REPORT OF THE JOINT SUBCOMMITTEE STUDYING

CAPITAL ACCESS AND BUSINESS FINANCING IN THE COMMONWEALTH

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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Introduction

As traditional manufacturing industries continue to decline and large corporations continue resizing, rightsizing, and downsizing initiatives, small and emerging businesses are playing an ever increasing role in our nation's economy. Virginia, in particular, must address ways to foster the development of these businesses as defense spending falls and the federal government shrinks.

It is estimated that over the next ten years, more jobs will be created by small businesses (those with less than 500 employees) than all other businesses combined. Moreover, the majority of today's workers are employed by companies that did not exist ten years ago. To support this wave of new businesses and ensure economic growth, the issue of providing capital to spur the development and expansion of these businesses has become critical.

In 1994, Governor Allen signed Executive Order 16 (94) which launched the *Opportunity Virginia* economic development strategic planning effort. As part of this initiative, over 800 business and community leaders participated in meetings across the state to assess Virginia's strengths and weaknesses in promoting economic development in order to create jobs and bring investment to the Commonwealth. The state's existing economic development policies were closely examined, particularly its programs that promote business development, to determine if gaps exist that must be addressed if the state is to move forward.

Opportunity Virginia also outlined ten key industry sectors which will be the most important to Virginia's future economic growth. Among these industries are aerospace, biotechnology, and information technology and telecommunications. Because these industries have only recently developed, they are among the most in need of capital to fund their growth.

Among the goals outlined in *Opportunity Virginia* for promoting the state's economic development initiatives relating to capital access issues were the need to focus on improving the economic success and competitiveness of Virginia's established and emerging base of companies and to capitalize on Virginia's technology assets and infrastructure to compete in the 21st century. In order to achieve these goals, several strategies were outlined in the report. Two of the most important strategies, and the most relevant to the issue of capital access, were that the state should seek to make working capital and financing for expansion more accessible for Virginia's smaller established firms and to evaluate the availability of "risk capital" and develop strategies to attract additional seed and venture capital to Virginia.

The most common concern voiced by the participants in the *Opportunity Virginia* effort and by entrepreneurs and business owners to Virginia's economic development professionals is that there is a lack of capital available for firms which want to begin or expand. These people often cite what is perceived as an unwillingness on the behalf of banks and other traditional sources of capital to lend to ventures where the risk is high and there is often little or no track record upon which to base repayment of a loan. Despite initiatives in the past decade by financial institutions to address the needs of small business, particularly in order to meet federal Community Reinvestment Act requirements, businesses still overwhelmingly feel that they are being denied access to funding.

Banks and other financial institutions, however, are not the only source of funding for these businesses. During the past thirty years, a network of seed and venture capital funds have emerged to link investors with new businesses. These funds are usually more willing to accept higher risk than financial institutions, but they are not nearly as accessible. It is often very difficult to bring together a fund manager with a business in need. Moreover, it appears that these funds like to be near the companies in which they invest. Because there are so few venture capital firms in the Commonwealth, there are few opportunities for seed and venture fund managers to "kick the tires." Another source of funding, usually for companies that have been in existence for several years, is a private offering of securities to a limited number of individuals. Such offerings, because of their small size, can be a lucrative source of funding without significant regulatory barriers. Initial public offerings of stock are also one of the ways that fast-growing companies take to access large amounts of capital.

It is unfair, however, to blame capital access problems solely on financial institutions and other sources of capital. A poorly developed business plan can significantly reduce the chance of an entrepreneur receiving funding from any source. Also, few entrepreneurs are willing to invest the time, or have the time, to fully investigate all funding options that are available to them. The large number of small businesses and a fixed amount of capital available to help them naturally means that some are funded while others cannot be, often leaving those business owners who do not receive loans frustrated and disappointed. Finally, many business owners are unwilling to surrender a portion of the ownership of their company in return for start-up financing as is often required by seed and venture capital organizations or when securities are sold.

In order to meet the need for capital, state governments have developed a variety of programs to increase the availability of capital and to strengthen existing businesses to make them more "acceptable" to traditional funding sources. These programs include the creation of loan funds, guarantee programs, technical workshops and seminars, and other resources to spur the development of new businesses. While the state has a role to play in promoting business development, it should not replace the private sector as the primary provider of financing. Instead, the state must find the balance between facilitator and provider of loans and other business funding programs. The state needs to work closely with the private sector to create opportunities for the development of capital and link them with those businesses which need capital in order to grow.

In 1995, the General Assembly passed Senate Joint Resolution 370 and House Joint Resolution 591 to more closely examine these issues. Specifically, these resolutions created the Joint Subcommittee to Study Capital Access and Business Financing to examine "various new initiatives and existing state programs which increase the accessibility of private financing for business development and attract investment and working capital, including seed, operating, and expansion capital, to the Commonwealth in order to support economic development efforts; programs pursued in other states targeted at increasing the availability of private capital; and the appropriate role of the state in facilitating business financing."

For the purposes of this study, capital access and business financing programs have been differentiated from standard economic development incentives such as tax credits, grants, and infrastructure support. While incentives can promote capital access and business financing is an incentive, the Subcommittee focused on those ways in which the state either provides direct financing to businesses in need or on market-oriented solutions to promote lending to these businesses by private entities.

This report outlines the programs already offered by Virginia, other states, and the federal government to address capital access issues and explores several options for creating new opportunities to ensure that the Commonwealth is able to compete in the 21st century.

Existing Virginia Business Financing Programs

During the past fifteen years, Virginia has moved rapidly to develop a series of programs to promote the development and expansion of small businesses. For the most part, these programs are concentrated at the state's Department of Economic Development in the Virginia Small Business Financing Authority. Some small programs have also been initiated at the Department of Housing and Community Development to promote microenterprise development in economically distressed communities in the Commonwealth. The State Corporation Commission, through its securities division, also plays a role in business financing by facilitating the issuance of limited private offerings of securities and initial public offerings of stock. The General Assembly has also supported the development of VEDCORP, a private venture capital fund.

The following is detailed information about each of these programs and the impact they have had on promoting capital access and fostering economic development in Virginia.

Virginia Small Business Financing Authority

Virginia began to respond to the financing needs identified by small businesses with the creation of the Virginia Small Business Financing Authority in 1984 within the Department of Economic Development. An important step to more effectively address the needs of small business was taken by the Allen Administration in consolidating all business financing programs within one state agency during 1995, with the transfer of the Virginia Economic Development Revolving Loan Fund programs (previously housed within the Department of Housing and Community Development) to the Financing Authority. This move has greatly enhanced access to Virginia's financing programs for businesses and economic development professionals by linking the technical expertise of the Authority staff closer to individual business prospects.

Since its inception, the Financing Authority has attempted to identify specific financing obstacles in the marketplace and design its financial products accordingly. All programs established by the Authority work to supplement and enhance private sector resources. The Authority does not attempt to act as a bank, but rather to fill gaps and serve as a catalyst for private sector investment. A summary of programs developed to date and a brief description of the market deficiency they seek to address is provided below.

Industrial Development Bonds - The Financing Authority is a statewide issuer of tax-exempt and taxable industrial development bonds. Tax-exempt bonds for the purchase of land, buildings, and equipment provide long-term financing at below-prime interest rates. The technical expertise and knowledge of the Authority's staff is available to assist the smaller-project borrower through what can be a somewhat overwhelming process. Such assistance in determining eligibility criteria and working directly with the business's financial institution is generally not available through a local industrial development authority (the other alternative issuer). A goal of the industrial development bond financing program is to assure that as many smaller companies as possible take advantage of this lower cost method of financing. Taxable bonds issued by the Authority provide investors with an exemption only from state personal income tax, an exemption that does lower, though not as significantly as tax-exempt issues, the interest rate that to the business owner must pay.

