PUBLIC HEARING

before

ASSEMBLY ECONOMIC DEVELOPMENT AND AGRICULTURE COMMITTEE

ASSEMBLY BILL 3282

(Creates New Jersey Venture Investment Fund,
and Appropriates $2 Million)

March 5, 1987
Room 449
State House Annex
Trenton, New Jersey

MEMBERS OF COMMITTEE PRESENT:

Assemblyman Joseph Azzolina, Chairman
Assemblyman Jack Collins, Vice Chairman
Assemblyman John E. Rooney
Assemblyman Richard A. Zimmer
Assemblyman George Hudak
Assemblyman Anthony S. Marsella

ALSO PRESENT:

Gregory L. Williams
Office of Legislative Services
Aide, Assembly Economic Development
and Agriculture Committee

* * * * * * * * * *

Hearing Recorded and Transcribed by
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Public Information Office
Hearing Unit
State House Annex
CN 068
Trenton, New Jersey 08625

JOSEPH AZZOLINA
Chairman
JACK COLLINS
Vice-Chairman
JOHN T. HENDRICKSON, JR.
JOHN E. ROONEY
RICHARD A. ZIMMER
GEORGE HUDAK
ANTHONY S. MARSELLA

New Jersey State Legislature

ASSEMBLY ECONOMIC DEVELOPMENT AND AGRICULTURE COMMITTEE

STATE HOUSE ANNEX, CN-068
TRENTON, NEW JERSEY 08625
TELEPHONE: (609) 984-0445

M E M O R A N D U M

February 24, 1987

TO: Members of the Assembly Economic Development and Agriculture Committee

FROM: Assemblyman Joseph Azzolina

SUBJECT: Committee Meeting on March 5, 1987

(Address comments and questions to Gregory L. Williams, Committee Aide (609) 984-0445)

The Assembly Economic Development and Agriculture Committee will meet on Thursday, March 5, 1987 at 9:45 a.m. in Room 449, State House Annex, to consider the following bills:

A-3472 Brown	Appropriates $100,000 to Dept. of Commerce and Economic Development for grant to Interracial Council for Business Opportunity.
A-3557 Ogden	Permits the use of 1981 farmland preservation bond fund moneys to be used by the State for purchasing fee simple absolute interests in certain farmland.
S-2180 (2nd OCR) Lipman	Appropriates $100,000 to the Department of Commerce and Economic Development for grant to Interracial Council for Business Opportunity.

Immediately following consideration of these bills the committee will adjourn and reconvene to hold a public hearing on the following bill and subject matter.

A-3282 Azzolina/ Villane	Creates the New Jersey Venture Investment Fund, appropriates $2 million.

The purpose of the Hearing will be to consider a variety of approaches that the State can take, including the approach used in A-3282, to help stimulate the production of new products and technologies by new and existing companies in the State.

ASSEMBLY, No. 3282

STATE OF NEW JERSEY

INTRODUCED OCTOBER 2, 1986

By Assemblymen AZZOLINA, VILLANE, Miller, Kline, Schuber, DiGaetano, Assemblywoman Donovan, Assemblymen Kosco, Hendrickson, Frelinghuysen, Gargiulo, Arango, Singer, Chinnici, Palaia and Muziani

AN ACT creating a private-public New Jersey Venture Investment Fund, supplementing P. L. 1974, c. 80 (C. 34:1B-1 et seq.) and making an appropriation.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. For the purposes of this act:

a. "Advisory board" means the Venture Investment Advisory Board established pursuant to section 5 of this act.

b. "Co-venture investment" means a seed capital investment by the authority in qualified securities of an enterprise which is made in conjunction with one or more professional investors or seed capital investors who or which are also making equity investments in that enterprise, as provided in this act.

c. "Economically distressed municipality" means a municipality which qualifies for State aid under the provisions of P. L. 1978, c. 14 (C. 52:27D-178 et seq.) or a municipality which meets two of the following standards:

(1) The unemployment rate is above the State average;

(2) The per capita income is lower than the State average;

(3) The ratables per capita are less than the State average.

A municipality shall be regarded as an economically distressed municipality for a period of one year after it ceases to meet the above criteria.

d. "Enterprise" means an individual, corporation, partnership, joint venture, trust, estate or unincorporated association.

e. "Primary employment" means work which pays at least one and one-half times the minimum wage as defined in section 5 of P. L. 1966, c. 113 (C. 34:11-56a4) or as established by federal law, whichever is higher, provides adequate fringe benefits including health insurance, and is not seasonal or part-time.

f. "Professional investor" means any: bank; bank holding company; savings institution; trust company; credit union; insurance company; investment company registered under the federal "Investment Company Act of 1940," 54 Stat. 789 (15 U. S. C. § 80a-1 et seq.), as amended; pension or profit-sharing trust or other financial institution or institutional buyer; licensee under the federal "Small Business Investment Act of 1958," Pub. L. 85-699, 72 Stat. 689 (15 U. S. C. § 661 et seq.), as amended; or any enterprise the principal business of which is making venture capital investment and which has a net worth exceeding $250,000.00.

g. "Qualified security" means any note, stock, convertible security, treasury stock, bond, debenture, evidence of indebtedness, limited partnership interest, certificate of interest or participation in any profit-sharing agreement, preorganization certificate or subscription, transferable share, investment contract, certificate of deposit for a security, certificate of interest or participation in a patent or application therefor, or in royalty or other payments under the patent or application, or, in general, any interest or instrument commonly known as a "security" or any certificate for, receipt for, guarantee of, or option, warrant or right to subscribe to or purchase any of the foreging.

h. "Seed capital" means financing in the form of investments in qualified securities that is provided for the applied research, development and initial production and marketing of a new technology, product or industrial process.

i. "Seed capital investor" means any person, partnership, corporation, trust or other entity, except for a prefessional investor, making a seed capital investment.

2. The authority shall establish and maintain a special fund called the New Jersey Venture Investment Fund, referred to in sections 2 through 7 of this act as the "fund". The authority is authorized to accept any and all grants and loans, as authorized by this act or any other law, subsidies, matching funds, reimbursements, appropriations, transfers of appropriations, federal grant moneys, income derived from investments, or other things of value

from the federal or state governments or any agency of any other state or from any institution, person, firm or corporation, public or private, for deposit in the fund.

The authority is authorized to use moneys deposited in the fund expressly for the purposes specified in and according to the procedures established by sections 3 through 7 of this act. The authority may appoint a director to manage the activities associated with the fund. The director shall receive compensation as determined by the authority.

3. The authority shall have, in addition to the powers enumerated in section 5 of P. L. 1974, c. 80 (C. 34:1B–5), the following powers concerning the investment and reinvestment of moneys in the New Jersey Venture Investment Fund:

a. To enter into, following consultation with the advisory board, written agreements or contracts, including limited partnership agreements, with one or more professional investors or seed capital investors for the purpose of establishing a pool of funds to be used exclusively as seed capital, provided that the amount of funds to be provided under each such agreement or contract by the authority from the fund shall not exceed 25% of the pool of funds to be established by such agreement or contract. The authority shall not invest more than \$2,000,000.00 in a pool or pools of funds.

The agreement or contract may provide for the pool of funds to be managed by a professional investor. The manager may be the general partner of a limited partnership of which the authority is a limited partner.

The agreement or contract may provide for payment to the manager of a percentage, not to exceed 20%, computed on an annual basis, of cash and other property payable to the authority as its pro rata share of distributions to investors in the pool of funds, provided that: (1) no amount shall be received by the manager upon sale or other disposition of qualified securities in enterprises until recovery by the authority of its investment; (2) upon liquidation or withdrawal of the authority from the pool of funds the manager shall be obligated to refund any amount received by it from such percentage if necessary to allow the authority to recover its investment; and (3) the terms of payment of cash and other property to the authority are no less favorable to the authority than payments to other seed capital investors or professional investors other than the manager, who are parties to the agreement or contract;

b. To make a co-venture investment in qualified securities of any enterprise approved pursuant to section 4 of this act by entering into agreements with one or more professional investors or seed capital investors who agree to invest an amount of not less than 50% of the amount that the authority invests in the enterprise for the purpose of providing seed capital, but not more than $500,000.00 shall be invested by the authority in the qualified securities of a single enterprise, unless the authority determines that additional investments are necessary to protect or enhance the authority's initial investment, in which case the authority may invest not more than $750,000.00 in the enterprise.

Each co-venture investment agreement shall provide that the authority will recover its investments prior to or simultaneously with any distribution to participating professional investors or seed capital investors. The authority and participating professional investors and seed capital investors shall share ratably in the profits earned in any form on such co-venture investment; and

c. To make investments of any funds held in reserve or sinking funds, or any funds not required for immediate disbursement, in any direct obligations of, or obligations as to which the principal and interest is guaranteed by the United States of America or such other obligations as the authority may approve.

4. a. An enterprise seeking a co-venture investment from the fund or seed capital from a pool established pursuant to subsection a. of section 3 of this act shall file an application with the authority along with an application fee to be determined by the authority. A valid application shall contain a business plan, including a description of the enterprise and its management, a statement of the amount, timing and projected use of the capital required, a statement concerning the feasibility of the proposed technology, product, or industrial process, its state of development and likelihood of commercial success, a statement of the potential economic impact of the enterprise on the State, including the number, location and types of jobs expected to be created, and any other information required by the authority.

No application for a co-venture investment or seed capital shall be approved until the authority consults with the advisory board and determines that:

(1) The enterprise has a reasonable chance of success;

(2) Authority participation is necessary to the success of the enterprise because conventional, private funding is unavailable in the traditional capital markets, or because funding has been offered only on terms that would substantially hinder the success of the enterprise;

(3) The technology, product, process or invention for which the investment is being made is feasible, has the potential to achieve commercial success and the enterprise has the reasonable potential to create a substantial amount of primary employment within the State per dollar invested and that the employment will be located in an economically distressed municipality unless the authority determines that locating the new employment in an economically distressed municipality is not feasible. In determining the feasibility and commercial viability of the technology, product, process or invention, the authority shall give consideration to any potential for its eventual sale in export markets;

(4) The entrepreneur, investors, shareholders, and other founders of the enterprise have already made or are obligated to make a substantial financial and time commitment to the enterprise;

(5) The securities to be purchased are qualified securities;

(6) The possible gains on the investment are at least commensurate with the risk of loss and that there is a reasonable possibility that the authority will recoup its investment, within 10 years after such investment or such other time period as negotiated by the authority, through the receipt of interest payments, dividends, capital gains or other distribution of profits, or return on investments made by the authority; and

(7) The enterprise is willing to make, prior to the investment being made, binding commitments with the authority:

(a) For adequate reporting of financial data to the authority, which shall include a requirement for an audit of the financial records of the enterprise at least once each year;

(b) That any employment created because of the investment shall be located in the State, and located in an economically distressed municipality unless the authority determines that locating the new employment in an economically distressed municipality is not feasible; and

(c) That the authority shall have sufficient contractual rights as the authority shall deem prudent to protect the investment of the authority and to assure that the employment created would be located in the State and located in an economically distressed community unless the authority determines that locating the employment in an economically distressed community is not feasible.

b. If the application is for seed capital from a pool established pursuant to subsection b. of section 3 of this act, the professional investor acting as manager of the pool shall, after the authority makes the determinations required by subsection a. of this section, decide whether to approve the application. If the application is for a co-venture investment from the fund, the authority shall decide whether to approve the application.

5. a. There is established in the Department of Commerce and Economic Development, a Venture Investment Advisory Board. The board shall have nine members as follows: the Commissioner of Commerce and Economic Development and the executive director of the New Jersey Commission on Science and Technology, created pursuant to P. L. 1985, c. 102 (C. 52:9X-1 et seq.), both of whom shall serve ex officio; and seven members appointed by the Governor with the advice and consent of the Senate for terms of three years, except that of the seven members first appointed by the Governor, three shall be appointed for three years, two shall be appointed for two years, and two shall be appointed for one year. Not more than four of the members appointed by the Governor shall be of the same political party. The members appointed by the Governor shall include two individuals with experience in small businesses involved in the development and commercialization of new products or industrial processes, two individuals with research and development experience in major established industries, and two individuals with investment or financial experience related to the development and commercialization of new products or industrial processes. Each member shall hold office for the term of appointment and until his successor is appointed and qualified. A member apopinted to fill a vacancy occurring in the membership of the board for any reason other than the expiration of the term shall have a term of appointment for the unexpired term only. All vacancies shall be filled in the same manner as the original appointment. Any member may be removed from office by the Governor, for cause, after a hearing and may be suspended by the Governor pending the completion of the hearing. Members of the board shall serve without compensation, but shall be reimbursed for necessary expenses incurred in the performance of their duties as members. Action may be taken and motions and resolutions may be adopted by the board at a board meeting by an affirmative vote of not less than five members. As soon as practicable, the members of the board shall select from among themselves a chairman, vice-chairman and treasurer.

b. It shall be the duty of the advisory board to:

(1) Study and make recommendations concerning those activities of the authority which are undertaken to implement the purposes of this act;

(2) Review any proposal of the authority to establish a pool pursuant to subsection a. of section 3 of this act and advise the authority concerning the proposal; and

(3) Review any application made to the authority under the provisions of this act and advise the authority concerning the application.

6. Any documentary materials or data received by any member, agent or employee of the authority or the advisory board, to the extent that the material or data consist of trade secrets, commercial or financial information regarding the operation of any enterprise conducted by an applicant for, or recipient of, any form of assistance which the authority is empowered to render, or regarding the competitive position of the enterprise in a particular field of endeavor, shall not be deemed public records; except that if the authority purchases a qualified security from such enterprise, the commercial and financial information, excluding trade secrets, shall be deemed to become a public record of the authority after the expiration of three years from the date of purchase of the qualified security, or, if the information is received by the member, agent or employee of the authority after the purchase of the qualified security, three years from the date the information was received.

7. There is appropriated from the General Fund to the New Jersey Venture Investment Fund the sum of $2,000,000.00.

8. This act shall take effect immediately.

STATEMENT

This bill creates the New Jersey Venture Investment Fund and authorizes the New Jersey Economic Development Authority to use moneys deposited in the fund to make seed capital investments in enterprises engaged in the applied research, development, and initial production marketing of a new technology, product or industrial process.

The bill authorizes two kinds of seed capital investments by the authority:

1. Investments made through seed capital pools of funds in which not more than 25% of the funds would come from the authority and the remainder would come from one or more private investors.

The authority is permitted to make an agreement with a qualified major private investor to have the investor manage the pool. Authority investments in such pools are limited to $2,000,000.00.

2. Co-venture investments in individual enterprises made jointly with one or more private investors who agree to invest at least 50% of the amount invested by the authority. The authority's share of a co-venture investment would be limited to $500,000.00, or, if the authority finds that more is needed to protect or enhance an initial investment, $750,000.00.

The bill appropriates $2,000,000.00 to the New Jersey Venture Investment Fund.

ECONOMIC DEVELOPMENT

Creates New Jersey Venture Investment Fund, appropriates $2 million.

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

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mjz: 1-43

ASSEMBLYMAN JOSEPH AZZOLINA (Chairman): We would like to start the public hearing now on Assembly Bill 3282, which creates the New Jersey Venture Investment Fund and appropriates $2 million.

MR. WILLIAMS (Committee Aide): This bill creates the New Jersey Venture Investment Fund and authorizes the New Jersey Economic Development Authority to use moneys deposited in the Fund to make seed capital investments in enterprises engaged in the applied research, development, and initial production and marketing of new technologies, products, or industrial processes.

The bill authorizes two kinds of seed capital investments by the Authority:

1) Investments made through seed capital pools of funds in which not more than 25% of the funds would come from the Authority and the remainder would come from one or more private investors. The Authority is permitted to make an agreement with a qualified major private investor to have the investor manage the pool. Authority investments in such pools are limited to $2 million.

2) Co-venture investments in individual enterprises made jointly with one or more private investors who agree to invest at least 50% of the amount invested by the Authority. The Authority's share of a co-venture investment would be limited to $500,000, or, if the Authority finds that more is needed to protect or enhance an initial investment, $750,000.

