Section 4 -
Economic Development Issues -

Role of Special Purpose Nonprofits

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Issue Statement

The objective of this paper is to examine the role of the four special purpose nonprofit agencies established by the State of North Carolina to conduct economic development activities, and to make recommendations about their appropriate role and relationship in carrying out State economic development initiatives. The four special purpose nonprofits are:

- Rural Economic Development Center (REDC)
- Technological Development Authority (TDA)
- Microelectronics Center of North Carolina (MCNC)
- North Carolina Biotechnology Center (Biotech)

This issue paper is one of four issue papers on economic development. For further information on the subject of economic development, see the issue papers on Strategic Planning, Coordination and Organization of Economic Development, and The Regional Offices of the Economic and Community Development Divisions of the Department of Commerce.

Background

The State of North Carolina's economic development efforts are carried out by a broad spectrum of players including various state agencies, the community colleges, the University of North Carolina (UNC) system, and various nonprofit agencies. These nonprofit agencies fall into two categories: the special purpose nonprofits established by the State to conduct economic development related activity; and other nonprofits involved in economic development that receive state funding. The four special purpose nonprofits are:

- Rural Economic Development Center (REDC)
- Technological Development Authority (TDA)
- Microelectronics Center of North Carolina (MCNC)
- North Carolina Biotechnology Center (Biotech)

The other nonprofits that have received state funding for economic development in the last three years include the North Carolina Institute for Minority Economic Development, Land Loss Prevention Project, Inc., and North Carolina Coalition of Farm and Rural Families. This paper focuses on the four special purpose nonprofits created by the State to conduct economic development activities.

In fiscal year 1992, these four nonprofits expended over $30 million or 36 percent of all general fund expenditures justified in the budget process as economic development. Exhibit 1 shows the distribution of general fund dollars for economic development among the major providers of economic development services. Exhibit 2 shows the distribution of these dollars among the nonprofits.

The mission, programs, and funding levels of each of the four special purpose nonprofits are described below.

Rural Economic Development Center (REDC)

The North Carolina General Assembly, during the 1985 Session, authorized the North Carolina Commission on Jobs and Economic Growth to study economic development issues facing the State. The Commission's final report of November 12, 1986, identified areas in which the State's efforts could be enhanced. One of the Commission's recommendations called for the development of an organization to provide economic development services to rural areas of the state. In response, the General Assembly, in 1987, appropriated funds to establish the North Carolina Rural Economic Development Center, Inc., as a nonprofit organization. The 1987 Budget Act did not stipulate a mission or specified purpose for REDC.

In its annual report, REDC notes its key mission is "identifying the forces of change in rural areas and finding ways to build and improve on them." In a separate publication (Fact Sheet), REDC notes that it is "charged with developing and advocating innovative strategies to help stimulate economic growth and job creation throughout the state's rural areas."

In pursuit of its mission, REDC conducts or supports a variety of research and demonstration projects. From 1988-1992, the Center has been involved in 86 projects in four major issue areas: Business Development, Natural Resources/Agriculture, Infrastructure Development, and Human Resources/Community Development. In addition, the Center published, in conjunction with North Carolina State University, *North Carolina Rural Profile: A Look at Social Economic Trends Affecting Rural North Carolina.* In October, 1991, the Center also released the result of a two-year strategic planning process: *Securing the Future: Rural Development Strategies for the 1990s.*

REDC plans to take a stronger policy role in rural economic development in the future. Specifically, REDC plans to:

- Strengthen its programs by undertaking fewer, more multi-disciplinary projects with significant potential for statewide impact

