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Letter from D.D. Pearsall to B. D'Arcey

Duane Pearsall
Mr. Blaine D'Arcey  
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Dear Blaine:

Since the SBA Task Force is not really "pressure" business, I thought you might be interested in what happened at the meeting last week.

The group was a little smaller since the following people were not there: Walter Stultz, Pat Liles, Paul Bancroft, Dick Hexter, Bill Sword and Charls Walker.

First, John Werner (SBA) discussed high technology small business and the life cycle of commercialization of high technology. The major difference with this type of small business is the need for "seed capital". They estimated between six and thirty million dollars of "seed capital" was being expended compared to some $600 million of venture capital total each year.

He brought a stack of manuals that represented about one and one-half million dollars in studies (and he estimated this was only about one-half of the total) on small business and the potential for development. Unfortunately, out of all of these studies, nothing is done.

National Science Foundation has been reducing the amount available for "seed" grants. The opinion was that this was exactly the wrong direction.

Bill Hambric indicated that since the Tax Reform Bill, he has received many more inquiries about investment in Sub-Chapter "S" corporations. He expects this area to grow significantly.

Bill Casey raised a concern about the problem of getting new ideas into producible products. Charlie Lea said they estimated an evaluation of products would cost about $50,000 per idea to support the inventor long enough to get the product into a decision point.
Werner pointed out that ERDA had received 4,000 applications for solar energy development. They gave these to the Bureau of Standards who qualified only two of the group as practical. I challenged the wisdom of the National Bureau to make that judgment. I also described our proposed subsidiary corporation and the talent required to identify a marketable product in high technology.

I suggested possibly SBA could support a technical advisory committee to evaluate inventions and perhaps even establish an award for "inventor of the year".

Attached is a proposal for Roll Over Lending in Small Business out of the sub-committee. Casey's opinion was that their request was too broad. It was finally concluded that small business be defined by the SBA's established and accepted definitions, and if capital gains are defined as those gains resulting from an initial investment in small business, that with the general concerns for small business in the legislature and the precedence for capital gain deferral in home sales, there would be a reasonable chance for this tax law change to be accepted.

Much discussion about Rule 146 and that it was a complicated problem. Apparently, Rule 146 does not pose a major problem in the Bill Hambric arena. He suggested that perhaps a compromise regay offering, which would only cost about $20,000, local printing, etc., might allow a small company a reasonable multiple - though still not comparable to a merger circumstance. He produced the financial statements of a small company started by Stanford University which produces an opticon, a machine allowing a transfer from the printed word to a Braille image. They are turning out some $400,000 net after on sales of $4.2 million and currently in the public market, could only secure a multiple of about five to seven. He felt with an inexpensive regay offering that multiple could be increased to ten to twelve, assuming Rule 144 were relaxed. He recommended that Rule 144 is too restrictive and negative to liquidity. It should be changed from the 1% in six months to 1% in three months, and would not cause any disorder in the market. In addition, they should put in a maximum period of five years where the investor is free to bail out. This rule would not apply to the owner. Hambric felt the regay program should apply to secondary offerings as well.

Ed Bunce discussed the Benson Plan of allowing 1% of pension funds exempt from ERISA rules. Some figures introduced suggested that if this were 5%, which no one thought was unreasonable, it would produce more capital than small business could consume in that sector. Ed Bunce suggested that if this could be done, that the institutional investor could get into the high capital requirement small business markets, leaving the venture capital to operate where the natural market force allows.
We reviewed the COSIBA provisions, allowing for changes in the new tax law, and tried to identify those specific points this Task Force felt were the more important. As a general philosophy, it was agreed that the Task Force could be more effective with approximately three strong recommendations, than to have a laundry list. Casey asked for a review of the positions the committee might take to help the "small-small" business. The areas involved were first, the graduated income tax (which the U.S. Chamber is opposing). Second, the possibility of SBA participation in a guaranteed bank loan in the area between the normal banks credit line and the business ability to secure long-term credit. Don Steffes sighted a cadillac dealer in McPherson, Kansas - net worth of $300,000, increased costs of cadillacs required twice the investment, and the bank was loaned to its loan-deposit limit. His only choice is to send his good customer, with good credentials, to the bank down the street in order that SBA could effect a guaranteed loan without reducing the bank's current loan exposure.

No one could come up with a solution to this problem.

The next meeting will be an attempt to digest all of the proposals made to date and each come prepared to identify the priorities both of affectiveness and of their practicality in securing legislative or administrative changes.

Again, this meeting was a great education. You'll note that I'm beginning to use some of your terms as if I knew what they meant.

If you get any really good ideas, don't get too excited about them, but just calmly write them down and I'll make sure they get the committees' attention on November 19.

We are off to Lake Powell.

Best regards,

Duane Pearsall
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P.S. - Jim Hutchinson is no longer with the Department of Labor and Jim Parris is no longer with SEC -- the committee must put some kind of a hex on government employees.