

INTERIM REPORT AND RECOMMENDATIONS

KANSAS ECONOMIC DEVELOPMENT STUDY

prepared by the

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The University of Kansas

in consultation with

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## PREFACE

There has been serious concern throughout the state that Kansas could be losing its competitive edge in attracting economic development. As well, there has been a growing awareness of other states' efforts to foster new industry. Recognizing these significant developments, the 1985 Kansas Legislature appropriated funding for a research study of Kansas business conditions and climate, and for the development of a state strategy for economic development. Matching funding has been provided by major Kansas organizations (listed at the end of this report), and the University of Kansas and Wichita State University have combined to provide an equivalent contribution in resources.

The study is being undertaken by the Institute for Public Policy and Business Research at the University of Kansas, in close consultation with Wichita State University, Midwest Research Institute (Kansas City), ASLAN (Washington, D.C.), and Counsel for Economic Development (Boston). The main elements of the study are:

- 1) An identification of key factors affecting state economic development as perceived by Kansas business, state and community leaders, and by non-Kansans.
- 2) An identification of key factors affecting firm decisions to locate and not to locate in Kansas.
- 3) A delineation of Kansas economic trends, strengths and weaknesses.
- 4) An analysis of other states' incentives and strategies.
- 5) A target industry analysis of the types of industries best suited to Kansas and its regions.
- 6) Recommendations for consideration.

This is an interim report, prepared at mid-point of the study. The final report will be submitted in March 1986. The objectives of this interim report are to facilitate discussion among Kansans concerning this important issue, to provide the basic framework for a state strategy, and to provide guidance for legislative action in 1986. Not all tasks specified for the study have been completed, so that further recommendations, and possibly some modification to the proposals in this report, could occur in the final report.

The recommendations do not contain specific funding suggestions. Furthermore, priorities have not been designated, nor is the timing of implementation specified. These dimensions will be addressed in the final report.

Finally, there are some gaps and omissions in the Interim Report. One reason has been the lack of time to focus on some important aspects, such as the role of vocational/technical education and training. Another has been the self-evident nature of a particular aspect, such as the proper funding of public education. And in some instances, important matters could not be dealt with in a study of this magnitude because they were not central to the focus of the study, such as state support for quality of life aspects, like the arts. Some of these omissions will be addressed in the final report.

While the Institute has made extensive use of consultant advice in undertaking this study, the authors are responsible for the specific recommendations of this Interim Report.

## EXECUTIVE SUMMARY

### Basic Findings

The current weakness of the Kansas economy is not a temporary phenomenon. Unabated, a continuation of existing trends will result in a relative erosion of the state's economic base and its ability to provide quality services for Kansans. However, the state can influence these trends in a positive direction. This will involve providing support for adaptation and change and the application of science and technology to the existing economic base as well as building upon strengths to develop new industry.

Kansas has important strengths and sound economic fundamentals upon which to develop its future. At the same time, there are some barriers to the development of modern technology-based enterprises, to small business entrepreneurship, and to expeditious technology transfer to Kansas industry. The recommendations that follow are designed to remove the impediments and to build upon the strengths.

The basic strategy for development should emphasize a balanced approach of supporting the existing economic foundation, including the traditional sectors, as well as fostering growth through the expansion of current and the attraction of new industry. It should involve an integrated state-local community effort. The state should not adopt a strategy for development based on tax incentives, but rather have a tax structure which is consistent with that of competing states with respect to business tax burden.

The erosion of the state's economic base will continue unless Kansas makes a large and sustained funding investment over the next decade to support a well designed package of economic development initiatives. This will require a significant investment of state financial resources. Our survey of 700 Kansas business and governmental leaders show overwhelming support for "bold, new initiatives," and their input has considerably influenced the following recommendations.

### Recommendations

#### Agriculture

1. Establish a Task Force on Agriculture Development and Marketing to develop a strategy on:

- a) the diversification of Kansas agriculture into new products;
- b) the application of science and technology to the value added processing of Kansas commodities within Kansas; and
- c) the provision of technical assistance for production, processing and market development.

## Taxation

2. Allow a sales/use tax exemption on all machinery and equipment used in manufacturing and on computers for business use.
3. Allow a reduction in corporate income tax liability through a tax credit given for research and development expenditures.
4. Allow a reduction in income tax liability through a tax credit for investment in private state-approved venture capital funds and state chartered innovation corporations.
5. Allow local taxing jurisdictions to give property tax abatements for new and expanding manufacturing facilities, research and development facilities, equipment and machinery, and for a limited scope of non-manufacturing facilities having a potential for job creation. The authority to grant the abatement should be detached from the issuance of industrial revenue bonds.
6. Support the 1986 constitutional amendment that would phase out the property tax on inventories.

## Education, Research, and Technology Transfer

7. Expand substantially the level of funding for the Centers of Excellence Program.
8. Expand substantially the level of funding for the Research Matching Grant Program.
9. Establish Institutes for Applied Science and Technology at the major research universities.
10. Provide resources to the state universities for the purpose of upgrading the quality and increasing the quantity of applied social and economic research.
11. Provide funding for the establishment of an industry liaison function at the main universities.
12. Endorse strongly a continuation and expansion of the state's commitment to all levels of public education in Kansas. Public education in general and higher education in particular are crucial elements for the future progress of Kansas.

## Finance, Capital Formation, and Innovation

13. Establish a Kansas Corporation of Innovation Development (KCID).
14. Establish a Kansas Product Development Corporation.

15. Establish a state fund to match federal Small Business Innovation Research grants to Kansas small businesses.
16. Establish a Kansas Science and Technology Authority.
17. Sponsor or organize a financial symposium for Kansas companies.
18. Provide temporary state funding for Certified Development Companies.
19. Establish a secondary market for the SBA guaranteed portion of bank loans.

