

GAINESVILLE SEED FUND FRAMEWORK

“Seed and venture capital, delivered locally by resident professionals, is a key ingredient for growing entrepreneurship, particularly in communities where the knowledge and experience of business venturing is less common. For policymakers concerned about local, state, and regional economic development, finding ways to nurture the culture of entrepreneurs, and the capital that feeds them, must become a top priority.” (Heard and Sibert. *Growing New Businesses with Seed and Venture Capital: State Experiences and Options*)

A. Overview

The Gainesville Seed Fund will provide Gainesville’s most promising seed-stage companies with the investment necessary to develop their ideas, create initial products, and fund preliminary business operations. The Gainesville Seed Fund will be community-based, furthering the efforts to make Gainesville a hotspot for entrepreneurial activity and high-wage employment.

Seed-stage companies are very young firms that have usually not yet established commercial operations. These firms may be in the process of putting together a business plan, developing a product, conducting market research and/or finding the right business team. There is a clear funding gap that exists for seed-stage companies between the initial personal/family investments and VC financing. As VCs continue their trend towards funding later stage companies, the gap grows wider.

Unfortunately, Gainesville does not currently have an organized seed-stage financing mechanism. Without seed-stage funding, local start-ups do not have the financial support needed to grow out of this critical development stage. The Gainesville Seed Fund will help fill the funding gap.

B. Community Assessment

The Kauffman Foundation provides an outline to assess the necessary community attributes for supporting an angel organization (i.e. seed fund). Few communities excel in every attribute, but conducting such an assessment allows for focused resource allocation and tailored program design. A preliminary analysis of the Kauffman Foundation outline indicates that Gainesville is well positioned to host a thriving seed fund.

1) Potential angel community – *Does your community have sufficient numbers of accredited investors to for a viable group? Is there a sufficient core of experienced investors or other resources to help with educating nascent angel investors?*

- Needs development, but pieces are beginning to fall into place.
- There are local individuals with required level of experience and expertise.
- Gainesville has institutional investors that are committed to economic development initiatives.
- Gainesville has high net-worth individual investors.
- Alachua County is home to many successful entrepreneurs (tech and non-tech).

- 2) Prevalent industries in the region – *What established and developing industries are in your region?*
 - Gainesville is poised for high growth in the “creative-class”.
 - Current clusters in biotechnology, medical devices, health care, software/gaming, web applications, and insurance.
 - Gainesville Regional Utilities is first utility to introduce solar feed-in-tariff.

- 3) Entrepreneurial pool – *Does your community have an active entrepreneurial environment?*
 - Gainesville hosts a number of young companies and new ones are forming.
 - Gainesville has won many accolades for being a great place to live, work and start a business.
 - University of Florida has graduate programs in engineering, science and math.
 - University of Florida hosts several government-funded research centers.

- 3) Entrepreneurial infrastructure – *Does your community have entrepreneurial centers and entrepreneurial education programs and associations?*
 - Cade Prize for Innovation.
 - Numerous student-oriented initiatives (GatorNest, Entrepreneurs Club, SIFE).
 - University of Florida undergraduate and graduate business programs are highly ranked.
 - Santa Fe College provides significant business curriculum; houses the Center for Innovation and Economic Development.
 - Support from resource providers such as SCORE, SBDC and the Gainesville Chamber of Commerce.
 - GAIN and Start-up Network provide a networking forum for tech entrepreneurs.

- 4) Support services/teams – *Does your community have a solid pool of experienced service providers and potential senior management?*
 - University of Florida continuously graduates country’s best and brightest graduates; many graduates looking to stay in Gainesville.
 - Entrepreneurial activity is creating a network of seasoned entrepreneurs.
 - Gainesville has accountants, lawyers and marketing firms.

- 5) Follow-on funding – *Are there adequate local sources for sizable and later-stage financing?*
 - Needs development.
 - Most potential funding is from out-of-town investment.

The elements are in place for the development of the Gainesville Seed Fund. The fund will need to focus on developing Gainesville’s angel community and sources for follow-on funding.

D. Program Goals

Successful community-based seed funds employ “For-Profit” strategies to achieve “Non-Profit” goals. (*Growing Seed Funds*. National Business Incubation Association, 2004)

By filling the capital gap that exists locally, The Gainesville Seed Fund will:

- Advance entrepreneurial activity in the City of Gainesville.
- Support the development of successful companies which employ high-wage employees.

