Addressing capital access in 2021

How states can make the most of the second
State Small Business Credit Initiative

Produced by:

SSTi

April 29, 2021
Addressing capital access in 2021

The *American Rescue Plan Act* authorizes a $10 billion State Small Business Credit Initiative (SSBCI) as part of the national response to the coronavirus pandemic-induced recession. This funding is unlike other small business assistance programs authorized during the emergency so far in that SSBCI specifically provides funds to states—at least $56 million per state—to use for their own capital access initiatives, including programs that make investments in small businesses.

SSBCI was previously authorized in 2010 to help address the severe decline in small business lending that had accompanied the Great Recession. The U.S. Department of the Treasury (Treasury), which managed the initiative, approved more than 150 state and municipal programs for funding. Through 2016, these efforts tapped $1.0 billion in federal funds to leverage an additional $8.4 billion in private capital. As a result, the program facilitated more than 16,000 transactions that allowed businesses to remain solvent, if not expand, preserving and creating an estimated 190,000 jobs.

The challenges faced by small businesses today, however, are different than those faced in 2010. One significant difference is that small business lending was on the rise through 2020 instead of declining. Overall equity investment is at record levels as well. Despite these high-level strengths, both markets contain structural challenges for specific types of small businesses (e.g., minority-owned enterprises and new companies), and these segments particularly can benefit from SSBCI assistance.

While the condition of the capital markets in 2020 is very different from their status in 2010, SSBCI, which is a flexible model for bolstering state-based efforts to address regional capital challenges, remains an appropriate mechanism to help address the current economic strife. However, the same may not be true of all of the 150+ state programs approved by Treasury in the past. The onus is on the states to identify the challenges and needs of their small business capital markets today and design appropriate plans to meet the moment.

The purpose of this brief is to help states prepare to make the most effective possible use of funds from the SSBCI reauthorization (SSBCI 2.0). To this end, we discuss the history of the SSBCI program, including lessons learned, recent trends in capital access, how SSBCI 2.0 is structured differently from the original, and recommendations for making the most of this opportunity—including prioritizing funds for seed investment, manufacturer competitiveness and addressing inequitable capital access.

Contents

Addressing capital access in 2021 ........................................................................................................... 2
Defining SSBCI 1.0 .................................................................................................................................. 3
Lessons for states from SSBCI 1.0 ......................................................................................................... 4
Recent trends in small business capital access ................................................................................... 6
SSBCI 2.0 ................................................................................................................................................ 11
Recommendations for states ............................................................................................................... 12
About SSTI ............................................................................................................................................. 20
Defining SSBCI 1.0

SSBCI was authorized by the Small Business Jobs Act of 2010 to facilitate small business access to capital. Congress provided $1.5 billion for the program, which was operated by Treasury. Apart from a small portion reserved for Treasury's costs, the $1.5 billion was allocated to the states (as well as Washington, D.C., and the U.S. territories) according to a formula that accounted for each state's share of the unemployment effects of the Great Recession. Every state received at least $13.2 million, and some received far more (California was allocated the most at $168.6 million). Every state was entitled to access its allocation, as long as it submitted a letter of intent to apply, submitted an application, and proposed a set of programs that met SSBCI's requirements.1

The core requirement of SSBCI programs is that federal funds must be matched by private capital, whether in the form of loans or investments. The law establishes two categories of programs to define this leverage requirement: “capital access programs” and “other credit support programs.” The former are essentially pooled loan insurance funds that use a 2.5-5.0 percent contribution of SSBCI funds on each loan in the program—providing, by definition, a leverage ratio of at least 19:1. “Other” programs could include almost any model from loan guarantees to seed funds, so long as each deal has at least 20 percent participation of private capital and each program earns at least a 1:1 match of federal and private capital across all of its deals. The final private capital leverage requirement is that when states apply to Treasury for program approval, they must demonstrate a reasonable expectation that they will be able to generate 10 private dollars for every dollar of SSBCI funding.

The flow of capital from Treasury to the states, to approved programs and, when matched with private capital from lenders or investors, to the participating small businesses, is shown at right.

Another significant requirement for the states is that the funds must be used relatively expeditiously. The states receive their money in three tranches and must use nearly all of the funds within one tranche before Treasury can release more funds to the state. Under the original law, states needed to access each tranche within two years or Treasury could deny the state access to additional funding. This provision was not often used within SSBCI 1.0.

