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# MAINE SMALL BUSINESS DEVELOPMENT FINANCE

Final Report

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Counsel for Community Development, Inc. is a firm specializing in development finance and economic development in this country and overseas. Since its founding by Belden Hull Daniels in 1971 the firm has been active in urban and regional economic development activities at the federal, state, and local levels in North America, Europe, and Third World countries. In recent years the firm has been a leader in the design of strategies to promote small business enterprise, financing of local development organizations, innovations in the regulation of capital markets, and other public development finance activities.

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## 1.0 INTRODUCTION

State-sponsored economic development programs across the nation have traditionally directed tax and cost-of-capital incentives to large and out-of-state firms hoping to influence plant location and expansion decisions. States designed these policies under the assumption that large businesses were the source of net job creation and increases in tax revenue. However, recent studies underscore the critical economic development role played by new and expanding small- and medium-sized business.

There is growing recognition in Maine that a strong small business sector is critical to the long-term health and vitality of the Maine economy. Small businesses, in fact, dominate the economy of the state. With the increased understanding of the importance of small business comes a concern with the developmental constraints which many smaller enterprises face. In particular, a great deal of concern has been expressed that many local small businesses may not have access to appropriate financing to meet their needs.

Out of this concern with capital availability a number of public policy questions are raised: to what extent do businesses in the region have difficulty gaining access to capital because of their location, their size, or because of the type of goods and services they produce? If problems do exist, do they represent a failure of capital markets to operate efficiently, or are these problems the result of the efficient allocation of resources in a state with a weak economy and poor market potential? Finally, are the existing state mechanisms designed to make the capital allocation process successful in meeting the legitimate capital needs of small business in the state which are not being met by the private financial sector? This draft final report attempts to answer these basic policy questions.

The overriding purpose of this report is to identify more precisely the nature of the capital availability problem in Maine and to recommend changes in existing state programs as well as new initiatives which will improve the capital allocation process in the state.

The report is organized as follows:

- Chapter Two is an examination of the demand for capital in Maine by analyzing the state's economy by sub-state region, sector and scale of economic enterprise.

- Chapter Three is an examination of the supply of capital by the private financial sector.

- Chapter Four is an analysis of the purpose, structure, and operations of existing statewide institutions involved in capital allocation.

- Chapter Five is a presentation of our recommendations for policy changes in existing institutions as well as new initiatives.

- The Appendix is an inventory of all existing federal, state and local programs involved in small business development finance in Maine.

Before proceeding with our analysis of the capital availability problem specific to Maine it is important to review some of the general methodological problems inherent in such an analysis and some of the structural problems in the national capital markets which have restricted capital availability to smaller businesses.

## 1.1 Problems in Measuring Capital Availability

In order to assess whether local financial markets in Maine are failing to meet the needs of businesses because of firm size, location or sector rather than on the level of risk or returns, it would be necessary to:

- Measure the demand for funds by examining the financial conditions and needs of firms by size, location, and sector.
- Know precisely how bank funds are being allocated by firm size, location and sector.

To date, no comprehensive empirical study has been completed on a less than national level that documents capital availability by size, firm location and sectoral analysis. To understand the true nature of the availability of capital in the state would require methods that both quantify the demand for funds on the local level, and precisely measure the supply and allocation of capital by financial institutions. There are, however, serious limitations in accurately quantifying both demand and supply.

On the demand side, measuring a capital "gap" would require examining all users of capital to evaluate whether their businesses are able to support the cost of capital at the current market price. In other words, as Richard Coffman and Maxwell Fry, who studied capital availability in Alaska noted, "the issue is not demand by firms <u>willing</u> to pay market rates of interest, but demand by firms <u>able</u> to pay with the market rate."

Gathering the data necessary to accurately determine the supply and availability of credit from banks would entail having full access to the internal documents of Maine financial institutions as well as out-of-state institutions. Publicly available data does not tell us:

- what industries are represented in a loan portfolio,
- the size of the businesses represented in a loan portfolio,
- the terms of the financing,
- the location of the investments of local banks,
- the magnitude of investments in Maine firms by out-of-state banks.

Thus, the information that is available is not adequate for undertaking precise valuation of capital supply which included an analysis of in-state lending by both in-state and out-of-state institutions.

Methodological problems make it difficult to define precisely capital availability as it affects small business. But inability to quantify a problem does not mean that the problem does not exist, nor that it should be ignored. Indeed, the importance of small business to Maine's economy and the quality of life in the state requires that the issue of capital access be addressed.

## 1.2 Reflections of the Lack of Capital Availability for Small Business

Before looking specifically at the economy and private financial market in Maine, it is useful to summarize the findings of studies which have generally looked at the issue of capital availability for small enterprises. Studies of the operations of capital markets and of small business access to capital have led to some general conclusions that can be viewed as reflections of the problem of capital availability. These reflections are:

1. Viable, expanding small businesses are often unable to gain access to long-term debt and equity markets.

2. Because small businesses cannot find long-term debt and equity, they must substitute by using short-term, high-rate capital from local commercial banks.

3. Structural and institutional factors limit the extent to which these local commercial banks can adequately provide capital to small businesses.

External capital financing for a business can take the form of equity, long-term bond issues, commercial mortgages, direct borrowing from other corporations, and short-term credit. Small businesses are, however, limited in their ability to gain access to most sources of long-term debt and equity capital. As a result small businesses must depend on receivables financing by other corporations, bank financing or finance companies. Small businesses also have limited access to banks outside their immediate location. Recent data compiled by the California Office of Economic Policy, Planning and Research illustrates that although the rate of return for firms under $5 million in assets is higher than for larger firms, they are overly dependent on trade debt, short-term bank loans and retained earnings.

The lack of access to long-term debt and equity as sources of funds is first a reflection of the inability of small businesses to gain access to the public stock and bond market. The biggest obstacles to entering these markets lie in the high information and transaction costs of "going public." Because the cost of underwriting generally does not vary with the size of the offering and because capital needs are smaller, small firms are at a decided disadvantage if they seek to raise capital in this manner. The transaction cost is proportionately greater for the small firm than it is for a larger corporation.

The recent trend toward concentration of brokerage houses in the securities industry has intensified these problems. The dramatic reduction

Table 1.1

Sources of Funds for Manufacturing Expansion, 1977-1980* (size in $ millions)

| SOURCE / SIZE (in sales) | ALL | 5 | 5-10 | 10-25 | 25-50 | 50-100 | 100-250 | 250-1,000 | >1,000 |
|---|---|---|---|---|---|---|---|---|---|
| Total Growth ($ Millions) | 379,259.25 | 21,663.58 | 4,479.34 | 9,131.20 | 6,921.08 | 7,397.50 | 9,241.34 | 1,338.75 | 305,680.33 |
| Total Growth (Percent) | 40.7 | 27.7 | 20.7 | 26.9 | 24.7 | 22.0 | 14.2 | 10.8 | 59.6 |
| Retained Earnings % | 36.3 | 41.0 | 38.5 | 36.7 | 33.5 | 35.1 | 23.6 | 39.3 | 36.0 |
| Capital Stock % | 4.9 | -0.4 | 1.9 | -1.6 | 3.6 | 4.3 | -1.4 | -14.0 | 6.9 |
| Short-term Bank Loans % | 3.1 | 6.0 | 8.0 | 12.8 | 7.6 | 12.6 | 16.4 | 8.0 | 1.5 |
| Other S-t Loans % | 1.7 | 3.2 | 3.3 | 2.2 | 1.9 | 1.4 | 1.4 | -1.0 | 1.7 |
| Trade Debt % | 12.1 | 18.1 | 19.6 | 18.0 | 14.3 | 16.2 | 20.1 | 17.5 | 10.7 |
| Other S-t Liabilities % | 18.5 | -0.3 | 9.0 | 13.8 | 14.7 | 11.9 | 8.0 | 27.0 | 19.2 |
| Long-term Bank Loans % | 5.2 | 11.4 | 11.4 | 12.7 | 10.4 | 8.9 | 15.1 | 10.9 | 3.7 |
| Other L-t Debt % | 9.4 | 7.8 | 10.0 | 4.1 | 9.7 | 5.7 | 9.8 | 4.8 | 10.0 |
| Other L-t Liabilities % | 8.8 | -0.3 | -1.7 | 1.3 | 4.3 | 3.9 | 7.0 | 7.5 | 10.2 |
| Rate of Return on Equity % | 14.9 | 18.3 | 14.6 | 12.5 | 13.3 | 13.6 | 13.66 | 14.5 | 15.0 |

*Percentage figures represent the contribution of that source of capital as a percent of the increase in total assets.

SOURCE: State of California Office of Economic Policy, Planning and Research, Derived from Quarterly financial reports, Federal Trade Commission; taken from selected issues 1977-1980 in numbers of investment banking firms has occurred primarily among the "regional" or "specialty" houses which have historically been the principal underwriters of small firm capital needs. These smaller, local houses were the ones that made the small business transaction possible. In the research sector, the regional and specialty houses have also been the principal source of information on new potential investments. Without adequate information on a firm, no market can be made in the purchase and sale of its stocks or bonds.

Finally, as the principal buyers and sellers of publicly traded stocks and bonds have shifted from many individuals to a small number of large institutional investors, the volume of shares required to make a single profitable transaction has risen substantially. As a rule of thumb, most institutional investors cannot afford to trade in the stocks of firms with less than $200 million in sales without seriously disrupting the market for that stock.

An alternative to the public market is private placement capital markets. The primary sources of financing in this market are the venture capital industry, corporate acquisitions, insurance companies, and commercial banks.

The venture capital market is the primary supplier of direct equity capital to new, small and young, expanding enterprises. It is comprised of private venture firms, the venture capital divisions of large corporations, closed-end investment companies, family investment companies, and federally licensed institutions such as Small Business Investment Companies. These intermediaries provide initial equity capital as well as capital for expansion. The primary shortcoming in this market is the lack of liquidity for private securities. The easiest way for a venture capital firm to realize its investment is to sell its equity securities in the public market; yet this market is cyclical, as the lack of an active "new issues" market through the 1970s demonstrated. Even when there are substantial sources of venture capital, as there are now, the industry essentially focuses only on the most glamorous, high return industries--such as high technology, energy and bioengineering firms. A small business in a service industry would find it very difficult to attract venture capital at any time.

The life insurance industry has been an important source of long-term debt. However, the fiduciary nature of their role as savers for and insurers of policyholders limits the types of investments these institutions will consider. Their fiduciary responsibilities encourage extreme risk aversion for the sake of guaranteed return. Generally, insurance firms do not lend less than $5 million in any deal. Consequently, the life insurance industry is not a source of funds easily accessible to small business.

Difficulty in raising long-term debt and equity capital results in an additional problem for smaller businesses--the lack of long-term debt or adequate equity changes a business's financial profile away from optimal proportions, reducing the ability of a small business to get a loan from a commercial bank. An inadequate equity base or long-term debt structure is one of the most common explanations for loan denials by bankers.

Since smaller businesses are often unable to locate long-term funds or equity capital they are forced to become dependent on short-term borrowing from local commercial banks--to the extent that they are able to generate external financing at all. This market is often unable to meet their needs. Because small businesses rely so heavily on local banks, any problems in the local market tend to fall hardest on small firms. Larger firms have more flexible financing options and can approach larger, regional banks or national and international money center banks, tap the national debt and equity market, or even the Eurodollar market if local banks are unable to meet their needs. But money center or regional banks will rarely lend to a small business in a remote rural area of a state, since the loan value is unlikely to be large enough to offset the increased information and transaction costs associated with servicing distant, small loans. Whereas Fortune 500 firms typically deal with 50 or more banks, theirs is a different world from the small firm which normally deals with only one or two local banking institutions. When the local bank turns down a loan request, there is virtually nowhere for the small company to turn.

The short-term liabilities of commercial banks require that they in turn make short-term loans. Thus, having to depend on commercial bank loans means that small firms must live with relatively short-term loans. At the very most, local commercial banks may be able to provide small firms with the working capital they require, but not the intermediate or long-term credit which they need.

Studies of local banking markets have identified the following constraints on their ability to meet the needs of small business:

1. Small banks outside of large metropolitan areas often do not have the technical skills necessary to assess new ventures or unfamiliar industries, or to package the unusual loans necessary to properly reform a small business's financial structure.

2. Small banks isolated from money centers do not have as easy access to external loanable funds as larger, metropolitan banks and thus may face liquidity problems. Under conditions of rapid development, local sources of funds may not be adequate to meet demand.

3. Small, rural banks often serve an undiversified market, making risk spreading more difficult. The result is a reluctance to make more risky loans.

4. Many small, rural banks are the only bank or, at best, one of only two banks serving their community. This market concentration and the resulting lack of competition leads to less aggressive lending practices. The fact that market concentration affects risk-taking behavior of banks has been extensively documented in many studies.

5. Although small businesses as a class are at least as profitable as larger businesses, they are individually very risky and volatile. This presents a problem for the loan officer who needs to pick a "winner" to insure his own profitability. To avoid this problem lenders can either raise interest rates to compensate for the higher risk or create pooling and spreading mechanisms which average out the high variability of risk. Often, however, neither of these solutions is pursued because there are simply less risky, less costly, larger borrowers.

6. Under conditions of tight credit, small businesses are hurt more relative to larger businesses, new firms are hurt more relative to established firms, and long-term lending is hurt more relative to short-term lending. Small business, new business and longer-term credit needs are last-in and first-out (LIFO) in the credit allocation line.

7. In the end, money always passes between individuals, and it is the amount of trust and confidence those individuals have in each other which determines whether a deal occurs. Since it is human nature to trust the familiar more than the unknown, loan officers tend to be skeptical about products, processes, locations, management forms and people they do not know. Investors often hesitate to finance new production techniques and innovative products, especially for unproven markets. They carefully scrutinize the backgrounds of new borrowers and enterprises with nontraditional organizational forms. The result: smaller, newer, and non-traditionally based businesses have a difficult time borrowing funds.

This substantial body of empirical evidence that local commercial banks are often unable as a result of structural problems, or are unwilling as a result of their risk preferences, to lend aggressively is an additional "reflection" of the problem of capital availability for small businesses, especially in smaller, rural communities.

In the following sections we look in detail at the state's economy and at the private capital markets in Maine to provide insight into potential financial problems encountered by small businesses. This analysis will highlight how capital problems in Maine are more extreme than this general overview portrays because of inadequate capital resources in the state, market concentration, and risk aversion on the part of lenders.

# 2.0 DEMAND FOR CAPITAL BY MAINE SMALL BUSINESS

## 2.1 Introduction

This chapter of our report assesses the demand for capital among Maine's small businesses. It is important to recognize at the outset that new and expanding small businesses play a critical and insufficiently recognized role in the vitality and resilience of a state's economy. Recent studies on small business have found that:

- Small businesses are key to the job creation process: Approximately 50 percent of job creation can be traced to the births of new establishments. Firms with 20 or fewer employees generate 66 percent of net new jobs (Birch, 1979).

- Small businesses are profitable: A recent study of the relationships between asset size and profitability for manufacturing firms during the period from 1958-1976 demonstrated that firms with less than $1 million in assets were more profitable than all other firms except those with over $1 billion in assets (Daniels and Kieschnick, 1979).

- Small businesses are the main source of innovation: Studies confirm that small firms and independent investors are the main source of innovation and that they innovate more efficiently and at a lower cost than larger firms (Smollen and Apple, 1978). For smaller, technically based firms, innovation plays a critical role in the economic viability of the business and is responsible for the creation of new products and processes, new jobs, and new markets. In general, smaller firms innovate to foster external development and growth while larger firms innovate to improve internal efficiency, cut costs, and substitute capital for labor.

Capital is only one of many requirements in the development of a healthy small business environment. In addressing the issue of capital it is important to recognize that businesses have different capital needs at each stage of development. Equity capital is required for start-up, new product development and as a base for major expansion. Long-term debt capital is required for the purchase and expansion of durable assets--land, plant and equipment. Businesses need intermediate-term debt to pay for "software": market research, advertising and personnel expansion. Finally, short-term debt is required to ease seasonal fluctuations in the availability of working capital.

All four forms of capital should be viewed as integral parts of the continuum of business financing needs. If a business is to thrive, it needs access to each type of capital to satisfy its varying operational and investment needs. The absence of any one type of capital can put undue strains on the available sources of capital and thereafter the firm's viability.

Other factors internal and external to a business will affect the types and amounts of capital it needs:

- business size, because it often determines which capital sources are accessible and affects the type of capital available;
- industry characteristics--market trends, technology, and competition--are important determinants of capital needs;
- where business is tied to a local market, trends in local population, employment and income will influence capital needs.

Subsequent sections of this chapter evaluate the likely impact of these three factors on capital needs. In order to provide a general framework for this discussion, we briefly review the current state of Maine's economy.

## 2.2 The Maine Economy: An Overview

The 1970s marked a period of renewed vigor for the Maine economy after several decades of stagnation. Major indicators of economic growth and development indicate that the state's slide relative to the rest of the nation has been stemmed and that the state is, at the very least, keeping pace with national economic trends. The most important of these indicators are displayed in table 2.1 and summarized below.

### 2.2.1 Industrial Expansion

During the 1970s the state's economic growth, as measured by increases in employment and output, grew at a pace only slightly less than that of the U.S. as a whole, substantially reducing the decades old gap between national and state economic growth. Between 1970 and 1980 non-agricultural employment in the state grew by over 26 percent, only slightly less than the U.S. rate of 28 percent and substantially above the New England regional average of 20 percent. During the same period the state's gross product increased by almost 150 percent, somewhat below the increase of about 165 percent in the U.S. gross national product, but still above the New England average of about 135 percent. Indicative of the relatively strong performance of the Maine economy vis-a-vis the U.S. as a whole is the fact that in 1981,

Table 2.1

Major Indicators of Economic Change: 1970-1981

| | Maine | New England | U.S. |
|---|---|---|---|
| Population Growth 1970-80 | 13.2% | 4.2% | 11.4% |
| Non-Agricultural Employment Growth | | | |
| 1970-80 | 26.2% | 20.3% | 27.8% |
| 1978-80 | 3.1% | 4.9% | 4.5% |
| Average Monthly Unemployment Rate 1981 | 7.2% | 6.0% | 7.4% |
| Growth in Gross State Product | | | |
| 1970-80 | 146.7% | 135.6% | 164.5% |
| 1978-80 | 20.6% | 23.6% | 21.8% |
| Real Per Capita Income Growth 1970-80 | 24.1% | 21.3% | 24.8% |
| Per Capita Income 1980 | $7,925.00 | $10,105.00 | $9,521.00 |
| % of U.S. Per Capita Income | 83.2% | 106.1% | --- |

SOURCES: U.S. Department of Commerce, Statistical Abstracts of the United States, 1981, Tables 9, 668, 699, 715; Federal Reserve Bank of Boston, "New England Economic Indicators," July, 1982, p. B6; Federal Reserve Bank of Boston, New England Economic Almanac, 1982, pp. 10, 11, 13.

Maine's annual unemployment rate dipped below the U.S. average for the first time in a quarter of a century.

The state's industrial expansion is notable not only for its magnitude but for its quality. It is marked by a significant shift away from the state's traditional economic base of resource-based and non-durable manufacturing industries, many of which are either stable or declining, toward technology-based durables manufacturing industries, most notably shipbuilding and the production of electric and electronic equipment, fabricated metal products and machinery, and service industries.

### 2.2.2 Population Growth

Between 1970 and 1980, Maine's population grew by over 13 percent, exceeding the national rate of 11½ percent and far exceeding the average increase for the New England region of about 4 percent. This sharply reverses the trend of the 1960s when Maine's population growth rate of under 3 percent lagged far behind both the U.S. and the New England regional growth rates, both approximately 13 percent. Moreover, for the first time since World War II, Maine turned from an outmigration to an inmigration state.

The state's high population growth rate has important implications for the development of Maine's economy.

- Population growth during the 70's exceeded employment growth. This indicates that increased levels of inmigration may be in response to factors other than employment opportunities. The high quality of life offered by the state is often mentioned as a particularly important factor in attracting new residents. While influxes of population can, with the additional goods and services they demand, generate additional employment in the state, the net impact of this trend will be to place increasing demands on the state economy to produce sufficient employment opportunities for both long-time and recently arrived residents.

- Population growth has been uneven in its regional distribution. Population growth among Maine's sixteen counties between 1970 and 1980 ranged from a 25 percent increase in the south coast resort county of Lincoln to a 3 percent decline in the northeast lumber and potato producing county of Aroostook (U.S. Bureau of the Census.)

- Maine is a predominantly and increasingly rural state. In 1980, over 52 percent of the state's population lived in rural areas (defined as places with populations of 2,500 or less by the U.S. Census Bureau), approximately twice the U.S. rate. Between 1970 and 1980 the proportion of rural population increased. While the urban population as a whole increased in absolute terms, eleven of Maine's fifteen largest central cities actually lost population. All but two of the state's counties had greater increases in their rural populations than in their urban populations. And, of the state's eight fastest growing counties, five are predominantly rural and include the two counties with the highest rural populations, Washington and Franklin Counties (U.S. Bureau of the Census). While some rural areas are in close proximity to the employment and consumer goods available in urban centers, these trends nonetheless indicate that the employment and consumer needs of the state's rural population remain strong.

### 2.2.3 Personal Income

Real per capita income in the state increased by almost a quarter during the 1970s. This rate was commensurate with that of the nation as a whole and somewhat exceeded the average for the New England region. While the increase in living standards for Maine residents kept pace with the rest of the nation, the state's absolute position remained substantially below that of the nation as a whole. In 1980, the Maine per capita income stood at 83 percent of the national average. This placed the state thirty-eighth among all states. Moreover, a study by the National Center for Economic Alternatives concluded that when taking into account state-by-state variations in living costs, Maine actually ranked fiftieth, primarily due to high energy costs (New York Times, 2/15/82, p. A10). While some factors, such as the widespread practice of small-scale farming for personal consumption, may render such a conclusion misleading, it is evident that a substantial income gap between Maine and the rest of the nation remains.

One important factor in Maine's lower standard of living is relatively low wage rates in most of the state's industries. In 1980, Maine ranked 47 among all states in average wages. In the important manufacturing sector, the average weekly earnings for a Maine production worker in 1980 were about 83 percent of the U.S. average (U.S. Bureau of the Census). While some manufacturing industries, notably the paper and shipbuilding industries, pay wages in excess of the national average, this is more than counterbalanced by average or lower than average wages in other major manufacturing industries (Maine Department of Labor).

A second factor is the seasonality of employment in some sectors of the state economy, most notably tourist- and resource-related industries. This is reflected in wide seasonal variations in the state's unemployment rate. In 1981, for example, when the state's annual average unemployment rate stood at 7.2 percent, monthly unemployment ranged from a high of 9 percent in January to a low of 6 percent in August (Maine Department of Labor). These statistics do not include the state's agricultural workers, a large proportion of whom are seasonal workers. One state planning official has noted that while poverty in Maine is not abnormally high, the high degree of seasonal employment, often in low-paying industries, has created a large pool of people just above poverty level (New York Times, 2/15/82, p. A10).

2.2.4 Summary

These general trends in industrial development, population growth and living standards in the state offer some broad indications of the changing nature and extent of capital needs for small business development.

- As the state economy moves toward levels of growth and sectoral balance which more closely track the national economy, the state's capital markets will experience increasing demands for capital in greater amounts and for a greater variety of needs.

- Growing population and inmigration levels will stimulate increasing demands for consumer products and services and increasing entrepreneurial activity among both current and arriving residents. These developments can only be fully realized with an adequate supply of capital for business expansion.

- Regional shifts in population growth within the state will require commensurate shifts in capital supply in order to sufficiently meet regional employment and consumer needs.

- The state's low per capita income may somewhat reduce the impact that increased employment and population levels might be expected to have on capital demand.

In short, the modernization, diversification, and steady growth of Maine's economy will require increasing aggressiveness, sophistication and flexibility on the part of Maine's financial institutions, accustomed to years of lackluster economic growth and the preeminence of Maine's traditional industries. The following sections of this chapter will seek to pinpoint more precisely the capital needs of Maine's small businesses in coming years. Three characteristics of the small business sector will have an important influence on the amounts and types of capital it requires: first, the size of the business--very small, or micro-businesses of ten or fewer employees are likely to have very different capital needs than businesses with several hundred employees; second, the industrial sector--for instance, the capital needs of a service or retail firm are likely to differ from those of a manufacturing firm; those of a firm in a mature or declining industry from those of a newly emerging industry; third, the region--each region of the state will have varying capital needs depending on the size and sectoral distribution of its small businesses.

## 2.3 The Role of Small Business in Maine's Economy

### 2.3.1 A Working Definition of Small Business

The term small business is used to characterize a wide range of business sizes, from the tiny "mom and pop" grocery store to the growing electronics firm with over 1,000 employees and $100 million in annual sales. The Small Business Administration offers one of the most expansive definitions of small business, which it uses to determine eligibility for its loan programs. Under SBA guidelines, a small business includes:

- a manufacturing firm of up to 1,500 employees,
- an agricultural concern with annual sales of up to $1 million,
- a service firm with annual sales of up to $8 million.

All but a handful of Maine business firms would qualify as small businesses under these definitions. At the other extreme, David Birch, in his noted study of job generation among small firms, defines small businesses as those employing fewer than twenty employees. Between these extremes, a range of definitions, using either employment, sales, or asset measures, have been developed by small business trade associations, researchers, and government agencies. In recent years, a definition of fewer than 500 employees has been adopted in several important public forums, including the White House Conference on Small Business, Congress in drafting the Equal Access to Justice Act, and the Federal Interagency Task Force on Small Business. Given the use of this definition by these important sources of research and public policy, we have adopted it for use in this report.

A uniform definition of small businesses, however, may not be sufficient to fully analyze the capital needs of Maine's small businesses. In fact, within this broad size range, the capital structures of the smallest and largest small businesses even within the same industry, are likely to be quite different. The largest of these businesses are likely to have access to a range of equity and debt markets, both public and private, some operating in regional and national financial centers far from the home office of the firm itself. In contrast the smallest of these businesses has access to a very restricted list of capital sources, primarily relatives, friends, suppliers, and local banking institutions. These important differences in capital access require that our definition of small business be broken into two sub-categories. The smaller, or micro-businesses, we define as having less than ten employees. The larger small businesses we define as those with more than ten employees but less than 500 employees.

