Program Specifications for the OCAST Technology Business Finance Program

I. Statutory Authority, Constraints, and Requirements

A. Statutory Authority

Section 5060.20a of Title 74, Oklahoma Statutes, authorizes the Oklahoma Center for the Advancement of Science and Technology (OCAST) to develop and implement a technology business financing program to assist qualified Oklahoma firms to commercialize new products and processes. The Oklahoma Legislature made an initial $1 million annual appropriation for this Program in FY99 and has annually provided the funding for the Program. The authorizing statute gives OCAST the responsibility for establishing program specifications, to be approved by OCAST's Board of Directors.

B. Statutory Constraints and Requirements.

1. Funding for this program cannot be used to make equity investments. By state law, only funds appropriated to OCAST's Seed Capital Revolving Account can be used to make equity investments. Funds for this program were not appropriated to that account; consequently, this program cannot make equity investments.
2. A non-state appropriated match is required.
3. The statute states that the program may require the payment of royalties, fees, interest or other revenues which result from the financing. This clause provides considerable flexibility to structure the program such that it would be possible to obtain a Return on Investment (ROI). Previous letters from the Office of the Oklahoma Attorney General also state that OCAST has authority to require a payback on funds it provides.
4. The legislation does *not* address the following essential program terms, which are left to OCAST to set out in its program specifications:
   - the stage(s) of permitted funding,
   - the amount of awards,
   - the amount or type of match,
   - the processes to select projects for funding,
   - the funding instruments to be used to award funds, and
   - the amount or form of payback from the firm for the program's investment.
5. The legislation gives OCAST authority to contract with any qualified entity, such as i2E, Inc., to operate this Program. The Contractor selected to operate this Program shall enter into an annual contract with OCAST which will specify the Contractor's duties, responsibilities, and budget for the fiscal year. The Contractor shall also provide a Plan, which may be

incorporated into an annual Business Plan, for the Program's operation, which shall be submitted for approval to OCAST's Board.

II. Problem/Need

A. Lack of "Pre-seed" Venture Capital

A 1996 study sponsored by the Oklahoma Department of Commerce found a shortage of "early stage risk capital (seed and start-up), particularly in moderate amounts ranging from $10,000 - $250,000" as the most pressing capital need in Oklahoma. *[Study of Oklahoma Capital Needs and Financial Assistance Programs, June, 1996, Stanley, Provus & Associates, under contract to the Oklahoma Department of Commerce, p. 7]* The final report of that study stated that "risk capital, including equity and near equity, was also identified as a critical need to support growth." *[Ibid, p. 7]* The study found an "overwhelming consensus" among businesses and capital providers that risk capital was in short supply in Oklahoma. One particular problem identified was lack of financing for intellectual-based firms due to lack of understanding of their industries by existing financial sources, because the principal assets of these firms are founded on intellectual property generated by talented individuals rather than on tangible assets as in traditional Oklahoma industries such as energy and agriculture. It is noteworthy that shortages of capital at this stage are found in most areas of the U.S., for what is generally termed "pre-seed" venture capital.

B. Definition of Pre-seed Venture Capital

"Pre-seed" venture capital represents early stage capital to finance the development, proof of concept, pre-feasibility business planning and demonstration of commercial feasibility activities in the life cycle of a firm. Prototype development may be considered under the "pre-seed" stage, depending on the industry involved and level of funding available. Related activities funded at the ***seed*** stage include complete business planning and detailed market analyses, and executive recruitment.

C. Definition of Pre-seed for the Purposes of This Program

"Pre-seed" financing shall be defined as ***financing which takes place during the period from idea conceptualization up to established steady market sales.*** This definition in effect includes both pre-seed and seed financing. This broader definition is necessary to insure firms funded at the "pre-seed" stage do not die at the "seed" stage for lack of follow-on capital from the private sector.

III. Program Purpose

The purpose of this Program is to help new technology firms start up and get to the next stage of investment by private sources by providing pre-seed funding in incremental stages.

