RESEARCH TO ACTION LAB

Promoting Equity Investments for an Equitable Recovery

International Lessons for the US

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The COVID-19 pandemic has underscored both the importance and the vulnerability of many of our country's support systems. As we move toward recovery, we can strengthen policies and programs so they better support an inclusive economy and ensure equitable access to services and opportunities. This moment offers us the chance to learn from other countries and to explore how solutions they have undertaken might be applied or adapted to our circumstances.

The Urban Institute, supported by a grant from the Robert Wood Johnson Foundation, set out to study how innovative policies and programs from abroad could inform state and local efforts in the US to advance an inclusive recovery from the COVID-19 pandemic. To share what we learned, we produced five briefs, each profiling an approach from abroad that addresses a different policy priority: child care, broadband access, local economic development, parks and public space, and housing stability and affordability. A sixth brief describes the project's methodological approach. Resources from the full project are available at https://urbn.is/lessons.

Despite the COVID-19 pandemic, equity financing in the US is at an all-time high. But this form of capital in the US is highly concentrated by geography, industry, race, and gender. Equity investors are increasingly financing larger, more mature businesses rather than smaller startups in need of capital, and most equity financing is concentrated on the coasts and in the male-dominated fields of technology and software. As the economy appears to enter a recovery phase from the COVID-19 pandemic, we scanned international equity financing programs that could inform US policymakers' efforts to improve the supply of and access to venture capital investments across geographies, industries, gender, and race and ethnicity. We identified three international programs (in Germany, Sweden, and Canada) that we believe can provide valuable lessons for policymakers in the US seeking to stimulate economic development and build shared prosperity.[1]

First, we examine Germany's INVEST program, which combines grantmaking and certification processes to encourage new angel investors to provide equity to young, innovative companies. For lessons on promoting more-even geographic and industry-based distributions, we analyze Sweden's Regional Co-Investment Funds, which use public and private sources to create investment funds for each Swedish region. And finally, we discuss two emerging efforts in Canada: the Women in Technology Venture Fund and the Black Innovation Fund, which use some public funding to target venture capital toward historically underrepresented groups. We find these programs from abroad provide the following key lessons for US policymakers:

- Using grant-based funding instead of tax credits can create more of an immediate incentive for investors to provide equity financing to newer, smaller businesses.
- Creating a certification process for newer, innovative businesses can act as a "quality signal" to attract new equity investors.
- Targeting resources toward historically underfunded regions and business owners can create a more equitable venture capital and angel investing market.
- Overcoming the lack of equity financing information among newer businesses and mitigating high transaction costs is critical for policies to be effective.

We believe that in implementing the new round of funding for states through the American Rescue Plan, policymakers can learn from not only these lessons but also those distilled from the implementation challenges and successes of these policy initiatives. We list those challenges and successes in the conclusion of this brief.

Background on the Equity Financing Industry and its Existing US Public Support

Healthy communities depend on a steady, accessible stream of investment to advance, sustain, and share economic growth. Businesses, regardless of size or age, are critical to economic development. Smaller and younger businesses provide a path for their owners to build family wealth (Klein 2017) and, at the neighborhood level, to shape the cultural identity of neighborhoods, build social capital, and provide intangible benefits through services and amenities. Although no universal definition exists of a "small or young business,"[2] for this brief we define them as having fewer than 100 employees and/or being less than 10 years old.

Although historically young businesses have been the primary source of job creation in the US (Kauffman Foundation 2015), the number of jobs created by start-up businesses has stagnated since 2015 and has yet to reach the level seen before the 2008 financial crisis.[3] Further, although young firms create lots of new jobs, they also destroy them at similar rates.[4] Startup failure can be partly explained by lack of capital: nearly four in five (79 percent) of small businesses that fail started with too little capital.[5]

Many firms get their financial start with the owner's equity or money from friends or family, but small businesses often need to turn to other forms of financing, such as debt, equity, or debt with equity-like features, to sustain themselves or grow. Sufficient supplies of debt and equity capital are essential for the economic development of communities, but public policies have historically done more to encourage the provision of debt.[6] Equity financing provides capital to an investee in exchange for a certain number of shares of a given company. As opposed to debt, equity investments do not carry repayment obligations; rather, they require giving up a portion of the firm's ownership to the investor. Equity investors mainly make money through payment of dividends, through capital gains after selling the shares or stocks, or when other shareholders buy back the investor's shares. In table 1, we summarize the four main investor classes and how they serve companies at different stages.

Although all types of investors play an important role in the small-business finance ecosystem, angel investors and venture capital are more likely to fund smaller, innovation-driven firms in their early stages. These two investor classes can be key to spurring business ownership, wealth building, innovation, and job growth. Granted, equity investments in the form of angel investors (unless from friends or family) or venture capital are not appropriate for *all* small or young businesses. Although there are networks of social impact investors that will put community development goals at the center of their investment decisions (Theodos, González-Hermoso, and Hariharan 2021), firms without high growth projections, such as child care facilities or corner grocery stores, are not well-suited for this type of capital and are unlikely to catch the interest of venture capital or profit-driven angel investors.

