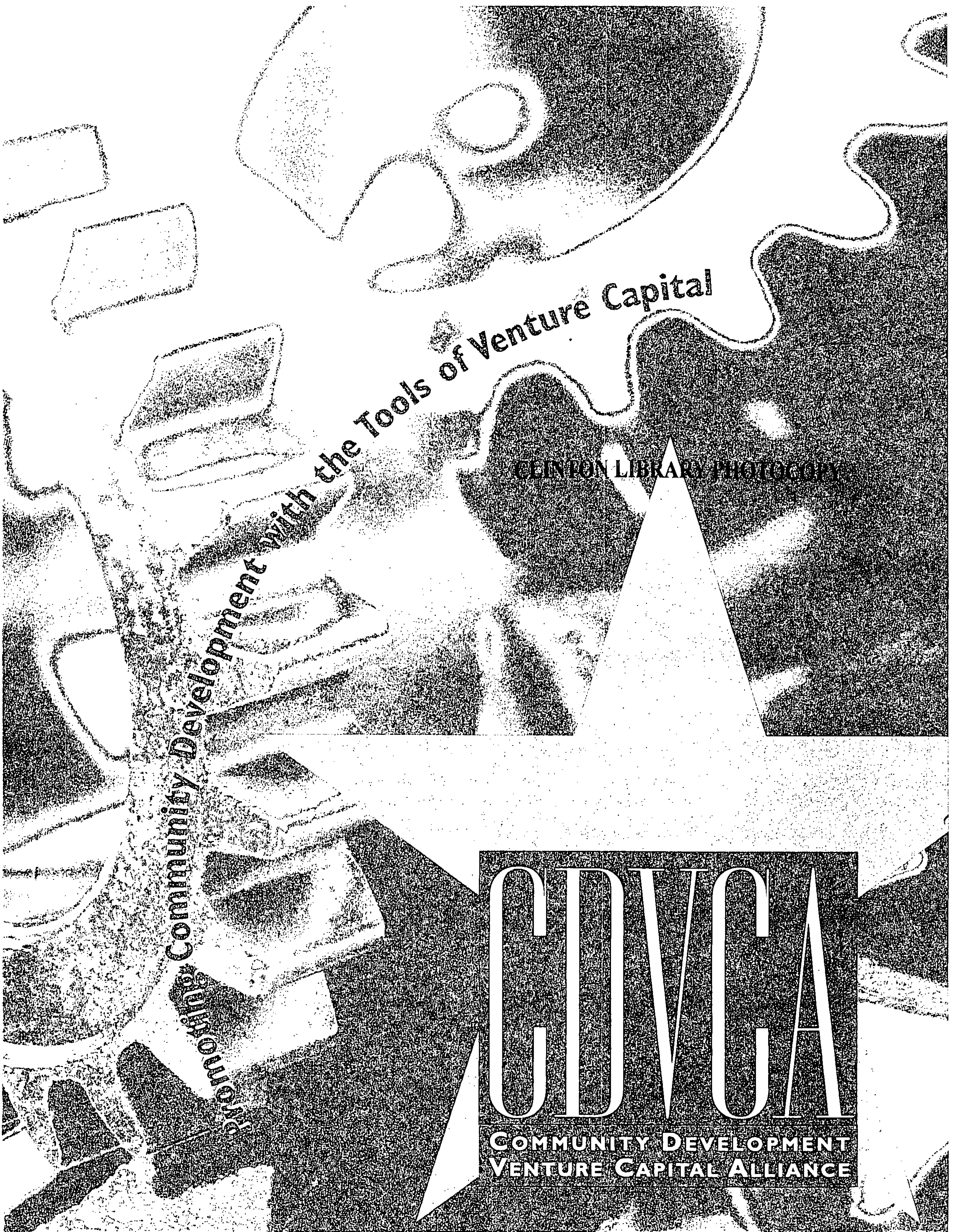

Promoting Community Development with the Tools of Venture Capital

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CDVCA

Community Development Venture Capital Alliance

KENTUCKY HIGHLANDS
INVESTMENT CORPORATION

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Booklet, "New Markets and Stronger Communities," 16 pgs.

NEW MARKETS and STRONGER COMMUNITIES

the case for a community development tax credit

Community Development Tax Credit Coalition

Community Development Tax Credit Coalition
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Venture
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CDVC Fund Profiles

Examples of Community Development Venture Capital Funds at Work Today:

Boston Community Venture Fund, Massachusetts

Coastal Ventures Limited Partnership, Maine

Community Development Ventures, Inc., Maryland

Kentucky Highlands Investment Corporation, Kentucky

New York Community Investment Company, New York

Northeast Ventures, Minnesota

Boston Community Venture Fund

30 Germania Street
Jamaica Plain, MA 02130
(617) 522-6768
Elyse Cherry, President

* * *

Total Assets: $5.5 million

# of Businesses in Portfolio: 7

Legal Structure: For-profit limited liability corporation.

Geographic Focus: Primary focus is state of Massachusetts. Can invest outside the state.

* * *

Boston Community Venture Fund (BCVF) is a community-based venture capital fund that makes equity investments in high-potential, emerging businesses in low-income communities in metropolitan Boston and eastern Massachusetts.

Established in 1996 by **Boston Community Capital**, BCVF invests in seed stage and growth stage companies as a means of providing stable employment, livable wages and career mobility to low-income people. By investing in growing businesses in distressed urban neighborhoods, BCVF aims to improve the long-term economic health of communities and help integrate them into the larger economy.

Founded on the conviction that "financial return and social return need not be mutually exclusive," BCVF focuses on investments which have a clear means of returning the fund's invested capital with a reasonable profit. It looks for strong management, a growth-oriented business strategy, a target hurdle rate of 20 percent, and an anticipated return of investment in five to seven years.

