

Approved April 3, 1986
Date

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation

The meeting was called to order by Senator Fred A. Kerr at
Chairperson

11:00 a.m./~~pm~~ on Tuesday, April 1, 19 86 in room 519-S of the Capitol.

All members were present ~~except~~ XXXX:

Committee staff present:

Tom Severn, Research Department
Melinda Hanson, Research Department
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:

Representative Jim Braden
Dr. Tony Redwood, University of Kansas
Ron Ryan, Advanced Technology Commission
Dr. Takeru Higuchi
Dr. Philips V. Bradford, Advanced Technology Commission
Sam D. Campbell, Capital Research
Ken Koger, Reimer & Koger Associates
Charles J. "Jamie" Schwartz, Department of Economic Development
Carol Hedges, Governor's Office
Harold Stones, Kansas Bankers Association

S.B. 754 - Tax credits for research and development

S.B. 757 - Establishing the Kansas venture capital company act

Representative Jim Braden provided written testimony on both bills (Attachments 1 and 2). He noted that both bills were unanimously approved by the Legislative Economic Development Commission. He explained that S.B. 754 would provide a tax credit of 6.5% of the amount invested in research and development over and above what that business expended on the average over the last three years. The maximum credit that could be taken in any one year is 25% of the total tax liability of the taxpayer and the remaining credit could be carried forward.

Senator Frey asked about the format of the bills, such as the needs and mission statements contained in the bills. Senator Winter (a member of the Legislative Economic Development Commission) said this has been discussed by the Commission and they felt this format is important since many of the ideas and concepts in the bills are new and are going to be subject to interpretation by the courts and by future legislatures. The Commission's idea was to give as much guidance as possible. Senator Karr asked about the fiscal impact of S.B. 754. Representative Braden said there is no reduction in the existing tax base since the bill would only apply to expenditures beyond what is presently being invested.

Representative Braden provided copies of a newspaper article (Attachment 3) to illustrate his point that most growth comes from small businesses. He said that S.B. 757 provides a tax credit of up to 25% of an individual or entity's tax liability for investment in a certified Kansas venture capital company. The credit would be spread over four years and the tax credit could not exceed 25% of the total tax liability. Any excess could be carried forward. Representative Braden said that the maximum credit would be \$24 million. The fiscal note would not exceed \$1.5 million a year for the four-year period. He advised that the bankers have agreed to invest \$10 million in the Kansas Venture Capital Corporation if the state matches those funds. Representative Braden mentioned there are also funds available from the Small Business Administration.

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Representative Braden urged that the two bills be passed. He feels there are plenty of safeguards in the bills and noted that they allow for a great deal of oversight by the private sector.

Dr. Tony Redwood spoke in support of S.B. 754. He testified that the research and development expenditures in Kansas are relatively low and, in the long run, this affects the ability of Kansas companies to compete. Dr. Redwood said that Kansas has mostly small businesses and has become, to some extent, a "branch" state. He stated that profitability and survival are dependent on research and development. He advised that 19 other states offer a tax credit or tax exemption with respect to research and development. S.B. 754 is patterned after an Iowa statute. A negative Dr. Redwood sees is that this type of proposal is so new there has not been sufficient time to gauge its success; however, he noted that the federal provisions for research and development have been very successful. He feels the bill sends a very important signal to the business community. Another point in favor of the proposal is that the limits contained in the bill can keep the cost relatively low. Dr. Redwood stressed that Kansas really does have a research and development program. Senator Karr asked if there is a problem of identifying what is bona fide research and development. Dr. Redwood answered that the bill contains the federal definition.

With regard to S.B. 757, Dr. Redwood said that the number one impediment to business in Kansas is the availability of seed and risk venture capital. He stated that this is especially acute because of the small-business nature of Kansas. He advised that about 30 states have some form of state initiated or sponsored venture capital program and tax credits are one type of initiative that is used. The 25% credit proposed in S.B. 757 is a relatively modest percentage but some states have limits on the amount of credit or on the term of carry-over, so Dr. Redwood feels that S.B. 757 is reasonably competitive. He said that the main negative to the proposal is the fiscal impact. He feels that the main benefit is that the concept has been very successful in other states in leveraging capital availability. Another advantage is that the bill is very simple.

Answering a question from Chairman Kerr, Dr. Redwood said that the importance of the bill is not so much that Kansas is trying to compete with other states but rather that Kansas "is in there". In response to Senator Hayden's question, Dr. Redwood said that the Kansas economy is lagging substantially behind the U.S. average. He questioned the creditability of some surveys which rank states according to their business climate. Dr. Redwood said that such rankings may cause companies to give preliminary consideration to Kansas, but without incentives, Kansas is at a disadvantage.

Ron Ryan spoke in favor of the bill (Attachment 4). He discussed the importance of adequate capitalization and a respected educational system. He said that banks are not equipped to fund high risk ventures. Mr. Ryan mentioned a \$7 billion trust fund for airport and aviation improvement which Kansas cannot participate in because of its internal improvements prohibition. He noted that his own company could not find a bank in Kansas to fund them, so they now have a substantial investment in a Michigan bank. Mr. Ryan talked about the importance of improving Kansas' image outside the state.

Dr. Takeru Higuchi said he was testifying as a private citizen. He said both bills are mechanisms for improving the image of the state. He questioned whether S.B. 754 would include capital expenditures or just operational expenditures and whether the expenditures are to be carried out within Kansas. Dr. Higuchi said S.B. 754 would provide an incentive for research and development companies to move to Kansas. With regard to S.B. 757, he questioned whether line 195 excludes services performed outside the state if the money is returned to Kansas. He asked how venture capital companies are to be liquidated. Dr. Higuchi said that while both bills deserve support, he feels the real shortage in Kansas is for good research programs out of colleges and universities.

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Answering a question from Senator Allen, Dr. Higuchi said he thinks there is ample capital for good programs, but the high-risk ventures need capital. He said that, in comparison to other states, Kansas has done nothing with regard to economic development in this area.

Chairman Kerr asked what effect the bills would have on areas outside the major metropolitan centers of Kansas. Dr. Higuchi feels that S.B. 754 would have a broader effect than S.B. 757. He thinks that new ventures will probably center around existing metropolitan areas, particularly those associated with universities. Responding to questions from Senator Karr, Dr. Higuchi said that there should be no difference between basic research and applied research. He emphasized the importance of research being "mission oriented" and that the goals be clearly identified. He said that he feels that the participation of the private sector with regard to S.B. 757 will help ensure wise investments. Senator Salisbury asked if Dr. Higuchi thinks that tax credits should be allowed for capital expenditures. Dr. Higuchi answered that he feels they should be allowed. He would not extend the credits to out-of-state companies. He recommends that the credits should be applied beyond the initial \$1.5 million because many new venture corporations will end up losing money at first and will need additional funds to keep going. Dr. Higuchi said that it is basically correct that additional funding for higher education is important for the initiatives to succeed.

