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AMERICA'S INNOVATION CHALLENGE: WHAT OBSTACLES DO ENTREPRENEURS FACE?

HEARING

BEFORE THE

SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on November 2, 2011	1
Statement of:	
Koester, Eric, co-founder and CEO, Zaarly, Inc.; Lonna J. Williams, CEO, Ridge Diagnostics; and TSVI Goldenberg, CEO, eemRa	9
Goldenberg, TSVI	30
Koester, Eric	9
Williams, Lonna J.	18
Letters, statements, etc., submitted for the record by:	
Goldenberg, TSVI, CEO, eemRa, prepared statement of	32
Koester, Eric, co-founder and CEO, Zaarly, Inc., prepared statement of	12
McHenry, Hon. Patrick T., a Representative in Congress from the State of North Carolina, prepared statement of	4
Williams, Lonna J., CEO, Ridge Diagnostics, prepared statement of	21

AMERICA'S INNOVATION CHALLENGE: WHAT OBSTACLES DO ENTREPRENEURS FACE?

WEDNESDAY, NOVEMBER 2, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND
BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:33 a.m. in room 2203, Rayburn House Office Building, Hon. Patrick T. McHenry (chairman of the subcommittee) presiding.

Present: Representatives McHenry, Amash, Meehan, Guinta, Maloney, Quigley, and Yarmuth.

Staff present: Will L. Boyington, staff assistant; Molly Boyl, parliamentarian; Peter Haller, senior counsel; Christopher Hixon, deputy chief counsel, oversight; Hudson T. Hollister, counsel; Rebecca Watkins, press secretary; Jeff Wease, deputy CIO; Jaron Bourke, minority director of administration; Adam Koshkin, minority staff assistant; Jason Powell, minority senior counsel; Brian Quinn and Davida Walsh, minority counsels; and Rory Sheehan, minority new media press secretary.

Mr. MCHENRY. The committee will now come to order.

This is the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs. Today's hearing is on America's Innovation Challenge: What Obstacles Do Entrepreneurs Face?

It is the tradition of this subcommittee to begin with the Oversight and Government Reform Committee's Mission Statement.

We exist to secure two fundamental principles. First, Americans have the right to know that the money Washington takes from them is well spent. Second, Americans deserve an efficient, effective government that works for them.

Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold government accountable to taxpayers because taxpayers have a right to know what they get from their government.

We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission of the Oversight and Government Reform Committee.

I will recognize myself for 5 minutes for an opening statement.

Over 2 years into an economic recovery, America's labor and capital markets continue to face unprecedented challenges. Nearly 14 million Americans remain officially unemployed, an additional 11

million underemployed, and small businesses continue to struggle to access capital despite endless numbers of government initiatives. Fixing our capital markets and economy will not occur overnight, nor will it be achieved with more government regulation.

Today's oversight hearing serves as part two in our capital formation series, examining government barriers to small business, capital formation and growth. The origin of these barriers to capital formation rest in two major Federal securities laws: the Securities Act of 1933 and the Securities Exchange Act of 1934, they have not been substantially updated since a gallon of gasoline cost 10 cents, 31 percent of American households had a telephone, and the national debt was just $22.5 billion.

Today, gas prices are 35 times that per gallon and nearly every American owns a phone. In fact, most households have access to the internet in their pockets. The national debt, well, that is maybe for a different hearing.

While the comparison of then and now is nostalgic, the ramifications of not modernizing our securities regulations have led to registration and reporting requirements so onerous and costly that small companies have great difficulty raising capital.

For instance, if a startup company offers an equity stake to investors through a medium like Facebook or Twitter, it is presumably in violation of SEC regulations for such communication and offerings. However, soliciting money for one's favorite charity or political candidate, it is perfectly legal using the internet medium and that is clearly saying something is wrong. When politics exceeds where business is, there is something wrong culturally with that.

Since September when this subcommittee had its first hearing to address barriers to capital formation, the House Financial Services Committee approved four pieces of legislation with bipartisan support that will modernize SEC regulations to promote rather than hinder small business access to capital financing. The full House is expected to vote on all four of these this week.

The Small Company Capital Formation Act of 2011, sponsored by Congressman Schweikert of Arizona, would authorize the SEC to exempt from registration any class of securities so long as the 12-month aggregate offering does not exceed $50 million.

Congressman Himes of Connecticut sponsored legislation to raise the bank shareholder threshold for SEC registration from $500 to $2,000. The SEC has neglected to update this threshold for nearly 50 years.

The Access to Capital Job Creators Act, sponsored by Congressman McCarthy of California, removes a regulatory ban that prevents small, privately held companies from using advertisements to solicit investors.

Last, my legislation, the Entrepreneur Access to Capital Act, which I introduced a few weeks ago, removes SEC restrictions on crowd funding to allow entrepreneurs to raise capital from everyday investors. This legislation simply extends the same characteristics of crowd sourcing or crowd funding today that is limited to the realm of charities and the arts through online communication social networking. This would allow small businesses and innovators to raise capital.

Already, this is prevalent in Europe and Asia and has proven that broadening communication and investment capabilities between investors and entrepreneurs can have a positive impact on capital formation, the lifeblood of our economy.

Each of these bills strengthens the mission of the SEC to protect investors, maintain fair, orderly and efficient markets and facilitates capital formation. Federal and State regulators remain empowered to fight deceit, misrepresentation and other fraud in the sale of securities.

This is an important piece. This key mandate for investor protection in each capital formation bill is why all four drew broad, bipartisan support from Members of Congress on both sides of the aisle and marketplace participants. While the bills approved by the House Financial Services Committee serve as a solid first step, there is more to do. That is what this hearing is about today.

I look forward to the SEC to complete its review of regulatory burdens on small business capital formation, which they have pledged to do, including the exemption of credit investors and employees from outdated 500-shareholder cap limitations.

Today's witnesses serve as real life examples of businesses that face barriers when raising capital and would benefit from simple, modern updates to SEC regulations. I am interested to hear what each of you have to say about the various bills before Congress and the additional ideas that you have for businesses that face the challenge of raising capital and the immediate effects it would have from responsible securities laws and what the SEC can do to protect investors and increase access to capital. This was a very important note in order for us to reduce the unemployment rate and get people working again.

[The prepared statement of Hon. Patrick T. McHenry follows:]

Over 2 years into our economic recovery, America's labor and capital markets continue to face unprecedented challenges. Nearly 14 million Americans remain officially unemployed – with an additional 11 million underemployed – and small businesses continue to struggle to access capital, despite an endless number of government initiatives.

Fixing our job market and economy will not occur overnight nor will it be achieved with more government regulation. Today's Oversight hearing serves as a Part 2 in our Capital Formation Series, examining government barriers to small business capital formation and growth.

The origin of these barriers to capital formation rest in two major federal securities laws, the Securities Act of 1933 and Securities Exchange Act of 1934, that have not been substantively updated since a gallon of gasoline cost 10 cents, 31 percent of households owned a telephone, and the national debt was $22.5 billion. Today, a gallon of gasoline costs 35 times more per gallon than it did then, nearly every American owns a phone – most of which have internet access from their pockets, and the national debt is.....well, that is for another hearing.

While the comparison of then and now is nostalgic, the ramifications of not modernizing our securities regulations have led to registration and reporting requirements so onerous and costly that small companies have great difficulty raising capital.

For instance, if a startup company offers an equity stake to investors through a medium like Facebook or Twitter, it is

presumably in violation of SEC law for such communication and offerings. However, soliciting money for one's favorite charity or political candidate through the same Internet medium is perfectly legal. Clearly, something is not right.

Since September, when this Subcommittee had its first hearing to address barriers to Capital Formation, the House Financial Services Committee approved four pieces of legislation – with bipartisan support – that will modernize SEC regulations to promote, rather than hinder, small business access to equity financing. The full House is expected to vote on all four this week.

The Small Company Capital Formation Act of 2011, sponsored by Congressman Schweikert, would authorize the SEC to exempt from registration any class of securities so long as the 12-month aggregate offering does not exceed $50 million.

Congressman Himes sponsored legislation to raise the bank shareholder threshold for SEC registration from 500 to 2,000. The SEC has neglected to update this threshold for nearly 50 years.

The Access to Capital for Job Creators Act, sponsored by Congressman McCarthy, removes the regulatory ban that prevents small, privately held companies from using advertisements to solicit investors.

And lastly, the Entrepreneur Access to Capital Act, which I introduced, removes SEC restrictions on "crowdfunding" to allow entrepreneurs to raise capital from everyday investors.

This legislation simply extends the same characteristics of crowdfunding – today limited to the realm of charities or the arts through online communities and social networking – to America's small businesses and investors. Already prevalent in Europe and Asia, crowdfunding has proven that broadening the communication and investment capabilities between investors and entrepreneurs can have a positive effect on capital formation – the lifeblood to a growing economy.

Each of these bills strengthens the mission of the SEC to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

Federal and state regulators remain empowered to fight deceit, misrepresentations, and other fraud in the sale of securities.

This key mandate for investor protection in each capital formation bill is why all four drew broad, bipartisan support from Members of Congress and marketplace participants.

While the bills approved by the House Financial Services Committee serve as a solid first step, there is more to do. I look forward to the SEC to complete its review of regulatory burdens on small business capital formation, including the exemption of accredited investors and employees from the outdated 500-shareholder cap.

Today's witnesses serve as real life examples of businesses that face barriers when raising capital and would benefit from simple, modern updates to SEC regulations.

I am interested to hear from each witness about the various bills before Congress, what businesses face when raising capital, the immediate effects that would result from responsible securities laws, and what the SEC can do to protect investors and increase access to capital. I appreciate their attendance and look forward to their testimony.

Mr. MCHENRY. With that, I recognize Mr. Quigley of Illinois, the ranking member.

Mr. QUIGLEY. Thank you, Mr. Chairman. Thank you for holding this hearing and for your recent bipartisan work to spur capital formation for startup businesses through crowd funding legislation.

I thank our witnesses for being here today.

We recognize that the number one priority of this Congress has to be lowering the 9 percent unemployment rate. For businesses to expand and hire new workers, they need capital. A July 2010 report by the Chamber of Commerce states "Clearly, any strategy to jump start the economy must have a robust small business component that allows entrepreneurs to access capital and retain existing cash-flow from operations in order to start, grow and expand their enterprises."

That is why I am pleased to see that both President Obama and Chairman McHenry have found common ground on the idea of crowd funding. To the extent that crowd funding can match ready capital with quality investment opportunities, it will be a success. The question should not be whether to allow crowd funding but under what terms it should move forward and what other ideas we should consider.

After exploring crowd funding with the help of expert testimony, at our September 5th hearing, I am encouraged that many of the potential problems with crowd funding were addressed when the chairman's legislation was taken up by the Financial Services Committee.

Still, some issues remain. For example, there are legitimate concerns that exempting crowd funding from securities regulation would open or expand opportunities for fraud. Just as water standards keep our water safe to drink, financial regulations protect us against unsafe financial products.

Crowd funding might also expose ordinary investors to a level of risk that is unacceptable and not accompanied by standard registration and disclosure. We have to be careful to ensure that investors fully understand the risk of investing in these financial products.

There is also the issue of State preemption. We have to carefully consider what role State securities administrators should play in managing fraud concerns and maintaining the integrity of the securities market.

Finally, although I think it is wonderful that we are exploring crowd funding as one way to encourage business innovation in this country, an important point to remember is that crowd funding is not a panacea for the state of the U.S. economy, job growth or even the capital needs of small and startup businesses.

The challenges facing small businesses and entrepreneurs in the United States are varied and so too should be our strategies. For example, Ms. Williams, as I understand it, will testify about how her business' initial achievements were made possible through small government-sponsored grant programs such as the Small Business Innovation Research Program.

I hope that all of our witnesses can touch on how a multi-pronged approach to capital formation can reach the most potential entrepreneurs. I also hope they can help us explore how the strate-

gies the President laid out in his Jobs Act will help small business and entrepreneurs overcome some of the obstacles they are facing and spur American innovation.

I thank the chairman again for calling this timely hearing and I yield back.

Mr. MCHENRY. I thank the ranking member. Members have 7 days to submit opening statements for the record.

I will now recognize the panel. Our first panelist today is Mr. Eric Koester who is the chief operating officer and co-founder of Zaarly, which is a Web site. Ms. Lonna Williams is the chief executive officer of Ridge Diagnostics. Dr. Tsvi Goldenberg is the chief executive officer of eemRa.

