



State of Oklahoma

Incentive Evaluation Commission

Draft Oklahoma Capital Investment Board Evaluation

September 29, 2020

PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
43rd Floor
Philadelphia, PA 19103



Contents

Key Findings and Recommendations 3

Introduction 6

Background 8

Incentive Usage and Administration 11

Economic and Fiscal Impact 17

Incentive Benchmarking 19

Appendices 23



Key Findings and Recommendations



Overview

The Oklahoma Capital Investment Board (OCIB) was created in 1987 and authorized to function as an independent trust in 1991 by the Oklahoma Capital Formation Act. Its statutory mission is “to mobilize equity and near-equity capital for investment in such a manner that will result in significant potential to create jobs and diversify and stabilize the economy of the State of Oklahoma.” OCIB has used two programs to pursue its mission. The first is the Oklahoma Capital Access Program (OCAP), launched in 1992, which seeks to increase access to capital by partially securing loans made to small businesses in the State. The second is the Venture Investment Program (VIP), launched in 1993, which makes investments in venture capital funds that invest in Oklahoma businesses. In order to fund these programs, OCIB’s enabling legislation authorizes it to sell \$100 million in transferrable tax credits.

OCIB has been significantly constrained by the Legislature in recent years. In 2012, SB1159 directed the OCIB to not enter into any new or additional contracts, investments or loan guarantees. While OCIB is able to participate in existing investment pools and contracts, no otherwise new activity is taking place. Tax credits authorized for use by OCIB expired July 1, 2020 unless the credits were purchased or agreed to be purchased prior to 1996.

Recommendation: Retain and allow the program to sunset as scheduled.

Key Findings Related to Established Criteria for Evaluation

- **OCIB’s Venture Investment Program has made funding commitments to 19 venture capital funds, totaling \$69.5 million.** A total of \$65.9 million have been funded as of FY 2019 with \$2.0 million not expected to be drawn, leaving \$1.6 million in remaining commitments.
- **As of FY 2018, OCIB-supported funds invested a total of more than \$171.0 million into 38 Oklahoma-based companies.** With total OCIB support of \$65.9 million, \$2.59 was invested in Oklahoma-based companies for every dollar funded by OCIB, exceeding its statutory requirement of \$2.00.
- **Four venture funds receiving OCIB commitments totaling \$21.1 million did not invest in any Oklahoma-based firms.** These funds include three of the five funds receiving OCIB commitments of \$5.0 million or greater.
- **OCIB has sold \$39.2 million of tax credits to support its investments.** This includes a total of \$8.3 million since FY 2018. The program was intended to support itself through investment returns with tax credits available to sell if investment returns were insufficient. All proceeds from the sale of tax credits have been used to pay down long-term debt.
- **OCIB’s Oklahoma Capital Access Program (OCAP) has enrolled over 1,500 loans covering \$34.2 million.** OCIB collected about \$1.3 million in fees from lending institutions and contributed \$1.6 million in matching funds to its OCAP reserve account to help offset loan losses.
- **Overall claims paid by OCAP totaled 6.6 percent of total covered loans.** A total of \$2.3 million has been paid out of the reserve fund, leaving about \$0.6 million to pay future claims.
- **OCIB’s total cost to the State as of FY 2019 was \$39.2 million with potential additional costs estimated at \$6.2 million.** The program’s current cost to the state is equal to tax credits sold to date. Potential costs include its remaining liabilities, which may be paid through sale of additional tax credits in FY 2020 if investment returns are not sufficient.

Other Findings



- **All tax credits sold by OCIB were sold as part of agreements entered into prior to 1996, meaning state statute does not place a limit on their carryforward period.** In 2012, when the Legislature extended the expiration date of tax credits sold by OCIB from 2015 to 2020, an exception was included for credits purchased “pursuant to an agreement originally entered into no later than December 31, 1995.” According to OCIB, this exception applies to all credits sold under the program, which means there is no expiration date on credits that have been sold by OCIB.
- **The goals of OCIB are currently being carried forward by State programs that are better aligned with the principles of well-designed state venture capital programs.** The Seed Capital Fund, which the Incentive Evaluation Commission reviewed in 2019, follows several key principles missing in the design of OCIB’s venture program. It is targeted toward specific industries and a specific stage of startup development, intentionally fosters entrepreneurial ecosystems by providing guidance and networking opportunities directly to its invested companies, and provides pathways to startups for the next round of investment. It also invests directly in Oklahoma-based startups rather than investing in funds that do so. This ensures that State funds are only used to support Oklahoma startups. OCIB’s venture program has itself invested in the Seed Capital Fund. In fact, it ranks second among all funds OCIB has made commitments to in the number of Oklahoma-based firms it has invested in.