Dr. Bradford advised that the federal definition of research and development includes capital expenditures.

Senator Hayden moved that the minutes of the March 27 and March 31, 1986 meetings be approved. Senator Karr seconded the motion, and the motion carried.

The meeting was recessed until 5:30 p.m.

Dr. Philips V. Bradford provided a summary of his testimony in support of S.B. 754 (Attachment 5). He said the bill will provide an incentive for corporations to support research at Kansas universities and will provide an incentive for corporations to consider locating research and development assets and operations in Kansas. He noted that something like 90% of the high tech employees working in Kansas are employed by firms whose headquarters are outside the state. Dr. Bradford said S.B. 754 will provide better opportunities for advanced degree graduates to obtain employment in Kansas. He observed that approximately 90% of the advanced degree graduates in the sciences from Kansas universities leave the state. Responding to questions from Chairman Kerr, Dr. Bradford said that research and development is a very desirable type of industry to have in the state. He feels that the private sector will see that the research is targeted to meet specific needs. Senator Salisbury asked about the definition of research and development. Dr. Bradford replied that he prefers that the bill refer to the federal definition and noted that companies would not have to have a separate accounting if Kansas conforms to the federal definition. He feels that there should be a requirement that the research and development funds be spent in Kansas.

Dr. Bradford explained his reasons for supporting S.B. 757 (Attachment 6). He said the bill provides an incentive for Kansans to invest locally. He explained that if there are sources of support in the state, then it is much easier for companies to obtain major financing from the major money centers. He talked about "border" cases where companies in neighboring states have an option to locate across the state line.

Sam D. Campbell testified in support of S.B. 757. His company is the first venture capital company started in Kansas and is located in Lawrence.

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He told the Committee, from his own personal experience, he found it is very difficult to attract venture capital monies in Kansas. He explained there is a lot of competition for investment dollars and many of these competitors already have tax incentives associated with them. Mr. Campbell said that in some parts of the state, the overhead and labor costs are cheaper, so they are just as likely, or even more likely, to locate in smaller communities outside the major metropolitan areas. He stressed that there is no good source of money for smaller start-up types of companies that don't have a track record and gave examples of companies that could not get financing from conventional sources. Mr. Campbell said his company does not have the capacity to invest very large sums so there is always a threat that companies will move out of Kansas to states where financing is available. He observed that the educational institutions and centers of excellence are very important but said what Kansas needs is the ability to produce a product once it is developed. He feels that Kansas needs as many venture capital companies in the state as possible so they can work together in cases where a project exceeds the resources of an individual venture capital company.

Chairman Kerr noted that the bill excludes investments in oil and gas, banking, service and retail and real estate development and asked Mr. Campbell his opinion on these exclusions. Mr. Campbell said he doesn't necessarily agree that service and retail companies should be excluded. Senator Salisbury asked Mr. Campbell about the initial capitalization of \$1.5 million. Mr. Campbell feels that is the base minimum amount and it is his opinion that there should be tax credits beyond the initial investment. Senator Salisbury asked about liquidation. Mr. Campbell advised that most companies have a life of about 10 years, 15 years would be the most. Chairman Kerr asked if the 20% maximum should be changed. Mr. Campbell said the policy of his own company is a 10% maximum, but he would not recommend lowering the 20% figure because it is important to provide as much flexibility as possible.

Ken Koger said his investment counseling firm manages a portfolio for KPERS. He stated that not only is there a national problem of investment risk capital, there is a national problem of insufficient capital. Mr. Koger said Kansas has an additional problem in that its three major industries are hurt by disinflation and two of the three are hurt by a strong dollar. He urged that the general investment partner not be restricted any more than absolutely necessary. Mr. Koger testified that venture capitalists generally invest at least 50% of their capital within a 200-mile radius of their location, so it is his opinion that even without restrictions, half or more of the investments will be made locally. Senator Frey asked if there should be limitations on the KPERS investments. Mr. Koger feels that federal law probably provides sufficient restrictions.

Charles J. "Jamie" Schwartz provided a research paper on State Venture Capital Financing Programs (Attachment 7). He stressed that people from small towns have no place to go for funding. In response to Chairman Kerr's question, Mr. Schwartz said he thinks the costs of administering the program in S.B. 757 can be absorbed.

Carol Hedges stated she was representing the Governor and testifying in support of both bills. She said the bills are needed to reinvigorate the state's economy. She stated that S.B. 754 is needed to develop products and S.B. 757 is needed to give products a chance to be developed.

Harold Stones testified that his association supports the initiatives and the bills. They do not feel their expertise is in the area addressed by these two bills.

The Committee discussed the accountability and audit provisions of S.B. 754. Senator Salisbury and David Barclay (Department of Economic Development) explained that Kansas, Inc. is a proposed advisory group predominantly composed of the private sector and is given the same review authority in the other bills in the economic development package. The enabling legislation

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for Kansas, Inc. is in the House of Representatives currently. Harold Stones observed that he thinks the intent is more a review and report than an audit in the traditional sense of the word.

The Committee asked the Revisor to draft a substitute bill for S.B. 754 deleting sections 1 and 2 from the bill but including "purpose of the act" language; revising the wording of section 3 to more traditional statutory language, including rewording the 25% limitations and the carryover and carryback provisions; and referring to the federal definition of research and development. It was noted that the bill has a seven-year sunset date and the concept would be subject to a performance audit by Legislative Post Audit at any time.

The Committee asked the Revisor to draft a substitute bill for S.B. 757 removing the captions from the bill; deleting sections 1 and 2, with the exception of the language in lines 49-57; striking "or is Kansas related" from line 83 and striking "survival" from line 93. David Barclay advised that the provisions in lines 120-126 relate to the venture capital company in Lawrence. He noted that section 5 was lifted from a Louisiana statute. The Committee directed the Revisor to change section 5 in the substitute bill to provide that the secretary shall adopt rules and regulations and serve as a clearinghouse for information. It was agreed: to delete lines 162-165, to make section 6(c) consistent with provisions of the Administrative Procedures Act, to delete lines 206-208; to strike "reasonably" from line 211; to delete the phrase starting with the word "meet" in line 232 and ending with the word "shall" in line 234; to include a provision for voluntary decertification in line 266; to delete "easily understandable language" from lines 276-277; to delete "attempt to" from line 289; to delete lines 294-310 and provide for a sunset of the tax credits after seven years; and to change "may" to "shall" in line 311.