Without objection, I ask unanimous consent that the panel may each have 6 minutes for their opening comments.

I will now recognize Mr. Koester. If you could summarize your opening statement, you have 6 minutes. Then we will have plenty of time for questions.

STATEMENT OF ERIC KOESTER, CO-FOUNDER AND CEO, ZAARLY, INC.; LONNA J. WILLIAMS, CEO, RIDGE DIAGNOSTICS; AND TSVI GOLDENBERG, CEO, eemRa

STATEMENT OF ERIC KOESTER

Mr. KOESTER. Good morning, Chairman McHenry, Ranking Member Quigley and members of the committee.

My name is Eric Koester and I am one of the co-founders and the chief operating officer of Zaarly, a real-time, online commerce marketplace.

Zaarly represents an early success story of our innovation economy, having been formed just this past March, launched the product in May, added over 100,000 users just this past summer, and hired 30 employees with hopes of hiring more.

This past month, we were able to announce that we had raised venture capital funding and were fortunate to add Meg Whitman to our board, who we hope can help us take this product from early adoption to mass scale.

I hope to provide a bit of a unique vantage point to the challenges faced by entrepreneurs because of my background. During my career as an attorney specializing in advising entrepreneurs, small businesses and startups, I was able to work with hundreds of entrepreneurs across dozens of industries. Then I too followed the allure of the American dream and left the practice of law to launch my own company, Zaarly.

As a result of these experiences, I think I do have an insight to the challenges faced by today's entrepreneurs. Today, my testimony will focus on three key areas: one, what are the key challenges broadly faced by today's entrepreneurs; two, an examination of the broad landscape that is facing today's entrepreneurs and small business owners; and finally, how some enhancements to today's regulatory scheme can help aid entrepreneurs.

The first question is what are the overall key challenges faced by some entrepreneurs today? I think the important one discussed by this committee today has to do with fundraising and opportunities to get access to capital.

The second one is really an access to talent. Zaarly has hired 30 new employees just this past year and if I had the opportunity to hire 10 more qualified engineers, I certainly would. I think this can be addressed in a number of different ways, but I do think looking at opportunities for immigration reform and continuing to invest in education, sciences and more innovation opportunities will help that.

The third opportunity and challenge faced by small businesses and entrepreneurs is streamlining the paperwork, the formation in the regulatory scheme that we face.

The fourth is an open and free internet, cell phone and data opportunity and access to those resources.

Finally, I think the largest challenge we as entrepreneurs face is the general challenges of operating a business, getting more customers and making them love our products.

Starting a business is obviously never easy. There are thousands of ways for businesses to misstep from team dynamics to market forces to the inability to find financing. The reforms being discussed by the committee will not necessarily make starting or expanding a business any easier. There are still thousands of ways for businesses to misstep and thousands of ways for businesses to fail.

However, the reason these reforms are important are that they do allow another opportunity for businesses to expand and potentially succeed, to find new sources of capital, to raise additional cushion to hire more employees, or provide an additional runway for the business model to be expanded. By providing these additional avenues to access to funds this is the opportunity I think businesses will now have to expand and grow.

What are the key challenges faced by entrepreneurs and business founders today that are different from the days when, as Chairman McHenry noted, gas was 35 cents a gallon? My time advising entrepreneurs and small business owners has been important in noting my views. Just as important, I have been fortunate to learn firsthand in the founding of Zaarly what some of those challenges are.

The first lesson about today's landscape is that starting a business is now cheaper than ever before, although there is not an easy way to start a business without access to some capital. Today, businesses, with the help of technology, have been able to be started for as little as $5,000 and expanded into tens of thousands of dollars.

While technology has been able to reduce these costs for things such as bookkeeping, advertising, data storage and equipment rental, today's technology businesses and other businesses still do require technology and capital to expand those businesses and exceed beyond that early proving point.

The second challenge in expanding the opportunity for businesses today is the explosion of the freelance economy. Today, 1 of every 10 workers for companies is not an employee of the company they work for. These individuals are independent contractors, freelancers and individual entrepreneurs that can help these businesses be more effective and efficient. This trend is only expected to continue with careers such as graphics design, software develop-

ment, photography, writers and artists, all expect to see their ranks grow by as much as 10 percent in the next 10 years.

These individuals are entrepreneurs and small business owners who do require access to capital to grow and expand as our economy needs them more and more.

The next new change in the landscape has been the emergency of international competition that affects businesses even earlier and earlier. Two examples of the innovation economy, Groupon and Living Social, have seen international copycats pop in as few as months after they launched their businesses. Leading businesses such as Zaarly and those on the panel today need to launch faster, quicker and gain access to capital soon.

Finally, I would like to note that it is important that these innovation reforms be expanded to allow crowd funding and similar tools. They eliminate the restriction of general solicitation and they align with the current provisions to expand the credit investor rules.

Ultimately, I believe these reforms will open new channels for fundraising and allow businesses such as ours to succeed.

Thank you and I look forward to questions.

[The prepared statement of Mr. Koester follows:]

Good morning Chairman McHenry, Ranking Member Quigley and members of the committee. My name is Eric Koester. I am one of the founders and the Chief Operating Officer of Zaarly, a real-time, online community marketplace.

In your invitation letter, you asked me to address the challenges entrepreneurs of today face, specifically around the matter of raising capital. I am grateful for the opportunity to discuss my views this morning.

Introduction

Because of my background, I hope to provide a unique vantage point into the challenges faced by entrepreneurs. During my career as an attorney specializing in advising entrepreneurs, small businesses and startup businesses, I was able to work with hundreds of entrepreneurs across dozens of industries. Then I too followed the allure of the "American Dream" and left the practice of law to launch my own full-time business venture (Zaarly) earlier this year with several close friends and partners.

As a result of these experiences, I have what I hope is some relevant and useful insights into the face of today's entrepreneur, the challenges that entrepreneurs of today face and the changing landscape for today's early-stage businesses and business owners. My testimony today will focus on those aspects of the changing landscape and how enhancements in private company financing regulations can not only enhance job growth and spur new business creation, it can also push additional technological innovation.

My testimony will focused on three key areas:

1. Examination of the New Landscape for Entrepreneurs and Small Business Owners
2. Lessons from a fast-growing company, Zaarly
3. How Enhancements to Regulations Can Aid Today's Entrepreneurs

I also had the privilege to testify before the full Oversight Committee in May 2011 and I am thankful to see the work of this committee has helped to advance many of the reforms discussed during that hearing. During that hearing, my testimony focused on the reduction of regulatory friction for new business ventures and entrepreneurs. Those same beliefs hold true – that the most effective reforms can help entrepreneurs 2.0 (or whatever version today's entrepreneurs might be appropriately called) more effectively focus on building their businesses.

Why These Reforms Matter

Before becoming a full-time entrepreneur, I was fortunate to work with hundreds of entrepreneurs, small business owners and business founders as their attorney or advisor. Most of those experiences started the same way: 'I have a great idea… can you tell me how to raise enough money to quit my job and do it.' For most of these early conversations with an

entrepreneur my answer was consistent: 'How much have you saved up or how much can your family help you pursue your dream?' For those of means, the answers were easier than those without.

As the economy worsened in the past three years, startup lawyers began to see more individuals looking to strike out on their own out of necessity after they were unable to find a job. And unfortunately, the answer to my questions above was more often than not: 'not enough.'

Starting a business is never easy. There are thousands of ways for a new business to misstep – from team dynamics to market forces to inability to find financing. The reforms being discussed by the Oversight Committee will not necessarily make a starting or expanding a business any easier. There are still thousands of ways for a business to fail. However, the reason I believe reforms of regulations around private company fundraising are important are that they provide a new opportunity for these businesses to potentially succeed; to find that source of capital they need to grow; to raise that additional cushion to hire more employees; or to provide a few more months of runway to validate the business model. By providing more avenues to raise these funds, we create the opportunity for more businesses to succeed and that is why I am passionate about the need to expand opportunities by enhancing these regulations.

The current regulatory regime puts unnecessary limits on business owners and investors who want to help those businesses. If a business owner is able to convince 100 neighbors to put in money to open a neighborhood coffee shop, we should not only permit it, we should encourage it. If an entrepreneur can advertise that they are looking for investors on their company's blog or through social media and use new advertising mediums to find excited partners, then we should facilitate that. And if a business needs thousands of smaller partners to get off the ground to facilitate ownership and partnership, then we should allow it.

Changing Landscape for Entrepreneurs and Business Founders

My time advising entrepreneurs and small business owners has been important in informing my views of the new world faced by the founders of these small firms. And just as important, I've been fortunate to learn those lessons firsthand through my own experiences as an entrepreneur with Zaarly and other business ventures. These experience have taught me that the challenges faced by businesses even ten years ago are changing rapidly – and the regulations designed decades ago no longer match the realities for today's entrepreneur and small business owner.

Reduction in Costs of New Business Formation. Technology has helped reduce the cost of starting a business today. This is not to imply that today's entrepreneur has it easy (starting a restaurant still requires money for the lease, the equipment, the inventory and the advertising). However, technology has helped reduce certain costs such as bookkeeping, advertising, data storage, equipment rental and general administration. For today's technology-heavy businesses, this can be understood simply by looking at the reduction in the cost of storing data. In 1980, the average hard disk cost to store just one gigabyte of data (the

amount we routinely store or send today for a single photo) was $3 million. By 1990, that cost had fallen to $8,000, by 2000, $30 and today less than 8 cents. This means that today's businesses don't necessarily need millions of dollars to start and succeed. However, it does not mean that there are not costs to start a business – especially in the new information economy.

Explosion of the Freelance Economy. Today one of ten workers is not an employee of the company they work for – they represent independent contractors, freelancers and individual entrepreneurs that can help businesses be more efficient and effective.[1] And this trend is only expected to continue with common freelance professions such as graphics designers, software developers, photographers, writers and artists all expected to see their ranks grow by ten percent by 2018.[2] These individuals are themselves businesses who may need small amounts of money to start, grow or expand.

Emergence of International Competition (even earlier). Groupon and Living Social, online group buying and coupon sites, have each become success stories in relatively short periods of time. Those businesses also quickly found out how fast international competitors can emerge, with the "Groupon-of-fill-in-the-blank-country" popping up almost as quickly as Groupon or Living Social were able to grow their businesses domestically. Today's 'flat' world has created competition from not only across the street, but also from across the world.

Challenges to obtain Bank Loans. In years past, business owners would go to their local bank to obtain a loan to start their business. Today, fewer banks are lending to small businesses and more early stage businesses do not have the right profile to obtain bank loans. That means that banks no longer represent an option for today's technology-based or freelance-based businesses – the very heart of businesses that are growing the fastest.

What do these changes mean for today's business owner or entrepreneur? It means that raising capital to start or expand the business may not follow the traditional paths from just a few years ago. Further, these changes mean that to keep up with the world, we need to continue to think progressively about supporting new innovation and new opportunities for business growth.

The Story and Lessons of Zaarly

Entrepreneurship spurs job creation. Data from academic research confirms the importance of young companies in job creation (Kauffman research notes that companies less than five years old contribute two-thirds of new job growth). And anecdotal evidence shows that new companies such as Zaarly, Groupon, Facebook and others drive new job creation – in fact, Zaarly has added more than thirty (30) new jobs to the U.S. economy in just under eight months since being founded in a weekend.

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[1] www.navigateconomics.com

[2] www.bls.gov/oco/ocos090.htm

Zaarly is a marketplace that connects people buy and sell with people nearby. In just 5 months, Zaarly has had nearly $8 million of requests of all types posted – people looking to find a plumber, people wanting to buy a used lawn mower, people hoping to find a cleaning person, or people hoping to buy tickets to the big game. In many cases, these requests are for services or goods that may never have been bought or sold without our platform. And as a result, we've seen people in local communities keep million of dollars in their community. Today, Zaarly provides a way for a stay-at-home mom to make extra money with her part-time cleaning business; an opportunity for a student to earn money editing term papers; and a source of new leads and business for the local small business owner.

The reasons for Zaarly's rapid growth are many. But two things in particular stand out:
1. Zaarly was able to convince smart, savvy investors to invest in the company early in our lifecycle; and 2. The Zaarly marketplace helps other individuals and businesses, specifically freelancers, entrepreneurs and business owners that are looking to make money in their local markets.

Zaarly was fortunate to receive funding early in its life cycle to help the business hire employees and grow. Additionally, Zaarly has grown because we provide a marketplace for individuals looking to save money by finding a good or service locally or looking to make additional money in their own community. We are most proud of the fact that Zaarly not only contributes to local economies but it spurs job creation of news businesses serving these local economies. We are seeing businesses utilizing Zaarly in places from Nashville to Kansas City to Seattle to Boston.

