

Center for **RURAL** **ENTREPRENEURSHIP**



Development of an Entrepreneurial Support Organization: The Case of the Kentucky Highlands Investment Corporation

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About the Research Case Studies Series

The Center for Rural Entrepreneurship is committed to learning from those organizations and collaboratives that are actively supporting entrepreneurship in rural America. This report, *Development of an Entrepreneurial Support Organization: The Case of the Kentucky Highlands Investment Corporation*, is the first in a series of research case studies that the Center plans in the future. Each case study draws on an evaluation framework created by the Center to gather information from diverse entrepreneurship development practices in a systematic way so that the elements of successful practice can be discerned across a variety of implementation forms. Sharing these elements of successful practice with the practitioner and policymaker communities is an important component of the Center's mission.

About the Authors

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Development of an Entrepreneurial Support Organization: The Case of the Kentucky Highlands Investment Corporation

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Introduction

Entrepreneurs are critical to the success of any local economy. Entrepreneurs perceive opportunities within the local or global marketplace and create business enterprises around these opportunities. Their endeavors lead to the creation of jobs, income, and wealth for themselves and others in the area. However, most entrepreneurs do not bring a full set of skills to the process of enterprise creation, thus their success is dependent on their ability to access support services within the local market. For entrepreneurs operating in rural markets, the limited support service infrastructure creates a significant obstacle to business creation and growth. The development of an entrepreneurial support infrastructure in rural regions is an important strategy for encouraging entrepreneurship and rural economic development.

KHIC is an economic development organization that uses the tools of debt and equity capital to create jobs and wealth. . .”

Entrepreneurial support organizations (ESOs) play an important role in creating strong entrepreneurial environments. ESOs can take a variety of organizational forms, including networks, intermediary organizations, and industry clusters. However, based on field observations, the Center for Rural Entrepreneurship has identified three common attributes of ESOs (Macke 2002):

- They place primary focus on entrepreneurs rather than the enterprises they create.
- They build a support system that nurtures entrepreneurs during the idea phase, provides the resources and tools needed to create new enterprises, and guides the entrepreneur through the process of growing a business.
- They contribute to the creation of entrepreneurial environments where entrepreneurship is supported in both the public and private sectors.

While these attributes provide a useful framework for understanding ESOs, it is important to understand the history and operation of effective ESOs in order to benefit from the lessons learned by these institutions. This case study describes one model for supporting entrepreneurs in rural America: the Kentucky Highlands Investment Corporation (KHIC) of London, Kentucky. KHIC is an economic development organization that uses the tools of debt and equity capital to create jobs and wealth in a nine-county region in southeastern Kentucky. This “capital-led” strategy has evolved over time, leading to the creation of a

sustainable model for enterprise creation in one of the most impoverished rural regions in the U.S.

The case study entailed extensive on-site interviews with three groups of individuals: Kentucky Highlands' management, program staff, and Board members; entrepreneurs assisted by Kentucky Highlands; and staff of other economic development organizations operating in the region. A list of interviewees and their organizations is provided in Table 1. In addition, background on Kentucky Highlands was obtained through the organization's website and an unpublished background piece, *Of These Hills*, prepared by a former KHIC president (Miller).

The findings of this case study are summarized in four sections. The following two sections provide a brief history of Kentucky Highlands and describe the KHIC programs available to support entrepreneurs in the region. The third section presents the lessons learned from the Kentucky Highlands experience, and the final section draws some conclusions from this study for the broader discussion of the roles and functions of ESOs in building entrepreneurial environments across rural America.

Brief History of Kentucky Highlands

Kentucky Highlands was founded in 1968 by six community action agencies as a Title VII Community Development Corporation with principal funding provided by the Office of Economic Opportunity (OEO). Under the name Job Start Corporation, the organization was charged with stimulating community and economic development in a nine-county region of southeastern Kentucky (Figure 1 – the counties of Bell, Clay, Clinton, Harlan, Jackson, McCreary, Rockcastle, Wayne, and Whitley). At this time, employment opportunities in the area were dominated by declining industries (mining, agriculture, textiles, and wood products), and poverty and unemployment rates were significantly above the national averages. In response to this situation, the adopted mission of Job Start was “to provide and retain employment opportunities in southeastern Kentucky through sound investments and management assistance” (www.khic.org).

