

WE CREA+E CAPITAL

Financing Startup and Early-Stage Companies
in the Kansas City Region: June 2015



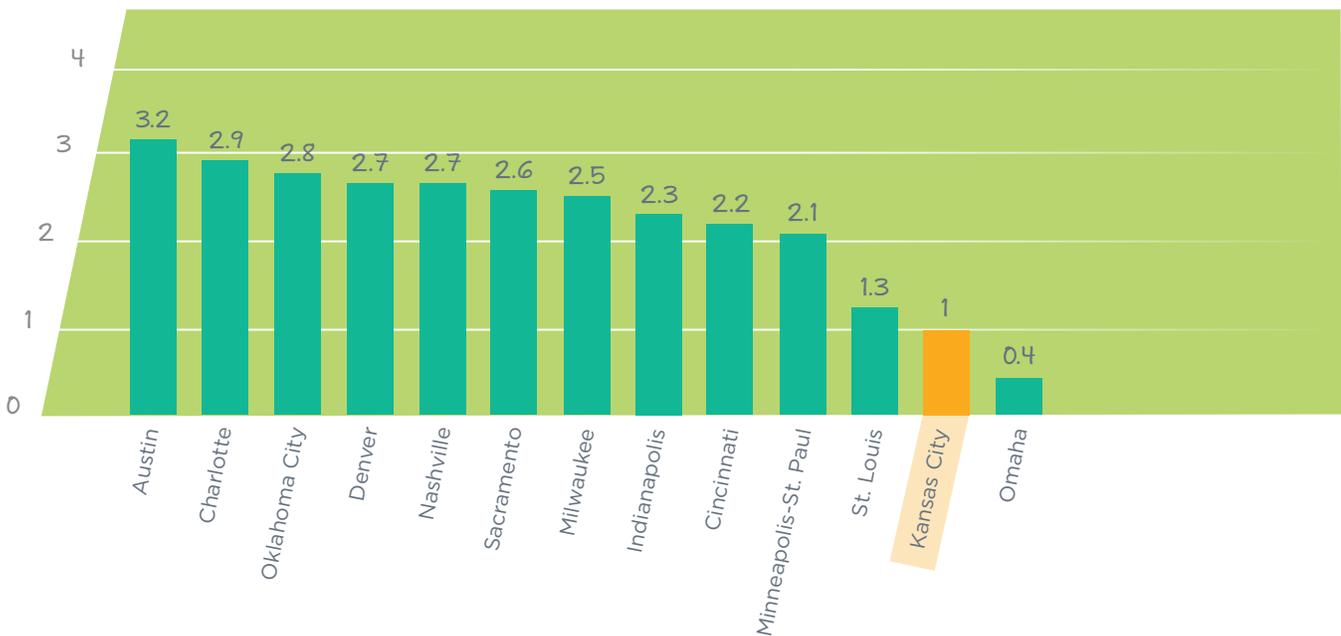
WHERE WILL KANSAS CITY FIND JOBS?

Kansas City has a proud tradition of economic and entrepreneurial success, spanning several generations. The community, however, has been slow to replace jobs lost during the recent Great Recession.

PERCENT CHANGE IN EMPLOYMENT

November 2013 - November 2014

Kansas City has one of the lowest percentages of employment growth since November 2013 when compared to the 12 peer metropolitan areas typically used to benchmark our region.



Research by the Kauffman Foundation shows that of the 12 million new U.S. jobs added in 2007 alone, young firms (up to age five) were responsible for creating nearly 8 million of those jobs.

Fully leveraging and sustaining the emerging entrepreneurial movement is critical to increasing job growth in Kansas City.

The Kansas City region can increase regional growth rates, job creation and wealth creation by increasing access to capital for growth-oriented startup and early-stage businesses.

THE COMMUNITY NEEDS TO:

- 1 build capacity in organizations that can provide capital,
- 2 encourage the formation of new microloan programs, angel investor groups, seed capital funds and venture capital funds and
- 3 build capacity in existing nonprofit organizations that provide assistance to entrepreneurs seeking capital.

To accomplish these strategies, regional investors, community leaders, corporations, nonprofit organizations, entrepreneurs, educators and public policymakers need to work collaboratively to set objectives.

WHAT WILL IT TAKE TO FUEL THE FIRE FOR EARLY-STAGE COMPANIES?

- + **WE NEED** more experience and connectivity to take advantage of tens of millions of dollars in both federal and private funding that could be supporting our businesses.
- + **WE NEED** to take a step today, or our tomorrow will look the same.
- + **WE NEED** to make that step impactful.

+ **WE NEED TO DO IT TOGETHER.**

FUNDING BY THE NUMBERS

\$10,000

typical startup capital for small businesses

\$80,000

typical startup capital for high-tech companies, with financing usually coming from a combination of debt and equity

51%

of funding for small businesses comes from loans

7%

of funding financed by credit cards

4%

of funding comes from angel or venture capital

\$0

amount of startup capital for about one-third of new non-employer and 12% of employer startups

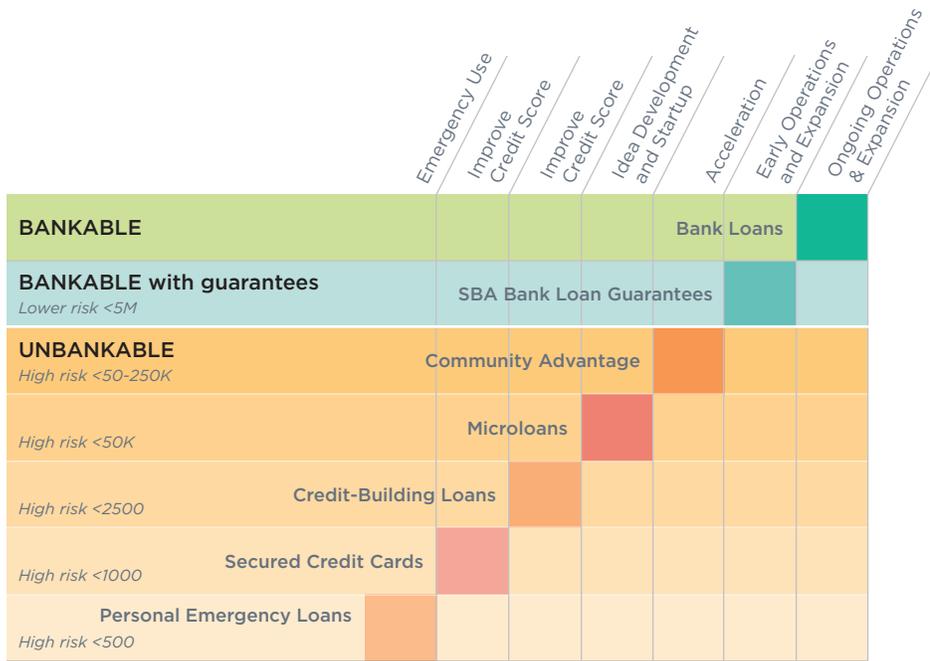
Source: U.S. Small Business Administration

This report outlines specific steps that can drive early-stage funding for Kansas City's future. >

LOANS

Businesses that can't qualify for bank loans can build credit through credit-building loans, access alternative loan funds or take advantage of SBA loan guarantees. Moving businesses along this path sets them up to be "bankable," where they can be good bank customers and build their businesses.

