

Approved: March 11, 1999
Date

MINUTES OF THE SENATE COMMERCE COMMITTEE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on March 10, 1999 in Room 123-S of the Capitol.

All members were present except:

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

Conferees appearing before the committee:

Charles R. Ranson, President, Kansas, Inc.
David Frankland, President, Digital Archaeology
Jessica Booth, representing Clinton J. Everton, President, Knowledge
Communication
Keith Molzer, Entrepreneurial Consulting Corporation
Rod R. Martin, President, PitStop Auto.com, Inc.
Tom Blackburn, Executive Vice President, Kansas Venture Capital, Inc.

Others attending: See attached list

Upon motion by Senator Barone, seconded by Senator Umbarger, the Minutes of the March 9, 1999 meeting were adopted. The voice vote was unanimous in favor of the motion.

SB 315 - Certified Capital Company Act

Charles R. Ranson, President, Kansas, Inc., introduced representatives of various companies in Kansas to explain their interest in the passage of **SB 315**.

David Frankland, President and Chief Executive Office of Digital Archaeology, a revolutionary software technology company based in Lenexa Kansas, stated Digital Archaeology has developed a patent pending technology that enables businesses to implement "just in time", flexible knowledge manufacturing systems for decision support. The technology simplifies the way data is transformed into knowledge and has two unique characteristics: 1) it eliminates the need to define data structures or data types, and 2) it provides a simple, visual method that empowers the business analyst to analyze and act on the data for better business decisions.

Digital Archaeology could not exist without venture capital. They received an initial investment of \$1 million in seed capital through Kansas City Equity Partners, and subsequently raised \$7.5 million in equity investments provided by local investment groups including Kansas City Equity Partners, Gateway Associates and other private investors. In 1999, Digital Archaeology projects revenues to exceed \$4 million and by the year 2003, anticipate revenues to exceed \$100 million and anticipate employing hundreds of people in the State of Kansas. If current trends in the financial markets continue, it is not unreasonable to expect a market cap approaching \$1 billion.

Mr. Frankland stated his greatest fear as a CEO of a high technology company in Kansas is the lack of available local capital to fuel growth. Digital Archaeology is raising its third round of equity and of 35 venture capital firms it has approached, none reside in the state of Kansas. Presently, Kansas funds do not have sufficient capital to meet the company's needs. Partnering opportunities should be better if Kansas had a larger venture capital base. Digital Archaeology is contributing to the development of an emerging technology industry in the State of Kansas; and it is imperative that the State diversify its economic base, fostering the growth of new industries, such as technology, which can only be

CONTINUATION SHEET

MINUTES OF THE SENATE COMMERCE COMMITTEE, Room 123-S of the Statehouse, at 8:00 a.m. on March 10, 1999.

accomplished if the State creates an environment and an attitude that serves to attract and retain successful companies. **SB 315** is a good start. (Attachment 1)

Jessica Booth, representing Clinton J. Everton, President, Knowledge Communication, testified in support of **SB 315**. Ms. Booth stated the most important ingredient to making Knowledge Communication successful has been investment capital. There is no shortage of talented men and women who have what it takes to make a company successful, but there is a lack of capital to fund a company in the State of Kansas.

Knowledge Communication creates simulation-learning environments to teach managers such topics as interviewing, customer service, leadership and team building. They offer over 25 programs on CD-ROM currently, corporate networks and the Internet. By the end of 1999, they will have more than 50 software programs. Knowledge Communication has compiled a customer base of more than 125 companies and will earn approximately \$2.5 million in 1999. The company projects it will continue to grow at a rate of between 100% and 200% over the next three years and is already at a point of evaluating an Initial Public Offering of the company's stock.

Ms. Booth stated that, although product development remains in Wichita, which is about one-third of its company, it was necessary to relocate the balance of the company in Dallas Texas, due to the money available that it takes to build a successful technology business. The KTEC network and Ad Astra II funds were available to provide seed capital financing for funding the research and development stages, but there was no money available to make a secondary investment in product development and marketing. Kansas was not able to capitalize on the success that Knowledge Communication has experienced. (Attachment 2)

Keith Molzer, Entrepreneurial Consulting Corporation, is a member of the Kansas Inc., Technical Advisory Committee. Venture capital investments in Kansas are one-third the national average, and more significantly, there were no seed/start-up funds invested in Kansas last year. Mr. Molzer stated, as an entrepreneur, he is not only looking for money, but is looking for added knowledge that comes with the money. Kansas based start-ups need Kansas based investments, not only to survive, but to gain credibility in the market place. **SB 315** will not just provide an avenue to capitalize seed capital funds, it will provide a knowledge base and the credibility that is currently missing in Kansas.

By establishing legislation that supports the development of seed capital funds, the State of Kansas is giving start-ups: 1) access to knowledge the fund managers, investors and their partners bring to the table with their investment; 2) access to additional capital markets based on the credibility of the new investments they receive; 3) additional funding from private/angel investors because of the added security of the new local equity investment markets; 4) a new pool of talented and trained entrepreneurs; and 5) a new set of angel investors that have been created through these seed investments.

SB 315 provides the proper incentive package needed to develop seed funds. Mr. Molzer stated his belief that the Committee needs to direct its energies to ensuring that the recipients of the funds are entrepreneurial start-up companies. Early stage companies are starving for cash and those are the companies that need access to the funds provided by **SB 315**. (Attachment 3)

Mr. Molzer responded to questioning that eligible companies should have a technology spin for the most part.

