TESTIMONY OF JOSEPH L. SCHOCKEN

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Good morning, Chairman Vitter, Senator Shaheen, and members of the Committee. My name is Joseph Schocken, and I am founder and President of Broadmark Capital LLC, a FINRA member broker-dealer based in Seattle, Washington. I am glad to have the opportunity to speak to you today about strategies to expand entrepreneurs' and startup companies' access to capital.

Established in 1987, Broadmark Capital is a merchant bank providing direct investment opportunities for accredited investors, and financing and management services to emerging companies. For nearly 30 years, we have raised capital for, invested in and advised on transactions with an aggregate value of well over $1 billion. Our success reflects our long-term relationships with investors who trust us to structure mutually advantageous financing opportunities.

Broadmark is an active participant in the Innovation Economy, which we see as the most important part of the American business environment — because the Innovation Economy, as study after study has shown, is the engine that creates new jobs. For several years now, Broadmark has lobbied for policy changes that support the Innovation Economy, many of which were recently legislated in the JOBS Act. I am proud to have had a role in crafting that legislation, and look forward to helping create and pass future job creation legislation.

New jobs are a goal that we can all agree on, regardless of political party or economic status. New jobs mean new tax revenue to the government, which makes all government work possible. In this election year, I know that all of you have been hearing middle class workers' concerns about the economic pressures they feel from globalization, from automation, from demographic changes and more. The

Innovation Economy is the key to generating new jobs that directly impact the middle class, but we are not talking enough about this. The productivity of the Innovation Economy should be a constant focus of Washington's policy conversation about building the economy and adding jobs. Today's hearing is a valuable step toward remedying that, and I hope it will be the start of a larger initiative to make this conversation permanent and ongoing.

The Innovation Economy: a Unique Asset at Risk

The American Innovation Economy has been the envy of the world for decades, even centuries. Entrepreneurship and technological advances have created iconic brands, with a line of innovation that stretches from General Electric to IBM to Apple to Facebook to Uber. These businesses and many others have invented, identified and seen uses for disruptive technology in ways that create jobs, build wealth, and improve American lives. The high-paying jobs these businesses create have helped to create tax bases that build everything from schools to bridges.

The Innovation Economy operates, roughly, in two sectors. The first is the one that attracts the most attention: the high-growth, high-wage, export-oriented, knowledge-based companies that tend to be high tech and venture backed. These companies, such as Apple and Google, are the companies that are big job multipliers. Their operations drive big ripples of job creation throughout the economy. The second part of the Innovation Economy, no less important, is composed of more traditional start-ups that tend to be local or regional businesses, such as restaurants, small retailers, and small service businesses.

While the distinction between these types of start-ups is important, and they do have different needs, both are absolutely critical for job creation and economic development. The smaller, more traditional start-ups are important because they create many of the low-wage, entry-level jobs that are vitally important for community development and full employment.

In recent years, we have seen alarming reversals of this essential American dynamic. The recovery expected after the crash of 2008 has been uneven. It has not created enough jobs, and it has not been equally distributed geographically. It is leaving too many behind.

We may allow ourselves to be distracted by the flashing success of "new economy" businesses such as Airbnb and Uber, but the reality is that over the past five years, we have seen an unprecedented decline in new business formation in the United States. Business deaths now outpace the birth of new businesses, and the startup environment is not thriving.

It is more difficult now than it has been in decades to finance and build an early stage company. The number of venture capital firms declined by 48 percent between 2000 and 2013. Over the past 20 years, we've seen a 50 percent decline in the number of publicly listed companies. Consolidation of financial firms, particularly regional investment banks, has led to the disappearance of small, regional IPOs.

Although the government's job statistics have been improving, a closer look shows serious trouble in the fundamentals. American adults continue to leave the

workforce at unprecedented rates. Many are working at multiple hourly jobs instead of the salaried positions they once held.

Looking ahead, we see trends that threaten job growth even more. The technology that makes even complex tasks faster and more efficient is eliminating jobs by increasing automation and replacing human beings with machines. According to studies from the University of Oxford, 47 percent of American workers — almost half — face a high risk of losing their jobs to automation.

These trends not only suppress job growth, but also contribute to increasing concentration of economic gains in the hands of a few. This becomes a cycle, as large organizations draw greater government oversight that raises barriers to entry even higher for new businesses. If you are concerned about income inequality, policy that supports the Innovation Economy should not be overlooked. A healthy Innovation Economy will lead to more middle class jobs, and therefore less income inequality.

Early-stage start-ups and emerging companies face unique needs that current funding and regulatory structures are not supporting. Small and high-growth companies are always starved for cash. They need constant infusions of capital, which is not available from large financial institutions with rigid lending policies. Government policy should be geared towards encouraging investments in these companies.

Start-ups and emerging companies face regulatory requirements created for businesses that are already up and running, businesses that have reached a size large enough to accommodate internal compliance staff or pricey external counsel. Our employee protection laws were not formulated to cover the self-employed, or

longtime contract employees, and retirement plans, in particular, are hard to put together outside a traditional salaried employee model.

Most frustrating of all, start-ups and emerging companies can identify every one of these challenges, but feel powerless to address them. They have no organized voice in Washington, no national advocate. The demands of starting a new business leave no extra money or time to formulate policy proposals or lobby for them in Washington. They have no national organization, and the national organizations that speak for big business and unions do not speak for them.

