



United States General Accounting Office
Washington, DC 20548

Resources, Community, and
Economic Development Division

B-285262

June 1, 2000

The Honorable Christopher S. Bond
Chairman, Committee on Small Business
United States Senate

Subject: Small Business: SBA's Proposed Venture Capital Program

Dear Mr. Chairman

The Small Business Administration (SBA) has proposed the creation of the New Markets Venture Capital program as one of several “new markets” initiatives developed by the Clinton Administration to stimulate economic development in low- and moderate-income communities. The proposed program is intended to increase the amount of capital available for investing in small businesses in low- and moderate-income areas by creating new investment companies that will provide equity capital and operational support to promising small businesses in these communities.

At your request, we compared three features of SBA's proposed program to existing federal programs to determine whether other federal programs have similar features.¹ These three features involve (1) providing equity investment capital to small businesses, (2) providing intensive operational support to these businesses, and (3) geographically targeting the program's assistance. (See p. 8 for a detailed description of our methodology.)

Results in Brief

Aspects of SBA's proposed New Markets Venture Capital program can be found in many other federal programs, but we found that only a small part of one program—the Department of the Treasury's Community Development Financial Institutions program—provides the full range of equity investment, operational support, and geographic targeting included in SBA's proposed program. Overall, we found 34 federal programs that provide some form of financial assistance to

¹For purposes of this review, we considered activities listed separately in the Catalog of Federal Domestic Assistance to be separate programs.

small businesses, but 31 of them provide assistance through either loans or grants, rather than through equity capital investment. While we identified 39 programs that provide some level of technical assistance to small businesses, only 5 of them include the level of direct operational support included in SBA's proposed program. We found that 23 of the programs that provide financial assistance or technical assistance also include some form of geographic targeting and that 14 of them include an area's economic condition as a criteria.

Background

According to SBA officials, the proposed New Markets Venture Capital program is modeled after a type of venture capital company referred to as a community development venture capital fund. These funds focus their investments in low-income inner city and rural areas and characterize their mission as seeking a "double bottom line" of profitability for their investors and increased economic opportunity for economically disadvantaged communities. Community development venture capital funds are also willing to invest in enterprises that promise more modest returns or that will take longer to grow into profitability than those businesses typically invested in by other venture capitalists.

SBA's proposal is to fund 10 to 20 new venture capital companies. Collectively, these companies would have \$200 million in capital (approximately one-half of which would be in the form of bonds guaranteed by SBA) to invest in small businesses. Under the proposal, the new venture capital companies would need \$5 million or more in outside investments to be allowed to sell a matching volume of government-guaranteed debentures. The companies' capital from outside investments would be at risk before the government-guaranteed portion. In addition to this infusion of capital, SBA's proposal includes another \$60 million (\$30 million raised by the new venture capital companies and \$30 million from SBA grants) in funds set aside for the new venture capital companies to use to provide direct operational support over a 5- to 10-year period to the small businesses in which they invest.

Each new venture capital company would be a privately managed company, formed to provide equity capital and operational support to small businesses located in specific areas. For this program, a small business is defined as a company that, together with its affiliates, has a financial net worth not exceeding \$6 million, has an average annual after-tax earnings for the previous 2 years not exceeding \$2 million, or meets SBA's size standards for its industry.

SBA expects investments made by the new venture capital companies to range from \$50,000 to \$300,000. According to SBA, equity capital is a key component in the growth of some companies, particularly those that lack the necessary financial history and collateral to qualify for a commercial loan. This is because equity investment is based more on potential future growth than on a company's current balance sheet. According to SBA, equity investment capital is also very

difficult for small businesses to obtain, particularly small businesses in economically distressed areas.

SBA describes operational support as “hands-on” assistance in such areas as marketing or production. This assistance may also help develop a business plan or provide other support prior to the formal investment in an enterprise. Direct operational support is a more intensive level of assistance than general technical assistance. Under SBA’s proposal, each new venture capital company would have to have funds set aside for operational support equal to at least 30 percent of its capital from outside investments to use over a 5- to 10-year period. SBA would provide matching grants to use for the same purpose.

The new venture capital companies would target at least 80 percent of their investments to small businesses in areas that meet the proposed program’s criteria for low and moderate income. SBA defines these areas as Census tracts with a poverty rate of at least 20 percent; or

- if the tract is located within a metropolitan area, the median family income does not exceed the greater of 80 percent of the statewide median family income or 80 percent of the metropolitan area median family income; or
- if the tract is not located within a metropolitan area, the median family income does not exceed 80 percent of the statewide median family income.