BCVF is currently capitalized at $5.5 million. The fund anticipates increasing that capitalization to over $8 million by the end of 2001 and expanding its investment portfolio to 20 companies.

BCVF Portfolio Company:

SpringBoard Technologies
Tony Dolphin, President and CEO
Springfield, Massachusetts

In 1993, Tony Dolphin, an African-American entrepreneur, saw an opportunity to create his own business when Digital Equipment Corporation announced that it would close the division in which he was working. Tony had been a General Manager at Digital for more than 10 years and decided to approach the company with a proposal to buy out its hard drive repair division.

*Digital agreed, and Dolphin formed **SpringBoard Technologies**, carving out a niche in the competitive computer repair business, providing computer systems, network products and peripherals to service providers and large computer manufacturers. Despite early successes, Dolphin knew that, to stay competitive, the company would have to be able to respond rapidly to a quickly-changing market. "In this business," says Dolphin, "it's either acquire or be acquired. We need to continually expand our technology capabilities if we are going to stay relevant within this industry."*

*But to make the kind of investment necessary to keep his business competitive, Dolphin had to secure substantial equity capital financing. The company sought and obtained $500,000 from **Boston Community Venture Fund**. More than 60% of SpringBoard's employees live within a two-mile radius of the company, which is located in Springfield, Massachusetts. SpringBoard is committed to workforce training and development and is working closely with the local community college to create a technical training partnership. This round of community development venture capital financing will create 45 new jobs. "We want to bring people in from the community, give them some basic skills, and help them to advance within the company," says Dolphin. "SpringBoard's inner-city employees have not only the opportunity for good jobs at good pay, but also potential for career advancement."*

"Boston Community Venture Fund is different," observed Dolphin. "They go beyond the money. Once they understood our business, they identified opportunities, directed us to the person to speak with, and facilitated the discussion. That's the value-added piece. That's why their investment is so important to us."

Coastal Ventures Limited Partnership

2 Portland Fish Pier, Suite 302
Portland, ME 04101
(207) 772-5356
Nathaniel V. Henshaw, President

* * *

Total Assets: $5.5 million

Current Equity Investments: $1.9 million

Investment Size: The fund seeks to make equity investments of between $50,000-$500,000 in growing Maine companies.

# of Businesses in Portfolio: 10

Legal Structure: For-profit limited partnership. Subsidiary of a non-profit 501 (C) (3)

Geographic Focus: State of Maine. Can invest small portion of assets outside the state.

* * *

In 1996, **Coastal Enterprises, Inc. (CEI)**, a non-profit community development corporation with a 20-year track record of providing financial and technical assistance to small businesses and housing and social service providers in Maine, established **Coastal Ventures Limited Partnership (CVLP)**, a for-profit limited partnership, to raise, manage and invest socially responsible venture capital funds. CVLP was capitalized at $5.5 million by investments from more than 20 institutional investors, including eight Maine banks, several national foundations and CEI, which serves as a general partner.

CVLP makes equity investments of up to $500,000 in growing Maine companies that can generate above-average equity returns over five to seven-years, while creating quality jobs and meeting other social goals. In addition to the investment of capital, CVLP provides management assistance and strategic planning, financing and introductions to service providers in the local and national business communities.

CVLP requires businesses that it invests in to sign an Employment Training Agreement (ETAG), committing the company to train and hire low-income individuals as a result of the growth the fund is financing. Companies are expected to offer a living wage and some level of health care coverage to their employees. CVLP also gives preference to businesses in the poorest sections of Maine.

CVLP Portfolio Company:

Cuddledown of Maine
Christopher Bradley, President
Portland, Maine

***Cuddledown of Maine** was founded in 1973 by Ellen Manson. Manson frequently traveled to Europe, where she discovered fine down-filled comforters and high-quality bedding products. She brought samples back to Maine and friends began asking Manson to bring some back for them as well. Recognizing a good business opportunity, Manson placed ads in U.S. magazines and began selling products by mail order.*

By 1985, Cuddledown sales had grown to $1.2 million, exceeding Manson's comfort level and leading her to sell the business. However, the new owner lacked the necessary dedication and experience, and sales declined. In August 1988, a family investor group headed by Christopher Bradley purchased Cuddledown and began turning the company around.

*As a growing business, Cuddledown needed capital. However, the company's existing debt level meant that they couldn't approach traditional sources of financing. That's when Bradley turned to **Coastal Enterprises**. He had heard about CEI's commitment to growing Maine businesses through debt and equity investments.*

CEI worked to secure a $1.2 million financing for Cuddledown, in coordination with the Atlantic Bank, the Small Business Administration, and the Finance Authority of Maine. By 1998, Cuddledown needed additional capital and Coastal Ventures, a community development venture capital fund, came through with a $300,000 equity investment. In addition, CEI assisted in hiring a chief financial officer for Cuddledown by doing the initial screening and supplying a list of the most promising candidates.

Currently, Cuddledown is growing at more than 25% a year. It employs 83 people and expects to add many more positions in the next few years. All employees receive a benefits package, including a health insurance plan. Wages and working conditions are also excellent and there is very little turnover.

Community Development Ventures, Inc.

MMG Ventures, L.P.
826 East Baltimore Street
Baltimore, MD 21202
(410) 333-2550
Anthony Williams, Executive Director

* * *

Total Assets: $8 million

Investment/Loan Size: $100,000 to $500,000 for a term up to 10 years.

Legal Structure: Not-for-profit 501 (C) (3)

Geographic Focus: Makes investments in businesses located in and around Baltimore's Empowerment Community and Enterprise Zones.

