



DEPARTMENT OF THE TREASURY
COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND
601 THIRTEENTH STREET, NW, SUITE 200 SOUTH
WASHINGTON, DC 20005

**Overview
of the
Community Development Financial Institutions Fund**

The Community Development Financial Institutions (CDFI) Fund was created to expand the availability of credit, investment capital, and financial services in distressed urban and rural communities. The Fund was authorized by the Riegle Community Development and Regulatory Improvement Act of 1994, and was a bipartisan initiative. By stimulating the creation and expansion of diverse community development financial institutions (CDFIs) and by providing incentives to traditional banks and thrifts through the Bank Enterprise Award (BEA) Program, the Fund's investments work toward building private markets, creating healthy local tax revenues, and empowering residents. The CDFI Fund provides relatively small infusions of capital to institutions that serve distressed communities and low-income individuals. The Fund's activities leverage private-sector investments from banks, foundations, and other funding sources. Since the Fund's creation, it has made over \$180 million in awards to community development organizations and financial institutions.

CDFIs are specialized financial institutions that work in market niches that have not been adequately served by traditional financial institutions. These CDFIs provide a wide range of financial products and services, including mortgage financing for first-time home-buyers, financing for needed community facilities, commercial loans and investments to start or expand small businesses, loans to rehabilitate rental housing, and financial services needed by low-income households and local businesses. In addition, these institutions provide services that help ensure that credit is used effectively, such as technical assistance to small businesses and credit counseling to consumers. CDFIs include community development banks, credit unions, loan funds, venture capital funds, and microenterprise loan funds.

CDFI Fund Initiatives

Community Development Financial Institutions Program

The Community Development Financial Institutions (CDFI) Program represents a new type of community development initiative. It uses limited federal resources to invest in and build the capacity of private, for-profit and non-profit financial institutions, leveraging private capital and private-sector talent and creativity. The Fund invests in CDFIs using flexible tools such as equity investments, loans, grants, and deposits, depending upon market and institutional needs. These needs are demonstrated by the applicant CDFI in its business plan and in its ability to raise comparable non-federal matching funds, both requirements of the application process. The Fund evaluates each applicant CDFI in a manner similar to a private investor determining the investment-worthiness of an institution, including assessing financial performance, management capacity, and market analysis. Thus, the Fund is able to effectively assist these organizations to enhance their ability to meet community needs, develop, and grow.

The CDFI Program has three separate components: the Core Component, the Intermediary Component and a new Technical Assistance Component. The Core Component is the Fund's main program under which CDFIs, or entities proposing to become CDFIs, may apply for financial and technical assistance. The Intermediary Component is created specifically for intermediaries who focus primarily on the financing of other CDFIs. A new Technical Assistance Component was designed to better meet the unmet capacity needs of CDFIs, or entities proposing to become CDFIs, who have significant potential for increasing their community development impact.

Through the first three rounds of the CDFI Program, the Fund has made \$122.8 million in investments to CDFIs, including community development banks, loan funds, credit unions, venture capital funds, and microenterprise loan funds. These organizations serve both rural and urban areas in local, regional, statewide, and multi-state markets in 46 states and the District of Columbia. In the next two to three years the CDFI Fund's investments are expected to leverage three to four times the investment in total capital raised for these institutions.

A Notice of Funds Availability for the 1999 CDFI Program – Core Component and the Intermediary Components – was published in the Federal Register on October 26, 1998. The deadline for the Intermediary Component is February 2, 1999. The deadline for the Core Component is February 4, 1999.

The CDFI Fund anticipates that the Notice of Funds Availability for the 1999 CDFI Program – Technical Assistance Component – will be published in the Federal Register late in January of 1999.

Bank Enterprise Awards Program

The Bank Enterprise Award (BEA) Program recognizes the key role played by traditional financial institutions in community development lending and investing. It provides incentives for these regulated banks and thrifts to invest in CDFIs and to increase their lending and provision of financial services in distressed communities. The BEA Program supports the community reinvestment efforts of these financial institutions.

Through the first three rounds of the BEA Program, the Fund has awarded \$58 million to banks and thrifts. These institutions provided nearly \$133 million in equity investments and financial support to CDFIs, and \$143 million in total direct lending and financial services in distressed communities.

A Notice of Funds Availability for the 1999 program round was published in the Federal Register on September 1, 1998. The deadline for applications was November 24, 1998.

Presidential Awards for Excellence in Microenterprise Development

At the direction of President Clinton, the CDFI Fund designed and implemented this non-monetary award program to bring wider attention to the important role and the successes of domestic microenterprise development in enhancing the economic opportunities of disadvantaged individuals across America. In the first round of these awards, seven organizations were recognized for their work assisting individuals to become successful entrepreneurs. These annual awards were created as one of the commitments made by the United States at the United Nations Fourth World Conference on Women, held in Beijing, China in September 1995.

The 1998 Presidential Awards for Excellence in Microenterprise Development will be announced in early 1999.

For More Information...

Please visit the CDFI Fund's website at www.treas.gov/cdfi, or call the CDFI Fund at (202) 622-8662.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

25

Divider Title: _____

BusinessLINC:**Business-to-Business Relationships that Increase the Economic Competitiveness of Firms**
January 15, 1998

Today, Treasury Secretary Robert E. Rubin and SBA Administrator Aida Alvarez announced that the Administration's FY 2000 budget includes seed funding of \$3 million to expand BusinessLINC to new markets in economically distressed communities around the country.

In June 1998, Vice President Al Gore launched BusinessLINC -- Learning, Information, Networking, and Collaboration, and asked Secretary Rubin and Small Business Administration Administrator Alvarez to lead the effort. BusinessLINC is a unique partnership between the federal government and America's business community to encourage large businesses to work with small business owners and entrepreneurs, in order to improve the economic competitiveness of smaller firms located in distressed areas, both urban and rural.

As a part of the initiative's efforts to gather information on current efforts encouraging business-to-business linkages, a series of six regional meetings were held in Atlanta, Cleveland, Chicago, Dallas, Los Angeles, and New York. The regional meetings, which included participation by business leaders from both large and small companies; local business and civic organizations; and federal, state and local government officials, served as forums to spark further interest from the private sector community, share information about their business-to-business partnerships and mentor-protégé programs, and exchange ideas and best practices.

Vice President Gore released a report on successful corporate strategies, *BusinessLINC: Business-to-Business Relationships that Increase the Economic Competitiveness of Firms*, at the second White House Business and Entrepreneurial Roundtable on December 16, 1998. At the Roundtable, leading businesses announced new BusinessLINC initiatives, including BankBoston; Bell Atlantic; Chase Manhattan Bank; Delilah's Southern Cuisine; GE Capital; ITC Personnel Services; Lazo Technologies; McDonald's Corporation; Science Applications International Corporation; and Trumark Metal Stamping.

Vice President Gore also announced a new private sector BusinessLINC leadership coalition; a Treasury mentor-protégé program -- *Success Partnerships*; and a BusinessLINC website (businesslinc.sba.gov) that will serve as a national database for small and large companies and intermediaries to identify business linkages. The \$3 million in new funding will leverage these private sector efforts to spur BusinessLINC at the national and local level, to bring vital business expertise to economically distressed communities across the country.

The benefits to large and small firms from BusinessLINC can be significant. Smaller firms can use these strategies to obtain technical assistance and management development, leverage core strengths, access new sources of financing, increase marketplace credibility, and enter into subcontracts and joint ventures. Larger companies may use BusinessLINC to reach new markets, partner with agile companies, create a strong supplier base, thrive in industries that call for inter-firm collaboration, and create a stronger community and overall business environment.

BusinessLINC: Learning, Information, Networking and Collaboration

**Business-to-Business Relationships
that Increase the Economic Competitiveness of Firms**

A Report to Vice President Al Gore

Table of Contents

Executive Summary	1
Summary of Action Agenda	8
I. Introduction: The Benefits of BusinessLINC	9
II. Choosing Potential BusinessLINC Partners	16
III. BusinessLINC Strategies	22
One-on-One Technical Advice and Consulting	22
Classroom and Group Training	23
Peer Groups and Boards of Advisors	26
Supplier Development and Strategic Alliances	27
Sales Channel Development	31
IV. Key Factors in Successful BusinessLINC Strategies	34
V. Focus: Intermediary Organizations as a Factor in Successful BusinessLINC Strategies	38
VI. Focus: Targeting BusinessLINC to Economically Distressed Areas	44
VII. Conclusion: BusinessLINC Action Agenda	49
APPENDIX A: BusinessLINC Executive Memorandum	A-1
APPENDIX B: BusinessLINC Case Studies	B-1
1. Chase Manhattan Bank's Business Resource Center	B-3
2. Turner Construction's James Walker Construction Management Training Program	B-8
3. GM Minority Mentoring Program	B-12
4. McDonald's Corporation's Franchisee Support Program	B-19
5. NCR Corporation's Business Advisory Programs	B-26
6. GE Capital Small Business College	B-32
APPENDIX C: BusinessLINC Regional Meetings and Attendees	C-1
APPENDIX D: Federal Resources for Business Technical Assistance	D-1
APPENDIX E: SBA BusinessLINC Resources	E-1

Executive Summary

Vice President Al Gore launched an initiative in June 1998 called "BusinessLINC" -- Learning, Information, Networking, and Collaboration -- to galvanize business-to-business relationships that build the competitive strengths of small businesses, especially those located in economically distressed urban and rural areas. The Vice President asked Treasury Secretary Robert E. Rubin and U.S. Small Business Administration's Administrator Aida Alvarez to co-chair the effort to research business-to-business advisory services in all contexts and to suggest how best practices could be applied in urban and rural economically distressed communities.

Small businesses are critical to job growth and the economic vitality of the United States. Of the approximately 6.6 million employers in the U.S., over 5.5 million are businesses that employ fewer than 100 employees.¹ Small businesses with fewer than 100 employees employ over 37 percent of all full-time employees.² As America grows more diverse, the face of small business is also changing: in the most recent survey of business ownership prepared by the Bureau of Census, the number of minority-owned small businesses grew at a 62 percent rate while the total number of firms grew 26 percent, from 1987 to 1992. Yet relatively little attention has been paid to the ways that business relationships with larger firms can help smaller firms thrive and compete effectively.

The Department of the Treasury and the Small Business Administration, in partnership with other Federal agencies, held a series of BusinessLINC Regional Meetings across the country with over 500 business people, civic leaders and practitioners in the summer and fall of 1998. In addition, Treasury staff have conducted additional research, including in-depth interviews with experts from corporate and civic organizations, to learn from a wide array of experience. Because there has been little academic research on this topic, Treasury also contracted with Harvard Business School Professor Michael Porter's research and consulting firm, the Initiative for a Competitive Inner City, which has expertise in business strategy and economic development, to conduct additional research and develop detailed case studies of several business-to-business relationships. Finally, members of a CEO working group put together by Secretary Rubin, and outside expert reviewers, provided additional material and extensive input for the report. The report is based on our findings from these meetings, interviews and additional research.

Our work suggests that business-to-business relationships -- which include learning, information-sharing, networking among firms and intermediaries, and collaboration on specific projects-- can be essential to business success and a vital resource to help economically distressed

¹ U.S. Census Bureau, U.S. Firms, Establishments, Employment, Annual Payroll, and Estimated Receipts by Industrial Division and Enterprise Employment for 1995.

² Office of Advocacy, U.S. Small Business Administration, from data provided by the U.S. Department of Commerce, Bureau of the Census, March 1997 Current Population Surveys.

communities. Both companies and individual business professionals can bring their expertise and resources to bear through BusinessLINC activities. As Michael Porter has stated, "business-to-business connections, whether they be in training, purchasing, mentoring, or supplier relationships, are the most precious resource companies can contribute. A network of business relationships and sources of advice is critical to any company's success."³

Based on the meetings, interviews and research conducted as part of the BusinessLINC initiative, this report for the first time catalogs these corporate relationships ("BusinessLINC strategies"), sets forth the lessons to be learned from them, and presents an action agenda for businesses to create more BusinessLINC relationships -- at the individual business level, in local initiatives and at the national level.

"Chase has long recognized that the growth and strength of small businesses is a key element to the overall health and vitality of our communities and of our own business success in those communities."
— Walter V. Shipley, Chairman, The Chase Manhattan Corporation

The Regional Meetings also illustrated how BusinessLINC strategies can have an important impact on distressed areas. An objective of this report is to encourage businesses outside economically distressed communities to enter into partnerships with businesses in these areas. The action agenda is designed to provide a blueprint for allowing the benefits of BusinessLINC strategies to reach more small and large businesses, particularly those in economically distressed areas.

Companies enter these business-to-business collaborations to further their business objectives. The report presents how companies are creating profitable opportunities with smaller firms as part of their business strategy. For example,

- Turner Construction operates a nationwide training program that has trained over 7,000 construction subcontractors, providing Turner with high-quality low-cost suppliers;
- The North Texas Commission and the Dallas/Fort Worth Minority Business Development Council annually match 35-40 entrepreneurs with corporate mentors to advance the growth of small minority and woman-owned companies and also to benefit the mentors;
- Chase Manhattan Bank's Business Resource Centers have counseled over 5,000 small business owners directly or through referrals to outside professionals,

³ Porter, Professor Michael E., "The Next Agenda for America's Cities: Competing in a Global Economy," First Annual James W. Rouse Lecture, June 24, 1997.

resulting in more than \$38 million in loans to more than 500 small businesses; and

- The Women's Network for Entrepreneurial Training program, operating from the Boise, Idaho SBA District Office since 1995, has served over 1,000 women business owners with assistance through mentoring roundtables.

The benefits to both large and small companies from BusinessLINC practices can be significant, as discussed in Chapter I. Smaller firms can use BusinessLINC strategies to enhance their capability and their capacity through:

- obtaining technical advice;
- enhancing management development;
- leveraging core strengths;
- accessing sources of financing;
- increasing marketplace credibility; and
- entering subcontracts and joint ventures.

Larger companies may see benefits such as:

- reaching new markets;
- partnering with agile companies;
- cultivating a world-class supplier base;
- thriving in industries that call for inter-firm collaboration; and
- creating stronger communities and a stronger business environment.

Based on our extensive interviews, we found that the major participants in business-to-business relationships often are: (1) corporations that rely on smaller companies as suppliers and sales channels; (2) financial institutions; (3) business-led membership organizations; (4) specialized nonprofits; and (5) individual business professionals. We discuss this more fully in Chapter II, along with the range of partner firms. Although this report primarily focuses on BusinessLINC strategies used by corporations, these activities are often led by entrepreneurial individuals within firms. Individual business professionals may be interested in applying the ideas in this report within their company or through the intermediary organizations mentioned above.

In Chapter III, we classify this range of business-to-business relationships into five basic strategies: (1) one-on-one technical assistance and consulting; (2) classroom and group training; (3) peer groups and boards of advisors; (4) supplier development and strategic alliances; and (5) sales channel development.

No matter which BusinessLINC strategy was used, firms and practitioners who were interviewed repeated many of the same keys to successful BusinessLINC strategies, discussed in Chapter IV:

- The business-to-business relationship must be mutually beneficial -- a "win-win" for both firms. These BusinessLINC have the hallmarks of a serious business relationship – a

focus on business outcomes, commitment, efficient and effective interactions, and accountability.

- The greatest benefits of BusinessLINC relationships come over a long term and often in unanticipated ways. BusinessLINC relationships rarely generate large profits in the short-term, but often provide real benefits over time.
- The business must be committed to the relationship at both the top management and staff levels, with appropriate incentives for performance.
- Successful business-to-business relationships often rely on successful personal relationships. People often tend to do business with people they like and trust. BusinessLINC strategies are a method for finding and developing common business goals and capacities, and developing trust and personal ties.

Chapter V focuses on the role of intermediary organizations – specialized nonprofits and business-led membership organizations – in forging and supporting BusinessLINC. These organizations can provide the necessary local market knowledge and business skills to maximize a company's investment in BusinessLINC strategies.

"General Motors believes a positive working relationship between small and large businesses is critical to the development of healthy, vibrant communities. By working together, small and large companies can learn from each other, benefit from each other, and provide the economic growth needed for communities to flourish."
-- John E. Smith, Jr., CEO, General Motors

In particular, these strategies can have force in economically distressed communities, as is discussed more fully in Chapter VI. Successfully partnering with businesses in distressed communities requires the same type of local market knowledge – about the companies, about the marketplace, and about the competitors – as it does to penetrate any new market. Although there are important challenges to BusinessLINC with firms in these communities, there are also real business opportunities. Secretary Rubin has said, "these BusinessLINC relationships can play an important role in helping firms in economically distressed communities to grow and succeed."

A number of companies and organizations target their efforts to foster business-to-business relations in economically distressed areas. For example,

- GE Capital's Small Business College is an 11-week structured networking and educational seminar for small business owners that partners with organizations that reach local firms in distressed areas, such as the Port Authority of New York and New Jersey, and Public Service Electric & Gas of New Jersey.

- Coastal Enterprises in rural Wiscasset, Maine provides technical assistance and financing to small businesses, having loaned or invested \$50 million in 1,000 ventures and provided training and technical assistance to roughly 4,000 women-owned businesses. Coastal Enterprises facilitates peer networks and advisory boards for owners, in conjunction with training or individual consultation.
- Baltimore Advisors is a privately funded nonprofit whose mission is to increase employment in Baltimore by strengthening companies with annual sales from \$1 million to \$20 million. A network of corporate partners, comprised of business professionals and owners and mid- to large-size businesses provides one-on-one direct work, group strategy sessions and advisory boards.

