Approved: 1/11/95
Date

1-

MINUTES OF THE SENATE COMMERCE COMMITTEE

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on January 10, 1995 in Room 527-S of the Capitol.

Members present: Senator Salisbury, Downey, Feleciano, Gooch, Harris, Kerr, Petty, Ranson, Reynolds, Steffes and Vidricksen.

Committee staff present: Lynne Holt and Jerry Donaldson, Legislative Research Department
Bob Nugent,Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:

Others attending: See attached list

Lynne Holt, presented an overview of the Report of the Joint Committee on Economic Development to the 1995 Kansas Legislature. see attachment 1.

There was a general discussion of the Report.

Senator Reynolds requested information as to the number of applications for CDBG funds that have been requested, the number awarded and the number rejected.

The Chairman announced the Committee would meet at 8:00 a.m., Wednesday, January 11, in Room 527-S.

1/10

NAME	REPRESENTING
MARK BARCELCINA	KDOC+H
Harold Stones	KBA
Charlie Warren	Kansas Farm
Senator Ben Vidricksen	
Jean Barbee	TIAK
Jim Edwards	KIDA
Meg Hansen	Sen. Burke

Report of the Joint Committee on Economic Development to the 1995 Kansas Legislature

Chairperson
Senator Pat Ranson

Vice Chairperson
Representative Bob Mead

OTHER LEGISLATIVE MEMBERS

Senator U. L. "Rip" Gooch
Senator Anthony Hensley
Senator Dave Kerr
Senator Alicia Salisbury

Representative Garry Boston
Representative Gary Haulmark
Representative Richard Lahti
Representative William Mason
Representative John M. Toplikar
Representative Nelson Van Fleet
Representative Jack Wempe

January 10, 1995
Commerce

December, 1994

Attachment 1

BACKGROUND

The Joint Committee on Economic Development focused on the issue of business finance assistance at its meetings on September 12-13, October 17-18, and November 14. The Committee heard many presentations on state and federal programs and initiatives in Kansas and in other states that are designed to assist businesses and entrepreneurs with their financing needs. (References to businesses will hitherto include entrepreneurs.) State and federal programs vary with respect to: populations served; financing needs addressed; forms of financing and nature of project; geographical access; and availability of technical assistance. This report has four parts:

1. policy questions that should govern the design and evaluation of state business financing assistance initiatives;

2. a table summarizing state and federal programs in terms of who receives assistance; the stage of growth to which the program is targeted; the terms of assistance financing; and agency oversight of the program;

3. the possible forms that state financing assistance might assume and policy objectives that could be realized by such forms of assistance; and

4. a list of Committee recommendations to the 1995 Legislature.

PART I -- POLICY QUESTIONS

Policy questions that are important for the design and evaluation of state business financing assistance are listed below. In its review of state and federal business finance programs and its recommendations, the Committee attempted to address some of these questions.

1. What forms might state financing assistance assume and what policy objectives could be ascribed to such forms of assistance? Are these objectives consistent with the state's economic development strategy? What advantages and disadvantages are attributable to the various state roles in business assistance financing?

2. What business financing needs are being met currently by federal, state, or local programs in Kansas?

3. What types of businesses are receiving public sector financing assistance? Under what terms? At which growth stage of business? For what types of projects?

4. Is this assistance available to businesses throughout the State of Kansas? If not, why not?

5. Is adequate managerial or technical assistance being provided to the businesses that receive financial assistance? If not, why not?

6. What gaps in business financing assistance have been identified as significant issues for business formation and growth and industrial recruitment?

7. With respect to identified business financing gaps, on what basis has the demand for specific financial assistance been established? Is the evidence of financing needs supported empirically or anecdotally?

8. For those identified gaps, what rationale exists for a state role in meeting those needs? What forms of state government involvement in business financing are established by precedent, by examples of other state initiatives, or by findings in economic development literature?

9. Given competing demands for limited state economic development resources, how should priorities be assigned to new and existing business financing programs?

PART II -- STATE AND FEDERAL FINANCE ASSISTANCE PROGRAMS

The following is a table outlining state and federal finance assistance programs by structure of financing. These programs were, for the most part, addressed in the meetings of the Joint Committee on Economic Development. The table does not in any way attempt to analyze the effectiveness of these programs; nor does it examine the barriers that end users may encounter in trying to secure financial assistance through these programs.

STATE OF KANSAS PROGRAMS

Direct Loans and Grants

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Kansas Trade Show Assistance Program	Kansas small business concerns with products or services originating in the state, or products receiving value-added processing in Kansas. No restriction on geographical coverage.	No growth stage specified.	Matching grants are awarded on a reimbursement basis for up to 50 percent of eligible expenses, not to exceed $3,500 per foreign show and $1,500 per domestic show. (Domestic shows must have an international impact.)	Direct funding through Kansas Department of Commerce and Housing.
KDFA Beginning Farmer Loan Program	Individuals who, or partnerships that, engage in farming. No geographical restrictions apply.	Targeted to start-up farm operations; there are certain limitations on land ownership.	Loans of not more than $250,000 (lifetime aggregate amount per borrower) for agricultural land, agricultural improvements, and depreciable agricultural property; terms to be negotiated.	Loans provided by lending institution or other entity that purchased tax-exempt bonds from KDFA.
Infrastructure Partnership Fund	Eligible projects may include the construction, reconstruction, rehab, alteration, expansion, or improvement of public facilities that support Kansas basic enterprises. Roads, streets, wastewater collection, and water treatment facilities are examples of authorized projects.	No growth stage specified.	Fund is currently limited to moneys available through the revolving function of the loan portfolio. Repayment terms will not be for a greater period than the anticipated life of the improvement and rates are adjustable. The city or county receiving funding must establish a dedicated source of revenue for repayment of the loan.	Kansas Department of Commerce and Housing.

