APPALACHIAN REGIONAL COMMISSION

Capitalizing on Rural Communities

Emerging Development Venture Capital Funds in Appalachia

PUBLICATION PARTNERS :

Community Development Venture Capital Alliance
Federal Housing Finance Board
Federal Reserve Bank of Cleveland
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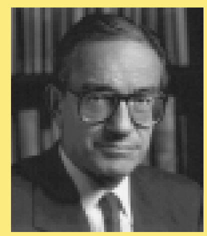
ARC

"The Entrepreneurship Initiative seeks to broaden and deepen the culture of entrepreneurship throughout Appalachia. Creating a public infrastructure for small business creation and expansion—including building critical partnerships with the private sector—will help our homegrown businesses to diversify and strengthen Appalachia's economic base. It will also move us beyond the old model of branch plant recruitment to a more vibrant, internal model of development which creates true local wealth and local control of our destiny."

Jesse L. White, Jr.
Federal Co-Chairman
Appalachian Regional Commission

"An important key to the success of small and large businesses is having access to capital and credit. First and foremost, I would emphasize that credit alone is not the answer. Businesses must have equity capital before they are considered viable candidates for debt financing … the newer the firm, the greater the importance of the equity base."



Alan Greenspan, Federal Reserve Chairman
Business Access to Capital and Credit Conference, Arlington, Virginia
March 9, 1999

"Small business is big business throughout Appalachia. In West Virginia alone, more than 90 percent of the state's businesses employ fewer than 20 people. Development Venture Capital (DVC) funds offer tremendous potential to help small businesses grow in rural communities throughout Appalachia. To keep pace with rapidly growing urban areas, expanded equity finance programs like DVC funds are necessary to foster new economic growth in our rural communities."

West Virginia Gov. Cecil H. Underwood
ARC States' Co-Chairman

"ARC appreciates the support of its publications partners. Although our federal partners can not endorse specific investments, they do encourage investment activity which strengthens the economic prospects of under-served communities."

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Both rural and metropolitan regions throughout America have increasingly begun to launch Development Venture Capital (DVC) funds to attract new sources of equity financing to underserved communities. In the 13-state Appalachian Region, several new funds are being created, and the Appalachian Regional Commission has taken an active role in a region-wide effort to support these funds.

Like traditional venture capital funds, DVCs seek a strong return on investments; but unlike most traditional funds, they also seek to provide social benefits to the communities in which investments are made. In many cases, DVC funds are helping to make local economies stronger so that they can attract traditional venture capital investment.

The Appalachian Regional Commission considers the establishment of new DVC funds a critical component of its three-year Entrepreneurial Initiative, which is creating more than 1,000 new businesses and fostering a culture of entrepreneurship throughout the Region. For many of Appalachia's poorer communities, and for underserved communities throughout the nation, DVC funds may be the only way they can share in the enormous increase of venture capital investment in the United States. In 1999, venture capital funds invested $35.6 billion domestically, far exceeding the $14 billion invested in 1998.

How is the Appalachian Region faring as a participant in this tremendous explosion of venture investment? And what role can DVC funds play in helping rural communities take advantage of this unprecedented availability of investment capital? This publication explores these questions, provides a review of new development funds being created within the Region, and presents a range of resources for those interested in the new field of development venture capital.

DEVELOPMENT VENTURE CAPITAL FUNDS

Focusing on the Double Bottom-Line

Development venture capital (DVC) 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 DVC field is a relatively new one. The oldest DVC fund was created in 1968 and is still in operation in Appalachian Kentucky, having invested in over 80 businesses and created 4,500 new jobs. Most DVC funds were founded in the last 10 years.[1] Currently, there are over 50 community DVC funds operating or in formation in the United States and Canada, with nearly $300 million under management. DVC funds include non-profits, for-profits, and quasi-public organizations. Their structures include corporations, limited partnerships, community development corporations, limited liability companies, and Small Business Investment Companies (SBICs). Investors in DVC funds include foundations, banks, insurance companies, utilities, 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.

DVC funds make equity and equity-like investments[2] in small and medium-sized businesses that hold the promise of growth through new products, new processes, or market expansion. From a development standpoint, these locally owned companies provide social benefits to distressed communities in the form of good jobs,[3] growing industries, and the accumulation of local wealth. From a financial perspective, the return on these investments provides the capital to support the continued operation of the DVC fund and to maintain the fund's capital pool for additional investments. Thus, DVC funds must balance two goals and achieve a "double bottom-line"; to improve the economic health of distressed communities and to ensure a fund's ability to continue operations without subsidy and make investments into the future. In contrast, traditional financial institutions, such as private venture funds, principally make investment decisions on the basis of expected rate of return.

DVC funds do much more than provide capital to growing companies in distressed communities. As serious investors with an interest in the success of their portfolio companies, they also provide intensive technical assistance and in some cases become almost working partners with entrepreneurs. Like traditional venture capital investors, representatives of the DVC fund may sit on the board of directors, help identify and structure additional financing, make contacts with customers and suppliers, help with executive recruitment, and may even provide day-to-day managerial assistance. They become experts in the industries in which they invest and work alongside business owners to ensure the success of the businesses. For businesses in low-income areas, this assistance is often as crucial as the financing itself.

While DVC funds operate much like traditional venture capital funds, the "double bottom-line" approach to doing business brings challenges that separate them from traditional venture capital funds

DEVELOPMENT VENTURE CAPITAL SUCCESSES

CTI: Engineered Steel Containers

In mid-December 1999, the Sustainable Jobs Fund, a DVC fund based in North Carolina, closed on an investment in Container Technologies Industries, LLC (CTI), of Helenwood, Tenn. CTI manufactures standard and custom steel Department of Transportation (DOT)–certified containers for the storage and transport of low-level radioactive waste, hazardous waste, and specialty materials. Prior to this closing, CTI was having difficulty generating the sales growth necessary to ensure company stability. Upon closing this investment, the management and board of the organization were restructured. CTI recently successfully completed an extensive quality audit administered by Bechtel Jacobs, a major Department of Energy (DOE) contractor working under a $2.5 billion contract to clean up DOE sites in Oak Ridge, Tenn., Portsmouth, Ohio, and Paducah, Ky. CTI has strong new orders, including a two-year contract with Bechtel Jacobs.

CTI currently occupies about 25,000 square feet in the economically distressed Appalachian community of Helenwood (31 percent poverty level) and provides 40 jobs for local blue-collar workers. As a result of this new financing, an additional 20 jobs have been created and an additional 30,000 square feet of manufacturing space will be required. For more information about this investment, visit http://www.sjfund.com/.

Kentucky Highlands Investment Corp. (KHIC)

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 $31 million dollar capital pool and a portfolio of investments ranging from $100,000 to more than $1 million.

KHIC provides a range 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.

KHIC has invested in over 80 businesses, which have generated $1.1 billion in sales and created 4,500 jobs representing 3.8 percent of the total wages and proprietors' income in the ten-county service area.

More information on mature DVC Funds can be found in Appendix A, and in *CDVC FUND PROFILES, EXAMPLES OF COMMUNITY DEVELOPMENT VENTURE CAPITAL FUNDS AT WORK TODAY*, Community Development Venture Capital Alliance, New York, 1999. www.cdvca.org with respect to deal flow, operating costs, investment size, and hence rates of return.

DVC funds usually have higher operational costs than traditional venture capital funds. The community development mission of DVC funds compels them to address the need for smaller investments, ranging from $50,000 to $1 million per company. Traditional venture capital investments are rarely less than $500,000, and now average over $9 million. Since staff time and other transaction costs are relatively the same for small deals as larger deals, the costs to close and provide oversight to small investments are a relatively larger portion of the invested capital. Additionally, because of the nature of their portfolio companies, DVC funds need to provide more time-intensive technical assistance than do their counterparts managing traditional venture capital funds. Thus, while the operating costs of traditional venture capital funds rarely exceed 2.5 percent of funds under management, costs at DVC funds can be as high as 6 to 8 percent.

Most DVC funds cannot raise the size of investment pools that a traditional venture capital firm can raise, since traditional firms focus on the maximization of profit and thus appeal to a broader range of investors. Existing DVC funds range from $5 million to $30 million in size, with most falling between $5 million and $10 million. A DVC fund most likely must reach $10 million in capitalization to be sustainable. Traditional venture capital funds are rarely smaller than $25 million, and funds with assets in the hundreds of millions are not unusual. For the DVC industry to reach a sustainable economic scale and demonstrate the full power of the model, substantial new sources of risk capital must be found.

