

**HB**

**490**

# ALASKA STATE LEGISLATURE

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LEGISLATIVE COUNCIL

**REPRESENTATIVE BETTYE DAVIS**  
DISTRICT 21

## MEMORANDUM

**TO:** Representative Jeannette James  
Chair, House State Affairs Committee

**FROM:** Representative Bettye Davis *BD*

**DATE:** March 14, 1996

**RE:** HB 490: Extending the sunset date and authorizing the Alaska Science and Technology Foundation to make grants to BIDCOs.

RECEIVED BY  
MAR 14 1996  
Rep. Jeannette James

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I am writing to request a hearing for HB 490 in the House State Affairs Committee at your earliest convenience. Attached please find a copy of the most recent version of the bill, sponsor statement, zero fiscal notes, sectional summary and backup materials.



Under current law, the ability of ASTF to authorize new financial assistance to BIDCOs without legislative approval will sunset on June 30, 1996. HB 490 would thus extend the sunset date to June 30, 2000.

# FISCAL NOTE

STATE OF ALASKA  
1996 LEGISLATIVE SESSION

BILL NO. HB490

Revision Date: \_\_\_\_\_  
Title: BIDCO Assistance Program

Department: Commerce and Economic Development  
BRU: \_\_\_\_\_  
Component: Alaska Science and Technology Foundation

Sponsor: Rep. Bettye Davis  
Requestor: Rep. Bettye Davis

COMPONENT SERIAL NO. \_\_\_\_\_

Expenditures/Revenues	(Thousands of Dollars)					
OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES						
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FUND SOURCE	(Thousands of Dollars)					
1002 Federal Receipts						
1003 GF Match						
1004 General Fund						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other	ASTF Endowment Earnings					
<b>TOTAL</b>	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 96) cost: \$ 0.0

POSITIONS						
FULL-TIME						
PART-TIME						
TEMPORARY						

**ANALYSIS:** (Attach a separate page if necessary)  
Zero fiscal note to HB 490. ASTF does not anticipate that HB 490 will require any funds from the ASTF endowment interest income to accomplish the purpose for the legislation contained in HB 490.

Prepared by: James R. Kenworthy  
Division: Alaska Science & Technology Foundation  
Approved by Commissioner: William L. Hensley  
Agency: Commerce and Economic Development

Phone: (907) 272-4333  
Date: February 15, 1996  
Date: 2-16-96

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# FISCAL NOTE

**STATE OF ALASKA**  
**1996 LEGISLATIVE SESSION**

**BILL NO. HB 490**

Revision Date: \_\_\_\_\_  
 Title: Financial Assistance to BIDCO's

Department: Commerce and Economic Development  
 BRU: Banking, Securities and Corporations  
 Component: Banking, Securities and Corporations

Sponsor: Representative B. Davis  
 Requestor: \_\_\_\_\_

COMPONENT SERIAL NO. 1233

**Expenditures/Revenues**

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	0.0	0.0	0.0	0.0	0.0	0.0

<b>CAPITAL EXPENDITURES</b>	0.0	0.0	0.0	0.0	0.0	0.0
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<b>CHANGE IN REVENUES</b>	0.0	0.0	0.0	0.0	0.0	0.0
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**FUND SOURCE**

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 General Fund						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
<b>TOTAL</b>	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 96) cost: \$ 0.0

**POSITIONS**

FULL-TIME	
PART-TIME	
TEMPORARY	

**ANALYSIS:** (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director  
 Division: Banking, Securities and Corporations  
 Approved by Commissioner: William L. Hensley  
 Agency: Commerce and Economic Development

Phone: 465-2521  
 Date: 2-27-96  
 Date: 2-27-96

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FEB 29 1996

Ans'd.....

## Position Paper on BIDCOs

### What are BIDCOs?

Business Investment Development Companies (BIDCOs) are private sector financial institutions structured to serve the middle risk market financing businesses through a combination of debt and equity investments. BIDCOs generally finance a broader range of deals than are eligible for only equity or venture capital investment and riskier deals than can be financed by banks doing asset-based lending. The BIDCO legislation passed by the Alaska legislature was modeled from Michigan where public funds were matched 2-1 by private investors to capitalize twelve BIDCOs at \$5-12 million apiece. Based on their performance, most BIDCOs in Michigan have now had a second round of capitalization by banks and other investors to total more than \$200 million in capitalization.

