

Community Investments Vol 15, Issue 3 Investing for Social Good: Community Development Venture Capital

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Venture capital can be a powerful tool for building strong entrepreneurial businesses. Because of the patience of equity capital and the entrepreneurial and managerial assistance that a good venture capitalist provides to augment the investment, businesses are able to grow in ways they generally cannot with debt financing alone. The field of community development venture capital (CDVC) recognizes this and seeks to use the powerful tool of equity finance, not just to build businesses, but to build businesses that benefit low-income people and distressed communities.

Like traditional venture capital funds, CDVC funds look for businesses with strong growth potential that promise to provide outstanding financial returns for investors. However, unlike traditional venture capital funds, CDVC funds also have their eye on a second, social bottom line. They look to invest in businesses whose growth has the potential to create good jobs for people with limited job opportunities. This double-bottom line approach means that while traditional venture capital funds and CDVC funds use the same financing techniques, their investment portfolios ultimately look quite different.

CDVC funds invest in geographic areas that are not typical VC hotspots. Between 1991 and 2000, 65.2 percent of all traditional venture capital

investment dollars went to companies located in just five states — California, Massachusetts, New York, Texas, and Colorado. In contrast, CDVC funds invested in places like rural Kentucky, the Mississippi River Delta, and Macedonia; and when they invest in states like Massachusetts, their investment dollars tend to go to areas like Roxbury rather than high-tech hot spots around Route 128.

CDVC funds also invest in industry sectors that are atypical for traditional venture capital funds. While CDVC funds make some investments in technology or biotechnology related businesses, two sectors where traditional venture capital dollars are concentrated, CDVC funds typically focus elsewhere. Manufacturing businesses made up 39 percent of all CDVC investments in 2002, with service-related businesses following at 20 percent. Both these industry sectors tend to offer good employment for people without advanced degrees.

The Community Development Venture Capital Alliance (CDVCA) is the trade association for the community development venture capital industry. As an outgrowth of its mission to promote the use of venture capital to create jobs, wealth, and entrepreneurial capacity that benefit low-income people and distressed communities, CDVCA has its own investment fund the CDVCA Central Fund, which makes investments in CDVC funds and co-investments alongside other funds in businesses that meet its social and financial criteria. In August 2003, the Central Fund closed its first direct investment into a business — SelecTech, Inc. This investment highlights many of the characteristics typical of CDVC investing.

SelecTech is located in Taunton, Massachusetts, a formerly thriving industrial area that has suffered as textile manufacturing has moved offshore. The company manufactures products made from 100 percent post-industrial and post-consumer plastics. Its newest product, Freestyle, is a durable flooring material ideal for commercial spaces. Freestyle, named

because it is a free-lay product that requires no subfloor preparation, special adhesives, or professional installation, is also moisture resistant and does not expand or contract with changes in heat and humidity — all significant commercial flooring considerations. SelecTech already has large contracts with a number of major customers, and with the introduction of this new product line, CDVCA expects SelecTech to experience tremendous growth in the next few years.

In addition to looking like a company that will generate terrific financial returns, SelecTech has already begun generating strong social returns. The company has created 15 manufacturing jobs and anticipates creating 30 to 40 more in the next four years. All of the jobs are located in Taunton with wages starting at \$9 to \$9.50 an hour for production jobs and \$18 to \$22 an hour for supervisors. The company provides health care coverage, a stock option plan, and a 401(k) plan. Additionally, SelecTech provides on-the-job training and opportunities for employees to move up to more independent and supervisory roles as they master the necessary skills.

With its investment of \$250,000, structured as a five-year subordinated loan paying 10 percent annual interest and ten-year warrants as an equity kicker¹, the Central Fund joined other CDVC co-investors — SJF Ventures, Fleet Development Ventures, and the Boston Community Venture Fund. This group will move forward together, not only to provide further financing as necessary, but also to provide technical assistance to the company to help it grow.

The growth of small businesses is integrally connected to healthy economies and successful communities. With the awareness of the role equity capital can play in developing such businesses, the CDVC industry is one of the fastest growing sectors of community development finance. Since the end of 2000, the industry has grown from 52 domestic CDVC funds actively investing or in formation with \$300 million in capital under management to

80 funds investing or in formation with \$548 million in capital under management as of the second quarter of 2003. Banks have been the single largest provider of capital for the industry, accounting for 40 percent of all equity investments made into funds. This growth has taken place during one of the most difficult fundraising environments the venture capital industry has ever faced. In the year 2000, the venture capital industry raised \$106 billion in new capital. In 2002, the venture capital industry was able to raise only \$6 billion. During those same years the CDVC industry grew by 38 percent.

To learn more about the community development venture capital industry, visit the Community Development Venture Capital Alliance's website at www.cdvca.org.

¹ Warrants entitle the holder to buy a specified amount of common stock or preferred stock at a specified price for a period of years. In the case of CDVCA's investment, the price at which CDVCA can purchase stock in SelecTech is locked in for the next 10 years.

Biography



Kerwin Tesdell is the president of CDVCA. He is also an adjunct professor at New York University School of Law, where he teaches a course in community development law. Prior to joining CDVCA, Kerwin was a program officer at the Ford Foundation. Before that, he was the director of the Community Development Legal Assistance Center, which provides corporate, tax, and real estate legal assistance to community development

organizations in New York. Kerwin was also an associate with the law firm of Debevoise & Plimpton and served as a law clerk to a federal judge in Manhattan. He graduated from Harvard College with a degree in economics and holds law and business degrees from New York University, as well as a certificate from the Venture Capital Institute.

Charity Shumway is a program assistant at CDVCA where she focuses on communications and development initiatives. Prior to joining CDVCA, she worked for a business news radio station and directed several educational programs for at-risk youth. She graduated from Harvard College with a degree in English.