Mature DVC funds have experienced significant success. Northeast Ventures in northeastern Minnesota has been in operation for 10 years and has invested in 26 opportunities resulting in the creation of 940 jobs. In greater Philadelphia, DVCRF Ventures (a subsidiary of The Reinvestment Fund) has made six investments resulting in the creation of over 500 jobs in a three year period. And in Maine, Coastal Ventures has invested in 16 firms resulting in the creation of 125 jobs over four years.

However, the benefits promised by these funds—and the economic growth they are designed to stimulate—will largely go unrealized in rural communities unless nascent funds can demonstrate the managerial skill and institutional capacity that private investors demand before investing significant capital in them.

Entrepreneurship and Development Venture Capital

Despite robust economic growth nationally, structural changes in declining sectors such as coal mining, manufacturing, textiles, and agriculture—exacerbated by globalization and technological change—have hit Appalachia disproportionately hard, threatening to reverse the modest economic gains that many Appalachian communities have made.

Appalachia's future economic vitality—and the future vitality of rural America—in large measure depends upon nurturing home-grown firms, encouraging innovation and risk taking and enhancing investment in new businesses. While the Region has several outstanding examples of entrepreneurial communities and organizations and possesses many entrepreneurial assets, including the self-reliance of its people, it also faces many challenges. These entrepreneurial shortcomings stem from Appalachia's long-standing dependence on extractive industries and branch plant manufacturing, and the presence of many absentee landlords who have siphoned off

Kentucky Highlands Investment Corporation has invested in over 80 businesses to date, which have generated $1.1 billion in sales and created 4,500 jobs in the ten-county service area.

value from the Region. Furthermore, the culture of entrepreneurship is neither broad nor deep throughout Appalachia, and research findings indicate that there are many gaps in the infrastructure for supporting entrepreneurship, ranging from technical assistance to development finance.

ARC views entrepreneurship as a critical element in the establishment of self-sustaining communities that create jobs, build local wealth, and contribute broadly to economic and community development. Appalachia needs to cultivate resourceful entrepreneurs who not only create value by recognizing and meeting new market opportunities, but who increase the value-added within the Region.

Responding to these conditions, in 1997, ARC launched a multi-year, $15 million Entrepreneurship Initiative to build entrepreneurial economies across Appalachia. Through these activities, ARC has learned how entrepreneurial activity can be nurtured through a variety of educational, business assistance, and capacity-building initiatives.

ARC has focused support on four areas that support the infrastructure necessary for creating entrepreneurial economies:

- Entrepreneurial education and training, both for existing business owners and youth;
- Improving access to debt and equity capital for growing firms;
- Developing entrepreneurial networks, particularly those focused on strategic industries; and
- Technical and managerial assistance, with a special focus on Appalachia's business incubation strategies and needs.

Through this Entrepreneurship Initiative, the Commission has funded projects that include support for youth entrepreneurial education like the REAL Enterprise program; capitalization of microbusiness lending programs; targeted support for specific strategic industries such as wood products, food processing, and ceramics manufacture; and support for business incubators.[4]

In each of the four areas that support an entrepreneurial economy, ARC has convened advisory committees composed of regional practitioners and state partners to help ARC both stimulate innovative programming and bring additional resources and expertise into the Region. Initially, ARC's Innovations in Development Finance Advisory Committee[5] reviewed existing literature in the field of development finance and found significant gaps in the provision of equity capital to small and medium-sized enterprises, particularly those located in distressed communities. After a series of convenings, the Advisory Committee has recommended that the Commission create four to five new Development Venture Capital funds, each capitalized at $10 million, to be located in the Region. The Advisory Committee has also observed that in addition to the lack of access to equity investment capital, the Region lacks the management expertise and institutional capacity to manage new equity funds—and has recommended a series of activities to support the development of these funds.

CAPITAL GAPS IN RURAL COMMUNITIES

Capital and credit gaps for rural businesses have been identified as a significant regional problem in research conducted by the Federal Reserve Board, Appalachian Regional Commission, and Economic Research Service of the U.S. Department of Agriculture (USDA).[6] These studies reveal that while the availability of debt capital for fixed asset financing appears to be readily available, significant gaps exist in the availability of equity capital for start-up firms and for certain types of working capital financing.

In a description that is particularly apt for Appalachia, Federal Reserve Chairman Alan Greenspan clearly stated both the need and the opportunity:

"Continued efforts to develop the markets for private equity investments will be rewarded by an innovative and productive business community. This is especially true in lower-income communities, where the weight of expansion debt obligations on small firms can severely impede growth prospects, or more readily lead to business failure."

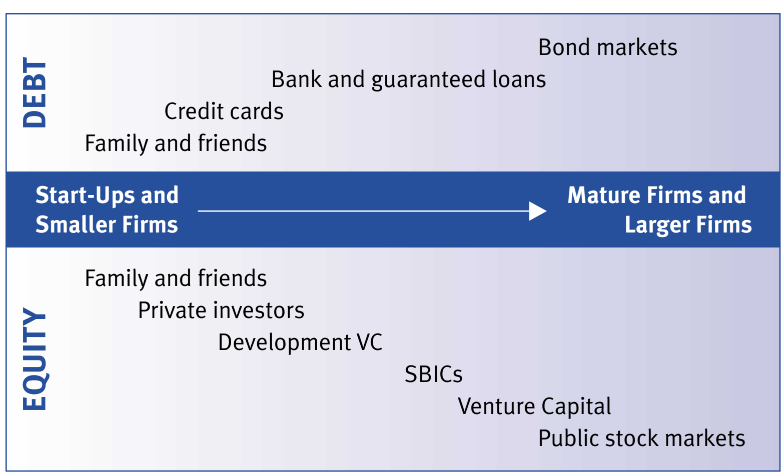
The general feeling among business owners, both rural and urban alike, is that debt capital is readily available in the marketplace. The National Federation of Independent Businesses reports that financing availability for rural firms is similar to that of urban firms. Banks are aggressively seeking to attract new customers. And bank mergers, far from limiting competition, have created opportunities for small local banks to grow, filling the voids in small markets left by the merger of larger regional players. The USDA Economic Research Service study notes that, "Rural financial [debt] markets generally work well. Credit for rural sectors is generally priced comparably to urban credit. Banks are adequately capitalized to provide commercial credit to rural sectors." The report concludes that rural banks have performed as well as their urban counterparts with respect to capitalization, profitability, and problem loans.

The most significant gap in the availability of financing in rural areas is that of equity or risk capital.

Unsurpassed Growth—But for Whom?

In 1999, the US economy witnessed an explosion of investment capital available to finance entrepreneurial growth; $35.6 billion was invested by venture capital firms, far exceeding the $14 billion invested in 1998.[7]

Typical Sources of Company Financing



Adapted, U.S. Small Business Administration.

James D. Atwell, managing partner of the Venture Capital Practice at the accounting firm PricewaterhouseCoopers, noted that "Technology companies are attracting venture capital at astounding rates. The increase in both absolute dollars and percentages is unprecedented." Taken together, biotechnology and Information Technology (IT) companies accounted for $32.4 billion, or 90 percent, of all investments in the third quarter of 1999. On average, each portfolio company received $8.9 million, up from $5.2 million a year earlier. And investment in Internet-related companies, which cut across all standard industry classifications, jumped almost sixfold to $11.9 billion.

How have rural America and Appalachia fared as participants in this tremendous explosion of entrepreneurial investments? Do the types of deals found in rural America fit the profile sought by venture investors? To what extent are $9 million equity deals common in our rural communities? How prevalent are fast-growing biotechnology and IT firms in non-urban centers? Can rural communities take advantage of this unprecedented availability of investment capital?

One way to answer these questions is to look at the types of companies operating within rural communities. Do they fit the profile that venture capital investors are attracted to? When we review industry concentration data, we find that fewer than 2 percent of companies operating in Appalachia are biotechnology or IT firms.[8] Instead, the bulk of the Region's firms are in mature manufacturing, service, or natural resource–based industries with more modest rates of growth and profitability.

Another way to answer these questions is to review the location of firms receiving venture capital investments. Data reveal that just over 1 percent of total venture capital was invested in Appalachia. When economically competitive urban areas of Appalachia are excluded from the database (for instance, Chattanooga, Tenn., Birmingham, Ala., Greenville, S.C., and Pittsburgh, Penn.), just one-third of 1 percent of professionally managed venture capital—only $117 million out of the $35.6 billion across the United States—was invested in the rural portions of Appalachia.

