Economic Development Activities

Overview

In the early 1990's, many states designed programs to encourage, facilitate, or supplement the formation of local seed money and venture capital for business development. The intent is to encourage local entrepreneurs thus creating new wealth and quality jobs. Utah established the Utah Technology Alliance to develop strategies and address the objectives of attracting and retaining venture capital along with related professional services required by high-tech entrepreneurs. Until the capital markets, management base, and service infrastructure is developed to support a high level of successful public offerings, many Utah entrepreneurs will continue to look to sell their companies before they can mature.

Utah Economic Development

The level of venture investing in the U.S. has grown fivefold in just the last three years from $17 billion in 1997 to $104.1 billion in 2000. Utah has enjoyed an even greater increase growing from $79.8 million in 1997 to $569.2 million in 2000. In the face of the current recession and stock market slump, third quarter 2001 venture investment in Utah (although down approximately 60% from the previous year) was still twice its previous level for all of 1998.[1]

The Progressive Policy Institute[2] (PPI) ranked Utah fourth in the nation in the share of jobs in "gazelle" companies (companies with annual sales revenue growth of 20% or more for four straight years) as a share of total employment. Despite growth of progressive firms and venture activity in Utah, the state's venture capital markets are dwarfed in comparison to states like California, Texas, and Washington. The main source for funding for local ventures comes from institutional and private investors within a respective state.

According to a study by the National Governors Association[3], states have pursued four basic strategic objectives to accomplish local entrepreneurship: expand the knowledge of seed money and venture investing; promote the visibility of local entrepreneurs to investors and of investors to entrepreneurs; create investment capital to fill a gap or to grow a sector; and, create investment capital to build local seed and venture capital industries. The National Governors Association report concludes, "venture capital is critical to growing the new businesses in our economy. Seed and venture capital, delivered locally by resident professionals, is a key ingredient for growing entrepreneurship, particularly in communities where the knowledge and expertise of business venturing is less common. Exploring ways to nurture the culture of entrepreneurs, and the capital that feeds them, must be a top priority of states."

The California Research Bureau[4] performed a study on business capital needs in California. They reported that "Obviously, Gazelles are getting some capital; they could not grow as quickly as they have without it. Early state capital for Gazelles and other small businesses comes from a mix of the business owners' own money and assets, bank loans, investments by "business angels" and venture capitalists." The study found that "the industry makes investments through an organic web of personal interconnections and specialized knowledge that began in high technology and has not yet matured to the point where it provides capital to other fields that are probably as economically attractive." The study estimated that a shortfall in California venture funding exists and is between $5 billion and $11 billion and noted that it would consume a sizable share of the state's budget to fill California's many unmet business capital needs.

The Utah Venture Report

In January 2001 the Department of Community and Economic Development released a report on venture capital in Utah[5]. The report is based on interviews with venture capitalists (both inside and outside Utah); company founders, chief executive officers, presidents and other principal executives; service providers such as accountants and attorneys; and, federal, state, and other community leaders. The report also included a poll of top executives in Utah-based technology firms and an extensive analysis of third party research.

Findings

The main findings of the report, relating to venture capital, are:

- Utah entrepreneurs see a lack of capital available in Utah to grow their businesses;
- A stronger venture capital presence in Utah is necessary (a number of new venture firms have been established in Utah in recent years);
- Lack of large venture funds making many Utah funded companies eventually dependent on venture funds from sources outside of Utah;
- Utah lacks the able to fund its own community (Utah has one angel network and could support more); and,
- Utah entrepreneurs look to sell their companies after a certain point instead of growing them into sustainable operations (attributed to Utah's lack of capital and availability of supporting services).

The Utah Venture Report finds that regarding entrepreneurship in Utah that:

- Utah firms face a shortage of experienced mid and senior level managers to guide their growth;
- Utah's educational advantage is weakening, as differences between states in educational attainment narrow despite the state's strong focus on education; and,
- Utah's services infrastructure has significant shortages (legal services along with commercial and investment banking are areas were Utah has strained to support its rate business growth).

The Utah Venture Report further finds that:

- Venture capitalists in Utah need to collaborate more (of the approximately 180 venture deals done by Utah venture capitalists, only nine were funded by more than one Utah venture firm - collaboration, even among firms with different specialties, has a number of benefits such as access to a broader base of capital through extended relationships, access to experienced management for portfolio companies, and increased deal flow);

1 Source: Venture Economics

2 The New Economy Index, Progressive Policy Institute, 1998.

3 Growing New Businesses with Seed and Venture Capital: State Experiences and Options, National Governors' Association, 2000.

4 Business Capital Needs in California: Designing a Program, California Research Bureau, 2000.

5 The Utah Venture Capital Report - January 2001 http://utah.org/silicon/The_Utah_Venture_Report.pdf

- Business service providers, government officials, entrepreneurs, and financial capital providers need a more communal orientation (currently no major Utah organization - having a majority of the significant players - participates with other organizations on a regular basis); and,
- Utah entrepreneurs need to be educated in the complete "venture process".

