Venture Strategies *for Distressed Areas*

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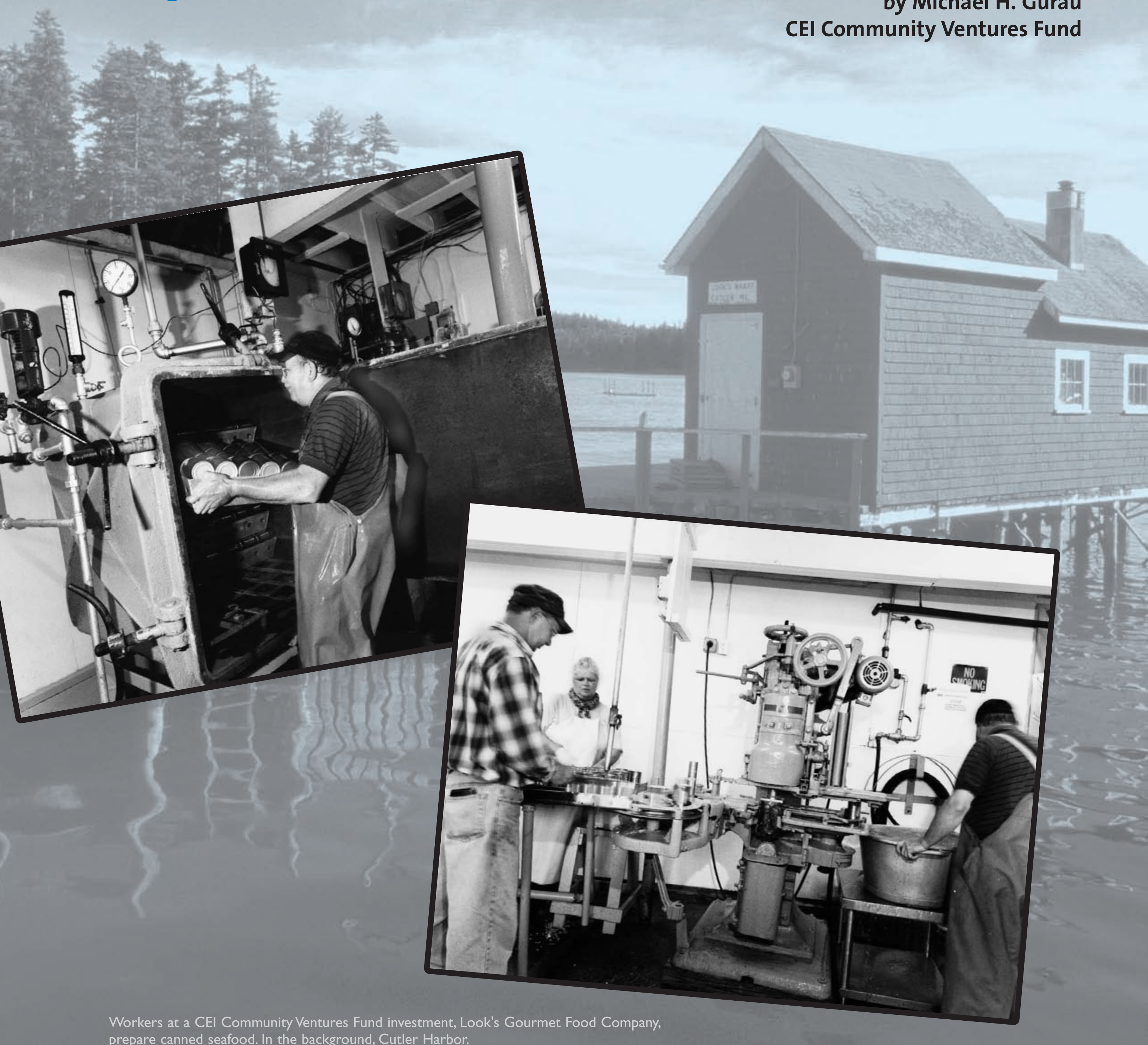

Workers at a CEI Community Ventures Fund investment, Look's Gourmet Food Company, prepare canned seafood. In the background, Cutler Harbor.

Look's Gourmet Food Company's plant in Whiting, Maine.

Venture capital is a powerful tool of economic development. This form of high-risk, high-return investment typically trades capital for minority ownership in fast-growing small businesses. Venture investors provide capital to small, often loss-making businesses with the hope and intent that the capital will accelerate business development and result in value appreciation for owners.

In urban markets, venture capital investment creates meaningful employment and resources for the community and stakeholders. It also helps foster a culture of innovation and risk-taking. However, rural and distressed communities tend not to attract this form of capital.

Of the more than $30 billion of venture capital raised over the past five years and available to support fast-growing businesses, most will go to a few cities. As much as 80 percent of venture capital in the United States is invested in just five states. Venture capital tends to be directed toward high-margin, high-growth businesses, such as information technology and life sciences. It is a tremendous catalyst for job creation in those sectors, but the jobs require skill sets one generally doesn't find in rural and distressed communities.

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Nevertheless, those communities have businesses and entrepreneurs capable of building the sort of value that venture capital investors require. Opportunities in these markets may be less well developed, but with the right resources and guidance, they can deliver investment-grade returns—as well as jobs and economic development for markets that do not have the resources of their richer urban neighbors.

