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Entrepreneurial Ecosystem Shifts, Trends, + Unicorns

EDCC
ECONOMIC DEVELOPMENT COUNCIL OF COLORADO

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OUR HISTORY

Established in 1976, the Economic Development Council of Colorado (EDCC) promotes effective, responsible economic development practices across Colorado. Today we are the state's premier economic development resource, representing the economic development interests of both the private and public sectors throughout the state. We connect our communities, our members and our partners to high-quality educational opportunities and trusted resources, and advocate for sound policies and programs that support a vibrant economy and enhance quality of life for all Coloradans.

EDCC members come from a variety of settings. We are rural and urban, public and private-sector, for profit and not-for-profit, and include individual communities, counties and regional organizations, local and state government, chambers of commerce, universities, and private industry. We are economic development professionals, community volunteers, and business and political leaders.

OUR VISION

To be recognized as Colorado's most trusted resource for economic development stakeholders committed to promoting a vibrant Colorado economy.

OUR MISSION

To promote effective, responsible economic development by connecting Colorado's economic development stakeholders to high-quality educational opportunities and trusted resources and advocating for sound policies and programs that support a vibrant economy and enhance quality of life for all Coloradans.

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Entrepreneurial Ecosystem Shifts, Trends, + Unicorns

TABLE OF CONTENTS

Executive Summary

ENTREPRENEURIAL ECOSYSTEM SHIFTS, TRENDS, + UNICORNS

A new age, heightened by the prospect for economic opportunities – unseen since the end of the Web 2.0 boom (2004 – 2008) – is dawning. Akin to the Industrial Revolution, innovators are charging ahead creating new technologies designed to meet the growing demands across a multitude of vertical markets.

As economic developers, we need to continue to support and advocate for the development of infrastructural and financial ecosystems to benefit these companies and ensure that Colorado's entrepreneurs have every advantage to form, launch, and scale their businesses.

The Economic Development Council of Colorado (EDCC) assembled a panel of five experts to provide perspectives on the needs and barriers along a startup's journey to become a thriving business. Barriers and challenges to accessing markets, early-stage funding, and essential infrastructure improvements topped the list of challenges that confront new and expanding businesses as we rebuild and recover from the economic downturn brought on by the pandemic.

Come examine with us the shifts and trends that are affecting Colorado's startup ecosystem and learn what is needed for these startups to become unicorns in Colorado's post-pandemic entrepreneurial ecosystem.

VENTURE CAPITAL INVESTMENT

– Mike Freeman, General Partner & CEO, Innosphere Adventures

Colorado companies are on-pace – with five months remaining in 2021 – to eclipse 2020's record-breaking $2.7B in venture capital investments. Typically, news of this record-breaking trajectory would be cause for celebration. Yet, for Mike Freeman, Innosphere Venture's CEO and general partner, there are red flags lurking just outside the glow of this "good news."

First, the majority of this venture capital is flowing into the state from outside venture capital groups. In the first six months of 2021, none of the $2.6B in Series-A Round Funding *(investment based on the ability to demonstrate a strong business model and the potential to grow and generate revenue)*, or later, is reaching Colorado's early-stage startups.

"Data indicates that Colorado is not balanced in attracting Venture Capital (VC) and early-stage capital investments," Freeman said. "When companies are sold, we have not seen a reinvestment by the principals of these successful exits." States that have healthy investment ecosystems, he adds, build healthier, more sustainable startup communities.

While the prospect for continued flow of Series Funding into Colorado remains strong for the near future, due to what Freeman characterizes as an abundance of VC capital waiting for deployment, he also believes that Colorado's relative, "raw competitive position" could be threatened as startups migrate to where early-stage capital is also more readily available.

Underscoring this point, Freeman cites the Milken Institute's Best-Performing Cities 2021 report, which lists three Utah cities among the top 10; and ranks Denver-Aurora-Lakewood, 11th *(the highest placement for any Colorado community)*; followed by Colorado Springs in 12th position. "This definitely impacts tech more than retail or manufacturers," Freeman noted.

