

**Congress of the United States**  
**U.S. House of Representatives**  
**Committee on Small Business**  
2561 Rayburn House Office Building  
Washington, DC 20515-6515

**MEMORANDUM**

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**TO:** Members, Subcommittee on Economic Growth, Tax, and Capital Access  
**FROM:** Sharice Davids, Chairwoman  
**RE:** Subcommittee Remote Hearing: Innovation as a Catalyst for New Jobs: SBA’s Innovation Initiatives  
**DATE:** July 14, 2021

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The Committee on Small Business, Subcommittee on Economic Growth, Tax, and Capital Access will meet for a remote hearing entitled, “Innovation as a Catalyst for New Jobs: SBA’s Innovation Initiatives.” The hearing is scheduled to begin at **1 P.M. on Wednesday, July 14, 2021, via the Zoom platform.**

Innovation is key to the success of America’s small businesses and the country’s long-term economic prospects. The Small Business Administration (SBA) has a number of programs to stimulate innovation at startups across the country. Members will have the opportunity to learn more about these programs and the importance of federal investment in innovation as a means to foster entrepreneurship, particularly in the post-pandemic economy.

**Panel**

- Mr. E. LaVerne Epp, Executive Chair, KU Innovation Park, Lawrence, Kansas
- Mr. Benjamin Johnson, Chairman, Innovation Advocacy Council, Westerville, Ohio
- Dr. Gabriel R. Burks, Vice President and Head of R&D, FrostDefense Envirotech Inc., Champaign, IL
- Mr. Jeffrey Maguire, Managing Partner & Co-Founder, Clearly Clean Products LLC, Orwigsburg, PA

**Background**

Innovation is the “process of discovering new ideas and realizing those ideas at large scale, changing the ways we live and work.”<sup>1</sup> The exceptional economic performance of the U.S. has largely been driven by a focus on innovation and has led to new business formation and improved the lives of all Americans. For most of the 20<sup>th</sup> century, the rapid pace of innovation and the increases in productivity led to greater efficiency of American workers and lowered prices of goods and services.<sup>2</sup> However, since the 1970s, the pace of innovation has slowed leading to Americans

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<sup>1</sup> Michael Greenstone and Adam Looney, *A Dozen Economic Facts About Innovation*, The Hamilton Project, August 2011, [https://www.brookings.edu/wp-content/uploads/2016/06/08\\_innovation\\_greenstone\\_looney.pdf](https://www.brookings.edu/wp-content/uploads/2016/06/08_innovation_greenstone_looney.pdf) [hereinafter “Hamilton Project”].

<sup>2</sup> *Id* at 2.

at the middle and bottom of the wage spectrum to experience wage stagnation or wage reduction when adjusted for the cost of living.<sup>3</sup>

Business startups play an important role in job creation but, have a limited economic effect on net job creation over time because fewer than half of all startups are still in business after five years.<sup>4</sup> However, startups that remain in business during that five year period tend to have a positive employment effect.<sup>5</sup> Of America's 30 million small businesses, approximately eight percent are considered young startups that average six employees per firm.<sup>6</sup> The performance of these firms is shaped by the knowledge and financial investments they receive, particularly from the public sector.<sup>7</sup> Investments primarily fall into three categories, physical capital, research and development (R&D), and education and training.<sup>8</sup> Ensuring more startups survive the first five years of operation may lead to increased economic opportunities.

The Global Innovation Index's 2020 report states that one of the main challenges to innovation is access to stable financing mechanisms.<sup>9</sup> The Congressional Budget Office (CBO) reports that federal investment can promote long-term economic growth and in 2018, the federal government spent \$492 billion on investment generally, representing 12 percent of all federal spending and two percent of gross domestic product (GDP).<sup>10</sup> Yet, federal investment in innovation has been steadily declining from its peak of 30 percent of federal spending in the 1960's, and of the amount of discretionary spending spent on investment, only a small portion goes directly to investments in the small business innovation ecosystem.<sup>11</sup>

Small business financing needs vary widely and funding in the earliest stages of company development, such as pre-revenue or pre-product development, can be difficult to find.<sup>12</sup> Small businesses generally raise capital through a combination of retained business earnings, personal funds, and external financing.<sup>13</sup> However, the utilization of retained business earnings is only an option for established businesses and personal funds are only an option for those with existing resources, leaving external financing as the only option for many emerging small businesses.<sup>14</sup>

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<sup>3</sup> *Id.* at 1.

