INVESTING IN RURAL AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

AND THE

SUBCOMMITTEE ON AGRICULTURE, ENERGY, AND TRADE

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

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INVESTING IN RURAL AMERICA

TUESDAY, JULY 24, 2018

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS,
JOINT WITH THE
SUBCOMMITTEE ON AGRICULTURE, ENERGY, AND TRADE
Washington, DC.

The Subcommittees met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Dave Brat [chairman of the Subcommittee on Economic Growth, Tax and Capital Access] presiding.

Present: Representatives Brat, Luetkemeyer, Kelly, Blum, Fitzpatrick, Evans, Lawson, and Schneider.

Chairman BRAT. Good morning. I would like to call this hearing to order.

Access to capital continues to remain a topic of concern for American small businesses, nowhere more than rural America, which has been slower to recover from the recession of 2008, et cetera.

Although venture capital has become a popular financing mechanism for small businesses trying to expand, data shows that more than 75 percent of venture capital goes to just three cities in the United States. This means that there are great small businesses' ideas that are frequently overlooked in my district in Virginia, Mr. Evans's in Pennsylvania, and across the country. This issue is compounded by the fact that the decline in community banks has adversely impacted rural areas as well. According to community bank data from the Federal Deposit Insurance Corporation, there are 625 rural counties in the United States without a community bank based in the county.

While this Committee and my Subcommittee have performed rigorous oversight to ensure that SBA's funding programs can be a resource for small businesses that cannot obtain credit elsewhere, today's hearing focuses on private sector solutions to address small business capital access.

I want to thank Chairman Blum for co-chairing—thank you, Rod—this hearing to examine this important issue. Today's witnesses are working to bring together small businesses and entrepreneurs in rural American with private investors. While there is a learning curve for both, these organizations are working with trade associations, land grant universities, local economic development organizations, and others, to help bring those with capital together with those who need it to impact local economies and businesses. When these partnerships work, both the small businesses and the investors can benefit. It is a true win-win.

I look forward to hearing from our witnesses today about private sector solutions to the financing gap for small businesses, and also to their suggestions about how Congress can help or stay out of the way.

I now yield to our Ranking Member of the Subcommittee on Economic Growth, Tax, and Capital Access, Mr. Evans, for his opening statement. Thank you.

Mr. EVANS. Thank you, Mr. Chairman.

Good morning. The resolve of the American entrepreneur was put to the best following the Great Recession. Credit was slow to return to the small business sector, where 70 percent of all new jobs are created. Today, most economic indicators show sustainable growth of rural and traditional undeserved sectors, like women and minorities, continue to face challenges accessing the capital needed to start and grow small businesses.

The reasons for uneven access are many. Venture capital and private equity, which help high-growth small businesses scale up quickly is highly concentrated and shuns most rural and underserved markets like some in North Philadelphia. Similarly, uneven economic recovery has seen less bank capital being made available to women, minorities, and rural small businesses. This trend can be seen by using the SBA data as a proxy for the broader small businesses lending market. Less than 3 to 10 loans go to those who self-identified as minority. Similarly, 7 in 10 loans go to male-owned firms.

Earlier this year, Committee democrats held a series of roundtables to better understand the issues facing traditional underserved entrepreneurs. One focused on how to better deploy SBA lending programs, like 7(a) and 504 loans. Another focused specifically on the lack of diversity both demographically and geographically in the venture capital industry. I think the broader takeaway from those meetings was that a holistic approach needs to be taken with significant investments by both the private and public sector.

Today's hearing will further shed light on the issues these communities face and help build the public record on possible solutions. The witness panel represents some of the most leading-edge thinkers and investors that are crafting new and innovative ways to spread needed capital more demographically across the country.

I look forward to hearing your thoughts on how to help the millions of entrepreneurs and small business owners that deserve an opportunity but are currently shut out through no fault of their own. Unlocking the potential of these hardworking Americans are potentially adding trillions to our economic output and providing hundreds of thousands of good paying jobs in communities that need them most like some of those in Philadelphia.

I want to thank the Chairman for holding this important hearing and look forward to your testimony.

I yield back, Mr. Chairman.

Chairman BRAT. Thank you, Dwight.

I would now like to yield to the Chairman of the Subcommittee eon Agriculture, Energy, and Trade, Mr. Blum, for his opening statement.

Mr. BLUM. Thank you, Chairman Brat.

This Congress, I chaired a series of Subcommittee hearings focused on revitalizing rural America. I am pleased to join with Chairman Brat today to focus on an issue that is very near and dear to me, and I hope everyone in here as well, investing in rural America.

At two previous Subcommittee hearings on agricultural technology and innovations, witnesses emphasized the importance of entrepreneurs and farmers working together so that both small businesses and small family farms will benefit from the emerging technology and innovations.

While innovation and technology is one important component of rural prosperity, witnesses at those hearings also highlighted another important component, economic development. Small businesses and entrepreneurs must be able to access capital so they can continue to operate and expand their businesses and also attract talent, dollars, and jobs to their communities.

While other Committee hearings have focused on oversight of the SBA funding programs, our witnesses today will highlight success stories of other groups and organizations who are driving private investments to rural America through initiatives and partnerships with a wide variety of stakeholders, including Iowa State University, which is a partner of the Rural Opportunity Initiative represented today by Mr. McKenna. Investing in and growing rural America is vital not just to citizens to live there but also to the future of our country.

I want to thank all of our witnesses for being here today, and I yield back my time to Chairman Brat.

Chairman BRAT. Thank you, Rod.

I now yield to Ranking Member on the Subcommittee on Agriculture, Energy, and Trade, Mr. Schneider, for his opening statement.

Mr. SCHNEIDER. Thank you, Mr. Chairman. And I want to welcome the witnesses.

Since the Great Recession, local economics in rural America have been struggling to stay competitive in the 21st century global economy, losing business and people, especially young people to metropolitan areas. While urban businesses experienced record profits in a tight job market, rural counties have yet to fully recover from the lulls of 2008-2009. As more and more people move to urban areas to find better opportunities, Congress must seek ways to help rural communities attract the resources to invest in small businesses.

As a consequence of the financial collapse, rural businesses seeking capital remain at a disadvantage. Over 1,900 small local banks that would otherwise dispense that capital have closed down since 2009. Significantly, 78 percent of venture capital is concentrated in just three states—New York, Massachusetts, and California, and even in these states it is concentrated in the major cities. Because of this, over half of firm creation has been centered in only five metropolitan areas where access to broadband and educated workforce and necessary infrastructure have rapidly outpaced their rural counterparts.

Even though their geographic location requires sturdy roads and high-speed internet, rural America infrastructure has been neglected due to the scarcity of capital. Their decreasing population means a smaller tax base, and therefore, not enough money to educate the future workforce.

Meanwhile, President Trump's scattershot trade war threatens the heart of rural America. Our agricultural industry is threatened with billions of dollars in retaliatory tariffs, risking thousands of rural jobs and millions in profit, all while producers face years of low crop prices.

That is one reason I introduced H.R. 6396, which would expand the trade adjustment assistance to firms to help our local businesses damaged by these tariffs. Despite the challenges, the millions of people living in rural communities in all 50 states still hold that distinctive "can do" American spirit. In fact, rural counties have the highest rate of self-employed business owners in the Nation and those businesses are resilient, averaging a better 5-year survival rate than their urban business counterparts. Although rural Americans build strong businesses, they still need to access capital to start them.

Our guests here today have worked to bridge the divide between rural and urban growth, whether providing loans to agricultural business or connecting entrepreneurs to investors, these witnesses have discovered strategies that can regrow our rural economies. I look forward to hearing what each of you have to say and discussing what Federal policymakers can do to help.

Thank you, and I yield back.

Chairman BRAT. Thank you.

If Committee members have an opening statement prepared, I ask they be submitted for the record.

I would like to take a moment to explain the timing lights for all of you with us today. You will each have 5 minutes to deliver your testimony. The light will start out green. When you have one minute remaining, the light will turn yellow. Finally, at the end of your 5 minutes it will turn red. I ask that you try to adhere somewhat to that time limit. I will give you a little variation.

I would now like to introduce our witnesses. Our first witness is Mr. Matt McKenna. Mr. McKenna is an Executive in Residence at the McDonough School of Business at Georgetown University, where he leads the Rural Opportunity Initiative, a partnership between McDonough at the U.S. Department of Agriculture, Purdue University, Iowa State University, and Mississippi State University. I look forward to hearing your testimony and you may begin. Thank you for being with us today.

STATEMENTS OF MATTHEW M. MCKENNA, EXECUTIVE IN RESIDENCE, RURAL OPPORTUNITY INITIATIVE, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY; FALON DONOHUE, CHIEF EXECUTIVE OFFICER, VENTUREOHIO; AMY H. GALES, EXECUTIVE VICE PRESIDENT, REGIONAL AGRIBUSINESS BANKING GROUP COBANK; ROSS BAIRD, PRESIDENT, VILLAGE CAPITAL, INNOVATOR-IN-RESIDENCE, EWING MARION KAUFFMAN FOUNDATION

STATEMENT OF MATTHEW M. MCKENNA

Mr. MCKENNA. Thank you. Thank you, and good morning, Mr. Chairman, Mr. Blum, Mr. Chairman Brat, Ranking Members, and members of the Committee.

People keep track of numbers pretty tightly when it comes to venture capital. And in just the first 6 months of 2018, over $57 billion have been invested in venture capital across America. $57 billion. Yet, as we have heard already this morning, only a small fraction of those dollars found their way through funds in companies based in rural America. This capital deficit—and it is a deficit with respect to rural America—is starving, innovative, and valuable growth opportunities. Without it, job growth and rural economic development will continue to lag the rise in prosperity that the rest of the country has enjoyed.

The Rural Opportunity Initiative is a partnership housed at Georgetown University. And while Georgetown University often lacks real rural roots, our partners do not. Our partners are the Department of Agriculture, our friends at Iowa State, Mississippi State, and Purdue. Together, this group has embarked on an effort to increase investment from the private sector in rural America, the part of America that as we know is almost 95 percent of the country in land mass, yet only 20 percent of its population.

It is well established that small businesses, and particularly new small businesses, are the greatest source of job growth in the country. Yet, these new businesses often lack access to critical sources of capital. The Rural Opportunity Initiative was organized to address this imbalance. Together with our partners, we have begun by organizing events that bring together both investors and entrepreneurs. At Iowa State recently, in Des Moines, we held an event that attracted dozens of small businesses, small Iowa businesses, together with potential investors, including regional venture capital funds and large institutional banks.

Last month, we held a similar event down in Starkville, Mississippi, where we listened to pitches from new businesses, businesses that range from a microwave sensor technology developed on campus at Mississippi State. That technology detects spillage in grain elevators. At the other end of my spectrum was a business that made healthy crackers using flower that was a byproduct of craft beer. And there is a lot of craft beer down in Mississippi, and those crackers were pretty good.

Also on our schedule for the rest of the year are events on Georgetown's campus around rural lending and expanding our partnership with USDA. And in November, we will be hosting a major conference on campus around rural capital and how dollars flow to investments and markets away from the coast. This conference, the Rural Capital Forum, scheduled for November 15th, will identify both hurdles to capital access and tools available to overcome those obstacles. And let me discuss just two of those obstacles this morning.

The first is clearly a lack of awareness. We need to introduce the innovation and emerging technologies that are growing in rural America to institutional investors. This is the primary purpose of our investor conferences that we held in Des Moines and Starkville, and will the central theme for our much larger meeting this November.

Other examples are well publicized. Steve Case from AOL has a very famous tour called the Rise of the Rest, which is going from town to town in rural America talking about innovation and investment opportunities. Another comes this fall when the Walton Family Foundation is hosting a major event in Bentonville, Arkansas, around rural economy and rural innovation.

But awareness building is only the opening of a door to the investment decision. Other more significant barriers remain. Chief among these is the issue of scale. Most rural businesses are small businesses. They are not looking for hundreds of millions of dollars. They are looking for $500,000 or $2 million of initial financing, money that is essential to the development of a business plan, initial working capital, and operations.

Yet, when the numbers get to be this small, there are few organized sources for this type of capital. One way of addressing this issue of scale is the development of funds that target this level of investment. The recent wave of Rural Business Investment Companies (RBICs) is a good example. Their charters limit their investments to rural-based businesses, and the typical investment slice has been typically in the $1 million to $5 million range.

Another tool is a fund to funds approach where many small funds are brought together by institutions as a way of allowing their customers to obtain the diversity and scale that has denied them more targeted funds, and at Georgetown, we have been working with two big banks in New York to arrange these fund to fund approaches.

And finally, there is a role for the federal government and there is a role for Congress as well, in tackling some of the obstacles that exist. And let me just talk about three of these paths forward from the federal government side.

The first is a Rural Business Investment Company. Under the authority of the Department of Agriculture, the recent wave of RBICs has been impressive. By my count, several hundred million dollars have already been raised in these funds. More are in line and awaiting approval, and I would be remiss if I did not mention the incredible contribution, not just from USDA but also from CoBank, one of my fellow panelists. CoBank has been a leader in establishing the RBIC and funding some of the RBICs, and their wisdom and guidance has paid very real dividends for small businesses in America.

In addition, we have the recent tax bill that created an Opportunity Zone. The Opportunity Zones that are being provided to shelter some capital gains from investments. The Opportunity Zones are working their way through the system right now. They are a tremendous opportunity I feel. And as I have looked over by my account, over 23 percent of the zones identified by the states are rural based. So that is a significant piece of the Opportunity Zone legislation will be directed to rural America. More to come on that I hope in the future.

Finally, the pending Farm Bill has a provision which I think is important for rural America. The Senate side S5034 is a provision and an opportunity to spur even more investment into rural communities. We think this is a good thing and we urge the House conferees to join the Senate in this effort.

These pushes from the federal government are certainly important, but my role, and certainly the role and my role at Georgetown with my partners, is to focus on the primary source of change, which I think is going to come from the private sector. We know these dollars are available. $57 billion in the first half of this year alone. But the challenge is how to change the direction of these investments, to channel them towards geographies where venture capital has not been well represented. That is ultimately a challenge of building awareness of those investment opportunities. This is where the Rural Opportunity Initiative and our partners are heading.

Thank you, Mr. Chairman.

Chairman BRAT. Thank you, Mr. McKenna. We appreciate your testimony.

Our second witness is Ms. Falon Donohue. Ms. Donohue is the CEO of VentureOhio, ventured in Columbus, Ohio. VentureOhio's mission includes increasing capital access for Ohio entrepreneurs. Ms. Donohue served our country in the Ohio Air National Guard. Thank you for your service. And is an active member of the Columbus Chamber of Commerce.

We welcome Ms. Donohue and thank you for your service. You may begin.

STATEMENT OF FALON DONOHUE

Ms. DONOHUE. Thank you very much, Mr. Chairman, Chairman Blum, and Ranking Members, and members of the Committee.

Thank you for the opportunity to provide testimony for this important hearing this morning.

