The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Higher Education Appropriations Committee

BILL: CS/CS/CS/SB 2414

INTRODUCER: Higher Education Appropriations, Governmental Operations Committee, Higher Education Committee and Senator Ring

SUBJECT: Sure Ventures Commercialization Program

DATE: April 16, 2007 REVISED: ______ ______ ______ ______

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Harkey	Matthews	HE	**Fav/CS**
2.	Rhea	Wilson	GO	**Fav/CS**
3.	Bryant	Hamon	HI	**Fav/CS**
4.			TA	
5.				
6.				

I. Summary:

This bill creates State University Research Commercialization Assistance Grant Program to finance the commercialization of products and services developed from the research and development conducted at Florida public universities. The program is to be administered by the Florida Technology, Research, and Scholarship Board, which is presently advisory to the Board of Governors of the State University System for the Centers of Excellence and world class scholars programs.

There are three types of commercialization grants to be provided - for early market research, to match private investment in a university commercialization proposal, and to match private investment relating to the implementation of a completed business plan for a university research project. The grants must be awarded according to criteria established in the bill.

The bill appropriates $10 million in nonrecurring funds from the General Revenue Fund for the 2007-2008 fiscal year for the purpose of implementing the grant program.

This bill amends section 1004.226 of the Florida Statutes.

II. Present Situation:

The Venture Capital Industry[1]

[1] The primary source for information in this section is the National Venture Capital Association website, available at http://www.nvca.org/def.html . Last visited March 18, 2007.

"Venture capital" is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for startup companies.[2]

Venture capital investments typically have several characteristics, including an investment in a start-up or expansion-oriented company that has a higher level of risk than is typically associated with traditional bank lending activities; equity participation in the business by the venture capitalist; long-term investments with a 5- to10-year time horizon; and an established mechanism for the payout to the venture capitalist at the end of that time period.

Venture capitalists generally:

- Finance new and rapidly growing companies;
- Purchase equity securities;
- Assist in the development of new products or services;
- Add value to the company through active participation;
- Take higher risks with the expectation of higher rewards; and
- Have a long-term orientation.[3]

Venture capitalists actively work with the company's management by contributing their experience and business savvy gained from helping other companies with similar growth challenges. A venture capitalist may invest before there is a real product or company organized, known as "seed investing," or may provide capital to a company in its first or second stages of development known as "early stage investing." Venture capitalists mitigate their risks by developing a portfolio of young companies into a single venture fund.

Over the past decade, a number of states have adopted programs targeting the formal venture capital industry. Programs fall into five basic categories :

- Direct investment by state agencies to individual businesses. This type of program may be problematic, because it is difficult to find state agency staff with appropriate expertise.
- Investment by state agencies or pension funds into privately managed funds that have extensive geographical limitations (such as enterprise zone location requirements).
- Investment by state agencies or pension funds into a portfolio of privately managed funds. Investments are made in several private partnerships along with other investors. This model is effective at diversifying risk and helping focus a variety of experienced investors on legitimate capital needs of businesses.
- Private investment spurred by offering state tax credits for qualifying investments. Programs include direct tax credits for investment in qualified businesses and direct tax credits for investment in qualified venture capital funds.
- Private investment spurred by offering contingent state tax credits used as a source of value for guaranty of investment. The tax credits are contingent because they are not claimed unless the venture capital investment fails to meet a guaranteed rate of return.

[2] *Ibid.*
[3] *Ibid.*

Venture Capital in Florida

Enterprise Florida, Inc. (EFI), reports that in Florida, total venture capital spending was more than $555 million for 114 deals in 2003 and 2004, and that 27 venture capital firms have headquarters in Florida.

EFI also reports that since the late 1990's, venture capital investment in Florida has fallen sharply both in absolute dollar terms and as a share of the U.S. total. Despite being the fourth-most populous state, Florida ranked 13th in the U.S. in terms of venture capital investment in 2004. In 2004, Florida accounted for only $300 million, or 1.42 percent of the total venture capital funding in the U.S.

