

Approved 2-9-89
Date

MINUTES OF THE SENATE COMMITTEE ON Senate Economic Development

The meeting was called to order by Senator Dave Kerr at
Chairperson

8:00 a.m./p.m. on February 7, 1989 in room 123-S of the Capitol.

All members were present except:

Senator Janice Lee McClure, Excused

Committee staff present:

Bill Edds, Revisor of Statutes' Office
Lynne Holt, Kans Leg Research Dept
Carol de la Torre, Secretary to the Committee

Conferees appearing before the committee:

Harland Priddle, Secretary of the Department of Commerce

Rich Bailey, Economic Development Representative, Dept
of Commerce

Rex Wiggins, Kansas Venture Capital Inc., Lenexa, Ks.

Jerry Mallot, Enterprise Management Incorporated, Wichita, Ks.

Henry Zigtama, Director of Taxes, Arthur, Young & Co.
Wichita, KS.

Bob Taylor, Devlin Venture Partners, L.P., Wichita, KS.

Bill Brundage, President, Kansas Technology Enterprise
Corporation (KTEC)

Senate Bill 101 - An act relating to economic development;
concerning the limitation on tax credits
allowable for investments in Kansas
Venture Capital, Inc., certified Kansas
venture capital companies and certified
local seed capital pools, amending K.S.A.
1988 Supp. 74-8304 and 74-8401 and repealing
the existing sections.

A briefing was presented by Harland Priddle, Secretary
of the Department of Commerce and Rich Bailey, Economic
Development Representative, Depart. of Commerce, on Senate
Bill 101, a bill which would increase the \$24 million
lid of cash investment in certified venture and seed capital
funds to \$40 million to help insure the further availability
of risk capital for Kansas small businesses. Attachment
1.

The first conferee was Rex Wiggins, Kansas Venture Capital
Inc., Lenexa, Ks. He pointed out that the outlook for
Kansas Venture has never looked brighter and that this

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON Economic Development,
room 123-S Statehouse, at 8:00 a.m./p.m. on February 7, 1989

was good news for the Kansas economy. His specific observations are found in Attachment 2. Mr. Wiggins recommended to the Committee amending the bill as outlined in Attachment 3.

Jerry Mallot, Enterprise Management Incorporated, Wichita, Ks., was the next conferee. His testimony is included in Attachment 4. Also testifying with him was Henry Zigtema, Director of Taxes, Arthur, Young & Co., Wichita. (Attachment 5). They asked the Committee to consider inserting a carry-back provision in the bill which would allow for additional venture capital investments to be made, utilizing gains occurring within the last three years. Mr. Mallot offered to help design this amendment by which the carry-back provision could be simplified. Senator Kerr suggested that he contact Rich Bailey, D.O.C. in this regard.

The next conferee was Bob Taylor, Devlin Venture Partners, L.P., Wichita, Kansas. His testimony in response to Senate Bill 101 is found in Attachment 6. Mr. Taylor suggested one modification to the bill: making the service sector an eligible investment.

Bill Brundage, President, Kansas Technology Enterprise Corporation (KTEC), presented his testimony before the Committee. (Attachment 7). He pointed out that this bill was critical due to the fact that the investment has almost reached the current limit. He questioned whether the \$40 million was enough and needed to be raised. Another suggested change recommended including on line 97 the words "operational costs".

Senator Vidricksen questioned whether \$40 million in certified and seed capital funds was enough. He suggested that the Committee think more in terms of \$50 million.

Minutes of the February 1 and 2, 1989, meetings were reviewed by the Committee. It was moved by Senator Vidricksen and seconded by Senator Francisco that the minutes be approved. Motion carried, minutes approved.

There being no further business, the meeting was adjourned.

Attachment 7 is missing. 7/2/89-TM.

