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Overview of Venture Capital in North Carolina

Venture capital (VC) is an important tool for spurring innovation among companies that in turn generate economic growth, create jobs, and drive our economy. VC firms help to provide entrepreneurs the capital they need to develop concepts, start companies, grow companies, manufacture products, and, eventually become publicly traded. While obtaining VC funding can be a catalyst for an emerging firm, the market for VC funds is highly competitive, with less than one percent of firms receiving VC funding.[1] In addition, VC firms are focused on fueling specific types of companies that are expected to yield a very high rate of return. In this sense, VC firms are not competitors of other lenders that provide capital to very small, brick-and-mortar businesses. Each type of lender/investor undertakes different strategies, targets different types of businesses, and provides different kinds of funding. This brief provides an overview of the VC industry in North Carolina.

The Venture Capital Approach

The aim of VC investing is to purchase equity in a growing firm and sell it for a high profit within set amount of time. VC firms typically seek a 30 to 40 percent (or higher) annual rate of return. At the time of investment, an exit strategy is developed that details when a company will go public (typically between three to five years) and when the VC firm will liquidate its investment. VC funding is typically not geared toward companies that are planning to remain private.[2]

VC firms generally narrow their scope of investment by the stage of investment, geography, investments size, or industry. By and large, VC investments are targeted toward high-growth industries, such as information technology, medical devices, biotechnology, and life sciences. There are also several stages at which VC firms target their investments:

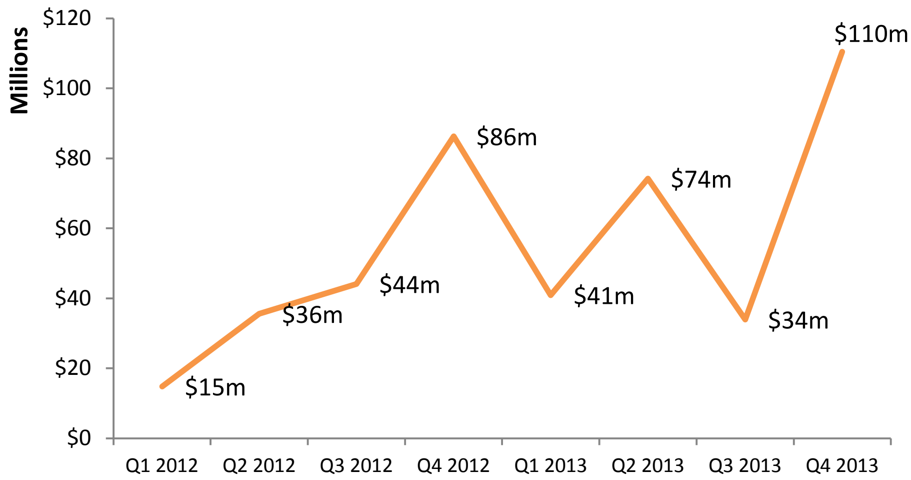
- *Pre-Seed Financing:* for entrepreneurs developing an innovation and businesses that are just forming.
- *Seed or Early-Stage Financing*: for companies that are already formed, but lack significant revenue and are not yet profitable. This can include start-up funding, which is the most difficult to obtain.
- *Later-Stage Financing*: for firms that are already growing. This includes third-stage, or mezzanine financing, which is for major companies that are seeing increasing sales and are about to break even or become profitable. Fourth-stage is for bridge financing for companies about to go public within six months, and is paid with IPO proceeds.[3]

Venture Capital in North Carolina

In North Carolina, there are roughly 100 active VC firms. In the fourth quarter of 2013, VC firms made 18 investments in companies in our state, totaling $110.5 million. This is a significant increase from the previous quarter, and also from the start of 2012.

[1] NC Rural Entrepreneurship Development System. "Fueling Your Business in North Carolina: A Guide to Financing for Small Businesses." http://marketing.thrivenc.com/acton/attachment/4901/f-0040/1/-/-/-/-/file.pdf
[2] Small Business & Technology Development Center. "Capital Opportunities for Small Businesses. A Guide to Financial Resources for Small Businesses in North Carolina." www.sbtdc.org/pdf/capopps.pdf
[3] Cromwell Schmisseur LLC. "Information and Observations on State Venture Capital Programs." Prepared for the U.S. Department of Treasury. http://www.treasury.gov/resource-center/sb-programs/Documents/VC%20Report.pdf

North Carolina Venture Capital Investments, 2012-2013



Source: National Venture Capital Association, Regional Data

The VC firms that are active in NC provide a wide range of investment, though generally they begin at $1 million, with the majority up to $20 million. Very few make investments under $200,000. The chart below shows the diversity in how much VC firms are seeking to invest. In addition, although many firms are willing to invest at all stages of business development, most are looking to invest in the seed and early stages. Roughly half of firms have an interest in financing at this stage, followed by those that do not have a specific focus, and then those that are looking to finance expansion.[4]

Preferred Investment Size	% of firms with data
Under $200,0000	4%
Starting below $1M - $20M	39%
$1M - $20M	37%
$5M - $50M	7%
$10M - $50M	5%
Over $25M	8%

Preferred Industry Focus	% of firms with data
Technology	69%
Healthcare & Life Sciences	51%
Business Services	4%
Financial Services	3%
Other	4%
No focus indicated	5%

Preferred Financing Stage	% of firms with data
All	20%
Seed & Early	51%
Early to Expansion	5%
Early to Mid	4%
Early to Late	4%
Mid to Late	3%
Expansion/Growth	11%
Other	1%

[4] Data for the investment amounts, financing stage, and industry focus were obtained from the SBTDC "Capital Opportunities" Report, the Charlotte-Mecklenburg Chamber of Commerce (http://charlottechamber.com/clientuploads/Economic_pdfs/Venture_Capital.pdf), and the North Carolina Biotechnology Center (http://www.ncbiotech.org/business-commercialization/business-loans-support/venture-capital). These aggregations are estimates based on available information. Percentages do not necessarily total 100% because of overlap.

In regard to industry focus, the majority of VC firms invest in technology firms. This includes communications, information technology, networking, hardware, software, and other high-tech businesses. Healthcare and life science is also a major focus, which encompasses biotechnology, medical devices, pharmaceutical companies, and other healthcare related sectors. A few of the VC firms focus on other industries such as financial and business services, real estate, consumer products, and industrial companies.

Venture Capital and Small Business Lending

VC is important for providing financing to companies that are game-changers in their industries. These firms generate innovative ideas and products, and with VC funding, they can be catapulted into high-growth, high-demand companies. This kind of economic activity is vital for a strong economy. Eventually these firms are able to hire many workers and have a ripple effect on other businesses in their communities, across the state, and across the nation. Their suppliers, contactors, service providers, and other ancillary businesses all benefit, as do workers, households and communities.

However, VC funding is first and foremost very competitive. As mentioned above, only a sliver of companies are able to obtain an investment. Secondly, given the nature of VC funding, it is not the appropriate type of financing for all businesses. Small businesses like restaurants, day cares, retail shops, and other “Main Street” businesses do not fall within the VC funding model. As such, a diversity of financing options is necessary to meet the needs of all types of businesses—big and small, in a range of industries, and that require large and small investments.