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Office of
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And Government Accountability
John W. Turcotte, Director
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Review of the Capital Development Board of Enterprise Florida, Inc.

Abstract

- **Although the Capital Development Board has reported achieving its standards, improvements in Florida businesses' access to financial markets are primarily due to factors other than board programs.**
- **The Legislature could discontinue the Capital Development Board without impairing Florida businesses' ability to develop venture capital and debt financing.**

Purpose

Florida law requires the Office of Program Policy Analysis and Government Accountability to review Enterprise Florida, Inc., and its related boards prior to the Legislature's 1999 regular session. In this review, we assessed:

- the Capital Development Board's progress towards achieving standards;
- the circumstances contributing to the Capital Development Board's ability to achieve, failure to achieve, or exceed standards; and
- whether it would be sound public policy to continue or discontinue funding the Capital Development Board, and the consequences of discontinuing the Capital Development Board.

This is one of seven reports related to our review of Enterprise Florida, Inc., and deals with the Capital Development Board. We will issue three other reports on the Technology Development Board, International Trade and Economic Development Board, and Workforce Development Board. In a fifth report, we will report on our review of Enterprise Florida, Inc.'s private matching contributions, and in a sixth we will report on the Cypress Equity Fund. In the seventh and final report, we will issue our overall assessment of Enterprise Florida, Inc.

Florida law also requires the Office of Program Policy Analysis and Government Accountability to report to the Legislature the status of actions taken in response to its prior reports. In an earlier report on state business loan programs, we recommended that Enterprise Florida, Inc. revise the design of its business loan programs to increase the participation of the private sector through letters of credit or some other means of leverage.[1] This report also provides information regarding the actions taken by Enterprise Florida, Inc. in response to this recommendation (see page 4).

Background

In 1993, the Legislature created the Enterprise Florida Capital Partnership for the purpose of building access to financial markets for firms critical to creating a Florida economy characterized by better employment opportunities leading to higher wages. In 1996, the Capital Partnership was renamed the Capital Development Board and became an affiliate of Enterprise Florida, Inc., the state's principal economic development organization.

To accomplish its purpose, the Capital Development Board seeks to help Florida high growth businesses obtain access to venture capital resources and debt financing.[2] The board's goal is to develop Florida's

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[1] *Review of the State-Supported Small Business Loan Programs*, Report No. 96-19, November 1996.

[2] Venture capital is used to fund early-stage and later-stage investments in

financial infrastructure to eliminate gaps in the marketplace and to deliver products in a seamless fashion through partnerships with Florida's economic development organizations. The Capital Development Board seeks to match businesses with the financial product provided by the appropriate financial service organization in as efficient a manner as possible.

The Capital Development Board reported that its efforts helped 16 companies obtain $69 million in venture capital financing in Fiscal Year 1997-98. It also reported providing $4.7 million in loans to three Florida businesses through its Enterprise Bond Program. This bond program finances the acquisition of fixed assets by small manufacturers and some not-for-profit organizations. Fixed assets consist of land and buildings, construction and renovations, and new machinery and equipment. Program loans range in value from $500,000 and $2,000,000 and may be for a term of 10 years for equipment and 20 years for real estate. The program's bonds are issued by the Florida Development Finance Corporation, which was created by the Legislature in 1993 to issue tax-exempt and taxable bonds to be sold in publicly traded markets or to large institutional investors. Fixed-rate bonds are guaranteed through a combination of debt service reserves, guaranty reserve account monies (a $1.2 million fund that was capitalized by member banks), and the liability to access a limited amount of funds in the State Transportation Trust Fund.

The Capital Development Board also responded to 2,700 inquiries in Fiscal Year 1997-98. Services provided to those inquiring about capital issues included assisting businesses in obtaining capital, referring businesses to other service providers, and providing training in the various capital products available to businesses. The board also reported that it showcased 63 Florida businesses at venture capital forums in Fiscal Year 1997-98. At a venture capital forum, entrepreneurs present their ideas or products to venture capitalists who can then choose to provide financial backing to worthwhile projects.

