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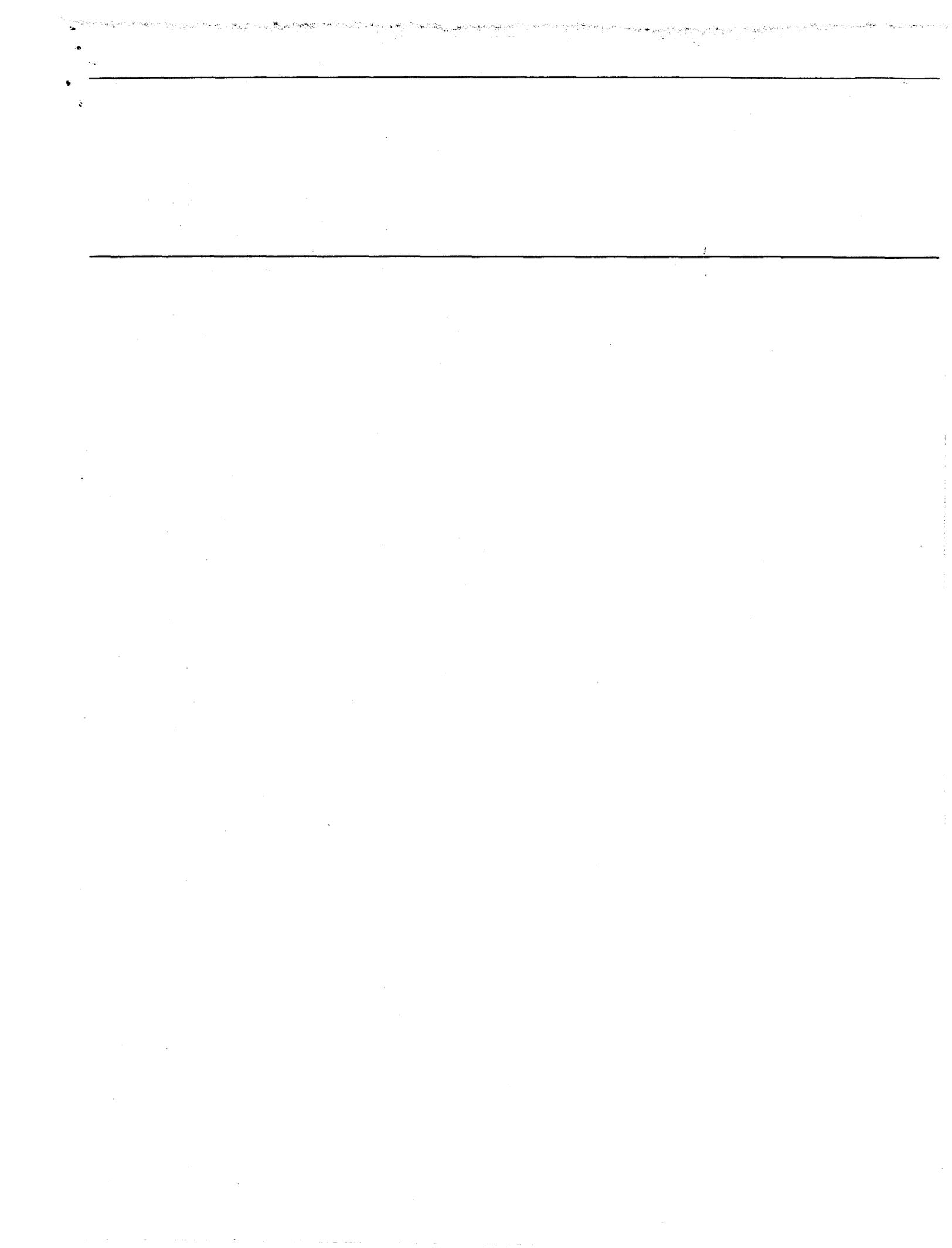
Briefing Report to the Chairman,
Committee on Small Business, House of
Representatives

May 1989

SMALL BUSINESS

**Profiles of Venture
Capital Financing,
1983 Through 1987**







United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-206827

May 19, 1989

The Honorable John J. LaFalce
Chairman, Committee on Small Business
House of Representatives

Dear Mr. Chairman:

You requested that we study the role of Small Business Investment Companies (SBIC) and Minority Enterprise Small Business Investment Companies (MESBIC) in providing venture capital assistance to small businesses. As agreed with your office, we obtained information from the Small Business Administration (SBA) on SBIC and MESBIC venture capital financings in calendar years 1983 through 1987. We also analyzed trends in SBIC and MESBIC activities during this period to determine the distribution of financings among states, types of financial arrangements, and recipient industries. In addition, we assessed the reliability of the SBA database we used to perform our analyses.

The Small Business Investment Act of 1958 created the SBIC program to help small businesses obtain equity capital, management assistance, and long-term financing. The act also established the MESBIC program, which targets similar assistance to small business concerns owned by socially or economically disadvantaged persons. In return for pledging to finance only small businesses, SBICs and MESBICs qualify for long-term, government-assisted loans to augment their own financial resources. SBA's Investment Division administers the SBIC and MESBIC loan programs, licenses the investment companies, and maintains regulatory oversight over them. At the close of calendar year 1987, there were 307 SBICs and 128 MESBICs licensed nationwide.

In summary, we found that small business venture capital financings have been concentrated in relatively few states under both programs. SBIC financings have been fairly evenly distributed between transactions secured and those not secured by an equity interest in the recipient firm. MESBIC financings typically have been secured by debt instruments rather than equity interests. SBIC financings have assisted a more diverse range of industries than MESBIC financings, nearly half of which have gone to five industries.

DISTRIBUTION OF FINANCING

In 1987, SBIC venture capital financings were concentrated mostly in California, New York, Texas, Connecticut, and Massachusetts. These states accounted for approximately 57 percent of the \$491.3 million in venture financings made that year. The five states also accounted for the largest percentage (58 percent) of the \$2.3 billion in SBIC financings between 1983 and 1987. MESBIC financing activity among the states was even more concentrated. New York alone accounted for over 43 percent of the 1987 total of \$140 million and together with California, Michigan, Texas, and New Jersey accounted for nearly 80 percent of this total. From 1983 to 1987, 77 percent of the total \$547.5 million financed by MESBICs went to businesses located in the same five states. (See sec. 1.)

TYPES OF FINANCIAL ARRANGEMENTS

SBA categorizes SBIC and MESBIC financings into three general classes according to the type of security obtained from the investment companies. These are debt-only, equity-only, or debt/equity, which is a financing arrangement with a combination of debt and equity security. Both in 1987 and between 1983 and 1987, SBIC financings were fairly equally distributed among the three categories. In contrast, MESBIC financings have typically been heavily secured by debt, with the proportion of debt-only financings increasing over time. In 1983, 67 percent (\$38.4 million) of the total \$57 million in MESBIC financings were debt-only. By 1986, the peak year for MESBIC financings, debt-only financings had tripled in dollar amount (\$117.3 million), accounting for 80 percent of all MESBIC activity. (See sec. 2.)

INDUSTRIES FINANCED

The industries financed by SBICs were more diverse than those financed by MESBICs. For example, in 1987, the five industries with the greatest SBIC activity (miscellaneous retail operations, taxicabs, television broadcasting, communications services, and single-family home contractors) totaled \$93.8 million, which constituted less than 20 percent of all SBIC financings. Between 1983 and 1987, the top five industries--electronic computing equipment, communication services, radio broadcasting, computer programs and software, and taxicabs--accounted for approximately 19 percent (\$439 million) of the \$2.3 billion in total SBIC financings. MESBICs, on the other hand, concentrated almost half of their total financings in five

industries. In 1987, the taxicab industry alone received \$29.5 million, more than 20 percent of all MESBIC financings for that year. The grocery store, eating place, radio broadcasting, and hotel/motel industries received the next greatest amounts. Over the 1983-1987 period, these five industries received approximately one-half (\$269.1 million) of all MESBIC financings. (See sec. 3.)

OTHER TRENDS

In 1987 and from 1983 to 1987, SBICs and MESBICs concentrated most of their financings in first-time ventures (60 percent and 75 percent, respectively). SBICs, however, channeled a greater proportion of their financings to continuing small business operations than did MESBICs. In 1987, small businesses used over one-half of all SBIC and MESBIC financing proceeds for operating capital. In 1987, MESBIC financial arrangements with small businesses generally were distributed among a similar range of interest rates as SBIC arrangements. However, the latter had higher degrees of debt-equity and equity participation. (See sec. 4.)

Finally, in 1987, SBICs predominately funded small businesses located outside their home states, while MESBICs funded a higher concentration of businesses within their home states. On an SBA regional basis, SBIC funding went mainly to small businesses located outside the SBICs' home regions. On the other hand, the vast majority of MESBIC assistance was provided to businesses located within MESBICs' home regions. Of nine SBA geographic regions, the Middle Atlantic region received the greatest proportion of the overall SBIC and MESBIC financings. (See sec. 5.)

RELIABILITY ASSESSMENT OF DATABASE

As requested, we also assessed the reliability of SBA's database to determine its accuracy and completeness. (See sec. 6.) We found the data to be acceptable for performing our analyses. Our accuracy test showed that the small business financing information reported by the investment companies to SBA had been entered into the database with very few errors. To illustrate the accuracy range for elements examined within the database, we found that in the best case virtually all the data were entered accurately, whereas in the worst case about 4.8 percent of the data were entered inaccurately.

Our test for completeness showed that an estimated 8 to 16 percent of the reports were not included in the database for various reasons. According to SBA, the principal reason was that the investment companies filed their information past SBA's cutoff date for entering information into the database. SBA Investment Division officials share our opinion, however, that the exclusion of the data should not affect the identification of overall trends within the industry. As agreed, we did not undertake the additional work required to add the missing records into the database.

AGENCY COMMENTS

SBA agency officials reviewed a draft of this report and suggested certain technical changes, particularly to our analysis of SBIC and MESBIC interest rates in section 4. SBA stated that with these changes, the report fairly represents the SBIC and MESBIC financings for 1987 and for the period 1983 to 1987. (See app. I.)

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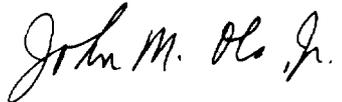
Our review was conducted between January 1988 and September 1988. We obtained and analyzed SBA's automated records on investment company financings made to small businesses during the period January 1983 through December 1987 and its directory of the investment companies as of December 1987. We also discussed SBA's policy and procedures for maintaining the databases with representatives of its Investment Division. In performing our reliability assessment, we used statistical sampling techniques to measure the extent of errors and missing records within the database. We did not attempt to evaluate the effectiveness of the SBIC and MESBIC programs. (See sec. 7.)

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

B-206827

Should you require any additional information on the contents of this document, please call me on (202) 275-5525. Major contributors to this briefing report are listed in appendix II.

Sincerely,

A handwritten signature in cursive script that reads "John M. Ols, Jr.".

John M. Ols, Jr.
Director, Housing and
Community Development Issues

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ABBREVIATIONS

GAO	General Accounting Office
MESBIC	Minority Enterprise Small Business Investment Company
SBA	Small Business Administration
SBIC	Small Business Investment Company
SIC	Standard Industrial Classification

SECTION 1

INVESTMENT COMPANY FINANCING ACTIVITY BY STATE

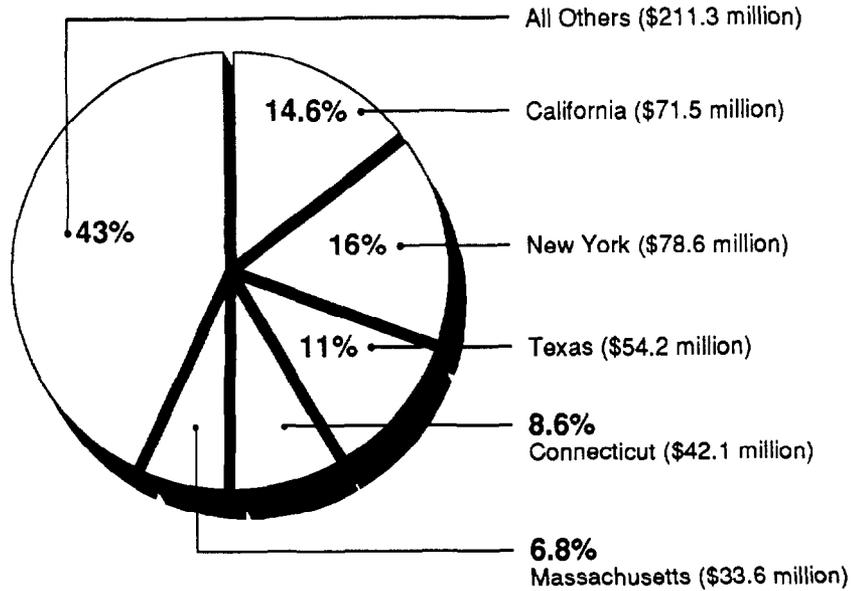
SBICs and MESBICs nationwide financed approximately \$2.8 billion in small business venture capital from 1983 to 1987. In 1987 alone, these investment companies distributed about \$630 million to small business concerns located in the 50 states and territories. Our analysis, which profiles the distribution of SBIC and MESBIC venture capital funds by state, shows that five states received over half of SBIC funding in 1987 and from 1983 to 1987. An even greater concentration of funds occurred in the MESBIC program.

STATE DISTRIBUTION OF SBIC FINANCINGS

Figure 1.1 illustrates the distribution of the \$491.3 million in total venture capital funded by SBICs nationwide during 1987. Five states received 57 percent of all small business venture capital financings for that year.

