State Venture Capital Programs
Perspectives, Practices & Principles to Inform State Leaders

As "laboratories of innovation" for economic development policies and programs, states are increasingly focused on improving their business environments for innovation and high-growth entrepreneurship. A comprehensive innovation agenda for states is a competitive advantage – an agenda that organizes public and private resources to build research, entrepreneurial and private investment capacity. While the "supply" of innovation and entrepreneurial talent is viewed as adequate in many states, the supply and accessibility of risk capital is often identified as a critical economic development need. Capital formation is a complicated policy arena, but there are customizable strategies to consider for changing investment perceptions and capital flows.

Perspectives and Practices:

- **Philosophical – Why should government have a role in stimulating private investment?**
  - Innovation drives economic growth/diversification, and equity investment drives innovation. Without access to risk capital, a state's entrepreneurial ecosystem is likely to underperform on economic development expectations relative to potential.
  - Venture capital – managed and invested – is concentrated in two geographic regions, which results in talent flowing to capital rather than capital flowing to talent.
  - Comprehensive returns from economic development programs (indirect economic benefits plus the return of state investment) are possible for innovative state leaders.
- **Strategic – What are states doing to increase the supply and accessibility of risk capital?**
  - State venture capital programs are often described inaccurately as "public venture funds." Investment funds managed by state bureaucrats are rare, with most programs managed by private investors or private nonprofit corporations with credible teams.
  - Fund-of-Funds, Co-Investment Funds, and Seed/Commercialization Funds are strategic options for states to consider and not examples of states "picking winners and losers."
- **Financial – How are states financing small business finance programs at appropriate scale?**
  - To build sustainable private investment capacity and innovation networks, it is necessary to capitalize state capital programs at an appropriate scale = > $50 million.
  - Innovative financing solutions exist to fund programs at an acceptable cost of capital and defer fiscal impact over multiple years (e.g. $100 million Innovate in PA).

Principles: Any state venture capital program should align with a "best principles" framework:

1. <u>Efficiently finance state capital programs</u> for small business investments and consider aligning state fiscal impact with comprehensive economic development impact;
2. <u>Invest in/with legitimate venture investors selected via a competitive selection process</u>;
3. <u>Restrict investments to address identified small business financing gaps</u> not adequately served by the private sector (equity and debt capital sources); and
4. <u>Require a market-standard return of capital invested</u> (100% of principal and a meaningful % of profits) when utilizing for-profit managers so that state interests are aligned with private investors and capital is returned for ongoing support of a state's innovation economy.

C|S
Cromwell Schmisseur LLC
www.cromwellschmisseur.com