SSBCI 1.0 did not provide meaningful programmatic funding. States could use 5 percent of the first tranche and 3 percent of subsequent tranches for administrative costs.

Finally, it is worth noting that SSBCI included regulatory and reporting requirements on states and all participating lenders and businesses. Treasury’s Inspector General also audited each state at least once.

---

1 Two states did not submit a letter of intent and one more did not apply. In these cases, municipalities in that state are allowed to apply for the funds instead.
Lessons for states from SSBCI 1.0

The first lesson for states is simple: use the program. Three states—Alaska, North Dakota and Wyoming—elected not to participate in the first SSBCI, which enables cities that apply and meet the same requirements to use the funds instead. There is no substantial, practical downside to state participation in the program and therefore no reason not to utilize the federal funds to strengthen the state’s economy.

Beyond this choice to participate, there are many complex decisions for states regarding how to design the best mix of programs. States must create initiatives that will attract the interest of both borrowers and private investors/lenders. Further, states must strike a balance between using funds in a timely manner with achieving substantial leverage of private capital.

Ultimately, SSBCI’s flexibility is a strength to the extent that states are prepared to determine what programs are needed in their markets. This same flexibility, in the absence of careful planning, can enable states to enroll a suite of programs that will receive little use, wasting the opportunity.

Fortunately, the 150+ programs that Treasury approved during SSBCI 1.0 created ample learning opportunities for important considerations to guide effective state program design. The following list captures some of the most critical lessons across the entire program:

- Programs that address more specific gaps in the regional private capital markets are more likely to see early and robust use, while programs that offer more generalized capital access or address non-existent needs may not.
  - For example, a region that has relatively few new tech companies may see more traction from establishing a seed fund at a knowledgeable Venture Development Organization (VDO) than it would from creating a fund to co-invest with later-stage investors.

- Pre-existing relationships with investors and lenders contributed to early success with programs. New programs can still do well but are more likely to succeed if the state (or its partners operating the program) have strong relationships and reputations. In such cases, the state may be able to build on this experience to launch a new program to work alongside these investors and lenders, or, similarly, be able to leverage its reputation to expand existing program models to new types of partners.
  - States planning to implement a new program type for an unfamiliar audience can still see success but should likely plan to devote resources to outreach and allow for a more gradual uptake of the program.

- Staff experience was critical to program implementation and consistency. Experience not only helps with the technical management of the program but also makes it more likely that clients will have a better and more confidence-inspiring interaction whenever questions or concerns inevitably arise.

---

2 Treasury’s final report on the program provides lessons learned across all of SSBCI and within individual states and programs. We strongly encourage states to review this information. https://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI%20Program%20Evaluation%202016%20-%20Full%20Report.pdf
• Equity/investment programs arguably provided the best balance between rapid use of SSBCI funds and leverage of private capital. These programs used $278 million through 2016 with a leverage ratio of 11:1.
  o Loan participation programs were the next-best at this balance, using $376 million with a ratio of 7:1. Collateral support programs were popular ($210 million) but lower-leverage (5:1), followed by guarantees ($158 million at 7:1). As proscribed in statute, capital access programs achieved great leverage (23:1) but utilized limited funds ($22 million).

• States did not need to operate the programs themselves in order to be successful. In fact, nonprofit, mission-driven financial intermediaries were often the most effective operators of SSBCI programs.
  o On the debt side, CDFIs were active program participants and particularly helped states support underserved populations.
  o For investment programs, VDOs achieved some of the best results, including substantial leverage and/or expedient use of program funds.
  o Attempting to work with private, for-profit entities led to delays for many states (while overseeing competitive selection processes) and necessitated creative workarounds of the statutory limits on administrative funds.
Recent trends in small business capital access

In 2021, businesses face critical levels of financial stress and uncertainty related to the pandemic and recession. However, a general unavailability of capital does not appear to be a significant challenge. To the extent that small businesses are facing capital access issues, the problem is likely related to: 1) temporary pandemic-related demand-side impact on revenue and cash flow; or 2) structural issues regarding unequal access to finance, particularly if the company is new, located in an underserved area, or is minority- or women-owned. The pandemic appears to have highlighted or exacerbated long-term challenges for the availability of capital for small businesses more than it has created new concerns.

