GOVERNOR'S CONFERENCE

ON VENTURE CAPITAL

Friday, January 31, 1986
9:30 a.m. to 3:00 p.m.
at the Casper Events Center

Presented by
Wyoming Futures Project
Economic Development and Stabilization Board
Wyoming Bankers Association
Wyoming AFL-CIO

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CONFERENCE PARTICIPANTS

JOHN BECK has founded five separate companies, with such diverse interests as paper, resort management, executive recruitment, computers, and systems applications. He is a current director of four of those companies and a former director of the other.

He is now managing partner in the New York City investment counselling firm of Beck, Mack, and Oliver.

He serves the New York Metropolitan Museum of Art as a member of its investment committee...and gives financial and management advice to his alma mater, Princeton University.

Mr. Beck is a charter member of Princeton's board of trustees. And he is chairman of its investment subcommittee, which keeps watch on the Princeton endowment, now totalling over one-point-six billion dollars.

MORTON COLLINS began his professional life in the classroom, teaching calculus, applied mathematics, and digital computing at Princeton and Rutgers Universities. He put his chemical knowledge to work at Esso Research and Engineering, then began his successful career in venture capital, on which he is one of the nation's leading experts.

He has founded five separate firms, which provide management assistance to emerging companies concentrating on high technology. His most recent three efforts specialize in providing venture capital. He is now general partner of his latest venture, DSV Partners IV.

He has been the executive vice-president, the president, and the chairman of the board of the National Venture Capital Association, an industry lobby group, based in Washington; D.C.

EDWARD COHEN was heavily involved in developing the New Jersey community college system and has served as an assistant chancellor of education in New Jersey in health education and science and technology.

He is currently the executive director of that state's Commission on Science and Technology. In 1983, the commission published its first set of findings, which have been credited with creating a positive new attitude toward science and research in his state.

Since the report came out, five advanced technology centers have been developed, and New Jersey is now home to one of the four major supercomputer centers in the country. But the commission's work hasn't all been high tech. New technical centers have also been established in the fields of fishing and agriculture.

JAMES GALBREATH is president of four Denver-based financial service and investment companies, including Galbreath Financial Services Corporation. It is that company which has been chosen to be the professional manager of the proposed Wyoming Enterprise Fund. He has been a general partner and co-manager of two other Colorado-based venture capital partnerships.

Mr. Galbreath is a former investment counselor and portfolio manager and a chartered financial analyst.

He has studied economics and business at the University of DenVer and the University of Stockholm. He is a frequent guest lecturer at DU's Graduate School of Business.

CONFERENCE BACKGROUND
Pete Williams
Wyoming Futures Project

I'd like to sound a note that I suspect will be echoing all throughout the next few hours that we'll be here, exploring this topic together. In a way, we're all a little guilty of that form of advertising called "bait and switch," because this conference today will be considering a whole range of ways to raise money, not just venture capital.

We thought about calling this "The Governor's Conference on Entrepreneurial Capital Formation and Mobility," but we were afraid no one would come.

So, it's a conference on venture capital, and we're delighted to have here today some of the nation's leading experts on the subject.

This is the Governor's conference, because the idea for this meeting grew out of a letter which Governor Herschler wrote late in November to Raymond Plank. He's the chairman of the Ucross Foundation, which, along with the state, is one of the two parents of the Wyoming Futures Project.

The governor's letter said this: "As soon as possible, 1 would like the Wyoming Futures Project, in conjunction with the Economic Development and Stabilization Board, and other Wyoming groups, to develop and host a seminar on venture capital and capital formation in Wyoming. I understand that you have been able to identify nationally recognized experts in this area who might be willing to participate in such a seminar."

The governor's letter called for a cooperative, teamwork approach to the sponsorship of this seminar. And as you see from your program, that's precisely how our seminar was put together, with the help of the Economic Development and Stabilization Board, the Wyoming Bankers Association, and the Wyoming AFL-CIO.

MR. JOHN BECK
Beck, Mack & Oliver

Mort Collins, Ed Cohen, and I could not be more pleased to be with you all of you here today. it's an exciting challenge---one which I don't think Mort or I have ever seen before. This is more down Ed's alley. I think you should be warned in advance that we don't bring solutions to problems, nor do we intend to chart paths toward solutions. Rather, it is our hope that we can stimulate discussion. To that end, my remarks will be brief. Mort Collins will walk you through, as no other can, this new world of venture capital. And then you'll hear from Ed, who is a very thoughtful practitioner at the state level in developing programs quite similar to those in your prospect.

I'd like to discuss my own sense of the national capital markets and try to develop, at least in broad outline, what effect the current capital markets will have on Wyoming's future efforts. I have heard that there's some sense that a major problem facing Wyoming is that there just isn't money available to do what needs to be done. I think I've satisfied my self--and I hope I will satisfy you before I'm through---that this really is not the case.

America is awash with capital. Not capital seeking agricultural loans, to be sure, or energy loans, or real estate loans. But give them a reason in any industrial or service sector to make a loan and equity investment, and I think you'll find the markets will provide for your needs.

The capital marketplace

The capital market is separated into two entities. One services the established, growing, and mature companies. These are the companies which, almost by definition, have earned a place in the long-term lender's pocket, as well as in the public equity marketplace. These markets today have changed. Some of the traditional lending and investing patterns of yesteryear no longer obtain. The life insurance companies, for example, were a major source of long-term capital through the years. Because of their new life insurance products, they have shifted to a dramatically shorter-term investment profile. They really are not to be found as substantial sources of longer-term capital for the established U.S. businesses.

On the other hand, another important investing group is growing like a weed. Pension funds have really walked in and taken over the place that life insurance companies played 15 or 20 years ago. Moreover, there are two new phenomena in the long-term credit markets, which deserve attention, and which will continue to grow. The first is the whole concept of leasing as a financing vehicle. It may not surprise many of you, but it surprises me each quarter to see the percentage of General Electric's earnings which are derived from the new General Electric credit corporation.

Almost 20 percent of their earnings in 1985 will come from an effort they were not even involved in five years ago. And they are financing leases on a short term basis of two or three years, and on a 15 and 20 year basis, where they can find a credit worthy of their attention. The credit is both the lessee plus the equipment which he leases. They are very competitive lenders, and they have spawned around them a large number of well capitalized leasing companies, both independent as as part of other financial institutions.

And then the darling of the 1985-86 marketplace, the junk bond world, is providing to established companies a whole new source of long-term credit. I don't wish to get involved in the investment merits of this practice, but it is new and very substantial. And I think it brings to borrowers who may not have been able to borrow traditionally a chance to borrow on terms which, if the project they have in mind has any merit, probably will make the project a successful one.

Short term markets

In the shorter term borrowing area for established companies, banks, of course, and pension funds have discovered project financing in a world which increasingly is project oriented. And it is an area where demand exists: you can find short term credit on a basis which is quite compatible with the characteristic of the borrowing need.

The second phenomenon which exists is the proliferation of interstate banking. One of the largest lenders today in Denver is our own CitiCorp of New York, which also has an office in Salt Lake. In fact most of the larger money center banks can be fotind as lenders in most of the non-traditional markets. And i think they are providing credit on a competitive basis with the local banks. And I certainly would encourage any of you to seek out, perhaps a little more broadly than you had traditionally, to see if some of these new lending offices can provide for your needs.

For the smaller companies---and that's why we're here today—there are vehicles which have been established 15 to 20 years ago, whose capital has been replenished because of the success of the first go-round. That's this whole venture capital world, which Mort Collins will attend to later. It has attracted private capital, institutional capital such as Princeton University. And states themselves have been parties to, or have started on their own, venture capital pools, to improve the investment performance of the state pension funds and to improve the economic environment of the states.

And finally, there's the corporate world itself. The large S&P 400 companies have decided that if they are to get extraordinary returns on their capital tomorrow, they had better begin to try to divine some new areas of enterprise today. And to that end, they have become competitors of the venture capitalists themselves.

Potential tax law changes

The only negative I can identify in the capital area is the question raised by the new tax bill dialogue in Washington. I think the capital gains tax treatment, as an example, has been a major plus to the growth of venture capital monies. As I read the proposals, they seem to creep back up in their taxation of capital gains. They're fiddling around with depreciation lives again and investment tax credits. And both have been financial assists to the corporations which have faced financial requirements.

No capital shortage

Put them all together, and I believe quite strongly that there really is no shortage of capital facing any legitimate borrower in the United States today. I think that is as true for Wyoming as it is for any other state. If you can bring to the lender or the investor a combination of good people, properly educated and motivated, and a geographical situation where the tax, labor, and environmental atmosphere are conducive to the successful execution of the proposed investment, then you will find capital.

DR. MORTON COLLINS
DSV Partners IV

What I would like to do here today is to discuss venture capital to a degree, talk some about its history, and give you some perspective of its size on a national basis. I'll make a few comments about the recent growth of the industry—which has been substantial, then address this question: does venture capital matter at all in the national economy?

To address that question, I'd like to talk about some historic national economic problems and provide you with some brief snapshots of data to point out where my views have come from. I want to warn you: if you haven't already heard, I'm not an economist. So those among you who are economists or who are trained in economics (the "science" of economics. I use the term loosely) may not like what I'm saying. On the other hand, I'm simply approaching it as an engineer does. I'm looking at the data, and I'm trying to discover whether there's any information contained in it. I don't care about the cause and effect relationships.

And I'd like to say a few words about small companies and their contributions to the economy. That has been a big upsurge in the last two decades in this country. After that, some words briefly about what venture capital does and doesn't do. If you're on the verge of creating some venture capital activity in this state, you ought to have a realistic idea of what it might be able to accomplish and what it doesn't do.

I recognize that Wyoming is Wyoming., The lessons that come from the national economy do not necessarily all transfer and apply here. Nor do the lessons of New Jersey necessarily apply here. In New Jersey, we have 7 1/2 million people, in the 7th-smallest state. And you have somewhere between 400,000 and 500,000 people in the 9th largest state. So it's quite a different view. And I recognize that your problems may not be the same as the ones I've been looking at.