Distressed urban and rural areas face a number of challenges. Businesses often must deal with outsiders' lack of market information about the local business community and its resources; outsiders' preconceived stereotypes of businesses, workers or consumers located in poorer areas; and the limitations business owners in these areas may face due to their isolation from mainstream business networks.

Despite these barriers, certain advantages may enhance business opportunities for firms interested in investing in, or linking with, smaller firms in these communities.

Michael Porter suggests that inner cities have four basic competitive advantages: strategic location near

business, transportation or communication networks; unmet local customer demand in high density areas; committed and available workforce; and integration with regional industries and clusters.⁴ Likewise, in rural areas, latent competitive advantage may be found in proximity to natural and extractive resources, availability of developable sites, and human resources.

"GE Capital views the GE Capital Small Business College as a sound investment in the communities it serves. It yields stronger small businesses, enhanced employment, improved economic conditions, and the potential for future business partnerships with our company"
— Gary Wendt, CEO, GE Capital

At the Regional Meetings and follow-up interviews, most successful examples of BusinessLINC activity in economically distressed communities involved the use of intermediaries brokering business-to-business connections. In Chapter VI, this report identifies special considerations and recommendations for BusinessLINC initiatives in economically distressed areas:

- Partner with a skilled intermediary organization to fill market information gaps, supplement skill training and build trust;
- Profile the business community and its existing support organizations;
- Access to new customers and new markets is critical;

⁴ "The Competitive Advantage of the Inner City," *Harvard Business Review*, May/June 1995.

- Create a long-term growth plan to provide useful encouragement; and
- Consider the full range of skills distressed-area businesses will need to grow.

BusinessLINC concepts also part of the first Roundtable in June, including the announcement by Pam Aguirre, CEO of Mexican Industries, that her firm had undertaken two joint ventures with larger firms in the automotive industry that would strengthen all the firms involved. These ventures continue to move forward today, and this report reviews a much wider range of BusinessLINC strategies.

Treasury Secretary Rubin and SBA Administrator Alvarez transmitted this BusinessLINC report at the second in a series of White House Business and Entrepreneurial Roundtables on Community Empowerment. At this Roundtable, the Vice President announced a series of initiatives to implement BusinessLINC:

Secretary Rubin explained that the Administration would launch:

- a new BusinessLINC website developed by Treasury and to be maintained by SBA that will allow businesses to identify local resources for BusinessLINC activity, success stories, and interested small and large companies;
- the launch of a Departmental BusinessLINC program to encourage these business relationships in its own procurement practices;
- To carry on BusinessLINC in the private sector and apply the expertise gathered in this report, Secretary Rubin acknowledged the creation of a new coalition of organizations that will take up the Action Agenda. Participating organizations include the Business Roundtable, the National Minority Supplier Development Council, the Conference Board, the National Black Chamber of Commerce, the U.S. Hispanic Chamber of Commerce, National Association of Women Business Owners, the Women's Business Enterprise National Council, the National Association of Minority Contractors, and the National Congress for Community Economic Development;
- A number of local organizations in the cities where we held regional meetings have also agreed to foster BusinessLINC in their communities:

New York City:	American Women's Economic Development, Asian Women in Business, Chase Manhattan Bank, New York City Partnerships & Chamber of Commerce.
Cleveland:	Cleveland Regional Minority Purchasing Council - Greater Cleveland Growth Association.
Dallas:	Dallas-Ft. Worth Minority Business Development Council, GTE, North Texas Commission, North Texas Women's Business Council.
Los Angeles:	Asian, Inc., UCLA School of Public Policy and Social Research, Vermont Slason Economic Development Corporation.

Chicago: Chicago Association of Neighborhood Development
Organizations, Chicagoland Chamber of Commerce.
Washington, DC: The Greater Washington Board of Trade.

SBA Administrator Alvarez stated that "SBA has made a strategic commitment to increasing access to its programs by these new, emerging small business communities. SBA is committed to increasing economic opportunity for all Americans." SBA helps small businesses succeed by acting as an intermediary for capital, counseling, contracting, and networking for small businesses. Administrator Alvarez explained the SBA announcements:

- The launch of the HUB Zone program to provide Federal contracting opportunities for qualified small businesses in distressed communities. The SBA expects that HUBZone contracting will equal roughly \$2 billion in FY 1999 and increase to almost \$6 billion in 2003.
- The approval of the first formal mentor-protégé relationship before the first of the year under SBA's new 8(a) Mentor-Protege Program to enhance the capacity of these firms and improve their ability to receive federal contracts.
- The development of a new on-line "Small Business Classroom" for training and informing entrepreneurs on how to raise capital, how to write a business plan, and how to reach counselors and mentors.
- The expansion of ACENet (Angel Capital Electronic Network) that will help minority- and women-owned businesses to access investment capital.

Companies also announced several new BusinessLINC activities including:

- Bell Atlantic will target \$1.8 billion in direct purchases and subcontracts to small businesses by the year 2000, pursuant to a Memorandum with the SBA. Bell Atlantic will also formally mentor at least three companies each year.
- Science Applications International Corporation (SAIC), with \$4 billion in sales, will sign joint marketing agreements with small businesses to pursue commercial contracts, applying its lessons learned from federal mentor-protege programs. In addition, SAIC will establish a high-level committee to examine how to develop relationships with small businesses in HUB Zones, Empowerment Zones and Enterprise Communities.
- Chase Manhattan Bank will open a Business Resource Center in the Bronx, its third BRC, to provide technical assistance to an estimated 500 small businesses per year. Chase will also offer in-depth, structured BusinessLINC assistance to selected Chase suppliers and other minority- and women-owned businesses from Chase's senior executives and the National Association of Black Management Consultants. Additionally, Chase will become a corporate sponsor of the new coalition promoting BusinessLINC activities.

- GE Capital will further extend its successful outreach for its four Small Business College sites (New York City, Newark, NJ, Philadelphia and Stamford, CT) with 200 graduates annually to small businesses in distressed areas. In the Spring of 1999, GE Capital will open a fifth College site, in St. Louis. GE Financial Assurance will pilot a new seminar series for women business owners in Washington DC, reaching an estimated 2,500 people in the first year.
- Trumark broke ground in the last month for a joint venture with Mackie Automotive Systems that will create over 300 jobs in Detroit's Empowerment Zone, an example of an increasingly common BusinessLINC strategy in the automotive industry. In addition, Trumark has enlisted the National Association of Black Automotive Suppliers to act as the BusinessLINC intermediary in the Detroit area to foster new BusinessLINC's.
- McDonald's, as part of its efforts to support small business entrepreneurship in central cities, facilitated the sale of 19 restaurants in Youngstown, Ohio, including inner city sites, to an African-American franchisee. McDonald's also announced that of the 125 applicants in training to be new McDonald's franchisees, 65% are minority and women, including 43 African-Americans, 13 Hispanic-Americans and 12 Asian Americans. Moreover, McDonald's reported that purchases from minority suppliers have more than quadrupled since 1997, putting such purchases at almost \$3 billion in 1998.

This report is intended to spark further efforts by the private sector, local organizations, and government, working together. To foster these initiatives, the report suggests a BusinessLINC Action Agenda, summarized on the next page and detailed in the final chapter.

Summary of Action Agenda

A. Starting Individual BusinessLINC

1. Consider objectives and desired outcomes.
2. Profile the potential BusinessLINC partners.
3. Learn about existing organizations and resources, public and private, that could complement the effort.
4. Formulate a BusinessLINC strategy for your company or organization, such as:
 - one-on-one technical advice and consulting,
 - classroom and group training,
 - peer groups and boards of advisors,
 - supplier development and strategic alliances, or
 - sales channel development.
5. Consider special factors in establishing BusinessLINC in economically distressed areas.

B. Catalyzing More BusinessLINC at the National Level:

1. Recruit a coalition of organizations to advocate BusinessLINC strategies through their networks, and corporations to build into their core business strategies.
2. Disseminate BusinessLINC best practices and case studies, and create forums for businesses to exchange information and practices.
3. Develop a national award for leading BusinessLINC practices, and compose case studies of winning companies.
4. Create a seed fund that a national BusinessLINC coalition could award to local BusinessLINC initiatives focused on economically distressed areas.
5. Promote and support an Internet website to encourage BusinessLINC activity.

C. Catalyzing more BusinessLINC at the Local Level:

1. Recruit local firms to employ BusinessLINC strategies.
2. Galvanize support to bolster local intermediary organizations, such as specialized nonprofits and business membership organizations, that foster BusinessLINC.
3. Target resources to enlist existing organizations that can encourage more BusinessLINC activity in economically distressed communities.

DETAILED BACKGROUND

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

26

Divider Title: _____

Investment Division

How SBICs Are Formed & Operate

The Structure of Venture Funds

Venture capital funds do not follow customary corporate organizational structures. They are usually not infinite life entities that look to sell out or go public in order to make their investors and managers rich. They are generally limited life entities (10 years with one year extensions that usually lead to 15 year lives). Investments are made during the first five years and the majority harvested over the ensuing five to ten years. Often, especially when the stock market is booming, some investments will mature during the first five years, but this is not within the plan; it is considered "fortuitous".

For legal and tax reasons, there are usually three entities in the creation of a venture fund:

1. The limited partnership (LP) into which the investment money is placed, and this is the entity which makes all the investments. This entity has *Limited Partners* (the money investors) who put up 99% to 100% of the funds, and get about 80% of the profits. The other 20% goes to the general partners. The limiteds are insulated from personal liability for the activities of the partnership.
2. The general partners, in turn, insulate themselves from liability by forming a *General Partner* of the limited partnership, historically a corporation, but nowadays is starting to tend toward LLCs (Limited Liability Companies).
3. The third entity is a management company which contracts with the general partner to conduct the day-to-day activities of the limited partnership. Almost always, the general partners own and manage the management company. The management company also usually employs a part-time bookkeeper and an administrative assistant, and if the fund is larger, a CFO (Chief Financial Officer), associates, and junior analysts. As with the general partnership, the management company isolates both the limited partnership and general partner from the everyday liabilities encountered in the daily conduct of business that the management company may incur.

The financial goal of investors is to obtain *cash-on-cash* returns from their investments, taking into account the time value of money. Thus, venture funds not only like to obtain high profits on their investments, they ideally like to achieve them as soon as possible, even though in their heart-of-hearts they plan on a five year time horizon, and even longer for early stage deals.

The Goals of Investors

Investors in a venture capital fund are seeking *risk-adjusted returns*. They are seeking returns that exceed those found in the stock market. Please keep in mind that all returns are relative. If stock market returns are 16%, venture investors will be seeking 23% per year internal rates-of-return (IRRs). If stock market returns are lower, a 15% IRR to investors may be sufficient. In today's world, the most successful SBICs are achieving IRRs of 30%.

While most SBICs hold out the prospect of 16% to 23% IRRs, we only expect an average of about 10.25% to be achieved overall within the program, after allowing for failures. Nonetheless, for a well-run SBIC, investors should have a low probability of suffering a loss of capital.

There is a critical difference between SBIC investing and stock market investing. In stock market investing, if a stock doesn't go up, it usually goes down, and the action of the stock is often independent of the company itself. The market may take a tumble or an industry sector may fall out of favor.

With venture investing, losses almost always flow from bad management selection, and rarely from any other reason. Profits, on the other hand, can flow not only from good management selection (or luck), but also from the pricing of a deal when it was made, as well as the overall business climate when one seeks to exit. (Exit strategies will be discussed later.)

Forming a Venture Fund

Typically, three people get together (normally middle-aged white guys) and decide to form a fund. The majority of SBICs are first funds, and the average amount of capital that is raised for a leveraged fund in FY98 was around \$16 million, which included second and later funds. We don't have breakdowns, but the average first fund size is probably around \$12 million of private capital.

However, a venture fund is not usually viable with less than \$30 million of capital. Thus, the attractiveness of the SBIC program to a management group with only \$12 million of private capital, is the prospect of \$24 million of leverage which leads to economically viability. It appears that there is a glass ceiling in raising venture capital. When you go above \$20 million, it becomes dramatically more difficult for a first fund than under \$20 million. Why is this?

Money for larger funds, particularly those over \$70 million comes mostly from institutions. In 1999, institutions are quite sophisticated in selecting fund managers and, with only a few exceptions, almost exclusively invest in second or later funds where the management team has been together for a few years and *have a demonstrated track record as a team*. (In the SBIC program, we demand demonstrated individual competence, but not a team track record.)

The money for first fund SBICs comes mostly from wealthy individuals who often are not as sophisticated in venture fund investing as are institutions. Furthermore, in today's world, skilled fund managers with an excellent track record are turning money away and private individuals who are not supremely wealthy would not even be accepted. For whatever the reason governing the dynamics of money raising, perhaps because of the limits of personal networks, there is a void between \$20 million and \$70 million in fund size (excluding SBA leverage).

Organizational Idiosyncrasies of Venture Funds

A major idiosyncrasy of venture funds is that as they become larger, they don't do more deals, they merely scale up the size of the deals they do. In other words, an SBIC with \$15 million of private capital (plus \$30 million of leverage) will probably make investments that center around \$2 to \$2.5 million, with a maximum of \$3 million. During its lifetime, the fund will make around 20 investments.

If a fund raises \$100 million of capital, instead of now making 40 investments, it scales up and makes the same number of investments, but each will be twice the size. Why is this?

A first fund, as previously noted, has three partners. When they add a second fund, these partners still have to spend time with investments from their first fund. They don't have to invest the 80 to 140 hours per investment that they might when leading a new investment, but they have to attend board meetings of companies in which they have invested, and they have to spend large amounts of time with companies that have problems and which they wish to save from collapse. These companies are often referred to as the "living dead".

Because some, or much of the partners' time is absorbed with prior investments, they then will add an analyst or two to their staffs, and the more promising analysts will become associates, meaning that they will not just crunch numbers and perform due diligence, but may negotiate smaller deals, and get bigger bonuses.

If this were a law firm or an accounting firm, the most capable associates would look forward to becoming partners. Not so, for most of the venture industry. Why?

In 1995, when I took one of the country's most successful venture capitalists to visit with folks over at OMB, one of the people there asked the question, "As your funds grow, why don't you just do more deals rather than scaling up in size?" The totally honest response was, "We don't want to share the profits."

Thus, most capable associates save up their annual bonuses, and after five or more years, when they've accumulated sufficient funds and contacts, leave to form their own funds, most often SBICs. The process of raising money is grueling and expensive. The projected out-of-pocket expenses are often in the \$250,000 on up range for lawyers and travel expenses. The process takes at least 18 months during which time one is drawing no salary. This activity is often referred to as "groveling", which is why so many venture capitalists wear knee pads.

Obtaining an SBIC License

At SBA, we have recently changed our licensing process to make the process more transparent, and to enable potential licensees to learn whether or not they would probably qualify for a license before they have made the huge time and money commitment previously mentioned.

Potential applicants have the option of answering an approximate 30 question questionnaire called the *Management Assessment*. This gets to the core of their competency. We do an analysis and then invite the participants to meet with us to discuss their strategies and capabilities. We then give them guidance as to their strengths and weaknesses and their likelihood of obtaining a license, all with the caveat that there are no guarantees.

There is no charge for this, and this process will normally be done when a potential applicant has about \$5 million of what are termed "soft circles" on his fund. A soft circle is strong verbal interest by an investor for a certain amount of investment in the fund. When the applicant has firm commitments of \$8.5 million (or \$4 million if doing a debenture fund with a local orientation), the managers will file a formal application. This has a fee structure of a base of \$10,000 plus \$5000 additional if a partnership or LLC plus \$5000 more if utilizing participating securities.

As soon as an application is received we forward the personal biography and fingerprint cards to the Inspector General's office who forwards the material to the FBI for a background criminal investigation.

There is currently a queue before other processing can begin, but once processing is begun, it is our goal to have the entire application processed within four months, although six months seems to be closer to the norm. (Responses to our questions and legal issues by the applicants and their counsel often take time. We're quite responsive once processing has begun.) The processing focuses on two primary activities:

- § *Due Diligence.* We do background checks on the competency and character of the managers/general partners, as well as any non-institutional investors who own 10% or more of the fund.
- § *Legal.* A partnership agreement with certain annexes that tie to leverage must be approved by the Office of General Counsel.

During this process, the fund's general managers must all attend a one-day regulations training class that we give. The Investment Division Investment Committee meets bi-weekly to discuss the status and issues regarding every applicant and potential applicant.

When all of the due diligence is completed and all the legal work is satisfactory, the application goes for a vote to the Division Licensing Committee; if it passes there, it goes to the Agency Licensing Committee, composed of the top level officers of the SBA, and finally it is sent to the Administrator for approval.

Managing an SBIC

Once an SBIC is licensed and is in operation, there are five main tasks that management must devote itself to:

- § Marketing
- § Due diligence
- § Negotiation and deal structuring
- § Oversight, and
- § Exits.

Marketing. A typical venture firm makes about 4 to 5 new investments a year, and they only invest in 1% or 2% of all the proposals that they look at. Therefore, if a firm does not have around 350 deals per year to review, it is likely that they will start to make lower quality investments than their strategy calls for. This then leads to future problem companies and subsequent losses.

