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"Why Low-Income Communities Should Value Smart Entrepreneurs over Smart Capital"

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Dileep Rao is a clinical professor of entrepreneurship at Florida International University. He studies high-performance entrepreneurs to learn how they built big businesses and created jobs. Outside Silicon Valley, billion-dollar entrepreneurs grew with capital efficiency, not with venture capital, and they created significantly more jobs than venture capitalists. Previously, as vice president of business development at one of the country's most successful community development and finance institutions, Rao financed and developed over 450 businesses using equity, subordinated and senior debt, hybrids, and leases. He advises entrepreneurs, the U.S. government, corporations (Medtronic, General Mills), and financial institutions on high-performance strategies to build businesses and create jobs. Rao has written several books, including *Business Financing: 25 Keys to Raising Money* (2000), *Handbook of Business Finance & Capital Sources* (1982), and *Finance Any Business Intelligently*™ (2008). His latest book, *Bootstrap to Billions* (2010), shows how entrepreneurs built Fortune 500 companies without resources. Rao has been the entrepreneurial finance columnist for Forbes.com. He has a doctorate in business administration and two engineering degrees.

Summary and Findings: Job creation is tough, especially in low-income areas. Governments have tried offering equity financing, assuming that the problem is a shortage of risk capital, which, if offered, can earn high returns and create jobs. But the problem persists because the programs may be misdirected. Two studies suggest that areas outside Silicon Valley may gain more from developing smart entrepreneurs than from promoting smart money. One study analyzed the strategies of 85 U.S. billion-dollar entrepreneurs, who built companies to over $1 billion in sales and valuation from scratch. The other study interviewed 28 Minnesota entrepreneurs of whom five were billion-dollar entrepreneurs and 23 were hundred-million-dollar entrepreneurs who built over $100 million in sales and/or valuation. Minnesota has developed the highest number of Fortune 500 companies per capita. The findings include: about 88 percent of Silicon Valley's billion-dollar entrepreneurs used venture capital (VC). Outside Silicon Valley, only about 9 percent did. Previous studies have shown that few VCs (about 4 percent) earn most of the IPO profits. This study suggests that these top VCs are in Silicon Valley or invest there. VCs need to exit from their ventures so the jobs may leave the area. Smart entrepreneurs succeed by developing the right skills.

Implications for Policy and Practice: Low-income communities can reduce their needs for capital and increase job creation by developing smarter entrepreneurs. Many development financiers offering high-risk capital in low-income communities seek the "double bottom line" of financial returns and job creation. But without home runs, venture capitalists outside Silicon Valley have a difficult time earning high returns in early-stage ventures. And outside Silicon Valley, billion-dollar entrepreneurs seem to be better at creating jobs that remain in the area than venture capitalists. Rather than focusing on capital formation, policymakers may better serve their communities by developing smarter entrepreneurs who build bigger, capital-efficient, and competitive businesses. This means that low-income communities can benefit by assisting entrepreneurs get the skills learned by the billion-dollar entrepreneurs, which include sales and financial management skills for value-added sales with limited assets and financing; recruiting and managing skills to build competitive organizations without resources; and leadership skills to build dominant organizations to lead their industry. For low-income communities, developing smart entrepreneurs with capital-efficiency skills may be more important than offering venture capital. This can be done by ensuring that entrepreneurs who have obtained real results with capital efficiency are encouraged, rather than those who only have impressive business plans.