SOUTH CAROLINA

CAPITAL MARKET STUDY

PREPARED FOR:

THE NEW CAROLINA ENTREPRENEURSHIP TASK FORCE

DEVELOPED BY:

FABER ENTREPRENEURSHIP CENTER

DARLA MOORE SCHOOL OF BUSINESS

UNIVERSITY OF SOUTH CAROLINA

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ABOUT THE FABER ENTREPRENEURSHIP CENTER:

The Faber Entrepreneurship Center at the Darla Moore School of Business was established in 1997 following a gift to the Moore School from Tim and Karen Faber, two USC graduates and successful entrepreneurs. The center provides support for all entrepreneurial endeavors associated with the University of South Carolina.

The prime mission of the center is to encourage student entrepreneurs -- people with the ideas, the vision, and the perseverance to launch the new businesses that form the state's economic bedrock.

Among its other activities, the Faber Center:

- Facilitates and supervises the conduct of in-depth consulting and research projects by students and faculty in The Darla Moore School of Business;
- In concert with Innovista and CETi, sponsors and manages The Proving Ground business plan competition and supports incubators across the state;
- Hosts the annual conference of the National IP Task Force focused on intellectual property strategy and management for high-impact companies.

For more information on Faber Entrepreneurship Center contact Dean Kress, Associate Director, at faber@moore.sc.edu.

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Executive Summary

High-growth companies in South Carolina are creating most of the new jobs and wealth in the state. Access to capital is cited as a primary concern of the top executives for these high-impact firms and is one of the top limitations in scaling up their companies.[i] This study addresses the following two questions: (i) "Why are many of South Carolina's high-impact companies experiencing difficulties in finding and securing financing?" and (ii) "What initiatives would have the strongest impact on improving South Carolina companies' access to financing?"

Capital markets for high-impact firms are tight in all parts of the United States, not just in South Carolina. In the wake of the recent economic challenges worldwide, over 70 percent of U.S. firms cite financial woes and concerns.[ii]

South Carolina has received national recognition for some of the outstanding efforts the state has made in enhancing the business and financing environment for high-impact firms. Some examples of organizations set up to help high-impact companies in South Carolina include the following:

- SC Launch, a venture development program, operated by the South Carolina Research Authority (SCRA) that, since the inception of the program in 2006, has provided funding to 280 entities which have in turn secured $201 million in follow-on capital;
- The InvestSC program that committed $48 million in 2007 to four venture capital firms to drive investments in South Carolina, with $43 million of those funds invested to date (Appendix D);
- State/federal partnerships such as South Carolina's Small Business Development Center (SBDC) and the South Carolina Manufacturing Extension Program (SCMEP), which provide small businesses with a range of services, including assistance in obtaining financial capital;
- Angel networks which have made dozens of investments and created hundreds of jobs in South Carolina within the last five years;[iii]
- New Carolina, a public/private partnership working to increase South Carolina's economic competitiveness through a cluster development strategy (Appendix E), including strategies focused on promoting the growth of South Carolina's high-impact firms;
- The University of South Carolina, Clemson University, the Medical University of South Carolina, and other academic institutions throughout the state with comprehensive programs that provide a broad range of services to support high-impact firms.

There has been progress in improving capital access and the business environment for high-growth companies in South Carolina. However, the research conducted as a part of this study identified some key issues that are impeding access to capital and growth for these high-impact firms. Survey results, extensive interviews, and third-party data indicate that addressing the following two issues would provide the strongest improvement to capital access for high-impact firms in the current economic environment.

KEY ISSUES

Capital Markets Gap: There is a mismatch between the *types* of financing currently available and the financing needs of high-impact firms, particularly for financing technology commercialization by early-stage firms and working capital for more established, high growth firms.

The Business Environment: The culture, talent pool, business networks, and other aspects of the business environment in South Carolina are strong for developing small business but are not as strong for securing significant financing and growing these businesses into large nationally and internationally competitive firms.

This report recommends two sets of initiatives to address the key issues described above. The following recommendations are expected to have a strong, near-term, and sustainable effect on the access to capital for high-impact firms in South Carolina.

RECOMMENDED INITIATIVES

Put in place **direct financial incentives** to enhance access to capital for high-growth ventures in South Carolina.

Develop a more formalized **South Carolina business network** supporting potential and existing high-impact firms, with a focus on enhancing the business environment and improving management expertise.

Capital Markets Gap and Recommendations

The data in this report demonstrates that, compared to the historical norm, obtaining debt and equity financing remains difficult for high-impact firms since the 2007-2008 financial crisis. In the area of debt financing, banks are under shareholder pressure to provide a return on equity at more conservative risk levels. This drives them both to increase their minimum lending and collateral requirements and to lend to larger, well established firms. At the same time, there has been a severe reduction and consolidation of institutional equity investment, including venture capital. In addition, private investors have become more conservative in managing their investment portfolios. This reduces the amount of equity capital available to high potential start-up firms and existing high-impact firms, which are generally viewed as higher-risk investments than larger, more established firms. Many states are proactively addressing this reduced access to high-growth capital through state-driven incentives and enhanced regulatory environments. Based on feedback from executives from many of the state's high-impact firms and the financial community, there is solid support for similar actions in South Carolina.

The following four recommendations for direct incentives are designed to build on successful existing initiatives in the state and to address specific capital market gaps identified as a part of this study.

i. Enact an Angel Investor Tax Credit Statute. This type of legislation provides tax credits to individual high net worth investors who make stock or convertible debt investments in early-stage South Carolina-based firms and helps to encourage South Carolina investors to invest in these potentially high-impact South Carolina companies rather than the more traditional investments in real estate, mutual funds, and exchange-listed equities.

ii. Increase the annual funding cap on the SC Launch Industry Partnership Fund from its current $6.0 million level. This fund, which is managed by a unit within SCRA, consists of investment from local entities that receive a tax credit. It is widely recognized as being an excellent source of financing for high-impact ventures and could support a larger number of high-impact ventures in the state.

iii. Provide some matching funds for selected Small Business Innovation Research (SBIR) Phase II grants in order to attract federal funding for technology commercialization by in-state firms and to attract technology-based firms from other states.

iv. Revise the state's investment adviser registration/examination requirements to promote the growth of equity funds in the state.

The Business Environment and Recommendations

Investors and lenders perceive that South Carolina is strong in developing small businesses but not in scaling them up. They see the following challenges in scaling up high-impact firms in the state:

- A lack of management teams with a proven track record in scaling-up smaller, high-impact firms into larger firms serving national and international markets;[iv]
- A business culture in South Carolina that is less aggressive than most states in scaling up companies if it involves increased risk or equity dilution; and
- The need for more effective business and communication networks to enable high-impact firms to interact in an effective way with each other, anchor customers, and sources of capital.

A more formalized South Carolina business network to support potential and existing high-impact firms would enhance access to capital in a number of ways, primarily by improving the *match* between available capital and high impact firms. It would improve communication between sources of capital and high-impact firms, improve the qualifications of high-impact firms looking for capital, and have an impact on the investment and business culture to better support these high-impact firms.

The South Carolina Department of Commerce would be a strong candidate to lead and/or augment the following initiatives:

i. Support regional industry-led peer-to-peer programs to support high-impact firms and their management in a variety of ways, including business networking and education.
ii. Promote the development and expansion of private investor (angel) networks.
iii. Support regional advisor, mentor, and training programs.
iv. Conduct and support regional conferences, in collaboration with the universities and others, to connect capital providers and high-impact firms.
v. Create outreach initiatives to ensure that high-impact firms are aware of existing finance-related resources.
vi. Identify SC high-impact firms in traded sectors, and then establish outreach initiatives to specifically support the growth of these firms.
vii. Establish finance-related outreach programs for high-impact firms in targeted clusters (linked with other initiatives such as the New Carolina cluster initiatives and SCRA vertical markets initiative).

viii. Provide assistance to out-of-state and/or out-of-country, high-impact firms that are seeking information on financing options as they consider moving their North American headquarters to South Carolina.

In addition, the South Carolina Department of Commerce and the state and regional non-profit organizations that provide services targeted to high-impact firms should enhance processes for sharing information and promoting collaboration. Moreover, the State of South Carolina should continue to provide support for the federal/state partnerships that provide technical assistance to South Carolina businesses, such as the Small Business Development Center (SBDC) and the South Carolina Manufacturing Extension Partnership (SCMEP), and leverage these resources and federal matching funds to increase support for high-impact firms.

Recommendations Summary and Expected Outcomes

Putting in place the financial incentives recommended above would address the capital markets gaps directly, by making it more financially attractive to make investments in high-growth companies. It would also enhance the business environment by drawing attention to the financial and business development opportunities associated with these high-growth companies. Interviews for this report suggest that financial incentives are already having a clear, positive impact on driving more direct investments and enhancing the business environment and opportunity recognition for high-impact firms, notably through the SC Launch program among others.

Building a more formalized South Carolina network to support potential and existing high-impact firms would: (i) help address the capital markets gaps by facilitating communication and matchmaking between available capital and high impact firms, (ii) enhance the capabilities of high-impact firms through training and support, and (iii) enhance the business environment for high-impact firms by facilitating connections to talent and corporate partners.

