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SSBCI 2.0: A New Capital Tool for Revitalizing and Diversifying Manufacturing

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The COVID-19 pandemic has unleashed unprecedented challenges for small businesses, and Congress has responded with a wide array of measures to help entrepreneurs ride out the pandemic, including well known programs such as the Paycheck Protection Program. Flying somewhat below the radar, the American Rescue Plan Act (ARPA) allocated $10 billion to the State Small Business Credit Initiative (SSBCI), a program that fosters small business development by supporting existing or creating new state pipelines of accessible credit and capital investments. These new funds will reactivate and significantly expand a program funded during the Obama administration, but dormant since then. SSBCI dollars can be used to create capital access programs, other capital support programs, and venture capital investments. The main goals of these vehicles are to reduce collateral requirements, lower lending costs, and provide new equity investments in private companies, using public dollars to leverage substantial private investment. Importantly, this version of SSBCI includes new funding provisions that take aim at long-standing systemic gaps in access to capital as part of the nation's response to the economic challenges of the pandemic.

The expansion of this program is promising news for small manufacturers. Business owners in this sector face barriers to accessing credit for new equipment, raw materials, or simply working capital that can make it harder for them to expand their businesses than owners in other sectors. The mechanisms available through SSBCI proved very valuable during the credit crunch after the Great Recession, and are poised to boost the sector again. Moreover, they could provide a potent tool for aspiring manufacturing entrepreneurs to translate their work as inventors, innovators, and creators into job-creating businesses in the communities that need them the most. SSBCI has the power to accelerate equity in communities through providing patient capital to diverse small businesses, and progress on racial equity should be the measuring stick of success for this program alongside job creation and retention.

Some of the most successful initial SSBCI program implementations worked closely with community development financial institutions (CDFIs). CDFIs are in closest touch with diverse entrepreneurs who currently are not well served by traditional banking institutions and can benefit from credit support. The SSBCI program as expanded under ARPA has been given more resources and a stronger mandate to serve businesses owned by socially and economically disadvantaged individuals and very small businesses. Meeting this challenge will require even closer connections with CDFIs and the deployment of innovative financial products.

This report—the first in a series between the Urban Manufacturing Alliance (UMA) and The Century Foundation (TCF)—describes the SSBCI program and offers recommendations from the perspective of mission-based lenders and those seeking to support the revitalization of manufacturing as a strategy for wealth-building and racial equity. The reporting and recommendations offered are based on work by the Urban Manufacturing Alliance, particularly its State of Urban Manufacturing research project, which conducted surveys and focus groups among manufacturing entrepreneurs (mostly with ten or fewer employees) in six cities (Baltimore, Cincinnati, Detroit, Milwaukee, Philadelphia, and Portland), and its subsequent Pathways to Patient Capital program that delved further into models for providing patient capital to these promising businesses in a cohort of CDFIs and similar practitioners from Asheville (NC), Boston, Detroit, Duluth, Jacksonville, Milwaukee, Minneapolis, Nashville, Oakland, and Pittsburgh.

Key Lessons From SSBCI 1.0

The American Rescue Plan Act revives a program used to support small business recovery during the Great Recession, but not since then. The State Small Business Jobs Act of 2010—which created SSBCI—provided at the time $1.5 billion to state small business financing programs. The reason for creating SSBCI was to use public dollars to unlock private capital, and the federal government set a goal of a ten-to-one ratio between private and public dollars. States were able to use that federal money to leverage $8.4 billion in private lending and capital for small businesses, using a set of strategies outlined in the law and implemented by the states.[1] These statutory mechanisms are unchanged by the American Rescue Plan Act in 2021, and thus provide a broad roadmap for SSBCI 2.0 implementation.

As states are poised to get a much larger infusion of resources from the SSBCI 2.0, the experience with the first round offers important lessons toward the goal of supporting the manufacturing sector, and racially diverse entrepreneurs within it. The most successful state implementations of SSBCI leveraged an existing infrastructure of mission-driven investors, such as community development financial institutions and venture development organizations.[2] In the case of Georgia, the state's CDFIs went to the state government and secured an investment that solidified the field and allowed CDFIs to grow their balance sheets through borrower interest and repayments.[3] CDFIs have the advantage of deep relationships with communities and entrepreneurs that have the least access to credit. If states have an interest in supporting the class of entrepreneurs that are not typically well-served by traditional banks and sectors such as manufacturing that have unmet capital needs, they need to turn to mission-based lenders who are closer to the ground and have earned more trust among such borrowers.