#### State Organization for Economic Development

20. The Legislature should establish a permanent joint House-Senate Committee on Economic Development or, alternatively, separate committees in each house.
21. The Small Business Division of the Kansas Department of Economic Development should be substantially expanded, and additional field offices established.
22. A new international trade division within KDED should be established within the Kansas Department of Economic Development.
23. Increased efforts should be made to attract foreign firms to locate in Kansas.
24. An existing industry program should be initiated in Kansas Department of Economic Development.
25. Kansas Department of Economic Development should implement a marketing program aimed at targeted industries.
26. Kansas should initiate a national promotion campaign aimed at improving the image of Kansas among business leaders with responsibility to make business location decisions.
27. Review the constitutional prohibition on internal improvement to determine if it should be modified or repealed.

#### Community Development and Small Business

28. Provide low or no-interest matching loans to local governments and nonprofit organizations to facilitate establishment of the incubators.
29. A general loan pool for infrastructure development should be available for use by communities to promote economic development.
30. Substantially expand technical assistance to local communities on how to promote economic development.

31. Federal Community Development Block Grants should be used to the fullest extent possible for economic development projects.

32. A state community development block grant program should be established, targeted to economic development.

33. Expand the "Certified Cities" program.

34. Provide state funding for the Small Business Development Center (SBDC) network to expand technical assistance to small businesses through consulting and training sessions.



## THE KANSAS ECONOMY

This overview of the evolution, current status, and outlook of the economic and demographic environment provides the basis for identification of the problems, issues, and choices associated with the future of the Kansas economy. The bottom line is that the state economy is not well positioned to go forward strongly in the next decade, and repositioning the state economy is the challenge for the state and its communities for the remainder of this century.

The structure of the Kansas economy has changed over this half century from being predominantly agricultural to a mixed form somewhat parallel to the national industrial structure. The trend is clearly one of long transition out of farming to other forms of economic activity, so that today farming produces about 8 percent of the state product and manufacturing, 20 percent. These figures would have been reversed 40 years ago.

Over time Kansas farms have become fewer, larger, and more capital intensive. This has been in response to the imperative to become more efficient in the light of real price decline and increasing costs. Today 1 percent of the state's farms produce nearly 50 percent of the state's agricultural products. Important consequences follow from this. First, the larger capital intensive farms are more vulnerable to the general business cycle; and second, farming employs fewer and fewer people. This labor displacement has not been offset, however, by new industry. Employment growth in the non-farming sector has been chronically inadequate to provide sufficient alternative basic industry job opportunities for Kansans. Hence employment in the key sectors of agriculture, manufacturing, and oil and gas is 24 percent of the state total compared with about 30 percent for the nation.

There have been significant demographic consequences to this great change in the economic structure.

- (1) Kansas population has declined from 2.27 percent of the U.S. population in 1890 to 1.04 percent in 1980. It is projected to be 0.93 percent in 2000, and could be 0.75 percent in 2030.
- (2) Kansas has had one of the slowest population growth rates in the nation.
- (3) The state has experienced net out-migration every census decade since 1890; net outflow was around 130,000 for 1960-70 and 25,000 for 1970-80. For the period 1980-84, net out-migration is estimated to be about 6,000. The predominant groups of out-migrants have been young adults and persons with higher education and skill levels.

- (4) The state average age is above the U.S. average and the state has a substantially higher proportion of persons over 65. The state ranks 9th among states in the proportion of population that is 65 years and over. This aging of the Kansas population will continue.
- (5) Although the state still has a higher rural population (33 percent) than the U.S. (26 percent), there has been a significant redistribution within the state to regions of employment opportunity (much of which has been concentrated in the area roughly bounded by Interstates 35, 135, and 70).

Turning to current economic conditions, the state economy fell further, started to recover later, and has grown more slowly than the national economy, in relation to the most recent 1980-82 recession. The industrial structure is now such that Kansas can no longer be considered recession proof, and indeed the last recession has illustrated how vulnerable the state economy is to the business cycle.

Total employment in Kansas returned to its 1979 peak level only in the second half of 1984, in contrast to the nation where the 1979 level had been exceeded significantly by that time. Again the rate of business formation in Kansas in recent years has been well below the national rate; it has been significantly below that of the contiguous states of Oklahoma and Colorado, and about the same as Missouri and Nebraska. Furthermore, virtually all sectors of the state economy have been effected but the primary impact has been in manufacturing, construction, and services.

A number of economic factors underlie this relatively weak economic performance in recent years. These include factors beyond our influence, including the strength of the dollar, the chronic cost-price squeeze in agriculture, and weakening oil prices in world markets. Factors however, within our influence include inadequate overall employment growth, inadequate growth in education and skill intensive sectors, and inadequate growth in those sectors that are expected to expand strongly in the next decade.

Key considerations affecting the future vitality of the state economy include:

- (1) the likelihood of continued depressed agricultural prices due to chronic oversupply;
- (2) the likelihood of long-term diminution of the state's mining industry as depletion outstrips discovery, and as world prices erode, also due to oversupply;
- (3) the likelihood of modest growth potential for the general aviation industry; and

- (4) the secondary impact on the service sector of this expected relative weakness in the above core sectors.

The state economic problem can therefore be summarized as follows. The state economy is highly dependent today on a set of industries that have served us well in the past. While these sectors will remain important in an absolute sense, their future outlook has limits, so that continued reliance on them alone will reinforce the negative trends and erosion now evident in our economic base.

At the same time the U.S. economy is undergoing significant and dynamic change that is technologically based. Kansas does not have a natural comparative advantage in these sectors, as it had for the great industries of the past. Consequently, the state has not been attractive to this "new industry" to the extent necessary to establish a strong economic base from which to grow and provide opportunities for Kansans in the years ahead.