And as a result of our ability to raise funds, in less than eight months, Zaarly has been able to add these thirty jobs and to help local individuals earn money in their own neighborhoods. Examples like Zaarly showcase the importance of maximizing the opportunities for smart entrepreneurs to raise funds – and why we should reduce hurdles by expanding the current regulatory regime to allow for more investors, to open doors for crowd funding and to permit broader fundraising solicitation. Today, an individual who has some graphics design training can utilize a platform like Zaarly to find clients and by finding new ways for them to raise funding, we can help them expand their business and add additional jobs to the economy.

As the U.S. works to retain its leadership status in the innovation economy, so too must our government continue to push innovative reforms in the funding environment that can continue to inspire the next generation of businesses.

Importance of Regulatory Reforms

Many of us were enthralled with the breakout movie hit The Social Network, which told the story of the founding of Facebook. Facebook was started in a college dormitory at Harvard by a smart young man, Mark Zuckerberg. Facebook also had the fortune to have received a few thousand dollars from a family friend to get the business started. And while the dollar amount may not have been significant, the question remains about what could have been without those funds. What if Mark Zuckerberg hadn't had that money so readily available? What if Mark Zuckerberg had started Facebook at a community college and needed a few

thousand dollars to get it started? Innovation comes from unlikely sources and while we cannot ensure this innovation turns into Facebook, we can make sure that these entrepreneurs have the most opportunity to succeed possible.

I support regulatory reforms that allow for the broad use of crowdfunding and similar tools for businesses to raise up to $5 million, that eliminate the rules restricting general solicitation and that align with the currently proposed revision of accredited investor rules and the expansion of shareholder caps. Ultimately, I believe these reforms will open up new channels to fundraising. However, the efforts to expand options for new ventures to raise funds are not completed by these reforms. Instead, the efforts to provide channels for businesses to raise funds from existing sources such as banks or sophisticated investors and new sources such as community members or neighbors must continue to be examined. It may be one of these channels that will provide the necessary funding for the next Zaarly, Amgen, or Facebook or it may be a channel that we have not yet thought about.

Does this expansion induce new risk to investors? As we expand opportunities for businesses to leverage solicitation mediums online, as we permit crowd funding, as we expand the number of investors, and as we permit more individuals to participate in funding private companies, how do we continue to protect the investors? I believe the answer is no. In fact, I believe that today's investors will have more protections than ever before simply by trusting the market to utilize the very tool that has helped lead to the explosion of new businesses: the Internet.

Today, individuals have their reputation, their experience and their backgrounds on display every day all across the Internet. If you want to learn about anyone, simply use a search engine to find articles, credit scores, social networks and more with a click of the mouse. This explosion of data also provides new insights by these potential investors into the individuals and the company they are investing in. You can quickly discover prior job references online (through a tool like LinkedIn), find common connections (through a tool like Facebook), read articles by or about the business (through tools such as search engines) and ask a broader community for feedback on any person or business (through tools such as Quora or Twitter). The expansion of tools to discover information about any person or business, and the ability to discover "reputation" quickly and easily, puts investors in an incredible position to protect themselves.

As platforms for crowdfunding, online solicitation of investors, and business tracking grow, those very platforms can leverage all this available online data to provide more information to prospective investors than ever before. These tools will reward individuals and businesses that build strong reputations for openness and collaboration, rather than hide behind secrecy and opacity. Investors will invest in companies through platforms that help them to identify, sort and separate the best businesses from those that are not a good fit. And self-interested investors will utilize platforms that provide the best protections.

There will of course be situations where unscrupulous individuals can beat the system and will defraud people. That has happened from the dawn of time and no regulatory scheme can

fully protect investors. However, by empowering new platforms and individuals in these areas, we should expect even greater innovations to occur.

Conclusion

In conclusion, I want express my sincere gratitude to Chairman McHenry, Ranking Member Quigley and members of the committee for your time today. Spurring innovation, small business growth and creation and expansion of fundraising opportunities for new entities is without question a key aspect to job creation in America. You could even argue that these regulations will play the key role in new venture creation and will ultimately lead to the creation of millions of jobs from more Zaarlys, Facebooks, Home Depots, and Amgens, as well as the thousands of neighborhood and community businesses.

I am passionate about the entrepreneurial ecosystem as a member of the ecosystem and as a concerned citizen. The opportunity to assemble a panel of outstanding thought-leaders to discuss how to spur job growth, increase innovation and increase competitiveness is a crucial point of discussion. I thank this committee for its efforts to find ways to spur job creation, innovation and global competitiveness. With a continued eye on innovation, we can help America play a leadership role for the future.

Thank you.

Mr. MCHENRY. Thank you, Mr. Koester.

Ms. Williams.

The lights in front of you, I didn't point this out, red, yellow and green, 1 minute remaining, the yellow light will come on, and means to wrap it up, you have a minute to go. The red light obviously still means stop.

Thank you.

STATEMENT OF LONNA J. WILLIAMS

Ms. WILLIAMS. Thank you. I am very pleased to be here today and recognize all of you.

I am glad to hear you are all recognizing the challenges that entrepreneurs have today in sourcing capital. These are very unique times for this. The things I will talk about today really are in contrast to what you just heard because I am a life sciences entrepreneur. We are creating products that are medical products of which we need to train physicians to use as well as go through the research and development stages to get them to the useful, marketable tools for physicians.

I am Lonna Williams. I am the CEO of Ridge Diagnostics. Ridge is an early stage life science company with a mission to develop objective, diagnostic and therapy management blood tests for neuropsychiatric disorders. Neuropsychiatric disorders are things like bipolar disorder, schizophrenia and very importantly, depression. Our testing also impacts the medication selection and efficacy of those particular drugs used for those disorders.

This climate has created what I call a near perfect storm for medical product innovation. As you know, most innovation comes from small companies in this country and many of the jobs created are coming from small companies as well. We are facing growing issues.

I am going to talk about Ridge but most medical companies that are at the same stage as mine are facing these growing issues like questionable hurdles at FDA, some are known, some are not known; a very slow Patent and Trademark Office that has prevented us from issuing a number of different studies and publishing our work because it took 2½ years to get the first Office Action from the USPTO, so it slowed down our ability to move forward with our technology and our publications.

Also there is an unknown path to reimbursement. There are methods of getting reimbursement yet still some of it is unknown. Ultimately, the real crux is the limited sources of capital available to us to grow our companies. We can work through just about anything if we have the time and money to be able to do that.

A little bit about Ridge, who we are and what we do, all of us that are engaged in our board of directors, our senior management team are serial entrepreneurs. We have been engaged in over 20 companies in the aggregate startup or have founded or have managed since the mid-1980's. We have also had experience in large, multinational companies. We all agree we are facing a very unique time as it relates to our traditional means of funding.

Ridge is providing blood tests that will create objective diagnosis for depression. That really is useful for a variety of reasons. First is serving the under served that don't have access to specialty med-

ical care. It will create a substantial number of jobs because this is a very, very large problem we are trying to solve. The scope and size of this is huge.

Twenty million adults suffer from depression in the United States and 6 million teens very year. That is about 1 in 10 Americans that are taking antidepressants today. That is more than cancer, cardiovascular disease and AIDS. With that number of prescriptions being written, it is truly a health care crisis.

We are finding in the last few years, antidepressants have been at least in the top three of all prescription drugs written in the United States and the single most prescribed drug for people age 18 to 44. I have read a number of different statistics but one in particular recently published was that antidepressant use has increased by 400 percent between 2005 and 2008. With these numbers we are looking at this broad prescription rate, yet no objective tools to diagnose depression or to help choose or select the therapy that might be the most effective.

Our system is paying for treatment, whether it be the right treatment or not, but it is not paying for the early stages of accurate diagnosis and prevention.

What we know is that 50 percent of all of the cases of depression are missed by primary care physicians, so it is not as easy to diagnose as the pharmaceutical advertisements seem to make it. We know that 50 percent of those initial 200-plus million prescriptions written for antidepressants fail.

We have a significant problem in financing a company and a product that can add objectivity to this large, costly situation we are facing. Traditionally, venture capital has played a role in taking technologies like mine to the mass markets. We start out in the early phases of our companies being funded by angel investors, by friends and families, ourselves, by government grant programs like the SBIR Program from which we received a National Science Foundation Grant. We also have a study on teenagers being funded by NIH.

Those grants are very helpful but they don't give us enough capital, if you will, to continue on with studies and to make our products commercially available and to be able to educate physicians in a way where they can start adopting the technologies.

Diagnostics are very, very useful. However, they are not contributing yet to the high cost of care because although 60 to 70 percent of all decisions in health care are made by some kind of diagnostic test. Diagnostics only account for 2.3 percent of all national health care spending and only 1.6 percent of Medicare spending. Having more diagnostics on the market is going to bend the cost down curve by identifying the right patient and perhaps providing the right drug at the right time. It is not going to contribute to the overall higher cost of care.

Last, I would like to say that because we are without venture capital funds, it is important for us to look to other means of capital. Certainly the crowd funding initiative is one that could be very important for us but we also have looked to large corporations because this is where our options have left us.

That comes at a high cost because it does affect autonomy and autonomy is where innovation comes from and it does affect job

creation. As you know, most jobs are created by small companies. I have just a couple of facts I want to share with you that I received from the Kauffman Foundation related to this specifically. This is in a report they published in March. From 1980 to 2005, firms less than 5 years old accounted for all net job growth in the United States.

I will end by saying that we think these additional forms of capital that will replace venture capital for companies like ours will certainly help to change the curve related to slower job growth, certainly will rapidly bring products that are efficient and cost effective to care, especially to the underserved, and will help to bend the health care cost curve down as related to a disease area that affects 1 in 10 Americans.

Thank you.

[The prepared statement of Ms. Williams follows:]

Testimony of

Lonna J. Williams
CEO of Ridge Diagnostics

on behalf of CONNECT

Before the

U.S. House of Representatives

Committee on Oversight & Government Reform Committee

Subcommittee on TARP, Financial Services and

Bailouts of Public and Private Programs

Hearing on

"America's Innovation Challenge: What Obstacles do Entrepreneurs Face?"

November 2, 2011

Good Morning Congressman McHenry and Members of the Committee. It is an honor to appear before the committee today and testify on the challenges those of us raising capital for early stage, innovative new companies face in this financial and regulatory environment. I commend you for acknowledging that sources of capital today are uniquely limited, thus creating a serious problem that greatly impacts innovation and job creation in this country. I am pleased to know you are exploring means to remedy the situation and proposing new legislation to loosen regulations and free new sources of capital for privately held companies.

I am Lonna Williams, CEO of Ridge Diagnostics. Ridge is an early stage Life Sciences company with the mission of developing objective, diagnostic and therapy management blood tests for neuropsychiatric disorders. Neuropsychiatric disorders include Depression, known clinically as Major Depressive Disorder, Bipolar Disorder, Schizophrenia and others. Our testing also includes monitoring the efficacy of

medications like antidepressants and antipsychotics. None of these types of testing has been available for patients and health care providers before Ridge.

There are several aspects limiting entrepreneurs and early stage companies today which are perhaps creating a near perfect storm for early stage Life Science or medical product innovations in our country. I will focus on Ridge today, but realize it is an example of many companies, all of whom are facing the same growing issues which are deterring financiers, such as FDA hurdles, a slow U.S. Patent and Trademark Office and an unknown path to reimbursement.

About Ridge Diagnostics

Ridge Diagnostics was founded in 2006 by three scientists from Research Triangle Park, North Carolina, and San Diego, California. Their innovation, and Ridge's first commercial product, is the first blood test to aid in diagnosing depression. It is currently being marketed to psychiatrists in pilot regions in the US. The testing is performed in our laboratory in Research Triangle Park, NC. Our technology, the first to provide biologically based results in the area of mental health medicine, is a break-through, first-in-class innovation that could positively change the management of mental health disorders, including to the underserved, create a substantial number of jobs considering the size and scope of this issue, and importantly, dramatically bend the health care cost curve in this sector of medicine. I ask you not to underestimate the size and scope of this particular area of medicine and the problems to be solved. With approximately 20 million adults and 6 million teens suffering from depression each year in the US, more than AIDS, cancer or cardiovascular disease, the cost to employers currently exceeds $43 billion dollars a year in lost or compromised work hours and the cost to health insurers exceeds the employers' loss per patient due to the high level of consumption of services through mis-diagnosis and excessive resource utilization related to the trial and error associated with diagnosis, medication selection and treatment options. Over the last several years, antidepressants were in the top three most often prescribed drug

class annually in the US, and the most commonly used drug among people aged 18-44. According to a recent report issued from US Centers for Disease Control and Prevention's National Center for Health Statistics, the use of antidepressants jumped nearly 400% between 2005 and 2008 and are now being used by more than one in ten Americans. This is approaching a health care crisis in our country.

