INDIANAPOLIS
BUSINESS JOURNAL
CENTRAL INDIANA'S BUSINESS AUTHORITY
VOL. 21 NO. 35 • NOVEMBER 13–19, 2000

New strategy for investing in Indiana

BRIAN S. WILLIAMS

In 1996, Hoosiers endorsed a constitutional amendment that permitted the state to place its assets in investment vehicles other than debt instruments backed by the full faith and credit of the U.S. government. In May 1997, the state of Indiana invested in public equities for the first time in more than 100 years. The merits of broadening the state's investment opportunities, specifically higher returns, portfolio diversification and minimizing the direct tax dollars required to meet the state's pension obligations, apply to the discussion of how the state participates in private capital markets.

Private capital markets are the offerings of debt, equity or hybrid investments that are exempt from registration and are sold only to investors deemed sophisticated enough to make an independent determination of their investment merits. Such investors include insurance companies, pension funds, endowments and wealthy individuals. Some advantages of a private equity offering to the seller include lower issuance costs and speed of execution. The advantages of a private equity offering to the purchaser may include a higher yield.

Indiana should prepare to enter the private capital markets by forming a state-owned, but independently managed, company—Indiana Investment Co. Indiana Investment Co. would create local, highly technical jobs and would assist in attracting private equity to Indiana.

Like public markets, with their varying asset types, private capital markets also enjoy distinct investment classes that can be generally defined as early-stage financing, expansion financing and acquisition or buyout financing.

Early-stage financing is a relatively small amount of capital provided to an inventor or an entrepreneur to prove a concept.

Expansion financing is working capital used for the initial growth of a company that is developing, installing or expanding its product or service or hiring staff to develop or deliver its product or service. Mezzanine financing is provided for major expansion of a company with increasing sales volume.

Another class of private equity could be defined as acquisition or buyout financing. Acquisition financing provides funds to finance an acquisition of another company.

The advantages of private equity, debt or hybrid investments to the entrepreneur and to the community are many and widely documented. In brief, for entrepreneurs, managers of private equity funds are willing to take the risks traditional lending institutions are not.

More important, the managers of such funds dedicate their intellectual capital along with their financial capital to increase the probability of success for their portfolio companies. Generally, private-capital-backed companies are more successful in gaining market share, realizing profitability, attracting managerial talent and creating new high-paying jobs.

Indiana has a limited supply of private capital. It is broadly recognized that Indiana lags its Midwestern peers in venture capital; however, Indiana also trails its neighboring states in mezzanine funds, buyout funds and others. Given Indiana's strong manufacturing base, we should actively support the formation of additional mezzanine and buyout funds, in addition to venture capital funds, that can help Indiana entrepreneurs acquire existing manufacturing companies. Indiana's public pension funds could serve as a catalyst for the expansion of Indiana's private equity community by allocating a reasonable portion of their assets to private capital markets.

Today, 75 public pension funds representing 37 states have allocated public pension funds to private equity. By investing public pension fund dollars in private equities, debt or hybrid investments, Indiana can achieve the worthwhile public policy objective of aiding in the formation and growth of Indiana businesses. In return, the state will benefit from additional investment opportunities and potentially higher investment returns. The state will also benefit from new businesses and new jobs.

Finally, and most important, how do we balance the desire to invest in Indiana while meeting the fiduciary responsibilities of public pension funds? One possible solution would be the creation of a quasi-state agency, Indiana Investment Co. This company,

Continued on back

Continued from front

state-owned but independently managed, could then be retained by Public Employees' Retirement Fund and Teachers' Retirement Fund to manage and invest their combined private equity portfolio. Indiana Investment Co. would be responsible for identifying investment opportunities in Indiana and across the country.

Rather than send all or a portion of Indiana's dollars out of state to be managed and invested, let us keep the responsibility for selecting meritorious ideas. However, for Indiana Investment Co. to be successful, public and elected officials must be willing to pay competitive salaries to attract the caliber of talent necessary.

By forming such an entity, we can ensure that Hoosiers will maintain the responsibility for managing their investments from their state capital. In so doing, we can provide opportunity for the financial engineers graduating from our universities who in turn can invest in the mechanical, electrical and chemical engineers and entrepreneurs creating the Indiana technology and manufacturing companies of tomorrow.•

Williams is executive director of TechNet Indiana and a member of IBJ's *Corporate Opinion Board.*