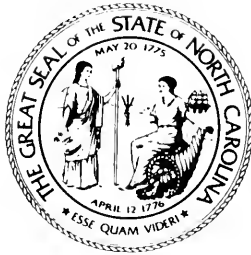


**REPORT OF THE
ENTERPRISE ZONE —
VENTURE CAPITAL
STUDY COMMISSION**



**REPORT TO THE
1987 GENERAL ASSEMBLY
OF NORTH CAROLINA**

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

SEN RUSSELL G WALKER
REP CHARLES D OWENS
CO-CHAIRMEN

MARTHA H. HARRIS, COUNSEL
(919) 733-6660



February 9, 1987

TO MEMBERS OF THE 1987 GENERAL ASSEMBLY:

The Enterprise Zone - Venture Capital Study Commission
herewith reports to the 1987 General Assembly under the
authority of Chapter 792 of the 1985 Session Laws
(House Bill 929).

Respectfully submitted,



Senator Russell G. Walker



Representative Charles D. Owens

Co-Chairmen

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
COMMITTEE PROCEEDINGS	2
FINDINGS AND RECOMMENDATIONS	4
I. Enterprise Zones	
II. Venture Capital	
III. North Carolina Capital Markets Analysis and Innovation Plan	
APPENDICES	
A. Authorizing legislation	
B. Members, Enterprise Zone - Venture Capital Study Commission	
C. Agendas, Enterprise Zone - Venture Capital Study Commission	
D. Counsel for Community Development, Inc. firm resume	
E. Contract between Legislative Services Commission and Counsel for Community Development, Inc.	
F. North Carolina Capital Markets Analysis and Innovation Plan (Summary)	

INTRODUCTION

INTRODUCTION

In 1985, Chapter 792 of the 1985 Session Laws (House Bill 929) created the Enterprise Zone - Venture Capital Study Commission and authorized it to study the establishment of a system of enterprise zones in North Carolina; the need to establish a program to stimulate and supplement the flow of private equity capital to businesses in the State; whether it would be appropriate and beneficial for the State to create a quasi-public corporation to provide capital for private business ventures; and any other means to encourage the expansion of existing industry and the construction of new industries.

COMMITTEE PROCEEDINGS

COMMITTEE PROCEEDINGS

The Enterprise Zone - Venture Capital Study Commission met six times between January 1986 and February 1987. At its first two meetings, the Commission heard from a number of speakers who discussed whether the State should enact Enterprise Zone legislation and how the State can stimulate the flow of investment capital to businesses in the State. After the second meeting, Senator Ted Kaplan and Commission Counsel Martha H. Harris represented the Commission at a Forum on Enterprise Zones presented by the American Association of Enterprise Zones. At its third and fourth meetings, the Commission heard more testimony on the need for State programs to stimulate the flow of investment capital in North Carolina. A list of the speakers who addressed the Commission is attached as Appendix C of this report.

At its September meeting, the Commission heard from Belden H. Daniels of the Counsel for Community Development, Inc., a management consulting firm specializing in economic development and development finance. (Resume attached as Appendix D). Daniels presented a proposal for a study of North Carolina's capital needs and a plan for economic development to meet the unique needs of every part of the State. The Commission accepted the proposal and obtained funds from the Legislative Services Commission to fund the project. (Contract attached as

Appendix E).

The Counsel for Community Development, Inc., presented the North Carolina Capital Markets Analysis and a preview of the North Carolina Markets Innovation Plan to the Commission at its December meeting. The final Capital Markets Innovation Plan was presented at the Commission's last meeting in January 1987. The Commission adopted the plan as part of its final report to the 1987 General Assembly.

FINDINGS AND RECOMMENDATIONS

FINDINGS AND RECOMMENDATIONS

I. ENTERPRISE ZONES

An enterprise zone is a designated geographical area in which special economic incentives and regulatory relief are offered to encourage economic development. Enterprise zones are designed to stimulate economic growth in distressed areas. The incentives that may be offered include: tax credits; tax exemptions; special eligibility for economic development programs; job training and other services; improved law enforcement and transportation; and exemption from administrative regulations.

Federal enterprise zone legislation has been considered in Congress each year since 1980, but no significant incentives for enterprise zones have been enacted. Despite the lack of action on the federal level, nearly thirty states have established their own enterprise zone programs. Of seventeen states responding to a survey conducted in March 1986, about half indicated that their zones were successful to some extent. The other states reported that their programs had shown no results or were too new to have produced results.

In 1984, the League of Municipalities conducted an evaluation of enterprise zones and other economic development proposals.

The League worked with the Department of Commerce, the Department of Natural Resources and Community Development, the Association of County Commissioners, and the N.C. Association of Citizens for Business and Industry.

The League of Municipalities concluded that the establishment of enterprise zones should not be pursued because there were a number of other economic proposals that were more promising.

The North Carolina Commission on Jobs and Economic Growth was created in 1985 to identify the major economic challenges facing the State and to develop proposals to meet these challenges. On November 12, 1986, the Commission released its report to the 1987 General Assembly. That report included a recommendation that an appropriate State agency should designate severely distressed rural areas of the State as Growth Opportunity Counties and establish a system of tax credits for businesses that create jobs within the designated areas. The Commission has had legislation drafted to implement its recommendation.

The Enterprise Zones - Venture Capital Study Commission finds no pressing need at this time to establish a system of enterprise zones in addition to the system recommended by the N.C. Commission on Jobs and Economic Growth.

II. VENTURE CAPITAL

Venture capital can be defined as early-stage equity financing of entrepreneurial businesses with high growth potential. Despite its name, the Enterprise Zone - Venture Capital Study Commission is charged with studying the need for all types of funding for private businesses in the State. The issue of venture capital investment is just part of a larger concern with financing for small businesses in general. The Commission found that there are significant problems with the supply of capital to North Carolina companies, especially new businesses and small businesses.

North Carolina's economy is in transition. With the decline of agriculture and textiles, there is a shift from manufacturing to a non-manufacturing, service-oriented economy. In light of this trend, the success of North Carolina's new small businesses is vital to the State's continued economic health. Most North Carolina firms are small businesses: 97% employ less than 100 people; 80% of these employ less than twenty. In North Carolina, most new jobs are created by small businesses. Nationwide, small businesses account for two out of every three new jobs. If North Carolina can find a solution to the problem of lack of financing for small businesses, it can encourage economic growth and create new job opportunities.

During the course of its study, the Enterprise Zone - Venture Capital Study Commission identified several different aspects of the problem of financing for North Carolina businesses. It found that the needs of new businesses are not being served by the financial community. Eighty-five percent of all new businesses are financed by the owner's personal resources. The Commission heard testimony citing the need for a public policy commitment to new business formation and small business development throughout the State.

Representatives of the North Carolina Technological Development Authority (TDA) alerted the Commission to another gap in the supply of capital for small businesses. The TDA administers the Innovation Research Fund, which provides small grants to entrepreneurs for research to develop ideas into prototypes. The TDA has found that after developing their prototypes, the businesses are often unable to obtain seed capital for the transitional stage of product or service development, market research, and establishment of management. Projects initially funded by the TDA may be lost due to lack of funds at this stage. If this happens, the innovative research will not reach the public domain, the State will lose its investment, and the business' potential to benefit the economy will be wasted.

The Commission also found that the scarcity of venture capital funds in North Carolina is a major problem. Venture capital is geographical in nature and most venture capital is concentrated in the Northeast and on the west coast. Because

venture capitalists are closely involved in the management of the businesses they invest in, they need those businesses to be close by. The Commission found that North Carolina lags far behind in its venture capital supply, even in comparison with other Southern states. The Commission also found an alarming number of cases in which North Carolina entrepreneurial businesses with high growth potential (and thus high job creation potential) were unable to obtain funds from venture capitalists unless they agreed to move out of state. The geographical nature of venture capital could work to the advantage of the State if the flow of capital to North Carolina venture capitalists were stimulated. These venture capitalists would then be likely to invest in local businesses with the potential to create jobs in the State.