In essence, from an economic perspective, there is a more limited future for our historical major industries relative to the past, the current industrial structure is underrepresented with future growth sectors, and the problem is compounded seemingly by a lack of comparative advantage that would attract industry naturally to the state. From a demographic perspective, if the present economic trends continue, the state population will experience modest growth, a decline in relative size, a further continuation of the "brain drain" and aging, and further redistribution from rural to urban areas.

The state economy is in a state of transition. The objective of economic development is to influence the direction of change towards a future economic structure more favorable to Kansans.

## BASIC FINDINGS AND IMPLICATIONS

The recommendations from this study are based on the following findings.

1. It would be a mistake to assume that the current weakness in the Kansas economy is a temporary phenomenon, or that some favorable federal action (e.g., better farm policy) will precipitate a rebound in our economic fortunes. The competitive realities of the new international economic order have initiated forces that are harmful to our traditional sectors in their present form.
2. Unabated, a continuation of existing trends will result in an on-going and relative erosion of the state's economic base. This will lead to reduced services, lower quality roads and other physical infrastructure, lower quality education opportunities at all levels, fewer job opportunities, and higher taxes.
3. The state can influence these trends in a positive direction. It is true that the state does not have the capacity or power to conduct a comprehensive industrial policy that makes broad, strategic allocation decisions affecting all aspects of economic development. Nor can it control world markets, capital markets, print money, or erect tariff barriers. But the state can play a vital role by establishing an optimum foundation (e.g., tax structure, physical infrastructure) and the key relationships (e.g., private sector-universities-state partnership) that will foster sustained private sector growth and modify existing trends favorably. The task for Kansas state government is to identify those limited but important areas where state involvement is essential for economic success.
4. The objective of an economic strategy is to foster timely adaptation to change and transition. The harsh reality is that those industries which develop and apply new knowledge and technologies the most rapidly and efficiently will be the ones with the competitive edge. For Kansas, this will involve providing support for innovation and the application of science and technology to the existing economic base as well as building upon existing strengths to develop new industry.
5. Kansas has a set of important strengths that provide the foundation for progress that would be largely based on internal development. These include the high quality of the education system from top to bottom, a productive work force, state fiscal stability, some elements of the transportation infrastructure, diversity and durability in its primary economic sector (agriculture, oil and gas, manufacturing), and central location (for some types of industry). These advantages provide Kansas with the capacity and opportunity to compete fully in the modern economy. However, the state does not have a natural comparative advantage that would underpin a strategy largely based on attracting new industry from outside, although this avenue must be pursued vigorously to

complement internal development.

6. The economic fundamentals of Kansas are basically sound with respect to business location in the state. That is, the factors that business take into account in expansion and location decisions, such as wage levels, energy costs, quality and availability of labor, transportation, services, and tax levels and structure are not "out of line," and tend on balance to be favorable in comparison with many states. There is a recognized sense of integrity and solidity about the state. Indeed, with exceptions (e.g., liquor laws), the external perception of Kansas is better than Kansans perceive it to be, being more balanced in character than negative. While improvements in the fundamentals and image of the state would be productive and should be made, these factors are not insurmountable handicaps to state development.
7. But a number of significant barriers and gaps do exist which interfere with the development of modern technology-based enterprises, with small business entrepreneurship and innovation, and with the expeditious transfer of technology to Kansas industry. These include inadequate investment in research and development, impediments in the state tax structure, the difficulties new firms experience in obtaining capital in general and non-traditional capital in particular, insufficient links between business and universities, inadequate funding and imbalanced emphases of the current state effort.
8. Consequently, an optimum strategy for the economic development of Kansas should emphasize a balanced approach of supporting the existing economic foundation as well as fostering growth through the expansion of old and the attraction of new industry. Such a strategy would incorporate the following elements:
  - a) Enhance and extend the traditional sectors, for example through diversification into new agricultural products and greater value-added in processing.
  - b) Sustain existing industry, which is largely small scale, support its modernization and competitiveness, foster its expansion and the birth of new business, and encourage Kansas entrepreneurship.
  - c) Develop new industry, but in doing so, recognize:
    - i) that only certain types of industry will find Kansas attractive;
    - ii) that most new jobs will evolve from existing Kansas industry, particularly small business; and

- iii) that foreign investment is playing an important role in job development in other states, particularly the east, southeast, and west regions of the U.S.
  - d) Strengthen the local community basis for development. All business location decisions take both state and local factors into account. Greater success will come from an integrated state-local approach. Further, there needs to be a clear recognition of the geographic diversity of the state in designing development initiatives and support mechanisms.
9. The state should not adopt a strategy for development based on tax incentives, but rather should have a tax structure that is consistent with that of competing states with regard to business taxes. A strategy based on tax incentives is expensive and there is no evidence it would work. On the other hand Kansas will lose its attractiveness relative to competing states if its tax structure and levels contain significant anomalies or fails to send the right 'signals' about business climate. In particular, the state must avoid having a tax that negatively impacts business in any significant way that is generally not found in other states. The Kansas tax structure does contain some impediments to business development and the tax burden on business is perceived to be slightly high.
  10. To achieve a significant long term improvement in the economic base, the state will need to make a large and sustained funding investment over the next decade to support a well designed package of economic development initiatives. Even so, there is no absolute guarantee of success from a large scale effort. Patience will be necessary because the specific pay-offs will be long term and uncertain. It is clear, however, that without it, relative erosion of the economic base will continue.

While the challenge facing Kansas is not an insurmountable one, it will be difficult and it will require substantial investment. A strong commitment will be necessary in funding by the legislature, in planning by the executive branch, and in cooperation by Kansas organizations. Our survey of Kansas business, state and community leaders showed a strong majority (78 percent) favoring state and local governments "to take bold, new actions to encourage economic development," as distinct from adapting a do-nothing (2 percent) or minor change (20 percent) approach.