This Program serves as a facilitating investment effort to move the product or process forward towards the market place while overcoming current financial gaps, which, if not addressed, could prematurely stop commercialization or significantly slow the time to market by the entrepreneur.

Through this Program, Oklahoma can provide initial funding for product and process development leading to commercialization or additional investment capital. Many creative firms and individuals generate ideas. While many have commercial potential, there is insufficient private sector interest and funds to undertake proof-of-concept or early product development. Unless means are found to bring the product or process to the point where it can attract major investors, strategic partners, or demonstrate the likelihood of commercial success, the concept may never become commercialized in Oklahoma. This Program is designed to bridge this funding gap.

This Program's funds are designed to provide the pre-seed financing for firms with prospects for high growth but little private sector investment raised to date. In most instances the program's investment will represent the "first look" at these enterprises by any outside investor. Consequently, part of the challenge is to utilize this program to position these firms to be ready for follow-up stages of financing.

IV. Program Goals and Objectives

A. Program Goal

The primary goal of this Program is to enable promising ideas and entrepreneurs to move forward in the commercialization process in Oklahoma by addressing the private sector capital market gap through provision of limited, publicly-supported pre-seed financing.

B. Program Objectives. The Program will endeavor to:

1. Increase the number of start-up, advanced technology firms in Oklahoma;
2. Improve the survival rate of these firms; and
3. Leverage other venture dollars (i.e., attract outside, private funds to deals).

V. Program Administration

A. **Program Integration.** It is OCAST's intention that the TBF Program will be organizationally linked to other activities performed by the Contractor's organization. In the Contractor's Business Plan, a description shall be included describing how TBFP activities will interface with other OCAST-funded activities, as well as other OCAST partner organizations.

B. **Budget and Financial Plan.** The Contractor may charge reasonable expenses for costs associated with operating this Program as negotiated with OCAST and specified in an annual contract executed with OCAST. The Contractor shall submit a detailed activity-based budget that shows how the State funds will be used as part of its annual Business Plan.

C. **Administration of Funds Repaid to the Program**. The Contractor and OCAST will work cooperatively, within administrative guidelines provided by the State and by the OCAST Administration and Finance Division, to determine how TBFP repayments will be collected, retained, used, returned, carried over, and reported to OCAST.

D. **Review Process.** The Contractor's Business Plan shall specify how the operation of the TBF Program handles clients from beginning intake to final disposition of the funding and repayment, if any. Included shall be a sequential process outline, as well as criteria that are used to make decisions at each stage of the process. Also included in the Plan shall be a description of the monitoring and evaluation system to be used to track investments, progress and performance and to report in accordance with the accountability measures required by OCAST.

E. **Other Administrative Matters**. Because the State's open meeting laws will require the Contractor to maintain public access, while at the same time protecting the confidentiality of proprietary data and technology of potential TBFP funding Recipients, the Contractor must establish procedures to comply with these requirements.

F. **Reporting**. The Contractor shall prepare and submit reports to OCAST at least quarterly including, but not limited to, information about the Program funding Recipients, the amounts and structure of the funding provided, the status of repayments, if any, and the amount of non-state money invested in the Recipient firms. Such reports may be included as part of the Contractor's general quarterly reports covering all OCAST-funded programs.

G. Measures of Success and Accountability. The Contractor shall also provide reports in a time and manner agreed to by the Contractor and OCAST, including:

1. Primary measures

Effective state-based technology development efforts should be designed for evaluation. While the immediate objective of the program is to get a company to a point where it is attractive to private investors and obtains additional private investment, the State's primary measures are:

- Number of start-up firms assisted;
- Survival rate of start-up firms assisted;
- Leveraging other private dollars, especially venture capital funds.

