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Venture Hubs Across America: How to Reinvigorate Regional Economies

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Takeaways

Four metropolitan areas—all on the coasts—account for over half of all venture capital in the United States. Three factors contribute to this capital concentration: business opportunity, mature industry ecosystems, and talent. As a result, far too many entrepreneurs in small and midsized cities throughout the United States are being overlooked. To reverse this trend, we're calling for a sweeping new initiative called Venture Hubs Across America that will attract investors and give scalable businesses in historically overlooked cities a shot at success.

Imagine identical startups—same founder, same technology, same staff—but one was located in Toledo, OH and the other in San Francisco, CA. Aside from access to beaches and wine country, the California-based entrepreneur has one other key advantage: a far better shot at securing venture capital.

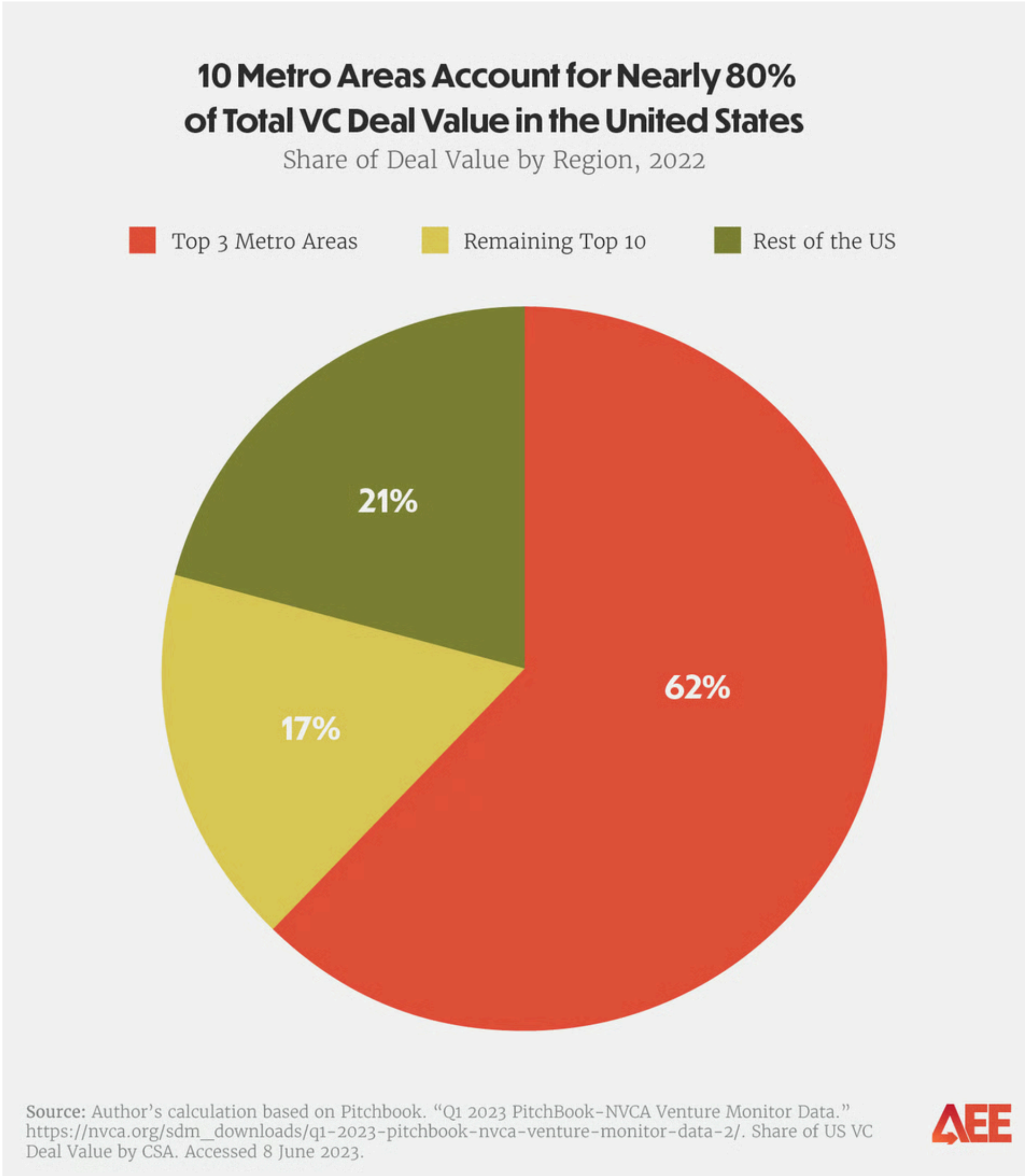
For decades, venture capital (VC) has been a key part of the financial infrastructure that provides for innovation and job growth. It's the prevailing way that private sector investors finance the highest-potential new businesses. In 2022, over $246 billion in VC dollars were committed to seed, scale, and take public new ventures.# Unfortunately, not everyone has the same access to this valuable source of capital.