Rod R Martin, President of PitStop Auto, stated he and his partner started a venture to sell used auto parts. The company evolved into a company focused on the selling of new aftermarket collision auto parts such as bumpers, grilles, fenders, hoods, lights and mirrors over the Internet. With no knowledge of how to raise capital, they have financed their company through personal loans, cashed in IRA's and loans from friends and family. In January 1999, PitStop Auto signed up as a client of Wichita Technology Corporation in an attempt to raise seed capital through a private offering. Currently PitStop Auto has two local investors who have stated an interest in investing in the company as well as one investment group in

CONTINUATION SHEET

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Dallas and one in San Francisco. Mr. Martin stated a company is either required to get 20 to 30 local investors to commit small amounts of capital or go to an investment firm which is not located in Kansas in order to raise enough seed capital to fulfill their offering. There is a lack of local investors willing to invest seed capital in young entrepreneurial companies.

Mr. Martin stated Yahoo projects that PitStop Auto will add 30 to 40 new jobs in the Wichita area through the year 2000 and bring in over \$15 million in sales. **SB 315** provides a solution to the hardest part of starting a business in Kansas, obtaining seed capital. (Attachment 4)

Tom Blackburn, Executive Vice President, Kansas Venture Capital, Inc., stated he is a member of the Kansas, Inc. Technical Advisory Committee on Seed and Venture Capital, and believes there is merit to legislative initiatives to encourage investing in Kansas companies not effectively served by existing private seed and venture capital investors. Mr. Blackburn stated support of **SB 315** is conditioned upon amended "qualified Kansas Business" language to ensure that Capco investments are targeted to under served businesses. Investments should be targeted to start-up, seed and early stage companies with annual revenues of \$1 million or less. **SB 315** as originally drafted does not effectively target Capco funds. The proposed definitions in the original bill and the subsequent amendment proposed by Kansas, Inc. are too broad and will not appropriately target the types of businesses that were contemplated by the Technical Advisory Committee in its deliberations and consistently advocated by venture capital users, facilitators and providers throughout the state.

Mr. Blackburn stated that the use of only an employee census test to define the target market is problematic. Using a 100-employee benchmark includes established businesses of \$10 million, \$20 million, \$30 million, or higher in revenues. Currently there are significant private sector venture capital, mezzanine and debt financing sources on commercially reasonable terms to companies of that scale in Kansas. If Capcos have the option of investing in larger, more established businesses, most will elect to do so at the expense of investing in start-up, seed or early stage companies. The net result likely will be that the very companies who were intended to be the beneficiaries of **SB 315** will be passed over in favor of larger, more established businesses. A \$1 million revenue test will ensure that these early stage companies will have access to Capco resources. (Attachment 5)

The meeting adjourned at 9:00 a.m.

The next meeting is scheduled for March 11, 1999.



**DIGITAL ARCHAEOLOGY TESTIMONY: SENATE BILL 315
PRESENTED TO THE SENATE COMMERCE COMMITTEE
3/10/99**

INTRODUCTION

- Good morning, my name is David Frankland. I am the President and Chief Executive Officer of Digital Archaeology, a revolutionary software technology company, based in Lenexa, Kansas. I am pleased to have the opportunity to speak before you today about the importance of Senate Bill 315. Rather than quote a myriad of statistics you have undoubtedly heard before, I want to share what seed capital has meant to my company.
- By the way of background, most of my business career has been spent in high technology where I have had the privilege of working for some of the best companies in the world, including ITT, Informix Software, and Sun Microsystems. I have also had the good fortune of working for several technology start-ups, so my experience seems appropriate for what is being debated here today.

DIGITAL ARCHAEOLOGY HISTORY

- Digital Archaeology was founded in 1994 by software industry veterans to commercialize a revolutionary new technology. For more than 15 years, Michael Forster, the Company's founder, has advanced the mathematical foundation for a new software architecture, known as X-Set™, that radically simplifies the process of transforming data into knowledge. Our basic tenet is that information technology should adapt, seamlessly, to the dynamic needs of the knowledge worker.

DIGITAL ARCHAEOLOGY SOLUTION

- Digital Archaeology has developed a patent pending technology that enables businesses to implement "just in time", flexible knowledge manufacturing systems for decision support. The underlying technology radically simplifies the way data is transformed into knowledge and it has two unique characteristics: (1) it eliminates the need to define data structures or data types, and (2) it provides a simple, visual method that empowers the business analyst to analyze and act on the data for better business decisions.

- Our first product based on this breakthrough technology, Discovery Suite, is a complete customer data mart that can be fully implemented in a matter of hours or days, instead of the many months or years that it takes for competitive solutions to be implemented. The same technology that allows this revolutionary performance also allows the system to change dynamically with customer needs and significantly reduces the burden placed on IT and the costs associated with implementing and maintaining data marts and other decision support systems.
- The solution has application for medium and large companies that are implementing customer-centric strategies and having difficulty getting timely information out of existing database systems and/or trying to integrate web-based or e-commerce data to drive customer and business strategies.

NEED FOR CAPITAL

- Digital Archaeology could not exist without venture capital. A letter from Michael Forster to Paul Henson, the driving force behind Kansas City Equity Partners, resulted in an initial investment of \$1 million in seed capital. During subsequent rounds of financing, we raised \$7.5 million in equity investments again provided by local investment groups including Kansas City Equity Partners, Gateway Associates (out of St. Louis) and other private investors. While this may seem like a substantial sum of money, it pales in comparison to our competitors, some of whom have raised \$12 to \$18 million when they were at our stage of development.
- We are currently seeking to raise \$10-15 million to support continuing operations through the fourth quarter of the year 2000 at which point DA projects that it will be cash positive through internally generated funds.
- We have grown from 3 employees in the first three years to 51 associates currently. While we have attracted highly qualified staff from all over the country and relocated them to Kansas, the majority of our associates are home grown, with a large percentage of our Executive Team members and developers being Kansas State and University of Kansas alumni.
- In 1999, we are projecting revenues to exceed \$4 million and by the year 2003, we anticipate revenues to exceed \$100 million and that we will employ hundreds of people in the State of Kansas. Given the current trends in the financial markets will continue, it is not unreasonable to expect that we would have a market cap approaching \$1 billion.
- The single, greatest fear I have as a CEO of a high technology company in Kansas is the lack of available local capital to fuel our growth. As I mentioned, Digital Archaeology is raising our third round of equity and of 35 venture capital firms we are approaching, none reside in the state of Kansas.

