

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

MEMORANDUM

To: Members, House Committee on Small Business
From: Chairwoman Nydia M. Velázquez
Date: June 18, 2019
Re: Full Committee hearing: “Unlocked Potential? Small Businesses in the Cannabis Industry”

The House Committee on Small Business will meet for a hearing titled “Unlocked Potential? Small Businesses in the Cannabis Industry.” The hearing is scheduled to begin at **11:30 A.M. on Wednesday, June 19, 2019 in Room 2360 of the Rayburn House Office Building.** The hearing will allow Members to learn about the opportunities the legitimate cannabis industry presents for small businesses in states with legal cannabis, as well as entrepreneurs from traditionally underserved communities. The hearing will also explore the challenges currently faced by those businesses, but also by so-called “ancillary” or “indirect” cannabis businesses that may not be directly involved in the production or distribution of cannabis products but transact with direct cannabis businesses. The witnesses will be:

- Ms. Shanita Penny, M.B.A.; President of the Board of Directors, Minority Cannabis Business Association, Washington, DC
- Mr. Eric Goepel; Founder & CEO, Veterans Cannabis Coalition, Walnut, CA
- Ms. Dana Chaves; Senior Vice President and Director of Specialty Banking, First Federal Bank of Florida, Lake City, FL
- Mr. Paul Larkin; John, Barbara, and Victoria Rumpel Senior Legal Research Fellow in the Meese Center for Legal and Judicial Studies, The Heritage Foundation, Washington, DC

Background

Currently, forty-six states, the District of Columbia, and the Commonwealth of Puerto Rico have decriminalized or legalized the use of marijuana to some degree (including limited medical use).¹ Because of this, the cannabis industry is having an impact on the broader economy. In 2018, consumer spending passed \$10 billion for the first time and consumer spending is expected to increase to \$23 billion by 2022.² Investment activity soared last year, increasing to \$13.8 billion from \$3.6 billion in 2017.³ Meanwhile, the cultivation, possession, and distribution of marijuana

¹ National Cannabis Business Association state policy map, <https://thecannabisindustry.org/ncia-news-resources/state-by-state-policies/> (last visited June 17, 2019).

² Adam C. Uzialki, Business News Daily, CASH IN ON CANNABIS: BUSINESS IDEAS FOR THE EMERGING INDUSTRY (Feb. 5 2019), <https://www.businessnewsdaily.com/9722-cannabis-industry-business-ideas.html> (last visited June 17, 2019).