Meeting adjourned.

ASSESSMENT AND TAXATION

OBSERVERS
(PLEASE PRINT)

DATE	NAME	ADDRESS	REPRESENTING
4/1/86	Mary Ellen Conlee	Wichita	Ks. Sm. Business Assoc.
"	Ronald D. Ryan	Wichita	KATC
	Phillips V. Bradford	Topeka	KATC / KDED
	Judy Krueger	"	IC/DIA
	TREVA PATTER	"	NORTHERN NAT. GAS
	Don Jones	"	KCCI
	Harold Pitts	"	TARTA
	Ken Koger	Mission Ks	Reima + Koger Assoc.
	SAM CAMPBELL	LAWRENCE, Ks	CAPITAL RESEARCH
	Marshall Campbell	"	KPER
	BUD GRANT	TOPEKA	KCCI
	Tak Higuchi	Lawrence	Private citizens
	Kevin Carr	Topeka	KATC
	Terry MARLIN	TOPEKA	KDED
	DEANNE VIEUX	Topeka	KDED
	D. Barclay	"	KDED
	Jim McFarland	Topeka	Observer
	RON GACHES	WICHITA	BMAC
	CHARLES BELT	WICHITA	C of C
	DANA FERRELL	Topeka	Budget
	CJ Schwarz	Topeka	KDED
	Ken Koger	Mission Ks	Reima + Koger Assoc.
	Sand Campbell	LAWRENCE, Ks	CAPITAL RESEARCH

INITIATIVE NO. 3: TARGETED RESEARCH AND DEVELOPMENT TAX CREDIT.

REDWOOD/KRIDER REG. NO.: 3

BILL NO.: SB 754

A. Statement of Need:

Research and development activities play a vital role in the development of new products and processes. The promotion of such activities within the state of Kansas will lead to more interaction between the business community and institutions of higher learning. This increased interaction will assist in the creation of job opportunities and encourage more industry to expand or relocate to the state.

B. Mission Statement:

The purpose of the bill is to encourage increasing research and development activities within the state by providing corporate income tax credit to companies who make such additional investments.

C. Provisions:

1. Corporate income taxes shall be reduced by a state tax credit for increasing research and development activities in this state.
 - a. Corporations shall receive a credit equal to 6.5 percent of the expenditures for increasing research and development activities within the state.
 - b. Credit shall be based on the amount of expenditures which exceeds the corporation's average expenditure during the previous three year period.
 - c. Credit allowed shall not exceed 20% of the total tax liability of a corporation.
2. Because this targeted research and development tax credit is only for increased research and development, there is no reduction of the existing tax base from the enactment of this provision.

D. Other States:

The nineteen states most identified with innovative research and development have similar research and development tax credit provisions including Iowa, Massachusetts, New Jersey, New York, and Pennsylvania.

INITIATIVE NO. 2:

VENTURE CAPITAL TAX CREDIT

REDWOOD/KRIDER REC. NO.: 4

BILL NO.: SB 757

A. Statement of Need

Small businesses are responsible for most new job creation in Kansas. Difficulty in obtaining equity financing is inhibiting the establishment and growth of small and expanding firms in Kansas, the adoption of new and innovative production techniques, and the development of new products. The lack of risk capital is a significant weakness in the Kansas economy and may be the greatest impediment to Kansas economic development. Correction of this problem will result in diversification and stimulation of the economy of the state, will attract new jobs, retain existing jobs, and retain and generate the financial resources necessary to foster a growth economy.

The creation of small business venture capital funds, which is recommendation #4 of the Redwood Report, will ameliorate this problem, resulting in diversification and stimulation of the economy of the state, new jobs, retention of existing jobs, and generation of the financial resources necessary to foster a growth economy.

B. Mission Statement

The purpose of the Small Business Venture Capital Act is to encourage the formation of private venture capital funds in Kansas.

C. Bill Provisions

1. The Secretary of the Department of Economic Development is authorized to certify venture capital companies.
 - a. A capital company has as its primary purpose the investment of funds in return for equity in other companies that are in need of capital for survival, expansion, and new product development.
 - b. A capital company must have greater than a \$1.5 million investment pool in order to be eligible for certification.
2. Investors in certified capital companies are eligible for income tax credits.
 - a. Persons and corporations that invest in a venture capital company will receive a 25% tax credit against their Kansas income tax liability. The credit would be spread over a four year period.
 - b. The tax credit given shall not exceed 25% of total tax liability in any given year.
 - c. There will be a ceiling of \$1.5 million in tax credits given in the first year. This could generate \$24 million in venture capital funds, the maximum expected level of demand anticipated in fiscal 1987. The ceiling of \$1.5 million will meet the needs of the \$10 million Kansas Venture Capital Corporation described in the first initiative, and \$14 million of additional maximum expected demand from other new venture capital partnerships in local communities throughout Kansas in fiscal 1987.

3. The Secretary must review all certified capital companies on an annual basis to determine if they are in compliance with certification requirements.
 - a. At least 30% of a capital company's capitalization must be in equity investments at the end of four years; 50% within seven years; 75% within nine years. If a capital company fails to achieve the specified investment in equity by the end of the specified year, then the tax credit is lost to the investors and the investor must pay back any tax benefit gained from the credit to the Kansas Department of Revenue.
 - b. At the fourth year, seventh year and ninth year investment levels, 60% of the total investments must be in Kansas businesses in which the funds so invested are used solely for enhancing productive capacity, ability to do business within the state, or generating value added.
 - c. No one equity investment of a capital company can exceed 20% of its total assets.
 - d. Investments in oil and gas, real estate, banking and lending, service and retail businesses do not count for purposes of maintaining certification.
4. Seven years after the effective date of this act, a special 12-member review panel shall be convened to perform a financial and program audit of the act.

D. Other States:

State of the art models from which this initiative was developed include those in Arkansas, Indiana, Michigan, Massachusetts and Louisiana.

JAMES D. BRADEN
MAJORITY LEADER

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TOPEKA

HOUSE OF
REPRESENTATIVES

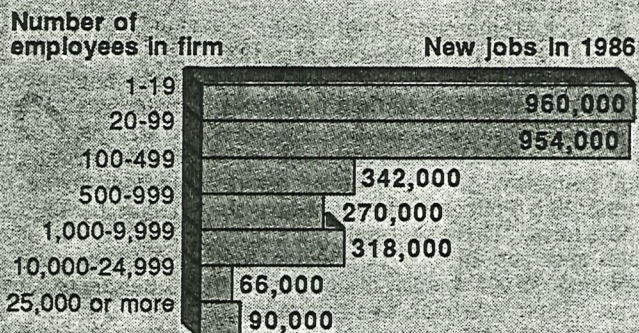
VIA SATELLITE

Money

MONDAY, MARCH 31, 1986

New jobs predicted

A survey forecasts 3 million jobs will be created this year, 64% of them in businesses with fewer than 100 workers:



Source: Dun & Bradstreet Corp. survey of 5,000 firms

USA TODAY

3 million more jobs forecast

By Constance Mitchell
USA TODAY

USA businesses are pumping up their payrolls again this year with 3 million jobs, 1 million more than last year.

