

Launching a Public Sector Supported, Private Sector Driven Innovation Finance Initiative



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A critical component of the development finance toolbox, innovation finance provides access to capital for entrepreneurs, new technology ventures, and emerging small businesses. CDFA created the new **Innovation Finance**

Course, held this past May in Boston, MA, to teach development finance agencies of all sizes how to create an innovation finance initiative that supports entrepreneurship, business investment, job creation, and 21st century technology development.

The new course explores the seed, venture capital, and angel investment industry and provides a roadmap for designing a program that uses public sector connections, resources, and coordination to drive long-term and sustainable private sector investment.

When thinking about developing or bolstering a culture of innovation finance that harnesses the investment potential of the private-sector through the support of the public-sector in your region, here are four benchmarks to consider:

1) Know Your Community's Entrepreneurial Ecosystem

Entrepreneurs exist in every region of the country, and knowing where they are in your own community and how to support them is critical to establishing a thriving entrepreneurial culture. Engaging the full range of organizations and individuals that

exist within the spectrum of innovation finance will help ensure that your community is poised for success.

According to Maria Meyers of U.S.SourceLink, a course faculty member, identifying the primary contacts in the following groups is essential to establishing the entrepreneurial support system in your community:

- University and Research Centers
- Intellectual Property Attorneys
- SBIR/STTR Assistance Programs
- Public Agencies and Financing Authorities
- Angel Groups and Networks
- High-tech and Biotech Incubators
- Venture Capital Firms
- Serial Entrepreneurs
- Mentorship Programs
- Small Business and Technology Development Centers (SBA)

Creating a network where these types of organizations can communicate with entrepreneurs will help facilitate the growth of your entrepreneurial ecosystem. Depending on the size and structure of your community, this list may include just a handful of people, or it may weave together individuals across different cities and sectors.

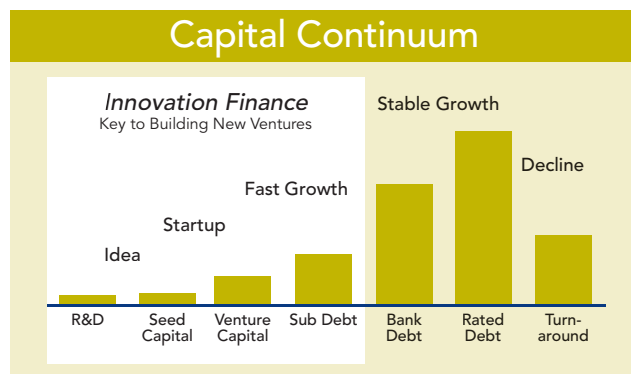
2) Utilize the Full Capital Continuum

We all know that as a business launches and grows, it will need various forms of capital over time. Identifying the sources of capital in your community

and acknowledging the organizations that are best suited to providing debt or equity financing will help you advise entrepreneurs in need of support.

An entrepreneur can benefit from a variety of forms of innovation finance, depending on the scope and sophistication of his or her business. R&D, seed, venture, and sub-debt capital are often complementary and can be used together to meet the capital needs of a particular company. Jeremy Halpern of Nutter McClennen & Fish LLP, a course faculty member, pointed out that being aware of the different costs of each form of capital will help you identify which source is best in each deal.

To be able to provide access to all of these forms of innovation finance, seek out those individuals or organizations in your community that could serve as grantors, angel investors, seed funds, or venture funds. These groups are primarily found in the private sector, but some public agencies can be structured to offer these forms of access to capital.



Source: CDFA Innovation Finance Reference Guide

3) Learn How to Think Like an Investor

Investors think differently than providers of debt capital, such as traditional lenders, and learning how to evaluate a deal like them will better prepare you to lead or guide the development of an innovation finance initiative in your community.

Because early or seed stage investors are about to assume an ownership stake in a company, most of them usually conduct two levels of due diligence before making an investment. First, they carry out an initial screening, involving a cursory look at the business, the entrepreneur, and the numbers. Second, a more in-depth evaluation completes the due diligence process with an analysis of the management team, competitive advantage of the business, and ability to achieve fast growth in their market.

In particular, learning how to value a company and structure the legal terms of a venture investment will help you better understand some of the technical aspects of these types of deals. John Hession of Cooley LLP, a course faculty member,

advises that you should know the following terms in order to fully speak the language of innovation finance:

- Pre-Money Valuation
- Participating Preferred
- Anti-Dilution Protection
- Class Voting/Veto Rights
- Cumulative Dividend
- Drag Along Rights

A quick hint: if these terms are unfamiliar, CDFA's *Innovation Finance Reference Guide* is a good starting point to learn more.

4) Develop Local Angel Networks

Once you are familiar with your community's entrepreneurial ecosystem, and have assembled the necessary capital resources, and developed the knowledge to understand equity investments, you will be ready to champion the development of angel networks in your community.

In every region of the country, there exists a potential source of angel investors, or individual investors, who could be coalesced into interactive angel networks. By organizing these types of groups, you

will be able to make the knowledge and capital of angel investors more easily accessible to local entrepreneurs.

We learned from Robert Heard of Cimarron Capital Partners LLC, a course faculty member, that these angel networks can be assembled in a variety of ways, from member-led, to manager-led, to professionally facilitated. No matter the type of networks you seek to create, being able to engage and recruit angel investors to participate will strengthen the entrepreneurial support system and develop a thriving culture of innovation finance in your region.

Put Your Plan into Action

Innovation finance programs are an emerging trend in the development finance industry. With the awareness of these four benchmarks, building an innovation finance initiative in your community can be an achievable endeavor. Take the next steps in your community to be ahead of this important trend and start building your private sector driven—but public sector supported—innovation finance initiatives. ■

Explore the DFCP Program.

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