The bill includes provisions to safeguard the Authority's investment under both the pools and co-venture investments by requiring the terms of payment in any investment to be at least as favorable to the Authority as to other investors.

The bill requires that the Authority make no seed capital investment unless it determines that:

1) The enterprise has a reasonable chance of success, and the likelihood of gain for the Authority is commensurate with the risk of loss;

2) Other sources of funding are not available on reasonable terms;

3) The new technology, product, or industrial process is feasible and likely to create a substantial number of jobs per dollar invested which are located in economically distressed communities to the extent feasible; and,

4) The enterprise agrees to make binding commitments with the Authority to provide the Authority with adequate financial reports and with contractual rights to protect the Authority's investment and insure that new jobs are located as required by the bill.

The bill establishes within the Department of Commerce and Economic Development a Venture Investment Advisory Board to advise the Authority concerning individual investments, the selection of private managers for investment pools, and the overall implementation of the bill.

The bill appropriates $2 million to the New Jersey Venture Investment Fund.

There is also a memo included in the legislators' packets on other states' programs of a similar nature. These can be entered into the record.

ASSEMBLYMAN AZZOLINA: All right. Good morning. This bill is sponsored by myself and Doc Villane. Many State planners and policymakers have recently focused their attention on the issue of venture capital, providing seed capital financing used to start or expand a business. In a real sense, this represents just another strategy aimed at the retention and expansion of existing businesses and, more importantly, the start-up and nurturing of new companies.

The lack of capital from traditional sources such as banks and other financial institutions for these types of ventures has triggered many states to launch initiatives compensating for that gap.

Entrepreneurial spirit is the backbone of our nation. More and more firms are locating or relocating into our State. As a matter of fact, a recent New Jersey Business and Industry Association survey indicated that 80% of the respondents view New Jersey as better at promoting economic development. Let's make sure that this State continues its track record on this mark. One of the primary benefits of focusing on further assisting business start-ups is an increased level of job creation.

Today's hearing will allow the Committee members to better assess the gap between demand and need for capital and the actual capital availability for early stage and expansion of business. In addition, we hope to discuss the pros and cons of the various venture capital finance strategies, including my legislation, to nurture business growth and expansion in our State. My special thanks to those of you who will be providing testimony to the Committee this morning.

I would like to first call on Jim Hughes from EDA. Do you have anything you want to present at the moment, any amendments, or whatever?

J A M E S H U G H E S (speaking from audience): Assemblyman, I didn't come prepared to testify this morning. I came to answer questions and be available as a resource, if needed. The Committee has received input from our Authority for some time now on some of our concerns. I am happy to see that they are addressed in the bill -- the need for private sector involvement, and certain things like that. We do have a couple of other reservations, technical amendments. I would be happy to discuss them further with you, but I have no formal presentation.

ASSEMBLYMAN AZZOLINA: Okay, thank you.

MR. WILLIAMS: May I ask that anyone who is going to speak come up to the microphone, because this is a public hearing and it just doesn't get picked up for the record from a distance.

ASSEMBLYMAN AZZOLINA: I would like to call on George Jenkins, Vice President, Midlantic National Bank, Edison, New Jersey. Are you here, George? (affirmative response) Any relation to George Jenkins Public Supermarkets in Florida -- the owners?

GEORGE JENKINS: No. I imagine there are a lot of Jenkinses of Welsh descent here somewhere.

I didn't come this morning with a prepared formal response. I interpreted the discussion as being one more attempting to share some of our perspective with what is going on in the State of New Jersey, particularly what we are doing as a bank, and what we tend to believe the needs are out there of the young company -- the development stage company community.

ASSEMBLYMAN AZZOLINA: That is what we want to hear. Would you please pull the mike closer to you?

MR. JENKINS: Sure.

ASSEMBLYMAN AZZOLINA: It is not a P.A. mike; it is just for the record, that's all. It's a recording.

MR. JENKINS: Just some background history: About three years ago, we decided to set up a technology group in the bank. The technology group really has focused on development stage companies. The view of the bank was that there would be an expanding opportunity in the State of New Jersey, partly driven by the deregulation of the Bell operating companies, changes we saw happening in the major drug firms, and a lot of dynamics that suggested to us that programs were going to be curtailed, budgets were going to be curtailed, and that professional people would be in the marketplace attempting to take projects or technology and look for external funding for these opportunities, and to create companies.

We felt there was a role for the bank to get involved in that process, and we have gotten very involved in it. To date, we have a portfolio probably in excess of 20 or 23 companies, that we would classify as very early stage businesses. By early stage I mean a business that is probably, in many instances, less than a year old when we get involved. In many instances, it may be two to three years before that company is going to be profitable. We are looking at the bank performing in a variety of ways in support of that company. This would range from the bank being active at an early stage raising private placement capital, with the bank actually acting as the conduit to the venture community to try to create visibility for a particular project. I think the bank's imprimatur on that project has helped to move opportunities more rapidly through a venture funding process, and typically the bank's role, following that funding-- I think I need to distinguish here that we are not playing venture capitalist in these projects, but if you had to look at what we are doing on the spectrum of venture capital to traditional lending, we are somewhere in-between.

We typically are getting involved in providing debt finance to finance equipment needs, to finance working capital needs at a very early stage. Our involvement has ranged everywhere, as I say, from initial funding to helping that company go public in the public marketplace. There are a number of examples of companies here in New Jersey I can give you, wherein we were instrumental in causing those companies to be funded. In some instances, we were instrumental in causing those companies to get access to the public marketplace.

The long and the short of this is, I think that certainly from Midlantic's perspective, there is an active program in the banking industry, through our institution, to support young companies. We have anchored ourselves at one end with making bank investments in venture capital limited partnerships. We have two to date. One is a fund called Edison. The specific mission of Edison is really to focus on the tristate area, primarily New Jersey, and primarily on seed stage opportunities. Our partners in that fund include Prudential Insurance, Mutual Benefit, Public Service, ourselves, General Motors, and Ameritec, which is one of the regional Bell operating companies.

The other fund we are involved in is a fund called TDH, which is in Philadelphia, and really covers the surrounding community in Eastern Pennsylvania and across into the southern New Jersey border area.

ASSEMBLYMAN AZZOLINA: Is this high risk?

MR. JENKINS: These funds are venture funds, yeah, absolutely. I mean, this is where you are looking--

ASSEMBLYMAN AZZOLINA: Have you lost much in it?

MR. JENKINS: Well, the history is too short. In the case of TDH, TDH is an established group of professional fund managers who have had one fund or another for the last 15 years. Their track record is pretty good in terms of producing a return on capital. In the case of Edison, Edison was founded in August of '86. You know, the record there is obviously much too short, but the first transaction that Edison did was a transaction that we brought to them, which was a company here in Princeton, which received a million dollar commitment for development capital to drive that business forward. We subsequently brought in a public underwriter. The company went public in February, and went out with a market valuation of about $14 million, and raised about $4.5 million.

So, they are well on their way. They have increased interestingly. Their employment has gone from about 16 people in July to about 30 currently. I anticipate that before the year is out they will probably be up to about 50 people. So there is a significant pattern of job creation here.

But, to go back to the central issue of what we see happening, I think there is a role for some expanded venture capital commitment in the State of New Jersey. I am concerned with how that gets managed. We have spent three years and an inordinate amount of time learning how to survive in this marketplace. I can tell you from firsthand experience, it is not easy. I question, to some degree, if the State is going to pursue making capital available, whether that should be in the public domain, other than being funded from the public domain. I think an approach -- and you seem to suggest an approach in your bill -- that you team with experienced venture capital general partners who understand the industry to manage that money, is probably an appropriate approach in this marketplace. You know, the record of the industry is that only one in ten is a major success. We have seen that in our own portfolio in the bank.

The other thing that I think will happen, and I think you need to have some patience-- A lot of what will happen in the future in terms of availability of venture capital is going to be a function of just a socialization of this process; a network being created wherein you have the major public accounting firms, the major banks, other business development kinds of entities better acquainted with the whole process and, through that network, they are able to bring people together and get these transactions funded.

I am not convinced in my own mind that there is a gross shortage of venture capital in the State of New Jersey, based on our ability to take what we think are worthwhile projects, and to get those projects funded. You know, I think there is some gap there that can be supported by the State, but I don't think it is a gross gap. That would be my impression.

ASSEMBLYMAN AZZOLINA: Do other banks in our State make loans of this nature, or get involved in this kind of--

MR. JENKINS: No.

ASSEMBLYMAN AZZOLINA: Is yours the only bank involved in it?

MR. JENKINS: There are about a half a dozen banks in the entire country. There are four or five banks which are very, very active in the Boston 128 area. We are the only bank, to our knowledge, in the entire metropolitan area. I think it has been borne out by the deal flow we have. I mean, we spend the bulk of our time talking with the major institutional players in the venture marketplace, looking to them to derive deal flow and, in turn, sending projects to them.

There is no adversity, believe me, to putting money to work in the State of New Jersey. What I think has been a primary problem is, there hasn't been a mechanism to create visibility with these funds. It has been all too easy to go up to Route 128 or out to Silicon Valley or to Research Triangle, where the process is much more institutionalized than it is here in New Jersey. I think we are making progress by virtue of what Ed Cohen is trying to do, what we are trying to do, and what others are doing.

Bear in mind that you have over a half a billion dollars worth of venture capital managed just in Princeton. You know, the numbers are significant -- half a billion dollars. The problem is that only a small proportion of that has been invested in New Jersey.

ASSEMBLYMAN AZZOLINA: Are there any questions anyone would like to ask?

ASSEMBLYMAN ZIMMER: I have a question.

ASSEMBLYMAN AZZOLINA: Yes?

ASSEMBLYMAN ZIMMER: How would you describe that gap which the State could fill? What sort of investments-- Presumably they would be investments you wouldn't or couldn't make.

MR. JENKINS: That bank, at this point, does not have a directly owned venture capital arm. Traditionally the way this would be done would be through a small business investment corporation, which is the way the regulators would allow us to do it. Therefore, if somebody comes to us with an early stage project that is largely in the form of, "I've got an idea. I've written a business plan. I have three contemporaries who have appropriate skills who are going to join me in this endeavor," the bank is able to sit down and help them enhance that business plan, and help them to get visibility with people who can fund that project. But the bank will not put the initial equity capital into that project. What the bank is doing is putting debt on top of an initial layer of equity capital that somebody else has to provide. That debt, traditionally, has not been available, that leverage, from the banking community.

The banking community looks to see several years of financial statements and operating history. So, the issue is, is there a role there for the State? I think there probably is, but I think you should also focus on the fact that there is a role for an expanded network to help to bring existing sources of capital to bear on that problem. I think that is happening, but I think you have to be patient to some extent.

ASSEMBLYMAN ZIMMER: So, the gap that you referred to is one that would not necessarily be better filled by the State. It is one that could be filled by the private sector, if only the means of bringing the private equity in contact with the entrepreneurs were approved.

MR. JENKINS: To a degree. The issue there is, you have to look at each individual fund, and ask that fund what their mission is. There are relatively few funds that concentrate on what we would call a seed stage type of investment; the problem being that the record of being able to successfully develop companies starting at a seed stage is one that does not inspire a lot of people. It takes a tremendous amount of time, a tremendous amount of effort to grow these companies. Therefore, a lot of the money in the venture community is going into development funding of existing businesses, that would have an opportunity to grow much beyond their current level, and still need to do it in the form of equity capital, or it is going into leverage buyouts.

Therefore, I think an appropriate role for the State is one of holding up the flag, through the mechanism of a professional investor, or several professional investors, to create some momentum in this process by the creation of an entity such as you suggest. But I don't see the State having a major role in that process. I really think that with time, with other banks getting involved, a process will be created where the mechanism exists to bring projects in front of the venture community and get them funded.

ASSEMBLYMAN ZIMMER: So, the State would be taking an equity position, not so much for its intrinsic value, but as a means of somehow developing a cohesive community of equity investors.

MR. JENKINS: You've got to get started somewhere.

ASSEMBLYMAN ZIMMER: I understand that.

MR. JENKINS: The question is, what bounds do you put on that kind of a commitment? I think there is an appropriate role, as I say, to get the process moving in the right direction, and to essentially energize it.

ASSEMBLYMAN ZIMMER: Has the experience in other states indicated that the private sector is brought into play by such public equity funds to a greater extent than it would have been?

MR. JENKINS: My experience is limited, in that our primary market territory has been New Jersey and Pennsylvania. We have recently began supporting a company which is an outgrowth of the Ben Franklin partnership, that piece of it which is based at Lehigh University. That is a tangible example in our eyes of a state project which has funded a seed stage business, which has gotten to a stage where we will get involved as a bank. We have made a significant commitment there. We have also introduced them, interestingly, to a venture group in Princeton, which will very likely fund them -- fund them with a significant seven-figure amount of initial capital.

So, what I am saying is, the process is there. The mechanisms are not overly well-developed at this stage. There is a time component in that. I think time scales can probably be accelerated by what you are suggesting in this bill. I would also suggest that $2 million in the nature of what you are trying to do is absolutely insignificant.

ASSEMBLYMAN AZZOLINA: How much do you need?

MR. JENKINS: I think you are talking about at least $10 million, $15 million, or more, to have an impact. It is rare that you can get involved in an early stage business, for the first person involved in that business, for less than half a million to three-quarters of a million dollars. So, how many projects are you going to finance? I think a very limited number.

ASSEMBLYMAN AZZOLINA: Don't we have to crawl first?

MR. JENKINS: Excuse me?

ASSEMBLYMAN AZZOLINA: We have to crawl first, I think.

MR. JENKINS: Well, I think it is a worthwhile concept. I am just giving you a candid reaction here to what I see happening.

ASSEMBLYMAN AZZOLINA: Let me ask you this question: Do you think the approach taken in this bill would be incentive enough for private sector investment?

MR. JENKINS: Co-investment?

ASSEMBLYMAN AZZOLINA: Co-investment, yes. (indiscernible comment from audience) I'm sorry, they can't hear in the back. I asked if the approach taken in this bill would be incentive enough for private sector investment -- co-investment -- public and private?

MR. JENKINS: The answer to that lies in each individual project. I think the private sector is going to be attracted to a project they feel has potential, if the State is a partner with them in that process. I think everybody on the front end likes to share the risk. They certainly don't like to share the profits from the endeavor. Certainly, in a seed stage involvement, you need somebody for a partner who is going to share the risk in something that is just in the concept stage.

I think the answer to the question is yes, but I come back to the issue of, I don't think that with $2 million you are going to accomplish a lot, because I think you are limiting yourself, very dramatically, to three or four projects. This is a game of numbers. I mean, it is a statistical game. Regardless of how professional you are, the impact of the industry is very clear when you look at what their portfolios show. The average venture firm has one to two major hits out of every 10 deals they do, and they write off 30%, 40%, 50% of the transactions they get involved in.

ASSEMBLYMAN AZZOLINA: Yes, go ahead.

ASSEMBLYMAN ZIMMER: As a bank, I know you are drastically limited in the kind of equity investment you can make in your banking capacity. But you do manage, as a fiduciary, billions of dollars of investment funds. Could you not get involved in seed equity investments if the legal investment rules were modified to permit a small percentage of that large investment fund to be invested in start-up companies?

MR. JENKINS: The answer to that is, absolutely. I think the examples are numerous. The primary one I can think of would be First Chicago Venture Investors, which is probably the largest venture investor in the nation. Most of that money comes out of pension funding. We haven't, to date, because we have chosen to put the bank's own equity capital at risk in these partnerships. I think there has been a feeling that prudent-man rules have limited us in terms of taking common trust fund moneys and putting them to work in this kind of a vehicle. I think that is just a function of attitude in the bank. I tend to think that if we wanted to do it, we could probably do it today.

ASSEMBLYMAN ZIMMER: Under the current--

MR. JENKINS: Under the current rules. However, you know, there is something to be said for having those rules clarified, so that it makes one feel comfortable with the risk burden you are taking on board.

ASSEMBLYMAN ZIMMER: May I ask staff a question?