BUILDING A CONTINUUM FOR EARLY-STAGE LOAN INFRASTRUCTURE



WHAT'S THE GAP?

A cohesive infrastructure for loans less than \$250,000 for non-bankable entities did not exist in Kansas City in 2009. A partnership between many organizations has been working diligently to build solutions.

Kansas City's largest microloan program is the KC Regional Microloan Fund operated by Justine PETERSEN in partnership with OneKC for Women, the KCMO CDE, the city of Kansas City, MO KC BizCare and other partners including a number of financial institutions.

KC REGIONAL MICROLOAN PROGRAM BY THE NUMBERS

Launched in **2012**

\$3 million

in lending

262

loans with an average loan size of **\$11,000**

59% to women

45% to minorities

Approximately **800** jobs

Default rate less than **3%**

This highly successful microloan program benefits less than 2% of the microenterprises in Kansas City.



Bankable companies have the collateral, track record and/or cash flow to qualify for conventional bank small business financing. "Non-bankable" companies typically need access to alternative loans or bank guarantees.

Community Development Financial Institutions (CDFI) are private-sector financial intermediaries with community development

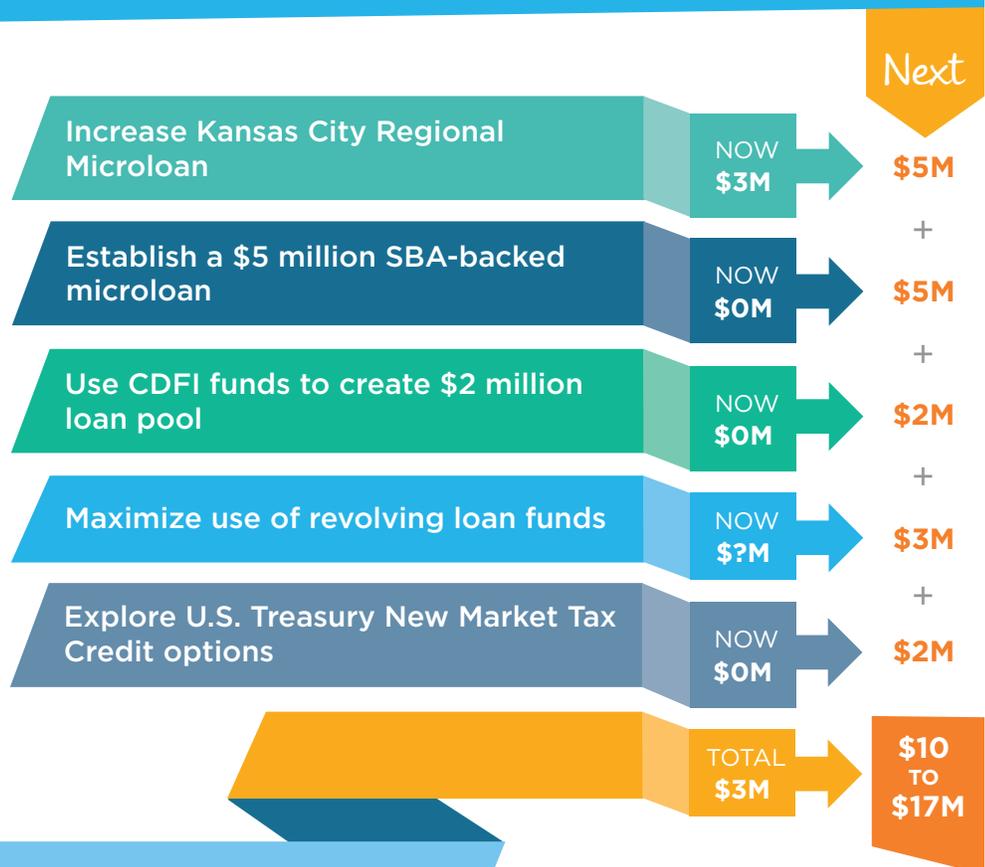
as their primary mission. While many CDFIs serve as community development banks, they can offer microenterprise funds which provide small amounts of business capital to small scale entrepreneurs.

The Community Reinvestment Act (CRA) of 1977 is intended to encourage depository institutions to help meet the credit needs

of the communities in which they operate, including low- and moderate-income neighborhoods. Lending institutions can receive favorable CRA consideration for investments in a pool that would be used to make microloans to promote economic development in a regional area that includes the institution's assessment area.

Increase the availability of alternative loans to \$10 million by 2020.

- The Kansas City Regional Microloan Fund has demonstrated the value of microloans to support “unbankable” companies.
- Underutilized federal programs through the SBA and U.S. Treasury could rapidly introduce more alternative loan funding to Kansas City.
- Kansas City needs to build microloan servicing experience to qualify for additional federal funds.
- OneKC for Women and KCMO CDE have agreed to pursue needed federal certification.



WHAT'S IT GOING TO TAKE?

INCREASE LOAN CAPITAL

- + Rally CRA funding to support early-stage loan funding mechanisms and programs.
- + Add additional capacity and support fundraising for an initial microloan pool for OneKC for Women to achieve the experience necessary to garner the \$5 million SBA-backed microloan program.
- + Assist OneKC for Women and KCMO CDE in applying for and achieving CDFI certification, accessing funds for loan pools and expanding capacity to administer loans and provide technical assistance.
- + Convene an ad hoc group to explore U.S. Treasury New Market Tax Credits (NTMC) and work with existing CDEs to promote NMTC Program to businesses and support additional allocation requests to the region.

INCREASE ACCESS TO LOANS

- + Convene an ad hoc committee to review existing alternative loan funds for activity and available funds.
- + Increase community support for programs that provide entrepreneurial and business development training to develop a pipeline of borrowers for the various loan products offered by traditional and non-traditional lenders.
- + Create a strong marketing program that raises awareness of existing loan products and services to appropriate audiences.
- + Develop a “train the trainer” module to educate service providers and entrepreneurs in the Kansas City region about available alternative loan programs and application procedures to get alternative loans.
- + *FURTHER STUDY:* Convene an ad hoc committee to review small business lending practices by banks and identify hurdles banks face in deploying more capital in the community.

