



# ENTREPRENEURSHIP AND ACCESS TO CAPITAL

# INNOVATION AND RISK CAPITAL

## OPPORTUNITY:

Support Alabama businesses in industries with technologies and proprietary products, processes or knowledge that provide high-growth opportunities. In order to assist the innovation ecosystem, the Alabama Innovation Corporation should look for ways to reduce the friction encountered by startups in search of funds and provide a better return for their efforts. The following recommendations align with portions of the recommendations provided in the Hoover Institution Report under “Tax Policy, Subsidies and Innovative Business Investment in Alabama: Past and Prospect” on pages 91-92.

## 1. SEED CAPITAL FUND – ACTION

### RECOMMENDATION:

Create two Alabama Innovation Corporation-managed seed capital funds. The first would be a \$5 million revolving, “evergreen” equity fund that would invest in Alabama-based high-growth businesses in strategically identified sectors. The second would be a \$2 million fund that would invest in less scalable small businesses and underrepresented companies in Alabama with the intent of increasing access to capital. The goal for each would be to use the state’s investment to attract additional private investment. A state investment would require at least a 50 percent match from private sources to be eligible for an investment from the seed capital funds. One critical component of this recommendation would be the creation of a private investment adviser exemption from registration in collaboration with the Alabama Securities Commission in order to facilitate greater private investment in Alabama.

### BACKGROUND AND RATIONALE:

Venture capital funding provides startup companies with needed capital funding to support the development of products and services at an early stage in the business life cycle. More than three quarters of venture capital investments are made in California, New York and Massachusetts, leaving other states struggling to compete and develop or keep startup companies within their borders. Alabama is one of many states across the country that has developed programs to support in-state venture capital.

Alabama ranks low compared with nearby states and the nation in terms of venture capital funding disbursed. According to data from the National Science Foundation, Alabama ranks 46th among all states in the average dollars of venture capital disbursed per state gross domestic product in 2019. Except for Mississippi, which is ranked 49th, Alabama ranks over 20 spots lower in this metric compared with its neighboring states. This disparity may be explained by the type of entrepreneurial activity taking place in Alabama. It is possible that a significant number of new entrepreneurs in Alabama are starting businesses outside of the typical high technology target industries for venture capital. The disparity between entrepreneurial activity and venture capital funding may also suggest that Alabama is at risk of losing startups to outside venture capital investment as the supply of venture capital in the state falls short of demand. By providing a state funding match into targeted high-growth startups, Alabama can attract additional entrepreneurial-focused capital.

## MEASURES OF SUCCESS

Program use and amount of capital investment.

Comparison of capital investment in general to capital investment in eligible projects.

Alabama jobs created by firms receiving incentive.

Financial performance of the funds.

State return on investment.

## MILESTONES

2021-22

Draft formation documents to create the seed capital funds.

Identify and select fund manager.

Develop review process for different levels of investment.

2022-23

Obtain additional legislative appropriations to establish the seed capital fund.

Create data analysis system to collect relevant data points on investment recipients.

**LEGISLATION REQUIRED:**  
**ADDITIONAL FUNDS REQUIRED:**

**NO**  
**YES**

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## 2. NONDILUTIVE FUNDING – ACTION

### RECOMMENDATION:

Create a \$2 million annual grant program to provide nondilutive working capital (growth capital) targeted at high-growth companies in need of additional financing and present promising opportunities within targeted industry clusters. This program would provide grants of up to \$50,000 to support commercialization activities of companies at the concept stage in high-growth industries, prior to the seed capital funding round. Grant applicants would first have to satisfactorily complete the mentorship network program.

### BACKGROUND AND RATIONALE:

As noted, the state has a lack of early-stage capital for small businesses developing and commercializing new, innovative technologies. Creating a nondilutive grant program would address a critical private-sector market gap for investment dollars as the size is usually too small for larger venture funds or traditional sources of capital to consider.

## MEASURES OF SUCCESS

Program use and number of grants awarded.

Additional follow-on investment.

## MILESTONES

2021-22

Draft documents establishing the grant program (e.g., application form, selection criteria used by the corporation, etc.).

2022-23

Obtain additional legislative appropriations to adequately fund the grant program.

Develop branding campaign to advertise the grant program.

Issue awards to targeted startups.

Create data analysis system to collect relevant data points on grant recipients.

**LEGISLATION REQUIRED:**  
**ADDITIONAL FUNDS REQUIRED:**

**NO**  
**YES**

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## 3. SSBCI FUNDING – ACTION

### RECOMMENDATION:

The Alabama Innovation Corporation should partner with the state government to apply for and implement the federal State Small Business Credit Initiative (SSBCI) by assessing small business needs, engaging partner organizations and marketing programs to private sector participants. The corporation should also consider the ability to use these SSBCI funds as the initial capitalization of a targeted evergreen fund

### BACKGROUND AND RATIONALE:

The SSBCI is a federal-state partnership where a state agency is designated to participate in the program and implement approved program strategies. ADECA is the state agency responsible for the SSBCI in Alabama.

