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Association News

May 11th IVCA/NVCA Luncheon: Speakers and Highlights from the Annual Event including Mark Heesen of the NVCA and Chicago Mayor Rahm Emanuel

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CHICAGO – The Daniel Burnham Room of The Chicago Club on East Van Buren Street was the setting for the annual Illinois Venture Capital Association and National Venture Capital Association Luncheon. It is appropriate that one of Daniel Burnham’s signature quotes was “make no little plans,” for the newly minted Mayor of Chicago, Rahm Emanuel, was on hand to express his point-of-view on the upcoming administration.

The luncheon event, sponsored by accounting/advisory firm Baker Tilly and global law firm Ropes & Gray LLP, also featured speakers Mark Heesen, President of the NVCA, and Doug Lowenstein, President of the Private Equity Growth Capital Council.

The luncheon program was moderated by Darren Snyder, the Vice Chairman of the IVCA and Partner at Prairie Capital. He began the proceedings by introducing James Lidbury, Partner at Ropes & Gray. “We’ve found that the IVCA has been a valuable forum for [Ropes & Gray] to be involved in,” Lidbury said.

Next up was Tim Christen, the Chairman CEO of Baker Tilly. “It is a big pleasure and an honor to participate as a sponsor for the IVCA, it is a great organization,” Christen said. “Participating with you is really important, because bringing deal flow to you and our other clients is an important part of the equation at Baker Tilly.”

Highlights of Remarks by Darren Snyder, Vice Chairman of the IVCA...

- o “I can tell you that change is constant, and there are no ordinary times.”
- o “We need to see the positives – in the economy, the entrepreneur and the opportunity. There are no ordinary times, but there are good times to invest. And this sure seems like one of those times.”
- o “The IVCA has a decade-long track record of success. It’s the only regional association representing both venture and buy-out communities. Those two groups are definitely in different life stages from an investment standpoint, but the commonalities are many, including the goals of growth, scale and enterprise values of our companies.”
- o “The IVCA provides a hub in our network for employees, resources and deal flow. The role is to connect, engage, advocate and collaborate, to strengthen our industry locally.”

o “Today, the IVCA is joined by our long-time partner, the NVCA, who represents the venture capital community in Washington. Also we welcome the Private Equity Growth Capital Council, representing the large players in the buy-out community. It’s encouraging that the IVCA, NVCA and the PEGCC are all working independently on communications that explain the process of investing in private companies.”

o “It’s a great time to invest for our industry, and a great time to invest in our industry.”

Highlights of Remarks by Rahm Emanuel, Mayor of the City of Chicago...

o “You never should get so ensconced in the office, that you lose touch with people. In fact, three bills that I introduced that ended up passing all came from people who said something to me at the grocery stores and I ended up looking into it, and you end up solving people’s problems.”

o “You can’t do what you’re going to do if I don’t have a trained workforce here. Going to college, 3 out of 4 jobs in the future are all going to require something in a post high school education, a minimum of two years. Many of them way beyond just two years of college education.”

o “I think we are in a different place than we were as a city, literally just eight years ago. When you look at the pieces that make up what it takes to start the dynamic new businesses of tomorrow, clearly we have the research institutions. We have a great transportation system, we have a skilled work force – you couldn’t have a Groupon in Chicago if you didn’t.”

o “What has been missing in the years, and what is coming about, is that you now have the serial entrepreneurs who are two or three ventures in and they have something on their track record, so both you and the other venture capitalists are confident that you have an entrepreneurial class that has a track record of success.”

o “When you look at what makes up the basic building components of a very successful economic culture in a start-up community, it is the entrepreneur, the research institutions, the financial backing, as well as the coaching that comes from successful entrepreneurs to help young entrepreneurs who have new ideas to nurture them, sponsor them and encourage them to succeed.”

o “City government does not create jobs. Creating jobs is your job. My job is to create the conditions for you to create jobs. I have to stay in my wheelhouse, you’ve got to stay in your wheelhouse. You will have ideas and recommendations for me, without a doubt, and that is a good conversation to have.”

o “I have to make Chicago an exciting place to live, so you have the talent pool that will not make it a struggle to start up a company.”

o “We have to make sure our research entities, both public and private, are funneling the type of basic research that you can convert to a form of commerce. We don’t have in our universities a culture of commercialization and research, it has been historically in those institutions just a culture of research. We have to get better at commercialization without losing the integrity that comes with pure research.”

o “I am very confident about Chicago’s future. I am confident about what we have here, and I think people will see a city that is on the move, confident of its future and willing to attack the challenges it faces. I can look at them as challenges, or as opportunities to do big things.”

Highlights of Remarks by Mark Heesen, President of the NVCA...

o “I do see reasons for optimism, not only for Illinois but for the middle part of the United States. I think we have seen some positives over the last couple of months and hopefully that will bode well for the future as a whole.”

o “We have found in 2010 that 11% of private sector comes from companies that at one point were venture backed. That is an increase from where we were two years ago, during a very difficult period. This industry continues to be an incredibly important part of the U.S. economy.”

o “You continue to see growth in Chicago, that growth continues to get stronger and in 2010 venture capitalists invested in 47 Chicago companies, almost three quarters of a billion dollars. That was the

highest number for Chicago since 2001.”

o “The growth potential is in these emerging growth companies, for Chicago’s tax base and for moving forward, under very difficult times. What the new mayor brings is an appreciation for public policy as a part of growing an entrepreneurial community.”