In 1968 there were few organizations in the region that provided information or resources to promote local economic development, thus Kentucky Highland's early programs attempted to address deficiencies in a number of areas. KHIC engaged in social programs (anti-poverty and housing), industrial recruitment, community development educational training for community organizations and public officials, and the development of industrial parks and sites for prospective businesses. KHIC also worked with the Institute

Table 1. Case Study Interviewees

Interviewee	Organization	Category
Jerry Rickett	Kentucky Highlands	Management staff
Ray Moncrief	Kentucky Highlands	Management staff
Brenda McDaniel	Kentucky Highlands	Management staff
Elmer Parlier	Kentucky Highlands	Management staff
Michael Hayes	Kentucky Highlands	Program staff
Edgar Davis	Kentucky Highlands	Program staff
Glen Callebs	National City Bank	Bank focus group
Bob Jones	National City Bank	Bank focus group
Mack Butler	Monticello Banking Co.	Bank focus group
Ewell Balltrip	KY Appalachian Commission	KHIC Board; Regional economic development org.
Bill Singleton	Lumber King	KHIC Board
John Henry	Jackson Co. Entrepreneurship Center	Regional economic development org.
Cheryl Moorhead Stone	EKU Center for Economic Development, Entrepreneurship, and Technology	Regional economic development org.
Marcus Bordelon	Appalbanc	Regional economic development org.
Gary Thor	Mountain Economic Development Fund	Regional economic development org.
Greg Jones	Southern KY Economic Development Corp.	Regional economic development org.
Lonnie Lawson	Center for Rural Economic Development	Regional economic development org.
John Sturgill	Fantasy Custom Yachts (Monticello)	Entrepreneur
Steve Meng	Retail Floors (Manchester)	Entrepreneur; former KHIC management staff
Dwight Looney	Integrity Mold and Die (Mt. Vernon)	Entrepreneur
Mike Whitaker	Eagle Carriers (Somerset)	Entrepreneur
Joanna Gregory	Monticello Wood Products (Monticello)	Entrepreneur
Kelly Upchurch	American Health Management (SE KY)	Entrepreneur
Jack Grosswiler	Bluegrass Springs (London)	Entrepreneur
Jack Mills	Patriot Industries (Monticello)	Entrepreneur
Carmen Perry	Holiday Inn Express (Whitley City)	Entrepreneur
Steve Hart	TriTech Electronics (Williamsburg)	Entrepreneur
J C Egnew	Outdoor Ventures (Stearns)	Entrepreneur
Ray McGregor	Cumberland Gap Provisions (Middlesborough)	Entrepreneur

Figure 1. Kentucky Highlands Service Area

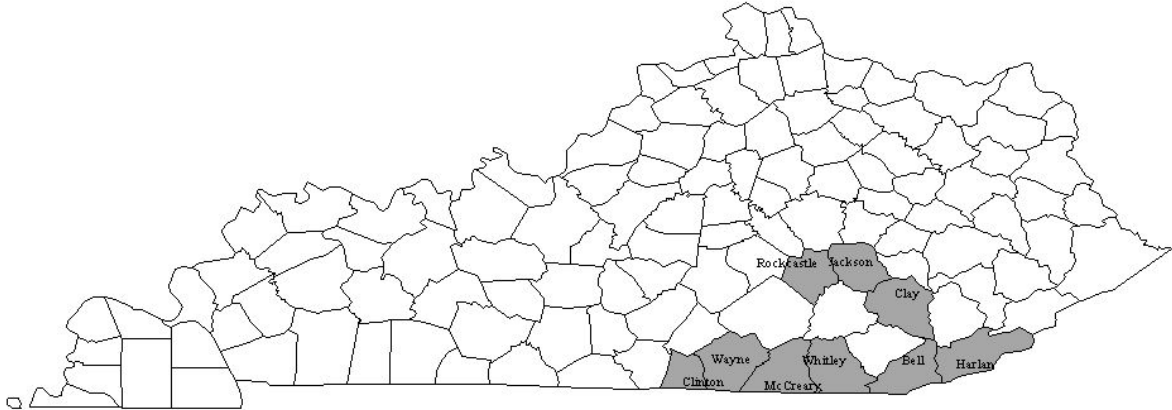


Figure 1. Nine County Service Area for Kentucky Highlands Investment Corporation

for New Enterprise Development to identify aspiring entrepreneurs for whom financing was available if the business was located in the nine county service area. Before making an investment, KHIC would develop a business plan and submit the plan to OEO for approval. If the plan were approved, OEO would release funds for KHIC to invest in the new company. From 1968 to 1980, KHIC received approximately \$14 million from OEO and others to support operations and investments in area businesses.

KHIC's early efforts at recruiting outside businesses and stimulating local entrepreneurs were relatively unsuccessful. Initial investments by the program were primarily debt, and most of the businesses receiving funding were started and managed by KHIC employees. Kentucky Highlands eventually dropped this model of business development (starting and managing businesses) because the organization's staff was too small to have an impact on area job creation if all new businesses were managed by KHIC. Industrial recruitment and real estate development efforts also were phased out as local industrial development

authorities were formed and assumed these responsibilities. Finally, in 1980 President Reagan ceased funding for OEO, which eliminated KHIC's principal source of grant funding.

The loss of grant funding opportunities in 1980 coincided with a change in KHIC leadership and a shift in program emphasis from creating jobs to supporting entrepreneurs who can create new companies. KHIC economic development efforts in the 1980s focused on starting businesses, and KHIC worked closely with entrepreneurs to develop their business plans and provide capital to support the new firms. KHIC personnel also were very active in assisting or managing struggling portfolio companies. KHIC found that their clients required more technical support than portfolio companies of traditional venture capital funds. Entrepreneurial skills were scarce among the indigenous population and new companies faced a business environment lacking in support services and infrastructure.