Current federal law restricts the use of tax-exempt bonds in many ways, including limiting issues to $10 million and allowing only a small portion of the bond proceeds to finance associated office and warehouse space. Changes to these restrictions are critical to the more effective use of this capital access program.

Umbrella Bond Program - A major obstacle for bond projects of a smaller size (typically less than $1 million) is the up-front closing or issuance costs. The Authority has effectively lowered the threshold for bond project financing by structuring a placement program with a low fee structure. Significant cost savings, largely through lower legal fees, make this financing opportunity cost-effective for smaller projects. With interest rates averaging 45 - 50% of the prime lending rate, the benefits to the small to medium-sized manufacturer in financing capital investments through this method are substantial.

Virginia Revolving Loan Fund program - The program consists of two funds, the Virginia Economic Development Revolving Loan Fund (VEDRLF) and the Virginia Defense Conversion Revolving Loan Fund (VDCRLF), which have been funded through state appropriations and federal grants. These direct loan funds are designed to fill the financing gap between private debt financing and private equity. With the VEDRLF, funds are provided for fixed asset financing to new and expanding industries that are creating new jobs or retaining "at risk" jobs in Virginia. Through the VEDRLF, the maximum loan available for each project is $700,000. The maximum amount of financing available is 50% of the total project cost, thus requiring private equity and other private sector lending.

The VDCRLF is designed to assist businesses adversely affected by defense downsizing. It provides fixed asset and working capital financing for defense dependent industries making the transition to the production of commercial products and services. This Fund may be used where financing from private sector lenders is unavailable or not affordable. The maximum loan available from the VDCRLF is $200,000. For both funds, one permanent full-time job must be created or retained for each $10,000 borrowed from them.

The VEDRLF has its origins in a $6 million grant given to the Department of Housing and Community Development (DCHD) in 1977 by the Economic Development Administration (EDA) of the U. S. Department of Commerce. The purpose of the grant was to loan the funds to a group in Augusta County for a management buyout of the American Safety Razor Company to avoid the parent company from closing this Virginia-based affiliate. DHCD agreed to accept the grant and loan the funds to the company through the Augusta County Industrial Development Authority with all loan repayments coming back to DHCD to be used for "other economic development activities in Virginia." DHCD, with EDA's concurrence, used the loan repayments for grants to localities to match other EDA grants given to various localities for water and sewer development and for other economic development projects. In 1984, DHCD decided to use the loan repayments exclusively for a revolving loan fund for fixed assets. The Department developed criteria for the loans and received approval from the Board of Housing and Community Development to actively market the fund to localities, Planning District Commissions, and economic developers across the Commonwealth.

The Board of Housing and Community Development adopted a policy to only loan funds for job creation or retention for plant expansions by manufacturing firms, and later expanded the eligible businesses to include basic industries (those companies that derive at least 50% of their revenues from outside Virginia). The Board decided that the offer of loans to companies should only take place when they could not obtain all of their financing at reasonable terms and rates to make their project go forward, to provide the loans for a fixed term at rates slightly below the prime rate, and to require financing from commercial lenders in each project.

The EDA put a number of restrictions on the use of the VEDRLF funds such as dictating that certain counties and cities were not eligible for loans because they had not suffered from long-term economic distress, a maximum loan amount of $250,000 (EDA later agreed to raised the loan amount to $700,000), one job created for each $10,000 loaned, and, since the original funds were federal funds, loan repayments could not be used to support companies relocating to Virginia if jobs were lost as a result of moving from a the previous location/labor market.

Because of these restrictions, DHCD decided to request state general funds to supplement the program to achieve statewide coverage and to offer financing to companies moving to Virginia. In 1989, the General Assembly appropriated state funds to further capitalize the VEDRLF to allow for increased project financing, to be able to accommodate financing requests from out-of-state companies wanting to relocate their operations to Virginia, and to provide greater flexibility in structuring loans. In addition, DHCD received an additional EDA grant during fiscal year (FY) 1989 to finance a project to reopen a closed facility in central Virginia (Craddock Terry Shoe). In FY 1995, DHCD received a $2.3 million Defense Conversion grant to assist Virginia firms impacted by defense downsizing to transition to non-military products and markets.

The VEDRLF is made up of four sources of funds, each having separate qualification criteria, although all four focus on job retention and creation and encourage private sector investment in economic development. Since the beginning of the program, the funds collectively have received $9,053,010 in federal EDA funds and $10,004,603 in state general funds to provide economic development project financing. The following is a table showing the sources of funds by year.

VIRGINIA ECONOMIC DEVELOPMENT REVOLVING LOAN FUND SOURCES OF FUNDS

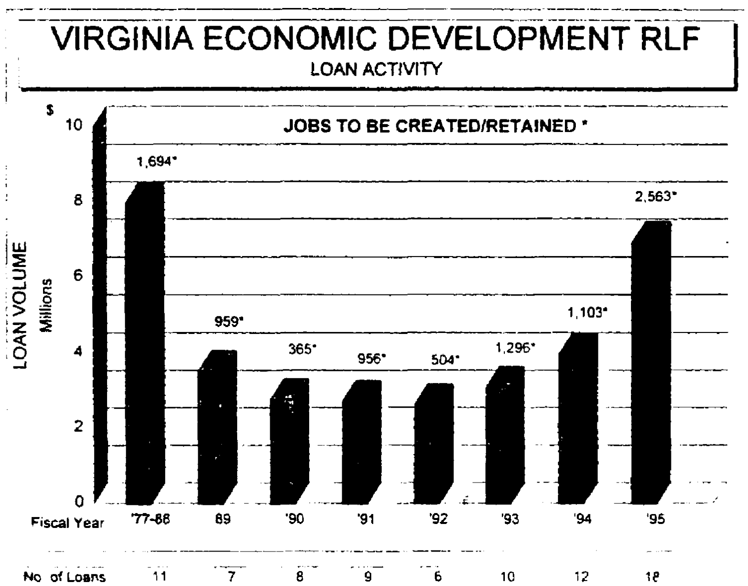
	STATE	FEDERAL			
FISCAL YEAR	ECONOMIC DEVELOPMENT	TITLE IX LTED	TITLE IX SSED	DEF. CONV.	TOTALS
FY 1977	$0	$6,000,000	$0	$0	$6,000,000
FY 1989	$2,246,990	$0	$753,010	$0	$3,000,000
FY 1990	$2,500,000	$0	$0	$0	$2,500,000
FY 1991	$1,550,000	$0	$0	$0	$1,550,000
FY 1992	$945,484	$0	$0	$0	$945,484
FY 1993	$630,484	$0	$0	$0	$630,484
FY 1994	$1,132,734	$0	$0	$0	$1,132,734
FY 1995	$998,911	$0	$0	$2,300,000	$3,298,911
FY 1996	$0	$0	$0	$0	$0
TOTAL	$10,004,603	$6,000,000	$753,010	$2,300,000	$19,057,613

As detailed in the table, FY 1996 is the first year since FY 1989 that new funds (state or federal) were not available to provide economic development financing. The VEDRLF has grown from a lending level of two loans totalling $500,000 in FY 1986 to 18 loans totalling $6,920,000 in FY 1995. During FY 1994, 16 projects totalling $6,335,000 were approved, however, several projects did not close and funds rolled over to FY 1995. The following is a table showing the Loan Volume per fund source since the beginning of the program.