TESTIMONY ON SENATE BILL NO. 101

SENATE ECONOMIC DEVELOPMENT COMMITTEE

Rich Bailey

Kansas Department of Commerce

February 7, 1989

Sen Co - Devs
2-7-89
Attachment 1

Thank you, Mr. Chairman, for the opportunity to testify before this committee on Senate Bill No. 101, which would increase the \$24 million lid of cash investment in certified venture and seed capital funds to \$40 million to help insure the further availability of risk capital for Kansas small businesses. I am Rich Bailey, Venture Capital Specialist with the Kansas Department of Commerce, which is the agency charged with the administration of the state venture and seed capital programs. The following is a brief update on the progress of the venture programs in Kansas:

I. Number of Companies

In 1988, the Kansas venture capital efforts may have "turned the corner" with the certification of nine venture capital companies and one local seed capital pool. With this increased activity the past year, Kansas now has 12 venture capital companies and one local seed capital pool certified. Here is a list of the funds and the year of certification:

Venture Capital Companies

1. Research Capital Management Group I, Ltd; Lawrence; 1986.
2. Kansas Venture Capital, Inc.; Topeka; 1987.
3. Research Capital Management Group II, Ltd.; Lawrence, 1987.
4. Devlin Venture Partners L.P.; Wichita; 1988.
5. DeBoer Venture Capital Company, Inc.; Wichita; 1988.
6. Jabara Ventures Group; Wichita; 1988.
7. Kansas Business Investment Company; Topeka; 1988.
8. Carmen Venture Partners, L.P.; Wichita; 1988.

9. DV Venture Investments, L.P.; Wichita; 1988.
10. Ruhfus Venture Capital Corporation; Wichita; 1988.
11. Coleman Venture Capital, Inc.; Wichita; 1988.
12. R.M.B. Venture Capital Co.; Wichita; 1988.

Local Seed Capital Pools

1. Kansas Seed Capital Fund, Inc.; Wichita; 1988.

II. Investments in Certified Companies

Investment qualifying for Kansas income tax credits in certified venture capital and seed capital funds has totaled \$21,930,735.56 to date. Thus, the cash investment amount eligible for tax credits remaining is \$2,069,264.44 (\$24,000,000 less \$21,930,735.56). Of this amount, \$644,770 has been held in reserve for investment in Kansas Venture Capital, Inc., so that KVICI will be able to reach \$5 million of qualifying cash investment. At December 31, 1988, the cash investment in each of the companies, plus the amount in reserve for KVICI, was as follows:

Research Capital Management Group I, Ltd.	\$ 1,575,599.90
Kansas Venture Capital, Inc. (private investment)	\$ 4,335,230.00
Research Capital Management Group II, Ltd.	\$ 1,549,905.66
Devlin Venture Partners, L.P.	\$ 2,000,000.00
DeBoer Venture Capital Company, Inc.	\$ 1,500,000.00
Jabara Ventures Group	\$ 1,500,000.00
Kansas Business Investment Company	\$ 1,500,000.00
Carmen Venture Partners, L.P.	\$ 1,770,000.00

DV Venture Investments, L.P.	\$ 1,500,000.00
Ruhfus Venture Capital Corporation	\$ 1,500,000.00
Coleman Venture Capital, Inc.	\$ 1,500,000.00
R.M.B. Venture Capital Co.	\$ 1,500,000.00
Kansas Seed Capital Fund, Inc.	\$ 200,000.00
(Reserved for KVCI)	\$ 664,770.00
	<hr/>
TOTAL:	\$22,595,505.56

III. Tax Credits Generated

Although there have been over \$20 million of investment in certified Kansas venture and seed funds, only \$421,042 in Kansas income tax credits have been claimed as of January 23, 1989.

Two reasons probably account for this small amount of income tax credits actually being claimed. First, most of the venture capital companies were certified in 1988 meaning the eligible income tax credits will not be claimed until the 1989 tax filing at the earliest. Second, prior to passage of Senate Bill No. 673 in 1988, investors in certified funds could only claim 25 percent of their total eligible tax credits in a single taxable year. Now, investors in certified funds can take the entire credit "up front" if they have the tax liability. This will also be reflected in 1989 or later tax returns.