Community banks proved to be a powerful partner for states as they are more likely than larger institutions to vet smaller manufacturers and put some of the bank's own private resources into the mix for such deals. For example, Alabama created a partnership between the state and its community banks to create the state's first credit support program for small businesses, the Alabama Loan Guarantee Program, which executed nearly 600 transactions with SSBCI backing.[4]

Unfortunately, not enough is known about the effectiveness of the SSBCI program in serving racially diverse entrepreneurs. The U.S. Department of the Treasury's evaluation of the program in 2016 concluded that states that had stronger relationships with CDFIs delivered more transactions in low- and moderate-income areas, and capital access programs that target the smallest loan amounts penetrated these areas the most.[5] Evaluators found that efforts to reach underserved communities were enhanced among states that specifically targeted their SSBCI products to underserved populations and marketed them in partnership with African American, Latinx, and women's business organizations.[6]

Understanding SSBCI 2.0

The American Rescue Plan Act included a major refunding of the State Small Business Credit Initiative as part of the imperative to help rebuild a small business sector devastated by the COVID-19 pandemic. The State Small Business Credit Initiative will be implemented in 2022, offering a new tool to support small businesses after other signature COVID-19 era federal programs such as the Paycheck Protection Program and the Restaurant Revitalization Fund Program have wound down.[7] Unlike these programs, under SSBCI states will have ten years to spend the money, and can use it almost as a foundational investment in state small businesses that can become self-sustaining beyond that time. Significantly, ARPA puts $10 billion towards SSBCI, which is more than six times the amount initially allocated to the program a decade ago. Moreover, this version of SSBCI includes a number of important new funding provisions that take aim at systemic gaps in access to capital (as opposed to the goal of getting banks lending again at all to small businesses in the wake of the financial crisis). An overview of the funding, per implementation guidelines[8] released on November 10, 2021, is as follows:

- **$6 billion of the funds will be distributed to all states on a formula basis.** Of note, states will get one-third of this funding up front, and then can draw the remaining funds in two tranches after three and six years, based on successful dispersion of 80 percent of each third of the funding.

- **$1.5 billion is reserved for businesses owned by social and economically disadvantaged individuals (SEDI).** The U.S. Department of the Treasury has defined SEDI broadly[9] to include a wide range of businesses including a broad categories of individuals who have been underserved by traditional capital including women, people of color, people with disabilities, and LBGTQ+ singled out as priorities in Executive Order 13985[10] as well as those from rural areas, in CDFI investment areas, or who are operating in CDFI investment areas.

- **$1 billion for jurisdictions who excel at serving and allocating funds to SEDI businesses.** The U.S. Department of the Treasury will set aside $500 million to add to each of the first and second tranches, providing an extra incentive for states to serve SEDI investment areas.

- **$500 million for very small businesses with fewer than ten employees.** This category includes independent contractors and sole proprietors.

- **$500 million set aside for tribal governments,** which the guidance automatically qualifies as SEDI.

The implementation guidelines highlight the tremendous potential of SSBCI to serve those who face the greatest barriers to access credit, as well as some pitfalls. The ARPA funding heavily emphasizes aid to SEDI-owned businesses, with $3 billion of the $10 billion devoted to these purposes. However, the guidelines define SEDI very broadly. While this has the benefit of allowing each state to come up with a workable plan to spend SEDI funds allocated to them, it does mean that states that want to ensure that funds reach businesses owned by women and people of color will need to rely on more than federal regulatory requirements. The total amount and length of time for implementing SSBCI make it a promising source of patient capital. However, the vast expansion of SSBCI compared to the first version provides a countervailing pressure for states to set up vehicles that create deals that are larger in size. States will certainly feel pressure to get money out but they must simultaneously prioritize work to reach previously under-served entrepreneurs. In developing their SSBCI plans, states must be careful to ensure that this unique source of patient capital reaches those small businesses who are most poorly served by traditional banking capital and investors, including very small businesses and minority entrepreneurs. The loose guidelines for what counts as SEDI mean states will have to be extra vigilant to make sure these funds meaningfully address those populations facing systemic credit gaps.