In 1989, leadership of KHIC changed and the new CEO emphasized finding and using new sources of government and foundation funding to support the mission of creating and nurturing companies. In the last 10 years KHIC increased the diversity of its financial offerings with the addition of a number of federally funded programs including the USDA Intermediary Relending Program, SBA Micro Loan Program, USDA Business and Industry Guaranteed Loan Program, Empowerment Zone Venture Capital Fund, New Markets Venture Fund, and the Community Development Financial Institutions fund. In addition, Kentucky Highlands has received funds from a number of sources for revolving loan funds (USDA's Rural Business Enterprise Grant program, Office of Community Services, U. S. Department of Housing and Urban Development, and the Appalachian Regional Commission.) Program related investments from the Ford Foundation and the MacArthur Foundation were used for revolving loan funds and equity investments. KHIC also borrowed funds from the Rural Local Initiative Support Corporation for relending to companies in the region. Current KHIC activities are balanced between traditional venture capital activities (finding, starting, and supporting new business development) and increasing the breadth of program offerings for area businesses through aggressive grantsmanship.

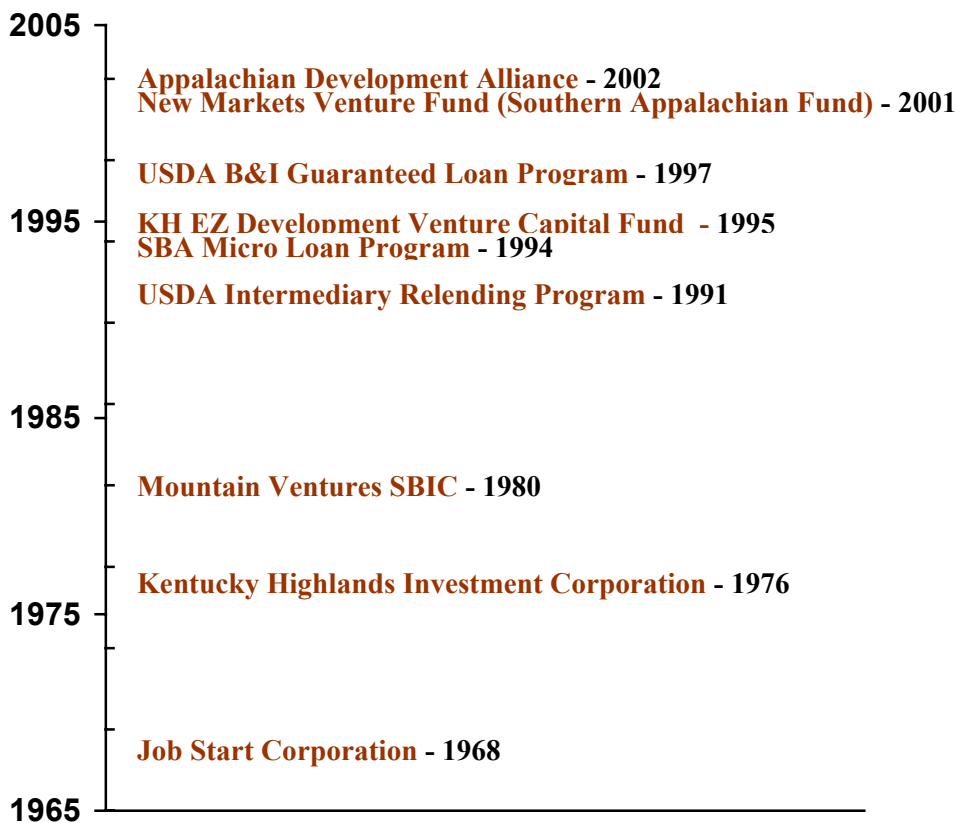
KHIC did not begin with a complete package of capital tools but rather evolved this toolkit over time in response to the perceived needs of entrepreneurs.

Kentucky Highlands has seen steady growth in its investments and net worth over time. Beginning in 1970 with investments valued at \$5,000 KHIC's investments have grown to almost \$30 million. The organization's net worth has increased as well, growing from about \$12,000 in 1970 to over \$30 million in 2002. Over time, the portfolio has moved in favor of debt, with debt now accounting for over 80% of the portfolio. KHIC has invested more than \$100 million in over 200 business ventures and averages 35 business loans per year totaling approximately \$7 million.

Current Kentucky Highlands Program Areas

The mission of KHIC has remained unchanged since Job Start was founded in 1968; however, the region has evolved in that residents and businesses are less isolated, educational and training opportunities are more easily accessible, and economic and community development organizations are more prevalent and sophisticated. Development within the service area permitted KHIC to focus program offerings on financial and technical assistance for area entrepreneurs and small businesses. Kentucky Highlands' program orientation also was influenced by the organization's leadership whose interests and expertise ranged from managing businesses to operating a venture capital fund to seeking grants and new program opportunities. The growth of KHIC program offerings since 1968 is presented in Figure 2 and summarized in the following discussion.

