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Risk and REWARD

Joe Kumiszczka's got a \$100 million game plan for growing Maine's technology sector

BY REBECCA GOLDFINE

MESDA has a clever ring to it, perhaps because within certain circles in Maine it's associated with all things techie. But the Westbrook-based technology association has decided to throw off its old moniker. Ditching the outdated acronym that originally stood for the Maine Software Developer's Association, MESDA will now be referred to as the Technology Association of Maine, or TechMaine for short.

TechMaine Executive Director Joe

Kumiszczka says the name better reflects the broad spectrum of technology companies the trade association now assists, which range from software developers to biotech and IT firms. But TechMaine will not divert from its original calling, which is to help carry Maine's economy into the future, right up to the bloody brim. "It's not just cutting — it's the bleeding edge," Kumiszczka explains.

Now more than ever, Kumiszczka is looking beyond the horizon at the many possibilities for the state's technology sector. And TechMaine is zipping into 2008 with several

ambitious plans, including creating a software testing center for students and pushing for a \$100 million venture capital fund that could invest in technology start-ups in the state. The spin-offs from both ventures could be significant: The testing center could fertilize a growing technology cluster in southern Maine, and the venture fund could stimulate economic growth by investing in promising new companies.

TechMaine's aim has always been to forge a robust technology community in Maine. And if its membership count is any indicator, the industry here is growing. MESDA started

in 1992 with seven member companies; now it has nearly 300. But to create a foundation for a truly prosperous tech sector in Maine, with shining computer screens lit up across the land, Kumiszczka says TechMaine still needs to build up two critical components: education and capital.

First off, Kumiszczka wants to open a software testing lab and usability design center in Westbrook next fall. A university, college and vocational high school — along with the city of Westbrook — are behind the project, which will have students testing software for local companies. Not only would the center provide a needed service, Kumiszczka says, but it could also create a skilled workforce and potentially draw more technology companies to the state.

And to muster up some major capital, TechMaine is attempting to attract \$100 million in venture capital to Maine in a financial arrangement called a “fund of funds,” which is a way for Maine to attract capital to fund risky — but potentially very successful — young businesses. But Maine would be liable for covering any loss of this investment money, a risk that has raised some doubts in Augusta.

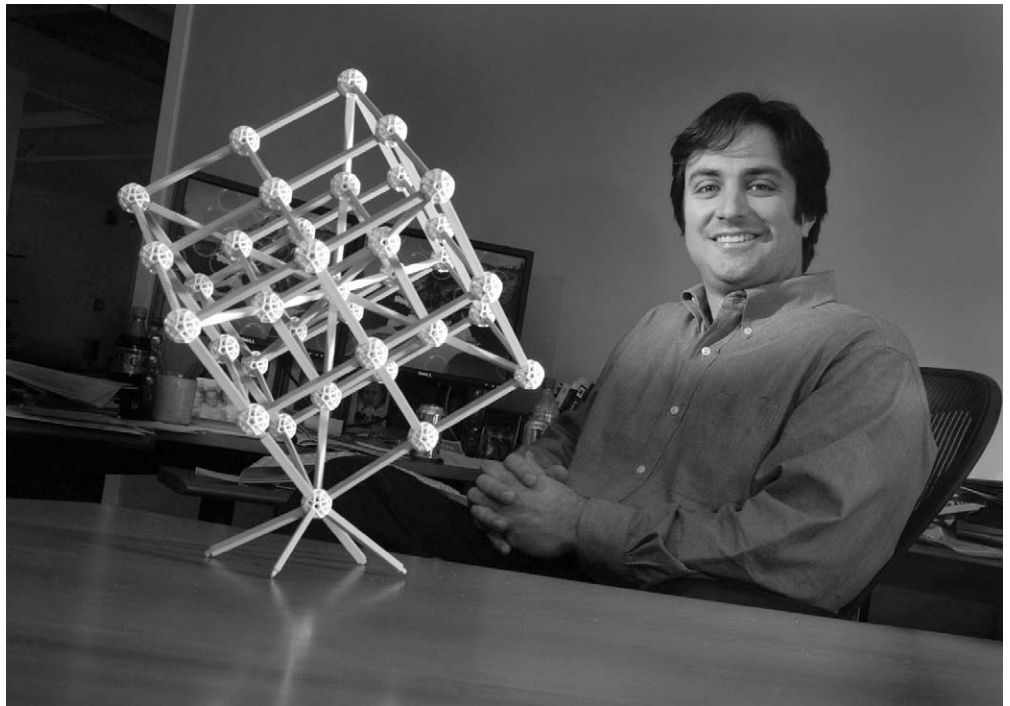
“What can Maine specialize in?” Kumiszczka asks rhetorically, setting up his pitch for promoting technology here. “The Brookings Report came out last year, and Maine has a brand, and that is quality. Where does quality and technology intersect? It doesn’t right now.”

