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SBA'S ENTREPRENEURIAL DEVELOPMENT PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTEENTH CONGRESS

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SBA'S ENTREPRENEURIAL DEVELOPMENT PROGRAMS

WEDNESDAY, OCTOBER 6, 2021

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to call, at 10:07 a.m., via Zoom, Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Golden, Crow, Davids, Mfume, Phillips, Newman, Bourdeaux, Carter, Chu, Evans, Delgado, Houlahan, Andy Kim, Craig, Luetkemeyer, Hagedorn, Williams, Meuser, Tenney, Garbarino, Young Kim, Van Duyne, Donalds, and Fitzgerald.

Chairwoman VELAZQUEZ. Good morning. I call this hearing to order.

Without objection, the Chair is authorized to declare a recess at any time.

I would like to begin by noting some important requirements. Standing House and Committee rules and practice will continue to apply during hybrid proceedings. All Members are reminded that they are expected to adhere to these standing rules including decorum.

House regulations require Members to be visible through a video connection throughout the proceeding, so please keep your cameras on. Also, remember to remain muted until you are recognized to minimize background noise. If you have to participate in another proceeding, please exit this one and log back in later.

In the event a Member encounters technical issues that prevent them from being recognized for their questioning, I will move to the next available Member of the same party and will recognize that Member at the next appropriate time slot provided they have returned to the proceeding.

For those Members and staff physically present in the Committee room today, in accordance with the attending physician's most recent guidance, all Members and staff will be required to use masks in the hearing room. Furthermore, all Members and staff who have not been fully vaccinated must also maintain 6-foot social distancing from others. With that said, Members will be allowed to briefly remove their masks if they have been recognized to speak.

Today, our nation's 30 million small businesses are the foundation of the American economy. Small firms employ nearly half of the private workforce, account for 44 percent of the economic activity, and export over $1 trillion in goods annually. It is hard to over-

state the importance of small firms to the country's economic well-being.

Recognizing the structural importance of these firms and the need for new business formation, the Small Business Administration offers a range of free or low-cost counseling and training services to entrepreneurs. SBA relies on its resource partners to deliver these services: Small Business Development Centers, Women Business Development Centers, and SCORE.

These resource partners provide invaluable training to small businesses all across America, from first-time entrepreneurs to system business owners, these resource partners offer training to help small firms succeed.

Resource partners have a profound impact on the small businesses that take advantage of their services.

A 2013 report from SBA found that small businesses that receive 3 or more hours of counseling have higher survival rates than firms that receive less counseling.

We also witnessed the power of entrepreneurial development training throughout the COVID crisis. Over the past 18 months, SBA resource partners have helped small businesses navigate unchartered territory. From shifting business models to stay afloat, to instituting health precautions to protect customers and employees, these organizations have helped small firms overcome enormous challenges.

The Office of Entrepreneurial Development (OED) at SBA oversees the programs and services that support the counseling and training needs of small businesses. It is considered SBA's technical assistance arm with the resource partners located all across the country.

OED has also been charged with implementing one of President Biden's top small business priorities, the new Community Navigator Pilot Program. The new program will increase outreach to underrepresented small businesses by partnering with trusted voices in the community. I look forward to learning more about the agency's work to get this new program up and running.

I am also looking forward to learning more about what is working and what needs to be improved with the entrepreneurial development programs. The Committee plans to reauthorize these programs in the coming months and SBA's perspective is an important part of this process.

In sum, the strength of our recovery is dependent on the well-being of small businesses. That is why SBA's entrepreneurial programs must be well-equipped to offer their services to small businesses in need.

I now yield to the Ranking Member for his opening statement, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Madam Chair. And thank you for calling this important hearing with Mr. Madrid, Associate Administrator of the SBA Office of Entrepreneurial Development.

As Members of the Committee, it is crucial that we hear directly from SBA officials on implementation and oversight of the SBA's programs. The success of our entrepreneurs determines the success of our nation's economy. Entrepreneurs are not only our nation's innovators and job creators, but they are also the key to advancing

America's economic opportunities. Unfortunately, entrepreneurs continue to be hamstrung by the Democrats who are forcing through increased government mandates, misguided entitlement programs, and reckless spending.

For months, Democrats' failed policies and unemployment incentives have paid Americans to stay home and not go back to work which has hindered economic growth for small businesses and our communities. As reported in the August NFIB's Small Business Economic Survey, they have found that 50 percent of small business owners have at least one unfilled job opening. This was a disincentive for 8.4 million Americans who were unemployed in August to stay off the job and on the sidelines while there were 10.5 million job openings across the country. This is obviously counterproductive.

Additionally, staffing shortages and supply chain disruptions are hindering business operations and limiting small businesses from reaching their full potential. The NFIB Research Center's September COVID-19 survey found that half of small business owners reported supply chain disruptions significantly impacting their business.

Main street USA continues to be left with the bill for President Biden's reckless tax and spend agenda. As inflation hits a 30-year high, it is no surprise that a recent Goldman Sachs 10,000 Small Businesses Survey found that 81 percent of small business owners say inflationary pressures have increased since June. 84 percent have seen an increase in operating costs, and 74 percent report inflationary pressures having negatively impacted their business's financial health.

As Republican leader of this Committee, I appreciate the resources and training that the SBA's Entrepreneurial Development Resource Partners continue to provide to small businesses, especially as they recover from the COVID-19 pandemic. I also look forward to learning more about these programs and how they are supporting small businesses as they navigate the previously mentioned government mandates, supply chain disruptions, labor shortages, and inflationary pressures.

However, I remain concerned that taxpayer dollars are not being used wisely after several Office of Inspector General reports found that SBA did not provide effective oversight of both the SCORE and Women's Business Center programs. I am also concerned that the Community Navigator Pilot Program is duplicative of current resources. This program was signed into law in March, yet not a single grant has been awarded and no services have been deployed to assist small businesses to date. Instead of creating a new program with new providers, I believe that resources would have been better spent ramping up Small Business Development Centers and existing resource partners. This should be thoroughly examined.

Beyond the SBA resources, numerous private sector partners, including nonprofit organizations and companies, exist to advocate for entrepreneurs, provide mentorship, increase awareness of financial opportunities, and offer support to innovators as they stand and expand their businesses. The SBA programs must be examined closely to ensure that duplication does not occur and that waste, fraud, and abuse is prevented.

Mr. Madrid, I thank you for being here today. I look forward to working together on effective, economical, and efficient policies to support entrepreneurs.

And with that, Madam Chair, I yield back.

Chairwoman VELAZQUEZ. Thank you, Mr. Luetkemeyer. The gentleman yields back.

I would like to take a moment to explain how this hearing will proceed. Our witness will have 5 minutes to provide a statement and each Committee Member will have 5 minutes for questions. Please ensure that your microphone is on when you begin speaking and that you return to mute when finished.

With that, I would like to introduce our witness. Our witness today is Mr. Mark Madrid, Associate Administrator for the Small Business Administration's Office of Entrepreneurial Development. Mr. Madrid is charged with leading the administration's technical assistance arm of the Small Business Administration. Before joining the SBA, Mr. Madrid served as the CEO of the Latino Business Action Network at Stanford University. In 2019, the Silicon Valley Business Journal named him the Silicon Valley Non-profit CEO of the Year. In addition, he is an honorary colonel of the U.S. Army and a Jefferson Award recipient which recognizes individuals and organizations for excellence in service at a national or international scale. Quite an impressive resume.

Thank you for joining us today, Mr. Madrid, and you are recognized for 5 minutes.

STATEMENT OF MARK MADRID, ASSOCIATE ADMINISTRATOR, OFFICE OF ENTREPRENEURIAL DEVELOPMENT, UNITED STATES SMALL BUSINESS ADMINISTRATION

Mr. MADRID. Good morning, Chairwoman Velázquez, Ranking Member Luetkemeyer, and distinguished Members of the Committee. Thank you for the invitation, and I am energized to discuss SBA's Office of Entrepreneurial Development. Our mission is to help small businesses start, grow, and compete in global markets by providing quality training, counseling, and access to resources. OED is SBA's technical assistance arm.

Throughout my career, nothing has been more purposeful than truly empathizing with and supporting small business owners. I am a product of entrepreneurship.

Like many of our U.S. small business owners, my dad was unrelenting in changing the course of our family's destiny as he built a welding business in the Texas panhandle. We are proud of my dad for his evolution from the cotton fields to being his own boss. Mi Papa, my dad, died of COVID-19 and we almost lost my mom. We are thankful to God that my mom survived. So I consider supporting small businesses like my dad's the honor of a lifetime and I have a proven track record of doing so.

At OED, we oversee SBA's network of resources partners, including Small Business Development Centers, Women's Business Centers, and SCORE. Additionally, our Office of Entrepreneurship Education (OEE) spearheads our Electronic Learning Initiative and the Community Navigator Pilot. Over the last 9 months, we have made great strides in fighting the pandemic and recovering our economy, achieving historic job growth for a new administration.

However, we still have a long way to go, which is why President Biden announced the COVID-19 Action Plan, a comprehensive national strategy to fight COVID-19 and to protect our economic recovery. At the SBA, we are honored to support these efforts, making critical improvements to the COVID Economic Injury Disaster Loan, streamlining forgiveness of small Paycheck Protection Program funding of $150,000 or below, and launching the Community Navigator Pilot.

Enacted by the American Rescue Plan Act of 2021, Navigator's goal is to strengthen outreach to our nation's smallest businesses, both in rural and urban America, particularly those owned by women, veterans, and socially or economically disadvantaged individuals. This program will advance our reach of SBA services and access to federal, state, and local resources by leveraging a national network of hyper-local community navigators who, in the words of Administrator Guzman, are "on the ground truly connecting, empathizing, and tailoring solutions for our small businesses."

The Community Navigator Pilot is a $100 million competitive grant funding opportunity. Alongside our Office of General Counsel, our office is currently reviewing proposals and we look forward to announcing the grant recipients this month.

Our combined efforts are more critical now given the urgent state of recovery of our U.S. small businesses. Thus, in addition, Navigator's OED is laser focused on supporting our Resource Partners. Supported by our Office of Small Business Development Centers, we are proud of our network of SBDCs for their tireless work throughout the pandemic, including utilization of CARES Act funding to increase support of our small businesses over this past year and a half. Between April and December 2020, SBDCs were able to use CARES Act funding to support 592,000 small businesses.

Supported by our Office of Women's Business Ownership (OWBO), our 138 Women's Business Centers support female entrepreneurs through training, technical assistance, and providing access to capital, credit, and federal contracting opportunities. These hyper-local centers are more important than ever as women business owners have been disproportionately impacted by the pandemic. We are proud that OWBO has launched 24 new WBCs this year, including two in Puerto Rico and Tulsa.

Supported by our Office of Entrepreneurship Education and SCORE, our nation's largest network of volunteer business mentors, with over 250 local chapters and over 10,000 mentors nationwide, provide personalized mentorship to entrepreneurs across all 50 states and Puerto Rico. During the pandemic, the application of mentorship became increasingly critical and SCORE made it accessible through the creation of an online resilience HUB.

I close by stating OED priority to execute strong controls to ensure our programs have robust management and oversight. To underscore this commitment, we have introduced a next generation reporting system to monitor performance and accountability. This is a very difficult time for America's small businesses, and yet, they continue to embody that grit and resilience and hope. And we look forward, alongside your efforts, to support them every step of the way.

Thank you for this invitation. I am honored to be here and I look forward to your questions. Thank you.

Chairwoman VELAZQUEZ. Thank you, Mr. Madrid. My condolences to you and your family.

I will begin by recognizing myself for 5 minutes.

SBA has been relying on an outdated legacy system, EDMIS, to collect data on counseling and training programs. I understand that SBA developed a performance reporting system to replace EDMIS. To what extent has SBA implemented the system and how has it increased operational reliability performance?

Mr. MADRID. Thank you, Chairwoman, for that question. We are definitely leaning in to Administrator Guzman on Technology Forward and that also applies to what you are referring to in terms of we have had a migration from an EDMIS Legacy system to EDMIS Next Generation which will increase our reporting capabilities, efficiency, allow for real-time reporting of data and data acquisition which will also increase our efficiency of human capital. With the Community Navigator Pilot, we will have graduated to a new system altogether that will increase these capabilities even further.

Chairwoman VELAZQUEZ. Are all resource partners reporting performance data in the system to date?

Mr. MADRID. That is right. Thank you, Congresswoman. In fact, with the EDMIS Next General reporting system as of May there was a 100 percent deployment across all resource partners—the SBDCs, WBCs, and SCORE.

Chairwoman VELAZQUEZ. Thank you.

In a recent hearing, we heard concerns from resource partners about delays in notices of awards and grant reimbursement. I have since learned that OED worked hard to address outstanding reimbursement. Why did the backlog occur and what can be done to prevent it from happening again?

Mr. MADRID. Thank you, Chairwoman.

First and foremost, that is absolutely on target. We are committed to getting those timely reimbursements in place. There was a little bit of a delay with the initial funding to disburse. Having said that, we also experienced some delays frankly with the supply of demands that were in the system with the pandemic but now with graduation to our EDMIS NG system, we have also created efficiencies within the teamwork. We have opened lines of communication. Those delays have been mitigated.

Chairwoman VELAZQUEZ. Okay. Are you telling me that OED needs additional support from the Committee to ensure funding is disbursed on time or not?

Mr. MADRID. Well, thank you for that statement. We definitely appreciate your support. You know, we are leveraging our resources as Administrator Guzman has commissioned us to do. So your ongoing support is appreciated. We have established new efficiencies. We have opened lines of communication. And so thank you for your ongoing support. It is very, very helpful to us and we are reaping the rewards from it. Thank you.

Chairwoman VELAZQUEZ. Thank you.

Let's talk about the Community Navigator Pilot Program. It is projected to begin disbursing grant awards in the coming weeks.

Can you please tell us or give us an update on where SBA is in the grantee selection and funding disbursement?

Mr. MADRID. Thank you, Chairwoman.

We are energized that the grantees will be awarded this month, in October. We are in the third leg of our review process that spans 6 to 7 weeks. It was diligent, and as a frame of reference, we were anticipating 200 to 250 proposals. We received over 650. That was a product of our message getting out, making sure that we increased our outreach plan to all communities. So we are excited that we are in the third leg of this review process, which is a business management review, alongside our Office of General Counsel. And we will be announcing the grantees later this month in October.

Chairwoman VELÁZQUEZ. Can you please explain how the Community Navigator Pilot Program will work with SBA's resource partners to provide counseling and training?

Mr. MADRID. Absolutely. The Community Navigator Pilot is a hyper-local approach which is deploying community navigators that know their local territories, their audiences, and most importantly, the small business owners that truly connect with them in culturally relevant ways. And so through these community navigators and this national network, including the resource partners and any organizations supporting small businesses, we have to support our small businesses during recovery. The bottom line is, as reported by our Office of Advocacy in the first quarter of 2020, Black-owned businesses declined 41 percent, Hispanic declined 32 percent, Asian American declined 26 percent, and Women business owners, active business owners, declined 25 percent. So it is going to take this consolidated effort, which is a coalition-building endeavor, and we are committed to it.

Chairwoman VELÁZQUEZ. Thank you. Thank you very much. My time has expired.

Now we recognize the Ranking Member, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chair.

Mr. Madrid, on May 4, 2021, the OIG released an audit of SBA's oversight of the Women's Business Center program and found that SBA did not provide effective oversight of the program. Specifically, the SBA did not detect that WBCs had failed to remedy accounting deficiencies identified during the mandated financial reviews. They did not detect anything that the WBCs made improper budget transfers. They did not detect that they had used federal funds for unallowable costs. They did not detect reported unsupported matching funds and program income earned. And they also failed to submit accurate financial reports. Even more concerning, SBA program officials detected significant noncompliance that warranted removal of two WBCs from the program but did not take action.

So the question, I guess, is how far along is SBA in resolving OIG's 10 recommendations? And have any of these WBCs been closed in the last few weeks here?

Mr. MADRID. Thank you, Ranking Member, for your question.

The Office of Women's Business Ownership is active in resolving the recommendations from the IG. And so I can go over some of

those with you now. Recommendation, there is one that has been closed. There is one that is in negotiation in terms of our Office of Women's Business Ownership is finalizing discussions and receiving feedback from the OIG itself. Three recommendations have final closeout dates of September 24, 2024 as they have financial obligations on the part of WBCs that need to be regrouped and reconciled if possible. So OIG has agreed to a date of September 24, 2024 for final action. And five recommendations have final target dates associated with them for the end of this year, calendar year 2021, and these five recommendations overall relate to oversight, compliance, and monitoring of the WBC program with specific concerns regarding finance examination. On this front——

Mr. LUETKEMEYER. Thank you for that. But one of my concerns is that, number one, we knew that at least two of these programs had problems to the extent that they should have been closed and were not. So I guess my question to you on that is, why not? What kind of action have you taken since then to rectify the situations? Number two, even though you say that these recommendations were implemented, the IG report on a couple different occasions on different programs have said that the employees do not implement the rules. They do not follow the rules. Even though the recommendations are put in place, the employees still do not follow them. So what have you done to make sure that there is a follow up on this to make sure that the employees actually follow through on the recommendations? Because obviously, there is no action been taken on the two that should have been closed, which tells me that somebody is asleep at the switch. And if that is going to happen, then who is going to actually push people to actually do the job because nobody is pushing people to do the job to begin with on these two that we have shown do not work?

Mr. MADRID. Thank you, Ranking Member. I would like to report that three WBCs have indeed been closed.

Mr. LUETKEMEYER. Good.

Mr. MADRID. So that is on the one front in terms of action.

On the second, there is an important, let's say, advancement that has occurred here at the Office of Entrepreneurial Development, is that there is a strong relationship between the office itself and all the offices of the department, including the Office of SBDCs, the Office of Women's Business Ownership, and our Office of Entrepreneurship Education. So there are open lines of communication. And another action that has occurred in this administration, this leadership, is we have a tracker for all OIG and GAO audits. So we meet on those frequently and I concur with the head of Office of Women's Business Ownership every week. So I hope——

Mr. LUETKEMEYER. I support that. I support the Women's Business Centers. Do not get the wrong impression here. But by the same token, my job is to provide the oversight of all of the programs, to make sure they are working properly. And if they are not, number one, they are hurting the integrity of the program and they are wasting taxpayer dollars. And if they are found to do that, which you say they have now closed three, that is great. We need to correct those things and fix them quickly.

And another thing is, again, I urge you to continue to follow up to make sure that the personnel follow up and adhere to the rec-

ommendations of the IG once they are implemented because what is very concerning to me is that the report on a couple of other issues here, EIDL program in particular, the employees were ignoring the IG report and the recommendations that are set out. And so they really do not do any good, even though they are in place, they are still not doing any good because if they are not being implemented and followed, we are still back to the same place doing business the same way we always did. And so I would urge you to look into that. And I am sure my time is about up.

And with that, Madam Chair, I yield back.

Chairwoman VELAZQUEZ. The gentleman's time has expired.

Now we recognize Mr. Golden, the gentleman from Maine.

Let me just say that, yes, Mr. Luetkemeyer, we all care about protecting the program from fraud and abuse and taking corrective steps. Many of those points that have been raised by the IG occurred under the Trump administration. So far, this administration has a track record on addressing those issues. With that, let me recognize Mr. Golden.

Mr. LUETKEMEYER. Let me just respond to that, Madam Chair. I appreciate that and I acknowledge that some of this was done under the previous administration. It does not make it right. It still needs to be cleaned up. And I think——

Chairwoman VELAZQUEZ. But they are. They are, sir.

Mr. LUETKEMEYER. My concern though is that the IG report also showed that the employees of SBA, the staff, was not following up and adhering to the recommendations. That is the point I am trying to make. We have got to make sure that if the recommendations are put in place that they are followed. The IG is trying to do their job but if these recommendations are not followed, they are worthless. We have accomplished nothing. So that is my point. Thank you.

Chairwoman VELÁZQUEZ. Mr. Golden, you are recognized for 5 minutes.

Mr. Golden, you are muted.

Ms. Davids, you are recognized for 5 minutes, the gentlelady from Kansas.

You are muted.

Ms. DAVIDS. Sorry. Thank you. Good morning.

I did not realize that Mr. Golden would be unavailable. Okay, well, thank you so much. I appreciate, Chairwoman, you holding this hearing.

SBA's Entrepreneurial Development programs have been critical resources for small businesses, for small business owners and entrepreneurs from before and during this pandemic. And our ED partners, our Entrepreneurial Development partners have gone above and beyond to provide small businesses across the country with information, with assistance during this unprecedented public health and economic crisis. In fact, the Kansas City Women's Business Center, which is based in and serves not just—it is based in the Third District here in Kansas but it also serves a pretty wide area here. And they helped over 600 clients last year. And helping small business owners adjust to things like COVID safe workplaces and navigating the various relief programs that we have heard a little bit about this morning, it is part of the reason that last Con-

gress the Women's Business Center here helped me see that the Women's Business Centers Improvement Act was necessary. Reauthorizing the WBC program, increasing funding levels, increasing the cap on individual center grants is an important priority for me.

A few months ago, the Subcommittee on Economic Growth, Tax, and Capital Access held a hearing focused on women's entrepreneurship where we discussed the importance of WBC programs for entrepreneurs.

So Mr. Madrid, I was hoping to hear from you about how the passage of a similar bill this Congress could expand the WBC program and frankly, expand opportunities for female entrepreneurs.

Mr. MADRID. Thank you, Congresswoman, for that question.

Women's entrepreneurship continues to be the fastest growing segment in the U.S. They are contributing to the economy. They are job creators. We all know that. We all know women business owners. Thank you for that reflection about the Women's Business Center in Kansas City.

It is important to note that the Women's Business Centers have risen up to meet the occasion of the pandemic. I can tell you that the network overall had almost $10,000 capital infusions. On the ground, I have been on the road in Fort Dodge Iowa, I have been on the ground in Milwaukie and Brooklyn and Nevada, that women business owners were just instrumental in pandemic resourcing and they are instrumental as we digitize. So the Women's Business Centers have been absolutely critical during the pandemic. They continue to be critical for recovery. And when you have that stat to reflect upon that in the first quarter of 2020, businesses owned by women declined by 25 percent, you know, in our minds, one business closing is one too many. And so we are going to continue on the effort to increase the scope of the WBCs.

Ms. DAVIDS. Thank you for that. And I would just close, and I will not take up the entire time, I just thank you for the work that you all are doing over at SBA. It has been a long year and a half and there has been a lot of pressure put on frankly everybody during the pandemic. And I appreciate your efforts to continue to work on those OIG issues that have been brought up and also to just continue supporting our small business owners. We will talk to you soon, hopefully. Thank you so much.

Madam Chair, I yield back.

Chairwoman VELAZQUEZ. The gentlelady yields back.

Now, we recognize the gentleman from Texas, Mr. Williams, for 5 minutes.

Mr. WILLIAMS. Thank you, Madam Chair. And thank you, Chairman, for being with us today.

I am an entrepreneur. I have been in business and still am 51 years. This is my 51st year in business. I employ hundreds of people and it is challenging right now. And as you are aware, small businesses across the country continue to face financial uncertainty as we reemerge from the COVID-19 pandemic. Unfortunately, we have not seen the necessary speed from the SBA that main street America deserves after Congress has passed billions of dollars in aid over the past year.

Now, as a prime example is the Shuttered Venue Operator Grants program which I basically wrote which left music venues

and movie theaters waiting for over 7 months until money was disbursed and thousands of businesses did not survive the delays that were caused by that. Now, I am concerned that the implementation that you talked somewhat about this morning of the Community Navigators Program is headed in a similar direction and this program has been in the works since April of 2021 and still have not seen any money from the SBA about the selection process. And I just need to remind you, Small Business, unlike government employees, where government employees have salaries and guarantees, small business owners, they are out every morning trying to sell something. They are on commission. They need to bill. They cannot have these delays. So we need to do better with that.

And you talk about how you support small business. Well, how can you support small business when you support raising taxes and raising regulations to small businesses? Can you answer me that?

Mr. MADRID. Thank you, Congressman, and the perspective of that you bring as a business owner. Thank you very much.

In terms of SVOG, the Shuttered Venue Operators Grant, we have issued decision on 97 percent of all initial 17,644 applications. And $11 billion in grants have been awarded, $9.7 billion disbursed.

In terms of your question on the Navigator Pilot and the timing, just as a frame of reference, there was a hyper-local interest in terms of the local institutions that wanted to be a part of this process and apply. We had to extend the deadline for proposals that we pushed forth the end of July and when we had 656 proposals come in relative to the 200 to 250 that we were anticipating, we had to make sure and instill a diligent oversight process and review process. So we look forward to announcing those this week.

In terms of the tax question under the Build Back Better plan, it is important for small businesses to know that no one earning under $400,000 incur or experience a tax increase. And so I just wanted to make sure and address your points.

Mr. WILLIAMS. I know that is what you all say but that is not true. But we will move on.

The SBA has also shown an inability to track taxpayer dollars in implementing some of these programs. With the EIDL program alone, there has been an estimated $1.1 billion in potential fraud. Since the Community Navigators program was allocated $100 million, we must ensure that we do not repeat the mistakes of the past and take the appropriate measures to prevent the waste of taxpayers' dollars.

So Mr. Madrid, can you talk about the measures that the SBA has taken to detect fraud with the Community Navigators program?

Mr. MADRID. Absolutely. Thank you, Congressman.

We are ensuring oversight in compliance is top of mind. We are complying with quarterly reporting that will occur at the grantee level, so that is going to be one way that we enforce compliance and oversight. The technology that also is being deployed will increase our accuracy and ensure our accuracy. It is real-time, so that is one area that we will keep our eyes on very, very diligently. As well, we are collaborating with our Office of Field Operations when it comes to the spokes on the ground level. And so all that said, we

have our mind to mitigate fraud, waste, and abuse, and also being compliant to 2 CFR regulations. And also increasing our open line of communications through our GAO and IG tracker that also includes internal controls. And that will definitely apply with the Community Navigator Pilot immediately as it is launched. So thank you for your question.

Mr. WILLIAMS. In the time that I have got left. Rural communities. I have a rural district that face unique challenges while recovering from the pandemic. So can you elaborate on how the SBA is ensuring rural businesses have access to these programs and are made aware, which is important, of the assistance that is available?

Mr. MADRID. Thank you, Congresswoman—Congressman.

Mr. WILLIAMS. Now you are calling me Congresswoman.

Mr. MADRID. No, Congressman.

Mr. WILLIAMS. Because of my hairdo?

Mr. MADRID. We have our Office of Rural Affairs and that is being handled at our Office of Field Operations. Thank you for your question on rural entrepreneurs.

Mr. WILLIAMS. Okay. Thank you very much. And just in supporting small business, when you cut taxes it helps small business. When you raise taxes, it really hurts small business. I yield back.

Chairwoman VELÁZQUEZ. The gentleman's time has expired.

Now we recognize the gentleman from Maryland, Mr. Mfume, for 5 minutes.

Mr. MFUME. Thank you very much, Madam Chair. I want to thank you and the Ranking Member for scheduling this hearing. And thank the representatives here who have given written and oral testimony.

The gentleman before me raised the issue of potential possible fraud and abuse of the Navigators program. I want to just stay on that program for a second and ask you, sir, if you would take a moment to talk about expressly the goals as stated of that particular program. And then as juxtaposition give us on this Committee some sense as to where you are meeting those goals.

Mr. MADRID. Thank you, Congressman, for the question on the Community Navigator Pilot.

The bottom line is small businesses, the smallest of the small were left behind of pandemic resources. And some have historically been left behind. So our goal is to bridge that gap with the Community Navigator Pilot. And that is deploying community navigators that are culturally competent in terms of understanding their terrain. I say let's fight a ground war, not an air war meaning that you are in touch with the ground. That you know exactly what their small businesses are facing and that is including, of course, in rural America. And so this effort here is a chance to build coalitions and in order to bridge that gap. In prior positions that I have held supporting small businesses we used to say get to know the bank before you need the money. In this instance it is get to know the SBA before you need the SBA. Also, the Community Navigator Pilot is ensuring access to federal, state, and local resources.

And what I would say as well is those that have not experienced SBA for whatever reason including during the pandemic, we want to introduce these small businesses to the SBA so they keep coming

back, not only in the present and the future. And that is in line with Administrator Guzman in terms of saying we have to to build the customer-first environment, technology forward, and advancing equity. That is exactly the goals that we will achieve with the Community Navigator Pilot. And that includes geographical diversity in terms of service commitment. So thank you for your question.

Mr. MFUME. Well, how long has the program been operational? Not conceptually but operational?

Mr. MADRID. Great question. Thank you very much for asking it.

We will announce our grantees later this month in October and then it starts a 2-year period of performance.

Mr. MFUME. And has SBA developed a matrix to be able to measure? I agree with you on the issue of cultural competency, but have you developed a matrix to be able to see where you actually are in terms of success or lack of success? And what has been the feedback back into the SBA from those businesses that you are working with specifically?

Mr. MADRID. That is a great question. I can tell you that I have been on the ground in rural America and Iowa and also talking to tribal-owned businesses and Native American businesses in Nevada. I also had the experience of talking to women entrepreneurs in Brooklyn. And so I have talked to businesses that were eligible and applied and received our pandemic resources, one or the other or combined. I also talked to business owners who had not. And I said, what would it take, what would it have taken for you to be more engaged with us? Give us your feedback. And overall, it was lack of navigation, that they had more questions. They did not understand a process. They needed help with the paperwork. They did not have a scanner. They needed some tax codes in order for document preparation. They needed translation services. So all these issues here on the ground is what we are trying to resolve with the pilot.