A Need for Capital

In 2001, the U.S. Small Business Administration launched the New Markets Venture Capital program to drive capital into distressed and underserved communities. Under this program, SBA matches capital and operational-assistance resources raised by fund managers who qualify to deploy this regionally targeted form of capital.

To date, six funds have been licensed to receive New Markets funding. As a group, they manage $10 million to $30 million in equity coupled with $3 million to $6 million in operational-assistance grant funds. One of these funds is CEI Community Ventures Fund (CCVF), a $10 million for-profit subsidiary of Coastal Enterprises, Inc. CEI is a nonprofit community development financial institution (CDFI) based in Maine.[1]

All photographs for this article are courtesy of Look's Gourmet Food Company

CCVF is in its fourth year of investing funds in its targeted areas—Maine, New Hampshire, and Vermont.

Why Communities Lack Capital

In city centers such as Boston, venture capital investors typically don't lack for investment-grade opportunities. The New Markets program, however, faces challenges in uncovering and developing growth opportunities in distressed communities, whether urban (say, Lewiston, Maine, or Manchester, New Hampshire) or rural (Downeast Maine).[2] The challenges include:

- **Less-experienced entrepreneurs.** Business owners in undeserved markets often have limited perspective on their business and market opportunities. That is frequently due to lack of capital (which necessitates modest growth ambitions) and to the inexperience of the individuals running the businesses. Moreover, the business owners often lack basic information about the nature and availability of growth or expansion capital, other than that available from friends, family, and banks.

- **Few companies seeking capital.** When companies do not know that capital for growth exists, they tend to work within their own resources to build their businesses. In many cases, companies that might be able to pursue faster growth simply are not aware that they could be a fit for growth or expansion capital. Additionally, entrepreneurs often possess an aversion to taking on outside investors. They worry that sharing ownership could cause them to lose out economically or in terms of control.

- **Sector limitations.** Distressed and underserved communities are not hotbeds for technology start-ups and thus seldom attract traditional venture capital funds. Consumer- and industrial-product companies are more common than technology companies in these regions.

CCVF'S Approach

The experience of CEI Community Ventures Fund may be instructive. CCVF focuses on community education and proactive origination. To optimize the odds for success, it elected to work its markets harder and more comprehensively than traditional funds in more developed urban markets would. The fund educates local communities using seminars and editorial contributions to business publications.

In the area of education, CCVF has partnered with regional economic development organizations and business sponsors to organize and deliver nearly 40 Financing Fast Growth seminars to more than 1,500 attendees over the past three years. Such capital clinics serve two purposes: to educate potential and existing entrepreneurs that this unique form of capital exists; and to create opportunities for CEI Community Ventures Fund.

In addition to educating through seminars, the fund contributes articles on venture capital and small business growth issues to business periodicals in the targeted states of Maine, New Hampshire, and Vermont. Topics include how to find capital, how to value your business, and how to negotiate and work effectively with investors.

CCVF also develops investment opportunities directly by identifying, researching, and contacting companies whose business and market appear suited to the fund's form of capital. To find opportunities, staff members review more than 40 local and regional business publications every day looking for stories on local companies. They scan help-wanted ads and local and regional online job listings. The belief is that if companies are hiring, they may be growing—and in need of capital.

CEI Community Ventures Fund also mines Chambers of Commerce web sites to identify potential investment opportunities in a specific region. And it uses mapping applications overlaid atop business databases to identify all companies in a target region. Then it sifts through to find businesses of interest from a venture investment perspective.

Consumer education helps owners understand how to look at their businesses through an investor's lens.

The CCVF approach appears to be working well. Consumer education helps owners understand how to look at their businesses through an investor's lens. Armed with new insight, entrepreneurs and business owners can not only make an informed decision as to whether to seek such capital, but also can prepare themselves for the difficult discussions ahead—about the company's value, how much the VC should own, and who should control what.

Companies that don't understand the risk that investors take in financing small businesses tend to let their emotions and their desire for total ownership overrule their own self-interest and their willingness to engage with risk investors.

CCVF's proactive outreach and educational efforts complement each other well. The seminars and editorial contributions encourage entrepreneurs to see the fund as a trusted partner with whom they might be willing to "do the dance" that venture capital investment involves. Reaching out proactively gives CCVF a chance to talk about the value of capital to a growing business and the value of the fund's experience and network.

CCVF, licensed by SBA in 2003, has had success in booking deals but cannot expect to see overall financial performance results until 2008 to 2011, the back half of the 10-year limited-partnership life cycle. Nevertheless, it seems clear that the fund is making a difference in communities. By partnering with economic development organizations and local and regional businesses—and by providing both education and networking opportunities—it is helping the business community. Learning and connecting can create relationships and intellectual capital that last.

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Endnotes

1 Coastal Enterprises, Inc., makes loans and investments in small businesses, natural resource industries, community facilities such as child care operations, and affordable housing. With $370 million in capital under management or committed, CEI operates several financing programs for microenterprises and small business, venture capital investing, and large investments under the federal New Markets Tax Credit Program. Venture capital funds represent about 10 percent of total capital managed by two separate subsidiaries, CEI Ventures, Inc., and CEI Community Ventures, Inc., which often co-invest. CCVI is a New Markets VC with certain requirements targeting deals in specific high-distress census tracks throughout northern New England.

2 For data on investing venture capital in secondary cities, see Prabal Chakrabarti and Carole Carlson, "Venture Capital Investment in 'Secondary' Cities," *New England Community Developments*, issue 4 (2006): forthcoming.