## RECOMMENDATIONS

### Agriculture

1. Establish a Task Force on Agriculture Development and Marketing to develop a strategy on:
  - a) the diversification of Kansas agriculture into new products;
  - b) the application of science and technology to the value added processing of Kansas commodities within Kansas; and
  - c) the provision of technical assistance for production, processing and market development.

One mission of the Task Force would be, with consultant support and research studies, to identify new products or crops suitable to Kansas, explore potential markets and cost feasibility, and recommend ways to encourage farm entrepreneurs to develop these opportunities. Kansas agriculture is highly dependent on wheat and beef, and would achieve greater stability with a broader base.

The second task is to devise ways and means of bringing new technology to bear on the processing of Kansas commodities in Kansas. A high proportion of Kansas crops are now processed out-of-state so that the employment and income benefits of adding value to raw materials are lost from rural areas in the state. The greatest benefit would be in the form of employment and income of local persons in the processing facilities, with flow-on to local business, state revenues, etc.

Finally, the Task Force would recommend permanent organizational and funding arrangements to implement the diversification and value added strategy over time.

These tasks would be undertaken obviously in close cooperation with the Board of Regents and in particular, Kansas State University.

### Taxation

The primary objective of the following tax proposals is to adjust the tax structure by removing several impediments to business location in Kansas. The recommendations will also (a) minimize negative perceptions of the business tax burden in Kansas, (b) bring Kansas into line with competing states, and (c) enhance the business climate for general manufacturing and for research and development. It should be noted that this study has not undertaken an in-depth review of the Kansas tax structure. Such a review would be very useful in identifying other changes not only from the perspective of the tax burden on the business sector but also for state revenue enhancement.

2. Allow a sales/use tax exemption on all machinery and equipment used in manufacturing and on computers for business use.

The state sales/use tax on machinery and equipment is a serious anomaly in the Kansas tax structure. Kansas is the only state in this region which does not exempt all machinery and equipment used in manufacturing from the sales tax. Missouri, Colorado, Iowa, Nebraska, and Oklahoma have this exemption. By the end of 1984, 39 states exempted machinery and equipment from the sales/use tax. Kansas does allow refunds and exemptions from sales tax on machinery and equipment only in certain limited circumstances. Business leaders across the state noted the sales tax on machinery and equipment as a major disadvantage to economic development within the state. Allowing the exemption to also apply to computers used in business could lead to more jobs in the service and high-technology sectors. The cost of this exemption to the state would have been approximately \$16 million in FY1984; this budgetary impact could be minimized by a several year phasing in of the exemption.

3. Allow a reduction in corporate income tax liability through a tax credit given for research and development expenditures.

The objective of this measure is to encourage the long run competitiveness of the state's industry by encouraging Kansas firms to lead rather than lag in technological innovation. By the end of 1984, seventeen states offered a tax exemption or tax credit to encourage research and development. Iowa, for example, currently allows up to a 100 percent reduction in corporate income tax through a credit equal to 6.5 percent of a firm's qualifying research expenditures. In addition, the promotion of research and development within Kansas would lead to a higher level of interaction between the business community and universities as well as increase the business community's role in research and development. The cost of this program to Iowa for both FY1984 and FY1985 was approximately \$1 million, i.e., about \$15.5 million of research expenditures made by firms qualified for the tax credit. Iowa defines research and development expenditures as stated in section 174 of the Federal Tax Code. Some limit on the credit can be imposed (e.g., credit on a percentage of excess expenditure over a base period, limit on the proportion of overall corporate tax liability).

4. Allow a reduction in income tax liability through a tax credit for investment in private state-approved venture capital funds and state chartered innovation corporations.

The objective of this measure is to encourage the formation of private venture capital funds in Kansas to support entrepreneurship and innovation. The lack of seed and venture capital has been clearly identified as a significant weakness in Kansas, if not the greatest impediment to business development, given the small business nature of Kansas industry. State involvement would be limited to certification that the funds are targeted for new technology and innovation oriented business activity in Kansas. Investors would receive a tax credit



against Kansas tax liability, and some limits can be imposed on the degree of liability offset.

5. Allow local taxing jurisdictions to give property tax abatements for new and expanding manufacturing facilities, research and development facilities, equipment and machinery, and for a limited scope of non-manufacturing facilities having a potential for job creation. The authority to grant the abatement should be detached from the issuance of industrial revenue bonds.

There are at least thirty-two states now providing a tax exemption or moratorium on one or more of the above types of property. Iowa currently offers property tax abatement on new research facilities and Missouri provides a twenty-five year property tax incentive for redevelopment of urban areas. Neither state ties the abatement of property taxes to IRBs. Kansas allows a moratorium on land and capital improvements and equipment only if purchased with industrial revenue bonds. The federal income tax exclusion on interest earnings from industrial revenue bonds is being phased out. Thus, the total quantity of industrial revenue bonds issued in Kansas will decline, thereby limiting local jurisdictions opportunities to offer tax abatements. The detachment of tax abatements for the described properties from the issuance of industrial revenue bonds will provide local communities with a continuing capacity to compete on an equal footing with other communities.

6. Support the 1986 constitutional amendment that would phase out the property tax on inventories.

Kansas is one of only eight states which does not exempt inventories from property tax. The tax is anomalous overall, and as well is a disincentive for certain types of industries to develop in Kansas.

#### Education, Research, and Technology Transfer

Kansas has an excellent higher education system, particularly in relation to competing states. The system overall, and especially the major universities, provide a strong foundation on which to build future progress, and needs to be 'harnessed' to the state economic development effort in two senses:

1. maintain the existing quality differential relative to competing states; and
2. link university research expertise in many fields, but particularly in science and technology, to Kansas business sectors.

The following recommendations are designed to strengthen the education, research, and technology foundation of Kansas and to systematically link them to the business sector. They recognize that technological innovation is the sustaining force behind the development

of new industries, new jobs, and productive improvements in the modern economy. As well, the greatest hope for increasing the rate of productivity, and hence the competitiveness, of older traditional industries also lies in technological innovation.