Mr. MFUME. And let me just ask if I might in the time that I have left, first, an observation. Racial minorities primarily, ethnic minorities secondarily, tend to be underrepresented in small businesses and small business programs. Can you tell me just what sort of efforts the SBA has in place to provide counseling, training assistance to those businesses who are doing everything they could do but in oftentimes find themselves lacking, or excuse me, not lacking but up against procedures and policies that make their job more difficult? So whether it is capital standards or bonding requirements or anything else?

Mr. MADRID. Thank you, Congressman.

We are definitely leaning in to Administrator Guzman. She says, let's bring silos amongst the units of the SBA so we are working together. The OED, the Office of Entrepreneurial Development is working with our government contracting and business development unit. We are working with OFO in our district offices. We are working with OII, Investment and Innovation on innovative startups. So all that said is advancing equity is definitely central and all our units working independently and collectively.

Mr. MFUME. Well, my time has expired but I am assuming you have done that with that or are doing it with the Women's Busi-

ness Centers as well, and hopefully, we will get a chance to follow up in a future hearing. But I may very well have some questions directly to you following this.

I want to thank you. I want to thank the Chairman, and I yield back any time I may have.

Chairwoman VELÁZQUEZ. The gentleman yields back. Now we recognize the gentleman from Minnesota, Mr. Hagedorn, for 5 minutes.

Mr. HAGEDORN. Thank you, Madam Chair. I appreciate you holding the hearing. Administrator, it is good to see you today.

I want to focus a little bit on the administration's executive orders on vaccinations and how it applies first to the SBA. The SBA has many, of course, these small business development centers across the country. In the state of Minnesota, five of them are located in universities, different university systems in our state. And if the administration comes along and says people have to be vaccinated that are covered contractors and yet they work in a university system that may have different rules, how do you square that, Administrator? What are they supposed to do?

Mr. MADRID. Thank you, Congressman.

As we continue to navigate COVID-19, the administrator has made safety and security top of mind.

Mr. HAGEDORN. I do not need the lecture on that. What are they supposed to do? What are the rules?

Mr. MADRID. Well, we are working directly with the Office of OPM, frankly, and leaning into their advice and counsel. I can take this back and we would be happy to answer any follow-up questions.

Mr. HAGEDORN. That is fine. That is fine, but I think a lot of your people have asked you over the last many weeks what are the rules and you have not even discussed it with them. You have given the no guidance. And so, again, it looks like you have a policy that you are just dumping out and then you will try to figure it out later. That does not make a lot of sense.

Let's move on to the one that President Biden has to force every company over 100 employees to have their employees vaccinated. First of all, we are in a situation in American where virtually, every business, every entity is looking for work. And the idea that we are going to go out of our way to fire people at this point in time does not make a lot of sense with 10 million or so open jobs and 8 million people still unemployed. Why the heck would we want to do that, particularly when according to the science that I have seen, whether you have a vaccination or not, you can still get COVID and you can still transmit COVID. The vaccination does not stop you from getting it. It just makes hopefully the end result much better because it reacts and helps you get through it hopefully without death. So it seems like what has happened is the president came out and said there is going to be this rule under OSHA and then since then he has gotten on the phone with American Airlines and a bunch of other companies and used the pressure of the federal government in order to get those entities to implement his policy so it looks like everybody likes what he is doing even though, of course, the federal government has a lot of oversight over these companies and sometimes can deliver money or

not deliver money. And yet, who knows when this is coming out? Who knows what the details would be? But I do not understand where the administration is coming on this. Why is the president and others so intent to get people fired and to push this issue when it looks like the science is anybody can get COVID and anybody can spread it whether you are vaccinated or not. Someone has got to answer that question for me.

But if you could, since we are talking about small business, and if you want to help small businesses, please deliver this message to the administration. We have 80 people in Caledonia, Minnesota, who are going to lose their jobs. Eighty good manufacturing jobs down there because Rawlings Company and Major League Baseball decided that they want to shut down that plant and move the vast majority of those jobs to Communist China. Now, the people at that plant, what they do is they make batting helmets for the Major League baseball players and they make composite softball bats. And the president of the United States, he has been out there again. He has been calling all these companies, trying to get them to implement his policy which is going to leave the people being fired and less workforce in America. Here is an opportunity for the administration to pick up the phone and call the commissioner of baseball and say, look, let's not be shipping our jobs to China. Let's keep our manufacturing jobs in the United States. And so I hope you will deliver that message to the administration that they can help save a small business and save jobs and it is very important to the community that I represent down in Southeast Minnesota.

Lastly, the last thing you can take back to the administration is they have it exactly backwards. Instead of trying to regulate everything and every business and every person to go get a shot or not get a shot or whatever, we should have a liability shield for businesses, for educational entities, and of course, medical care providers. So if people cannot just have a bunch of lawsuits and then maybe these entities will not have to worry so much about whether or not everybody that works for them has the shot. Again, I am vaccinated. I think these decisions should be made between doctors and patients, not with the federal government, politicians, or bureaucrats leading the way, and certainly not the heavy hand of the federal government.

With that, I will yield back. Thank you.

Chairwoman VELAZQUEZ. The gentleman yields back.

Now we recognize the gentleman from Minnesota, Mr. Phillips, for 5 minutes.

Mr. PHILLIPS. Thank you, Madam Chair. Greetings, Mr. Madrid and colleagues.

In my past life as an entrepreneur, I engaged with a SCORE mentor who shared memorable and really impactful counsel with me that I have employed ever since in my business career. So I really know firsthand how impactful these programs can be, particularly for those who lack the experience or the mentorship networks, particularly the access to capital that one needs to succeed as an entrepreneur. And I also believe deeply that business can and should be a means to an end, the end not being how much an owner can accrue in success; rather, how much that owner can share with those who made it possible. And I really believe strong-

ly that building this kind of stakeholder capitalism into business models is best done at early stages.

Earlier in another hearing, Mr. Rowe mentioned succession planning and transitioning businesses to employee-owned models as an example of how SBDCs can engage in this work. So could you explain how OEP can maybe play a role in helping inspire more employee ownership at early stages of companies as they are seeking counsel to establish themselves.

Mr. MADRID. Thank you, Congressman, on a very important topic in terms of let's talk about ESOPs, for instance. We are delighted that the SBDC network in pockets of the county has introduced webinars that approach this topic. In fact, there was an ultimate linkage that occurred at OED and connecting the dots is very, very important to us. And I will talk about SCORE here in a moment. But literally, I was talking to an 8(a) certified firm that is a Native American business and I was talking to the two sisters that opened the company Sister Sky that has been in operation for 20 years. And one of the sisters had her two daughters there. And she said these two daughters are going to take over this family business. I was able to then connect that with the ESOP training happening with the SBDC. So that is critical. As well, you mentioned mentorship. I have very diligent experience and the last experience where I led a nonprofit focusing on the largest cluster of scale Latinx firms in U.S. history is mentorship was the secret sauce of what SCORE has offered during the pandemic and their persistence through an online resilience HUB has been beneficial. As well, the WBCs are also having trainings throughout on succession planning. So I think we have our bases covered on a very important topic.

Mr. PHILLIPS. I appreciate that. And a note to my colleagues. I think Democrats and Republicans can agree that capitalism works best when we have more ownership, not less, and if we can bake some of these principles into early-stage businesses with incentives and counsel and mentorship, I think we are all better off for it.

My second question, Mr. Madrid, is relative to the CARES Act. Of course, it provided $25 million for SBDC and WBC associations to create a centralized platform if you will for COVID-19 resources and backend and training platforms for counselors. With funding for those programs set to expire in April, forthcoming in 2020, how do you categorize the success of that platform? And what were the metrics for success? And how would OED like to see the platform pivot perhaps to a post pandemic use?

Mr. MADRID. Thank you for that question, Congressman. The Resource Partner Training Portal is definitely a coalition-building endeavor, so we thank America's SBDC and the Association of Women's Business Center for stewarding that particular platform. The best way to talk about the platform and its success and potential for the future is that most recently when we rolled out EIDL enhancements through the Office of Capital Access, we partnered with the Resource Partner Training Portal and there was an appetite frankly for that from the business advisors across the resource partners, including SCORE and the VBOCs, the Veteran Business Outreach Centers. We had a record attendance that was navigated

through America's SBDC and the Association of Women's Business Centers. And so those are the type of metrics that we want to capture. They have captured, of course, attendance, and so we just need to keep pushing the metrics further. I was encouraged. I was encouraged by the couple of events that we have held together and more on the way if it continues.

Mr. PHILLIPS. I appreciate it, sir. With that, I yield back, Madam Chair. Thank you.

Chairwoman VELAZQUEZ. The gentleman yields back. Now, we recognize the gentleman from Pennsylvania, Mr. Meuser, for 5 minutes.

Mr. MEUSER. Thank you very much, Madam Chairwoman. And I thank the Ranking Member and my colleagues. And Administrator Madrid, good to see you.

Yes, I think the Small Business Development Centers have been important throughout my district in Pennsylvania. In fact, I have gotten to know a few. They certainly help facilitate the PPP loans and they seem very excited and driven to assist and create outreach, so that is good. And I think that should continue. Many of them are involved with schools where the centers are within my district and it is a very positive thing.

The OIG report, that oversight has got to be taken very seriously. I hear what the Chairwoman said, that it happened very much in the previous administration. Fine. But we are just finding out about it for the most part now. And we are really not hearing it being taken completely seriously. We have met with the Inspector General and he is a great individual. I really appreciate him. But it has got to be taken seriously.

My next question, Administrator Madrid, was intended to be what are your needs to do your job better for our businesses. But first, I think it is very important that you have a real good understanding of the needs of small business. And I say this because even when we met with Administrator Guzman, I asked her about taxes and her response was, "Hmm, we do not get into taxes. We leave that for another department." And that is not an advocate of small business that does not understand the taxes. And what you said a little while ago about under 400K is not accurate. Okay. But first off, there is a tremendous amount of uncertainty that exists with my small businesses throughout Pennsylvania, throughout the great Commonwealth of Pennsylvania. Tax is just one of the issues. Inflation. All right? All this monstrous spending that we want to even trickle down on moving forward. Inflation is a big problem for small business. Workforce availability, big problem. Supply chains, that is other matters are getting into effect there. The energy costs. Okay. That is a direct result of much of what is going on with the Biden administration. If the reconciliation passes, utility costs are going up. That affects everyone. Natural gas. You all want to tax natural gas. More than half our small businesses get their energy from natural gas. And homes. Thousands and thousands of home costs are going to go up. So to say it is under 400K.

And then I am going to just give you a little bit of math here. All right? A typical business with 40 to 50 employees that does revenues of about $12 million has a net income of about 8 percent, which is about a million dollars. If you reduce the 400,000 level,

because you are looking to reduce in reconciliation, in the bill, the 20 percent small business deduction. Okay, 20 percent of 600K, the difference between $1 million and 400K is 600. You take that 20 percent, that is $120,000. At the new rate of 40 percent, that is about $50,000. That small business owner is probably paying himself $150,00, $180,000, maybe $220,000 for him and his family of four. So not only will he have to pay $50,000 more in taxes, he will probably let somebody go. That is what will probably happen. He will try to do more with less and maybe invest in automation, but you are also removing some of the cap gains or deductions. Not to mention the capital gains increase. How does that not affect anybody who makes $50,000 or more that looks to sell a stock because their child is going to college? So to say it is not under 400K is a complete inaccurate thing to say.

Stating that, I will now go back, because we need you all to advocate for small business like your life depends upon it because the small businesses' lives do depend upon it. Okay, every day I hear from them.

Now, I will go back. How can we help your department serve and advocate for small businesses?

Mr. MADRID. Congressman, I would be happy and energized to answer questions related to our programming and our purview in terms of business counseling and training and education and so we appreciate your support with those tenets of OED.

Mr. MEUSER. All right. Thank you.

Madam Chair, I yield back.

Chairwoman VELAZQUEZ. The gentleman yields back.

Now we recognize the gentlelady from Georgia, Ms. Bourdeaux.

Ms. BOURDEAUX. Thank you, Chairwoman Velázquez and Ranking Member Luetkemeyer, for holding today's hearing. And thank you to Associate Administrator Madrid for joining us today and your employment work with the SBA.

The local SBDCs in my district have been extremely helpful resources as my office ahs helped small businesses navigate the effects of the pandemic. I represent a rapidly growing company in Gwinnett County where our population has grown by 20 percent between 2010 and 2020. And much of this growth has come among immigrant and first generation American communities moving into our district. These are demographics that we know start businesses at higher rates than the rest of the population. This means that our SBDCs are serving a larger and more diverse population of small business owners with the smaller allocation which accompanied our previous census results.

So my question is, it is very important to me and to small business owners that these new census numbers ensure that we get federal resources and get them to where they are most needed. So I was curious. Now that we have entered fiscal year 2022, albeit on a continuing resolution, when can SBA's resource partners in and around my district expect to see the implementation of the new funding allocations based on the results of the 2020 census?

Mr. MADRID. Thank you, Congresswoman. Thank you for your work in your area and experiencing that rise.

I can attest to the fact that our Office of SBDC leadership has taken a look at the census. In fact, they reported to me most re-

cently that that is happening and occurring. There is an open line of communication with the SBDC network on that so we look forward to adjusting those measures accordingly. And thank you for your efforts and your statements related to immigrant-owned businesses, which they declined over 36 percent according to our Office of Advocacy data for the first quarter of 2020. So as well, through our Resource Partner Network, we have an inclusivity for all challenge that has been launched through that network. It started in Northern California, and my first visit here officially at SBA was in Fort Dodge, Iowa, where the Iowa SBDC invited me to be a part of their launch of their Inclusivity for All Challenge. And that has extended itself thanks to the SBC Network nationwide. So I hope all that together that we are looking at making sure that the applicable census figures do apply to allocations. Thank you for your question.

Ms. BOURDEAUX. Great. Thank you so much. And inclusivity and those kinds of initiatives we look forward to seeing that in my community. We just have a lot of very, very diverse communities, very entrepreneurial, and I want to make sure that they are getting resources.

One of the other challenges we faced is making sure that these very diverse communities are aware of the existence of the SBDCs, the WBDCs, SCORE, the VBOCs, so I also wanted to know what you are doing to promote awareness of these very important resources across diverse communities, communities where English may be a second language?

Mr. MADRID. Thank you for that question.

Inclusivity in diversity and outreach is definitely central with Administrator Guzman's leadership across the agency, across units, and definitely here at the Office of Entrepreneurial development. We have made measures to make more culturally linguistic options available, including pandemic resourcing. We did the same when we were rolling out the process of the Community Navigator Pilot. We messaged the opportunity to minority chambers, regional economic development organizations, to mayors, to states, to tribes. It was a very successful endeavor in terms of building our ground game. And I come back to having experience on the ground, fighting a ground war, not an air war, meaning that you are connected to the ground, know every part of the terrain. And so we were able because of those efforts to receive triple the amount of proposals than we were anticipating. So we will continue to make sure to lift up the Inclusivity for All challenge with the Women's Business Center Network. Several new Women's Business Centers have been implanted in HBCU territory and also in rural areas. So that continues to be a focus as well. And SCORE has also stepped up with their resilience and marketing efforts, including a Black-owned business initiative. So I hope all those factors combined give you a sense of confirmation of reinforcement. I appreciate your question.

Ms. BOURDEAUX. Great. Well, thank you so much for your work, and look forward to working with you more in the future to try to continue to build that support network for our very diverse community of small businesses.

Madam Chairwoman, I yield back.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Now we recognize the gentleman from New York, Mr. Garbarino.

Mr. GARBARINO. Thank you, Chairwoman. And thank you, Ranking Member, for hosting this hearing. I also want to thank Mr. Madrid for being here.

Mr. Madrid, in your opening statement you said your mission is to help small businesses to start, grow, and expand. According to the NFIB's latest COVID-19 survey, half of small employers report supply chain disruptions and staffing are significantly impacting their businesses. How is your office assisting small businesses in overcoming these supply chain disruptions and staffing shortages?

Mr. MADRID. Thank you, Congressman. I can tell you that supply chain vulnerability is a scenario that is being addressed by our Government Contracting Business Development. I would be happy to take your questions back and get back to you on that to support your questions.

Mr. GARBARINO. All right. Well, I mean, because I have friends coming up to me now with little kids that are saying I am not going to be able to get Christmas presents and a lot of businesses in my district, I am sure most of my colleagues' districts, do a majority of their business during the holidays. And if they do not have products to sell, they will not be able to grow or expand or pay their employees. So making sure supply chain issues are addressed is huge. So I appreciate you getting back to me with answers, more specific answers.

I also want to talk about inflation. A key metric measuring inflation is at its highest rate since 1991, 30 years. How is your office helping small businesses navigate the rising cost of goods? What are you doing to educate them or to help them grow?

Mr. MADRID. Thank you for your question. The best way to create durable economic growth over the long run that eases bottlenecks and inflationary pressures is to increase the supply of goods that consumers want to buy, improve the resiliency of our supply chains, and reduce the cost of producing and getting goods to markets. So that is something that we look forward to working with you. I do want our DCBD area to get back with you. I assure you that I will get this question to you. I can tell you on the workforce development front because the resource partners are doing skill building scenarios across the network. So thank you for your question, Congresswoman.

Mr. GARBARINO. All right. But I mean, I am just wondering, what is the answer. If a business is calling, that you are dealing with is calling up a restaurant and saying chicken wings. Chicken wings prices have tripled. You know, I cannot sell chicken wings for $16. What are you telling them? How are you telling them? How are you advising? How is your department advising these businesses that do not know what to do with the rising costs?

Mr. MADRID. Well, I would be happy to answer any questions related to our programming at OED with our counseling and our education and our training. I will tell you that I did meet a woman-owned business in Iowa in a rural territory that had benefitted from PPP and the Restaurant Revitalization Fund and she was talking to me about the increased price of beef. And what she did was she pivoted in terms of saying what else can we do? What are

the alternatives? Can we cut down our costs and other endeavors? We have kept our employees. So that is just one reflection I have heard on the ground that was offered by herself, but she was frustrated with the rising cost of beef but she was looking for alternatives. And that is where the counseling, the skills building, the digitizing efforts at the resource partner level really came to her benefit.

Mr. GARBARINO. But, I mean, it is hard for a steakhouse to pivot when its business is based on selling beef. So, I mean, that is an issue. It is not easy for every business to pivot, especially small businesses.

Lastly, I want to bring up something Jeremy, as the Ranking Member of the Cyber Subcommittee for Homeland, COVID made everybody go digital. Every small business. People that never thought they would. It is a new thing we are dealing with. Everybody has got to deal with. What is your department doing to help small businesses grow and start? How are you handling it with cyber? Because it is definitely something that is a huge issue. And ransomware, businesses are paying between $5,000 and $15,000 to keep their businesses going due to ransomware. So what is your department doing on that?

Mr. MADRID. Thank you, Congressman. Under our purview at OED, we are releasing a notice of funding opportunity for a cybersecurity grant that will be offered to the state government. So more to come on that. And cybersecurity is a priority. Thank you.

Mr. GARBARINO. Thank you. And I yield back.

Chairwoman VELÁZQUEZ. The gentleman's time has expired.

Now we recognize the gentleman from Louisiana, Mr. Carter, for 5 minutes.

Mr. CARTER. Madam Chair and Ranking Member, thank you very much for the opportunity. Thank you for having this hearing.

Mr. Madrid, how can the Office of Entrepreneur Development increase their coordination with HBCUs and minority-serving institutions?

Mr. MADRID. Thank you. Thank you, Congressman, for that question.

HBCU outreach, engagement, and application of engagement, meaning results and action, is very, very important to the administrator. It is important to our agency and definitely resonates at the Office of Entrepreneurial Development. We are excited to see with the SBC network that there is over 30 service centers. And just as a frame of reference, there are over 900 service centers. There are over 30 that are implanted in the HBCU environment. We need to do more, frankly. And we are working here this office knows under this leadership that we want documented results. Certainly, our role into the platform of EDMIS from a Legacy system to Next Generation reporting is going to help us with that.

And on the WBC side, we are extremely excited. A number of new WBCs have been implanted in HBCU environments so that in and of itself I think speaks volumes in terms of action. But we have got to do more and that extends itself to MSIs, to tribal colleges and universities, to Hispanic-serving institutions. But we are very, very excited on the progress from HBCUs. And you will definitely

be learning more from it with our implementation with the Community Navigator Pilot as well.

Mr. CARTER. Excellent. Thank you. Let me ask you this, and I appreciate that, and that is incredibly important particularly to my district. But tell me, what can we do as Members of this Committee or me as a Member of Congress on the ground in Louisiana with multiple HBCUs in my district, what can I do to assist you or to advance this very noble cause?

Mr. MADRID. Congressman, we would be happy to work with you. And so if you have nuances, sometimes being on the ground, what I have learned in my 15 years of supporting small businesses, specifically before that I was in the banking industry, is I come back to that premise of being on the ground. And so if we are several states away, we want to know what is happening. So we would be happy to work with your office on nuances that are specific on your ground.

Mr. CARTER. Okay, great. Fantastic. I have two quick questions before my time runs out. Tell me about the reentry entrepreneurship counseling and training program because that is sounding also very important. We know that we have to do something different for our recently incarcerated individuals if we expect them to be able to survive in main street America. Share with me a little bit about what you are doing there and how those programs work.

Mr. MADRID. Absolutely, Congressman. Thank you for that question.

The best way to approach this question is from an example, frankly. I will point to an entrepreneur, Larry, who was formerly incarcerated in prison 20 years for a first offense, nonviolent crime. And with the help of an SBDC in Nashville, all Larry has done is launched his new business in the waste removal industry. And now they are working together. He is trying to obtain a line of credit. So we are committed here at OED to expand the footprint of our resource partners and also to start the process before release. That is very, very important. We have got to be as entrepreneurial as our small business owners and we look forward to this particular population contributing toward the economy. So starting before their release in structured programming——

Mr. CARTER. I do not want to cut you off but I have got just about another, less than a minute. So two quick questions.

One is we have a program in Louisiana called First 72. It is a program that in that significant period of the first 72 hours of someone being recently incarcerated, there is programming set up. I would love to offline have a conversation with you to talk about the merits of this program in Louisiana and see if there may be some practices that they have that you can use or maybe some best practices you can share with them to improve on them.

So lastly, real quickly, my last 30 seconds, there were several organizations in my district that applied for Community Navigator Pilot competitive grants. If an organization in my district was not selected, will they have an opportunity to apply again for this funding in the future?

Mr. MADRID. Thank you, Congressman. I look forward to hearing more about First 72.

The Community Navigator Program is a pilot, so the imagined state is that it is institutionalized in some way, shape, or form. If it is done through Congress, we are happy to execute it. Thank you very much for your question.

Mr. CARTER. Thank you.

I yield back, Ma'am.

Chairwoman VELAZQUEZ. The gentleman yields back.

The gentlelady from California, Ms. Young Kim, is recognized for 5 minutes.

Ms. YOUNG KIM. Thank you, Madam Chair Velázquez. And I want to thank our Ranking Member Luetkemeyer for holding this hearing. And Mr. Madrid, thank you for being with us to discuss the state of SBA's Entrepreneur Development Programs.

I want to point to your testimony where you talk about Mr. Montgomery of American wagyu cattle. By the way, during the pandemic, I am one of those who had mail orders and ordered the delicious Wagyu beef because I really like that. So I really appreciate you mentioning him and thanks to PPP, Mr. Montgomery was able to keep his staff full force and expand his businesses. And this is where he attended an event where he was able to meet up with his partner, lending partner, find the right banker that was able to guide him and tell him about the PPP.

Can you describe how that partnership with local lending institutions and the Entrepreneur Development Resource Networks makes it easier for small businesses to gain access to capital?

Mr. MADRID. Thank you, congresswoman. I look forward to ordering some wagyu beef myself. So beyond talking about it, to do it myself. I look forward to that and we are proud of Patrick Montgomery and part of the Missouri SBDC.

But clearly, at OED, we are trying to forge collaboration building as much as possible. That is the case also with the Women's Business Centers in terms of some of them being CDFIs. That has been helpful to some of the women clientele that have had barriers to access to capital. So we will encourage coalition building when it comes to getting these entrepreneurs. That case specifically, Patrick was a serendipitous event as you had mentioned, and so we are glad that he was able to pivot to keep up with that mail order business, so I hope that is a reinforcement.

Ms. YOUNG KIM. Other than sharing our love of wagyu beef, I want to get to the point of, you know, would you agree that it helps to have the bank representatives who know their communities on their ground as a resource for the networks? Because I say this because a while ago we sent a letter to the congressional leadership, both the Republicans and Democrats, to ensure that we do not remove the lending institutions from the equation and move towards a direct lending approach through SBA because there is that talk of that in the latest reconciliation package that went through the Committee. So should that happen, who will be filling the void of those community backers and credit union representatives that are on the ground providing information and services to our small businesses?

Mr. MADRID. Thank you, Congresswoman. I believe that you are referring to the efforts surrounding direct lending by the SBA. And I will just purport to this. I want to preamble this by saying we

will be happy as well to work with you and get questions to our Office of Capital Access. But what I will testify to is from being on the ground, those loan amounts, that $150,000 or less have been so hard to access for many of our communities that have been left behind historically who were left out of pandemic resources. It is hard territory and we frankly, we feel like we have to step in here. But I would be happy to take your questions back specifically to our Office of Capital Access. But some of those folks who are trying for those loan amounts are subject to very high interest rates and we all can agree that that is a very, very difficult environment, especially for a business owner who has not had access to funding. So sometimes they are first entry. So I look forward to any questions that you have that we can take back to that office.

Ms. YOUNG KIM. The point that I want to make and emphasize is that we do not need to move away from that public-private partnership model that has a track record of success and that does a better job in protecting taxpayers from fraud and abuse and other SBA direct lending programs like the EIDL because the success of our entrepreneurs and small businesses should not be reliant upon a greater extension of government on main street.

So in the remaining time, Mr. Madrid, you also indicated in your testimony that you are committed to ensuring ED programs have robust programs and that SBA is introducing Next Generation reporting program. I think the Chairwoman mentioned this, but can you clarify the reporting, the timeline of the reporting system and its implementation? Can you provide a little information on that?

Mr. MADRID. Yes, Congresswoman. Thank you.

In terms of the EDMIS Legacy System, I know I have a couple of seconds, but 100 percent was deployed across our Resource Partner Network, the SBDCs, WBCs, and SCORE. So we are about on the fifth month of implementation there.

Chairwoman VELÁZQUEZ. Time has expired and now we recognize the gentlelady from California, Ms. Chu, for 5 minutes.

Ms. CHU. Mr. Madrid, thank you for being here and representing the Office of Entrepreneurial Development and SBA resource partners across the country.

When I came to Congress, I worked hard to bring two SBDCs to my district in the San Gabriel Valley in Southern California. Now we have two successful locations in Pasadena and La Verne that have been immensely important and never more so than during the pandemic. One of the reasons why it was so important to get the SBDCs into our area is that we have a large entrepreneurial immigrant and limited English proficient community, and communities, actually. That is why I worked to insert language into the CARES Act requiring that we make in-language materials available for these business owners.

So I am especially glad to see that in-language services is prioritized in the Community Navigator program but that is actually just one part of the equation. When I talk to my local SBDCs, they tell me that translations are important but not as important as gaining the trust and confidence of the communities that are hard to reach. And to do that, they have been successful in partnering with different community-based organizations that have both the language skills and the longstanding relationships. So I

am proud that our local SBDCs do have these existing partnerships with these groups. But we also have one of the largest immigrant populations in the country and some well-established community organizations that serve them.

So, this Community Navigator program that you are able to reach these immigrant populations that some might consider hard to reach that need to have access to those trusted organizations. So how are you going to make sure that happens through your guidance and awarding process? And I know there is a program of having a hub and a spoke. And will the spokes get funding? I just want to know how exactly you are going to work this to make sure everybody is reached.

Mr. MADRID. Thank you, Congresswoman. Being culturally and linguistically competent is very, very important to us in terms of reaching those terrain elements that you speak of. And so we were excited in our outreach endeavors with the Community Navigator Pilot, that we leverage organizations that know different communities where translation is an issue. It was very, very important for us to have them at the table. With the anticipation of the grantees being announced later this month, I can assure you because of the diligent review process that we will achieve geographical diversity, as well as diversity of sectors being served. And through the spokes, which are the community champions on the ground, you know, we have reinforced over time different examples of what a navigator could be and translators were definitely one of those items of reinforcement that we addressed time and time again. So that is a very important scenario here.

With the hub and spoke model, the hubs are grantees, so they will be being funded by the SBA. And then the spokes on the ground, through consortia agreements with the hubs will receive their funding. So we are excited that this model, it is a national model but with a hyper-local approach, we are excited to go into new ground where folks who have been left out running these businesses being job creators have the opportunity to truly understand how to connect with SBA. That is the first step of many but we are excited to take that first step in many instances on the ground through this program.

Ms. CHU. And will the determination of the funding for the spokes be made by the hub?

Mr. MADRID. That is right. That is right. And that is in proposal all together in terms of the review, the review process that we have now. It is a proposal of the hubs with their spoke engagements.

