

Overview of Rural Developmental Venture Capital and CDVC

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October 5, 2007



Agenda

- ★ **The developmental venture capital model**
- ★ **Statistical overview of rural developmental venture capital and the CDVC industry**
- ★ **Financial and social returns**
- ★ **Challenges of rural developmental venture capital and policy recommendations**

The Developmental Venture Capital Model

The Double Bottom Line

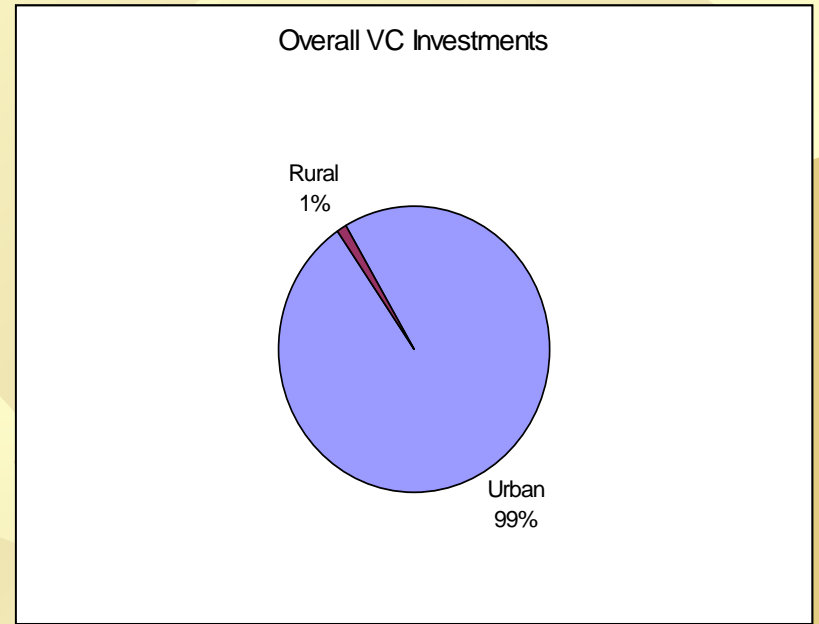
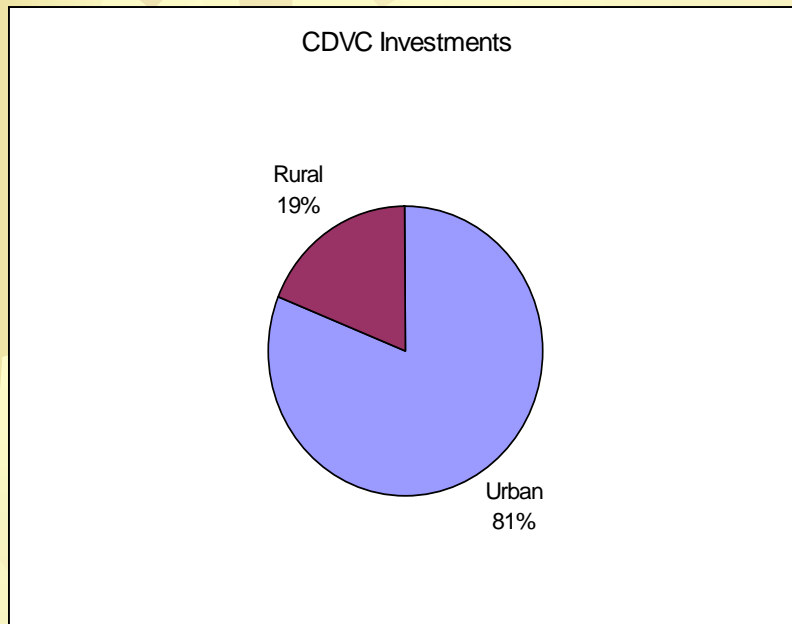
- ✿ Pursue market rates of return for investors
- ✿ Pursue social returns by creating employment and economic activity in underinvested areas

Why Venture Capital?