Introduction



Incentive Evaluation Commission Overview

In 2015, HB 2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. Between 2016 and 2019, the Commission conducted more than 40 evaluations.

The Oklahoma Capital Investment Board, first evaluated in 2016, is among nine programs scheduled for an updated review by the Commission in 2020. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the Legislature related to these incentives.

The following are key findings and recommendations from the 2016 evaluation of this program:

Fiscal and Economic Impact	\$3.4 million of tax credits were sold by OCIB in FY 2011, which was the only cost incurred in the study period (FY 2011 through FY 2015). The economic impact could not be calculated using available data.
Adequate Protections for Future Fiscal Impact?	Yes, the statute limits the program to total tax credits of \$100 million and use of no more than \$20 million per year – to date, \$31 million expended. The Legislature has also limited further OCIB investments and program activities in a way that limits future fiscal impact.
Effective Administration?	Yes, the program uses professional management and a ‘fund of funds’ approach that diversifies investments and risks. OCIB policies and procedures include industry standard approaches to conflict of interest, reporting and audits of investments and returns.
Achieving Its Goals?	As with many public sector venture capital programs, return on investment analysis is more complicated than for private sector investors, and weighing the benefits and opportunity costs does not yield a clear answer. Past concerns about risk have led the Legislature to constrain OCIB program activities.
Changes to Improve Future Evaluation	Should the program be retained, additional reporting on results related to Oklahoma firms (pre and post investment payroll, jobs, capital investment) and investments by sectors.

Criteria for Evaluation

The provisions of HB 2182 require that criteria specific to each incentive be used for the evaluation. A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In this case, the 1991 Capital Formation Act established that the program’s mission is “to mobilize equity and near-equity capital for investment in such a manner that will result in significant potential to create jobs and diversify and stabilize the economy of the State of Oklahoma.”

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Net change in jobs and payroll created in Oklahoma via the Board’s investments;
- Loan repayments as a percentage of total loans made;
- Loan repayment rates compared to industry/other state metrics;
- Dollars invested in Oklahoma businesses as a percent of principal guaranteed by the Board;
- Return on investment, measuring economic impact versus cost of the program.



Industry Background

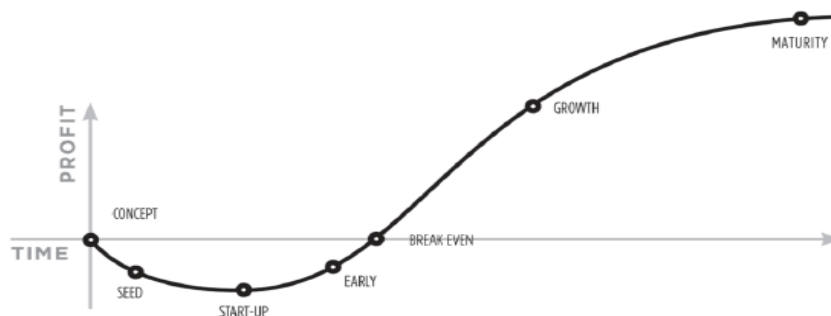


Background and History

Venture capital provides risk capital for high-growth startups. It provides access to capital for entrepreneurs that is necessary for developing and commercializing a product or service that can generally take five to eight years or longer to become profitable. Venture capital funds make long-term investments in startups and receive returns when a startup is acquired or goes public, often referred to as an “exit.”

Startup firms require inflows of capital throughout their lifecycle. Venture capital funding is particularly scarce for startup firms that are in the stage of development commonly referred to as the “valley of death” – the period between initial capital funding and when the startup begins generating revenue.

Figure 1: Startup Lifecycle



Source: Oklahoma Center for the Advancement of Science and Technology

OCIB's Venture Investment Program (VIP) is not targeted toward a specific stage of startup development. VIP invests in venture capital funds which subsequently invest in firms. Firms receiving investments from OCIB-supported funds have ranged from early stage startups to late stage expansions. While it is a best practice to target State venture capital based on the supply and demand of existing venture capital funding in the state, when VIP was created its wide net may have been justified because there was little to no existing venture capital investment in Oklahoma firms. In fact, from 1995 through 1999, just \$4.4 million in venture capital was disbursed in Oklahoma. OCIB reports that there were only three venture capital firms based in the State when OCIB was established in 1992.