Freeman believes the biggest challenge to overcoming this imbalance of available early-stage and seed funding is the scarcity of Colorado funds willing to lead the raise process. "Later stage capital is not the difficulty," he claims. "When I talk to investors, they are rarely able to name one or two private equity funds. Asset managers don't get a percentage for private equity investing."

Compounding this challenge, "You talk to people who can invest and it's hard to argue that real estate is not a good investment in Colorado, and less risky than a tech startup," Freeman stated.

To overcome this hurdle, Freeman is an advocate for diversification by would-be investors; a process whereby they are encouraged to place funds into a wide-range of private equity funds that cater to Colorado's startup businesses.

COMMUNITY GOALS

– Marc Nager, Partner of the Greater Colorado Venture Fund and Co-Founder of Startup Weekend

What are the goal posts? Marc Nager, Partner of the Greater Colorado Venture Fund and Co-Founder of Startup Weekend (UP Global, Startup America, Startup Weekend, Startup Digest, and Startup Next) posed this question to start the conversation to find out what economic developers are aiming for and how each area defines success? In his observation, what can be a healthy goal for one community today, may not be shared by all communities. Understanding where your community is in its evolution and agreeing on a long-term goal purely through an economic development lens, is helpful in building a better understanding of your entrepreneurial ecosystem.

Nager noted, there was an acceleration of trends already in progress last year that favored delivery services and technology-enabled companies. The call to action on this would be to have every Main Street shop equipped with a direct-to-consumer technology to reach a broader consumer base. Nager refers to the success of Bluegrouse Bread out of Norwood as an example, which successfully expanded their distribution from Telluride to Montrose and Durango and is now looking into selling their grain to a wider audience.

Looking through an economic development lens creates a template for how small retail businesses can survive and thrive. Economic developers can lead discussions with decision makers on localizing and regionalizing their supply chains, with the goal of replicating a proven, sustainable model. As an example he used to help align people in Telluride focused on economic diversification: "You can only imagine the impact of five $10MM businesses in a community," noted Nager. "The average $10MM-company will create roughly 30 jobs with an average wage of at least $70,000."

This goal, he acknowledges, is probably more attainable for communities across the Western Slope, than along Colorado’s Eastern Plains due to the entrepreneurial and investment networks that have been drawn to communities West of the Continental Divide.

“Communities on the Eastern Plains are on pace, but they are still almost a decade behind in terms of the resources and infrastructure to support entrepreneurship” he noted. He attributes the acceleration of the ecosystem across the Western Slope to strong programs like Telluride Venture Network, SCAPE, ICELab, CoVenture and others that are leveraging the plentiful capital and intellectual resources found in our mountain communities.

One interesting shift noted from COVID was the increasing availability of capital in the Western Slope communities. “When we started the venture fund three years ago, we thought we could account for two-thirds of the capital to be local, yet during the pandemic we have seen more early-stage investors participating up to 100% of the capital needs of companies. I think this is drive by successful individuals who relocated during the pandemic who are looking for ways to participate in a more meaningful and deeper level with local businesses; and investing in a local company is a way to accomplish this," Nager said.

Despite this upward trend in access to localized investment capital, Nager continues to see two main gaps in funding access in rural markets: an early-stage "pre-seed" gap as well as a later stage "growth capital" gap, which are essentially both earlier and later stage than where his fund is focused.

When asked about the flood of capital flowing to later-stage tech companies from investors outside the state, Nager said, "I think there is both an opportunity and a risk in the flood of outside funding supporting Colorado startups. On one hand, outside capital coming in currently has no reason to pull these companies away, but there is always a longer term risk when primary ownership isn't held locally inn our communities. He cited QuietKat and Rever, both located in Eagle, Colorado, along with Montrose based Campground Bookings, who were all recipients of investments from the Greater Colorado Venture Fund, as examples of this acquisition dynamic. "To the contrary, we believe that being located in a rural market actually made these companies more attractive to potential buyers. They are closer to the customers they serve and the embody the culture of the companies that produce their products." In both cases, Nager believes, the firms received stronger offers because they attracted interest from out-of-state investors.

