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ACCESS TO CAPITAL *for* ENTREPRENEURS: REMOVING BARRIERS

2021 UPDATE

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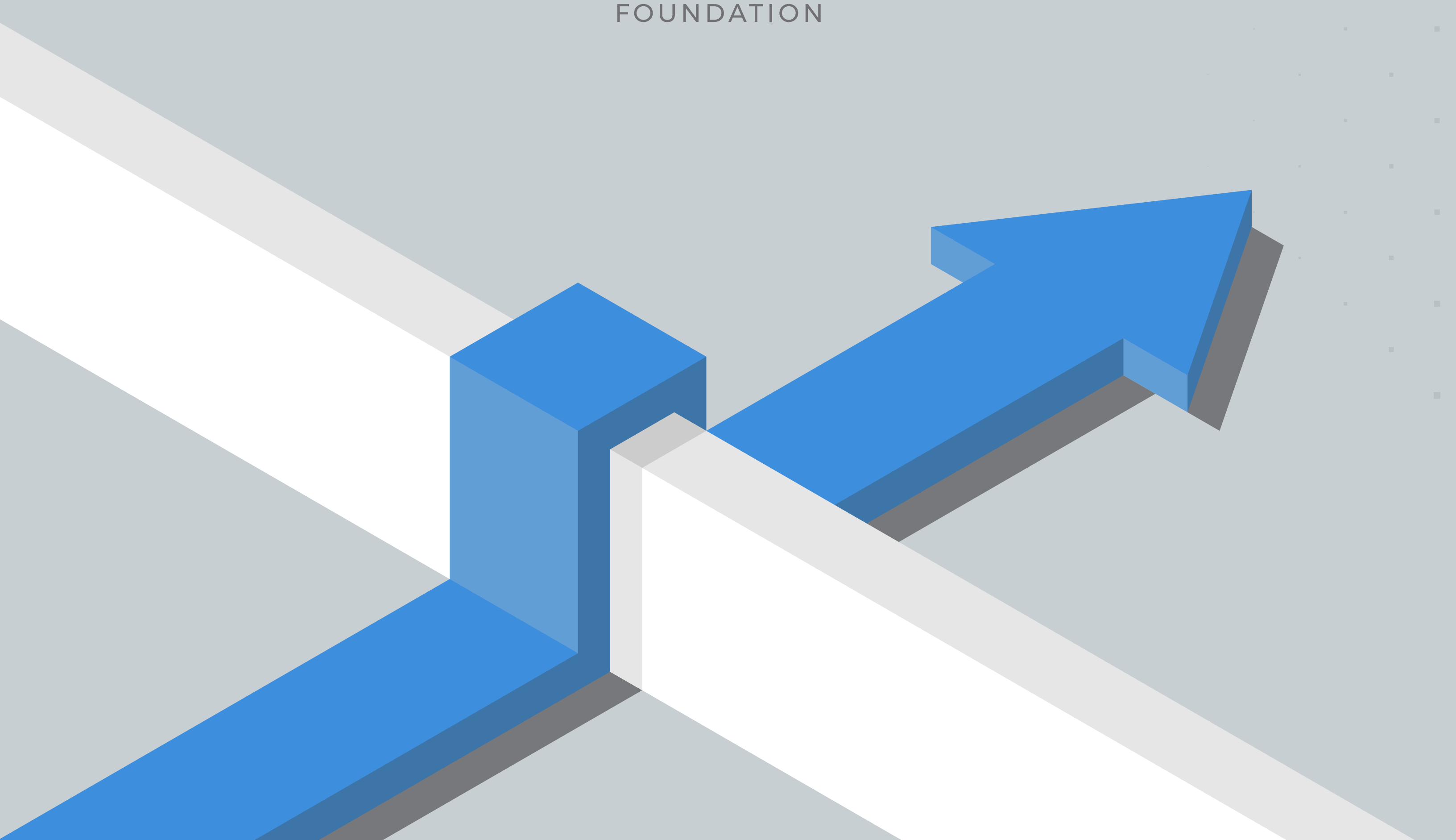

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Access to Capital for Entrepreneurs: Removing Barriers | 2021 Update

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INTRODUCTION

In 2019, the Ewing Marion Kauffman Foundation published *Access to Capital for Entrepreneurs: Removing Barriers*, a report that surveyed the landscape of capital available to entrepreneurs and highlighted the need for innovative concepts to improve capital access systems. The report suggested that effective long-term solutions to expanding access to capital should focus not only on funding companies led by underserved founders directly, but also on building up what the report defined as critical market infrastructure: capital (greater diversity of investment vehicles); people (capital entrepreneurs); information (data and technology) and knowledge (targeted research); and policy that removes barriers entrepreneurs face accessing capital. To that end, the report asked questions and posed challenges to promote greater access to capital for entrepreneurs.[1]

In the two years since publication, much has changed. As we noted in America's New Business Plan,[2] the fundamental inequities of race, gender, and geography have become even more visible as America confronts the dual pandemics of both COVID-19 and racial injustice. The COVID-19 pandemic has disrupted the lives and businesses of many entrepreneurs, their families, and their communities. Widespread concerns about public health and the economy have resulted in the shuttering of many small businesses, significant shifts in new entrepreneurial activity, and pervasive uncertainty.

