

# The Abell Report

*What we think about, and what we'd like you to think about*

Published as a community service by The Abell Foundation

## ABELL SALUTES: Resident Teacher Program: A Unique Program in Baltimore City Brings Non-Teachers into Teaching. There's a Lesson in it . . .

For years, in the Baltimore City School System, there had been a growing consensus that the pool of highly qualified, well-educated teachers was limited by the requirement that teachers new in the system hold an undergraduate degree in "Education." Although serving the best interests of the system in many ways, the requirement did have an unexpected negative consequence: the barring from the school system's faculty of an important group of mature, dedicated individuals.

Enter, four years ago and with support from The Abell Foundation, the Resident Teacher's Program.

### **Wanted; Teachers Not Trained to Teach**

*Baltimore City is looking for men and women who want to teach.*

*If you have never been trained to teach, but demonstrate intelligence, ability, and a relentless commitment to providing a future for our children...*

Responding to Help Wanted ads such as this one, and to the power of persuasion by word-of-mouth, hun-

*(continued on page 5)*

## The 2% Solution For Maryland: Increase Pension Fund Investment In Venture Capital

*The Hope and the Promise:  
Increased Returns and Fresh  
Stimulus For Local Economic  
Development*

### **At Stake: \$640 million**

Could the Maryland State Retirement and Pension Fund System, while adhering to sound investment principles, have grown its pension fund over the last ten years by an additional \$640 million, and at the same time, have provided stimulus to the Maryland economy? "2%" could have made the difference. Market returns over the last ten years support the idea that the fund could have achieved higher returns and greater economic stimulus by investing 2% of its assets in venture capital.

To benefit from similar gains in the future, the state's pension fund managers, with citizen understanding and support, need to adjust management philosophy to new realities. All who have an interest in the growth of the fund, and in the economic stimulus that such growth provides, need to reassess the state's investment philosophy, with a hospitable view towards the idea of increasing a commitment to venture capital.

### **Background**

Maryland, like any market in the country, depends upon high growth companies to fuel its economy and create new jobs. However, growth-oriented companies are considered more risky than traditional small businesses because they are developing new technologies or introducing new services and they may not recognize revenues for several years. Risk and financial exposure make it more difficult for these firms to obtain capital from traditional sources; venture capital, consequently, has become a critical source of funding for growth companies.

Venture capital is money that individuals and institutions invest in small, growth oriented companies through professionally managed intermediaries known as venture capital partnerships. Venture capital represents 68% of the funds that growth-oriented companies raise; it is an important source of financing for both start-ups and expansion. In 1994, venture-backed companies in Maryland employed 43,000 individuals and contributed \$2 billion in revenue to the local economy.

Nationwide, an increase in ven-  
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ture capital has helped to meet an increasing demand for risk-oriented investment dollars. Despite gains, however, some segments of the industry are underfunded, which may result in missed opportunity to create new jobs and industries.

Specifically, the nationwide boom in venture capital has neglected the following sectors:

1) Certain industries, such as biotechnology. In 1994, according to Ernst and Young, 1,308 biotech companies attracted \$679 million in venture investment, down from \$719 million in 1993. The lack of capital has forced unwanted mergers and acquisitions. Maryland is particularly vulnerable to biotech mergers and acquisitions because the state's biotech industry is younger and smaller and more likely to be acquired and moved. With the third largest concentration of biotech firms, Maryland should be concerned about the missed opportunities associated with a decrease in funding for this industry segment, and should be looking for ways to encourage capital investment in biotech.

2) Early stage companies and start ups. With large amounts of money under management and large blocks of investments from institutional investors, venture capitalists prefer to invest in large deals. One study by the National Venture Capital Association pointed out that venture capital partnerships prefer to make large single investments of

\$3 million or more, which precludes smaller start-up firms and early-stage companies that often need investments in the range of \$250,000 to \$2 million. Maryland, with a young technology industry and a number of new enterprises, stands to lose from this neglect, unless the state is able to encourage early stage investments.