Data indicate that the number of angel/seed capital, early-stage venture capital, and late-stage venture capital investments have all increased since 2010. However, the pace of growth has varied. Angel/seed investment deals peaked in 2015 but have stagnated since (Pitchbook and NVCA 2021). Although the number of equity investment deals has grown across investor types, the increase in volume has been even greater, indicating that investors are prioritizing larger deals (figure 1). Other analysis finds that equity investments of less than $5 million have experienced a decline, while deals for $5 to $10 million have steadily increased.[7] According to data providers, larger investors are taking a less active role in seed funding, preferring to invest in more mature businesses in later funding stages.[8]

TABLE 1

Comparison of Investor Classes

	Angel investment	Venture capital	Private equity	Debt with equity features
Investor	High-net-worth individuals, such as entrepreneurs who founded their own companies and had successful exits	Companies or funds that are typically managed by teams of entrepreneurs, investment bankers, or other types of finance professionals	Companies, funds, or investors	Angel investors, venture capital firms, or others
Stage of investee firms	Preseed and seed funding stage: The initial funding to launch a company's operations	Seed or early stage: (Series A and B): When firms have developed a track record and seek capital to optimize or scale up their operations	Late stage (Series C, D, etc.): When firms seek capital to develop new products, expand into new markets, or to acquire other companies	Early stage (Series A and B): Borrower needs a "market-proven" product or service and a minimum $3 million in annual revenue
Size of investment	Typically $10,000 to $1 million	$1 to $20 million	Greater than $5 million	$1 to $5 million
Types of investments	Equity or Simple Agreements for Future Equity, which are similar to convertible notes	Common equity, preferred shares, and convertible debt securities in companies	Equity (sometimes acquiring debt to complete the transaction)	Convertible debt or revenue-based financing, such as royalty-based financing, where capital is provided up front in exchange for a percentage of a company's monthly top-line revenue

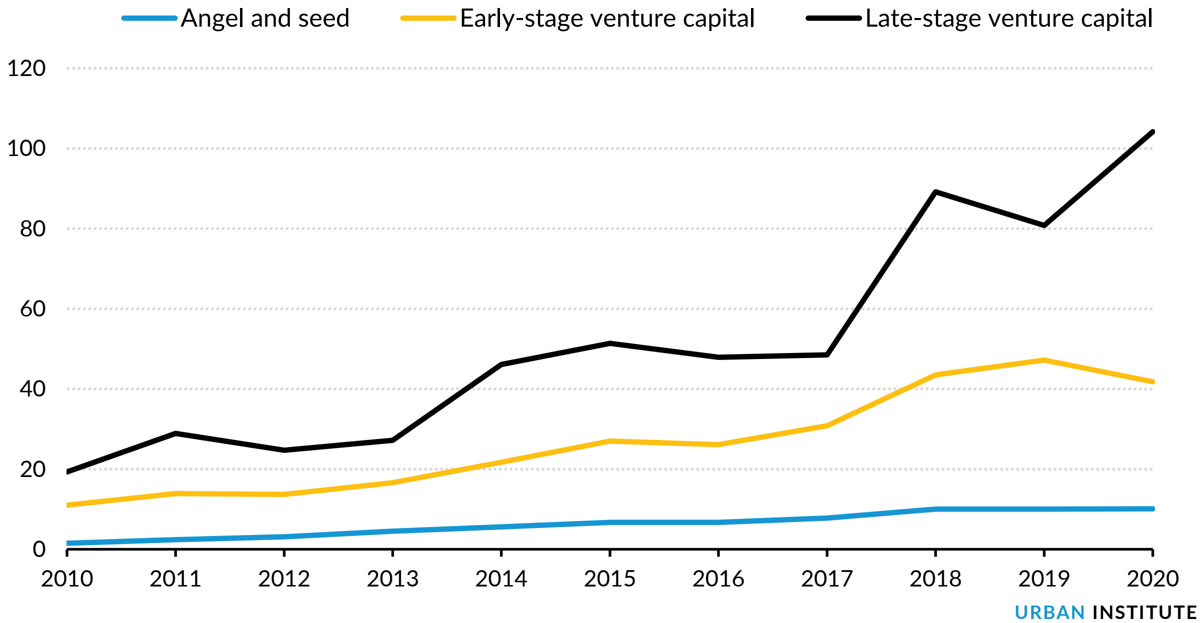
Sources: "Private Equity vs. Venture Capital vs. Angel/Seed Investors," Corporate Finance Institute, accessed October 14, 2021, https://corporatefinanceinstitute.com/resources/careers/jobs/private-equity-vs-venture-capital-vs-angel-seed/; "What Is Series B Financing?" Corporate Finance Institute, accessed October 14, 2021, https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/series-b-financing/; "What Is Royalty Based Financing?" Chase Growth Capital, accessed October 14, 2021, https://chasegrowthcapital.com/?page_id=773.