* * *

Community Development Ventures, Inc. (CDV), utilizes "socioeconomic" investing as a means to improve the well-being of economically or socially disadvantaged individuals and businesses. Its mission is "to strengthen the economic base of distressed communities through business and entrepreneur development."

CDV was created in 1998 by MMG Ventures, L.P, which is owned and operated by four African-Americans highly skilled in finance. CDV fuels economic development through a combination of venture capital, management and technical assistance, training and entrepreneurial development. CDV provides senior and subordinated debt and equity to businesses located in and around Baltimore's Empowerment Community and Enterprise Zones that are in need of growth or start-up capital. It also offers a Management & Technical Assistance Program (M&TAP) to Baltimore businesses and a Youth Entrepreneurial Program that promotes entrepreneurial awareness and skills among high school students.

To date, CDV has raised a total of $8 million from a variety of sources, including The Ford Foundation, Prudential Insurance Company, and Empower Baltimore Management Corporation. CDV has also received $1.25 million from the U.S. Department of Treasury's Community Development Financial Institution (CDFI) Fund.

CDV Portfolio Company:

Ntegrity Telecontent Services, Inc.
Dwayne Goldsmith, CEO
Baltimore, Maryland

*In 1997, Dwayne Goldsmith and Theresa Osborne, quit their executive jobs at Chicago's Ameritech Corporation to launch **Ntegrity Telecontent Services, Inc.**, a telecommunications company that provides local and long-distance phone service to small business and residential customers.*

Capitalizing on a spate of deregulation in the telecommunications industry, Ntegrity was established as a Competitive Local Exchange Carrier – or reseller – of local and long-distance phone service, enabling it to provide bundled communication services, including paging, voice messaging and Internet service, to its customers.

With a customer base in New Jersey, Pennsylvania and Maryland and the right to resell phone service in Massachusetts and New York, this minority-owned start-up could have been headquartered in any number of northeast cities. But the group decided to move to Maryland after CDV offered it $500,000 in subordinated debt, providing a significant portion of the total $2 million the company needed to meet its working capital, equipment and office development needs.

While Ntegrity did attract the attention of a number of traditional venture capitalists, Ntegrity executives pursued the CDV offer largely because of the consultative services and management assistance that came with it – something Ntegrity executives believed gave the firm "a strategic advantage to other sources of funds."[1]

In the summer of 1998, Ntegrity Telecontent Services, Inc., moved into its new offices in Baltimore's Empowerment Zone, bringing 41 job opportunities to the area. As part of its agreement with CDV, it has agreed to fill a portion of these jobs with Empowerment Zone residents. Four neighborhood residents have already been hired. Ntegrity's first year revenues are expected to reach $4.5 million.

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[1] Source *The Daily Record*, Saturday, January 30, 1999, quote from Keith Machen, Ntegrity vice president.

Kentucky Highlands Investment Corporation

P.O. Box 1738
London, KY 40743-1738
Phone: (606) 864-5175
L. Ray Moncrief, Executive Vice President and Chief Operating Officer

* * *

Total Assets: $31 million

Investment Size: $100,000 to more than $1 million

Legal Structure: Not-for-profit 501 (C) (4) Community Development Corporation with several for-profit subsidiaries.

Geographic Focus: Nine counties of southeast Kentucky in Appalachia

* * *

Kentucky Highlands Investment Corporation (KHIC) invests in start-up and expanding non-retail business enterprises located or willing to move to a nine-county area of southeast Kentucky in Appalachia, where income, employment and education levels are still significantly below national averages. Founded in 1968 as a Community Development Corporation, KHIC now has a multi-million dollar capital pool and a portfolio of investments ranging from $100,000 to more than $1 million.

KHIC provides a multitude of services to businesses in its region including subordinated equity, debt, real estate construction and management, and management consulting services. In many cases, KHIC will actually create new businesses from the ground up if it sees a market need. On several occasions, KHIC leadership has written a business plan, financed the plan and recruited a CEO to run the business.

In 1994, KHIC was designated the "Lead Entity" for a Rural Empowerment Zone for an area covering three of its counties. As the Lead Entity, KHIC directs the use of $40 million in Empowerment Zone funding and is responsible for the administration and implementation of a strategic plan for the region.

KHIC Portfolio Company:

American Health Management, Inc.
Kelly Upchurch, President
Richmond, KY

At the age of 32, Kelly Upchurch had an ambitious vision: to open a network of adult "day care" centers that would offer supervised daytime care for the elderly throughout rural Kentucky. Nationally, there are more than 6,000 such centers – usually in metropolitan areas – but Mr. Upchurch believed that rural Kentucky had a tremendous need. So in 1997, he quit his job at a local hospital to start ***American Health Management, Inc.***

A psychologist, with extensive experience in the field of rehabilitation, Mr. Upchurch needed financing to get started and business expertise to ensure lasting success of his business. At ***Kentucky Highlands Investment Corporation (KHIC)****, he found that exact combination. Ray Moncrief, Executive Vice President and Chief Operating Officer at KHIC (and a CDVCA board member), was impressed with Mr. Upchurch's vision. "I thought his idea was a natural fit for us because it would create professional jobs in a rural area where we need more professional jobs."*

KHIC provided American Health Management, Inc. with a $75,000 equity investment and $15,000 in working capital for its first center, The Clinton Adult Day Health Care, which opened in January 1998 in Kelly's hometown of Albany. As part of the deal, KHIC owns a percentage of the company, which Upchurch can buy back over a five-year period. The KHIC team also provided countless hours of technical assistance, helping Mr. Upchurch develop his business plan, set up an accounting and cash management system, make financial projections, and plan for the future growth of the business. According to Mr. Upchurch, technical assistance was the real appeal of Kentucky Highlands. "I'm strong in health care systems, but they were strong in things I didn't have experience in. Basically, they assigned me a team and gave me the name of a person I could call anytime to ask for advice."

