

# Enterprising Capital

*Bringing the Knowledge-Based Economy Home*

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Some venture capitalists call Minnesota, Iowa, Oklahoma and even Washington the “flyover states,” places to pass by when traveling to Silicon Valley or Boston’s Route 128.

And unfortunately, investment statistics show that the tag fits. The PriceWaterhouseCoopers’ 2003 Fourth Quarter MoneyTree Report reports that Silicon Valley, New England, New York and Texas accounted for more than 60 percent of the nation’s total venture capital investments. The Midwest, Northwest, Southwest, Southeast, North Central and South Central areas of the country accounted for less than 20 percent of the total.

## **“Invisible” Early Stage Capital - Angel Investors**

But venture capital is just part of what it takes to launch startup companies. Research by Dr. Jeffrey Sohl of the University of New Hampshire Center for Venture Research shows that early stage capital – pre-seed, seed and angel funding – is the driving force in starting and growing the new companies that create tomorrow’s jobs and attract new capital. Importantly, angels prefer to invest in seed and start-up stages of emerging entrepreneurial ventures, usually investing in the \$100,000 to \$1 million range.

According to Dr. Sohl, about 400,000 early stage investors (individual angels or groups) annually invest in at least 10 times the number of deals made by venture capitalists. Before 2000, annual angel investment totals always exceeded total venture capitalist investment. In peak years, angels invested more than \$50 billion in over 50,000 ventures; recently, however, both angel and venture capital investments have dropped below \$20 billion annually. Angels, although a relatively “invisible” part of total early stage capital investments, are plainly powerful drivers of local jobs and capital attraction.

Leaders in flyover states – and in communities in rural and non-metropolitan areas – are now discovering angels as important, yet largely untapped, sources of local capital for

homegrown enterprises. Individually, angels provide critical startup capital. But they provide even greater value when part of an angel group or formal syndicate, bringing in-depth knowledge of tech-based industries and significant regional and national contacts. Their help in creating new companies with high-growth potential often attracts the next stage of funding, regional venture capital investment.

Angel investors are excellent resources because many are entrepreneurs who have cashed out from successful tech-based companies. An equally valuable resource may be the local leadership, or “civic entrepreneurs,” who work with local seed investors to expand sources of entrepreneurship and new enterprises. They find ways to reach across institutional and geographic boundaries to work with public, non-profit and private sectors, create a shared vision of change for their community, and bring together key resources to build a local knowledge-based economy.

The most important function of angel investments is to fill the new enterprise funding gap, typically about \$500,000 to \$2 million. Known as the “valley of death,” this is the equity funding usually needed to launch a company after funds from friends, family and “fools” have been exhausted and before the company has grown enough to be of interest to a venture capitalist. Some communities, like Worthington, Minnesota, have formed (or are working to form) local seed funds to fill the gap.

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## **The Worthington Way**

Worthington, Minnesota, is a town in the state’s southwest corner. In this community of about 10,500 people, the Worthington Regional Economic Development Corporation (WREDC) has formed several successful partnerships that reach into Minneapolis and surrounding states. WREDC, local business leaders and



Networking is one of the most important aspects of seed investing seminars and angel networks. Patrick Hamner of Dallas and Robert Dean of Shreveport shake hands while Ben Woods, also of Shreveport, looks on.



Participants at a seed investing seminar in Shreveport practice conducting due diligence on a proposed deal.

Minneapolis's Minnesota Investment Network, Inc. (MinCorp) have set up Prairie Capital LLC, an early-stage investment fund of about \$640,000. Prairie Capital has made about \$1.2 million in investments – \$530,000 from the fund and another \$700,000 from individual investors in Prairie Capital LLC.

Now the fund is in process of recapitalizing, and WREDC and Prairie Capital LLC are seeking to attract investors from South Dakota, Iowa and Minnesota. As a way to invite investors to participate in the new fund, WREDC held a one-day training session on the seed investing process, produced by the National Association of Seed and Venture Funds (NASVF). Those who attended represented 14 Minnesota cities, four South Dakota cities and one city each in Iowa, Nebraska and Wisconsin. Participants included 10 representatives from venture capital/investment companies, a dozen private investors (angels), almost as many entrepreneurs, and several representatives of university and federal laboratory tech transfer programs interested in building the local economy.

Their effort aims at creating a \$3 million local fund that will partner with MinCorp to make investments in the Worthington area. The fund will be structured as a limited liability company and function like a small venture fund. MinCorp will provide 10 percent of the fund, up to \$100,000.

Worthington is typical of a new trend in which local leaders reach beyond traditional geographic boundaries and work creatively with early stage investors to help build local, fast-growth enterprises, generate new jobs and attract investment capital. Similar efforts are underway in Spokane, Washington; Whitefish, Montana; Las Cruces, New Mexico; Shreveport, Louisiana; Fairfield, Iowa; Tulsa, Oklahoma; Greenville, South Carolina; Morgantown, West Virginia; Portland, Maine, and many other communities across the nation.