It used to be that one could build a deal flow network over three years and then count on it to perpetuate itself. This is no longer the case. It is now necessary for the general partners to make marketing a key and integral part of their management activities. Good deal flow leads to good deals which lead to high profits.

Due Diligence. In-depth due diligence is critical to success. There is a saying in the venture industry that there are three things that you look for when making an investment: *management, management, management*. In contrast to bankers who lend against cash flow and against assets, when bank lines are all tapped out, venture capitalists provide high-risk unsecured financing. Therefore, the quality of management of a small enterprise is the most critical element. There's another saying in the industry, "Given the choice between a superior product and mediocre management or a mediocre product and superior management, choose the latter."

The amount and depth of due diligence that is performed has a dramatic bearing upon one's investment results. For success, one is looking at 80 to 140 hours of due diligence per deal that is closed.

Before a venture capitalist will even look at a company, the entrepreneur must have prepared a credible business plan. It doesn't have to be perfect; before an investment is made, the strategies may change and the forecasts will surely be modified, but without a business plan almost no SBIC will enter into conversations. This is a dramatically different the environment in which New Markets Entrepreneur Funds would operate where the level of sophistication and preparedness is much less.

Deal Structuring. A former boss of mine used to say that "bought right is half sold". In other words, you can't afford to overpay for an investment. If you overpay, it becomes very difficult to achieve the types of returns that one seeks, even if the company is successful. The most skilled venture capitalists tend not to overpay. This is also a function of your deal flow. If deal flow is insufficient, one tends to overpay because one cannot be idle and not make investments without having unhappy investors.

Oversight. This is another element that has a heavy bearing upon one's ultimate returns. The industry is replete with aphorisms, and another one is "Twenty-five percent of your success is based upon making the investment and seventy-five percent on what takes place afterwards." Venture capitalists, although often referred to as "vulture capitalists" are actually, for the most part, amazingly tolerant of management mistakes and bad behaviour, perhaps too tolerant.

At a conference I attended in San Francisco, when a panel of the superstars of high-tech investing were discussing mistakes they had made and they talked about how they had often waited too long before sacking incompetent management, there was a big roar of knowing laughter and approval of what had been said.

Venture investors are semi-active, or semi-passive, depending upon whether you say the glass is half-full or half-empty. Above all, they do not want to run businesses, but they do provide guidance, and they should step in forcefully and take corrective action when things start to go awry. Some are good at this, and many are not. Those who are not have less ability to recover from down-drafts.

In the venture business, there are only four exit mechanisms.

- § The most common successful exit is to sell or merge the company to another firm at a profit.
- § The most highly publicized exit which can be the most profitable is through an initial public offering (IPO). Recent years have been uncommon in the number of months that IPOs have remained popular. Normally, the IPO window lasts about 18 months every few years. While IPOs gather a great deal of press coverage, they are not a common exit mechanism, and even when there is an IPO, terms of the offering often prohibit private investors from selling shares for 6 months after the offering, by which time, the stock may be below the offering price.
- § When an investment winds up in the living dead category, the exit mechanism is to sell shares back to the company. After 8 years, one tends to realize about an 8% IRR.
- § The final exit mechanism is the least desirable -- scrounge what you can from the assets after a company has failed, or sell your shares at a loss. This is to be expected and goes with the territory. At a conference that we sponsored, one highly successful SBIC manager who was a speaker said, "If you don't have failures, you're not making deals."

Directing SBICs to LMI Investments

Earlier it was stated that marketing networks were critical to deal flow and ultimately to success. One tends to network with those people with whom you are familiar -- normally other venture capitalists, investment bankers, merger and acquisition brokers, lawyers, and accountants. Practically no investments that are made come into an SBIC directly; practically all come through third parties.

Why is this? The third parties prepare the entrepreneur for the financing. They not only may assist with the business plan and with the pricing of an investment, but they also prepare the entrepreneur mentally for dealing with outside investors.

The way that SBICs will start to make LMI investments is if deals come to them through networks to LMI communities. This becomes the role of community development organizations -- to prepare the entrepreneur for a financing, and to introduce businesses with good growth prospects to SBICs. In my experience, SBICs merely want good deals -- they are not particularly choosy about where in a city a firm is located or whether a minority or woman is the principal in the firm.

They just want high growth prospects and entrepreneurs that can manage growth or be willing to hire people who can. In fact, most SBIC managers would prefer to make investments that are within easy driving distance of their offices rather than ones that require boarding a plane. Thus, insofar as SBIC managers can be introduced to community development folk, which is a prime purpose of the outreach workshops, LMI investments will start to flow naturally.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

27

Divider Title: _____

Investment
Division

SBIC Briefing for Gene Sperling

1/13/99

Program Purpose

The Small Business Investment Company (SBIC) program was created to address the particular needs of small *high-growth* companies which are small today but intend to become large tomorrow. The financing needs of such companies typically exceed what traditional, lending and leasing can provide. To support their growth, these high growth firms must have equity-type capital -- what is generally termed "venture capital". This involves unsecured, high risk investments where participation in the rewards of equity ownership are expected to represent a significant element of the investor's ultimate financial return.

SBICs are privately-owned and operated venture capital investment companies, organized with a minimum of \$5 million to \$10 million of private capital, which agree to restrict their investments to what is permitted under SBA regulations in exchange for SBA's supplementing their investment capital. The SBA's role is

- § To license them
- § To regulate their operations for compliance with the public policy objectives of the Small Business Investment Act and to protect the government's creditor interest, and
- § To supplement their private capital through public offerings of SBA-guaranteed securities (termed "leverage").

A fundamental strength of the program lies in the fact that all investment decisions are made by private investors with their own money at risk ahead of SBA's; however, this also limits SBA's ability to direct SBIC investments toward specific target areas.

SBICs tend to serve small businesses whose venture capital needs fall in the \$500,000 to \$5,000,000 range. This exceeds the amount usually available from so-called "angel investors" but falls short of the minimum typically required to interest institutionally-funded private venture capital firms.

A June 1996 study commissioned by the SBA Office of Advocacy estimates that the number of entrepreneurial ventures that need equity financing includes about 50,000 start-ups per year (5-10 percent of total start-ups) and 300,000 ventures growing faster than 20 percent per year (including 80,000 growing at faster than 50 percent per year). In that year, SBICs and private venture firms *together* invested in only about 4,000 firms, or just over 1 percent of the estimated need.

Program Statistics

- § During FY98, SBICs invested a record \$3.2 billion in 3,456 small business financings, more than 90 percent of which were equity-oriented.
- § The smaller average investment size of \$937,000 for SBICs versus more than \$6.8 million for private venture capital firms, demonstrates the SBIC program's success in serving its target market.
- § Over 55% of the financing dollars were invested in businesses 3 years old or less.
- § Over the past 40 years, SBICs have provided more than \$20.7 billion in approximately 118,000 financings to about 88,000 small business concerns, including such national successes as Apple Computer, Intel Corporation, Federal Express, and Cray Research, as well as America Online, Sun Microsystems, Callaway Golf and Outback Steak House which can trace their early financings to SBICs.

Less spectacular but equally important are the thousands of small concerns which have been able to develop into sound businesses as a result of SBIC funding and the contribution of experienced SBIC managers who share their knowledge as true partners, with a shared risk and commitment.

It is estimated that SBIC investments have contributed to the creation of more than one million jobs in the manufacturing and service sectors of the economy. Because all investment decisions are made by the SBIC's private management, SBIC investments address many financing needs and cover a broad spectrum of business activities.

During FY98, SBICs invested in companies located in all 50 states plus the District of Columbia, Puerto Rico, and the Virgin Islands. Ninety percent of the funds invested had equity features, and 49 percent was to firms less than 3 years old. The attached SBIC program overview provides additional detail on program financings.

1998 SBIC INVESTMENT ACTIVITY

TYPE OF SBIC	Number of Investments	Total Amount Invested (\$millions)	Average Size of Investment	Median Size of Investment
Participating Security	651	\$510.2	\$783,000	\$350,000
Debenture	1576	492.8	313,000	150,000
Bank SBICs	590	2127.0	3,605,000	1,300,000
Specialized SBICs	639	109.4	171,000	129,000
Total SBIC Program	3,456	\$3,239.4	\$937,000	\$195,000

HISTORY

The SBIC program was created in 1958 in response to a Federal Reserve Bank of Boston study indicating a significant gap in the availability of long-term debt and equity for small business. Since institutional venture capital largely did not exist at the time, the program was an experiment without precedent on which to draw. After many years of mixed results, culminating in significant failures in the 1989-91 period, the program was restructured in 1992 and has demonstrated remarkable success since.

The Small Business Equity Enhancement Act of 1992, and its implementing regulations rejuvenated the SBIC program. Besides addressing a number of structural problems in the program, the 1992 Act created "participating securities" as a funding mechanism for those SBICs that concentrate on equity-type investing (where the SBIC is investing to achieve long-term capital gains and receives very little current income to defray the interest cost of its own debenture leverage). With participating securities leverage, an SBIC defers paying the quarterly interest-like costs ("*prioritized payments*") until it realizes sufficient gains through the sale of its investments to achieve cumulative profitability.

In exchange for making the prioritized payments on behalf of the SBIC, SBA receives approximately a 10 percent participation in the SBIC's profits. Because of the increased financial risk, SBA has been very selective in the licensing of such SBICs and has generally required a \$10 million minimum of private capital.

Since September, 1994, 72 SBICs with total initial private capital of \$1.3 billion have been licensed to use participating securities leverage. Their average private capital was \$15.3 million which compares with the \$2.3 million average for SBICs licensed during the four years prior to 1994. Although the first participating securities leverage was only issued in February 1995, 20 of these licensees have already realized sufficient investment gains to be making their prioritized payments, and through January, 1999, 12 of them have also paid \$16 million of their profits to SBA.

The 1994 implementing regulations also corrected a number of other program weaknesses. In addition to implementing the Act's statutory provisions, SBA's 1994 regulations significantly strengthened the licensing, oversight and administration of the program. They increased the minimum private capital required for licensing (to \$5 million for SBICs utilizing debentures and \$10 million for those utilizing participating securities) and required that SBIC managements have demonstrated investment experience appropriate to the proposed SBIC's operating plan.

The regulations also introduced the concept of "management/ownership diversity" which requires that, under most circumstances, at least 30 percent of an SBIC's private capital is from non-management investors. This eliminates "hip pocket" SBICs, wherein SBIC manager/owners were able to use an SBIC as their own private bank, and insures that there are investors whose interests in the SBIC's financial success complements SBA's interests as a partner/creditor. Other oversight procedures introduced in 1994 include specific guidelines for SBICs to use for valuing portfolio securities in their financial reports; a credit

review process for granting leverage; more frequent, better focused examinations of licensees; and a "watch-list" for troubled licensees to insure that prompt action is taken in protecting SBA's creditor position.

Licensing Activity

Since the new program was introduced and the new regulations were implemented in FY94, 152 new SBICs have been licensed (including 40 bank-dominated SBICs) with initial private capital of \$2.4 billion. *This is more than the total private capital raised by the program in the preceding 34 years.*

Combined with additions to the private capital of existing SBICs, this has resulted in a nearly tripling of private capital in the program over the past five years, from \$2.26 billion at the end of FY 1993 to \$6.64 billion through January 6th. At the same time, committed SBA-guaranteed leverage has increased from \$860 million to \$3.0 billion, bringing the program's total capital resources to \$9.6 billion. *The SBIC program today* consists of 325 licensees located in 42 of the 50 states, plus the District of Columbia and Puerto Rico, with concentrations in New York, California, Texas and Massachusetts.

SBIC LICENSEES (As of 1/13/99)

TYPE OF SBIC \$ in thousands)	Number	Private Capital	Committed Leverage	Total Capital
Participating Security	73	\$1,312.5	\$1,601.9	\$2,914.3
Debenture	93	914.1	1,115.5	2,029.6
Bank SBICs	87	4372.8	50.0	4,322.8
Specialized SBICs	72	165.3	195.1	360.3
TOTAL	325	\$6,664.6	\$2,962.5	\$9627.1

Bank-dominated SBICs are typically operated as subsidiaries of commercial banks to enable them to make equity investments otherwise prohibited by the Glass-Steagall Act. They typically do not utilize SBA leverage, and many of them are very large (several with private capital in excess of \$100 million). Bank SBICs represent 67 percent of the private capital in the program, and they serve the SBIC program's public policy objectives *without a leverage cost to the taxpayers.*

Specialized SBICs were licensed under Sec. 301(d) of the Act and are restricted to investing only in companies owned by persons who are socially or economically disadvantaged. The 1996 Small Business Programs Improvement Act repealed Sec. 301(d) but grand-fathered existing 301(d) licensees.

PROGRAM FUNDING LEVELS (Committed)

Program Levels (thousands)	1995	1996	1997	1998	1999 (Estimated)
Participating Sec.	\$219,940	\$267,777	\$410,942	\$700,000	\$1,000,000
Debentures	104,430	106,144	256,426	488,000	700,000
SSBIC Debentures	25,410	0	0	0	0
SSBIC Pref. Stock	5,623	0	0	0	0
TOTAL	\$355,403	\$373,921	\$667,368	\$1,188,000	\$1,700,000

APPROPRIATIONS

Appropriations (thousands)	1995	1996	1997	1998	1999
Participating Sec.	\$19,575	\$24,100	\$13,520	\$11,582	\$16,620
Debentures	15,299	16,410	8,180	8,648	3,000
SSBIC Debentures	7,077	0	0	0	
SSBIC Pref. Stock	2,423	0	0	0	
TOTAL	\$44,374	\$40,510	\$21,700	\$20,230	\$20,280

SUBSIDY RATES

Subsidy Rate	1995	1996	1997	1998	1999
Participating Sec.	8.90%	9.00%	3.29%	2.54%	2.19%
Debenture	14.65%	15.46%	3.19%	2.30%	1.38%
SSBIC Debentures	27.85%	29.03%	--	--	--
SSBIC Pref. Stock	43.10%	42.85%	--	--	--

New legislation in FY 1996 further strengthened the program. In 1996, the Senate Small Business Committee introduced legislation intended "to insure the safety and soundness of the SBIC program as it grows." This was enacted in the Small Business Programs Improvement Act of 1996, and essentially codified into law many of the regulatory provisions that SBA had previously introduced. In addition, the legislation increased fees charged for leverage which permitted SBA to cut its appropriations in half while doubling the leverage available to SBICs. (The up-front leverage fee was increased from 2 to 3

percent and a 1 percent *annual charge* was added to all new leverage.)

Other notable provisions of the 1996 legislation included repeal of section 301(d) which created Specialized SBICs; reauthorization of the 3% SSBIC preferred stock repurchase program, with the proceeds available as budget authority for additional debenture leverage; a provision for the licensing of SBICs as limited liability companies; clarification that for size status determinations of eligible SBIC investments, the ownership by venture-type investors would be ignored; a requirement to process new license applications promptly without regard to leverage availability and to inform applicants of the status of their applications within 90 days.

Since funds for SBIC leverage are provided by private investors who purchase the debentures or participating securities issued by the SBICs and guaranteed by the SBA, a Congressional appropriation is required only equal to the "cost" of the guarantee. In FY99, an appropriation of \$20.2 million will enable SBA to guarantee almost one billion dollars of SBIC leverage. Since such leverage typically requires one-half that amount in underlying private capital, the \$20.5 million appropriation will have generated \$1.5 billion of equity-type investments in small businesses.

Because these types of investments are almost always subordinated to bank borrowings, such levels of investment can support an additional 50% in commercial credit, providing \$2.25 billion in total financing dollars, or over 100 times the \$20.2 million of government "cost". By way of comparison, the \$20.2 million is less than one-tenth the annual taxes paid by just the corporate SBICs (\$242 million in 1996), without taking into account the taxes paid by investors in partnership SBICs, much less the small businesses themselves.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

28

Divider Title: _____

SMALL BUSINESS INVESTMENT COMPANY PROGRAM

Outline of Comments

By

Saunders Miller

Senior Policy Advisor

U.S. Small Business Administration

FOR INFORMATION

General Telephone Number (202) 205-6510

Web Page: www.sba.gov/INV/

I. Introduction

- A. In 1958, the Federal Reserve Bank under William McChesney Martin did a study of access to the capital markets by small businesses. Findings: inadequate.
- B. Venture capital industry did not exist. The phrase had not even come into use. Only a dozen or so very wealthy families using professional managers, plus one public company, American Research and Development, made venture investments routinely.
- C. Small Business Investment Act of 1958 was passed.
- D. First SBIC licensed On March 19, 1959.
- E. Public/Private partnership in which profit-driven IRRs of 15% or greater should be attainable for an SBIC over a 10 year period.

II. What Is an SBIC?

- A. Privately managed venture capital firm in which the managers make all the investment decisions.
- B. They must finance only small businesses and cannot, except for start-ups and when a

company is heading south, control them.

- C. Each SBIC management team identifies the target market they wish to reach, that is, types of industries, hi-tech or low tech, and life-cycle of the business -- early-stage or late-stage
- D. Purpose of the program:
 - 1. Meets a market need for risk capital that is typically in the \$300,000 to \$5 million range which is the minimum size preferred by totally private venture capitalists.-- are straight equity, preferred stock, or debt with warrants
 - 2. 90% of investments made have equity features
 - 3. Program designed to finance active small operating companies having no more than \$6.0 million of after-tax income *and* no more than \$18.0 million of net worth.
 - 4. Goal is to finance companies that grow a minimum of 40% per year.
 - 5. Most don't meet that target. In fact, in an SBIC or any venture firm, 20% of your investments are responsible for most of your profits; with 20% of your companies, you lose some or all of your investment, and on the other 60%, you ultimately earn about 8% per year return-on-investment.
 - 6. In a well-run SBIC, over a 10 year period of time, you should realize an internal rate of return of 15% to 23% or more.

