



# **Entrepreneurial Investment Capital: A Critical Part of Our Entrepreneurial Ecosystem**

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# Outline

- Steve Ringlee
- Iowa's Scorecard in Entrepreneurial Activity
- Founding Capital: FFF and Angels
- Venture Capital
- Government Capital
- Community Capital
- Private Equity Capital
- Business Advice for Startups

# Iowa's Entrepreneurial Scorecard

- Price Waterhouse “MoneyTree” (2007)
  - Iowa: secured .074% of national VC investments during 1995-2000 and .046% during 2003-2007
  - Trend has been down but is flattening
- Kaufman Foundation “New Economy Study “
  - Business Starts: 26<sup>th</sup> (2007)
  - VC Investment: 42<sup>nd</sup>
  - IA: 38<sup>th</sup> Overall
  - State Science & Technology Index (2004): 37<sup>th</sup>, down 2

# Founding Capital: FFF

- Friends and Family Finance
  - Source of most initial startup capital: network
  - \$5k to \$500k
  - Savings, credit cards, bank loans, mortgages
  - Personal accountability: you are accountable to your family and friends
  - Usually no involvement in business
  - Related to “bootstrapping”

## Founding Capital: Angels

- *Amazon*: Jeff Bezos 1994  
12 angels: \$100,000
- *Google*: Larry Page and Sergey Brin 1998 maxed out credit cards
- *Sun Microsystems*: Andy Bechtolsheim Angels: \$100,000
- *NewLink Genetics*: Chuck Link  
Iowa angels supported over \$15m

# Who are Angels?

- SEC Rule 501: Accredited Investors
- Guardian Angel: experienced with Rolodex
- Operational Angel: executive experience
- Entrepreneurial Angel: startup experience
- Hands-Off Angel: investor only, no time
- Control Freak Angel: high ego density
- Network Angel: invests through a group or groups

# Angels vs. Venture Capital

- **VC: pension money in funds, larger & later deals**
- **Angels: individual money in clubs, smaller & earlier deals**
- *All VC Deals: \$26b averaging \$7.5m per deal in 3,800 companies*
- *Seed and Early Stage VC: \$1.2b averaging \$3.8m per deal in 312 companies*
- *Angel: \$26b averaging \$500k per deal in 51,000 companies*

# US Angel Market Growth

- 2006: \$25.6 billion in 51,000 ventures
- 2005: \$23.1 billion in 49,500 ventures
- 2004: \$22.5 billion in 48,000 ventures
- 2003: \$18.1 billion in 42,000 ventures,
- 2002: \$15.7 billion in 36,000 ventures

# Where Do Angels Invest?

<u>Sector</u>	<u>2006</u>
Healthcare	21%
Software	18%
Biotechnology	18%
Retail	8%
Electronics/Hardware	2%
Media	4%
IT Services	3%
Industrial/Energy	6%
Fin/Bus Products	6%