But Kumiszczka says the software center, which will test for quality assurance, could help bridge the gap between a lot of software and excellence. And generating investment capital, too, could help build a bigger bleeding-edge technology sector, stretching the Maine brand to encompass not just lobster rolls and balsam pillows, but sophisticated software programs as well.

The search for funding

Cheryl Phillips-Day, the chief technology officer for BlueTarp Financial in Portland, says when her company started out in 2000, the leadership team had a hard time wrangling investment funds. Again and again, BlueTarp, which provides credit lines for contractors, found that venture firms were unwilling to hand over money because the company was located in a small city in a rural state.

“What we have found, by and large, is the larger venture capital firms want to move you to a larger metropolitan deal where they have a lot of projects and deals,” Phillips-Day says. (BlueTarp did eventually raise \$35 million over the past few years after going on what Phillips-Day describes as “horrendous road shows” to sell their business idea to potential



Staying home: Peter Murray, founder of Portland software developer Quantrix, says many potential investors have wanted to move the company out of Maine before promising any funding

fundors.)

Peter Murray, the founder and chief technology officer of Portland software developer Quantrix, says many venture capital firms asked his company to leave the state. But he resisted. “I’m in Maine because I want to be in Maine,” he says. “The thing that Maine has going for it is the quality of place. Entrepreneurs want to be here, but not because there’s lots of venture capital.”

Meanwhile, local venture capital funds are far and few between, Murray says. Kumiszczka says, too, that while it’s possible to attract up to \$500,000 here from some financial sources, it’s not easy to land much beyond that.

So, to inject capital — lots of capital — Kumiszczka and the TechMaine board last year asked the Maine Legislature to guarantee an investment of up to \$100 million in venture capital that could be used to invest in Maine firms, with an agreement that the state would cover any potential losses.

Kumiszczka says now is the time to act to stir up capital, because he insists that accessible venture capital funds need to follow the recent research and development bond passed in November, which will inject \$55 million of R&D investment into the state. He says those willing to take the next step to develop the ideas that come out of the research and development phase are going to need capital. Or else, “we’ll lose the ideas we funded,” Kumiszczka says.

The fund of funds, as it is called, basically works by mobilizing capital from relatively conservative sources, such as banks, to use for far riskier ventures, such as biotechnology start-ups, which, when successful, can offer

lucrative returns. But Maine has to first secure conservative capital from a lender, which it would do by guaranteeing up to \$100 million. A legislative committee scheduled a Dec. 4 work session on the proposed fund bill. After listening to testimony, legislators decided to schedule one more work session before pushing the bill to the floor for a vote next session, which begins in January. Sen. Peter Mills, a Republican from Skowhegan who is sponsoring the bill, says support from committee members was enthusiastic.

Although Mills says that he was initially wary about the fund of funds when he first learned of it last year, he has grown to believe in it. “Frankly, I greeted it with skepticism,” he says. “It sounded too good to be true, and it was hard to understand. But it wasn’t hard to understand that the state’s credit was being placed at risk, and for what reason, what gain?”

The gain is that the fund manager would invite venture capital firms to invest in Maine companies, according to Catherine Renault, director of the state Office of Innovation. “We’ll need to work very hard to polish our companies to present to these guys,” she says.

In the handful of states that have implemented a fund of funds, “they have worked out awesome,” Renault says. Ten states have such funds, and three more are developing them. (For more on how Maine’s fund would work, see “Venture adventure,” this page.)

Oklahoma set up a \$100 million fund 13 years ago. Since then, 19 companies in

Oklahoma have received investment capital, and they in turn have created more than 1,000 jobs and increased economic activity in Oklahoma by \$695 million based on an economic multiplier effect, according to Renault. The only blemish in Oklahoma has been an \$8 million loss incurred after the dot-com bubble burst.

