COMMISSION ON INVESTMENT CAPITAL

FINAL REPORT

October 6, 1993

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APPROVED

APR 24 '90

BY GOVERNOR

CHAPTER

914

PUBLIC LAW

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND NINETY

H.P. 1564 - L.D. 2170

An Act to Continue the Effort to Preserve and Promote Affordable Housing and Economic Opportunities for Maine People

Emergency preamble. Whereas, Acts of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, increasing investment opportunities are available to the State beyond its borders; and

Whereas, those investment opportunities may represent substantial economic opportunities for Maine businesses; and

Whereas, the State should take full advantage of those opportunities; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore,

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 5 MRSA §12004-I, sub-§6-B is enacted to read:

6-B. Economic Development	Commission on Investment Capital	Expenses Only	5 MRSA §13064

Sec. 2. 5 MRSA c. 383, sub-c. II, art. 3 is enacted to read:

Article 3

COMMISSION ON INVESTMENT CAPITAL

§13064. Commission on Investment Capital

The Commission on Investment Capital is established and is composed of 17 members. The membership includes the Commissioner of Economic and Community Development, the Director of the Maine State Housing Authority, the Chief Executive Officer of the Finance Authority of Maine, the Executive Director of the Maine State Retirement System, the Director of the Maine Municipal Bond Bank, 2 Senators, 3 members of the House of Representatives, 6 members of the public appointed by the Governor and one member of the public appointed jointly by the President of the Senate and the Speaker of the House of Representatives.

1. Appointment. The President of the Senate and the Speaker of the House of Representatives shall appoint the 2 Senators, the 3 members of the House of Representatives and one member of the public. The Governor shall appoint 6 members of the public who are able to provide expertise in the area of capital investment.

2. Terms of office. Members appointed by the President of the Senate and the Speaker of the House of Representatives serve at the pleasure of these appointing authorities. The appointees of the Governor serve at the pleasure of the Governor.

3. Cochairs. There are 2 cochairs of the commission. The public member appointed by the President of the Senate and the Speaker of the House of Representatives is a cochair. The Commissioner of Economic and Community Development is a cochair of the commission.

4. Compensation. Members of the commission are entitled to compensation in accordance with chapter 379.

5. Meetings. The commission shall meet at least 4 times each year at the call of the cochairs.

6. Quorum. A quorum consists of 7 members. A quorum is necessary for the commission to conduct its business at any commission meeting.

§13065. Duties and responsibilities of the commission

The commission shall undertake a comprehensive evaluation of the capital investment needs of the State, including an analysis of the sources and magnitude of current capital investments in all sectors of the State's economy, an analysis of the obstacles to capital investments in the State, the identification of sources of funds in the State that may be used to leverage new capital investments and a review of the impact and opportunities resulting from foreign investment in the State.

The commission shall report its activities and findings to the Governor and the joint standing committee of the Legislature having jurisdiction over housing and economic development matters no later than July 1st following each first regular session of the Legislature. The commission may initiate reports to the joint standing committee of the Legislature having jurisdiction over housing and economic development matters at any time during its deliberations.

7/93

§13066. Agency cooperation

All agencies of State Government shall cooperate with the commission during its deliberations by responding to requests for information and technical support in a timely manner.

§13067. Sunset

Authorization for the commission expires on July 1, 1993. In its final report, the commission shall provide its recommendations to the Governor and the Legislature concerning the need for extending authorization for the commission.

Sec. 3. 5 MRSA §13081, sub-§6, as enacted by PL 1987, c. 534, Pt. A, §§17 and 19, is amended to read:

6. Local development corporation. "Local development corporation" means any nonprofit organization created by a municipality; incorporated under Title 13, chapter 81; incorporated under Title 13-B or otherwise chartered by the State; and designed to foster, encourage and assist the settlement or resettlement of industrial, manufacturing, fishing, agricultural, recreational and other business enterprises within the State. A majority vote of the municipal officers is sufficient to form a local development corporation, notwithstanding Title 13, chapter 81. Notwithstanding this subsection, a "local development corporation" is any nonprofit organization incorporated under Title 13, chapter 81; incorporated under Title 13-B or otherwise chartered by the State; and designed to foster, encourage and assist the settlement or resettlement of industrial, manufacturing, fishing, agricultural, recreational and other business enterprises within the State that applies for financial assistance for a project under this article, as long as that application is formally endorsed by a vote of the governing body of the municipality in which the project is to be located.

COMMISSION ON INVESTMENT CAPITAL MEMBERSHIP

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REPORT SUMMARY

Months of investigation and discussion by the members of the Commission on Investment Capital with the Maine business community lead to one inescapable conclusion: **The State of Maine has a reputation for being anti-business.** It is impossible for us to tell by any objective analysis of data whether this reputation is deserved or not, but in a way, that is irrelevant. All people, including business people, make decisions based upon perception and as long as Maine is perceived to be hostile to business, the effect will be harmful to the goal of attracting new business or encouraging expansion of presently existing businesses.

The anecdotal evidence that is always mentioned to substantiate the point of view that Maine is hostile to business falls in that all too familiar pattern. The first item almost always mentioned is the high cost of worker's compensation. That is usually followed by a reference to the difficulties of doing business with our present regulatory environment and then, depending on the perspective and interest of who is talking, issues such as high taxes, high energy costs, high health care costs, transportation disadvantages, etc. are mentioned. The litany is a very familiar one.

The evidence of companies like UNUM, Bath Iron Works, L.L. Bean, the paper companies and many, many other large companies give lie to the fact that good profitable businesses of any size cannot exist in Maine.

There are obviously disadvantages that are based upon our location and our climate and our distance from many raw materials that will be impossible to overcome. But, in our judgment, these are more than outweighed by the many good things that Maine does have to offer.

The Commission believes that a never-ending effort must be made to separate fact from fiction in analyzing these complaints and to address the causes of the legitimate ones and to continuously work to dispel those that are not reality based.