1-5

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Kansas Economic Opportunity Initiatives Fund (KEOIF)	To be considered for funding, one of the following conditions must exist: (1) a major expansion of an existing Kansas enterprise; (2) the potential location of a major employer; (3) the award of a major federal or private sector grant which has a matching requirement; (4) the loss or substantial reduction of a major employer; or (5) the closure of a major federal or state institution/facility.	No growth stage specified.	Flexible terms. Can be either a grant or loan. Performance requirements as a condition of funding can be incorporated into the contractual agreement.	A five-member panel consisting of the Secretary of Commerce and Housing, the Presidents of Kansas Inc. and KTEC, and the private sector chairpersons of Kansas Inc. and KTEC.
Kansas Industrial Training (KIT) Program	Basic enterprises that create at least five new jobs. Basic industries include manufacturing, distribution, etc., as well as companies involved in the production of goods and services to out-of-state customers.	No growth stage specified. Start-ups may qualify.	Companies receive grants to pay negotiated costs for pre-employment, classroom, and on-the-job training. Maximum of $2,000 per trainee. Determination of funding level influenced by a variety of factors including company need or matching funds.	Direct funding through Kansas Department of Commerce and Housing.
Kansas Industrial Retraining (KIR) Program	Intended for basic enterprises that are restructuring due to new technology, product diversification, or new product activities. Additionally, the company must train at least five employees and provide a 100 percent match for state program grants.	Established companies. Not for start-ups.	Companies receive grants to pay for such things as instructor salaries and training materials for existing workers who are likely to be displaced due to obsolete or inadequate job skills in relation to the companies' new needs.	Direct funding through Kansas Department of Commerce and Housing.

2-7

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
State of Kansas Investment in Lifelong Learning (SKILL)	Kansas basic enterprises creating a large number of new jobs or new jobs paying above average wages. No restriction on geographical coverage.	Larger training projects than projects served by KIT/KIR.	Generally, grants are awarded for training project costs, such as instructor salaries, travel expenses, supplies, manuals, and planning costs.	Kansas Department of Commerce and Housing must approve and oversee contracts between educational institutions and companies for SKILL projects.

Public Private Parternerships/Equity Investment

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Ad Astra Seed Capital Fund I and II	Companies with an advanced technology base; no restriction on geographical coverage.	Targeted to start-up and early-stage businesses.	Equity or debt.	Funding through KTEC (a public-private partnership) and private investors. Funds are managed by Campbell-Becker, Inc. of Lawrence.
Kansas Certified Venture Capital Companies	Private investors in certified venture capital companies; such companies must invest in ventures that are in need of capital for expansion, new product development, or similar business purposes.	Start-ups and early stage company expansions.	Equity funding by investors is stimulated by a 25 percent Kansas income tax credit with carry-forward provisions.	Annual review by the Kansas Department of Commerce and Housing of each certified venture capital company is required for compliance.

Risk-Sharing

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Kansas Basic Enterprise Loan Program (KBEL)	Program is not operational but is targeted to basic enterprises that do not meet the equity requirements of lending institutions and/or SBA or other lending entity. No restriction on geographical coverage.	Targeted to small businesses that do not have gross revenues in excess of $1.5 million in the most recently completed year.	Long-term, fixed or variable rate, fixed asset loans to qualified basic enterprises; private lender, KDFA, and borrower would all share risk but KDFA exposure would not exceed $200,000 per project, to be matched by a subordinated loan from a financial institution. Borrower would have to inject 10 percent of total project costs.	KDFA would provide guarantees for loans made by private lending institutions.
Export Loan Guarantee Program	Targeted to small and midsize Kansas companies. Program applies to the export of products or services substantially produced in Kansas for export from the U.S. No restriction on geographical coverage.	No growth stage specified.	State's loan guarantee is limited to the lesser of 90 percent of the loan amount, or 50 percent of the reserve fund balance for a maximum term of one year. The loan guarantee fee equals 1/2 to 1 percent per year.	Kansas Department of Commerce and Housing provides guarantees on loans made by financial institutions. Loan guarantees must be approved by a five-member review committee.

Tax Incentives

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
High Performance Firms Incentives Program (HPIP)	Manufacturers and certain service sector firms that employ less than 500 employees, pay above average wages for the SIC in the county in which the company is located, and invest at least 2 percent of payroll in training or participate in KIT, KIR, or SKILL. HPIP incentives are available statewide for qualified firms.	No restrictions apply but the tax incentives are unlikely to be claimed by many start-up firms.	State and local sales tax exemption: (1) 10 percent investment tax credit on capital investment in excess of $50,000, with a ten-year carry-forward; (2) workforce training corporate income tax credit of up to $50,000 per year on training above 2 percent of payroll; (3) matching funds for approved consulting services; and (4) sales tax exemption.	Secretary of Commerce and Housing must certify annually that the firm meets criteria for receipt of incentives.
Research and Development Tax Credits	Taxpayers investing in research and development in accordance with federal IRC provisions.	No restriction on stage of growth, although company R & D activities will be in expansion stage for taxpayers to meet eligibility test to receive credits.	Credit is equal to 6½ percent of amount by which the amount invested exceeds the average of actual expenditures in the taxable year and the preceding two taxable years; 25 percent of credit may be claimed each year until the credit is exhausted.	Kansas Department of Revenue implements this Act.
Local Seed Capital Pools	Private investors in local seed capital pools; such pools must fund Kansas small business investments in prototype development, business plan development, and marketing plan development.	Very early stage ventures.	Equity funding is stimulated by a 25 percent Kansas income tax credit with carry-forward provisions. Private investment of at least $200,000 in the pool is a precondition for a tax credit.	Annual review for compliance is required of Secretary of Commerce and Housing.