Small business lending

Unlike during the Great Recession, when bank lending declined from 2008-2010 by $60 billion (or 8 percent), small business lending appears to have increased during 2020. The San Francisco Federal Reserve estimates that the first half of 2020 saw corporate borrowing from banks increase by 5.1 percent (compared to 3.6 percent for the same period in 2019). Notably, about half of all loans to small businesses during this period were enrolled in the Paycheck Protection Program (PPP) with the U.S. Small Business Administration (SBA). In FY 2020, SBA approved more than $525 billion in PPP loans. The agency approved another $191 billion in the Economic Injury Disaster Loan program and $28 billion through its traditional 7(a), 504 and microloan programs.

The strength of small business lending in 2020 built upon several years of robust lending. The figure below, reproduced from an SBA report, shows fairly steady growth in loans to small businesses since 2013. SBA found an overall growth in small business lending of 4.1 percent from 2017-2019.


The amount of capital available to small businesses overall appears to be strong. Nonetheless, there are weaknesses within the small business lending market.

---


The SBA report revealed that smaller lenders have been providing a declining share of small business loan volume from 2017-2019. The cutoff point for lender assets in this distinction is $10 billion, but the smaller the bank, the greater the decline. Tracking small business lending data by number of loans instead of volume reveals a similar story of decline among smaller banks, although the largest banks ($50 billion or more in assets) have also been making fewer small business loans (but of much larger sizes).

The figure below, also from the SBA lending report, shows that this trend toward a concentration of small business loans among larger banks has been in place for most of the past decade, with only the 2019 data suggesting the start of a reversal.

One reason the difference in lending trends by bank size matters is that recent survey research by the Federal Deposit Insurance Corporation shows that small banks (less than $10 billion in assets) and large banks have different underwriting standards for new businesses. Larger banks are particularly likely to request guarantees for new companies, including SBA’s products, to support a new business loan.

Not all small businesses had equal access to bank lending before the recession. According to a report by the Federal Reserve, 23 percent of Black-owned small businesses had accessed a traditional loan, compared to 34 percent of LatinX-owned businesses and 46 percent of white-owned businesses.

Anecdotes and indirect data suggest these uneven connections to lenders played a role in access to PPP loans, as businesses in majority-minority areas appear to have received the emergency loans more slowly—majority Black neighborhoods received loan approvals on average a week later than majority white neighborhoods—and were more likely to see approvals by Community Development Financial Institutions (CDFIs) and non-traditional lenders.

---

7 https://www.fedsmallbusiness.org/survey/2020/report-on-employer-firms
While 2020 was a strong year overall for small business lending, the market may be even better in 2021—and include billions of dollars targeted to traditionally-underserved communities. Congress appropriated SBA more PPP funds to disburse, and the Treasury is providing an additional $9 billion to depository CDFIs and an extra $1.25 billion in emergency funding to all CDFIs (in addition to the program’s current $200 million appropriation). In this context, many states may not exhibit a significant need for small business lending and, therefore, general small business lending programs may not see robust levels of participation in many parts of the country.

Targeted lending programs may be more appropriate and needed. The specific gaps that seem most likely to exist are for loan products suitable for new companies and to under-banked communities and businesses, which are disproportionately likely to be minority-owned. Of course, these observations speak to the national trends. States should speak with their lenders and small businesses to determine the nature of the capital market in their state.

Investments in startups

The market for equity investments and alternative financial instruments into small businesses has, similar to the national small business lending market, seen growing topline dollar values that conceal challenges for the newest companies and diverse entrepreneurs.

In 2020, the venture capital market set a record with $156 billion invested. However, this record was driven by a multi-year trend toward large investments in relatively established companies at the expense of the smaller seed and angel investments that fuel the early growth of technology- and innovation-driven companies. The figure below, from the PitchBook and National Venture Capital Association’s report on venture capital in 2020, shows this shift in the market away from deals investing less than $1 million and toward deals investing more than $50 million.