3) Certain geographic markets, such as Maryland. While venture capital activity in Maryland has increased recently (since 1991 the region has recorded a 73% annual increase in the number of companies financed), Maryland still lags behind competitors California, Massachusetts and New York in the amount of venture capital invested in local companies. As Grotech Capital President Stuart Frankel pointed out in a 1994 article in Washington Technology, "There is a tremendous amount of growth...(but) not enough capital to serve that growth." While outside investors have been paying more attention to the region, it is preferable to have local investors since venture capitalists prefer to be physically close to their companies. Venture capital investments from out-of-state partnerships make local companies vulnerable to relocation.

Despite the nationwide increase in venture capital and a proven track record of success for those that invest in venture capital, Maryland may still be missing important opportunities to create jobs and develop new industries as dollars bypass certain industry segments and categories that are critical to the Maryland economy. Any further investment in venture capital through a mechanism like the Maryland Venture Capital Trust could have an impact on the local economy while

expanding the pension system's return on investment.

## Definitions

Venture capital is appealing to investors for a number of reasons. Historically, venture capital funds have achieved superior returns over the long run compared to other investment opportunities such as stocks and bonds. Secondly, venture capital is not tied as closely to the stock market as other assets, and because venture capital investments take longer to mature, the resource may help to mitigate portfolio risk. A third benefit to venture capital investing is the economic development that often results from investments in new growth companies.

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## *The benefits to Maryland . . .*

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Venture-capital backed companies are the fastest growing companies and add substantially to the economy; they grow faster than companies that do not enjoy the infusion of venture capital.

Maryland has benefited from growth in venture capital. In 1994 alone, venture-capital backed companies contributed \$2 billion in revenue (in the form of wages, purchased goods and taxes) and provided 43,000 jobs to the Maryland economy.

How does venture capital work to get its results? As an investment instrument, venture capital is one of the most patient forms of funding; its dollars go to fund young growth companies. Venture capital funds will invest in several growth companies over a 5 to 10 year cycle.

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Over time, 20% of these companies hold the potential to do quite well and pay back significant multiples; 10% may do extremely well, and pay back the private investors at even more significant multiples, generally, by going public, the remaining 70% will probably not have positive returns.

Availability of venture capital at the risk stage of development allows a company to continue on a fast track; to grow and employ people; to put dollars into circulation; and to enter into critical development agreements. It is patient money at a key time when the fledgling enterprise needs it in order to grow quickly. Enterprises in start-up situations cannot command capital from traditional financing; banks are more likely to go with middle-stage companies. Without venture capital and its related management assistance there simply wouldn't be as many young entrepreneurial companies in the marketplace.

### **Pension Funds: Leading Investors In Venture Capital**

Venture capital funds operate by attracting investment dollars from a variety of sources and investing these dollars in companies through limited partnerships known as venture capital funds. Historically, investments have come from individuals, corporations and foundations. At the end of the 1970's, the U.S. Department of Labor's interpretation of ERISA regulations (Employment Retirement Income Security Act) were amended to give public pensions funds the ability to invest in venture capital investments. Ever since, public pension funds have been the fastest growing source of new venture capital investments. In 1993, public and pri-

vate pension funds represented the majority, 59%, of the total investments in venture capital funds, versus 36% in 1989. Public pension funds now represent close to 30% of the total investments in venture capital funds which total over \$1 billion a year. The pension funds of large corporations like BG&E, AT&T, GE, and IBM are also active investors in venture capital.

However, foundations and endowments are more active than other institutional investors in venture capital investing. In a 1992 study, endowments and foundations allocated 10.4% of their fund dollars to alternative assets including venture capital, versus 4.9% for corporate funds and 2.5% for public funds (which are most often the largest in total dollars).