Digging Deeper

There are many causes for this dearth of venture capital investment in rural communities. Venture capitalists typically invest (as the lead investor) in deals that are within a few hours' travel of their (urban) offices so that they can easily monitor their investments and provide support when needed. Not surprisingly, 72 percent of all venture capital invested in 1999 went to firms located in California; Texas; the Washington, D.C. metropolitan area; New York metro; and New England. (New York, California, and Massachusetts account for 70 percent of the supply of all venture capital nationally.)[9]

Venture capital firms are also looking for companies that are projected to grow rapidly, generate significant profits, and be relatively easy to exit. Firms with these growth and profit profiles tend to be in high-technology sectors such as IT and biotechnology. It is these firms, not the traditional manufacturing or service enterprises typically found in rural communities, that command the huge payouts seen in the Initial Public Offering (IPO) market.

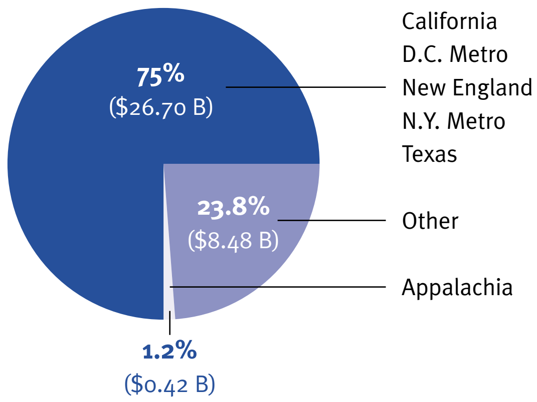
Last, equity funds look for larger deals and do not typically provide seed financing for start-up firms. The average investment size of $9 million, when leveraged with debt, could likely result in a $27 million deal, which is quite large for most rural communities. In the most recent quarter, only 2.6 percent of venture investments were characterized as "seed," or start-up financing. Given that most existing firms in rural communities do not fit the profile sought by venture investors, and that venture funds rarely invest in start-up firms, most rural firms must search other sources for the equity capital they need for their growth.

A recent ARC-commissioned study by Mt. Auburn Associates found that as a result of this lack of access to formal outside sources of risk capital, entrepreneurs in the Region have been heavily reliant on personal savings, retained business earnings, and support from family members, friends, and business colleagues for their risk capital financing. Given the generally low levels of personal wealth in the region, such reliance has translated into scarce levels of risk financing. Informal sources of risk capital, "business angels," also were not a significant source of risk financing in the Region, and the investments they made were primarily in larger and higher-growth businesses.

Initial learnings from public and private sector programs that try to link wealthy "angel investors" from one community with businesses in other communities, such as the US Small Business Administration's ACEnet program, reveal that these private investors often rely on personal relationships to evaluate their investments. These investors also prefer to locate their investments nearby in order to more readily monitor company performance. Other programs and businesses, such as garage.com, aim to provide smaller investors access to venture capital-like investments, and therefore seek portfolio firms that mirror the investment profile desired by venture capital funds. Thus, programs that electronically match entrepreneurs and investors often use the same investment profile and face the same proximity limitations noted for venture capital funds, and therefore do not adequately address the equity capital needs of rural entrepreneurs.

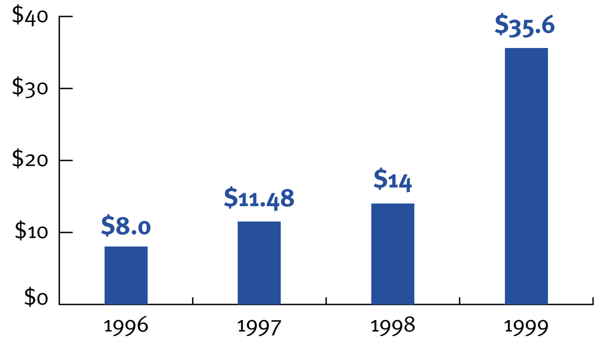
Venture Capital Investments by Region

Total U.S.= $35.60 Billion (1999)



Growth of Venture Capital Investment in the 1990s

(in billions)



Source: PricewaterhouseCoopers *Moneytree Report*.

Ray Moncrief, Chief Operating Officer of Kentucky Highlands Investment Corporation, a $30 million investment fund located in rural Kentucky, notes:

"Equity or venture capital is the most vital, and by far the most difficult form, of capital for an entrepreneur to secure. Generally speaking, rural entrepreneurs have a particularly hard time accessing this from of capital as they operate far from major financial centers where firms specializing in this type of investment activity are frequently located. In addition, they lack access to family wealth and may need significant technical or business assistance before they can tap into conventional sources of venture capital. Furthermore, without this critical equity component, an entrepreneur may not be able to attract additional financing, such as bank loans, that is necessary to establish or expand a business."

CONSTRUCTING NEW FUNDS

Given the dearth of equity funds in Appalachia and the need for risk capital to support growing businesses, it is not surprising that ARC has already received several requests to support new DVC funds. To date, ARC has funded five of these requests. ARC has provided $400,000 in capital for a fund managed by the Mountain Association for Community Economic Development (MACED) located in Berea, Kentucky; $71,000 in start-up support to Mountain Maryland Ventures in Cumberland, Maryland; $400,000 in operating support and capitalization to the North Carolina Department of Commerce to develop the North Carolina Economic Opportunities Fund; $350,000 in an operating grant for Technology 2020 in Oak Ridge, Tennessee; and $80,000 in an operating grant and $100,000 in capital for The Conservation Fund, located in Shepherdstown, West Virginia.

ARC has received additional proposals, some in draft form, for the creation of several more DVC funds in the region. In the coming years, ARC may invest in these new funds as well.

Courtesy of Federal Reserve Bank of Richmond

ARC Federal Co-Chairman Jesse L. White, Jr. (center, top row), joins other sponsors at an Equity Capital for Rural Communities conference in Charlotte in October, 1999. **Top row, l to r:** Jack Blanton, *VP and CAO, Federal Reserve Bank of Richmond;* Charles McLean, *Deputy Director – Constituent Services Division, Federal Housing Finance Board.* **Bottom row, l to r:** Jane Henderson, *Sr. VP & Director of Community Development, First Union National Bank;* Mr. Jimmy Loyless, *Regional Director, FDIC.* **Not pictured:** Ruth Clevenger, *AVP & CAO, Federal Reserve Bank of Cleveland.*

As noted above, ARC's Innovations in Development Finance Advisory Committee observed that not only does the Region lack access to equity investment capital, but these communities also lack the management expertise and institutional capacity to manage new equity funds. To support the creation of these new DVC funds, the Innovations in Development Finance Advisory Committee has recommended that ARC undertake the following set of activities:[10]

- Partnerships: build support for equity funds among potential private and public sector partners;
- Management support: develop a network of qualified fund managers;
- Institution building: support the creation of new equity funds and expansion of the mission of existing successful loan funds; and
- Capitalization: increase the amount of capital available to these funds.

As a first step toward building partnerships with potential investors, ARC sponsored of a series of conferences focusing on equity capital in the fall of 1999.

ARC projects that investments in the development of six to seven new funds capitalized at $10 million each will result in the creation of 75 new firms and 1,300 jobs over a five-year period . . .

These conferences were held in partnership with the Federal Reserve Bank, FDIC, and Federal Housing Finance Board, and resulted in participation by over 130 financial institutions and philanthropies.

ARC has undertaken several activities to stimulate interest in, and provide support to, communities interested in the field of development venture capital. In the spring of 1999, an introductory workshop on community development venture capital was held in Pittsburgh, co-hosted by ARC and the national trade association, the Community Development Venture Capital Alliance (CDVCA).

To increase management capacity within the region, ARC is developing a regional co-investment fund (see Improving Fund Management, page 22) that will create linkages between new funds and established funds in order to provide mentoring and improve the investment skills of new fund managers. The Commission is also reviewing support for a fellowship/management internship program to provide development finance internships in existing venture capital funds and development funds to promising new managers.

And in an effort to leverage the existing resources of the region, the Commission is building on existing programs with the potential to expand their missions, such as micro credit funds and Revolving Loan Funds (RLFs), while creating new institutions where warranted.

