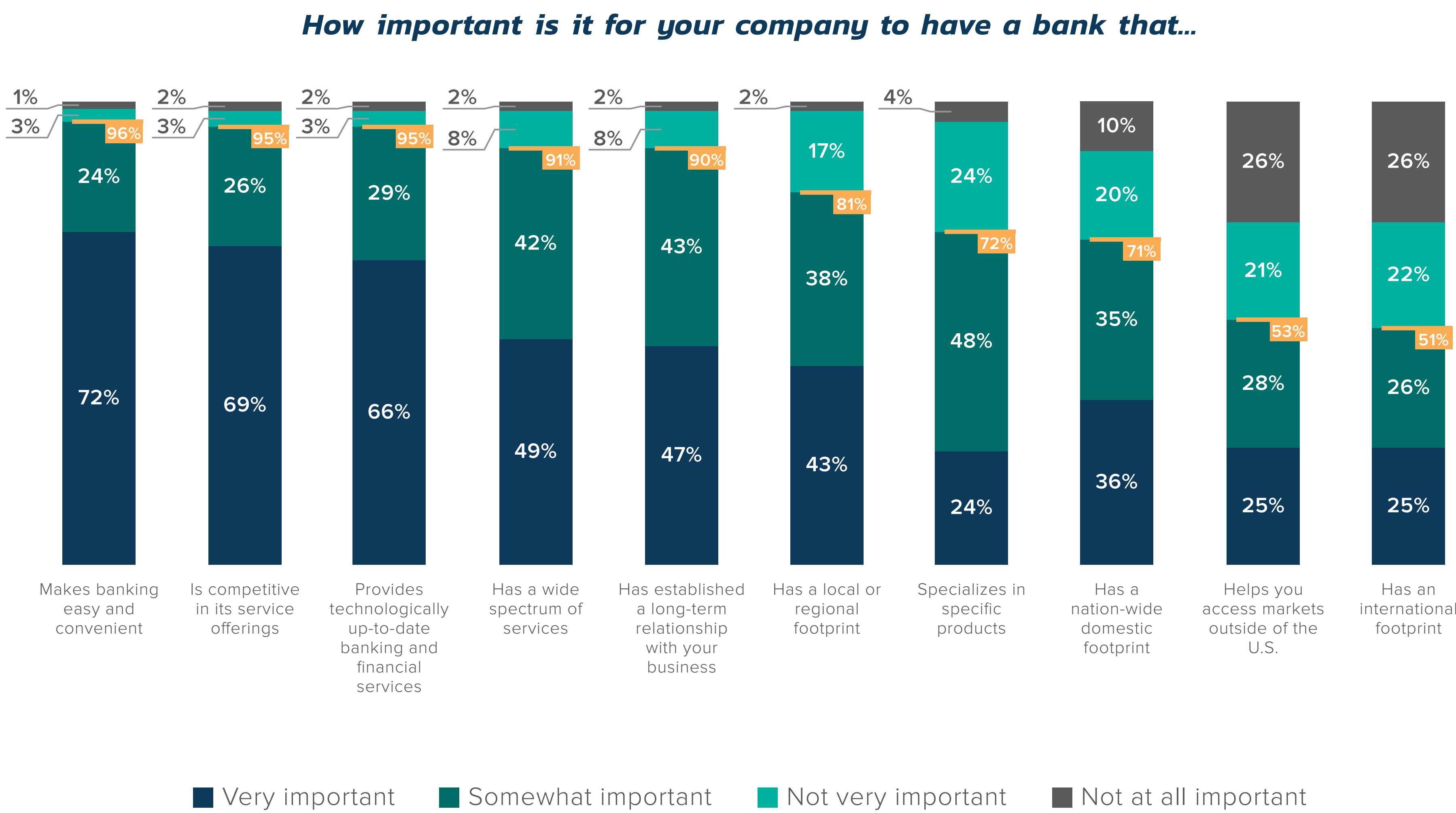
Small Number of Institutions Used for Services

Most companies use between one and three financial institutions for key services, with little deviation based on the type of service used



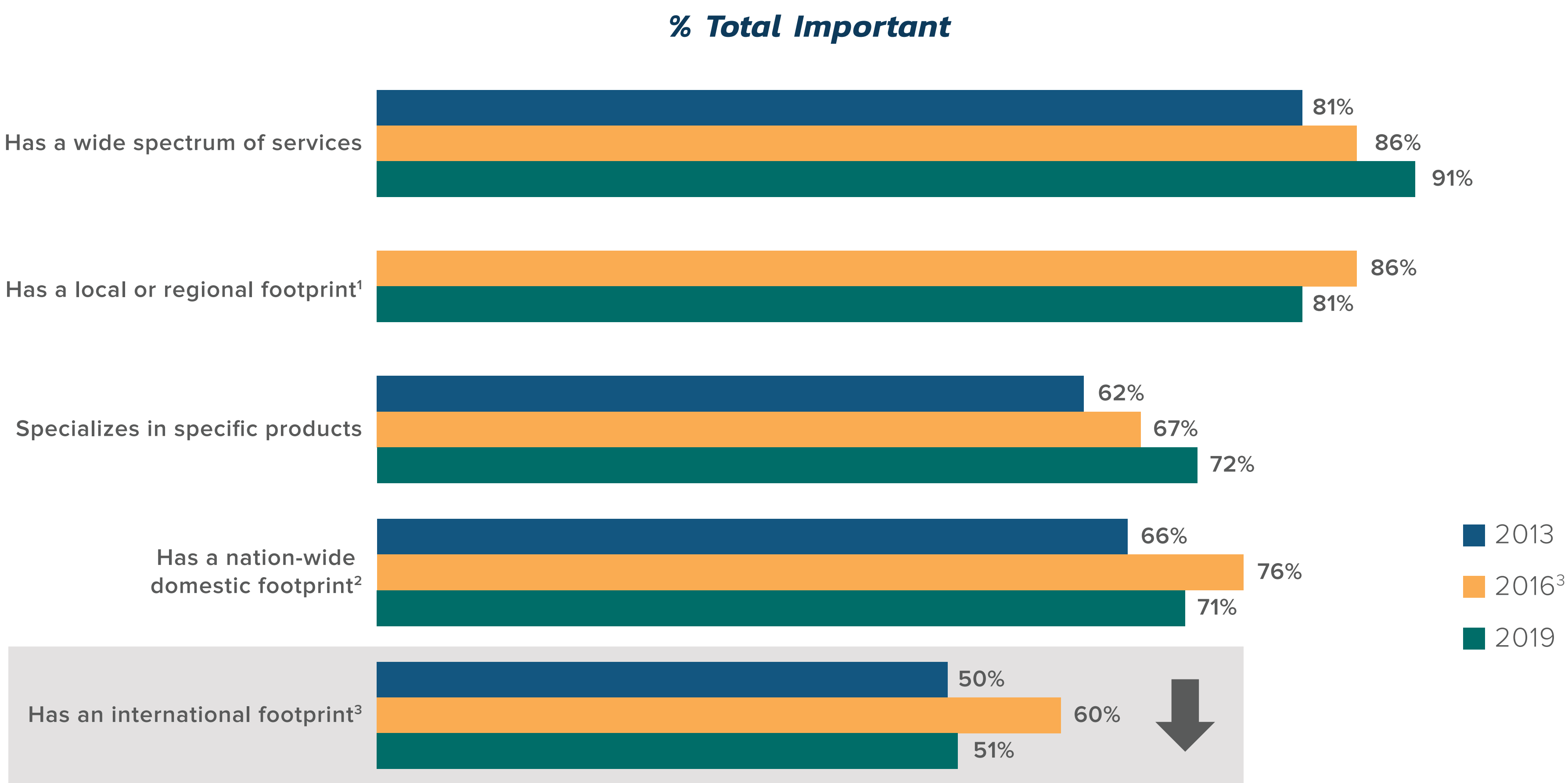
Ease-of-Use and Competitive Offerings Are Top Attributes for Banks

