



Venture Capital

An Overview

Economic Affairs Committee

Jan. 23, 2004



First Question:

What is the state's goal regarding venture capital?

- Economic development?
 - More jobs
 - More business contacts and spinoffs?
- More wealth?
 - State tax base
 - Investor wealth
- Regional boost to economic development?

Who Provides Investment Capital?

- Core Investors
 - Entrepreneur, Family and Friends
- Angel Investors
- Venture Capitalists
- Economic Development Offices
 - Federal, State, Regional and Local
- Banks, through Conventional Loans

Who are Angel Investors?

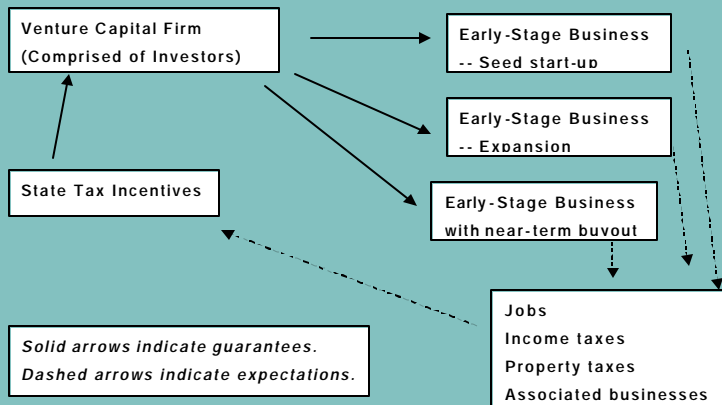
- Fill gap between friends/credit cards/family & Venture Capital Investments/Bank Loans.
- Typically invest between \$25,000 and \$250,000.
- Invest advisory time as well as money.
- May require preferred stock, board seat.

■ Following the money

- Investors pool \$\$\$ in Venture Fund
- Venture Fund is a company that:
 - Takes fees for services
 - Invests in start-ups
 - Offers advice, including management assistance
- Start-ups provide return on investment
 - Through public or private offering, mergers
 - Through tax credits, if available
- Venture Fund cashes in/moves on

How some State-Funded

■ Venture Capital firms work:



■ Benefits of Venture Capital?

- From the investor's perspective
 - High return on investment
 - Most likely if young company is innovative, has potential for being traded publicly (IPO) or being acquired by established firm (exit payoff)
- From the state's perspective
 - Economic Development

■ Where VC Investments Made

- What states?
 - California, Massachusetts, New York, Texas and Colorado have most investment
 - Of \$61.6 billion invested from 1998 to 2000 less than \$1 billion was in semi-rural areas
- What types of companies?
 - Formative-stage companies
 - Technology-related companies

■ Types of Venture Capital Firms

- Private
- Private, state-sponsored with state funds or tax credits
 - CAPCOs (certified capital companies)
 - BIDCOs (business & industrial development corporations)
 - Fund of Funds

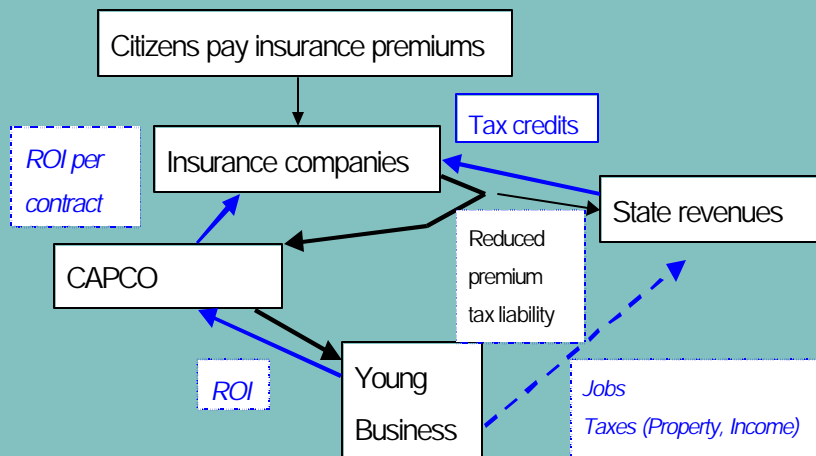
■ Private

- Compete for best ideas
- Typically centered in high-population areas, like New York and California
- Close proximity to many start-up firms (makes oversight of many firms easier)
- Willing to accept high risk for high returns

■ CAPCOs

- Certified capital companies that receive investments from insurance companies.
- Insurance companies in turn receive:
 - immediate tax credits for the investment
 - whatever yield on the investment that falls within their agreement with the CAPCO.
- CAPCOs get management fees and returns on the venture funds they invest.

■ CAPCO Investment Flow



■ BIDCOs

- State-chartered, private-lending institutions
- Typically structured so that state investment is forgiven if clients meet specified goals
- Private investors put up additional funds
- Targeted for areas ignored by investors

■ Fund of Funds

- Privately operated fund
- Investors achieve return on investment through venture fund management
- State sets aside projected revenues to serve as deferred tax credits (for use if venture fund's return is inadequate)
- May be structured to target state goals

■ Montana's Previous Ventures

- Science and Technology Development Seed Capital Fund, repealed in 1989
- Montana Capital Companies Act (still on books but tax credits have expired)

■ Choosing Options - Goals

- Creating jobs
- Creating wealth
 - Internal Rates of Return
 - (State return on investment)
 - (Investor's return on investment)
- Targeting regional economic development

■ Choosing Options - Structure

Public Money
&
Management

Targets
Economic
Development

Private Management
With
State Investment

Both ED and IRR

Private Management
With
State Incentives

Both ED and IRR

State sets
policy to
attract
private
money
without
incentives

Low cost
IRR private