GRANTS

Business plan competitions, reward-based crowdfunding and other contests have given rise to grant funds that often move concepts to a point where they can be validated in the market.

Digital Sandbox KC was established in 2013 to provide support for proof-of-concept projects. LaunchKC grants of \$50,000 each will become available in 2015 to attract companies to Kansas City, Missouri.

Additionally, federal agencies with extramural research and development budgets that exceed \$100 million are

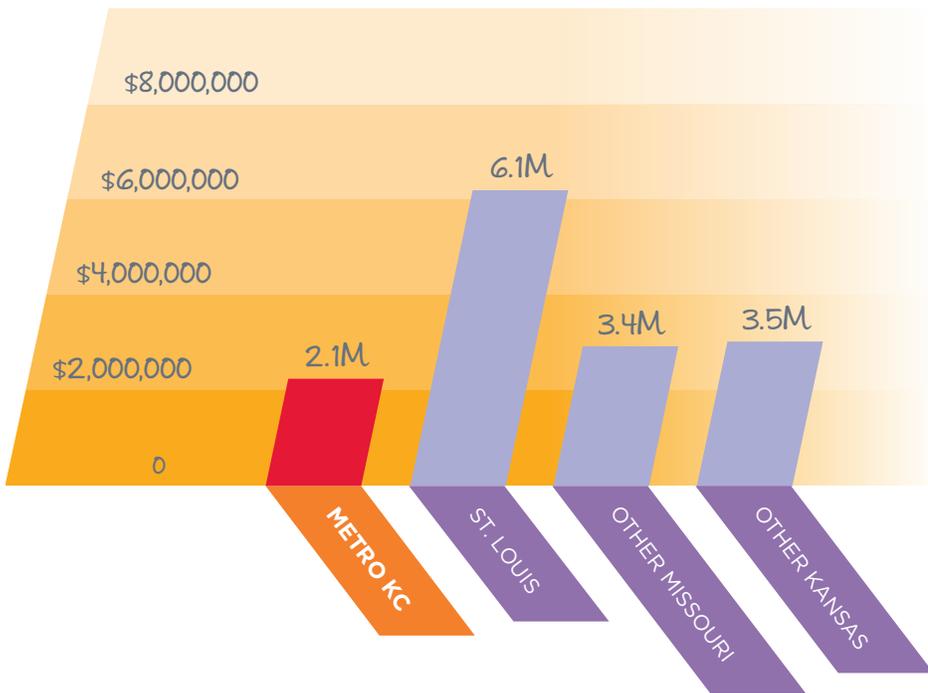
required to set aside annually a portion of that funding to the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs. These programs provide some of the very few federal grants available for small companies. SBIR and STTR programs can assist very early-stage and established companies.

WHAT'S THE GAP?

Originally launched through a federal grant from the U.S. Department of Commerce Economic Development Administration, Digital Sandbox KC provides about \$20,000 per company in proof-of-concept resources for market validation, prototyping and beta testing of digital technologies within new and existing businesses. In addition to this support, Digital Sandbox links companies to a variety of resources to help with business development and follow-on funding.

KS/MO SBIR GRANTS AWARDS, 5-YEAR AVERAGE

2010-2014



Missouri and Kansas generally do not take full advantage of SBIR funding. Missouri ranks 28 and Kansas 39 in the number of SBIR grants received since 1982.

The Kansas City metro region also lags behind other Missouri and Kansas regions in total dollars. From 2010-2014, Kansas

City was awarded \$10,890,619 in SBIR grants, averaging slightly more than \$2 million per year. The St. Louis region garnered almost three times that amount at \$30,692,854. Even the regions outside the two major metros outperformed the KC area.

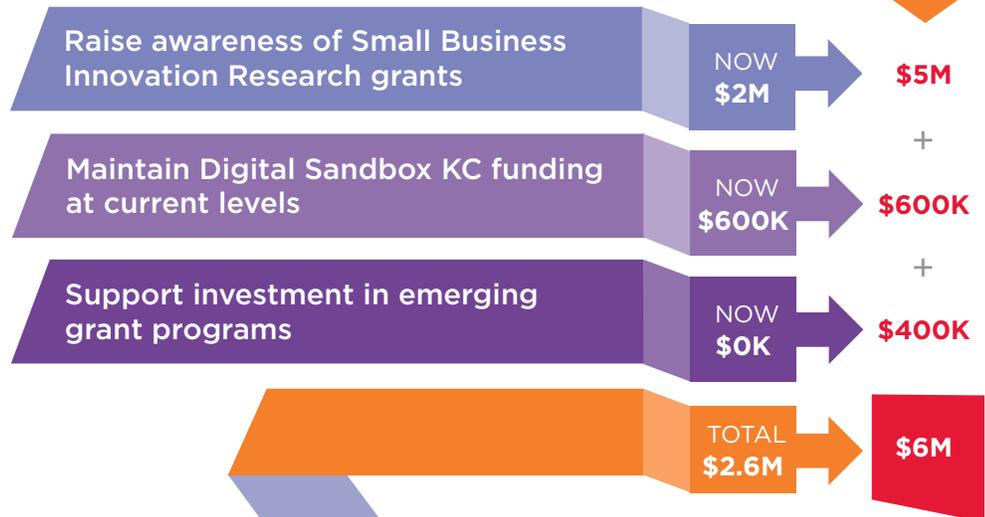
DIGITAL SANDBOX KC BY THE NUMBERS

- Launched in **2013**
- 226** total applicants
- 46** proof-of-concept projects funded for area startups
- 23** new KC-based companies created
- 33** companies have secured follow-on investment
- \$17.7** million in follow-on funding
- 181** new jobs created
- Nearly **\$5.5** million in total salaries

Digital Sandbox KC was able to fund only 20.4% of applications.

Increase local, state and federal grant funding to early-stage and R&D focused businesses in the Kansas City region to \$6 million by 2020.

- Fledgling companies need community support to be positioned for later funding and success. It is critical that we fill the pipeline at the early stage.
- Few private investors provide capital at this stage.
- Digital Sandbox KC has been very successful, but is one of the few sources of capital for this stage.



We need more experience and connectedness...

WHAT'S IT GOING TO TAKE?