The Enterprise Zone - Venture Capital Study Commission found that these gaps in the availability of capital for North Carolina businesses are not being filled by private financial institutions. It is not the nature of banks and similar institutions to be risk-taking concerns; they must be fully collateralized for their financial commitments. Banks are lenders, not investors. They cannot be expected to provide the early-stage financing or the technical assistance needed by new businesses. For these reasons, the needs of small businesses are not being met in the private sector.

While the Commission found evidence of these specific problems, it concluded that it needed a better understanding of North Carolina's overall economic picture before it developed its proposals. The Honorable Harlan Boyles, State Treasurer, urged

the Commission to gather documentary evidence of real needs and to investigate the best types of programs to meet these needs before taking action. The Department of Commerce noted that the problems of small businesses are multi-dimensional and endorsed the Treasurer's call for an in-depth study. In order to develop a plan to meet the unique needs of every part of the State, the Commission found that it was necessary to have a professional economist and development expert conduct a comprehensive study of North Carolina's economic strengths and weaknesses.

Accordingly, the Commission hired the Counsel for Community Development, Inc., to perform a North Carolina Capital Markets Analysis and Capital Markets Innovation Plan, discussed in Part III of this report.

The Commission found that more than thirty states have instituted some sort of program to stimulate the flow of capital to small businesses. By 1985, twenty states had created state venture capital funds and at least seven states had invested a portion of their pension funds in venture capital.

A typical venture capital investment made by a reputable firm has a high return--about twenty-five percent. The turnover time for a venture capital investment is about seven years. Venture capital investment by the State could provide an opportunity for returns greater than those achieved through publicly traded stocks and bonds. In deciding whether to invest State funds in venture capital, however, the State must weigh whether to lower its qualitative investment standards in order to stimulate local economic development by limiting its investments to businesses

within the State. The Commission concluded that where the purpose of a State investment program is to achieve the greatest return with the least risk in accordance with prudent investment standards, the program should not limit its investments to in-State businesses.

The Enterprise Zone - Venture Capital Study Commission heard several proposals for using a percentage of the State Employees' pension fund for venture capital investments. The North Carolina State Employees' Retirement System is one of the best managed pension funds in the nation. It ranks second among the states in rate of return. The Commission found that Retirement System funds should be invested in venture capital only after North Carolina's study of and experience with venture capital demonstrates that high rates of return can be consistently achieved without significant risk of loss.

III. NORTH CAROLINA CAPITAL MARKETS ANALYSIS AND INNOVATION PLAN

The Counsel for Community Development, Inc., submitted its economic analysis of North Carolina in accordance with its contract. The analysis showed that Eastern North Carolina, the Piedmont, and Western North Carolina have different levels of population, income, and employment growth, and differing business size and economic profiles. These differences must be taken into account in formulating economic policies. The analysis found that North Carolina's small, emerging innovative firms have extremely poor access to all forms of essential capital. Furthermore, the analysis identified key export industries whose access to financing is essential to the future of the State: wood products, textiles, and other established industries; agribusiness and fishing; and technology- and knowledge-based innovative industries. Finally, the analysis indicated that the capital needs of North Carolina firms at all stages of business development are acute.

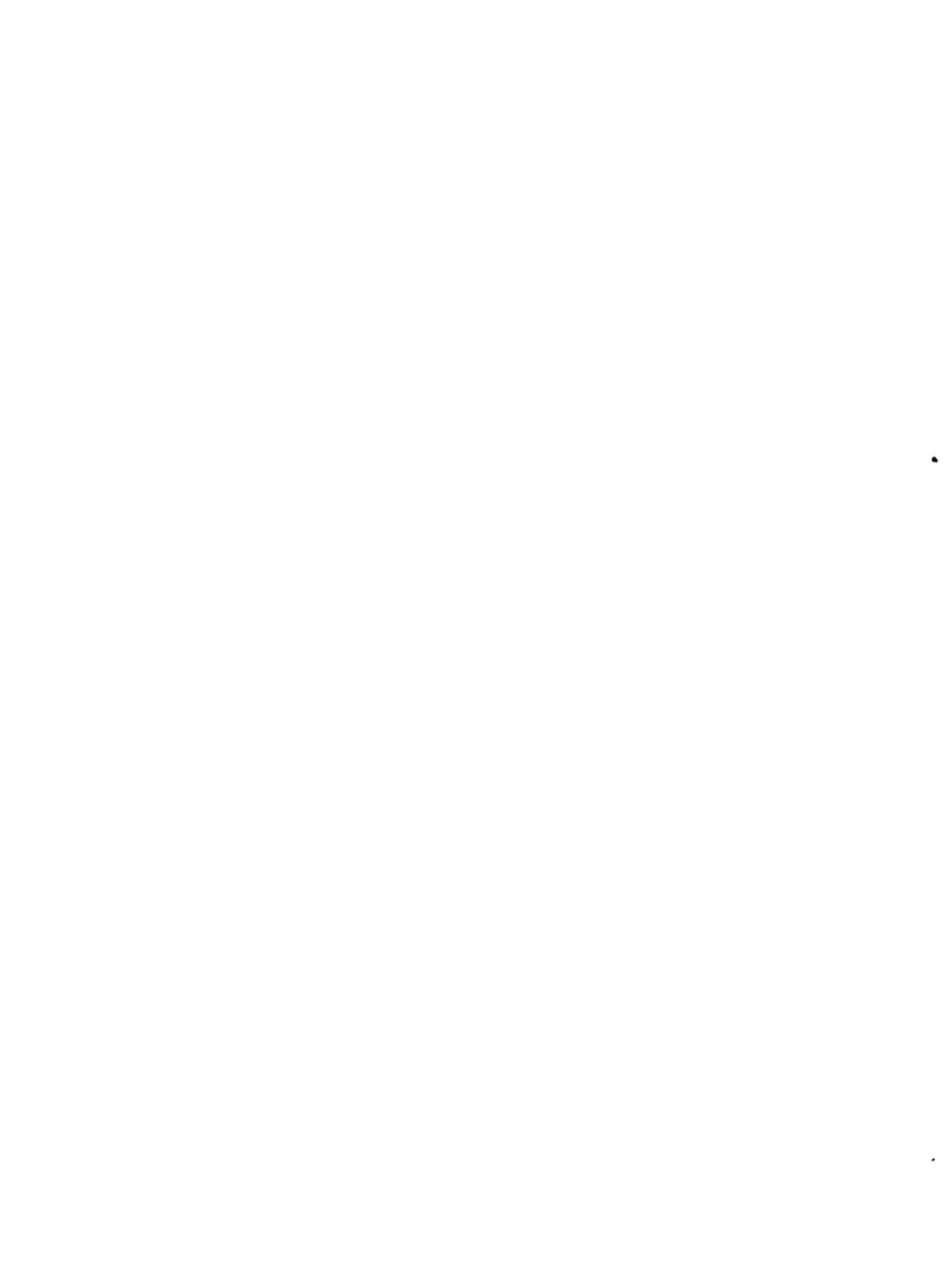
The Counsel for Community Development, Inc., also submitted its plan for economic development in accordance with its contract. The plan is divided into two parts: Phase I, which recommends changes that can be made by the 1987 General Assembly this year; and Phase II, which contains recommendations for subsequent years. A summary of the North Carolina Capital Markets Analysis and Innovation Plan is attached as Appendix G; copies of the complete Analysis and Plan are available in the Legislative Library.