As the COVID-19 pandemic and its economic consequences persist, the Kauffman Foundation's work to dismantle the barriers facing many entrepreneurs as they endeavor to start, grow, or sustain businesses becomes even more urgent. The need for access to opportunity, funding, knowledge, and support is perhaps greater than ever before. In particular, one of our primary priorities is to ensure that historically underserved entrepreneurs are able to access the capital required to survive and thrive.

As we continue in this work, we want to take this opportunity to document what we have learned, share where we are in our efforts, and highlight possibilities and potential collaborations as we move forward. In the report that follows, we discuss the work we have embarked on since the publication of *Access to Capital for Entrepreneurs* to generate more innovative and

Effective long-term solutions to expanding access to capital should focus not only on funding companies led by underserved founders directly, but also on building up what the report defined as critical market infrastructure.

As the COVID-19 pandemic and its economic consequences persist, the Kauffman Foundation's work to dismantle the barriers facing many entrepreneurs as they endeavor to start, grow, or sustain businesses becomes even more urgent.

effective ways to support entrepreneurs in accessing capital. Much of this work began prior to the pandemic, though what we have learned remains not only relevant today, but also crucial to informing efforts to help entrepreneurs survive and thrive during the pandemic and beyond. We conclude with a discussion of the COVID-19 pandemic's impact on the entrepreneurial ecosystem as a whole and on the capital access system specifically, and we highlight key challenges and opportunities moving forward.

BUILDING INFRASTRUCTURE TO GENERATE SOLUTIONS

In *Access to Capital for Entrepreneurs*, we proposed a new approach to expanding access to capital. The report suggested: *"Rather than creating and growing specific investment vehicles to invest directly in entrepreneurs, organizations with influence – such as large institutions, foundations, and governments – could instead build up market infrastructure to enable the marketplace of entrepreneurs and capital mechanisms to solve problems."*

The report focused on key pieces of infrastructure, including capital, people, and policy. We raised a series of questions related to these infrastructure pieces, which has served as a call to action. We have been working to respond to this call in the months and years since. Below, we outline the knowledge we have gained regarding each of these infrastructure pieces, as well as questions remaining and emerging.

Capital infrastructure: how can philanthropic organizations, governments, and other leaders play a role in bridging the gap between large asset holders and the entrepreneurs who are currently too small to be served effectively by the capital markets?

In 2019, the Kauffman Foundation launched the Capital Access Lab (CAL), and later the Rockefeller Foundation joined as an initial co-funding partner. The CAL is a national pilot initiative that is aimed at helping address gaps in access to capital. It is an effort to find, promote, and scale innovative investment managers who are providing new kinds of capital to underserved entrepreneurs and communities in the U.S.[3] The CAL has $3.4 million in commitments from the Kauffman Foundation and Rockefeller Foundations, and these funds have been leveraged by $162 million in co-investment from other U.S. foundations (such as Surdna Foundation, Andrew W. Mellon Foundation, Living Cities, and Lindmor Foundation), and corporations (Google, Apple, PayPal, and Mailchimp).

The request for proposals issued when launching the CAL resulted in a pipeline of more than 100 funds. Of these funds, 55% were led by women, and 41% were led by people of color. They hailed from 32 different states in the U.S. Together, they represent more than $1.6 billion of investible opportunities. These funds are testing a range of approaches to investing in underserved

Limited partner capital refers to an investing relationship in which the investors are partners in a fund but are typically "silent," meaning that they have limited voting power and no involvement in the day-to-day management of the fund.[5]

entrepreneurs that are outside of traditional venture capital (VC) and small business lending. Most are using revenue-based or profit-sharing investing mechanisms and developing new ways to source entrepreneurs and deploy capital. These mechanisms differ from traditional bank loans in that they require businesses to pay a percentage of their revenue or profits over time, rather than an amount based on the loan size, and they differ from VC in that they do not require the founders to give up ownership. At least 83% of entrepreneurs do not access either of these forms of financing at startup according to the U.S. Census Bureau's Annual Survey of Entrepreneurs.[4]

Limited partner capital refers to an investing relationship in which the investors are partners in a fund but are typically "silent," meaning that they have limited voting power and no involvement in the day-to-day management of the fund.[5] To date, the CAL has announced limited partner capital investments – or investment capital – to six funds that provide capital directly to entrepreneurs:

- **Capacity Capital**,[6] based in Chattanooga, TN, makes revenue-based investments in local businesses that cannot access traditional bank loans.
- **Collab Capital**,[7] based in Atlanta, GA, uses an innovative profit-share model that targets early-stage Black tech founders across the U.S.
- **Indie.vc**,[8] based in San Francisco, CA, provides flexible capital to businesses that want to remain independent and employee-owned, while providing a chance for an emerging and diverse group of managers to build a track record through its Verified Scout program.[9]

Using revenue-based or profit sharing investing mechanisms and developing new ways to source entrepreneurs and deploy capital.