After one year, American Health Management was able to use modest profits from its first center to finance the opening of a second in Monticello, Kentucky. Ultimately, Upchurch plans to open 16 centers and grow American Health Management into Kentucky's largest adult health care center, creating more than 100 quality jobs – recreational therapists, nurse's aides, registered nurses – in a state where good jobs are scarce. All staff are hired from within each community and receive competitive wages and health insurance. But Upchurch is just as proud of the fact that these centers enable their patients' caregivers to remain employed. "We give people the opportunity to take good jobs and go to work each day with peace of mind."

New York Community Investment Company

120 Broadway, 36th Floor
New York, NY 10271
(212) 693-0870
Howard Sommer, President

* * *

Total Assets: $10 million

Legal Structure: For-profit limited liability corporation

Geographic Focus: Initial $10 million must be invested in New York City. Subsequent $15 million can be invested anywhere in the state of New York.

* * *

The **New York Community Investment Company (NYCIC)** was created in 1996 by a consortium of New York City commercial banks to provide creative financing solutions to New York's small business community – particularly businesses located in low-and moderate-income neighborhoods and businesses owned by women and members of minority groups.

Member banks set up and capitalized the corporation with $10 million to identify potential new deals for the banks to invest in, but also to help meet their federal Community Reinvestment Act obligations.

NYCIC provides equity and subordinated debt to companies with sales from $1 million to $10 million that are located in the five boroughs of New York City. The fund focuses especially on women- and minority-owned businesses, as well as on businesses located in lower-and middle-income areas of the city, but does not restrict itself to these criteria.

To date, each dollar invested by NYCIC has leveraged a dollar and a quarter in additional financing.

NYCIC Portfolio Company:
Square One Design
Anne Jaroszewicz, President and CEO

*For years, people in the home furnishings industry told Anne Jaroszewicz to come out from behind the curtain of "private label" design and start her own product line. Her New York City-based company, **Square One Design,** had established a reputation over more than 10 years, developing home furnishing accessories for some of the biggest retailers in the country. But market forces were pushing more and more retailers to bring their work in-house and Square One's business was beginning to flatten.*

*Starting her own product line, however, would be tantamount to building a business from the ground up. Ms. Jaroszewicz would need financing for a whole new infrastructure, to warehouse and manage her inventory, establish systems for tracking orders and billing, and hire staff to manage the anticipated growth. And although Square One had an impressive track record -- with customers as notable as Pier I Imports and Pottery Barn -- few banks were interested in financing the expansion of a small business. Fortunately, one bank gave Ms. Jaroszewicz a hot tip, suggesting she send her business plan to the **New York Community Investment Company (NYCIC).***

*Ultimately, **NYCIC** provided Square One with $250,000 in the form of convertible debt that can, at NYCIC's option, be converted to shares of the company. As a direct result of this financing, Chase Manhattan Bank loaned Square One an additional $325,000. With this new infusion of cash, Ms. Jaroszewicz launched her own line, **Annie J.***

In addition to financing, NYCIC staff also helped the company develop a plan for upgrading the company's accounting and management information systems. To ensure that the company can keep up with the growing demand for its product, Square One has created several new jobs at a range of skill requirements, from warehouse jobs – paying nearly double the minimum wage with benefits – to a national sales manager position. The company rented 7,000 square feet of warehouse space in Red Hook, Brooklyn, hired a manager and two full-time staff to staff it, and is currently recruiting additional warehouse workers and an on-site customer service representative. In the Manhattan showroom, Square One will also add a number of support and professional staff positions.

"NYCIC's money came into the business at the right moment, allowing us to fuel this growth," said Jaroszewicz. "Right now, we are more than 24 percent ahead of our most optimistic projections and if we are able to stay on this trajectory, we will more than double the business we did last year."

Northeast Ventures

802 Alworth Building
Duluth, MN 55802
(218) 722-9915
Greg Sandbulte, President and Chief Operating Officer

* * *

Total Assets: $11 million

Investments to date: $8.3 million

# of Businesses in Portfolio: 23

Jobs created: 695 jobs created or saved since 1989

Legal Structure: For-profit corporation

Geographic Focus: Northeastern Minnesota. Up to 15% of assets can be invested in the rest of the state.

* * *

Northeastern Minnesota is a largely rural area that historically has relied on iron ore production for its economic base. When the domestic steel industry encountered significant foreign competition in the 1980s and began shutting down obsolete facilities and using cheaper foreign ore, the region was left with few economic opportunities. In 1989, **Northeast Ventures (NEV)** was established as a for-profit community development venture capital fund to help diversify the region's economic base and spur entrepreneurship by making equity investments in local companies.

In addition to providing capital and technical assistance, it makes its portfolio companies aware of government placement services that can make it easier for them to hire low-income workers.

NEV was capitalized by a combination of program-related investments from the Ford and MacArthur foundations; equity investments from the Blandin and Northwest Area foundations, Minnesota Power utility, and Minnesota Technology (a state development organization); and a grant from the Community Development Financial Institutions Fund.

NEV Portfolio Company:

Powerain Systems, Inc.
Stephen Kerr, President and CEO
Tower, Minnesota

In 1990, a group of entrepreneurs approached Northeast Ventures about setting up a car wash equipment manufacturing facility in Tower, a town of 508 people in one of the poorest parts of Northeastern Minnesota. NEV thought the market opportunity was attractive and that the business could create jobs and bring economic vitality to a region. However, the company had an incomplete business plan and lacked a Chief Operating Officer.

