AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 115–400

THE INNOVATION ECONOMY, ENTREPRENEURSHIP, AND BARRIERS TO CAPITAL ACCESS

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

JULY 25, 2018

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PUBLISHING OFFICE
31–302 WASHINGTON : 2019

JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

HOUSE OF REPRESENTATIVES
ERIK PAULSEN, Minnesota, *Chairman*
DAVID SCHWEIKERT, Arizona
BARBARA COMSTOCK, Virginia
DARIN LAHOOD, Illinois
FRANCIS ROONEY, Florida
KAREN HANDEL, Georgia
CAROLYN B. MALONEY, New York
JOHN DELANEY, Maryland
ALMA S. ADAMS, PH.D., North Carolina
DONALD S. BEYER, JR., Virginia

SENATE
MIKE LEE, Utah, *Vice Chairman*
TOM COTTON, Arkansas
BEN SASSE, Nebraska
ROB PORTMAN, Ohio
TED CRUZ, Texas
BILL CASSIDY, M.D., Louisiana
MARTIN HEINRICH, New Mexico, Ranking
AMY KLOBUCHAR, Minnesota
GARY C. PETERS, Michigan
MARGARET WOOD HASSAN, New Hampshire

COLIN BRAINARD, *Executive Director*
KIMBERLY S. CORBIN, *Democratic Staff Director*

CONTENTS

Opening Statements of Members

Hon. Erik Paulsen, Chairman, a U.S. Representative from Minnesota 1
Hon. Martin Heinrich, Ranking Member, a U.S. Senator from New Mexico 2

Witnesses

Mr. Phil Mackintosh, Global Head of Economic Research, NASDAQ 5
Ms. Rachel King, CEO, GlycoMimetics 7
Ms. Lisa Mensah, President and CEO, Opportunity Finance Network 9

Submissions for the Record

Prepared statement of Hon. Erik Paulsen, Chairman, a U.S. Representative from Minnesota 28
Prepared statement of Hon. Martin Heinrich, Ranking Member, a U.S. Senator from New Mexico 29
Prepared statement of Mr. Phil Mackintosh, Global Head of Economic Research, NASDAQ 31
Prepared statement of Ms. Rachel King, CEO, GlycoMimetics 40
Prepared statement of Ms. Lisa Mensah, President and CEO, Opportunity Finance Network 49
Prepared statement of Mr. Michael Brown, General Partner, Battery Ventures 84
Slides submitted by Representative Maloney
Fact: Business lending has increased 75% after Dodd-Frank 93
Total number of banks in U.S. (1998–present) 94
Response from Mr. Mackintosh to Questions for the Record Submitted by Senator Sasse 95
Response from Ms. King to Questions for the Record Submitted by Senator Sasse 96
Response from Ms. Mensah to Questions for the Record Submitted by Senator Sasse 97

THE INNOVATION ECONOMY, ENTREPRENEURSHIP, AND BARRIERS TO CAPITAL ACCESS

WEDNESDAY, JULY 25, 2018

UNITED STATES CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to call, at 10:03 a.m., in Room 1100, Longworth House Office Building, the Honorable Erik Paulsen, Chairman, presiding.

Representatives present: Paulsen, Comstock, Handel, Maloney, and Delaney.

Senators present: Lee, Heinrich, and Peters.

Staff present: Ted Boll, Colin Brainard, Daniel Bunn, Ryan Ehly, Hannah Falvey, Connie Foster, Ricky Gandhi, Colleen Healy, Beila Leboeuf, Allie Neill, Neomi Parikh, Ruben Verastigui, Kyle Westra, Jim Whitney.

OPENING STATEMENT OF HON. ERIK PAULSEN, CHAIRMAN, A U.S. REPRESENTATIVE FROM MINNESOTA

Chairman Paulsen. I call the committee hearing to order.

The United States has fallen to 11th place in the 2018 Bloomberg Innovation Index, and one thing is clear: Our job as policymakers is to figure out how to find the right mix of policies to spur innovation along. After all, economists agree that innovation is critical to growth and prosperity, and with the headway we have made since the passage of the Tax Cuts and Jobs Act, this momentum must continue.

Innovators start their work from a difficult place. After all, great ideas don't appear fully formed. They take research, development, and testing. Innovation is just as likely to happen in a suburban garage as it is in a corporate lab. That is because people of all walks of life can come up with the next big thing.

Are we advocating for the best policies to assist that? The Joint Economic Committee has held two previous hearings on this topic. Witness testimony, combined with analysis by our staff of economists, makes clear that too many barriers stand in the way of innovators and the life-improving ideas that they have to offer.

Today's hearing is about innovation, entrepreneurship, and barriers to capital access, and how can we ensure that innovators have access to financial resources they need to succeed. Nearly 70 percent of all startup businesses received less financing than they ap-

plied for. Nearly 28 percent of startup businesses were not approved for any financing at all.

Innovators know that if an idea is entirely new, it shows promise, the first challenge is to finance its development. As such, each innovator has to, not only create something entirely new, but also fund the work involved by means that require more effort and persuasion than simply applying for a commercial bank loan.

Access to capital is one of the most challenging parts of starting a new business, especially in the tech sector where companies are at the forefront of new technologies and are developing products and services for which there is no track record. The risks are high, and subsequently, it is difficult to raise money from investors.

For there to be progress, we need to remove obstacles to raising seed capital. Take, for example, a company going public via an IPO has long offered real advantages. Overregulation, however, has driven down the number of IPOs which deprives the entrepreneurial ecosystem of capital access.

We should take a second look and modernize this system so that we would remain competitive. We have already taken major steps to help. The Tax Cuts and Jobs Act included several provisions that may be helpful in expanding capital access. Ways and Means Committee Chairman Brady is embarking on tax reform 2.0, and now we must take an innovation-friendly approach that increases incentives to invest in new companies and technologies.

The government itself is not and can never be the prime mover in the world of innovation. Washington shouldn't be subsidizing particular companies or activities in the hopes of winning big, because picking winners and losers goes against America's entrepreneurial spirit and undermines the process by which our strongest ideas are honed and improved. Today, I look forward to hearing from our witnesses and my colleagues in how we can reduce the barriers in empowering those with big ideas to make even bigger strides.

We are facing fierce competition. In 2017, one-third of the world's IPOs happened in China. Domestic IPOs today total nearly half of what they were 20 years ago. I am hopeful that our work today can help us, not only get back into the top 10 innovative economies in the world, but to make us number one overall.

And I now yield to Ranking Member Senator Heinrich for his opening statement as well.

[The prepared statement of Chairman Paulsen appears in the Submissions for the Record on page 28.]

OPENING STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, A U.S. SENATOR FROM NEW MEXICO

Senator Heinrich. Mr. Chairman, thank you for focusing on barriers to capital access. It is an important issue, and I look forward to the insights of our witnesses here today.

We have talked before about the important role that small and new firms play in driving innovation and creating jobs. Yet the startup rate has been declining now for years and new businesses increasingly are concentrated in the large urban counties, while rural communities are struggling to keep up.

A big challenge for entrepreneurs in small towns and remote areas is getting access to capital to turn their idea into a business or to take their business to the next level. JEC Democrats recently released a comprehensive report, "Investing in Rural America," that examines the economic challenges and opportunities as well facing rural communities.

Two challenges jumped out: First, insufficient access to broadband leaves communities disconnected from economic opportunities and unable to reach customers around the globe; and second, insufficient access to capital constrains growth. The more rural you get, the less access to capital there is.

Many rural communities have seen their financial institutions disappear and with them access to the loans that people need to build and to expand their businesses.

In New Mexico, there are just a handful of cities with 50,000 people or more. Often, small towns are less able to access grants and other Federal resources that may be available to them, and smaller communities have fewer financial institutions, whether we are talking about banks, credit unions, community development, financial institutions, or nonprofits.

Let's look at banks. From 2008 through 2016, 86 new banking deserts, areas where no banks exist within 10 miles, were created in rural communities. We need to reverse that trend. Expanding access to capital must go hand in hand with building the know-how and the expertise to launch and grow businesses.

In my State, nonprofits like WESST help budding entrepreneurs create new business plans, access micro loans, and build their businesses. More than two-thirds of those that they serve are women, and an even larger share are low income. SBA's Women's Business Center helps fund WESST, but SBA and USDA don't have the staff needed to go out and build awareness of the many programs they operate that could support rural business development. We need more boots on the ground.

There are also a growing number of resources available online. Online services allow consumers to continue to have relationships with financial institutions that no longer have a physical presence in a community. But the reality is for this to be a viable option for rural and Tribal communities, these communities need to be connected to broadband, and too often that is simply not the case.

It is not just a shortage of banking options. Venture capital is also scarce in rural areas. More than three-quarters of venture capital goes to companies in New York, in Boston, in San Francisco, and Los Angeles. There are entrepreneurs across this country with good ideas and smart business plans, but they need access to investors who can help transform these ideas into growing businesses.

The Federal Government has a vital role to play. We need to support small business lending through proven programs at the SBA, USDA, and the CDFI Fund. We also need to build the technical expertise to help people access Federal resources, while also promoting increased awareness about the programs that exist at SBA, USDA, and Treasury. That is what an organization called Grow New Mexico is doing. They connect people, businesses, and communities through resources that can help.

Unfortunately, the Trump administration seems to be heading in the opposite direction. Instead of doing more to increase access to capital, the Administration proposes zeroing out the CDFI Fund's grant making. The White House's recision package also targeted several USDA programs that support rural communities, a sign that the Administration is failing to get money out the door. And the recent Republican tax law actually makes the Tax Code more complex for small firms.

We need to realign our priorities. Expanding access to capital means providing more and better options, and ensuring that people and communities are able to utilize those options.

I look forward to hearing from our witnesses on how we can build an innovation economy that supports innovation and growth in all parts of our country.

Thank you, Chairman.

[The prepared statement of Senator Heinrich appears in the Submissions for the Record on page 29.]

Chairman Paulsen. Thank you.

And with that, we will introduce our witnesses. And I thank each of you, first of all, for taking the time to be here for a second time on a reschedule. Our fourth witness wasn't able to be here, but we will make sure his testimony is inserted into the record.

First, Mr. Mackintosh is the global head of economic research at Nasdaq, where he leads initiatives in the U.S. and Europe to improve market structure, capital formation, and trading efficiency. Mr. Mackintosh has nearly 30 years of experience in the finance industry and is an expert in index construction and ETF trading. He has published extensive research on trading ETFs and market structure.

Before joining Nasdaq, Mr. Mackintosh was head of trading strategy at Virtu Financial, where he authored numerous papers of market structure, trading, retail flows, and ETFs. Prior to this role, he was a managing director at Credit Suisse. Mr. Mackintosh holds a BA in commerce from the University of South Wales in Sydney and a master's in quantitative finance from the University of Technology in Sydney.

Also with us is Ms. King, who is cofounder and CEO of GlycoMimetics, a clinical-stage biotechnology company developing treatments for serious diseases. Before founding GMI, Ms. King was an executive in residence at New Enterprise Associates, NEA, one of the Nation's leading venture capital firms. Ms. King joined NEA after serving as a senior vice president of Novartis Corporation, where she was CEO of Genetic Therapy, Inc., a subsidiary of Novartis. Ms. King also worked previously at ALZA Corporation in California, and at Bain and Company in Boston.

Ms. King is a past chair of the Emerging Companies Governing Board and of the Board of the Biotechnology Innovation Organization, BIO, and continues to serve on the BIO's Executive Committee. Ms. King received her BA from Dartmouth College and her MBA from Harvard Business School.

Ms. Mensah, who is with us, is the president and CEO of Opportunity Finance Network, OFN, the Nation's leading network of community development financial institutions. In this role, Ms. Mensah expands sources of capital and provides greater visibility

for CDFIs. Ms. Mensah joined OFN in March of 2017, bringing private and public sector experience and expertise in using financial tools to improve the economic security of the working poor.

In 2014, Ms. Mensah was nominated by President Obama and confirmed by the U.S. Senate for the position of Under Secretary of Agriculture for Rural Development. Previously, Ms. Mensah was the founding executive director of the Initiative on Financial Security at the Aspen Institute. Ms. Mensah also holds a BA from Harvard University and an MA from the Paul H. Nitze School of Advanced International Studies of the Johns Hopkins University.

And our fourth witness who was going to be with us this morning, Mr. Michael Brown, from Battery Ventures, was scheduled also to testify. And without objection, I would like to make sure his testimony is also submitted for the record for members as well.

[The prepared statement of Mr. Brown appears in the Submissions for the Record on page 84.]

And with that, we would like to welcome each of you to be here this morning with us. And we will recognize Mr. Mackintosh for your opening statement, not to exceed 5 minutes.

STATEMENT OF PHIL MACKINTOSH, GLOBAL HEAD OF ECONOMIC RESEARCH, NASDAQ

Mr. Mackintosh. Okay. Good afternoon—or good morning, Chairman Paulsen, Ranking Member Heinrich, and all of the members of the Joint Economic Committee. Thank you for the opportunity to testify on capital formation and to share Nasdaq's views on how to maximize economic growth and job creation, as well as providing quality high-growth investment options for Americans who need to grow their savings.

In our view, this is best achieved if we modernize the public company model, while preserving critical investor protections. So today, I will be focused on why capital formation is important, not only to help grow the American economy, but also to provide retirement security to Americans.

So how do companies access capital for growth? In the beginning stages of a company's life, they are usually cash flow intensive. Startups often use crowdfunding or angel investors, in addition to their own funds, but as investment needs get larger, better organized and deeper sources of funds are often used, like private equity or public markets.

There are two key reasons why growing our public or listed markets is important: Firstly, American investors will benefit. Most American workers, including teachers, nurses, and firefighters aren't qualified investors. This generally means they can only invest in the listed companies.

If American workers are to benefit from the wealth effect of new growth companies, we need to attract as many as possible at early stages into the public markets. For example, this wealth effect, consider that just five Nasdaq listed companies—Apple, Microsoft, Amazon, Google, and Facebook—have added more than $2.5 trillion of combined value to shareholders since their IPO.

But secondly, the U.S. economy will benefit. Companies that list in the U.S. mostly have head offices in the U.S., so they are likely to also hire more Americans. In fact, one study found that the IPOs

between 1996 and 2010 collectively employed 2.2 million more people in 2010 than before they went public.

But our public markets need to be able to compete domestically and internationally, not only with less regulated forms of investment here, but also with exchanges from overseas. In fact, a recent Wall Street Journal article about the strength of the 2018 IPO market highlighted that Hong Kong has attracted new listings after it changed its standards to allow dual-class shares, which begins to answer the question: Do we actually have a problem attracting IPOs to list here? The data seems to show that we do.

Firstly, there is evidence that companies are choosing to stay private longer. There are 2,000 less companies with market cap below $250 million now compared to 2003. Second, there is no lack of entrepreneurs. The number of private companies has grown since 1998, while the U.S.-listed companies have roughly halved. And thirdly, this is not a global phenomenon, quite the opposite. Over the same time that U.S. listings have halved, offshore listings have roughly doubled.

So what are the reasons? Well, academics and economists have suggested many reasons for the decline in U.S. listings, including a more organized and competitive private equity market. Our issuers also claim that regulatory and reporting burdens, as well as the cost to shareholders in proxy fights and litigation, distract management and make it harder to grow their business.

Clearly, excessive regulation and costs place the U.S. public markets at a competitive disadvantage. But the value that investors get from listing standards and corporate accountability cannot be underestimated. The cost of those standards needs to be weighed against the benefits.

So what do we propose for the U.S.? Many of the solutions we propose were included in our revitalized report released 1 year ago. Over the past year, we have seen many positive developments on these suggestions, including the SEC has made changes to help remove repetitive, unsuccessful proxies.

Congress has moved to improve transparency of proxy advisers, businesses have started to support more flexibility in quarterly reporting, the SEC has an interest in helping small companies to trade better by consolidating liquidity into a single exchange, and the House Financial Services Committee Chairman Jeb Hensarling and Ranking Member Maxine Waters' proposals under the moniker of JOBS Act 3.0 passed the House with a vote of 406 to 4, and we look forward to the Senate moving to pass this bipartisan bill.

We also listed a number of tax reform proposals, including some to improve competitiveness of public listings on an aftertax basis for investors. While on that topic, I would like to commend Congress on the passage of tax reform legislation last year. This is having a positive impact on the ability of small companies to grow and expand.

In conclusion, we shouldn't ignore the fact that the U.S. has the deepest, most liquid, and most efficient capital markets in the world, but we need to make sure we keep it that way in the face of increasing competition. We appreciate the opportunity to present Nasdaq's views on such an important topic for American investors and the economy.

Thank you, Mr. Chairman and all members of the Joint Economic Committee.

[The prepared statement of Mr. Mackintosh appears in the Submissions for the Record on page 31.]

Chairman Paulsen. Thank you, Mr. Mackintosh. Perfect timing.

Ms. King, you are recognized for 5 minutes.

STATEMENT OF RACHEL KING, CEO, GLYCOMIMETICS

Ms. King. Thank you.

Good morning, Chairman Paulsen, Ranking Member Heinrich, and members of the Joint Economic Committee. You both touched on issues in your opening remarks that are very close to my heart and are really critically important to small innovative companies like ours, so I am very happy to be here to be able to share our thoughts on that.

I run a biotechnology company based in Rockville, Maryland, Congressman Delaney's District. And in the biotechnology industry, we are working on therapeutics that are highly dependent on our access to capital. Our timelines are long. We are developing drugs at substantial risk, and these are critical issues to us.

More than 90 percent of biotechnology companies in this country are actually in the R&D stage, which means we are preapproval. We don't yet have an FDA-approved drug on the market. So virtually every dollar that we spend is a dollar that we have to raise from an investor.

And most drugs that are in development actually fail, so when you account for the cost of those failures, the average cost to develop a new drug is over $2 billion. These are very expensive and very long efforts that we undertake, in some cases up to 15 years, to get from the labs to the market.

So the key point I want to bring to you today, though, is that what you are doing in Congress really makes a difference. The policies that you put in place really make a difference to companies like ours, and I would like to touch on a couple of those.

First, a bit of background on GlycoMimetics. We are a clinical-stage company that is developing two drugs now in advance testing, one for sickle cell disease and one for leukemia. We completed an IPO successfully in January 2014, and we benefited from the on-ramp provisions and from some of the regulatory relief provisions for emerging growth companies that were part of the JOBS Act.

We also benefited from another law known as FDASIA, and because of that law we were able to get breakthrough therapy designation for our leukemia product. And that was critical to our ability then to raise, over the past 12 months, almost $250 million through the public markets in order to now finance the trials that will help us to determine whether, in fact, that is a drug that can bring breakthroughs to patients.

So together these policies have dramatically improved our ability to raise financing, which enables us to potentially develop these lifesaving or life-enhancing therapeutics. So I encourage you to continue to focus on these important types of legislation.

I want to make some comments today on a provision of the JOBS Act which relates to Sarbanes-Oxley 404(b) exemptions, which are important to our companies, and then make some comments on patents.

So the JOBS Act has been a tremendous success for the biotechnology industry, and one of the provisions that has been important in that has been an exemption from Sarbanes-Oxley 404(b) auditor attestation requirements, and that is a very specific type of extra audit that is required under 404(b), that without additional action by Congress, many of the pre-revenue biotech companies like GlycoMimetics will lose that JOBS Act exemption. So in our particular case, that means that our financial reporting requirements will nearly double to over $1 million a year in order to comply with Sarbanes-Oxley 404(b).

So to alleviate these burdens, we encourage the Senate now to pass the Fostering Innovation Act, which I know just passed the House, and we were very happy to see the overwhelming support for that, particularly the strong bipartisan support.

We wanted to commend Senators Thom Tillis and Gary Peters for sponsoring the Fostering Innovation Act in the Senate; and Representatives Kyrsten Sinema and Trey Hollingsworth for sponsoring it in the House; and also thank Representative Delaney for his cosponsorship of that legislation.

Tax issues are also very important to us, and even though we don't have current income tax liability, the Tax Code still could have significant impact on us, in particular as it relates to NOLs, net operating losses. We want to thank you, Chairman Paulsen, for your work on NOLs, which is critical to companies like ours.

I want to also touch on patent reform, which is another critical issue for us. There are very few areas in the Nation's economy that are as dependent on patents as the biotechnology industry. Our investors rely on the strength of patents in order to make investments in companies like ours, and we need to ensure that these rights are robust and enforceable.

Unfortunately, there have been a number of changes recently, both through legislative action, through agency actions, and through court decisions that have made the patent system weaker, and, in particular, the fact that challenges can now be brought under a new process called IPR. That greatly concerns us and that weakens our ability to enforce patents.

So we urge Congress to advance the bipartisan STRONGER Patents Act, which would address many of these deficiencies in the IPR process. And here I want to applaud Representative Steve Stivers and Bill Foster for sponsoring that legislation in the House and Senators Chris Coons and Tom Cotton for introducing the bill in the Senate.

So in conclusion, policies enacted by Congress really do make a significant impact on our ability to raise money to do the work that we are doing to try to develop these lifesaving potential therapies in biotechnology, so we thank you for your work in that regard, and we ask you to continue to support the type of legislations that will support that kind of innovation. Thank you.

[The prepared statement of Ms. King appears in the Submissions for the Record on page 40.]

Chairman Paulsen. Thank you.

And, Ms. Mensah, you are recognized for 5 minutes.

STATEMENT OF LISA MENSAH, PRESIDENT AND CEO, OPPORTUNITY FINANCE NETWORK

Ms. Mensah. Thank you, Chairman Paulsen, Ranking Member Heinrich, and members of the Joint Economic Committee. I am pleased to be here, Lisa Mensah, as President and CEO of the Opportunity Finance Network.

I represent a network of community development financial institutions. Those are mission-driven community banks and credit unions, loan funds, and venture capital funds who are all investing to create a strong economy.

CDFIs fill the market gaps that you both mentioned, and public sector support for this role is critical. Key Federal programs help CDFIs assure that more communities, including those in rural and native and persistently poor areas, have access to the capital and the chance to participate in the innovation economy.

A few months ago, I attended the 40th anniversary of Coastal Enterprises, a CDFI located in rural Maine, actually in Portland, Maine, that serves rural businesses throughout the State. And at this celebration, I met Tilson Technology Management, a Portland-based IT company that builds broadband infrastructure across the U.S.

And Tilson was founded by an Army veteran, Josh Broder. It started with only three people in 2007, and by 2013, it had grown to 50 people. But then they got stuck. They needed financing to expand, and so that is when Tilson turned to Coastal Enterprises for an initial round of capital, and it enabled the company to grow now to over 230 employees in now eight locations.

Subsequently, the company expanded, and its investor base went beyond Coastal to many other range of private sector investors. So Tilson is not only creating jobs, they are building that vital physical infrastructure that Senator Heinrich mentioned: broadband networks.

As the JEC report "Investing in Rural America" notes, more than one-third of rural residents currently lack access to broadband, impeding them from reaching new markets and growing businesses.

So small businesses like Tilson turn to CDFIs when they can't access capital from traditional lenders. Tilson's technology success is really just one example of the way that CDFIs are spurring the economy and encouraging entrepreneurship.

But there is a challenge of small businesses. Since the recession, the availability of capital for small businesses has contracted and credit standards have tightened. Small business loan originations are 30 percent below their 2007 levels, and rural areas are especially hard hit. Small business lending in rural communities remains less than half of what it was in 2004. And, in fact, when you adjust for inflation, lending to rural small businesses is below 1996 levels.

But CDFIs are hyper local financial institutions with a proven ability to reach deep into hard-to-serve rural and native and persistently poor communities. When formal credit markets for small

business contract, CDFIs step up to meet the needs of businesses not well served by those traditional financial institutions.

And during periods of economic contraction, like the Great Recession, CDFIs play a counter-cyclical role. Between 2007 and 2009, while SBA 7(a) lending contracted by more than 35 percent, CDFI business lending actually grew by more than 26 percent.

So I am here today to commend the Congress for its continued support of Federal small business lending programs that expand the CDFI capacity to help small businesses succeed. And my recommendation today is for Congress to sustain and enhance Federal programs that bring about the kind of innovation economy we need.

