

### **Executive Summary**

Gov. Bob Taft's Third Frontier program to back high-tech business has become an increasingly important part of Ohio's efforts to build a stronger economy. Despite the defeat of Issue 1, which would have allowed Ohio to borrow \$50 million a year for a variety of development purposes, more than \$100 million a year is being spent on the Third Frontier program.

One part of the program, the Third Frontier Action Fund, has been operating for five years. Even before a round of grants approved in October, it had awarded 80 grants worth \$55 million to universities, private companies, and other entities that try to spark high-tech development. Though the program has undergone various changes, its purpose has remained much the same since early on: Providing financial support to projects that contribute to technology-based economic development in Ohio.

The program began as an effort to attract more federal research money to Ohio. The grants now focus on three areas: Early-stage capital for start-up or young technology companies, collaborations to commercialize new technologies, and Gov. Taft's Fuel Cell Initiative. Grants are awarded on a competitive basis and require matching funds. Technology commercialization grants have accounted for half the number of TFAF grants awarded, and most grants recently have gone to private companies. Most grantees have been located in Cuyahoga or Franklin counties.

The largest recipient of TFAF money -- \$4.8 million altogether in four grants over more than five years -- is the Glennan Microsystems Initiative, which aimed to research and commercialize tiny sensors and other devices that can function in harsh environments. Glennan has helped move products closer to commercialization, supported new companies and drawn more backing for its mission, leveraging \$35 million in other support. However, the initiative has generated less than 20 new commercial jobs.

Altogether, the TFAF program's impact on the commercial economy has been slight, and the program has not been sufficiently accountable:

**Jobs:** Many grantees have not aimed directly at creating new positions, and others could yet develop into more substantial employers. However, the Third Frontier Action Fund has not been a big job creator. Total new jobs number in the hundreds. An exact count of jobs created by TFAF grantees is impossible because reporting such figures is not required.

**New products:** Thus far, few products involving TFAF grants have been commercialized. In some cases, companies are making headway, and the program could help generate more successful businesses. But in most instances that will take more than a year or two—or even five, as Glennan's experience illustrates.

**Early-stage capital:** A quarter of the grants have gone for early-stage capital, in whole or part. Altogether, seed and venture funds with TFAF support have raised at least \$134 million. "Between what the (Third Frontier Action Fund) has instigated and what the

private market has, there's quite a lot of venture capital here, compared to two years ago, which is really a sea change," said Frank Samuel, Gov. Taft's science and technology adviser. However, we lack a clear idea of how much early-stage capital the state needs.

The new venture funds have supported more than two dozen new enterprises, in businesses ranging from spinal implants to Internet security. One TFAF-supported fund, Early Stage Partners, has invested in SupplierInsight, a Cleveland software company whose services include helping companies find and evaluate suppliers in low-cost countries. It boasts of having "over 100 trained auditors in China ready to complete supplier facility reviews." The likely outsourcing of manufacturing jobs to China conflicts with the Third Frontier goal of increasing manufacturing investment in the state.

Three TFAF grants benefited companies that later decided to move out of Ohio. They included Cincinnati Machine, which received aid through grantee Techsolve Inc. in developing a new machine tool but shut its Ohio factory; ChipRx Inc., an Ohio State University spin-off company whose founder moved to California and will split its operations between there and Kentucky; and Quark Biotech Inc., which is eliminating its Ohio staff and will do its clinical development in California. Spokespersons for these grantees say they fulfilled their obligations, and grant rules in effect at the time did not require recipients to stay in Ohio.

The Ohio Department of Development (ODOD) has stiffened the rules requiring Ohio benefits since those grants were made. Now, a grantee that moves out of Ohio may have to repay the state the monies it has received, plus interest. However, the department is an inattentive monitor – it appeared to be unaware of ChipRx's relocation, for example.

Grantees are required to report quarterly to the Department of Development. The department says that it asks grantees when report information is missing regarding their progress, but did not respond to a request for details. ODOD keeps no list of when it has withheld funds over questions relating to grantees' performance. This record-keeping policy – or lack of one – does not allow the public to know whether the program is functioning as it should.

Two Columbus-area companies provide much of the evaluation for the state for TFAF applications. ODOD has not always required adequate competition for these contracts. For instance, BizLogx LLC of New Albany, Ohio, was the only company that applied to evaluate the fiscal 2004 and 2005 early-stage capital grant proposals.

If state efforts such as the Third Frontier Action Fund are to succeed they must have clearly defined goals, for both the program as a whole and for individual grantees. Grant evaluators must be selected through a clearly competitive process. The state should monitor the measures taken to ensure Ohio benefits and implement more such reforms. More systematic effort must be made to ensure that grantees are delivering on their promises. Taken together these steps would add accountability to the Third Frontier Action Fund.