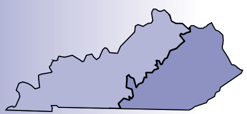
The Commission believes that all these steps must be in place—investment partners, skilled management, and strong institutions—before DVC funds are successfully capitalized. Currently, the Commission is producing Investment Guidelines to direct its future investments in this program area.

ARC projects that investments in the development of six to seven new funds capitalized at $10 million each will result in the creation of 75 new firms and 1,300 jobs over a five-year period, with a particular focus on the most distressed communities in the Region.

Summary information on DVC funds under construction in the Region is provided, below, to assist potential investors in identifying suitable partners in the Appalachian Region, and to help developing funds and communities support and partner with efforts already underway.

Fund summaries are presented for:

- Kentucky, Strategic Capital Fund
- Maryland, Mountain Maryland Ventures
- New York, Alternatives Venture Fund
- North Carolina, North Carolina Economic Opportunities Fund
- Ohio, Appalachian Ohio Development Fund
- Ohio, ACEnet Ventures
- Ohio, The Enterprise Fund
- Tennessee, The Empowerment Fund
- Virginia, Appalachian Community Ventures Fund
- West Virginia, Natural Capital Investment Fund



Strategic Capital Fund

KENTUCKY

MISSION AND STRATEGY

Fund manager Mountain Association for Community Economic Development (MACED) uses a combination of equity and debt to make it possible for companies with job creation potential to access more traditional capital markets. MACED analyzes the capital needs of a company and utilizes equity and/or subordinated debt to structure a comprehensive financial package that attracts other commercial lenders and satisfies the company's capital needs.

The Strategic Capital Fund (SCF) was designed to provide the following benefits to MACED, funding partners, and the Appalachian region:

- Provide needed capital for MACED's business development work;
- Demonstrate the use of strategic equity in creative deal structuring that attracts commercial capital and strengthens the potential for business success;
- Develop innovative and diverse exit strategies that do not require the sale of a business or an Initial Public Offering (IPO); and
- Demonstrate the potential of this strategy for community development corporations, especially as an organizational strengthening and capitalization strategy.

STRUCTURE

MACED is a private, non-profit 501(c)(3) corporation.

MANAGEMENT

MACED's Investment Advisory Board consists of experts in the field of equity investment. The board provides training to MACED's investment committee and staff, provides mentoring to the MACED staff in reviewing business proposals that request equity investments, and assists in structuring and negotiating the terms, conditions, and exit strategies for investments.

The board initially consists of Fred Beste, Managing Partner, Mid-Atlantic Venture Fund; J. Gregory Dees, Stanford University; Josh Lerner, Harvard Business School; Steve Meng, CEO, Casecraft; and Thomas F. Miller, founder, Kentucky Highlands. MACED manages a $2.8 million revolving loan fund that has provided support to more then 16 firms since 1994.

TARGET MARKET

The MACED service area is one of the nation's most intensely and persistently poor rural areas. Funds will be invested exclusively in the 49 counties of eastern Kentucky, as defined by the Appalachian Regional Commission.

INVESTMENT STRATEGY

Investment strategies include building staff capacity, building sustainable communities, leveraging other funds, building entrepreneurial capacity, creating employment, serving distressed areas, and project replication. Targeted investments include start-up financing, expansion financing, and management buyouts.

TECHNICAL ASSISTANCE STRATEGY

MACED has an extensive network of business development partners in eastern Kentucky. These partners range from the University of Kentucky's Center for Robotics and Manufacturing Systems to small, rural Industrial Development Authorities. MACED will evaluate a company's technical assistance needs, then solicit the appropriate support.

CAPITALIZATION

Currently, the SCF is capitalized at $500,000. MACED intends to grow the fund to $5 million in the next two to three years.

Mountain Maryland Ventures, LLC

MARYLAND

MISSION AND STRUCTURE

Mountain Maryland Ventures, LLC (MMV) is a seed and early-stage venture capital fund investing in companies that will be based in the western Maryland region. MMV is dedicated to supporting ventures with strong business strategies, including firms operating in the high technology sector. MMV will partner with the Mountain Maryland Entrepreneurial Development Center, Inc. (MMEDC), a non-profit organization dedicated to supporting entrepreneurship in the region. MMV is seeking $15 million in capitalization and will officially begin its fund raising activities in January 2000.

MANAGEMENT

The Fund will be managed by Maryland Venture Management, LLC (the "Manager"), which will be led by Theodore S. Higson and which will have Messrs. Glenn J. Kline and John Ciannamea as Special Members. The Fund will also include a supporting staff and a Fund Advisory Board, which will assist the Manager with issues related to portfolio investments.

Mr. Higson has served as an independent consultant specializing in business development issues for start-up companies seeking venture capital, and for venture capital funds, performing due diligence on prospective investment recipients. Messrs. Ciannamea and Kline have a combined 30 years of experience in venture capital, finance, and executive and operations management with growing seed and early-stage development companies, including management of regional venture capital funds.

TARGET MARKET

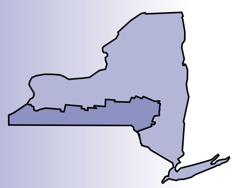
MMV will focus on companies that will leverage Network.Maryland, a project developed by the state of Maryland and Level 3 Communications, Inc. This project has provided infrastructure to allow western Maryland–based companies to utilize a broad-band network that will place them at the forefront of computer networking capabilities. This strategy allows growth companies the ability to escape the high rents and concerns associated with many metropolitan areas and gain access to cutting-edge technologies and the quality of life available in the region. MMV will also target opportunities that can be supported by the institutions and resources available in the western Maryland region, including Frostburg State University, the Center for Environmental Science, Appalachian Laboratory, and other area assets.

INVESTMENT STRATEGY

The Fund will seek to invest in five to seven new seed and early-stage opportunities per year, with initial investments in portfolio firms ranging between $75,000 and $500,000 and follow-on investments between approximately $250,000 and $500,000. No more than 10 percent of the Fund's total capitalization is expected to be invested in any single portfolio investment. MMV will syndicate later investment rounds with partnering venture capital funds and/or institutional investors. The Fund will attempt to gain exit from deals within three to seven years, primarily through buyouts or IPOs. The Fund hopes to achieve an Internal Rate of Return in the range of 20 to 30 percent from its investment activities.

TECHNICAL ASSISTANCE STRATEGY

Because of the seed and early-stage investment focus of MMV, the Manager will actively support portfolio companies by providing assistance in the construction of business plans, helping to build management teams, and linking the firms to providers of key management services. In addition, MMV will partner with the Mountain Maryland Entrepreneurial Development Center, Inc., a non-profit organization dedicated to supporting regional entrepreneurship. MMEDC will assist entrepreneurs (including MMV portfolio companies) through infrastructure development, including management of a business incubator facility, financial assistance through the organization of an "angel" investor network and links to a range of financial resources, and provision of consulting, training, and networking services.



Alternatives Venture Fund

NEW YORK

MISSION AND STRATEGY

This "kinder, gentler" locally based venture fund will assist small businesses, and provide returns great enough to justify the level of investment risk. The fund will be based on the following principles:

- Equity capital is vital to the growth and success of microenterprise. Capital is in short supply for small businesses owned by people of modest means, living in rural upstate New York, and starting businesses that are not professional or based on new technology.
- Businesses suited to this type of investment are likely to expand, and growth creates jobs.
- Fees will be tailored to socially responsible business benchmarks.
- Venture capital leverages other financing. Traditional loans will be made safer with the infusion of equity capital into the businesses, thereby avoiding the threats that face undercapitalized businesses.

STRUCTURE

The Fund will begin as a non-profit that will create a demonstration portfolio, and will then develop a subsidiary LLP or SBIC. Initial capitalization will be $600,000, with a goal of $5 million in capital.

MANAGEMENT

The Alternatives Venture Fund (AVF) is a component organization of the Alternatives Group, which has been built by the experience and skill of Alternatives Federal Credit Union's management team. The Credit Union is a $28 million community development financial institution that has provided over $900,000 in loans to local firms. Fund management will be shared by the organizations in the Group. AVF will have an experienced fund manager and a board of directors that will include investors and others with significant experience in financing small businesses.

TARGET MARKET

The Fund will make investments in small businesses in an eight-county region in central New York. The Fund will focus on non-export-based businesses, with significant ownership by, or employment of, low- to moderate-income income individuals. Our most likely market will be among those entrepreneurs for whom cash flow is a prime consideration. In our experience, one distinctive subgroup is made up of immigrants who do not have other resources for investment in their businesses. AVF anticipates closing four deals in 2000, eight in 2001, 14 in 2002, and 16 in 2003.