In previous work, we detailed how women and people of color have been historically excluded from the venture capital ecosystem, with Black and Hispanic female founders receiving less than 0.5% of all VC investment in 2020.# But there is another gap: the geographic concentration of capital in a select few metro areas. Over half of VC investment goes to companies within the four venture hubs of San Francisco, New York, Boston, and Los Angeles.# The accumulation of capital in these regions has a profound impact on new business formation and often leaves Midwestern and Southern cities struggling to compete.

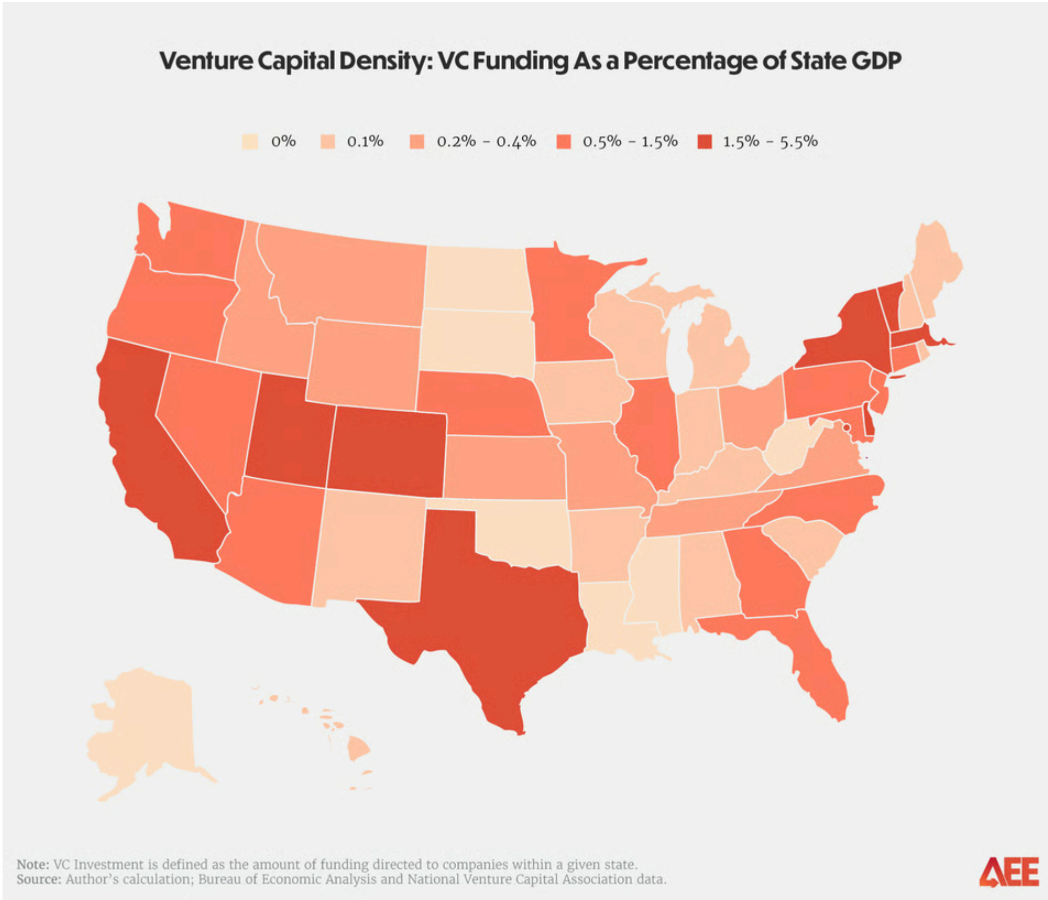
Although a mere 0.5% of small businesses seek venture capital to finance their start-up operations, all businesses stand to benefit from the resulting influx of new residents and potential customers that move into their communities to work at these growing companies.# To better help entrepreneurs throughout the country and reinvigorate regional economies, we propose a landmark federal commitment to establish "venture hubs" around the country that will attract investors and give scalable businesses in historically overlooked cities a shot at success. In this report, we pinpoint the appeal of the traditional centers of capital and show policymakers how to replicate these features in new communities.