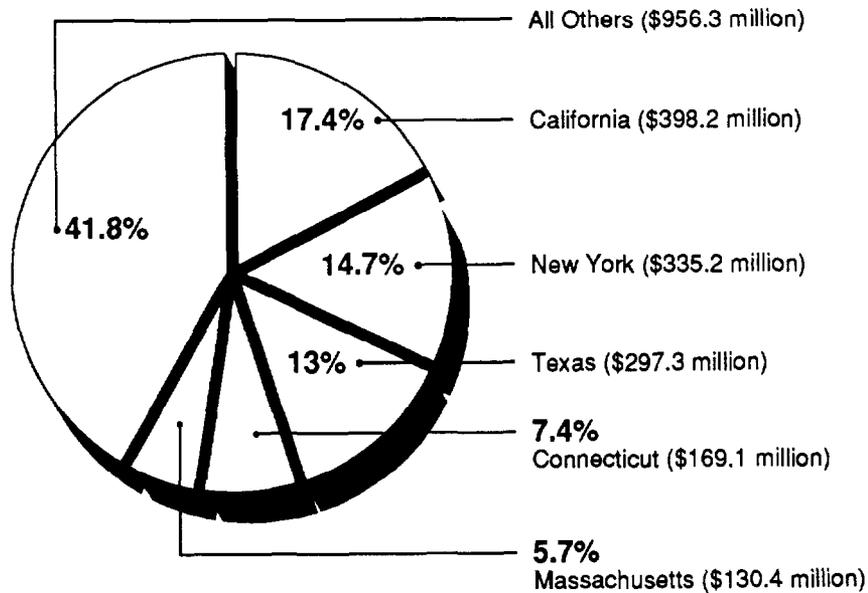
Figure 1.2 shows the concentration of SBIC small business financings for the years 1983 to 1987, a total of about \$2.3 billion. The same five states received the most SBIC assistance in 1987 and over the period 1983 to 1987. Together, these states accounted for approximately 58 percent of all SBIC activity over the 5-year period. Table 1.1 shows the 5-year SBIC funding trends for all states, ranked by the amount of SBIC funding received.

Figure 1.1: Distribution of SBIC Financings by State, 1987



Source: GAO analysis of SBA data.

Figure 1.2: Distribution of SBIC Financings by State, 1983 Through 1987



Source: GAO analysis of SBA data.

Table 1.1: SBIC Financing Trends By State, 1983 to 1987

State	Dollars financed					5-Year total	Percent of 5-year total
	1983	1984	1985	1986	1987		
California	\$84,989,184	\$75,270,383	\$79,954,211	\$86,531,711	\$71,450,808	\$398,196,297	17.41
New York	40,694,333	56,205,061	78,243,665	81,475,064	78,571,575	335,189,698	14.66
Texas	69,487,076	67,030,679	52,907,694	53,683,978	54,231,146	297,340,573	13.00
Connecticut	23,229,212	18,874,161	45,023,980	39,849,658	42,095,947	169,072,958	7.39
Massachusetts	32,600,118	26,926,289	23,504,605	13,872,739	33,559,645	130,463,396	5.71
Ohio	11,818,252	7,301,633	8,861,754	11,608,117	28,128,050	67,717,806	2.96
Minnesota	12,525,776	14,667,176	11,394,797	13,942,460	9,702,839	62,233,048	2.72
Michigan	13,313,167	7,722,577	9,730,487	14,897,093	15,550,105	61,213,429	2.68
Florida	16,234,361	13,620,257	11,190,828	12,527,354	7,264,218	60,837,018	2.66
New Jersey	9,294,397	13,113,993	10,079,871	15,383,127	10,721,897	58,593,285	2.56
Pennsylvania	9,108,019	3,600,105	5,305,354	7,841,210	19,743,594	45,598,282	1.99
Illinois	5,980,872	5,384,840	10,853,260	10,876,501	12,336,795	45,432,268	1.99
Colorado	12,556,582	7,145,215	11,658,605	6,510,147	7,095,070	44,965,619	1.97
Wisconsin	4,738,108	8,097,250	3,800,209	10,144,612	13,615,205	40,395,384	1.77
Indiana	3,732,695	5,651,073	3,351,208	17,784,372	7,160,005	37,679,353	1.65
Virginia	8,377,611	3,658,600	5,925,692	5,477,602	10,161,409	33,600,914	1.47
Alabama	5,170,272	4,446,698	5,547,957	16,089,085	1,293,000	32,547,012	1.42
Louisiana	4,612,502	6,568,464	9,124,300	8,694,294	833,191	29,832,751	1.30
Oregon	3,068,788	4,491,245	4,732,602	9,258,845	5,164,899	26,716,379	1.17
Georgia	9,721,041	4,300,664	4,851,350	3,135,382	4,618,950	26,627,387	1.16
Tennessee	2,327,141	2,414,404	924,300	13,984,972	4,704,220	24,355,037	1.07
North Carolina	1,457,831	6,958,861	5,355,781	7,865,318	2,638,078	24,275,869	1.06
Maryland	2,967,267	3,600,607	5,456,458	5,448,132	5,686,298	23,158,762	1.01
Washington	6,453,213	4,827,807	7,556,238	1,119,270	3,171,969	23,128,497	1.01
Rhode Island	1,381,030	1,913,326	1,708,683	10,280,621	5,869,386	21,153,046	0.93
Oklahoma	6,833,691	5,150,563	1,902,373	2,644,405	3,008,406	19,539,438	0.85
Arizona	3,088,321	1,895,028	4,609,898	3,745,905	2,819,970	16,159,122	0.71
South Carolina	2,527,323	5,477,383	1,319,500	1,330,526	3,242,178	13,896,910	0.61
Mississippi	2,647,642	4,923,980	3,481,500	542,328	1,079,735	12,675,185	0.55
Dis. of Columbia	789,737	573,726	373,000	2,900,579	6,638,266	11,275,308	0.49
Iowa	1,640,000	86,000	986,666	559,250	7,103,792	10,375,708	0.45
New Hampshire	3,332,154	1,787,481	945,006	1,189,972	2,754,999	10,009,612	0.44
Utah	1,586,500	1,782,385	2,546,154	1,154,900	2,313,337	9,383,276	0.41
Kansas	2,673,170	1,753,955	1,966,491	731,600	1,506,894	8,632,110	0.38
Montana	573,996	2,352,000	4,160,060	0	0	7,086,056	0.31
New Mexico	2,217,724	1,190,131	2,377,221	465,000	610,000	6,860,076	0.30
Missouri	762,045	948,000	756,667	3,099,999	1,223,000	6,789,711	0.30
Arkansas	517,039	1,559,442	1,567,752	1,426,000	440,681	5,510,914	0.24
Kentucky	166,000	1,559,010	607,000	1,501,133	1,202,982	5,036,125	0.22
Maine	662,720	1,452,577	1,393,674	1,260,990	242,000	5,011,961	0.22
Nebraska	775,000	1,244,162	452,000	772,000	636,528	3,879,690	0.17
Nevada	1,650,000	0	0	1,236,250	141,800	3,028,050	0.13
Wyoming	195,000	967,940	1,020,799	481,000	275,000	2,939,739	0.13
Vermont	140,000	133,143	385,000	598,667	200,025	1,456,835	0.06
Idaho	788,000	72,000	184,000	282,000	0	1,326,000	0.06
South Dakota	729,955	316,254	150,000	50,000	0	1,246,209	0.05

Delaware	0	21,400	1,000,000	0	100,000	1,121,400	0.05
Hawaii	220,000	85,000	400,000	0	400,275	1,105,275	0.05
North Dakota	672,768	30,000	79,325	31,800	0	813,893	0.04
Alaska	0	0	400,000	150,000	0	550,000	0.02
West Virginia	20,000	310,000	0	104,400	0	434,400	0.02
Virgin Island	0	0	60,000	0	0	60,000	0.00
Puerto Rico	0	0	0	0	0	0	0.00
Total	<u>\$431,047,633</u>	<u>\$409,462,928</u>	<u>\$450,167,975</u>	<u>\$504,540,368</u>	<u>\$491,308,167</u>	<u>\$2,286,527,071</u>	<u>100.00%</u>

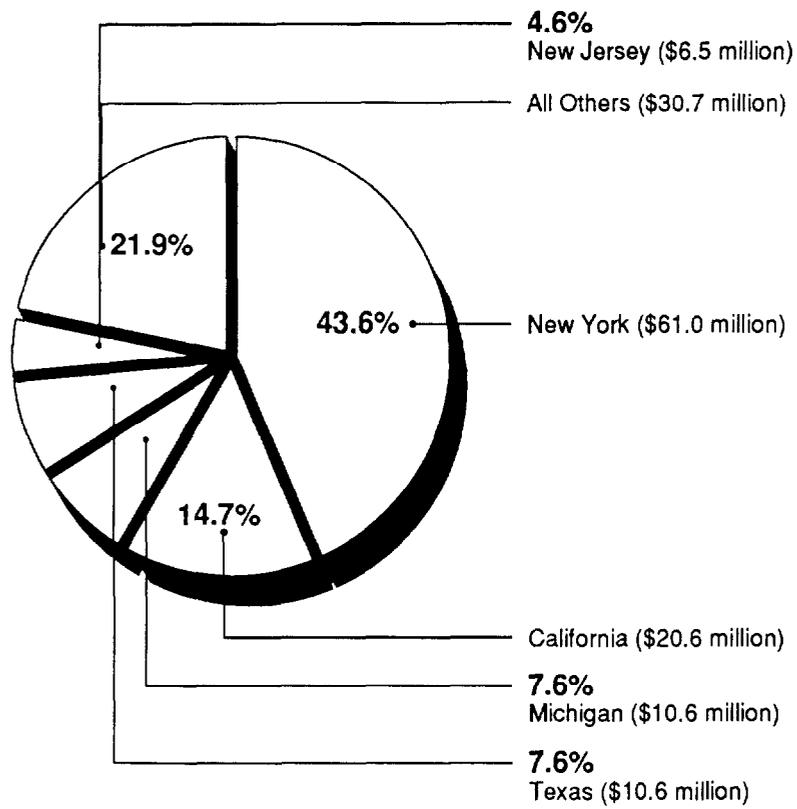
Source: GAO analysis of SBA data.

STATE DISTRIBUTION OF MESBIC FINANCINGS

Figure 1.3 illustrates the five states receiving the largest share of the \$140 million in MESBIC financing during 1987. Nearly 80 percent of all financings were concentrated within these states, with New York alone receiving over 43 percent of the financing total. The concentration of funding is more pronounced for MESBICs than for SBICs.

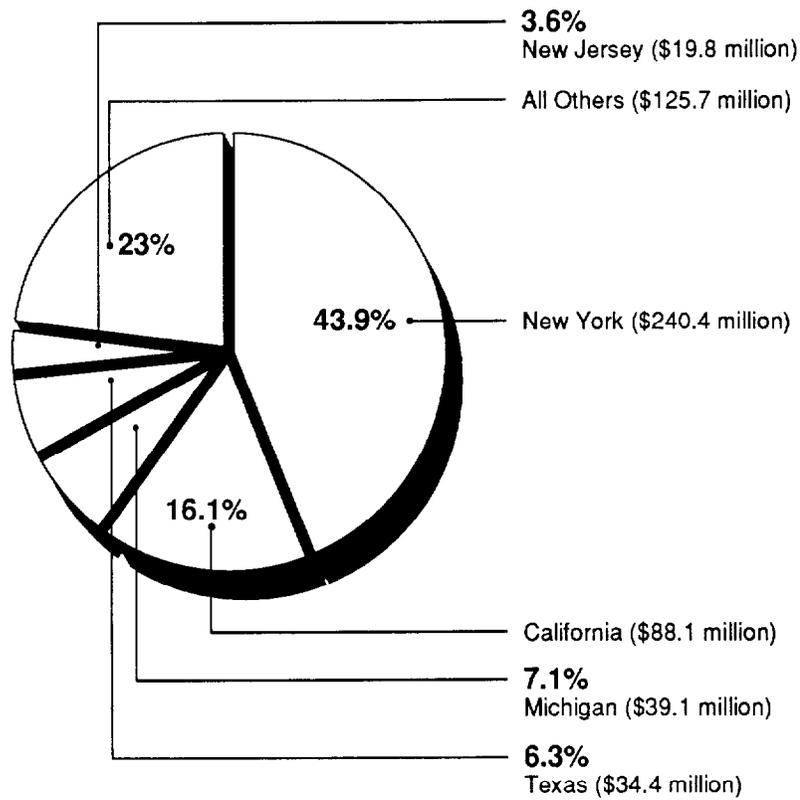
Figure 1.4 shows that the same five states also received the largest amount of MESBIC assistance between 1983 and 1987, with a total of \$422 million. These states received 77 percent of all MESBIC financing over the 5-year period (\$547.5 million), with New York claiming about 44 percent of the total. Table 1.2 ranks the 5-year MESBIC funding totals for all states.

Figure 1.3: Distribution of MESBIC Financings by State, 1987



Source: GAO analysis of SBA data.

Figure 1.4: Distribution of MESBIC Financings by State, 1983 Through 1987



Source: GAO analysis of SBA data.