1-9

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Kansas Enterprise Zone Act	The following may receive enhanced income tax credits and state and local sales tax exemptions: (1) manufacturers creating two or more jobs; (2) non-manufacturers creating five or more jobs; (3) corporate headquarters creating 20 or more jobs; and (4) retailers creating at least two jobs, but only if located in communities with a population of 2,500 or less.	Program intended for expanding companies.	Job creation tax credits are higher for qualified companies in non-metropolitan areas than in metropolitan areas.	The Secretary of Commerce and Housing is responsible for promulgating rules and regulations and for establishing criteria for nonmetropolitan regions. The Department of Revenue must determine the eligibility of applicants.

Technical and Management Assistance

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Small Business Development Centers	Targeted to owners or potential owners of small businesses; coverage is statewide.	No restriction on stage of growth.	Benefits include: (1) free one-to-one counseling (management and technical assistance) to clients; (2) low-cost training; and (3) free referrals to other small business service providers. SBDCs are licensed by the SBA and are federally funded and funded by affiliated universities and community colleges, but the State SBDC Office also receives a state grant from the EDIF and makes allocations to the ten regional SBDCs in Kansas.	The Kansas Department of Commerce and Housing administers the state grant and awards it to the state SBDC office in Wichita for allocations to the regional centers.

1-10

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Certified Development Companies	Small businesses receive financial packaging assistance and access to a variety of financing sources. There is statewide coverage through services of 11 CDCs and three associate CDCs.	Growth stage depends on restrictions, if any, in programs which are packaged or provided by CDCs.	CDCs are certified by SBA and receive federal funding but also receive annual state support from the EDIF based on their performance during the previous year. FY 1995 funding was approved with a condition that no more than 10 CDCs receive funding.	Kansas Department of Commerce and Housing administers the funding and makes allocations to individual CDCs.

1-11

FEDERAL PROGRAMS

Direct Loans and Grants

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
CDBG-ED Program	Companies that meet HUD guidelines and requirements, including low-to-moderate income provisions. Coverage is statewide, excluding six cities receiving HUD funds directly.	No restriction on growth stage.	Low interest subordinated loans with a 50 percent to 100 percent matching requirement for plant, equipment, or infrastructure to be financed.	Grants from Kansas Department of Commerce and Housing to local governments which, in turn, make loans to businesses.
JTPA	Companies with employees who are dislocated, disadvantaged, or face barriers to employment benefit from financial training assistance.	Businesses with job openings are eligible to use JTPA.	Employers receive up to a 50 percent reimbursement of employee wages during the training period.	Intermediary is the Service Delivery Area receiving funds from Kansas Department of Human Resources.
Tax Exempt Private Activity Bonds	Manufacturers and processors.	Generally, companies that have established credit capacity.	Lease payment by beneficiary company to local government that issues IRBs; this arrangement lowers finance costs for a company's capital expenditures. Ownership of financed assets ultimately reverts back to the company.	Intermediary is the local government which must receive allocations from Kansas Department of Commerce and Housing.
SBA 504 Program	Small businesses; available statewide through CDCs.	No restriction on growth stage but the borrower must have capacity to inject at least 10 percent of project cost.	Loans are for long-term fixed assets, such as land, buildings, equipment, and machinery. No more than $1 million may be lent to a given borrower. Loans may have fixed rate terms of 10 or 20 years.	The SBA issues bonds; bond proceeds are combined with bank financing; the CDC packages and administers the loans. The bank gets a first lien position on fixed assets and the CDC gets a second lien position.

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Intermediary Relending Program	Small businesses and nonprofits are eligible, but interest rates on loans vary according to type (lower for manufacturing and nonprofit than for other). Four CDCs presently have the capacity to offer this program in Kansas.	No restriction on growth stage.	Loans of up to $150,000 for land, buildings, machinery, equipment, inventory, and working capital.	Farmers Home Administration loans are provided by an intermediary CDC. The SBA and bank must be unwilling to do the project or the project is ineligible for SBA programs.
Revolving Loan Fund	Small businesses, public entities, and nonprofits are eligible but interest rates on loans vary according to type (lower for private enterprises). Six CDCs and Kansas City, Kansas offer this program in Kansas.	No restriction on growth stage.	Loans not to exceed $300,000 for land, buildings, machinery, equipment, inventory, and working capital.	Loans from the Economic Development Administration are provided by intermediary CDC. The SBA and bank must be unwilling to do the project or the project is ineligible for SBA programs.
Small Business Investment Companies (SBICs)	A beneficiary of SBIC funding is any small business which has a net worth not greater than $18 million and which has not had an average after tax income for the previous two fiscal years in excess of $6 million. Small businesses owned by socially or economically disadvantaged persons may be assisted by Specialized SBICs.	No restrictions on stage of growth, although generally used for start-ups and expansion.	SBICs use their own capital and funds borrowed from SBA to provide financing for businesses in the form of noncontrolling ownership interest, equity interest, and long-term loans for a period of up to 20 years. Leverage ratios are up to 3:1 for a regular SBIC and 4:1 for a specialized SBIC	SBICs are private investment firms that are licensed and regulated by the SBA; KVCI is the only SBIC in Kansas but has not used its SBIC status to borrow SBA funds. Kansas City Equity Partners in Missouri is a functioning SBIC, which operates in the Kansas City metropolitan area.