VIRGINIA ECONOMIC DEVELOPMENT REVOLVING LOAN FUND
LOAN VOLUME

	STATE	FEDERAL			
FISCAL YEAR	ECONOMIC DEVELOPMENT	TITLE IX LTED	TITLE IX SSED	TITLE IX DEF. CONV.	TOTALS
FY 1977	$0	$7,966,900	$0	$0	$7,966,900
FY 1989	$1,755,000	$1,000,000	$753,010	$0	$3,508,010
FY 1990	$2,604,725	$150,000	$0	$0	$2,754,725
FY 1991	$1,876,500	$845,000	$0	$0	$2,721,500
FY 1992	$1,075,000	$1,300,000	$250,000	$0	$2,625,000
FY 1993	$2,900,000	$200,000	$0	$0	$3,100,000
FY 1994	$1,420,000	$2,290,000	$250,000	$0	$3,960,000
FY 1995	$5,170,000	$1,350,000	$200,000	$200,000	$6,920,000
TOTALS	$16,801,225	$15,101,900	$1,453,010	$200,000	$33,556,135

The following is a chart showing the level of financing, number of loans granted and jobs to be created/retained on an annual basis from all fund sources.



Since the original grant from EDA in 1977 and through FY 1995, the VEDRLF has provided over $33 million in loans for economic development financing in Virginia. These loans have supported an additional $169 million in other financing to create or retain 9,536 jobs in the Commonwealth. While the VEDRLF can provide up to 50% of the financing on any project, in reality it has provided only an average of 20% of the project financing due to the high level of private sector participation. The following is a table showing the level of public and private sector participation and the benefits of the loans.

LOAN PARTICIPATION AND BENEFITS

REVOLVING LOAN FUND (RLF)	OTHER FINANCING	JOBS	RLF $ / JOB
$33,600,000	$169,200,000	9,536	$3,523

Given the current level of economic development project activity, demand for the program is extremely strong. The lack of new state and federal funding for FY 1996 limits Virginia's ability to respond competitively to economic development project opportunities. The RLF generates approximately $3.1 million in loan repayments per year, and without additional funding, loan volume per number of jobs created or retained will revert to FY 1990 through FY 1993 levels.

<u>Export Financing Assistance Program</u> - Prior to the establishment of the Financing Authority's Export Financing Program in 1992, Virginia businesses had limited access to financing assistance to support their export activity. As a result, the Authority developed the Export Financing Assistance Program to provide assistance to qualified Virginia exporters in obtaining export financing by accessing loan guaranties from two federal agencies; the Export-Import Bank of the U.S. (Eximbank) and the U. S. Small Business Administration (SBA). The Authority's professional staff works on behalf of Virginia exporters by pre-qualifying their applications, packaging and submitting the applications to the appropriate federal agency, and by assisting the exporters in locating a bank to fund the guaranteed loans.

The Authority also provides Virginia exporters with access to Eximbank export credit insurance to insure their foreign accounts receivable against non-payment by the foreign buyer. With coverage under the Authority's Export Credit Insurance Umbrella Policy, Virginia exporters can offer open account terms to their overseas customers, thereby increasing their competitive advantage in world markets. The ability to insure foreign receivables against commercial and political risk also enhances the value of receivables for use as collateral on bank loans.

This program has provided an excellent framework for access to capital in this arena, however, it is constrained by federal regulation, funding uncertainties, and a bureaucratic federal approval processes. For these reasons, many states have established their own state export loan guaranty funds to more efficiently and effectively accommodate smaller transactions at the state level.

Loan Guaranty Program - This 50% guaranty of bank loans or lines of credit directly addresses the difficulty of obtaining sufficient working capital financing. Companies experiencing rapid growth and/or opportunities to add product lines have received significant assistance through this non-bureaucratic, user-friendly state program. A number of companies that had obtained financing through this program presented compelling testimony to the Subcommittee regarding the importance of the program and the access to capital it provided at critical junctures in their business cycles. In the last year, demand for the program has exceeded the Financing Authority's guaranty capacity. The demand for access to working capital has been well-established and the Loan Guaranty Program has had a good deal of success, however, the Capital Access Program, as discussed later in this narrative, is a more cost-effective approach to meeting this financing need and generates a much higher return on the state's investment.

Child Day Care Financing Program - Offered in cooperation with the Virginia Council on Child Day Care and Early Childhood Programs, this program provides small direct loans to child day centers and family home providers for quality enhancement projects or to meet or maintain child care standards. The program was developed to make financing available to day care providers that often find it difficult to obtain loans from conventional sources. Installment loans are made at a fixed rate of interest in amounts of $1,500 to $25,000. Loans may be used for a variety of purposes including:

- equipment for infant care
- providing access or services for the disabled
- renovations to plumbing and electrical systems, kitchens and bathrooms
- playground equipment purchases and installation of resilient surfaces
- vans, buses and other appropriate transportation equipment

The availability of quality child care and development programs is an essential facet of attracting and retaining businesses in the Commonwealth, building a competitive future workforce, and stabilizing economic growth within communities statewide.

Capital Resources Directory - In 1993, the General Assembly passed House Joint Resolution 649 requesting the Department of Economic Development to develop "certain programs to assist small businesses in locating and obtaining capital financing." In response, the Department, in cooperation with the Virginia Small Business Financing Authority and the Virginia Bankers Association, created the Virginia Capital Resources Directory which lists hundreds of sources of capital for small and emerging businesses. This directory, which was published in 1995, has become a useful tool for these businesses to locate both public and private sources of capital.

Capital Access Program - The Virginia Small Business Financing Authority has also explored several alternative methods for more adequately addressing business financing needs in the Commonwealth. One of the most innovative programs examined by the Authority is the Capital Access Program. Instead of attempting to directly supplement the credit market, a Capital Access Program (CAP) is designed to enable commercial banks to close capital gaps on their own. Specifically, a CAP provides banks with a loan loss reserve to absorb the higher risks associated with many business loans, while remaining in compliance with bank regulations. Recognizing the merits of a CAP's innovative design, many state and local governments have recently adopted the program. The following table shows the public investment and the level of private sector participation in CAP programs across the country.

CAPITAL ACCESS PROGRAMS

STATE	YEAR	PUBLIC INVESTMENT	NUMBER OF LOANS	LOANS ENROLLED
ARKANSAS	1993	$5,000,000	67	$2,400,000
CALIFORNIA	1994	$10,000,000	984	$142,000,000
COLORADO	1993	$50,000	82	$1,900,000
CONNECTICUT	1993	$10,000,000	120	$10,200,000
MASSACHUSETTS	1993	$5,000,000	30	$2,500,000
MICHIGAN	1986	$14,000,000	3,091	$161,000,000
MINNESOTA	1992	$5,000,000	85	$3,200,000
NEW HAMPSHIRE	1993	$5,000,000	448	$19,300,000
NEW YORK CITY	1993	$3,000,000	174	$8,400,000
NORTH	1994	$1,750,000	32	$2,000,000
OKLAHOMA	1992	$3,000,000	264	$7,800,000
OREGON	1991	$1,500,000	787	$24,000,000
WEST VIRGINIA	1991	$3,000,000	71	$4,200,000

Note: The 1993 and 1994 programs are new and have additional capacity for loans

In a short period of time, the cities and states which have created CAPs have facilitated over $417 million in private sector financing for businesses in their jurisdictions. This volume has been achieved in a relatively short period of time with sufficient capacity remaining to support at least another $700 million in financing. For every $1 million in public funds committed, over $21 million of private bank loans can be leveraged. This aggressive leveraging of private investment enables the CAP to achieve a much greater impact for a limited amount of public investment than do most development finance alternatives.