INVESTMENT STRATEGY

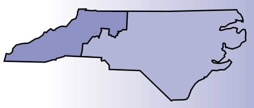
We will focus on small investments, with a maximum investment of 10 percent (or $500,000) of the Fund's capital in one portfolio company. Our product will (1) not require immediate payments, (2) have "upside" potential should the business become successful, (3) allow debt to enter the business, and (4) be easy and inexpensive to administer and understand, thereby reducing legal and accounting costs.

The most feasible product seems to be low-interest subordinated debt with royalties, or an ongoing, revenue-based fee. This will permit AVF to realize a return on investment sooner than through a more traditional equity investment (e.g., purchase of common stock). For a small start-up Fund, the stability and cash flow generated in this way compensate for the somewhat lower rate of return than the more traditional equity investment would produce. Exit strategies will include payment of debt, refinancing, and acquisition. Our return goal to investors is 8 percent.

TECHNICAL ASSISTANCE STRATEGY

Alternatives Federal Credit Union is a key partner of AVF. In addition to its Business Lending Department and links to the US Small Business Administration (SBA), the Credit Union offers access to Community Enterprise Opportunities (CEO), a microenterprise development program. CEO assists businesses with financial and market projections, marketing and promotional materials, and legal and accounting issues. Involvement of Cornell University faculty and MBA students will provide additional technical assistance to the project and its businesses.

North Carolina Economic Opportunities Fund, LP



NORTH CAROLINA

MISSION AND STRUCTURE

The North Carolina Economic Opportunities Fund, LP, will be a private, for-profit, federally licensed Small Business Investment Company (SBIC) of up to $150 million in capitalization, making equity and debt security investments principally in the expansion of established entrepreneurial companies located in rural areas of North Carolina. Fund capitalization of up to $50 million will be drawn primarily from the state's 70 community, regional, and national banks. Additional capital is anticipated from corporations, endowments, foundations, and other institutional sources.

MANAGEMENT

At maximum capitalization, the Fund would be managed by three to five partners supported by several additional investment associates and analysts. Fund management will consist of experienced growth capital professionals encompassing a diversity of venture capital, investment banking, and economic development finance expertise. Industry-specific expertise will be incorporated as consultants and advisors are utilized on an "as needed" basis to enable the construction of a broadly diversified portfolio.

TARGET MARKET

North Carolina's rural areas are unusual in that they are both heavily industrialized—40 percent of the state's jobs are in manufacturing—and highly entrepreneurial. The 85 rural counties are home to more than 3,000 smaller but rapidly growing entrepreneurial firms that have recently accounted for 36 percent of rural North Carolina's net new jobs and 77 percent of its net new manufacturing jobs. These entrepreneurial companies often require financing, such as equity and/or subordinated debt, beyond the capacity of North Carolina's extensive banking industry. At the same time, institutional equity financing is practically non-existent in the state's rural economies.

INVESTMENT STRATEGY

The Fund's investment strategy will focus on early-stage, expansion-recapitalization and buy-out financings to lower-market companies with proven operating histories located within the rural areas of North Carolina. Initial financings would typically range from $500,000 to $2 million, with investments generally in the form of preferred, and/or common stock or subordinated debt with warrants.

The objective of the Fund is to generate a rate of return in excess of 20 percent per annum to its limited partner investors over a five-to ten-year horizon. Capital gain distributions, if any, would be expected to occur between the fourth and 10th years of the partnership's life.

TECHNICAL ASSISTANCE STRATEGY

Technical assistance strategies are under development at this time.

CAPITALIZATION

Implementation will require up to 18 months, culminating in the approval of an SBIC license by the SBA.

Appalachian Ohio Development Fund

OHIO

MISSION AND STRATEGY

To serve as a catalyst for shared and sustainable economic growth in Appalachian Ohio by providing equity capital and expertise to small businesses in the region and generate attractive financial returns for investors.

STRUCTURE

For-profit, limited partnership with a 10-year life and up to two one-year extensions. Management fee of 3 percent; organizational costs of 2 percent or less.

MANAGEMENT

- David Wilhelm, General Partner and Founder. Mr. Wilhelm brings over 20 years of asset management, general business management, labor management, and public policy experience to the fund. An Athens, Ohio, native, Mr. Wilhelm is best known for his role as national campaign manager for Clinton/Gore in 1992 and his leadership position as chair of the Democratic National Committee from 1992 to 1994. Since then, Mr. Wilhelm has served as senior managing director of Everen Securities and as a consultant to Aeltus Investment Management. Mr. Wilhelm is now the president of Wilhelm and Conlon Public Strategies, based in Chicago, and is a director for the Federal Home Loan Bank of Chicago.
- Jakki Haussler, General Partner and Fund Manager. Ms. Haussler is an attorney and CPA with 20 years of experience in venture capital, investment banking, mergers and acquisitions, and public accounting with such firms as the Blue Chip Opportunity Fund, Cincinnati Bell, Ernst & Whinney, and CAD-PAC, Inc.
- Lynn Gellermann, General Partner. Mr. Gellermann brings 15 years of banking experience to the fund, including several positions with Bank One Corporation, where he provided leadership in the areas of venture capital, community development, business lending, and partnership marketing.
- Ray Moncrief, Investment Committee Chair. Mr. Moncrief currently serves as the Executive Vice President and Chief Operating Officer for Kentucky Highlands Investment Corporation (KHIC), where he has worked since 1984.

Associates and staff to be hired upon closing of the fund; currently anticipate hiring one analyst and one business development officer.

TARGET MARKET

Investments will be limited to the 29-county area in southeastern Ohio known as Appalachian Ohio. The Appalachian Ohio Development Fund (AODF) will focus on small businesses with high growth potential, defensible market positions, and local job creation opportunities. Businesses in the start-up, early, and expansion stages of their life cycles will be targeted. The Fund will also focus on, but not limit its investment activity to, three sectors: (1) value-added food production and processing, (2) heritage and environmental tourism, and (3) technology and manufacturing.

INVESTMENT STRATEGY

The Fund will make first and second round equity investments ranging in size from $200,000 to $2 million. Mezzanine and royalty financing opportunities will also be considered. A typical investment term will be three to five years. Exit strategies will include refinancing and recapitalization, owner buy-backs (puts), external buy-outs, employee stock ownership plans (ESOPs), and IPOs.

TECHNICAL ASSISTANCE STRATEGY

The Fund will provide hands-on technical assistance to portfolio companies in which it invests. The level and amount of technical assistance will depend on the needs of the firm to achieve its growth objectives. For companies and entrepreneurs not yet ready to obtain equity financing, the Fund has established a partnership with Ohio University that will provide technical assistance through its newly developed Regional Entrepreneurship Initiative (REI). The Fund and REI will work together and refer business prospects to one another in order to ensure that businesses receive the right solutions for their particular situation.

CAPITALIZATION

The Fund will be capitalized with $15 million. Two-thirds of this amount has been raised, and aggressive efforts are underway to raise the remainder.

ACEnet Ventures

OHIO

MISSION AND STRATEGY

ACEnet Ventures is a sectorally focused community development venture fund that provides flexible financing and investments to businesses in the food and technology sectors in a 26-county area in Appalachian Ohio, West Virginia, and Kentucky. ACEnet Ventures' mission is to assist in the creation of quality jobs and a healthy and sustainable regional economy in distressed regions of central Appalachia. Its strategy is to invest in businesses with growth potential in the food and technology sectors, where the fund can draw on the years of sector expertise of its affiliate, the Appalachian Center for Economic Networks, and thus lower risk, increase deal flow, and increase the expansion potential of firms.

STRUCTURE

ACEnet Ventures is incorporated as a non-profit organization, enabling it to obtain charitable funds—a combination of grants and long-term, low-interest loans—from foundations. ACEnet Ventures, Inc., is a subsidiary of the Appalachian Center for Economic Networks. Because of high unmet demand for patient capital among area firms, the Fund has an initial capitalization goal of $5 million, which will be expanded to $15 million within five years. This non-profit fund will be a permanent fund. Subsequently, a for-profit fund, structured either as a limited partnership (LP) or a limited liability corporation (LLC), will be set up to partner with socially responsible investors. This for-profit fund will be structured as a 10-year, limited-term fund.