Other assistance was needed before NEV could provide financing for the effort. Northeast worked closely with Powerain's founders to revise the business plan and identify a strong CEO candidate for the company. Northeast also invested $200,000 in equity in the business. Northeast's involvement did not stop after making its first investment.

Over a multi-year period, NEV has talked daily with Powerain CEO regarding subjects as diverse as sales, executive recruitment, strategic planning, distributor relationships and the financial structure of debt deals. NEV has even worked to locate suitable housing for senior management of the company. NEV has assisted Powerain in all subsequent rounds of financing, totaling $826,932.

Powerain had a record sales year in 1998 and is expecting another record year in 1999. The company currently employs 20 full-time people, and expects to increase that number significantly in the future. The company provides ongoing training to its staff and entry-level positions begin at $8 an hour, with full benefits. Most employees earn well in excess of $10 an hour.

Community Development Venture Capital Alliance

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Community Development Venture Capital Alliance

The Community Development Venture Capital Alliance (CDVCA) promotes use of the tools of venture capital to create jobs, entrepreneurial capacity and wealth to advance the livelihoods of low-income people and the economies of distressed communities.

CDVCA has more than seventy members, including approximately fifty community development venture capital funds. CDVCA's membership is made up of organizations located throughout the United States and throughout the world who seek to apply the powerful engine of growth that has driven the economic expansion in Silicon Valley and other hotbeds of business development to the economic needs of low-income communities. We believe that the combination of equity capital and related intensive entrepreneurial and managerial assistance that community development venture capital funds can provide is a critical part of promoting the growth of local businesses and good jobs in distressed communities.

Community development venture capital is a new field that presents real opportunities to make enduring changes in the lives of low-income people. While the model is promising, there is still much to explore and learn. CDVCA plays a crucial role in fostering this rapidly growing field by:

- providing training and specialized technical assistance
- increasing access to capital and other resources
- collecting and distributing information
- developing standards and best practices
- offering opportunities for peer exchange and learning among professionals
- advocating for the field
- encouraging traditional venture capitalists and individual angel capitalists to become more involved in community development finance.

For more information about CDVCA contact: Christina Mayo (e-mail: cmayo@cdvca.org).

COMMUNITY DEVELOPMENT
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Using the Power of Venture Capital to Revitalize Communities

An Argument for New Markets Venture Capital Legislation

June 1999

For more information contact:
Kerwin Tesdell, President
Community Development Venture
Capital Alliance

SUMMARY: USING THE POWER OF VENTURE CAPITAL TO REVITALIZE COMMUNITIES

The remarkable performance of the U.S. economy in recent years has improved the incomes of tens of millions of Americans. At the same time, this prosperity has left millions of other Americans behind – trapped in chronic poverty, marooned in areas of high unemployment and stagnating in underemployed circumstances.

Unequal development harms large numbers of today's adults, robbing them of opportunities to enjoy a better standard of living and robbing society of their talent and potential. It also threatens our future. With more than one out of five of the country's children growing up in poverty, far too many are not attaining the skills and knowledge needed for the 21st-century economy.

Fortunately, a new industry of "community development venture capital" (CDVC) funds has devised an effective strategy for creating jobs and alleviating economic distress – by targeting investment capital and business expertise to low-income areas. These mission-driven funds are demonstrating that there are a large number of business opportunities, with substantial financial potential and tremendous social benefits, in poor rural and inner-city communities. Their disciplined, business-like investment approach to community economic development has already delivered some astonishing results. A modest federal investment could dramatically expand on this success.

Low-income communities in the U.S. face multiple and varied barriers to sustainable growth. But a common obstacle to virtually all such communities is that they are unable to attract sufficient equity capital and technical assistance for starting and expanding businesses. Federal Reserve Board Chair Alan Greenspan recently observed that equity capital is crucial to the existence of an innovative and productive business community, especially in lower-income communities. Yet we know that currently about three-fourths of conventional private venture capital investments are steered toward high-technology companies, and as recently as the first quarter of 1999, more than half of all venture investments have been going to just two regions of the country – California's Silicon Valley and New England's hi-tech corridor.

CDVC funds are beginning to address this severe market shortcoming. They apply the tools of venture capital to fuel business creation and expansion, create good jobs and improve the lives of people in economically distressed communities. These funds seek to demonstrate that the same model of business development that has driven economic expansion in Silicon Valley and Route 128 in Massachusetts can also make a powerful difference in areas like the Mississippi Delta, inner-city Baltimore, and Appalachia. There are currently more than 40 CDVC funds operating and fund-raising across the United States and Canada. In the U.S. alone, such funds have nearly $300 million under management.

In the heart of Appalachia ... ***Kentucky Highlands Investment Corporation*** *invests in start-up and expanding businesses located in southeastern Kentucky and has created many successful new companies from the ground up, writing and financing business plans, recruiting CEOs to run the businesses, and providing whatever ongoing management assistance is needed to assure the companies' success.*

In inner-city Baltimore ... ***Community Development Ventures, Inc.*** *provides equity financing to minority-owned businesses in need of growth or start-up capital in and around Baltimore's Empowerment Community and Enterprise Zones, raising $8 million in its first year and offering a Youth Entrepreneurial Program to promote entrepreneurial awareness and skills among high school students.*

In Northeastern Minnesota ... ***Northeast Ventures Corporation*** *has invested $8.3 million in 23 local businesses, creating or saving nearly 700 jobs, and is intensely involved in the day-to-day operations of its portfolio companies, helping to jump-start a regional economy devastated by the restructuring of the U.S. steel industry.*

CDVC funds are committed to the "double bottom line" that considers both the social and financial implications of their investments. Their mission is fighting poverty, but they are in every way serious investors who invest in companies with strong management, good ideas, impressive growth potential, and the promise of high return rates. These funds conduct the same rigorous analysis that any traditional venture investor would. They find that the businesses in which they invest need a degree of intensive nurturing that most traditional investors are not willing to provide—but which CDVC funds consider central to their work.