Table 1.2: MESBIC Financing Trends By State, 1983 to 1987

State	Dollars financed					5-Year total	Percent of 5-year total
	1983	1984	1985	1986	1987		
New York	\$13,017,395	\$34,323,318	\$52,774,516	\$79,279,890	\$61,011,166	\$240,406,285	43.91
California	13,274,138	16,007,718	20,468,338	17,775,767	20,611,608	88,137,569	16.10
Michigan	5,274,826	6,647,072	8,529,208	8,070,906	10,594,397	39,116,409	7.14
Texas	2,208,720	4,498,112	6,735,062	10,337,419	10,605,993	34,385,306	6.28
New Jersey	871,900	1,933,500	4,094,851	6,370,796	6,547,467	19,818,514	3.62
Florida	2,205,597	1,292,765	3,460,700	2,703,490	5,239,750	14,902,302	2.72
Illinois	1,286,513	2,381,250	2,233,405	4,659,930	3,191,351	13,752,449	2.51
Alabama	1,726,200	1,382,800	1,051,404	2,212,131	1,453,850	7,826,385	1.43
Puerto Rico	3,051,768	3,204,496	405,669	400,000	0	7,061,933	1.29
Dis. of Columbia	260,750	561,362	631,000	719,000	4,503,178	6,675,290	1.22
Georgia	1,200,000	1,101,001	870,450	3,110,000	308,400	6,589,851	1.20
Arkansas	1,554,284	525,797	705,000	2,053,670	956,000	5,794,751	1.06
Pennsylvania	1,216,351	1,389,408	1,247,000	1,010,500	821,025	5,684,284	1.04
Massachusetts	235,000	750,000	586,662	906,800	2,682,400	5,160,862	0.94
Louisiana	657,000	1,311,325	972,150	1,184,125	566,500	4,691,100	0.86
Maryland	393,000	1,204,690	1,215,120	652,562	979,170	4,444,542	0.81
Virginia	475,000	885,000	640,000	1,093,000	991,500	4,084,500	0.75
Tennessee	756,361	850,548	709,582	524,000	670,500	3,510,991	0.64
Colorado	7,500	980,038	200,000	731,008	1,563,800	3,482,346	0.64
Ohio	912,687	1,192,500	380,000	500,000	300,000	3,285,187	0.60
New Mexico	1,389,121	633,198	150,000	197,500	892,253	3,262,072	0.60
Washington	270,000	25,000	1,875,003	366,000	325,000	2,861,003	0.52
Nebraska	833,100	1,189,254	55,000	73,425	152,400	2,303,179	0.42
Minnesota	674,950	230,500	190,000	0	1,093,000	2,188,450	0.40
Kentucky	106,400	314,200	733,425	510,913	280,500	1,945,438	0.36
Mississippi	557,500	683,000	0	175,000	475,571	1,891,071	0.35
Connecticut	941,400	325,000	352,500	90,000	150,000	1,858,900	0.34
Hawaii	448,000	110,000	155,000	310,000	697,632	1,720,632	0.31
Alaska	378,000	473,000	241,600	5,800	0	1,098,400	0.20
South Carolina	86,500	674,000	61,000	212,000	0	1,033,500	0.19
Indiana	258,950	100,000	43,500	33,000	517,000	952,450	0.17
Wisconsin	0	425,400	0	85,000	398,438	908,838	0.17
Missouri	0	180,000	311,100	31,500	381,700	904,300	0.17
North Carolina	200,000	240,000	200,000	40,000	121,900	801,900	0.15
Oklahoma	100,000	200,000	0	217,750	220,550	738,300	0.13
Wyoming	0	0	465,010	177,800	4,376	647,186	0.12
Kansas	0	0	400,000	0	72,500	472,500	0.09
Arizona	115,307	340,000	5,000	0	0	460,307	0.08
Delaware	0	280,000	100,000	50,000	0	430,000	0.08
Oregon	0	317,500	0	81,000	0	398,500	0.07
New Hampshire	0	0	0	300,000	0	300,000	0.05
Virgin Islands	0	300,000	0	0	0	300,000	0.05
North Dakota	0	0	0	0	235,600	235,600	0.04
West Virginia	0	0	0	0	225,500	225,500	0.04
Utah	0	217,500	0	0	0	217,500	0.04

Iowa	0	0	74,600	61,500	50,000	186,100	0.03
Maine	0	0	71,000	115,000	0	186,000	0.03
South Dakota	0	35,000	15,000	0	60,000	110,000	0.02
Vermont	32,000	0	0	0	0	32,000	0.01
Montana	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00</u>
Total	<u>\$56,976,218</u>	<u>\$89,715,252</u>	<u>\$113,408,855</u>	<u>\$147,428,182</u>	<u>\$139,951,975</u>	<u>\$547,480,482</u>	<u>100.00%</u>

Note: Rhode Island, Nevada, and Idaho did not receive any MESBIC funding for above years.

Source: GAO analysis of SBA data.

SECTION 2

INVESTMENT COMPANY ASSISTANCE TO SMALL BUSINESSES BY TYPES OF FINANCIAL ARRANGEMENTS

SBA requires SBICs and MESBICs to report their distribution of venture capital financings in three categories--debt-only, debt/equity, and equity-only--depending on the type of security the business pledges to obtain the financing.¹ In 1987 and from 1983 to 1987, SBIC financial arrangements with small businesses were generally equally distributed among these three categories, although the distributions fluctuated annually. By contrast, MESBIC venture capital investments over the same periods were mostly secured by debt, ranging from 67 percent to 80 percent of the total annual funds financed.

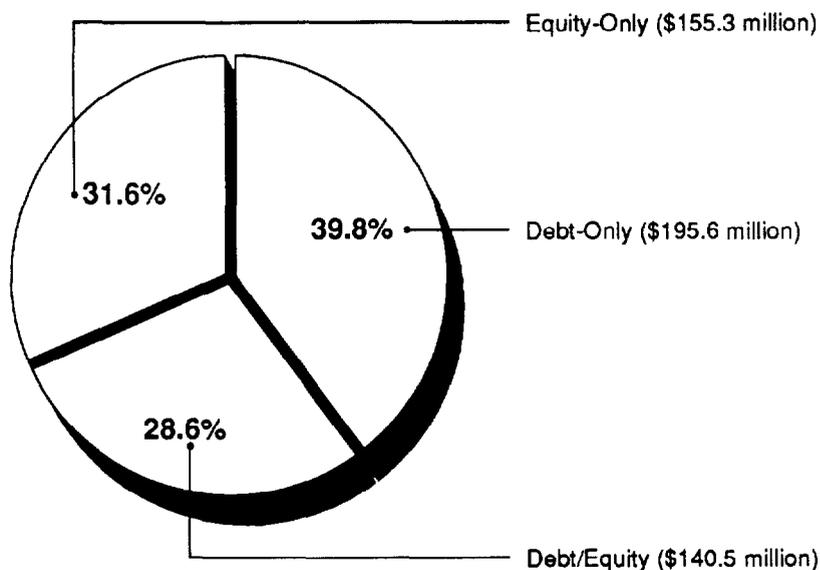
SBIC FINANCING ARRANGEMENTS

Figure 2.1 shows the distribution of total SBIC financings in 1987 according to the three SBA financing categories. The SBIC financings were fairly evenly distributed among the categories.

Debt-only financings comprised \$684.3 million (30 percent) of total small business SBIC financings over the period 1983 to 1987; debt/equity financings comprised \$767.9 million (34 percent); and equity-only financings comprised \$834.3 million (36 percent). As figure 2.2 shows, the proportion of debt-only financings gradually increased from a low of 24 percent (\$102.7 million) in 1983 to 40 percent (\$195.6 million) in 1987. As the proportion of debt-only

¹SBA defines debt-only as a financing arrangement secured by an instrument of indebtedness; equity-only as one secured only by an ownership interest (equity) in the business concern; and debt/equity as an arrangement secured by both an instrument of indebtedness and an equity interest in the small business concern.

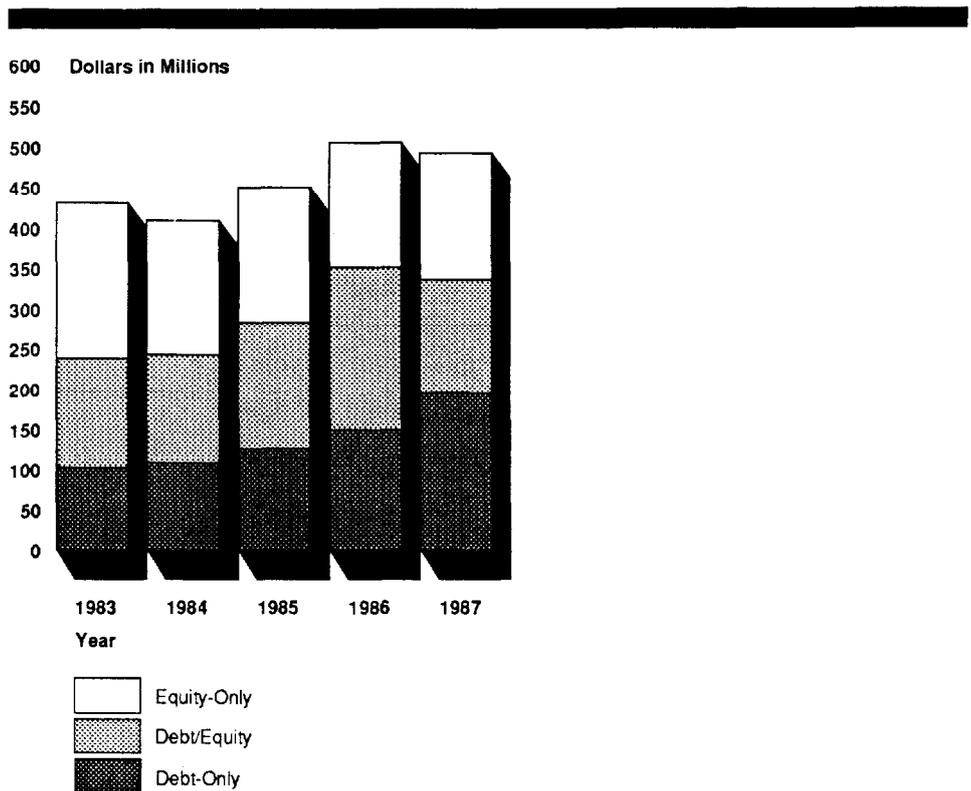
Figure 2.1: Breakout of SBIC Financings by Type, 1987



Source: GAO analysis of SBA data.

financings grew, the proportion of equity-only financings correspondingly decreased, dropping from 45 percent (\$192.9 million) in 1983 to a low of 30 percent (\$153 million) in 1986. The proportion of debt/equity financings shifted from 31 percent (\$135.5 million) in 1983 to 40 percent (\$201 million) in 1986 and then dropped to 29 percent (\$140.5 million) in 1987.

Figure 2.2: Breakout of SBIC Financings by Type, 1983 Through 1987



Source: GAO analysis of SBA data.

MESBIC FINANCING ARRANGEMENTS

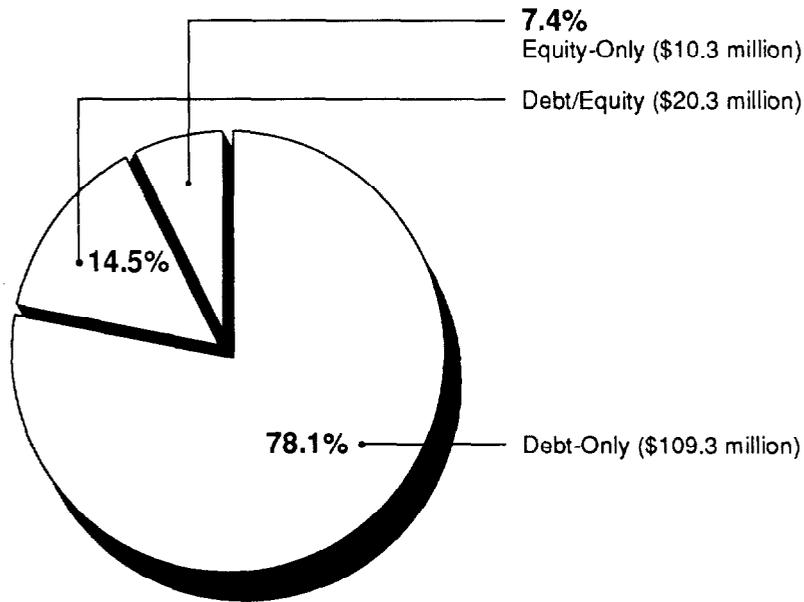
MESBIC financings in 1987 were heavily debt-oriented (\$109.3 million, or 78.1 percent of the total dollars), as figure 2.3 shows. Debt/equity financings at \$20.3 million made up 14.5 percent of the total, while equity-only financings at \$10.3 million constituted the smallest category (7.4 percent).

From 1983 to 1987, debt-only financings comprised \$422.2 million, or 77.1 percent of the MESBIC portfolio; debt/equity financings comprised \$73.3 million, or 13.4 percent of the portfolio; and equity-only financings comprised \$52 million, or 9.5 percent. Debt-only financings, as illustrated in figure 2.4, consistently made up the largest portion of MESBIC financings between 1983 and 1987, growing from 67 percent of the total \$57 million in 1983 (\$38.4 million) to a high of 80 percent of the total \$147.4 million (\$117.3 million) in 1986.

