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MEMORANDUM

1976

TO: Edward DLG. Pangelinan, Chairman
Marianas Political Status Commission

SUBJECT: Development Corporations

This memorandum provides background information on the purposes, structures, and operations of three forms of economic development corporations in the United States. While probably none of these forms will meet all of the requirements of the Marianas, they do provide a sense of the scope of possibilities and even suggest some of the guidelines which might be followed in creating an organization specifically for the Marianas. It should be emphasized that while it is useful to think about guidelines at this early stage, it would be premature to become committed to any given organizational form. The Marianas Political Status Commission should be flexible in its thinking, and it must be realized that the kind of development corporation which will be most appropriate undoubtedly will be determined by the terms of the settlements resulting from the negotiations.

Review of Development Corporation Forms

Each of the three kinds of development corporations discussed below has been created to serve specialized purposes. However, each of them also has features which might be appropriate for inclusion in a Marianas development corporation.

Corporations Established by the Alaska Native Claims Settlement Act (1971)

Regional and village corporations have been established to manage the $960 million in claims settlement monies provided to Alaskan Natives (Eskimos, Indians, Aleuts) under the Alaska Native Claims Settlement Act. The primary functions of the corporations are:

(1) To decide on the uses and distribution of settlement funds;
(2) To manage expenditures for the purposes adopted; and
(3) To carry out investment programs based on the decisions of the Native community.

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Structure: The regional corporations, each operating in one of 12 geographic regions in Alaska, are the initial recipients of settlement monies to be paid by the U. S. Government over a period of 20 years. Each regional corporation shares its settlement payment with village corporations established for each village in the region, and with individual Natives who are registered in the region. Each Native registered in a region is issued shares of stock in the regional corporation. In addition, each Native is issued stock in a village corporation of the village of which he is a member.

The stockholder of regional and village corporations vote for boards of directors and receive dividends and distributions. The stock of individual stockholders may not be sold, pledged or subjected to a lien or judgment execution for a period of 20 years. Upon the death of a stockholder, ownership of his stock can be transferred in accordance with his will and testament or under the laws intestacy. However, if the holder through inheritance is not a Native, voting rights of the stock are suspended for the 20-year period. In the event the deceased stockholder fails to dispose of his stock by will and has no heirs, the stock is returned to the corporations.

Operations: Each regional corporation has all the powers of an Alaskan business corporation and may operate as a profit or non-profit corporation. Regional corporations must approve the incorporation of village corporations, and funds for village corporations can be withheld by the regional corporations until the village corporations have submitted satisfactory plans for the use of funds.

There is considerable flexibility in the use that can be made of the funds retained by the regional corporations and of the funds made available to the village corporations. The corporations are expected to promote the economic development of the Natives and the Native villages. This will be done through loans and grants for housing, health facilities, education, commercial enterprises and similar activities that will promote the welfare of the Natives.

Because of the limited amount of time which has passed since the formation of the Native corporations, it is not possible to assess or evaluate their activities. However, the structure of these corporations would permit the implementation of a variety of development strategies. The basic choices of the corporations are: (1) to spend the settlement funds to meet immediate needs in the regions and villages, (2) to invest the funds to generate income flows over time, or (3) to spend part and invest part The last seems the most likely choice and, if done skillfully, can provide a continuously rising level of living for the Alaskan Natives. By investing a gradually increasing share of the annual payments so that the income from investments would equal the annual payout to individuals by the twenty-first year, the Natives would have a permanent income from their investments.

Native corporations might also manage their affairs to develop sources of funds and make investments so that over time an increasing amount of funds is available for social development. This assumes that in addition to claims settlement monies, the corporations can obtain government loans, private investment, and Federal grants. Corporate funds can be invested in property or real estate, stocks and bonds, or ownership of income producing projects. The last probably would provide the greatest benefits to the Native community since it would provide jobs, as well as income.

Community Development Corporations (CDC)

The concept of Community Development Corporations was developed under the Special Impact Program of the Office of Economic Development for the purpose of helping to solve the economic and social problems of both depressed inner-city and rural areas.