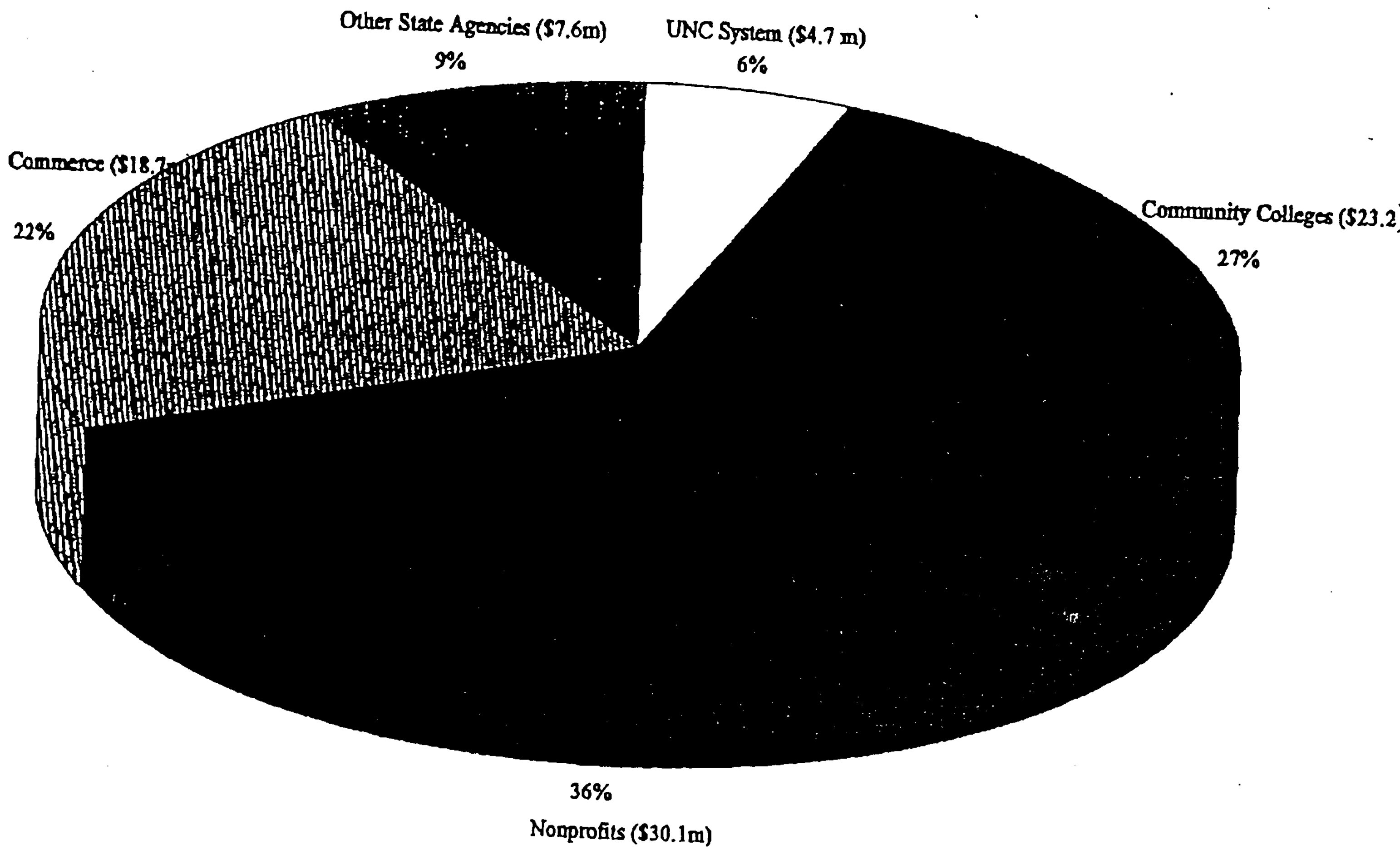
- Concentrate more effort on replicating successful projects, facilitate the implementation of policy innovations, and advocate policy improvements

- Enhance its role as convener through a regular calendar of programs and activities;