I am honored to represent VentureOhio's members who are innovating and creating high-paying jobs in communities throughout the Midwest. On behalf of these incredible entrepreneurs, innovators and investors, I am excited to share with you the momentum building in America's heartland.

The Midwest is in the midst of a renaissance. As smart robotics and industrial automation proliferate, the Midwest is as reliant on innovation and research and development as our friends in Silicon Valley. Our brightest minds are electing to stay in Columbus, Cincinnati, Indianapolis, and other growing cities across the Midwest, and no longer feel they need to leave for a coast to work at a thriving tech company. The Midwest is earning a reputation as a promising new frontier in venture capital investing and entrepreneurship.

For the past few years, AOL co-founder Steve Case has been traveling alongside renowned author J.D. Vance, and shining a spotlight on innovation in overlooked communities. Their $150 million Rise of the Rest seed fund has supported promising companies in communities throughout the Midwest.

Another supporter of the region, Columbus-based Drive Capital has raised over half a billion dollars to invest in growing businesses throughout the Midwest. The publication Tech Crunch recently noting, "The firm is spurring an investment revolution in areas of the country that are more synonymous with tractors than with technological innovation."

Venture capitalists build ecosystems and support the key drivers of economic development—innovation, talent, and capital. Columbus-based NCT Ventures funded and helped to launch the Center for Entrepreneurship at The Ohio State University to inspire and educate entrepreneurs for generations to come. In Detroit, legendary entrepreneur Dan Gilbert and his team at Detroit Venture Partners have sponsored numerous accelerators and startup activities to stimulate innovation in the Motor City. The ripple effects of these investments in underserved areas are profound, supporting workers in high-paying jobs and their families and communities.

But despite this promising momentum, America's heartland is lacking the critical access to capital enjoyed in Silicon Valley, New York, and Boston. Three-quarters of venture capital is being invested in just three states. My home state of Ohio received less than 1 percent. Talent is equally distributed, but if capital continues to be concentrated in the hands of a few based on geography, we risk letting this momentum fade away.

The proposals to catalyze entrepreneurship through regulatory reform are critical to not only VentureOhio members but also to our peers in the national startup community. And more broadly, in this new tech-based economy, these conversations will affect the entire Nation. Most of the capital invested in startup companies goes toward research and development, job creation and salaries, and other expansion activities. VentureOhio and our partners at the National Venture Capital Association know that founders, startup employees, venture capitalists, and angel investors must all find the risk-to-return ratio worthwhile in order for our entrepreneurial ecosystem to flourish.

The hardworking startup founders and investors that support them, especially in America's heartland, could benefit from additional regulatory relief to reach their true potential. In particular, the Volcker Rule, aimed at preventing banks from taking unnecessary risks, should be reinterpreted. Unfortunately, it was written overly broadly and unnecessarily prevents banks from investing in venture capital funds, eliminating a critical source of capital for startups. Investors and entrepreneurs would like to see a narrower interpretation to allow banks to participate in this proven source of job creation and economic output. This regulation is especially burdensome to communities outside of major metropolitan areas, dampening entrepreneurship and economic activity where it is needed most.

To be sure positive changes are taking places, we applaud the bipartisan Investing in Opportunity Act, which promotes investment in struggling areas with the benefit of deferred or reduced capital gains taxes. We look forward to seeing use of this opportunity proliferate in Ohio and beyond.

A few targeted initiatives can positively impact capital formation for startups in the U.S., making long-term risk investment as attractive as possible. I speak for many entrepreneurs and investors, and we urge Congress to create a clear and rational framework to allow America's entrepreneurial ecosystem to thrive for generations to come.

Thank you very much again. I look forward to answering your questions.

Chairman BRAT. Thank you, Ms. Donohue. I appreciate your testimony as well.

I would now like to introduce our third witness, Ms. Amy Gales. Ms. Gales is executive Vice President, Regional Agribusiness Banking Group of CoBank, headquartered in Greenwood Village, Colorado. CoBank is a national cooperative bank serving vital industries across rural America and in all 50 states.

Welcome, Ms. Gales, and you may begin. Thank you very much.

STATEMENT OF AMY H. GALES

Ms. GALES. Good morning, Chairman Brat, Blum, Ranking Members Evans and Schneider, and members of both Subcommittees. Thank you for calling this hearing today to focus on investing in rural America.

I am Amy Gales, and I serve as executive vice president of the Regional Agribusiness Banking Group for CoBank. CoBank is a national cooperative bank headquartered in Denver, Colorado. Our mission is to be a dependable provider of credit and financial services to agriculture and rural infrastructure businesses for the benefit of rural America.

CoBank is a proud member of the Farm Credit System, a national network of cooperative banks and lending associations chartered by Congress to support the borrowing needs of U.S. agriculture and the Nation's rural economy.

We are acutely aware of the capital needs of entrepreneurs in rural America and strive to find flexible and innovative ways to address those needs. We call this collectively CoBank's Growing Rural America Initiative.

CoBank supports rural entrepreneurs by providing flexible loan products in the Co-op Start program supporting the technical assistance and education needs to create new cooperatives, funding rural equity investments; financing community facilities in partnership with USDA, farm credit associations and community banks with bond investments; sponsoring predevelopment funding; financing and advocating for rural infrastructure nationwide; partnering with farm credit associations to serve young, beginning, small, and minority farmers; and supporting youth entrepreneurs.

To address the capital needs of small or emerging agricultural cooperatives, CoBank developed a creative, flexible solution, Co-op Start. As consumers increase demand for local foods and other specialty crops such as hops for the growing craft brewing industry, we started to see the formation of new farmer-owned cooperatives for the purpose of distribution and marketing. The Farm Credit Administration, our independent Federal regulator, maintains guidelines that we must follow in terms of safety and soundness. When the new emerging agricultural cooperatives did not meet our loan underwriting guidelines, the CoBank board proposed a solution to FCA—create a separate risk pool designed to provide more flexible financing for these cooperatives. Co-op Start was launched in 2012 to provide financing up to $250,000 to early growth stage cooperatives.

As a cooperative, CoBank's commitment to foster the creation of new cooperatives runs deep through our support of numerous education and technical assistance programs. To meet the needs of food access in rural towns, CoBank recently teamed with the National Cooperative Bank to support the Food Co-op Initiative (FCI). FCI provides free technical assistance to rural communities interested in starting a food co-op, either to reopen or maintain their local grocery store.

CoBank understands that rural entrepreneurs, the engine driving rural economies, need dependable sources of equity capital to improve infrastructure. They depend on this to grow their businesses. While access to senior debt is generally available, equity in junior debt remains more difficult to source. Few rural focused investment funds exist beyond those that concentrate on acquiring farm land. Recognizing this gap and the challenges faced by rural entrepreneurs, CoBank and other farm credit associations started to make investments in equity funds focused in rural America. Rural equity investments serve as an effective source of capital to increase rural economic prosperity. These rural equity funds catalyze private capital investments and create jobs all across the country.

Since 2013, CoBank has committed $52.5 million across four private equity funds, along with commitments by other farm credit associations, commercial and community banks, and other institutional investors. These funds are providing $300 million in equity capital to rural entrepreneurs. So far, more than 26 rural businesses have received investments from these funds.

I want to thank Congress for its foresight in passing the Rural Business Investment Program legislation that has been a catalyst for the formation of rural focused funds. The capital challenges in rural America require innovative solutions. We are proud of the partnerships and initiatives we have developed with our Growing Rural America initiative and look to find new ways to support rural America.

Thank you for the opportunity to testify before the Committee and for all that you do for rural America. I look forward to answering your questions.

Chairman BRAT. Thank you for what you do as well. Thank you for your testimony, Ms. Gales.

I will now yield to our Ranking Member Evans for the introduction of our final witness.

Mr. EVANS. Thank you, Mr. Chairman.

Ross Baird is the co-founder of Village Capital, one of the most active early-stage investors in the U.S. Since its founding in 2009, Village Capital has invested in nearly 100 entrepreneurs and supports over 1,000 more through affiliate programs such as with a particular focus on economic distressed areas. Ross is also an innovator in resident with the Ewing Marion Kauffman Foundation where he focuses on issues related to access to capital for entrepreneurs, and is the author of the best welling book, The Innovative Blind Spot. He is a graduate of the University of Virginia where he was a Jefferson Truman scholar, and the University of Oxford where he was a Marshall scholar.

STATEMENT OF ROSS BAIRD

Mr. BAIRD. Thank you, Ranking Members. Thank you, Chairman. Thanks for the invitation to address the Committee.

So I am thankful to share my experience both investing and supporting entrepreneurs as the cofounder of Village Capital and also studying this issue in my role with the Kauffman Foundation, which supports education and entrepreneurship across the country.

So today we have heard the bad news. Despite a strong stock market, entrepreneurial activity in the U.S. is actually approaching a 40-year low. Rural entrepreneurship in particular has declined 33 percent in the last 30 years. Now, this is a huge problem. New businesses create nearly 100 percent of new jobs in the country. So today I would like to talk about the role access to capital plays.

So Kauffman Foundation research estimates it costs about $30,000 to start a business. Some entrepreneurs self-fund. Sixty-seven percent of entrepreneurs begin their businesses with personal wealth. This is savings, second mortgages, contributions from friends and family. Yet, most Americans' wealth is on the decline. In the Great Recession, 25 percent of Americans lost at least 75 percent of their wealth, most often home equity, which is a typical source of startup capital. Student debt has grown more than 100 percent in the 20 years. This wealth gap is particularly wide of women, African-Americans, Latinos, and rural entrepreneurs. As one entrepreneur told me over a cup of coffee at a McDonald's in Orange, Virginia, in Chairman Brat's district last year, starting a business has become a rich man's game.

So most entrepreneurs then need to access external capital, which has got two ends of the spectrum which we talked a lot about today. On one end, small businesses have typically turned to banks, but large banks have become bigger, and small and medium-sized banks that are more likely to back new and rural businesses are disappearing. Small community banks have declined 41 percent since 2008. Today, only 18 percent of new businesses get a bank loan.

We have also heard a lot today about venture capital, which is on the other end of the spectrum. It is an important tool and very valuable for a lot of businesses, but only 0.6 percent of businesses ever raise venture capital. It is usually a very specific type of tech company, usually in a big city. Less than 1 percent of venture capital goes to rural areas.

So that leaves 81 percent of businesses stuck in between with no access to formal capital. So what do these 81 percent look like? Five years ago, I met Lula Luu, a woman who founded a business called Fin Gourmet in Paducah, Kentucky. Fin Gourmet catches Asian carp, a huge nuisance in the Mississippi River watershed, filets it, rebrands it Kentucky Blue Snapper, and sells it to high-end restaurants all across the country. I am serious. It is like Chilean Sea Bass is actually a muckraking bottom feeder.

So when I met Lulu, she earned over $100,000. She was employing 12 people, but banks said her business was too young and too risky for a loan. Venture capitalists said she was not high growth enough. And so we innovated. We invested in Fin Gourmet and in an innovative dividend based model. They would repay us a percentage of the company's revenue as they grew until we would reach a predetermined return on investment. So we invested. Lulu more than doubled her employment and her revenue. She still faces a lot of challenges, but there are tens of thousands of Lulus in America who are too risky for a loan and too normal for a venture capital fund.

So what can Congress do for the other 81 percent? First, help entrepreneurs without wealth start a business. I have seen ideas, for example, focused on student debt. Entrepreneurs who start businesses and create jobs in economically distressed areas such as opportunity zones can have their loans deferred or forgiven based off of reaching certain benchmarks.

Second, innovative in the space between equity and debt. For example, the State of Colorado helped set up a fund for rural entrepreneurs, a private sector fund. And instead of a debt of equity fund it is this revenue-based investment, the Fin Gourmet model. Its creators argue that its structure is perhaps a better fit for the majority of rural businesses.

Finally, build on existing tools you have created. I am encouraged by the recent bipartisan creation of opportunity zones across the country, yet I am a bit worried. Without a focus on entrepreneurs, I can see this being a vehicle for large real estate investment. To address this, we are hearing from entrepreneurs about regulatory clarity that might help. As one example, it is unclear today how reinvested interim capital gains from an opportunity fund are treated. If an investor earns a return on investment from Fin Gourmet, they are more likely to invest in future Fin Gourmets if the tax incentive still applies to their interim gains if they reinvest in another entrepreneur.

Also, I encourage your creation and support for RBICs, as well as the Small Business Investment Company Fund, but I would take a look at the possible uses of funds. SBICs, for instance, have about a 4 billion annual allocation, and amazingly, the private sector does not even ask for anything close to the full 4 billion each year. You literally cannot give away money you have allocated, which maybe says it is perhaps the wrong product.

The SBIC Fund can invest only debt. I hear from entrepreneurs and investors that the use of this fund for equity and alternative structures may expand the playing field significantly.

Finally, programs such as the EDA's i6 grant have been helpful in creating venture capital funds, and perhaps you could also accelerate the use of other innovative vehicles by expanding the mandate of private funds it could support.

So we are lucky to be in an economy with good signs, but I want to remind the Committee that 55 percent of entrepreneurs starting a business today actually think the economy is on the wrong track.

If you are able to remove barriers like access to capital, a lot more entrepreneurs will be successful in realizing the American dream.

Thanks for the opportunity to be here.

Chairman BRAT. Very good. Thank you very much for that testimony.

I guess it is on to me now for the question session. We will go around the horn. I will ask a question, give a sermon, and then return to the question.

The question relates to the big man's game, the big firm's game, how you want to put it. I am totally opposed to that. I taught economics for 20 years and that is the sermon that is coming.

The question will be, how has the consolidation of the banking industry impacted rural small businesses? It is kind of a softball. What key financial services are difficult to access in more rural parts of the country? And how do we give small firms the real tools to compete?

And so for me, I think we have a big project on our hands. You mentioned 2008. Everybody is starting to go back to 2008 again, look in the rearview mirror. And what produced that? Risk. Banks no longer did risk assessments. They threw all the risk onto Fannie. And the financial crisis started only in the housing sector, right, and blew up. And you got the book on Johnson, his bio. He had 50, many fiefdoms across all states that no politicians could touch. Right? So that is the big man's game. Right? And the smalls cannot compete in that and so we are losing one small bank a week, et cetera, something on that.

And so if you go back to my Virginia heroes, we have got Madison. You might have heard of James Madison. He is from my district. Wrote a document called the Constitution. And roughly speaking, he and Adam Smith share the exact same logic. Right? So he has enlightenment, you know, logic. He wanted a large number of small factions duking it out against each other. A large number of small factions duking it out. What do we have in D.C. today? Big, big, big. Right? So we have failed. We failed to stay true to that vision. Adam Smith had the exact same logic. No one knows anything about it because we do not teach economics in school anymore. But he wanted a large number of small firms competing against each other. Right? That produces all the best outcomes. No one knows this. Right? Everybody thinks the exact opposite is the case. That capitalism in free markets leads to profits for the big guys. So Adam Smith was exactly the opposite. There are no profits in the long run in perfect competition when you have a large number of small firms competing.