In short, we need to turn our business reputation around from an unfriendly one to one that welcomes and assists businesses, both large and small. No one step will do as much as this to improve the level of private capital investment in Maine. The Commission believes that this can be done if enough consistent focus is brought to bear on the individual problems cited.

The focus on our real or presumed disadvantages hides the reality that Maine has many positive business attractions. Business executives and professional people move to Maine throughout the year from other environments. Many of them come from larger communities, many from higher paying jobs, because they recognize that life in Maine can be better than where they lived previously. Maine has much to offer, most of it subsumed under the title of "Quality of Life", but a good work force with an excellent work ethic; an abundance of natural resources including forests, fisheries and agriculture; clean, unpolluted, relatively crime-free towns and cities, many with world class cultural institutions; and a coast, mountains, and lakes and streams that make high quality recreation something that is more easily obtained in Maine than perhaps in any other state in the country.

It is the Commission's belief that the Governor and the Legislature and the leaders in the Maine business community need to exert more effort in constituting themselves as a group of "ambassadors of business truths" so they can tell their friends and colleagues in other states that Maine, indeed, is a great place to live and a good place to do business, to invest capital, and to make money.

The range of actions that a state can take to attract large amounts of capital are relatively limited. However, there are a variety of actions that perhaps in a quantitative sense affect only the margins of economic activity but that can be very important to the continued growth of small businesses and to the elevation of the quality of life in Maine. A number of positive steps that can be taken are detailed in this report.

Formed by an act of the Legislature in 1990, the Maine Commission on Investment Capital was granted a very broad charter to examine and report on the needs for and sources of investment capital in Maine. The Commission's seventeen members were drawn from both the public and private sectors. The Commission held numerous public forums and met with government officials and business people throughout the State. Lacking any budgeted funds or permanent staff, the Commission decided early in its tenure to focus on capital needs within the private sector, a topic as to which it believed its efforts were likely to be most useful.

This represents the final report of the Commission. A general summary of the Commission's conclusions and recommendations follows. More specific findings and recommendations appear later in the report.

Whether Maine businesses have adequate access to investment capital is critically important to the vitality of the State's economy. Investment capital comes in many forms and covers a wide spectrum of risks and rewards from fully secured loans (low risk) to equity investments in start-up businesses (high risk). Unless investment capital is available and affordable over this entire spectrum, opportunities for business expansion and job creation will often be squandered.

The Commission's findings suggest that there is both good news and bad news regarding the investment capital picture in Maine:

> The good news is that, despite softness in the Maine economy, the full range of investment capital appears to be available to larger Maine businesses on reasonable terms. During the past several years, banks, insurance companies, and investment banking firms have vigorously competed with one another to provide loans and equity investments to larger, well-established companies in Maine. For these companies, the amount and terms of available capital are primarily a function of the risk and profitability of the particular business.
>
> A second piece of good news is that bank loans for small and medium sized companies appear to be more readily available now in Maine than had previously been the case. With the rash of bank failures in New England in 1989 and 1990, business credit for small and medium sized companies became very tight. However, banks such as Key, Fleet and Casco Northern are once again competing with one another for these types of accounts. The Commission believes that the easing of business credit in Maine was assisted by government guaranty programs offered by the Small Business Administration (SBA) and the Finance Authority of Maine (FAME).
>
> The bad news is that equity capital for smaller Maine businesses is very scarce and very expensive. While this is by no means a new phenomenon or one that is limited to Maine, the scarcity and cost of equity capital for smaller businesses hinders their prospects for growth and will put them at an ever-increasing disadvantage in a globally competitive marketplace. This is a critical issue for Maine. To a greater degree than in most other states, small businesses represent the vast majority of businesses in Maine, and are responsible for most employment in the State. This dependence on small business as a source of employment is likely to increase over time, notwithstanding efforts to attract large businesses to Maine.[1]

[1]Small businesses have traditionally generated much of the economic growth and new jobs in the nation. From 1988 to 1990, the most current year for which nationwide figures are available, all of the new jobs in the nation were created by small businesses. In Maine, small businesses created 85.2% of the net new jobs over the same time period.

Summary Recommendations

1. The Commission recommends that FAME be given adequate loan guarantee authority and resources to ensure that loan guarantee programs will continue to be available.

2. The Commission recommends that FAME provide a report by June 1994 to the Housing and Economic Development Committee on the status of the micro-lending programs in the State to determine if they are adequate to meet the needs of microenterprises throughout the state.

DID WE EVER DO THIS?

3. Despite a serious shortage of equity capital in Maine for smaller businesses, State government should continue to exercise great caution before using public revenues to take equity positions in private enterprise.

4. Our elected officials in Augusta and Washington should continue to support programs and policies that make bank credit available to small businesses.

5. The Commission strongly supports extension by the federal government of the Small Issue Industrial Development Bond Program which provides reduced interest rate financing to manufacturers for capital expansion projects.

6. Maine's Congressional Delegation should actively support legislative efforts to modernize the federal Investment Company Act of 1940 to provide exemptions for various types of venture capital funds that could be a source of new capital for small businesses.

STATUS?

7. Innovative programs aimed at reducing the costs associated with conducting public offerings of securities in Maine should be encouraged whenever they can be achieved without harm to potential investors. Potential regulatory changes that should be examined include:

-Simplifying of securities law exemptions for small, non-corporate issuers.

-Encouraging local businesses to publish their financial results in return for easier access to capital markets.

-Clarifying and perhaps expanding existing state laws regarding exemptions for resale of non-publicly traded securities.

-If changes are made in the federal Investment Company Act of 1940, adopting complementary changes in Maine securities laws.

8. The Venture Capital Forum held in May 1992 by the three Northern New England states should be enlarged and made a bi-annual event.

9. The Commission recommends that FAME and the Department of Economic and Community Development (DECD) cosponsor a Venture Capital Forum during the summer in a coastal community to attract seasonal residents interested in investing in Maine businesses.

10. The Commission recommends that FAME and DECD form a public/private partnership with a bank to produce and distribute a comprehensive directory of the many public organizations offering business assistance in the State, including loan sources and equity funding, specifically noting debt versus equity programs.