As of June 30, 1998, the Capital Development Board had six positions. For Fiscal Year 1998-99, the Capital Development Board's budget is $802,654. Of this amount, $559,439 is from state general revenue with the remainder from fees.

Measures of Program Performance and Standards

We assessed the Capital Development Board's performance using outcome measures and standards for Fiscal Year 1997-98 included in Enterprise Florida, Inc.'s strategic plan for 1998-2003. The strategic plan's measures and projected standards for Fiscal Year 1998-99 are identical to the measures and standards related to the board included by the Legislature in the 1998-99 General Appropriations Act. We therefore concluded that it was appropriate for us to use the strategic plan's measures and standards in assessing the board's performance.

Findings

The Capital Development Board reported achieving its performance standards, but these results are likely more attributable to general economic conditions rather than the board's programs.

Capital Development Board's Performance Exceeded Standards

As shown in Exhibit 1, the Capital Development Board's performance exceeded standards for three of its four outcome measures in Fiscal Year 1997-98.

- Presenters at board-sponsored forums obtained $5.6 million more than expected in venture capital investments.
- The percentage of national venture capital invested in Florida reached 2.75%. However, the board will have to significantly improve its performance to achieve its long-term goal of Florida businesses receiving 10% of the venture capital invested nationally by 2005.
- Companies that received board Enterprise Bond Program loans created 111 jobs.

However, the board did not meet performance standards for jobs created by companies obtaining venture capital investments aided by the board.

growth-oriented business ventures in anticipation of substantial capital gains. The investment is usually in the form of stock or an instrument which can be converted into stock at some future date. Unlike publicly traded securities, venture capital investments are high risk and illiquid for many years.

Exhibit 1
The Board Exceeded Three of Its Four Standards for Fiscal Year 1997-98

Outcome	Actual Fiscal Year 1997-98	Standard Fiscal Year 1997-98	Actual as Percent of Standard
Venture capital raised by presenters at venture forums (millions of dollars)	$10.6	$5.0	212%
Jobs created as a result of venture capital activities	258	300	86%
Jobs created as a result of enterprise bond loans	111	100	111%
Percent of national venture capital invested in Florida (3-year average)	2.75%	2.25%	122%

Source: Compiled by OPPAGA

While the board reported meeting three of its four performance standards, we nevertheless concluded there is no compelling evidence that the board's venture capital efforts have been materially effective in increasing access to venture capital and that the board could be discontinued without detriment to state businesses. The board's Enterprise Bond Program has not assisted many businesses to date, but should be continued for the time being to determine whether the redesigned program can produce a sufficient volume of loans to make the program financially self-sufficient.

Increases in Amount of Venture Capital Invested in Florida Companies Are More Attributable to General Economic Conditions Rather Than Board Programs

Our review of the board's major venture capital initiatives, such as the Cypress Equity Fund, led us to conclude that the increased availability of venture capital was more likely due to factors like the growth in the state's economy and general positive economic conditions rather than the board's programs.

Over the period from 1990 through 1997 Florida's share of national venture capital ranged from .71% to 3.26%. Exhibit 2 shows that prior to the creation of the board for the four years 1990 through 1993, Florida's share of national venture capital ranged from a low of .71% to a high of 2.39%. For the four years 1994 through 1997 after the creation of the board, the exhibit shows that Florida's share ranged from a low of 1.34% to a high of 3.26%. During this period, the dollar amount of venture capital investment in Florida increased from $36.6 million to $380 million and Florida's share of national venture capital increased each year from 1994 through 1996 and then decreased in 1997.

Exhibit 2
Florida's Share of Venture Capital Fluctuated During the Period From 1990 Through 1997

Calendar Year	Percentage of Total U.S. Venture Capital Invested in Florida	Amount of Total U.S. Venture Capital Invested in Florida (in millions)
1990	1.10%	$ 21.2
1991	0.71%	9.6
1992	1.78%	45.3
1993	2.39%	73.3
1994	1.34%	36.6
1995	1.96%	140.5
1996	3.26%	307.4
1997	2.97%	380.0

(Shaded area represents activity after the board was created.)