III. Why Invest in an SBIC

- A. All investors invest in all venture firms, including SBICs, because they expect IRRs in excess of 15%.
- B. They choose to invest specifically in SBICs because the SBA supplements their private capital at very cheap rates.
 - 1. In the SBIC program, SBA supplements the private capital of investors with what is known as *Leverage* which are securities sold in the public markets through underwriters, and carries SBA's full faith and credit guarantee of principal and interest. Two types of leverage are available:
 - i. *Debenture Leverage* -- up to 2X or 3X private equity capital:
 - a. Has an interest rate of 75 to 95 basis points over the 10 year Treasury Rate, and
 - b. Has semi-annual interest payments.
 - ii. *Participating Securities Leverage* -- A preferred equity instrument -- up to 2X private equity capital:
 - a. Similar interest rate spread, but
 - b. Dividend payments are only made when an SBIC has positive retained earnings. This enables the SBIC to make long-term equity type investments. The SBIC also pays SBA approximately 10% of its profits.
 - 2. For a profitable leveraged SBIC, its IRR can increase by 600 to 800 basis points. Of course, leverage can cut both ways, and below an IRR of 11% to 13%, an SBIC's investors would be better off without leverage.
 - 3. To be a full-fledged venture firm, generally at least \$30 million of capital is needed in order to support the necessary overhead, which typically is around \$750,000 per

year.

- i. The industry standard for management expenses for small venture funds doing growth and expansion financings is typically 2.5% of total capital.
- ii. For a full-fledged national or regional venture fund, this normally means \$750,000 per annum, minimum.
- iii. For a more geographically focused lender, overhead as little as \$375,000 is sometimes possible.
- iv. Such overhead expenditures imply certain minimum capital amounts. \$750,000 divided by 2.5% equals \$30,000,000.
- v. A glass ceiling exists: to raise above about \$15 million becomes dramatically more difficult for new fund managers.
- vi. The average private capital size of non-bank SBIC applicants is around \$12 million.
- vii. Therefore, firms that can only raise \$10 million, but which have qualified managers, can become economically viable; and thus be able to help grow small, dynamic businesses, which is the purpose of the SBIC program.

C. Why do banks invest in SBICs?

1. The SBIC program provides an exemption to the Glass-Steagall Act, and therefore, enables banks to make investments in which they are able to own more than 4.9% of the voting equity of non-financial companies or more than 24.9% of the non-voting stock of a non-financial entity
2. In addition, banks can obtain CRA (Community Reinvestment Act) credit on the CRA investment test if they invest in SBICs.
3. Most importantly, investing in SBICs is profitable. For the 10 year period ending 1997, bank-dominated SBICs averaged an internal rate of return of 13.1%. They achieved the same IRR for the prior 10 years, too.

D. Can utilize the SBIC program for economically targeted investments ("ETI").

1. Pension fund investors -- Calpers in California invested in a California targeted fund; New York City pension funds invested in a New York oriented fund, and a Maryland state investment was made in a Maryland based fund.
2. Any ETI oriented SBIC must still have a primary profit motivation and experienced management
3. However, no more than 33% of private capital can come from state or local funds; but state and local pension funds are considered "private capital".
4. History has a most important lesson for bankers: experience has shown that the most successful SBICs are those that are run independently of the bank.
 - i. Commercial lenders are not venture capitalists.
 - ii. Bankers look at past performance and make loans based on cash flow, financial statements, and collateral.
 - iii. Venture capitalists look at future potential and make investments based on the quality of management, because the financial statements are usually pretty weak. If they weren't, commercial lenders would provide all the financing.
 - iv. SBIC managers are usually paid more than commercial loan officers and the SBIC compensation plan must be long-term oriented in order to have the SBIC

managers nurse their investments along over many years. In venture investing, 75% of success takes place after the initial closing.

IV. A Few Key Statistics:

- A. In 40 years, SBICs have invested more than \$20.7 billion in 118,000 financings.
- B. During FY98, SBICs invested \$3.2 billion in 3,456 financings totaling in excess of \$3.2 billion in most all states plus some territories
- C. 90% of the funds invested had equity features, and 55% went to firms zero to 3 years old
- D. As of January 13th, 1999, there were 325 licensees with \$6.7 billion of private capital. 87 bank- dominated SBICs represented 66% of that with \$4.4 billion. This compares with \$2.2 billion of private capital at 1993 year-end before the new program was implemented, of which 70% or \$1.6 billion was bank-dominated private capital.
- E. That's more new capital in 5 years than in the prior history of the program. Banks and private investors are demonstrating their faith in the program.
- F. Committed program leverage as of January 13, 1999 was \$3.0 billion compared with \$860 million at the end of fiscal 1993. For fiscal 1999, \$1.7 billion of leverage is estimated to be available
- G. Currently, we have 44 active applications on hand representing approximately \$500 million of private capital

V. Program has had many successes.

- A. In *Fortune's* 1996 list of the 100 fastest growing companies, 18 had received SBIC funding.
- B. Early examples: Federal Express, Intel, Cray Research, and Apple Computer.
- C. More recent well-known companies: America on Line, Staples, Amgen, Callaway Golf, Microcom, Sierra Semiconductor, and Gymboree.
- D. Was not a smooth road from 1958 to the present.
 - 1. Program shrank during the 1980s with \$600 million of gross leverage liquidations before any recoveries which are at about 60%.
 - 2. In 1990 and 1991, at Senate hearings, the question was raised whether to eliminate the program.
 - 3. To deal with this issue, in 1991, an Investment Advisory Council was formed, staffed with non-SBIC venture capital managers. Their findings were:
 - 4. The program was basically sound.
 - 5. It had a high all-in return to the taxpayer, but
 - 6. A number of identifiable problems existed:
 - i. Inadequate management.
 - ii. Capital base of most SBICs was too small to be economically viable.
 - iii. Portfolio valuations were done poorly which led to inaccurate reporting and inaccurate credit evaluation by the SBA.
 - iv. Mis-match of funds flow, i.e., debt leverage was being used to finance equity investments.
- E. These problems were corrected by new legislation in 1992, and by new regulations

finalized in April, 1994, and fully re-written and modernized in January, 1996.

1. Admit only qualified management. License hard and regulate rationally. The key is: management, management, and management.
 2. Minimum capital requirements now exist based on economic viability which encompasses the need for sufficient expenditures on overhead to perform adequate due diligence and continuing oversight.
 3. Thus, to obtain a Participating Security equity license, \$10.0 million private capital minimum is required under most circumstances. Enables the SBIC to perform sufficient due diligence, oversight, and marketing.
 4. For a debenture licensee who may make loans on a smaller geographic scale, as little as \$5.0 million private capital may be acceptable.
 5. However, only \$3.0 million of private capital is required for a non-leveraged license because the SBA is not at financial risk, and overhead is often absorbed by a bank. However, we don't recommend this little an amount.
 6. The final major change was curing the mis-match of funds flow with an equity participating security.
- F. Two kinds of SBICs:
1. Regular -- 301(c) -- which is the only type that can now be licensed, and
 2. Specialized -- 301(d) -- which are oriented towards financing firms owned by persons who are "socially or economically disadvantaged". These types are no longer being licensed, but existing ones are grand-fathered. In the past they had access to subsidized leverage such as 3% and 4% preferred stock which was sold to the SBA. However, this proved to be too costly to the government, costing 43 cents per dollar of leverage compared with less than two cents for the regular program.

VI. Qualifying Investments

- A. Investments made only to small businesses, generally those with no more than \$6 million of after-tax income and no more than \$18 million of net worth.
- B. Prohibited uses of funds (other than real estate)
 1. Relending & reinvesting.
 2. Most real estate unless a majority of the space is used by a qualified operating company.
 3. Passive businesses. *Exception:* A holding company with operating subsidiaries are okay.
 4. Foreign investments.
 5. Activities contrary to public interest, e.g., casinos, even if legal.
 6. Project financing, e.g., oil wells vs. oil development companies.
 7. Financing other Licensees.
 8. Farm land.
 9. Associated supplier.
 10. Catchall category: activities not contemplated by the Act, e.g., stock market investing.

VII. Structuring the Investment

- A. Funds must be furnished directly to the small company unless through an underwriter.
- B. Maximum of 20% of private capital in any one company, known as "overline limit". Provides for portfolio diversification which reduces risk.
- C. Initial financings must be long-term: either equity or a minimum term of 5 years, or 4 years for an SSBIC financed investment. Bridge loans permitted under some circumstances.
- D. SBA sets ceilings on interest rates, known as *Cost of Money*:
 - 1. 6% spread above a calculated base rate on debt with equity features.
 - 2. 11% spread on straight loans.
- E. Redemption provisions -- 5 year minimum term.
- F. Calls are permitted.
- G. Commitment fees and closing fees allowed, with certain limitations.
- H. Prepayment penalties permitted.
- I. Interest rate can be boosted 700 basis points for monetary or reporting defaults.

VIII. Other Aspects of Investing

- A. Control generally not permitted, including control over the checkbook. Exceptions:
 - 1. Early stage investments to include seed capital and start-ups.
 - 2. When a company encounters major difficulty.
- B. Conflicts of Interest is a major violation of regulations
 - 1. Self-dealing.
 - 2. Co-investing with Associate creates problems, except that normal bank credit lines are not considered conflicts.
 - 3. However, serving on a board is permitted.
 - 4. Exemptions to conflicts of interest require public notice.
 - 5. Management Services are permitted so long as rates are reasonable, and only for services actually performed.

IX. Licensing Process

- A. See web site at www.sba.gov/INV/ (Note that last three letters must be in caps.)

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

29

Divider Title: _____

JAN 13 '99 08:52PM MED

A Small Business Investment Company (SBIC) Success Story

TLC Next Generation International Holdings LLC St. Louis, Missouri

Minority-owned

TLC Next Generation is the largest distributor of wireless communications products (including cellular and digital phones, pagers, and related equipment) in the St. Louis metropolitan area. Leroy Wright, the company's founder and CEO, created TLC Next Generation in 1997 by combining two St. Louis cellular phone distributors: Wright's own company, Wright Cellular, serving business customers in downtown St. Louis; and Next Generation, a 15-store chain of Southwestern Bell Wireless (SBC Communications) retail outlets in suburban shopping malls. The combined company now employs 77 people.

Leroy Wright, at age 28, is the first African American in St. Louis to accomplish this type of multimillion dollar acquisition. Wright says he hopes to become St. Louis' first Black-owned firm traded publicly on the stock exchange. A native of St. Louis, Wright was raised by his grandparents, both of whom were blind. Wright's grandfather had his own business selling brooms and washcloths door-to-door. Leroy often went along, learning from an early age how to be a salesman. "My grandfather would say to me, 'Look what I'm doing, and I'm blind! Just imagine what you can do,'" Wright recalls.

It was as a salesman in 1996 that Leroy Wright found his lead investor for the creation of TLC Next Generation. Byron Winton needed a phone. He had just arrived in St. Louis to manage the newly formed Civic Ventures Investment Fund, a multimillion dollar fund established by a group of Fortune 500 companies to provide capital as well as management and financial advisory services for small businesses, particularly minority-owned companies, in St. Louis and the Midwest. Winton went to Wright Cellular and struck up a conversation with Leroy Wright. The two businessmen kept in touch over the next year, during which time Civic Ventures became a federally licensed small business investment company (SBIC) and Wright Cellular became the fourth largest seller of cellular phones in the region.

Byron Winton recalls: "Wright was doing well with his small business, but he didn't really want to settle for fourth place. I said, 'Why not play to win?'" With backing from Civic Ventures, Wright decided to purchase Next Generation, Inc., his main competition and a much larger company. Wright and his wife were willing to invest everything they had in the deal. Civic Ventures could finance a portion (\$1 million) of the purchase price, but Wright needed other investors. He went to every major bank in town, but they all turned down his proposal. "It seemed like a 'mission impossible' for a while," says Winton.

Then, at a business conference in Baltimore, Wright met Elyn Dortch, a senior vice president of NationsBank in North Carolina. NationsBank had just purchased Boatmen's Bank, one of the St. Louis banks that had rejected Wright's loan request. Dortch, intrigued with Wright's plan, called a bank colleague in St. Louis and urged him to reconsider Wright's proposal. Two months later, NationsBank agreed to provide a package of senior debt and capital to help finance the deal, including a venture capital investment of \$500,000 from NationsBank SBIC Corporation, a small business investment company that focuses on minority and woman-owned businesses and on providing venture capital for community development purposes.

Wright credits his financial partners with making the acquisition a reality: "The deal was able to get done because of the proactive involvement of NationsBank and Civic Ventures," Wright says. "They've exhibited the kind of progressive thinking that's needed today to support minority entrepreneurship in St. Louis." 3/5/98

National Association of Small Business Investment Companies
666 11th Street NW • Suite 750 • Washington DC 20001
Tel: 202.628.5055 • Fax: 202.628.5080 • E-mail: nasbic@nasbic.org
<http://www.nasbic.org>

JAN 13 '99 08:53PM MED

A Small Business Investment Company (SBIC) Success Story

Minority-owned Midwest Stamping and Manufacturing Company Bowling Green, Ohio

Midwest Stamping and Manufacturing Company produces medium and heavy gauge metal components (known in the industry as "stampings") that are integral parts of the bodies and frames of automobiles. Many of the world's leading auto manufacturers, including Ford, Honda, Mercedes, Nissan, Saturn, and Mazda, use Midwest products. Both Honda and Saturn have presented Midwest with awards for product quality.

The company's CEO, Ronald Thompson, purchased Midwest Stamping and Manufacturing Company in March, 1993, with financial backing from a specialized small business investment company, TSG Ventures, in Stamford, Connecticut. TSG's principals, Duane Hill and Cleveland Christophe, had known Thompson for years and had worked with him in a previous business transaction. Confident in the entrepreneur's abilities, TSG Ventures invested \$2 million to enable Thompson to acquire Midwest Stamping and Manufacturing.

At the time of the acquisition in 1993, Midwest had revenues of \$64 million and employed 320 people. By the end of 1996, revenues had grown to \$108 million. Today, Midwest employs over 600 people. Most work at the company's two Ohio plant facilities in Bowling Green and Edgerton. In addition, Midwest employs about 100 people at its plant in Sumter, South Carolina and 10 people in Dearborn, Michigan. In 1998, the company plans to open a plant in Springfield, Kentucky, and hire another 100 employees.

Thompson believes TSG Ventures has played an important role in his company's success:

"Before I acquired Midwest Stamping and Manufacturing Company, I was in the business of manufacturing railroad and defense materiel. The equity financing from TSG was important originally in structuring the acquisition transaction because it gave me credibility as I entered a new industry. We had our own equity, but having institutional equity investors added to our credibility. TSG was also helpful in negotiating terms of our senior and subordinated credit agreements. Since the acquisition, they've helped us evaluate strategic opportunities that have presented themselves. TSG has provided not only capital resources, but access to a very valuable network of human resources as well."

According to Duane Hill, President of TSG Ventures:

"The Midwest Stamping investment is an excellent example of how a small business investment company (SBIC) can start early on with an entrepreneur and grow with him, providing financial and strategic advice. It's a classic case of what the SBICs were created to do."

12/9/97

National Association of Small Business Investment Companies
666 11th Street NW • Suite 750 • Washington DC 20001
Tel: 202.628.5055 • Fax: 202.628.5080 • E-mail: nasbic@nasbic.org
<http://www.nasbic.org>

* JAN 13 '99 08:50PM MED

A Small Business Investment Company (SBIC) Success Story

Woman-owned

The Merchandising Group (TMG)
New York City, NY

TMG is a woman-owned and managed company that provides field marketing support for Fortune 500 manufacturers of consumer products. TMG employs 110 full-time and 4,500 part-time staff who work on an assignment basis to introduce products to retailers all over the country. The permanent cadre of full-time staff can be expanded quickly with part-time staff as needed.

The senior management of TMG includes:

- Carol Atwood, President. Atwood has 20 years' experience working in retail marketing. She started with TMG in 1983 and became President in 1988.
- Diane Teigen, Executive Vice President for Sales. Teigen has worked in retail for over 25 years and started with TMG in 1977.
- Carole Crist, Executive Vice President for Operations, joined TMG in 1976.
- Susan Kiernan, Vice President for Sales and Marketing, joined TMG in 1990 after working with NYNEX and Communispond.

TMG is part of the rapidly growing \$1 billion field marketing industry. TMG sets itself apart from competitors with advanced on-line reporting systems, a proprietary field performance quality control process, and a high retention rate of experienced people. The company was started in 1947; the current management group acquired the company in 1990 and has more than doubled the company's annual sales.

Sterling Commercial Capital, a small business investment company (SBIC) licensed in 1988, has provided \$500,000 in financing to TMG for working capital to support its expansion. This is one half of the \$1 million in financing TMG will use this year to meet its current growth requirements. The other half comes from New York Community Investment Company LLC, a non-SBIC investment company owned by a number of major NYC banks.