2. Secondary measures

The Contractor will be required no less than annually to provide OCAST information on the above measures, plus the following:

- Revenues/paybacks to OCAST (year-by-year and cumulative)
- Internal Rate of Return
- Return on Principal

3. Additional data

In addition, the Contractor will submit an economic impact analysis of the program. This analysis will measure such items as: jobs, annual average salaries of jobs created/retained, state and local tax revenues, etc. Such a study should also attempt to generate return on investment statistics for the program.

Other measures may be added as deemed necessary by OCAST or the Contractor, and may include statistics such as sales of firms assisted, tax revenues of firms assisted, new products and processes introduced into the marketplace, IPO value of firms assisted, etc. However, the primary three measures will be the key measures used to assess the impact of this Program.

H. Audits and Other Contractual Issues. Included in the Contractor's contract will be the following stipulations:

1. OCAST has the right to audit the Contractor and to examine its books and records, as well as those of any firm that receives TBFP funding.

2. OCAST has the right to contact, visit, or otherwise discuss any matters involving this Program with a firm that receives TBFP funding.

3. OCAST has the right to terminate its contract with the Contractor if performance is unsatisfactory or other circumstances require, according to the terms of the annual contract.

4. OCAST can require the Contractor to complete and submit an annual compliance audit by a certified, third-party independent accounting firm in accordance with accepted and established state standards.

VI. Program Specifications

A. Eligibility

1. **Eligible firms.** Eligible firms are those which meet the following standards:

a. Advanced technology

The Program is directed toward firms commercializing advanced technology. Advanced technology is defined as a proprietary state of the art product, process, material, design, and/or know-how. The definition guides which industries this Program will assist. These industries include, but are not limited, to:

- life sciences,
- information technologies,
- communications technologies,
- aerospace,
- electronics and related fields,
- materials,
- robotics,
- medical devices and instruments,
- telecommunications,
- agri-sciences, and
- energy.

Service and related firms developing a proprietary product or technology are eligible for further development of that product or technology.

b. High performance potential

Eligible firms must be technology-based and should be sufficiently innovative to provide a competitive advantage in the marketplace. The firm must have the potential for significant, high wage performance growth.

While the Contractor will have considerable discretion to determine the characteristics of the types of firms to which the Program provides funding, the general characteristics of such firms are:

- ***Firms with projected/potential high growth and high performance***.

  Such firms would exemplify, in comparison to other firms, potential for high sales per employee, value added per employee, wage levels 35-40% higher than average, and related measures of wealth generation for the Oklahoma economy.

- ***Firms with products/processes and target markets attractive to subsequent sources of capital.***

It is expected that this program will focus on getting a qualifying firm to a point where it is attractive to private investors and thus generates additional private investment. Consequently, firms selected for investment must have products, processes and target markets that will be attractive to subsequent sources of capital after receipt and expenditure of funds from this program.

c. Location in Oklahoma

Firms applying for assistance under this program must be located in, or have relocated to and have their primary domicile in Oklahoma, or have significant financial, employment, and/or operational ties within Oklahoma as determined by the Contractor and OCAST, prior to receipt of funds under this Program.

d. Size

Firms must be classified as small in accordance with the U.S. Small Business Administration (usually no more than 500 employees).

e. Stage of development

Firms should be primarily in the development stage defined as idea conceptualization up to, and prior to, established market sales at a steady stream state, and prior to full production. This, for the most part, suggests firms in the development, proof of concept, and prototype stages of their life cycle.

“Pre-Seed” venture capital represents early stage capital to finance the development, proof of concept, pre-feasibility business planning and demonstration of commercial feasibility activities in the life cycle of a firm. For purposes of this Program, prototype, complete business planning and detailed market analyses, and executive recruitment are also included as eligible activities.

2. Ineligible firms

Firms not eligible for funding under this Program include:

- retail services,
- oil and gas exploration and production,
- franchisees,
- real estate development, management and investment
- any technology or non-technology firms that do not have a proprietary product or service.

However, firms will not be disqualified by the fact that their customers are in such industries.

