

For a lot of well-off people, it's boring to invest in little pieces of paper or numbers on a screen. The real he-man—and she-woman—investor likes investments he can touch, talk to and advise.

Blue chips in your own backyard

By Fleming Meeks and Kate Bohner Lewis



McALESTER, OKLA. is best known for its Labor Day prison rodeo, where prisoners try to snatch a leather pouch containing a \$100 bill from between the horns of a bull. The rest of the year, however, McAlester (pop. 19,003) seems every bit the sleepy little cattle town, where life moves so slowly that the UPS man leaves his truck parked in the middle of Choctaw Avenue for an hour every day as he makes pickups and deliveries at local shops and offices.

Appearances are deceptive. Ninety miles due south of Tulsa and a world away from Wall Street, McAlester is part of one of the most vibrant capital markets in America.

Every Wednesday morning, in a narrow room off to the side of an automobile engine remanufacturing plant out on the Highway 69 Bypass, you'll find ten of McAlester's most prominent businessmen. There, sipping tepid coffee and sliding a box of chocolate-covered doughnuts up and down the table, the group swaps amiable japes as the conversation moves from college basketball to crappie fishing to the business at hand—venture capital.

Yes, venture capital. Not for these fellows are the carefully packaged investments offered by stockbrokers. These are folks who like to get close to where they put their money. "We like to take a hands-on approach with our investments," says Jim Mills, 68, a retired funeral home director and McAlester's former mayor. "And gosh, there's just so many investment opportunities locally."

Seven years ago Mills sold his 14 Oklahoma funeral homes to Houston-based Service Corp. International for "more than I dreamed I could." After a stint as a rancher,

during which he crashed three helicopters while herding his 15,000 head of cattle, Mills turned to something a little bit safer: investing in companies in his own backyard.

Among his confederates in the McAlester Investor Group are Brad Fenton, 41, who owns four car dealerships in McAlester and surrounding towns; Dee Sanders, 74, a retired rancher and the former county sheriff; Don McClain, 71, owner of McClain Building Center, a big lumberyard in town; and Noble Miller, 71, a retired Air Force colonel and owner of Miller Brothers Construction.

Over the past three years, this gang of ten has put up \$1 million in equity, \$4 million in loans and \$5 million in loan guarantees to back five local startup companies.

"Our first deal kinda went sour," says Noble Miller's brother Jim, 67, a rancher who ran a wholesale and retail glass business in town for 32 years before selling out to his family in 1986. Led along by a pair of promoters who promised to put up a factory in McAlester to rebuild foreign car generators and quickly take the company public, the McAlester boys put up \$210,000 in seed capital.

They also made a fatal mistake. "They [the promoters] convinced us that we didn't need to have two signatures on the checks," explains Jim Mills. Within six months, all of their money was gone.

But what the hell, you can lose money in the stock market, too. "We were already into two more projects when that deal went south," says Mills with a soft "hee-hoo" laugh, when asked why they didn't throw in the towel then and there.



On Choctaw Avenue with the McAlester Investor Group (seated, left to right): Jim Miller, M.W. Priddy Jr., Noble Miller; (standing) Dee Sanders, Don McClain, Jim Mills, Gerald Calaway
"Gosh, there's just so many investment opportunities locally."

Missoula, Mont. investors Bob Small (left) and Bob Mullendore (right), with Thompson Dental's Tommy Thompson
"I knew we had a good product. But you bet on the people."



The little investment group had learned its lesson. Ever since, the group has insisted on controlling either the bank account or the board of directors, or both, in every company they invest in.

Ask the McAlester boys how they're doing and you'll get a broad smile. Three years ago the group put up \$500,000, or \$50,000 apiece, to back an entrepreneur, Mitch Morris, looking to start an engine remanufacturing plant.

Big auto parts retailers like AutoZone and Trak Auto signed as customers and were soon placing orders in the thousands for Phoenix Industries' remanufactured light-truck and automobile engines, which wholesale for around \$800. In its first full year, 1993, sales hit \$6 million.