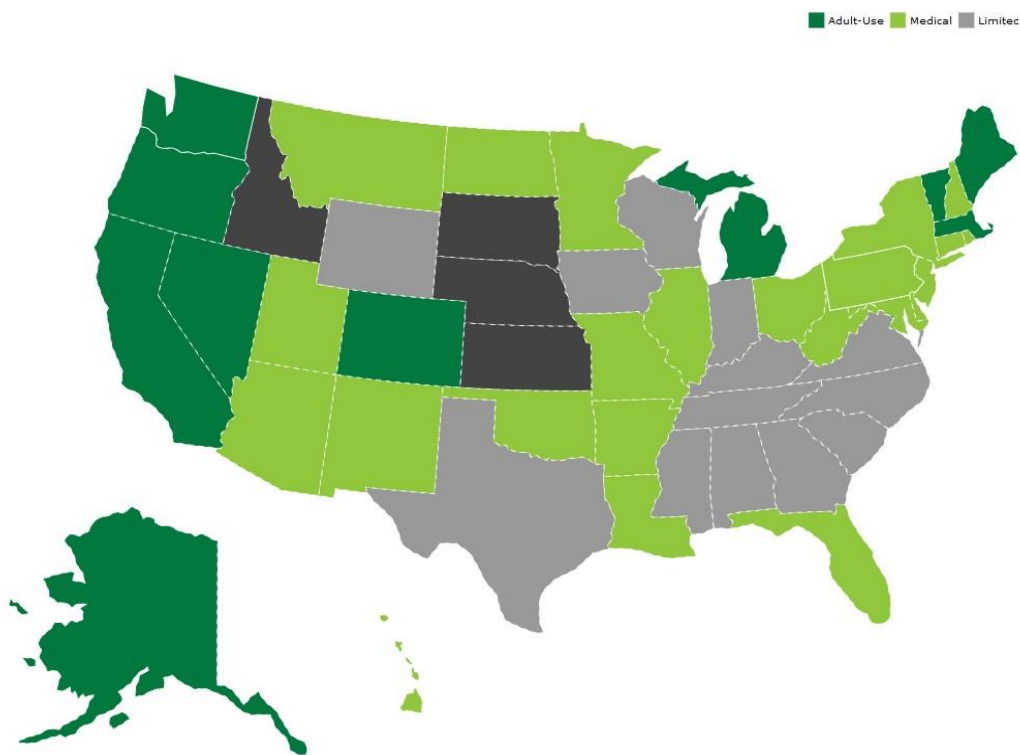
³ *Id.*

remain illegal under federal law.⁴ In an atmosphere of conflicting legal guidance from the federal government and the various states, an increasing number of financial institutions have expressed interest in providing financial services to state-authorized, marijuana-related businesses, but many are refraining from doing so due to legal and compliance concerns.

Small businesses in states with legal marijuana are particularly struggling with the conflict of laws. This is especially true of those small firms in states with legal marijuana seeking to access affordable capital on reasonable terms through Small Business Administration (SBA) financing. Under current SBA guidance, ancillary businesses are not eligible for SBA-backed financing.⁵

Table 1 shows States that permit adult-use of cannabis, medical use, limited medical use, or none of the above.⁶

Table 1



Source: National Cannabis Industry Association

⁴ 21 U.S.C. § 812.

⁵ U.S. Small Bus. Admin., Office of Fin. Assistance, SOP 50 10 5(K); *see also* SBA Policy Notice 5000-17057.

⁶ National Cannabis Industry Association. The map does not reflect the recent action in Illinois to legalize adult-use marijuana, making it the 11th state to do so. Notably, the Illinois legislation requires the governor to pardon individuals with past convictions for low-level marijuana possession.

Emerging Opportunities for Entrepreneurs and Small businesses

The current marijuana legalization movement presents new opportunities for entrepreneurship and business start-up in the cannabis industry. Generally, this can be broken down into two segments; cultivating cannabis, which is the growing of cannabis and involvement in dispensation, which includes the selling of cannabis. However, these are far from the only businesses operating within the cannabis industry. Examples of other businesses included laboratories for product testing, industry related data resources, legal professionals, and banking. There are also the numerous ancillary businesses needed to support the processing, sale, and distribution of cannabis and cannabis related products. These include payment processors, accountants, insurance agents, agriculture-technology companies, technology companies developing apps, and countless more. Many are the same types of companies that provide support services to any industry. As a result, the ongoing legalization of cannabis and cannabis related products creates countless opportunities for entrepreneurs and small businesses in this emerging industry.

According to data, there are over nine thousand active and licensed cannabis businesses operating in the United States with over 100,000 employees.⁷ The numbers are even greater when considering the downstream impact to ancillary businesses. In fact, some estimate that the U.S. cannabis market would be worth nearly \$30 billion in tax revenues if legalized today and taxed at tobacco levels.⁸ And, just like any industry, small firms are an important part of the equation and deserve a level playing field.

And because this is such a nascent sector, legalization also allows policymakers to increase equity and diversity in the cannabis industry, which can take the form of addressing financial barriers to market entry and ensuring the industry reflects the local community. Part of that entails having the business owners in a legalized marijuana industry fully and accurately represent our nation's rich diversity. For instance, the legal American cannabis industry has a high rate of women in leadership roles with 36 percent on average and the highest being at 63 percent in high-level executive positions in testing labs.⁹ The average for other U.S. businesses is just 22 percent.¹⁰

Another factor states are focusing is assisting communities most impacted by prohibition and the War on Drugs by supporting companies and individuals entering the industry from disproportionately impacted communities. Whether it is encouraging entrepreneurs with convictions or offering industry training to offenders with cannabis-related convictions, there are many ways in which small firms and local communities can benefit from federal recognition and clarity of cannabis-related laws and regulations.

⁷ Aaron Smith, CNNMoney, THE U.S. LEGAL MARIJUANA INDUSTRY IS BOOMING, (Jan. 31, 2018) <https://money.cnn.com/2018/01/31/news/marijuana-state-of-the-union/index.html> (last visited June 17, 2019).