Areas that qualify under the Historically Underutilized Business Zone, Empowerment Zone, and Enterprise Community programs also qualify under the proposal.²

Similarities Between Federal Programs and SBA’s Proposal

Only a small part of one federal program, the Department of the Treasury’s Community Development Financial Institutions program, provides the combination of equity investment, direct operational support, and geographic targeting found in SBA’s proposed New Markets Venture Capital program. Other federal programs provide financial support to small businesses, some provide

²SBA’s Historically Underutilized Business Zone program targets federal contracting activity to businesses located in communities with low income or high unemployment. For the Empowerment Zone and Enterprise Community programs, an urban or rural economically distressed area develops a comprehensive strategy to promote economic opportunity and community revitalization and applies to the Department of Housing and Urban Development for designation as an Urban Empowerment Zone or Enterprise Community or to the Department of Agriculture for designation as a Rural Empowerment Zone or Enterprise Community.

them technical assistance, and some of these programs geographically target their assistance.

Other Federal Programs Provide Financial Assistance to Small Businesses

We found 34 federal programs that provide some type of financial assistance to small businesses. As shown in table 1, we found that 20 of these programs make loans available to small businesses (either directly or by guaranteeing commercial business loans), 18 programs provide capital through grants, and 3 programs involve equity investment. Some programs provide capital in more than one form. One, the Department of the Treasury’s Community Development Financial Institutions program, funds institutions that provide all three forms of financing. In addition, some small businesses receive federal grants for research under the Small Business Innovation Research program, which we did not include in our analysis. (See enc. I for a list of the individual federal programs we identified that provide financial assistance to small businesses.)

Table 1: Programs Providing Financial Assistance to Small Businesses, by Agency and Type of Assistance

Agency	Programs providing direct or guaranteed loans	Programs providing grants	Programs providing equity investment	Total ^a
Agriculture	6	3	0	8
Commerce	0	3	0	3
Housing and Urban Development	3	5	0	7
Transportation	1	1	0	2
Treasury	2	1	2	2
Small Business Administration	6	2	1	7
Other ^b	2	3	0	5
Total	20	18	3	34

^aSome programs provide assistance in more than one category. This total is the number of unique programs providing financial assistance in any form or any combination of forms.

^bDepartments of Defense, Interior, and Energy; the National Science Foundation; and the Overseas Private Investment Corporation.

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

Two Department of the Treasury programs--the Community Development Financial Institutions and the Bank Enterprise Award programs--provide equity investment. Community Development Financial Institutions are private profit-making or nonprofit financial organizations that provide financial services to distressed geographic areas and populations that are underserved by conventional lenders and investors. Organizations in the Community Development Financial Institutions program include community development banks and credit unions, loan funds, and community development venture capital funds. The Department of the Treasury provides financial and technical

assistance to these organizations to enhance their ability to make loans and investments and to provide services for economically distressed communities, targeted populations, or both. Of the 382 Certified Community Development Financial Institutions in the program, only 12 are venture capital funds.³ According to SBA's Associate Deputy Administrator for Capital Access, community development venture capital companies in the Community Development Financial Institutions program are more community-oriented and less growth- and profit-focused than companies in the proposed New Markets Venture Capital program would be. The Bank Enterprise Award program rewards banks for increases in lending and investments in distressed communities. About one-fourth of this lending and investment involves Community Development Financial Institutions, and three-fourths is done by banks directly in distressed communities.

The third program that provides equity capital to small businesses is SBA's Small Business Investment Company program. Companies in this program provide funding to small businesses through equity investments and loans. In addition to using their own private capital to support these businesses, Small Business Investment Companies can also obtain funds by issuing SBA-guaranteed debentures or participating securities,⁴ which SBA pools and sells to the public, in a manner similar to that in the proposed venture capital program. Specialized Small Business Investment Companies target their investments to small businesses owned and managed by socially or economically disadvantaged people. According to SBA officials, Small Business Investment Companies invested \$771 million in small businesses in low- and moderate-income areas during 1999. However, most of these investments were \$1 million or more, which is larger than the size of investments proposed for the new program. SBA officials told us that, like most other venture capital companies, Small Business Investment Companies tend to invest only in areas with which they are familiar, where experienced management teams are in place, and where they see the potential for significant profits. These criteria would likely be absent from most investments made by the new venture capital companies in the proposed program. Also, Small Business Investment Company investments are generally from \$300,000 to \$5,000,000, while investments made by companies in the proposed program would range from \$50,000 to \$300,000.