Another concerning trend in the private venture capital market is a decline in the share of companies that are receiving investments for the first time. This trend was exacerbated in 2020 as the number of

---

companies receiving “first financings” fell off sharply in 2020. While PitchBook records 892 first investments for companies in the first quarter of 2020, that figure fell to just 628 in the second quarter and 2,883 on the year—the fewest since 2011. These figures brought the share of deals that were a company’s first investment (versus a follow-on investment) to 26 percent in 2020. This figure is a record low but also not dissimilar from the 27 percent seen in each of 2018 and 2019. Collectively, the past three years have been far worse for new companies than in the past (from 2006-2015, the average share of first financings was 37 percent).

The private venture capital market contains several other structural biases that negatively affect the ability of many companies to access investment financing. These include geographic concentration, investment preference, and demographic homogeneity.

The VC market remains severely geographically concentrated despite decades of national discussion of the issue. In 2020, nearly three-quarters of all venture capital dollars in the U.S. were invested in just three states: California, Massachusetts and New York. In fact, measuring investment location by state understates the concentration, as the same share is really invested in just a few regions (i.e. combined statistical areas): San Jose-San Francisco-Oakland, Los Angeles-Long Beach, New York-Newark, and Boston-Worcester-Providence. The figure below displays the number of deals (which are slightly less concentrated than dollars) by state for 2020.10

The private venture capital market also skews heavily to two sectors: software and biotech/pharmaceuticals. About a third of all capital invested in 2020 went to “software” companies (a figure that does not include companies providing sector-specific information through proprietary platforms). The second-place sector is pharma and biotech, which received about 17 percent of all capital invested in 2020.

The demographic make-up of venture-backed entrepreneurs does not reflect America’s population. Only about one percent of founders that received venture capital investment are Black, and only about 20 percent are female.11

10 https://ssti.org/blog/useful-stats-later-stage-vc-has-banner-year-uncertainty-about-early-stages
Because of these structural biases and investment preferences in the conventional private venture capital market, even during a record-setting year, many tech- and innovation-driven companies that should be strong candidates for investment may struggle to find willing financiers. Companies may have difficulty attracting investment if they are relatively new and/or looking to raise small rounds, and particularly if they have not previously accessed venture capital. Companies that are located outside one of the leading few metros, work on technology beyond software, or are owned by people who are not white males are also likely to face substantial challenges in accessing private investment financing. These are all challenges that states’ SSBCI programs could be designed to help address.
SSBCI 2.0

The new legislation bears many similarities to SSBCI 1.0, but there are significant differences. Congress is authorizing $10 billion for SSBCI 2.0, and this change alone should affect decisions about optimal design for state programs, particularly in light of timeliness requirements (for example, states may find it prudent to enroll more programs in SSBCI 2.0 than they did in the original program). Within the total funds, $6.5 billion is provided for a nearly-direct reauthorization of SSBCI 1.0. This funding will again be allocated to the states according to each state’s share of unemployment during the recession. A separate, $500 million pool will be divided among Tribal governments to participate in the program as well. See the figure on this page for a breakdown of SSBCI 2.0.

One substantial legislative change regarding this portion of the reauthorization is that states will now have three years, instead of two, to access each additional tranche of funds. Treasury will also be able to reallocate any funds that states are unable to use within this timeframe. The combination of greater leniency and an opportunity to reuse captured funds suggests that Treasury will treat the timeliness requirements more strictly than it did with SSBCI 1.0.

The more significant changes to SSBCI 2.0 are in the treatment of the remaining funds. Treasury will allocate an additional $1.5 billion among the states according to the needs of businesses owned and controlled by socially and economically disadvantaged individuals (SEDI businesses). These funds are required to be used by states to address the capital access needs of these businesses. Another $1.0 billion will be available as incentive payments to states that perform particularly well in working with SEDI-businesses during the first few years of the program. The final $500 million will be used for technical assistance. Part of the funds will go to states to provide technical assistance, with priority given to SEDI businesses. Treasury will also be allowed to transfer these funds to the Minority Business Development Agency or hire technical assistance providers directly.

Treasury is required in the new statute to allocate at least $500 million of the funds to support businesses with fewer than 10 employees. However, given that more than 40 percent of SSBCI 1.0’s funding went to businesses in this category, this standard of 5 percent is quite low. Treasury included this pool of funding with its allocation of the other $6 billion in employment-based allocation, which is how the totals are discussed above and in the graphic. Treasury will provide guidance to states around any additional requirements related to this portion of the funding.
Recommendations for states

States should look to achieve several objectives for their use of SSBCI 2.0 funds:

- Address market gaps/inefficiencies in order to provide better access to capital across geographic, demographic and sectoral divides within the state;
- Strengthen the state’s economy by improving industry competitiveness and diversifying the state’s economic base;
- Put the capital in the market for as long as possible by prioritizing program designs that will recycle funds for use by other companies; and,
- Deploy the funding quickly enough to businesses in order to access the state’s full allocation (without misusing or squandering the funds).