Mind you, this kind of investing involves more than just an occasional call to a stockbroker and the cursory reading

"In the big city it's called networking. Down here it's called being neighbors."

of quarterly reports. A.W. (Bill) Kinkead, 56, a local land developer and former Army colonel who commanded the task force that oversaw the 1980 Mariel boatlift, is one of the original backers of Phoenix. "Success is a terribly expensive thing. As this company does better, it just sucks up capital like a vacuum cleaner," Kinkead says. The McAlester group, which owns 92% of Phoenix's equity, has had to pump out \$2.5 million in direct loans and loan guarantees to finance growth.

This, as Jim Mills said, is hands-on stuff. Last May the

group saw that Phoenix's rapid growth was quickly outstripping the abilities of its managers. So they turned to one of their own, Gerald Calaway, who ran a local factory for Charles Komar & Sons, a \$40 million (revenues) lingerie maker. They installed Calaway as chairman and chief executive and put founder Mitch Morris in charge of sales. That solved their management problem, but the cash calls continue. One Wednesday this past December, Calaway, 59, told his fellow investors that he needed \$500,000 by Friday to cover payroll and bills from suppliers.

"Being a small town and everybody knowing each other helps a lot," says Bill Kinkead, when asked how members of the group managed to come up with \$50,000 each in cash on such short notice. Jim Miller, he notes, used to sing in the Baptist church choir with the chairman of the Bank N.A., and M.W. Priddy Jr., 83, an accountant, attends the Presbyterian church with the chairman of the First National Bank of McAlester. "In the big city it's called networking," says Kinkead. "Down here it's called being neighbors. And it makes a big difference when we walk in and say, 'I need a couple of hundred thousand for a few weeks.'"

This year Phoenix Industries is expected to earn over \$1 million on revenues of \$22 million. And since it's organized as a Subchapter S corporation, the profit will flow straight through to the McAlester investors. Jim Mills guesses the value of their investments has increased tenfold in three years.

Mills, the former mayor of McAlester, is even prouder of the fact that the five companies they've backed have created 400 new jobs, bringing McAlester's unemployment rate to under 9%, the lowest in the area. Now that's a



feeling of accomplishment you can't get from buying a mutual fund and watching it grow.

McAlester is not all that unique. Similar informal venture capital networks exist all over the U.S., creating lots of jobs and lots of new wealth.

William Wetzel, who heads up the Center for Venture Research at the University of New Hampshire, has watched the so-called informal venture capital market for the past 15 years. He estimates that there are as many as 250,000 informal investors—mainly successful business owners who are reinvesting their wealth into promising young companies—spread across every village and town in America. Wetzel estimates that the Brad Fentons and Bill Kinkeads of the country last year invested \$10 billion to \$20 billion into more than 30,000 companies in their own backyards.

To put this informal activity into perspective, the institutional venture capital funds, which raised \$4.2 billion last year, invested in fewer than 4,000 companies. Another 181 companies raised \$1.1 billion in deals of \$10 million or less in the initial public offering market. The informal venture market is clearly no small thing.

Investing locally is nothing new. Henry Ford, for instance, didn't go to Wall Street, to the House of Morgan or to the House of Schiff for his grubstake. He got his initial backing in 1903 from five Detroiters, including Alexander Malcomson, a wealthy coal merchant, and Charles Bennett, founder of the Daisy Air Rifle Co.

The difference is that, now, with the emergence of small business as the driving force behind the U.S. economy, the number of potential angels has expanded manifold.

Consider John Schinas. A former rocket scientist who

helped write software for the Apollo moonshot, Schinas mortgaged his house ten years ago to raise capital to start Digi International (*FORBES*, Nov. 8, 1993). In its first full year the suburban Minneapolis firm, which makes circuit boards and software that turn personal computers into multiuser systems, earned a small profit. But to ramp up production Schinas needed capital.

Schinas decided to tap the informal investor community in Minneapolis and St. Paul. Two months and 200 phone calls later, Schinas rounded up 15 local investors who put up \$1 million for 20% of his company's equity.

Modest and soft-spoken, Schinas took his company public in 1989 and now owns Digi shares worth \$39 million. Those early investors who've stuck with the company have seen their investment grow fortyfold.