INCREASE GRANT CAPITAL

- + Support public and private investment in emerging and existing grant programs.
- + Monitor, assess and apply for all state and federal resources that add additional funding pools to the region. Examples include Regional Innovation Strategies grants from the U.S. Department of Commerce Economic Development Administration.
- + Better position the community to access public funding, especially state and federal innovation grants, by creating a pool of matching funds that can be rapidly allocated to special projects.

...so that we can take advantage of tens of millions of dollars in federal funding that could be supporting our businesses.

INCREASE ACCESS TO GRANTS

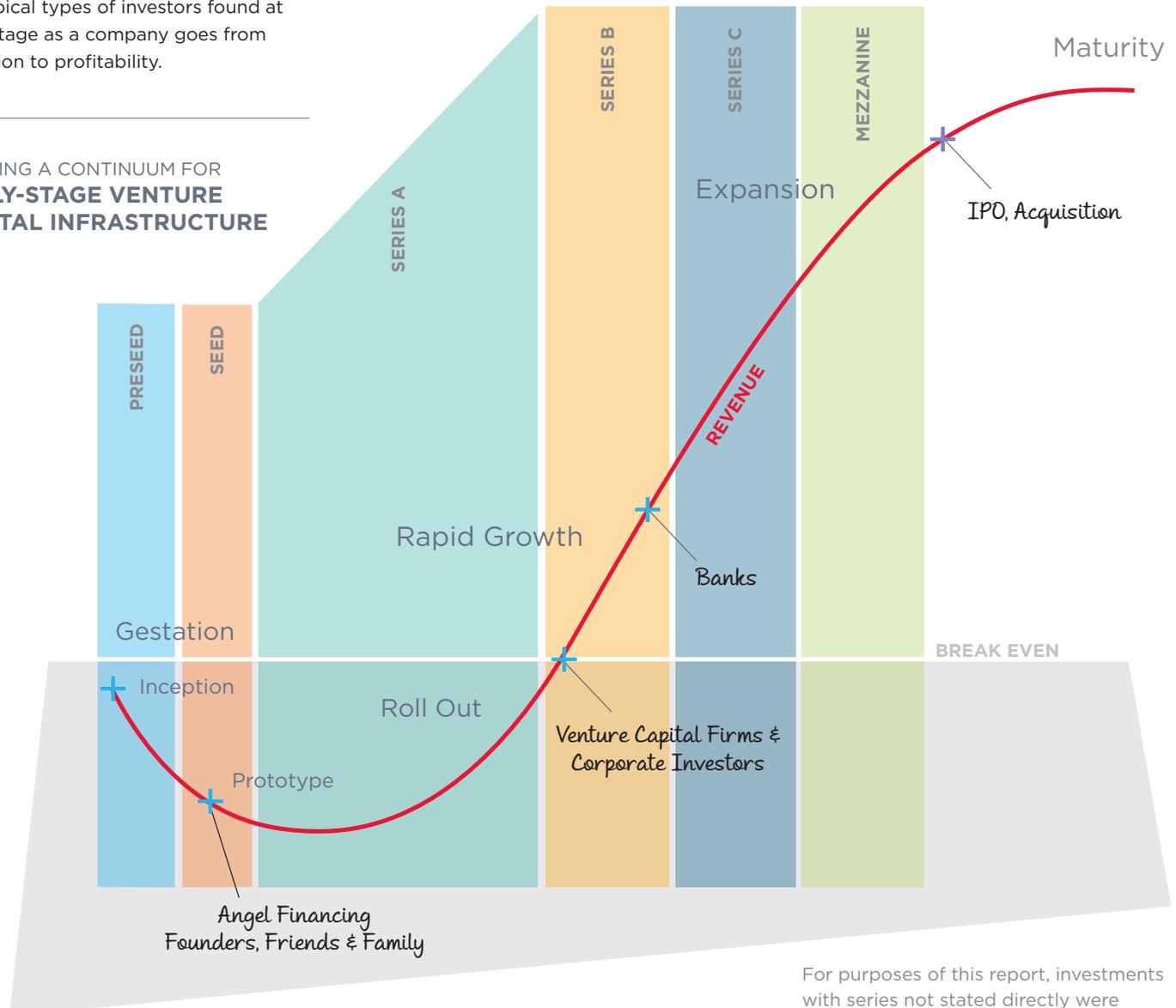
- + Create and implement a strong awareness campaign for SBIR and STTR grants that drives people to existing SBIR/STTR training seminars.
- + Develop a "train the trainer" module to educate entrepreneurs and resource partners in the Kansas City region about available grant programs and how to apply for and win grants.

EQUITY CAPITAL

Young companies with large market potential often turn to equity investors for capital. Investors provide capital to these startup and early-stage businesses, generally in exchange for convertible debt or ownership equity. Investors seek companies developing differentiated products that address large global markets, offer an exceptional exit potential in a reasonable period of time and promise high return on the invested capital.

Equity investment in emerging companies usually comes in stages. Defining these stages is somewhat arbitrary, and they can differ based on industry type and individual company characteristics. The chart below shows the typical types of investors found at each stage as a company goes from inception to profitability.

BUILDING A CONTINUUM FOR EARLY-STAGE VENTURE CAPITAL INFRASTRUCTURE



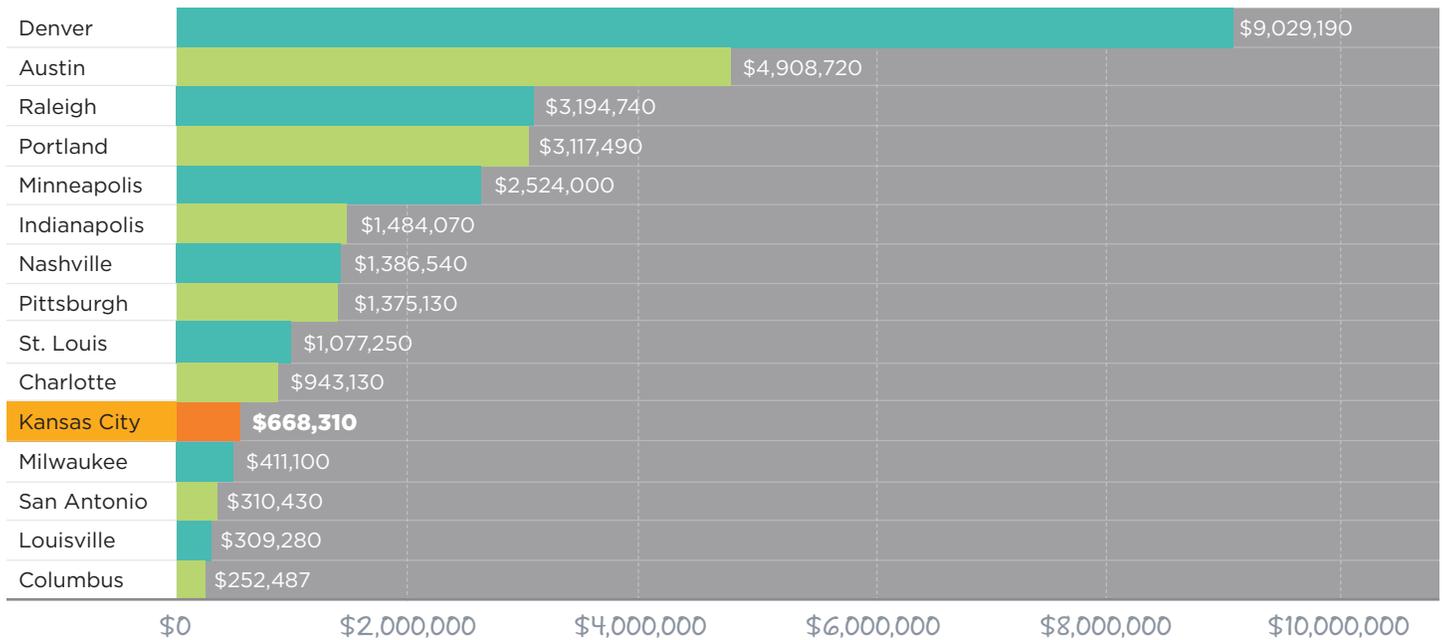
For purposes of this report, investments with series not stated directly were categorized by deal size as shown.