In order to accomplish these goals in the context of the factors discussed on the previous pages, the most appropriate and effective structure for SSBCI in many states will be to focus on the following strategies:

- Developing the state’s pipeline of new tech- and innovation-driven companies;
- Strengthening manufacturer competitiveness; and,
- Addressing inequitable access to capital.

Fortunately, SSBCI 2.0 will provide states with sufficient funding to pursue these strategies and achieve these goals simultaneously.

Developing the state’s pipeline of new tech companies

One of the best uses of SSBCI funds will be to improve the rate at which the state produces new companies driven by technology and innovation, for the following reasons:

- SSBCI-backed investment and tech-friendly debt programs can address the problematic and systematic coverage gaps present in the private investment capital markets;
- Funding to the newest innovation-driven companies has been declining in recent years, creating a specific financing need for new, small businesses in most states;
- Accelerating new technology-focused companies can lead to economic diversification and growth simultaneously by generating new products, employment and even industries;
- Investment programs can use money with sufficient speed to meet SSBCI 2.0’s requirements while achieving a strong rate of leverage; and,
- Well-run investment funds can recycle returns back into the program, becoming an evergreen source of early-stage risk capital to draw economic opportunity and private investment into the region.

Program design considerations for this strategy

- Financing for new tech- and innovation-driven companies will lean toward investment programs, although states can also create startup-friendly debt programs (such as revenue-based or deferred repayment terms).
- The critical factor is that programs need to target companies very early in the business lifecycle: at the “seed” stage in investment finance terms. This is the point at which capital that can be
“patient” in putting the long-term health of the company and its technology ahead of short-term financial considerations is most valuable. The public and nonprofit sectors particularly are able to play the role of a patient investor.

- The economic development purpose of providing capital to companies at this stage is to help these companies grow more rapidly—thereby creating more jobs sooner while putting new technologies into the market. The programs should have ancillary benefits in signaling the opportunity for startup formation to potential entrepreneurs and marshalling the region’s potential investors to action.

- As is the case any time a state considers a new financing program, states should take care to measure their current private investment and entrepreneurship activity.
  - Preferably, such an assessment will look at activity by stage, as well as within sub-state regions and within sectors.
  - If the state already has activity in this space, the review should look at the pipeline of companies eligible to participate in existing programs, and the health of companies moving on from existing programs (e.g., are they able to exit and survive at this point and/or can they access follow-on financing).
  - States may find, for example, that seed investment is readily available for bioscience companies but not hardtech companies, or, that metro A has an active angel network but there is no comparable activity in metro B. Such findings will determine if a broad or targeted program is more appropriate to address the existing market gaps.

- The early stages of a company lifecycle pose the greatest risk to the investment, and seed-stage investment programs therefore may achieve a relatively low initial match and may have some difficulty finding private investors/lenders in under-developed markets. However, successful investments will provide great leverage opportunities through follow-on investment (assuming this is again counted toward leverage in Treasury’s program rules).

- States can encourage recycling of SSBCI funds for future investments by writing terms about the reuse of fund proceeds into management agreements. Again, nonprofit fund managers generally will be more consistent in recycling public funds toward future programs.

- States should incorporate initiatives into their SSBCI programs that are already working to commercialize new technologies. At the least, these initiatives will be good sources of companies for potential investments/loans, but states may find it worthwhile to mold programs specific to one or more of these audiences. Initiatives in this space include:
  - Companies participating in the Small Business Innovation Research (SBIR) program;
  - I-Corps programs;
  - University or federal lab technology transfer or commercialization offices; and,
  - Accelerators or incubators.