Now Schinas himself has joined the ranks of informal venture capitalists. Over the past several years, he's plowed close to \$1 million into a half-dozen small companies in the Twin Cities area. Schinas doesn't recommend this sort of investing to people who want to limit their commitment in time and effort to a few hours a week spent with Value Line. Schinas says he looks at 100 to 150 deals a year, sometimes without finding a single one that piques his interest.

Though circumspect about his investments—Schinas declines to say much more about the companies than that they are technology-based—he says, "I've been rather lucky so far. Two have already gone public."

Schinas guesses that there are 60 serious investors in the Twin Cities area pumping more than \$200 million a year into promising young companies—far more cash than was available eight years ago when he went looking for money for Digi International.

Be it Minneapolis or McAlester or Missoula, Mont., demographics show that there is a lot of money in the hands of those most likely to be willing to back promising entrepreneurs or to invest in emerging private companies. A survey done by the Federal Reserve in 1989—the last year for which the data have been tabulated—notes that there were 164,000 families with net worths of over \$5 million in the U.S. Combined, they command \$1.8 trillion in assets. Nine out of ten of those families own businesses.

That means that for every Bill Gates and Warren Buffett, there are thousands of well-to-do car dealers, Coca-Cola bottlers and building contractors who understand what it takes to make a business go. Tens of thousands of them have spare capital to invest. Most of these still invest their spare cash the conventional ways: stocks, bonds, mutual funds, real estate. But more and more are providing seed capital for other businesspeople.

Robert Small, who owns \$15 million (revenues) 4 Seasons Motors in Missoula, is just such an investor. A former linebacker with the University of Montana Grizzlies and a fitness fanatic, Small, 61, met Thomas H. Thompson at the local fitness center eight years ago. Thompson, then just 21 and a senior at Small's alma mater, was desperately trying to revive his grandfather's dental equipment company, which had fallen on hard times.

Over the next few months Bob Small watched as young Tommy Thompson battled to keep Thompson Dental Manufacturing, which makes handheld dental instruments, like mirrors and picks, afloat. "He's 99% hustle," says Small. "I could see that from the beginning." But hustle alone was not enough. In February 1988, with the Internal Revenue Service threatening to shut down the company for back

payroll taxes, Small stepped in. He loaned Thompson \$67,000 at 12%, secured against receivables, and put in \$13,000 in equity for 30% of the company.

For Small this was business, not charity. He structured the deal in a way that would protect his investment, provide for a handsome return and still leave Thompson with plenty of incentive to keep hustling.

In addition to the loan, Small took a \$300-a-month consulting contract. Thus he was assured he'd be paid off the top if the investment worked out while the Thompsons retained control of the company. "I knew we had a good product," explains Small. "But you bet on the people."

With Small's cash, Thompson, now 28, began expanding distribution overseas. And when cash demands increased, Small brought in a local attorney, Robert Mullendore, who put in \$100,000 in equity and debt. That, in turn, gave the company a solid enough equity base to secure a \$250,000 bank loan.