Two new initiatives that will be considered by the 106th Congress this year build on the promise of these CDVC funds and look to public/private cooperation to support their work and increase the flow of capital into traditionally underserved areas and populations. A **New Markets Venture Capital Program**, proposed in concept by President Clinton in his budget proposal for FY 2000, would create 10-20 New Markets Venture Capital Companies (NMVCs) to provide a combination of equity venture capital financing and technical assistance to smaller businesses in low-income areas or employing low-income individuals. And the **Community Development Venture Capital Assistance Act of 1999** (S.619), which was passed by the Senate last year and has been reintroduced this year, would provide matching funds to strengthen and support this emerging field through professional training programs, internships, technical assistance, research activities, and promotion of best practices. These two pieces of legislation complement each other and, together, will help build a strong industry of funds that will serve distressed communities throughout the country.

* * *

About the Community Development Venture Capital Alliance

Established in 1992, the Community Development Venture Capital Alliance (CDVCA) promotes use of the tools of venture capital to create jobs, entrepreneurial capacity and wealth to advance the livelihoods of low-income people and the economies of distressed communities. CDVCA has over seventy members who seek to apply the powerful engine of growth that has driven the economic expansion in Silicon Valley and other hotbeds of business development to the economic needs of low-income communities.

Community Development Venture Capital: An Introduction to the Field

Community development venture capital (CDVC) funds apply the tools of venture capital to fuel business creation and expansion, create good jobs, and improve the lives of people in economically distressed communities. The community development venture capital field is a relatively new one. The oldest fund was created in 1968, and most current funds were founded in the last 10 years. CDVC funds include not-for-profits, for-profits and quasi-public organizations. Their structures range from corporations to limited partnerships, community development corporations (CDCs), limited liability companies (LLCs) and Small Business Investment Companies (SBICs). Investors in CDVC funds include foundations, banks, insurance companies and other corporations, government agencies and private individuals. They invest because of an interest in a "double bottom line" that considers both the social and financial returns of the funds.

CDVC vs. Traditional Venture Capital: Differences Point to Challenges

Types of Investments

CDVC funds make equity and equity-like investments in highly competitive small businesses that hold the promise of rapid growth. These fast-growing companies produce a "double bottom line" of both financial returns and social benefits in the form of good jobs and healthier communities.

Operational Costs

CDVC funds have higher operational costs than traditional venture capital funds because of the smaller sizes of their deals and the need to provide extensive technical assistance to their investees. Smaller deals require as much staff time as larger ones, forcing CDVC funds to spend more time overseeing each investment than a comparably sized traditional venture capital fund. The level of technical assistance that CDVC portfolio companies require further exacerbates this need for additional staff. While the operating costs of traditional venture capital funds rarely exceeds 2.5 percent of funds under management, costs at CDVC funds can be as high as 6 to 8 percent.

Typical Investment Size

CDVC investments range from $50,000 to $1 million per company, while traditional venture capital investments are rarely less than $500,000 and the average such investment is now nearly $5 million. The community development mission of CDVC funds compels them to address the need for smaller investments, which are more expensive to administer and thus less attractive to traditional venture capital sources.

Raising Capital

The pool of potential investors that share an interest in the social component of the "double bottom line" is limited, therefore most CDVC funds cannot raise the kinds of funds that a traditional venture capital firm can raise. Existing CDVC funds range from $5 million to $30 million in size, with most falling between $5 million and $10 million. Traditional venture capital funds are rarely smaller than $25 million, and funds with assets in the hundreds of millions are not unusual. For the CDVC industry to reach a sustainable economic scale and demonstrate the full power of the model, substantial new sources of risk capital must be found.

Technical Assistance

CDVC funds do much more than provide technical assistance; as serious investors with an interest in the success of their portfolio companies, they actually become working partners with entrepreneurs. In many cases, representatives of the CDVC fund will sit on the board of directors, provide day-to-day managerial assistance, help identify additional financing, make contacts with customers and suppliers and help with executive recruitment. They become experts in the industries in which they invest and work alongside business owners to ensure the success of their companies. For businesses in low-income areas, this assistance is often as crucial as the financing itself. As critical as this technical assistance is to the success of the investment, it also adds substantially to the cost of operating a CDVC fund.

Deal Flow

Because of their focus on impoverished rural and urban regions, CDVC funds generally have significantly fewer investment opportunities to choose from. A traditional venture capital fund will review hundreds of business plans in order to select 2 or 3 in which it wants to invest. A typical CDVC fund will evaluate from 5 to 100 deals a year and make 1 to 4 investments. Because the readiness of those deals for investment is usually lower than that seen by traditional venture capital funds, CDVCs also need to provide substantial technical assistance to the companies in which they invest.

Rates of Return

CDVCs' rates of return are ordinarily less than traditional funds because they are not yet able to reach the same economies of scale as traditional venture capital funds.

Addressing the Key Needs of the Field: Equity Capital, Technical Assistance and Capacity Building

The emerging community development venture capital industry has begun to demonstrate that it can be a powerful tool for economic development and community revitalization. But to achieve its full potential, it will need the increased public and private support that the New Markets Venture Capital Program and the Community Development Venture Capital Assistance Act of 1999 can provide. These programs address the three most critical needs of the field: equity capital, technical assistance and industry capacity building.