Equity financing struggles even more than debt financing to be equitably or broadly distributed.[9] Despite the pandemic, US companies raised a record $143 billion in venture capital during 2020. But women-owned companies raised only $3.2 billion,[10] or 2.2 percent of the total, even though nearly 20 percent of firms with employees are owned by women.[11] Similarly, Black- and Latino-owned businesses raised only 2.3 percent of all venture capital funds in 2020[12] even though 8 percent of employer firms are owned by Black or Latino people.[13] And in some cases, these trends are not improving: although overall venture capital investments rose 12 percent in 2020 compared with the previous year, they declined 22 percent for companies owned by women.[14]

FIGURE 1

Trends in Equity Investments

Investment volume ($B)



Source: Authors' analysis of data from Pitchbook and NVCA (2021).

Equity capital also distributes unequally by geography, with just three states (California, New York and Massachusetts) receiving about 75 percent of all venture capital investments.[15] Moreover, one-third of US-based venture funds invested in the first quarter of 2021 were based in Silicon Valley and the Bay Area.[16] This geographic concentration often results from agglomerations of experience, staff, skill, and money that lead venture capital to be concentrated in a few industries. To compensate for the risk inherent to equity financing, investors seek firms that can generate high investment returns, meaning those with rapid, even exponential growth potential. Consequently, nearly two-thirds (65 percent) of venture capital investment dollars went into companies in the internet, mobile and telecommunications, and software industries[17] even though the information sector only accounts for around 5 percent of all gross economic output in the country.[18]

Existing US Public Sector Support for Equity Finance

Although consistent, sufficient, and equitable access to equity capital is key to achieving inclusive economic prosperity and wealth creation, the public sector in the US has done relatively little to facilitate the provision of equity finance to operating businesses from geographies, industries, and owners that are not already well served. Past and existing policy efforts to stimulate the provision of equity capital have had varied success in achieving their goals. The New Markets Tax Credit (a tax credit worth 39 percent of the original investment if made through Community Development Entities) and the Opportunity Zones program (a combination of tax deferrals and exemptions provided to investors if their capital gains are invested in qualified census tracts) are largely used to finance real estate despite their intended goal of providing small businesses with access to capital (Theodos et al. 2020; Theodos, González-Hermoso, and Hariharan 2021).

The State Small Business Credit Initiative, created by the Small Business Jobs Act of 2010, provides one prominent source of public capital for equity financing. The program distributed $448 million to state, territory, and tribal government venture capital programs (Center for Regional Economic Competitiveness 2016)[19] and supported other forms of small-business financing, such as credit support and access, before it expired in 2015. But the American Rescue Plan Act of 2021 reinstated and significantly expanded the program, providing $10 billion in funding, some portion of which will likely be used for equity financing.

Another public-sector equity-finance program is the Small Business Administration's Small Business Investment Company (SBIC) program, created in 1958. With this program, qualified investment funds are licensed to operate as SBICs and can leverage government-guaranteed debt in addition to capital raised from private investors. Between 2014 and 2018, SBICs invested $29 billion in over 5,600 small businesses (US Small Business Administration 2018). Research has found that SBIC financing is more diverse than private venture capital with respect to geography, sector, and owner demographics (Temkin, Theodos, and Gentsch 2008). However, the program is often used for mezzanine debt[20] rather than pure equity financing.

The US Economic Development Administration's Build to Scale program provides grants on a competitive basis to intermediary organizations supporting new business ventures through its Venture Challenge. The Capital Challenge, also part of Build to Scale, provides operational support for early-stage investment funds, angel capital networks, or investor training programs. The overall Build to Scale program is deploying $38 million in grants in 2021.[21]

In addition to these federal efforts, 31 states have angel investor tax credit programs to stimulate more equity financing activity. In most cases, these programs offer personal income tax credits equal to a fraction of the investment, regardless of outcomes. But recent evidence suggests these programs are not well targeted and have had little to no impact on state-level job creation, innovation, or business entry. In part, these programs are ineffective because more than half of investors (in a surveyed sample) find these incentives "unimportant" or too small to move the needle on their investment decisions (Denes et al. 2020). We summarize these policies in table 2.