The Kansas City region garnered \$668,310,000 in equity investments from 2009-2014. Compared to other peer cities, Kansas City ranked only 11.

Source: CB Insights

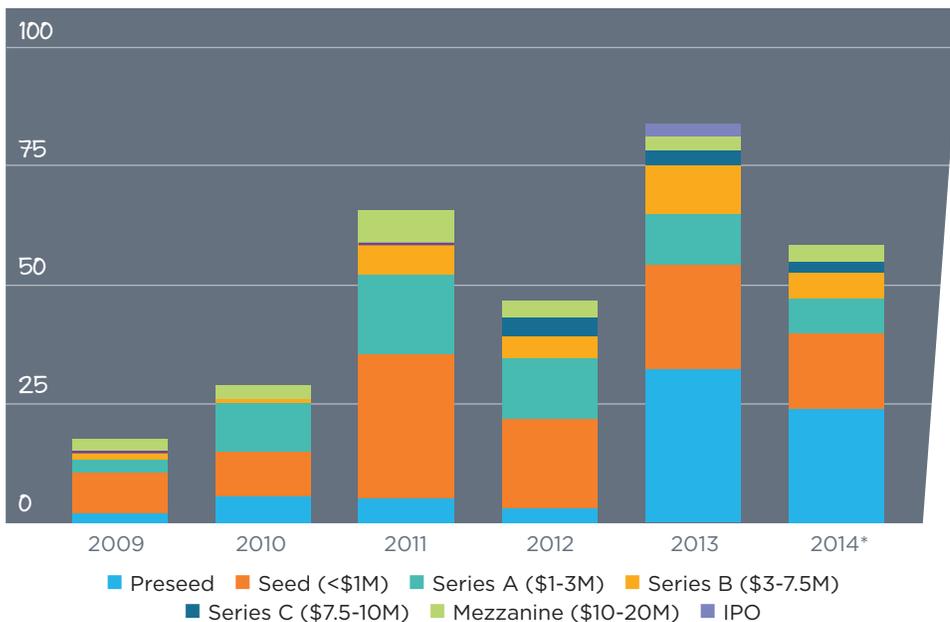
TOTAL EQUITY INVESTMENTS PER METRO (IN THOUSANDS)

2009-2014



NUMBER OF DEALS BY SERIES, BY YEAR

2009-2014



How many equity deals does Kansas City have?

The number of deals in the Kansas City region has increased since 2009. IPOs included QTS Realty, AMC Theatres and Aratana Therapeutics. Proteon Therapeutics, Inc., founded in Kansas City, completed an IPO in 2014 but by then had moved its headquarters to Massachusetts. The increase in the preseed funds in 2013-2014 is due to the entrance of accelerators in the community and the establishment of the Digital Sandbox KC proof-of-concept center.

*2014 data is underreported due to delays in reporting.

SEED CAPITAL

Plotting the location of companies that received funding in 2014 shows many of the companies receiving seed investment are located on the Kansas side of the state line.

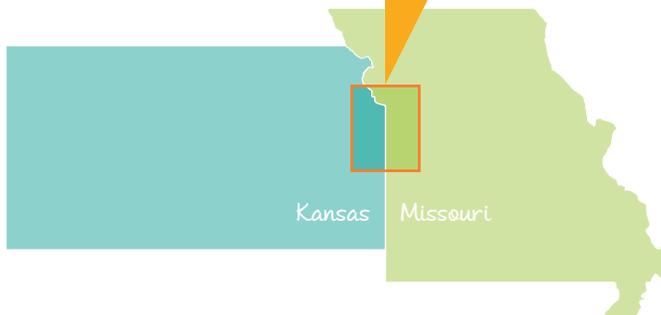
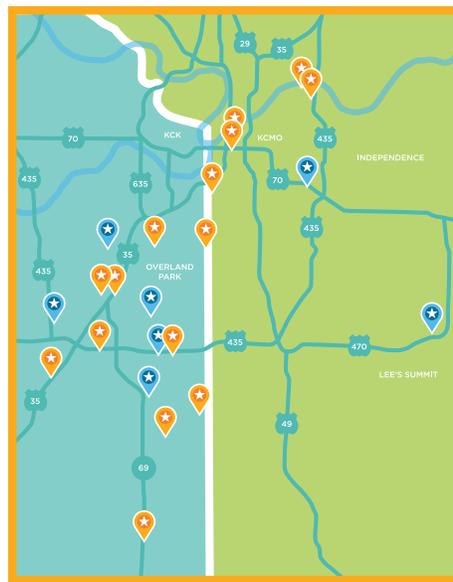
Kansas has traditionally had a strong seed capital system. The combination of Kansas Technology Enterprise Corporation (KTEC), the Kansas Bioscience Authority (KBA) and the Kansas Capital Multiplier Venture Fund through NetWork Kansas, coupled with Kansas Angel Tax Credits, provided support to many early-stage businesses.

The Kansas City region has two strong angel groups, MidAmerica Angels and Women’s Capital Connection. Started in 2006 and 2008 respectively, these groups are composed of approximately 140 angels and have averaged \$1.7 million in investment each year.

