

# MEMORANDUM

12/7/2018

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**TO:** Oregon Business Development Commission  
**FROM:** John Saris, Finance Manager  
**SUBJ:** Transfer of funds from Oregon Business Development Fund to Oregon Royalty Fund

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Business Oregon's business finance staff and Oregon Business Development Commission's finance committee are requesting that the commission approve a \$5,000,000 fund transfer from the Oregon Business Development Fund (OBDF) to the Oregon Royalty Fund (ORF) to seed a new business finance program recently adopted by the Oregon legislature.

## **Background and Context for Oregon Royalty Fund**

It has been well documented that early-stage, high-growth companies—especially those operating in rural communities and/or that are minority-owned or women-owned—encounter funding barriers as they seek to grow and expand.

Typically as these companies are starting out, the owners will invest all available personal assets, will look to family and friends to raise additional capital, and then face a 'valley of death' when they need growth and working capital to demonstrate market demand and acceptance of their products in order to become bankable.

The funding gaps with these types of business ventures has been documented by the Oregon Capital Scan. Since 2012, the Oregon Capital Scan has been commissioned Business Oregon, Oregon State Treasury, Oregon Community Foundation, Meyer Memorial Trust, Ford Family Foundation, The Lemelson Foundation, NW Health Foundation, the Federal Reserve Bank of San Francisco, and others. It is a biennial study to gather empirical data on the availability of capital over the life cycle of a business.

The 2016 Oregon Capital Scan revealed that while there has been a strong improvement in the early stages of company formation, Oregon continues to lag—in both absolute amount and per capita amounts—relative to Washington and California in:

1. Attracting and establishing resident institutional venture funds, private equity, and mezzanine funds
2. Attracting capital to fund working capital expansion associated with inventory and production needs of emerging food and consumer product manufacturing

Additionally, since 2012, capital gaps identified in Oregon have been:

1. Seed stage capital
2. Growth capital for bootstrapped businesses
3. Clean technology
4. Life sciences
5. Growth and turnaround capital
6. Working capital for growth of small manufacturers
7. Micro-lending gap
8. Non-bank loan capital

All of these gaps continue to exist in varying degrees. Based on the findings in the 2016 current report, only the general seed stage capital gap looks to have significantly narrowed over the past four years, though regional imbalances still exist.

To improve the accessibility of working capital to boot-strapped businesses in the food manufacturing, consumer manufacturing, and consumer/business services industries, during the 2018 Legislative Session, the Senate Majority Leader, 24 Co-Sponsors and Business Oregon collaboratively introduced SB 1516. The bill created the Oregon Small Business Expansion Loan Program. To better market the program and improve the understanding of the capital support being provided, it has subsequently been rebranded as the Oregon Royalty Fund (ORF).

### **How will the Oregon Royalty Fund be administered?**

The ORF supports a very targeted financial niche for entrepreneurs. Qualified applicants will be traded-sector business that have a significantly different risk profile than those applying to Business Oregon's traditional direct loan program, the Oregon Business Development Fund.

The companies applying often have minimal history of sales, minimal business assets, have invested most—if not all—of their personal net worth into their business, may not be a good candidate for traditional equity investment, and would greatly benefit from a more a more flexible repayment plan than traditional payment of principle and interest.

Most applicants are looking for capital to support inventory to fulfill orders, working capital to support marketing and sales of their products, to begin floating accounts receivables, or to acquire essential equipment to scale manufacturing. The companies are trying to do this at a time when they lack historical sales, profitability, and assets meaning that these companies are not traditionally bankable.

Successful applicants will demonstrate very significant growth potential projecting 50-500% year-over-year growth with high gross profit margins. The products and services they manufacture will compete in domestic and global markets. Many companies will need a skilled workforce to support manufacturing, sales and operations. Accessibly to local capital will help encourage the retention of these companies in Oregon.

ORF program benefits include:

- Business owners are not required to dilute their ownership in their companies through equity raises.
- Demonstrate market demand and proof of concept helping firms raise future rounds of debt and equity necessary to continue their growth.
- Should the business seek future rounds of equity investment, the company will usually be able to obtain a higher valuation enhancing the potential financial benefit to the founders, and minimizing the dilution of their ownership.
- Demonstrated ability to raise equity and debt shortly after obtaining state funding.
- Repayment is based on company revenues (sales) and scale as the borrower becomes increasingly successful.
- Revenue financing may be less expensive than equity-based investments.
- Provides funding that is not otherwise available through traditional sources of debt (banks, credit unions, CDFIs) or from other public programs.

Based on the proposed initial capitalization, Business Oregon approves loans up to \$250,000. To date, Business Oregon has funded 10 loans totaling \$1,979,100 and has a pipeline of four projects totaling \$650,000. The current receivable balance is \$962,693. Three of the ten loans have repaid in full. It is anticipated that these loans will have a high-risk profile with default rates near 25%.

### **Recommendation:**

At this time, Business Oregon's finance staff and the Oregon Business Development Commission's Finance Committee recommend a \$5,000,000 transfer from OBDF to ORF to seed the program. The transfer is recommended to be structured as follows:

<b>Description</b>	<b>Amount</b>
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OBDF Receivable Balance (estimated)	\$950,000
OBDF Lottery Cash	<u>\$4,050,000</u>
<b>Total</b>	<b><u>\$5,000,000</u></b>

As of November 5, 2018, the status of the **OBDF** cash account was:

<b>Description</b>	<b>Amount</b>
OBDF Cash Balance (11/05/2018)	\$22,332,714
Less Proposed Transfer	(\$5,000,000)
Less Allowance for Loan Loss	(\$4,212,432)
Less Loan Commitments	(\$2,505,000)
Less Current Pipeline	(\$2,483,400)
<b>Projected Cash Available</b>	<b><u>\$8,131,882</u></b>

Business Oregon’s business finance staff estimate that the recommended \$5,000,000 transfer will provide adequate capital to continue operating ORF into the 2021-23 biennium. As demonstrated by the table above, while OBDF program demand is increasing, there remains adequate resources to meet current and projected demand.

**Action Required**

	<b>Amount</b>	<b>Approved?</b>
Transfer of Funds from OBDF to CAP	\$5,000,000	<input type="checkbox"/> Yes <input type="checkbox"/> No

Comments:

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Kanth Gopalpur, Chair  
Oregon Business Development Commission