TABLE 2

US Support for Equity Investing

	Government agency/level	Investor type	Description
State Small Business Credit Initiative	Federal: Treasury Department	Venture capital funds and angel investors	Flexible funding for state small-business financing programs, which include credit support and access, and support for venture capital activity.
Economic Development Administration's Build to Scale	Federal: Economic Development Administration	Angel investor networks and investment funds	A portfolio of grant competitions for venture capital intermediaries, investment funds, and companies engaged in sustainable use of ocean resources (this last grant added in 2021).
Small Business Investment Company Program	Federal: Small Business Administration	Investment funds	Licensed Small Business Investment Companies use their own capital, plus funds borrowed with an SBA guarantee, to make equity and debt investments in qualifying small businesses.
Opportunity Zone Tax Incentive	Federal: Treasury Department, Internal Revenue Service	High-net-worth individuals and investment funds	Investors receive tax benefits if they invest capital gains in operating businesses or real estate located in designated Opportunity Zones.
America's Seed Fund / Small Business Innovation Research / Small Business Technology Transfer	Federal: National Science Foundation and Small Business Administration	Direct government investment in firms	Through contracts or grants, the US government invests in small businesses doing research and development in strategic areas
Angel Investor Tax Credits	State: Local revenue agencies	High-net-worth individuals and investment funds	Investors receive personal income tax credits equal to a fraction of the investment, regardless of outcomes.

Source: Center for Regional Economic Competitiveness (2016); "Build to Scale (B2s) Program," US Economic Development Agency, accessed October 14, 2021; "Equity Investment - Small Business Investment Company (SBIC) Program," GovLoans, accessed September 28, 2021; "About," America's Seed Fund, accessed September 28, 2021.

International Policies to Improve the Supply of and Access to Equity Capital

Stimulating Equity Capital in Younger and Smaller Firms Through Angel Investors: Germany's INVEST Grant Program

Created in 2013, Germany's INVEST venture capital grant program supports equity financing from private investors in young, innovative companies. The program is administered by the German Ministry for Economic Affairs and Energy and was created to boost the market of angel investors in Germany which, according to an interviewed expert, "was lagging behind other countries in similar levels of economic development." Policymakers identified two goals for the program: (1) provide "risk relief" to entice experienced investors and (2) mobilize new angel investors, or "virgin angels."[22] We investigated this program because increasing angel investment activity can improve the supply of equity capital for smaller and younger firms.

The program provides grants at both the entry and exit of the investment and certifies the newer, innovative companies eligible to receive the grant. Through the program, private investors (individuals or business angel syndicates) receive a nonrepayable tax-free grant that they can use to purchase shares in certified companies.[23] The grant received is equivalent to 20 percent of the investor's equity investment, which must be above €10,000 (approximately US$11,800), with a limit of €500,000 (approximately US$558,000) per investment and €1M (approximately US$1.2 million) per year and company. To be nonrepayable, the investment must be kept in place for at least three years. Further, investors receive an exit grant worth 25 percent of the profit earned from the sale of shares acquired under the program, capped at a maximum of 80 percent of the investment. The combined total of the exit grant and the investment must not exceed the original amount invested. To qualify for the exit grant, the capital gain must amount to at least €2,000 (approximately US$2,350).

Through May 31, 2021, INVEST has approved 12,940 acquisition grants with a total worth of €203.6 million (approximately US$240 million). About two-fifths of grants (38 percent) have gone to venture capital funds; the remainder (62 percent) have gone to angel investors.[24] Roughly half the value of INVEST-backed investments has gone to companies outside the information technology and information services industries, and 66.4 percent of INVEST-backed investments have gone to the five German states with the largest economies, arguably an equitable geographic distribution of this subsidy.

A third-party evaluation of the program in 2019 found that INVEST successfully helped companies get necessary capital and stimulated more individuals to be first-time angel investors. Roughly half (54 percent) of the companies that received grant-supported funding said that they were more successful in finding investors because of INVEST, and 44 percent said that the additional capital enabled faster implementation of development work. Similarly, 44 percent of angel investors who received a grant were first-time investors, and 66 percent of investors said they made their investment decision because of the INVEST program (either because of the grant or because the company certification served as a "quality label"). When compared with a control group of venture capital portfolios, the mobilization effect of INVEST was calculated to be 52 percent. That is, for every Euro issued as an INVEST grant, investors additionally invest an average of 0.52 Euros in young, innovative companies (Keil et al. 2019).

Promoting Geographic Equity in Venture Capital: Sweden's Regional Coinvestment Funds

In 2009, Sweden created a program that formed 11 (originally 12) regional coinvestment funds to address gaps between the capital available on the market and the demand for it. The program specifically sought to encourage regional development. The 11 coinvestment funds cover all eight of Sweden's regions and Stockholm,[25] enabling a more equitable geographic distribution of the program.[26] By improving the geographic distribution of capital, the program achieved a relatively more equitable distribution across industries, although this was not an explicit goal of the program.

Each fund was composed of a maximum of 50 percent of capital contributed by the public sector and a minimum of 50 percent from the private sector (OECD 2020), with management from both public and private institutions. One-half of the public sector capital came from the European Regional Development Fund, and the other half came from public regional financiers, such as regional associations or county administrative boards (Growth Analysis 2016).