The distribution of MESBIC debt/equity and equity-only financings fluctuated over the 5-year period. Debt/equity financings made up 21 percent of all financing in 1983 (\$11.8

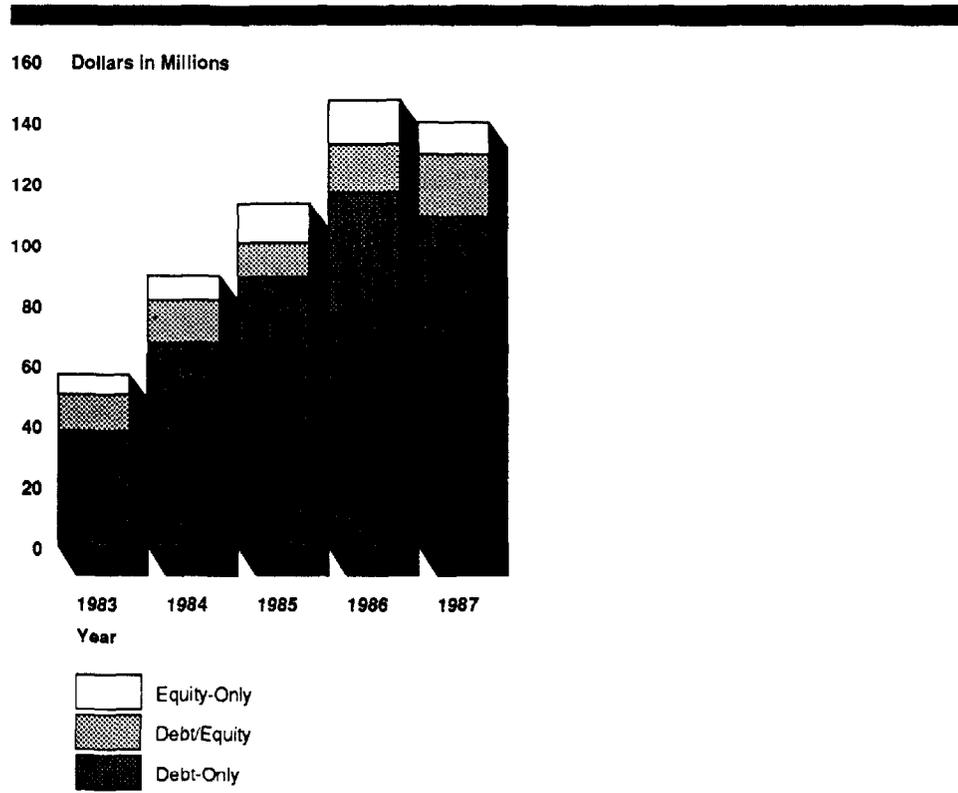
million), fell to 10 percent (\$11.4 million) in 1985, and then rose to 15 percent (\$20.3 million) in 1987. The distribution of equity-only financings also fluctuated annually, with the highest percentage of equity-only financings at 12 percent in 1983 (\$6.7 million). The lowest percentage occurred in 1987, when equity-only financings accounted for 7 percent (\$10.3 million) of MESBIC financing.

Figure 2.3: Breakout of MESBIC Financings by Type, 1987



Source: GAO analysis of SBA data.

Figure 2.4: Breakout of MESBIC Financings by Type, 1983 Through 1987



Source: GAO analysis of SBA data.

SECTION 3

INDUSTRIES RECEIVING LARGEST AMOUNTS OF INVESTMENT COMPANY FINANCING

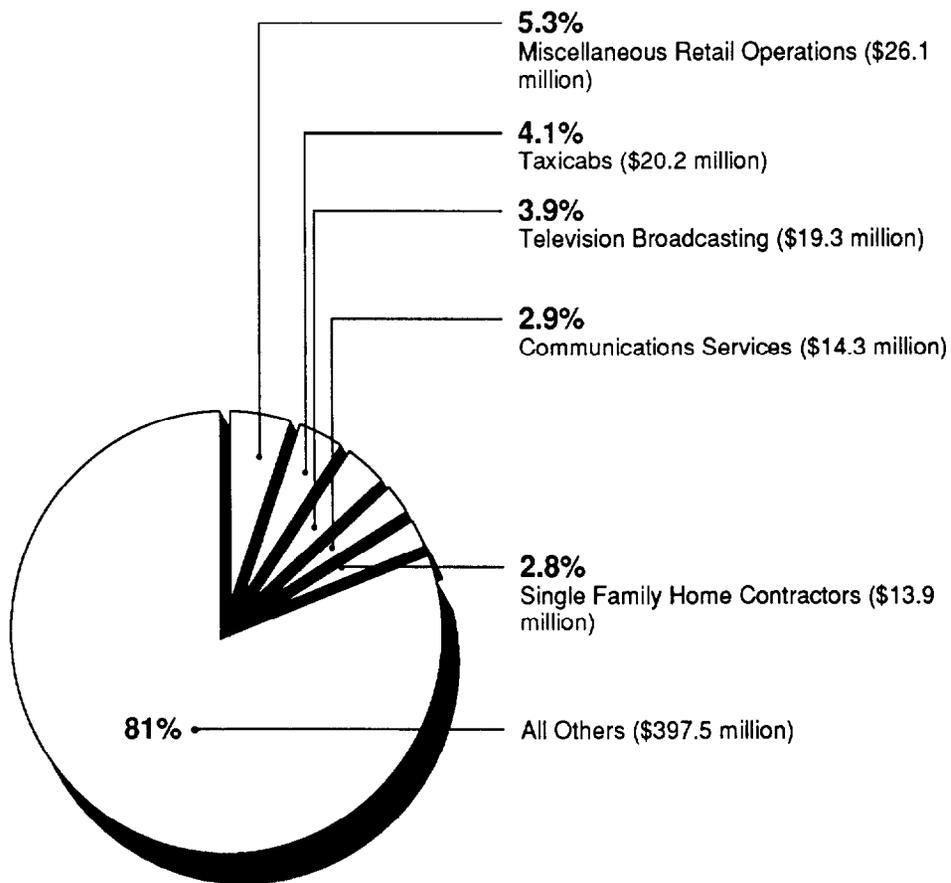
From 1983 to 1987, SBICs and MESBICs have assisted small businesses in hundreds of industries by providing them venture capital. For 1987 and the period 1983 to 1987, we identified the five industries receiving the largest shares of SBIC and MESBIC financings. Over these periods, we found that the five largest MESBIC-assisted industries received a much greater proportion of the total funds than did the five largest SBIC-assisted industries. From 1983 to 1987, almost 50 percent of the total MESBIC financing was invested in five industries, while five SBIC-assisted industries received less than 20 percent of the total SBIC financing.

INDUSTRIES RECEIVING THE LARGEST SBIC FINANCING AMOUNTS

To identify the five industries that received the greatest amounts of SBIC and MESBIC financings, we analyzed the 4-digit Standard Industrial Classification (SIC) codes as reported to SBA by the investment companies. Figure 3.1 profiles the five industries that received the most SBIC funding during 1987. Together, these industries accounted for 19 percent (\$93.8 million) of all SBIC activity for that year. The remaining 81 percent of SBIC financing in 1987 was distributed across hundreds of other reported industry classifications.¹

¹It is important to note, however, that some other industries may be related to the five SBIC and MESBIC groupings in our analysis. Generally speaking, these industries made up much smaller fractions of the total investment company financing and are not included in our analysis.

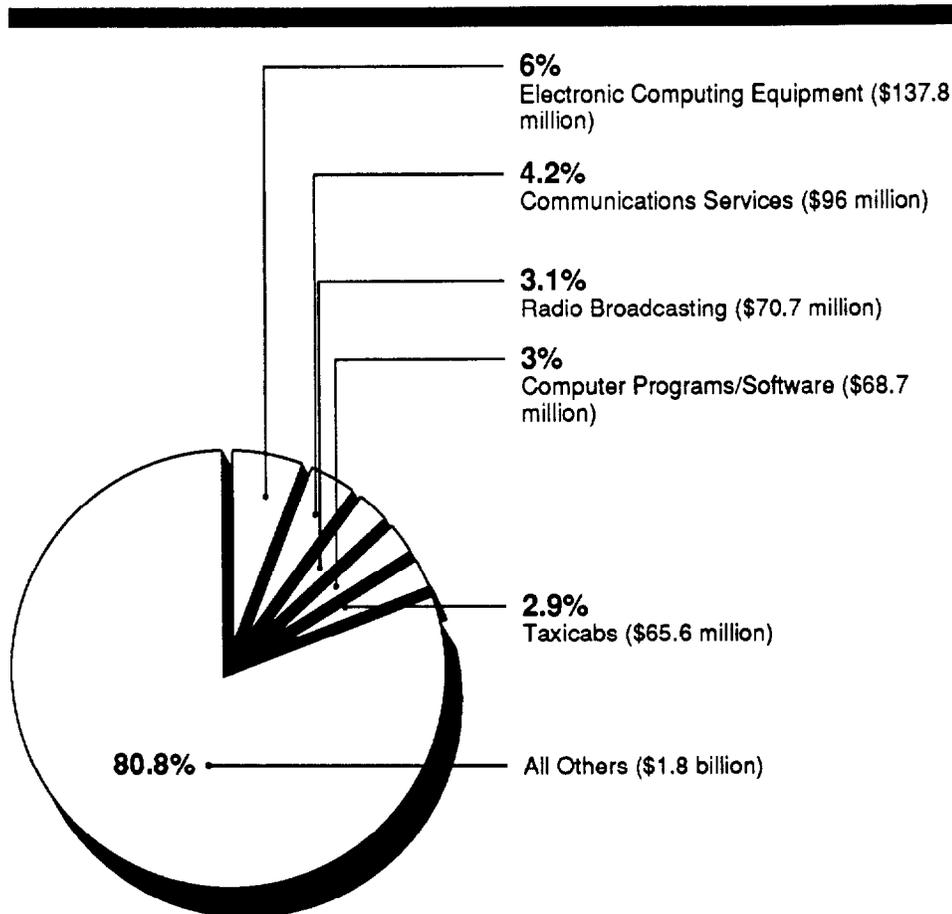
Figure 3.1: Five Industries Receiving Largest Amounts of SBIC Financing, 1987



Source: GAO analysis of SBA data.

As figure 3.2 shows, the five industries receiving the largest share of SBIC financing differed for the period 1983 to 1987. Cumulatively, these industries accounted for about 19 percent (\$438.8 million) of all SBIC financings, with the remaining 81 percent (\$1.8 billion) distributed across hundreds of other industries.

Figure 3.2: Five Industries Receiving Largest Amounts of SBIC Financing, 1983 Through 1987



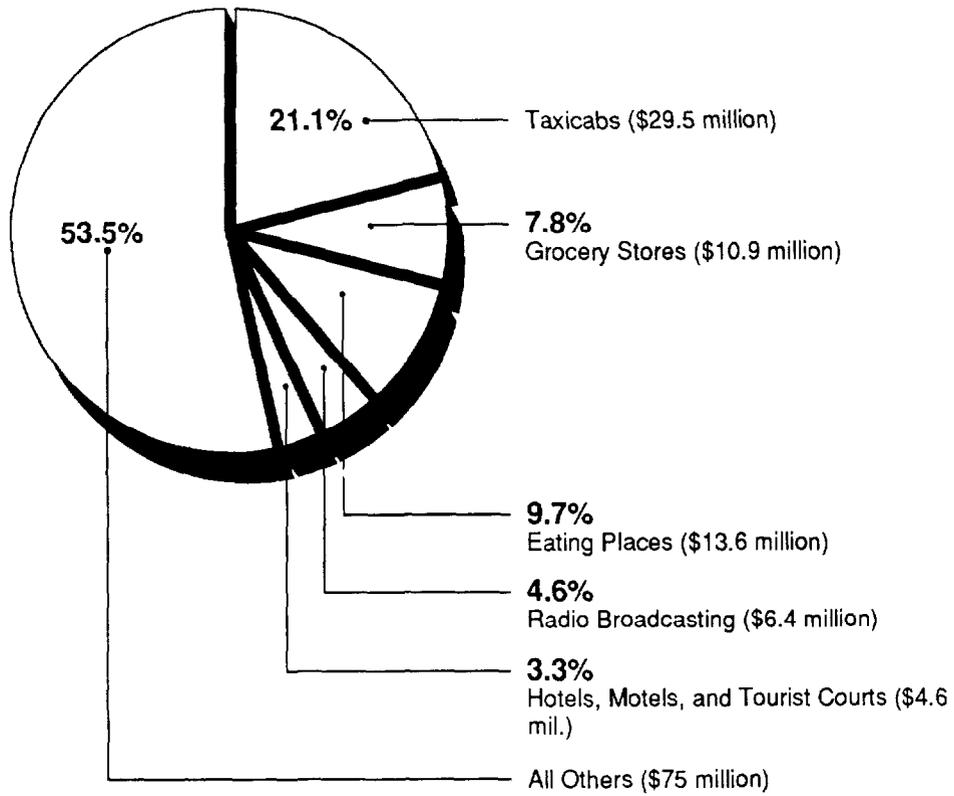
Source: GAO analysis of SBA data.

INDUSTRIES RECEIVING THE LARGEST MESBIC FINANCING AMOUNTS

The five industries with the largest shares of MESBIC financing during 1987 are shown in figure 3.3. Nearly half (\$65 million) of all MESBIC financings was invested in five industries. In contrast, the five industries receiving the largest SBIC financing shares accounted for less than 20 percent of all financings. The taxicab industry, alone, claimed more than one-fifth of all MESBIC financings, receiving \$29.5 million. In addition to the five most heavily financed industries, hundreds of other small businesses in different industries received MESBIC assistance totaling \$75 million.