A special reserve fund is established for each bank participating in the CAP program to cover potential losses from loans enrolled in the program. Owned and controlled by the state financing entity, each account is earmarked in the bank's name. Payments are made into the reserve each time a CAP loan is made. The borrower makes a premium payment of between 1.5% and 3.5% of the loan amount; the bank matches that payment, and the state matches the combined total. The premium amount to be paid by the borrower is negotiated between the bank and the borrower. Total reserve contributions can range from 6% to 14% for each loan. The bank may recover the cost of its reserve contribution from the borrower through either a higher interest rate or closing fees.

Default rates on commercial loan portfolios generally average less than 1.5%, therefore, the added loss protection provided by the reserve fund enables banks to take on four to nine times their conventional lending risk when making a CAP loan and still be covered against expected losses. The CAP uses limited resources as a catalyst to allow private lenders to take more risk in financing firms, while remaining in compliance with regulations on soundness and safety of capital. In other words, the CAP provides the government lending entity with a cost-effective vehicle to promote economic development lending without compromising bank policy. An added advantage is that the program limits government losses to 7% of program loans, while providing banks with a strong incentive to make smaller business loans under reasonable levels of risk. A key feature of the program is that the full amount in the bank's reserve is available, as needed, to cover a loss on any of the loans made by the bank in its CAP portfolio. If loans are paid off without loss, the funds stay in the reserve.

Because the CAP is structured to ensure that banks act prudently, there is no need for the state to second-guess or impose bureaucratic restrictions on lending decisions. In determining the terms and conditions of each loan, the bank uses criteria that it considers appropriate and submits a one-page loan filing form after the loan is made. Thus, the CAP loan enrollment works as an automatic process with no customer delays, application requirements, or heavy paperwork. This is an important feature for bankers who are reluctant to use government lending programs. The simplicity of the program puts the lender at ease and enables the loan process to remain internal, improving turnaround time and customer service.

The staff of the Virginia Small Business Financing Authority has received concurrence with the concept from the Virginia Bankers Association, and extensive discussions have been held with the presidents and chief executive officers of the major Virginia-based banks. The response from the banking community was overwhelmingly positive and all indicated a willingness to participate in such a program. There has been general concurrence that demand for such a program exists and that it would represent an excellent tool in meeting the financial needs of the Virginia business community. The concept has been well-tested and proven in states nationwide and represents a strong trend in public sector financing. The program would be another resource in Virginia's support of a competitive, growth-oriented business climate.

The anticipated economic impact of the program includes:

- Support of up to $10.5 million in bank financing for approximately 200 Virginia businesses in Virginia each year based upon an initial state investment of $500,000. (This amount represents a leverage ratio of 21:1 vs. the average guaranty program leverage of 4:1.)
- The program nationwide has shown extremely strong performance in assisting younger companies, women and minority-owned businesses, as well as highly technical companies (particularly because their primary assets are intellectual property rights).

Department of Housing and Community Development

In 1994, the General Assembly requested the Department of Housing and Community Development to "develop a plan for implementing a microenterprise loan program." Microenterprises are typically defined as those businesses with fewer than five employees which require small loans to start. Typically, these loans are under $5,000. Because of the small size of these loans and the high risk involved, banks and other financial institutions are usually unwilling to provide these loans at a reasonable interest rate. There are organizations, particularly consumer finance companies, which will provide small personal loans, however, the interest rates charged usually exceed 20%.

In order to address the issue of providing these small loans, a variety of government and non-profit sponsored programs have been started during the past twenty years. In addition to offering financial assistance, many of these programs provide technical assistance such as teaching of management skills, product development and marketing assistance, support networks, and assistance with the development of business plans. The program sponsors have often noted that this type of assistance is just as important to the success of a microenterprise as the initial start-up capital.

The Department of Housing and Community Development unveiled the Virginia Enterprise Initiative in 1995 in response to the General Assembly's request. The initial program was designed to provide funds to fifteen non-profit organizations across the Commonwealth to enable them to establish microenterprise loan programs. These organizations are required to lend out the state funds to microenterprises, and as the loans are repaid, create a revolving loan fund to support additional microenterprise loans in the future. Each organization was also provided funding as a loan loss reserve to cover any loan defaults.

For FY 1996, the General Assembly appropriated $1,098,911 for the Virginia Enterprise Initiative (VEI). The principal funding source for the VEI was the $998,911 that the General Assembly had provided since 1989 to increase the capitalization of the Virginia Economic Development Revolving Loan Fund. In addition to the general fund appropriation, approximately $200,000 from the Appalachian Regional Commission was available to supplement the VEI. Chapter 853 of the 1995 Acts of Assembly required, however, that $200,000 of this total be provided to the City of Roanoke to help start a small business incubator program.

The Department set aside a small amount of this money to provide technical assistance to the non-profits which were going to receive funding through this initiative. Therefore, $994,439 was available to fund microenterprise loan programs created by the non-profits. In April 1995, the Department of Housing and Community Development sent notices to over 1,000 potential applicants to let them know about the program. Twenty-four organizations submitted applications for funding. Most of these organizations requested an average of $70,000 from the state which was matched by private and public sector contributions as required by the program guidelines.

In August 1995, the Department announced the fifteen organizations which were selected to receive funding through the Virginia Enterprise Initiative. These agencies were People, Inc. of Southwest Virginia, the Franklin County Chamber of Commerce, the Northside Richmond Business Association, the Virginia Eastern Shore Economic Empowerment and Housing Corporation, Total Action Against Poverty, the New Enterprise Fund, Inc., the Ethiopian Community Development Council, Inc., the Virginia Economic Development Corporation, the Business Development Centre, Inc., the Virginia Community Development Loan Fund, the South Fairfax Business Resource Center, the Portsmouth Community Development Loan Fund, Empowerment Resources, Inc., the Foundation for International Community Assistance, and the City of Richmond Office of Economic Development.

As part of its plan for the Virginia Enterprise Initiative, the Department made a two year funding commitment in order to initiate this statewide microenterprise program. It is the Department's intent that after 1997, no additional state funding will be necessary as the loans are repaid and lent out again through the revolving fund each of the non-profit organizations have established.

While this program has helped to address a niche in financing the smallest businesses, it was not designed to handle broader capital access issues. Therefore, additional options need to be explored to meet the needs that have been identified by businesses across the Commonwealth.

State Corporation Commission

In 1995, the General Assembly passed House Bill 1662 which amended the securities registration requirements to exempt from the law the need for these small offerings, as long as they are offered to fewer than 35 people during any 12 month period, to register under the broker-dealer act and various other regulations. Such a change reduces the amount of paperwork, particularly the private placement memorandum, that must be filed by a company which is seeking to raise capital through an offering of securities.

Through its Division of Securities and Retail Franchising, the State Corporation Commission participates in the Small Corporate Offering Registration (SCOR) program. The SCOR program allows a corporation to issue securities valued at up to $1 million. Such offerings allow small companies to raise the capital necessary to spur their growth. The SCOR form, created by the North American Securities Administrators Association, details exactly what information must be disclosed by a business owner in order to make a private offering of securities. The information necessary includes basic information about the company, its risk factors, how the proceeds of the sale of securities will be used, and federal tax aspects.

