Pepperdine Private Capital Index Survey Responses  
Second Quarter 2012

In recent years there has been increased attention on improving small business lending. In 2009, President Obama announced a measure allowing smaller community banks to borrow at low rates from the Treasury Department’s Troubled Asset Relief Program and raising the loan caps on several popular Small Business Administration programs. In September 2010, President Obama established a new Small Business Lending Fund to provide capital to qualified community banks and community development loan funds in order to encourage small business lending. In September 2011, several of nation’s largest banks announced a commitment to increase small business lending by $20 billion over the next three years. Flash forward to present day and despite these and other efforts we are seeing continued and increased difficulty in small businesses securing loans.

In an effort to gauge the demand of small and medium-sized businesses for financing needs, the level of accessibility of private capital, and the transparency and efficiency of private financing markets, Pepperdine University’s Graziadio School of Business and Management and Dun & Bradstreet Credibility Corp recently launched the Pepperdine Private Capital Access (PCA) and Private Capital Demand (PCD) Index. This new index will measure the demand for, activity and health of the privately-held businesses on a quarterly basis. This first Index report was derived from second quarter survey results collected from July 10 to August 3, 2012 and contrasted with first quarter survey results collected from April 3 to April 10, 2012.

Second quarter survey results revealed that 75% of respondents report the current business environment as difficult to raise new business financing and only 44% of those who applied for business loan from a bank were successful. The research also shows that many small business owners are tapping into their personal assets to fill financing gaps with 41% of business owners saying they transferred personal assets to their business over the last 6 months.

With all of the stimulus efforts and concentration on increasing access to capital, the question is why are small businesses still struggling?

The Small Business Administration could take the lead in helping small businesses become more knowledgeable about which types of capital are best suited for them. One of the problems is that many business owners have limited knowledge of the different classifications of capital. Capital markets are expansive and today’s small businesses are not limited to a bank or friends and family as their sole source of financing.
Second, capital providers can help small business owners understand the criteria that are needed to attain financing from different sources. In many instances, loans are negotiated separately and privately and there is no record of information. If capital providers share this information with business owners – who gets capital investments and who doesn’t – lenders can streamline the process for those who are seeking capital by eliminating the sources that clearly do not meet their business requirements.

Third, many small businesses may need to enhance their understanding of important benchmarks used by capital providers in their decision-making process. This lack of understanding results in a deadweight loss for the economy as these businesses waste time pursuing loans for which they have no chance to qualifying. Previous Pepperdine research (October 2011) showed that about 35% of private businesses attempted to get a bank loan in the previous year and 50% were successful. Today, 44% of businesses were successful in securing a bank loan. The application-to-loan ratio is alarmingly low. Private companies are faced with a cash crunch and lenders are missing opportunities to make higher yield loans. Banks could help solve this problem by publishing the minimum thresholds for qualification for various important financial ratios and metrics (i.e., fixed-charge coverage ratio) for approvals and declines.

Employing some new techniques to close the lending gaps could go a long way in serving both private capital lenders and private businesses. Opening the lines of communication and increasing transparency is the first step in improving our business environment and strengthening our economy.
About Pepperdine Private Capital Access and Private Capital Demand Index

The Q2 Private Capital Access and Private Capital Demand Index survey results were generated from responses by 4,686 business owners. Index weights were derived using factor analysis and then the resulting raw index values were scaled from zero to one hundred. The higher the value of the PCA Index or the PCD Index, the greater the access to capital or demand for capital, respectively. A value of less than fifty for an index represents a low level of access or demand, while a value greater than fifty can be interpreted as relatively high capital access or demand.

Businesses involved in services accounted for 28% of respondents followed by retail trade (11%), construction (11%) and manufacturing (9%). Approximately 58% of respondents have less than or equal to $1 million in revenues, followed by 20% reporting between $1 million and $5 million. 10% of respondents have negative net income, 46% of respondents have net income between $1 and $100,000, followed by 27% reporting between $100,000 and $500,000. Thirty-nine (39%) of respondents have businesses that are older than 20 years, 24% of respondents have firms between 10 and 20 years old, and 15% of respondents reporting their firm age between 5 and 10 years. Approximately 56% of respondents have less than or equal to five employees.

PCA and PCD Index Results – Whole Sample

<table>
<thead>
<tr>
<th>TOTAL MARKET</th>
<th>PCA INDEX</th>
<th>PCD INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-Q1</td>
<td>27.8</td>
<td>37.0</td>
</tr>
<tr>
<td>2012-Q2</td>
<td>27.0</td>
<td>36.5</td>
</tr>
<tr>
<td>Change</td>
<td>-0.8</td>
<td>-0.5</td>
</tr>
<tr>
<td>Pct. Change</td>
<td>-2.9%</td>
<td>-1.4%</td>
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</tbody>
</table>
The Q2 PCD Index number for the entire sample is 36.5, reflecting weakness in demand for external loans and other financing. This number represents a 1.4% decrease from the Q1 demand indication of 37.0. The Q2 PCA Index is 27.0, which is a 2.9% decline from the Q1 index value of 27.8. The PCA numbers reflect continued and increased difficulty securing loans and other business financing sources.