Equity Capital and Technical Assistance: Inextricably Linked

The New Markets Venture Capital Program, to be introduced by leading members of Congressional Small Business Committees, would create 10-20 New Markets Venture Capital Companies (NMVCs). These would provide a combination of equity venture capital financing and intense technical assistance to smaller businesses located in low-income communities or employing low-income individuals. The New Markets Venture Capital Program would provide support for urgently needed equity capital and matching technical assistance grants to allow the intensive hands-on entrepreneurial and managerial assistance that is key to the success of community development venture capital. Participation would be on a competitive basis and would be geared toward funds that have expertise in the field of developmental venture capital, a strong financial track record and a mission of community development. NMVCs will be for-profit venture capital investment companies.

Building on a Promising Model

The New Markets Venture Capital Program will be administered by the U.S. Small Business Administration (SBA) and is designed to complement the SBA's existing programs. In developing the initiative, the SBA used the growing community development venture capital industry, whose members are making successful equity investments in distressed communities, as a model for the program. The New Markets Venture Capital Program recognizes the promise of the model and the unique knowledge and skills of its practitioners. It is a model that can effectively address the very real challenges involved in raising capital, providing technical assistance to early-stage businesses in low-income communities, and help create the jobs and economic opportunity that distressed communities need so badly.

Under the proposed program, each NMVC fund would be eligible to issue SBA-guaranteed debentures, which would have deferred interest for the first five years of a ten-year term. This government guaranteed funding leverages matching capital raised by NMVC funds to produce the maximum investment.

Capacity Building: Boosting the Benefits of a New Industry

Passed by the Senate last year, and reintroduced in the Senate this year by Senator Paul Wellstone of Minnesota, the **Community Development Venture Capital Assistance Act of 1999 (S.619)** would promote the development of community development venture capital organizations by providing matching funds for a range of capacity building activities for the industry, including professional training programs, internships, technical assistance, research activities, and promotion of best practices.

CDVC Assistance Act Nurtures the Field to Maximize Impact

This legislation would provide $20 million in matching funds over four years to build and strengthen the field of community development venture capital through a number of activities. The legislation would authorize the U.S. Small Business Administration to enter into contracts with and make grants to intermediary organizations and community development venture capital funds.

The CDVC Assistance Act would enhance the economic development benefits of the industry by:

- Advancing the skills of professionals in the field through training programs, university centers, and internship opportunities.

- Promoting best practices in the field through conferences, publications, and networking opportunities.

- Supporting research on economic, operational, and policy issues relating to community development venture capital.

- Providing for intense, direct assistance to community development venture capital funds that will strengthen and support their work.

Frequently Asked Questions

Q: How does community development venture capital benefit distressed communities?

A: First, it provides access to the equity capital that is vital to the success and growth of small businesses and is in particularly short supply in low-income areas. The primary source of risk capital for most small businesses is personal savings and support from friends and family. In low-income areas, these tend to be lacking. Traditional venture capital firms provide financing for only a tiny portion of businesses nationally, and venture capital is almost completely absent from low-income urban and rural areas. Equity capital also leverages other financing. Banks and other lenders will not make loans to businesses unless they maintain a prudent ratio of equity capital to debt capital. An infusion of equity capital is often the lynch pin for assembling other financing for new or expanding businesses.

Second, CDVC funds target companies that are highly competitive and likely to expand rapidly. These companies not only provide substantial financial returns, but also create large numbers of good jobs and have the financial resources to offer decent wages, employee benefits, worker training, and opportunities for career advancement. This sector of small, competitive businesses can form the backbone of a successful local economy.

Third, CDVC funds provide significant entrepreneurial and managerial assistance to businesses. Unlike lenders, equity investors become partners with their investee companies, sitting on their boards of directors and providing a variety of advice and assistance with marketing, finance, and strategic planning. For businesses in low-income areas, this assistance is often as crucial as the financing itself. In fact, CDVC funds often go beyond providing financing and technical assistance and actually start and nurture new businesses, and then recruit local business people to own and operate them. In this way, CDVC funds are able to jump-start business development in even the most economically distressed areas.

Q: Why do CDVC funds need help raising capital?

A: CDVC funds generally raise their capital from "social investors," which share the funds' interest in community development as well as financial goals. The pool of social investors is quite limited, so CDVC funds have difficulty reaching the scale necessary to operate efficiently and to meet the investment and economic development needs of their communities.

The proposed New Markets Venture Capital Program would help remedy this problem. While requiring substantial private sector investment, the program would provide matching capital in the form of SBA-guaranteed debentures to help CDVC funds reach scale and meet the needs of their communities.

Q: Why do CDVC funds require supplementary funding for the technical assistance they provide to businesses?

A: The heart of community development venture capital is the ability of a CDVC investor to provide extensive entrepreneurial and managerial assistance in ways that create healthy, successful businesses in areas where they would not otherwise exist. CDVC funds become financial partners with businesses, and, like partners, they do whatever they can to make these businesses succeed. This assistance can include sitting on the board of directors of a business, helping it to assemble other financing, assisting with marketing and production problems, and sometimes even taking over various operating functions of a business for a time to assure the business' success. This is all done in areas of the country where attractive investment opportunities are not easily found, and often have to be created. As a result, a CDVC fund's operating expenses can be as high as 6 to 8 percent of capital under management, as compared with the more common 2.5 percent for traditional venture capital funds.

To address this issue, the New Markets Venture Capital Program provides technical assistance money to match private sector investments to help cover the higher costs CDVC funds incur in providing extensive entrepreneurial and managerial assistance to the companies in which they invest.

Q: Can't existing small business assistance programs address the needs outlined in the NMVC Program?