⁸ Michael Sheetz, CNBC, BARCLAYS ESTIMATES US WEED MARKET WOULD BE \$28 BILLION IF LEGALIZED TODAY, GROWING TO \$41 BILLION BY 2028, (May 1, 2019) <https://www.cnbc.com/2019/05/01/barclays-us-cannabis-market-28-billion-if-legalized-today.html> (last visited June 17, 2019).

⁹ Nancy Won, Fashion Magazine, CANADA'S BUDDING MARIJUANA INDUSTRY IS HELPING WOMEN BREAK THE GLASS CEILING, (Oct. 17, 2018) <https://fashionmagazine.com/culture/women-marijuana-industry> (last visited June 17, 2019); *see also* Becky Olson, Marijuana Business Daily, CHART OF THE WEEK: WOMEN HOLD 36% OF EXECUTIVE-LEVEL POSITIONS IN THE CANNABIS INDUSTRY, (Oct. 12, 2015) <https://mjbizdaily.com/chart-of-the-week-women-holding-more-seats-in-the-executive-suite-at-cannabis-companies> (last visited June 17, 2019).

¹⁰ *Id.*

Current Issues

Access to Capital

Starting a regulated cannabis business can be an expensive undertaking with the average startup cost at about \$775,000 and annual operating costs of close to \$2 million.¹¹ The capital-intensive industry requires much-needed investment and loans upfront just to get off the ground. Yet, small businesses generally face significant hurdles accessing capital from banks and other traditional sources. This is especially true of women-owned, minority-owned, veteran-owned, and rural-based small businesses.

To fill this gap, SBA administers numerous programs to support small businesses, including loan programs designed to encourage lenders to offer loans to small businesses that may not be able to access affordable capital elsewhere on reasonable terms. These include the 7(a) Loan Guaranty Program, the 504/Certified Development Company Program, and the Microloan program. In FY18, the 7(a) program approved \$25.4 billion in loans, which supported 60,353 small businesses and 543,171 jobs.¹² The 504/CDC program approved \$4.8 billion in loans, which supported 5,874 small businesses and 55,729 jobs.¹³ The Microloan program, in which the average loan size is approximately \$14,000, saw its intermediaries approve more than 5,000 microloans totaling nearly \$77 million and supporting more than 20,000 jobs.¹⁴

1. Current SBA Policy: SBA SOP 50 10 5(K)

Current SBA guidance under SOP 50 10 5(K) makes both “Direct Marijuana Businesses” and “Indirect Marijuana Businesses” ineligible for the SBA’s loan programs. Effectively, this rule forces small businesses in states with legal marijuana into an unfair choice: remain eligible for SBA’s loan products, or do business with a rapidly-growing and state-sanctioned industry. Under the definition of an indirect marijuana business, a business that generates any of its revenue from sales to a direct marijuana business of products or services that aids in the use, growth, enhancement, or other development of marijuana is ineligible for SBA-backed financing. This policy forces small businesses in states with legal marijuana into making the choice to remain eligible for loan assistance by losing a customer base.

Though SBA’s longstanding policy has been to prohibit SBA-backed lending to businesses engaged in “illegal activity,” SBA’s SOPs began expressly identifying direct and indirect marijuana businesses as such in 2019, and did so without regard to state law.¹⁵ Additionally, the SOP creates confusion by blurring what can be considered an indirect marijuana business. In the

¹¹ Statista, TYPICAL REVENUE, EXPENSES AND STARTUP COSTS FOR MEDICAL MARIJUANA DISPENSARIES IN THE U.S. AS OF 2017 (IN U.S. DOLLARS), (last edited May 7, 2019), <https://www.statista.com/statistics/784483/revenue-expenses-and-startup-costs-for-medical-marijuana-dispensaries/> (last visited June 17, 2019); see also Aleks Merkovich, FitSmallBusiness, CANNABIS INDUSTRY STATISTICS, (Mar. 19, 2019) <https://fitsmallbusiness.com/cannabis-industry-statistics/> (last visited June 17, 2019).

¹² U.S. Small Business Administration, *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report* (2019), p. 30.

