NEW JERSEY ECONOMIC DEVELOPMENT AUTHORITY

MEMORANDUM

TO: Members of the Authority

FROM: Timothy J. Lizura
President and COO

DATE: August 9, 2016

SUBJECT: Edison Innovation Venture Capital Investment Program Update

Request:

The Members of the Board are requested to approve an update to the Authority's Venture Fund investment policy, along with the implementation of a scoring model.

Background:

As part of the Authority's technology financing activities, the Edison Innovation Fund venture program seeks to make equity investments into NJ-based early-stage technology companies by leveraging collaborative relationships with committed venture fund partners. Investments are expected to earn a reasonable rate of return, measured in financial return and by job growth in the State.

The Authority has committed over $40 million in venture capital funds since 1999. Most of these funds have had a 2:1 matching requirement that require $2 of private capital to match each dollar of Authority funding into NJ-based early-stage technology companies. Cumulatively, these funds exceeded this requirement and invested approximately $202.40 million or 5.74x EDA's investment into New Jersey companies. The portfolio has a total investment into underlying New Jersey companies from EDA partner funds and other third party investors of approximately $1.9 billion, a Private/Public (EDA) leverage ratio of 54:1 on $35.29 million of invested capital. The current New Jersey portfolio companies employed 1,749 full time employees as of December 31, 2015. Of note, there have been 63 companies which have received funding in this program since 1999. The Authority's venture fund portfolio currently includes two active funds making new investments.

Venture Fund Guidelines and Scoring Matrix

In August 2008 the Authority's board reviewed and approved the current Technology Venture Fund Investment Guidelines. As a result of accrued experience over this time, staff is recommending some minor updates to the investment guidelines to include a "Governance" guideline, further clarification on expected returns, as well as documenting the practice of a maximum investment size (See Appendix A).

Furthermore, in addition to the noted enhancements to the policy guidelines, staff is recommending the integration of a scoring model to supplement the Guidelines. Applicant firms must meet New Jersey Economic Development Authority Technology Venture Fund Investment Guidelines in order to qualify for scoring. This model will help the Authority meet the demand for investment consideration from newly created funds with a focus on New Jersey. With limited Authority resources, a scoring model built on the Authority's experience as a venture fund investor will help provide a consistent and efficient rating of applicant funds, similar to the analysis used in the Authority's Edison loan model. The proposed confidential rating model will also inform the Authority board of a proposed commitment level for the investment based on the scoring matrix outcome. The scoring matrix will focus on 13 objective criteria. Review of each criterion individually and with respect to the others enables a holistic evaluation forming a comprehensive view of a prospective venture partnership. Each criterion is assigned a weight to represent its relative importance in the assessment. Through the application and interview process, information will be gathered to evaluate the investment offering based on the following:

1. **Quality of Leadership:** Consideration is given to senior leadership's length of experience together as an institutional fund manager and investor, as well as, the relevance of experience to the targeted strategy.
2. **Depth of Resource:** Consideration is given to the size and experience of additional team, as well as, the current staffing processes used in order to effectuate the strategy. Succession / continuity planning is considered.
3. **NJEDA Partnering:** The prospective manager is assessed on its ability and willingness to serve as a strategic partner to the NJ EDA, support the Technology & Life Sciences ecosystem in New Jersey and locate in the State.
4. **Sourcing:** The prospective manager is assessed on its ability to source and track relevant and non-traditional deal flow to maintain an advantage in effectuating the stated strategy, with particular emphasis on New Jersey.
5. **Strategic Focus:** In order to align with NJ EDA objectives, the target fund should be focused on early-stage companies with less than $3 million in trailing twelve month revenue prior to investment, diversified across technologies.
6. **Geographic Focus:** The investment offering will be assessed according to the percentage of the total fund identified for investment in New Jersey and to the breadth of exposure within the State. Consideration may be given to funds with a regional or national approach, emphasizing investment in NJ.
7. **Consistency of Strategy:** The manager's history and degree of past success executing the targeted fund strategy is indicative of its understanding and ability to mitigate associated risks, particularly in an institutional fund structure.
8. **Performance History:** Investment returns on individual funds are reviewed on an absolute basis and relative to peers. Returns across prior funds should be consistent. Volatility of returns within funds should be tolerable relative to the broader asset class. Consideration will be given to first time institutional managers based on individual principal track records.

