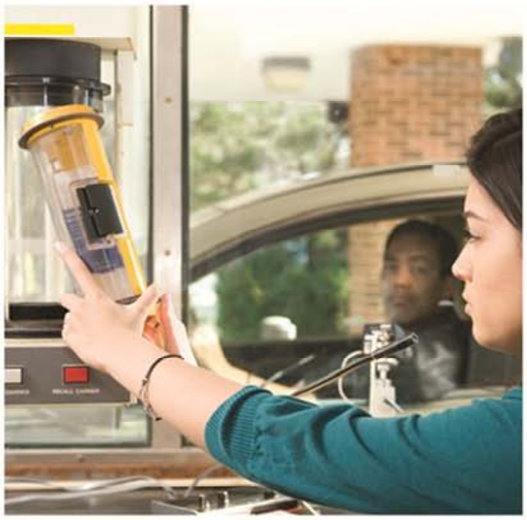


SSBCI PROGRAM PROFILE: VENTURE CAPITAL PROGRAM

May 17, 2011

State Small Business Credit Initiative (SSBCI)

U.S. Department of the Treasury

What is a Venture Capital Program?

A Venture Capital Program provides investment capital to create and grow start-up and early-stage businesses. State Venture Capital Programs often take one of two forms: a state-run venture capital fund (which may include other private investors) that invests directly in businesses; or a fund of funds, which is a fund that invests in other venture capital funds that in turn invest in individual businesses. Many factors, particularly resources and available talent, inform a state's decision on which form to choose. For example, a state may choose to invest in a large venture fund that agrees to reinvest in that particular state an amount equal to that invested by the state, as opposed to trying to attract that same talent to a smaller fund capitalized with state money.

What are the Investment Characteristics?

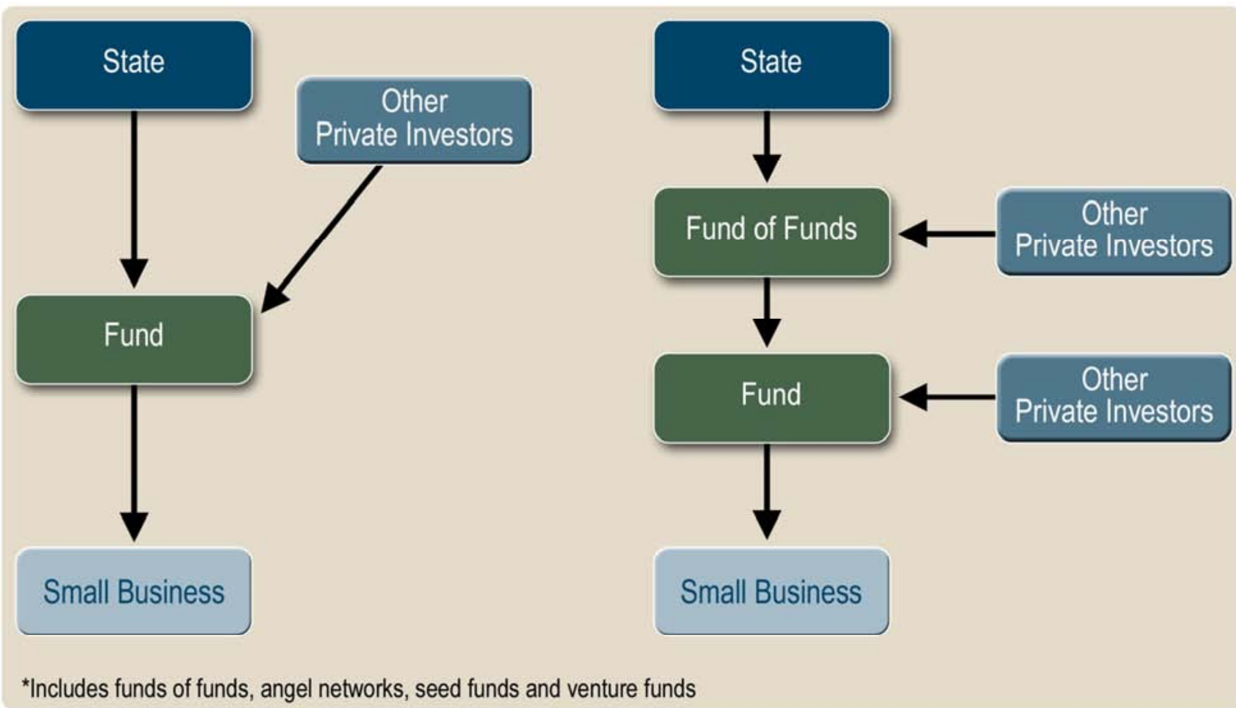
Like all credit programs, a Venture Capital Program can be tailored to meet a state's objectives. The table below describes key investment characteristics that should be considered when designing a Venture Capital Program.