When thinking of important qualities, Financial Executives cite making banking easy and convenient and having access to a competitive, technologically up-to-date suite of offerings as top attributes



Attribute Importance Unchanged Over Time

Having an international footprint is less important to respondents in 2019 than it was to them in 2016



[1] "Has a well-established local or regional footprint" in 2016 survey; not asked in 2013 survey

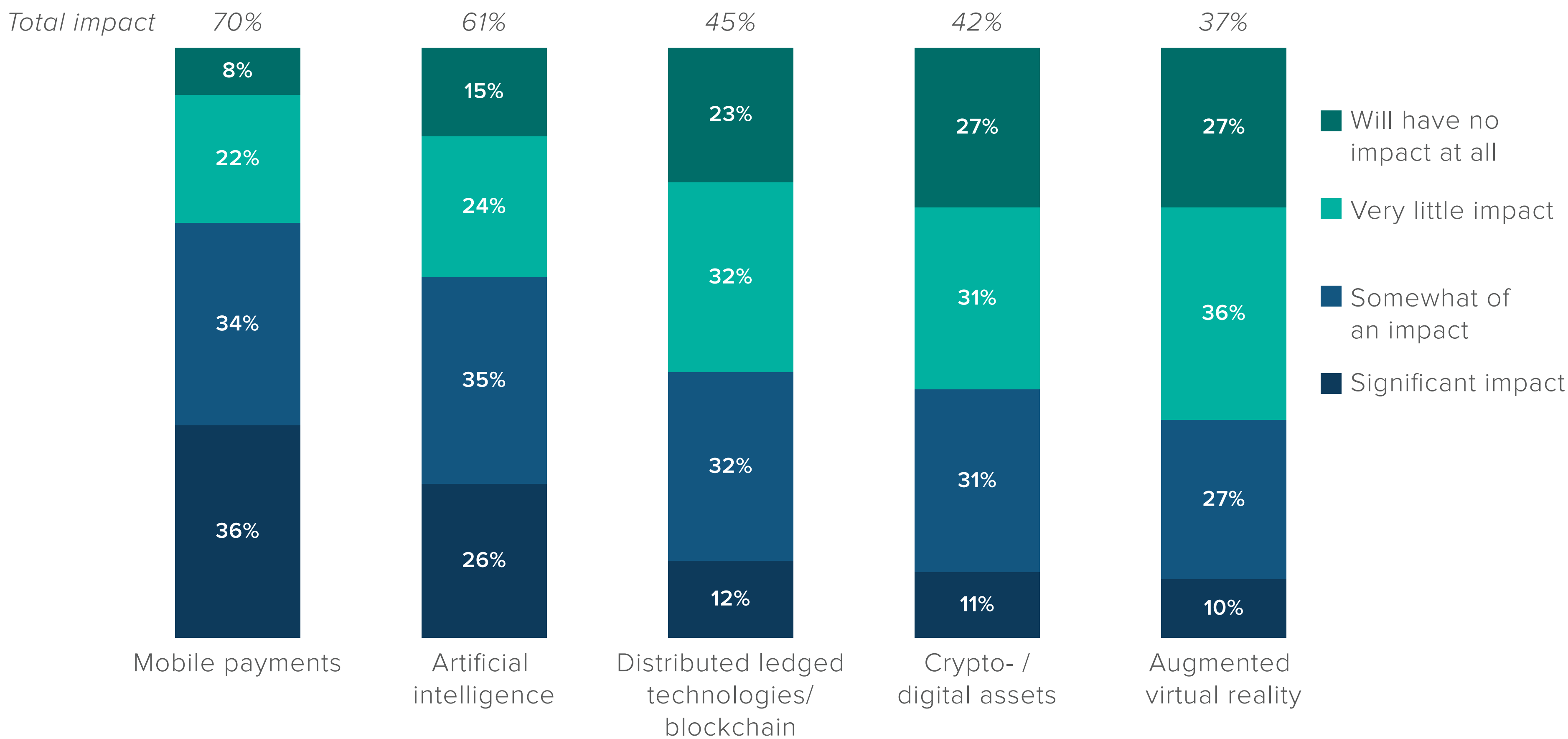
[2] "Has a large domestic footprint" in 2016 survey

[3] "Has a large global footprint" in 2016 survey

Mobile Payments to Impact Growth the Most

Respondents were most likely to say that mobile payments and AI will have the biggest impact on their company's growth strategies and ability to streamline business functions in the next five years

To what degree do you see each of the following impacting your company's growth strategies and ability to streamline business functions over the next five years?



THE ONGOING IMPACT OF FINANCIAL REGULATION ON MAIN STREET

Businesses have had to grapple with a historic number of new regulations imposed on the financial services sector over the past decade. While many of these regulatory efforts were designed to enhance the safety and soundness of the financial system both in the U.S. and abroad, oftentimes they have missed the mark and only made it harder for the financial system to serve the broader economy. The 2013 and 2016 surveys conducted by the Chamber both found that the cumulative effect of post-crisis regulations impacted businesses in their attempts to raise capital.

The results of the 2019 survey include a number of similar findings. Of companies, 82%—up from 61% in 2013—report that they have had to take some action as a direct result of new banking regulations. These actions include substituting or reducing the number of financial institutions that provide services to banks, absorbing the higher costs of banking services, or increasing prices for customers. In fact, 28% of businesses have had to pass regulatory costs on to customers, while 27% substituted or reduced the number of financial institutions that provide services to them.

Notably, companies specifically cite bank capital charges, which include mandates such as the G-SIB surcharge, as a challenge to accessing credit. Two-thirds of companies—up from half in 2016—report that increased bank capital charges have increased costs or other challenges. Companies accordingly express strong support for federal regulators tailoring capital requirements for large banks when lending money to small businesses and for consistent regulatory treatment between U.S.-based banks and foreign banks operating in the U.S.

This year's survey also found that it is not just post-crisis rules that are presenting challenges for companies. For example, the 2019 survey found significant concerns over PCAOB audit standards for small and midsize businesses as compared to larger businesses.

> "It's definitely creating pressure on our end to manage risk. Sometimes that means pressure to increase prices for customers just to cover the additional fees and so forth."
>
> ***– A Mid-Sized Company Financial Executive Survey Respondent***

KEY FINDINGS:

- Of companies, ***82%*** report taking some action as a result of changes to banking regulations, up from 61% in 2013 and 79% in 2016.
- Of businesses, ***45%*** report absorbing the higher costs of banking services and loans, while 28% report increasing prices for customers as a result of financial regulation.
- Of businesses, ***27%*** report substituting or reducing the number of financial institutions that provide services to them.
- Of companies, ***66%*** report that increased bank capital charges have led to increased costs or other challenges, up from 50% in 2016.
- Of companies, ***63%*** support federal regulators recalibrating capital requirements for large banks when lending money to small businesses.
- Of businesses, ***88%*** support foreign banks operating in the U.S. being held to the same regulatory standards as U.S. banks.

