Pension Funds and Small Firm Financing: Models of Successful Small Business Investment Programs

Prepared for the U.S. Small Business Administration
Office of Advocacy
Contract # SBAHQ-95-C-0008

Mariana A. McNeill
Richard F. Fullenbaum

M&R Associates
11622 Boiling Brook Place
Rockville, MD 20852
301-468-2668
January 1996

The findings and recommendations stated in this report are those of the authors and do not necessarily represent the positions and policies of the U.S. Small Business Administration.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Summary</td>
<td>i</td>
</tr>
<tr>
<td>I. Introduction</td>
<td>1</td>
</tr>
<tr>
<td>A. Purpose</td>
<td>1</td>
</tr>
<tr>
<td>B. Background Information</td>
<td>1</td>
</tr>
<tr>
<td>II. Data Sources</td>
<td>4</td>
</tr>
<tr>
<td>III. Survey Results</td>
<td>7</td>
</tr>
<tr>
<td>IV. Pension Fund Characteristics</td>
<td>15</td>
</tr>
<tr>
<td>V. Conclusions and Areas of Future Research</td>
<td>18</td>
</tr>
<tr>
<td>Appendix: 1995 Phone Interview Questionnaire and 1995 and 1994 Results</td>
<td>APP</td>
</tr>
<tr>
<td>Public Employees' Retirement Association of Colorado</td>
<td>APP21</td>
</tr>
<tr>
<td>Illinois Municipal Retirement Fund</td>
<td>APP2</td>
</tr>
<tr>
<td>Teachers' Retirement System of the State of Illinois</td>
<td>APP4</td>
</tr>
<tr>
<td>Policemens' Annuity and Benefit Fund of Chicago</td>
<td>APP12</td>
</tr>
<tr>
<td>Massachusetts Pension Reserve Investment Management Board (PRIM)</td>
<td>APP20</td>
</tr>
<tr>
<td>Massachusetts State Employees' &amp; Teachers' Retirement System (MASTERS)</td>
<td>APP19</td>
</tr>
<tr>
<td>New York State Common Retirement System (NY State and Local)</td>
<td>APP10,14</td>
</tr>
<tr>
<td>New York State Teachers'</td>
<td>APP15</td>
</tr>
<tr>
<td>New York City Systems</td>
<td>APP16</td>
</tr>
<tr>
<td>Pennsylvania Public School Employees' Retirement System</td>
<td>APP17</td>
</tr>
<tr>
<td>Pennsylvania State Employees' Retirement System</td>
<td>APP18</td>
</tr>
<tr>
<td>Virginia Retirement Fund</td>
<td>APP6</td>
</tr>
<tr>
<td>Washington State Investment Board</td>
<td>APP8</td>
</tr>
<tr>
<td>State of Wisconsin Investment Board</td>
<td>APP22</td>
</tr>
</tbody>
</table>
Executive Summary

I. Conclusion and Areas of Future Research

There are eight characteristics that are generally associated with public pension funds that invest in small businesses. These are:

- There are no legislative mandates or requirements to invest in small business;
- Small Business is not an explicit target;
- Most of the alternative investments are managed externally;
- Focus of the investment is on long-run returns;
- Several of the funds have a geographic focus within the state;
- Funds with small business investments tend to invest in venture capital;
- They tend to be among the larger pension funds;
- They tend to be concentrated in the more established (older) pension funds.

It should be noted that some of the programs deviate in one or more respects from the general profile described above. For example, some of the pension funds have internal mechanisms and do not rely primarily on venture capital, but rather, rely on direct loans as the primary investment vehicle.

There are three types of small business investment approaches, or "models" that we have observed in the public pension funds surveyed in this research effort. The first is the approach utilized by the Wisconsin Investment Board. The investments have a heavy in-state focus and are primarily direct loans. Unlike most other pension funds, there is an extensive internal direct loan mechanism that allows evaluation of Wisconsin small business investment opportunities. This internal mechanism would not be easily replicated by other pension funds. The WIB invests between 1.5 and 2% of its funds in small business.

The second approach is typified by the Massachusetts Pension Reserve Investment Management Board, PRIM. Altogether $277 million is invested in small business, with a heavy
in-state focus. This is comprised of: (1) two ETIs, (2) a joint venture with MASTERS; and (3) $200 million committed to 20 different venture capital funds. There are few internal resources devoted to alternative investments. The driving force in establishing these small business investments is the manager of alternative investments. PRIM's small business investment represents 5% of its pension assets.

PRIM represents a relevant model of small business investment. It relies primarily on outside expertise in focusing funds on in-state investments. While pension officials are concerned about being able to obtain this expertise, it has been relatively successful and enlightened in its investment approach. Its primary objective is to maximize returns to the fund. This fund demonstrates that significant investments can be committed to the small business sector without significant internal administrative support.

The third model is represented by the approach utilized by the Virginia Retirement System. Two percent of this $19 billion fund is invested in venture capital. A significant portion of this is in early stage investments, unlike many of the other funds that are more heavily invested in later-stage venture capital. There are only minimal resources devoted to oversight of private equity investments. While there is no geographic focus to the investments generally, the fund is invested in Virginia Economic Development Corporation (VEDCROP). VEDCROP is a mezzanine capital pool that funds rural Virginia businesses.

In order to promote these approaches both Federal and State policy makers should embark on aggressive efforts to provide information on successful alternative investment strategies. Obstacles to small business investment are often created by the lack of information resulting in considerable risk and uncertainty. For this reason it is not surprising that many successful programs have a local orientation.

Successful funds have operated within an environment in which their investment options are not limited. At the same time, successful alternative investment initiatives have not been mandated by the states.

The next step for the SBA is to be involved in a demonstration project that would help to promote one or more variants of the models described above. We believe that many states might be willing to participate in a jointly sponsored public-private partnership investment with a local development/small business focus. The notion of equity or loan pools with this emphasis might be attractive to public pension funds interested in maximizing returns to beneficiaries.
II. Fund by Fund Detail

The general characteristics described above are detailed in the table below. This table provides an overview of selected characteristics for the fourteen funds we have surveyed as well as summary statistics for the eight states in which they are located. The eight states are ranked one through seven and tenth in terms of the small business dollars originating in public pension funds within a state. The fourteen funds collectively account for 24% of all U.S. public pension fund assets. With the exception of New York City Employees' Retirement System all of the funds have some investment in venture capital. Some of the funds have invested as much as 3% of fund assets in venture capital.

Legislative constraints are virtually non-existent among the funds examined. Five funds have limits on the percentage of fund assets that can be invested in venture capital. Eight funds have some investments with an in-state focus. However, in no instance is there a trade off between rate of return considerations and the in-state focus. None of the funds surveyed indicated that small business represented an explicit investment target. However, the end result of several investment strategies such as economic development, job growth, etc., are closely tied to investment in the small business sector. Therefore, it is not critical that small businesses per se represent an investment target. For those funds that focus their small business investments exclusively in venture capital success is attributed to the capability of the external fund manager.
Table 3: SELECTED PENSION FUND CHARACTERISTICS ($ millions)

<table>
<thead>
<tr>
<th>STATE/FUND</th>
<th>Small Bus. Investment/rank(^1)</th>
<th>Pension /State share(^2)</th>
<th>V.C. Shares(^3)</th>
<th>Other Investments(^4)</th>
<th>Legsl. Cons.</th>
<th>V.C. Lim.</th>
<th>In-State/Local Focus</th>
<th>Small Bus. Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO Public Employees'</td>
<td>$439/4</td>
<td>$17,881/78%</td>
<td>1%</td>
<td>$166</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IL</td>
<td>$382/7</td>
<td>$48,263/49%</td>
<td>1%</td>
<td>$0.00</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Policemen's Annuity and Benefit Fund of Chicago</td>
<td>$2,300/5%</td>
<td>3%</td>
<td>no</td>
<td>3%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>IL Municipal</td>
<td>$8,100/7%</td>
<td>3%</td>
<td>no</td>
<td>3%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>IL Teachers'</td>
<td>$13,000/27%</td>
<td>2%</td>
<td>no</td>
<td>5%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>MA</td>
<td>$253/10</td>
<td>$18,829/65%</td>
<td>2%</td>
<td>$3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MA State Employees' &amp; Teachers'</td>
<td>$7,200/38%</td>
<td>3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>MA Pension Reserve Investment Management</td>
<td>$5,000/27%</td>
<td>3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>NY</td>
<td>$639/1</td>
<td>$170,964/78%</td>
<td>0.5%</td>
<td>$150</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY State &amp; Local</td>
<td>$68,200/40%</td>
<td>1%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>NY State Teachers'</td>
<td>$42,000/25%</td>
<td>0.1%</td>
<td>no</td>
<td>1%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>NY City Employees'</td>
<td>$23,000/13%</td>
<td>0%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>PA</td>
<td>$563/2</td>
<td>$43,982/87%</td>
<td>1%</td>
<td>$105</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public School Employees'</td>
<td>$5,000/57%</td>
<td>1 - 2%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>PA State Employees'</td>
<td>$13,200/30%</td>
<td>1%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>VA</td>
<td>$387/6</td>
<td>$20,426/93%</td>
<td>2%</td>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VA Retirement System</td>
<td>$19,000/93%</td>
<td>2%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>WA</td>
<td>$452/3</td>
<td>$28,866/79%</td>
<td>1%</td>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WA St Invst Board</td>
<td>$22,700/79%</td>
<td>2%</td>
<td>no</td>
<td>10%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>WI</td>
<td>$425/5</td>
<td>$37,289/78%</td>
<td>0%</td>
<td>$417</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>St of WI Invst Board</td>
<td>$29,200/78%</td>
<td>0.3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$3,540</td>
<td>$291,900/24%</td>
<td></td>
<td>$841</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^1\) All Small Business dollars are taken from Pension Funds and Small Firm Financing, February 1995, M&R Associates.