- Inclusion and diversity should be key considerations for programs receiving SSBCI (and any other public) funding. This means both that any publicly-supported fund should be actively recruiting minority and female entrepreneurs to be considered for investments, and that the investment staff and committees of those funds should be improving their own representation.
Key programs to execute this strategy

- **Seed investment funds** – Seed funds invest SSBCI monies into new companies alongside private investors/funds.
  - To help ensure that capital will be patient and will be recycled into future companies, nonprofit entities, such as Venture Development Organizations, are particularly well-suited for this program model.
  - States are strongly encouraged to pair seed capital with technological and entrepreneurial development services to help produce the strongest-possible companies.
  - Some seed fund managing entities may be able to commit private funding at the time the SSBCI fund is created, enabling a partial initial match of SSBCI funds.

- **Angel investment funds** – Angel funds invest SSBCI monies alongside one or more angel investors.
  - To help ensure that capital will be patient and will be recycled into future companies, nonprofit entities, such as Venture Development Organizations, are particularly well-suited for this program model.
  - When paired with operational funds and an experienced manager, the fund can provide leadership around due diligence and deal development to assist and educate new or infrequent angel investors.

- **Technology development loans** – Technology (or enterprise) development loan programs guarantee or participate in loans to companies looking to develop new technologies or firms.
  - Because new tech-focused companies may lack steady revenue in their early operations, creative terms, such as deferrals, balloon repayment options or royalty-based repayment structures will be most conducive to use by new companies.
  - Due to the specialized terms, community banks and nonprofit lenders may have an easier time participating in these loans than larger banks that centralize underwriting across state lines.

Other programs that may be relevant

- **Pre-seed funds** – Similar to a seed fund (described above) but for earlier-stage companies, which means smaller investments and may attract less initial leverage. Pairing this type of investment with technological and entrepreneurial development services should be considered a necessity for companies at this stage. Pre-seed funds will be most relevant to states that have had a hard time translating new technologies to market, or if there are questions about the pipeline of companies currently-suitable for seed investment.
• **Early-stage venture capital funds** – Similar to a seed fund (described above), but for more mature companies, which means that the investments may be larger but should attract more initial leverage. This program may be most appropriate when developed as a follow-on to a state seed investment fund (companies within existing Venture Development Organization portfolios), but may be worth considering in states that have solid seed fund activity but a lack of corresponding local venture capital activity.

• **Bridge loans to private financing** – As companies grow through the seed investment stage, they may be looking to a large investment round or traditional debt (including SBA lending vehicles) for their next source of capital. Bridge loans provide short-term debt that allows a company to continue operations as normal until it can lock-in the financing. For SSBCI-funded initiatives, such loans can provide opportunities for quick recycling of funds.

• **Impact investment funds** – States may choose to pursue the creation of impact investing funds that provide investments into companies with technologies or business models expected to yield beneficial environmental and social impacts, often in lieu of higher financial returns. These investments may, on average, be more attractive to nonprofit than for-profit investors, but either type of investor should meet the SSBCI definition of a “private” entity for the purposes of counting leverage in the state’s programs.

### Strengthening manufacturer competitiveness

Manufacturing should be considered a critical industry for all states, as economic activity within the sector has one of the strongest ripple effects across the rest of the economy. The pandemic has shown that we need to bolster our manufacturing industry, including both by assisting the launch of new manufacturing firms and by aiding the ability of established small and medium-sized enterprises to diversify product lines, adopt more efficient production practices and convert to more competitive Industry 4.0 technologies. Three additional considerations about the manufacturing industry are the increasing important of cybersecurity, the oversized economic importance of small and medium-sized manufacturers in smaller communities, and the succession planning of aging proprietors of locally owned, small manufacturers.

Strengthening the competitiveness of a state’s manufacturers is an appropriate use of funds for SSBCI for the following reasons:

• SSBCI-backed programs can lower the costs of capital for manufacturers that make investments in their equipment, processes and workforce, providing an incentive to make the improvements or to add new product lines;

• Accelerating the transition of the state’s industry to Industry 4.0 should help the sector be more adaptable to future economic shocks and create better-paying employment opportunities;

---

12 Note that while some regions with under-developed private investment markets may benefit from public funds participating in early-stage venture capital, the value proposition tends to become less clear as the company advances. At a certain point, a company should either be beyond the need for public funds to leverage private participation (i.e. when a valuable exit appears to be evident) or raise concerns about being a late-stage failure (in which case public funds may do little more than extend the pain or help to bail out earlier investors). Therefore, states should be cautious about establishing funds that invest beyond an initial venture capital round.
• Loans for equipment and training costs may use relatively large portions of capital at a time while achieving a reasonable leverage ratio (e.g., collateral support programs achieved 5:1 leverage ratio while using the third-most capital among all program types); and,
• Well-run debt programs can recycle returns back into the programming, becoming an evergreen source of small business capital in the region.