That forecast was based on today's Dun & Bradstreet Corp. 1986 employment survey of 5,000 USA corporations.

Joseph Duncan, D&B's chief economist, said the 3 million new jobs would be a "major improvement" over the 2 million jobs generated in 1985. He called the report a strong indication that "executives and consumers are optimistic about the prospects for economic growth."

As in past years, the survey showed that small businesses, which are about 90% of all businesses, will do most of the hiring. Small firms, defined as those employing fewer than 100 workers, expect to increase their work force by 15.3%, or 1.9 million workers.

In contrast, the USA's largest firms, those employing 25,000 or more workers, forecast only an 0.6% increase, contributing only 90,000 new jobs.

Large firms running "lean and mean" operations have been reluctant to increase payrolls, instead turning to temporary help and part-time workers to meet staffing needs, Duncan said.

A breakdown of the results by industry shows that the largest percentage of firms expecting to increase employment are in financial services, where 40.6% of the businesses plan to add workers. Only 8.7% of companies in mining plan to add employees. In other industries, the percentage of firms planning to add workers ranged from 20% to 30%.

But Duncan said the gains may not be big enough to drive down the stubborn unemployment rate, because of a simultaneous increase in the size of the labor force.

He said unemployment probably will be about 6.5% at the end of the year, 0.8 percentage points lower than the current 7.3% rate.

Attachment 3

Senate Tax Comm. - 4/1/86

Testimony Presented to the
Senate Assessment & Taxation Committee

Ron Ryan, Chairman
Advanced Technology Commission

Venture Capital and Research and Development Tax Credits. Are they needed? Who do they help? At what cost? Who benefits the most?

Since serving on the Governor's High Tech Task Force, the Wichita Area Chamber of Commerce High Technology Task Force, the Midwest Technology Development Institute and as Chairman of the Kansas Advanced Technology Commission, I have reviewed a lot of successes and failure in efforts to promote economic development.

First I ought to tell you what I think the bottom line of economic development is - the creation of meaningful jobs so the state and its citizens can enjoy a better quality of life.

In almost every study done on economic development, two primary subjects surface. They are the need for adequate capitalization for expanding or developing companies or entrepreneurs and the need for a sound respected educational system that works in harmony with new and existing industries. We are fortunate that we here in Kansas have all the right ingredients for sound economic development. We need the legislature to now bring these ingredients together in a meaningful way that will result in positive change for our state.

A lot of people are opposed to change yet the only thing we know for sure is change will occur. We have the opportunity to make that change a positive one that will not only benefit us, but generations yet to come.

All the studies, reports and knowledge are worthless unless we are prepared to act on what we learn. As the old saying goes, "it's not what you know but what you do with what you know that counts". We have a blueprint for success with the Belden Daniel's plan based on the Tony Redwood KSU-KU study, combined with the Governor's high tech task force study, combined with KDED's findings, combined with all kinds of available research on the subject. It is now time we do something with what we know and you have that opportunity.

Why do we need venture capital and or tax credits for research and development? All studies have shown adequate capitalization is essential for business success. Yet banks and bankers are not yet set up or equipped to fund high risk low equity entrepreneurs or emerging developing companies. If you get charged two points above prime you feel a banker is taking advantage of you, yet venture capital averages a 35% return! My research hasn't revealed any major venture capital sources going broke to date. There would be no aviation industry in Kansas if it wasn't for venture capital availability for the Clyde Cessna, Walter Beech and Lloyd Stearman. Our state is now in need of new venture capitalists.

Who will the proposed bills help? Every taxpayer in the State over the long pull. This is like priming a pump - yet us farm boys know if you only have a limited amount of water you prime the pump carefully. No matter what part of the state an idea comes from hopefully that idea can grow where it originated rather than be forced to migrate where capital is available which for the most part is in major cities today. I believe the proposed plan is truly designed to be statewide in its delivery.

We need to be sure we place the responsibility of the new Kansas Technology Enterprise Corporation in capable hands and then monitor it closely. It will work and can pay back handsomely in new jobs, state income, improved educational opportunities, better industry university cooperation, and better images for our state.

As former chairman of the Kansas Aviation Advisory Commission, I have strongly recommended changing the constitutional prohibition against state spending on internal improvements. The FAA will fund 90% of airport improvements, yet this state cannot by law come up with the 10% to help our cities and counties get a share of the \$7 + billion in a trust fund for airport and aviation improvement. This same constitutional provision hurts economic development and should be changed.

As I have said earlier change will come. I hope together we can make that change a positive one. I urge you to support the tax credit for research and development, to establish incentives for meaningful venture capital creation and see the Kansas Technology Enterprise Corporation become a reality. Our children will be proud of our actions and positive influence on change.

R & D TAX CREDIT:

- PROVIDES AN INCENTIVE FOR CORPORATIONS TO SUPPORT RESEARCH AT THE UNIVERSITIES IN KANSAS.
- PROVIDES AN INCENTIVE FOR CORPORATIONS WITH OUT-OF-STATE HEADQUARTERS TO CONSIDER LOCATING OR RELOCATING R & D ASSETS AND OPERATIONS IN KANSAS ALONG WITH THEIR OPERATING DIVISIONS.
- WILL CREATE A BETTER ENVIRONMENT FOR ADVANCED DEGREE GRADUATES OF KANSAS UNIVERSITIES TO OBTAIN HIGH QUALITY OPPORTUNITIES FOR EMPLOYMENT WITHIN THE STATE.
- PROVIDES AN OPPORTUNITY FOR GROWTH OF INDUSTRY THROUGH R & D THAT WILL INCREASE TAX RATABLES MANY FOLD OVER THE FOREGONE REVENUE COST.

VENTURE CAPITAL TAX CREDIT:

- PROVIDES AN INCENTIVE FOR KANSANS TO INVEST IN KANSAS RATHER THAN ELSEWHERE.
- ENABLES HIGH-GROWTH ADVANCED TECHNOLOBY COMPANIES TO OBTAIN VENTURE CAPITAL FOR STARTUP AND EXPANSION FROM SOURCES WITHIN THE STATE, ADDING TO THE PROSPECT OF MAJOR FINANCING FROM OUTSIDE OF THE STATE.
- PROVIDES A MANY FOLD RETURN TO THE TAXPAYERS IN THE FORM OF CREATING NEW TAX RATABLES WHICH WILL GREATLY EXCEED THE FOREGONE REVENUE FROM THE CREDIT.
- HELPS TO BRING KANSAS MORE INTO LINE WITH COMPETING PROGRAMS IN OTHER STATES (SEE HANDOUT).