9. **History Investing in New Jersey:** The amount invested to date in New Jersey by the manager on an absolute basis and relative to peers will be considered in conjunction with the investment return on New Jersey -based companies and the ability to create jobs in the State.
10. **Fees and Expenses:** The manager must represent a budget for the target fund and General Partner. Fees and expenses will be compared to peers and should be sufficient only to effectuate the stated strategy of the investment offering under consideration.
11. **Incentive and Alignment:** Carry (performance incentive) as a percent of profit sharing between the LP and GP should be comparable to peers and properly aligned for the relative risk and reward of the targeted strategy. Within the firm, carry ownership should be equitably spread among the team with consideration for contribution to the success of strategy. The General Partner commitment should be personally meaningful and significant relative to the total fund size.
12. **Governance:** Governance terms should sufficiently protect Limited Partners. The NJ EDA requires a seat on the Limited Partner advisory board for all investments in excess of $1,000,000.
13. **Fundraising Status:** Stage of fundraising will be considered with respect to the manager's ability to effectuate the strategy. Participation by other institutional Limited Partner's in the fund offers an additional validation signal to the NJ EDA and helps effectuate the value-add.

As necessitated by the long-term investment horizon of venture capital, the Authority seeks to maintain active investment partnerships deploying capital across market cycles. The Authority has implemented guidelines to ensure its venture capital fund investments support the success of emerging technology companies in New Jersey. These guidelines set forth a strategy for staff to review and assess qualifications for venture capital fund commitments in a consistent and equitable manner. To facilitate a transparent process as an element of the Edison Innovation Fund, applicants will apply through the online application for assessment conducted using the Guidelines and scoring matrix outlined herein.

Timothy J. Lizura

Attachment

Prepared by: Kathleen W. Coviello
Timothy B. Rollender

Appendix A

New Jersey Economic Development Authority
Technology Venture Fund
Investment Guidelines

A. Mission

The mission is to complement EDA's investment in technology business by providing guidelines for the allocation of funds to technology venture funds.

B. Objectives

- Facilitate the success of companies developing emerging technologies
- Support economic development in the State through technology investment and job growth
- Maintain a consistent, comprehensive investment approach
- Leverage EDA resources (financial and human)
- Hedge against risk
- Earn a reasonable rate of return

C. Strategy

- **Stage** – Investments will focus on NJ-based early-stage technology companies with less than $3 million in trailing twelve month revenue prior to investment.

- **Industry Sectors** - of focus include, but are not limited to, telecommunications, information technology, hardware, life sciences and energy. Fund managers must demonstrate the ability to source meaningful deal flow in NJ. The prospective fund manager's detailed portfolio construction plan is reviewed against the EDA's diversification objectives (e.g. targeted geographies, sectors, stages).

- **Management** – Fund managers will be assessed on the basis of operational and financial experience, as well as, the breadth and depth of resources to successfully identify and manage investments. The potential fund manager's commitment and ability to execute in New Jersey is tied to the physical proximity to and presence in the State.

- **Track Record** – The manager's historic track record is evaluated based on a review of absolute performance and performance relative to peers. The track record should be representative of the manager's ability to successfully execute the targeted strategy. First time funds may be reviewed with consideration to a representative track record of the fund principals.

- **Partnering and Alignment** – Venture fund managers serve as strategic partners to the EDA. This may be demonstrated by the active promotion of all related EDA initiatives.

The fund manager is expected to be available, as needed, for due diligence assistance under the Authority's technology initiatives. Additionally, the fund managers may be considered leaders in the New Jersey community and serve as supporters of the membership led groups that support these industry sectors.

- **Governance** – Fund terms will be assessed on their basis to protect and support the long-term objectives of the fund partnership. Fees and expenses are expected to sufficiently align the fund manager and investors and to provide incentive, along with the GP's own commitment. The EDA shall require a seat on the fund advisory board for all investments in excess of $1 million.

- **Return Objective** – The target return on investment will be measured by both financial returns and the growth of jobs in targeted sectors and geography. The fund manager must be able to measure the creation of jobs in companies financed through the program. The EDA seeks a net internal rate of return on investment of greater than 8% and net multiple of invested capital of greater than 2x.

- **Leveraging** –The track record of the fund under consideration, should demonstrate the manager's ability to leverage the Authority's investment with other investment dollars. A minimum leverage factor should be 2:1 for an early stage investment portfolio.

- **Location/New Jersey** – There will be a strong preference for the fund to have a physical presence in New Jersey. Depending on the amount of the investment, relative to the size of the fund, that presence can range from a satellite office, to the commitment of a full time partner in the New Jersey region.

  Any fund under consideration should have a history of at least ¼ of their investment portfolio in the State and a commitment to maintain that or a higher level of funding to New Jersey based companies. In the event they do not have a New Jersey track record, they will be required to commit to opening an office in NJ with a full time partner level employee managing the office. New Jersey based companies will include companies with their headquarters and a minimum of 75% of their employees in the State. A higher concentration of New Jersey based portfolio companies could warrant a higher level of EDA Investment.