The aims of the CDC program are rather broad in scope, including social as well as economic development. Basically, these aims include: (1) control of the economic resources, land and business by the community; (2) physical development of the community, including housing and commercial center construction; (3) job creation and human resource development through CDC-financed business ventures; (4) an attempt to build a business-community partnership to make the resources of the business sector available for community development; and finally, the building of community support for community development institutions.

Structure: CDCs may be structured as either profit or non-profit organizations. In either case they are set up as corporations, with boards of directors or trustees to govern the affairs of the corporation and a hired staff to handle day-to-day administration and to carry out policy.

In most cases CDCs have been set up as non-profit organizations, especially as there is a tax benefit to this method in the United States. However, a CDC may be set up as a public corporation which sells stock directly to community members, and operates for profit to the stockholders. This may have the advantage of more direct community control and accountability to the community.

When a CDC is not owned directly by the community, it must have a sponsor, a group of businessmen, or a coalition of local interest groups or organizations who form the corporation and select the board members. In this case, the CDC will represent the needs of the various elements of the community only as well as its sponsor does.

Operations: Community Development Corporations were funded by grants from the Office of Economic Opportunity under the Special Impact Program

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beginning in 1967. However, the Community Development Corporation must also raise investment money for its enterprises from the community, from local businessmen or other organizations within the community.

Ventures undertaken by CDCs have been primarily of two types: pro- perty development or construction and non-property development. Most development enterprises have been in the non-property category: ventures in manufacturing, retail and service sectors. CDCs may co-sponsor new ventures with other business or community groups, or they may set up subsidiaries to run enterprises. Business ventures of this type may be sold directly to private investors as they become profitable, or stock may be issued in a holding company.

In general, CDCs in the United States are regarded as having pro- vided a fairly flexible institution for channeling funds for community de- velopment. On the whole, they have had the strong support of the people of their communities, although the ultimate issue of accountability to the com- munity has not been adequately resolved.

Local Economic Development Corporations (LEDC)

The Economic Development Administration of the [illegible] Department of Commerce encourages the creation of local economic [illegible] cor- porations as a tool for economic growth in small, poor [illegible] organizations are local in formation and control, are able to [illegible] talent and energy, and can channel financial resources into community busi- ness ventures and ownership.

The basic purpose of an LEDC is to improve the economic status of the residents of the community served, to upgrade skills and income, and to provide opportunities for potential entrepreneurs and managers. To do this, the LEDC may conduct research on local business potential and in- vestment opportunities, provide managerial and technical assistance to new or expanding business, provide financial assistance in the form of high-risk loans or loan guarantees, and acquire buildings or equipment for subsequent sale or lease to community businesses.

Structure: Most LEDCs are organized as non-profit membership corpor- ations. Non-profit status is essential to obtain exemption from income taxes, but in addition, the corporation must limit its activities to charitable, scien- tific and educational purposes and also restrict any political activity if it is to have tax exempt status.

LEDCs have adopted various patterns of community participation de- pending upon the type of activity the corporation is engaged in. Eligibility requirements for membership are prescribed in the articles of incorporation for the LEDC. One common structure limits membership in the LEDC to community residents or to persons who have demonstrated special interest

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in the community's economic development. The elected representatives of established interest groups are sometimes prescribed as members. This would include business, social, religious, social welfare and educational groups. Such groups are also sometimes designated to elect the board of directors of the corporation.

Some LEDCs are organized on a profit-making rather than a non-profit basis. In such cases, provision is normally made for distribution of earnings to community residents. These corporations are normally stock, rather than membership, organizations. They are, of course, subject to the U.S. Internal Revenue Code and pay income taxes. The control of these corporations depends upon: (1) the rules established for issuing various classes of stock, and (2) how each class is weighted for voting purposes. These factors can be arranged to give control to community representatives, to directors, to employees, to managers, or to a combination of these.

Operations: LEDCs have been used to support a wide variety of enterprises including assisting small businesses through Small Business Loan Companies, establishing franchised businesses, consumer and producer cooperatives, housing projects, and, in some cases, entering into joint manufacturing ventures with private firms.

