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Bill Analysis

“Invest Georgia” Has Merit, Cannot Take Priority Over Other Needs

Bill Analysis: Senate Bill 224 (LC 34 3791) and House Bill 285 (LC 34 3705)

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Overview

Two bills under consideration by the General Assembly would create an ambitious new economic development program, “Invest Georgia.” It would direct $100 million in state money over five years to improve Georgia businesses’ access to venture capital – an important form of financing for new companies and entrepreneurs. Senate Bill 224 (SB 224) and House Bill 285 (HB 285) are similar to each another, although they differ on how they would fund the new program.

The proposals are a response to concerns in the state’s business community that Georgia’s relatively small pool of available venture capital is causing high-potential startup companies to relocate, especially to places like California and New York where this form of financing is concentrated. These two bills are logical efforts to address that challenge. It avoids the flaws of a similar program, CAPCO (short for Certified Capital Companies), that has failed in other states. The Georgia Budget and Policy Institute previously explained in detail the flaws in the CAPCO model, which provides a large tax break for insurance companies with little to no economic benefit in return.

While it is open to debate whether supporting venture capital is the proper role for the state, this kind of proposal is likely the most appropriate choice if lawmakers are intent on Georgia taking this step. The program’s approach has merit, but Invest Georgia would be a costly and unproven new program coming at a time when the state is failing to meet even its most basic obligations, such as education and health care. Georgia’s finances are still battered from the Great Recession and lawmakers have reacted by cutting services rather than considering new revenue options. Invest Georgia is a luxury the state cannot afford.

Cost

To create Invest Georgia, the state would spend $100 million over five years, with a staggered fiscal impact over that span: $10 million in year one, $15 million in years two and three, $25 million in year four and $35 million in year five. This initial allocation would create a pool of money for Invest Georgia to use as a permanent revolving fund. Its funds would be continuously invested, returned to the state and then reinvested over time. If this cyclical structure proved successful, Invest Georgia could remain capitalized in future years without additional state appropriations.

Venture Capital Explained

Venture capital is a form of startup funding for small businesses and entrepreneurs, provided by wealthy investors and companies. It is typically geared toward newer companies that are not yet able to secure traditional financing, such as bank loans. It is meant to serve as a source of “bridge” funding that helps a company grow from its initial phases to its full potential. Because venture capital goes to companies that are not yet mature, it is by definition a riskier form of investment than more traditional forms of financing. With that increased risk comes higher potential for both above-average losses and above-average profits. Georgia companies received about $265 million of venture capital funding in 2012, or 1 percent of the national total, compared to 48 percent for California and 10 percent for Massachusetts.

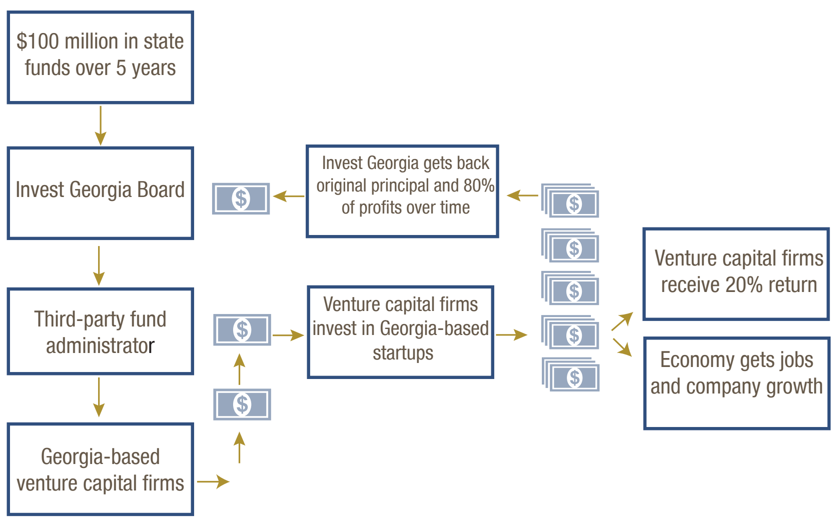
Sources: Atlanta Business Chronicle, Pricewaterhouse Coopers, National Venture Capital Association

What the Bill Would Do

The shared goal of SB 224 and HB 285 is to boost Georgia-based startup companies by strengthening Georgia's community of venture capitalists and expanding access to this form of financing. It is a response to the perception Georgia is falling behind economies of other states because companies have an incentive to relocate to areas where such financing is more available. In a recent survey by the Technology Association of Georgia (TAG), for example, 41 percent of the state's "technology decision-makers" selected "more venture capital" as the most-needed improvement to Georgia's business climate – nearly three times more than any other option.[1] And a study by the Georgia Institute of Technology (Georgia Tech) found approximately 40 percent of Atlanta's high-tech startup companies leave the city within three years, while 60 percent leave within five years.[2]

How Invest Georgia is Supposed to Work

Program would establish a new state fund, managed by a third-party administrator, to funnel state money through Georgia venture capital firms and into Georgia startup companies



Sources: House Bill 285 and Senate Bill 224 GBPI STAFF

If Invest Georgia becomes law, it would have a structure similar to programs in Maryland and other states. Here is how the initiative would work:

Administration

- Invest Georgia would be a distinct state entity housed within the Advanced Technology Development Center (ATDC) at Georgia Tech. Currently an incubator for technology-based startups, the center previously managed the Georgia Seed Capital Fund – a smaller program that lawmakers have not funded in many years.

