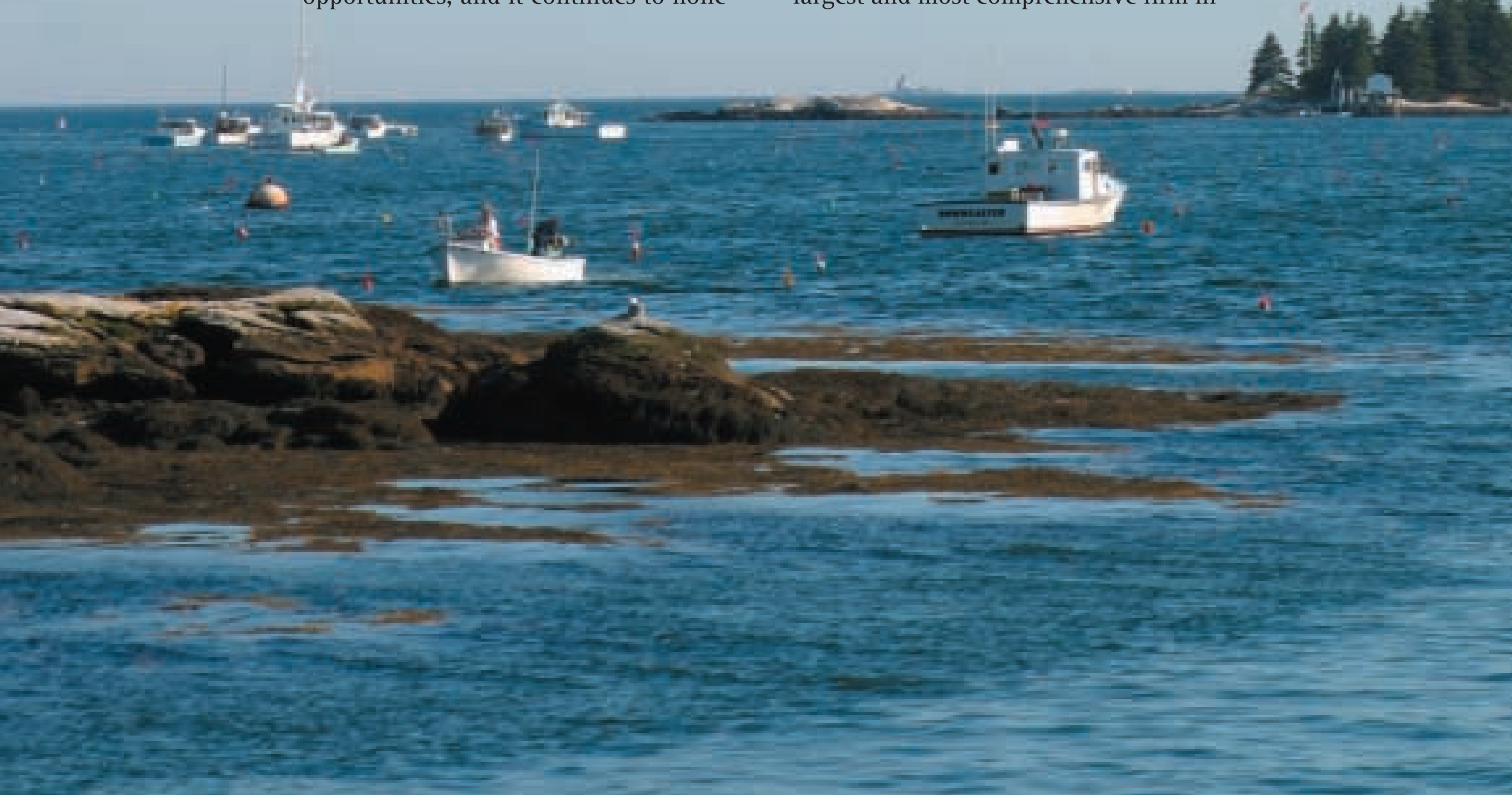
Netting Venture Capital *from a* Fishing Village

by Keith Bisson

Commercial fishing wharves and equity investing might seem an unlikely duo, but in Boothbay Harbor, Maine, they paired together nicely. When a processing and freezer facility, known as Boothbay Region Fish and Cold Storage burned down in the mid-1970s, the community and local fishermen owners scrambled to rebuild it. A little-known community development corporation, Coastal Enterprises, Inc. (CEI), did some scrambling of its own to help rebuild the facility. CEI provided financing in the form of subordinated debt and preferred stock, and leveraged its investment with financing from a local bank. Today, in a town dominated by waterfront hotels and restaurants, the facility remains one of Boothbay's few working wharves and continues to benefit the region. This was CEI's flagship project and its first equity investment. Before the term "community development venture capital" was even coined, CEI had added equity investment to its community development arsenal.