Many of the recommendations in this study build on highly successful programs that are already operating in the state. The study does not call for the establishment of new government programs to deliver services, but, rather addresses the optimal use of resources for statewide initiatives that support the growing community of local and regional organizations that are currently providing support for high-impact firms in South Carolina.

Research Methodology

Companies that generate less than $50 million in sales and less than $10 million in EBITDA (earnings before interest, taxes, depreciation, and amortization) are experiencing the most challenges in raising debt and equity financing.[v] In order to explore how to better facilitate access to capital for South Carolina companies at different stages of growth from pre-revenue to $50 million, information for this report was gathered using three methods:

- A survey of business owners from over 100 South Carolina companies was conducted to document their perceptions and experiences related to accessing capital in South Carolina.
- Personal interviews were conducted with bankers, venture capitalists, private-equity managers, angel group directors, company owners, business consultants, attorneys, certified public accountants, investment advisors, and investment brokers. A list of organizations interviewed is in Appendix B.
- Secondary research was performed using a variety of reference sources including the academic literature, business publications, and web sites. Where appropriate, these sources are cited in the report; and a more complete list of references accessed is in Appendix C.

SOUTH CAROLINA CAPITAL MARKET STUDY

1.0 Introduction

High-impact firms are a major driver for job creation in South Carolina. For example, they accounted for only 2.7 percent of the private-sector firms in South Carolina during 2004-2008, but contributed 66.8 percent of all net employment gains during that period. Previous research indicates that South Carolina is outperforming other states in small business job creation and has stimulated employment through high-impact firms.[vi] However, the state has been less successful than most neighboring states in nurturing high-impact companies to scale up annual sales beyond about $25 million.

Top executives at high-impact firms in South Carolina have indicated that *access to capital* is a key limiting factor in their ability to scale up their companies. Two specific areas in which it is particularly challenging for these executives to access capital are for technology commercialization and for working capital during periods of fast growth.

This study addresses the following two questions: (i) "Why are many of South Carolina's high-impact companies experiencing difficulties in finding and securing financing?" and (ii) "What initiatives would have the strongest impact on improving South Carolina companies' access to financing?"

Common, high-level observations from the interviews and research include the following:

i. Capital markets are tight in all areas of the United States, not just in South Carolina;
ii. A lack of managerial and workforce experience is limiting the growth of high-impact South Carolina firms and their access to capital;
iii. South Carolina business culture does not lend itself to scaling up companies if it involves increased risk or equity dilution, and
iv. There is widespread support in South Carolina for expanding incentives to enhance access to capital for high-impact firms.

2.0 The Macroeconomic Environment

Interviews and research consistently confirmed that capital markets are generally very tight nationally and internationally. During the most recent recession, a 2012 U.S. Department of Commerce study shows that the business formation rate fell dramatically, decreasing more than 20 percent.[vii]

2.1 Debt Financing

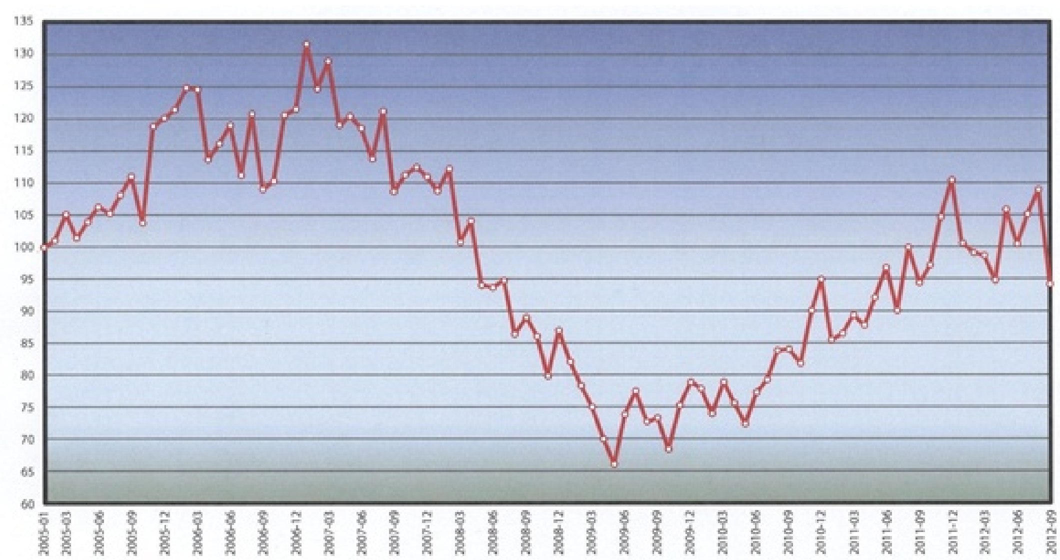
Debt is the most common type of outside financial capital used by small businesses, generally in the form of term loans and lines of credit.[viii] Demand for credit among small, growing businesses remains high, but the availability of credit products is not meeting the needs of the borrowers from their perspective.[ix,x] High-impact firms generally require higher amounts of capital than average due to the increased working capital needs associated with rapid revenue growth. The need for capital is expected to be even larger still for high-impact *manufacturing* firms due to additional fixed asset needs.[xi] In an October 2010 survey conducted by the South Carolina Small Business Development Center (SBDC) in partnership with others, over 50 percent of South Carolina small business respondents claimed that financial issues were one of their top three concerns, second only to sales and growth strategies.[xii] Of the financial issues cited in the survey, the top two issues seen as the most important overall were "cash flow management" and "where to go to obtain loans that meet business needs."

The availability of debt capital for small businesses has been severely limited since the commencement of the most recent recession. Commercial banks and asset-based lenders interviewed for the *2013 Capital Markets Report*, published by Pepperdine University, confirmed that *every* category of asset-based lending has declined in the past 12 months, ranging from a 49 percent decline in real estate loans to a 29 percent decline in accounts receivables loans.[xiii]

There are signs of a moderate loosening of the credit markets as shown in the Thomson Reuters/PayNet Small Business Lending Index graph on the following page.[xiv] However, small bank approval rates for small business loans have risen to only about 50 percent in 2012.[xv] Big banks approved 11 percent of applications for small business loans in June of this year, compared to 8.9 percent in June of 2011.[xvi]

Smaller, high-growth firms in particular are at a disadvantage in procuring debt financing. Investment bankers from across the country who were surveyed for the Pepperdine *2013 Capital Markets Report* "indicated a general imbalance between companies worthy of financing and capital available for the same. There is a reported shortage of capital for those companies with less than $10 million in EBITDA (earnings before interest, taxes, depreciation, and amortization), but a general surplus for companies with $10 million in EBITDA or more.”[xvii] This is influenced in large part by the current return on equity targets of banks and the very low tolerance for risk. The banking managers are incented to bundle credit products and lend more money to larger, well-established firms.[xviii] A representative of a major bank interviewed for this report stated that, while asset-based loans are obtainable, the minimum loan size is usually $7 million and the companies that are successful in obtaining loans must have $15 million to $20 million in inventory and/or accounts receivable.

Chart 1: Thomson Reuters/PayNet Small Business Lending Index



It can be challenging for high-impact firms to meet the “keys to credit success” identified by Federal Reserve Bank research, which include: (i) business longevity of at least five years, (ii) ability to demonstrate a capacity to generate positive sales/revenue growth, or (iii) ability to use retained earnings to fund their needs.[xix] The National Federation of Independent Businesses (NFIB) and Federal Reserve Bank both found that many small businesses (37 percent to 40 percent in 2010) are not even applying for credit because of reasons such as: (i) the need for capital was obtained from friends and family or retained earnings, (ii) a perception that they would not qualify for financing, preventing them from applying, and (iii) the application processes and paperwork, especially for government sponsored programs, was too burdensome.[xx]

2.2 Equity Investment

Interviews performed in 2011 by Booz Allen Hamilton for the National Institute of Standards and Technology (NIST), revealed that many small manufacturers are not able to secure debt financing and turn to private equity placements or sources of capital provided through family and friends.[xxi] This form of capital is particularly appropriate for high-impact firms that cannot secure credit due to a lack of collateral and/or retained earnings. This is an especially important issue for manufacturers and some knowledge economy firms who may require significant up-front capital investments.

As with debt financing, equity investment has been severely limited since the commencement of the most recent recession. "Access to capital is an issue everywhere," noted one venture capitalist, who was interviewed as a part of this study. He went on to observe that the venture capital industry is consolidating dramatically. Another interview participant noted that the private-equity market was as "difficult as it has ever been." It was stated several times that the venture capital market continues to consolidate, a fact that is confirmed by the National Venture Capital Association. The number of active venture capital firms in the U.S. in 2000 was 1,022 and had dropped to 462 by 2010.[xxii] According to Ernst & Young, U.S. venture funds increased their total assets by 5% from 2010 to 2011, reaching $16.2 billion and a median fund size of $140 million. However, dramatic consolidation to top-tier funds continues and only 135 funds closed in 2011, down 12% from the year before.[xxiii] Geographically, venture capital investments are being concentrated in traditionally strong areas for the venture capital industry such as the Silicon Valley and New York areas with a greater decrease in activity in the Southeast.[xxiv]

Equity investments by high net-worth individuals ("angels") are even more limited than institutional venture capital compared to demand.[xxv] This has a material impact on potential high-impact firms because, although venture capital supports the rapid growth of many of these firms, it is early stage and seed capital provided by private investors that often determines whether they are formed in the first place. Early private investment is often used to help an early-stage company survive the "Valley of Death," the period of negative cash flow in which a company attempts to establish its initial business.[xxvi]

2.3 Grants

Grants for businesses are relatively rare. However, for qualifying businesses, there are opportunities to secure non-dilutive "free money from state, county and city governments, as well as private foundations and corporations."[xxvii] The dominant grant program for businesses is the federal Small Business

Innovation Research (SBIR) program, which is coordinated by the U.S. Small Business Administration. The program encourages small businesses to engage in research and development that has commercialization potential.[xxviii]

A similar program, the Small Business Technology Transfer Program (STTR), uses a comparable approach to the SBIR program to expand partnerships between small businesses and research institutions in the United States. When the term "SBIR program" is used, it often refers to both SBIR and STTR funding.