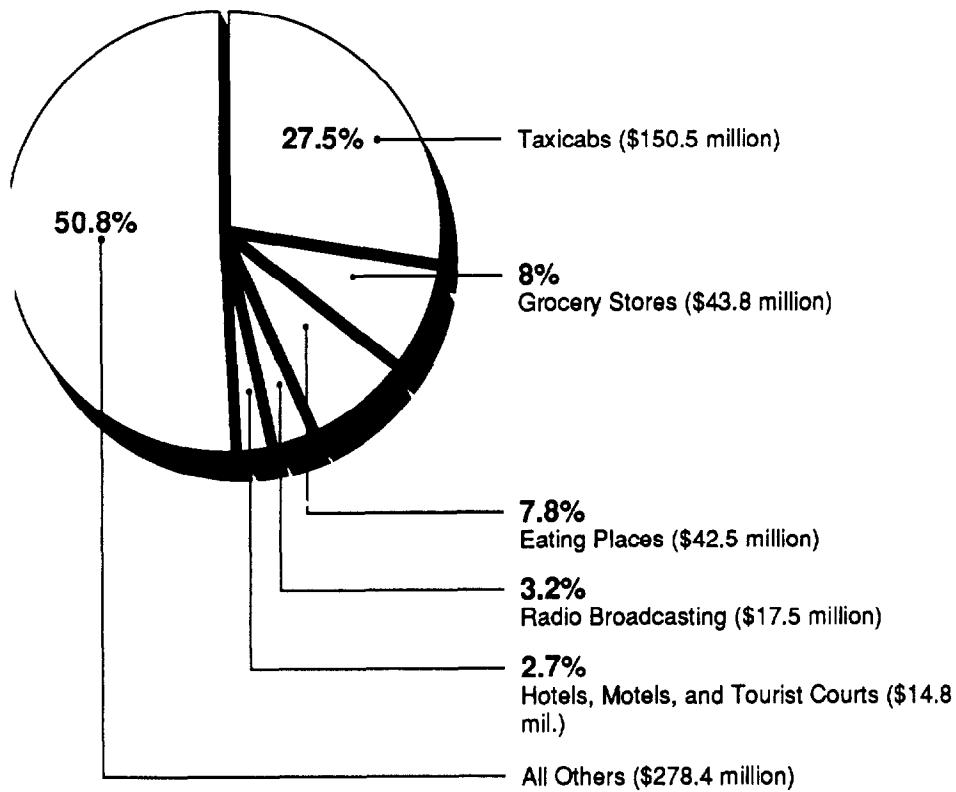
Figure 3.4 shows that from 1983 to 1987, the five industries receiving the largest share of MESBIC financings also accounted for about one-half (\$269.1 million) of all MESBIC financings, a pattern resembling the 1987 distribution. The taxicab industry received \$150.5 million, over one-fourth of the total financings for this period. In comparison, the top five industries financed by SBICs made up about 19 percent of the total SBIC financing over the 5 years. The remaining MESBIC investment (\$278.4 million) was spread across many other industries.

Figure 3.3: Five Industries Receiving Largest Amounts of MESBIC Financing, 1987



Source: GAO analysis of SBA data.

Figure 3.4: Five Industries Receiving Largest Amounts of MESBIC Financing, 1983 Through 1987



Source: GAO analysis of SBA data.

SECTION 4

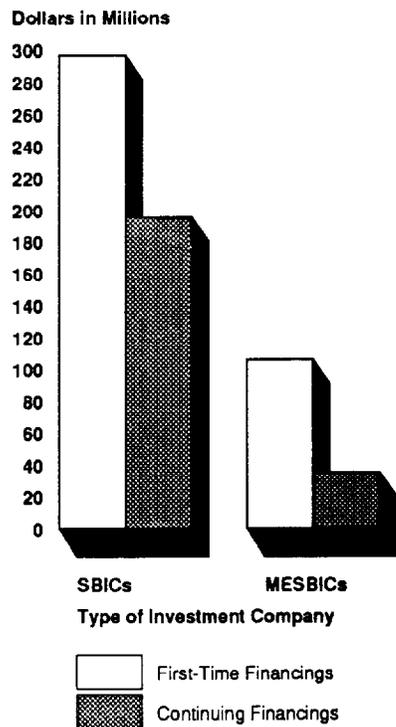
TRENDS IN FINANCING TIMING AND OTHER CHARACTERISTICS OF SBIC AND MESBIC FINANCINGS

As requested, we also analyzed other information from SBA's database on characteristics of SBIC and MESBIC financings for 1987 and for the period 1983 to 1987. These included the distribution of funds for start-up (first-time) financing by small businesses compared with ongoing (continuing) financing; the intended purpose of the financing proceeds by the small businesses; and the interest rates that investment companies charge small businesses for the capital they provide. Over the analysis periods, we found that both SBICs and MESBICs concentrated most of their financings in first-time ventures. SBICs, however, channeled a greater proportion of their small business financings to continuing small business operations than did MESBICs. We also found that in 1987 small businesses used over one-half of all SBIC and MESBIC financing proceeds for operating capital. Finally, we found that MESBIC financial arrangements with small businesses for 1987 generally were distributed among a similar range of interest rates as SBIC arrangements. However, the latter had higher degrees of debt-equity and equity participation.

COMPARISON OF THE TIMING OF INVESTMENT COMPANY FINANCING

Figure 4.1 shows the distribution of SBIC and MESBIC dollars invested in small businesses during 1987 according to whether financings were reported as "first-time" or "continuing." SBA defines a first-time financing as one in which a small business has not received any previous assistance from a SBIC or a MESBIC; a continuing financing is any financing provided after the first financing.

Figure 4.1: Distribution of First-Time and Continuing Financings for SBICs and MESBICs, 1987

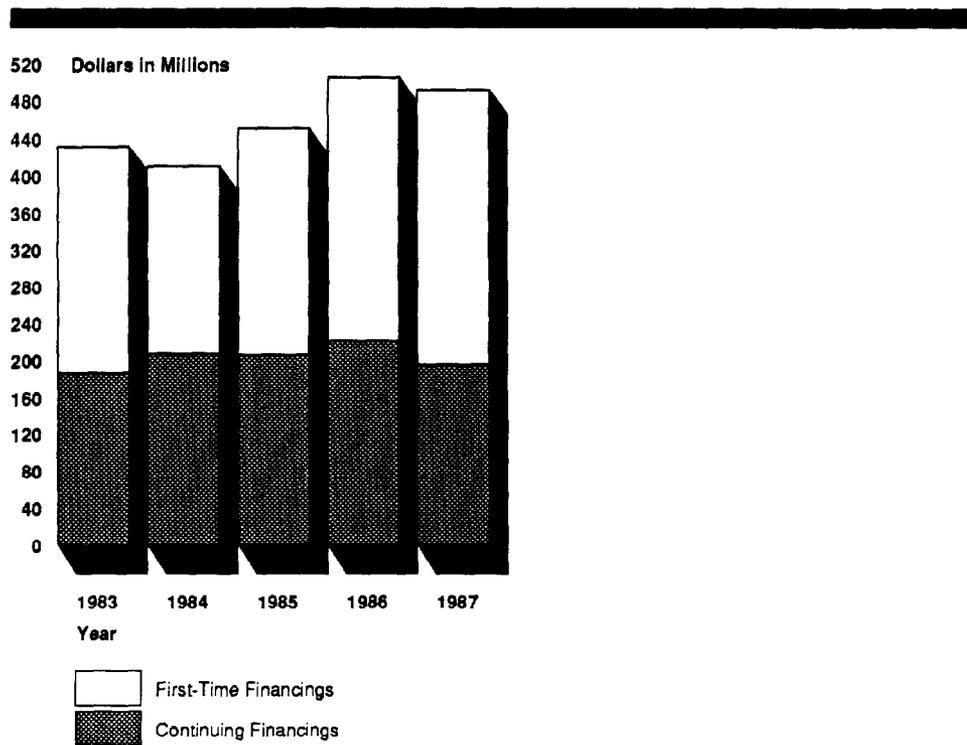


Source: GAO analysis of SBA data.

As figure 4.1 illustrates, first-time SBIC financings amounted to \$296.4 million (60.3 percent of the total SBIC financing) during 1987, compared with \$194.9 million (39.7 percent) in continuing financings. While MESBIC first-time financings, at \$105.4 million, were lower, they comprised a higher proportion of the total MESBIC financings (75.3 percent). Likewise, at \$34.6 million, MESBIC continuing financings comprised a lower proportion of total financing (24.7 percent) than such financings in the SBIC program.

Between 1983 and 1987, SBICs provided \$1.3 billion in venture capital for first-time financings and another \$1.0 billion for continuing financings. Figure 4.2 shows the trends in each category by year. With the exception of 1984, the proportion of SBIC first-time financings to overall financings gradually increased. In 1983, approximately 57 percent (\$244.6 million) of the total were first-time financings. By 1987, this category accounted for 60 percent, or \$296.4 million, of the total financing.

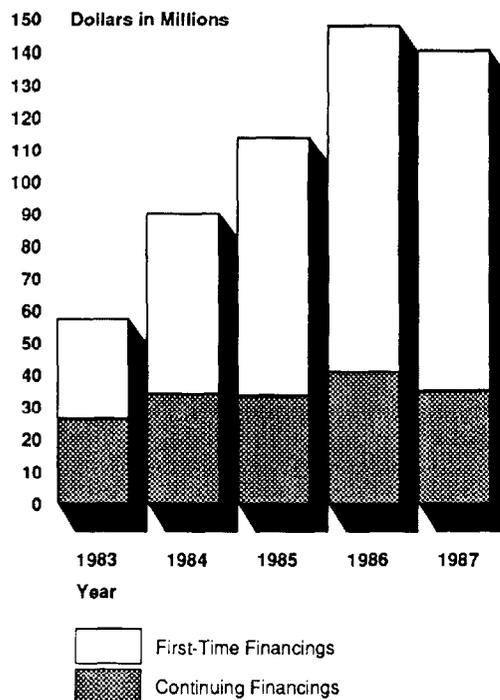
Figure 4.2: Trends in First-Time and Continuing Financings for SBICs, 1983 to 1987



Source: GAO analysis of SBA data.

From 1983 to 1987, MESBICs provided \$379.7 million in venture capital for first-time financings and another \$167.8 million for continuing financings. Figure 4.3 shows the annual trends for each category. Over the period, MESBICs more than tripled the number and funding level of first-time financings. In 1983, first-time financings totaled \$31.1 million, but by 1986 they had peaked at \$106.9 million. The proportion of first-time financings grew from 54.7 percent in 1983 to 75.3 percent in 1987.

Figure 4.3: Trends in First-Time and Continuing Financings for MESBICs, 1983 to 1987



Source: GAO analysis of SBA data.

SMALL BUSINESSES' USE OF INVESTMENT COMPANY FINANCING PROCEEDS

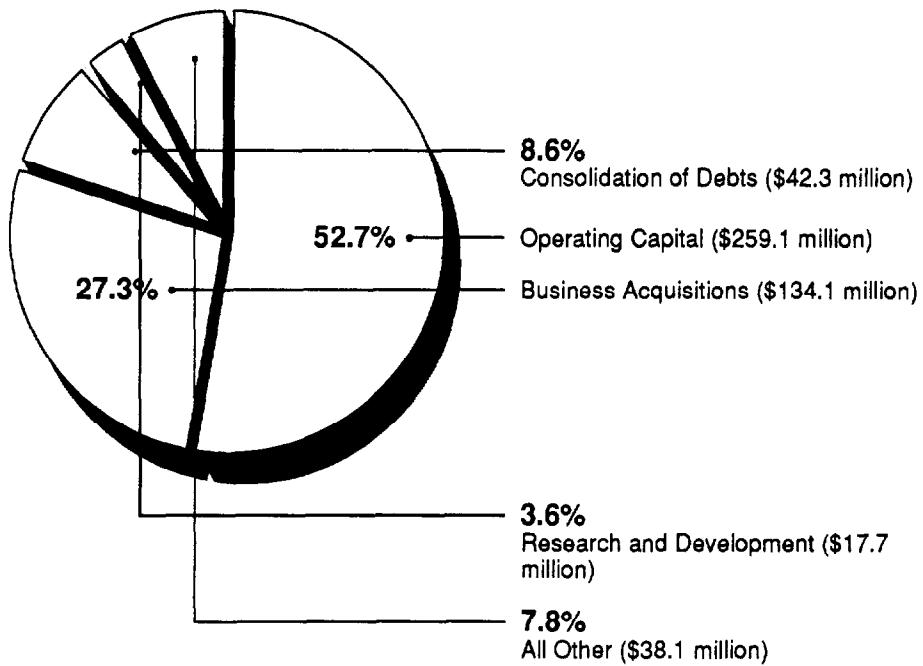
SBA requires SBICs and MESBICs to furnish SBA with information on small businesses' primary intended use for venture capital funds they receive from the investment companies. On the basis of the investment companies' reported information, SBA classifies the purpose of SBIC/MESBIC financings in 10 general categories.¹ SBA started entering purpose-of-financing information into its

¹The 10 general categories that SBA reports for financing purpose are (1) operating capital or inventory purchases; (2) plant modernization or leasehold improvements; (3) acquisition of all or part of an existing business, asset acquisitions, or stock purchases; (4) consolidation of obligations or non-SBIC debt refunding; (5) new building or plant construction; (6) acquisition of machinery and equipment; (7) land acquisition or building of dwellings on existing land; (8) marketing activities; (9) research and development; and (10) other.

automated database in 1987 and during our review was in the process of entering this information retroactively for 1983 to 1986. Because the 1983 to 1986 information was unavailable at the time of our review, we analyzed only the 1987 data.

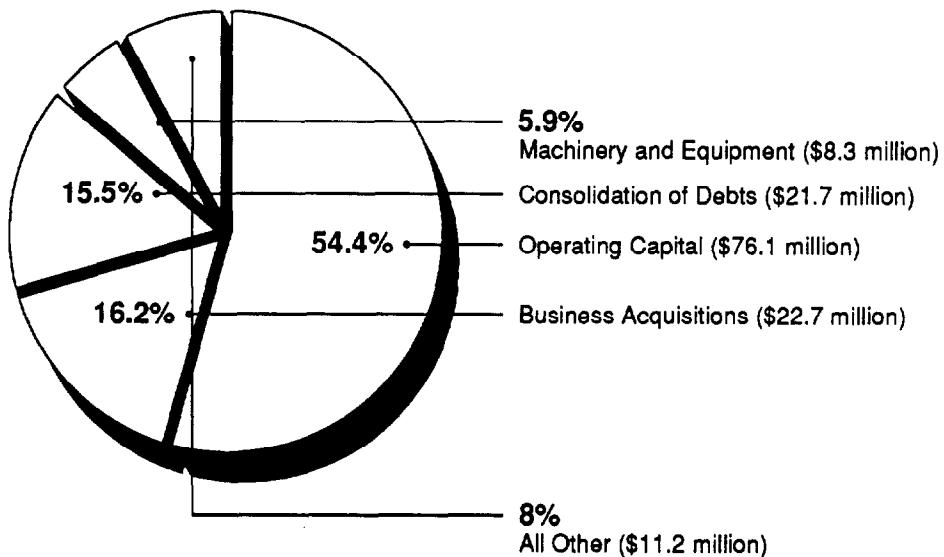
As shown in figure 4.4, over half of all SBIC financings (\$259.1 million) reported in 1987 provided the recipient small businesses with operating capital. The second greatest amount was for business acquisitions (27.3 percent), which accounted for \$134.1 million. Figure 4.5 shows that similarly in 1987, over one-half of all MESBIC financings (54.4 percent) provided operating capital for small businesses, and business acquisitions accounted for the second largest amount, \$22.7 million (16.2 percent). In reviewing this section, SBA stated that its information on the purpose of financing from 1983 to 1987 shows that small businesses' use of the financing proceeds mirrored our 1987 results.