Based on its own study and on the analysis performed by the Counsel for Community Development, Inc., the Commission finds that there is a real shortage of risk capital for North Carolina businesses. Increasing the supply of investment capital in North Carolina is vital to the State's economy. Because of the complexity of the issues involved and the difficulty of designing effective solutions to the problems identified in the time remaining to the Commission, the Commission decided not to recommend a specific legislative proposal to the 1987 General Assembly. Instead, the Commission recommends that:

- (1) The Lieutenant Governor and the Speaker of the House of Representatives refer copies of the North Carolina Capital Markets Analysis and Innovation Plan to the appropriate standing committees of the 1987 General Assembly for their consideration; and
- (2) The committees to which the Analysis and Plan are referred develop appropriate legislation, in cooperation with the Department of State Treasurer, to address the problems identified in this report.

APPENDICES

APPENDIX A



PART III. ~~THE~~ ENTERPRISE ZONE-VENTURE CAPITAL STUDY COMMISSION.

Sec. 4.1. The Enterprise Zone-Venture Capital Study Commission is created. The Commission shall consist of 12 members: four Senators appointed by the President of the Senate; four Representatives appointed by the Speaker of the House; and four representatives of the business community, two appointed by the President of the Senate and two appointed by the Speaker of the House. All initial appointments shall be made by August 1, 1985. Vacancies on the Commission shall be filled in the same manner as initial appointments.

Sec. 4.2. The President shall designate one Senator as cochairman and the Speaker shall designate one Representative as cochairman. The cochairmen shall call the initial meeting of the Commission.

Sec. 4.3. The Commission shall study the establishment of a system of enterprise zones in North Carolina; the need to establish a program to stimulate and supplement the flow of private equity capital to businesses in the State; whether it would be appropriate and beneficial for the State to create a quasi-public corporation to provide capital for private business ventures; and any other means to encourage the expansion of existing industry and the construction of new industries.

Sec. 4.4. The Commission shall submit a final report of its findings and recommendations to the General Assembly on or before the first day of the 1987 Session of the General Assembly by filing the report with the President of the Senate and the Speaker of the House of Representatives. Upon filing its final report, the Commission shall terminate.

Sec. 4.5. Upon the approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist in the work of the Commission. Clerical staff shall be furnished to the Commission through the offices of House and Senate Supervisors of Clerks. The expenses of employment of the clerical staff shall be borne by the Commission. The Commission may meet in the Legislative Building or the Legislative Office Building, upon the approval of the Legislative Services Commission.

Sec. 4.6. Members of the Commission shall be paid subsistence and travel allowances as follows:

- (1) Commission members who are also General Assembly members at the rate established in G.S. 120-3.1;
- (2) Commission members who are also officials or employees of the State at the rate established in G.S. 138-6;
- (3) All other Commission members at the rate established in G.S. 138-5.

Sec. 4.7. There is appropriated from the General Fund to the Legislative Services Commission for fiscal year 1985-86 the sum of twenty-five thousand dollars (\$25,000) to fund the Commission. The Legislative Services Commission may allocate to the Commission funds necessary to enable the Commission to complete its study.

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1985



HOUSE BILL 929

Short Title: Enterprise Zone Study Comm.

(Public)

Sponsors: Representatives Lancaster; C. D. Woodard, Nye..

Referred to: Appropriations.

May 13, 1985

1 A BILL TO BE ENTITLED

2 AN ACT TO CREATE THE ENTERPRISE ZONE-VENTURE CAPITAL STUDY
3 COMMISSION.

4 Whereas, Congress is currently considering legislation
5 to establish a system of enterprise zones, specific economically
6 disadvantaged areas in which businesses would be subject to lower
7 taxes and fewer regulations than in other areas; and

8 Whereas, the proposed federal enterprise zone
9 legislation would select from zones nominated by State and local
10 governments only 75 zones nationwide over the first three years
11 of the program; and

12 Whereas, North Carolina is one of the few southern
13 states that have failed to enact enterprise zone legislation; and

14 Whereas, studies have shown that enterprise zones in
15 other states have created new jobs, preserved existing employment
16 opportunities, and encouraged expansion of existing business and
17 start-ups of new businesses in areas of poverty, unemployment,
18 and economic distress; and

19 Whereas, economic development is possible only when our
20 laws and regulations encourage the expansion of existing industry

21

1 and the construction of new industries and only when adequate
2 capital is available for the cost thereof; and

3 Whereas, in a 1980 survey of North Carolina businesses,
4 forty-one percent (41%) of businesses responding stated that
5 access to capital was a significant problem; and

6 Whereas, a 1983 report of the United States Small
7 Business Administration revealed that North Carolina received
8 only four-tenths percent (.4%) of available venture capital in
9 1980 and one-tenth percent (.1%) in 1981; and

10 Whereas, several states have established quasi-public
11 finance and development corporations to provide venture capital
12 for small businesses and targeted industries; and

13 Whereas, the Small Business Finance Study Commission was
14 created in 1983 to study the need for a program to stimulate the
15 flow of capital to small businesses, but, due to illness and
16 other problems, was unable to meet; Now, therefore,

17 The General Assembly of North Carolina enacts:

18 Section 1. The Enterprise Zone-Venture Capital Study
19 Commission is created. The Commission shall consist of 12
20 members: four Senators appointed by the President of the Senate;
21 four Representatives appointed by the Speaker of the House; and
22 four representatives of the business community, two appointed by
23 the President of the Senate and two appointed by the Speaker of
24 the House. All initial appointments shall be made by August 1,
25 1985. Vacancies on the Commission shall be filled in the same
26 manner as initial appointments.

27 Sec. 2. The President shall designate one Senator as
28 cochairman and the Speaker shall designate one Representative as

1 cochairman. The cochairmen shall call the initial meeting of the
2 Commission.

3 Sec. 3. The Commission shall study the establishment of
4 a system of enterprise zones in North Carolina; the need to
5 establish a program to stimulate and supplement the flow of
6 private equity capital to businesses in the State; whether it
7 would be appropriate and beneficial for the State to create a
8 quasi-public corporation to provide capital for private business
9 ventures; and any other means to encourage the expansion of
10 existing industry and the construction of new industries.

11 Sec. 4. The Commission shall submit a final report of
12 its findings and recommendations to the General Assembly on or
13 before the first day of the 1987 Session of the General Assembly
14 by filing the report with the President of the Senate and the
15 Speaker of the House of Representatives. Upon filing its final
16 report, the Commission shall terminate.

17 Sec. 5. Upon the approval of the Legislative Services
18 Commission, the Legislative Services Officer shall assign
19 professional staff to assist in the work of the Commission.
20 Clerical staff shall be furnished to the Commission through the
21 offices of House and Senate Supervisors of Clerks. The expenses
22 of employment of the clerical staff shall be borne by the
23 Commission. The Commission may meet in the Legislative Building
24 or the Legislative Office Building.

25 Sec. 6. Members of the Commission shall be paid
26 subsistence and travel allowances as follows:

27 (1) Committee members who are also General Assembly
28 members at the rate established in G.S. 120-3.1;

1 (2) Committee members who are also officials o.
2 employees of the State at the rate established in G.S. 138-6;

3 (3) All other Committee members at the rate established
4 in G.S. 138-5.

5 Sec. 7. There is appropriated from the General Fund to
6 the Legislative Services Commission for fiscal year 1985-86 the
7 sum of twenty-five thousand dollars (\$25,000) to fund the
8 Commission. Unexpended funds at the end of the 1985-86 fiscal
9 year do not revert but shall remain in the budget to fund the
10 Commission until it terminates. The Legislative Services
11 Commission may allocate to the Commission funds necessary to
12 enable the Commission to complete its study. Upon termination of
13 the Commission, any unexpended funds shall revert to the General
14 Fund.