Figure 2. Evolution of KHIC Program Offerings



Capital Programs

Over time, Kentucky Highlands developed a set of capital tools that can be used to meet the needs of the region's entrepreneurs. As the following summary indicates, KHIC did not begin with a complete package of capital tools but rather evolved this toolkit over time. The organization was opportunistic in the sense of taking advantage of public and private funding opportunities to expand the amount and type of capital that could be tapped for any particular deal. However, Kentucky Highlands added these new capital tools in direct response to the perceived needs of entrepreneurs in southeastern Kentucky.

Job Start Corporation (1968) and Kentucky Highlands Investment Corporation (1976). In the early years of Job Start Corporation, the organization started and ran businesses using its own staff, with financing from the OEO. The first venture capital investment was made in 1972. To reflect the change in emphasis from operating businesses to investing in businesses, the organization changed its name to Kentucky Highlands Investment Corporation in 1976. Kentucky Highlands' initial investment strategy was implemented through the creation of the KHIC Fund. Although the fund was organized as a traditional evergreen venture capital fund, it was operated as a business development program. KHIC staff provides both business development support and financing to entrepreneurs, distinguishing its approach from more traditional venture capitalists. The KHIC Venture Fund received \$14 million in grants from 1968 to 1980 to support both operations and investments. The benefit of the evergreen organizational structure is that, over time, the value of the Fund has increased to over \$30 million as a result of interest and profit payments on KHIC investments, CDFI awards, and foundation grants. Through this fund, KHIC provides debt and equity investments to entrepreneurs along with extensive technical assistance. Funding for the technical assistance is provided by returns on other KHIC investments (primarily interest income from loan programs) and USDA and SBA funding set-asides.

Mountain Ventures SBIC (1980). In 1980, OEO provided a \$1 million grant to KHIC to create a licensed SBIC. OEO hoped that the SBIC status would enable KHIC to better leverage OEO development funds. However, Kentucky Highlands did not use the leverage provided by the program until 2000. Funds from Mountain Ventures SBIC are the only KHIC program monies that may be co-mingled with equity investments from the original KHIC Fund, and all profits (earned interest) from the deals are used to capitalize the KHIC and Mountain Venture Funds.

In 1989, Kentucky Highlands' current president, Jerry Rickett, was hired. Rickett brought grantsmanship skills to KHIC and these skills are reflected in the establishment of three programs: USDA Intermediary Relending Program, SBA Micro Loan Program, and the Empowerment Zone project.

USDA Intermediary Relending Program (1991). Kentucky Highlands became involved in USDA's Intermediary Relending Program (IRP) as a way to meet the needs of entrepreneurs who could not qualify for bank financing. Entrepreneurs come to KHIC when they cannot get a loan elsewhere in the region. Under the USDA IRP, the USDA makes a direct loan to KHIC at an annual interest rate of 1% for a maximum of 30 years. KHIC then makes loans from this revolving fund to businesses in the service area that do not qualify for bank financing. Maximum deal size is \$150,000 with the exception that 25% of the deals may be up to \$250,000. All loans to area companies are made at slightly less than market rates and are secured by collateral. KHIC submits each potential deal with a portfolio company to USDA and the Kentucky State Environment Clearinghouse for approval. All repayments on the IRP loans are kept by KHIC except for the amount required for annual loan payments to USDA. The remaining interest income and fees may be used for KHIC administrative costs, technical assistance, and fund replenishment. The IRP Loan Fund has made approximately 35 loans to area businesses and has used about \$4 million of the \$15 million allowed by USDA program guidelines.

SBA Micro Loan Program (1994). KHIC added the SBA micro loan program to its program offerings because it hoped that the availability of small loans would lead to bigger deals for Kentucky Highlands' other venture capital and loan programs. The micro loan program provides very small loans (maximum of \$35,000) to business start-ups or growing small businesses. Under the micro loan program, KHIC borrows from SBA a specific amount for a specific time. To date, KHIC has contracted with SBA for two funds: Fund I of \$300,000 and Fund II of \$500,000. While loan losses on the first fund were high (about 50%), there have been no losses yet on the second fund. KHIC has used stricter underwriting standards on loans made under Fund II.

The small loans available through the SBA micro loan program may grow into larger deals for KHIC's other programs.

The SBA micro loan program requires that the intermediary provide technical assistance and business training to their micro borrowers. SBA compensates Kentucky Highlands for this assistance the year after KHIC documents that (1) the technical assistance was provided, and (2) KHIC provided a 25% match for the assistance. The total amount available from SBA to KHIC for technical assistance is limited to 25% of the amount KHIC owes SBA.