- ✿ Equity Capital is important
 - ✿ It's in short supply in most regions and industries
 - ✿ Traditional VC is almost nonexistent in most rural areas
 - ✿ Traditional VC is available primarily to a narrow group of mostly high tech companies
 - ✿ Low-wealth rural communities often do not have alternate sources of equity financing
 - ✿ It's a powerful tool to build strong, rapidly growing businesses
 - ✿ It leverages debt capital
 - ✿ These businesses tend to create good jobs
- ✿ Venture capital provides more than money
 - ✿ Entrepreneurial and managerial assistance
 - ✿ Opportunity to boost social returns through board participation and activities of affiliated not-for-profit

Availability of Venture Capital in Rural Areas

Urban v. Rural



Rural Developmental Venture Capital

- ✦ Developmental venture capital was born in rural America and rural funds still dominate the industry.
- ✦ Because creation of economic development and jobs are paramount in rural areas, developmental venture capital is a particularly important policy initiative.

Markets

- ★ Rapidly growing businesses with proprietary technologies or other competitive advantages
 - ★ Where in the new economy are good jobs being created?
- ★ Underinvested rural markets where other VCs do not compete
 - ★ Proprietary deal flow with lower valuations
- ★ Smaller companies in industries not typically served by traditional VCs
 - ★ Possible lower beta

Management

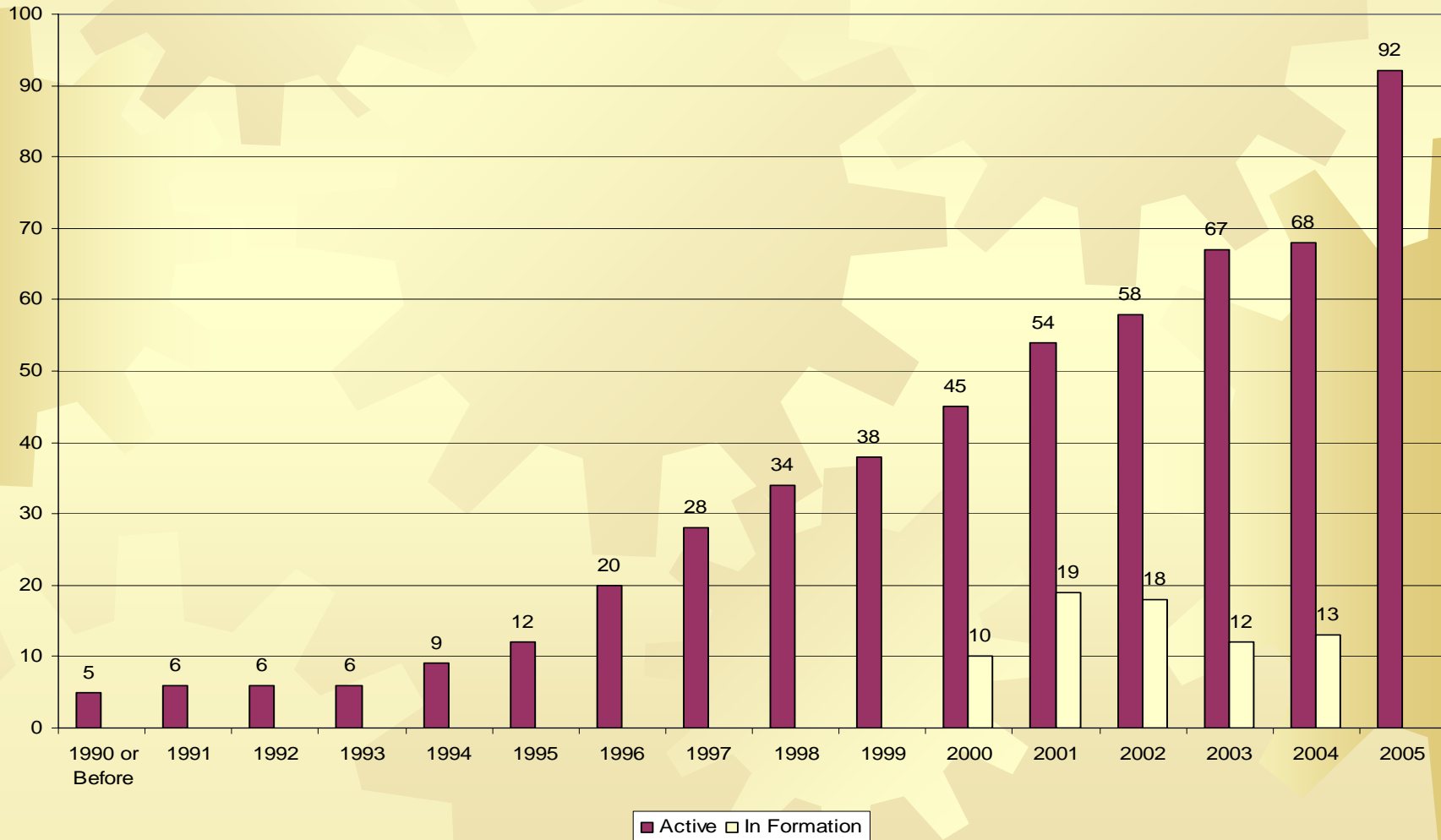
- ★ Experienced venture capitalists and economic development professionals
 - ★ Strong roots in and understanding of local markets
 - ★ Experts in rural businesses
 - ★ Experts in growing companies with large entry-level workforces
 - ★ Relationships with economic development agencies and government
- ★ Volunteer VCs on investment committees and business people who provide entrepreneurial mentoring