Although the wide spread use of antidepressants exists, there are no objective tools to accurately diagnose depression. In fact, it has been published that over 50% of the actual cases of depression are missed by primary care providers. It has also been published that over 50% of initial prescriptions fail and that an effective course of therapy is only found through trial and error. Up to three to eight different drugs may be prescribed over years before a safe and effective course of treatment is established. Yet, a proven blood test, independently evaluated at top academic institutions, including the Massachusetts General Hospital/Harvard University and Vanderbilt University, cannot get financed by venture capitalists in today's environment. This is the case despite the fact that our technology will aid those who are undertrained in the diagnosis of depression, including primary care physicians, and is one of the most sought after blood tests by both physicians and patients.

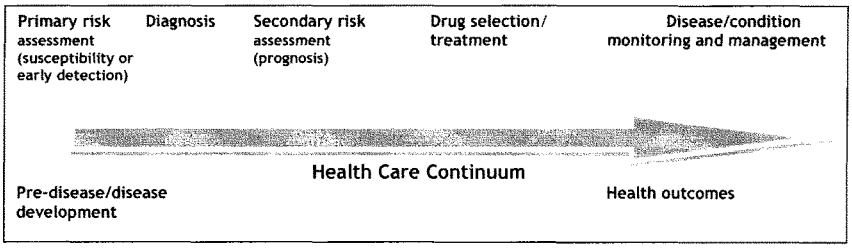
This challenge also exists with the military. We have had a research proposal before the Army for over a year to test active duty servicemen and servicewomen in hopes of detecting depression in these stoic individuals who do not talk about their feelings so that we can assist in reducing the extraordinarily high suicide rate associated with this war. Unfortunately, priorities were focused elsewhere within the military and the proposal is still awaiting funding, countless and unnecessary suicides later. The financing environment needs to be changed as we are depriving physicians, patients and payers, and our soldiers, the benefit of this valuable and cost effective heath assessment tool.

The management team and Board of Directors at Ridge Diagnostics are seasoned professionals; all are serial entrepreneurs in the pharmaceutical, biopharmaceutical and

clinical diagnostics sectors of health care. During our careers, we have been associated with large multi-national companies, as well as founded or managed over 20 start-up companies in the aggregate since the mid-1980's. Today, we are facing a financial climate critically restricting traditional means of capital formation for new, innovative biotech and life sciences companies. We have not witnessed challenges of this magnitude in our professional history and are seeking alternative sources to further finance this company's commercialization plan and research programs. Additionally, Ridge is a graduate of San Diego's innovators industry organization, CONNECT's Springboard Program, which aids entrepreneurs toward funding and was also a finalist in CONNECTS' Most Innovative New Product competition in 2010.

Challenges associated with Capital Formation for Early Stage *In vitro* Diagnostic Companies

Clinical diagnostic tests, or *In vitro* Diagnostics, are those blood tests we have all had from time to time and some routinely. In their simplest form, they are tests that may be preventative in nature, like routine cholesterol testing, or diagnostic for a particular disease or disorder, like strep throat. Today's advances now allow for prenatal testing, the early screening for cancers and cardiovascular risk and the determination of the right cancer drugs for the right patient. The Lewin Group, in a report prepared for The Advanced Medical Technology Association (AvaMed) in July of 2005, encapsulated the value of clinical diagnostic testing to health care. Diagnostics play a role along the disease management continuum.



Extracted from Levin Group report to AvaMed July 2005

Lewin's reports emphasize that diagnostic methods enable accurate detection of health risks and disease at earlier stages and improve treatment and disease management, while diminishing subsequent health problems and their associated costs. *Sixty to seventy percent of medical decisions are influenced by some type of diagnostic testing, yet diagnostics accounts for only a tiny fraction or 2.3% of national health care spending and 1.6% of total Medicare expenditures.* Our system is paying for treatment, but underpaying for diagnosis or prevention. Regulator and financial support for of this type of testing could dramatically reduce treatment costs. Emerging and high need areas of diagnostics, such as personalized medicine, therapeutic management and objective diagnostics for neuropsychiatric disorders, such as those developed and commercialized by Ridge, have the potential to fundamentally alter clinical practice. These technologies are intended to match the "right patient with the right treatment at the right time." As such products become more widely available, patients and physicians will be able to assess the risks and benefits of their care options and customize health management strategies to optimize health and quality of life.

Why would such valuable and economical tools for health care providers and patients prove difficult to finance?

From the mid-1980's to 2008, for companies like Ridge, capital was initially available through angel investors, friends and family and government sponsored grant programs, such as the SBIR NSF, which Ridge received, to assist the company to achieve measureable, financeable milestones. Achieving the key milestones triggered the need for larger amounts of capital, typically an institutional financing, such as a Series A offering of company stock. At this point, Venture Capital funds came into play and hence have had a significant role in the development of new technologies. Over the last three years, VC resources for Series A investments in life sciences have waned. Sources of capital have diminished forcing VC partners to reduce their risk profiles and limit or even eliminate new, early stage investments. Instead, VCs are investing in later stage, lower risk, companies, including buying undervalued stocks in the public market. Venture Capitalists have been forced to retain a higher percentage

of their funds to support their existing portfolio companies and the lack of liquidity of their portfolio companies due to the lagging IPO market have also left them with limited cash available for new investments. Angels and friends and family have also fallen victim to the financial crisis and are holding onto cash, while government resources are limited and slow.

It is truly a financing crisis for health care innovation. Because of the limited access to capital for early stage companies, those few financiers with resources to invest are heavy handed and insist on taking a larger percent of the company for a smaller investment, which, not surprisingly, is a disincentive for those with innovative new concepts to step out and establish a company to exploit it. Additionally, in my opinion, full government control of medicine and health care in the US will not help these companies nor stimulate entrepreneurs. For the benefits of innovative products to move health care forward and be widely available, a reasonable reimbursement structure must exist. Without a reasonable financial opportunity for each stakeholder involved from product conception, to funding, commercialization and utilization, innovation will be stifled.

Why is it critical to seek new sources of capital for clinical diagnostics? Why is the clinical diagnostic sector important to all aspects of medicine, including thoughtful reform?

In a 2009 report for the American Clinical Laboratory Association and AdvaMed, The Lewin Group stated:

Innovation, demonstrated clinical benefit, and appropriate use of laboratory *screening and diagnostic tests are essential for achieving the goals of health system reform. Clinical laboratory testing is integral to evidence-based improvements in health care quality, patient outcomes, efficiency, and accountability.*

Examples of existing, state-of-the-art laboratory screening and diagnostic tests that can contribute to health system value are presented in the table below:

Right Diagnosis

- **Cardiac enzyme marker tests,** which are released after a heart attack and identify heart damage
- **Fragile X syndrome** tests for inherited developmental delay, to determine appropriate management and risk of familial recurrence.

Early Detection and Treatment

- ***BRCA1* and *BRCA2*** test to identify increased risk of breast cancer and ovarian cancer in the absence of tumor
- **Prenatal and newborn screening** for inherited disorders, to enable initiation of treatment and to reduce adverse effects
- **IAI test,** a non-invasive cervical-vaginal fluid to diagnose intra-amniotic infection, a condition that is 80-90% asymptomatic

Right Treatment to the Right Patients

- **HER-2/*neu*** (human epidermal growth factor receptor 2, for patients with breast cancer who will benefit from targeted treatment with Herceptin
- ***KRAS* gene mutation testing** for patients with metastatic colorectal cancer distinguishes who are most unlikely or likely to benefit from cetuximab
- ***BCR/ABL* oncogene testing** for patients with chronic myelogenous leukemia who will benefit from treatment with imatinib (Gleevec)

Fewer Mistakes and Repeats in Treatment

- **HIV viral load test** to determine disease progression and whether the drug is working
- **Emphysema gene test** to identify likelihood of liver disease in emphysema patients without biopsy and allows early intervention

Fewer delays in the Care Delivery Process

- **Rapid molecular MRSA testing** for *mecA* identify within two hours, antibiotic-resistant *S. aureus* infections to guide drug selection and timely hospital control measures
- **Point-of-care tests**

extracted from Lewin 2009

Impact on Job Creation

Today, our options as entrepreneurs are limited, thus we are forced to turn to mid to large size corporations, now rich with cash, to partner with or fund our companies at a much earlier stage than in the past. This financing strategy may ultimately be helpful

and accelerate availability of our new products to patients, but typically, the outcome is the opposite, and at a much higher cost in terms of autonomy, innovation associated with autonomy, and importantly, job creation. Most large companies absorb the technology into their existing departments, limiting the job growth otherwise associated with the smaller company growing and hiring. Large, publically traded companies frequently move at a glacial pace relative to start-ups and are much more risk adverse.

Consider some facts associated with this situation. I would like to recognize the Kauffman Foundation, Cameron Cushman and Carl Shramm, for providing this data. According to the Kauffman Foundation's Fast Facts, published March 2011, *from 1980 to 2005, firms less than five years old accounted for all net job growth in the US.* Another fact, New *Firms add an average of 3 million jobs in their first year, while older companies loose 1 million jobs annually.* In the diagnostic industry, jobs typically are held by college graduates and have been reported to pay far higher salaries than the US average. At Ridge alone, we expect to generate over 300 jobs, with appropriate levels of financing, in approximately five years. Kauffman also reported from a Poll on Entrepreneurship, January 2010 which said 71% of entrepreneurs did not expect to create new jobs in 2010. More than 1/3 said it was because the economy had taken a toll on their businesses.

New or alternative methods to finance private companies promise to alter the trend of flat to negative job growth realized by companies like Ridge.

Summary

I appreciate the opportunity to provide this information to the Committee and summarize by emphasizing that new sources of capital for early stage life sciences companies are highly necessary. Making new resources available will enable the following:

- Critical, cost effective and timely health care delivery tools brought efficiently to patient care
- The bending of the cost curve down by minimizing trial and error and rapidly and accurately diagnosing disorders and selecting and monitoring treatments

- The creation of new, higher paying jobs
- Accurately and efficiently service the underserved with objective measures and without specialist intervention

Appropriate use of diagnostics is integral to high quality health care, including informing earlier, more targeted health care interventions and averting adverse health outcomes and unnecessary costs. To continue to make these valuable tools available, alternative sources of capital for early stage, privately held companies is critical.

Thank you.

Mr. MCHENRY. Thank you, Ms. Williams.

Dr. Goldenberg.

STATEMENT OF TSVI GOLDENBERG

Dr. GOLDENBERG. Chairman McHenry, Ranking Member Quigley and other distinguished House Members, it is a distinct honor and privilege to testify before this committee.

I want to share with you my firsthand experience as an entrepreneur and to help you understand the challenges entrepreneurs face today.

For over 20 years, I have been a co-founder and executive of a medical device company, biotech company and most recently, a healthcare IT company located in San Diego. I am here today to describe how difficult life is in the valley of death of healthcare startup companies. I will compare and contrast my experience funding startup companies 20 years ago to the difficulties I am currently encountering.

Before I go to the present, I want to go back to the past. My goal here is to convince you of the need for Congress to act to create new opportunities for funding which is vital to the advancement of medical technology and essentially create an unfettered access for all Americans to their own medical records.

One of the companies I co-founded in the late 1980's was Advanced Interventional Systems, AIS. During the late 1980's, the standard of care in cardiology for treating blocked coronary arteries was to perform coronary artery bypass surgery, a medical procedure performed to relieve angina and reduce the risk of death from coronary artery disease.

AIS was a part of a new wave of companies that pioneered coronary angioplasty. Angioplasty as you may know is the technique of widening a narrowed or obstructed blood vessel, typically occurring as the result of atherosclerosis. My co-founder and I launched AIS with just $3 million series A investment from VCs. This initial investment allowed us to hire a core team who developed a catheter prototype for animal study. There was also sufficient funding from this initial infusion of funds for our first submission to the FDA requesting permission to initiate clinical trials in several hospitals.