Research Paper



STATE
VENTURE CAPITAL
FINANCING PROGRAMS

Policy Analysis & Research Unit

Kansas Department
of Economic Development

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STATE

VENTURE CAPITAL FINANCING PROGRAMS

March 20, 1986

Kansas Department of Economic Development
Policy Analysis and Research Unit

Project Staff:

Terry Marlin
Deanne Vieux

EXECUTIVE SUMMARY

Venture capital refers to the financing of (1) new companies that have developed a product or service and are in the process of bringing it to the market or (2) mature companies involved in major expansions, introduction of new technologies, or changes in ownership. The major difference between venture capital and other types of financing is in the risk/return feature; venture capitalists will bear a high degree of risk for the potential of gaining high returns on investment. Private sector venture capital is used for long-term (five to ten years) capital appreciation while public sector venture capital is used for capital appreciation along with an improvement of broad economic concerns.

This study found 28 states having some form of state-government initiated and/or sponsored venture capital program. Between one half and two thirds of these programs have been initiated since 1983, which makes it difficult to evaluate the success of most programs. The five basic approaches that states have used for venture capital programs are: (1) creating a public sector fund, (2) operating a fund through a quasi-public entity, (3) creating a singular state-initiated private fund, (4) encouraging the use of public pension fund investments, and (5) providing tax incentives.

Program success is measured by the ability to raise the necessary capital, degree to which additional private investment or co-venturing is attracted, number of companies assisted, and number of jobs created or retained. State government sources of funding have included tax credits, appropriations, bond issues, and public employee pension funds. Depending upon the type of program initiated, the cost to a state can vary considerably.

Before designing a program, policy makers must identify and set priorities for state economic development aims. The relative importance of the aims calls for different types of venture capital programs. If the purpose of the program is to provide risk capital to deserving projects that meet the same qualifications as a private venture capitalist would impose, then the program should replicate the private sector, or tie into the private investment decision process on a co-venture basis. On the other hand, if the program is to use the venture capital concept to address broad economic issues, then a vehicle unique to the public sector should be used.

I. Overview

1. What is Venture Capital and How Does it Differ From Other Types of Financing?

Venture capital commonly refers to the financing of new companies that have developed a significant product or service and are in the process of bringing it to the market. The venture capital concept may also extend to the financing of mature companies when it involves major expansions, introduction of new technology, or a change in ownership. In any case, there must be potential for significant long term growth, and a high return on investment. The expectation of a high rate of return is based on proprietary technology, market position, or managerial expertise.

The major difference between venture capital and other types of financing is its risk/return characteristics. Venture capital investments have the possibility of generating a very high rate of return, but the chance of failure is much higher than conventional financing. This results from the fact that the technology or product concept is unproven in the market. In case of failure, the salvage value may be insignificant since the real collateral underlying the investment is the management team and the product concept, rather than assets that can easily be liquidated.

A venture capital investment usually takes the form of equity (partial ownership) or a debt instrument that converts into equity. Exercise of ownership rights may take the form of a seat on the Board of Directors, or close communication with the management team. In case of difficulties, the venture capital group may provide extensive assistance to the management team. In contrast, the investors normally take a passive role in the direction of the firm under a conventional financing program.

2. What is the Role of a Public Sector Venture Capital Program Vis-A-Vis a Private Sector Program?

A private sector venture capital program is organized around the goal of long term capital appreciation. Broader economic development concerns are of secondary importance. Public sector programs often have multiple objectives. In addition to earning a return on its investment, a public fund may be concerned about job creation, promotion of the small business sector, or aiding the transfer of technology from universities to industry. In certain public programs, particular industries or geographical areas may be targeted. Thus, a public sector fund may attempt to deal with a broad range of economic problems, rather than simply concentrating on providing a source of funds for promising venture projects.

II. Venture Capital Programs in Other States

1. What are Other States Doing in the Field of Venture Capital Financing?

Table 1 provides a synopsis of states' programs.

TABLE I

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
AK	Resources Corp.	1978	QP	State approp. \$40M from permanent fund.	3 member board appointed by Governor.	Rehabilitation & enhancement of renewable sources & tourism industry.	49% equity in firm, also some debt and grants.	Most of appropriation committed. Operation phase-out by 1988.
AR	Capital Development Corporations	1986	T	Private Investors; 33% tax credit.	Bank Commissioner & State Banking Board.	No particular targets.	Loans, equity, bonds, etc.	No development corporations have been formed at this time.
AR	Science & Technology	1985	QP	\$1.8M from investment fund of Authority.	11 Directors, 10 of which appointed by Governor.	Technology based companies in idea or early stages.	Seed capital.	No projects completed.
CA	Innovation Devel. Loan Program	1981	PU	\$2M from EDA,	Office of Small Business Loan Advisory Bd., Dept. of Commerce.	Small businesses with innovative products. Located in LTED areas.	Loans for working capital, machinery, real estate,	7 projects; all funds are loaned out.
CT	Product Devel. Corp.	1972	QP	\$17M in state approp., may become self sustaining.	Directors appointed by Governor.	Innovative products and defense companies wishing to diversify.	Product investment with royalty agreement.	Over 60 products, \$14.2M.
CT	Innovation Devel. Loan Fund	1979	QP	\$1.5M state, \$1M EDA,	Administered by Product Devel. Corp.	Businesses with new products or processes.	Loans from \$40,000 - \$200,000, Max. term six years.	15 projects, \$2M.
FL	High Tech. Innovation Research & Dev. Fund	1985	PU	\$1.6M from general revenue.	Board: treasurer comptroller & 7 members of private sector appointed by governor.	R&D activities of new and existing small, high-tech firms.	Equity agreements.	No projects have been funded yet.
IL	Business Innovation Fund	1985	PU	\$3M state.	Dept. of Commerce & Community Affairs; Technology Commercialization Grants-In-Aid Council.	Technology-based new business start-ups or new product development of existing businesses.	Royalty agreements up to \$100,000.	15 projects have been approved, and 10 have already received funding.