### 2.3.2 Measuring the Role of Small Business

Below we present data which indicates the relative importance of different sizes of small businesses in the Maine economy. We then proceed to briefly analyze the likely impact of that size distribution on the demand for capital within the state.

Recent efforts by the Small Business Administration to compile more comprehensive and accurate information about small business now permit us to measure the importance of small business in the economy with greater precision than previously possible. The SBA is currently compiling an extensive small business data base. In contrast to most widely used sources of small business data which compile data using individual business establishments as a unit of classification, the small business data base uses business firms as its unit of classification, grouping together all establishments belonging to a single firm. Classification of data by firm size rather than establishment size provides a more relevant tool for analyzing the capital needs of the small business sector since the types and sources of capital demanded by a firm are more likely to be influenced by its total size than by the size of each subsidiary establishment.

Table 2.2 presents an overview of the relative importance of different sized business firms in Maine's economy, classified by the number of employees per firm. The data compares firms classified by employment size, using two measures: percentage of total establishments and percentage of total employment. This data confirms that small businesses dominate Maine's economy. Fully 75 percent of employment and virtually all business establishments are associated with small firms. Businesses employing between ten and ninety-nine employees are collectively the most important employers of the size groupings presented, providing about one-third of total state employment. Businesses employing between 100 and 499, and 500 or more employees are also important employers, each providing about one-quarter of total state employment. Microbusinesses dominate the state in terms of numbers of establishments but provide a substantially smaller amount of employment than firms in larger employment-size categories, less than one-fifth of total employment.

As Table 2.2 indicates, Maine's economy is more dependent on small businesses than the average state. Maine's small businesses employ a higher proportion of the state's workforce, and employ fewer employees per firm than the average state. Moreover, this distinction appears to be widening somewhat. Data measuring changes in employment by establishment size between 1977 and 1979 indicate that while employment growth in establishments of 500 or more employees dropped substantially in Maine compared to substantial growth at the national level, growth

Table 2.2

Percentage of Establishments and Employment,
by Employment-Size Class of Firm, 1978

| | Employment-Size Class of Firm | | | |
|---|---|---|---|---|
| | 1-9 | 10-99 | 100-499 | 500+ |
| % of Employment | | | | |
| Maine | 17.1 | 33.1 | 25.6 | 24.2 |
| U.S. | 16.5 | 31.9 | 22.8 | 28.8 |
| % of Establishments | | | | |
| Maine | 77.1 | 20.6 | 1.9 | 0.37 |
| U.S. | 76.8 | 20.9 | 1.9 | 0.36 |

Mean Employment per Firm

| | |
|---|---|
| Maine | 13.6 |
| U.S. | 22.3 |

SOURCE: Small Business Data Base, U.S. Small Business Administration.

in establishments of less than 100 employees in Maine exceeded the national trend (see Table 2.3). While established data is less useful than firm data, for reasons noted above, the data indicates that Maine's economy may actually be becoming less concentrated compared to the national trend of growing concentration.

Table 2.3

Percentage Growth in Employment by
Employment Size of Establishment, 1977-1979

| | Employment Size of Establishment | | | | |
|---|---|---|---|---|---|
| | Less than 20 | 20-99 | 199-499 | 500 or More | Total Change |
| Maine | 9.30 | 17.96 | -1.87 | -15.47 | 5.71 |
| U.S. | 9.17 | 13.24 | 13.16 | 11.70 | 11.84 |

SOURCE: Small Business Data Base, U.S. Small Business Administration.

This data supports the conclusion that Maine's capital needs are by and large the capital needs of a small business economy. This assessment is further strengthened by the fact that larger firms in Maine are often headquartered out of state. This applies particularly to the important manufacturing sector, where the forest products, transportation equipment and electronics industries are dominated by large, out-of-state concerns. These firms are far less dependent on capital sources within Maine than are smaller, locally controlled firms. In sum, the ability of Maine businesses to obtain the capital they need to grow and prosper rests to an important degree on the capacity of the state's commercial credit providers to respond to the credit and other financial service needs of the state's smaller firms.

## 2.4 Variations Among Maine Industries

### 2.4.1 Determinants of Industry Demand for Capital

The aggregate small business in Maine's economy is an important indicator of the demands the state's smaller firms will place on the state's capital sources. However, the exact nature of these demands depends on the distribution of small businesses within various sectors of the economy. Different industries have differing capital needs, based on such factors as:

- the size and development stage of firms within the industry,
- trends in demand for the industry's products,
- sources of national and international competition,
- technological changes in products and production processes,
- changes in the costs of production factors--land, labor and materials.

This section will examine these factors with respect to the key sector of Maine's economy in an effort to analyze variations in sectoral demand for capital within the state.

As in most states, Maine's economic growth is heavily dependent on the strength of its manufacturing sector. Manufacturing industries are usually placed in the category of "primary" or export industries because they are likely to produce for a market which exceeds the boundaries of the state in which they are located. They create a net inflow of income into their home state and stimulate demand for additional goods and services among earners of that income. Thus, these primary industries induce economic activity in the state's secondary or service industries.

As table 2.4 indicates, Maine's economy is more heavily dependent on manufacturing than most states. Manufacturing industries provided 27 percent of the state's employment in 1980 compared to 22 percent for the U.S. as a whole. Even more striking perhaps is its much heavier emphasis on non-durable manufacturing, primarily its resource-based paper and food processing industries, shoe manufacture, and textile and apparel production. Durable manufacturing employment has increased at a much faster pace, led by strong gains in the electronics, fabricated metals, machinery and shipbuilding sectors, but nonetheless remains far behind the state's traditional non-durables industries in aggregate levels of employment. This reverses the relationship of durables and non-durables manufacturing in the national economy.

Three other sectors of the economy are large generators of employment--the service, trade and government sectors. To a great extent these sectors comprise secondary economic activity--activity generated by income from primary sectors. However, within the trade and service sectors are important areas of primary economic activity. Foremost among these is the state's tourist industry. Within the retail sector, the largest employers and leaders in sectoral growth were eating and drinking establishments, a significant

Table 2.4

Non-Agricultural Employment by Sector, 1980; Growth in Non-Agricultural Employment by Sector, 1975-1980

| | Employment 1980 (000's) | % of Total Non-Agricultural Employment, 1980 | | Employment Growth 1975-1980 Maine (%) |
|---|---|---|---|---|
| | | Maine | U.S. | |
| Construction | 19.7 | 5 | 5 | +5.9 |
| Manufacturing | 113.2 | 27 | 22 | +17.5 |
| Durable | (41.7) | (10) | (13) | (+32.0) |
| Non-Durable | (71.5) | (17) | (9) | (+10.5) |
| Transportation and Public Utilities | 18.81 | 4 | 5 | +6.2 |
| Wholesale and Retail Trade | 99.2 | 21 | 23 | +18.4 |
| Finance, Insurance, and Real Estate | 16.5 | 4 | 6 | +16.2 |
| Services | 78.5 | 19 | 20 | +31.7 |
| Government | 83.3 | 20 | 18 | +11.4 |

SOURCE: U.S. Department of Commerce, Statistical Abstracts of the United States, 1981, Table 669; Maine Department of Labor, Bureau of Employment Security, Division of Economic Analysis and Research, "The Maine Economy Records Significant Growth from 1975 through 1980."

portion of which are dependent on tourism. Also of growing importance to tourism is the growing number of factory outlets and recreational and outdoor products retailers. In the service sector, the lodging industry--hotels, motels and camping are a significant employer. Another key component of the service sector is business services. Business services include computer and data processing, management and consulting, personnel supply, marketing, and equipment rental and leasing. While these businesses develop in large part in response to the needs of other businesses, their availability is important in attracting new businesses into the state. Along with health services, business services have been one of the most rapidly growing segments of the service sector, growing 73 percent between 1970 and 1980 (County Business Patterns).

Agriculture is another key industry in the state both as an export sector and as a provider of raw materials for the food processing industry. Average annual agricultural employment in 1980 was approximately 5 percent of total state employment. Agricultural employment declined in both real and relative terms between 1970 and 1980 (Maine Department of Manpower Affairs).

### 2.4.2 The Varying Sectoral Role of Small Businesses in Maine's Economy

Micro-businesses and other small businesses exist in significant numbers in every sector of Maine's economy. However, within individual sectors of the economy, micro-businesses and small businesses as a whole have varying degrees of importance. Data describing the distribution of employment among different sized business within each industry sector is presented in Table 2.5.

Table 2.5 is compiled from County Business Patterns, published annually by the U.S. Census Bureau. This document can be used to determine for each industrial sector the share of total employment and total business establishments accounted for by establishments with different sized workforces. This is currently the most comprehensive data on employment by business size broken down by industrial sector. However, the data has an important limitation which should be noted. Classification is made by size of establishment rather than size of firm, with no distinction between establishments which represent individual firms and those which are branches or subsidiaries of larger firms. Thus, for example, no distinction is made between a ten-employee grocery store which is independently owned and a similar store with the same number of employees which is owned by a large, out-of-state convenience store chain. In general, the proportion of small establishments is likely to be higher than the proportion of small firms since small establishments are sometimes owned by large firms. This is an important distinction because the type and source of capital is more likely to be influenced by the overall size of a parent firm, not by the size of its subsidiary establishments. This distinction becomes increasingly important as the employment size of the establishment grows. National data indicates while the smallest establishments are almost all independently owned, the porportion of establishments belonging to a larger parent firm grows substantially as establishment size increases (The State of Small Business).

Table 2.5

Percentage of Establishments/Percentage of Employment for Major Industrial Sectors by Employment-Size Class, 1980[a]

| | Total Number | Employment-Size Class 1-9 (%) | 10-49 (%) | 50-99 (%) | 100-499 (%) | 500-999 (%) | 1000+ (%) | Mean Employment per Establishment |
|---|---|---|---|---|---|---|---|---|
| Construction | | | | | | | | |
| Establishments | 2,637 | 88 | 11 | 1 | * | * | 0 | 6.5 |
| Employment | 17,062 | 38 | 31 | 5-10** | 15 | 6-11 | 0 | |
| Manufacturing | | | | | | | | |
| Establishments | 1,745 | 50 | 28 | 8 | 11 | 2 | 1 | 65.3 |
| Employment | 113,889 | 3 | 10 | 9 | 41 | 18 | 20 | |
| Transportation and Other Public Utilities | | | | | | | | |
| Establishments | 980 | 68 | 25 | 4 | 2 | * | 0 | 15.7 |
| Employment | 15,427 | 12-20 | 34 | 18 | 26-34 | 3-6 | 0 | |
| Retail Trade | | | | | | | | |
| Establishments | 6,659 | 76 | 21 | 2 | 1 | 0 | 0 | 9.9 |
| Employment | 65,746 | 29 | 4 | 42 | 11 | 0 | 0 | |
| Wholesale Trade | | | | | | | | |
| Establishments | 1,534 | 67 | 29 | 3 | 1 | * | 0 | 12.2 |
| Employment | 18,733 | 21 | 49 | 14 | 12-13 | 3-4 | 0 | |
| Finance, Insurance, and Real Estate | | | | | | | | |
| Establishments | 1,709 | 82 | 16 | 1 | 1 | 0 | * | 9.9 |
| Employment | 16,906 | 23-33 | 32 | 7-14 | 22 | 0 | 6-9 | |

Table 2.5(continued)

| | Total Number | Employment-Size Class 1-9 (%) | 10-49 (%) | 50-99 (%) | 100-499 (%) | 500-999 (%) | 1000+ (%) | Mean Employment per Establishment |
|---|---|---|---|---|---|---|---|---|
| Services | | | | | | | | |
| Establishments | 6,445 | 84 | 12 | 2 | 1 | * | * | 10.8 |
| Employment | 69,852 | 22 | 24 | 14 | 24 | 5-10 | 6-11 | |
| TOTAL | | | | | | | | |
| Establishments | 23,385 | 76 | 17 | 2 | 2 | * | * | 13.8 |
| Employment | 321,841 | 18 | 25 | 12 | 26 | 9 | 9 | |

*Less than 1%.

**Exact data withheld to avoid disclosure of operations of individual establishments.

[a]Excludes self-employed persons and agricultural and government employees.

SOURCE: U.S. Department of Commerce, County Business Patterns, 1980: Maine, Tables 1B, 1C.

As Table 2.5 indicates, small businesses provide the lowest proportion of employment within the manufacturing sector, and among small manufacturing businesses, microbusinesses play the least important role. However, it should be noted that because of the high absolute levels of employment in this sector, small business employment actually exceeds that of most other sectors. Within the manufacturing sector, food products, lumber products, and nonelectrical machinery manufacturers tend toward the smaller end of the size scale, while paper products, transportation equipment, leather products and electronic and electrical equipment tend toward the larger end. In other sectors of the economy, small businesses more clearly predominate. Microbusinesses alone generally comprise over 65 percent of establihments in these sectors and between 20 percent and 40 percent of employment. Establishments with between 10 and 100 employees generally comprise between 35 percent and 50 percent of employment.

### 2.4.3 Capital Needs of Key Small Business Sectors

The previous two sections describe the key sectors of the state economy and the role played by small businesses in these sectors. Each of these sectors will experience capital needs in coming years. While a precise estimate of these needs is beyond the scope of this report, the following observations about the extent and nature of these needs can be made:

- Non-Durables Industries: These comprise most of Maine's traditional industries: the resource-based industries of paper manufacture and food processing, and labor intensive textile, apparel and shoe industries. While not as dynamic as the high growth, technology-based industries in the durable goods sector, these industries are still a vital source of employment for Maine residents. These are mature industries which are not likely to experience much expansion but, aside from the sliding textiles industry, appear stable.

The major challenge to these industries is increased international competition in the face of stable or declining demand for their products. Investments must be made in more efficient production processes and more effective marketing efforts. The paper industry has, in fact, already made huge capital investments in more efficient production equipment. A large segment of the paper industry, however, is comprised of large often nationally based firms with easy access to national capital markets. Other non-durables industries, with a higher proportion of small and microbusinesses, will be heavily dependent on local sources to finance modernization.

- Durables Manufacturing: These comprise both traditional industries such as wood and lumber products as well as newly emerging, technology-based industries. The wood and lumber products industries face a similar environment and similar capital needs as other traditional industries in the non-durables sector. The technology-based industries, however, are in a more dynamic stage of development, with major product innovation and growing demand. It is important to note that much of the expansion in these sectors derives from the location or expansion of facilities by large nationally based corporations such as General Electric, Data General, Digital Equipment, and Congoleum, as well as smaller out-of-state corporations.

This expansion does not, except in cases where locational incentives are offered, depend on capital from Maine sources. However there are also many small, innovative firms within these sectors which do depend on in-state capital. The availability of equity capital for product development and commercialization is particularly essential.

- Services and Trade: With a poor national economic climate, tourism in Maine might be expected to benefit from its proximity to east coast population centers and the relatively low cost of a Maine vacation. Capital should be available to facilitate expansion of the tourist industries. Perhaps of equal importance to the economy is the need to expand business and consumer services to facilitate the growth and diversification of the state's economy and its increasing population. These businesses fall almost exclusively into the microbusiness category and are usually dependent on local capital sources, primarily local banks, for financing.

- Agriculture: The state's agricultural industries, particularly the important potato and poultry sectors, have experienced sharply declining income and employment in recent years. While high short-term interest rates have been a factor in this decline, more efficient production and marketing by industry competitors is perhaps a more basic cause. If farm owners take an aggressive stance in seeking to stem this decline they will need capital to modernize their production facilities and reorganize marketing mechanisms.

## 2.5 Regional Economic Variations and Their Effect on Regional Demand for Capital

Just as capital needs for small business vary by industry, they also vary by region. County level data for the state reveals widely varying levels of population and employment growth, substantial disparities in income, and local economic structure. Variations in regional capital needs for small business development are likely to be heavily influenced by these factors. In this section we summarize some of the most salient distinctions in regional economic conditions and their likely impact on regional demand for small business capital.

### 2.5.1 Regional Economic Variation

The solid eight percent increase in Maine's employment during the five-year period between 1976 and 1981, when examined at the county level, reveals wide disparities in performance ranging from impressive expansion to outright decline. The highest growth, 31 percent, was experienced in Sagadahoc County, mainly on the strength of its dominant industry, the Bath Iron Works. Other strong improvements were experienced in Lincoln County (20 percent), an increasingly popular tourist center, and York County (18 percent), with its rapidly growing technology-based sector and strong tourist industry. The lowest rate, an 8 percent decline, occurred in Waldo County, reeling from the collapse of poultry farming and processing, its dominant industries. The other weak counties were Washington (+1 percent) and Piscataquis (+3 percent), both heavily dependent on the state's resource-based and non-durables industries.

Population trends among counties also varied widely. While the state population grew by 13 percent between 1970 and 1980, increases among counties varied between 25 percent and -3 percent.

Table 2.6

Major Demographic and Economic Indicators--Maine Counties

| | Population | | Employment | | | Per Capita Income | | |
|---|---|---|---|---|---|---|---|---|
| | 1980 | Percent Change 1970-80 | Average Employment 1981 | Percent Change 1976-81 | Average Unemployment Rate, 1981 | 1980 | Rank | Percent of U.S. Average |
| Androscoggin | 99,657 | 9 | 43,920 | 7 | 8.1 | $7,873 | 6 | 83 |
| Aroostook | 91,331 | -3 | 33,430 | 7 | 10.1 | 6,355 | 15 | 67 |
| Cumberland | 217,789 | 12 | 95,950 | 9 | 5.6 | 9,463 | 1 | 99 |
| Franklin | 27,098 | 21 | 11,710 | 7 | 7.3 | 6,940 | 11 | 73 |
| Hancock | 41,781 | 21 | 18,270 | 5 | 7.1 | 7,789 | 7 | 82 |
| Kennebec | 109,889 | 15 | 46,150 | 8 | 7.2 | 8,150 | 4 | 86 |
| Knox | 32,941 | 14 | 13,680 | 4 | 7.8 | 8,113 | 3 | 85 |
| Lincoln | 25,691 | 25 | 9,420 | 20 | 7.2 | 8,404 | 2 | 88 |
| Oxford | 48,968 | 13 | 19,440 | 11 | 8.4 | 7,222 | 10 | 76 |
| Penobscot | 137,015 | 9 | 61,170 | 10 | 6.7 | 7,627 | 9 | 80 |
| Piscataquis | 17,634 | 8 | 7,490 | 3 | 5.9 | 6,724 | 12 | 71 |
| Sagadahoc | 28,795 | 23 | 12,240 | 31 | 5.7 | 7,708 | 8 | 81 |
| Somerset | 45,028 | 11 | 18,300 | 12 | 10.0 | 6,587 | 13 | 69 |
| Waldo | 28,414 | 22 | 9,230 | -8 | 11.2 | 6,344 | 16 | 67 |
| Washington | 34,963 | 17 | 13,620 | 1 | 10.6 | 6,400 | 14 | 67 |
| York | 139,666 | 25 | 57,980 | 18 | 6.1 | 7,960 | 5 | 84 |
| Maine | 1,124,660 | 13 | 472,000 | 8 | 7.2 | 7,868 | | 83 |

SOURCES: U.S. Department of Commerce, 1980 Census of Population, PC80-1-A21, Table 3; Maine Department of Labor, Bureau of Employment Security, Civilian Labor Force Estimates; U.S. Department of Commerce, Per Capita Personal Income - County, Maine, U.S., April, 1982.

In some cases, population growth corresponded closely to employment growth. The three counties with the highest rate of employment growth also experienced the highest rate of population growth. However, in other instances, these trends diverged markedly. Six of the seven other counties that experienced higher than the state average population growth, experienced lower than the average employment growth. Ironically, Waldo, the only state to suffer an employment decline between 1976 and 1981, experienced much higher than average population growth during the 1970s. This imbalance is reflected by Waldo's 1981 unemployment rate, the highest in the state.

Counties also displayed highly divergent levels of personal wealth. Cumberland County, with Portland's highly diversified manufacturing sector and concentration of business and financial services, is the wealthiest, with a per capita income only slightly below the national average. The three poorest counties, Washington, Waldo, and Aroostook, each have economies heavily dependent on the state's traditional resource-based and non-durables industries, often with one or two of these industries dominating the manufacturing sector.

Aside from growth and income levels, Maine's counties differ in the sectoral composition of their economies (table 2.5). Some counties, notably Cumberland and York, have highly diversified manufacturing sectors, with higher than average concentrations in technology-based durables sectors. These counties are also among the highest in per capita income and lowest in unemployment rates. Other counties, notably Washington, Waldo, Somerset, Piscataquis, and Aroostook, are heavily dependent on one or two industries, generally in traditional non-durables sectors and resource-based production. These counties have the lowest per capita incomes and, with the exception of Piscataquis, the highest unemployment rates. Lincoln, with the smallest manufacturing sector and largest service sector, depends heavily on tourists and summer residents, while Sagadahoc, with the largest manufacturing sector and both the smallest service and retail sectors, depends heavily on one manufacturing firm, the Bath Iron Works. Both of these counties have among the highest employment growth rates although only average per capita incomes.

### 2.5.2 Impact of Regional Variations on Demand for Small Business Capital

Data on variations in regional growth and economic characteristics offer indications of likely variations in capital demand for small business development:

- Counties like York, Sagadahoc, and Lincoln, with more rapidly expanding population and employement are likely to experience increased demands for consumer products and services, stimulating business development efforts in the small business-dominated service and trade sectors.
- Counties, like York and Cumberland, which are experiencing new business development and diversification of their economies arelikely to experience increased demand for business services, stimulating development of new business service firms.
- Diversifying regions like York and Cumberland have greater needs for business start-up capital.
- Counties with industries experiencing declining employment, such as Waldo, will have growing labor surpluses which may provide attractive opportunities for new business start-up.
- Counties with high concentrations of mature but stable industries may need long- and intermediate-term capital for industry modernization.

Table 2.7

Distribution of Employment in Major Industries - 1980

| | Androscoggin | Aroostook | Cumberland | Franklin | Hancock | Kennebec | Knox | Lincoln | Oxford | Penobscot | Piscataquis | Sagadahoc | Somerset | Waldo | Washington | York | STATE AVERAGE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Percentage of Total County Employment* | | | | | | | | | | | | | | | | |
| lected Industries | | | | | | | | | | | | | | | | | |
| nufacturing | 40% | 32% | 23% | 62% | 29% | 30% | 34% | 18% | 54% | 35% | 59% | 59-73% | 50% | 45% | 34% | 44% | 36% |
| tail Trade | 19% | 24% | 22% | 12% | 23% | 21% | 22% | 29% | 16% | 21% | 15% | 10% | 16% | 17% | 23% | 21% | 21% |
| rvices | 21% | 21% | 25% | 17% | 25% | 25% | 23% | 26% | 18% | 22% | 16% | 9-24% | 19% | 20% | 24% | 17% | 22% |
| | Percentage of Total County Manufacturing Employment* | | | | | | | | | | | | | | | | |
| lected Manufacturing dustries | | | | | | | | | | | | | | | | | |
| od Products | b | d | c | - | c | c | c | - | a | a | - | a | - | d | c | a | 9 |
| xtile Mill Products | c | - | a | - | - | c | c | - | b | b | d | - | a | - | b | c | 8 |
| parel | - | b | b | - | - | c | a | - | - | - | b | a | a | a | a | a | 3 |
| mber and Wood Products | a | d | a | d | c | b | a | - | d | c | d | - | d | b | d | a | 12 |
| per Products | b | c | c | d | d | c | - | - | c | d | - | - | c | - | d | a | 16 |
| bber and Plastic Products | c | a | a | a | - | - | - | - | - | a | - | - | - | - | - | c | 5 |
| ather and Leather Products | d | a | c | d | - | a | b | - | c | c | a | a | d | c | - | c | 17 |

Table 2.7 (continued)

| | Androscoggin | Aroostook | Cumberland | Franklin | Hancock | Kennebec | Knox | Lincoln | Oxford | Penobscot | Piscataquis | Sagadahoc | Somerset | Waldo | Washington | York | STATE AVERAGE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fabricated Metal Products | a | a | b | - | a | a | a | - | - | a | - | - | a | - | - | c | 4 |
| Nonelectrical Machinery | a | - | c | - | - | b | b | - | a | a | - | - | - | - | - | a | 5 |
| Electric and Electronic Equipment | b | - | c | - | b | a | b | e | a | a | - | a | b | - | - | c | 7 |
| Transportation Equipment | - | - | a | - | c | - | a | c | - | a | - | e | - | - | - | a | 6 |
| Total Manufacturing Employment | 13,482 | 6,119 | 18,961 | 5,383 | 2,758 | 10,114 | 2,904 | 700 | 6,600 | 14,652 | 2,321 | 6,526-7,834 | 5,135 | 2,011 | 1,915 | 13,614 | |

Key

0 - - (dash)

1-5% - a

6-10% - b

11-25% - c

26-50% - d

50+ - e

* Excludes agricultural, government, and self-employed workers.

SOURCE: U.S. Department of Commerce, County Business Patterns, 1980: Maine, table 2.

# 3.0 THE PRIVATE FINANCIAL MARKET IN MAINE

## 3.1 Introduction

Financial institutions throughout Maine face a rapidly changing environment. Changing economic conditions in many areas of the state have and will continue to have a serious impact on its private financial markets. State and regional economic changes are intensified by larger transformations occurring in national capital markets. Traditional distinctions between different financial intermediaries are blurring. The growth of money market funds is just one example of changes to the nation's capital markets which seriously affect where capital flows in that market. Financial institutions throughout the country are making preparations for the arrival of interstate banking in the near future. The direction these changes in the financial market take, and how effective and innovative Maine financial institutions will be in facing these new challenges, will have a significant effect on the availability of capital for small businesses in the state.