DID anybody DO THIS

11. We encourage the further development and distribution of educational materials and other programs designed to increase the financial sophistication of Maine business owners.

12. We recommend encouragement of efforts by the Maine State Retirement System (MSRS) to invest in Maine, provided prudent investments can be found.

I. INTRODUCTION

A. The Legislative Mandate

This document serves as the final report of the Commission on Investment Capital. Mandated by the Legislature through "An Act to Continue the Effort to Preserve and Promote Affordable Housing and Economic Opportunities for Maine People," and approved by the Governor on April 24, 1990 (Chapter P.L. 914), the Commission was specifically charged with

- ."a comprehensive evaluation of the capital investment needs of the state, including an analysis of the sources and magnitude of current capital investments in all sectors of the state's economy,

- .an analysis of the obstacles to capital investments in the state,

- .the identification of sources of funds in the state that may be used to leverage new capital investments, and

- .a review of the impact and opportunities resulting from foreign investment in the state."

B. The Methodology

The Commission was composed of 17 members from both the public and private sectors. (See attached list of members.) The Commission operated without a budget, and with borrowed staff. Supportive information, such as minutes of meetings and other communications, is available from the Department of Economic and Community Development (DECD).

The Commission approached its mission by first defining the scope of its work. The wide breadth of its legislative duties required a significant amount of time spent interpreting and developing a focal point. The members decided initially to investigate three fundamental and interrelated uses of investment capital: business activity, public infrastructure, and affordable housing.

In August of 1990, the Commission assembled a working group of staff from various state agencies, and asked them to investigate the "sources and magnitudes of current capital investments" during the past decade in these three areas.

In December 1990, the Commission held a series of four public meetings in Lewiston, Presque Isle, Bangor, and Portland to gather information. Specifically, the Commission sought to identify obstacles to capital formation and other issues of capital access.

The Commission held two additional information gathering meetings in early 1991 at the request of individual organizations. The first included representatives of Maine's financial institutions whose perspectives focussed on the "credit crunch". The second round table discussion examined the capital needs of very small, or "micro", enterprises with representatives of Coastal Enterprises, Inc., a non-profit economic development organization located in Wiscasset.

The input collected at these public information sessions was summarized in meeting notes and a list of recurring capital issues. This list and proposals from members of the Commission helped finalize a set of discussion questions.

II. DETERMINING THE ISSUES

The members of the Commission determined that they would research, review, and discuss the issues deemed relevant to the mandate, and then make recommendations for courses of action they felt were needed to improve capital investment in the State of Maine.

This report provides insight into the research, questions, and points of discussion that arose during the Commission's study. It includes resulting questions that need further study and recommendations for solutions. However, the conclusion was also reached that a comprehensive study tracking the actual sources and uses of investment capital in the State was not possible given the broad mandate and limited resources available to the Commission. To fully explore the subject in a quantitative manner would require data collection and analysis mechanisms that are not currently available, because capital flows into, around and back out of Maine in such diverse and difficult to quantify ways.

After the public hearings, it was concluded by the Commission that its initial focus would be on three key issues: public infrastructure, housing, and business activities as they relate to investment capital. These topic areas were selected because of the magnitude and importance of capital needs in each area.

A. Infrastructure

Each year, substantial amounts of capital are needed to pay for the construction and operation of the State's basic infrastructure: public utilities, transportation, waste disposal, water and sewer, etc. Even the most rudimentary investigation reveals a capital need for Maine towns of staggering proportions. The financing of these needs threatens to consume every-increasing amounts of State and local tax dollars and require ever-increasing fees for users of these facilities.

Due to the scope of this subject, the Commissioners chose to limit their treatment of infrastructure to noting its importance as a factor in the formation of capital, and as a critical element in Maine's economic future. The State faces formidable infrastructure requirements. Transportation and environmental infrastructure requirements are projected at over two billion dollars by the year 2000. Meeting current federal mandates for waste water treatment and drinking water standards alone will require over one billion dollars that will have to be paid for by fee increases paid by both residential and business customers of the State's water and sewer systems. Such large infrastructure costs forewarn increasing business costs, and underscore the importance of a healthy, growing economy to finance them. The Commission believes that existing capital markets and State supported financing mechanisms are able to provide whatever capital may be needed to fund infrastructure projects -- but at a price. The issue here is not availability of capital, but rather the cost to taxpayers and users.

B. Housing

As with infrastructure, it was concluded after preliminary research and discussion that the issue of housing, specifically the empty housing that was significantly affecting the marketplace during the late 1980's and early 1990's, was not an issue that this Commission could act upon. The Commission determined that it could deal only with the interrelated issue of increased private business activity which thus affects the housing market through increased jobs and tax revenues. Like infrastructure, this issue is not one of availability, but of affordability. The Commission determined that the State could have only a limited role in providing subsidies or reduced borrowing costs for housing projects and that federal programs offered the best opportunity to make housing more affordable for low income residents.

C. Business Activity

It is apparent that our standard of living is directly tied to the level of private business activity in Maine. Improvements in the standard of living depend on growing businesses that create jobs, pay taxes, create wealth to support housing and infrastructure needs and improvements, and produce more and better goods and services.

Investment capital allows an entrepreneur to start a business venture. It enables an existing company to purchase, produce, and sell its goods or services, creating wealth in the process. This wealth provides salaries and wages for the company's employees, funds its operations and growth, adds to the pool of investment capital available, and allows the business to borrow or attract additional capital from lenders and investors. As a consequence, capital circulates through the economy, multiplying as it supports business growth.

Without access to investment capital, new businesses are unable to form, and existing companies are unable to grow. As business activity stalls, private investment capital becomes scarce and even more costly. These consequences ripple through the economy, with companies deferring the investments that keep them competitive. Deferring investments also slows employment and income growth. An adequate supply of investment capital is one key to improving the standard of living for the people of Maine.