The state funds lower the risk needed to attract private investors to providing startup and earlier-stage financing. The loan is structured in the form of an interest-bearing loan with credits earned to forgive the loan based on the jobs and sales increases in the businesses invested in by the BIDCO.

### Legislative and ASTF History

Originally, \$3 million in state funds were requested but when the BIDCO Assistance Program was passed (AS 37.17.20), in 1994 only \$1 million earmarked from Alaska Science and Technology Foundation (ASTF) earnings was appropriated. The legislation provided for a minimal private investment of \$500,000 match.

ASTF issued an RFP to form a BIDCO and in October 1995 both final proposals were turned down because neither finalist could pledge the minimal \$500,000 to launch a BIDCO. Spreadsheet analysis showed that \$1.5 million is too small a capitalization to cover the administrative expenses of managing a risk capital institution and providing the hands-on management assistance required in startup ventures, processor turnarounds, and other BIDCO client investments.

At its February 23, 1996, meeting, the ASTF Board decided that establishing a BIDCO was sufficiently important to its mission to develop the technology infrastructure of the state that an additional \$2 million in ASTF earnings should be pledged to be matched 1-1 by a private sector. This would provide the \$6 million in capitalization which ASTF believes is the minimal size to establish a BIDCO.

### The Case for BIDCOs

A number of reasons have been identified for the importance of establishing BIDCOs:

1. There is a thin infrastructure in the state which is experienced and able to do prebankable risk capital financing. The growth of an increasing number of technology-based firms and innovative natural resource processing firms is limited in a state with little risk capital available. It is also important to establish firms in Alaska with the experience and capability in putting together debt-equity deals and the management of such enterprises.
2. Many programs to provide business development capital provide unleveraged public funds with decision making in the public sector. BIDCOs have the opposite intent; they use public funds to attract private sector management to risk their own capital and build a permanent private sector financial institution.
3. The state loan is performance based. Credits to pay off the loan are earned by increased sales and payroll in Alaska for the first five years after BIDCO investment in an Alaskan firm. To recognize the additional costs of doing deals in Alaska in rural Alaska and the presence of few minority-owned firms, smaller additional credits are available for those types of deals. Since no

credits are earned for BIDCO investment in firms which do not increase sales and jobs, there is no incentive for the BIDCO to invest in a business which is not expected to succeed.

4. The cost of BIDCO loans are priced to insure that BIDCO deals represent investment which would not have otherwise occurred. A firm which could qualify for lower rate bank financing would take it rather than pay the 20% return on investment represented by a loan with the expected above prime interest rate plus additional warrant or equity. The price of a BIDCO loan reflects the higher reward necessary for a private investor to accept the higher risk of a firm with a promising growth potential but insufficient assets to qualify for bank financing.
5. The program can be administered in a nonbureaucratic way. The Michigan experience was to audit annually the firms to calculate the credits earned through increased payroll in the state and sales.

#### Next Steps

In order for ASTF to capitalize a BIDCO, the legislature should amend the ASTF statute to extend the June 30, 1996, sunset provision of BIDCO funds to June 30, 2000. Proposed statute changes would also exempt the BIDCO grant from the \$100,000 limitation of AS 37.17.090(d).

It is also suggested that the title to HB490 be: "An Act relating to the BIDCO assistance program" to avoid any misunderstandings as to purpose.

# LEGAL SERVICES

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STATE OF ALASKA

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130 Seward Street, Suite 409  
Juneau, Alaska 99801-2105

## MEMORANDUM

February 16, 1996

**SUBJECT:** Sectional Summary of HB 490  
(Work Order No. 9-LS1652\C)

**TO:** Representative Bettye Davis  
Attn: Jonathan Sperber

**FROM:** *JB*  
Theresa Bannister  
Legislative Counsel

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Adds a reference to the new BIDCO endowment grant section created by sec. 9 of this bill. Allows the net income from the Alaska science and technology endowment to be used for the BIDCO endowment grants.

Section 2. Adds a reference to the new BIDCO endowment grant section created by sec. 9 of this bill. Includes BIDCO endowment grants in the grants that are to be made by the board of directors of the Alaska Science and Technology Foundation.

Section 3. Adds a reference to grants under the new BIDCO endowment grant section in sec. 9 of this bill. Removes BIDCO endowment grants from the preference established under the section.