This section of the report examines the private financial intermediaries in Maine in an attempt to increase public understanding of both the sources and uses of capital in the state. The report concentrates on the commercial banking industry--the largest source of funds in the state. Other depository instituitons, as well as the larger pools of capital in the state available for longer-term financing, are also described in order to present a picture of the larger private financial market in the state.

Although available data does not allow us to draw any definitive quantitative conclusions on the adequacy of capital resources in the state to meet demand, it does provide an overview of the problem of capital availability for small businesses.

## 3.2 The Capital Allocation Process and the Role of Capital

Before looking at the Maine financial market it is useful to briefly review the capital allocation process and the role capital plays in the economic development process. How and where capital is allocated is critical to economic development. The capital allocation process involves the flow of funds from the suppliers of capital to the demanders of capital through financial intermediaries. This process must be viewed in the following context:

- First, it should be noted that statewide capital markets are not self-contained. Suppliers and demanders interact in national and international markets. Capital allocation is not a self-contained local or even regional process. Put simply, capital can come from anywhere and it can go anywhere. Capital is increasingly mobile, the suppliers of capital are increasingly diverse, and the demanders of capital are increasingly competitive. The capital allocation process must be understood within this context.

- Second, the importance of capital in the development process is often overstated and misunderstood. Successful development hinges on a number of conditions: a favorable market; access to the key factors of production--land, labor and capital; and managerial and organizational capacity to produce for that market. Capital is a necessary, but insufficient, ingredient in the economic development process. It cannot make up for the lack of markets or management or overcome the high costs of land or labor. The availability and affordability of all the factors of production are crucial to any business's development. The relative importance of any one factor depends on the relative proportion of business costs accounted for by that factor. While capital is important to the development process, we must keep its role in proper perspective.

- Third, when capital becomes a critical factor, it is usually the availability of capital and not its cost which is important. Capital costs are relatively constant across regions and are usually not a significant part of the total costs of doing business. Differences in capital costs are important to the private sector primarily when geographic differences in markets and production costs are small. However, many firms never get to consider the issue of cost because they have no access to capital at any cost.

- Finally, although access to capital is the primary problem faced by smaller firms, the current high interest rates are an equally important problem for small businesses. Smaller firms generally operate on a smaller profit margin and thus high interest rates have a greater impact on them.

For the small firm which is poorly managed, cannot capture market share, or suffers from extremely high production factor costs, access to capital at any price will have little effect on its more basic problems. In Maine what is often viewed as a problem with the cost of bank loans or with access to any capital by small businesses is in fact a problem with the market for a good or service or with the management of an enterprise. This is particularly the issue with many micro-businesses which do not have the managerial skills necessary to generate the type of information which banks require in the lending process. The question which we are addressing here is whether potentially profitable and well-managed small businesses have access to the right kind of capital, at the right time and at the right cost.

## 3.3 The Banking Industry in Maine

Commercial banks are specialized financial institutions which both in Maine and nationally are the chief providers of borrowed capital for most business firms. Commercial banks are generally constrained to provide predominantly short-term loans since short-term deposits comprise their main source of loanable funds. Figure 1 illustrates a simple model of the capital allocation process in the commercial banking industry.

The primary component of a commercial bank's commercial and industrial loan portfolio is comprised of working capital loans which finance inventories and accounts receivables. Although commercial banks are the primary source of working capital, business finance companies, commercial factors and suppliers and purchasers of goods are also potential sources of inventory financing. In Maine commercial finance companies have not been aggressive and the mutual savings banks are an additional, though limited, source of short-term credit to businesses.

For the most part working capital markets function relatively well. Many of the problems in the market are cyclical rather than structural. However, smaller businesses in certain localities do face particular problems obtaining working capital. Smaller businesses

Commercial Banks: Capital Allocation Process

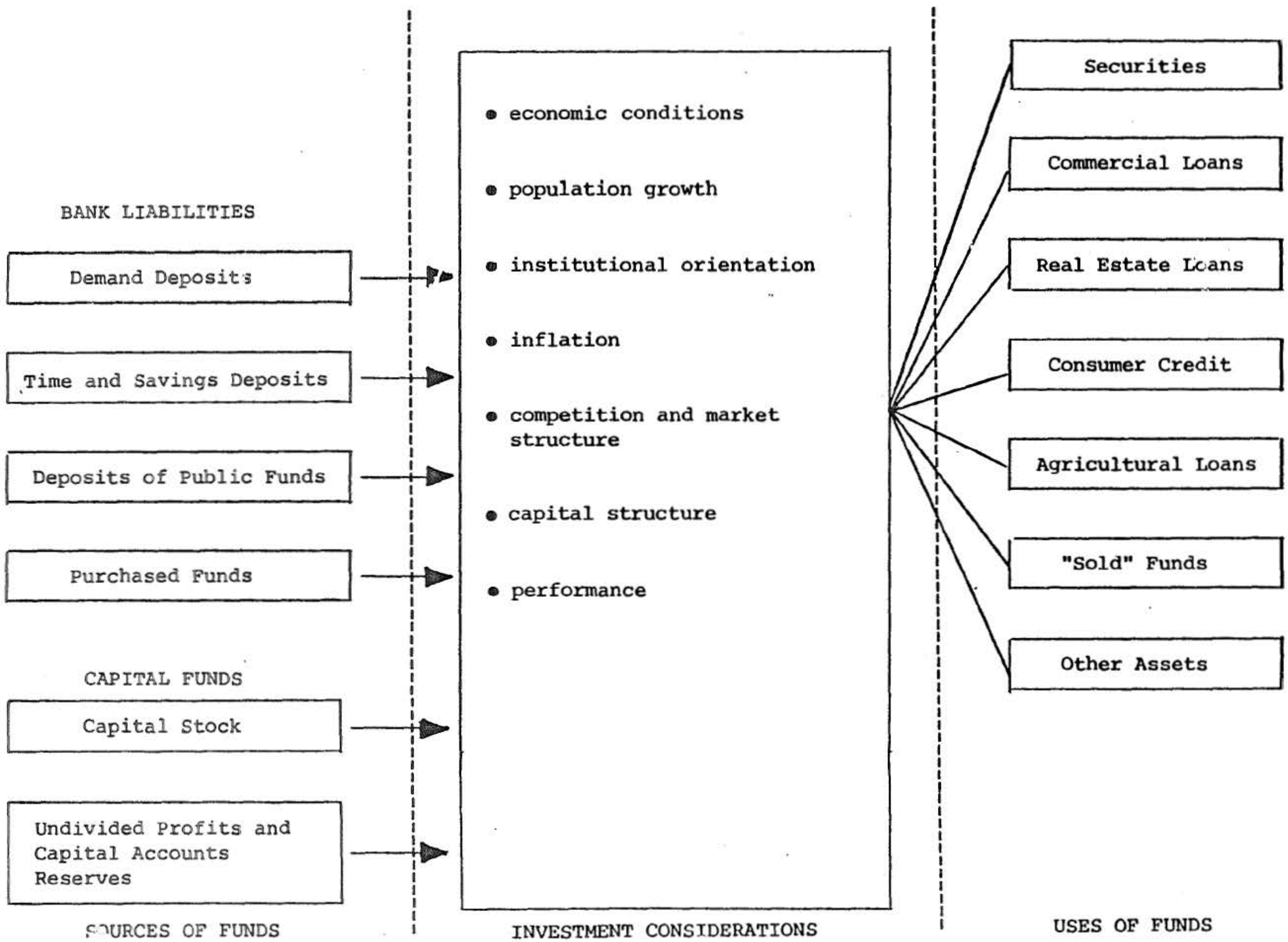


Figure 1

are more dependent on their local banking market. If that market is highly concentrated, is unable to provide sophisticated banking services, faces liquidity problems, or has inadequate capital resources to meet credit needs, the greatest impact will fall on the smaller businesses which are seeking capital.

In addition to working capital the banking industry provides intermediate-term debt for business expansion and long-term fixed asset financing. Commercial banks again dominate in this category, though thrift institutions do provide commercial and industrial mortgages.

This section reviews: the adequacy of capital, both working capital and longer-term debt, in the banking industry; the use of funds by the banking industry; and the banking market structure. From this analysis we can reach some preliminary conclusions about the availability of short-term working capital and longer-term fixed asset financing from the in-state banking industry.

### 3.3.1 Adequacy of Bank Resources

As of December 31, 1981 there were 36 commercial banks in Maine with 356 branches in operation. There was a decline over the one-year period from 12/31/80 to 12/31/81 of five commercial banks due to mergers and absorptions and an increase of forty-eight branches, forty-five of which were new branches of the Maine National Bank. Total deposits in commercial banks as of 12/30/81 were $3 billion, an increase of 3.6 percent from the prior year.

There are currently six bank holding companies operating in Maine. Four of these are multi-bank holding companies and two are single bank holding companies. BHCs control $2.14 billion in deposits or 71 percent of the total deposits in the state. This is a slight decline from 1979 when BHCs controlled 73 percent of the deposits (in 1979 this was significantly above the national average of 51.6 percent). If the proposed merger between Depositors Corporation and Canal Corporation goes through, the new entity would be the largest in the state.

Tables 3.1, 3.2, and 3.3 provide information on characteristics of the Maine commercial banking industry in 1970 and 1980 as compared to the U.S. as a whole. This information provides evidence that relative to its size and economic position, capital resources in Maine fell significantly below the U.S. average in both 1970 and 1980. In fact, in many of the statistics Maine's position between the ten years relative to the U.S. has declined. For example:

- In 1980 Maine ranked number 49 in assets per capita in the U.S. (see table 3.2). In 1970 assets per capita were 51.7 percent of the U.S. figure. By 1980, it had declined to only 37.6 percent of the U.S. average (see table 3.1).

- In 1970 total assets in Maine were .25 percent of the total in the U.S.; by 1980 assets in Maine comprised only .19 percent of total U.S. assets (see table 3.1).

- Deposit and loan growth between 1970 and 1980 in Maine fell significantly below the U.S. growth rate, whereas population growth in Maine was higher than the U.S. average. (See table 3.3).

- Whereas Maine's gross state product was .35 percent of the total national gross product in 1980, commercial and industrial loans were only .14 percent of the U.S. total. A 1973 study of Maine banks by Golembe Associates used this measure to support the view that relative to output the level of business credit available in Maine is significantly below what would be expected.

Table 3.1

Commercial Bank Characteristics

| | 1970 | | | 1980 | | |
|---|---|---|---|---|---|---|
| | Maine | US | Maine as a % of US | Maine | US | Maine as a % of US |
| Number of Banks | 39 | 13,511 | | 41 | 14,430 | |
| Total Assets (000's) | $1,452,701 | $574,463,336 | .25% | $3,465,087 | $1,855,687,813 | .19% |
| Total Deposits (000's) | $1,254,314 | $480,711,000 | .26% | $2,895,397 | $1,481,160,716 | .19% |
| Net Loans (000's) | $ 866,272 | $313,213,000 | .28% | $1,898,007 | $ 992,415,361 | .19% |
| Commercial and Industrial Loans (000's) | $ 251,688 | $111,883,726 | .22% | $ 559,012 | $ 390,930,841 | .14% |
| Net Loans-to-Assets | 59.6% | 54.5% | | 54.8% | 53.5% | |
| Loans-to-Deposits | 69% | 65% | | 65.6% | 67% | |
| Capital-to-Assets | 8.3% | 7.4% | | 7.4% | 6.2% | |
| Assets per Capita | $1,462 | $2,825 | 51.7% | $3,081 | $8,192 | 37.6% |
| Commercial and Industrial Loans to Assets | 17.3% | 19% | | 16.1% | 21% | |
| Gross Product | $3,700,000 | $992,700,000 | .37% | $9,127,000 | $2,626,100,000 | .35% |

SOURCE: FDIC Bank Operating Statistics, December 31, 1970 and December 31, 1980.

Table 3.2

Assets per Capita - 1980

| State | Commercial Bank Assets Per Capita | State | Commercial Bank Assets Per Capita |
|---|---|---|---|
| 1. New York | $26,290 | 26. Hawaii | $ 5,576 |
| 2. Illinois | 12,362 | 27. Idaho | 5,409 |
| 3. California | 10,051 | 28. Kentucky | 5,309 |
| 4. Texas | 8,355 | 29. West Virginia | 5,290 |
| 5. Minnesota | 7,797 | 30. Ohio | 5,211 |
| 6. Oklahoma | 7,549 | 31. Tennessee | 5,185 |
| 7. Pennsylvania | 7,540 | 32. Florida | 4,929 |
| 8. Iowa | 7,463 | 33. Oregon | 4,922 |
| 9. South Dakota | 7,366 | 34. Arizona | 4,920 |
| 10. Rhode Island | 7,358 | 35. New Jersey | 4,905 |
| 11. Wyoming | 7,327 | 36. Arkansas | 4,852 |
| 12. Nebraska | 7,326 | 37. Nevada | 4,700 |
| 13. Missouri | 7,092 | 38. New Mexico | 4,698 |
| 14. North Dakota | 7,090 | 39. Vermont | 4,695 |
| 15. Kansas | 7,023 | 40. Utah | 4,616 |
| 16. Montana | 6,759 | 41. Mississippi | 4,549 |
| 17. Massachusetts | 6,311 | 42. Virginia | 4,525 |
| 18. Delaware | 6,190 | 43. North Carolina | 4,450 |
| 19. Indiana | 5,960 | 44. Connecticut | 4,390 |
| 20. Louisiana | 5,933 | 45. Alabama | 4,334 |
| 21. Michigan | 5,766 | 46. Georgia | 4,258 |
| 22. Washington | 5,723 | 47. Maryland | 3,924 |
| 23. Wisconsin | 5,696 | 48. New Hampshire | 3,582 |
| 24. Alaska | 5,621 | * 49. Maine | 3,081 |
| 25. Colorado | 5,589 | 50. South Carolina | 2,448 |

SOURCES: F.D.I.C., Bank Operating Statistics: 1980

U.S. Census: 1980 Advance Counts

Table 3.3

Ten-Year Growth Trends: Maine and United States

| | Maine | U.S. |
|---|---|---|
| Population Growth 1970-1980 | 13.2% | 11.4% |
| Commercial Bank Deposit Growth 1970-1980 | 130.9% | 144.5%[1] |
| Commercial and Industrial Loan Growth 1970-1980 | 122.1% | 249% |
| Mutual Bank Deposit Growth 1970-1980 | 174% | 114% |
| Total Depository Institution Deposit Growth 1970-1980 | 158.6% | 210% |

[1]Figure excludes foreign deposits.

Table 3.4

Depository Institutions: Deposits per Capita

| | 1970 Total Deposits | | 1980 Total Deposits | | 1970 Deposits per Capita | | 1980 Deposits per Capita | |
|---|---|---|---|---|---|---|---|---|
| | Maine | U.S. | Maine | U.S. | Maine | U.S. | Maine | U.S. |
| Commercial Banks (000's) | $1,254 | $480,711 | $2,895 | $1,481,161 | $1,262 | $2,364 | $2,574 | $6,539 |
| Mutual Banks (000's) | $ 924 | $ 71,580 | $2,535 | $ 153,501 | $ 930 | $ 352 | $2,254 | $ 678 |
| Savings & Loans (000's) | $ 195 | $141,620 | $ 600 | $ 498,650 | $ 196 | $ 697 | $ 533 | $2,201 |
| Credit Unions (000's) | $ 100 | $ 15,523 | $ 366 | $ 65,743 | $ 101 | $ 76 | $ 325 | $ 290 |
| TOTAL (000's) | $2,473 | $709,434 | $6,396 | $2,199,055 | $2,485 | $3,490 | $5,687 | $9,709 |

Sources: National Association of Mutual Savings Banks, 1971 and 1981 National Fact Book of Mutual Savings Banks.

Federal Deposit Insurance Corporation, 1970 and 1980 Bank Operating Statistics.

Federal Home Loan Bank Board, Combined Financial Statements, FSLIC Insured S&Ls, 1970 and 1980.

National Credit Union Administration, State Chartered Credit Unions Annual Report, 1970 and 1980. Annual Report of the National Credit Union Administrators.

- Deposits per capita in the entire banking industry fall significantly below the U.S. average. Total deposits per capita in all depository institutions in Maine were only \$5,687 as compared to \$9,709 in the U.S. In 1970 deposits per capita in Maine were 71 percent of the U.S. per capita figure; by 1980 it was only 59 percent of the U.S. figure. (See table 3.4.)

Comparative statistics of the banking industry in the 50 states as of December 31, 1981 (Sheshunoff, Banks of New England 1982) provide additional information on how Maine's banks compare to national averages:

- The percentage growth in deposits in Maine of 3.6 percent between 1980 and 1981 was one of the lowest in the nation. The average among the states was 8.4 percent; only three states had a lower growth rate.

- Similarly, the five-year compound deposit growth rate in Maine of 6.8 percent is significantly below the average of 9.6 percent in all 50 states. Only four states had lower five-year growth rates.

- Loan growth in Maine between 1980 and 1981 was only 1.9 percent. The average rate in the nation was 9.1 percent; only six states had a lower rate.

- Income growth in Maine banks and profitability were also well below average. The five-year compound growth rate of income was only 8.1 percent statewide. The average of all 50 states was 15.3 percent. In 1981 return on average assets in Maine was .83, again below the average of 1.00 in the nation.

Since these statistics used statewide averages, the results are somewhat distorted by the smaller than average size of Maine banks. Thus, we also looked at statistics which compared Maine banks to their peer group averages (Sheshunoff, Banks of New England, 1982) and other New England States (see table 3.5). The results are very similar. In terms of deposit growth, loan growth, income growth and profitability, Maine banks compared very poorly to banks in their own size groups and to banks in the rest of the region.

Table 3.5

Maine and New England Commercial Bank Characteristics

| | 1980-81 Deposit Growth | 5-year Deposit Growth | 5-year Compound Income Growth | 1980-81 Income Growth | 1980-81 Loan Growth | 1981 Loan to Assets | 1970-80 Population Growth | 1970-80 Deposit Growth |
|---|---|---|---|---|---|---|---|---|
| Maine | 3.6% | 6.8% | 8.1% | -2.5% | 1.9% | 52.7% | 13.2% | 130.9% |
| Vermont | 3.5% | 8.5% | 11.9% | 6.7% | 5.8% | 65.3% | 15% | 147.7% |
| New Hampshire | 7.7% | 10.6% | 15.7% | 4.2% | 8.5% | 60.0% | 24.8% | 182.2% |
| Massachusetts | 5.7% | 9.1% | 27.6% | 22.1% | 10.4% | 48.1% | 8% | 155.6% |
| Connecticut | 4.0% | 8.9% | 22.4% | 15.1% | 8.5% | 57.1% | 2.5% | 121.35% |
| U.S. Mean | 8.43% | 9.57% | 15.3% | 7.95% | 9.8% | 52.1% | 11.4% | 144.5% |

SOURCE: Sheshunoff, Banks of New England; 1980 U.S. Census; Federal Reserve Bank of Boston

3.3.2 Lending Activity

From the viewpoint of small business development in Maine it is important to know if banks are aggressively lending their funds so that the capital is generating economic activity in the state. Statistics cannot tell very much about this issue--they do not indicate the terms of a loan, the attitudes of bankers or the type of business activity which is supported. They do provide limited information on how Maine banks in aggregate compare to the nation.

In general, statistics show that Maine banks have kept up with the nation in the amount of lending they do relative to their asset and deposit base (see table 3.1). In fact in both 1970 and 1980 the loan-to-asset ratio in Maine exceeded the national average. Currently banks in Maine are in a highly liquid position, not due to lack of aggressive lending as much as to general economic conditions and soft credit demand.

Maine has historically lagged behind the U.S. in commercial and industrial loan growth (see table 3.3) and commercial and industrial loans as a percentage of assets (see table 3.1). Between 1970 and 1980 Maine's share of the total commercial and industrial loans in the country had declined from .22 percent to only .14 percent. These statistics which partially reflect the relative economic base of Maine do provide some evidence that Maine's commercial banks have not kept pace in the area of business lending.

Statistics on commercial and industrial loans by banks somewhat distort the true availability of commercial credit. Many small business people, particulalry involved in microbusinesses, have noted that the working capital they received is considered consumer credit by their banks. In order to grant a commercial loan, loan officers will usually have to have their decisions approved by senior managers.

If they simply expand the credit line on a personal credit charge approvals are unnecessary. Thus, for many micro-businesses Master Charge and Visa are the primary source of working capital.

In terms of commercial and industrial real estate loans, Maine's banks in 1981 had 19.3 percent of their entire loan portfolio in this category. Only one other state (Nevada) had a higher percentage of their loans in this category and the mean percentage among the 50 state was only 9 percent of loans (Sheshunoff & Co., 1982).

In assessing the commercial and industrial lending activity in the state, one must include the state's thrift industry, given its broadened powers in this area. Maine's thrift institutions have been granted liberal powers to compete with commercial banks in the state for commercial and industrial lending. Although granted these powers in 1975, Maine's thrift institutions have not, for the most part, become actively involved in business credit. An analysis of the June 30, 1982 Call Reports of the state's mutual savings banks shows that commercial and industrial loans comprise only 1.8 percent of the assets of mutual banks and commercial and industrial real estate loans comprise 8.7 percent of total assets. Only a few banks appear to be involved in non-mortgage-based commercial credit--Gardiner Savings Bank holds 9.2 percent of its assets in commercial and industrial loans; Maine Savings Bank holds 5 percent and Waterville Savings holds 5.8 percent. A number of banks including Bangor Savings, Heritage Savings, Maine Savings and Norway Savings have over 15 percent of their assets in commercial and industrial real estate.

The lending activity of Maine's banks is also notable for the almost complete absence of agricultural lending. As the recent study by the Maine Department of Agriculture showed, Maine's banks have almost entirely gotten out of the business of lending to farmers. Between 1978 and 1980 loans secured by farmland as a percentage of net loans declined from .70 percent to .51 percent. Short-term farm loans declined during this period from 1.62 percent to .83 percent. The extremely low percentage of assets in agriculture loans in the state is evidence that an entire sector of the economy can be virtually deserted by the private financial market in the state.

These statistics are not able to provide a complete picture of business lending in the state. In addition to the statistics, there is "impressionistic" evidence that there are problems with the business lending activity of Maine banks. A survey by Golembe and Associates in 1973 concluded that bankers in Maine were excessively collatoral oriented; were not amenable to "new" kinds of credit arrangements; and that new and out-of-state firms had difficulty in the banking market. In our work in the field, we were told that Maine banks were not up-to-date in the types of financing which are currently available elsewhere (i.e., asset based financing) and requirements were excessive. It is interesting to note that a Chicago banking consultant at the most recent convention of the Savings Bank Association of Maine advised that Maine banks should make special efforts to attract the business of small businesses. This has not yet been the case in either the commercial banking or thrift industry in the state.

### 3.3.3 Market Structure

The banking market structure of a state will affect the availability of capital to small businesses for two major reasons. First, as previously discussed, studies have shown that banks in more concentrated markets tend to be less aggressive lenders. Second, the competition for deposits between the thrift industry and commercial banks will affect how local savings are used.

Statistics show that the Maine banking market structure can be characterized as highly concentrated:

- A 1979 study by the Federal Reserve Bank found that in every major banking market defined in Maine the four bank concentration ratio exceeded the 75 percent standard established by the Justice Department to define a highly concentrated market (Federal Reserve Bank, Changing Commercial Bank Structure).

- As of March 31, 1981 Maine as a whole ranked twelfth in the country in the five-bank concentration ratio (74.5 percent of deposits were in five banks) and sixteenth in the three-bank concentration ratio (49.7 percent of deposits were in three banks) (Federal Reserve Bank).

- These percentages represent an increase from the concentration found in Maine in 1975. As of June 30, 1975, 47.14 percent of deposits were in the top three banks and 72.84 percent of deposits were in the top five. Between 1960 and 1975 Maine had the second largest percentage increase in its five bank concentration ratio in the country. In 1960 only 48.96 percent of the deposits were in the top five banks. If the proposed merger between Depositors and Canal goes through the concentration ratio in Maine will again increase.

These statistics provide evidence that the Maine commercial banking market is not highly competitive. This concentration in the market would tend to increase the risk aversion of local banking institutions which are not actively competing for borrowers. The impact of such behavior usually falls hardest on small businesses which are perceived as the highest risk class of borrowers.

As previously discussed, capital resources in Maine are relatively scarce. Commercial banks must compete with thrift institutions for the savings of local residents. Thrifts hold relatively more deposits in Maine than in the U.S.:

- In Maine, the thrift institutions (mutual savings banks, savings and loan associations and credit unions) hold more deposits than the commercial banks (see table 3.4). In fact, the largest financial institution at the present time is a mutual savings bank.

- The percentage of the total deposits in Maine which are in commercial banks is significantly below the U.S. average and has declined since 1970 (see table 3.5). Commercial deposits as a percentage of total deposits in Maine declined from 50.7 percent in 1970 to only 45 percent in 1980. The corresponding U.S. figure remained constant at about 67 percent.

- Maine has a greater percentage of its deposits in mutual savings banks and credit unions than the average in the U.S. (see table 3.5).

The distribution of deposits in Maine among the depository institutions is important in terms of the availability of capital to small businesses in the state. As previously discussed, capital resources in Maine are scarce because it is a relatively poor state with low savings. Mutual banks, savings and loans, and credit unions primarily invest their funds in residential mortgages and consumer credit. Since commercial banks are by far the most significant lenders

Table 3.6

Depository Institutions: Percentage of Market

| | 1970 | | 1980 | |
|---|---|---|---|---|
| | Maine | U.S. | Maine | U.S. |
| Commercial Bank Deposits<br>% of Total | 50.7% | 67.6% | 45.5% | 67.4% |
| Mutual Bank Deposits<br>% of Total | 37.4% | 10.1% | 39.9% | 7.0% |
| Savings and Loans Deposits<br>% of Total | 7.9% | 20.1% | 9.4% | 22.7% |
| Credit Union Deposits<br>% of Total | 4.0% | 2.2% | 5.2% | 3.0% |

to businesses, the flow of deposits into the thrift industry potentially means that much less capital is available to business. This is more dramatic in Maine since it is a capital-short state. Although the savings banks are able to become involved in commercial lending, they have not yet become actively involved in that market. Thus, the relative proportion of the state's total savings which are invested in business is significantly below what is the case in the rest of the country.