³As of February 23, 2000.

⁴A debenture is an unsecured debt instrument issued by a Small Business Investment Company that requires periodic interest payments and the repayment of the principal when the debenture matures, which is generally in 5 or 10 years. A participating security is a financial instrument that allows SBA to invest in Small Business Investment Companies as a limited partner and to share in their profits while allowing them to defer payments to SBA until they are generating profits.

Other Federal Programs Provide
Technical Assistance

We found 39 federal programs that make some form of technical assistance available to small businesses, but only 5 of them provide direct operational support. (See table 2.) In some cases, technical assistance involves providing general business information, although several programs provide business counseling specific to the needs of the small businesses that use them. For example, the Service Corps of Retired Executives links volunteer counselors with small businesses to encourage their development and growth. (See enc. II for a list of the individual programs we identified that provide technical assistance to small businesses.)

Table 2: Programs Providing Technical Assistance to Small Businesses, by Agency and Type of Support

Agency	Programs providing technical assistance	Programs providing direct operational support	Total ^a
Agriculture	5	0	5
Commerce	9	2	9
Housing and Urban Development	4	0	4
Transportation	4	0	4
Treasury	3	1	3
Small Business Administration	10	2	10
Other ^b	4	0	4
Total	39	5	39

^aSome programs provide both types of assistance. This total is the number of unique programs providing either technical assistance or direct operational support or both.

^bDepartments of Defense and Energy and the General Services Administration.

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

Only five programs--two from SBA, two from the Department of Commerce, and one from the Department of the Treasury--provide direct operational support to small businesses. Three of these programs--SBA's Small Business Investment Company and Microloan programs and Treasury's Community Development Financial Institutions program—combine direct operational support with loans or equity investments, and the organizations providing capital to small businesses have a stake in seeing them succeed. Two Department of Commerce programs—Minority Business Development Centers and the Native American Program—also provide significant operational support to help create, expand, and preserve minority-owned businesses. This assistance is not linked to capital investment.

Other Federal Programs Include Targeting

We found that 23 of the federal programs that provide financial or technical assistance to small businesses also include some form of geographic targeting. (See table 3.) Some of the targeting was a result of the nature of the program. For example, we counted programs to assist farmers as including geographic targeting because farms are usually found in rural areas. In addition, we found 26 programs targeted to small businesses owned by socially or economically disadvantaged people. Some programs include both geographic and demographic targeting. (See enc. III for a list of the individual programs we identified that include geographic targeting.)

Table 3: Programs Targeted to Geographic Areas, by Agency and Type of Targeting

Agency	Programs that include geographic targeting			Programs whose targeting includes an area's economic condition	Total
	Urban ^a	Rural	Other ^b		
Agriculture	0	8	0	4	8
Commerce	1	0	2	2	3
Housing and Urban Development	5	0	1	5	6
Interior	0	0	1	0	1
Treasury	0	0	2	2	2
Small Business Administration	0	0	3	1	3
Total	6	8	9	14	23

^aFor purposes of this analysis, we considered cities with a population of 50,000 or more to be an urban area.

^bSome targeting is not related to population. Disaster areas, for example, can include different population densities.

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

As shown in table 3, we found 14 programs that include some type of targeting based on an area's economic condition. The criteria that these programs apply vary from program to program. For example, the Department of the Treasury's Community Development Financial Institutions program targets areas where unemployment is at least 1.5 times the national average or where the percentage of the population living in poverty is at least 20 percent (among other criteria), while the Department of Agriculture's Rural Business Opportunity Grants program targets services to rural communities that (among other criteria) have been "persistently poor" for 60 years or more or that have experienced long-term population decline or job losses. In September 1999, SBA changed the Small Business Investment Company program to encourage investment in businesses in low- and moderate-income areas or in those that employ people from such areas.

Agency Comments and Our Evaluation

We provided a draft of this report to SBA for review and comment. SBA agreed with the data presented in the report and provided clarifying and technical comments, which we incorporated as appropriate.