o “You have to put your money where your mouth is. And one of the easiest things to do is put a small portion of the State of Illinois pension fund, the City of Chicago pension fund, into alternate assets. Be it private equity or venture capital, it is a strong signal that the city or the state is serious about wanting to bring innovation, jobs and venture-backed companies to its jurisdiction.”

o “It is very important to understand the federal budget cuts that will be going down in the next several years. I think the budget cuts will be very significant, and for portfolio companies I think it’s very important. Venture capitalists, you have portfolio companies that have contracts with federal, state and local governments. You have to make sure those will continue, or that you have other alternatives besides contracts to keep those companies moving, because things are going to get difficult over the next several years.”

o “Of all the issues out there, I continue to think that immigration reform, from a venture backed perspective, is probably the most important issue out there. You have to be able to keep the people in the country who are helping to create the jobs. Half of our companies today, that we invest in, have either the CEO or founder or both come from outside the United States. They want to stay here and create the jobs here.”

o “When it comes to the definition of venture capital from the Dodd-Frank perspective, that process is moving forward, but we’ve not heard anything from the SEC. At this point, as to how they’re are going to define venture capital, we’ve been given somewhat of a reprieve from the July 21st effective date.”

Highlights of Remarks by Doug Lowenstein, President of the Private Equity Growth Capital Council...

o “It’s very fitting to be here in Illinois because our members alone, about 36 firms now, we have 160 private equity owned facilities in the State of Illinois, employing over 64,000 people. In Chicago, 69 facilities employ about 14,000 folks. Total private equity investment in Illinois today is about 76 billion dollars.”

o “There is a general sense about carried interest that in the short term we have some breathing room there, as the politics surrounding it has changed. The geopolitics have changed as well, with the House being controlled by Republicans. That being said, I think it would be a false sense of security to think the issue has disappeared. There are scenarios, not the least of which is some form of a larger agreement around budget and tax policy, where I can see that carried interest would be part of a throw in.”

o “The Obama administration is talking about putting out a tax reform plan sometime later this month. Obviously that’s a good thing, we need to have a look at the tax codes, but there are some real risks lurking out there for those of us in the private equity space. The context of tax reform is simple, if you’re going to have some reduction in corporate rates, you have to broaden the base.

o I think it’s very likely we will see a proposal from the administration that will propose capping or significantly reducing the flow-through treatments available to partnerships. Also of interest to the private equity community, we’re hearing rumblings that there will be another look into the whole question of interest deductibility.”

o “On the regulatory front, we are focused on issues in respect to Dodd-Frank. One is the Registration Advisory Act, which is going through a Congressional debate about the nature of registration requirements. Should it apply to all private equity firms, or should it be modified for firms based on size, scale and systemic risk criteria?”

Q&A Session, Featuring Mark Heesen and Doug Lowenstein...

Q: Doug, you’ve built a new association from the ground up. What are your thoughts on how you will continue to grow represent the private equity industry?

Doug Lowenstein: In brief, we set aside growth initially and concentrated on immediate challenges, like the carried interest issue. It was in the beginning of last year that we made a commitment to grow the organization. The idea is to be diverse and broad-based, but to grow in a way we can manage. That's our goal, and we want to be broadly represented.

Q: Doug, in your tax discussion you didn't talk about capital gain rates. What do you foresee on that?

Lowenstein: I think we'll see more activity around the tax reform issue, I don't see the environment coming together for real broad-based tax reform between now and the election year of 2012. I think fundamental tax reform is an extraordinary challenge, it doesn't happen very often, and when it does happen you have to have the confluence of very unusual forces. I could see big budget deals that need revenue offsets, and those offsets could come from a lot of different places, and can be characterized as tax expenditures.

Mark Heesen: I agree with Doug on the issue of fundamental tax reform. It's hard to see that occurring anytime soon. I think the Bush tax cuts will sunset, because when we see the budget cuts actually hit at home, then people will say 'we've gotten that pound of flesh, now let's look at the other side.' I think it's difficult, even with Republicans, and you're probably back to 20% for capital gains.

Q: Mark, can you give us your perspective on the fundraising environment for venture right now?

Heesen: Unquestionably, it's been a difficult fundraising environment. I think a year and a half ago, Limited Partners were not answering the phone. A year ago they were answering the phone but not taking a meeting. What you're seeing today is that they're taking the meeting. Sometimes that meeting is 'I'm not working with you anymore,' LPs have made it clear that they're going to cut the number of relationships – they're not going to have 15 relationships, they're going to cut it to five. You are seeing a contraction in the industry.

At the same time, you are finally seeing returns. We had a record number of acquisitions in 2010, and a very healthy first quarter in acquisitions, and these are quality acquisitions being done. I see that through the rest of the year.

On the IPO front, certainly we're not where we want to be, but we're starting to see some good in IPOs as well. We have 50 companies in registration, which is also higher than where we've been, and all those companies want to go public. So you have a stable stock market, more companies will be going out, LPs will be getting more checks and I think the pocketbooks will open up a little more.

Lowenstein: Let me add one point that you might not think about in the context of fundraising. This whole debate involving defined benefit plans involving state pension funds is something that people in this industry have a real stake in. And if you talk to the pension funds the pressures that they are under on this side, could well effect their continued ability to allocate into these asset classes. They are looking for ways to validate the defined benefits model as an important long-term part of the retirement security system in this country. Because if it is not, if there a successful broad-based attack on that form of retirement security, it is going to have an effect on people in our business.