<sup>4</sup> CONGRESS OF THE UNITED STATES, CONGRESSIONAL RESEARCH SERVICE (CRS), SMALL BUSINESS ADMINISTRATION AND JOB CREATION, (2021) at 2.

<sup>5</sup> CONGRESS OF THE UNITED STATES, CONGRESSIONAL RESEARCH SERVICE (CRS), SMALL BUSINESS ADMINISTRATION AND JOB CREATION, (2021) at 2.

<sup>6</sup> L. Lanahan et al., *Do public R&D subsidies produce jobs? Evidence from the SBIR/STTR program*, Elsevier B.V., 1, (2021).

<sup>7</sup> David B. Audretsch & Albert N. Link, *Entrepreneurship and Knowledge Spillovers from the Public Sector*, *International Entrepreneurship and Management Journal*, 2-3, (2019).

<sup>8</sup> CONGRESS OF THE UNITED STATES, CONGRESSIONAL BUDGET OFFICE (CBO), FEDERAL INVESTMENT, 1962-2018, (2019) [hereinafter "CBO Report"].

<sup>9</sup> S. Dutta et al., *Global Innovation Index 2020*, vii, (2020) [hereinafter "GII 2020"].

<sup>10</sup> CBO Report at 2, *supra* note 8.

<sup>11</sup> CBO Report at 1 and 20, *supra* note 8.

<sup>12</sup> U.S. SECURITIES AND EXCHANGE COMMISSION, *Annual Report for Fiscal Year 2020: Office of the Advocate for Small Business Capital Formation*, (2020), <https://www.sec.gov/files/2020-oasb-annual-report.pdf> [hereinafter "SEC Report"].

<sup>13</sup> *Id.* at 35.

<sup>14</sup> *Id.* At 35.

Prior to the pandemic, the trend of venture capitalists pursuing “mega-deals”, that were generally unsuccessful, slowed down that avenue of funding for small business startups.<sup>15</sup>

During the pandemic, that trend continued with private sector funding through Venture Capital (VC) deals, Initial Public Offerings (IPOs), and start-ups declining.<sup>16</sup> The U.S. currently ranks third in the Global Innovation Index (GII), behind Switzerland (1) and Sweden (2), and the innovation landscape continues to shift with China (14), Vietnam (42), India (48), and the Philippines (50) rising in the rankings.<sup>17</sup> As the country emerges from the pandemic, boosting innovation amongst small businesses may be an avenue to increase America’s GII ranking.

## **Innovation Gaps**

### *Geographic*

Where people live is crucial to determining their economic opportunities.<sup>18</sup> Over the last several decades, evolving trade and technology patterns have created concentrated geographic prosperity.<sup>19</sup> Clustering of economic activity in specific geographic areas can happen for many reasons but some researchers point to the desirability of living in the area, market accessibility through location, infrastructure, and transport, and an innovation-promoting policy environment.<sup>20</sup> With 70 percent of VC funding concentrated in three metro areas, New York City, Boston, and San Francisco, gaps in available funding exist for many parts of the country.<sup>21</sup>

### *Demographic*

The inability to unlock the innovation potential of all people in America may be limiting broad-based opportunity and the nation’s prosperity.<sup>22</sup> Women constituted 27.6 percent of entrepreneurs seeking capital in 2019 but tended to raise less per funding round than their male counterparts.<sup>23</sup> Minority entrepreneurs experience similar barriers to funding with minorities constituting 9.3 percent of entrepreneurs seeking capital in 2019 and are more likely to use personal funds as their primary business funding source.<sup>24</sup> When seeking credit approval for their business, minority entrepreneurs are approved at a generally lower rate and, when they are approved, are less frequently approved for the full amount of their loan.<sup>25</sup>

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<sup>15</sup> GII 2020 at 20, *supra* note 9.