15 Sec. 8. This act is effective upon ratification.
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APPENDIX B

ENTERPRISE ZONE - VENTURE CAPITAL STUDY

Authorization: Chapter 792 Part III (HB 344-Rep. Hunt, et al, HB 929-Rep. Lancaster, et al)

Report to: General Assembly

Date: Convention of 1987 Session

Members:

Lt. Governor's Appointments

Sen. Russell G. Walker, Cochairman
Post Office Box 1831
Asheboro, NC 27203
(919) 625-2574
625 LOB 3-5621

Mr. Jesse S. Capel
Capel, Inc.
Troy, NC 27371
(919) 576-6211

Sen. Ted Kaplan
P. O. Box 5128
Winston-Salem, NC 27113-5128
(919) 766-7374
520 LOB 3-5748

Mr. Thomas Veach Long, II
Maricultura, Inc.
Post Office Drawer 565
Wrightsville Beach, NC 28480
(919) 256-5010

Sen. William N. Martin
P. O. Box 21325
Greensboro, NC 27420
(919) 373-1108
2003 LB 3-5652

Sen. Melvin L. Watt
Suite 730, 951 S Independence Blvd
Charlotte, NC 28202
(704) 375-8461
522 LOB 3-5620

Speaker's Appointments

Rep. Charles D. Owens, Cochair
P. O. Box 610
Forest City, NC 28043
(704) 245-1786
1219 LB 3-5776

Rep. Alexander M. Hall
718 Market Street
Wilmington, NC 28401
(919) 343-8433
531 LOB 3-5820

Rep. W. Casper Holroyd, Jr.
1401 Granada Drive
Raleigh, NC 27612
(919) 787-5047
1303 LB 3-5821

Rep. Luther R. Jeralds
1817 Murchison Road
Fayetteville, NC 28301
(919) 488-5565
1218 LB 3-5779

Rep. H. Martin Lancaster
P. O. Box 916
Goldsboro, NC 27533
(919) 735-7275
1206 LB 3-5987

Rep. Edd Nye
Courthouse Drive
Elizabethtown, NC 28337
(919) 862-3679
534 LOB 3-5863

Staff Attorney: Martha H. Harris
(919) 733-6660

Clerk: Mollie W. Prescott
(919) 872-3191 (H)
(919) 733-5477 (O)

APPENDIX C

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

SEN. RUSSELL G. WALKER
REP. CHARLES D. OWENS
CO-CHAIRMEN

MARTHA H. HARRIS, COUNSEL
(919) 733-6660



A G E N D A

January 10, 1986

10:00 a.m., 1425 Legislative Building

Introduction

- Opening remarks by chairmen
- Adoption of budget
- Study Commission's charge and deadline
- Presentation of bibliography

Enterprise Zones

- Short introduction to enterprise zones
- Fifteen minute video tape: Enterprise Zones in America
- Dick Cowden, American Association of Enterprise Zones
- David Reynolds and Fred Baggett, NC League of Municipalities

Venture Capital

- David Stover, Assistant Secretary of Commerce
- Walter Wilkinson, Kitty Hawk Capital, Charlotte

Conclusion

- Discussion by Commission
- Instructions for staff; setting date for next meeting
- Adjournment

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

MARTHA H. HARRIS, COUNSEL
(919) 733-6660

SEN RUSSELL G WALKER
REP CHARLES D OWENS
CO-CHAIRMEN



A G E N D A

February 14, 1986

10:00 a.m., 1425 Legislative Building

Introduction

Adoption of minutes

Venture Capital

Investment of State pension funds in venture capital

1. Overview and constitutional issues (Staff)
2. State Treasurer Harlan Boyles, Questions and Answers
3. Discussion

Creating a State venture capital fund

1. Overview and constitutional issues (Staff)
2. Juliann Tenney, Executive Director, Technological Development Authority (TDA)
3. Kirsten Nyrop, former Executive Director, TDA
4. Discussion

Enterprise Zones

Discussion of how to investigate the need for a system of enterprise zones in North Carolina

1. Janice Faulkner, Director, Regional Development Institute
2. Overview and list of possible speakers (Staff)
3. Discussion and suggestions

Conclusion

Instructions to staff; setting date for next meeting

Adjournment

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

MARTHA H. HARRIS, COUNSELLOR
(919) 733-6660

SEN. RUSSELL G. WALKER
REP. CHARLES D. OWENS
CO-CHAIRMEN



A G E N D A

April 13, 1986

9:30 a.m., 1425 Legislative Building

Introduction

Adoption of minutes

Speakers on Venture Capital Issues

1. The Honorable James B. Hunt, Jr., Poyner and Spruill
2. Lewis Myers, Assistant Secretary of Commerce
Kevin Kennelly, Deputy Secretary of Commerce
3. Scott Daugherty, Small Business & Technology Development Center

LUNCH BREAK

4. Doug LeBon, Wilshire and Associates
5. John Pirotte, The Aviation Group
6. Butch Cunnells, State Employees Assn. of North Carolina, Inc.

Discussion and recommendations

Instructions to staff

Discussion of proposed speakers

setting date for next meeting

adjournment

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

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RALEIGH 27611

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REP. CHARLES D. OWENS
CO-CHAIRMEN



A G E N D A

September 9, 1986

10:00 a.m., 1425 Legislative Building

Introduction

Adoption of minutes

Venture Capital

Investment of State pension funds in venture capital

1. Update - April meeting of Board of Trustees of Retirement System (Staff)
2. Questions and Answers - Representatives of the State Treasurer's Office and the State Employees Association will be present to answer questions

The need for a venture capital fund in North Carolina

1. Update - Constitutionality of proposals (Staff)
2. Earl Bardin, N. C. Bankers Association
3. Belden H. Daniels, Counsel for Community Development
4. Bert Amdahl, Council for Entrepreneurial Development

Enterprise Zones

1. Report of Enterprise Zone Forum and update on federal legislation (Staff)
2. Senator Ted Kaplan, Analysis of Enterprise Zone Forum

Conclusion

Discussion and recommendations

Instructions to staff

Setting next meeting date

Adjournment

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

SEN RUSSELL G. WALKER
REP CHARLES D. OWENS
CO-CHAIRMEN

MARTHA H. HARRIS, COUNSEL
(919) 733-6660



A G E N D A

December 12, 1986

9:30 a.m., 1124 Legislative Building

Introduction

Adoption of Minutes

Mr. Belden Hull Daniels

Counsel for Community Development, Inc.

Presentation of North Carolina Capital Markets Analysis
Preview of the Capital Markets Innovation Plan, to be
presented at the next meeting

Discussion

Conclusion

Instructions to Staff

Setting next Meeting Date

Adjournment

STATE OF NORTH CAROLINA
ENTERPRISE ZONE—VENTURE CAPITAL
STUDY COMMISSION

100 LEGISLATIVE OFFICE BUILDING
RALEIGH 27611

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REP. CHARLES D. OWENS
CO-CHAIRMEN

MARTHA H. HARRIS, COUNSEL
(919) 733-6660



A G E N D A

January 30, 1987

10:00 a.m., 1425 Legislative Building

Introduction

Adoption of minutes

Presentation of rough draft of report

Mr. Belden Hull Daniels

Counsel for Community Development, Inc.

Presentation of North Carolina Capital Markets Innovation
Plan

Discussion and Adoption of Report

APPENDIX D

Counsel for Community Development, Inc. (CCD), is a management consulting firm specializing in economic development and development finance in this country and overseas. Since 1971, the firm has created nearly \$50 billion of new development institutions for state and local governments in every section of the nation. CCD has been retained by more than thirty-seven states in North America, dozens of localities, and a number of overseas governments and major corporations to provide strategic planning, policy analysis, and program design in a broad range of development areas. The firm is nationally known as a leader and innovator in the fields of strategic economic analysis, capital market analysis, strategic planning and development finance. In the past five years, CCD has undertaken major economic reviews and created new development institutions in Alaska, Alberta, Arizona, Arkansas, Colorado, Illinois, Indiana, Kansas, Louisiana, Maine, Massachusetts, Montana, Nebraska, Nevada, New Mexico, New York, Oregon, Pennsylvania and Utah. The firm has also helped many local communities design and implement innovative development strategies, and is currently engaged in such diverse localities as Chicago, Illinois and Shreveport, Louisiana.