In 2014, 47 companies used \$6.1 million in Kansas angel tax credits. Thirty-six of those companies were in the Kansas City metro area. There is a strong correlation between companies receiving angel tax credits and receiving funding from MidAmerica Angels and Women’s Capital Connection.

2014 FUNDED COMPANIES

Seed and Series A

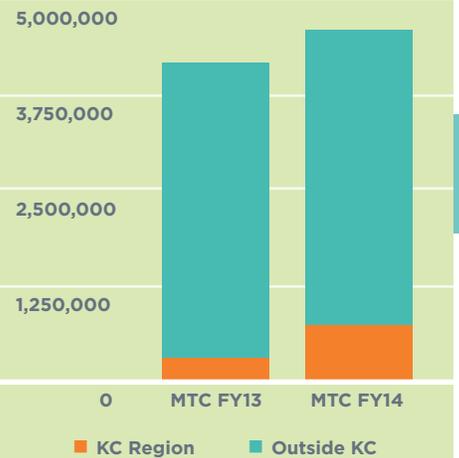


WHAT'S THE GAP?

KTEC was dissolved in 2011, and as of January 2015, KBA is no longer funding seed rounds and Kansas angel tax credits are scheduled to sunset in 2016.

In Missouri, seed funding is currently available through the Missouri Technology Corporation’s IDEA Fund TechLaunch and Seed Capital Co-Investment programs. Most of MTC funding goes to companies outside of the Kansas City area.

Value of Investment in Kansas City Region Companies by Missouri Technology Corporation



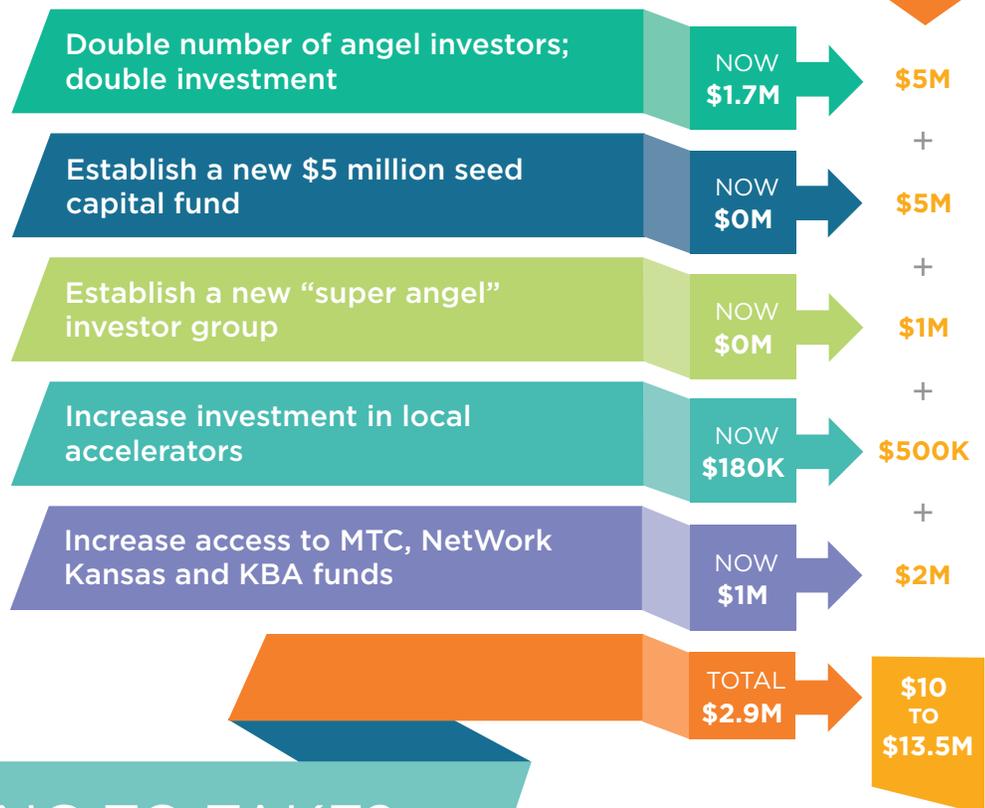
Seed Investments help take a company from proof of concept to market, build a user base and begin scaling. Investment ranges from \$250,000 to \$1 million.

Angel investors are high net worth individuals who provide capital to high growth potential startup and early-stage businesses, usually in exchange for equity or convertible debt. Angels generally invest their own money, often making investments in the range of \$5,000 to \$100,000.

Super Angels are experienced investors with greater means than angels that either invest their own capital or invest larger amounts cooperatively with other like-minded individuals. They often fill the \$250,000-\$1 million funding gap.

Increase seed capital investments to more than \$10 million per year by 2020.

- We are losing sources of seed capital in the region.
- Policy makers will be important in helping to fill this gap.
- Angel tax credits work. Companies with access have been successful in securing funding.
- Missouri Technology Corporation funds are underutilized.



WHAT'S IT GOING TO TAKE?

INCREASE SEED CAPITAL

- + Work with emerging and existing angel capital groups to increase membership.
- + Extend the angel investor tax credit program in Kansas at the current funding level; establish an angel investor tax credit program in Missouri.
- + Add capacity to organizations that support angel groups.
- + Urge ultra high net worth individuals to come together as a super angel network with a visible gatekeeper.
- + Leverage the qualified early-stage evaluation teams at local organizations to vet deals.
- + Coalesce early-stage investors into a new \$5 million seed fund to be located at an existing organization.
- + Maintain and increase seed stage investment funds that exist at the Missouri Technology Corporation, Kansas Bioscience Authority and NetWork Kansas.

INCREASE ACCESS TO SEED CAPITAL

- + Conduct networking events that increase the interconnectedness and contributions of local investors.
- + Convene an ad hoc group of attorneys, investors and resource partners to provide insight on angel investment terms and obstacles to closing angel investment deals in the region and educate the community on angel investment deal structures.
- + Develop a "train the trainer" module to educate investors, service providers and entrepreneurs in the Kansas City region about angel investing and how to seek and obtain angel investments.

VENTURE CAPITAL

In Kansas City during the past five years, most preseed investments for which investors were reported came from the Kansas City area. Nebraska shows up prominently in the early rounds, as do other Midwestern cities. East and West Coast investment sources are more prevalent in later rounds.

A variety of efforts have attempted to bring more local, later-stage dollars to area startups to help keep companies in our region. For example, Kansas Bioscience Authority (KBA) in 2009 established a “fund-of-funds” program that made limited partner investments in venture capital funds located outside the region in exchange for a pledge to establish a regional office. This encouraged several firms to establish

regional offices. However, this program was ended and most offices have closed.