Section 4. Adds a reference to the new BIDCO endowment grant section in sec. 9 of this bill. Removes the BIDCO endowment grants from the peer review requirement established by the section.

Section 5. Adds a reference to the new BIDCO endowment grant section in sec. 9 of this bill. Removes the BIDCO endowment grant awards from the consistency requirement of the section.

Section 6. Adds a reference to grants awarded under the new BIDCO endowment grant section. Removes the BIDCO endowment grants from the fiscal year distribution requirements of the section.

Representative Betty Davis  
February 16, 1996  
Page 2

Section 7. Adds a reference to the new BIDCO endowment grant section. Applies to the BIDCO endowment grants the requirement, among other things, that the grantor pay into the endowment a fair and reasonable return from revenue, economic value, or profits derived by the grantee from the grant project.

Section 8. Extends until June 30, 2000 the authority of the foundation to authorize new financial assistance under the BIDCO assistance program provisions without legislative approval.

Section 9. Authorizes the Alaska Science and Technology Foundation to make grants from the Alaska science and technology endowment to accomplish the purposes of AS 37.17.200.

If I may be of further assistance, please advise.

TLB:klb:pl  
96-105.klb

# Technology foundation poised for new challenges

By Rose Ragsdale —  
Alaska Journal of Commerce

Having proven that it can nurture fledgling high-technology companies, the Alaska Science and Technology Foundation is ready to advance to the next stage of attracting capital and technology to the state.

"Alaska is starting to get some infrastructure around which we can attract some technology-based businesses," said Paula Rasmus Dede, ASTF's director of administration and finance. "We've proven we can do grants, but technology brokering — getting people interested in the things being developed here is another matter."

Robert Harris, ASTF's director of technology, said the big challenge for ASTF "is getting businesses through the doors of banks and other funding sources to get capital." Harris said an entity with the ability to link such start-up businesses with conventional financing is not readily available in Alaska. "We see ourselves developing the networks and resources for these businesses," he said.

ASTF, for example, has issued requests for proposals from parties to establish a new type of market-oriented private financing institution authorized by the Alaska Legislature that would provide risk capital and management assistance to businesses in Alaska.

Known as a ~~state~~ <sup>state</sup> institution is intended to bridge the gap between traditional

bank financing and venture capital funding. While IDICs take substantially more risk and require higher returns than banks, they do not require their investments to offer the explosive growth and ultimate public offering of stock necessary to yield the super high rates of return sought by venture capital funds such as the Polaris Fund, according to the foundation's RFP.

Preliminary proposals are due May 15, 1995.

Created in the late 1980s to encourage research and development that would benefit Alaska and its 650,000 residents, ASTF is pursuing its mission with gusto even as foundation board members search for a new executive director.

The search, precipitated by the departure of executive director John Sibert in February, is drawing applicants from some of the best technology development hotbeds in the country, foundation officials say.

Meanwhile, they point with pride to projects that improve road construction over permafrost; strengthen concrete with waste products; make rural power generation more efficient and cost-effective; create a DNA database for the FBI; and use waste heat to create a cold storage alternative that brings to mind the old adage, "Selling ice cubes to Eskimos."

Foundation officials say they are on target with their goals, having managed 102 active grants during 1994 totaling \$11 million in project funding and attracting \$27 million in

matching contributions. The foundation also concluded 30 projects during that fiscal year. In so doing, the foundation has created the equivalent of 629 direct full-time jobs in Alaska, according to an independent evaluation.

Currently, ASTF is managing 110 active grants, including a few that are generating substantial royalty checks for the foundation. In addition, the foundation awarded \$350,000 in very small grants in fiscal 1994 to science teachers statewide.

"Most people wouldn't think of Alaska as a place where cutting edge research is being done, but it is happening here. A couple of our new grantees are on the threshold of doing great things," Rasmus Dede said. "One grantee keeps sending us checks, and they are rather large checks."

But grants administration director Kay Fuller said the real payoff for ASTF is in seeing new businesses take root and grow from the seed capital stage.

"The Foundation has learned and grown in providing guidance to these companies," Fuller said. "We, at ASTF, are committed to solving rural problems in Alaska, and we would love to see more big picture thinking taking place in the state."