Figure 4.4: Purpose of SBIC Investments, 1987



Source: GAO analysis of SBA data.

Figure 4.5: Purpose of MESBIC Investments, 1987



Source: GAO analysis of SBA data.

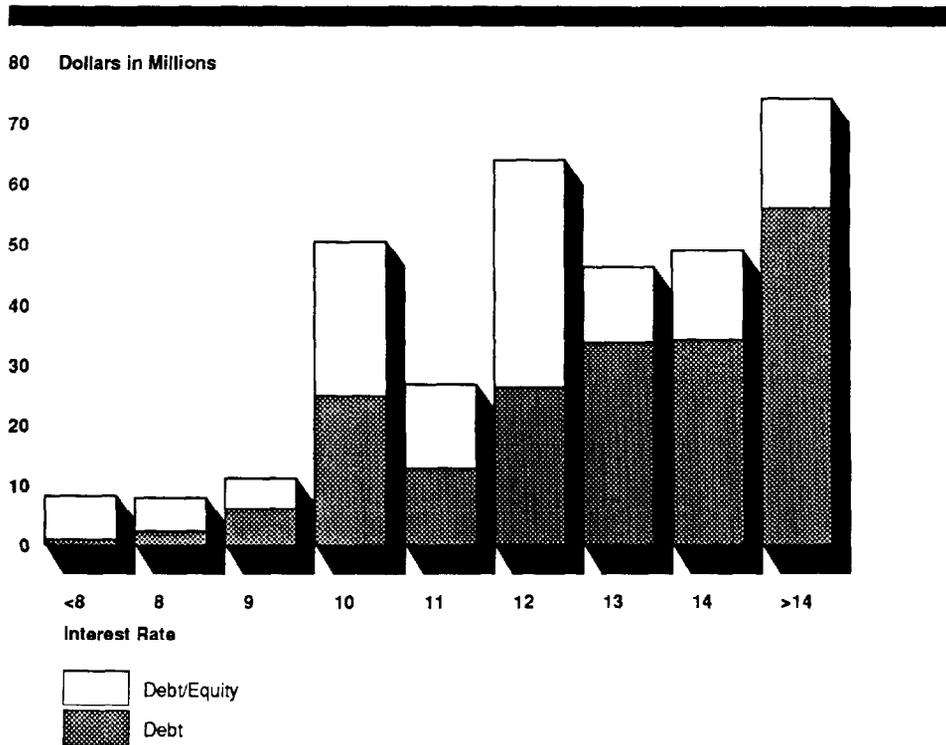
INTEREST RATES OF INVESTMENT COMPANY
FINANCING ARRANGEMENTS

We analyzed SBIC and MESBIC financings according to the interest rates that SBICs and MESBICs reported for the financings in 1987. SBA began entering interest rate information on SBIC and MESBIC financings into its automated database in 1987. At the time of our review, SBA was in the process of entering interest rate information retroactively from 1983 to 1986. Because the past-year information was not available, we analyzed only the 1987 interest rate information. Our analysis was also limited by SBA's method of entering interest rate information into the database. SBA enters the financing interest rate as a whole number and excludes any fractions. For example, the value of an interest rate that SBA enters into the "8 percent" category may actually fall within an interest rate range of 8 percent or greater, but less than 9 percent.

Figure 4.6 shows the distribution of 1987 SBIC financings, identifying the value of loans at each interest rate category for debt-only- and debt/equity-type financing. These loans constituted about \$336 million (68 percent) of the total SBIC financing in 1987. An additional \$155.3 million (32 percent) was financed as equity-only transactions, but it is not shown in the chart because this financing is secured by an ownership share of the business rather than by an obligation to repay the financing with interest.

As figure 4.6 illustrates, amounts of SBIC debt-only financings generally were concentrated among the higher-interest-rate categories, with about 63 percent of total debt-only financings (\$123.1 million) made at interest rates of 13 percent or higher. On the other hand, the amounts of SBIC debt/equity financings (\$140.5 million in total) were generally distributed among lower-interest-rate categories, with the majority--\$95.2 million (68 percent)--financed at interest rate categories of 12 percent or less.

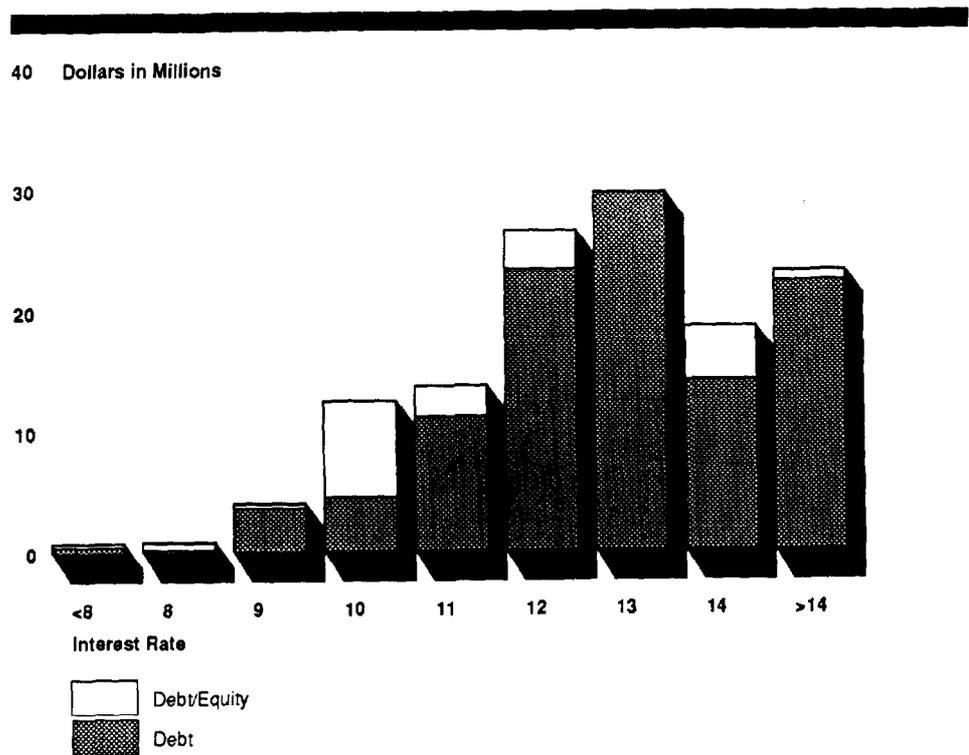
Figure 4.6: Distribution of SBIC Financings by Loan Interest Rate and Type of Financing, 1987



Source: GAO analysis of SBA data.

Figure 4.7 shows the distribution of interest rates in 1987 for MESBIC debt-only and debt/equity financings at each interest rate category. These financing types comprised about \$129.6 million (93 percent) of the total MESBIC financing. The chart does not show the additional \$10.3 million in MESBIC financing in 1987 for equity-only transactions (7 percent of the total). Compared with SBICs, MESBICs had proportionately a much smaller degree of financings with equity participation.

Figure 4.7: Distribution of MESBIC Financings by Loan Interest Rate and Type of Financing, 1987



Source: GAO analysis of SBA data.

As illustrated in figure 4.7, about 61 percent of the MESBIC debt-only financings of \$109.3 million in 1987 were concentrated at interest rates of 13 percent or greater. In contrast, debt/equity financings made up about \$20.3 million of total MESBIC financings in 1987. The majority of this amount (73 percent) was financed at interest rates of less than 13 percent. Moreover, compared with SBICs (see fig. 4.6), MESBICs had a lower proportion of debt/equity financings.

SECTION 5

FLOW OF FUNDS INSIDE AND OUTSIDE THE STATES AND REGIONS WHERE THE INVESTMENT COMPANIES ARE LOCATED

We identified state and regional distributions of SBIC and MESBIC venture capital financing in 1987 to show the amounts that were distributed to small businesses located within the same state and region as the investment companies. On a statewide basis, there were great differences in the distributions of SBIC financings and MESBIC financings within and outside the companies' home states. SBICs predominately funded small businesses located outside their home states, while MESBICs funded a higher concentration of businesses within their home states. Regionally, SBIC funding went mainly to businesses located outside the SBICs' home regions. SBIC activity among the nine SBA regions fluctuated greatly. On the other hand, the vast majority of MESBIC assistance was provided to businesses located within MESBICs' home regions. In both cases, however, small businesses in one region--the Middle Atlantic region--received the largest share of the overall SBIC and MESBIC financings.

VENTURE CAPITAL DOLLAR FLOW BY INVESTMENT COMPANY STATE

For SBICs and MESBICs, we used SBA's automated database to analyze the distribution of total venture capital funds within and outside the states where the investment companies are located. SBA started entering information to identify the flow of venture capital funds into its automated database in 1987 and during our review was in the process of entering this information retroactively for 1983 to 1986. Because the 1983 to 1986 information was unavailable at the time of our review, we analyzed only the 1987 SBIC and MESBIC data.

SBIC Activity

Table 5.1 shows the distribution of venture capital in 1987 that SBICs provided to small businesses both within and outside their states. Nationwide, SBICs made more financings to businesses located within the same state (1,389 versus 861), but the financings totaled fewer dollars than those made to businesses outside the state (\$221.9 million versus \$252.7 million). There was insufficient information in the 1987 database to identify the destination of \$16.7 million (3.4 percent of the total financings) by state.

As shown in table 5.1, dollar flows within and outside the SBICs' home states varied substantially from state to state. New York SBICs had a particularly large volume of dollar activity both within (\$64.2 million) and outside the state (\$94.1 million).

SBICs in Texas and California, on the other hand, predominately funded businesses within their own states (respectively, \$41.5 million versus \$16.3 million and \$28.2 million versus \$9.0 million). Massachusetts SBICs showed the opposite trend, with only \$2.9 million provided to within-state businesses and \$43.8 million provided to out-of-state businesses.

MESBIC Activity

Table 5.2 shows the distribution of MESBIC venture capital provided to small businesses in 1987 located within or outside the MESBICs' home states. Nationwide, MESBICs financings made to businesses located within the same state were of much greater numbers (1,215 versus 299) and dollars (\$99.6 million versus \$36.8 million) than those made to businesses outside the state. There was insufficient information in SBA's database to identify the destination of \$3.6 million (2.6 percent of the total financings) by state. As table 5.2 also shows, New York MESBICs had the largest amount of dollar activity, with \$54.7 million provided to within-state businesses and \$7.7 million provided to businesses outside the state. California MESBICs were second, with financings of \$15 million provided to businesses within the state and \$3.2 million to businesses outside the state. Michigan and Texas MESBICs gave more funding to small businesses located within the state than those outside the state, at \$10.1 million versus \$0.6 million and \$5.4 million versus \$1.8 million, respectively.

Table 5.1: Flow of SBIC Funds Within and Outside the State Where the SBIC is Located, 1987

State	Within the state		Outside the state		National totals	
	No. of financings	Dollars	No. of financings	Dollars	No. of financings	Dollars
Alabama	9	\$1,293,000	8	\$1,720,429	17	\$3,013,429
Arkansas	3	440,681	0	0	3	440,681
Arizona	6	1,322,000	11	888,044	17	2,210,044
California	124	28,252,984	47	8,976,620	171	37,229,604
Colorado	1	100,000	0	0	1	100,000
Connecticut	233	29,070,225	73	10,163,052	306	39,233,277
Dis. of Columbia	8	1,950,000	44	6,544,200	52	8,494,200
Delaware	0	0	0	0	0	0
Florida	27	2,372,625	43	3,170,914	70	5,543,539
Georgia	4	246,000	8	1,467,000	12	1,713,000
Hawaii	0	0	5	1,053,000	5	1,053,000
Iowa	2	450,003	1	200,000	3	650,003
Illinois	17	4,629,911	45	17,243,429	62	21,873,340
Indiana	0	0	0	0	0	0
Kansas	4	955,594	0	0	4	955,594
Kentucky	8	103,000	11	562,000	19	665,000
Louisiana	16	833,191	2	310,755	18	1,143,946
Massachusetts	38	2,891,444	127	43,839,142	165	46,730,586
Maryland	3	491,600	25	6,671,433	28	7,163,033
Maine	3	140,000	0	0	3	140,000
Minnesota	65	8,848,685	45	18,653,334	110	27,502,019
Missouri	4	821,500	7	1,723,079	11	2,544,579
Mississippi	3	385,000	0	0	3	385,000
North Carolina	10	854,124	23	3,173,111	33	4,027,235
Nebraska	8	319,028	2	53,789	10	372,817
New Hampshire	1	101,000	2	101,186	3	202,186
New Jersey	11	1,511,835	21	3,241,500	32	4,753,335
New Mexico	9	610,000	3	166,750	12	776,750
Nevada	0	0	1	82,075	1	82,075
New York	464	64,221,292	170	94,170,149	634	158,391,441
Ohio	19	4,290,165	18	2,372,912	37	6,663,077
Oklahoma	3	1,140,000	3	440,000	6	1,580,000
Pennsylvania	23	1,941,724	8	2,221,180	31	4,162,904
Rhode Island	14	2,230,000	9	985,997	23	3,215,997
South Carolina	9	1,067,030	4	418,432	13	1,485,462
Texas	190	41,473,097	68	16,261,211	258	57,734,308
Virginia	16	3,316,381	19	4,231,656	35	7,548,037
Washington	2	280,000	1	20,000	3	300,000
Wisconsin	32	12,949,531	7	1,572,656	39	14,522,187
Subtotal	1,389	\$221,902,650	861	\$252,699,035	2,250	\$474,601,685
Plus: Unknown records					195	16,706,482
Total	<u>1,389</u>	<u>\$221,902,650</u>	<u>861</u>	<u>\$252,699,035</u>	<u>2,445</u>	<u>\$491,308,167</u>

Source: GAO analysis of SBA data.