<sup>16</sup> GII 2020 at 20, *supra* note 9.

<sup>17</sup> GII 2020 at 24, *supra* note 9.

<sup>18</sup> Ryan Nunn et al., The Geography of Prosperity, The Hamilton Project, September 2018, [https://www.hamiltonproject.org/assets/files/PBP\\_FramingChapter\\_compressed\\_20190425.pdf](https://www.hamiltonproject.org/assets/files/PBP_FramingChapter_compressed_20190425.pdf) [hereinafter “Nunn et al.”].

<sup>19</sup> *Id.* at 1.

<sup>20</sup> Peter Egger and Nicole Loumeau, The Economic Geography of Innovation, VOXeuCEPR, (January 2019) <https://voxeu.org/article/economic-geography-innovation>.

<sup>21</sup> SEC Report at 36, *supra* note 12.

<sup>22</sup> Wesley Tharpe et al., Tapping More People’s Capacity to Innovate Can Help States Thrive, Center on Budget and Policy Priorities, (December 2020), [hereinafter “Tharpe et al.”] <https://www.cbpp.org/research/state-budget-and-tax/tapping-more-peoples-capacity-to-innovate-can-help-states-thrive>.

<sup>23</sup> SEC Report at 48, *supra* note 12.

<sup>24</sup> *Id.* At 54.

<sup>25</sup> *Id.* At 54.

In addition to women and minority entrepreneurs facing barriers when raising capital, women and minorities are also underrepresented in investor leadership roles. Only 12 percent of decision-makers in VC firms are women, with minorities representing similar or lower rates with 15 percent Asian, 3 percent Hispanic, and 3 percent Black Americans having a seat at the decision table.<sup>26</sup> Representation in investor leadership teams is important to address the funding gap as small business founders are 21 percent more likely to be funded by an investor of the same ethnicity.<sup>27</sup> In addition, female VC partners are twice as likely to invest in startups with at least one female founder and more than three times as likely to invest in startups with female CEOs.<sup>28</sup>

### **SBA Innovation**

SBA's Office of Investment and Innovation (OII) leads programs that provide the high-growth small business community with access to financial capital and R&D funds to develop commercially viable innovations.<sup>29</sup> The OII specifically oversees the Small Business Investment Companies (SBIC), Small Business Innovation Research (SBIR), Small Business Technology Transfer (STTR), and Growth Accelerator Fund Competition (GAFC) programs. In addition, SBA manages an entrepreneurial development initiative, Regional Innovation Clusters (RICs).

These programs provide entrepreneurs and small business owners with the mentoring and technical assistance to develop and commercialize products, create entrepreneurial networks, and build the next great American company.

### **Growth Accelerator Fund Competition**

Accelerators are programs that help entrepreneurs bring their technologies, ideas, or products into the marketplace and help them develop viable businesses.<sup>30</sup> Accelerators and incubators provide a range of services and assistance to support for-profit startups with high-growth potential.<sup>31</sup> They focus on coaching and developing these startups so they can secure early-stage "seed" funding to expand their ideas and businesses.<sup>32</sup>

Founded in 2014, the Growth Accelerator Fund Competition promotes innovation and entrepreneurship by identifying and funding gaps in the entrepreneurial ecosystem and providing \$50,000 prizes to business accelerators, incubators, and other organizations to provide entrepreneurs and small business owners with support, mentorship, and commercialization assistance.<sup>33</sup> The Growth Accelerator Fund Competition not only spurs economic development and creates jobs, it fills geographic gaps by supporting the development of accelerators and startups in regions of the country where there are fewer sources of capital. Since inception, the program

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<sup>26</sup> *Id.* at 51 and 57.

<sup>27</sup> *Id.* at 56.

<sup>28</sup> SEC Report at 51, *supra* note 12.

<sup>29</sup> Office of Investment and Innovation, SBA.gov, <https://www.sba.gov/about-sba/sba-locations/headquarters-offices/office-investment-innovation>.

<sup>30</sup> C. Scott Dempwolk et al., *Innovation Accelerators: Defining Characteristics Among Startup Assistance Organizations*, SBA Off. of Advoc., 7, (Oct. 2014).