\(^2\) State percentages represent the combined share of listed funds. Fund percentages represent share of state total. TOTAL shows column fund total of all individually listed pension funds and their share of all U.S. public pension funds. The source for state pension dollar totals is Money Market Directories, 1995 and the pension dollar totals for the individual funds are derived from phone interviews made in 1994 and 1995.

\(^3\) Venture capital shares are derived from the 1995 Investment Specialties Guide and from phone interviews conducted in 1994 and 1995.

\(^4\) Data for Other Investments are taken from Pension Funds and Small Firm Financing.
I. Introduction
A. Purpose

This report is the result of a contract extension of "Public Pension Funds and Small Firm Financing", completed in February 1995 by M&R Associates. The purpose of this additional research is to develop models of successful small business investment programs undertaken by public pension funds. Successful programs are defined as those which make relatively substantial investments via economically targeted investments and/or venture capital focused on the small business sector of the U.S. economy. The goal is to collect sufficient information from case studies through interviews and secondary sources to develop a profile of characteristics which define a successful program and which are transferrable to other public pension fund operations.

B. Background Information

The notion of using public pension funds to help finance small businesses is not new. One of the mechanisms by which this is accomplished is through economically targeted investments. In New York, for example, the policy of using public pension funds for economic development or other social objectives was established by the Legislature and the Governor in 1983. However, the use of pension fund financing for small business investment is not widespread either in terms of the number of states or the penetration within states. In 1992, the percentage of pension fund assets invested in small businesses varied by state from 0.0% to just under 6%.

Pension fund investments in small business are made through the market in the form of general venture capital investments, through special programs such as ETIs, or the purchase of SBA guaranteed loans. Table 1 provides the 1992 total financial assets from all of these investment sources for each state. The major source of these estimates was the detailed 1993 IFE report, *Economically Targeted Investments, A Reference for Public Pension Funds; the 1992 Money Market Directory of Pension Funds and their Investment Managers; the 1992 Money Market Directory Investment Specialties Guide*; and phone discussions with selected investment managers.

Table 1 provides the ranking by public pension plan dollars (assets) of all fifty states plus the District of Columbia. The number next to the state is that state's rank. The estimate of small business dollar investments, the share of those investments relative to the total plan size and the number of pension plans per state are also shown.
<table>
<thead>
<tr>
<th>STATE</th>
<th>TOTAL PENSION $</th>
<th>SURVEY ETI DOLLARS</th>
<th>IMPUTED SB$</th>
<th>OTHER VC$</th>
<th>TOTAL SB$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>VC</td>
<td>PP</td>
<td>SB</td>
<td>O</td>
</tr>
<tr>
<td>1- California</td>
<td>$150,250</td>
<td>$50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2- New York</td>
<td>$136,289</td>
<td>$95</td>
<td></td>
<td>$150</td>
<td></td>
</tr>
<tr>
<td>3- Ohio</td>
<td>$51,608</td>
<td>$45</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4- Texas</td>
<td>$42,615</td>
<td></td>
<td></td>
<td>$83</td>
<td></td>
</tr>
<tr>
<td>5- Illinois</td>
<td>$36,656</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6- Pennsylvania</td>
<td>$33,011</td>
<td>$458</td>
<td>$3</td>
<td>$50</td>
<td>$52</td>
</tr>
<tr>
<td>7- Michigan</td>
<td>$31,753</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8- Florida</td>
<td>$28,648</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9- Wisconsin</td>
<td>$28,064</td>
<td></td>
<td>$400</td>
<td>$17</td>
<td></td>
</tr>
<tr>
<td>10- New Jersey</td>
<td>$27,200</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11- Georgia</td>
<td>$18,198</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12- Alaska</td>
<td>$18,174</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13- North Carolina</td>
<td>$18,141</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14- Maryland</td>
<td>$17,621</td>
<td></td>
<td>$15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15- Minnesota</td>
<td>$16,536</td>
<td>$6</td>
<td></td>
<td>$20</td>
<td></td>
</tr>
<tr>
<td>16- Washington</td>
<td>$16,080</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17- Virginia</td>
<td>$16,002</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18- Tennessee</td>
<td>$14,898</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19- Massachusetts</td>
<td>$14,340</td>
<td>$250</td>
<td>$1</td>
<td>$2</td>
<td></td>
</tr>
<tr>
<td>20- Oregon</td>
<td>$12,576</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21- Connecticut</td>
<td>$11,186</td>
<td></td>
<td></td>
<td>$25</td>
<td></td>
</tr>
<tr>
<td>22- Arizona</td>
<td>$11,013</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23- Missouri</td>
<td>$10,915</td>
<td>$33</td>
<td></td>
<td>$75</td>
<td></td>
</tr>
<tr>
<td>24- Colorado</td>
<td>$10,299</td>
<td>$64</td>
<td>$100</td>
<td></td>
<td>$66</td>
</tr>
<tr>
<td>25- Alabama</td>
<td>$10,135</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>26- Louisiana</td>
<td>$9,804</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>27- South Carolina</td>
<td>$8,784</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**TABLE 1**

1992 STATE PENSION FUND DOLLARS FOR SMALL BUSINESSES BY SOURCE

$ MILLIONS

* M&R Associates -2- #SBAHQ-95-C-0008
<table>
<thead>
<tr>
<th>STATE</th>
<th>TOTAL PENSION $</th>
<th>SURVEY ETI DOLLARS</th>
<th>IMPUTED SB$</th>
<th>OTHER VC$</th>
<th>TOTAL SB$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>VC</td>
<td>PP</td>
<td>SB</td>
<td>O</td>
</tr>
<tr>
<td>28- Kentucky</td>
<td>$8,781</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>29- District of Columbia</td>
<td>$8,508</td>
<td></td>
<td></td>
<td></td>
<td>$55</td>
</tr>
<tr>
<td>30- Indiana</td>
<td>$6,296</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>31- Iowa</td>
<td>$6,140</td>
<td>$17</td>
<td></td>
<td>$38</td>
<td>$55</td>
</tr>
<tr>
<td>32- Oklahoma</td>
<td>$5,341</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>33- Mississippi</td>
<td>$5,122</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>34- Arkansas</td>
<td>$4,569</td>
<td>$17</td>
<td></td>
<td>$11</td>
<td>$28</td>
</tr>
<tr>
<td>35- Utah</td>
<td>$4,500</td>
<td>$60</td>
<td></td>
<td>$0</td>
<td>$60</td>
</tr>
<tr>
<td>36- New Mexico</td>
<td>$4,403</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>37- Hawaii</td>
<td>$4,283</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>38- Nevada</td>
<td>$3,909</td>
<td></td>
<td></td>
<td>$39</td>
<td>$39</td>
</tr>
<tr>
<td>39- Kansas</td>
<td>$3,863</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>40- Montana</td>
<td>$3,791</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>41- Rhode Island</td>
<td>$2,995</td>
<td>$23</td>
<td></td>
<td>$40</td>
<td>$63</td>
</tr>
<tr>
<td>42- Nebraska</td>
<td>$2,698</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>43- West Virginia</td>
<td>$2,592</td>
<td>$150</td>
<td></td>
<td></td>
<td>$150</td>
</tr>
<tr>
<td>44- Maine</td>
<td>$2,152</td>
<td>$10</td>
<td></td>
<td>$0</td>
<td>$10</td>
</tr>
<tr>
<td>45- South Dakota</td>
<td>$1,959</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>46- Idaho</td>
<td>$1,887</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>47- Delaware</td>
<td>$1,880</td>
<td></td>
<td></td>
<td>$35</td>
<td>$35</td>
</tr>
<tr>
<td>48- Wyoming</td>
<td>$1,659</td>
<td>$13</td>
<td></td>
<td>$14</td>
<td>$14</td>
</tr>
<tr>
<td>49- New Hampshire</td>
<td>$1,404</td>
<td></td>
<td></td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>50- North Dakota</td>
<td>$1,114</td>
<td></td>
<td></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td>51- Vermont</td>
<td>$756</td>
<td>$1</td>
<td></td>
<td>$150</td>
<td>$0</td>
</tr>
</tbody>
</table>

**TOTAL** | $891,399 | $1,094 | $503 | $634 | $120 | $112 | $2,907 | $5,370

Note: SB$=small business dollars from all sources; VC= venture capital dollars; PP=private placement and direct loan ETI dollars; SB=Small business investments; and O=Other investment ETI dollars.