Originally set to run until 2014, the program's closing was postponed to the end of 2015. By then, nearly €374 million (approximately US$440 million) was invested in 320 companies around Sweden (Growth Analysis 2016). The program financed a broad range of industries compared with those reached by typical equity financing. A quarter of the investment volume went to businesses in the information technology and telecommunications sector; at that time in the private equity investment market, almost half of all investments went to information technology and telecommunications. It appears the regional diversity was in part responsible for the sectoral diversity.

Evaluators found that the program had a “medium to large positive impact” on the local structure for equity financing in half of the regions. For this assessment, the qualitative study looked at whether the program increased access to capital for startups and small businesses, led venture capital players to take greater ownership of regional development issues, or resulted in more collaboration among regional economic development and business investment actors (Growth Analysis 2016). Further, companies receiving investment under the program increased their number of employees in a larger proportion than businesses in a control group of similar funds (Growth Analysis 2016).

Promoting Social Equity in Venture Capital: Canada’s Women in Technology Venture Fund and Black Innovation Fund

Like the US, Canada faces disparities in the provision of equity capital to firms owned by women and people of color. The federal government has sought to address that with the creation of two dedicated investment funds: the Women in Technology Venture Fund, the world’s largest venture capital fund dedicated to investing in women-led technology companies (created in 2019), and the Black Innovation Fund, focused on investing in companies founded by Black entrepreneurs (currently in formation).[27]

The C$200 million (approximately US$160 million) Women in Technology Venture Fund seeks to provide equity capital for women-led tech companies between the seed funding and Series A & B stages. In addition to direct investment, the fund connects female investors with female-led companies and facilitates training opportunities and workshops for entrepreneurs.[28] The Canadian government created the fund to address patterns of gender inequality in the technology startup sector (patterns that are similar to those in the US).

On June 2021, the Business Development Bank of Canada announced that it would also launch a C$10 million (approximately US$8 million) Black Innovation Fund that will focus on investing in Canadian preseed and seed-stage technology companies founded by Black entrepreneurs. The fund will be managed by Black Innovation Capital, which was also created in 2021 for this purpose. The Black Innovation Fund has an initial commitment by investors of C$6.4 million (approximately US$5 million), which includes commitments from private funds in addition to the Business Development Bank of Canada.[29] The fund managers’ hope is “to help build successful, Black-led businesses, deliver returns to investors, and increase diversity in the venture capital ecosystem.”[30]

Although both initiatives are still nascent (the Women in Technology Venture Fund has only had two exits so far),[31] they are promising examples of more direct government investment in venture funds with explicit gender and racial equity considerations.

International Lessons to Improve the Public-Sector Support for Equity Finance

The innovative features of these programs provide promising lessons for US policymakers at all levels, but state officials in particular have a meaningful, but time-sensitive, opportunity to improve initiatives to support small business financing with the new Specialized Small Business Investment Company funding.

Using Grants and Certifications

By using a grant-based model and precertifying small, innovative businesses, the German INVEST model effectively boosted early-stage investment. Rather than using a tax credit akin to the US programs, the INVEST program offered an acquisition grant that immediately subsidized an investor's contribution and offered the promise of future grants should the investor stay for three years before exiting. One interviewee we spoke with said that investors saw this incentive model as more immediate, and thus more attractive, than tax credits. For states with angel investor tax credits, pivoting to a grant-based system could encourage more uptake and better distribute capital to smaller businesses. The certification process was also viewed as a valuable feature that helps investors reduce search costs. INVEST has a strict certification process, meaning that some investors found the certification process to serve as a "quality label" for the companies in which they were considering investing.[32]

Targeting Capital toward Underfunded Regions and Owners

Sweden's coinvestment funds ensured that each of the country's regions received public money to stimulate venture capital supply even as the investment decisions in each fund largely followed a return maximization logic rather than community development goals. Given the concentration of equity finance in the US to just three states (with one area of California receiving the bulk), a similar regionally structured approach could benefit US small businesses. Such regional initiatives to improve access to equity financing are not unprecedented; for example, Opportunity Appalachia was created to drive Opportunity Zone investments into Ohio, Virginia, and West Virginia.[33] The Swedish example also demonstrates that greater geographic diversity can lead to greater sectoral diversity.

Further, although Canada's venture funds targeted toward women and Black entrepreneurs are still too recent to draw lessons from, policymakers in the US can learn from their design and implementation processes. By targeting equity financing toward historically underfunded entrepreneurs, the two Canadian initiatives offer valuable blueprints for how private funding can complement public funding, how management decisions can produce returns while meeting social equity goals, and how funds can support investees through networking and technical assistance. In the US, several recent judicial decisions have found stimulus policies targeting people of color to be discriminatory.[34] Thus, when structuring similar programs, US policymakers should establish a strong fact base supporting both the existence of past and current discrimination and the targeted nature of the programmatic response.