The Problem

Most businesses that want to raise money from venture capital firms turn to coastal hubs. It's no wonder why: nearly 80% of the investments made by VC firms in 2015 went to coastal cities. Almost a decade later, funding has spread more geographically but just four metropolitan areas—San Francisco, Los Angeles, New York City, and Boston—still account for over half of all deal value in the United States.# Together, these regions had over 7,900 deals totaling more than $150 billion in 2022.# In fact, just 10 metro areas brought in 80% of all VC deal value in 2022, with California, New York, and Massachusetts accounting for more than 60%.



As a result of capital concentration, a small group of metro areas is leaving other regions in the dust in terms of contributions to the economy. When we compared the volume of VC investment to state economic output, we found that all three high-investment states had a VC-to-GDP ratio above the national average.# To be fair, California and New York are among the nation's most populous states, so we would expect their VC-to-GDP ratios to be strong. But even Massachusetts, which has a modest population of 6.9 million, surpasses states like Texas and Florida which have three to four times more residents.



Three Ingredients

Three features make venture capital regions attractive to investors: abundant business opportunities, mature entrepreneurial ecosystems, and availability of skilled workers. These characteristics would need to be replicated in other parts of the country if new regions are to draw the attention of investors.

First, VCs need a steady flow of entrepreneurs and businesses to explore for potential investment. A survey of VCs published in Harvard Business Review found that "VCs look at more than 100 opportunities for every one they invest in."# Investors spend upwards of 22 hours a week networking and sourcing deals, trying to find the one that fits their portfolio. If there isn't a high concentration of businesses in a region, it makes little sense for an investor to spend her time there.

Second, VCs want to invest in industries and regions that have mature entrepreneurial ecosystems. Investors like to see a pattern of success in a particular industry or region before making new commitments. That is why we see dollars concentrated in software companies, commercial products and services, and pharmaceutical or biotech companies.# Mature ecosystems can mean there are established entrepreneurial supports, like favorable local tax incentives or an existing network of enthusiastic domestic investors.

Finally, VCs will gravitate toward places with a thriving workforce. When companies secure equity investments, most will use the financing to develop new products, prioritize marketing, and most importantly, add new staff. This accelerates a company's growth and gets the investors closer to their payout. This explains why we see many startups spring up around the nation's top universities. These institutions are not only producing new founders but also a highly-skilled, technical workforce that can add value immediately to scaling companies.