I have three recommendations: First, I urge a continuation of the $250 million appropriation for the Department of Treasury's CDFI Fund. For every $1 awarded by a CDFI Fund, a CDFI is able to make $12 in investment. Second, at the Small Business Administration, I urge you to make permanent the community advantage program. And, finally, at the Department of Agriculture, I urge full funding for rural development small business lending programs.

Now, what do these big Federal programs look like on the ground? Well, in New Mexico, because of the Treasury CDFI Fund, Accion New Mexico can lend to native-owned small businesses, like the I Knead Sugar bakery and other micro enterprises.

And in Saint Paul, Minnesota, because of this SBA's Community Advantage Loan Program, Meda can offer its line of credit to 4RM+ULA, a minority-owned architectural business, allowing it to reach its full growth potential.

And in South Dakota, because of the USDA, the Lakota Fund can provide financing to help the Lafferty family on the Rosebud Reservation expand one of the only native-owned cattle businesses.

The Federal Government is such a vital partner to CDFIs, helping to close the market gaps that prevent too many Americans from participating in the innovation economy. And that is why I am here, and I look forward to a continued dialogue and your questions. Thank you.

[The prepared statement of Ms. Mensah appears in the Submissions for the Record on page 49.]

Chairman Paulsen. Thank you.

We appreciate all of your testimony and your being here this morning.

With that, we will begin the questioning period for our members. I will just begin.

Mr. Mackintosh, you mentioned in your testimony, you talked about the concerning decline in IPOs, which negatively impacts the entire economy. And if Congress can't help address this problem with legislation that eases the burden imposed by Sarbanes-Oxley, it is going to have a long-term impact. What do you think that long-term impact will be? Do you think this will have—what will it have on technological progress, economic growth here in the United States without attention?

Mr. Mackintosh. So I think there are two aspects to that question: One is the fact that the investors themselves in America won't have access to a lot of these companies, unless they start to invest money offshore. And, in fact, we are actually starting to see that

trend play out already. So if you look at mutual fund holdings over the last 10 or so years, there has been around about $1.5 trillion coming out of U.S. mutual funds, and a third of that has gone back to equities overseas. So I think one of the problems that you might have is that U.S. investors buying U.S. companies aren't going to have access to the growth, which is going to be worse for their retirement savings.

The second thing is that the companies that end up IPOing overseas, where the environment is better, are more likely to grow their businesses overseas, have head offices overseas, and that is going to affect employment. And it is eventually, to your point, going to affect where the technology resides and where the IP resides as well. And from that, like I think the industries and the network effect as well of the IP and the sophisticated developments being overseas will make it harder for us to keep up and catch up.

Chairman Paulsen. Ms. King, speaking of intellectual property, in a lot of the work and the background that you have you talked about long-term investments. You also mentioned section 382 of the Tax Code that was put in place to prevent companies from acquiring operations that lose money just to offset their taxable income. But it also represents an impediment to startups that have no tax liability and then accumulate net operating losses.

I have been concerned about this issue for a while. You mentioned a number of bipartisan initiatives in your testimony. Speaking of section 382, the legislation that I am working on right now to address this problem would help the disadvantaged side of the startup community, particularly technology startups that conduct that valuable research with the potential to help improve and maybe even save lives. It is unfair to those companies and then damaging to the overall economy that discourages investment in innovation.

So while section 382 was intended to prevent loss trafficking, how should we weigh its benefits against the costs that have been borne largely by startups?

Ms. King. And thank you for your work on this because this is, in fact, something that is really critical. And we have actually had to address this in the context of some of the financing that we have done at GlycoMimetics.

So the problem, as you point out, is that you want to prevent what is known as loss trafficking. But what you don't want to prevent is smaller companies raising money, which also sometimes results in significant ownership changes through the natural course of investors coming in and out of a company like ours.

That is the kind of situation where we want to be able to preserve our net operating losses, because we hope someday to be profitable and to be able to use them. But we don't want to discourage the kind of investment that needs to come into companies like ours that have to raise a lot of money from a number of different investors.

So I think the objective of preventing trafficking in NOLs is a reasonable objective, but we really don't want to inhibit the ability of companies like ours to raise the significant capital that we raised that also could inadvertently be prevented by the law, by this section 382.

Chairman Paulsen. Would you like to see legislation accomplish anything in particular in this area? And what effect do you predict it would have if we were able to move something forward on capital formation for startups?

Ms. King. Well, yes, what we don't want to—what we don't want to do is we don't want to discourage large investments in companies like ours. So I think when we look at these reforms, we have to be very careful, as I know you are, to look at specifically continuing to encourage investment without limiting the ability for companies to retain those NOLs for future uses.

Chairman Paulsen. Thank you.

Ms. Mensah, you mentioned several recommendations that you had with the Small Business Administration, continuing appropriations for CDFIs. Do you sense continued bipartisan support, or what other message would you have for us as we go through the appropriations process and focus on some of these initiatives right now?

Ms. Mensah. I think these initiatives, the three recommendations that I raised, all have bipartisan support, particularly at the CDFI Fund. We were so pleased to see Congress move forward, and I urge this bipartisan continuation. I had the privilege to meet with the small business administrator who said we are aligned, but this program needs to move from pilot to permanent.

And the Department of Agriculture has traditionally been heavily bipartisan, so I see no losers here in doubling down just when the economy needs a push into the very areas that don't rise easily with market forces. So I look forward to seeing more bipartisan work and to your leadership and encouraging this.

Chairman Paulsen. Thank you.

Senator Heinrich, you are recognized for 5 minutes.

Senator Heinrich. Thank you.

Ms. Mensah, you—in your last comment, you brought up something that really keeps me up at night, and that is, as we have come out of the recession of 2009, 2010, and the Great Recession, as they called it, response to that has been fairly robust in the coasts and in urban areas. That recovery has not extended to every part of our country. And I think, you know, the thing that worries me the most is us falling back into recession before many of those communities can see the full benefit of this recovery.

I want to ask you about one thing in particular. I have got a number of team members who are meeting with small businesses in New Mexico this week to learn about the sort of current state of the challenges that they face. And one of the things that you mentioned in your testimony is just the very real challenges that when you have bank closures and consolidations, and those have accelerated in recent years, it really has left a lot of high-need communities in the lurch.

What does it mean—can you speak to the—what the absence of a physical bank presence in a community means to the ability to access capital and to develop new business plans?

Ms. Mensah. Thank you, Senator. I think the absence of a physical bank, you lose two things. You lose trusted relationships; you lose human beings who can talk with you, even if there is a turn down; you lose connections for firms; and you lose a regulated ap-

proach to providing capital. And while we applaud new moves in technology, we regret those loss of tight connections.

Where the CDFI field can step in is to become the partners. Many, many bank CDFI partnerships exist, and so—but it is clear that, particularly in our rural areas, when you see—it is a people touch and it is a fairness and it is someone to talk through. It is additional expertise that I think we—is a social capital to this that we miss.

Senator Heinrich. How does that CDFI role change in those places I mentioned that are banking deserts, where we no longer have a credit union, we no longer have a community bank that is playing that trusted role of somebody that you know in your community and you can go access capital through?

Ms. Mensah. CDFIs I think of as the Swiss Army knives of a local economy. They are able—they are mission driven, so they are able to take time. They can often make the loan, like in my example of Coastal, when other financing sources aren't yet ready to play. So they have time, they have ingenuity, they can build portfolios.

We estimate that even amongst our own memberships, we have been lending over $50 billion as a network, cumulatively. And so it is not a little field. It is a serious field with balance sheets ready to help the kind of small businesses that we are talking about. So a CDFI steps in, partners, gets those businesses to permanent, larger markets, like what we have been talking about here. So I see it as part of the growth. And I commend you for your concern about those parts of the economy that didn't rise yet and that will need to be given an extra push. We do know what to do.

Senator Heinrich. One of those places, and there is a whole lot of overlap, but rural communities and Tribal communities face some of the same challenges here, and one of them is obviously the lack of the physical connection to parts of the economy that are thriving, to be able to access those markets. So broadband connection, in particular, if you don't have it, it really does cut you off from all sorts of avenues to growth.

Do you have thoughts for how we do a better job of making sure that those Tribal communities, those rural communities, how much of a governor is that on growth in the places that haven't yet seen this recovery?

Ms. Mensah. I am so glad to have mentioned our rural areas and our Tribal areas. And the very core infrastructure, as I saw in my time at the Department of Agriculture, broadband infrastructure is one of the things that is critical. It is critical not only for our students and our elders to learn, but it is critical for businesses to be able to sell.

You have the titles that exist, both—and significant ones at the Department of Agriculture. So I think there is a bipartisan moment. And I believe CDFIs are here to be partners to both the construction, the furthering of broadband infrastructure. And I see it as one of the true ways I saw agreement on this to keep building in that final mile. They call it the last mile in broadband.

Senator Heinrich. Ms. King, do you want to add just a real short statement on venture capital with your experience? How can

we do a better job of making that venture capital available to more geographically?

Ms. King. Well, actually, when you made the comment about the geographies, that also struck close to my heart, because it is true that even for companies like ours, which are somewhat larger than the very small ones you are talking about in rural areas, even for us getting venture capital outside of those major cities is a significant concern.

I think we can do things like what we are talking about in terms of improving access to capital, because this is the type of thing that helps really any company located anywhere. So if we are talking about, for example, the 404(b) legislation that we are looking at exempting us from, these things that help support the emerging growth companies in general will, I think, increase the flow of capital to other regions around the country. And I think that is a critical issue.

Many of the things that support biotech companies come out of Federal labs. I think things that come out of Federal labs that need to get that financing to get over that hurdle, I think, can certainly be helped with the type of legislation we are talking about to improve capital access generally.

Senator Heinrich. Thank you, Mr. Chairman.

Chairman Paulsen. Thank you.

And I recognize the Vice Chairman, Senator Lee, for 5 minutes.

Senator Lee. Thank you very much, Mr. Chairman.

Thanks to all of you for being here.

There is an old saying in politics that goes something like this: Don't tax you, don't tax me, tax the guy behind the tree. The trick being to pass at least some of the cost of government along to someone who either doesn't vote or can't vote or is imperceptible to the common voter.

In some ways, our corporate tax system hides taxes and ends up being a fairly regressive tax, one that is paid for by poor and middle class Americans, even without their knowing about it. They pay higher prices on goods and services, basically everything they purchase, as a result of corporate taxes. They sometimes pay for it through diminished wages, unemployment, and underemployment. It does end up being paid for, one way or another, to a significant degree by America's poor and middle class.

It is one of the reasons why in the past I have proposed the idea of eliminating the corporate tax and replacing the revenue lost from that by taxing capital gains as ordinary income. In my view, this policy would accomplish a few things: Number one, I think it would make the United States one of the most competitive and attractive places in the world for people to invest their money; and number two, I think it would also help free up the workers' share of businesses' corporate tax expenses.

In addition to this, we can see other benefits by way of making the market more efficient and therefore reducing the passthrough price on goods and services, wages, unemployment, and underemployment that consumers ultimately experience.

So, Mr. Mackintosh, I would like to ask you, do you think this sort of corporate integration tax policy would impact the competi-

tiveness of the United States when it comes to decisions on where, when, and how to locate workers?

Ms. Mensah. I think tax policy is definitely an incentive that will redirect investments, and I think that we should try to encourage people to invest in companies. I think it is fair to say that workers—and ideally, as we go towards the future—workers' retirements are more self-funded and their investments are coming from investments in companies and in listed companies and the growth of those companies.

So you want to make sure that the taxes on those company earnings and also on the distributions of those company earnings and the returning of capital and returning of the profits back to the investors are also not excessively taxed. So I think that that is one of the more important things as well to consider is the workers that we are talking about protecting also have savings. Ideally, they would have even more savings, and we want to make sure that we don't overtax the savings that they have as well.

Senator Lee. For the last—for centuries, traditional brick-and-mortar manufacturing has served as the primary source for building tools for infrastructure, transportation, for technology. But today, we have got a lot of advances in automation that are changing that. Certain technologies, including things like 3D printing, are pointing us toward a future in which we can imagine the end consumer being able, in some ways, to manufacture their own toys, their own houses, or at least major components thereof, and even things like prosthetic limbs, simply by plugging in a few inputs to the right machine.

What can you tell us about how this might impact our economy, how things like 3D printing, how this might affect workers in manufacturing industries like automobile manufacturing assembly, food processing, and so forth?

Mr. Mackintosh. I guess my expertise is not in manufacturing. But from the perspective of automation and the markets, there has definitely been huge cost savings brought to the stock market and to a lot of markets because of automation. The stock markets themselves, especially in America, are one of the most transparent and electronic and equal and cheap to trade markets.

So I think that automation has brought a lot of change to the stock markets, but that has been overwhelmingly good for investors. And because it has been good for investors, it has been overwhelmingly good in terms of the micro structure for trading for the issuers that are trying to list their stocks as well. America has some of the tightest spreads and the lowest volatility across all of the markets in the world.

Senator Lee. Ms. King, the Food and Drug Administration plays a pretty critical role when it comes to innovation in both food and medicine. I am personally a strong supporter of the right-to-try concept, and I am hopeful for the results of policies like that and what they can bring.

What, in your opinion, are some other reforms to drug policy that we should pursue in order to ensure that we are striking the right balance between the need for regulation while also promoting innovation and protecting health?

Ms. King. Yes, well, I think I would say that I strongly support a strong and effective FDA, and I think that that is one of the things that has enabled our industry to really deliver what we think of as the gold standard for regulatory approval. So I think having a strong FDA is critically important. And I do think we need to maintain the standards that the FDA has in terms of giving their drug approvals.

Some of the things that have been instituted recently, for example, I mentioned the FDASIA law in my testimony, which enabled the FDA to grant breakthrough therapy status. That is an example of something that gives the agency, gives companies like ours an opportunity to work closely with them during the development process in order to streamline the regulatory process.

So I think to the extent that we are able to continue to streamline that process, improve communications, improve the FDA's ability to hire and retain the critical people that they need, those are the kinds of things that I think can continue to ensure that we get a gold standard that we can have confidence in and that we get delivery—and that we are able to deliver cures rapidly to the patients who can benefit from them.

Senator Lee. Thank you very much.

Thank you, Mr. Chairman.

Chairman Paulsen. Thank you.

Representative Maloney, you are recognized for 5 minutes.

Representative Maloney. Thank you, Mr. Chairman and Mr. Ranking Member, for calling this hearing, and all of our panelists.

Capital is the life blood of our businesses. As one of our witnesses, Mr. Mackintosh, said today: The United States has the deepest, most liquid, and most efficient capital markets in the world, end quote. And I am very proud to represent Nasdaq and also the city of New York, one of the greatest financial centers in the world. But not all businesses can access the capital they need to grow and create jobs, so this is particularly true for small businesses and underserved areas, as the Ranking Member's report recently showed. They depend on small banks and institutions that support them, and I will get to my questions on that.

But first, I would like to address a claim that we have heard so often and even in this hearing that Dodd-Frank, Wall Street reform, that Sarbanes-Oxley reform, and the Consumer Protection Act have severely limited business lending and access to capital. I would say that this is false. In fact, as this slide shows, business lending has increased 75 percent since the passage of Dodd-Frank. It is now at $2.15 trillion, and commercial and industrial bank lending is also at a record high.

Some claim that Dodd-Frank and Sarbanes-Oxley has killed community banks, an important source of capital and strength to all of our small businesses and communities. And, again, this is false. As this slide indicates, the total number of banks has been declining since the 1980s, long before Dodd-Frank.

And let's look at what business owners themselves are saying about access to capital. In a report released just last month in the National Federation of Independent Business, which former Federal Reserve Chair Janet Yellen often liked to quote and refer to: The NFIB survey of business owners found that only 3 percent re-

ported that not all of their borrowing needs were not met, and 30 percent said all their credit needs were met, and only 2 percent reported that loans were harder to get.

So I think it is a myth that Dodd-Frank has crippled business lending and devastated smaller banks. But I think that we have to move forward in an economy that takes care of everyone, including our rural and underserved communities where it is tremendously difficult to get funding for small businesses.

And I would like to ask Ms. Mensah about CDFIs, community development financial institutions, that help make capital available to small businesses in underserved communities and rural areas.

In my District, we have several that are very successful. I want to read them into the record: the Lower East Side Federal Credit Union, the NYU Federal Credit Union, the Community Preservation Corporation, the Community Development Trust, and the Local Initiatives Support Corporation. And they work by leveraging private capital to help underserved areas. And how does that leverage work? And what is the approximate return to our government investment in these CDFIs? And I thank my colleagues for supporting CDFIs.

Ms. Mensah.

Ms. Mensah. Thank you, Congresswoman Maloney, for your interest and your support of these important community development financial institutions.

When they receive a financial assistance award from the U.S. Treasury CDFI Funds—I believe all the ones you mentioned may have profited from those—that forms a kind of permanent capital to which they can lend against. So a $1 million financial institution award is able to be converted into 10 million of borrowings on this.

And then in our rural areas, in our native areas, and in areas right in New York City, which are working with new immigrant communities or new businesses that are yet to qualify, they are pre-Nasdaq, they are pre these stages, they build their track record often financed by CDFIs, not only financing the businesses, but often the facilities that hold them.

So this leverage ratio, this is an important role of government. It is hard to grow a mission——

Representative Maloney. How much is a leverage usually?

Ms. Mensah. We say 12 to 1. $1, 12 out, so—and that may be an undercount.

Representative Maloney. I would like to ask Mr. Mackintosh very quickly about the listings. You mentioned that listings are down, but I would say that there is not a level playing field on IPOs. I read stories about some countries, they create a business, then they buy the business and that is their IPO.

And also, I would say that it used to be that companies would—smaller companies would go to an IPO, and now they seem to be waiting till they are larger companies. Why is that happening? But I guess the basic question is, what are the benefits for listing in America? And could you comment on how many foreign companies are still coming to America, or do you find foreign companies going elsewhere now?

Mr. Mackintosh. Sure. So I think looking at the IPO data that we see year on year, there is definitely an increase in the larger

companies with $1 billion-plus IPOs, and a decrease in the smaller companies each year that are listing, the less than $250 million companies.

Representative Maloney. Why do you think that is?

Mr. Mackintosh. There is a lot of academic research that is done on the reasons for the shrinkage of the outstanding companies at all. But I think that the private equity market is better organized now. I think that some of the angel investors are much better organized, and so that is making it easier to access that capital. There are probably tax incentives and also the cost of being public that I think make people resist turning themselves into public companies until they are much larger and they have much more economies of scale.

On your second point about the internationalization of markets, one data point that I would draw your attention to is in Nasdaq we have a Nordic venture market called First North, and it has actually grown its listings by 300 percent in the last 12 or 13 years.

So there are countries in the world with much more companies coming to markets and listing in venture type markets, and that is potentially an avenue that we could pursue to get more companies to list in America and stay in America as public markets here.

Representative Maloney. So foreign countries are up in listing in America, right? Are American companies going abroad to list?

Mr. Mackintosh. I don't have data on that right now. I can get back to you.

Representative Maloney. Thank you. I yield back.

Chairman Paulsen. Thank you.

Representative Handel, you are recognized for 5 minutes.

Representative Handel. Thank you very much, Mr. Chairman, and thank you to all the witnesses.

I am going to start with Ms. King, and first, thank you. I am a Novartis alum as well, so it is great to have you here.

I wanted—and I am going to ask all of you this. As we as Congress start to undertake the next version 2.0 of tax cuts, what are your thoughts on the critical components that ought to be included in the next version or the next step in tax cuts and tax reforms?

Ms. King.

Ms. King. So as I said in my remarks, we are a pre-revenue company. So for us, the critical issues really relate to this issue of NOLs that we were talking about earlier. To be able to get that section 382 reform, I think, would be very important to us.

We look to the day when we are revenue positive, but for us—you understand the industry—we spend many years where we are just spending and so we are accumulating those NOLs. So for us, the critical tax issue is really this NOL issue.

Representative Handel. Great. Thank you.

Ms. Mensah.

Ms. Mensah. Congresswoman, you had a wonderful hearing a few weeks back on opportunity zones——

Representative Handel. Yes.

Ms. Mensah [continuing]. Which was part of the new—of the first tax reform. I would encourage you to keep moving forward. It is rare to get everything right the first time something passes. This has created quite a lot of excitement in our field, and yet a big hope

that those kind of opportunity zones and opportunity funds can have a tighter connection with community development financial institutions and can intensify in the way they reach rural areas, persistently poor areas. So I would encourage you to take another look at how we can deepen that part of the legislation.

Representative Handel. Okay. Thank you.

Mr. Mackintosh.

Mr. Mackintosh. So I think tax incentives for savers are a pretty strong incentive to give to the market to do more saving. And it was mentioned in my introduction, I am from Sydney. A couple of things that Australians have done, and they have a really strong retirement system, is the money that you earn—it is a little bit like the 401(k) system here. It goes into a mutual fund structure tax free, and you can take it out at a lower tax rate when you retire as well. Plus, on dividends, they have made sure that there is no double taxing of dividends. And I think things like that can incentivize companies to return the money that they have earned to investors, and the investors can receive those moneys on a more aftertax effective basis.

Representative Handel. Okay. Thank you.

In Georgia, Atlanta, Metro Atlanta in particular, has become a really robust environment for startups and even access to capital. And some of that is being driven by, my observation, of some really innovative approaches to how do we get capital, in particular, to women entrepreneurs. Georgia is number one in the most number of companies that are owned by—women-owned companies. And we have some innovative initiatives like the ACE Women's Business Center, The Rich Group, and some other initiatives.

What more can we do to drive that type of innovation and thinking in how we can create more access to capital? And maybe, Mr. Mackintosh and Ms. Mensah, if we have time.

Ms. Mensah. I will start because you mentioned the Access to Credit for Entrepreneurs, ACE, in Georgia. It is a powerful CDFI that has led innovation throughout the State, actually. And, again, my recommendation is to a full renewed commitment of $250 million appropriation to the Department of Treasury CDFI Fund.

ACE wouldn't have grown had it not had the kind of support from the CDFI Fund or from the SBA's community advantage program and from the Department of Agriculture's business lending. So I think those are exactly the kind of programs that can reach those women entrepreneurs that can help. At many stages we have community development venture capital funds, so I would urge the Congress to keep going.

Representative Handel. Seventy-one women-owned companies have gotten loans and financing in investment through ACE. It is great, so——

Mr. Mackintosh.

Mr. Mackintosh. Yeah. So I guess coming from a larger company perspective, some of the things that we hear from our issuers are just that the reporting obligations are a big problem just to get over in terms of getting a company going. So the accounting and reporting obligations, I think, would be one thing to streamline for new companies so that the entrepreneurs are able to focus on grow-

ing their business rather than focus on all of the bureaucracy and administration of the companies.

Representative Handel. Great. Thank you.

Ms. King, would you like to add anything there?

Ms. King. Well, for us, that speaks to specifically the 404(b) issue.

Representative Handel. Yeah. Yep.

Ms. King. And to the point that Congresswoman Maloney was making earlier, I think that we are talking about a specific provision of Sarbanes-Oxley, that it would help us greatly if we could retain the exemptions that we got under the JOBS Act so that we don't have to increase the financial reporting obligations beyond what we currently have, which we think are sufficient for transparency for our investors.

Representative Handel. Great. Thank you.

Mr. Chairman, I yield back. Thank you.

Chairman Paulsen. Thank you.

Senator Peters you are recognized for 5 minutes.

Senator Peters. Thank you, Mr. Chairman.

And, Ms. King, thank you for talking quite a bit about the Fostering Innovation Act. I am happy to work with Senator Tillis on that legislation here in the Senate, and hopefully we will be able to move it forward. You mentioned the strong support it received in the House.

Ms. King. Thank you for that.

Senator Peters. Well, you are welcome, but thank you for what you do in your business and in bringing this to our attention as to this is an important element for your company.

I think it is important, you've talked about it in response to several questions already, but if you could let folks know for the record the fact that you won't have this kind of reporting requirement, which we, I agree, is being handled in terms of other types of reporting and so the transparency is still there.

What will that mean for your company, and more specifically, what will it mean for jobs if this bill passes?

Ms. King. So, again, I just want to reiterate the point which you made, which is that we already have and we already provide what I think are very transparent, audited financial statements——

Senator Peters. Right.

