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Working Paper

Bureau of Business and Economic Research

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***NORTHEASTERN MINNESOTA
EQUITY INVESTMENT
NEEDS ANALYSIS***

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WHY WE SURVEYED

On behalf of Northeast Ventures, The Center for Economic Development conducted an analysis of the need for equity investment capital in the seven-county northeastern Minnesota region.

When searching for relevant data pertaining to the availability of equity investment capital in northeastern Minnesota, data was found to be unavailable. The Center for Economic Development therefore needed to gather this information through direct contact with economic development practitioners and business finance sources. To gather missing data, researchers from the Center for Economic Development (CED) constructed a short survey to analyze the current situation and to assess the perceptions of economic development professionals in the seven-county region regarding equity capital. The survey instrument used in this study is attached as Appendix 1.

WHO WE SURVEYED

The mailing list was constructed from two groups: the Arrowhead Growth Alliance and the Range Economic Alliance, which together represent the economic development professionals in the northeastern Minnesota area. Fifty-three possible respondents were contacted with a letter inviting them to participate in the survey.

To expedite response, the Center for Economic Development designed this survey in the form of a fax transmission and requested that respondents fax their responses to CED A.S.A.P. The survey was designed to be completed in five minutes or less.

Of the 53 names contacted, 26 responded. We note that included in that 50% return were the majority of the largest economic development practitioners and business finance sources in the area. Of the major development finance entities contacted, 14 out of 18 did respond.

RESULTS

All of the responses are shown in Appendix 3: Table of Responses.

Question 1

1. Have the businesses and entrepreneurs that you work with been frustrated in trying to secure equity investments for business growth or new business startup?

Answers to question one were overwhelmingly positive. With 1 = a positive response and 2 = a negative response (see Appendix 3), the mean for question 1 was 1.08, with a very small standard deviation of .27. Twenty-four out of 26 respondents answered yes.

Question 2a

2. Are there projects/businesses in your areas that would startup or expand if there were equity investment capital available?

Answers to question 2a were unanimous in the affirmative.

Question 2b

If Yes, approximately how many businesses or projects, which your organization has worked with in the last year, could benefit from increased availability of equity investment capital?

Approximate Number = _____

Question 2b was responded to by 24 of the 26 respondents. The mean response was 11.71 with a standard deviation of 10.54. The largest number of projects reported was 50 and the least number of projects reported was 2. Total number of projects reported by survey respondents was 305. (Note: There could be some duplication in the total project count for question 2b because of possible multiple involvement by economic development professionals.)

Question 3

3. How do you rate the unmet need for equity investment capital in the area you serve?

Respondents answered question three by indicating on a five point scale their perception of the *unmet need for equity investment capital* in their area.

The mean answer for question three was 4.50, where significant need was high (5) and no need was low (1). The standard deviation for answers to question 3 was 0.59.

Question 4

4. How do you rate the unmet need for debt capital in the area you serve?

To contrast the need for debt equity capital and investment equity capital and as a control on question 3, the survey asked respondents to rate the *unmet need for debt capital*. The mean response to question 4 was 3.29, where significant need was high

(5) and no need was low (1). The standard deviation for answers to question 4 was 1.04.

Question 5

5. Compared to the Twin Cities Metro area, how do you rate the availability of equity investment capital in the area *you* serve?

Question five asked respondents to rate the availability of equity investment capital in their area, using the Twin Cities Metro area as the control. The mean response to question 5 was 1.19, where more available was high (5) and less available was low (1). The standard deviation for answers to question 5 was 0.39. No respondent returned a response higher than 2.

Question 6a

6. Are there individuals, or identifiable groups of individuals (geographic, economic, social, or other) who have had more difficulty accessing equity investments than others?

Answers to question 6a were largely positive. With 1 = a positive response and 2 = a negative response, the mean for question 1 was 1.15. With a very small standard deviation of 0.36. 22 out of 26 respondents answered yes.

Question 6b

If Yes, please identify: _____

The most frequent responses were “low income” and “location...(rural/remote/nonmetropolitan).”