Oklahoma, like many other states, has made efforts to improve the availability of venture capital funding for entrepreneurs and startups within its borders. Venture investment activity is seen as a leading indicator of economic growth and job creation.¹ Although most venture-backed companies fail, those that survive often grow rapidly. In 2012, venture-backed firms accounted for 11.0 percent of the nation's private sector workforce, and their revenue accounted for 21.0 percent of GDP.² A significant concern and motivation for many states to support venture capital programs is the risk of losing these high-growth startups to other states due to lack of available financing. This concern is substantiated by a review of venture capital funding disbursed by state across the country. More than half of all venture capital disbursed in the US was in California (55.2 percent), followed by New York (11.5 percent), and Massachusetts (10.2 percent).

Even with the addition of VIP and other venture capital focused State programs, Oklahoma continues to lag behind the rest of the country and its surrounding states in the amount of venture capital it disburses. The

¹ U.S. Department of Treasury. “Information and Observations on State Venture Capital Programs” February 2013. Accessed electronically at <https://www.treasury.gov/resource-center/sb-programs/Documents/VC%20Report.pdf>

² Brookings Institution. “As the Venture Capital Game Gets Bigger, the Midwest Keeps Missing Out” June 6, 2019. Accessed electronically at <https://www.brookings.edu/research/as-the-venture-capital-game-gets-bigger-the-midwest-keeps-missing-out/>



National Science Foundation maintains a database of venture capital disbursed by state and compares across states by measuring the amount disbursed per \$1 million of state GDP. Despite increasing its figure significantly since the 1990s, Oklahoma ranks last among its surrounding states and 86.7 percent lower than the national average for 2010 through 2018.

Table 1: Average Venture Capital Disbursed per \$1 million of State GDP³

	1995-1999	2000-2009	2010-2018
Oklahoma	\$11	\$174	\$228
Arkansas	\$38	\$64	\$343
Kansas	\$26	\$230	\$526
Louisiana	\$99	\$69	\$395
Missouri	\$725	\$472	\$931
New Mexico	\$237	\$909	\$700
Texas	\$581	\$1,819	\$1,445
Oklahoma Rank	7 of 7	5 of 7	7 of 7
US Average	\$399	\$1,214	\$1,712

Source: National Science Foundation

³ National Science Board. "Venture Capital Disbursed per \$1 Million of Gross Domestic Product." Accessed electronically at <https://nces.nsf.gov/indicators/states/indicator/venture-capital-per-1-million-state-gdp>



Incentive Usage and Administration



Incentive Characteristics

The Oklahoma Capital Investment Board (OCIB) was created in 1987 and authorized to function as an independent trust in 1991 by the Oklahoma Capital Formation Act. Its statutory mission is “to mobilize equity and near-equity capital for investment in such a manner that will result in significant potential to create jobs and diversify and stabilize the economy of the State of Oklahoma.” OCIB has used two programs to pursue its mission. The first is the Oklahoma Capital Access Program (OCAP), launched in 1992, which seeks to increase access to capital by partially securing loans made to small businesses in the State. The second is the Venture Investment Program (VIP), launched in 1993, which makes investments in venture capital funds which invest in Oklahoma businesses. In order to fund these programs, OCIB’s enabling legislation authorizes it to sell \$100 million in transferrable tax credits.

OCIB has been significantly constrained by the Legislature in recent years. In 2012, SB1159 directed the OCIB to not enter into any new or additional contracts, investments or loan guarantees. While OCIB is able to participate in existing investment pools and contracts, no otherwise new activity is taking place. Tax credits authorized for use by OCIB expired July 1, 2020 unless the credits were purchased or agreed to be purchased prior to 1996.

OCIB is required by statute to ensure \$2.00 is invested in Oklahoma businesses for every \$1.00 of principal it guarantees.

Administration of the Program

Venture Investment Program

The Venture Investment Program invests in venture capital funds, which then directly invest in companies. These investments are funded by a line of credit secured by the \$100 million in tax credits OCIB is authorized to sell. Statute provides guidance that investments are to be selected in a manner which will result in a significant potential to create jobs and diversify and stabilize the State’s economy. In pursuit of this goal, VIP invests in venture capital funds that present a plan for identifying and investing in Oklahoma companies. However, there is no statutory requirement that funds committed to venture capital funds be invested in Oklahoma-based companies.

