

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

COMMERCE AND LABOR COMMITTEE SUBCOMMITTEE ON VENTURE CAPITAL

Thursday, September 7, 2000
Conference Room, West Fargo Chamber of Commerce
West Fargo, North Dakota

Representative Eliot Glassheim, Chairman, called the meeting to order at 12:30 p.m.

Members present: Representatives Eliot Glassheim, George J. Keiser, Dale C. Severson; Senator Deb Mathern

Member absent: Senator Tony Grindberg

Others present: Joy Johnston, Greater North Dakota Association, Bismarck

Doren Krabbenhoft, Fargo-Moorhead Chamber of Commerce, Fargo

Tom Kenville, Mid-America Aviation Inc., West Fargo

Kim Koppelman, State Representative, West Fargo

Bruce Hager, Financial Advisors, Fargo

Randy Schwartz, Department of Economic Development and Finance, Bismarck

Syver Vinje, Securities Commissioner, Bismarck

Chairman Glassheim said the purpose of the Commerce and Labor Committee Subcommittee on Venture Capital is to evaluate the need for venture capital in the state, consider how technology might benefit from increased venture capital, and review bill drafts.

Chairman Glassheim called on Mr. Tom Kenville, Mid-America Aviation Inc., West Fargo, for comments regarding the role the state might be able to play in encouraging venture capital. Mr. Kenville said his business experience has exposed him to how the North Dakota Future Fund works. He said it is hard to start a business in North Dakota because the state lacks a one-stop service provider. Additionally, he said, smaller businesses that need startup capital have an especially hard time finding investors because investors are more interested in the larger projects. However, he said, the North Dakota State University Engineering Department has recently opened a one-stop center to help with the promotion of technology as it applies to startup businesses.

Mr. Kenville said he currently has about 20 projects setting on his desk which are looking for startup funding. He said each of these startup projects requires between \$50,000 to \$100,000 to move forward. He said there is a need for a single entity to provide these startup services, and the state

needs to consider the level of urgency needed in pursuing these startup business ideas.

In response to a question from Representative Glassheim, Mr. Kenville said in order to be financially successful, he proposes that startup funding come in part from the business owner, in part from the state, and in part from the banking sector. Additionally, he said, it would be helpful if the federal government were willing to give tax credits, and it would be helpful if the state gave tax credits.

Chairman Glassheim called on Mr. Bruce Hager, Financial Advisors, Fargo, for comments regarding the state's role in assisting startup companies. Mr. Hager said if the state created an early stage investment fund for startup companies, the state would need to provide some type of tax credits to act as an incentive to get investors to invest in the fund. However, he said, to be really effective, the federal government will need to provide tax credits as well. Without a federal tax credit, he said, it might not be possible to get enough investment money in the fund.

Chairman Glassheim called on Mr. Syver Vinje, Securities Commissioner, for comments regarding the state's role in assisting startup businesses. Mr. Vinje said if the state offers a tax credit, there would be a dollar value to that tax credit regardless of whether the federal government provides a tax credit. He said a 30 percent investment tax credit would be the minimum amount the state would have to offer for creation of a startup fund to be successful.

In response to a question from Representative Glassheim regarding whether it might be feasible for the state to create a mutual fund type product in which North Dakota investors could invest \$1,000, Mr. Kenville said there is a certain amount of money required to administer the fund. He said the creators of the fund would have to weigh and balance the values of high volume with small investments versus lower volume with larger investments.

Mr. Hager said the committee might want to consider the use of a state income tax checkoff on the income tax form. He said one benefit to implementing a checkoff system would be that the structure for collecting the money is already in place. Mr. Kenville said the committee should keep in mind there are a

variety of systems in the state that are in place to collect and distribute startup funds.

Mr. Vinje said since the last meeting of the subcommittee, he has performed research that indicates one way the state might avoid federal law limitations regarding daily valuation of shares is to organize the fund through a limited liability company.

Mr. Hager said if the committee determines state funding should be used to create a startup pool of funds, in using the state's funds, the state should be able to handle investing one-half of one percent to one percent of the state's funds in high-risk venture capital such as a startup fund.

Mr. Vinje said portfolio theories indicate investment funds should have a broad range of investments, including a small amount of money in very high-risk investments.

Representative Koppelman said it sounds like the committee has considered a variety of methods of funding a state startup fund, including tax credits, direct state investment, state managerial involvement, private investment, and Public Employees Retirement System funds. He asked the subcommittee whether it has determined which funding source to pursue.

Representative Glassheim said the subcommittee is considering elements of each of these funding sources.

Senator Mathern said the provision of state funds has a certain amount of risk associated with it and state appropriations change from legislative session to legislative session.

Mr. Kenville said the state should focus on providing startup funding for smaller North Dakota businesses. Additionally, he said, the subcommittee needs to recognize that any benefits of creation of a startup fund will take several years to evolve. He said the committee may want to consider offering special investment incentives for rural areas.

Ms. Joy Johnston, Greater North Dakota Association, Bismarck, said Oklahoma is an example of a state that provides business funding in preferred counties.

Mr. Hager said he is a member of the Regional Investment Bankers Association, a national association, and he suggested legislators attend one of these meetings before pursuing the topic of startup investments.

In response to a question from Senator Mathern, Mr. Kenville said he has been involved in a business project in a small business administration HUBZone. Mr. Randy Schwartz, Deputy Director, Department of Economic Development and Finance, said the department has not pursued development in HUBZones.

Chairman Glassheim called on committee counsel to present the venture capital bill draft. Committee counsel said the bill draft is based on Ohio Senate Bill No. 301, which is being considered by the Ohio General Assembly. She said the funding source for the venture capital program would be tax credits and, according to Senator Grindberg, there is federal

legislation pending which would provide the details for how the tax credits would work.