### 3.3.4 Capital Availability on a Sub-State Level

The problem of capital availability is not the same across the state: The availability of capital varies, the concentration in the market varies; and the distribution of deposits varies.

- Commercial bank deposits per capita were significantly below the statewide average in Sagadahoc, Somerset, Waldo, Washington and York Counties. It was above the average in Aroostook, Cumberland, Knox and Lincoln County. (See table 3.6.)

- Total commercial and mutual deposits per capita were significantly below the average in Franklin, Arrostook, Waldo and Washington Counties and above the average in Cumberland, Knox, and Kennebec Counties. (See table 316.)

- Maine was relatively well served by banking offices throughout the state. Only in Sagadahoc County and Waldo County were the number of residents per bank office high.

- The commercial banking market concentration varied across the state. A few countries (Knox, Lincoln, Piscataquis and Waldo) were extremely concentrated with a three-bank concentration ratio of over 90 percent. York County was the only county in the state with a three-bank concentration ratio under 75 percent (see table 3.6).

This analysis of banks on a county-wide level provides some evidence of possible problems in capital available to business on a

Table 3.7

Commercial Bank Characteristics by County - 6/30/81

| unty and pulation | Number of Commercial Banks / Offices | Total Commercial Deposits (000's) | Number of Mutual Banks / Offices | Total Mutual Bank Deposits (000's) | Total Mutual and Commercial Deposits (000's) | Commercial Deposits Per Capita / % of State* | Commercial and Mutual Deposits per Capita / % of State* | People Per Bank Office | % of Deposits in Top Commercial Bank | % of Deposits in Top Three Banks |
|---|---|---|---|---|---|---|---|---|---|---|
| idroscoggin ),657 | 5 / 27 | $218,351 | 4 / 13 | $282,726 | $501,077 | $2,191 89.7 | $5,028 102 | 2,491 | 52.8 | 80 |
| roostook l,331 | 6 / 37 | $305,498 | 2 / 5 | $ 50,249 | $355,747 | $3,345 127.9 | $3,895 79 | 2,174 | 48.9 | 81.3 |
| imberland l5,789 | 8 / 76 | $610,175 | 7 / 25 | $714,709 | $1,324,884 | $2,828 108 | $6,139 124.6 | 2,136 | 37.9 | 83.2 |
| ranklin 7,098 | 5 / 11 | $ 63,212 | 3 / 7 | $ 63,212 | $ 79,906 | $2,333 89.2 | $2,949 59.8 | 1,505 | 31.4 | 80.7 |
| incock l,781 | 5 / 18 | $136,676 | 4 / 4 | $ 80,439 | $217,115 | $3,271 125 | $5,196 105 | 1,899 | 33.8 | 76.1 |
| ennebec )9,889 | 9 / 36 | $292,810 | 5 / 11 | $291,214 | $584,024 | $2,650 101 | $5,314 107.8 | 2,338 | 43.9 | 81.4 |
| iox 2,941 | 3 / 12 | $122,834 | 3 / 5 | $ 87,555 | $210,389 | $3,729 142 | $6,387 129.6 | 1,938 | 39.2 | 100 |
| incoln 5,691 | 4 / 10 | $ 80,530 | 2 / 2 | $ 30,241 | $110,771 | $3,135 119.8 | $4,311 85.5 | 2,141 | 45.7 | 93.2 |
| xford 3,968 | 4 / 16 | $122,533 | 4 / 9 | $108,951 | $231,484 | $2,502 95.6 | $4,727 95.9 | 1,959 | 37.7 | 83 |
| enobscot 37,015 | 9 / 42 | $445,583 | 6 / 14 | $292,153 | $737,736 | $3,252 124 | $5,384 109 | 2,447 | 43.6 | 74.3 |

Table 3.7 (continued)

| County and Population | Number of Commercial Banks / Offices | Total Commercial Deposits (000's) | Number of Mutual Banks / Offices | Total Mutual Bank Deposits (000's) | Total Mutual and Commercial Deposits (000's) | Commercial Deposits Per Capita / % of State* | Commercial and Mutual Deposits per Capita / % of State* | People Per Bank Office | % of Deposits in Top Commercial Bank | % of Deposits in Top Three Banks |
|---|---|---|---|---|---|---|---|---|---|---|
| Piscataquis<br>17,634 | 2 / 6 | $ 45,012 | 1 / 2 | $ 30,780 | $ 75,792 | $2,553<br>97.6 | $4,298<br>87 | 2,204 | 56.9 | 100 |
| Sagadahoc<br>28,795 | 4 / 5 | $ 33,381 | 4 / 4 | $ 64,521 | $ 97,902 | $1,159<br>44 | $3,400<br>69 | 3,199 | 42.4 | 86.6 |
| Somerset<br>45,028 | 6 / 14 | $ 86,162 | 3 / 6 | $ 94,715 | $180,877 | $1,913<br>73 | $4,017<br>81.5 | 2,251 | 39.4 | 84.2 |
| Waldo<br>28,414 | 4 / 7 | $ 44,351 | 2 / 2 | $ 39,165 | $ 83,516 | $1,561<br>59.7 | $2,939<br>59.6 | 3,157 | 49.5 | 96.2 |
| Washington<br>34,963 | 5 / 16 | $ 64,969 | 2 / 3 | $ 54,173 | $119,142 | $1,858<br>71 | $3,408<br>69 | 1,840 | 48.2 | 81.1 |
| York<br>139,666 | 8 / 36 | $270,213 | 7 / 20 | $298,827 | $569,040 | $1,935<br>74 | $4,074<br>89.7 | 2,494 | 19.1 | 54.8 |
| STATE | 41 / 369 | $2,942,290 | 28 / 132 | $2,600,324 | $5,542,614 | $2,616<br>100 | $4,928 | 2,245 | | |

* This number compares county figures to the statewide average.

sub-state level.[1] The counties which are growing fastest in terms of employment and population growth--Sagadahoc, Lincoln, and York--all have deposits per capita in the banks which are below the statewide average. Sagadahoc in particular has the lowest commercial bank deposits per capita in the state. It is precisely in these counties where demand for goods and services is rising that small business growth is the most likely. Businesses in these counties could possibly go to other counties or to out-of-state banks for capital. However, smaller businesses, particularly the type which grow in response to population and employment growth, face many limitations in dealing with banks outside of their local areas. Thus, small businesses in these higher growth counties may face relatively more problems than their counterparts in lower growth counties which have a greater amount of capital resources per capita.

As one would expect, the poorest, lowest growth counties--Waldo, Washington and Aroostook--all have per capita deposits below the state average. Aroostook County is interesting in that on a per capita basis it has the highest percentage of deposits in commercial banks in the state. However, it has very few mutual banks. Thus, businesses in that county potentially have greater resources available to them for lending than in other parts of the state.

### 3.3.5 Non-Local Competition in the Maine Financial Market

The banking industry in Maine must compete for funds and lending opportunities with a variety of out-of-state depository and non-depository

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[1] It must be emphasized that counties do not exactly coincide with a bank market area. They are, however, often used as a good proxy for a market area.

institutions. Thus, local businesses are not solely dependent on the in-state banks for credit. Although we know that these institutions are a source of capital to Maine businesses, there is no way of quantifying the level of resources which they provide.

Nationally, the financial market is in a state of flux. With a growing awareness of the likelihood of interstate banking, financial institutions are trying to position themselves in markets throughout the country. Thus, competition from out-of-state institutions may become more significant than intrastate competition in Maine. Out-of-state competition can take a number of forms:

- Edge Act Corporations can be established by a bank in any state to provide full banking services specifically for international transactions.
- Loan Production Offices (LPOs) can be established to service loans for a bank in another state.
- Non-depository institutions such as Sears, Control Data, Merrill Lynch or Fidelity Management can engage in activities and provide services throughout the country which compete with local banks.
- Finance, leasing and factoring companies owned by Bank Holding Companies can engage in competitive activities and yet not be limited by geographic regulation.
- Correspondent banking relationships can become an important method of increasing multistate presence.
- Out-of-state financial institutions can purchase minority stock interest in local institutions to gain a foothold in the market.
- Foreign banks can establish branch offices which compete with local banks.
- Forced mergers between troubled in-state and stronger out-of-state thrift institutions provide an entry to new markets.

Maine was first in the nation in allowing acquisitions of Maine banks by out-of-state bank holding companies from states with similar rights for Maine banks. Legislation recently passed in New York now provides such reciprocity and opens the way for Maine banks to be purchased. A couple of major Maine banks are already negotiating with New York banks.

In addition to outright purchases, out-of-stock institutions have acquired financial interests in Maine. For example, First National Bank of Boston is now the owner of 27.9 percent of the outstanding stock of Casco-Northern Corporation, providing conversion.

Other out-of-state institutions, particularly from Massachusetts, are aggressively pursuing lending opportunities in Maine. These banks are often able to provide services to their customers not currently available in Maine. For example, one Maine entrepreneur of a growing small business was forced to turn to a Boston bank when he was unable to find a bank in Maine willing to provide asset-based financing. According to this businessman, within one week the Boston bank had wooed away ten of the best small business customers from the local banks.

In the long run, banks in Maine must learn to compete with the non-depository institutions and out-of-state banks if they are to survive. That may require developing more aggressive lending policies and providing more sophisticated services. Such a change in the behavior of local banks will not only benefit the banks themselves. Through serving their own needs, they will also better serve the small business community in the state and enhance Maine's overall economy.

## 3.4 The Availability of Long-Term Debt and Equity

This section of the report analyzes the availability of sources of long-term debt (outside of the banking industry) and equity capital. As previously discussed, long-term debt, particularly subordinated debt and risk capital, are the most difficult types of capital for small businesses to locate. The lack of availability of this type of capital is particularly severe in Maine where there has historically been no large pool of risk capital available.

### 3.4.1 Large Capital Pools in the State

The large pools of capital potentially available for in-state investment include the insurance industry and the Public Employee Pension Funds. Maine, however, does not have a large domestic insurance industry. Currently there are 65 domestic insurance companies but Union Mutual in Portland, the thirty-ninth largest in the country, is the only company of any significant size.

Nationally, insurance companies are a significant source of long-term debt. However, they rarely consider investments in firms of under $100 million in sales. Thus, they are not a source of funds to the state's small business community. In fact, Union Mutual in Maine has a higher minimum investment restriction than some Boston-based firms (Brace, 1977).

Public pension funds are increasingly becoming an important force in national capital markets. The growth of these large public trust funds has spurred the realization that they can be a valuable source of financing for economic development. It is possible to use these funds to increase the supply of capital for housing or business finance and still maintain a fund's primary responsibilities to its beneficiaries.

As of June 30, 1981 the Maine State Retirement System had assets of $384 million, making it one of the largest financial institutions in the state. The fund's portfolio is comprised of 49.1 percent corporate stocks; 37.9 percent bonds; 1.5 percent mortgages; 2.3 percent in an insured guaranteed contract; and 8.5 percent in a commingled trust fund. Maine's fund currently has virtually no investments in the state. It is interesting to note, however, that it does invest in pools of home mortgages which could potentially benefit the state. However, not one of its pools is of Maine mortgages. The majority of the mortgages are from the sunbelt--Florida, Texas, Arizona, North Carolina and Georgia.

There are important models throughout the country of public employee retirement systems which are successfully making targeted venture capital investments, as well as in-state mortgage investments. They provide evidence that the public employee pension funds could be an important capital resource in the economic development of a state.

There is another potential pool of capital in the state of Maine. In 1981 legislation was presented which would create a Mining Trust Fund with taxes collected from mining companies. This legislation called for using the Trust Fund for the development of parkland, the restoration of natural resources, and education and construction projects. Our extensive experience working with and establishing similar trust funds in the resource-rich Western states has led us to the conclusion that trust funds should be used for four purposes:

1. paying for the current costs associated with the exploitation of that resource,

2. helping existing local small businesses to participate in development associated with the boom,

3. diversifying the economy away from dependence on the non-renewable resource, and

4. saving for the rainy day when the resource is gone.

If restructured in this manner the mineral trust fund could be a source of capital for economic diversification in the poorer regions of the state.

### 3.4.2 Other Sources of Risk Capital

The two primary sources of equity capital for small business, outside of friends and family, are the publicly traded stock market and the private placement venture capital industry. Both sources of equity capital are extremely cyclical and often reach only firms in certain locations or in selected industries. Consequently, small businesses, particularly those serving regional and local markets, are constrained in their ability to obtain equity capital.

Venture capitalists seek investments that offer extremely fast growth and high returns. Until very recently, they primarily invested in firms located near their home offices in Boston, San Francisco or New York, and then primarily in the booming high technology firms. Consequently, there was a dearth of venture capital for many years. However, the success rates experienced by major venture capital pools has enticed massive amounts of high-risk investment capital into the market.

Further investigation reveals, however, that the bulk of any new investment will not benefit smaller firms in non-glamour industries. Recent reports depict investors clamoring for investment opportunities, trying to convince firms that they need to raise even more money than originally planned. But these deals are almost entirely made with energy development firms and high technology companies (e.g., computer software, medical technology).

The availability of organized forms of risk capital is extremely scarce in Maine. The limited availability of sources of equity capital in the state was the impetus behind the 1977 legislation which created the Maine Capital Corporation (see Chapter 4 and Appendix). Prior to the creation of MCC the only source of risk capital was one SBIC in the state which was not an active investor. (In 1979 the existing SBIC made two investments for a total of $31,800; in 1978 there was no SBIC financing in the state.) MCC, however, is only capitalized with $1 million and has not yet made any significant venture capital investment.

What venture capital there is in Maine is extremely unorganized. Many entrepreneuers we spoke with noted that there are wealthy individuals in the state who are looking for investment opportunities. An aggressive entrepreneur will usually be able to get into a network which is aware of these sources of risk capital. Although this is potentially an important capital resource in the state, there is no way of quantifying it or precisely identifying it. If there was a way to organize these resources or simply develop an institution to act as a broker, these isolated sources of risk capital may flow more productively into Maine's small businesses.

# 4.0 ANALYSIS OF STATEWIDE DEVELOPMENT FINANCE MECHANISMS

Maine has been a national innovator in the area of development finance and has developed a broad range of programs to address capital needs of business in the state. The development of the Maine Guarantee Authority, the "umbrella" revenue bond program, the Maine Capital Corporation and the Small Business and Veterans Loan Authorities are all evidence of Maine's commitment to increasing the flow of capital to smaller enterprises. In addition to these statewide programs Maine also has a strong network of regional and local corporations actively involved in the economic development process.

Although the fundamental structure for an effective and comprehensive small business development finance system exists in Maine it is now necessary to reconsider the legal structure, management structure and operations of the existing statewide institutions. In addition, based on our analysis of the economy and capital market it is important to assess how well these institutions are filling identified capital needs. The following chapter thus looks in detail at how well current programs are addressing the needs of small business finance in Maine. Programs included in this analysis are:

1. the Maine Veterans Small Business and Small Business Loan Authority,
2. the Maine Guarantee Authority,
3. the Maine Capital Corporation,
4. Small Cities Program,
5. Regional Development Finance organizations.

## 4.1 Maine Veterans Small Business and Small Business Loan Authorities

These programs are designed to primarily serve Maine's micro-business borrowers. Each authority is authorized to guarantee a maximum of 80 percent of loans of up to $30,000 made by Maine lending institutions to independent Maine-based businesses. Loans of up to $60,000 to businesses owned by war veterans can be guaranteed jointly by the two authorities. By limiting the risk exposure of the lending institution, these guarantees enable Maine lenders to extend credit to sound business ventures which they consider too risky to finance conventionally.

### 4.1.1 Uses of Funds

The authorities guarantee loans for both fixed assets and working capital, including land and building acquisition, real estate improvement, machinery and equipment purchases, and inventories. The setting of interest rates and loan maturities are at the discretion of the lender in accordance with market conditions, although the authorities must find that the terms set by the lender are reasonable. Loans must be secured by sufficient collateral, either tangible or intangible.

### 4.1.2 Sources of Funds

Funds to administer the authorities and capitalize the guarantee funds are derived primarily from state appropriations: $200,000 in 1974 for the start-up of the veterans program, $100,000 in 1978 for start-up of the general program, and a subsequent $70,000 set aside from a state contingency fund. The budget is augmented by fees charged to participating banks. Lenders are charged an annual fee of 1 percent of the outstanding balance of guaranteed loans they hold. Approximately $85,000 in fees had been collected as of June 30, 1982. These sources of funds have been adequate to cover the operating expenses of the authority.

In addition, the two programs have standby bonding authority of $6.5 million. This could be used to vastly expand operations and to create a secondary market. To date, the activity of the program has not yet reached a level which has required use of this authority.

### 4.1.3 Program Administration

Each authority is governed by a nine-member voting board. Eight members are appointed by the Governor from the general public. These are generally small business owners, bankers, and, in the case of the veteran's program, representatives of veterans organizations. A state official serves as the ninth voting member, the Director of Veterans Services in the case of the veterans program and the Director of the State Development Office in the case of the general program. The State Treasurer serves ex-officio in both boards. The two boards jointly select a manager to administer both programs. An additional staff person is hired by the manager to provide clerical and administrative support.

The authorities consider loan guarantee applications at the instigation of the lending institution. They do not accept applications directly from borrowers. The guarantee process occurs in the following manner.

A business owner approaches a commercial bank or savings institution with a loan application. The lending officer reviews the application and all supporting business and personal data in the manner prescribed by the lender for conventional business loans. If the bank determines that an unguarantied loan would be too risky on terms affordable to the borrower, but that the loan is sufficiently collateralized and not otherwise unsound, it can forward a guaranty request to one or both (in the case of a veteran) of the authorities. The manager of the Authorities evaluates the request, using the same application forms and supporting data employed by the lending institution, and forwards a recommendation to the appropriate board or boards. Upon approval of the guaranty, the loan is issued by the lending institution. The lender is responsible for administration and servicing of the loan and, in case of default, liquidation of collateral. The authorities guaranty the lender repayment of the difference between 80 percent of the amount of principal and interest remaining due on a defaulted loan and the amount obtained from collateral liquidation.

Information about the programs is disseminated to the state's lending institutions through face-to-face contact between the authorities' manager and bank officials and through two or three annual mailings to central and branch offices of all Maine institutions. Typically, the manager will make initial contact with an institution through its senior management. Subsequently, contacts are made with managers of branch operations and individual branch managers. Contacts with branch personnel are emphasized on the assumption that since they work directly with borrowers, their awareness and understanding of the guaranty program is likely to have the greatest impact on the volume of guarantied loans issued.

4.1.4 Operating History

As of June 30, 1982, the two programs had outstanding guaranty commitments of almost $1.2 million on 120 loans, for an average commitment size of $10,000. The number of commitments annually average thirty-one for the Veterans program over eight years of operations and eighteen for the general program over four years of operations. While no annual figures are gathered, the manager of the authorities estimates that during the fiscal year ending June 30, 1982, approximately twenty guaranties were made under the Veterans program and between thirty and thirty-five under the general program. Loans guarantied by the authorities are divided roughly evenly between business acquisition, inventory expansion and new equipment loans. Acquisition loans can be both long-term and working capital. Although historically authority-guarantied loans have had on average a 10-15 year term, the recent trend seems to be towards working capital loans. This reflects business and bank caution in a high-interest rate environment. Use of the programs has been somewhat uneven, both sectorally and regionally. They have been used primarily by small service and retail firms and fishermen, but few manufacturing firms. Lending institutions participating in the program have been primarily from the southern regions of the state, while those located north of Bangor have generally not participated.

The authority-guarantied loans have had an extraordinarily low default rate, having written off only $70,000 of guarantied loans in eight years.

4.1.5 Analysis

Any assessment of these programs rests on how well they have functioned to make loans more widely available to the state's smallest business enterprises. On these grounds they score well in targeting the guaranties to the intended recipients, but less well in expanding the volume of small business loans by private institutions. Guaranties approved by the authorities have been for loan commitments averaging $10,000, indicating that they have gone to very small businesses. The manager of the authorities confirms that most guaranties are issued to sole proprietorships employing fewer than fifteen people. While program regulations do not prescribe size limits for firms eligible for guarantied loans, both the size limits to the guaranties and the philosophy of the board and staff of the authorities have effectively focused these programs on the state's smallest firms.

While the program appears to have been well targeted, the level of its use has been disappointing. An average of fifty guaranty commitments annually is small when measured against the approximately 18,000 microbusinesses in the state (County Business Patterns, 1980). In contrast to these commitment levels, the Small Business Administration issued a total of 291 direct loans and loan guaranties in 1981, despite the fact that the larger firms served by the SBA are fewer in number than those served by the state small business loan authorities.

These low commitment levels do not result from program funding limitations. The two authorities have a combined guaranty authorization of up to $6.5 million, to be backed if necessary by the issue of state general obligation bonds. Nor do administrative complexities or costs to participating lending institutions appear to be the issue. In fact the program is remarkable for its absence of paperwork and the flexibility given to lending institutions in negotiating loan terms with borrowers. In fact, the programs' ease of administration combined with reduced risk exposure for the lender should make banks more eager to service the needs of its smaller borrowers.

A number of other factors offer more plausible explanations for the program's low levels of use. These include:

- Unfamiliarity with the program among both banks and small business borrowers. While the authority conducts ongoing efforts to publicize the program among lenders, our discussions with the senior managers of lending institutions throughout the state revealed a surprising lack of awareness or only vague familiarity with the program among many of these managers. Moreover, small business owners themselves were often unaware of the program. Because the authorities do not market their programs directly to borrowers, small businesses rely primarily on information from lends and thus often cannot independently assess their eligibility for the programs or request that lenders unwilling to make conventional loans consider applying for a guaranty under the programs.

- Failure of some banks to recognize the advantages of the program. Even when aware of the program, some banks appear to be reluctant to make full use of it. This has been particularly true in the northern regions of the state. These banks tend to have more conservative lending policies, greater reluctance to participate in government-sponsored programs, and to experience fewer competitive pressures to expand services to small business customers.

- Poor diffusion of information from senior managers to branch managers and lending officers. Support for the program among senior managers may produce different levels of program use by different banks. Some banks use more systematic means than others to convey upper level support to branch personnel, such as including program instructions in procedural manuals or having centralized commercial lending departments. Such indications of a positive attitude among senior management are likely to influence the behavior of front-line personnel.

- <u>Low loan maximum discourages use of the program for small businesses needing larger loans</u>. Since 1977, when maximum loan amounts for the program were not set, the costs of doing business have risen substantially. Many businesses whom the programs were designed to serve may find themselves unable to use the programs under the limits now in effect. Moreover, there is a substantial gap between the upper loan limit for these programs and the lower limits for other state and federal guaranty programs. The Maine Guarantee Authority's loan insurance program is typically used for loans of several hundred thousand dollars, and the SBA program is not generally used for loans of less than $100,000. Businesses needing loans in the $30,000 to $100,000 range are thus at a disadvantage to those needing either smaller or larger loans.

- <u>Illiquidity of loans make them unattractive to lenders during periods of low bank liquidity</u>. While currently low levels of loan demand have put Maine's banks in a highly liquid position, lending under these programs may be unattractive to lenders during periods of high demand because they are unable to maintain liquidity through sale of the loans in the secondary market.

- <u>80 percent guaranty does not sufficiently reduce lender's risk exposure</u>. Some bankers have commented that they would more aggressively use the program if the guaranty were increased to 90 percent, the limit currently in effect for SBA-guarantied loans.

## 4.2. <u>Maine Guarantee Authority</u>

The Maine Guarantee Authority (MGA) was established to promote and encourage the development and expansion of industrial, manufacturing, fishing, agricultural and recreational enterprises in Maine. To this end MGA utilizes programs to insure business loans and to finance business credits by the provision of industrial revenue bonds.

MGA was created in 1973 to consolidate the activities of the Industrial Building Authority, the Recreation Authority and the Municipal Securities Approval Board. The consolidation was motivated in part by the large defaults suffered by both the Building and the Recreation Authorities. Since 1973, MGA has introduced its industrial revenue bond financing programs, in order to more adequately serve as a development finance tool for Maine.

### 4.2.1 Uses of Funds

Currently, MGA operates the following four programs:

1. Mortgage Insurance Program, which permits the insurance of all or part of first mortgage loans;

2. Revenue Obligation Securities Program, which permits the issuance of industrial development bonds by the Authority;

3. Municipal Securities Approval Program, which oversees the issuance of industrial development bonds by municipalities;

4. Community Industrial Building Program through which the Authority financially assists municipalities in the construction of industrial building in approved industrial parks within the state.

4.2.1.1 Mortgage Guarantee Program. The mortgage guaranty program is MGA's most popular and its most controversial program. The program insures industrial and recreational projects. Average guarantied amounts are approximately $1 million for industrial projects and about $450,000 for recreational projects.

The guaranty program is based on the assumption that businesses may require the extensive backing of the state's full faith and credit in order to be "bankable." The provision of the state's guaranty of a business loan does nothing to improve the business's viability. Rather, it replaces the credit risk inherent in any business, with the essentially risk-less credit of the state of Maine. While this certainly encourages banks to finance projects, it does little to encourage the lender to be diligent in its evaluation or monitoring of a project. By shifting almost all the risk of default from the bank to the state, the Maine program created complacency among lenders, who were not as discerning as possible in the application process and fail to play an active role in maintaining the health of a business

The history of the guaranty bears out these problems. Authority officials estimate that MGA has suffered at least a 30 percent loss rate. That is, of $90 million worth of guaranties which have been issued by MGA since its inception, the state has had to sell approximately $30 milion of bonds to cover MGA losses. These figures do not include projects which have failed but from which the lender has been able to recover its loan amount without calling on the state guaranty. Authority officials assert that losses in the 30 percent range continue to be the case at MGA. In fact, of MGA's $50 million constitutional authorization, only $4 million remain either unspent on past defaults or uncommitted to current projects.