Moreover, while ARPA funds set aside for economic development have specifically prioritized manufacturing, SSBCI is sector agnostic.[11] This cuts against economic development planning that favors manufacturing as a sector that punches above its weight in economic value added and jobs created. States committed to rebuilding their manufacturing economy will need to make sure the financial intermediaries it recruits to deploy SSBCI are familiar with the opportunities associated with the manufacturing sector, and comfortable with the different financing needs of manufacturers to thoughtfully inject SSBCI credit vehicles into the manufacturing ecosystem.

Capital Access Issues Facing Small Manufacturers

Manufacturing tends to have larger capital requirements than other economic sectors that can more quickly convert products and services into sales. Manufacturers need capital to purchase input materials and to produce them into final goods, with returns on capital coming primarily after their final production. Additionally, unlike many other businesses, manufacturers need access to capital to make significant purchases of technologies, machinery, and equipment as well as to secure specialized facilities before beginning or expanding their production. Federal policies recognize the critical role of manufacturing in the economy to meet national needs, create jobs (every dollar in manufacturing creates an additional $1.38 in economic activity, much higher than other sectors[12]), and spur innovation (68 percent of all R&D spending is in manufacturing) and have put in place financing programs such as the Export–Import Bank that specifically target manufacturing. A review by the federal Manufacturing Extension Partnership (MEP) office found, however, that even these programs are "not fully accessible to small manufacturers, nor do the programs target funds directly for small and medium sized companies."[13] When it comes to private bank financing, the consolidation of the financial sector has drained the local expertise and familiarity with manufacturing that once could be found in regional banks.

Private venture capital has steered mostly toward software technologies, rather than the "hard" technologies tied to manufacturing, because of a perception that software has a greater chance for an exponential return on investment in a shorter period of time. A federally financed study found that just 0.4 percent of private venture capital funds were invested in manufacturing.[14] Moreover, there is a geographic mismatch between the regions that attract equity investment and concentrations of manufacturing activity; the vast majority of venture capital is being invested in coastal regions rather than in more manufacturing-heavy Midwestern and Southeastern states.[15] In response, state and local governments have invested in publicly supported venture funds in states such as Indiana, Pittsburgh, Maryland, and Ohio that are more likely to invest in manufacturing companies.[16]

Small Manufacturing Entrepreneurs, Especially People of Color, Face Additional Barriers to Capital

As the U.S. economy recovers from the pandemic, small manufacturers are poised to scale up along with it, but many lack access to the capital needed to do so, particularly manufacturing entrepreneurs of color.[17] As the UMA research project referenced above discovered, rather than accessing more traditional lines of business credit, these entrepreneurs typically tend to turn to personal lines of credit or families and friends as part of their access to capital. These entrepreneurs have limited success with the traditional banking sector, which sees these small businesses as a risky bet, and typically cannot engage with venture capital firms because manufacturing is not seen as "sexy enough." These barriers will make it especially hard for small manufacturing entrepreneurs to ramp up along with the post-pandemic recovery.

These barriers are especially acute for Black entrepreneurs. McKinsey found that, overall, white entrepreneurs start with three times as much capital as Black entrepreneurs.[18] When entrepreneurs of color receive an equity investment, it is only 43 percent of that for white small business entrepreneurs.[19] With these advantages in hand, white small business entrepreneurs have a survival rate (20 percent) that is far higher than for Black entrepreneurs (4 percent). These disparate rates are not just the result of the entrepreneur's socioeconomic status but rather of discriminatory treatment in the financial system as well. After controlling for salient economic issues such as neighborhood redlining, race remains the leading negative indicator of business loan acceptance and quality.[20] It is not surprising that many entrepreneurs of color report shunning traditional banking institutions given this discriminatory context. These challenges came to a head during the pandemic as Black- and minority-owned businesses suffered higher rates of failure: the signature Paycheck Protection Programs relied largely on traditional banking institutions, leaving heavily Black areas such as Detroit and the Bronx with disproportionately fewer PPP loans.[21]

