U.S. Small Business Administration

NEW MARKETS VENTURE CAPITAL (NMVC) – Q & A

1. What is the New Markets Venture Capital Program?

The New Markets Venture Capital (NMVC) program is modeled after the Small Business Administration's extremely successful Small Business Investment Company (SBIC) program but is specifically targeted on economic development. Through a combination of equity-type financing and intensive operational assistance to smaller businesses located in Low- and Moderate-Income (LMI) geographical areas, the program seeks to build a local entrepreneurial environment and create quality employment opportunities for residents.

2. Why is a New Markets Venture Capital Program needed?

While there are a number of sources of debt financing for smaller businesses located in rural and inner city areas, including SBA loans, such businesses do not have access to the *equity-type capital* that they must have if they are to grow and become successful. Most existing venture capital institutions, including SBICs, invest only in areas that they are comfortable with, where sophisticated management teams are in place, and where they see the potential for significant profits. This seldom includes LMI areas for many different reasons, ranging from the very real costs of doing business outside of concentrated areas of economic growth to varied misperceptions of the marketplace. New investment vehicles are required, hence the proposed New Markets Venture Capital companies.

3. Why can't a Small Business Investment Company (SBIC) make these types of investments?

SBICs can and do make investments in rural and inner city areas. However, today's typical SBIC investment ranges from $300,000 to $5 million, and SBA estimates the need for equity investments in the $50,000 to $300,000 range is being only partially satisfied. SBICs are inherently profit-driven, and LMI areas generally hold few investment opportunities that are not costly or too limited in exit opportunities for an SBIC to consider.

NMVC firms would offer two key components that would differ from the SBIC program and allow such investing: (1) a mission focused on economic development and (2) grant funds to conduct intensive, hands-on technical assistance.

4. Why can't existing SBA technical assistance programs, such as the Small Business Development Centers (SBDCs), provide the necessary technical assistance component of the NMVC proposal?

SBA provides many technical assistance services to small businesses through programs such as SBDCs, Women's Business Centers, Service Corps of Retired Executives (SCORE) and Business Information Centers. However, much of the technical assistance provided is focused on business development – the nuts and bolts of how to start a small business, including obtaining financing. This 'front-end' training is vital to the success of small, start up businesses. NMVCs, however, would help provide an ongoing relationship and assist in the day-to-day operations of a small business, such as filling incomplete management teams.

Ultimately, it is the investor and the entrepreneur who have the highest stake in ensuring the success of a small business. Since an NMVC company's money is at risk before the SBA guaranteed portion, it is in the best interest of the government, the investors, and the small business concern for the NMVC to provide or facilitate the needed 'hands-on' operational assistance – such as in marketing, sales, and legal areas. NMVCs, whose money is at risk, will need to have more control over the degree, intensity and content of the assistance given to their small business investments.

5. What's the difference between the purposes of the NMVC program and that of the Specialized Small Business Investment Company (SSBIC) program?

NMVCs target entire communities for business investments while SSBICs seek business investments with targeted groups of individuals. NMVCs will focus on the location of the business rather than on ownership of the business and will also provide significant technical assistance, which is not a component of the SSBIC program.

Although an NMVC will have a different purpose than an SSBIC, it does not mean that one is not needed or more important than the other. SBA envisions the NMVC program co-existing with the SBIC and SSBIC program in a complementary fashion.

6. What is a New Markets Venture Capital company?

A New Markets Venture Capital (NMVC) company will be a privately managed investment company, formed for the purpose of providing equity-type capital and hands-on operational assistance to smaller businesses located in specific rural and urban areas. An NMVC company will be mission driven and will be accepted by SBA as a participant in the NMVC program through a contractual agreement.

NMVCs must:

- Be a newly formed for-profit entity. It may be organized as a partnership, a limited liability company, or a corporation. It may be a newly formed subsidiary of an existing entity.
- Have a management team with demonstrated experience in community development financing or venture capital.
- Have at least $5 million of "contributed capital" (including binding commitments acceptable to SBA) from any source other than an agency of the Federal government.
- Have binding commitments (in cash or in-kind) from any source other than SBA to fund technical assistance over a multi-year period (5 to 10 years) in an amount equal to at least 30 percent of its contributed capital. An annuity may be purchased in lieu of providing commitments.

7. What are the benefits of forming an NMVC company?

1. *SBA Financial Assistance.* SBA will provide financial assistance by guaranteeing debentures issued by the NMVC company. The cash generated from those debentures will approximately equal the company's own capital. The debentures will have a term of up to 10 years and be issued at a discount to eliminate the requirement for any payments of principal or interest during the initial 5 years. SBA will arrange "just-in-time" funding for the debentures under the procedures utilized in the SBIC program. The debentures are expected to be priced at a current market rate for comparable U.S. Government Treasury securities plus a premium of approximately 100 basis points.