- On the other hand, I regularly receive calls from Chambers of Commerce and investors in cities on the East and West Coasts and in the South who have offered to invest in Digital Archaeology if we were to relocate the company. Since the primary factor keeping me awake at night is where to find the capital during our start-up phase, I must admit these offers are very attractive.
- Digital Archaeology is committed to remaining in Kansas as long as we can continue to find investors willing to invest. It takes an inordinate amount of time to identify outside investors and persuade them to make a financial commitment to a company residing in Kansas today.

IMPORTANCE OF INVESTING IN KANSAS-BASED COMPANIES

- Digital Archaeology is contributing to the development of an emerging technology industry in the State of Kansas. We not only hire individuals who are native Kansans and who would otherwise look for employment in the technology industry elsewhere, but we support the development of the industry by participating in local college internship programs.
- At a time in our State's history when it is imperative that we further diversify the economic base in Kansas, fostering the growth of new industries, such as technology, will only be accomplished if the State creates an environment and an attitude that serves to attract and retain successful companies. Senate Bill 315 is a good start.

QUESTIONS

- This concludes my testimony. Thank you for allowing me to express my views this morning. I would be happy to answer any questions you might have.

**Testimony from Clinton J. Everton
Founder and President of Knowledge Communication**

S.B. 315

**Presented to the Senate Commerce Committee
March 10, 1999**

Let me first offer you my apologies that I cannot be there in person to present this testimony. As an entrepreneur, the subject of today's meeting, investment capital, is one of vital importance to me. I have a first-hand understanding of the challenges, frustrations, exhilaration, and rewards involved in creating a business. One of the most important ingredients to making my company, Knowledge Communication, successful has been investment capital. I want to share with you from first-hand experience, that there is no shortage of talented men and women who have what it takes to make a company successful, but there most certainly is a lack of capital to fund a company in the State of Kansas. I hope my story can help you better understand why this subject is so important.

Knowledge Communication is a software company that was created with the goal of changing the way people learn. Born and raised in Wichita, Kansas, I started this company four years ago in the basement of my parent's house. At the time, I was a business student at Wichita State University, and I became frustrated that many of the subjects that were most important to my future success were not taught in school. Reading a book or listening to a lecture was not giving me the skills needed to actually lead a work group, coach an under-performing employee or manage a difficult person. The only way I would learn how to improve my interpersonal and managerial skills was on the job. However, the risk involved with making mistakes on the job as I learn these skills, could come with a high cost.

I decided that there was a better way to learn these job skills. Every year, companies spend billions of dollars training their employees. I believed that I could use technologies, such as the Internet and CD-ROM, to create virtual training environments in which people learn by doing, by exploring, and by actually experiencing on-the-job situations. What does this mean? Let me give you an analogy. A parent can explain to a child that a stove is hot and they should not touch it. However, the child usually does not listen, but instead "learns by doing." It is not until they have burned their hand that they understand what the parent is saying.

Using the same philosophy, Knowledge Communication creates simulation-learning environments to teach managers such topics as interviewing, customer service, leadership and team building. We currently offer over 25 programs on CD-ROM, corporate networks and the Internet, and will have more than 50 software programs by the end of the year.

Over the past year we have compiled a customer base of more than 125 companies, including Allied-Signal, Boeing, Hewlett-Packard, Morgan Stanley Dean Witter and New York Life Insurance. During this time, Knowledge Communication has become a company that will earn approximately \$2.5 million in revenue in 1999 and is Income Statement and Cash Flow positive. We are the leader in a nascent and fast-growing industry. This is a company operating on Internet time. We will continue to grow at a rate of between 100% and 200% over the next three years and we are already at a point that we are evaluating an Initial Public Offering of the company's stock. We have a bright future ahead of us.

Senate Commerce Committee

Date 3-10-99

Attachment # 2-1 thru 2-2

Please understand that I am an entrepreneur and not a politician. My job is to do whatever it takes to make my company successful and make money for my shareholders. The State of Kansas can lay claim to part of the company's success, but Kansas has also missed out on a big opportunity. One of the reasons that I am not here today is that although product development remains in Wichita, I have had to relocate most of my company to Dallas, Texas. To be candid with you, I could not find the kind of money that it takes to build a successful technology business in the State of Kansas, so I turned elsewhere.

There were people in the State of Kansas who had the vision and took the risk to make Knowledge Communication a successful business. Specifically, members of the KTEC network and the Ad Astra II fund were there to provide seed capital financing to prove the company had potential. But, while Kansas took all of the risk funding research and development, there was no one there to make a secondary investment in product development and marketing. Kansas was not able to capitalize on the success that Knowledge Communication was experiencing.

Instead of writing and selling software, I spent three years of my life begging for money. It was not until I left the state of Kansas that I found people who not only understood my vision, but also had the capital to accelerate the growth of my business. I would have liked very much to keep my whole company in Kansas. The people have a great work ethic, the economics are compelling and I did not want to leave my roots behind. However, I knew that I had a sound idea, but I was struggling to raise \$50,000, while my competitors were easily raising \$5 million. The progress that we have made as a company has occurred over the past year, in the 12 months since I received an outside investment of \$1.5 million from a group of Dallas investors. So, although Kansas took all of the early stage risks, outside investors were able to make the secondary investment and by providing this funding they will gain most of the rewards. Access to capital has been the catalyst for Knowledge Communication's growth.