Today, angioplasty is the standard of care of cardiology. What was initiated and developed by many small startup companies developed into a multibillion dollar industry. Angioplasty has saved lives, lowered health care costs and created many thousands of jobs.

This success would not have been possible without the initial investment from a group of VCs who were willing to come in at the startup stage with a long term view to success. Unfortunately, this would not happen today. VCs have drifted to a later stage safe zone and shy away from the risk associated with the early stage of venture.

Let us fast forward to the present. The company that we are trying to currently fund, eemRa, is a consumer-centered, healthcare information, financial services portal. It is designed to operate as a key element of the Health Information Exchange or HIE.

HIEs were created by the High Tech Act to serve the community which will demonstrate the future meaningful use of electronic

medical records exchanged among hospitals, clinics and labs. eemRa's goal is to develop access for Americans to all their health related information. As medical insurance premiums are increasing, a growing number of Americans are choosing high deductible plans to lower their medical insurance costs.

Our mission is to act as a single service provider for consumers that aggregates information from providers and insurers. Our portal will enable the consumer to compare the cost of healthcare services at different providers. For example, if a patient needs a battery of blood tests, he or she could go into our portal to compare the cost of getting the blood tests at one lab versus an alternative. This is valuable to those with high deductible insurance plans and the average struggling American trying to make ends meet.

Yet, despite our innovative technology that can increase patient control of their healthcare, eemRa faces funding difficulties in this economic climate. If Congress were to pass some of the bills being considered, we could start immediately hiring 15 people with a $3 million investment to start our operation. eemRa is not alone. The American Recovery and Reinvestment Act of 2009 has been producing large numbers of discoveries and inventions. This is great. However, in order for these discoveries to be developed into devices, drugs and software, startup companies are needed to commercialize these discoveries and inventions.

Large companies are unwilling or incapable of handling high risk/high gain endeavors. Their complex hierarchies are unable to move fast enough to provide the intense concentration of effort needed to execute early stage projects.

As you can see from my example, the severe shortage of capital funding has slowed the formation of startup companies to a trickle of what it has been. The result is the American people are being hurt by the lack of creation of small companies which produces technology that increases the quality of life while also producing high paying jobs.

Additionally, until ARRA discoveries are moved into commercialization, the public is not really benefiting from ARRA.

In closing, I encourage this committee and Congress to promptly act to advance legislation that will allow capital to flow to emerging companies and startups.

Thank you.

[The prepared statement of Dr. Goldenberg follows:]

Testimony of

Herbert Tsvi Goldenberg, Ph.D.

CEO and Co-founder, eemRA

on behalf of CONNECT

For the U.S. House of Representatives

Committee on Oversight and Government Reform

Subcommittee on TARP, Financial Services and
Bailouts of Public and Private Programs

Hearing on

"America's Innovation Challenge:
What Obstacles Do Entrepreneurs Face?

November 2, 2011

Chairman McHenry, Ranking Member Quigley and other distinguished House members, my name is Herbert Goldenberg and it is a distinct honor and privilege to testify before this Committee of the United States Congress. I want to earnestly thank you for your invitation to testify today which gives me the opportunity to share with you my first-hand experience as an entrepreneur and to help you understand the challenges entrepreneurs face today. Let me be clear, entrepreneurs want to see the economy recover, and we are doing our best to help it along, but market conditions are challenging as I'll explain.

For over 20 years, I have been an entrepreneur, co-founder and executive of a medical device company, a biotech company, and most recently, a healthcare IT company located in Orange County and San Diego, California. I am here today to describe how difficult life is in the 'valley of death' of healthcare startup companies. I will compare and contrast my experience funding startup companies 20 years ago to the difficulties that I am currently encountering and the pitfalls that presents to the public at large.

My goal is to convince you of the need for Congress to act to create new opportunities for funding which is vital to the advancement of medical technology and unfettered access for all Americans to their own medical records.

One of the companies I co-founded in the late eighties was Advanced Interventional Systems or AIS. During the 1980's, the standard of care in interventional cardiology for treating blocked coronary arteries was to perform Coronary Artery Bypass Surgery, a medical procedure performed to relieve angina and reduce the risk of death from coronary artery disease. AIS was part of a new wave of companies that pioneered coronary angioplasty. Angioplasty, as you may know, is the technique of widening a narrowed or obstructed blood vessel, typically occurring as a result of atherosclerosis.

My co-founders and I launched AIS with just one $3 million series A investment from VCs. This initial investment allowed us to hire a core team who developed a catheter prototype for animal studies. There was also sufficient funding from this initial infusion of funds for our first submission to the FDA requesting permission to initiate clinical trials in several hospitals. Once we accomplished this milestone, we attracted more funding to commercialize the product.

Today, angioplasty is the standard of care in interventional cardiology. What was initiated and developed by small start-up companies developed into a multi-billion dollar industry. The evolution of angioplasty has saved lives, lowered healthcare costs and created many thousands of jobs.

This success would not have been possible without the initial investment from a group of VCs who were willing come in at the startup stage with a long term view to success. Unfortunately, this would not happen today. VCs have drifted to a later stage, safe zone and shy away from the risk associated with early stage ventures. Because VCs have drifted to later stage funding, Congress needs to find alternative avenues to encourage funding in early stage companies and start-ups. The kind of ground-breaking innovation that my company

discovered over 20 years ago is still occurring today, but can't break into the market until new avenues for funding materialize.

Let's now fast forward to the present.

The company that we are trying to currently fund is eemRa, a consumer-centered, healthcare information and financial services portal. It is designed to operate as a key element of the Health Information Exchange or HIE. HIE's were created by the HITECH Act to serve as a community which will demonstrate the future meaningful use of electronic medical records exchanged among hospitals, clinics and labs.

eemRa's goal is to develop access for Americans to all their health-related information. As medical insurance premiums are increasing, an increasing number of Americans are choosing high deductible plans to lower their medical insurance cost. Our mission is to act as a single service provider for consumers that aggregates information from providers and insurers. Our portal will enable the consumer to compare the cost of healthcare services at different providers. For example, if a patient needs a battery of blood tests, he or she could go onto the portal and compare the cost of getting the bloods tests at one lab versus an alternative. This is valuable to those with a high deductible insurance plan and the average struggling American trying to make ends meet.

Yet despite our innovative technology that can increase patient control of their healthcare which will bend the cost curve down, eemRa faces funding difficulties in this economic climate. eemRa is a company that would directly impact the average American's ability to control their medical costs and takes advantage of the latest technology resulting from our financial investment in the HITECH act. eemRa would seem to be an ideal candidate for early stage funding in our current business climate. Yet, for the past year, we have found it difficult to raise an initial round of funding. If Congress were to pass some of the

bills being considered, we could start immediately hiring people with a $3 million investment to start our operation.

eemRa is not alone. The American Recovery and Reinvestment Act, ARRA, of 2009 has been producing large numbers of discoveries and inventions. This is great. However, in order for these discoveries to be developed into devices, drugs, and software, startup companies are needed to commercialize these discoveries and inventions. Large companies are unwilling or incapable of handling high risk/high gain endeavors. Their complex hierarchies are unable to move fast enough to provide the intense concentration of effort needed to execute early stage projects.

As you can see from my examples, the severe shortage of capital funding has slowed the formation of start-up companies to a trickle of what it has been. The result is that the American people are being hurt by the lack of creation of small companies which produce technologies that increase the quality of life while also producing high paying jobs. Additionally, until ARRA discoveries are moved into commercialization, the public is not benefiting from the ARRA.

In closing, I encourage this committee and Congress, to promptly act to advance legislation that will allow capital to flow to emerging companies and start-ups.

Thank you for your attention.

Mr. MCHENRY. Thank you. I thank the panel for their testimony.

The normal tradition is the chairman asks questions first, then the ranking member and we go back and forth from there. At this time, because of Mr. Quigley's schedule, I would like to recognize him and I will then ask questions and go through the normal path of Republicans, Democrats in that order.

With that, Mr. Quigley is recognized.

Mr. QUIGLEY. Thank you, Mr. Chairman.

You all make a compelling case for trying to find new ways to raise venture capital, capital to do all of the job creation ideas you have brought forward. This is different, and because you have gone through this I will start with you, Mr. Koester. Here we are talking about the potential for less sophisticated investors and at the same time, less regulation. We want this to work and I am for this.

If you are in our shoes, how do you try to protect those new investors in terms of the advice they might need? You are used to more sophisticated investors perhaps who are doing more due diligence. How do we protect them? What are your thoughts? Then we will go to the other witnesses.

The President's suggestion was a maximum of $10,000. Some have suggested a low of $100. What are your thoughts having been through this?

Mr. KOESTER. Thank you. That is a great question.

I think that the key lesson that we can take is what has happened with the information explosion the internet has brought. I think even among sophisticated investors, we have actually seen a dissemination of information that allows investors to make better decisions among private companies today.

A great example is the company called AngelList , which actually assembles and aggregates startup companies looking for financing among accredited investors. That tool actually now allows you to take information, such as the profile of the entrepreneurs being invested in, potentially their social network blogging about them, and then also when one investor has met with that team and validated they are a sophisticated team or an investment they would make, that kind of information is able to be assimilated into the reputation of that startup company that then assists the other investors.

What I think really is happening is that by allowing kind of the dissemination of this information across a number of tools, I think you will start to see what is similar to reputation on the Internet where now you can snap your fingers and suddenly know if someone is qualified to take a loan or if someone is qualified to essentially do work on your house.

I think that same level of information will start to be a sign to startup companies so that we can take all this information from a credit score of an entrepreneur to his prior businesses successes, aggregate that information and give you a risk profile on that startup company. I think you will see that from the crowd funding discussion you had by allowing entrepreneurs to essentially understand this sector which would be the early stage crowd funding.

I think you will start to see some interesting innovations that will allow reputation to help these businesses make those decisions.

Mr. QUIGLEY. Ms. Williams.

Ms. WILLIAMS. I agree. I think there are a number of means that we can use to disclose information about our companies in a way where we can provide enough information that these reasonably informed investors can make a decision on their own.

Like they are making decisions going to the stock market and buying something on the public market, they are making a decision based on something that exists that they feel is worthwhile.

We have 20-plus individual investors in our company now. They are accredited investors but we provide them with a number of disclosure documents, including our financials. We provide bios on ourselves and have meetings with them. Some are over the internet by Skype or something like that.

I think we can create some guardrails that are very helpful. Whether it is done on the internet, which it should be, I think we can securitize that, but disclosure I think is really the key.

Dr. GOLDENBERG. I agree with my colleague. I would like to add that I do see a role for the SEC. The SEC will simplify the language, for example, and make it more readable by the average person. I don't think the issue of sophistication will play a role.

To give you an example, in the past, I have seen many sophisticated investors, the VC or the Angel, and they made mistakes and the ratio of success has now changed. Being sophisticated or being experienced will not necessarily give you a chance to a higher success.

I see the combination between simple rules from the SEC which will be properly displayed on the Web site of the company and the company sharing information and this is all about sharing. I think the bigger issue is to force the company to share information to make sure they are not holding back because we have that issue even when you are private or public. You have to share information. If you share all the information, bad and good, I think that will eliminate some of the risk.

Mr. QUIGLEY. Very briefly, the bad actors out there that can discourage investment by all, any thoughts on who should play a role in helping investors deal with them?

Mr. KOESTER. I do think the market will solve that. I ultimately think because of the reputation of these bad actor investors, bad actor companies will be kind of disclosed. I do think that solves a lot of it. I think even today for example, when we were choosing which venture capitalist to go with, there is actually now tracking that will basically give the reputation of the venture capital fund and the venture capital partner himself.

When we were making decisions on who to take as an investor, we were able to look at that information on their reputation and decide which of them would be a bad addition to our team and the same when we are adding team members to our company, we can look at background information as well as reputation on tools like Linked In to find out who those bad actors are. That information really does help empower the individuals.

Mr. QUIGLEY. Thank you for your accommodation, Mr. Chairman.

Mr. MCHENRY. I thank the ranking member and I certainly appreciate the work he has done in Congress for disclosure which is to the panel's point.

I recognize myself for 5 minutes.

Panelists, you all are basically serial entrepreneurs, that's fair to assess you that way. In raising capital, my legislation, which is the crowd funding idea, we originally designed it to allow folks to raise up to $5 million in capital from a large number of people. Individuals are capped at 10 percent of their annual income or $10,000 to make sure this is low dollar, that folks aren't risking their 401(k). In fact, they can't even access their 401(k) for this type of investment.