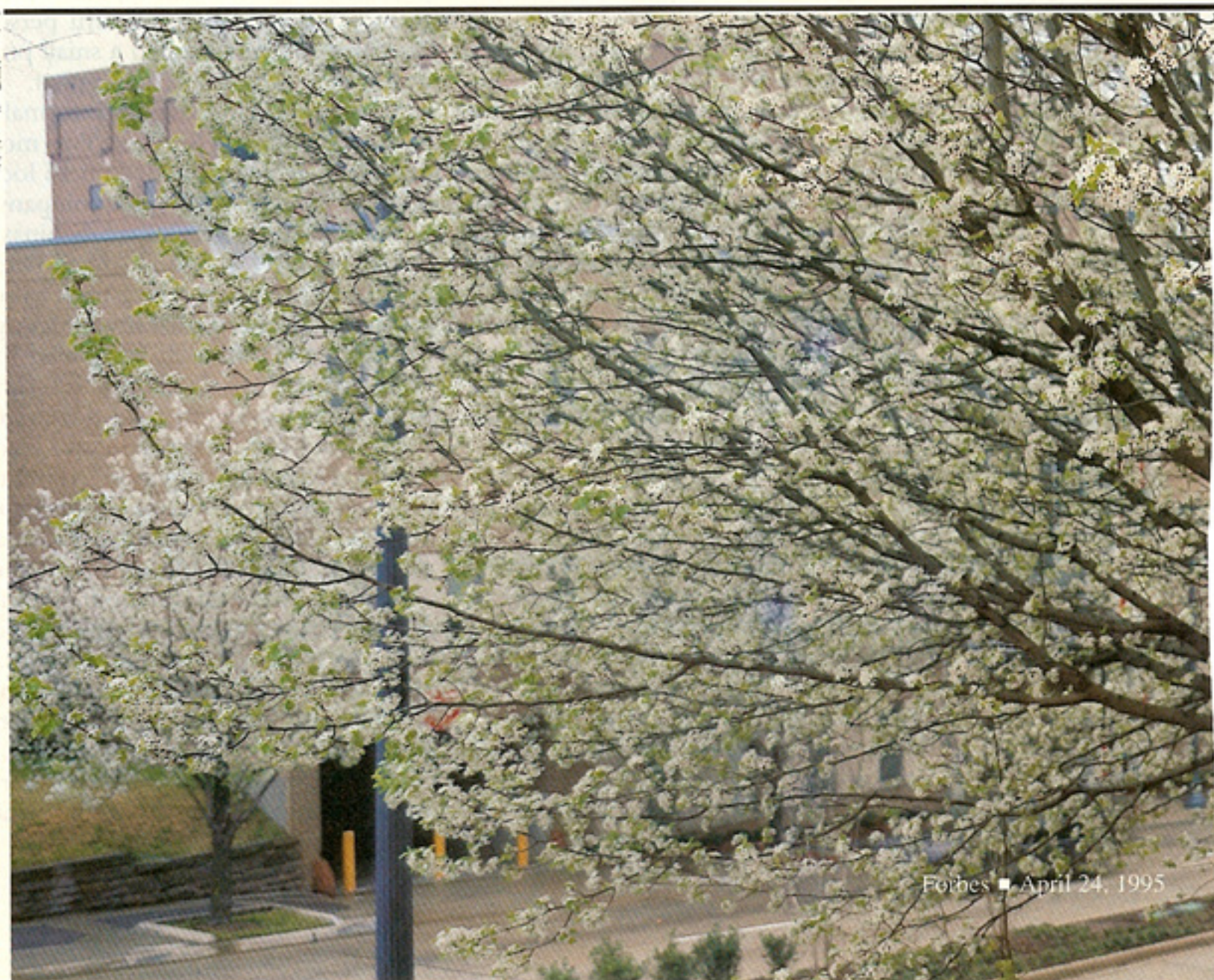
Last year Thompson Dental's revenues topped \$3 million, making it the second-largest manufacturer of dental hand instruments in the country. That's up from \$400,000 in 1988; pretax profits last year were \$250,000. A labor-intensive business, Thompson Dental now employs 100 people, up from 8 in 1988. Small and Mullendore own 60% between them; the Thompson family owns 40%.

Neither Small nor Mullendore has much money in the stock market. Mutual funds? "Everyone's always talking about mutual funds," says Mullendore, who has invested in seven small companies over the past eight years. "We like to invest in things we can touch. We like to know the people."

This is no game for those who take comfort in the knowledge that they can turn their stocks and bonds into

Kustom Threads' Cathy Miller, in downtown Birmingham, Ala., with backers Randy Hammond (left) and Russell Maddox
Her investors bring more than just money. Experienced entrepreneurs, they are also available for advice and managerial input.

Jackson Hill/Southern Lights



money in seconds with a telephone call. Liquid it is not. Getting your money out of a privately held company, particularly if you're a minority stakeholder, can be next to impossible. Small and Mullendore say they couldn't care less—so long as the business is growing in value. "I'm not interested in a short-term hit," says Small. "I don't want to pay taxes. Paying taxes really pisses me off." Eventually he expects the company will be acquired. But for now, he's encouraging Thompson to look for other dental products he can pump through Thompson Dental's distribution network, which now stretches into 120 countries. Says Small: "I'll just watch the whole thing grow tax deferred."