PU = public sector

QP = quasi public

SSP = singular state-initiated private

PP = public employees pension fund

T = tax incentive/credit

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
IL	Equity Investment Fund	1985	PU	\$1M state.	Dept. of Commerce & Community Affairs; Equity Investment Review Committee.	Small technology-based companies that are attempting to expand.	Equity, royalties, or participation certificates. Maximum amount is \$250,000, 2:1 private/public match.	No projects have been funded yet.
IL	Illinois Venture Fund Frontenac Venture Co.	1984	SSP	\$2M state approp., \$5M from Frontenac, & \$5M from other institutional investors.	Private firm (Frontenac) responsible for investments.	Prefers technology based startups.	Equity in form of common stock or convertible securities.	No projects completed.
IL	State Investment Board	1982	PP		Investment Board.		Limited partner.	\$11M committed.
IN	Corporation for Innovation Dev.	1981	SSP	No app. State provides 30% tax credit on \$10M of private capital.	7 member board, 3 appointed by Lt. Governor.	Technically oriented, growth firms at various stages of development based in Indiana.	Equity or equity type investments with CID taking significant management role.	10 projects, \$5M.
IN	Corporation for Science and Technology	1982	QP	\$20M state approp. from general fund every 2 years.	Board composed of individuals from public & private sector.	Technology-based research leading to product that will enhance Indiana economy.	Royalty agreements and contract research.	37 projects, \$21M.
IA	Product Devel. Corp.	1983	QP	\$1.2M in state funds. Also, lottery will provide more capital.	Board selected by governor & confirmed by senate.	New innovative product development that will enhance Iowa job creation.	Product investment with royalty agreement. Only prudent investor deals.	7 projects, \$995,000.
IA	Venture Capital Fund, L.P. Invest America Group.	1983	SSP	Private & institutional investors. Capitalization at \$10.7M.	Limited partnership. managed by private firm. (Invest America)	Start ups. First 18 months all investments must be in Iowa. After that, up to 1/3 capital can be invested out of state.	Equity agreements, significant management role sought.	2 projects.
KS	Kansas Investment Fund	1985	PP	Up to \$20M of public pension fund.	Ks. Pub. Emp. Ret. Sys. & Investment Counsel.	State business impacts.	Secured debt & limited partner.	\$4M committed to 2 funds.

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
LA	Small Business Equity Corp.	1980	QP	\$2M state approp. in 1982.	Board appointed by governor.	Small growth firms, minority owned businesses.	Lend through intermediaries (SBIC's, Minority Enterprise SBIC's, & certified dev. corp.) on matching basis. These operations then finance firms through equity debt.	2 projects, \$275,000, only limited equity.
LA	Capital Companies Tax Credit	1984	T	Private investors 35% tax credit.	Dept. of Commerce.	Business capital for survival, expansion, & new product development; excludes oil & gas, real estate, and banking.	Primarily equity.	No capital companies have been certified.
ME	Capital Corp.	1980	SSP	\$1M of private capital; 50% tax credit.	Private, for-profit SBIC.	Developing, new companies, or mature leveraged buyouts. No specific industry target.	Equity & equity type financing. Role sought on firms board of directors.	11 projects, \$750,000.
MD	Equity Participation Investment	1985	PU	Approp. from existing fund. Add'l. funding expected in 1986.	Maryland Small Business Devel. Financing Authority, no formal guidelines yet.	Minority (race and sex) franchise businesses.	Temporary equity & start-up capital.	Operational in 1986.
MA	Capital Resource Company	1977	T	\$140M from life insurance industry.	Limited partnership owned by nine life insurance companies.	Expansions, turn arounds, management buyouts.	Mostly subordinated debt; some equity, or convertible debt. Deals range from \$200,000 - \$4million.	110 companies have been funded; 2,500 jobs have been created or retained.
MA	Community Devel. Finance Corp.	1980	QP	Investments made from \$10M fund provided by state.	Independly operated. Board consists of 3 government officers & 6 appointees of governor.	Viable small businesses sponsored by Community Devel. Corporations.	Equity, usually shared with CDC's as well as some debt.	32 projects, \$8.5M.
MA	Technology Devel. Corp.	1979	QP	\$4M from state, \$3M from EDA.	Board consists of 3 gov't officials, 2 academic sector, 6 from private. All appointed by governor.	Early stage, tech. based firms.	Combinations of equity & debt. All investments on co-venture basis.	29 projects, \$7.3M created or retained 1,342 jobs.

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
MI	Venture Capital Division	1982	PP	Can invest up to 5% of public pension, i.e., \$450 million.	State treasurer.	Small business or venture capital firms; high growth high tech firms.	Direct & passive investments.	\$126M, 25 companies and 12 venture capital funds.
MS	Chapter 459	1985	T	Private investors 25% tax credit.	State Board of Economic Development.	Small business engaged in mfg., agriculture, minerals, transportation, R & D, etc.	Debt equity or lease-back financing.	Not yet functioning.
MT	Capital Companies	1983	T	Private investors 25% tax credit.	Economic Devel. Board.	Small business engaged in mfg., agriculture, tourism, transportation, R & D, etc.	Loans & Equity.	4 capital companies have obtained their initial capitalization of \$200,000.
NM	Business Devel. Corp.	1983	SSP	\$2M private as well as \$5M credit capacity with state & financial institutions.	Private.	Early stage firms, start-ups on limited basis.	Collateralized debt; equity also available.	7 projects and \$1M committed.
NM	Energy, Research & Devel. Institution	1981	PU	\$3.5M per year from state funds. Royalty program to reduce need for further app.	State agency.	Innovators in energy related services and products.	R&D seed capital on 2% royalty basis.	16 projects, \$2.7M.
NY	Business Venture Partnership	1984	PP	Can invest up to 5% of public pension fund (\$60M).	Private firm.		Limited partner.	\$10M committed.
NY	Corp. for Innovation Devel. Program, Science & Tech. Foundation	1982	QP	\$2.8M in state & federal funds (EDA, \$1M).	Decision made by Foundation Board of Directors, composed of commissioners of health, education & commerce & private sector individuals.	Foster innovative, tech. based, new ventures that will stimulate state economy.	Debt, equity, or both 3:1 private match.	23 projects, \$2.25M.
NC	Innovation Research Fund	1983	QP	\$225,000 state approp. \$375,000 state approp.	State Technological Development Authority.	To firms with relevance to NC economy; want links to state universities, up to \$50,000 per project.	Seed capital, royalty.	16 projects.