History of venture capital

I suspect venture capital has always been around. As long as there has been someone with money, and someone else with ideas and energy, somehow, in some forum, they've gotten together. The money has been applied, and the person with the ideas turned it into wealth for the society at that time. When I look for specific examples, the first I can discover was that famous venture capitalist, Queen Isabella. She financed Christoper Columbus, admittedly with someone else's money. His goal was to find new trade routes to the Far East, using Spain's money.

He took career risks, and personal risks, and everything associated with venture capital. And Spain risked the capital. The results were not exactly as anticipated, and I would say they were dramatically more rewarding for Spain than had been guessed at the outset. And, in fact, my business is precisely that. We produce results that are not exactly what we expected. It always turns out that way. And we have results that are dramatically more rewarding than we expected at the outset.

As I look closer into history, venture capital really became the province of individual investors and wealthy families. They are names that you recognize: Whitney, Rockefeller, and so on. And the first real transaction of a venture nature, done pretty much the way we do it today, was done by the Rockefeller family in the 1930's when they backed a crazy young fellow with goggles and a scarf named Eddie Rickenbacker and formed what is now Eastern Airlines. I'm not so sure today that they're happy they accomplished that task.

Next came American Research and Development in Boston, formed by a frenchman, Gorges Doriot, in 1946-47, right after World War II. It was the first prototype venture capital company that did things as they are done today and concentrated its efforts mainly on developing high technology. It is really the root cause of the venture industry surrounding Boston today.

Modern changes

In the mid-1960's to early 70's, the nature of the business changed. There came an institutionalization to the business. My own firm for instance, formed in 1968, was one of the first that brought together capital from various of these organizations and family sources that had previously done venture capital investments in their own right. But now they came together grouped, with a professional manager (or with a manager, at least---me) and others that I had gathered around me to take those contributed funds, invest them, and work closely with the companies that we invested in.

That organization has gone on to a fare-thee-well now, where almost all venture capital is invested that way. And the individual venture capitalist, who used to be the bulk of the business back before 1960, is almost not to be found today. 1 won't say such people don't exist, but they're not part of the main stream of the industry as we now know it.

It's impossible to know the size the industry in the early days with any accuracy, because it was all the province of private individuals. Back in 1968, when my company, DSV was formed, we started with $6 million. That was looked upon to be an enormous sum of money. And people asked me, "How are you ever going to invest $6 million?" Today, $150 million is not hard to find.

By 1970, the industry had in the aggregate about $2.5 billion in assets. That size was essentially constant through 1977. The capital flow rate into the industry was fairly constant also. It was about $250 million to $300 million a year. That grew to a high of about $41 billion in 1984. That's an enormous growth. The total assets of the industry have grown to about $19 billion. I got that figure from Venture Economics in Wellesley Hills, Massachusetts. [P.O. Box 348, Zip Code 02181] Stan Pratt is the unofficial official scribe of the industry. And if you need specific information, that's the place to go. He has the best statistical data.

Another measure of the size of the industry is the National Venture Capital Association, which was formed in 1974. The objective of that group was to provide a forum in which regulatory agencies could find out what the effects might be if regulations or tax laws were changed. Before then these changes were made, and no one ever asked. It offended me back in 1969 when the tax laws were changed radically, and no one ever asked anybody in venture capital if that would have any effect on the industry.

Recent industry trends

In 1977, NVCA had 69 member firms. And as of January 29, 1986, there were 220 member firms. In 1977 the average firm had about $10 million in capital. Today, the average is closer to $60 million or $70 million. $100 million is not uncommon, and there are many $150 million funds around. And if you took at the total dollars under management by specific groups, it can easily be $350 million these days.

The growth in the industry has been fast, and in recent years the capital flow has been too much and too quick for the industry to digest. The industry created some problems for itself as a consequence. Many new firms were formed. Many did not have the experience or the perspective to invest the money wisely. Many unwise investments have been made, many of them not working out so well today.

Congress restricts the flow

If you consider the time from 1965 to 1970, we as citizens received some messages from our Congress, even though we may not have realized it. The first message was: "Don't invest. Whatever you do, don't invest." And how did they send us that message? They raised capital gains taxes from a maximum of 25% to a maximum of 49.1% in 1969.

They weren't satisfied with that, so they sent out a second message. And that was: "Don't invest." They restricted the deductibility of losses. If you were foolish enough to invest, and then you lost your money, you couldn't deduct that loss against your other income. They restricted that to $3,000 a year. And it's still that way.

Not being satisfied still, a third message was sent out. You won't be surprised to guess what that was: "Don't invest." That was done by restricting the deductibility of interest expenses on investments. That's interest on funds borrowed to carry investments. If you were foolish enough to invest in the first place, and if you were even more foolish and borrowed money with which to invest, you now could not deduct the interest on those borrowings as an itemized deduction, either. That restriction still applies as well.

What the restrictions did

Those laws, along with several restrictive rules from the Securities and Exchange Commission, provided us as citizens a real line-up of ways to influence our behavior. Did it influence our behavior? What happened in that time horizon?

If you look at the New York Stock Exchange data, you'll find out that shareholders of public corporations increased, from about 4 1/2% of the population to about 16%, from 1959 to 1969. By 1980, that percentage had dropped to 8%. From 1969 to 1975, the U.S. Labor force increased by about 14.7%, and the number of shareholders in public corporations declined by 18.1%. If you extract the absolute meaning of those numbers, they show that 10 million investors took $104 billion out of the capital markets.

That was at a time when capital was sorely needed to create the jobs for that increase in the labor force. The number of companies that raised new capital in the market declined from about 1800 in 1969 to 150 in 1975. That's a 91.7% decline. If you looked at small companies, with capitalizations of less than $5 million, you'll find an even sharper decline of 98.6%. In essence, there were no public offerings for small companies in 1975.

From 1960 to 1969, annual real growth in the Gross National Product averaged 4.3% a year. From 1969 to 1975, that figure declined to an average of 1.7% a year. That's a decline of 71.8%. From 1960 to 1969, the Consumer Price Index had an average annual growth rate of 1.8%. From 1969 to 1975, the growth rate increased to an average of 6.6%. That's an increase of 270%. And guess what happened after that? Double-digit inflation.

The job creation rate also dropped significantly over that period. But the most fundamental factor in the economy is the U.S. Annual Productivity Increase. From 1969 to 1975, that dropped from an average of 3.2% to about 1.6%, a decline of 53%. That, in my view, is the single most important factor in the U.S. competitive position in world markets. And not surprisingly, the merchandise trade balance, which increased steadily every year before 1969, levelled off and dropped precipitously. It swung from average of about $4 billion before 1969 to a minus 8.3 billion dollars in the years immediately after 1969. Now, if you look at the trade balance on a monthly basis, it will stagger you.

It's not just a song in their hearts

We look at Japan and West Germany, two of our major trading partners, very carefully these days. From 1960 through 1974, the United States invested about 13.9% of its own Gross National Product in its economy. And we had an average productivity increase of 3.3% a year. The Japanese, on the other hand, invested 26.%---just about twice as much of their GNP---and experienced a productivity increase of 10% a year over that 15 year period. West German data is somewhere in between those two.

Could investment be a key to productivity? The Japanese did 10% a year, and we did 3.3%. And that may not seem like such a big deal. But in fact, it happened every year for 15 years. So you have to look at the compounded number. And when you do that, you find out that the 3.3% comes out to a 63% productivity increase for the United States. Japan's 10% compounds out to 318%. Therefore, they increased their productivity, relative to our own, by a factor of 5 in a 15 year period.

So when people wonder why it it that they're driving to work in their Japanese cars, looking at their Japanese watches to see what time it is, listening to music on their Japanese stereos, and taking pictures of their children on the weekends with Japanese cameras, that's why. It's not just because of singing the company song, or some magical management technique. It's because the Japanese, through investment, with a technology content and input, increased their productivity relative to ours by a factor of 5 over 15 years. And that has continued.

Where economic growth comes from

The American Electronics Association, a trade group of young and old electronics manufacturers, put together a survey of about 1,000 member firms in 1977. They took all the firms and submitted all their economic data to a third party blindly. They called the 20-plus-year-old companies "mature," the 10-20-year-old companies "teenaged" companies, the 5-10-year-old companies "developing" companies, and the 0-5-year-old companies "start ups."

They found the teenaged companies had employment growth of about 20 times that of the mature companies. The developing companies had employment growth of 55 times the mature ones. And even more startlingly, the start up companies had employment growth of 115 times that of the mature companies. True, it's easier to grow from a small base. The mature companies had 27 times the employees in total of all the others. However, the start up companies produced twice as many net new jobs as the mature companies.

Of course, we say we want jobs, but those jobs are to create tax-payers, who pay taxes at several levels. The data showed that for each dollar of equity investment in the companies in this survey, the 0-5-year-old companies produced an average of 70c of export sales, 33c in research and development expenditures, 5c in state taxes, and 30c in federal taxes. That means for each dollar invested in equity in those companies, they produced $1.38 per year in benefits.

The government wasn't 100% satisfied with that survey, although I assure you it was done on a completely accurate basis. So the General Accounting Office did a more complete survey, for Sen. Lloyd Bentsen, who was then chairman of the Joint Economic Committee of Congress.

That survey attempted to uncover the data for all of the venture capital-backed companies for a decade, in the 1970's. And in fact, they found 1,332 companies. And the total invested in those companies was $209 million, a very small amount by today's standards. And they did a detailed study on 72 of those companies. They found that in 1979, those companies had $6 billion in revenues, a 33% average annual growth rate, produced 130,000 new jobs, paid $300 million in federal taxes, and produced $900 million in export sales.

If you normalize that to the same kind of data as used in the electronics company survey, it's even more staggering. In 10 years, each dollar of equity invested in those companies studied by the GAO produced

$30 of revenue, $1.39 in federal taxes, 28c in state taxes, and $4.31 in export sales. The only thing I can conclude from this is that venture capital did make a difference, at the federal level, and certainly at the state level in those states in which it mostly operated, which, at that time, were California and Massachusetts.

What venture capital does

Today, it principally finances early-stage companies—usually innovative, high technology companies. It funds the losses of those companies from the time they're started until they reach break even on a profit and loss basis, and sometimes somewhat beyond that. It basically provides for the negative cash flow from the start up of the company until it becomes - viable from a banker's point of view.