Kentucky Highlands Empowerment Zone Development Venture Capital Fund (1995). Kentucky Highlands was successful in bringing federal money to three counties in its service area through the creation of an Empowerment Zone (EZ). The EZ was created in 1994 and includes Jackson County, Clinton County, and parts of Wayne County. The EZ funding provided \$40 million over 10 years for projects in these counties. While \$22 million was assigned to county projects, the Empowerment Zone (EZ) Fund was capitalized

with \$12 million; \$11 million targeted for general business and \$1 million for agricultural activities. In addition, \$2 million of EZ funding was used to capitalize the Mountain Venture SBIC, but loans based on the capitalization can be made only in the three EZ counties (Clinton, Jackson, and Wayne). KHIC is fiduciary to the EZ funds. The loan focus for the EZ fund is manufacturing and specific professional services. Loans are primarily long term, fully collateralized, with fixed rates of interest. A separate loan committee approves EZ loans, and for the first seven years of the program, EZ investments cannot be made in a company that also received financial assistance from a KHIC program. However, profits and interest earned on the EZ fund's investments remain in the KHIC Venture Fund, and KHIC is reimbursed for project management out of the EZ general budget. All of the EZ Fund is invested in area businesses, and 75 percent of the businesses that received EZ funding are locally owned.

Nonbank USDA Business and Industrial (B&I) Lender (1997). In the late 1990s, Kentucky Highlands added another federal program to its capital toolkit. KHIC became a B&I lender to provide an additional source of funds for area businesses and to assist area banks by packaging these loans. The B&I program permits KHIC to make larger deals (minimum of \$250,000 up to \$10 million for special cases) than other lending programs available to them. The USDA B&I Guaranteed Loan Program provides guarantees (80%, 90% within the EZ) for loans made by eligible commercial lenders to rural businesses. Loan proceeds may be used for working capital, equipment, and real estate. Currently, KHIC has participated in \$12 million of B&I loans, 7 loans originated by KHIC (4 closed, 3 in progress) plus other loans in partnership with area banks.

Southern Appalachian Fund (2001). The Southern Appalachian Fund (SAF) is a joint venture between KHIC and Southeast Community Capital, a private venture capital firm in Oak Ridge, TN. SAF is a conditionally approved New Markets Venture Capital Company as defined in the New Markets Capital Program Act of 2000. KHIC elected to participate in a New Markets fund so that it could provide access to capital to a broader service area and bring new sources of capital to its nine county service area.

The fund will be capitalized with \$12.5 million, \$5 million raised from institutions concerned with economic development in Appalachia (e.g., TVA, ARC, foundations, banks) and \$7.5 million in federal matching funds (1.5 to 1 match). Investments by SAF are limited to low-income census tracts (80% of state median income, 20% in poverty) in Kentucky, Tennessee, N. Georgia, N. Alabama, and N.E. Mississippi. SAF will be operated as a limited partnership with a 10-year life. KHIC and Southeast Community Capital are the general partners, and they will receive 25% of the earned interest. Other investors in the fund (the limited partners) will receive the principle plus 75% of earned interest. The SAF will have \$8 million available for investing in portfolio companies after

set-asides for SBA discounts, reserves, and management fees (3.5% per year for 10 years). In addition, the fund will receive \$1.5 million from the SBA matched with \$1.5 million from other sources to provide technical and management assistance to the businesses in which SAF invests.

The Appalachian Development Alliance (2002). The Appalachian Development Alliance (ADA) is a consortium of nine area economic development organizations (Pine Mountain Development Corporation, Southern Kentucky Economic Development Corporation, East Kentucky Corporation, Mountain Association for Community Economic Development, Mountain Economic Development Fund, HEAD Loan Fund, Community Ventures, Jackson County Entrepreneur Center, and KHIC). The Alliance allows these organizations to collaborate and tap into funds that might not otherwise be available, such as state funds. ADA operates as a fund of funds, with each organization providing capital (minimum of \$50,000) and different areas of expertise and specialization. The Alliance serves a broader geographic area than the nine counties in KHIC's service region, and the larger geographic region makes ADA eligible for state assistance. ADA recently received \$1 million from the Kentucky coal severance tax fund, and the Alliance is investigating the possibility of receiving CDFI funding. It is planned that each of the organizations in ADA may borrow from the Alliance after it receives external funding.

Technical Assistance Programs

Part of what distinguishes a capital-led economic development program, like Kentucky Highlands, from more traditional venture capital funds is the provision of hands-on, customized technical assistance to entrepreneurs. Particularly in the southeastern Kentucky region, entrepreneurs often lack the business and technical skills necessary to manage a successful business enterprise. The KHIC model recognizes these potential limitations and works with the entrepreneurs to develop the requisite management capacity.

KHIC provides three principal types of technical and managerial assistance to local entrepreneurs and businesses. First, KHIC works one-on-one with a business after the company becomes a member of the KHIC portfolio. Technical assistance provided by KHIC includes devising strategies and business plans, developing markets and marketing products, developing treasury skills in terms of managing flow of funds for collections and payables, getting good terms of credit with suppliers and creditors, and getting access to credit from local banks. KHIC also will provide these services for an entrepreneurial team but a fee will be charged for the assistance if the entrepreneurs go elsewhere for funding. Second, KHIC may take over management of a portfolio company if the firm defaults on its equity or loan agreement. KHIC also may undertake a "constructive takeover" whereby Kentucky Highlands stipulates that future loans or equity investments will be forthcoming only if the business meets certain

conditions. Third, Kentucky Highlands offers technical assistance to entrepreneurs and small businesses through its business-planning center (The Launching Pad). The Launching Pad is an Entrepreneurship Institution funded by the Appalachian Regional Commission, United States Department of Agriculture, and the Small Business Administration.