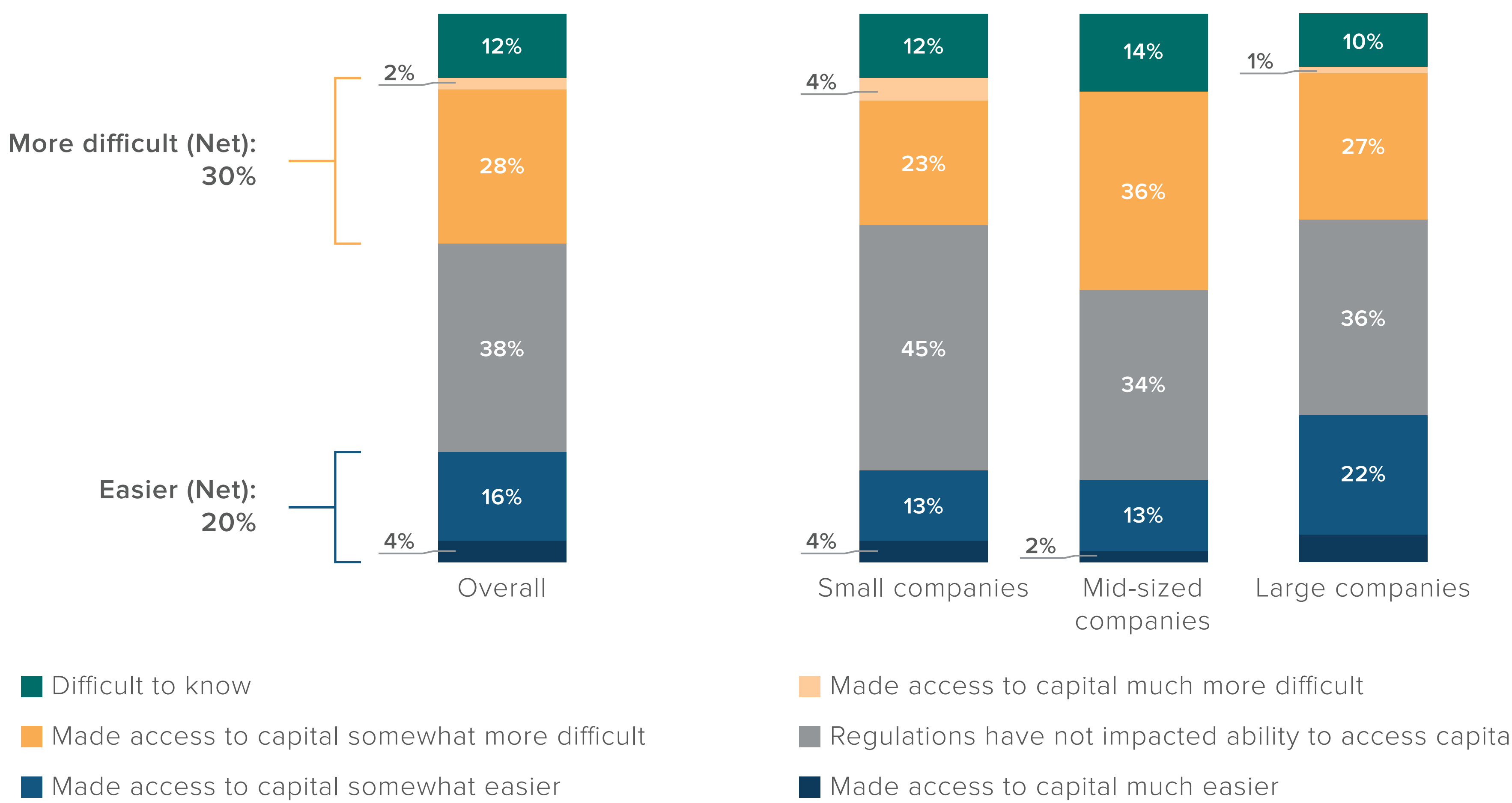
"Greater regulation on banks means that it will be even harder for them to give us access to cash and credit, especially when it comes to a small company. The more regulation there is, the less appetite those banks will have to support small companies like ours."

– A Small Company Financial Executive Survey Respondent

Access to Capital More Difficult Due to Regulations

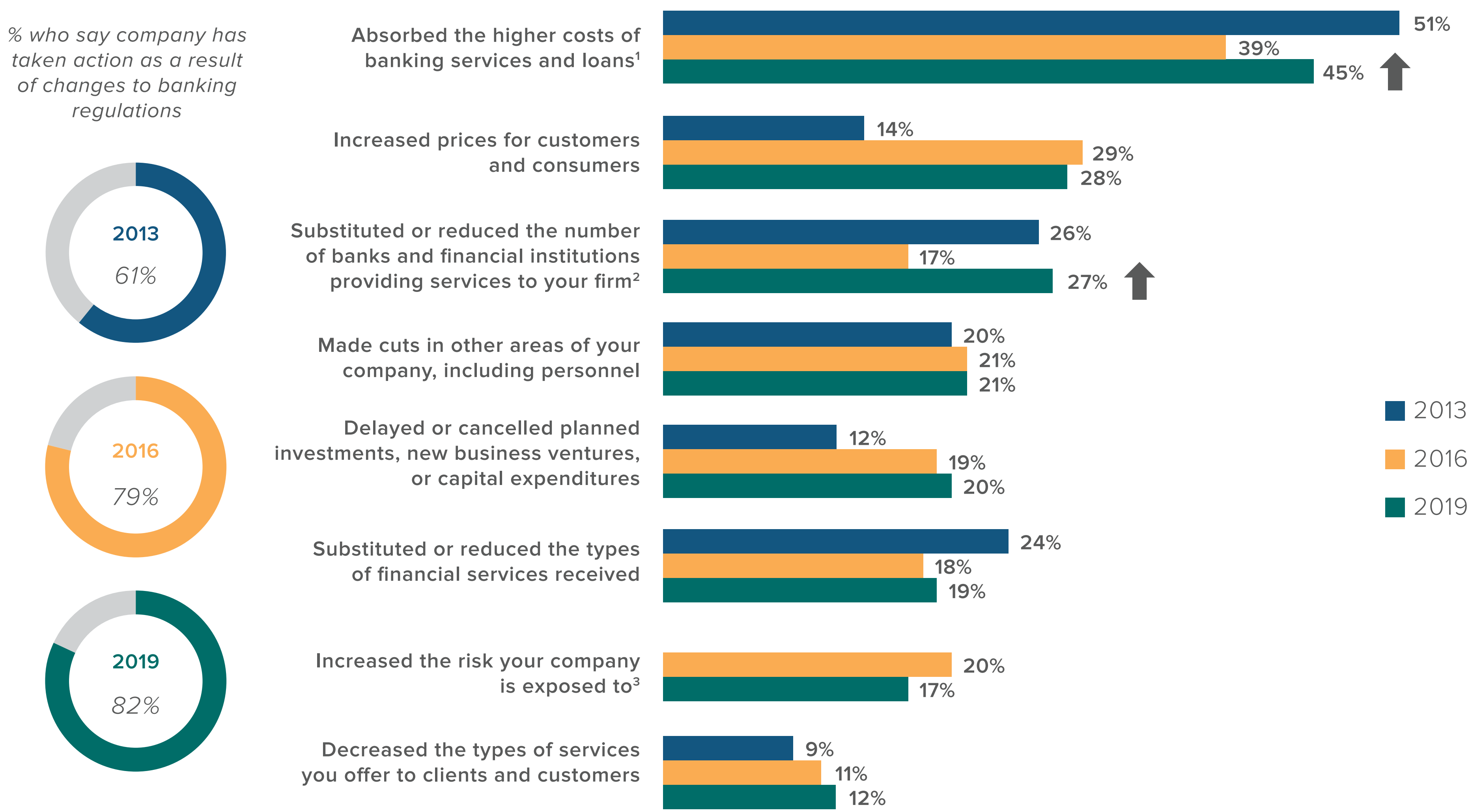
More Financial Executives than not say their ability to access capital has been hampered by regulations on the industry

To what extent have financial services regulations impacted your comapny's ability to access capital?