IV. Investment in Kansas Businesses

Since the inception of the venture capital programs in 1986-87, certified venture companies have invested \$4,675,147 in 28 investments in Kansas. In 1988, 13 project investments were made in Kansas

totalling \$2,754,647.00. The 1988 investment totals are somewhat lower than what might be expected with the number of funds now certified, but this can likely be attributed to the fact that most of the 1988 funds were certified very late in the year.

VI. Estimated Jobs Created or Preserved

In 1988, a total of 455 full-time jobs were created or preserved in Kansas as a result of certified venture capital company investment. Since the Kansas Venture Capital Company Act became law in 1986, a total of 669 Kansas jobs have been created or retained through investments of certified venture capital funds. By dividing the amount of tax credits actually claimed to this point (\$421,042) by the reported number of jobs created or preserved so far (669), the cost to the state thus far has been only \$630 per created or retained Kansas job. This is a most impressive figure, as it is generally estimated that the cost of creating one basic manufacturing job is between \$5,000-\$10,000.

VI. Future Demand for Tax Credits

The demand for additional venture capital tax credits appears very high. Kansas Venture Capital, Inc. is seeking another \$5 million in private cash investment; the KTEC Ad Astra Fund is attempting to create a \$5-\$15 million certified fund using tax credit incentives to lure investors; First Kansas Venture, Inc. in Junction City is seriously considering certification for their fund of several million dollars; and a group in Wichita is investigating the possibility of starting a large venture capital fund of which approximately \$6 million would be

earmarked for certification. There also appears to be potential for several more small funds across the state asking for certification in the next year. In addition, one of the currently certified companies has inquired about immediately increasing the size of their fund by approximately \$500,000 if tax credits are available.

This has been a brief summary of the progress of the state-sponsored venture capital programs in the past year. The Annual Report of certified Kansas Venture Capital Companies and Local Seed Capital Pools will be ready for distribution shortly.

Thank you again for the opportunity to testify before this committee.

KANSAS VENTURE CAPITAL, INC.

STATUS REPORT

For
Committee On Economic Development

February 7, 1989

*Sen Eco-Devo
2-7-89
Attachment 2*

KANSAS VENTURE CAPITAL, INC.

Business outlook for Kansas Venture has never looked brighter and that's good news for the Kansas economy. Specifically, some of the positive events of 1988 are as follows:

* Increased Capitalization:

As of December 31, 1988, 461 banks and other firms hold \$4,425,200 of Common Stock in KVCII and the State of Kansas, through the Pooled Money Investment Board, holds \$4,335,000 of Preferred Stock giving KVCII paid in capital of nearly \$9 million.

* New Investments:

KVCII made five investments in 1988. The companies are involved with asphalt repaving, interstate trucking, custom steel fabrication, data processing information systems, and biotechnology, and are located in Topeka, Olathe, Lawrence, Lenexa, and Kansas City, Kansas.

* Additional Staff/New Office:

A third professional staff person was brought on board December 5, who is in the process of opening our Wichita office. We anticipate making several investments in the Wichita area once our new office has been established.

* Restoration of Profitability:

At this time KVCII is profitable, and we plan to stay profitable.

OUTLOOK FOR 1989

- * Raise an additional \$3.5 million of Common Stock subscriptions (primarily through the insurance and utility industry) that will allow KVCII to call in \$10 million in Common Stock. This will also trigger additional investment by the State for a total capitalization of \$20 million by December 31, 1989.
- * Continue to expand investment activity. Our goal is to increase our professional staff with at least one additional person; and to continue profitability that was achieved in 1988.

Mr. Chairman, I move to amend Senate Bill 101 on Page 2, Line 45, by adding after "\$10,000,000", the following:

"to be specifically reserved for tax credits"

and on Page 3, Line 89, by adding after the word, "companies,", the following:

"including local seed capital pools, and which shall include not more than \$10,000,000 to be specifically reserved for tax credits for"

and on Page 3, Line 89 by striking all after the word, "Inc." and by striking all of Line 90.