Ms. King [continuing]. Transparent audited financial statements to our investors. So I think we provide that already. What we are talking about is that extra layer, which is going to cost us probably about another $600,000 a year. So to us, that is money spent on an extra layer of reporting as opposed to being spent on people that we can hire or research that we can conduct. So it is a real tradeoff. We don't have an unlimited pool of capital.

Senator Peters. Especially your business, which is heavily dependent on research and development.

Ms. King. Absolutely.

Senator Peters. That is money that you can put into basically the research, which will be the seed corn for your next big thing.

Ms. King. Exactly.

Senator Peters. Hopefully that will come out of your company, is your goal.

Ms. King. Exactly.

Senator Peters. The IP market, what you are talking about today, is one that is incredibly important to keep dynamism in the economy. And I have a great deal of concern about the concentration we are seeing in industries all—every industry sector, big companies becoming bigger, buying out companies prior to them having an initial public offering.

You went public last year, I believe?

Ms. King. 2014.

Senator Peters. Oh, in 2014. So you have been out for a while.

Ms. King. Yes.

Senator Peters. Given the issues related with an IPO, which is always complex, more complex than just having a company come in and write you a check, walk us through your company's decision. Why did you decide to go forward with an IPO?

Ms. King. Well, as to the complexity, if I had time, I would tell you a lot of stories about that.

Senator Peters. Well, I would like to do that at some point.

Ms. King. It is not an easy process. But for us, the critical ability to access that capital is what really made it important to us, because as a public company, we are able to access capital so much easier and so much more quickly than we can through the venture capital network. So it is—and it opens up a huge opportunity for us to be able to fund the type of research that we need to fund.

So it was critical to us to be able to get public, and for that the JOBS Act was really important. So I think it really—I mean, for companies like ours, for biotechs that have to raise so much money, if you can get public, I think generally companies want to do that, is the benefit to us.

Senator Peters. To what extent in your offering were employees included in ownership? Was that also a factor in the decision process?

Ms. King. Well, every employee in our company gets stock options the day they start.

Senator Peters. Every employee?

Ms. King. Every employee.

Senator Peters. Regardless of their position?

Ms. King. Correct. That is correct. That is an important—that is very important to me that every company—every employee in our company gets stock options.

Senator Peters. And tell me why.

Ms. King. Everybody contributes, and we want to recognize everyone's contribution, and we want to share the upside, recognize the contribution and share the upside.

Senator Peters. Well, I want to explore that further with Mr. Mackintosh, because in response to an earlier question, you talked about how folks are investors as well and can benefit as investors in these companies or investors in the economy generally.

To me, that is an incredibly important point, and particularly when you look at the tax act that we just passed where the vast majority of the tax breaks are basically share buybacks of increased dividends, so it goes to the owners of those companies.

And yet an awful lot of research shows—and I think Ms. King confirmed that—that having employee ownership on the ground

does a great deal for a company, and it actually, most studies show, enhances productivity dramatically because everybody has a stake in that company.

So my question is, you and your research that you have done, how significant is it that employees have a stake in that company and are able to participate in profits, whether it is in stock option plans, profit-sharing plans and others? And does that indeed lead to more productivity and a more dynamic economy?

Mr. Mackintosh. I mean, honestly, I think your experiences are probably better than the research that I have read in terms of motivating staff and getting them to connect with the objectives of the business. But from a financial perspective, if the employees have a vested interest in the performance of the company, then they are going to want to make the performance of the company go better. And I think that is kind of the key economic driver of giving staff a share of the company, whether it is in options or in stock.

Senator Peters. Great. Thank you.

Chairman Paulsen. Thank you.

Representative Delaney, you are recognized for 5 minutes.

Representative Delaney. Thank you, Mr. Chairman.

And I want to welcome all the guests, including Ms. King, whose business is located in my District. It is nice to have you.

Ms. King. Rockville, yep.

Representative Delaney. Exactly. Thank you for what you do.

I would like to ask a question, and it may be more targeted towards Mr. Mackintosh, but I will leave it open for anyone on the panel. One of the big things that concerns me is that if you look at the data, last year, about 80 percent of the professionally managed venture capital in the United States went to 50 counties in this country. And there are 3,000 counties in our country. So about 1.5 or 1.6 percent of the counties got 80 percent of the professionally managed venture capital, which is considered the smart money. It doesn't mean it always is making the right bets, but directionally, these are the people who have been hired by the most sophisticated investors in the world to allocate capital to what they view are the most promising businesses in the United States of America. And they have allocated that capital to a very, very small slice of our country. So that is kind of one statistic.

The second statistic is that 70 percent of the kids in the United States of America live in a county where there is no evidence of upward economic mobility, meaning the jobs that are being created are not as good as the jobs that used to exist.

So you have this situation where there is a dire need of new opportunities, new businesses, particularly ones that create jobs that have decent standards of living, in the majority of our country. Yet a very small slice of our country is getting most of the bets that investors are making.

So from a pure policy perspective, recognizing—and I am sure my colleagues talked about things we should do to make it easier to access capital, how we need regulatory relief, how there are too many burdens, and we have to do all kinds of things at the specific kind of tactical level to make sure companies get capital.

What do you think from a macro policy agenda we can do so that in 10 or 15 years, those statistics look different, and so that you

see a situation where 80 percent of the professionally managed venture capital is not going to 1.5 percent of our counties? It would be a huge victory if it went to 20 percent of our counties. I mean, what can we do so that in 10 years, those statistics look different?

Mr. Mackintosh. So I think there is a global trend towards people moving to cities, and that is probably because of the economies of scale of actually getting your network and your infrastructure all together in one place. At the same time, there is always—also the trend of people working remotely.

Representative Delaney. Yes.

Mr. Mackintosh. So it is possible that the people with the skill sets will actually be at work away from where the head offices are and sort of foster that interesting work and innovation and intellectual property in the country areas. It is not a very statistically significant sample, but I was on a venture capital company a few years ago which actually relocated itself to San Francisco because that is where its venture finance came from. And so potentially——

Representative Delaney. Right, because a lot of the venture capitalists are like, I don't even want to get on a plane anymore. If you want me to invest, I have to be able to drive to your company.

Mr. Mackintosh. Yes. So, potentially, what they are——

Representative Delaney. Which I can't blame them, but, you know.

Mr. Mackintosh [continuing]. Claiming is the companies are locating near their finance——

Representative Delaney. Right.

Mr. Mackintosh [continuing]. So that they can be involved with the companies more closely and manage the company.

Representative Delaney. Sure.

Mr. Mackintosh. You watch Shark Tank, you see that sometimes there is actually a management involvement as well as a financial involvement.

Representative Delaney. Sure. Right.

Mr. Mackintosh. With that specific company, half of the board of directors were actually still working remotely. So the skill set was actually still scattered around sometimes in remote areas of America, even though what looked like a San Francisco-based company.

Representative Delaney. So that is a trend you are observing. But what do you think we can do to accelerate those trends?

Ms. Mensah. Congressman, I would like to hop in.

Representative Delaney. Please.

Ms. Mensah. Because I hope, when you invite me back in 2028, we will be celebrating the success of the mediating institutions that are needed to work with traditional VC.

There are community development venture capital institutions. I testified to one of them in Maine. And what we have seen is that when you invest in the CDFIs, whether they are venture capital associations, loan funds, community banks——

Representative Delaney. Right.

Ms. Mensah [continuing]. That is jet fuel for the kind of hyper local—yes, it is still local institutions that help companies like Tilson Technology to expand a broadband business.

If we want to tackle the scale of what you have mentioned, 70 percent of the kids in low-mobility counties, from the Raj Chetty research, we need a bigger scale of investment in the very things that we know will reach those communities. This is a 40-year field of community investors, and community development financial institutions know how to make those investments.

So I hope that the 2028 solution that I will be coming back and celebrating is one that talked about what we added to the system. The channels are here. We need to add more fuel to those channels.

Ms. King. You are asking a very complex question which has a lot of things to do with education, with infrastructure, with where people live. Because even in Rockville, which is outside of the Nation's capital, you know, we talk about the need to incentivize getting venture capital here.

Representative Delaney. Right.

Ms. King. So it is a broad challenge.

Representative Delaney. Because we don't have many of those 50 counties actually, which is surprising.

Ms. King. Yeah, which is really surprising, in spite of the strength of our local economy and in spite of the national labs that we have here and the universities.

Representative Delaney. Right. We have all the assets.

Ms. King. Yes, exactly. So I will just add, and with one encouraging note, which is that you do see some venture capitalists now recognizing that good science, good technology, good people are not only in those counties and that there are actually opportunities to invest there because they may not be as widely known, maybe less expensive and therefore, you know, good opportunities for investments. That is also encouraging, I will say.

Chairman Paulsen. Thank you.

Representative Comstock, you are recognized for 5 minutes.

Representative Comstock. Good morning. I wanted to follow up a little bit on Mr. Delaney's comments but focus on not just location but gender. I am happy to see a panel here with women, but it is something like 2 to 3 percent of all venture capital goes to women, apparently. And since I am late, you may have addressed this already. And then, of course, the people you are going to pitch are men often.

And I was reading a column in Forbes about a very successful company, ThirdLove, which this woman is saying, I once went to a meeting with a venture capital firm to pitch them on my company ThirdLove. At the end of the session, the guy told me, sorry, we only invest in things we understand. ThirdLove is a women's very successful underwear company. I think probably Spanx had the same issue.

So not to just focus on, you know, things like that. Obviously, this goes beyond just understanding women's products, but the bigger picture of, you know, whether it is geographically we aren't—you know, the venture capital is not reaching people in equal ways throughout the country, and certainly there is talent everywhere. And Steve Case has done the Rise of the Rest tour, which I think kind of speaks to a lot of what Mr. Delaney was talking about.

So how do we get the rise of the 50 percent too?

Ms. King. Again, this is a challenging question that speaks to education and access and networking and a lot of issues. It is true that almost all the people that I have pitched in my career of raising money, both as a private company and as a public company, they are almost all men. That is true.

And so I think it is a challenge that over time, I hope, as more women become investors and more women become CEOs, we begin to kind of seed the future of greater diversity, not just gender diversity but diversity in all respects. So it is a complex question.

I know you had some specific comments to an earlier question on the same topic.

Ms. Mensah. Thank you, Congresswoman. I love the question because we can't leave out half of the people in the country in our solution to how to build an innovative and entrepreneurial economy. And I am proud to represent the community development financial institutions who have overwhelmingly invested in women-owned businesses.

I would say two things: First, Congress' ability to support the kind of capital that flows close to the ground with our community development financial institutions is critical to reaching women-owned businesses; second, Congress' protections through the Consumer Financial Protection Bureau, through the SBA, that ensure that when you start a company, you are not facing a rapacious kind of financing, that you are able to get the right, fair, and safe kind of financing to build your business so that you don't get overloaded with the wrong kind of credit.

So two things, both the availability of the capital and the fairness and safety of the capital to start pushing forward. I have seen tremendous entrepreneurial potential and much of it led by women, and I hope we are on the right trend. I know our CDFIs are in place to support those kinds of businesses.

Representative Comstock. Well, thank you. I appreciate it. I know this is an area where a lot of it is just understanding that that discrepancy exists when you hear the points like 1.6 percent of the counties are getting all of that. It is really, it is a boy's club. It is a boy's club in certain country clubs.

There is a rise of talent that we need to embrace all across the country. And I think, whether it is racially or women who are in other parts of the country, I think that discussion needs to be had at every level. And certainly, I think we need to shine a light on that about that this has been sort of a problem that has been just not recognized in the media at all. And not surprisingly, if we look at the boards of media, women are not on those boards either in any kind of equitable fashion.

So thank you.

Chairman Paulsen. Thank you.

I want to thank all of the witnesses for taking the time to be with us this morning. Appreciate that very much.

And then remind members also, should they wish to submit questions for the record, the hearing record will remain open for 5 business days. As a reminder, Mr. Brown also agreed to answer questions with his testimony submitted. He agreed to answer questions for the record as well.

And with that, the committee is adjourned.

[Whereupon, at 11:16 a.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD

I call this hearing to order.

The United States has fallen to 11th place in the 2018 Bloomberg Innovation Index and, one thing is clear: Our job as policymakers is to figure out how to find the right mix of policies to spur innovation along.

After all, economists agree that innovation is critical to growth and prosperity, and with the headway we have made since passage of the Tax Cuts and Jobs Act, this momentum must continue.

Innovators start their work from a difficult place; after all, great ideas don't appear fully formed. They take research, development, and testing. Innovation is just as likely to happen in a suburban garage as it is in a corporate lab.

That's because people of all walks of life can come up with the next big thing.

Are we advocating for the best policies to assist that? The Joint Economic Committee has held two previous hearings on this topic.

Witness testimony, combined with analysis by our staff of economists makes clear that too many barriers stand in the way of innovators and the life-improving ideas they have to offer.

Today's hearing is about "Innovation, Entrepreneurship, and Barriers to Capital Access," and how we can ensure innovators have access to the financial resources they need to succeed.

Nearly 70 percent of start-up businesses received less financing than they applied for. Nearly 28 percent of start-up businesses were not approved for any financing at all.

Innovators know that if an idea is entirely new but shows promise, the first challenge is to finance its development.

As such, each innovator has to not only create something entirely new, but also fund the work involved by means that require more effort and persuasion than simply applying for a commercial bank loan.

Access to capital is one of the most challenging parts of starting a new business, especially in the tech sector where companies are at the forefront of new technologies and are developing products and services for which there is no track record.

The risks are high, and subsequently, it's difficult to raise money from investors.

For there to be progress, we need to remove obstacles to raising seed capital.

Take, for example, a company going public via an IPO has long offered real advantages.

Overregulation, however, has driven down the number of IPOs, which deprives the entrepreneurial ecosystem of capital access.

We should take a second look and modernize this system so we remain competitive.

We've already taken major steps to help. The Tax Cuts and Jobs Act included several provisions that may be helpful in expanding capital access.

As my friend and colleague on the Ways and Means Committee Chairman Brady embarks on Tax Reform 2.0, we must take an innovation-friendly approach that increases incentives to invest in new companies and technologies.

Yet government itself is not and can never be the prime mover in the world of innovation.

Washington shouldn't be subsidizing particular companies or activities in the hopes of winning big.

Picking winners and losers goes against America's entrepreneurial spirit and undermines the process by which our strongest ideas are honed and improved.

Today, I look forward to hearing from our witnesses and my colleagues on how we can reduce the barriers and empowering those with big ideas to make even bigger strides.

We are facing fierce competition. In 2017, one-third of the world's IPOs happened in China. Domestic IPOs today total merely half of what they were 20 years ago.

I'm hopeful that our work today can help get us not only back into the top 10 innovative economies in the world, but to make us number 1 overall.

I now yield to Ranking Member Senator Heinrich for his opening statement not to exceed five minutes.

PREPARED STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, JOINT ECONOMIC COMMITTEE

Mr. Chairman, thank you for focusing on barriers to capital access. It's an important issue and I look forward to the insights of our witnesses.

We have talked before about the important role small and new firms play in driving innovation and creating jobs.

Yet, the start-up rate has been declining for years, and new businesses increasingly are concentrated in the large urban counties, while rural communities are struggling to keep up.

A big challenge for entrepreneurs in small towns and remote areas is getting access to capital to turn their idea into a business or to take their business to the next level.

JEC Democrats recently released a comprehensive report—Investing in Rural America—that examines the economic challenges and opportunities facing rural communities.

Two challenges jumped out.

First, insufficient access to broadband leaves communities disconnected from economic opportunities and unable to reach customers around the globe.

And, second, insufficient access to capital constrains growth.

The more rural you get, the less access to capital there is.

Many rural communities have seen their financial institutions disappear and with them access to loans people need to build and expand businesses.

In New Mexico, there are just a handful of cities with 50,000 people or more. Often, small towns are less able to access grants and other Federal resources that may be available to them.

And smaller communities have fewer financial institutions—whether they be banks, credit unions, community development financial institutions, or nonprofits.

Let's take banks.

From 2008 through 2016, 86 new banking deserts, areas where no banks exist within ten miles, were created in rural communities.

We need to reverse this trend.

Expanding access to capital must go hand in hand with building the know-how and expertise to launch and grow businesses.

In my State, nonprofits like WESST help budding entrepreneurs create their business plans, access micro loans, and build their businesses. More than two-thirds of those they serve are women. And an even larger share are low-income.

SBA's Women's Business Center helps fund WESST. But SBA and USDA don't have the staff needed to go out and build awareness of the many programs they operate that could support rural businesses.

We need more boots on the ground.

There are also a growing number of resources available online.

Online services allow consumers to continue to have relationships with financial institutions that no longer have a physical presence in a community.

But the reality is for this to be a viable option for rural and tribal communities, these communities need to be connected to broadband, and too often, that's not the case.

It's not just a shortage of banking options.

Venture capital is also scarce in rural areas. More than three-quarters of venture capital goes to companies in New York, Boston, San Francisco and Los Angeles.

There are entrepreneurs across this country with good ideas and smart business plans. But they need access to investors who can help transform these ideas into growing businesses.

The Federal Government has a vital role to play.

We need to support small business lending through proven programs at the SBA, USDA, and the CDFI Fund.

We also need to build the technical expertise to help people access Federal resources while also promoting increased awareness about the programs that exist at SBA, USDA and Treasury.

That's what an organization called Grow New Mexico is doing. They connect people, businesses and communities to resources that can help.

Unfortunately, the Trump administration seems to be heading in the opposite direction.

Instead of doing more to increase access to capital, the Administration proposed zeroing out the CDFI Fund's grant making.

The White House's rescission package also targeted several USDA programs that support rural communities, a sign that the Administration is failing to get money out the door.

And the recent Republican tax law actually makes the tax code more complex for small firms.

We need to realign priorities.

Expanding access to capital means providing more and better options—and ensuring that people and communities are able to utilize those options.

I look forward to hearing from our witnesses on how we can build an innovation economy that supports innovation and growth in all parts of the country.

Testimony of Phil Mackintosh
Senior Vice President
Global Head of Economic Research
Nasdaq, Inc.

Before the Joint Economic Committee
July 25, 2018

Good afternoon Chairman Paulsen, Ranking Member Heinrich and all the members of the Joint Economic Committee.

Thank you for the opportunity to testify on the importance of capital formation and Nasdaq's view on how to maximize economic growth and job creation – as well as providing quality, high-growth investment options for investors who need to grow their savings.

Maximizing economic vibrancy is best achieved, in our view, if we modernize the public company model, while preserving critical investor protections.

Nasdaq recently noted the one-year anniversary of launching its Revitalize Initiative (business.nasdaq.com/revitalize) in which we highlighted a set of ideas that our listed companies, stakeholders and investors tell us will restore the vibrancy of the capital markets.

These ideas are broadly grouped around three areas of the securities law: the proxy process, the disclosure rules, and the market structure that applies to the U.S. equity markets. Over the past year, we have seen many positive developments within Congress, federal agencies, and the business community at large, including:

1. Changes by the SEC to the process for removing repetitive, unsuccessful proposals from proxies
2. Movement in Congress to enhance transparency and fairness in the proxy advisory industry
3. Growing support from the business community to streamline and allow flexibility in quarterly reporting obligations for small and medium growth companies
4. Interest at the SEC in helping smaller public companies by consolidating displayed liquidity onto a single trading venue
5. The U.S. Treasury Department's 2017 Report, "A Financial System That Creates Economic Opportunities - Capital Markets"

As you know, the House Financial Services Committee has also worked on these ideas and they have embraced the need to improve capital formation. In fact, Chairman Jeb Hensarling and Ranking Member Maxine Waters have crafted a very good package under the moniker of JOBS Act 3.0. and

sent it to the Senate with a commanding vote of 406-4. We look forward to the Senate moving forward to pass this critical bipartisan legislation.

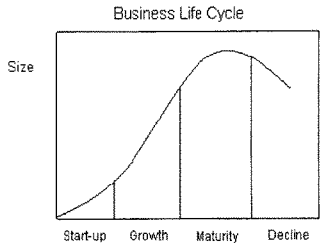
Today I will be focused on why Capital Formation is important not only to help grow the American economy but also to provide retirement security to Americans while reducing the burden on social security in the decades ahead.

Many of the solutions we propose are included in the Revitalize paper. One issue that I will not focus on today, but would like to commend Congress on, is the passage of important tax reform legislation late last year to ease the burdens on all corporations and move to a more territorial tax system for global companies. These reforms are having a positive impact on the ability of small companies to grow and expand.

For example, increased net revenues have allowed many companies to pay additional employee bonuses, while others are choosing to distribute wealth back to shareholders via dividends and buybacks – adding to the retirement wealth of US investors.

How do companies access capital for growth?

It is well documented that companies move through a variety of stages in their lifecycles. Early stages, sometimes referred to as "start-up" and "growth" phases are often capital intensive – requiring the injection of cash from owners and investors to help build and brand new products before sales take off.



Source: HBR, Nasdaq Economic Research

There are a number of places that entrepreneurs can go for cash during these growth phases. Start-ups often use crowdfunding or angel investors, in addition to their own funds. Perhaps in the not-too-distant future ICO's (initial coin offerings) on the blockchain might also be a popular option.

As the company grows, and the required investments get larger, better organized and deeper sources of funds are often used – like private equity or public equity markets.

Why are public companies important to the US?

There are two key reasons why it's important that public markets are a competitive and attractive source of funding for these companies:

1. **American Investors will benefit:** This is the growth phase of their lifecycle, when their valuation is increasing the fastest. So it's important that American investors can benefit from this wealth effect.

2. **US Economy will benefit**: Companies that list in the US almost always have head offices in the US. This means they hire more Americans, not only paying more US taxes, but also deepening the US workforce and economy.

How US public companies benefit the economy

Studies[1] have shown that economic benefits when more companies are willing to go public are significant.

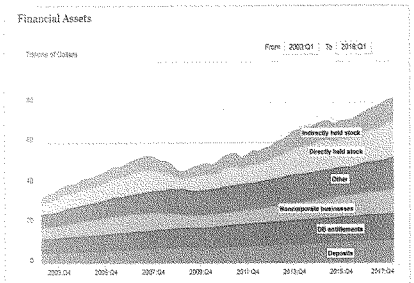
- A 2012 study by the Kauffman Foundation estimated that the 2,766 companies that went public from 1996 to 2010 collectively employed 2.2 million more people in 2010 than they did before they went public, while total sales among these companies increased by over $1 trillion during the same period.

- Another study by IHS Global Insight in 2010 found that 92% of a company's job growth occurs after it completes an IPO.

How public companies are important to investors

According to NY Fed, individual investors now have $29.4tr invested in stocks – both directly and indirectly.

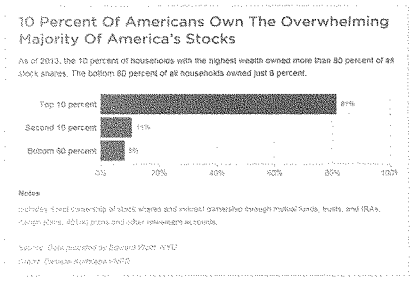
Statistics show that direct equity ownership is actually fairly concentrated, with the top 10% of Americans owning 80% of the assets. And many of those investors are likely "qualified investors", which means they can also invest in private equity and hedge funds.



Source: Fed Reserve

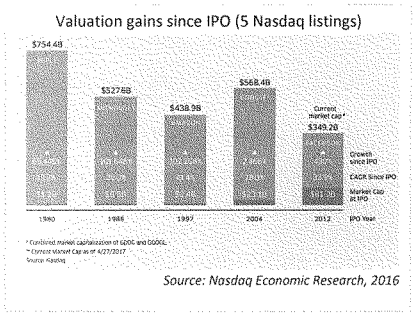
[1] Center for Capital Markets report: https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/04/IPO-Report_EXPANDING-THE-ON-RAMP.pdf

Consequently, the indirectly owned stocks are even more important to most Americans. As this $11.8tr is mostly invested in mutual funds and pension plans these naturally represent millions more Americans – many of who are veterans, retirees, teachers, nurses, firefighters, and city, state and federal workers. It's critical to their retirement security that these funds have strongest possible returns. And if we can deliver that, we will also reduce the burdens on social security in the decades ahead.