Challenges and Design Considerations

Equity finance for operating businesses comes with its own challenges and trade-offs, and agencies will need to adapt these models to meet their local contexts. The broad literature on the topic; evaluations of the German, Swedish, and Canadian programs discussed here; and experiences from within the US (where public support programs for equity investments have had mixed results) offer nuance for implementing these international models or some of their features. Here, we explore several considerations for policymakers operating in equity financing:

- **Small-business owners may lack knowledge of equity financing practices.** Equity financing experts we interviewed explained that business owners—particularly those of small and young firms—may not fully understand or be aware of what equity finance is or how it is structured. Unlike the providers of debt, equity investors are not well known to many small-business owners (Robb and Robinson 2014). And the banks and credit unions where small-businesses usually seek loans do not offer equity investing. Support may be needed to help business owners connect with investors, especially for those who do not have access to such capital through friends or family. Developing networks and facilitating environments where potential investors and investees meet and discuss deal opportunities could help bridge this gap, similar to the training and networking opportunities that Canada's Women in Technology Venture Fund offers.

  But even with more information about what equity financing is, small-businesses owners may still be reluctant to pursue that kind of funding. A Swedish study found that information is often shared unequally between entrepreneurs and venture capitalists (Glücksman 2020). Further, many entrepreneurs are reluctant to give away ownership or management control of their businesses.[35] Evaluators of Sweden's Regional Co-investment Funds recommended pairing similar programs with complimentary services, such as technical assistance tailored to each region, to improve the investment readiness of firms, their knowledge of the financing instruments available, and the companies' ability to develop and present their business plans (Growth Analysis 2016). These findings are relevant in the US context as past research has highlighted that "public policies aimed at creating healthy and supporting conditions for venture capital activity are necessary in addition to public financial support for venture capital funds" (Matisone and Lace 2020, 1).

- **Government-led equity financing will need to work with private investors.** Although inequities in angel and venture capital investments exist, government participation in this market will need to follow the lead of the private sector in many regards unless deeper levels of subsidy are provided. Evidence looking at several government interventions in the equity financing market worldwide suggests that coinvestment models increase investment better than pure-government venture capital (Dahaj and Cozzarin 2019). But the research also suggests that in collaboration with private investors, government involvement in venture capital funds increases innovation compared with just pure private investment (Bai et al. 2021; Brander, Du, and Hellman 2010).

  According to interviewed experts, a venture capital fund expects an overall return of 15 percent or higher, which helps explain why many equity investments go to tech-related businesses. Governments will need to be aware that "mission or impact equity largely does not exist," as one interviewee said. In this context, community development financial institutions (CDFIs), being unregulated entities, maybe able to play an increased role in the equity financing market and prioritize impact relevant investment criteria. In 2017, the CDFI Fund—the public entity that supports CDFIs with resources and programming—reformed its financial assistance application process to encourage mission-driven venture capital funds to receive public funding.[36] Similar reforms could be pursued to increase CDFI participation in this market, such as by making the CDFI-designation criteria more flexible and encompassing of different types of entities.

- **High transaction costs discourage small-scale equity deals.** In addition to the relatively high risk of these investments, investors need to offset high transaction costs, such as legal and accounting fees. Increasingly, they do so by leaning toward fewer but larger deals with older companies. If state, local, tribal, or territorial governments want to increase the supply of small-scale equity deals, they should explore the possibility of subsidizing transaction costs.

Grants, such as those from Germany's INVEST program, could make more small deals worthwhile for investors. An expert also noted the importance of subsidizing infrastructure costs, including labor costs such as salaries, in places without a robust equity investment market.

Even if policymakers can overcome these barriers, they should keep in mind that the type of equity angel investors or venture capitalists provide will not be the type that all businesses need. Truly small firms in underserved areas will require lower-power equity in the form of family-and-friends-style grants. Chicago's Neighborhood Opportunity Fund, for example, provides grants to small businesses in underserved commercial corridors if those entrepreneurs match the grant amount with their own equity or debt.

Conclusion

The pandemic has made evident the disparities between Wall Street and Main Street when it comes to equity investing. Although venture capital is at an all-time high, a greater share of the investments is going to larger, older firms.

Several initiatives have already been tried in the US at different levels to not only increase the supply of equity investment but also improve geographic and social equity in how it is distributed. But evidence suggests these programs fall short of targeting the businesses on the margins that, absent public subsidy, will not receive the financing they need. With Congress recently allocating $10 billion for a new round of the Specialized Small Business Investment Company program, US policymakers have a critical opportunity to intervene in the equity financing market and address the gaps that keep certain businesses from growing and succeeding.

As states consider how to use the incoming Specialized Small Business Investment Company funds as well as their own resources, they can draw lessons from other countries' experiences, successes, and challenges. Different from angel investor tax credits at the state levels or from federal initiatives that lack oversight and guardrails such Opportunity Zones, Germany's INVEST program relies on a more robust certification process for investees. Sweden decided to split its coinvestment fund initiative so that no region was left behind, which also created a more equitable distribution of capital across industries. And Canada has taken dedicated steps to address social inequities in venture capital.