TMG's management welcomes input from Sterling in connection with their long-range business plan. Sterling's President, Harvey Granat, considers this company to be an emerging success story because TMG has "an enlightened management group." According to Granat, "They're enterprising, well-organized. They're sticklers for operating in accordance with a business plan, making projections, and going by the numbers. They take great pride in the professionalism of all the people they employ. This pride starts from the top."

4/15/97

National Association of Small Business Investment Companies
666 11th Street NW • Suite 750 • Washington DC 20001
Tel: 202.628.5055 • Fax: 202.628.5080 • E-mail: nasbic@nasbic.org
<http://www.nasbic.org>

JAN 13 '99 08:50PM MED

A Small Business Investment Company (SBIC) Success Story

woman-owned

**Mothers Work, Inc.
Philadelphia, PA**

Mothers Work is a national retailer of maternity clothing designed for career women. The company operates about 545 locations nationwide in 46 states and employs approximately 3,000 people. Revenues in fiscal 1996 were \$199 million. In 1995, Mothers Work was recognized as Portfolio Company of the Year by the National Association of Small Business Investment Companies (NASBIC).

Mothers Work was established in 1980 by Rebecca Matthias, who realized (with the pending birth of her first child) that attractive maternity clothing suited to the needs of successful career women was hard to find. Seeing an untapped market, Matthias bought some executive maternity clothing wholesale on Seventh Avenue in New York City and tried to market her merchandise with a catalog. She sent out thousands of catalogs, but sold almost nothing. The result: a net loss of \$6,500 and a closet full of maternity clothes. Rather than give up, Matthias decided to call everyone who had requested catalogs but had not placed orders to find out what it was they needed that she didn't have. What she learned led her to begin manufacturing her own products.

Limited capital for expansion led to franchising as a way to grow the business. The success of the franchises gave Matthias the funds she needed to open the first company-owned "test store." In December 1988, the first institutional investor in Mothers Work was a small business investment company (SBIC), Meridian Venture Partners, which provided a \$250,000 loan with equity features. At that time, Mothers Work had about 75 employees. In June 1990, Meridian provided another \$300,000 loan. Meridian's investment attracted other venture capital sources, enabling Mothers Work to expand its business, in part by buying back the franchises and converting them into company-owned stores. By 1992, when Meridian made its next investment in Mothers Work, the company had grown from 75 to nearly 300 employees.

From 1988 until Mothers Work went public in 1993, Meridian Venture Partners invested over \$2.2 million in the company, providing the "patient," long-term capital Matthias needed to grow her company. "Patient capital is critical in a startup company," says Matthias. "A company doesn't grow in a straight line going from the bottom left to the top right of the growth chart." The initial public offering enabled Mothers Work to improve manufacturing technology. By 1995 Mothers Work had acquired three other maternity apparel companies--Page Boy, A Pea In The Pod, and Motherhood Maternity Shops--adding over 300 stores. Matthias is emphatic about the important role the SBIC played in her company's success:

"I had no experience. I had no capital. I really had no company. I had an idea. And if it hadn't been for the investment from an SBIC, that's where I'd still be."

3/12/97

National Association of Small Business Investment Companies
666 11th Street, NW, Suite 750, Washington, DC 20001
Telephone: (202) 628-5055 Facsimile: (202) 628-5080
e-mail: nasbic@nasbic.org

JAN 13 '99 08:51PM MED

P.4

A Small Business Investment Company (SBIC) Success Story

Ru701

**NuCo2, Inc.
Stuart, Florida**

NuCo2, Inc. is the country's leading supplier of liquid or "bulk" carbon dioxide (CO2) used by retail establishments to carbonate and dispense fountain beverages. Supplying CO2 in liquid form is a relatively new and convenient alternative to the traditional method of supplying CO2 in its gas form, which must be transported and stored in unwieldy 50-pound high-pressure cylinders. NuCo2 "takes its customers out of the CO2 business" by installing a stationary CO2 storage system on the customer's premises and keeping it filled with liquid CO2. Under this arrangement, the customer leases the CO2 storage system from NuCo2. Some customers own their own tanks and contract with NuCo2 to supply the CO2.

NuCo2 today has 30,000 accounts in more than 30 states. Major customers include McDonald's, Pizza Hut, Kentucky Fried Chicken, Burger King, Wendy's, Hardees, Subway, Shoney's, Chili's, 7-Eleven, AMC Theaters, Universal Studios, and Walt Disney World. Its headquarters remains where the company began, in Stuart, Florida, about 50 miles north of West Palm Beach.

Stuart has a population of about 17,000. With 210 employees nationwide and 71 in Stuart, NuCo2 is a major employer in this rural community. Even though business now extends throughout the eastern United States, the chief executive officer, Ed Sellian, has no intention of moving the company headquarters. Says Sellian:

We want to be a large company with a hometown flair. In a small community, the work ethic is different. We try to keep a family atmosphere in the workplace. There's creativity in that kind of atmosphere. People want to work here—they appreciate the way they're treated.

In May 1992, NuCo2 had 14 employees and had installed 700 tanks. All the company's business at that time was in the state of Florida. Revenues were less than \$1 million. Ed Sellian had bigger plans for his company, but he needed financing. Three small business investment companies (SBICs), led by Argentum Capital Partners, provided \$1.5 million. According to Sellian, the SBIC funds were crucial:

The banks and other lending institutions didn't really understand our business model or plan. We had a new concept. The banks had a hard time relating to a business whose assets were spread out, rather than all in one place. We wouldn't have been able to get as far as we did, to become a public company, without the small business investment companies.

With adequate financing in place, NuCo2 was able to expand its customer base dramatically and in December 1995 held a successful initial public offering. The company now generates annual revenues of about \$20 million. 6/17/97

National Association of Small Business Investment Companies
666 11th Street NW • Suite 750 • Washington DC 20001
Tel: 202.628.5055 • Fax: 202.628.5080 • E-mail: nasbic@nasbic.org
<http://www.nasbic.org>

A Small Business Investment Company (SBIC) Success Story

Douglas Machine Alexandria, Minnesota

Douglas Machine manufactures equipment for specialty packaging. Every household in America has products that have been packaged by Douglas Machine. Many of the largest U.S. producers of foods, beverages, and consumer products use Douglas machines at the end of their assembly lines to put packaged products into cardboard shipping cases. The company is named for the county in which it is located--Douglas County, population 30,000--about 100 miles northwest of Minneapolis. With 550 employees, Douglas Machine is the county's largest employer.

Brothers Vern and Paul Anderson and their cousin, Arnold Thoen, founded Douglas Machine in 1966. Vern and Paul had worked for Thiele Engineering in Minneapolis, selling customized packaging equipment. Arnold had a farm machinery repair shop which became Douglas Machine shortly after Vern joined the operation. From this modest beginning, Douglas Machine grew quickly to become a major player in the case packing industry. By 1986, the company had 270 employees and \$11.3 million in sales. That year the owners decided to sell the company to APV, an international conglomerate based in the United Kingdom. Douglas Machine continued to operate much as in the past, but with access to the resources of a large parent company. Vern and Paul Anderson continued as senior managers.

By 1993, sales had grown to \$28.6 million and Douglas Machine employed about 320 people. However, the Andersons were concerned about changes occurring at APV and decided to try to buy back their company and return it to local control. Their search for an equity partner led them to the Minneapolis-based small business investment company (SBIC), Norwest Venture Capital. With \$11 million in financing from Norwest, the Andersons were able to acquire Douglas Machine from APV in December 1993.

"The people at Norwest had good insight about what to expect when acquiring a company," says Vern Anderson. "They helped us negotiate with the banks and set up a strategic plan." Norwest had rights to two board seats at Douglas Machine. "We had gotten to know the folks at Norwest," Anderson recalls. "When it was time to decide who would sit on our board, they let us choose who we wanted." Anderson has been impressed with the board members from Norwest, John Whaley and Steve Sefton. "They take a long-range view," he observes. "They're not short-sighted about facilities improvements like some stockholders. They think about what's best for the company down the road."

Since the buy-out, the company's performance has steadily improved. Revenues in 1996 were \$48 million. For 1997, revenues of \$55 million are anticipated. Today, Douglas machines are used in nearly every state in the U.S. and in fifteen countries worldwide.

7/7/97

National Association of Small Business Investment Companies
666 11th Street NW • Suite 750 • Washington DC 20001
Tel: 202.628.5055 • Fax: 202.628.5080 • E-mail: nasbic@nasbic.org
<http://www.nasbic.org>

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

30

Divider Title: _____

DRAFT

Background paper on OPIC
June 18, 1998

OPIC has three basic programs:

1. **Political risk insurance.** Offers U.S. international investors insurance against political risks -- currency inconvertibility (inability to convert profits, debt service, etc. from local currency into dollars and transfer the dollars out of the host country), expropriation by a foreign government, and political violence (loss of assets due to war, revolution, or terrorism). OPIC does not insure investors against ordinary business risk, nor does it insure against currency devaluations.
2. **Project financing.** Provides medium and long-term financing for overseas projects involving significant equity participation by U.S. businesses. Loan guarantees are generally used for larger projects, while direct loans can be made for smaller ventures. OPIC can lend up to \$200 million per project. Loan terms vary from five to fifteen years, plus a grace period during which no interest payments are due. OPIC requires that projected cash flow be sufficient to cover all operating costs, service all debt and provide an adequate rate of return. Support from OPIC is available for but not limited to ventures that cannot secure conventional financing.
3. **Investment funds.** Guarantees long-term loans to private equity investment funds that finance joint ventures and other enterprises in eligible emerging markets. The funds, for example, can provide capital for privatization of government-owned businesses. The investment funds are privately owned and managed -- the OPIC-guaranteed loans supplement the private capital committed by investors. OPIC charges fees for the loan guarantees it provides to the funds.

OPIC currently supports 26 funds operating in sub-Saharan Africa, North Africa, India, the Middle East, other parts of Asia, the Pacific region, Latin America, Central and Eastern Europe and the former Soviet Union.

General criteria/restrictions. OPIC financing (including through funds) and insurance is limited to private sector projects in 140 developing countries or emerging markets (loosely defined) that promise significant developmental (economic and/or social) benefits for the host country. To be eligible, projects must not have an adverse impact on U.S. employment or the host country's environment and must not contribute to violations of internationally recognized worker rights.

Points relevant to Trillion Dollar discussions:

1. Fund managers must seek OPIC approval for each of their investments, to ensure that it meets the general criteria above -- i.e., each fund investment must meet the standards that apply to projects directly financed or insured by OPIC.

2. Generally, the OPIC-guaranteed loan to a fund must be fully repaid (with interest) before the fund's investors see any profits. The OPIC loan is also secured with project assets, but not with the fund's remaining uncommitted private capital.
3. Earlier, OPIC chose funds for financing through both competitions and consideration of unsolicited proposals received. Henceforth, all OPIC funds will be selected/established through a competitive process.
4. Political risk insurance is OPIC's primary activity, as measured by financial exposure and revenues, but project financing and investment funds also represent significant components of OPIC's business. As of March 31, 1998 OPIC had a maximum financial exposure of \$17.6 billion (total of insured amounts, maximum loans and loan guarantees extended -- the amount drawn down is considerably lower). Of this amount, \$11.1 billion is in the insurance program and about \$6.5 billion in the project financing and investment fund programs. The \$6.5 billion is split evenly between project financing and the investment funds -- the investment fund program has grown from about \$100 million to over \$3 billion during the last five years.

OPIC Southern Africa Funds

In fiscal year 1997, in response to a call from Congress and the Administration to encourage U.S. private investment in sub-Saharan Africa, OPIC announced a \$100 million loan guaranty for the Modern Africa Growth and Investment Company, supplementing the Fund's \$50 million in private equity. In addition, OPIC is currently soliciting proposals (due date of June 30) for one or more private equity investment funds, with up to \$500 million in capital, focusing on investments in sub-Saharan African infrastructure projects such as roads, harbors, rail systems, waste treatment and power plants. A portion of the \$500 million would be private capital, with the remainder loaned to the fund as senior secured debt guaranteed by OPIC.

OPIC had already (in 1996) provided an \$80 million loan guaranty to the New Africa Opportunity Fund. The New Africa Fund, which is managed by a unit of the Sloan Financial Group (headed by Maceo Sloan), made its first investments in 1997, including \$5 million in Afinta Motor Company, which manufactures light commercial buses to facilitate commuting by a population that now travels to work largely by taxi. The New Africa Opportunity Fund invests in projects located in Southern Africa (e.g., South Africa, Botswana, Namibia, Zimbabwe, Lesotho, and Mozambique) and is subject to the rules applicable to other funds -- for example, each New African Opportunity Fund investment must be approved by OPIC.

Q: Why don't we have a domestic equivalent of OPIC? Why do we subsidize investment overseas but not here at home?

As many of you know, the Overseas Private Investment Corporation (OPIC) has three basic activities:

1. Political risk insurance. Insuring U.S. international investors against political risks -- currency inconvertibility, expropriation by a foreign government, and political violence (loss of assets due to war, revolution, or terrorism). OPIC does not insure investors against ordinary business risk, and charges premiums for the risk insurance provided.
2. Project financing. Providing medium and long-term financing for overseas projects involving significant equity participation by U.S. businesses. Loan guarantees are generally used for larger projects, while direct loans can be made for smaller ventures. OPIC can provide loan guarantees of up to \$200 million per project. OPIC requires that projected cash flow be sufficient to cover all operating costs, service all debt and provide an adequate rate of return. Support from OPIC is available for but not limited to ventures that cannot secure conventional financing.
3. Investment funds. Guaranteeing long-term loans to private equity investment funds that finance joint ventures and other enterprises in eligible emerging markets. The funds, for example, can provide capital for privatization of government-owned businesses. The investment funds are privately owned and managed -- the OPIC-guaranteed loans supplement the private capital committed by investors. OPIC charges fees for the loan guarantees it provides to the funds.

OPIC currently supports 26 funds operating in sub-Saharan Africa, North Africa, India, the Middle East, other parts of Asia, the Pacific region, Latin America, Central and Eastern Europe and the former Soviet Union.

- The average OPIC fund has about \$124 million in capital (private equity plus guaranteed loans). Roughly half of the funds (11 of 26) have less than \$100 million in total capital, while the remaining 15 have between \$100 million and \$300 million.

OPIC vs. SBIC

There are strong similarities between the SBIC program (that John Gray discussed during the first panel) and OPIC, although we would not go so far as to call the SBIC program a domestic OPIC.

- OPIC provides loan guarantees to funds that make investments overseas; the SBIC program guarantees the debt issued by funds that make investments in small and medium sized businesses here.

- The average size of an OPIC fund is about \$124 million; the maximum size for an SBIC-supported fund is \$150 million (\$50 million in private capital and \$100 million in SBA-supported debt or participating securities held by SBA).
- Generally, the OPIC-guaranteed loan to a fund must be fully repaid (with interest) before the fund's investors see any profits on their equity investment; the investors in an SBIC must lose all their equity before the SBA-guaranteed funding is at risk.
- Both have a public policy mission: OPIC financing (including through funds) and insurance is limited to private sector projects in 140 developing countries or emerging markets that promise significant developmental (economic and/or social) benefits for the host country; SBICs can invest in businesses with up to \$6 million in profits and \$18 million in net worth, to ensure that the program remains focused on its mission of promoting the development of small and medium-sized businesses.

The majority of SBICs investments are in the \$500,000 to \$5 million range -- too much for wealthy individual investors but too little to interest traditional, institutionally-funded venture capital firms.

Category	OPIC	SBIC
Form of support to investment funds	Loan guarantees	Guaranteeing the principal and interest on debt issued by the funds, and acquiring preferred securities in the funds that promise the preferred stock rate of return plus a share of the profits. The private equity is at risk before these securities.
Order of risk	Generally, private investors must lose all their equity before OPIC incurs a loss	Private investors must lose all their equity before SBA incurs a loss
Size of funds	Average of \$124 million	Maximum of \$150 million, average of \$30 million ¹
Limits on investment	Each investment must be approved by OPIC, but it need only meet certain general criteria (promote social/economic development of the country, not have an adverse effect on the environment, worker rights or U.S. employment).	Investments are limited to firms with \$6 million or less in after-tax income (profits) and \$18 million or less in net worth. The SBIC program is otherwise not involved in fund investments.
Total capital	\$3.2 billion	\$7.6 billion
Number of funds	26	320

- We generally prefer to make better use of an existing program rather than creating a new one; the Vice President may talk a bit later about our plans to improve the performance of the SBIC program with regard to investments in under-served communities.
- Nonetheless, we have been and will continue to explore cost-efficient ways to stimulate

¹This average does not include the specialized small business investment companies, formerly the minority enterprise SBICs, which are smaller than standard SBICs.

investment in less advantaged areas (could refer to neutral principles); the answer may be better use of existing programs, new proposals or a combination.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM

To: Emil Parker
From: Cliff Kellogg *CK*
Date: June 18, 1998
Re: OPIC Equity Funds

This memo summarizes our preliminary finding on the OPIC investment funds. There is much additional research we could pursue, but we should confer beforehand to focus any additional research efforts.

OPIC Funds

The Overseas Private Investment Corporation (OPIC) grew out of USAID in 1971, with the purpose of aiding developing countries other than through direct government-to-government aid. OPIC describes itself as financially self-sustaining and profitable every year, with no net cost to taxpayers. The agency is in the executive branch of the federal government, and its authorization to operate is subject to renewal every two years by Congress.