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
ND	Venture Capital	1985	T	25% tax credit to investors up to a max. of \$250,000 each (\$4M state total).	Private, state-certified capital corporations (\$50,000 base).	Small business, R & D.	Start up and venture; not seed.	None certified yet.
OH	Edison Seed Development Fund	1983	PU	Approx. \$10M out of the \$32.4M state-funded Thomas Alva Edison Program.	Dept. of Development Advice also provided by Industrial & Enterprise Advisory Board, a bipartisan independent body.	Advanced applied research directed at innovative products.	R&D Capital with royalty agreement, some grants.	12 deals, \$2.7M.
OH	PERS	1981	PP	Up to 5% of \$11B fund.	Public Emp. Ret. Sys.	Not for seed cap.	Direct and passive investment.	\$64M committed.
OR	Resource & Technology Devel. Corp.	1985	QP	Up to \$10M state approp., depends on lottery receipts.	Non-profit, public corporation. Board represented by governor & 10 directors chosen by him from various sectors.	Innovation in existing industry & development of new industries.	Seed capital, as well as some grants.	Not yet in operation.
OR	Investment	1983	PP	Can use up to 5% (\$300M).	Investment Council, but relies on financial assessments of private venture capital firms.	None	No equity.	\$100M committed.
PA	Ben Franklin Partnership Seed Capital Fund Program.	1983	QP	\$3M set aside from \$190M industrial revenue bond financial program.	Four regional privately-managed funds.	New businesses during early stages including firms in small business incubators.	Equity financing private match.	1 project.
UT	Tech. Finance Corp.	1983	QP	\$3.2M program revenue base. Approx. \$1M for venture capital program.	Board appointed by Governor. Venture capital Program operated independently by Utah Technology Venture Fund I.	New and emerging based companies.	Equity position, some management role sought.	No projects completed.
WA	State Investment Board	1981	PP	Can use up to 30% of state pension funds.	Board of Trustees for fund.	None	Limited Partnerships.	\$200M committed.

STATE	NAME	YEAR	TYPE	FUNDING SOURCES	GOVERNING OVERSIGHT	TARGETS	INVESTMENT TYPES	ACTIVITY
WI	Comm. Capital, Inc., Wisconsin Comm. Develop. Finance Authority	1982	QP	\$250,000 in one-time only state approp., \$2.6M from contributions. \$100,000 attracted through 75% state tax credit.	Comm. Capital created by Authority, but independent operation. Work together in assistance programs. Capital's Brd. of Dir. elected by shareholders. Patterned after Mass. CDFA; licensed as SBIC.	Firms connected with comm. development corporations. Create jobs for chronically unemployed.	Equity and debt.	2 projects, \$125,000.
WY	Capital Corp. of Wyoming	1979	QP	\$1.2M initial capital. Also many institutional stockholders.	Investment decisions made by privately-managed brd. Created Capital Corp., a private SBIC (funding available from SBA).	Diversified mfg. enterprises with potential growth management.	Equity and debt.	Approx. 25% of over \$12.7M committed and viable.
WV	Indus. and Trade Jobs Devel. Corp.	1985	QP	Authority being reviewed by attorneys.	3 member board.	Companies using hydro-carbon energy; development of properties owned by the state.	Equity, start-up.	

2. How Many States Have Programs?

According to the results of this research effort, there are 28 states that have some type of state-initiated venture capital financing mechanism for small businesses (this does not include any state grant programs). This figure is subject to immediate change as states are showing much interest in initiating such types of programs. Of the 27 states with venture capital financing programs, eleven states have more than one program underway.

3. What Types of Public Sector Venture Capital Financing Programs Exist?

States have used five basic approaches for providing venture capital:

- (1) creating a public sector fund;
- (2) operating a fund through a quasi-public entity;
- (3) creating a singular state-initiated private fund;
- (4) encouraging public pension funds to make venture capital investments;
- (5) providing tax incentives to encourage private investments in certified venture capital funds.

Public Sector Funds. Public sector funds are capitalized with state or federal money, and are administered by the state department that handles the economic development function. Project screening and initial review is done by regular staff members; additional review and final approval is given by an advisory board. In some cases the program is directed towards technology-based projects; other programs are oriented towards the small business sector. If federal funds are involved, projects may be restricted to designated areas experiencing long term economic decline. Projects chosen by public sector funds must have the potential for significant job creation or retention. These six states have this type of program: California, Florida, Illinois, Maryland, New Mexico, and Ohio.

Quasi Public Entity. Fifteen states use a quasi-public entity. The Massachusetts Technology Development Corporation and Indiana's Corporation for Science and Technology illustrate this approach. These entities are established by state government, but are independent agencies. The governing board is made up of representatives of industry, academia, and government. Operating expenses of the organization and the fund capitalization are provided by government. These funds are usually restricted to investment in projects involving advanced technology. Other states with this type of program are Alaska, Arkansas, Connecticut, Iowa, Louisiana, New York, North Carolina, Oregon, Pennsylvania, Utah, Wisconsin, Wyoming, and West Virginia.

Singular State-Initiated Private Funds. These funds allow the newly created entity to take an equity position that most states cannot assume directly because of state constitutional prohibitions. With this mechanism, the single entity provides service for the entire state. A state provides no operating capital and has no input into decision making beyond any general criteria in the legislation. The state may participate as an investor in the capital pool but the main form of participation is by granting tax credits (of, for example 30% to 50%) to private sector investors for capitalization of the fund. The legislation identifies the

maximum amount of tax credits that will be allowed for investors in the fund for a given time period. Investment decisions are made by a private firm or by a board of private individuals on a for-profit basis. Illinois, Indiana, Iowa, Maine, and New Mexico have this type of program.

Public Pension Fund Investment. This type of program can provide venture capital by using small portions of public pension funds. Of those seven states which have made investments with pension funds, using the prudent man rule, most only undertake passive investments in the form of limited partnerships with other venture capital funds. The amount of funds invested in venture capital entities usually varies from less than 1% of the pension funds up to 5% of the funds. States using this approach are: Illinois, Kansas, Michigan, New York, Ohio, Oregon, and Washington.

Tax Incentives. Tax incentives are used by those states who want to participate in a passive role. With programs of this nature, the state allows tax incentives for private investors to place their monies in state-certified venture capital funds. The legislation initiating this program usually specifies how a private venture capital fund gains certification and which types of investments qualify for the tax credit. (This approach should not be confused with the use of a tax incentive granted to private investors who capitalize a singular state-initiated fund, such as the Indiana Corporation for Innovation Development.) One state used tax relief as a bargaining tool to induce the insurance companies to set up a large venture capital fund for in-state investment. States using tax incentives are: Arkansas, Louisiana, Massachusetts, Mississippi, Montana, and North Dakota.

4. How Do Existing Programs Measure Success?

For private sector funds, initial success is measured by how quickly the fund raises the necessary capital. As projects are selected, success is measured by the degree to which the fund is able to attract additional investment on a co-venture basis. Once the program is well underway, success is measured by the number of companies assisted, amount invested in projects, return on investment, and long term capital appreciation. In addition, public and quasi-public sector programs may have other performance measures, e.g., number of new or retained jobs, number of new products, and technological innovations brought to market.