Developing Models of Patient Capital for Emerging Manufacturers

As the economy recovers, a more patient source of capital is needed. The Urban Manufacturing Alliance's Pathways to Patient Capital program provides examples of these approaches. The program features a group of thirteen community-based CDFI and nonprofit lenders who are serving entrepreneurs, particularly manufacturers and makers of color. These lenders work alongside and in service of small business owners who inform their financial products and programmatic offerings. Beginning in November 2019 and throughout 2020, UMA hosted a series of focus groups and workshops to encourage peer-learning between these capital practitioners, where they could lift up their own work, learn from one other, and consider replication. Each member has found a successful or promising approach to helping entrepreneurs of color—including makers and manufacturers—to get access to the capital and know-how they need to realize their business ideas and plans at scale.[22] The members of the cohort identify two primary areas of action to expand credit to diverse entrepreneurs:

- **Capital readiness for businesses:** developing impactful programs and resources to get manufacturers in a position where they can benefit from innovative financial products. These capital readiness programs help entrepreneurs organize their finances for the underwriting process. But to truly address equity gaps, they also tackle the impacts of social inequality, such as weak personal credit and legitimate aversion to taking on the risk of capital investment. Community development financial institutions and other mission-based lenders prioritize this type of capital readiness, and are seeking to create even stronger links to the concerns of entrepreneurs of color.[23] For example, LISC Duluth has cultivated a craft and arts district that has attracted national renown but whose entrepreneurs did not represent the diversity of the community. They started a focused pre-incubation program, Creative Startups, recruiting a class including 40 percent people of color.

- **Financial product innovation:** designing financial products and tools to better address capital access needs of maker and manufacturing businesses owned by people of color in underserved communities. These financial products recognize that many aspiring entrepreneurs can have promising ideas and successful small businesses, but don't have the collateral or credit history to realistically access the capital they need to grow their businesses. For example, the residents of the Dorchester, Roxbury, and Mattapan neighborhoods in the Boston area voted to invest money raised from the community and supported by foundations in the Boston Ujima Project fund to invest in five local businesses using a character-based loan, backed up by the Kiva lending platform.[24] Character-based loans engage community members or organizations who add credibility to the borrower by vouching for their character, business, and social impact. This provides further support to small business owners who typically may have a loan rejected due to racial discrimination, low credit scores, or a lack of supporters to vouch for them. Other examples of financial product innovations being discussed by cohort members include revenue-based financing, equity-like capital or convertible debt, first-loss capital, and forgivable loans.In this category, "equity-like" capital is a financial innovation that can support entrepreneurs of color in the manufacturing sector positioned to scale up or sustain their businesses. Manufacturers seeking to scale up have particularly intensive financing needs due to the need to acquire fixed assets such as equipment and space. Some impact funds and CDFIs are envisioning or currently deploying scale-up funds that extend equity-like capital for manufacturers of color. These funds would either extend equity without revenue-sharing or deploy deeply subordinated long-term debt. With equity-like capital, the entrepreneur can preserve their ownership stake and gain leverage to finance growth on their own terms. Equity-like capital can also be used as down payment assistance for ownership transitions that can unlock opportunities for ownership and transition wealth to entrepreneurs of color.

SSBCI 1.0 Provides a Blueprint to Unlock Capital

The initial state Small Business Jobs Act of 2010 contained programs that remain in the American Rescue Plan Act in 2021 and thus provide a blueprint for assisting small manufacturing enterprises and addressing some of the challenges identified by the Pathways to Patient Capital program:

- **Capital access programs (CAPs):** The most common vehicle used under SSBCI has been state capital access programs,[25] which are portfolio insurance programs that reduce the risk of lending to small businesses by establishing loan loss reserves. In these programs, lenders and borrowers each contribute 2 percent to 7 percent of a loan's value as insurance premiums, which are then matched by SSBCI on a one-to-one basis. Capital access programs are well-suited to small loans, including credit support to very small businesses and start-ups, and represent over two thirds of all SSBCI transactions but just 3 percent of all SSBCI funds.[26] For example, microlender Accion's Opportunity Fund in California has been the most productive SSBCI entity, generating 4,700 transactions with an average loan value of $12,000, making loans to largely minority-owned small businesses.[27]

As described in Section 3006 of the law,[28] other credit support programs approved under the law must at a minimum demonstrate that they will generate a minimum of $1 in new private credit for every $1 of public investments. The vehicles contemplated in this category are:

- **Collateral support programs (CSPs):** SSBCI collateral support programs provide lenders with an additional source of cash collateral, allowing them to extend credit to borrowers who have insufficient collateral for a loan.[29] Since some equipment may itself not provide enough collateral (because customizations required reduces its resale value) for the lender to make the loan, a CSP can make such loans more possible.