A Small but Rapidly Growing Industry

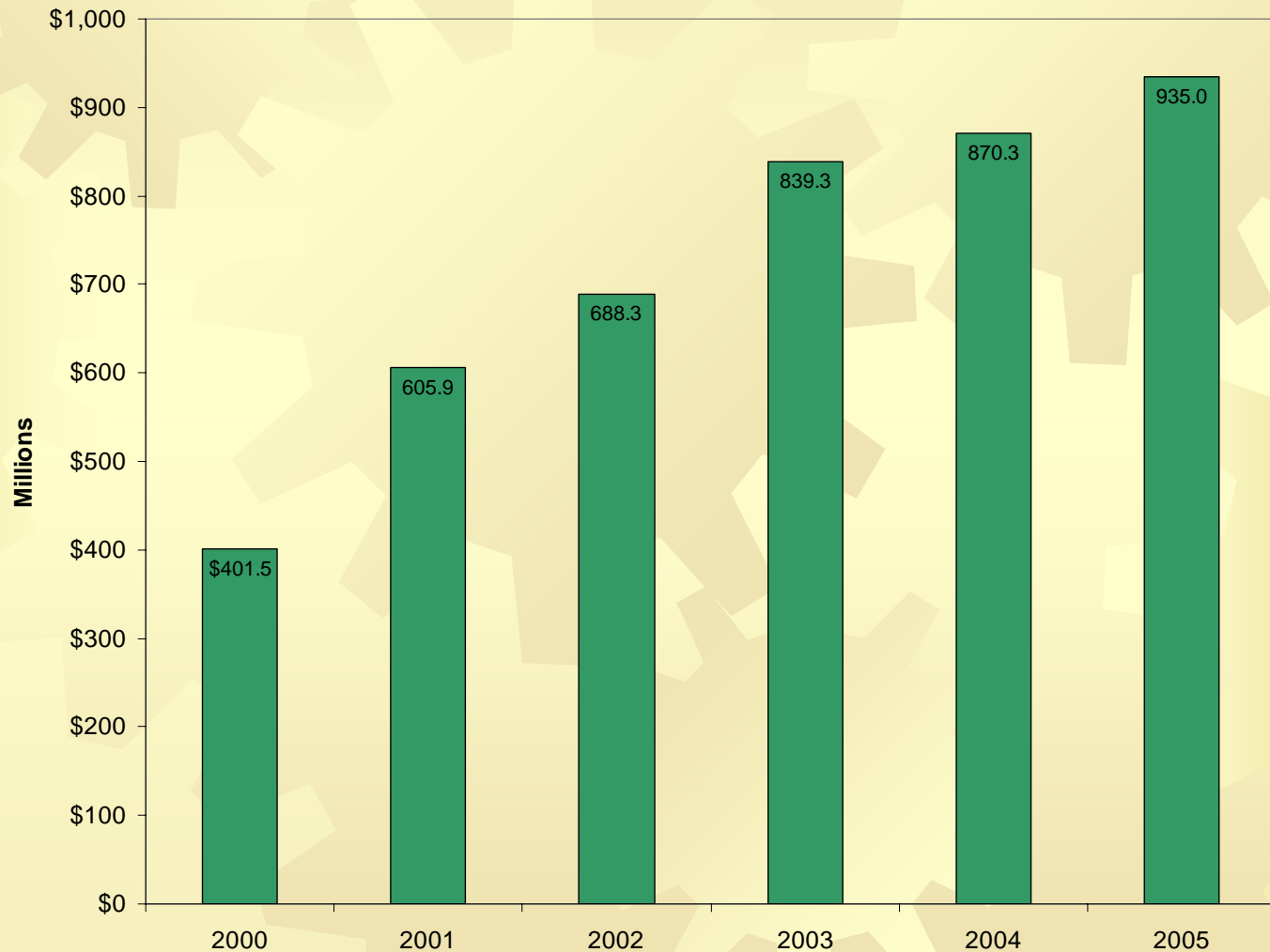
- ★ 92 funds operating and information in the United States, with others forming throughout the world
- ★ \$935 million under management domestically