Capital Access Program

The Capital Access Program (OCAP) was designed to encourage banks to provide loans to Oklahoma companies at a higher risk threshold than conventional lending criteria. Under the program, Oklahoma banks pay a premium to OCIB to enroll qualified loans in OCAP. The borrower and/or the bank remit 3 to 7 percent of the loan amount up front to OCIB. For a bank’s first \$3 million in loans enrolled in the program, OCIB provides a 150 percent match. Beyond a bank’s first \$3 million, OCIB’s match is 100 percent. This remittance and OCIB’s matching amount are used to establish a reserve account. If the bank incurs a loss on the loan, the cash in the reserve account may be paid to the bank to offset the loss.

Historic Use of the Program

Venture Investment Program

Over the life of the program, VIP has made \$69.5 million in commitments to 19 venture capital funds. As of the end of FY 2019, \$65.9 million of these commitments has been funded, leaving a total of \$3.6 million in unfunded commitments remaining. It is estimated that \$2.0 million of these commitments will not be drawn, leaving an expected \$1.6 million in unfunded commitments. Investment commitments range from \$1 million to \$7.5 million.



Venture funds that have received commitments from OCIB have invested in 38 different Oklahoma-based firms. Each of these 38 companies are listed on OCIB’s website along with the OCIB-supported funds that have made an investment in each. Many companies received investments from more than one OCIB-supported fund. The highest number of Oklahoma companies supported by one OCIB fund is 10 (Oklahoma Life Sciences Fund II, LLC). Meanwhile, 4 funds that have received OCIB commitments do not appear to have invested in any of the 38 companies. A summary of this information is provided in the following table by venture fund, sorted by the OBIC total funded investment commitment. Three of the funds among the five largest commitments provided from OCIB do not appear to have invested in any Oklahoma-based firms. A full listing of the 38 companies receiving investments from OCIB-supported venture funds can be seen in Appendix B.

Table 2: OCIB-Supported Venture Funds and Oklahoma Investments

Entity	Funded OCIB Commitment	Number of Oklahoma Companies Invested In
Tullis-Dickerson Capital Focus III, LP	\$7,500,000	0
SSM Venture Partners III, LP	\$6,600,000	0
Oklahoma Equity Partners, LLC	\$6,023,137	6
Dolphin Communications Fund II, LP	\$6,000,000	0
Davis Tuttle Venture Partners, LP	\$5,000,000	1
Prolog Capital II, LP	\$4,979,467	1
Intersouth Partners III, LP	\$4,000,000	3
Richland Ventures, LP	\$3,680,000	2
Pacesetter Growth Fund, LP	\$3,500,000	1
Chisholm Private Capital Partners, LP	\$3,385,700	7
Rocky Mountain Mezzanine Fund II, LP	\$3,000,000	1
Mesa Oklahoma Growth Fund I, LP	\$2,745,000	4
Ventures Medical II, LP	\$2,000,000	1
Oklahoma Life Sciences Fund II, LLC	\$1,658,589	10
Blue Sage Capital, LP	\$1,527,055	1
Emergent Technologies Oklahoma, LP	\$1,380,435	6
Acorn Growth capital Fund III, LLC	\$1,000,000	0
Richland Ventures II, LP	\$974,040	2
Oklahoma Seed Capital Fund, LLC	\$922,000	7

Source: OCIB Financial Statements and Website (OCIB.org)

Tullis-Dickerson Capital Focus III, a fund listed on OCIB’s website as having an Oklahoma strategy, received the largest commitment from OCIB (at \$7.5 million) but does not appear on the program’s list of funds invested in Oklahoma-based firms. SSM Ventures received \$6.6 million from OCIB, but it also does not appear to have invested in any Oklahoma-based firms. A total of \$21.1 million has been committed by OCIB to funds that have not invested in Oklahoma-based firms.

One of the funds with the highest number of Oklahoma-based investments is the Oklahoma Seed Capital Fund. It is another State-sponsored program that has also been evaluated by the Incentive Evaluation Commission. Using an OCIB commitment, the Oklahoma Seed Capital Fund is listed as having invested in 7 Oklahoma-based firms.