**Small Business PCA and PCD Index Results (< $5M in Revenues)**

<table>
<thead>
<tr>
<th>&lt;$ 5M REV$</th>
<th>PCA INDEX</th>
<th>PCD INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-Q1</td>
<td>26.6</td>
<td>38.8</td>
</tr>
<tr>
<td>2012-Q2</td>
<td>26.0</td>
<td>38.0</td>
</tr>
<tr>
<td>Change</td>
<td>-0.6</td>
<td>-0.8</td>
</tr>
<tr>
<td>Pct. Change</td>
<td>-2.3%</td>
<td>-2.1%</td>
</tr>
</tbody>
</table>

The Q2 PCD Index number for small businesses is 38.0, reflecting weakness in demand for external loans and other financing. This number represents a 2.1% decrease from the Q1 demand indication of 38.8. The Q2 PCA Index for small businesses is 26.0, which is a 2.3% decline from the Q1 index value of 26.6. The PCA numbers reflect continued and increased difficulty securing loans and other business financing sources.

**Lower Middle Market PCA and PCD Index Results ($5M – $100M in Revenues)**

<table>
<thead>
<tr>
<th>$5M - $100M</th>
<th>PCA INDEX</th>
<th>PCD INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-Q1</td>
<td>34.7</td>
<td>32.3</td>
</tr>
<tr>
<td>2012-Q2</td>
<td>33.5</td>
<td>33.1</td>
</tr>
<tr>
<td>Change</td>
<td>-1.2</td>
<td>0.8</td>
</tr>
<tr>
<td>Pct. Change</td>
<td>-3.5%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

The Q2 PCD Index number for lower middle market companies is 33.1, reflecting weakness in demand for external loans and other financing. This number represents a 2.5% increase from the Q1 demand indication of 32.3. The Q2 PCA Index for lower middle market companies is 33.5, which is a 3.5% decline from the Q1 index value of 34.7. The PCA numbers reflect continued and increased difficulty securing loans and other business financing sources. When compared to the small business indicators, lower middle market companies demonstrate lower demand (33.1 vs. 38.0) and higher access (33.5 vs. 26.0).
Current demand for external financing

Thirty-three percent (33%) of respondents attempted to raise external financing in the last six months. About sixty percent (63.4%) of respondents indicated need for external financing due to planned growth or expansion including acquisitions (not yet realized), 61.2% of respondents indicated need for external financing due to working capital fluctuations, and 52.8% of respondents indicated need for external financing due to increased demand already realized. Nearly forty-eight percent (47.9%) of those who indicated need for external financing reporting high or extremely high need due to planned growth. Sixty-one percent (61%) of respondents believe the current business financing environment is restricting growth opportunities while 52% of respondents believe it restricting their ability to hire new employees.

Accessibility rate

Seventy-five percent (75%) of respondents characterize the current business environment as difficult to raise new business financing and only 11% of respondents characterize the current environment in regards to raise new financing as easy. 44% of those who applied for bank business loan were successful. Twenty-eight percent (28%) of respondents were successful obtaining asset based loan while just 15% were able to raise private equity. Forty-two percent (42%) of respondents indicated growth or expansion including acquisitions as their main purpose to raise external financing. Forty-one percent (41%) of business owners transferred personal assets to their business over the last 6 months.

Satisfaction rates

Respondents who raised financing from grants, friends or family, credit unions, trade credit, or banks are the most satisfied with pricing and contract terms, whereas respondents who raised financing through a mezzanine lender, personal credit card, factor companies or venture capital are the least satisfied with pricing and contract terms. Respondents also indicated that raising financing from trade credit, leasing companies and grants have an easier general financing process. Fifty-one percent (51%) of those respondents who were unsuccessful in raising capital feel their general category of financing is still a good fit for their business.
Expected demand for external financing

Thirty-two percent (32%) of respondents are planning to raise new financing in the next 6 months, 47% of respondents are not planning to raise financing in the next 6 months and 21% of respondents are unsure. Sixty-one percent (61%) of respondents indicated need for external financing due to planned future growth or expansion, 57% of respondents indicated need for external financing due to expected working capital fluctuations and 54% of respondents indicated need for external financing due to expected increase in demand.

Expected access rates

Seventy percent (70%) of respondents expect it would be a difficult business environment in which to raise new financing in the next 6 months, 12% of respondents expect it would be the same, and only 18% of respondents expect it would be easy. Sixty-five percent (65%) of respondents are planning to obtain a bank business loan, 41% of respondents are planning to use a credit line and 36% are planning to raise financing from a credit union. Fifty-eight percent (58%) of respondents expect a need for external financing due to planned growth or expansion (including acquisition) and 18% of respondents expect to raise financing due to working capital fluctuations. Respondents indicated higher confidence for successful financing from leasing, friends or family, personal credit cards or loan and factor companies.

Hiring/growth outlooks and financing failure impacts

Thirty-eight percent (38%) of respondents are not planning to hire any additional employees in the next 6 months. Forty-seven percent (47%) of respondents are planning to hire from 1 to 5 employees, and 7% of respondents are planning to hire from 6 to 10 employees. 71% of respondents expect slower business growth if their business is unable to raise new external financing in the next six months, 54% of respondents will hire fewer employees than planned, and 23% of respondents will reduce number of employees. The average revenue change expectation in the next 12 months is 7.3%, although the average last 12 months revenue change was -0.7%.
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