For these reasons, state government unavoidably has a stake in the effective operation of Maine's capital markets. In a free market, the flow of capital is based on principles of investment risk and return, resulting in flows of capital which may leave gaps that are contrary to public policy concerns. Federal and state governments certainly influence capital on a macro level. They also intervene at the level of individual transactions to fill gaps in the availability of capital, to redress the effects of severe economic dislocations, to overcome inefficiencies, and to correct imperfections in the flow of information regarding capital. Municipalities too often become involved in the issue of business development, providing incentives and other support to those businesses already serving their communities and to start-up ventures considered to be particularly important to the community. Tax rates and assessments, building codes and other issues of municipal regulation directly affect businesses and can either encourage or deter private development. (why and what is too often ?)

In contrast to infrastructure and housing, the issue of business financing is primarily an issue of availability, not affordability. Many of the Commission's findings and recommendations flow from this central point.

Following the preliminary investigations and deliberations outlined above, the Commission decided to focus its major efforts on the following questions:

.The relevance of the business climate to capital formation;

.Gaps in the capital market;

.The State's role in business financing.

III. RELEVANCE OF THE BUSINESS CLIMATE TO CAPITAL FORMATION

There is a perception among many business people in Maine that the business climate in the State is anti-business and not conducive to business development. In speaking informally with a variety of business people, Commission members heard the overriding opinion that Maine is essentially anti-business and that there are fundamental areas that must be corrected before the State will be perceived as a good place to invest or expand one's business. The two primary areas of perception that appear to have produced this viewpoint are:

.Laws and public policies taken as a whole are not friendly toward business development (e.g., issues of high worker's compensation costs and taxation, bureaucratic red tape, the regulatory environment, etc.);

.A significant number of people in Maine are suspicious of business development.

This is supported by many surveys and independent analyses, the most recent of which is a survey of Chief Executive Officers of manufacturing firms in Maine, New Hampshire, and Vermont conducted by the College of Business Administration at the University of Maine in Orono ("1992 Northern New England Manufacturing Business Climate Satisfaction Survey"; published February 1993.) This survey finds the following key disadvantages to a Maine business location:

.Worker's compensation (87%)

.State government's attitude toward business (53%)

.Energy costs (23%)

.State business taxes (15%)

.Waste disposal and pollution control costs (14%)

.Fringe benefits (14%)

.Local government's attitude toward business (12%)

.State personal taxes (11%).

Among the three states included in the survey, CEOs in Maine were most likely to consider relocating to another state.

Anecdotal evidence suggests that some established businesses, when faced with increased costs and other impediments to doing business in Maine have elected to leave the State for more favorable regions of the country. Others have weighed the options and have elected to stay, often for reasons of work force availability or lifestyle, in spite of the problems they face in maintaining profits and growing their businesses. Using the axiom that "perception is reality", these same attitudes are probably carried beyond the State's borders and freely discussed within its borders, creating a broader perception of an unfriendly business climate among potential investors both internally and externally.

IV. GAPS IN THE CAPITAL MARKET

The investment of capital is most often influenced by the balance of risk and return offered by the investment. Every investment is characterized by a risk that the investor will lose his capital, and by a potential return through the interest, royalty, profit or appreciation paid to the investor for the use of his capital. Businesses doing feasibility studies or in the research and development stage present the highest risk, while well-established companies are relatively lower in risk potential. The degree of perceived risk associated with a particular capital need determines whether that capital is available at all and, if available, on what terms and at what cost.

Along the risk spectrum of capital needs, there have always been gaps that are not readily filled by available capital sources. To the extent that gaps exist, businesses suffer and either decline or forego opportunities to expand. Since the inception of the Commission, much attention has been focused on reasons why capital may not be available to meet every business need.

A. The Range of Business' Capital Needs

A fundamental question of access to capital is whether capital is available along the entire spectrum of risk and business size. The delivery system of investment capital can be shown as a progressive spectrum. As companies move along in the ever-changing growth and development of their businesses, the types and sources of capital change, following variations in risk and return. It is nearly impossible to quantify the size of the demand for each type of financing due to the individual nature of each company, its products and how it manufactures and markets those products and the constant changes taking place in the capital needs of the State's businesses.

Traditionally, there are four primary stages of business growth: Start-Up, Development, Young Operating, and Maturity. The following delineates the first three of those stages, since they usually require outside capital infusion to help the company move forward, and the types of capital normally available to them or currently available in the State of Maine. They are listed with the caveat that no two businesses are alike and usually defy strict classification due to the entirely unique financial needs, availability, risk and return offered by the companies.

Even the most aggressive government programs only affect the margins of a much larger volume of private transactions. Most state and federal loan and loan guarantee programs in Maine assist the "Young" and "Middle-Aged Operating" companies as defined in the following section. Some regional and local programs offer assistance to businesses at the "Development" stage, also defined below. The State lacked direct sources of capital for companies in need of start-up, venture, and middle risk equity capital at the time the Commission began its work.

1. Start-Up Stage: Personal Savings, Personal Credit Lines, Friends, Relatives, and "Angels"

An entrepreneur's personal savings, credit card advances, borrowing against life insurance, a second home mortgage, profit-sharing funds from a previous job, and loans from friends and relatives are, and are likely to remain, the most important sources of start-up capital. Public sources of start-up capital are scarce but not nonexistent. The lack of government intervention may have reflected the idea that an entrepreneur should bear the risks of start-up, and that these risks are too high for the taxpayer to bear. Since then, several public and private programs for microlending have been developed, including the SBA Microlending Program that is being administered by Coastal Enterprises Inc. located in Wiscasset. In addition, the Finance Authority of Maine's Job Start Program can provide loans up to $10,000 to micro-businesses for start-up or expansion.

Business angels -- wealthy individuals who have a high tolerance for risk -- usually invest quietly, with company and investor meeting through a trusted referral source. The Commission discussed the potential of tapping into this source of capital, but determined through talks with the Finance Authority of Maine (FAME) about its Maine Capital Network, that, while government has an interest in increasing such activity, it has difficulty finding entree into these closed circles. The Maine Capital Network was established by FAME to match investors with companies seeking capital but most of the investors in the program are not interested in start-up businesses.