Scope and Methodology

To identify current federal programs to compare to SBA's proposal, we performed keyword searches of the Catalog of Federal Domestic Assistance.⁵ We searched the on-line version of the Catalog for entries containing the words "small business," "start-up," "venture," and "entrepreneurs," and found a total of 87 entries that (1) contained one or more of these words and (2) were not Small Business Innovation Research programs. We did not include the numerous Small Business Innovation Research programs operated by federal agencies with external research and development budgets over \$100 million. These grant programs emphasize the benefits of technological innovation and the ability of small businesses to transform the results of research into new products, but they do not provide technical assistance and are not targeted to specific areas. Our search results also provided other programs that we did not analyze because they were clearly not related to the three main features of SBA's proposed program. We also searched the Catalog for entries that included the words "venture capital," "start-ups," "smaller business," and "smaller businesses," but these searches produced no additional entries. The search terms we used may not identify all programs in the Catalog that could provide support to small businesses. The program information in the Catalog is submitted by each agency and terms might not be used consistently. We did not independently verify the information in the Catalog.

For the programs identified through our search of the Catalog of Federal Domestic Assistance, we compared their features according to the Catalog's descriptions and, in some cases, other sources of descriptive information. Through this review, we identified three additional programs that did not turn up in our search of the Catalog, which we added to the list of potentially comparable programs. We reviewed these program descriptions to determine if each program served small business through some combination of financial and technical assistance and whether it was geographically targeted. In the course of our review, we determined that 31 of these programs did not provide such support to small businesses.

We also discussed the features of SBA's proposal and the results of our analysis with the Associate Deputy Administrator for Capital Access, the Associate Administrator for the Investment Division in the Office of Capital Access, and other SBA headquarters officials.

⁵The Catalog of Federal Domestic Assistance is a governmentwide compendium of federal programs, projects, services, and activities that provide financial and nonfinancial assistance or benefits to the American public.

We conducted our work from March through May 2000, in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Honorable Aida Alvarez, Administrator, Small Business Administration; and interested congressional committees. Copies will be made available to others upon request.

If you or your staff have any questions about this report, please contact me at (202) 512-7631. Key contributors to this report were Susan Campbell and David Lewis.

Sincerely yours,

A handwritten signature in black ink that reads "Stanley J. Czerwinski". The signature is written in a cursive style with a large, sweeping initial 'S'.

Stanley J. Czerwinski
Associate Director,
Housing, Community Development, and
Telecommunications Issues

Enclosures - 3

Federal Programs Providing Financial Assistance to Small Businesses

This enclosure lists the programs we identified that provide financial assistance to small businesses, the type or types of financial assistance they provide, and whether providing financial assistance to small business is their primary purpose.

Agency	Program	Type of financing			Primary purpose is financial assistance
		Loans ^a	Grants ^b	Equity ^c	
Agriculture	Alternative Agricultural Research and Commercialization Program		X		X
	Farm Operating Loans	X			X
	Farm Ownership Loans	X			X
	Intermediary Relending Program	X			X
	Business and Industry Loans	X			X
	Rural Development Grants	X			
	Rural Business Opportunity Grants		X		
	Rural Economic Development Loans and Grants	X	X		X
Commerce	International Trade Administration Special Projects		X		X
	Fisheries Disaster Relief		X		X
	Advanced Technology Program		X		X
Defense	Defense Technology Conversion, Reinvestment, and Transition Assistance		X		X
Energy	Energy-Related Inventions		X		
Housing and Urban Development	Mortgage Insurance-Two Year Operating Loss Loans	X			X
	Community Development Block Grants/Entitlement Grants		X		X
	Community Development Block Grants/Small Cities Program		X		X
	Community Development Block Grants/States Program		X		X
	Historically Black Colleges and Universities Program		X		X
	Community Development Block Grants/Economic Development Initiative	X	X		X
	Community Development Block Grants/Section 108 Loan Guarantees	X			X

Agency	Program	Type of financing			Primary purpose is financial assistance
		Loans	Grants	Equity	
Interior	Indian Loans/Economic Development	X			X
National Science Foundation	Engineering Grants		X		X
Overseas Private Investment Corporation	Foreign Investment Financing	X			X
Small Business Administration	Economic Injury Disaster Loans	X			X
	Physical Disaster Loans	X			X
	Small Business Investment Companies (SBIC)	X		X	X
	Small Business Loans (7(a) Loans)	X			X
	Bond Guarantees for Surety Companies		X		X
	Certified Development Company Loans (504 Loans)	X			X
	Microloan Demonstration Program	X	X		X
Transportation	Bonding Assistance Program		X		X
	Disadvantaged Business Enterprises/Short Term Lending Program	X			X
Treasury	Community Development Financial Institutions Program	X	X	X	X
	Bank Enterprise Award Program	X		X	X

^aLoans include both direct and guaranteed loans.

^bGrants include surety bond guarantees.