Sen Eco - News
2-7-89
Attachment 3

to be specifically reserved for tax credits

45 amendments thereto, which shall include not more than \$10,000,000
46 for Kansas Venture Capital, Inc. The credits shall be allocated by
47 the secretary for cash investments in certified Kansas venture capital
48 companies in the order that completed applications for designation
49 as Kansas venture capital companies are received by the secretary.
50 Any certified Kansas venture capital company may apply to the
51 secretary at any time for additional allocation of such credit based
52 upon then committed cash investments, but priority as to such ad-
53 ditional allocation shall be determined at the time of such subsequent
54 application. Notwithstanding the provisions of subsection (c), inves-
55 tors in Kansas venture capital companies established after July 1,
56 1984, which otherwise meet the requirements specified in this act,
57 shall be, upon certification of the Kansas venture capital company,
58 entitled to the tax credit provided in subsection (a) in the calendar
59 year in which the investment was made.

60 (c) No taxpayer shall claim a credit under this section for cash
61 investment in Kansas Venture Capital, Inc. No Kansas venture capital
62 company shall qualify for the tax credit allowed by Chapter 332 of
63 the 1986 Session Laws of Kansas for investment in stock of Kansas
64 Venture Capital, Inc.

65 (d) The provisions of this section, and amendments thereto, shall
66 be applicable to cash investments made in any taxable year com-
67 mencing after December 31, 1985, and prior to January 1, 1993.

68 Sec. 2. K.S.A. 1988 Supp. 74-8401 is hereby amended to read
69 as follows: 74-8401. (a) There shall be allowed as a credit against the
70 tax imposed by the Kansas income tax act on the Kansas taxable
71 income of a taxpayer for cash investment in a certified local seed
72 capital pool an amount equal to 25% of such taxpayer's cash in-
73 vestment in any such pool in the taxable year in which such in-
74 vestment is made and the taxable years following such taxable year
75 until the total amount of the credit is used. The amount by which
76 that portion of the credit allowed by this section exceeds the tax-
77 payer's liability in any one taxable year may be carried forward until
78 the total amount of the credit is used. If the taxpayer is a corporation
79 having an election in effect under subchapter S of the federal internal
80 revenue code or a partnership, the credit provided by this section
81 shall be claimed by the shareholders of such corporation or the

including local seed capital pools, and which shall include not more than \$10,000,000 to be specifically reserved for tax credits for

82 partners of such partnership in the same manner as such shareholders
83 or partners account for their proportionate shares of the income or
84 loss of the corporation or partnership.

85 (b) The total amount of credits allowable pursuant to this section
86 and credits allowable pursuant to K.S.A. 1987 1988 Supp. 74-8205,
87 74-8206 and 74-8304, and amendments thereto, shall be attributable
88 to not more than \$24,000,000 \$40,000,000 of cash investments in
89 Kansas venture capital companies, Kansas Venture Capital, Inc. and
90 local seed capital pools.

91 (c) As used in this section, (1) "local seed capital pool" means
92 money invested in a fund established to provide funding for use by
93 small businesses for any one or more of the following purposes: (A)
94 Development of a prototype product or process; (B) a marketing
95 study to determine the feasibility of a new product or process; or
96 (C) a business plan for the development and production of a new
97 product or process;

98 (2) "Kansas business" means any small business owned by an
99 individual, any partnership, association or corporation domiciled in
100 Kansas, or any corporation, even if a wholly owned subsidiary of a
101 foreign corporation, that does business primarily in Kansas or does
102 substantially all of its production in Kansas.

103 (d) No credit from income tax liability shall be allowed for cash
104 investment in a local seed capital pool unless: (1) The amount of
105 private cash investment therein is \$200,000 or more; (2) the moneys
106 necessary to administer and operate the pool are funded from sources
107 other than the private and public cash investments; and (3) funds
108 invested by the local seed capital pool shall be invested at 100% in
109 Kansas businesses.

110 (e) Public funds may be invested in a local seed capital pool
111 except that each dollar of public funds, other than that which may
112 be used to administer and operate a pool, shall be matched by not
113 less than \$2 of private cash investment. Public funds shall have a
114 senior position to any private cash investment and may receive a
115 lower rate of return than that allowable for a private cash investment.