2. Development Stage: Venture Capital

The venture capital industry in Maine has consisted of the following sources:

- Maine Capital Corporation
- North Atlantic Capital
- Katahdin Securities
- The Passamaquoddy Tribe
- Private, individual efforts

The Commission's findings suggest that the absence of other funds and a relatively low level of venture investment may be due to the following reasons:

-The relatively small amounts of capital sought by Maine's predominantly small businesses are not cost-effective investments for venture capitalists;

-A retrenchment in the venture industry at large as economic conditions produce fewer or unfamiliar "high-growth" investments;

-A lack of sufficient investment opportunities promising high return to draw the attention of venture capitalists to Maine. Companies in proximity to proven research and development "pipelines" such as MIT in Cambridge, California's Silicon Valley, or North Carolina's Research Triangle, have more success in attracting venture capital for those types of businesses best served in such an environment.

To overcome some of the cost disincentives to investors, and perhaps to test the accuracy of the other reasons stated above, the three states of New England have held a Venture Capital Forum once a year for the past two years to bring together investors and companies seeking venture investment. The Forum was successful in getting businesses in front of potential investors. The participating companies found it to be a positive experience resulting not only in increased contacts but in learning more about the potential for investment opportunities. The first Forum was deemed the most successful. The second Forum was less so since the best companies were selected to attend the first Forum, leaving the second tier to attend the second Forum. The organizers are now considering a two year gap between future Forums to insure a better selection of ready businesses.

3. Young Operating Stage: Debt and Equity Financing

a. Debt Financing

Maine's financial institutions serve a band of the capital spectrum characterized as lower risk and of a certain minimum size, and characterized by demonstrated cash flow to pay debt and a reasonable amount of collateral as a fall back.

Public programs which guarantee loans enable banks to lend outside their usual lending parameters, but do not induce banks to lend to businesses that do not demonstrate a reasonable likelihood of repayment. Federal and state agencies such as the U.S. Small Business Administration (SBA), FAME, and the Farmers' Home Administration (FHA) offer an assortment of loan guarantees for debt.

Under the Maine Job Start Program, FAME, in cooperation with four community action agencies, can make loans of up to $10,000 available to micro businesses that meet certain low income eligibility criteria. The loans are for starting or expanding a small business, and are available when the applicant does not have access to other sources of credit.

Since the Commission's first meetings, the SBA Microlending Program administered by Coastal Enterprises, Inc. in Wiscasset, has begun on a limited level to fill the need of small loans for micro-enterprises, historically an underserved market. Other similar programs are being developed by both public and private lending sources. For example, in 1991, Key Bank established a loan fund of $5 million for small business loans for members of the Women's Business Development Corporation (WBDC), a non-profit, state-wide membership organization devoted to economic development for rural, low-income women. In 1992, Key Bank established a $75,000 line of credit to be administered by WBDC for microloans to its members. In addition, WBDC is the exclusive representative in Maine for Working Capital, a peer lending program based in New Hampshire aimed at micro-enterprises that allows untried small business owners access to credit not normally available to them.

These programs were established to serve a special market that is not lucrative enough for traditional lending by banks and other groups, yet they fill the need of small businesses to obtain small amounts of money during the initial stages of start-up and growth. In addition, lending to women, particularly rural, low-income women, brings unique factors to the table. It provides the help they need to break the cycle of poverty, to learn and establish responsible credit patterns, to slowly develop their often home-based businesses, and to eventually graduate to larger loans available through more traditional sources once a credit rating is secured and sales increase.

It is acknowledged that microlending will not create macroenterprises, but it does serve an important purpose, especially when teamed with technical assistance. Technical assistance helps to ensure a higher rate of success and growth among these microenterprises. Many of the sponsoring agencies and organizations such as Coastal Enterprises, WBDC, the SBA, DECD and FAME do currently provide such assistance alone and as a collaborative effort through one-on-one counseling, seminars and conferences held in all regions of the State for small business owners, publications, and more.

At a higher level, FAME has created several programs to serve the capital needs of larger businesses including the Economic Recovery Loan Fund which made $7 million available for near equity, subordinated loans. Through the Department of Economic and Community Development (DECD), the State Tax Increment Financing Program has also been introduced to enable municipalities to receive up to 25% of the net increase in sales and income taxes resulting from a business start-up or expansion to pay for a portion of the cost incurred in undertaking the start-up or expansion.

Through FAME's Seed Capital Tax Credit, investors can realize a tax credit on equity investments made in Maine companies. In 1992, at the urging of the Commission on Investment Capital, FAME sought and received statutory authority to liberalize the rules governing this program to encourage its use. Previously, the credit was available only to companies that exported outside the State and had annual sales of $500,000 or less. The statutory changes now permit the credits to be awarded for businesses with $2 million in annual sales if the businesses are manufacturers, exporters, or if they bring substantial capital into the State.

Also during 1992, legislation expanded what FAME could do under their loan guarantee programs. To facilitate the use of loan guarantees for smaller businesses, the eligibility limit on their small business guarantee program was increased from $2 million in sales or 20 or fewer employees, to $5 million in sales or 50 or fewer employees. The guarantee maximum was increased from $500,000 to $1 million and the guarantee percentage was increased from 85% to 90%. By qualifying more loan guarantee requests under the small business loan guarantee program (guarantees up to $1 million versus the $7 million authorized under the more formal Commercial

Loan Insurance Program), FAME can expedite processing and has increased flexibility in approving requests. The FAME Board has also expanded the use of loan guarantees for working capital and for loans made by non-traditional lenders (individuals, partnerships, trust funds, etc.) in an effort to expand the types and sources of capital available to small businesses.

These changes, combined with the improvement in the economy and the impact of federal regulatory agencies on banks, have dramatically increased usage of FAME's loan guarantee programs. From July, 1992 through March, 1993, FAME provided loan guarantees on loans totalling over $70,000,000 for 224 businesses, compared to loans of $25,000,000 for 92 businesses during the same period of the prior fiscal year. This increase coincides with much increased interest in commercial lending that Maine banks have exhibited over the past 6 to 12 months.