In more recent years, venture capital has spread its activity to some other things. A venture capitalist of my ilk cannot understand its use in leveraged buy-outs, but other people do it and seem to make money at it, although I wonder for how long. You do see venture funds formed specifically for that purpose, and they've had great success in a short period of time.

What we do in venture capital is become partners with the managements and the entrepreneurs of these companies. We have experience at dealing with start ups in early stage companies. And we have experience at seeing what happens when you take certain assumptions, generate a business plan from those assumptions, and then execute that business plan. We've learned over the years a lot of things to do, and some things not to do. And we try to communicate those things to the entrepreneurs and help them in a partner-like manner.

We also provide capital, another necessary ingredient for their company. They provide boundless energy, lots of hard work, creative ideas, and, together, we take on the world. That's quite a different activity from selecting securities in a portfolio and managing investments in that way.

For us as the venture capitalist to win, the company has to win. The only way we can be successful is if the company is successful. So we're very pure in our motives. We do what is in the best interest of the company at all times.

Our involvement in any given company rarely lasts fess than five years. And if it ever does, it typically is an unhappy outcome. Stan Pratt, whom I mentioned earlier, has an expression for this. He says "Lemons ripen more quickly than peaches." We're usually involved for a period of five to ten years. It's not unusual for us to be involved for as much as 15 years or more. So this is not a short-term process.

The large get smaller

There's been a major change in the structure of the American economy from about 1965 to now, about the last two decades. We were an economy that was based on industrial production. And if you read <u>Megatrends</u> and

The Coming Boom you'll find them all saying that we're going through a revolution from an industrial production-based economy to an information-based economy. I've tried to figure out what they mean by that, and I've had great difficulty with it. If we're all manipulating information, who's making anything and buying anything?

I think it's more nearly accurate to think of this as a change that has occurred from a managerial economy to an entrepreneurial economy. An entrepreneurial economy is one where you focus on obtaining resources and creating wealth from them. A managerial economy is one in which you optimize the use of fixed or existing resources, and the big institutions are doing that. They're trying to optimize, and often not so well, the use of existing resources.

Over the past two decades in the United States, we've managed to create 40 million new jobs. That's pretty staggering when you consider that fact in light of any of the existing economic theories. We had two major energy crises, at least. We had all kinds of stagflation, inflation, double-digit increases in the consumer price index, economic disasters---call it every name you like. But we created 40 million new jobs.

If you go to the period before 1965, almost all new jobs came from large institutions which were growing larger. Yet, in about 1965, the total employment of those big institutions started to fall off. And today, they employ 5 million fewer people than they did in 1965. Almost all of these net new jobs were created in small organizations and small companies. New companies are currently being formed at the rate of about 600,000 a year. In 1965, that rate was about 80,000 a year. So it's a substantial change in the mindset of this country.

Lest you think all of this is in high technology, when you don't in your state have a blessing of lots of high technology, only about one-eighth of those new jobs have been in high technology. Seven-eights have been in the things you don't read about. So there is hope.

Money in search of ideas

The venture capital industry itself today is in very good shape. Almost $13 billion dollars in net new capital was raised by the venture industry from 1982 to 1985. At least half of that, or $6 1/2 billion, is now available nationally for investment in new companies. And capital is highly mobile: it goes where opportunity is. We also have the profits available from investment successes before 1982. So there is an enormous amount of capital by any historial perspective. Remember, we're talking about an industry that had $2 1/2 billion in assets for the decade from 1965 to 1975 and even later, almost to 1980.

Things to keep in mind for Wyoming

1. Investment is the most important key to economic growth. So construct your incentives accordingly.

2. Small entrepreneurially driven companies are critical in the current national mindset. There's an analogy here to Japan. You hear a lot about Japanese management techniques and singing the company song. I pooh-poohed that a while ago, based on the investment side of it. But that's an important consideration. One of the reasons that we're having such success in this country at creating new jobs in small companies is because people behave differently in small companies than they do in large ones.

People behave like owners in small companies, and they tend to behave like employees in large ones. If you don't believe that, look at the trucks stopped for fuel, when you next stop on the interstate. A lot of them look like old wrecks. They're dirty, filthy, and awful. And you'll see a lot of them with shiny chrome and big bulldogs on the front---the drivers are the owners of those trucks. The companies, who employ drivers, own the other trucks. So it starts very close to home.

And the Japanese, because of their complex cultural heritage, are able to behave like owners in large companies, even though they're not owners. But it's a cultural matter. It won't work here. The Japanese cannot bring their management techniques to American workers, who have a different culture, and have them behave as the Japanese do.

3. Results of any program that you lay out here in Wyoming are going to take longer than you think they should or want them to. Ten years is a minimum time scale. Twenty years, it might be. Think in terms of 20 years, and you'll be less disappointed. It certainly generally doesn't happen within political lifetimes. So sometimes you have to do what's good for the society, regardless of what your constituency may think is popular.

4. Productivity is the key to market success, in world markets, in local markets, in any markets. And there's often a high technology content to productivity.

5. Try to guard against unrealistic expectations. They are the easiest things to come by in the euphoria of trying to do something, when you're not sure what it is you should do.

6. High technology tends to get all the attention but provides a small percentage of the jobs---one-eighth.

7. Venture capital is only a part of the development program. Operating skills on the part of venture capitalists are a key to success in the partnership with the entrepreneur. The venture capitalist who is a financial analyst is not going to be able to help very much in the real world of running a company. At best he might be able to identify certain problems or put his finger on what the cause of the problems might be. But he will probably not have the operating skills to get in there and make it work.

8. And don't forget that even in Wyoming, economics rules the world. True economic factors will end up in control every time. Politics is something that deviates around and gets in the way from time to time. But it's economics that ultimately rules the world.

MR. EDWARD COHEN
New Jersey Commission on
Science and Technology

It's really a personal and a wry reminder to me of how times can change to be here. The last, and actually the only other, time I've been in Wyoming was in 1947. I was all of 17, and I was hitchhiking to a laborer's job in Idaho in the Forest Service. Cars were few and far between, and I can truly say I came to appreciate your state in the only way it should be done. I walked a great deal.

Today, I'll first summarize what we've been doing in New Jersey. Then I'll make some observations about Wyoming. And finally, some do's and don'ts, drawn from our experience of the last three years.

But first, let me play wise man. There are no quick fixes. I should break that phrase down:

> Quick: You cannot expect to make a one-time investment with significant results in the near future. You've got to reconcile yourselves that you're either in this for the long haul, with sustained budgetary commitments or content yourselves to the charge of being developmental amateurs---or, worse yet, dilletantes in it for publicity, or ego satisfaction, or facile political gain.
>
> Fixes: There is no simple solution, no one-shot action that you can take. I think it was Santayana who said, "For every complex problem, there is a simple solution. And invariably it's wrong."

The programs of the Commission on Science and Technology in New Jersey cannot all possibly apply here. And I don't intend to go through these projects as a way of saying, "Look how we're dancing." You may or may not find something to extract from it.

The Commission's purpose

Everything we do is geared to fostering economic development and the creation of new jobs by stimulating the growth of industry, including especially small businesses based on science and technology. High technology, whatever that means, is indeed a major aspect of our focus. But by no means is it all. We are committed to fostering the application of science and technology to all of business and industry, including the "smokestack" or vanishing industries. Our objective is increasing productivity and the competitiveness of the state's economy.

We are supported by state funds, consisting of a $90 million general obligation bond issue to construct the brick and mortar aspects of our program. Over the last three years, our operating funds from annual appropriations have grown to over $16 million dollars. To' get a perspective on this, you should note that in the current year, fiscal 1986, the New Jersey budget is over $9 billion.

We are now a permanent, statutorially established regular agency of government. I report to the governor's office and am responsible to a non-paid, blue-ribbon, 17-member commission, composed of leading industrialists and scientists, three members of the governor's cabinet, four legislators from both houses and both parties, and two university presidents.

Philosophically, we are a partnership. We represent the joint efforts of industry, labor, academia, and government. Moreover, I should tell you it really does work. We have a republican governor, descended from two signers of the Declaration of Independence, who signed the bill for the bond issue. And its prime sponsor was a Hoboken-based democratic assemblyman. They are very different people, and they represent the enormity of that partnership that we achieved.

The bond issue was promoted by a citizens' committee co-chaired by a utility company president from the southern part of the state and the president of Prudential Life. They were aided by, among others, the head of the state AFL-CIO, a black man who is the CEO of a small company, and the presidents of all of our colleges and universities---large and small, public and private. The 1984 referendum for ,the bond issue received the second-highest positive vote in New Jersey's history.

Roots of ivy

Our effort came out of higher education. Now it's oriented toward economic development and job creation, but there's an extraordinary role to be played by academia. I have a feeling that the academic sector is not very well represented in your activities thus far. And I think that's a mistake. I don't mean, in receiving support from industry for certain targeted types of research, that we in any way want to pursue something that would compromise academic values. I didn't spend 18 years in higher education to have that come about.

So far, our efforts in New Jersey have been directed to four comprehensive areas of activity. I'll talk about them in ascending order of our priorities of investment of time, money, and staff.

Human resources

An economy increasingly geared to scientific and technological advances cannot survive without an educated, sophisticated work force. Our commission has functioned successfully as a bully pulpit to foster higher salaries for teachers in our public schools, to create a merit system for master teachers, to insist on higher progress and exit standards for all students, and to increase the budgets for undergraduate collegiate programs that are science and technology related. We are pursuing the establishment of specialized high schools focusing on science and technology for outstanding students drawn from all over the state.

Regulatory climate

If business and industry are going to establish themselves, and be encouraged to expand in an area, it won't happen in a hostile environment. We share a necessary and indisputable concern for the health and safety of our citizens, and we recognize that taxes upon industry are an indispensable part of state revenues. Nonetheless, we believe that a proper balance can be achieved. It's not an either-or.

Taxes which discourage business enterprise and regulations which harass legitimate business activity can be disincentives to economic growth. We are committed to a careful analysis and effort to eliminate such measures. We are equally committed to finding, and having enacted, legitimate incentives to business and industry.