5. How Have the Various Types of Venture Capital Programs Performed?

State involvement in venture capital financing is a relatively new phenomenon. Twenty-three of the 42 programs have been initiated since 1983. Most programs have been in operation for too short of a time period for a definitive verdict on their performance. However, a few programs have attained tentative success or recognized failure.

The Massachusetts Technology Development Corporation has operated a public venture capital fund since 1978. It is one of the older and more well-known programs. It has investments in 29 companies representing nine different industries. The program has helped to create 1,342 jobs and attract \$38 million of private capital. Program start-up was not inexpensive. The fund was capitalized with \$3 million of Federal money from EDA and \$4 million of state funds. It is now self supporting.

The New York State Science and Technology Foundation (a public corporation) started a Corporation for Innovation Development Program in 1982. Initially, there was a \$1.8 million appropriation from the state and \$1 million was obtained from EDA. The revolving investment fund is for start-up capital to high tech firms, preferably in New York. Both debt and equity mechanisms are the financing vehicles, and investment in EDA eligible areas is sought. The program is not for seed capital. By mid 1985, the program had invested in 14 companies (\$1,795,000) and claims to have created 200 new jobs. In addition, \$38,000 has been turned in to the program as loan repayment and/or return on investment.

Maine has a state chartered private venture capital fund which was established in 1980 in conjunction with establishing a 50% state income tax credit. This entity is also chartered as a Small Business Investment Corporation by the Small Business Administration. The fund raised \$1 million and has invested in eight projects. It has generated \$15 million of co-venture money.

In return for obtaining tax relief, the life insurance industry in Massachusetts established a large venture capital fund. It was originally capitalized at \$100 million, and now has \$140 million of capital. Since 1977, it has invested in 110 companies. The investment portfolio is divided almost evenly between technology-based companies and traditional businesses. This program has been instrumental in the creation or retention of 8,200 jobs.

One of the most notable examples of the public pension fund approach is the Michigan program. In 1982, a Venture Capital Division was created in the Michigan State Treasury Department. It has invested \$126 million in 25 firms and 12 venture capital funds. These investments have created 2,700 jobs for Michigan residents and have leveraged \$105 million of private investment.

Not all of the programs have been successful. The Alaska program, initiated in 1978, allowed for a state appropriation of up to \$40 million to aid industries involving renewable resources, i.e., lumber, fishing, and tourism. The investments were made primarily in the form of equity. These industries were depressed when the program was set up. This program did not prove successful, and is in the process of being phased out.

6. What are the Sources and Amounts of Funding for These Programs?

Funding for Venture Capital programs comes from both the private and public sector. Public sources of funding include state appropriations, state bond issues, public employee pension funds, state tax credits and in a few isolated cases, the Economic Development Administration of the U.S. Department of Commerce. Private funding is provided by wealthy individuals, banks, insurance companies, other financial institutions, utilities and industrial corporations.

The level of funding varies according to the scope and type of program. The public pension fund programs are the largest fund pools. For example, the Michigan program has invested \$126 million in venture capital funds or projects in less than four years. However, it should be pointed out that this is not new money. If the program did not exist, the funds

would be invested in more traditional opportunities. Some of the public and quasi-public sector venture capital funds also involve large sums of money. Indiana's Corporation for Science and Technology has invested \$20 million of state funds since 1982.

As an alternative to state funding, several states provide tax credits for private investments in state-chartered or state-certified private sector venture capital funds that concentrate their investment portfolio in in-state companies. The tax credit ranges from 25% (in Montana) to 50% (in Maine.) The amount of initial capitalization also varies widely; Montana requires \$200,000 while Louisiana requires \$3 million.

7. What Criteria do Public and Private Programs use to Identify the Projects They Fund?

Both public and private programs look for a strong management team and a product or company that has strong growth potential. This potential could be based on superior technology, marketing prowess, or domination of geographical area or market niche. Public sector programs may also be concerned about other factors: job creation, providing aid to the small business sector, encouraging partnership between industry and universities, and even the location of the project.

8. What Types of State-Initiated Programs Does Kansas Have?

The Kansas Public Employees Retirement System (KPERs) has designated approximately \$200 million for the Kansas Investment Fund. This Fund is managed by an investment counselor for the purpose of investing in companies that impact the Kansas economy. The investment policy guidelines developed by the KPERs trustees and their independent pension consultant, Callan Associates, allow investments that typically range between fixed asset loans and venture capital. The anticipated rate of return is to be commensurate with the associated risk. KPERs has chosen to include financing of venture capitalists. One such financing has been completed and a commitment to finance a second group of venture capitalists has been made. Total commitments for financing venture capitalists to date are \$4 million. It is anticipated that \$10 million to \$20 million could be invested within the state of Kansas in this manner.

There are private sector efforts, also. Kansas Venture Capital, Incorporated, which is affiliated with the Kansas Development Credit Corporation, has been in operation since 1978. Its investments, which range from \$150,000 to \$200,000, are primarily in the form of subordinated debt with small amounts of equity. In addition, it appears that several venture capital firms are operating or emerging in the Kansas City, Lawrence, and Wichita areas.

9. What Policy Choices Should be Considered in Designing a Program for Kansas?

Before attempting to design a program, policy makers must first be aware of the role and scope of private venture capital in the state as well as be aware of the problems and capital needs of the businesses and entrepreneurs in the state. They need to look at state-level consensus regarding economic development aims and determine how a venture capital program

can fit into the established objectives. In doing so they need to know what existing mechanisms are available for generating venture capital financing. Then, after setting priorities on state-level economic development aims, policy makers can better evaluate the costs and benefits of instituting a state-sponsored venture capital initiative.

Examples of some state-level objectives which must be put in relative priority order are:

- 1) need to create an environment more supportive of entrepreneurial activity;
- 2) need to diversify the state's economic base;
- 3) need to foster small business' access to capital markets;
- 4) desire to promote applied research at the universities, and transfer technology to industry;
- 5) desire to remain competitive with other state' development programs;
- 6) need to provide job opportunities in areas of the state facing long term economic decline;
- 7) need to minimize expanded use of state general revenues.

The relative priority of these (and, perhaps other) issues will affect the design of the program.

If the purpose of the program is to provide risk capital to deserving projects that meet the same qualifications as a private venture capitalist would impose, then the program should replicate the private sector, or tie into the private investment decision process on a co-venture basis. On the other hand, if the program is to use the venture capital concept to address broad economic issues, then policy makers should design a vehicle unique to the public sector.

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