How do you keep this from happening again to other companies like Knowledge Communication? If you are truly interested in diversifying and creating an information-based Kansas economy, the answer is straightforward. Kansas needs early stage investment capital that can help companies like mine be successful in a global market. As I said earlier, I am an entrepreneur. Knowledge Communication is only my first of many businesses. If you can provide the capital infrastructure, Kansas would be a great place to start my next business.

Sincerely,

Clinton J. Everton
President
Knowledge Communication, Inc.



ENTREPRENEURIAL CONSULTING CORPORATION

8526 WEST 109TH TERRACE - OVERLAND PARK, KANSAS 66210
913-963-6052 - FAX 913-339-9110 - ECCORP@ATT.NET

SB 315 Testimony

**Presented to the
Senate Commerce Committee
March 10, 1999**

Thank you for giving me the opportunity to offer my support of SB 315.

My name is Keith Molzer from Overland Park, Kansas. I have been involved with entrepreneurial activities for over 12 years, of which the last 8 have been in Kansas. My entrepreneurial activities range from owning a garment printing company in Nebraska 13 years ago to founding a tradeshow development company in 1995.

For the last seven years I have dedicated my energies to providing consulting services to start-up companies and entrepreneurial support organizations. My company, Entrepreneurial Consulting Corporation (ECC), is dedicated to assisting companies develop business plans, raise capital and develop strategic partnerships. I have consulted with over 300 start-up companies located primarily in Kansas and Missouri.

Today I want to briefly discuss how the absence of Kansas based seed capital funds has adversely affected start-up companies in the state. My testimony is based on my involvement with the Kansas Inc, Technical Advisory Committee, my personal involvement with seed capital investments and information from Tuesday's proceeding with this committee.

Entrepreneurs are faced with many challenges, not in the least which is the ability to properly capitalize their companies. The majority of companies I have worked with have been capitalized by the founder with their own money and through the F&F capital markets ...that is "Friends and Family". Friends and family have historically been the only group that will initially listen and "buy into" the entrepreneur's vision.

Most of these start-ups do not qualify for funding from formal banking channels, which look at the four C's - character, collateral, cash flow and credit. These entrepreneurs, which usually only have one C - character, must rely on what I call P.I.C. variables - Passion, Innovation and Chutzpah, to obtain funding.

As these entrepreneurial ventures rapidly grow and need additional funds, the F&F network's ability to fund the project usually diminishes. It is at this stage a Kansas based company is forced to look to other markets for funding. As the Kansas Innovation Index shows in indicator 15 (see attached Exhibit A), venture capital investments in Kansas are one-third the national average, but what is more significant is that virtually no seed/start-up funds were invested in Kansas this last year.

Senate Commerce Committee

Date: *3-10-99*

Attachment # *3-1 thru 3-8*

I have raised significant amounts of money for my own enterprises and have assisted many others raise funds for their own companies. As an entrepreneur I am not only looking for money, I am also looking for added knowledge that comes with the money. Kansas based start-ups need Kansas based investments not only to survive, but to gain credibility in the market place. The proposed S.B. Bill 315 will not just provide an avenue to capitalize seed capital funds, it will provide a knowledge base and the credibility factor that is currently missing in Kansas.

I e-mailed a client Monday to tell him I needed to reschedule our appointment for today because I was testifying in front of this committee on the need for seed and venture capital. His response was timely, it read: "Go get'em. Win one for us little guys because I don't want to be little for long". He is in the process of trying to raise \$500,000 of equity by June 1, 1999 or he will be forced to tell 6 employees that the dream has died and he must shut the doors...where is he supposed to go? Right now it is my job to help him, and the answer I must give him does not include the word Kansas.

There are many, many aspiring entrepreneurs in Kansas that have Passion, Innovation and Chutzpah. If Kansas wants to see them grow, it must be proactive and give them the tools they need to succeed. If the State is not willing to be an active participant in the funding of new technology based start-up companies, it must, at the least, give those that are willing to invest the added incentive to do it in Kansas.

By establishing legislation that supports the development of seed capital funds, the State of Kansas is giving start-ups:

- Access to knowledge the fund managers, investors and their partners bring to the table with their investment.
- Access to additional capital markets based on the credibility of the new investments they receive.
- Additional funding from private/angel investors because of the added security of the new local equity investment markets.
- New pool of talented and trained entrepreneurs.
- New set of angel investors that have been created through these seed investments.

The establishment of a viable seed capital market in Kansas will provide entrepreneurs the ability to fund growth. It will give angel investor the added security of knowing that companies they invest in have a viable market to raise 2nd and 3rd stage capital to continue growth. In addition, it will ensure that new entrepreneurial start-up companies stay in Kansas, grow, flourish and fund the next generation of entrepreneurs.

Many companies I have worked with in the past, including several of my own, have not succeeded. I do not blame their failure entirely on the lack of available equity, but I do

feel strongly, many of them would have not only survived, but would have thrived if they would have had the ability to get equity funding from a local seed capital fund.

This Bill in its current form does provide the proper incentive package needed to develop seed funds, but what I feel this committee needs to do is direct its energies to assuring that the recipients of the funds are the entrepreneurial start-up companies. As the Technical Advisory Committee recommended to Kansas Inc.'s board, early stage companies are starving for cash and those are the companies that need access to these funds. Those companies with less than \$1 million in annual sales are the future gazelles of Kansas. This bill needs to target them exclusively, wherever they may be located in Kansas.

Thank you for your time.

KANSAS, INC.