Table 5.2: Flow of MESBIC Venture Capital Funds Within and Outside the State Where the MESBIC Is Located, 1987

State	Within the state		Outside the state		National totals	
	No. of financings	Dollars	No. of financings	Dollars	No. of financings	Dollars
Alabama	28	\$1,328,850	3	\$356,000	31	\$1,684,850
Arkansas	4	775,000	2	250,000	6	1,025,000
Arizona	0	0	0	0	0	0
California	210	14,961,142	18	3,196,050	228	18,157,192
Colorado	6	419,500	1	30,000	7	449,500
Connecticut	0	0	0	0	0	0
Dis. of Columbia	1	200,000	62	8,499,550	63	8,699,550
Florida	28	2,686,750	26	2,242,508	54	4,929,258
Georgia	2	174,400	0	0	2	174,400
Hawaii	7	591,632	0	0	7	591,632
Iowa	0	0	0	0	0	0
Illinois	33	1,869,701	15	1,258,896	48	3,128,597
Indiana	0	0	0	0	0	0
Kansas	0	0	0	0	0	0
Kentucky	2	115,000	2	155,000	4	270,000
Louisiana	2	56,500	1	250,000	3	306,500
Massachusetts	4	360,000	2	60,000	6	420,000
Maryland	1	40,000	0	0	1	40,000
Maine	0	0	0	0	0	0
Michigan	117	10,084,377	3	605,000	120	10,689,377
Minnesota	6	906,500	11	4,906,616	17	5,813,116
Missouri	0	0	0	0	0	0
Mississippi	0	0	1	200,000	1	200,000
North Carolina	0	0	0	0	0	0
Nebraska	1	44,000	0	0	1	44,000
New Hampshire	0	0	0	0	0	0
New Jersey	13	2,240,000	19	2,366,670	32	4,606,670
New Mexico	11	715,003	4	550,000	15	1,265,003
Nevada	0	0	0	0	0	0
New York	640	54,741,900	86	7,738,906	726	62,480,806
Ohio	0	0	2	75,000	2	75,000
Oklahoma	0	0	0	0	0	0
Pennsylvania	4	380,000	6	1,120,000	10	1,500,000
Rhode Island	0	0	0	0	0	0
South Carolina	0	0	0	0	0	0
Tennessee	9	670,500	0	0	9	670,500
Texas	74	5,408,243	13	1,824,000	87	7,232,243
Virginia	10	597,000	22	1,129,677	32	1,726,677
Washington	0	0	0	0	0	0
Wisconsin	2	187,038	0	0	2	187,038
Subtotal	1,215	\$99,553,036	299	\$36,813,873	1,514	\$136,366,909
Plus: Unknown records					52	3,585,066
Total	<u>1,215</u>	<u>\$99,553,036</u>	<u>299</u>	<u>\$36,813,873</u>	<u>1,566</u>	<u>\$139,951,975</u>

Source: GAO analysis of SBA data.

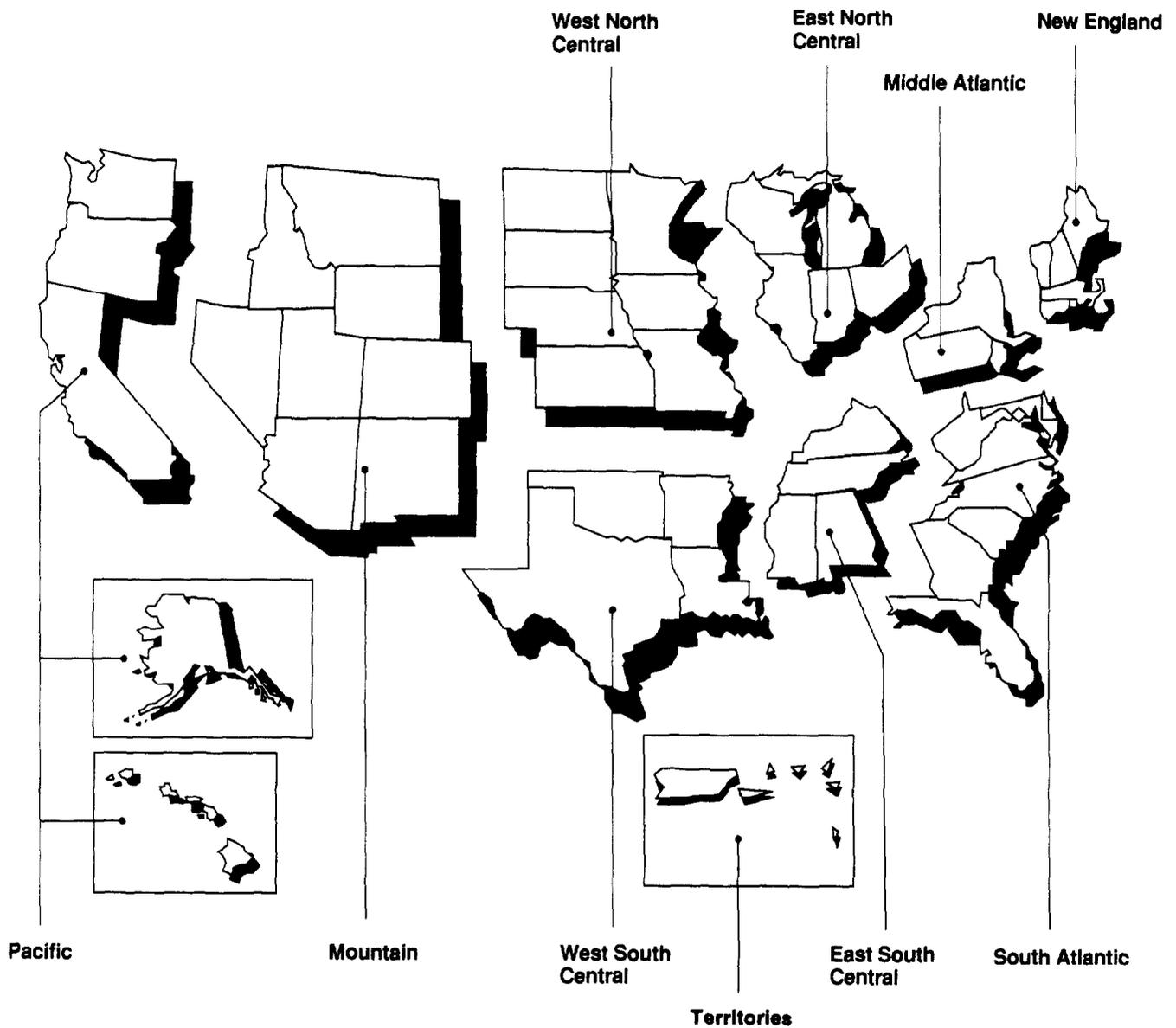
VENTURE CAPITAL DOLLAR FLOW BY
INVESTMENT COMPANY REGION

In addition to determining the flow of venture capital funds inside and outside the SBICs' and MESBICs' home states, we expanded our analysis to show the flow of these funds inside and outside the investment companies' home regions. We used the same regional classifications as SBA in preparing this analysis (see fig. 5.1).

SBIC Activity

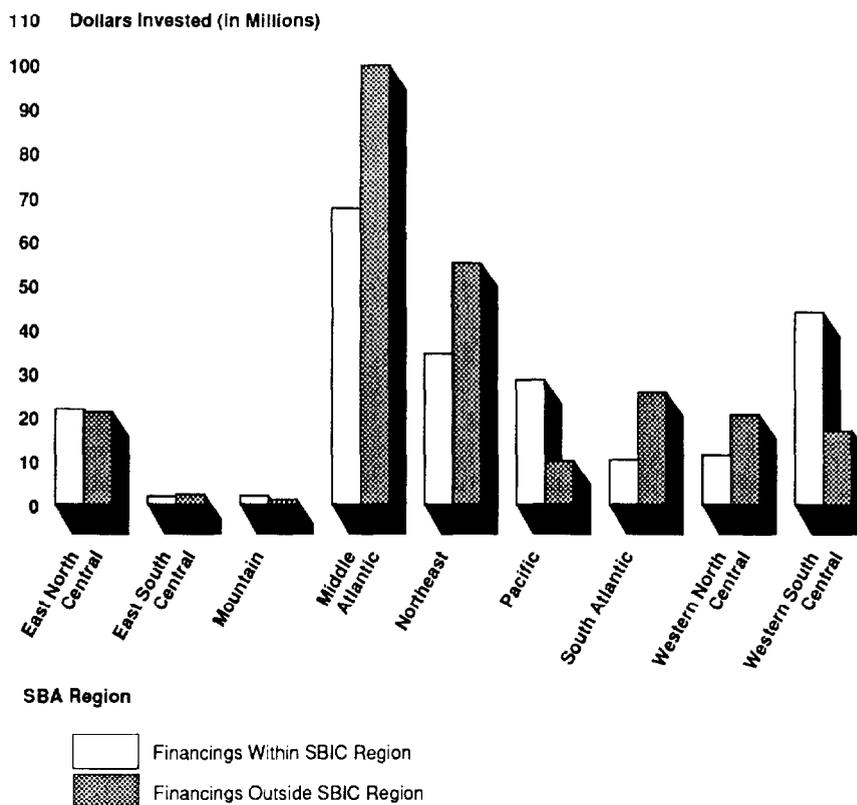
Figure 5.2 illustrates the flow of funds in 1987 within and outside the nine SBA regions where the SBICs financing the activity were located. As shown, the funding flows varied widely by region. Overall, Middle Atlantic regional small businesses received the greatest amount of funding, \$167.3 million, and the Mountain region the least, \$3.2 million. As discussed previously, we could not identify the destination of approximately \$16.7 million in SBIC transactions, about 3.4 percent of the total financings.

Figure 5.1: SBA Geographic Regions



Source: Small Business Administration, SBIC Digest (Apr. 1988).

Figure 5.2: Flow of SBIC Funds Within and Outside the Region Where the SBIC Is Located, 1987



Note: For SBA records of 195 financings (\$16.7 million), we were unable to identify whether the financing occurred within or outside the SBIC region.

Source: GAO analysis of SBA data.

In some regions, SBIC funding flows were generally equal; i.e., the dollar amounts going to small businesses outside the SBIC region were about the same as the dollar amounts going to small businesses within the region. For example, the East North Central region SBICs provided within-region financings of \$21.9 million and outside-of-region financings of \$21.2 million. In other regions, the flow was predominantly either within the region or outside the region. Within-region financings were proportionately greatest in the Pacific and Western South Central regions. The Pacific region SBICs provided \$28.5 million in venture capital to businesses within the region (74 percent) and \$10 million outside the region (26 percent). Western South Central region SBICs financed \$43.9 million of business activity within the region (72 percent) and \$17 million outside it (28 percent).

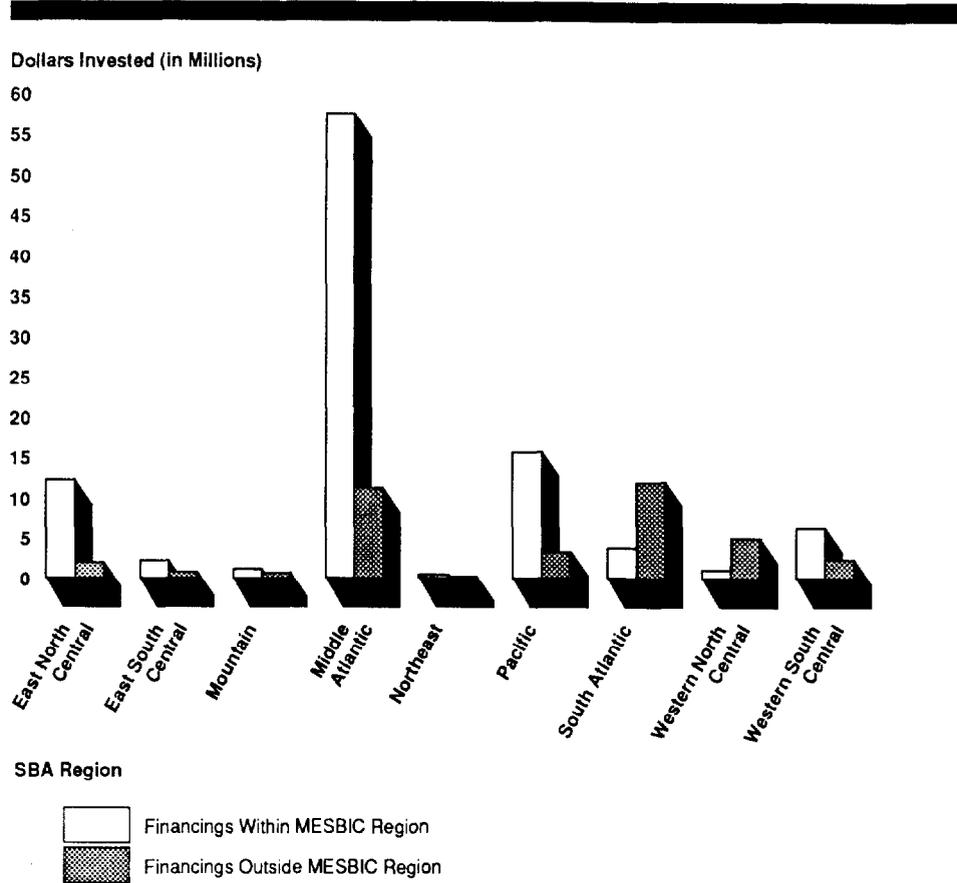
In five of the nine regions, however, the financing amount for small businesses located outside the region exceeded the amount financed within the region. Middle Atlantic region SBICs had the greatest amount (\$99.6 million) going to small businesses outside the region. However, South Atlantic region SBICs proportionately had the largest percentage of their financings going to businesses outside the region (about 71 percent of the region's total), with \$10.3 million in financings within the region and \$25.7 million outside the region.