- Further the development of local angel and VC networks.
- Attract outside companies that follow funding.

The Gainesville Seed Fund will base investment decisions on the strategy of returning a sizable profit to the fund, and invest in companies that have the potential to yield the highest returns. Funds that yield small returns will eventually deplete funds and be out of business. Furthermore, by focusing on profits, the fund will avoid investing in companies that “sound good” but are unlikely to succeed. If the Gainesville Seed Fund invests in successful companies and is sustainable in the long run, it will achieve the community goals outlined above.

The Gainesville Seed Fund will be an “Evergreen Fund”, where all returns from public/institutional investments are reinvested back into the fund. The goal is for the Gainesville Seed Fund to be able sustain all operational expenses without additional injection of capital.

Recognizing that companies ultimately follow money and talent, The Gainesville Seed Fund and its stakeholders will develop the local resources to ensure that funded companies do not leave when they get to the next stage of growth.

E. Guiding Principles

“In the best cases, state leaders take the initiative in getting programs launched and helping set the long-term direction. They rely on private-sector managers to make the investment decisions.” (Herb and Sibert)

The Gainesville Seed Fund will be developed with the following principles in mind:

- The fund must not be afraid to make money.
- The fund must be big enough to make a difference.
- The fund should allow for the discretion of professional managers and not be burdened by arduous rules and regulations.
- Government involvement in day-to day operations of fund must be minimized.
- Investment decisions involve relationships between high quality people. (Herb and Sibert)

F. Geographic Focus

Because initial capital for the fund will come from local public and private sources, the fund will be used to further *local* economic development within the City of Gainesville limits. Funded companies should have, or should plan to have, some presence in the City of Gainesville at the time of investment, until maturity.

The Gainesville Seed Fund should avoid too strict geographic requirements because such restrictions can limit the pool of applicants and the potential magnitude of success.

According to Paul Graham, founder of the successful seed-stage accelerator Y-Combinator, “Good startups will move to another city as a condition of funding. What they won’t do is agree not to move the next time they get funding.” (Christiansen, Jed. *Copying Y Combinator: A framework for developing Seed Accelerator Programs*)

The key to keeping companies in the City of Gainesville is to build a robust entrepreneurial ecosystem which ties the company and its principles to the area. The ecosystem not only includes the development of the money and talent needed for the company's next growth stage, it also includes the development of mentoring relationships, a citywide culture of innovation and a high quality of life. The stakeholders of the Gainesville Seed Fund must commit to the development of such an ecosystem.

G. Industries Targeted

Successful community-based seed programs focus investments in industries in which the region is already strong. Gainesville's competitive advantage is in the "creative-class" economy. The Gainesville Seed Fund will invest in innovative companies that use high-wage, knowledge-based workers employees to solve complex problems in fields such as healthcare, finance and business.

By focusing on specific industries, the Gainesville Seed Fund will be able to:

- Make better-informed investment decisions.
- Foster development of industry clusters.
- Offer specialized education/mentoring programs for funded companies.
- Better measure and compare outcomes.

This targeted approach is consistent with the City of Gainesville's Economic Development Strategic Plan, and the vision for both Innovation Gainesville and the Innovation Square.

Examples of seed stage companies that The Gainesville Seed Fund would search for, market to, and invest in, would include those involved in biotech/life sciences, software, gaming, solar, artificial intelligence, and other technologies developed out of the University of Florida and Santa Fe College. Of course, any investment decision should involve the discretion of the fund management.

H. Structure

There are two primary options for structuring The Gainesville Seed Fund:

- 1) The Gainesville Seed Fund will be an independent, 501(c)3 non-profit corporation. The 501(c)3 status will allow contributions to be tax deductible.

In accordance with IRS requirements, the Gainesville Seed Fund will be organized and operated exclusively for the purposes of "advancement of education or science" and "lessening the burdens of government" with respect to economic development efforts.

The National Development Council will house the Gainesville Seed Fund under its IRS group exemption until such time as a new 501(c)3 non-profit corporation is set up locally. At that point, The Gainesville Seed Fund will be transferred to the new non-profit organization.