"The mission of the SBIR program is to support scientific excellence and technological innovation through the investment of Federal research funds in critical American priorities to build a strong national economy."[xxix]

The program is split into three phases:

- ***"Phase I.*** The objective of Phase I is to establish the technical merit, feasibility, and commercial potential of the proposed Cooperative Research or Research and Development (R/R&D) efforts and to determine the quality of performance of the small business awardee organization prior to providing further Federal support in Phase II. SBIR Phase I awards normally do not exceed $150,000 total costs for 6 months.
- ***Phase II.*** The objective of Phase II is to continue the R/R&D efforts initiated in Phase I. Funding is based on the results achieved in Phase I and the scientific and technical merit and commercial potential of the project proposed in Phase II. Only Phase I awardees are eligible for a Phase II award. SBIR Phase II awards normally do not exceed $1,000,000 total costs for two years.
- ***Phase III.*** The objective of Phase III, where appropriate, is for the small business to pursue commercialization objectives resulting from the Phase I/II R/R&D activities. The SBIR program does not fund Phase III projects. However, some federal agencies provide non-SBIR follow-on funding for selected R&D or production contracts that result in the deployment of products or services for use by the U.S. government."[xxx]

Since the SBIR program was established in 1982, over 21,000 firms have been involved in SBIR grants, including some now well-known firms such as Qualcomm, Genzyme, and Amgen. Over 90,000 projects have been funded and approximately 7,500 firms are currently active in the program. To date, almost $36 billion have been expended and the annual commitment is $3 billion. The firms may be small when they receive the SBIR funding, but "their ideas, capabilities and achievements are anything but small:

- Collectively these SBIR funded firms have issued over 90,000 US patents - about 10-12 every day - and are maintaining a very creditable citation rate and substantial international holdings.
- Almost 15 percent of all venture capital in the U.S. in the past decade has been invested in SBIR-involved firms.
- Over 2,500 large and mid-sized corporations have various types of working relationships in place with SBIR-involved firms.
- Almost eight percent of the firms have been acquired."[xxxi]

Currently in South Carolina, when a firm receives an SBIR Phase I grant, that firm is eligible for a matching grant of up to $50,000 through a program administered by SC Launch. The purpose of the matching program is to foster job creation and economic development in South Carolina by increasing the competitive position of South Carolina small businesses attracting SBIR and STTR grant funding and to provide an advantage for Phase I award-winning companies who compete for the more substantial Phase II program. The goals of the matching program are to:

- "Increase the number of applications for Federal research dollars submitted by South Carolina small businesses;
- Help South Carolina companies bridge the funding gap period between the final Phase I payment and the first Phase II payment in the Federal SBIR/STTR Program;
- Increase the intensity of the research conducted under Phase I, making South Carolina small businesses more competitive in the competition for Phase II funds; and
- Encourage the establishment and growth of high-quality, advanced technology firms in the State of South Carolina."[xxxii]

3.0 Managerial and Workforce Experience

The reason cited most often by equity investors for not making equity investments in potential high-impact South Carolina firms was a lack of appropriate management talent.[xxxiii] Specifically, these investors noted that there are a limited number of executives in South Carolina who have experience in scaling a high-impact firm. Therefore, they perceive a bigger challenge, and higher risk, associated with forming high-performance management teams for high-impact firms in the state. Similar concerns were expressed by banks and other lenders. More urban areas were viewed as having a competitive advantage in general for sourcing management talent for high-impact firms.

The inability of companies to hire experienced employees was also identified in a significant portion of the executive interviews as a barrier to growth and a barrier to accessing capital. As one interview subject put it, there is a “dramatic shortage” of people to work. This is not limited to management and knowledge workers, but is an issue with the broader labor force with one executive claiming that “blue collar workers are the professionals of yesterday.”

A Kauffmann Foundation poll of entrepreneurs attending the Inc. 500/5000 Conference and Awards ceremony in September, 2011, supports these South Carolina interview results. According to that poll, “Finding qualified people is the biggest obstacle standing in the way of continued growth for 40 percent of companies.”[xxxiv]

4.0 South Carolina Business Culture

The majority of investors, lenders, service providers and executives that were interviewed for this study observed that most South Carolina firms are averse to giving up equity to procure financing under standard market terms. Also, they observed that South Carolina firms tend to be more conservative in leveraging debt financing. As one respondent explained, companies reach a certain level of sales and profits and are reluctant to “double down” (i.e., take additional risk or make additional investments for the opportunity of realizing a higher return). Relative to other states, operating companies in South Carolina generally pursue a path of controlled, slower, more manageable growth, which in general does not require extensive external financing. This is consistent with the traditional industries in South Carolina such as farming, manufacturing, banking, healthcare, real-estate, tourism and other industries that have focused on cash flow and/or have relied on physical assets that could serve as debt collateral with a focus on the return on assets.

This business environment provides a local investment approach, management expertise, partnership structures, service providers, and general ecosystem well suited to support a traditional small business but not experienced in supporting high-impact firms. High-impact, South Carolina companies tend to “cash out” when they reach a valuation in the $25M - $50M range rather than attempting to scale the company larger. Evidence of this can be seen in a recent analysis of information about acquisitions in the state. According to that analysis, since the year 2000, over 150 South Carolina firms have been acquired by firms outside of the state. During that same period, less than 80 acquisitions of other firms were made by South Carolina firms. [xxxv]

5.0 Survey Results

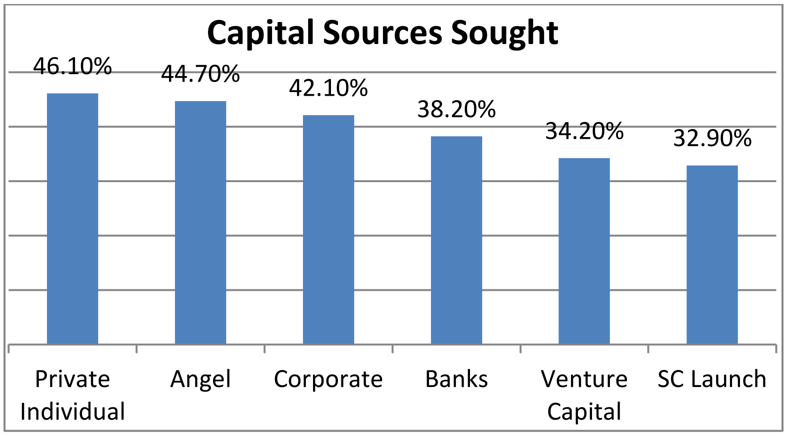
The companies surveyed posted revenues in 2011 of from less than $250,000 to over $100 million and were headquartered in 17 different counties in South Carolina. Sixty-nine percent of the companies indicated that they were currently seeking capital from outside sources. For those companies, the source cited most often as a target was a private individual investor (other than friends and family), with 46 percent of companies stating that private individual investment was being pursued. The next most sought sources, in order, were angel investor groups, corporate strategic investors, banks or credit unions, venture capital funds, and SC Launch.

Profile of Survey Respondents

The business owners who responded to the survey primarily represented small, high-growth companies that sell products/services outside of South Carolina. For example:

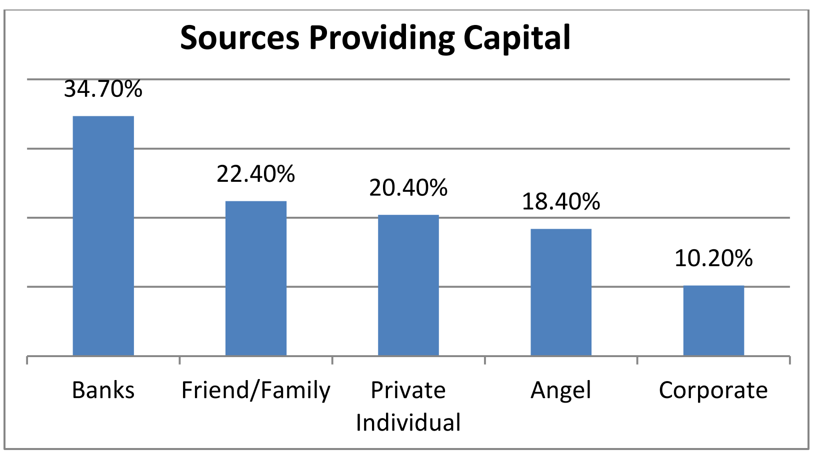
- More than 60 percent employed 10 or fewer employees at the time of the survey and almost 60 percent had less than $1 million in annual revenue;
- During the last three years (2009-2011), more than 40 percent experienced annual sales growth of more than 10 percent per year, and only 8 percent experienced a decline;
- Fifty-seven percent reported that more than half their sales were generated outside of South Carolina; and
- The top three industries represented were – manufacturing (18 percent), information technology (14 percent), and professional/technical services (13 percent).

