



Bill Summary
MicroCap Small Business Investing Act of 2021
May 20, 2021

Summary: The MicroCap SBIC proposal introduced on May 20, 2021, by U.S. Sens. John Hickenlooper (D-CO) and James Risch (R-ID) is a market-driven proposal that would (1) provide a new tool to fulfill the mission of the SBIC program by filling gaps in capital access; (2) seed an entirely new and more diverse generation of successful fund managers across a broader geographic range than is currently being served; and (3) serve more very small businesses.

The “**MicroCap Small Business Investing Act**” is designed to fill several gaps:

- **Inclusivity.** Currently, SBA requires that to get an SBIC license a person must have 10 or more years of experience on the investing committee of a private equity or venture fund. Given that these pools of human capital are not as diverse as the people and geography of the entirety of the United States, this proposal will expand inclusivity to more underserved markets and people.
- **Underserved areas.** Most venture capital and large private equity investments are generally concentrated in or around a handful of metropolitan regions on either coast. SBICs overwhelmingly invest outside of this concentrated footprint, but there are still very few funds in smaller cities. MicroCap SBICs are the right size to serve small businesses in smaller markets that are outside of the nation’s financial centers.
- **Smaller Small Business Sizes.** There is a direct correlation between the size of an investing fund and the size of the business into which they invest. SBA has increasingly moved away from licensing smaller funds. Licensing more funds as MicroCap SBICs, however, will allow for more investments into the smaller end of the small business spectrum. Smaller funds are also more likely to be first time funds led by women and minority managers. Because of the collaborative structure and partnership model, the MicroCap SBIC model sets up these new, smaller funds for success.
- **Speed.** The MicroCap SBIC proposal provides clear timelines and regulatory transparency to applicants which is currently a significant deterrent to first time SBIC funds.
- **Market Gaps.** Access to equity capital is by far the hardest type of capital for smaller businesses to access. It is also the most patient form of capital and the most impactful for job growth. With a lower leverage rate, these smaller funds can not only invest in more, smaller businesses, but also make a higher proportion of their investments in equity – filling a challenging market gap. These investments would not likely be in early-stage venture, but could be targeted toward growth-stage companies.
- **Taxpayer Protection.** For decades, the SBIC program has operated at zero subsidy to the federal government. The MicroCap SBIC program should not risk this successful record because with a

lower leverage ratio (1:1), a hard cap on leverage per MicroCap SBIC (\$25M), a limited number of MicroCap SBIC licenses issued per year (no more than 10), and with experienced SBIC fund managers on the investment committee for each licensed MicroCap fund, the financial risk to the taxpayer would be extremely limited.

What is a MicroCap SBIC?

- An SBIC license with a broader funnel to allow more teams to qualify. Teams must have expertise consistent with the investing strategy they are pursuing, but they do not need to have run a fund before.
- MicroCap SBICs, because of scale, will likely be in smaller cities and have a regional focus. They are not meant to be national platforms or to serve the biggest cities.
- Leverage is limited to 1:1 (SBA leverage: private capital) with a cap of \$25 million of SBA money and no cap on the amount of private capital.
- Each licensed MicroCap SBIC fund must have at least two (2) independent members on their investment committee – both of whom must approve an investment before it is made. These independent members must be or have been licensed SBIC fund managers (highly experienced fund managers who understand both the market and the regulatory restrictions the SBA has). This will ensure that the MicroCap SBIC has experienced fund managers to help guide them, filter opportunities and structure transactions. These board members are not paid a management fee, but can earn part of the carry.
- The MicroCap SBIC model would be for teams that are largely first-time fund managers, or a team comprised of both experienced and newer fund managers. The pool of human talent is far more diverse if pulling from the ranks of people with banking, investment banking, finance, or specialized entrepreneurial backgrounds. MicroCap SBICs are not designed for investment teams with previous experience running an SBIC fund; those teams should apply for a conventional license.
- There is no limit on the amount of private capital raised by a MicroCap SBIC fund. There would only be a limit on the amount of leverage a MicroCap SBIC could access. The leverage limit would likely be 1:1 or \$25M – whichever is lower. With this type of leverage most MicroSBICs would likely be \$25-60M in fund size (with leverage) and would be located in smaller markets.
- For SBIC fund managers that are on a MicroCap SBIC's investment committee, SBA would not hold the performance of the MicroCap SBIC for or against the SBIC manager or their other funds.