Growth of Industry

Number of Funds Active or In Formation



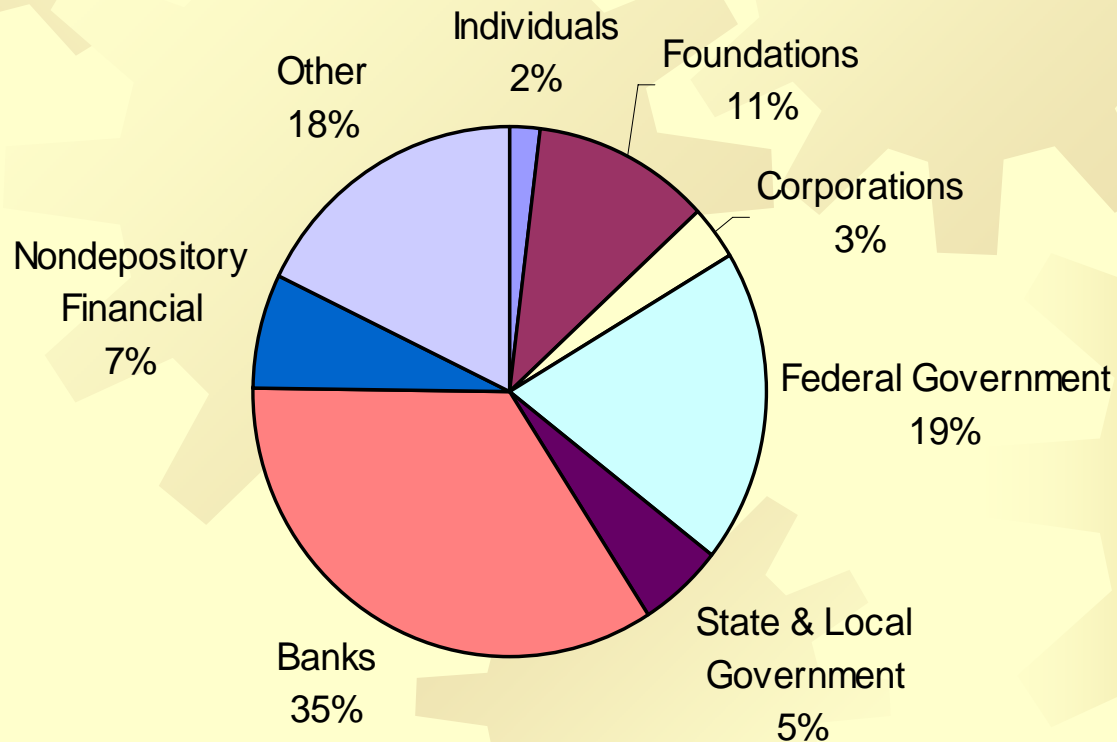
Growth in CDVC Capital Under Management



Investors

- ★ CDVC funds assemble significant pools of capital from investors who share our interest in double bottom line returns
- ★ Banks (CRA); other financial institutions; corporations; foundations; federal, state, and local government; religious institutions; wealthy individuals; pension funds