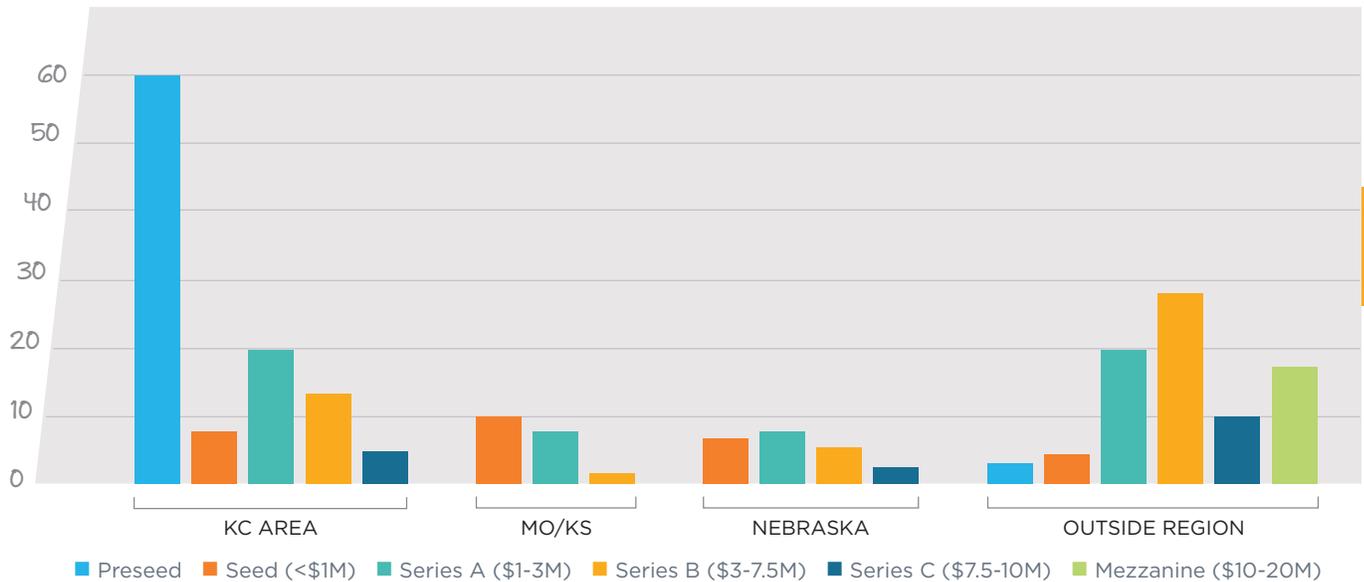
Recently Flyover Capital, a new venture capital firm, closed a \$43 million fund that seeks to make investments of \$500,000 to \$3,000,000 and is an important step in addressing this regional funding gap. To be competitive, the region needs additional funds of this size or larger headquartered in the region.

WHAT'S THE GAP?

The Kansas City region is far below national and regional peer regions in venture capital (VC) investment. This lack of capital can lead to the relocation of promising young companies to other regions.

NUMBER OF INVESTORS IN KC COMPANIES

By Location of Investors, 2009-2014

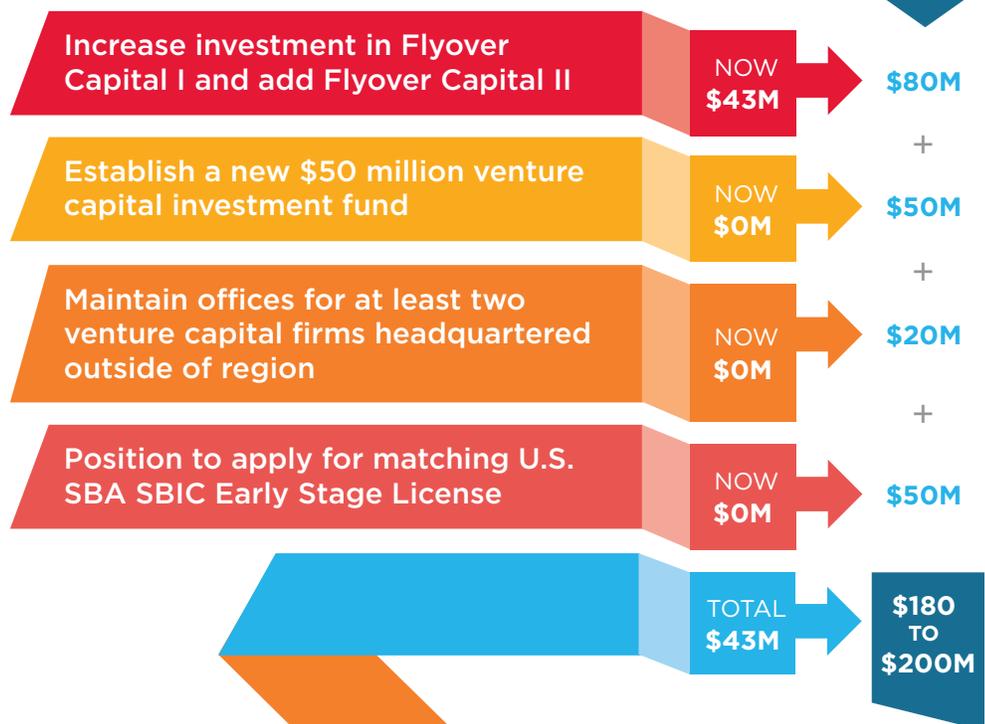


Venture Capital Firms comprise “general partners” who invest funds provided by other “limited partner” investors. Examples of limited partners include pension funds, insurance companies, foundations and ultra high net worth individuals. Venture capitalists generally make larger investments than angels, usually from \$1 million to \$10 million.

Discussions with investors indicate that additional venture capital may be forthcoming if more assistance with due diligence were available from others with experience in selecting, managing and reporting on investments. Additional early-stage capital could be developed if experienced managers could be identified and agree to take on the management of additional funds.

Double the number of venture capital investments of \$1 million-\$10 million in the Kansas City region by 2020.

- Corporate, foundation and individual investors need to understand investing at this level to coalesce around Flyover Capital and a new fund.
- Experienced fund management will be needed for a new fund.
- Underutilized federal programs through the U.S. Small Business Administration (SBA) could provide growth capital.
- Kansas City needs an experienced investment firm to take advantage of SBA funding.
- Flyover Capital is currently building an investment portfolio and provides opportunity for developing needed experience for federal funding.



Next

WHAT'S IT GOING TO TAKE?