Unfortunately, some business owners are reluctant to offer securities because it results in a decrease in their share of ownership in the company. Moreover, while the process has been made more simple during the past few years, it continues to be misunderstood and is not a principal method that many growing companies will use to raise capital until later stages in their development.

An additional avenue for raising capital is through an initial public offering of stock. Such transactions are facilitated by a brokerage firm which, for a fee, will sell shares of stock in a company. The business owner receives additional capital in return for surrendering part of his ownership in the company. Because of the fees associated with an initial public offering and the general unwillingness of the market to purchase stock in companies unless they have a track record means that this is a financing option available only to a limited few.

VEDCORP

VEDCORP was formed with an appropriation made by the General Assembly in 1990 in order to create a Virginia-based venture capital fund. This appropriation provided VEDCORP with a $600,000 matching fund loss reserve and a $600,000 loan that must be repaid in 2000. VEDCORP was originally created to focus on deals only in rural areas of the Commonwealth, however, this requirement has since been dropped. The fund is organized as a private, for-profit limited liability company to provide second stage venture and mezzanine capital. Since its creation, over 35 private sector investors have invested $12,305,000 in VEDCORP. An eleven person Board of Managers oversees the fund, including nine representatives elected by the private sector investors and two appointees chosen by the Governor. VEDCORP has a staff of four people.

The fund focuses its attention on growth companies with product or service acceptance in the marketplace, ownership transitions where an experienced management team still exists, and corporate turnarounds. VEDCORP avoids seed capital situations, real estate-oriented projects, and finance companies because of the higher risk associated with such investments. A typical investment made by VEDCORP usually ranges from $200,000 to $1 million and includes some combination of subordinated debt (including warrants for common stock) or preferred stock as collateral. There is a five year horizon and either a fixed interest or dividend rate for repayment of any loans.

Pat Donnelly, the President of VEDCORP, provided testimony to the Subcommittee regarding VEDCORP's performance since 1991 and its deal flow activity by region of the Commonwealth. This information is as follows.

	1994	1993	1991
Increase in members capital	$308,677	$109,204	$120,771
Portfolio investments	$7,086,681	$3,518,459	$1,304,348
Total investments	10	7	3
Average investment	$708,668	$502,637	$434,783
Dividend payout	$308,677	$300,000	n/a

Deal Flow Activity by Region	
Northern Virginia	42.75%
Central/Southside	27.53%
Tidewater	18.90%
Shenandoah/Southwest	10.82%

A list of all investments made by VEDCORP is included in Appendix B.

According to Mr. Donnelly, VEDCORP has been instrumental in bringing over $40 million to the Commonwealth as a result of its activities. It has been active in bringing Virginia companies into contact with members of the Mid-Atlantic Venture Association and the National Association of Small Business Investment Companies.

Throughout its history, however, VEDCORP has been criticized for not doing enough to promote business development in the Commonwealth. Critics charge that the fund managers in the past have been too cautious in making loans as evidenced by the small number of deals and amount of investments made by VEDCORP since its creation.

Among the problems confronting the fund are that in comparison with venture funds formed by neighboring states, VEDCORP's portfolio is small. The state's initial investment of $1.2 million comes no where near matching the multi-million commitments made in Pennsylvania or South Carolina. Also, the lack of other incentives to attract venture capital to the Commonwealth, particularly the unfavorable BPOL tax treatment of venture capital funds and no tax credits for venture capital investments, has contributed to keeping VEDCORP a minor player among venture capital funds.

In order to overcome some of these difficulties, VEDCORP is in the process of converting to a Small Business Investment Corporation (SBIC). An SBIC leverages a loan portfolio in return for receiving additional money for loans through the Small Business Administration. VEDCORP estimates that it could access an additional $25 million by becoming an SBIC.

Existing Federal Government Business Financing Programs

In addition to the state's role in supporting business development by addressing capital access issues, the federal government has also created a variety of programs to provide money to entrepreneurs. Because of the greater resources of the federal government, these programs are larger and can offer significantly higher amounts of capital than those programs offered by the state.

Among these programs offered by federal agencies are the Small Business Administration's 7(a) Guaranteed Loan Program which leverages public spending with additional private sector funds. The size of this program shows the level of support that the federal government can provide to address business financing issues. From October 1992 to September 1993, the Small Business Administration approved 25,014 guaranteed business loans valued at $5.16 billion. As referenced previously, the federal government also permits the creation of Small Business Investment Corporations which are similar to private venture capital firms.

Some of the more innovative federal programs guarantee loans offered by small community banks across the county. For example, the Rural Economic and Community Development (RECD) agency has a intermediary lending program that allows loan funds to be established in local jurisdictions that can be used for economic development lending. These funds are lent to the region at zero percent interest and may be re-lent at market rates. The RECD is paid back as the loans are repaid but the jurisdiction keeps the interest to capitalize a local loan fund. RECD Loan Guarantees authorize up to 80% of a qualified loan made by a bank to be fully guaranteed by the RECD. This guarantee program is targeted toward mature companies that have a history and track record, but may require an additional safety net for the lender to attract private financing or may be too large of a loan for small bank financing. This guarantee is not included in the lending limits of the bank, therefore, it allows smaller regional and local banks to make larger loans than normal because of the guarantee.

Despite recent initiatives by federal agencies to reduce the amount of time and paperwork involved in processing loan applications, seeking funds from the federal government remains a time-consuming process, thus driving away many potential applicants.

Capital Access Programs in Other States

The National Association of State Development Agencies (NASDA) has recently completed a survey of the programs in other states that are designed to assist small and minority businesses in accessing financing. Many of these programs use a variety of direct state appropriations, tax credits, and partnerships with the private sector to support business development goals. The following is a summary of those programs which were reviewed by the Subcommittee.

Colorado

In 1987, the Colorado legislature created the Minority Business Office (MBO) to provide targeted assistance to new and existing small minority-owned businesses. No state funds were appropriate to operate the MBO, so the minority business community raised $50,000 to fund the opening of an office. The minority business community later lobbied the Colorado legislature and successfully acquired annual general fund support for the office.

While initially created as a central point for information dissemination on issues relating to minority business development, the scope of the MBO was greatly expanded in 1993 with the creation of the Colorado Credit Reserve Plus (CCR+) program. This program, which is based on the existing Colorado Credit Reserve (CCR) program managed by the Colorado Housing and Financing Authority, was designed to assist minority firms in obtaining loans for business development and expansion.

As part of the loan application process, a prospective borrower, in cooperation with the CCR, contributes to a loan-loss reserve pool maintained at the bank which will originate the loan. The CCR+ then provides an additional incentive to lend to minority-owned firms by contributing an additional 2% of the loan amount to this loan-loss reserve fund. The CCR+ contribution is funded by the MBO and the state's Women's Business Office. These contributions reduce the risk to the financial institution of lending to firms which lack access to traditional lending sources and covers any losses incurred from defaulted loans.

In 1994, sixteen lending institutions participated in the program, granting 45 loans to minority and women-owned businesses. The average loan was $20,770, and it is estimated that the CCR+ program has created or retained around 260 jobs.

Florida

The Florida Black Business Investment Board (FBBIB) was created in 1985 at the recommendation of the Governor's Advisory Council on Minority Enterprise Development to address disproportionate barriers to obtaining capital for business expansions and startup. The enabling legislation also created four trust funds totalling $5 million which are held by the state

Treasurer's Office. These funds are the Florida Investment Incentive Trust Fund, the Black Contractors Bond Trust Fund, the Black Business Loan Guarantee Trust Fund, and the Black Business Loan Guarantee Administrative and Loan Loss Reserve Fund. An additional $2.6 million has been added to the capitalization of these funds since that time.

