

## Venture Capital Initiatives – Type of Initiatives Vis-a-Vis Investment Goals

*Venture Discussion Paper Prepared\* for the Economic Affairs Committee, Jan. 23, 2004*

The involvement of a State in the venture capital formation process as well as in directing operations of Venture Capital funds can be categorized into one of four different buckets.

	1	2	3	4
<b>Type of operation</b>	Publicly Funded/Publicly Managed	Privately Managed Funds with Public Funding	Privately Managed with Publicly Provided Incentives	State Involvement in VC limited to advisory, no direction to BOI
<b>Primary Goal</b>	Economic Development (ED) Driven	Dual Bottom Line: Both ED and IRR	Dual Bottom Line: Both ED and IRR	IRR Driven
<b>Examples</b>	MN Tech Corp. Investment Fund	SBICs BIDCOs	CAPCOs Fund of Funds (e.g. Northern Rockies Venture Fund and Glacier Venture Fund)	Governor's Economic Dev. Office works with private sector and with MT Board of Investments. (E.g. BOI recommends contacts with Private Equity Portfolio managed by Adams Street Partners)
<b>Comments</b>	Upfront investment by state	Upfront investment by state or federal government (in case of SBICs)  Can be structured to stress ED or IRR and rural or urban	Incentives can be guaranteed (CAPCOs) or used as backstop (OK Capital Investment Board)  Can be structured to stress ED or IRR and rural or urban	No cost to state, indirect results, state investments focus only on best return available

---

\*The discussion paper was developed by Gary Bloomer, with modifications from members of the following working group, after a January 6, 2004, meeting in Helena:

Jon Marchi, Glacier Fund

John O'Donnell, TechRanch

Gary Bloomer, TechRanch

Dave Gibson, State of Montana

Karen Powell, State of Montana, Deputy Securities Commissioner

Gary Morehouse, State of Montana, Dept. of Commerce

Jacqueline Lenmark, Keller Law, representing Advantage Capital, among others

Tom Wells, Montana Venture Law

Bill Lombardi, Lombardi Strategic Communications

Additional participants are expected to join discussions at a follow-up meeting Feb. 6, which is scheduled to plan for a Venture Capital presentation at the EAC's March 11 meeting.

As briefly described above, a goal can be placed along a continuum between IRR (internal rate of return) and Economic Development. The goal also can be focused along a second continuum of rural vs urban.



The placement of a goal on either continuum mandates a brief overview of costs and benefits associated with any decision.

### **First: the tradeoffs between IRR and Economic Development**

A purely IRR driven endeavor holds as its highest goal the maximization of a return of capital for each degree of assumed risk. For example, the Board of Investments has this as a goal. Although BOI invests in a Fund of Funds managed by Chicago-based Adam's Street Partners the goal is to seek the highest return of capital weighted against risk and balanced through diversification.

Each incremental step away from a maximization of return on cash invested (given commensurate risk) and towards Economic Development goals mandates a lower IRR. Simply, the goals of maximizing both Economic Development results and IRR on cash committed cannot be placed on the same pool of capital.

A pure Economic Development goal is built from the interest of stakeholders, such as a state, in such things as increasing the tax base, increasing employment, increasing job quality and maximizing or minimizing other metrics not associated with a return on capital.

### **Second: the Rural v. Urban option**

Different models are more, or less, appropriate in determining deployment of capital for rural or urban benefits. Determining how to shape policies that best serve the state in putting Venture Capital to work is difficult for many reasons. These are further complicated when trying to deploy investment capital outside of the significantly populated areas such as Billings, Missoula, Helena, Bozeman, Kalispell, and Butte for the following reasons.

Rural areas are more likely to foster businesses not well aligned to IRR-driven Venture Capital. These businesses are often family owned – creating exit problems for Venture Capital firms that may have invested in hopes the business would generate equity investment on the open market or that the company grows to a point where an outside company will buy out participants. Rural businesses also may be: service based – leading to narrower operating margins; constrained in

their ability to attract additional management and technical personnel; and, geographically isolated to the point of making professional services, such as qualified business law and accounting, difficult to deliver. While not aligned for IRR-driven Venture Capital efforts, the rural areas are well aligned to receive and utilize Economic Development initiatives.

In contrast, urban areas are much better prepared to both receive and put to work Venture Capital funds. Likewise, they are not as well suited to receive Economic Development funds. Bozeman, Billings, Great Falls, Butte and Missoula have active Economic Development initiatives that may not be the same as those in Havre, Glendive, Cut Bank and elsewhere in Montana. Defining the targeted audience is part of defining the goal.

**Direction Sought from Economic Affairs Committee:**

Models exist to meet a variety of goals as long as they are not in opposition. Case studies are available from all regions of the country. The working group listed below is willing to put together a menu of options, based on the goals specified by the Economic Affairs Committee.

Sources:

Rural Policy Research Institute; Rural Equity Capital Initiative. *A Study of Non-traditional Venture Capital Institutions*. Funded by USDA Fund for Rural America

*National Public Seed Fund Survey, Final Report*. Compiled by Technology Gateway, a Seed Capital Coalition Steering Committee for the State of Missouri.