Characteristics	Description
What kinds of businesses are eligible to participate?	• Determined by each state and may target specific industries, regions and/or types of businesses, depending on the state's objectives. • Under SSBCI, should target an average business size of 500 employees or less, and should not exceed a maximum business size of 750 employees. In practice, small businesses are typically much smaller than 500 employees. • Corporations, partnerships, and sole proprietorships are eligible, including non-profits and cooperatives. • SSBCI Policy Guidelines provide specific guidance on certain businesses who are prohibited from participating in this program.
What sizes of investments are eligible?	• Under SSBCI, must target an average principal amount of $5 million or less and cannot exceed $20 million on any individual loan. In practice, the average small business investment is less than $5 million.
What types of investments are eligible?	• Typical businesses for investment have the potential for fast growth and can create an exit strategy for the equity investors. All stages of venture capital financing are eligible, including seed/angel, early stage, expansion and mezzanine financing. • Investment types are typically equity and hybrid investments, such as preferred equity and subordinated debt.
How can investment proceeds be used by eligible businesses?	• For any business purpose, including, but not limited to: start-up costs, working capital, business procurement, franchise fees, equipment, inventory, as well as the purchase, construction, renovation, or tenant improvements of an eligible place of business that is not for passive real estate investment purposes. • Restrictions apply to refinancing and other uses; please refer to the SSBCI Policy Guidelines for additional details.
Who negotiates the terms of the investment?	• Terms are negotiated between the business owner and the venture capital fund, based on the fund's valuation of the business.

Characteristics	Description
What are the program's strengths?	• Provides risk capital to emerging businesses before they meet typical lending credit criteria. • Programs aim to attract other investors and help cultivate an industry of private risk capital investors.

How Does a Venture Capital Program Work?

State Venture Capital Programs take one of two forms: 1) a state-run venture capital fund with other private investors, which invests directly in businesses; or 2) a fund of funds, which is a fund that invests in other venture capital funds, which in turn invest in individual businesses. In a fund of funds structure, other private investors may co-invest either at the level of the fund of funds or at the level of the venture capital fund.



Operating Mechanics	Description
What kinds of funds are eligible to participate?	• Funds that invest in eligible companies, as determined by the state. • SSBCI recommends that states screen funds to demonstrate sufficient venture capital investment experience and financial and managerial capacity to participate.
Who originates deals in this program?	• In a state-run venture capital fund, the state fund conducts deal sourcing. • In a fund of funds structure, the venture capital funds in which the state's fund of funds has invested conduct deal sourcing. • In both cases, the day-to-day fund management is typically outsourced to a professional firm.

Operating Mechanics	Description
Who has responsibility for investment decisions?	• In a state-run fund, the state fund makes the investment decisions. • In a fund of funds structure, the venture capital funds make the investment decisions in eligible businesses.
How are investments monitored?	• In a state-run fund, the state actively monitors all of its investments. • In a fund of funds structure, the state provides high-level monitoring of aggregate performance of its portfolio, with monitoring of a small amount of data on each venture capital investment; in this model, the venture capital funds actively monitor individual investments.
What kinds of fees may be charged?	• Under the standard venture capital model, the general partners receive a 2% annual management fee based on assets under management and a 20% carried equity interest on any capital gains.
What is the term of an investment?	• The standard life of most venture capital funds is 12 years. • Individual fund investments are typically for 3 to 7 years.
What leverage requirements exist?	• Under SSBCI, each OCSP approved by Treasury must individually demonstrate a minimum private financing ratio of 1:1 over the lifespan of the SSBCI program. • States must demonstrate a plan that creates a reasonable expectation that the approved programs, when considered in sum, will result in 10:1 leverage over the lifespan of the SSBCI Allocation Agreement or Allocation Time Period.
What is the state's liability?	• Venture funds are typically limited partnerships or limited liability companies (LLCs), in which the state's liability would be limited to funds invested or committed.

Who are the Key Stakeholders and What are Their Roles?

The stakeholders in a Venture Capital Program are: the state, the venture capital funds or fund of funds, a fund manager or general partner, and an implementing agency/entity, if assigned by the state to manage the program. Implementing entities may include a specific department, agency, or political subdivision of the state, or an authorized agent of, or entity supervised by, the state.