The first program undertaken by the FBBIB was the establishment of Black Business Investment Corporations (BBIC) across Florida. A BBIC is a community development corporation which is principally controlled by local financial institutions. The FBBIB matches investments between $500,000 and $1 million made by financial institutions in individual BBICs. The primary purpose of the BBICs is to issue loan guarantees on standard commercial loans. Each BBIC also facilitates special counseling and planning for businesses which are unable to meet its guarantee requirements.

In 1994, the FBBIB reported that during its existence, it generated over $26 million in loans to 271 black-owned businesses and created or retained 1,825 jobs. Of these 271 loans, only 37 had been written off. The FBBIB was given bond authority when it was created, and it is currently exploring issuing up to $25 million in bonds to finance more staff and new programs.

Maryland

The Maryland Small Business Development Financing Authority (MSBDFA) was created in 1987 by the Maryland General Assembly to assist businesses owned by socially or economically disadvantaged citizens. The MSBDFA has created four programs: the Contract Financing Program, the Long-Term Guarantee Program, the Surety Bond Guaranty Program, and the Equity Participation Program. An initial $2 million state contribution has been supplemented since 1987 to finance the expansion of the programs offered by the Authority.

Briefly, these programs assist eligible firms through loan and equity guarantees, ,direct loans for working capital and equipment acquisition, and issue performance bonds for minority-owned firms bidding on government contracts. The projected economic impact of the loan, including the number of jobs created or retained, is the primary criterion for awards.

The Contract Financing Program offers direct loans or loan guarantees up to $500,000 with an interest rate capped at the prime rate plus 2% for guarantees or the prime rate for direct loans. Eligible businesses must pay a $250 application fee to participate in this program. The Long-Term Guarantee Program also offers loan guarantees and provides interest rate subsidies to financial institutions which offer loans to eligible businesses. Guarantees are offered up to $600,000. Loans begin at $5000 for a period of no more than 10 years and an interest rate not to exceed the prime rate plus 2%. Loan subsidies up to 4% are offered by the MSBDFA. The Surety Bond Program issues bid, performance, or payment bonds up to $250,000 at a fee of 3% for each $1,000 of the contract price of a project. These programs have relatively low default rates.

The Equity Participation Investment Program purchases any type cf securities offered by eligible businesses including stocks or debts up to $100,000 for the franchise component, and up to $500,000 for the business acquisition or technology component. This program, which most closely represents a venture capital fund, has the highest default rate, estimated at 23.2%.

As of June 30, 1994, a MSBDFA study reported that 83% of its clients were minority-owned businesses and that it had financed over $57 million in loans and bonds. The average loan size was $200,000, and these activities had created over 3,500 jobs and retained almost 5,700 jobs.

Maryland also offers an export loan guaranty program for any Maryland business sending its products overseas or for businesses in other states which use Maryland facilities, particularly the Port of Baltimore, for exporting.

Missouri and South Carolina

The State of Missouri has focused its capital access efforts on the creation of tax credits to spur the development of capital and the creation of seed and venture capital funds instead of relying on direct state appropriations. For example, the state has a 33% tax credit for any new equity investment in a Missouri-based company. Both in-state and out-of-state investment funds are eligible for this credit, and the credit may be transferred to a third party.

South Carolina took a similar approach, however, it offers a 33% tax credit to firms that invest in the Palmetto Seed Capital Fund, a state sponsored entity. The state provided $5 million in tax credits to initially capitalize what would eventually become a $15 million fund. These tax credits can be taken over five years.

The other state programs reviewed by the Subcommittee primarily focused on revolving loan funds, loan guarantee programs, and microenterprise loan programs. Many of these states also offered technical assistance to small businesses.

The Role of the Virginia Retirement System in Promoting Capital Access

The Virginia Retirement System (VRS) serves as the agency responsible for investing contributions from the state to provide pensions for its employees upon retirement. As of June 10, 1995, 229 state agencies, 361 political subdivisions, and 146 school boards were participating in the VRS. Because of the size of the state's workforce and the significant number of local governments which participate in the VRS's programs, its portfolio is among the largest in the nation. With $18.8 billion in assets, the VRS is the ninth largest public pension system in the United States and it is the 32nd largest public or private pension system in the country.

In order to cover the anticipated costs of government employee pensions, the VRS invests its portfolio in a variety of financial instruments to generate a sufficient return. Typically, these investments include real estate, equity (including stocks and other securities), and bonds. Like most cautious investors, the VRS has a diversified portfolio to ensure level growth of its assets.

Because of the size of the VRS, it has been looked to during the past few years as a potential source of funding for Virginia companies. In 1994, the General Assembly passed House Joint Resolution (HJR) 264 which requested the Virginia Retirement System to "study the feasibility of economically-targeted investments (ETIs) in venture capital projects located in the Commonwealth." Several states, including Alabama, California, Pennsylvania, and Wisconsin have required that their state pension funds make economically-targeted investments. ETIs are often used to revitalize distressed communities, fund business development, and provide a source of financing affordable housing.

In its report resulting from HJR 264, the VRS recognized that ETIs have been a popular tool for promoting economic development in many states, however, their success varies widely. Many of those states with an ETI program have reported that the investments have not performed as well as more traditional investments. While the VRS supports investing in viable Virginia business opportunities which can offer competitive returns at a comparable level of risk to other investments, it is adamantly opposed to any mandate requiring it to invest a certain portion of its funds in ETIs.

The primary reason the VRS cites for its opposition to an ETI program is the "prudent manager" rule under which it operates. Section 51.1-124.30 of the *Code of Virginia* provides that:

> "The Board [of Directors of the Virginia Retirement System] shall discharge its duties with respect to the Retirement System solely in the interest of the beneficiaries thereof and shall invest the assets of the Retirement System with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

It is the contention of the VRS that it is contradictory to impose an ETI mandate on it while at the same time requiring the agency to fulfill the prudent manager rule. If the VRS were directed to invest in Virginia companies, it could miss out on other opportunities that may offer higher yields and more security.

Although the VRS is opposed to a mandated ETI program, it does support making "alternative investments" as part of its portfolio diversification efforts. Alternative investments include investments in seed and venture capital funds. The VRS has a target of placing 15% of its portfolio in these alternative investments, however, it currently only has 4.4% of its portfolio invested in this manner. Of this 4.4%, about 28% is invested in venture capital funds. Investments made in turn by these venture capital funds in Virginia-based companies have a market value of $124.2 million.

It is important to understand, however, that the VRS rarely invests directly in an individual business. For the most part, it is a limited partner participating in a venture capital fund administered by a general partner or as a direct investor investing alongside a general partner's fund.

Seed and Venture Capital in Virginia

One of the biggest problems identified by the Subcommittee was that there are few venture capital firms in the Commonwealth. While there are no accurate figures available for the number of funds based in the state, most are concentrated in northern Virginia and serve the high technology community there. These funds are often small and invest in specific industry sectors. Also, the small size of the VEDCORP portfolio restricts it to only a few deals a year.

It is unclear why seed and venture capital firms have been reluctant to move to Virginia. One of the perceptions that was identified in testimony before the Subcommittee was that Virginia is not seen as an entrepreneurial state. Because of the state's traditional reliance on agriculture, government employment, and defense contracting, Virginia is not considered a place where businesses are being created at a fast enough rate to justify a seed or venture capital firm locating here.