For these investors, getting growth companies into public markets is critical. That's because mutual funds are mostly restricted to invest in "listed" companies. In addition their risk and performance is measured against to established and transparent listed company benchmarks like the Nasdaq Composite or the S&P500.

But not all listed companies grow at the same rate. A recent study by Hendrik Bessembinder[2] showed that the returns from equity funds typically come from just a few high-performing stocks. For example, five Nasdaq listed companies (Apple, Microsoft, Amazon, Google and Facebook) have added more than $2.5tr to their combined valuation, and therefore the market valuation, since they IPO'd.



Source: Nasdaq Economic Research, 2016

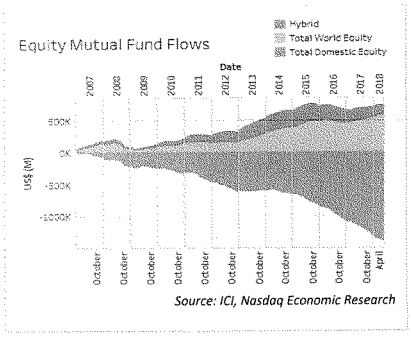
For American workers to benefit from this wealth effect it's vital that US public markets are able to compete – not only with alternative forms of capital but also with other countries – to attract the best new companies from all over the world, as early in their lifecycles as possible.

[2] *Do Stocks Outperform Treasury bills?, Bessembinder, Arizona State University, May 2018*

Don't underestimate the mobility of capital

One final point I want to make about investors is that their capital is highly mobile. We are not just competing within the US for forms of investment capital – but we are also competing internationally for where companies choose to base and list themselves.

What we've seen is that investors can, and in fact already are, shifting their investments offshore. We've seen US equity Mutual Fund outflows, totaling almost $1.5tr over the past 10 years. Around 1/3rd of that has been invested into international equity markets.

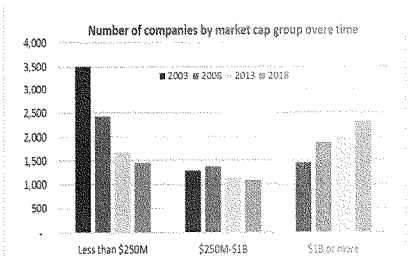


Source: ICI, Nasdaq Economic Research

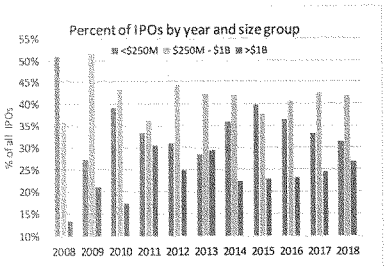
Which begins to answer the important question of "do we actually have a problem?" with attracting IPO's to list in the United States.

Data seems to show that we do:

Firstly, there is evidence that companies are choosing to stay private longer. In fact, US markets have seen growth of around 50% in the number of listed companies with market cap over $1bn. But the count of listings with a market cap ***under $250m*** *has* ***fallen*** by over 2000 (left chart below). Similarly, when we look at IPO's we see companies with less than $250m in market cap contributing a declining proportion of all IPO's, offset up an increase in larger $1bn+ IPOs (right chart below)



Source: Nasdaq Economic Research (through May 2018)

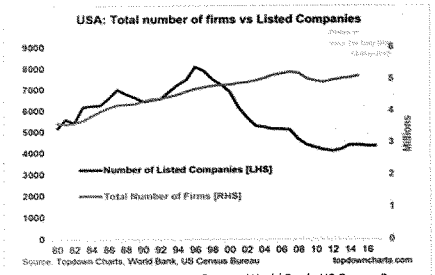


Source: Nasdaq Economic Research (through June 2018)

That's supported by a report from Vanguard which noted that microcap companies account for most of the decline in listings.

The reason this is important, is because those micro-cap companies are likely to be the ones experiencing rapid growth – which in turn means rapid gains in valuation. If we want all Americans to share in the growth of these companies, it's important that listed markets are attractive, so these stocks make their way into mutual funds at an earlier point in their life-cycle.

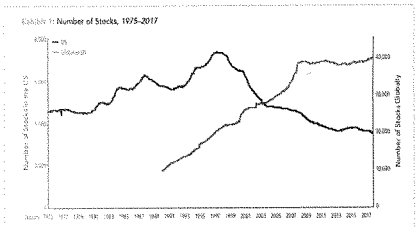
Second, this is not due to a lack of entrepreneurs. You may have also heard that 1999 was a "blip" in listed companies, caused by the tech bubble, and should not be considered normal. However data shows that the number of private companies has grown, albeit more slowly, since 1998. Over the same timeframe, listed US companies have roughly halved.



Source: World Bank, US Census Bureau

Thirdly, this is not a global phenomenon. Quite the opposite in fact.

Global data shows that over the same time that US listings have halved, offshore listings of companies have roughly doubled. This reconfirms that we are in global competition for listings.



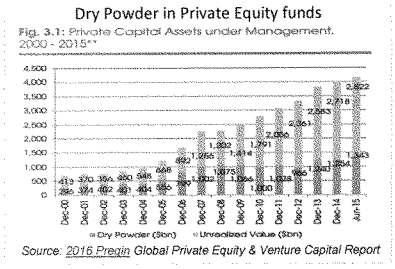
Source: World Bank

Some of you may have seen reports last week that 2018 is shaping up to be a strong year for IPO's in US markets. But that same story highlighted that many of the largest listings this year will actually be in China. It made specific mention of some companies listing in Hong Kong after the HK stock exchange loosened its listing rules around dual-class shares.

What are the reasons?

Academics and economists have suggested many reasons for the decline in US listings. Including:

- Acquisitions of small companies by larger companies
- A more highly organized and competitive Private Equity market
- Excessive regulatory burdens, often focused on Sarbanes Oxley, but also applicable to other regulations



Source: 2016 Preqin Global Private Equity & Venture Capital Report

In putting together our revitalize initiative, we talked to many of our issuers about their experiences. There were a number of common themes that deter them from, or make it more difficult to, be public.

Many of them talk about the **regulatory and reporting burdens** in the United States. And in fact, you may have seen the recent letter by Jamie Dimon and Warren Buffett criticizing the short-termism of US investors[3].

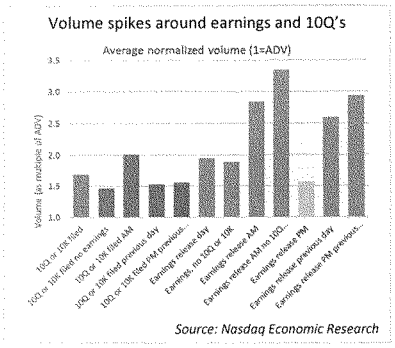
Companies also highlighted the costs of shareholder proxy fights and litigation, which also distract management from growing their businesses.

In our own studies we also see that investors react more to earnings releases than the more detailed 10Q that follows, measured by the uptick in trading activity.

Not surprisingly, changes to these are among the key recommendations in our revitalize paper.

We also list a number of tax reform proposals to improve competitiveness of public listings on an after tax basis for investors.

But total deregulation is also not the answer



Source: Nasdaq Economic Research

[3] Short termism is harming the Economy: https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801

Clearly, excessive regulation and costs, place the US public markets at a competitive disadvantage.

But the value that investors get from listing standards, and corporate accountability cannot be under-estimated.

The costs of those standards need to be weighed against the benefits.

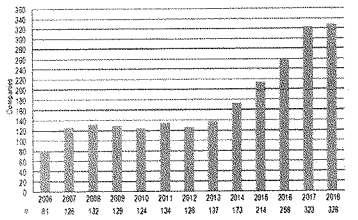
An interesting example that we can draw using international experience is to compare Nasdaq's First North venture market to AIM, the UK's venture market.

Since 2006, First North listings have increased 300%. More recently First North has been listing more companies than the more established AIM market in the UK.

Why?

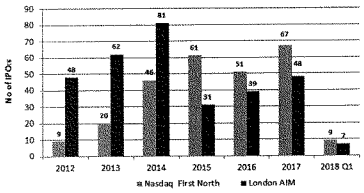
Regulatory uncertainty from Brexit is likely a factor. But so too, we understand, is some poor investor returns and experiences from AIM listed companies.

Companies in First North, Nasdaq's venture market (by year)



Source: Nasdaq Economic Research

New Venture listings (First North vs AIM)



Source: Nasdaq and LSE, AIM

What do we propose for the US?

As indicated earlier, Nasdaq studied this issue over a year ago, reached out to public and private CEOs and entrepreneurs running emerging growth and high growth companies, industry experts and others to understand the roots of these problems. There is no single variable that can be changed and solve the problems. Like the well-intentioned laws and regulations that layered themselves into barriers, several policies aimed at several fronts to reduce those barriers to listing will help improve capital flows into the public markets. That includes:

- Strengthening the market trading experience for smaller companies;
- Deploy intelligent minimum price movements, or tick sizes, for small and medium growth companies;
- Cultivate innovative solutions that improve the trading of small and medium growth companies.
- Increasing the flexibility of reporting obligations;

- Enhancing transparency around activist investing;
- Equalizing short interest transparency and;
- Supporting the dual class structure that is critical to attracting the most innovative and growing companies to participate in public markets.

Conclusion

We should not ignore the fact that the US has the deepest, most liquid, and most efficient capital markets in the world. But we need to make sure that we keep it that way as competition from less regulated investment pools and other regions increases.

We appreciate the opportunity to present Nasdaq's views on a such an important topic for American investors and the economy.

Thank you Mr. Chairman and all members of the Joint Economic Committee.

Rachel King
Chief Executive Officer, GlycoMimetics, Inc.

On behalf of the Biotechnology Innovation Organization

Before the Joint Economic Committee of the United States Congress
---
Hearing on the Innovation Economy, Entrepreneurship, and Barriers to Capital Access

July 25, 2018

Executive Summary

GlycoMimetics is a clinical-stage biotechnology company based in Rockville, Maryland. The Biotechnology Innovation Organization (BIO) represents GlycoMimetics and 1,000 other innovative biotech companies, the vast majority of which are pre-revenue small businesses.

- GlycoMimetics undertook a successful IPO in January 2014 using key provisions in the Jumpstart Our Business Startups (JOBS) Act. In the six years since the JOBS Act became law, 276 biotech companies have gone public as emerging growth companies (EGCs).
- GlycoMimetics will lose its status as an EGC in January 2019, five years after our IPO. As a result, we will immediately be subject to onerous auditor attestation requirements set forth in Section 404(b) of the Sarbanes-Oxley (SOX) Act, despite being years away from having a product on the market
- GlycoMimetics, like many other biotechnology companies, has a high valuation thanks to the promise of its technology and investor confidence in our future. However, we are currently locked out of several valuable tax breaks due to our future potential. Simple changes to existing provisions of the tax code could promote innovation by allowing us to invest more in our R&D—and ultimately get our treatments to patients faster.
- BIO fully supports policies that build on the success of the JOBS Act, FDASIA's "breakthrough therapies" designation, as well as policies that provide tax relief and strengthen patent protections. Together, these policies would increase the flow of capital to innovative small businesses, decrease capital diversions from the lab to unnecessary compliance burdens, and support companies once they are public.
- These policies include:
    - Expanding the current smaller-company exemptions from Sarbanes-Oxley Section 404(b) auditor attestation requirements by passing the "Fostering Innovation Act" (H.R. 1645/S.2126/S.488), which would extend the JOBS Act exemption for EGCs for an additional five years;

- Reforming Section 382 of the tax code to encourage investment in high growth, pre-revenue companies, while maintaining the current anti-abuse provisions;
- Simplifying and expanding Section 1202 of the tax code to exempt gains on investments in Qualified Small Business Stock (QSBS) to encourage investment in innovative breakthroughs;
- Broadening the criteria to enable more innovative startups to benefit from the payroll R&D credit in Section 41 of the Tax Code; and
- Strengthening patent protections through enactment of the STRONGER Patents Act, which would improve biotech companies' abilities to attract investors who recognize the potential of our innovations.

Testimony

Good morning Chairman Paulsen, Ranking Member Heinrich, and Members of the Joint Economic Committee. My name is Rachel King, and I am the co-Founder and Chief Executive Officer of GlycoMimetics, Inc., a 50-employee public biotech company based in Rockville, Maryland. I also serve on the Board of Directors for the Biotechnology Innovation Organization (BIO), which represents GlycoMimetics and over 1,000 other growth-stage biotechs that are driving the search for the next generation of cures and breakthrough medicines. I am pleased to be testifying in front of Representative Delaney, in whose district GlycoMimetics is based, as well as Representative Comstock, whose district is also part of the local biotech healthcare cluster, the BioHealth Capital Region. It is my privilege to be here today to discuss policies that will help small growth companies like biotechs access the capital necessary to fund the next innovative breakthrough to address disease, hunger or pollution.

Private emerging companies working on innovative therapeutics are highly dependent on access to capital.[1] More than 95% of these companies are in the R&D process without an FDA-approved product on the market. It costs over $2.6 billion to develop a single life-saving treatment[2], and most companies spend more than a decade in the lab before their first therapy is approved. During this long development process, virtually every dollar spent by an emerging biotech comes directly from investors. Expenses ranging from buy-in-bulk beakers to $150 million clinical trials are all funded by investment capital because biotechs generally remain pre-revenue through their entire time in the lab and the clinic. In short, investment capital is the lifeblood of scientific advancement.

Early-stage biotech innovators do not have the luxury of funding their product development through sales revenue. Instead, the groundbreaking research that leads to a company's first

---

[1] BIO Industry Analysis, "Emerging Therapeutic Company Investment and Deal Trends," 2018, http://go.bio.org/rs/490-EHZ-999/images/BIO%20Emerging%20Therapeutics%20Company%20Investment%20and%20Deal%20Trends%20Report%202008-2017.pdf?_ga=2.69712784.1270809009.1528142129-1736185180.1496688333.

[2] BIO, "The Biotechnology Ecosystem: By the Numbers," https://www.bio.org/toolkit/infographics/biotechnology-ecosystem-numbers.

product is funded by a series of financing rounds from angel investors, venture capitalists, large pharmaceutical companies, and, eventually, public market investors. The capital burden of a pivotal clinical trial—which can require hundreds of patients in the clinic to meet the stringent safety and efficacy standards necessary to ensure patient care—often necessitates an IPO to fund this critical stage of the research process. Additional follow-on offerings through public markets can provide timely access to capital after key clinical or regulatory milestones.

Licensing also provides a significant source of funding for emerging companies, and often entails sharing development expertise and technical resources with a larger company.[3] In 2017, roughly 43% of emerging company programs are partnered with other companies, demonstrating the importance of licensing and collaborations in the biopharmaceutical industry.[4] Each of these financing pathways—venture financing, IPOs, follow-on offerings, and licensing partnerships—are vital to translate novel drug candidates into approved medical products for patients. The policies championed by Congress to improve capital formation and encourage innovation through regulatory relief, tax incentives, and restored patent protections have a meaningful and very tangible impact on emerging biotech companies' abilities to access each of these pathways and attract the long-term investment necessary to bring the next innovative cure to the market.

To that end, BIO supports policies that facilitate small innovators' access to capital. As described below, Congress plays a critical role in enacting policies that help small companies attract capital and minimize its diversion from the lab to unnecessary compliance burdens.

Success of the JOBS Act

Since pre-revenue small businesses like GlycoMimetics utilize only investment dollars to fund our work, we place a high value on policies like the JOBS Act that induce investment in innovation and prioritize resource efficiency. Any policy that increases the flow of capital to emerging companies could lead to funding for a new life-saving medicine—while any policy that diverts capital to unnecessary and costly regulatory burdens could lead to the same treatment taking longer to get to patients, or worse, left on the laboratory shelf.

Enacted in 2012, the JOBS Act has been an unqualified success, enhancing capital formation and allowing companies to focus on science rather than compliance. In the six years since the JOBS Act became law, 276 biotech companies have gone public as emerging growth companies (EGCs). As a result, emerging growth biotech companies have raised 22.5 billion dollars through IPOs that paved the path for them to develop 27 novel drugs that have garnered FDA approval. The IPO onramp and regulatory relief provisions in the JOBS Act certainly helped facilitate GlycoMimetics's IPO in January 2014. However, without action by Congress, once GlycoMimetics loses its JOBS Act provisions in January 2019, we will immediately be forced to spend additional hundreds of thousands of dollars per year on regulatory requirements related to increased financial reporting.

As companies like mine face the end of the JOBS Act on-ramp at the five-year mark, legislation currently before Congress that would extend this on ramp would be extremely

---

[3] BIO Industry Analysis, "Emerging Therapeutic Company Investment and Deal Trends," 2018, http://go.bio.org/rs/490-EHZ-999/images/BIO%20Emerging%20Therapeutics%20Company%20Investment%20and%20Deal%20Trends%20Report%202008-2017.pdf?_ga=2.69712784.1270809009.1528142129-1736185180.1496688333.

[4] Ibid.

beneficial for growing companies that stand to lose EGC status for no other reason than time, despite still qualifying by all other metrics.

Sarbanes-Oxley 404(b)

One of the critical achievements of the JOBS Act was the exemption from Sarbanes-Oxley (SOX) Section 404(b) for EGCs for the first five years after their IPO. Section 404(b) requires an external auditor's attestation of a company's internal financial controls that provides little-to-no insight into the health of an emerging biotech company. Instead, biotech investors tend to demand information about the variables that will determine whether the company will ultimately succeed or fail to develop the next innovative breakthrough—such as the science and technology underpinning company's potential, the diseases it could treat, the patient population that could be impacted, and the FDA approval pathway, among others. SOX 404(b) is ultimately a key pain point for emerging growth biotech companies because of its extraordinary expense, their pre-revenue status, and the fact that it is of little use to their investors.

Accordingly, the JOBS Act's exemption from Section 404(b) is extremely valuable for pre-revenue biotechs and other emerging growth companies. This time-limited relief allows us to invest more dollars in research and development rather than raising funds solely to comply with the costly auditor attestation requirements under current law. However, as helpful as the five-year exemption is, biotech development timeline is a decades-long affair. Most biotechs that went public under the JOBS Act will still be in the lab and the clinic at the beginning of year six on the market, at which point they will face a SOX 404(b) compliance burden identical to that faced by commercial leaders and multinational corporations, even as they remain pre-revenue.

Public biotech companies are subject to extensive audit and disclosure requirements beyond SOX 404(b). After my company's IPO, our audit fees increased by roughly $500,000 due to the existing regulatory environment for public companies. These costs cover our external audits, and we also provide an annual assessment of our company's internal controls over financial reporting. Yet our audit fees will skyrocket even further once our Section 404(b) exemption expires. When GlycoMimetics rolls off its EGC status in a few short months, we expect our Section 404(b) compliance obligations alone to more than double our compliance costs to as much as $1.1 million annually, even though we are still years away from having a product on the market and generating product revenue. This is a substantial amount that will be diverted from R&D and the clinic, and instead spent on compliance requirements that offer little to no benefit to our investors. My company is far from being an outlier in this situation—most of the over 276 biotechs that have gone public since the JOBS Act was enacted are still years away from getting their drug approved and becoming a profitable company. It is counterproductive for these growth-stage companies to face a full-blown compliance burden identical to those faced by large, multi-national revenue-generating companies.

To alleviate these burdens for EGCs, we urge the Senate to pass the "Fostering Innovation Act," which was part of the JOBS & Investor Confidence Act that passed the House of Representatives last week with broad bipartisan support (S.488).

The Fostering Innovation Act would extend the Section 404(b) exemption for certain EGCs for an additional five years. BIO commends Senators Thom Tillis and Gary Peters for sponsoring this bipartisan bill in the Senate, and Representatives Kyrsten Sinema and Trey Hollingsworth for sponsoring it in the House. We also thank members of this Committee,

including Representative Delaney, for cosponsoring this piece of legislation. This bill recognizes that a company that maintains the characteristics of an EGC is still very much an emerging company even if it has been public for longer than five years. It provides a targeted exemption from Section 404(b) compliance requirements to companies in years 6-10 of being public that have a public float less than $700M and average annual revenues less than $50M. These restrictions ensure that only companies who are truly still EGCs are eligible—if a company eclipses the revenues or public float thresholds, their full compliance obligations kick in. The Senate Banking Committee recently considered it as part of a hearing on capital formation bills on June 26th. I urge the Senate to take up this important legislation in a timely manner, before any more companies are rolled off the JOBS Act provisions and subject to the onerous auditor attestation burdens.

It is also within the SEC's authority to provide regulatory relief from SOX 404(b) for small business innovators by expanding the definition of a "non-accelerated filer" under the Commission's disclosure rules. The SEC Chair recently directed the Commission staff to develop a proposal to expand the pool of smaller companies that would be designated "non-accelerated filers" to provide much-needed relief from SOX 404(b). Expanding this exemption would build on the progress made in the JOBS Act by right-sizing compliance requirements for smaller public companies to more accurately reflect the nature of emerging businesses and allow them to tailor certain disclosure obligations accordingly.

As you might expect, there is overwhelming support for an expanded exemption of Section 404(b). Proposals that would expand the Section 404(b) exemption have received the strong support of industry leaders.[5] Further, the SEC Advisory Committee on Small & Emerging Companies and SEC Government-Business Forum on Small Business Capital Formation have called for expanding the exemption for several years.[6]

Section 382 Net Operating Loss Reforms

Tax rules relating to the treatment of losses can unintentionally punish start-ups for investing in the growth of their companies. In particular, the rules in Section 382 of the tax code were written in the mid-1980s with the intent of preventing loss trafficking, or the strategy of companies acquiring failing firms with enormous losses on their books for the sole purpose of using the tax losses to offset other income. While we recognize the importance of preventing abusive loss trafficking, the excessive application of these rules has created an impediment for start-ups, which depend on investment capital and often accumulate net operating losses (NOLs) because of substantial R&D expenditures and rapid hiring.

For example, the typical biotech company does not have a product on the market yet, nor a steady source of revenue, and spends tens of millions of dollars on R&D annually. The biotech industry, as a whole, is responsible for more than 20 billion dollars of annual

[5] See Comments on SEC's Proposed Rule: Amendments to Smaller Reporting Company Definition, in particular comments submitted by Nasdaq, NYSE, the National Venture Capital Association, CONNECT, Corporate Governance Coalition for Investor Value, https://www.sec.gov/comments/s7-12-16/s71216.htm. See also, IPO coalition report entitled "Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public," Spring 2018, https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/04/IPO-Report_EXPANDING-THE-ON-RAMP.pdf.

[6] See most recent reports of the: SEC Government-Business Forum on Small Business Capital Formation, November 30, 2017, https://www.sec.gov/files/gbfor36.pdf; and SEC Advisory Committee on Small and Emerging Companies, September 21, 2017, https://www.sec.gov/info/smallbus/acsec/acsec-final-report-2017-09.pdf.

research investment and employs millions of individuals nationwide. Absent a current tax liability, virtually all of this investment results in NOLs.

Unfortunately, under Section 382, raising new capital investments can trigger limitations on a start-up's ability to utilize its NOLs in the future. Thus, Section 382 discourages investment in innovation and works at cross purposes with tax policy that generally seeks to encourage R&D, such as the R&D credit.

BIO supports certain changes to Section 382 that would help free biotech investment from the specter of severe and unwarranted loss limitations. These include exempting capital contributions to the company from ownership change calculations and exempting R&D expenses (defined as Section 174 expenses) from limitation, preserving the company's ability to use its NOLs generated from R&D expenditures.

By enacting a 12-year limit as well as retaining anti-abuse protections and retaining the continuity of business enterprise test, Congress can ensure that the original intent of preventing loss-trafficking remains intact while also fostering economic growth and job creation.

Mr. Chairman, BIO appreciates your concern about this issue and looks forward to working with you to develop a solution that supports innovation.

Section 1202 Qualified Small Business Stock Reforms

Another critical tool for encouraging investment in small business innovators is the tax benefit under Section 1202 of the Internal Revenue Code.