Kansas, Inc., in behalf of its project partners the Kansas Department of Commerce & Housing and the Kansas Technology Enterprise Corporation, is pleased to submit this study of "Best Practices of State Sponsored Seed and Venture Capital Programs and Alternatives to Direct State Funding." Transmittal of this report marks the culmination of a research effort that began in May of 1998. It also represents the beginning of what we hope will be a reasoned and reasonable dialogue concerning the needs of a growing Kansas economy and the means to satisfy the capital needs of entrepreneurs across the state.

Performed by Economic Innovation International, Inc. (a globally-recognized, Boston-based consultancy with nearly thirty years experience in the field of economic development and entrepreneurship), local input was assured by the active participation of a 20-member Technical Advisory Committee (TAC). It is to this group of unpaid Kansas volunteers that we express our sincere thanks for guidance throughout this process.

The analysis, lessons and recommendations thoroughly researched and professionally presented herein, would be incomplete without inclusion of implementing details offered by the TAC at its last meeting. Within this group of Kansans, a clear consensus emerged in support of the broad findings of Economic Innovation International, Inc.

In addition, this group of practitioners proposed that investors in certified seed capital funds receive a 100% non-refundable tax credit against corporate, individual, premium and privilege tax, with these credits both transferable and subject to indefinite carry forward. In recognition of the diverse needs of Kansas business, it is further recommended by the TAC that a funding component modeled after the Community Services Program be created to enable investments through rural development organizations to support modernization and expansion of rural manufacturers.

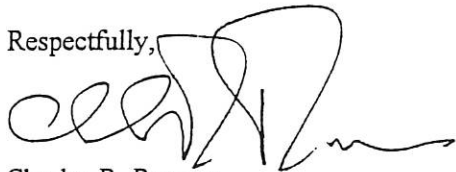
Aware that transparency and accountability are central to a successful program, the TAC has proposed that funds established be certified by the Kansas Securities Commission. Suggested benchmarks include:

- ◆ Investments must be in start-up companies with less than \$1 million in annual sales.
- ◆ At least 60% of fund must be invested in Kansas domiciled companies (100% for rural funds.)
- ◆ Confidentiality and accountability standards based on established industry practice must be maintained.
- ◆ Clearly prescribed conflict of interest standards must be maintained.

Certifications would remain subject to annual review by the Securities Commission to ensure continued observance of all certification standards.

The Kansas economy is evolving from its traditional bases to one in which services and the successful commercialization of technology are emerging as key components. As these new sectors fuel growth in our economy, a compelling need exists for access to adequate capital with which to support incubation of start-up ventures promising the greatest growth potential. It is the steadfast hope of the Kansas, Inc. Board (and its partners) that this study will provide a strong foundation upon which all interested parties will work positively and constructively to adopt policies that will assure our lasting economic success.

Respectfully,



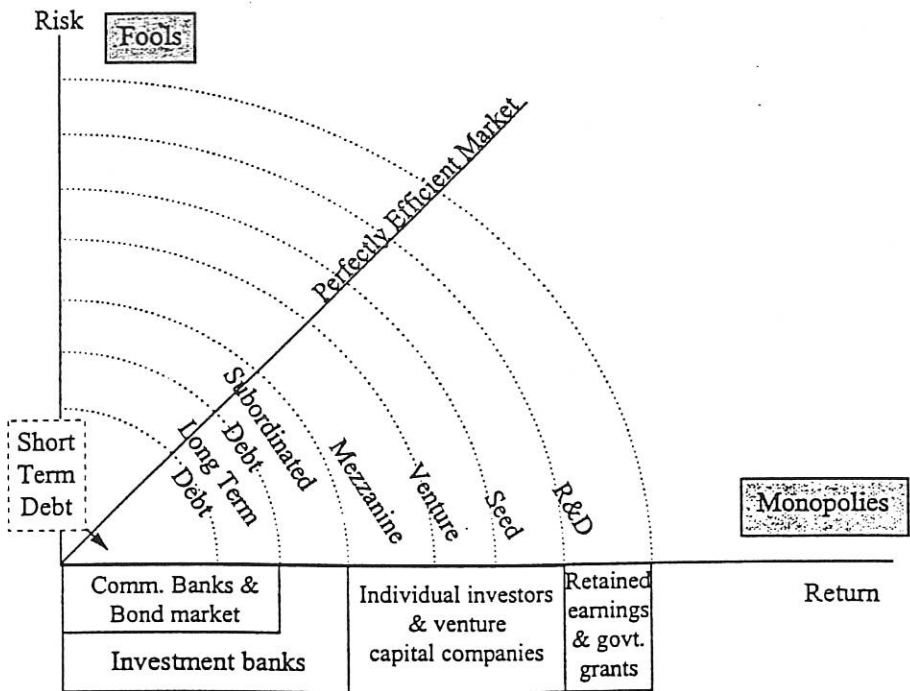
Charles R. Ranson
President

absolute size) and for which a clear exit strategy exists, particularly through an initial public offering.

Venture capital is provided by a number of sources, including individual investors, institutional investors, and venture capitalists. Venture capitalists also invest mezzanine, buy-out and other forms of private equity financing.

All businesses pass through conceptualization, start-up and expansion, but only a very small number warrant venture capital at any of these stages. Mezzanine capital for small firm expansion, subordinated intermediate term debt, commercial bank loans or internally generated financing may, for example, be more appropriate. For clarity, this report on Success Factors refers specifically to the stage *and* form of finance, not just the stage (for instance, seed stage venture capital rather than simply seed capital).

