Executive Summary

Program Evaluation of the U.S. Department of Treasury State Small Business Credit Initiative

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Small businesses are a vital part of the American economy and their success is a critical component of economic growth. Established by the Small Business Jobs Act of 2010, the State Small Business Credit Initiative (SSBCI) provided nearly $1.5 billion to state small business financing programs. A departure from federal credit programs with uniform requirements, SSBCI gave states significant flexibility to design programs that met local market conditions. For some states, this meant targeting micro-businesses; for others, it meant targeting manufacturers or high-tech businesses. Each state has its own needs and, with them, a unique set of partners to administer the programs.

With this flexibility, states, territories, and municipalities directed SSBCI funds to 152 small business programs with a wide range of models and strategies. Approximately 69 percent of the funding supported lending or credit support programs and 31 percent supported venture capital programs. This report studies program activity based on data reported to Treasury on 16,919 transactions made between 2011 and 2015, and interviews of state program managers and their partners.

Key Program Statistics

- **State SSBCI programs supported nearly $8.4 billion in new capital in small business loans and investments by the end of 2015.** States expended $1.04 billion (72 percent of available SSBCI funds) to leverage nearly $8.4 billion of new lending and investing.

- **SSBCI provided capital to very small and young businesses.** Eighty percent of SSBCI transactions supported businesses with 10 or fewer full-time employees and nearly half the supported businesses were less than five years old.

- **States designed and marketed SSBCI programs that addressed capital needs in low- and moderate-income (LMI) areas.** Through 2015, 42 percent of the 16,919 SSBCI transactions were with small businesses located in LMI census tracts. In several states, a successful relationship with community development financial institutions (CDFIs) resulted in higher percentages of loans in LMI areas.

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1 Treasury approved applications from 47 states, the District of Columbia, five territories, and municipalities in three states (collectively referred to as “states”).
General Themes

From 2012-2015, the consultants interviewed managers of SSBCI state programs. Several overarching themes emerged from these interviews.

- **The SSBCI program model leveraged state expertise and networks.** States are well positioned to collaborate with the federal government on small business programs because they understand local market needs, can build an integrated support system, and can manage these programs either directly or with local partners.

- **States expanded existing or built new programs that addressed local objectives.** State programs addressed the spectrum of small business financing needs, from loans for microbusinesses and equipment purchases for small manufacturers to equity capital for early stage technology businesses.

- **SSBCI helped build capacity at the state level.** Treasury played an active role as technical assistance provider to facilitate knowledge sharing among state program managers. By participating in a national network of practitioners interested in documenting and sharing detailed information on small business financing programs states replicated best practices and expanded their capabilities.

- **SSBCI state programs complemented existing federal small business programs.** State programs complemented federal programs, such as Small Business Administration (SBA) or U.S. Department of Agriculture (USDA) loan guarantees, which typically have uniform national requirements. Furthermore, SSBCI’s state programs filled market gaps that some other federal programs do not cover, such as guaranteeing loans from CDFIs, financing non-profits, directly targeting collateral shortfalls related to falling property values, and supporting equity financing for high-growth potential businesses.

- **Successful state programs shared common characteristics.** State programs that successfully deployed SSBCI funding in support of small business financing:
  - addressed a clearly defined capital gap;
  - were staffed by teams with relevant experience and strong working relationships with private lenders and investors;
  - aligned with state economic development objectives and had the support of their state agency and state leadership; and,
  - aligned with market expectations in terms of pricing and business practices.
Observations from Credit Support Programs

States directed approximately $1 billion, or 69 percent of total SSBCI funds, to credit support programs that supported small business lending, such as capital access, loan guarantee, loan participation, and collateral support programs. Through different mechanisms, each program type shares a portion of the risk of loan repayment with lenders, thereby enabling transactions that might not otherwise have occurred. From 2011 to 2015, states operated 103 active credit support programs supporting nearly 15,600 transactions. Credit support programs expended $766 million in SSBCI funds to spur $5.3 billion in new loans and investments.

- **Capital access programs (CAPs) supported a high volume of very small loans:** The median CAP loan size was approximately $14,800 and almost 47 percent of CAP loans supported businesses in LMI areas. CDFIs actively adopted CAPs in states with pre-existing programs. CDFIs accounted for 65 percent of the 10,561 CAP transactions. Large banks did not adopt CAP as many states had expected in 2011, leading states to reapportion 85 percent of their original CAP allocations to other programs.