ASSEMBLYMAN AZZOLINA: Sure.

ASSEMBLYMAN ZIMMER: Have we got legislation introduced to do that -- to change the investment guidelines for private institutions managing their own deposits?

UNIDENTIFIED STAFF MEMBER: Not that I know of.

ASSEMBLYMAN AZZOLINA: Wouldn't that be Federal law, though?

ASSEMBLYMAN ZIMMER: No.

ASSEMBLYMAN AZZOLINA: No? (several members of Committee speaking at the same time)

MR. WILLIAMS: It depends on which banks.

ASSEMBLYMAN AZZOLINA: Oh, okay.

MR. JENKINS: The bank also--

ASSEMBLYMAN AZZOLINA: Well, you're not State, you're national.

MR. JENKINS: Yes, we're a national charter.

ASSEMBLYMAN AZZOLINA: So, how would they--

ASSEMBLYMAN ZIMMER: But, who governs? Aren't you governed both by Federal and State laws as far as your legal investment rules go?

MR. JENKINS: You are getting into an area where I am uncomfortable responding. I simply don't know the answers there. You know, one of the problems the banking community has in performing in both roles -- that of the venture role and that of the banking role -- is that you have a problem of equitable subordination. The courts have said, "If you are going to put equity into a company, you better strictly put equity in. Don't put debt in. If you put debt in, you're dead in a distress situation when they get qualified as equity."

You know, I guess the reason more banks are not involved is because it is very difficult to make money. You are commiting yourself to spending six, seven, eight years holding hands with a young business to try to grow it to some scale, all the time betting that you are going to be successful. So, there is a tremendous opportunity cost here. You know, it takes some real skills to be successful in this marketplace.

ASSEMBLYMAN ZIMMER: Why are you involved then at all? Is it an altruistic contribution to the general economy, or do you feel you may get lucky and get yourself a big client?

ASSEMBLYMAN AZZOLINA: He's a hungry banker. You don't see any advertising.

MR. JENKINS: I would like to put it in the category of enlightened greed. (laughter)

ASSEMBLYMAN ZIMMER: What has made America great.

MR. JENKINS: I think somebody had to stand up and present a forward role here, and we saw this as an opportunity. I think we have made pretty good progress with what we are doing. On the same hand, I can't stand up and point to a compact computer or an Apple that has come out of what we are doing. But we certainly hope that five years from now, I am going to be able to stand up and say, you know, "That is a business based in New Jersey with 1000 employees, with $100 million in turnover, that would not be here if it weren't for the range of services we are providing into this business sector."

ASSEMBLYMAN ZIMMER: When you make a loan to a company, does it include what is called "an equity kicker," that is, if the company makes good, you get warrants or other opportunities to cash in on the increased value of the equity?

MR. JENKINS: There are two answers to that question. The first answer is, historically, to date, we have. The second answer is, going forward, we will. The rationale there is that we have spent three years, and we realize how difficult it is to build up a revenue stream to justify the professional talent we have committed to the activity. There are so many risks downstream for a bank, not the least of which is that 60% of the companies that are founded never go public. They get sold to somebody else. They get sold to GTE; they get sold to 3M. If you are a bank, and your objective is to grow a long-term bank relationship, that may be truncated in the process.

So, there are a lot of issues that bear on what we are doing that may not be material to this Committee. But I think the answer in the future is yes.

ASSEMBLYMAN ZIMMER: Well, I would think that if banks can, and do, get involved with an equity investment indirectly through their lending, it might enhance the supply of loans and advice and technical assistance of a sort that your bank engages in, because there would be more of a--

MR. JENKINS: The answer there is, I think it enhances patience. It doesn't really enhance availability, because from the bank's perspective, you are making a credit judgment. You are making a business development judgment that this thing will be successful. You need something to cover that pain threshold of sitting around for seven or eight years before you know whether you were right in your decision process.

So, I would argue that it only enhances availability from the standpoint of enhancing your willingness to sit there and continue to support this business. I don't think it enhances initial availability, if that distinction is clear.

ASSEMBLYMAN AZZOLINA: If there are no more questions, we have about five or six more speakers, so we really have to move. Thanks a lot. It was very enlightening.

MR. JENKINS: Thank you very much, Assemblyman.

ASSEMBLYMAN AZZOLINA: Norma, do you have any comments you want to make?

N O R M A   L o S A V I O: I don't have testimony, but just a point of information. When George Jenkins was speaking, he said that what was needed, more than money perhaps, was a central location where people could find out where all of these services are available. In the Governor's State of the State Address, he mentioned just the same kind of thing -- a computerized list. He has given the Department of Commerce $100,000 this year to put together such a list. We have already been in the process of putting together the kind of marketing skills that a venture capital entrepreneur might need, the kinds of capitalists who are out there who are willing to put money into such ventures, banks, marketing skills. All the kinds of things that young businesses, or new businesses would need would be available in this directory.

That is the kind of thing we are doing now and building on. We just have sort of a base now, but we do have something. We are working on that now with this $100,000, to develop it more thoroughly.

ASSEMBLYMAN ZIMMER: Does the Department have a position on this legislation?

MS. LoSAVIO: Not particularly on this legislation. We are really not in favor of the State getting involved in venture capital. It is a very high risk situation. There seems to be a lot of money out there for large projects. As Mr. Jenkins mentioned, what you have in the bill isn't enough money, because each project maybe needs a million, or whatever. The need is for the very small businesses. They can't get their money because the risk is far greater than the ones which have already been nursed along and have a very good chance of succeeding. They are the ones who can get money. There is lots of venture capital money out there. It is for these very small ones; for instance, the man who has an invention which maybe he has thought up in his garage, who needs someone to help him to finance it -- to give him the seed money.

ASSEMBLYMAN AZZOLINA: Yeah, but this is where you are going to help those kinds of people. Right?

MS. LoSAVIO: Yes. However, those kinds of people take up not even 1% -- less than 1% of the small businesses. Therefore, this is a lot of money to focus on just less than 1% of the small businesses which need this kind of assistance.

ASSEMBLYMAN AZZOLINA: Why don't we save our opinions until we hear a lot of other speakers? We don't have to decide anything today.

MS. LoSAVIO: Sure. You called on me.

ASSEMBLYMAN AZZOLINA: Oh, I just called you for a quick comment. Okay, sit down. (laughter)

Next will be Robert Little, President, Southern Jersey Venture Capital Group, Mount Holly. Try to keep the questions short, and the answers short, and the comments short and to the point, so I can cover most of the people in the next 50 minutes.

R O B E R T   L I T T L E: I am Bob Little, and I would like to say that I am very, very much in favor of such a bill as this. There can be all kinds of questions raised about whether it is large enough, whether it will really create very, very viable businesses in the State, and so forth and so on. It is a start. I think we have to have it. Other states have it, and we have to be competitive -- the Benjamin Franklin group over in Philadelphia. We have to be competitive with these other states. I think it is a start. I think it should run to about $2 million a year for 10 years, or something like that. But I think those things can be worked out down the road.

As far as the management of it is concerned, there is a tremendous amount of talent in this State. A lot of this talent is available at no charge. I happen to run, and did start, the Southern New Jersey Venture Capital Group, which is a nonprofit group, to put entrepreneurs together with investors. Our membership is primarily made up of investors or people who have access to money. A lot of this is informal venture capital. There is a tremendous amount of informal venture capital within the State -- not formal.

As far as I am concerned, I think this will certainly gain a lot of publicity for the State. I think it will help some investors now who are a little bit afraid of going into a venture situation. Knowing that the State is going to put a little money in there, that will help them to get in. I am very much for the plan.

ASSEMBLYMAN AZZOLINA: Thank you very much.

ASSEMBLYMAN COLLINS: I have a question.

ASSEMBLYMAN AZZOLINA: You had to have one, because you are from South Jersey.

MR. LITTLE: By the way, I happen to have a couple of pieces of literature on this nonprofit group, which we are going to have all over the State in the next year.

ASSEMBLYMAN AZZOLINA: Look at that. It covers part of Monmouth County, too.

ASSEMBLYMAN COLLINS: That's really slighting South Jersey.

MR. LITTLE: We are going to cover the rest of the State with blue there.

ASSEMBLYMAN COLLINS: This will be a quick question: You mentioned that one of the pluses you saw with this is that with the State involved, some people may be more interested and may be a little more confident. The philosophical question is, what about the State getting involved in this with private enterprise? What is your feeling on that? Does that bother you at all?

MR. LITTLE: In combination with private enterprise?

ASSEMBLYMAN COLLINS: In combination with private enterprise.

MR. LITTLE: Very definitely. If you take the $2 million this year and you give it to a fund, say, over in Philadelphia or one of the New Jersey funds -- and there are New Jersey funds -- they could undoubtedly come up with another $6 million, so that under the law you would be at 25% invested, and you could specify that those only go into start-ups. This could be done, and in the State, and in those certain areas. You could put all kinds of things on it. Probably that could be done.

The bank won't do that. By the way, there are other banks that do have money in venture funds, but not invested in this State. They have invested in-- I mean, State banks, or banks within the State. The Bank of New Jersey has a $2 million venture fund, or partnership in a venture fund in Connecticut. They have not, to my knowledge, made any investments in this State as yet.

This money should be for this State. It should not be out of this State.

ASSEMBLYMAN AZZOLINA: I agree.

MR. LITTLE: So, we have a problem in this State. We've got to get our industry up and running. I am an ex-entrepreneur. I know it can be done. There are all kinds of opportunities. We just have to encourage the investors we have here -- the informal investors -- by showing them, I think, that the State is interested, and we will get a lot more industry going. I brought in industries from Pennsylvania in the last year or so. I am very much interested in incubators, and so forth. I think we can do it, but we have to have something like this bill to get more people interested. There are people who will serve on your committees free of charge -- excellent people. People who have been through it know that no venture that a venture fund invests in should fail, if they have put the money into it and they have used their heads deciding to put their money into it.

ASSEMBLYMAN COLLINS: Are you saying this is a no-risk operation? Are you willing to go that far?

MR. LITTLE: I think it is.

ASSEMBLYMAN COLLINS: Okay.

ASSEMBLYMAN AZZOLINA: I would like to call Mr. Ralph Klopper from Union County.

R A L P H   S.   K L O P P E R: Rather than pass out copies of my remarks, which you will hear, here are some very critical statistics published very recently by the Federal Bureau of Labor Statistics, which bear very much and strongly on this question.

First, Mr. Chairman and Committee members, let me commend this Committee for coming up with a bill and attempting to address a most severe problem with a worthwhile effort. Unfortunately, in our view, we do not see it as effective -- not nearly as effective as a different approach could be.

The manufacturing sector of businesses in New Jersey and nationally is under constant pressure, and the result has been, over the last six or seven years for sure, that manufacturing employment has declined substantially. Our manufacturing base in this State is clearly threatened. The big question is, are we going to do something meaningful about it now with the lead time that is required in programs of this nature, or are we going to lock the barn door after the horse has been stolen?

If you will just take a quick look at those statistics, there are just two main points out of that whole page, but they are very much to the point. The 21 counties in New Jersey, in the last six or seven years, have lost manufacturers. The total is almost 1000. The average employment in those manufacturing entities was 100. The jobs that have been lost in the last six or seven years totaled 100,000 jobs in that period in the State. Sixteen of the 21 counties have lost manufacturing jobs.

When you look at that allusive concept of the multiplier effect of manufacturing which, depending on which particular industry you are looking at, runs from one and a half, two, two and a half, three other jobs for each manufacturing job, you quickly appreciate the seriousness of the problem.

We feel it is of critical importance to New Jersey employment and the economy to retain manufacturers here in the State; make them resistant to the inducements that many other states are offering, which states -- some of them -- have very highly developed incentive programs, in very superior business climates. We want to help our manufacturers to expand in New Jersey, to grow and prosper. The object of it all is sustaining jobs, increasing tax ratables, certainly maintaining tax ratables, and promoting stability.

One extremely meritorious and productive means of helping to accomplish this is to make funding available to any New Jersey manufacturer, not just in targeted areas, for new products, research and development, and production and marketing. Because the focus of such a program is the smaller manufacturer who does not have the financial resources of the giants or the multinationals, the loan/investment terms have to be clearly favorable to stimulate these goals.

It is a well-documented fact that the greatest job growth has been realized in the smaller business sector, not by the multinational corporations. These additional jobs mean increased tax revenues to the State, decreased unemployment, decreased welfare costs, and, overall, a stronger and healthier economy.

One of the most clever and productive approaches -- as some of the staff know -- has been the Connecticut approach, which, incidentally, had its genesis in Great Britain after the Second World War. This has been a loan/investment payback based essentially on sales royalties which result from newly developed products. Rather than recreate the wheel with any special legislation, we can look at Connecticut, which has had an 11-year successful track record. Such a program as they have cannot be accomplished by traditional lenders in whole or in part, who have to have secured collateral. They have to have relatively quick payback. This need cannot be met by -- or hasn't been met by venture capital groups. They require large and quick percentage returns on their funding, and they will always take sizable equity positions, if not actual management positions.

In short, there is a considerable market gap in financing for new products for a great many of our New Jersey manufacturers and a program which will not jeopardize their working capital in quick loan paybacks. A legislative bill approach to accomplish this can be flexible. We are not here to recommend any specific bill. For example, initial funding can be met by either general appropriations, taxable bonding, Federal funding, whatever is most acceptable, or any combination of them.

We have a list of recommended dos and don'ts. We feel strongly that the repayments of the money advanced to these companies should be royalties on a scheduled basis -- from royalties. We feel the initial funding should be in the vicinity of $4 million. Connecticut, for example, which has a stable program, is approving somewhere between eight and twelve of these investments per year. The average is approximately $300,000. We feel this program should be oriented toward existing businesses that are established here in the State, not new start-ups. There is room for helping new start-ups, but we do not feel that should be mixed in with a program such as this.

We feel the maximum commitment of these funds should be $500,000. That $500,000 is leveraged on a 60/40 basis, with 40% coming from either the assets of the corporation -- the business -- or from other borrowed money. They have to demonstrate a probability of success as part of the application process, which would require consultants, marketing studies, financial projections. In short, the whole onus of that application and making their case would be on the borrower. The requirements of the product and facility location should be totally in New Jersey. There should be penalty clauses, and immediate due and payable clauses on the money, if any of these manufacturers, after a product has been developed, attempt to move the production of it out of the State.

We feel that the best administrative entity for this should be a quasi-public corporation, in but not of the Department of Commerce and Economic Development. It could be the Economic Development Authority, or it could be, as in Connecticut, a separate corporation. The business development plan funding should be defined by traditional or venture lenders, on comparable or affordable terms. The banks are literally awash with money today. The venture capital groups-- There is no shortage of funds. The problem is, in a situation like this, you have those statistics where the manufacturers are going out of business fast and furiously. That is in spite of the money that is available from the banks and from the venture capital groups.

We feel there should be no geographical targeting. We feel there should be no other lender requirements. We feel the program should not be narrowed by any science or technology oversight.

If I may conclude by talking specifically about the bill -- A-3282 -- we feel there is really no incentive for first-rate venture capital groups to get involved in this kind of a program. They are not there now. They don't need the

State. This bill does not do anything for them. We feel that targeting would be seriously restrictive. We have found, in studies we have done, that employment, for example -- that jobs-- There is a wide, wide radius of those jobs out from the initial area, so that although the home location of a corporation, or a business, may be in a given town, the jobs are quite a distance out.

Assembly Bill 3282 would require an ownership position, which is onerous to a number of small business owners. It would require corporate debt on their balance sheet, and it would have a definite negative effect on their working capital. The approach we recommend encourages expansion by not taking an ownership position; by getting payback from royalties of sales only. It will not add any additional debt on the balance sheet of the company, and will not decrease their working capital.

ASSEMBLYMAN AZZOLINA: Let me ask you a question: On the Connecticut -- the payback of a Connecticut corporation -- does that only cover the administrative costs, or is there extra money in there for future use -- future financing of projects?

MR. KLOPPER: Yes.

ASSEMBLYMAN AZZOLINA: Yes what?