Peter Mills says that he would like to make sure Maine taxpayers are protected, not only from any huge bills that might result from bad investments, but also by ensuring they see some benefit from taking on such a risk. His instinct is to introduce a clause encouraging venture firms to at least look at Maine companies as they consider their investments. "There is a balance there," he says. "We should make sure [the fund manager] has enough freedom to produce a liberal return, but create either inducements or constraints to ensure that this benefit rebounds in the Maine economy."

Mills says he has been warned that enforcing tighter constraints could turn firms off or cause the fund to fail. Venture firms would not cherish being limited to a small market like Maine's. They would be challenged to find enough profitable companies here in which to invest the entire \$100 million and gain substantial returns, Mills says. Instead, venture firms will need diverse portfolios to bolster the fund, which

is in Maine's best interest.

Computing power

Besides finding more money for Maine, Kumiszczka is also trying to stimulate more education and train more students in the software development field.

And a new software testing and usability design center, as Kumiszczka envisions it, would attract local computer science students who could work at the center for credit, testing real-world software submitted by companies.

"Software testing and development is like a job shop," Kumiszczka says — in other words, it's a hands-on experience that'll give them the tools they need to find good-paying jobs after they graduate. Kumiszczka believes, as well, that too many companies currently use their customers as testers for their software, or outsource their testing needs because of a lack of local options. And he also suspects that liability issues will increasingly arise over software failures. Thus, anticipating a growing need for such a service, Kumiszczka says the testing center will be good business and good for businesses, as well as helpful for students.

Jim Smith, vice president of acquisitions at Unum in Portland, says the company now ships much of its insurance applications to

India for testing. While he says Unum would consider using the TechMaine center to assess its "hundreds and hundreds" of software programs, he anticipates the center could also be helpful in producing an employee pipeline.

Erik Carson, Westbrook's director of economic and community development, has submitted an application for \$300,000 in grant funding from the federal Economic Development Administration to support the testing center. He has applied in conjunction with the University of New England's pharmacology school and the city of Portland's proposed biotech business park on Rand Road. (Kumiszczka says he also will apply for \$200,000 from the Maine Technology Institute.)

Carson says Westbrook has teamed up with Portland and UNE because the software testing center fits into the region's overall push to become a bustling hub of biotechnology. "We're trying to build a life-sciences cluster here," he says, adding to a group that already includes Idexx, Artel, UNE and Maine Medical Center. "There is a constellation of stars spinning around this sun, which is life science."

The center's anticipated funding is expected to support the nonprofit center for two to three years before it becomes self-sustaining based on contracts with companies, Kumiszczka says. The center plans to hire about seven staffers and a new faculty person at the University of Southern Maine.

Meanwhile, Carson and Kumiszczka are negotiating for a space in Westbrook. They're tentatively looking at a 2,000 to 3,000-square-foot space at the Sappi Fine Paper mill in Westbrook. This space in particular is attractive because it's located in a 250-acre Pine Tree Zone that encompasses the mill. And the mill is now running at sharply reduced capacity, with much of the facility sitting empty. If new businesses moved into this zone they could apply for the tax breaks originally meant for Sappi, Carson explains.

"[The center] needs to be in a location that is going to work to encourage associated business to be nearby," Carson says about the center. "It will create a cluster."

"It's a holistic approach," Kumiszczka says. "Workforce development [and] economic development. We'll try to put all the pieces together to build technology in Maine and to build Maine's economy."

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Venture adventure

How a proposed \$100 million fund of funds would work for Maine

Technology advocates in Maine want the state to set up a \$100 million venture capital fund. To support this endeavor, Sen. Peter Mills, (R-Skowhegan) is sponsoring a bill that would set up a complex financial arrangement designed to stimulate new economic activity.

To launch the fund, the state would first invite a major funder — say, a bank like Deutsche Bank or Merrill Lynch — to provide the initial multi-million-dollar line of credit. Mills explains that several banks would likely bid on the program by offering competitively low interest rates, probably somewhere around seven percent. (The state will guarantee to repay the loan, even if the fund of funds tanks.)