Given this large loss rate MGA has followed the recommendations of many analysts to reduce the percentage of loan costs which are guarantied. MGA has stopped granting the full 100 percent guaranty and in the last two years has been issuing partial guaranties of 50-90 percent. Of the six deals during this period the average guaranty has been reduced to about 82 percent. Although the decision to go with only partial guaranties is a large improvement over the past, they have not consistently lowered the guaranty, and losses at MGA remain very high.

Beyond actual losses, the guaranty incurs an additional cost to the state. Because of its historic loss record, and the fact that existing guaranties are viewed as contingent liabilities of the state, the guaranty program has been estimated to increase the state's cost of borrowed funds by nearly 50 basis points.

Taken together, these factors argue strongly for a systematic rethinking of the program and its utility as a tool for economic development in Maine. To this end, it may be useful to consider the experience of other states.

That experience, particularly in New England, suggests that viable mortgage insurance programs can operate without a full faith guarantee. In Massachusetts, the Industrial Finance Agency (MIFA) operates an insurance program capitalized by a $2 million, one-time state appropriation and premiums charged to users. By maintaining a reserve fund balance equivalent to one year's debt service on outstanding guarantied portions of loans, MIFA has been able to maintain liquidity in the program. It should also be noted that, on average, MIFA guaranties only about 25 percent of loan amounts. In so doing, lenders are protected against loss on the riskiest portion of their investment, yet must still be concerned with the ongoing monitoring of the loan. In this way, a constructive, three-way (business, bank, guaranty program) sharing of risk is achieved.

Another New England program, operated by the Connecticut Development Authority (CDA) illustrates that a program very similar in structure to MGA's can be operated far more successfully. CDA's insurance program does ultimately have the full faith and credit backing of the state and does insure projects to 90 percent of loan amounts. However, the Connecticut program, in addition to collecting premiums, also provided for coverage by a special capital reserve fund. Further, CDA is empowered to insure 200 percent of its allocated bonding authority. Its loss still has no impact on the state credit ratings.

Last year, the Maine legislature appropriated $1 million to MGA to begin to capitalize a similar fund. It was anticipated that funding would continue at similar levels for several years until a significant reserve fund would be created. However, the first year funding has already been eliminated to pay off defaults.

In sum, the operation of these two highly successful mortgage insurance programs suggest that the MGA programs may not be structured as effectively as possible and that, within its current structure, it may not be operating as efficiently as possible. The mortgage guaranty program, as MGA's biggest and most problematic program, requires change. The experience in Massachusetts and Connecticut offers some positive new directions.

4.2.1.2 The Revenue Bond Programs. MGA currently operates three different programs; the two components of the Revenue Obligation Securities Program (self-sustaining and umbrella) and the Municipal Securities Approval Program.

The first two programs--self-sustaining and umbrella--are relatively common. MGA's umbrella program was announced in 1981. This program would permit the consolidation of several project loans into a single bond issue. Loans under MGA's Umbrella Bond Program would be for permanent financing for projects whose total costs do not exceed $1.5 million. The amount of a loan may be up to $1 million. These limits are a little higher than in other programs. For example, the Connecticut Development Authority sets a limit of $850,000 for each project. The average size of CDA umbrella loans between 1973 and 1981 was $380,843.

The Umbrella program has not yet been used. From August 1981 to July 1982 IRBs, particularly smaller ones packaged into a single large bond, were unavailable as a result of IRS ruling 81-216. Now that the IRB issue has been clarified at the federal level, it can be anticipated that the program will begin to play a more significant role in financing small business development in Maine. The self-sustaining program held six projects (as of 12/31/81) averaging nearly $2.4 million in size. Three of the projects are also guarantied. The experience of these programs across the country suggests that they can be valuable tools for financing economic development activities. However, the MGA program seems unnecessarily constrained in several respects.

First, neither program is empowered to finance commercial projects or service sector industries. While the programs' emphases should properly be focused on industrial projects, experience elsewhere suggests that IRB financing of commercial projects can serve valid economic development purposes. It should be noted that the recently passed 1982 tax bill eliminates some of the most flagrant abuses of commercial project financing, including golf courses, country clubs, racquetball courts and racetracks.

Soundly constructed programs such as the Commercial Area Revitalization District (CARD) program in Massachusetts have proved to be a valuable tool for rehabilitating the depressed downtown districts of older cities and towns. By creatively and constructively limiting the kinds of commercial facilities which can be financed with IRBs, significant economic benefits can be achieved. While downtown revitalization in Maine may not be as crucial an issue as it is in Massachusetts, the CARD program illustrates the flexibility of the IRB tool in meeting the economic development needs of a state. The importance of service sector industries in Maine (they employ 20 percent of the workforce and are the fastest growing sector) suggests that MGA's IRB programs could be more carefully targeted so that this sector is not excluded and that benefits to the state are maximized.

We do not overlook the differences in credit evaluation required for commercial projects or the service sector generally. We also recognize the somewhat greater risks associated with financing projects of this type. However, a properly conceived, carefully administered approach to this kind of financing can yield benefits which exceed those risks.

4.2.1.3 Community Industrial Building Program (CIB). The CIB program is designed to assist local communities in constructing industrial buildings to attract industrial tenants to those communities. Since 1974 five buildings have been built; three have been sold. Program officials anticipate that buildings will remain vacant for five to eight years before a tenant or buyer is identified. It is difficult to identify the local development benefits which this program produces. It is not clear that a building standing vacant for five years is either a wise expenditure of scarce state revenues or a valuable boost to a community's economic development efforts.

Similar programs sponsored by the Economic Development Administration have produced vacant shells. The key point about such a program is that market demand for industrial space should dictate supply. If a business wants to locate in Maine, the existence of a shell building will not be decisive. The experience of a similar program in New Hampshire is instructive. There, buildings were quickly occupied in the southern part of the state, because of the general market forces, while buildings remained vacant in the northern counties. The state's dollars would be better spent on a program which is more repponsive to the market.

4.2.2 Program Administration

MGA has a professional staff of three including an executive director. By any comparison with other state development authorities, this is a small staff. Staff responsibilities include application evaluation, portfolio monitoring and the recovery of costs on projects in default. It is simply not possible for MGA to adequately scrutinize applications and maintain an up-to-date status of its portfolio at its current staff levels.

Staff are state, civil-service employees. This is at variance with state development authorities around the country. A well-run, successful MGA is ultimately a function of its staff. It is often difficult, within the constraints of state civil service requirements to hire the kind of professional staff, skilled in financial management necessary to ensure MGA's success. This is no reflection on current staff at MGA, rather it is the recognition of the positive experience elsewhere.

MGA's Board of Directors has ten members. Two, the executive director of the State Development Office and the state Treasurer, serve ex-officio. The remaining eight members serve four-year terms and are appointed by the Governor and confirmed by the legislature. A board of this size and composition is typical of state development authorities, but the requirement of legislative confirmation is unusual. In light of MGA's reputation for being overly political, legislative involvement in the selection of Board members may be counterproductive.

In light of MGA's small staff, the Board takes a large role in the selection and structure of MGA projects. Without reflecting on the current Board at all, this is not a highly efficient process. It is far better to utilize full-time, professional staff (if adequately and appropriately staffed) to evaluate proposals than to rely on part-time, unpaid Board members not necessarily holding professional skills.

### 4.2.3 Analysis

Since its founding in 1973, MGA has been plagued by operating problems, large losses, and concomitant failure to engender credibility among the business, political and financial communities. These problems are especially serious given that MGA is the largest source of development capital available to Maine business. If MGA is to play a central role in the development efforts of the state it must recognize and address its problems.

In addition to some of the programmatic problems which have been discussed, three other issues are of serious concern:

- The past operating history and huge defaults of MGA organizational predecessors and MGA itself are very strongly in the minds of the banks, business community and general public. This creates a serious image problem not only for MGA but for all development finance institutions in the state. MGA's losses have created a negative perception about state involvement in capital allocation. The memory of the sugar beet default and Evergreen Valley remains very strong. The history of past mistakes and huge losses must be overcome if MGA is to become an effective development institution. Its continued high loss rate, as exemplified in MGA already using up the $1 million yearly appropriation which was meant to capitalize a reserve fund, has not contributed to changing the institution's image.

- An additional "image" problem which we found among the financial community, small businesses and the general public is the perception that MGA is a politically motivated organization. Although we found no evidence to support these accusations the perception in the field, of political interference remains a problem. Thus, although this perception may not be grounded in any truth, MGA's operations continue to be affected by credibility problems with individuals and organizations it does business with. As of yet MGA has not succeeded in altering these perceptions of political interference.

- Finally, as a development institution with a legislatively mandated public purpose, MGA has to become more "pro-active." It is not enough for MGA to simply react to applications from potential borrowers. The Authority should have a more aggressive approach based on a more comprehensive plan for business development in Maine. This entails more active marketing than is currently undertaken as well as a greater planning capability.

## 4.3 Maine Capital Corporation

In 1977 the state legislature in Maine, recognizing that the lack of investment capital presented severe obstacles to statewide economic development, enacted the legislation which created the Maine Capital Corporation. MCC is legislatively mandated to make investments in new Maine businesses or in existing businesses looking for expansion capital. To capitalize the institution the state provided a 50 percent tax credit against personal and corporate income taxes. In any taxable year, investors can credit the lessor of 10 percent of the investment or 50 percent of the total tax imposed on the investor. There is a four-year carry forward provision, enabling investors to spread the unused portion of the credit over a maximum five-year period. If the investor disposes of MCC stock within six years the investment credit is recaptured in full.

Although individuals, corporations, and trusts and estates could potentially use the tax credit, because of the small size of the state's capital market and the limited familiarity with venture capital investing, it took almost one year to raise the $1 million capitalization. The shares were eventually sold to six individuals, six corporations and nineteen banks.

To date, MCC's operating history has been disappointing. Until very recently, MCC has made only one investment, $52,500 in a firm called Cabletronix, Inc. Shortly after that investment was made, in June 1981 Cabletronix filed for bankruptcy. Recently, MCC made a $150,000 investment in the startup of a new Maine firm. This investment has also attracted nearly $2 million in outside capital.

Since MCC is one of the only organized sources of venture capital in the state and could cost the state as much as $500,000 in forgone tax revenues, it is important to look back at its operating history and its current institutional objectives to assess how well it is meeting the intent of the legislation.

### 4.3.1 Management and Operating Policies

MCC was initially operated under a management agreement with the Maine Development Foundation. The Foundation retained the services of a manager to be responsible for performance of the terms of the agreement. Under this management form only one investment was made in Cabletronix Inc. This one investment was liquidated shortly after it was made in 1981.

Late in fiscal year 1981 the manager of MCC resigned. Following the failure of its first investment and the resignation of its manager, the Board of Directors of MCC reviewed their operating policies and procedures and hired a new manager directly responsible to the Board. The organization also moved out of the offices of the MDF in Augusta and transferred their operational base to Portland.

The current investment guidelines of MCC appear to emphasize expansion financing of firms with a relatively established market position, and leveraged buyouts. Start-up financing will be considered only in exceptional cases, of which the recent investment is a case in point. The stated objective in MCC's brochure is "to create long-term capital appreciation for the venture's stockholders and for Maine Capital."

MCC has no published investment criteria. According to the current staff director, MCC is using the same investment criteria as venture capitalists in Massachusetts, New York or other parts of the country. According to the current management, the primary purpose of MCC is to create capital gains for stockholders and to bring outside capital into Maine. To accomplish this goal, MCC believes that it cannot compromise its expectations of return or any other investment criteria when looking for ventures in Maine. This would suggest that only expected returns in the range of 25-30 percent would be acceptable to MCC.

Although MCC has indicated that it is not looking for any set percentage of equity or specific return requirement, a number of entrepreneurs and small business finance specialists in Maine have commented that one of the problems with MCC was that it was looking for a 30 percent equity position and too high a return. Such a percentage of ownership is in line with general venture capital expectations. However, this percentage of control is perceived to be too high by many entrepreneurs in Maine. Thus, although 30 percent ownership and 25-30 percent return on investment may not actually be a requirement of

MCC in practice, there is a fairly widespread perception in the business community that MCC is looking for too much equity and too high a return.

### 4.3.2 Analysis

The lack of consistent management and minimal investment activity has led to a general confusion in the field about what MCC has been doing and what its objectives are. There is also a general perception that MCC has not yet been successful. The immediate and complete failure of MCC's first venture and the lack of any new investments until the recent startup has contributed to its "image" problem.

It is important to note that many of the problems with MCC are due to the initial legislation. One problem in the legislation which has affected the development of MCC's investment guidelines was the limitation on capitalization to $1 million. Although it is unclear how much more stock MCC could have sold without the $1 million cap, the very small capitalization necessitates a more risk adverse institutional orientation. The current capitalization of MCC does not allow for many losses and does not generate sufficient income for adequate administration. It was the small capital base which led to MCC becoming an SBIC.

A second problem with the initial legislation was that it did not tie the tax incentive to performance nor specify the public purpose of the institution. In the case of the tax break given to the insurance industry in Massachusetts which was tied to the capitalization of the Massachusetts Capital Resource (MCRC) Company, the tax break was granted after MCRC certified a certain number of jobs created as well as a series of other requirements including investment size, sector and location. In the legislation which created MCC there is little mention of job creation objectives or other specific public benefits that MCC should pursue.

It is also important to note that MCC is a young institution. Two years is too early to make any definitive assessment about a financial institution. However, given that there were critical legislative limitations and that MCC is still a young institution, it has not yet developed and may not in the future develop into an aggressive and effective provider of venture capital for Maine enterprises for two major reasons: First, it has apparently relatively narrow investment guidelines and second, it has apparent high return requirements.

4.3.2.1 Narrow Investment Guidelines. During 1981 52 percent of all venture capital investment in the U.S. was for seed, start-up or early stage financing and 48 percent was for expansion financing. The trend over the past few years has been towards increasing early stage financing. Leveraged buyouts are considered in the venture capital industry not as venture development but as a separate category of investment. Less than 8 percent of total venture capital activity in 1981 was in this category. However, despite its recent startup, MCC has expressed primary interest in lower-risk, later stage venture financing and leveraged financing. Although an investment strategy which emphasizes expansion financing and leveraged buy-outs may prove low risk and profitable to MCC's investors (Narragansett Capital Corporation, one of the country's most successful SBICs has concentrated on a leveraged buy-out strategy), there is a substantial question of whether this strategy is meeting the intent of the MCC legislation or the most significant venture capital needs in Maine.

Early stage financing consists of seed financing for product development, start-up financing for early stage product commercialization and first-stage financing to initiate commercial manufacturing and sales. By financing those entrepreneurs and enterprises, MCC could add significantly to the state's economy. Although expansion capital is a critical risk capital need it is not the only need in Maine. MCC was established to provide both higher-risk early-stage financing of new enterprises and expansion capital to existing business (Chapter 180, section 951).

There is serious question as to whether a strategy which focuses on leveraged buyouts and expansions enhances the productive capacity or ability of a firm to do business in Maine or generates value added to goods or services for export to out-of-state markets as stated in the MCC legislation. A leveraged buy-out is simply a transfer of ownership. The only transfers which will contribute to economic activity in the state are those which entail preserving an establishment in Maine which will be closed or moved out of state without the transfer or the immigration under new ownership of an out-of-state firm. The purchase by management and workers of Bates Fabrics in Lewiston in 1977 which saved over 1,000 jobs is an example of a leveraged buy-out which retained economic activity. However, buy-outs of this sort will rarely provide the 25-30 percent return MCC's management is looking for.

MCC has not indicated a significant preference for investments that involve the migration of out-of-state firms, preserve existing jobs that would be lost or transfer ownership to Maine interests. Although MCC probably does have internal preferences, its guidelines should clearly state that the transfer of ownership from one Maine group to another would not be considered unless there is some conclusive evidence that jobs would be lost. Although such an investment may represent a real capital need the issue is: What should be the priorities of a risk capital institution capitalized through the provision of a state tax incentive?

4.3.2.2 Excessive Return Requirements. Given the use of a tax incentive by the state of Maine to attract private capital to MCC there is a real question of whether MCC's image of itself as a privately capitalized investment company which should operate exactly like any other venture capital company is appropriate. (It is important to note that tax incentives have the same revenue consequences as direct state appropriations. The tax incentives could accurately be called a tax expenditure.) Thus, the second major issue concerning MCC is: should MCC's primary mission be long-term capital appreciation for venture stockholders? Such a mission leads to risk averse behavior and the need for returns of 25-30 percent on deals.

A tax credit was used by the state because it was thought that only if investors were provided with current returns would they invest capital in MCC. This assessment was based on the fact that the originators of the concept did not think that the Maine fund would generate the type of returns found in alternative investments. Thus, a tax credit which allowed for a 10 percent return for five years for investors was worked out. Yet current management is still using the return standards of a Massachusetts private venture capital fund capitalized without the benefit of any tax incentive. (A recent conversation with Venture Economics, a private company which is the recognized, national expert on venture capital, confirmed that 25-30 percent is the average return which venture capitalists look for. On higher-risk deals expected returns may be higher; on the lower-risk spectrum, similar to MCC's, expected returns may even be lower.) Again it should be noted that MCC's low initial capitalizaing is partially responsible for the high return requirements.

One way of looking at MCC is to think of the $1 million capitalization as 50 percent private and 50 percent from the state of Maine since in effect the investors are receiving up to 50 percent of their investment in a credit from the state. Thus return to MCC stockholders could be calculated on an equity base of approximately $500,000 (to be exact you would have to discount the credit over five years). This amount represents the investor's real equity investment, rather than $1 million. For example, a 20 percent return on an equity base of $1 million is equivalent to a 40 percent return on an equity base of $500,000. In effect then, the investors in MCC, under the current investment guidelines, will be receiving returns on their real equity investment which is substantially higher than is expected in the private venture capital community.

### 4.3.3 Conclusion

The return requirements and portfolio guidelines of MCC should also be viewed in the following context:

- Recent legislation in Indiana established a "Corporation for Innovation Development" in that state. Using only a 30 percent tax credit that corporation has already attracted over $9.5 million in capital. This corporation's investment guidelines are much broader than MCC's in terms of retention of mature firms and seed and start-up capital.

- A survey of informal risk capital in New England undertaken by William Wetzel and Craig Seymour in 1981 found that among the investors surveyed the median portfolio return expectation for established firms was only 15 percent and on an individual deal the expected return for an established firm was 22-25 percent. These figures were below MCC's expectations. They also found that over one third of the survey respondents would accept lower returns (up to 20 percent lower) when risk capital investments create employment in their region.

Our overall conclusions about MCC are:

- If MCC pursues the course outlined in its venture guidelines, it will continue to have an extremely slow investment pace as the returns and requirements it is looking for are rare in Maine.

- MCC's narrow investment guidelines and concentration on the lower risk spectrum of venture capital minimizes its impact on job creation in the state.

- The 50 percent tax incentive provided by the state of Maine to capitalize MCC should be a consideration in its return requirements.

- Since MCC was capitalized through the granting of tax credits by the state of Maine it should be accountable to the state for its activities.

- Given its extremely slow investment pace, narrow investment guidelines and excessive return requirements, MCC as of yet has done little to contribute to the risk capital needs of small businesses in Maine.

### 4.4 Community Development Block Grants

Currently the Small Cities Community Development Block Grant Program in Maine is run by the State Planning Office. In fiscal year

1982, 46 percent of all awards were for economic development projects. This program has been a potential source of small business finance and thus should be viewed as part of the development finance system in Maine.

The term economic development has gained increasing currency in the jargon of local government policies and programs. Too often, however, local officials have only a vague conception of what is meant by economic development and an insufficient understanding of the complex economic and political environment with which local economic development programs must interact. Consequently, local economic development efforts have tended to focus on relatively "safe" projects such as commercial facade and parking improvement programs, or ill-conceived projects. Often lack of information and/or understanding of the development process leads to missed opportunities for more aggressive, innovative and comprehensive economic development efforts at the local level.

There is some need in Maine to increase the capacity on the local level to undertake economic development. Although in this fiscal year there were many economic development proposals, if the experience of other states holds in Maine, the quality of those requests was not as high as anticipated. A capacity building/technical assistance component in the small cities program could add to the quality and effectiveness of local economic development efforts. A training effort, similar to the one undertaken recently by the Massachusetts Small Cities Program, could present local officials with a comprehensive overview of the many ways in which CDBG funds could be used to lever more aggressive and innovative local economic development efforts.

An economic development training program could build the capacity of local community development specialists in the following areas:.

- formulating an economic development strategy,
- designing local economic development efforts to maximize coordinated public and private sector participation: coordinating with other public efforts, working with the local financial community and working with community-based and other voluntary organizations,
- designing local economic development projects: commercial revitalization, land assembly and development and industrial retention and expansion.

Such an effort could lead to more innovative and comprehensive local development efforts. In turn, it could potentially lead to more effective and coordinated support for the small business community in Maine.

## 4.5 Regional Development Finance Programs

Regional development efforts in Maine, as elsewhere, have traditionally been initiated by federal efforts. In Maine, the predominant regional development programs which provide capital to small businesses are:

- revolving loan funds initially capitalized by the Economic Development Administration (EDA) but entirely under the administration of regional development organizations,
- SBA 503 corporations which have access to debentures issued by the Small Business Administration (SBA).

### 4.5.1 Revolving Loan Funds

Currently there are three general purpose regional revolving loan funds in Maine. They are operated by:

- the Northern Maine Regional Planning Commission serving Aroostook County;

- the Eastern Maine Development Corporation serving Hancock, Knox, Penobscot, Piscataquis, Waldo and Washington Counties; and
- the Androscoggin Valley Regional Planning Commission serving Androscoggin, Franklin and Oxford Counties.

In addition the Lewiston-Auburn Growth Council administers a revolving loan program in those two cities and Coastal Enterprises Inc. runs a resource-based revolving loan fund in Eastern Cumberland, Sagadahoc and Lincoln Counties.

The advantages of the revolving loan funds are several. They are flexible in that they can be used to finance a broad range of business needs including working capital. They are relatively inexpensive to operate and can, therefore, be used to finance a wide variety of business sizes. Program officials note that RLF loans range from less than $10,000 to over $250,000. Typically, RLF funds are used in conjunction with both public funds from state and federal sources and private bank financing. This capability to serve as the "glue" money necessary to bring a financing package together is perhaps the most valuable function of the RLFs.

Unfortunately the EDA-financed RLFs only serve the counties listed above. The remaining Maine counties--Cumberland, Lincoln, Kennebec, Sagadahoc, York and Somerset--lack this important financing tool. This is in part a result of the fact that EDA revolving loans programs were available only in designated distressed areas. While several of the counties without RLFs are rapidly growing and more prosperous than those with RLFs, the need nonetheless exists for a source of "glue" capital to induce private lenders to participate in projects.

The size of typical RLF loans has gone through an interesting evolution. Prior to the advent of the 503 program, the average RLF loan was somewhat larger than is currently the case. Now, it appears that the 503 programs have supplanted the larger end of the spectrum of RLF loans.

4.5.2 503 Program

The SBA sec. 503 program is a new and relatively successful innovation in business development financing. There are currently six 503's being operated in the state.

- Northern Maine Regional Planning Commission
- Eastern Maine Development Corporation
- Androscoggin Regional Planning Commission
- Lewiston Development Corporation, serving the city of Lewiston
- Coastal Enterprises, Inc. (CEI), serving Eastern Cumberland, Sagadahoc, Lincoln and Knox Counties
- the Maine Development Foundation (MDF), serving the entire state.

As with the RLFs, the sec. 503 program does not serve all areas of the state equally. In fact, beyond MDF, York, Western Cumberland, Somerset and Kennebec Counties lack access to a sub-state sec. 503. SBA officials in Maine have noted their intentions to establish a sec. 503 corporation in York County to serve southern Maine. While Kennebec County, in which MDF is based, and Western Cumberland, which includes Portland, may well be adequately served by MDF, the lack of a sub-state sec. 503 in Somerset should be rectified.

While the sec. 503 has been successful nationally and appears both to have been intelligently organized and to be well run in Maine, the program is not without problems. Several sec. 503 officials have noted that the fee structure of the program is insufficient to reimburse the development agencies for the costs of administering the program. This fact helps to explain the predominance of larger financing by the 503 programs (average sec. 503 loan is between $150,000 and $300,000). Sec. 503 financing is not available for more than $500,000 per project and must be lent for fixed asset financing.

An important feature of the regional development programs is their relationship to state-level development efforts. The regional programs, for the most part, were not initiated by state efforts and continue to operate separately and independently of the state. This independence maintains an important sense of local control and allows for greater sensitivity to local and regional economic conditions. But it is also important to coordinate regional efforts more closely with state level efforts.

One tool for increasing this coordination is the recently initiated Small Business Economic Revitalization Program (SBR) sponsored by the Department of Housing and Urban Development (HUD), the Small Business Administration (SBA) and the Department of Commerce. The program will provide each of the twenty-one SBR states (Maine is one) with $40,000 for the training of four economic development professionals (EDP). These EDPs will be trained in creative loan packaging, including the use of sec. 503 programs. As a result, these professionals will be able to serve as a clearinghouse for business development activities and as an important link between state-level and regional development efforts.

## 5.0 POLICY RECOMMENDATIONS

The analysis of the state's economy, the supply of private capital and the existing statewide development finance mechanisms have led to a number of general conclusions:

1. Although Maine has a broad range of small business finance mechanisms, the lack of coordination and long-range planning among the existing state institutions reduces the effectiveness and efficiency of the entire system.

2. Neither the private capital market nor the publicly initiated but privately capitalized and managed Maine Capital Corporation provides necessary seed and start-up capital for Maine entrepreneurs. Early-stage risk capital thus remains a serious capital gap.

3. Although the Maine Guarantee Authority and the Maine Veterans Small Business and Small Business Loan Authority have the capability of aggressive and effective involvement in providing capital to small business, there are problems in the current structure and operation of both mechanisms.