1-13

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
SBA 7(a) Guarantee Program	Most types of small businesses (manufacturing, wholesale, services, retail, construction, and agriculture); eligibility terms vary by sector. No restriction on geographical coverage; available statewide.	Businesses could be start-ups provided that they have sufficient capital for start-up expenses and initial operations. (SBA may require that owners have up to one-third or even one-half of total assets needed.)	Loan guarantee of up to 90 percent from SBA; for loans exceeding $155,000, the maximum SBA guarantee is 85 percent. Guarantees generally apply to loans of up to $750,000. Loans are available for real estate, expansion, machinery, equipment, working capital, or inventory. Loans are generally made for more than three years; loans could be up to 25 years for land and buildings. Interest rates are negotiated between the lender and borrower.	Guarantees are financed by SBA; loans are made by private lenders.
SBA 502 Program	Most types of small businesses (manufacturing, wholesale, services, retail, construction, and agriculture). Eligibility terms vary by sector. This program is available in counties served by CDCs but has been largely replaced by the SBA 504 program.	No restriction on growth stage.	Preferential guarantee terms for rural projects (85 percent guarantee of project cost or $1 million, whichever is less); for nonrural projects (40 percent guarantee of project cost or $750,000, whichever is less). Financing is provided for fixed assets only.	The SBA guarantees the loan. The loan is made by a bank, which, in turn, relends to CDC.
SBA LowDoc Program	Start-ups or other small businesses that have average annual sales for the preceding three years which do not exceed $5 million and employ ten or fewer people. No restriction on geographical coverage.	No growth restrictions, although new businesses are targeted.	SBA guarantee is up to 90 percent of loans of $100,000 or less; loans may not exceed 25 years for fixed assets and ten years for other purposes. Stream-lined application process, particularly for loans of $50,000 or less.	Loans are made by financial institutions and guaranteed by SBA. Collateral may be inadequate if personal guarantees are made.

1-14

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
SBA Lines of Credit Programs	Four programs include: (1) Greenline Revolving Line of Credit -- small businesses that meet SBA 7(a) eligibility criteria; (2) Seasonal Line of Credit -- targeted to small firms, particularly in the service sector; (3) Export Revolving Line of Credit -- small business exporters; and (4) Contract Line of Credit -- contractors and subcontractors in construction, manufacturing, and service industries.	No growth stage restrictions.	Short-term loans are: (1) up to five years for a Greenline loan for inventory, receivables, contracts, machinery, equipment, real estate, and personal assets; (2) up to one year for a seasonal loan for working capital and fixed assets; (3) up to three years for an export loan for labor and materials needed for manufacturing, purchase of goods or services for export, development of foreign markets, and the financing of foreign accounts receivable; and (4) up to 18 months for a contract loan for financing of estimated labor and materials needed to perform a specific contract. Terms of loan guarantees are the same as SBA 7(a) guarantees, except for Greenline where the maximum SBA guarantee is 75 percent.	SBA guarantees loans which are made by private lenders.
Defense Conversion Loan Program	Program is not yet operational; to be targeted to small businesses adversely affected by downsizing or closure of military bases.	Information not available.	SBA will guarantee the loans; information is not available on specifics.	Loan guarantees from SBA; loans to be made by private lenders.

1-5

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Business and Industrial Guaranteed Loans	Targeted to small businesses with fewer than 50 employees. Borrowers must be located outside boundaries of a city of 50,000 or more and its adjacent urbanized areas; population density must be no more than 100 persons per square mile.	No restriction on stage of growth.	The Farmers Home Administration guarantees up to 90 percent of a loan; loans are made by commercial lenders for up to $10 million under the program. Loans may be made for construction, conversion, land acquisition, machinery, equipment, supplies, materials, and working capital.	No state agency oversight. Loans are guaranteed by the Farmers Home Administration and made by private lenders.

Tax Incentives

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
Low-Income Housing Tax Credits	Limited partners (generally "C" Corporations) that invest in low-income housing projects. Projects must be rented for a minimum of 30 years to low- and moderate-income tenants. Generally, investors put up half of the money a developer needs for a housing project; the developer sells the project's tax credits to investors.	Housing project must be completed and initial occupancy must have occurred.	Receipt of 99 percent of annual tax credits for ten years. Limited partners may claim annual passive losses generally structured over 15 years.	Kansas Department of Commerce and Housing publishes the annual plan for the statewide allocation of tax credits.

1-16

Technical and Management Assistance

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
SBA Business Innovation Centers (BICs)	Entrepreneurs and small businesses are provided access to: (1) market research databases; (2) use of spreadsheet and planning software; (3) other information to start and expand businesses; (4) one-to-one counseling; (5) one-stop shopping for the latest information on business trends; and (6) SBA's on-line National Bulletin Board System. There is one BIC in Kansas City, Missouri and none in Kansas.	No restriction on stage of growth.	No charges for any BIC services; BICs are federally funded by SBA.	No state agency oversight or involvement.