Small Business Investment Companies (SBIC[illegible] long-term [illegible] funds and venture capital to small business concerns. These organizations also provide management consulting services to small business concerns. SBICs qualify under the Small Business Investment Act of 1958 for long-term (15 year) loans from the Small Business Administration. The SBIC must raise private capital to qualify for such borrowing and may borrow 200% of the private capital invested or even more under certain circumstances. The LEDCs are a source of such private capital. Small Business Investment Companies have had a remarkable record of growth and a much smaller rate of failure than is normal for new business ventures. The existence of adequate capital and of the ability to provide managerial assistance to their clients are generally credited for this success.

The LEDC can assist entrepreneurs in establishing franchised businesses. For an LEDC that is attempting to establish a range of retail facilities--from dry cleaners to shoe stores to supermarket to restaurants--in a community, the development of a franchising shopping center offers one possible technique. The franchisor normally assumes responsibility for training, equipping, supplying, and supervising the business. However, the LEDC can assist the local businessman in his negotiations with franchisors and provide equity capital if he needs it.

Consumer and producer cooperatives often require organizing assistance, initial financing, and managerial assistance and are structured in a manner that makes them suitable for LEDC sponsorship. They have open membership, membership control of the enterprise, distribute profits to the membership in proportion to the members' patronage, and sell to the membership at competitive market prices.

Housing projects are often supported or undertaken by LEDCs. This requires an experienced development team, a suitable site, and a financing package. A development team should include: (a) a sponsor (the LEDC), (b) an investor to furnish "seed" money and long-term equity, (c) a builder, (d) an architect, (e) an attorney, and (f) an accountant. Long-term mortgage funds are available from the Department of Housing and Urban Development under certain conditions.

Manufacturing corporations and LEDCs often enter into joint ventures. Industrial development is desirable because of the jobs it creates and the general strengthening that it brings to a local economy. A large, industrial corporation, will, under certain conditions, join with an LEDC to create a new industrial facility. The ownership and control of such a facility is a matter for negotiation between the LEDC and the corporation. These negotiations depend on such factors as: (a) the extent of integration that is required with the parent company, (b) the form of venture that is most efficient and economical, (c) the market for the product and its relationship to the parent company, (d) the availability of skills and managerial talent and their relationship to the parent company and (e) the expectations of the parties as to the sharing of equity in the venture.

Possible Guidelines For A Marianas Economic Development Corporation

The range of development corporations which have been established in the United States is certainly broad enough to insure that a development corporation to meet the specific requirements of the Marianas can be created. Further, if a Marianas Economic Development Corporation is carefully conceived, it will provide a vehicle for access to the resources of many Federal departments and agencies. In general, it appears that the purposes of establishing a Marianas Economic Development Corporation should be:

(1) Indigenous Control of Development. The development corporation should provide a means whereby the effective control of economic and social enterprises in the Marianas is retained by the people of the Marianas.

(2) Development of Financial Leverage. The development corporation should be structured to attract capital not otherwise available from public and private sources. It should be capable of serving as the recipient of Federal department and agency loans and grants as well as to serve as a partner with private parties willing to provide equity capital for development ventures.

(3) Development of Infrastructure. The development corporation should supplement formal government programs to improve community facilities, utilities and housing.

(4) Development of Industry. The development corporation should provide basic capital and technical assistance in expanding the industrial base of the Marianas. It should be capable of providing equity capital, loans and operating expertise to establish new ventures and to expand older enterprises.

(5) Development of Manpower. The development corporation should create the opportunities and provide the training necessary for the people of the Marianas to acquire the skills and receive the rates of pay which will provide them with meaningful and prosperous lives.

As the negotiations for the establishment of the political status of the Marianas proceed, it will be possible to determine more precisely the amounts of capital that could be made available, and to better assess the role which might be played by a development corporation. In the meantime, a continuing review of possible corporation structures and functions will provide a basis for rational decision-making in the future.