This section will focus on the debt programs that will help existing companies upgrade their operations. However, as we discuss below, the investment and debt programs noted in the preceding section can be useful to launch new manufacturing companies.

Program design considerations for this strategy
• States should review the needs of the sector before launching a program:
  o Due to the general availability of debt financing, many small manufacturers may be able to access loans without assistance.
  o This review should assess availability of loans as well as costs—even if loans are nominally available, states may find that an SSBCI-backed program can lower the cost of capital to the manufacturer substantially.
  o There are several specific activities that states should want to encourage within its manufacturing sector but that may not be being served well by the current financial markets:
    ▪ Growth of minority-led manufacturers, which may be underbanked relative to their peers;
    ▪ Adoption of new technologies, primarily in the form of advanced manufacturing equipment; and,
    ▪ Training the manufacturer’s existing workforce to operate new machines, software and operations.
  o The state should also consider whether subsectors of the manufacturing industry that are important to the regional economy merit additional assistance. Examples may include solar panels, batteries, or computer chips.
• Programs built around improving the competitiveness or cybersecurity of manufacturers should consider partnering with the state’s Manufacturing Extension Partnership (MEP) Center. The Centers will be able to assist with program design, refer clients to the financial programs and are a source of technical assistance for companies that approach the financing before developing a clear plan for their improvements.
• States should be prepared to find that community banks and nonprofit lenders, particularly CDFIs, will be the most active participants in these programs. Larger banks tend to have centralized underwriting processes, which may cause them to be relatively cautious about participating in state-specific lending programs.
  o Nonprofit lenders may be able to function in these programs as either a participating lender or as a contracted manager of the funds. If the state uses the lenders as a manager, the operational agreement should ensure that funds will continue to be recycled for future borrowers.
• Many states will find that a large share of the owners of their small manufacturers are rapidly approaching retirement age and may not have a clear succession plan for their company. In some cases, SSBCI funds may be able to assist the transition of the company to an alternative structure.
(e.g., employee stock ownership plan, worker-owned, cooperative) and provide financing terms that will facilitate its continuation (such as through a co-investment or a bridge loan).

**Key programs to execute this strategy**

- **Investment funds and technology development loans** – When it comes to developing new manufacturing firms, the investment strategies discussed in the preceding section can apply.
  - States should consider ensuring that manufacturing startups receiving publicly-backed seed investments have access to technological services offered by “hard” tech labs in the region (including universities, Manufacturing USA institutes, and federal labs) and business services available through MEP Centers.

- **Collateral support programs** – Collateral support programs use SSBCI monies to make a deposit, which serves as collateral, with the participating lender on behalf of the borrower. The intention is to buttress the lender’s underwriting evaluation directly (as opposed to a guarantee’s assistance for loans that have fallen short during the underwriting evaluation).
  - In the context of Industry 4.0 conversion, a collateral support program may be relevant to the extent that banks are uncertain about the collateral value of equipment that is new to the market or at least partially specialized to the specific manufacturer.
  - A loan for worker training will most likely be underwritten as a working capital loan, which may have higher rates than an equipment or construction loan. A collateral support program may be able to achieve a lower cost of capital to the extent that the bank is willing to exchange the deposit for a lower interest rate to the borrower.

- **Loan participation programs** – Loan participation programs use SSBCI monies to provide direct loans to borrowers alongside the private loan, either on an equal or subordinate basis (with subordinate loans generally lowering the borrower’s costs more but increasing the risk to the program). Generally, these programs facilitate loans by lessening the bank’s exposure and collateral needs (but may not help to address underwriting shortfalls related to the company’s total debt load or repayment ability).
  - A loan participation program that targets complete Industry 4.0 equipment + training projects may be able to lower costs of capital to the borrower by providing the SSBCI-backed loan for the unsecured, training-related part of the project.
  - States can provide flexibility to target borrowers by adjusting the terms on the SSBCI-backed portion of the loans. Examples include lower interest rates for minority borrowers or deferral periods for young companies.