Belden Daniels, founder and president, is an attorney and former international banker who has taught economic development and development finance for many years at Harvard and MIT.

APPENDIX E

STATE OF NORTH CAROLINA

COUNTY OF WAKE

STRATEGIC CAPITAL MARKETS ANALYSIS AND PLAN

CONTRACT

THIS AGREEMENT, made and entered into this July day of October, 1986, by and between Counsel for Community Development, Inc., of 10 Concord Avenue, Cambridge, Massachusetts, a Massachusetts corporation, hereinafter referred to as "Contractor," and the Legislative Services Commission, hereinafter referred to as "Commission."

WITNESSETH:

THAT WHEREAS, the Contractor has submitted to the North Carolina Enterprise Zone-Venture Capital Study Commission, hereinafter referred to as "Study Commission," a proposal for the performance of certain services; and

WHEREAS, the parties hereto desire to reduce the terms of this agreement to writing;

NOW, THEREFORE, for and in consideration of the mutual promises to each other, as hereinafter set forth, the parties do mutually agree as follows:

1. The Contractor agrees to perform in a manner satisfactory to the Commission, the following services:

The Contractor shall undertake a qualitative strategic capital markets analysis of North Carolina and shall develop a capital markets innovation plan to be submitted to the Study Commission. The Contractor shall perform the analysis and plan in accordance with the paper it submitted to the Study Commission on September 9, 1986, entitled "Targeting North Carolina capital to meet the emerging needs of the North Carolina economy" and in accordance with its proposal dated September 17, 1986, and the time and budget constraints of the Sec. 3.5 "Scaled Estimated Budget" attached to the proposal.

The capital markets analysis shall assess the supply of different kinds of capital to North Carolina enterprises; it shall investigate the availability of financial resources throughout North Carolina and the capacity of North Carolina's capital markets to attract capital from around the world to support innovation and entrepreneurship.

The analysis shall evaluate qualitatively the supply of capital and shall supplement the qualitative analysis to the extent possible with quantitative evaluations based upon existing data, information gathered by other groups, and comparison with detailed quantitative studies performed in other states with similar economic conditions.

The Contractor shall involve key private and public sector leaders in performing the analysis and shall ensure their continuing involvement and commitment to the plan and its goals.

The Contractor shall develop a capital markets innovation plan which shall be a well-integrated, comprehensive design for capital markets initiatives that will enhance North Carolina's comparative economic advantages in innovative, job-creating, export-oriented industries.

The plan shall be based upon the nine-step analysis outlined for the Study Commission in the September 9, 1986, paper "Targeting North Carolina capital to meet the emerging needs of the North Carolina economy."

The Contractor shall select to assist throughout the analysis and plan a subcontractor who has extensive experience in economic development and specialized knowledge of the North Carolina economy and existing North Carolina development programs.

The final draft of the plan shall include proposed legislation which shall be drafted in collaboration with and under the technical supervision of the Contract Administrator. The Contractor shall satisfy the Study Commission that the

plan is designed to be economically viable and to maximize its acceptance by key political leaders.

The Contractor shall perform the contract in three months. During the first month, it shall meet with representatives of the Study Commission, undertake the capital markets analysis, and complete the first draft of the analysis. During the second month the Contractor shall complete the analysis, prepare the final draft of the analysis, engage in the ongoing collaboration and planning necessary for developing the capital markets plan, and prepare a first draft of the plan. During the third month the Contractor shall complete the development of the plan, prepare the final draft, and meet with representatives of the Study Commission for final approval of the product.

The Contractor shall submit to the Contract Administrator each draft upon its completion. At the end of the second month, the Contractor shall make an oral presentation of the final draft of the analysis and the first draft of the plan at a meeting of the Study Commission. At the end of the third month, the Contractor shall make an oral presentation of the final drafts at a meeting of the Study Commission for final approval.

2. The Contractor has, or will secure at its own expense, all personnel required in performing the services under

this agreement. Such personnel shall not be employees of, or have any individual contractual relationship with the Commission.

3. The Contractor shall not substitute the following employee-personnel: Belden H. Daniels assigned to the performance of this contract without prior approval by the Contract Administrator. All independent consultants hired to perform services under this contract shall receive the prior written approval of the Contract Administrator.

4. Work proposed to be performed under this contract by the Contractor or its employees shall not be subcontracted without prior written approval of the Contract Administrator.

5. The services of the Contract are to commence on or about the twentieth day of October, 1986, and shall be completed by the twentieth day of January, 1987.

6. If, through any cause, the Contractor fails to fulfill in timely and proper manner the obligations under this agreement, the Commission shall have the right to terminate this contract by giving written notice to the Contractor of the termination and specifying the effective date thereof to be not earlier than 15 days after the mailing of notice of termination. In that event, all finished or unfinished deliverable items under this contract prepared by the

Contractor shall, at the option of the Commission, become its property, and the Contractor shall be entitled to receive just and equitable compensation for any satisfactory work completed on such materials. The Contractor shall not be relieved of liability to the Commission for damages sustained by the Commission by virtue of any breach of this agreement, and the Commission may withhold any payment due the Contractor for the purpose of setoff until such time as the exact amount of damages due the Commission from such breach can be determined.

7. The Commission may terminate this agreement at any time by 15 days' notice in writing from the Commission to the Contractor. In that event, all finished or unfinished materials as described in Paragraph 6 above shall, at the option of the Commission, become its property. If the contract is terminated by the Commission as provided in this paragraph, the Contractor will be paid in an amount which bears in the same ratio to the total compensation as the services actually performed bear to the total services of the Contractor covered by this agreement.

8. The payment of compensation specified in this agreement, its continuation or any renewal or extension, is dependent upon and subject to the allocation or appropriation of funds to the Commission for the purposes set forth in this agreement.

9. Any information, data, instruments, documents, studies or reports given to or prepared or assembled by the Contractor under this agreement shall be kept as confidential and not divulged or made available to any individual or organization other than the Contract Administrator or the Study Commission without the prior written approval of the Contract Administrator.

10. Upon the entering of a judgement of bankruptcy or insolvency by or against the Contractor, the Commission may terminate this contract for cause.

11. The Contractor shall not assign or transfer any interest in this agreement.

12. No deliverable items produced in whole or in part under this agreement shall be the subject of an application for copyright by or on behalf of the Contractor.

13. It is agreed between the parties that the place of this contract, its situs and forum, shall be Wake County, North Carolina, and in this County and State shall matters, whether sounding in contract or tort, relating to the validity, construction, interpretation and enforcement of this agreement, be determined.

14. The Contractor agrees that the State will have the right to audit the records of the Contractor pertaining to

this contract both during performance and after completion. The Contractor shall retain all such records for a period of three years following completion of the contract.

15. The Contractor agrees that it shall be responsible for the proper custody and care of any property furnished to it for use in connection with the performance of this contract or purchased by it for this contract and will reimburse the State for the loss or damage of the property.

16. Martha H. Harris, Study Commission Counsel, is designated as the Contract Administrator for the Commission.

17. The non-discrimination clause contained in Section 202 Executive Order 11246, as amended by Executive Order 11375, relative to Equal Employment Opportunity for all persons without regard to race, color, religion, sex, or national origin, and the implementing rules and regulations prescribed by the Secretary of Labor, are incorporated herein.