Source: Developed by OPPAGA from information in the Capital Development Board Annual Report June 30, 1997

However, the board's activities do not appear to have played a significant role in increasing the dollar amount of venture capital invested in Florida companies since 1993. We determined in a separate review that the board's major venture capital initiative, the Cypress Equity Fund, has not contributed to improving Florida businesses' access to venture capital since its investments were not targeted to in-state companies. We also concluded that the Cypress Equity Fund was not a factor in the decisions by national venture capital firms receiving fund moneys to invest in specific Florida companies. For example, the Capital Development Board reported that through June 1998, national venture capital companies receiving moneys from the fund had invested in six Florida companies, with cumulative investments totaling $96 million. However, based on our interviews with executives from these companies, we concluded that these results are not due to the fund's existence. None of the executives we interviewed reported any relationship between Cypress Equity Fund’s investments in their firms and their subsequent decisions to invest in Florida companies.[3]

Further, the board's efforts were not critical in establishing venture capital forums. Venture capital

[3] We interviewed executives from four national venture capital firms that received Cypress Equity Fund moneys and were reported as investing in Florida companies.

forums typically have numerous private and public sponsors other than the board.

Based on the above, we concluded that the increase in the amount of venture capital in Florida was more likely due to factors such as the growth in the general positive economic conditions and opportunities for investments in the state rather than the board's programs

The Board's Enterprise Bond Program has not been a significant source of debt financing. The board's Enterprise Bond Program was designed to fill a gap in financing for small to mid-sized manufacturers needing $500,000 to $2,000,000 to pay for fixed asset acquisitions. According to board documents, Florida banks and other financial institutions were not providing such financing at favorable interest rates when the board was initially created.

Few Florida businesses have received loans under the Enterprise Bond Program. As noted previously, the program made $4.7 million in loans to three Florida businesses in Fiscal Year 1997-98. One loan in the amount of $2.0 million was made to enable a Florida manufacturer of commercial bakery products to expand a 20,000-square-foot building. Another loan of $1.2 million was made to enable a Florida manufacturer to buy, renovate, and equip a 60,000-square-foot building to manufacture recreational powerboats. The third loan of $1.5 million was made to a Kansas corporation authorized to operate in Florida to allow it to buy, renovate, and equip a facility for manufacturing decals for ceramic and glass products.

Although the Enterprise Bond Program has made few loans, the board has taken steps to improve its performance. For example, it re-designed the program in Fiscal Year 1997-98 so that businesses no longer apply directly to the board for a loan, but instead apply through a bank. The bank reviews the business's credit worthiness and then issues a letter of credit to the business that uses the letter of credit to help guaranty their loan. This approach is consistent with a prior OPPAGA report's recommendations for improving the program's leveraging of its financial resources.[4] This new approach appears to be increasing the program's loan activities. During the six-month period from April 1, 1998, through September 30, 1998, the program made a total of $9.9 million in loans to six businesses.

In our opinion, the program should be given more time to see if the recent improvements improve its impact on state businesses. However, the program's continuation should be re-evaluated in four years because there may be less need for it in the future. Potential changes in financial markets and products could enable some banks and financial institutions to make similar loans with amounts and interest rates comparable to most of those offered by the program. While it was once not cost-effective for banks and financial institutions to issue bonds for less than about $3 million, some banks and financial institutions may be able to make market such bonds for amounts as little as $1.5 million. Four of the nine loans made under the bond program were for $1.5 million or more ($7.7 million of the $13.14 million in bonds issued).

The program should also be given more time to determine whether it can become financially self-sufficient. The program's operating budget for Fiscal Year 1998-99 is $300,000, of which $130,000 will be paid for by fees and $170,000 will be from general revenue. The program assesses a fee of 1% on the face amount of its loans, which does not generate enough revenue to cover its annual operating costs. To become self-sufficient, the program will either have to issue at least $30 million in bonds each year or raise its fees. If the program cannot become self-sufficient or continues to serve only a small number of Florida businesses, it should be discontinued.

The Legislature could discontinue the Capital Development Board without impairing Florida businesses' ability to access venture capital and obtain long-term debt financing.