- **Other credit support programs varied widely in design, but tended to support larger loans:** Loan guarantee, loan participation, and collateral support programs supported larger transactions, with a median size of $300,000. On average, states used SSBCI funds to support 17.4 percent of each transaction, implying a leverage ratio of 5.75:1. By redeploying funds after repayment (recycling), other credit support programs achieved a leverage ratio of 6.44:1 by year end 2015. Manufacturers were the most common business type, representing 17 percent of all non-CAP credit support transactions.

- **Community banks and CDFIs were the most active lenders:** Community banks and CDFIs were the most active lenders in the credit support programs. Together they represented 81 percent of the total number of loans supported by SSBCI and were critical in helping SSBCI provide capital to underserved areas. Community banks alone accounted for 61 percent of the dollar volume supported by SSBCI credit support programs. Few large national banks participated, representing 6 percent of total loans, but several that did were among the top volume lenders.

- **Lessons learned from implementation:**
  - The most widely used programs incorporated input from lenders in the program design process; aligned their terms, conditions, and documentation with market practice; and engaged in a consistent marketing effort.
  - Programs that subordinated the state’s position on collateral to the lender achieved faster market acceptance.
  - CAPs levered private dollars 23.12:1 and all other credit support programs combined achieved 5.69:1 leverage on initial deployment (before recycling).
  - Reaching underserved communities requires focused marketing through a network of lenders connected to targeted communities.
Observations from Venture Capital Programs

Thirty-eight states directed approximately $450 million, or 31 percent of total SSBCI funds, to venture capital programs. Market conditions for equity financing vary widely across the country so states customized their SSBCI venture capital programs to work locally.

This report categorizes venture capital programs into four different groups based on the type of entity primarily responsible for operating the program: funds, state-supported entities, state agencies, and co-investment models. Between 2011 and 2015, venture capital programs supported over 1,300 equity investments with $278 million in SSBCI funding, generating $3.1 billion in new investment.

- **States partnered with specialized third-parties to administer venture capital programs:** In most cases, states partnered with private investment funds (funds) or specialized non-profits (state-supported entities) with expertise to source, structure, close, and manage equity investments in small businesses. Funds and state-supported entities managed 83 percent of the SSBCI funding allocated to venture capital programs.

- **States tended to target early-stage businesses:** Venture capital programs targeted high-growth potential businesses in various stages of development: pre-seed and proof-of-concept; seed-stage and early-stage; growth stage and later stage; and mezzanine and debt investments. About two-thirds of the transactions supported pre-seed and seed capital investments where states saw the greatest immediate need.

- **States with less access to venture capital tended to use SSBCI for equity programs:** States outside the historically dominant venture capital hubs were more likely to allocate SSBCI funds to venture programs.

- **Measures of success varied with program strategy:** States prioritized financial return and economic development outcomes differently depending on their program objectives. The primary measure of success was leverage – the amount of new investment supported by or induced by SSBCI. States also monitored financial return on investment, investee contributions to the state tax base, and quality of jobs created, among other outcomes. However, because venture investments mature over a long timeframe (typically six to 15 years), the full extent of outcomes from these investments will not occur or be measured until after SSBCI sunsets in 2017.

- **Lessons learned from implementation:**
  - Selecting partners and establishing new funds may take up to a year.
  - A base of local investors, specifically local investment funds, is critical to supporting high growth potential businesses.
  - Key operational and compliance considerations include conflicts of interest and the ability to track federal funds through to each transaction.
About the Report

This report presents an analysis of SSBCI program activity from 2011 to 2015. Chapters 1 and 2 provide program background and examine overall outcomes in relation to federal program objectives. Chapters 3 and 4 summarize credit support and venture capital program activity separately. The report concludes with a synopsis of key findings and conclusions derived by the authors from their own experience as well as input provided by state SSBCI program managers. A team of consultants under the management of Ken Poole from the Center for Regional Economic Competitiveness and Eric Cromwell and Dan Schmisseur of Cromwell Schmisseur authored this report.

The report draws on quantitative data reported to Treasury by the states combined with more than 200 telephone interviews with state program managers, several expert practitioner working group reports, more than 50 lender and investor interviews, and more than 20 site visits conducted between 2012 and 2015. From this data and the cumulative insights gleaned from SSBCI staff and consultants retained to provide technical assistance to states, this report offers an assessment of program results and lessons for public-supported financing programs that impacted every state and territory.