Representative Keiser said the committee may want to consider limiting venture capital investments through the North Dakota venture capital program to first-phase funding for startup businesses.

Representative Severson agreed with Representative Keiser's suggestion.

Representative Glassheim said by focusing on startup companies, the bill draft would be helpful for rural communities and might possibly be expanded at a later date to include second- and third-tier venture capital investments.

Ms. Johnston said seed capital investment tax credits already exist on the long form of the state income tax; however, using the long form is not convenient, therefore the tax credit is not being utilized.

Representative Glassheim said if the bill draft is limited to first-tier businesses, the subcommittee may want to consider expanding beyond investment in technology businesses.

Representative Keiser said he would recommend keeping legislators off the North Dakota Venture Capital Authority. He said he recognizes the value of some government involvement but does not believe legislators would be necessary on the authority.

Representative Severson said he agreed with Representative Keiser's comment regarding legislative representation on the authority.

Representative Keiser suggested perhaps the North Dakota Venture Capital Authority could be composed of a member from the State Board of Higher Education; a member from the Greater North Dakota Association; a member from the AFL-CIO; a member from a state bankers association; three members appointed by the Governor; and ex officio members including the securities commissioner, the director of Economic Development and Finance, and the president of the Bank of North Dakota. He said the authority chairman can be selected by the committee, and the committee members should have at least some banking or business experience. Representative Keiser also questioned whether it is necessary to provide reimbursement of North Dakota Venture Capital Authority members.

Ms. Johnston said chief executive officers of major businesses do not need reimbursement of \$62.50 per day.

Mr. Schwartz said regarding the creation of a North Dakota Venture Capital Authority, the North Dakota Development Fund Board is housed in the Department of Economic Development and Finance, so there is already a structure in place to distribute venture capital funds; however, the North Dakota Development Fund has not been adequately funded. He said the law addressing the North Dakota Development Fund could be modified to provide the services proposed to be provided under this bill draft. Under the North Dakota Development Fund, he said,

the state is taking equity positions in a small number of investments.

Senator Mathern said one problem with using the existing structure of the North Dakota Development Fund is that the fund uses state money, and it would be better to use private funding for venture capital, primarily because of the improved continuity.

In response to a question from Representative Keiser, Mr. Schwartz said the North Dakota Development Fund Board members are appointed by the Governor from the private sector and include the director of the Department of Economic Development and Finance. He said the North Dakota Development Fund works well with startup companies and assisting in establishing businesses. The trend, he said, is to fund businesses through loans instead of taking equity positions.

Representative Keiser said historically the return of the state funds has been zero; however, jobs are created. He said the Legislative Assembly needs to be honest with investors and in marketing the fund needs to err on the side of being conservative.

Ms. Johnston said if the committee is expecting a return to the investor, the fund cannot be benevolent.

Mr. Vinje said the subcommittee could consider using a refundable tax credit spread out over five to ten years.

Representative Severson said he likes the idea of a "sister fund" to the North Dakota Development Fund.

Mr. Schwartz said the North Dakota Development Fund could be modified to allow the fund to contract for providing loans and investments.

Chairman Glassheim called on Ms. Doren Krabbenhoft, Fargo-Moorhead Chamber of Commerce, Fargo, for comments regarding the role of the state in capital investment. Ms. Krabbenhoft asked why a private, nonprofit investment fund manager would take the position of managing a fund unless there is a return. She said the success of a project is measured by the amount of the financial return or by the creation of jobs.

Committee counsel said providing individuals with tax credits would result in deferring general fund revenues.

Representative Keiser said projections indicate there will not be a budget surplus in upcoming years.

The committee discussed the possibility of providing a tax credit of up to 150 percent over 5 to 10 years and discussed the possibility of individual investor's returns being limited to the tax credit, with any money made by the fund going back to the state.

The committee questioned whether the state would need to set aside money for the entire 5 to 10 years in an appropriation for the first biennium and

questioned whether the tax credit would be an obligation of the state which extended to future Legislative Assemblies.

Ms. Johnston said the committee's discussion is significantly different from the program provided under the Ohio bill draft. She said under the Ohio bill draft, the investors would reap the benefit of the success of the fund; whereas, the committee's discussion sounds more like the previous Technology Transfer, Incorporated.

Representative Keiser said the committee's discussion regarding a tax credit of up to 150 percent of the individual's investment would be the worst business decision in the world. He said it would be foolish for the state to spend \$3 million in state revenues in order to put \$2 million in a state venture capital fund.

Mr. Vinje said a 10 percent tax credit for five years would provide that at the end of five years an individual or investor could recoup 50 percent of an investment and could additionally reap any benefit that might be realized from investment in the fund.

Representative Keiser said if the committee considers creating a true venture capital corporation, with individual investors having ownership in shares of the fund, the issues of securities is a major consideration. He said more information is necessary regarding how the state and federal security laws may impact the ability to pursue this type of state fund.

Representative Glassheim raised the possibility of creating a fund that provided 15 percent of its investments to first-tier investments; 45 percent of the investments to second-tier investments; and 40 percent of the funding investments to third-tier investments.

Representative Keiser suggested the committee focus on second-tier investments, focusing on businesses that are already in existence for two to five years.

It was moved by Senator Mathern, seconded by Representative Keiser, and carried on a voice vote that the venture capital fund bill draft be amended to decrease funding from \$10 million to \$5 million.

Representative Glassheim distributed to committee members a copy of a bill draft he requested of the Legislative Council which would create a program that would provide funding on a matching basis to local venture capital organizations.

No further business remaining, Chairman Glassheim adjourned the meeting at 4:20 p.m.

Jennifer S. N. Clark
Committee Counsel