Originally established by the Small Business Jobs Act of 2010 in the wake of the Great Recession, SSBCI provided \$1.5 billion in federal funds at that time to states to restore small business lending and investing activity by sharing in financial risk. SSBCI-supported lending programs work with mission lenders such as community development finance institutions and community banks to address the systemic market needs of socially and economically disadvantaged individuals.

On March 11, 2021, President Joe Biden signed the American Rescue Plan Act (ARP) which provided \$10 billion to re-fund the SSBCI and broaden its activities. The new SSBCI is designed to support entrepreneurs and small businesses, and Alabama will initially receive approximately \$56 million in SSBCI funds, of which \$25 million will go toward the Alabama Rural, Agribusiness and Opportunity Zone Jobs Act. These funds can be used to design a portfolio of small business financing programs that meets the unique needs of local entrepreneurs and considers the conditions of local capital markets.

### MEASURES OF SUCCESS

Number of SSBCI participants.

Amount of private dollars leveraged.

Revenue and employee growth of participant businesses.

## MILESTONES

2021-22

Meet with state government and identify partners with relevant experience to administer the SSBCI funding.

Draft procedures for administering SSBCI funding.

2022-23

Continue distribution of SSBCI funding.

Create data analysis system to collect relevant data points on SSBCI recipients.

**LEGISLATION REQUIRED:**  
**ADDITIONAL FUNDS REQUIRED:**

**NO**  
**YES**

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## ENCOURAGING ENTREPRENEURSHIP AND BUSINESS DYNAMICS

### OPPORTUNITY:

Tap into Alabama-based talent for institutional knowledge pertaining to raising capital, developing a market and planning an exit, and connect entrepreneurs to seasoned leaders. Increase the success rate of underserved entrepreneurs and small businesses throughout Alabama by providing funding opportunities at key points in their growth stage. The following recommendations align with portions of the recommendations provided in the Hoover Institution Report under “Introduction” on page 6 and “The Role of Alabama Universities in Fostering Innovation and Growth” on page 30.

### 1. MENTORSHIP NETWORKS – STRATEGY

#### RECOMMENDATION:

Develop mentorship networks for founders and business owners to help diversify the state’s economy, take advantage of innovation-based opportunities and drive broader participation among underserved and underrepresented communities. Such mentorship networks could also be avenues for technical assistance to be delivered to founders and business owners and a method to use the mentors to evangelize innovation in the state.

## BACKGROUND AND RATIONALE:

In Alabama, there is a lack of experienced, serial entrepreneurs/mentors who know how to turn an idea or a product into a successful venture. Such serial entrepreneurs are needed not only to lead new ventures, but also to serve as mentors to help fledgling entrepreneurs develop their skills and increase their chances of success. Serial entrepreneurs/mentors have contacts in the investor community, can recognize quality deals and help to generate deal flow that helps firms access capital markets.

Many entrepreneurs, particularly in underserved communities, lack the network, resources and personal relationships often needed to get businesses off the ground. A statewide program to connect serial entrepreneurs/mentors with underserved and underrepresented entrepreneurs would strengthen Alabama's startup ecosystem and bring new and diverse voices to the table.

A strong mentoring group in the state could become a driving force for encouraging and marketing success in the state and would unify business leaders in participating in state-based innovation.

## MEASURES OF SUCCESS

Number of new business starts by underrepresented and underserved entrepreneurs.

Number of businesses applying for and receiving nondilutive funding.

## MILESTONES

2021-22

- Identify regions of the state where these mentor networks could/should be established.
- Identify seasoned leaders in each region who will participate in the mentorship networks.
- Develop marketing campaign to promote the mentorship network program.

2022-23

- Obtain additional legislative appropriations to adequately fund the mentorship networks.
- Accept first cohort of entrepreneurs.
- Create data analysis system to collect relevant data points on program participants.

**LEGISLATION REQUIRED:**  
**ADDITIONAL FUNDS REQUIRED:**

**NO**  
**YES**

## TAX CREDITS

### OPPORTUNITY:

Encourage private-sector innovative activity through the implementation of a state R&D tax credit to foster R&D among Alabama’s key industries. Stimulate job growth, create wealth and accelerate the creation of new ventures in Alabama by incentivizing the transfer of capital from investors to entrepreneurs, particularly during early-stage growth. The following recommendations align with portions of the recommendations provided in the Hoover Institution Report under “Tax Policy, Subsidies and Innovative Business Investment in Alabama: Past and Prospect” on page 84, “The Role of Alabama Universities in Fostering Innovation and Growth” on page 31 and “Supporting Advanced Manufacturing” on pages 65 and 76-78.