The Innovation Economy's Short-term Needs

As I mentioned earlier, emerging businesses are constantly short of capital. Government can and should encourage early-stage investments by qualified investors. Congress, the SEC and other agencies can make several policy changes that would encourage qualified investment, perhaps via a "JOBS Act 1.5." These include:

- **Amend general solicitation rules to allow investors to self-certify**.
- **Create a safe harbor for issuers of funds from friends and family.**
- **Modify and expand equity crowdfunding.**
- **Maintain accreditation standards, but allow for education-based, occupation-based and experience-based accreditation.** The goal is to expand the number of investors who are qualified to risk their capital in early-stage investments. Investors should be qualified not only because of their financial strength, i.e. net worth or annual income, but also qualified

due to sophistication, specialized knowledge and the ability to protect themselves.

Wherever possible, regulators should recognize the disproportionate burden that may fall on new and emerging companies, and allow for appropriate adjustments. The responsible agencies should solicit ideas for changes that would have the most immediate impact on new businesses.

Long-Term Challenges Facing the Innovation Economy

Beyond these short-term needs, the Innovation Economy as a whole faces a wide range of systemically important long-term challenges that have drawn almost no attention from policymakers. Many of these challenges are direct consequences of other systemic changes that have seriously injured job creation. Addressing these issues may require regulatory and legislative changes. The challenges include:

- Regional concentrations of venture capital and new company formation, which can mean that good ideas and entrepreneurial energy in other regions aren't getting the attention and funding they deserve. A Dow Jones VentureSource report, cited in the July 11 *Wall Street Journal*, found the percentage of venture capital invested in the Bay Area rose from 30 percent in 1995 to almost 50 percent in 2015.
- As previously noted, the continuing decline in the number of venture capital firms. This issue is critically important, because the United States does have a robust "angel" or seed financing network that helps get a business started. That initial funding goes only so far; at a certain point, in order to become a

going concern, a new business needs longer-term financing. Traditionally, the venture capital firms provide that financing, which is often a bridge to an eventual public offering. These are the firms that have disappeared. The firms that remain tend to be the largest ones, and we see them making much larger and later-stage investments than in previous decades (in some instances leading to the proliferation of "unicorns," and severely slowing the velocity of risk capital in the U.S.). As a result, the $5 million or $10 million Series A round of financing, for a small high-growth business that has outgrown its angel investors, has all but disappeared. That is not an exaggeration. PitchBook's second-quarter 2016 U.S. Venture Industry Report found that 39 percent of all venture capital went to private companies valued at $1 billion and higher, while only 1.2 percent of seed-financed startups were able to complete A-round financing deals.

- The disappearance of regional and smaller IPOs, caused by the consolidation of regional investment banks into giant nationwide institutions. Financial firms have grown in response to new capital and compliance requirements. They're looking for big investment opportunities, and are not interested in smaller, regional companies. This may force a company to "go big or go home," when it might be better to keep its operations small; or it might mean the company has no access to public funding at all. The $25 million regional IPOs that funded craft breweries and boutique clothing manufacturers a decade ago are no longer available to emerging companies. The former vice chairman of NASDAQ, David Weild, testified before Congress last year that,

"In the 1990s, the U.S. was the top-ranked IPO market for both small and large IPOs. Today, despite having the world's largest GDP, the U.S. ranking for small IPOs has fallen to a dismal 12th place."

- The long-term capital gains tax policy, which should be designed to make early-stage investments as attractive as possible.
- The need for enhanced and expedited visa programs that support entrepreneurship, so that new American businesses can attract the talent they need for success
- The need for accessible retirement plans for self-employed persons
- The need for more careful evaluation of the impact of new regulations on startups and small business
- Funding for research and development; Congress should commit to making research and development two percent of our gross domestic product.
- Expatriation of emerging industries: why is this happening, and how can we stop it? A recent and especially alarming example of this is biotech. This hugely important industry of the future used to be almost exclusively American, like the pharmaceutical industry. Other countries, recognizing the importance of biotech, have created much-needed funding mechanisms to support this capital-intensive industry. The United States has had tremendous difficulty funding these early stage biotech and biopharma companies; very little capital is available, except for the few companies that can attract professional investment. Most American biotech start-ups die for

lack of funding. Other countries are providing that funding, and we are in danger of losing a major part of this important industry.

A Presidential Commission on the Innovation Economy

I propose the formation of a Presidential Commission on the Innovation Economy.

Pursuing the Innovation Economy's needs and goals will require a directed national effort to recognize and encourage investment in start-ups and emerging companies. While the economy's largest players will always get the lion's share of policy attention, and should, the Innovation Economy has a demonstrable role to play in addressing the major objectives of our national economic policy: job creation, income inequality, manufacturing, the trade balance, and investments in infrastructure. Real growth and steady employment are impossible without new technology, new industries and the new businesses they create. As Congress exercises its oversight over the large, established businesses that ground our economy, it cannot afford to ignore the Innovation Economy.

A Presidential Commission on the Innovation Economy would be the best way to address the Innovation Economy's long-term challenges. Its role would be to identify and prioritize the Innovation Economy's short-term needs and long-term goals, and to advise the President and Congress on strategies and tactics for meeting them. The Commission would include industry leaders, venture capitalists, academics, lawyers and entrepreneurs, and would advise key decision makers from the White House, Congress and the federal agencies.

The unique American entrepreneurial economy is too large and diverse for any one agency to support. Although all the responsible agencies say they look out for the interests of start-up companies, no agency can make these entrepreneurs its top priority. A Presidential Commission would provide a forum for a holistic, macroeconomic approach to promoting early-stage start-ups, job creation and innovation. Organizations such as the Angel Capital Association and the National Venture Capital Association are already talking about these issues, but are not large enough or influential enough to command the kind of focused attention the Innovation Economy needs.

I urge this Committee and other members of Congress to establish this Commission on a permanent basis, to encourage innovation for generations to come. I appreciate the opportunity to share my perspective on funding the Innovation Economy, and I look forward to working with you toward improving access to capital for the emerging businesses that are building our future. I would be happy to answer any questions you may have.