And so this is kind of a setup for you. Right? This is the original architecture that made this country great, made us rich. Now it is big everything. Right? It is big insurance, big cars, big—anything. Big banking, big everything. Right? And so we need your help. And if you want to really help the small firm compete, I do not think small firms can outdo and survive in the current environment. We have $2 trillion in regulatory overhang per year out of a $20 trillion economy.

And so I just want to get your insights on how do we return to give the small firm, the small man, the small woman a fighting chance? Where are the key bottlenecks where we can get out of the way, and take a proactive stance to return small firms to a competitive stance? Right?

You brought up trade a little bit and that is kind of ironic, too. Right? So we have $2 trillion regulatory costs we put on our businesses, and the rest of the world does not have that yet. Right? China, India, et cetera. Two billion people. And we say go free trade. Well, that is a cynical joke. Right? So go compete on a neutral playing field when you have a $2 trillion regulatory disadvantage against you. And it is the same kind of argument.

So I just want to tee you all up. Why do you not, Mr. Baird, since you started down there, on a big level, right, I do not think we are going to get to where we all want in returning power to the states and localities and small businesses without some major steps. What do you think some of those major steps are?

Mr. BAIRD. Sure.

Chairman BRAT. That is part of it. Fire away.

Mr. BAIRD. Sure. I am also from Virginia, and I will start with another Virginia hero, Thomas Jefferson, who is not in your district but close by. There was a big debate between Jefferson and Hamilton at the founding of the republic. Jefferson said, do we design the economy for producers? And Hamilton said, do we design the economy for financiers and consumers? And the producers won, and probably rightly so, and I think over the last 30 to 40 years we have seen a major shift in how government defines competition which says so long as prices are low and profits are high, the economy is competitive. And I think we have seen whether it is in the chicken industry or the pork industry or the banking industry or cable or airlines, we have seen massive consolidation. It is very, very difficult for small businesses to compete all across the board. And I think these are intentional policy questions.

So, for example, this Congress passed probably 7 years ago a bill called Robinson-Patman that actually protected small producers against large producers and was very, very good for rural areas. Robinson-Patman is still on the books today, but when a large quasi-monopoly puts a small producer out of business, the courts have said that prices are low, it does not matter, even though it is technically against a congressional statute.

So I would say think about ways to promote and protect specific producers. Some of this is looking at large tech platforms that are both running platforms and selling things on the platforms. And I know you have a number of different hearings and questions about that. Some of that is ways to look at banking and financing and having different capital controls for smaller and larger banks. I can go into more detail, but that is kind of the intellectual framework I would look at if I were you.

Chairman BRAT. Great. Thanks. I think we will go around the horn once and maybe get back to that for the rest of the panel as well.

We will go to our Ranking Member, Mr. Evans, for his questions.

Mr. EVANS. Thank you, Mr. Chairman.

Mr. Baird, you raised an issue that I was just dealing with last week. If you ever get to Philadelphia, in Roxborough there is a place called Le Bus. They have some of the best food. But there is a woman who has been running a business for 13 years. You stated in your written testimony that business lending is outdated when it comes to service businesses with many assets used as collateral. How can banks' lending be restructured to allow more small service industry to access the need to start up or expand? That is exactly her issue. Listening to you, she has been in for 13 years. She went out and she bought another restaurant. Did not do well. Had to sell that restaurant. And she is struggling because of the very same issue you are talking about.

So talk about from that big picture standpoint. If that model is a failed model, what do you see?

Mr. BAIRD. Sure. In my conversations with larger banks, the minimum loan size that is profitable for a larger bank to underwrite is about $250,000. Now, going back to the Kauffman research, it takes about $30,000 to start up a business. That means most people are far too small to matter.

So there is an issue that banks were created in a day where most businesses were goods businesses. You buy a big machine. Then you get a loan. And if the business goes under, you can reclaim the machine and that is your collateral. Today, most businesses are services businesses, like the business that you described. So the industry has changed and banking has not. One of the things that we have the opportunity to look at though is the role of technology in making lending off of cash flows rather than lending off of assets.

So, for example, we invested in a company in Houston called Fig Loans. Houston is the payday lending capital of the world, and Fig Loans is a couple of numbers data scientists who have developed an algorithm to actually predict what a small business's cash flow might be. And they actually lend off of the potential of the business, even if the business is 9 months. They have a number of data pieces that go into it and they have a predictive algorithm and they are able to dramatically compete with payday lenders. So I would say there are technologies that help us look at cash flows. There are also regulations that may have different, again, capital controls, on balance, off balance. We want to manage risk, but many of these smaller banks and startup financial services technology companies are doing forward-looking cash flow lending rather than backward looking asset lending which is more in touch with most businesses starting today I think.

Mr. EVANS. Banks will then turn around and blame people like us in Congress and regulators why they cannot do what you have said because there is a certain amount of money they need to keep in the bank. What is your response to that when they turn and blame us?

Mr. BAIRD. Well, you recently passed a bill that loosened control significantly that were put in for Dodd-Frank. And one of the things I would keep an eye on in this Committee is banks have said for a while that they have not been able to lend because of these controls. So you loosen regulations. I would hold them accountable. I would say we did what you told us to do. Are you actually lending to rural businesses, small businesses? So in some ways you have removed an excuse, and I would hold banks accountable to make sure they do what they said they were going to do before you remove the excuse.

Mr. EVANS. Ms. Gales, you mentioned in your written testimony that one of the companies you support is an American company who regularly relies on exports with the business model. Are you worried that the administration tasked on our neighbors and biggest trading partners, are these companies worried? And what are we going to do to give certain and support to this trade stressed time?

Ms. GALES. We are absolutely very concerned about trade as our industry of agriculture is very reliant on exporting to get fair prices. We are very good at production, agriculture, and so it is very important for us to be able to sell products abroad. Most of our products we cannot consume totally in the United States, so we really rely on that market. So I will say we are looking at it very, very closely. We are working with our customers very, very closely. And reminding the panel that in good times and bad, the Farm Credit System is there to work with our financial partners. So we are keeping a keen eye on it. I would have to say we are worried about what that is going to do to impact cash flows of the businesses that we finance.

Mr. EVANS. I yield back, Mr. Chairman.

Chairman BRAT. Thank you.

I would like to recognize Rod Blum for his questions.

Mr. BLUM. Thank you, Chairman Brat.

Mr. Baird, you said in your testimony entrepreneurship is at a 40-year low. And this to me is stunning. And I cannot believe it. Fifty-five percent of entrepreneurs think the economy is on the wrong track. I do not buy it. Tell me why I should.

Mr. BAIRD. So I think that there is an increasing dichotomy to Chairman Brat's point between big and small, and I think that largely older firms—and when I say entrepreneurs, this is a Kauffman Foundation survey from February, and we look at businesses that are fewer than 5 years old. So that is the technical definition. So the vast majority of businesses that are older than 5 years old think the economy is on the right track. Fifty-five percent of businesses that are fewer than 5 years old think the economy is on the wrong track. And I think it is because it is very difficult for small businesses to compete against large businesses for a number of reasons.

Mr. BLUM. Nobody said it was easy. I did it.

Mr. BAIRD. So did I.

Mr. BLUM. It is not easy.

Mr. BAIRD. It is incredibly difficult. But I think there has been, for example, if you are in any range of industries—advertising is a large source of revenue for many types of businesses, media, whatever it is. Ten years ago, the advertising industry was very much divvied up. Today, 85 percent of online advertising is owned by two companies—Google and Facebook. And you have to build something on someone else's platform and then they have the ability to shut you down. So I think there is an increasing sense that large businesses are both making the rules and using the rules to compete against you if you are an entrepreneur. This is something I hear over and over again. You hear it in the agricultural supply chain trying to compete with increasing conglomerates. You hear it in financial services.

Mr. BLUM. The converse of that though is 2 weeks ago we had in here folks that were on Amazon's platform and they were all small businesses between $500,000 a year in revenues up to $12 million a year selling on Amazon and Etsy and eBay. So conversely, yes, they are big. Those are big companies. But the platform is for entrepreneurs.

Mr. BAIRD. So I think the question to ask if I am on your Committee is, what are the rules for platforms? So, for example, Amazon as compared to eBay. I wrote a book. I cannot control the price on Amazon. And it goes up and down and I do not understand why that is. On eBay, if I sell my book for $30, no one will buy it. If I sell it for 99 cents, people will buy it but I will lose money. But I get to choose. And so I think that the question of do people competing on a platform have choice over how to take their product to market is a really important one.

Mr. BLUM. Thank you. And I did mention during that hearing that Amazon needs competition.

Mr. BAIRD. They do.

Mr. BLUM. And when we get into sectors of industries when there is not enough competition, then that is where we have problems typically.

Mr. BAIRD. That is right.

Mr. BLUM. Mr. McKenna, consolidation in the farming industry, not the banking industry, good thing or bad thing? And is it being driven by only the large farms can get credit in the small—I mean, I am 63. I can remember when your average farmer would farm 80 acres or 160 acres. Today, in Iowa, I do not meet a farmer that is farming less than 12,000 acres. And I know the investments are bigger and their capital needs are probably higher. Do you think it is a good thing or a bad thing farms are consolidating and getting bigger?

Mr. MCKENNA. From a venture capital perspective, I think it is probably a pretty good thing in the sense that it creates a platform under which entrepreneurs, new people, new technologies, smart ideas can bloom. And the demand for technology, the demand for innovation is as great as it ever has been. Who are going to come up with those ideas? Who are going to be the people that develop those ideas? Big companies, big farms, it may be below their radar. On the other hand, there was a lot of smart people, a lot of innovation coming out of our land grant system, coming out of smart people's garages that are invited to participate with these larger consumers, with the larger enterprises. So from a venture capital perspective, I think bigness is perhaps a fact of life. On the other hand, there is still the opportunity for the smaller firm. There is still the opportunity for the young, new person to create a new business. That new business may not be able to compete on an agriculture basis but may compete on a technology basis. May compete on a logistics basis. May compete on some part of the economic chain that the big farms are following. And that is where the innovation is that I am seeing. I am seeing innovation below that level of the big, big farm.

Mr. BLUM. If we go back 8 years, let's say 2008, 2010, I can recall I think Warren Buffett was very interested in the agriculture markets. They were saying the hottest trends in Silicon Valley was now agriculture and precision farming, if you can recall that. Prices were also high back then for commodities. Is this a price-driven thing? If we can increase the prices of the commodities through trade, you know, will all the money flow back in then with this marketplace?

Mr. MCKENNA. Certainly, a rising tide. We will float a lot of boats. That is certainly the case. But also, look at the small businesses. Cannot compete from a fixed capital perspective. In other words, a farm today needs a certain size. Needs a certain amount of land. Needs a certain amount of equipment. And that is expensive. On the other hand, if the small business is technology based or software based, the capital invested there is a relatively smaller number and that creates the opportunity for the entrepreneur. What I see as the opportunity for the financial side is funding those people, funding those smaller ideas. And I still think there is a world of opportunity for those smaller ideas.

Mr. BLUM. Thank you. I yield back the time I do not have.

Chairman BRAT. Thank you, Mr. Blum.

I would like to recognize Mr. Schneider for his questions.

Mr. SCHNEIDER. Thank you. And I want to thank the witnesses again for sharing your perspectives. And the chair, and for allowing us to have this actually very important hearing.

Mr. Baird, you touched on the struggle between the Jeffersonians and the Hamiltonians at the founding of our Nation. Fair enough. But it was an important debate at the time. But at the time we were an agricultural economy. Over the 240 years since that debate, we have gone from agriculture to industry to a knowledge economy, and increasingly, to a services economy. And Mr. McKenna, you touched on I think very importantly that agriculture has gone from the small plot of land to a high-tech, high-investment industry that you need scale.

And so my question broadly is if we look at the opportunities taking place, and I will pick on the three states, New York, Massachusetts, and California where venture capital is going, a lot of these ideas are started at low scale in garages. People with a computer and an idea are able to create something that can grow into a fabulous business. There is no reason that cannot be done anywhere in the country. And Ms. Donohue, you talked about talent being equally distributed. It may be at birth, but by the time they go to school and there are these ecosystems that are developing in these concentrated metropolitan areas.

So my broad question is how do we use the very same technology that is in many ways creating this concentration to deconcentrate and allow businesses that need access to capital, that need access to talent, but cannot succeed without the opportunity for scale to gain capital, gain talent, and achieve scale while staying in smaller rural communities? And I will open it up to the panel.

Mr. BAIRD. Sure. I will give a quick answer and then turn it over to folks. Thanks for the question.

I think there are a lot of things that government tries to do in startups like create funds and things like that that government is not particularly good at. You know, picking specific winners and losers is not a core competency of government, I think. But there are two things that I think government has done well, particularly in rural areas in the past. The first is infrastructure.

So my mom lives on a farm in Cumberland County, Virginia, just south of your district. And my wife and I, we go there. It is great because we do not do any work, but we cannot do work because they do not have broadband because there is no internet there. And I think that that is a huge, huge barrier. And the next generation of the Rural Electrification Act or the Interstate Highway Act is something around rural broadband.

And the second, I want to go back to market competition. So scale is great if buyers and sellers are all treated equally. Right now in the chicken industry or the pork industry there is basically one buyer, which means farmers cannot compete for better prices. So some of this is technology. There are tech platforms that do not treat all buyers and sellers equally. Some of it is market platforms. I think making sure that free market competition rules happen in market infrastructures is a core competency of Congress.

Mr. SCHNEIDER. Ms. Gales?

Ms. GALES. I would like to take a crack at that.

On the broadband comment that you have, I think there really is a role for government and private entities to work together. And CoBank finances communications. But when you start getting into a rural area where the density does not allow a return on a significant investment, we run into the same problems when we go home or I go home to my rural farm where I was raised in Southeast Minnesota, and you really do not have good broadband coverage. So when we start looking at what are some possible solutions to that, the Universal Service Fund Reform I think has to have some changes, and the Rural Broadband Loan and Grant program I think is also important as a way for government and private entities to work together. So rebuilding our broadband and making it attractive for our young people to stay in rural areas, as well as to have agriculture. We have been talking about agriculture, and the Farm Credit System provides 40 percent of the capital to agriculture. And so it is very important. How do we run precision agriculture? How do we turn on a tractor that drives itself? How do we look at other things, such as telemedicine? So that we can have the same kind of care that we have in urban settings; that we can have that same kind of care in rural settings. So I think there is big room for private-public partnerships.

Mr. SCHNEIDER. Ms. Donohue?

Ms. DONOHUE. I think building ecosystems are complex and it just takes time. I know in Ohio we are doing a lot of the right things, but we are so much newer than Silicon Valley or Boston or New York. Public-private partnerships are a very important piece of this, including building infrastructure and access to the internet. I think our corporations have a large role to play, leaning in and supporting these entrepreneurs, providing customer validation and using their products. I think the government could lean in in that way as well and be a first customer for startup companies and entrepreneurs. They are not looking for a handout. They are looking for a hand up, and I think that is one way that the government can contribute.