Question 7

7. In your own words, can you identify the equity problem in your area?

See Appendix 4 for a transcription of all answers to question 7. Some representative answers were as follows:

- There are many excellent business development projects that could prove viable if only equity capital was a part of the overall funding package. The lack of equity is a problem that needs to be addressed as a part of an overall economic development strategy focusing on improving economic conditions of people in our region. Low income people and disadvantaged populations have much to gain from additional equity earmarked for development in our area.
- With a very few exceptions, we lack a core group of individuals and corporations who are actively seeking to make equity investments in our community. The result is that investments with the same or better chance of succeeding here than in other communities, do not happen.
- The perception that out-state, rural means we somehow less desirable, lower quantity, less competitive areas with fewer services.
- Two areas need to be addressed: (1) severe shortage of early stage equity (2) strong need for additional equity fund companies.
- Most equity investors are looking for fast growth companies and high rates of return. Rural businesses tend to be too small, not high tech enough and slower growing operations.
- Individuals seeking to start a business in the retail, services or manufacturing categories cannot demonstrate sufficient collateral or equity to entice private or public finance assistance. Often, a lack of business experience adds to their difficulties in filling and financing needs.

DISCUSSION

In addition to reporting the mean and the standard deviation for responses to the survey, we conducted two tests for the difference between two population means. We wanted to know whether there was a significant difference between the responses to questions 3 and 4 out of the survey. In short, is there a greater need in the region for equity vs. debt capital?

We conducted the tests for small samples, one test assuming the standard deviations for the two populations were equal, and the other test assuming the standard deviations for the two populations were not equal. Both rejected the null hypothesis that $\mu_1 - \mu_2 = 0$. In other words, the mean for the second category, *unmet need for debt capital*, is significantly less than the mean for the first category, *unmet need for equity investment capital*.

APPENDIX 1: Survey Instrument

to: Center for Economic Development
fax #: (218) 726-6338

**Northeastern Minnesota
Equity Investment
Needs Analysis**

from:
Your Name _____

Your Organization _____

1. Have the businesses and entrepreneurs that you work with been frustrated in trying to secure equity investments for business growth or new business startup?

No Yes

2. Are there projects/businesses in your areas that would startup or expand if there were equity investment capital available?

No Yes

If Yes, approximately how many businesses or projects, which your organization has worked with in the last year, could benefit from increased availability of equity investment capital?

Approximate Number = _____

3. How do you rate the unmet need for equity investment capital in the area you serve?

no need moderate need significant need
1.....2.....3.....4.....5

4. How do you rate the unmet need for debt capital in the area you serve?

no need moderate need significant need
1.....2.....3.....4.....5

5. Compared to the Twin Cities Metro area, how do you rate the availability of equity investment capital in the area you serve?

less available about the same more available
1.....2.....3.....4.....5

6. Are there individuals, or identifiable groups of individuals (geographic, economic, social, or other) who have had more difficulty accessing equity investments than others?

No Yes

If Yes, please identify: _____

7. In your own words, can you identify the equity problem in your area?

Thank you. Please use the return fax number at the top of this page.

APPENDIX 2: Mailing List

Equity Needs Analysis mailing list
12/95

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APPENDIX 3: Table of Responses

	Frustrated?	Projects?	How Many?	Equity Need?	Debt Need?
	1.00	1.00	13.50	5.00	4.50
	1.00	1.00	4.00	5.00	2.00
	1.00	1.00	7.50	4.00	4.00
	1.00	1.00	4.00	3.00	4.00
	1.00	1.00	25.00	4.00	3.00
	1.00	1.00	5.00	5.00	4.00
	1.00	1.00	6.00	5.00	3.00
	1.00	1.00	20.00	4.50	3.00
	1.00	1.00	10.00	4.00	4.00
	1.00	1.00	3.00	4.00	3.00
	1.00	1.00	10.00	5.00	3.00
	1.00	1.00	8.00	5.00	5.00
	1.00	1.00	50.00	5.00	4.00
	1.00	1.00	20.00	5.00	3.00
	1.00	1.00	na	5.00	3.00
	1.00	1.00	27.00	5.00	3.00
	1.00	1.00	20.00	5.00	5.00
	1.00	1.00	6.00	4.00	2.00
	1.00	1.00	7.50	5.00	2.00
	1.00	1.00	12.00	4.00	2.00
	2.00	1.00	5.00	3.50	4.00
	1.00	1.00	12.00	5.00	5.00
	1.00	1.00	10.00	4.00	2.00
	2.00	1.00	2.00	4.00	3.00
	1.00	1.00	17.00	5.00	1.00
	1.00	1.00	na	4.00	4.00
n =	26				
Average	1.08	1.00	11.71	4.50	3.29
Std Deviation	0.27	0.00	10.54	0.59	1.04