Negative Internal Impact

Despite the fairly positive assessment of individual regulations, the cumulative effect on businesses has become increasingly challenging since 2013



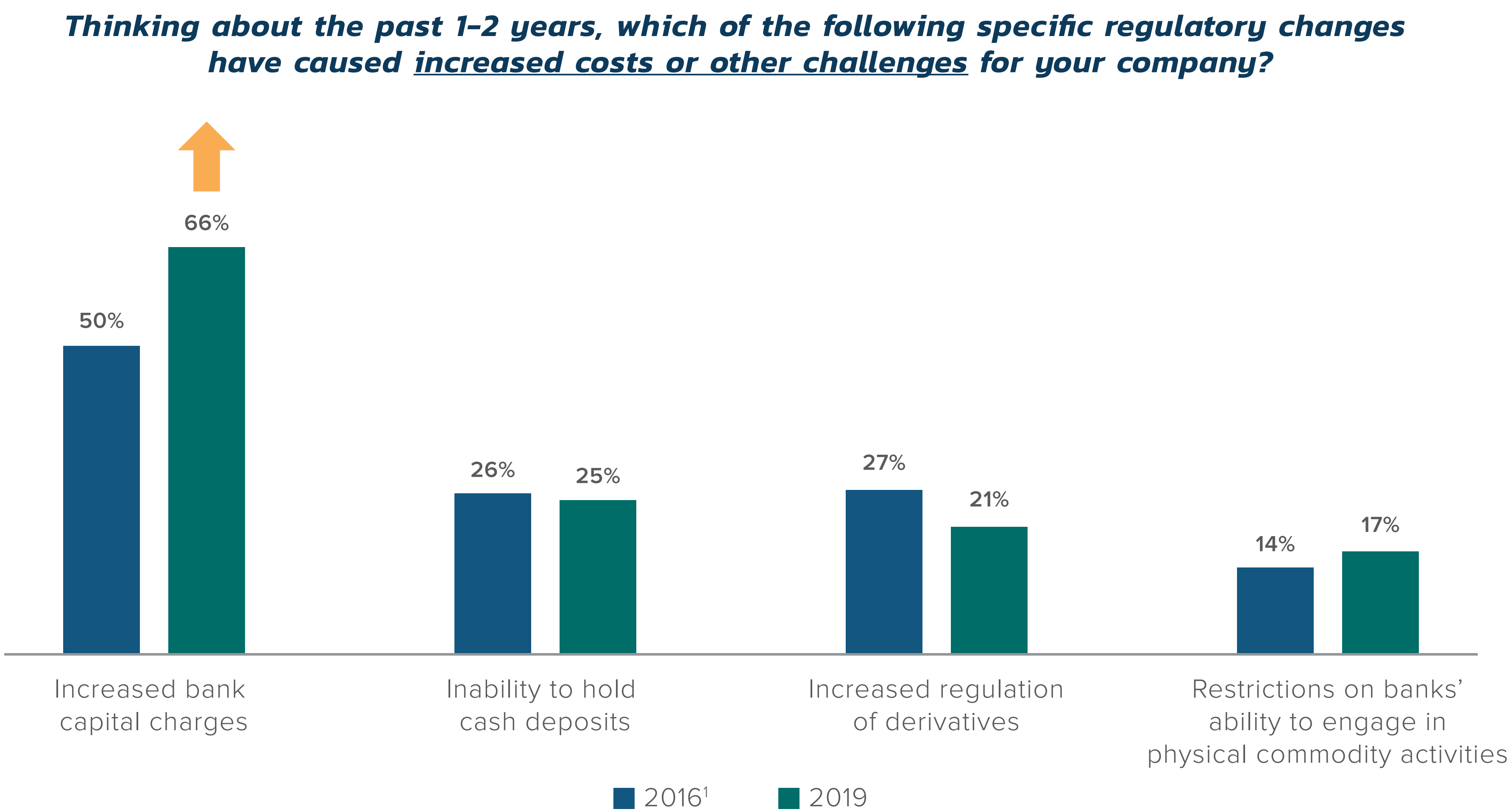
[1] "Absorbed the higher costs of those services" in 2016 survey

[2] "Substituted or reduced the number of financial institutions providing services to your firm" in 2016 survey

[3] Not asked in 2013 survey

Bank Capital Charges a Core Challenge

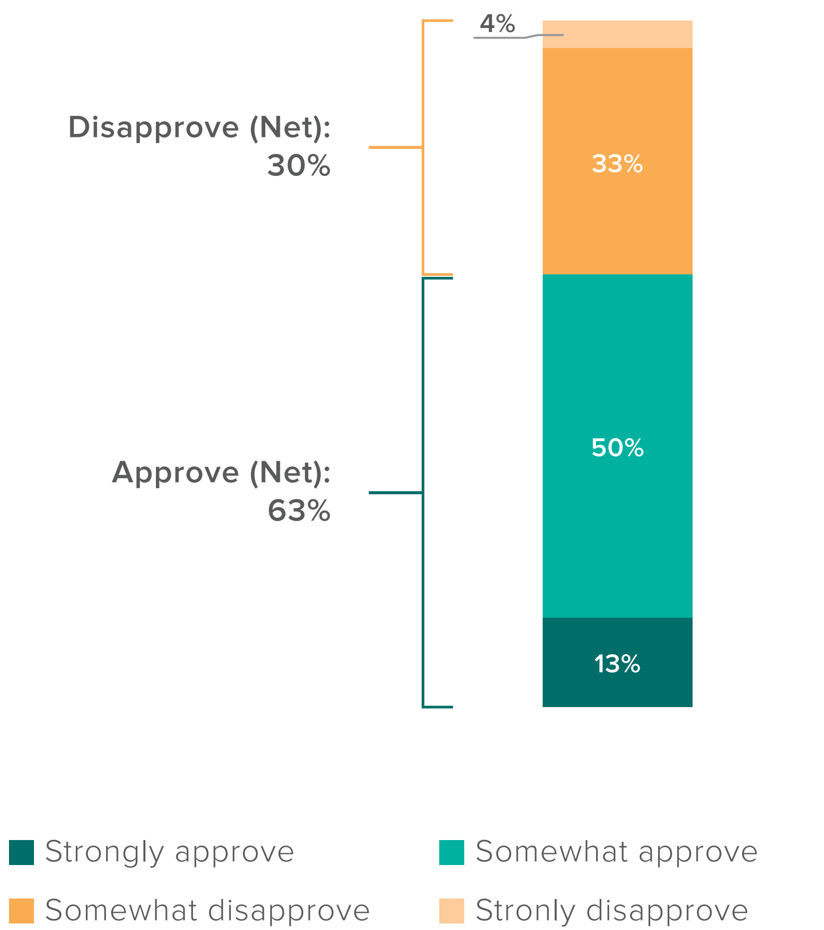
Increased capital bank charges are seen as the regulatory change that has increased costs the most in the last 1-2 years, and are much more of a challenge now than they were in 2016