Program for Employment of the Handicapped (Affirmative Action): Regulations issued by the Secretary of Labor of the United States in Title 20, Part 741, Chapter VI, Subchapter "C" of the Code of Federal Regulations, pursuant to the provisions of Executive Order 11758 and Section 503 of the Federal Rehabilitation Act of 1973 are incorporated herein.

18. Contractor shall obtain, pay for, and keep in force for the duration of the contract the following minimum insurance and shall furnish to the Commission certificates evidencing that such insurance is in effect and providing that the carrier shall give the Contractor and the Commission at least 10 days' written notice of any material change in or cancellation of such insurance:

- (1) Worker's compensation insurance, required by the laws of North Carolina, covering all of the Contractor's employees engaged in any work hereunder;
- (2) Public liability insurance against liability for bodily injury or death of any one person in any one accident in the amount of \$100,000, and in the amount of \$300,000 for the injury or death of more than one person in any one accident; this policy shall further provide against liability for property damage in the amount of \$100,000 for any one accident and \$100,000 in the aggregate, which may be caused by the contractor or its employees in the course of doing its work.

All above insurance coverage must be obtained from a company duly licensed to do business in the State of North Carolina and countersigned by a licensed resident agent.

19. Neither party shall be deemed to be in fault of its obligations under this contract if and so long as it is prevented from performing the obligations by any act of war,

hostile foreign action, nuclear explosion, riot, strike, provider boycott, civil insurrection, earthquake, hurricane, tornado, or other catastrophic natural event or act of God.

20. The Contractor shall be required to comply with all laws, ordinances, codes, rules, regulations, and licensing requirements that are applicable to the conduct of its business and the work to be performed, including those of Federal, State, and local agencies having jurisdiction and/or authority.

21. The Contractor shall be considered to be an independent contractor and as such shall be wholly responsible for the work to be performed and for the supervision of its employees, consultants, and subcontractors.

22. This contract and exhibits annexed hereto and any documents or exhibits incorporated specifically by reference represent the entire agreement between the parties and supersede all prior oral or written statements or agreements.

23. This contract may be amended only by written amendments duly executed by the Commission and the Contractor.

24. Any notice under this Contract to the Commission shall be sufficient if mailed to the Commission as indicated below:

Martha H. Harris
Contract Administrator
Legislative Drafting
100 Legislative Office Building
Raleigh, North Carolina 27611

25. Any notice under this contract to the Contractor shall be sufficient if mailed to the Contractor as indicated below:

Belden H. Daniels
Counsel for Community Development, Inc.
10 Concord Avenue
Cambridge, Massachusetts 02138

26. All promises, requirements, terms, conditions, provisions, representations, guarantees, and warranties contained herein shall survive the contract expiration or termination date unless specifically provided otherwise herein, or unless superceded by applicable Federal or State statutes of limitations.

27. Payment for the project will be made within 10 days following receipt of invoices from the Contractor and their approval by the Enterprise Zone Venture Capital Study Commission as follows:

- (1) First payment of four thousand dollars (\$4,000.00) payable as of October 20, 1986. Second payment of five thousand dollars (\$5,000.00) payable as of November 20, 1986. Third payment of six thousand dollars (\$6,000.00) payable as of December 20, 1986. Fourth payment of nine thousand five hundred

twenty-five dollars (\$9,525.00) payable as of January 20, 1987.

The payment of the second invoice shall be dependent upon satisfactory submission of the first draft analysis to the Contract Administrator. The payment of the third invoice shall be dependent upon satisfactory submission of the final draft analysis and first draft plan to the Contract Administrator. The final invoice shall be paid upon receipt, review, and approval by the Study Commission of the final strategic capital markets plan.

- (2) Total payment under this contract shall not exceed twenty-four thousand five hundred and twenty-five dollars (\$24,525.00).

IN WITNESS THEREOF, the parties have executed this agreement in duplicate originals, one of which is retained by each of the parties, effective the day and year first above written.

For LEGISLATIVE SERVICES
COMMISSION

WITNESS:

T. D. Sullivan

BY:

Liston B. Ramsey
Liston B. Ramsey, Chairman

J. J. Harrington
President Pro Tempore

For COUNSEL FOR COMMUNITY
DEVELOPMENT, INC.

WITNESS:

Sonia M. Toledo

BY:

Belden H. Daniels
Belden H. Daniels
President

T-194A

APPENDIX F



617-492-5461

COUNSEL FOR COMMUNITY DEVELOPMENT, INC.
10 CONCORD AVENUE, CAMBRIDGE, MASSACHUSETTS 02138
BELDEN HULL DANIELS, PRESIDENT

NORTH CAROLINA
CAPITAL MARKETS INNOVATION PLAN

Final

January 30, 1987

Submitted to:
Senator Russell Walker, Co-Chairman
Representative Charles Owens, Co-Chairman
North Carolina Enterprise Zones-Venture Capital
Study Commission

Submitted by:
Belden Hull Daniels, President
Catherine A. Sieros, Associate

NORTH CAROLINA CAPITAL MARKETS INNOVATION PLAN

EXECUTIVE SUMMARY

The North Carolina economy, like that of the United States as a whole, is undergoing the most profound structural change which has taken place in over 200 years as a state or nation. The North Carolina Capital Markets Innovation Plan, presented to the Enterprise Zone/Venture Capital Study Commission, is a targeted two phase Action Plan which comprehensively addresses the state's capital markets in light of this decade's global structural economic revolution.

Phase I of the Capital Markets Innovation Plan is a Legislative Action Plan that is doable now and that stands on its own once passed by the Legislature:

o PHASE I Sources of Funds

Create a NORTH CAROLINA RAILROAD VENTURE CAPITAL FUND (RRVF) with North Carolina Railroad (NCR) stock to initiate North Carolina investment in innovation. Minority share NCR stock proceeds will be placed in a Type II Fund managed by the Treasury.

o PHASE I Uses of Funds

RRVF NATIONAL INVESTMENT POOL -- The Treasurer will invest 50% of the Fund in competitive venture capital partnerships nationwide and instate to demonstrate the potential returns and soundness of such investments.

RRVF ECONOMIC DEVELOPMENT POOL -- With an Advisory Council of private sector leadership, the Treasurer will invest 50% of the Fund in highest current state-of-the-art economic development mechanisms:

- 1) Expand the NORTH CAROLINA TECHNOLOGICAL DEVELOPMENT AUTHORITY'S investment capabilities including more flexible applied research investments and an SBIR Transition Fund. Build TDA's management to include persons meeting national venture capital industry standards and provide specialized management assistance for North Carolina firms undergoing rapid growth.
- 2) Provide for the creation of NORTH CAROLINA CAPITAL CORPORATIONS (NCCCs). NCCCs are private, for-profit investment firms which will invest subordinated, convertible debt and equity in firms statewide that North Carolina banks and venture capital firms are unable to supply.

Phase II of the Capital Markets Innovation Plan follows from Phase I and can easily be accomplished in the next one or two legislative sessions. Although the 1987 bill creates a sound base from which to work, the bill is only about 30% of a comprehensive, 100% solution to the development finance problems North Carolina faces. Additional necessary policies and programs can be addressed easily during the 1988, or 1988 and 1989, Legislative Sessions.

The Capital Markets Innovation Plan is derived from a thorough understanding of the North Carolina economy and the global economy in which it competes. North Carolina is a state with enormous comparative economic advantages across all aspects of its economy: industry, financial services, labor, universities and the public sector. Nevertheless, North Carolinians run the great risk of allowing their maturing technological base and their economic future to erode IF they do not address as a part of a coherent whole each of the problem areas which weaken North Carolina's economic strength that are cited in the Capital Markets Innovation Plan.