### **The Maryland Venture Capital Trust; Creation and Performance**

In 1989 The Abell Foundation published a report that called for more pension fund investments in venture capital. The report argued that Maryland should follow the examples of several states across the country and invest a small percentage (1 to 5) of its pension funds into venture capital, with preference given to venture capital partnerships that committed to make their best efforts to invest in Maryland companies. The report concluded, "Investing in venture capital can be justified on the merits of superior investment return, reduction of risk through diversification, and support and stimulus for the state's economic well being."

The Maryland General Assembly subsequently passed a resolution recommending that the Maryland State Retirement and Pension

System consider investing a portion of assets in venture capital as a way to boost returns and reduce risk for the pension fund, and to stimulate the development of Maryland companies. The Maryland Venture Capital Trust was established with an initial investment of \$2 million from the state's general fund. Within the following two years, the trust raised another \$17.1 million from the Maryland State Pension and Retirement System (\$1.5 million) and the Employees Retirement System of the City of Baltimore and the Fire and Police Employees Retirement System of the City of Baltimore (\$2.1 million). As of June, 1994, \$19.1 million had been committed to eight venture capital partnerships, with each partnership committed to make "best efforts" to invest in Maryland companies.

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### ***The state's economic goals have been achieved***

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Although it is still too early to assess the financial performance of the Trust (since most venture capital investments take years to mature), data on the progress of the partnerships indicate that the state's economic development goals have been achieved. Since the Maryland Venture Capital Trust's initial investment of \$19.1 million, the eight venture partnerships have invested \$19.3 million in 23 Maryland companies which employ 1,053. Because the eight funds still have \$50 million available in their funds, more Maryland companies might benefit from further investment.

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## Survey Results

A survey conducted for The Abell Foundation found that the median allocation for venture capital was 2% of total fund dollars among the public pension funds surveyed with programs in venture capital. Approximately 58% (15 of 26 funds) of the pension funds invested in venture capital had allocation targets for the amount of total fund dollars to be invested in venture capital. The average allocation for venture capital per fund among these programs was 2.4% of the total fund with a range of 0.1% to 7.5%. The primary purpose for investing in venture capital for almost all of the pension funds surveyed is to increase the overall expected return of the portfolio. The target rates of return, however, varied dramatically by fund, ranging from goals of 8% to over 20%. Most portfolios set a target return at a specific number of basis points above a widely used market index such as S&P 500, CPI, NASDAQ or long term equity index.

In addition to return objectives, most of the funds surveyed had diversification goals for their venture capital portfolios among stages of investment (seed, early, later, etc.), industry and investment managers.

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### *Many states are seeking to develop "best effort" goals for investing in-state*

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Almost all of the funds surveyed invested in venture capital through venture capital funds (private limited partnerships), as opposed to directly in growth companies. A number of public pension funds have goals to invest in-state or regionally

but most do not have mandates to do so. Of the 21 responses to the survey, three states had a formal regional investment strategy, either as an explicit goal or mandate—Maryland, Ohio, Pennsylvania. Massachusetts has a new in-state pension investment program in development as well as a successful Massachusetts-only private venture capital fund that was created 14 years ago with state and federal funds, which now accept pension investments. Many states are seeking to develop "best efforts" goals for investing in-state.

And finally, the overall returns of the venture capital and alternative investment portfolios varied dramatically among the pension funds surveyed. Some of the newer funds (i.e., less than 5 years old) have produced returns in the 18% to 20% range, while some other funds (i.e. over 10 years old) have produced negative returns. The negative returns are characteristic of venture funds originating in the mid-1980's, a period marked by a rapid increase in venture capital and a resulting competition for good investments. Overall, while it may be too early to conclusively assess pension funds' return, their recent investments in venture capital have been performing to industry expectations, which exceed traditional market opportunities.

### State Strategies

Massachusetts: The State of Massachusetts has achieved positive returns on its venture capital investment through a unique private venture capital fund that has invested in only Massachusetts-based emerging companies. It has produced over 17% annual return in 14 years.