- **Maximum Participation** – In all instances, if the EDA is one of several proposed limited partner in a fund (i.e. not a side car fund), the maximum investment amount shall be limited to the lesser of 10% of the total fund commitment of capital or $10 million.

NJEDA

MEMORANDUM

To: Members of the Authority

From: Tim Sullivan

Date: September 12, 2019

Subject: Venture Fund Program – Policy Updates

Request:
Approve an update to the EDA's current venture fund investment policy to include the addition of a fourteenth bonus rating criteria, Diversity & Inclusion, and recommend clarifications to specific existing rating criteria to improve clarity and accuracy in the venture fund risk rating model.

Background:
In August 2016, the Authority's board approved an updated Venture Fund Policy, including, the implementation of the Venture Fund Rating Matrix as a new element in the underwriting process when considering the Authority's potential investment as a Limited Partner in venture capital funds. The approved rating model was devised from a culmination of the EDA's 20 year experience investing in venture funds, and substantial research from industry trade organizations, like the Institutional Limited Partners Association and the National Venture Capital Association ("NVCA"), and the best practices of respected individual and institutional investors including, for example, insurance companies, investment banks, private and public pension funds, sovereign wealth funds, etc. The rating tool serves as one element in the Authority's investment analysis. In accordance with the Authority's current Venture Fund Investment Policy, the venture fund rating tool uses thirteen objective criteria in examining a venture capital firm and fund for prospective commitment. This objectivity allows reviewers to clearly articulate the qualities of an offering and assign a score. The resulting output offers a suggested commitment amount, subject to the Authority's long-term, patient capital available. Having clearly defined rating criteria is paramount in the model to ensure a consistent, efficient and equitable process. This also creates, for both the Authority and the applicant, a productive level of transparency to communicate a distinct outcome of the decision-making process.

Since the approval of the Venture Fund Investment Policy in August 2016, the Authority has committed to three venture funds (Newark Venture Partners, Tech Council Ventures II and Edison IX) for total commitments of approximately $8.6M.

Staff recommends the Board consider approving the request to update the Venture Fund Policy, including the addition of a fourteenth criteria – Diversity and Inclusion – and modifying language of the Venture Fund Risk Rating model to create additional clarity in the scoring categories. These updates are reflective of both the changing venture capital industry environment, historically, limited in diversity and inclusion, and the EDA Venture Fund Investment Policy's alignment with Governor Murphy's Economic Development Plan goal to create the most diverse innovation ecosystem in the nation.

The venture industry has long suffered from a lack of diversity and inclusion. We are at an important juncture in history at which the industry begins to adopt policies and practices to progress from this position. This change is already being led by some industry groups like the NVCA through their Venture Forward initiative.[1] The NVCA is a prominent global trade organization in the venture capital industry. The additional modifications to the model will further enhance the functionality of the rating matrix. Such revisions are a function of ongoing policy and process improvement. The proposed changes are outlined below.

Venture Fund Policy Update

EDA has committed more than $51M in 16 venture capital funds in the last 20 years. These investments have generated more than 5,000 jobs in NJ and resulted in a private sector capital multiplier in excess of 50x the amount of EDA capital invested in the State. EDA last conducted revisions to the venture fund investment policy in 2016, coincident with the implementation of the venture fund rating matrix to assist in the allocation decision to VC funds. This tool was implemented to enhance the robustness of EDA's venture fund investment evaluation methodology and to create process efficiencies.

This new addition of a Diversity and Inclusion criteria, and clarifying updates, are recommended to further strengthen our process and create a fairer policy that aligns with the objective to support the innovation economy in New Jersey. This criterion is designed to recognize the deliberate efforts of investors who have institutionalized policies and practices to invest with high caliber management teams with a consideration for diversity & inclusion. In turn, this effort leads to additional capital funding to accomplish the fourth goal of the Governor's Economic Development Plan – closing the racial and gender wage and employment gaps. The result of these efforts will support deployment of more venture capital from private sector investors into a more diverse set of companies growing in New Jersey.