Other Program Areas

Kentucky Highlands received grant funding from numerous government agencies for specific projects. These sources include the USDA Rural Business Enterprise Grant Program, the Department of Health and Human Services Office of Community Services, the U.S. Department of Housing and Urban Development Rural Housing and Economic Development Program, and the USDA Rural Business Opportunity Grant Program. KHIC also received capacity building grants and loans from the Rural Local Initiative Support Corporation and the Ford Foundation.

Fiscal Responsibility

The program descriptions above demonstrate the breadth of funding sources used by Kentucky Highlands. While this program breadth enables KHIC to meet the unique technical assistance and capital needs of entrepreneurs in its service region, this flexibility comes at a cost in terms of added fiscal responsibility. KHIC has an annual A-133 audit, but the SBA, IRS, and USDA also conduct audits. In addition, the Inspector General of any other organization that provides funds to KHIC may request an audit. Over the years, Kentucky Highlands has developed relationships with advisors in the areas of accounting, taxation, legal, and insurance and KHIC works very closely with them on a number of issues, such as the non-profit ownership of a for-profit enterprise. Kentucky Highlands relies heavily on the counsel of these advisors in order to be successful. It is as important for effective entrepreneurial support organizations to develop a network of support providers as it is for the entrepreneurs they serve.

Entrepreneurs' Perspective

The true measure of Kentucky Highlands' success is found in the experiences of entrepreneurs who received assistance and capital from the organization. The twelve entrepreneurs interviewed for this case study produce a wide range of goods and services and are located throughout the Kentucky Highlands service area (see Table 1). Business product lines include wood flooring, military equipment, houseboats, molds for plastics, printed circuit boards, hams and sausages, springs, a tire recycling process, sporting goods, adult daycare centers, a trucking service, and a hotel. The products and services provided by these entrepreneurs do not meet the high tech, bio tech focus of many venture capital funds, but rather they reflect the Southeastern Kentucky economy

“Kentucky Highlands provided these entrepreneurs with much more than capital.”

with a concentration of more traditional manufacturing and service sector enterprises.

While each deal between Kentucky Highlands and an entrepreneur is uniquely structured, a number of common themes can be drawn from their experiences with KHIC. One important theme was that Kentucky Highlands provided these entrepreneurs with much more than capital. All of the entrepreneurs identified technical or business assistance provided by KHIC as part of the financing package and indicated the value of this assistance to the business. One entrepreneur described Kentucky Highlands as being more like a partner than an investor. This entrepreneur also indicated that the company would want KHIC representation on the board even if there were no longer a financial relationship. In another case, an entrepreneur sought KHIC staff expertise to help screen applicants for a management position even though this was not required by Kentucky Highlands. Another entrepreneur described how Kentucky Highlands used contacts within the banking community to pull together a financing package and used connections with community officials to help smooth the way for this new business enterprise. One entrepreneur indicated that his company was looking for more than money. The company wanted investors who understood the business and they got such investors in KHIC.

While entrepreneurs benefited from KHIC technical assistance, the financing was also critically important to their success. Several entrepreneurs received equity investments from Kentucky Highlands, capital that was not available from any other sources in the region. Other entrepreneurs indicated that they were unable to get debt financing from local banks until Kentucky Highlands became involved in the deal. In addition to the first round of financing, several entrepreneurs pointed to the importance of the follow-on capital that Kentucky Highlands was able to provide as their businesses grew or struggled and needed additional financing.

Another common theme among the entrepreneurs interviewed focused on Kentucky Highlands' "staying power" in a deal, i.e., KHIC's flexibility and willingness to stick with an entrepreneur as the business experienced difficult times. This "staying power" included providing management or technical assistance as well as stepping in with an additional infusion of capital to get the business through a rough period. In one case, Kentucky Highlands was working with an entrepreneur going through bankruptcy proceedings while at the same time discussing how KHIC might be involved in his next business opportunity. In another case, KHIC served on the board of a company as the board encouraged the company to change directions and pursue a new market. Kentucky Highlands stood by the company and showed confidence in the management and the future direction. A final theme that emerged from the entrepreneur interviews was that Kentucky Highlands was the principal, and often the only, entrepreneurial support

organization used by the emerging business. A number of entrepreneurs indicated that they would not have started their businesses without the involvement of KHIC. While many of these entrepreneurs eventually acquired bank financing and a few took advantage of state tax credit programs, very few of them sought assistance from other economic development organizations in the region. In most cases, the engagement of other financial or assistance providers was the result of Kentucky Highlands' efforts to bring additional partners or pools of capital to the table. These experiences confirm the role of KHIC as a lead entrepreneurial support organization in the region.