Pennsylvania: In 1992 a statute

governing the state's pension fund's investment policies was changed to allow the pension funds to invest in venture capital partnerships. The fund has a goal to invest 2% (\$290 million) in venture capital by 1998. Of this, 24% (\$69.6 million) will be targeted for Pennsylvania companies. Targeted return is the S&P-500 plus 5%

Virginia: Virginia has been successful in dedicating a significant share of its assets to venture capital over a short period of time. Venture capital now represents 1.5% and is expected to increase to a level within 1.8% to 2.5% over the next 5 years.

### Recommendations

The Maryland State Pension and Retirement Systems and other public pensions in the state should increase their venture capital investments to 2% of total fund dollars. Public pension fund investments in venture capital have been growing

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### *Maryland's system should reevaluate the size of its allocation to venture capital*

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dramatically over the last decade and a half. Over 30 states in the U.S. have programs underway or in development that invest in venture capital. The majority of these state pension funds have approximately 2% of their total fund dollars invested in venture capital.

Since venture capital invested by experienced venture capitalists can raise the expected rate of return of portfolios, provide portfolio diversification benefits, and further stimulate the regional economy, it

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is recommended that Maryland's retirement and pension system re-evaluate the size of its allocation to venture capital and increase its investment from 0.1% (\$15 million) to at least 2% (\$320 million) of total fund dollars, a national average for public pension funds.

Venture capital has outperformed traditional asset classes by 5% over the last 20 years. In addition, venture capital has low correlation with other asset classes and therefore can raise the expected return of a portfolio without increasing its overall expected risk.

A prudent strategy for the Maryland pension fund would be to invest 1% (\$160 million) of the total pension fund assets in venture capital over the next five years and an additional 1% over the following five years, bringing the pension fund's allocation to venture capital up to the 2% national average of total fund dollars (\$320 million) in ten years.

Pension funds should diversify within their venture capital portfolio aiming at a range of venture capital—seed, early, and later stage venture capital—as well as other private equity sub-classes.

Pension funds should hire qualified professionals to help select the venture funds that will receive pension fund investment. Pension funds in Maryland should initiate policies to encourage investment within the state. Maryland and the Mid-Atlantic region have a supply of experienced venture capitalists. In addition, the state has a growing supply of ventures with superior growth potential. These two strengths create a healthy environment for investing in Maryland. To encourage investment in-state, pension funds

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## ABELL SALUTES: The Resident Teacher Program

*(Continued from page 1)*

***“The lesson learned is that the chief beneficiaries of the program are, in the end, are the students.”***

dreds of men and women—young and not-so-young, black and white—sought the opportunity and the challenge to teach in an urban school system without having a traditional degree in Education.

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***“You have to be willing to work very hard”***

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The program was implemented. Training for candidates included (and includes) classroom observation, pre-service institutes, in-school mentors to provide experienced oversight, weekly seminars, and active support through field supervision. Of this demanding training and preparation to become a Resident Teacher, the 1990 Baltimore City Teacher of the Year Cranston Dize, who teaches in the program, commented, “You have to be tough, willing to work very hard, and determined to care about every child in the classroom.”

The fundamental assumption of the Resident Teacher Program is that the ability to teach grows in people while they work at teaching in the best of all environments: schools. It is geared specifically to individuals who may be changing careers and who do not have a lot of flexibility with their time before they begin teaching.

Starting this year there will be a new program for career changers wishing to become special education teachers.

The pre-service training for the Resident Teacher Program entails

(1) an integrated methods course at a local college in early summer and (2) a two-week training institute in August. Once the school year begins, teacher growth is shaped by group interactions with peers and experienced BCPS teachers, inquiry into teaching and learning, and personalized mentoring.