MANAGEMENT

June Holley, ACEnet president, is founder of the Fund. Jay Dewhurst, with an MBA from Marshall University and years of small business experience, is fund manager. Board and investment committee members include the chair of a local loan fund investment committee, the director of the Ohio University Voinovich Center for Entrepreneurship, a former CFO of a Fortune 500 firm, a lawyer with business law background, the director of the Ohio Community Finance Fund, a food marketing specialist, and a local small business owner. ACEnet will donate support from staff with relevant industry expertise to assist in deal evaluation and to provide ongoing support to portfolio firms. ACEnet has worked with over 150 firms, including 75 start-ups, helping to create 170 new jobs since 1985.

TARGET MARKET

ACEnet Ventures will invest in the economically distressed 26-county region of Appalachian Ohio, West Virginia, and Kentucky. The Fund will primarily invest in specialty food businesses during its first year, and then will increasingly invest in technology businesses. Currently, over 30 are firms with high growth potential and are in need of patient capital to support rapid expansion during the coming year. In addition, several technology firms have requested investments.

INVESTMENT STRATEGY

The Fund is a full life cycle investor and will utilize a variety of investment structures to support the rapid start-up and growth of firms, including senior loans, subordinated debt, participation fees, royalties, and warrants. Equity investments (generally structured as preferred convertible stock) will be utilized where there is a high likelihood of a management buy-out or buy-out through an Employee Stock Ownership Plan (ESOP). Most investments will be in the $25,000 to $250,000 range in the first year, with deal size increasing as the Fund matures. The target IRR for investments is 12 to 15 percent. Primary exit strategies include ESOPs, management buy-outs, and buy-outs by larger firms.

TECHNICAL ASSISTANCE STRATEGY

Technical assistance services include support for developing investment applications and business plans, venture readiness services to improve operating systems, expansion services to develop new markets and processes, and trouble-shooting services. Partners in the provision of these services include both ACEnet and the Ohio University Voinovich Center for Entrepreneurship. The Fund will also partner with other central Appalachian development venture funds for staff training and co-investment.

CAPITALIZATION

ACEnet Ventures currently has $50,000 in grant funds from the C. S. Mott Foundation, $150,000 in low-interest loan funds from the Hitachi Foundation, and $75,000 in contributed staff time from ACEnet. The Fund is currently seeking additional foundation, public sector, and local socially responsible investors. The non-profit fund is looking for a combination of low-interest long-term loans and grants.

The Enterprise Fund

OHIO

MISSION AND STRATEGY

Designed to expand jobs in a four-county impact area by creating new local business and by expanding existing businesses, the Enterprise Fund offers a flexible means to finance small businesses in the counties of Pike, Scioto, Jackson, and Ross in Ohio. The Fund will provide direct assistance to businesses, creating new jobs for the residents of the impact area.

STRUCTURE

The Fund is operated by the Community Action Committee (CAC) of Pike County, a 501(c)(3) nonprofit organization. The Fund has been capitalized at $750,000 by the US Department of Energy, and it is anticipated that an additional $250,000 will be secured through local lenders.

MANAGEMENT

Randy Runyon, the CAC's assistant executive director, serves as the director of the Enterprise Fund. Mr. Runyon was previously the executive director of the CAC and spent three years in Ohio state government as the director of the Governor's Office of Appalachia. The Fund also employs Stephanie Blevens, who has operated the CAC's microenterprise training program and loan fund since 1994. Brian Martin, who has over 15 years of lending experience, is also involved in fund operations.

TARGET MARKET

The fund targets current and dislocated employees of the Portsmouth Gaseous Diffusion Plan. The fund also targets residents of the four-county impact area.

INVESTMENT STRATEGY

Clients may apply for a loan or equity participation in amounts ranging from $200 to $100,000. Loans exceeding $20,000 require the participation of a private lending institution and at least a 10 percent equity contribution from the borrower. Equity investments will be made in the form of stock purchase or convertible debentures. Terms may include but are not limited to a seat on the Board of the portfolio firm and approval of the Chief Financial Officer of the portfolio firm. Expected returns are typically in excess of 15 percent per annum. A 2 percent origination fee is charged to the portfolio firm. The Fund envisions a three-year investment window, with 20 percent of investments taking place in year one of Fund operations and 40 percent of investments closing in each of the subsequent two years.

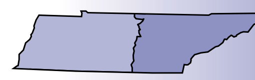
TECHNICAL ASSISTANCE STRATEGY

The CAC offers several types of business development services including training programs that focus on the business planning process, one-on-one business plan development support, and technical assistance during business start-up and expansion. The CAC also provides support through relationships with accountants, economists, and other professional service providers. Partnerships with many lenders in the region ensure that the best financing packages are available to client firms.

CAPITALIZATION

One million dollars from the US Department of Energy has been secured, with $750,000 designated to capitalize the Fund.

The Empowerment Fund



TENNESSEE

MISSION AND STRATEGY

The mission of The Empowerment Fund is to develop and provide both traditional and non-traditional funding sources to qualified east Tennessee companies. As a subsidiary of Technology 2020, the Fund will use a combination of equity and debt in a development venture capital role to promote private sector growth in the region. The Empowerment Fund accomplishes its mission through directing its own investment funds and through a pending management contract with the TennesSeed Fund 1, a Small Business Investment Corporation (SBIC). The creation of wealth for companies and the creation of new jobs in Tennessee will be two economic indicators measuring the success of the Fund.

STRUCTURE

The Empowerment Fund is a private, non-profit 501-(c)(3) and a subsidiary of Technology 2020, another non-profit corporation, whose mission is to leverage information technology resources in east Tennessee to incubate new businesses and create private sector jobs. The Empowerment Fund manages various investment funds such as the New Business Development Loan Fund and an SBA Micro-loan Fund.

MANAGEMENT

Technology 2020 created The Empowerment Fund to address its goal of providing community-based development venture capital in east Tennessee. The Empowerment Fund has a six-person board of directors, which consists of experts in the field of equity and debt investments with significant experience in financing small businesses. The board assists the management team of the Fund in structuring and negotiating the terms, conditions, and exit strategies for all Fund investment decisions.

TARGET MARKET

The unique technological resources in east Tennessee represent a significant opportunity for The Empowerment Fund. Over the last 10 years, more than $20 billion dollars has been invested in basic and applied research in some of the nation's finest research institutions and universities, most notably the Oak Ridge National Laboratory. The Fund will make its initial investment in its portfolio companies at an early stage, the "seed" or start-up phases of a company's growth.

INVESTMENT STRATEGY

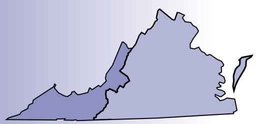
The Fund's management team appreciates that entrepreneurial companies often require unique creative financing structures, such as a combination and mixture of equity and/or subordinated debt, well beyond the capacity of Tennessee's banking industry to structure such deals in early-stage companies. The lack of institutional equity and debt financing is pervasive throughout the region's urban and rural communities, creating a unique opportunity for The Empowerment Fund. While emphasis will be placed on start-up financing, expansion financing and recapitalization opportunities will be considered as well.

TECHNICAL ASSISTANCE STRATEGY

Building management capability is as important as providing access to capital, and is a key to creating employment and wealth in distressed areas. The Empowerment Fund will use the resources of Technology 2020 to provide technical assistance to those companies in which it invests. These Technology 2020 programs include business planning assistance and counseling, a network of business incubator facilities in the region, an annual venture capital forum, a business mentor and "angel" investing group, a Technology Business Alliance networking group, a Center for Entrepreneurial Growth that promotes technology transfer, and a Digital Crossing e-commerce center. The Empowerment Fund will evaluate and determine the technical assistance needs of each company and will work with Technology 2020 to deploy the appropriate amount of support needed by each company.

CAPITALIZATION

Currently The Empowerment Fund has $2 million under direct management and expects to raise the level to $5 million in the next two years. In addition, The Empowerment Fund will manage the TennesSeed Fund 1 SBIC, which will be capitalized with a minimum of $30 million.



Appalachian Community Ventures Fund

VIRGINIA

MISSION AND STRUCTURE

The Appalachian Community Ventures Fund is a non-profit corporation that is a subsidiary of People, Incorporated, also a non-profit corporation. The goal of this small business investment and development Fund is to create and expand living wage, sustainable jobs for low-income persons in the region. Initially, the Fund is seeking a minimum of $3 million in capitalization. It is anticipated that the Fund will eventually be capitalized at $10 million.