To date, Florida has promoted the investment of state funds in venture capital through two programs: the Cypress Equity Fund and the Certified Capital Company Act (CAPCO).

The Cypress Equity Fund

In 1995, the Enterprise Florida Capital Partnership, Inc., created the Cypress Equity Fund as part of a strategy to help improve Florida businesses' access to venture capital. The Cypress Equity Fund's purpose is to facilitate initial venture capital investments by Florida private financial institutions and institutional investors, and provide a means to encourage national venture capital managers to consider investment opportunities in Florida. This program invests both public and private funds into privately managed venture capital funds.

The Cypress Equity Fund is designed as a "fund of funds" to invest in national private venture capital funds that, in turn, would invest in companies with high growth potential. However, investments may be made in venture capital funds located anywhere in the country and therefore are not required to target in-state companies.

The Cypress Equity Fund began with a total of $35.5 million in commitments: $20.5 million from five private financial institutions, and $15 million from the Florida State Board of Administration. The Cypress Equity Fund Management Corporation, an entity established by the Capital Development Board, is responsible for overall management of the fund. The corporation, in turn, contracts with a private equity manager to invest fund assets with national venture capital firms.

In a 1998 report on the Cypress Equity Fund, the Legislature's Office of Program Policy Analysis and Government Accountability (OPPAGA) concluded that the fund has not contributed to achieving the goal of improving Florida businesses' access to venture capital because its investments were not targeted to in-state companies.[4]

As of December 31, 2006, the Cypress Equity Fund portfolio is valued at $10.3 million. Since the program's inception, distributions and realized gains to investors have totaled $49.5 million, and the net compound internal rate of return is 22.5 percent.[5]

[4] "Review of The Enterprise Florida, Inc. Capital Development Board's Cypress Equity Fund," Report No. 98-33. Available at http://www.oppaga.state.fl.us/monitor/reports/pdf/9832rpt.pdf

[5] Letter from Abbott Capital to Enterprise Florida, Inc., dated Feb. 15, 2007. On file with the Commerce Committee.

CAPCO

The 1998 Florida Legislature enacted the Certified Capital Company Act.[6] This program encourages private investment in venture capital by providing direct tax credits for investment in qualified businesses. The stated purpose of this act is to stimulate a substantial increase in venture capital investments in Florida by providing an incentive for insurance companies to invest in state-certified capital companies (CAPCOs) which, in turn, will invest in new or expanding businesses. Eligible insurance companies are granted insurance premium tax credits in amounts equal to investments in CAPCOs. The increase in investment capital is intended to contribute to employment growth, create high-paying jobs, and expand or diversify Florida's economy.

A 2005 review of the CAPCO program by the Governor's Office of Tourism, Trade and Economic Development (OTTED) indicated that $3 million was invested in 12 new investee companies, ranging from a business that specializes in transportation of construction materials, to child-care centers, to pool and spa installation.[7] Another $1.8 million was invested in existing companies. As of December 31, 2005, a total of $153.4 million has been made available to the 59 investee companies, which have created 1,028 jobs.

While as many as nine states have created CAPCOs, this type of program is increasingly viewed as the more "problematic" of the Venture Capital Funds (VCF) programs, in terms of:

> "...its high cost, poor design and target inefficiency. Unlike any other VCF program, the CAPCO program provides a 100% premium tax credit to insurance company investors. In effect, the government underwrites the entire investment risk."[8]

Other Models for Public Investment in Economic Development

Florida statutes include a variety of state subsidies, tax credits, and tax exemptions targeted for economic development. Most are distributed or administered by OTTED or the Department of Revenue (DOR). However, in some cases the Legislature has established an alternative mechanism for specific purposes. Recent examples include the Innovation Incentive Program, Centers of Excellence, and Scripps Funding Corporation.

[6] Chapter 98-257, L.O.F., codified at s. 288.99, F.S.