Exhibit II



Particular stages at which venture capital may be invested include:



- **Seed Stage Venture Capital** is essential at the point the enterprise is completing its initial product research and development, building a prototype, completing market research, hiring the initial management team members and formulating an overall strategy to achieve very high growth.
- **Early Stage Venture Capital** is essential at the point the enterprise has high growth potential, minimal product revenues, frequently an incomplete management team, and an unleveraged balance sheet.

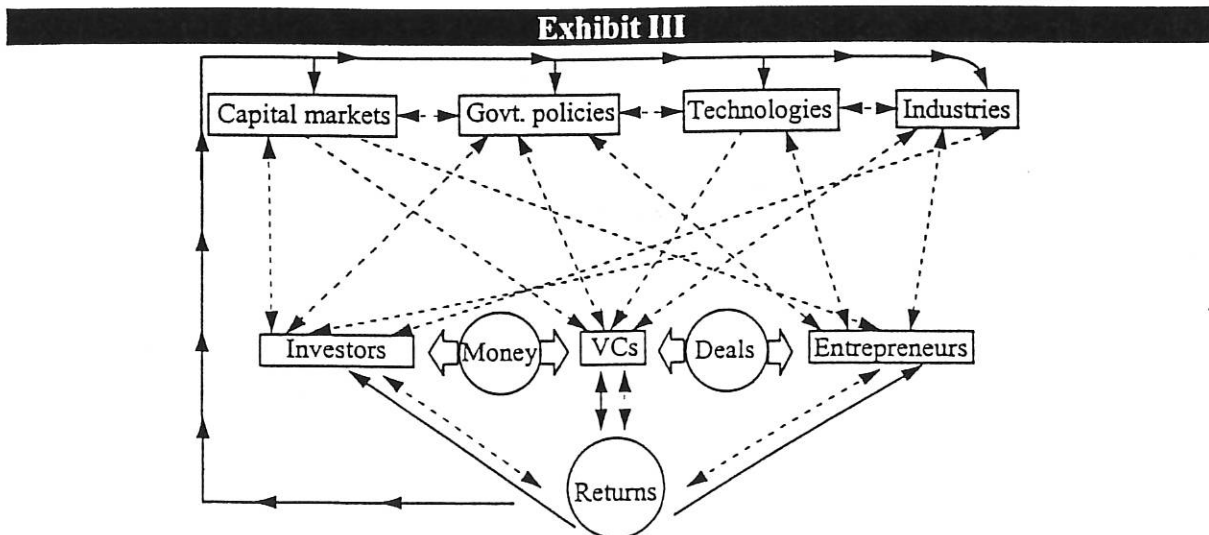
- **Later Stage Venture Capital** is essential at the point the enterprise has begun to demonstrate its growth potential, has increasingly substantial product revenues, has a complete management team, has profits that are becoming positive and are increasing, and has a balance sheet that is increasingly leveraged.

From an economic development standpoint, successful venture capital activity results in a high impact on a small number of often high profile companies. Very high quality jobs tend to be created. When venture capital is flowing into an economy at substantial volume, overall economic competitiveness and resilience is considerably improved as a result of greater diversification, greater entrepreneurial creativity, and overall ability to respond to emerging market trends.

From an overall economic development standpoint, this fact is important in terms of future prosperity and economic stability. As noted in earlier, new companies formed with venture capital backing are a vital source of economic revitalization and are a bellwether of future economic activity. By definition, venture capital seeks out those industries of the future that will encompass large markets with high growth rates. In an era of very rapid economic and technological advancement, new high quality jobs tend to be created and maintained in those economies in which the national venture capital industry finds successful investment opportunities.

2.4 Factors Influencing Flows of Seed and Venture Capital

Certain factors affecting seed and venture capital investment are national in nature. These include federal government policies, such as SEC regulations, ERISA rules governing pension fund investment, and FDA regulatory approval, as well as the behavior of the publicly traded capital markets. Particularly relevant to seed and venture capital are opportunities for an initial public offering (IPO), because the IPO market provides one of the most profitable exit strategies for investors in early stage technology-based companies.



Source: W. Bygrave, in D.L. Sexton & J.D. Kasarda, eds. *The State of Entrepreneurship* (Boston, PWS-Kent, 1992)

Exhibit A

Indicator 15 Venture Capital

Venture capital funding in Kansas is one-third the national per capita average

Indicator Significance

Venture capital is essential for new business start-ups. A state with access to venture capital is more successful in fostering the creation and growth of start-up firms in technology-based areas. A lack of venture capital indicates a weakness in a state's prospects for future growth in emerging technologies. Also, entrepreneurs also may choose to locate in an area with greater prospects for obtaining access to venture capital.

While every new start-up will not require all forms of venture capital, entrepreneurs may need:

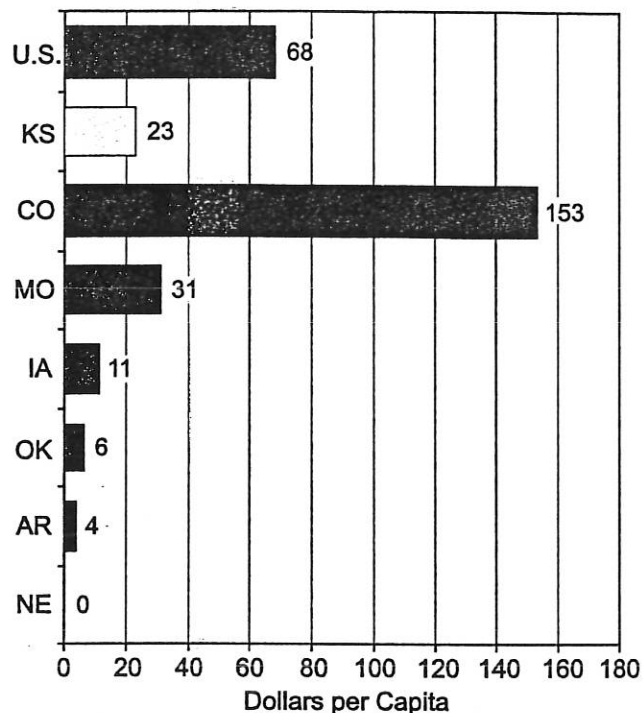
- *seed/start-up capital* - the firm is proving the concept (seed), completing initial product R&D, building a prototype, completing market research, and hiring initial management and employees;
- *early stage capital* - the period when the new firm has high growth potential but minimal product revenue and often an incomplete management team;
- *second stage capital* - the firm has started producing, has growing sales, and needs funding for expansion;
- *late stage capital* - the firm is continuing to grow, may be showing a profit, and needs additional funds for improvement and expansion.