Our efforts met with their first success almost a year ago, when Governor Tom Kean signed legislation establishing a loss carry forward tax incentive. Under this provision, businesses which experience losses in one year can carry them forward for up to three years as deductions against later profits on their tax statements. This, we think, should prove a particular help to start up firms and help reduce their rate of failure.

Venture capital and business assistance

I won't discuss venture capital at any length, not with three such prominent practitioners surrounding me. My own venturesomeness is confined to the roulette wheel in Atlantic City. But let me venture a comment. Venture capitalists don't invest in vacuums. Unless a whole gamut of supportive factors exist as a hedge against their bets, don't expect them to come forward. What I am describing in this first section of my remarks are aspects of a comprehensive, encouraging environment which our nation's not-all-that-venturesome venture capitalists look for.

To attract more venture capital to New Jersey, we're working on legislation to permit our New Jersey state employees' pension fund to invest in venture capital activities. Our pension fund is now over $11 billion, and even if only 1% of that were invested---$110 million---that's pretty good. This is one area in which, so far, we have just not been successful.

Regarding business assistance, we are motivated by the realization that start up businesses often need help and encouragement. And keep in mind, as Mort said, that virtually all net employment increases come from small, not large, firms.

Help for small business

We give small financial grants to increase the competitiveness of our firms which are applying for federal Small Business Innovation Research grants. We are going to encourage and provide modest subsidies for incubation space for small science and technology based start up firms. These would provide below-market price working space and certain business and technical services for a few years, while they work the bugs out of their widgets and get into production and marketing.

We shortly plan to create a computerized network that will match entrepreneurs with interested members of the informal venture market, a sort of "dating game" arrangement. I don't mean the Becks or the Collinses, or their professional colleagues. I mean the retired executive, the physician or dentist, the rich person with money to spare, who often lacks the contacts and access to potential deals. A network of this kind has been developed in New Hampshire.

We also plan to create a New Jersey Entrepreneur's Forum, where start up company leadership can be put through the paces and advised on their business plans. It's a Harvard Business School case book approach, where friendly experts act as interlocutors, and other entrepreneurs observe and gain pointers, even while they're not, themselves, in the dock. The MIT alumni association has sponsored this sort of thing for several years in various parts of the country, not just Massachusetts.

Academic-industrial interaction

I mentioned that I'd list our broad areas of activity in ascending order, and this is the one where we put most of our time and 95% of our money. This is a high priority for two reasons. First, science and technology related industry recognizes that the action in the future is out there on the frontiers of knowledge. Research and development are indispensable to remaining productive and competitive.

And while no productive, successful company can afford not to invest in its own R&D, industry also recognizes that great resources exist in academia, and they've got to work together. Industry is increasingly locating not just its R&D facilities but often its productive facilities where the academic research talent is located, so as to facilitate intellectual interaction and mutual stimulation.

The second reason for this high priority is that industry in New Jersey, particularly in such certain fields as chemicals, pharmaceuticals, telecommunications, and electronics, is very powerful. But the level and quality of our academic based research was not commensurate with industry's strengths and requirements. New Jersey based firms often were, and still are, collaborating with and supporting research efforts elsewhere. And they're often correct to do so. Johnson & Johnson is located in New Jersey, but it puts millions of dollars into places like Scripts in California and not in New Jersey as yet.

We realized that we had to change the attitudes of, or at least to further stimulate, the research faculties of our universities to be more concerned with industry's needs. We also had to strengthen our collegiate resources in some areas to make it possible for academia to give more help to industry. And, in turn, we had to set in motion a growing awareness in industry that in certain targeted fields, New Jersey is on the move and is where the action is.

A sine qua non always in our decisions was, "Does it make economic sense for New Jersey to so invest in a field? Can it compete with the best? Can we realize a significant return on our investment?"

Getting the interaction going

The mechanisms, the fields in which we're located, and the location of those activities were carefully, indeed very painfully at times, worked out with strict use of objective peer group evaluations. For these peer groups, we drew liberally upon industry's talents, both in and outside New Jersey, and the very top drawer academic researchers, particularly from out of state. We insisted upon candor, warts and all, in their assessments and recommendations.

And I have been beaten up on several occasions by those upon whom the chips fell. You won't have that problem. Some institutions are upset if they don't win the brass ring. You've only got one institution. It does or it doesn't win. it can't beat you up because you gave it to somebody else. That's a blessing, but it's also a drawback: they don't have to compete.

Four mechanisms for interaction

We're only on the eve of launching incubation programs. But we will insist on every incubation space that we can support being co-sponsored by a university and some profit making business group. We call the second mechanism "innovation partnerships." We put up money to researchers, and industry must match on at least a one-to-one basis in selected fields. We put out a request for proposal, and the responses are judged by a peer group. We have them now in biotechnology, telematics (we use the French phrase to describe the growing confluence of telecommunications and computer science), and in surface modification technology, where ion bonding and other techniques are used to change surface structures to improve the quality of materials.

The third mechanism is "tech centers." These are technical extension centers, pattered after agricultural extension centers. They assist in the transfer of known technology to small and medium sized firms. Small firms often do not have the ability to conduct their own research. They often aren't aware of what's state of the art. The fields we're engaged in now are polymer processing, fishing and aquaculture, and information services, which includes office automation.

The fourth mechanism, the one in which enormous sums of money are invested, is the advanced technology centers. These are intended to be world-class research enterprises led by the strongest directors and investigators we can attract, provided with state of the art equipment and liberal support for graduate fellows. I keep mentioning graduate fellows. They are the life stuff of starting new businesses.

We have advanced centers in biotechnology and medicine, hazardous and toxic waste management (In New Jersey, we have an enormous resource in this field), industrial ceramics, food technology, computer aids to industrial productivity, artificial intelligence, and one of the nation's five supercomputer centers.

What about Wyoming?

Our states are obviously very different. We proceed from dramatically different bases regarding population, gross state product, industry mix, geography, and traditions. But, to paraphrase Teddy Roosevelt, you do the very best you can, where you are, now.

I read with great interest the generally excellent report commissioned by the Wyoming Futures Project from SRI International. And by and large, I'd follow their recommendations. Most significantly at the University of Wyoming, investigate whether you'd want to establish a world-class center for energy-related mineral research and utilization. Do it well if you do it. That means do it first class. Obviously, don't just focus on the extraction aspects. Search for ways to add value here in Wyoming, and use the research strengths you build to find new technologies to complete more of the process here in the state.

Like most marital relationships, the energy industry has its ups and downs. But it won't go away, and you sit on a gold mine of energy related resources. When the wheel turns again, and the nation and the world are looking for their next energy infusion, if you have built your strengths to the point there there is no question but that this is the place to turn, you'll be in a good situation.

At the risk of alienating a few members of the audience, look outside your state to evaluate it, with a very hard eye as to what you have and what you need. And make your plans to stay with it for the long haul.

You have a strong educational system, and you should keep it that way or make it better. If you want to retain, much less attract, the growing industries with their bright personnel, make sure you have a very sound educational system. They want the best education for their children, and they won't go where it's not available.

Work on the margin

Just as there are no quick fixes, there are no large fixes. Nothing you do can have a major, startling impact on your economic well being. No one thing will have significance on the order of magnitude of even a tenth of your gross state product. Instead, all of your best and most successful efforts will take place on the margins---maybe 2% or 3% effects. But that isn't bad, and it wholly justifies the effort.

A 2% or 3% additional increment is the difference between stagnation and growth. Two or 3% on top of the general economic tide in the nation can mean prosperity. You don't have to get great, dramatic effects.

Ten aphorisms

1. Hire good, objective people to study your situation carefully and use peer group techniques to come up with your final programs. You'll avoid political influence. When you bring people together, they try their hardest to let you know how smart they are and how honest they are. We get excellent advice, and usually pay nothing for it.

2. Don't diffuse your investments to the point where you lack the resources to attain the critical mass necessary for high quality activity.

3. At the same time, don't put all your eggs in one basket. When energy is down, electronics may be up. When both are down, have an anchor out to windward.

4. If these two points seem to contradict, so what? Lyndon Johnson rightly criticized people who couldn't walk and chew gum at the same time.

5. Create, apply, and protect technology. Innovation spurs new industries and revives mature ones. Technological advances lead to improved productivity, which is essential for raising living standards.

6. Increase the supply and reduce the cost of capital available for investment, and ease its free flow to productive uses.

7. Develop a more skilled, flexible, and motivated work force. Provide strong educational foundations. Reduce barriers to labor mobility. And create incentives to work cooperatively toward increased competitiveness.

8. The key to competitive success lies with the private sector. Government cannot legislate economic development. It *can* only help create the proper environment.

Product commercialization and process technology is a business responsibility. Increased investment in productive assets is a business responsibility. Business must even do more in employee development and training. And while government can help coordinate, it is business which has to broaden its perspectives regarding the possibilities for marketing its products domestically and abroad.

9. The government should lead a consensus-building partnership between itself, industry, labor, and academia. And above all, it must pursue a stable fiscal and monetary policy, insuring non-inflationary growth, nurturing technological innovation, and insisting on high educational standards.

10. All you need is leadership, commitment, and money. Governor Herschler's sponsorship of this conference, and your presence, obviously indicate you have the leadership. Only time can tell whether you have the commitment. And as for money, may I cordially invite you to try your luck in Atlantic City.

MR. JAMES GALBREATH
Galbreath Financial Services

While living in this region for the past 20 years, I have observed that Wyoming's population is only 100,000 more than when I arrived in the Rockies in the mid 1960's. In fact, the population of your state is now the same as it was in 1979.

For the past seven months, I have been actively studying the economic picture in Wyoming. I have travelled through most of this state and have become familiar with some difficult circumstances that now exist, which must be addressed soon.

Wyoming needs to diversify

The United States is now in its fifth full year of declining or relatively low inflation, while Wyoming is actually suffering from deflation. This state has become so clearly tied to commodity price swings that it has little ability to adjust its course. When inflation declines, so do interest rates and prices on commodities---agricultural, mining, oil, and gas, Without prompt economic diversification, this deflationary cycle might continue to depress this state's future.