[7] "Certified Capital Company Act" (CAPCO) Annual Report, January 1-December 30, 2005. Prepared by OTTED. Copy on file with the Commerce Committee.

[8] Daniel Sandler, Professor at the Faculty of Law, The University of Western Ontario, London; senior research fellow of the Taxation Law and Policy Research Institute, Melbourne; and associated with Minden Gross Grafstein & Greenstein LLP, Toronto. See Daniel Sandler, *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States* (Toronto: Canadian Tax Foundation, 2004) ("Sandler VC Study").

Innovation Incentives Program
Chapter 2006-55, L.O.F., created the Innovation Incentive Program.[9] The purpose of the program is to provide resources for significant economic development projects, including the location or expansion of research and development entities and innovation businesses in Florida. The law appropriated $200 million for the program for FY 2006-2007. These funds were placed in reserve by the Executive Office of the Governor. Unexpended funds for fiscal year 2006-2007 are subject to annual appropriation.

Section 288.1089, F.S., requires Enterprise Florida, Inc. (EFI), to evaluate applications for innovation incentive funds and to recommend eligible businesses to OTTED. Next, OTTED must certify the applicants as qualified businesses, and then recommend qualified businesses to the Governor for approval. The Governor is required to consult with the Legislature and receive approval prior to releasing innovation incentive funds to qualified businesses.

Two recent recipients of funding under this program are the Burnham Institute (Burnham) for Medical Research and the Torrey Pines (Torrey Pines) Institute for Molecular Studies.[10] Burnham in August 2006 announced plans to open a research facility in Orlando, and has received $155 million in state innovation incentive funds.[11] Torrey Pines in September 2006 announced plans to expand its research operations to the city of Port St. Lucie, and has received $32 million in state innovation incentive funds.[12]

Centers of Excellence
Chapter 2006-58, L.O.F., created the Centers of Excellence Program, which is designed to foster and promote the research required to develop commercially-promising, advanced, and innovative science and technology and to transfer those discoveries to commercial sectors.[13] The law established the Florida Technology, Research, and Scholarship Board within the Board of Governors of the State University System to recommend to the Board of Governors methods for implementing and administering the Centers of Excellence Program. The Board of Governors was authorized to select the Centers and disburse the $30 million appropriated for this purpose.

In November 2006, the Board of Governors disbursed the entire amount to five universities to advance various research projects: Florida Atlantic University, Florida State University, the University of Central Florida, the University of Florida (which received two separate grants), and the University of South Florida.

Scripps Florida Funding Corporation
During Special Session E in 2003, the Legislature provided for the creation of the Scripps Florida Funding Corporation (corporation), which is responsible for contracting with The Scripps Research Institute (TSRI) to establish a state-of-the-art biomedical research institute and campus

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[9] Section 288.1089, F.S.
[10] "Florida Has Implemented Promising Biotechnology Initiatives, But Faces Challenges," Report No. 06-71, by the Florida Office of Program Policy Analysis & Government Accountability. Published November 2006. Available at http://www.oppaga.state.fl.us/reports.
[11] Ibid.
[12] Ibid.
[13] Section 1004.226, F.S.

in Florida.[14] The funding for the contract is provided by $310 million of the $543.5 million in federal economic stimulus funds provided to Florida under the Jobs and Growth Tax Reconciliation Act of 2003.

OTTED was the initial recipient of the $310 million appropriation. OTTED disbursed the funds to the corporation pursuant to a funding agreement. The purpose of the corporation was to receive a lump-sum payment of $310 million guaranteeing that a funding source will be available for periodic disbursements to TSRI's Florida operation over a seven-year period. Undisbursed funds held by the funding corporation have been invested by the State Board of Administration. The law stipulated that undisbursed funds revert back to the General Revenue Fund only if the contract between the funding corporation and TSRI is terminated. To date, scheduled annual disbursements have been made to TSRI, pursuant to their contract with the corporation.