Sources:
2. Based on information obtained from Institute for Fiduciary Education (IFE) Survey of Economically Targeted Investments (1992).
3. Based on estimates developed by M&R Associates.
II. Data Sources

The focus of this research effort was to more closely examine those public pension funds which were identified in "Pension Funds and Small Firm Financing" as having significant small business investments. The purpose is to collect sufficient information to develop a profile of characteristics which define a successful program and which could be replicated by other public pension fund operations. The following list identifies the funds we attempted to examine more closely:

**Colorado** -- Public Employees' Retirement Association of Colorado;


**Massachusetts** -- Massachusetts State Employees' and Teachers' Retirement System and MA Pensions Reserve Investment Management Board;

**New York** -- New York State and Local Retirement System, New York State Teachers' Retirement System and New York City Employees' Retirement System;


**Virginia** -- Virginia Retirement System;

**Washington** -- Washington State Investment Board;

**West Virginia** -- West Virginia State Board of Investments;

**Wisconsin** -- State of Wisconsin Investment Board.

The data sources for this research effort build on M&R Associates' February 1995 study and include the results of surveys on ETIs, recurring publications containing up-to-date information on public pension funds, annual pension fund reports, phone interviews with individual fund managers and other literature focusing on targeted investment programs of individual states. The most recent and comprehensive survey from which small business investments and the characteristics of the funds that make them can be derived is *Economically Targeted Investments, A Reference for Public Pension Funds*, conducted by the Institute for
Fiduciary Education (IFE). This survey was released in July 1993 and covered 119 of the largest public pension plans in the country. While the published survey results are provided on an aggregate basis, for the purposes of this report we obtained individual fund information for selected questions. Since the survey was geared towards ETIs, the information obtained pertained only to those funds with ETIs and not funds with venture capital investments or other non-ETI alternative investments.

Table 2 provides a quick overview of the sources of data from three different surveys for each of the fourteen pension funds examined in this research. All of the funds were included in the IFE survey, while nine were in the 1994 M&R phone survey and six participated in the M&R 1995 phone survey.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Employees' Retirement Assoc. of CO</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Policemens' Annuity and Benefit Fund of Chicago</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>IL Municipal Retirement</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>IL Teachers' Retirement</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>MA Pension Reserve Investment Management Board</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>MA State Employees' &amp; Teachers' Retirement</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>NY City Employees Retirement System</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>NY State &amp; Local Retirement System</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>NY State Teachers' Retirement System</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>PA Public School Employees' Retirement</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>PA State Employees' Retirement System</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>VA Retirement System</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>WA State Investment Board</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>State of WI Investment Board</td>
<td></td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

In addition to the IFE survey data, information is taken from the Directory of Pension Funds and Their Investment Managers, published by Money Market Directories, Inc. (MMD). This information is derived from personal phone interviews and questionnaires and includes both...
public and private pension funds. The 1995 directory covers 1,165 government plans with assets of at least $1 million, for a total of $1,216 billion in assets. A complementary Directory which is also published by MMD, *Investment Specialties Guide*, provides a listing of pension funds by the types of investments in their portfolios. This is used to identify all state pension funds with venture capital and the amount of those venture capital investments.

The third source includes phone discussions with selected fund managers that took place over two separate intervals. The first set of phone contacts was made in the Fall of 1994. These pension fund managers were contacted in order to verify certain small business estimates, obtain information on the characteristics of several ETIs and gain some insights regarding future trends. The second set of phone discussions was completed from August through October of 1995 and focused on a standard set of questions on background; determinants of the decision-making process; fund management and performance/characteristics of the investments. (The full 1995 questionnaire and responses to both surveys are provided in an appendix to this report.)
III. Survey Results

The most recently completed survey (1995) covers funds primarily investing in venture capital. The survey conducted in 1994 includes both venture capital and private placements, as well a miscellaneous set of other small business investments including those made through ETIs. Finally, the results from the last Institute for Fiduciary Education (IFE) survey (1992-1993) includes funds investing in a variety of debt and equity instruments. As noted in Table 2 there is some overlap across these surveys in terms of the funds that were contacted. The phone conversations with fund managers that occurred in the Fall of 1994 did not focus on the same set of questions as the more recent survey discussed above. However, there are some similarities which address the current research issue and they are included below. In this section the information obtained from each of these sources is combined for each fund examined.

i. Public Employees' Retirement Association of Colorado

The total fund size was $14 billion in 1994. There are four venture capital funds -- all externally managed -- with $131 million in commitments (the manager was not sure how much of that is actually drawn down). Other small business related investments include $10-$15 million in loans to the Housing Finance Agency to make loans to small businesses in Colorado and about $36 million in private placements. When thinking of investing in venture capital and ETIs the overriding concern is the fiduciary responsibility to their members. The fund manager also stated that small businesses are not a specific target of their investment decisions. In-house staff promoted the idea for these funds. The objectives of the investments were business development and job creation, although these were secondary to strong returns on investment. A portion of the fund was invested in-state. There is a statute which limits the percent of the fund invested in-state to 20%. They reported no major difficulty in either developing or operating these investments. At the time of the IFE survey, they were generally satisfied with the performance of the investment returns.

ii. Policemens' Annuity & Benefit Fund of Chicago

The Policemens' Annuity & Benefit Fund of Chicago is a $2.3 billion pension fund established 74 years ago. The Board has set a limit of allowing 3% of assets to be invested in venture capital. That allocation has been attained, i.e., investments in venture capital total $67 million.

The decision to invest in this asset class was made by the Board of Trustees as a prudent
diversification vehicle. They do not expect to relax the 3% limit on this type of investment. (This is probably due to perceived risk.) The small business sector is not an explicit target of the investments. The program is managed externally because the Fund does not have an investment staff.

There is no geographic focus to any of the investments and there are no legislative constraints that affect the Fund.

Overall, officials are happy with the performance of these investments. Venture capital is considered a long-term investment strategy. The most important factor contributing to a successful program is the selection of money managers. (This is especially important to a relatively small pension fund with no internal investment staff.)

iii. Illinois Municipal Retirement Fund

The Illinois Municipal Retirement Fund has $8.1 billion in assets. Three percent of the fund -- $243 million -- is set aside for venture capital investments. Approximately 67% of this allocation has been funded. The fund began this investment strategy during the 1984 to 1985 time frame.

The decision to target funds in venture capital came as a result of a decision by the Board to "...enhance portfolio design." It appears that it was the Director of Investments who initiated this strategy, brought in external managers for presentations to the Board, etc. It is clear from the responses to the questionnaire that the fund decided to use these investments as a way of increasing overall returns, even though there was some risk associated with this strategy. However, it is risk that inhibits further investments. Given the volatility of this class of assets, changes in the composition of the portfolio can not be justified. Small businesses have been targeted in the past but do not appear to be an explicit target currently. The venture capital investments are managed externally. The in-house expertise is not present to undertake this activity directly.

Investments are evaluated for "geographic placement". However, return rates take precedence over geographic diversification. There are no specific legislative constraints that affect the pension fund staff in terms of investment recommendations.

There have been some disappointments as well as some surprises in terms of performance. Overall, fund officials have been satisfied with the venture capital investments. These are all long term investments. Finally, fund officials indicate that the most important factor in a successful program is having an "excellent fund of funds manager(s)". In other words, the individuals who
make the selection of external managers are critical to the success of the program.

iv. Illinois Teachers' Retirement Fund

The Illinois Teachers' Retirement Fund has $13 billion in assets and has been in existence for 57 years. Up to 5% of the fund, or $650 million, is potentially available for venture capital investment. Thus far, $150 million has been invested, while an additional $300 million has been committed. The remaining $200 million, while technically available, has not yet been committed. These investments were started in 1983.

The Chief Investment Officer was the driving force behind this investment strategy. There is no explicit small business target. However, some of the managers target start-ups and middle stage investments, which tend to be proxies for small businesses. In terms of further commitments to venture capital, the staff believes that they have the right composition of asset classes and do not recommend further commitments. This category of investment is externally managed because of staffing constraints and lack of internal expertise. There is no geographic focus to the investments and there are no legislative constraints.

To date, the staff is happy with the performance of their venture capital investments, which are long term in nature. Only one fund has reached maturity so it is difficult to make a definitive statement in this area. Finally, they believe that success in this investment area is primarily a function of proper (external) manager selection.

v. Massachusetts Pensions Reserve Investment Management Board (PRIM)

The manager of alternative investments and private placements was contacted. The total size of the fund at the time of the interview was $5 billion. The fund is active in both ETIs and unrelated venture capital. Two active ETI funds are Massachusetts Technology Corp. ($2 million) and the Mayflower Fund ($50 million). A third will have $50 million in a joint venture with Massachusetts State Employees and Teachers Retirement System ($25 million each). The joint venture will be externally managed and the investments focused in-state. The fund also has housing-related ETIs which were promoted by a combination of internal staff, the pension investment committee and an outside bank.