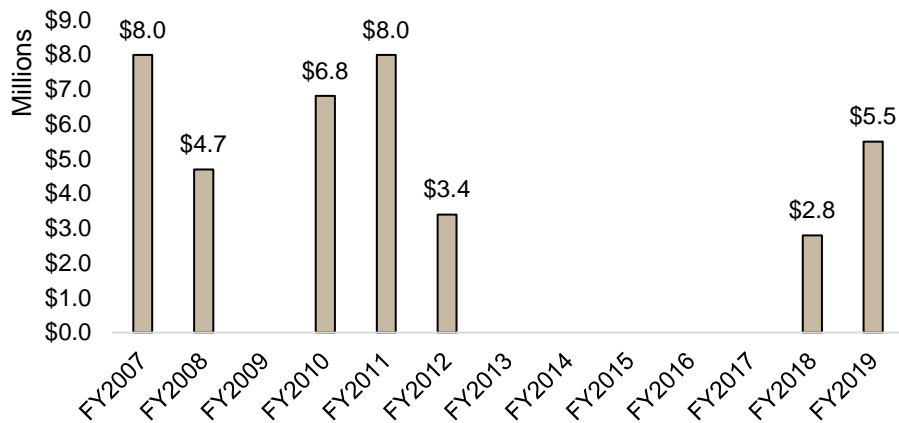
According to a 2015 economic impact study conducted by Applied Economics, a Phoenix-based firm hired by OCIB, Oklahoma firms receiving investments from OCIB-supported venture funds employed 758 people with a total payroll of \$15.5 million.



OCIB's venture investments are funded using a line of credit secured by \$100 million in tax credits that OCIB is authorized to sell. OCIB may sell tax credits at its discretion in order to pay debt but is limited to no more than \$20 million per year. Tax credits are sold at face value.

Ideally, distributions received from investments would be sufficient to pay down the program's long-term debt. However, if revenue generated by investments is not enough to meet debt requirements, OCIB may sell tax credits to pay down long-term debt. Over the life of the program, OCIB has sold \$39.2 million of tax credits. The following chart shows the amount sold by fiscal year over the life of the program. It should be noted that it is not clear when these credits were claimed. Data provided by the Oklahoma Tax Commission (OTC) for tax years 2013 through 2018 shows that OCIB credits were claimed on 3 returns in tax year 2013, 1 return in tax year 2016, 2 returns in tax year 2017, and 1 return in tax year 2018. The OTC is unable to disclose the amount claimed in those years due to the low number of returns.

Figure 2: Tax Credits Sold by OCIB



Source: OCIB Financial Statements

According to statute, tax credits authorized for use by OCIB expired on July 1, 2020 unless the credits were purchased or agreed to be purchased prior to 1996. According to OCIB, all credits sold by the program were pursuant to agreements entered into prior to 1996. As a result, there is no limit to the carryforward period for these credits.

Oklahoma Capital Access Program (OCAP)

Since the program began in 1992, more than 1,500 loans totaling \$48.7 million have been enrolled in the program. Of that total loan amount, \$34.2 million was covered by OCIB. OCIB has received \$1.3 million in fees from lending institutions, representing 3.8 percent of the total covered loan amount. Matching funds provided by OCIB totaled \$1.6 million, or 4.6 percent of the covered loan amount. These figures show matching funds provided by OCIB equal 121 percent of fees paid by lending institutions. The fees provided by lending institutions and the matching fund provided by OCIB combine to create a \$2.9 million reserve account that may be used to offset loan losses.

As of June 30, 2019, a total of \$2.3 million has been paid out of the reserve fund to offset loan losses, leaving about \$0.6 million available to pay future claims. Total claims paid have exceeded fees collected from lending institutions by \$0.6 million. Overall loan losses (total claims paid) totaled 6.6 percent of total covered loans.