Chart 2: Capital Sources Sought by Survey Respondents



Less than half of the companies looking for capital, 47 percent, were successful in obtaining outside capital in the past six months. This is consistent with national data.[xxxvi] Representing 35 percent of the successful funding events for survey companies that did obtain capital, the most common source of capital was banks or credit unions. Other sources cited, in order, were friends and family, private individual (other than friends and family), and angel investment.

Chart 3: Sources Providing Capital to Survey Respondents



The majority of surveyed companies did not believe that debt or equity capital were readily available for growing companies in South Carolina. When asked to agree or disagree with the statement, “Loans for growing companies are readily available in South Carolina,” 60 percent disagreed or strongly disagreed. Only 17 percent agreed or strongly agreed with that statement. As to the statement “Equity capital for growing companies is readily available in South Carolina,” 65 percent disagreed or strongly disagreed. The most difficult type of financing to acquire, according to the survey results, is financing for commercializing a new or improved product. Over 53 percent of the respondents – especially the owners of very early-stage firms - stated that it was difficult or extremely difficult to finance such a commercialization.

The survey respondents were asked to comment on what the major barriers were confronting their company in securing capital. Here are a few of the comments:

- "Banks are the only reasonable option and they are not reasonable."
- "We are a high growth (100%+ annually for four years) company that has more than $10 million in annual revenue and positive EBITDA, yet traditional bank financing, though available, is still time consuming (meaning 4-6 month process). We are a tech company with little to no hard assets and even though banks got burned lending on hard assets, that still seems to be the preference versus lending to cash flow producing companies."
- "There is not a real community of angel investors, venture capitalists, and investment bankers in this state. What little we have are unfamiliar with and uncomfortable with genuine technology and modern manufacturing."
- "Insufficient funding sources in South Carolina and unwilling sources outside of South Carolina."

6.0 Recommendations

This report recommends two sets of initiatives to address the key issues identified in this study: financial incentives and business networks. The following recommendations are expected to have a strong, near-term, and sustainable effect on the access to capital for high-impact firms in South Carolina.

6.1 Financial Incentives Targeted to High-Impact Firms

The following four recommendations for direct incentives are designed to build on successful existing initiatives in the state and to address specific capital market gaps identified as a part of this study.

6.1.1 Angel investor tax credits

RECOMMENDATION #1	**Enact an angel investor tax credit statute.**

A strategy that has been used to incentivize investments in business has been to provide tax credits to angels who invest in seed, start-up, or expansion ventures. "An angel is a wealthy individual willing to invest in a company at its earlier stages in exchange for an ownership stake, often in the form of preferred stock or convertible debt."[xxxvii] Angel investor tax credits are state-specific credits as angels are allowed to take a certain percentage of the investment as a credit on the state income tax. "Nearly half the states in the country offer such credits, and several more are actively considering putting tax credits for angel investment in place," according to the Wall Street Journal.[xxxviii] The National Advisory Council on Innovation and Entrepreneurship (NACIE) under the United States Department of Commerce issued a report in June 2011 recommending a similar tax credit at the federal level.[xxxix]

There was near unanimous support in our interviews for South Carolina legislation to provide incentives for angel investors and angel investor networks. According to professional angel investment managers in South Carolina, less than one-half of one percent of qualified investors in South Carolina is involved in angel investing, or other similar investments (e.g., venture capital).[xl] One angel investment manager said that South Carolina investors are much more likely to be in real estate or the stock market. It is believed that a tax credit incentive would both provide a direct financial reason for investors to more actively engage in angel investments as well as draw more attention in South Carolina to early-stage investments in high-impact firms.

The amount of the tax credit in various states has ranged from a low of 10 percent of the investment (New Jersey) to a high of 100 percent of the investment (Hawaii).[xli]

Other provisions of the various tax credit legislations may include a cap on how much tax credit a single investor may claim, and a cap on the total amount of tax credits issued by the state. For instance, in Georgia, the tax credit rate is 35 percent. The tax credit cap per investor is $50,000, and the annual tax credit cap for the state is $10 million.

It is broadly observed that the effect of these programs is to increase angel investing, increase the number of start-up businesses, and increase the number of jobs in the state. Wisconsin passed a tax credit bill in 2005. Since that time, the number of angel groups in the state has increased from 4 to over 20, a much faster growth rate than most states. The Wisconsin Economic Development Corporation reported in February of this year that 125 companies had received investments since the angel tax credit legislation went into effect. Those companies had created 930 jobs with an annual average salary of $83,000.[xlii] In Minnesota, 67 businesses received $28 million in funding in the first six months of a program granting a 25 percent tax credit to angel investors.[xliii]

For five of the approximately 22 states that currently offer angel investment credits, the following table lists the tax credit rates, the maximum dollar amount of credit for each angel investor, and the total dollar amount of credits available to all investors during one tax year.

Georgia, North Carolina, and Virginia are geographically close to South Carolina and serve as comparable states in the Southeastern region. Minnesota and Wisconsin were discussed above as states that have enacted tax credit legislation and demonstrated increased levels of angel investing.

	Tax credit rate	**Tax credit cap per investor**	**Annual tax credit cap per state**
Georgia	35%	$50,000	$10 million
North Carolina	25%	$50,000	$7.5 million
Virginia	50%	$50,000	$3 million
Minnesota	25%	$125,000	$12 million
Wisconsin	25%	$125,000	$3 million

6.1.2 SC Launch investments

RECOMMENDATION #2	Increase the annual tax credit cap on the SC Launch Industry Partnership Fund.

There was wide agreement concerning the effectiveness of the SC Launch program and very strong support for not only continuing their programs, but expanding them. Among other services, such as mentoring support for South Carolina knowledge-based businesses, SC Launch provides funding in the form of grants, loans, and equity investments to qualified companies. Since its inception in 2006, SC Launch has provided funding to 280 entities, and those companies have secured $201 million in follow-on capital, after receiving SC Launch funding.[xliv]

"Funding in the form of grants, loans and equity investments is available to qualified companies in the SC Launch program. Grants may be awarded to help defray the cost of business services such as legal, financial, marketing and intellectual property protection. Grants such as the SBIR/STTR grant program are also intended to further the applied research and development efforts and better position a company for future growth. A company that has met certain milestones and due diligence requirements may be asked to go before the SC Launch Inc. Board for approval of a loan or equity investment. The SC Launch funding process prepares its clients for the rigors involved in acquiring follow-on funding from angel investors and venture capital firms."[xlv]

Examples of SC Launch Success Stories

SC Launch has helped to build a significant number of new South Carolina technology-based businesses. Five examples are cited below:

- Immunologix delivers on a key unmet need, in fully realizing the vast clinical and market potential of antibody-based therapeutics.
- ISI Technology is commercializing a new-technology tankless electric water heater. The value proposition is 40% energy savings and 10% water savings at no incremental cost.
- Sabal Medical is a medical technology company that designs and manufactures medication distribution systems to increase patient safety and workflow efficiency.
- Zipit is a premier provider of wireless device software and infrastructure software for connected and managed devices.
- CreatiVasc Medical develops innovative medical devices for the vascular access and dialysis field. The company manages products from concept to prototype through lab, animal and human clinical trial testing.

Convertible debt (resulting in equity) investments from SC Launch are made from the Industry Partnership Fund. A South Carolina taxpayer who contributes to the Industry Partnership Fund may receive an income tax credit for contributions he or she makes to the fund.[xlvi] Currently, the total amount of tax credit that can be claimed by all contributors to the fund combined is $6 million which, in practice, keeps the annual fund size to about that amount. The investments made by SC Launch out of the Industry Partnership fund are generally the first institutional investment that a high-impact company receives. It is often instrumental in accelerating the growth of these companies. The fund is still relatively young, about six years old, but indications are that the fund is outperforming the venture capital industry as a whole. There is strong demand from high-impact firms in South Carolina for this type of funding and increasing the annual tax credit cap for the Industry Partnership Fund would be expected to increase the fund size and amount of early stage financing available to high-impact firms. This would be expected to accelerate the growth of a larger number of potential and existing high-impact firms and make them stronger candidates for follow-on investment.

6.1.3 SBIR grants

RECOMMENDATION #3	Provide matching funds for selected SBIR Phase II grants.

As stated earlier, SC Launch administers a matching program for firms which have received SBIR Phase I funding, providing up to $50,000 of matching funds. Currently, no matching program is available for South Carolina firms that receive SBIR Phase II funding. Two states, Kentucky and Oklahoma, do offer matching programs for firms that receive Phase II funding. Kentucky's program, in addition to providing up to $150,000 in matching funds for Phase I funding, also provides "up to $500,000 per year, but for no more than two years, for Phase II SBIR/STTR grants from any of the participating federal agencies."[xlvii] In Oklahoma, the state has discontinued matching of Phase I funding to be able to fund Phase II matching. The Oklahoma program provides a maximum matching amount of $25,000. The same state office, the Oklahoma Center for the Advancement of Science and Technology (OCAST), also provides expertise to assist firms in developing and preparing the SBIR and STTR applications.