    Example: An NMVC company with $10 million of contributed capital would be eligible to issue debentures with a face amount of $15 million. If a 7 percent interest rate prevailed when the debentures were issued, the company would receive net proceeds of $10.63 million for the $15 million of debentures. No payments would be required for the first five years. Commencing with the sixth year, the NMVC company would pay interest on the $15 million at a 7 percent rate semi-annually, and the entire $15 million of principal would be due at maturity.

2. *SBA Technical Assistance Grants.* The SBA will also match the funding that the NMVC company has raised for technical assistance (whether in cash or in-kind) with an equivalent grant payable over 5 to 10 years. The grant funds will be available to the NMVC company for providing marketing, management and technical assistance to the enterprises in which it invests.

8. How can one participate in the NMVC program?

SBA will solicit applications from potential NMVC companies that believe they have the required management experience and can raise the necessary capital and technical assistance funding. The application will require, among other things:

- A business plan that describes how the applicant will make successful venture capital investments in LMI areas within the specific geographic areas that it identifies.
- A statement of the qualifications and general business reputation of the applicant's management.
- A description of how the applicant will interface with existing community organizations.
- A description of how SBA's technical assistance grant funds will provide marketing, management and technical assistance to smaller firms expecting to be financed by the applicant.
- Measurement criteria by which to evaluate the applicant's performance in meeting NMVC program objectives.
- A discussion of the management and financial strength of any parent or affiliated firms or any firms essential to the success of the applicant's business plan.
- Identification of the expected sources of contributed capital and technical assistance funding, and a discussion of the probability of the applicant raising the required amounts.

9. How will SBA select firms for the NMVC program?

Conditional approval. SBA will evaluate the submitted applications, which may include interviewing an applicant's management and obtaining the advice of industry experts. It will then select companies to be conditionally approved to operate under the program. The selection will be based upon the merits of the application and the relationship of the proposed geographic area relative the objective of achieving geographical diversity for the program. Selection criteria will include at least the following:

- The likelihood that the applicant will meet the goals of its business plan.
- The experience and background of the applicant's management team.
- The need for equity investments within the target investment areas.
- The extent to which the applicant will concentrate its activities on serving its investment areas.
- The likelihood that the applicant will be able to raise the necessary capital and technical assistance funding.
- The extent to which the proposed activities will expand economic opportunities within the investment areas.

Final approval to operate as an NMVC company. If you are conditionally approved, you will have up to 24 months to:

1. Raise the required $5 million minimum capital from one or more investors other than an agency of the Federal government. (The NMVC legislation specifically authorizes national banks, member banks of the Federal Reserve System, insured nonmember banks, and Federal savings associations to invest in NMVC companies.)
2. Obtain binding commitments for the corresponding 30 percent technical assistance funding ($1.5 million minimum) from any source other than the SBA. (Note that the NMVC company is permitted to form an affiliated non-profit entity to provide technical assistance funding.)
3. Enter into a "participation agreement" with the SBA. The participation agreement will establish the terms of the applicant's operations under the NMVC program, and will require, among other things, that the applicant invest in smaller enterprises, at least 80 percent of which are located in LMI geographies. The agreement will also formalize the applicant's detailed operating plan and investment criteria.

10. What limitations are imposed on an NMVC's investment activities?

1. *Size Restriction—smaller companies.* An NMVC company is restricted to investing only in smaller enterprises as defined by the statute. These are companies that, together with affiliates, have a financial net worth not exceeding $6 million and average annual after-tax earnings for the previous 2 years not exceeding $2 million. Alternatively, the enterprise must meet the standard industrial classification size standard established by the SBA for its industry.

2. *Geographical Restriction—LMI geographies.* At least 80 percent of the investments that an NMVC company makes must be in LMI geographies as defined in the legislation. These include:
   - census tracts with a poverty rate of at least 20 percent or
     - if the tract is located within a metropolitan area, the median family income does not exceed the greater of 80 percent of the statewide median family income or 80 percent of the metropolitan area median family income, or
     - if the tract is not located within a metropolitan area, the median family income does not exceed 80 percent of the statewide median family income (see http://www.ffiec.gov/geocode/);
   - a HUBZone (see http://www.sba.gov/hubzone/hubqual.html);
   - an Urban Empowerment Zone or Urban Enterprise Community (see http://www.hud.gov/ezec/locator); or
   - a Rural Empowerment Zone or Rural Enterprise Community (see http://www.hud.gov/ezec/locator).

One can determine whether a specific address is located in an LMI geography by entering the address in the internet web site noted above for any of the categories.

3. *Other Restrictions.* Such additional limitations as may be established by regulations or as agreed upon between the NMVC company and the SBA.