Community and Economic Development in North Carolina and Beyond Blog: Venture Capital for Community Economic Development

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When we think of venture capital, we imagine business people making investments in the most innovative companies and technologies: pharmaceuticals, medical devices, computer software, and nanotech applications, to name only a few. Indeed, this month's venture capital conference in Pinehurst, North Carolina, is boldly titled, "Where Great Minds Meet Smart Money." But it might take a particularly innovative investor with an especially great mind to make venture capital investments in distressed communities in pursuit of economic growth *and* social benefits. It's a safe bet that some of those great minds are found in community development venture capital firms. Let's take a look at a few of the models for this kind of investing.

The original rural community development venture capital firms were formed in the 1970s and invested in rural businesses with two primary goals: producing economic growth in rural areas and creating employment opportunities for low-income rural residents. North Carolina's Rural Venture Fund follows in this mold and concentrates its investments in distressed Tier 1 counties.

A few venture capital funds have gone beyond these traditional aims and seek to use their investor role as a means for building assets for low-income employees in portfolio companies. Kentucky Highlands Investment Corporation (KHIC) was the first venture capital firm to focus entirely on financing businesses in struggling rural counties. In determining where it invests its equity, KHIC strongly prefers companies that provide living wages and a minimum benefits package (life, health, and disability insurance) to low-income employees. Additionally, KHIC requires all companies in its portfolio to establish an equity compensation plan—e.g., a stock option plan—for low-income employees.

Pacific Community Ventures (PCV) provides venture capital support for established and growing businesses located in low- and moderate-income communities. PCV makes its investments based not only on a company's growth potential, but also on how high a portion of the workforce was hired from low- and moderate-income communities. As part of its management efforts, PCV instructs its portfolio companies on establishing programs to help low-income employees build and retain wealth. Programs include employee financial education, retirement plans for low- and moderate-income employees, and equity sharing for lower-income employees. According to PCV, its portfolio companies experience higher growth rates, provide higher median wages, and are more likely to provide health benefits to hourly wage employees than similar companies across the country.

Finally, New Markets Tax Credit (NMTC) investor funds deserve mention even though they are not true venture capital funds. NMTC funds, such as the Self Help Venture Fund, make investments in businesses located in low-income census tracts in order to qualify for federal tax credits. Investors earn a large portion of their return on investment from the value of the tax credit.

The question is whether investor capital will continue to flow to these funds. Community development venture capital funds are typically capitalized by foundations, the federal government, and commercial banks. These sources of community development capital have declined in recent years, so it remains to be seen how future funds will be capitalized. If low-profit limited liability company (L3C) legislation is enacted by the General Assembly [UPDATE: S.L. 2010-187 was approved in August 2010], perhaps L3C entities will unlock additional funding in the form of program-related investments from charitable foundations (see a related post here).

Have any of these funds made a difference in your community?