Ms. CHU. And let me say also, people really need to know about the Community Navigator Program but we know that SBDCs, they were not allowed to advertise their services. So what is going to be done to make sure that there is an actual awareness of the Community Navigator Program? Will there be a role for advertising?

Mr. MADRID. That is right. There will be a role. There was an appropriation, aside from the one under our purview, that talks about that application of marketing the Navigator Pilot. Thank you very much for your question.

Ms. CHU. Thank you. I yield back.

Chairwoman VELAZQUEZ. The gentlelady yields back.

The gentlelady from Texas, Ms. Van Duyne is recognized for 5 minutes.

Ms. VAN DUYNE. Thank you very much, Chairman Velázquez and Ranking Member Luetkemeyer. And thank you, Mr. Madrid, for joining us today.

Your visit comes at a difficult time for small businesses that have endured many challenges and hardships over the last 18 months. And now as they try to get back on their feet they are faced with a slew of new manufactured challenges. Luxurious and unsustainable unemployment benefits have played a significant role in labor shortages and seemingly never-ending stimulus has led to record inflation.

In addition, Democrats are now trying to force through the largest spending bill this country has ever seen, leaving our smallest employers fearful of massive tax hikes bound to stretch their already small margins.

I heard your answer to Congressman Roger Williams's question about increases in taxes and you said that no one earning under $400,000 will experience tax increases. Now, as a direct result of this administration's fiscal policies, folks making under $400,000 in small businesses are already paying more in taxes. We are all suffering from increase in out-of-control inflation. For example, and I would hope that working for the Small Business Administration you see this, you have heard this, and you know this, too. Example is the cost of cargo containers. They have gone from $4,000 last year to now an average of $29,000. We have seen a 54 percent increase in fuel costs, a 7 percent increase in food costs, and escalating employee costs if small businesses can even find employees. And to that point, Congressman Hagedorn brought up the list of impacts that are going to be hitting the small businesses as a result of the vaccine mandates.

I spoke with Members of the aviation industry yesterday who are already experiencing drastic shortages of pilots, and with this December 8th deadline looming over their heads, cargo carriers warn that this mandate will "have a tremendous disruption on commerce in this country." So pretty much anyone who drives, buys anything, or eats will be paying more and it is only getting worse.

So despite misleading claims pushed by this administration, increased taxes, including the Democrat Reconciliation Plan, will negatively affect the close to 1.5 million small businesses organized as C corporations and most small businesses organized as pass-through entities.

So according to the Texas Public Policy Foundation, I know you are a Texan so you will appreciate this, the proposed policies Democrats are pushing will result in Texas businesses losing well over $650 billion in investments and reduce full-time employment by 12,000 jobs. So given that the state admission of your office is to "help small businesses start growing in global markets," my first question to you would be, do you believe increased taxes on small businesses help them to grow and compete?

Mr. MADRID. Thank you, Congresswoman. And a big shout out to Texas. Thank you for that.

Regarding the tax plan, I would love to, you know, we are happy to respond to your questions in writing. I would love to respond or

answer any questions about our counseling and training related to the programs.

Ms. VAN DUYNE. What I asked you is do you believe that increased taxes in small businesses help them to grow and compete?

Mr. MADRID. Our forte is not tax policy so we would be happy to address your questions in writing but I would be happy to talk about——

Ms. VAN DUYNE. Do you believe increases in inflation helps small business to grow and compete?

Mr. MADRID. I would be happy to take your questions and respond to them in writing, Congresswoman.

Ms. VAN DUYNE. So do you believe federal mandates that force small businesses to fire employees in a time when they cannot find people to hire helps small businesses to grow and compete?

Mr. MADRID. Congresswoman, I would be happy to respond, take your questions back and respond in writing.

Ms. VAN DUYNE. So you come to us today to answer questions. I am asking you what kinds of impacts on small businesses this administration's fiscal policies will have. Are you unprepared to answer those questions today?

Mr. MADRID. I would be happy to talk about the Community Navigator Pilot, our resource partners, what is happening on the ground with our WBCs, our SBDCs, and SCORE.

Ms. VAN DUYNE. Okay. So the mission, which is to make small businesses be able to compete and grow, we are unable to talk about that today?

Mr. MADRID. I would be happy to talk about what is happening on the ground to support that mission.

Ms. VAN DUYNE. Okay. So as the Ranking Member of the Subcommittee on Oversight, Investigations, and Regulations, I was concerned by the Inspector General's audit of the Women's Business Centers earlier this year found that the SBA did not provide efficient oversight resulting in close to a million dollars of potential fraud. So as the administrator overseeing entrepreneurial development programs, can you tell me how many people on your staff are designated to provide oversight of these programs?

Mr. MADRID. Yes. Well, the Office of Women's Business Ownership and the leadership there is responsible. We have closed three Women's Business Centers as elaborated earlier.

Ms. VAN DUYNE. Can you tell me how many people are designated to provide oversight of these programs?

Mr. MADRID. Yes. We have a grant management officer and the supporting staff.

Ms. VAN DUYNE. Okay. So we have one person or——

Mr. MADRID. Congresswoman, we have a team supporting that effort at OBO that is centered around the grant specialist and the supporting staff underneath that.

Ms. VAN DUYNE. Thank you very much.

Mr. MADRID. Thank you.

Ms. VAN DUYNE. I yield back.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Now we recognize the gentleman from Pennsylvania, Mr. Evans.

Mr. EVANS. Thank you, Madam Chair. Thank you for your leadership.

Good morning, Mr. Madrid. It is a pleasure to come to speak before us today.

In my home of the City of Philadelphia, Temple University and Widener Small Business Development Centers have been critical to supporting entrepreneurs especially during the pandemic. Many small businesses in my district do not have the capital to hire accountants or professionals. During the past year, the centers have assisted in starting up 112 new businesses, 8,407 jobs, served over 2,600 clients, and helped them in forming nearly $40 million in capital for small businesses to develop. These centers are especially important in cities like mine where nearly half of the population is Black and nearly 25 percent is on poverty. However, this brings us to an issue around priorities and resources. So I want to ask the metric that comes with funding in making these decisions. These centers are based on increasing job save and capital formation. However, it appears to me that there seems to be a mismatch on the goals as is well documented the minority Black-owned businesses specifically have less access to capital and fewer employees than in fewer White-owned businesses. If the SBA keeps increasing the goals around job save and capital, is this not counterproductive to the centers increasing their already stellar performance of minority women, veterans, and rural entrepreneurs?

Mr. MADRID. Congressman, I apologize but I had an interruption. So I heard the first part of your commentary and your question. I apologize to the Committee here but can you repeat the last part of your question. I apologize, all, for that interruption.

Mr. EVANS. Basically, let me go back. I basically said these centers in particular assisted in starting 112 new jobs, new businesses, 8,000 jobs, and over 2,600 clients. Now, the question I asked, in terms of the goals of job save and capital, I asked the question is this counterproductive in terms of increasing the centers' already stellar performance of minority, women, and veteran entrepreneurs in terms of the objectives?

Mr. MADRID. Yes. Well, thank you for your question, Congressman. We certainly want to make sure that we are evaluating the performance of the SBDCs. And so we are going to continue to reevaluate metrics and be timely with, especially what is happening during the pandemic. So we feel like new business starts, capital infusion, job creation, of course, is important, as well as asking if the folks being served are veterans and go deeper on demographic information. So we are definitely making sure that the metrics apply to the current environment. And we have learned a lot from the pandemic.

Mr. EVANS. Well, can you talk a little bit about, just in your mind, of what you think you have learned in terms of the goals that you see of job save and capital? What specific example can you give in terms of what you have learned?

Mr. MADRID. Absolutely. I mean, when it comes to capital infusion, I mean, the SBDCs certainly across the network had notable advancement there. Some of it was the numbers but they had to pivot to a virtual environment. So bringing some of those engagements into the fray is very, very important because the digital and virtual world is not going to go anywhere anytime soon. In other words, the SBDCs that we have talked to them about that are

going to have to evaluate new measures of how that virtual audience is security capital, for instance, is one item. With the WBCs, just extending to our resource partner network, they had 10,000, almost 10,000 capital infusions. So those are examples that were taken into account that also will be applied with the Community Navigator Pilot just to connect the dots between the resource partners and the open lines of communications between our offices and the networks themselves.

Mr. EVANS. Any way you think that this Committee can assist you more in terms of ensuring that you meet those goals?

Mr. MADRID. Well, we look forward to working with you. I mean, I hope that is the commonality that I have across this Committee. And so we proposition, we look forward to working with you. Thank you.

Mr. EVANS. Thank you, too. Thank you.

Madam Chair, I yield back. I yield back to you, Madam Chair.

Chairwoman VELAZQUEZ. Yes. Thank you. The gentleman yields back.

Now we recognize the gentleman from Wisconsin, Mr. Fitzgerald, for 5 minutes.

Mr. FITZGERALD. Thank you, Mr. Madrid, for being with us today. The issues being discuss, kind of a cross-section obviously on entrepreneurs as well as some of the SBA programs and the PPP stuff. So I just wanted to go back to that. Congresswoman Kim talked a little bit about it.

I think the frequent visits or the interactions I have at the local level with either local bankers or those that are part of the credit union system, oftentimes it is reassuring to know that if there is a separate set of eyes on the process, and I think this was very interesting when it came to the PPP loans. Very successful. Absolutely bailed out a lot of small businesspeople across this nation during the pandemic. But when you talk to bankers and they say, listen, I had a conference table and it was full of folders on people, some clients that they knew very well, others that maybe they had just worked with a little bit, but you know, they were going through these files, making sure that all the T's were crossed, all the I's were dotted. And as a result of that you can see in the PPP program that there is a lot less fraud and abuse as a result of that. And then if you move to the SBA program's direct loan programs, and I have talked to individuals that have received those loans, far less scrutiny, issued in a way that sometimes was a mystery even to those that had received the loans themselves.

So I would once again encourage you to be an advocate for this within the SBA to say, hey, listen. If we want to reduce those numbers, if we want to bring those fraud and abuse numbers down, involve local financial institutions. It is like an answer that is staring us right in the face. We just need to reach out and make sure we embrace that. And it does not matter which side of the aisle we are on. Obviously, we have an inherent responsibility to make sure that we take care of the taxpayer dollars.

So that is more of a comment, I guess, than anything else. And let me give you a chance to either respond or give me your thoughts on that if you would.

Mr. MADRID. Congressman, thank you. The direct lending legislation and lending is based off of our successful 7(a) loan program. And this program will not be in isolation. We will continue to partner with community banks and credit unions and the community financial institutions which will counsel borrowers through the application and repayment process. So that is a little bit of an answer from this perspective but we would be happy to work with you, take your questions back to the Office of Capital Access. Thank you for your comments.

Mr. FITZGERALD. Well, very good. So let me just follow up real quickly. I know I have got a couple of minutes.

So when it comes to entrepreneurs, I have been an entrepreneur, small businessperson for many years before I became a Member of Congress. Most of the time, small businesspeople want you to just get out of the way. They are not looking for all these types of programs and assisted grants until they are kind of up and running. And Congressman Williams talked about this earlier in his experience but, you know, the last burdensome government can be and the less taxing that can happen, the better off all small businesses will be. I do not care if you have got one employee or if you have got 20 employees, that is something that consumes a lot of the day for some of these people that are willing to jump in with both feet. And it is a risky thing. And people lose sleep. And people go without paychecks week after week who run these small businesses. I do not care if it is a woman or a veteran or any other group that can have great success in small business. You need to develop programs and work to structure programs so they may assist only when small business owners ask for their help. For too long, the federal government specifically, but in my state of Wisconsin, there has been too much intrusion in that process and it leaves us in a position of trying to work around government versus interacting with them.

And another thing, I felt, you know, I had the opportunity today to talk a little bit about that. I want to thank you for being with us today and I would yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

Now we recognize the gentlelady from Pennsylvania, Ms. Houlahan.

Ms. HOULAHAN. Thank you, Madam Chair. And thank you for the opportunity to speak. I think this hearing has been very reflective of the complexity of small businesses in this country and particularly during lots of distressors such as this pandemic. Having been one of those people who has lost sleep and signed my house over and a variety of other things to grow small businesses, I can clearly empathize with the small businesses in our community and all of the complexity of these questions that people have been asked reflect why we are here and why we are trying to be helpful.

One of the things that I was also struck by that I cannot let go because it was mentioned several different times is vaccine mandates. It is one of those kinds of things where it depends on who you talk to how it is received. Some people, business owners, are very positive about that. In fact, the vast majority of people whom I have spoke with have been extremely positive and grateful for the clarity that has been provided by a mandate. One of the things

that I find most frustrating about the narrative is somehow that this should be a choice between a doctor and a person. The irony there is not lost on me and that somehow the science tells us that this ends up with us just being able to be more safe from being hospitalized rather than also to save one another from death. And so I get extremely exercised, as you can probably tell, by this frustrating narrative that somehow this is contributing to the unemployment in our nation other than the fact that we are also contributing to helping each other survive in this country.

So the question that I have, Dean actually asked my question regarding ESOPs and employee ownerships and the very important aspect of making sure that we are thinking about stakeholder capitalism, but with the remaining parts of my time, if it is all right, I would like to ask about cybersecurity which is also something that is true and present, a true and present danger to particularly small businesses that do not have the ability to protect their businesses, to protect their bank accounts, to protect other people's financial information. So if you could please in the remaining time that I have, offer up what resources that the Office of Entrepreneurial Development has for cyberhealth, cybersecurity, and cyber awareness. I would appreciate that. Thank you.

Mr. MADRID. Thank you, Congresswoman. And Happy National Cybersecurity Awareness Month to all. That is this month in October. And this has been on the minds of the administrator and also OED. And I will report on a couple of items, one of which is a cybersecurity grant. We are releasing through the Office of Entrepreneurship Education a notice of funding opportunity for that program that will increase outreach and application of cybersecurity, not only of awareness but we know that ransomware has been a big issue. We are also partnering with DHS on their Stopransomware.gov website to make sure that socialize with our small businesses.

But we are not stopping there. We come back to the terrain, making sure that we are on the ground, meeting small businesses where they are. The smallest of the small, if we are really honest, and I know you all have experienced this, is when you talk to a small business owner that has one or two employees and you talk to them in corner where they have built trust with you and you ask them, do you really know what ransomware is and how it can affect your business? Do you feel vulnerable? And most of the time I have heard absolutely yes. So we want to make that government website translatable and relatable to the small business owners.

There is also another rung and it applies to certification and procurement. So we are working with our GCBD, Government Contract and Business Development. They are small businesses that are certified that need C training, certification training in cybersecurity in order to be eligible for procurement opportunities. So the bottom line is segmentation, to approach it that way. It is not a "one size fits all."

The last thing I will say is that our Office of Entrepreneurship Education headlines an electronic learning initiative which includes the Women's Online Business Curriculum ASCENT and we will add to that a cybersecurity pillar. So we are very, very excited

about that going forward. And it will continue to be a priority in OED and through our office of entrepreneurship education.

Ms. HOULAHAN. Thank you. With what remains of my time, I look forward to working with you on those issues of cybersecurity because I think they are critical to the success of small businesses.

Here in my community, we will be hosting a job fair where more than 100 businesses will come to hopefully find people to fill the jobs. It has been a month and a half or so since all of these benefits supposedly have expired and still we have only 4 percent unemployment in my community and many, many, many jobs to fill. So this is a vastly complex situation that we are managing. Only I believe it is 7 percent of people who returned to the economy in August were women so we really have quite a lot of complexity that we need to deal with in order to find our way back to a level set in our economy right now.

Thank you and I yield back, Madam Chair.

Chairwoman VELAZQUEZ. The gentlelady yields back.

Now we recognize the gentleman from Florida, Mr. Donalds.

Mr. DONALDS. Thank you, Madam Chair.

Mr. Madrid, what is your job? What do you do? I have been on the road. So I have been driving from Tampa this morning. I was at a prior engagement. So I have been catching the hearing and bits and pieces. So what actually do you do at the SBA?

Mr. MADRID. Well, thank you. Thank you for your question, Congressman.

I serve as associate administrator for the Office of Entrepreneurial Development. And we oversee the technical resources arm of the SBA through our Office of Small Business Development Centers, our Office of Women's Business Ownership, and our Office of Entrepreneurship Education. So there is a rung there that——

Mr. DONALDS. I got it. That's cool. I do not need the long version. I just need the short version, Mr. Madrid.

So obviously, your office is responsible for trying to help small businesses get off the ground all across the country with technical assistance they might need to help their financing needs to keep their businesses afloat. That is the short note; right?

Mr. MADRID. We help businesses start and grow. And that is through our resource partner network. And we also have an education aspect or Office of Entrepreneurship Education through an electronic learning initiative. And then we are also responsible for the Community Navigator Pilot that will be launched.

Mr. DONALDS. Okay. All right. So I have got a couple questions for you. So I had to stop at the gas station. Obviously, there are some people who might try to start convenience stores. What do you think the increased excise tax on cigarettes will have on a small business or sole proprietor trying to open up a convenience store or a gas station? Maybe not a gas station. There is a little bit more regulations involved in that. Let's say a convenience store in the United States. What do you think an increase in the excise tax is going to do to their ability? Do you think that is going to hinder their ability to open and maintain profitability or do you think it is going to hurt their ability to stay open and help their profitability? Yes or no. Is it going to help or is it going to hurt. Yes or no?

Mr. MADRID. Congressman, tax policy is not in our purview. I would be happy to talk about——

Mr. DONALDS. Oh, Mr. Madrid, but you are a head—Mr. Madrid, you are the head of the Entrepreneurial Division. You engage with small business owners all across the country. You have got to have that understanding of the impact of tax policy.

All right. Let's move on. Another small business tax policy in the Budget Req bill. Do you think it will help or hurt small businesses getting rid of the section 199A small business deduction on small business owners' taxes? Will that help or hurt small businesses in the United States, yes or no?

Mr. MADRID. Congressman, I am not in a position for tax policy——

Mr. DONALDS. Come on, Mr. Madrid, you are in the position. You coordinate with small business owners all across the country. You said so yourself. That is your job title. You provide technical assistance to all types of small businesses. So you have to have firsthand knowledge of what is going to impact them. If the Section 199A is going to basically be taken away from them, I mean, they are going to pay more in taxes, you do not know if that is going to help or hurt the same small businesses you are trying to provide technical assistance to help?

Mr. MADRID. Congressman, I would be energized to talk about our programs at the Office of Entrepreneurial Development, the Community Navigator Pilot, how we are on the ground with business and counseling and education. I would be happy to talk about that.

Mr. DONALDS. Mr. Madrid, Mr. Madrid, that is not a yes or no answer. You are trying to give me bureaucratic speech. And to be honest, I have been listening to bits and pieces of this hearing and I just find it to be ridiculous. You guys are charged with helping small businesses open, thrive, and prosper. That is your purpose. But I do understand that you cannot talk about tax policy. Frankly, your boss, when she came before us, she could not talk about tax policy. We were given the same runaround in that hearing as we are getting today.

Last question. Do you think an increase in the corporate income tax rate and/or increase in the personal income tax rate for small business owners whose income passes through to their 1040, do you think that will help or hurt small businesses being able to thrive in the United Sates, yes or no?

Mr. MADRID. Congressman, I am not in a position to, and it is not my purview——

Mr. DONALDS. Mr. Madrid, I am going to reclaim my time. With all due respect, if you are not in a position to make a very clear delineation on the impact of increased taxes on small businesses, then how in the heck are you the administrator for entrepreneurial divisions with respect to small businesses in the United States? If you cannot understand that, then I am very, very concerned about what can be understood at the SBA.

Madam Chair, I yield back.

Chairwoman VELAZQUEZ. The gentleman yields back.

I want to thank Mr. Madrid again for taking time to answer our questions today.

SBA's Office of Entrepreneurial Development plays a critical role in facilitating the well-being and growth of American small businesses and your commitment and dedication to small businesses shined through today. For many small businesses, counseling from an SBA resource partner can mean the difference between success and failure. Going forward we must work together as a Committee to ensure those critical organizations are in position to thrive and that the OED has the resources it needs to effectively implement the various programs under their jurisdiction.

I ask unanimous consent that Members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

If there is no further business to come before the Committee, we are adjourned. Thank you.

[Whereupon, at 11:58 a.m., the committee was adjourned.]

APPENDIX

Testimony of Mark Madrid
Associate Administrator
Office of Entrepreneurial Development
U.S. Small Business Administration

before the
House Committee on Small Business
Hearing on "SBA's Entrepreneurial Development Programs"

October 6, 2021

Testimony of Mark Madrid
Associate Administrator
Office of Entrepreneurial Development
U.S. Small Business Administration

Good morning, Chairwoman Velázquez, Ranking Member Luetkemeyer, and distinguished members of the committee. Thank you for the invitation to discuss the SBA's Office of Entrepreneurial Development. Our mission is to help small businesses start, grow, and expand by providing quality training, counseling, and access to resources through Resource Partners located across the country and the Office of Entrepreneurship Education. The devoted team at the SBA is energized to serve under the results-driven leadership of Administrator Guzman.

Throughout my career, nothing has been more purposeful than supporting small business owners where they are, empathizing with them, listening to them, and understanding their unique terrain. I have devoted all my energy and dedication to customizing solutions for small businesses at the Houston Hispanic Chamber of Commerce, the Greater Austin (Texas) Hispanic Chamber, Stanford University Latino Entrepreneurship Initiative and Latino Business Action Network, and now at the SBA's Office of Entrepreneurial Development (OED).

At OED, we oversee the SBA's network of Resource Partners including Small Business Development Centers (SBDCs), Women's Business Centers (WBCs), and SCORE. Additionally, our Office of Entrepreneurship Education (OEE) spearheads our Electronic Learning Initiative, our Online Learning Center, and the Community Navigator Pilot Program. OEE also leads our Cybersecurity Grant Program and Regional Innovation Clusters.

Over the last nine months, we have made great strides in fighting the pandemic and recovering our economy, achieving historic job growth for a new administration. However, we still have a long way to go, which is why President Biden announced the COVID-19 Action Plan, a comprehensive national strategy to fight COVID-19 and to protect our economic recovery. At the SBA, we are honored to support these efforts, making critical improvements to the COVID Economic Injury Disaster Loan, streamlining the forgiveness of small Paycheck Protection Program loans of $150,000 or below, and launching the Community Navigator Pilot. Today, I share an update on that Pilot, a key component of the COVID-19 Action Plan which was enacted through the American Rescue Plan Act of 2021, and I will also provide an overview of our foundational programs in the Office of Entrepreneurial Development. I will start with the Community Navigator Pilot.

To advance equity at this unprecedented time, it is critical to reach those in hard-to-reach areas. The Community Navigator Pilot's goal is to strengthen outreach to our nation's smallest businesses—both in rural and urban America—particularly those owned by women, veterans,

and socially or economically disadvantaged individuals. This program will complement and enhance our core counseling programs by leveraging a national network of community navigators who, to use the words of Administrator Guzman, are "on the ground truly connecting, empathizing, and tailoring solutions for our small businesses."

The Community Navigator Pilot is a $100 million competitive grant funding opportunity. Entities eligible to apply include nonprofit organizations, Tribes, States, units of local governments, and SBA Resource Partners. The grant awards will range from $1 million to $5 million for a two-year performance period. We have been overwhelmingly energized by the interest in the program and are pleased to report that we received 656 proposals by the July 23rd deadline. As a frame of reference, we originally anticipated over 200 proposals. We are currently reviewing the proposals, and we look forward to announcing the grant recipients this fall.

Our combined efforts are more critical now given the uncertainty that the Delta variant poses to our U.S. small businesses. Thus, in addition to rolling out the Community Navigator Pilot, the Office of Entrepreneurial Development is laser focused on supporting our Resource Partners. We are proud of our network of Small Business Development Centers (SBDCs), which are supported by our Office of Small Business Development Centers, for their tireless work throughout the pandemic, including their utilization of CARES Act funding to increase support of our small businesses over this past year and a half.

One example comes out of Weston, Missouri - a small but growing business called KC Cattle Company that raises American Wagyu cattle. When the pandemic hit, KC Cattle saw their mail order business grow dramatically, and they found themselves unable to meet the exploding demand. Patrick Montgomery, their CEO, attended an event that featured numerous Kansas City banks that was hosted by the Missouri SBDC at the University of Missouri–Kansas City. It was there that he found the right banking partner in order to apply for PPP funding. With the CARES Act Funding, Montgomery was able to keep his staff full force and then add 75 percent more people to meet the booming demand. This is one example of the aid and guidance tailored to the local community that our 62 SBDC Lead Centers and over 900 Service Centers provide.

Supported by our Office of Women's Business Centers, our 138 Women's Business Centers (WBCs) support female entrepreneurs through training, technical assistance, and by providing access to capital, credit, and federal contracting opportunities. These hyper-local centers are more important than ever before, as women business owners have been disproportionately impacted by the pandemic. The Office of Entrepreneurial Development and Office of Women's Business Centers is approaching these vital needs with a sense of urgency, by administering more than $70 million in federal grants to support the growth of women-led firms. Also, we are proud to have launched 24 new WBCs this year, two in Puerto Rico this month and one awarded just this week in Tulsa, Oklahoma.

Next, I highlight SCORE, our nation's largest network of volunteer business mentors, with over 250 local chapters and over 10,000 mentors nationwide. This network is comprised of business leaders, both working and retired, who advise and coach small businesses online and in person. SCORE chapters provide personalized support to entrepreneurs across all 50 states and Puerto Rico. Also, SCORE hosts live educational events in multiple languages, such as sessions on revamping your business plan or optimizing your pricing strategy.

To bolster the technical assistance that SBDCs, WBCs, and SCORE provide, the Office of Entrepreneurship Education (OEE) provides digital education tools and trainings such as Ascent (our online women's business curriculum) to meet small business owners where they are, both in urban and rural America. In an effort to actively support our small businesses with timely and digestible information, we are augmenting our educational tools with cybersecurity resources and placing broadband access as a top priority.

Underlying OED's partnerships is a deep commitment to ensuring that our programs are running as efficiently as possible to maximize the impact of our support for America's small business owners. We invest heavily in implementing strong controls to ensure our programs have robust oversight. To underscore this commitment, we are introducing a next generation reporting system to monitor performance and accountability within the network.

This is a very difficult time for America's small businesses. We are striving to not only meet the small business entrepreneur wherever she is on her journey, but also support her as the business grows and adapts. This customer-centric approach is what commits us to reaching all entrepreneurs, especially those in rural areas, women, veterans, and underserved communities that have been hurt most by the pandemic. I look forward to continuing collaboration with you.

Thank you for this opportunity to appear before you today.

House Committee on Small Business
Questions for the Record
October 14, 2021

Questions for the Record from Chairwoman Nydia Velázquez (D-NY)

- Last Congress, the House passed H.R. 4406, the Small Business Development Center Improvement Act of 2019, which would modernize and strengthen the SBDC program. How important is it that the House pass similar legislation this Congress?

The Small Business Development Centers Improvement Act of 2019 ensured that each SBDC was being equitably and sufficiently supported, it authorized centers to market their services directly to small businesses, and it strengthened SBDC oversight and data collection, for example, by instating an Annual Report on Data Collection and a Working Group to Improve Data Collection.

It is important that we continue these efforts, particularly during this period of recovery. We've seen the impact that investing in SBDCs can have on America's small businesses. Between April and December 2020, SBDCs were able to use CARES Act Funding to support 592K small businesses and collectively invested over 2 million hours counseling small businesses and individuals. These numbers speak to not only how much small businesses need the support of SBDCs, but also how much SBDCs need congressional support.

- Last Congress, H.R. 4406, the Small Business Development Center Act of 2019, clarified that SBDCs would be allowed to market their services. How can SBA better market the services of SBDCs?

It is vital that SBA bolster its outreach efforts to increase awareness of SBDCs and of all the SBA's Resource Partners, particularly to those communities that have historically been left behind. Two key ways that we can better market our Resource Partners: by integrating Resource Partner referrals into every outreach activity that the SBA performs, including our activities performed by our District Offices, and by promoting our Resource Partner network through the Community Navigator Pilot Program.

Our Community Navigator Pilot Program will strengthen community-centric organizations serving as community liaisons in areas with small business ecosystems that have historically been left behind for resourcing. This program empowers traditional business assistance organizations to enlist trusted, culturally and linguistically knowledgeable partners who conduct targeted outreach to specific sectors of the entrepreneurial community. We appreciate your continued support of our Resource Partners, the Community Navigator Pilot Program, and all SBA programs.

- Last Congress, the House passed H.R. 4407, the SCORE for Small Business Act of 2019 which modernized the SCORE program and addressed concerns from the 2019 Office of Inspector General (OIG) report. Since then, SCORE has closed all recommendations from that OIG report and has been a steadfast resource for entrepreneurs and small businesses

across the country. How would updating and passing a similar bill be beneficial to SCORE and its clients?

The SCORE for Small Business Act of 2019 was vital to support the SBA's continued relationship with SCORE because it ensured that SCORE would recruit diverse volunteers for each chapter of its program and provide services to rural and underserved communities, which is a priority for the SBA. It also underscored the SBA's emphasis on oversight, and we are satisfied that SCORE has closed all the findings.

SCORE has been a vital partner throughout the pandemic because—through its Small Business Resilience Hub—the organization shifted its scalable mentor network into a virtual environment. Also, SCORE is advancing equity, as it offers programs targeted towards underrepresented and underserved small business communities (e.g., SCORE for Hispanic Entrepreneurs, and SCORE for Black Entrepreneurs, both of which offer personalized support and resources).