Both states make use of the matching funds programs in recruiting firms to their states. A representative of OCAST noted that the matching funds program, as well as information about the SBIR/STTR training that is available, is included in the recruiting package used by the Oklahoma Department of Commerce. Kentucky makes very aggressive use of the Phase II matching in recruiting firms and has been very successful in these efforts. The Kentucky Science and Technology Corporation (KSTC) administers the program and a representative of KSTC reported that since 2007, when the Phase II matching program began, over $32 million in matching funds has been awarded to 70 companies. Of those 70 companies, 18 moved to Kentucky from other states after being awarded the matching funds. Companies outside of Kentucky are able to apply for the matching funds. If the matching funds are awarded to a company outside of Kentucky, that company has 90 days to move the company's headquarters into the state. Six million dollars per year is budgeted by the Kentucky state government specifically for Phase II matching funds and the program was recently reauthorized for two more years. KSTC also offers workshops and other support for preparing the SBIR and STTR applications.

It is recommended that South Carolina investigate matching grants for selected Phase II SBIR grants and consider allocating state funds to support SBIR outreach programs that are designed to recruit SBIR applicants and assist them in obtaining Phase II grants. The programs should be developed as a partnership among the three research universities in the state, which are in a strong position to provide a range of support for these grants.

6.1.4 Investment adviser registration/examination requirements

RECOMMENDATION #4	**Revise the state's investment adviser registration/ examination requirements to promote the growth of equity funds in the state.**

Recently enacted federal statutes regulate equity funds with assets exceeding $150 million. This leaves the regulation of smaller funds to the states. South Carolina's current regulations subject equity firms to the same registration and examination requirements that are designed for financial advisors that serve the retail market of individual and business investors. Many states either have already adopted or are in the process of adopting more specific regulations that are more appropriate for overseeing the equity fund industry, which attract funds from high net-worth individuals and other more sophisticated investors. States that do not adopt regulations that are more appropriate for the equity fund industry will be less competitive in attracting equity fund operations.

Revising South Carolina's investment adviser registration/examination requirements would promote the growth of equity funds in the state. If South Carolina develops a balanced set of investment advisor regulations that protect investors without imposing unnecessary and wasteful regulatory burdens on equity fund managers, the state can expect to expand the base of local venture capital and private-equity funds. This would increase the dollar amount of capital available to high-impact South Carolina companies.

As a result of conversations that were conducted in this study, the Corporate, Banking and Securities Council of the South Carolina Bar Association will draft recommendations that are more focused on the equity fund industry. These recommendations will be submitted to the Securities Division of the South Carolina Attorney General's Office during the first quarter of 2013.

6.2 A More Formalized Network to Support High-Impact Firms

RECOMMENDATION #5	**Have the South Carolina Department of Commerce assume a stronger facilitation role in supporting collaborations that promote the growth of high-impact firms in the state.**

A more formalized South Carolina business network to support potential and existing high-impact firms would enhance access to capital in a number of ways, primarily by improving the *match* between available capital and high impact firms. It would improve the communication between sources of capital and high-impact firms, improve the qualifications of high-impact firms looking for capital, and have an impact on the investment and business culture to better support these high-impact firms. Business networks also improve the overall productivity of high-impact firms and improve their ability not only to secure financing but to grow their business more aggressively.[xlviii] The South Carolina Department of Commerce would be in a strong position to facilitate this type of business network.

All of the initiatives recommended in this section would build on the strengths within state's growing community of local and regional organizations that are providing entrepreneurial support services. Especially within the last six years, the number of entrepreneurship initiatives that are affiliated with the state's universities, regional chambers of commerce, and non-profit organizations has increased the level of services dramatically and has become more sophisticated. The initiatives outlined in this section should be developed and implemented in collaboration with these local and regional organizations.

6.2.1 Peer-to-peer networks

The most effective support networks for high-impact firms are industry-led, peer-to-peer networks. These are best developed by creating locations and physical spaces that facilitate regular interaction of people to exchange ideas and know-how, and to create new responses "before their coffee gets cold."[xlix] Companies depend on an external ecosystem of customers, inventors, designers, entrepreneurs, financiers, lawyers, and others to support their efforts. A strong, local group of these peers can have a dramatically positive effect on a high-impact firm but requires finding and/or developing locations where this type external ecosystem exists. Peer-to-peer networks can also be established virtually online, via telepresence, or through conferences and other events. The key success element of these peer-to-peer networks is the ability to quickly develop and leverage strong personal relationships for the advantage of the company. The SC Department of Commerce and others should work to facilitate physical and virtual environments where executives of high-impact firms in South Carolina can engage their peers in a rich and relevant ecosystem.

6.2.2 Private investor networks

Private investor (angel) networks bring together groups of people, typically between five and fifty in South Carolina, to collaboratively evaluate and invest in high-impact firms. Many of these networks have members who are experts in various fields and can leverage their knowledge and experience to more thoroughly evaluate a potential investment and then assist high-impact firms once an investment is made. The investments made by private investors in high impact firms typically take five to seven years to become liquid. Investors without a background in these types of investments are often deterred by this long investment cycle. However, investor networks that are able to invest with this horizon, and perform good due diligence, very typically return greater than 20 percent as an annual rate of return.[l] Private investment networks provide an important source of capital for high-impact firms and can yield very good returns for investors. However, there are very few of these private investor networks in South Carolina. The Upstate Carolina Angel Network (UCAN) and others have been working to increase awareness, participation, and collaborations associated with private investor networks. There are about 120,000 accredited households in South Carolina that would qualify to participate in private equity (angel) investments either individually or in collaboration with a network. Less than one-half of one percent of these households is making these kinds of investments today.[li] The Department of Commerce and others should work to increase the participation in private investment networks through education, incentives, and facilitating investment collaborations through both physical and virtual environments.

6.2.3 Advisor, mentor and training programs

Access to advisors, mentors, and training are key components in helping high-impact companies that are seeking capital. According to a recent Gallup poll, Americans who have a mentor are ten times more likely to have a plan to start a business in the next 12 months vs. those without a mentor.[lii] The relatively high percentage of entrepreneurial intent among those who have access to a mentor suggests that mentors play an important role in the early-stage development of companies. Without advisors and mentors, the executive of an early-stage firm may find it difficult to access resources, build networks, and create partnerships that help the enterprise grow.

There are tangible and intangible benefits of having advisors and mentors. Gallup's consulting work with more than 1,000 entrepreneurs in Mexico and the U.S. found that mentors increased the confidence, self-awareness, and business thinking of these entrepreneurs.[liii] The ability to accelerate the development of the executive management in a high-impact firm, through advisors and mentors, can accelerate the development of the entire firm itself. The polls cited above strongly indicate that establishing mentor and advisory relationships boosts the creation, survival, and growth of high-impact firms.

Similarly, training has a positive impact on financial margins, particularly in smaller firms.[liv] As discussed in Section 3 of this report, finding and/or training qualified people is one of the strongest limitations to growth for Inc. 500 firms.

The Department of Commerce and others should facilitate the engagement of advisors, mentors, and training for high-impact firms in order to help these firms in general, and specifically to help them in accessing capital.

6.2.4 Match-making conferences

Several organizations in South Carolina facilitate relationships between high-impact firms and various potential customers, suppliers, and partners. Many of these organizations host excellent conferences held throughout the state that focus on various aspects of education and match-making for high-impact firms. Two examples include the Innoventure conferences, which are widely recognized as an excellent forum for high-impact firms to network with peers and potential partners, and EngenuitySC's Ignite conference which is widely recognized as bringing attention to the importance of entrepreneurship and high-impact firms in South Carolina. There are several other conferences that have had a dramatic positive impact on helping high-impact firms network within the state. A series of regional conferences to connect capital providers and high-impact firms should be supported by the SC Department of Commerce and the state of South Carolina as an important tool for networking and outreach.

The SC Department of Commerce already is conducting regional "Lender Matchmaker" conferences that help a broad range of small businesses that are interested in learning how to be more effective in obtaining traditional bank financing. A more sophisticated version of the program specifically for South Carolina's high-impact firms that have less than $50 million in annual revenues and less than $10 million in EBITDA would help significantly. The invitation-only meetings should focus on opportunities to increase asset-based lending, convertible debt, and equity-based financing.

6.2.5 Outreach initiatives

The majority of companies surveyed for this report did not believe that debt or equity capital was readily accessible for growing companies in South Carolina (see section 5). Similarly, the debt and equity providers generally acknowledge that it is more difficult for high-impact firms throughout the nation to secure financing than it has been historically (see section 2). The SC Department of Commerce and others should create online outreach initiatives to ensure that high-impact firms are aware of as many existing finance-related resources as possible to increase the access to capital for these firms.