Today Wyoming has only 3% of its population employed in the manufacturing sector, a total of 8,000 jobs. Mr. Cohen has dozens of companies in his state of New Jersey with that number of employees. Wyoming may still be called an "agrarian" state. It never really experienced the industrial revolution, let alone the current high tech and communications revolution.

Historically this state has been the leaching field for the entire country. It was tapped for agriculture in the late 1800's through the 1930's, for uranium in the 50's and again in the 70's, and finally it was tapped for its oil, gas, coal, and trona during the 70's and 80's.

Today there are over 110,000 people in New Jersey involved in research and development jobs. That equals one-fourth of Wyoming's total population. In contrast to states rich in human, scientific, and financial resources, Wyoming has a void in all three. However, it is fortunate to have quality in its human resources.

Don't wait for the next oil boom

As residents of this state, I hope you will not be lulled into waiting for oil and gas prices to re-stimulate activity in Wyoming. After all, with booms there are always busts: the two seem to be permanently wed.

Sometimes we all try to make gross predictions about trends or prices, a practice which can be dangerous. This reminds me of the story about E.J. Smith, who, in 1912 as captain of the Titanic, said, "I cannot imagine the circumstances under which this ship would no longer float."

Wyoming has but one small $1 million equity fund. Other than that, there is not one other single equity resource in the state. Under these circumstances, trying to compete for new economic activity from entrepreneurs within the state or outside the boundaries is like trying to rope a steer with one hand behind your back. Meanwhile, you are competing with the guy in the next chute, who has both hands free, two ropes, a heat-sensing horse and has paid off the time keeper.

Venture capital and investments

There is now over $19 billion in venture funds in the United States. Since 1970, over 5,000 American companies have received venture financing, but that represents only about 3% of those who wanted equity for growth.

Many interesting companies are turned down by venture firms, because they do not have a large enough potential market or the potential return is not deemed to be adequate for the risk taken. But remember, those venture managers and investors have only very high expectations. One in seven venture firms concentrates its investments on a finite region. Most are casting their lines into several streams around the country simultaneously. There are about 15 venture funds in the Rocky Mountain states, with about $300 million to invest. About half of this is still in cash, because these funds are new.

In 1984, a breakdown of venture fund investments nationally revealed that fewer than 10% were in non-high tech areas. Ninety percent were medical, electronic, in telecommunications, automation, or in genetic fields. More than 60% of all venture investments are aimed at higher productivity goals. This suggests that there are many industrial or service businesses without much attention. Some of them may have very good products, management, and potential. We need to attract some of them to Wyoming.

In an average venture portfolio, the classic performance distribution shows that about 30-35% are losers, 30% are "sleeping dead," and 30% have some success. Only a small portion of those are very large winners. In effect, most venture funds seem to be higher risk, higher reward oriented.

What venture capitalists are after

There are three primary characteristics of a venture capitalist: he seeks equity participation in the company, he is generally long-term oriented in his commitment---usually 4 to 7 years, and he is actively involved in helping his portfolio companies grow.

You may be interested to know what activities a venture capitalist pursues during the course of an average week. He will:

Read three to five business plans

Conduct negotiations with a banker for a new line of credit for a portfolio company

Negotiate terms on a new portfolio investment

Meet with a marketing consultant regarding a new product introduction

Hold meetings or conversations with his investors

Speak to an off-shore company interested in licensing a line of products

Meet with another venture firm to review a prospective investment

Negotiate with a portfolio company on a new round of financing

Make due diligence calls regarding a prospective investment.

There are some who believe that venture capital is only another investment fad and that, like many other boom and bust phenomena, will fade into the sunset. I disagree, unless Congress does something to negatively affect this tide. It is true that there has now been a substantial correction in venture capital valuations, which had accelerated dramatically during a few short years, from 1980 to 1983. But the effect of venture financing nationally has been a spectacular success, in terms of creating new jobs, new technology, and new industries.

What's right for Wyoming

Is Wyoming only going to follow the crowd into high tech, early-stage investments? Or will its citizens call for a careful, steady, broader growth plan, which involves the full support of its businesses, legislators, and educators?

It is insufficient simply to put up a billboard on 1-25 or 1-80 and announce to the world that Wyoming has cheap bond money and some equity capital for investment. Both of these things are badly needed, but they represent one leg on the stool.

Perhaps there has been some misunderstanding about my firm's perspective on how to start this state's engine. We believe Wyoming must establish a new economic beginning, stimulated by both equity and debt capital formation, as well as by reducing investment disincentives. This capital should be managed by professionals and the effort should be supported by the state and both state and local economic development boards.

We believe Wyoming's residents, bankers, educators, and legislators need to believe they can initiate some positive, long-lasting programs for stable economic growth. There must be an inner confidence that there is a well coordinated, bi-partisan program which will be activated and will be successful.

To initiate this inner confidence, we believe new jobs must be created now by attracting some existing healthy, profitable, expanding businesses. Investing in these existing businesses can show immediate-term results over the next 5 to 10 years. Closely at the heels of that effort should he the support, education, and financing for in-state entrepreneurship. Finally, a direct tie to this corporate growth should be coordinated programs with the University of Wyoming and the community colleges.

Some specific recommendations

Hard equity, not just bank or bond debt, will be needed to support non-cyclical, non-commodity based businesses, which can capitalize on the positives available for Wyoming to promote. These positives are a well-educated, hard working labor force, relatively inexpensive real estate and rent, an attractive recreational environment and lifestyle, and good highways and rail systems.

This is not a big basket of assets from which to work, so let's consider some others which can be added:

> Develop a program for loaned executives. Try to establish a cooperative sharing program with neighboring states through assistance from the Western Governor's Policy Office.
>
> Create a University task force to exploit ideas from the faculty and the student body.
>
> Establish a communication hot line for out-of-state companies working in specialties upon which the state is now going to focus.
>
> Create a very large advertising budget to promote "Wyoming Wants You." Your budget here is the lowest in the country. Sell the state's beauty, recreation, and uncrowded environment. I could imagine an ad which says, "How to Unwind on Your Way Home." On one side of the page, an easterner in a pin-striped suit has a folded paper fan in one hand while holding onto a strap on a crowded train. On the other side, a Wyoming man is pulled off to the side of the road with his waders on, fly fishing.

To turn on the Wyoming economy, a multi-faceted program for long-term growth will be needed. I would like to suggest some programs to be researched and developed.

Build an economic war chest, which includes:

1. Equity capital for in-state entrepreneurs, new joint venture efforts with the University and community college system, and businesses from out-of-state who wish to expand. Other states around you are building that capital base.

2. Inexpensive long term debt or guarantees via bond issues or tax revenue allocation.

3. Regulations to allow banks and savings and loans to participate in revenue sharing or participating interest loans.

4. Tax incentives for personal and corporate equity investment in qualified and approved public and private funding activities.

5. Appropriation of a substantial advertising budget to compete with other states.

6. Encouragement of more active investment by insurance companies who have offices in Wyoming.

7. Direct mail and telemarketing programs to non-cyclical company employers in attractive industries in other states. Address expansion opportunities in Wyoming.

8. Creation of a very small universal marketing package, outlining all economic stimuli actively being offered in the state.

9. A task force to determine ways to improve telecommunications and air transportation.

Next, establish three to five targeted industries and disciplines upon which the state wants to build a base over the next decade:

1. Establish privately-publicly funded industries and departments at the University of Wyoming and other community colleges. Seek corporate support for this effort.

2. Provide research grants to attract top-level engineers, researchers, and educators. Start with strong candidates and build to higher levels as programs develop.

3. Build specialties that utilize the state's attributes wherever possible. Some examples might be food processing, packaging, and preservation technology; aquaculture and agriponics; climatological forecasting; and communications services.

4. Create credits for employers who provide on-the-job training.

5. Establish an incubation center to foster an environment to enhance entrepreneurial activity. I understand Casper College has just started a small business development center with SBA funding.

Investments in education are at least as important as, if not more important than, investments in plants and machinery. However, you must ask whether the Wyoming school children are going to raise cattle and drill for oil or whether they will be educated here and then leave for opportunities in other states. If you want to keep them home, give them alternatives. Don't educate them and send them off to Colorado.

What time's the next boom?

Over the past 100 years of American economic history, in nearly 80 of those years, inflation was below 8%. There have been three distinct periods of high inflation this century: 1914 to 1920, 1940 to 1948, and our recent bout during the decade of the 70's. All were connected to the government's financing of wars while trying to run the economy at stable or growing levels.

All of this talk about capital formation leads me to the most important part of my talk with you today, the need for bold steps to be taken by both the private and public sectors, hand in hand, to create equity expansion funds for Wyoming.

Notice that I did not stress the words "venture capital," which seem to connote high-tech, early-stage investing. The establishment of creative environments for proprietary research and new product development can be undertaken steadily and deliberately. But these programs will not solve problems in Wyoming overnight. They take time.

I believe you must now take bold steps as a state to address these difficult budgetary decisions. You know January and February are particularly dangerous months to address those difficult budgetary matters. The others are March, April, May, June, July, and August, and then September, October, November, and December.

With the mineral severance tax at 6% and the oil, gas, and minerals industry paying 70% of the state's tax bill ($420 million in 1985), it is difficult to excite those oil people toward contributing equity to stimulate Wyoming's economic picture. They have asked me, "Will we be paying 70% of an increasingly large bill if the state grows and more infrastructure must be built?" If the answer is yes, they are not interested in most cases, and one can't blame them.

If the Wyoming constitution continues to restrict the state's participation in the capital formation process, and Wyoming primarily uses direct taxation of the extraction industry, then a new economic base may not be established in any foreseeable future.

Banks can't do it alone

There is a big job to be done here. The Wyoming banking community cannot be expected to pull the load by making high-risk loans. It has already been severely weakened by the spectacular downturn in commodity prices. Many a rich man is no longer in Wyoming. To be competitive, this state must loosen up and invest in its future.

If legislators do not support a joint private-public effort to combine an extensive marketing program with the formation of equity capital for expansion and business formation, your ship will not turn around soon. Non-oil, gas, and mineral extraction industries must be sought and developed. You must develop the other parts of this state's body besides the bone structure.

The creation of the Permanent Mineral Trust Fund had great merit. But what now will be done with that $2.1 billion? This money cannot buy back the lost reserves. It should be considered as a base from which to build the future.