Sources of Capital for CDVC Funds



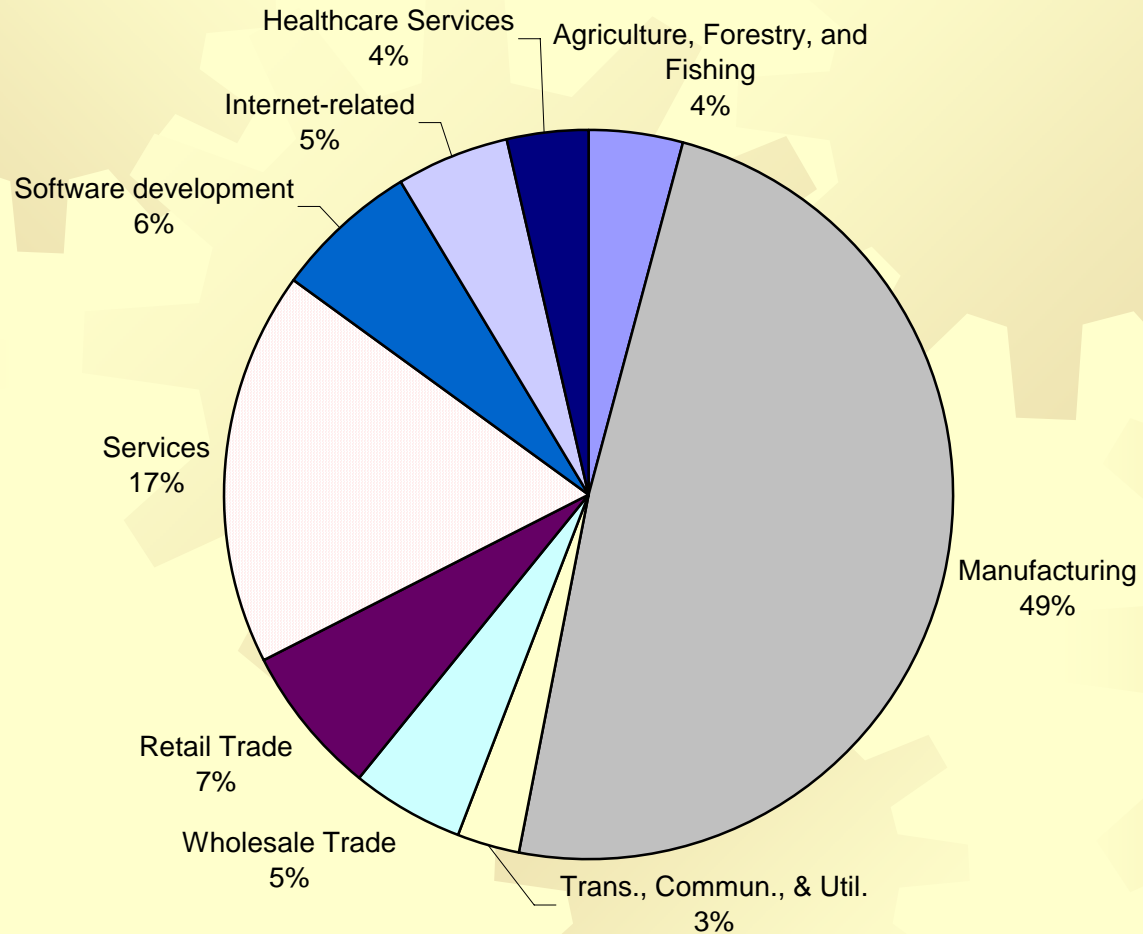
Structure

- Most new CDVC funds are being structured like traditional VC funds
 - 10-year partnerships
 - Management company managing multiple funds
 - Management fee and carried interest
- Some CDVC funds are organized as not-for-profit corporations