Strengths: Quick and easy to set up with shell from NDC; clear "public" mission; easy PR; all returns reinvested; philanthropic incentive to contribute.

Weaknesses: May be difficult to raise substantial private investment.

2) The Gainesville Seed Fund will be set up as a private Limited Partnership. The charter of the Limited Partnership will define the parameters of the fund. This structure will allow the fund to better leverage private investment to initially capitalize the fund. Investors will be brought on as limited partners and any returns will be distributed on a pro rata basis. Returns on any Public/Institutional/Philanthropic investment will be returned to the fund perpetually.

Strengths: Profit incentive to leverage private investment; potential for larger fund.

Weaknesses: Complicated disbursements; diluted focus.

I. Capitalization

The Gainesville Seed Fund will seek *Investment Partners* that can contribute a minimum investment of \$75,000. The initial goal will be to secure \$500,000 for the fund.

All returns from *Investment Partner* investments will be reinvested back into the fund.

The following organizations/individual will be solicited to serve as *Investment Partners*:

- Gainesville Community Redevelopment Agency (CRA)
- City of Gainesville
- University of Florida
- Santa Fe College
- Gainesville Area Chamber of Commerce/Council for Economic Outreach
- Shands
- Local Banks
- Corporations
- Foundations
- High net-worth individuals

If the fund is set up as a non-profit, smaller contributions will be solicited from *Donors* to further capitalize the Fund.

If the initial \$500,000 is not reached through the contributions of *Investment Partners*, and the fund is set up as a Limited Partnership, private investors will be sought.

J. Governance

The Gainesville Seed Fund will be governed by a Board of Directors. Each *Investment Partner* shall assign one representative to serve as an “ex-officio” member of the Board of Directors.

The Board of Directors should also include individuals with significant start-up and investing experience.

The representatives of the *Investment Partners* shall constitute the initial Board of Directors and will be responsible for soliciting and voting on other members.

K. Fund Management

The Gainesville Seed Fund will either be managed professionally or by an independent, volunteer Investment Team, consisting of local business owners, investors and other citizens (both options collectively referred to as “Fund Manager”). Independent management is important to de-politicize any investment decisions and because *Investment Partners* may not have sufficient investing and/or business knowledge.

The Board of Directors will solicit and obtain a Fund Manager to manage the operations and investments of the funds once it is capitalized.

The Fund Manager will be responsible for marketing the fund, soliciting a pool of applicants, conducting due-diligence on potential investments, and structuring terms of any deals. The Fund Manager shall bring all investment recommendations to the Board of Directors for approval.

The Fund Manager will also be responsible for coordinating the educational component of The Gainesville Seed Fund.

The Fund Manager shall make use of University of Florida MBA students to conduct research on applicants and to provide technical assistance to funded companies.

If the fund is professionally managed, The Board of Directors will need to develop an appropriate compensation structure for the Fund Manager.

Investors will need to also fund operations, through an annual dues mechanism or by allocating a percentage of the total assets of the fund. Once returns are realized, the “carry” will fund operations.

L. Investment and Funding Parameters

Ultimately, the *Investment Partners* will define the investment and funding parameters. The Board of Directors, with advice from the Fund Manager, will determine the mechanics of the investments.

The Gainesville Seed Fund will provide \$25,000 to \$150,000 in seed-stage investments through Convertible Notes.

Convertible Notes are essentially deferred interest loans which can be converted into equity at some point in the future. The loans can be structured to mature after a particular time period (i.e. after one year in the program) or at the time when a particular event occurs (i.e. company gets 2nd round of funding). Typical interest rates on seed fund convertible notes are between 6% and 10%. Convertible Notes can be secured by the company’s assets, including intellectual property.

Convertible Notes are preferred over other investment mechanisms in that they are simpler from a legal standpoint and do not require valuation of the seed stage company.

M. Follow-on Investments

Follow-on investment is one of the key determinants of whether a company succeeds and where it decides to locate.

In order to keep funded companies located in the City of Gainesville, The Gainesville Seed Fund will take affirmative steps to:

- Assist in the development of the local angel and VC network.
- Connect funded companies with outside angel and VC networks.
- Create a Side Fund to allow members and private individuals to invest in funded companies.