- Diversify its funding base

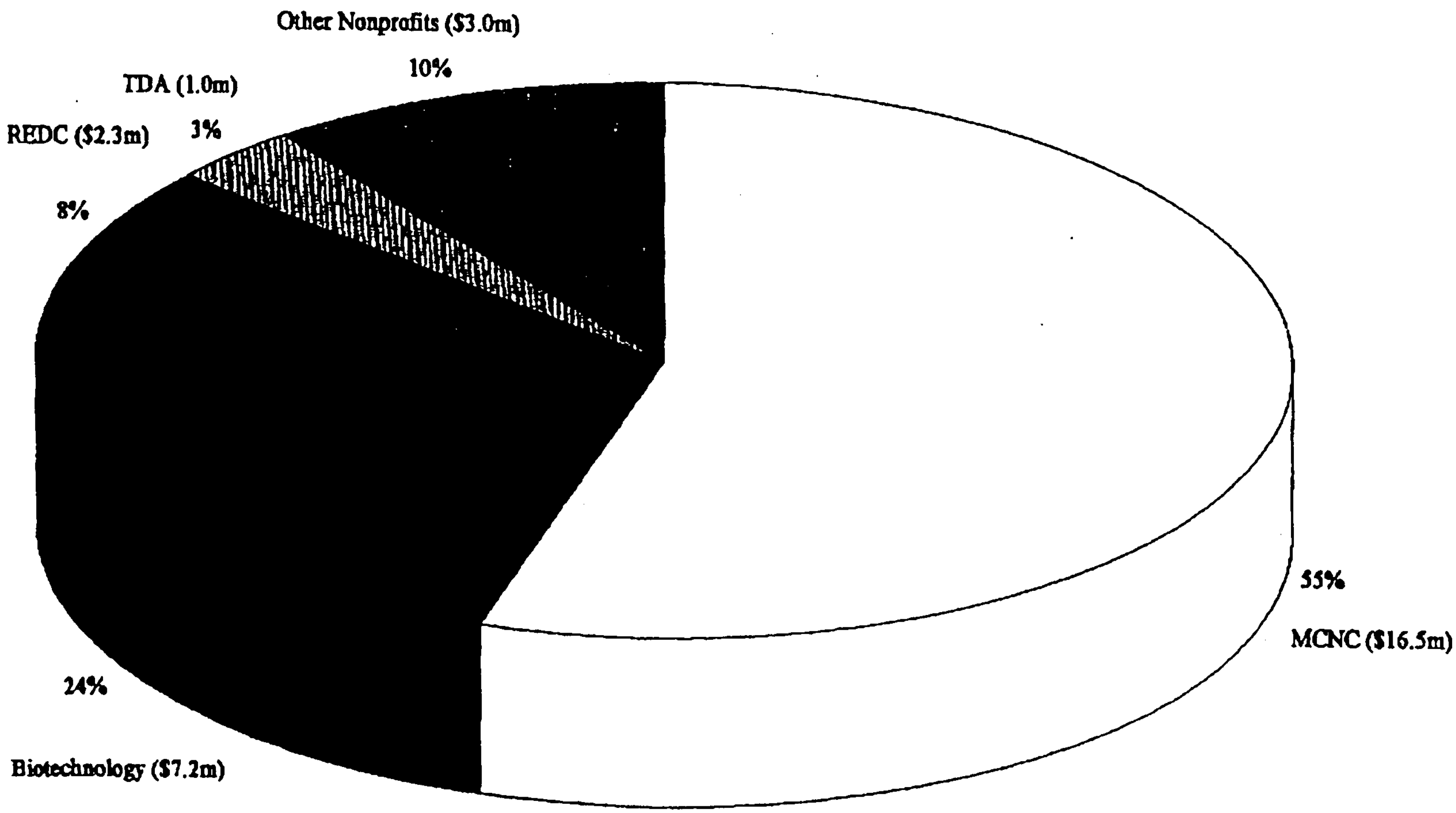
In the past three years, REDC general fund expenditures were $3 million in FY 1990, $2.2 million in FY 1991, and $4.6 million in FY 1992. Each year, a small portion of these

Exhibit 1
FY '92 Distribution of General Fund Dollars Among Economic Development Players



Source: Office of State Budget and Management

Exhibit 2
FY '92 Distribution of General Fund Dollars Among Nonprofit Organizations



Source: Office of State Budget and Management expenditures was passed through to four smaller nonprofits: Microenterprise Loan Program, Community Development Corporations, Minority Credit Unions, and the Credit Union Support Center.