OCIB Financial Performance

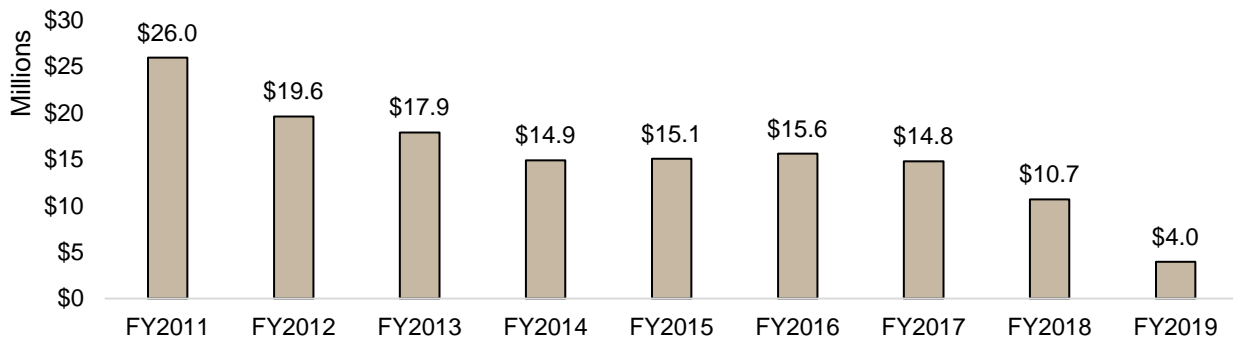


Through its Venture Investment Program, OCIB invests in venture funds which subsequently invest in portfolio companies, which are typically start-up entities. There are significant challenges in valuing the investments because the assets are not publicly traded and valuation of start-up firms is difficult due to lack of conventional performance or operating history. The investments are also illiquid. OCIB receives investment returns only when a venture fund’s portfolio company is acquired or goes public through an IPO. As a result, although OCIB’s investment interests are currently valued at \$9.9 million, it is difficult to predict when OCIB may be able to realize that value.

Distributions from investments have averaged about \$2.0 million per year over the last six years. All investment returns are used by OCIB in the year they are received to pay down long-term debt associated with its line of credit. While the program is designed to return any profits to the State, to date this has not happened.

Over the last three years, OCIB has paid down its long-term debt significantly, from \$14.8 million in FY 2017 to \$4.0 million in FY 2019. This was done with assistance from the sale of \$2.9 million of tax credits in FY 2018 and \$5.5 million of tax credits in FY 2019. This is the most significant decline in OCIB’s long-term debt since it last sold tax credits in FY 2012.

Figure 3: OCIB Long-Term Debt Payable



Source: OCIB Financial Statements

In 2005, the Oklahoma State Auditor conducted an audit of OCIB and attempted to calculate the potential financial risk to the State created by VIP and OCAP. The Auditor’s method was to combine the unfunded commitments pledged by OCIB to venture capital firms, the outstanding debt associated with OCIB’s line of credit secured by tax credits, and OCAP’s remaining reserve account. As of June 30, 2005, this amount totaled \$56.1 million. Using the same method as of June 30, 2019, the total financial risk to the State was \$6.2 million. However, in 2005, when the State’s audit was performed, OCIB had yet to sell any of its authorized tax credits. The amount of tax credits sold by the program can be added to this amount to calculate the total potential cost of the program as of FY 2019.

Table 3: Total Potential Cost of VIP and OCAP

	FY2019
Tax Credits Sold	\$39.2 million
Total Cost to the State as of June 30, 2019	\$39.2 million
Long-term Debt payable	\$4.0 million
Unfunded Investment Commitments	\$1.6 million
OCAP Reserve	\$0.6 million
Remaining Liabilities	\$6.2 million
Total Potential Cost	\$45.4 million

Source OCIB Financial Statements



OCIB has generated significant costs to the State through the sale of \$39.2 million in tax credits, but its potential for future costs appears to be limited. As explained previously, the program's long-term debt has declined significantly. Meanwhile its investment interests remain valuable. At the end of FY 2019, its remaining investment interests were valued at \$9.9 million. FY 2019 marks the only year since FY 2011 in which the value of the program's investment interests was greater than its long-term debt. Based on the program's remaining financial risks, the maximum amount of tax credits the program may need to sell to settle its obligations in FY 2020 would be about \$6.2 million, assuming no investment distributions were received.

Alternatively, if OCIB is able to realize the full estimated value of its investments, it would leave about \$3.7 million after its liabilities were cleared. According to statute, these remaining funds would be paid to the General Fund after OCIB's obligations are met. In that case, the program's total cost to the State would be reduced to \$35.5 million.



Economic and Fiscal Impact



Economic and Fiscal Impact

In order to evaluate the economic impacts of these investments, additional information is needed regarding the companies in which the funds have invested. Reporting by the funds on the Oklahoma companies should ideally include:

- The NAICS code of the company receiving the investment or loan
- The number of jobs and total payroll of jobs supported by the investment
- An evaluation of the company success or permanence (startup ventures have a high failure rate)
- Reporting on any spinoff companies resulting directly from the initial investment

Absent the data requirements above, a rigorous economic impact analysis of the OCIB program cannot be undertaken.



Incentive Benchmarking



Benchmarking

A detailed description of comparable state programs can be found in **Appendix A**.