1-17

1-18

PROGRAM	WHO RECEIVES	GROWTH STAGE	TERMS OF FINANCING	AGENCY OVERSIGHT
SBA One-Stop Capital Shop	Targeted to small businesses. The intent of the Centers is to coordinate SBA programs, federal, state, local, and private resources, in an effort to create, retain, and expand businesses and employment in distressed communities and underserved markets. These one-stop shops will be established in Empowerment Zones and Enterprise Communities. There will be 12 One-Stop Capital Shops, three in rural areas. The program is not yet operational.	No restrictions on growth stage.	Estimated federal funding of $3.2 billion and technical assistance over a five-year period for the entire initiative.	No state agency oversight. SBA will provide broad support but the Centers are community-directed and managed.
SBA Women's Prequalification Pilot Program	Targeted to women interested in owning businesses. The pilot is operating in 15 cities across the country; none in Kansas City, Missouri or cities in Kansas to date.	Targeted to start-up, early stage growth since program's intent is to assist business women in gaining increased access to commercial credit through loan application submittals. SBA reviews applications and refers prospective borrowers to a number of receptive commercial lenders.	No fee to women for assistance. This program is federally funded.	No state agency oversight is required.

PART III -- FORMS OF STATE FINANCE ASSISTANCE

This section describes five forms of state financing assistance and the policy objectives each addresses.

A. Direct Grants and Loans

One option for the state in providing financial assistance is to make direct grants or loans to businesses. Grants provided through state programs are a traditional form of economic development assistance and are usually tied to specific policy objectives. For example, the Kansas Trade Show Assistance Program (KATSAP) was created in 1991 to help small firms increase their international exports. Another example of long-standing in Kansas is the Kansas Industrial Training (KIT) and Kansas Industrial Retraining (KIR) programs, both of which provide grants to help firms train their workers. The KIT program is also used as an incentive for industrial recruitment. The federal JTPA program is designed for job creation and to subsidize worker training. JTPA reimburses employers on a matching basis for the wages of newly-hired workers who meet certain eligibility standards. With the exception of the KIT program, all the above-mentioned programs require that matching funds be expended by the participating company.

The federal CDBG-Economic Development Program (CDGB-ED) is administered by the Kansas Department of Commerce and Housing (KDOCH) and provides low-interest loans to businesses in the nonentitlement areas of the state. The program's objective is to create and retain jobs for low-to-moderate income people. CDBG loans are administered by the local governing body or its agent, and upon repayment, are retained in that jurisdiction for continued economic development financing. CDBG funds must be matched by private lender funds.

The Kansas Economic Opportunity Initiatives Fund (KEOIF) was created in 1993 to provide a source of funds for economic emergencies or opportunities, such as the closure of a major facility or the attraction or expansion of a company. In 1994, KEOIF was made a statutory fund from which either loans or direct grants could be made. Although there is no matching requirement in statute, the projects financed to date have all included private and/or local funds as part of the overall financial package.

Although categorized as direct grant and loan programs, many of the programs referenced above involve intermediary lenders and administrative capacity. The state's certified development companies (CDCs) are particularly instrumental in linking Kansas businesses with federal business finance dollars, *e.g.*, the SBA microloan program, the SBA 504 Program, the Intermediary Relending Program, and the Revolving Loan Program. Local governmental units become the intermediary lender for CDBG-ED funds, and are the issuing agent for tax-exempt IRBs. The service delivery areas (SDAs) are the intermediary for the JTPA Program, and KDFA works with private lending institutions in the issuance of tax-exempt bonds for the Beginning Farm Loan Program.

Proponents of direct grants and loans cite advantages of greater flexibility in the competition for business recruitment and retention. The argument for direct grants and loans is that, without such assistance, a business might have made a decision to relocate, not expand, reduce its workforce, or even leave the state. The argument continues that the benefit to the governmental entity exceeds the cost of the grant or loan. Opponents of direct loans and grants, particularly those without matching fund requirements, cite the potential for a lack of business risk and thus possible commitment to a project.

B. Public-Private Partnerships -- Equity Investments

The State of Kansas has embraced the philosophy of public-private partnerships for equity investments and has used that philosophy with great success in organizing much of the economic development efforts in the state. In practice, the state's role has become one of institution building and leadership. This concept was initially used in 1986 to meet the need for seed and venture capital in Kansas by creating Kansas Venture Capital, Inc. which was capitalized with $5 million. The same approach was taken through KTEC to establish the Ad Astra Fund and the Ad Astra II Fund to provide seed capital for high technology firms. By providing the initial capitalization, the state was able to stimulate additional investment from the private sector.

C. Risk-Sharing

The second method is for the state or federal government to engage in risk-sharing arrangements to stimulate the private sector. Most often, this involves the use of loan guarantees. For example, state loan guarantee programs include the Kansas Basic Enterprise Loan Program and the Export Loan Guarantee Program.

Many SBA programs use this principal, the most notable of which is the SBA 7(a) Guarantee Program. By offering guarantees on 80 to 90 percent of an approved loan, the lender's risk is greatly reduced. With more limited exposure, banks are more inclined to make the loan and in most cases are able to offer reduced interest rates.

The SBA microloan program provides capitalization for small loans, but requires nonfederal funds to make up a loan loss reserve fund. The microloan program administered by Wichita's South Central Kansas Economic Development District (SCKEDD) involves the financial participation of the state ($72,000) and Wichita Area Development ($40,000). Increasingly, loan programs are being structured to spread the risk among several parties. The SBA 504 loan program involves a financial partnership between a private sector lender, CDC, and the business.