After an investment loan is secured, an independent fund manager would then be hired to turn that money around and feed it to a diverse spread of venture capital firms. The selected venture capital firms would then bear the responsibility of picking companies to back financially. If the investments, which will inevitably be somewhat risky, pan out, the firms will pull in high returns, often 16% or more, according to Joe Kumiszczka, executive director of TechMaine, the Westbrook-based group that spearheaded the fund of funds proposal.

Yet if any of the investments fail, Maine would then have to issue the initial investor tax credits in the amount of the loss. In the worst possible situation, this could be up to \$20 million a year for five years. These tax credits, depending on how a statute is structured, may either be redeemed for cash or sold to another company that pays taxes here. But Maine would probably opt for the first option to prevent a messy tax-credit market from springing up, according to Catherine Renault, director of the state Office of Innovation.

Rebecca Goldfine

MAINE VOICES

Maine needs venture-capital stimulus

A plan to create a 'Fund of Funds' to aid emerging companies with high potential will return.

In this past legislative session, TechMaine, Maine's Technology Industry Association, was actively involved in an effort to increase the availability of capital for technology companies.

The legislative session nearly ended on a high note for TechMaine and others in the tech community who worked hard to pass LD 2320 – An Act To Stimulate Capital Investment for Innovative Businesses in Maine.

LD 2320 was passed by both the House and Senate, and would have enabled our state to create a "Fund of Funds" to grow Maine companies by leveraging private money. However, the bill will not take effect, as Gov. Baldacci chose to not sign it into law.

We strongly believe the Fund of Funds would attract new private capital to support high-wage ventures in Maine, and therefore we are committed to working with the governor and the Legislature next session to bring it to fruition.

Maine has a weak venture-capital market, often ranking in the lowest 10 percent in nationwide studies, and consistently ranking the lowest of all New England states.

Our inability to attract venture capital causes some of our most promising start-up companies to move to other, seemingly

ABOUT THE AUTHORS

Joe Kumiszcz is the executive director of TechMaine, the statewide association for technology companies, and **Peter Murray** is founder and chief technology officer of Quantrix, a Portland-based developer of financial modeling software.

more commercially viable areas. When this happens, we lose twice: We lose the promise of good jobs for our citizens, and we lose the tax revenues.

A Fund of Funds is a way to bridge the gap that emerging companies face in attracting capital when they transition

from start-up to commercial ventures.

Maine has done an excellent job in providing funding sources for start-up companies: the Finance

Authority of Maine (FAME), the Small Enterprise Growth Fund (SEGF), and the Maine Technology Institute (MTI) all have provided millions of dollars in start-up funds to innovative Maine businesses, much of it to develop new technologies.

However, emerging companies hit the funding wall once they move beyond the research-and-development or start-up phases.

The Maine Fund of Funds would build on the foundation created by these entities by creating better access to private venture-capital funding for our most promising enterprises.

While MTI, FAME, and SEGF

programs rely upon tax dollars, a Fund-of-Funds initiative creates a portfolio of private equity investment funds.

Equity firms would invest in the professionally managed Maine Fund of Funds, and would share a percentage of the revenues earned with the state. In return, they would receive a commitment that the state would cover a percentage of losses incurred if such losses were to occur.

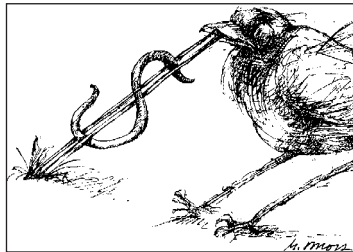
TechMaine has seen how successful Fund-of-Funds initiatives can be for other states: since its inception in 2006, the Utah Fund of Funds has created more than 700 jobs with average salaries of \$60,000.

Oklahoma estimates that its Fund of Funds has resulted in \$1 billion in positive impact to its economy, including a quintupling of venture-capital firms funding Oklahoma companies.

We worked hard within the past year to bring together our state legislators and government executives with venture capital partners and other successful Fund-of-Funds managers to develop legislation for Maine

This is complex legislation that involves some risk, but much potential reward. We're not ready to give up – we believe this is a good idea for Maine, and will work with our legislators and the governor in the next session to make the Fund of Funds a reality in our state.

We're eager to build new companies with high-paying jobs, grow our most promising businesses, and keep our best ideas here in Maine. Our future relies upon it.



Art by Geoffrey Moss