REDC also receives considerable support from non-State sources. For fiscal year 1993, REDC expects to receive $2.6 million from non-State sources. Most of this outside funding can be attributed to a $2.2 million grant recently awarded by the Ford Foundation.

Technological Development Authority, Inc. (TDA)

The Technological Development Authority was created in 1983 by the North Carolina General Assembly under G.S. 143B-471. The General Statutes describe the creation of the authority as follows:

> There is hereby created the North Carolina Technological Development Authority, to increase the rate at which new jobs are created in all regions of the State, by stimulating the development of existing and new small businesses. The Authority shall be administratively located within the Department of Commerce, but shall exercise its powers independently of the head of that department, as if it had been transferred to the Department of Commerce by a Type II transfer as defined in G.S. 143A-6(b). (1983, c. 899, s. 2)

G.S. 143B-471.3A, which described the powers of the TDA, explicitly authorized the TDA to "apply for and accept grants of money from the State of North Carolina, or any political subdivision thereof, from the United States, or from any person, corporation, foundation, trust, or business or from any foreign government for any of the purposes authorized . . " In addition, the section authorized the TDA to establish and administer the Incubator Facilities Program and the North Carolina Innovation Research Fund. When in 1991 TDA shifted its status from a Type II transfer entity to a nonprofit organization, these statutes were eliminated.

Although not explicitly written into the statutes, budget analysts and a TDA executive explained that the underlying premise on which TDA was created was that it would become self-sufficient within 10 years. In essence, the organization was established to validate the assumption that investment in high technology companies was viable in North Carolina's market. As a high technology venture capitalist, TDA's success was contingent on the success of its investments.

Ten years after its creation, TDA has become self-sufficient. In 1991, the TDA applied for nonprofit status and became the Technological Development Authority, Inc. The independent nonprofit organization moved its offices from Raleigh and is now located in Research Triangle Park. One reason cited for becoming an independent nonprofit organization was to leverage private dollars more effectively. As a state agency, the TDA was allowed to invest in private companies; however, any investment exceeding $25,000 was subject to annual government audits. While these audits may be useful generally, they create an additional barrier for small start-up companies trying to market innovative ideas. As an independent nonprofit entity, TDA's investments are no longer subject to this level scrutiny. TDA, Inc., plans to continue its investment in high technology start-up companies in the future and is currently engaged in a strategic planning process to help accomplish its goals.

Over the past three years, the TDA received $3.4 million in general fund dollars. For fiscal year 1994, the TDA will be fiscally self-sufficient from the state and will not submit a request for state funding.

Microelectronics Center of North Carolina (MCNC)

MCNC was founded in 1980 as a joint initiative of the State, Research Triangle Institute, the Triangle universities, North Carolina Agricultural and Technical State University, and the University of North Carolina at Charlotte, to stimulate growth in microelectronics in North Carolina.

In later years, access needs led to creation of the education and research telecommunications network (CONCERT) among the Triangle universities. CONCERT was assigned to MCNC. The General Assembly also decided to fund supercomputing capacity for university and industry uses and assigned supercomputing functions to MCNC.

MCNC currently defines its mission as follows:

> "To accelerate the use of emerging electronic technologies through innovation and market-driven applications that improve quality of life. MCNC will leverage state and federal investments, and the research resources of participating institutions, to develop cost-effective and productive technologies and applications through cooperative partnerships which benefit our customers. Our top priority will be the needs of industry, educational institutions, and the government agencies in North Carolina."

MCNC has three component centers: the Center for Microelectronics Systems Technology, which focuses on microelectronics technologies and markets use of the MCNC facility to users; the North Carolina Supercomputing Center, which focuses on supercomputing and computational science education programs; and the Center for Communications, which operates CONCERT and conducts research, education and training programs in information technology and its applications.