What have been the results of the Resident Teacher Program? In terms of raw numbers, the Baltimore City School System has been able to add over 200 dedicated teachers to its faculty. In 1992, 39 resident teachers were added; in 1993, 99; 1994, 42; and in 1995, 53.

How does the effort help in improving the education of Baltimore City's Public Schools—day to day, classroom by classroom, student by student?

The mission of the program, according to Helen Atkinson, staff specialist with the program, is twofold. First, to expand the numbers of qualified teachers available to the system, and, second, to provide within those additional numbers the mature (the average age is 35) male teachers (and 50 percent of those hired are males), for whom there is a special need in Baltimore City. On both accounts, Ms. Atkinson says, the program is working. “The lesson learned is that the chief beneficiaries of the program, are, in the end, the students. Their education experience is infinitely enriched by the maturity and varied backgrounds that the Resident Teacher Program brings to the classroom through these most unusual individuals.”

in Maryland should establish "best efforts" policies for investing public dollars in Maryland, such as those established by the Maryland Venture Capital Trust.

***Maryland should explore other successful models . . .***

In addition to a "best efforts" policy, Maryland should explore other successful models for regional investing such as the Massachusetts Technology Development Corporation, a Massachusetts State sponsored venture capital firm which has achieved a superior long-term return (17.5% over a 14-year period) from investing in only Massachusetts-based emerging companies. (For an earlier review of the MTDC performance, see The Abell Report, March-April, 1994.) With the right model, an investment program in venture capital should be able to achieve superior returns and impact the local economy, positively and significantly.

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This report concludes, as did The Abell Foundation report six years ago: When professionally managed, venture capital can increase the expected rate of return of the portfolio; provide diversified benefits to the portfolio; and further stimulate the economy.

Maryland should waste no time in moving forward.

The following back issues of The Abell Report are available.

Check request and send to:

The Abell Foundation  
111 S. Calvert St.  
Baltimore, MD 21202

PLEASE SEND ME:

- "Baltimore Unbound: New Study Warns: Foundering Baltimore City Could Pull Baltimore Region Down With It; Presents new Recommendations For Survival of Suburbs, City.
- Hopkins School of Hygiene and Public Health is "Making a difference — from Baltimore to Bangladesh."
- The Case For Regional Cooperation: Regions, Not Cities, Will be the Competitive Units of Tomorrow.
- Warehouses: For Baltimore City, Ugly Ducklings With Beautiful Potential; At Stake are Income and Jobs.

Name: \_\_\_\_\_

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**Some Recent Grants by The Abell Foundation**

**American Farmland Trust \$20,000**  
For expenses related to the development of geographical information systems (GIS) maps of economically and environmentally strategic farmland in the Chesapeake Watershed.

**American Red Cross \$100,000**  
For relocation expenses to move National HLA Reference Laboratory to Baltimore City's Empowerment Zone.

**Baltimore City Health Department \$50,125**  
For reduction of caseloads of the Reaching Families Early Program, a case management service for substance abusing women and their infants; and for an evaluation of program outcomes and cost effectiveness.

**Baltimore City Public Schools \$20,000**  
For capital improvements and retrofitting of three classrooms for the Ingenuity Project, an accelerated and intensive math and science program for 120 selected students in grades 6 and 7.

**Baltimore Substance Abuse Systems, Inc. \$16,600**  
For the purchase of a Relational Database Management System to link existing tracking systems for substance abuse treatment centers.

**Citizens Planning and Housing Association \$32,000**  
To prepare a series of maps and a report summary on the economic impact of urban sprawl and growing concentration of poverty in urban center.

**Downtown Partnership of Baltimore \$40,000**  
A study to expand the Video patrol Program providing safety surveillance in downtown Baltimore.

**House of Ruth \$500,000**  
Capital funds for expansion to double capacity for shelter and treatment of victims of domestic violence and their families.

**Maryland Food Committee \$35,000**  
For the Direct Feeding Program at soup kitchens and emergency shelters.