Recommendations
The Utah Venture Report puts forth a series of recommendations including:
- Develop a "Friends of Utah" database and affiliation group, including alumni information from Utah's colleges and universities;
- Promote more educational opportunities for entrepreneurs of start-up companies (including "evening education" curricula from colleges and universities devoted to starting and running a successful enterprise).
- Local business groups should sponsor events where individuals can meet, share ideas, and receive feedback;
- State organizations should champion the formation of local angel networks;
- Strengthen the R&D efforts at all research institutions in the state and expand engineering programs at state institutions of higher education to grow skilled technologists;
- Strengthen the local venture capital in Utah and help raise capital by providing introductions to coastal venture firms; and,
- State government should explore the possibility of providing financial backing to a number of venture capital firms in Utah.

Further, the Utah Technology Alliance is proposing a program similar to the one Oklahoma initiated in 1993; whereby, private venture investment is stimulated by a provision of corporate income tax credit guarantees.

Implementation
To foster growth in Utah's high-tech environment, task groups were appointed to bring to action the recommendations of the Utah Technology Alliance report. These task groups include:

Capital Investment. Ensure the availability of investment capital and to encourage increased investment from local retirement funds and other domestic sources into emerging Utah high technology businesses.

Deal Flow. Develop and implement a timely and accurate deal flow reporting mechanism for the state.

Education. Identify all issues related to strengthening the training of Utah's workforce in the new economy.

Entrepreneur/Management. Ensure an expanding supply of experienced entrepreneurs, middle and upper level managers, to establish and staff Utah high technology businesses.

Friends of Utah. Formalize, expand, and nurture the Friends of Utah Network.

Investor Training. Provide training to angels, seed investors and venture capitalists on the process and needs of entrepreneurial technology companies.

Professional Services. Address the issues of the professional support services community.

The 2001 Legislature's Senate Bill 61, "Enhancements to the State Systems of Public and Higher Education," put to action recommendations from Utah Technology Alliance report. This legislation set the goal of doubling in five years the number of graduates from Utah universities and colleges in engineering, computer science, and related fields; and then tripling the number in eight years. The Legislature appropriated $1 million for higher education to hire additional faculty and staff to help increase the number of students and graduates. Utah universities and colleges have agreed to match this money on a one-to-one basis through internal reallocation. The Legislature also appropriated $43.5 million for renovations and additions to the engineering buildings at the University of Utah and Utah State University.

The findings of the Utah Venture Report are similar to the findings of the California Research Bureau. The California study found additional holes in venture capital coverage. Venture capital tends not to invest in the earliest stages of businesses. They tend not to invest in very small firms. They tend not to invest in healthy but initially slow growing firms. They may not invest in certain industries or businesses.

However, like California the Utah study found that along with access to capital, strong local venture firms bring a number of advantages to a region: they help the regional economy grow by providing capital and mentoring to small businesses; they are able to recycle successful management teams; they act as gatekeepers for outside money flowing in through their venture relationships; and they are more in tune with regional deal flows and have better relationships with local service providers.

While the PPI study ranked Utah third in workforce education, Utah has frequently been a net exporter of its more skilled workers (1999 IRS data shows the median income of Utah's out-migrants was $3,800 higher than that of its in-migrants). The Utah Venture Report also found that the 1990's brought a decline of Utah's absolute number of degree completions in technology related fields. The report comments that Utah cannot afford to starve existing companies and potential start-ups of this essential resource.

An article by the Dismal Scientist noted that many "state governments have been losing their minds for years. Public universities educate millions of students each year, many at a lower in-state tuition, only to watch these new graduates move elsewhere when it comes time to apply their skills in the workforce. The ability to retain locally-educated students in a state's labor force, as well as attract those educated elsewhere, builds the stock of human capital and makes a state economy more attractive to businesses."

Government Involvement
Debate exists concerning government involvement in private equity. Numerous studies have been done with varying conclusions on the wisdom and efficacy of direct government involvement in the venture capital process. The California Research Bureau concludes that, "examination of programs in other states to promote early-stage business investment is somewhat discouraging," and it found "little evidence that these programs have been especially effective."

On the other hand the National Governors Association study profiles what they consider four successful state programs, in Colorado, Indiana, Oklahoma, and Pennsylvania. The common treads between these four programs are:
- State leaders take the initiative in launching programs and helping set long-term direction then rely on private-sector managers to make the investment decisions;
- They recognize that a large part of the challenge of capital

formation is not about money but about knowledge (how the business community understands seed and venture capital, the steps, common ground rules, and what build a world class company is like);

- Long term in perspective (shortcuts lead to errors and embarrassment;
- Careful not oversell the program;
- Marshal enough resources to make a difference; and,
- Governed not by mandate but by discretion exercised by trained professionals and experienced laymen.

Similarly, the California study lists two additional lessons learned from other states: a program needs a flexible structure that allows the organization to function without typically excessive bureaucratic restrictions; and, a program needs an oversight mechanism that detects operation deficiencies at an early state of the program.

Conclusion

Growing a world-class business in Utah remains a challenge to entrepreneurs. Until the capital markets, management base, and service infrastructure is developed to support a high level of successful public offerings, many Utah entrepreneurs will continue to look to sell their companies before they can mature. The economic development community will work to build capital investment and entrepreneur and managerial talent.