There have recently been several great success stories of startup ventures such as Durango based MuniRevs which will continue to attract later stage funders. "The hope is that as the market sees many great outcomes for entrepreneurs, investors, and their communities, that it will attract other institutional capital investors to help fill the current gap in later-stage funding needs," he adds that, "at the very least, the later stage investors from the Front Range will realize that there are real competitive advantages to rural based companies. Coupled with a shortage of available funding partners, there is a potential win/win scenario."

The current chasm in the earlier stages of startup funding that Nager sees, has led him to envision the formation of a pre-seed fund that could provide startups with seed investments between $25,000 to $50,000. A good model he suggested that it could be built off of is the Rockies Venture Club, which has an angel investor syndication model that primarily serves companies based on the Front Range. To be effective, Nager would like to see the current West Slope Angels group evolve to support 7-10 volunteer driven chapters across the state to offer both technical and financial assistance to local startups along with a centralized fund that can help both derisk and incentivize participation of local angel investors.

He added that business accelerators like CoVenture, Telluride Venture Network, IceLab, and SCAPE can help overcome the resource gap. These programs do a great job of organizing the amazing networks hidden within communities to support startup ventures in very specific ways, beyond just the capital needs.

While both the early stage and later stage gaps are real, Nager noted that formal efforts to solve for them are nacent at best; however, with the new allocations of federal stimulus and recovery dollars, such as the Build Back Better Programs and the SSBCI program, there is a real opportunity for leaders across the state to combine efforts and create programs and visions that support communities from the Eastern Plains and San Luis Valley to the Western Slope. “There is no reason that we cannot access some substantial funding to support entrepreneurial support programs across the state, and there is no better time than right now to build on the momentum we are currently seeing in parts of rural Colorado.” He hopes to see a new generation of entrepreneurial support organizations as well as direct funding sources for all underserved markets, not just rural Colorado, in the coming year or two.

CAPITAL IN ACTION

– *Elizabeth Marsh, Executive Director, Southwest Colorado Accelerator Program for Entrepreneurs (SCAPE)*
– *Azarel Madrigal-Chase, Program Director, First Southwest Community Fund*

Elizabeth Marsh, Executive Director of Southwest Colorado Accelerator Program for Entrepreneurs (SCAPE), shared her observations on trends she is seeing including an increase in capital coming into her program as well as an increase in desire to help support local businesses over the past 18 months. The capital and support are coming from new residents in her community who have moved to rural Colorado as part of the urban flight phenomenon and these new investor/stakeholders are eager to connect with their new communities. Within the industries that SCAPE is serving, Marsh indicated that Software as a Service and manufacturing, especially of outdoor rec related products, appear to be the most frequently served and, coincidentally, also some of the higher performing investments emerging from the pandemic.

At the First Southwest Community Fund, Program Director Azarel Madrigal-Chase stated that they have been seeing a significant increase in business start-ups during the pandemic with minority and woman entrepreneurs. As the stay-in-place orders required kids to be home schooled, service sector jobs became non-existent, and with women often filling these roles, starting a small business became a necessity for many households in order to survive.

These startup businesses were commonly in food service (baking or cooking), homemade products (textiles or retail products), in-house day care, or agriculture related (produce, eggs). Their strong social and familial networks helped these businesses navigate starting up in a pandemic. “Many of these entrepreneurs,” Madrigal-Chase mentioned, “had been working on these businesses as a “side-hustle” prior to the pandemic but then decided to invest more time and effort into the business as a way to support their families. The access to capital and assistance they were provided added to the legitimacy of the business startups.” The First Southwest Community Fund, through their provision of capital to these traditionally underserved populations, and through the provision of technical assistance to help the businesses launch successfully, supported this surge in micro-businesses.

When asked to cite a case study within the SCAPE investment portfolio that Marsh was most impressed with how they pivoted, she responded, “Without a doubt I am most proud of the pivot that was made by Impact Fenders. As a company who relied heavily on a direct, face-to-face sales model at trade shows with distributors, their business plan was abruptly disrupted with the travel restrictions and stay-in-place orders.” Marsh explained how Impact Fenders quickly implemented an online ordering system that opened up wholesale and retail sales opportunities a year or two ahead of schedule. Additionally, she commented about how they adapted early to local manufacturing to improve their control of the supply chain. This control allowed for reduced disruptions in the supply chain and ultimately lead to a record year of sales.