Having said that, what is the marker for raising capital that would be helpful in your experience, your past experiences and what you are going through right now? What is that dollar amount of capital you need to raise for crowd funding to be effective or helpful?

Mr. KOESTER. I think it is a great question. Some of it depends on industry. I do think we being an Internet mobile company, we started raising $1 million to get our product launched which was sufficient, but I do think to scale that business requires more capital.

I do think my colleagues will discuss in the biotech and medical sector that $1 million is enough to basically get you started maybe but it is not enough to really do enough damage to understand even if you have a product on your hands. I think the $5 million is really a place where venture capitalists actually will start to invest more. I think up to that $5 million is right now a lacking area.

Mr. MCHENRY. Pick a dollar amount, tell me a dollar amount, $2 million, $3 million, or $4 million?

Mr. KOESTER. I think at least $3 million.

Mr. MCHENRY. At least $3 million. Ms. Williams.

Ms. WILLIAMS. Obviously the sector I am in, we do require a little more capital than that. However, we have raised at Ridge about $4.5 million over the last couple of years through Angel money and the grants which got us to the point with our particular technology to be able to commercialize at least on a limited basis. We are receiving reimbursement.

We have had to work really hard for that $4.5 million because we are getting it in $50,000 to $100,000 increments. I think the $5 million number is a very good number because until we get to a point where we can demonstrate some kind of financeable milestone which takes out a lot of the risk factor, we need to continue to raise money, so $5 million to me is a really good starting point.

Dr. GOLDENBERG. I would agree with my colleague on the right. We need at least $5 million in the medical device biotech companies. Biotech is even more than medical devices, so $5 million would be the minimum. If we do health IT, we probably can do it with $3 million but I would go with $5 million.

Mr. MCHENRY. The higher amount. The concept of crowd funding, would that replace Angel investors in your minds or would that basically take you to a capacity to get venture capital money or other types of financing?

Ms. WILLIAMS. In my opinion, I think it could be one or the other frankly and it depends on the type of company even whether it is in the healthcare sector. For example, Angel money is available, so are the grants and loans to get you to a certain point. Venture money today is not available, so I can use $5 million that will sig-

nificantly take me into the marketplace where I can actually start generating my own capital and bootstrapping from there.

In this situation, I think it would replace venture capital. If the markets continue to be a volatile as they are, and we are seeing this now, Angels are dropping off and holding on to their cash. Individuals are doing the same thing. If that is the case, crowd funding could certainly replace some of those typical accredited investors that may not want to participate at a higher level of investment but the folks who might be a part of the crowd funding initiative not buying stock on the open market because they don't want to be in the stock market.

Mr. MCHENRY. Do you think that crowd funding could be competition to bring down the cost of capital from Angel investors?

Ms. WILLIAMS. I think it certainly could be. In all cases today, there is limited competition whether it is in the VC side or the Angel side, that those of us raising money are giving up a significant amount of the company for very small amounts of money.

Mr. MCHENRY. Mr. Koester.

Mr. KOESTER. Absolutely. The reality of what this does is it allows another avenue which essentially creates more competition for these companies. I think what has been noticeable by this company AngelList that I think has started to mass market the Angel investment space is by literally creating competition in disclosing information across these companies you create better value for the companies that are going to succeed, you windup increasing the amount these companies are able to own and you give companies a new angle to raise money they might not otherwise have had.

Mr. MCHENRY. Thank you. My time has expired.

Mr. Koester, I was on Zaarly yesterday looking at what is available in the Washington, DC, market, who is seeking to buy and who is seeking to sell and I know somebody in Adams Morgan is looking for a gently used iPad 2. Thanks so much and I appreciate your testimony.

We will now go back to the normal process. Mr. Meehan is recognized for 5 minutes. Then we will go to Mr. Yarmuth and back and forth.

Mr. MEEHAN. Thank you, Mr. Chairman. Thanks to the panel not only for the work that you are doing and allowing us to explore this issue but what you are doing out there to try to create jobs.

I am stuck on a couple of things which I would like you to tell me how we get out of. One, I am struck by the fact that you are entrepreneurs particularly in the life sciences. I have a lot of that in my area. I hear frequently about the legacy of significant investment by big pharma or otherwise. The truth of the matter is there is a library of work that has been done but it sits. There is a lot of opportunity in there and yet we cannot acquire it and get it down to where entrepreneurs can actually take advantage of some ideas they would be willing to move forward on. How do we unleash more of that? The second question would be how do we prevent that? Maybe you're answering by virtue of your testimony today.

I am struck by the fact that you keep saying because of the VC market drying up and because of banks not doing loaning, you are being pulled right back into the same circumstance in which it is

the big corporations you have to go back to, the very ones that are too big and too slow to respond to a global marketplace.

How do we unleash that $1.4 trillion that is sitting on corporate balance sheets and do it in a way that can allow you to put that money to work and reverse this tendency to keep going back because that is where the money is but it slows down the entrepreneurial spirit?

I will take it in order. Mr. Koester, as a recovering attorney, I will let you jump into that first.

Mr. KOESTER. I appreciate that. Thank you.

The point you are raising about unlocking potential sciences locked in various places really does come down to capital. When I was an attorney, one of the things I did see was that you have to pay to license that technology from big pharma. I do think it all comes back to money.

Mr. MEEHAN. What can we do to require them to do more? I guess these are proprietary things but sometimes they have had government money invested in that. I am a told an awful lot of good ideas that are sitting on the shelf. Do you agree with that?

Mr. KOESTER. I think that actually part of it would come down more to education, matching entrepreneurs with these businesses. A lot of times these assets that are locked up are unknown to the potential entrepreneurs and they are looking for ways to disclose it. A smart, savvy entrepreneur who can figure out where these ideas and this technology is might be able to acquire it very cheaply.

I have seen that happen with a client named Clineta that formed a business simply to go out and extract unutilized resources from biotech companies and used those in turn to commercialize those and sell them back.

Mr. MEEHAN. Ms. Williams, do you have some thoughts?

Ms. WILLIAMS. There are a lot of technologies that come out of big pharma that don't meet their revenue hurdles, that get acquired by smaller companies, biopharma companies and are developed to a point where they see proof of principle and then they sell them back to pharmaceutical companies. That is where venture capital has facilitated that loop.

They have pulled the capital to allow the entrepreneurs to further develop that technology and then sell it back.

Mr. MEEHAN. Why has venture capital money dried up? You would suspect that people see opportunity in this environment?

Ms. WILLIAMS. You would suspect that. I have talked to over 100 venture capitalists in the last 18 months and what I hear from them is that their resources, their sources of capital have waned, so they now have to reduce what they consider their risk profiles.

Instead of investing in Series A capitalization for companies like mine, they are investing in later stage and what they perceive to be less risk type companies. In fact, they have gone so far as to buy stock in the open market because it has been undervalued.

They have to protect their own investors, they have to protect their portfolio companies. There is very little liquidity in their portfolios now because of the lagging IPO market, so they are stuck. They can't make new investments for the most part or they are not willing to. That is why it has dried up for early stage companies.

Your comment is a good one. There is a lot of pent-up technology sitting there that could be very useful but not useful enough that it is addressing the masses. Without access to capital, available moneys, it is not going to come out of big pharma or any other corporation.

Mr. MEEHAN. Dr. Goldenberg, do you have any thoughts?

Dr. GOLDENBERG. First of all, I would like to clarify that one way to start companies is not normally our ideas. We basically would go to a university in San Diego, the University of California San Diego, and that is where we get our idea, our discoveries. We basically package it and put in a business plan, do the planning and then go out and talk to the VC.

We ask the same thing talking to the VC that they basically prefer to be later stage for a simple reason, because they are afraid of the market. If they invest in a small startup right now, they have to come multiple times until they take it IPO. The IPO market doesn't exist right now. For them to invest, they get stuck with an investment, and go to their limited partners and say, I have no exit scenario for you.

Mr. MEEHAN. Because there is nobody coming behind that is making an investment?

Dr. GOLDENBERG. No, because there is no public market for new companies. Private companies do not go public right now. The stock market is structured in a way right now that there is no issues of new companies.

Mr. KOESTER. The one point to that is the hearing in May talked about second market which can be secondary markets, the semi-public market where you have certain disclosure opportunities. I think that is what is being addressed by the 500 shareholder limit increased.

Fundamentally, we hope that does allow more companies such as Zaarly when it does advance to a further stage that we can do a non-fully public sale but we can sell to sophisticated investors in an open market that is constrained, so it is not public entirely but it is constrained in a way.

I think that addresses that and I do think that is an important step in this process and why I am still supportive of the 200 limit because it does address that ill liquid market right now.

Dr. GOLDENBERG. If you open the public market, the VC will come back. The VC are not bad people, it is a risk versus gain. That's one point.

The second point, you mentioned the $1.3 trillion, one way of unlocking that money is some tax break. If you go to big pharma and tell them for every dollar they invest in a biotech with an idea or without an idea, they get a tax break off their taxable income or revenue, that may be looked as a good investment because what big pharma wants to do is increase the pipeline of drugs. Right now they don't invest that much in biotech because they like to keep the cash for themselves for rainy days. If you give them a tax break, you meaning Congress, they may unlock their money.

Mr. MCHENRY. The gentleman's time has expired.

Mr. Yarmuth is recognized for 5 minutes.

Mr. YARMUTH. Thank you, Mr. Chairman.

I thank the panel for the testimony. It is a very interesting discussion.

I have the background of having been involved in the startup of a number of ventures, some successful, some not so successful because that is the way the world works. I am familiar with many of the issues and challenges that you face.

I am intrigued by the whole notion of crowd funding. I think it has enormous potential. I also think there are enormous opportunities for mischief in this area. We know that any time we create some kind of new business technique, there are those out there who want to take advantage of it for purposes other than which it was intended. I am concerned about the regulation.

The chairman asked what kind of monetary limit you would think would be appropriate. If we were to lift the 499 limit on number of investors, do you have any sense of what a manageable amount would be and something that would still retain some kind of element of security?

Mr. KOESTER. I think the current proposal that has a broad base of 2,000 and includes certain individuals as credit investors and employees does allow you to solicit from a broad enough pool. I think fundamentally as executives of companies, 2,000 shareholders is something I cannot fathom to manage.

However, I do think if the decision is to close the company or to have 2,000 shareholders and I believe in the idea, I would absolutely take 2,000 shareholders and not sleep because I do think it is one of those things that ultimately entrepreneurs like us believe in our vision so much that we are willing to do what it takes. If that means manage 2,000 shareholders, then that is what we do.

Mr. YARMUTH. I think Ms. Williams mentioned the issue of how much equity is given up in some of these deals particularly with venture capital and that is always going to be in the equation. If you had your absolute ideal situation for getting money any way you could get it, what way would be preferable? Would it be selling equity, just having access to affordable loans? What would be your preference?

Ms. WILLIAMS. I think I would probably look to a variety of different sources. I think selling equity would be one. You look for that, not just for money, but you look for it for expertise, for assistance with other areas of business. To me, that is not necessarily a bad thing.

I would like to see that happen in a way where you are not giving up the majority share of your company to be able to gain expertise. I think loans would be fantastic. Those are pretty much unavailable to us today.

Mr. YARMUTH. The cost of borrowing money, if you could get it, the interest rates now are far lower than the cost of the equity you would have to give up?

Ms. WILLIAMS. Yes.

Mr. YARMUTH. Which leads me to the next point, I have a piece of legislation that I have introduced that would actually direct the SBA to lend money to small businesses on the same basis that we are lending it to large banks—in other words, free. The idea if you have a certain track record, why not use government funds to make

those kind of loans. SBA doesn't want to do that, I must confess, but that is why the legislation actually directs them to.

Is this the kind of program you think might be helpful in your situations, probably not in the $2 million to $5 million range but $500,000 or so? You could get very low income financing.

Dr. GOLDENBERG. I actually went to the SBA. We got so desperate about 6 months ago and went to the SBA. We said we started a company right here in San Diego and talked with the head of SBA in San Diego and explained the situation. He said, you need to go to a bank. We went to the bank and the bank said something very simple. What is the collateral you are going to bring me, how about your house? That is not the business we are in.

As a startup company, medical device or health IT, I cannot put up my house. In other words, the availability of free money, when I say free money, I mean inexpensive money in the form of a loan will not help me that much.

Mr. YARMUTH. Would not help you?

Dr. GOLDENBERG. Would not help me, not the type of company we are.

Mr. YARMUTH. Because you cannot afford to pay it back.