MR. KLOPPER: Future use. Their administrative costs, after the program has been established, are covered by the payback, as well as engendering a profit, if you want to look at it that way. There is a scheduled repayment. They lose some, they win some, and the winners are accumulating capital, because the payback goes way beyond just replacing the dollars that were initially advanced.

ASSEMBLYMAN AZZOLINA: Thank you very much. I would like to call on Don Scarry.

MR. KLOPPER: Incidentally, Mr. Franklin is here from my corporation.

ASSEMBLYMAN AZZOLINA: Oh, did he want to say something?

MR. KLOPPER: I am sure he does. (Mr. Franklin replies in the negative from the audience.)

ASSEMBLYMAN AZZOLINA: Oh, okay. Don Scarry?

DONALD SCARRY: Good morning, Mr. Chairman and members of the Committee.

ASSEMBLYMAN AZZOLINA: Is he the one on TV -- Franklin? Aren't you on TV sometimes? (addressing Mr. Franklin who is in the audience) You're with Public Service, aren't you? (Mr. Franklin again replies in the negative) Oh, okay.

Go ahead, Mr. Scarry.

MR. SCARRY: My name is Don Scarry. I am with the New Jersey Business and Industry Association. You have had a lot of speakers, and all of them are better than I. All of them are more knowledgeable than I.

I want to indicate that we do support this bill, but not in this particular form. I want to do two things. First I want to tell you a little anecdote about a southern New Jersey business. I will make it as brief as possible, and then I want to talk about some of the things we have difficulty with.

I counseled a small southern New Jersey business that was comprised of two partners. They had a series of valid patents on a toothbrush that had a sponge on one end of the handle for delivering medication and things to your gums. I don't know whether this was a clever idea or not. They put about $60,000 of their own money into this business to have a model to take around to show people, to do the patent work, and to do other work. They did all the right things. They went to J&J, they went to Block Drug, they went to all kinds of people who have interests in toothbrushes -- in making toothbrushes.

They got a generally positive reception, except that at the end of the interviews everyone would say, "Well, give us half a gross of those toothbrushes, and we will put them in our testing program and get back to you." Well, they couldn't. They had a model; that is all they had. They had a little blue brush; that was all they owned. They needed about $150,000 to make a multi-cavity mold to produce these brushes. Producing the brushes was cheap. No place in New Jersey could they raise $150,000. They eventually hooked up with a venture capitalist in Richmond, Virginia, who gave them the $150,000. They gave away the store to get that $150,000. They might have had to do that in New Jersey. I am not commenting on that deal.

But, now, that little company is in Richmond, Virginia. It employs about 20 people -- minimum wage people. The brushes are made in India; they are bristled in Pennsylvania; the sponges come from Indiana; and they put them together. Okay? For $150,000, the venture capitalist called all of the shots.

One of the hopes I see in this bill is that little companies like that Burlington County company could be growing here in New Jersey. Now, I am not talking about a lot of jobs -- 20 minimum wage jobs. I understand that, but everything counts, especially in southern New Jersey -- everything.

Some problems we have with this bill, as it is written: There is no way you are going to be able to keep this kind of production in economically distressed municipalities. I don't think you are going to get any takers for the money, even if you stack all of the programs that exist to put someone in Camden or New Brunswick or Newark or someplace like that. I can see a geographic restriction to New Jersey and, in fact, if you didn't have a geographic restriction to New Jersey we would be in total opposition to the bill.

I have some problems with your definition of "primary employment." I think you are going to be saddling a new company, just at its start-up time, with one and a half times the minimum wage. "Adequate fringe benefits" -- I don't know what that is; I am not sure you do -- "including health insurance, and is not seasonal or part-time." That is a hell of a burden to take on as a brand-new company. And, in fact, southern New Jersey has a somewhat lower wage level than does northern New Jersey, and this would be more onerous in southern New Jersey than it would be in northern New Jersey.

One of the things we really like is seed capital. I would like to see this limited completely to seed capital -- no big loans. You are only talking about $2 million. Even if you double it, even if you triple it, it is still a small amount of money. I would like to see this for the business I described to you, for people who are looking for $150,000, $250,000. I am not a venture capitalist. I don't know what is a lot of money. But I would like to see this, small.

We are especially pleased that this will be in EDA, but we note that the Director of EDA is not on the group that decides on investments. I think you should have Jim Hughes on that, because he has one of the best business heads in Trenton.

ASSEMBLYMAN AZZOLINA: Take a bow.

MR. SCARRY: Pardon?

ASSEMBLYMAN AZZOLINA: I am telling him to take a bow.

MR. SCARRY: No, he has to pay me $5 now.

MR. HUGHES (speaking from audience): Well said, Don. You are going to get it.

MR. SCARRY: I have some difficulties with one of the conditions where you talk about where this money will go to a company, and you say: "Authority participation is necessary to the success of the enterprise because conventional, private funding is unavailable in the traditional capital markets" -- I think that is a clear statement -- "or because funding has been offered only on terms that would substantially hinder the success of the enterprise."

ASSEMBLYMAN AZZOLINA: What page are you on there?

MR. SCARRY: Oh, I'm sorry. It's page 4, the last item on the page. It is indented paren 2, starting at line 18. I'm sorry. "Or because funding has been offered only on terms that would substantially hinder the success of the enterprise." I don't know what that means, and I don't know how we, as a group, or any group would be able to assess that in reality. That is a very-- I think that is too vague.

Now, I have, at this point, no suggestions for improvement. If I think of one, I will communicate with the Committee Aide.

My last comment -- I am trying to be as brief as possible -- is, I don't think that $2 million is an adequate amount of money, unless you stay with very small projects. If you are thinking of any projects of reasonable sizes, I think you ought to rethink the appropriation.

Thank you for your time.

ASSEMBLYMAN AZZOLINA: Thank you very much. I would like to call on Mitchell Rabil.

M I T C H E L L R A B I L, E S Q.: Mr. Chairman, Members of the Committee--

ASSEMBLYMAN AZZOLINA: John Crosbie will be next.

MR. RABIL: --thank you very much for this invitation to speak before you on this proposed legislation. I am happy to give you the benefit of my perspective on this particular area of activity. I am in the private practice of law in Cherry Hill. I have been involved in corporate finance, taxes, and SEC matters in my practice for about 20 years in private practice.

From my perspective, I find very little seed capital out there. Most seed capital in any business venture with which I have been involved has generally come from family, friends, personal savings.

ASSEMBLYMAN AZZOLINA: That's right; I know.

MR. RABIL: There is very little of it. The banks are not interested. Large investors are not interested. Investors might be interested in a very small investment, but not a large investment, and you generally find that you have to try to put a group of people together.

I think the legislation is important, in that it makes a statement, first and foremost, with reference to where New Jersey stands in this area, and that it intends, and wants, to encourage venture capital acivity, or the start-up of new business, entrepreneurs, business activities. I think the general area of seed capial is obviously very risky, and hence you will find that is the reason very few people want to put up any sizable amount of capital.

I do think that for the State, its position is somewhat different, inasmuch as any economic activity that is generated within the State does have some kind of fallout by virtue of increased payroll, salaries, etc., particularly to the extent that your funds might be able to attract funds from another state, to increase the capital that is available. It seems to me that by virtue of the presence in at least South Jersey of Campbell Soup, RCA, and a lot of technical companies, there seems to be a number of individuals who have a lot of good ideas. We would probably be an importer of capital for people who have a lot of good business plans of their own.

So, I generally would feel that this legislation would be helpful, at least from my perspective. Whether the funds are adequate or not, at least it is a start; it is a statement.

ASSEMBLYMAN AZZOLINA: Let's see if we can get the $2 million first.

MR. RABIL: Yes, I think so.

ASSEMBLYMAN AZZOLINA: We will be lucky if we get that.

MR. RABIL: My own experience has been-- I would probably say with reference to the specific legislation, I would try to be as flexible as I could, because, really, when you are trying to make an investment, and you select the right investment, a great deal of judgment and flexibility is required insofar as any restrictions you place. I think maybe I would try to establish some major goal, and then try to be sure that the advisory board applies that goal and the accomplishment of it, rather than putting a lot of restrictions on it.

It might well be that some funds should go to the development phase of certain companies that could use the help and would continue employment in our State. But, generally speaking, there are more funds available for them than there are for that seed capital situation. There is some subsidy out there for seed capital. I put together a research and development group syndicate to invest in a start-up situation. We had to limit our funds to R&D type activity in order to enjoy the tax benefits, and therefore to obtain the subsidy we needed from the Internal Revenue Service. In a case like that, if the State were a partner and could put the funds in that were required for the marketing of that product, it would have made that project much easier and more likely to have succeeded.

I think that kind of thing must be considered on a case-by-case basis, but you need to have flexibility in your legislation to permit that kind of decision-making by the people in control of the funds.

I thank you very much for this opportunity. I will be glad to answer any questions you might have.

ASSEMBLYMAN AZZOLINA: Thank you very much, Counselor. I am afraid I have to get two more speakers up yet.

MR. RABIL: All right. Thank you.

ASSEMBLYMAN AZZOLINA: Thank you. I have John Crosbie and I have Robert Esposito. Is Robert Esposito here? (affirmative response) Okay, good. So, I have 15 minutes to divide your time.

JOHN CROSBIE: All right. I will do my best, Mr. Chairman.

ASSEMBLYMAN AZZOLINA: I will give you seven minutes.

MR. CROSBIE: Okay.

ASSEMBLYMAN AZZOLINA: Five to seven.

MR. CROSBIE: Five to seven.

ASSEMBLYMAN AZZOLINA: I may have to give Mr. Hughes a chance to wrap up; I don't know. I mean, what the hell, you got nice comments today. You're one of the best in the State, right?

MR. HUGHES (speaking from audience): I am here to listen, Mr. Chairman.

ASSEMBLYMAN AZZOLINA: Okay, let's go.

MR. CROSBIE: The reason I am here today is, the New Jersey Commission on Science and Technology was an offshoot of the Governor's own Commission on Science and Technology. I believe you have all seen the "Green Report." Within that study was a study of venture capital, and how to stimulate new capital within the State. The Task Force that we assigned to do the work on that, which was summarized in this report-- I brought a copy of the Task Force's full findings, which I will share with you and enter into the record. The reason I want to explain the Commission's point of view is, we understand what you are trying to do, and we are the agency within State government that is trying -- within the science and technology field, which is where innovation is taking place -- to stimulate capital.

Let me tell you how we are doing it, and then you can perhaps understand why we are going to have some reservations about your bill. Within this Task Force and within the guidelines set by the Governor's Commission -- and our findings have continued to confirm this -- our role should be one of stimulating the private sector. We have sought to do this through a variety of programs which are, first off, a venture match program, which I believe you heard mentioned earlier. This is a data program. It is almost like a dating service for entrepreneurs and sources of venture capital. This data base is being assembled through a grant from the Commission on Science and Technology.

We also have an entrepreneurs' forum, which includes working and retired executives who examine business plans. And then, after giving that expertise to an entrepreneur, they help to guide him to sources of venture capital. It is guided by professors at Rutgers University, and is funded by our Commission. We are also involved in incubators. I am happy to mention that one of them is in South Jersey.

ASSEMBLYMAN COLLINS: South Jersey is doing well all of a sudden.

MR. CROSBIE: Oh, yes. I like to let you know what we are doing, Assemblyman. We also have one that will be up at Stevens in Hoboken, where we are providing some funding to get going. These types of services are ones that provide incentives. The problem that comes with going with State appropriations, which is the heart of your legislation, is one that-- Venture money is patient money. You do not get a return when you put money in this year, as has been said by previous speakers. It takes a long time. The problem you have is when you go with $2 million, if you go through the appropriations process. People here have said, "Well, we need $2 million appropriated each year for the next 10 years." Next year there is a major storm along the shore. The State's resources have to go there. There is a budget deficit, and suddenly we have to make cuts. It is between whether we are going to fund the cities, or whether the money is going to go there.

When you deal from appropriations, you do not have a stable source of funding for a program that demands it. You are dealing in the investment medium. You are dealing with bankers who are going to demand this kind of security. Therefore, I urge caution when you look at an appropriations process for any kind of venture capital program.

When you look at the Connecticut Product Development Corporation, which is something this Commission is again doing-- Based on the inquiries from this Committee, and from members of the Senate who have expressed an interest in that exact same program in Connecticut, the Commission has reopened, has visited Connecticut, and is in the process of doing a study. It would be premature for me to come and say that we have decided this or that. We are very seriously, however, thinking of making a proposal to the Legislature as to how we might proceed in a similar vein. But, again, it would be premature. But, the key behind the Connecticut plan is that it deals with funding that comes through a long term, i.e., bonding. It does not come through appropriations. If you are going to get the investment community -- which you are seeking to stimulate through this legislation -- involved, you are going to have to provide that stable source of funding.

I have given a very short overview here. I could have touched on other things as well, but I am trying to respect the Committee's wishes.

ASSEMBLYMAN AZZOLINA: No, you covered a lot of meat. Any questions?

ASSEMBLYMAN COLLINS: Where is the South Jersey project?

MR. CROSBIE: It is going to be in Egg Harbor.

ASSEMBLYMAN COLLINS: That's pretty far south; that's good.

MR. CROSBIE: It is scheduled to open in September or October.

ASSEMBLYMAN COLLINS: I just didn't want it to be one of those South Jersey projects in Princeton, or--

ASSEMBLYMAN AZZOLINA: Is that an incubator facility?

MR. CROSBIE: That is correct. It was leveraged from a $30,000 grant from us to help them to get started. They will be eligible for another $60,000 grant once they get off the ground, to help them to buy equipment for all the incubator tenants. But, this is a privately run incubator. We are talking about an industrial park, where the owners were convinced that it is in their interest to provide incubator space, because the firms that spin out of an incubator become future tenants.

ASSEMBLYMAN AZZOLINA: When is your survey going to be ready on the Connecticut--

MR. CROSBIE: Again, I speak prematurely, because this is in the study phase. The next Commission meeting is April 22. It is our hope, though I cannot guarantee it, to present some recommendations for the full Commission to act on at that time.

ASSEMBLYMAN AZZOLINA: May we see the study when you get it?

MR. CROSBIE: Oh, absolutely. It will be in the form of a recommendation as well, Mr. Chairman.

ASSEMBLYMAN AZZOLINA: Thanks a lot.

MR. CROSBIE: Thank you.

ASSEMBLYMAN AZZOLINA: Okay, Mr. Esposito, from Peat, Marwick, Mitchell and Company, Princeton Pike Corporate Center -- auditors.

R O B E R T   E S P O S I T O: I have prepared a brief outline of my comments for the Committee, and I will try to get through my comments in the next seven minutes.

ASSEMBLYMAN AZZOLINA: Is there anyone else out there who wishes to speak? (no response) Since there is not, you have 10 minutes.

MR. ESPOSITO: Okay. Thank you for the opportunity to present my comments today. My primary purpose for being here today is not to speak on the pros or cons of the bill, but to share with the Committee some of the experiences that we have encountered over the last few years with growth emerging companies in New Jersey, from a different perspective, since we are a non-provider of funds.

Just a little bit of background: I have been in this business of public accounting for 11 years, primarily in the Princeton, Central Jersey, and southern New Jersey marketplace, so that most of the practice I have been experienced with has been with start-up type companies, companies with annual revenues of anywhere from zero to $25 million.

We, as a firm, have made a tremendous commitment to technology-based and growth emerging companies. We made that commitment many years ago, because we saw this as a good opportunity for us. However, I will comment that it has been a very, very difficult market. There is a lot of risk; a lot of exposure; and a lot -- as one previous speaker has mentioned -- of opportunity cost that has to be committed. Fortunately, with the resources we have available, and the number of people we have available in the State, we are able to do it, but there are many other professionals in the accounting profession in New Jersey which cannot provide that type of service at low cost to these start-up companies.

Just as a little bit of a prelude to my specific comments, we conducted a survey about a year and a half ago of entrepreneurs who had been fairly successful in growth emerging companies which had been in business in excess of five years. I just want to share with you some of the results of that survey which I think will add some perspective to your bill. First of all--

ASSEMBLYMAN AZZOLINA: Is that for this State?