ECONOMIC SECTOR: Industries like tobacco, textiles and wood products are just beginning to face the extreme competition of which the emerging global economy is capable. Even North Carolina's preeminence as a technological center is facing severe global challenge that would have been unimaginable a decade ago.

Agribusiness enterprises to remain competitive must adapt to profound global structural changes in food production. For example, the stiffest price competition for North Carolina communities dependent on tobacco is from Brazil and Zimbabwe. Basic and applied research capital, technology transfer capabilities and seed capital are essential to develop new products and processes which increase the competitiveness of North Carolina's agricultural products, diversify communities' economies, and create value-added agricultural activity.

Wood Products Textiles and Other Mature Industries can become globally competitive and create quality jobs by developing new processes and technologies. To do so, they must have access to applied research capital and technology transfer capabilities as well as equity capital for start-up businesses and for firms restructuring to meet new global industry demands.

High Value, Technology and Knowledge-Based Industries are emerging in North Carolina that offer quality employment and diversify the economy, yet they lack access to capital at every stage of enterprise development essential to competitiveness.

STAGE OF BUSINESS DEVELOPMENT: North Carolina is not creating new firms, new entrepreneurs, new ideas, new products and new processes at the rate that other major technological centers are in California and New England. The state is perceived by national investors as an economy to watch, but not quite ready yet.

Basic and Applied Research Capital for innovation must be available to all industries in North Carolina. Innovation does not mean just "hi-tech"; it includes mundane but highly efficient developments that significantly increase the profits of an industry. North Carolina is not bringing its universities, its two Research Centers and its private sector into the kind of day-to-day confidential relationship that generates a stream of profit-earning innovation.

Seed Capital is not generated in North Carolina to finance start-up firms that then attract major infusions of venture capital. Only two seed capital financings were undertaken in the state in 1985 averaging \$900,000. North Carolina's emerging enterprises need much smaller seed capital injections, in the range of \$50,000 to \$300,000 and need access to highly specialized management assistance.

Venture Capital is poorly supplied statewide and that which is available is highly concentrated geographically and by industry. North Carolina is not generating a base of sufficiently capitalized home-grown venture capital firms capable of creating new firms at the same rate as other growing technological centers.

Investment Capital, or "mezzanine finance" is the most difficult form of capital for North Carolina enterprises to find, yet is perhaps the most important form of capital for statewide economic growth. North Carolina is not restructuring and encouraging innovation among its existing entrepreneurial base in more traditional industries statewide at the rate that areas such as New England, Arkansas and Kansas are.

Long Term Debt for Industry and Infrastructure is no longer well supplied in North Carolina because of structural changes in global capital markets, such as deregulation of financial services and the Piedmont superregionals' growth explosion.

SIZE OF ENTERPRISE: North Carolina is predominantly a small business state: over 97% of all firms have less than 100 employees. On the other hand, these same small firms account for less than 50% of total state employment. Yet many medium size firms are in traditional industries undergoing restructuring. North Carolina's ability to generate quality jobs depends largely on its ability to nurture those small firms that can grow into competitive enterprises. The North Carolina economy does not yet focus on birthing new firms out of the state's inherent comparative economic advantages.

- o North Carolina's small, emerging firms have extremely poor access to all forms of capital that are absolutely essential for growth and innovation.
- o Because North Carolina is a state without a major metropolitan center, rapidly emerging small firms throughout the state have limited resources for expert, timely specialized management advice. Insufficient specialized management assistance causes those small firms key to North Carolina's economic future to be overlooked by the venture capital industry.

SUBSTATE LOCATION: The nature and extent of the economic siege wrought by global structural economic change is felt unevenly in different sections of North Carolina, and becomes more acute as one moves from the Piedmont to more traditional economic centers on the coast and in the mountains.

Eastern North Carolina is historically the poorest area of the state. Yet nearly one-third of the state's new jobs in 1980 were in the east, and the region attracted 40% of all new industrial development. Despite recent growth and economic restructuring, eastern North Carolina is extremely shy of risk capital.

The Piedmont is the most concentrated area of economic growth and new technological developments. Piedmont Crescent cities prospered because each was the headquarters of a major business; the Research Triangle promoted competitiveness through the 1980's by creating a stable environment in which established firms could flourish. Continued economic growth statewide depends on the Research Triangle's evolution from a "foster-parent" of established firms, to the state's spawning grounds of job-creating innovative enterprises.

The Smokies' economic opportunities have been historically in wood products, and to a lesser extent, textiles. More recently, low value-added firms have emerged in the mountain counties creating new jobs, but also jobs that are low-paying and cyclical.

The Capital Markets Innovation Plan is specified to attend to these substate economic differences. It carefully crafts solutions to North Carolina's most urgent capital market problems. As Benjamin Franklin said on July 4, 1776, "either we all hang together, or we all hang separately".



COUNSEL FOR COMMUNITY DEVELOPMENT, INC.
10 CONCORD AVENUE, CAMBRIDGE, MASSACHUSETTS 02138
BELDEN HULL DANIELS, PRESIDENT
NORTH CAROLINA CAPITAL MARKETS INNOVATION PLAN

SYNOPSIS

The North Carolina economy, like that of the United States as a whole, is undergoing the most profound structural change which has taken place in over 200 years as a state or nation. The North Carolina Capital Markets Innovation Plan, presented to the Enterprise Zone/Venture Capital Study Commission, is a targeted two phase Action Plan which comprehensively addresses the state's capital markets in light of this decade's global structural economic revolution.

Phase I of the Capital Markets Innovation Plan is a Legislative Action Plan that is doable now and that stands on its own once passed by the Legislature:

o PHASE I Sources of Funds

To be competitive into the next century, North Carolina must begin to perceive itself, and to be perceived by other economies, as entrepreneurial and innovative. A NORTH CAROLINA RAILROAD VENTURE CAPITAL FUND (RRVF) should be created with North Carolina Railroad (NCR) stock to initiate North Carolina investment in innovation. Minority share NCR stock proceeds will be placed in a Type II Fund managed by the Treasury. Following a full cycle of limited partnership investments, the Fund will be subject to review and evaluation by the Legislature.

o PHASE I Uses of Funds

North Carolina is perceived by the national venture capital industry as an economy to watch, but not quite ready yet. The RRVF National Investment Pool will demonstrate the profitable, but fiduciarily sound, returns to be earned from venture capital investment properly undertaken. The Treasurer will invest 50% of the RRVF in competitive venture capital partnerships according to nationally accepted standards for fiduciary responsibility and modern portfolio practice. Under no circumstances are these funds to be used for social investment.

RRVF ECONOMIC DEVELOPMENT POOL -- The North Carolina venture capital industry will mature and the state economy will be competitive only if there is: a clear demonstration of the capacity for profitable, job creating innovation among North Carolina universities, businesses and the financial service sector; and a clear demonstration of North Carolinians' confidence in the returns to be earned through investment in their own venture capital industry and in their own enterprises.

With an Advisory Council of private sector leadership, the Treasurer will invest 50% of the RRVF in highest current state-of-the-art economic development mechanisms:

- 1) Expand the NORTH CAROLINA TECHNOLOGICAL DEVELOPMENT AUTHORITY's investment capabilities including more flexible applied research investments and an SBIR Transition Fund.

Build TDA's management to include persons meeting national venture capital industry standards and provide specialized management assistance for North Carolina firms undergoing rapid growth.

Require economic development plans from the North Carolina Biotechnology Center and the Microelectronics Center of North Carolina which spell out mechanisms for joint-venturing closely with both TDA and small businesses statewide.

- 2) Provide for the creation of NORTH CAROLINA CAPITAL CORPORATIONS (NCCCs). NCCCs are private, for-profit investment firms which will take subordinated, convertible debt and equity positions in firms statewide that North Carolina banks and venture capital firms are unable to undertake. Private and institutional investments in an NCCC should be eligible for a private venture capital tax credit. RRVF will have the option of investing a minority share in NCCCs.