It's no surprise that many of the best of the informal venture capitalists are themselves entrepreneurs, people who like the smell and texture of doing business and who are left cold by the whole idea of just investing in pieces of paper or numbers on a screen.

Take Russell Maddox. He started his first company in Birmingham, Ala. in 1979 with a \$50,000 second mortgage on his house, and later raised another \$127,500 from local investors. Russ Pharmaceutical, Inc. quickly established itself as a niche player, marketing analgesics for people who had just had surgery to hospitals, orthopedic surgeons and private clinics. Ten years later Maddox sold out to Ethyl Corp. for around \$30 million. Maddox personally walked away with about \$10 million.

"Someone did it for me, so I'm going to do it for someone else," says Maddox, who now runs \$38 million (revenues) Diagnostic Health Corp., which owns 11 medical imaging centers, where patients come for mammograms, CAT scans and MRIs. Over the past five years he's sunk \$4 million into five local firms. One is a distributor of

prenatal vitamins and other products for the obstetrics/gynecology market. Another is a physician management company. Four years ago he even wrote out a check for \$30,000 while riding up in an elevator with a former salesman, who needed the cash to secure distribution rights to a promising new drug for cystic fibrosis. Maddox later invested another \$1 million, for 10% of Scandipharm, his former salesman's company. "Informal capital is about the only kind of venture capital we have down here," says Maddox, a 54-year-old Atlanta native.

For every Bill Gates and Warren Buffett, there are thousands of well-to-do car dealers and Coca-Cola bottlers who understand what it takes to make a business go.

Unlike Small, with his couldn't-care-less attitude toward cashing out, Maddox always goes in with an exit strategy firmly in mind. "When we enter a deal, we look to get out in one of three ways—a sale, a merger or a public offering." In the case of Scandipharm, which earned \$615,000 on sales of \$15.7 million last year, Maddox expects the company will eventually be sold to a big drug company.

Maddox's latest investment, made last September, is in a Birmingham-based company called Kustom Threads, which prints logos on T shirts, jackets, caps, pens, mugs and the like, mostly for corporate customers. Cathy Miller, a former paralegal who runs the tiny \$275,000 (1994 revenues) company, knew Maddox by name and reputation from her legal days. When she needed to raise



Watch out for Murphy!

"IF YOU'RE GOING to get involved in investing in early stage companies, you're going to have to have the stomach for it," says Bill Wetzel, who heads the Center for Venture Research at the University of New Hampshire.

"You've gotta be able to live with Murphy's Law, because there isn't any venture that ever got started that unfolded according to its initial business plan."

Wetzel recommends

teaming with a group of investors with business experience. "Usually in that group there are one or two individuals whose professional careers have prepared them to really understand the technology or the market that the new venture's getting started in," he explains.

Don't assume your first dollar invested will be your last. Successful companies can guzzle money as fast as unsuccessful ones. "If the venture really does succeed, it's going to need more capital down the road," Wetzel says. "You

need to realize if there's a success, you'll be called on to put up additional money or be prepared to see your position diluted."

Where does one look for deals and coinvestors? Your lawyer and accountant can certainly give you leads. But the best way is to just get your name out to everyone you know: business associates, fellow members of the tennis club—even your preacher or old high school coach. Just let it out that you've got some money you'd like putting to work. At one time or another nearly ev-

eryone knows someone who is looking for capital.

Another place to hunt for leads is at local venture capital clubs and networks. These are often affiliated with universities and chambers of commerce and help connect potential investors with entrepreneurs in search of money. There are over 150 of them nationwide, from Maine to Alaska. The International Venture Capital Institute, in Stamford, Conn., publishes a directory of clubs and networks that sells for \$19.95. Call: 203-323-3143. —F.M. ■

\$50,000 to buy out a partner and hire a salesman, she looked him up.