Across the country, the Kauffman Foundation engaged over 100 funds that were developing alternative strategies to venture capital and debt. Below are a few common tools that multiple funds use to better meet the needs of certain types of entrepreneurs:

- **Revenue-based investing:** in this structure, investors receive a share of a company's total revenue at a fixed percentage, until there is a predetermined payback; e.g. an investor might invest $100,000 and receive 5% of revenue until they have $300,000 in returns.
- **Profit-sharing:** similar to revenue-based investing except for the share is of a company's profits, not revenue.
- **Employee ownership:** in this structure, an investor will purchase equity interests in a company, and receive a return of capital from employees directly, through a stock ownership or employee purchase plan. For example, an investor could invest $100,000 with a goal of earning $300,000, but instead of being repaid out of revenue, their shares could be purchased directly by employees.

- **1863 Ventures**,[10] based in Washington, D.C., uses a revenue-based financing model to help accelerate "New Majority" businesses from high-potential to high-growth.
- **Anzu Partners**,[11] based in Washington, D.C., provides revenue-based financing to mature industrial and life science technology companies in manufacturing, materials, modeling, and measurement that typically find it difficult to access VC.
- **Founders First Capital Partners**,[12] based in San Diego, CA, provides revenue-based investments and advisory services to service-based small businesses across the U.S. that are located outside of major capital markets.

The Capital Access Lab explicitly chose to invest in the first five of these funds as limited partners. Reflecting the CAL interest in innovation, its investment in Founders First was as part of the General Partner responsible for overall management of the fund rather than the more typical route of being a limited partner.

These funds were chosen because their missions, strategies, and diverse experiences closely align with the core purpose of the CAL, which is to address gaps in access to capital through helping to scale innovative investment models.

- The funds share a commitment to providing access to capital to historically underserved entrepreneurs – those who have lacked the opportunity to capitalize their companies due to race, gender, geography, or other factors.
- The funds have a diverse group of managers; 60% are women-led, and 67% are led by people of color.
- They represent geographic diversity, as they are based in five different states and Washington D.C.
- They offer diversity in investment strategies, including revenue-based investing, employee ownership strategies, profit-sharing, and a strategy to take small companies public to retail investors, with a common goal of providing innovative solutions for the 83% of entrepreneurs who do not access venture capital or loans at startup.

Below and on the next page, we spotlight two of the entrepreneurs who these funds have invested in.

Tracey Pickett

Founder, Hairbrella; Collab Capital investee; Atlanta, GA

Tracey Pickett founded Hairbrella through a successful Kickstarter campaign in 2016 and saw substantial traction, especially with Black women who have often been overlooked by the fashion industry. She grew her line of hats that protect hair from rain and humidity into an Amazon best seller. However, Pickett struggled to raise venture financing. She received her first investment from Collab Capital, a CAL investee focused on Black-owned businesses, in a unique profit-sharing structure. This flexible capital and mission-aligned investor allowed Pickett's business to be nimble and successful during the COVID-19 pandemic. Seeing a need, Tracey was able to use Collab investment to build out her business' capacity to expand her line beyond selling hats to also selling domestically manufactured PPE.

> Pickett received her first investment from Collab Capital, a CAL investee focused on Black-owned businesses.

India Calloway

Founder, Dolly Monroe Beauty Academy; Capacity Capital and Founders First Capital Partners investee; Tampa Bay, FL

India Calloway started an academy for prospective entrepreneurs who want to be beauticians, stylists, or other hair care professionals. She started her venture as a studio location for one-on-one classes, but since then the company has expanded to offering group classes and online interactive courses during the pandemic. Through her academy, students are able to obtain certifications which can help them access higher-paying careers or enable them to start a business for themselves.

During the shutdown of 2020, India's business was growing but lacked access to equity and debt financing with reasonable terms. Capacity Capital helped with a capital strategy to improve her business' balance sheet and provided revenue-based investment. This flexible investment accelerated her transition into a scalable, online model. After the initial investment, Capacity Capital then partnered with Founders First Capital Partners, another CAL investee, so India could access a 90-day Bootcamp committed to fast-growth, businesses led by women and entrepreneurs of color.