**Addressing inequitable access to capital**

While the general small business lending market is strong, states may find that SEDI businesses lack access even to traditional small business loans at reasonable rates. Therefore, states may want to create general capital access tools for these companies that will be unnecessary for many of the state’s businesses. (As noted, inclusion and diversity should be important considerations in any program created for new technology-driven companies or manufacturers.)

**Program design considerations for this strategy**

- As much as possible, states should design programs that will improve access to capital by addressing the specific drivers of inequity.
Some possible problems in the state’s current lending market, with example programmatic approaches, include:

- Borrowers in certain areas may be subject to different collateral requirements than borrowers in other areas—the state may respond with a program that requires universal application of the most generous collateral standard by participating lenders;
- Equal collateral requirements by dollar value may have substantially different impacts on borrowers from different starting economic positions (e.g., the availability of savings to back up a personal guarantee compared to pledging a primary residence)—the state may respond by establishing a program to low-asset borrowers; and,
- Borrowers that lack an existing banking relationship may receive limited consideration for commercial loans—the state may respond by creating a program specifically for unbanked businesses.

States should be prepared to offer programs suitable for small loans as tools to support SEDI businesses (loan participation and capital access programs may be particularly relevant here), but should not assume that small loans are the only area of need or the only type of loans of interest to SEDI businesses.

- Any CDFIs or MDIs operating within the state should be viewed as key partners to provide input on program design, to refer customers to the programs and to participate as lenders (or, possibly, as program managers).

- Other entities that may provide valuable input or referrals for these programs include: Women’s Business Centers, Minority Business Development Centers, and business associations/chambers specific to target populations.
  - If the state’s internal capacity to reach business owners in languages other than English is limited, the state should seek out partners that serve these communities (such as business associations/chambers, targeted CDFIs and others).

- States should be prepared to provide technical assistance (directly or through a partner) to businesses before the SSBCI loan can be closed—this may be particularly needed by businesses that have not received previous loans or do not have a current banking relationship.

**Key programs to execute this strategy**

Any type of capital program can fit into this strategy, as unequal and inequitable access can be a problem across any market. The key factors for these programs will be adjusting loan eligibility and/or terms in order to support the regional need.

**Additional considerations**

States may plan to utilize SSBCI funds for activities outside of the three strategies outlined above. For those plans, states should weigh the following considerations:

- SSBCI provides a perfect opportunity to develop regional economies in sectors that are under-served by traditional markets by could have transformational impacts on the state’s economy or well-being of the population. Beyond manufacturing, sectors that may merit special consideration include water, climate, healthcare and food systems.
- Many states will be tempted to hire private, for-profit companies as program managers. As noted earlier, this approach caused significantly delays during SSBCI 1.0 for many states and will generally lead to higher fees. Programs led by for-profit companies may not exhibit the same preference that public or nonprofit entities would have for economic development outcomes relative to profit-maximizing outcomes. Any states that choose to utilize for-profit managers should do their best to address potential issues in their solicitation processes and operational agreements.

- No program should be created without careful consideration of context. Recent emergency legislation has provided previously-unseen levels of financial assistance for companies. In addition to PPP and additional CDFI funding, businesses have access to new federal tax credits, restaurants and hospitality industries are receiving preferential treatment for some programs, and state and local areas have created a wide range of new grant and loan programs. States planning to use SSBCI funds for small business lending programs should, as much as possible, consider the compatibility of SSBCI-backed programs with at least the most significant of these other efforts, as well as what gaps may exist in the state’s market relative to these initiatives.
About SSTI

SSTI strengthens initiatives to create a better future through science, technology, innovation and entrepreneurship.

As the most comprehensive resource available for those involved in the innovation ecosystem, SSTI offers the services that are needed to help build innovation-based economies. We strive to maximize the capacity of our members to deliver successful outcomes within the context of the complex innovation communities in which they participate.

Since its inception in 1996, SSTI has developed a nationwide network of practitioners and policymakers dedicated to improving the economy through science, technology, innovation and entrepreneurship. To best assist nurturing more vibrant economies, SSTI conducts research on common performance standards, identifies best practices, analyzes trends in and policies affecting the innovation ecosystem, and fosters greater cooperation among and between all public, private and nonprofit organizations encouraging prosperity.

Learn more about SSTI at ssti.org.