Mr. SCHNEIDER. And if I may request time for Mr. McKenna, Mr. Chairman?

Mr. MCKENNA. Thank you, sir. I would go back to the comment from Chairman Brat about, I like the expression, the competition of a large number of small firms. The rural business investment companies, the RBICs that Congress authorized and USDA administers, are a tremendous success. Giving them access to the leverage provided by the Small Business Administration would be a great benefit as well. And that is pending before the House Senate Conference right now as part of the Farm Bill. So I would urge you to consider giving them that access.

Mr. SCHNEIDER. Great. Thank you. And I am out of time. I yield back.

Chairman BRAT. Thank you.

And I would like to now yield time to Mr. Lawson for his questions.

Mr. LAWSON. Thank you very much, Mr. Chairman. Welcome to the Committee.

Mr. McKenna, I was interested when they said you were from Georgetown. I was wondering what kind of rural development you have around Georgetown. You know, but I do know you have had the opportunity to work with people down south. And I would like to know how did you get involved with that research to work with people being you are from Georgetown? Do you really know what is going on down there? How can you help them with the research and so forth that you are doing in terms of economic development and small business growth?

Mr. MCKENNA. Georgetown, you are absolutely right. Georgetown barely has a campus, let alone an agricultural footprint. But they recognize that there is an opportunity to be a door keeper, so to speak, for other organizations to Washington, D.C. And in the rural space, they felt there was a need for that access to Washington, D.C. to advance rural issues. Obviously, they need partners, and that is why we have reached out to the campuses, land grant campuses at Mississippi State, Purdue, and Iowa State, because they obviously have that skill, that expertise, and the desire to address those needs. So the Center at Georgetown University relies upon our partners, USDA, and those three land grant schools to be the place where the ideas come up, where the needs are identified, discussed, and then brought to the proper forum in Washington, D.C., to be discussed.

Mr. LAWSON. Okay. And next, Ms. Donohue, how do you keep the character of rural communities intact with economic development? I grew up in a rural community and when things start drying up, you know, developers start selling property and a lot of people moved in. And a lot of people start saying we do not even know these people are on the commission now. You know, they started incorporating their cities. I had a lot to do as somebody within the Florida legislature. But how do you keep the integrity of the community? And someone else might want to comment on it, too, about infrastructure, the character of the community, at the same time increasing economic development.

Ms. DONOHUE. I think that is a very important topic. We love our friends in San Francisco but are very wary of how that city has developed. So inclusive economic development is very important in how we build these communities and these ecosystems.

I can tell you that in Ohio we have been able to maintain character by repurposing a lot of the old buildings, the old structures, job retraining, job creation, and bringing people from industries that are outdated and training them for the jobs of the future is something that is very important to us in Ohio.

Mr. LAWSON. Okay. And Ms. Gales, do you think about that when you are giving loans and so forth to these developers in those communities?

Ms. GALES. We absolutely do. And there is no corner on the market of good ideas in urban areas. There are many good ideas in rural areas. And oftentimes it seems what is needed is technical support so that we can work with people. I worked with a cooperative development center for 3 years in South Dakota, and there was no shortage of good ideas. But that technical assistance is so important to put the business plan together, to make sure that it fits with the community's desires, that it fits without changing the character of the community. I mean, whatever the factors are that are important to the people with the good ideas. So I think technical assistance is really a very important part of making successful businesses get off the ground in the best possible fashion.

Mr. LAWSON. Mr. Baird?

Mr. BAIRD. Yeah, I think a lot of this is the design of the types and tools of capital. So it is the saying, if you have a hammer, everything looks like a nail. Venture capital funds are a great fit for high growth technology companies. There may be other kinds of investments that are a better fit for rural businesses, and innovations like the fish company I told you about, the investment structure we used, I can see an opportunity to identify and scale, and maybe government can help seed some of those efforts.

The second thing I would say is to your question around developers and real estate, I am very encouraged by and supportive of opportunity zones. And with the caveat that there is a world in which it is a real estate developer only benefit, and there is a world in which entrepreneurs and small businesses are at the center of it. There are a couple of questions around how gains from opportunity funds can be used. How and whether opportunity funds can raise and utilize debt that would make it much more entrepreneur friendly. So I encourage Congress to listen to entrepreneurs as regulatory clarity comes out in opportunity zones to make sure the entrepreneurs in the communities benefit.

Mr. LAWSON. Thank you.

Mr. Chairman, if I could have just a few more seconds.

Mr. Baird, you said that there is always a lot of money left on the table. You know, I have only been up here about 17 months. What do you mean by the money left on the table?

Mr. BAIRD. So the Small Business Investment Company Fund out of SBA is a fund of funds that seeds funds across America like we all are excited about. It makes money for the government. It was 2 billion. A few years ago you extended it to 4 billion, but the private sector does not ever come close to asking for that 4 billion because it is a debt investment vehicle. And most risk capital are either equity funds or quasi-equity funds like the Fin Gourmet idea. So no one wants to raise debt and then uninvest equity. And if you are raising senior debt as Ms. Gales said, it is actually relatively straightforward and much easier to raise. So I think changing clarifications on how the SBIC funds could use I think would be a lot more responsive to the private sector as one strategy you might pursue.

Mr. LAWSON. Okay. Thank you. And I yield back, Mr. Chairman.

Chairman BRAT. Thank you very much.

I think maybe we can do a short lightning round. I will just make a couple comments. Ms. Gales, your comments on technical assistance I think very interesting and provocative. Having taught freshman economics for 20 years, I always ask myself, what would the world look like if we taught our K-12 kids about business ahead of time? Right? So they start doing internships and being creative and looking at technical assistance early on in life. Right? While they are in high school even. And then they move on to business certificates and technical education and all that. And they are working on that the whole time. Right? The kids coming out of K-12 right now, it is not the fault of the teacher. They do not know what a business is at all. They do not know a price, a cost, a profit, zip. So we spent 13 years, $14,000 per year, and that is what we got. And then colleges, some of them are hostile to business and free markets, et cetera. So if you want to make a dent, I think there is a lot of resources in those channels. We could turn a world around. It is like turning a battleship around. But we could turn the world around.

And then finally, I kind of gave my little architect there with Smith and Madison or whatever, but I want to give a cautionary note. When you come up here on the opportunity zones, real estate, whatever, and the same thing. It kind of has to do with the kids. We got $4 trillion that comes up here. Right? $20 trillion economy. $4 trillion comes up here. And then who controls that pot? The small guys? Right? Everybody knows. And so that is the tricky part, is how do you keep these things from getting gamed and captured? And there is economic literature on all this stuff. And so the clearest example for me, right, we have got $21 trillion in debt right now. We have got $100 trillion in unfunded liabilities. And that is going to affect who? The one major group in our country that has no lobbyists, the kids. So that is just a cautionary note on working up here instead of keeping it down there. Or whatever we write up here, better send it all back home, right, to the states and localities, et cetera.

And so I kind of started the last section of what can we do on a big scale? And I got to Mr. Baird and Mr. McKenna, and Ms. Donohue and Ms. Gales, if either of you want to weigh in on what we can do better big time. Not just on this issue, but overall, to have the government be a fair broker as we try to adjudicate between these groups who have been left behind.

Ms. GALES. I would comment on rural youth. We have got a lot of blue jackets in the room, and rural and urban youth are going to be the future of our United States. And so you start looking at what are some of the opportunities for youth? And there are so many great projects, like Campus Kitchen program, or I look at what 4-H is doing, the other organization that I was a part of. But Scouting for Food, Campus Kitchens have been a real success. So I look at not only technical assistance but how are we working with youth who are the entrepreneurs or future entrepreneurs that are really going to help us do a better job bringing capital and ideas and keeping them in rural America.

Ms. DONOHUE. It is very difficult to get a first-time venture capital fund off of the ground. Less than 100 are created every year. That is especially difficult in the Midwest. Lifting the Volcker Rule I think would be very important and have a significant impact on the Midwest. Prior to the Volcker Rule, banks played a very critical role in the creation of venture capital funds in Ohio. We do not have the stacked LP base that our partners on the coast do. We are very limited as to the number of institutional investors who can invest in venture capital and who are educated on venture capital. So banks not only made up a significant amount of the fund; they were the first investor in providing confidence for subsequent investors. So for us in Ohio, the Volcker Rule is very critical.

Mr. MCKENNA. Just repeating what I said before, the opportunity for small venture capital funds exists. They are out there. They just need a little bit of push. And most of that push is going to come from the private sector. But from an SBA perspective, having the RBICs gain a little bit of access there would be, I think, a helpful push.

Chairman BRAT. Great.

Mr. Evans.

Mr. EVANS. Thank you, Mr. Chairman.

Chairman BRAT. Anyone else that wants a second crack?

Mr. EVANS. I want to follow up with Ms. Gales.

You mentioned in your testimony that CoBank is working with minority groups and farmers to help them get a leg up in agriculture. What types of programs are they doing? And who are you working with to ensure that everyone is getting fair access to capital?

Ms. GALES. Thank you for the question.

We work with our Farm Credit partners who are responsible for working with small, beginning, and startup companies and minority companies. And so we have a program that I would like to just highlight called Farm Start that is in our East Coast office that we work with our Farm Credit East, Farm Credit partner and Yankee Farm Credit partner in Vermont and Massachusetts. And so they identify small, beginning, new farmers, minority farmers that need some additional help. And we support that program with some equity capital. They make the analysis. They are the farm lenders. They make the analysis on the loan product that we provide, but there is another program where we do not follow traditional underwriting standards in many cases to give those individuals a leg up.

Mr. EVANS. Thank you, Mr. Chairman.

Mr. Baird, I want to go back to something I heard you mention. This is a follow-up to Mr. Lawson.

Could you discuss the potential problem created if opportunity zones are used for real estate investment only? I heard Mr. Lawson raise some questions about opportunity zones.

Mr. BAIRD. Yes, thank you, Congressman.

I think this goes back to a theme of this which has been the big versus small. So opportunity zones investment, I like it a lot because it is private sector totally. It is no government capital, so it is the private sector driving it. However, today, the way the regulations are interpreted, you have to, if you sell a stock, if you own stock and then want to invest it in an opportunity zone, you have to sell it and invest it within 6 months. And the larger the investment, the bigger tax benefit you get. So it is a lot easier to invest it in a $10 million real estate project than 10 $250,000 growth equities and small entrepreneurs. And so we are seeing communities—I was just in Central Valley of California, where we are seeing farm communities collect and syndicate groups of small investments, and that is the kind of thing the private sector is doing, which is encouraging. But right now, the way regulations are interpreted, it is a lot easier to invest in one big project than a number of small entrepreneurs that are trying to compete in the economy. There are a number of——

Mr. EVANS. That were counter to the overall mission of opportunity zones?

Mr. BAIRD. Potentially. I think that the idea of opportunity zones is to create economic dynamism in economically distressed areas. And if you invest in real estate only without investing in businesses that are creating jobs, creating growth, creating churn, it is unlikely that you will see net economy activity. And I have put this in my testimony. There are a couple of open questions on regulatory clarity that would be very, very helpful for small entrepreneurs that we keep hearing from the field that I would take a look at.

Chairman BRAT. Mr. Schneider, any further questions?

Mr. SCHNEIDER. Yes, thank you.

I want to go back to this idea of creating ecosystems or environments where entrepreneurs can achieve success. Last year, I introduced AOSA, the Accelerate Our Startups Act. The idea is to invest in these incubators and accelerators, particularly in communities, whether it is rural or economically distressed communities. I love your perspective on what impact that might have of having incubators, of having places where entrepreneurs, small businesses can come, learn from each other, get resources, besides just access to capital, but resources of understanding how to read a P&L or how to reach a new market.

Mr. MCKENNA. I would take a look at the land grant system. Every land grant school I visited has an environment, a room, a building that encourages that. And whether they call them accelerators or incubators or regional investment councils, that feeling is present in every land grant campus that I have been to. And it is often staffed by a professor, by a team. Sometimes that team is funded partly through the USDA funding. Sometimes funded through state funding. But it is an incredibly valuable tool. It is on the university. The university has access to R&D. And it marries both the technological side and also the investment side. So I think the land grants hit the ball out of the park as far as that is concerned.

Ms. DONOHUE. Density is a critical component of a healthy entrepreneurial ecosystem. Getting all the entrepreneurs in the room together, they can feed off of each other, the energy, the excitement, teach each other new things and just offer a support system is very important. Also, bringing in those mentors. And to my point earlier about us just being kind of new, we do not have a lot of mentors. We do not have a large number of people who have successfully grown and exited a tech company or whatever, life sciences company, whatever it may be. So I think we need a lot of time. But getting mentors from all over the country and bringing them to smaller areas, parts of Ohio, teaching them the ropes and how they were able to achieve success in California I think could be great. I love the program. I love the idea.

Ms. GALES. I also believe the co-op business model plays a role with a long-term perspective, and cooperative development centers across the United States have been very instrumental in helping those cooperatives get started, whether it is a food cooperative, some sort of a technology-type of cooperative. I mean, there are many places where that type of model really is worthwhile. And so I look at, again, what is the technical assistance, getting people together, coming up with ideas, understanding best practices, knowing where to find capital. There is just so much information that a young entrepreneur needs to start a business, and I think the cooperative business model is one area that can serve a very important purpose.

Mr. SCHNEIDER. Mr. Baird, last word to you.

Mr. BAIRD. I had not heard of AOSA, but Congressman, I think it is the right idea. I mean, one of the things in the Kauffman Foundation, I have looked at all kinds of government funding to try and increase access to capital. And the evidence is pretty clear that direct funding of businesses from the government actually does not provide good outcome. It is kind of neural. People in Ohio, or people in Indiana are better placed to decide who to support and incubate and invest in businesses than people here or in New York or Silicon Valley. And so things like the EDA i6 grant which seeds fund managers instead of investing directly in businesses has had good outcomes. Things like investing in incubators, accelerators. You know, Ms. Donohue stat that fewer than 100 new venture funds are starting, I think that is probably a contributor to the lack of economic dynamism because you do not have people close to businesses being able to support those businesses. So Congressman, I am encouraged by that line of thought and encouraged to hear about your thinking on that. I think you are on the right track and the evidence would support it.

Mr. SCHNEIDER. Thank you. I yield back.

Chairman BRAT. All right.

Mr. Lawson?

Mr. LAWSON. Thank you very much. I keep hopping on Georgetown. They have got a new coach over there. I hope he does well.

How can we help universities partner with rural community development? You hear presidents oftentimes talk about this area, but how can we help them to close the skills gap? What can we do to encourage the universities to close the skills gap so many industries can prosper?