- The program would be managed by a five-member Invest Georgia board appointed by the Governor, Lieutenant Governor and House Speaker. The board's primary responsibility would be to select a third-party fiduciary, or fund administrator, which would be an independent company with prior expertise in managing state venture capital programs. This independent fund administrator would then select a collection of Georgia-based venture capital funds to receive taxpayer money. The board would decide how much each selected fund receives.

- The bill includes guiding principles for the board and fund administrator to follow when selecting venture capital funds, factoring in a company's experience and history of investing and creating jobs in Georgia.

- Chosen firms would be required to match the state's allocation with funding from the private sector. Private investment requirements would range from 10 to 50 percent, depending on whether the firm's focus is on "early stage" or "growth stage" businesses.

- Venture capital funds receiving the money would then invest in selected startup companies that are headquartered in Georgia, have less than $1 million in annual revenue and have fewer than 20 or 100 employees, depending on the maturity of the business; there would also be a preference for companies that work primarily in "technology, health care, life sciences, agribusiness, logistics, energy and advanced manufacturing."[3]

- Importantly, the bill lays out several measures aimed at ensuring transparency and accountability, which is lacking in most state economic development programs. The selection of both the fund administrator and venture capital firms would be subject to open bidding. The program would also have to publish an annual report on its overall performance, including the financial return and number of jobs created by investments. There are also "clawback" provisions that require startup companies to immediately return the state's money if the firms leave Georgia within the first three years of receiving assistance.

Funding

- The two bills differ on how Invest Georgia would be funded. HB 295 proposes to capitalize the program through a mix of direct appropriations, grants from the OneGeorgia Authority and tax credits that would be sold to insurance companies in exchange for up-front cash. SB 224, conversely, does not include the tax credit option. This implies that Invest Georgia would need to be directly funded through the annual appropriations process.

- Because Invest Georgia is designed as a revolving fund, its expenditures would be returned to it over time. The bills would require that selected firms repay both the state's original principal and 80 percent of the eventual profits. The venture capital firms would retain the other 20 percent of profits. This is the same benefit structure found in standard private sector venture capitalist agreements.

Policy Consideration: Difficult to Justify with Limited Revenues

SB 224 and HB 285 are carefully thought out efforts to address concerns in the Georgia business community that the state lags behind in the race to attract venture capital. Its authors deserve credit for designing the bill with a solid approach. They avoided the serious pitfalls of the flawed CAPCO model and based their proposal on respected programs from other states. The legislation also includes some critical safeguards to protect taxpayer money, which are often missing from Georgia's economic development programs.

However, lawmakers must also weigh the anticipated benefits of Invest Georgia against today's strained budget realities. Georgia's finances are still battered from the Great Recession and critical state funding for education and other essential services needs shoring up. Budgets for many state agencies are down by as much as 20 to 30 percent since before the recession began, which in some cases is compromising even the basic administration of state government, such as employing adequate staff to process tax returns or drivers' licenses. The state is already likely to spend nearly $400 million on economic development programs and tax credits in the next fiscal year[4] and taxpayers have very little idea what they are getting in return.[5]

Since the state is not even raising enough money to meet its most basic obligations, it is hard to justify Invest Georgia as a top priority. To excel in a 21st century economy, Georgia needs an educated and versatile workforce, world-class infrastructure and adequate public services that meet the state's growing needs. Achieving these goals requires positive investments that strengthen Georgia's quality of life. Programs like Invest Georgia divert the revenue that lawmakers need to make those investments. If Georgia had more financial flexibility through increased revenues, then Invest Georgia might be a proposal worth considering. Instead, it is a diversion of state money that Georgia cannot spare.

Endnotes

[1] "Key Findings," 2011 State of the Industry: Technology in Georgia. Technology Association of Georgia (TAG). http://www.tagstateoftheindustry.net/keyfindings.html

[2] "Sustainable High-Tech Clusters in Georgia," 2/24/10. http://stip.gatech.edu/?p=29. Article describes original Georgia Tech report cited here: Breznitz, Dan and Taylor, Mollie, The Communal Roots of Entrepreneurial-Technological Growth? Social Fragmentation and the Economic Stagnation of Atlanta's Technology Cluster. 10/2/2009. http://ssrn.com/abstract=1481857

[3] Text of House Bill 285.

[4] GBPI analysis based on official Georgia Tax Expenditure Report for FY 2014. Described more fully in "Georgia FY 2014 Budget for Business Tax Breaks," Georgia Budget and Policy Institute. 2/7/2013. http://gbpi.org/overview-georgia%E2%80%99s-2014-budget-for-business-tax-breaks

[5] Georgia was recently ranked as one of 26 states that are "trailing behind" on measuring if its economic development tax credits are effective, which basically means the programs are not reviewed very often, or very thoroughly. "Evidence Counts," Pew Center on the States. 4/12/2012. http://www.pewstates.org/research/reports/evidence-counts-85899378806

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