There are some who fear that this economic diversification idea is intended to lead to a heavy industrial environment, which will bring too much cement and too many high-rise buildings. I vote for trying to build a gradual but steady growth pattern, which is far from the boom and bust cycles best illustrated by this very city of Casper.

Priming the pump

Stimulating enterprise requires a willingness to invest, to innovate, and to take risks. The state cannot create the spirit for entrepreneurial activity. But it can allow it to flourish by removing barriers which inhibit growth and development.

This is not the time for the provincial thinking that has often hurt Wyoming in the past. Nor is it the time to focus on any one industry sector and demand that it pay the freight. It must be a unified, state-wide effort. I applaud the current efforts underway by the Economic Development and Stabilization Board and the Wyoming Community Development Authority to collaborate in a joint effort to provide more creative financing sources to help the state's economy grow.

It is this kind of hand-in-hand attitude that will break the log jam and pave the way to new economic growth, diversification, and stability. May I suggest a bi-partisan board of advisers or blue ribbon panel be formed to implement a multi-faceted effort, using many of the ideas presented here today.

I also ask the legislators to re-examine this state's constitution and the inherent restraints on direct state investment, whether it be from general funds, mineral trust funds, or retirement funds. It is interesting to note that the pension fund industry is now the largest investor in venture capital funds today. In fact, many state retirement funds are invested in venture capital funds.

I hope you will not leave here today waiting for a new commodity price boom to save your bacon. Trying to predict when that will come is similar to predicting interest rates or outright speculation in commodity futures. You are playing a no-win game.

Panel Discussion

Panel: John Beck, Morton Collins,
Edward Cohen, James Galbreath

Questioners:
Garve Chapman, Economic Development and Stabilization Board
Lynn Duncan, Wyoming Bankers Association
Rep. James Barlow, Wyoming Legislature
Richard High, *Casper Star-Tribune*

Master of Ceremonies: Dave Freudenthal
Economic Development and Stabilization Board

Dave Freudenthal: Our panelists will be asking a combination of their own thoughts as well as the questions that the audience submitted.

Using state money

Jim Barlow: As a legislator, this question hits the issue right on the head for me. It says, "How can a venture capital fund using state money be managed and set up? What are the potential dangers?"

Morton Collins: We in New Jersey made the decision reasonably early on that we did not wish to use state funds, and I mean taxpayer dollars as opposed to state pension funds. If we could produce an investment vehicle that was private and governed by the private sector, and create a good investment opportunity for the state penSion funds in the state in which the pensioners reside, that would be all the better.

Edward Cohen: We are adamantly against putting state money into investments. There is no way that bureaucrats are going to be capable of maintaining the sort of knowledgeability about these matters to make good choices. Nor, present people excepted, of course, can we assure that in the future lesser people than ourselves won't somehow be influenced.

Collins: I chaired the task force in the [New Jersey] Governor's Commission [on Science and Technology] on capital for new technology. We tried to come up with a format that would involve some state money, some taxpayer money, as a stimulus to the flow of private capital. We tried to create a vehicle for three dollars of private money per dollar of taxpayer money. We dubbed it either "quasi-private" or "quasi-public," depending on to whom we were talking. We managed to connote exactly the opposite of what we wished to whichever audience we were speaking.

If I spoke to one of New Jersey's major corporations, to be a capital contributor to this fund governed by the private sector, he saw the governance being compromised by the quasi-public aspect. He thought the governor and the legislature wouldn't let private governance occur. On the other side, when I talked to the public sector, they saw it as impossible for taxpayer funds to be invested in this without their having the governance. It's just not workable, so don't try that.

Getting the deals going

Barlow: Here's another question that states the issue in a little different fashion: "What steps can Wyoming, without a history of non-commodity or non-resource enterprises, do to encourage 1) A strong creative enterprise class here, and 2) a varied and economically attractive deal flow at home which can attract sound venture capital investments?"

Collins: It's a matter of creating role models. You have to have somebody strike out and do this, and they don't even have to be successful role models. It just has to he role models. If people see others striking off and doing this, human nature is such that they will say, "If that guy can do it, or if she can do it, I surely can do it just as well or better." That's particularly true if those are people whom they know, familiarity breeding contempt.

That fuels a lot of this entrepreneurial zeal that's going on. Once people try that, they find a tremendous reward in finding the immediate result of their actions apparent to them. They know that they did it, instead of being a cog in a machine, where they can't tell whether their own output produced anything useful. It is a matter of building on a small start and having it grow. That's one of the reasons why 1 say it takes such a long time. That is not going to happen overnight.

Finding venture capital

Lynn Duncan: This question is directed, to Mr. Beck. "Where do you go to find venture capital opportunities, how much of your business do they own, and can you name some creative financing methods?"

John Beck: As for examples of creative financing, I probably cannot cite any. I think it is important, however, especially in the non-high tech area, that there is a mistaken impression that you need lots of capital to start new businesses. In two of the businesses we started, the venturer came to us with a request for X-number of dollars, and the businesses were started with only 25% of X. We didn't feel that the capital requirements warranted raising as much as they requested. And if the entrepreneur had raised four times what we gave him, he would have given up so much of his equity that it would have made more sense for us as the investor than for him as the entrepreneur.

As Wyoming is looking around it should remember there's something called the service sector, which is by definition a relatively low capital intensive area of commerce. It rests much more heavily on the quality of people, their concepts, and their ability to execute on the concepts. If I were in Wyoming, I would look as hard in that broad area as I would in some of the more capital intense areas.

Duncan: And how much of a business will the venture capitalist own?

Beck: There's no pattern. Each is trying to give or take as much as he can get away with. It varies with the times. In the oil business, the royalty goes up and down with the supply and demand. And it's very true in venture capital.

Wyoming's image in the mysterious East

Garve Chapman: What, in your opinion, is the image of Wyoming in the mind of the eastern business establishment as it relates to investments and our business climate?

Beck: None.

Chapman: There's a second part to this question. It says, "What shall we do?"

Cohen: If there is no impression left now, then clearly if you do something that becomes attractive, maybe you might change the impression.

Beck: Let's take the state of Maine as an example. Today, it's one of the most vital states in the nation from the point of view of real growth over the last five to ten years. It has natural resources, to be sure, but those resources are just as volatile as your own. God put an awful lot of trees in that state, and timber goes up and down like oil goes up and down. Ten years ago, they made a decision to do something about it. What happened, form the financial community's point of view, is that Maine offered a viable investment environment.

We are looking now at commercial real estate in Maine. Ten years ago, you wouldn't have touched it with a 40-foot pole. They rehabilitated the downtown of Portland, using initially local money, encouraged by federal law changes and a very constructive attitude on the part of the governance of the city, And Portland, Maine today is a most attractive city.

The way you do it is to start small. You have a plan, yes, but you don't try to accomplish point 10 until you've done point 1. There is a limit of money.

Don't be so concerned with image

Collins: Capital tends to go wherever opportunity is. One doesn't have to have some preconceived notion about the state of Wyoming to look at an opportunity in Wyoming and provide capital for that opportunity, if it seems viable. I tend to go to the same places—California, the Northwest, Massachusetts, and New Jersey. They are very homogeneous, with the respect to the way the businesses I'm involved in are conducted. In fact, when I come to a place like this, I see that the homogeneity is not as complete as I might think. But I don't have any perception of one state or another being a much better climate in which to do business. It's a matter of looking at the individual opportunities.

Economic leadership

Dick High: Wyoming has large resources available; we have high proportional personal income. We have an enormous state portfolio that's growing rapidly. We have corporations doing business here that can either move money in or out. It seems to us at the paper there's a lot of movement of money out of the state. The banks have had an actual decline in the amount of loans recently, for the first time since the Depression. Proprietary capital is moving elsewhere. There's a kind of panic in the state. So, how do you get the people in the place to see the opportunities without panic? How do you get local people to put up local money?

Cohen: One of the reasons we could achieve a great deal in New Jersey is because times were good. When times are bad, there's a great deal of scapegoat Boating. People don't focus on positive things, and what they ought to do, but rather look around for partisan advantage to find someone else guilty. it may be because things are not going that well, that you're not moving with the rising tide. Those of you who really care and are really capable are just going to have to overcome what might be a bad period of time in which to bring people together.

Beck: You cite two factors as problems. The outflow of money from the banking system is really a symptom of the disease, and I would treat it as such. The largess in the pension funds and other funds is an opportunity, not a problem. The fact that the money is running out and the investment profile is looking beyond Wyoming suggests that there is not yet in place here anything to hold monies in or re-focus the investment attention back in the state. Neither would concern me at the moment. I wouldn't seek either to artificially invest the pension funds or to embargo the banking funds. Rather, try to improve the climate, and both will respond, 1 can assure you.

The future of the Small Business Administration

Duncan: I'd better ask a question of one of our bankers, as long as I'm representing the Bankers Association: "I believe the SBA is one of the best vehicles for the start up of new businesses in Wyoming. What's your opinion of it, and is it going out?"

Jim Galbreath: The actual results from the SBA program have at times come under fire. Yes, it is very close to going out. There is some replacement plan being developed, but there is a chance that it may not be around any more.

Collins: I would agree that it is close to going out. And it's going out not on the premise that it hasn't done a good job for the taxpayers. It's one of the few programs to have earned a profit. On the other hand, the private sector seems to be doing the job of providing that equity capital that the SBA originally was intended for. Therefore, the theory is that there's no need for the program and that it shouldn't therefore exist.

A large amount of activity did not go where the program was intended to go. It basically provided secured loans, which is not what the idea was.

And it's been a minority, percentage-wise, of the total number of SBIC's formed, that really invested their funds in the form that was intended by the legislation in the first instance.

What a state can do

Freudenthal: I'm curious about how you define a state and local development program, given the large role you defined this morning for the federal government.