[1] "Question wording was for "past 2-3 years" in 2016 survey

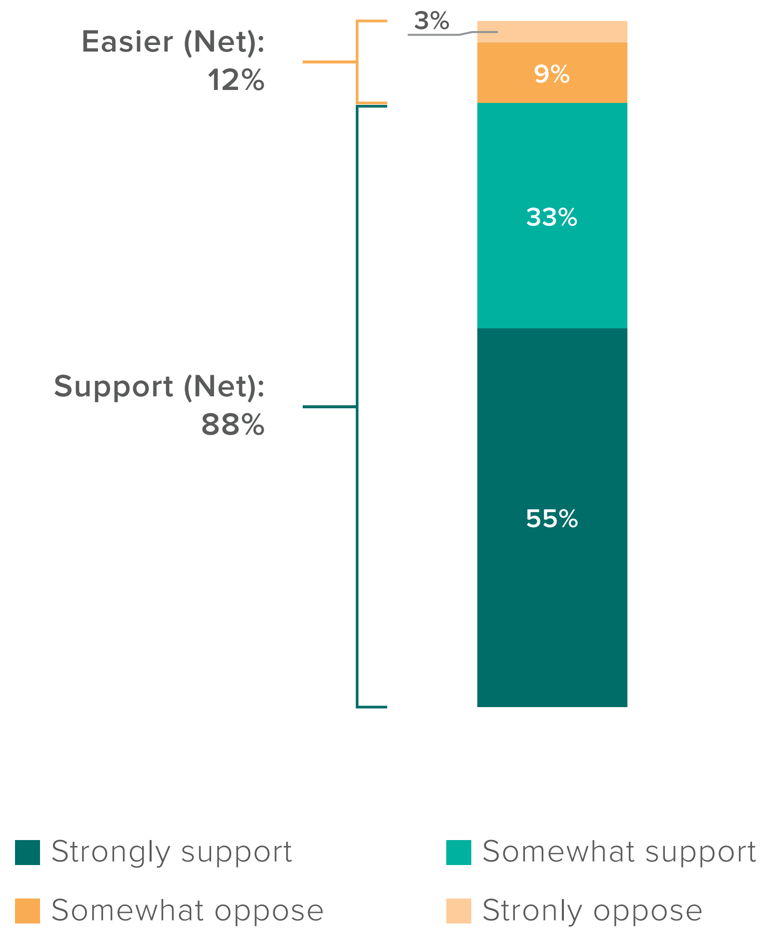
Approval of Recalibrating Requirements for Large Banks

Nearly two-thirds of respondents approve of federal regulators recalibrating capital requirements for large banks when lending money to small businesses



Same Treatment for Foreign Banks

A large majority support foreign banks being held to the same regulatory standards as US banks



ABILITY TO PARTAKE IN CERTAIN FINANCING TRANSACTIONS HAS IMPROVED, BUT ISSUES REMAIN

Main Street businesses have diverse financing needs that evolve through time. Short-term financing is needed to finance payrolls and day-to-day operations as well as to manage inventories. Long-term capital, in the form of debt or equity, is needed to support capital expenditures and expansions into new lines of business or new geographies. Many companies also must use derivatives in order to manage currency, interest rate, agricultural, or other risks depending on their lines of business. And for businesses that grow from small to large in a short period of time, financing through private capital markets or via an initial public offering (IPO) can become a consideration as well.

Businesses report improvements across virtually all aspects of their financing needs; however, the ability to both raise and invest in short-term capital has improved the most. And while more businesses than not say that their ability to raise equity has improved, the rate of improvement has seen a stark decrease over time.

To help businesses raise equity through both public and private channels, the Chamber strongly supports passage of legislation that would build on the success of the 2012 JOBS Act, which helped increase activity in the IPO market. Legislation similar to the JOBS and Investor Confidence Act—passed by the House of Representatives in 2018—would go a long way toward helping entrepreneurs and businesses access the equity they need to grow from small to large.