- How can SBA streamline and strengthen the Cooperative Agreement and Terms and Conditions negotiations process between OED and the SBDCs?

Last year the Office of Management and Budget (OMB) finalized changes to the latest version of 2 CFR 200, the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards. These changes required Federal agencies to make their standard grant terms and conditions available to the public. Per OMB requirements, the SBA Office of Grants Management (OGM) made the standard terms and conditions available to the public on SBA's website. Prior to this requirement, the terms and conditions were a combination of standard terms and program office specific terms. Standardizing terms and conditions substantially reduced the level of review, discussion and negotiation required between OED and the SBDCs. OED and the SBDCs now only are required to discuss SBDC program specific terms and conditions.

- How can SBA streamline the SBDC grant proposal, Notice of Award, and grant reimbursement processes to ensure policies are put in place to allow funding to efficiently flow to SBDCs?

Each year, OSBDC reviews the Notice of Funding Opportunity (NOFO) to ensure that only necessary and applicable information is included. For the 2022 NOFO, OSBDC performed an extensive crosswalk between the SBDC NOFO and the Program terms and conditions to ensure that repetitive instructions and requirements were eliminated and reduced administrative burdens that may impact the SBDCs. The OED OSBDC office continuously reviews and updates its reimbursement procedures to ensure that optimal oversight and reimbursement are provided in the most reasonable time. Specifically, in FY 2021 for the 2022 Program Year, OSBDC conducted an after-action review of OSBDC processes to identify opportunities for improvement.

Questions for the Record from Representative Antonio Delgado (D-NY)

- What steps is the SBA taking to ensure that underserved rural communities will benefit from the Community Navigator Grant Program?

The Community Navigator technical review committee selected grantees that focus in Rural areas: of the 51 grantees, 23 have a special focus on Rural areas, and collectively these grantees support 175 spoke organizations across the country. Additionally, to ensure that underserved rural communities will benefit from the Community Navigator Pilot Program, the program office will also be tracking and reporting on Community Navigator penetration in rural areas, as 'rural' or 'urban' is one of the questions on the form that Navigators will have the option to fill out about each client.

- Now that many of the SBA's pandemic assistance programs for small businesses have either expired or are winding down, what role does the agency see the Community Navigator Grant Program playing in the coming months once grants are distributed?

In addition to helping small businesses access recovery resources including EIDL, the Community Navigator Pilot Program will provide a range of timely and no-charge business assistance services on an ongoing basis, including—but not limited to—access to federal, state and local resources, access to capital, counseling, targeted educational resources (e.g., cybersecurity), certification/procurement, digitization, and/or access to capital. Community Navigators are local experts that are embedded in communities, which enables them to nuance their advice to the region that they serve. For example, Navigators in New York can help small businesses determine if they're eligible for New York pandemic relief programs such as New York Forward Loan Fund (NYFLF) and New York City Musical and Theatrical Production Tax Credit.

Questions for the Record from Representative Dean Phillips (D-MN)

Section 1103 of the CARES Act created a centralized platform for federal COVID-19 resources and trainings for Resource Partners. $25 million was provided to SBDC and WBC Associations to create this platform, but its funding expires in April 2022. Can you please provide responses to the following questions regarding the current and potential future use of this platform:

- How has the platform generally been utilized and how widely is it used?

This centralized platform funded by the CARES Act has enabled America's SBDC (ASBDC) and the Association of Women's Business Centers (AWBC) to jointly launch a web platform (http://covid-sb.org) as a Content Management System (CMS) to provide resource information to small businesses and an online Learning Management System (LMS) for SBA Resource Partner mentors in year one of the Resource Partner Training Portal (RPTP) project.

The two target audiences are: (1) small business concerns for the CMS; and (2) business mentors and service providers of the SBA Resource Partners (SBDCs, WBCs, VBOCs, and SCORE) for the LMS.

Our Resource Partners have been as entrepreneurial as the small businesses they serve by finding many uses for the platform. For example, the Office of Entrepreneurial Development worked with our Resource Partners to launch a training for SBDC, WBC and other workers on EIDL through RPTP. This RPTP event session generated a record audience, in terms of both registration and attendance.

In creating covid-sb.org thought the RTPT project, the ASBDC and AWBC have delivered a COVID relief information platform that provides small businesses with access to a consolidation of COVID-19 related information and resources from multiple federal agencies.

- What are the metrics for success for the platform and how would you categorize the success of this platform?

Performance metrics for the platform include total users, new users, mentors registered, mentors logged in, and mentors trained. The SBA has seen evidence of the platform helping small business owners.

- Is SBA aware of any issues with the implementation and management of the platform?

SBA is not aware of any issues with the implementation and management of the platform. SBA has weekly and monthly meetings to discuss the project and any outstanding items.

- How can the platform be utilized post-pandemic? Would OED like to see the platform pivot for post-pandemic use?

The platform can be used post-pandemic to deliver content and produce webinars and deliver turnkey toolkits to bolster application of materials by the small business ecosystem and increase

coalition building and resource sharing between our Resource Partners, our service providers and the SBA.

- Does a similar platform to centralize resources, particularly for current or prospective small business owners, exist for other SBA programs or other agencies?

SBA is not aware of a similar web platform that provides resource information to small businesses and training for the SBA Resource Partner advisers in response to the COVID crisis.

- Would an interagency one-stop shop for all prospective business owners seeking information on how to launch their enterprises, or current business owners looking to access resources, be an appropriate next phase to the current Resource Partner platform?

The SBA and its Resource Partners offer a portfolio of electronic learning resources aimed at providing small business owners with the tools that they need to launch or sustain their enterprises, such as Ascent, our Women's Learning Platform. We are always looking to hone the tools that we offer to small business owners and to make them more robust, and we're committed to working with Congress to ensure business owners have access to the information they need.

Questions for the Record from Representative Judy Chu (D-CA)

- There are some concerns from SBDCs in my district that the Community Navigator grants will require a different customer relationship management (CRM), accounting, and performance tracking system. This could pose an administrative burden for small SBDCs and limit their ability to be helpful resources to small businesses in their areas. If SBA chooses to require that Community Navigator funds be managed and tracked completely separately, how will you assist grant recipients in managing the additional administrative requirements?

The SBA will have its own Customer Relationship Management (CRM) system for tracking Community Navigator Pilot Program grant recipient organizations. Initially the awardees will be able to enter their tracking data manually, or via XML into the CRM. As the system matures, the awardee's existing system will be able to automatically update the CRM via an Application Programming Interface (API). As part of the application process, awardees described their capability in tracking and managing data. Throughout the Community Navigator Pilot Program, the SBA will systematically collect and integrate feedback from hubs and spokes to ensure that reporting is as seamless as possible. The SBA will also support Community Navigator Pilot Program grant recipient organizations with adoption of the technology through webinars, trainings, and other resources.

Questions for the Record from Rep. Blaine Luetkemeyer (MO-03):

- How far along is the SBA in resolving the OIG's 10 recommendations outlined in the recent WBC audit? Please specifically detail when each recommendation will be closed.

Recommendations # 1, 5, and 6, have final target dates associated with them of (4/30/2022). These recommendations overall relate to oversight, compliance and monitoring of the WBC program with specific concerns regarding finance examinations. OED is positioned to utilize financial examiners on staff for this purpose.

The SBA is requesting an extension to 5/30/22 on recommendations # 2, 3, 4, and 7 that have final closeout dates of 3/30/2022 as we are actively communicating with OIG about the financial obligations on the part of the WBC that need to be recouped and/or reconciled if possible.

Recommendations #9 and 10 are closed.

- Has your office taken any additional steps to protect taxpayer dollars and improve oversight of the WBCs' use of federal funds?

Yes, the Office of Women's Business Ownership has undertaken the following steps to protect federal funds:

  - Implemented GrantSolutions, which is an automated grant management system which the Office of Women's Business Ownership will use to manage awards from announcement to closeout
  - Utilized targeted financial analysis (TFA) to 1) ensure compliance when issues of potential fraud waste and abuse are identified and 2) as preventative strategy, as grantees can be asked at any time for the documentation needed to conduct a TFA; and
  - Hosting "Office Hours" to providing training and technical assistance to grantees on program management and compliance issues.

- How do you ensure that Resource Partner employees comply with OIG recommendations once closed and implemented?

To ensure that our WBCs comply with OIG requirements once closed and implemented, the Office of Women's Business Ownership uses the Risk Assessment process and targeted financial analysis to ensure WBCs are compliant with addressing the recommendations of the OIG. In addition, if WBCs fail to comply with recommendations, they are subject to payment holds, suspension, or termination.

Our Office of Entrepreneurship Education (OEE) meets with SCORE's Compliance Manager weekly to ensure SCORE is compliant with policies, procedures, and internal controls.

Finally, when the Office of Small Business Development Centers receives referrals it follows up with the SBDC Networks to help ensure internal controls, mitigate fraud waste and abuse, and strengthen compliance with OSBDC policies and procedures to ensure future compliance.

- In light of multiple concerning OIG audit reports, do you believe the SBA is providing adequate oversight of its Resource Partners to ensure proper stewardship of taxpayer dollars?

Yes, we do believe that the SBA is providing adequate oversight of its Resource Partners under this Administration. We are integrating Administrator Guzman's values of being technology-forward and customer-centric into our oversight processes to strengthen them and make them more robust. As such, OED has implemented a sustainable and collaborative tracking system to effectively manage audit findings.

- What SBA staff resources have you committed to the oversight of the SBA's Entrepreneurial Development Programs?

Currently 7 staff members oversee Small Business Development Centers, 9 staff members oversee Women's Business Centers and 1 staff member oversees SCORE (with supervision from the head of the OED Office of Entrepreneurship Education).

Additionally, the Office of Entrepreneurial Development Financial Examination Unit (FEU) is instrumental in the oversight process by conducting biennial financial examination reviews of SBDC recipient organizations. The FEU is also responsible for Women's Business Center financial examinations which are conducted every three years.

- The American Rescue Plan appropriated $100 million to establish a new SBA Community Navigator program. The last update our Committee received on the program was six months ago (*April 22, 2021*). When will these grants be awarded and when do you anticipate navigators being deployed to communities?

We announced the Community Navigator Pilot Program grantees on October 28, 2021, and the period of performance began in December.

- I think we can agree that Small Business Development Centers and other SBA Resource Partners have provided vital services to small businesses throughout the pandemic and educated them on the SBA resources and programs available. How is the Community Navigator Pilot Program not duplicative of existing efforts of SBA Resource Partners and advocacy organizations? Why was a new grant program with new service providers needed, and are there long-term plans for the Community Navigator Program?

The SBA does not see the Community Navigators Pilot Program as reinventing the wheel, nor do we believe that SBDCs, WBCs, VBOCs, and SCORE are failing our small businesses. Today small businesses have an evolved ecosystem of need in the United States. The small business that we are serving at the SBA are only a drop in the bucket compared to the 32.5 million small businesses in the U.S. At the same time, we've seen an explosion of entrepreneurship, with a

record 5.4 million new business applications in 2021, surpassing the previous record by over 1 million. We must keep in mind that 20% of small business die in year 1, which presents a tremendous opportunity to save and cultivate these small businesses that are being born at an unprecedented rate. Finally, we have a commitment to support those small business owners who were accessing, or attempting to access, SBA resources for the first time during the pandemic, including those who did not qualify. Community Navigators aim to connect with those small business owners who we haven't yet reached, this massive cohort of new entrepreneurs, and those that came to the SBA for the first time in the pandemic.

Perhaps most critically, the Community Navigators will also be a critical tool in progressing the Biden-Harris Administration's goal of advancing equity for the chronically underserved. During early rounds of pandemic relief, we saw not only that women, minorities and other disadvantaged business owners had difficulty accessing federal resources, but also that it took longer on average for them to receive loans.[1] Narrowing opportunity gaps disadvantaged small businesses helps Main Street flourish and positions *all* American businesses to succeed. Community Navigators enable us to build authentic relationships with these entrepreneurs that we must reach.

Additionally, we are positioning the pilot to foster coalition building. A resounding example of this is my recent visit to Syracuse University, which was a recipient of a Community Navigator Pilot Program grant. There, we convened a roundtable discussion with representatives from Syracuse as a grantee, SBA's Office of Entrepreneurial Development, SBA's Office of Veterans Business Development, representatives from the SBA's local New York District Office, leaders from our local resource partners, SBDCs, WBCs, SCORE, Veteran Business Outreach Centers, and even representatives from New York government. We talked about the challenges that each of these leaders has seen small businesses experience through the pandemic. Notably, we discussed the unique ways that each of these organizations has pivoted to support small businesses in this new environment. It was a great example of how the SBA, our Community Navigators, and our Resource Partners can continue to provide unique services, refer within the network and build sustainable coalitions to better serve small businesses and reach small businesses lacking access to SBA and other federal, state and local resources.

- On March 23, 2010, former President Obama signed into law the Patient Protection and Affordable Care Act, which established a Navigator Program that led to fraudulent behavior and posed concerning threats to the safety of consumers' personally identifiable information. What steps will be taken by the SBA to prevent fraud and abuse in the Community Navigators Pilot Program?

Rigorous grants management is critical to the success of our programs at SBA—including the Community Navigator Pilot—and we ensure the mitigation of fraud, waste and abuse through strong internal controls. For the Community Navigator Pilot Program, we have several internal controls in place:

[1] Sifan Liu and Joseph Parilla. "New data shows small businesses in communities of color had unequal access to federal COVID-19 relief." Brookings. September 17, 2020. https://www.brookings.edu/research/new-data-shows-small-businesses-in-communities-ofcolor-had-unequal-access-to-federal-covid-19-relief/

- The grantees submit financial reports using SF 425 (Federal Financial Report). Also, the grantee must provide detailed information regarding its actual expenditures broken down by the same cost category line items identified in its approved budget.
- The grantee must attach a certification to each annual and financial report.
- Grantees submit complete copies of their audited financial reports to comply with OMB Financial Reporting regulations. This report will be prepared by a licensed independent accountant within 150 days of the end of the recipients' fiscal year.

There are several parties within the SBA that are responsible for oversight of the program (several checkpoints and lines of defense):

- A designated Grants Management Officer (GMO) within OED will be responsible for oversight administration
- n and issuing the Notice of Award (NOA), approving payments and making applicable amendments to the award.
- A designated National Program Manager (PM) located within OED at SBA Headquarters will be responsible for the overall monitoring and oversight of the Community Navigator Pilot Program grantees,
- A District Program Officer (DPO), located within the Office of Field Operations (OFO), will be assigned to each award to assist the Program Manager in ensuring overall compliance with the Grants Agreement, in addition to our grants oversight procedures.

- Will you commit to providing additional briefings and testimony on the Community Navigator Pilot Program to Congress to allow for proper oversight?

Yes, indeed.

- Has the SBA provided its Resource Partners with any additional details about the Community Navigator Pilot Program? When can Congress expect to receive information on the program's awards and implementation?

The SBA has been keeping its stakeholders, including the Resource Partner network, aware of developments in the Community Navigator Pilot Program. Congress received information on the program's grantee awards at the end of October 2021.

- In light of the SBA Inspector General's Management Alert on the Shuttered Venue Operators Program, what performance indicators will be used to measure the success and effectiveness of the Community Navigator Pilot Program?

Performance metrics, as outlined in the Community Navigator Pilot Program Notice of Funding Opportunity, include the following:

1. Number of unique clients who receive assistance in the development of their:
    a. Loan application (PPP, Microloan, Exporting, Other Loan)
    b. Forgiveness applications of SVOG or RRF reports (post-funding reports)
    c. Grant application (SVOG, RRF or other Federal, State, Local or Private Sector Grants)

   d. Other application (Contracting certifications or other business assistance program)
2. Dollar (millions) amount request of completed
   a. Loan application (PPP, EIDL 7(a), 504, Microloans, Exporting, Other Loan)
   b. Grant application (SVOG, RRF, other Federal, State, Local, or Private Sector Grants)
3. Dollar (millions) amount of approved
   a. Loans (PPP, EIDL, 7(a), 504, Microloans, Exporting, Local Loans)
   b. Grants (SVOG, RRF, other Federal, State, Local or Private Sector Grants)
4. Number of counseling hours to develop and submit
   a. Loan application (PPP, EIDL, 7(a), 504, Microloan, Exporting, Local Loan)
   b. Grant application (SVOG, RRF, other Federal, State, Local, or Private Sector Grants)
   c. Other application (Contracting certifications or other business assistance program)
5. Number of counseling hours provided for:
   a. Disaster preparedness/recovery
   b. Credit counseling, financial literacy
   c. Business technical assistance (operation, marketing, sales, management, etc.)
   d. Contracting and procurement
   e. Other business development technical assistance (exporting, industry specific technical assistance)
6. Number of training hours
7. Number of clients trained
8. Number of clients receiving approved loan or grant funding starting a business
9. Number of clients receiving approved loan or grant funding with their business in operation (business survival)
10. Number of jobs created or retained
11. Percent increase of revenue (gross sale dollars)
12. Metric Crosscuts. The SBA seeks to measure the outputs and outcomes through the following crosscuts:
   a. Gender
   b. Race
   c. Ethnicity
   d. Veteran Status
   e. Disability Status
   f. LGBTQ
   g. Business Status - Years in Business
   h. Business Industry
   i. Geography (via Zip Code)
   j. State
   k. Information on other American Rescue Plan or other Covid related Federal aid programs provided by "Spokes"

- How can existing entrepreneurial development resources, such as Small Business Development Centers, Women's Business Centers, SCORE, or Veterans Business Outreach Centers, better tailor their programs to meet the needs of recovering small businesses?

We continue to work with our Resource Partners including Small Business Development Centers, Women's Business Centers, SCORE, or Veterans Business Outreach Centers to ensure that we are leveraging technology to drive efficiencies, promoting existing programs, and making our data collection environment more robust.

- Your testimony states that the Community Navigator Pilot Program will "complement" existing Resource Partners. Given the fact that at this point in time zero dollars have been distributed and zero small businesses have been served by this program, would it have been better to utilize existing programs rather than establish a new one that is already experiencing delays with implementation?

While our Resource Partner network is strong, 20.7% of the more than 7.9 million small business establishments (<500 employees) are in counties without any type of SBA-funded service centers. This underscores the need for the Community Navigator Pilot. Also, certain diverse small business ecosystems have been left behind, many of whom have historically been left behind. At this critical time of recovery, we believe it is prudent to leverage all possible organizations to connect with these businesses.

- You mentioned a tracker of "all OIG and GAO audits." How frequently is the tracker updated? Will you commit to sharing this tracker with Committee Members?

The OIG/GAO audit tracker is an internal document used to provide up updates on progress and items to resolve, along with associated timelines. We commit to working with Committee Members to provide consistent updates.

- How do VBOCS, SBDCs, WBCs, and SCORE differ from similar private sector Resource Partners? What steps can be taken to reduce the overlap among the SBA's Resource Partner programs?

SBDCs, VBOCs, WBCs and SCORE differ from similar private sector resource providers in that their counseling and training services are no-cost to low-cost to small businesses who cannot afford services provided by private sector resource providers. SBA Resource Partners work collaboratively to refer a small business client between the partner systems, if applicable. The Resource Partners perform an assessment of the small business client to determine unique needs. This assessment helps to determine which Resource Partner is better suited to provide the needed assistance. They also engage in joint collaborative efforts such as training and service awareness webinars; as a result, small business owners can distinguish services by each Resource Partner.

The ability of WBCs to provide free or low-cost assistance and also integrate into the goals and metrics of SBA District Offices uniquely positions WBCs to ensure women entrepreneurs realize their business goals.

At the same time, we've seen an explosion of entrepreneurship, with a record 5.4 million new business applications in 2021, surpassing the previous record by over 1 million. The increased interest in entrepreneurship indicates that there is a large enough market for private and publicly supported entrepreneurial development programs to operate.

However, to prevent overlap among WBCs OWBO ensures WBCs operate within strict catchment areas, provide services that match the local economy and deliver services that don't already exist in the communities they engage.

- One of our most important duties as Members of Congress is to investigate agency programs, identify problems, and determine whether programs are working and taxpayer dollars are prudently spent. In your view, what are the most important needs for the SBA Office of Entrepreneurial Development as you administer these programs in a responsible manner?

Per Administrator Guzman's leadership, we are constantly evaluating how we can streamline our operations via leveraging technology and being more customer-centric. We must continue to have the support to oversee our Resource Partner network (SBDCs, WBCs, SCORE) and to lead the Community Navigator Pilot.

- The Biden administration has claimed that the majority of small businesses will be exempt from President Biden's proposed tax hikes – but the Tax Foundation has said that's "misleading." In fact, almost 900,000 small businesses could be hit with Democrats' limitation of the pass-through deduction based on 2018 Internal Revenue Service data. Who within the SBA is advocating for these entrepreneurs that will be harmed by these tax hikes?

The Administration's proposed revenue increases do not raise taxes on those earning under $400,000, and revenue raised will be used to finance public investments that help workers, raise productivity, help small businesses access capital and markets, and improve the economic competitiveness of the U.S. economy such that small business on the whole will exist in a more prosperous economy.

- Given that the SBA is the voice of small businesses within the Executive Branch, has the agency provided the White House any counsel or advice regarding the impact of taxes on small businesses? If so, please detail the information that you provided to the White House and the Treasury Department?

Yes, the SBA regularly advises the President and broader Executive Branch on tax policy and other matters important to small businesses. Administrator Guzman has advocated strongly for investments in infrastructure, in strengthening supply chains, expanding access to capital, childcare, and more. To finance these investments, Administrator Guzman has advocated for targeted tax increases that ask the largest corporations and wealthiest individuals to pay their fair share, as reflected in the Administration's FY23 Revenue Proposals. She has also advocated for lower taxes for America's lower- to middle-income entrepreneurs.

- How does the capital gains rate impact investments in small businesses?

For a potential investor in a small business, what matters is the effective tax rate on that business relative to other potential investments, such as corporate stock. The President's tax agenda does not diminish the after-tax profitability of small businesses relative to alternative investments. In many cases, the President's proposals improve the attractiveness of small business investment.

- Has the SBA studied the effects of the 2017 Tax Cuts and Jobs Act on small business pass-through entities? If so, please provide the agency's analysis on the impact of the Section 199A provision on small businesses?

SBA has not published a study on this topic.

- If SBDCs, WBCs, VBOCs, and SCORE representatives have questions on tax policy, who do they talk to at the SBA?

If SBDCs, WBCs, VBOCs, and SCORE representatives have questions on tax policy, they speak with The Ombudsman or Office of Advocacy.

- Will eliminating stepped up in basis, hinder small businesses and small farmers interested in passing down their businesses to others?

The President's proposal to reform stepped-up basis includes an exclusion of $5 million per person for transfers of property by gift during life, allowing for any remaining portion to be used following a decedent's death, and special rules for real estate, farms, and other illiquid assets to protect small family-owned-and-operated businesses.

- Given the current Budget Reconciliation language that is moving through Congress, how many small businesses will be impacted by the increases to the corporate tax rate and the individual rates?

The proposed increases are limited to individuals in the highest income brackets and only affect a share of tax units in the low single digits. If one is going to look more broadly at the indirect effects of these measures, one would have to also examine the effects of the job-generating, and productivity-enhancing investments made with the generated revenue.

- Knowing that millions of small businesses have been impacted by COVID-19 and are in the process of recovering, does the SBA believe increasing taxes on them will be helpful right now?

SBA has administered over $1 trillion in relief aid to America's small businesses. Overwhelmingly, America's small businesses stand to benefit from investments in infrastructure, supply chains, capital access, childcare, worker training and other productivity enhancements. The tax measures in the Administration's FY23 Revenue Proposals are focused overwhelmingly on the largest corporations and wealthiest individuals.

- According to NFIB's latest COVID-19 survey, half of small employers report supply chain disruptions are significantly impacting their businesses. How is your office assisting small businesses in overcoming these supply chain disruptions and staffing shortages?

Since President Biden announced the creation of the new Manufacturing HUB Office on July 28th, SBA's contracting office has been meeting with small business manufacturers to better understand their pain-points and specific areas where SBA has the authority or programmatic capabilities to address the gap.

- 7.7 million Americans remained unemployed in September despite there being 10.4 million job openings. How is your office assisting small businesses in hiring during this labor crisis?

Many but not all SBDCs and WBCs support small businesses with workforce development. One example is the WBC at Winston Salem State University in North Carolina partnered with Army Community Services from Fort Bragg to host the Milspo Career Expo which aimed to address employment needs and opportunities. This event gave small businesses an opportunity to share their job openings and aimed to bridge the gap between military spouses who want to be employed and the need for positions to be filled. Also, a number of SBDCs and WBCs are offering workforce development webinars and online resources, such as the WBC in Grand Rapids online learning platform (which provides resources to support small businesses with hiring and managing employees).

- What are the biggest challenges to entrepreneurs in accessing the SBA programs?

The small business that we are serving at the SBA are only a drop in the bucket compared to the 32.5 million small businesses in the U.S. A major challenge in entrepreneurs accessing SBA technical assistance programs is awareness that they exist. The SBA has been very supportive of our Resource Partners, working to increase awareness of them through SBA channels. In the last year, posts mentioning resource partners/SCORE generated 1.3M impressions and over 20K engagements. We also hope to leverage the Community Navigator Pilot Program to raise awareness for our Resource Partners by empowering Navigators to point clients to our Resource Partners when appropriate.

- To what degree are SBA Resource Partners, like SBDCs, known in the entrepreneur community? How is your office working to better promote them?

The SBDC Program includes 62 Lead Centers and over 900 Service Centers throughout the United States, Puerto Rico and U.S. territories. Resource partners like the America's SBDC (ASBDC) used some of the CARES Act funding on marketing their services to reach new and existing clients. We continue to grow awareness for Women's Business Centers as we launch new ones across the United States, and now have a footprint of 140 WBCs. SCORE has grown awareness for its services via its Small Business Resilience Hub, which was created in response to the needs of small business owners through the pandemic.

The move to a virtual environment during the pandemic encouraged our network of Small Business Development Centers, Women's Business Centers, and SCORE to reach small business owners in new ways, including via Search Engine Optimization and Social Media. In addition to supporting these efforts, the SBA also works to expand awareness of our resource partners via being able to offer services in more languages. The CARES Act authorized funding for the Small Business Administration to ensure its resources and services are available in 10 common languages other than English.

- What do entrepreneurs report is the most helpful SBA resource and outreach as they reopen their doors and begin the path to recovery?

Our small business ecosystem is diverse and the answer to this question depends on multiple factors (e.g., industry, location, number of employees, seasonality, revenue size, capital reserves, capital infusion, broadband access, digital presence, etc.). We have discovered that each SBA pandemic resource has been valued by small business clusters throughout the U.S.

- Small businesses in rural areas are often overlooked, and we can do more to help them. How is your office currently serving rural communities and what ideas do you have to further support these entrepreneurs?

Our network of over 62 SBDC Lead Centers/900+ Small Business Service Centers and Women's Business Centers are strategically located throughout the country, including in rural areas. District offices collaborate with community leads on local technical assistance strategies and rural business development initiatives with other federal partners including USDA.

The SBDC Program authorizing language requires rural assistance to small businesses. SBDCs help rural businesses increase their participation in exporting, government procurement, tourism, access to credit, incubators, innovation and technology and other small business programs, in cooperation with the U.S. Department of Commerce, the U.S. Department of Agriculture and other relevant Federal Agencies. The SBDCs develop marketing and production strategies that enable the rural businesses to better compete in the domestic and international markets, provide technical assistance needed by rural small businesses, make available managerial assistance to rural small business concerns and provide information and assistance in obtaining financing for business startups and expansion. The SBA requires SBDCs to report on these activities semi-annually and annually.

In fact, the SBDC CARES Act Notice of Funding Opportunity reflected the requirement to reach rural communities.

Additionally, SCORE, which is supported by our Office of Entrepreneurship Education, provides resources for rural entrepreneurs. Farmers, ranchers, agribusinesses, entrepreneurs and small businesses can receive free mentoring, training and resources from SCORE and USDA.

Our Office of Entrepreneurship Education also provides digital education tools and trainings such as Ascent (our online women's business curriculum) to meet small business owners where they are, including rural areas.

The Community Navigator Pilot, as well, will serve rural footprints.

- If an SBDC or other Resource Partner has questions about one of the COVID-19 small business relief programs, what steps do you take in advising them?

Our Resource Partners have worked with our SBA District Offices and the various SBA units to address questions regarding PPP, PPP forgiveness, EIDL, RRF and SVOG. SBA Headquarters Office of Entrepreneurial Development partner with the Office of Disaster Assistance, the Office of Capital Access and the Office of Field Operations to host "office hours" to provide Resource Partners with key, up-to-date information and to respond to questions.

- How does your office advise SBDCs and other Resource Partners on tax increases proposed by this Administration?

SBDCs help small businesses access technical assistance on tax compliance for what exists in current tax law. If the tax law changes, SBA will help SBDCs provide assistance on any new tax law. SBA does not advise SBDCs on policy proposals because SBDCs do not make tax policy.