In addition the fund has $200 million committed to 20 different venture capital funds. They do not specifically target small businesses: "We are out to make money." All of their ETIs and VC investments are externally managed but he expressed a difficulty in finding good managers. Most investments are focused in-state and there is some concern regarding the ability of the state to absorb the influx of money.
vi. Massachusetts State Employees' and Teachers' Retirement System (MASTERS)

The size of this fund is $7.2 billion. Although the fund has about $295 million invested in ETIs, for the most part, they are housing related and not in the small business arena. The exception is the joint venture with PRIM. They also had a small amount in SBA loans which they will continue to hold. They do not intend to purchase any more because this program does not "expand the economic climate" since purchasers for the paper already exist -- there is no expansion into new markets.

The return on the investment is the primary driver of decisions with a secondary goal of expansion of the state's economic climate. The contact felt some frustration at not being able to find good investment opportunities involving small businesses carrying some type of guarantee other than the SBA loans which are not satisfactory for reasons mentioned above.

vii. New York City Systems

This $50 billion fund has most of its $900 million for ETIs in housing-related investments because that is the area where they get the guarantees they "need". The New York City Controller's Office runs the ETI programs for the various New York City Pension funds. While none of the targeted investments focus on small businesses explicitly, there are probably some indirect benefits accruing to small business. In virtually every case, the programs were developed by a combination of internal staff and outside organizations, including non-profit groups and government agencies.

In general, most of the issues related to developing these programs did not pose significant difficulties. On a scale of 1-5, with 5 being the most difficult, issues such as return/risk requirements, liquidity levels, operational issues, etc. were ranked in the 1-3 range of difficulty. For some of the programs, however, issues such as Board concerns, procurement of a competent asset manager and selection of an appropriate performance benchmark were considered more difficult (ranked as a 4). Fund officials were generally satisfied or indifferent with the ETIs. All of the programs are targeted within New York City.

$50 million is committed to the Excelsior Fund which is a loan fund promoted by former-governor Cuomo. They have no venture capital investments because they feel that there is very little information for evaluating returns and that VC programs are costly to develop and implement.

Like the MASTERS program the return on investment is the primary driver, with guarantees on return a key factor. There are two other issues which are factored into the
investment decision: the bulk of the investments must be in NYC and a capital gap must exist which other lenders will not fill, so that they are not displacing other lenders. (Note: like MASTERS they like the loan guarantees provided in the housing market and don't like SBA loans because they are so competitive and don't fill a gap.) No monies are explicitly earmarked for small businesses.

viii. New York State and Local Retirement System

The New York State and Local Retirement System has assets of $68.2 billion, and has been in existence for 75 years. The fund began investing in venture capital in 1983. $220 million has been committed, of which $167 million has been invested. An additional $75 million is in the New York Business Development Corporation (NYBDC). NYBDC is a state-chartered public benefit corporation which makes loans to small businesses. The pension fund and the NYBDC negotiated a complex deal linking the fund's rate of return to 90-day Treasury Bills. Loans of up to $1 million are made for working capital, equipment and real property.\(^1\) The VC and NYBDC are both externally managed.

The motivation for these investment initiatives was an asset allocation decision, i.e., to develop alternative investments in order to improve returns to the fund. There was little difficulty in reaching this decision and there were no trade-offs vis a vis prudence rules, political considerations, etc. While small business is not a target per se, the staff realizes that the venture capital approach is a de facto investment in small business.

One of the inhibiting factors discussed concerned the issue of the size of commingled funds. A large pension fund, such as the New York State and Local Retirement System, finds investing in a venture capital fund, or other alternative investment fund (e.g., economic development fund) an inefficient investment vehicle. Given the typical size of such a fund -- $100-$200 million -- and given the diversification requirements, investments of this nature can not have a significant impact on returns. For example, in the context of a $100 million fund, of which the pension system is one of four investors each contributing $25 million to diversify risk, a significant return on the pension fund's investment, say $3 million, is insignificant from an overall bottom line perspective. Investment managers will tend to seek more significant overall returns that do not require hundreds of such investments.

The venture capital portfolio is managed externally because the expertise to perform this function is not available in-house. The nature of the venture capital investments has changed since the mid-80s. Early stage venture capital has decreased in the 90s relative to later stage venture capital and private equity investments. Most of the latter are probably focused on small businesses, but there is no way this can be determined precisely without actually talking to the external fund managers.

The staff of the fund is happy with the performance of the vc investments. The latter are long term in nature. There are no legislative constraints per se; however, where it is feasible, given prudence considerations, the fund should consider investments which "bolster the state of New York." The staff attributes the successful investment performance to a strategy of investing in funds that focus on later-stage investments. Early stage investments are considered extremely risky.

ix. **New York State Teachers' Retirement System**

This $42 billion fund has approximately $60 million invested in VC, which funds small businesses, including some mezzanine financing. In January of 1995 they began formal implementation of a program to increase the allocation of alternative investments to 1% of the fund's assets. The alternative investments are all externally managed. While small businesses are not a direct target of the fund's investments they are a de facto recipient. The driving factor in making investment decisions is the rate of return -- a Department of Labor ruling stated that risk adjusted rate of return must be the primary consideration.

The respondent felt that there was a dearth of information on government guarantees for investments and would welcome more information. He expressed a desire to make investments which support the growth of small businesses through mechanisms like the Excelsior Fund.

x. **Pennsylvania Public School Employees' Retirement System**

This $25 billion fund has no ETIs but has $1 billion committed in private placements with $330 million invested. In addition, there is a venture capital program which is 100% invested at $300 million with about half of the programs in Pennsylvania. Members of the legislature in Pennsylvania promoted and helped develop the venture capital program. The issues that posed the greatest difficulty (a ranking of 4) were return/risk, liquidity, board concerns, internal staff considerations and selection of a competent asset manager. The overall difficulty of operating the funds was moderate (a ranking of 3). The targets of the investments, in order of importance, are high technology development, business development, job creation and an increase in tax revenues.
Most of these objectives, while not explicitly focused on small business development, clearly provide investment capital to small firms.

The primary reason for investing in-state is the ease with which the sites can be visited and monitored. Rate of return is the number one consideration in making all investments, with no conscious decision to invest in small businesses. There are two internal staff members who deal with alternative investments and oversee the externally managed venture capital and private placement funds.

xi. Pennsylvania State Employees' Retirement System

This fund currently has approximately $13 billion in assets with no explicit ETIs. There is a state statute which dictates that "all things being equal" investments should be made within the state. Alternative investments are managed externally.

In the last IFE survey, pension officials reported that there were 4 ETI programs. These included: a private placement account, a residential and commercial mortgage portfolio, the Pennsylvania Index Fund, and various venture capital limited partnerships. Except for the private placement account (promoted by labor union/employee groups) all of the ETIs were promoted and developed internally, that is, by internal staff and board members.

The overall level of difficulty in developing and operating these programs was 3. (The exception to this was a 4 in the case of operating the private placement accounts.) As mentioned above, investments are targeted on in-state businesses, where possible.

xii. Virginia Retirement Fund

The Virginia Retirement Fund is a $19 billion pension system established in the 1950s. Between 1 and 2% of the fund is invested in early stage and later stage venture capital. (These investments were started in 1983.) Almost 4% of the fund is invested in other private equity, but most of this does not flow to the small business sector.

The venture capital investments were established through the efforts of the previous investment manager. The primary decision factor in making these investments was improving the return to the fund. There is no explicit small business target to the investments. The only inhibiting factor to further venture capital investment is the uncertain performance of early stage venture capital. Until that is clear, there will not be any further investments in this category.

While the venture capital funds are managed externally, there is internal oversight of the outside managers or general partners who actually make the venture capital investment decisions. Two staff members monitor all activity related to private equity investments. There is no
geographic focus to the investments and there do not appear to be any legislative constraints.

Fund officials are happy with the performance of their venture capital investments which are long term in nature. They consider their success in this investment category due largely to careful evaluation of the external managers and their track records.

**xiii. Washington State Investment Board**

The Washington State Investment Board is a state-wide pension fund with $22.7 billion in assets. A total of $1.9 billion is invested in 43 venture capital funds. Approximately $330 million of that amount is invested in "pure" venture flowing to small businesses. The remaining amounts are for mezzanine financing and buyouts. No more than 10% of the fund can be invested in venture capital. The fund began investing in venture capital in 1981.

While small business is not an explicit target, some of the capital is focused on start-up businesses. A significant portion is for mezzanine financing. There is no geographic focus to the investments. The only constraint facing the fund is that no more than 10% of the fund's assets can be invested in venture capital.

**xiv. State of Wisconsin Investment Board**

The $29 billion fund has approximately $78 million in vc, $891 in LBO funds, $2.8 billion in private placements and $17 million to Bando-McGlocklin (an SBIC) for loans to small business. Wisconsin-based companies make up about $400 million in pension-financed direct loans. While rate of return is the primary investment driver, all other things being equal, they look to companies they can visit and which are easily accessible. There are additional risks associated with this strategy due to the size of the companies. The investments are a little more volatile for this reason. The nature of the private placement loans is such that internal management is used.

The decision to go with Bando-Glocklin was made specifically to help small business; however, recent changes to Federal regulations would not allow them to be a "senior" lender without being actively involved. They don't feel that they can be actively involved. At the time of the interview this issue was not resolved.