Guarantee programs should be structured to meet actual end user needs. For example, the Kansas Export Loan Guarantee Program was modified statutorily in 1994 to meet the financial needs of exporters involved in mid-size export transactions; prior to modification, the program could only assist exporters engaged in very small export transactions. Inadvertently, the program failed to serve a segment of the population for which it was initially intended. Finally, loan guarantee programs, particularly federal programs, are often reported to be cumbersome to access.

Properly designed loan guarantee programs should promote shared risk among several parties (including state government), provide proper incentives to private lenders, be well targeted to meet real needs, and be user friendly. If they meet these criteria, they can be an important component of a state's financial assistance strategy.

D. Tax Incentives

Tax incentives, in the form of state income tax credits, sales tax exemptions, or property tax abatements or exemptions can increase a company's available capital by reducing its tax liability.

Traditionally, income tax incentives have been used to stimulate private investment in facilities or equipment or to encourage job creation. The High Performance Firms Incentives Program (HPIP) was designed to serve both those objectives and to encourage firms to increase their expenditures on work force training and to pay higher wages to their employees. Income tax credits usually do not benefit a company in start-up stages of growth since the company must be profitable in order to benefit from the credit.

Property tax relief, in the form of abatements or exemptions, also increases a company's available capital. In addition, property tax abatements and exemptions may play a key role in local business retention and expansion efforts and recruitment bids. Property tax abatements/exemptions, as well as sales tax exemptions, benefit companies at all stages of growth and do not depend on a company's profitability.

E. Technical and Management Assistance

Kansas supports Small Business Development Centers (SBDCs) and Certified Development Companies (CDCs) with EDIF funds administered by KDOCH. These organizations can be of great benefit to small companies in nearly every stage of growth. They also assist firms in obtaining conventional financing and state economic development block grant funds by helping them develop business plans (SBDCs) and by packaging loans (CDCs).

The State of Kansas also sponsors conferences to bring investors together with entrepreneurs who are seeking venture capital. These conferences have operated successfully for several years under the sponsorship of KDOCH, KTEC, and Ernst & Young of Kansas City.

KDOCH's business finance programs were consolidated into the Office of Business Finance in July of 1994. Comprehensive referral services in the area of business finance are provided through this newly created office. The Office of Business Finance also oversees the state's network of CDCs and SBDCs providing funding and leadership for both groups. A Committee recommendation is included in Section IV to broaden the scope of the Office of Business Finance through coordination of the efforts of other existing programs and agencies offering business financing (SBA, KTEC, and EDA).

PART IV -- BUSINESS FINANCE POLICY OPTIONS

The Committee recommends the following actions:

Management, Coordination, Evaluation, Technical Assistance

1. *Information should be collected by Kansas Inc. and presented to the appropriate standing committees during the 1995 Legislature to help them assess the merits of recommending an audit of capital demand. Kansas Inc., in conjunction with the Kansas Inc. Action Planning Committee on Business Finance, should develop a scope statement for how such an audit would be performed, the groups that would be surveyed (the Committee emphasized the importance of surveying end users), and the estimated costs for such an audit. Kansas Inc. should contact the Aspen Institute which has published a book Business Finance as a Tool for Development, and request information on capital demand audits that have been performed by states similar to Kansas, including associated methodologies, costs, and the use of audit findings.*

   The argument presented to the Committee for recommending such an audit is that the last comprehensive study of capital availability in Kansas was done by Kansas Inc. during fiscal year 1989, but that study focused almost entirely on the supply side of business finance in the state. The Committee was informed that Kansas policymakers need systematic, empirical data on the demand for financing, in order to review existing programs and determine if financing gaps exist, whether new financing tools are needed, and if the programs currently in existence should be retained or modified. The collection of such data is difficult due to confidentiality restrictions and the subjective character of credit worthiness. Methodologies and approaches are available to derive an objective understanding of financial demand. The Committee notes that the Legislature might need to provide the resources to finance the recommended audit if, after obtaining additional information, it is determined that such an audit is warranted. If an audit is performed pursuant to this recommendation, the Committee underscores the importance of gathering data that might substantiate the need for establishing a statewide or expanded CDC program. Moreover, such an audit could serve as the basis for making informed decisions on the need for increasing commercial lending through the use of tax incentives or other subsidies.

2. *The Kansas Inc. Action Planning Committee on Business Finance should conduct an analysis of existing business assistance programs to determine their effectiveness in meeting the needs of targeted clients and serving intended customers. Service recipients should be surveyed as part of this analysis.*

The justification for this recommendation is that mere existence of a state or federal finance program does not necessarily mean the program is filling the need it was originally created to fill. Nor does an inventory of financing programs provide an adequate appraisal of program delivery, timeliness, or capacity. Before policy-makers can make responsible recommendations, they must have access to accurate information about existing programs. This evaluation could be done in conjunction with the audit referenced above assuming that the audit is to be performed. No additional resources are anticipated for the analysis of existing programs which is considered a part of Kansas Inc.'s oversight responsibilities.

3. *The new Secretary of Commerce and Housing should consider methods of strengthening the coordination of, and delivery system for, business finance programs.*

The Committee notes the importance of strengthening the Office of Business Finance within the Department of Commerce and Housing to build a central, statewide entity or office to provide complete one-stop shopping for business finance and to coordinate existing programs and agencies offering business financing (SBA, KTEC, and EDA). The Secretary of Commerce and Housing should establish a steering committee of public and private sector representatives to provide direction and guide coordination efforts. The Committee observes that additional staffing and budgetary resources would need to be targeted toward the Office of Business Financing, although this could probably be accomplished through a funding reallocation.