We concluded that the Capital Development Board could be discontinued without impairing Florida businesses' ability to obtain venture capital and long-term debt financing. The board's efforts have not had a major effect on Florida business's efforts to obtain such financing. We also determined that the board's existence is not critical for continuation of venture capital forums. Venture capital forums typically have numerous private and public sponsors other than the board.

We also note that a 1998 legislative initiative should have a much more significant impact on Florida firms' access to venture capital than the Capital Development

[4] *Review of the State-Supported Small Business Loan Programs,* Report No. 96-19, November 1996.

Board's activities. The Legislature enacted the Certified Capital Company Act (Ch. 98-257, Laws of Florida) to stimulate venture capital investments in Florida. This law provides incentives for insurance companies to invest in certified capital companies. These companies are to invest in new or expanding small Florida businesses. The act is expected to result in at least $75 million in qualified investments being made over the next five years, of which $37.5 million must be invested in early stage technology businesses. As of December 1, 1998, the Department of Banking and Finance had received 15 applications to establish certified capital companies.

We estimate that discontinuing the Capital Development Board would save the state $229,882 annually. (See Exhibit 3.) In developing this estimate, we made several assumptions.

- The board's venture capital services and activities would be eliminated.
- Enterprise Florida, Inc., would take over responsibility for handling inquiries from Florida businesses regarding the availability of equity and debt financing, and refer the callers to potential providers. Our estimate assumes that Enterprise Florida, Inc., would receive $159,557 in general revenue presently allocated to the board for performing this function
- The Cypress Equity Fund Management Corporation, which administers the Cypress Equity Fund, would continue its fund management responsibilities, as we recommend in our *Review of the Enterprise Florida, Inc., Capital Development Board's Cypress Equity Fund* (see Report No. 98-33). The corporation's operations are funded by fees charged to investors. The Florida Development Finance Corporation would continue to administer the bonds it has already issued and issue new bonds under its revised program, pending a future review of its activities. Regardless of whether the corporation issues any new bonds, its responsibility would continue at least through 2023 when the most recently issued bonds mature. Our estimate assumes that the corporation would continue to receive $170,000 in general revenue.

Exhibit 3
Discontinuing the Capital Development Board Would Save About $230,000 Annually

Fiscal Year 1998-99	
General Revenue Appropriation	$559,439
Enterprise Florida would assume responsibility for processing inquiries regarding equity and debt financing availability	(159,557)
The Florida Development Finance Corp. would continue fund management responsibility for bonds issued and issue future bonds	(170,000)
Annual savings achieved by eliminating the Capital Development Board	$229,882

Source: OPPAGA

The state could save an additional $170,000 if the Florida Development Finance Corporation was able to generate sufficient fees to cover its operating costs. The Enterprise Bond Program costs $300,000 per year to operate. The program charges borrowers 1% of their loan amount as fees for receiving loans under the program. For Fiscal Year 1998-99, program staff expect these fees to generate $130,000 in revenue. The bond program could become financially self-sufficient by increasing the volume of its program loans, by increasing the fees charged to loan customers, or by a combination of the two approaches.

While we support discontinuing the board, we believe that the state would benefit from having a forum at which representatives of Florida's financial institutions could periodically meet with state government representatives to collectively discuss business venture capital and financing needs and develop strategies for addressing identified problems. Responsibility for coordinating these meetings could be assigned to Enterprise Florida, Inc.

Conclusions and Recommendations

The Legislature could discontinue the Capital Development Board without impairing the availability of venture capital to Florida companies or the ability of Florida businesses to obtain debt financing. Increases in national venture capital invested in Florida companies are more likely the result of other factors, such as general economic conditions and increased efforts to commercialize new technologies in the state.

We recommend that the Legislature discontinue the Capital Development Board. This will save about $230,000 in state general revenue annually. If this recommendation is adopted, we further recommend that Enterprise Florida, Inc., take over responsibility for handling inquiries from Florida businesses regarding the availability of equity and debt financing, and refer the callers to potential providers.

We recommend that the Legislature continue the Enterprise Bond Loan Program under Enterprise Florida, Inc., until 2003, at which time its continuation should be re-evaluated. This will provide more time for determining whether recent program improvements will increase its impact on state businesses and whether the program can generate sufficient fees to cover its operating costs. If the program appears to be no longer needed or does not become financially self-supporting, it should be eliminated.