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are ‘perfect peers’ – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.⁴ These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically begins with bordering states. This is generally the starting point, because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison. In this case, benchmarking is focused on four states with similar programs that were funded with state tax credits. These programs include the Arkansas Institutional Fund, Iowa’ Fund of Funds, the Venture Michigan Fund, and the Ohio Capital Fund.

Arkansas Institutional Fund

The Arkansas Institutional Fund (AIF) was granted \$60 million in tax credits to fund its investments, with a limit on tax credit sales of \$10 million per year. The AIF has not used any of its issued tax credits to date. However, as of January 1, 2016, AIF is not permitted to make any new investments. The Legislature restricted the fund because of poor investment returns. The AIF is still receiving distributions from its existing investments and using that revenue to pay down its debt. As of December 2019, AIF had about \$22.0 million in loans outstanding. If the AIF’s investment returns are not sufficient to repay debt, state tax credits may be sold.⁵

Iowa Fund of Funds

The Iowa Fund of Funds was granted \$60 million in tax credits to fund its investments, with a limit on tax credit sales of \$20 million per year. This program requires funds it invests in to make a commitment to invest in Iowa businesses. It also stipulates that 5 percent of its total funding be used for rural and small business investment.

In 2012, the Fund of Funds was restructured when it faced default on its \$40 million line of credit due to poor investment returns. As part of the restructuring, the Fund was restricted from making any new investments. The State was forced to sell \$25.6 million of tax credits to avoid default on the line of credit.⁶

Ohio Capital Fund

The Ohio Capital Fund is funded through the issuance of bonds supported by \$380 million of tax credits, with an annual sales limit of \$20 million. The program required that 75 percent of fund money be invested in Ohio-based venture capital funds. In 2017, the fund was forced to use its allotted tax credits for the first time and warned the State of the possibility credits would be needed in future years. A total of \$22.3 million in credits have been used between 2017 and 2019.

Venture Michigan Fund

⁴ The primary instances of exactly alike state incentive programs occur when states choose to ‘piggyback’ onto federal programs.

⁵ <https://www.arkleg.state.ar.us/Calendars/Attachment?committee=470&agenda=3406&file=Exhibit++Arkansas+Institutional+Fund+Annual+Report+2019.pdf>

⁶ <https://www.legis.iowa.gov/docs/publications/DF/855914.pdf>



The Venture Michigan Fund (VMF) was established in 2003 and has been authorized to use \$450 million in tax credits to secure loans in order to finance its investments. VMF was required to invest in funds with a significant presence in Michigan and ensure that the funds would invest in Michigan start-ups an amount equal or greater than the investment provided by VMF.

A 2018 audit of the program found it failed to meet its investment goals. Most funds did not invest equal or greater amounts in Michigan start-ups. One invested fund was found to have no investments in Michigan. The program has created significant costs to the State. The program's first round of funding was a \$200 million loan which the State was forced to repay with \$171.1 million in tax credits. The second round of funding – a \$250 million loan – is scheduled to begin repayment in FY 2020 and is projected to cost the State \$237.6 million in tax credits.⁷

Best Practices

In 2013, the US Treasury Department released a report reviewing venture capital programs across the country. The report included several principles of well-designed state venture capital programs. These principles include:

- Understand the supply of and demand for venture capital;
- Focus on capacity building with an ecosystem approach;
- Create pathways to the next investment round;
- Plan for the long-term and manage expectations;
- Proactively address the potential for conflicts of interest and political influence;
- Attract the most capable leaders to manage resources;
- Measure results accurately with defensible logic;
- Align state economic development interests with the financial interests of fund managers and limited partner VC fund investors.

The following is a review of the design of OCIB's VIP program relative to several of these principles.

Understand the supply of and demand for venture capital

The Treasury report suggests using an understanding of the availability of venture capital in the state at all stages of the startup lifecycle in order to target a program toward a segment of venture capital funding that is most likely to induce greater private sector investment. Many state programs have exclusively targeted seed or early-stage startups, for example, in order to fill a gap in existing private investment. OCIB's VIP program is not targeted toward a specific segment of the startup lifecycle and OCIB-supported venture funds have invested in firms in all lifecycle stages. When the program was created in 1992, there was very little venture capital presence in the State. At that time there may have been an argument for casting a wide net in order to develop an industry in the State. However, this broad approach is no longer a recommended practice for state venture capital programs.

