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Economic Commentary

A monthly look at Florida's Economy

Angel and Venture Capital in Florida

Taking a great idea or invention and turning it into a viable business typically takes a significant amount of funding. What do Florida inventors and entrepreneurs do when faced with this reality?

The last two monthly issues of *Economic Commentary* have discussed the university technology transfer system in Florida and the incubator system available to start-up and growing companies. The university tech transfer system takes inventions created by faculty and other university employees, and either licenses them to outside companies or helps the inventors create start-up companies. Approximately two out of three license deals entered into by a Florida university tech transfer office create jobs in Florida. About half of the jobs created stay in the vicinity of the university, with the other half locating in some other area of Florida.

The incubator system helps young companies take their ideas and inventions and develop them into profitable companies. This is done by not only assisting fledgling companies with facilities and personnel support, but also by matching companies in the incubator with entrepreneurs that mentor them. Around 90 percent of companies that go through a Florida incubator stay in Florida once they "graduate" from their incubator.

What young companies have in common is the need for funding to develop their product or process to move the business toward being able to sustain itself. During this process of becoming viable, there are multiple expenses and little revenue. There must be enough funding to sustain the business through all the stages between start-up and commercial success, or the business will not survive. This gap between start-up and sustainability is treacherous for young companies, and is often referred to by entrepreneurs and capital providers as the "valley of death."

Photo source: creativedoxfoto

Companies can expect several stages of funding needs, often supplied from different types of investors. Start-ups typically start out with seed funding from the founders, friends, and family (commonly noted as 'FFF'). In the case of a company based upon a specific product, working prototypes must be produced. These early prototypes are used to show potential investors that the product does work, so that investors will be comfortable investing their capital in the business.

Prototype production can be extremely expensive, often requiring more capital than the FFF can provide. Often "angel investors" that will fund the early stages of promising products or ideas are sought to provide the funding for the prototypes. Angel investors are typically successful entrepreneurs who want to both help young entrepreneurs and to invest in new products with the hopes of receiving significant returns. In these early stages, angel investors are aware that many of the young companies that they invest in will never become commercial successes. However, they hope that the few that do provide significant returns on their investment to offset losses in other start-ups. To manage their risk, angel investors often form angel networks so they can manage their risks as a group. These angel investors are typically located close to their investments and have regular involvement with the business.

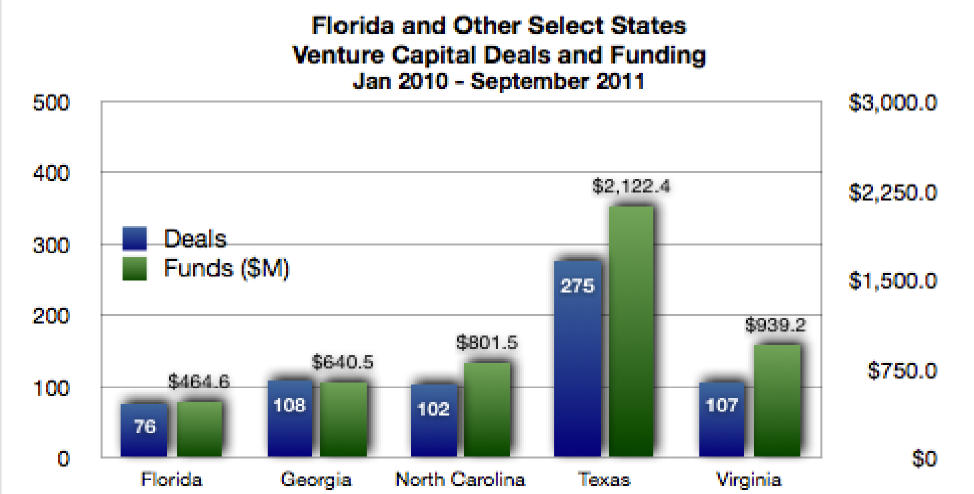
If companies do well through this initial phase, they typically need more funding for their growth. This is the stage where regional or national venture capital firms invest and take equity positions in the company. Some venture capital firms specialize in different stages of company growth—some concentrate on early stages and others concentrate on the later stages of developing companies. Venture capital firms look for firms that have the potential to be scalable to national and international levels. They bring knowledge of growing companies along with industry contacts that can help develop companies to their full potential. Payout occurs when the company is sold, either by initial public offering (IPO) or sale to another private entity.

Venture Capital In Florida

According to Enterprise Florida, there have been more than 750 venture capital deals in Florida since 2000, representing nearly $6.3 billion in venture capital spending. However, on a national scale, Florida has only a small amount of venture capital activity. California dominates the venture capital landscape with approximately 40 percent of all venture capital deals, and almost 50 percent of the total funding. The next most active state is Massachusetts with around 10 percent of the deals and funding.

Although Florida's economy is approximately five percent of the U.S. economy, venture capital statistics from PricewaterhouseCoopers/National Venture Capital Association MoneyTree Report, using Thomson Reuters data show that Florida received 1.22 percent of the deals and only 1.04 percent of the venture capital funds allocated in 2010 and the first three quarters of 2011. From January 2010 through September 2011, Florida has received 76 venture capital deals valued at $464.6 million.

How does Florida compare to other states that we typically benchmark? The chart to the right shows the number of venture capital deals and the amount of venture capital funding received by comparable states. It's easy to see that Florida trails other states in both the amount of deals and the total venture capital funding amount over the most recent 21 months for which data is available.



Data: PricewaterhouseCoopers/National Venture Capital Association MoneyTree Report, Thomson Reuters

What is Florida doing to attract more venture capital?

Trying to attract more venture capital to Florida has been a challenge for the state. Venture capital industry insiders indicate that the current lack of exit opportunities negatively affects the ability to raise new venture capital. This is a direct result of the volatility of world financial markets and its negative effect on potential initial public offerings. Millions of venture capital dollars are tied up in companies that would normally have gone public, which would have allowed venture capital investors to cash out of those companies and reinvest in new ventures.

Realizing that a gap exists in funding for growing companies that are important to job creation in the state, Florida has created two vehicles to improve the funding for start-ups in the state: The Florida Growth Fund and the Florida Opportunity Fund.

The Florida Growth Fund is part of the Florida Retirement System Pension Plan Trust Fund. This fund contains approximately $500 million and is managed by Hamilton Lane, a private equity asset management firm. The Florida Growth Fund uses both private equity fund investments and co-investments with other institutional investors. It concentrates on technology, aerospace, renewable energy, and medical companies who have a substantial presence in Florida.

The Florida Opportunity Fund was created by the Florida Legislature in 2007. It was created as "fund of funds" that would invest in venture capital funds, providing seed capital and early stage venture capital. It is sponsored by Enterprise Florida and managed by Florida First Partners, a joint venture between Milcom Venture Partners and the Credit Suisse Customized Fund Investment Group.

The Florida Opportunity Fund launched a direct investment program with $36 million in initial funding in 2010. Named the Clean Energy Investment Program, this fund will provide funding for projects in energy efficiency and renewable energy for Florida companies.

These programs will not, by themselves, close the funding gap between Florida and other states. However, these types of programs can signal to the venture capital community that Florida is committed to helping high-growth companies and developing a "critical mass" of those high-growth companies that will help to attract more venture capital to the state. Hopefully, they will provide returns to the state in terms of not only capital returns, but also additional job creation.

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