FAME is currently developing a new program that will allow lenders holding a FAME guaranteed loan to sell the insured portion of the loan on a secondary market to investors. This program will encourage additional lending for two reasons: first, it will provide additional liquidity to Maine lenders allowing them to loan funds to more borrowers, and second, it will increase their yield, making commercial loans more attractive to them. No other state has a secondary market of this type.

The members of the Commission heard testimony regarding the need for equity and for subordinated debt and had several discussions about whether the State should provide capital directly for higher risk investments. The Commission as a whole determined not to recommend direct involvement by the State in equity investments because of the risk of loss and difficulty in picking the winners and losers. Members also questioned whether the State should be taking an ownership position in Maine businesses. The Commission does support State funding for subordinated debt programs, which can meet many capital needs not filled by existing private sources of capital but without the same level of risk associated with equity investment.

Subordinated debt can be used to leverage private sources of capital and can be structured to tie repayment in to cash flow needs of the business. Successful subordinated loan programs have been operated at the State level by FAME, the Department of Agriculture, and the Department of Economic and

Community Development, and by several regional entities.

b. Equity Financing

The working group's research identified the major public sources of capital, several of which leverage public or private investment. However, it did not include the flows of capital from private sources, such as individual investors and the reinvestment of business profits. It was determined that this information is very difficult to identify since it is not a matter of public record and is often informal with agreements struck privately between investors and business owners. It is acknowledged by the Commission that private sources of capital are significant sources of capital for any state, but they are beyond the capacity of the Commission to quantify.

However, capital for equity investments of medium risk, or "mezzanine financing", has been lacking in Maine. A number of established businesses in Maine would be classified as medium risk investments. Ventures by these companies offer more modest returns on equity than a venture capitalist requires, but carry too much risk to be debt-financed by banks.

It is the consensus of the Commission that the most serious capital shortage in Maine relates to equity capital. Some people in the State speculate that many businesses are over-leveraged as a result of

1) High levels of debt originally acquired during the 1980's when banks were aggressively lending against appreciated real estate;

2) An interruption in business revenue growth that at one time justified a higher level of indebtedness;

3) Historical aversion on the part of many Maine business owners toward sharing control of a business; and,

4) An inherently inefficient and costly market for small equity investments.

The first two factors are, realistically, beyond the control or influence of State government officials. The third factor, it is felt, will disappear over time without State intervention.

The fourth factor -- inefficient and costly capital markets for small equity investments -- is due to the following reasons:

Information. Communication between small businesses and potential investors is haphazard, highly variable, and uncertain. In contrast, public capital markets thrive on widely available information.

Skill. Many small business owners have little or no training or experience in seeking equity capital. Even those who are quite skillful in their dealings with bankers often lack the skills needed to attract, evaluate, and negotiate equity investments. In contrast, businesses whose securities are traded in public capital markets generally have one or more executives who have developed expertise in such matters. Moreover, the larger size of public market transactions attracts highly specialized brokers and other professionals to assist in such transactions.

Liquidity. Investments in small businesses are highly illiquid, which in and of itself represents a significant risk for potential investors since they do not know when they will be able to recoup their investment. In contrast, public market transactions are generally characterized by relatively high liquidity.

Relative Transaction Costs. Equity transactions for small businesses tend to be relatively small in size and yet may involve complexities and costs similar to those in larger, public transactions. As a result, the relative size and significance of transaction costs tend to be higher for small business investments than for public market investments. Negotiation costs are one significant (and probably inherent) factor in small business investments. Costs arising from applicable federal and state securities laws can also be a significant factor.

If for no reason other than economies of scale, it is felt that the small business capital markets will never be as efficient as the public markets. Some recommendations to reduce the inefficiencies of equity capital markets within Maine are outlined in the final section of this report.

B. The "Credit Crunch"

In the late 1980's and early 1990's as the stalling economy caused loan defaults, federal regulators required banks to adopt more stringent lending practices. At the same time, many banks were shaken by loan write-offs and many failed, including several in Maine. The resulting changes in the availability, terms and cost of capital provoked already worsening business conditions for the banks' existing and prospective borrowers. At one point in this cycle, banks were reporting low demand for loans. The poor economy may have dampened businesses' capital requirements or made them more risky investments. At the same time, it also reduced the banks' appetites for risk. Banks were also forced to spend tremendous amounts of staff time working out troubled loans and preparing credit files for regulator review rather than focusing on business lending.

These three events -- national recession, difficulties in New England's financial institutions, and a changing Federal regulatory environment -- were drawing even more attention to questions of access to investment capital during the first months of the Commission's existence. The economic environment had been changing rapidly for a year or more and recurring accounts of restrictive lending practices caused the Commission to add the question of the effect of a "credit crunch" to its agenda.

The evidence on either side of the question is nearly always anecdotal. Some businesses reported that banks had terminated their lines of credit without considering the companies' past creditworthiness. The banking community maintained that any changes in lending practices were the result of a more risky economic environment, and more stringent guidelines from federal regulators. Interstate banking was not demonstrated to have negatively affected the availability of capital. However, banks also reported low demand for loans, suggesting that the capital problem is an issue of risk and cost rather than availability.

The Commission believes that the "credit crunch" is largely behind us. Failed banks have been absorbed, banks have learned to adapt to the changed regulatory environment, and businesses have downsized where necessary to survive the recession. The result has been a move toward more active lending, and heightened competition between banks for commercial customers. However, the combination of bad loans and federal regulations will have a lingering impact on business lending, and the recession continues to dampen borrowing for expansion or new projects.

C. Lack of Consolidated Information

One of the greatest difficulties for people interested in evaluating the operation or performance of Maine's capital market is a lack of consolidated and comprehensive information. Some of this knowledge is unattainable or would require an impractical amount of effort to obtain. Public sector participation in business financing represents only a fraction of the whole, but attempting to identify the entire range of private sources of capital in Maine is beyond the capacity of existing data gathering resources in the State.