MR. ESPOSITO: Pardon me?

ASSEMBLYMAN AZZOLINA: Is that for this State only?

MR. ESPOSITO: That was for the East Coast, but a good representative of those surveyed companies were in the State of New Jersey. We gave these companies a number of variables which we asked them to identify as what they consider their most primary needs. Sixty-one percent of the surveyed group said that cash management was their most important need. They also said internal control, pricing strategies, and cost reduction were important, but raising equity capital was something that they just did not feel they had the expertise, when they were starting out as a start-up company, to provide themselves. They were looking externally for that type of assistance. They were looking to the accountants, to the attorneys, to the banking community to provide that type of technical advice and networking ability.

For example, from the accountants-- They recommended that the accounting profession get more involved, with better coordination, with the bankers and the venture capitalists in the investment community, to provide them with an avenue for which they could identify capital needs. They recommended that the bankers try to be a little bit more flexible on their financing requirements for some of these start-up companies, to reduce their collateral requirements in certain situations, and to make more timely decisions with respect to lending money to them.

Just to give you a little bit of perspective as to what I am facing currently, I currently have a number of companies that we are working with that we really don't even generate any fees from. We are providing basically a gratis service to them to help them to get started with their game plan. We are noticing that there are quite a few companies that are being formed as spin-offs or divestitures of the Fortune 500 companies that are based in the State of New Jersey. With the RCA merger with GE, the divestiture of AT&T, Johnson & Johnson, and some of these major companies, we are finding teams of highly technical groups of people who are losing their identities in the restructured organizations, and are going out and forming their own new companies. They have tremendous ability with respect to the technology which they perhaps even developed for these multinational corporations, and they are trying to go out and start up their own brand-new companies. So, they have the technical expertise. In many cases, they have already developed their product, so there is not an extensive amount of research and development cost that they need to incur to go to market.

Their bigger problem is being able to present themselves, to understand the business needs of going out there and putting their best foot forward to attract the interest of the venture capital market, the banking market, and other private investment sources.

Just to give you an example, I am working with three computer software developers right now, a robotics company, two biotechnology companies, three medical instrumentation companies, two telecommunications companies, a sporting goods inventer, and two technology-based commercial instrumentation companies. These are all companies that have products that are at least 75% to 100% developed, but they cannot get to market because they do not have enough money to put a business plan together -- or a quality business plan together. They do not have enough money to print a brochure, to hire the proper marketing people, to bring this technology which they have already developed to the marketplace.

Where did they get the money to finance the development? Well, as I said, much of the technology was developed when they were part of multinational corporations, but the remainder of it comes from their own money -- the sweat equity, the seed money that came from their families. People are taking first and second mortgages, home equity loans. They are putting virtually everything they have on the line. I have one company right now that-- Every founder of that company has basically taken every dollar of equity out of his home. If this company goes down the tubes, their entire life savings are going to go down with it.

One of the questions that was asked me by the Committee was, what type of capital availability do these companies face in today's market in New Jersey? Well, we have heard from the banking community; we have heard from venture capitalists. A number of these companies are considering going public. Many of them are going prematurely, both on the U.S. markets, and there is a lot of interest in the U.K. markets. We are advising many of these start-up companies to stay away from that right now, because they tend to go prematurely, without the proper infrastructure in place to do that.

Private placement money, SPIR grants, and other government grants are what we see as the more traditional ways of looking to obtain financing, but they have not been very successful in that area. What are the reasons for the lack of these start-up companies obtaining capital? I say start-up tongue in cheek, because, like I said, most of the technology in many of these companies has already been developed, whether it be in a garage, whether it be in a previous organization. I heard one comment today from one of the speakers. I think a question was raised by the Committee to Mr. Jenkins: "What is the reason why you, as a bank, want to make an investment in these start-up companies?" I can give you one small example that I think reflects why the professional community does get involved.

About 22 years ago, there was a company that was started out of a garage up in Connecticut with some technology, that nobody would put a dime into. These individuals -- these inventers -- put their own money into it. They put $5000 into their technology, and today that company is Xerox. So, although it is a very, very small percentage of those companies that make it big, there is always that chance for the few that will.

I would like to conclude my comments by just spending a few minutes on giving my observations as to why I see there being a lack of capital, and what some suggestions might be within the State for providing help to these start-up companies. First of all, from the banking community side, the experience we see is that the banking community, in general, will not accept a high level of risk. They have a tremendous amount of pressure they receive from the Federal regulators that are coming in to audit their records. They receive a tremendous amount of pressure from senior management, which does not want to face any loan losses, and from their own shareholders. We all read in the papers everyday about banks failing and big loan write-offs, and this is the primary reason why the banking community has quoted to me, on many, many occasions, that they do not want to be the lender of first resort in start-up, risk-type ventures.

When you talk about the venture capital market, you have to look at the demand versus supply function there. I mean, the venture capital community is bombarded with business plans requests for capital. They do not have a lot of time, and they basically only allocate enough money for perhaps six to ten investments per year. Yet they might receive 1000 to 2000 business plans per year. So that means that a start-up company that cannot put, if you will, a Cadillac type business plan on their desk, will have very, very little chance of attracting any attention, unless they have a contact with an accountant, an attorney, or a banker who has made an oral and formal introduction for them.

The cost, the time commitments, the lack of resources, and the lack of a business infrastructure in a lot of these small start-up companies prevent them from being able to really get to the sources of private funding that are currently available in the State. Also, we found a tremendous amount of problem with respect to-- Companies all say they want to go public when they are just starting out, when really a more appropriate means of them financing their business might be a private placement. But it has been very difficult to find brokers in the private placement market that would be willing to invest time and money and take the risk associated with doing a private placement with some wealthy private investors for these companies.

SPIR grants is an area that would be a very, very viable way for a lot of these research-based companies to get some initial funding. However, most of these companies have minimal business backgrounds and minimal time and money to go ahead and pursue that.

I guess I will conclude my comments by just saying, obviously, funding that might be provided through a State bill would be very helpful, but I also think non-cash assistance is very critical in this process. There really is a need to provide a better line of communication. There are only a few professionals in this marketplace in New Jersey who spend time at either no cost or minimal cost, to help these start-up companies, to make the contacts, to help them write the business plans. If the State is really looking to help these start-up companies, I think they could complement any type of monetary funding with some sort of an infrastructure, some sort of a program that would provide easy access to information, easy access to the names of individuals who are out in the marketplace who could help these companies prepare the appropriate game plans to present their best foot forward.

Thank you.

ASSEMBLYMAN AZZOLINA: Thank you very much. Assemblyman Franks wants to make a couple of comments. Mr. Crosbie, I will get you back in a minute. Assemblyman Franks?

A S S E M B L Y M A N R O B E R T D. F R A N K S: Mr. Chairman, thank you very much. I will be very brief, but I couldn't help but conclude, upon listening to the deliberations this morning, Mr. Chairman, that there appears to be two unique, distinct yet compelling needs which need to be addressed in whatever legislation moves from this Committee.

One challenge that faces New Jersey is to create a climate in which new business enterprise can flourish. And to create that climate, new enterprises need start-up capital. Much of the talk around the table this morning has been, how can we make that capital available to new business ventures at the appropriate moment, and in a climate that those types of enterprises can flourish in here in New Jersey?

The second one, Mr. Chairman -- and I think this was spoken to rather eloquently by Ralph Klopper from the Union County Economic Development Corporation -- is, we live in a very fully developed State, with a very large manufacturing base. According to the chart that has been making its way around the room, my county has suffered dramatically in terms of the loss in the number of manufacturing-based jobs.

Mr. Chairman, we need to stop the hemorrhage of manufacturing job loss from New Jersey, and treat it as a priority equal to creating a climate for new business development. Those two are unique and separate and distinct needs, and I believe the efforts that the legislation developed by this Committee-- The needs to be constructed may have to run on separate paths to achieve those two unique ends. I would urge the Committee not to overlook either one of them. Both of them are compelling as they relate to the continuing economic viability of New Jersey, whether you reside in Salem County or Union County. You want to promote new business ventures, and you certainly want to retain the base we have worked so hard to achieve.

I would ask you, Mr. Chairman, not to make a mutually exclusive choice, but to make sure that those two needs are addressed by this Committee.

Thank you.

ASSEMBLYMAN AZZOLINA: The other is a much more comprehensive plan probably -- to try to retain jobs. We are losing jobs in droves.

ASSEMBLYMAN FRANKS: Absolutely.

ASSEMBLYMAN AZZOLINA: Big plants are closing down continually.

ASSEMBLYMAN COLLINS: Yeah, but at least you are starting off at a point where you have them.

ASSEMBLYMAN AZZOLINA: Oh, I agree. I say we have to get into it. Assemblyman Franks, you make a good point.

ASSEMBLYMAN FRANKS: Thank you, Mr. Chairman.

ASSEMBLYMAN AZZOLINA: Mr. Crosbie, I will give you one minute, and then we have to secure.

MR. CROSBIE: Thank you, I appreciate it. There were points made earlier regarding the SPIR program, which is a Federal program where you get Federal research money to initiate things. Under the Federal law, a certain number of Federal departments have to award a certain percentage of their R&D money to private small business.

In New Jersey, we have developed a support program. That support program ranges from helping businesses to compete for that money-- Once they get to the first stage, if they qualify under those guidelines, they get up to $10,000 a quarter for up to four quarters from us. So, this is a form of venture capital -- helping to keep these firms on their feet.

Last year, we gave $310,000 through the Commission from the Legislature to this program, and we would like to do more. We are developing programs that will help these companies compete successfully for Federal research money, because what happens is, the Phase 2 can be a half a million dollars from the Federal government to develop products. Plus, they maintain the patent rights; they don't go to the Federal government, which means businesses and jobs.

ASSEMBLYMAN AZZOLINA: Okay, thank you very much, Mr. Crosbie.

We will have to adjourn now. Thank you very much everyone. It was an excellent hearing.

(HEARING CONCLUDED)

APPENDIX

New Jersey State Legislature
ASSEMBLY ECONOMIC DEVELOPMENT
AND AGRICULTURE COMMITTEE
STATE HOUSE ANNEX, CN-068
TRENTON, NEW JERSEY 08625
TELEPHONE: (609) 984-0445

M E M O R A N D U M

March 4, 1987

TO: Members of the Assembly Economic Development and Agriculture Task Force

FROM: Gregory L. Williams

SUBJECT: State-sponsored venture capital investment programs in other states.

As of May, 1986, 21 states had established venture capital investment programs operated by public agencies or quasi public entities. Six states had initiated (through tax credits or other means) privately-operated venture capital investment funds. Most of these programs were adopted during the preceding three or four years. Generally, they have involved public expenditures of several million dollars per year, but in some cases, more.

The purpose of these programs has been to provide long term equity investments for high risk undertakings, usually small manufacturing firms in their beginning stages or small and medium sized manufacturing firms involved in major expansions, the introduction of new products, or changes of ownership. Most of the programs involve making investments through ownership interests in the firm being financed, but seven states have public or quasi public programs which invest in specific new products rather than in a company as a whole and accept commitments for royalty payments in return.

The rationale usually given for focussing attention on relatively small companies is:

1. That small growth companies have been alleged to be responsible for most net job growth in recent years,

2. That it is often unproductive to aim state government incentives at large Fortune 500 companies which may be less rooted in the local economy than small indigenous firms and more likely to relocate in search of greater incentives elsewhere, and

3. That traditional loan financing may be too burdensome to firms which are in their early stages of development and therefor in need of the "patient capital" of equity investments (It might be added that in New Jersey even if a manufacturing firm is seeking traditional loan financing for expansion, it may encounter greater than average difficulty. In 1984, the State's per capita rate of commercial and industrial loans was only 71% of the national rate, while all of the surrounding states had rates higher than the national rate, some with per capita loan rates several times greater than the national average).

Why should public resources be committed to venture capital investments when more than ten billion dollars are already available for such investments from private venture capitalists? Advocates of such programs point to the fact that nearly three quarters of all venture capital investments are made to companies located in the top four states. Tables I and II show how New Jersey compared to the leading states in venture capital resources and commitments during 1984.

TABLE I
VENTURE CAPITAL RESOURCES FOR
LEADING STATES AND NEW JERSEY, 1984

STATE	RESOURCES (in millions)	RESOURCES PER CAPITA
California	$5296	$210.38
New York	$3262	$185.64
Massachusetts	$2054	$356.16
Illinois	$863	$75.13
Connecticut	$794	$253.03
Texas	$775	$49.29
NEW JERSEY*	$285	$38.16

(*Ranks tenth)

TABLE II
VENTURE CAPITAL COMMITMENTS FOR
LEADING STATES AND NEW JERSEY, 1984

STATE	COMMITMENTS (in millions)	COMMITMENTS PER CAPITA
California	$1184.4	$46.89
New York	$639.1	$36.17
Massachusetts	$481.0	$83.41
Connecticut	$196.7	$62.68
Illinois	$144.9	$12.62
Maryland	$103.2	$23.98
NEW JERSEY*	$37.8	$5.06

(*Ranks tenth)

Proponents of a greater role for the states in venture capital activity also argue that the total volume of venture capital for the whole nation is minuscule when compared to the capital in publicly traded corporations. Only 1.2% of all U.S. corporations are publicly traded, but, in 1983, the total assets of the Fortune 500 industrials (which comprise a small fraction of that 1.2%) were $1.4 trillion compared to total assets of $13 billion for all U.S. venture capital firms and small business investment companies combined.

Of course, it may be that smaller firms, which are usually less capital-intensive, simply are not interested in or can not make effective use of more equity capital than has been available. In response to this, surveys of small businesses and start-up entrepreneurs have been conducted in various states concerning their perceptions of their need for capital investment. A recurring theme is that it is difficult to get start-up capital in the earlier stages of a business's development. Venture capitalists are alleged to almost never make investments of less than $300,000 and usually do not make investments of much under $1 million. This has been a commonly stated rationale for state support of "seed capital" investment funds. Even here, opponents of such programs argue that the businesses which can not get financing in the market probably do not merit special assistance from government.

Less evidence is available concerning "capital gaps" for more established small and middle sized companies seeking financing for new product development or expanded operations generally. In 1985, the Wisconsin state government conducted a survey of small to medium size privately held manufacturing firms with significant employment growth. From the results of the survey it was concluded that somewhat more than half of the firms had no interest in obtaining equity finance, but that more than a third of the firms felt that the cost of equity finance was either too high or involved giving up control to outsiders (these complaints have been echoed by a number of New Jersey manufacturers as well). It was recommended that a state product development corporation be created modeled on the existing Connecticut program. The Massachusetts Commission on the Future of Mature Industries recommended a similar program for that state, which already has one of the more successful seed capital programs, the Massachusetts Technology Development Corporation. But overall, most states with venture capital programs have targeted these programs more at start up companies than established firms.

Jersey lost 100,000 blue-collar jobs in six years

By DONALD WARSHAW

During the 1980s. New Jersey lost more than 100.000 factory jobs and nearly 1.000 manufacturing plants while blue-collar employment declined in all but five of the state's 21 counties. according to a study released yesterday by the federal Bureau of Labor Statistics (BLS).

A companion study by the BLS showed. however, the healthy condition of the state's overall economy has been a key factor in enabling most workers displaced by plant closings and moves. and abolishment of their jobs to find new employment.

Regional BLS Commissioner Samuel M. Ehrenhalt said with the loss of 103.262 blue-collar jobs since 1979. employment in the manufacturing sector declined to 684.262 last year—the lowest level since 1940.

There was a net loss of 964 manufacturing plants in the state during the six-year period studied. with the total declining from 14.146 in 1979 to 13.182 in 1986. the commissioner said. Many of the plant closings involved major employers. he added, including 1,700 employees laid off at the GM plant in Linden.

Twelve counties lost plants. with 985. or 84 percent, of the 1.171 plants that shut their doors or moved concentrated in five counties—Essex. Hudson. Bergen. Union and Passaic.