These three programs have the potential to improve the state universities' role in technology transfer, a process through which an entity that develops a new technology, but does not have the wherewithal or desire to bring it to market, transfers that raw technology to another entity that has the ability to commercialize it. A 2001 report by the Senate Commerce and Economic Opportunities Committee[15] noted that university-to-industry technology transfers can be a key factor in building a high-skill, high-wage state economy. However, the report concluded that, by 2002, Florida universities, in general, did not appear to be performing as many technology transfers as their peer universities.

The report identified the importance of university-to-business transfers, reviewed the statutory and regulatory framework for technology-transfer activities, and identified the impediments to successful university-to-industry collaboration. Commercialization resources that a university needs to fuel the technology-transfer process include pre-venture "seed" funding, sound business guidance, and administrative support.

III. Effect of Proposed Changes:

This bill creates the State University Research Commercialization Assistance Grant Program to provide financing for the commercialization of products and services developed from the research and development conducted at Florida public universities. A university may apply for funds to be used for a variety of premarketing activities, including, but not limited to, securing patents, establishing start-up companies, developing license agreements, attracting private investment, and supporting other activities that are necessary to establish commercially viable ventures for the marketing and sale of products resulting from university research.

The grant program will be administered by the Florida Technology, Research, and Scholarship Board which was created by chapter 2006-58, L.O.F. This 11 member board, which is advisory to the Board of Governors of the University System (BOG) for the Centers of Excellence and world class scholars programs, will make the grant awards and agreements for this program with administrative support from the BOG. The Florida Technology, Research, and Scholarship

[14] Section 288.955, F.S.
[15] "Technology Transfer and Commercialization." Senate Interim Project Report 2002-123. November 2001.

Board is representative of business leaders, industrial researchers, academic researchers, scientists and leaders in the emerging and advanced technology sector.

Grants under the State University Research Commercialization Assistance Grant Program may be provided under the following categories:

- Phase One grants, which may not exceed $50,000 per project, may be used to assist with early market research, independent evaluation, consultation, and other initial activities that may be required to develop an initial business model for a university research product having the potential for commercialization.
- Phase Two grants, which may not exceed $100,000 per project, may be used to match private investment in a university research commercialization proposal. Phase Two grants must be used to develop a complete business plan for the commercialization of a university research product. For a Phase Two grant proposal, the university must document the availability of $1 in private support for each $1 in state funding requested.
- Phase Three grants, which may not exceed $250,000 per project, may be used to match private investment relating to the implementation of a completed business plan for a university research product. For a Phase Three grant proposal, the university must document the availability of $1 in private support for each $1 in state funding requested.

Subject to the availability of funds, the board must periodically solicit specific proposals from universities for grants. When evaluating the projects submitted for funding the board must consider the following criteria:

- The potential return to the university which may be reasonably assumed based on the business case presented in support of the proposed project;
- The potential for the creation of high-wage jobs resulting from the success of the proposed project;
- The potential of the proposed project to address a pressing needs of the residents of the state;
- The potential of the proposed project to enhance the economic competitiveness of the state and the university;
- The technical, financial, organizational, and marketing feasibility of the project and its business plan; and
- The potential of the proposed project to create other related business enterprises.

The proposed project must be evaluated on its individual merits.

The bill appropriates $10 million in nonrecurring funds from the General Revenue Fund for the 2007-2008 fiscal year for the purpose of creating and implementing the grant program.

The bill will take effect July 1, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill is designed to promote the commercialization of university research products (which appears to include the institutes created within or at those universities) for the purpose of enhancing the state economy and the state's public universities.

C. Government Sector Impact:

The bill appropriates $10 million in nonrecurring funds from the General Revenue Fund for the 2007-2008 fiscal year for the purpose of creating and implementing the grant program.

The Florida Technology, Research, and Scholarship Board may provide grants for university commercialization projects within three phases:

- Phase One grants, not to exceed $50,000 per project
- Phase Two grants, not to exceed $100,000 per project, and
- Phase Three grants, not to exceed $250,000 per project.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.