Sources of venture capital include individual investors, institutional investors, and venture capital firms. This indicator measures the amount of venture capital invested in a state from venture capital firms.

Kansas Performance

For 1997 and the first two quarters of 1998, Kansas had \$23 per capita in venture capital funding. This was one-third of the national average of \$68. During this period, there were 10 venture capital investments in Kansas for a total of \$59,701,000. Kansas ranked third in the region behind Colorado and Missouri.

15a. Venture Capital Funding, Q1 1997 - Q2 1998 (per Capita)



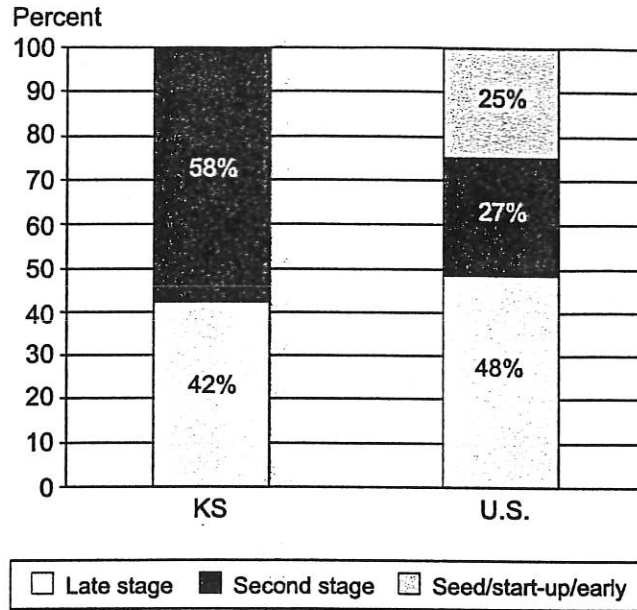
Source: PriceWaterhouseCoopers Money Tree™ Survey.

“ . . . Kansas had \$23 per capita in venture capital funding . . . only one-third the national average of \$68.”

Notably, Kansas did not have any seed/start-up/early stage venture capital for 1997-98. These earliest stages of venture capital are important for moving ideas from a research lab to commercialization. If the absence of venture capital funding of start-up firms continues, it would indicate a serious gap in Kansas support for new firms with high growth potential.

This indicator suggests that Kansas is not starting and growing a sufficient number of new businesses using venture capital. Either too few entrepreneurs are starting new firms requiring venture capital or inadequate access to venture capital resources exists.

15b. Venture Capital Funding by Stage of Financing, Q1 1997 - Q2 1998



Source: PriceWaterhouseCoopers Money Tree™ Survey.

“If the absence of venture capital funding of start-up firms continues, it would indicate a serious gap in Kansas support for new firms with high growth potential.”

PitStop Auto.com, Inc. Testimony

S.B. 315

Presented to the
Senate Commerce Committee
March 10, 1999

Good Morning Senate Commerce Committee Members!

My name is Rod R. Martin, and I am the President of PitStop Auto, which is based out of Wichita, Kansas. I would like to share with you a little bit about my personal background and some of the struggles my company has been through regarding raising seed capital.

I am from Pratt, Kansas, and I received a Bachelor's degree from DeVry Institute of Technology in Kansas City before moving to Omaha, Nebraska to work for First Data Corporation. In 1995, my family and I moved to Wichita to work for Koch Industries.

In October 1997, my partner and I started a venture to sell used auto parts over the Internet, and the Company has evolved into a company focused on the niche of new aftermarket collision auto parts. PitStop Auto sells aftermarket collision auto parts such as bumpers, grilles, fenders, hoods, lights, and mirrors over the Internet. PitStop Auto plans to revolutionize the auto parts industry. With no knowledge of what it was like to raise capital, we had absolutely no idea what type of roller coaster ride was ahead of us.

Our roller coaster began with a flat start with a lawyer friend and a parts person friend of his putting in a very small investment. This investment was enough capital to allow us to live for a couple months, since we didn't have any major costs other than salaries. Once those funds depleted, we received a small loan from one of our partners. This is when the ride took a large down turn.

After January 1998, my partner and I did not receive any wages or expense reimbursement until October 1998. During this time, we received a small investment from my sister-in-law, which helped us keep the lights on in our office. Also during this time, my partner and I took out personal loans and cashed in IRAs in an attempt to keep the company going. After giving our 1998 wages and expenses to the company in exchange for a small ownership position, my partner and I have once again not received payment for wages in January and February 1999.

Neither my partner nor I came from an affluent family or, for that matter, even knew any affluent people very well. Therefore, we were perfect strangers to any potential investors we met. In June 1998, we stumbled into a meeting with a local lawyer, and he seemed to take us under his wing in an attempt to help us raise capital. He has introduced us to several of his friends who happen to be affluent businessmen. In October 1998, we received our first significant seed capital from two of the individuals we met through our mutual acquaintance lawyer.