4. A vast majoriy of commercial lending is currently and should remain in the hands of the private banking industry. The banks remain by far the largest source of small business finance in the state. The problems of how well banks are meeting the credit needs of small business must be viewed from two perspectives: First, from the bank's point of view credit is often denied because small businesses are either undercapitalized or poorly managed; this is a valid concern. Second, from the point of view of the small business bank loan guidelines are often not appropriate to their situation and loan officers lack full understanding of small businesses. This too is a valid concern.

These four general conclusions have led to the development of the following policy recommendations.

- the establishment of a Maine Development Board which will coordinate and oversee the activities of the state development finance mechanisms;

- the consolidation of the MGA and the MVSB/SBLA into a reorganized Maine Business Development Finance Authority.

- the establishment of a Maine Innovation Development Corporation to provide seed and start-up capital to entrepreneurs and the reactivation of a restructured Business Development Corporation to provide longer-term, subordinated debt financing;
- the initiation of a cooperative and constructive dialogue between the small business community and the banks.

## 5.1 Coordination and Oversight of Existing Development Finance Mechanisms

### 5.1.1 The Problem

The inventory of programs in the Appendix illustrates the broad range of small business support efforts in the areas of finance and management and marketing which currently exist in Maine. The more in-depth analysis of the individual state level efforts, however, provides evidence that in practice some of the institutions are not operating as effectively as possible. Through our analysis of existing and proposed development finance mechanisms as well as our extensive conversation with members of the small business and financial communities, our most fundamental concern with development finance in Maine is the lack of communication and coordination among existing institutions.

Lack of coordination of efforts results in a number of serious problems. First, it creates lack of understanding and confusion in both the small business and finance communities. Second, it leads to many inefficiencies: two organizations may be providing the same service or may be looking for the same information. Lack of coordination decreases the efficiency in the operation of each institution and the system as a whole. Third, without coordinated planning none of the programs are targeted as effectively as possible to meet stated public policy objectives. Finally, individual institutions do not jointly participate on as many projects as would be possible with increased coordination.

## 5.1.2 Purpose and Tools of the Maine Development Board

Given the lack of coordination in Maine that has been noted by all observers of the development finance system we recommend that a larger, umbrella organization be formed to integrate and coordinate activities of the individual organizations. Although there are a number of options in the creation of such an "umbrella," the purpose of such an organization would be:

- to bring a statewide perspective to small business and economic development,
- to be a central clearinghouse for development projects and inquiries,
- to coordinate needed background research and analysis of different sub-state economies and sectors of the economy,
- to provide oversight and accountability to insure that development activities further the objectives of the state,
- to have an emergency capacity to identify problem sectors or communities and develop programs and target resources more effectively.

Although a Maine Development Board would be created, the specific tasks outlined above would be allocated by the Board to the appropriate institution. For example, in terms of research and analysis the staff and expertise of the State Planning Office and the Maine Development Foundation could be used; or the State Development Office could become the clearinghouse agency for all inquiries and projects.

### 5.1.3 Management and Legal Structure of a Development Finance Board

Although ideally it would make sense to centralize a lot of the current and proposed development finance mechanisms under the direction and control of one central, aggressive development institution, we do not think that it is currently feasible or appropriate in Maine. However, we do think that the state should be working towards the eventual goal of consolidating most of the existing and proposed development and technical assistance institutions.

What we propose is the creation of a Maine Development Board appointed by the Governor, which will meet on a monthly basis and which will have specified powers relative to the other institutions. The current agencies and institutions which it would have direct oversight of would include:

- the reorganized Development Authority which would include the current MGA and MVSB/SBLA;
- the proposed Maine Natural Resource Finance and Marketing Authority;
- Maine Capital Corporation;
- the proposed Innovation Development Corporation;
- the State Planning Office with its community development funds and proposed Development Opportunity Fund;
- the Maine Development Foundation
- the State Development Office.

In addition, the Regional Planning Commissions should be tied into the process.

Each of these agencies and institutions would maintain their own Board and operate independently. The role of the oversight committee would be to:

1. Develop statewide policy objectives on development issues;

2. Identify priority projects based on these objectives;

3. Identify target sub-state regions and sectors which require development assistance;

4. Coordinate the activities of institutions under its "umbrella" in relation to priority projects and targeted regions and sectors so they function more as "windows" of one integrated agency;

5. Coordinate future funding decisions, appropriations and debt issues of participating institutions;

6. Be a central forum for requests for development assistance and refer proposals to appropriate institutions;

7. Have some "emergency" power to deal with specific crisis situations such as plant closings or serious problems in major industries. (The purpose here is to address special situations such as the problems in the poultry industry.)

8. Coordinate the development of any new legislation or any amendment to existing legislation.

The Board should be appointed by the Governor. Members could include the Director of the State Planning Office, the State Development Office, the Commissioner of the Department of Agriculture and the Department of Conservation, and a representative from the Maine Development Foundation, the business community, the financial community, and a local development organization. Special subcommittees on special concerns could be formed with representation from relevant organizations.

The Board could be established through an executive order and does not necessarily require legislative approval. However, to institutionalize the Board as a long-term component of the development process in Maine may require formalizing its establishment beyond the executive. Minimal funding would be required. The organization of meetings and special projects could go through the State Development Office staff or the Governor's office.

## 5.2 New Initiatives to Increase the Supply of Risk Capital

### 5.2.1 The Problem

Risk capital--long-term subordinated debt and equity capital--is in very short supply in Maine. Private venture capitalists from outside Maine rarely enter the state looking for deals. When they do their interest is primarily in technical enterprises in the southern part of the state. Although there are unorganized sources of investment and investment brokers who are able to locate venture sources in the state for clients, the only organized source of venture capital in Maine is the Maine Capital Corporation. As we have previously discussed, their contribution in the area of risk capital is limited for three reasons:

1. MCC is only interested in late-stage financing and leveraged buy-outs. It has excluded seed and start-up capital in its investment guidelines.
2. The level of returns and type of deals it is looking for are extremely difficult to locate in Maine and it is unwilling to balance its returns with potential public benefits to the state.
3. Its initial capitalization of $1 million was very small for a venture fund and has contributed to the investment orientation of MCC.

In the area of long-term subordinated debt--another important and difficult-to-locate form of capital--Maine small businesses in the past had access to the Development Credit Corporation. However, due to a very poor operating history the DCC was dissolved by its members.

Maine entrepreneurs and growing small businesses often face serious obstacles in their search for risk capital. Innovation, new enterprise formation, and small business growth are key to the creation of a diversified and resilient economy. Without the availability of risk capital none of these processes are likely to occur. Increasingly even states with strong traditions of economic and political conservatism are considering public actions to channel capital to innovative businesses whose higher risks deter private investment. Given this need in Maine we recommend two new initiatives:

1. the creation of a seed and start-up capital corporation;
2. the reactivation of the Development Credit Corporation modeled along the lines of the more successful BDCs around the country.

### 5.2.2 Innovation Development Corporation

5.2.2.1 Institutional Purpose. The purpose of the creation of an Innovative and New Enterprise Development Corporation would be to provide seed and start-up capital for new product development and new enterprise development. This new institution would not necessarily invest in only the so-called "high-tech" industry. Investments in seed capital in the state's more mature industries and in the natural resource sector would be part of the portfolio of the new institution. The larger mission of such an institution would be to create jobs and to aid in the development of a more diversified economy in Maine. Unlike the case of MCC the legislation for this proposed institution will be clear in stating that the mission will be first and foremost to promote economic development.

5.2.2.2 Institutional Tools. Maine has a long history of independent entrepreneurial activity. One of the problems which entrepreneurs perceive in MCC is that it is looking for too much equity in its deals. Maine entrepreneurs are often unwilling to give up equity because it means a loss of their control over their firm. Given this background, the proposed institution would have two major investment tools:

- venture capital investment in firms involved in new product development, refinement, marketing and production;
- research and development investments in new products with the institution not acquiring any equity position in the company, but royalty income from successful products.

Thus, a Maine innovation and new enterprise corporation could incorporate aspects of the Massachusetts Technology Development Corporation, a public venture capital fund which invests in equity and subordinated long-term debt instruments in early-stage, high-risk, technology-based companies, and the Connecticut Product Development Corporation which invests directly in the research and development of new products and processes.

In addition to these investment tools the "Innovation Development Corporation" could leverage additional outside private capital by acting as a clearinghouse and broker for inventors and entrepreneurs in Maine and for out-of-state entrepreneurs interested in relocation. The corporation would work very closely with the New Enterprise Institute at the University of Maine with NEI. The Corporation could provide a networking and referral function which is as important as its investment function.

5.2.2.3. Management and Legal Structure. There is no doubt that the experience over the past decade in the creation and operation of state-level public equity institutions points to one fundamental fact: management is the key to success. There have been privately managed funds which have performed poorly as well as publicly managed funds with significant successes. What determines their performance is the skill of their managers.

Although as recently as a few years ago there was a great degree of skepticism in the field about the capacity of a public equity institution to have as effective a management as a privately operated fund, the more recent operating history of the four existing state-level institutions provide evidence that this skepticism was in some instances unfounded. To summarize:

- By 1981 the Connecticut Product Development Corporation (CPDC) has invested approximately $3.5 million in 33 Connecticut firms. Twelve of these products together returned royalties of over $200,000 to CPDC in 1981, a 400 percent improvement over the previous years. CPDC has directly created 160 jobs in the state.

- By 1981 the Massachusetts Technology Development Corporation has made over $3 million in investments and has leveraged an additional $14 million in private capital. This investment is expected to generate almost 1,000 new jobs in the state. Although income figures do not yet reflect it, all involved report that MTDC has a number of significant "winners" in its portfolio which will return market rate returns to the institution.

- Although the other state-level institutions--the Massachusetts Community Development Finance Corporation and The Alaska Resources Corporation--have been experiencing problems in their management and portfolio, both institutions are currently undergoing major changes and are in turnaround positions.

What makes a successfully managed institution is not so much whether it is a public or private institution--the issue is that the management of a financial institution has at least the equivalent skills of its counterparts in the private sector and is compensated in a range which approaches the private sector.

The management of an institution involves more than its staff. Who sits on the Board of Directors is another fundamental element in the success of a development institution. A finance institution must have individuals on its board with the skills necessary to make sound financial judgements. A board must also be insulated to a large degree from the political process.

The Board of Directors for the Innovation Development Corporation could have the following characteristics:

- staggered six-year terms;
- four public members representing the relevant state departments;
- six private members including successful Maine entrepreneurs, an engineer/scientist, a representative of the state university system, and representatives of the financial community. Sepcific qualities of the Board members could be specified in the legislation.

5.2.2.4 Capitalization. There are a number of options in considering how to capitalize the proposed institution:

1. Use of a G.O. Bond to capitalize an institution in the manner of the Massachusetts Community Development Finance Corporation;
2. Use of annual appropriations;
3. Use of a tax credit along the lines of MCC

We would recommend that the state consider a combination of these options. Specifically, the study undertaken by Wetzel and Seymour for the SBA on Risk Capital in New England found that 52 percent of those surveyed indicated a moderate to strong interest in participating as passive investors in professionally managed, pooled risk capital investment funds. Although it was difficult to attract investors to Maine Capital, the state may decide to offer the same tax incentive as was offered to investors in Maine Capital, but couple the tax credit with an equal match of public funds to private funds. The state may try to market the concept to its many wealthy residents rather than to financial institutions and provide administrative support for the institution.

5.2.2.5 Acccountability. As a public corporation, the proposed institution must be directly accountable to the state of Maine to assure that it is achieving its public purpose. The legislation establishing the corporation should explicitly state that the institution provide an annual report to the legislature which includes an estimation of the direct and indirect public benefits due to the operations of the institution. This report should include an estimation of the number of direct jobs created, indirect economic spinoff benefits to local communities, and decreases in social overhead expenditures by the state. The annual report should also include an estimation of the financial return of the organization to the state and its other stockholders.

There should also be a provision in the legislation which requires a full review of the corporation at some determined point in the future.

### 5.2.3 The Reactivated Business Development Corporation

Development credit corporations (DCCs) or business development corporations (BDCs) are state-chartered, privately capitalized and managed lending institutions which usually operate on a statewide basis. The first DCC in the country was established in Maine in 1949.

5.2.3.1 Purpose and Operations of a BDC. Generally, BDCs lend with an eye toward job development and economic expansion in a state or sub-state region. They can provide equity and debt for as short as a month or for as long as twenty years but most of their lending is intermediate in term. BDCs make funds available to firms refused credit by conventional lenders. Lenders will refer marginal borrowers to their BDC, frequently providing a senior, shorter-term portion of the firm's financing needs, with the BDC providing longer-term, junior financing.

BDCs are initially capitalized with an equity investment of $.5 to 2 million, usually raised through a private placement offering made to financial institutions, corporations, quasi-public development organizations and individual investors in the state. The BDC then solicits members from deposit institutions in the state--typically banks and thrifts, but can also include life insurance companies. These members extend lines of credit for a specified period of time which the BDC calls upon for its lendable funds. The BDC uses these lines of credit to leverage its equity base usually up to a maximum limit of 10:1.

The BDC model seems to be the ideal institution to fill that risk financing role that is so desperately needed by small business. Three characteristics operate in their favor:

- First, BDCs operate outside federal and state depository regulations. Consequently, they are able to assume riskier financing positions without fear of being questioned by bank auditors for taking unacceptable levels of loan portfolio risk. The best BDCs take on subordinated financing positions and accept forms of collateral that are less negotiable than that demanded by banks and insurance companies.

- Second, BDCs give member institutions the ability to diversify the risks otherwise associated with small business lending. By pooling funds within the BDC, each member receives a small part of many higher risk loans. Thus, the risk of an individual loan default to each lender is minimized. The resulting risk exposure is far below that which would be faced by an individual lender who makes similar loans independently.

- Third, BDCs present an opportunity to concentrate, in one institution, expertise in higher risk lending to growing firms. Thus, higher risk lending will be a specialization, not an afterthought. Further, economies of scale should result in reducing the information and trasnaction costs associated with this type of lending.

While there are several operating BDCs that live up to the promise of the prototype model, the overall record of BDCs is disheartening. Most have tended to be conservative institutions that pursued little or none of the risk lending for which they were established. Collectively, BDCs have a large, unused borrowing capacity; they could lend almost double their existing portfolios based on available lines of credit (Litvak and Daniels, 1979).

5.2.3.2 The History of the Development Credit Corporation of Maine. Although the DCC ceased operating in 1974 it played an important role in small business development finance for a number of years. It is discussed here because its history has affected perceptions about development finance on the part of the state's financial community which may affect the feasibility or acceptance of any new private market risk-spreading innovation in the future.

The Development Credit Corporation of Maine (DCCM) was an extremely innovative institution for its time. Planning for DCCM began when Maine's leading bankers and industrialists began to realize the inability of small businesses in the state to obtain capital for development and expansion. Consequently in August 1949 the Maine State Legislature passed a special act establishing a charter for DCCM. Organization proceeded quickly and the DCCM made its first loan in May 1950.

The DCCM made loans for working capital as well as long-term financing of plant and equipment. Loans were also made for new construction, for machinery and equipment expansion and for plant and equipment renovation and purchase. Loans were generally made for intermediate-to long-term, ranging from three to fifteen years.

The DCCM originally had a small capital stock base of $50,000 divided into 500 shares of $100 each. The stock was purchased by 77 Maine individuals, business firms and utilities. The lending capability of the DCCM came from lines of credit extended to the DCCM by Maine commerical banks, savings banks, trust companies, building and loan associations and insurance companies that became members of the DCCM for a minimum of five years. Any financial institution that became a member agreed to lend funds to the DCCM at its call up to a maximum of 2.5 percent of its own capital and surplus.

The DCCM operated profitably during the period 1963 to 1971 with an average of $1.3 million in loans outstanding. As a result of losses incurred from 1971 to December 1974, the Board of Directors suspended all new lending activity for an indefinite period. Work began immediately to liquidate the DCCM's loan portfolio. In total, DCCM made 190 loans of which 30 were to new businesses, 145 to already established firms and 15 to firms relocating to Maine from other areas. Loans were made primarily to manufacturing concerns with some lending to firms in commercial real estate, distribution (wholesale and retail) and recreation and service. The firms aided by the DCC employed over 10,000 individuals.

Although the DCCM is no longer in operation, it provided an important source of capital to small businesses in Maine during its life. The CEO of one of Maine's fastest growing small companies noted that he had reached a point in the history of his firm in which he was unable to locate the type of capital he needed for that stage of his firm's development. Without a loan which he received from the DCC he says it is doubtful whether his business could have survived.

5.2.3.3 Reviving a Maine Development Credit Corporation. The very poor operating history of the DCCM in its last few years of activity is a formidable obstacle to investor interest in a new BDC mechanism in Maine. However, since DCCM was dissolved there has been renewed vigor and interest in BDCs on a national scale.

Although there is a great deal of skepticism among Maine financial institutions about the BDC mechanism, bankers in states who have dealt with successful BDCs have found that BDCs complement their operations. By providing sound but higher risk financing to businesses, the BDC assures the viability of many businesses that would have found no available sources of financing. Four benefits offered by a BDC support this point:

- First, they offer intermediate- to long-term lending and will often sell the shorter-term portion of the loan to the member banks, giving them paper that matches their deposits.
- Second, BDCs will often take a subordinated position on loans they offer, giving further security to the member bank's loans.
- Third, the operating business maintains its deposit relationship with the member bank.
- Fourth, the operating business maintains its short-term working capital lending relationship with the member bank.

BDCs can be successful. A recent change in management in the Massachusetts Business Development Corporation has resulted in a new, aggressive outlook in business investments. During the period from 1976 to 1979, MBDC did an average of 8 to 10 loans per year for a total of about $3 million. In 1980, loans committed jumped to 23, totaling $6.7 million; the 1981 total is expected to increase to 30 loans totaling $9 million.

MBDC concentrates on the following types of loans:

- working capital loans, secured by fixed assets;

- leveraged buy-outs when a significant loss of jobs to the state is expected;
- second mortgages, either with conventional taxable financing or with an industrial revenue bond, for expansion or new production plants;
- government-guaranteed loans under programs such as SBA, EDA, and Farmers Home Administration;
- long-term loans for equipment or energy conversion.

MBDC has less strict collateral requirements than those imposed by banks and insurance companies. Further, it does not always require as extensive an earnings history as do other lenders.

MBDC's success can be attributed, in large part, to its dynamic new leadership and an emphasis on member involvement. They recognized early on that personal contacts with members of MBDC had to be increased to regain member confidence and to prepare them to make increased credit lines available when needed. An Advisory Council has been reactivated to provide a direct channel for member input. Regional sub-centers are being considered to take MBDC directly into the field. All these efforts have been quite successful. An officer of one of MBDCS's larger member banks recently told MBDC's president that the "in thing" at the bank is to package a loan with or through MBDC.

There are other successful, innovative BDC operations. The Kansas Development Credit Corporation (KDCC) owns 51 percent of Kansas Venture Capital, Inc., a small business investment company (SBIC) that makes equity and long-term debt available. KDCC also buys the guaranteed portions of SBA loans from Kansas banks, packages them and resells them to pension funds, banks and other Kansas investors. The Wyoming

Industrial Development Corporation (WIDEC) also operates Capital Corporation, a wholly owned SBIC.

Although there is a good deal of overlap beween the SBA 503 program and a BDC, the development of the 503 program does not mean that the BDC is not needed. First, the BDC mechanism could provide more flexible financing than the 503. Second, the BDC is able to meet a wider range of small business credit needs. Finally, by involving financial institutions in the process BDCs could provide greater leveraging and greater awareness of risk capital financing among the state's banks.

If a restructured DCCM (or renamed Maine BDC) is considered, it should be structured and operated according to the following six principles:

- First, the boards of development credit corporations or business development corporations require the presence of both businesses and local development corporations on the board as well as bankers.

- Second, they require on the executive committee the same mix of banks, businesses, and local development corporations.

- Third, they require extremely able management. To hire a banker is not necessary to create a successful development corporation. The person managing this corporation must be an aggressive individual with a background in riskier financing who is capable of working closely with the banks, assisting the banks to do loans they could otherwise not do. As the brochure of the Massachusetts Business Development Corporation states to its member banks, "You Do Not Have To Say No."

- Fourth, a properly structured Maine Development Credit Corporation would package deals in which the deposit relationship was kept by the bank, as well as the shorter, senior maturities and a fee for servicing. The longer subordinated junior maturities would be carried by the Development Credit Corporation at a higher rate, which legitimately would cover their risk capital. The borrower would benefit by the "blended rate," longer terms and some near equity risk capital in the profitable growing firm.

- Fifth, the name of the game is "joint venture"--not just between the DCC and the bank, but also other members of the development finance system. Longer-term mortgages for the firm could be sold off in the secondary market--perhaps to the public pension fund--and MCC and other private venture capitalists might take some of the front end of the high risk.

- Sixth, just as Maine businesses should be on the board and executive committee, large, national corporations doing business in Maine should be asked to invest in the MDCC.

## 5.3 The Creation of a Maine Business Development Finance Authority (MBDFA)

The objectives of state development efforts are, principally, two-fold:

- to increase the access of smaller business to financing at reasonable terms and rates; and,

- to minimize the exposure of the state's funds to risk.

It should be clear that these two objectives must be balanced. In the past Maine's development efforts have failed to minimize exposure in their effort to increase access. This condition must be addressed.

The over-exposure of state funds has been caused, in Maine, for two reasons. One is a function of program design; the other is a function of program operation. Before proceeding to our specific recommendations in this area, it is useful to delineate several key principles which should guide both the design and operation of successful development finance programs.

A statewide development authority must be designed to:

- be responsive to publicly defined purposes;

- be targeted and specific in the goals it seeks to achieve;
- be flexible to ensure its ability to respond quickly to changes in economic conditions and in financial markets;
- maximize its use of scarce public dollars; and,
- induce the active, aggressive participation of the state's private financial markets.

Beyond its design, a state development authority must be properly administered and operated if it is to meet the goals for which it was designed. Specifically, it must:

- be adequately staffed by properly trained, properly compensated professionals;
- have an aggressive, skilled, experienced Board of Directors;
- thoroughly screen applications for financing and be willing to say "no" to projects the benefits of which are not adequate, although the project is eligible;
- rigorously monitor its portfolio on an ongoing basis to ensure its soundness and identify problem situations at an early stage; and,
- aggressively market its program to the business and financial communities to ensure maximum participation.

Utilizing these principles as guidelines we make the following recommendations for state development finance activities in Maine. The first seven recommendations pertain to program design; the remaining seven recommendations pertain to program operation.

### 5.3.1 Changes in Program Design

1. The Maine Guarantee Authority, the Small Business Loan Authority, and the Veterans Small Business Loan Authority should be consolidated into a single statewide development authority.

Such a consolidation would not only effect economies of scale with regard to staff capability and marketing, but would also create a single institution to meet the financial needs of a broad spectrum of smaller businesses in Maine. The institution should be guided by a single Board of Directors which includes individuals sensitive to the conditions and needs of the full range of Maine small businesses but with a single sense of purpose for the Authority.

It should be noted that, while we are convinced that a consolidation would strengthen Maine's development efforts, we recognize that, regardless of whether such a recommendation is adopted, much can be done to strengthen the operations of MGA, SBLA and VSBLA. We proceed by making recommendations which, although specific to each of the three programs, would nonehteless remain valid if the authorities were consolidated.

2. The composition of MGA's Board of Directors should be revised to include the Director of the State Planning Office and to stipulate more precisely the skills the members from the private sector should have.

The State Planning Office (SPO) serves an important function analyzing the state's economy--which is integral to the development process. The inclusion of the Director of SPO on MGA's Board will help to insure MGA's sensitivity to the state's economic conditions.

Beyind this, greater specificity is needed in defining the private sector Board members. We recommend that MGA's legislation stipulate that Board members come from the banking industry, small business and the financial community. This specificity will help to ensure the quality and perspective of the Board. It should also help to reduce the perception of political influence in the Board.

3. MGA's program investment guidelines should be revised to emphasize the state's greatest areas of need.

MGA's existing eligibility guidelines are not well matched to current economic conditions in Maine. We have noted the growing importance of the service sector in Maine and yet service sector projects cannot be guaranteed by the MGA. We recommend that the eligibility guidelines of MGA's IRB programs be expanded to mirror the IRS guidelines for their use. We also recommend that the guarantee program be made available to all projects which are eligible for IRB financing. At the same time that the eligibility guidelines are broadened, we further recommend that additional criteria for project selection be adopted. An early task for the new "Development Finance Board" will be to develop such criteria. Examples of such criteria will include wage rate guidelines (MIFA, in Massachusetts requires that new jobs pay 150 percent of minimum wage) or locational guidelines favoring the state's areas of greatest need.

4. MGA's credit insurance and guarantee programs should be revised to increase their market sensitivity and to conserve the scarce state dollars available for this purpose.

In addition to scaling back the overall level of project costs which are guaranteed, a trend which has already begun, we recommend that the use of the guarantee program be oriented towards the classes of businesses which most clearly need it. The projects of larger businesses can probably be secured without the use of the guarantee. New private market mechanisms to insure business credits have recently been developed and should be explored by MGA officials. The creation of a credit insurance fund created by a one-time legislative appropriation might suffice to insure larger, sounder credits. It might help to set limits by project size for allocating available guarantee funds. While the precise details of such a program remain to be developed, we are convinced that the guarantee program can be revised to insure business credits more effectively and to utilize scarce public dollars more prudently.

We suggest the following three-tiered approach:

- MGA's largest credits should utilize private market mechanisms, such as back-to-back letters of credit, or private commercial mortgage insurance. MGA need not commit any of its scarce guarantee funds to such projects.

- Medium-sized credits could utilize a fully capitalized credit insurance fund to back their projects. Businesses of this size may not qualify for the private mechanisms available to larger firms and will, therefore, need the assistance of this kind of state-sponsored program.

- MGA's smallest credits (and those that utilize SBLA and VSBLA) seriously lacking access to capital should still have access to guarantee funds. By concentrating its guarantees on smaller firms MGA will diversify the risk in its portfolio and help to preserve its funds.