CEI and Community Development Venture Capital

From its early days in the fishery and natural resource industries, CEI had succeeded in identifying new market opportunities, and it continues to hone this skill. Another early example of equity experience came in 1984, when CEI invested $50,000 in a small tent-making company in Belfast, Maine. CEI's investment helped this small but established company diversify by financing a new product line that reduced dependence on summer-related business. Moss Tent Works, a world-renowned maker of backpacking tents, used CEI's investment to focus on manufacturing strong, lightweight frame-and-fabric structures for the trade-show industry. As a result, Moss is credited as the inventor of "tension fabric exhibitry" and its clients have grown to include museums, shopping malls, and public spaces. Since its May 2002 acquisition of Chicago-based Exhibit Architecture, Inc., Moss Inc. has become the world's largest and most comprehensive firm in



its market. Moss is not only a story of business success, but also of social responsibility. In 2000, the company received the Eagle Feather Award from Maine Businesses for Social Responsibility, the organization's highest honor.

With these initial and tentative steps, CEI staff gained some experience in equity investing – but CEI was not really known in the venture capital market. In 1988, CEI founder and President Ron Phillips hired Nat Henshaw as a loan and investment officer at CEI. Nat's background was in traditional venture capital and he was hired to help develop CEI's equity portfolio. By 1993, when Phillips and Henshaw created CEI Ventures, Inc., CEI had made 16 equity investments. This track record, the financial community's confidence in the fund managers, and Maine's widespread equity needs gave credibility to CEI's proposal to form a venture capital subsidiary. The formation of CEI Ventures Inc. brought focus and scale to CEI's equity investing.

CEI Ventures Inc. would use venture capital investing to foster economic development, environmental soundness, and resource equity among people. It would shrink the gap in the availability of equity capital for small- to medium-sized enterprises in northern New England. In return, CEI was looking to achieve a "double" or even "triple" bottom line. This meant that CEI wanted its venture capital to provide a financial return, a social return, and a product or service compatible with the environment.

Now nearly 10 years old, CEI Ventures, Inc. is a wholly owned for-profit subsidiary of CEI that manages two socially responsible venture capital

At Moss Inc., Joanne Desjardins does manual patterning. . .

. . . while Rory Kimberlin rides high to help assemble an exibit for Harley Davidson.

About CEI

CEI was organized in 1977 as a community development corporation (CDC), and certified in 1996 as a community development financial institution (CDFI) by the U.S. Treasury. Early on, CEI focused on natural resources development. It has since expanded to achieve a scale of operations and impact in pursuit of its mission: to help people and communities, particularly those with low incomes, reach an adequate and equitable standard of living, working and learning in harmony with the natural environment. Since inception, and in partnership with banks and other financial institutions, CEI has directed $400 million to over 1,200 projects that have created or sustained some 15,000 jobs. CEI has developed 526 units of housing and 120 child-care projects supporting over 2,500 children; it has also provided business counseling to 10,000 new and emerging enterprises (many of which are small operations).

A former motor garage in Wiscasset, Maine, is the base of operations for CEI.

funds: Coastal Ventures LP and Coastal Ventures II LLC. The first fund is fully invested at $5.5 million and has performed ahead of initial financial and social projections, investing in 20 companies that employ over 1,700 people. The second fund is well on its way to raising $20 million and has already invested nearly $2 million in five Maine companies and one New Hampshire company. This newer fund will make investments of between $100,000 and $1.5 million in approximately 20 companies over the next five years.