New Jersey has lagged the rest of the nation in the growth of women-owned and minority-owned businesses, ranking 33rd nationwide in the growth of women-owned firms since 2007 and 30th in the growth of minority-owned businesses since 2014. With the addition of the Diversity & Inclusion criteria, a venture capital firm's policies and past investment portfolios will be considered to identify the Manager's commitment to diversity and inclusion across the firm culture and the influence on investment strategy. As it stands today, the Venture Capital industry is one of the least diverse industries at both the investment management level and among venture-backed startups. Women-owned and minority-owned businesses make up a disproportionately small percentage of emerging technology business, with estimates as low as one percent of funded emerging technology business owned by African Americans and eight percent of funded emerging technology business owned by women. In 2017, for example, women-led startups received just 2% of venture capital investment, according to the NVCA. Looking at the investment firms themselves, minorities represent just 22% of investment professionals. Managers

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1 https://nvca.org/ecosystem/ventureforward/

with strong diversity policies in place, and that demonstrate an inclusive culture, tend to align well with the objective to create a diverse innovative ecosystem in the State. In addition, statistics show there is a high probability of producing an outsized return when decisions are made with a consideration to different viewpoints and experiences.

The definitions of Diversity & Inclusion may vary widely in consideration to the venture capital and investment landscape. To date there is no single metric against which investment firms base this assessment. Consideration of this metric with regard to fund evaluation as a policy puts the NJEDA at the forefront of institutionalizing this practice and recognizing the benefit of diversity and inclusion. The concepts selected here are, largely, presented by the Centre for Global Inclusion (http://centreforglobalinclusion.org/), a Las Vegas, NV-based research and education organization that created the Global Diversity & Inclusion Benchmarks ("GDIB") publication. This is a respected source referenced by many organizations since its initial release in 2006, through its latest revision in 2017. The definitions presented by the GDIB for Diversity and Inclusion:

> **Diversity** refers to the variety of similarities and differences among people, including but not limited to: gender, gender identity, ethnicity, race, native or indigenous origin, age, generation, sexual orientation, culture, religion, belief system, marital status, parental status, socio-economic difference, appearance, language and accent, disability, mental health, education, geography, nationality, work style, work experience, job role and function, thinking style, and personality type. Inclusion of various diversity dimensions may vary by geography or organization.
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> **Inclusion** is a dynamic state of operating in which diversity is leveraged to create a fair, healthy, and high-performing organization or community. An inclusive environment ensures equitable access to resources and opportunities for all. It also enables individuals and groups to feel safe, respected, engaged, motivated, and valued, for who they are and for their contributions toward organizational and societal goals.

From these definitions, we offer the proposed fourteenth criteria for addition to the rating matrix:

> **Diversity & Inclusion:** Venture Capital Firm policies and past investment portfolio are considered to identify commitment to diversity and inclusion across the firm culture and the impact on investment strategy.

Consideration in the rating model is given to the fact that investment management teams and companies at the EDA's targeted investment stage (early-stage, less than $3M in revenue) tend to be organizationally immature and thinly resourced. This often results in a lack of transparency with regard to the topic of diversity & inclusion at the firm level. To mitigate this issue and support evaluation of this criteria, EDA has developed an eighteen question self-reported survey to examine the policies and investment record of the venture capital firm. This survey is based on the research conducted, principally from PWC, the Centre for Global Inclusion and is modified from the 2020 Bloomberg Gender-Equality Index Framework.[2] The survey is constructed to capture the most relevant details of a private market investment firm's policies and investment practices for the purpose of the evaluation criterion and reference for potential future refinements of the evaluation process. The survey is meant to capture insight on the VC firm and the past portfolio companies both. The VC Firm's employment base and policies are regarded to offer a potential risk reduction bonus. EDA Staff will look to a VC's past portfolio to recognize how many of the companies represented diverse management or ownership teams and ascertain the degree of diversity in the Manager's portfolio for reference only.

Venture Capital firms will self-report on the requested survey. The responses to question numbers 1, 2, 3 and 4 below will be reviewed to offer a potential risk reduction score bonus:

1. Does the firm have a stated diversity and inclusion policy which serves as a guiding document for the organizational practices of the firm?
2. Does the VC firm have a named senior executive with the primary function of managing the firm's diversity and inclusion policy?
3. Does the firm have a consideration or stated goal for diversity & inclusion when making new investments?
4. If the firm has a consideration or stated goal for diversity & inclusion when making new investments, can it verify it has achieved this goal?

Additional questions will be posed to the manager to ascertain information regarding diversity & inclusion exposures. This information will not be scored or considered in evaluation in any way. This data is purely for research purposes to, potentially, inform future refinements in the evaluation process. The comprised of the additional 14 questions may be updated from time to time.

Recommendation

The above policy update and proposed changes are submitted with a recommendation that will enhance the EDA's already robust venture fund investment review process. Implementation of these measures will refine the set of rules to direct Authority capital in venture investing and encourage additional private sector investment in targeted sectors within New Jersey's innovation economy.

Attachments

Prepared by: Madhavi Bhatia
Timothy B. Rollender

2 https://data.bloomberglp.com/company/sites/46/2019/05/EXEC_GEI_Index_GenderReportingFramework_PDF_V6.pdf