They are very happy with the investments they have made. The success of their small business-related programs is based on a careful evaluation of companies, site visits, communication with management etc.
IV. Pension Fund Characteristics

The case study approach used in this research does not allow inferences to be drawn regarding small business investments by one fund versus another. The survey results point to many characteristics which are common across the funds. Table 3 below provides an overview of selected characteristics for the fourteen funds we have surveyed as well as summary statistics for the eight states in which they are located. The eight states are ranked one through seven and tenth in terms of the small business dollars originating in public pension funds within a state. The fourteen funds collectively account for 24% of all U.S. public pension fund assets. With the exception of New York City Employees' Retirement System all of the funds have some investment in venture capital. Some of the funds have invested as much as 3% of fund assets in venture capital.

While we don't have information on a fund-by-fund basis for other small business investments, we are able to provide this information on a state-wide basis. For both Colorado and Wisconsin other investments are a significant 1% or so of total public pension plans assets, whereas in the remaining states other investments are only between 0% and .5%. Other small business investments include private placement debt and equity investments, SBA guaranteed loans, direct lending, etc.

Legislative constraints are virtually non-existent among the funds examined. The exception to this is Colorado Public Employees' Retirement Association with statutory limits of no more than 20% of fund assets committed to in-state investments.

Five funds have limits on the percentage of fund assets that can be invested in venture capital. These limits reflect internal investment allocations set by the board of trustees. In only two cases have the funds met the limit, the Policemens' Annuity and Benefit Fund of Chicago and the Illinois Municipal Retirement Fund.

Eight funds have some investments with an in-state focus. However, in no instance is there a trade off between rate of return considerations and the in-state focus. For example, the Pension Reserve Investment Management Board in Massachusetts focuses venture capital investments in high-technology businesses that are Massachusetts-based; yet they view this strategy as maximizing returns. The same approach has been adopted by the Public School Employees'...
Retirement System in Pennsylvania. The risk-adjusted return is maximized with some significant in-state investments. The latter can effectively reduce risk to a fund that is in close proximity to the businesses that receive financing. The same business could have a much higher risk premium (and therefore a lower risk-adjusted return) to an out-of-state pension fund. At the same time, several funds explicitly focus their investments in-state, once fiduciary responsibilities have been met. Thus, collateral benefits will play a decisive role in choosing among alternative investments with the same risk-adjusted return.

None of the funds surveyed indicated that small business represented an explicit investment target. However, the end result of several investment strategies such as economic development, job growth, etc., are closely tied to investment in the small business sector. Therefore, it is not critical that small businesses per se represent an investment target.

For those funds that focus their small business investments exclusively in venture capital success is attributed to the capability of the external fund manager. Most pension funds do not have internal expertise and therefore rely on outside investment managers. This reliance can be so great that for some funds the major factor which was cited as crucial to the success of the program was the fund of funds manager(s).

Several of the funds surveyed provided consistent answers to the question of how a particular small business investment was promoted and then developed. The idea for a particular investment initiative was promoted by a legislative body, or the Board, or the fund's internal staff, or some combination of these entities. It is not clear which of the three parties most often initiates the investment idea.

Board members and internal staff were most frequently cited as the entities responsible for the development of alternative investments. In this context it is noteworthy that the most difficult issues confronting pension officials were return/risk requirements and the procurement of a competent asset manager. (Both the 1993 IFE Survey and the 1995 survey provide consistent responses on this issue.)
## Table 3: SELECTED PENSION FUND CHARACTERISTICS ($ millions)

<table>
<thead>
<tr>
<th>STATE/FUND</th>
<th>Small Bus. Investment /rank²</th>
<th>Pension /State share³</th>
<th>V.C. Shares⁴</th>
<th>Other Investments⁵</th>
<th>Legsl. Cons.</th>
<th>V.C. Lim.</th>
<th>In-State/Local Focus</th>
<th>Small Bus. Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO Public Employees'</td>
<td>$439/4</td>
<td>$17,881/78%</td>
<td>1%</td>
<td></td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td></td>
</tr>
<tr>
<td>IL</td>
<td>$382/7</td>
<td>$48,263/49%</td>
<td>1%</td>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policemans' Annuity and Benefit Fund of Chicago</td>
<td>$2,300/5%</td>
<td>3%</td>
<td>no</td>
<td>3%</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IL Municipal</td>
<td>$8,100/7%</td>
<td>3%</td>
<td>no</td>
<td>3%</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IL Teachers¹</td>
<td>$13,000/27%</td>
<td>2%</td>
<td>no</td>
<td>5%</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MA</td>
<td>$253/10</td>
<td>$18,829/65%</td>
<td>2%</td>
<td>$3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MA State Employees' &amp; Teachers¹</td>
<td>$7,200/38%</td>
<td>3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MA Pension Reserve Investment Management</td>
<td>$5,000/27%</td>
<td>3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY</td>
<td>$639/1</td>
<td>$170,964/78%</td>
<td>0.5%</td>
<td>$150</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY State &amp; Local</td>
<td>$68,200/40%</td>
<td>1%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY State Teachers¹</td>
<td>$42,000/25%</td>
<td>0.1%</td>
<td>no</td>
<td>1%</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NY City Employees¹</td>
<td>$23,000/13%</td>
<td>0%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PA</td>
<td>$563/2</td>
<td>$43,982/87%</td>
<td>1%</td>
<td>$105</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public School Employees¹</td>
<td>$5,000/57%</td>
<td>1 - 2%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PA State Employees¹</td>
<td>$13,200/30%</td>
<td>1%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VA</td>
<td>$387/6</td>
<td>$20,426/93%</td>
<td>2%</td>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VA Retirement System</td>
<td>$19,000/93%</td>
<td>2%</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WA</td>
<td>$452/3</td>
<td>$28,866/79%</td>
<td>1%</td>
<td>$0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WA St Invst Board</td>
<td>$22,700/79%</td>
<td>2%</td>
<td>no</td>
<td>10%</td>
<td>no</td>
<td>no</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WI</td>
<td>$425/5</td>
<td>$37,289/78%</td>
<td>0%</td>
<td>$417</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>St of WI Invst Board</td>
<td>$29,200/78%</td>
<td>0.3%</td>
<td>no</td>
<td>yes</td>
<td>no</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>$3,540</td>
<td>$291,900/24%</td>
<td>$841</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

²All Small Business dollars are taken from Pension Funds and Small Firm Financing, February 1995, M&R Associates.

³State percentages represent the combined share of listed funds. Fund percentages represent share of state total. TOTAL shows column fund total of all individually listed pension funds and their share of all U.S. public pension funds. The source for state pension dollar totals is Money Market Directories, 1995 and the pension dollar totals for the individual funds are derived from phone interviews made in 1994 and 1995.

⁴Venture capital shares are derived from the 1995 Investment Specialties Guide and from phone interviews conducted in 1994 and 1995.

⁵Data for Other Investments are taken from Pension Funds and Small Firm Financing.
V. Conclusion and Areas of Future Research

There are eight characteristics that are generally associated with public pension funds that invest in small businesses. These are:

- There are no legislative mandates or requirements to invest in small business;
- Small Business is not an explicit target;
- Most of the alternative investments are managed externally;
- Focus of the investment is on long-run returns;
- Several of the funds have a geographic focus within the state;
- Funds with small business investments tend to invest in venture capital;
- They tend to be among the larger pension funds;
- They tend to be concentrated in the more established (older) pension funds.

It should be noted that some of the programs deviate in one or more respects from the general profile described above. For example, some of the pension funds have internal mechanisms and do not rely primarily on venture capital, but rather, rely on direct loans as the primary investment vehicle.

There are three types of small business investment approaches, or "models" that we have observed in the public pension funds surveyed in this research effort. The first is the approach utilized by the Wisconsin Investment Board. The investments have a heavy in-state focus and are primarily direct loans. Unlike most other pension funds, there is an extensive internal direct loan mechanism that allows evaluation of Wisconsin small business investment opportunities. This internal mechanism would not be easily replicated by other pension funds. The WIB invests between 1.5 and 2% of its funds in small business.

The second approach is typified by the Massachusetts Pension Reserve Investment Management Board, PRIM. Altogether $277 million is invested in small business, with a heavy in-state focus. This is comprised of: (1) two ETIs, (2) a joint venture with MASTERS; and (3)
$200 million committed to 20 different venture capital funds. There are few internal resources devoted to alternative investments. The driving force in establishing these small business investments is the manager of alternative investments. PRIM's small business investment represents 5% of its pension assets.

PRIM represents a relevant model of small business investment. It relies primarily on outside expertise in focusing funds on in-state investments. While pension officials are concerned about being able to obtain this expertise, it has been relatively successful and enlightened in its investment approach. Its primary objective is to maximize returns to the fund. This fund demonstrates that significant investments can be committed to the small business sector without significant internal administrative support.

The third model is represented by the approach utilized by the Virginia Retirement System. Two percent of this $19 billion fund is invested in venture capital. A significant portion of this is in early stage investments, unlike many of the other funds that are more heavily invested in later-stage venture capital. There are only minimal resources devoted to oversight of private equity investments. While there is no geographic focus to the investments generally, the fund is invested in Virginia Economic Development Corporation (VEDCORP). VEDCORP is a mezzanine capital pool that funds rural Virginia businesses.