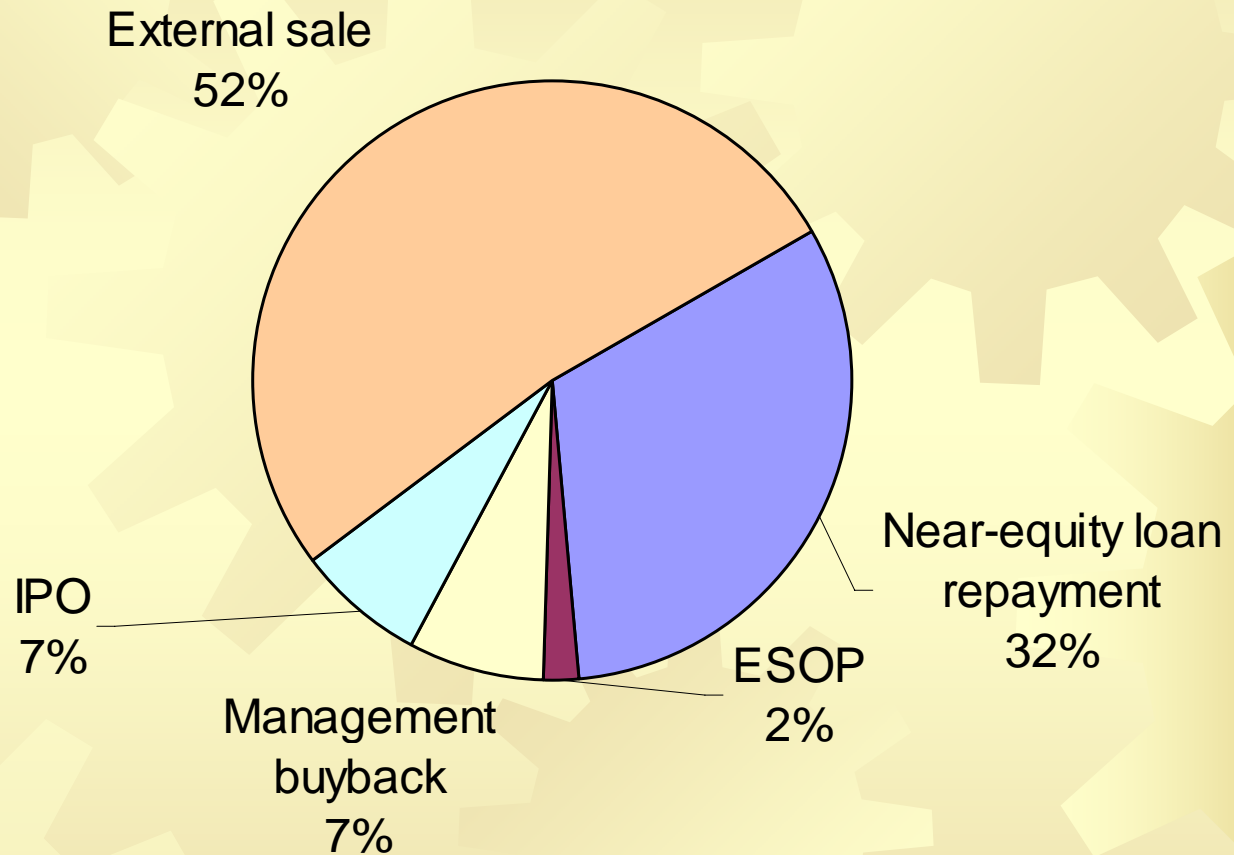
Structure

- ★ Unlike traditional VC funds, many CDVC funds have associated not-for-profit corporations, which provide:
 - ★ Fund organization
 - ★ Intensive pre- and post-investment support for portfolio companies
 - ★ Workforce development services
 - ★ Wealth-building for employees
 - ★ “HR department” for portfolio companies
 - ★ Entrepreneurial mentorship
 - ★ Measurement of fund’s social impact
- ★ These enhance both financial and social returns

CDVC Investments



CDVC Exits



Financial Returns

- ★ Too early to provide return data equivalent to Venture Economics data
 - ★ First traditionally structured fund will not wind up for a couple of years
- ★ We pooled exited and written off investments from three mature funds made between 1972 and 1997
 - ★ 31 exits: 24 successful, 7 write-offs
 - ★ Average holding period: 6.1 years
 - ★ 15.5% gross IRR
- ★ All three were perpetual life, two were not-for-profit

Social Returns

- ✱ Measurable social returns
 - ✱ Job creation, particularly for entry-level workers with lesser economic opportunity
 - ✱ Quality employment
 - ✱ Living wage
 - ✱ Medical benefits
 - ✱ Opportunities for training and advancement
 - ✱ Opportunities for employee ownership and wealth-building
 - ✱ Measure social impact rigorously for investors and to improve performance
 - ✱ CDVCA's Measuring Impact Toolkit

Additional Social Impacts

- ★ Women and minority ownership
- ★ Environmentally sustainable businesses
- ★ Products useful to communities
- ★ Good employment practices

Social Returns

- ✿ Increase in jobs during time of investment
- ✿ Data show substantial increase in jobs at portfolio companies, but much larger increase in low-income jobs