Nine other counties—Burlington. Ocean. Somerset. Morris. Sussex. Monmouth. Hunterdon. Gloucester and Warren—added a total of 207 plants.

The downward spiral in manufacturing came at a time when New Jersey's otherwise booming economy was adding 600,000 jobs. with tremendous growth in employment in services and the wholesale and retail trades. the commissioner said.

Ehrenhalt said that new jobs were found for some 65 percent of 139,000 workers (20 years old or older with three years or more on the job) who were displaced from January 1981 through 1986.

Another 15 percent remained unemployed but actively seeking work. while 20 percent dropped out of the labor market entirely, Ehrenhalt said.

Nationally. 64 percent of workers dislocated since 1981 have found new employment. while in neighboring New York State only 55 percent of manufacturing workers displaced since 1981 have found other jobs.

The commissioner tied New Jersey's poor factory job picture to severe declines in manufacturing in the 1981-1982 national recession. with a "brief and partial" recovery in 1983, followed by another downturn in the past two years.

"While the figures for the second half of 1986 showed some stabilization in the losses of manufacturing jobs. there certainly has been no sign of a turnaround. The broader record of the 1980s points to a massive loss of jobs that spells the loss of competitive advantage for many industries and locations throughout the state." Ehrenhalt said.

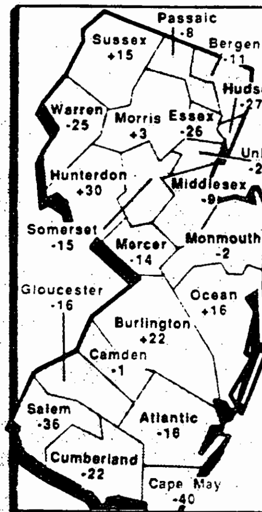
The study showed that "sharp factory job losses in the 1980s were particularly severe in the older northeastern New Jersey industrial counties and in the southern part of the state, including Cape May. Salem. Gloucester and Atlantic counties." Ehrenhalt said.

Only five counties—Hunterdon. Burlington. Ocean. Sussex and Morris—saw job growth in manufacturing since 1979.

N.J. MANUFACTURING LOSS, MARCH 1979-86

Changes in numbers of manufacturing businesses

COUNTY	CHANGE
Burlington	+53
Ocean	+41
Somerset	+27
Morris	+22
Sussex	+19
Monmouth	+16
Hunterdon	+11
Gloucester	+8
Warren	+1
Salem	-9
Cape May	-15
Cumberland	-21
Atlantic	-26
Middlesex	-28
Camden	-38
Mercer	-40
Passaic	-109
Union	-152
Bergen	-183
Hudson	-247
Essex	-294
New Jersey	*-964*



Percent changes in manufacturing employment

Star-Ledger Graphic

Essex. Union. Hudson. Warren. Cumberland. Cape May and Salem counties suffered manufacturing job losses of more than 20 percent. well above the statewide 13 percent decline. Ehrenhalt said.

Numerically. the largest cutbacks in manufacturing jobs were in Essex. down by 23.000, or 26 percent of the job base in 1979; Hudson. down 19.000. or 27 percent, and Union. which lost 19.000. or 22 percent. of its manufacturing jobs.

Cape May had the sharpest percentage decline. with the loss 751 jobs accounting for a 40 percent decline in the 1,260 factory jobs in 1979.

Salem lost 3.431 manufacturing jobs during the 1980s. or 36 percent of its 9.456 factory jobs in 1979.

Since 1979. Warren County blue collar employment fell by 4.302 to 9.952 last year. a loss of more than [illegible] percent.

Cumberland County suffered the loss of 4,052 manufacturing jobs, or [illegible] percent. of its job base since 1979 with the number of blue collar workers down to 14.397 last year.

Other counties suffering major losses included Bergen. down by 12.[illegible] jobs or 11 percent; Middlesex. down by 7.648 jobs or 9 percent: Passaic. down 5,534 or 8 percent; Mercer. down 5.[illegible] or 14 percent; Somerset. down 4.302 or 15 percent; Gloucester. down 2.457 or 16 percent. and Atlantic. down by 1.[illegible] or 16 percent.

Camden and Monmouth counties suffered minor declines. with the number of blue-collar jobs down by 464. or 1 percent, in Camden. and by 376. or 2 percent. in Monmouth.

Burlington County led those counties gaining in blue-collar employment: it added 4,410 jobs between 1979 and 1986. for an increase of 22 percent.

Hunterdon added 1,807 jobs during the six-year period. for a 30 percent increase: Morris gained 1,439 jobs. for an increase of 3 percent; Ocean added 9[illegible] jobs. up by 22 percent. and Sussex added 475 jobs. for an increase of 15 percent.

The growth areas. Ehrenhalt noted. were "typically on the fringe of metropolitan areas." suggesting a "deconcentration" in the state's factory job base.

While county-by-county employment losses and plant shutdowns were closely related. Monmouth. Somerset and Gloucester counties lost blue-collar employment while attracting additional manufacturing plants. Ehrenhalt noted

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TECHNOLOGY ENTERPRISE IN NEW JERSEY

Proposals for Public/Private Institutions to Foster New Technology-based Enterprises

The Task Force on Capital for New Technology

Morton Collins, Chairman

The Governor's Commission on Science and Technology

Edward E. Barr, Chairman

July, 1983

This Task Force report is submitted for the consideration of the Governor's Commission on Science and Technology. The findings and recommendations contained herein should not be considered the final recommendations of the Commission.

TECHNOLOGY ENTERPRISE IN NEW JERSEY

Findings

We find and hereby declare that:

- o New products and processes are the basis for development of the New Jersey economy, including development of new markets, new firms, and new industries.

- o The State of New Jersey exhibits a comparative advantage in the production of inventions, new products, and new processes, as indicated by the number of patents, technically trained people, et al.

- o Small business and new businesses are the major source of new job creation.

- o Small, new or young business enterprises are also a major source of inventions and innovations.

- o Enterprises based on new technologies grow much faster than other businesses and are the source of new industries to replace those likely to stagnate, decline, or disappear in our state.

- o Yet relatively few of the inventions and innovations generated by the state's technological base are translated into new enterprises or other commercially exploitable forms which enhance the state's economic base.

- o Furthermore, the mechanics of the private capital markets and the dynamics of our private market economy are such that many viable new business ventures go unfunded even in the best of times, while absolute shortages of venture capital may arise at other times. Thus, there is underinvestment in new enterprises which may not be attractive investors but which could eventually provide employment opportunities to the citizens of New Jersey.

We also find that:

- o There is a need to promote the development of the State's economy.

- o In this era of rapidly increasing technological progress, the development of new products, new processes, new businesses, and new job opportunities is crucial to the welfare of the State and its citizens.

- o The development of new products, processes, businesses and jobs provide the State and its municipalities with the increased tax revenues which are essential to maintaining public services.

- The rate of return of venture capital investments is, collectively, much higher than on other types of investments and, thus, the financial benefits to both the public and private sectors from promoting new ventures in New Jersey are considerable.

- The provision of financial and technical assistance to new technology-based enterprises as set forth in this proposal will assist in the creation of new products, businesses, and industry in our State, in the public interest, and for the public benefit.

Recommendations

To implement these findings, we recommend the creation of three complementary vehicles: The New Jersey Venture Capital Partnership, The New Jersey Direct Placement Fund, and a publicly-chartered technical assistance agency.

- **The New Jersey Venture Capital Partnership** will make equity investments in new technology-based companies operating in New Jersey. It will emphasize seed, start-up, and early stage financings. It will be a pooled investment fund operating under the management of a private venture capitalist. The investors will include public and private pension funds within the state, as well as other institutional investors. It will be expected to achieve investment returns competitive with other venture capital partnerships operating in the national market.

- **The New Jersey Direct Placement Fund** will make intermediate and long-term loans to growth-oriented, technology-based companies that have already established themselves in the marketplace, but which need additional capital to assure their survival and continuing growth. As with the Venture Capital Partnership, it will be a commingled fund--in this case, a direct placement separate account employing the management services of a life insurance company. [For a discussion of commingled funds, see Appendix A.]

- **The publicly-chartered technical assistance agency** will provide pre-venture development assistance to entrepreneurs and inventors. It will be a publicly-funded corporation, employing a blend of staff resources and privately-contracted venture development organizations. While it will not be constrained from charging fees for its services, it will not be expected to operate on a self-financing basis. It will provide assistance in three areas: product development, entrepreneurial development, and venture development.

Taken together, the New Jersey Venture Capital Fund and the

New Jersey Direct Placement Fund will provide an important addition to the state's existing network of financial institutions. They will accelerate the rate at which new businesses are formed in the state, as well as the rate at which existing, growth-oriented businesses are able to expand. They will also enable New Jersey to remain competitive with the growing number of states which have enacted similar programs in recent years.

In addition to providing the opportunity for a competitive rate of return on investment, both the Venture Capital Partnership and the Direct Placement Fund are structured to provide New Jersey-based institutional investors with: 1) the involvement of specialized professional investment management, 2) the opportunity to invest with private, profit-oriented co-investors, 3) an opportunity to commit only a small percentage of total assets, 4) insulation from political pressures to invest in a particular company, and 5) the ability to diversify in-state business investments.

Accordingly, the discussion of their designs is organized around the issues that are most important to their operations: investment objectives, investment guidelines, and operational structure.

As mentioned above, both vehicles are structured as commingled funds. In a commingled fund, investors place a portion of their assets in a common pool. In return, they receive a specified share of the income and capital gains on investments, along with the return of their initial paidin capital on an agreed upon basis. The pool is under the management of professional investors with skills and experience relevant to the pool's type of investing. It is because this specialization is so important to financial success that there are two pools rather than one. Each employs a managment structure appropriate to the type of investing in which it will engage. [For more information on commingled funds, see Appendix A.]

Both vehicles are structured to take advantage of relevant federal tax laws, securities and financial regulations, and state insurance and banking regulations.

Implementation. Several steps will be necessary to create these new investment vehicles.

First, a fundamental reform must be made of the statutes governing the investment of New Jersey's public pension funds. Those statutes must be revised to incorporate the tenets of modern portfolio theory, and to permit the prudence of any single investment to be gauged in the context of the role it plays in balancing the portfolio as a whole. The current method of investment regulation makes it extremely difficult for the managers of public funds to develop innovative new approaches to investment management as financial conditions change over time. [See Appendix B.]

Second, conditional commitments must be obtained from key pension funds and other institutional investors.

Third, professional managers must be selected for each of the two investment pools.

Fourth, the required legal documents must be drawn up, a formal legal offering made, and the documents executed. Only then will these vehicles become operational. The only legislative action which will be required is the reform of the investment statutes governing state and local pension funds. No state appropriation will be required for either investment vehicle. [Further details on implementation are contained later in this report.]

The publicly-chartered technical assistance agency, by contrast, will require legislative enactment, and would be funded with a direct state appropriation. As mentioned above, it will not be expected to operate in a selffinancing manner, although the use of fees and charges to defray certain expenses will be encouraged where feasable.

While these three institutions share certain common purposes, they serve very distinct functions and constituencies. Each has different operational guidelines and objectives. Each would be capitalized (or funded) in a different way. Each would be separately managed. Their structures must therefore be formally separate and distinct. Potential investors in either of the two commingled funds will demand clear assurances that the their investments will not be undermined by the operations of funds and organizations in which they are not investors.

On the other hand, these institutions are meant to complement each other. The following chart provides a rough idea of their differing roles:

The publicly-chartered technical assistance agency

- o Product development (initial screening and evaluation of new product ideas; referral services for management assistance, financing, patents and licensing; workshops for would-be entrepreneurs)
- o Entrepreneurial development (screening and evaluation)
- o Venture development (assistance developing: management teams; product strategies; sales design; cost analysis; business plan development; etc.)

New Jersey Venture Capital Fund

- o Seed capital
- o Start-up financing
- o Early-stage financing
- o Expansion financing
- o Leveraged buyouts

New Jersey Direct Placement Fund

- Longterm debt

Some of the entrepreneurs who emerge from the technical assistance agency's screening and t.a. program with an acceptable product idea, business plan and management team may be eligible for consideration by the New Jersey Venture Capital Fund (although they could not be guaranteed financing or even given a preference over more qualified applicants). Similarly, those companies that have grown beyond the capacities of the Venture Capital Fund may be eligible for and interested in financing through the Direct Placement Fund.

1.) New Jersey Venture Capital Fund

Summary: A limited partnership would be created for the purpose of venture capital investing in New Jersey. The general partner would be a professional venture capital management firm receiving both incentive compensation and a management fee; the limited partners would consist mainly of pension funds. The partnership's primary objective would be to achieve a higher rate of return than is normally achieved in public equity markets. A secondary consideration would be the contribution made by the partnership's investments to the State of New Jersey's economic development. The partnership's organizational structure would closely resemble the other professionally managed venture capital partnerships in which pension funds now invest. Each venture financing by the partnership would involve co-investment by at least one other investor.

Objective: The primary objective of the partnership would be to earn a higher rate of return than is normally achieved in public equity markets. The partnership would seek returns competitive with other professional venture capital investors now operating in the national market. Normally, such returns would be achieved by taking an equity position in technology firms with unusual development potential.

Within the context of pursuing a superior return, the partnership would contribute to New Jersey's economic development by financing growth-oriented, technology-based enterprises. It would make a significant contribution to the net capital available for firms promising major job and income generation in the state.

General Investment Guidelines: The partnership would take equity positions in a carefully selected and diversified group of New Jersey businesses. Typically, these companies would be in the earlier stages of corporate development and would be developing new technology-based products, processes or services.

Although a strong emphasis would be placed on seed, start-up, and early stage financings, partnership investments would include all the following categories:

- Financing for product development, for initial marketing, and initiating commercial marketing and sales.
- Financing for enterprises that have recently passed through the above stage and need capital for continued growth of production and marketing capacity.
- Financing to enable operating management (or other parties) to purchase a division of a larger company or closely-held business for the purpose of more dynamic growth.

Concentration in any single industry, sector or geographic area within New Jersey would be avoided.

The form of investment used by the partnership would vary. Common stock, preferred stock and debt with equity participation would all be used. Investments would be long-term in nature, with only a modest current yield. The vast majority of returns would be achieved only through the realization of capital gains. The partnership's holdings would normally be private placements, but each investment would have a mechanism to allow the partnership to ultimately realize its gains.

Investees would have to be technology-based companies situated in New Jersey or companies whose operations would directly contribute to commerce and employment within the high technology sector of the New Jersey economy.

Additional investment guidelines would be developed in conjunction with the general partner and potential limited partners.

Limited Partners: As is customary in such partnerships, the limited partners would provide about 99% of the partnership's capital. Total capitalization of the partnership would initially be in the vicinity of $75 million. The limited partners would primarily be public and private pension funds in New Jersey. Each participating pension fund would normally commit less than one percent of its assets to the partnership. Banks, insurance companies, and other qualified investors might participate as well. The contributions of each limited partner would be drawn down by the partnership over a two to three year period.

In exchange for their limited liability, limited partners would forego an active role in the operations and decisions of the partnership. They would retain the right to terminate their participation at the end of 10 years. A qualified investment advisory committee would be formed to represent the interests of the limited partners. It would periodically review the operations of the partnership and report back to the limited partners.

General Partner: A professional venture capital management organization would serve as general partner and be responsible for all investment and management decisions of the partnership. The general partner would search out, evaluate, negotiate and closely supervise all investments. The general partner would operate an office in New Jersey to conduct the investment operations of the partnership. The general partner would receive as compensation both an annual management fee and an incentive participation in returns.

Co-investors: The partnership agreement would include a requirement that each of the partnership's venture financings include some minimum co-participation by at least one other investor. The co-investor would normally be at least one other professionally managed venture capital pool; it would take a minority participation. Co-investment would further ensure that sound investments are made on behalf of the partnership.