While this is not the only appraoch to the issue, it does offer at least a framework for consideration.

5. The Community Industrial Building program should be reassessed to determine if it is the best use of funds in the program.

We have outlined our concerns with the program and encourage MGA officials to review its operations and to consider alternative approaches to the problem.

6. SBLA and VSBLA guidelines should be changed to raise the maximum loan amount and put limits on the size of businesses eligible for a guarnatee.

We recommend that the legislature double the $30,000 maximum for loans guaranteed by the Small Business Loan Authority, while leaving the $30,000 maximum under the Veterans Small Business Loan Authority intact. The limit for non-veteran business owners would thus increase to $60,000 while the limit for veterans would increase to $90,000. This adjustment is advisable from two standpoints. First, it compensates for real dollar declines in the limits since they were set by the legislature in 1977. While costs have increased substantially in the past five years, loan size limits have remained constant, reducing the utility of these programs as a credit source for small businesses and reducing the size of business that can effectively utilize them. Second, this increase addresses the gap in guaranteed financing for loans in the $30,000 to $100,000 range, greater than the maximum amount available to the non-veteran business owners under the SBLA program but below the minimum size SBA-guaranteed loan typically offered by Maine banks. This puts credit sources for businesses needing loans in this size range on more of a par with those for other businesses.

A related change which would ensure that the program retains its appropriate focus on the state's smallest businesses should also be considered. In order to ensure that increased loan limits do not result in utilization of the program by larger businesses than initially intended, the legislature should consider placing limits on the size of business eligible for the program. This limit should be large enough to encompass the range of businesses which genuinely rely on financing of the scale provided by the authorities, and simple enough to avoid application of complex eligibility standards. An employment size limit of 20 to 30 might serve as an appropriate standard.

7. SBLA and VSBLA officials should consider increasing loan guarantee coverage from 80 percent to 90 percent to strengthen incentives for bank participation.

Some senior bank executives have expressed the view that bank participation in authority guaranty programs would be likely to expand if the banks' exposure in the case of default was reduced by expanding the guaranty to 90 percent of the loan amount. Such an increase would cut the bank's risk in half while only slightly increasing the already substantial risk borne by the authorities. It would also bring the coverage of the guarantee into line with the terms of SBA guaranteed loans. While these considerations have some validity, we are not convinced that this measure would be either effective in outcome or desirable from a policy standpoint. The risks of an authority-guaranteed loan to the originating bank are already substantially below that of non-guarantied commercial loans. While the program's loss rate is within an acceptable range for a bank's conventional commercial loan portfolio, the bank's actual exposure to loss on a guaranteed loan is limited whereas for a conventional loan it is not. At the same time, the bank is free to charge a comparable rate for a guaranteed loan as for a more risky conventional loan. It is problematic whether banks unwilling to participate in the programs under these favorable circumstances could be induced to do so by additional pot sweetening. Moreover, it may be questionable from a public policy perspective whether risks assumed by the state's private lenders should be reduced to such a low level. One important rationale for creating public development finance mechanisms which offer incentives for private lending rather than lending directly is that private institutions, guided by trade-offs of risk and reward, are likely to lend more efficiently than public agencies. Further reducing the risks born by private lenders under this program may too greatly reduce their incentives to lend efficiently or may provide them with excessive returns in relation to the risks they have assumed.

### 5.3.2 Change in Operations

In addition to recommendations for changes in the design of a new Development Finance Authority we recommend a number of operational changes.

1. MGA's staff should be increased, removed from state civil service requirements and compensated in accordance with the market.

Ultimately, the success of any development program is a function of its staff. Currently, with a staff of only two professionals, MGA is not able to perform the screening, evaluating and monitoring tasks which are required and keep abreast of new innovations in the development finance field. We recommend that additional professional staff be hired.

The state civil service requirements are inappropriate for the dynamic, aggressive staffing of a development authority. An authority's director needs to be able to hire the best professionals available, pay them well enough to keep them and remove them if their performance is unsatisfactory. Most of the nation's best development authorities are staffed in this way.

2. Rigorous application screening procedures should be adopted.

Under new eligiblity guidelines, the development of which we recommend above, it is necessary that MGA staff screen applications aggressively to assure that the most deserving projects are financed and that those projects are as strong as possible. Even at this early stage, problems can be identified and steps taken to rectify them. It is necessary that MGA undertake significant screening of applications beyond those made by the referring bank.

3. Active portfolio monitoring procedures should be instituted.

Currently, MGA's portfolio monitoring is cursory. Regular and frequent site visits and the provision by businesses of periodic financial statements, at a minimum, would help MGA to identify problem situations at an early stage. Without such monitoring MGA can only wait passively to be presented with problems that cannot be rectified short of default. MGA's record and the scarce dollars remaining uncommitted demand a more aggressive approach to portfolio management.

4. MGA should embark on an aggressive public relations campaign to increase its visibility and improve its reputation.

Although it is the largest source of development funds available in Maine, MGA currently maintains a very low profile. As a result, perceptions based on events which occurred fifteen years ago remain strong. MGA must develop a marketing approach directed first at banks and then at the business community. We recommend that MGA begin to publish an annual statement, that it prepare an information brochure for the financial community and one for the business community. This will be particularly important if MGA revises its existing programs or adopts new ones. Many of our recommendations are intended to make MGA a more business-like development authority, utilizing a broader range of tools to achieve its goals. But the impact of these changes will be severely limited, if the business and financial communities are not made aware of them.

5. Encourage greater use of the Small Business Loan Authority and Veterans Small Business Loan Authority through a more aggressive marketing program.

This marketing program should be broadly targeted at all parties whose decisions will affect the level of program use, including lending institutions (both senior management and front-line lending personnel); providers of small business technical assistance and small business owners themselves. This program should be designed with the following objectives:

- Obtain active commitment to the program from institutions' senior management. Branch loan officers are far more likely to use these programs when prompted by a clear, widely disseminated bank policy sanctioning their use. Current contacts by the authorities with bank chief executive officers should be expanded and should be aided where appropriate with efforts by cabinet officials respected in the banking community, and by bank executives who have used the program successfully. Bankers should be encouraged to adopt the programs as part of their standard set of commercial lending services and to convey this policy to front line lending personnel through the bank's operating manual or printed directives.

- Increase understanding of program among front-line lending personnel. Bank policies encouraging use of the programs are more likely to be translated into practice if loan officers who deal directly with small business customers are personally familiar with the programs. While the mechanics of the programs are fairly simple, short seminars demonstrating use of the program to loan officers would be likely to increase their confidence of understanding the program, increasing their likelihood of using it. These seminars should be frequently repeated to account for the frequent turnover in branch lending personnel.

- Increase program visibility within the small business community. Banks will more aggressively provide a servide that is in demand among their customers. If small business borrowers take bank participation in this program into consideration when initiating banking relationships, competitive pressures will encourage more banks to use the program. With this in mind, efforts should be made to increase awareness of the program among small business owners, by developing communications channels with both organizations offering technical assistance to small businesses and small businesses themselves, through trade organizations and media. While we recognize concerns that these efforts could generate pressures on banks to forward lower quality loan applications to the authorities, it is our view that accurate information about the program's terms and operations will convey a clear impression to most businesses owners that the program is not designed to compensate for unsound loan proposals. Overall, such an information effort is more likely to increase the flow of sound deals to the authorities.

6. Expand the staffing of Small Business Loan Authority and Veterans Small Business Loan Authority programs.

The staff of the authorities is insufficient to both undertake the increased marketing efforts we are recommending and to handle the increased deal volume that is likely to be generated by these efforts and other recommended changes. The authorities should create a new staff position with responsibility for coordinating the authorities' marketing efforts. This position should be filled by a professional in the field of small business finance with sufficient range and depth of experience to understand the perspectives of both the financial and small business communities, and to have high credibility among both. Additional staff for processing guarantees is unlikely to be needed unless the volume of deals increases significantly. If this occurs, the authority should consider further increasing the staff to include a full-time loan officer to review guarantee applications. This would free the manager from loan review responsibilities and permit him to concentrate on staff oversight, planning, interagency coordination, high-level program promotion, and other responsibilities generally assumed by senior agency executives.

7. Create a secondary market for Small Business Loan Authority/ Veterans Small Business Authority loans by packaging and selling loans to the State Retirement Funds.

Creation of a secondary market for SBLA/VSBLA loans by offering banks a mechanism to enhance their liquidity would encourage banks to maintain or expand Authority-guarantied loans during periods of low liquidity. Because the guarantied portions of these loans are backed by the full faith and credit of the state, they are of the same high investment quality as other state-backed securities which are routinely sold to investors in national markets. Individual loans could be assembled into larger packages to create securities of a size attractive to secondary market investors.

While SBLA/VSBLA guaranties are backed by the full faith and credit of the state, their unfamiliarity in national markets may initially inhibit their purchase by national investors. This reluctance, however, may not be characteristic of in-state investors more familiar with the operations of state government. Therefore, a good first step in creating a secondary market for Authority loan packages would be through a negotiated purchase by the State Retirement Funds. Specifications for packages could be developed with principal amounts and rates negotiated by the Authorities and the Retirement Funds, and packaging could be done either internally by the Authorities or by one of the state's larger lending institutions. A program of this type would provide managers of the Retirement Funds the opportunity to purchase investment grade securities while contributing in a significant way to state economic growth.

Colorado has had recent experience that shows it is possible to package an amalgam of non-related businesses to suit the needs of the major in-state institutional investor--the Public Employees' Retirement Association (PERA). Over the past several years, PERA has pursued a very active program for purchasing both residential and commercial mortgages from Colorado savings and loan associations. For a mortgage of more than $1 million in size, PERA buys directly from the originating S&L. For smaller mortgages, Empire Savings & Loan, a large association based in Denver, packages several loans before selling them to PERA.

The Development of a secondary market program would require changes in the Authorities' current operating procedures. Under existing procedures, when an Authority-guarantied loan goes into default, the lender must liquidate loan collateral before being reimbursed by the guarantying authority. However, under a secondary market program, the Authorities would, upon default of the borrower, either have to maintain payments to investors or require that the lender do so prior to collateral liquidation and settlement between the Authorities, the lender, and the secondary market investor. In addition, an adequate loan volume would have to be maintained to insure the timely assembly of appropriately sized packages in order to avoid losses to the packager stemming from interest rate declines between conclusion of negotiations with the investor and assembly of the loan package.

## 5.4 Development of Mechanisms to Provide the Private Financial Sector with Incentives to Increase Small Business Lending

No solutions to the problems of small business finance can be developed without the involvement of Maine's depository institutions.

Maine's commercial and savings banks remain by far the largest source of small business finance in the state. Their extensive branch network and local orientation make them easily accessible to small businesses and particularly sensitive to financial and non-financial service needs of these businesses. Therefore, measures to improve the capacity of these institutions to serve the small business sector must be part of the state's efforts to improve the system of small business finance in the state.

As we discussed in Chapter Three of our report, both statistical analysis of Maine's banking industry and impressions gained through discussions with small business owners, state officials, and others knowledgeable of small business conditions indicate that Maine banks may not be aggressively meeting the credit needs of local enterprises. We recognize, however, that there are no simple explanations for this problem, and that the perspectives of both the small business and banking communities must be considered. From the side of small business, and particularly microbusiness owners, we have heard that the sensitivity of banks to small business credit needs, their ability to accurately assess the financial strength of small businesses, and the reasonableness of their collateral requirements are, at best, uneven. From the bank's point of view, the problem rests with the businesses themselves, problems of undercapitalization, incomplete or inaccurate financial data, inexperienced management and weak markets.

The success of mechanisms to increase the flow of capital from depository institutions to small business enterprises hinges in large part on a common understanding of both these perspectives by all parties who must participate in the development and use of these mechanisms. This is why we view the process of developing such mechanisms as no less important then the alternatives ultimately chosen. Consequently, we propose that before specific measures are considered, a constructive dialogue be initiated among the state's small business and financial communities to explore means by which, through mutual cooperation, these mechanisms can be developed.

We will not, therefore, recommend what form such mechanisms should take in this report. Concrete proposals must develop from the dialogue we propose in order to be consistent with the unique characteristics of Maine's small business and banking communities and its particular brand of business-government relations. We are, however, prepared to assist in these discussionsthrough our knowledge of relevant efforts in other states.

Without discussing the specifics of these mechanisms, our experience in the state to date indicates to us that they will be most successful under the following circumstances:

- Banks must closely examine their lending policies to determine whether they place undue restraints on small business lending, and effectively monitor the practices of front-line lending personnel to assess their responsiveness to small business loan applicants.

- Efforts to increase lending to small business must be combined with expanded availability of technical assistance tailored to small business needs.

- The state must commit itself to active, appropriately targeted use of its regulatory, tax and expenditure powers both to encourage expansion of small business lending by depository institutions and strengthen sources of assistance to small businesses.

- Structures must be developed which assure ongoing dialogue between bankers, small businesses and appropriate state officials, and refinement of the credit expanding mechanisms put in place.

We recommend that, as a first step, the State Development Office convene a working group composed of representatives of the small business and banking communities, sources of assistance to small business, and the State Banking Commissioner to consider the options available for increasing access to private capital for small business. We are prepared to provide this group with a number of specific options for their consideration, based on models adopted or under consideration in other states, and to suggest ways in which these options can be adapted to the Maine context.

Small Business

Development Finance in Maine

APPENDIX:

Summary of Small Business Development

Programs Operating in Maine

# APPENDIX

## SUMMARY OF DEVELOPMENT FINANCE PROGRAMS OPERATING IN MAINE

### I. INTRODUCTION

The following are brief summaries of the wide variety of programs--public and private--which provide assistance to small businesses in Maine. The descriptions here are brief and intended only to give the reader a general sense of the range of programs in Maine and their operations.

To provide the reader with the breadth of programs in Maine which potentially address the finance needs of small businesses we have included federal, state, regional and local programs. On the state level we have included expenditure and regulatory policies which potentially impact capital availability for small businesses. This inventory also includes programs which provide capital directly to small businesses and programs which provide only technical assistance to small businesses for the purpose of increasing their likelihood of obtaining the capital they need.

Although these program descriptions are brief they provide a sense of the range of resources available to Maine businesses. The programs evidence a level of innovation and foresightedness not often seen in other states.

## II. FEDERAL PROGRAMS

### A. U.S. Small Business Administration

The U.S. Small Business Administration (SBA) manages a full range of financing and technical support programs operating across the state of Maine from their main office in Augusta. This section will review the important programs.

- Direct Loan and Loan Guarantee Programs: The direct loan and loan guarantee programs are the backbone of the SBA's small business financing assistance. The direct loan program, while quite small, makes debt capital available to qualifying small businesses. The loan guarantee program guarantees the repayment of a bank loan to a small firm up to a total of 90 percent of the loan or $500,000, whichever is less. With these two programs, the SBA is able to lever its base of funds to encourage maximum private lender involvement in small business finance.

Table A-1 describes the level of SBA direct loan and loan guarantee activity in Maine from 1979 to 1981. In 1981, the SBA approved 291 loans and loan guarantees for a total dollar volume of $29.9 million. It is estimated that 97 percent of this total is loan guarantees. High interest rates have resulted in minimal demand for direct funds this year. The average size of a loan/loan guarantee was $102,600. According to the local SBA office the median size of their loans is $75,000. The average borrower receiving a loan or guarantee employed eleven people. In total, the SBA Maine district office services a portfolio of over 3,600 loans to enterprises, with an outstanding dollar volume of the portfolio exceeding $149 million.

Table A-1

U.S. Small Business Administration

Total Direct Loans and Guarantees in Maine
(in thousands)

| | 1981 | 1980 | 1979 |
|---|---|---|---|
| Augusta - Waterville | | | |
| number of firms | 24.0 | 17.0 | 20.0 |
| dollar volume | $204.0 | $1,400.0 | $1,392.0 |
| average size | $ 85.1 | $ 82.4 | $ 69.6 |
| Bangor | | | |
| number of firms | 7.0 | 8.0 | 14.0 |
| dollar volume | $572.0 | $1,211.0 | $1,519.0 |
| average size | $ 81.7 | $ 151.4 | $ 108.5 |
| Lewiston - Auburn | | | |
| number of firms | 24.0 | 12.0 | 21.0 |
| dollar volume | $1,240.0 | $1,487.0 | $1,955.0 |
| average size | $ 51.7 | $ 123.9 | $ 93.1 |
| Portland - South Portland | | | |
| number of firms | 32.0 | 30.0 | 37.0 |
| dollar volume | $3,307.0 | $2,479.0 | $2,830.0 |
| average size | $ 103.3 | $ 82.6 | $ 76.5 |
| Presque Isle - Houlton | | | |
| number of firms | 14.0 | 9.0 | 18.0 |
| dollar volume | $2,288.0 | $ 533.0 | $1,081.0 |
| average size | $ 163.4 | $ 59.2 | $ 60.1 |
| Balance of State | | | |
| number of firms | 190.0 | 188.0 | 262.0 |
| dollar volume | $20,417.0 | $17,619.0 | $24,903.0 |
| average size | $ 107.5 | $ 93.7 | $ 95.0 |
| TOTAL | | | |
| number of firms | 291.0 | 264.0 | 372.0 |
| dollar volume | $29,866.0 | $24,729.0 | $33,680.0 |
| average size | $ 102.6 | $ 93.7 | $ 90.5 |

The SBA in Maine is a critical source of finance for businesses looking for loans in the range of $30,000 to $1 million. According to the local SBA office they "do not truly service very small business". Loan requests in the range of $25,000 to $50,000 are uneconomic for banks to pursue through the SBA because of the costs of the SBA paper work. Firms with total project capital needs of over $1 million are sent to the MGA.

- Secondary Marketing of Guaranteed Loans: The SBA offers packaging and technical assistance to local banks to enable them to enter national secondary markets to sell the guaranteed portion of bank loans. In Maine during 1981, $3.4 million in SBA guaranteed loans were sold and $2.4 million were reassigned, resulting in a total of $5.8 million in SBA guaranteed loans being placed in national secondary markets. This secondary marketing assistance is of critical importance for capital formation in the state, for it enables banks to import capital from national money markets to make additional loans to small businesses in Maine.

- 503 Economic Development Program: The 503 Economic Development Program is the SBA's newest economic development effort. Authorized in July 1980, the program establishes the Certified Development Corporation (CDC), a statewide or local development agency with a professional, full-time economic development staff. Once the CDC is authorized by the SBA it has several powers. First, it can issue debentures for a value of up to $500,000 per project. These debentures carry a 100 percent SBA guarantee. Second, through the SBA the CDC can sell those debentures to the Federal Financing Bank for a term of 15 to 25 years at a rate only 1/8 point higher than the rate on U.S.

Treasury bonds of comparable maturity. Third, the CDC can use the proceeds from the sale of the debenture to make low interest subordinated long-term loans to small businesses. CDCs can make loans for land acquisition, building construction, land and plant expansion, buyout of fixed assets, renovation and equipment purchase. Typically interim construction financing would not be eligible. Usually the debentures provide permanent financing for 40 percent of project cost, which is subordinated to a first mortgage provided by a private lender of 50 percent of project costs. The remaining 10 percent of financing would be provided by the CDC itself or the business.

The SBA anticipates that the authorized CDCs will take a fairly aggressive posture in assembling business projects that will offer sound economic development benefits. The CDC is expected to aggressively seek out development projects. Once identified, the CDC staff helps the small business prepare its loan applications and supporting financial documents. These are then submitted to the local SBA office. Once approved, the SBA issues terms to the CDC for selling the debenture to the Federal Financing Bank. The CDC services the loan to the small business for its life. The 503 program is not recommended for loans of less than $100,000 or for total project costs of under $200,000.

The SBA in Maine has been very selective in certifying CDCs. They were looking for organizations which were effective packagers and good at servicing loans. Currently there are six Certified Development Corporations in Maine. These six CDCs and their operating territory are:

- Northern Regional Planning Commission in Aroostook County;
- Eastern Maine Development Foundation in the counties of Hancock, Knox, Penobscot, Piscataquis, Waldo and Washington;
- Androscoggin Valley Regional Planning Commission in the counties of Androscoggin, Franklin, and Oxford;
- Lewiston Maine Development Corporation in the city of Lewiston;
- The Maine Development Foundation (MDF) operating across the state of Maine; MDF has contracted with the Portland Chamber of Commerce to service the Portland Metropolitan area;
- Coastal Enterprises, Inc. in the counties of Eastern Cumberland, Sagadahoc, Lincoln and Knox.

In addition to these six, the SBA is interested in certifying a development corporation in southern Maine.

The Augusta, Maine SBA district office reports that over the last twelve months projects totalling $3.3 million have been approved in the state. They report that the projects have created or retained 490 jobs for an average debenture investment per employment opportunity of $2,712.

- Women Entrepreneurs Program: In 1981, the SBA nationally targeted loans for start-up and expansion to women-owned businesses. In line with this emphasis the Maine district office made loans to 43 qualified women-owned businesses for a total dollar volume of $1.6 million and an average loan size just under $38,000.

In addition to these finance programs the SBA has procurement and management assistance programs for small business. These programs include:

- Small Business Procurement Programs: The Maine offices of the SBA operate several programs to increase small business procurement. In September 1981, a Small Business Procurement Conference for Contractors, Subcontractors and Suppliers was held to provide information to Maine small businesses on how to participate in government contracting. The SBA also operates the Procurement Automated Source System (PASS). PASS was designed to improve procurement opportunities for small firms by providing profiles of prospective small business bidders to government agencies and prime contractors.

- Service Corps of Retired Executives/Active Corps of Executives (SCORE/ACE): SCORE/ACE are organizations of volunteer businesspeople which assist small businesses with management problems. In Maine, SCORE/ACE offices are located in Augusta, Bangor, Bath, Calais, Caribou, Ellsworth, Lewiston, Oxford Hills, Penobscot Bay, Portland and Waterville. In fiscal year 1981, SCORE/ACE volunteers counselled 1,689 new clients.

- Small Business Institute (SBI): SBIs offer management assistance to businesses through business student teams at Maine colleges and universities. SBI programs are operated at the University of Southern Maine, the University of New England, Nasson College, St. Joseph's College, Thomas College, UM-Farmington, UM-Orono, UM-Presque Isle, and Husson College. In fiscal year 1981, student teams assisted 69 Maine small businesses.

- Small Business Development Centers (SBDCs): SBDCs operate as part of the New Enterprise Institute. They provide management and technical assistance to small businesses by organizing the resources of the private, public and academic sectors in Maine. Maine's SBDC is headquartered at the University of Southern Maine in Portland and has branches at UM-Bangor, UM-Machias and UM-Caribou. SBDC counselled 873 small business owners in fiscal year 1981.

- Management Training Sessions: Training sessions are frequently offered by the SBA on a wide variety of subjects including taxes, retail crime, international trade and energy. Sessions are usually sponsored in conjunction with a local chamber of commerce, college, university, or professional association.

B. Economic Development Administration

Although the level of Economic Development Administration (EDA) activity has been significantly curtailed in the recent budget cuts at the federal level, the EDA has been a significant source of funds for economic development in Maine. Generally, EDA activity has fallen into four categories: public works grants, technical assistance grants, business loan assistance and revolving loan fund grants. In this section we will briefly examine EDA activity in these four categories.

- Public Works Grants: Although most EDA public works activity provided funds for municipal infrastructure improvement, funds have been made available for projects more directly tied to local and regional economic development efforts. Projects of this type include industrial park deveopment, fish processing facility development and fish pier and marina development. Specific examples of projects funded over the last five years include:

    - $210,000 for industrial park development in Calais,
    - $435,000 for commerical fish pier development in Lubec,
    - $440,000 for a fish processing facility in Vinalhaven,
    - $140,000 for agricultural/industrial park development in Fort Fairfield.

- Technical Assistance Grants: EDA Technical Assistance Grants are typically awarded to provide funds for pre-project analysis, general economic development training, and direct technical assistance. Funded projects have included business feasibility studies, planning studies, market studies and technology feasibility studies. Specific examples of projects funded over the last five years include:

- $7,500 for a Commercial Development Study in Dennysville,
- $26,000 for a Forest Resource Availability Study in Piscataquis,
- $82,000 for a Technical Assistance Grant for Operating Funds to the Coastal Resource Center,
- $286,739 for "Levesque Lumber Energy from Wood" Project Study Grant in Masardis,
- $30,000 for a grant to the state of Maine for Project Woodchip Study.

- Business Loan Assistance: EDA business loan assistance comes in the form of direct loans and loan guarantees. Over the last five years, EDA has provided $10,906,000 in ten direct loans to Maine business and $13,561,482 in ten 90 percent loan guarantees. The dramatic drop in EDA loan and guarantee activity in Maine can be seen in the following breakdown of that activity over the period.

EDA Business Loans and Guarantees in Maine
1977-1982

| | |
|---|---|
| FY 1977 | $2,000,000 |
| FY 1978 | $8,471,200 |
| FY 1979 | $8,900,000 |
| FY 1980-82 | $5,096,282 |

Activity over the last three fiscal years has averaged only $1.7 million per year.

Specific examples of business loan assistance projects funded over the last five years include:

- $2,000,000 to Lincoln Pulp and Paper Company in Lincoln,
- $243,000 to Knox Pier Inc. in Rockland,
- $68,000 to Deer Isle Granite Company in Stonington,

- $3,000,000 to McCain Foods in Easton and Washburn,
- $8,837,000 to R.T. French Potato Plant in Washburn.

The size of these loans illustrate that most of the funds have gone to large businesses in the state.

- Revolving Loan Fund Grants: EDA has made grants to statewide, regional and local development agencies to establish revolving loan funds. Typically the funds are managed by the recipient agency. Interest rates are usually lower than that available through private lending sources. Typically applicants pay origination fees, commitment fees and all legal costs associated with the loan review process.

Examples of EDA revolving loan funds (RLF) currently operating in Maine include:

- Androscoggin Valley Regional Planning Commission with an RLF of over $600,000,
- Eastern Maine Development Corporation with an RLF of approximately $550,000,
- Northern Maine Regional Planning Commission which has participated in loans totaling over $8,000,000.