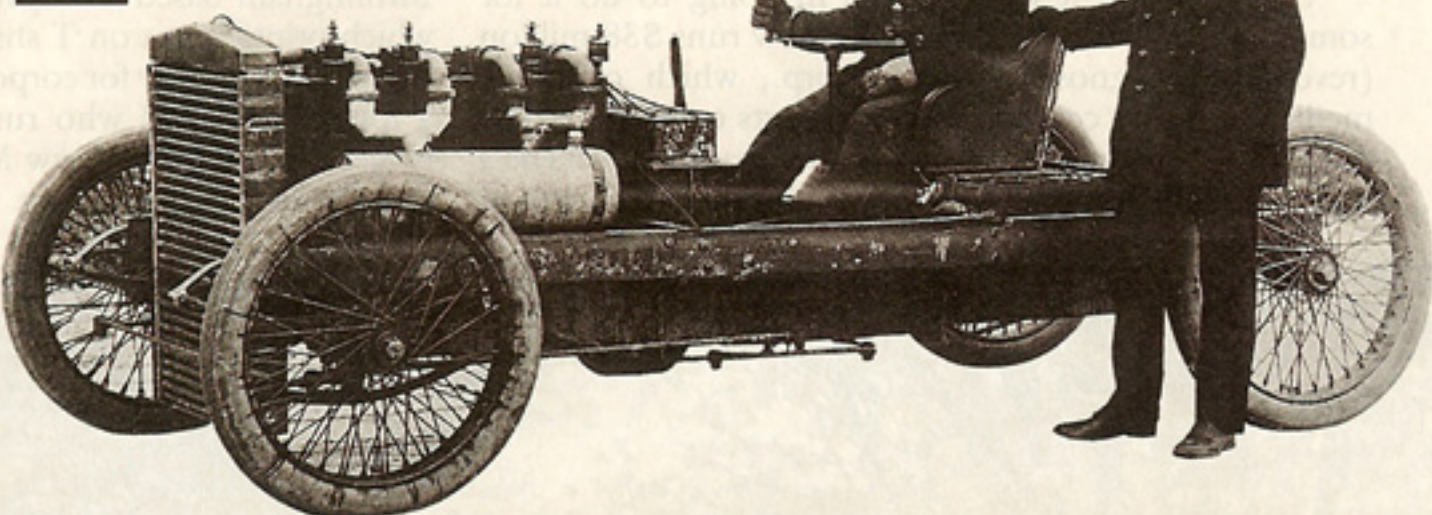
Maddox says: "She had the goods, and her quality was right up there. She just needed to get her name out there." Together with a partner, Randy Hammond, chief operating officer of Diagnostic Health, Maddox gave Miller the \$50,000 in exchange for 70% of the equity.

How did he figure 70%? "We just took a pot shot at it," laughs Maddox, when asked how he parsed the value of the company. "We figured if 50% was worth \$30,000 [the amount the partner was asking for his half], then 70% ought to be worth \$50,000. Real high math." He also wrote a provision into the agreement allowing Miller to buy back the equity after five years for three times cash flow.

Miller, 40, says she was willing to take a minority interest because she felt she was getting more than just money: She was also getting experienced partners who would be available for advice and managerial input. "We were all involved in hiring this new salesperson," she says, adding that Kustom Threads is branching out to colleges and universities.

"Managed accounts? Mutual funds? That stuff is for people who aren't in business. This is where the money is," says Maddox with a deep southern drawl. "I like to invest in a company where I know the guy I'm investing in. I want to be able to shake his hand when I see him downtown." Where do you look for deals if you want to try your hand at informal venture capital? What are the rules of the game? See the boxes on this page. ■

Henry Ford (right) with auto racer Barney Oldfield
Ford's first investors included a wealthy Detroit coal merchant and the founder of the Daisy Air Rifle Co.



How long?

CHARLES WESTHEIMER, 82, is a veteran of more than 40 years of investing in privately held companies. The former Cincinnati stockbroker guesses that he's put money into more than 40 companies over the years. He warns that you must expect many losers for every winner.

Westheimer was lucky. In the 1950s he put a small amount into a fledgling company called Cincinnati Insurance. Now called Cincinnati Financial, it has

grown to \$4.7 billion in assets, and Westheimer's investment has increased nearly 300-fold. That one bet has paid for lots of losers—and then some.

Westheimer recites a cardinal rule in private investing: patience. "It takes a long time for these things to mature," he says. How long should an investor be prepared to wait?

"There's an old saying," Westheimer chuckles. "'How long is a piece of string?' How do you know?" —F.M. ■