Questions for the Record from Rep. Jim Hagedorn (MN-01):

- In Minnesota the SBDC is run by the MN State Department of Workforce and Economic Development, they sign the cooperative agreement. Under the COVID contractor mandate, would all the employees of the State of Minnesota be required to be vaccinated, just the employees of the Department of Workforce and Economic Development, or just the employees at the SBDC?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- The individual SBDC centers are all subcontractors. Would all the employees of say Minnesota State University in Mankato need to be vaccinated or just the ones working at the SBDC?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- In the language of this executive order, what is the term "covered contractors"? What's the definition of a "covered contractor workplace"? Is it just the office or the whole building? For example, the Minnesota SBDC lead office is in Suite E200 in Minnesota Department of Workforce and Economic Development in a building in Minneapolis, is just their office the "covered workplace" or does this span to the entire building encompassing the Minnesota Department of Workforce and Economic Development?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- Will this apply to employees who are working remotely? And how will vaccination be verified?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- One of the questions many SBDC State Directors have been seeking answers on pertaining to President Biden's Executive Order is how the SBA plans, or is anticipating, to resolve the conflicts between this new federal vaccine mandate and the possibility for differing policies of college, university, and other agency policies that host SBDC centers throughout the country. How are you advising SBDCs on this matter?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- In Minnesota alone, we have 5 centers hosted by state colleges, 2 private universities and 2 private nonprofit foundations that host SBDC centers. All of them have differing policies about masking, distancing, and vaccines. How do the SBA and OMB plan to address the possibility of diverging/conflicting policies?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- Several universities have made accommodations for employees who are not vaccinated, the guidance allows for accommodations if the employee is "legally entitled" to an accommodation. Who determines "legally entitled" and how?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

- Will these mandates apply to all the Community Navigators Pilot Programs who utilize grants rather than cooperative contracts? When their grants are issued will this mandate be included?

Executive Order 14042 Ensuring Adequate COVID Safety Protocols for Federal Contractors has been enjoined nationwide. SBA is thus not enforcing the covered contractor employee vaccination requirement.

Questions for the Record from Representative Pete Stauber (R-MN)

- What is the SBA doing to see that OIG recommendations are implemented to ensure that taxpayer dollars are not wasted on programs that have perpetuated fraud?

The Office of Entrepreneurial Development is taking the following steps resolve and close current OIG recommendations:

- Reviewing policy and procedures for data collection. The program office is making the appropriate changes to address feedback received via recommendations from OIG
- Reevaluating internal policy and procedures relating to program and making appropriate corrective actions
- Creating baseline performance data for programs as discussed with OIG to satisfy recommendation requirements
- OED Program Offices are working with OIG to address and satisfy all recommendations

- Does the SBA see the Community Navigators program as reinventing the wheel? If not, where does the SBA believe the SBDCs, WBCs, VBOCs, and SCORE are failing our small businesses? Would it not be more efficient to improve the programs we already have in place?

The SBA does not see the Community Navigators Pilot Program as reinventing the wheel, nor do we believe that SBDCs, WBCs, VBOCs, and SCORE are failing our small businesses. Today small businesses have an evolved ecosystem of need in the United States. The small business that we are serving at the SBA are only a drop in the bucket compared to the 32.5 million small businesses in the U.S. At the same time, we've seen an explosion of entrepreneurship, with a record 5.4 million new business applications in 2021, surpassing the previous record by over 1 million. We must keep in mind that 20% of small business die in year 1, which presents a tremendous opportunity to save and cultivate these small businesses that are being born at an unprecedented rate. Finally, we have a commitment to support those small business owners who were accessing, or attempting to access, SBA resources for the first time during the pandemic, including those who did not qualify. Community Navigators aim to connect with those small business owners who we haven't yet reached, this massive cohort of new entrepreneurs, and those that came to the SBA for the first time in the pandemic.

Perhaps most critically, the Community Navigators will also be a critical tool in progressing the Biden-Harris Administration's goal of advancing equity for the chronically underserved. During early rounds of pandemic relief, we saw not only that women, minorities and other disadvantaged business owners had difficulty accessing federal resources, but also that it took longer on average for them to receive loans.[2] Narrowing opportunity gaps disadvantaged small businesses helps Main Street flourish and positions *all* American businesses to succeed. Community Navigators enable us to build authentic relationships with these entrepreneurs that we must reach.

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[2] Sifan Liu and Joseph Parilla. "New data shows small businesses in communities of color had unequal access to federal COVID-19 relief." Brookings. September 17, 2020. https://www.brookings.edu/research/new-data-shows-small-businesses-in-communities-ofcolor-had-unequal-access-to-federal-covid-19-relief/

Additionally, we are positioning the pilot to foster coalition building. A resounding example of this is my recent visit to Syracuse University, which was a recipient of a Community Navigator Pilot Program grant. There, we convened a roundtable discussion with representatives from Syracuse as a grantee, SBA's Office of Entrepreneurial Development, SBA's Office of Veterans Business Development, representatives from the SBA's local New York District Office, leaders from our local resource partners, SBDCs, WBCs, SCORE, Veteran Business Outreach Centers, and even representatives from New York government. We talked about the challenges that each of these leaders has seen small businesses experience through the pandemic. Notably, we discussed the unique ways that each of these organizations has pivoted to support small businesses in this new environment. It was a great example of how the SBA, our Community Navigators, and our Resource Partners can continue to provide unique services, refer within the network and build sustainable coalitions to better serve small businesses and reach small businesses lacking access to SBA and other federal, state and local resources.

- How does the SBA measure the success of entrepreneurial development programs? Should these programs wane from success, or not meet certain goals, what accountability actions does the SBA take to ensure funds are used effectively?

All programs in the Office of Entrepreneurial Development have robust goal setting and program oversight. If goals are not met, OED has procedures in place to adjust resourcing or tactics accordingly. For instance:

The SBDC program uses comprehensive metrics and reporting requirements to ensure SBDCs are delivering a seamless cadre of services measured by indicators, such as unique clients served, new business starts, jobs supported and capital infusion. In addition to these metrics, SBDCs provide SBA annual economic impact data and other key performance data. The SBA reserves the right to terminate non-performing recipient organizations.
The WBC program also uses a robust set of performance metrics to ensure WBCs are performing and compliant. Among the key performance metrics used for the program are unique clients served, new business starts, and capital infusion transactions. Each year WBCs establish performance targets for these measures and OWBO, using EDMIS data, assesses WBCs performance to determine if they are above, below, or on target. For those that are not performing OWBO's Program Managers work with WBCs to develop corrective action plans. WBCs that continue to underperform can be recommended for suspension or termination.

Questions for the Record from Rep. Dan Meuser (PA-09):

- American small businesses depend on the SBA every day for vital programs and resources. The mission of the Office of Entrepreneurial Development is to "help small businesses start, grow, and compete in global markets." How can Congress help your office serve and advocate for our small businesses?

Per Administrator Guzman's leadership, we are constantly evaluating how we can streamline our operations, leverage technology and deliver more customer centric resources. Additionally, we are strengthening the relationship between the OED office and our Resource Partner network. We appreciate your continued support for the Office of Entrepreneurial Development's programs and structure and the ongoing support of each Resource Partner.

- Small businesses in rural areas, like many of those in my district, do not have the same access to resources as their more urban and suburban counterparts. How is your office currently serving more rural communities and what ideas do you have to further support these entrepreneurs?

Our network of over 62 SBDC Lead Centers/900+ Small Business Service Centers and Women's Business Centers are strategically located throughout the country, including in rural areas. District offices collaborate with community leads on local technical assistance strategies and rural business development initiatives with other federal partners including USDA.

The SBDC Program authorizing language requires rural assistance to small businesses. SBDCs help rural businesses increase their participation in exporting, government procurement, tourism, access to credit, incubators, innovation and technology and other small business programs, in cooperation with the U.S. Department of Commerce, the U.S. Department of Agriculture and other relevant Federal Agencies. The SBDCs develop marketing and production strategies that enable the rural businesses to better compete in the domestic and international markets, provide technical assistance needed by rural small businesses, make available managerial assistance to rural small business concerns and provide information and assistance in obtaining financing for business startups and expansion. The SBA requires SBDCs to report on these activities semi-annually and annually.

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Additionally, SCORE, which is supported by our Office of Entrepreneurship Education, provides resources for rural entrepreneurs. Farmers, ranchers, agribusinesses, entrepreneurs and small businesses can receive free mentoring, training and resources from SCORE and USDA.

Our Office of Entrepreneurship Education also provides digital education tools and trainings such as Ascent (our online women's business curriculum) to meet small business owners where they are, including rural areas.

The Community Navigator Pilot, as well, will serve rural footprints.

- Thanks to massive levels of increased government spending, inflation is at its highest in 30 years. Because of this, I've recently introduced legislation that would require the Congressional Budget Office to take account of inflation during their scoring process for reconciliation bills. How is your office helping small businesses navigate the rising costs of goods?

SBA continues to work with small businesses through our entrepreneurial development's advisory network across the country to help businesses with strategy and pivoting to adapt to the marketplace. Additionally, the SBA administered several COVID relief programs which supported small businesses in need of operating capital.

The FY23 President's Budget invests in fiscally-sustainable growth-enhancing policies that address long standing issues such as childcare, eldercare, and healthcare, which have had an outsized impact on small business owners and workers. These investments will directly address major needs of America's small businesses by: providing access to affordable capital to entrepreneurs; making quality childcare affordable and providing universal Pre-K so more parents can return to work; creating apprenticeships to address gaps in skilled labor; helping them deliver more affordable healthcare to their workers; giving them access to affordable, clean energy; mitigating against the disastrous consequences of climate disasters; and investing in our port, freight transportation to speed the flow of good and strengthen the supply chain.

- What specific steps will the Office of Entrepreneurial Development take to ensure that those taking part in the Community Navigators Program are effective and qualified resources for our nation's small businesses?

Technology-enabled oversight is critically important to the success of the Community Navigators Pilot program. As with all grants, SBA will review the grantees' performance to ensure that the grantees are fulfilling the terms of the grant. If not:

- OED will require corrective actions to fix deficiencies and come into compliance with the terms of the grant (cure notice)
- Also, SBA can seek the return of grant funds and terminate the grant (this action will also get noted in the Federal Awardee Performance and Integrity Information System (FAPIIS)

Questions for the Record from Rep. Andrew Garbarino (NY-02):

- According to National Federation of Independent Business' (NFIB) latest COVID-19 survey, half of small employers report supply chain disruptions and staffing shortages significantly impacting their businesses. How is your office and the greater SBA assisting small businesses in overcoming these supply chain disruptions and staffing shortages?

Since President Biden announced the creation of the new Manufacturing HUB Office on July 28th, SBA's contracting office has been meeting with small business manufacturers to better understand their pain-points and specific areas where SBA has the authority or programmatic capabilities to address the gap.

- A key metric measuring inflation is at the highest rate since 1991, that's the highest rate in 30 years. How is your office helping small businesses navigate the rising costs of goods?

SBA continues to work with small businesses through our entrepreneurial development's advisory network across the country to help businesses with strategy and pivoting to adapt to the marketplace. Additionally, the SBA administered several COVID relief programs which supported small businesses in need of operating capital.

- As the Ranking Member of the House Homeland Security Committee's Subcommittee on Cybersecurity, Infrastructure, Protection, and Innovation, I am very concerned with the impact cyber-attacks have on the U.S. economy and our small business community. What is your office and the greater SBA doing to ensure that small businesses are prepared to withstand direct cyber-attacks and are trained to protect themselves from any economic impact caused by such attacks?

A number of our Resource Partners conduct cybersecurity training to small business concerns on a regular basis. The SBA has worked collaboratively with America's Small Business Development Centers to prioritize cybersecurity assistance and protection for small businesses. Each SBDC Network has access to a curriculum for beginning, mezzanine and sophisticated levels of training for small business. The SBA's Office of Small Business Development Centers is developing working relationships with Cybersecurity and Infrastructure Security Agency (CISA) and NIST. SBA works in concert with CISA who leverages our SBA broadcast channels to promote cybersecurity awareness for small business.

SBA has included cybersecurity as a focus initiative for 2022 as noted in the SBDC Notice of Funding Opportunity. The ASBDC shared their North Star cybersecurity training resources with our internal colleagues in the SBA Office of Government Contracting who are preparing small businesses to do business with the Federal Government and require a Cybersecurity Maturity Model Certification.

Also, we are launching a Cybersecurity for Small Business Pilot which will enable states to further their assistance to early-stage businesses facing cyber threats and attacks. This will take the form of three $1M awards.

Additionally, the SBA regularly coordinates with Federal partners such as DHS to promote resources (e.g., StopRansomware.gov) and engage in outreach campaigns. Through Ascent, our online learning platform for women, we will be releasing (next 3 months) a cyber-focused module.

Questions for the Record from Rep. Young Kim (CA-39):

- In your written testimony you talk about Mr. Patrick Montgomery who received a PPP loan by learning about it through the SBDC program. Thanks to the PPP, Mr. Montgomery was able to keep his staff full force and expand his business. Can you describe how the partnership between local lending institutions and the entrepreneurial development (ED) resource networks facilitates access to capital for small businesses? Does it help small business owners and entrepreneurs to have bank representatives who know their communities as a resource for the networks?

SBA lenders refer applicants that are not quite ready for financing to SBA's resource partners such as the Small Business Development Centers, SCORE, and Women's Business Development Centers to receive pre-financing support, including developing business plans including how to do projections. SBA resource partners work regularly with local community bank representatives regarding SBA programs.

- In your written testimony, you indicated that SBA is introducing a next generation reporting system. Can you provide the Committee with more information on the timeline of the reporting system's implementation? Can you provide more details on this investment and reporting system?

Successfully, we have migrated from EDMIS to EDMIS-Next Generation (NG). As of late May, we are 100% deployed, and currently we are hardening the environment, particularly the XML reporting. The EDMIS-NG has translated into more efficient, timely, customer-centric, and robust reporting. Consequently, our oversight is more timely and efficient. We are shoring up the system and now and are checking in with Resource Partners for feedback to strengthen our system training efforts.

- Are there any internal procedures within the Office of Entrepreneurial Development to better coordinate and address duplicative efforts between the different entrepreneurial programs?

Under this Administration, the OED Deputy Associate Administrator meets with the OED department heads weekly to discuss previous week's activities plus to share priorities going forward. This level-setting ensures the distinction of each of the offices and respective programs. As well, the Associate Administrator and Deputy Associate Administrator are streamlining internal duplicative processes. Additionally, we are working to build stronger coalitions between Resource Partners to best serve our small business ecosystem during recovery.

Questions for the Record from Rep. Beth Van Duyne (TX-24):

- Despite misleading claims pushed by this Administration, increased taxes included in the Democrat reconciliation plan will negatively affect the close to 1.5 million small businesses organized as C-corporations and most small businesses organized as pass-through entities. According to the Texas Public Policy Foundation, the proposed policies Democrats are pushing will result in Texas businesses losing well over $650 billion in investments and will reduce full-time employment by 12,000 jobs. Do you believe increased taxes on small businesses helps them grow and compete?

Administrator Guzman listens to small business owners calling for federal investment in infrastructure, energy, childcare, healthcare affordability, capital access, technical assistance and more. She believes the targeted tax increases on the largest corporations and wealthiest individuals, in the Administration's FY23 Revenue Proposals, which will be put to use in financing these investments, will in fact help entrepreneurs grow, hire, and compete.

- In your interaction with Ranking Member Luetkemeyer, you mentioned a tracker for all OIG and GAO audits, and that you meet frequently regarding that tracker. Can you give us more information on this tracker, how it works, and how it affects your oversight efforts?

The OIG/GAO audit tracker is an internal document used to provide updated information on each audit under the OED auspices. The tracker will ensure the ongoing sustainability, consistency and accuracy OED actions related to OIG and GAO efforts. Through communication and delegated roles among OED leadership and between OED offices, this tracker inspires a proactive vs. reactive approach. This tracker has improved our oversight efforts by increasing communication, tracking individual and collective deadlines and providing a consistent tool for reporting to management and OIG and GAO offices.

- As the Administrator overseeing entrepreneurial development programs, can you tell me how many people on your staff are designated to provide oversight of these programs?

Seven members are designated to provide oversight of SBDC Programs through the Office of Small Business Development Centers, nine staff members are designated to provide oversight of WBC programs through the Office of Women's Business Ownership and one staff member is designated to provide oversight of SCORE with supervision by the head of the Office of Entrepreneurship Education.

- The audit being referenced was released in May, and since then, this committee has had no communication with the SBA on the progress of resolving OIG's ten recommendations. This committee also hasn't had an SBA official before it in over four months, making it difficult to get updates on oversight progress. Can you commit to providing more routine updates and reports on WBC and other entrepreneurial program oversight?

Yes, we are committed to ensuring as much transparency as possible for this Committee to have visibility into progress on GAO and OIG audits.

Questions for the Record from Rep. Bryon Donalds (FL-19):

- What impact will the increased excise tax on tobacco have on a small business or sole proprietor trying to open a business?

Congress enacted a federal excise tax on tobacco in 1862, and it has been a regular source of revenue for the U.S. Government since. Every state and the District of Columbia have implemented cigarette taxes. America still developed into the most entrepreneurial country in the world.

- Will it help or hurt small businesses to get rid of the Section 199A, the small business income deduction?

Under the 2017 Tax Cuts and Jobs Act, the Qualified Business Income Deduction, or 199A, expires in 2025. In contrast, the corporate tax cuts enacted in the TCJA were made to be permanent. This was unfair to small business owners and contributed to uneven playing field they face relative to the largest corporations.

- Do you think an increase in the corporate income tax rate and/or an increase in the personal income tax rate for small and micro business owners whose income passes through to their 1040s would benefit or impair those businesses' profitability?

The tax measures in the Administration's FY23 Revenue Proposals are focused overwhelmingly on the largest corporations and wealthiest individuals. The vast majority of small business owners will see no drop in their after-tax profitability from these measures. The vast majority of small business owners will see an improvement in their profitability from the investments in the bill, which directly address supply chain issues, capital access, childcare for workers, worker training and health care affordability, for example.

- How will the IRS financial institution reporting requirement for inflows and outflows of accounts holding more than $600 impact small businesses?

These reporting requirements were not included in the Administration's FY23 Revenue Proposals this year. While we stand by the need to reduce tax evasion by the wealthiest Americans, we seek to collaborate with Congress to find the best solution.

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How Wealth Fuels Growth

The Role of Angel Investment

BY CHRIS EDWARDS

EXECUTIVE SUMMARY

The role of wealth in the economy is the focus of much policy debate. This study examines wealthy individuals as "angel" investors, who fund startup businesses. Angel investors provide a unique source of support for America's entrepreneurs, particularly in leading-edge industries.

Many people are familiar with the idea of angel investors from the television show *Shark Tank*. As the show portrays, angels provide their money, effort, and experience to help new businesses grow. Many of the most successful businesses in American history got off the ground with the help of angel investors.

Today, there are 335,000 wealthy angels across the nation who take large risks to fund a diversity of startup businesses. Angel-backed startups often pioneer breakthrough products and technologies that create broad-based benefits to society, a role that goes back to the Industrial Revolution. Young companies funded by angels are making advances today in biotechnology, energy, transportation, financial services, space travel, and many other industries.

Some policymakers complain that wealthy people and big corporations rig the economy and deny opportunities to others. But wealthy angels do the opposite: they fund startups that pry open rigged industries and generate competition. The best check on big corporations is vigorous competition in deregulated markets from well-funded startups.

Angel investment is crucial to the economy, but there are storm clouds in Washington. Democrats are proposing to sharply raise capital gains taxes. If applied to startup investing, that would kill incentives for angels and starve cash from the virtuous cycle in technology hubs of successful investors and entrepreneurs generating wealth and then plowing it back into new businesses.

America needs diverse sources of funding for innovative businesses, and wealthy individuals are a crucial source. Wealth is central to the nation's entrepreneurial ecosystem, which has spawned so many great companies and advances over the decades.



CHRIS EDWARDS is director of tax policy studies at the Cato Institute and editor of DownsizingGovernment.org.

WEALTH IS BUSINESS OWNERSHIP

A 2019 *Washington Post* editorial lamented the "ever-higher concentration of national wealth at the top."[1] That same year, *New York Times* columnist Paul Krugman wrote that we are "living in an era of extraordinary wealth concentrated in the hands of a few people."[2] During the 2020 campaign, presidential candidate Joe Biden said "no one is supporting billionaires" and Sen. Elizabeth Warren (D-MA) advocated higher taxes to "address runaway wealth concentration."[3]

Wealth is concentrated by some measures.[4] The top 1 percent of the wealthiest Americans own 32 percent of U.S. household wealth.[5] But that statistic does not tell us where the wealth came from, what it consists of, or how it is used.

Where does top wealth come from? In the U.S. economy, the wealthiest 1 percent of households mainly earn their wealth from work and entrepreneurship. About 70 percent of these wealthiest Americans are self-made, rather than inheriting fortunes.[6] Also, 74 percent of them own a business, compared to 13 percent of all households.[7]

What does top wealth consist of? Some people seem to think that big fortunes consist of personal consumption assets. In discussing her proposed wealth tax, Senator Warren's website says, "Consider two people: an heir with $500 million in yachts, jewelry, and fine art, and a teacher with no savings in the bank."[8] Media articles on wealthy individuals often focus on the value of their personal assets, such as homes.

However, most top wealth consists of business assets, not personal assets. Looking at the top 0.1 percent of the richest households, 36 percent of their combined wealth is equity in private businesses and 33 percent is equity in publicly traded businesses.[9] Another 23 percent is debt, pensions, and other assets, much of which ultimately consists of capital in businesses. Just 8 percent of this group's wealth are their houses. Thus, the great majority of top wealth consists of business assets, which support economic growth.

Looking just at billionaires, the consulting firm Wealth-X estimates that just 2 percent of their fortunes consist of homes, yachts, jewelry, cars, and other luxury assets.[10] Consider the richest man in America, Jeff Bezos. His homes are worth about $500 million or more, but that accounts for less than about 0.3 percent of his total wealth of about $180 billion.[11] The great majority of Bezos's wealth consists of his ownership share of Amazon, a company he founded in his garage in 1994.

People complain that wealth is "concentrated." But in terms of how it is used, wealth is dispersed across the economy in productive business assets. Bezos's wealth reflects capital in Amazon's vast operations, which employ more than a million people. Without capital to support them, those workers would not have their jobs and billions of Amazon packages would not be delivered.

> "Most top wealth consists of business assets, not personal assets."

Senator Warren said: "The top 0.1% of families—the richest 1 in 1,000—now have nearly the same amount of wealth as the bottom 90% of American families combined. Meanwhile, for everyone else, opportunity is slipping away."[12] But with his Amazon assets, Bezos is generating job opportunities for many people while serving millions of consumers.

Bezos's wealth is mainly public equity, but what about private equity, which is the largest part of top wealth? One of the largest private companies in America is the food conglomerate Cargill, based in Minnesota. The Cargill and MacMillan families own 90 percent of Cargill, which has annual revenues of about $115 billion.[13] These families have built Cargill over decades, creating opportunities for workers in the food, agriculture, and transportation industries.

Many politicians seem to think that wealth and workers—capital and labor—are enemies. But the capital assets on Cargill's balance sheet of about $60 billion enable the company to employ 155,000 people. Like Cargill, many large private companies in America have been built over generations as families have stewarded productive assets. Sometimes an entrepreneur builds a large private business only to have subsequent family generations mismanage the business and dissipate the wealth, but there is nothing admirable about that.

French economist Thomas Piketty has claimed that "past a certain threshold, all large fortunes, whether inherited or entrepreneurial in origin, grow at extremely high rates."[14] That is not true. Wealth in the form of business ownership does not grow unless it is nurtured by sound management, careful investment, and ongoing innovation.[15]

Wealth in the form of business ownership is always tentative and subject to change, as it represents an estimate of the present value of discounted future net earnings. Every private and public company in America could be undercut by competition or changing tastes at any time and then plunge in value. In July 2021, the stock market said that Uber was worth about $92 billion, but the company has been losing money and will be worth little if it cannot figure out how to earn consistent profits.

In market economies, old wealth is often in decline as new wealth is being created by entrepreneurs starting and growing businesses. All businesses begin small, and most remain small. However, a limited number of them will become fast-growing "gazelles" and ultimately grow into large corporations. The growth of gazelles is often kick-started by angel investment, venture capital, or a combination of the two financing sources. The focus of this study is angel investment, but both sources of equity finance play an important role in fueling growth in promising young companies.

> "Every year, about 8 percent of businesses shut down and millions of jobs are lost from the closures."

The following sections describe the basics of angel investment and discuss how angel-funded companies generate innovation and competition. Angels steer their wealth to unproven products and technologies, and some of their risky bets ultimately become large businesses and cornerstones of the American economy.

FUNDING NEW VENTURES

The American economy is hugely dynamic. Every year, about 8 percent of businesses shut down and millions of jobs are lost from the closures.[16] Fortunately, entrepreneurs are continually creating new businesses to replenish jobs and incomes. Indeed, startup businesses create most net new jobs in the economy.[17] Without those startups, and without some of the startups becoming gazelles and growing quickly, the U.S. economy would shrink in a permanent recession.

Startups are experiments. Entrepreneurs make bets about technologies and consumer demands, and they adjust their plans as they go. Yet, despite all the time, effort, and money put into launching startups, half of new companies go out of business within five years and about two-thirds within 10 years.[18] Nobody knows in advance which ideas and products will succeed, so we need a steady stream of entrepreneurs launching a variety of new ventures. Economist John Haltiwanger and colleagues noted, "In the first years following entry, many startups fail . . . but the surviving young businesses grow very fast. In this respect, the startups are a critical component of the experimentation process that contributes to restructuring and growth in the U.S. on an ongoing basis."[19]

Angel Investment and Venture Capital

New businesses need funds to launch and grow. Entrepreneurs often tap into their savings, borrow on their credit cards, borrow against their homes, or sell some of their belongings to raise cash, which is called bootstrapping. Steve Jobs sold his VW van to raise cash for the launch of Apple Computer in 1976. Len Bosack and Sandy Lerner mortgaged their home and ran up their credit cards to get network hardware company Cisco Systems off the ground in 1984.[20]

Most startups will remain small businesses that serve local or narrow markets. These firms may not need outside financing, perhaps aside from small loans from friends, family, or local banks. Alternatively, some startups grow into large companies over time by relying on reinvested profits, not outside financing.

However, a share of startup and young businesses need outside equity financing. They do not have sufficient cash flow to pay interest on loans, and they may not be eligible for loans because they have few hard assets for collateral and do not have a track record of stable revenues. Furthermore, the main assets of some startups are intellectual property, which is not easy for potential lenders to evaluate. In these circumstances, equity financing is needed. After initial bootstrapping, Apple and Cisco both received outside injections of equity.

For technology startups, equity funding makes sense. Harvard Business School professor Tom Nicholas notes, "Because research and development is highly intangible and tends to be specific to the firm in which it is being used, it

has limited liquidation value. As a general rule, the use of debt tends to decrease with asset intangibility."[21] Also, in technology industries there can be a large information gap between an entrepreneur and a potential funder. A funder will need a close association with the entrepreneur to close that gap, which is a role that angels and venture capitalists (VCs) specialize in, but that banks and stock exchanges do not. Angels and VCs use staged financing—parceling out funding over time—to reduce the information gap and keep entrepreneurs focused and accountable.

Angel investors provide hands-on equity finance. They provide entrepreneurs with funding, mentorship, and access to their business contacts. They often have industry expertise and can help young companies raise additional funding. In his book on angel investing, Jason Calacanis summarized the four inputs of angels as "money, time, network, expertise."[22]

There are 334,680 active angel investors in the United States, according to the Center for Venture Research.[23] A 2019 survey by the Angel Capital Association found that two-thirds of U.S. angels have been entrepreneurs themselves, and three-quarters are over age 50.[24] A typical angel puts about 10 percent of his or her wealth into angel investment.[25]

A well-regarded survey on entrepreneurship found that 5 percent of U.S. adults are informal friends and family investors to startups.[26] Thus, roughly 10 million Americans may be considered informal angels. But in this study I focus on the smaller group of wealthy and professional angel investors, the type included in the Center for Venture Research estimate.

U.S. angel investment was $25 billion in 2020.[27] Angels invested in 64,480 companies, with an average investment of $392,025.[28] That year, 36 percent of U.S. angel investment went to health care and biotechnology, 23 percent to software, and most of the rest to energy, financial services, and retail.

The goal of many angel investors is to support startups that will become gazelles and grow rapidly. Some famous angel-funded startups that grew into large corporations include Apple Computer, Amazon, Facebook, Google, Uber, Home Depot, Costco, and Starbucks.

In fast-moving industries, gazelles need outside funding to scale up operations and gain a market presence with a new product or innovation. Gazelles often receive, in sequence, personal funding, then angel funding, and then numerous rounds of venture capital funding. If a business succeeds, it may be acquired or go public in an initial public offering (IPO) down the road. An acquisition or IPO creates an "exit" for angel and VC investors, who often use the proceeds to invest in new startups.