116 (f) The provisions of this section, and amendments thereto, shall
117 be applicable to all taxable years commencing after December 31,
118 1986.

to the

SENATE ASSESSMENT & TAXATION COMMITTEE

ECO-Devo

by

Jerry Mallot, President
Enterprise Management, Inc.
8100 E. 22nd Street North, Building 500
Wichita, KS 67226
(316) 681-5177

Dear Senators:

The Kansas Legislature has taken very aggressive actions in the last few years to create an environment that encourages investment in Kansas industries, particularly those where higher levels of risk are involved. Legislation was passed allowing for credits for venture capital investments and providing for positive tax consequences in the year of the investment.

In its initial stages, this legislation suggested the need for a carry-back provision which would allow for the capture of income earned over a three-year period. This provision ensures that an individual who acquires a major gain in one year, may have the time to sort out and make a commitment for a venture capital investment within three years following that gain.

We find ourselves in this specific position at the current time. A 1987 gain from the sale of a company created venture capital opportunities which we have been utilizing. The 1988 Legislation, however, does not allow for a carry-back which would make it more advantageous and encouraging to invest funds in Kansas, rather than in out-of-state alternatives that may be more attractive.

We are asking your consideration to insert a carry-back provision which would allow for additional venture capital investments to be made, utilizing gains occurring within the last three years. The net effect is the same, i.e. the Legislation encourages, and in this case, will certainly assure significant venture capital investment in the State on the part of Mr. Jack P. DeBoer and potentially others. We have demonstrated a significant capacity and desire for investment through the funding and acquisition of several companies during the past eighteen months. The opportunity to utilize this venture capital legislation will mean that Kansas investment alternatives will become more attractive than other options we are currently pursuing. We would appreciate your support in this endeavor and commitment to focus significant investment amounts within the State of Kansas.

Thank you for your time and I would be pleased to answer any questions.

js

Mr Devo - Devo
2-7-89
Attachment 4

TESTIMONY

to the

~~SENATE ASSESSMENT AND TAXATION COMMITTEE~~ *ECO-Devo*

by

Henry G. Zigtema
Arthur Young & Company
1000 Sutton Place
Wichita, Kansas 67202
(316) 265-9537

Dear Senators:

Thank you for this chance to speak on the proposed amendment to the Kansas Venture Capital Company Act.

The case Mr. Mallot makes for allowing credit carrybacks is compelling but by no means unique to any particular individual. It is a typical scenario for the entrepreneur intent on making his venture successful.

What Jack DeBoer and other venture capitalists have recognized is that the key to funding and building successful ventures is patience. The normal business cycle for new business ventures is not the single year contemplated by the statute but rather 3 to 5 years. It takes that long to differentiate between success and failure. During this period the venture capitalist will sustain continued losses rather than the income necessary to use any credits. It is only after a venture has matured to profitability that a credit has value. We think the purpose of the statute is best served by providing incentives for those venture capitalists who are willing to sustain the initial years of loss and reinvest their profits in new ventures. Allowing a carryback will give flexibility to those investors who are willing to make that commitment.

A carryback of venture capital credits will allow Jack DeBoer and others like him to recover from those ventures that fail. It will allow them to be patient with ventures that grow slowly and to take risks on entrepreneurs who would otherwise go begging. And finally, it will reward those investors who are willing to reinvest their profits in the future successes of others.

There are at least a dozen states with venture capital statutes similar to ours. Three of those states have recognized the problems Mr. Mallot and I have outlined and allow venture credits to be carried back, as well as forward. We hope that Kansas will do the same.

Thank you for your time and I would be pleased to answer any questions.

Sen Eco-Devo
2-7-89
Attachment 5

ROBERT D. TAYLOR
PRESIDENT
DEVLIN VENTURES, INC.

Testimony in response to Senate Bill 101 "Tax Credit's Allowable
for Venture Capital and Local Seed Capital Pool Investments"

February 7, 1989

*Sen Eco - Devo
2-7-89
Attachment 6*

I, along with two partners manage 3 certified Venture funds totaling \$5,270,000. There are a total of 15 individual investors in the funds, who have invested between \$25,000 and \$1,350,000. Our first fund, Devlin Venture Partners L.P. was formed in July 1988 and has made three separate investments aggregating \$536,000. Two of these investments are manufacturing related located in Hutchinson, and the other a national distribution company in Wichita.