Despite these promising features, CB Insights recently found that unicorn birth rates—companies valued at $1 billion or more—have fallen by 5% in the United States and globally have reached a 6-year low.# Perhaps it's time to look elsewhere for the next generation of high-potential businesses. Fortunately, by pulling the right levers, the model that made Sand Hill Road a moniker for Silicon Valley VCs can be replicated in cities throughout the country.

The Solution: Venture Hubs Across America

Venture capital shouldn't be an afterthought for a Black entrepreneur in Toledo—or any other entrepreneur in a midsize city who is too often shut out of VC. That's why we're calling for a sweeping new initiative called ***Venture Hubs Across America*** that will attract investors and give scalable businesses in historically overlooked cities a shot at success. These centers of economic and technological growth would replicate the technical workforce, friendly entrepreneurial environment, and business opportunities that have made California, New York, and Massachusetts prime targets for investment.

Venture Hubs Across America has three components:

1. Establish a strong technical workforce.

- **Launch a federal lab education accelerator**. According to the Federal Laboratory Consortium, the United States has more than 300 labs nationwide that operate research centers on behalf of federal agencies that foster the commercialization of technologies for the marketplace. Congress should better connect federal labs with local institutions of higher education and provide additional funds to facilitate training for undergraduate and graduate students in technology transfer, STEM, and product commercialization. Agencies could also partner to establish innovative ecosystems out of their labs that equip entrepreneurs with go-to-market skills.

- **Expand technical apprenticeships in high-growth fields**. Startups and growing firms need a ready supply of skilled workers. Enter apprenticeships: a training model where individuals earn while they learn. Congress can increase the supply of skilled apprenticeships by providing flexible state block grants that help regions build and expand intermediaries that link employers, educators, community organizations, and prospective apprentices. Resources can also be provided to small and midsized businesses to incentivize them to hire apprentices.

2. Develop a mature entrepreneurial environment.

- **Incentivize private sector local investments**. Federal and state tax authorities should incentivize angel investors and VCs to drive a larger share of their capital into overlooked areas. Lawmakers should target areas with low levels of venture capital investment as a percentage of GDP as well as regions with low business growth over the last ten years. Credits would go to investors who provide funding to startups operating in the designated regions.
- **Leverage public capital to prime the pump**. In a recent report, we recommended that Congress revive the Participating Securities SBIC Program, which would allow the federal government to become a Limited Partner in targeted investment funds. If the program's structural and statutory flaws were corrected in a renewed effort to provide patient capital to scalable businesses in historically overlooked regions, the government would help lead the way for the private sector to make similar investments.

3. Create abundant business opportunities.

- **Foster innovation on campus**. Most Historically Black Colleges and Universities are outside of the coastal VC hubs. Congress could help institutions launch new businesses from their campuses by establishing a program that expands incubators and accelerators for underserved entrepreneurs. The *UPLIFT Act,* authored by Senator Ben Cardin and Mazie Hirono, would achieve a similar goal by allowing the Small Business Administration to enter into cooperative agreements with colleges and universities to advance innovation on campus.
- **Capitalize on newly minted tech hubs**. The recent passage of the CHIPS and Science Act of 2022 included a $10 billion effort to revitalize economically distressed regions by establishing "innovation hubs" across 20 metro areas. As these centers are selected

and receive funding, investors should be looking for opportunities to enter into public-private partnerships with state and local officials.

Conclusion

It is often remarked in investment circles that past performance is not a guarantee of future results. Truer words were never spoken. As Midwestern and Southern cities position themselves to play a role in the new economy, could now be the time to bet on historically underestimated regions and founders? We think so.

Establishing venture hubs across America will set the right conditions for business growth by replicating the features that made places like Silicon Valley, Boston, and New York so attractive to investors in the first place. Improving the talent pipeline, incentivizing local investment, and establishing regional centers of innovation can increase the likelihood that new, highly scalable businesses will emerge in places that investors may not have previously considered. Local economies are intricately woven together and small businesses stand to gain a lot from the success these growing companies bring to communities when access to capital is enthusiastic and abundant.