Currently, two-thirds of MCNC's $25 million annual budget comes from the General Assembly's appropriations, with the remainder coming from funded research, fees for services provided, and other sources. The initial state appropriation was $1.1 million in FY 1981 and the FY 1992 state appropriation was $16.5 million. (See Exhibit 2.) The State has invested a total of approximately $191 million in MCNC from FY1981 through FY 1992. Of this total investment, $73.5 million was for capital investments in buildings, furnishing, supercomputer, and equipment. In addition, during its 12 year history, MCNC has provided $13 million of its funds in direct grants to North Carolina universities, primarily for equipment. The remaining $104.5 million supported MCNC's operations. Excluding the capital portions, funding to date for operations has averaged $8.4 million per year during the 12 year period of MCNCs existence.

To date, the State's investment has leveraged an additional $68 million (or 26 percent of total MCNC funding) from other sources, which include industry donations (primarily discounts and in-kind donations), industrial affiliates, research contracts, and other fees. Both in FY 1981, when total funding was $1.8 million, and in FY 1992, when total funding was $25 million, the State's contribution represented about 65 percent of the total MCNC budget.

North Carolina Biotechnology Center (Biotech)

The North Carolina Biotechnology Center was created by the General Assembly in 1984 to support the growth of biotechnology in the State. When it was first established, Biotech only made grants to universities. In 1988, Biotech began making loans to start-up biotechnology companies. In 1990, the Center revised its program to support start-up companies by using stock warrants, in addition to loans, as a financing vehicle.

Biotech's role has evolved over the eight years since its creation. Its mission, as currently stated, is "to provide long-term economic benefit to North Carolina through support of biotechnology research, development, and commercialization statewide". The goals of Biotech are to:

- Enhance the research capabilities of the State's universities
- Encourage collaborations and technology transfers among government, industry, and academia
- Assist business development
- Educate the public about biotechnology
- Strengthen North Carolina's leadership role in the development of biotechnology

Biotech works to accomplish its mission through four programs:

- Scientific Program, which provides funding for basic and applied university research, sponsors conferences and workshops, and maintains a data base on the research capabilities of North Carolina's public and private universities
- Educational and Public Affairs Program, which informs and educates the public about biotechnology, addresses public issues that arise from it, and helps prepare a

workforce for the industry

- Economic Development Program, which provides financial assistance to young biotechnology companies through low interest loans and holding stock warrants, encourages collaborations and technology transfer, sponsors meetings on small business planning and development, and assists in recruiting new companies to North Carolina

- Institute for Biotechnology Information, which provides strategic information to businesses and government

Distribution of funding for the Center currently is 90 percent from the State and 10 percent from private sources. For FY 1992, funding from the General Assembly totaled $7.2 million. (See Exhibit 2.) The Center's current corporate plan calls for more of its activities to become self-financing. The Center plans to build "escrow" accounts from loans/equity to fund future financial assistance programs. In this manner, it will be able to reduce demands on State funds and continue to fund five companies per year.

Findings

Finding 1: ***The use of nonprofits as a mechanism for state-initiated economic development is unusual, but not unique among southeastern states.***

Of seven southeastern states surveyed in this study, four use nonprofits as part of their delivery system of economic development services: Kentucky, South Carolina, Florida, and North Carolina. Clearly, North Carolina is not unique in this regard. The degree to which nonprofits are used, however, is unusual. South Carolina provides a total of about $2 million in funding to four nonprofit economic development agencies including Enterprise Development, Inc., the Southern Center for International Studies, the Southern Manufacturing Technology Association, and the Small Business Development Corporation. Kentucky provides about $.5 million in funding to the Eastern Kentucky Development Corporation. The state of Florida is in the process of creating a nonprofit agency, Enterprise Florida, to be used as a facilitator of economic development services. While the budget has not yet been approved, the initial budget request for Enterprise Florida was for $24 million. As demonstrated by the Florida project, other southeastern states are just beginning to substantially invest in nonprofits as a mechanism for economic development.