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CEI and Socially Responsible Investing

Phillips has always viewed CEI's work as socially responsible investing, a phrase that has many definitions and encompasses diverse activities. For CEI, it means sticking to its core purpose of creating economic opportunities for people and communities. Phillips believes that, "By putting our money to work in the right places we can help people and communities find hope and fulfillment. We try to be a place where social values and basic economics can converge." The socially responsible investing practiced by organizations like CEI recognizes that companies have stakeholders other than shareholders. It acknowledges that companies must meet investors' needs for financial returns, but that they also must tend to the needs of vendors, customers, employees, and the community at large.

Traditional venture capital funds seek high returns and quick turnarounds with their investments. Community development venture capital funds aspire to more normal market rates of return and are focused on being a source of patient capital. On top of these formidable goals, community development venture capital funds aim to both act in a socially responsible manner and meet financial targets.

But how does one identify and achieve a social return on investment? CEI Ventures is guided by the principles of the "3Es — Economy, Environment, and Equity." It seeks investments that build a strong and sustainable economy, use environmental resources wisely, and create equity for community residents. More specifically, CEI Ventures looks for businesses that create quality income, employment, and ownership opportunities for people with low incomes while following socially responsible business and employment practices. In order to verify its impact, CEI Ventures has developed a social index that tracks 45 indicators ranging from the financial side of the equation to social measures including job creation, low-income impact, and employee benefit information.

A good example of a typical investment combining the 3Es can be found in Washington County, Maine's poorest. The launching of Coast of Maine Organic Products, Inc. is a story that blends modern chemistry with strong social and environmental benefits. The company is focused on converting the seafood industry's costly waste disposal problem into a revenue-generating operation and is committed to developing the best compost on the market. Its products are sold in top-line garden supply stores all over the Northeast. The social benefits of this investment are threefold: Coast of Maine reduces a major disposal problem for marine industries, helps gardeners replace chemical fertilizers with natural ones, and creates jobs in a distressed region of the state.

In practice, says CEI Ventures President and co-founder Nat Henshaw, "community development venture capital and socially responsible venture capital are about balancing the needs of communities with the need to generate a profit. In best practice, these goals support and enhance each other. An economically disadvantaged person is a valued and profitable asset to a growth company. Conversely, polluting the countryside can be very

Its all about "balancing the needs of communities with the need to generate a profit," says CEI Ventures President Nat Henshaw.

detrimental to shareholder value and to public health. Traditional venture capital is all about internal rate of return (IRR) and community development venture capital is about external rate of return (ERR). To quote Edward Tasch of the Investors' Circle,[1] 'to IRR is human, to ERR divine.'"

Tagging onto Investments

Because job creation and economic opportunity are central to CEI, its venture capital investments come with some additional socially directed agreements. These agreements commit companies to hire and train individuals with low incomes. The Employment and Training Agreement (ETAG) commits the portfolio company to work with employment and training providers and social service agencies to foster employment opportunities for low-income and other disadvantaged workers. Similarly, the ETAG requires the affiliated training and social service organizations to provide prospective employees with training and related support services so that they can be successful in their jobs. CEI maintains an employment and training staff to manage this process and reduce its impact on the business. The program adds substantial value to portfolio companies by supplementing their human resources operations.

Taction, for instance, is a company that has used CEI's investments and services to create quality jobs. A Maine-based customer contact center, Taction is located in the rural town of Waldoboro, one of the poorest towns in Maine's midcoast region. Since 1995, when CEI first financed Taction to help restore its century-old building in Waldoboro, and later in 1999 when Coastal Ventures made an equity investment in the company, Taction's workforce has grown from 50 employees to over 100, and the average wage for its customer service representatives has risen from $6.75 to $9.95 per hour. Most recently, it implemented "Taction University," an in-house initiative aimed at the personal and professional development of its workforce. The company is also exceeding its current financial goals, with the first quarter of 2002 its most successful ever.

Lessons from Maine

Venture capital investment is a limited but powerful tool. It requires a thorough understanding not only of community development finance but also of equity and sub-debt financing. It also requires an understanding of the overall financing continuum in a particular marketplace. Community development venture capital, more than traditional venture capital, is truly place-based. Replication of any particular approach can be difficult, but a common denominator among successful community development venture capital funds is an understanding of the communities in which they are working.