Among funded projects that aim to enhance or add value to Alaska resources:

- Power Generation from Alaskan Low-rank Coal-water Fuels, LRCWFs — Commercial Demonstration Program, \$185,000;
- Applicability of Siberian Placer Mining Technology to Alaska, \$32,933;
- Biological Methods of Treating Mine Waste Water for Cyanide and Heavy Metals, \$193,100;
- Commercial Development of Innovative Placer Mining Technology, \$150,000;

- Construction Uses for Alaska Coal Ash, \$99,698;
- Enhanced Resource Evaluation Using Geochronology, \$89,156;
- High-temperature Drying of Alaskan Coals, \$60,056;
- Mined Land Reclamation with Woolly Browse Species, \$31,103;
- Potential Effects of North Slope Air Pollutants on Arctic Vegetation, \$363,650;
- Power Generation from Alaskan Coal-Water Fuel, \$68,770;
- Process for the Removal of Arsenic and Iron in Well Water, \$69,460; and
- Reservoir Characterization for Enhanced Oil Recovery in Schrader Bluff Pool, Milne Point Unit, \$300,000.

Another project, "New Refrigeration System for Rural Fish Processing," uses NA technology that takes waste heat from a Kotzebue Electric Utility and produces more than 12 tons of ice per day for the commercial fishing industry there. ASTF put up \$317,928 which was matched with \$352,866 in public and private funds. Capital costs are a fraction of conventional refrigeration, operating costs are low, minimal training is needed to run it and no harmful CFCs are used, ASTF officials say.

Not only is the new system being used in Kotzebue, but Kodiak and Prince William Sound also are evaluating it as a low-cost alternative to provide the necessary cold storage to enhance the development of value-added fish processing, they say.

# Alaska Bidco seeks funding

## Finance company may provide risk, growth capital

By Rose Ragsdale  
*Alaska Journal of Commerce*

Despite an energetic start last year, Alaska's bid to follow the lead of Michigan in developing a different type of finance company, known as a "Bidco," has slowed to a crawl.

Yet the concept, which is designed to provide capital to businesses that qualify for neither venture capital nor bank loans, has attracted a growing fan club, including a group of Alaska business specialists who plan to launch a consulting business next month under the name Alaska Bidco.

Meanwhile, proponents of a law enacted last year that authorized the creation of Bidcos in Alaska say they are busy encouraging state lawmakers to appropriate the \$10

million needed to launch one or more of the financing companies. They are also conducting a series of seminars on how Bidcos work.

Steven Rohde, a consultant who helped develop the first Bidcos, told state officials and business leaders recently the new type of finance company is designed to provide risk and growth capital for businesses that can't qualify for bank financing and lack enough growth potential to interest venture capitalists.

Since Michigan passed legislation authorizing Bidcos in 1986, Rohde said, 10 have been created in that state, including one with a focus on investing in minority businesses and another with a focus on rural enterprises. He said the eight standard Bidcos were formed with state and private funds in a 1.5 to 1

match, and the minority and rural Bidcos required minimum \$500,000 private investments.

"So far, the state of Michigan has invested \$34.9 million in 80 companies through the Bidcos, and an additional \$52.3 million in capital has been attracted for those companies from other sources," Rohde said. "But Michigan has 10 times the population Alaska has. The realistic potential in Alaska is for one Bidco, maybe two."

What makes Bidcos special?

First, they tend to invest with loans at lower than market interest rates, but they also obtain some equity interest or potential equity interest, such as warrants, in the companies in which they invest.

If they are investing with public funds, they typically offer a conversion formula where a company can convert the loan to a grant by creating a certain number of full-time, permanent jobs and by generating a certain level of

sales.

Bidcos are also typically run by people with 10 to 20 years business management experience, such as former bank presidents, Rohde said.

Among those the Bidco concept has attracted in Alaska is Fred G. Brown, a Fairbanks attorney and hearing officer for state Workers' Compensation. Brown and Pat Shier, a Fairbanks auditor, have seized the opportunity they perceive in the Bidco law to start Alaska Bidco, a consulting firm tailor-made to fit the specifications of the new financial entity.

"My basic thesis is there's a lot of opportunity in Alaska and if a Bidco enables us to realize them, then great," Brown said.

A Bidco could help him and others in the consulting group pursue lucrative investment opportunities in Alaska mining, timber, tourism and transportation in the near future, he said.