Fortunately, these perceptions are false. Northern Virginia has the second highest concentration of high technology firms in the country after Silicon Valley. There are more people holding doctorate degrees in Virginia than any state in the South. Most interestingly, because the state has depended so heavily on government-supported employment in the past, the recent reductions in the size of the federal government have led to an increase in new business formation.

The Center for Innovative Technology (CIT) has taken an active role in bringing together emerging technology firms with venture capital funds. In 1995, the CIT sponsored the Greater Washington Venture Capital Conference which featured 27 businesses and 200 venture capitalists. Each of the 27 business owners made a presentation regarding his company while the venture capitalists reviewed their product designs and business plans. There were also additional opportunities for the business owners and the fund managers to discuss the capital needs of these emerging technology companies. According to Dr. Robert Templin, the President of the CIT, this event has become the premiere venture capital summit in the Mid-Atlantic states, and it is demonstrating that Virginia has many viable products worthy of national attention from seed and venture capital firms.

Because of the urgent need for capital, particularly among high-technology companies, the CIT has set aside $500,000 to create a seed capital fund. The CIT is actively looking for partners to increase the size of this fund.

The Department of Economic Development, however, has not focused on attracting seed and venture capital funds to the state. Traditionally, the state's economic development efforts have been focused on recruiting businesses to relocate to or expand in the Commonwealth. Since this recruitment results in immediate job creation and investment in the state, little attention is given to attracting capital to spur the creation of new businesses.

Being a hub for technology and business development is one of the most important factors in bringing seed and venture capital firms to the Commonwealth. The Subcommittee was repeatedly told that money looks for good deals, so if there are enough good prospects in a state, capital will flow in to fund them. It is only now that Virginia is starting to see a few nationally recognized seed and venture capital funds locate branch offices in the state, mainly in northern Virginia to take advantage of opportunities there. According to a study by Coopers & Lybrand, the Washington DC metro area (including Baltimore) was fourth in the nation in the first six months of 1995 in venture capital investments, totaling about $176.2 million. Of this total, 36.8% were in communications companies. Unfortunately, this amount is still only 6.8% of all venture capital invested nationally during the same period.

It is important to note, however, that this 1995 figure includes all levels of seed and venture capital funding including seed and early stage, mezzanine level, and second stage venture capital. At the meeting of the Private Sector Initiatives Task Force of the Subcommittee, several venture fund managers suggested that there is adequate venture capital available to fund deals in Virginia. Typically, venture capital funds focus on businesses which have been in existence several years and have strong potential. It is in the area of seed and early stage capital, money that finances business startup and the development of small businesses, were the need for capital is most acute.

While there may be many opportunities for seed and venture capital funds to find good deals in the Commonwealth, it appears that there remain impediments to the rapid development of a well-established network of these funds. At its second meeting, the Subcommittee heard from Barbara Molera, the President of Triad Investors, a seed capital fund based in Maryland. Ms. Molera has invested in Virginia-based companies, and she has generally been impressed with the quality of businesses that exist in the Commonwealth. She noted, however, that when she tried to raise additional capital from within the state, her efforts were unsuccessful. Her company spent $75,000 on marketing materials and other promotions to attract capital from within the Commonwealth. No money was forthcoming despite her company's excellent track record.

One impediment to the development of seed and venture capital funds in the Commonwealth may be the use of the Business, Professional, and Occupational Licensing (BPOL) tax. While banks and other financial institutions enjoy an exemption from the BPOL tax, seed and venture capital firms do not. Therefore, they are subjected to this regressive tax on their gross receipts, an unfair method of taxing an entity that depends on capital flow to make a profit.

Finally, Virginia lacks a well developed "angel" network. Angels are individuals who invest directly in small and emerging businesses. The Hampton Roads Small Business Development Center (SBDC) has developed a system to match these private investors with its clients who need financial assistance. These private investors could prove to be a valuable source of financing for a small number of entrepreneurs.

Recommendations

As a result of the Subcommittee's work, it has become clear that the state must make a serious effort to promote the availability of capital to fund business development.

Virginia has an excellent program structure in place through the Virginia Small Business Financing Authority to address the market deficiencies limiting access to capital. There are several basic principles for public sector intervention through financing programs which the Authority has embraced. The best development financing programs tend to have the following traits in common:

- Are market based. They are designed to change, not replace, private sector behavior and decision making.
- Can be sustained. They are innovations that market participants themselves will value and support through fees and interest payments.
- Tend to be simple. They are typically easy to administer and use. In short, they are user-friendly.
- Involve low public cost. They use a minimum amount of public money to achieve their purposes.
- Can achieve significant scale. They are able to mobilize private resources equal to the size of the capital market problem.
- Are managed by non-bureaucratic organizations. Although they may be financed with public money, they are run by independent authorities with an ability to be flexible and work well with private sector investors and financial institutions.

While the state has a role to play in directly providing a limited amount of funding to enhance loan opportunities, it is the private sector that should take the lead in providing business financing. Many of the principles outlined above, particularly making any program simple and achievable with little state cost, should be followed in establishing any coordinated effort to promote capital access in the Commonwealth.

As a result of materials reviewed by the Subcommittee and testimony of representatives from banks, seed and venture capital firms, government organizations, and business owners, it is apparent that the state needs to address the barriers to the development of capital in the Commonwealth and aggressively pursue existing opportunities which have not received attention in the past.

The recommendations of the Subcommittee are as follows:

Legislative Initiatives

1. **The General Assembly should study making an exemption to the BPOL tax for seed and venture capital firms in order to attract these firms to Virginia. Venture firms are hurt by the BPOL tax because there is little relationship between their gross receipts and profits. Since Virginia has very few venture firms in Virginia, the revenue loss to localities would be minimal. The Subcommittee recommends that this issue be referred to the Commission on State and Local Government Responsibility and Taxing Authority (HJR 487) for further study and to define "seed and venture capital firm" for the purposes of drafting an exemption.**

2. **The Commonwealth should support the creation of a Capital Access Program. The program could be started with an initial appropriation of $500,000, and/or the state could begin to convert dollars in the present working capital guarantee program (about $900,000) in order to fund the Capital Access Program. Before the existing working capital program funds are converted to the Capital Access Program, the Subcommittee recommends that the Virginia Small Business Financing Authority hold a public hearing to discuss such a change because of the popularity of the working capital program.**

3. **The General Assembly should consider passing legislation to provide tax credits to financial institutions for loans made in enterprise zones. Similar legislation has been introduced in both 1994 and 1995, however, it was not included in the final compromise bill that passed in 1995. Legislation creating these credits should not be introduced until the state has had sufficient experience with the new tax credits now available in order to determine if they are adequate to promote business development in the state's economically distressed communities.**

4. **The Secretary of Commerce and Trade should study the creation of a Seed and Early Stage Debt Fund, particularly to address the capital access needs of the state's high-technology sector. The fund should either consist of tax credits offered to individuals and businesses which invest in a seed and early stage equity funds or take the form of loan guarantees to offer additional security to financial institutions making loans to risky businesses. If guarantees are chosen as the preferred method, then the Secretary should examine whether the state should accept equity kickers (ownership) as collateral.**

5. **The State Corporation Commission (SCC) should stay abreast of changing Securities and Exchange regulations relating to small offerings of securities**

to ensure that Virginia businesses can take full advantage of this opportunity. Should the SCC need additional statutory or regulatory authority to reach more quickly to these changes on the federal level, then legislation should be introduced to achieve this goal.