Many organizations working on economic development initiatives spend time trying to find a “unicorn” business to relocate to their community with the hopes that these businesses bring significant job growth with high wages, capital for investment, and improve the local tax revenue. Opinions on the effectiveness of this strategy vary by community and by the scope of the entities serving the community. “SCAPE’s mission is to build scalable businesses and we feel a tremendous amount of pride when our efforts help contribute to the growth and success of a company that becomes a “unicorn”. Having strong returns from businesses exiting our investment fund help perpetuate our investors’ interests and desires to continue to contribute to our investment funds." These “big-wins” from exiting unicorns also allow for a higher risk tolerance for investing in some other smaller businesses. Besides generating more capital for other investments, unicorns also help develop talent in the local workforce. “In my experience," Marsh continued, “many new start-up businesses will emerge from the employees of a unicorn business in a community. That was evident in Durango after Mercury Payment Systems was acquired by Vantiv and then again by World Pay. The talent remained long after the business had been relocated and they had capital and expertise to create new businesses.” Marsh further added, “SCAPE’s goal is to develop growth businesses for the community. While there may be challenges that remain if an occasional unicorn leaves a community, the benefits of the remaining workforce and the capital that is reinvested in the community will have a positive ripple effect for many years after a unicorn leaves the community”.

When asked about her opinion on unicorn businesses within the community, Madrigal-Chase replied, “The mission of the First Southwest Community fund is generally focused on the underserved populations and the micro-businesses in our communities. It is our hope in serving the underserved entrepreneurs, that with access to capital and technical assistance they could someday become a unicorn business. All unicorn businesses were once a startup. So, building a local ecosystem that supports small business owners throughout any stage of their life cycle will organically help create unicorns. It takes a village to support a business through its life cycle. By fostering collaboration and a community connection amongst small business owners, this helps build social capital and strengthens the ecosystem in a community.”

In looking ahead to the future, Marsh was asked about initiatives and or benchmarks that could be set as a way to help the entrepreneurial ecosystem become stronger and more sustainable in Colorado. “First, the continued development of the local workforce is highly critical. In rural Colorado there are shortages of skilled workers to fill the positions of these new companies that we are developing every year. The labor shortage, coupled with the high cost of housing are often the biggest contributing factors to businesses deciding to relocate or exit a community.” Lastly, “the entrepreneurial ecosystem could also be improved by additional collaboration to create a regional investment pool of funds, specifically one that has funds target industry and region. By clustering and concentrating efforts in a specific industry sector, not only will the quality of technical assistance improve over time, but positive momentum tends to build within the development of the labor pool and risk capital sources.”

“At First Southwest Community Fund," Madrigal-Chase noted, "we see opportunities to support the entrepreneurial ecosystem through creating greater social inclusion in all that we do. We are working on translating our documentation and modifying our marketing to remove barriers that might have previously been intimidating or exclusive to the traditionally underserved populations. There is a lot of opportunity that is expected to be opened up through inclusive communication.”

BREAKING THE NORMS TO CREATE NEW OPPORTUNITIES

– *Delaney Keating, Executive Director, Startup Colorado*

Lost in the conversations around access to startup and phase-two capital is the role that communities can play to provide local businesses with creative terms for funding, according to Delaney Keating, Executive Director for Startup Colorado. In the long-term, she believes, taking a creative approach to incentivizing local startup businesses can benefit the community through increases in local jobs and community sustainability.

In Keating's opinion, "What's hard for governments and their EDOs *(Economic Development Organizations)* is taking risks in the same ways that entrepreneurs do."

Keating cites one city government in Colorado that stepped up to the challenge and gave an entrepreneur a $200,000 interest-free loan that, as the primary repayment term, obligated the company to create a set number of jobs, at a specified minimum (livable) wage, all within an agreed-to timeframe. The terms stipulated that if the employer met these conditions, they wouldn't have to payback the loan.

She believes it is examples like this that give other communities the confidence to structure similar loan incentive packages. "So that's a great example of what I'm talking about, EDOs need to be thinking more about these kinds of experiments to gain traction within their own market." Communities that dare to test, prototype, and experiment as a course of habit, in her estimate, will attract innovative and new projects.