Capacity Capital helped with a capital strategy to improve her business' balance sheet and provided revenue-based investment.

The CAL has demonstrated that philanthropic organizations, governments, and other leaders can provide capital and support that is catalytic for these alternative structures. Its holistic approach provides early-stage investment to fund managers to help them establish and scale up their funds, as well as engaging fund managers through a community of practice where members can share learnings, best practices, and ideas.

Investors often do not want to be the first to invest or to take a risk on an unproven model. Early seed funding from a philanthropic organization or other investor can, therefore, help get these new approaches off the ground, allowing them to validate their models and attract further investments. As noted above, the $3.5 million in investments by CAL played a catalytic role in $162 million in co-investments from other investors and institutions in these funds.

The CAL has demonstrated that philanthropic organizations, governments, and other leaders can provide capital and support that is catalytic for these alternative structures.

Foundations and barriers to innovation

Foundations, however, face barriers to innovation. Both in our work with the CAL and in panel discussions at the Alternative Capital Summits, fund managers noted several consistent barriers to innovative finance structures:

1. **Lack of common structures** – There are, for example, few (if any) existing templates, limited partner agreements (LPAs), and term sheets that incorporate charitability requirements for philanthropic investors. Foundations and fund managers often do not have the bandwidth to create these documents that can appropriate safeguards for their charitable mission.
2. **Lack of systematized due diligence processes** – Unlike traditional debt and private equity/VC, which typically already have such processes and routines in place to evaluate and underwrite both return and impact potential of the funds, the vast majority of foundations and fund managers we spoke with have had to create due diligence processes from scratch in order to set up a fund with an alternative capital structure.

In many cases, both investors and fund managers shared that this lack of a common set of documents and processes can contribute to a significant delay in fund diligence and the investment closing process. It is our hope that both the Capital Access Lab and the community of practice work in alternative finance can contribute to both these structural and process challenges.

Foundations and other organizations that support innovative financing need new structures in place to help facilitate investments in these models. As one example, the Kauffman Foundation's General Counsel created a Charitability Term Sheet[13] that may help other foundations feel comfortable funding for-profit investment funds with program-related investment (PRI) capital.

People infrastructure: is it possible to support capital entrepreneurs who are implementing innovative strategies, business models, and vehicles that remove barriers for investment-worthy entrepreneurs who are not currently well-served?

In order to help fund managers and others engaged in this work, the Kauffman Foundation organized and supported forums for fund managers seeking to develop these entrepreneurial approaches to financing. The Alternative Capital Summit was hosted by the Kauffman Foundation in Denver, CO, in September 2019, which was followed by a second summit in Kansas City, MO, in January 2020.

In addition to these summits, the Kauffman Foundation supports community of practice initiatives that foster peer learning and connections among practitioners. These initiatives include the Revenue-Based Financing Network (RBFN) speaker series that holds monthly interviews with practitioners, as well as a biweekly newsletter to help facilitate knowledge sharing. Online groups for the community continue the dialogue regarding entrepreneurial approaches to financing and alternative capital products.

Diversification of fund managers: expanding the base

In addition to this need for support and for a platform to connect managers of innovative investment funds, there is a need to promote greater diversity among fund managers and to invest in funds managed by diverse teams. The lack of diversity among the fund managers who decide where funding goes is one of the barriers to accessing capital for many entrepreneurs. Research has found, for example, that female VCs invest in twice as many female-founded startups as male VCs.[14] Only 12% of VC firms and angel investors, however, have women in investment decision-making roles.[15] The data on investment performance is somewhat limited, but there is evidence that greater gender diversity on investment teams at VC funds leads to higher returns and improvements in fund performance.[16] Despite these findings, diversified team managers still often lack access to capital to fund their investments.

In order to address the market gaps that these managers face, the Kauffman Foundation supported Living Cities[17]

How Philanthropy Can Think Differently in Helping Entrepreneurs Access Capital

By John E. Tyler III, General Counsel, Kauffman Foundation

Private foundations, charitable endowments, and other organizations that may be primarily focused on charitable purposes, outcomes, and results have opportunities to actively participate in efforts to improve the flow of capital. One means for doing so is by providing capital directly themselves, which will require that they think differently. They will need to take a new approach to private equity, on the one hand, or to their charitable activities, on the other.

The charitability term sheet can be a useful start for this new approach to investing, whether program- or mission-related. It presents clear ways to determine standards for charitability, proportional and necessary reporting, and means for accountability for deviations from those expectations. Notably, concessionary returns are not a requirement.

Thinking differently also applies to the private equity/investor side of the activity when charitable outcomes are primary. In this respect, different may mean openness to alternative approaches to the provision of capital, such as jettisoning being based in equity in favor of being revenue-based, profit-sharing, or otherwise. At more micro levels, different may mean alternative approaches to key person provisions, involvement of debt, flow of capital reinvestment and returns, approval thresholds, fees, and claw back provisions.