MANAGEMENT

Rob Goldsmith, president of People, Incorporated, will be the chief operating officer of the Fund. An experienced fund manager will be sought once start up operating funds are secured. People, Incorporated, operates a $1.9 million micro-credit loan fund that has provided 84 loans and created 1,000 jobs since its inception in 1994.

TARGET MARKET

Initially, the fund will serve the core service area of People, Incorporated: Dickenson, Washington, Russell, and Buchanan counties as well as the city of Bristol, Virginia. Efforts will be made to market the fund to the distressed counties within Appalachian Virginia. As the fund grows, it is anticipated that the fund will make investments in businesses throughout southwest Virginia. Women, minorities, and low-income entrepreneurs will be encouraged to apply to the fund.

INVESTMENT STRATEGY

Investments up to $250,000 will be the initial target. Specific investment strategies are under development at this time.

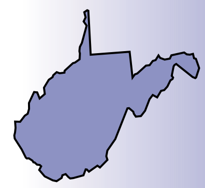
TECHNICAL ASSISTANCE STRATEGY

Strategic partnerships already exist with Small Business Development Centers, the School of Entrepreneurial Studies at Virginia Tech, and the Southwest Virginia Technology Center. Business trainers and consultants are also available in-house through existing People, Incorporated programs such as BusinesStart and the Incubator Without Walls program.

CAPITALIZATION

Banks, foundations, private individuals, and state and federal sources will all be approached to provide funds for capitalizing the fund.

Natural Capital Investment Fund



WEST VIRGINIA

MISSION AND STRUCTURE

The Natural Capital Investment Fund of West Virginia (NCIFWV), a program of the non-profit Conservation Fund, is a sectorally focused community development venture fund that provides flexible financing and investments to new and expanding businesses involved in natural resource–based activities in West Virginia. The NCIFWV is dedicated to advancing sustainable economic development in West Virginia. The Fund will begin as a program of The Conservation Fund, which will create a demonstration portfolio, and will then develop a subsidiary to operate the Fund. During the first two years of operation, the NCIFWV will raise capital from public and private contributors and invest that money to build a track record of experience and successful deals.

MANAGEMENT

Marten Jenkins will serve as the Fund Manager. The Fund Manager will work with a loan fund administrator and a 13-member Advisory Committee. The Advisory Committee includes experienced venture capitalists and entrepreneurs, as well as community development experts. The NCIFWV has signed a Memorandum of Understanding with the West Virginia Capital Corporation to provide loan fund administrative services during the pilot phase of operations. An eight-member Loan Committee drawn from the West Virginia financial community will review all debt and equity deals undertaken by the NCIFWV.

TARGET MARKET

The Fund will target new, emerging, and expanding businesses with a special emphasis on the 26 distressed West Virginia counties. The NCIFWV will target enterprises involved in natural resource–based activities such as specialty agriculture, recycling, and value-added wood and agricultural products.

The NCIFWV is building deal-sourcing referral relationships with key peers, ranging from state and local technical assistance to training providers, including the West Virginia Small Business Development Center, the West Virginia University Extension Service, and community development corporations such as MountainCAP and the West Virginia Capital Corp.

INVESTMENT STRATEGY

The NCIFWV will invest in businesses at any stage of development that have strong management in place and cannot obtain debt financing or equity capital from traditional sources. The NCIFWV has a target hurdle IRR of 15 to 20 percent. During the first two years of operation, the NCIFWV's investments in common stock, preferred stock, or debt capital will average $25,000 to $75,000 per deal. Exit strategies for equity investments will include, but not be limited to public offering, acquisition, employee stock ownership plan, company/management buy-back, and participation agreement.

TECHNICAL ASSISTANCE STRATEGY

The NICFWV will provide aggressive pre-loan and post-loan technical assistance to help ensure that borrowers' critical non-financial needs are addressed. Technical assistance will also be provided on an as-needed basis by NCIFWV partners, including, but not limited to the West Virginia Small Business Development Center, West Virginia University Extension Service, and the US Forest Service.

CAPITALIZATION

Using the seed capital provided by the Appalachian Regional Commission, the NCIFWV will pursue funding from major foundations, local corporations, and state and federal agencies with an interest in the sustainable economic development of West Virginia. With the successful completion of the pilot phase, the NCIFWV will initiate a fund-raising campaign to capitalize the fund at $5 million, half of the long-term goal of $10 million.

IMPROVING FUND MANAGEMENT

Creating a Regional Co-Investment Fund

The ARC Innovations in Development Finance Advisory Committee has identified management capacity as one of the critical issues facing the creation of successful DVC funds in the Region. This concern has also been identified in the literature as one of the key success factors impacting public venture capital programs,[11] and is underscored by Kerwin Tesdell, president of the Community Development Venture Capital Alliance (CDVCA), the industry trade association, who notes, **"**Recruiting and retaining the talent necessary to operate funds is perhaps the greatest challenge the industry currently faces. Community development venture capital requires all the skills of traditional venture capital, plus additional skills of economic development.**"**

Since the lack of seasoned management is a problem shared by the DVC industry in general, practitioners have been active in seeking solutions to the problem. For example, CDVCA provides numerous opportunities for training and peer learning. CDVCA's annual conference provides "nuts and bolts" training on equity investment issues based on case studies that are developed and taught by members of the faculty at leading business schools and universities. While training is important, a fund manager learns more through "doing" actual deals than he or she will learn in the classroom. Thus, it is important that new fund managers are exposed to the real world of deals.

One avenue for achieving on-the-job training for new equity fund managers involves making an initial series of investments with a "co-investment" fund that is led by seasoned equity investors. Co-investment is a common practice in the venture capital industry. A "lead" investor identifies and secures the investment opportunity, conducts much of the due diligence, negotiates the basic transaction, and then brings in fellow venture capital firms to provide a portion of the business's capital needs. By bringing in co-investment partners, the lead investor is able to avoid concentration of risk and bring a broader array of expertise and contacts to the business in which the investment is being made.

The Appalachian Regional Commission is in active discussions with public and private partners to develop a Co-Investment Fund targeting the Appalachian Region. The investment process is anticipated to work in much the same way as traditional venture fund co-investments, but will emphasize the mentoring role of the experienced management team leading the Co-Investment Fund.

Initially, the new DVC fund (the lead investor) will identify a potential investee and perform appropriate due diligence. The Co-Investment Fund will review the potential investment, and if satisfied, would take a lead role in structuring the transaction. Alternately, the Co-Investment Fund might identify additional outstanding issues that need to be resolved before participating as a co-investor. Ultimately, the lead DVC fund must make its own decision about each investment—whether to invest in a company along with the Co-Investment Fund and implicitly meet the investment parameters set by the co-investor, or to go it alone.

Through this process, the new DVC fund will learn in a practical, hands-on fashion from seasoned mentors in the DVC industry. It is anticipated that after structuring several co-investments with a specific lead DVC fund, the Co-Investment Fund will move on to target co-investments with other nascent DVC partners.

Additional activities under consideration by ARC to strengthen management expertise in this new field include support for a Management Fellowship Program, currently under development by the Community Development Venture Capital Alliance. This program would enable both recent MBAs and others with appropriate backgrounds to spend six months to two years working in existing, established DVC funds, and possibly in traditional venture capital funds as well. Upon completion of the program, fellows could employ their new skills at emerging DVC funds in distressed communities. The program could be modeled after, and leverage the educational resources of, the successful Venture Capital Fellows program created by the Kauffman Foundation.

NOTES

1 See Appendix A for a listing of mature DVC funds.

2 See Appendix B for a discussion of how equity and debt differ.

3 A good job can be considered as one "in industries that are growing and pay above average wages." One way to evaluate "good jobs" is to consider the rate of pay of a job compared to the average rate of pay in a locality, and to consider historical job growth in the target industry. For a more thorough treatment on the subject of "good jobs," see *Socio-Economic Review of Appalachia: The Evolving Appalachian Economy*, Andrew Isserman, under contract to the Appalachian Regional Commission (December 1996).

4 Additional information on the Entrepreneurship Initiative, including a listing of funded projects, can be obtained from the ARC Web site at www.arc.gov/programs/reginit/entrep.htm.

5 See Appendix C for a listing of committee members.

6 See Bibliography.

7 PricewaterhouseCoopers *Money Tree*™ Survey, 1999. http://204.198.129.80/index.asp. This survey reported activity from 936 venture capital firms. The National Venture Capital Association and Venture Economics reported that $48.3 billion was invested in 1999, but a broader definition of venture investing appears to have been employed.