Mr. MCKENNA. The example I have seen that has been successful I think is what the Department of Agriculture does. And through their Regional Community Development program where they have teamed up with four land grant schools and divided the country into a series of sectors where those schools lead local regional economic development activities. A little bit of money comes from the Federal government, not very much, but it is enough to create a very vibrant, local examination of those issues. And I agree with the comments before. Not much happens in Washington as far as that traction is concerned. The traction has to take place in the local community. They know what the businesses are. They know where the economic demand is. And the more situations where the money can flow down to those organizations, land grant—there are others, but land grant is an example that is up and running—the better, I think.

Mr. LAWSON. Anyone else care to comment?

Ms. GALES. I will comment that I think private industry also has a role in that. In the case of CoBank, we have partnerships with universities, primarily land grant universities since we are rural focused, where we are working together to identify where those needs and how can we work together, and also put money where our mouth is.

Mr. LAWSON. Mr. Chairman, can I ask one more question?

Chairman BRAT. Yeah, sure. You bet.

Mr. LAWSON. Mr. Baird, you mentioned about Dodd-Frank. And there was a great deal of discussion about whether you help the small commercial banks and credit union with the undue regulation. And I think in your testimony you stated that if we move some of the regulations, then we need to hold their feet to the fire. Can you comment on that a little bit?

Mr. BAIRD. Sure. I mean, I think that obviously, macroeconomics is very complicated, and I think that there are very sophisticated arguments on both sides of the recent bill you passed as well as Dodd-Frank. But the legislation that has passed, the argument at least from small and medium-sized banks was if you pass this, we will lend more to small businesses. And I would keep an eye on that. It remains to be seen whether this is the right or the wrong legislative decision. I think it is not my role to comment on that, but I do think that if banks say pass this and we will help small businesses more, you should gather evidence and ask questions and invite people to a hearing like this for a follow up of we did this; are you doing what you said you would do?

Mr. LAWSON. Okay. Thank you. I yield back.

Chairman BRAT. I like the "gather evidence part."

All right. I want to thank you all for being here. I think we are all very happy with the way this went today. Tomorrow, the New York Times, the headline I am sure will be republicans and democrats united with a great panel of articulate hosts all in favor of helping the small guy, the small gal, the small firm. It was all good news. Right? Good news never makes the paper. That is what is wrong. Right? I mean, we have got to make that make the paper someday. Right?

So I want to thank my democrats. There were three in here versus one at one time, and I am walking out of here smiling. So it is a good day up in D.C.

So with that I will ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned. Thank you all very much.

[Whereupon, at 11:23 a.m., the Subcommittees were adjourned.]

APPENDIX

GLOBAL SOCIAL ENTERPRISE INITIATIVE
GEORGETOWN UNIVERSITY McDonough
SCHOOL of BUSINESS

July 21, 2018

Re: Testimony for the House Committee on Small Business

Subcommittees on Economic Growth, Tax, and
Capital Access and Agriculture, Energy and Trade

Matthew M. McKenna

Executive-in-Residence
Global Social Enterprise Initiative
McDonough School of Business
Georgetown University

Investment in venture-backed companies in the United States reached $57 billion in almost 4,000 deals in the first half of 2018.

And yet, only a fraction of those dollars found their way to funds and companies based in rural America. This capital deficit is starving innovative and valuable growth opportunities. Without it, job growth and rural economic development will continue to lag the rise in prosperity of the rest of the country.

I am here today on behalf of the Rural Opportunity Initiative, an effort by the Global Social Enterprise Initiative at Georgetown University to address this imbalance. The Global Social Enterprise Initiative brings the power and innovation generated by cross-sector partnerships to bear on the world's most pressing problems by emphasizing implementation and measurable social change.

The Rural Opportunity Initiative is a partnership between Georgetown's McDonough School of Business, the United States Department of Agriculture and three leaders of our land grant university system: Iowa State University, Mississippi State University and Purdue University. Together, we have embarked on an effort to increase investment from the private sector in rural America...a geography that is more than 95% of the country's land area and less than 20% of its population.

It is well established that small business and particularly new small businesses are the greatest source of job growth. Yet, these new businesses lack access to a critical source of capital. The Rural Opportunity Initiative was organized to address this imbalance.

Together with our partners, we have organized events that bring together both investors and entrepreneurs in order to begin to fund this capital deficit. With Iowa State, we held an event in Des Moines that attracted dozens of small businesses and potential investors, including regional VC funds and large institutional banks. Last month, a similar even was held at Mississippi State in Starkville where we listened to pitches from new businesses that ranged from microwave sensor technology (developed in the labs at MSU) which detect spoilage in grain elevators to healthy crackers made from a flour rescued from the by-products of craft beer.

Also on our schedule for the rest of this year are events on Georgetown's campus around rural lending and an expanding partnership with USDA. And in November, we will be hosting a major conference around rural capital and how those dollars flow to investments and markets away from the coasts.

This conference, the Rural Capital Forum, is scheduled for November 15, 2018 and will identify both hurdles to capital access and the tools available to overcome those obstacles. Let me discuss just two of those challenges this morning.

The first is a lack of awareness. We need to introduce the innovation and emerging technologies that are growing in rural America to institutional investors. That was the primary purpose of our investor conferences in Des Moines, IA, Starkville, MS. It will be the central theme for our much larger meeting this November in Washington, DC.

Others are also making this effort. Steve Case's well publicized Rise of the Rest tour is one example. Another is a major event this fall in Bentonville, AK to be hosted by the Walton Family Foundation.

But awareness building is only the opening of the door to the investment decision. Other more significant barriers remain. Chief among these is the issue of scale. Most rural small business are small businesses. They are not looking for hundreds of millions of Angel investment or a Series A funding. More often they are looking for $500,000 or $2 million of mezzanine financing...money that essential to the development of a business plan, initial working capital and operations. Yet, few organized sources exist for this level of funding.

One way of addressing the issue of scale is the development of funds that target this level of investment. The recent wave of Rural Business Investment Companies is a good example. Their charters limit their investments to rural based businesses and their typical investment slice has been in the $1-5 Million range. Another tool is a fund of funds approach, where many small funds are brought together by institutions as way of allowing their customers to obtain the diversity and scale that is denied them in more targeted funds.

Finally, the federal government has a role in tackling some of the obstacles that exist to small business investments in rural America.

Rural Business Investment Companies

Under the authority of USDA, the recent wave of RBICs has been impressive. Several hundred million dollars have been raised in these Funds. More are in line awaiting approval.

Opportunity Zones

Last year's Tax Bill and the Opportunity Zones provisions are a source of great potential for incremental equity investments. About 23% of the state designated investment zones are located in rural America.

2018 Farm Bill

The Senate version of the 2018 Farm Bill includes language that would expand the opportunities for RBICs. Specifically, the bipartisan Rural Jobs and investment Act of 2018, S. 5034, is an opportunity to spur more investment into rural communities. We think this is a good thing and urge the House conferees to join the Senate in this effort.

These pushes from the federal government are important. But the primary source of change is going to come from the private sector. We know those dollars are available...$57 Billion in the first half of 2018 alone...but the challenge is how to change the direction of those investments toward sectors of the economy and geographies where venture capital has not been well represented. That is ultimately a challenge of building awareness of those investment opportunities. That is where the Global Social Enterprise Initiative at Georgetown, the Rural Opportunity Initiative and our partners are heading.

Matthew M. McKenna

Global Social Enterprise Initiative
McDonough School of Business
Georgetown University

Written Testimony to the Small Business Committee of the U.S. House of Representatives
by Falon Donohue, CEO, VentureOhio
July 24, 2018

1. Introduction

Chairman Chabot, Ranking Member Velazquez, members of the Small Business Committee, thank you for the opportunity to provide testimony for this important hearing. My name is Falon Donohue and I am the CEO of VentureOhio, a non-profit organization dedicated to the growth and diversification of Ohio's startup community. I am honored to represent the incredible entrepreneurs, innovators and investors who make up our membership and who are creating high-paying jobs in communities throughout the Midwest.

The proposals to encourage entrepreneurship through regulatory reform are critical to not only VentureOhio members but also to investors and founders across the country. And more broadly, in this new tech-based economy, these conversations affect all facets of the U.S. economy.

While conditions are ripe for continued innovation and economic expansion, there are underlying concerns about the ability of entrepreneurs and investors to reach their potential as job creators and maximize their impacts on communities—especially in areas between the coasts. VentureOhio suggests addressing restrictive regulations in order to create an environment in which capital flows more equitably to promising businesses in need.

In supporting these long-term, high-risk ventures—proven time and again to be the engine of our economy—we can ensure generations to come are able to turn bold ideas into world-changing businesses.

2. Momentum in the Midwest

The Midwest is in the midst of a renaissance—no longer a languishing "rust belt" of abandoned manufacturing facilities. As smart robotics and industrial automation proliferate, the Midwest is just as reliant on innovation and R&D as Silicon Valley.

In Ohio, we have seen remarkable growth in our entrepreneurial ecosystem. Venture capital activity is at the highest point ever, our annual report showing that investments have increased 46% since 2014. In 2016 alone, investors pumped $470 million into 210 Ohio startups.

The Midwest is earning a reputation as a promising new frontier in venture capital investing. For the past four years, AOL co-founder Steve Case has been traveling alongside renowned author JD Vance to seek out innovation in overlooked communities. Their $150 million Rise of the Rest fund has supported promising companies in a number of Midwest communities. Another supporter of the region, Columbus-based Drive Capital, has raised a half-billion dollars to invest in promising businesses throughout the Midwest—the publication TechCrunch noting it is spurring "an investment revolution in areas of the country that are more synonymous with tractors than with technological innovation." The ripple effects of these investments in underserved communities are profound, as they support high-paying jobs and the families of those workers.

Venture capitalists build help to ecosystems and support the key drivers of economic development - innovation, talent and capital. Columbus-based NCT Ventures funded and helped to launch the Center for Entrepreneurship at The Ohio State University to inspire Midwestern entrepreneurs for generations to come. In Detroit, legendary entrepreneur Dan Gilbert and and his team at Detroit Venture Partners have sponsored numerous accelerator and entrepreneurial startup activities to stimulate innovation in the Motor City.

Our brightest minds are now electing to stay in Columbus, Indianapolis, Detroit and other growing cities across the Midwest—they no longer feel like they need to leave for a coast to work at a thriving tech company. Local policymakers are supportive of the progress. The state of Indiana, for example, is now mandating computer science classes for every grade from K-12 in public schools.

Despite all these positive signals, one serious shortfall remains. America's heartland lacks the critical access to capital enjoyed in Silicon Valley, New York and Boston. Three-quarters of venture capital is being invested in just three states. Our home state of Ohio received less than 1%. Talent is equally distributed but, if capital continues to be concentrated in the hands of a few based on geography, we risk letting this momentum fade away.

This is perhaps the most exciting time for entrepreneurship in the history of the Midwest. To cultivate this high-risk, fast-paced environment, we must address the shortcomings and the underlying policies that can turn them into strengths.

4. Regulatory and Tax Changes

The hardworking startup founders and the investors that support them are in need of regulatory relief to reach their true potential.

Most of the capital invested in startup companies goes toward research and development, job creation and salaries, and other expansion activities. VentureOhio and our partners at the National Venture Capital Association (NVCA) recognize that founders, their employees, venture capital firms and angel investors must find the risk/return ratio worthwhile in order for the entrepreneurial ecosystem to flourish. If capital regulations and investment policy are hurdles to participation, investment in entrepreneurship will suffer.

Venture capital's influence on the American economy can not be overstated. In 1979, regulatory changes allowed pension funds to invest in VC, creating the modern venture capital industry as we know it today. According to a recent Stanford University study, 43% of the public companies founded between 1974 and 2015 were venture-backed. These companies represent 38% of the employees and 57% of the market cap of the "new" public companies.

While lower tax rates can have a substantial impact on many small businesses, venture-backed companies with negative income do not benefit from these changes. The ecosystem is in need of thoughtful policy specific to the companies and investors operating in the space.

Specifically, VentureOhio agrees with the following recommendations from the National Venture Capital Association which we believe will encourage new company formation:

- **The Volcker Rule**
  Formed in response to the 2007 financial crisis, the Volcker Rule aims to prevent banks from taking unnecessary risks. Unfortunately, it was written too broadly and unnecessarily prevents banks from investing in venture capital funds, eliminating a critical source of capital for startups. Section 619 of the Dodd-Frank Act includes "prohibitions on proprietary trading and certain relationships with hedge funds and private equity funds" without any mention of venture capital. Investors and entrepreneurs would like to see a narrower interpretation to allow banks to participate in this proven source of job-creation and economic output. This regulation is especially burdensome to communities outside of major metropolitan areas, dampening entrepreneurship and economic activity where it is needed most.

- **Registered Investment Advisor Rules/Developing and Empowering Our Aspiring Leaders (DEAL) Act**
  Congress required hedge and private equity funds to become registered investment advisors (RIAs), but exempted venture capital funds and directed the SEC to define a VC fund. Seven years later, the definition needs to be modernized as many VC funds must now plan around how to stay within the confines to avoid registration. The DEAL Act, sponsored by Rep. Trey Hollingsworth (R-IN), directs the SEC to modify the definition of a venture capital fund to make certain qualifying secondary investments. In the venture ecosystem,these shares generally come from founders, early stage employees or individual investors who are seeking liquidity. VCs have been left with a choice to either limit their participation in certain financing rounds or incur significant compliance costs by becoming a registered investment advisor (RIA). It woulld be beneficial to allow VCs to continue providing equity investment to more of their portfolio companies, encouraging patient capital investment and long-term company growth. We strongly support theJOBS and Investor Confidence Act which contains the DEAL Act and passed the House by a 406-4 margin. We hope this can make it into law.

- **Expanded Research and Development Tax Credit**
  Current law allows very early stage startups—less than five years old and with less than $5 million in annual sales—to use R&D credits to offset up to $250,000 in payroll tax obligations. We believe Congress should expand this credit to startups with less than $100 million in assets, and allow them to offset up to $1 million worth of payroll taxes with R&D credits. The creation of the payroll tax offset for startups as part of the PATH Act was a promising start to encouraging the growth of innovative American companies, but the restrictions leave many startups unable to access the benefits of their R&D tax credits at a time when they are pouring considerable resources into R&D to build the enterprise. Increasing these limits will increase the country's global competitiveness and ensure startup companies can access the benefits of the R&D credit when they need it most. This will have significant impact in overlooked communities.

- **Maintaining Carried Interest Capital Gains**
  While many different factors have converged over time to create America's leadership in innovation, significant credit is due to our long-standing tax policy that supports the spirit

of entrepreneurship. One such policy is the capital gains treatment of carried interest received by venture capitalists. Carried interest is the primary economic incentive for participation in venture capital. Venture capitalists create partnerships with institutional investors (e.g. pension funds, endowments, foundations) and individual accredited investors. This partnership marries the talent, expertise, and personal capital of the venture capitalist with the capital of the institutional or individual investor to make high-risk, long-term equity investments into innovative startups. These are generally partnerships that last 10 to 15 years. Carried interest is the VC's share of gains (if there are any) from the partnership in accordance with the partnership agreement. Capital gains treatment of carried interest is an important feature of the tax code that properly aligns the long-term interests of investors and entrepreneurs to build great companies together since the creation of the modern venture capital industry. Venture capital activity is consistent with the core concepts of a long-term capital gains tax rate. As such, partnership gains attributable to the general partners of a venture capital partnership should continue to be afforded capital gains treatment.