This lack of a comprehensive information base also extends to foreign investment in Maine. The Commission was originally charged with the task of identifying and analyzing foreign investment which is an important source of capital with great potential for certain industries. However, the group found the task beyond the resources it had at its disposal.

For companies in the earlier stages of development, there are numerous seminars and conferences aimed at business owners and aspiring entrepreneurs that take place throughout the year in all regions of the State. Sponsored by various agencies, non-profit associations, and private businesses including the SBDCs, FAME, the SBA, WBDC, DECD, the Maine Development Foundation, the Maine World Trade Association, the Maine Department of Transportation, Bath Iron Works, and others, information on the different financing options aimed at developing businesses is provided freely to participants. Each group also actively promotes its various lending programs through a variety of publicity techniques.

Key Bank of Maine produced a booklet entitled "Public Sources of Capital in Maine" in November 1992. Now being updated, it is to be used to "familiarize businesses and individuals with the various federal, state and regional public commercial financing programs available as well as residential real estate and venture capital sources." This booklet is the most comprehensive compilation of capital sources we have seen so far, and is "intended to assist small and medium sized businesses to start up or expand their operation and employment." For business owners willing to make a modest effort, there are many sources of readily available information on business financing options.

V. THE STATE'S ROLE IN BUSINESS FINANCING

A positive business climate is just as relevant as healthy capital delivery to the creation and growth of capital. Factors such as operating costs, government regulation, uncertainty, and the quality of available resources (both human and material) define the context in which Maine businesses must operate.

Ordinary business cycles in the national economy should not be confused with these structural attributes of Maine's economy. Though often distorted by national economic peaks and troughs, much of the State's business climate is the cumulative result of public policy decisions.

A. Non-Market Variables

Prudent businesses expect and allow for a degree of uncertainty in the general economic conditions, the market for their products, and from their competition. They seek a loan at a fixed rate of interest, or sign multi-year contracts with customers, for example. However, businesses need to know what to expect of non-market variables, such as regulation and taxes, in order to make long-term investment decisions. If these factors change rapidly, businesses must devote resources to comply and monitor developments. An environment of uncertainty, tax or regulatory, frustrates businesses' ability to plan, and inhibits investment.

B. Costs of Doing Business

Low operating and input costs were once considered the driving force of business location and investment decisions. States and municipalities sought to lower artificially the costs of doing business through tax holidays and abatements in order to attract companies from their neighboring states. This "beggar-thy-neighbor" tactic to encourage investment has waned as the significance of operating costs has been understood more accurately.

However, when one state's costs exceed another's by wide margins, the more expensive state will obviously have difficulty attracting new investments. More importantly, businesses already established in the state may consider moving to a more favorable state, or directing new investments elsewhere. For some businesses, moving out is not an option. They must compete as best they can or consider closing. Finally, a poor business climate would seem to inhibit the formation of new businesses, and cause many to die in infancy.

Admittedly, it is impossible to measure foregone investment; the new ventures that would have been formed, or the expansion that would have occurred. It is almost as difficult to separate the effects of business climate from larger market and industry trends since they operate hand-in-hand.

The Department of Economic and Community Development has recently sought to determine some of the reasons for company closures and layoffs. A scan of 69 companies reporting under the Worker Adjustment and Retraining Notification Act sought to determine the reasons for companies closing, or laying off workers in the first four months of 1991.

Changes in overall economic conditions ("economic downturn") and import competition were cited by 52 companies as factors in decisions to close or lay off workers. Twelve companies listed workers' compensation costs among their reasons, and five mentioned health care costs. Other explanations, such as business or property taxes, occurred in no more than two instances, less frequently than poor operating results.

While not scientifically accurate, the Commission suggests that these informal survey results might support the idea that companies recognize economic trends as having primary influence over the health of their businesses. Issues of business cost seemed to have close, but secondary, importance.

Fifty-one of those companies surveyed responded to a follow-on question: "What should the State of Maine do (correct or change) in order to retain or bring new businesses to the State, in essence, to create a healthier business environment?" The following is a rough categorization of the most common responses:

Changes Advocated by Respondent	Number	(Percent)
Changes to Workers' Compensation System	48	(94%)
Tax Structure	12	(24%)
Health Insurance Costs	8	(16%)
Import Competition	6	(12%)
Department of Environmental Protection (time frames, fines)	5	(10%)

With the exception of import competition, responses all dealt with business cost issues. These issues may not be the primary factor determining layoffs or closings, but they appear to be viewed as the areas over which the State of Maine has control.

VI. RECOMMENDATIONS FOR ACTION

The following section presents recommendations of the Commission on ways to address the issues presented in this report.

1. The Commission believes that the loan guarantee programs offered by FAME provide a very valuable service in making capital available to small Maine businesses that would not otherwise be able to borrow the capital they need. The Commission recommends that FAME be given adequate loan guarantee authority and resources to ensure that its programs will continue to be available.

2. The revolving loan funds in the various municipalities and the micro-lending programs offered by organizations such as Coastal Enterprises, the SBA, FAME, and WBDC cannot be measured in terms of dollars or wealth created. As micro-lending programs often aimed at people with little or no capital or credit history, they have successfully helped families get off AFDC through the development of micro-businesses, giving families a new lease on life and a sense of self worth. This human aspect is a very important one. The Commission recommends that FAME provide a report by June 1994 to the Housing and Economic Development Committee on the status of the micro-lending programs in the State to determine if they are adequate to meet the needs of microenterprises throughout the state.

3. Despite a serious shortage of equity capital in Maine for smaller businesses, State government should continue to exercise great caution before using public revenues to take equity positions in private enterprise. The amount of public resources available for such investments is, at most, a small fraction of the private resources that are potentially available. Direct public investments run the risk of further skewing the allocation of resources within the private sector, and almost inevitably raise difficult questions of fairness. Improvements in education and physical infrastructure represent more traditional investments for government agencies and tend to have a broader impact and produce greater dividends.

4. Banks have traditionally served as a primary source of capital for smaller businesses. Our elected officials in Augusta and Washington should continue to support programs and policies that make bank credit available to these types of businesses.