Section 1202 provides an incentive for investment in smaller business by making capital gains from the investment in Qualified Small Business Stock (QSBS) tax free. This exemption was made permanent in 2015 in the Protecting Americans from Tax Hikes (PATH) Act and was retained in the Tax Cuts and Jobs Act in 2017. We believe that maintaining the permanent exemption on gains from investments in QSBS is vital to encourage the early-stage investment necessary to spur groundbreaking innovation. We applaud lawmakers for retaining this incentive in the new tax law.

Section 1202 has the potential to be one of the most powerful federal policies for encouraging an expansion of entrepreneurship across the country. However, the incentive is currently too narrowly drawn for many biotechs to qualify. Though they are still small pre-revenue companies, many biotechs hold valuable intellectual property that easily eclipses the $50 million gross assets limit, thus rendering them ineligible for qualified small business status.

BIO supports simplifying and expanding Section 1202 to encourage more investment in start-ups across the country. For example, raising the gross assets limit to $100 million would unleash a wave of investment in small but highly valued biotech companies. In addition, simplifications to the provision could also reduce uncertainty for investors and help fuel investment.

Section 41 Payroll R&D Credit Expansion

BIO applauds Congress for creating the payroll R&D credit in the Protecting Americans from Tax Hikes (PATH) Act in 2015. The provision allows companies in their first five years of operation with less than $5 million in annual gross receipts to utilize up to $250,000 in R&D credits annually. This was an important recognition by Congress that R&D tax credits do not yet benefit pre-revenue companies. Unfortunately, these size and age restrictions leave many biotech start-ups unable to access the benefits of the payroll R&D credit.

BIO supports expanding this provision to encompass a wider, more representative universe of start-ups and emerging innovators. Given the long development timelines of the biotechnology industry's groundbreaking innovation and the high costs of breakthrough research, targeted expansions to the payroll credit would ensure that more innovative pre-revenue companies can take full advantage of this new incentive.

Patent Reforms

Very few sectors of the nation's economy are as dependent on predictable, enforceable patent rights as the biotechnology industry. Robust patents that cannot be easily circumvented or invalidated, and that can be predictably enforced against infringers, enable biotechnology companies to secure the enormous financial resources needed to advance biotechnology products to the marketplace. Further, they allow biotechs to engage in the partnering and technology transfer that is necessary to translate basic scientific discoveries into real-world solutions for disease, pollution, and hunger. These financing pathways include venture financing, IPOs, follow-on offerings, and licensing partnerships, and are all predicated on the existence of stable and enforceable intellectual property rights. Without a dependable patent system, capital for the cures of the future will not be available.

These financing pathways have been critical to the success so far of GlycoMimetics. Without strong and reliable patents, we would not have been able to secure the investment or partnerships that have kept our doors open for so many years as we seek to prove the safety and efficacy of our leading therapeutic candidates.

If patents can be invalidated under overly broad criteria, if the ability to enforce them becomes limited, or if limits on patent eligibility call into question the ability to obtain patent protection for innovative cures, third parties would be less likely to invest in or license the technology, and major sources of R&D funding would move elsewhere. The result – patients waiting for the next new cure or treatment will have to wait longer or may not ever get it at all. Because investment-intensive businesses can tolerate only so much risk, even moderate additional uncertainty can cause business decisions to tip against developing a high-risk, but potentially highly-beneficial, product.

Unfortunately, changes to our patent laws through legislation, agency actions, and court decisions, have severely weakened our patent system. Although the U.S. patent system was once considered the gold standard for the rest of the world, in the latest global survey conducted by the U.S. Chamber of Commerce, our patent system was rated only 12th in the world, behind Singapore, France, and South Korea, among other countries.[7]

To remedy this concerning trend, BIO encourages Congress to advance patent litigation reform legislation that is currently pending review by the House and Senate Judiciary Committees and is highly relevant to the biotech business model. BIO supports the bipartisan STRONGER Patents Act, H.R. 5340, introduced by Representatives Steve Stivers

[7] Global Innovation Policy Center, Create: U.S. Chamber International IP Index, 6th ed. 35 (2018).

and Bill Foster, and S. 1390, introduced by Senators Chris Coons and Tom Cotton, which would address many of the deficiencies in the IPR process. It also incorporates the TROL Act, which would protect patent holders from predatory demand letters, and it would ensure that fees paid to the Patent and Trademark Office would not be diverted to other government functions.

BIO also commends the efforts of the U.S. Patent and Trademark Office to reform the IPR process. The recent proposal to harmonize claim construction standards with those used in Federal Court will go a long way to removing a significant incentive to game the system.[8]

Food and Drug Administration Safety and Innovation Act (FDASIA)

The Food and Drug Administration Safety and Innovation Act (FDASIA) provides a good example of how legislative and regulatory changes can create meaningful opportunities for innovative small businesses to attract investments that improve their potential to put a life-saving treatment on the market. FDASIA enabled the Food and Drug Administration (FDA) to review certain promising "breakthrough therapies" on an expedited basis, which has improved investor confidence in certain products' potential and helped increase the flow of capital to innovative biotech companies. The "breakthrough therapy" designation signals to investors that the FDA views a particular product as having promising potential to treat a serious condition and that may demonstrate substantial improvement over other available therapies. The "breakthrough therapy" designation is designed to expedite the review of designated therapies without changing FDA's safety and effectiveness standards for new drug approval. Receiving "breakthrough therapy" designation allows the FDA to provide intensive guidance during the regulatory review of a drug development program and reflects an organizational commitment involving senior FDA managers for products that receive such designation. Accordingly, the "breakthrough therapy" designation and associated benefits provide a powerful signal to investors that the product with designation has a promising path through regulatory review.

GlycoMimetics received "breakthrough therapy" designation for our drug candidate, GMI-1271, for treatment of adult relapsed/refractory acute myeloid leukemia or ALM in May 2017. In the year following that designation, we have been able to raise nearly $250 million, and this funding will enable us to conduct the definitive clinical testing of the drug. This underscores just how powerful of a signal the "breakthrough therapy" designation provides investors in terms of the pathway to receiving regulatory approval for a designated product.

I urge Congress to continue to support policies like these that provide investor certainty and encourage investment in innovative industries like biotech.

Conclusion

Thank you for the opportunity to testify today in support of policies to help ensure small business innovators like biotechs have access to sufficient capital. Policies enacted by

---

[8] U.S. Patent and Trademark Office, Changes to the Claim Construction Standard for Interpreting Claims in Trial Proceedings Before the Patent Trial and Appeal Board, 83 F. Reg. 21221 (May 9, 2018).

Congress and regulators play a significant role in how emerging growth companies like biotechs attract, retain, and efficiently deploy their much-needed capital.

Despite past successes, there is still work to be done to encourage long-term investment in innovation. Building on legislation like the JOBS Act and FDASIA's "breakthrough therapies" designation, refining our tax code, and strengthening the patent system, would make the public capital markets a more attractive financing pathway for emerging biotech companies, improve investor confidence, and ease regulatory burdens for smaller companies. I look forward to working with you on these issues and I am happy to answer any questions you may have.

OPPORTUNITYFINANCE NETWORK™

Testimony of Lisa Mensah

President and CEO, Opportunity Finance Network

Provided to the Joint Economic Committee

July 12, 2018

Note: This version corrects a data error on SBA 7(a) lending trends in rural areas (Page 11) and differs from the testimony submitted originally.

Good afternoon Members of the Joint Economic Committee. Thank you for holding this hearing on "The Innovation Economy, Entrepreneurship, and Barriers to Capital Access." My name is Lisa Mensah, and I am President and CEO of the Opportunity Finance Network (OFN). I am pleased to be here today to testify on this critically important issue of access to capital for small businesses.

OFN is a national network of community development financial institutions (CDFIs), mission-driven community development banks, credit unions, loan funds and venture capital funds investing in opportunities that benefit low-income, low-wealth, and other under-resourced communities across America. CDFIs connect communities to capital that creates jobs, supports small businesses, builds affordable housing, cultivates healthy food and energy efficiency, and promotes safe borrowing and lending.

Currently there are more than 1,100 CDFIs certified by the Department of Treasury's Community Development Financial Institutions (CDFI) Fund. CDFIs in OFN's membership alone have originated more than $54.9 billion in financing in urban, rural, and Native communities through 2016. With cumulative net charge-off rates of less than 1 percent, CDFIs lend prudently and productively in unconventional markets often overlooked by conventional financial institutions.

CDFIs exist to move money to people and places missed by traditional lenders. It is our industry's view that in order to have an economy that supports innovation in all 50 states, especially in areas where growth has lagged or poverty is high, there is an urgent need to invest in the partnerships that will create more small businesses.

727 15th Street NW, Suite 750 ▪ Washington, DC 20005
P: 202.618.6102 ▪ info@ofn.org

Today I would like to provide an overview of some of the challenges facing small businesses in accessing credit, with special emphasis on how those challenges impact small businesses in rural and Native communities, how CDFIs are helping to address those challenges, and the role the federal government can play in providing resources to further stimulate the flow of capital to businesses that need it most. As the former Undersecretary for Rural Development at the US Department of Agriculture, I saw not only the challenges facing our rural communities but also gained a deep understanding of how targeted resources from the federal government have the potential to unlock the promise and opportunity we know is present in rural America.

The Small Business Lending Landscape

Small businesses are important drivers of economic growth but face macroeconomic and microeconomic challenges when seeking access to credit. As the economy recovers, some small businesses are rebounding amid stronger economic growth. The Federal Reserve's *"2017 Small Business Credit Survey of Employer Firms"* found the net share of firms reporting profitability, revenue growth, and employment growth all increased from 2016 levels, and expectations for revenue and employment reached their highest levels since 2015 with nearly two-thirds of firms anticipating revenue growth in 2018.[1] While these improvements in the small business outlook are welcome, this growth is not experienced evenly for all small businesses. Although lending conditions have remained relatively stable for the past several years, credit standards for loans from traditional lenders have tightened sharply since the Great Recession, leaving some small business owners with few options to obtain financing.

Several factors impact the availability of credit for all small businesses: contractions in the banking system and lending to small business, a decline in the availability of small dollar loans, weak or limited credit history, lack of business and financial management skills, inadequate entrepreneurial training and networks, limited

[1] "2017 Small Business Credit Survey: Report on Employer Firms", Federal Reserve System, https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-employer-firms-report.pdf

awareness of lending options, discrimination, and insufficient access to broadband and technology.

- **Bank Closures and Consolidation** – The trends in the banking industry towards consolidation have accelerated in recent years. A report by the *Wall Street Journal* found the number of bank branches in the U.S. shrank by more than 1,700 in the 12 months ending in June 2017, the biggest decline on record.[2]. As branches close, access to banking services as well as credit and loans is diminished for the areas served by the branches.

  A decline in the number of bank branches and community banks especially impacts the availability of credit to small businesses, who typically rely on relationship lending from their local lenders. The Federal Reserve's *Report to Congress on the Availability of Credit to Small Businesses* states "the structure of the local banking market is particularly important because changes in concentration could affect the level of competition for small business lending, which, in turn, could influence the cost of borrowing and the quantity of credit demanded."[3] The recent decline in bank branches has hit rural communities especially hard -- by the end of 2017, there were 625 rural counties without a community bank based in the county, at least 35 counties have no bank, and 115 are served by just one branch.[4]

- **Contraction in Small Business Lending** – Recent data shows that small business lending is still struggling to recover from the impact of the financial crisis. A 2018 report on small business lending trends from the Federal Reserve Board of Governors notes that the dollar volume of small business

---

[2] Rachel Louise Ensign, Christina Rexrode and Coulter Jones, "Banks Shutter 1,700 Branches in Fastest Decline on Record", Feb. 5, 2018 https://www.wsj.com/articles/banks-double-down-on-branch-cutbacks-1517826601. Accessed July 7, 2018.
[3] Federal Reserve System, "Report to the Congress on the Availability of Credit to Small Businesses", September 2017. Accessed July 6, 2018. https://www.federalreserve.gov/publications/files/sbfreport2017.pdf
[4] Ruth Simon and Coulter Jones, "Goodbye, George Bailey: Decline of Rural Lending Crimps Small-Town Business", December 25, 2017. Accessed July 6, 2018. https://www.wsj.com/articles/goodbye-george-bailey-decline-of-rural-lending-crimps-small-town-business-1514219515.

loan originations grew about 31% between 2010 and 2016 but remains nearly 30% below the 2007 high.[5] There are some areas of improvement in lending conditions: large bank lending to small businesses is increasing, with loan approval rates at big banks (those with $10 billion or more in assets) hitting a post-recession high in May 2018 and approval rates at regional and community banks rising to 49.4%, the highest for small banks since May 2015.[6] Despite this increase, large banks still approved only 25.9% of loan requests by small business owners, meaning nearly three quarters of applicants were denied financing and regional banks denied more than half of the funding requests they received in May 2018.[7]

A deeper look into the data reveals a less rosy outlook for small business in rural communities. A *Wall Street Journal* analysis of Community Reinvestment Act data reveals the dollar value of small loans to businesses in rural communities peaked in 2004, and in 2018, lending levels are still less than half of 2004 levels in those same communities. In fact, when adjusted for inflation, rural lending is below 1996 levels.[8] Further, loans to rural communities account for only ten percent of all small business loans.[9]

- **Decline in availability of small dollar loans** - There has also been a decline in the availability of smaller dollar loans, which are critical for many small businesses, but especially microenterprises. For lenders, small business loans have high transactions costs, often making it unprofitable to make small loans. In addition, new startup firms or owners with limited business experience often require a level of technical assistance that can make small business and microlending even more cost prohibitive to a lender.

---

[5] Dore, Tim, and Traci Mach (2018). "Recent Trends in Small Business Lending and the Community Reinvestment Act," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, January 2, 2018. Accessed July 7, 2018/ https://doi.org/10.17016/2380-7172.2122.
[6] Biz2Credit Small Business Lending Index, May 2018, https://www.biz2credit.com/small-business-lending-index/may-2018
[7] *Id.* at 6.
[8] *Id.* at 4.
[9] *Id.* at 4.

A report by the Woodstock Institute, "*Patterns of Disparity*" stated the number of CRA-reported loans under $100,000 in 2015 remained 58% lower than in 2007 and two percent lower than in 2001. The total dollar amount of those loans decreased nearly 47% from its peak in 2007 but rose by 16 percent, from $67.0 billion to $77.9 billion, between 2001 and 2015.[10] At the same time, the demand for loans of less than $100,000 remains high. The 2017 Small Business Credit Survey found that 55% of applicants sought $100,000 or less in financing, creating a significant access to capital gap.[11]

- **Weak credit history/collateral -** Tight credit markets can have an impact on small business owners who may have weak or limited credit history, lack of collateral, poor financial documentation, and modest business revenues. Many of these small business owners use their personal credit to finance their business. The 2017 Small Business Credit Survey found that 50% of small businesses rely exclusively on their owners' personal credit scores to secure debt, and another 37% use both the owners' personal scores and business credit scores.[12] Weak credit history makes it more difficult to secure financing from mainstream sources and makes these small business owners more vulnerable to predatory online lenders.

  In Native communities, collateral requirements are often an impediment to securing business financing. The Office of the Comptroller of the Currency notes that some banks are uncertain about lending to businesses and individuals in Indian Country since commercial lenders offer loans backed by hard collateral and often real estate. Lending in Indian Country may require special arrangements, largely because of the sovereign status of tribes and

[10] "Patterns of Disparity: Small Business Lending in the Detroit and Richmond Regions", The Woodstock Institute, January 2017. Accessed July 6, 2018. http://www.woodstockinst.org/sites/default/files/attachments/Detroit%20and%20Richmond%20Report%20Website.pdf
[11] "2017 Small Business Credit Survey: Report on Employer Firms", Federal Reserve System, https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-employer-firms-report.pdf
[12] *Ibid.*

the unique status of Indian lands, which increase transaction costs and make the market less attractive for mainstream lenders.[13] This amplifies the need for Native CDFIs that understand the economic and cultural dynamics of financing businesses in Indian Country and have deep connections to the communities in which they work.

- **Inadequate Business Training and Financial Management Skills –** Inadequate business training and financial management skills are challenges facing many small businesses seeking financing. CDFIs have noted the need to: provide specialized training and technical assistance to small business borrowers to identify areas of weakness in the business, develop a strategy for delivering technical assistance to that borrower, and build capacity to ensure the business owner is prepared for financing. This hands-on approach to business development is a key component to the success of CDFI lending to small businesses.

- **Access to business and professional networks –** Small business owners often lack access to business and professional networks needed to access venture capital, private equity or other institutional capital. Further, underserved business owners often lack personal capital and are less likely to have friends and family networks with strong access to capital. Access to business networks and mentorship can build relationships or lead to financial opportunities.

- **Limited Awareness of Financial Options** – Often small business owners are not aware that they may have affordable options to finance their businesses, or that responsible lending alternatives like CDFIs are available. It is also important to address the role of online and marketplace lenders in the small business lending space. The emergence of online lending has produced a seismic shift in the delivery of capital and financial services to consumers

[13] Office of the Comptroller of the Currency, "Commercial Lending in Indian Country: Potential Opportunities in a Growing Market", February 2016. Accessed July 7, 2018. https://www.occ.gov/topics/community-affairs/publications/insights/insights-commercial-lending-indian-country.pdf

and business owners. As traditional brick and mortar lending institutions continue to retract and reduce their numbers, new online lenders have entered the small business marketplace to meet the credit needs of small business borrowers.

Responsible marketplace lenders like those signed on to the Small Business Borrowers Bill of Rights are filling a gap and providing a financing option to people with limited access to business credit and financial services.[14] Still, there remains too many unscrupulous, predatory lenders with opaque business models, underwriting methods, and portfolio quality. There are lenders offering high-cost loans targeting the most vulnerable small businesses with little transparency about loan pricing and terms upfront. The lack of oversight in the online lending market limits the ability of business owners to make informed decisions.

- **Discrimination** – Lending biases can also prevent small businesses from accessing mainstream lending. Studies show that small businesses owners of color are less likely to apply for a loan due to fear of rejection. A 2016 Independent Business Survey conducted by the Institute for Local Self Reliance reported that of the business owners of color who applied for a bank loan in the last two years, 54% were rejected.[15] The SBA's research shows minority business owners are disproportionately denied financing even when controlling for factors such as business credit scores and personal wealth.[16] The Minority Business Development Agency's (MBDA) research finds that

[14] The Small Business Borrowers' Bill of Rights identifies 6 fundamental rights that all small business owners seeking financing deserve along with the specific practices that lenders and brokers must abide by in order to uphold and protect those rights. The Small Business Borrowers' Bill of Rights is a product of the Responsible Business Lending Coalition (RBLC), a network of for-profit and non-profit lenders, brokers and small business advocates. For more information, visit http://www.borrowersbillofrights.org/.
[15] Advocates for Independent Business and Institute for Local Self-Reliance, "2016 Independent Business Survey", February 2016. Accessed July 9. 2018. https://ilsr.org/wp-content/uploads/2016/02/2016_Survey_Report_FINAL.pdf
[16] Christine Kymn, "Access to Capital for Women- and Minority-owned Businesses: Revisiting Key Variables by Advocacy", Issue Brief 3: Access to Capital, Small Business Administration, Office of Advocacy January 2014. Accessed July 6, 2018. https://www.sba.gov/sites/default/files/Issue%20Brief%203%20Access%20to%20Capital.pdf

minority business owners are denied loans at nearly three times the rate of non-minority owners.[17] Even when controlling for credit and collateral differences, when small business owners of color do access capital, they often receive lower loan amounts and pay higher rates. This can discourage small business owners from even applying for financing. The Federal Reserve's *"2017 Small Business Credit Survey"* found 13% of respondents did not apply for financing in the previous 12 months because they believed they would be turned down. That figure grows to 21% for businesses with revenues of less than $100,000.[18]

- **Access to Broadband and Technology** – Access to broadband is an issue for many low-income communities, but its impacts are especially pronounced in rural and Native communities. As the Joint Economic Committee's *"Investing in Rural America: Bringing Progress and Economic Opportunity to Rural Communities"* report notes, more than one third of residents currently living in rural communities do not have access to broadband.[19] Expanding broadband access could increase businesses' access to banking and financial services to mitigate the impact of bank closures. Access to broadband also offers opportunities for small businesses to grow online, improving the ability to reach new markets and drive revenue growth.

Role of CDFIs in Small Business Lending

CDFIs are an important part of the small business lending ecosystem, providing capital to businesses that cannot access traditional financing. As mission-driven lenders, increasing access to affordable, responsible capital for business owners with

---

[17] Robert Fairlie, Ph.D. and Alicia M. Robb, Ph.D., "Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs", U.S. Department of Commerce, Minority Business Development Agency, January 2010. Accessed July 6, 2018. http://www.mbda.gov/sites/default/files/DisparitiesinCapitalAccessReport.pdf

[18] *Id.* at 4.

[19] Congressional Joint Economic Committee Democrats, "Investing in Rural America: Bringing Progress and Economic Opportunity to Rural Communities, June 2018. Accessed July 6, 2018. https://www.jec.senate.gov/public/_cache/files/ed5bf0b5-dd14-473f-acdc-fd86ba98a6e1/investing-in-rural-america.pdf

limited options: women, people of color, startup firms with limited revenue and less than perfect credit, is a key component of the CDFI lending strategy.

While other lenders have exited the market or charge high interest rates and fees to borrowers, CDFIs have figured out how to lend successfully in the most distressed markets by taking a localized approach to lending, adjusting their strategies and products to meet the needs of their communities, and by being accountable to the communities they serve.

For small business owners with financial impediments to securing financing like lack of collateral, cash flow challenges, modest business revenues, or imperfect credit, CDFIs address these issues in a variety of ways. CDFIs offer a variety of financial products including working capital, equity investments, bridge loans, senior and subordinated debt - sometimes at below market rates with lower and fewer fees. Often CDFIs can employ more flexible underwriting criteria, credit standards, collateralization and debt service requirements than what is otherwise available in the marketplace. While some of the challenges facing small businesses served by CDFIs are financial, others are related to business management practices. The experience of CDFIs has shown that both issues must be addressed for the business to be successful and grow. To that end, CDFIs provide financial education, technical assistance, and capacity-building development services to their borrowers, including business training and access to social and professional networks.

Beyond providing capital and technical assistance, CDFIs serve as an anchor in partnerships with community stakeholders including nonprofits, foundations, chambers of commerce, government agencies, and financial institutions, allowing them to connect entrepreneurs to a rich network of resources and opportunities. Many CDFIs also have referral relationships with local financial institutions, whereby a bank may refer a potential borrower who is not quite ready for conventional financing to a CDFI where the business owner can receive any needed training or technical assistance as well as financing. For many CDFIs, the goal is to help the borrower strengthen and grow their business, improve their financial position, and eventually be able to "graduate" to traditional financing from a mainstream financial institution.

The track record of CDFIs to date is impressive. Through OFN's annual member survey, CDFIs in our network that have reported annual data between 2005-2016 and primarily lend to small businesses (including microenterprises) showed a 200% increase in small business lending from 2005 to 2016, while SBA 7(a) lending increased 58% over the same period. CDFIs are also key financial partners during periods of economic contraction and have demonstrated the ability to increase lending countercyclically.

OFN Member CDFIs exhibited average growth rates in business lending of 7.2% during recessionary years (2007-2009) and 13.2% during post-recessionary years (2010-2016); substantially higher than SBA 7(a) lending where rates averaged -13.6% during 2007-2009 and 17.3% during 2010-2016.[20] In other words, CDFIs increased their small business lending during the recession – and substantially increased lending after the recession – while SBA 7(a) lending, also intended for borrowers that do not qualify for conventional loans, decreased during the recession and shows similar growth rates as CDFIs in the sample following the recession.[21]

Not only did OFN member CDFIs increase business lending during 2007-2009 while SBA 7(a) lending decreased, CDFIs averaged a 4.1% net charge-off ratio compared to 13.9% in the SBA 7(a) portfolio during this period. During post-recessionary years (2010-2016) CDFIs averaged a 2.3% net charge-off ratio compared to 1.2% in the SBA 7(a) portfolio. Over the entire 2005-2016 period, CDFI business lending net charge-off ratios averaged 2.9% compared to 6.5% for SBA 7(a) lending. These trends show that CDFI business lending portfolios offer more stable and better overall performance, avoiding the erratic loss ratios of other business lending portfolios.