- **Loan participation programs:** Loan participation programs involve the state buying up to 80 percent of the loan at closing, or offering a companion loan at a lower interest rate.[30] Among other advantages, loan participation programs can address a shortfall in collateral among borrowers and also enable lenders to make a larger loan than it's maximum legal threshold. For example, NC Rural Center's loan participation program allowed CEA manufacturing to get a loan for advanced manufacturing production equipment that was too expensive to meet their bank's legally required loan-to-value ratio.[31]

- **Loan guarantee programs:** Loan guarantee programs partially insure an individual loan by guaranteeing a lender a partial repayment from the state in the event that a loan defaults. This mechanism is similar to CAPs, but it operates on an individual loan basis and for this reason is typically used for larger transactions (averaging $450,000). Significantly, SSBCI rules have required that lenders liquidate all collateral before the guarantee can be used.

- **Venture capital funds:** SSBCI venture capital programs delivered early equity investments in companies that showed promise for growth and scale, drawing in $4.2 billion in private financing against $327 million in federal dollars. SSBCI venture capital funds were particularly popular in states such as Alaska, Arkansas, Hawaii, and Missouri that are typically passed over for traditional capital investments. For example, the 49th State Angel Fund took $13.2 million of SSBCI funds into an evergreen fund that supports high-growth job creating businesses in Alaska and fosters the entrepreneurial ecosystem.[32]

Implementation Recommendations

Although the implementation guidelines were only released on November 10, 2021, states were required to initiate their application by December 11, 2021 and must finish their application by February 11, 2022.[33] While SSBCI is not competitive, municipalities in states that decline to apply for their portion of SSBCI funds would be allowed to apply for funds originally designated for their states. States will have the opportunity to modify their plans, with approval by the U.S. Department of the Treasury, especially when they make an application for the second tranche of SSBCI funds. Thus the recommendations below are aimed at approaches that states can take in their initial rollout of SSBCI and the years that follow. They also are aimed to help educate practitioners on the role that they can play in implementing the program.

- **Build the capacity of CDFIs and mission-based lenders.** CDFIs are uniquely positioned to reach small makers and manufacturers, as well as entrepreneurs of color, who are most poorly served by traditional sources of capital. States should not only think about CDFIs as implementation partners, but also look at SSBCI as a key tool to build the capacity of the CDFI sector. This was the approach in states such as Colorado, Georgia, and Pennsylvania. States should structure their capital access programs to be a source of working capital for CDFIs, such as in Georgia's investment of $20 million in CDFIs, which they used as a source of capital for loans and then built their balance sheets with repayments and interest. Following recommendations from Accion's Opportunity Fund, states should develop a CDFI participation plan.[34] States should be mindful of resourcing CDFIs that are themselves staffed and led by leaders from the socially and economically disadvantaged communities that SSBCI is meant to serve,, and states should mobilize philanthropy to support the creation of new CDFIs (with support of SSBCI technical assistance dollars and other flexible American Rescue Plan dollars) if needed. Moreover, given the broad economic benefits of manufacturing, states should use the SSBCI opportunity to engage the CDFI community more deeply in the sector.

- **Leverage the unique technical assistance funds being provided by SSBCI.** The $500 million in funds for technical assistance provided by the American Rescue Plan Act through SSBCI represents a historic investment in financial, legal, and accounting coaching for aspiring entrepreneurs. Of particular note, SSBCI technical assistance dollars can go to projects helping organizations support entrepreneurs accessing SSBCI and "other state and federal programs supporting small businesses."[35] States should work closely with their CDFIs and adjacent organizations representing people of color- and women-owned businesses to design the technical assistance. Technical assistance dollars can be a critical way to support outreach to businesses traditionally hesitant to access credit, and should be tailored to present information in multiple languages and to multiple communities.