In order to promote these approaches both Federal and State policy makers should embark on aggressive efforts to provide information on successful alternative investment strategies. Obstacles to small business investment are often created by the lack of information resulting in considerable risk and uncertainty. For this reason it is not surprising that many successful programs have a local orientation.

Successful funds have operated within an environment in which their investment options are not limited. At the same time, successful alternative investment initiatives have not been mandated by the states.

The next step for the SBA is to be involved in a demonstration project that would help to promote one or more variants of the models described above. We believe that many states might be willing to participate in a jointly sponsored public-private partnership investment with a local development/small business focus. The notion of equity or loan pools with this emphasis might be attractive to public pension funds interested in maximizing returns to beneficiaries.
Appendix:
1995 Phone Interview Questionnaire and
1995 and 1994 Results
Venture Capital/Small Business Fund Study
SURVEY QUESTIONNAIRE

1995 Survey Questions and Responses

1. Name of Fund
2. Name, Title & phone number of contact
3. Size of fund
4. Age of fund
5. Size of ETI or VC investments: How many separate accounts or funds?
6. When did the Fund begin venture capital or ETI investing?
7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
8. How difficult was it to establish the funds?
9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)
10. Was a decision made to invest specifically in small businesses? How was that decision made?
11. Are there any inhibiting factors that keep you from investing even more of your funds in the venture capital sector?
12. Are government guarantees a significant incentive in your small business investment decision?
13. Is your ETI/VC program internally or externally managed? Why?
14. If internally: how large a staff? What is the oversight mechanism? Is this program grouped with other pension programs?
15. How is the ETI or VC program implemented and how has it evolved or changed over time?
16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?
17. Is there a geographic focus of investment?
18. Are there any specific legislative constraints unique to your fund?
19. Are there specific factors which you think have made your program successful?
1. Name of Fund
Illinois Municipal Retirement Fund

2. Name, Title & phone of contact
Edward N. Sambol, Investment Manager, (708)368-5380

3. Size of fund
$8.1 billion

4. Age of fund

5. Size of ETI or VC investments:
3% of fund allocated: $243 million. They are about 2/3 funded. They work through fund-of-funds managers (large allocation to a manager who then evaluates partnerships and places the money into partnerships which then invest.)

6. When were each of these funds established?
Initial investments began in late 1984 or early 1985.

7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
The Board, in conjunction with the Director of Investments and after presentations from external managers, determined that it would be beneficial to enhance portfolio design overall and that Venture Capital would be an effective way to do this.

8. How difficult was it to establish the funds?
Staff doesn’t do much with them because of the structure of the management, so it’s not really difficult at all.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)
No trade-offs. Rate of return primary driver in all decisions.

10. How was the decision made to invest in small businesses? Was the small business sector an explicit target of your investment strategy?
Lots of these are probably small businesses, but the fund-of-funds managers makes the decisions, and then it goes to the partnerships. There are two extremely small allocations directly to small business: one which is US focused, but is liquidating now and one which is European focused and very close to liquidation.

11. Are there any inhibiting factors that keep you from investing even more of your funds in the Venture capital?
The class as a whole is extremely volatile; and so increasing the allocation increases risk. Also, an increase in this class means to a decrease in another. It’s a larger question of altering the composition of the portfolio which they probably wouldn’t do.

M&R Associates -APP2- #SBAHQ-95-C-0008
12. Are government guarantees a significant incentive in your small business investment decision? (I asked: "would government guarantees be an incentive to invest in small business" because they really don't do it now) 
"It'd be interesting to see if the government would do it." In addition, if there were government guarantees, the bond market might snap up the guarantees, and you'd lose the capital gap which currently exists and opportunities would be fewer.

13. Is your ETI/VC program internally or externally managed? Why? 
External. No way they have the time, expertise or staff to do it internally. It takes an extreme amount of technical expertise to be able to do these investments, and, in proportion to the overall fund size, the number of staff who would need to be devoted to it renders it infeasible for them to manage internally.

14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?

15. How is the ETI program implemented and how has it evolved or changed over time? 
Interesting changes in the market as a whole: increase in activity in stock distribution area. Movement of companies from VC stage, to mid-level to small cap to large cap. For example: one of their VC funds used to be Philene's Basement. Obviously, that's not VC any more.

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment? 
Overall, yes. There have been some disappointments along the way, but there have been some happy surprises as well. The investments are all long-term. It can take 3 years just to place the money, then it has to mature.

17. Is there a geographic focus of investment? 
Investments are evaluated for their geographic placement (by the Fund of Funds manager). However, return rate takes precedence over geographic diversification.

18. Are there any specific legislative constraints unique to your fund? 
None that he can think of.

19. Are there specific factors which you think have made your program successful? 
Excellent fund of funds manager.
1. Name of Fund
   Teachers' Retirement System of the State of Illinois

2. Name, Title & phone of contact
   Darren Wright, Investment Analyst, (271) 753-0370

3. Size of fund
   $13 billion

4. Age of fund
   57 years old

5. Size of ETI or VC investments: How many? What are individual amounts?
   Venture capital only. Up to 5% of the fund can go to VC, for a total of $650 million potentially available. Currently, about $150 million is invested; an additional $300 million is committed to managers but not drawn down. The other $200 million or so that is technically available has not yet been assigned to a manager.
   7 managers; with a total of 10 limited partnerships.

6. When were each of these funds established?
   Earliest one was established in 1983.

7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
   Wasn't with the fund in 1983, but believes it was the staff, and most especially the CIO, who felt that this was probably a good way to diversify the portfolio. Then, of course, it was approved by the Board.

8. How difficult was it to establish the funds?
   Doesn't know.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)
   Doesn't know

10. How was the decision made to invest in small businesses? Was the small business sector an explicit target of your investment strategy?
    Small businesses are not an explicit target. Some of their managers target start-ups, which means they will have small businesses there. Others target middle or late stage investments.

11. Are there any inhibiting factors that keep you from investing even more of your funds in the VC sector?
    Issue for them is maintaining a truly diversified portfolio for the pension system. Any more commitment to VC would mean taking the money away from the other areas, which they aren't ready to do.

M&R Associates

-APP4-

#SBAHQ-95-C-0008
12. Are government guarantees a significant incentive in your small business investment decision? Don't invest in small businesses as a target. There are no guarantees in VC.

13. Is your ETI/VC program internally or externally managed? Why?
Externally managed. Staffing expertise and time.

14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?

15. How is the VC program implemented and how has it evolved or changed over time?
Doesn't know of any real changes over time. Some managers target high-tech; some target communications, etc. Have made no significant changes, like from businesses to housing development.

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?
Overall, basically happy with the investments. Only one fund is actually at maturity. Others are in varying stages of maturity so it's tough to gauge their returns. Investments are considered long-term: 10 years.

17. Is there a geographic focus of investment?
No. As a preference, the fund believes it is more prudent to invest in US-based businesses rather than foreign-based businesses.

18. Are there any specific legislative constraints unique to your fund?
No.

19. Are there specific factors which you think have made your program successful?
Manager selection is critical to success of the investments.
1. Name of Fund
   Virginia Retirement Fund

2. Name, Title & phone of contact
   Larry Kicher, Investment Manager, (804) 344-3157

3. Size of fund
   $19 billion

4. Age of fund
   Don't know: established sometime in the late 50's

5. Size of ETI or VC investments: How many? What are individual amounts?
   No ETIs. Approximately 1.25% ($237 million) in VC early stage and later stage.
   There are other Private Equity investments in other areas. A total of 5 percent of
   the fund is allocated to Private Equity, but 3.75% is in other areas of private equity which would not be into small businesses.

6. When were each of these funds established?
   Began the funds in 1989.

7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
   Previous investment manager, John McLaren, pushed for it.

8. How difficult was it to establish the funds?
   Not too tough: developed a white paper to evaluate the issues and establish the objectives. Expected a return over what S&P could produce. Based on current valuation, it appears that they have been over S&P.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)

10. How was the decision made to invest in small businesses? Was the small business sector an explicit target of your investment strategy?
    No target of small businesses.

11. Are there any inhibiting factors that keep you from investing even more of your funds in the Venture capital?
    So far, buy-outs have outperformed early stage investments. Wouldn't want to increase that until there was an increase in performance.

12. Are government guarantees a significant incentive in your small business investment decision?

13. Is your ETI/VC program internally or externally managed? Why?
    < $200 million: have a manager-of-managers who selects the managers. > $200

M&R Associates -APP6- #SBAHQ-95-C-0008
14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs? 2 staff internally. Board have final approval of any investment recommendation. As noted above, there are other types of investments in this Private Equity category, but he does track the performance of these VC funds separately.

15. How is the ETI program implemented and how has it evolved or changed over time? No ETI -- not any real clear evolution of the funds so far, but it's a young program.

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment? Overall, very happy with the investments. Long-term investments.