OPIC strives to supplement the private market by "stepping in" where the private sector is "not fully available to finance or insure investments." OPIC offers three types of services: direct loans, loan guarantees (both for bank loans and for a portion of the capital in equity funds), and political risk insurance. It charges market rates for these services.

- Direct loans, ranging from \$2 million to \$30 million, are targeted to industrial companies with annual sales below \$198 million, or non-industrial businesses with stockholders' equity of less than \$67 million.
- Loan guarantees are typically used for larger projects (up to \$200 million).
- OPIC guarantees the debt portion (2/3) of 26 private investment funds with investable capital of more than \$3 billion (explained more fully below). The funds are active in 140 countries around the world, and invest in a broad range of industries, including agriculture, energy, construction, infrastructure, natural resources, telecommunications, transportation and distribution, banking, services, and others.

OPIC states that its loan recovery rate on these collective investment activities is 97%, but more analysis would be necessary to understand the performance of the individual activities.

How the OPIC Funds are structured

OPIC creates a private investment fund when the agency either approaches or is approached by a fund management firm, usually one that has experience in venture capital investing. OPIC does not seek Congressional pre-approval prior to establishing a fund. The management firm presents a proposal involving a certain amount of private equity, which the manager has gathered. If the proposal is approved, OPIC will issue a loan guarantee for up to two times the equity raised by the managers. This can be done in one of two ways.

- With the "leverage" approach, the manager can pool the private equity and then borrow from an American bank up the OPIC guarantee amount. If the fund is unsuccessful, the investors lose their equity, but must pay back as much of the OPIC-backed loans as possible. In other words, the equity providers absorb the losses fully before the debt providers (usually banks).
- With the second, or "unit" method, investors' money is designated one-third as equity and two-thirds as debt. In this case, OPIC insures two-thirds of each investor's contribution, treating the debt portion of each investor's contribution just as it would a financial institution. This approach lessens each investor's risk, and since the investor has effectively acted as a lending institution, he or she is entitled to collect interest on the "loan." If enough time has passed, the accrued interest might even cover the loss in equity.

OPIC's guarantees for these funds are typically for ten years, with the option to extend for one or two years. Rates are set at U.S. Treasuries plus a certain amount of basis points. Interest may be paid either in a "balloon" payment or semi-annually, depending on the fund managers' preference. Fund managers usually receive a management fee of around 2 1/2% of the total amount of the fund, plus whatever carried interest (usually 18-20% of each transaction) they earn from investments.

OPIC fund managers make all investment decisions, with OPIC screening only for environmental and human rights considerations, and to ensure that no American jobs are relocated overseas. Institutions investing in the funds must be at least 51% American-owned. Different funds often focus on different markets, choosing to target either small to medium size businesses or larger, industrial projects. Fund managers target investments that will earn returns of between 25% and 40% annually.

OPIC's sub-Saharan Africa Funds

There are three OPIC private investment funds that are targeting sub-Saharan Africa:

The Africa Growth Fund is managed by Equator services. It has \$25 million in investable

capital and focuses mainly in mining, manufacturing, and financial services in the sub-Saharan region.

The **Modern Africa Growth Fund** is managed by *Modern Africa Fund Managers*. They manage \$150 million in capital, and invest in all sub-Saharan countries excluding South Africa. The fund has direct equity investments ranging from \$5 to \$20 million in mining, telecommunications, and manufacturing (mainly agribusiness and pharmaceuticals).

The **New Africa Opportunity Fund** is managed by *New Africa Advisors*, which is a subsidiary Sloan Financial Group, the largest black-owned asset management firm in the world. The fund totals \$120 million, and although it mainly targets South Africa, it also has investments in Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Tanzania, Zambia, and Zimbabwe. Its portfolio includes consumer products, services, telecommunications, health care, financial services, light manufacturing, and construction. The Fund is looking for mainly small to midsize businesses.

Both the Modern Africa Fund and the New Africa Fund are attempting to capture the emerging black market in Africa by providing products and services that had heretofore been inaccessible to the majority population and that are suited to the needs of a rising middle class. Both encourage participation of black shareholders and management.

cc: Gene Sperling

OPIC

Overseas
Private
Investment
Corporation



OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

Page 1 of 4

1100 New York Avenue, N.W.
Washington, D.C. 20527-0001
(202) 336-8400
FAX (202) 408-9859

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
Africa Growth Fund Equator Services	Joe Jandreau Managing Director The Africa Growth Fund 45 Glastonbury Blvd. Glastonbury, CT 06033 860-633-8999 860-633-6799 Fax	\$25 million Sub-Saharan Africa	Investing	Equity investments in mining, manufacturing and financial services.
Agribusiness Partners International America First Companies	Mr. Robert Peyton America First Companies 1004 Farnam Street Omaha, Nebraska 68102 402-444-1630 402-345-8966 Fax	\$100 million NIS/Baltics	Investing	Equity investments in agriculture, food firms, infrastructure projects, privatizations, food storage and distribution facilities.
AIG Brunswick Millennium Fund American International Group Brunswick Capital Management Ltd.	Mr. Peter Yu AIG Capital Partners, Inc. 70 Pine Street New York, NY 10270 212-770-7000 212-514-9628 Fax	\$300 million NIS/Baltics	Investing	Equity investments in large infrastructure projects including power, transportation, natural resource development and related industries.
Allied Capital International Small Business Fund Allied Capital Advisers	Mr. Cabell Williams III President Allied Capital Advisers, Inc. 1666 K Street, NW, 8th Fl. Washington, DC 20006 202-331-1112 202-659-2053 Fax	\$20 million Global	Investing	Equity investments in basic manufacturing and service industries sponsored by qualifying U.S. small businesses.
Aqua International Partners Texas Pacific Group	John Sylvia, CEO/Aqua Texas Pacific Group 6000 California St. #1850 San Francisco, CA 94108 (415) 616-0400 (415) 616-0420 (FAX)	\$300 million Global	Raising Capital	Equity investments in operating and special purpose companies involved in the treatment, bulk supply and distribution of water in emerging market countries.
Asia Pacific Growth Fund Hambrecht & Quist	Mr. Ta-lin Hsu, Chairman One Bush Street San Francisco 94104 (415) 676-3300 (415) 676-3621 (FAX)	\$75 million Philippines, Malaysia, Thailand, Taiwan and other countries in Southeast Asia	Investing	Equity investments in light manufacturing, financial, construction and telecom services.
Bancroft Eastern Europe Fund The Bancroft Group	Mr. Fred Martin President The Bancroft Group 64 rue de Varenne 75007 Paris, France 33-1-63-63-28-28 33-1-63-63-28-29 Fax	\$100 million Central Europe	Investing	Equity investments in distribution networks, basic manufacturing, consumer goods and related service networks.
Caucasus Fund Commonwealth Property Investors Junction Investors, L.L.C.	Irakli Rukhadze Commonwealth Property Investors 63 State Street, 16 th Floor Boston, MA 02109 617-261-9300 617-261-9333 FAX	\$48 million Armenia, Azerbaijan and Georgia	Raising Capital	Equity investments in real estate, agribusiness and transportation.

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

Page 2 of 4

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
GEENIS Property Fund Auburndale Central Europe Realty Management Inc.	Mr. Greg Hunt Auburndale Realty Management Inc. 372 Washington Street Third Floor Wellesley, MA 02181 718-431-2600 718-431-1007 Fax	\$240 million Central Europe/NIS	Investing	Investments in light manufacturing, office, warehousing and distribution property development projects.
Draper International India Fund Draper International	Mr. William H. Draper, III Draper International 50 California Street Suite 2925 San Francisco, CA 94111 415-816-4050 415-616-4050 Fax www.drapercvc.com/intl	\$55 million India	Investing	Equity investments in information technology, telecommunications and consumer goods.
Emerging Europe Fund Templeton Direct Advisors SG Europe Ltd.	Mr. Jamie Halper Templeton Direct Advisors 30 Elm Street Greenwich, CT 06830 203-625-4515 203-625-6671 Fax	\$60 million Central Europe	Investing	Equity investments in sustainable development industries.
First NIS Regional Fund Sovlink-American Baring Asset Management	Mr. Alistair Stobie Sovlink Corporation 10 Uspenski Pereulok Moscow, Russia 103006 011-7095-967-1300 011-7-095-967-1308 FAX	\$200 million NIS/Baltics	Investing	Equity investments in natural resource-related companies, telecommunications, light manufacturing and consumer products and services.
Global Environment Emerging Markets Fund GEF Management	Mr. H. Jeffrey Leonard President GEF Management Corp. 1201 New York Ave Suite 200 Washington, DC 20005 202-789-4500 202-789-4508 Fax	\$70 million Global	Investing	Equity investments in environment-oriented sectors relating to the developing, financing, operating or supplying of infrastructure relating to clean energy and water.
Global Environment Emerging Markets Fund, II GEF Management	same as above	\$120 million Global	Raising Capital	Equity investments in environment-oriented sectors relating to the developing, financing, operating or supplying of infrastructure relating to clean energy and water.
India Private Equity Fund Oppenheimer & Co. Chase Capital	Mr. Bob Schwabe Vice President Oppenheimer & Co. World Financial Center New York, NY 10281 212-667-4580 212-667-4468 Fax	\$140 million India	Investing	Equity investments in consumer goods, basic manufacturing and related industries.
InterArab Investment Fund InterArab Management, Inc.	Dr. Fuad Abu Zayyad InterArab Management, Inc. 340 Golden Hills Drive Portola Valley, CA 94028 415-851-9371 415-851-9373 Fax	\$45 million West Bank/Gaza, Jordan, Oman	Investing	Equity investments in basic industries that create intra- and inter-regional synergies.

OPIC Investment Funds Department, 1100 New York Avenue, N.W., Washington, DC 20527

e:\fdcontact.doc

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

Page 3 of 4

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
Israel Growth Fund Apax - Leumi Partners	Mr. Allan Barkat APAX-Leumi Partners, Inc. 2 Weizman Street P. O. Box 33031 Tel Aviv 61330, Israel 011-872-3-696-6990 011-872-3-696-5977 Fax	\$40 million Israel	Investing	Equity investments in technology, telecommunications, consumer retailing and consumer products
Modern Africa Growth and Investment Fund Modern Africa Fund Managers, LLC	Steve Cashin Modern Africa Fund Managers, LLC 1101 Connecticut Ave., NW, Suite #700 Washington, DC 20036 202-887-1772 202-887-1788 Fax e-mail: mafmdc.mafm.com	\$150 million Africa	Raising Capital	Equity investments in all sub-Saharan countries excluding South Africa with focus on manufacturing, telecommunications and natural resources.
New Africa Opportunities Fund New Africa Advisers	Mr. Justin Beckett President & CEO New Africa Advisers 103 West Main Street Durham, NC 27701 919-688-8092 919-688-8095 Fax	\$120 million Southern Africa	Investing	Equity investments in diversified manufacturing, financial and service industries.
Newbridge Andean Partners, L.P. ACON Investments	Mr. Bernard Aronson ACON Investments, L.L.C. 1133 Connecticut Ave., N.W. Suite 700 Washington, D.C. 20036 202-861-6060 202-861-6061 Fax	\$160 million Bolivia, Ecuador, Peru and Venezuela	Investing	Equity investments in diversified manufacturing, financial and service industries.
New Century Capital Partners, L.P. New Century Advisors	Mr. George Rohr President NCH Advisors 712 Fifth Avenue, 46th Floor New York, NY 10019-4108 212-641-3200 212-641-3201 Fax	\$250 million Ukraine, Armenia, Belarus, Estonia, Georgia, Kazakhstan, Latvia, Lithuania, Moldova, and Russia	Investing	Equity investments in diversified manufacturing, consumer products, financial and service industries.
Poland Partners, L.P. Poland Partners Management Co.	Mr. Landon Butler Poland Partners Management Co. 700 Thirteenth Street, NW Suite 1150 Washington, DC 20005 202-737-7300 202-737-7804 Fax	\$65 million Poland	Investing	Equity investments in manufacturing, consumer goods, distribution networks, merchandising and related service networks.
Russia Partners Siguler Guff & Co. International Economic Cooperation	Mr. Drew Guff, VP Siguler, Guff & Co. 630 Fifth Avenue, 16th Floor New York, NY 10111 212-332-5100 212-332-5120 Fax	\$155 million NIS	Investing	Equity investments in natural resource-related companies, telecommunications, light manufacturing and consumer products and services.

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

Page 4 of 4

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
South America Private Equity Growth Fund WestSphere Capital Associates	Mr. Eduardo Borhoquez President & CEO WestSphere Equity Assoc. LP 55 East 59 th Street 13 th Floor New York, NY 10022 212-317-3600 212-317-0739 Fax	\$180 million South America	Investing	Equity investments in diversified manufacturing, financial and service industries.
South Asia Capital Ziff Brothers Investments	Ms. Terry Dewey, CFO Ziff Brothers Investments, 153 East 53rd Street, 43rd Floor New York, NY 10022 212-292-6622 212-292-6644 Fax	\$150 million Bangladesh, India, Indonesia, Laos, Philippines, Sri Lanka, Thailand	Investing	Equity investments in infrastructure, telecommunications, agro- industry, health-care and consumer products and services
West Bank/Gaza & Jordan Fund Capital Investment Management Corporation	Scott Stupay Capital Investment Management Corporation 8862 Elm Street, Suite 720 McLean, VA 22101 703-847-0870 703-847-3068 Fax	\$60 million West Bank/Gaza & Jordan	Raising Capital	Equity investments in basic service and manufacturing companies.



1100 New York Avenue, N.W.
Washington, D.C. 20527-0001
(202) 336-8400
FAX (202) 408-9859

INVESTMENT FUNDS DEPARTMENT

Summary Program Description

OPIC supports the creation and capitalization of investment funds that make direct equity and equity-related investments in new, expanding or privatizing companies in emerging market economies. By providing long-term, patient growth capital and facilitating critically needed technology and management skills development, these privately-owned, privately-managed funds act as a catalyst for private sector economic activity in developing countries.

Along with OPIC's insurance and project finance activities, these investment funds serve to carry out OPIC's mission, which has three primary objectives:

- Support for the achievement of U.S. foreign policy objectives, including privatization of state-owned businesses and economic development of emerging markets in order to increase political and economic stability and provide opportunities for U. S. commerce;
- Development of new markets for American companies, facilitating early access to new consumers in the emerging economies and the developing world;
- Creation of U.S. jobs through support of business in emerging markets which have relationships with U.S. companies such as joint ventures, franchising, supply or distribution arrangements, or the procurement of U.S. goods and services.

The direct equity investments of OPIC-supported funds complement OPIC's insurance and project finance activities. By supplementing the capital of funds which are privately financed and managed by experienced private investment professionals, OPIC supports investment activities which have a profit objective, and which include management guidance to enhance the development of companies in which investments are made. A particularly important aspect of this program is its use as a source of risk capital and financial expertise for small and medium-sized U.S. companies seeking to enter new emerging markets.

Fund Formation

OPIC's participation in the funds takes the form of long-term, secured loans and loan guaranties that supplement the fund's privately-raised equity. OPIC's guarantee, backed by the full faith and credit of the U.S., may be applied only to the debt portion of the fund's capital. OPIC does not offer any guarantee of the fund's equity, and all equity investments in OPIC-backed funds are fully at risk.

OPIC-supported direct investment funds are organized and structured like other U.S.-based private equity investment entities, usually as limited partnerships or limited liability companies. The fund general partners are experienced sponsors of previous U.S.-based investment vehicles, and raise the funds' equity capital through private placement of limited partnership interests with sophisticated institutional, corporate and high net worth investors. Funds are typically managed by the fund general partner or its affiliate.

OPIC supplements the private equity capital by lending or guaranteeing long term debt (typically 10 to 12 year maturity) to the funds, in an amount up to twice the private equity capital invested in the fund. OPIC-guaranteed debt must be held by "eligible investors" as defined in OPIC's governing statute. In general, eligible investors include: U.S. citizens; U.S. corporations, partnerships, or the like which are more than 50% beneficially owned by U.S. citizens; and foreign entities wholly owned by U.S. citizens.

OPIC receives commercially-based fees as compensation for its participation in a fund; the program is structured to ensure that the fees and profit participation will fully cover the cost of the program.

Selection Criteria

OPIC's evaluation of prospective funds is based primarily on the following criteria:

- Responsiveness of the proposed fund to current foreign policy objectives of the United States in countries and market segments which are eligible for OPIC participation, and in which there is a shortage of private U.S. investment capital.
- Credibility and thoughtfulness of the fund's strategic concept and business plan, including the fund manager's ability to link qualified U.S. business partners or suppliers to prospective investments.
- Experience and depth of the proposed management, both in the U.S. and in the countries in which investments are to be made. OPIC seeks fund managers with an experienced track record in direct equity investments and relevant regional experience. The fund manager is expected to add value to the portfolio investments by providing management expertise,

improved marketing and access to international manufacturing technologies, and to have a strategy for the eventual liquidation of investments.

- Ability of the fund sponsors to raise the required private capital in a reasonable period of time.

OPIC Statutory Requirements and Policies

In accordance with OPIC's statutory criteria and policy guidelines, the funds will only make investments in opportunities that satisfy OPIC's policy considerations, including worker rights, the environment and U.S. economic impact. Fund investments are expected to have a connection with U.S. companies which will benefit the U.S. economy.