CDFI Small Business Lending in Rural and Native Communities

OFN member CDFI lending to businesses has also increased in rural and Native communities: lending in rural areas increased 90% from 2005 to 2016 and lending to

---

[20] Opportunity Finance Network, Database of Annual Member Survey Data, Accessed July 9, 2018.
[21] U.S. Small Business Administration, "Open Data", Released 2018. Accessed July 6, 2018. https://www.sba.gov/about-sba/sba-performance/open-government/foia/frequently-requested-records/sba-7a-504-loan-data-reports .

businesses in Native areas increased 39% from 2010 to 2016.[22] Even during the financial crisis, while SBA 7(a) lending to rural areas decreased during recessionary years, CDFI business lending to rural areas held steady. CDFI business lending in rural areas shows average growth rates of 0% during 2007-2009 and 14% during 2010-2016 compared to -6% and 14% in the SBA 7(a) portfolio, respectively. [23] Overall, CDFI business lending to rural areas increased 90% from 2005 to 2016 while SBA 7(a) lending increased 63 percent.

In addition to providing financing and technical assistance to individuals and businesses in distressed communities, CDFIs can also be partners in addressing bank closures in rural areas. When Regions Bank was faced with the possibility of closing branches and creating a banking desert in two low-income communities in rural Mississippi, they turned to a CDFI and OFN member Hope Enterprise Corporation/Hope Credit Union. Regions donated the bank branches to Hope, along with a $500,000 technical assistance grant, enabling Hope to reopen and continue to provide access to much needed financial services and credit in those communities.[24]

Federal Support of Small Business Lenders

The federal government has several existing tools that can increase the supply of capital to mission driven lenders like CDFIs, who are adept at channeling those resources into distressed communities. The subsidy and credit enhancements provided by federal programs make CDFI business lending financially viable. For lenders, transaction costs are similar whether the loan amount is $10,000, $100,000 or $1,000,000, causing most financial institutions to focus their attention on the higher dollar loans. CDFIs on the other hand, are committed to meeting the credit needs of their borrowers, who seek smaller loans and have nontraditional financing needs.

Existing federal programs are complementary resources that work together, allowing CDFIs to offer a variety of financing tools to meet the needs of businesses seeking

---

[22] Lending figures for Native areas are not available prior to 2010.
[23] The original version of this testimony incorrectly stated the rate of SBA lending between 2007-2009 was 6 percent. The actual rate of SBA lending was -6 percent.
[24] "Hope Credit Union to Expand Presence in the Mississippi Delta", June 25th, 2015. Accessed July 9, 2018. https://hopecu.org/2015/06/hopeforthedeltarelease/

financing, whether it is a $500 microloan to a new entrepreneur, $100,000 to help a business grow, or multimillion dollar financing for larger businesses to purchase equipment or real estate. CDFIs are key partners for underserved businesses along the spectrum.

The following are recommendations that will preserve and expand key federal programs that increase the availability of capital for small businesses:

- **Full funding for the Department of Treasury's CDFI Fund's Financial Assistance and Technical Assistance program** to allow certified CDFIs access to flexible, patient capital needed to provide financing to underserved businesses, and to provide critical technical assistance and development services to help small businesses grow and thrive. The CDFI Fund programs have helped CDFIs deepen their reach into highly distressed communities. The Department of Treasury's CDFI Certification criteria requires CDFIs to originate at least 60% of loans and investments in eligible distressed census tracts or to underserved populations, and CDFIs continue to exceed that target: in FY 2017, CDFI Program awardees surpassed the 60% threshold for the percentage of both the dollar amount (81.2%) and the number of CDFI loans (83.0%) made to eligible distressed communities and underserved populations.[25] Further, in the FY 2017 award round, 29% of award recipients primarily served rural markets, well above the 14% of Americans currently residing in rural areas.

  While these results are impressive, additional resources for the CDFI Fund will further stimulate financing to small businesses in rural and Native communities. The CDFI Fund programs are highly oversubscribed: applicants on average have requested more than four times the available amount of funding each year. In the FY 2018 application round, the CDFI Fund received 538 applications from 485 organizations across the country requesting more than $504 million. In the CDFI Program alone, 432 organizations requested

[25] U.S. Department of the Treasury, "Community Development Financial Institutions Fund Congressional Budget Justification and Annual Performance Report and Plan FY 2019", March 8, 2018. Accessed July 9, 2018. https://www.treasury.gov/about/budget-performance/CJ19/13.%20CDFI%20FY%202019%20CJ.pdf

$334.9 million in CDFI Program Financial Assistance (FA) and Technical Assistance (TA) awards, while the CDFI Fund has only $160 million in funding to award in FY 2018.[26]

The Native CDFI Assistance (NACA) Program has catalyzed dramatic growth in lending to Native communities. Native CDFIs seen their assets grow fivefold since 2001, in large part due to the CDFI Fund, which has provided over $93 million in capital, training and technical assistance to Native CDFIs.[27] The NACA program is similarly oversubscribed: in FY 2018, 53 organizations requested $33.7 million in NACA Program FA and TA awards, more than double the $16 million available in appropriated funds.

- **Full funding for the Department of Agriculture's Rural Development Small Business Lending programs:**
    - *Intermediary Relending Program (IRP)* provides local intermediaries, such as CDFIs, access to low-cost, long-term flexible capital up to 30 years to address challenges in rural communities. CDFIs then relend this money to businesses and economic development projects which create jobs in rural communities.
    - *Business and Industry Loan Guarantee Program* is a loan guarantee program designed to *assist* help credit-worthy rural businesses obtain needed credit.
    - *Rural Microentrepreneur Assistance Program (RMAP)* provides loans and grants to non-profit organizations, like CDFIs, which provide technical assistance and microloans to rural small business owners.
    - *Rural Business Development Grants (RBDG)* are competitive grants that support targeted technical assistance, training and other activities

[26] U.S. Department of the Treasury, CDFI Fund Releases Application Demand for FY 2018 Round of CDFI Program and NACA Program", May 24, 2018. Accessed July 6, 2018. https://www.cdfifund.gov/news-events/news/Pages/news-detail.aspx?NewsID=301&Category=Updates

[27] Derrick Rhayn, "In Indian Country, Native CDFIs Work to Restore Food Sovereignty", Nonprofit Quarterly, April 17, 2018. Accessed July 9, 2018. https://nonprofitquarterly.org/2018/04/17/indian-country-native-cdfis-work-restore-food-sovereignty/

leading to the development or expansion of small and emerging private businesses in rural areas that have fewer than 50 employees and less than $1 million in gross revenues.

- *Value-Added Producer Grants (VAPG)* - The Value-Added Producer Grant (VAPG) program is a competitive grant program administered by the Rural Business-Cooperative Service of USDA that provides funding to independent agricultural producers, groups of independent producers, producer-controlled entities, organizations representing agricultural producers, and farmer or rancher cooperatives to create or develop value-added producer-owned businesses. These grants may be used to fund business and marketing plans and feasibility studies or to acquire working capital to operate a value-added business venture or alliance.

- **Make permanent the Small Business Administration's Community Advantage program** for mission driven lenders which is set to sunset December 31, 2020 and raise the maximum loan amount to $500,000. The Community Advantage program, is currently a pilot program under the SBA's popular 7(a) program to meet the credit, management, and technical assistance needs of small businesses in underserved markets. Community Advantage provides mission-based lenders access to 7(a) loan guaranties as high as 85% for loans up to $250,000. Since the program's inception, Community Advantage lenders have approved more than 4,000 loans for small businesses totaling over $500 million, and of the 125 approved Community Advantage lenders, 84 are certified CDFIs, helping the program reach businesses in underserved markets.[28] [29]

  With an average loan size of $129,108, and a requirement that at least 60% of the number of loans made under program go to underserved communities, Community Advantage allows lenders to make those smaller loans of $50,000

[28] U.S. Small Business Administration, FY 2019 Congressional Justification and FY 2017 Annual Performance Report, May 8, 2018. Accessed July 9, 2018. https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_19_508-Final-FINAL.PDF
[29] U.S. Small Business Administration, Office of Economic Opportunity, Presentation at the 2018 OFN Small Business Finance Forum, June 25, 2018.

to $250,000 that are often difficult for business owners to access. Lenders are also able to sell the guaranteed portion of the loan on the secondary market, generating unrestricted, earned income that can help mission-driven lenders finance even more small business lending.

Earlier this year Congress passed bipartisan legislation to increase the SBA's borrowing authority under the 7(a) program but did not make the Community Advantage Pilot program permanent as part of the legislation. This program meets a pressing unmet financing need for businesses poised for growth out of the microloan program but that might not be ready for traditional bank financing, but lenders need the certainty that a permanent Community Advantage program would provide.

- **Expand the Small Business Administration's Microloan** Program and provide additional technical assistance funds. The Microloan program is an important source of capital for microlenders to make loans up to $50,000 to women, low income, veteran, and minority entrepreneurs, and other qualified small businesses. Under the Microloan Program, SBA makes direct loans to intermediaries that use the proceeds to make small loans to eligible businesses and provides grants to intermediaries and other qualified non-lending technical assistance providers to assist borrowers with marketing, management, and other business based training and technical assistance. Demand for the financing provided through the Microloan program has been increasing steadily: the number of businesses assisted by the program has increased by more than 17% since FY2012, and the number of jobs supported by microloans has increased by nearly 40 percent.[30]

- **Reauthorize of the recently expired State Small Business Credit Initiative (SSBCI),** a program created through the Small Business Jobs Act of 2010 to increase access to capital for small businesses by providing credit enhancements for small business lending, with a focus on reaching underserved communities. CDFIs made nearly 11,000 loans or investments supported by SSBCI funds, totaling $835 million in new financing through

[30] *Id* at 20.

2016. A new round of funding could further stimulate small business development.

- **Strengthen strong small business borrower protections** that ensure business owners have access to information about the types of business loan products offered so business owners can make informed decisions. Small business borrowers deserve better information, clear disclosure, and understanding of financial resources and agreements. There are substantial disclosure requirements in the mortgage lending and consumer lending arenas, but no such protections or requirements exist for small business borrowers.
- **Support better research and data on access to capital issues in rural and Native markets** – There is limited comprehensive information available focused on analyzing the specific needs and challenges facing businesses in rural and Native markets. Congress should provide funding to study the specific challenges in these markets to identify targeted solutions that meet community needs.

Conclusion

CDFIs are critical intermediaries that deliver capital to businesses and communities that need it most, building credit and financial infrastructure that provides the financing needed to improve their economic well-being. At their core, CDFIs are about partnership, innovation, and creating opportunity in those communities that are often forgotten. But the work of CDFIs is not done alone: partners like the federal government remain vital to continuing the powerful work of mission driven lenders like CDFIs. CDFIs are also a smart investment for the federal government: small amounts of public subsidy are leveraged to amplify its impact. For example, the CDFI Fund has reported that for every dollar it awards to a CDFI, the CDFI leverages twelve dollars from non-federal sources.

Additional investments in proven solutions and programs like those that support the work of CDFIs will stimulate the flow of capital to business owners, generating economic activity that can catalyze community development, create jobs, generate

income and wealth, and help chip away at the persistently high poverty rate in too many rural and Native communities.

APPENDIX: CDFI Stories

ALASKA	
Igiugig	Ocean Renewable Power Company (ORPC) (CEI Maine)
COLORADO	
Denver	Boar & Castle (Citizen Potawatomi Community Development Corporation)
MAINE	
Portland	Greater Portland Health (CEI Maine)
Portland	Tilson Technology Management (CEI Maine)
Gorham	Seedlings to Sunflowers (CEI Maine)
Damariscotta	Central Lincoln County (CLC) YMCA (CEI Maine)
MINNESOTA	
St. Paul	4RM+ULA (FORM + Urban Landscape Articulation) (Meda)
NEBRASKA	
Omaha	JJ Reynolds Transport (Nebraska Enterprise Fund)
Omaha	Lion's Gate Security Services (Nebraska Enterprise Fund)
NEW MEXICO	
Albuquerque	True Grit Tattoo (Accion)
Gallup	I Knead Sugar (Accion)
Santa Ana	RedWing Design (Accion)
NEW YORK	
New York, NY	Nawa Beauty Supply (Business Center for New Americans)
New York, NY	S.K Grocery, INC (Business Center for New Americans)
New York, NY	T&T Express Shipping (Business Center for New Americans)
New York, NY	Shuvashree Inc./Sapphire Nails & Spa (Business Center for New Americans)
OKLAHOMA	
Tecumseh	Nations Laboratory Services (NLS) (Citizen Potawatomi Community Development Corporation)
SOUTH DAKOTA	
Eagle Butte	Number Nine Steakhouse (Four Bands)
Rosebud Reservation	Lafferty Family LLC (Lakota Funds)
UTAH	
Salt Lake City	Soul of Salt Lake (Utah Microloan Fund)
Holliday	Wyatt Eye, LLC (Utah Microloan Fund)
Taylorsville	Bee Craft Consult, LLC (Utah Microloan Fund)

ALASKA

IGIUGIG, AK

CDFI: CEI Maine

Business: Ocean Renewable Power Company (ORPC)

Loan Detail: Multiple loans

Story Summary: Bringing power to rural, off-grid locations presents formidable challenges.
Since 2004, Ocean Renewable Power Company (ORPC) has addressed this challenge with a series of increasingly innovative marine hydrokinetic turbines.

For more than ten years, ORPC has stayed true to its founding principles: partner with local communities and develop power systems that do not harm the marine environment.
Part of the commitment to rural coastal communities is ensuring that fish and other marine life, which provide sustenance and economic activity, are not harmed.

Financing is another critical element of ORPC's success. The business has gone to CEI twice for financing and both times secured financing that was critical to its survival. The most recent round was a $750k working capital loan to sustain the company through the final stages of commercializing its marine hydrokinetic power systems and the initial project in northern Quebec.

***

COLORADO

DENVER, CO

CDFI: Citizen Potawatomi Community Development Corporation (CPCDC)

Business: Boar & Castle

Loan Detail: Startup capital, business plan guidance

Story Summary: Chef Jorge Cazares opened the Boar & Castle mobile eatery in December 2017 with his wife Aimee, who is a Citizen Potawatomi Nation tribal member.

When going into business the Cazares struggled to access financing. They made all the necessary arrangements, incorporating, getting personal funds together, and locating a truck. Mainstream finance lending institutions denied them a loan because they lacked restaurant management history and experience and good credit.

CPCDC stepped in where banks couldn't, providing the restaurateurs with a startup capital loan, small business resource tools, and expert guidance.

***

MAINE

PORTLAND, ME

CDFI: CEI Maine

Business: Tilson Technology Management

Loan Detail: Equity investment in award-winning veteran owned small business

Story Summary: Tilson Technology Management, a Portland, Maine-based network deployment and IT professional services firm, was recently named by the U.S. Small Business Administration (SBA) as Maine and New England's Veteran Owned Small Business of the Year. Led by CEO Josh Broder, a veteran of the U.S. Army, Tilson took on major regional projects early on, including Maine Fiber Company's Three Ring Binder and Central Maine Power's grid modernization effort, which gave them credibility in the highly competitive national market. Starting with just three people in 2007, the company now has 230 employees in eight locations, and is currently seeking to fill 50 open positions.

Tilson was nominated for the SBA award by CEI Ventures, Inc. (CVI), started by CDFI CEI, which provided equity investments in Tilson in 2013 and 2015, and Rand Capital SBIC, Inc. which joined CVI as an investor in Tilson in 2015 and 2016.

CVI was Tilson's first outside investor, and introduced the business to many of its current investor team. Since CVI's investment, Tilson has not only grown its services business by several orders of magnitude, but also rolled out its first software product, and moved into telecom infrastructure ownership.

***

PORTLAND, ME

CDFI: CEI Maine

Business: Greater Portland Health (GPH)

Loan Detail: Financing capital to bring IT infrastructure in-house to reduce hosting expenses and help provide more healthcare services to the uninsured

Story Summary: GPH is a federally qualified health center (FQHC) that serves more than 10,000 patients; 50% are uninsured and may have otherwise not had access to quality healthcare services. GPH staff works collaboratively with many other nonprofits in the community to provide services to anyone in need. GPH services are offered to anyone who walks in the door.

In any of the health center's nine locations around the Greater Portland area, multiple languages are spoken; individuals receive financial counseling, peer support,

and case management; and a full suite of healthcare services that include medical, behavioral health and oral healthcare.

In 2013, GPH began operating as a 501c3 after four years of support from the City of Portland. A CEI loan enabled the health center to get through its first year on its own. A second loan from CEI provided capital to bring IT infrastructure in-house to reduce hosting expenses and be able to provide more healthcare services to the uninsured.

***

GORHAM, ME

CDFI: CEI Maine

Business: Seedlings to Sunflowers

Loan Detail: Loan financing from the USDA Community Facilities program and TD Bank to help with land acquisition, construction, and development of the facility

Story Summary: While attempting to find childcare for their own children, friends Marissa Ritz and Meghann Carrasco experienced waitlists, high teacher turnover, less than ideal curriculums, and a lack of collaboration among centers and parents. Their frustration with a lack of options and a passion for educating children inspired the idea of starting a new childcare center. Seedlings to Sunflowers, a start-up nonprofit childcare center in Gorham broke ground on its new facility in November 2017 and opened in June 2018.

The woman-owned and -operated non-profit educational childcare center offers voucher slots to low-income families and a sliding scale pricing structure for children aged six weeks to five years, as well as after school programs for children aged five to ten years. Programming will include a STEAM-based curriculum and garden-to-table activities in an adjacent 16 by 20-foot greenhouse.

Due to the startup nature of the business, Seedlings to Sunflowers was challenged to find the significant capital needed for the construction of the new 5,300 square foot center.

CEI stepped forward with $1.5 million in loan financing from the USDA Community Facilities program and TD Bank. The financing helped with land acquisition, construction, and development of the facility. CEI is also providing workforce assistance to help Seedlings to Sunflowers reach its goal of creating quality jobs and hiring 50 percent of its employees from low to moderate income backgrounds.

***

DAMARISCOTTA, ME

CDFI: CEI Maine

Business: Central Lincoln County (CLC) YMCA

Loan Detail: With financing from the USDA's Community Facilities Relending Program, CEI provided loan to CLC YMCA for a facility renovation and expansion

Story Summary: CEI closed the first loan of its kind using financing from the USDA's Community Facilities Relending Program, with up to $100 million guaranteed by Bank of America. The $2,460,000 loan to Central Lincoln County (CLC) YMCA, a landmark community center in the midcoast region, allows for the renovation and expansion of its existing facility, originally built in 1973. The terms of the closing provide for an up-front construction loan from CEI that will be replaced by USDA funds upon the completion of construction.

The CLC YMCA has been a community hub for decades, offering exercise and workout facilities, after school and summer childcare, and summer camp programs to meet the needs of the 10 town, 25-mile service area in the rural mid-coast region. Approximately 10 percent of year-round residents are members.

Renovations and upgrades to the facility include an expansion from 51,000 to 68,000 square feet, a new fitness center, teaching kitchen and communal space, an elevator, elevated running track, and welcome center. The Y is already expanding enrollment for its programs for all ages, and the facility will also become home to Spectrum Generations. The expansion will create new jobs including a Healthy Living Director as well as additional maintenance staff.

***

MINNESOTA

ST. PAUL, MN

CDFI: Meda

Business: 4RM+ULA (FORM + Urban Landscape Articulation)

Loan Detail: Line of Credit

Story Summary: James Garrett, Jr. co-founded 4RM+ULA in 2002. Headquartered in St. Paul, 4RM+MULA focuses on transit-oriented design and urban redevelopment projects.
Garrett was born on the island of St. Thomas and became interested in urban settings during his formative years in St. Paul.

His talent and rigorous academic training prepared him to compete for high-profile architectural projects that foster community. But nothing prepared him for the financing barriers faced by minority entrepreneurs every day.

Despite 15 years in business, national awards, nine employees and a solid portfolio of clients, 4RM+ULA still couldn't access the capital it needed to transition from a start-up.

Meda saw the firm's value, and helped it obtain a line of credit. In 2017, 4RM+ULA opened an office in New York and hired two full-time employees — establishing its presence in a key market for urban infill projects.

***

NEBRASKA

OMAHA, NE

CDFI: Nebraska Enteprise Fund (NEF)

Business Name: JJ Reynolds Transport

Loan Details: Working capital and technical assistance

Story Summary: Julius Reynolds was excited to grow his trucking and transport business when he approached Nebraska Enterprise Fund in the fall of 2017. Although Julian thought he was ready to double his fleet, NEF helped him realize he needed to map out his financial and business goals to get on the road to success.

For weeks, NEF helped Julius build a business plan that was optimized for growth, including a marketing plan and financial projections. When the business plan was complete, NEF approved Julius for a $20,000 loan which he used to purchase a second truck.
With added knowledge and a business plan under his belt, Julius is hopeful for the future. NEF is poised to continue working with him until he is ready to transition to a larger loan from a local bank.

***

OMAHA, NE

CDFI: Nebraska Enterprise Fund

Business: Lion's Gate Security Services

Loan Detail: Working capital for minority-owned small business

Story Summary: Retired police officers Joe Hodges and Calvin Jones began Lion's Gate Security Services in 2010 with a full range of security services such as personal safety, fire arms safety, corporate security, and strategic emergency planning for businesses.
They approached NEF in 2013 because they were unable to secure traditional financing—even though their sales exceeded $300,000. NEF recognized their business capacity and determined that the business could support a loan that would lead to additional growth.

When NEF's loan was disbursed in mid-2013, the company had two full-time and 12 part-time employees. By 2014, the company grew revenues to over $1 million. They employ 15 full-time positions and 123 part-time positions.

***

NEW MEXICO

GALLUP, NM

CDFI: Accion

Business: I Knead Sugar

Loan Detail: Loan for grand-opening supplies for Native-owned small business

Story Summary: Jacqueline Ahasteen began baking as a teenager. When she was in the kitchen, she was in heaven.

When she grew up, however, she put that passion aside in favor of a steady paycheck and a job in IT. That lasted until 2016, when Jacqueline decided to open a bakery, securing a location, signing a lease and beginning renovations. In May 2017, she and her husband opened I Knead Sugar in Gallup.

But I Knead Sugar nearly closed before it even opened. After spending hard-earned personal resources on renovations and build-out, Jacqueline realized they didn't have enough money for baking ingredients. The local Small Business Development Center referred Jacqueline to Accion, where she quickly obtained the capital she needed to buy flour, sugar, bowls, utensils and other supplies.

Capital isn't the only support Jacqueline has received from Accion. As a Native small business owner, Accion has helped connect her to other Native women entrepreneurs.

***

ALBUQUERQUE, NM

CDFI: Accion

Business: True Grit Tattoo

Loan Detail: Start-up loan for veteran-owned small business

Story Summary: Johnny Mac Howell was managing a tattoo shop when he decided to break out on his own. He had been tattooing for 15 years, but with a son graduating from high school, it didn't look like he would be able to afford to put him through college. He wanted to make more money as his own boss.

A native New Mexican, Johnny Mac grew up in foster care, and he attributes his strong work ethic to his WWII-era foster parents. He is also a veteran of the U.S. Navy. After serving his country, Johnny Mac found himself struggling to make ends meet. He worked as a stone mason to provide for his son and exercised his creative skills as a tattoo apprentice

Determined to realize his dreams, Johnny Mac made the decision to focus on his talent as a tattoo artist and Accion took him on as a client, providing a $20,000 start-up loan to build out the tattoo parlor. Today, nearly 11 years later, Johnny Mac's shop, True Grit Tattoo, is thriving.

***

SANTA ANA, NM

CDFI: Accion

Business: RedWing Design

Loan Detail: Loan for working capital for Native-owned small business

Story Summary: When Shirley Pino was a girl, she learned to use an electric sewing machine. Her mother encouraged her sewing and taught her precious techniques that Shirley uses to this day. Years later, she came to realize she could create her own business centered on crafting clothes inspired by her late mother, who also had a sewing business. And, grateful to her grandfather for giving her the name RedWing, Shirley named her sewing business RedWing Design.