Collins: I pointed out what happened when the federal government reduced the incentive to invest. A lot of bad things happened in the economy that got to the root economic problems. Four problems are inter-related: inflation, unemployment, the merchandise trade balance, and the national debt. By reinstituting incentives to invest, at least two of these problems nationally have been overcome for the moment, unemployment and inflation. The debt and the trade balance have not yet yielded to these cures.

in a state program, my message was that if you have disincentives for investment in the state, get rid of them. And there are all kinds of disincentives. Some communities in New Jersey claim they want my business. But in fact, one of my companies could start a building in California at the same time as I start in New Jersey. And before I even have the hole in the ground at home, I'd have people employed in the plant in California. So there are all kinds of disincentives to invest. And you're just not going to create jobs without investment.

Beck: Nothing is clearer in the president's program than his goal of returning responsibilities to the states for much of what is currently being done at the federal level. I wouldn't wait for the federal government to come forward and offer you additional assistance. Secondly, the current thinking on the tax law includes a proposition which, if enacted, would play directly into Wyoming's hands. If they do away with the deductibility of state taxes, we who live in New York and pay 15% of our income in tax might be far more approachable by a proper appeal from states like Wyoming and New Hampshire.

Questions from the audience

Public funds for venture capital

Stan Smith, State Treasurer: Some legislators may get the wrong impression from Mr. Collins's statement that public funds should not be used in venture capital formation. In Wyoming we have a permanent mineral trust fund that is looked on as a state resource, to replace minerals removed. It's a resource, just as state lands are. Why should we not use this resource for business development?

Collins: I wouldn't say that you shouldn't use this resource. This is not the kind of thing that we considered. This is a special case, as far as I'm concerned, that's unique. I don't know if other states have such things. We have no such resource in New Jersey, and we were thinking only in terms of funds that could be raised by a current bond issue that could be used in equity kinds of investments---not in loan guarantees, not in debt structures—and we thought that inappropriate because of the governance question. We couldn't get away from the kind of governance that may, in fact, predefine the failure of the effort.

Cohen: In New Jersey, we have had for several years an economic development authority, which initially received some rather modest state appropriation in getting going, in providing loans and loan guarantees. They have done so remarkably well that last year and the year before, long beyond the need for any subsidy, just on the basis of their earnings, they put out over $1 billion in each of those two years in loans and loan guarantees. They don't take equity positions, and they have a very rigorous set of criteria before they make a loan.

Start with the private sector

Galbreath: I'll compare this state to Colorado for a moment. There, you have 11 operating equity capital funds: you do not need to go to the state. It has flooded into the state. We're in good shape, and we have plenty available. That is not the case here in Wyoming. We're dealing with a very difficult environment for raising capital from private citizens and corporations. And rightfully so. We're in a recession up here. I believe, though, that there's a real common agreement among the speakers that you have to lead this process from the private sector. That's where the leadership and the management have to come from. There has to be the proper incentive to do the best and most efficient job.

Where the equity comes from, and in what mix, and where the pockets are tapped will differ between every state. Here, if you try to avoid equity investment and calf it loan guarantees, that's interesting. But I've seen a lot of venture investments in the form of loans that turn out to be equity. The fact is, you're taking risks.

Collins: Equity is that which you lose on the downside. [Laughter]

Managing the investment of public money

Rep. Lynn Birleffi [D, Laramie County]: How would you suggest setting up such private managers? Would you appoint a board that you would hire to decide what to invest in? And what about New Jersey's use of retirement funds in venture capital? If so, how do you do that? The political part is selecting the projects to invest in.

Collins: Typically, state laws prohibit investment by pension funds into something where somebody else makes the investment decision ultimately, such as in a venture capital fund, like my own, where I would then decide what to invest in. The laws prohibit that. So the first issue is changing the state law to allow that to happen.

In states where they have been allowed to invest directly, and the investment decisions have been in the state bureaucracy, it just plain hasn't worked. The funds have been invested with an enormous social overlay.

Social policy is one thing, and investment return is another. And you should not try to mix the two.

Several states have changed their laws so that the investment decision can be delegated. That enables their pension funds to look at investment opportunities presented to them by various venture managers. An established venture group with a track record of success or a new group can then go with their investment brochure or banker and approach the state pension funds seeking an investment. And many state pension funds have picked 10 or 12 or 15 different venture groups around the country, and they've tried to create a diversity of interests. Some people specialize in start ups, some in later stage investments, and some states have tried to pick a broad spectrum.

New York changed its laws, created one large fund, and gave it to one aroup that had a track record of success in venture investments. New Jersey has not yet passed that law to even allow the pension fund group to be approached. Delaware has taken three outside people, sophisticated in various areas of finance, and said "Tell us what outside managers to invest our state pension funds in, and we're going to do it totally outside."

No capital shortage

Beck: I don't think Wyoming's problem is a shortage of capital. It's a shortage of opportunities. And until you get good investment opportunities, I would not spend a lot of time trying to figure out how to invest your surplus money. I would cite that Wyoming is not unique in this respect. The Delaware River Valley, with the encouragement of the University of Pennsylvania, tried to establish a regional venture capital fund, to take advantage of the opportunities from that rather fertile valley. It took quite some time, and it's moving very slowly. Wyoming is not unique in its dearth of investment opportunities.

But you must have equity

Galbreath: if you've got the infrastructure, with a lot industry and research and development going, you can attract money ultimately. We don't have that here. Although it may seem backwards to bring the capital out and dangle it and say, "Come get it," I would argue that from the 300 business plans that 1 review a year, that is not the case. There are plenty of interesting businesses that go unfunded, because the bulk of venture capital activity in Denver still is focused on high-tech, early-stage. Yes, you have deal flow available within the region. Yes, those companies can be attracted. Part of the attraction has to be the badly needed equity. if you only force them into the banking community, banks cannot support that kind of risk. You must have equity.

Where's the bait?

Robert McBride [Buffalo]: Buffalo has everything that I just know somebody out there in the big U.S.A. would like to have, to come in with a small industry. Is there any vehicle for getting that word out?

Galbreath: You're going to have some provincial problems in terms of the very diverse cities and towns around Wyoming, each wanting to have their share of the attention. Each town, through its economic development coordinator or mayor, should develop a list of the most attractive attributes that the town has to offer. That is included in a state-developed package that the potential entrepreneur or businessman, who may wish to expand into Wyoming, can use to select those attributes that most carefully fit his set of requirements.

Collins: The key point is expand. In New Jersey, as in many states, one of the mistakes made by the development people was the idea that they could get companies to move from some other state to there. There are infrastructure differences, there are tax differences, and little differences at the state level. But frankly, when you add all of those things up, the pluses and the minuses, generally when you look state to state you come out with about the same total at the bottom. So it's too hard to create enough incentive to have a company move from another state, except in a very special situation. But to expand and create a new facility in your state, highly possible.

How Colorado money sees Wyoming

[Man in audience]: Do the venture capital firms in Colorado view Wyoming the same way as the gentlemen from the East see it, that there are no opportunities here?

Galbreath: No. I can be very specific. We have just made an investment in one company here and are looking at two others in this state. One of them would fit more classically into the venture capital business. It is high tech, but service related. Others are manufacturing related. I think there's a closer proximity. There's an ability for that capital to come out from Denver and for the venture firms to be able to go on site and see what they're investing in, which is the purpose of regionalization. And there are some in the business that prefer to be able to kick the tires constantly, rather than having to zig-zag across the country.

But I don't think there's any misunderstanding about the fact that the current opportunities that have risen to the surface are relatively few. I suspect with this well-educated citizenry, that you will be amazed at the number of tremendous ideas, once the capital base is in place, that will flow to the surface. We should not just make an effort to invest by attracting those opportunities out of the state to expand in.

We need university cooperation for research and development, investment in existing entrepreneurs when they have a good business plan right here in Wyoming, and attracting outside businesses to have some more immediate impact on job growth. We have to turn the psychology that Mr. High was referring to around.

Beck: My concern is that the earlier idea of a $30 million pool to be invested only in Wyoming companies may be invested in Wyoming companies before there is this adequate flow of investable ideas. If you're going to go into the venture capital business, you must bring with you a set of investment standards that are very, very tough. Otherwise, you might just as well term it a handout.

Barriers to economic development

[Man in audience]: Mr. Galbreath, you talked this noon about barriers within the state. What barriers do you see in the state at the present time?

Galbreath: You do not have a research facility here with a non-extractive orientation. So in terms of a company coming in that might draw from a research facility, whether it be university based or independent, you don't have that in place that I'm aware of. You have a highly educated labor force, but not a large one. The decision for Anheuser-Busch to come into Ft. Collins may be dependent on a number of factors, including the absolute number of employable people to service that large facility.

There are some weather and transportation constraints here. If you have a heavy product here that you've machined and you have to ship it long distances, the transportation costs are going to be prohibitive. You've got it to fit the right company to the characteristics that exist. I don't think it's the easiest state in the world to work with, but I don't think it's an impossible state to work with, by any means.

Academic research strength

Cohen: Everyone agrees there's a need to diversify. But you have a very strong mineral base here, and one should always work from one's strengths. Mr. Galbreath said you perhaps don't have a non-extractive academic strength. Let me pose the question: do you have a strong enough extractive mineral industry academic strength? That's a painful question.

I asked some oil company that shall be nameless, "Would you turn to the University of Wyoming if you wanted to engage in some level of research pertinent to the growth of your company?" To his shame, he answered, "We don't invest in any of that sort of stuff in any case." But I asked him then, "If you did, however, would you turn to the University of Wyoming?" And he said no. And, "Would your colleagues turn to the University of Wyoming." And he said no. "Where would they turn?" And of course you know the answers, a certain place in Colorado and in Texas.

If you're going to attract people, think of how difficult it will be to attract world-class people, or very, very good people to a non-extractive academic department. It would be much more difficult. At least you have the minerals here. You have something here for someone who's going to win something for his discoveries in the energy related extractive mineral industry. It's very difficult to attract top talent to academia. You've got the Princetons of the world to contend with. They have an attitude that people ought to pay to teach there. And they get away with it. You've got Texas, which has built an incredible strength in everything from Latin American affairs to biotechnology. They did it with money.

Galbreath: And that's the point, isn't it? You do have to start somewhere. And this state previously, perhaps 20 years ago, didn't have even the strength it posesses today at the University. It's got to be a multi-pronged approach. You can't just put money back into the extractive area and concentrate on that.