A: The New Markets Venture Capital Program is designed to complement the SBA's existing programs and represents a new model of small business development that is unique in many ways. CDVC funds are mission-driven investment funds that make it their work to operate in low-income communities, invest in new or expanding businesses for the purpose of creating jobs, and roll up their sleeves to do everything possible to make those businesses succeed. While they take a disciplined venture capital approach to investing, they do so with a goal of benefiting distressed communities and low-income people. Small Business Investment Companies (SBICs) and other private sector venture capital funds cannot and should not be expected to take this mission-driven approach to equity investing.

There is no question that the SBA's SBICs and Small Business Development Centers (SBDCs) are extremely successful and effective at what they do. SBDCs provide valuable information and management assistance to small business owners, but they have, by design, a limited amount of time they can spend with each business owner. SBICs provide critical equity capital to thousands of small businesses across the country, but they tend to focus on larger investments in more investment-ready companies than CDVC funds. CDVCs are designed to drive business and job creation in areas where it otherwise simply would not occur.

Q: What is "capacity building" and why is it necessary?

A: By capacity building, we mean developing an infrastructure that will support and nurture the continued growth of this promising field. So far, the 40 community development venture capital funds at work throughout the nation are showing promising results, but the field is still very new. In order for it to grow and fulfill its potential, there need to be more opportunities for training professionals in this highly specialized model, attracting experienced professionals to the field, sharing knowledge and promoting best practices among the different funds, providing technical assistance to the funds themselves, and generating interest in this powerful tool.

Together, these funds are experimenting with and building a model that is different from traditional community economic development strategies, and is not quite traditional venture capital either. It is a new hybrid that borrows sophisticated tools of finance and applies them in promising new ways to some of the most serious and intractable problems of our time. It's a new approach that deserves attention and support. The Community Development Venture Capital Assistance Act of 1999 could be the catalyst that enables this field to show its promise. Ultimately, it will be the communities served by CDVC funds that have the most to gain.

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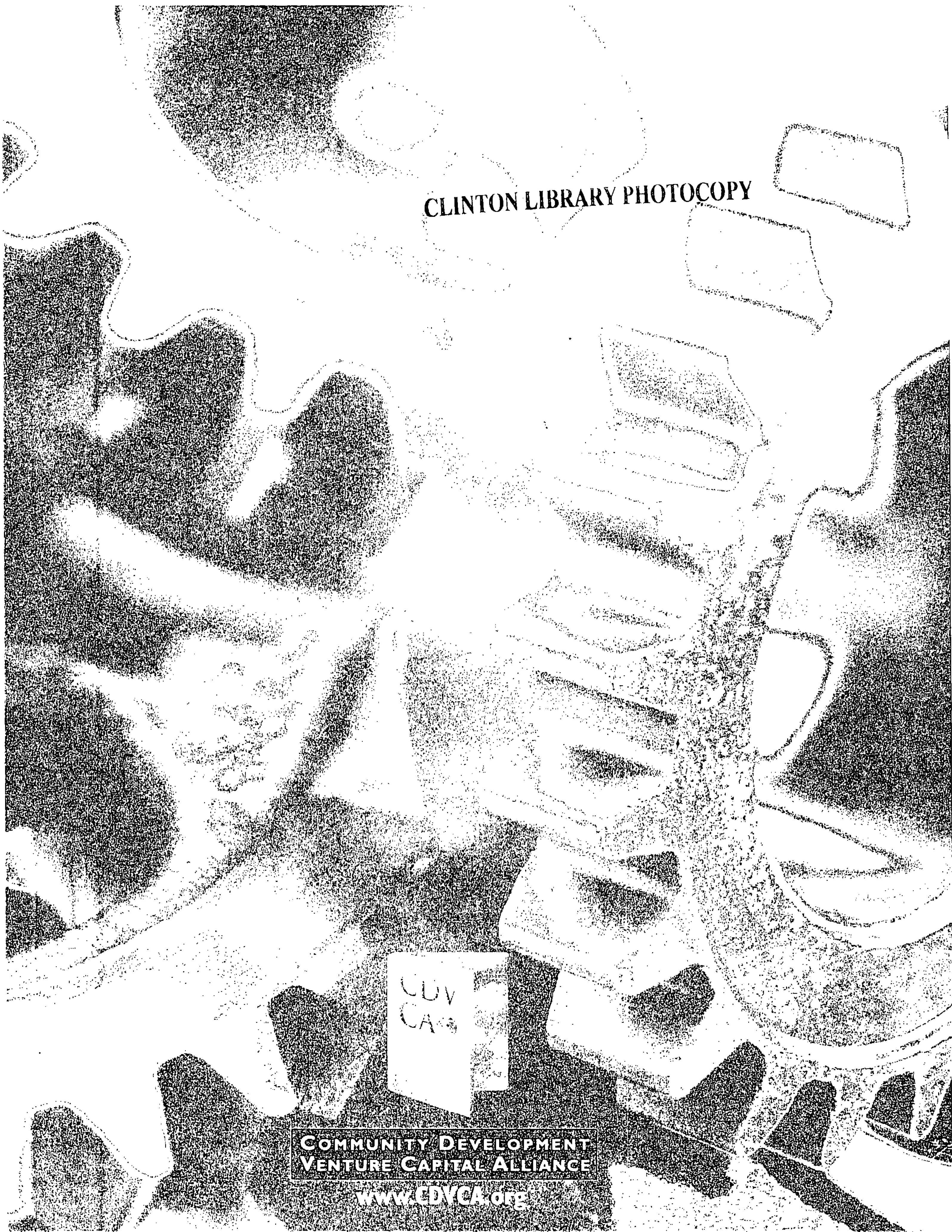

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