

**TESTIMONY OF**  
**JOAN SWEENEY**  
**CHIEF OPERATING OFFICER,**  
**ALLIED CAPITAL CORPORATION**

**BEFORE THE**  
**U.S. HOUSE OF REPRESENTATIVES**  
**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATION**  
**OF THE**  
**COMMITTEE ON FINANCIAL SERVICES**

**September 23, 2004**

## STATEMENT OF JOAN SWEENEY

Madam Chairwoman, members of the Subcommittee, I am Joan Sweeney, the Chief Operating Officer of Allied Capital Corporation. Our business is investing in the American entrepreneurial economy, and we are the nation's largest Business Development Company or BDC. Thank you for the opportunity to discuss the essential role that BDCs play in providing growth capital and expertise to smaller businesses. I also want to thank you, Madam Chairwoman, and Congresswoman Velasquez for your efforts in passing H.R. 3170, the "Increased Capital Access for Growing Business Act." If enacted, this important piece of legislation will increase the number of U.S. companies that could access capital from BDCs. This legislation has not yet moved through the Senate, and we understand that the SEC is now undertaking rulemaking initiatives concerning the definition of eligible portfolio company, which is so appropriately addressed by H.R. 3170.

Allied Capital has been investing in small and growing businesses for 46 years, and over that time we have provided financing to thousands of American small businesses. Our assets today are over \$3 billion, and we have investments in 116 portfolio companies, which generate aggregate annual revenues of approximately \$11 billion and employ more than 105,000 people.

We provide both mezzanine debt and equity capital, which is used for growth, buyouts and recapitalizations. We believe that smaller companies need additional financing sources. The U.S. financial services industry has been contracting as a result of broad-based consolidation. This trend has reduced the amount of debt capital available to smaller companies. In addition, the cost of being a public company and accessing the markets in a post-Sarbanes-Oxley world is

higher than ever. Going public has become less attractive, and more companies are seeking private financing options.

Small public companies, however, cannot turn to a BDC as a private financing source, because, under current law, they are not eligible. This is unfortunate because BDCs, as regulated entities, provide transparency as to their investing activities and are a natural match for smaller companies. Deprived of this option, many small public companies, desperate for capital, have instead sought private financing from private equity and hedge funds, which provide private investment in public equities, or “PIPE,” financing. These unregulated funds have little transparency as to their activities, and may not have the best interests of the small company in mind. Some have even structured “death spiral” PIPEs where the fund intends to profit from the fall of the small firm’s stock price.

Congress recognized the need for alternative sources of financing for smaller companies in 1980 when it created BDCs. In defining the types of businesses eligible for BDC financing, Congress set the definition of an “eligible portfolio company” as a company that did not have a class of marginable securities under the rules of the Federal Reserve. According to the legislative history, Congress intended the pool of eligible portfolio companies to be “very broad,” and it was estimated that 8,000 of the 12,000 publicly traded companies at the time would be eligible.

However, in 1999 the Federal Reserve greatly expanded the definition of marginable securities. Today, any security listed on the Nasdaq Stock Market is considered marginable, which is a substantial shift from what was marginable in 1980. The Federal Reserve’s changing view of marginability collided with Congressional intent for BDCs and drastically reduced the universe of companies eligible for BDC financing. Small public companies needing cash for

growth are no longer eligible, and recently questions have been raised about the eligibility of private companies with outstanding debt securities, since debt securities are also now marginable. BDCs are permitted to invest a limited amount of capital in companies that are not eligible portfolio companies, but there should be no limit when it comes to providing growth and expansion capital for smaller companies.

Let me give you one example of an investment Allied Capital made in a small public company. Blue Rhino, which you may recognize as the provider of the propane gas cylinder that powers your outdoor grill, came to us in 2001 for \$15 million in financing. Their stock was trading at only \$3.70 per share and their market capitalization was less than \$100 million. This company was not a candidate for a secondary public offering. Our financing enabled the company to grow its sales substantially in 2001 and 2002. The company increased in value, its shareholders benefited, and Allied Capital's shareholders benefited with a capital gain.

BDCs work well. They are regulated, and provide significant disclosure. BDCs can play a more meaningful role in providing capital to entrepreneurial companies if the definition of eligible portfolio company is updated to be consistent with what Congress intended in 1980.

We encourage the Subcommittee to review the rule-making activity of the SEC to ensure that the definition is appropriately amended both to restore Congress's original vision and to provide consistency with the provisions of H.R. 3170.

Thank you for the opportunity to testify today.