Ready to launch her business, Shirley was in need of new sewing equipment and more supplies. A friend referred her to Accion for a $2,000 start-up loan. Since then, Shirley has received additional loans from Accion to continue growing her business

***

NEW YORK

NEW YORK, NY

CDFI: Business Center for New Americans (BCNA)

Business: Nawa Beauty Supply

Loan Detail: Working capital, microloans

Story Summary: When Nawa Coulibaly, a native of Ivory Coast, first came to the US in 2006 she supported herself by working at various stores, including a beauty supply story in Crown Heights, Brooklyn. In 2010, the store's owner presented her with the opportunity to purchase the retail business for $10,000.

Nawa first approached to BCNA when Nawa Beauty Supply business was struggling. The loan officer was impressed with Nawa's hard work and creativity. BCNA approved Nawa for a $2,000 loan to help build her credit score. While the business was not an immediate success, Nawa gradually improved her business model, modifying her inventory to include more clothes and accessories.

Since her initial loan, Nawa has continued to work with BCNA, receiving three more loans from BCNA for $5,000 each. Her most recent loan of $15,000, disbursed on November 20, 2017, enabled her to purchase inventory in time for holiday shopping.

This business is open seven days a week and employs a part-time sales person.

***

NEW YORK, NY

CDFI: Business Center for New Americans (BCNA)

Business: S.K Grocery, INC

Loan Detail: Loan for inventory and working capital for immigrant-owned small business

Story Summary: In 2016, Sabana Guragai used her family's savings to purchase a corner convenience store in Queens when the previous owner could not continue to run the business. Within the first few months of running S.K Grocery, INC, she saw an opportunity to generate more income by adding specialty food items requested by people in her community.

But, she needed a loan to add the additional inventory, complete a renovation, and hire one full-time employee and increase the hours of her part time employee. Sabana didn't qualify for a bank loan but heard about BCNA's microloan program and applied.

She received a $20,000 loan in 2017. Since then, Sabana's business is thriving — and she has repaid almost half of the loan.

***

NEW YORK, NY

CDFI: Business Center for New Americans (BCNA)

Business: T&T Express Shipping

Loan Detail: Loans

Story Summary: Patricia Williams, who came to the U.S. from Trinidad in 1989, is the founder and president of Brooklyn-based T&T Express Shipping, a moving company with locations in New York and Florida that specializes in shipping to the Caribbean.

Having worked in the same field in her home country, she was able to use her knowledge of that local industry to expand her business here into that market. Patricia came to BCNA through a referral from Santander, a partner bank, and has since expanded her company to include shipping within the continental Unites States and grown her staff to 10 employees.

Her future plans include opening more service offices to further expand her business, develop new markets, and increase her sales and reach.

***

NEW YORK, NY

CDFI: Business Center for New Americans (BCNA)

Business: Shuvashree Inc./Sapphire Nails & Spa

Loan Detail: Loan for new equipment and to refinance high interest loan

Story Summary: Sunita Adhikari, who came to the United States from Nepal in 2007, is the owner of Shuvashree Inc./Sapphire Nails & Spa. Sunita's loyal customers enjoy a suite of luxury spa services including manicures, pedicures, massage, waxing, threading, and facials.

When Sunita first moved to New York, she worked in other beauty salons to support her family. With a background in business and years of salon experience, she was motivated to start her own enterprise. In 2012, she opened her first salon and spa on the Upper East Side.

Sunita approached BCNA in 2014 to purchase new equipment and refinance a high-interest loan. Since then, she has opened a second salon in Midtown, just blocks

from the Empire State Building. Her two spas have created more than 20 jobs for New Yorkers.
With impeccable service, high-quality products, and a calming spa atmosphere, Sunita's new salon location continues to grow – which means more jobs for more people.

***

OKLAHOMA

TECUMSEH, OK

CDFI: Citizen Potawatomi Community Development Corporation (CPCDC)

Business: Nations Laboratory Services (NLS)

Loan Detail: Business plan services, training support, real estate assistance, start-up capital

Story Summary: Steven Weddle wants to provide more accessible and economical testing services to Native Americans across Oklahoma and formed Nations Laboratory Services (NLS).

He recognized that Native Americans are not always provided the most advanced testing available and the cost of providing cutting-edge testing services can take a heavy toll on tribal contract health funds. He put his years of experience providing regional ancillary healthcare and laboratory services to work and designed NLS's reference laboratory business model to bring advanced testing services closer to tribal health focused providers.

CPCDC helped Steve with by providing a business plan template and training support system to make his planning process flow and stay on track. When Steve was ready to find the right space for the laboratory, CPCDC introduced Steve to key real estate professionals.

NLS will be a moderate to high complexity reference laboratory that provides clinical and medical testing services for diagnosis, treatment, and prevention of disease. Laboratory services will be offered locally via courier service and across the state and region via overnight shipping. NLS will focus specifically on tribal healthcare facilities and Indian Healthcare Services facilities as well as other physicians, clinics and hospitals which serve a high population percentage of Native patients.

***

SOUTH DAKOTA

ROSEBUD RESERVATION

CDFI: Lakota Funds

Business: Lafferty Family LLC

Loan Detail: Agricultural Loan from the USDA FSA

Story Summary: Although the latest USDA Census of Agriculture shows there are 3,218 agricultural operations on Indian reservations in South Dakota, only 924—less than a third—are Native American-owned.

A major barrier to starting or expanding any type of business is lack of access to capital. This is especially true for agri-businesses, because of their large working capital needs. If you factor into the mix a business location that is on a reservation, finding a lender that will meet your financing needs can be nearly impossible. This is a dilemma that Craig Lafferty (Rosebud Sioux), partner in Lafferty Family LLC, faced when he when wanting to expand his cattle operation on the Rosebud Reservation.

Lakota Funds helped him access capital.

Lakota Funds was able to secure a $300,000 agricultural loan with a 90% guarantee from the farm service agency (FSA) of the USDA for the Lafferty Family LLC. Lakota, who did the underwriting and issuing of the loan, could do so as a result of the partnership formed with the USDA, demonstrating the value of the government guarantee. To date, Lafferty Family LLC has utilized two loans from Lakota Funds to grow their Red Angus / Charolais cattle to a herd of 200.

***

EAGLE BUTTE, SD

CDFI: Four Bands

Business: Number Nine Steakhouse

Loan Detail: Technical assistance, working capital

Story Summary: Accountant Cheryl DuPris became a Four Bands client in 2004. As a single mom, she was seeking ways to start her own business. Initially, her relationship with Four Bands began as a contract opportunity to help local businesses set up their accounting systems and financial management procedures. In the meantime, she was working at her family's food truck business.

She had an idea for a business but was in debt and worried about her credit score. So, she participated in Four Bands courses, developed a strategy, presented her ideas to the CDFI, and got funding from the CDFI.

Eventually, Cheryl was ready to purchase the business from her parents and has been the sole operator for the past three years. She has nine employees.

In 2017, she began planning for a brick and mortar building. With a small business loan from Four Bands she renovated an existing, vacant building in downtown Eagle Butte, and in July 2018 opened the Number Nine Steakhouse with 22 employees. She continues to operate the food truck.

***

UTAH

SALT LAKE CITY, UT

CDFI: Utah Microloan Fund (UMLF)

Business: Soul of Salt Lake Food Truck

Loan Detail: Small business training and loan

Story Summary: Victoria White first came to the UMLF in 2016 with a dream to serve her delicious – and soulful – food throughout the state of Utah. She participated in Banking On Women™ in 2016 to build her business and entrepreneurial skills. The UMLF supports Banking On Women™ with the help of financial partner, Syncrony Bank. It is a free course offered to female entrepreneurs to equip them with the tools they need to succeed. By the end of the course, Victoria was prepared and ready to pursue her entrepreneurial dream.
In 2017, after completing Banking On Women™, Victoria and her husband, Nick, applied for a small business loan through the UMLF loan program. Unsurprisingly, the couple's dream to open their own business came true!

***

HOLLIDAY, UT

CDFI: Utah Microloan Fund (UMLF)

Business: Wyatt Eye, LLC

Loan Detail: Capital for equipment and working capital

Story Summary: Early in 2016 Wade Wyatt, MD was teaching college courses at a local junior college and had been out of medicine for almost four years. His career vision of helping to restore sight and prevent blindness among the underserved and those without the means for quality eye care seemed like a distant, unattainable dream.

After returning to medicine later in the same year (2016), Dr. Wyatt found himself unable to move forward in his career without additional funding. He was working with a non-profit organization called "Eye Care 4 Kids" when he realized the unmet demand for surgical eye care among low-income, underserved populations along the Wasatch Front.

He came to the UMLF as a referral from a partner bank in late 2017. UMLF provided Dr. Wyatt with critical funding for equipment and working capital needed to move forward and help patients.

***

TAYLORSVILLE, UT

CDFI: Utah Microloan Fund (UMLF)

Business: Bee Craft Consult, LLC

Loan Detail: Start-up loan, small business training, credit building loan, mentorship

Story Summary: Daniel Oduntan, is a life-long master bee keeper and proud owner of Bee Craft Consult, LLC. Daniel started the business with the help of UMLF and the CDFI's community partner, the International Rescue Committee (IRC).

Daniel received funding from both the UMLF and the IRC, as well as ongoing trainings, a credit building loan, and mentorship. After receiving a start-up loan of $12,000, Daniel was finally able to start a bee-keeping business in the U.S. after receiving asylum. In addition to bee-keeping, Daniel also teaches community courses about how to start and maintain a personal bee hive and turn it into a business.

***

Statement of Michael Brown
General Partner, Battery Ventures
Before the U.S. Congress Joint Economic Committee
"The Innovation Economy, Entrepreneurship, and Barriers to Capital Access"

July 12, 2018

Chairman Paulsen, Ranking Member Heinrich, and Members of the Committee, thank you for the opportunity to testify today on the important subject of capital formation for growth companies. My name is Michael Brown, I have been a venture capitalist for twenty years and am currently a General Partner at Battery Ventures. Battery is a venture capital (VC) firm that invests in and partners with growth companies in a broad range of industry areas. I am here in my capacity as a board member of the National Venture Capital Association.

Put simply, venture capital is long-term equity investment into growth companies. We generally either come in alongside or follow angel investors as the next growth financing step for startups. Most of the capital we invest is used on research and development, salaries and hiring, or other expansion activities at our portfolio companies.

But, venture capital is also about more than just investment. Successful VCs don't simply pick winners, we work alongside our portfolio companies to build startups into successful enterprises. We usually serve on the boards of directors of our portfolio companies. We provide advice and counsel, contacts, and do whatever we can to support the growth of our portfolio companies. We generally provide multiple rounds of financing as our companies hit certain growth milestones over a period of five to ten years, sometimes longer. The standard agreement to invest in a venture capital fund runs ten years with options for extensions, to provide some context of the time horizon for a VC fund.

There's an important distinction between startups and small businesses. Both start small, but while traditional small businesses are more likely to use debt for financing needs and stay somewhat small throughout their existence, startups generally use equity financing and their goal is growth into significant enterprises. To illustrate this point, recent research has shown venture capital invests in less than one percent of all new businesses in the U.S., but nearly half of all companies that have become public companies since 1979 have been backed by venture capital[1].

Encouraging investment in startups and centers of innovation across the country has a positive compounding effect that I have experienced first-hand. In 2009, I led a $70 million investment in a company in Indianapolis named ExactTarget. With our investment, Scott Dorsey, the founder and CEO, along with a talented management team was able to more than triple their investment in research and development and create an additional 1,500 jobs in the State of Indiana. As a result of the company's growth, ExactTarget went public in mid-2012, which was the largest IPO of a subscription software company ever in the U.S. Approximately a year later, the company was purchased by Salesforce for $2.7 billion and has continued to grow and add hundreds of jobs to the economy. More interestingly, many former ExactTarget employees are reinvesting the proceeds from the sale of the company into dozens of new startups with the help of Scott Dorsey and his venture studio called High Alpha. The strategy is to leverage the success of ExactTarget to create the next generation of great start-ups, resulting in a virtuous cycle of innovation over the decades to come.

---

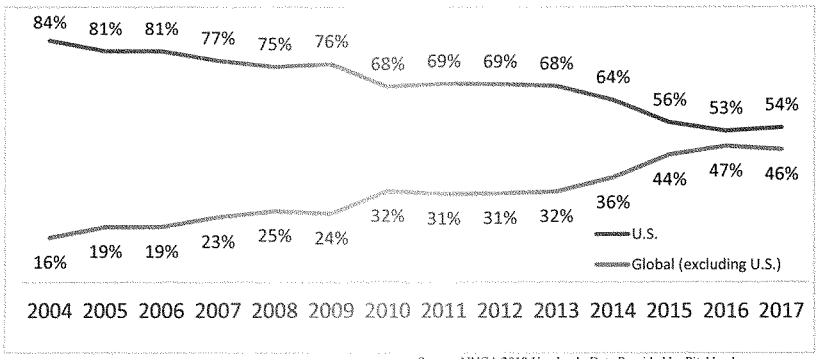
[1] "How Much Does Venture Capital Drive the U.S. Economy," Stanford Graduate School of Business (October 21, 2015), *available at* https://www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy.

Importance of Entrepreneurship Policy

The creation and growth of new companies is critical to American economic competitiveness. The U.S. invented the modern venture capital industry and has historically been the global leader in the modern era in innovation and entrepreneurship. As recently as the late 1990s, over 90 percent of global venture capital was invested in U.S. growth companies. Our country has benefited greatly from this leadership. A 2010 study from the Kauffman Foundation found that young startups, many venture-backed, were responsible for almost all the 25 million net new jobs created since 1977[2]. Companies such as Apple, Amazon, Alphabet (formerly Google), Amgen, and Genentech are a few examples of venture capital success stories which have become household names.

But that position has changed dramatically over the past several decades as global competition has increased, and last year just 54 percent of global venture capital was invested in American startups. Other countries have studied what we have done right and launched policy reforms to emulate and improve on our model. China is now the second most prominent destination for venture capital, and the European Union has seen some significant growth as well. In fact, last year seven out of the ten largest venture deals in the world took place in China, when eleven years before that ten of out of the ten largest deals took place in the U.S.[3]

U.S. VC Investment Dollars as % of Global Total



Source: NVCA 2018 Yearbook, Data Provided by Pitchbook

A healthy competition among countries to find cures for diseases and next generation technologies can certainly be positive for the world, but it's a competition where we should desire to win. We need commitment from American policymakers to do that.

---

[2] "The Importance of Startups in Job Creation and Job Destruction," Kauffman Foundation Research Series: Firm Foundation and Economic Growth," (July 2010), available at http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2010/07/firm_formation_importance_of_startups.pdf.

[3] Pitchbook – NVCA data.

This is why the hearing you have called today is so critical to informing our public policy debate. In order to view this issue in its entirety, I strongly encourage Congress to look not just at policies that impact investment in entrepreneurship, which are important issues unto themselves, but also policies impacting participation in the entrepreneurial ecosystem. Founders, startup employees, VCs, and angel investors must all find the risk/return ratio worthwhile in order for our entrepreneurial ecosystem to flourish. We can have the most liquid startup investment model in the world, but if these investments produce disappointing returns or if tax policy depresses incentives for participation, investment in entrepreneurship will suffer.

I would also encourage Congress to think of the issue with two priorities in mind:

1. build global-scale companies and preserve America's leadership in the 21st century economy, and
2. expand venture capital and entrepreneurial activity to more areas of the country.

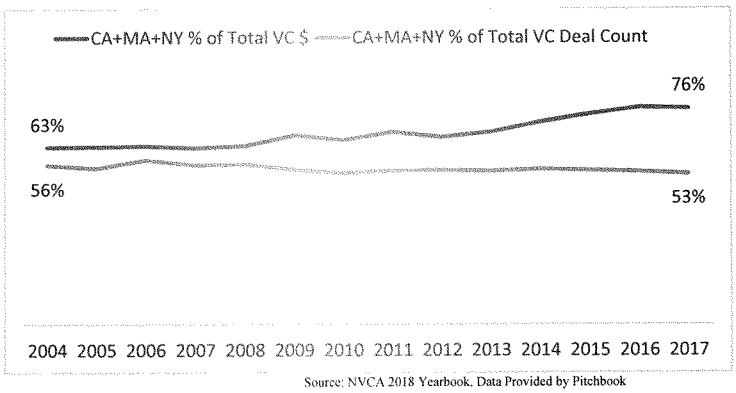
These priorities are certainly complimentary, and most of what I will discuss today will impact both, though some issues will have a more significant impact on one priority.

Policies that Impact Investment in Entrepreneurship

The venture capital industry serves as a sort of intermediary between the capital provided by institutional investors seeking higher-risk returns, such as pension funds, endowments, and foundations, and the startups seeking to use that capital for growth. VCs have a unique view of startup capital formation issues because we see both the perspective of having to ask for capital to invest in startups from our limited partners (LPs) and the investor perspective when we deploy that capital into companies.

While there is currently significant capital clustered in the three largest tech centers in the U.S.--California, Massachusetts, and New York--many other states have a shortage of access to venture capital financing. The good news is that the percentage of U.S. venture capital deals in states other than these three has increased over the last ten years, but at the same time, capital has concentrated further within those three large, coastal tech centers.

CA/MA/NY Venture Capital Investment Activity



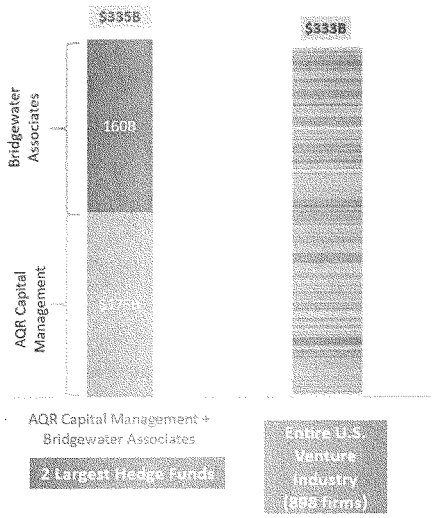
Source: NVCA 2018 Yearbook, Data Provided by Pitchbook

As Scott Dorsey is showing with his work at High Alpha Venture Studio, the most effective way to spread venture capital, and thus entrepreneurial activity, to more regions of the country is to increase the number of venture capital firms off the coasts. As I discussed earlier, venture capital tends to be a hands-on business. We want our portfolio companies in close proximity so we can communicate more frequently and effectively. We are partners with our companies, so ideally we are present at board meetings and other significant events. Encouraging the creation and growth of more local VC firms will A) provide more access to capital to companies in their backyards and B) give larger out of state VC funds contacts we can work with in finding and financing companies outside of our home regions.

Volcker Rule

One painless way to help seed new venture capital funds in emerging regions would be to exempt bank investment in venture capital funds from the covered funds prohibition of the Volcker Rule. Congress put this prohibition in place to prevent banks from circumventing Volcker Rule restrictions on proprietary trading that could create systemic risk simply by shifting it to a sponsored private fund. This concern does not apply to venture capital as the business model does not create systemic risk. We use equity investment to finance growth, so while the companies we invest in are certainly not guaranteed to succeed, the worst that can happen is a loss of the capital invested. Further, prior to the Volcker Rule's passing, banks generally only invested a small percentage of their overall assets in venture capital. This is somewhat similar to our other limited partners, who often invest no more than a few percent of their total assets in venture capital. As an industry, we are a fraction of the size of either the hedge fund or private equity industries.

Assets Under Management (AUM) As of Dec. 31, 2016 ($ billions)



Source: NVCA 2017 Yearbook, Data Provided by PitchBook; hedge fund websites

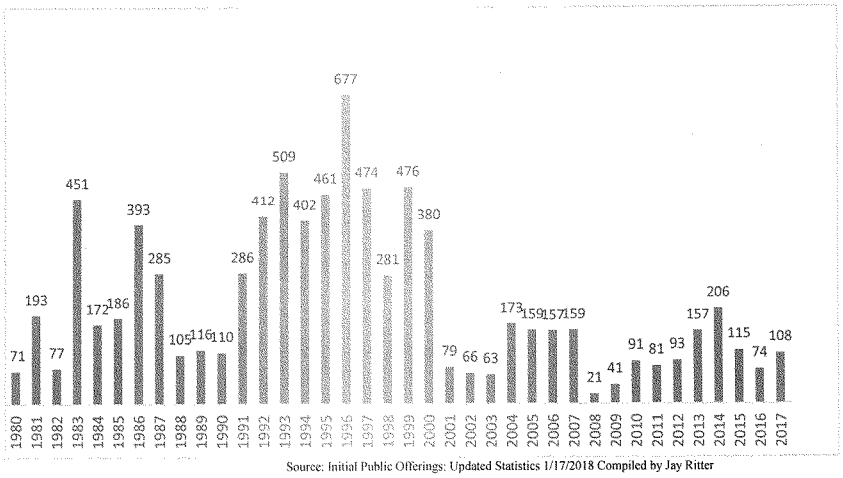
There was no intent by Congress to ban bank investment in venture capital funds during Dodd-Frank. In fact Chairman Dodd noted at the time that capturing venture capital was not his intent, at one point stating: "properly conducted venture capital investment will not cause the harms at which the Volcker Rule is directed." But the regulators unfortunately interpreted the covered funds prohibition to include VC investment. Almost overnight, a key source of financing for startups in the Midwest and other non-coastal areas of the U.S. disappeared. This prohibition has been particularly challenging to my colleagues in smaller firms because they have less access to the large institutional investors who are looking to make larger investments than they can absorb, and so often need to raise capital from a more diverse set of limited partners. Banks were often called anchor investors, as they would become a key limited partner in a VC fund that could attract other capital by offering a sort of validation of the fund.

The unfortunate effects of the Volcker Rule on the venture industry can be fixed quite simply: allow banks to invest in venture capital funds again. Congress can use the definition of venture capital fund crafted by the Securities and Exchange Commission (SEC) to define the universe of eligible funds. This would provide near immediate access to capital for high-growth startups that will create American jobs, innovation, and tax revenue, and much of these benefits would be in the regions for which we all support bolstering capital formation.

Encouraging More Public Companies

As mentioned earlier, the IPO markets are critical to the VC business model, and unfortunately fewer companies are choosing to go public today.

Total Number of U.S. IPOs by Year, 1980-2017



Source: Initial Public Offerings: Updated Statistics 1/17/2018 Compiled by Jay Ritter

Partly as a result, the U.S. now has about half the number of public companies than we did twenty years ago[4]. I believe there is a confluence of circumstances that have led to this point. First, the cost and complexity of being a public company has increased significantly over the last twenty years. Second, the research and market making infrastructure that previously supported small capitalization companies has collapsed. Finally, the culture of short-termism has advanced, which can be particularly damaging to the type of innovative companies we support as venture capitalists.

I applaud the House Financial Services Committee for their dedication to fixing this issue. The Committee has spent a great deal of time and intellectual energy trying to understand these root causes and finding solutions that can make it more attractive for startups to become public companies. The Jumpstart Our Business Startups (JOBS) Act was a great start, and the recent slate of bills the committee has worked on are a great way to build off of the success of the JOBS Act.

Developing and Empowering Our Aspiring Leaders Act

One bill I would like to highlight is the *Developing and Empowering our Aspiring Leaders* (DEAL) Act, sponsored by Representative Trey Hollingsworth (R-IN). The DEAL Act would direct the SEC to modify its definition of a venture capital fund to make secondary investments in emerging growth companies (EGCs) qualifying investments. A secondary investment is a share of a company purchased from anywhere other than the company directly. In the venture ecosystem, these shares generally come from founders, early stage employees, or investors (such as angel or seed investors) who may need to find liquidity for life events. With companies staying private longer, there are more significant amounts of secondaries included in venture capital financing rounds. It is considered a positive for VC investors to pick up these secondaries as A) it provides liquidity to participants in the entrepreneurial ecosystem when they need it, thus making it more attractive in general to participate in entrepreneurship, and B) the VCs are already partners in these companies, so it keeps their ownership structure clean.

Despite the fact that it's common practice for VC funds to acquire secondaries, these investments were determined to be nonqualifying by the SEC. Therefore, VCs are left with a choice: either limit their ability to participate in certain financing rounds and fit within the definition or incur hundreds of thousands of dollars (or millions in some cases) a year in compliance costs by becoming a registered investment advisor (RIA). The DEAL Act would make secondary investments in growth companies qualifying for purposes of the definition. This would allow VCs to continue providing equity investment to more of their portfolio companies, encourage patient capital investment, and long-term company growth. The modification would be limited in scope to equity investment by venture capital funds, activity that is generally a bipartisan priority.