6.2.6 Traded sectors and clusters

Firms concentrated in regional clusters with ready access to relevant education, training, finance and marketing services, anchor customers, suppliers, and partners experience higher rates of job and wage growth than comparable firms not embedded in such clusters. Industry clusters create a repository of specialized expertise, technology, institutions, and talent in the given field. This increases access to talent, R&D capabilities, venture capital, and a wide range of relationships for high-impact firms. Clusters are important to states and regions because strong clusters are associated with higher growth in both employment and wages, ideal conditions for innovation and entrepreneurship, and strong survival rates among early-stage, high-impact firms. A good strategy to drive access to capital for high-impact firms, and to increase economic growth overall, is to pursue the development of clusters, particularly in high-wage, high-growth industries.[lv] In coordination with other initiatives in this area, such as the New Carolina cluster initiatives and SCRA vertical markets initiative, the SC Department of Commerce should explore initiatives specifically to support high-impact firms specifically within the various traded sectors and clusters in South Carolina.

6.2.7 Out-of-state firms

There is conflicting data in the literature regarding access to capital as an incentive in recruiting high-impact firms from out of state. However, many neighboring states have implemented recruiting initiatives that leverage access to capital as an incentive. During the course of this study, several international, high-impact firms indicated that they were looking for a location for a North American headquarters in order to better access U.S. markets and were considering South Carolina as one option. The SC Department of Commerce and others should consider expanding the initiatives proposed in this study to complement a recruiting strategy for out-of-state and/or out-of-country, high-impact firms as they consider establishing a North American headquarters in South Carolina.

6.2.8 Small Business Development Center

RECOMMENDATION #6	Continue to support SBDC initiatives.

The South Carolina Small Business Development Center (SC SBDC) assists entrepreneurs and small businesses throughout all 46 counties by providing no cost business consulting and affordable training programs. The network includes 17 service centers located in both rural and urban areas to ensure easy access. These centers are staffed by about 45 experienced, trained professionals.

While the SC SBDC provides assistance on a wide variety of business issues, one of the key services is consulting and training to help obtain financing. SC SBDC consultants know both lender and SBA programs, and they work privately with clients to help them:

- Understand what types of financing are available
- Learn about the criteria of lenders in order to qualify for their loans
- Discover how to become a qualified applicant
- Prepare good loan application documents
- Improve overall fiscal management of their businesses

The SC SBDC assistance to entrepreneurs and small business owners helps these clients obtain and average of $35 to $50 million of financing annually. It is recommended that the SC Department of Commerce and others coordinate the initiatives recommended in this report with the existing programs of the SBDC.

6.2.9 *South Carolina Manufacturing Extension Program*

RECOMMENDATION #7	Continue to support SCMEP initiatives.

The South Carolina Manufacturing Extension Partnership (SCMEP) is a private non-profit group whose mission is to utilize a "strategic, hands-on, partnering approach to help South Carolina companies improve their competitiveness, performance and profitability." An affiliate of the National Institute of Standards & Technology (NIST), the SCMEP operates under the U.S. Department of Commerce to promote innovation and industrial competitiveness. The national MEP program was established through legislation introduced by South Carolina Senator Fritz Hollings in 1989, and the first three centers were located in South Carolina, Ohio, and New York.

Today, the SCMEP offers a broad range of hands-on assistance and training programs for small manufacturers in areas such as:

- New product development and engineering,
- Process and product improvement,
- Human resource management, and
- Operations management, including marketing and financial management.

The SCMEP is currently partnering with PNC Bank to conduct financial assessments for small manufacturers and to develop plans for securing capital. Also, the SCMEP is working with merchant banks to help manufacturers obtain non-bank financing. It is recommended that the SC Department of Commerce and others should coordinate the initiatives recommended in this report with the existing programs of the SCMEP.

SCMEP's focus is to deliver services to manufacturers in alignment with the Next Generation Strategies set forth by NIST. These strategies are: Continuous Improvement, Workforce Development, Supplier Development, Sustainability, and Technology Acceleration. During the last year, SCMEP has delivered 496 projects in these areas:

- 326 Continuous Improvement projects
- 58 Workforce Development projects
- 54 Technology Acceleration projects
- 52 Sustainability projects

- 6 Supplier Development projects

The SCMEP is one of the few non-profit groups supporting South Carolina companies that charges its clients and is, in fact, required to generate 1/3 of its revenue (funding) from clients in order to receive federal funding and the state match to that federal funding. This provides a tangible market test of the SCMEP value to South Carolina Companies. The organization has recently moved under the South Carolina Department of Commerce and provides a strong model for market-driven support of high-impact firms in which the company clients directly acknowledge the value through paid engagements.

7.0 Concluding Remarks

In the current economic environment, access to capital for high-impact firms is a major problem nationally and worldwide. South Carolina has implemented some very successful initiatives to support high-impact firms in the state which, in turn, has helped these firms access the capital needed for growth. However, there are key issues related to capital market gaps (i.e., a mismatch between the types of financing available and the needs of high-impact firms) and the business environment for high impact firms. The capital market gaps are best addressed through financial incentives, and the business environment issues are best addressed through facilitating a stronger business network in the state. Most of the recommendations presented in this report build upon initiatives that are already underway. It is our view that, by improving the statewide business environment for high-impact firms and proactively helping these firms access growth capital, South Carolina is positioning itself very well for growth as the U.S. economy recovers.

Appendix A: Background of the Study and High-Impact Firms

In July, 2011, The Moore School of Business at the University of South Carolina published a report on "High-Impact Firms in South Carolina".[lvi] The report on high-impact firms, which was sponsored by New Carolina, highlighted two key issues related to job creation in South Carolina.

1. A relatively small number of High-Impact Firms are clearly a major driver for job creation in South Carolina, just as they are throughout the United States. High-impact firms accounted for only 2.7 percent of the private-sector firms in South Carolina but contributed 66.8 percent of all net employment gains during 2004-2008.

2. South Carolina falls below the national average in creating well-compensated management, professional, and technical jobs. South Carolina does appear to be outperforming other states in small business job creation and has stimulated employment through high-impact firms. However, the state has been less successful than the United States as a whole in nurturing high-impact companies to scale up sales beyond about $25 million.[lvii] Larger, high-impact firms with local headquarters tend to generate well-compensated employment opportunities.

To examine how South Carolina might better nurture local high-impact firms with the ability to scale up revenues beyond $25 million, and therefore have a large impact on the creation of well-compensated jobs, New Carolina's Entrepreneurship Task Force and the South Carolina Department of Commerce (SC DOC) conducted a series of interviews with top executives at high growth South Carolina-headquartered firms throughout 2011. These interviews demonstrated that access to capital was a primary concern of most top executives at high growth South Carolina-headquartered firms and one of their top limitations in scaling up their revenues. The executives indicated problems in securing proof-of-concept funding, seed capital, commercialization funding, working capital financing, export assistance funding, second-round financing after seed capital, and venture capital.

This study follows the method used in the 2011 study by Woodward et al. referred to above to define high-impact firms. Our definition of a high-impact firm is a firm that has a South Carolina Headquarters and has: (i) strong sales growth (doubling revenues on average in the most recent four years) and (ii) strong employment growth (Employment Growth Quantifier > 2 in four years). The "Employment Growth Quantifier" is the product of a firm's absolute change and percent change in employment. Similar to the Woodward et al. study, our analysis excludes Non-Profit Organizations, Public

Administration, Religious, Grant making, Civic, Professional, and Similar Organizations, Utilities, Banks and Credit Unions, Educational Services, Hospitals, Offices of Physicians, Offices of Dentists and Offices of Other Health Practitioners. These sectors are left out because they do not reflect private-sector entrepreneurial activity, depend primarily on public-sector funding, and/or have sales patterns that distort the analysis.

Appendix B: Interview Participants

Top executives from the following organizations participated in either in-person or telephone interviews.

Allied Reliability
American Promotional Products
Astralis Group
Atlas Technology
Azalea Capital
Bauknight, Pietras, & Stormer
BB&T
BCI Lending Services
Bellamy Law Firm
BoomTown
Center for Venture Research, UNH
CETi
Charleston Metro Chamber of Commerce
Council for Development Finance Agencies
Council for Entrepreneurial Development (North Carolina)
Certus Bank
ECI Find New Markets
EngenuitySC
First Community Bank
First Federal Bank
Four Bridges Capital
Frontier Capital
Fulcrum Private Equity
Innovation Development Institute
Innoventure
Innovista
InvestSC
JEDA
Kentucky Science and Technology Corporation
McKinley Crating
Nelson Mullins Riley & Scarborough
Nexsen Pruet
NEXT – Greenville Chamber of Commerce
Nexus Medical Partners
NIST Manufacturing Extension Partnership
Noro-Moseley Partners
Owen Graduate School of Management
Vanderbilt University
Oklahoma Center for the Advancement of Science and Technology
Panorama Capital
Pegasus Steel
ProPac
Rebel Capital
Robinson Bradshaw & Hinson
SCRA Technology Ventures
Silicon Valley Bank
SK Strategies
South Carolina Small Business Development Center
South Carolina Department of Commerce
South Carolina Manufacturing Extension Partnership
South Carolina Retirement System
Southern Technology Council
Square 1 Bank
The Alternative Board
The Wharton School
Twin River Ventures
Upstate Carolina Angel Network
USC/Columbia Technology Incubator
US Venture Partners
Vanderbilt University
Watermark Advisors
WJ Partners
WR Sequence
Webster Rogers
Wells Fargo
WHM Capital
Womble Carlysle
Wyche Law Firm
Zuuk International