We also recommend that the Legislature consider requiring Enterprise Florida, Inc., to convene periodic meetings at which state private financial institution and government representatives can meet to consider and propose strategies for improving Florida businesses' access to financial markets.

ENTERPRISE FLORlDA

Govemment & Business Developing Florida's Economy

December 22, 1998

Mr. John W. Turcotte, Director
Office of Program Policy Analysis &
Government Accountability
Claude Pepper Building, Room 312
111 W. Madison Street
Tallahassee, FL 32302

Re: Response to the OPPAGA draft report on the Capital Development Board

Dear Mr. Turcotte:

We concur with OPPAGA's determination that the Enterprise Bond Program should be given an opportunity to continue increasing the accessibility of tax-exempt financing to promising small manufacturers and not-for profit organizations that are creators of living wage employment opportunities. This program is poised to generate future bond volume in the coming years that will be capable of producing fee income sufficient in order to completely finance operations without state funding. This critical mass, however, will take a few years to be reached.

Enterprise Florida agrees with your conclusion that the Capital Development Board met three of its four performance standards in FY '98. In light of this fact, it is our position that the Capital Development Board should continue to exist. Our board possesses a wealth of financial knowledge and experience that is invaluable. We believe that the Capital Development Board should serve in a public policy role, as evidenced in its involvement with regard to the CAPCO legislation. Additionally, there is a need to provide leadership in the continued enhancement of the statewide venture capital network infrastructure.

At the same time, please find two separate attachments that both address the rationale for retaining the Capital Development Board and clarify a few items, which were mentioned in your report. We respectfully ask that you revise your final report accordingly and retain the aforementioned attachments as a matter of public record.

William C. Jones / Director of Operations/ Enterprise Florida Capital Development

WCJ/mv

enclosures

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ATTACHMENT 1

<u>Significance of the Capital Development Board</u>

The talent assembled on the Capital Development Board is a vital resource that the state of Florida can ill afford to lose as a public policy standard bearer. Comprised of executives from the state's largest financial institutions, venture capital professionals, academicians, and economic development practitioners, this body is involved in shaping financial/capital policy on a statewide, and in some cases, regional basis. It would be beneficial to have the ability to seek the board's counsel to steer our efforts as they relate to stimulating the growth of early stage venture capital sources and other initiatives.

The board's public policy role was in evidence with respect to the CAPCO legislation. We have been visibly involved in both assisting in crafting the legislation and obtaining its passage. This is in keeping with our mission to enhance the availability of venture capital through supporting innovative strategies that rely upon private sector participation.

The Capital Development Board can also be a catalyst for the continued evolution of the enhancements being made to the state's venture capital network infrastructure. In April of 1998, the Capital Development Board organized a special meeting where 15 venture capital professionals convened to share ideas regarding ways to expedite the development of a more effective and synergistic statewide venture capital network infrastructure. In conjunction with the workshop, a venture network survey was developed and circulated to a cross-section of approximately fifty (50) venture network participants. This survey was designed to achieve a consensus opinion on priorities for venture network activities in Florida.

Survey respondents highlighted the need for both additional early stage sources of capital and better networking among statewide investors and "angels." Recommendations arising from the workshop, which are presently being implemented, included the following: 1) making a statewide calendar of events available to all practitioners; 2) assisting in the development of a statewide inter-regional venture network to share investment opportunities with individual or institutional investors; 3) the investigation of ways to reform Florida's blue sky laws which inhibit entrepreneurs' efforts to raise capital; and 4) study and evaluation of "best practices" employed by private investor groups, such as Tri-State Invest Group, based in North Carolina. Another initiative championed by the Capital Development Board and embrace by the Innovation and Commercialization Centers (ICCs) and venture forums is striving to develop uniform protocols for information sharing and the compilation of an "angel" investor database. Again, the Capital Development Board is facilitating this process in a leadership role.

OPPAGA Note: Attachment 2 contains recommended clarifications. OPPAGA made changes to the report draft where appropriate.

The Florida Legislature

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