MESBIC Activity

Figure 5.3 displays the flow of MESBIC financings in 1987 to small businesses both within and outside the investment company's home region. The Middle Atlantic region small businesses received nearly one-half of all financings (\$68.6 million), approximately 84 percent of which (\$57.4 million) came from MESBICs located within the same region. The smallest amount of overall financing--\$420,000--occurred in the Northeast region. As with our state funding flow analysis, we could not identify from SBA's database the destination of MESBIC financings totaling \$3.6 million (2.6 percent of the total dollars).

In seven of the nine regions, MESBICs provided more financing to businesses located within the same region than to businesses located in a different region. In two regions, the South Atlantic and Western North Central, MESBICs provided the most significant percentage of their total financings to outside-region ventures--76 percent (\$11.9 million) and 84 percent (\$4.9 million), respectively.

Figure 5.3: Flow of MESBIC Funds Within and Outside the Region Where the MESBIC Is Located, 1987



Note: For SBA records of 52 financings (\$3.6 million), we were unable to identify whether the financing occurred within or outside the MESBIC region.

Source: GAO analysis of SBA data.

SECTION 6

RELIABILITY ASSESSMENT OF SBA'S DATABASE

In testing the accuracy and completeness of SBA's automated database for SBIC and MESBIC financings, we found that the database was acceptable for performing our analyses of the investment companies' activities and trends. Our test for accuracy found that SBA made few errors in entering information into its automated database as reported by the investment companies. In the best case, virtually all the automated records were accurate; in the worst case, about 4.8 percent of the records were inaccurate. Our test for completeness found that an estimated 8 to 16 percent of small business financing reports were not included in the automated database records. According to SBA, the principal reason for these omissions was that the investment companies submitted their information after SBA's cutoff dates for entering data into the system. However, the exclusion of this information and other information we found missing should not adversely affect our analysis of overall trends in the SBIC and MESBIC industries.

ACCURACY TEST

To determine the accuracy of SBA's automated database files, we compared a random sample of 450 automated database records with hard-copy source documents filed at SBA headquarters. Section 7 provides additional details on our sampling methodology. Following this comparison, we calculated point estimates of the percentages of errors for each field in the database that we tested. Using a 95-percent confidence interval, we calculated an upper and lower bound in which the true percentage of error could be expected to fall 95 out of 100 times. Table 6.1 shows the results of our test summarized by the applicable fields we tested, the point estimates of the percentage of error, and the upper and lower bounds of the percentage of error.

As shown in table 6.1, we found a low incidence of errors for the data fields we examined in the automated records. Concerning the overall accuracy ranges shown above, in the best possible case, virtually all the records were entered accurately in the database. In the worst possible case for two fields--license number and purpose of financing--4.8 percent of the records were entered inaccurately.

Table 6.1: Accuracy Test Results

<u>SBA database field name</u>	<u>Number of errors</u>	<u>Estimated percentage of records in error</u>	<u>Lower bound of error (percent)</u>	<u>Upper bound of error (percent)</u>
Financing type	4	0.89	0.200	2.2
Financing amount	4	0.89	0.200	2.2
License number ^a	1	0.90	0.020	4.8
Financing purpose ^a	1	0.90	0.020	4.8
SBIC name	2	0.40	0.053	1.6
Date financed	2	0.40	0.053	1.6
First/continuing financing	0	0	0	0.8
Interest rate of financing ^a	0	0	0	3.2
Form of business ownership ^a	0	0	0	3.2

^aSBA had not finished collecting this information prior to 1987 (see sec. 7). This reduced the applicable universe to 5,050 records and our sample size, for purposes of estimating percentage of error, to 113 records.

COMPLETENESS TEST

Our completeness test, also explained in section 7, compared 326 SBA hard-copy financing reports with records contained in SBA's automated database. We subsequently documented the cases for which hard-copy reports were not found in the automated records and discussed them with representatives of SBA's Investment Division. Table 6.2 categorizes the omitted records according to the reasons that SBA gave for omitting them in its database. The table also shows our calculations of the point estimates of the percentage of missing records from the universe of all hard-copy files and the upper and lower bounds of the percentage of missing records at the 95-percent confidence interval.

Table 6.2: Completeness Test Results

<u>Reason for omission</u>	<u>Number missing</u>	<u>Missing financings (percent)</u>	<u>Lower bound of missing financings (percent)</u>	<u>Upper bound of missing financings (percent)</u>
Late filing by investment companies	22	6.7	4.30	10.0
Refinancing by small businesses	8	2.5	1.10	4.8
Omission due to oversight	3	0.9	0.20	2.7
Update of financing previously disbursed	2	0.6	0.10	2.2
Partial disbursement of single financing	2	0.6	0.10	2.2
Investment company guarantee of financing by another institution	1	0.3	0.01	1.7
Total for all reasons	38	11.7	8.40	15.6

Note: Calculations are based on an estimated total universe of 23,574 SBIC and MESBIC financing hard-copy records.

Source: GAO analysis of SBA data.

As shown in table 6.2, we observed 38 missing records in the sample of 326 hard-copy records. At the 95-percent confidence interval, we estimate that approximately 8 to 16 percent of the universe of hard-copy records were not included in the automated database. This would cause the totals we have reported on investment company financing activity to be understated by the dollar amount of the true percentage of missing records. We did not project the dollar value, however, because of the wide variance in our estimate of the missing records.

According to information that SBA provided us, most of the omissions (22 of the 38 observed) occurred because investment companies submitted their financing reports to SBA late. Under SBA

policy, investment company financing records submitted more than 3 months after the date of financing by SBICs (or 6 months past the date of financing by MESBICs) are filed in hard-copy form but not entered into the database. In discussing these cases with us, SBA Investment Division officials stated that it was unlikely that the omissions would materially affect the reporting of past trends for the industry. In examining our sample of these records, we found that the data did not appear to be substantially different from the records in the automated file. Accordingly, we did not undertake the additional work necessary to add the omitted information in the database.

The cases in which hard-copy data were omitted from the automated database for other reasons would have had little, if any, impact on our analysis. For example, SBA officials stated that eight cases of omitted records--representing about 1 to 5 percent of the total records that we estimate are missing--were due to small businesses' refinancing of loans made by the investment companies. SBA believes that these loans do not represent any new net financial activity on the part of the investment companies, and accordingly, the agency excludes them from its automated records. We agree with SBA that refinancing of the existing loans would have little relevance to our reporting of the past SBIC and MESBIC activity and trends.

SECTION 7

OBJECTIVES, SCOPE, AND METHODOLOGY

As requested by the Chairman, Committee on Small Business, we analyzed SBA records of venture capital financings that SBICs and MESBICs had provided to small businesses between calendar years 1983 and 1987. Specifically, we developed industry profiles detailing the location of firms assisted by the investment companies, the type of financing provided, the industrial category of the small businesses assisted, and other requested characteristics of the financings. A private consultant, Gerald L. Feigen, the former Associate Advocate for Capital Formation/Venture Capital, SBA, assisted us in designing our analysis. Additionally, using the source documents on file at SBA's headquarters, we assessed the reliability of SBA's database to determine its accuracy and completeness. We conducted our review between January and September 1988.

SBIC/MESBIC INDUSTRY PROFILES

The Investment Division in SBA's Washington, D.C., headquarters maintains automated databases on SBIC and MESBIC activities. There are separate databases on (1) the SBICs and MESBICs that are licensed and regulated by SBA and (2) the small businesses that are financed by these investment companies. We discussed the policy and procedures for maintaining these databases with SBA Investment Division representatives and reviewed written instructions and source documentation as applicable. We obtained the automated records on the investment companies as of December 31, 1987, and on small business financings whose dates fell between calendar year 1983 and the first quarter of 1988. SBA's investment company database contained information on 307 SBICs and 128 MESBICs. Between January 1983 and March 1988, there were 20,825 records of small business financings totaling \$3.0 billion.

SBA's Investment Division maintains a database file on all active investment companies on which it publishes information annually. The division maintains another database--small business financings--based on periodic reports that the investment companies are required to file with SBA (Portfolio Financing Reports--SBA form 1031) each time a new financing originates. SBA's Investment Division enters the data from these reports into its database upon receipt of the forms and prepares reports on a semiannual basis.

To perform our analysis of SBA's investment company financing database, we used the Statistical Analysis System, a software program to analyze computerized databases. The statistics we

developed in our review are generally reported by SBA.¹ However, as discussed below, several factors affected our analysis, causing us to depart from SBA's normal reporting of statistics.

SBA compiles its database according to the dates it receives the small business financing reports rather than the actual dates of the financings. SBA includes those reports that the Investment Division receives within a 3-month period following a SBIC financing or a 6-month period following a MESBIC financing. Because of this lag, some financings do not reflect the actual year in which they originate. For example, an SBIC financing originating in November 1987 but reported to SBA in January 1988 would be reported with its 1988 calendar year data. To obtain a truer representation of the activity actually occurring within a given calendar year, we based our analysis on the actual date of financing rather than on SBA's reported date. Accordingly, our annual statistics differ from SBA's.

One of our profiles highlights the primary industries receiving funds through SBIC or MESBIC financings. We developed this profile by analyzing the 4-digit Standard Industrial Classification (SIC) Codes included on the financing reports. SBA enters all four digits of the SIC codes, as reported by the investment companies, in its database, but it periodically reports data based only on the first two digits, representing the broad industry classification. SBA officials cautioned us that they perform a limited verification of the SIC code data and do not check to the 4-digit level. We verified SIC codes to source documents as discussed in section 6, but we did not separately validate SIC codes at the investment company locations. Rather, we based our statistics on the investment companies' reports to SBA.

Our analysis of financing characteristics was also limited by the number of elements in SBA's database. Prior to 1987, their small business database contained fewer information elements. In 1987, SBA expanded its automated records to include information such as the intended purpose of financing, interest rates of financings, and other information to identify investment company locations. During our review, SBA was in the process of entering these additional data elements retroactively for 1983 to 1986. However, because these elements were not available at the time we completed our work, we did not develop 5-year trend profiles for them.

¹SBA does not develop information based on the flow of venture capital within or outside the states and regions where the investment companies are located. We analyzed these factors for 1987 by identifying the locations of small businesses and investment companies from SBA's small business financing and investment company databases.

RELIABILITY ASSESSMENT OF SBA'S DATABASE

SBA maintains a hard-copy file of small business financing reports that provides the source data for its automated database on small business financings. SBA requires all SBICs and MESBICs to submit these reports within 15 days of a financing. We based our reliability assessment on two tests of the financing records that made up the database.

The first test we conducted, to assess the accuracy of the information entered into the database, involved comparing a random sample of 450 financing records from SBA's computerized files on the 20,825 financings from January 1, 1983, to March 31, 1988, with the hard-copy source documents filed at SBA headquarters. We compared the following data fields from each of the sampled records with the data contained in the hard-copy files:

- financing type,
- financing amount,
- investment company license number,
- purpose of the financing,
- investment company name,
- date of origination of the financing,
- first/continuing financing,
- interest rate of the financing, and
- form of business ownership.

Using a statistical method based on the hypergeometric distribution, we calculated point estimates of the percentages of errors for the fields we tested. We also calculated upper and lower bounds in which the true percentage of error would statistically fall 95 out of 100 times (statistically referred to as the 95-percent confidence interval).

In our second test, to assess the completeness of the database, we drew a sample of 667 documents from hard-copy files at SBA headquarters and then checked for their inclusion in SBA's automated records. We sampled documents from SBA's headquarter file drawers at established intervals. For documents falling between January 1, 1983, and March 31, 1988 (326 documents), we recorded the name of the business financed, the date of the financing, and the investment company name for comparison with the automated records. We subsequently recorded the cases for which hard-copy reports were not found in the automated records and discussed them with representatives of SBA's Investment Division. As in the first test, we calculated point and range estimates (also at the 95-percent confidence interval) of the percentages of the universe of hard-copy financing records that we found were missing. For purposes of this analysis, we estimated a universe of 23,574 hard-copy records of SBIC and MESBIC financings.

Section 6 discusses the results of our reliability tests. As agreed, we did not extend our testing of information to investment company locations and records because they are scattered nationwide.

COMMENTS FROM THE SMALL BUSINESS ADMINISTRATION



OFFICE OF THE ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

MAR 22 1989

Mr. J. Dexter Peach
Assistant Comptroller General
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Washington, D. C. 20548

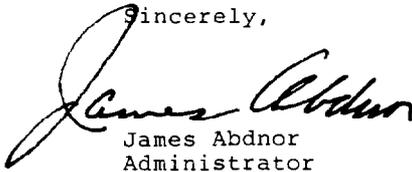
Dear Mr. Peach:

As requested by your letter of February 16, 1989, we have reviewed your draft report to the Chairman, Committee on Small Business, House of Representatives entitled "SMALL BUSINESS: Profiles of Venture Capital Financing from 1983 through 1987."

SBA officials met with your staff on March 9, 1989 to discuss the draft report. We believe that the draft report, with agreed upon modifications, will fairly represent SBIC and 301(d) SBIC financing to small businesses. Accordingly, we have no further comments on the draft report.

We appreciate the opportunity to comment on this report.

Sincerely,


James Abdnor
Administrator

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