B. Size of Investments

With more than 100 firms funded through the TBF Program since the Program's inception in FY1999, the goal of portfolio diversification has been achieved. As the Program begins operation for FY2013, an operational goal is to give the Contractor as much flexibility as possible in developing the size and terms of the funding through TBFP. Therefore, funding amounts to be provided in the Program may vary widely from amounts as low as $25,000 to $50,000 – to as high as several hundred thousand dollars. It is the Contractor's responsibility to determine and document the amount needed to get the Recipient firm to the point of generating an income stream. At that development stage, the Recipient firm should achieve stability and be able to begin funding repayment.

C. Number of Funding Awards per Firm

A firm may receive more than one award, or a single award may contain provisions that allow for multiple tranches of the TBFP funding upon the firm achieving measurable or identifiable milestones, as specified in the TBFP Funding Agreement.

D. Matching Provisions

In general, firms must leverage $1 of cash, or cash equivalents as defined in the Contractor's Business Plan and/or in the TBFP Funding Agreement, for every $1 of financial assistance requested from this Program. However, the Contractor may, on a case-by-case basis, adjust this matching requirement to a lesser amount. Any such adjustment shall be documented by the Contractor, including factors and the rationale used to modify this matching requirement. Furthermore, any such adjustment will be noted in the TBFP Funding Agreement, which is subject to OCAST approval. The Contractor shall include a detailed description of how such reduced matching requirements will be analyzed in its Business Plan.

It is important that the award not be viewed as a "grant", with the Program funding the entire effort. Applicants must demonstrate a significant and ongoing personal commitment to the proposed venture through a cash match showing the applicant's willingness to place assets and investments in the firm and his/her personal resources into the venture.

In its application for funding, the firm must specify sources and amounts of cash match. The match must be documented in subsequent reporting.

E. Repayment Provisions

1. Minimum and maximum payments

Historically throughout the Program, the repayment made by any TBFP Recipient was two times the original investment, e.g., a $100,000 investment by the Program would require in total a return of $200,000. However, the Contractor may, on a case-by-case basis, adjust this repayment requirement to a lesser or greater amount. Any such adjustment will be documented by the Contractor, including factors and the rationale used to modify this requirement. Furthermore, any such adjustment will be noted in the TBFP Funding Agreement, which is subject to OCAST approval. The Contractor shall include a detailed description of how such reduced repayment requirements shall be analyzed in its Business Plan.

Awardees will have the option to prepay their obligations subject to certain conditions on a scaled basis over time, as specified in the TBFP Funding Agreement.

2. Initiation of repayment

Repayment would begin as required by the Contractor when one, or a combination, of the following events occurs:

- net sales
- royalty stream/licensee fees begin
- an infusion of capital, and/or
- when off-balance sheet financing or a development fee occurs.

3. Time limit for repayment

A clear statement of the dates and amounts of expected repayments shall be specified in the TBFP Funding Agreement. Factors influencing such a time table shall include the amount of the award, the nature of the business, the amount of time the firm has been in business, the risk factor for the use of the TBFP funding amount, the general business environment, and the business/industry sector, and other relevant issues, all of which shall be set out in the Contractor's Business Plan.

4. Other repayment "triggers"

Contractual provisions will ensure that there is an agreed-upon repayment amount, adjusted for present value, due, at the discretion of the program manager, upon the occurrence of any one of the following trigger events:

- Liquidation
- Bankruptcy
- Acquisition
- Fraud
- Out-of-state relocation
- Asset sale, or
- Death of a principal.

5. Contractor's discretion

The Contractor is allowed discretion to structure the repayment terms and provisions of each deal, including determining how much the royalty and license fees should be upfront and ongoing, since the terms and conditions may vary depending on the risk profile of the proposed transaction, including the amount of the Program's funding, the stage at which the funding was provided, the industry type, and the amount of further funding required to move the firm toward commercialization.