Focus on capacity building with an ecosystem approach

This principle is further described in the report as having an emphasis on building long-term entrepreneurial capacity and a sustained venture capital presence in the State. While the venture capital capacity in the state has increased since the creation of VIP, the program does not explicitly focus on supporting an entrepreneurial ecosystem in the State. In fact, more than half of the venture funds that received commitments from OCIB had no offices in Oklahoma. Three of the out-of-state funds VIP made commitments

⁷ <https://audgen.michigan.gov/wp-content/uploads/2018/04/r000043516-9944.pdf>



to claimed to have an Oklahoma strategy. However, one of these funds, Tullis-Dickerson Capital Focus III, does not appear to have invested in any Oklahoma firms.

Create pathways to the next investment round

As a fund-of-funds, the VIP program is indirectly involved with the Oklahoma-based companies benefitting from its funding. While the VIP program thoroughly evaluated the quality of the funds and encourages them to spend time working with Oklahoma entrepreneurs, it is unclear if the VIP program performs any actions to ensure companies have pathways to additional funding.

Proactively address the potential for conflicts of interest and political influence

The program meets this design principle. OCIB has a clearly defined conflict of interest policy outlined in statute. The policy requires the removal of any board member in violation of the policy and the cancelation of any contracts related to the violation.

Measure results accurately with defensible logic

This principle is difficult to carry out as the venture capital industry has few recognized standards for measuring results. As discussed earlier in the report, it is also difficult generally to value venture capital investments. However, OCIB has a clear mission to mobilize equity and near-equity investment capital in a manner that will encourage job creation and help stabilize the economy of the State of Oklahoma. OCIB regularly reports the amount of funding it has provided to venture capital funds and the total amount invested in Oklahoma-based firms in its annual reports. However, OCIB's annual reporting generally lacks metrics on job creation and average wages at firms receiving investment. It also does not clearly report on the sectors the investments support which may help to support the program's goal of stabilizing the State economy, assuming this would be done through diversification of the State economy. Ideally, reporting would also compare benefits to the costs incurred by the State, including tax credits sold. The State of Michigan requires its Venture Michigan Fund to not only report the tax credits sold to date on an annual basis but also an estimate of the potential use of tax vouchers over the next five years.



Appendices



Appendix A: Comparable State Programs

Program	Total Credit Allotment	Per Year Tax Credit Limit	Investment Requirement
Oklahoma Capital Investment Board	\$100 million	\$20 million	Two dollars invested in Oklahoma businesses for every dollar of principal guaranteed
Arkansas Institutional Fund	\$60 million	\$10 million	No specific requirement, just the goal of promoting economic development in the state
Iowa Fund of Funds	\$60 million	\$20 million	Funds must make a commitment to invest in Iowa businesses. 5 percent of tax credits to be used for rural and small business investment
Venture Michigan Fund	\$450 million	Not specified	Two dollars invested in seed or early stage businesses in the state for every dollar of principal guaranteed
Ohio Capital Fund	\$380 million	\$20 million	At least 75 percent of program fund money must be invested in Ohio-based venture capital funds



Appendix B: Oklahoma-Based Companies Receiving Venture Funding from OCIB-Supported Funds

Company	Location	Company	Location
R360	El Reno	InfoGlide Corporation	Tulsa
AEMT	Tulsa	InnovAlarm	Oklahoma City
AliveCor	Oklahoma City	Inovar Packaging, Inc.	Tulsa
Alkami	Oklahoma City	Inoveon	Oklahoma City
Altheus	Oklahoma City	Life Guard America	Tulsa
Amber Waves	Tulsa	Lifetone	Oklahoma City
Caisson Biotech (a subsidiary of Heparinex)	Oklahoma City	MedSynergy	Oklahoma City
Cansano Healthcare	Oklahoma City	MelanX Corporation	Oklahoma City
Care ATC	Tulsa	NetCom Solutions	Oklahoma City
Choncept	Oklahoma City	Otologic Pharmaceuticals	Oklahoma City
Credit Point	Oklahoma City	Precision Healthcare Group	Oklahoma City
Dominion Management	Edmond	Premier Parks	Oklahoma City
eMotion Media	Oklahoma City	Pure Protein	Oklahoma City
Excel Energy	Tulsa	Selexys	Oklahoma City
Exerbotics	Oklahoma City	StadiaNet Sports, Inc.	Tulsa
Global Dispatch Tech	Oklahoma City	Tetherex	Oklahoma City
Heparinex	Oklahoma City	The Rock Island Group	Oklahoma City
Hyalose	Oklahoma City	Torch Health Care	Lawton
Infinitec Communications, Inc.	Tulsa	Webcast.com (iBeam)	Edmond