

Independent Sponsors and SBIC Funds: A Match Made in Policy

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Why lower middle market deals and government leverage work so well together.

If you've spent any time around independent sponsors and the capital providers who support them, you've noticed a pattern. SBIC funds show up again and again, sometimes even providing both debt and equity in the same transaction. This is not a coincidence, and it's not just because SBICs send friendly people to conferences. It reflects a genuine structural alignment between two distinct corners of the financial world: one a product of government policy dating back to 1958, and the other a relatively modern evolution of the private equity model. Understanding why they find each other so reliably requires a look at how each one works, and what each one needs.

What is an SBIC Fund, Exactly?

The Small Business Investment Company program was created by Congress in 1958 with a straightforward mandate: stimulate private investment in American small businesses by making it cheaper and easier for investment funds to deploy capital into them. The mechanics are elegant in their simplicity. A private fund manager raises capital from limited partners in the usual way and then applies to the Small Business Administration

("SBA") for an SBIC license. Once licensed, the fund gains access to low-cost, long-term SBA-guaranteed debt that can be layered on top of the private capital raised, enabling the fund to make substantially larger investments in qualifying U.S. small businesses than it could on its own.

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The leverage itself comes in the form of debentures, or SBA-guaranteed loans to the fund. These debentures generally carry a 10-year term, are non-amortizing, and can be prepaid without penalty, with interest rates typically ranging 40 to 70 basis points above the 10-year Treasury rate.¹ The ratio of government leverage to private capital is typically 2-to-1, up to a maximum of \$250 million for an individual SBIC and \$450 million for a family of commonly controlled funds. So, a fund



manager who raises \$125 million in private capital can access up to \$250 million in guaranteed SBA debentures, putting roughly \$375 million to work in total.

There's an important detail embedded in that structure: the SBA's guarantee means the fund is borrowing at rates that arguably do not fully reflect the risk of the underlying assets. The program has operated under a zero-taxpayer-subsidy model and has generated a net surplus of \$1.5 billion to the U.S. Treasury over the past 24 years² — so it's not a money-loser for the government in aggregate — but the individual debenture rate is still more favorable than what an unguaranteed lender of similar risk profile could access in the open market. That subsidy, modest as it may be, is the key to understanding what follows.

Why is There Such a Strong Connection to Independent Sponsors?

Independent sponsors — deal-by-deal acquirers who source transactions without a committed fund and raise capital on a per-deal basis — operate overwhelmingly in the lower middle market. According to

the 2025 Citrin Cooperman survey, 79% of independent sponsor respondents target companies with EBITDA between \$2 million and \$5 million.³ These are businesses that are historically too small for large private equity funds to invest in, and too large for individual passive investors to take on alone.

SBIC funds are structurally sized for exactly this market. A typical SBIC fund, maxed out at \$250 million in debentures against \$125 million in private capital (and before the limits were raised this May, capped at \$175 million in debentures and \$87.5 million in equity), is operating with a total fund of somewhere between \$100 and \$260 million. The 2025 SBIC fund cohort shows most funds targeting businesses with \$2 million to \$20 million in EBITDA⁴, which means that the Venn diagram of “companies an SBIC wants to invest in” and “companies an independent sponsor wants to acquire” overlaps substantially.

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But size alignment alone wouldn't be sufficient. The more interesting reason for the affinity is what the government subsidy does to the SBIC fund's required return.

Consider the position of an unlevered capital provider: a family office or an unlevered private equity fund with no access to cheap government debt. To achieve a market-competitive return on



their LPs' capital, they need the underlying investment to generate returns that are entirely attributable to the business itself. To the degree that leverage can be used alongside equity in the capitalization of the company, its pricing reflects the company's risk profile, rather than the US Treasury rate. An SBIC fund, by contrast, has a portion of its deployable capital structured as cheap, long-term, government-guaranteed debt. That debt doesn't need to earn equity-like returns, it just needs to service the debenture. The equity layer on top of the debt still needs to perform, but the blended cost of capital across the full fund is lower.

The practical result: an SBIC fund can offer more competitive terms to both the independent sponsor and the target company, while still achieving acceptable returns to its own LPs. SBICs in the top half of the private equity benchmark have delivered a 5 to 10 percentage point IRR boost to their LPs as a result of SBA leverage⁵ — which means the fund's investors are happy even when the fund prices its capital more aggressively than a non-leveraged competitor would.

This creates a meaningful advantage in the independent sponsor market, where economics are fiercely negotiated. SBICs are also often notably flexible on capital stack construction — they can operate across debt, mezzanine, and equity simultaneously⁶ — which can make them attractive one-stop partners for independent sponsors who are trying to keep their capital raise manageable. Rather than separately sourcing a senior lender, a mezzanine provider, and an equity co-investor, a sponsor can often get meaningful or even complete coverage from a single SBIC relationship.

The data reflects this affinity. The 2025 Citrin Cooperman survey found that 53% of independent sponsors cited SBIC funds as a capital source — a 19-percentage point increase over the prior three years.⁷ That is a significant and directional shift.

But is This a Good Thing?

That's an interesting question, and it doesn't have an obvious answer.

On one hand, the mechanism functions as intended: government-subsidized capital flows into a segment of the economy that is demonstrably underserved by purely private capital. The lower middle market is where most American businesses actually live; often founder-owned, regionally specific, and operationally concentrated, these businesses can benefit from the real operational expertise and transaction discipline sponsors bring. If the SBIC subsidy helps those acquisitions get done at better terms than would otherwise be available, there is a plausible argument that outcomes for businesses, employees, and a broad swath of stakeholders improve as a result.

On the other hand, it's fair to ask whether subsidizing the acquisition of profitable, already-operating businesses by sophisticated financial professionals is actually what Congress had in mind in 1958. The program's stated mission is to stimulate investment in small businesses, and many SBIC-backed buyouts genuinely do that, providing growth capital, operational support, and eventual transition management to companies that need it. But "supporting small businesses"

and "subsidizing lower middle market private equity returns" are not the same thing, even if they often overlap.

This is ultimately a policy question, not a financial one. The SBIC program, by most measures, does not actively cost taxpayers money. The program generates a surplus for the federal government, with nearly \$1.5 billion transferred to the U.S. Treasury over the past two decades, so while the subsidy is real, the bill is modest.

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Whether that subsidy is being directed toward its highest and best social use is a fair discussion, but that's for a policy blog,

not a thought piece from a boutique investment bank. What's not in question is that for the independent sponsor looking to close a lower middle market deal, and for the SBIC fund looking to put government-backed leverage to work in it, the arrangement makes a great deal of financial sense for everyone at the table.

- (1) RSM US, "Significant changes to the Small Business Investment Company program," rsmus.com
- (2) RSM US, "Recapping a significant year for the SBIC program," rsmus.com
- (3) Citrin Cooperman Independent Sponsor Report, 2025, as cited in VeriVend, "The Capital Stack for Independent Sponsors," verivend.com
- (4) Dakota, "Top SBIC Fund Launches of 2025," dakota.com
- (5) U.S. Small Business Administration, "Apply to be an SBIC," sba.gov
- (6) Small Business Investor Alliance, "ISF Perspectives," sbia.org
- (7) Citrin Cooperman Independent Sponsor Report, 2025, as cited in VeriVend, "The Capital Stack for Independent Sponsors," verivend.com

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