Question 5 Relative Avail?	Question a Groups?	Question 6b Who?
1.00	1.00	Low Income
2.00	2.00	N.A.
1.00	1.00	Minorities, Young People, Remote Locations
1.00	1.00	Location
1.00	1.00	Low to Medium Income
1.00	1.00	St. Louis County in General
1.00	1.00	No Response
1.00	1.00	Iron Range, Northern Minnesota in General
1.00	1.00	Enterprises With Limited Net Worth, Low Income
2.00	2.00	N.A.
1.00	2.00	N.A.
1.00	1.00	Low Income
1.00	1.00	Entire Iron Range
1.00	1.00	Low Income Persons, Investments With Good Chances Elsewhere
1.00	1.00	Outstate Minnesota
1.00	1.00	Low-med Income
1.00	1.00	Low Income, MN populations, small slower growth businesses
1.00	1.00	NE MN--rural location = difficulty
1.00	1.00	Low Income, People w/no or limited resources
2.00	1.00	Smaller business/moderate growth
1.00	1.00	Non-technical and smaller growth industries
1.00	1.00	Small business startups
2.00	1.00	Low income
2.00	2.00	State-wide agency/ exposure to equity investment needs is not very extensive
1.00	1.00	Low income entrepreneurs, minority entrepreneurs, rural small businesses
1.00	1.00	Startups, investors, early growth stage companies 1-3 years
1.19	1.15	Average
0.39	0.36	Std Deviation

APPENDIX 4: Comments from Respondents

Question 7: Comments from Respondents

In your own words, can you identify the equity problem in your area?

1. The venture capital community in the Twin Cities will not normally consider investments in outstate Minnesota.
2. Inadequate amount.
3. There are many excellent business development projects that could prove viable if only equity capital was a part of the overall funding package. The lack of equity is a problem that needs to be addressed as a part of an overall economic development strategy focusing on improving economic conditions of people in our region. Low income people and disadvantaged populations have much to gain from additional equity earmarked for development in our area.
4. Location-NE MN has, because of its rural location, had difficulty in obtaining venture capital.
5. NA
6. With a very few exceptions, we lack a core group of individuals and corporations who are actively seeking to make equity investments in our community. The result is that investments with the same or better chance of succeeding here than in other communities, do not happen.
7. Inadequate supply.
8. The perception that out-state, rural means we somehow less desirable, lower quantity, less competitive areas with fewer services.
9. Small amounts of equity fund available in area (NE MN) that can be used here -- other areas (Twin Cities) unwillingness to invest here.
10. While we have made significant progress identifying new equity sources, we still have a great need -- especially in the jobs? that have significant risk.
11. The further your business is from the larger communities, the more difficult the access to capital.

12. Lack of expansion capital.
13. Two areas need to be addressed: (1) severe shortage of early stage equity (2) strong need for additional equity fund companies.
14. Few if any equity investments have been made in recent history -- There is no track record for this type investment.
15. Lack of equity to invest in smaller startups and expansion of smaller successful companies.
16. Existing venture equity resources limited and need further capitalization and flexibility.
17. NA
18. There has been heavy private sector investment in our county that attracts new investments. Since that's the case we are still trying to attract equity in our base economy or either to create a base economy.
19. A lack -- severe lack -- of providers in the area. One does not need to look to the cities for a comparison, as there are more opportunities in Duluth.
20. Rural business development, Low income individuals, dislocated workers with recent job termination.
21. We need to develop many sources of equity since each fund only makes a few investments annually. We need more socially motivated investors as well.
22. Most equity investors are looking for fast growth companies and high rates of return. Rural businesses tend to be too small, not high tech enough and slower growing operations.
23. Small business strategy capital, small business expansion capital and facilitators.
24. Individuals seeking to start a business in the retail, services or manufacturing categories cannot demonstrate sufficient collateral or equity to entice private or public finance assistance. Often, a lack of business experience adds to their difficulties in filling and financing needs.

25. Note: Our service territory is the entire state. We ordinarily avoid working with startups of small companies so our exposure to equity investment needs is not very extensive.
26. Our rural are is significantly undeserved by venture capital, with many real opportunities lost.