One pool of wealth that flows into startups and growth companies comes from "family offices." These are business structures that manage the investments of wealthy families with generally more than $100 million of investable assets. There are more than 2,000 family offices in the United States, and about four-fifths of them invest in private equity.[29]

This study focuses on angels, but angel and VC investment are interconnected, particularly in technology industries.[30] An expert at VC data company PitchBook noted that angels are "a key piece of the VC ecosystem" and that "angels and VCs have a symbiotic relationship."[31] Angels generally fund earlier stages of company growth with smaller investments, while VCs fund later stages with larger investments. Angels use their personal wealth to invest directly in startups, whereas VCs are structured as limited partnerships and raise funds from wealthy individuals, family offices, corporations, pension funds, university endowments, and foundations. Over the past decade, VC investment has averaged $91 billion a year, but it spiked to $166 billion in 2020.[32]

"Some famous angel-funded startups that grew into large corporations include Apple Computer, Amazon, Facebook, Google, Uber, Home Depot, Costco, and Starbucks."

A difference between angel and VC investment is the geographic dispersion. Angels are in every town and city and usually invest in startups close to home so that they can advise and monitor entrepreneurs. Venture capitalists are more concentrated in innovation hubs, such as Silicon Valley. More than one-third of American VC investment goes to Silicon Valley, whereas only about 17 percent of angel investment goes to California as a whole.[33]

Both angel and VC investment are "patient capital," but angels are even more patient than VCs. Angels often do not see a return on their successful investments for 5 to 10 years, and all the while they are working with entrepreneurs to

achieve success.[34] Angel investments are long term, risky, and highly illiquid. It is only people with substantial wealth, time, and expertise who can fill this unique role in the economy.

"Angel investments are long term, risky, and highly illiquid. It is only people with substantial wealth, time, and expertise who can fill this unique role in the economy."

Consider current efforts to improve battery technologies, which is a central challenge to improving the performance of electric vehicles. Enovix, founded in 2007 and backed by angel T. J. Rodgers and VC companies, is just now going public and is expecting to make its first commercial battery sales next year.[35] Meanwhile, QuantumScape was founded in 2010 and backed by angel Bill Gates, Volkswagen, and VC companies. It is pursuing a revolutionary design for solid-state batteries, which would have faster charging and reduced fire risks than existing batteries. The *Wall Street Journal* notes, "QuantumScape's investors are playing a very long game. The business plan doesn't envisage meaningful revenues before 2026. There is also no guarantee that the company's solution will win out over those of Toyota and others."[36] That is patient capital.

Risks and Rewards

Angel investors face many risks. The startups they invest in may misjudge consumer demands, their products may be faulty, or competitors may beat them to market. Angels also face risks that entrepreneurs have poor management skills, leave their startups, or that they hide bad news or act unethically.[37] Angel and VC investors in the high-flying blood-testing company Theranos, for example, discovered too late that the company's founders appear to have pulled a huge fraud.

Angel investment is generally higher risk than VC investment because companies have shorter track records when angel investments are made. The guidance that angels provide to young companies helps "de-risk" them for later VC investment. Angels also face financing risk, which means the risk that an angel-funded company will not be able to attract the VC funding it may need in the future for it to continue growing.

Politicians and the public underappreciate the huge risks that entrepreneurs and angel investors face. Most people are aware only of the companies that became large and successful, not the huge graveyard of startups that failed.[38] Today's big retail and technology companies seem to fill obvious consumer needs, but companies are never a sure thing when they are launched.

Music-streaming giant Spotify was a long shot when it was launched in 2008. One expert noted: "Most investors didn't want to touch it. The music industry was risky, had razor-thin margins, and opened a world of headaches in negotiating with industry execs."[39] There were worries that Spotify would face copyright issues, which had killed Napster. Fortunately, a wealthy Hong Kong angel and a VC firm took a chance on the Swedish startup.[40]

When Google was a startup, numerous VCs turned down the chance to invest. Google "was by no means a sure-shot investment in 1999. The search algorithm space was already crowded" at the time.[41] Similarly, some VCs passed on the chance to invest in Airbnb.[42] In the 1970s, Atari founder Nolan Bushnell turned down the chance to be an angel investor in Apple Computer, even though Steve Jobs had been an employee of his.[43]

As for Atari, Bushnell says that when he discussed his startup plan in 1972, "people thought the idea of playing games on a television set was the stupidest idea they'd ever heard of."[44] But Atari made Bushnell wealthy, and he put that wealth to good use by becoming a serial entrepreneur, including launching the Chuck E. Cheese restaurant chain.

As a wealthy angel, Jason Calacanis writes that he turned down an offer to invest in Twitter as a startup because the app seemed "inane and pointless."[45] He says that as a pioneer of blogging, he did not initially see any benefit in Twitter's short messages. He says of the startups that angels invest in, "If these businesses didn't look completely crazy, then everyone would want to invest in them and there would be no need for angels."[46] Calacanis invested $25,000 in Uber early on. He discusses how he invited Uber leaders to present at an angel forum in San Francisco to raise further funding.[47] Most angels at the forum passed up the chance as they saw no future in Uber, which at the time operated in a small niche market.

He notes that early investment in YouTube was also a risky bet because the company "was burning money, had come after a dozen previous failures doing the same thing, and had massive legal risk."[48] As for Tesla, Calacanis writes, "Elon Musk was delusional to think he could upend the car industry by going electric."[49] But Tesla has driven itself to the front of the electric car industry, ahead of existing major car producers.

To reduce risks, angels perform extensive screening and due diligence on companies before they invest. Unlike the quick decisions portrayed by the angels on *Shark Tank*, these activities are very time-consuming.[50] Despite their best efforts, angels typically lose money on more than half of their investments. They can diversify by investing in numerous startups, but screening and due diligence is so time-consuming that it is difficult for angels to diversify sufficiently when they invest alone.

"In angel investment, a small share of the bets produce big wins, and those big wins need to cover the losses on the many failed investments."

With such high risks and large time demands, why do angels do it? Why don't they just put their wealth in a stock index fund? Angels often have a strong desire to mentor young entrepreneurs, and they see their role partly as a social mission. They want to earn high returns, but they also enjoy the excitement of new ventures and want to contribute to innovation.

We do not have great data, but it appears that angels overall earn positive returns. A 2007 analysis by Robert Wiltbank and Warren Boeker examined returns on 1,137 angel investments.[51] They found that 52 percent produced losses, while the best 7 percent produced 75 percent of the overall returns. A 2017 analysis by Wiltbank and Wade Brooks examined returns on 245 angel investments.[52] They found that 70 percent lost money, while 10 percent produced 85 percent of the overall returns. The overall average gross rate of return across investments was 22 percent.

In angel investment, a small share of the bets produce big wins, and those big wins need to cover the losses on the many failed investments. The same pattern is evident in the venture capital industry. The rule of thumb in VC is that about two-thirds of investments fail to produce a return, and that is about what the data show.[53] In recent years, average VC investment returns appear to have fallen from the high levels of the 1990s.[54]

Another result from the Wiltbank and Brooks study needs stressing. The average holding period for angel investments they studied was 4.5 years, but the exits on the biggest successes often took about 10 years. The rare big wins from angel investment often take a decade of effort to pay off.

Trends in Angel Investment

Angel investment has changed in recent decades. Because of the high risks, the more investments an angel makes, the more likely they will earn positive returns overall. For that reason, angel investment has become more networked and structured. About 400 regional angel groups have been formed across the United States to make joint investments, up from just 10 such groups in the 1990s.[55]

Angel groups allow investors to pool funds and diversify, to learn from each other, and to efficiently screen companies and perform due diligence. Also, angel groups with pooled resources are better able to provide follow-on investments in growing companies. The groups are a major development in improving the flow of risk capital to young companies.

Another development is the rise of online angel investment platforms. AngelList, SeedInvest, Gust, and other platforms help match startups with angels. AngelList is designed "to make the investment process more transparent for angel investors and entrepreneurs through an online platform. Since its 2010 launch, 1,040 startups have raised $445 million from angel investors."[56]

A relatively new source of funds for entrepreneurs is "crowdfunding," which is small-dollar investments made through internet platforms. Kickstarter launched in 2009 and has pumped $6 billion from 20 million people into more than 200,000 projects and companies.[57] Betsy Mikesell and Angie White had a new idea for bunk bed sheets. In 2014, they raised $108,000 on Kickstarter to launch their business, called Beddy's.[58] The business succeeded and now generates $7 million in annual sales. Philosophy professor David Barnett raised money on Kickstarter in 2012 to develop his

smartphone accessory PopSockets. He has sold more than 200 million units of the product, which people laughed at when he first proposed it.[59]

Other new funding options for startups include initial coin offerings and exotic blends of debt and equity.[60] And there are new institutions to aid startups, including incubators and accelerators. The former provide office space, administrative support, and advisory services to startups for periods of up to two years. The latter provide intensified support and usually make equity investments in startups, but offer support for shorter periods than incubators. Y Combinator in Silicon Valley housed Airbnb in 2009 and provided $20,000 in exchange for 6 percent of the company's equity.[61]

"Henry Ford, Steve Jobs, and other business leaders built the American economy. However, angel investors played key supporting roles."

Angel investment has evolved within broader changes in U.S. capital markets. One shift has been a huge increase in private equity compared to public equity. The number of publicly traded firms in the United States has fallen by half since 1996.[62] Another shift has been that VC investments have become larger and happen later in startups' growth phase, which has left a void for angels to fill in early stage investing. In parallel, exits for VC-funded firms tend to be later and larger. Finally, while exits used to be mainly through IPOs, they are now mainly through mergers and acquisitions.[63]

While the term "angel investment" was coined in the 1970s, angel investment is nothing new.[64] Wealthy individuals have been backing risky startups since the beginning of the Industrial Revolution, as discussed in the next section. As market economies have grown over the centuries, wealth has been continuously shifted from older industries to newer ones. Angel investors have been at the center of the action, steadily recycling wealth into promising startup enterprises.

ANGELS FUNDING ENTREPRENEURS

Economic histories often focus on the achievements of inventors and entrepreneurs. Henry Ford, Steve Jobs, and other business leaders built the American economy. However, angel investors played key supporting roles. As Tom Nicholas notes in his history of risk capital, "Some of America's leading entrepreneurs and technologists owed their start to wealthy individuals providing finance for investment and expansion."[65]

Henry Ford cofounded Ford Motor Company in 1903 with angel investor Alexander Malcomson, who had earned his wealth as a Detroit coal merchant.[66] His investment in Ford was a gamble because most automobile companies at the time failed.[67] Indeed, Ford's first automobile startup failed, and he left his second startup. Fortunately, Ford Motor Company succeeded. Henry Ford introduced his Model T in 1908 and earned a fortune by continuously cutting the car's price and expanding sales to the benefit of millions of consumers.

George Eastman was a bank clerk in the 1880s, and in his spare time experimented with photography. He quit his job and launched a photography company in 1888 with a $6,000 angel investment from Henry Strong, who had gained wealth by making buggy whips.[68] The startup became Eastman Kodak, which revolutionized photography in the 20th century by simplifying the process and cutting prices.

King Gillette was a traveling salesman, inventor, and author of utopian socialist novels, but he ended up earning wealth as a capitalist by introducing the first safety razor in 1903. Gillette's razor used disposable blades mounted in a handle. Like many entrepreneurs, he faced naysayers: "Machinists and metallurgists told Gillette there was no way to manufacture the thin blades he had in mind, making it impossible to find financial backers."[69] But Gillette persevered and eventually found an angel in John Joyce, who was willing to fund research and the purchase of manufacturing equipment.[70]

Gillette made his hoped-for breakthrough, and his company led the industry for the next century. More recently, startup Dollar Shave Club disrupted Gillette and other big players in the industry with a low-price, direct-to-consumer model. Dollar Shave Club was launched in a Los Angeles incubator and funded by angels and VCs.[71]

Steve Jobs and Steve Wozniak launched Apple Computer in 1976 and grew the company with the help of angel Mike Markkula, who had earned wealth at Fairchild Semiconductor and Intel Corporation. He invested $91,000 in 1977 to help launch the Apple II, and he guided Apple's inexperienced

cofounders, later becoming CEO.[72] Markkula's investment was followed by $288,000 in VC funding in 1978.[73]

Jeff Bezos's dream of an online bookstore became a reality with the help of private investors. Bezos started Amazon in his garage in 1994 using his personal savings and funding from his parents. Then, in 1995, wealthy telecom executive Thomas Alberg and others kicked in angel funding.[74] There was uncertainty about the company's prospects: "Bezos was looking to raise $1 million for his fledgling startup. While others balked at the $6 million valuation, Alberg saw promise."[75] Looking back, Alberg remembers, "When it started, I don't think Jeff or any of us had any idea of what Amazon would grow to."[76]

"Micron Technology received crucial angel funding and has grown to become one of the world's largest semiconductor companies."

Micron Technology received crucial angel funding and has grown to become one of the world's largest semiconductor companies. In 1978, Ward Parkinson, Dennis Wilson, and Doug Pitman left Texas-based computer chipmaker Mostek to found Micron in Idaho, the home state of Parkinson and Pitman.[77] Ward's brother Joe also joined the firm. Micron initially aimed to design semiconductors for other producers, but it soon switched to manufacturing memory chips itself in Boise.

The founders convinced three Idaho business people—Tom Nicholson, Ron Yanke, and Allen Noble—to invest $300,000 in the startup.[78] Nicholson was a rancher, Yanke owned a machine shop, and Noble was a potato farmer who knew the Parkinsons. Joe Parkinson recalls that the three angel investors showed "enormous courage" and "put everything they had at risk."[79] Indeed, it would have seemed crazy investing in a new semiconductor firm in tiny Boise, isolated from the technology hubs in Texas and Silicon Valley, especially when the industry was facing rising competition from Japanese chipmakers.

Micron's angel investors had business dealings with billionaire Idaho potato farmer J. R. Simplot and convinced him to invest $1 million in the fledgling company the following year, followed by millions more in subsequent years.[80] With the angel funding, Micron broke ground on its first semiconductor plant in 1980 and eventually battled its way to top of the industry with continuous innovation.[81] Today, Micron has more than 30,000 employees, including more than 6,000 in Idaho.[82]

Angels continue to be important to technology startups, but they invest in many different industries. Some of *Shark Tank*'s successful investments have included $350,000 for Squatty Potty (a toilet accessory); $300,000 for Lovepop (a greeting card company); $125,000 for Simply Fit Board (a fitness device); $75,000 for Sleep Styler (a hair roller); $2 million for Ten Thirty One Productions (an entertainment company); $100,000 for Tipsy Elves (an apparel company); and $300,000 for Bubba's Q Boneless Ribs (a food company).[83]

Wealthy Merchants

Wealthy individuals have long played a central role in funding entrepreneurs. Historically, many entrepreneurs had needs for capital that were not met by financial institutions such as banks and stock exchanges. Instead, entrepreneurs sought funding from wealthy people who were willing to share the risks of launching a new venture. During the Industrial Revolution, wealthy merchants were often angel investors.

Harold Livesay and Glenn Porter studied how manufacturing entrepreneurs in the 19th century raised money to start businesses and fund their fixed and working capital.[84] Banks in the 19th century were conservative and startups often did not have collateral for loans. Stock exchanges at the time mainly raised money for large enterprises, such as railroads.[85]

Where did manufacturing entrepreneurs get funding? Usually it was from wealthy merchants, often merchants who wanted to support producers making the items they traded. Livesay and Porter discuss how businesses making iron, textiles, machinery, rail equipment, and other products were often cofounded by cash-poor entrepreneurs and cash-rich merchants. Wealthy merchants brought money to the table as well as marketing experience. Livesay and Porter found, "Only the preexistence of a prosperous, experienced, and efficient mercantile community permitted such a rapid development of mass production in America."[86] They found that merchants were the "agents of transfer" in the 19th century, meaning that they recycled wealth from older industries to the newer industries of the day.

The same pattern is evident in the 18th century.[87] At the time, landowners had wealth, but it was not liquid. Merchant wealth was liquid and thus available for lending and equity investments.[88] As the 18th century progressed, the domestic and international trading wealth of merchants was increasingly invested in new manufacturing industries. Manufacturing startups needed funds for both fixed capital and working capital, the latter meaning assets such as raw materials, inventories, and customer credit. Entrepreneurs needed substantial working capital because of the inefficient payment and transportation systems at that time.[89]

A place with a good claim as the birthplace of the Industrial Revolution is Coalbrookdale, Shropshire, England. During the 18th century, entrepreneurs in the area made major advances in iron production. In 1709, Abraham Darby I was the first to use coking coal in a blast furnace to produce pig iron, which reduced the cost of the metal and expanded its use in the machinery and infrastructure of the rising industrial economy. Previously, charcoal made from timber was used in ironmaking, but it was expensive and the process caused deforestation. Darby's innovation was "one of the most important technological breakthroughs of the Industrial Revolution."[90]

Darby, his son, and his grandson were innovative leaders in ironmaking for decades.[91] Their success was capped off in 1779 when Abraham Darby III built the "Iron Bridge," which became world famous at the time and still spans the River Severn in Coalbrookdale today. This pathbreaking infrastructure was financed by local entrepreneurs, who were paid back over time from bridge tolls.

Historians have called Coalbrookdale the Silicon Valley of its day.[92] Area entrepreneurs and merchants in the 1700s reinvested their profits into a range of advanced infrastructure, including an incline railway to raise and lower boats, the first iron-wheeled railways, the first iron-hulled boat, and early steam engines that were used for pumping water out of mines, powering furnaces, and recycling water for waterwheels.

The Darbys are remembered by historians today and Coalbrookdale is a United Nations World Heritage Site. But behind the scenes, a wealthy merchant family from Bristol was crucial to the Darbys' success. Two generations of the Goldney family were angel investors in the Darby businesses, funding capital investments in their ventures.[93] The Goldneys helped manage the Darbys' finances and market their products. The Goldneys stepped in to oversee the Darby enterprise during crises, helped with business strategies, and made sure that the Darby financial accounts were in order. Like modern-day angels, the Goldneys provided risk capital in a very hands-on way.

"Where did manufacturing entrepreneurs get funding? Usually it was from wealthy merchants."

The Goldneys would be called "superangels" today for their prolific startup investing. Thomas Goldney II originally gained wealth from merchant activities, such as ship voyages. He plowed his merchant profits into Darby's iron startup beginning in 1708, and then reinvested his earnings over the years into a mining startup, a bank startup, a brass and copper startup, and ironmaking startups.[94] A history of the family reveals how risky all these ventures were, but the Goldneys seemed to have good management, logistical, and financial skills.[95] They earned steady profits and recycled them back into leading-edge ventures of the day.

In sum, wealthy angel investors have been playing an important role in the economy for a long time. They supply equity risk capital to entrepreneurs when loans are not available. They advise and mentor entrepreneurs, helping them expand their enterprises. And they act as "agents of transfer," meaning that they take the risks of moving resources from past ventures into promising new ventures that are often at the leading edges of technology.

Angels Are Diverse

Angel investors come in all types. Some are individuals who take a chance on opportunities they happen to come across, while others are superangels who expertly screen and analyze opportunities and invest in dozens of startups.

Ian McGlinn is the first type. He is the angel who helped Anita Roddick launch the retail chain Body Shop. Roddick opened Body Shop as a single location in Brighton, England, in 1976. The next year she wanted to open a second location, but was turned down for a loan by numerous banks.

McGlinn was a friend of a friend and a local business owner, and he took a chance and invested £4,000 (about $8,000 at the time) with Roddick for an equity stake.[96] That was the beginning of a great success, as Body Shop expanded to thousands of locations across the globe.

Scientist Peter Buck invested $1,000 with a young family friend, Fred DeLuca, to open a sandwich shop in Bridgeport, Connecticut, in 1965.[97] It was a good call. Subway grew to more than 40,000 franchised locations, and the partners became wealthy.

Beatle George Harrison was an angel investor. In 1978, he invested $2 million to fund Monty Python's *Life of Brian* after EMI Films pulled out of the movie project, wary of its controversial theme.[98] Harrison's gamble paid off, as the movie was a hit. Wealthy individuals are often willing to take gambles on risky ideas that big companies shy away from.

Some angels are not so fortunate. Using wealth earned from his writing, Mark Twain invested in a range of startups making such products as a typesetting machine, grape shears, protein powder, watches, steam generators, cloth, and many others.[99] Alas, Twain made many bad calls, and over a 15-year period he bankrupted himself from such investments.[100] In 1877, Twain turned down an inventor's offer to invest in his electrical device, saying he "didn't want anything more to do with wildcat speculation."[101] The inventor was Alexander Graham Bell, who wanted Twain to invest in his telephone.

Andrew Mellon was a more successful angel than Twain. He began his career in banking, and as he gained wealth in the late 19th century he made equity investments in dozens of startups and young companies, often in leading-edge industries of the day, including electricity, petroleum, steel, and aluminum.[102] Mellon used his equity stakes to help guide companies and fix management failures, similar to the hands-on approach of angels and VCs today.

Laurance Rockefeller inherited vast wealth as the grandson of the founder of Standard Oil. If he had wanted, Rockefeller could have held his wealth in safe assets and relaxed. Instead, he set up an office with an expert team to screen and invest in an array of technology startups in aviation, electronics, and other dynamic industries of his day.[103] Rockefeller invested in 59 startups between 1938 and 1969. He said, "We are undertaking pioneering projects that with proper backing will encourage sound scientific and economic progress in new fields—fields that hold the promise of tremendous future development."[104] Rockefeller lost money on 44 percent of his angel investments. Overall, he earned a return over the decades somewhat less than his funds would have earned in the stock market.

Today, America is blessed with many wealthy superangels. Ron Conway is perhaps the most prolific, having made investments in about 650 companies over 35 years.[105] After working at a semiconductor firm during the 1970s, he founded, and then sold, several successful companies by the early 1990s. With this wealth, Conway became a full-time angel because he "enjoyed mentoring entrepreneurs more than being the entrepreneur himself."[106] He has had many hits, including early investments in Google, Facebook, Twitter, and PayPal, but he admits that he has also had failures and missed opportunities.[107]

Numerous Hollywood celebrities and music stars have used their wealth to invest in startups. PitchBook reported, for example, on 11 well-known rap stars—including Jay-Z, Nicki Minaj, 50 Cent, and Diddy—who have made angel investments in music companies, lifestyle products, and technology ventures.[108] And there is actor Ashton Kutcher, who has become an angel and venture capitalist. He began steering his wealth toward startups more than a decade ago as an early investor in Skype, followed by investments in Uber and other technology companies.[109] With partner Guy Oseary, he now runs a venture capital firm.[110]

"Today, America is blessed with many wealthy superangels."

Finally, many wealthy individuals fund startups with social purposes they consider important. Bill Gates has invested equity in dozens of startups, and with his ex-wife has funded startups with grants from the Bill and Melinda Gates Foundation. The foundation provided a $100,000 grant to startup Apeel, founded by young engineer James Rogers, who invented a coating for fruits and vegetables that extends product life and reduces food spoilage.[111] Two other startups have also introduced innovations to tackle food spoilage: Hazel Technologies, founded by Northwestern University students, and Afresh, founded by Stanford University graduates.[112] It is often startups—not existing companies—that succeed in tackling problems that have been around a long time.

Moderna and BioNTech

In the United States, COVID-19 has been beaten back by vaccines developed by Moderna of Massachusetts and BioNTech of Germany. BioNTech teamed with American pharmaceutical giant Pfizer in manufacturing and distributing its vaccine. As of August 2021, about 360 million doses of the two vaccines had been delivered in the United States.

The development of the technologies that enabled the two firms to respond quickly to the crisis was a product of scientific advances and large private investments over many years. Governments funded some of the research underlying the vaccines, and during the pandemic it funded production and distribution, but wealthy angels and venture capitalists played the crucial roles in the growth of the two companies.

"Governments funded some of the research underlying the vaccines, but wealthy angels and venture capitalists played the crucial roles in the growth of the two companies."

In the 1990s, Katalin Karikó at the University of Pennsylvania explored the potential of messenger RNA (mRNA). But "her work, attempting to harness the power of mRNA to fight disease, was too far-fetched for government grants, corporate funding, and even support from her own colleagues."[113] Nonetheless, after years of work, Karikó and her colleague Drew Weissman made a breakthrough in the early 2000s for practical applications of mRNA technologies.

Derrick Rossi of Stanford University, and later Harvard Medical School, realized the potential of the research, and in 2010 added his own advances to mRNA technologies. He teamed with academic colleagues and VC firm Flagship Pioneering to found Moderna that year.[114] The cofounders included Rossi, Kenneth Chien of Harvard Medical School, and Robert Langer of the Massachusetts Institute of Technology. Moderna's founding and current chairman is Noubar Afeyan of Flagship.

Moderna's plan was to "cut out the middlemen in biotech [by] creating therapeutic proteins inside the body instead of in manufacturing plants. The key: harnessing messenger RNA, or mRNA."[115] The plan was "highly risky. Big pharma companies had tried similar work and abandoned it because it's exceedingly hard to get RNA into cells without triggering nasty side effects."[116]

A 2020 piece in the *Wall Street Journal* examined how "skepticism has dogged Moderna since its creation in 2010" regarding its gamble on mRNA technology.[117] As late as mid-2020, a New York finance executive who focuses on health care said, "The idea that Moderna's going to rush a vaccine to the market and get it right the first time, the probability is extraordinarily small."[118]

In contrast to Moderna, the giant pharmaceutical firm Merck dropped the ball on mRNA technology and a COVID-19 vaccine. The company had looked into mRNA but "preferred to focus on proven technologies," reported the *Wall Street Journal*.[119] In July 2020, Merck's chief executive "told an online audience hosted by Harvard University that those raising hopes for a widely available vaccine by the end of this year are doing 'a grave disservice to the public.'"[120] Similarly, the CEO of pharmaceutical giant Novartis said in 2020 regarding COVID-19 that "an effective vaccine may not be available until the end of 2021."[121] Even experts cannot foresee the future in their own fields, which is why we need diverse independent flows of risk capital pushing all the edges in leading-edge industries.

Numerous streams of private capital supported Moderna's research. Scientist Timothy Springer invested $5 million at Moderna's founding. He had gained wealth from founding a previous biotech company.[122] Another early funder was financier Patrick Degorce, who invested in equity and provided Moderna a grant for cancer research.[123] By 2012, Moderna had raised more than $40 million in angel and venture investment.[124] By the time Moderna went public in 2018, it had raised more than $2 billion from private investors, including angels, venture capitalists, and corporate partners.[125] As for government funding, Moderna received just two awards prior to 2020 from federal agencies, for up to $25 million and $125 million, respectively.[126]

Meanwhile in Germany, husband and wife biotech entrepreneurs Uğur Şahin and Özlem Türeci read about the early advances in mRNA technologies and, with Christoph Huber, founded BioNTech in 2008 to explore them. Katalin Karikó joined BioNTech in 2013.[127] Şahin and Türeci had

previously founded successful biotech company Ganymed Pharmaceuticals, which they sold in 2016.

At its founding, BioNTech received a €150 million (more than $180 million) angel investment from Thomas and Andreas Struengmann.[128] The German brothers had founded a pharmaceutical firm in 1986 and sold it in 2006 for $7 billion. They had started the company "with about two-dozen employees in an apartment building near Munich and grew it into the world's fourth-largest generic-drug company."[129] With their wealth, the Struengmanns have invested in a range of life sciences startups, including Ganymed and BioNTech.[130]

All in all, BioNTech raised $1.3 billion from private investors before going public with an IPO in 2019.[131] One funder was the Bill and Melinda Gates Foundation, which invested $55 million. Before 2020, the company appears to have received, at most, only a few tens of millions of dollars of government funding.[132]

"Even experts cannot foresee the future in their own fields, which is why we need diverse independent flows of risk capital pushing all the edges in leading-edge industries."

When COVID-19 hit, Moderna and BioNTech began immediately working on vaccines after the companies' CEOs read about the new virus in January 2020.[133] When Chinese health officials published the genetic code of COVID-19, it took Moderna just two days to design a vaccine. Within 42 days, Moderna had shipped vials of its vaccine to the National Institutes of Health. Both companies gained government approval for their vaccines by December 2020 and began distributing millions of doses. These are the world's first vaccines created by mRNA technologies. Vaccines typically take many years to develop and deploy, but these vaccines took less than a year.

The Moderna and BioNTech vaccines are triumphs of the biotechnology industry, which has grown up alongside the pharmaceutical industry in recent decades. Generally, biotech firms derive medicines—biologics—from living organisms, whereas pharmaceutical companies derive medicines from chemical compounds. However, biologics are becoming an increasing share of revenues for traditional pharma companies as well, and most top-selling drugs today are biologics. The pharmaceutical industry is dominated by large multinational corporations, whereas the biotech industry consists of thousands of smaller research-based firms, which are often started by scientist-entrepreneurs.

For more than four decades, the U.S. biotech industry has been powered by risk capital, which sustains research spending, as firms may go years without earning profits. Indeed, one historian argues, "Venture capital created biotechnology as an industry."[134] The industry was launched in 1976 with the founding of Genentech by biochemist Herbert Boyer, venture capitalist Robert Swanson, and venture capital firm Kleiner Perkins, which initially invested $100,000 in the startup.[135] Genentech's first landmark was producing synthetic human insulin in 1978, and its insulin drug Humulin was the first genetically engineered therapeutic on the market. Insulin had previously been produced by harvesting versions of the hormone from millions of animal pancreases.[136]

Tom Perkins of Kleiner Perkins played a crucial role in the founding of Genentech, which set the biotech industry model for decades.[137] Perkins was an engineer who had gained wealth from computer investments. Through his "relentless effort to make Genentech a success, Perkins himself created a new mold for the entrepreneurial venture capitalist."[138] He oversaw Genentech's landmark 1980 IPO, which one study on the biotech industry noted was a "spectacular success" that "gave credence to the view that scientific research, infused with start-up firm spunk, could be a critical component of economic growth."[139]

Venture capital investment in U.S. biotechnology companies soared from $3.6 billion in 2011 to $18.0 billion in 2020.[140] Over the past 18 months, many biotech firms have been developing vaccines, antivirals, and treatments for COVID-19.