Lessons Learned

Kentucky Highlands provides a useful model for identifying lessons learned because of its long operating history and the evolution of its program portfolio over time. There are, however, important caveats to this experience that must be acknowledged. First, KHIC received substantial public (federal) investment at its inception, funding that is unlikely to be available to programs created today. The capitalization of an entrepreneurial support organization is a significant challenge that must be considered. Organizers of an ESO will need to devote resources during the start-up phase to raising capital from a variety of sources including public, private, and non-profit.

Second, KHIC provides assistance to entrepreneurs who the staff identifies as being viable candidates for investment. KHIC may work with an entrepreneur to develop a business idea to the point of being investment ready; however, the organization does not attempt to identify potential entrepreneurs who articulate an interest in starting their own business but who present no concrete business idea. There continues to be a gap in the region in providing this deal flow development activity. While this development is occurring in specific parts of the region, such as in the Jackson County Entrepreneurship Center, it is not widespread throughout Appalachian Kentucky.

The following lessons learned are offered as input to other organizations serving rural regions that are interested in developing effective ways to support entrepreneurs and encourage economic development. The uniqueness of rural regions suggests that no single model will be applicable in all places. As a result, the shared learning from Kentucky Highlands can be applied to other models of entrepreneurial development and should be viewed as guiding principles for other organizations to use as they create their own unique strategies.

Lesson One: Focus on Entrepreneurs and their Enterprises

The focus of Kentucky Highlands' activities is on the entrepreneur and his or her enterprise, not the capital used to support the entrepreneurs. KHIC works with individual entrepreneurs to put together a package of assistance that will

increase the probability of the new business' success. This assistance includes recognizing the weaknesses in an entrepreneur's set of management skills and plugging the gaps in the management team, even with KHIC staff. Staff members are committed to making the entrepreneurs and businesses in which they invest successful, and the KHIC staff invests in businesses that they can run if necessary. The willingness to step into a management position and work side-by-side with entrepreneurs to turn a business around differentiates the Kentucky Highlands model from the typical venture capital or business investment model.

As an example, KHIC Vice President for Investments, Elmer Parlier, assumed the duties of president in one of KHIC's portfolio companies, working along with the company's president. Through his efforts, the company instituted changes that put the business on the road to profitability. Control of the company then reverted back to the president. This ability to fill a gap in an entrepreneur's management team, even as high as the president, is particularly important in a rural region like southeastern Kentucky where the pool of potential management talent is limited. This hands-on technical assistance also helps to build the skill set of the entrepreneur and the ability to manage a successful company in the future.

Lesson Two: Committed and Skilled Staff

The quality of support provided to entrepreneurs is a function of the quality of staff assembled in the Kentucky Highlands organization. Individual staff members demonstrate a strong commitment to both the southeastern Appalachian Kentucky region and the organization itself. Many of the senior management staff have been with the organization for more than 10 years and have been in the region even longer. The current staff averages 9.5 years of service. This longevity helped KHIC maintain a strong focus on and commitment to the organization's mission.

“Individual staff members demonstrate a strong commitment to both the southeastern Appalachian Kentucky region and the organization itself.”

The Kentucky Highlands staff brings a set of diverse skills to the mission of assisting entrepreneurs. Staff members who work directly with entrepreneurs have technical skills, such as accounting, along with experience managing business enterprises. This business experience is essential to KHIC's mission since staff can assume management of a portfolio company as needed in order to turn a company around. This blend of deal making and business management skills is important for working with the more inexperienced entrepreneurs that seek assistance from KHIC.

A primary concern for many ESOs is management succession. Most ESOs are created by individuals who are dedicated to serving entrepreneurs in a particular distressed region. For example, there is a missionary zeal evident among KHIC's long time staff. Maintaining staff quality and commitment over

the long term, however, is a potential problem for entrepreneurial support organizations. KHIC addresses this issue in two ways, by developing local talent and by compensating staff adequately. KHIC recruits interns from local colleges to work in the organization and then actively encourages those with talent and commitment to return after college. This cultivation process has provided them with additional staff people as needs developed. Currently, at least three of the eleven business development and office staff came to KHIC through internship opportunities. In terms of compensation, KHIC staff has an opportunity for some profit sharing as well as salary packages that compare favorably with other economic development organizations. However, Kentucky Highlands is not in a position to offer compensation packages in line with more traditional venture capital funds, limiting their ability to attract staff from these institutions.

Lesson Three: Focus on Grantsmanship

Grantsmanship is a key function within the KHIC organization. KHIC has been successful in tapping a number of federal programs (as described above) that provide greater flexibility in responding to an entrepreneur's needs. The success in raising grant money is a function, to some extent, of the specialization of senior management. The CEO of the organization has an explicit focus on grantsmanship while the COO and Vice President focus on deal making, deal development, and entrepreneurial assistance. While this specialization evolved over time as new leadership was brought into KHIC, it can serve as a model for other organizations.