In addition, the venture capitalist's provision of business technical assistance can help achieve social and financial goals. For this reason, CEI is expanding its business technical assistance and community development venture capital expertise through the New Markets Venture Capital program, sponsored by the Small Business Administration. In July 2001, CEI was chosen as one of seven organizations nationwide to organize a New Markets Venture Capital fund; CEI's will be the Community Ventures Fund. This newest fund, which is poised to manage $10 million, will also administer a $3 million pool of funds to provide technical assistance. The New Markets program was created by Congress, which recognized that despite the nation's overall economic prosperity in the late 1990s, many parts of the country, especially rural and inner-city areas, have neither shared in this prosperity nor have had access to jobs or entrepreneurial opportunities. This became even more obvious as the economy cooled.

Business savvy, commitment to socially responsible investing, and the ability to raise money are crucial to making community development venture capital work.

Coast of Maine Organic Products, Inc. fit right into Coastal Enterprises' quest for companies whose practices further the 3Es: economy, environment, and equity.

A successful community development venture capital fund should also engage the banking community early on. A crucial ingredient in all of CEI's activities, especially in venture capital investing, is partnerships with the banking community. Banks have a local understanding of their markets and can complement the knowledge of a community-based organization. CEI always viewed access to capital as critical to building Maine's local economy, but initially it did not have the financial expertise or resources to address those needs. Fortunately, CEI recognized the importance of bank partnerships and reached out to the financial community. Banks remain close and valued partners with CEI as investors and volunteer board members.

Moreover, business savvy, commitment to socially responsible investing, and the ability to raise money are crucial to making community development venture capital work. As Nat Henshaw said,

> *Venture capital experience is very important. It's easy to lose money in this business. We're fortunate to have some retired venture capitalists involved, and bankers – we have lots of people with individual experience. It's hard to hire an experienced venture capitalist, but we can look to retired people with experience, and others without experience but a strong desire to learn.*
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> *Second, the social aspect is critical. While I personally think that pure venture capital can be very socially beneficial, as a community development venture capital fund, we're not just doing venture capital. When we created CEI Ventures, our premise was that we would be working with good, socially responsible managers who would, therefore, have lower employee turnover and better company performance.*
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> *Third, a community development venture capital organization has to be able to raise money, which means the organization and the people involved need a track record of some kind. CEI Ventures was fortunate to be able to build on a track record of 16 equity investments by Coastal Enterprises, Inc. prior to the launch of the venture fund.*

Getting Involved

Banks have many options for getting involved in community development venture capital. In the case of CEI Ventures, banks are key investors, and bankers serve as board members and resources for the fund managers. Investing in a socially responsible venture capital fund is high risk, but has the potential for above-average financial returns. In addition, by supporting equity investing in their communities, banks can create customers. Banks can also receive credit in support of their Community Reinvestment Act goals.

A new opportunity for bank involvement in equity finance is now on the horizon. The New Markets Tax Credit Program is an economic development program enacted by Congress in December 2000 that aims to spur the investment of $15 billion of private capital in a variety of businesses, commercial real estate, community facilities, and other projects located in qualified, low-income, rural and urban census tracts. The program is managed by the CDFI Fund of the U.S. Treasury and consists of a 39 percent credit spread over seven years against federal income taxes. CEI and other eligible community development organizations, as well as other financial institutions, will seek allocations of tax credits for private investors, including banks, insurance companies, developers, and individuals. CEI is planning to create a fourth regionally oriented venture capital equity fund specifically for tax credit investors.

Starting with the unlikely pairing of fishing wharves and equity investing, CEI has shown that creative financing can do more than land a good catch. Based on sound philosophy and practical experience, CEI cultivated its community development venture capital approach. CEI's good ideas have changed the venture capital landscape in Maine and brought new opportunities to its communities.

Forget gray ceiling tiles. Jennifer Whitehill works in Taction's restored 1899 building and particpates in Taction University.

Endnote

1. The Investors' Circle is a national nonprofit network of angel and institutional investors, foundation officers, and entrepreneurs who seek to balance financial, social, and environmental returns.

About the Author

A native of Brunswick, Maine, Keith Bisson is earning his master's degree at the Yale School of Forestry and Environmental Studies. He just recently left his position as research assistant at Coastal Enterprises, Inc. where he provided the organization with market research, including economic, geographic, and impact data analysis. Bisson was also responsible for assisting CEI with proposal development, research, and writing.