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Appendix D: InvestSC Program

The Venture Capital Investment Act was created by the state legislature in 2005 in order to promote the availability of capital for creating and building business ventures in South Carolina. The Venture Capital Authority was established as an agency within the SC Department of Commerce to identify and select qualified professional investors who will invest in South Carolina companies. The authority is a seven member board selected by the governor and state lawmakers. In 2007, the authority received financing by a private institutional lender secured by state tax credits. Four venture capital firms were then selected to make investments within the state. [lviii] The four funds are Noro-Moseley Partners, Nexus Medical Partners, Frontier Capital, and Azalea Capital.[lix]

InvestSC, Inc. was formed by the South Carolina Jobs-Economic Development Authority at the specific request of the Venture Capital Authority. The authority selected InvestSC to serve as a "Designated Investor Group" for the purpose of assisting the authority in meeting the goals and objectives of the Venture Capital Investment Act. InvestSC was organized in 2007 as a nonprofit corporation and received 501(c) (3) tax-exempt status approval from the Internal Revenue Service. [lx]

Examples of InvestSC Success Stories

InvestSC funds have been invested in more than 50 deals through the end of fiscal year 2012, with 11 having operations in South Carolina. Five of the deals are highlighted below:

- An investment to acquire the auto textile division of Milliken resulted in a new company called Sage Automotive Interiors, and it saved more than 600 jobs in South Carolina.
- An investment in Perceptis, a leading provider of outsourced help desk and information technology services for educational institutions, resulted in the relocation of the company from Cleveland, OH to Greenville. The company employs more than employs over 200 people in South Carolina.
- An investment led Lab21, a UK-based firm, to acquire Selah Technologies, which resulted in a growing healthcare diagnostics operation that is located in Greenville.
- An investment in PeopleMatter, a Charleston-based software company that manages the needs of the food service industry, has helped the company grow to more than 50 employees.
- As a result of an investment, American Titanium Works is locating the first titanium mini-mill in the world in Laurens, SC.

The following table contains a summary of investments and fair value (InvestSC 2010 Annual Report):

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Investment				
Noro-Moseley Partners VI, LP	$5,997,993	$6,259,924	$3,997,993	$3,914,658
Nexus Medical Partners II, LP	$19,498,750	$20,543,866	$20,000,000	$21,524,083
Frontier Fund II, LP	$6,391,293	$8,545,753	$5,242,663	$5,922,527
Azalea Fund SC, LP	$71,118	$102,990	$90,318	$154,139
Azalea Fund III, LP	$2,206,938	$7,297,926	$2,550,000	$2,419,076
	$34,166,092	$42,750,459	$31,880,974	$33,934,483

InvestSC, Inc. can best be described as a fund of funds and is committed to promoting economic development within the state. The program provides an invaluable resource for companies already located in South Carolina or for companies looking to locate here. Formed by JEDA, InvestSC, Inc.'s purpose is to assist the Venture Capital Authority (VCA) of South Carolina in meeting their goals and objectives. The VCA has partnered with four venture capital funds that are willing to invest in companies looking to locate or expand within the state.[lxi]

Appendix E: New Carolina

New Carolina - SC Council on Competitiveness focuses on the growth/retention of existing companies in South Carolina. New Carolina identifies core industries where South Carolina already has an economic advantage and critical mass, and helps them to grow through cluster development. Cluster development increases productivity through competition, builds trust through collaboration, and increases access to shared resources such as skilled workforce and improved infrastructure. Clusters can enhance competitiveness by establishing a value chain, providing opportunities for joint industry marketing, research and development, and can also provide a platform for the sharing of best practices.

New Carolina's role in cluster development begins with the convening of the top industry stakeholders. The organization works to facilitate a vision for the industry and develop a plan to overcome obstacles for that vision enabling the cluster members to achieve more together than they can alone. New Carolina designs solutions that make our companies more competitive in their industry by staying in South Carolina.

The Board of Directors is led by Ed Sellers, Chairman Emeritus of BlueCross BlueShield of SC. The Board reflects the broad reach both geographically and industrially of New Carolina with representatives from across the state and in many of the state's key industries. Some of those key industries are transportation, distribution and logistics, insurance technology and services, and the recycling sector.

In addition to the direct management of the clusters themselves, New Carolina supports task forces focused on issues of vital importance across industries. There are currently two such task forces: Education/Workforce Development and Entrepreneurship.

During the past five years, New Carolina's Entrepreneurship Task Force has organized a series of four statewide forums that were designed to help entrepreneurship service providers exchange ideas and to discuss options for statewide collaborative initiatives. Based on the feedback from these forums, the task force has partnered with University of South Carolina researchers to produce two reports:

- A study on High-Impact Firms in South Carolina (see Appendix A), which helped to identify the types of companies that are creating the vast majority of all new net new jobs and wealth in South Carolina.
- The South Carolina Capital Market Study, included in this report.

Appendix F: Sponsor Information

AdvanceSC is a limited liability company established by Duke Energy in 2004 to support communities in Duke Energy's South Carolina service area through grants for public assistance and economic development programs. AdvanceSC concentrates on advancing education to support industry, assisting other economic development organizations to attract and retain industries in Duke Energy's service territory, and enhancing the competitive position of manufacturers in Duke Energy's service territory. For more information, visit the website, www.advancesc.org.

Bauknight Pietras and Stormer, P.A.'s entrepreneurial services team is dedicated to serving the accounting, income tax, and business advisory needs for high-growth companies. We understand the hurdles facing growing companies -- hurdles such as cash flows, internal controls and business process improvement, financing, acquisitions, new technology, and product/process costing, as well as the evolving regulatory environment. For more information, please contact Mike McGovern at mmcgovern@bpscpas.com.

BB&T Corporation, headquartered in Winston-Salem, N.C., is among the nation's top financial-holding companies with $174.6 billion in assets and market capitalization of $17.5 billion, as of Dec. 31, 2011. Its bank subsidiaries operate approximately 1,800 financial centers in the Carolinas, Virginia, West Virginia, Kentucky, Georgia, Tennessee, Maryland, Florida, Alabama, Indiana, Texas and Washington, D.C. BB&T full-service retail and commercial services include investments, consumer finance, retail brokerage, leasing and trust, corporate finance, payment services, international banking and a broad range of mortgage services. For more information, please go to www.BBT.com

BCI Lending is a preferred SBA and USDA commercial lender. We specialize in providing fully amortizing long-term loans to small-to- medium size firms. BCI, which is headquartered in Columbia, has regional offices in Greenville and Charlotte. For more information, please contact Ed Kesser, Executive Vice President – Lending: ekesser@bcilending.com.

First Federal is the largest financial institution headquartered in the Charleston metropolitan area and the third largest financial institution headquartered in South Carolina based on asset size. Owned by First Financial Holdings, Inc., First Federal provides integrated financial solutions, including personal, business, and wealth management services throughout coastal South Carolina, as well as the Florence, Columbia, and upstate regions of South Carolina, and Wilmington, NC. For more information, please visit the website: www.firstfederal.com.

The South Carolina Jobs-Economic Development Authority serves as conduit bond issuer for reducing the borrower's financing costs. Since its creation in 1983, JEDA has issued nearly $7.5 billion in bonds, resulting in the creation or retention of over 197,000 jobs. Hospitals, educational facilities, manufacturers and other not-for-profit companies have benefitted from this innovative, typically tax-exempt financing to help create and keep jobs in South Carolina. JEDA's mission is economic development and job creation, and the agency operates at no cost to taxpayers, but rather is funded by its own operation. For more information, please visit the website at http://scjeda.com.

Nelson Mullins is a South Carolina-based full-service law firm with 440 attorneys offering a broad range of services. Nelson Mullins' attorneys work closely with startup companies and high growth companies in connection with their financing needs. Information about the firm is located at www.nelsonmullins.com. For more information, please contact Mason Hogue at mason.hogue@nelsonmullins.com.

SC Launch helps grow knowledge-based businesses, commercialize new technologies and create new jobs in South Carolina. Since inception, the program has supported 251 innovative start-up businesses, assisted in the relocation of 12 landing parties to South Carolina, and matched 36 SBIR Phase I awards. SC Launch companies have raised over $167 million in follow-on capital from angel, venture, and other private sources and are creating hundreds of quality jobs in South Carolina. For more information, contact: info@sclaunch.org.

WebsterRogers LLP is a South Carolina-based regional accounting and consulting firm that provides a broad spectrum of assurance, tax and advisory services to our clients. Founded in 1984, WebsterRogers offers the degree of personal attention, responsiveness and accessibility our clients expect and deserve—coupled with regional resources that can satisfy their needs. For more information, contact: tallen@websterrogers.com or visit www.websterrogers.com.

WRSequence, LLC, specializes in financial transactions ranging from $2 million to $100 million in size while adding value to each transaction. We help clients find solutions to issues and opportunities related to special financing needs including Mergers & Acquisitions for both buyers and sellers, Debt Restructuring, Capital for Growth, and Legacy Exit Alternatives. For more information, contact: gking@wrsequence.com or visit www.wrsequence.com.