2.) New Jersey Direct Placement Fund

Summary. A separate account for pension fund investors will be established under the management of a qualified life insurance company. This account will be known as The New Jersey Direct Placement Fund. The fund will make competitively priced, intermediate and long-term private placement loans to technology-based companies in New Jersey. The primary objective of the fund will be to achieve a superior rate of return for the participating pension funds; secondarily, it will attempt to contribute to the development of New Jersey's high technology companies. Each loan will have a minority co-participation, either from another account of the insurance company or another financial institution.

Objectives. The primary objective of the fund will be to earn a rate of return superior to that available on higher grade, similar maturity, publicly-traded bonds. The fund will seek returns competitive with other private placement accounts and will command competitive liquidity, risk and other premiums in its lending.

Within the context of earning a superior return, the fund will contribute to the preservation, expansion and modernization of technology-based New Jersey businesses. It will increase the availability of longer term and fixed-rate debt financing for the plant, equipment and working capital needs of medium-sized technology-based firms in the state.

Like the venture capital partnership, the direct placement fund has two separate but complementary objectives. For the same basic legal and practical reasons, the financial objective is primary.

The financial objective is defined in relation to a public bond benchmark. In making loans on a private placement basis--which precludes easy resale to other investors--the fund's investors will be bearing illiquidity. In addition, since the loans are to companies of medium credit quality, the pension funds will be bearing at least a moderate amount of additional credit risk. The appropriate return objective is a total return in excess of what could be obtained in similar maturity, higher quality, publicly traded bonds--the major traditional alternative to private placements in the fixed income category. Pension funds investing in a separate account which did not seek this superior rate of return would be conceding earnings that they could otherwise obtain in the marketplace and would thereby violate their fiduciary obligations.

In order to insure that no concession is being made simply to make a loan in New Jersey, a specific test will be applied to each financing. The loan must offer the same premiums that a loan with the equivalent features in the national market would offer.

As with the venture capital partnership, the development finance objective of this direct placement fund is to help technology-based New Jersey businesses obtain the capital they need to reach maximum growth potential. Long-term debt financing will be provided for plant, equipment, and working capital. The private placement fund differs from the venture capital limited partnership in that it will be providing:

- Debt capital (rather than equity).
- Capital to firms with a longer track record and of a larger size than the typical venture capital investee (but still moderate to medium-sized companies).
- Capital to firms more likely to be representative of existing industrial sectors important to the New Jersey economy.

General Investment Guidelines. The account will provide debt financings with the following characteristics.

- Loans will only be made for uses of funds within New Jersey.
- The maximum maturity of financings will range from ten to fifteen years.
- Loans will generally carry a fixed interest rate, and in some cases may be supplemented with equity participation features.
- Credit quality of borrowers will span the "A," " BAA," and "BA" categories, with an emphasis on the latter two ratings.
- Loans will typically range from $500,000 to $3 million in principal amount. Borrowing companies will typically have between $5 million and $30 million in assets.
- Loans will be used for plant, equipment or working capital financing, and will be secured or unsecured as appropriate.
- Loans primarily will be to technology-based manufacturing companies. Suitable diversification will be maintained with regard to industries and companies represented.

The purpose of these investment guidelines is to balance the desire to reach an underserved borrower market with the need to maintain prudent levels of maturity, credit standing and transaction/management costs.

For firms of certain size with high credit ratings, the debt markets function well, even for long-term borrowing. Consequently, this separate account should focus on firms which are not high grade credits, are not so large that they have general access to the public bond market, are not primarily borrowing for short term uses, and are not able or willing to accept a variable interest rate arrangement. The investment guidelines relating to maximum maturity, interest rate, credit quality and loan and borrower size are meant to focus the account's lending activity on companies falling outside these categories.

At the same time, the guidelines are designed to keep risk and management costs within a level that can be sufficiently

15X

compensated by interest rate premiums. The guidelines do not permit 20 to 30 year maturities (where interest rate risk can become unmanageable), nor low grade credits where companies are experiencing financial distress and loans would be highly speculative, nor truly small companies where the cost of loan origination and servicing would be too high.

The majority of private placements by life insurance companies already fall into the medium credit category (generally "BAA"), but this fund will have an even greater representation of "BAA" and "BA" credits. In terms of loan and borrower size, the account will be dealing with significantly smaller size loans and companies than the insurance company average. In addition, its loans will have considerably longer final maturities than typical current insurance company loans and will offer a fixed interest rate, which has not been typical in recent years.

With respect to the longer final maturity and the fixed interest rate, the fund's placements will more closely resemble the types of loans insurance companies were making before they had to re-orient their portfolios due to cash flow problems. (The ten to fifteen year upper limit on final maturities for this account is a partial reflection of these same concerns about excessively long maturities, since traditionally a long maturity loan by a pension fund would have been twenty to thirty years. Also, average principal payback will be less than the final maturities due to amortization requirements.)

As presently written, the guidelines would permit loans for plant, equipment or working capital uses. These are the traditional purposes for which companies use medium to long term debt. Loans could be limited to plant and equipment purposes, where the development impact is more straightforward and the in-state use of funds more identifiable, but working capital loans are often critical to the expansion of aggressive, growing manufacturing firms. These loans will be secured or unsecured senior notes, depending on several factors, including the use of funds, the financial condition of the firm, etc. However, even though some loans will be secured, the fund is intended to be primarily a credit-oriented lender, looking more at the company's overall prospects than simply at the liquidation value of its assets.

Loans will be made primarily to technology-based manufacturing companies. The rationale for this preference is that such companies are more likely to overlap with the objectives of the fund: it is in manufacturing companies where the availability of long term capital is most crucial to competitiveness and growth, and where employment impact is likely to be most direct, as opposed to in the financial or utility sectors, for example. Within the broad universe of manufacturing firms, only technology-based companies would be eligible.

Additional investment guidelines will be developed in conjunction with the managing insurance company and participating pension funds.

Management. The fund will be under the management of a life insurance company with demonstrated experience and competence in private placement lending. This company will provide identification, evaluation, selection, negotiation and monitoring of all loans. The managing insurance company will receive a fee based on a percentage of assets in the fund. This fee will be deducted from the income passed through to the participating pension funds.

The insurance company will be selected on the basis of experience and competency in direct placement lending of the type this separate account will do, competitiveness of fees, and ability to operate in the New Jersey market. The selection will be made by an ad hoc committee including representatives of the likely major investors and designees of the state.

Placing this loan pool under the umbrella of a life insurance company will provide strong professional management, as well as insulation from improper political pressures. Life insurance companies are also the most capable, experienced managers for this type of financing. A separate account represents a pool of assets "separate" from the general portfolio of the insurance company and managed for a specific client (or set of clients). There is a legal contract between the insurance company and each pension fund participating in the account, technically known as a variable annuity contract, which outlines the policies of the account.

Activities of the manager. Lending functions will be performed by the commercial and industrial loan department of the insurance company, the unit which is responsible for the private placement loans made by the general account and other separate accounts. It is unlikely that an office would need to be set up in New Jersey to originate the loans, even if an out-of-state insurance company is selected as manager. Either an in-state or out-of-state company would rely on both a network of existing "finders" (including investment bankers, commercial banks, accountants, etc.) and their own direct efforts at "beating the bushes" to identify loan opportunities.

Management fee. The management fee charged annually by the insurance company would be about .5% to 1.0% of the fund's net asset value. It will vary depending on the size of the fund and the size of the typical loan. The lower the average size of the loans targeted, the higher the management costs. This will not necessarily affect the net return to the participating funds however, since these costs will, in principle, be passed on to the borrower.

Selection of the manager. The selection of a competent and experienced insurance company will be critical to the fund's financial and development success. Like the venture capital partnership, the insurance company will be chosen by an ad hoc panel consisting of representatives from the pension funds likely to participate and designees of the state.

Investors in the fund. Participants in the fund will be New Jersey pension funds, primarily state and local retirement funds and jointly-trusteed private pension funds. Each individual fund will typically be committing less than one percent of its assets to the fund.

The fund will resemble a closed-end pool. After some period for initial capital commitments, it will be closed to new commitments. New commitments could be accepted into an additional fund or other provisions could be made for the fund's refunding or growth. Liquidation of participating funds' investments will occur as principal and interest payments received by the fund are passed through to them on a pro rata basis. Options for the reinvestment of this money, either in this account or in a new, similar fund, could also be offered.

A qualified advisory committee will be formed to represent the interests of the participating pension funds. It will review the operations of the fund on a periodic basis and report to participating pension funds.

Pension funds and other institutional investors will be the source of all of the fund's capital. They will be passive investors, with the fund's managers having sole discretion in investment decisions. It seems likely that the bulk of the capital will be provided by a small group of pension funds making relatively larger commitments and an additional number of funds making smaller commitments.

Size of fund. The minimum size of this fund should be in the $50 million range. This is where good diversification can start to be achieved, where economies of scale in management costs will come into play, and where a competent insurance company lender can be attracted to manage the account. Private placement lenders differ on the issue of appropriate minimum size, according to their views of how much it would cost to run the fund, how large the average loan would be, how much effort would be involved in identifying loan opportunities, and so on. The maximum size of this fund is probably of more theoretical than practical interest. Given the potentially large number of firms in New Jersey who would justifiably be eligible for financing from this fund, it is the interest of pension fund investors that will likely determine the real upper limit. A reasonable target capitalization for the fund would be $75 million to $100 million.

Closed-end versus open-end structure. The fund cannot be a straightforward, open-end account for two reasons. First, there is no certainty that there will be a sufficiently even inflow of new investors. Second, the insurance company would not be willing to provide a source of funds to take-out to investors who want to leave. Also, an open-end structure requires the portfolio to be market-valued periodically to determine the price for which the units in the fund should be sold. This adds to the costs and complexity of the fund. The open-end structure should not be ruled out completely, however, since it gives at least potential liquidity to the investors and provides for the inflow of new contributions in the account. There might be an option to convert the fund into an open-end account at some future date.

Accountability of the manager. The accountability of the manager will be provided for in a manner similar to the venture capital limited partnership. The fund contract can be terminated if the manager does not adhere to the provisions of the agreement. In addition, there will be an advisory committee similar to the one for the venture capital partnership. One of its chief activities will be to review the loan portfolio periodically to make sure loans are consistent with the agreed investment guidelines.

Co-investment. Either the general account of the managing insurance company, another of its separate accounts, or another major financial institution will take a minority participation in each of the fund's loans. This will further guarantee that sound and competitively priced loans are made on behalf of the account.

Co-participation will help assure that bad loans are not being "dumped" onto this separate account fund and that the terms of its loans are competitive. Co-participation will also increase the amount of new money made available as a result of the account's creation. The most likely co-participant will be the managing insurance company's general account. Insurance companies appear to be willing either to take 15% to 25% of each loan for their general account or to find another co-participant for that loan (such as one of their other separate accounts).

3.) Implementing Recommendations Concerning The New Jersey Venture Capital Fund and The New Jersey Direct Placement Fund.

Three steps remain before these designs can be turned into actual operating investment vehicles.

- Conditional commitments to participate must be obtained from the state's key pension funds.
- Management organizations must be selected for each of the two vehicles.
- Legal documents must be drawn up, follow-up marketing with pension funds pursued, and legal agreements executed.

Obtain conditional commitments from key pension funds. The designs of the two vehicles have been worked out in sufficient detail to begin gathering conditional commitments to participate from key pension funds. These pledges would be conditional in two senses: 1) no formal securities offering would be made to the funds at that time; and 2) it would be understood that their formal and binding commitment could hinge on information not yet available.

These conditional pledges must be obtained before selecting the general partner for the venture partnership and the insurance company for the separate account. Major potential investors will want to have a role in the selection of pool managers. Having the funds first make a commitment will draw them into the selection process, help indicate whether a sufficient number of funds are willing to participate, and bring out any changes or additions that might be needed in the vehicles' design. Moreover, potential managers will take the selection process more seriously if these pledges have been obtained.

Initially, this effort will focus upon discussions with the largest funds with potential for participating. In particular, this should include the major state pension funds, given their large size and the commonality of interests between their cont-ibutors and beneficiaries and the goals of these vehicles. In addition, smaller public and jointly-trusteed funds would be more likely to participate if the major state funds were major investors in the two vehicles. Other good candidates include public utilities and other corporations whose operations are significantly affected by the New Jersey economy.

Select managers for the two vehicles. Once a sufficient number of conditional commitments have been obtained, the manager selection process would begin. There are two management organizations which have to be chosen, the general partner for the venture capital limited partnership and the insurance company for the private placement separate account.

The initial step would be to form two ad hoc panels (under the sponsorship of some state agency or office) which would be responsible for making the selections. The two panels would correspond to the two vehicles, and would include representatives of the likely major investors and designees of the state. (If there was sufficient overlap between the investor groups, then one panel might be able to deal with both selections.) Those pension funds who were going to be funding the largest percentages of the vehicle would have preference in sitting on the panel, and there should be an effort to include funds which were representative of key categories. State government designees should include people with both financial expertise and interest in (and knowledge of) New Jersey economic development issues.

Each panel would agree to a request for proposals. The RFP would include a basic description of the vehicle, the requirements which will be placed on the manager, and the selection criteria. The RFP would be circulated widely to insure fairness. Based on the information submitted by the potential managers and follow-up research, a group of finalists would be chosen. These finalists would be interviewed and a selection made by each panel.

Selection criteria would include:

- o The experience of the organization in making the proposed types of investments.
- o The quality of their personnel.
- o Fees and compensation demanded.
- o Sensitivity to the development objective.
- o A commitment to co-invest.
- o The ability to operate in the New Jersey market.

All else equal, a New Jersey-based organization would be preferable. However, the factors listed above should take precedence over location in the selection process.

Formal establishment of the vehicles. Once the venture capital general partner and insurance company have been chosen, most of the responsibility will shift to them for completing the steps to formal establishment of the respective vehicles. The main steps are drawing up of documents, formally offering the investment to the pension funds, and execution of legal agreements. Advisory letters might also have to be obtained from the U.S. Department of Labor if there are any unresolved ERISA issues.

The primary role of the state at this point would be to monitor this process and to assist in the formal marketing of the two vehicles. This marketing assistance could be especially important.

4.) The publicly-chartered technical assistance agency

The primary objectives of this agency will be to:

- Screen new product ideas, preferably in the high-technology area, for possible funding by privately operated venture capital mechanisms, including the New Jersey Venture Capital Partnership.

- Provide, in response to the submission of new ideas, feedback to assist the submitter to promote further his/her idea.

- To develop and maintain a data bank, at least partially computerized, to enable ready access to the kinds of information needed by those coming to the corporation for assistance.

- To provide brokering, referral and networking assistance to entrepreneurs to improve their access to relevant resources outside the corporation, such as university resources, venture capital firms, banks, lawyers, accountants, etc.

- To sponsor workshops to help identify, encourage, screen, and train potential entrepreneurs.

- To sponsor workshops on other specialized topics of value to entrepreneurs as needed (e.g., new product development, venture capital financing, preparation of business plans, patent and licensing procedures.)

- To provide entrepreneurs and inventors in the State of New Jersey with a reliable source of objective review of new product, process, of business ideas.

Structure. The agency will be a publicly-chartered development corporation subject to the laws which govern other public corporations in New Jersey.

The agency will be governed by a board of seven (7) directors appointed by the governor. All of these directors will have extensive professional experience in one or more of the following areas: 1) technological innovation, 2) small business development, 3) legal aspects of new venture creation, 4) patents or licensing of new technology, 5) new product development, 6) the lending operations of commercial banking, 7) the marketing of technology-based products. One of these directors will be appointed Chairman of the Board by the governor. The Commissioner of Commerce and the Chancellor of Higher Education shall serve as ex-officio members of the Board. The initial appointees to the board will serve irregular terms. Two shall be appointed for two years, two for three years, and two for four years. The Chairman shall serve at the pleasure of the governor. All directors, including the chairman, will be eligible for reappointment.

The board will appoint a president to administer the corporation. The president will serve at the pleasure of the board and will receive such compensation as is determined by the board. The president will be solely responsible for the selection of staff. The employment of staff will not be subject to the state's administrative code or subject to the supervision or control of any board, bureau, department or other agency of the state.

