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Connecticut Innovations

TESTIMONY OF CONNECTICUT INNOVATIONS, INC. REGARDING S.B. 1059 AN ACT IMPLEMENTING THE RECOMMENDATIONS OF THE COMMISSION ON ENHANCING AGENCY OUTCOMES

Good Morning Senator Slossberg, Representative Morin and members of the GAE Committee. I am Peter Longo, President and Executive Director of Connecticut Innovations (CI). For those committee members unfamiliar with CI, let me take a moment to explain the role CI plays in the state's economic development efforts. CI is a quasi-public authority created by the legislature in 1989. We act as the venture capital arm of the state investing in and growing the state's technology sector. Through our four main investment funds we have invested $142.9 million in 104 start-up technology companies. Since 1995 our investment activity has attracted over $2 billion in private capital to the state and created on average 1610 jobs per year. Our investment portfolio today consists of 52 technology companies at various stages of development.

CI has reviewed S.B. 1059 which reflects the work of the Commission on Enhancing Agency Outcomes. We applaud the efforts of this committee to identify potential cost savings, operating efficiencies and service improvements in state government. We do not agree, however, that the best way to achieve these efficiencies, savings and improvements is simply to merge all of the state economic development agencies into a single legal entity. CI, because of its unique mission, should remain a separate quasi-public authority and should not be included in the new Connecticut Economic Development Authority created beginning in Section 24 of the bill.

My written testimony outlines the complex legal and operational challenges that will result from trying to merge a state agency, the Department of Economic and Community Development, with three very distinct quasi-public authorities, each with its own important mission. I would like to focus my comments today on describing the value Connecticut Innovations brings to the state of Connecticut so that you may better understand our opposition to being included in any merger proposal.

CI is a successful model of how to use private sector practices to accomplish public sector goals. We work directly with entrepreneurs and venture capitalists to grow the state's technology sector. For the most part, our clients don't rely on the state's other economic development entities for financial assistance. Entrepreneurs need risk-capital and CI is the only economic development entity in Connecticut offering it.

Since 1995, CI's model of making risk capital investments in emerging technology companies has provided a positive return on investment to the state of Connecticut. Since 1995:

- CI's investments grew Connecticut's jobs by an average of 1610 jobs per year (563 direct jobs and 1,046 indirect and induced jobs).
    - The majority of the direct jobs are high-value positions with good salaries and benefits.
    - CI's "cost per job" created regularly ranks among the lowest, compared to other state economic development initiatives.
- CI's record of return on invested capital regularly attracts private sector venture capitalists to CI's portfolio companies. This allows for the deployment of private capital in Connecticut that otherwise would not occur.
    - CI has co-invested with over 60 different private capital entities that have come to rely on our expertise and ability to be nimble, innovative and entrepreneurial like the companies we invest in.
    - Since 1995, CI's investment activities have resulted in over $2 billion in private capital being invested in Connecticut.
    - Merging CI into a larger economic development entity puts at risk these relationships with our co-investors. CI's operating independence is a key attribute in attracting and successfully working with private capital investors on behalf of its portfolio companies.

- CI's investment activity increased the State of Connecticut's gross domestic product by $3.6 billion cumulatively and by $258.5 million on average annually, from 1995 through 2008. During this time period, for every dollar CI invested:
    - Connecticut's personal income increased $14.30 ($155.3 million per year)
    - Connecticut realized $1.97 in net state revenue ($14.9 million annually)

- CI is recognized nationally as a leader in technology-based economic development (TBED).
    - In 2007 the State Science & Technology Institute awarded CI with the "Excellence in TBED Award" because of its positive impact on Connecticut's technology sector

I have included with my written testimony testimonials from entrepreneurs and investors validating the points I made here today. They recognize that CI is an important component of the state's economic development team but that it is also important that CI maintain its independence in order for it to achieve its core mission of growing jobs in the technology sector.

<u>Legal & Operational Challenges</u>

There are vast and significant legal and operational differences between DECD, which is a department of state government, and the quasi-public agencies identified in S.B. 1059. There are also significant differences in the programs, priorities and operations of

CI, the Connecticut Development Authority and the Connecticut Housing Finance Authority. As examples the business of CHFA, which provides single and multifamily residential mortgage programs, operates in an entirely different regulatory and business environment than CI, with public policy objectives that have few, if any, similarities to those pursued by CI. Even CI and CDA, which might superficially appear to be the most alike, are in fact not. CDA is principally involved in project finance, and most often acts as a facilitator (loan guarantor, subordinate loan participant, issuer of revenue or TIF bonds, etc.) inducing a project, and other lending or investment, that might not otherwise have occurred. CI, on the other hand, is focused on the development of technology-based businesses, and is typically investing its own funds at an early stage for a risk-based return. These are very different markets, with different players, expertise, customs and methods, and approaches to analysis and underwriting. CDA and CI financial assistance results in portfolios with very different asset types, cash flows, valuation methodologies and ongoing needs for management and administration. A substantial concern with consolidation would be the possible loss of separate focus and identity, both internally and externally, with the result that the combined organization would not be as responsive or effective as any of them are separately.