Senate Commerce Committee

Date: 3-10-99

Attachment # 4-1 thru 4-2

Even with a prominent lawyer on our side, getting individuals to invest significant amounts of money has been extremely difficult. PitStop Auto has been well received by all the individuals we have met with, however, these individuals have still been reluctant to sign a check for seed capital.

In January 1999, we signed up as a client of Wichita Technology Corporation in an attempt to raise our seed capital through a private offering. Since the offering began, we have had one investor provide a small amount of seed capital, and I have invested almost all of my IRA in the company.

PitStop Auto currently has two local investors who have stated interest in investing in our company, in addition to one investment group in Dallas and one investment group in San Francisco, which was referred to us by our local Ernst & Young representative. It appears at this time that we are either going to be required to get 20 to 30 local investors to commit small amounts of capital or go to an investment firm which is not located in Kansas in order to raise enough seed capital to fulfill our offering. There seems to be a lack of local investors willing to invest seed capital in young entrepreneurial companies. In companies such as ours, time is a critical piece in determining whether a business is successful, and the amount of time and energy it takes to get 20 to 30 investors could keep a company from being successful.

The fear I have as an owner of a Kansas based company is that in order to obtain the seed capital my company needs, I may have to relocate the company's headquarters to the city in which the funding company is located. This is what brings me to Topeka today.

I believe that any incentive that can be given to investors in young local companies is good for the companies and good for the state's economy. For instance, current projections have my company adding 30 to 40 new jobs in the Wichita area through the year 2000. In addition, the company plans to bring in over \$15 million in sales by the year 2000. These sales will come from all over the U.S., as well as international. Since going on-line in December, the company has currently sold parts to over 30 states in the U.S. and 3 countries. If these sales dollars were given to a different state due to lack of seed capital, it would be a great loss for the State of Kansas.

In addition to my company, I am active in the Youth Entrepreneurs of Kansas program in Wichita as a mentor, and I continually stress to these amazing young people that the hardest part of starting a business is getting it funded. I look forward to the day when I can tell these young people that because of SENATE BILL No. 315, the hardest part of starting a business in Kansas is not getting seed capital.

I will leave you with this closing thought. If you feel that it is not necessary to pass SENATE BILL No. 315 because there is an ample amount of seed capital present in Kansas, I would like to talk with you after these hearings to find out where that seed capital is located!

**Kansas Venture Capital, Inc.
S.B. 315 Testimony**

**Senate Commerce Committee
March 10, 1999**

**Tom Blackburn
Executive Vice President**

Thank You Madam Chair and members of the Senate Commerce Committee. My name is Tom Blackburn. I am Executive Vice President of Kansas Venture Capital, Inc. ("KVCI") and I appreciate the opportunity to be here today to provide testimony on SB315. I stand before you today as an Officer of KVCI - the most active institutional venture capital firm in Kansas; as a venture capital practitioner having been directly involved in the venture capital investment process in Kansas for the past decade; and as a member of the Kansas, Inc. Technical Advisory Committee on Seed & Venture Capital ("TAC").

I am here today to stand in support of SB315. We believe there is merit to legislative initiatives to encourage investing in Kansas companies not effectively served by existing private seed and venture capital investors. Specifically, I am referring to start-up, seed stage, and early stage growth companies. Our support of SB315 is conditioned upon amended "Qualified Kansas Business" language to ensure that CapCo investments are targeted to these under served businesses. These investments should be targeted to start-up, seed and early stage companies with annual revenues of \$1 million or less. The remaining bill provisions are well thought out and drafted and have our unconditional support. Kansas, Inc. staff and their working partners have done an outstanding job in bringing SB315 to this point, certainly not an easy task given the complexity of the subject matter.

SB315 as originally drafted will not effectively target Capco funds. The problem, as discussed in previous testimony, lies within the definition of what constitutes a "Qualified Kansas Business". The proposed definitions in the original bill and the subsequent amendment proposed by Kansas, Inc. are too broad and will not appropriately target the types of businesses that were contemplated by the TAC in our deliberations and consistently advocated by venture capital users, facilitators and providers throughout the State.

Use of only an employee census test to define the target market is problematic. For example, a 100-employee benchmark would include established businesses of \$10 million, \$20 million, \$30 million, or higher in revenues. Kansas businesses of this size have many capital options regardless of investment stage, industry, geographic location or number of employees. Currently, there are significant private sector venture capital, mezzanine and debt financing sources on commercially reasonable terms to companies of such scale in Kansas.

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Attachment # 5-1 thru 5-2

Setting aside the question of need, if CapCos have the option of investing in larger, more established businesses, most will elect to do so at the expense of investing in start-up, seed or early stage companies. The net result will likely be that the very companies who were intended to be the beneficiaries of the CapCo legislation, will be for the most part, passed over in favor of larger, more established businesses. The capital markets validate this premise every day. A \$1 million revenue test will ensure that these early stage companies will have access to CapCo resources.

SB315 with the appropriate "Qualified Kansas Business" language should provide ample incentives to the private sector to step forward and play an important role in filling the financing gap that currently exists for Kansas-based start-up, seed and early stage businesses. The proposed tax credit of 100% should be attractive enough to ensure that the desired goals can (and should) be accomplished. From a public policy perspective, SB315 as drafted also incorporates the necessary provisions to ensure appropriate accountability, transparency and integrity.

In conclusion, I want to reiterate our support for an amended SB315. The inclusion of a \$1 million revenue test will ensure the appropriate targeting. If the Legislature agrees with the premise that start-up, seed and early stage Kansas companies lack access to adequate seed and venture capital funds and that a subsidy is required, language can be crafted to ensure appropriate targeting. With a 100% tax credit, desired targeting can and should occur.

Thank You.