Another barrier that Keating believes is "mission critical" is the lack of diversity in funding that is available in Colorado. She extrapolates that a broader range of funding resources, dedicated to serve businesses of all types and ethnic ownerships — with the inherent lack of access to matching funds and equity that is typical of bootstrapping a venture — could accelerate a good number of startups into their growth stage. "I think a place that we should really focus is that early to growth stage," she says, "because they're out there right now, they've weathered this storm."

Embracing the "character-based lending which is hallmark to the CDFI *(Community Development Finance Institutions)* program, Keating would like to see a culture-based lending initiative developed alongside CDFI's mission. "Culture-based lending will be increasingly important, especially when you look at the crisis. If we don't have the ability to put people into homes or first homes, and those same people want to start a business, you no longer have a base of people that can leverage an asset to take out a traditional loan."

Retaining a skilled and educated workforce presents another key to maintaining a vibrant startup ecosystem in Colorado, according to Keating. "Retaining and creating a brain trust comes down to company culture, opportunity and the ability for those companies to grow," she maintains. Within certain regions of Colorado this is more challenging than in other regions, which she believes can be offset through the development of regional training programs. "I do think there is a high level of really capable people worth investing in and to uplift them into those jobs; and we need better structures to do that."

Keating sees the establishment of a statewide program, aligned with the workforce needs of new-to-market companies, as a "unique way we can also provide funding to some of our startups and early-stage companies to help them offset training and payroll costs," and provide an employment benefit to workers willing to take the risk of aligning with Colorado's dynamic entrepreneurial eco-system.

As the director for Startup Colorado, Keating doesn't believe that the state should only support companies which are destined to become unicorns *(achieved when a company's CAP rate reaches $1B)*. For her, the question of where to allocate resources comes down to whether the state is best served through placing "by taking the risk on one big bet, or spreading bets?" She falls in the camp that is encouraging state leaders to diversify and distribute the recovery funds that are coming down from the federal government across the state's multitude of "incredible people".

CONCLUSION

VENTURE CAPITAL INVESTMENT

Colorado companies are on-pace - with five months remaining in 2021 - to eclipse 2020's record-breaking $2.7B in venture capital investments. Red flags lurk with what would typically be cause for celebration. In the first six months of 2021, the majority of venture capital flowing into the state from outside venture capital groups, none of the $2.6B in Series A Round funding, or later, is reaching Colorado's early-stage startups. Furthermore, Colorado's relatively "raw competitive position" could be threatened as startups migrate to where early-stage capital is more readily available. Data indicates that Colorado is not balanced in attracting VC and early-stage capital investments. After successful exits, principles have not reinvested into the ecosystem. States that have healthy investment ecosystems, build healthier, more sustainable startup communities.

Action: Reversing the scarcity of seed and early-stage funding in Colorado by diversifying would-be investors and encouraging them to place funds into a wide-range of private equity funds that cater to Colorado's startup businesses.

– Mike Freeman, General Partner & CEO, Innosphere Ventures

COMMUNITY GOALS

Economic Developers play a significant role in growing their community's Entrepreneurial Ecosystem. Each community has evolved based on talent, resources, and market. At this intersection lies the opportunity to either develop, retain, or attract entrepreneurs. Several action items have been identified to aid in EDO's supporting their entrepreneurial ecosystems.

Actions:

- Identify community goal posts: Communities need to identify a healthy goal post in developing, retaining, and attracting a healthy entrepreneurial ecosystem by which understanding where the community is in its entrepreneurial ecosystem evolution. What works for one community, may not work for another.
- Lead discussions on localizing and regionalizing supply chains: The pandemic accelerated direct-to-consumer technology, helping businesses reach a broader consumer base. This has now opened a larger opportunity for EDO's to lead discussions on localizing and regionalizing supply chains.