At a macro level, the approach to providing capital may involve degrees and types of engagement that are more open to deeper understanding of the relevant circumstances and relationships beyond that of being a source of capital. That is, perhaps more listening and understanding while also being more collaborative and broadly aligned.

Thinking differently does not mean being taken advantage of or presumptively absorbing disproportionate risk of loss or decreased participation in gains. It does not need to involve intentionally pursuing concessionary strategies, especially when legal compliance requires protecting against impermissible private benefit. However, these prescriptions are not violated by prioritizing charitable purposes and thereby challenging presumptive norms based on that priority.

We as a society need these entrepreneurs to have fair access to capital so that we can benefit from their contributions to new products and services, the dignity of their work, improved standards of living, enhanced quality of life, community stability, and more.

Perhaps the most significant shift in thinking may be in recognizing that we as a society need these entrepreneurs to have fair access to capital so that we can benefit from their contributions to new products and services, the dignity of their work, improved standards of living, enhanced quality of life, community stability, and more.

To take a deeper dive on the topic of how charitable foundations can structure these innovative investments, check out John Tyler's article in the Taxation of Exempts Journal called "Think Different about the Flow of Capital When Prioritizing Social or Charitable Outcomes"[18] in its development of a new investment vehicle, with a goal to raise a $100 million fund to invest in funds managed by people from diverse backgrounds. This vehicle builds upon Living Cities' experience with managers of color and women managers, recognizing that these managers face substantial obstacles to launching first-time funds, such as more limited access to networks, being seen as riskier investments, and less access to personal capital that could contribute to the development of the fund.[19]

Living Cities has been engaged in supporting women managers and managers of color since the launch of the Living Cities Catalyst Fund (LCCF), a $38 million structured debt fund that closed in 2008 and was fully deployed and repaid in full to limited partner investors in 2021. The LCCF consisted of 19 investments across 16 states, supporting more than 60 small businesses, creating approximately 1,566 jobs, and helping to develop 2,400 units of affordable housing.

Lessons learned from the LCCF led to the subsequent $37 million Blended Catalyst Fund (BCF), also a structured debt fund, that was established in 2015. Building on the work of the LCCF, the BCF's 21 loans and five equity investments have provided more than 68,700 people with social services, developed 1,172 units of housing, and created 759 full-time jobs. The BCF seeks to be one of many efforts to help promising women managers and fund managers of color build a track record and successful portfolio.

In a similar vein, several of the funds supported by CAL were started by former entrepreneurs from diverse backgrounds seeking to invest in other new companies in their communities.

Kim Folsom

CEO, Founders First Capital Partners; CAL investee, San Diego, CA

One of the co-investments of the Capital Access Lab and Living Cities' Blended Catalyst Fund is Founders First Capital Partners, a San Diego-based, Black-woman-led accelerator and investment firm founded by CEO Kim Folsom in 2015. As a successful serial entrepreneur, Folsom consistently noticed gaps in access to capital, including major racial gaps even in traditional sources of wealth and equity, such as homeownership. Founders First's mission is to increase the number of diverse-founder-led businesses that generate over $1 million in revenues through a revenue-based financing model. In Folsom's words, revenue-based investment can "greatly increase our reach to diverse business owners who are poised for high growth but aren't a fit for venture capital or have the assets to meet traditional lending requirements."

Founders First's mission is to increase the number of diverse-founder-led businesses that generate over $1 million in revenues through a revenue-based financing model.

Kim Folsom started her first business during the dot-com era. She describes the business as a "side hustle" and recollects that she was fortunate enough to own a home in order to have collateral to finance the business. As Folsom became a successful serial entrepreneur, she consistently noticed gaps in access to capital, including major racial gaps even in traditional sources of wealth and equity, such as homeownership. Founders First seeks to be a "first source" of capital for promising businesses led by diverse founders.

Collab Capital managing partners Justin Dawkins, Jewel Burks, and Barry Givens

Justin Dawkins, Jewel Burks, Barry Givens

Managing Partners, Collab Capital; CAL investee, Atlanta, GA

Collab Capital, based in Atlanta, was created to fill a core market gap. As they evaluated the entrepreneurs they wanted to support, the Collab team consistently noticed that the traditional VC box did not fit many Black-owned businesses. As a result, they developed a distinctive profit-sharing model that is a potentially strong fit for businesses that have clear paths to revenue growth but will not have an obvious VC-style exit.

While the founders all had impressive entrepreneurial backgrounds, they did not have an investment and fund management track record, and like many fund managers, they were not connected to networks of potential investors. While it is very common for successful startup founders who do not come from under-represented backgrounds to raise venture funds, even as first-time fund managers, Collab found a myriad of obstacles in their way to securing anchor limited partner investments.