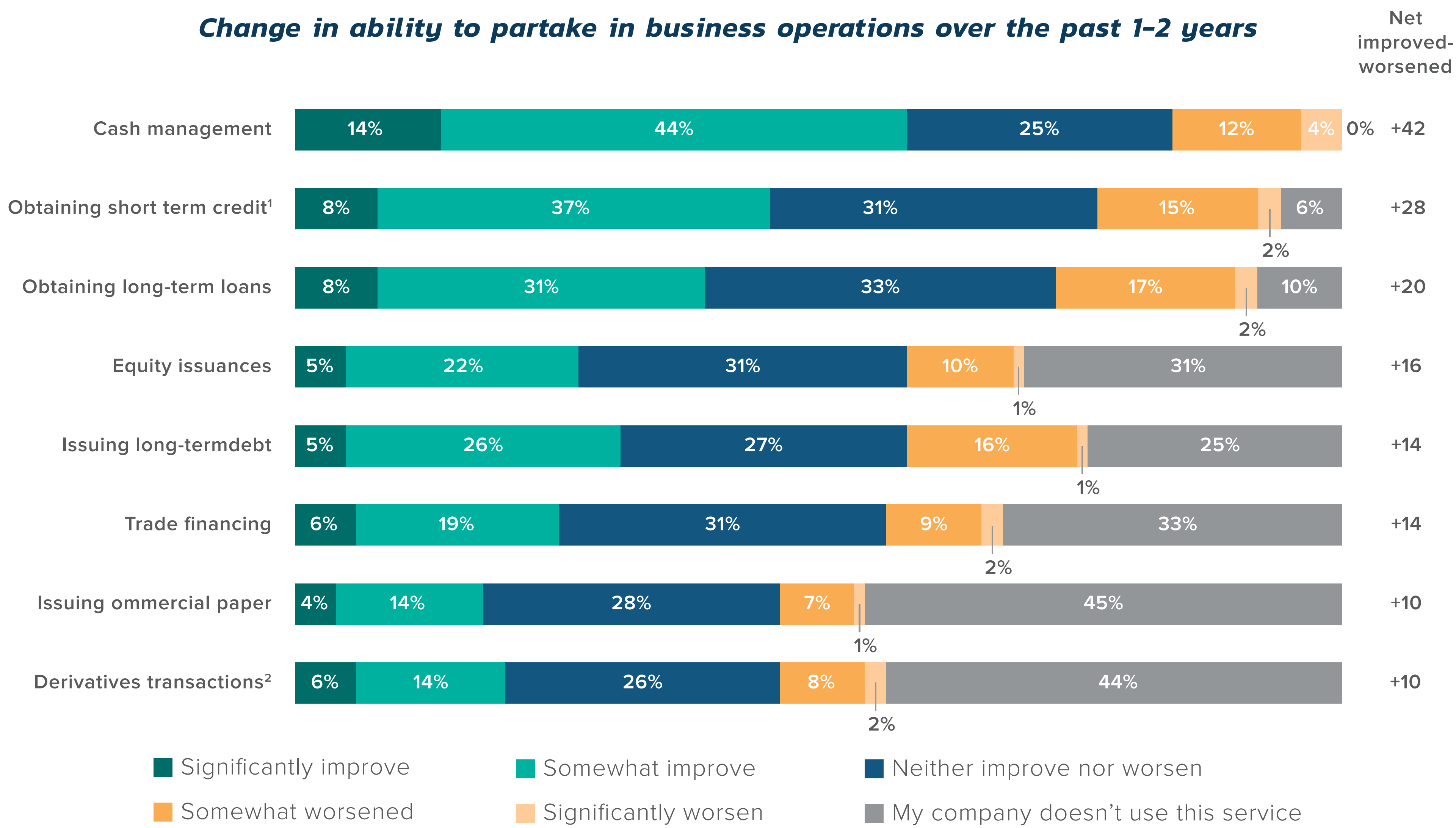
KEY FINDINGS

FOR BUSINESS OVER THE PAST TWO YEARS:

- Of businesses, ***58%*** report that their ability to manage their cash operations has improved.
- Of companies, ***45%*** say their ability to obtain short-term credit has improved, while another 31% report no change.
- Of companies, nearly ***20%*** say that the ability to raise equity from public and private markets has worsened.
- While more companies report that their ability to obtain trade financing had improved versus worsened, the rate of improvement for this form of financing has slowed.

Improvements in Financing Abilities

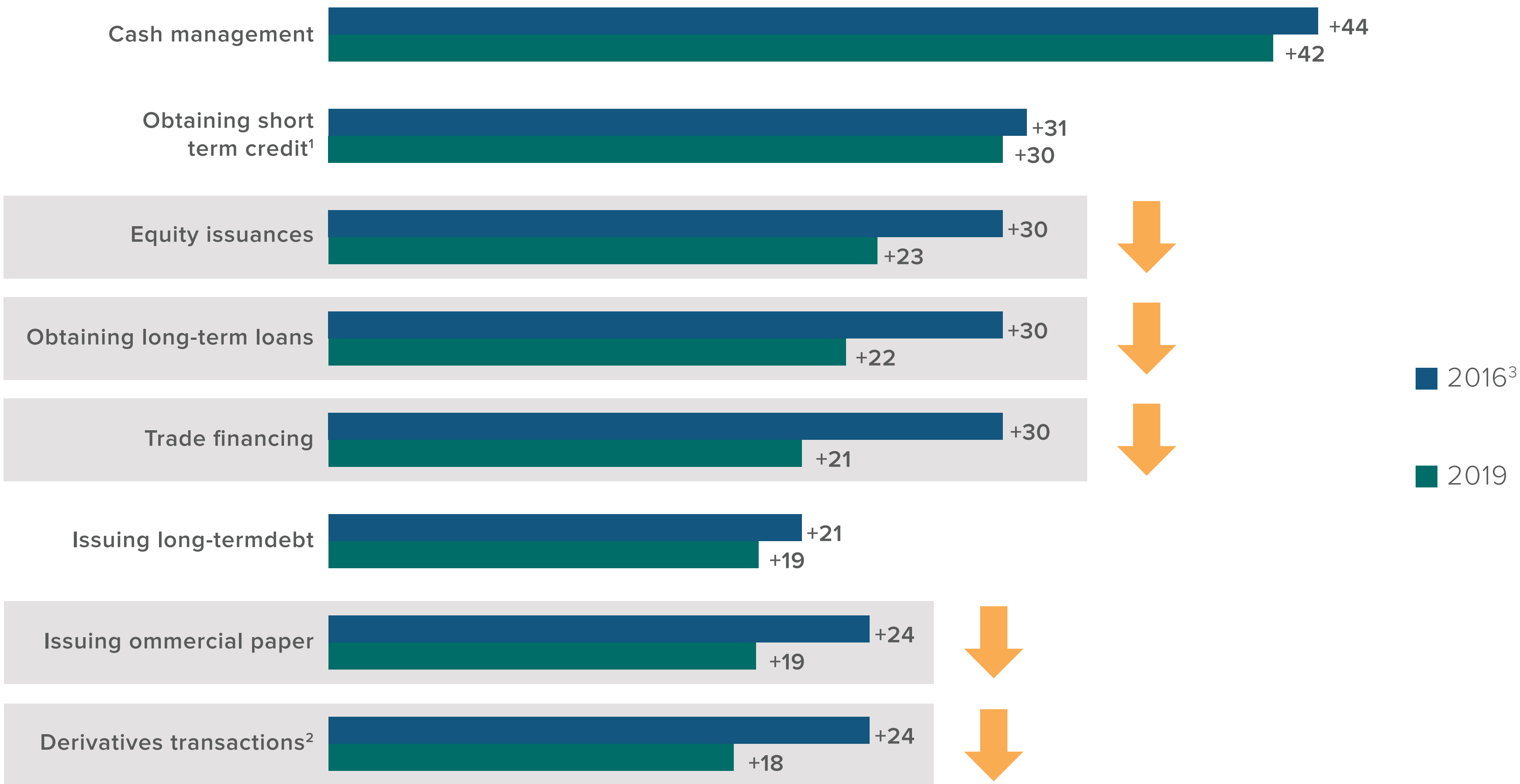
Companies' ability to partake in cash management has improved the most in the past 1-2 years, followed by obtaining short-term credit



[1] "Obtaining short-term loans" in 2016 survey
[2] "Purchasing derivatives" in 2016 survey

Similarly, the rate of improvement for financing options has slowed

Improvement in companies' ability to partake in most operations has declined in the past 1-2 years



[1] "Obtaining short-term loans" in 2016 survey

[2] "Purchasing derivatives" in 2016 survey

[3] Question wording was for "past 2-3 years" in 2016 survey

MIDDLE MARKET COMPANIES FEEL THE SQUEEZE FROM FINANCIAL REGULATION

One of the more striking findings from this year's survey was the negative feeling toward regulation of middle market companies relative to their smaller or larger counterparts. On a number of questions, midsize companies consistently reported being impacted to a greater extent than other firms.

For example, 42% of middle market companies impacted by new rules say that financial regulation has negatively impacted their ability to access capital, versus 31% of large companies and 30% of small firms. Middle market businesses are also more likely to be pessimistic about their own performance expectations. And over half of midsize companies state that they have had to absorb significant costs as a result of new regulation.

Midsize public companies are also more likely than large companies to say that PCAOB audit standards negatively impact them. While the Chamber has long believed in the importance of strong internal controls, we have also expressed concern that the standards that apply in this area have not been scalable based on a company's size. Accordingly, we continue to advocate for a move away from "one size fits all" audit standards.

The U.S. Chamber has long been concerned that middle market companies—which are critical sources of employment and growth in every region of the country—have been stuck in a regulatory "no man's land": They do not benefit from economies of scale enjoyed by larger competitors and are unable to benefit from certain regulatory exemptions or government programs intended for small businesses. We believe policymakers must consider the position midsize companies find themselves in when reviewing existing financial regulations on the books or considering new ones.

"If regulatory restrictions on the banking industry are expanded, the banks are going to pass those additional costs onto the customer. Banks will either pay a lower interest rate, or their services will not be as broad."

