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Rural Developmental Venture Capital: Challenges and Opportunities

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Community Development Venture Capital?

- Small (<\$10million) and local or larger and multi-state
- Good deal flow or limited deal flow?
- Profitable or not?
- Industry growing or not?

Community Development Venture Capital?

- Industry change over time
- Changed funding environment
- Learning from experience
- Consistent focus on benefiting low-income people and geographies
- Struggling with differentiation within “emerging domestic markets” concept
 - Social metrics key and untested vs. traditional VC and other types of DVC
- CDVCs not all alike, even within rural space

Current CDVC Models

- Mixed (rural and urban) investment geography
- Multi-state rural geography
- Partner with universities for technology transfer
- Develop regional sectoral expertise
- Provide TA via grants
- Utilize near-equity to increase number of potential investments and minimize need for VC exit

DVC Challenges

1. Difficulty raising capital

- Much of rural US un- or under-served
- Successful firms “lured to venture capital centers” for capital, especially follow-on and larger rounds
- Existing DVC funds not replicable
 - Sources of capital extremely limited
- Future shortage of tested fund managers
 - NMVC, RBIC, SBIC programs help create supply of fund managers who know how to invest in underserved geographies

ary Sources of Capital

■ Federal Government

□ New Markets Venture Capital and Rural Business Investment Company Programs

- Require reauthorization
- Debt not ideal for equity investing, especially with longer time horizons
- Leverage only

□ Small Business Investment Company

- Debt not ideal for equity investing, especially with longer time horizons
- Leverage only
- No TA provision

□ CDFI Fund

- Important source of equity but small increments

ary Sources of Capital

- Commercial Banks
 - Many lower risk options for meeting “investment test”
 - Few large banks with rural footprints
 - Bank consolidation eliminated many DVC investors
 - Perception rural DVC not viable
- Foundations
 - Few invest in DVC
 - Invest in small increments
- State Governments
 - Policy and funding instability

ossible Solutions

- Federal tax credit for investing in rural geographies
 - Reduces risk and increases incentive for equity investors
 - Investors are familiar with tax credits because of NMTC and LIHTC
 - More politically feasible than direct appropriations
 - Avoid “best effort” model

ossible Solutions

- Focus CRA investment test on business equity vs. real estate
- Expand CRA to more types of financial institutions and those with stronger rural presence
 - e.g., mortgage banks, insurance companies, farm credit bank system, federal home loan banks

ossible Solutions

- Fund of Fund approach at federal level
 - Government is limited partner with same rights as other LPs
 - DVCs that target underserved markets (rural, LMI, small <\$2 million, early stage)
 - Private capital must account for 50% of DVC fund
 - Program housed at SBA
 - Expedited (outsourced?) due diligence vs. SBIC process

Rural DVC Challenges

2. Inadequate deal flow

- Requires costly technical assistance
- DVC funds must expand geography to find sufficient deal flow
 - Limits their developmental impact
 - Hurts particularly distressed regions/states
- Rural portfolio companies often at earlier stage of development
 - Riskier investments with longer time to exit

ossible solutions

- Technical assistance grants
 - Administered by CDFI Fund
 - Experienced in selection and oversight
 - Decoupled from NMVC and RBIC programs to allow funds not interested in leverage to access
 - Based on amount of equity capital raised
 - e.g., 10% of equity raised, up to \$20 million
 - Limited pool awarded on competitive basis
 - Usage limited to TA (as in NMVC and RBIC programs)