BENEFITS OF THE KANSAS VENTURE ACT

I believe strongly that economic development is achieved most effectively through the private sector. Private investors, who risk their own capital, are in the best position to evaluate growth opportunities.

New businesses create more new jobs than all other sources, but the failure rate is high. The Kansas Venture Act provides entrepreneurs an attractive capital source which would not otherwise be available. The 25% tax credit is necessary in order to attract investors to commit to a long term Venture Program.

The act properly requires that funds be invested at inception and that the credit is granted, only if the defined investments are made. Consequently, the taxpayers of Kansas can be assured that investments will be made.

VENTURE CAPITAL OPPORTUNITY AND RISK

Since formation of our first fund in July, we have had an abundance of investment opportunities to pursue. In my opinion, there is a tremendous need for risk capital if the goals of economic development are to be achieved.

Without the tax credits, our group would not have made the financial commitment and staffed our organization to evaluate and monitor these investments.

UTILIZATION OF TAX CREDITS

Almost all of our partners were employees and stockholders of Rent-A-Center, Inc., which has created more than 500 jobs in Kansas over the last 15 years, most of which are in the home office, serving a nationwide chain.

A tax credit can only be used by a taxpayer, i.e., someone who has created income. The tax credit is less costly than any type of direct subsidy. The utilization of the credit is in effect a reinvestment of profits earned.

We all know the multiplier effect of creating one new job. To create this job risk capital is necessary. With each dollar of risk capital, \$1 to \$3 dollars can be obtained from traditional lending sources. Consequently, granting a 25% tax credit is a small cost measured against the overall results.

SERVICE SECTOR AS AN ELIGIBLE INVESTMENT

The definition of eligible investment under the act does not include the Service Sector. As a result, several labor intensive industries including software development, are excluded. We agree that retail, financial, etc. do not create new jobs and should not be eligible. It is ironic that a certified fund is permitted to invest up to 40% of its investments in out of state enterprises, but cannot invest in job creating service activities in Kansas. As an example, a California manufacturer is eligible, but a start-up service center for telemarketing is not.

CONCLUDING OBSERVATIONS

The Venture Act has stimulated a source of funds for new businesses, and expansion of existing businesses, and should be expanded to \$40-\$50 million this session.

I believe the best results for Kansas will be achieved through private investors setting aside their own cash for Venture Capital Investment. The legislature should be very careful in "earmarking" predetermined amounts for specific funds, at the expense of Private Sector investors who have put their money on the line.

The staff at the Department of Commerce has done an outstanding job in administering the program. Rich Bailey and others have been responsive to our needs and questions. If the Venture Act is expanded, sufficient budgetary amounts should be allocated to this Division to assure the quality of the program is maintained.

Robert D. Taylor
Biography
9920 East Harry
Wichita, Kansas 67207
316-686-1222

Born and Raised: Plainville, Kansas

Education

University of Kansas Lawrence, Kansas	B.A. Mathematics & Economics	1969
University of Michigan Ann Arbor, Michigan	MBA Finance & Accounting	1970

Work Experience

Devlin Enterprises Wichita, Kansas	Executive Vice President	1987 - Present
Rent-A-Center, Inc. Wichita, Kansas	Sr. Vice President Finance & Director	1982 - 1987
The Coastal Corp. Houston, Texas	Director of Financial Planning	1980 - 1982
Hesston Corporation Hesston, Kansas	Assistant Treasurer	1973 - 1980
Price Waterhouse & Co. Kansas City, Missouri	Staff Accountant	1971 - 1973

Association with Certified Venture Funds

President of General Partner of Devlin Venture Partners L.P.
President of General Partner of DV Investments L.P.

Other Professional

Member of Board of Directors, Railroad Savings & Loan
Wichita, Kansas

Certified Public Accountant