Serial Entrepreneurs

Leading-edge industries attract serial entrepreneurs, who are individuals that launch multiple startups. When entrepreneurs generate wealth from successful startups, they often act as their own angels in launching new companies. The biotechnology industry has attracted many serial entrepreneurs, including Moderna's cofounder, Robert Lander,

and Moderna's chairman, Noubar Afeyan, who have each founded or cofounded about 40 companies.[141]

Serial entrepreneurs have been important to America's economy for two centuries. Wilbur and Orville Wright channeled profits from their bicycle business into aviation research. George Westinghouse invented a braking system for trains that "saved untold numbers of lives and injuries," and then used the profits from that invention to launch numerous ventures, including Westinghouse Electric, which pioneered alternating current power systems.[142]

Peter Cooper held a range of jobs in New York City as a young man in the 1810s, including hatmaker, brewer, and grocer. He saved his money and bought a glue factory in 1821. He introduced several innovations to the glue industry and made large profits, which he channeled into new ventures. He invested in iron works in Baltimore, New York, and New Jersey. Cooper created America's first steam locomotive, and he was cofounder of a telegraph company and an investor in the first transatlantic telegraph cable. New Yorkers remember Cooper for founding the Cooper Union in 1853, a free private college for the education of men and women.

Thomas Edison launched more than a dozen businesses and garnered more than 1,000 patents. He was a telegraph operator in his teens and tinkered with inventions in his spare time. In his early 20s, he invented improvements to Wall Street stock ticker machines, earning tens of thousands of dollars. One success was a quadruplex telegraph machine, which he sold to Western Union in 1874 for $10,000. He used his profits to establish his Menlo Park research laboratory in 1876. A history of the telegraph noted, "Although Edison today is principally remembered for inventing the phonograph and the light bulb, it was his telegraphic background and the enhancements he made to the stock ticker that gave him the financial freedom to pursue his career as an inventor."[143]

Alexander Graham Bell invented the telephone in 1876. His research was financially supported by angels Gardiner Hubbard and Thomas Sanders. Bell struck it rich with the telephone, and then plowed his wealth into new ventures, including boat manufacturing, aviation, and research into deafness. Bell and Edison were typical of successful inventors of the late 19th century: many of them invested their own wealth into technology and research-driven startups.[144]

Henry Flagler began work as a teenager in grain sales in Ohio in the 1850s, saving money to buy his own store.[145] He also founded a distillery that he sold for a profit, and he cofounded a salt-mining business, but that went bankrupt. He then reentered the grain industry and, while in that position, he befriended John D. Rockefeller. Flagler and Rockefeller saw an opportunity in the new oil refining industry of the 1860s, and they cofounded the company that became Standard Oil. The business boomed and the pair became extremely wealthy.

"When entrepreneurs generate wealth from successful startups, they often act as their own angels in launching new companies."

While visiting Florida in the 1880s, Flagler envisioned the state's large tourism potential. Over the next three decades, he channeled his wealth into infrastructure along the east coast. He built a railroad that stretched from St. Augustine to Key West, and he built grand hotels in cities along the way. He built hospitals, schools, water and sewer supplies, churches, electricity grids, fire stations, city halls, and other facilities for the state's growing population. Flagler's rail project from Miami to Key West was a particularly massive and costly project, which he finished in 1912 at age 82. Flagler had wealth, but he also had the vision and drive to sustain high risks and make long-term investments that Floridians still enjoy today.

Richard Branson is perhaps the most prolific entrepreneur of recent decades. As a young man in the 1970s, he started a student magazine and a record store, and at age 22 he launched Virgin Records. Branson took big risks on nontraditional artists and had hits with Mike Oldfield, Tangerine Dream, and the Sex Pistols. In the decades since, Branson has launched ventures in air travel, passenger rail, mobile phones, hotels, space travel, and many other fields. He has had both hits and misses, but his willingness to think big, do things differently, and use his wealth to challenge incumbent businesses has been remarkable.

Jeff Bezos is the wealthiest person in America, with a fortune of about $180 billion, which consists mainly of his part ownership of Amazon. Bezos is a serial entrepreneur and angel investor. He invested $250,000 in Google as a startup in 1998, and he was an angel investor in Uber, Airbnb, and

Twitter. These days, Bezos invests in startups in biotechnology, software, media, vertical farming, fintech, and space travel.[146] He also gives to nonprofit ventures in education, health care, renewable energy, homeless assistance, and veterans.

The race between Branson, Bezos, and Elon Musk to develop private space flight and space tourism illustrates the unique role of wealthy angels in supporting risky innovations. Branson put hundreds of millions of dollars into Virgin Galactic before the company went public in 2019.[147] The company also attracted a $100 million angel investment from former Facebook executive Chamath Palihapitiya. Bezos pumps a $1 billion a year of his wealth into his space company Blue Origin.[148] Musk launched SpaceX in 2002 and, in the first few years, pumped in about $100 million of his own money.[149] The company has gone on to raise more than $6 billion in private capital.[150]

"The race between Richard Branson, Jeff Bezos, and Elon Musk to develop private space flight and space tourism illustrates the unique role of wealthy angels in supporting risky innovations."

On July 11, 2021, Branson traveled aboard his VSS *Unity* to the edge of space from his New Mexico space facility. He was followed about a week later by Jeff Bezos, who traveled to the edge of space in his *New Shepard* spacecraft. Meanwhile, Musk's SpaceX currently handles most of NASA launches—at a cost one-third less than NASA's alternative launch provider.[151] SpaceX's 2020 launch of its *Dragon* spacecraft was the first U.S. human spaceflight since the final space shuttle flight in 2011. Each of these three companies is pursuing different technologies to reduce the costs of space travel, which is a different approach than the former monopoly spaceflight provider NASA followed for decades.

Wealth Waterfalls

In private equity, a "waterfall analysis" shows the payouts each shareholder receives in an exit after an acquisition or IPO. Those events get cash flowing to angel investors, VCs, entrepreneurs, and company employees who hold shares. The Silicon Valley Bank talks about a "waterfall effect" when exits generate floods of cash that fuel new rounds of startups.[152] The chair of the Angel Capital Association said that, with successful exits, angels "routinely put much of it back into funding more startups," and with their new cash "the management teams of successful companies very often become active angel investors themselves."[153]

Numerous factors led to the rise of Silicon Valley as the preeminent technology hub. The climate is nice, the region attracts entrepreneurial immigrants, the culture is conducive to collaboration, and Stanford University is a leader in academic-industry ties.[154] The mobility of skilled workers has also been important. A history of Silicon Valley noted that many entrepreneurs "struck gold because they wanted to build something their current employers weren't interested in."[155] Steve Wozniak developed the Apple I in his spare time while working at Hewlett-Packard (HP). He repeatedly offered the computer to HP and they rejected it, so Wozniak left to cofound Apple Computer.[156] Around the same time, engineer Chuck Peddle had an idea for a cheaper microprocessor than that sold by his employer, Motorola.[157] Motorola rejected his idea, so Peddle left to launch his computer chip elsewhere.[158] That chip was in the Apple I, Apple II, and other early personal computers, and its low price helped launch the personal computer revolution.

Silicon Valley's wealth waterfall has been massive. Since the 1950s, each wave of innovation has created millionaires and billionaires who have plowed their wealth back into the next round of startups. Successful entrepreneurs in technology industries often become angels and VCs, and those investors tend to invest close to home. Once Silicon Valley's wealth waterfall was underway, it gained huge momentum.

A famous example begins with Shockley Semiconductor. In 1957, eight engineers who were unhappy with Shockley management left to form their own semiconductor company. The engineers looked for startup funding from major corporations, but none were interested.[159] Eventually they found an angel, Sherman Fairchild, the wealthy head of Fairchild Camera and Instrument, and together they launched Fairchild Semiconductor. The company was successful, but eventually its top engineers began leaving to set up their own companies. Gordon Moore and Robert Noyce left to found Intel

Corporation in 1968 with their wealth from Fairchild and funds from venture capitalist Arthur Rock.[160] Intel was a big success, and Moore and Noyce used some of their growing wealth to invest in Silicon Valley startups. One history found that "over the course of just 20 years, a mere eight of Shockley's former employees gave forth 65 new enterprises, which then went on to do the same. The process is still going."[161]

Silicon Valley was built on many such startup-wealth-startup cycles. PayPal was founded by Peter Theil and five partners in 1998. The company went public in 2001 and was acquired in 2002, which made company investors and some employees rich. With his wealth, Theil became a Silicon Valley superangel, and he was an early investor in Facebook, Airbnb, LinkedIn, Spotify, and Yelp. Theil has also founded numerous companies and nonprofit ventures. Other PayPal employees, including Elon Musk, went on to found dozens of companies, a network called the "PayPal mafia."

"Angels, usually in conjunction with venture capitalists, fund high-growth startups that expand into large companies and inject competition and innovation into markets."

Historically, other regions had their heyday as innovation hubs and had similar wealth-driven growth cycles. Naomi Lamoreaux, Margaret Levenstein, and Ken Sokoloff studied the business networks in Cleveland during 1870–1920. Cleveland "played a leading role in the development of a remarkable number of second-industrial-revolution industries, including electric light and power, steel, petroleum, chemicals, and automobiles."[162] As with Silicon Valley, entrepreneurs in Cleveland made breakthroughs, gained wealth, and then reinvested locally in promising new ventures. Business growth snowballed through the city.

Lamoreaux and colleagues focused on Brush Electric, which was founded in 1880 by inventor Charles Brush and backed by wealthy local businesspeople. The company boomed from the success of its arc lighting systems. That success generated spin-off companies in electrical equipment, electric smelting, streetcars, electric automobiles, and other products. Lamoreaux and colleagues describe how Cleveland entrepreneurs relied on angels for financing, not banks or other institutions:

> One of the most striking features of the foregoing company histories is the limited role played by formal financial institutions, not only in the formation of the original Brush Electric Company, but also in the many startups and spinoffs that came out of this hub. The entrepreneurs who organized and promoted these new ventures secured investment capital largely by relying on personal connections.
>
> . . . [Investment in Cleveland's new enterprises] came primarily through local informal channels. Family and friends played a prominent role, as did upstream or downstream enterprises who had special reasons to encourage the development of complementary businesses. Other significant amounts came from business people in the local community who were eager to follow the example of those who had gotten rich from investing in cutting-edge technologies.[163]

A similar pattern emerged in other leading-edge industries of that era, including aviation and automobiles. There were hundreds of automobile startups in the first decade of the 20th century. In Detroit, the main source of financing for automobile startups was "local businessmen who had personal knowledge of the lead inventor or entrepreneur. It was not really until the 1920s that these enterprises turned to banks or public offerings of securities for additional infusions of capital."[164]

Steven Klepper studied the origins of Detroit's automobile industry. Many startups were spinoffs from prior firms. He found: "Experienced auto men not only founded the spin-offs but were also instrumental in their finance. Much like modern venture capitalists, they arranged financing for employee start-ups, and helped direct them."[165] What Klepper calls venture capitalists were actually angels and groups of angels. He continues:

> The founders of the leading spin-offs were prominent men who had amassed some wealth, but generally not enough to finance their firms alone. Consequently, they had to seek finance elsewhere, mostly from wealthy

> individuals, as few firms were able to attract finance from banks or investment bankers such as J.P. Morgan. . . . [I]ncumbent firms served as the breeding grounds for both employees who left to found their own firms and the men who helped finance these firms."[166]

Whether Cleveland or Detroit 120 years ago, or Silicon Valley today, technology hubs do not just include networks of entrepreneurs and engineers. They also include wealthy and experienced angel investors who are eager to take on the risks of helping new ventures get off the ground.

ANGELS AND INNOVATION

The largest factor producing rising living standards over the long term is technological progress and innovation, not simply the accumulation of capital.[167] To the extent that angel investors and venture capitalists help to launch and build companies that become major innovators, they have a large effect on long-term growth. This section discusses the role of angels in fueling innovative growth companies.

Angels and Growth Companies

At about $25 billion a year, angel investment seems relatively small, but it has an oversized effect on the U.S. economy. That is because angels, usually in conjunction with venture capitalists, fund high-growth startups that expand into large companies and inject competition and innovation into markets. Angels fund about 65,000 startups a year in the United States, which is about six times more than the number of companies funded by venture capitalists.[168]

Angel investment makes a difference to companies. In a statistical analysis of investments by 13 angel groups, Josh Lerner and colleagues found that "angel investors have a positive impact on the growth, performance, and survival of firms as well as their follow-on fundraising."[169] As noted, angels provide not just capital, but also guidance to entrepreneurs.

Angel investment nurtures potentially high-growth firms before the funding baton is passed to VCs. An expert at PitchBook noted, "Angel investors are a bedrock of the VC industry" and "angels are an integral component of the growth of VC ecosystems."[170] We do not know the exact share of VC-funded companies that have also received angel funding, but it appears to be roughly half or more. I researched the U.S. companies on a list of the "best VC bets of all time" and found that 65 percent had received angel funding.[171] I also researched the U.S. companies on a list of technology firms that did IPOs in 2020 and found that 52 percent had received angel funding.[172] Finally, I examined a list of U.S. technology companies with valuations of more than $1 billion from a 2018 study, and found that 54 percent were angel-funded.[173]

"We do not know the exact share of venture capitalist–funded companies that have also received angel funding, but it appears to be roughly half or more."

Several studies have examined the effect of VC-funded companies on the economy, which are suggestive of the impact of angel-funded companies because of the angel-VC overlap. Will Gornall and Ilya Strebulaev looked at 1,339 U.S. public companies that were founded between 1974 and 2014, and found that VC-backed firms accounted for 42 percent of the total number and 63 percent of the market capitalization.[174] The share of public companies that have been VC-backed has increased over time, and currently about two-thirds of IPOs are for VC-funded companies.[175]

Companies funded by venture capital are research-intensive. Among the 1,339 companies studied by Gornall and Strebulaev, VC-funded companies accounted for 85 percent of all research spending. Similarly, Jeremy Greenwood and colleagues found that VC-funded companies have higher research-to-sales ratios than other companies.[176] VC and angel funding allowed Moderna and BioNTech to sustain high research spending for years before earning any profits. BioNTech had losses 12 years in a row before it struck gold with its COVID-19 vaccine.[177]

Companies funded by venture capital are patent-intensive. In an analysis of 20 industries over a three-decade period, Samuel Kortum and Josh Lerner found that "increases in venture capital activity in an industry are associated with significantly higher patenting rates."[178] Similarly, the study by Greenwood and colleagues found that VC-funded

companies account for about one-third of all U.S. patents, and that share has been rising rapidly. That led the authors to conclude, "While the share of VC funding in total investment is still relatively small . . . its punch far exceeds its weight."[179] Paul Gompers and Josh Lerner called their book on the VC industry *The Money of Invention*.[180]

These studies show that VC-funded businesses are innovative. We also know that business innovation creates "positive spillover benefits that traverse across the globe," as Gornall and Strebulaev describe it.[181] How large are such spillovers? William Nordhaus explored that question by modeling U.S. business profits and productivity over a five-decade period. He concluded that "only a miniscule fraction of the social returns from technological advances over the 1948–2001 period was captured by producers, indicating that most of the benefits of technological change are passed on to consumers rather than captured by producers."[182] He found that businesses received only about 2 percent of the benefits from their innovations, with the rest accruing to consumers.

Two historical innovations illustrate Nordhaus's estimates. Western Union paid Thomas Edison $10,000 for his invention of the telegraph quadruplex. The device quadrupled telegraph wire capacity and saved Western Union $500,000 in construction costs for new telegraph lines.[183] Thus, Edison's profit was just 2 percent of the cost savings created by his invention.

Similarly, inventor Michael Pupin sold AT&T a patent in 1900 for "loading coils," which greatly improved long-distance telephone transmission. The technology was estimated to reduce AT&T costs by $100 million over 25 years, yet Pupin received just $255,000 for his patent.[184] One technology historian called the advancement "the single most important invention" in the telephone's first 40 years, yet the inventor received just a small share of the benefits.[185]

Recent advances in smartphones, biotechnology, and other industries will likely have similarly large spillovers. Consider Moderna and BioNTech again. Their mRNA progress will spur long-term benefits to medicine far beyond COVID-19.[186] Already, numerous companies are aiming to create mRNA vaccines for influenza, which are expected to be cheaper and more effective than current flu vaccines.[187] Also, BioNTech announced that it will build on its mRNA advances to develop more-effective shots against malaria and tuberculosis.[188] Those two diseases together kill more than a million people every year.

Disruptive Innovation

In his research, former Harvard Business School professor Clayton Christensen highlighted the importance of disruptive innovations, which are new products or technologies that often start in niche markets but end up displacing existing businesses and industries.[189] Disruptive innovations are major advances, and they are usually pioneered by new companies.[190] In his 2019 book on entrepreneurs and economic growth, Arthur Diamond concluded, "Major breakthrough innovations almost always arise from individual entrepreneurs or small startup firms rather than from the research and development labs of large incumbent firms."[191]

Established companies tend to focus on growing their current markets and can miss shifts in tastes and technologies that startups stumble upon and exploit. In their book on the importance of VC-funded startups, Gompers and Lerner note that "most large, mature corporations tend to look at their existing lines of business when choosing projects to fund. Technologies outside the firm's core market, or projects that raise internal political tensions, often get shelved."[192]

"Established companies tend to focus on growing their current markets and can miss shifts in tastes and technologies that startups stumble upon and exploit."

IBM dominated the mainframe computer market in the 1960s and 1970s but was slow to recognize the shift to minicomputers, which were pioneered by Digital Equipment Corporation (DEC) and other new firms. Then both mainframe and minicomputer firms initially missed the shift to personal computers pioneered by Apple and other startups in the late 1970s. Then Apple and IBM initially missed the shift to portable computers pioneered by Compaq in the 1980s. DEC, Apple, and Compaq were funded variously by angels and venture capitalists.

In his research, Christensen found similar patterns of disruption by new companies in many industries, including disk drives, steel mills, retailers, motorcycles, ships, transistor radios, and construction equipment. This pattern goes back

more than a century. Lamoreaux, Levenstein, and Sokoloff found, "New firms . . . provided much of the technological leadership in second-industrial revolution industries," meaning the new industries of the late 19th century.[193]

Consider the telephone. At the time of Bell's invention in 1876, Western Union dominated the telegraph market and was in the best position to invent the telephone. But Western Union did not invent the telephone, nor did it realize its potential. Western Union's president described the new device as a "toy" and rejected Bell's initial offer to sell him the patent rights.[194] That was not an uncommon view. A journalist wrote in 1883 that the issuance of Bell's patent initially "attracted little or no attention in the telegraphic world. The inventor was practically unknown in electrical circles, and his invention was looked upon, if indeed any notice at all was taken of it, as utterly valueless."[195] It is a good thing that Bell and his angel investors did not listen the naysayers and forged ahead.

"Technology has reduced the costs of startups in recent decades, helping them compete with big corporations."

The pattern of disruptive innovations continues today. Ridesharing was pioneered by startup Uber, not existing taxi companies. Uber was founded in 2009 by Garrett Camp and Travis Kalanik. Camp put $220,000 into Uber, which he had earned from building StumbleUpon, a social networking site.[196] Other angels and VCs kicked in $1.6 million to Uber at an early stage.[197] Uber has about 100 million users today.

Homesharing was pioneered by startup Airbnb, not existing hotel companies. Airbnb was launched in 2008 by a group of young friends, Brian Cheskey, Joe Gebbia, and Nate Blecharczyk, and funded by credit cards and their profits from a business selling novelty cereal boxes.[198] The company received an equity investment and guidance from Silicon Valley accelerator Y Combinator. Airbnb struggled at first, but through trial and error it eventually took off and has about 150 million users today.

The leading electric vehicle (EV) company in America is Tesla, not any of the major car producers. Tesla was founded in 2003 by Martin Eberhard and Marc Tarpenning, who had gained wealth from creating an early ebook reader. The key angel investor was Elon Musk, who put in $6.5 million in 2004 and became Tesla's chairman. Musk had gained wealth from a software company he cofounded in 1995 and sold in 1999. He took those profits and cofounded an online financial company that turned into PayPal, which was sold to eBay in 2002.

Tesla currently has more than half of U.S. electric vehicle sales, which is remarkable given the huge research budgets of the major car producers. Angels and VCs have funded numerous other electric vehicle startups, including Canoo, Fisker, Faraday Future, Lordstown Motors, Lucid Motors, and Rivian Automotive. Some of these companies may fail or not live up to promises, but it is impressive that investors have been willing to fund them given the tough competition from Tesla and the major producers.

Along the lines of Tesla, Uber, and Airbnb, CNBC publishes a list of top "disruptive" startups that are launching "attacks on the status quo in many industries," including financial services, health care, logistics, energy, and consumer products.[199] Will these attacks succeed? Startups have some advantages over big corporations.[200] They often begin in niche markets that large firms ignore because they do not seem to offer substantial profits. Yet niches can turn into whole new industries, as we saw with personal computers, which started as a hobbyist activity.

Startups are more flexible than large firms in exploring new markets and technologies by trial and error. They act first and then change course as they receive feedback. By contrast, large companies tend to have "soft budget constraints" and bureaucratic incentives that make it harder to change course on failing projects.[201] Startups also tend to have fewer rules and less built-in risk aversion than big firms.

Finally, startups have numbers on their side. Many new firms pursuing different paths are more likely to stumble upon breakthroughs than a few big firms or government agencies. This is one reason why the funding that startups receive from a vast diversity of 335,000 angels provides strength to the U.S. economy.

Technology has reduced the costs of startups in recent decades, helping them compete with big corporations. The personal computer revolution of the 1980s and internet revolution of the 1990s gave small businesses the information advantages of big businesses. The costs of operating businesses and

performing research have fallen further because of cloud computing, internet marketing, open-source software, computer simulation, three-dimensional printing, and other developments.[202] The "introduction of cloud computing services by Amazon is seen by many practitioners as a defining moment that dramatically lowered initial costs of internet and web-based startups."[203] As for marketing, the Dollar Shave Club disrupted the shaving industry with the help of a successful viral video that cost just $4,500 to make.[204]

"America has been a leader in many technology industries for decades, and high levels of risk capital flowing to entrepreneurs have played a crucial role in the nation's success."

Even the costs of nuclear fusion research have plunged, which has prompted two dozen startups to explore this energy source. While governments used to spend billions of dollars on fusion research, today "advances in computing, precision machinery and synthetic materials have allowed scientists to design reactors a fraction of the size and cost of those just a few years ago. Lower price tags have put fusion within reach of private investors, allowing ventures to sprout."[205] The funding for nuclear fusion startups is coming from venture capitalists and angel investors, including Bill Gates and Jeff Bezos.

The rise of smartphones, data mining, and other advances have led to swarms of fintech startups trying to undermine big banks and financial services companies:

- Chime and other "neobanks" provide basic account services with low fees and smartphone access. Chime was founded in 2012 with $3.75 million of angel funding and has 10 million customers.[206]
- Fair was founded in 2021 by Khalid Parekh with $20 million of angel funding to provide banking services to underserved immigrant communities.[207]
- Square is a digital payments company that has simplified retail point-of-sale processing and expanded into other business financial tools. The company was cofounded by Twitter cofounder Jack Dorsey and has received large angel and VC investment.
- Dave is a money management app with a loan facility that cuts bank overdraft fees for users. CNBC noted that Dave "is designed to eliminate many of the features customers can't stand about legacy banks."[208] Billionaire Mark Cuban invested $3 million in the company and sits on the board.
- Fundbox and other startups are reducing small business costs for borrowing, payments, and cash management, which has been a "boon to hair salons, bakeries and other small businesses that don't qualify for bank credit."[209] A Harvard Business School study noted, "as banks of all sizes have moved away from small firms and small dollar loans, new entrepreneurs have entered the field and used innovative approaches to fill the gap."[210]
- Robinhood was the first company to provide commission-free stock trades. It wants to "provide everyone with access to the financial markets, not just the wealthy."[211] The company received $3 million of early funding from venture capitalists and angel investors, including Tim Draper and Howard Lindzon.[212]
- SoFi is trying "to crack open one of Wall Street's oldest clubs: those getting distribution of IPOs at the offering price, before shares begin trading."[213] The company proclaims "everyone should have access to the uncapped upside potential of IPOs. Not just institutional investors."[214] SoFi was funded by angel Ron Suber, who has invested in more than a dozen fintech startups.
- Affirm "seeks to cut credit card companies out of the online shopping process by offering a way for consumers to secure immediate, short-term loans for purchases."[215] Affirm was cofounded in 2012 by PayPal cofounder Max Levchin, who raised $45 million in a first round of venture funding.[216]
- Hippo and other startups are invading the insurance industry. Hippo was founded in 2016 and received funding from a family office, angels, and VCs.[217] The company aims to improve home insurance with better data analysis and satellite photos.[218]

Some of these startups may not succeed, but consumers are benefiting from all the new competition. Fintech companies aim to cut fees and tap underserved markets,

and they "are clearly disruptors from a Clay Christensen point of view," noted the Harvard Business School study.[219] Christensen found that established companies often overlook downmarket consumers, which creates space for lower-cost startups to enter markets.[220]

History is replete with entrepreneurs who struck it rich by finding better ways to serve the poor. In their history of Western economies, Nathan Rosenberg and L. E. Birdzell Jr. found that "the West's system of economic growth offered its largest financial rewards to innovators who improved the life-style not of the wealthy few, but of the less-wealthy many."[221] Henry Ford innovated to slash the price of his Model T from $825 in 1908 to just $290 by 1927.[222] Ford was a great entrepreneur, but he needed a wealthy angel investor to help him launch his company.

ANGEL INVESTMENT AND PUBLIC POLICY

The U.S. economy is admired for its dynamism and innovation. America has been a leader in many technology industries for decades, and high levels of risk capital flowing to entrepreneurs have played a crucial role in the nation's success. Angel and venture capital investment is much larger in the United States than in other high-income countries.[223]

This section discusses regulatory and tax policies that affect flows of funding to startup businesses. Rigged industries have entry barriers that undermine the ability of entrepreneurs to raise money and challenge incumbents. Financial regulations affect the breadth of capital available for investing in startups. And tax policies affect investor incentives to take on the large risks and burdens of funding startups.

Opening Rigged Industries

Sen. Elizabeth Warren (D-MA) complained that "monopolists dominate our economy" and that the wealthy want to "keep the system rigged for themselves while opportunity slips away for everyone else."[224] Indeed, some industries have been "rigged" by government regulations that protect incumbent businesses from competition at the expense of consumers.[225] But America has always had entrepreneurs and wealthy angels eager to challenge entrenched companies and the regulations that protect them.

The classic case is MCI Communications' battle to undo AT&T's telephone monopoly from the 1960s to the 1980s.[226] AT&T provided mediocre customer service, was slow to adopt new technologies, and strongly defended its turf against market entrants.[227] MCI founder John Goeken teamed with millionaire Bill McGowan in 1968, and with McGowan's leadership and investment in the company, they challenged AT&T.

The federal government required AT&T to provide universal service, which was used as justification for keeping long-distance rates artificially high in order to subsidize local phone service. This structure created an opportunity for MCI to enter the long-distance market and undercut AT&T's prices. At the same time, AT&T restricted other companies from access to its local exchanges and barred anyone from attaching non-AT&T equipment to its system.

"America has always had entrepreneurs and wealthy angels eager to challenge entrenched companies and the regulations that protect them."

The AT&T monopoly began to crack with the 1968 Carterphone decision by the Federal Communications Commission (FCC), which allowed outside equipment to be attached to the phone system. That was followed by a long legal battle between MCI and AT&T, beginning with MCI's application for a license to use a microwave system for business-to-business long-distance services, which the FCC granted in 1969. Economist Robert Crandall noted how McGowan continued to push the FCC and AT&T during the early 1970s: "He knew that the FCC had kept AT&T's long-distance rates obscenely high in order to subsidize its local residential rates, and he wanted a piece of the much larger general long-distance market. In the 1970s, he simply began to offer this service without the FCC's permission."[228]

With momentum for reform, MCI was able to start raising millions of dollars from private investors, followed by proceeds from a 1972 IPO.[229] The company launched an antitrust suit against AT&T in 1974 and lobbied to gain full access to local exchanges. The federal government launched a parallel

antitrust suit against AT&T, which ended in a settlement in 1982 that broke up the AT&T system and opened the door to full long-distance competition.[230] With the legal uncertainty out of the way, MCI was able to raise $1 billion from high-yield bonds to make huge network investments. MCI cut consumer prices, pursued new technologies, and remade the telecommunications industry. Also worth noting is that the next revolution in telecommunications—cell phones—was also delayed by barriers to entry.[231]

Around the same time MCI was battling to enter long-distance markets, FedEx was dealing with regulations blocking its attempt to expand into the package delivery industry with overnight service. A young Fred Smith launched FedEx in 1971 based on an idea he wrote about during college. To finance the purchase of planes and trucks, Smith and his family invested about $8 million, and after a struggle he lined up venture investments and bank loans of about $50 million by 1973.[232] At the time, an oligopoly of delivery firms, protected by regulations, provided generally poor service. Smith faced restrictions imposed by the Civil Aeronautics Board (CAB) and the U.S. Postal Service. He reminisced to the *New York Times*, "People thought we were bananas" to take on all the market and legal challenges.[233]

FedEx had a bumpy ride the first few years, losing money and being turned down by the CAB to buy the larger jets it needed. Then, in 1977, Congress deregulated the air cargo industry, and FedEx was able to buy larger jets.[234] As the company's prospects brightened, it was able to raise cash for expansion from public equity markets. In 1979, the U.S. Postal Service—under political pressure—liberalized its monopoly over letters, which allowed FedEx to expand into "extremely urgent" overnight letters.