As promising and informative as these examples are, they should not be considered for exact replication in the US. Policymakers will need to consider what specific features make sense for their contexts and how to address challenges in the supply and demand sides of equity capital. Furthermore, decisionmakers can learn from the successes and challenges during the implementation of these international models. We have distilled the key takeaways for the US context as follows:

1. Provide **funding to cover start-up costs for emerging fund managers**, especially those representing places and groups that have historically lacked access to equity capital.
2. Adapt certification requirements and financial support to **help CDFIs** play an increased role in the venture capital and angel investor market.
3. Link financial support with **technical assistance for new and expanding fund managers** that improves their ability to access and deploy equity capital.
4. Bolster locally delivered **technical assistance for businesses**, growing their abilities to understand and make use of equity capital. Develop networks and facilitate venues where potential investors and investees meet and discuss deal opportunities that could **help business owners access new streams of capital**.
5. Angel investors and venture capitalists may not provide the type of equity all businesses need, so consider offering **family-and-friends-style grants to help small firms** in underserved areas (Theodos and González-Hermoso 2019).

Notes

[1] An older program of interest is also the Yozma program, created by the Israeli government in 1993.The Israeli government matched up to 40 percent of investments made by foreign entities in the Yozma funds, which in turn invested in Israeli tech startups. Further, foreign investors received equity guarantees and tax breaks, and they were able to make major investment decisions. The public portion of the investment would be bought out within seven years at the same amount plus interest. Through its lifetime, Yozma received around $100 million in public investment distributed among 10 drop-down public-private funds. In 1998, when the Israeli government considered the program to have fulfilled its objectives, it privatized and sold the investment funds. Yozma is considered to have catalyzed the venture capital market and high-tech industry in Israel. By 2000, Israel's annual venture-capital outlays increased almost 60-fold, the number of companies launched using venture funds grew from 100 to 800, revenues in Israel's information and tech industry increased from $1.6 billion to $12.5 billion, and the country became second only to the US in terms of private equity investments as a share of GDP (Baygan 2003).

[2] See Andrew Hait, "What Is a Small Business?" US Census Bureau, September 15, 2021, https://www.census.gov/library/stories/2021/01/what-is-a-small-business.html.

[3] "Number of Jobs Created by Start-Up Businesses That Were Less Than One Year Old in the United States from 1994 to 2020," accessed July 22, 2021, https://www.statista.com/statistics/235515/jobs-created-by-start-ups-in-the-us/.

[4] Robert Atkinson and Michael Lind, "Debunking the Myth of Small Business Job Creation," MIT Press Reader, May 30, 2019, https://thereader.mitpress.mit.edu/small-business-job-creation-myth/.

[5] Michael Flint, "Cash Flow: The Reason 82% of Small Businesses Fail," *Preferred CEO*, June 8, 2020, https://www.preferredcfo.com/cash-flow-reason-small-businesses-fail/.

[6] Such as through the Small Business Administration's 7(A) and 504 programs and revolving loan funds supported by the Department of Housing and Urban Development, Economic Development Administration, and US Department of Agriculture.

[7] Gené Teare, "Decade in Review: Trends in Seed and Early Stage Funding," *Crunchbase news* (blog), March 13, 2019, https://news.crunchbase.com/news/decade-in-review-trends-in-seed-and-early-stage-funding/.

[8] Gené Teare, "Decade in Review."

[9] In 2019, 3 percent and 2 percent of the Small Business Administration's 7(A) and 504 loans, respectively, went to Black-owned firms. Meanwhile, 6 percent and 8 percent of these loans went to Hispanic-owned firms (authors' analysis of Small Business Administration data; see "WebsiteReport as of August 30, 2019," US Small Business Administration, accessed October 14, 2021," https://www.sba.gov/sites/default/files/aboutsbaarticle/WebsiteReport_asof_20190830.pdf. According to the 2019 Federal Reserve's Small Business Credit Survey, 54 percent of white-owned firms received the full amount of debt financing sought, while only 26 percent of Black-owned firms and 32 percent of Latino-owned firms received the full amount (authors' analysis of data from Federal Reserve Bank of Atlanta [2019]).

[10] Gené Teare, "Sole Female Founders Raised $1B Less In 2020 Despite Record Venture Funding Surge In the US," *Crunchbase news* (blog), March 24, 2021, https://news.crunchbase.com/news/sole-female-founders-raised-1b-less-in-2020-despite-record-venture-funding-surge-in-the-us/.

[11] Data is for 2018. See the latest available from Andrew W. Hait, "Number of Women-Owned Employer Firms Increased 0.6% from 2017 to 2018," US Census Bureau, March 29, 2021, https://www.census.gov/library/stories/2021/03/women-business-ownership-in-america-on-rise.html.