## C. Urban Development Action Grants

The federal Urban Development Action Grant (UDAG) program is administered by the U.S. Department of Housing and Urban Development (HUD). UDAGs are public grants made by HUD in a competitive application process to lever private sector investment in major development projects. Nationally UDAGs have been used to finance major commercial center developments in distressed areas, hotel and convention center development, housing development and industrial center development.

The revitalization of the Lewiston downtown commercial area is one innovative example of how a UDAG grant was used in Maine to involve local financial institutions in providing capital resources to small businesses. A local non-profit group, "Lewiston Tomorrow," was organized by local small business people in 1977 to improve the downtown area. Working with the city the group was able to obtain $10 million in private sector commitments including a $5.75 million loan pool which was capitalized and run by local banks. With this private commitment the city received a $3.8 million UDAG in 1978. Part of these funds were used to reduce by 3 points the interest rate on commercial building rehabilitation loans made by the "Loan Pool."

D. <u>The Farmers Home Administration (FmHA)</u>

The FmHA, an agency of the U.S. Department of Agriculture, has played an aggressive role in agricultural finance in Maine. Their programs include farm ownership loans, farm operating loans, emergency loans and economic emergency loans.

FmHA has been a significant source of capital to the state's farmers. In 1981 FmHA provided 53.3 percent of all Farm Real Estate Debt in Maine and 60.4 percent of all Farm Operating Debt. Total FmHA loans, excluding guarantees and subordinations, in 1980 were $49 million, declining to only $43 million in 1981 (Maine Department of Agriculture, June 1982).

Recently Congress has enacted major changes in the FmHA programs which could potentially impact capital available to the state's agricultural sector. There has been a 5 percent reduction in the percentage of loans earmarked for limited resource loans. According to the Maine Department of Agriculture, this could have a serious effect on beginning farmers. In addition, the economic emergency loan program is intended to lapse in September 1982; the emergency loan program is being reduced significantly; farm ownership loans are being reduced; and the operating loan program is expected to be expanded.

The Maine Department of Agriculture has recently estimated that changes in FmHA programs will probably decrease FmHA funds in Maine by at least $5 million. Potentially, with the reduction in the emergency loan program, the decrease may amount to as much as $20 million. With these cutbacks many Maine farmers will need to find other sources of capital.

E. <u>Farm Credit System</u>

The Farm Credit System includes a group of specialized institutions which address the special capital needs of the agricultural sector. The system, initially capitalized by the federal government, though now owned by the users, includes:

- Federal Land Banks and Federal Land Bank Associations to finance long-term fixed assets,
- Federal Intermediate Credit Bank and the Production Credit Associations to finance operating loans,
- the Banks for Cooperatives to finance farmers' cooperatives.

In 1980 the entire system provided between $25 and $30 million to farmers in Maine. This included $4.7 million from the Federal Land Bank and the rest from Production Credit Loans (Maine Department of Agriculture, 1982). The Production Credit Associations provided 31.2 percent of all farm operating debt in Maine in 1981. The Federal Land Banks provided 21.8 percent of all farm real estate debt in Maine in that year.

Since the Farm Credit System receives most of its funds from national money markets, it represents a significant capital importing mechanism in Maine. However, according to the Maine Department of Agriculture study, the Farm Credit System loans have generally tended to go to successful and well-established farmers.

## III. STATEWIDE FINANCIAL ASSISTANCE PROGRAMS

### A. Maine Capital Corporation

The Maine Capital Corporation (MCC) is licensed as a federally chartered Small Business Investment Company (SBIC). MCC's initial capitalization was provided by private financial institutions, companies and individuals, principally from within Maine. Although privately capitalized and managed, MCC was initiated by the state through a state statute (MRSA c. 108) which allowed investors a 50 percent tax credit on their investment in MCC. MCC's initial capitalization was $1,000,000. As an SBIC, MCC is empowered to borrow funds from the U.S. Small Business Administration.

MCC's enabling legislation charges the organization with investing equity capital in Maine businesses to "enhance their productive capacities" or to facilitate their ability to generate value-added on goods or services for export to out-of-state markets. MCC cannot invest more than $200,000 per firm. MCC investments are limited to common and preferred stock and/or debt convertible to stock or warrants to purchase stock. For investment requests larger than $200,000, MCC will assist the firm in the assembly of other sources of capital.

While MCC does not seek control of the firms in which it invests, it plans to take an active interest in the operations of the firm. MCC contends that a close working relationship with the management of its client companies substantially improves the likelihood of a venture's success.

B. Maine Guarantee Authority

The Maine Guarantee Authority (MGA) was established to promote and encourage the development and expansion of industrial, manufacturing, fishing, agricultural and recreational enterprises in Maine. To this end MGA utilizes programs to insure business loans and to finance business credits by the provision of industrial revenue bonds.

MGA currently operates four different programs. They are:

1. Mortgage Insurance Program, which permits the insurance of all or part of first mortgage loans;

2. Revenue Obligation Securities Program, which permits the issuance of industrial revenue bonds by the Authority;

3. Municipal Securities Approval Program, which permits municipalities to issue industrial revenue bonds; and,

4. Community Industrial Building Program through which the Authority financially assists municipalities in the construction of industrial building in approved industrial parks within the state.

• Mortgage Insurance Program: Currently the Authority holds 35 loans in its portfolio, totalling just over $22 million (as of December 1981). The Program has standby authorization to insure up to $50 million in mortgages. The program charges a 1 percent fee to all users which capitalizes a project reserve as well as helping to finance MGA's operation. A complete loss on a project would obligate the state to invoke its "full faith and credit" to reimburse lenders.

Until recently the program offered upt to 100% guarantees on loan value. Recently, the awareness that this practice eliminate all incentives among borrowers has caused the Authority to revise its practice and instead to insist on sharing risks with other lenders.

• Revenue Obligation Securities Program: This is the newest program operated by MGA. Since 1980 this program has allowed MGA to issue industrial revenue bonds (IRBs) in its own name to finance a variety of projects. IRBs are tax-exempt and offer borrowers financing at rates below those available at most financial institutions.

In January 1981 MGA announced its "umbrella" bond program, one of approximately ten in the nation. This program would permit the consolidation of several project loans into a single guaranteed bond issue. An umbrella revenue bond is a single note, issued much like any other industrial revenue bond. The difference between the two is that the proceeds of a single-issue umbrella revenue bond are lent to a variety of firms that stand behind the bond. Umbrella bonds are thus a very effective tool for making long-term, lower-cost funds available to small business. Loans under MGA's Umbrella Bond Program would be for permanent financing for projects whose total costs do not exceed \$1.5 million. The amount of a loan may be up to \$1 million.

- Municipal Securities Approval Program: Under this program, Maine municipalities can, with MGA's approval, issue IRBs. These IRBs provide similar benefits to those described in the Revenue Obligation Securities Program. During 1981 the Authority approved 40 issues in an aggregate amount of over \$105 million. This represents a significant infusion of capital into the Maine economy.

- Community Industrial Building Program. This program permits the Authority to loan money from a revolving fund to local development corporations for the purpose of building industrial shell buildings in approved industrial parks. The object of the program is to loan funds to communities to build facilities which can be "turn-keyed" to industrial occupants. Since the program's inception, five buildings have been constructed. As of December 1981, two of the buildings had been sold. The program was initially capitalized with \$400,000 and has since been augmented with \$300,000 for carrying costs for projects in communities with more than 10,000 residents. The proceeds of the sale of the buildings constructed under this program are used to replenish the fund to enable it to finance other projects.

C. Maine Veterans Small Business and Maine Small Business Loan Authorities (MVSB and MSBA)

These two programs provide guarantees on loans made to Maine resident businesses by local lending institutions. Both programs will guarantee up to 80 percent of a \$30,000 loan. Veterans can apply jointly to both programs for loans of up to \$60,000.

The two programs are administered jointly by a single staff and applications for guarantees are evaluated using the same criteria. Application forms and procedures used are those that the local lending institution employs. The setting of rates and terms for the loans are at the discretion of the lender.

As of June 30, 1982, the two programs had outstanding guarantee commitments of almost $1.2 million on 120 loans. The average commitment size of $10,000 indicates that the programs have been targeted toward Maine micro-businesses. Authority officials confirmed that most guarantees are issued to sole proprietorships employing fewer than 15 people. It appears that the size limit of the guarantee the programs can provide in itself focuses their impact on these smaller firms. Furthermore, the ease of application and administration of the program is intended to make banks more eager to service the needs of these smaller borrowers who are often expensive and, therefore, unattractive customers.

Both programs are operated on a $200,000 appropriation made in 1974 and a $70,000 set-aside from a state contingency fund. The authorities operate on a very low cost budget. This budget is augmented by fees charged to participating banks. Lenders are charged an annual fee of 1 percent on the outstanding balance of guaranteed loans they hold. These sources of funds have been adequate to cover the operating expense of the authorities.

In addition, the two programs have standby bonding authority of $6.5 million. This could be used to vastly expand operations, but utilization of the program has not yet reached a level which warrants such expansion.

## D. Maine Small Cities Community Development Block Grant Program

The consolidation of 57 targeted federal aid programs into 9 new block grants was one of the first moves the Reagan Administration undertook to implement the "new federalism." Among the first to be affected was the small cities community development block grant (CDBG). Previously the U.S. Department of Housing and Urban Development had administered the part of the community development block grant that went to cities with less than 50,000 population. Now state governments operate the small cities CDBG program with few strings attached. In Maine, the program is operated out of the State Planning Office.

For fiscal year 1982, the State Planning Office oversaw a competitive grant process in which Maine small cities submitted CDBG applications in three categories: housing, public facilities and economic development. Nineteen awards were made totalling $5,698,000 in one year commitments and an additional $1,434,000 in second year commitments. Thus, a total of $7,132,000 in small cities CDBG awards were made for fiscal year 1982.

Table A-2 describes that portion of the Maine small cities CDBG awards that went to economic development projects. A total of $2,116,000 in one year commitments was made with an additional $1,146,000 in second year commitments. Thus, awards in the economic development category represented 46 percent of all awards made. In general the awards were made for the following types of projects: downtown revitalization, business revolving loan funds, industrial park development and direct business assistance.

Table A-2: FY 82 Small Cities CDBG General Competition Awards
Maine State Planning Office

| MUNICIPALITY | CATEGORY | AMOUNT | PROJECT SUMMARY |
|---|---|---|---|
| Brownville (Piscataquis County) | Economic Development | $ 268,000 | Revolving loan fund is established with initial loan to Katahdin Lumber and Supply Co. for new equipment and machinery. |
| Calais | Economic Development | $ 350,000<br>$ 400,000* | Downtown revitalization with street reconstruction, sanitary and storm water separation, landscaping, business improvement loan principal write-downs, and parking lot development |
| Gardiner | Economic Development | $ 380,000<br>$ 371,000* | Downtown revitalization, drainage improvements, street and sidewalk reconstruction, landscaping, subsidized loans for business improvement. |
| Mechanic Falls | Economic Development | $ 90,000 | Purchase of land for development of industrial park; loan to manufacturing company that will locate in park. |
| Princeton | Economic Development | $ 350,000 | Loan to lumber company to assist in purchase of mill and provide new machinery and equipment; 60 to 70 permanent jobs will be created. |
| Searsport | Economic Development | $ 350,000<br>$ 375,000* | Construction of causeway and water facility lines to Sears Island for development of major cargo port; project includes funding from State Department of Transportation (bond issue) and Economic Development Administration. |
| Skowhegan | Economic Development | $ 328,000 | Purchase and demolish two buildings, provide relocation assistance, develop parking lot and downtown landscaping, provide principal write-downs for business loans for building improvements. |
| | | $2,116,000 | |
| TOTAL | | $1,146,000* | |

* Second year funding

Although these awards do not represent a significant source of finance to the state's small businesses they can be used in innovative ways by cities to increase the availability of capital directly through revolving loan funds and direct investments, and indirectly through land and infrastructure development which lowers the costs to expanding small companies.

## F. Maine State Banking Regulations

State banking regulations could have a direct effect on the availability of capital to the state's small business. The powers given to the depository institutions may affect the level of capital available and the type of capital available. Maine banking law is marked by a high degree of innovation and foresightedness. Despite the industry's size and the structural problems afflicting the nation's financial institutions, Maine has made every attempt to allow its banks and thrift institutions to operate free of the regulatory constraints which can only exacerbate market problems.

In 1975 the Maine banking code was totally revised and recodified. The new code is a document which anticipates both market changes and changes at the federal regulatory level. The code continues to place Maine's state-regulated financial institutions in the vanguard of the industry nationally. The code clears the way for the quick reaction by financial institutions to market changes and, in at least some respects, for the anticipation of those changes. The following is a brief summary of the major aspects of the 1975 recodification.

• <u>Bank Holding Companies</u>: The following regulations were designed to guide the expansion of bank holding company operations within the state and to reduce the market advantages created for bank holding companies.

1. The authority for the state banking commissioner to regulate bank holding companies,

2. The right of out-of-state holding companies to purchase Maine banks so long as Maine holding companies have reciprocal rights in that state,

3. The power for thrift institutions not affiliated with bank holding companies to engage in the same non-bank activities as the bank holding companies.

The interstate purchase statute was the first of its kind nationally and remains one of the most far-reaching. However, the slowness with which other states have moved in this direction has drastically limited the impact of the legislation. In light of this the state sought to go further in the past legislative session by enacting legislation which would have eliminated the reciprocity requirement. However, the legislation was defeated.

A major reason for the defeat of the legislation was a concern that capital resources would be drained out of Maine by out-of-state banks. In response to this concern the Bureau of Banking has proposed a new regulation which would assure that a significant portion of the deposits gathered in Maine in the form of loans and investments remains within the state should a non-Maine financial institution holding company acquire a Maine financial institution. This regulation outlines precisely the daily average amount of eligible Maine assets which must be maintained in the bank's asset structure. This new regulation is in the process of being reviewed.

• Branching Requirements: The following reforms were enacted to provide more equitable service to the more rural and economically depressed areas of the state which had not previously been served:

1. State-wide branching was allowed for all commercial banks, thrifts and credit unions.

2. The establishment of part-time and seasonal branches was allowed in communities not served by full-time branches.

In addition, a recent amendment allows financial institutions to share "satellite" facilities.

• Depository Powers: The following provisions were designed to enable thrift institutions to compete with commercial banks for new consumer deposits and to retain existing savings during periods of rising interest rates:

1. Thrift institutions were allowed to offer checking accounts, and the powers of state-chartered thrifts were permitted to keep pace with those of federally chartered thrifts.

2. All state-chartered institutions were empowered to offer NOW accounts.

3. All financial institutions were required to carry federal insurance coverage on all deposits.

## IV. STATEWIDE TECHNICAL ASSISTANCE PROGRAMS

### A. Maine Development Foundation

The Maine Development Foundation (MDF) is an independent, non-profit development corporation organized by business, government and academic leaders to stimulate development in Maine. Chartered by the Maine State Legislature, MDF seeks "to foster, support, and assist economic growth and revitalization in Maine . . . in coordination with the economic development activities of the private sector, community and regional agencies and state government." MDF does not provide actual financial assistance to businesses; rather it operates as a catalyst to encourage development. In effect it acts as a broker bringing together businesses and entrepreneurs with potential financiers and technical assistance providers.

A mission statement recently developed by the Board of Directors highlights four priorities for MDF's operations in the 80's.

- Mission #1: Industrial Development - to undertake focused activities to attract expanding quality firms to Maine and to encourage Maine-based firms to expand in-state.
- Mission #2: Development Projects - to identify key economic opportunities in Maine and actively support their development.
- Mission #3: Environment for Economic Development - to compile information on the Maine economy and analyze issues which affect the prospect for sound economic development; to enhance development strengths and reduce obstacles.
- Mission #4: Development Services - to provide specific economic development services to individual entrepreneurs, businesses and municipalities.

MDF has also been involved in direct development finance. It played a critical planning and start-up role in the development of the Maine Capital Corporation and was recently certified by the SBA as the only statewide certified development corporation for the SBA 503 program.

MDF is truly a public/private venture. By law, the fifteen-member Board of Directors which oversees MDF operations must include seven representatives from the private sector and seven from the public sector. MDF is funded in large part by private and public contributors and state matching funds. Contributors to MDF become corporators of the Foundation with full voting rights in its affairs. Currently there are over 225 private and public corporators representing business, development organizations and communities across the state.

B. New Enterprise Institute

The New Enterprise Institute (NEI) is a management and technical assistance organization established to aid small businesses and entrepreneurs in Maine. Founded in 1975, NEI's headquarters are at the Portland campus of the University of Southern Maine with branches at the University of Maine campuses at Farmington, Machias and Orono.

NEI developed out of Project New Enterprise, which was operated in 1974 out of the Center for Research and Advanced Study at the University of Southern Maine. NEI's purpose is to strengthen the Maine economy and improve the material and social well-being of Maine residents. NEI fulfills this purpose by stimulating and supporting entrepreneurial activity focusing especially on those enterprises with high potential for having large economic impacts.

Developing out of these purposes, NEI operates a wide variety of managerial assistance programs, educational services and research projects focusing on:

1. identifying and helping entrepreneurs to organize new ventures;

2. encouraging innovations which will expand markets for existing companies; and

3. improving the understanding of entrepreneurship and private enterprise in Maine.

NEI is organized into four divisions:

1. Business Consulting Group, offering one-on-one intensive counseling in strategic planning, market research and analysis, financial analysis, production control, loan negotiations and merger and acquisitions.

2. Marketing and Technology Group, operating as an information clearinghouse for business, universities and trade and professional organizations emphasizing market development and technology transfer.

3. Education and Research Group, offering graduate level instruction on new business formation and development.

4. Small Business Development Centers, offering information and short-term assistance on management and financial issues. Organizes conferences and seminars on problems related to small business development and management.

From 1976 to 1980, NEI provided assistance to over 1800 organizations and individuals in Maine: 1,474 cases were handled on a short-term basis exclusively at the Small Business Development Centers and 338 cases were handed on a longer-term basis through the Business Consulting Group.

NEI's staff is made up of business, finance and management professionals and successful former executives, supplemented by the use of private consultants. NEI receives funding from the W. K. Kellogg Foundation, and the University of Southern Maine. NEI has also received annual U.S. Economic Development Administration Technical Assistance

Center Grants and is one of the original eight Small Business Development Centers funded, in part, by the SBA. Client counseling fees also contribute to NEI's annual operating budget, which in 1980 totalled approximately $400,000.

C. The Maine Idea

The Maine Idea is an organization devoted to improving the quality and success of Maine's micro-businesses. The program is the outgrowth of a study of Maine's smallest businesses undertaken by ACCION, International located in Massachusetts.

The Maine Idea provides a wide variety of technical assistance to Maine's micro-business community. Services include:

- Management Assistance: Programs include "how-to" workshops covering planning, effective recordkeeping, marketing and personnel management. Educational materials specifically designed for the entrepreneur have been published. In addition, individual consultation services are also available.

- Finance: The Maine Idea helps entrepreneuers prepare business plans and approach local banks. Recently, workshops have been held for bank lending officers and branch managers to assist them in assessing and working with micro-business customers.

- Personnel: Programs help to analyze personnel needs and to locate qualified candidates. In addition, management training for existing workers is also provided.

- Marketing: The Maine Idea's marketing program is designed to help link small business together to facilitate the exchange of products and services and to promote cooperative marketing when appropriate.

Beyond these assistance programs, the Maine Idea is also committed to helping micro-businesses to gain a greater voice in the political process. To this end, they have established a micro-business association to provide special services, to promote greater self-help and to give members more of a voice in government.

The Maine Idea has responded to the reality that many small business capital problems are management-related at base. By attempting to address these problems, the program is likely to improve the flow of capital to Maine's smallest businesses.

## V. REGIONAL DEVELOPMENT FINANCE PROGRAMS

The State of Maine has numerous regional development organizations. Of these, however, only three operate programs which provide financial assistance to businesses in the region. The three--Northern Maine Regional Planning Commission, Eastern Maine Development Corporation, and Androscoggin Valley Regional Planning Commission--are described below.

The financing programs operated by these three regional organizations provide valuable locally based assistance for these regions' businesses. The local input of the regional organizations make them a useful force for development in Maine, and particularly in the more rural, less developed regions of the state they serve.

A. Northern Maine Regional Planning Commission (NMRPC)

The NMRPC provides business development, technical assistance and a wide variety of planning and development assistance to the communities of Aroostook County. The Commission's development finance programs are an EDA-funded revolving loan fund and an SBA 503 certified development corporation. The revolving loan fund since its inception has participated in loans totaling over $8,000,000 to businesses in the region. The RLF is designed to operate as a source of supplemental low-interest loans, primarily designed to help develop or expand resource-based industries in Northern Maine. Ranging in size from $20,000 to $300,000, these loans must leverage $4 in financing from other sources for every RLF dollar invested. The applicant is required to pay all origination fees, commitment fees, and legal costs associated with the loan process. Interest rates are maintained at several points below market rates.

The NMRPC 503 Certified Development Company program is relatively new. The operation of a 503 program has been outlined above. The 503 program will augment NMRPC's ability to finance fixed asset business loans significantly.

B. Eastern Maine Development Corporation (EMDC)

EMDC also operates both a revolving loan fund and an SBA 503 program. Currently the RLF exceeds $550,000 and can be used to finance a broad variety of business needs including plant construction, land acquisition, machinery and equipment purchases and working capital. The maximum RLF loan is $750,000 and cannot exceed 80 percent of a project's cost. RLF loans will be made only in participation with other lenders. Ideally, RLF funds will serve as glue to put difficult financing packages together. RLF assistance is targeted to basic "export" industries.

C. Androscoggin Valley Regional Planning Commission (AVRAC)

Like NMRPC and EMDC, AVRPC operates both an EDA-funded revolving loan fund and a recently authorized SBA 503 program. The AVRPC RLF has provided over $600,000 in loans to area small businesses. The fund has been able to leverage over $2.4 million of private sector participation. Currently, the loan portfolio contains 10 investments averaging almost $50,000 each. The criteria for RLF financing are similar to those employed by EMDC.

## VI. LOCAL AND COMMUNITY-BASED DEVELOPMENT ORGANIZATIONS

A myriad of organizations concerned with economic development in their local areas operate across the state of Maine. These organizations range in structure from fully private organizations such as chambers of commerce and community development corporations (CDCs) to fully public organizations such as local economic development departments. All have the common concern of improving economic conditions in their local area. These groups have become increasingly concerned with the capital problems of small businesses in their communities. In this section we review the general categories of local and community-based development organizations involved in providing capital and technical resources to local businesses.

A. Community-Based Organizations

A common form of community-based organization is the community development corporation (CDC). CDCs are private, locally based, non-profit state-chartered corporations formed to serve economically distressed areas or target populations. CDCs typically have a member base drawn from the local community and some full or part-time paid staff. CDCs across the country have provided risk capital and technical support to local entrepreneurs and businesses.

Maine has a number of CDCs operating within her borders. Most well known is Coastal Enterprises, Inc. (CEI) in Wiscasset, Maine. CEI was organized in 1977 by organizations and individuals active in fisheries, agriculture, aquaculture, small business and housing. CEI's purpose is to promote economic development through local small businesses, cooperatives and resource-based industries.

CEI's members elect the majority of its 15-member Board of Directors. The Board includes representatives from the low-income community, finance, business, industry and the public sector. CEI employes a full-time staff of eight core people and three special project people, including business and industry specialists.

CEI operates numerous business financing and assistance programs. While operating primarily in the midcoast area of Maine, CEI's industrial development strategy is to assist businesses throughout the state. It just recently received authorization from the SBA to operate as a Certified Development Corporation for the SBA's 503 Economic Development Program. CEI also operates or has organized the following:

- an Aquaculture Development Workshop, where over 100 individuals have been trained in oyster and mussel culture techniques,
- a statewide lamb marketing demonstration project with over 50 commercial sheepherders participating,
- Kennebec Valley Growers Cooperative through which 23 growers are striving to expand their markets,
- assisted in the development and financing of two major fish processing cooperatives, the Boothbay Region Fish and Cold Storage Coop and the Penobscot Bay Fish and Cold Storage Coop,
- a wood energy conversion and fuelwood production project.

CEI raises funds from federal state and local governments along with private foundations and churches. Combined with income from its investments, CEI hopes to be self-sufficient by 1984.

Other community-based organizations operating within the state include the following:

- H.O.M.E., Inc., based in Orland, with members drawn from crafters, farmers, food co-op members, students, and social service clients. H.O.M.E. began as a craft cooperative and now includes a wood service for the elderly, a livestock and food cooperative, a land trust, a sawmill, an auto repair shop and a grocery store. H.O.M.E. provides direct employment for 45 people.
- Mars Hill Economic-Community Development Project, in Mars Hill, which provides technical assistance to local businesses, advice on financing and organizing skills.
- Oxford Hills Area Development Corporation in Norway, which has helped to develop several industries for the South Western Oxford County area, including a leather company and shoe company.
- Action Committee of Fifty, Inc. in Bangor, which provides information on the area to businesses as well as information on available financing mechanisms, permitting processes and tax credit incentives.

B. Local Development Organizations

The Lewiston-Auburn Economic Growth Council (LAEGC) which combined the Lewiston Development Corporation and the Auburn Business Development Corporation is a good example of a locally based development organization operating in the state. Both cities operate revolving loan funds which provide below market loans to local businesses. In addition LAEGC operates an SBA 503 program for the two cities as well as the local revenue bond program.

The revolving loan programs currently hold 21 loans totalling about $1 million. Loans are for equipment and working capital. Typically the programs take about 25 percent of the project cost. Ninety percent of the companies financed have been local firms and only one has been a start-up. The electronics and machine tool industry have been targeted. Both RLPs are capitalized with CDBG funds and both seek to lend funds to job-generating enterprises.

In both cases, the RLPs and the 503 program operate on the basis of close interaction between the local business, the city's development department, LAEGC, and private, local financial institutions.