However, grantsmanship does require a commitment of organizational resources. Both time and talent are required to identify potential sources of grant/program dollars and complete the applications required. For example, the EZ program application process took ten weeks to complete, requiring almost complete focus on the part of several staff. Jerry Rickett, CEO, devotes most of his time to grantsmanship so that Kentucky Highlands has one FTE devoted to this function. While KHIC has been successful in expanding the resources and tools available to help the region's entrepreneurs, it is important to recognize the significant commitment of resources required. In addition, Ray Moncrief noted that public funds to capitalize an organization similar to Kentucky Highlands are more limited today. Other resources, such as private and philanthropic dollars will have to be targeted as well.

Lesson Four: Active and Supportive Board

The KHIC Board of Directors played and continues to play an active role in supporting the organization's mission. As with the staff, the continuity and longevity of the Board has helped KHIC maintain its focus on helping entrepreneurs within the region. The current Board averages 17.3 years of service per director. Wayne Stewart, the past president of the Board, served for more than 25 years. The Board challenged KHIC to be innovative and try new

approaches to encouraging economic development in the region through support of entrepreneurs. According to Jerry Rickett, the Board encouraged KHIC staff to take risks and have an impact on the region. Rickett was asked each year what new thing the organization was going to try and what its two biggest failures had been. If there were no failures, Stewart felt that KHIC was not achieving its mission of taking risks to create sustainable businesses in the region.

The organization of the KHIC Board changed over time in an effort to provide ongoing and politically neutral support of the organization's mission. Initially, Board members were elected by the six community action agencies that founded KHIC, in keeping with OEO's requirement that the poor have an opportunity to participate in the governance of the organization. However, as Kentucky Highlands' focus shifted over time from community development to a capital-led economic development strategy, it became more important for the Board to have greater control over its membership. The Board needed members with a deep understanding of the organization's mission and a commitment to KHIC's investment strategy. As a result, the Board became self-perpetuating in 1981, and the remaining members of the Board select replacements for open seats. This new structure provides insulation for the Board from the political process since Board members are not appointed by county-level organizations.

The level of Board commitment to KHIC is high. Bill Singleton, current chairman of the Board, indicated that Board members have been focused generally on Kentucky Highlands' mission and not very much on self-interest. The Board members are very dedicated and have established strict participation requirements in order to retain a Board seat. Singleton also indicated that Board members generally feel that serving on the Board is a meaningful experience and that they are giving something back to the region. This level of commitment has been critical to the success of KHIC.

Lesson Five: Partnering to Create an Entrepreneurial Region

The organization's success over time encouraged the formation of other local development organizations and helped to create a more entrepreneurial region. Kentucky Highlands was influential in the creation of a number of development organizations within the region, including MACED and the Appalachian Development Alliance. At the same time, partnerships are a key to KHIC's success, allowing the organization to share risk, extend its geographic reach, and increase the talent pool available to help entrepreneurs. Partnerships also permit market segmentation so that KHIC can focus on the larger deals and existing entrepreneurs while other organizations target smaller deals and potential entrepreneurs.

In addition to partnering with regional organizations, Kentucky Highlands has developed a significant network of national partners. KHIC works closely with the Rural Local Initiative Support Corporation, the National Congress for Community Economic Development, the Community Development Venture Capital Alliance, the National Community Capital Association, the National Cooperative Bank and others. These partnerships help strengthen Kentucky Highlands and bring additional resources into the southeastern Kentucky region. While initially KHIC may have been viewed as the “big brother” among regional development organizations, the capacity within the region has improved over time. Other regional organizations have expanded in size and experience. These organizations have had time to build relationships so that individual organizations are thinking about partnering as opposed to going it alone. As a result, the partnerships among these different organizations create an entrepreneurial support infrastructure that no single organization could provide.

Conclusions

Kentucky Highlands has a long history of supporting entrepreneurs and providing capital to create new business enterprises in the southeastern Kentucky region of Appalachia. The organization has evolved a set of programs over time that provides a range of capital products and technical services to area entrepreneurs. Kentucky Highlands uses the developmental venture capital model to promote economic development in its service region. If the organization’s success is measured against the standards of venture capital funds, in terms of rate of return achieved, Kentucky Highlands’ returns are not in line with those of more traditional funds. However, as a self-sustaining economic development organization, supporting entrepreneurs and their businesses and creating jobs and wealth in the region, Kentucky Highlands has been highly effective.

According to former president Miller, Kentucky Highlands has been entrepreneurial itself – finding creative, innovative solutions to the challenges the organization has faced as it pursued its mission. While the organization’s orientation and programs have changed over its history, the focus on creating jobs and locally controlled wealth by investing in entrepreneurs and their business enterprises has not changed. Kentucky Highlands’ success is a product of a committed and skilled staff, a dedicated and active board, an explicit focus on grantsmanship, and a willingness to partner with or encourage the creation of other regional development organizations focused on building the entrepreneurial capacity in the region. KHIC’s capital-led strategy is just one means of encouraging entrepreneurial development; however, the lessons learned from Kentucky Highlands experience apply to other economic development organizations that are committed to becoming effective entrepreneurial support organizations in their rural regions.

In pursuit of its mission, KHIC has been entrepreneurial – finding creative, innovative solutions to the challenges faced.

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