



**Community Development
Venture Capital Alliance**

*Private equity in the
public interest*

To: CDFI Fund Advisory Board

From: Kerwin Tesdell

Date: August 27, 2020

Subject: Written Comments for August 27, 2020 Meeting Regarding Economic Impact of Pandemic

Thank you for the opportunity to provide written comments regarding the economic impact of the Covid pandemic on the community development venture capital (CDVC) industry and the businesses and low-income communities we serve. I look forward to meeting virtually (is there any other way these days?) with the CDFI Fund Advisory Board on August 27 and to answering your questions.

CDVC funds provide risk capital investments to start-up and high-growth businesses to create good jobs, productive wealth, and entrepreneurial capacity that advance the livelihoods of low-income people and the economies of distressed communities. We are unique among CDFIs in focusing on flexible, equity capital investments for businesses, rather than loans.

Effects of the Pandemic and CDVC Responses

As you are aware, the pandemic has in general had a devastating impact on low-income people and economically distressed communities, particularly communities of color. Through surveys and discussions with our member funds during the past several months, we have heard substantial concern about future impact, as the secondary effects of the downturn ripple through the economy, but as yet the portfolios of our CDVC funds are holding up fairly well. Our investments are not concentrated in hard-hit industries such as entertainment and travel, but rather tend to be focused on industries, such as manufacturing and business services, which have so far weathered the COVID storm fairly well. And other investments are in industries, such as online services, that have actually benefited from the pandemic. We have also heard a tremendous need for additional capital, as demand for their investments remains strong and has even accelerated.

CDVC funds have responded to the effects of the pandemic not only with capital but also with extraordinary levels of Development Services to business owners. As venture capitalists, we sit on the boards of directors of the companies in which we invest, so we provide extensive operational and strategic advice and assistance to businesses that go well beyond what a lender would typically provide. The situations in which CDVC fund portfolio companies have found themselves as a result of the pandemic, and examples of the responses of the funds, are as follows.

- **Immediate Survival.** Some portfolio companies, hurt by the pandemic, face immediate threats to their survival, such as a temporary plant closure because of a Covid outbreak or interruption of their primary customer markets. CDVC funds are able to provide flexible, equity capital financing to businesses to help them through these temporary disruptions, giving them cash to meet payroll or pay off debt that a bank would not renew. CDVC funds also provide strategic planning and business assistance to help companies meet immediate challenges. While equity investment funds do not provide PPP loans, many of our funds worked closely with their portfolio companies to obtain such loans quickly. CDVCA posted extensive information about the PPP loan program on our Peer Group virtual platform for fund managers, and we conducted a training webinar on the subject.
- **Immediate Response to Medical Emergency.** CDVC funds helped companies in the health services industry respond to crises and opportunities. For example, a fund in Puerto Rico provided financing to a medical services company to bring 79 incubators to the island early in the crisis in April. These undoubtedly saved many lives in the past months.
- **Adjustment to New Operating Environment.** CDVCA funds were able to provide both Financial and Development Services to help portfolio companies adjust to their workflows in the pandemic. For example, they helped manufacturing companies redesign their workflow to comply with requirements for social distancing and to erect barriers to virus transmission.
- **Pivots in Business Model.** Some portfolio companies found their core business models disrupted but were able to pivot quickly to new activities and markets that were more viable in the pandemic. For example, the original business model of a young company in which a CDVC fund invested was to set up vending machines in large office buildings to sell farm-fresh produce. As office buildings emptied, this market was no longer viable. With the help and advice of the CDVC fund, this business pivoted to selling farm-fresh produce and ready-made salads online. (Shameless advertising: <https://www.farmersfridge.com/>).
- **New Opportunities.** The pandemic has not been bad for all businesses. For example, a manufacturing company that makes parts for recreational vehicles experienced an explosion in demand, as people sought ways to travel without exposing themselves to the virus in motels and restaurants. A fund is considering providing additional financing for this company to help it take advantage of this market opportunity and create many much-needed new jobs in a low-income rural area.

Needs of CDVC Funds

Venture capital equity investment can have a tremendously positive impact on low-income communities by helping companies to not only weather the COVID storm, but also take advantage of opportunities to reshape local economies and business ownership. However, if history repeats itself from the 2008-10 Great Recession, the availability of risk capital may dry up just as it is most needed. In the Great Recession, capital markets became extremely risk averse, and it became almost impossible for CDVC funds—on the extreme tail end of the risk spectrum—to raise new capital. (Unlike other CDFIs, traditionally structured CDVC funds typically have 10-year lives, and fund managers must create and

raise successor CDVC funds to continue operating.) It is an important role of government to assure the continued flow of flexible, equity capital to businesses in low-income communities, even as capital markets become more risk averse.

In addition to capital, two types of technical assistance are needed. First, there is tremendous interest right now in forming new funds in low income communities across the nation, particularly among African American and Latinx fund managers. Of the 90 managers on CDVCA's Emerging Managers Peer Group virtual platform, 74% are minorities. Because fund managers from low-income places, and particularly from minority communities, have been shut out of the experiences and connections needed to raise an equity fund, technical assistance is vitally important to help those managers get over the finish line of raising a new fund. Second, regarding existing managers, the pandemic has presented unprecedented challenges for both their funds and their portfolio companies. Technical assistance and peer learning opportunities are needed now more than ever to help fund managers climb this steep learning curve to operate effectively in this new environment.

Looking Toward to the Future: Not Just Threats, But Opportunities

It is in the DNA of the venture capitalist to see crises such as the current pandemic as creating not only threats but also opportunities. No one knows what the economy will look like five or ten years after Covid, but one thing is certain: it will look different. A threat to low-income communities and businesses is that large corporations will take over the markets of locally-owned businesses. (Think Amazon v. the local retailer; Netflix v. the local theater.) It is a natural, immediate, and important response to a crisis such as this pandemic to try to save what exists. But looking forward, it will be equally important to create new businesses and ways of doing things in low-income communities, started by and owned by local entrepreneurs. If we do not, the results will be disastrous for the communities we serve as CDFIs. That is why CDVC funds—while focused, like everyone else at the moment, on helping existing companies get through this crisis—are most excited about the last two bullet points above: helping companies pivot to adopt new business models and helping others take advantage of entirely new opportunities created by the economic disruption of Life With Covid. CDVC funds—and the flexible, equity capital we provide—are necessary to finance these new businesses and business activities. Debt is not sufficient.

Another opportunity we see is to change the nature of who starts and owns businesses in this nation. It is a tragedy that businesses are currently failing in record numbers. However, a silver lining of this very dark cloud is that new entrepreneurs and business owners may be more diverse than current ownership, which is overwhelmingly dominated by white males. To make this transition in ownership, we will need appropriate supports in low-income, rural, and minority communities—including venture capital equity financing—to assure that the current ownership structure is not simply replicated.

*Give people fish, and they eat for a day.
Teach people to fish, and they eat for a lifetime.
But what's really important is who owns the boat!*

We see opportunity in the current crisis to help create new boat owners.