Brown's efforts to pull together a strong and diverse management team has netted a group with weighty resumes and accomplishments, including a mining expert, two CPAs, a timber expert, a former state senator, two former bankers, an economist and several business management specialists.

Brown's own background includes running his own farm in Oregon and organizing a national network of farm borrowers. A resident of Alaska since 1983, he said he has served on the North Star Borough Agriculture Commission where he helped get a meat processing plant back in operation and on the board of the Northern Alaska Health Resources Association. Brown said he also helped negotiate a contract for state public employees, co-edited a procedural manual on workers' compensation, and taught business classes at one of the Fairbanks military bases.

John Sibert, executive director of the Alaska Science & Technology Foundation, said Brown is the only Alaskan, so far, who has begun putting together a management team that could qualify to run a Bidco.

Still, Bidcos have an uphill climb in Alaska to gain widespread understanding of how they work, Sibert said.

Alaska Journal of Commerce

3/27/93

**CARR ASSOCIATES**

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**RISK CAPITAL FORMATION  
AND  
BUSINESS AND INDUSTRIAL DEVELOPMENT CORPORATIONS  
ECONOMIC DEVELOPMENT FINANCE  
OPTIONS FOR ALASKA**

Prepared for:

~~MEMBER OF THE STATE~~ **BOARD OF DIRECTORS  
ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY**

by

**GREGORY L. CARR**

February 1993

## THE "CAPITAL GAP"

As public policy makers in Alaska struggle to find solutions that will expand the state's relatively narrow economic base, they have come to focus on the problem of the lack of investment capital in general and risk or venture capital in particular.

The national and international lending environment limits access to development and operating capital for many businesses in the United States. This trend has been magnified in Alaska due to the small size of the market, a relatively narrow economic base, the lingering effects of the recent recession, and geographic isolation. As a result, Alaska businesses are faced with several severe capital problems:

- 1) Commercial bank and institutional lenders are often unwilling (or unable due to regulation) to provide long term lending for major capital expansions. Only those projects that are financially feasible with very short (5 to 7 year) loan amortization can be financed.
- 2) Regulatory pressure is forcing some commercial banks to divest loans because they represent unwanted industry or geographic concentration in the lender's portfolio. Other regulations force loans to be called because certain rigid performance criteria are not being met – even though the borrower is profitable and the loan has a perfect performance record.
- 3) Many private sources of venture capital have curtailed their financings of start-up companies or have concentrated on a narrow band of industries (biomedical, etc.). Overall venture capital availability is significantly diminished from the high levels of the mid to late 1980's.

This constricted capital environment inhibits potential establishment of both large and small Alaska businesses. AIDEA's programs have provided, and will continue to provide, an essential alternative source of needed capital for these businesses. As a result of these market conditions, AIDEA will face financing demand from several directions for the foreseeable future: 1) long term loans and leases for major economic development facilities (roads, airports, ports, utilities), 2) business working capital, acquisition, expansion, equipment and facility loans (either new loans or as a replacement for existing bank loans), and 3) venture/start-up capital for small businesses throughout Alaska, but particularly in rural areas."<sup>[1]</sup>

Such capital is badly needed to support both existing business expansions and new business start-ups, particularly in high growth entrepreneurial business ventures. To solve this "capital gap" problem, the state has created a new development finance program—Business and Industrial Development Corporations (BIDCOs).

Patterned after the Michigan Strategic Fund's BIDCO Program, Alaska's BIDCO Program is an ambitious initiative designed to catalyze the formation of a new industry of private financial institutions. It will help meet the financing, managerial support, and technical assistance needs of emerging, small, and medium sized businesses in Alaska.

The purpose of this paper is to provide AIDEA's Board of Directors with information, assistance, and advice about BIDCOs and the potential for AIDEA's involvement with BIDCOs such that the Board may make informed decisions about AIDEA's future role and involvement, if any, with BIDCOs. In addition, a series of general recommendations both for improving the structure and operations of existing state "economic development finance programs" and for establishing new programs where none currently exist will also be offered.

A primary working hypothesis of this paper is that state-managed economic development finance and risk capital programs may never function effectively without having substantial private sector venture, and venture-type, e.g. BIDCO capital resources available for coinvestment purposes. Hence, a major emphasis throughout will be on the private venture capital industry; how it works, and how it can complement state development finance programs.