– A Mid-Sized Company Financial Executive Survey Respondent

KEY FINDINGS:

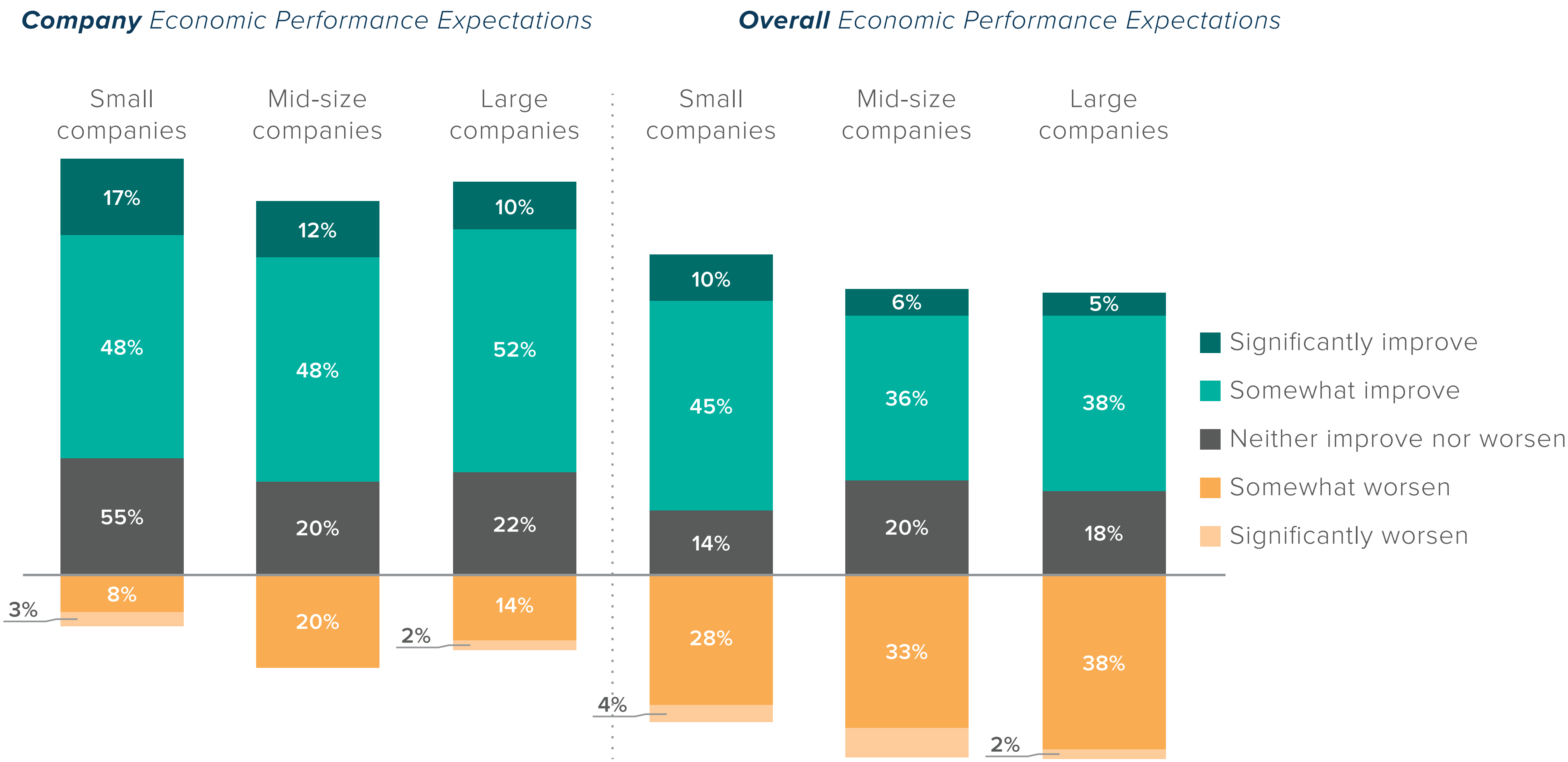
Of middle market companies that reported being affected by regulation:

- ***42%*** believe financial regulation has negatively impacted their ability to access capital.
- ***31%*** (versus 20% of large companies) say PCAOB audit standards have a negative impact on them.
- ***29%*** say that margin requirements for derivatives transactions have negatively impacted their operations.

Furthermore, 20% of middle market companies expect their own performance to worsen over the next 12 months, while 39% expect the broader economy to worsen.

Alignment on Perceptions

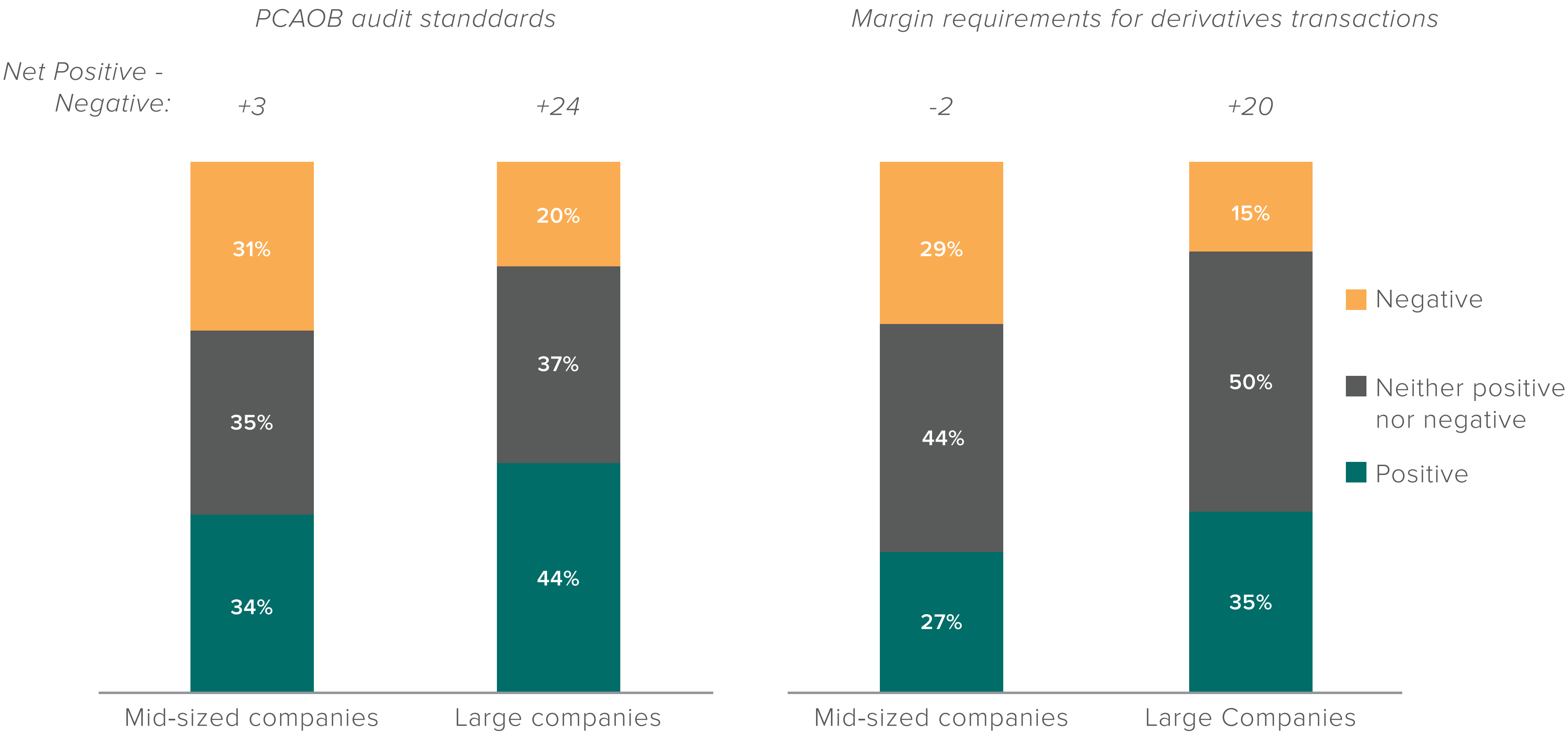
Importantly, positivity toward one's own company's expected economic performance is similar across company size, as is pessimism toward the economy overall