When a startup fails, the carried interest on a deal is zero. In fact, carried interest is only realized if one or more startups in a venture capital fund are so successful as to offset the operational expenses and inevitable failures in the fund. Carried interest tax policy is defined by a simple equation, which holds that no benefit is extended unless and until our country receives the benefit of greater economic activity through company and job creation. This policy has been critical to our country's economic success. In a state like Ohio, which saw more than $600 million in new funds raised last year, a tax increase on carried interest could be devastating for our recently burgeoning venture capital community.

5. Conclusion

Entrepreneurship is the bedrock of the American economy. It leads a perpetual cycle of innovation and wealth creation that sustains high-paying careers and supports communities from Silicon Valley to Ohio.

When startups succeed, they produce the most revolutionary innovations that impact our communities, the country and humankind. A few targeted initiatives can positively impact capital formation for startups in the U.S., making long-term risk investment as attractive as possible. VentureOhio speaks for the state's community of entrepreneurs and investors when we urge Congress to create a clear and rational framework to allow America's entrepreneurial ecosystem to thrive for generations to come.

Thank you again to Chairman Shabot, Ranking Member Velazquez, and members of the Small Business Committee for your time and attention to this important matter.

Testimony

of

Amy Gales

Executive Vice President, Regional Agribusiness Banking Group

on behalf of

CoBank

Before the Subcommittees on

Agriculture, Energy and Trade

and

Economic Growth, Tax and Capital Access

of the

Small Business Committee

United States House of Representatives

July 24, 2018

Good morning, Chairmen Brat and Blum, Ranking Members Evans and Schneider and Members of both Subcommittees. Thank you for calling this hearing today to focus on the capital needs of rural entrepreneurs and to discuss how those needs are being met.

I am Amy Gales. I serve as Executive Vice President of the Regional Agribusiness Banking Group for CoBank based in Greenwood Village, Colorado. CoBank is a cooperative bank serving a national footprint, with a mission to provide dependable credit and other value-added financial services to agriculture and rural infrastructure businesses for the benefit of rural America. CoBank is a proud member of the Farm Credit System[1], a national network of cooperative banks and retail lending associations chartered by Congress to support the borrowing needs of U.S. agriculture and the nation's rural economy.

We are a financially strong institution – delivering value to our customer-owners

We are immensely proud of the value and service we provide our customer-owners across rural America. Financial strength and stability are critical to our ability to serve and deliver value to our customer-owners and fulfil our mission to support rural communities and agriculture with reliable, consistent credit and financial services for today and tomorrow.

As a cooperative, we pay patronage to our customer-owners. That means CoBank's earnings go directly back to our customers – not outside shareholders. Over the past five years, CoBank has distributed almost $2.6 billion in patronage to our customers across rural America, highlighting the enduring value of the cooperative model.[2]

Today, I plan to outline for you how CoBank supports rural entrepreneurs focused on rural America by:

- providing flexible loan products in the form of Co-op Start
- supporting the technical assistance and education needed to create new cooperatives with a recent focus on cooperatively owned grocery stores
- funding rural equity investments
- funding community facilities in partnership with USDA, Farm Credit Associations and community banks with bond investments
- sponsoring predevelopment funding
- financing and advocating for rural infrastructure nationwide
- partnering with Farm Credit Associations to serve young, beginning, small, and minority farmers
- supporting youth entrepreneurs

We are investing in innovation – Growing Rural America Initiative

We at CoBank are acutely aware of the needs for rural America and strive to find flexible innovative ways to address those needs. We call this collectively, CoBank's "Growing Rural America Initiative" and it encompasses a variety of tools to meet the needs of rural entrepreneurs.

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[1] https://farmcredit.com/

[2] http://www.cobank.com/~/media/Files/Searchable%20PDF%20Files/Newsroom%20Financials/Annual%20Reports%20and%20CSR/2017/COB_AR17_FullBookw10k_030118.pdf

The landscape of agriculture and rural America is diverse and complex. Historically, some small and/or emerging farmer-owned cooperatives have been overlooked when it comes to financing and other technical assistance. To truly fulfill our mission and strengthen our rural communities, we also recognized a need to serve these customers whenever possible.

Co-op Start

To address the capital needs of small and/or emerging agricultural cooperatives, CoBank developed a creative solution. As consumers increased demand for local foods and other specialty crops such as hops for the growing craft brewing industry, we started to see the formation of new farmer-owned cooperatives for distribution and marketing. The Farm Credit Administration (FCA)[3], our independent federal regulator, maintains guidelines that we must follow in terms of safety and soundness. When the new, emerging agricultural cooperatives did not meet these underwriting guidelines, CoBank proposed a solution to FCA - creating a separate risk pool designed to provide more flexible financing for these cooperatives. After FCA approval, Co-op Start was launched in 2012. Co-op Start provides flexible financing up to $250,000 to early growth stage agricultural cooperatives. This program has generated great success stories.

In 2017, the Midwest Elderberry Cooperative used the Co-op Start program for a seasonal line of credit to pool its member's fruit and market their harvest in their first year of business. Owned by eighteen elderberry growers in Minnesota, Wisconsin and Iowa, the cooperative has developed a domestic market for locally grown elderberries by pooling its member fruit – a timeless cooperative principle.

In Waterloo, Wisconsin, the Wisconsin Hop Exchange uses a Co-op Start loan to support their cooperative business dedicated to providing their hop growers with agronomic, processing and marketing services. The Wisconsin Hop Exchange connects local brewers with local hop growers.

Our Harvest Cooperative in Cincinnati, Ohio uses the Co-op Start program to finance its food hub that works to make sustainably grown food available to all of the Greater Cincinnati community. Our Harvest Cooperative has one distribution center that benefits 22 local food producers. It has been in operation for five years and CoBank proudly provided a portion of its initial capital.

Great River Organics is a farmer-owned nonprofit cooperative comprised of eight vegetable farms in central Ohio. They use the Co-op Start program to market their sustainable, organic produce to retail establishments and their Community Supported Agriculture (CSA) program.

Co-op Start has supported urban agriculture, too. In downtown Cleveland, Ohio, Green City Growers works with the Co-op Start program to finance its operation. A worker-owned cooperative that opened in 2013, Green City Growers produces leafy greens from a hydroponic greenhouse. It currently employs 43 worker-owners, all of whom are paid a living wage and are equity owners of the cooperative.

The Inter-Tribal Maple Syrup Producers Cooperative in Sawyer, Minnesota used a Co-op Start Loan for a seasonal line of credit and a lease for maple processing equipment.

[3] https://www.fca.gov/

Co-op Start has been used by 17 different small cooperatives in nine states with $2.5 million of total commitments in loans and leases.

Technical Assistance for New Cooperatives

Cooperatives follow a set of principles[4] that set us apart from other businesses. Three of those cooperative principles include: education, training and information; cooperation among cooperatives; and concern for community. As a cooperative, CoBank's commitment to foster the creation of new cooperatives runs deep through our support of numerous education and technical assistance programs. Locally owned grocery stores are a mainstay of economic and social activity in rural communities across the United States. We believe that local food cooperatives offer a solution to the growing problem of local grocery store closures and an ownership transfer option when an independent rural grocer lacks a succession plan. Forming a consumer-owned cooperative offers a positive option to communities as owners prepares for retirement.

The Food Co-op Initiative (FCI)[5] is a national cooperative development center that provides free technical assistance for people in the U.S. – including rural entrepreneurs – to start a retail food cooperative that meets the community's needs. New startups can lean on FCI's materials and staff as well as provide consultations for additional technical help. This assistance, during the early stages of development, is vital to the long-term success of a sustainable cooperative grocery store. Last year in Moran, Kansas, (pop. 517) they transferred ownership of an existing grocery to a locally owned cooperative and in Geraldine, Montana, (pop. 261) they have successfully re-opened a grocery store as a cooperative. Interest is growing in this sector, and in Montana alone there have been three new conversions to cooperative grocery stores in the past year.[6]

In June, CoBank joined the National Cooperative Bank[7] in announcing a joint, multi-year contribution of $200,000 to FCI in support of their outreach to rural communities.[8] Rural communities face significant challenges for access to affordable food, whether it is the shear distance or a complete lack of a grocery store. When communities work together to invest in new local food cooperatives, it can provide small towns with a stronger economic foundation.

Access to equity for rural entrepreneurs

CoBank understands that rural entrepreneurs - the engine driving rural economies - need dependable sources of capital to improve the infrastructure they depend on to grow their businesses. While access to senior debt is generally available, equity and junior debt remain more difficult to source. Few rural-focused investment funds exist beyond funds that focus on acquiring farmland.

Recognizing this gap and the challenges faced by rural entrepreneurs, CoBank and other Farm Credit Associations started to make investments in equity funds focused in rural America. Rural equity

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[4] https://www.ica.coop/en/whats-co-op/co-operative-identity-values-principles
[5] https://www.fci.coop/
[6] https://montanacouncil.coop/rural-grocery-co-ops-get-down-to-business/
[7] https://ncb.coop/
[8] http://www.cobank.com/Newsroom-Financials/CoBank-News-Feed-2/2018/June/20180625-CoBank-and-National-Cooperative-Bank-Donate.aspx

investments serve as an effective source of junior capital to increase rural economic prosperity. These rural equity vehicles catalyze private capital investment and create jobs.

Since 2013, CoBank has committed $52.5 million across four private equity funds that in concert with Farm Credit institutions, commercial and community banks, and other institutional investors are providing over $300 million in capital to rural businesses. The four funds are: (1) Midwest Growth Partners, West Des Moines, Iowa; (2) Advantage Capital Ag Partners, St. Louis, Missouri; (3) Innova Ag Innovation Fund, Memphis, Tennessee; and (4) Open Prairie Rural Opportunities Fund, Effingham, Illinois. More than 26 rural businesses have received investments from these four funds.

The first fund CoBank supported, Midwest Growth Partners, was in partnership with Central Iowa Power Cooperative, the Iowa Corn Growers Association and other investors to form Midwest Growth Partners. This $41 million equity fund targets growth stage investments in the upper Midwest in manufacturing, food and agriculture and distribution and logistics businesses.

In Adel, Iowa, Inland Coatings, received an investment from Midwest Growth Partners in 2014 to aid an ownership succession plan and facilitate a business expansion. Started in 1978, the founder passed away and the management team needed an equity infusion to purchase the company from the founder's heirs. One of the potential buyers was a rival manufacturer and there was no commitment to keep the existing plant open. With the equity infusion from Midwest Growth Partners, the management team purchased the company while retaining and adding jobs in Adel.

In Nixa, Missouri, Fresh Market Produce received an investment from Midwest Growth Partners to assist in its expansion plans to provide a wider offering of farm to fork produce options to meet growing consumer demand. The company increased its full-time employment in two years.

The other three funds that CoBank has supported have been with the Rural Business Investment Companies (RBIC), licensed by USDA.[9] These three RBICs are: Advantage Capital Agribusiness Partners, Innova Ag Innovation Fund and Open Prairie Rural Opportunities Fund. Each RBIC has a different focus.

In 2014, CoBank joined eight other Farm Credit institutions to launch the $155 million equity fund Advantage Capital Agribusiness Partners. It focuses on investments that grow rural economies, with an emphasis on companies involved in all aspects of the food and agriculture value chain. The fund has invested more than $85 million in 13 companies in California, Florida, Georgia, Iowa, Missouri, Oregon, Texas, Virginia, and Washington.

American Botanicals, a national products company based in Eolia, Missouri, received an investment from Advantage Capital in 2014 to help finance the expansion of its growing herbal industry business: health food, pharmaceutical, cosmetic and alternative medicines, flavoring and spice companies. American Botanicals buys, sells, and exports different roots, herbs, and spices.

In 2016, CoBank and seven other Farm Credit institutions invested $31 million in the Innova Ag Innovation Fund to focus on early stage companies that develop advanced technology solutions for the challenges faced by farmers and agriculture-related businesses. This fund has invested $1.375 million in 9 companies, many of which have received $50,000 in early-stage equity.

[9] https://www.rd.usda.gov/programs-services/rural-business-investment-program

Kilimo, Inc., based in Ripley, Tennessee, received an investment from Innova to support the development of its decision-support tool for irrigation management. Using satellite, climate and on-site data, Kilimo's Big Data engine enables producers to maximize their irrigation systems to improve their water use efficiency up to 70 percent and improve yields by 30 percent.

Skycision, located in Watonsville, California, received an investment from Innova to finance its drone technology and high resolution aerial imagery technology which provides farmers with precision field scouting capabilities for low-acreage, high value crops such as berries, specialty vegetables, vineyards, and orchards. Every year growers are afflicted with unforeseen pest and disease infestations, which can be catastrophic for a vineyard or an orchard. Blighted trees or vines have to removed and destroyed. After replanting, it can take three to five years before trees produce any crop. Skycision technology provides farmers a complete view of their fields. By comparing how the pictures change over time, farmers can identify problem areas and target treatment to avoid crop loss.

In 2017, CoBank joined with 11 commercial and community banks, five other Farm Credit institutions, strategic and individual investors to launch the $100 million Open Prairie Rural Opportunities Fund. The fund is a balanced private equity fund offering debt and equity capital to high-growth-potential companies throughout rural America and the agribusiness value chain.

CoBank continues to evaluate other RBIC opportunities to provide additional equity to rural businesses and their communities. These equity investments to rural entrepreneurs create and retain jobs and sustain rural communities. We applaud Congress in its vision to establish the Rural Business Investment Program and create the opportunities to form funds that focus on the capital needs of rural entrepreneurs. Continuation of this program and increasing its capacity to serve will be important to rural communities going forward.

CoBank has also supported the Farm Bureau Rural Entrepreneurship Challenge that is the first national business competition focused exclusively with food and agricultural businesses. I was pleased to have been a judge in the "Shark Tank" competition held for the four finalists in debut of the Challenge in 2015.

Rural Debt Obligations

Additionally, CoBank—along with other Farm Credit institutions, local community banks, and USDA—delivers critical capital to rural communities in need of hospitals, health clinics, and senior care. Through bond investments, these partnerships ensure that rural community residents have the access to quality health care that they deserve, create meaningful local employment opportunities, and strengthen the long-term viability of rural economies.