Collab Capital's innovation and persistence has paid off. Seeded with an initial limited partner investment from the CAL, Collab Capital announced a final closing of $50 million from institutional limited partners like Goldman Sachs and PayPal, family offices, foundations, institutions, and individuals in May 2021. Collab Capital's first fund had 99 investors, and the team now has the capital and runway they need to build a promising strategy.

Indie.vc

CAL investee, San Francisco, CA

Indie.vc was an experiment launched by venture capitalist Bryce Roberts to invest in companies that wanted to remain independent long-term. Indie.vc carved out a space in between "growth at all costs" venture and traditional lending, investing in 40 companies that generated a 5x multiple for investors.

However, in March 2021, Roberts announced that the Indie.vc experiment was going "on pause" because of the difficulty in gaining traction for and understanding of alternative models within the institutional investor market. The Indie.vc experience illustrates how more work needs to be done to help promising innovations reach institutional scale.

Despite the pause in raising an institutional fund, Indie.vc continued the desire to innovate. The CAL supported Indie.vc in a "spin-off" of the strategy, backing a cohort of "Verified Scouts" – 11 emerging investors. These scouts were all from underrepresented backgrounds, and had decision-making power over seed investments using innovative and alternative strategies. Programs like the "Verified Scouts" project can have a meaningful impact on diverse managers' ability to build a track record and gain experience backing a more representative group of entrepreneurs than traditional venture capital. These emerging managers – and the entrepreneurs they back – will hopefully create a track record to help strategies like this reach institutional scale one day.

BUILDING INFRASTRUCTURE TO GENERATE SOLUTIONS

Information infrastructure: what standards, categories, or methodologies for investment information and decisions could increase the flow of capital to entrepreneurs not currently served?

In *Access to Capital for Entrepreneurs*, we discussed the potential roles that predictive technologies, data systems, data and benchmarks, and standardized terms and language around investment structures can have in improving decision-making and creating more equitable access to capital. The Kauffman Foundation is working on identifying possibilities and solutions in this space that are responsive to the challenges that COVID-19 has posed. We recognize that technology is rapidly developing and that engaging technological solutions is a necessity. As we seek these new opportunities, our focus is on ensuring that we are breaking down existing biases and advancing equitable solutions.

Knowledge infrastructure: what knowledge, data, and research are needed to inform the development of future capital market efforts to serve entrepreneurs?

In 2020, the Kauffman Foundation piloted a nationally representative survey focused on entrepreneurship in the U.S. The survey represented an effort to better understand the experiences of individuals at various stages of the entrepreneurial process, including individuals in the process of trying to start businesses, individuals who were once interested in starting businesses but are no longer pursuing the opportunity, current entrepreneurs, and individuals who were once business owners but no longer are. The pilot survey results highlighted important insights regarding the capital-seeking behaviors of individuals. It found that among individuals who left the entrepreneurial process before starting a business, 1 in 5 talked to personal sources about financing (20%), and nearly the same share learned about financing options outside of personal sources (19%), yet only 5% of individuals actually applied for financing outside of personal sources before they stopped the entrepreneurial process.[20] This raises questions about the potential barriers individuals may have faced and the reasons that they didn't apply for financing.

Building on this pilot survey, the Kauffman Foundation will be investing in a nationally representative survey that will be conducted annually over the next five years, beginning in 2022. This survey will help us to better understand the capital needs and constraints of individuals throughout the entrepreneurial process. We will be paying particular attention to variation in individuals' experiences across gender, race, and geography.

> In *Access to Capital for Entrepreneurs*, we discussed the need to clearly and carefully specify metrics to track capital access and entrepreneurial success. Through our work over the past two years, we have sought to ensure that metrics are manageable and focus on the most important aspects of the work. For example, in creating our Charitability Term Sheet, we were careful to streamline the metrics we ask companies to report, requiring only those that we feel are most important. By focusing on the few metrics that are of the most value, we can help ensure that companies are able to spend their limited time working with entrepreneurs and aspiring entrepreneurs by only collecting data that is necessary.

Policy infrastructure: how can the voices of entrepreneurs be better integrated into capital markets policy to ensure more entrepreneurial starts and growth?

In 2019, the Kauffman Foundation partnered with a group of policy leaders to release America's New Business Plan (ANBP),[21] a series of recommendations for policymakers to better support entrepreneurs, including strategies for expanding access to capital. As part of this process, the Foundation surveyed entrepreneurs, consulted the research literature on entrepreneurship, and worked with leaders in the entrepreneur and policy communities to develop the recommendations. Incorporating the ideas, thoughts, and experiences of entrepreneurs as well as program and community leaders in the development of these recommendations was essential to ensuring that the recommendations would have a meaningful impact on the entrepreneurial ecosystem, particularly for those who have historically been left out.