7. Expand substantially the level of funding for the Centers of Excellence Program.

The Centers of Excellence Program is based on the principle that research universities, operating on the leading edge of science and technology, have the potential to stimulate economic growth by bringing together university-business partnerships to focus on research and "technology transfer." State funds, matched by the private sector, are devoted to areas of academic excellence in our system that have potential industrial application. The present program is funded at a minimum level, and expanded funding could be devoted to new Centers as well as provide additional support for the current centers. The Kansas Advanced Technology Commission has also recommended the expansion of this program.

8. Expand substantially the level of funding for the Research Matching Grant Program.

The Research Matching Grant Program is designed to encourage university-industry collaboration and to stimulate the process of technology transfer, for the purpose of fostering the competitiveness of Kansas industry. The program focuses on the applied research phase of the innovation process by supporting university-industry projects that have the clear potential for commercialization. State funds are invested in research projects at Regents institutions, with matching support from the sponsoring industrial firms. The Kansas Advanced Technology Commission attempts to maximize the return to the state by investing state funds as seed money for projects which have high potential for job creation. The Commission also recommends expansion of this program. It is essential that this program, and others involving university-state-private sector linkages, be conducted with a minimum of bureaucratic involvement and procedures.

9. Establish Institutes for Applied Science and Technology at the major research universities.

The objective of these institutes would be to foster the application of advanced science and technology to Kansas business and industry. Each Institute would concentrate on linking its academic strengths to Kansas industry and could embrace existing university programs. The existence of Institutes of this nature would provide a campus focus and direction to this objective and a visible focal point for industry/university applied research. There are various models in other states, for example, the 21st Century Center for Agriculture and Renewable Natural Resources at Oklahoma State University. Such programs in other states should be reviewed by a Task Force before a final form is determined for Kansas, but it would be an important principle that

the Institutes have joint state-private sector funding to ensure responsiveness to business needs.

10. Provide resources to the state universities for the purpose of upgrading the quality and increasing the quantity of applied social and economic research.

Applied social and economic research is important to industry in Kansas by providing data and analysis of the Kansas necessary to underpin sound business decision making in the complex, competitive world. Kansas has given low priority to this activity in the past, to the detriment of Kansas business.

11. Provide funding for the establishment of an industry liaison function at the main universities.

Each major university would establish an industry liaison office which would focus on developing joint research programs between the university and industry. Present liaison between higher education and the business sector is somewhat limited and has not received adequate priority in the past. The objective is to improve research and academic ties to business and promote a mutual awareness of research capabilities and needs. As such, the industry liaison office should be separate from the fund raising arm of the university, but able to work cooperatively with that arm.

12. Endorse strongly a continuation and expansion of the state's commitment to all levels of public education in Kansas. Public education in general and higher education in particular are crucial elements for the future progress of Kansas.

Kansas has a quality differential in education. It would be catastrophic for development if this were to erode.

In relation to higher education, the Board of Regents has clearly articulated the potential for erosion in their FY1987 budget issue papers. This Interim Report endorses those urgent concerns and proposed remedies with respect to faculty pay and benefits, instructional equipment and research instrumentation, student resources, library needs, etc.

#### Finance, Capital Formation and Innovation

In this section we address two of Kansas' most important economic development goals: (1) The formation and financing of innovative, technology based, new businesses and (2) the encouragement and leverage of private investment capital. Our research revealed that there is a serious lack of financing and venture capital for the start up of new and innovative businesses and the expansion of existing businesses which do not meet standards for traditional financing. Indeed, the lack of venture capital and financing is the main economic development problem

for Kansas. Financing is particularly needed for businesses that are applying research to develop new and innovative products. We propose several institutions to provide such financing primarily by leverage of private sector funds.

13. Establish a Kansas Corporation of Innovation Development (KCID).

The purposes of the KCID program would be to (1) supplement private sources of venture capital by serving the financial needs of start up businesses with innovative products when alternative sources are unavailable or exhausted, and (2) provide financing to existing industries that are developing innovative products or applying new technology in order to be more competitive. As the economy becomes more technology driven it is essential that financing be available so that new and existing Kansas firms have the means to update their products and apply technology to their business.

The KCID would have three basic responsibilities. First, the KCID would make direct investments in new/innovative businesses, providing "seed capital" to entrepreneurs who are just beginning production and marketing activities. These are the high-risk investments, often related to new technology, that banks and other traditional financing institutions are often unable to provide. Direct investment could also be made in private venture capital funds that are investing in state targeted industries. The KCID would be a limited partner in such funds. In addition, when appropriate the KCID program would assist entrepreneurs with a range of technical, business and management assistance to increase their chance for success.

Second, the KCID would provide equity and loan financing to established industries which need to develop new products or are applying new technologies to their businesses. This financing would provide the means for existing industries to expand (or even survive) by updating their products or methods of production. This financing would supplement, not duplicate, financing available from conventional financial institutions.

Third, the KCID would invest in newly established Small Business Investment Companies (SBICs) and would induce additional private investment in these SBICs through the same tax credit mechanisms employed to attract investment into the Corporation itself. These SBICs, which are licensed and regulated by the federal government, provide equity and loan financing to small businesses seeking to expand. In this fashion, the KCID could guide the establishment of a network for SBICs throughout the state.

The Kansas Corporation of Innovation Development would be started by having the Governor designate two or three Kansas entrepreneurs as the initial incorporators and members of the board. A tax credit against Kansas tax liability would provide for private investment. Thus, if a 30% tax credit were available for KCID investments, then \$3 million of investment tax credits would generate \$10 million of private investment

outlay, with the latter creating further economic activity through a multiplier effect. Further leveraging of state funds would occur if the KCID required that all its investments be matched with funds from the private sector.