¹³ U.S. Small Business Administration, *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report* (2019), p. 34.

¹⁴ U.S. Small Business Administration, *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report* (2019), p. 39.

¹⁵ U.S. Small Bus. Admin., Office of Fin. Assistance, SOP 50 10 5(K).

definition, an accountant or lawyer that advises a business owner who grows or sells cannabis is prohibited from utilizing SBA assistance. Yet, a plumber who fixes a sink is not prohibited. The subjectivity and unclear guidelines could result in lenders excluding legitimate small business owners from SBA's loan programs.

Market Consolidation

Like many other industries, the cannabis industry faces its own consolidation challenges. While some states have attempted to incentivize and increase the presence of small and medium businesses, efforts have proven difficult. In conjunction with a lack of approved banking and capital options, operating and pricing challenges have started to become more burdensome. Many small business owners have found it difficult to compete against well-financed conglomerates and other larger companies that have resources dedicated to locating and utilizing loopholes in laws. In California where limitations were placed on size and market entry of companies, it has been found that one company holds five percent of the over 3,000 active cultivation licenses in the state.¹⁶ Finally, with more competition in the legalized market, prices have drastically fallen. Though cheaper prices are attractive to consumers, small operators in the market are struggling to remain in business. For example, the average wholesale price of cannabis in Colorado fell from \$2,000 per pound in 2015 to about \$1,300 in 2017.¹⁷ The result could be fewer small businesses in the industry or highly specialized small companies.

Workforce Training

The cannabis industry is one of the fastest-growing market segments in the United States as more states consider its legalization. An inevitable part of that growth is the need for a skilled workforce. Estimates vary as to the future labor needs of the market but there is little doubt that a void will exist. Colorado has approximately 18,000 full-time workers in the direct cannabis industry, which does not include indirect workers such as legal services, guards, among others.¹⁸ With more states legalizing cannabis, experienced workers are leaving their jobs for new opportunities and more lucrative salaries and benefits. One challenge small business owners face is recruiting and retaining workers because the talent pool is unable to keep up. Training and educating employees can be expensive particularly due to a lack of established formal curriculum in schools. Much of the training is performed on-site or primarily in states where legalization has occurred. The hearing will give Members the opportunity to learn more about the current state of the industry and how small firms are faring and what policies could be put in place as federal decriminalization is being debated.

Conclusion

As increasingly more states legalize cannabis, it will be important for Congress and the agencies it oversees to work cooperatively to ease legislative and regulatory burdens on small businesses in

¹⁶ Susan Gunelius, CannabizMedia, BIG BUSINESSES FORCE SMALL BUSINESSES OUT OF THE MARIJUANA MARKET, (July 17, 2018) <https://cannabiz.media/big-businesses-force-small-businesses-out-of-the-marijuana-market/> (last visited June 17, 2019).

¹⁷ Scott Rodd, Pew Charitable Trusts, AS SMALLER MARIJUANA BUSINESSES GET SQUEEZED, STATE REVENUE TAKES A HIT, (June 21, 2018) <https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2018/06/21/as-smaller-marijuana-businesses-get-squeezed-state-revenue-takes-a-hit> (last visited June 17, 2019).

¹⁸ Erica Yee, CNBC, AS CANADA ENTERS RECREATIONAL MARIJUANA MARKET, COLORADO TRIES TO STEM A BRAIN DRAIN ON ITS CANNABIS INDUSTRY, (Oct. 17, 2018) <https://www.cnbc.com/2018/10/17/colorado-tries-to-stem-a-brain-drain-on-its-budding-cannabis-industry.html> (last visited June 17, 2019).

states with legal cannabis. At the same time, the entrepreneurship opportunity the legitimate cannabis industry presents for entrepreneurs from traditionally underserved communities, including minorities and veterans, must be recognized. However, small businesses in states with legal cannabis are currently struggling to fund and operate their businesses, due in part to conflicting federal and state guidance. Accordingly, this hearing will offer Members an opportunity to hear about the challenges faced by “ancillary” or “indirect” cannabis businesses, and how Congress can help remedy those challenges. Furthermore, the hearing will enable Members to explore ways to ensure a newly-legalized cannabis industry reflects our nation’s diversity, and is able to fairly compete with foreign and large companies.