Dr. GOLDENBERG. Because we have no collateral, we cannot pay it back. We are not going to have revenue for 3 to 5 years or we will have but it will not be where we can pay back our loans, so we will go into default.

Mr. YARMUTH. One quick question because you talked about research and a lot of other things for which funding is threatened right now because of our current financial situation as a nation. Do you think it is advisable at this point in our future to cut funding for things like scientific, medical research, education and many of the other things that would help support either directly or indirectly the activities you are in?

Mr. KOESTER. There is a shortage of engineers and scientists for the technology industries we are in.

Mr. YARMUTH. Thank you very much. My time is up.

Thank you, Mr. Chairman.

Mr. MCHENRY. The Vice Chair, Mr. Guinta from New Hampshire, is recognized.

Mr. GUINTA. Thank you, Mr. Chairman. I just want to follow up briefly on the SBA.

I think the SBA has a certain role to play in very, very small businesses. I am not sure the SBA is properly incentivized to assist the kind of companies you are looking to build, grow and expand. I think the clearer way to do this is to give you greater flexibility and greater opportunities to identify your own private capital.

There are a couple of things I want to talk to you about, Ms. Williams. You mentioned in your testimony a bit about autonomy issues when getting dollars from larger companies. First, can you expand on that a little bit?

Ms. WILLIAMS. Depending on what the transaction looks like, it could be something as limited as a licensing agreement or a strategic partnership. Today, to facilitate that, the larger companies are taking equity in the company. They are not just paying a licensing fee like they had in the past where you are left autono-

mous. They are actually taking equity in the company so they have some control over what it is you are doing.

It has gone so far for the most part and they are so heavy handed because they can be that they are basically acquiring the company. When that happens, they absorb the company into their own infrastructure. That then reduces the opportunity for job creation that would otherwise be realized by the small company hiring and growing. It takes away the autonomy as it relates to innovation because, for the most part, they are not willing to take risks and invest money in new ideas. It affects that whole job creation aspect as well. That is what I was referring to.

Mr. GUINTA. In my home State of New Hampshire, about 75 to 80 percent of our economy is generated by a small business owner. That is defined as 500 employees or less. In New Hampshire, it is even smaller. It is the lifeline and the life blood of our local economy.

We are trying to attract more companies like yours into the southern tier of New Hampshire and to the sea coast of New Hampshire. One of the things I continue to hear again is the lack of access to capital, the lack of choices.

I think someone on the panel mentioned we have a decline in the number of IPOs in this country and on the New York Stock Exchange. We have a decline in VC investment. We have a decline also in Angel investment. There is a lot here that is shrinking in terms of access. Some of that is actually going overseas and those companies are being created overseas and those jobs are being created overseas. Probably all three of your companies, you are talking a minimum of a $60,000 job plus. These are high paying, high quality jobs that we could be creating right here in America if the access to capital issue is addressed.

There are three components. One, I think the chairman's bill makes a lot of sense at $5 million instead of $1 million, which is what the President is looking for. I think we have to have the proper level of company disclosure, so individuals can do their own research. I tend to believe in the individual American, that they can make the right decision so long as the bad actors are minimized by access to information. That makes sense to me. Allowing an individual to invest in your company provides you greater access.

The second component I want to ask about you touched on a little bit is raising funds by issuing equity and how that gives you the ability to defer payments. If you get a loan from the SBA and your business plan suggests you are not going to be making money until 3 to 5 years out, you have already eliminated that option but selling equity provides you that greater opportunity, does it not?

Dr. GOLDENBERG. That is correct. One way to look at equity the way you describe it is that it is our way of printing money. We basically give a piece of the company for getting money in but that is some form of IOU for the future that we will develop it and have the revenue and then they will make much more.

Mr. GUINTA. This is exactly what spurs the entrepreneurship, the innovation and the ability to create an idea and bring it to market. That is what we want to see happening in our country with a 9.1 percent unemployment rate. This is a critical component.

The other component that I am very concerned about is the ban on general solicitation. Mr. Koester, could you talk a bit about that, how that has affected your company and what that would do if we lifted it. How could you get that capital quicker and how you could get job creation quicker as a result?

Mr. KOESTER. I think the real challenge is that an entrepreneur cannot use all the tools they can to generate business to generate investment. For example, if you have a presence on social media or write a book and say in that book that you are seeking funding, you could actually be sanctioned by the SEC. There are ways around those limits so it is more form over substance.

I think it allows people to just have open disclosure of information and we don't wind up having back channel discussions in cloaked secrecy. I think it puts an open tarp on things and for us, maybe our financing process could have been shortened from a 9-month process down to a couple month process if we could have opened it up and made it with open dialog.

Mr. GUINTA. Thank you all very much. I yield back.

Mr. MCHENRY. We will begin a second round.

There are a few other things on which I wanted your thoughts. We have a 500 shareholder cap. This was raised earlier but I want to get your feedback on this.

It appears right now that allowing an unlimited number of accredited investors to invest in your company is no longer legislatively attainable at this moment, at least in the short run. The cap will likely remain at 500 for the remainder of this Congress unless the SEC acts. How do you feel about this turn of events? How do you feel about that limitation? What impact do you think that would have if we raised that cap on your ability to raise capital and what that would mean for jobs, growth and innovation?

Mr. Koester, we will begin with you and go across the panel.

Mr. KOESTER. I think the challenge to the crowd funding legislation you have introduced is there essentially becomes a waterfall effect. By opening up crowd funding which may allow me as a company to add 100 shareholders, suddenly now I only have 400 left and I think we start opening it up to a broader audience but then we also basically keep the cap on that audience tight. I think those two need to be thought of as orchestrated together because I do think when you open up the shareholder base early in the company's life cycle, it winds up limiting what you can do later on down the road.

Essentially for me as a business, were I to add 200 crowd source investors to my company, down the road it would make it challenging or me to use a tool like second market or to use a tool that would allow me to not go over that cap and raise funds in that way. I do think it is a challenge to have those two not move in tandem.

Mr. MCHENRY. To be clear on this, my crowd funding legislation has no cap, so that is the beauty of it. It is a relatively small amount of capital you can raise, but it is from an infinite number of people. These individuals are capped by what they can invest annually. That was due to a lot of concern about fraud, to make sure someone doesn't put up $1 million on a $1.5 million crowd funding raising venture without having a clue. There is this concern for

fraud and investor protection. You wouldn't be subject to that. That I think is one of the positives of it.

To this larger question, we basically have a 500 shareholder cap which includes credit investors, includes connected people, employees, and those that are close relationship individuals. It is a pretty limited group. To remove employees from that calculation is helpful. To remove accredited investors, would that be helpful? Would that be a positive so you could have even pushing up to 1,000?

Mr. KOESTER. Yes.

Mr. MCHENRY. You mentioned you would much rather not have to deal with 1,000 individuals. I get that. I am the youngest of five kids. It would be easier to have a brother and sister and not two brothers and two sisters, especially when they are bigger than you. It is sort of difficult to deal with and contend with. Do you think it would be helpful to remove that accredited investor number from that 500 shareholder cap? Would that help?

Ms. WILLIAMS. I think it would. They have kind of separated themselves out anyway, so they are manageable as it is. If you think about 1,000 investors, to me I think there might be a way to create the mutual fund concept with those people so it doesn't mean that me or my CFO are managing 1,000 people. It means that I am managing an institutional vehicle or an investment vehicle of one, three or five that might have 100 or 150 people in it. That way they can kind of form their own opinions and that would come to me in the form of five opinions instead of 500 opinions. I think there are ways of making that manageable for the entrepreneur.

Mr. MCHENRY. Dr. Goldenberg.

Dr. GOLDENBERG. If I understand you correctly, you want to move the accredited investors out of the one available to invest?

Mr. MCHENRY. Rather limit it to 500 shareholders, to remove that accredited investor from that count or raise the count.

Dr. GOLDENBERG. Will they be allowed to invest in this crowd funding?

Mr. MCHENRY. Two separate issues. Crowd funding is available to every individual just capping the percentage they can invest of their income. The question with accredited investors and the 500 shareholder cap is a separate question. Do you think it would be helpful to raise that number? Additionally, would it be helpful to remove the accredited investors from that count of individuals?

Dr. GOLDENBERG. The way I look at this crowd funding is it is another form of IPO because you are going to have a large number of investors. I have taken a private company public and once you get used to it, it is manageable. The crowd funding to me is another form of a public offering without really calling it a public offering. Whether they give us the money now or later, we will manage the same with the risk and the reporting and everything, the disclosure. I would agree with your point, the more you have the better.

Mr. MCHENRY. Limiting the choices for raising capital, whether that is equity or giving away equity or getting a loan or bootstrapping, there is a cost to that. Widening the array of capital choices for you as an innovator and entrepreneur lowers the cost potentially. It gives you more opportunities.

I have too many questions and I know your time is limited. Ms. Williams, you said something very interesting which was right now, you are going to the big corporations, Fortune 500 companies or Fortune 1000 and getting capital from them. Describe for me the cost limitations, what that means beyond your company, what does it mean to your ability to grow jobs, to the ability of the economy to start moving? What is the macro view of what this means?

Ms. WILLIAMS. It can mean good and bad. To me as it relates to job creation to start, I think it is not going to help to create more jobs for the most part. As I said earlier, small companies really have the ability to create jobs where larger companies don't prove to do that. With a company like mine, they will absorb my company into theirs, so I will not be out hiring and growing. Therefore, job creation will be flat as it relates to me specifically.

I know I can create 300 jobs with under $10 million of funding in just a few years at Ridge alone based on our forecasting. To me, it is not the alternative I wanted to take but it is the only choice I have right now.

They will take a percentage of the company—frankly, we are negotiating that right now and what that is going to be—and they will control the single largest market because they will have licensing rights in the single largest area of use for this particular blood test. I am not going to have access to that. My shareholders will have a royalty revenue that will contribute to their value but not the full value of product sales. That is the balance we have to choose.

Typically the larger companies are very risk adverse. They have their own array of things they have to manage and I appreciate that. Therefore, they will be less likely to accelerate innovation. They don't want to have their earnings per share reduced for any reason, especially right now, and want to make sure management is retaining their physicians, so they are not going to make any mistakes. They will toe the line.

I think it is going to create a flat environment and a job reduction as relates to potential new jobs.

Mr. MCHENRY. When we talk about capital markets, regulations coming from Washington, whether SEC or the laws we have actively passed in this Congress, can you touch on what is limiting your ability to grow and create jobs? Tell me the limitations, the barriers and the problems. State the problem, a regulatory problem or law, that impedes your ability to grow and create jobs.

Mr. KOESTER. I think a lot of it has to come down to Sarbanes-Oxley. I think that has slowed the ability of private companies to go public. I think it has created a backlog within the entire cycle. I think we have locked up innovation capital exchange by having no clear exit valve for companies once they hit a certain size.

A company such as Facebook or Twitter in other days should have gone public by now. However, due to the fact there is an increased burden on being a public company, you are seeing those companies hold back longer than they would have before. The backward effect of that is the shareholders of Facebook, the venture capitalists who basically invested in them early, are unable to get back that capital so they can reinvest in the next wave of companies.

I think that creates a backlog of problems where you wind up not having the flow of that innovation capital exchanged back. What we need to find is more ways to spur companies to be able to go public. I think there are multiple ways of doing that. One is the public market and the second one is companies like second market and similar that do allow liquidity. I think the rules that limit liquidity of companies is where I think we really see some backlog.

Mr. MCHENRY. Ms. Williams.

Ms. WILLIAMS. I would agree. I cannot put my finger on any other specific things other than perhaps taxation which obviously is not something that affects us today. I live in the State of California but our laboratory and our research is all done in North Carolina. We are trying to create jobs there. There is a significantly different cost in doing business in California than there is in North Carolina as it relates to taxes and other things. That will be a driving factor and probably is for a number of companies where they decide they are going to incorporate and where they will develop their companies.

Mr. MCHENRY. Dr. Goldenberg.

Dr. GOLDENBERG. We talked about raising funds but the other obstacle is, for instance, in our case dealing with the Health and Human Services. There is their Office of National Coordinator. We tried to talk to them both about incorporating our system in their program, the HIE, the Health Information Exchange, and they kind of ignored us. They like to deal with large hospitals, community projects but they shy away and are not that interested in talking to small companies.

It would be nice to have them onboard and also recognize the role we are playing in commercializing all this.

Mr. MCHENRY. If you had just one thing you wanted to say about job creation, here is your moment. Go for it. Mr. Koester.

Mr. KOESTER. Give us a chance and we will create a lot of jobs.