ANBP outlines roles for policymakers at the federal, state, and local levels to support these emerging efforts. It suggests that the federal government can take steps such as the following:

Kauffman Foundation CEO Wendy Guillies co-hosts an America's New Business Plan roundtable focused on women entrepreneurs and fund managers.

- Instruct the U.S. Department of the Treasury, Small Business Administration (SBA), and other relevant departments and agencies to make concrete recommendations for improving existing capital access programs.
- Ensure that Congress makes substantial additional funding available to states for strengthening the private financing of new businesses by expanding capital access through innovative investment models, community banking, and other means.
- Establish clear goals for all federal capital access programs, including the number of new entrepreneurs who access capital (disaggregated by race, gender, socioeconomic class, and geography), revenues generated, new jobs created and sustained, and customer experience feedback.

Along the same lines, ANBP suggests objectives for state and local governments, such as:

- Create community investment funds that go beyond traditional lending and VC to support new businesses as they move through the early stages of proof-of-concept and product development.
- Support investment funds that spur the growth of new financial intermediaries – entrepreneurs creating capital to invest in other entrepreneurs – particularly those with innovative models such as revenue-based investing and profit-sharing.

ANBP also serves as a base for the Start Us Up coalition, which includes 200+ organizations from 39 states, Washington, D.C., and Puerto Rico. The Start Us Up coalition organized an advocacy community around the recommendations provided in ANBP. Since 2019, this coalition has worked to implement industry-wide goals and has achieved several significant successes. The coalition's objectives include:

- **Change who can invest in entrepreneurs.** The Securities and Exchange Commission (SEC), for example, changed its definition of an "accredited investor" in 2020, and it raised the regulation crowdfunding offering limit from $1.07 million to $5 million.
- **Change government support for entrepreneurs.** Advocacy from entrepreneurs and entrepreneur support organizations played an important role in the renewal and expansion of the State Small Business

Credit Initiative (SSBCI) plan, which is $10 billion authorized by the Treasury as a part of the American Rescue Plan to backstop direct investments in entrepreneurs as well as in entrepreneur support organizations and state-based and local funds.

- **Support entrepreneurs in key federal agencies.** The SEC appointed the first director of the Office of the Advocate for Small Business Capital Formation in January 2019. This role has helped inform actions and decisions that are responsive to entrepreneurs.

These recommendations have also been utilized by organizations across the country to drive change at the national, state, and local levels.

Finally, a range of executive, administrative, and legislative actions to increase capital are under consideration. The Center for American Entrepreneurship has organized an "Access to Capital" agenda that organizes and educates policymakers and the general public on ideas and concepts that could increase access to capital for entrepreneurs.

In 2021, the Center for American Entrepreneurship released the Policy Agenda to Revitalize American Entrepreneurship to educate about potential ideas:

- **Make the SBA more responsive to the unique nature and needs of startups** by establishing a common framework for how to engage with "new businesses" (as distinguished from small businesses).
- **Help SBA capital become more flexible**, beyond just existing SBA loans, which can serve only a very narrow audience of businesses.
- **Re-structure the SBIC program** to provide more "seed capital" to startups.
- **Raise the cap on the Regulation A exemption and the 3(c)(1) exemption**, two regulatory classifications that would increase the number of investors who could invest in new funds or companies.
- **Educate legislators on the potential benefits of proposed bipartisan legislation**, such as the New Business Preservation Act, which allocates federal dollars to venture funds, matched by private capital, in areas that are undercapitalized by the capital markets; a federal Angel Investor Tax Credit, which builds on successful state programs to increase angel investment; and the Ignite American Innovation Act, which enables startups to monetize operating losses on their balance sheet, providing more runway for success.

CONCLUSION

The 2019 *Access to Capital for Entrepreneurs* report concluded with guiding questions to help direct future work and investments aimed at broadening access to capital. The Kauffman Foundation has used these guiding questions to set its own strategic priorities and identify opportunities to innovate:

- Initiatives like the CAL, for example, have provided seed funding for funds that are deploying innovative investment strategies, such as revenue-based or profit-sharing lending. These strategies have the potential to expand access to capital for entrepreneurs who may be viewed as too risky for traditional bank loans, but not high-growth enough for VC.[22] Yet this diverse group of managers and strategies still has a way to go to reach scale, and there is more opportunity to engage institutional investors in this work that bridges the gap between Wall Street and Main Street.
- Initiatives like ANBP bring together stakeholders from every part of the entrepreneurial ecosystem to co-create policy recommendations that can begin to address the capital access problem that is particularly prevalent among businesses owned by women and entrepreneurs of color.[23] Policy work at

the national, state, and local level can continue to reduce barriers for entrepreneurs who have not been able to access capital.