The agency will be subject to sunset review after ten years of operations: Unless its charter is extended by the legislature, the corporation will be dissolved and any funds remaining under its control will be returned to the State Treasury. It will be free to adopt, amend, and repeal bylaws for the conduct of its affairs. The powers of the corporation will be vested in and will be exercised by the board of directors. A quorum will consist of five (5) members of the board. A majority vote of those present will be necessary for approval of any actions taken by the board.

Funding. The agency's funding (via legislative appropriations) would be gradually "phased-in" over three years. In year one, \$150,000; in year two, \$225,000; in year three (and subsequent years), \$300,000. It is unlikely that more than this amount could be efficiently spent. Indeed, giving the agency "too much" money at an early point in its life might be a danger to the development and implementation of an effective business and management plan. However, should the agency establish effective contractual relationships with university technical personnel or with private venture development organizations, higher levels of funding might be appropriate.

Any program concerned with new business creation must face a fundamental fact of economic life: most new businesses fail. Usually, these failures are attributable to poor management (we are not all cut out to be entrepreneurs) and/or improper debt/equity ratios. To some extent, these and other causes of new business failure can be ameliorated through programs such as this one. But they can never be eliminated entirely. Hence it is important that the agency be insulated from political pressures: the program must be able to tolerate the number of "failures" (or non-success stories) that is associated with the high risk business of starting new firms.

In all likelihood, some of the agency's clients will go nowhere, some will be modest successes, and a few will become genuinely significant contributors to the state economy. The fact that most agency clients fail to produce an Apple Computer Corporation should not be used to justify attacks on the program's importance. Nor should the fact that it will take time for the agency to produce measurable results.

This brings up a very important point. To the extent to which the agency is dependent on annual appropriations for its operating capital, it may be less inclined to take the type and number of risks that are needed to run an effective program. An alternative method of funding the agency which might alleviate this problem would be to capitalize the agency with a single $5 million state appropriation. This money could then be invested in high-yielding, short-term government securities and money market certificates. To the extent possible, the corporation's operations would be financed out of the income from this capital. From time to time, and with the approval of the governor, the corporation would be permitted to draw upon its capital for a share of operating expenses.

Functions. The agency will provide several types of assistance to would-be entrepreneurs:

- **Product development.** Initial screening and evaluation of new product ideas; providing access to information on similar products or technologies; providing referral services for non-corporation resources in such areas as management, venture financing, patenting and licensing (universities, accountants, management assistance firms, lawyers, venture capital firms, banks, etc.). Workshops will be conducted throughout the state, and university management assistance programs will be employed where appropriate.

- **Entrepreneurial development.** Through workshops and other forums, the corporation will attempt to identify entrepreneurs with the capability and drive to succeed in developing a new business. After an initial screening, the corporation's staff and appropriate consultants will sponsor intensive workshops to ascertain whether any of the participants have an appropriate combination of business management skills and entrepreneurial characteristics. Those participants who emerge from this selection process will be eligible for more intensive assistance in the venture development process.

- **Venture development.** General counsel in all the following areas: assembling management teams; devising basic product strategies; choosing an appropriate sales method; cost analysis (for both pricing decisions and profitability monitoring); production and delivery problems; negotiating and structuring financing; technology or product transfer; business plan development.

Thus, two very different forms of assistance will be provided. The first type is inherently more limited. It is passive. It offers virtually the same type of service to anyone who requests it. Virtually anyone is eligible. (The only deterrent would be the imposition of some moderate fee--in the range of $100--to keep away those without serious development potential.)

The second form of assistance is activist in nature: It seeks out people with entrepreneurial abilities, and attempts to assist them to develop appropriate business strategies. It is extremely expensive to develop a business plan (or to provide any other form of venture assistance), and before "investing" in an entrepreneur, the corporation should be confident that the individual has the capacity and drive to succeed in business. (Most people do not have the ability to become successful entrepreneurs, particularly in the high technology field, and scarce public dollars should not be expended in a futile effort to turn them into entrepreneurs.)

It is this second type of assistance which will help to prepare inventors and other potential entrepreneurs to approach private venture financing groups, by ensuring that they meet certain minimal requirements (business plan, management team, etc.).

Staffing. The agency's professional staff will consist of individuals with extensive experience in technology-based product evaluation, patenting and licensing procedures, small business management, accounting, and financial management. The agency will establish regular consulting arrangements with scientists and others working within the state's public and private universities to aid in product evaluation. In addition, the corporation will supplement its regular staff by regularly employing venture development organizations with extensive experience in entrepreneurial selection and development. The agency will not attempt to construct a permanent professional staff which is capable of providing all forms of technical assistance. Neither the hiring and compensation of professional staff nor the selection and compensation of consultants will be subject to the state's administrative code or civil service procedures. However, all consultant contracts will be reviewed and evaluated annually by the agency's board of directors.

Accountability. The agency be accountable to the legislature for the fulfillment of its public purpose. Because it is to be funded by the taxpayers through a legislative appropriation, the legislature has an obligation to see that its operations adhere to certain standards, and are appropriate to the concept of public purpose. The governor and the legislature should receive annual reports on the corporation's progress.

Implementation. Implementation of this recommendation will entail several steps.

First, appropriate legislation must be drawn up and enacted, and initial appropriations must be made. The agency must be reconstituted as a public corporation.

Second, a board of directors must be appointed, a chairman of the board designated, and a president selected.

Third, a detailed and specific business and management plan for the agency's first three years should be developed. It should be subject to review, modification and approval by the board of directors.

Fourth, on the basis of this management plan, the president should begin to recruit staff, establish contractual relationships with private consultants and venture development firms, and constitute whatever technical advisory groups are called for under the business plan.

APPENDIX A

Reform of investment statutes governing public pension fund assets

The current method of regulating New Jersey's public pension funds--far from guaranteeing their prudent allocation--is, on the contrary, inhibiting their effective management by enforcing an antiquated framework for investment which is unduly restrictive, particularly concerning the type of eligible investments.

New Jersey should adopt investment regulations similar to those governing the investment of private pension funds under ERISA. The ERISA language offers several advantages. It recognizes that pension funds are unique in the long-term nature of their liabilities, in their frequently substantial size, and in their opportunity for professional investment management. Accordingly, it includes in its concept of prudence a responsiveness to plan characteristics, tolerance for risk, liquidity needs, funding status, funding objectives, and so on. It also emphasizes, crucially, that individual investments should be evaluated on the basis of the role they play in the portfolio as a whole. Thus, an investment which might appear relatively risky in isolation can make an important contribution to the diversification of assets, or set a proper overall balance within the portfolio between the opportunity for gain and the need for safety.

The managers of New Jersey's public pension funds should be required to consider:

- o The composition of the portfolio as a whole with regard to the diversification of risk.
- o The volatility of the whole pension portfolio with regard to the general movements in stock prices.
- o The liquidity of the whole pension portfolio relative to the payment schedule for retirement benefits.
- o The projected return of the whole portfolio relative to the funding objectives of the pension plan.
- o The prevailing and projected economic conditions of the entity in which the plan proposes to invest.

This contrast strongly with the now antiquated common law approach of evaluating the "reasonableness" of each investment in isolation from the rest of the portfolio.

One of the many benefits of modern portfolio management techniques is that they permit a pension fund to balance a small percentage of higher risk investments against more conservative holdings.

For example, based on the historical systematic (nondiversifiable) risk of each investment type, the following to portfolios have an equal degree of risk:

<u>Traditional</u> <u>Portfolio</u>
- NYSE stocks (25%)
- Long-term corporate bonds (50%)
- Treasury bonds (25%)

<u>Development</u> <u>Portfolio</u>
- Venture capital (2.5%)
- OTC stocks (2.5%)
- NYSE stocks (17%)
- Long-term corporate bonds (53%)
- Treasury bonds (25%)

APPENDIX B

The Commingled Fund

In a commingled fund, investors place a portion of their assets in a common pool. In return, they receive a specified share of the income and capital gains on the investments, along with the return of their initial paid-in capital on an agreed upon basis. The pool is under the management of professional investors with skills and experience relevant to the pool's type of investing.

A commingled fund can be established under a variety of legal structures, with each linked to different kinds of investment management organizations. Specific types of commingled funds have evolved which make sense for pension funds given federal tax, securities and financial regulations, and state insurance and banking regulations. These provide pass-through of all tax consequences, exemption from federal and state securities law (in most cases), and limited liability. Thus banks use what are called common trust funds, insurance companies use pooled separate accounts, and private venture capital and real estate management firms use limited partnerships.

As a pension fund investment vehicle, a commingled fund provides four kinds of assistance:

- **Cost-sharing.** It provides a means of sharing the cost of specialized investment management with other investors. Commingled funds normally free the investing pension fund from any responsibility for investment identification, evaluation, selection, negotiation, and monitoring. Participating pension funds must still make sure that the fund is being managed in line with the investment agreement.
- **Diversification.** It provides improved opportunities for diversification. With the limited amount of capital available to it, a single pension fund operating by itself--but interested in making certain types of investments--might only be able to do five financings. But by participating equally with four other interested investors in a commingled fund, it could have a one-fifth share in twenty-five financings.
- Small percentage of portfolio assets. It makes it feasible for a participating pension fund to place a relatively small percentage of assets in higher risk investments while still maintaining overall portfolio risk at a proper level.
- Co-investment. It makes it easier to obtain co-investment on a deal-by-deal basis. The firm managing the fund could itself be a co-investor or could use its network of financial contacts to secure the participation of outside co-investors.

As the absolute dollar commitment which a pension fund is willing to make for a particular type of investment grows smaller, all of these features will, as a general rule, grow more attractive.

Because there are so many examples of commingled funds, it will be most useful to focus on the two types most relevant to development investing: 1) the limited partnership for venture capital investing, such as those under the management of Golder, Thoma or Menlo Associates; and 2) the pooled separate account for direct placement lending, such as the Prudential's Privest Account.

The limited partnership has become the preferred approach for pension funds interested in venture capital investing. Pension funds participate by purchasing limited partnership interests in the pool. As in a corporation, the liability of the limited partners is restricted to the amount of money each contributes at the start. As in a partnership, however, all tax obligations and benefits pass through to the individual investors with no tax obligation at a corporate level.

Because it is so easy to provide special performance incentives in the form of a share of capital gains, the limited partnership has been effective in attracting skilled investment managers to act as the general partners and be responsible for day-to-day investment decisionmaking. The abilities of the general partner are crucial to the performance of the partnership. In most limited partnerships the general partners have extensive experience in evaluating potential ventures, structuring deals, monitoring investee performance, and providing management assistance.

The initial partnership agreement specifies the types of investments, diversification requirements, compensation of the general partner, allocation of gains and losses among the partners, the authority of the limited partners, and how the partnership will be liquidated. To qualify as a limited partnership, it must have a predetermined liquidation date, which is usually ten years.

Recently initiated partnerships are starting out with between \$10 million and \$75 million in capital. Most restrict the number of limited partners to fourteen--the result of certain legal interpretations--and there are two to five general partners. Each limited partner will usually contribute at least \$1 million.

Once the limited partners have made capital commitments to the pool and all legal documents have been signed, the venture investment process begins. The limited partners typically pay in 25% of their commitments at the start, adding 25% each subsequent year for three years. Money is drawn from the pool's accounts--usually money market-type assets--as investments are made. Management fees are about 2.5% of assets annually. More significant is the "incentive fee" to the general partner. These parties contribute only 1% to 1.5% of the initial capital but receive 20% of the capital gains and income (after the limited partners have earned back their initial investments).

Pension funds and other fiduciary investors have been the major source of capital for limited partnerships for some time. For example, during 1979-1981, pension funds supplied 30% of new capital commitments to these pools, insurance companies 13%, and endowments and foundations 12%. The remainder came from corporations, individuals, and foreign investors.

More recently, however, public pension funds have begun to take a much more active role in venture capital investing. The Minneapolis Employees Retirement Fund recently invested in the Minnesota Seed Capital Fund, a vehicle providing start-up financing for the state's high technology companies. The State of Washington has made a several million dollar commitment of funds under management to a venture capital pool. And three public funds in Ohio have committed more than $15 million to a venture capital limited partnership that will make the vast majority of its investments in Ohio-based companies.

The investment vehicle of choice for pension funds wanting to participate in private placement corporate debt financings has been the insurance company separate account. Separate accounts are specific portfolios of investments managed under contract to pension funds and other qualified investors. The money in these accounts is managed according to an investment policy agreed upon by the account holders and the insurance company. The return to the pension fund varies directly with the income and value of the separate account's assets.

Separate accounts can be either "pooled" or "single customer." In a pooled account, several pension funds contribute money in return for a proportionate share of any returns. With a single-customer account, the investment policy is tailored to the needs and wishes of a particular account holder.

Several billion dollars of pension money is currently managed in commingled separate accounts devoted to private placements. The largest of these is the Prudential Insurance Company's PRIVEST account. PRIVEST is managed by Prudential's Bond and Commercial Loan Department, which also manages their general account portfolio of private placements. A substantial portion of the PRIVEST portfolio is in loans where the general account of Prudential is a co-lender.

As a separate account, PRIVEST has 1) an investment policy specifying what type of lending will be done, according to what procedures, and 2) investment guidelines specifying target portfolio quality distribution, diversification requirements, average maturity goals, ineligible investments, and 3) guidelines specifying when the account will not be a co-lender and how loan participation is to be allocated among PRIVEST and other

Prudential accounts.

Participating pension funds pay Prudential 0.25% of the value of their share of the account as a management fee. Because of its size, PRIVEST was also able to be structured as an open-ended account; thus, according to established rules, pension funds can withdraw their interest in the account or put new money in. Pension funds purchase units in the account through what is essentially a variable annuity contract. Unit values are recalculated periodically to reflect income and changes in market value. (A New Jersey direct placement separate account would almost certainly have to be closed-end, with participating pension funds receiving their money back only as the debt financed by the account was paid off.)

The commingled approach is the simplest and most direct vehicle for allowing New Jersey pension funds to make development investments.

- o It provides a full range of management services--which most public and private pension funds prefer.
- o It provides direct diversification.
- o It can attract private non-pension fund co-investment, either on a deal-by-deal basis or directly through the fund itself.
- o And its structure would make it possible for relatively moderate-size funds to participate. (This is more true of a direct placement separate account than it is of a venture capital limited partnership. The typical minimum participation for a limited partner is $1 million. Should it prove impossible to design a lower minimum, a barrier might be erected for those funds with less than $50 million in assets.)

The commingled fund approach can be tailored to any of a number of types of business financing. The venture capital limited partnership and the direct placement separate account have already been mentioned; a third alternative is the creation of a common trust fund specializing in New Jersey IPOs under the management of a bank trust department. Up to the point where it put in doubt the availability of a sufficient number of viable investment opportunities, a commingled fund could have additional stage specific (e.g., expansion), industry, or geographic priorities.

<u>A privately structured and managed pool is strongly preferable to one created by the state</u>. Many of the state's pension funds would be unlikely to participate in the operation of a publicly-chartered vehicle due to 1) concerns about the potential for improper political pressures on the vehicle's investment activities; and 2) doubts about the quality of management personnel available to public sector financial organizations. Without their participation, the ultimate viability of any vehicle would be seriously jeopardized.

Second, the recent history of state chartered financial institutions suggests several reasons for caution.

- It is extremely difficult to attract and maintain the talent needed to operate such a vehicle successfully in the public sector.
- A publicly chartered operation is always prone to excessive centralization, and almost always perceived poorly by the small enterprise community. (This is true of virtually all state development banks designed in the past several years.)
- More direct ties to legislative or executive power are likely to produce erratic lending behavior, while doing little to assure accountability to the vehicle's public purposes. Many development finance efforts have proved too "conservative" to be effective--the result of their dependence on legislative appropriations and the resulting fear about the way in which any defaults would be viewed by legislative overseers. Others have been corrupted by improper political machinations, and have been led to make loans on the basis of factors other than development impact or credit need.

The only clear drawback to the commingled fund approach is that it requires a high degree of consensus among participating pension funds on an appropriate investment policy and operational structure. This, in turn, requires the strenuous efforts of some independent group to broker the formation of the fund.

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