Short term tasks

Dick High: This seems fairly circular: if we have good deals, the money will come. We don't have good deals, so the money's not here. We can work on the University of Wyoming, which is presumably a fairly middle or long-term process. It's not something that's going to be changed over night. If we assume that Wyoming wants to start now, we'd obviously start with the University. What else can we do in the short term that will make a difference?

Cohen: One of the first tasks of an economic development agency or department of commerce would be to locate someone who would provide a one-stop service for any business that has questions with regard to getting started. That's some sort of dynamo, a compulsive type, who would know where things are available, who would do a lot of things himself, who would be a nag on the powers that be to get certain services started that are not available.

It doesn't cost a lot. And in the process, such a person will be like Johnny Appleseed, spreading ideas, creating networks, that kind of thing.

Pete Williams: I'd like to thank all of the members of our questioning panel. And we owe a very large Wyoming thank-you to these gentlemen, John Beck, Morton Collins, Edward Cohen, and Jim Galbreath, who have spent the better part of the day with us, giving the kind of presentation which I suspect, if this were not Wyoming and if we did not have the contacts that we have, would cost us considerably more to put on. We owe them a hearty thanks.

On behalf of the Wyoming Futures Project, the Economic Development and Stabilization Board, the Wyoming Bankers Association, and the Wyoming AFL-CIO, I'd like to thank you ladies and gentlemen very much for joining us today.

Governor's Conference on Venture Capital

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GLOSSARY OF VENTURE CAPITAL TERMS

Venture capital is not one type of financing. The term **venture capital** covers a broad spectrum of lending, most of it early-stage financing of small, rapidly growing companies. But venture capitalists are interested in expansion as well and have developed financing to help companies grow. Here are eight types of lending that all go under the flag of venture capital financing.

SEED FINANCING

A relatively small amount of capital provided to an inventer or entrepreneur to prove a concept and qualify for startup capital. This would generally involve product development, market research, and, if the outcome is positive, the development of a business plan.

STARTUP FINANCING

Startup capital is provided to companies for use in completing product development and initial marketing. Companies may be in the process of being organized or they may have been in business a short time but have not sold their product commercially.

FIRST-STAGE FINANCING

The capital provided to companies that have expended their initial capital and require funds to initiate full scale manufacturing and sales.

SECOND-STAGE FINANCING

Working capital for the initial expansion of a company which is producing and shipping and has growing accounts receivable and inventories. Although the company has clearly made progress, it may not yet be showing a profit.

THIRD-STAGE OR MEZZAININE FINANCING

The funds provided for major expansion of a company whose sales volume is increasing and which is breaking even or profitable. These funds are utilized for further plant expansion, marketing, working capital, or development of an improved product.

BRIDGE FINANCING

Money loaned for a company expecting to go public with six months to a year. This term also applies to short term financing for companies that are about to obtain permanent financing.

ACQUISITION FINANCING

Funds provided to a firm to finance its acquisition of another company.

MANAGEMENT/LEVERAGED BUYOUT

Fund provided to enable an operating management group to acquire a product line or business.

GENERAL GLOSSARY

All Hands Meeting

A meeting of all parties involved in preparing a registration statement, including company management, the company's attorneys, accountants, underwriters, and the underwriters' attorneys,

Accredited Investors

Individual or institutional investors who meet the qualifying Securities and Exchange Commission criteria with respect to financial sophistication or financial assets.

Analyst

A specialist, often employed by an investment banking firm, who follows certain companies and analyzes their financial statements for providing investment advice.

Arm's length

Refers to a business transaction where neither the buyer nor the seller is influenced by the other. A non-arm's length transaction might sell a family member assets of a business at a low price to move assets out of the business.

Best Effort Underwriting

A type of underwriting agreement in which the underwriter agrees to use only his best efforts to sell the shares on the issuer's behalf. The underwriters do not commit to purchase any unsold shares.

Blue Sky Laws

A common term for state securities laws.

Blue Sky Memorandum

A memorandum, usually prepared by the underwriters attorneys, which sets forth the various securities law provisions and restrictions applicable to each of the states in which the offering may be made.

Buy-Sell

A buy-sell agreement is one in which, under certain circumstances, the first party in a partnership must agree to buy out the second party, or the second party must agree to buy out the first party. Buy-sell agreements usually are negotiated between two partners such as an entrepreneur and a venture capitalist.

Buy-Out

The term refers to the sale of business; for example, when the buyer of a business buys it, he "buys out" the seller.

Capitalization

The company's debt to equity structure.

Cash flow

The most important aspect of any small business is the cash flow. The money coming in and the money going out is the flow of cash that determines whether a business will survive.

Cash in

The sale of all or part of stock for cash.

Cheap Stock

Common stock issued to selected persons (company insiders and promoters) prior to a public offering at a price less than the public offering price.

Closing

The event that occurs when the entrepreneur signs legal documents binding his company and transferring his cash from the venture capitalist to the company.

Collateral

The assets pledged fora loan made to a company. If the loan is not repaid, the collateral can be sold.

Comment Letter

A letter from the staff of the SEC describing deficiencies noted in its review of a registration statement.

Convertible

Usually refers to the debt or preferred stock, each of which is convertible into common stock of the company. Obviously, it is possible to have debt convertible into preferred stock and it is even possible to have preferred stock convertible in debt, although the latter is unusual.

Debenture

Another word for debt, note, or loan.

Debt Service

The amount of money you have to pay on a debt on order to keep it from being in default. If you make the payments that are called for under a note or loan, then you are servicing the debt.

Dilution

The effect on a prospective purchaser's equity interest caused by a disparity between the public offering price per share and the tangible book value per share immediately preceding the offering.

Downside

The amount of risk an investor takes in any venture is called the downside. If you stand to lose half your money if a business goes under, the downside risk is said to be 50 percent.

Due Diligence

The process of investigating a business venture to determine its feasibility.

Earn Out

The contract between the entrepreneur and the buying corporation that provides for the enterpreneur to earn additional money on the sale of his company, if operation earnings are in excess of a specified amount during the future years.

Equity

The preferred and common stock of a business. It also describes the amount of ownership of one person or a venture capitalist in a business.

Exit

The sale of equity of ownership in the business for cash or notes.

Firm Commitment Underwriting

A type of underwriting agreement in which the underwriters agree to purchase all the shares in the offering and then resell them to the public. Any shares not sold to the public are paid for and held by the underwriters for their own account.

Intrastate offering

An offering of securities exempt from registration, which will be sold only to residents of the state in which the issuer is doing a significant portion of its business.

Investment banker

The middleman between the company issuing new securities and the investing public. Also known as an underwriter.

IPO

Initial Public Offering

Lead Investor

The investor who leads a group of investors into an investment. Usually one venture capitalist will be the lead investor when a group of venture capitalists invests in a single business.

Letter of intent

A non-binding letter from the underwriter to the issuer, confirming the underwriter's intent to proceed with an offering and the general terms of the underwriting agreement.

Leverage

Another term for debt. Debt is usually referred to as leverage because in using debt, one does not have to give up equity. So for a very small amount of equity and a large amount of debt, one can leverage a business on the basis of its assets.

Leveraged buy-out

An acquisition of a business using mostly debt and a small amount of equity. The debt is secured by assets of the business.

Managing Underwriter

The lead underwriter whose functions include forming the underwriting syndicate.

Offering Circular

A document, similar to a prospectus, which is used in offerings not requiring registration with the SEC.

Options

The right given to someone, the venture capitalist, to buy stock in your company.

Partial secondary offering

An offering in which securities are offered for sale by both the company and by existing stockholders.

Pool

Usually a venture capital limited parnership in which each investor has "pooled" the resources by purchasing a limited partnership interest in the venture capital partnership. The partnership then invests in small businesses.

Price-earnings ratio

The number you multiply times the earnings per share number, in order to determine a fair price for a stock. For example, if a stock is earning $.50 a share and a price-earnings ratio of eight it used, then the stock is worth $4 a share.

Primary offering

An offering in which previously unissued securities are offered for sale by a company

Private placement

An offering of securities exempt from registration, which is limited in distribution.

Prospectus

The document or brochure, used as the selling document in an offering, that discloses pertinent information regarding the issuer.

Public offering

The selling of shares to the general public through the registration of shares with the Securities and Exchange Commission.

Quiet Period

The period between the time you reach an understanding with the underwriter regarding your intent to go public and ninety days after commencement of the offering, so-called because of the restrictions of publicity.

Raising capital

Raising capital refers to obtaining capital from investors or venture capital sources.

Red Herring

A preliminary prospectus, circulated during the waiting period, which bears a legend in red ink stating that the registration statement has not yet become effective.

Road Show

A tour by a company's executives during the waiting period for the purpose of making presentations to analysts and underwriters.

SEC

The Securities and Exchange Commission, established by Congress, to administer federal securities laws.

Secondary offering

An offering in which securities of previously unregistered stock are offered for sale by existing stockholders.

Structure

The term referring to the type of financing used in financing a small business. The structure might be $100,000 in common stock and $500,000 in debt for 15 percent interest for ten years.

Syndication

The process whereby a group of venture capitalists will each put in a portion of the amount of money needed to finance a small business.

Take back

Term referring to the situation where the seller of a business must take back something rather than cash. The take back usually refers to a note with reasonable terms and conditions.

Tender offer

A formal offer to purchase shares of stock from existing stockholders, usually in connection with an attempt to gain control of the company.

Tombstone

An advertisement announcing an offering of securities and indicating where a copy of the related prospectus may be obtained.

Transfer agent

An agency which keeps the official records of the names and addresses of a company's stockholders and handles the transfer of shares from one person to another.

Underwriter

The stockbrokerage house used to raise funds for small business in a public offering. in a public offering the stockbrokerage house that underwrites the small business is the one that buys the shares from the small business and sells them to the general public.

Underwriting agreement

An agreement between a company and its underwriters, setting forth the terms of the offering, including method of underwriting, the offering price, and commissions.

Unlocking agreement

A legal agreement between two parties under which one party may require the other to buy it under certain circumstances; thus, the so-called unlocking of the partnership.

Waiting period

The period between the date and registration statement is initially filed with the SEC and the date it is declared effective.

Warrant

A stock option given to someone else that entitles them to purchase stock in your company for a specified period of time at a specified price.