^cEquity includes preferred stock and common stock.

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

Federal Programs Providing Technical Assistance to Small Businesses

This enclosure lists the programs we identified that provide some form of technical assistance to small businesses, whether that assistance is the type of operational support called for in the proposed New Markets Venture Capital program, and whether technical assistance to small businesses is the primary purpose of the program.

Agency	Program	Technical assistance	Direct operational support	Primary purpose is technical assistance
Agriculture	Farm Operating Loans	X		
	Farm Ownership Loans	X		
	Rural Development Grants	X		
	Rural Business Opportunity Grants	X		
	Rural Economic Development Loans and Grants	X		
Commerce	Commercial Service	X		X
	Trade Development	X		X
	American Business Center	X		X
	Grants for Public Works and Economic Development	X		
	Trade Adjustment Assistance	X		X
	Manufacturing Extension Partnership	X		X
	Minority Business Development Centers	X	X	X
	Native American Program	X	X	X
Defense	Minority Business Development	X		X
	Procurement Technical Assistance for Business Firms	X		X
Energy	Energy-Related Inventions	X		X
	Management and Technical Assistance for Minority Business Enterprises	X		X
General Services Administration	Business Services	X		X
Housing and Urban Development	Community Development Block Grants/Entitlement Grants	X		
	Community Development Block Grants/Small Cities Program	X		
	Community Development Block Grants/States Program	X		
	Historically Black Colleges and Universities Program	X		

ENCLOSURE II

ENCLOSURE II

Agency	Program	Technical assistance	Direct operational support	Primary purpose is technical assistance
Small Business Administration	Business Development Assistance to Small Business	X		X
	8(a) Business Development	X		X
	7(j) Management and Technical Assistance for Socially and Economically Disadvantaged Businesses	X		X
	Procurement Assistance to Small Business	X		
	Small Business Investment Companies		X	
	Service Corps of Retired Executives Association	X		X
	Small Business Development Center	X		X
	Women's Business Ownership Assistance	X		X
	Veterans Entrepreneurial Training and Counseling	X		X
	Microloan Demonstration Program	X	X	
Transportation	Human Resource Programs	X		X
	Support Mechanisms for Disadvantaged Businesses	X		X
	Hispanic Serving Institutions/Entrepreneurial Training and Technical Assistance	X		X
	Historically Black Colleges and Universities/Entrepreneurial Training and Technical Assistance	X		X
Treasury	Taxpayer Service	X		X
	Community Development Financial Institutions Program	X	X	
	Bank Enterprise Award Program	X		

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

Federal Programs That Geographically Target Their Assistance to Small Businesses

This enclosure lists the programs we identified that include some form of geographic targeting, whether such targeting is specific to urban or rural areas or includes another type of geographic targeting, and whether targeting is based on an area’s economic condition.

Agency	Program	Geographic targeting			Targeting is based on an area’s economic condition
		Urban ^a	Rural	Other ^b	
Agriculture	Alternative Agricultural Research and Commercialization Program		X		X
	Farm Operating Loans		X		
	Farm Ownership Loans		X		
	Intermediary Relending Program		X		
	Business and Industry Loans		X		
	Rural Development Grants		X		X
	Rural Business Opportunity Grants		X		X
	Rural Economic Development Loans and Grants		X		X
Commerce	Grants for Public Works and Economic Development			X	X
	Fisheries Disaster Relief			X	X
	Minority Business Development Centers	X			
Housing and Urban Development	Community Development Block Grants/Entitlement Grants	X			X
	Community Development Block Grants/Small Cities Program	X			X
	Community Development Block Grants/States Program	X			X
	Historically Black Colleges and Universities Program			X	
	Community Development Block Grants/Economic Development initiative	X			X
	Community Development Block Grants/Sec. 108 Loan Guarantees	X			X
Interior	Indian Loans/Economic Development			X	

Agency	Program	Geographic targeting			Targeting is based on an area's economic condition
		Urban ^a	Rural	Other ^b	
Small Business Administration	Economic Injury Disaster Loans			X	
	7(j) Management and Technical Assistance for Socially and Economically Disadvantaged Businesses			X	X
	Physical Disaster Loans			X	
Treasury	Community Development Financial Institutions Program			X	X
	Bank Enterprise Award Program			X	X

^aFor purposes of this analysis, we considered cities with a population of 50,000 or more to be an urban area.

^bSome targeting is not related to population. Disaster areas, for example, can include different population densities.

Source: Catalog of Federal Domestic Assistance, Mar. 2000.

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