4. *The Kansas Department of Commerce and Housing, in conjunction with SBA, should provide for and organize participation in forums through which Kansas banks can learn about and be encouraged to become SBA Certified Lenders and Preferred Lenders.*

SBA 7(a) loans submitted to the SBA by banks having been designated by the SBA as "Certified Lenders" are reviewed and acted upon within three working days, substantially shortening the usual processing time by as much as weeks. Banks may earn this certification by doing a limited number of SBA 7(a) guaranteed loans (four to six) during the prior year and undergoing intensive training (between four and eight hours) in SBA credit and procedural analysis. A bank designated as a "Preferred Lender" can forego the usual submission process on SBA 7(a) guaranteed loans and approve the guarantees itself. The approval is then reported to the SBA, which reviews those loans on a quarterly or annual basis. To become a Preferred Lender, Certified Lenders simply request this upgraded designation and undergo additional training with the SBA.

The Committee was informed that the SBA has enthusiastically agreed to cooperate with KDOCH in this endeavor.

5. *KDOCH, local CDCs, and SBDCs should combine efforts in designated urban areas participating in the Kansas Urban Neighborhood Planning Program and inform the Legislature of those efforts on an ongoing basis.*

The 1993 Legislature revised the Kansas Community Assistance Strategic Planning Program to make blighted urban areas in metropolitan counties eligible for both planning and action grants. Metropolitan areas apply for funding on a competitive basis. Kansas Inc., KDOCH, and the SBA are developing an assistance program to enhance business development efforts in these metropolitan areas. Three pilot projects will be chosen from applications submitted by metropolitan counties to the existing program. In addition to receiving up to $15,000 to develop a local strategic plan for community development, each area will be assisted by SBA, KDOCH, and SBDC staff to ensure that sound business development strategies are included in the strategic plan. Staff from these entities will also work with each area during the implementation stage of the program, during which individual action grants of up to $25,000 will be available. This stage will focus on business development with SBA microloans, SBA 504 loans, and SBA 7(a) business financing. Community banks also will participate to provide support with emphasis on start-up and small firms, especially those owned and operated by minorities and women. The Committee notes that no appropriation or legislation is required, and that this activity can be accomplished within existing authority and resources. The Committee strongly supports this collaborative effort.

6. *All counties of the state should have access to the services of a dynamic, competent CDC by encouraging the assimilation of weaker CDCs by more aggressive CDCs. In order to promote more effective CDC operations, the funding formula should be re-evaluated with the intent of placing greater emphasis on capacity development, and only eight CDCs should be funded in FY 1996.*

Currently, 11 CDCs geographically cover all 105 counties of the state. KDOCH funds these CDCs on a performance basis. Mo-Kan and Topeka/Shawnee County were not funded for FY 1995 operations due to a lack of FY 1994 activity. In addition, SBA downgraded three other CDCs to the status of Associate CDCs due to lack of performance or failure to meet SBA performance criteria. The proposed assimilation can be accomplished through KDOCH, in cooperation with the SBA. Additional state funding may be needed, or existing funding levels could be reallocated, for CDCs to enhance staff capacity.

7. *The 1995 Legislature should consider legislation to repeal the Kansas Basic Enterprise Loan Program (KBEL).*

The KBEL statute, enacted by the 1989 Legislature, targeted basic enterprises needing to acquire and equip adequate facilities with limited access to conventional loan sources due to a lack of equity. At that time, SBA and the Farmers Home

Administration (FmHA) were requiring substantial equity positions by potential borrowers. Subsequent changes in SBA's and FmHA's lending policies have drastically liberalized equity requirements. The KBEL program was finally funded with $1 million in FY 1994.

Implementation of the program has been delayed as a result of two significant problems. First, the originally targeted KBEL borrower may no longer need assistance from this program due to a lending climate that has significantly improved since the 1989 Legislature enacted the bill. Second, since KBEL legislation prohibits lending to borrowers who qualify for SBA and FmHA programs, the financial capacity of potential KBEL borrowers would be inadequate to support bonds issued for the program. Bonds would be extremely difficult to sell, and leveraging of the guarantee fund would be virtually impossible.

KDFA recommended a legislative review of the program to determine its viability and to re-identify the targeted KBEL participant to enhance private lending to emerging value-added enterprises in agriculture and other basic enterprises. At a minimum, legislative amendments would be required to make KBEL effective or to redirect its focus. If the program were terminated, almost $1 million now appropriated could be reallocated to other business financing initiatives. The Committee notes that legislation providing for the repeal of the KBEL Program would afford the 1995 Legislature the opportunity to consider modifications and other program alternatives. The Committee was further informed that the 1994 law authorizing the establishment of swine production facilities under certain circumstances (Kansas Corporate Farming bill) accorded preferential treatment to agricultural business enterprise applicants for KBEL loans for swine production facilities and swine marketing pools.