5. The Commission strongly supports extension by the federal government of the Small Issue Industrial Development Bond Program which provides reduced interest rate financing to manufacturers for capital expansion projects. The Program has been a very important economic development tool in Maine, enabling Maine manufacturers who have borrowed more than $76 million since 1986 to finance 49 projects. These projects have produced direct investment of nearly $90 million and have created or retained over 4,000 manufacturing jobs. Manufacturing jobs pay better wages than service sector jobs, both in Maine and nationally. Without the existence of the lower interest rates resulting from the tax-exemption on the bonds, these projects would not have taken place or would have been reduced in size.

6. Finding new and more efficient ways to finance small business is critically important for Maine. Greater use of private venture capital funds to invest in local businesses is one potentially promising route. Currently, the federal Investment Company Act of 1940 is a substantial impediment to the formation of such funds. That Act generally imposes the same costly registration burdens on small local venture capital funds as it does on multi-billion dollar mutual funds. Maine's Congressional Delegation should actively support legislative efforts to modernize this Act to provide exemptions for various types of venture capital funds that could be a source of new capital for small businesses. In anticipation of favorable changes in federal law, FAME should examine whether steps can be taken to encourage the formation of these sources of capital for local Maine businesses.

7. Although not a major impediment to capital formation within the State, Maine securities laws do influence the ways in which local businesses raise capital. The Maine Securities Division recently adopted an innovative program (SCOR) aimed at reducing the costs associated with conducting public offerings of securities in Maine. These types of efforts to reduce the costs of raising capital should be encouraged whenever they can be achieved without harm to potential investors. Potential regulatory changes that should be examined include:

-Simplifying securities law exemptions for small, non-corporate issuers. The Revised Maine Securities Act presently provides very liberal exemptions for Maine corporations that have 25 or fewer security holders. In contrast, non-corporate issuers in Maine generally are forced to meet exemption criteria that are far more cumbersome than in most other states.

-Encouraging local businesses to publish their financial results in return for easier access to capital markets. One striking characteristic of public capital markets is the ready availability of information concerning publicly held companies. The availability of such information makes capital formation more efficient and provides certain protections to investors. Those Maine businesses that wish to raise equity capital from time to time could perhaps be encouraged to publish certain standardized information concerning their financial condition and results of operations. For example, Maine companies that regularly publish financial data might qualify for (i) clearer exemptions for resales of their securities or (ii) fast-track treatment of registration filings. The availability of such information could assist in attracting equity capital and could help improve liquidity by facilitating resales of such companies' securities.

-Clarifying and perhaps expanding existing state laws regarding exemptions for resale of non-publicly traded securities. The Revised Maine Securities Act provides registration exemptions for individuals who make occasional resales of securities of non-public companies. The Act is more restrictive of the activities of securities firms and other professional traders that, in public markets, play an important role in improving the liquidity of investments. The lack of liquidity of investments in small companies increases the risks associated with these investments and helps discourage capital formation for small companies.

-If changes are made in the federal Investment Company Act of 1940, adopting complementary changes in Maine securities laws. For example, special purpose registration procedures (analogous perhaps to SCOR) or special exemptions (such as some type of "qualified purchaser" exemption) could reduce the costs of forming these ventures and could facilitate development of a secondary market for their securities.

8. The Venture Capital Forum held in May 1992 by the three Northern New England states should be enlarged and made a bi-annual event. Small Business Development Centers could provide technical assistance to companies preparing a presentation for venture capitalists.

9. The Commission recommends that FAME and DECD cosponsor a Venture Capital Forum during the summer in a coastal community to attract seasonal residents interested in investing in Maine businesses. There clearly is a need to introduce potential investors to Maine business people in need of capital. By hosting a summer Forum, the State

can facilitate those introductions among a group not normally tapped by the State.

10. There presently is a multiplicity of business capital assistance programs offered throughout Maine by various federal and state agencies, quasi-public bodies, non-profit organizations and foundations, and local development bodies. Keeping track of these resources is becoming an increasingly difficult and time-consuming task. Maine businesses in need of such programs cannot benefit from them unless they know where to look or who to ask for the information.

It is recommended that FAME collaborate with Key Bank to distribute the bank's directory, "Public Sources of Capital in Maine", to small business owners through the business assistance providers. The wider distribution of the directory could lead to greater cooperation among the various providers of these services and, as a result, greater efficiency in the delivery of the services.

Through its own activities, FAME has acquired valuable expertise on the workings of Maine capital markets and on managing the delivery of business assistance programs. FAME is therefore well equipped to coordinate these programs and providers. The needs of small businesses in Maine for cost-effective financing are great, and we should make the most of every dollar of business capital assistance that is available to them.

11. Existing efforts to increase the financial sophistication of Maine business owners should be encouraged and better coordinated. There are a number of organizations within the State (e.g., SCORE, the SBDCs, WBDC, Displaced Homemakers, CEI, and the University system) that provide valuable training to entrepreneurs. The development and distribution of high quality educational materials and training programs can help improve the "intellectual capital" required to run a business efficiently and help the business owner make the most of scarce resources. The system used to distribute the business assistance directory described above could also be used to make available information on the educational materials and training programs offered by these same assistance organizations.

12. Encourage efforts of the Maine State Retirement System (MSRS) to invest in Maine, provided prudent investments can be found. Recently, as a result of discussions initiated before the Commission, the Maine State Retirement System and FAME entered into an agreement through which the Retirement System will invest $10,000,000 in Maine businesses by purchasing the insured portion of FAME-insured loans from lenders. Not only

will this program make additional capital available in the State that would otherwise be invested out of State, it also provides Maine businesses with financing at market interest rates based on FAME's credit rating versus the business's credit rating. As such, loans can be made at a lower cost to the borrower and the Retirement System is not providing a subsidy of any kind. The interest rate on the portion purchased by the Retirement System is based on the market rate of similar high quality insured investments. The borrower gets the benefit of a five year fixed rate that normally would be available only to a Fortune 500 company. The program is designed for loans of $500,000 or more.

Respectfully submitted by

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