Risk or venture capital has become increasingly popular as a solution to economic development financing problems. Yet, publicly sponsored programs are too often founded on an inadequate understanding of how the venture capital investment industry operates, and how it should fit into an overall capitalization continuum at both state and regional levels.

Economic development infrastructural hurdles, which are particularly acute in a state like Alaska, are too often ignored: For example, it can be extremely difficult to launch and sustain entrepreneurial and advanced technology-based business development not just because of a lack of risk capital, but just as importantly because of a lack, and/or ignorance of, managerial talent and entrepreneurial support resources (i.e., accountants, marketing consultants, securities attorneys).

Both of these resources are critical to a proactive entrepreneurial business development climate, and must be readily accessible in order to nurture such companies through successive stages of growth and development. If not, companies can feel increasing pressure as they develop and move to larger metropolitan areas where such talent and services can be found more easily.

Then too, the availability of conventional debt capital through banks and related institutions is almost as critical as managerial talent and support resources. Equally important is the contribution of risk capital to the development of a vigorous entrepreneurial business development climate.

This is particularly the case when entrepreneurial companies reach a stage of maturity where it would make greater sense for them to obtain conventional debt capital rather than venture capital. Many such private financial institutions are very reluctant to make loans, to rapidly growing manufacturing or service companies, particularly for working capital purposes. Thus, a very important downstream source of capital is usually only available to such companies after the point at which they really need it.

As previously stated, no state development finance or risk capital effort is ever going to be successful in stimulating and facilitating entrepreneurial economic development without substantial amounts of private risk capital being relatively accessible to emerging entrepreneurial companies.

Public policy makers should continue to provide a wide array of entrepreneurial support and financing mechanisms, while at the same time increasingly concentrating their efforts on seeking ways to stimulate larger amounts of private risk capital. This can be accomplished both through the creation of new sources of capital, e.g. BIDCOs, and through increased attention paid to investment opportunities in the Pacific Northwest region by existing venture funds located in metropolitan areas in, and around, the region.

## **THE ENTREPRENEURIAL ECONOMY DEFINED**

Over the past twenty years, the United States economy has been undergoing a major industrial restructuring. While the primary catalyst for this restructuring process was the oil-induced inflation of the 1970s and early 80s, increasing competition from our trading partners and the birth of technology-based products and services in the marketplace played a major role.

The bottom line is that during the past 15 years, Fortune 500 manufacturing companies, the traditional sources of most of the jobs in our economy, have experienced a decline in the number of workers employed in U.S. facilities.

However, the U.S. economy during that same time period actually experienced a net increase in the total number of jobs available. It is well-known by now that these new jobs, some 40 million in number, have come from small, entrepreneurial companies which have formed and grown during the seventies and eighties.

As Peter Drucker has pointed out, these new jobs have been created primarily by "small and medium-sized institutions, most of them small and medium-sized businesses, and a great many of them, if not the majority, new businesses that did not even exist twenty years ago." [2] From Drucker's standpoint, the most critical driving force behind this shift in economic vitality—from the large to the small institution—is the advent not of "high technology," but of "entrepreneurial management." [3]

"Management," says Drucker, "is the new technology (rather than any specific new science or invention) that is making the American economy into an entrepreneurial economy. It is also about to make America into an entrepreneurial society." [4]

In considering economic development based in significant measure on entrepreneurial companies, however, it is important to distinguish between such companies and what economist David Birch calls "income substitution" companies.

The difference between the two, according to Birch, is the difference between making a living and making money. "If you want to earn a living then you start up a small business. You get two or three employees and you stay at that level forever. If you want to make money...you start with three employees and you attempt to make that into 3,000 employees as quickly as possible." [5]

About 90 percent of the new companies which are formed each year are income substitution companies—the kind that earn a living; the other ten percent are entrepreneurial companies, and are also creating virtually all the new jobs. "It's not whether you have a lot of small businesses that count; it's whether or not you have a lot of entrepreneurial businesses that count. Therefore, the climate for entrepreneurial businesses is what's crucial to whether or not you grow or decline in the next 10 to 15 years." [6]

## **FINANCING ENTREPRENEURIAL COMPANIES**

Entrepreneurial companies by definition seek rapid growth and substantial size. As a result, they typically have a seemingly insatiable appetite for large quantities of cash in order to finance their rapid growth. The availability of investment capital in the form of large amounts of cash is perhaps the most important requirement in fostering a positive entrepreneurial business climate.