N. Education Component

Education (i.e. technical assistance) is an integral part of The Gainesville Seed Fund framework as it contributes to the entrepreneurial ecosystem, directly supports the success of a company, and ultimately protects any investments. If the primary goal to build an ecosystem, the emphasis must be on the educational elements of the program and its support network (Christiansen).

Funded companies should be educated in both business operations and product development.

The Gainesville Seed Fund should leverage the services of existing community resources such as the Small Business Development Center, SCORE, GTEC, CIED @ Santa Fe College and the University of Florida's Office of Technology Licensing. A Technical Advisory Committee will be developed to connect funded seed-stage companies to the resources they need to grow and be successful. The less money and time seed-stage entrepreneurs spend on securing office space, legal services, public relations, accounting and recruiting talent, the more resources they can spend developing and growing their business.

Gainesville Seed Fund will provide funded companies with a complementary one-year membership into an existing incubation program, such as GTEC.

O. Branding:

Strategic branding is key to the success of the Gainesville Seed Fund. The Gainesville Seed Fund brand should attract a large pool of the highest caliber seed-stage entrepreneurs from inside and outside Gainesville. Accordingly, the brand should portray the following:

- The Gainesville Seed fund is a business growth/accelerator program, versus just a loan fund
- The Gainesville Seed Fund is an innovative approach to seed funding and business acceleration.
- The Gainesville Seed Fund enjoys wide community support.
- The Gainesville Seed Fund is professional and profit-oriented, despite the ultimate public purpose.

P. Next Steps:

- 1) Solicit feedback from potential stakeholders and obtain buy-in.
- 2) Amend proposed framework, as needed.
- 3) Form non-profit corporation (with NDC) or form Limited Partnership.
- 4) Develop necessary legal documents.
- 5) Solicit and secure *Investment Partners* and other investment.

- 6) Formulate Board of Directors and convene inaugural meeting.
- 7) Board of Directors develop policy framework for fund.
- 8) Board of Directors solicit and hire a Fund Manager.
- 9) Board of Directors develop and adopt investment parameters and procedures.
- 10) Begin fund operations.

List of Works Cited and Consulted

Christiansen, Jed. (2009) *Copying Y Combinator: A framework for developing Seed Accelerator Programmes*.

Heard, Robert and John Sibert. (2000). *Growing Businesses with Seed and Venture Capital: State Experiences and Options*. Washington, DC: National Governors' Association.

Illinois Technology Development Alliance. (2006). *Seed Stage Financing with Convertible Debt*

Kauffman Foundation. (2003). *Las Vegas Angel Executive Summary*.

National Business Incubation Association. (2004). *Growing Seed Funds*.

Preston, Susan. (2004) *Angel Investment Groups, Networks, and Funds: A Guidebook to Developing the Right Angel Organization for Your Community*. Ewing Marion Kauffman Foundation.

SW Florida Regional Angel Fund Assessment Team. (2008). *Southwest Florida's Regional Angel Fund Assessment*.

Conversations:

David Whitney, Managing Director, Emergent Ventures

Jim Doughman, Senior Director of Operations, JumpStart Ventures

Jim Jaffe, President and CEO of National Association of Seed and Venture Funds

Seed Fund/Seed-Stage Accelerator Models:

Cincy Tech - www.cincytechventures.com

Innovation America - www.innovationamerica.us

Jumpstart - www.jumpstartinc.org

King Abdullah University of Science and Technology Seed Fund-
www.kaust.edu.sa/economic_development/seedfund/

Kickstart Seed Fund - www.kickstartseedfund.com

Mofet B'Yehuda Innovation Accelerator - www.greentech.co.il

NYC Seed - www.nycseed.com

Portland Seed Fund - www.portlandseedfund.org

Synogen - www.synogen.com

Y Combinator - www.ycombinator.com

Other Websites:

Advantage Capital Partners - www.advantagecap.com

Angel Capital Association – www.angelcapitalassociation.org

Angel Soft - www.angelsoft.net

Community Development Venture Capital Alliance - www.cdvca.org

Coronado Ventures Forum - www.cvf-nm.org

Ewing Marion Kauffman Foundation – www.kauffman.org

National Association of Seed and Venture Funds - www.nasvf.org

National Business Incubation Association - www.nbia.org

Trailblazer Capital – www.trailblazercap.com