There are also important balance sheet differences among the quasi-public agencies, and much damage could be done by a consolidation that does not properly account for those differences. For example, the financing activities of CHFA connect directly to the capital markets and are dependent on the strong, and separate, bond credit ratings CHFA enjoys. CDA, by contrast, has general obligation bond outstanding backed by a pledge of CDA revenues and regularly funds loans and other forms of financial assistance with its own money and takes credit risk associated with those loans, loan guarantees, bank participations and the like. CI has no bonding authority and has a balance sheet principally reflecting at-risk equity investments in its portfolio companies. A consolidation of these very different quasi-public agencies and DECD, and with it the consolidation of these assets and liabilities, would create something of a monster, with highly complex, and in some cases undesirable or unworkable, results.

It is also important to recognize that each of the quasi-public agencies has a dedicated, volunteer board of directors that brings substantial private sector knowledge and experience to bear for the benefit of the state. In many cases the applicable enabling statute requires that particular expertise be represented on the board, and this experience of course varies depending on the business of the particular quasi-public agency. Such expertise ranges, for example, from necessary housing finance and fair housing expertise at CHFA, to private venture capital experience at CI, to project finance expertise at CDA. Much would be lost if a single board were expected to be an effective steward for all of the very different programs and activities of CHFA, CDA and CI. It would also be such a daunting and time-consuming task to manage such a range of different programs and activities that it might be unrealistic to expect that such a single board of directors, made up primarily of private sector volunteers, would have the time or ability to do so effectively.

- Testimonials from Entrepreneurs and Investors –

"A large portion of CI's success, in my opinion, stems from its ability to be mobile and not get bogged down in a bureaucratic process. As a venture capitalist, I can attest that the ability to be flexible and make quick decisions is often the difference between success and failure." - **Alan Mendelson, General Partner, Axiom Venture Advisors, Inc.**

"Invaluable to CiDRA was the fact that CI's staff is able to join company boards and mentor its companies and offer them guidance/help them achieve their goals. Too much red tape would slow the process/deter interest from VCs. CI's independence is a critical element of its success." - **Kevin Didden, President, CEO and Founder, CIDRA**

"Any restructuring of CI that negatively impacts its ability to maintain its independence, speed and flexibility of operations presents enormous risk to CT entrepreneurs and their critical role to launch successful new enterprises that will drive innovation and job growth in CT."- **Brian J. McCarter, CEO, Sustainable Real Estate Solutions, Inc.**

"As a private venture firm, we have found it difficult to work with integrated state financial entities, as they tend to incur bureaucratic policies which are not suitable for the pace of the private investment sector. It would be a shame and a massive setback for Connecticut to lose CI, both as an investment partner and as fellow board members in the early stage ecosystem."- **Konstantine A. Drakonakis, P.E., Director, LaunchCapital, LLC**

"Because of CI's support (and the conditions of their investment) emerging firms won't be wooed to NC, MA or CA. To consolidate CI into the state government would be to reduce their effectiveness and therefore the number of jobs created by startup companies in the state." - **Andrew I. Greenawalt, Founder & CEO, Continuity Control**

"As a startup technology company, we have to operate at lightning speed or we will most certainly fail. To do this, we need partners who not only have the experience and resources to support our mission, but also ones who are ready and able to work at our pace – and this is precisely what CI does for us." - **Dave Hurwitt, Vice President, Marketing and Business Development, Optiwind**

"As an independent, quasi-public investment organization, CI is able to act and respond as quickly as any private VC that I have worked with. Investors who are familiar with CI have no issue working with them and, in fact, appreciate their partnership in investing in early stage companies."- **Joseph Catino, President & CEO, Helix Therapeutics**

"Abandoning the value of CI as a highly important resource to our community of universities, companies, and entrepreneurs in the state, will lead to an erosion of the necessary critical mass of early stage funding, and reduce the attractiveness of our state for these companies."- **Rick Nowak, President, Environmental Energy Solutions (EES)**

"As a firm that has been co-investing with CI for over 6 years, we hope that CI maintains its independence as the State's quasi Venture Capital arm. It would be shame to lose the momentum and positive relationships that CI has developed over the years as a quality value-added investor in the State of Connecticut." - **Andrew M. Zaback, Managing Member, Longmeadow Capital Partners, LLC**

When we are investing alongside other venture firms like CI, given the early stages of our companies, it is critical that we are able to moving rapidly both in the initial investment phase and while helping to guide the young firms while on their board. Any delay in decision-making costs these firms real money and can make the difference between success or failure." - **Timothy Shannon, M.D., Venture Partner, Canaan Partners**