~~OPIC does not participate in investment decisions made by the fund.~~ However, each proposed fund investment must be submitted to OPIC for review to determine whether such investment is consistent with OPIC's statutory and policy criteria.

Cost and Terms

OPIC is a self-sustaining government agency. All of OPIC's programs are market-based and charge market-based fees. Fees associated with OPIC's investment funds program include:

- retainer and commitment fees
- an annual fee based on the outstanding loan balance
- a participation in cash distributions from the fund after the OPIC-guaranteed loan has been repaid and investors have recovered their full investment in the fund.

###

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

31

Divider Title: _____

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220- WITH
OPK
STUFF

MEMORANDUM

To: Emil Parker
cc: Gene Sperling
From: Cliff Kellogg *CK*
Subject: State Department/AID Enterprise Funds
Date: June 13, 1998

We have completed about half of our background research into the Enterprise Funds discussed in the meeting with Rev. Jackson. This memo summarizes what we have gathered to date, with more to come in the next few days. We are also investigating the status and structure of the 26 OPIC Funds and will send this information to you also in the next few days.

Overview of Enterprise Funds

There are currently ten Enterprise Funds with a total of \$1.3 billion in authorized capital, of which \$700 million has been disbursed. The 1989 SEED Act (Support for Eastern European Democracy) created seven of the funds (Polish, Czech, Bulgarian, Romanian, Albanian, Baltic, Hungarian) with \$655 million in authorized capital. The 1992 FSA Act (Freedom Support Act) created three more. The Funds' initial investment came completely from USG funds through AID. AID taps into an account called the 150 account in the State Department.

Each Fund is a separate, private, not-for-profit organization. The USG appoints a Board of Directors, which hires a management board, that in turn looks for projects. Projects could be in the form of market rate loans or private equity investments. AID does not give the money all at once, but dispenses it to the Funds in "drips and drabs" yearly. For example, the full \$256 million for the Polish American Enterprise Fund was disbursed over 7 years.

It appears that each Fund has the discretion, with the approval of its Board of Directors, to structure its subsidiaries as it sees fit to meet market need. The subsidiary structure may be quite complex: for example, PAEF's organizational chart shows 11 subsidiary activities, which may include wholly-owned corporate entities, partial interests in corporate entities, or simply program areas operated directly out of PAEF.

Each Fund's management looks for potential investments and performs its own due diligence, a process that may take 3+ months to complete. The Fund's management then takes project proposals to its board for approval. Based on the management's screening and due diligence

5101007
prior to submitting a proposal, the Boards approve the vast majority of the project proposals. The Funds file annual reports (there are also semi-annual reviews) outlining the projects and how much they will cost. The State Department then advances to the Funds via a letter of credit, which they draw on throughout the year.

The investment parameters appear very flexible. The Fund is subject to all the AID rules of investment (e.g., no military projects, abortion equipment, or weather modification equipment), but otherwise, the Funds may invest in whatever they deem profitable and promising.

The Funds strive to keep their portfolios diverse. They are investing mainly in small and medium-sized businesses, along with micro enterprises (as small as \$1000 loans), perceiving these segments as the "engines of growth." Underwriting criteria follow business fundamentals: they look at the company's market and management, and whether the company will be profitable and foster development.

Polish American Enterprise Fund

The Polish American Enterprise Fund (PAEF), which is generally considered the most successful Fund in terms of disbursing its funds into commercially viable businesses and home mortgage credit, was appropriated \$256 million. The Polish American Enterprise Fund raised an additional \$265 million in private money (who invested is classified information, but investors include pension funds, large institutional organizations, large banks, etc.)

The Fund's report says they have assisted 12,346 enterprises through its various credit programs. PAEF's business investment programs that may be relevant to the discussions with Rev. Jackson include the following:

1. The Enterprise.Crédit Corp. issues loans to small businesses, with 40 branches around the country. It has basically merged with the First Polish-American Bank, which now administers its accounts. The Bank was purchased by the Fund when it was about to become insolvent. The merged firm is now traded on the Polish stock market.
2. The Polish Private Equity Funds encompass 3 funds created with the non-USG private money (\$265 million) that the Fund raised. These equity funds are for-profit and cost little or nothing to U.S. taxpayers. These Funds charge fees to manage private money and are exclusively devoted to private equity investments. The first fund was jump-started by \$50 million from the original fund, plus some money from the European Bank of Reconstruction and Development. Private investors include the GM pension fund and other similar large corporations.
3. The PAEF's direct investments in Polish industries include 32 equity investments totalling \$155.3 million. PAEF expects to turn \$24.7 million in profits from these investments.

[Alisa Kaplan of our office performed most of this research, based on literature searches, the PAEF Annual report and phone interview with Gary Imhoff of the State Department.]

Draft

SUMMARY COMPARISON

	Enterprise Funds	OPIC Funds
Total # of funds	11: 7 in Eastern Europe, 3 in former USSR, 1 in Southern Africa.	26: operate in 140 countries.
Total investable capital	\$1.7 billion	> \$3 billion
Type of management	Board of Directors hires fund manager.	Private management firms work with OPIC.
Manager's compensation	Fund manager's yearly salary capped by Congress at \$150,000, which is drawn from Fund account. Board of Directors is uncompensated.	2.5% of Fund's available capital + 2.5% of the cost basis of investments, net of any write-downs or write-offs.
Eligible investees	Subject to USAID requirements: human rights and environmental concerns, ban on military industries etc.	OPIC screens for human rights and environmental interests.
How decisions are made	Fund's Board and manager make all investment decisions, subject to USAID review	Fund's management firm makes all investment decisions, within OPIC guidelines.
Funding source	USAID provides 100% of initial capital.	Fund manager gathers private equity, OPIC issues loan guarantees up to 2x the amount of equity.
Most "successful" fund	Polish-American Fund. Initial USG grant was \$256 million, but Fund managed to raise \$265 million more in private capital. Net assets (FY '97): \$267.8 million. Success credited to star Board, good management, large initial investment, favorable market conditions.	

ADDITIONAL MATERIALS
& FAST SPEECHES.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

A

Divider Title: _____

12-30-98

copied
Podesta
opening

"Financial Solutions For The 21st Century"

Wall Street Project

Small Business Investment Company (SBIC)

- ❑ Program established in 1958 to address the gap in capital for long term financing of smaller growth oriented businesses in the \$500K to \$5 million range.

- ❑ Under SBIC program, SBA licenses, fund venture capital investment firms. Funds n through SBA guarantees are referred to a equal 2 to 3 times the invested private cap decisions are made by the SBIC. The priv. is always at risk ahead of the funds guara

Podesta / speaking
we need to check
with Andrea - see if
we can help him
with this -
TJR

- ❑ Minimum equity capital requirements are

- ▶ Participating Securities:
- ▶ Debenture Program:

- ❑ Currently: 320 SBICs \$7.5 Billion Capital Resources
39 Years Provided \$17 Billion 113,000 Financings
80,000 Small Business Concerns

- ❑ SBICs Minority & Women Ownership

Women:	2	African American:	0
Hispanic:	1	Asian American:	0
		Native American:	0

“Financial Solutions For The 21st Century”

Wall Street Project

Small Business Investment Company (SBIC)

- ☐ Program established in 1958 to address the gap in capital for long term financing of smaller growth oriented businesses in the \$500K to \$5 million range.
- ☐ Under SBIC program, SBA licenses, funds and regulates private venture capital investment firms. Funds made available to SBICs through SBA guarantees are referred to as leverage and may equal 2 to 3 times the invested private capital. Investment decisions are made by the SBIC. The private capital of the SBIC is always at risk ahead of the funds guaranteed by the SBA.
- ☐ Minimum equity capital requirements are:
 - ▶ Participating Securities: \$10 million
 - ▶ Debenture Program: \$ 5 million
- ☐ Currently: 320 SBICs \$7.5 Billion Capital Resources
 39 Years Provided \$17 Billion 113,000 Financings
 80,000 Small Business Concerns
- ☐ SBICs Minority & Women Ownership

Women:	2	African American:	0
Hispanic:	1	Asian American:	0
		Native American:	0

“Financial Solutions For The 21st Century”

Wall Street Project

12-30-98

Small Business Lending Company (SBLC)

- ☐ Established in 1975 to promote small business access to capital
- ☐ SBLCs are non-depository lenders who enter into participation agreements with the U.S. Small Business Administration (SBA) to provide business loans to qualified small businesses.
- ☐ Currently, there are fourteen (14) SBLCs in existence which account for as much as 10 percent of SBA's FY 1997 loan volume and 20 percent of its dollar volume.
- ☐ A moratorium was placed on licensing new SBLCs in 1982 due to concerns over SBA's capacity to adequately monitor.
- ☐ SBA had planned to expand this program as a result of focusing on the New Markets (Minorities, women & veterans) small businesses located in rural, distressed or inner cities and exporting.



☐ **SBLCs Minority & Women Ownership**

Women:	0	African American:	0
Hispanic:	0	Asian American:	0
		Native American:	0

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

B

Divider Title: _____

**Appalachian Regional Commission's
Innovations in Development Finance Committee**
Proposals for Discussion
Developed at January 22, 1999 meeting in Charlotte, NC

Equity Capital

Goal: To improve the flow of non-venture equity capital to Appalachia to provide support for businesses starts and expansions. The objective discussed was the creation of 4 to 7 equity vehicles capitalized at \$10M - \$20M each.

Issues and Recommendations: To achieve these goals, the committee recommended consideration of a three-faceted approach:

- developing quality fund managers;
- creating new funds or building on existing institutions, and;
- supporting fund capitalization.

I. *Management* – the top priority need is to develop quality fund managers. Committee members believed that capitalizing investment pools once a qualified management team is assembled is not a significant obstacle. Recommendations to improve management capacity in the Region include:

- Bring specialized training programs to the Region.
- Provide internship opportunities for development finance personnel to work in venture capital funds
- Involve traditional venture capitalists on boards of directors of community development venture funds.

II. *Expand Existing Programs or Create New Entities*

A. *Expand Existing Programs*

In some cases existing programs (Revolving Loan Funds, micro-credit funds, etc.) could expand their missions and develop equity programs. The committee underscored the importance of ensuring that candidate institutions have the capacity to undertake development venture capital as not all debt fund managers have the requisite skills to invest and manage equity portfolios.

B. *Create New Entities*

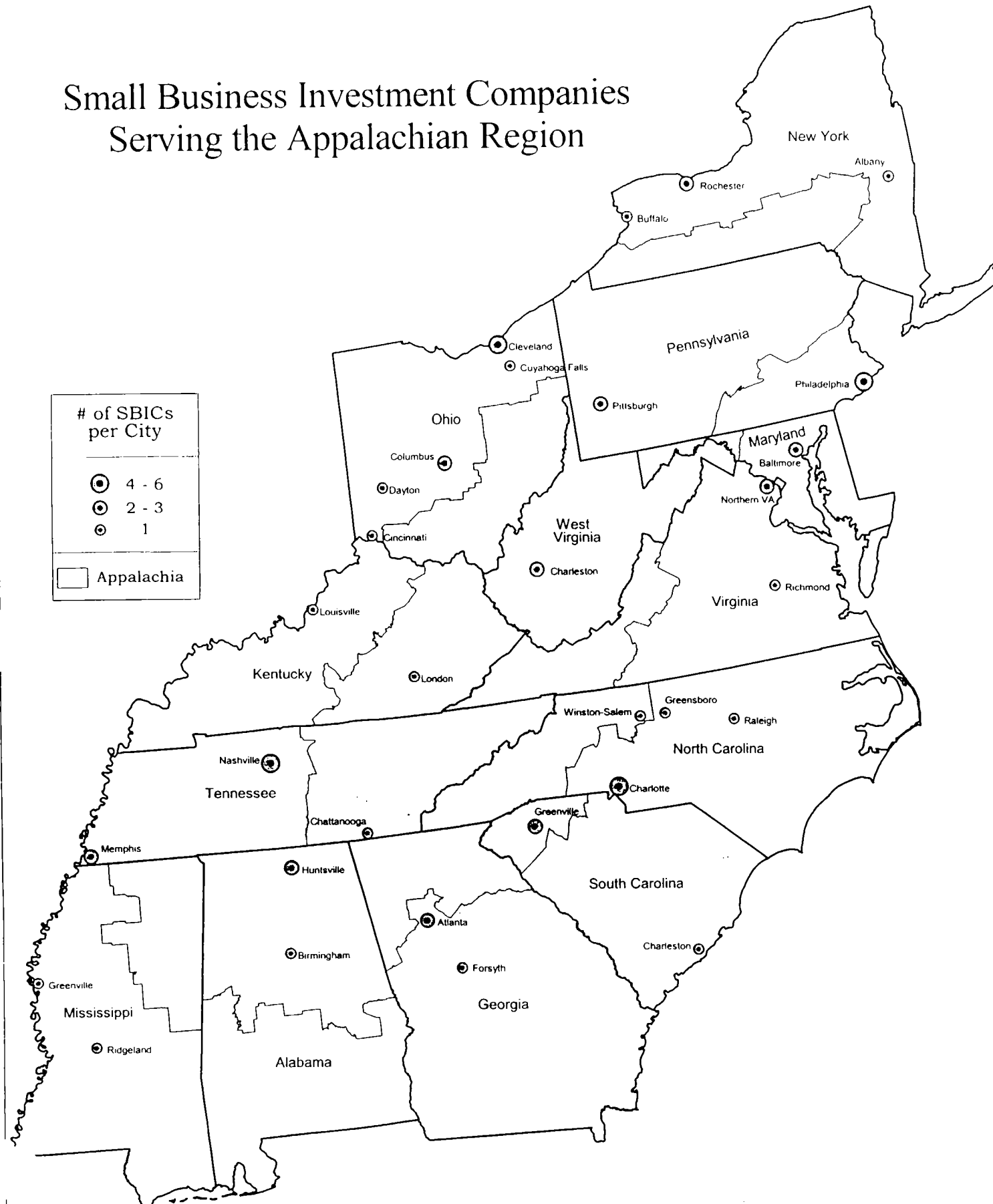
In other cases, new entities would need to be created. Committee members believed that sub-regional funds focusing on one or more states would be more effective than a large 13-state fund. This approach would allow local funds to select the structure (Small Business Investment Companies, community fund,

venture fund, etc.) that best suits local needs, and to leverage existing service providers networks to enhance deal flow.

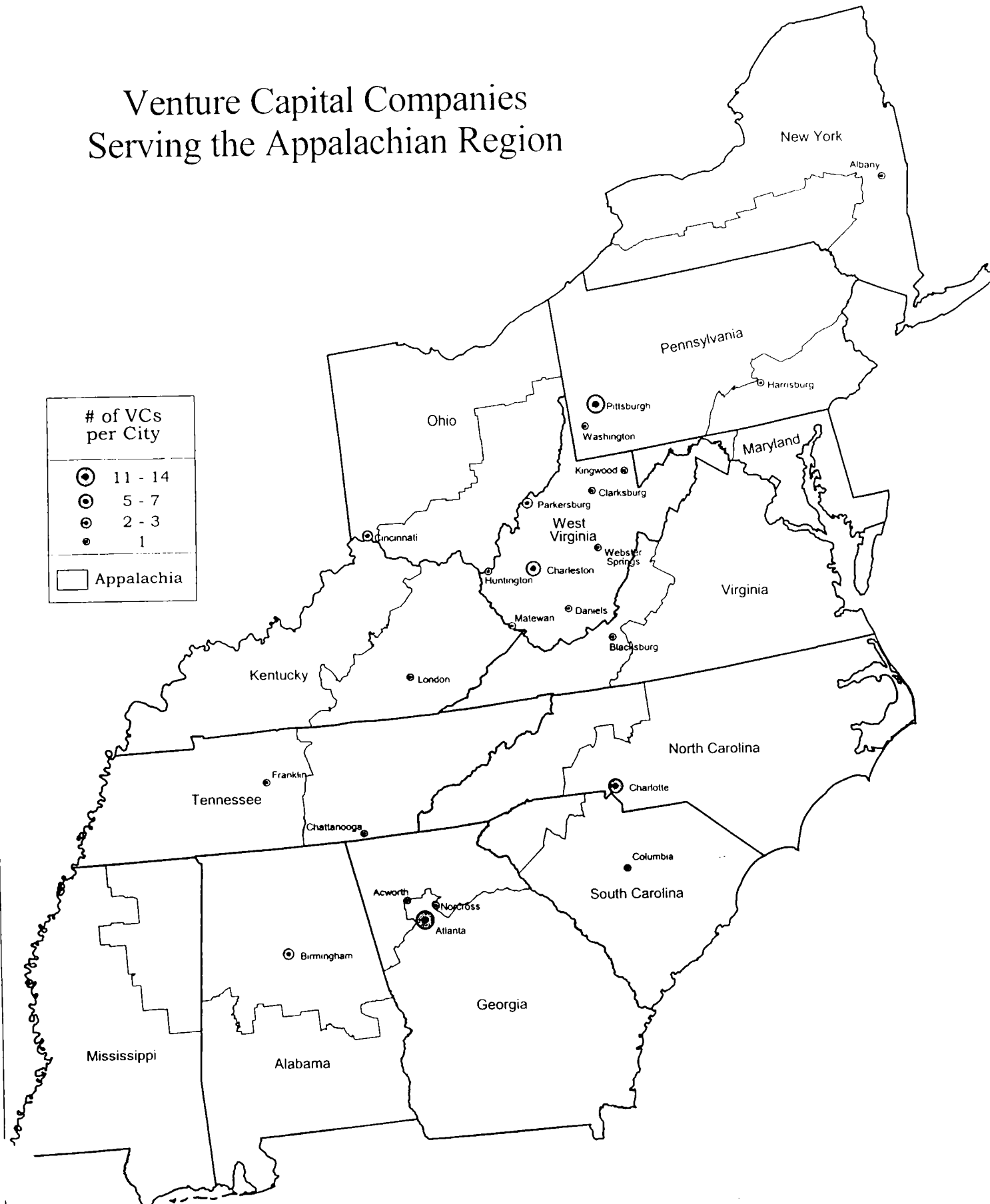
III. Capitalization – funds could be capitalized from a range of sources including investments from private financial institutions, foundations, and public sources. Recommendations to capitalize funds include:

1. Revise ARC's Revolving Loan Funds (RLFs) guidelines to allow transfers of capital from RLFs into approved community equity funds.
2. Identify regional investment opportunities relating to initiatives by the Federal Home Loan Bank system, and the Small Business Administration (particularly formation of more Small Business Investment Companies).
3. Convene a series of sub-regional Rural Equity Summits (2 to 4 venues), co-sponsored with the above partners, to include participation of the hosting Governors and the White House, with interested fund managers invited to attend. The objectives would be:
 - educating private investors about these new community development opportunities (which meet new CRA guidelines);
 - matchmaking public and private investors; and
 - hosting of a high-profile in-Region event focused on solutions.
4. Work with foundations to find investors for capitalizing sub-regional funds.
5. Work with state banker associations to examine these new development strategies and find investors to capitalize sub-regional funds

Small Business Investment Companies Serving the Appalachian Region



Venture Capital Companies Serving the Appalachian Region



Data Sources:
U.S. Small Business Administration and Mt. Auburn Associates.