14. Establish a Kansas Product Development Corporation.

Funds would be invested in viable ideas in order to develop new and innovative products (including but not limited to high technology). Assistance could be given in research and development, prototype development, or process development. The Corporation could structure its investment as a loan, as equity financing, or using royalty agreements. Although initial funds would be provided by the state, the Corporation would become increasingly self-sufficient over time.

The Kansas Product Development Corporation would differ from the KCID by providing financing to very high risk ventures: those that do not yet have fully developed products. It is intended to provide the link between research and the development of marketable products. A separate mechanism is needed because of the risk involved and because of the specialized skills needed in identifying viable ideas very early in the process and in providing assistance to entrepreneurs. Further, because of the risk, direct state funding would be required, at least initially.

The first product development corporation was started in Connecticut. They also exist in Iowa and Arkansas in this region.

15. Establish a state fund to match federal Small Business Innovation Research grants to Kansas small businesses.

The purpose of the Kansas Small Business Innovation Research (SBIR) program would be to stimulate technological innovation in small businesses.

The federal SBIR program was established in 1982 to provide funding for research and development by small businesses in order to promote the commercialization of new products and the growth of new technology-based companies. Federal Phase I Awards of \$50,000 or less are made to allow small firms to demonstrate the scientific and technical merit, and feasibility of the innovation. Firms that successfully complete Phase I may be selected for Federal Phase II funding of up to \$500,000 to further develop the innovation. Under the Kansas SBIR program, small businesses in the state that receive Phase I awards would also receive a matching grant from the state. Such a state grant is to assist innovative small business in Kansas develop products with commercial potential and to increase the probability of their receiving a Phase II award.

Several other states have matching programs in existence to encourage small business innovation. A Kansas SBIR program would encourage Kansas small businesses to compete for research funds and

would encourage such firms to stay in Kansas. These small businesses are competitive on a national basis and are exactly the type of innovative small businesses that Kansas needs to keep in order to improve economic growth.

16. Establish a Kansas Science and Technology Authority.

The Kansas Science and Technology Authority would operate the following programs:

1. The Kansas Corporation of Innovation Development,
2. The Kansas Product Development Corporation, and
3. The Kansas SBIR Program.

We believe the various financing mechanisms that are to be established need to be coordinated by a single Authority. This would allow the programs to operate more efficiently and would avoid possible duplication of effort and staff.

In addition, the Science and Technology Authority would have specific responsibilities for:

4. The management of a high technology venture capital fund,
5. the construction and operation of incubators, and
6. the solicitation and facilitation of joint research contracts and grants between state universities, businesses and government.

The High Technology Venture Capital fund would be capitalized by private investors, portions of investment pools of state funds such as the State Employees Pension funds, and financial institutions, such as banks. While its investments would be limited to high tech companies located in Kansas, the capitalization could be from anywhere. Most of the funds would be used to partially match private sources of capital in order to attract their investment in Kansas. The fund could also supply research funds to firms in the Matching Grants Program in return for shares of qualifying high tech companies that cannot afford cash outlays during their start-up periods.

The high technology venture capital fund is needed because the existing financial institutions within the State of Kansas are not equipped to provide start-up capital for emerging high technology businesses. There are no investment banking firms headquartered in Kansas that will underwrite a speculative issue of common stock shares for new or recently formed companies. The firms that are available are either branch offices or require syndication with decision makers that are outside the State of Kansas.

The Authority would also construct and operate low cost incubator space for high tech offices, laboratories, and start-up manufacturing. The need for high tech incubators is especially great in or near the state's universities and major commercial centers. Space would only be

available to businesses that (a) have a demonstrated need for low cost space, (b) are engaged in high technology, and (c) are jointly supporting research at a state supported university.

Finally, the Authority would assist in the solicitation of joint research contracts and grants between state universities, corporations, and government. Included would be the existing research matching grants provided by state and corporate funds. The Authority would also assist in acquiring federal grants and research grants sponsored by private industries to be conducted at state universities. Such research grants or projects would continue to be administered by the universities.

17. Sponsor or organize a financial symposium for Kansas companies.

In other states, high growth companies have presented their business plans and financing requirements to an assembly of investment bankers, venture capitalists, and other investors (such as pension funds utilities, insurance companies, etc., who have funds to invest). After the presentations, investors are given a chance to meet privately with a limited number of companies.

In Oregon this year, at the Fourth Annual symposium, approximately 22 companies made presentations to 59 registered venture capitalists or investment bankers. The companies were solely from the Northwest, but the investors were from as far away as Chicago, California, and Texas. Investors paid \$450 each registration fee.

This would be a low-cost, high impact project that would serve several purposes:

1. Help Kansas companies obtain financing.
2. Project a progressive image of Kansas business.
3. Familiarize the investment community of opportunities in Kansas.
4. Educate the Kansas investment community to the opportunities available.

18. Provide temporary state funding for Certified Development Companies.

The 13 Certified Development Companies (CDC) in Kansas provide small businesses with an important source of financing when funds are unavailable from a more conventional finance institution. These are especially helpful to firms that would like to expand into new areas of production but cannot get traditional financing. They are also helpful to firms that would like to expand their markets.

These non-profit organizations are certified by the Small Business Administration. Usually, CDC Boards are made up of lenders, local government officials, business leaders and community organization representatives. The financing package of a CDC always involves a participating bank. A typical loan is:

50 percent--participating bank at negotiated term and rate,  
40 percent--subordinate debt to Small Business Administration,  
10 percent--small business equity addition.

Such loans can be an important source of financing for Kansas firms that wish to expand.

State funding is necessary to assist the CDCs in their formative years so they can hire sufficient staff to package additional loans for expanding small business. They are financed primarily by a 0.5 percent charge on loans they organize. However, during their early years of existence they do not have sufficient loans outstanding to provide enough income to hire staff and maintain an office. As loan volume increases the CDCs should become self supporting.