Stakeholder	Role
What is the role of the state?	• Markets the program in their region or community. • In a state-run venture capital model, the state sources and originates investments in small businesses. • In a fund of funds model, the state selects venture funds in which to invest and responds to capital calls. • In each model, the state verifies the eligibility of portfolio companies, obtains assurances of eligibility from each business, and that proceeds will be used for acceptable business purposes. • In each model, the state provides high-level monitoring of fund performance and individual investment performance against a small set of performance criteria.

Stakeholder	Role
What is the role of a venture capital fund?	• A venture capital fund makes and manages portfolio company investments. • A fund of funds selects venture capital funds in which to invest and make disbursements when capital calls are issued.
What is the potential role of an implementing agency/entity?	• Acts on behalf of the state to run the Venture Capital Program. • Assists in marketing the program in their region or community. • May also operate other credit support programs.

What Kind of Operating Model is Needed to Manage a Venture Capital Program?

Venture Capital Programs using a fund of funds model may have lower operating costs for the state than other credit support programs due to less involvement in investment decisions and low portfolio monitoring requirements. Essential knowledge and experience that states need to set up a fund of funds include: analysis of venture funds in which to invest; and some operational and administrative experience. States may acquire these skills through the use of a qualified analyst or small team of analysts to serve as fund managers, reporting to a board of directors, to be consulted in selecting venture capital funds and responding to capital calls. State-run funds generally have higher operating costs than fund of funds due to resources required to attract top talent to staff capable management teams, conduct business analyses, monitor individual investment performance, and, in some cases, provide direct technical assistance to businesses in which the fund has invested.

How Does a Venture Capital Program Help to Achieve a 10:1 Private Financing Ratio?

To be eligible for federal funding, a state should reasonably demonstrate that, when considered with all other SSBCI programs of the state, such programs together have the ability to generate private lending of at least 10 times the new federal contribution amount, also known as the private leverage ratio, by December 31, 2016. Eligible private lending includes all loans or investments from a private source to an eligible borrower or eligible portfolio company, whether occurring at or subsequent to loan/investment closing, as well as any new infusions of cash by the owners of the eligible portfolio company. As an example, if a state-sponsored Venture Capital Program expects to make 20 venture capital investments to businesses with the aggregate investment profile shown below, the resulting projected “allocation time period private leverage ratio” would be 10:1. This calculation would be derived as follows:

a. SSBCI Funds used under the Participating State’s Venture Capital Program	$1,000,000
b. Other Private Equity Investment at Closing of SSBCI-Supported Transaction	$3,000,000
c. Other Private Transaction-Level Debt at Closing of SSBCI-Supported Transaction	$3,000,000
d. Subsequent Private Sector Investment resulting from SSBCI Support	$4,000,000
e. Total Private Financing (b + c + d)	$10,000,000
Private Leverage Ratio (e to a)	**10:1**

Where Have Venture Capital Programs Worked Well?

State-run Venture Capital Programs exist in at least 37 states. Most target early stage investments in companies that align with state development priorities. In the mid-1990s, Oklahoma launched a fund of funds program that uses tax credits to raise funds. These funds are invested in established venture capital firms that invest in potential Oklahoma growth companies. Variations of this model have been established in other states, such as Arkansas, Iowa, Michigan, Oregon, Ohio and South Carolina. Key features of the Oklahoma program were discussed in an SSBCI conference call on Venture Capital and are summarized below. This information is not drawn from Oklahoma's SSBCI application.

Highlights from Oklahoma's Venture Capital Program

- **Overview:** Oklahoma's Venture Capital Program is supported by Cimarron Capital Partners, an organization that manages private equity, angel, and venture capital investments. Oklahoma uses the program to generate a larger, more robust angel investor network.
- **Fund Start-up Timeline**: In Oklahoma, it takes several months to organize an angel investor training event, and one year to lay the foundation for a fund program.
- **Impact and Size of Funds:** The size of venture capital funds may depend on the region, and can range from $50 million to a number of local funds seeding at levels under $5 million; Oklahoma's model seeks to seed funds each starting at $500,000.
- **Staffing:** In Oklahoma, a fund manager finds funds based on established criteria, and then presents proposed fund investments to a state-appointed Board, which approves or declines the investment.

Who Can You Contact With Questions on Venture Capital Programs?

Treasury has posted policy guidelines and application materials on its website, available here: http://www.treasury.gov/ssbci. Questions may be asked via phone (202-622-0713) or via email at SSBCIquestions@treasury.gov.