While significant work has been undertaken to begin to answer the guiding questions proposed in the report, there is still much to be done.

A large portion of this work was initiated prior to the COVID-19 pandemic. Since the report was released, the U.S. has seen major social and economic upheaval. The last two years have made it even more clear that the distribution of the types of businesses that are able to access capital is highly uneven. Despite attention to the need to close geographic and demographic gaps in access to capital, disparities persist.[24]

As one example, the Paycheck Protection Program (PPP) – a large-scale government effort aimed at helping small businesses survive and continue to make payroll – was initially administered largely through banks. As Black-owned firms are less likely than white-owned firms to use banks as financial service providers, it is not surprising that Black entrepreneurs were less likely than white entrepreneurs to report having received PPP loans.[25]

There is potentially an opportunity to support a wave of new entrepreneurs across the country. Despite the many challenges facing business owners throughout the COVID-19 pandemic, there has been a resurgence of entrepreneurial activity in the U.S. New business applications fell in the early stages of the pandemic but then surged in the second half of 2020 and throughout the spring of 2021.[26] In addition, the Kauffman Early-Stage Entrepreneurship indicators reported the highest rate of new entrepreneurs on record in 2020.

At the same time, however, 2020 saw the lowest opportunity share of new entrepreneurs in the last 25 years. This suggests that while the pandemic provided unique opportunities for new entrepreneurs, many individuals were turning to entrepreneurship out of necessity rather than choice. The largest decreases in opportunity share were among Asian and Black entrepreneurs, which coincided with higher rates of long-term unemployment among Asian and Black workers in 2020. Whether individuals are turning to entrepreneurship out of necessity, or the pandemic is providing an opportunity to launch a new business, support will be critical for many entrepreneurs.

Early on during the pandemic, Philip Gaskin, the Kauffman Foundation's vice president of Entrepreneurship, and John Tyler, the Kauffman Foundation's General Counsel, co-authored a piece in the Chronicle of Philanthropy describing how philanthropy can support small businesses and address the challenges contributing to the lack of access to capital that is particularly prevalent among startup businesses owned by entrepreneurs of color and women.[27] This capital access problem was felt even more acutely during the COVID-19 pandemic. They argued that foundations and other groups need to be nimble in order to support small businesses during the pandemic and subsequent recovery. These organizations and groups, for example, may consider paying for goods and services upfront, making investments or loans directly to entrepreneurs, or creating funds that lend to entrepreneurs using more innovative funding mechanisms.

We have seen some bright spots emerging that provide us with an opportunity to build upon. Collaboratives like Living Cities have focused more intentionally on giving women, people of color, and geographically underrepresented investors decision-making power over capital. And alternative investment structures are moving from the margin to the mainstream. We are seeing federal legislation such as the U.S. Farm Bill, which includes funding for programs that provide technical assistance and capital that is better suited for the needs of rural entrepreneurs. We are also seeing that institutional limited partners from foundations to investment firms are supporting strategies for companies "in the middle" – those that are not able to access equity or debt.

These efforts are promising. As these new approaches and others make progress in the coming months and years, we need to continue track and measure outcomes to ensure that the entrepreneurs who have historically faced barriers have more pathways to success. The Kauffman Foundation is committed to advancing this work, which is even more critical in today's economy. Collaboration with other organizations, innovators, and policymakers will be essential in the success of these efforts.

ENDNOTES

1. Hwang et al. (2019).
2. https://www.startusupnow.org/
3. https://www.kauffman.org/capital-access-lab/
4. Hwang et al. (2019).
5. Wood (2020).
6. https://capacity.is/capital/
7. https://collab.capital/
8. https://www.indie.vc/
9. In March 2021, the founder of Indie.vc, announced that the Indie.vc experiment was going “on pause” because of the difficulty in gaining traction for and understanding of alternative models within the institutional investor market. See Roberts (2021).
10. https://www.1863ventures.net/
11. https://anzupartners.com/
12. https://foundersfirstcapitalpartners.com/
13. The nonprofit impact investment group TONIIC hosts the term sheet at https://www.impactterms.org/download/charitability-term-sheet/. Foundations can access the term sheet at this website and use the lessons learned from the CAL to inform their decisions.
14. https://www.kauffmanfellows.org/journal_posts/women-vcs-invest-in-up-to-2x-more-female-founders
15. West and Sundaramurthy (2020); Pitchbook and All Raise (2019).
16. See Gompers and Wang (2017); International Finance Corporation (2019).
17. https://livingcities.org/
18. Tyler (2021).
19. Grey and Cortes (2020); Chilazi (2019).
20. Desai and Howe (2020).
21. Start Us Up (2019).
22. Hwang et al. (2019).
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24. See for example Federal Reserve Bank of Atlanta (2019); Federal Reserve Banks of New York and Kansas City (2017).
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