Financial regulations more negatively impact medium-sized businesses

In particular, PCAOB audit standards and margin requirements for derivatives transactions are viewed has having more of a negative impact on mid-sized companies

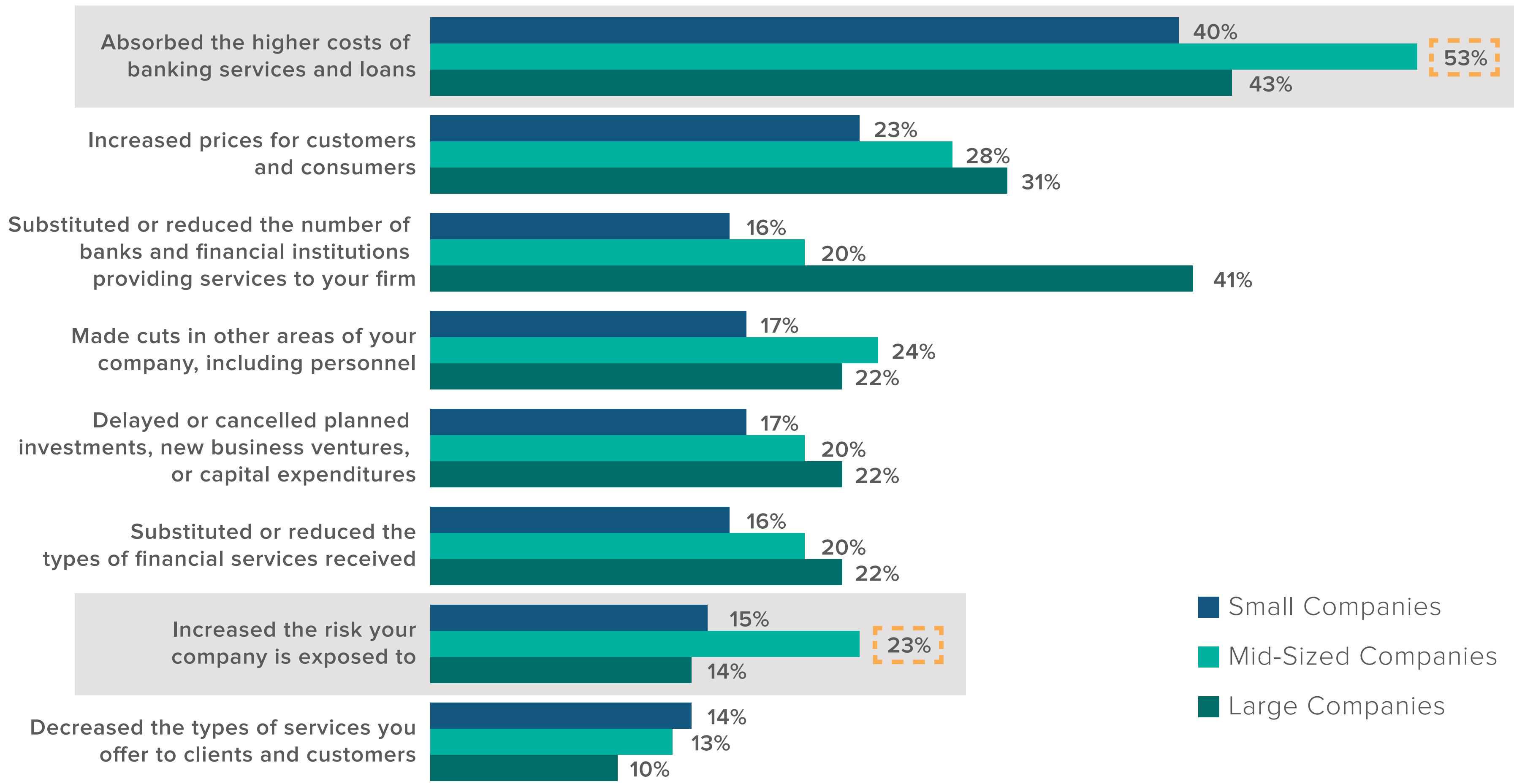
Impact of financial regulations on your company (of those that are affected by them)



Mid-sized companies are most likely to absorb higher costs and increase risk

Large companies are most likely to substitute or reduce the number of banks and financial institutions they use as a result of banking regulations

Which of the following actions has your company taken as a result of changes to banking regulations?



GLOSSARY OF KEY TERMS

Bank regulatory capital: The amount of capital that a bank must hold as required by its financial regulators. This is usually expressed as a ratio of required equity versus the assets held by a bank, adjusted for the assets' potential risk. Bank regulatory capital levels are established by international and domestic standard-setters and regulators, such as the Basel Committee on Banking Supervision and the Federal Reserve, respectively.

Cash management tools: Tools that assist a company with its short-term financial management needs and include a wide variety of products and services, including money market funds and certificates of deposit.

Commercial paper: An unsecured short-term debt instrument issued by a company to raise short-term capital and manage near-term liabilities.

Debt financing: A form of raising capital that includes issuing bonds and other forms of indebtedness through the public and private markets or borrowing money directly from a lender.

Debt financing requires paying interest and principal at specified dates.

Derivatives: Financial contracts whose value is driven by the value of another asset or security (known as an "underlying"). Commonly used derivatives include forwards, futures, and swap contracts. For example, swap contracts are used by businesses to manage risk, such as locking in a fixed rate of interest for an overseas payment.

Equity financing: A form of raising capital that allows cash to be contributed to a business in exchange for an ownership interest. Investors participating in equity financing typically have voting rights and share in the percentage of the firm's profits or potential losses.

Liquidity: The volume of activity in a market, as well as a general measure of the ease of selling securities, such as bonds and stocks, or converting assets to cash. Market makers, like investment banks, help facilitate the flow of trading and ensure efficient, liquid capital markets.

Long-term loans: Loans or other long-term debt obligations that generally last more than one year.

Payment systems: Tools that permit settlement of financial transactions by transferring monetary value.

Risk management tools: Tools, such as derivatives, that assist a company in managing its exposure to a variety of different risks, such as changes in interest rates, commodity prices, or foreign currencies.

Short-term loans: Loans or other short-term debt obligations that generally last less than one year.

Trade financing: A form of domestic or international financing that allows a firm to extend credit to its customer by selling its goods and services and permitting the customer to pay some date after the receipt of goods and services.

NOTES

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