NEWS RELEASE

PRESS OFFICE

Release Date: January 15, 1999
Release Number: 99-04

Contact: Mike Stamler (202) 205-6740
Internet Address: www.sba.gov/news/

PRESIDENT CLINTON, SBA OFFER NEW MARKETS INVESTMENT INITIATIVES TO FUEL BUSINESS AND JOB CREATION IN RURAL, INNER CITY AREAS

NEW YORK – President Clinton and U.S. Small Business Administration (SBA) Administrator Aida Alvarez today announced a sweeping new public/private partnership to provide tax credits, investment capital and credit, and technical assistance to stimulate business formation and job creation in economically distressed rural and inner city areas.

The New Markets Initiative could lead to investment of as much as \$15 billion in the nation's most economically distressed rural areas and inner cities.

"We have to do more to invest in our own people to give them the tools they need to succeed and to widen the circle of opportunity," the President said.

"Concentrations of poverty and joblessness continue to have a devastating effect on the social and economic fabric of communities across the country, and it is holding America back," the President said. "This lack of opportunity is at the heart of our deepest social divisions. The New Markets Initiative will direct billions of dollars of private and public investment capital and credit into these communities, and go a long way toward opening the doors of opportunity to all Americans."

SBA Administrator Alvarez noted: "It couldn't be more fitting that we are meeting on Martin Luther King's birthday – at the center of economic power in this country – to talk about opening the doors of economic opportunity, to tap into New Markets. Dr. King's words and actions remind us that when we limit economic opportunities for some Americans, we limit the possibilities for all Americans."

The comprehensive program announced today by the President includes participation by the SBA and the Departments of Treasury and Housing and Urban Development, as well as numerous private sector investment and banking professionals and private sector corporate sponsors.

The President and Administrator Alvarez announced the programs today at the Wall Street Project Conference sponsored by the Rev. Jesse Jackson.

The New Markets Initiative is designed to take advantage of attractive business opportunities in underserved rural and inner city communities that are not currently being met. The key elements include: tax credits and loan guarantee incentives, a network of private investment institutions to funnel credit, equity and technical assistance into businesses in America's New Markets, and technical assistance and mentoring programs to help targeted small businesses use new investments to finance growth. The New Markets Initiative includes:

- **New Markets Tax Credits** – To help spur \$6 billion in new equity capital for investment in America's New Markets, President Clinton has proposed a tax credit worth up to 25 percent for investments in a wide range of vehicles serving these communities, including community development banks, venture funds and corporations, the new investment company programs listed below, and other targeted investment funds.
- **New Markets Venture Capital Companies (NMVCs)** – NMVCs will be venture capital companies that provide a combination of equity venture capital financing and technical assistance to smaller businesses located in low- and moderate-income (LMI) areas. SBA is proposing a pilot program to create between 10 and 20 NMVCs.

LMI areas are census tracts where at least 20 percent of the population is beneath the poverty level, or where median family income is less than 80 percent of median family income for the surrounding area. SBA also intends to include other areas in which economic development is lagging, including HUBZones, Enterprise Communities, Empowerment Zones and counties with persistent poverty.

NMVCs will provide government-guaranteed long-term funding, combined with technical assistance grants, to private for-profit community-based venture capital companies that will target their efforts in these rural and inner city areas. NMVCs must raise at least \$5 million in investment capital, which SBA will match up to \$10 million for any single NMVC. The interest on the government funding will be deferred for the first five years. NMVCs must also obtain commitments to provide at least \$1.5 million in technical assistance funding over five years. SBA will provide technical assistance grants amounting to 30 percent of the private capital amount.

SBA anticipates that the program will involve \$100 million in SBA-backed funding and \$30 million in technical assistance grants. Establishing the program will require enabling legislation.

- **LMI Investments and Outreach Workshops** – SBA has organized a series of six workshops designed to recruit potential SBIC investors and management teams with experience in investing in small businesses in LMI areas. Beginning in late March, workshops are scheduled for Chicago, Kansas City, New York, Atlanta, Dallas and San Francisco.

These workshops will result in the creation of new SBIC licensees, new interest in rural and inner city investing, and a database of investment and community development professionals that will be available to work with SBA on this effort.

SBA also will create a new funding mechanism to provide financial incentives to encourage SBICs and Specialized SBICs to invest in LMI areas. The funding will be provided to licensees in amounts that match the level of their investments in small businesses that: 1) are located in LMI areas, or 2) hire at least 35 percent of their workforce from among residents of LMI areas.

- **America's Private Investment Companies (APICs)** – APICs, modeled on the Overseas Private Investment Corporation, will provide equity capital for the creation or relocation of large-scale businesses in inner cities and rural areas. It will fund large, investment partnerships formed by private investors for this purpose. It will be a Department of Housing and Urban Development (HUD) program administered jointly by HUD and SBA to combine SBA's venture investment expertise with HUD's expertise in large scale urban revitalization.

APICs will be organized as conventional, for-profit private venture capital funds with a minimum private capitalization of \$100 million. APICs will be eligible for twice that amount in government guaranties. APIC investments will be required to be in low- and moderate-income areas and require prior government approval for each investment transaction.

HUD and SBA anticipate that the program will involve \$1 billion of government-backed funding. Establishing the program will require enabling legislation.

- **BusinessLINC Initiative** – The BusinessLINC Initiative is a new partnership between the federal government and America's business community to encourage large businesses to work with small business owners and entrepreneurs, especially in America's rural areas and inner cities.

BusinessLINC, which stands for Learning, Information, Networking, and Collaboration, is designed to stimulate business-to-business relationships that will produce one-on-one technical advice and consulting, classroom and group training, peer group consulting, strategic alliances, and supplier and marketing development for small businesses.

- **New Markets Lending Companies (NMLCs)** – Under this pilot, SBA will select approximately 10 non-depository lending institutions to make SBA-guaranteed loans targeted to New Market small businesses. The proposed NMLC program is a limited term, limited participation pilot that will last between five and 10 years.

NMLCs will make SBA-guaranteed loans under the 7(a) General Business Loan Guaranty program, the agency's largest financial assistance program. Under the 7(a) program, SBA guarantees up to 80 percent of a loan that is made by a commercial lender to a creditworthy small business that cannot otherwise secure financing on reasonable terms.

Funding for loan guaranties made under the NMLC initiative will come from the SBA's appropriation for 7(a) program loans, which is funded at a level of \$10 billion for the current fiscal year.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

C

Divider Title: _____

COMMUNITY DEVELOPMENT VENTURE CAPITAL FUND INVESTORS

These corporations have invested in community development venture capital funds.

- | | |
|--|--|
| 1 ABC, Inc. | 43 Loews Corporation |
| 2 American State Bank | 44 Magellan Health Services, Inc. |
| 3 Androscoggin Savings Bank | 45 Merchants & Farmers Bank |
| 4 AT&T Corp. | 46 Merrill Lynch L.P. Holdings Inc. |
| 5 Bank of New York Co., Inc. (The) | 47 Metropolitan Life Insurance Company |
| 6 Bank of Yazoo City | 48 Morgan Stanley & Dean Witter & Co. |
| 7 BankBoston | 49 Nations Bank |
| 8 Bankers Trust Company | 50 NCB Development Corporation |
| 9 Bath Savings Institution | 51 New York Life Insurance Company |
| 10 Bear Stearns Companies, Inc. (The) | 52 Ocean National Bank |
| 11 Bell Atlantic | 53 PaineWebber Group Inc. |
| 12 Blackstone Group, L.P. (The) | 54 Peoples Heritage Bank |
| 13 Boston Edison | 55 Pepperell Trust Company |
| 14 Boston Safe Deposit & Trust | 56 Pfizer Inc. |
| 15 Calvert Social Investment Fund | 57 Planters Bank & Trust Company |
| 16 CBS Corporation | 58 PNC Bank |
| 17 Central Bank – Monroe | 59 Primedia Inc. |
| 18 Chase Manhattan Corporation (The) | 60 Reader's Digest Association, Inc. (The) |
| 19 CIBC Oppenheimer | 61 Simmons First National Bank |
| 20 Citibank | 62 State Street Bank |
| 21 Concordia Bank & Trust Company | 63 Tiffany & Company |
| 22 Consolidated Edison Company of New York | 64 Time Warner Inc. |
| 23 Corestates Bank | 65 Travelers Group |
| 24 Credit Suisse/First Boston | 66 Trustmark National Bank |
| 25 Deloitte & Touche LLP | 67 Union Planters Bank of NW Mississippi |
| 26 Deposit Guaranty National Bank | 68 USTrust and United States Trust |
| 27 Dime Bancorp | |
| 28 Donaldson, Lufkin & Jenrette | |
| 29 Estee Lauder Companies Inc. | |
| 30 Farmers Bank & Trust Company | |
| 31 Fidelity Investments | |
| 32 First National Bank of Commerce | |
| 33 First National Bank of Phillips County | |
| 34 First Union | |
| 35 Fleet Bank, N.A. | |
| 36 General Electric Company | |
| 37 Goldman, Sachs & Co. | |
| 38 Hibernia National Bank | |
| 39 Independence Savings Bank | |
| 40 J.P. Morgan & Co. Inc. | |
| 41 Kennebunk Savings Bank | |
| 42 Key Bank of Maine | |

compiled by Julia Rubin, Harvard University

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

D

Divider Title: _____

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 6, 1998

MEMORANDUM FOR MICHAEL FROMAN

FROM: Michael S. Barr *MSB*
Clifton G. Kellogg *CK*

SUBJECT: Proposal for a National Monetary Fund

Based on written materials and phone conversations with the organizers of the National Monetary Fund (NMF), this memo summarizes our understanding of the NMF, its strengths and weaknesses, and some possible next steps for Treasury's involvement. NMF has not yet developed financial projections, an implementation plan, or a management structure.

On the whole, NMF appears to be a suitable and timely concept for a national financial fund that would take advantage of the increasing interest in community development finance and the favorable funding possibilities due to banks' recent profitability. At the same time, the lack of identified management is a critical weakness, and the lack of a defined business plan means that NMF's viability cannot yet be evaluated fairly. Finally, NMF's mission calls for the design of serious and credible business services (as NMF itself recognizes), an exercise not yet undertaken.

NMF's Mission

NMF would be a fund that banks (or other financial institutions, corporations, and foundations) would invest in, that itself would invest in other financial institutions, ranging from minority venture capital funds, to CDFIs, to other special purpose funds designed to benefit low- and moderate-income areas and individuals. This structure is familiar to the private sector venture capital industry, and is sometimes called a "fund of funds." In addition, NMF plans to offer business assistance services, as yet undefined, to further its economic development mission.

The community development finance field would benefit from a professionally managed and skilled national private sector institution with this mission, as it currently lacks any such national private sector player. From the government side, Treasury's CDFI Fund could serve as an important co-investor with the NMF; as currently structured the CDFI Fund could not itself receive private sector investments nor does it aspire to financial self-sustainability. The CDFI Fund, by investing in CDFIs, is already developing market information, in effect helping the private sector determine the most promising CDFIs for investment. The NMF could spur co-investment or matches. Private foundations such as Ford, MacArthur, and Mott operate nationally, and given the lack of other support institutions, their activities weakly position the foundations in this role. As an analog, in the field of low-income housing development, both the Local Initiatives Support Corporation (LISC) and the Enterprise Foundation provide technical advice and some fundraising assistance to their national network of local chapters.

What are the pros and cons of the NMF's national scale? The NMF's national scale would bring increasing attention to the opportunities in this field, would allow for cross-learning among investees, and would provide a large market area in which to find investments. However, the national scale would also stretch management and dilute the possibility of creating visible impact in any single market.

The prospect for finding NMF investors is enhanced by the financial industry's recent profitability, however investors would need to be persuaded (1) that NMF could marshal superior underwriting skills versus the bank/investor's own staff, (2) that the NMF "food chain" is not economically inefficient versus direct bank/investor processes, and (3) that the investors/banks would receive the same or greater public recognition and regulatory recognition for efforts undertaken through NMF as compared with direct investments.

NMF has not stated a total funding need. For comparison, a \$200 million national "fund of funds" that focuses exclusively on minority venture capital has recently closed on its funding. NMF would probably need to open with at least equivalent levels of funding.

Next Steps

Treasury would need to decide whether it should become involved in this effort. Secretary Rubin could call Representative Waters to give her his opinion of the effort, and offer to have staff provide informal advice as the idea progresses. We could also provide the NMF organizers with publicly available lists of CDFI and BEA winners, and CDFI certified institutions, in order to describe the Fund's distribution network.

We would think it inadvisable for the Secretary to in any way "endorse" the NMF or to encourage particular financial institutions to invest in it. The Secretary could, however, in other speeches that touch on the CDFI industry, cite the generic need for similar types of organizations that would serve as market intermediaries in the development finance industry.

We could also arrange an informal roundtable discussion with the NMF organizers, the CDFI Fund and others in the community development field to share experiences and the sense of ambition and vision that the NMF organizers laudably evince.

We could also invite the organizers who have mentoring experience or interest to participate in the regional Business Mentoring Initiative meetings that are planned for this summer. The design of the business services is an important gap in the NMF plan, and we expect some productive exchanges on this point.

01/04/98 MON 10:03 FAX 202 822 5672

Barry Comm Dev Policy

2004

MAR-24-98 TUE 10:28 AM HON. BENNIE G THOMPSON FAX NO. 202 225 5888

P. 02

THE NATIONAL MONETARY FUND

The National Monetary Fund

Table of Contents

- Mission Statement
- Purpose
- Objectives
- Business Strategies
- Monitoring requirements of loan and portfolio clients
- Potential Funding of the NMF
- Organization Structure
- Organizational and Operating Framework
- Benefits to Bank Capital Sources
- Preliminary Advisory Board
- National and Regional Headquarters
- Next Steps

THE NATIONAL MONETARY FUND

MISSION STATEMENT

- TO EXPAND ECONOMIC OPPORTUNITIES FOR SMALL BUSINESSES AND RESIDENTS OF LOW AND MODERATE-INCOME URBAN AND RURAL COMMUNITIES IN THE UNITED STATES. THE NMF WILL PROVIDE CAPITAL AND SERVICES ESSENTIAL TO ECONOMIC DEVELOPMENT IN TARGETED REGIONS.

01/04/98 MON 10:03 FAX 202 622 5672
MAR-24-98 TUE 10:28 AM HON. BENNIE G THOMPSON FAX NO. 202 225 5898
Barry Comm Dev Policy

THE NATIONAL MONETARY FUND

PURPOSE

- Economic development of undeserved urban centers and rural areas.
- Start-up and growth capital
- Management assistance
- Job creation
- Business and farm development
- Expand infrastructure of professionals providing capital and services.
- Support entrepreneurship and build competitive businesses enterprises within economic development objectives.

The National Monetary Fund

Objectives

- Develop new and innovative approaches to economic development
- Promote positive and visible role models of successful women and minority entrepreneurs
- Develop strategic business success models for small businesses
- Provide managerial and technical support for small businesses and minority and women-owned businesses

The National Monetary Fund

Monitoring requirements of loan and portfolio clients

- Mandatory periodic reporting
- Board, advisory board, or technical assistance team review
- Review of business plans
- CPA compiled, reviewed or audited financial statements
- Financial performance comparisons to industry standards.
- Contingent covenants to control poor performance.

01/04/99 MON 10:04 FAX 202 622 5672
MAR-24-98 TUE 10:29 AM HON. BENNIE G THOMPSON
MAR-09-98 10:26A FAX NO. 202 225 5898

Bar Comm Dev Policy

P. 07

0009