17. Is there a geographic focus of investment? No geographic focus at all.

18. Are there any specific legislative constraints unique to your fund? Didn't have a chance to discuss this.

19. Are there specific factors which you think have made your program successful? They have a well-thought out selection criteria for managers which includes identification of factors which indicate success of the manager, evaluation of the managers exit strategies, the overall integrity of the firm, their performance factors. In addition, the timing of when they entered the market place was very good.
1. Name of Fund
   Washington State Investment Board

2. Name, Title & phone of contact
   Terry Blaney; Private equity/venture manager, (360) 664-8284

3. Size of fund
   $22.7 billion

4. Age of fund
   don't know

5. Size of ETI or VC investments: How many? What are individual amounts?
   Total of $1.9 billion invested in 43 funds. Of that $330 million in "pure" venture,
   which is going to be small businesses. The balance is in buyouts, mezzanine
   financing. A total of $2.5 billion is committed by the Board to VC.

6. When were each of these funds established?
   VC established in 1981

7. Who/what was responsible for developing the ETI or How was the decision made
   to invest in a VC fund?
   Board itself has to approve all investment decisions.

8. How difficult was it to establish the funds?
   Wasn't there at the time.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-
   return trade-offs, prudence rules, in-state investments preferable, administration
   more or less difficult? other considerations?)
   Lots of criteria established for employing capital. A maximum of 10% of the fund
   can be invested in venture areas.

10. How was the decision made to invest in small businesses? Was the small business
    sector an explicit target of your investment strategy?
    Small business not an explicit target. Some of the capital is now for start-up; lots
    of mezzanine financing too.

11. Are there any inhibiting factors that keep you from investing even more of your
    funds in the venture capital sector?
    Returns from the past 10 years in venture industry have been very poor. His
    professional opinion is that it is difficult for the pension industry to employ capital
    very effectively; primarily the problem is that fiduciary responsibility is their prime
    concern. Finally, it is an extremely risky business for a pension fund to be in.

12. Are government guarantees a significant incentive in your small business
    investment decision?
    Didn't ask this.

M&R Associates
13. Is your ETI/VC program internally or externally managed? Why?
   Externally managed

14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?

15. How is the ETI program implemented and how has it evolved or changed over time?
   Didn’t ask this, as he was quite new at the job (only there a few months)

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?
   Long term investments: Most are 10 year funds: invest in years 1-4; manage in years 2-5 and exit in years 6-10. Even then, 10 years is not always long enough to get return necessary.

17. Is there a geographic focus of investment?
   No, most of the investments are international.

18. Are there any specific legislative constraints unique to your fund?
   Max 10% invested in this arena.

19. Are there specific factors which you think have made your program successful?
   Didn’t get a chance to ask this.
1. Name of Fund
   New York State Common Retirement System (NY State & Local)

2. Name, Title & phone of contact
   Anne Collins (518) 473-4030, Investment Coordinator

3. Size of fund
   $68.2 billion

4. Age of fund
   75 years

5. Size of ETI or VC investments: How many separate accounts or funds?
   14 separate accounts in early-stage VC. Total of $220 million committed; $167 million contributed.

6. When did the Fund begin venture capital or ETI investing?
   1983

7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
   It was an asset allocation decision to develop alternative investments

8. How difficult was it to establish the funds?
   Not at all: went directly to external managers.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)
   None

10. Was a decision made to invest in specifically in small businesses? How was that decision made?
    Decision was made to invest in venture capital. De facto, there is investment in small businesses.

11. Are there any inhibiting factors that keep you from investing even more of your funds in the venture capital sector?
    Size of commingled funds make it inefficient to invest that way. Prudence rules necessitate diversification. The commingled funds can't take enough money to make the investments pay off for the retirement system.

12. Are government guarantees a significant incentive in your small business investment decision?
    No

13. Is your ETI/VC program internally or externally managed? Why?
    Externally managed. Expertise not available in-house
14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?

15. How is the ETI or VC program implemented and how has it evolved or changed over time?
   The biggest change has been that the amount of early stage VC has actually decreased in the 90's compared to what they did in the 80's. The allocation to alternative investments has not decreased. Rather, the fund is shifting money to other asset classes.

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?

17. Is there a geographic focus of investment?
   As the managers to look at NY state. See #19.

18. Are there any specific legislative constraints unique to your fund?
   Where it is possible and prudent, the fund should consider investments which bolster the state of NY.

19. Are there specific factors which you think have made your program successful?
   Best performance is being returned from the funds which focus on later-stage investments. These investments make excellent returns. Early state investments are by nature highly volatile and risky.
1. Name of Fund
   Policemens' Annuity & Benefit Fund of Chicago

2. Name, Title & phone of contact
   James B. Waters, Jr., Executive Director (312) 744-3891

3. Size of fund
   $2.3 billion

4. Age of fund
   74 years

5. Size of ETI or VC investments:
   $66 million in venture capital

6. When did the Fund begin venture capital or ETI investing?
   1984 & 1986

7. Who/what was responsible for developing the ETI or VC fund?
   The Board of Trustees determined that a Venture Capital investment would be a
   prudent diversification of some assets.

8. How difficult was it to establish the funds?
   The Board hired money managers to manage the assets. No effort was expended
   by the Board in establishing the funds.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-
   return trade-offs, prudence rules, in-state investments preferable, administration
   more or less difficult? other considerations?)
   The Board allows full discretionary investment of the assets by the money managers.

10. Was a decision made to invest in specifically in small businesses? How was that
decision made?
    N/A

11. Are there any inhibiting factors that keep you from investing even more of your
    funds in the venture capital sector?
    The Board has set a limit (3%) of assets and that limit has been attained.

12. Are government guarantees a significant incentive in your small business
    investment decision?
    N/A

13. Is your ETI/VC program internally or externally managed? Why?
    The VC program is externally managed because the Fund does not have the
    investment staff.

M&R Associates

-APP12-

#SBAHQ-95-C-0008
14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?  
N/A

15. How is the ETI or VC program implemented and how has it evolved or changed over time?  
We do not have an ETI program.

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?  
Yes, the Board is pleased with its current program. It is a long-term program.

17. Is there a geographic focus of investment?  
No.

18. Are there any specific legislative constraints unique to your fund?  
No.

19. Are there specific factors which you think have made your program successful?  
Selection of money managers.
Responses from 1994 Survey

The 1994 phone survey responses presented here are organized to correspond to the 1995 Survey questionnaire.

1. New York State and Local
2. William Barrett (518) 473-4553
3. $60 billion.
4. Don’t know.
5. Do not consider that they have an ETI, which they consider to be a bad word. Have a little over $100 million in venture capital, plus $75 million in a Business Development Corporation.
6. Don’t know.
7. Have not asked this question.
8. 
9. He indicated that the market rate of return was the primary factor when making any decision. There are no trade-offs on that issue.
10. Did not ask him how the decision was made. The Business Development Corporation makes direct loans to NY-based firms and so the result was to target small businesses; however, in the initial survey, when asked how much of the money is earmarked for small businesses, he indicated that market rate of return was the primary factor.
11. Indicated that they might increase the size of the investment in the Business Development Corp to $100 million.
12. Didn’t comment specifically about that.
13. Don’t have ETIs. The BDC and the VC are externally managed. The Venture capital funds are used to buy stock in small companies. The limited partners do the investing.
14. N/A
15. 
16. N/A
17. In-state
18. The pension system if fundamentally legalistic, operating under guidelines from the legislature. They are bound by particular requirements for levels due diligence, prudence in investments. If the market returns are less than market rate, the trustees get nervous.
19. N/A

M&R Associates -APP14- #SBAHQ-95-C-0008
New York State Teachers'

George Philips, AEO/CIO, (518) 447-2760

$42 billion

N/A

$60 million in VC for small business and mezzanine financing

Start up scheduled January 1995.

Following an asset allocation evaluation, the fund decided to increase the allocation to Alternative Investments to 1% of the total. This will include VC and mezzanine financing. Formal implementation of the program should have begun in January of 1995.

Several factors have influenced the overall decision. They had been called upon to invest in several areas, and began doing so in 1984, with very modest exposure. At that time, the money was difficult to place; one fund was restricted to in-state investments and was the worst performing. Mezzanine investments did much better, with an incremental increase in risk. They have been heavily marketed by politically connected enterprises.

It's not clear that small business is a "target"; it seems to be more of a de facto recipient.

The trick is, the enterprise must assume a fiduciary responsibility toward the fund. In addition, a DOL ruling has stated that the risk adjusted return must be the primary consideration. Any social or ancillary benefits which might accrue are fine, but cannot be considered more important than the return rate.

He indicated that they hadn't been able to find any good information about government guarantees in investments and he said "If you have any information on that, call me right away. I'd love to look like a good guy and still have a guarantee on the investment."

Hiring an external manager for the AI management.

N/A

Hadn't been implemented at time of interview. They were readying for implementation.

Supports the growth of small businesses. Exactly how the fund will be involved in that is hard to say. Cuomo backed a fund called the Excelsior fund. Perhaps could work through that.

Didn't indicate any geographical limitations.

DOL ruling

At the point the discussion took place, the primary investment hadn't occurred.