8 Dr. Gregory Bischak, Senior Economist, ARC. Source: 1996 County Business Patterns.

9 Rural Policy Research Institute, August 1999, *A National Snapshot of Rural Equity Markets*, prepared for the Federal Reserve Bank of Kansas City conference, "Equity for Rural America."

10 These recommendations build on the framework by Brophy and Mourtada, August 1999, "Policy Options for Rural Equity Capital Markets," presented at the Federal Reserve Bank of Kansas City conference, "Equity for Rural America."

11 Barkley, Markley, and Rubin, "Public Involvement in Venture Capital Funds: Lessons from Three Program Alternatives," Rural Policy Research Institute, November 1999.

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APPENDIX A

MATURE DEVELOPMENT VENTURE CAPITAL FUNDS

Summaries of three mature funds are excerpted from *CDVC FUND PROFILES, EXAMPLES OF COMMUNITY DEVELOPMENT VENTURE CAPITAL FUNDS AT WORK TODAY*, Community Development Venture Capital Alliance, New York, 1999.

Funds profiled:

- Coastal Ventures Limited Partnership, Maine
- Kentucky Highlands Investment Corporation, Kentucky
- Northeast Ventures, Minnesota

COASTAL VENTURES LIMITED PARTNERSHIP

2 Portland Fish Pier, Suite 302
Portland, Maine 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 and $500,000 in growing Maine companies.

Number 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. Ms. 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 her to bring some back for them as well. Recognizing a good business opportunity, she placed ads in US magazines and began selling products by mail order.

By 1985, Cuddledown sales had grown to $1.2 million, exceeding Ms. 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 could not approach traditional sources of financing. That was 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, Cuddle-down is growing at more than 25 percent 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.

KENTUCKY HIGHLANDS INVESTMENT CORPORATION

PO Box 1738
London, Kentucky 40743-1738
(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, Kentucky

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 Mr. Upchurch’s hometown of Albany. As part of the deal, KHIC owns a percentage of the company, which Mr. 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, Mr. 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 Mr. 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.”

NORTHEAST VENTURES

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

Total Assets: $11 million

Investments to Date: $8.3 million

Number 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 percent 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 the 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 the 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.

APPENDIX B

DIFFERENCES BETWEEN EQUITY AND DEBT

Equity and equity-like investments differ from debt in the following ways:

- Depending on the structure of an equity investment, a borrower may or may not have to repay the investment. In contrast, a borrower must repay debt.
- The total dollar amount eventually recouped as a result of an equity investment is a function of company performance and is not known at the time of investment. The amount to be repaid to a lender is a function of the amount borrowed and the interest rate, and is known at the outset of the loan.
- A business owner does not guarantee an equity investment in his or her business. A small-business borrower usually does.
- An equity investment is almost always unsecured. Most small-business loans, particularly those financing fixed assets purchases, are secured.
- An equity investment typically requires no or modest payouts to the investor during the early years of that investment. A loan requires debt service payments from its outset or shortly thereafter.
- An equity investment may represent or eventually lead to an ownership interest in the business, depending on the structure of the investment. A lender has no ownership interest.

Only the imagination and experience of the investor limit the form of an equity investment. Common forms include common stock, preferred stock, profit-sharing agreements, warrants, and convertible subordinated debt.

For information on the venture capital industry, visit the National Venture Capital Association web site at www.nvca.org.

Appendix B adapted with permission from David J. McGrady, January 2000, Policy Alternatives for the Appalachian Regional Commission to Support the Creation of Development Venture Capital Funds *(under contract with National Community Capital Association, Philadelphia, PA).*

APPENDIX C

ARC ENTREPRENEURSHIP INITIATIVE

Innovations in Development Finance
Advisory Committee

Tammy Arington, *Vice President*
First American National Bank
Bristol, Tennessee

Michele Flynn, *Executive Director*
Tennessee Network for Community Economic Development
Nashville, Tennessee

Jane Henderson, *Senior Vice President and Director of Community Development Group*
First Union National Bank
Charlotte, North Carolina

Brent Lane, *Executive Director*
Center for Entrepreneurship and Technology
North Carolina Department of Commerce
Raleigh, North Carolina

Kent Marcoux, *Senior Associate*
Corporation for Enterprise Development
Washington, DC

Charles McLean, *Deputy Director – Office of Policy*
Federal Housing Finance Board
Washington, DC

Karen Mocker, *Senior Advisor – Community Affairs*
Federal Reserve Bank of Cleveland
Cincinnati Branch
Cincinnati, Ohio

L. Ray Moncrief, *Chief Operating Officer*
Kentucky Highlands Investment Corporation
London, Kentucky

Jim Overton, *Commercial Specialist*
Self Help Ventures Fund
Durham, North Carolina

Tom Rogers, *President*
Technology 2020
Oak Ridge, Tennessee

Julia Sass Rubin, *Doctoral Candidate*
Harvard Business School, Harvard University
Cambridge, Massachusetts

Welthy H. Soni, *Director – BusinesStart*
People, Inc.
Bristol, Tennessee

Bill Steiner, *Executive Director*
Northwest Pennsylvania Regional Planning and
Development Commission
Oil City, Pennsylvania

Robert Strother, *Executive Director*
South Carolina Appalachian Council of Governments
Greenville, South Carolina

Kerwin Tesdell, *Executive Director*
Community Development Venture Capital Alliance
New York, New York

Dave Warner, *Executive Director*
West Virginia Economic Development Authority
Charleston, West Virginia

Trent Williams, *Principal*
Regional Technology Strategies
Carrboro, North Carolina

RESOURCES

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US Department of the Treasury
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Washington, DC 20005

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National Association of State Venture Funds
Robert Heard
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www.nasvf.org

US Small Business Administration, Small Business Investment Division
(Oversees the SBIC Program)
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Investment Division
Mail Code 7940
Washington, DC 20416

Phone: (202) 205-6513
www.sba.gov/INV/

ARC's Mission

Created by Congress in 1965, when Appalachia was considered "a region apart" from the rest of the nation, the Appalachian Regional Commission (ARC) is a unique federal-state partnership working to bring all of Appalachia's 22 million people into America's economic mainstream. ARC's mission is to be an advocate for and partner with the people of Appalachia to create opportunities for self-sustaining economic development and improved quality of life.

APPALACHIAN REGIONAL COMMISSION

FEDERAL CO-CHAIRMAN
Jesse L. White, Jr.

STATES' CO-CHAIRMAN
West Virginia Governor
Cecil H. Underwood

STATES' WASHINGTON REPRESENTATIVE
George W. "Bill" Walker

EXECUTIVE DIRECTOR
Thomas M. Hunter

GOVERNORS AND STATE ALTERNATES

ALABAMA
Governor Don Siegelman
Nick Bailey
Acting Director, Department of Economic and Community Affairs

GEORGIA
Governor Roy E. Barnes
Hugh Peterson
Director, Intergovernmental Relations

KENTUCKY
Governor Paul E. Patton
Jerry D. Johnson
Special Assistant to the Governor, Office of New Appalachia Development

MARYLAND
Governor Parris N. Glendening
Ronald N. Young
Acting Director, Maryland Office of Planning

MISSISSIPPI
Governor David R. Musgrove
David C. Cole
Chief of Staff
Office of the Governor

NEW YORK
Governor George E. Pataki
Alexander F. Treadwell
New York Secretary of State

NORTH CAROLINA
Governor James B. Hunt Jr.
James McCleskey
Director, State of North Carolina's Washington Office

OHIO
Governor Bob Taft
Joy Padgett
Director, Governor's Office of Appalachia

PENNSYLVANIA
Governor Thomas Ridge
David Black
Deputy Secretary, Community Affairs and Development
Department of Community and Economic Development

SOUTH CAROLINA
Governor James H. Hodges
Sam Cargill
Director, Community Grants Division
South Carolina Department of Commerce

TENNESSEE
Governor Don Sundquist
Michael E. McGuire
Director, Grants and Loans

VIRGINIA
Governor James Gilmore
William C. Shelton
Director, Virginia Department of Housing and Community Development

WEST VIRGINIA
Governor Cecil H. Underwood
Fred Cutlip
Director, Community Development Division
West Virginia Development Office

The **Appalachian Region** includes all of West Virginia and counties in 12 other states: Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia. The Region contains 406 counties, with a combined area of nearly 200,000 square miles.

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