Predevelopment funding for rural entrepreneurs

CoBank recognizes a lack in predevelopment funding that often exists when rural entrepreneurs undertake rural development projects. Predevelopment funding is an early stage investment when the risk is highest and collateral is scarce. In 2017, we partnered with Rural LISC[10] in making a $250,000

[10] Rural Local Initiatives Support Corporation (LISC) http://www.lisc.org/rural/

grant to support the Rural LISC Road to Capacity Predevelopment Fund (RCPF). The RCPF is a zero-interest, "repayable investment" available to Rural LISC partners for predevelopment costs in amounts up to $50,000 for a period of two years. Examples of the eligible predevelopment costs can be feasibility and marketing studies, environmental reviews or zoning requests. The RCPF is a revolving fund. Once the project has received financing, it repays the investment to allow funding for other projects. Rural LISC has leveraged CoBank's contribution to secure an additional $190,000 in grants for RCPF.

Below are the projects CoBank's contribution has funded to date:

Human Resource Development Council of District IX (HRDC) was awarded $20,000 to create a Housing First Village in Bozeman, Montana. HRDC plans to create 30-50 private "tiny homes" that will expand the impact of HRDC's housing assistance work and provide autonomy and safety to the homeless population in Bozeman will contribute to the need for affordable housing for previously-homeless individuals and families.

RCPF awarded the $20,000 to the **Woodlands Development Group (WDG)** to continue the predevelopment of five significant housing and commercial real estate projects in Elkins, West Virginia. The projects include: renovation of two floors of a downtown historic building for retail and office tenants, rehabilitation of 16 housing units in an apartment complex, and rehabilitation of 32 units and development of a drug rehabilitation facility at a former school. This grant supported Woodland's predevelopment costs, including hiring a consultant and the associated project fees. These projects are critical to the revitalization of WDG's small community.

Catholic Charities Housing Services – Diocese of Yakima (CCHS) was granted $20,000 to develop 20 homes for low and very low income families in the community of Wapato, Washington. The development will also incorporate road, water and sewer improvements in an effort to provide safe pedestrian facilities and improve access to affordable housing for the predominantly low and moderate income citizens of the city of Wapato. The proposed development is close to health care providers, hospitals, clinics, childcare centers, schools, grocery markets, restaurants, wineries, churches of various denominations, and it is less than a mile away from the city hall and police and fire departments.

CCHS will determine the economic feasibility of developing lots for low-income homebuilders, engaging a civil engineer to estimate infrastructure costs, hiring an architect to design and estimate the housing cost, paying the city plat mapping fees, and securing an appraisal of the finished homes to establish market value.

Garrett County Community Action Committee, Inc. (GCCAA) was awarded $25,000 to create Sunrise Gardens, a 32 unit development to be located along Sunrise Boulevard in Romney, West Virginia. The proposed project will be available to households with incomes between 40 to 60 percent of area median income. The site will consist of ten one-bedroom/1.5-bath, 18 two-bedroom/1.5-bath and four three-bedroom/2 bath townhome units with proposed tax credit rents ranging from $477 to $650 per month. The project anticipates completion in the summer of 2019. With the help of Rural LISC's predevelopment grant, GCCAA will assess the feasibility of creating the affordable housing units.

Prairieland Council Inc. NFP (PLC) is working with LISC to rehabilitate 50 units of public housing through a Rental Assistance Demonstration (RAD) conversion with Low-Income Housing Tax Credit (LIHTC) financing and creating 16 additional American Disabilities Act (ADA) compliant affordable units in Havana, Illinois. The Mason County Housing Authority currently owns 50 public housing units in Havana. Through the RAD conversion, they will transition ownership of all property to Prairieland Council. In addition, Prairieland will complete an extensive remodel of the 50 existing units while constructing 16 additional, ADA-compliant units. With the help of Rural LISC's repayable investment, Prairieland Council will assess the feasibility of rehabilitating and creating the affordable housing units, including completing a market study and appraisal, securing permits and determining impact fees, and implementing survey, and environmental work. The RAD conversion will result in 50 LIHTC affordable housing units in Havana plus 16 new affordable units.

Interfaith Housing Services, Inc. (IHS) received $20,000 to continue its sustainable community work serving low-income families. IHS will develop 48 units of mixed used housing in an adaptive reuse of the abandoned St. Elizabeth's Hospital in Hutchinson, Kansas. The Catholic Church donated the property to IHS in 2015 and the funds received will assist with predevelopment costs including an environmental review, environmental update, structural evaluation, and a market study.

These investments are a proven means to deliver projects that address the critical affordable housing needs in rural communities.

Rural entrepreneurs need rural infrastructure, especially broadband

Another important point to make focuses on the need for adequate infrastructure in rural America to support these rural entrepreneurs. As I mentioned in the beginning of the testimony, CoBank lends to rural infrastructure providers – electric, water, and communications. Without these basic services, rural entrepreneurs cannot grow their businesses and support economic development.

Rural entrepreneurs need access to modern high-speed broadband. CoBank lends to rural communication companies, but in many high cost rural areas, there is no business case to deploy broadband with so few customers per mile. We cannot expect companies to deploy broadband in areas where there is no return on investment unless there is a stable, cost recovery mechanism. We need dedicated federal investment so every American, even in remote, rural America, has access to broadband.

As the report on the federal Interagency Task Force on Agriculture and Rural Prosperity[11] highlighted – reliable and affordable high-speed internet e-connectivity will transform rural America as a key catalyst for prosperity.

CoBank is a member of the Rebuild Rural Infrastructure Coalition[12], which is comprised of more than 200 organizations from across the country focused on enhancing rural communities, engaging U.S.

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[11] https://www.usda.gov/topics/rural/rural-prosperity

[12] http://www.rebuildrural.com/

agricultural producers, aiding rural businesses, and improving the lives of rural families. The Rebuild Rural Coalition is dedicated to advocating for investment in rural America's infrastructure and understands that rural America's infrastructure needs are fundamentally different. Infrastructure that supports rural communities and links them to global markets has helped make the U.S. the unquestioned world leader in agricultural production. Our continued leadership and our rural economies demand that infrastructure be improved through increased investment.

Partnering with Farm Credit Associations to serve young, beginning, small, and minority farmers

To support young, beginning, and minority farmers, CoBank partners with Farm Credit East and Yankee Farm Credit, two Farm Credit Associations affiliated with CoBank, on the FarmStart Program. FarmStart supports individuals looking to launch businesses in agriculture, forest products, and commercial fishing in the northeastern United States. Since its inception, FarmStart has made over 250 investments total more than $11.3 million.

Educating the rural entrepreneurs of tomorrow

The challenges of the future will require creative solutions and CoBank remains committed to supporting youth in rural communities. We need to keep a laser-like focus on the next generation of rural entrepreneurs while we find way to support the ones making a difference in our communities today.

Our support for FFA's Living to Serve grants and the Campus Kitchen Project illustrate the creativity and energy of students to give back to their communities. These two programs help students learn how to navigate the challenges and create unique solutions to issues facing rural communities.

The FFA Living to Serve grants provide an opportunity for FFA members to identify community needs in the categories of Community Safety; Hunger, Health and Nutrition; Environmental Responsibility; and Community Engagement and create a project to address these needs.

The **Richmond Technical Center (RTC) FFA chapter** is addressing local urban food deserts in low-income communities with their Living to Serve Grant. Over the school year, to help families gain greater access to nutritional information and fresh produce, FFA members have partnered with FeedMoore food pantries and Peter Paul Development Center (PPDC), an established non-profit located within Richmond's 19 subsidized housing projects. The chapter is growing assorted produce and to date has donated nearly 500 pounds of fresh vegetables along with informational flyers, recipes, and financial and workout trackers to help community members adopt healthier lifestyles. Students also distributed starter materials for participants to plant gardens of their own. In the coming year, RTC FFA plans to continue its partnership with PPDC by expanding the number of local community gardens and adding cold frames to extend growing periods. Through the chapter's efforts, they want to change the culture of the community, so that residents are able to sustain healthy habits.

Inspired by Heifer International, **North Linn FFA** explored how they could help food insecurity in their small Iowa community. In an effort to provide fresh, locally grown protein sources, the chapter started raising laying hens to donate eggs. Students were so proud that they were donating eggs, that they expanded the project to provide a sustainable source of fresh meat to the food pantry. The new project utilizes the student's Animal Science skills to raise a gilt to market weight to be processed and donated. As if that wasn't enough, the North Linn FFA chapter has started a community garden to include locally grown vegetables in their on-going donations to the food bank.

In August of 2017, **Josè Emillo Lugo FFA**, in Puerto Rico was awarded a Living to Serve grant to focus on providing healthy, locally grown produce in school lunches. That September, Category 4 Hurricane Maria struck the island, thus the project took on much more significance. Instead of teaching the community to supplement their diets with a garden, they were teaching them how to prepare for future natural disasters by gaining skills to grow their own food in case it became scare again. In addition to creating gardens, the chapter was able to help rebuild a local plant nursery destroyed in the hurricane and distribute food, supplies, first aid materials, water, clothing and others items to those in need.

In California, the **Vista FFA** chapter raises high quality protein for the school's backpack program and food pantry, including over 200 pounds of lamb, 100 pounds of rabbit and hundreds of eggs. The students also produce hundred pounds of produce, including tomatoes, lettuce, strawberries, apples, raspberries and an assortment of other vegetables.

The **Stockdale FFA** chapter in Texas is addressing hunger with in the local community by growing vegetables to donate to local families in need. The chapter also grows flowers and plants for the local nursing home residents. The FFA students also teach younger students how to grow plants and importance of helping others.

At **University High School in Orlando**, Florida, the FFA chapter collects toiletries and other supplies to make toiletry kits, snack packs and "go bags" to be donated to the VA Fisher House Orlando.

The Campus Kitchen Project (CKP) empowers student volunteers in 63 schools across the country to recover one million pounds of food each year that would have otherwise gone to waste and transform this food into nutritious, balanced meals for food insecure Americans. Many of these schools are located in rural communities and address rural hunger. CKP students learn that they can leverage the existing resources of school campuses, with commercial kitchen space sitting dark in the evenings and weekends, excess food and eager student volunteers. By re-envisioning these resources, they develop lean, grassroots solutions to work for their own communities.

Many Campus Kitchen Projects are incubators of innovative ideas for addressing rural hunger while incorporating local produce. Students at **Gettysburg College** in Pennsylvania are addressing rural senior isolation by organizing community dinners, increasing the seniors' access to fresh, local produce through a partnership with Meals on Wheels. At **Utah State University**, the students are coordinating food donations from restaurants close to campus to supplement the donations from their campus dining service. At **Washington and Lee University** in Lexington, Virginia, the students created a mobile pantry to reach out to rural, food insecure residents. At **Elon University** in North Carolina, the students are coordinating with the local faith based community to reach out to low-income seniors.[13]

CoBank provides seed funding for new Campus Kitchen Projects serving rural communities.

The creative solutions developed under the FFA Living to Serve and the Campus Kitchen Project by students are developing tomorrow's innovators. CoBank proudly supports both programs.

Summary

The Chair and Ranking Members of both subcommittees have been leaders in strengthening our rural communities. It has been a pleasure to provide an overview of the various approaches CoBank takes to address the capital needs of rural entrepreneurs. I would be happy to provide further detail in response to your questions.

Thank you for the opportunity to testify before the committee and for all that you do for rural America. I look forward to your questions.

[13] https://campuskitchens.org/resources/

Testimony Before U.S. House Committee on Small Business

By **Ross Baird**

Testimony of Ross Baird
President, Village Capital
Innovator-in-Residence, Ewing Marion Kauffman Foundation

Before the
U.S. House Committee on Small Business

Bridging the Gap: How Capital Markets can Work for the Other 81%
July 24, 2018

Chairman Chabot, Ranking Member Velasquez, and members of the Committee, thank you for the invitation to testify at this hearing.

I'm pleased to share some insights and recommendations both from my experience as an entrepreneur, co-founding a group called Village Capital that has been one of the most active investors in new businesses in America, as well as in my role as an Innovator in Residence with the Ewing Marion Kauffman Foundation, which works together with communities in education and entrepreneurship to empower people to shape their futures and be successful.

America's economic dynamism is in retreat: the entrepreneurship deficit

While the stock prices of big companies often dominate our views of how the economy is doing, it is the small businesses and entrepreneurs that create economic dynamism in America.[1] New and young businesses create nearly all of the net new jobs in the country.[2]

From Silicon Valley to Shark Tank, the media narrative would suggest the United States is in a golden age of entrepreneurship. Unfortunately, that's not the case.

Entrepreneurial activity is nearing a forty-year low.[3] Over the past several decades, American economic dynamism—as measured by the ratio of new businesses starting to businesses closing—has been in steady decline.[4]

The causes of the decline in entrepreneurship are particularly felt in rural America. 33% fewer entrepreneurs are operating businesses in 2018 than were in 1988.[5] While the

[1] "Dynamism in Retreat." Economic Innovation Group. eig.org/dynamism
[2] Haltiwanger, John, Ron Jarmin, and Javier Miranda. 'Who Creates Jobs? Small vs. Large vs Young." NBER Working Paper, August 2011.
[3] Dynamism in Retreat.
[4] Ibid.
[5] Wilmoth, Daniel. "The Retreat of the Rural Entrepreneur." US Small Business Administration, 29 September 2017.

causes of this decline are complex, today I'd like to talk about how access to capital plays an important role.

How entrepreneurs finance new businesses

Kauffman Foundation research estimates it costs $30,000 to start a business[6]. And entrepreneurs who have access to more than $100,000 in capital are 23% less likely to fail than entrepreneurs who have access to less than $5,000 in capital.

Some entrepreneurs are able to self-finance. The majority of entrepreneurs—sixty-seven per cent[7]—begin their businesses with personal or family wealth. These sources of capital include individual savings, second mortgages on homes, and contributions from friends and family.

Yet over the last 40 years, and increasingly since the Great Recession, we have seen the household wealth reserves of the majority of Americans decline. Between 2007 and 2011, 25 percent of American families lost at least 75 percent of their wealth.[8] In addition, entrepreneurs have historically used a second mortgage on a home as a source of seed financing, but the U.S. homeownership rate in 2016 was at its lowest since 1967.[9] Furthermore, student debt has grown more than 100 percent in the last 20 years, and would-be entrepreneurs with student debt obligations are less likely to pursue startups[10].

The wealth gap is particularly wide for certain populations: women, African-Americans, Latinos, and rural entrepreneurs all have lower personal wealth than average..[11][12]

This decline in personal wealth has stunted America's entrepreneurial economy: while prior recessions saw a rebound in entrepreneurial activity, on the whole, we have continued to see a decline in entrepreneurship since the Great Recession of 2008.[13]

So the first barrier preventing the success would-be entrepreneurs do not personally have the financial resources they need to get their idea off the ground.

Entrepreneurs, especially those who do not have personal wealth, turn to a second method: raising capital from external sources.

The banking industry has historically been an important source of capital for entrepreneurs in America's history, but we have seen two major changes in recent years that contribute to a lack of access to capital.