M&R Associates

APP15-

SBAHQ-95-C-0008
1. **New York City Systems**
   
   *NOTE: The bulk of their "ETI" activity is in housing, because that's where they can get the guarantees they need. So, they really aren't relevant to small business, except in that they provide insight into what a fund is looking for in their investments -- and what they are finding in the housing area and not elsewhere. They do not have venture capital.*

2. Donna Anderson, Manager of Investments 212/669-2018

3. $50 billion. There are 5 retirement systems under the City. For the sake of clarity, this discussion considers all funds together.

4. N/A

5. Target of $900 million for ETIs. Not able to pinpoint exactly how much of that has been committed, except to note: $50 million committed in loans and $50 million to the Excelsior Fund. Don't do venture capital, and she noted that with any venture capital program there is very little data available to use in evaluation of the returns. Additionally, she noted that the programs are very costly to develop and implement from an administrative standpoint.

6. N/A

7. I don't know exactly where the interest came from. She was very supportive of the concept.

8. N/A

9.-12. Again, return rate must be primary consideration, and consequently the decision is driven by a guaranteed rate of return. In addition, there are two other criteria: the bulk of the investments must be in NYC and a capital gap must exist which other lenders will not fill, so that they are not displacing other lenders. The result of the combination of these factors is that the bulk of the commitments are in housing. The same factors sighted above are the factors which are inhibiting further investment. They do not explicitly earmark any of their money for small businesses. Obviously, guarantees, from whatever source, are very important to NYC. However, one of the other funds indicated that the SBA loans are easily salable on the secondary market, and consequently probably don't fill any capital gap.

13. Excelsior Fund is external, the other funds are as well.

14. N/A

15. N/A

16. Overall, happy with the investments, but not able to place all of the commitments, when we spoke, due to the criteria.

17. In-city

18. Routine fiduciary responsibility laws.

19. N/A
Pennsylvania Public School Employees’ Retirement System
John Lane, CIO, 717/772-4088
$25 billion
N/A
No ETIs. $1 billion committed in private placements; about $330 million committed. In addition, there is venture capital program which has about $330 million committed and about half of these programs are in Pennsylvania.
N/A
Their investments within the state are not out of any extreme loyalty to the state, but rather because they can drive to the site, visit with the management, etc.
N/A
N/A
No conscious decision to invest in small businesses. It happens that way. Major impediments to expansion are the rate of return and fiduciary responsibility. Citing fiduciary responsibility, he indicated they could not have non-financial objectives which would outweigh the financial considerations. As noted in #7, they are more likely to invest where they can actually establish contact with the company.
Not yet fully committed with their current allocation.
N/A
External. Have 2 internal staff who deal with all VC/PP and AI.
N/A
N/A
N/A
See 7 above.
Fiduciary responsibility
N/A
1. Pennsylvania State Employees' Retirement System
2. Erica Bushner, Alternative Placements, 717/237-0216
3. $13.2 billion.
4. N/A
5. No ETI. The only loan is 1 loan of $2.5 million to 1 company which employs about 1500 people. They do have about 1/3 of their investments in Pennsylvania, but only because, all things being equal, they invest in Pennsylvania. Note that the $282.5 noted in last study was committed to 23 partners and not necessarily drawn down. They are probably small businesses.
6. N/A
7. N/A
8. N/A
9. Statutes dictate "all things being equal" look to Pennsylvania investments.
10. No decision to target
11. N/A
12. N/A
13. External
14. N/A
15. Doesn't consider that they have an ETI, so the question wasn't discussed.
16. Didn't discuss
17. Pennsylvania
18. Yes, as noted above.
19. N/A
1. MASTERS
2. Mark Baker, Investments, 617/367-3900 X229
3. $7.2 billion
4. N/A
5. 3 areas of investment in ETI (not small business); $250 million in single family mortgages, purchased from Freddie Mac; $20 million in low income multi-family housing; and intention to commit $25 million with PRIM, or a fund like PRIM, for investment in Massachusetts. Hold about .5 million in SBA loans; while they will continue to hold these loans, they don't intend to purchase any more. See below.
6. N/A
7. N/A
8. No trade-offs they will discuss. Return is primary, with a secondary benefit for the expansion of the economic climate.
9. Investment decisions are driven by guarantee. If the guarantee is there, they will invest. The SBA loan program does not expand the economic climate because purchasers for the paper already exist -- there was no expansion into new markets involved, no expansion of the economy.
10. He expressed frustration at not being able to find good investment opportunities involving small businesses. There is very little readily available information about the federal programs which provide guarantees for investments and it's really hard to get any information.
11-12. The only ETIs they have are housing related. The commitment of the $25 million with PRIM will be externally managed.
13-15. Happy with housing investments
14. The $25 million fund with PRIM will be Massachusetts focused.
15. Didn't mention any.
16. N/A

M&R Associates -APP19- #SBAHQ-95-C-0008
1. **MassPRIM**
2. West Coughlin, Manager of Alternative Investment/Private Placements, 617/439-4600 X227
3. $5 billion.
4. N/A
5. 2 ETI funds: Massachusetts Technology Development Corporation, which has $2 million; and the Mayflower Fund, which has $50 million. Third fund should be started by now is the fund with MASTERS, which will have $25 million. $200 million committed in 20 VC funds.
6. N/A
7. N/A
8. N/A
9. None of their investments carry non-financial returns. "We're out to make money."
10. As with others, the market rate of return is critical. As a general concern about ETIs, whatever the target, he expressed that the ability of the state to absorb money without being flooded was important. Additionally, finding good managers, either internal or external is difficult.
11. Don't do small business.
12. ETIs and VCs are externally managed
13. N/A
14. N/A
15. Didn't say whether he was unhappy or happy.
16. In-state, for the most part
17. N/A
18. N/A
19. N/A
1. Colorado PERA
2. Daryl Roberts, Investment Operations Director
3. $14 billion
4. N/A
5. 4 VC funds, totaling $131 million in commitments, but now sure how much as been drawn down. Between $10 and $15 million in loans to Housing Finance Agency to make loans to small businesses in Colorado. Some private placements (about $36.4 million), but there's no way to know if they are small businesses. One loan was for $30.5 million to a company called Cogeneration Tech. The annual report does not indicate size of company, and Mr. Roberts didn't know either.
6. N/A
7. N/A
8. N/A
9. Fiduciary responsibility to their members is the overriding concern. Cannot place the balance of the population of Colorado over their members, or they are in breach of their fiduciary responsibility.
10. Small business is not a specific target.
11. Biggest impediment to investing in ETIs is the issue of fiduciary responsibility. See #9 above.
12. N/A
13. Not certain, but I believe that the bulk of their activity is externally managed. All VC is externally managed.
14. N/A
15. N/A
16. N/A
17. By statute, up to 20% of the fund, but no more than 20% of the fund, can be invested in the state.
18. Yes, see 18.
19. N/A

M&R Associates

-APP21-

#SBAHQ-95-C-0008
1. Name of Fund
   State of Wisconsin Investment Board

2. Name, Title & phone of contact
   Monica Janek, (608) 266-9022

3. Size of fund
   $29.2 billion

4. Age of fund
   N/A

5. Size of ETI or VC investments: How many separate accounts or funds?
   $78 million in VC funds; $891 million in LBO funds; Private placements of $2.8 billion ("highly unlikely that the number of companies with under 500 employees would be significant"); $17 million to Bando-McGlocklin (SBIC) for loans to small businesses.

6. When did the Fund begin venture capital or ETI investing?
   Don't know

7. Who/what was responsible for developing the ETI or How was the decision made to invest in a VC fund?
   Don't know. The fund as a whole is extremely committed to the private placements they operate. Wisconsin only companies make up about $50-400 million of the $2.8 billion private placement portfolio.

8. How difficult was it to establish the funds?
   Didn't discuss level of difficulty.

9. Can you describe any specific issues you evaluated in establishing the fund? (risk-return trade-offs, prudence rules, in-state investments preferable, administration more or less difficult? other considerations?)
   Don't trade of returns for anything. All other things being equal, they look to companies they can visit, which are accessible, etc. There are additional risks associated with this due to the size of the companies, and the investments are a little more volatile for that reason.

10. Was a decision made to invest in specifically in small businesses? How was that decision made?
    Decision to go with Bando was specifically to help small business. When we talked last year, she noted that recent changes in federal regulations had jeopardized their relationship with Bando because they could not longer be a "senior" lender without being actively involved, and they can't be actively involved. I don't know what the resolution of this issue was.

11. Are there any inhibiting factors that keep you from investing even more of your funds in the venture capital sector?
She didn’t mention any factors which impact the programs.

12. Are government guarantees a significant incentive in your small business investment decision?
   No.

13. Is your ETI/VC program internally or externally managed? Why?
    Internal.

14. If internally: how many staff? What is the oversight mechanism? Is this program grouped with other pension programs?

15. How is the ETI or VC program implemented and how has it evolved or changed over time?
    Don’t know

16. Overall, are you happy with the existing investment? Is it a long-term or short-term investment?
    They are generally very happy with the investments they have made.

17. Is there a geographic focus of investment?
    They tend to go toward Wisconsin companies, but only co-incidentally, as noted above.

18. Are there any specific legislative constraints unique to your fund?
    Didn’t discuss this.

19. Are there specific factors which you think have made your program successful?
    Careful evaluation of companies, site visits, communication with management, etc.