INCREASE VENTURE CAPITAL

- + Coalesce individual, corporate and foundation investors into Flyover Capital and a new fund of \$50 million with trusted due diligence.
- + Promote entrepreneurs and regional deals to regional, national and international venture capital firms to drive investment in the Kansas City region resulting in increased capital access and the presence of a regional office for a fund headquartered outside of Kansas City.
- + Support round two of Flyover Capital or other fund to position the community with the necessary experience to apply for SBIC Early Stage License funding.

- + Increase the amount of capital available for regional investment by Kansas Bioscience Authority, NetWork Kansas and Missouri Technology Corporation. Increase the success of regional companies in accessing these statewide capital sources.

INCREASE ACCESS TO VENTURE CAPITAL

- + Convene an ad hoc group of attorneys, investors, entrepreneurs and resource partners to provide insight on venture capital investment terms and obstacles to closing venture capital deals in the region and educate the community on venture capital deal structures.

INCREASE ACCESS TO EXISTING CAPITAL

WHAT ELSE IS IT GOING TO TAKE?

The reach of an entrepreneur's social network in Kansas City is an important asset when raising funds as many connections are made through trusted referrals.

A well-connected community can improve the success of both the entrepreneur in accessing funds and the investor in finding the right deals. In the Kansas City region, market fragmentation makes it difficult for entrepreneurs to identify and access appropriate funding sources.

According to research by Ted Zollar, professor at the University of North Carolina and Kauffman Foundation Fellow, Kansas City's entrepreneurial nodes are not as connected as in more established entrepreneurial hubs in the country.

In Kansas City, entrepreneurs are not connected to investors and investors are not connected to other investors.

In this inefficient market, pathways to equity investments pass through a set of gatekeepers. These individuals and organizations have knowledge of who invests at what stage, what types of opportunities certain investors look for and how a company needs to prepare for the "pitch."

Ways to improve the efficiency of this market include better connecting investors to enhance deal sharing, encouraging more seed investors to join angel groups and investing in accelerators. Education for both entrepreneurs and investors can increase the understanding of the types of deals certain investors prefer and their desired stage of investment. The formation of additional angel investor groups, seed funds and venture capital funds that are publicly "open for business" could increase the amount of capital available.

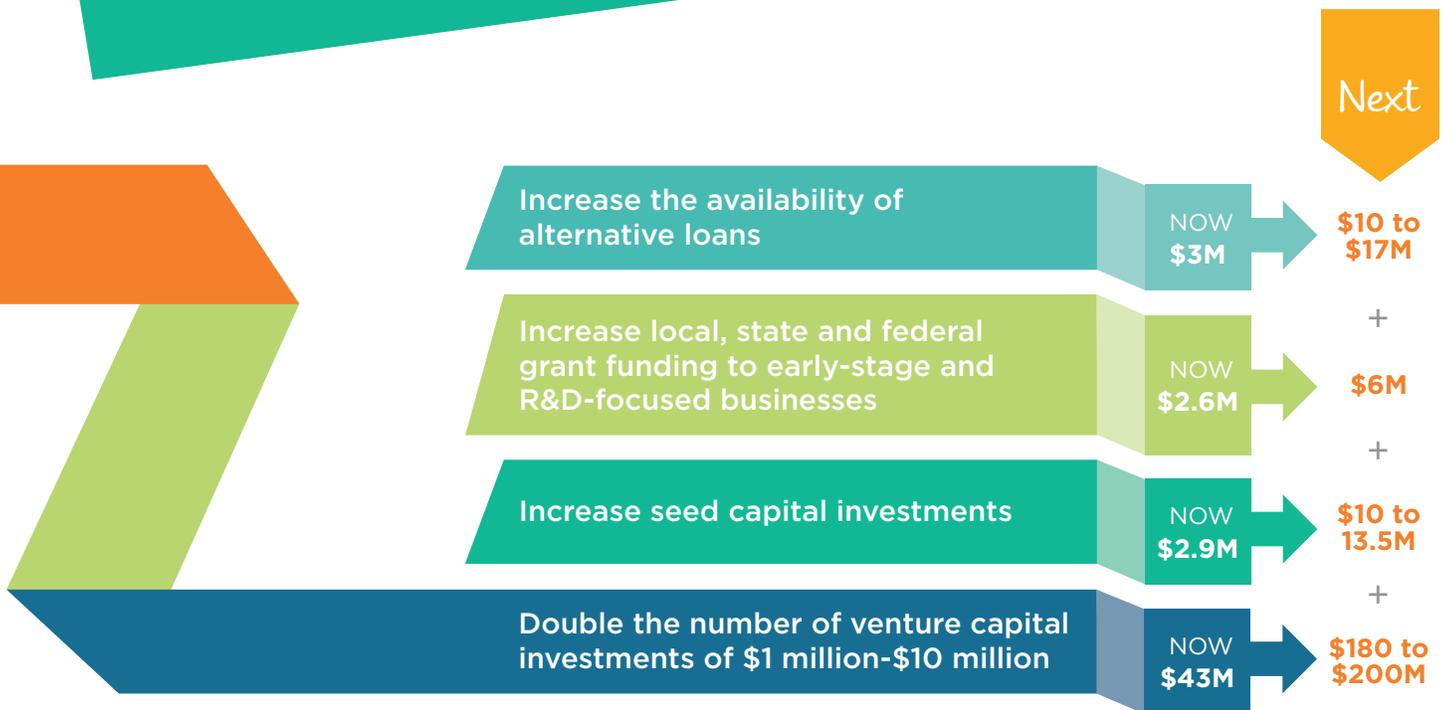


WHAT CAN WE DO?

- + Encourage regional investors to "put out their shingle" and publicize investment approaches, portfolios and investment levels.
- + Evaluate the use of technology to make deals more visible to individual investors and entrepreneurs in the region providing better visibility of who is being funded by whom to larger audience.
- + Create a systematic deal-tracking method to validate the yearly level of investments.
- + Prepare a comprehensive set of resource materials on raising capital in the Kansas City region and make it available to entrepreneurs, investors and support organizations. Promulgate best practices on deal structure and terms.
- + Work with existing organizations that provide specialized education programs that support access to capital and increase referrals to those programs through a strong awareness campaign.

“ We need to take a step today or our tomorrow will look the same. ”

— MATT CONDON, CEO and Founder
ARC Physical Therapy+ and Bardavon Health Innovations LLC
& Champion of the Greater Kansas City Chamber's Big 5 Entrepreneurship Initiative



This report was developed through a collaborative effort of the KCSourcelink network over 12 months. Many people contributed data and feedback. We thank them all. The data included is incomplete — we continue to find new information daily. For the complete report and references, please go to wecreatekc.com.



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