Air cargo deregulation in 1977 was followed by passenger airline deregulation in 1978. Previously, the CAB had limited airline entry, controlled routes, and micromanaged fares. The regulations produced bloated airline costs and high prices. Entrepreneurs might have tried to raise money and challenge the major airlines, but the uncertainty of CAB approvals would have undermined investor interest. Prior to deregulation, no new carriers had entered the national airline market for decades.[235] At its founding in 1967, low-cost carrier Southwest Airlines had to battle litigation from incumbent airlines for three years before gaining the regulatory approval to operate flights within Texas.[236]

Airline deregulation changed all that. One of the first airlines to enter was People Express, founded by airline industry veteran Donald Burr.[237] Burr sold his car, house, two condos, and drained his savings to put $350,000 into launching People Express in 1980.[238] Former business colleagues Gerald Gitner and Melrose Dawsey joined him and personally invested $175,000 and $20,000, respectively. Citibank Venture Capital invested $600,000, and then People Express raised $25 million in an IPO. The airline boomed in the early 1980s, driving down prices and changing the industry, but it later got into financial trouble and was acquired in 1987.

Investment banker Bill Hambrecht helped finance People Express and other upstart airlines in the 1980s. He shared Burr's view about challenging the "plutocrat" airlines and helping "small rivals to provide the public—especially those who, in the post-deregulation era, live in underserved markets—with better and cheaper service."[239] Perhaps the most successful low-price startup has been JetBlue, which was founded in 1999 by David Neeleman with $130 million in funding from venture capitalists and angel investor George Soros.[240] With startups injecting competition into the airline industry, real median fares fell almost 40 percent between 1980 and 2005.[241]

"In recent years, angel-funded startups have challenged incumbent firms and anti-competitive regulations in many industries."

Two new airlines launched in 2021: Breeze Airways and Avelo Airlines. Neeleman launched Breeze with $17 million of his own money and $83 million from angels and venture capitalists.[242] The two airlines will offer low-cost direct flights to underserved markets. One aviation specialist said, "Avelo and Breeze will be two new disruptors, promising friendly service, low fares, and flights on many routes that have limited or no current nonstop service."[243]

In recent years, angel-funded startups have challenged incumbent firms and anti-competitive regulations in many industries. Uber has fought regulations protecting taxicab oligopolies in city after city in its effort to reduce ride prices and

improve convenience. Airbnb has battled hotels that lobby to thwart the expansion of home rentals.[244] Tesla has battled state restrictions that limit new vehicle sales to independent dealerships and restrict direct-to-consumer sales.[245] Tesla uses various workarounds for these outdated laws.

When governments deregulate, capital flows to entrepreneurs. A 2020 study by Liya Palagashvili and Paola Suarez looked at 19,585 tech-driven startups in the United States and Canada across numerous industries. Their results "suggest that more regulated industries may exhibit lower rates of entry and that more regulated industries are associated with a greater likelihood of a startup closing."[246] They interpret their findings as showing that it may be easier for firms in industries with lighter regulation to attract risk capital.

'Angel investment occurs within a complex regulatory environment."

Deregulation has increased competition in numerous industries, but more reforms are needed. In aviation, the reforms of the 1970s opened entry to new airlines, but dominant airlines have continued to use their clout to restrict competitors from access to airport facilities.[247] In the beer industry, federal and state deregulation during the 1970s and 1980s allowed thousands of craft brewers to challenge the oligopoly of big producers, but today state distribution systems continue to favor big breweries over small ones.[248] Craft brewers in North Carolina call the beer regulatory system "rigged," which is the word that Senator Warren likes to use.[249]

In health care, federal and state policymakers relaxed barriers to telehealth during the pandemic, which prompted VC flows to telehealth startups to jump 70 percent in 2020 over 2019.[250] For example, telehealth firm Hinge Health was launched in 2016 with a $500,000 investment from the cofounder, and with the recent policy reforms the company was able to raise $300 million in venture capital.[251] However, numerous types of regulation continue to undermine entrepreneurship in health care, such as certificate-of-need rules in 34 states that restrict entry and investment.[252]

Regulatory barriers to market entry are a very broad topic. The narrower focus here is to suggest that investment will flow to startups eager to challenge incumbents when entry barriers are reduced. As such, policymakers worried about the market power of big corporations should reduce regulations and allow well-funded entrepreneurs to undermine that power.

Regulating Angel Investment

Angel investment occurs within a complex regulatory environment. The federal government imposes rules on private investment in startups, and it imposes regulatory burdens on public companies that can make it more difficult for angels to exit investments. Some investment rules have been liberalized in recent years, but further reforms are needed.

Equity investments in startups have long been limited to accredited investors. Under Securities and Exchange Commission (SEC) Rule 506 of Regulation D, these investors are generally individuals with annual incomes of more than $200,000, or at least $1 million in wealth aside from the value of their primary residences, although other individuals may also qualify. Private companies may receive funding from accredited investors with no dollar limit and without providing detailed disclosures. The idea is that accredited investors do not need government coddling.

However, the rules have reduced the ability of non-accredited (non-wealthy) Americans to invest in private businesses, including startups. That limits the capital available for startups and is unfair to the extent that private markets offer higher returns than public markets.[253] Arguing for repealing the accredited investor rules, angel Charles Sidman noted that "removing arbitrary and wealth-based legal barriers to economic opportunity is profoundly democratic."[254] In other words, repealing the rules would level the playing field for investors.

Former SEC chair Jay Clayton expressed a similar concern: "Because it is generally difficult and expensive for Main Street investors to invest in private companies, they will not have the opportunity to participate in the growth phase of these companies to the extent they choose not to enter our public markets or do so only later in their life cycle."[255]

Previously, most of the increase in value in technology companies occurred in public markets because IPOs were earlier in company growth cycles, but today larger appreciation often occurs prior to IPOs. With that in mind, a U.S. Treasury report noted, "To the extent that companies decide not to go public due to anticipated regulatory

burdens, regulatory policy may be unintentionally exacerbating wealth inequality in the United States by restricting certain investment opportunities to high income and high net worth investors."[256]

Another issue is that the accredited-investor rules do not ensure that only knowledgeable people pursue risky private investments. The rules mean that a wealthy doctor who knows nothing about mining can invest in a mining startup, but a nonwealthy mining engineer cannot.[257] Former SEC official Andrew Vollmer argued, "SEC's definitions necessarily engage in drawing fine lines between different types of investors and inevitably end up with arbitrary and irrational distinctions."[258] Vollmer concludes that the accredited-investor rules should be scrapped, as does the Cato Institute's Jennifer Schulp.[259]

The Jumpstart Our Business Startups (JOBS) Act of 2012 liberalized the rules for startup investing in several ways.[260] The act repealed a prohibition on startups using general solicitation to raise unlimited capital from accredited investors under Regulation D, Rule 506(c). And the act liberalized the Regulation A exemption to allow mini public offerings of up to $50 million, although it limited the ability of nonaccredited investors to participate in them.

The JOBS Act also legalized equity crowdfunding. Internet crowdfunding sites, such as Kickstarter, had allowed people to donate to activities such as arts projects or to prepay for upcoming products, but they did not allow equity investments. The JOBS Act changed that, allowing nonaccredited investors to invest through online portals, although within limits related to a person's income and wealth. Startups can now raise up to $5 million annually through such portals.

These reforms have broadened funding options for startups. Crowdfunding can "serve as a training ground" for investors who later become major angels.[261] Also, crowdfunding can help to de-risk startups to prepare them for later angel and VC funding. Crowdfunding can make financing available for a more diverse range of entrepreneurs.[262] In 2020, about $17 billion was raised in North America from crowdfunding of all types, although only a fraction of that was equity crowdfunding.[263]

Crowdfunding does not replace traditional angel investment. As discussed, wealthy angels provide not just funding, but also mentoring and networking support for entrepreneurs. Also, crowdfunding has downsides, such as opening a startup to negative publicity from small investors if things do not go as planned. Nonetheless, crowdfunding is a useful addition to funding options for entrepreneurs.

Angel investment is affected by the costs of going public in an IPO because that is one way that angels (and VCs) can exit their investments. One study across 14 European countries compared levels of investment to the ease of going public and found that "the opening of stock markets targeted at entrepreneurial companies positively affects the shares of early stage and high-tech venture capital investments."[264]

"Crowdfunding can 'serve as a training ground' for investors who later become major angels."

Unfortunately, the regulatory costs of going public have increased in the United States, which has been one factor in the declining number of public companies. The number of public companies fell from 7,322 in 1996 to 3,643 in 2019.[265] There was an average of 205 IPOs a year in the 1980s and 409 a year in the 1990s, but then just 126 a year over the past 21 years, although the number jumped in 2020 and 2021.[266] Growing companies are staying private longer before going public, with the result that the typical age of companies at their IPO increased from 4 years in 1996 to 11 years today.[267]

The Sarbanes–Oxley legislation of 2002 increased regulatory costs for public companies and may have dissuaded firms from going public.[268] The legislation appears to have raised costs for smaller companies relatively more than for larger companies.[269] Congress partly mitigated the damage with provisions in the JOBS Act to lighten compliance burdens for "emerging growth companies." These companies, which have annual revenues of less than $1.1 billion, are subject to fewer disclosures and reporting requirements for the first five years after an IPO.[270] Today, 90 percent of companies that go public are in this emerging growth category.[271]

Some market developments have made the process of going public easier in recent years.[272] One is direct listings or direct public offerings (DPOs), which reduce the lawyer and banker fees of going public and reduce the time burden imposed on company leaders from the IPO process. Spotify's

DPO in 2018 put this strategy on the map. The purpose of DPOs is not so much to raise money but to provide an exit for investors, including entrepreneurs, angels, and VCs.

Another development is the Special Purpose Acquisition Company (SPAC), which is a company that goes public as a shell and then finds private companies to acquire. It reduces regulatory costs because a SPAC IPO involves little in the way of business disclosures, and the acquisition of private companies may not be subject to the same disclosure rules. Virgin Galactic went public in 2019 through a SPAC. Special Purpose Acquisition Companies have been around for years, but their popularity has recently soared, with the number jumping from 59 in 2019, to 248 in 2020, and to more than 300 half way through 2021.[273] However, the SPAC wave may have recently crested and begun to fall.

The main exit for angels, entrepreneurs, and VCs is an acquisition by an established company. There are many more acquisitions than IPOs these days. For VC-funded companies, the share of all exits has shifted from about 80 percent by IPO in the 1980s to only 10 percent today, while the share by acquisition has increased from about 20 percent in the 1980s to 90 percent today.[274]

A disadvantage of acquisitions is that they may contribute to the dominance of large companies in the marketplace. Large technology companies, including Apple, Microsoft, Google, Facebook, and Amazon, each make numerous acquisitions each year.[275] Members of both parties in Congress worry about the power being exercised by large corporations. But federal rules that raise the costs of going public may be partly to blame by inducing startups to favor being acquired over listing as independent public companies.

Some policymakers favor antitrust enforcement to restrict or break up large companies, but antitrust interventions have a poor track record.[276] Instead, policymakers should reduce the regulatory costs of public companies and further liberalize the rules for investment in private companies to encourage entrepreneurial activity and flows of risk capital to startups.[277]

Taxing Angel Investment

Over the past century, Congress has nearly always kept effective tax rates on individual long-term capital gains below the rates on ordinary income. There are numerous reasons for this special treatment of capital gains. The first is inflation: if an investor buys a stock for $100 and sells it years later for $120, some portion of the $20 gain represents inflation and not a real return. A reduced capital gains tax rate is a rough way to correct this problem.

A second reason is that capital gains are highly responsive to taxation because capital is mobile and because gains are taxed on a realization basis. Higher capital gains tax rates would shrink the tax base substantially and possibly reduce tax revenues. The revenue-maximizing capital gains tax rate is 28 percent or less, meaning that the government would lose revenues by raising the rate higher than that.[278]

A third reason is the double taxation of corporate equity under the income tax. Equity is taxed at the business level by the corporate income tax and taxed again at the individual level by taxes on capital gains and dividends. By contrast, interest income is only taxed at the individual level. The result is that our tax code is biased against equity and in favor of debt, which may induce corporations to overleverage and, in turn, reduce their stability during downturns.

A fourth reason for keeping capital gains taxes low is the importance of gains as a spur to investment in startups and growth companies, particularly technology companies. A capital gain is the financial reward for the efforts, risks, and patience that entrepreneurs and angels put into potentially high-growth startups that end up succeeding.

"A fourth reason for keeping capital gains taxes low is the importance of gains as a spur to investment in startups and growth companies, particularly technology companies."

The top federal tax rate on long-term capital gains is 23.8 percent, which includes the basic rate of 20 percent plus a 3.8 percent net investment income tax. Including state taxes, the average U.S. capital gains tax rate is about 28 percent. That is higher than the 19 percent average rate among nations in the Organisation for Economic Co-operation and Development (OECD).[279]

The Biden administration is proposing to raise the capital gains tax rate from 23.8 to 43.4 percent for households with incomes above $1 million.[280] With state capital gains taxes, the average top federal-state rate would be 48 percent, or more than double the average OECD rate.[281] The Biden effort runs counter to a decades-long bipartisan consensus that keeping a low capital gains tax rate is important to innovation and economic growth.

The modern era of startup investing began in the late 1970s, spurred by two key policy changes. One was the 1979 relaxing of the "prudent man" rule allowing pension funds to allocate a larger share of their portfolios to riskier assets. The passing of the 1974 Employee Retirement Income Security Act had initially resulted in a conservative interpretation of the rule, which generally precluded pension fund investment in venture capital. With the 1979 reform, pension funds began allocating more cash to venture capital.

The other change was the slashing of the federal long-term capital gains tax rate. The Revenue Act of 1978 cut the top effective capital gains tax rate from 49 percent to 28 percent, and then the Economic Recovery Tax Act of 1981 cut the rate to 20 percent.[282] These reforms reversed the capital gains tax increases of the late 1960s, which were partly blamed for the low ebb of venture investment during the 1970s.[283]

Venture capital investment boomed after these reforms, quadrupling between 1980 and 1983 and continuing to grow after that.[284] The volume of angel investment during that period is unknown, but the capital gains tax cut would have increased angel investment incentives in parallel with VC incentives. That era saw flows of angel and VC investment into technology companies that reshaped the U.S. economy, such as Apple Computer, Compaq, Adobe, and Genentech.

Former Democratic senator Lloyd Bentsen of Texas was a key supporter of both the capital gains tax cut and the prudent-man reforms of the 1970s.[285] With taxes and regulations squelching the flow of startup capital at the time, Bentsen argued that without reforms, "we may never know how many potential Xeroxes or Polaroids have failed to get started."[286] At a June 1978 Senate hearing on the proposed tax cut, Bentsen said:

> This country has prospered because we have had a free enterprise system that has encouraged the entrepreneur, the small businessman, to take a risk with the understanding that he was going to be able to keep some of it if he won. We have not succeeded as a nation by playing it safe. Today, the risks of starting a new business are as high as ever, but the rewards are even less with our tax system.[287]

The 1978 capital gains tax cut had bipartisan backing in Congress, and it gained support from leading economists, such as Martin Feldstein, as well as leaders in Silicon Valley, such as Robert Noyce.[288] The cut was known as the Steiger Amendment, after Republican congressman William Steiger. The *Washington Post* editorialized in 1978: "The wild popularity of the Steiger amendment among the Democrats in Congress is a remarkable phenomenon. The Steiger amendment, you will recall, cuts capital-gains taxes for a small number of citizens, most of whom roost comfortably on the top rung of the income ladder."[289]

"With high capital gains taxes, potential entrepreneurs are less inclined to start businesses."

The capital gains tax rate was raised in 1986, but that prompted calls to cut it again, which happened in a bipartisan package in 1997. Leading up to the 1997 cut, Federal Reserve chair Alan Greenspan testified: "I think while all taxes impede economic growth to one extent or another, the capital gains tax, in my judgment, is at the far end of the scale. And so, I argued that the appropriate capital gains tax rate was zero."[290] The 1997 law signed by President Bill Clinton reduced the rate from 28 percent to 20 percent. Unfortunately, that sort of bipartisan consensus in favor of low capital gains taxes has broken down in recent years.

There are at least three effects of capital gains taxes on startups and growth companies.[291] First is a supply-side effect. With high capital gains taxes, investors are less willing to fund risky but potentially high-growth companies, instead favoring investments paying dividends or interest, such as tax-exempt municipal bonds.[292] Funds for VC investment come from numerous sources, each of which faces a different tax situation, including individuals, family

offices, corporations, pension funds, university endowments, and foundations. By contrast, angel investment comes from wealthy individuals, who are generally fully taxable at high marginal rates.

Second is a demand-side effect. With high capital gains taxes, potential entrepreneurs are less inclined to start businesses. An important financial return for the hard work, risk taking, and patience needed to launch a startup is the possibility of a capital gain five or more years down the road. Potential entrepreneurs compare wage employment with the possible payoff from a startup and the related capital gains tax burden.

'The capital gains tax is a 'success tax' because 'the government taxes the upside returns to investment but does not share symmetrically in projects that fail.'"

A third effect of capital gains taxes relates to the need of startup companies—particularly in technology industries—to attract highly skilled workers. Technology startups are usually cash-poor and often do not earn net returns for years after launch, yet they need to attract talented workers to compete with established corporate giants. One solution is to offer workers stock options, which pay off if a company succeeds and its valuation rises.[293] Three-quarters of VC-backed companies in the United States use stock options for their employees.[294] Such companies also use restricted stock awards and restricted stock units as equity-based compensation.

The taxation of stock options is complex, but the basic tax-planning goal for employees is to subject their gains to capital gains tax rates rather than ordinary income tax rates and the alternative minimum tax.[295] If the government were to raise capital gains taxes, it would reduce the ability of growth companies to attract top talent. The National Venture Capital Association called a proposed tax hike on stock options "an existential fight for the entrepreneurial business model."[296]

The capital gains tax is a "success tax" because "the government taxes the upside returns to investment but does not share symmetrically in projects that fail."[297] Capital gains are taxable, but net capital losses can generally only be deducted up to $3,000 annually against ordinary income. Numerous empirical studies have found that this success tax affects investment flows:

- A 2010 study by William Gentry measured the effects of state-level capital gains taxes on VC investment from 1969 to 2007. He found that "higher capital gains tax rates are associated with less venture capital funding flowing into a state."[298] Gentry interprets the findings as a demand-side effect: entrepreneurs are discouraged from starting high-growth businesses in states that have high capital gains taxes.
- A 2013 study by Alexander Popov and Peter Roosenboom looked at VC investment across 21 European countries from 1998 to 2008. They found that "venture capital investment has a stronger effect on new business creation in countries with lower taxes on capital gains."[299]
- A 2015 OECD study on financing young innovative companies summarized the academic literature, stating that "Capital gains tax is an important factor that shapes the seed and early stage equity market as tax will influence the investment and exit decisions by angel investors and venture capitalists."[300]
- A 2017 study by Magnus Henrekson and Tino Sanandaji examined the relationship between VC funding and the tax treatment of stock options across 38 countries.[301] Controlling for various factors, they found that countries with lower capital gains taxation of stock options have higher VC investment than other countries.
- A 2018 study by Alexander Edwards and Maximilian Todtenhaupt examined U.S. VC funding for 13,431 companies from 2005 to 2016.[302] Their analysis used the fact that a 2010 law exempted VC investments in some industries, but not others, from capital gains taxes. Using this difference, they estimated that the tax exemption increased funding in eligible startup firms per funding round by 12 percent.
- A 2019 study by Carolin Bock and Martin Watzinger examined 61,558 VC funding rounds across 32 countries from 2000 to 2012. They found that "higher capital gains tax rates are associated with fewer start-ups financed and a lower probability of receiving

follow-up funding."[303] The authors surmised that "an increase in the tax rate leads to fewer companies obtaining sufficient financial means to expand their idea as planned and hence, presumably, to less innovation within the economy."[304]

- A 2019 study by Jeremy Greenwood, Pengfei Han, and Juan Sanchez presents a model of VC investment, capital gains taxes, and the economy.[305] Their results suggest that if a country raises its capital gains tax rate from 15 percent to 50 percent, it would trim about 0.2 percentage points from annual economic growth by undermining VC investment.

Studies on the investment effects of capital gains taxes focus on venture capital rather than angel investment because we have much better data on VC. But the negative effects of higher taxes would be at least as strong on angel investment as on VC.

Angels have numerous options for exiting their investments, each having different federal tax implications. Angels can sell their shares for cash and realize a capital gain that is immediately taxable. That may occur after an IPO or when a company is purchased by another company in a stock-for-cash deal, called a "cash acquisition."

Another way for angels to exit is a stock-for-stock buyout. In this case, angels receive shares of the acquiring company and can defer payment of capital gains taxes until selling the shares down the road.[306] This is a "tax-free acquisition," or "reorganization."[307]

Yet another alternative is an "asset acquisition," or "merger." In this case, a company buys the assets of a target firm, then the target firm (if a C corporation) pays tax on the sale of the assets and the company is dissolved. Angel investors then pay capital gains taxes on their stock in the target company. There are numerous variations on this alternative, and each has different tax implications for the target company's assets going forward.

In addition to these tax considerations, the federal tax code includes breaks enacted to encourage investment in startup businesses. Tax code Section 1202 allows individuals up to a 100 percent exclusion of $10 million of capital gains on qualified small business stock (QSBS).[308] The stock must be held for five years in a domestic C corporation that has less than $50 million in assets at the time the stock was issued and immediately thereafter. If you sell your QSBS investment before five years, Section 1045 allows a tax-free rollover into another qualified startup. Investors, entrepreneurs, and employees are eligible for these benefits. However, Congress excluded numerous industries from the benefits, including hospitality, mining, architecture, law, engineering, and financial services.

Tax code Section 1244 is also important for angels. Since most investments in startups fail, the tax treatment of investment losses is important. Usually, taxpayers are only allowed to deduct net capital losses up to $3,000 against ordinary income annually, but Section 1244 allows for up to $50,000 annually in losses on qualified small business stock to be applied against ordinary income. The Section 1244 benefits are restricted to the same qualified businesses as Section 1202.

Optimally, investments in all types of businesses would be treated the same by the tax code. But the fact that Congress has carved out Sections 1202, 1045, and 1244 indicates that policymakers appreciate that low capital gains taxes are important for startup financing. To simplify the code and avoid distortions, Congress should adopt a uniformly low capital gains tax rate for all types of investment. A handful of high-income nations have adopted not just low tax rates on long-term gains, but the Alan Greenspan approach of a zero rate.[309]

"To simplify the code and avoid distortions, Congress should adopt a uniformly low capital gains tax rate for all types of investment."

Unfortunately, that is not the direction the Biden administration and many Democrats in Congress want to go. Instead, they want to equalize the top capital gains tax rate with the top ordinary income tax rate. And some Democrats, including Senate Finance Committee chair Ron Wyden (D-OR), want to impose accrual or mark-to-market taxation on capital gains for higher-earning taxpayers.[310] That would mean taxing changes in asset values every year whether or not assets are sold—or put another way, ending deferral for capital gains.[311] Such treatment would raise effective tax rates, increase tax code complexity, and

generate liquidity problems because changes in wealth on paper do not mean that individuals have cash available to pay taxes. Accrual taxation would be particularly misguided for assets such as startups and growth companies that have fluctuating valuations. No other nation in the OECD uses an accrual approach for taxing capital gains because of its impracticality and anti-growth effects.[312]

If Congress were to raise capital gains taxes, it is not clear whether it would keep special breaks such as Section 1202 for startup investing. If the general capital gains tax rate was jacked up and breaks were retained, there would be huge pressure to cram a wide range of economic activities through the breaks. Also, the higher the general capital gains tax rate were raised, the more lobbying pressure there would be to add new breaks for favored industries and types of investments.

"Wealth plays a central role because it drives the rapid creation and expansion of new businesses. Each round of startups that succeed generates returns for investors and entrepreneurs, who plow their new wealth into the next round of startups."

On the other hand, if Congress raised the general capital gains tax rate, that might embolden members to take further tax-hike steps, such as eliminating Section 1202 or deferral. Many tax economists advising liberal policymakers view the ideal tax system as having a Haig-Simons base, meaning full accrual or mark-to-market taxation—that is, taxing everybody's paper wealth gains every year.[313] This left-of-center approach of high capital gains tax rates, taxation of paper gains, and imposing high taxes on startup investing would severely damage America's technology and innovation industries.

It is troubling that federal policymakers are considering tax changes that would undermine entrepreneurial finance. Today's large and successful companies that drive the economy, such as Apple, did not just happen. In the beginning, there was often a wealthy angel who took a huge financial risk on an unproven entrepreneur. Tax policies should not create a barrier to such socially beneficial activity. Policymakers should strive for simple, uniform, and low taxation of capital gains.

CONCLUSION

This study examined the important role played by wealthy individuals in providing funding and guidance to startup businesses. With their independent pools of capital, angel investors support a large variety of promising startups that explore new goods, services, and technologies that existing businesses overlook. Many of the greatest successes in U.S. business history got off the ground with the help of wealthy angel investors.

Angel-funded startups generate competition. Many startups today are disrupting markets and challenging dominant companies in medicine, financial services, energy, automobiles, space travel, and other industries. The best check on corporate power is exposing industries to vigorous competition from well-funded startups.

The role of policymakers should be to foster an open and competitive environment allowing capital to flow to growth-oriented startups. Policymakers should continue liberalizing rules for investing in private companies, and they should reduce the costs of going public so that growing companies do not face barriers in pursuing initial public offerings.

Policymakers should repeal regulations that favor incumbent businesses over startups. Past reforms to industries such as telecommunications, package delivery, beer, and aviation illustrate how capital-fueled entrepreneurs will challenge dominant companies when regulatory barriers are reduced. But more federal and state reforms are needed in many industries to allow startups to compete on a level playing field with established businesses.

Policymakers should keep capital gains taxes low. Capital gains are the financial reward for the efforts, patience, and high risks of funding growth-oriented businesses. The Biden administration proposal to raise the top capital gains tax rate is misguided, especially since the U.S. rate is already higher than the OECD average. Proposals to tax gains on a mark-to-market or accrual basis would further raise effective tax rates and be a radical approach that is not followed by other nations.

All policymakers agree that America should be a global leader in technology. But they should recognize that technology hubs such as Silicon Valley are more than just groups of scientists and entrepreneurs. Wealth plays a central role because it drives the rapid creation and expansion of new businesses. Each round of startups that succeed generates returns for investors and entrepreneurs, who plow their new wealth into the next round of startups.

Higher capital gains taxes would starve cash from this virtuous growth cycle and undermine productive incentives. Without beneficial capital gains tax treatment, technology entrepreneurs would rather take salary jobs, investors would move their funds to safer assets, and employees lured to startups by stock options would instead favor big corporations.

In sum, policymakers should adopt tax and regulatory policies that are supportive of America's dynamic startup culture, which has spawned so many great companies and advances over the decades.

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October 5, 2021

The Honorable Nydia M. Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Velázquez and Ranking Member Luetkemeyer,

On behalf of America's credit unions, I am writing regarding the hearing entitled, "SBA's Entrepreneurial Development Programs." The Credit Union National Association (CUNA) represents America's credit unions and their more than 120 million members.

Credit unions recognize that financial inclusion and access to capital for entrepreneurs are critical to ensuring the growth and development of vibrant small businesses. As not-for-profit, consumer-owned financial cooperatives, credit unions have a laser focus on our mission of financial inclusion and serving our members. Establishing and retaining a relationship with a credit union is the best way for a small business entrepreneur to partner with a provider of essential financial services.

The Small Business Administration's (SBA) government guaranteed lending programs epitomizes a successful public-private partnership, and it's one that that leverages private sector expertise. Generally, the SBA does not function as a direct lender, but guarantees the repayment of loans made by a lender such as a credit union. SBA's lending programs, such as the 7(a) Loan Program, allow small businesses to work with local lenders or other lenders of a business's choice throughout the loan process. The SBA guarantees these loans ensuring that financial institutions are made whole in an instance of default by the borrower.

This public private partnership works as borrowers are able to obtain loans from financial institutions that they know well and that have vested interests in their borrowers' success. Furthermore, when working with local lenders, small businesses are likely to benefit from guidance and experience from a lender with a stake in helping the borrowing business succeed.

Credit unions oppose any legislation that would remove financial institutions from their direct relationship with borrowers by allowing the SBA to lend directly to small businesses. By becoming a direct lender to small businesses, the SBA is likely to harm local financial institutions' relationships with businesses and possibly hamper these businesses from establishing important banking relationships that can only help their business survive and flourish.

On behalf of America's credit unions and their more than 120 million members, thank you for the opportunity to share our views.

Sincerely,

Jim Nussle
President & CEO