We propose state funding of \$400,000 to support CDC's annually for five years. A pool of funds would be established for which each CDC could compete. Currently the state is funding two CDCs at \$40,000 each.

To be eligible for funding a CDC would have to (1) demonstrate a need for temporary state funding and (2) demonstrate that its activities are having a positive economic development effect in its area. Of particular importance would be an indication that the CDC is emphasizing financing for small businesses that are creating primary jobs to bring new dollars to a community rather than local service jobs that primarily recycle dollars within that community.

19. Establish a secondary market for the SBA guaranteed portion of bank loans.

Secondary market sales of SBA guaranteed loans have been permitted since 1972. The purpose of such a program is to increase the flow of capital to small businesses by allowing lenders to sell their loans to investors who normally do not lend funds directly to small businesses. The advantages are increased liquidity for a bank and a fiducially sound investment for the organization buying the SBA guaranteed loan. Equally important is that the state's economic development is also advanced. Such a program is expected to have a particularly favorable impact in rural areas where banks are typically less liquid.

One possibility would be to have the state, perhaps through the state pension fund, purchase the SBA guaranteed portion of banks loans. This would involve KPERS in financing for economic development through a loan that carries a competitive rate of interest and that carries the full faith and credit guarantee of the federal government.



## State Organization for Economic Development

The state's more sustained commitment to economic development needs to be reflected in the Legislature and KDEDs organizational structure. Legislative responsibility for economic development needs to be more focused and KDED needs adequate funding and staffing. At present, KDED is underfunded and understaffed. In particular, KDED needs adequate resources to:

1. Continue industrial recruiting of out-of-state firms,
2. Expand efforts to assist small businesses,
3. Initiate an existing industry program, and
4. Foster Kansas international trade.

Our basic conclusion is that economic growth in Kansas will come mainly through the growth of small business and the retention/expansion of existing industries. To be successful additional resources are needed in these areas.

20. The Legislature should establish a permanent joint House-Senate Committee on Economic Development or, alternatively, separate committees in each house.

The Legislature needs a permanent structure for considering legislation on economic development. Such a committee (or committees) would give greater visibility to this area and would focus legislative responsibility for economic development in one committee. The committee(s) would have responsibility for proposing legislation on economic development in the state. Over time, members of this committee would acquire valuable experience on public policies affecting economic growth in Kansas.

A permanent committee(s) is also needed to ensure that momentum on economic development is continued. We believe the state requires a long-term commitment in this area. As a first task the joint committee(s) would have responsibility for considering recommendations in this report that are not acted on during the 1986 legislative session. Appropriate legislation would be prepared for the 1987 Legislature.

21. The Small Business Division of the Kansas Department of Economic Development should be substantially expanded and additional field offices established.

The Small Business Division was established by the Legislature in 1985. However, its staff of six persons is too small to be effective. The Small Business Division should be adequately staffed and funded so it can:

- a. Effectively coordinate the state's efforts to foster the establishment and expansion of small businesses. For example, the division should have an important role in coordinating efforts to increase financing of small business.

- b. Coordinate technical assistance on small businesses to communities and organizations involved in economic development.
- c. Assist in the development of incubators for small businesses throughout the state.
- d. Work with the Small Business Development Centers at the state universities and colleges which provide technical assistance to small businesses.

These responsibilities can best be met by the establishment of additional field offices in the areas of Kansas not currently well served by KDED. Staffing of the field offices should be sufficient. The two field offices of the Small Business Division are not able to serve all parts of a state as large and diverse as Kansas.

22. A new international trade division within KDED should be established within the Kansas Department of Economic Development.

The international trade division (or unit of major status) would have two major functions: (1) assisting in international marketing of Kansas products and (2) providing assistance to Kansas firms that wish to initiate or expand efforts at exporting. Kansas is increasingly a part of the world economy. International trade is important for many Kansas industries and further efforts must be made to market our products internationally. Efforts at international marketing should all be concentrated in KDED. It is crucial that this area be made more visible by being in a separate division that is adequately funded. The staff should be led by experts in international marketing. Overseas offices in key markets should be established.

The international trade division would also provide assistance to Kansas firms desiring to initiate or expand exports. Small business in particular require assistance with export financing, licenses, import requirement and cultural/language issues. The division would assist with putting a complete package together in order to facilitate increased exports by small businesses.

23. Increased efforts should be made to attract foreign firms to locate in Kansas.

The industrial development division of Kansas Department of Economic Development has responsibility for attracting foreign firms to Kansas. Funding and staffing should be increased for this function. Increased foreign investment is being made in the east, southeast and western states and is beginning to come to the midwest. Kansas needs to obtain a fair share of such investment by expanding current efforts.

24. An existing industry program should be initiated in the Kansas Department of Economic Development.

The major priority of Kansas Department of Economic Development has been to attract out-of-state firms to locate in Kansas. This effort should be continued. At the same time, increased attention should be focused on industries already in Kansas. An existing industry program would work with Kansas industries to:

- a. Identify problems that prevent Kansas firms from being competitive and expanding.
- b. Propose solutions, to the extent possible, for those problems.

It is essential for the state to pay attention to the needs of business already in Kansas. We need to know if problems exist in such areas as: transportation, financing, availability of skilled labor, taxes and so forth. By working with existing industries in a systematic manner the state would increase the likelihood of retaining existing industries and facilitating their expansion. One part of this state level program would be to assist local communities in establishing their own local industries programs.

25. Kansas Department of Economic Development should implement a marketing program aimed at targeted industries.

This economic development study will identify growth industries particularly suited for Kansas. Follow through is required to identify specific firms in those industries and to market Kansas to them. This requires that KDED take the initiative in "selling" Kansas to this specific set of targeted industries. This will include advertising in particular trade journals and staff contacts with individual firms. Such a targeted market and program is essential if Kansas is to take the initiative in attracting growth firms to Kansas.