- **Community attraction goals:** Communities should strive to reach a goal of attracting or incubating five-$10MM companies within their communities. The average $10MM-company will create roughly 30 jobs with an average wage of $70,000.
- **What can the State do?** Help lead efforts to form a pre-seed gap fund in the State of Colorado that could provide startups with seed grant funding anywhere between $25,000 to 50,000.
- **Help spur chapter-based venture capital models:** Venture funds such as Rocky Venture Club, has a chapter-based model of an informal network of angel investors who serve in this capacity. To be effective, Nager would like to see seven to 10 volunteer driven chapters set up across the state to offer both technical and financial assistance to local startups. This fund would be governed by a playbook that allows deals to filter up with the prospect of companies being given access to larger investment rounds.
- **What to do with new stimulus funding?** With the allocation of new stimulus and recovery funds still under review by agencies across the state, Nager holds out the prospect of further discussions to build further support for the proposed network of chapter-based venture capital funds; thus, adding to Colorado's ability to incubate and retain innovative businesses.

– *Marc Nager, Partner, Greater Colorado Venture Fund & Co-founder of Startup Weekend*

CAPITAL IN ACTION

Since the onset of the pandemic, several trends are taking place in more rural markets, making this an opportune time to support local startups. Various rural markets in Colorado are experiencing an increase in new residents coming from more urban areas. With this trend has brought new capital and mentor support as these new residents are eager to connect with their communities. Industries emerging from this phenomenon are Software as a Service and manufacturing, especially outdoor rec related products. These emerging industries are being served at a greater volume and are outperforming investments spurring from the pandemic.

Stay-in-place orders forced many women to stay at home with their children. Out of necessity to support their families, side-hustles turned into full-fledge businesses with the help of early stage capital and technical support services that were primarily focused on underserved populations. Types of micro-businesses trending include food and homemade products, in-house day care, to agriculturally produced products that are filling in gaps in underserved communities.

Actions:

- **Removing barriers:** Modify communication that demystifies the process of starting a business so more people feel empowered to go after their dreams. Translate the communication for the various demographics in your community.
- **Continued development of a skilled labor force:** that matches the emerging industries in your community.
- **Housing:** Labor shortage, coupled with the high cost of housing, are often the biggest contributing factors to businesses deciding to relocate or exit a community.
- **Additional collaboration:** Create a regional investment pool of funds, specifically funds that target industry and region. By clustering and concentrating efforts in a specific industry sector, not only will the quality of technical assistance improve over time, but positive momentum tends to build within the development of the labor pool and risk capital resources.

– *Elizabeth Marsh, Executive Director, Southwest Colorado Accelerator Program for Entrepreneurs (SCAPE)*

– *Azarel Madrigal-Chase, Program Director, First Southwest Community Fund*

BREAKING NORMS TO CREATE NEW OPPORTUNITIES

Striking a balance between early stage startups and unicorns is a widely contested subject but is a meaningful discussion that each community needs to embark on. As economic developers we work hard to diversify our economies and so too should we when thinking about our entrepreneurial ecosystems.

For some communities, placing that one-big-bet versus placing many small bets has a lower output for success. Only supporting companies whom which are destined to become Unicorns can lead to exits and job transfer. By taking a holistic approach in developing healthy investment ecosystems allows us to build a robust and sustainable ecosystem of start to exit to back again.

Actions:

- **A creative approach:** Incentivizing a local startup benefits the community by increasing the local tax base, local employment opportunities, and community resiliency. Local governments that are willing to take bets on their local startups, who dare to test, prototype, and experiment as a course of habit, will attract a more innovative and resilient entrepreneurial ecosystem.

- **Embrace and innovate:** Embrace the mission of the CDFI program of "character-based" lending and blend it with a "culture-based" lending initiative to support those who are willing to take the brave leap into starting a business. If we don't have the ability to put people into homes or first homes, then starting a business is out of reach if they can't take on a traditional loan.
- **Development and retaining a skilled and educated workforce:** Companies grow when their culture, market, and workforce grows. If we don't have a skilled workforce to back them, they can't grow. Re-skilling, up-skilling, and next-skilling our local populations will be key to our success.
- **Aligning workforce development programs:** Establish a statewide workforce development program that supports the needs of early-stage companies to help offset training and payroll costs.
- **Mission critical diversification of funding streams:** A broader range of funding resources that are dedicated to serve businesses of all types and ethnic ownership could accelerate startups into their growth stage. By matching funds needed to support the investment, we can accelerate those businesses who have already "weathered the storm."

– Delaney Keating, Executive Director, Startup Colorado