Phase II of the Capital Markets Innovation Plan follows from Phase I and can easily be accomplished in the next one or two legislative sessions. Although the 1987 bill creates a sound base from which to work, the bill is only about 30% of a comprehensive, 100% solution to the development finance problems North Carolina faces. Additional necessary policies and programs can be addressed easily during the 1988, or 1988 and 1989, Legislative Sessions.

This Capital Markets Innovation Plan is derived from an understanding of the North Carolina economy and the global economy in which it competes. North Carolina is a state with enormous comparative economic advantages across all aspects of its economy: diverse, value-added industries; aggressive financial services; flexible labor force; world-class universities; and, a public sector committed to efficient economic growth. Nevertheless, North Carolinians run the great risk of allowing their maturing technological base and their economic future to erode IF they do not address as a part of a coherent whole each of the problem areas which weaken North Carolina's economic strength that are cited in the Capital Markets Innovation Plan.

ECONOMIC SECTOR. The Capital Markets Innovation Plan focuses on export industries which import wealth and quality jobs into North Carolina by exporting value-added goods and services outside the state. The Plan gives greatest attention to those export industries which currently or potentially provide the state with long-term comparative economic advantages in regional, national and international markets.

To maintain and develop comparative advantages in key export industries, North Carolina must plan carefully the expenditure of its scarce state resources. Industries like tobacco, textiles and wood products are just beginning to face the extreme competition of which the emerging global economy is capable. Even North Carolina's preeminence as a technological center is facing severe global challenge that would have been unimaginable a decade ago.

- o Agribusiness enterprises to remain competitive must adapt to profound global structural changes in food production. For example, the stiffest price competition for North Carolina communities dependent on tobacco is from Brazil and Zimbabwe. Basic and applied research capital, technology transfer capabilities and seed capital are essential to develop new products and processes which increase the compe-

titiveness of North Carolina's agricultural products, diversify communities' economies, and create value-added agricultural activity.

- o Wood Products, Textiles and Other Mature Industries can become globally competitive and create quality jobs by developing new processes and technologies. To do so, they must have access to applied research capital and technology transfer capabilities as well as equity capital for start-up businesses and for firms restructuring to meet new global industry demands.
- o High Value, Technology and Knowledge-Based Industries are emerging in North Carolina that offer quality employment and diversify the economy, yet they lack access to capital at every stage of enterprise development essential to competitiveness. These firms often have underdeveloped management teams and require specialized and committed management assistance to guide them through their rapid growth years.

STAGE OF BUSINESS DEVELOPMENT. North Carolina's economic development efforts over the past two decades have so far largely focused on creating an environment that is supportive of large, competitive industries. While North Carolina should continue to encourage large firms to locate within the state and well-established North Carolina industries to expand, North Carolinians must give greater recognition to their immense, but largely latent, potential to birth new, innovative job creating firms within the state.

North Carolina is not creating new firms, new entrepreneurs, new ideas, new products and new processes at the rate that other major technological centers are in California and New England. The state is perceived by national investors as an economy to watch, but not quite ready yet. To ensure a stable, diversified and expanding economy, North Carolinians must attend to all stages of business development since the availability of capital at any one stage is dependent on availability at every other stage.

- o Basic and Applied Research Capital for innovation must be available to all industries in North Carolina. Innovation does not mean just "hi-tech"; it includes mundane but highly efficient developments that significantly increase the profits of an industry. North Carolina is

not bringing its universities, its two Research Centers and its private sector into the kind of day-to-day confidential relationship that generates a stream of profit-earning innovation.

- o Seed Capital is not generated in North Carolina to finance start-up firms that then attract major infusions of venture capital. Only two seed capital financings were undertaken in the state in 1985 averaging \$900,000. North Carolina's emerging enterprises need much smaller seed capital injections, in the range of \$50,000 to \$300,000 and need access to highly specialized management assistance.
- o Venture Capital is poorly supplied statewide and that which is available is highly concentrated geographically and by industry. North Carolina is not generating a base of sufficiently capitalized home-grown venture capital firms capable of creating new firms at the same rate as other growing technological centers.
- o Investment Capital, or "mezzanine finance" is the most difficult form of capital for North Carolina enterprises to find, yet is perhaps the most important form of capital for statewide economic growth. North Carolina is not restructuring and encouraging innovation among its existing entrepreneurial base in more traditional industries statewide at the rate that areas such as New England, Arkansas and Kansas are.
- o Long Term Debt for Industry and Infrastructure is no longer well supplied in North Carolina because of structural changes in global capital markets, such as deregulation of financial services and the Piedmont superregionals' growth explosion.

SIZE OF ENTERPRISE. North Carolina is predominantly a small business state: over 97% of all firms have less than 100 employees. On the other hand, these same small firms account for less than 50% of total state employment. Many medium size firms, however, are in traditional industries undergoing restructuring. North Carolina's ability to generate quality jobs depends largely on its ability to nurture those small firms that can grow into competitive enterprises.

As a general proposition, the newer, smaller or farther from financial centers a firm is -- and the more unusual its product or the nature of its management or ownership -- the greater the likelihood that imperfections in

capital markets will impede the firm's access to appropriate capital at a reasonable price. A select few emerging North Carolina enterprises from the small firm category are based on new products or processes that create good paying, quality jobs and have opportunity for market growth. They are often on the cutting edge of innovation, will grow relatively rapidly, are increasingly the growth leaders in exports, and are essential to North Carolina's competitive position in world markets.

The North Carolina economy does not yet focus on birthing new firms out of the state's inherent comparative economic advantages:

- o North Carolina's small, emerging firms have extremely poor access to all forms of capital that are absolutely essential for growth and innovation.
- o Because North Carolina is a state without a major metropolitan center, rapidly emerging small firms throughout the state have limited resources for expert, timely specialized management advice. Insufficient specialized management assistance causes those small firms key to North Carolina's economic future to be overlooked by the venture capital industry.

SUBSTATE LOCATION. The nature and extent of the economic siege wrought by global structural economic change is felt unevenly in different sections of North Carolina, and becomes more acute as one moves from the Piedmont to more traditional economic centers on the coast and in the mountains.

- o Eastern North Carolina is historically the poorest area of the state. Yet nearly one-third of the state's new jobs in 1980 were in the east, and the region attracted 40% of all new industrial development. Despite recent growth and economic restructuring, eastern North Carolina is extremely shy of risk capital.
- o The Piedmont is the most concentrated area of economic growth and new technological development. Piedmont Crescent cities prospered because each was the headquarters of a major business; the Research Triangle promoted competitiveness through the 1980's by creating a stable environment in which established firms could flourish. Continued economic growth statewide depends on the Research

Triangle's evolution from a "foster-parent" of established firms, to the state's spawning grounds of job-creating innovative enterprises.

- o The Smokies' economic opportunities have been historically in wood products, and to a lesser extent, textiles. More recently, low value-added firms have emerged in the mountain counties creating new jobs, but also jobs that are low-paying and cyclical.

The Capital Markets Innovation Plan is specified to attend to these substate economic differences. It carefully crafts solutions to North Carolina's most urgent capital market problems. As Benjamin Franklin said on July 4, 1776, "either we all hang together, or we all hang separately".

In order to address comprehensively North Carolina's capital market problems, a large array of policies, programs and institutions must be attended by the Legislature and/or executive offices. The Capital Markets Innovation Plan is, therefore, divided into two sets of recommendations.

- o Phase I is a Legislative Action Plan that is doable now and that stands on its own once passed by the Legislature.
- o Phase II follows from Phase I and can easily be accomplished in the next one or two legislative sessions.