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[6] "Kauffman Firm Survey." Ewing Marion Kauffman Foundation. August 2009.
[7] Robb, Alicia and Morelix, Arnobio. "Startup Financing Trends by Race: How Access to Capital Impacts Profitability." *Ewing Marion Kauffman Foundation*, 2016, www.kauffman.org/what-we-do/research/2016/startup-financing-trends-by-race-how-access-to-capital-impacts-profitability.
[8] Pfeffer, Fabian T., *et al.* "Wealth Disparities Before and After the Great Recession." *The Annals of the American Academy of Political and Social Science*, vol. 650, no. 1, 25 Sept. 2013, pp. 98–123., doi:10.1177/0002716213497452.
[9] "Homeownership Rate for the United States." *FRED Economic Data*, Federal Reserve Bank of St. Louis, 30 Jan. 2018, fred.stlouisfed.org/series/RHORUSQ156N.
[10] Fry, Richard. "The Changing Profile of Student Borrowers." *Social & Demographic Trends Project*, Pew Research Center, 7 Oct. 2014, www.pewsocialtrends.org/2014/10/07/the-changing-profile-of-student-borrowers/.
[11] Fetsch, Emily. "Including people of color in the promise of entrepreneurship." Entrepreneurship Policy Digest, Ewing Marion Kauffman Foundation, 5 December 2016.
[12] Nine Charts about Wealth Inequality in America (Updated)." *Urban.org*, Urban Institute, 5 Oct. 2017, apps.urban.org/features/wealth-inequality-charts/.
[13]Economic Innovation Group.

The first trend: large banks have become larger, and small and medium-sized banks are disappearing. As one example, number of small community banks totaling under $50M in assets has declined 41 per cent since the Great Recession, either through consolidation or closing[14]. According to industry experts, loans of less than $150,000 do not meet the typical large and medium-sized bank's underwriting criteria[15], which means that the $30,000 that is the average cost to start a firm does not hit the vast majority of banks' radar.

The second is a change in the nature of new businesses. Historically, banks have lent against assets. But the majority of new businesses are services businesses, who do not have significant assets or collateral, and have cash flows that do not fit banks' traditional underwriting models. Traditional lending models no longer fit today's startups: only 18 per cent of businesses ever access a bank loan.[16]

Venture capital is another important tool to start companies. And while venture capital has been very helpful for many entrepreneurs, the industry is only focused on a very small percentage of businesses that are extremely high-growth: only .6% of businesses ever raise venture capital.[17] Furthermore, venture capital is highly concentrated: in 2016, 78 percent of venture capital went to just three states (NY, MA, and CA). Less than than one per cent of venture capital dollars go to rural areas.[18] Less than 2 percent of startup financing went to women. Only 1 percent went to African-Americans and Latinos.[19]

Because of increasing debt, rising inequality, and a decline in household wealth for the average family, the number of entrepreneurs who are in a personal position to self-finance their business is in decline. Any attempt to reverse the decline in firm creation in America must focus on expanding access to external capital to entrepreneurs.

Entrepreneur champions have focused on two ends of the spectrum—small business lending and venture capital—but 81% of new businesses do not access either source.

Gaps in capital access: the other 81%

I have a personal story about one of these 81%. I founded a firm, Village Capital, that has invested in nearly 100 businesses, and supported over 1,000 more through programs across the world. Lula Luu, who founded a business called Fin Gourmet in Paducah, Kentucky, in Representative Comer's district, in one of those entrepreneurs.

Fin Gourmet catches Asian Carp—a huge nuisance in the region—filets it, rebrands it "Kentucky Blue Snapper," and sells it to high-end restaurants in New York and San Francisco.

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[14] Lux, Marshall, and Robert Greene. "The Current State of Banking." *The Future of Banking: In a Globalized World*, Harvard Kennedy School, 2012, pp. 1–13.

[15] Banking Strategies. "Making Small Business Loans Profitably," 7 July 2015. https://www.bai.org/banking-strategies/article-detail/making-small-business-loans-profitably

[16] Robb and Morelix.

[17] Ibid.

[18] http://martinprosperity.org/media/Startup-US-2016_Venture-Capital-Goes-Urban.pdf

[19] Blanco, Octavio. "Why so Few Latino-Owned Businesses Get Venture Capital Funding." *CNNMoney*, 12 Apr. 2016, money.cnn.com/2016/04/12/smallbusiness/latino-venture-capital/index.html.

When I met Lula, she had earned hundreds of thousands of dollars in revenue and was employing a dozen people at a quality wage, in a high-unemployment part of Kentucky, but she wasn't able to access financing for her business to grow. Banks said she was too risky and early-stage for a loan, and venture capitalists said she was not "high growth enough."

With a group of investors, we $250,000 in Fin Gourmet in an innovative, dividend-based model: we received a percentage of the company's revenue in return until we would have a predetermined return on investment. The investment helped Lula grow, but she still faces challenges: while we were able to develop a creative mechanism for initial financing, the number of other capital sources who are able to do so are very small.

Lula's story is illustrative of a challenge to solve: There are tens of thousands of Lulas in America, too risky for a loan, and too "normal" for venture capital.

Ideas to increase access to capital: What Congress can do

If Congress wants to help reverse the decline in American entrepreneurship, I suggest thinking about ways to help the other 81% access capital.

First, look at ways that entrepreneurs without personal wealth can better have the financial flexibility to start a business. I've seen ideas where entrepreneurs starting a business can defer student loans for three years, or entrepreneurs who start a business in an economically distressed area, such as an Opportunity Zone, have their loans forgiven if the business is in operation for more than five years.

Second, look at ways that our capital markets infrastructure can better fit the businesses of the future. The cash-flow-based investment structure we used with Fin Gourmet in Kentucky is one type of investment structure where we are seeing both private sector and public sector innovation. Lighter Capital in Seattle has raised a $70 million fund to provide revenue-based finance to software-as-a-service companies that are growing steadily, but not a fit for venture capital. And the State of Colorado has backed an investment fund for rural entrepreneurs that primarily utilizes this revenue-based finance: its creators argue that this is perhaps a better fit than debt or equity for the majority of rural businesses.

I would also build on existing tools Congress has created. I'm encouraged by the recent bipartisan creation of the Investing in Opportunity Act, creating Opportunity Zones across the country, which can laboratories for innovation in helping entrepreneurs like Lula access capital.

I do see a risk Opportunity Zones become a vehicle for large real estate investment, with very little capital being directed towards entrepreneurs. I'm hearing from entrepreneurs and investors possible regulatory clarity that would be helpful.

I am most frequently hearing that it is unclear at this point whether re-invested interim capital gains from entrepreneurs in opportunity zones remain eligible for the tax incentive. I as an investor earn a return on investment from Fin Gourmet, I am much more likely to invest in future Fin Gourmets if the Opportunity Zone tax incentive applies to my interim gains. Regulatory clarity on this aspect could help mobilize substantial capital to entrepreneurs.

I also would encourage Congress to learn more about how other vehicles can be better utilized for the other 81%.

For example, the Small Business Investment Company investment fund has a $4B annual allocation, but the private sector almost never asks for the full $4B. I have heard from entrepreneurs and investors alike that the debt investment structure of the SBIC investment does not meet the needs of the majority of entrepreneurs: perhaps there is a way to use this pool of capital to spur the creation of innovative private sector vehicles. The Economic Development Authority's i6 grant has been very helpful in creating new venture capital funds, and perhaps programs such as these can also accelerate the use of more innovative private capital.

We are fortunate to be in a good economy, but according to a February survey, 55% of entrepreneurs starting a business in America think the economy is just fair or poor. If we are able to expand access to capital to any entrepreneur who faces barriers, more Americans will be able to contribute to the economic vitality of our country.

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

CHRISTEL SLAUGHTER, PhD, CHAIR
SMALL BUSINESS COUNCIL

TOM SULLIVAN, EXECUTIVE DIRECTOR
SMALL BUSINESS COUNCIL

July 24, 2018

The Honorable Steve Chabot
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

Re: July 25 Hearing entitled, "The Tax Law's Impact on Main Street"

Dear Chairman Chabot and Ranking Member Velazquez:

Thank you for holding a hearing on how the passage of last year's Tax Cuts and Jobs Act has benefitted small businesses.

I am Christel Slaughter, Ph.D., CEO of SSA Consultants based in Baton Rouge, Louisiana and the incoming Chair of the U.S. Chamber of Commerce's Small Business Council. The Chamber is the world's largest business federation. It represents the interests of over three million businesses and organizations of all sizes, sectors, and regions, as well as state and local chambers and industry associations. Ninety-six percent of Chamber member companies have fewer than 100 employees and 75% have fewer than 10. The Small Business Council works to ensure the views of small business are considered as part of the Chamber's policy-making process.

Examples of Positive Impact from Tax Cuts

The Small Business Council's last semi-annual meeting took place in conjunction with the release of the MetLife & U.S. Chamber of Commerce Small Business Index for the first quarter of 2018.[1] The findings of our quarterly survey reflected a confidence in the direction of the national economy and showed that 66.3% of small business owners had a positive outlook about their company and the small business environment in the United States. Most importantly, for the purposes of this hearing, small business owners were twice as likely to think tax reform would help their business than those who thought it would hurt. That confidence continues, as our more recent Index climbed to 68.7,

[1] Findings from an Ipsos poll of 1,000 small business owners and operators conducted by phone between January 8 and January 25, 2018. Results may be found at: https://www.uschamber.com/sbindex/SBI_2018_Q1.pdf.

reflecting that two out of every three small business owners are optimistic about their company and the small business environment.[2]

At our meeting, several of my fellow Small Business Council members discussed their plans to reinvest savings realized from the Tax Cuts and Jobs Act:

> Melissa Bercier founder of Couch Clarity, a private psychotherapy practice near Chicago, explained how tax cuts are giving her an opportunity to provide team building and professional development for her 10 staff members. Melissa calls her reinvestment strategy, "helping the helper." The strategy has a positive domino effect because Couch Clarity's two locations help people in the community and a happy Couch Clarity staff means a happy community.
>
> David Mahoney is the President and CEO of Noble Gas Solutions in Albany, New York, a gas distribution and welding supply company with 33 full-time and three part time employees. David explained how difficult it was getting through the recession, with Noble Gas Solutions experiencing a 15% decline in revenue and an eight-year business drought without experiencing additional sales in upstate New York. He told me that last year, the economy in the North East finally rebounded and his sales increased by 10%. The tax cuts allowed David to raise wages and prompted him to plan for hiring new staff, a luxury he could not afford for the past several years.

Melissa's and David's examples of how they are re-investing tax cut savings to provide higher salaries and increased benefits for their employees are echoed by small businesses throughout the United States.[3]

In my small business, our employees are taking home more of their earnings and many of our clients are benefitting from the Tax Cuts and Jobs Act. One of those clients, RoyOMartin, announced the opening of a new state-of-the-art Oriented Strand Board (OSB) plant in Corrigan, Texas this past May.[4] At full capacity, the plant will ship enough products to supply OSB for approximately 70,000 U.S. homes per year. RoyOMartin's investment in the new plant created 165 direct jobs and more than 470 indirect jobs in construction. The tax cuts would allow them to make additional investments in operations and staffing. This example shows the positive ripple effect of business confidence and optimism due, in part, to tax reform.

Our organizational consulting firm has seen an increase in business this year. Our clients are doing well and they want to remain competitive by working with us on

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[2] Findings from an Ipsos poll of 1,000 small business owners and operators conducted by phone between March 22 and April 23, 2018. Results may be found at: https://www.uschamber.com/sbindex/SBI_2018_Q2.pdf.

[3] See a map of businesses that are reinvesting tax cut savings at: https://www.uschamber.com/tax-reform.

[4] RoyOMartin is a forestry-related and wood-products manufacturing company based in Alexandria, Louisiana that employs 1,110 workers in their two manufacturing facilities.

strategic planning and making sure they retain their talented employees in this tight labor market.

Improvements Needed for Tax Reform to Have an Even Greater Positive Impact

While we are extremely appreciative of the lower rates made possible by the Tax Cuts and Jobs Act, the small business community is still waiting for the IRS to issue guidance on section 199A,[5] which governs the 20% deduction for small businesses. Until guidance is issued, many basic questions about the provision remain outstanding, thereby preventing small business owners from making informed decisions.

Finally, we would like to work with the Committee and your colleagues on the Ways and Means Committee to make the small business tax cuts permanent. Many of us want to plan ahead, whether it is to grow our businesses, sell our businesses, or pass what we have built on to our children. The expiration of several tax benefits in 2025 would limit our ability to implement expansion or transition plans for our businesses.

We look forward to working with you to improve the tax code through legislative action and we appreciate your attention to the ongoing benefits of the Tax Cuts and Jobs Act for the small business community by holding this hearing. Please do not hesitate to contact Tom Sullivan who heads our Small Business Council if you have any questions at TSullivan@USChamber.com or 202-463-3192.

Sincerely,

Christel Slaughter, PhD
CEO
SSA Consultants
Baton Rouge, Louisiana

[5] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

SBIA
SMALL BUSINESS INVESTOR ALLIANCE

July 24, 2018

Rep. Rod Blum, Chairman
House Small Business Subcommittee on
Agriculture, Energy and Trade
2361 Rayburn House Office Building
Washington, DC 20515

Rep. Brad Schneider, Ranking Member
House Small Business Subcommittee on
Agriculture, Energy and Trade
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Blum, Chairman Brat, Ranking Member Schneider, and Ranking Member Evans,

Thank you for holding this important hearing to examine capital access and the role of private investment in rural small businesses. Small businesses across America share a universal need for access to funding to help them grow, create jobs, and expand. Small businesses are the backbone of our economy, but small towns and rural areas struggle with attracting capital because of scale, visibility, and proximity to capital sources. The Small Business Investor Alliance (SBIA) commends the Subcommittee for its attention to this issue and for highlighting programs and partnerships that are already working to support growing rural small businesses.

The SBA's Small Business Investment Company (SBIC) program has an exceptional record of success helping small businesses in the U.S. access growth capital, expand their operations, and create jobs. A 2017 Library of Congress study found that SBIC-backed businesses created over 3 million new jobs and supported an additional 6.5 million private sector jobs between 1995 and 2014. SBICs invest exclusively in domestic small businesses and have invested in almost 15,000 small businesses across the country in the past 10 years, many of which were in areas far from major financial centers and in undercapitalized communities – both urban and rural. According to SBA program data, SBICs in FY2017 made 262 investments in businesses located in LMI areas, about 24% of the total number of companies financed. These critical SBIC investments support that private businesses that are often the lifeblood of rural communities.

Despite the success of the SBIC program, it could be used to a far greater degree to provide investments to rural businesses. The SBA has billions of dollars of unused SBIC capital that should be put to work growing small businesses across the country. We encourage this committee to continue to work with small business investors to consider options for improvements to the SBIC program to help make rural entrepreneurial dreams a reality.

SBIA thanks the Subcommittee for its efforts to highlight the capital needs of rural communities, as well as showcase the many partnerships and programs working to promote small business growth in underserved markets. We appreciate the opportunity to discuss the impact of SBIC investment in rural communities.

Sincerely,

Brett Palmer

Brett Palmer
President
Small Business Investor Alliance