### 1. ANGEL TAX CREDIT PROGRAM – ACTION

#### RECOMMENDATION:

Create an angel investor tax credit that would be equal to 25% of an equity investment made into a qualifying high-growth business that has been preapproved by the Alabama Innovation Corporation. The credit should be subject to a cap, such as \$5 million per year, there should be a minimum investment threshold (e.g., \$25,000) and the pool of potential investors should be limited to accredited investors. In order to maximize its impact, the credit should be able to be claimed against various tax types, including, but not limited to, taxes that the Growing Alabama Credit can be claimed against (e.g., the individual income tax, corporation income tax, insurance premium tax, etc.).

#### BACKGROUND AND RATIONALE:

Seed capital is difficult to raise for startups, especially in a state like Alabama that is still coalescing its startup ecosystem. Angel investors can meet that need, as they are willing to invest their personal funds into high-risk startups in exchange for an equity share of the business. Compared to later stage venture capital financing, angel investment tends to be smaller and occurs earlier in the life of the new business.

An angel investor tax credit program (or a direct matching program) would help Alabama entrepreneurs attract investors who provide much needed capital, helping to mitigate the risks involved in financing startup companies. The program would also help to address Alabama’s regional disparity in private equity investment and work to close the funding gap faced by entrepreneurs by incentivizing more private investment.

#### MEASURES OF SUCCESS

Number of companies participating.

Amount of private capital leveraged.

Businesses created by Alabama’s innovation endeavors.

## MILESTONES

2021-22

Meet with stakeholders to determine market-rate parameters of an angel tax credit program.

Draft legislation for the creation and funding of an angel tax credit program.

2022-23

Create data analysis system to collect relevant data points on angel tax credit program participants (both the investors and the related companies receiving the investment).

**LEGISLATION REQUIRED:** YES  
**ADDITIONAL FUNDS REQUIRED:** YES

## 2. RESEARCH AND DEVELOPMENT (R&D) TAX CREDIT PROGRAM – ACTION

### RECOMMENDATION:

Create an R&D state tax credit for certain targeted, high-growth industries that are critical to Alabama’s traded-sector strengths or emerging global market opportunities. The credit should be competitive with the R&D credits offered by peer states by exempting 5-10% of the taxpayer’s qualified research expenses from taxes and including a carry-forward provision to offset future profits, which is essential for startups that may not have profits during their early years when they invest most heavily in R&D. In addition, excess R&D tax credits should either be refundable – subject to an annual cap – or be able to offset the state’s payroll withholding, for more mature R&D firms.

### BACKGROUND AND RATIONALE:

Alabama ranks 45th among all states, according to the Tax Foundation, in terms of its tax competitiveness for established R&D firms, while its immediate neighbor, Georgia, ranks second overall. Alabama currently provides no R&D tax credit, which is suboptimal, since such credits have been shown to stimulate private-sector R&D investment and help locations move up the technology development value chain.

Technological innovation is the main driver of long-term economic growth and increases in living standards. It is difficult to have ongoing technological innovation and more productivity without investing in R&D. Increasing productivity – the goods and services that can be developed in a place given its availability of people, facilities and resources – is an important part of facilitating innovation and improving economic growth. While there are various paths to increasing productivity, a fundamental driver of this growth is the production of new knowledge through R&D. R&D comprises three main parts:

Basic research refers to the experiments or theoretical work that is undertaken without any application or use in view; the primary purpose is to expand knowledge, not to create or invent something.

Applied research seeks to solve specific, practical issues affecting individuals or groups such as states or businesses. Solving problems and improving conditions are important goals of applied research.

Development refers to the conversion of research into new ideas, services or products in order to improve standards of living. Common elements of the development process include concept formulation, design, product testing, prototyping and other types of pilot projects.

While basic research is important because it serves as the pipeline for ideation, there must be a focus within industry and academia on applied R&D, which helps generate further innovation and economic growth. Focusing on R&D and the early stages of knowledge generation helps fuel the other innovation ecosystem elements and will provide sustained growth for Alabama’s industry clusters.



## MEASURES OF SUCCESS

Number of R&D conducting firms created.

Number of high-tech jobs boosted.

Value of capital investment linked to the state's R&D tax credit.

## MILESTONES

2021-22

Meet with stakeholders to determine parameters of a R&D tax credit program that would encourage targeted business growth in Alabama.

Draft legislation for the creation and funding of an R&D tax credit program.

2022-23

Create data analysis system to collect relevant data points on R&D tax credit program participants.

**LEGISLATION REQUIRED:**  
**ADDITIONAL FUNDS REQUIRED:**

**YES**  
**YES**

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