### State-Level Efforts

Some states, such as Oklahoma and Washington, are increasing the availability of early-stage capital for new companies by helping create statewide networks of private angel funds.

The Oklahoma Technology Commercialization Center (OTCC), equipped with incentive legislation for the formation of angel funds, helped create a dozen, community-based \$1 million to \$2 million funds as LLCs. Members of the funds get “first looks” at technologies groomed for investors by OTCC.

The Washington Technology Center (WTC), supported by a grant from the Economic Development Administration, is creating a statewide network of angel groups – first, to help WTC evaluate market potential of new technologies, and second, to provide early stage capital resources. WTC staff identify and work with a leading businessperson (a “champion”) in each community who possesses the wealth, respect and prestige to draw other possible investors into the network. WTC then works with a local economic development organization to develop a network of possible investors, and establish training activities to develop the network's investment capabilities. Then they develop a deal flow of possible investments and work with groups formed throughout the state.

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Seminars provide the chance to role-play negotiations between investors and an entrepreneur as part of building the enterprise.

### Keep Your Eyes on the Enterprise

Community leaders are focusing more on the enterprise as the engine that drives a vibrant local economy. Important as they are, local institutions that churn out advanced technology, benevolent citizens who can write large checks, or well-endowed venture capital funds cannot by themselves create jobs and attract outside capital. Building the vision and changing the community culture is crucial in creating enterprises. Success comes from investors and entrepreneurs who talk with each other about what makes the enterprise succeed.

Fairfield, Iowa has made very good use of this principle. A community of 10,500 located about 70 miles from the setting for the film *Field of Dreams*, Fairfield is the 2003 Grassroots Award Winner from the National Council of Small Cities. At its Web site, the Fairfield Entrepreneurs Association advertises an entrepreneurs' relocation program, generous tax credits for investments in Iowa businesses and local venture capital of \$60 million. It reports that since 1990, more than \$200 million has been invested in local companies. The Web site is packed with potential resources for entrepreneurs and information on cooperative efforts throughout Iowa and surrounding states ([www.fairfield-iowa.com/fea.htm](http://www.fairfield-iowa.com/fea.htm)).

Shreveport, Louisiana is also on this path and has started several efforts to augment its oil industry and build a knowledge-based economy. The Biomedical Research Foundation (BRF) recently invited investors and investment professionals from across the state and as far away as Dallas, Oklahoma, New York and California to participate in a seminar on seed investing produced by the NASVF. Participants included about 30 venture capital representatives and private investors, plus a dozen investment professionals and entrepreneurs. Outcomes of the event include a \$3 million investment from a California venture capital firm in a local company and BRF's initiation and coordination of a regional network of angel investors who will evaluate local technologies for potential investment.

### And the Secret is...No Secret

Away from the spotlight, many of the nation's communities are extending their reach and participating successfully in regional and national early-stage investing. They tap private sector resources such as attorneys experienced with seed deals and expert in term sheets; high-profile private investors (super angels); venture capital companies that work with local private investors and participate in first-round and later rounds of financing; angel investment clubs skilled in assessing potential investments; consultants skilled in due diligence; seed fund managers; technology associations that help promote development of clusters, and local "cashed out" entrepreneurs seeking new opportunities (especially those entrepreneurs cashed out of successful technology-based companies).

They also take advantage of resources from technology commercialization experts; university intellectual property and technology portfolio managers; university seed and venture funds; recipients of Small Business Innovation Research (SBIR) and other federal technology business development grants; SBA Small Business Development Center professionals with experience in developing tech-based companies; state-sponsored seed and venture funds and technology commercialization programs; state and local finance authorities that work with regional and national seed and venture capital companies, and many more.

To enhance the process, these communities often hold seed investing seminars as network-building interactive workshops, and hold forums to engage regional civic leadership in defining the issues that affect their communities. In addition, they facilitate initiatives to:

- form angel clubs, formal seed investment groups and tech-based enterprise associations;
- build capacity for early-stage investment by holding investment forums, securing due diligence support services, and holding "ready for the commercial market" technology shows; and
- support tax credits for seed investments.

Successful communities are clarifying and strengthening their visions – and capabilities – to build local knowledge-based economies. They catalyze the process in which investors fill the funding gap and support new tech-based enterprises. And in the long run, they are increasing the potential for self-sustaining investment cycles in which successful enterprises create cashed-out entrepreneurs, who then help spawn a new generation of enterprises. ★★★

*The National Association of Seed and Venture Funds (NASVF) is a network of private, public and nonprofit organizations committed to building their local economies by investing and facilitating investment in local entrepreneurs. NASVF offers an annual conference, training events, a newsletter, e-mail list, and electronic discussion groups. For more information, visit [www.nasvf.org](http://www.nasvf.org).*