In contrast, about $30 million of North Carolina general fund expenditures were expended by nonprofit economic development agencies in FY 1992. This amount has decreased almost 14 percent from the FY 1990 level of $34.8 million, but remained almost constant in comparison to the FY 1991 level of $29.8 million. North Carolina also uses nonprofits for a broader range of economic development activity than do other states, as reflected in the descriptions of the four special purpose nonprofits above.

Finding 2: ***Each of the special purpose nonprofits has demonstrated success in its respective area of focus.***

The REDC has recently been awarded a $2.2 million dollar grant from the Ford Foundation, a highly sought-after source of funding for nonprofits. This award endorses REDC's external perception as an effective and successful agency. TDA has achieved self-sufficiency, one of the major implicit goals of its creation by the State. MCNC has recently been named one of five national test beds for the development of gigabit technology. To date, start-up companies that have received financing assistance from Biotech have been able to leverage $39 in private financing for every $1 in loans from Biotech, and grant funding from Biotech enables North Carolina universities to leverage increased federal research dollars in a ration of 18:1.

Furthermore, there is substantial evidence that the collective efforts of the special purpose nonprofits significantly contributes to North Carolina's reputation as a state committed to innovative, technology-based research and development. The President of the Research Triangle Park Foundation stated that all companies recruited to the Park receive tours of MCNC and Biotech to demonstrate the State's commitment to technology-based research.

Finding 3: ***Few mechanisms currently exist to ensure the accountability of the special purpose nonprofits to the State.***

The nonprofit organizations, as independent entities, have established some traditional reporting mechanisms. The four special purpose nonprofits publish annual reports which are presented to their board members at annual meetings. A variety of other reports are also published and widely available to interested parties.

Currently, oversight responsibility for the nonprofits is held by the General Assembly's Joint Legislative Commission on Governmental Operations. On a quarterly basis, nonprofits receiving state-funding report on the use of their funds. In addition, all agencies that receive more than $25,000 are subject to an annual government financial audit. The three special purpose nonprofits still receiving state funds therefore are audited annually.

These conventional accountability measures focus on inputs, or programs and budget levels of the nonprofits, rather than outcomes, or the results of their efforts. Without outcome-based accountability measures, the extent to which the nonprofits are fulfilling their intended purpose cannot be fully assessed.

Throughout economic development related entities in North Carolina, there is limited use of performance-based indicators to evaluate the use and value of economic development activities. As with state agencies, nonprofits have not fully developed and implemented meaningful measures to evaluate and report their performance. This leaves the General Assembly with limited means of evaluating the outcome of the significant state investments made in economic development.

Recommendations

Recommendation 1: ***North Carolina should continue to use nonprofits to deliver economic development services.***

North Carolina effectively has pioneered the use of nonprofits to conduct economic development activity. The nonprofit status of these entities allows them to:

- Successfully use State dollars to leverage private investments that exceed the public investment many times over
- Operate free of the traditional constraints of a state agency
- Be flexible, innovative, and entrepreneurial in their investments, programs, and strategies
- Be uniquely positioned to serve as an independent and objective liaison among the State, private industry, the university community; and the public
- Expand the State's activity level in economic development without requiring the provision of additional administrative support by Commerce's administrative support unit
- Conduct objective and nonpartisan policy-oriented research

However, there are several disadvantages to the nonprofit mechanism for economic development. First, there is potential confusion among State agencies and employees and others about the independent status of the nonprofits, leading to perceived inequities where nonprofit personnel and other policies vary from State policy. This can be addressed through clear and consistent communication about the status of the entities. More importantly, the State has limited means of ensuring the accountability of the nonprofits to the State as their primary source of funds. By putting in place effective accountability mechanisms, the State can avoid this potential disadvantage while continuing to reap the considerable advantages of the nonprofits. In the future, authorizing legislation should clearly stipulate the mission and specific purposes of non-profits with "sunset" legislation to assume a periodic, comprehensive review of the entity.