[12] Ronald White, "Black, Latinx and female entrepreneurs are still ignored by most venture capitalists," *Los Angeles Times*, June 5, 2021, https://www.latimes.com/business/story/2021-06-05/black-latinx-and-female-entrepreneurs-are-still-ignored-by-most-venture-capitalists.

[13] Authors' analysis of 2018 Annual Business Survey data and 2019 annual population estimates from the US Census Bureau.

[14] Gené Teare, "Sole Female Founders Raised $1B Less In 2020 Despite Record Venture Funding Surge In the US," *Crunchbase news* (blog), March 24, 2021, https://news.crunchbase.com/news/sole-female-founders-raised-1b-less-in-2020-despite-record-venture-funding-surge-in-the-us/.

[15] Authors' analysis of data from "Value of Venture Capital Investment in the United States in 2020, by State," Statista, March 2021, https://www.statista.com/statistics/424167/venture-capital-investments-usa-by-state/.

[16] Arielle Pardes, "Is Silicon Valley Dead? Not According to Venture Dollars," *Wired*, April 14, 2021, https://www.wired.com/story/silicon-valley-dead-not-according-to-venture-capital/.

[17] Authors' analysis of data from "Value of Venture Capital Investment in the United States in 2020, by State," Statista, March 2021, https://www.statista.com/statistics/424167/venture-capital-investments-usa-by-state/.

[18] Authors' analysis of data from the "Interactive Access to Industry Economic Accounts Data," Bureau of Economic Analysis, accessed October 14, 2021, (https://apps.bea.gov/iTable/iTable.cfm?reqid=150&step=2&isuri=1&categories=gdpxind). The information sector includes publishing industries, motion picture and sound recording industries, broadcasting and telecommunications, data processing, internet publishing, and other information services. Data are for 2019.

[19] From 2011 to 2015, two-thirds of states used State Small Business Credit Initiative funding to support equity financing. They allocated State Small Business Credit Initiative funds to 48 venture capital programs, and for every State Small Business Credit Initiative dollar invested, companies raised $11 of private financing (Center for Regional Economic Competitiveness 2016).

[20] Mezzanine debt refers to hybrid debt (debt with equity-like features, such as a convertible bond or preferred shares) that is subordinated to another debt issue from the same issuer. This debt has embedded equity instruments, often called warrants, or buy options, which give the shareholder or issuer first-buyer rights of additional shares if these increase in value. "What Is Mezzanine Financing?," Prudential Private Capital,

accessed August 13, 2021, https://www.prudentialprivatecapital.com/perspectives/what-is-mezzanine-financing.

[21] US Economic Development Administration, "U.S. Department of Commerce Launches $38 Million Build to Scale Program to Fuel Innovation and Tech-Based Economic Development," February 23, 2021, https://eda.gov/news/press-releases/2021/02/23/build-to-scale-program.htm.

[22] INVEST was partially inspired by the United Kingdom's SEIS and EIS tax relief programs for angel investors. Angels Den, "SEIS & EIS Tax Relief Overview," accessed July 22, 2021, https://www.angelsden.com/tax-relief/.

[23] The criteria to be certified as a young, innovative company include having fewer than 50 employees, balance sheet of less than €10 million (approximately US$ 11.8 million) and being in a sector defined as innovative by the trade register or own a patent, among others. Proof of innovative capacity can also be furnished in the form of a separate brief expert opinion compiled by a nominated independent expert. Federal Ministry for Economic Affairs and Energy (Germany), "INVEST- Venture capital grant," accessed July 23, 2021, https://www.bmwi.de/Redaktion/EN/Publikationen/flyer-invest.pdf?__blob=publicationFile&v=8.

[24] There are more approved grants than certified businesses because a single business can receive more than one INVEST-backed equity investment.

[25] The National Areas of Sweden are 8 second level subdivisions (NUTS-2) of Sweden, created by the European Union for statistical purposes. Eurostat, "NUTS 2021 classification," accessed July 22, 2021, https://ec.europa.eu/eurostat/web/nuts/background.

[26] Middle Norrland (Mellersta Norrland) and South Sweden (Sydsverige) had each two funds.

[27] Crunchbase, "BDC Capital Women in Technology (WIT) Fund," accessed July 22, 2021, https://www.crunchbase.com/organization/bdc-capital-women-in-technology-wit-fund.

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[31] Crunchbase, "BDC Capital Women in Technology (WIT) Fund," accessed July 22, 2021, https://www.crunchbase.com/organization/bdc-capital-women-in-technology-wit-fund.

[32] 19 percent of surveyed investors said that "they only invest with an INVEST refund." In this case, the certification process could also be a determining factor in their decisions.

[33] Appalachian Community Capital, "Opportunity Appalachia," accessed July 23, 2021, https://appalachiancommunitycapitalcdfi.org/oa-program/.

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