State Tax and Regulatory Approaches

8. *The State Banking Commissioner should explore the feasibility of state legislation that would relax examination standards required by state banking auditors for commercial loans under a certain size.*

Whenever the subject of business financing is discussed, restrictive banking regulations are cited as a major deterrent to commercial lending. Today, documentation requirements placed on lenders and the threat of a loan being classified as sub-standard by state examiners virtually eliminates many business loans that otherwise would have been approved by bankers in the past. In addition, banks face burdensome documentation impediments and loan servicing requirements. These conditions result in overwhelming administrative costs and bar banks from making smaller, less profitable loans. Although there is general agreement that the S&L scandal and the bank failures of the 1980s justifiably prompted tighter federal and state regulations, there is also a real concern that those same regulations have caused many legitimate projects to go unfunded. State legislative action would be required, if the State Banking Commissioner identifies certain areas under state jurisdiction for which examination standards could be relaxed.

Public-Private Partnership-Direct State Investment

9. *Legislation should be introduced to establish a Small Business Investment Company (SBIC) within KTEC to fill the currently unmet financing needs of high-tech start-ups in the post-Ad Astra, pre-KVCI stage of development.*

SBICs, licensed and regulated by the SBA, are privately owned and managed investment firms which provide equity capital, long-term loans, debt-equity investments, and management assistance to qualifying small businesses. They use their own funds, plus funds obtained by borrowing at favorable rates with an SBA guarantee and/or by selling preferred stock to SBA. The Acting President of KTEC testified about a financing gap for high-tech firms that comes after seed capital investment sources such as Ad Astra have been exhausted. Companies in this stage of growth are seeking investments in the range of $0.5 million to $2.5 million. Several Kansas companies have been nurtured to this point by KTEC, only to be lured to another state with this type financing. KTEC appears to have authority to establish the SBIC, but would require state funding to seed it. The legislation recommended for introduction would invite discussion about the desirability of such an SBIC.

10. *Legislation should be introduced to establish a program in KTEC to provide bridge financing between Small Business Innovation Research (SBIR) Phase I and Phase II grants.*

Compared to other states, Kansas has historically performed very poorly in obtaining SBIR grants and ranks 42nd nationwide in receiving SBIR grant awards. To improve its success rate, KTEC has restructured internally to put more staffing and budgetary emphasis on SBIR; KTEC is conducting SBIR workshops throughout the state. KTEC also works directly with Kansas companies to identify and submit applications for SBIR grants to the federal government. Phase I grants (up to $100,000) for technology feasibility design projects, which are expected to take about a year, are extremely difficult to obtain. However, recipients of Phase I grants have a reasonable chance of success in securing Phase II grants. Phase II grants, which can represent funding of up to $750,000, are used to develop a prototype, leading to eventual commercialization of Phase I research. KTEC has identified a funding gap between Phase I and II of the SBIR funding process. This gap can result in critical cash shortages, abandonment, or weakening of the project, or it can cause the company to lose key personnel. KTEC is proposing a "bridge funding" program to close this gap. Such programs exist in other states. Bridge awards, in amounts of up to $50,000 per project, would provide working capital to support a company's needs during the interval between Phase I and Phase II grant awards. Bridge funding would be structured to allow for repayment to KTEC if the venture proves successful. An additional appropriation would be required for bridge grants.

11. *The 1995 Joint Committee on Economic Development and the Kansas Inc. Action Planning Committee on Business Finance should monitor claims made by certified venture capital pools and local seed capital pools for income tax credits.*

At the November meeting, the Committee heard two presentations concerning the use and effectiveness of income tax credits for certified venture capital companies and seed capital pools. Of $50 million in investment capacity, there remains slightly more than $6 million in available capacity under the cap. Given a 25 percent allowable tax credit on a qualified taxpayer's cash investment, aggregate tax credits may not exceed estimated $1.5 million. At issue is the extent to which tax credits actually affect investment decisions in early-stage ventures. Because the time frame was extended to January 1, 1998 for the availability of venture capital tax credits and available investment capacity still exists, the Committee would prefer to postpone a decision on this matter and recommend that usage of the tax credit program be monitored in 1995.

12. *The Standing Economic Development committees should review the feasibility and implications of imposing fees for certain SBDC services that are currently provided at no cost to end users. A part of that review should be to consider the use of private consultants. In addition, the standing committees should invite staff from KTEC and the SBDCs to discuss their efforts to assist entrepreneurs and investors. The intent of those presentations would be to ensure the Legislature that no unnecessary duplication exists and that services are coordinated.*

The Committee notes that SBDCs provide free one-on-one management assistance in accounting and record keeping, business plans, market analysis, marketing, procurement/purchasing and many others. The Committee recommends that the feasibility of imposing fees on counseling services be examined by the 1995 standing Economic Development committees. On the one hand, the Committee was informed that federal guidelines governing the SBDC program do not permit centers to assess fees for such services. On the other hand, the Committee learned that SBDCs provided services to 9,810 businesses in FY 1994 and have encountered particularly heavy demand for services in Douglas and Johnson counties. In order to generate additional resources to meet growing demand and induce businesses to use these services more wisely, it might be advisable to impose fees on counseling services. The standing committees would need to identify whether there exists any flexibility for states to assess fees, and if waivers could be obtained, to permit the imposition of fees.

In addition, the Committee would like more information to be furnished in 1995 to the standing Economic Development committees or the Joint Committee on Economic

Development on the differences between the Kansas CLAIM Program, which intends to assist inventors and manufacturers in the development and commercialization of low technology, marketable products, and KTEC's assistance to inventors, which apparently has been confined to advising investors and no longer takes equity positions. The policy question is: how will the CLAIM Program and KTEC's assistance to inventors be coordinated to ensure that inventors are appropriately directed to the most useful services until the invention is commercialized?