Recommendation 2: ***The State should develop performance-based contracts with the nonprofits.***

Performance-based contracts provide an effective and appropriate accountability mechanism to assess the performance of the nonprofits on a regular basis. Performance-based contracts would articulate specific, measurable results for each of the nonprofits, and make their continued State funding contingent on achieving those results. Clear understanding of preestablished performance-based criteria allows nonprofits to understand the outcomes expected of them by the State. From the General Assembly's perspective, performance-based contracts will allow for more systematic evaluation of nonprofits to more objectively appropriate funds.

The State has begun to implement this concept, though only on a limited basis. In its direction to the REDC for the pass-through funds it administers to the four smaller nonprofits, House Bill 1340 states, "The North Carolina Rural Economic Development Center, Inc., shall establish and implement performance-based criteria for determining which community development corporations will receive a grant and the grant amounts." This model should be expanded to apply to all the special purpose nonprofits.

The greatest challenge in establishing performance based contracts is determining appropriate and measurable criteria to which to hold the nonprofits responsible. It is particularly difficult to attribute some results, such as the recruitment of a high technology company to North Carolina, to the efforts of any one individual entity. It is therefore important to select criteria that the individual nonprofit can substantively influence. The criteria should be based on baseline data and reasonable expectations. Examples of such criteria are:

- Achievement of a specific ratio of private funding to State funding
- Financial viability or long-term profitability, measured in quantitative terms, of those start-ups the nonprofits invest in
- A specific number of patents received by applied researchers supported by the nonprofit

Recommendation 3: ***A goal of self-sufficiency should be established for the Center for Microelectronics Systems Technology of MCNC and for the Economic Development Program (EDP) and Institute for Biotechnology Information (IBI) of the Biotechnology Center.***

While the State should continue to support the special purpose nonprofits, it is both reasonable and desirable to establish a goal of self-sufficiency for those entities for which self-sufficiency is viable. The Center for Microelectronics Systems Technology (CMST) of MCNC and the certain programs of the Biotechnology Center are especially well-situated to achieve self-sufficiency for one or more of the following reasons:

- Level of interest from private funding sources in the work they conduct
- Viability and growth projections of their respective technological focus areas
- Advancements toward self-sufficiency already achieved by these entities

- Investments made by the entities

A reasonable year for self-sufficiency is the year 2000. The State could employ a phase-in process whereby funding is maintained at current levels for the next five years (FY 1993-1997), and decreased in some increment between FY 1998 and FY 2000. This would yield considerable savings for the State in the form of future cost avoidance.

The model of TDA attests to the viability of implementing this recommendation. By requiring that these particular entities achieve self-sufficiency, the State is conveying a strong message to the public that it is strategically and efficiently using public funding to achieve public goals.

Recommendation 4: ***In its recommended statewide economic development plan, the State should explicitly address the appropriate role for nonprofit organizations in economic development.***

We have recommended that the State establish a statewide plan which encompasses all of the activities of economic development. Since the special purpose nonprofits comprise a significant portion of economic development activity, their role should be explicitly addressed in the statewide plan.

The nonprofits, as independent entities, are uniquely situated to conduct the entrepreneurial and high-risk activity of investing in and supporting new business creation in the State. The nonprofits therefore should be assigned a dominant role in these key component of economic development activity.

Implications

By adopting these recommendations, the General Assembly could maintain the many advantages of using nonprofits for economic development while ensuring their accountability. The recommendations also provide the General Assembly with objective and quantifiable data on which to base appropriations decisions.

Exhibit 3 summarizes the estimated savings to be realized by implementing these recommendations. These estimates assume that the EDP and IBI of Biotech and the CMST of MCNC would continue to be funded at current levels of about $1 million and $6 million, respectively.

EXHIBIT 3
Estimated Cost Savings of Implementing Recommendations

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
CMST of MCNC	$2m	$4m	$6m	$6m	$6m
EDP & IBI of Biotech	$.25m	$.5m	$1m	$1m	$1m
Total	$2.25m	$4.5m	$7m	$7m	$7m

Note: No savings are realized prior to FY 1998

References

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