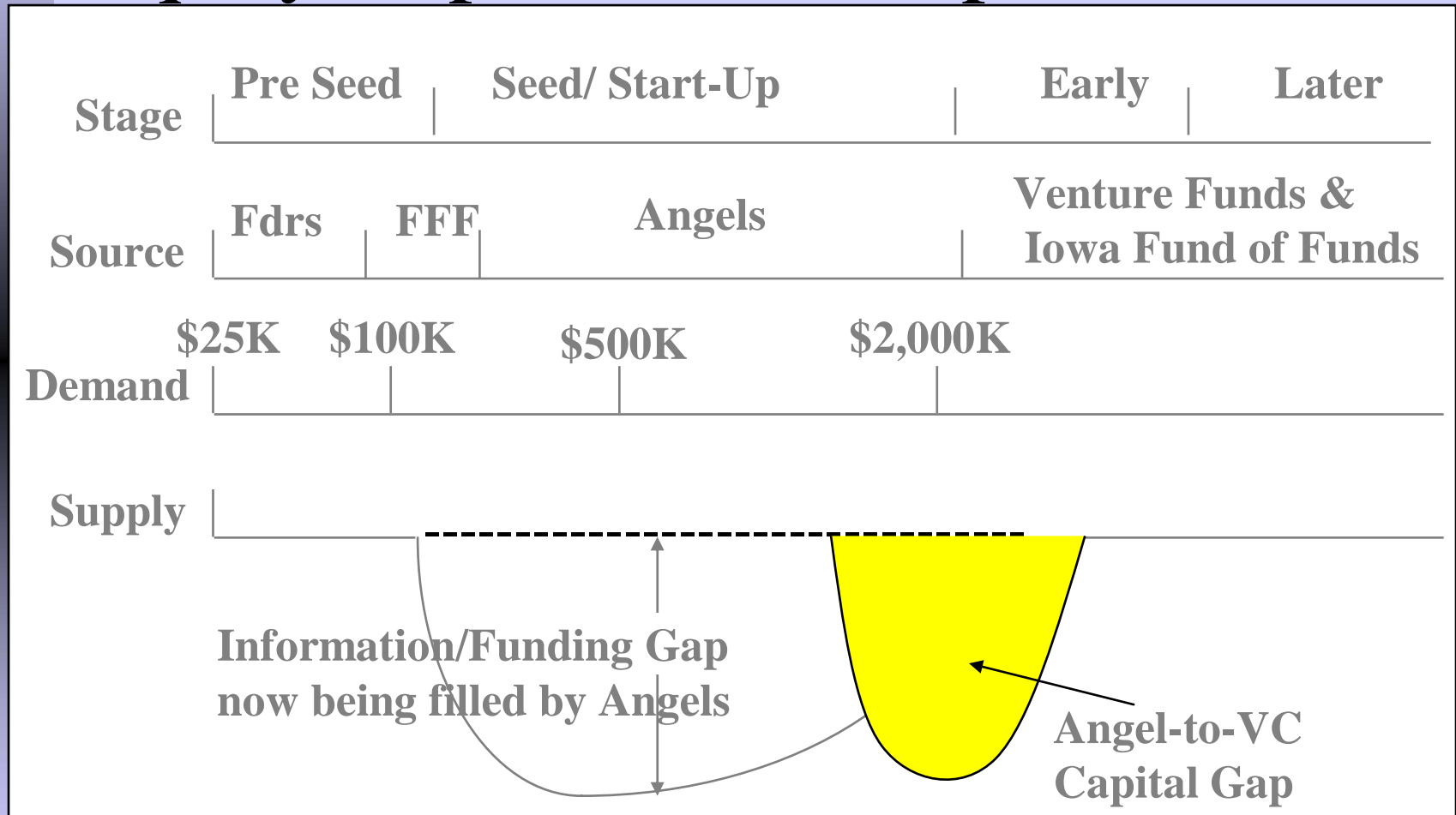
# Angel Fund Growth

	US	IA
1996	10	1
1999	98	1
2000	138	1
2001	126	2
2002	130	2
2003	141	4
2004	123	5
2005	132	7
2006	164	10
2007	171	12

# How Do Angels Invest?

- *Lemmings: social decisions*
- *Some due diligence investigation, but most decisions made on the basis of gut feel and the quality of the business plan*
- *Semi-active involvement depending on angels*

# Equity Capital for Entrepreneurs



# The Road Ahead

- Recognize the critical role of angels
- Create sustainable Iowa angel market growth and returns
- Convert latent angels into investors
- Encourage training, networking and cooperation
- Deal with the second funding gap
- Work on the angel - VC relationship

# Venture Capital

- What VC Is
- Size and Scope
- Iowa's Challenges

# Venture Capital

- Professionally managed equity capital invested alongside management in high potential, rapid growth companies for high returns.
- Organized into closely-held partnerships
- Funded by pension funds, foundations, wealthy individuals, corporate strategic investors

# Venture Capital

- Finances new and rapidly growing companies;
- Purchases equity securities;
- Assists in the development of new products or services;
- Adds value to the company through active participation;
- Takes higher risks with the expectation of higher rewards;
- Has a long-term orientation

# Venture Industry

- 800 VC firms nationally
- Heavily concentrated on both coasts
- General Partners paid fees + percentage of profits
- Average fund lifetime: ten years
- Investment criteria for each fund
- See many deals, invest in very few: 1 in 400

# Stages of Venture Capital Investing

- **Seed/Start-Up Stage**  
The initial stage. The company has a concept or product under development, but is probably not fully operational. Usually in existence less than 18 months.
- **Early Stage**  
The company has a product or service in testing or pilot production. In some cases, the product may be commercially available. May or may not be generating revenues. Usually in business less than three years.
- **Expansion Stage**  
Product or service is in production and commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit. Usually in business more than three years.
- **Later Stage**  
Product or service is widely available. Company is generating on-going revenue; probably positive cash flow. More likely to be, but not necessarily profitable. May include spin-outs of operating divisions of existing private companies and established private companies.
- **Acquisition, Turnaround or Recapitalization**  
of public and private companies

# VC Challenges in Iowa

- Few local VCs
- Many VCs are geographically focused
- Iowa deals are either “early or late”
- More difficult to assemble management teams in Iowa
- Remote from national technology centers

# VC Opportunities in Iowa

- <http://www.iowaentrepreneur.com>
- Pappajohn Entrepreneurship Centers
- Local Business Accelerators
- Small Business Development Centers

# Government Capital

- Federal:
  - *SBIR*: Small Business Innovation Research
  - *Grants*
  - **Agency Partnering**
- Iowa: Department of Economic Development
  - *Demonstration Fund*: \$100k
  - *Targeted Funds*: Power Fund, Values Fund
  - [www.iowalifechanging.com](http://www.iowalifechanging.com)

# Community Capital

- *CDFI's*: A \$21b source of capital
- Targeted toward lower demographics
- *Community Development Finance Institutions*:
  - Banks: for-profit, insured
  - Loan Funds: non-profit
  - Credit Unions: member owned
  - Venture Capital: for profit, targeted VC
- *New Markets Tax Credit* funds: \$15b
- *Rural Business Investment Company* funds

# Private Equity Capital

- Leveraged Buyouts: acquisition of an existing firm using debt capital
- Beginnings: use leverage via debt to enhance returns in breakup and restructuring
- Now: use operating improvements, build platform firms, build value

# Private Equity Deals

- Best deals:
  - Established firms with stable cash flows and clean balance sheets with little debt and good asset base
  - Strong market position
  - Good management team
  - Divestible assets
  - Potential for expense reductions
  - Good synergy opportunities
- Large market of funds seeking such deals in every size category

# Private Equity Deals

- Multiple layers of debt: senior, mezzanine
  - Senior debt: 50%, from banks, insurers
  - Mezzanine debt: 30%, from funds and insurers
  - Equity: 20%, from management, funds, investment banks, sub debt holders
- Huge worldwide market: \$110b invested in 2005
- Debt crisis has severely affected the buyout market

# Business Advice for Startups

- Open Discussion!