Ms. WILLIAMS. I agree and I think we should go back to talking about the loan opportunity because the State of North Carolina and the North Carolina Biotechnology Association has funded Ridge to the tune of over $500,000 over several years to be able to do our research and have our laboratory in that area.

Loans, whether they are securitized with some kind of collateral or not, which is what has happened in the State of North Carolina in that particular area because they are offering entrepreneurs the opportunity is really a terrific way to get jobs started. I think we need to go back and think about how to construct loans, whether it be through SBA or others where we are not giving up equity to be able to create jobs.

Mr. MCHENRY. Dr. Goldenberg.

Dr. GOLDENBERG. I think creating jobs is a great effort but we are also creating high paying jobs. I think that is very important and people forget about that. I think that should be recognized.

Mr. MCHENRY. Thank you.

Mrs. Maloney from New York is back. Before I recognize Mrs. Maloney, I want to thank my colleague for working diligently on improving the legislation I filed and working with me to amend it and working in a very collaborative way to bring a bill that has bipartisan support and allays a lot of the concerns about fraud and

the structure you worked with us on creating. I think it will be very beneficial and I thank my colleague.

Mrs. MALONEY. Thank you and it will be on the floor tomorrow and I will be there supporting it with you. I want to credit the chairman's leadership for being open to suggestions and working with us in a very creative way to make a good bill a better bill. People say this Congress can't work together, well this is one example where we are working together to help get access to the markets and to help smaller companies move forward, and to remove the barriers, in this case, to his legislation on what is called crowd funding, which is the aim of the chairman's legislation.

It is also, I might add, a component of President Obama's Americans Job Act. The President is likewise supporting the legislation. In fact, the President's legislation includes several provisions to increase the amount of capital, small or startup businesses can access, retain and put to good use.

While crowd funding would likely be helpful for some startups, I would like to ask the panelists, wouldn't you agree that crowd funding and related or similar changes to securities law are not the only tools that we can have at our disposal to encourage the startup of businesses and small businesses moving forward.

I would like to give to you for your comment some of the ideas that are put forward in the American Jobs Act which we would like to get to the floor also for a vote. I hope the chairman can help us move that legislation to the floor for the vote. For example, the American Jobs Act plan we have proposed cutting in half small business employer and employee payroll taxes. This would put money right back into workers' and employers' hands.

Another provision is temporarily eliminating employer payroll taxes for small businesses that create jobs or give raises for existing workers above the prior year's wages and eliminating the payroll tax if that is accomplished.

Extending an immediate 100 percent expensing writeoff into 2012 to encourage businesses to invest in machinery and other new equipment; extending tax credits for businesses that hire workers who have been unemployed for at least 6 months; raising the cap on many public offerings of small firms from $5 million to $50 million this is actually on the floor tomorrow and is a bill that likewise we have worked together on in a very positive way. That will be moving forward. Another provision is increasing skills-based training for youth and adults.

I would like to ask all the witnesses if you would comment on these policies and whether or not you think they would be helpful to new or small businesses and if you have another idea you think could help get our economy moving, help businesses grow and expand and hire more people. I would like to start with Mr. Koester and go down the line to Ms. Williams and Dr. Goldenberg.

Mr. KOESTER. It is great to see the support of small businesses and early stage companies because I do think that our goal is to grow into those large, mature businesses that can create thousands and thousands of jobs. I think across the board, any provisions that allow increased access to capital, increased ability to attract and retain employees and an ability to basically grow our business free of restrictions and limitations are helpful across the board.

I also think one of the points all of us will face in the technology sector is improvements to immigration will be an important thing for us to be able to attract talent from around the world. I think that is one of the things that the United States has an incredible advantage at doing. I do think that is another piece of long term sustainability.

Mrs. MALONEY. May I comment on that and I would like to bring it to the chairman's attention, I do have a piece of legislation called the Startup Business Visa Application. This would speed up visas for people coming to America sponsored by other American businessmen who are willing to invest in their startup idea. The money can come from either the immigrant or from an American businessman and help move that forward.

As the chairman and the panelists know, we have a program for investment where if an entrepreneur wants to come to this country and invest $1 million, then there is a speed up process to help them come and invest in a business that has been acknowledged and supported by American business. They are not using all those visas, so it wouldn't be new visas. It would be taking the visas that already exist and allowing them to come with capital.

I would like to request additional time to put forward another idea that I think is critically important. Thank you, Mr. Chairman. This is great. This is bipartisan cooperation.

Many businesses have been started by really very few people, one or two people with incredibly little capital. If you look at the story of Steve Jobs, he started in his garage with one friend and $100. A lot of businesses in America, in fact, most of them, have started with an idea and an entrepreneur trying to move forward.

I would like this committee to look at micro loans, the small loans that are given out to one or two individuals in small amounts. This country has supported micro loans in foreign countries in many ways to help their economy. I think it would be an excellent way to partner with the private sector to create a micro loan area that could respond to some of these young people who have a fine education but the jobs are not there for them. Let us give them a helping hand to move forward.

Mr. MCHENRY. Would you yield on the note of micro loans?

Mrs. MALONEY. Yes.

Mr. MCHENRY. In doing all the research we did for crowd funding, there are two interesting Web sites that are available—prosper.com and kickstarter.com. Mr. Koester mentioned that. Both Web sites do peer-to-peer micro lending and it is absolutely fascinating the success they have.

Earlier when my colleague had to step to the other hearing, Mr. Koester mentioned in essence you establish a reputation as an entrepreneur and that reputation will enable your investors to create a risk profile. Prosper is doing that. It is fascinating to watch.

Amazon allowed individuals to write negative reviews about a book. People said that was crazy, you are trying to sell books, why would you do that. He said, I want people to come back and buy another book, that is why. Likewise eBay, you have individuals who exchange goods on eBay every day and they are wonderful products. If you send the person a bad product, you are done. You are not going to be able to sell your stuff on eBay anymore.

Likewise, you can do one-on-one individual fraud but on the internet, it makes it very difficult because you establish a reputation which prevents you from getting away with it more than once or a limited number of times.

I would yield back.

Mrs. MALONEY. I thank the gentleman for his insight. I would like to request a hearing on Kickstarter and prosper.com to take a look at these smaller startups and the new technologies. I commend you for moving forward with the crowd funding. I think it is an exciting idea and excepting democratic amendments to really protect investors more and put more transparency out there, I think there is a lot of new ideas out there with this new economy and with the high tech economy. We should be looking at them.

I think the micro loans have been particularly successful, particularly with women starting small cottage businesses. I also think the young men and women who are out of work and highly educated would be very good prospects to have an idea and try to start working on it and give them a little support to do it.

I would like to ask Dr. Goldenberg if he could respond to micro loans and specifically the idea of a public/private match. We are all in this economy together, we are all in this country together. I would like an opportunity for successful businesses to really give back to the young men and women who want to follow in their footsteps of going forward with new products, innovation, new ideas.

Dr. GOLDENBERG. I think micro loaning is a great idea and I would encourage you to pursue it for a simple reason. It provides new money. American ingenuity is everywhere in every field, not just in our fields of medical technology or health IT. It can see it everywhere you go. There is a small business or small operator. I don't know the exact number for micro loans but $10,000 to $25,000, I think would be a big step for them to start working and producing something.

Mrs. MALONEY. What about a public/private match, what about involving the public sector? What is your feeling on that, voluntarily?

Dr. GOLDENBERG. Again, I am looking at it from the point of generating new funding. If you can do that matching and provide more services or more consulting that will help start a new business, I think that would be great.

Mrs. MALONEY. Ms. Williams.

Ms. WILLIAMS. Yes, I agree. I think micro lending is a valuable way to generate additional new businesses. I actually participated in it outside the United States in a very small way.

Mrs. MALONEY. Excuse me. I have to run to another hearing and give back my time. I look forward to working with you.

Mr. MCHENRY. You may finish your answer.

Ms. WILLIAMS. I am for micro lending.

Mr. MCHENRY. This is for the record and we are being streamed online, so it is helpful to establish this record because you are creating jobs. We in Congress may previously have created jobs in our previous work but we are trying to create the regulatory framework that frees you up and enables you to be creative.

The final question I have for the whole panel. The online guy, the woman who does biotech and the gentleman who does a dif-

ferent form of biotech, it is great to have this cross section, but do you think the lack of capital in the current market, affects certain industries more than others and what does that mean?

Dr. GOLDENBERG. As I am looking at the panel, one of the things that struck me was that we are operating at different time scales. In my world, before now, we talk about 3 to 5 years. My colleague, he operates on 6 months?

Mr. KOESTER. Twenty-four hours.

Dr. GOLDENBERG. Twenty-four hours. We are much slower and we need to invest now in order to see the fruit in 3 to 5 years. We are here asking the Congress to keep that in mind. A very large part of the American economy—I think actually the largest part of the American economy—is drugs, devices. I think it is approaching $100 billion or even more in sales per year. Whatever you decide to do will have a major impact. Keep in mind that the time to get there is not 6 months. That is very important.

Mr. MCHENRY. Over the horizon.

Dr. GOLDENBERG. Over the horizon. We are operating either with little revenue or have revenue but not necessarily profitable. That is something to keep in mind.

Mr. MCHENRY. Ms. Williams.

Ms. WILLIAMS. I think we can bifurcate that to a certain degree by saying what we do from a development and research standpoint in creating these new medical products takes more time. The dissemination of information about those products once they have been proven can go quickly with the tools being developed in the tech sector, so we can reduce the time that we make these products available and we can educate physicians online through Medscape and other ways of continuing medical education where it doesn't require some costly sales rep knocking on their door.

I think it is going to take us more time because we have to do that credible research and make sure we are creating a safe and efficacious product. We can disseminate that information much more quickly and essentially catch up from that standpoint with the technology sector.

Mr. MCHENRY. Mr. Koester, in terms of the lack of capital, does it affect one industry more so than others? For instance, in tech there is perhaps this emphasis on apps, the sexy, cool apps, the newest, greatest thing, is capital flowing whether it is Ashton Kutcher or whatever, putting a lot of money in those. You are actually in a more over the horizon perspective rather than an app where you have a very short turn time. You are actually building something that takes a little more time even though it is still very brief traditionally?

Mr. KOESTER. Yes, that is a very good point. Our ultimate goal at Zaarly is to create local commerce, local jobs. We have seen almost 8 million truly local American, community-based jobs and requests being generated from our tool. While it is relatively fast, I think we also see a long time horizon and hopefully spurring American jobs and hopefully keeping that $8 million that may never have otherwise existed in these communities.

Fundamentally, I think it is incumbent on government, corporations and the populace to support innovation. I do think that the biotech and health sector does have a longer horizon and I do think

that access to capital may sometimes slow those innovations that may not have mass market adoption. There are technologies that may meet a need of a healthcare need that is out there whereas they may not receive the funding because the venture capital space isn't quite as willing to bet on a $500 million company versus a $5 billion company. I think that is one of the challenges, helping those companies.

The other interesting thing about my industry is I think we benefit from the investment the U.S. Government made in telecom, the internet and those types of things. I think those investments that were made in infrastructure wind up allowing us to launch a business in a weekend. Were it not for the ability to get the internet on your phone that comes from investments made by the government and others, I don't think our ability to launch this company would exist.

I do think those kinds of investments do have a huge impact on our ability to launch technology businesses. I think those types of investments in things like genomics, research, super computers and those types of things that can speed up the healthcare and biotech sectors are crucial.

Mr. MCHENRY. Thank you for your testimony.

Today is largely focused on capital formation and regulatory impediments on capital formation but there are so many other issues we have to face. Through the testimony today, it is fascinating to hear no matter what we do to spur more capital formation, businesses still have the challenge and they can still fail. With a great idea, you can still fail.

The challenging environment today of getting consumers to actually use your product still remains or getting your product to the market, still remains, but we also need to make sure that we are in a fruitful space for that innovation to occur and the regulatory impediments that we can remove and relieve from small businesses, that we actually take that on.

We clearly have to have infrastructure, educational resources and the right investments and those constructs so that can take place. We still are the largest economy on earth, we still have wonderful opportunities and wonderful resources, even though we are going through very challenging times right now.

The fact remains that we can still get back to those good days of real and strong economic growth and job creation and get this unemployment rate down and give people choices and opportunities.

Thank you so much for testifying today in particular about capital formation and thank you for providing this committee and this Congress your insight and experience. We certainly appreciate that.

With that, the committee is adjourned.

[Whereupon, at 12:12 p.m., the subcommittee was adjourned.]

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