<sup>31</sup> *Id.* At 7.

<sup>32</sup> *Id.* At 7.

<sup>33</sup> U.S. SMALL BUSINESS ADMINISTRATION, FY2022 CONGRESSIONAL BUDGET JUSTIFICATION FY2020 ANNUAL PERFORMANCE REPORT, 66, (2021) [hereinafter "SBA CBJ"].

has awarded 303 prizes of \$50,000 each to organizations in 49 states, Washington, D.C., and Puerto Rico.<sup>34</sup>

In FY19, the Growth Accelerator Fund Competition focused on accelerators that work with high tech entrepreneurs who would use the award to focus at least 60 percent of their Competition-related work on businesses owned by women, socially and economically disadvantaged individuals, entrepreneurs in states with fewer SBIR and STTR applications, or were located in an Opportunity Zone.<sup>35</sup> In FY19 alone, the GAFC provided \$3 million in awards to 60 entities in 38 states, Washington D.C., and Puerto Rico.<sup>36</sup> In addition, in FY20, almost 5,500 businesses across the country participated in an SBA sponsored growth accelerator cohort.<sup>37</sup> In FY21, the Growth Accelerator Fund Competition received \$2 million in appropriations. The FY22 House Financial Services and General Government Appropriations bill appropriates \$10 million for the Growth Accelerator Fund Competition.

### Regional Innovation Clusters

Founded in September 2010, Regional Innovation Clusters are collaborations between business, research, education, financing, and government institutions that grow a particular industry, or set of related industries, in a particular geographic area.<sup>38</sup> Within the clusters, businesses work together as networking hubs to maximize resources and leverage each other to commercialize technology or create products and services more efficiently. In FY20, SBA oversaw 10 Regional Innovation Clusters and awarded seven new cluster projects to support rural communities.<sup>39</sup> According to a third-party evaluation of the program, a total of 1,220 small businesses participated in the clusters and the Regional Innovation Clusters provided approximately 7,500 hours of one-on-one counseling to participants.<sup>40</sup> In FY21, the Regional Innovation Clusters program received \$6 million in appropriations. The FY22 House Financial Services and General Government Appropriations bill appropriates \$10 million for the Regional Innovation Cluster program.

### Innovation Moving Forward

Investment in SBA's innovation initiatives and the expansion of innovation programs is one pathway towards unleashing the potential of women and minority entrepreneurs, as well as, entrepreneurs outside major metropolitan areas. Expanding access to accelerators and incubators in underserved and rural communities would allow more entrepreneurs to develop the technology and businesses needed for America to succeed in the 21<sup>st</sup> century. Leveraging SBA's existing resources and partnerships to achieve this expansion could ensure SBA's expertise and network are more fully utilized. In addition, expanding SBA's innovation network to work more closely with Historically Black Colleges and Universities (HBCUs) and Minority Serving Institutions (MSIs) could help close the innovation gap with minority entrepreneurs and small business owners.

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<sup>34</sup> *Id.* at 66.

<sup>35</sup> Office of Investment and Innovation Resources, U.S. Small Business Administration, <https://www.sba.gov/offices/headquarters/ooi/resources/1428931>.

<sup>36</sup> Office of Investment and Innovation Resources, U.S. Small Business Administration, <https://www.sba.gov/offices/headquarters/ooi/resources/1428931..>

<sup>37</sup> SBA CBJ at 67, *supra* note 33.

<sup>38</sup> *Id.* at 89.

<sup>39</sup> *Id.* at 89.

<sup>40</sup> *Id.* at 89.

## **Conclusion**

As the country rebounds from the COVID-19 pandemic, Congress has an opportunity to unleash innovation and economic growth for years to come. By focusing on expanding innovation geographically and demographically, Congress has the opportunity to tap into underutilized economic potential. In addition, ensuring SBA's innovation initiatives receive the support they need to continue to help entrepreneurs and small businesses is a worthwhile investment. Small businesses are the backbone of the American economy and an investment in innovation will enable Congress to help even more small businesses and entrepreneurs achieve their goals.