 - ✿ 89% increase in FTEs
 - ✿ 124% increase in low-income FTEs
 - ✿ 37% increase in higher income FTEs

Social Returns

- ★ 19% in rural areas
- ★ 41% in NMTC qualified area
- ★ 37% in CDFI Fund qualified area
- ★ 12.5% in CDFI Fund Hot Zone

Challenges of Rural DVC

- ✦ Raising private capital
 - ✦ Fewer large institutional investors and corporations
 - ✦ Fewer sophisticated investors
 - ✦ Less personal wealth
 - ✦ Less CRA-motivated investment

Challenges of Rural DVC

☀ Smaller Fund Sizes

- ✳ Less favorable economics of fund
- ✳ Smaller management fee
- ✳ Difficulty of attracting and retaining strong management

Challenges of Rural DVC

☀ Difficulty of Attracting Strong Management

- ☀ Many venture capitalists prefer to live in urban areas
- ☀ Fund size

Challenges of Rural DVC

- ✦ Fewer co-investors
- ✦ Greater distances – higher costs
- ✦ Smaller company and deal size – higher cost
- ✦ Deal flow quality/sophistication of management
- ✦ Fewer support services

Policy Recommendations

- ☀ Change CRA to encourage investment in rural areas
- ☀ Tax credit to attract private investors
 - ☀ Don't subsidize losses with investment guarantees
- ☀ Government leverage to increase fund size
- ☀ Operational assistance funds and subsidize operating expenses
- ☀ Training, capacity building and apprenticeship

Policy Recommendations

- ✦ Rural Business Investment Program
- ✦ New Markets Venture Capital Program
- ✦ Change the New Markets Tax Credit to make it more workable for VC or create a new credit to encourage private investment
- ✦ Make procedural and regulatory changes to CDFI Fund FA program to make it more workable for VC funds in rural areas
- ✦ Change CRA to include CDVC, RBIC and NMVC specifically.