End Notes

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[i] See Appendix A for more detail on the background of this report. Our definition of a high-impact firm is a firm that has a South Carolina Headquarters and has (i) strong sales growth (doubling revenues on average in the most recent four years) and (ii) strong employment growth (Employment Growth Quantifier > 2 in four years).

[ii] Robb A, Reedy EJ, et al. An Overview of the Kauffman Firm Survey: Results from the 2004-2008 Data. Ewing Marion Kauffman Foundation. May 2010.

[iii] The Upstate Carolina Angel Network (UCAN) alone has made over 18 investments in South Carolina (out of 22 total) and created over 250 jobs according to the Managing Director, Matt Dunbar.

[iv] About 40% of Inc. 500 entrepreneurs polled nationwide state that finding qualified people is their biggest obstacle to growth (Kauffman Foundation, Inc. 500 Conference, Sept. 2011). This is not just an issue in South Carolina.

[v] Consistent data from primary and secondary sources in South Carolina and nationally.

[vi] Dr. Douglas P. Woodward, Director, Division of Research et al., Moore School of Business, University of South Carolina, July 2011.

[vii] U.S. Census Bureau, Center for Economic Studies, Business Dynamics.

[viii] See for example the National Small Business Association "2010 Small Business Technology Survey", 2010.

[ix] Based on interview and survey results and supported by data from the National Federation of Independent Business, the Federal Reserve System, and others. For example, about 60% of small businesses polled by the Federal Reserve Bank of New York stating that they attempted to borrow in the first half of 2010 with only half able to secure at least one credit product that met their needs. ("Access to Credit: Poll Evidence from Small Businesses", October 2010).

[x] Judit Montoriol-Garriga and J. Christina Wang, " The Great Recession and Bank Lending to Small Businesses", Research Review, July 2011 - December 2011.

[xi] Coleman, Susan, "Capital Structure in Small Manufacturing Firms: Evidence from the Data," University of Hartford, 2006.

[xii] South Carolina Small Business Needs Assessment Survey, October 14, 2012, conducted by the South Carolina Small Business Development Center (SBDC), in partnership with local Chambers of Commerce, SC Launch and the Manufacturing Extension Partnership (MEP).

[xiii] 2013 Capital Markets Report, Pepperdine University, page 31.

[xiv] The Thomson Reuters/PayNet Small Business Lending Index (SBLI) measures the volume of new commercial loans and leases to small businesses indexed so that January 2005 equals 100.

[xv] See, for example, http://www.biz2credit.com or the survey, conducted for FICO by the Professional Risk Managers' International Association (PRMIA) http://www.marketwatch.com/story/fico-survey-us-bankers-say-small-business-lending-on-the-rise-2012-10-09

[xvi] "Warming Signs? Stuart, Alix, CFO, Sep2012.

[xvii] 2013 Capital Markets Report, Pepperdine University, page 7.

[xviii] Confirmed in interviews with traditional and investment bankers for this report.

[xix] Federal Reserve Bank of New York, "Access to Credit: Poll Evidence from Small Businesses," October, 2010.

[xx] Federal Reserve Bank of New York, "Access to Credit: Poll Evidence from Small Businesses," October, 2010.

[xxi] Booz Allen Hamilton for the NIST Manufacturing Extension Partnership, "Connecting Small Manufacturers with the Capital Needed to Grow, Compete, and Succeed: Small Manufacturers Capital Access Inventory and Needs Assessment Report," November 2011.

[xxii] http://www.nvca.org/index.php?Itemid=147&id=119&option=com_content&view=article

[xxiii] Ernst & Young. (2011). *Globalizing Venture Capital*, Global venture capital insights and trends report 2011.

[xxiv] This was consistently verified with all of our interviews with venture capitalists across the country.

[xxv] In the United States, 45 percent of respondents say there is a sufficient supply of venture capital to grow high-risk firms, but only 32 percent think there is sufficient supply of seed capital to start them (Monitor Group, "Paths to Prosperity: Promoting Entrepreneurship", 2009)

[xxvi] National Governors Association Chair's Initiative, "Growing State Economies: A policy Framework", 2011-2012.

[xxvii] Zimmerman, CNNMoney.

[xxviii] Only United States small businesses are eligible for SBIR grants. A small business is defined as 500 or fewer employees, according to the SBIR/STTR web site, http://www.sbir.gov/about/about-sbir#embedded_flash_55378163

[xxix] SBIR/STTR web site.

[xxx] SBIR/STTR web site.

[xxxi] The information in this paragraph was obtained from communication with Ann Eskesen of the Innovation Development Institute of Swampscott, Mass.

[xxxii] http://www.scra.org/sclaunch/sbir_sttr.html

[xxxiii] Observations such as this must be viewed the lens of the venture capital industry. John Taylor, Head of Research of the National Venture Capital Association, confirmed in a personal interview that the percentage of venture capital deals that are made is very small. The industry rule of thumb is that for every 100 business plans reviewed by a venture capital firm, 10 will receive serious consideration. Of those 10, only one will actually lead to

a deal. Mr. Taylor claims that no one has done serious research in this area, but that he is "comfortable" with that estimation of the percentage of successful deals.

[xxxiv] http://www.kauffman.org/newsroom/high-growth-entrepreneurs-plan-to-continue-growing.aspx After finding qualified people, the next largest obstacle to continued growth was simply managing fast growth (21 percent), followed by accessing capital (16 percent) and the sluggish economy (13 percent). Regulatory uncertainty and taxes were only 3 percent and 4 percent, respectively.

[xxxv] Ms. Emily Doyle, business librarian in the Springs Business Library completed this analysis of PrivCo (http://www.privco.com/) data.

[xxxvi] Tom Quindlen, "Access to Better Capital Drives the Mid-Market", Financial Executive, April 2012

[xxxvii] "What's an Angel Investor?" WSJ; April 19, 2010

[xxxviii] "Should Angel Investors Get Tax Credits To Invest in Small Businesses?" WSJ; March 19, 2012

[xxxix] National Advisory Council on Innovation and Entrepreneurship (NACIE), United States Department of Commerce, "Report to Secretary Locke: Improving Access to Capital for High-Growth Companies", June 2011.

[xl] According to Dr. Jeffrey Sohl, Director of the Center for Venture Research at the University of New Hampshire, precise data is not available regarding what percentage of qualified investors are involved in angel investing across the United States. He did comment that the number cited for South Carolina (one-half of one percent of qualified investors) is low.

[xli] The Hawaii law has expired. A listing of active and expired incentive legislation, as of 2010 is available in an Excel spreadsheet at

http://www.angelcapitalassociation.org/data/Documents/Public%20Policy/State/StateTaxCredits2010.xlsx

[xlii] "Should Angel Investors Get Tax Credits To Invest in Small Businesses?" WSJ; March 19, 2012

[xliii] "Tax Credits for 'Angels' Get Clipped" WSJ; February 2, 2012.

[xliv] SC Launch Annual Report. 2011

[xlv] http://www.scra.org/sclaunch/overview.html

[xlvi] The Industry Partnership Fund tax credit may be claimed against income taxes under Chapter 6 of Title 12, license fees under Chapter 20 of Title 12, or insurance premium taxes under Chapter 7 of Title 38, or any combination of these. The credit may be claimed by an individual, corporation, partnership, trust, bank, insurance company, or any other entity having a state income or insurance premium tax or license fee liability who makes a qualified contribution. No individual taxpayer may receive more than $2 million.

[xlvii] http://www.kysbir.com/index.php?option=com_content&view=article&id=72&Itemid=25

[xlviii] Porter, M. (2011, February 26). National Governors Associaton Opening Plenary Session.

[xlix] The National Governors Association "New Engines of Growth: Five Roles for Arts, Culture and Design", May 2012.

[l] According to a Kauffmann Foundation study from 5 years ago, for example, angel investors who were engaged in a number of early-stage investments and did proper due diligence received an average 27% on their annual rate of return and in 3.5 years produced 2.6 times their invested capital.

[li] Matt Dunbar, Managing Director, Upstate Carolina Angel Network (UCAN)

[lii] Sangeeta Badal and Rajesh Srinivasan , "Mentor Support Key to Starting a Business: Relationship is significant in the developing world and among young people", November 25, 2011.

[liii] Ibid.

[liv] Andy Cosh and Alan Hughes, with Anna Bullock and Margaret Potton, ESRC Centre for Business Research University of Cambridge, "The Relationship between Training and Business Performance", July 2003.

[lv] Mercedes Delgado, Michael E. Porter, and Scott Stern, "Clusters and Entrepreneurship," Journal of Economic Geography (2010): 1–24, http://www.isc.hbs.edu/pdf/DPS_ClustersPerformance_08-20-10.pdf.

[lvi] Dr. Douglas P. Woodward, Director, Division of Research et al., Moore School of Business, University of South Carolina, July 2011

[lvii] Since 2002, only 112 South Carolina companies started and grew beyond $25 million in sales

[lviii] InvestSC 2010 Annual Report

[lix] Ibid

[lx] Ibid

[lxi] South Carolina Department of Commerce web site; Financing; http://sccommerce.com/existing-sc-businesses/business-services/financial-services