In addition, the targeted industries study should be continued. A second phase of this study would identify target industries for the major regions of Kansas. Funding should be made available for this purpose.

26. Kansas should initiate a national promotion campaign aimed at improving the image of Kansas among business leaders with responsibility to make business location decisions.

A major problem identified by Kansas leaders is that the state has a poor image as a place to do business. Yet, there is a strong belief that Kansas is a good state to do business in, and we concur in that judgement. The need, therefore, is to narrow the gap between reality and perceptions of out-of-state business leaders.

We recommend the initiation of a long-term marketing effort aimed at business leaders to improve the image of Kansas. The basic message would be that Kansas is a good place to do business in and the state is committed to providing a positive business climate. The return will be high for a reasonable and moderate national promotion campaign.

27. Review the Constitutional prohibition on internal improvement to determine if it should be modified or repealed.

The implementation of several recommendations in this report may be limited by the constitutional prohibition on internal improvements. It would be appropriate to an interim committee if the Legislature, or some other group, examine the prohibition and recommend changes to permit the state to implement programs to promote statewide economic development.

### Community Development and Small Business

Firms choose to locate or expand in Kansas based on attributes of the state and the attractiveness of a specific community. If Kansas is viewed positively by business but local communities are not competitive with those in other states then economic development will lag. A major part of the state's economic development effort, therefore, should be directed toward assisting local communities to improve their own economic development programs. Several Kansas communities already have well developed programs that are competitive regionally and nationally. But other communities are just beginning their economic development programs and require assistance. We recognize that the state's role is limited and we propose that state assistance to local communities be in the areas of financial and technical assistance.

In this section we also present several recommendations directed to small businesses. Many of the recommendations in this report are intended to facilitate the start-up and expansion of small business, but there are several others not covered elsewhere. These relate to establishing incubators and providing technical assistance to small businesses.

28. Provide low or no-interest matching loans to local governments and nonprofit organizations to facilitate the establishment of incubators.

Incubators help draw out and develop entrepreneurs from within a community. Incubators are highly adaptable so the needs and resources of highly dissimilar communities can be met creatively; however, low cost funding is essential. Low or no interest matching loans to local governments can be used to support incubator developments. Funding for initial operating costs should be included. Illinois has allocated \$1 million for its first year of funding for incubators.

The incubator program should be sufficiently flexible to allow private sector operation of incubators even though the state provides initial financing assistance.

29. A general loan pool for infrastructure development should be available for use by communities to promote economic development.

The purpose of the loan pool would be to allow local communities to make improvements in infrastructure that would encourage or facilitate economic development. Included would be roads, sewers, water lines and other improvements with the potential for making possible the attraction of firms, the start up of new firms, or the expansion of existing firms. All funds would be targeted for specific economic development purposes such as improvements associated with an industrial park, improvements associated with an incubator or the preparation of a site for business use.

The intention is to assist local communities with the financing of infrastructure improvements that would directly improve the communities prospects for economic development.

30. Substantially expand technical assistance to local communities on how to promote economic development.

Firms considering a site for locating or expanding a business will look at characteristics of the state and the local community in making that decision. Many local communities have only recently begun economic development programs and are in need of technical assistance in many areas. It is important that assistance be given not only on how to attract firms to a community but also in areas that are important to the retention and expansion of existing industries. Some specific areas where technical assistance to local communities would be important include:

- incubator development
- industrial parks
- site development
- financing programs
- existing industry programs
- providing information to site consultants and firms
- identifying and targeting industrial prospects
- international markets

Such technical assistance would best be provided by an expansion of KDED field offices as proposed in Recommendation 21. Kansas is too large and diverse a state to have all communities served by Topeka. Staffing for technical assistance should be sufficient to serve all parts of the state and to allow employment of specialists in key areas such as international trade.

31. Federal Community Development Block Grants should be used to the fullest extent possible for economic development projects.

Currently 30 percent of the state's CDBGs is being used for economic development. This percentage should be expanded to the fullest extent possible. Infrastructure improvement, incubator financing, and industrial park financing are examples of possible uses of these funds.

32. A state community development block grant program should be established and targeted to economic development.

A state CDBG program could make grants available to local communities for infrastructure improvements, incubators, and industrial parks. Such grants could supplement loans as proposed in recommendations 28 and 30. All such grants would be targeted to specific economic development objectives but would not be limited to low income areas.

33. Expand the "Certified Cities" program.

KDED has recently begun a Certified Cities program which deserves to be supported and expanded.

With state-agency support and advice, communities make a comprehensive assessment of all their strengths and weaknesses in regard to economic development. An in-depth study of the labor force, capital availability, existing industries, educational opportunities, infrastructure, etc. would be made. Certified cities would be eligible for priority consideration for loans and grants for incubator, an industrial park, or other purposes. Technical assistance from KDED should be available to assist communities in areas where weaknesses are discovered.

34. Provide state funding for the Small Business Development Center (SBDC) network to expand technical assistance to small businesses through consulting and training sessions.

The basic thrust of the recommendations in this study is that Kansas is a state of small and medium sized businesses and that the major source of economic growth in Kansas will be from new and expanding small businesses. One important need of small businesses not covered in other recommendations is for technical assistance.

The major needs of small businesses are for financing and technical assistance. Financing is covered in other recommendations. Small businesses do need assistance in such areas as marketing, accounting, finance and personnel. The SBDCs are established at the six regents' institutions plus Johnson County Community College and Washburn University. They currently provide technical assistance using their own staffs, university faculty and students. Expansion of this function would be permitted by state funding. Currently, federal funding for these services is provided through the Small Business Administration, but this funding is not sufficient to serve the need for technical

assistance by Kansas small businesses. Universities and colleges are particularly well suited for providing assistance to small businesses.

Attachment

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