6. **The General Assembly should pass a resolution memorializing Congress to support a bill introduced by Congressman Phil English to ease restrictions on the Industrial Development Bond program including an increase in the limit to $20 million per deal and an expansion of the types of projects that can benefit from tax-exempt financing.**

7. **The General Assembly should pass a joint resolution continuing the Joint Subcommittee to Study Capital Access and Business Financing in the Commonwealth for an additional year to further discuss several unresolved issues.**

Facilitation Actions

1. **The Commonwealth should establish as a marketing goal the attraction of venture capital funds to Virginia. The Department of Economic Development should take the lead in this initiative.**

2. **The state's industrial development advertising and the efforts of the Center for Innovative Technology should promote Virginia as a high technology state. Special attention should be given to make sure the equity community is also being exposed to the advertisements.**

3. **The Commonwealth should continue, through cooperation with CIT, to support venture capital summits and the development of venture capital networks.**

4. **The Secretary of Commerce and Trade should convene a venture capital roundtable composed of representatives of firms involved in equity finance in the Commonwealth to discuss ways to promote business development in the Commonwealth.**

5. **All mandates on the VRS to invest in Virginia companies should be resisted. However, the VRS should be encouraged to play a role in supporting the Secretary's venture capital roundtable and to support Commonwealth-specific venture capital summits that showcase Virginia technology and Virginia companies. Also, the VRS should assist in establishing a streamlined process for Virginia companies to get direct access to Brinson Partners, its major fund investor.**

6. **The Virginia Small Business Financing Authority should issue bonds to increase the capitalization of the Virginia Economic Development Revolving Loan Fund and other Authority programs.**

7. **The Virginia Small Business Financing Authority should closely examine additional opportunities for RECD Intermediary Re-Lending and RECD Loan Guarantees by banks in the Commonwealth. The Authority should also work with local Industrial Development Authorities to support this lending program.**

8. **The Virginia Small Business Financing Authority (VSBFA) should work establish more Small Business Administration (SBA) preferred lenders in Virginia, and the VSBFA should play a role in working with local banks to encourage more SBA participation in the Commonwealth.**

9. **The Commonwealth should establish a statewide database like that of the Hampton Roads Small Business Development Center (SBDC). While some level of base funding will be required to support this network, much of the effort could be undertaken in partnership with various SBDCs, technology councils and other interested groups in each region who could assist with identifying and interviewing angel investors.**

10. **The Commonwealth should examine initiating a program in conjunction with the state's MBA programs to provide student teams to assist business owners to develop financing plans. Such a program would be mirrored on the International Marketing Plan program at the Department of Economic Development. This partnership is a win-win proposition because the company gets a quality product and the students get valuable practical experience.**

SENATE JOINT RESOLUTION NO. 370

Establishing a joint subcommittee to study capital access and business financing.

Agreed to by the Senate, February 23, 1995
Agreed to by the House of Delegates, February 22, 1995

WHEREAS, the primary challenge encountered by many businesses, particularly small and minority-owned businesses, is the inability to secure sufficient financing for new or expanding operations; and

WHEREAS, the continued growth of jobs and incomes in Virginia will depend heavily on facilitating the creation and expansion of these businesses; and

WHEREAS, availability of capital at all stages of business development has been identified as one of the most pressing issues facing businesses in the Commonwealth; and

WHEREAS, state and local governments have created lending authorities and other organizations to address some business financing needs; and

WHEREAS, "Opportunity Virginia: A Strategic Plan for Jobs and Prosperity" and other studies addressing economic development have indicated that these programs are limited in scope and may not sufficiently meet the needs of the Commonwealth to spur the creation and growth of new enterprises; and

WHEREAS, governments cannot and should not replace the private sector as the primary source of financing for business; and

WHEREAS, Virginia lacks a coordinated strategy for attracting privately managed investment and working capital to the Commonwealth; and

WHEREAS, some states have implemented initiatives to increase the accessibility of business financing and to attract investment capital; and

WHEREAS, the availability of investment and working capital is essential to economic development and job creation efforts; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study capital access and business financing issues. The joint subcommittee shall conduct a comprehensive study and examine the following: (i) various new initiatives and existing state programs which increase the accessibility of private financing for business development and attract investment and working capital, including seed, operating, and expansion capital, to the Commonwealth in order to support economic development efforts; (ii) programs pursued in other states targeted at increasing the availability of private capital; and (iii) the appropriate role of the state in facilitating business financing.

The joint subcommittee shall be composed of fifteen members to be appointed as follows: three members of the Senate to be appointed by the Senate Committee on Privileges and Elections; five members of the House of Delegates to be appointed by the Speaker of the House; six citizens who shall represent private business and financial institutions in the Commonwealth to be appointed by the Governor; the Secretary of Commerce and Trade and the Secretary of Finance, who shall both serve as nonvoting ex officio members.

The Department of Economic Development shall provide staff support to the joint subcommittee. All agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.

The direct cost of this study shall not exceed $6,000.

The joint subcommittee shall complete its work in time to submit its findings and recommendations to the Governor and the 1996 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.

GENERAL ASSEMBLY OF VIRGINIA -- 1995 SESSION

HOUSE JOINT RESOLUTION NO. 591

Establishing a joint subcommittee to study capital access and business financing.

Agreed to by the House of Delegates, February 23, 1995
Agreed to by the Senate, February 21, 1995

WHEREAS, the primary challenge encountered by many businesses, particularly small and minority-owned businesses, is the inability to secure sufficient financing for new or expanding operations; and

WHEREAS, the continued growth of jobs and incomes in Virginia will depend heavily on facilitating the creation and expansion of these businesses; and

WHEREAS, availability of capital at all stages of business development has been identified as one of the most pressing issues facing businesses in the Commonwealth; and

WHEREAS, state and local governments have created lending authorities and other organizations to address some business financing needs; and

WHEREAS, "Opportunity Virginia: A Strategic Plan for Jobs and Prosperity" and other studies addressing economic development have indicated that these programs are limited in scope and may not sufficiently meet the needs of the Commonwealth to spur the creation and growth of new enterprises; and

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The Department of Economic Development will provide staff support to the subcommittee. All agencies of the Commonwealth shall assist the subcommittee, upon request.

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The joint subcommittee shall complete its work in time to submit its findings and recommendations to the Governor and the 1996 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Services for the processing of legislative documents.

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Current Investments

Company	Location	Description
Acme Design Technology, Inc.	Crozet	Filing Systems
Charter of Lynchburg, Inc.	Lynchburg	Hospitality Furniture
Cybermotion, Inc.	Roanoke	Security Robots
Front Royal, Inc.	Glen Allen, VA/Cary, NC	Environmental Insurance
G. W. Haab Company, Inc.	Gloucester	Bottling Machinery
Innotech, Inc.	Roanoke	Multifocal Lenses
LTC Americas, Inc.	Sterling	Vaccuum Blasting Equipment
C. B. Nunn/MAECOR	Sandston	Food Processing Equipment
Pharmaceutical Research Associates, Inc.	Charlottesville/Mannheim	Clinical Research Organization
Virginia Gas Company	Abingdon	Distribution/storage of Natural Gas

APPENDIX B

Appendix C

Sources of Information

Bodziak, Caroline Robbins, "Techniques for Increasing the Liquidity of State and Local Intermediaries and Expanding Capital Access for Minority Businesses," National Association of State Development Agencies, 1995.

Report of the Virginia Retirement System, "To Study the Feasibility of Economically-Targeted Investments in Venture Capital Projects Located in the Commonwealth," House Document Number 11, 1995.

The State of Small Business. A Report of the President, 1994. Government Printing Office, Washington, 1995.