I would like to thank Congressman Hollingsworth for his leadership. It is wonderful to see a Member of Congress put such hard work into a technical issue that has a real and positive impact on the venture ecosystem, and I hope to see the legislation pass through Congress and ultimately become law.

Research and Development Tax Credit:

Another issue that can help innovation investment would be an expansion of the ability of startups to offset their payroll taxes with R&D credits. It is a bit of an anomaly that when a company needs the R&D credit the most—in its growth phase—the credit has been largely unavailable because there needs to be taxable profits to offset. The *Protecting Americans from Tax Hikes* (PATH) Act of 2015 had a valuable

---

[4] "The U.S. Listing Gap," Craig Doidge, G. Andrew Karolyi, and Rene M. Stulz (July 2015), *available at* https://www8.gsb.columbia.edu/faculty-research/sites/faculty-research/files/finance/Finance%20Seminar/Fall%202015/Doidge_Karolyi_Stulz_Listing_Gap_July2015.pdf.

provision which allows companies under five years old with less than $5 million in sales to offset up to $250,000 in payroll taxes. This was a helpful development, and I would encourage Congress to expand this to $1 million to create parity with Canada's Scientific Research and Experimental Development Tax Credit Program. To encourage simplicity, I also think the eligibility definition should align with the criteria we currently use for Qualified Small Business Stock rules under Section 1202. This would create a meaningful boost to research-intensive startups.

Policies that Impact Participation in the Entrepreneurial Ecosystem

Helping startups obtain financing is a critical issue, but it must be paired with an ability for participants in the entrepreneurial ecosystem, if successful, to realize rewards for the risks they take and the value they create. Mr. Chairman and Senator Portman, thank you for your work during the recent tax reform bill to ensure that the taxation of stock options was not moved forward to a point where startup employees would have been receiving multi-thousand dollar tax bills with no money to pay the bill. The proposal to tax stock options at vesting would have had a devastating effect on American entrepreneurship, but thanks to your efforts we were able to avoid a major self-inflicted wound. I would also like to thank you for the work you did to include a deferral of taxes for employees of companies who must exercise their options but don't have a liquid market in which to sell their shares. Your work here will have an enduring impact on the attractiveness of helping to build new companies in the U.S.

Net Operating Loss Safe Harbor

Mr. Chairman, another issue I know you are familiar with that impacts growth companies is how net operating losses (NOLs) are treated as our companies go through different stages of the growth process. The vast majority of startups lose money in their early years as they put investment capital to work to grow their business. Some, such as biotechnology and medical device startups, can be completely pre-revenue for years while they develop their product and navigate the Food and Drug Administration (FDA) approval process. There are rules under Sections 382 of the tax code that govern how NOLs can be carried forward when there are ownership changes in a company. These rules were put in place with the intent to prevent loss trafficking, where a dying company is bought so the acquiring company can use its accumulated NOLs to offset their own tax liability. The rules require a company to calculate the delta between the amount of losses on its books and its fair market value every time there's an ownership change. If the delta is too high, the rules limit the amount of losses that can be carried forward.

Unfortunately, Section 382 was written without much consideration given to the startup financing model, where ownership changes are a common event. In fact, financing events like new fundraising rounds or an IPO can cause a growth company to run afoul of the rules. The upshot is that today Section 382 serves to wipe out the value of growth company NOLs in a broad range of ownership change transactions where the company is growing or being sold for a gain. This is very far from the intended purpose of the rules, and even worse, serves to depress startup valuations in our most capital intensive startups such as life sciences and renewable energy. And when one considers that the majority of NOLs accumulated by startups are for spending on R&D and salaries and hiring, I hope it is clear that action is needed to provide a safe harbor for growing startups from the NOL limitation rules under Section 382. Mr. Chairman, I know you've been a leader on this issue and we look forward to continuing our work with you and your office to find a solution, because I think we all should agree that it makes no policy sense to discourage our startups from investing in their growth.

Qualified Small Business Stock Rules

The qualified small business stock (QSBS) rules, which provide an exclusion of up to $10 million dollars (or 10X basis) in capital gains for investments in early stage companies quickly started gaining the attention of potential participants in the entrepreneurial ecosystem when the PATH Act made the 100%

exclusion permanent. If we could find ways to simplify the rules and create more certainty, I believe that QSBS could become one of the most powerful incentives for investing in regional venture capital funds. Noncoastal VC funds tend to be smaller and in need of more diverse sources of limited partners than those of us in the most prominent areas. Accredited investors can step in and help fill that hole, and QSBS is a major incentive for them to do so.

Carried Interest Capital Gains

One issue that is critical to the economics of the VC ecosystem is the tax treatment of carried interest. While it is mainly criticized as a hedge fund loophole, in reality a tax increase on carried interest would have the least impact on the hedge fund business model, and the harshest impact on the venture capital business model that funds small, high-growth companies. In fact, after last year's tax bill passed, including a provision which tripled the holding period necessary to realize long-term capital gains treatment of carried interest, I would question whether there is even a meaningful amount of hedge fund income that will be taxed at long-term capital gains rates in 2018, as most hedge-fund activity is relatively short-term.

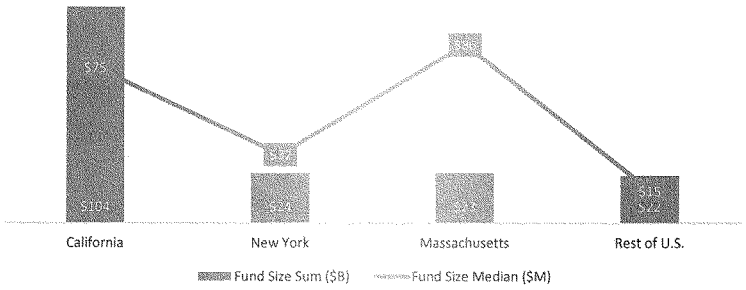
Carried interest is of particular importance to the VC business model for three primary reasons:

1) Venture capital is far smaller than other asset classes, so VCs are more dependent on carried interest to make the economics work. In fact, in many smaller VC funds carried interest is the sole economic incentive to participate in venture capital since fees generated from the funds (which are calculated as a percentage of the size of a fund) are not even enough to provide a salary to the general partners. As you will see below, the median size VC fund in states *other* than California, Massachusetts, and New York is about $22 million dollars in assets under management.

2) Venture capital holds assets for far longer than any other asset class. Arbitrarily applying ordinary income rates to carried interest that takes a decade to realize will have a particularly depressing effect on venture capital participation. Other asset classes could process multiple funds in the same time period it takes VCs to wind up one fund.

3) Venture capital is high risk, and a majority of funds are not successful enough to even realize carried interest.

VC Funds Raised by State Headquarter 2012-Q2 2017, Sum and Median



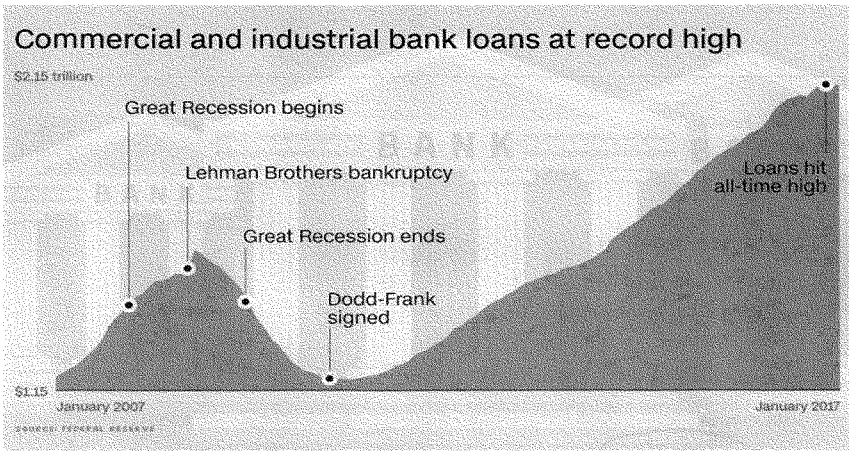
Source: PitchBook

I understand that carried interest has become a hot button political issue, but I implore the Congress to look through the rhetoric and understand that significantly increasing taxes on carried interest would be devastating to the capital formation environment for startups in the U.S. We are not asking for special treatment, just that we continue to receive the same tax treatment as anybody else who takes a risk and creates value in the economy.

Conclusion:
These are a number of different issues that can positively or negatively impact capital formation for startups in the U.S. While the technology we back may be complex, the policy formula to grow our ecosystem is not. Make the rules of the road simple and clear, encourage participation, and make long-term risk investment as attractive as possible. There is no quick fix here, but good policymaking can pay dividends for generations, as we have all enjoyed from the decisions of our predecessors.

Thank you to the committee for your interest in this important topic. I stand ready to answer any questions.

<u>FACT</u>: Business lending has increased 75% after Dodd-Frank



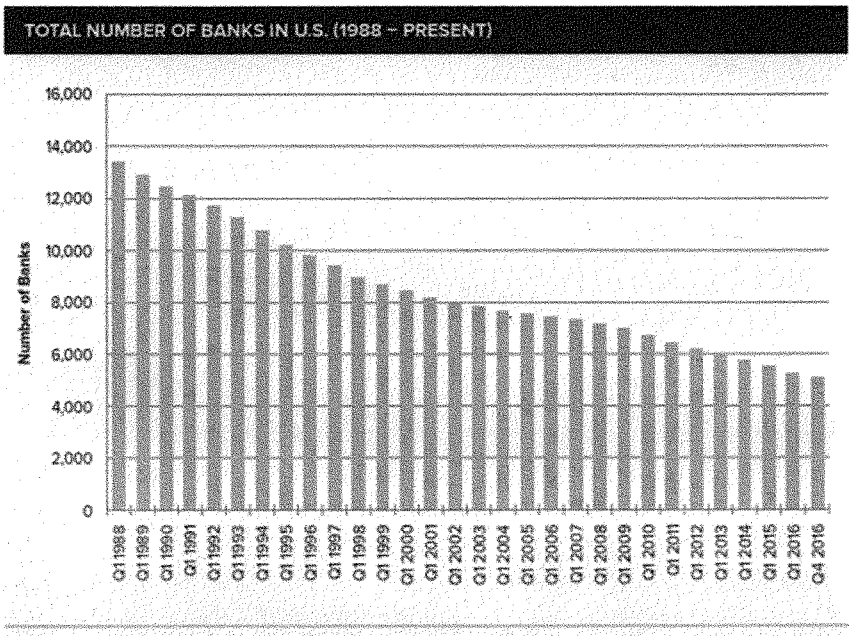


FIGURE 6 *Source: Federal Reserve FRED Economic Data (https://fred.stlouisfed.org/series/FREQ)*

The Roosevelt Institute

RESPONSE FROM MR. MACKINTOSH TO QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR SASSE

1. Rural lending has fallen and venture capital investment continues to be concentrated in a few major hubs. In your view, what is the single biggest policy change that would spur less concentrated investment and access to capital?

There are economic reasons why start-up firms are often located near their venture finance. The investors often contribute management, marketing and other skills lacking on the entrepreneurial team. Similarly, there are economic reasons why venture investors are geographically concentrated, as it creates economies of scale when attracting and meeting with investment opportunities. It's important to remember that start-up firms already have high cash-burn and limited resources, which makes expensive roadshows or travel prohibitive.

However, in my limited experience with venture investing, many start-ups also leverage telecommuting which allows those with the skills required for the start-up business to work from home, or in a city of their choice. Although the head office might be near the venture investors, not all investors leave their localities.

2. In your view, how has tax reform affected your industry and potential barriers to capital access? If there has not been any shift so far, do you anticipate future adjustments?

Tax reform has helped most industries. Many companies have paid bonuses to staff, while the strong earnings growth recorded since the changes is supportive of hiring and investor returns.

The changes have also been a boost to biotech companies looking to raise public capital to fund their research and investment into drugs and medical advances.

3. Overall, how do Sarbanes-Oxley regulations drive up costs and disincentivize firms from going public? In your opinion, how should these regulations change, and should changes/exemptions be limited to emerging growth companies?

Sarbanes-Oxley is among the rules that add to the costs, complexity and business risks for entrepreneurs considering going public. Our issuers have told us that regulatory burdens do affect them—this is something we detailed in our Revitalize paper. The paper also contains a number of recommendations for both EGCs and non-EGCs to reduce costs and burdens without creating greater risk for investors.

4. What regulatory burden exists to limit crowdfunding as a source of capital and what policy changes are needed to encourage the growth of this practice?

Unfortunately I have no experience with crowdfunding.

5. In your opening testimony, you referenced that initial coin offerings on the blockchain may soon be a popular option to fund start-ups. In your opinion, how far in the future is this and what are the opportunities and challenges with this approach to capital formation?

In the U.S., this will be significantly affected by the SEC, especially how they interpret and enforce the definition of a Security. However, the technology to allocate and track rights exists in the blockchain already. As with many things on the internet, it might be difficult to police investments by Americans into blockchain tokens issued in other countries.

The blockchain may in fact offer opportunities. Specifically, it may streamline custody and ownership rights for these small companies—while also providing access to a broader range of investors in a cheaper "crowdfunding like" way.

The challenges are weighing the lower costs and regulation, with investor protections. Investor protection and transparency are two of the key benefits exchanges offer investors.

6. Can you expand on your comment on how the expansion of companies into public markets interacts with retirement savings, potentially saving the government and taxpayers some of the financing burden? What data supports this sentiment?

Most 401k accounts are managed by professional asset managers who are typically restricted to holding listed companies.

The benefit of this is that listed companies offer more transparency and liquidity for those investors, as well as better disclosures and investor protections.

But the risk is that as companies stay private longer, these 401k accounts are unable to access wealth creation from these companies until they are far more mature and their growth has potentially started to slow. This can lead to limitations of the growth of these accounts which will limit the retirement savings of Americans which can lead to greater reliance on public entitlements.

RESPONSE FROM MS. KING TO QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR SASSE

1. Rural lending has fallen and venture capital investment continues to be concentrated in a few major hubs. In your view, what is the single biggest policy change that would spur less concentrated investment and access to capital?

I share your concern with the flow of venture capital to areas outside what we generally consider to be "hubs" for investment. Even my company, GlycoMimetics, which is based in Rockville, Maryland, encountered more difficulties raising capital than I think we would have if we had been in one of the major biotech hubs such as Boston or San Francisco. That is despite the presence of national labs and universities, and the strength of the local economy. Several policy proposals that I detail in my written testimony—including extending the JOBS Act exemption from Sarbanes-Oxley 404(b) for emerging growth companies as well as making certain fixes to the tax code to cultivate innovation—will help spur investment and increase access to capital in early stage companies located anywhere across the country.

2. In your view, how has tax reform affected your industry and potential barriers to capital access? If there has not been any shift so far, do you anticipate future adjustments?

I urge policymakers to do more to encourage emerging innovators like GlycoMimetics. Pre-revenue innovators that are still in the lab and do not yet have a product on the market are still years away from having a tax liability, and thus do not benefit from reductions in corporate rates. However, as I detail in my written testimony, several simple changes to the tax code can encourage entrepreneurship across the country. For example, modest tweaks to Section 382 of the tax code would encourage investment in innovation while maintaining the original intent of 382, which is preventing loss trafficking. I encourage Congress to take forward these reforms and I welcome further opportunities to exchange insights on how to improve our tax code to support innovators like GlycoMimetics.

3. Overall, how do Sarbanes-Oxley regulations drive up costs and disincentivize firms from going public? In your opinion, how should these regulations change, and should changes/exemptions be limited to emerging growth companies?

Sarbanes-Oxley (SOX) Section 404(b) was drafted with the intent of ensuring oversight over the internal controls over financial reporting of large, complex, multinational companies like Enron and WorldCom. It was not tailored for small, emerging companies, and therefore it has the unintended consequence of diverting money from science to compliance. SOX 404(b) is a key pain point for emerging growth biotech companies because of its extraordinary expense, our pre-revenue status, and the fact that it is of little use to our investors. For example, our external audit costs will more than double when we lose our JOBS Act on-ramp in a few months due to the SOX 404(b) external audit attestation provisions. This is all despite the fact that we, as a public company, are subject to extensive audit and disclosure requirements beyond SOX 404(b) that are designed to protect our investors. I encourage the Senate to advance the bipartisan "Fostering Innovation Act" (S.2126/S.488) to right-size compliance requirements for emerging growth companies, which I strongly believe will improve capital formation and scientific advancement while maintaining important investor protections.

4. What regulatory burden exists to limit crowdfunding as a source of capital and what policy changes are needed to encourage the growth of this practice?

To my understanding, crowdsourcing platforms are a growing source of seed capital for entrepreneurs, and most of the successfully funded campaigns generate $10,000 or less in funding.[1] As I mentioned in my testimony, more than 95% of biotech companies are in the R&D phase without an FDA-approved product on the market. The enormous financial resources required to develop a single life-saving treatment (which is estimated to cost 2.6 billion dollars), the long R&D timeline required to get a product approved by the FDA and on the market, and the science and technology underpinning the value of a potential medical breakthrough, generally make biotechs best positioned to raise startup capital from professional, long-term investors (such as angel investors and venture capital firms), rather than through crowdsourcing platforms, so I am unable to comment on ways to improve them.

---

[1] Kickstarter Stats, accessed 6 August 2018, *https://www.kickstarter.com/help/stats*.

RESPONSE FROM MS. MENSAH TO QUESTIONS FOR THE RECORD SUBMITTED BY SENATOR SASSE

1. Rural lending has fallen and venture capital investment continues to be concentrated in a few major hubs. In your view, what is the single biggest policy change that would spur less concentrated investment and access to capital?

While there is not a singular solution to address access to capital issues in rural communities, the Federal Government can play a critical role in building the financial and credit infrastructure rural communities need by providing robust funding for Federal programs that leverage public-private partnerships like the Department of Treasury's CDFI Fund programs.

By partnering with mission-driven lenders like CDFIs, the Federal Government can enhance its impact and deepen its ability to reach rural communities. As bank branches in rural communities continue to close, there are limited options for those seeking financing, making the organizations that are working in these communities more important than ever in ensuring access to capital. However, even the lenders in rural communities encounter challenges accessing the low-cost capital needed to successfully lend in rural areas, which can have high transaction costs and require significant technical assistance.

The Federal Government has existing tools that support rural lending by using "on the ground" partners to channel capital into rural communities like the aforementioned CDFI Fund programs, the SBA's Microloan and Community Advantage programs, or the Rural Development lending programs at the USDA. The low-cost capital and credit enhancements provided through Federal programs like these make lending in underserved communities financially viable, allowing CDFIs to offer a variety of financing tools to meet the needs of rural businesses seeking financing, whether it is a $500 microloan to a new entrepreneur, $100,000 to help a business grow, or multimillion dollar financing for more established businesses to purchase equipment or real estate.

However, these programs are not funded at adequate levels to meet the demand for financing, preventing critically needed capital from flowing to distressed communities. Strengthening these programs will build the capacity of organizations working in local communities, allowing them to lend to more rural businesses and individuals.

2. In your view, how has tax reform affected your industry and potential barriers to capital access? If there has not been any shift so far, do you anticipate future adjustments?

The Tax Cuts and Jobs Act created Opportunity Zones, a new tax benefit with the potential to catalyze investment in many distressed communities. CDFIs are hoping the new tax benefit will encourage additional investors to provide capital to finance projects and businesses by directing equity investments into designated low-income census tracts.

As CDFIs across the country explore how to use Opportunity Zones (O-zones), there is concern that O-zone investments could expedite displacement via real estate development booms in O-zone tracts near or within gentrifying areas. Many stakeholders hope O-zone guidelines will be modified to incentivize business investments as much as (or more than) real estate to mitigate displacement risk.

There is a significant opportunity for low-income areas to benefit from private sector O-zone equity investments, but there is also a need for greater accountability for investments in selected O-zone census tracts, either through detailed guidance from the Treasury and IRS or through legislative changes put forth by Congress.

3. As you noted, our financial system has become increasingly consolidated, as community banks and credit unions either close their doors or merge with larger institutions. What services can these smaller institutions provide that larger institutions cannot provide, and in particular, how are rural communities like those in Nebraska impacted?

CDFIs, including banks and credit unions, are an important part of the small business lending ecosystem, providing capital to businesses that cannot access traditional financing. For lenders, transaction costs are similar whether the loan amount is $10,000, or $1,000,000, causing most financial institutions to focus their attention on the higher dollar loans. CDFIs, on the other hand, are committed to meeting the credit needs of their borrowers, who seek smaller loans and have nontraditional financing needs.

While other lenders have exited the market or charge high interest rates and fees to borrowers, CDFIs have figured out how to lend successfully in the most distressed markets by taking a localized approach to lending, adjusting their strategies

and products to meet the needs of their communities, and being accountable to the communities they serve.

CDFIs offer a variety of financial products including working capital, equity investments, bridge loans, senior and subordinated debt—sometimes at below market rates with lower and fewer fees. Often CDFIs can employ more flexible underwriting criteria, credit standards, collateralization and debt service requirements than what is otherwise available in the marketplace. CDFIs also provide financial education, technical assistance, and capacity-building development services to their borrowers, including business training and access to social and professional networks.

CDFIs also have referral relationships with local financial institutions, whereby a bank may refer a potential borrower who is not quite ready for conventional financing to a CDFI where the business owner can receive any needed training or technical assistance as well as financing. A CDFI may also refer small business owners that need larger amounts of financing to their partners. For example, OFN Member Nebraska Enterprise Fund, a statewide business loan fund based in Oakland, NE, will refer small business owners they cannot serve to a partner like the Greater Omaha Chamber of Commerce, Small Business Association or Catholic Charities.[1] For many CDFIs, the goal is to help the borrower strengthen and grow their business, improve their financial position, and eventually be able to "graduate" to traditional financing from a mainstream financial institution.

In addition to providing financing and technical assistance to individuals and businesses in distressed communities, CDFIs can be partners in addressing bank closures in rural areas. Community development credit unions like HOPE, a Jackson, MS-based credit union that works in rural communities in the Delta region, and Self-Help, a Durham, NC-based credit union, have worked with regulators to reopen shuttered bank branches when traditional lenders leave the market, ensuring communities continue to have access to financial services in their local areas.

CDFIS IN NEBRASKA

There are currently 10 certified CDFIs headquartered in Nebraska, including two Native CDFIs: Ho-Chunk Community Capital, Inc. in Winnebago and Native360 Loan Fund, Inc. based in Grand Island. Some organizations like Nebraska Enterprise Fund or Midwest Housing Development Fund serve a statewide or multistate region, while others are focused on rural communities like Chadron Federal Credit Union, which serves Dawes, Sioux and Sheridan counties in Northwest Nebraska, or the Rural Investment Corporation, a Lyons-based business loan fund operated by the Center for Rural Affairs.

Communities throughout Nebraska benefit from CDFI lending. From FY2005 to FY2016, CDFI Fund grantees provided $35,716,181 in financing to communities in Nebraska that created 540 permanent jobs, developed 846,514 square feet of commercial space, developed 790 housing units, and financed 786 microenterprises and small businesses.

Chadron Federal Credit Union	Chadron	Nebraska
Community Development Resources	Lincoln	Nebraska
Ho-Chunk Community Capital Inc.	Winnebago	Nebraska
Midlands Latino Community Development Corporation	Omaha	Nebraska
Midwest Housing Development Fund, Inc.	Omaha	Nebraska
Native360 Loan fund, Inc.	Grand Island	Nebraska
Nebraska Enterprise Fund	Oakland	Nebraska
Northeast Economic Development, Inc.	Norfolk	Nebraska
Omaha 100, Incorporated	Omaha	Nebraska
Rural Investment Corporation	Lyons	Nebraska

○

[1] Deonna Anderson, Fund Wants to Show North Omaha Entrepreneurs "'Nebraska Nice,'" Next City, August 23, 2017. Accessed August 9, 2018. *https://nextcity.org/daily/entry/omaha-small-business-fund-lending-north-omaha*