- **Utilize flexibility in leverage requirements.** All SSCBI other capital support programs must have at least one-to-one leverage, but are recommended to have ten-to-one leverage. Some programs targeting small manufacturers and diverse entrepreneurs may have trouble reaching the recommended ten-to-one leverage. States should take advantage of U.S. Department of the Treasury guidelines that consider the economic benefits to the state when approving other capital support programs. The guidelines specifically cite manufacturing, stating that "investments in areas such as small and mid-size enterprise (SME) manufacturing and supply chain resiliency may result in stronger economic growth, high-quality jobs, and innovation."[36]

- **Target manufacturers by working with MEP and manufacturing practitioners to identify firms that can benefit from financial products.** States don't need to design special financial products to effectively reach manufacturers. But they should partner with manufacturing intermediaries to help analyze capital challenges facing manufacturers, and work with those intermediaries to make small manufacturers aware of the financial products. State MEP organizations and local branding initiatives (for example, Made in Baltimore, SF Made) have the necessary regular technical assistance contact with businesses, and they also can support lenders using SSBCI funds to become more comfortable with manufacturing capital needs. States can further this goal by reaching out to CDFIs who have already demonstrated experience in industrial development, and also provide training and support for those who are not yet acting in the manufacturing and making entrepreneurial space.

- **Focus on equity or loan products that can reach those without the credit profile to access traditional capital.** Collateral support and capital access programs can align with the needs of businesses looking to expand who represent communities that typically do not have significant collateral to secure credit. Yet even this step won't be enough to reach a significant number of aspiring businesses led by innovators who don't have solid traditional credit. States should explore loans that require no collateral, which can be more attractive to microbusinesses looking to scale. Another promising approach is revenue-based financing that bases loan repayment on future revenues. States should also help lenders to build capacity for character-based lending approaches, which require more time and resources than traditional underwriting, but offer a more holistic review of a business.

- **Advocate for a mix of loans and equity investments, including newer products.** States should resist pressure to simply reboot their SSBCI 1.0 approaches, only at a larger scale, to meet the 2.0 program's more compressed allocation timeline. The first SSBCI program was implemented at a time when the financial crisis had locked up nearly all lending. SSBCI 2.0 comes at a time when credit is much more widely available but equity gaps have only grown more severe. States need to be bold to reach people of color entrepreneurs with equity-like forgivable or convertible loans. These strategies (which could be folded into loan participation or loan guarantee funds) could reach diverse entrepreneurs reluctant to risk their hard-won microbusinesses on a credit system that has too frequently let their communities down. SSBCI gives states the opportunity to recruit private philanthropy and other donors that can help meet SSBCI's leveraging requirements. SSBCI can also free up state dollars used for traditional small business programs that can then be used for new products and pioneering approaches to capital access.

- **Develop trusted advisors for entrepreneurs of color.** When possible, states should operate their SSBCI venture capital programs in partnership with publicly supported state venture capital funds and venture development organizations (which are more likely to invest in manufacturing than private venture capital investors). State leaders should push these organizations to employ more advisors who are people of color, and are in a better position to build trust and support entrepreneurs of color.[37]

- **Steer equity investments into diverse ownership of transitioning manufacturing firms.** There are 125,000 small manufacturing companies nationwide, employing 2.6 million workers, owned by baby boomers close to retirement. Being on the cusp of this transition provides an opportunity for equity investors committed to keeping jobs in communities, and in diversifying ownership (including opportunities for employee ownership). Effective publicly supported venture development efforts could identify those potential buyers and bring in additional private capital to meet SSBCI's leverage requirements.

Looking Ahead

SSBCI provides a golden opportunity to rev up the recovery of the small business sector and to fill in gaps in credit that limit the wealth-building potential of manufacturing entrepreneurs of color. The mission-based lending sector stands ready to deploy patient capital to these businesses. It's incumbent on states to use SSBCI strategically to boost CDFIs, deploying the types of patient capital and technical assistance that can deliver private and public investment to businesses too long locked out of growth. States should heed these principles as they are finalizing their application in early 2022, and begin developing implementation partnerships and stakeholder bodies. Moreover, the mission-based lending and manufacturing support communities should activate to ensure that those who need access to new forms of financing take full advantage of the renewal of SSBCI.

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