PROMOTING INTERNET ENTREPRENEURSHIP: SHOULD THE GOVERNMENT TAKE ANY ACTION?

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PROMOTING INTERNET ENTREPRENEURSHIP: SHOULD THE GOVERNMENT TAKE ANY ACTION?

TUESDAY, APRIL 3, 2001.

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittee met, pursuant to call, 2:11 p.m. in Room 311 Cannon House Office Building, Hon. Mike Pence, [chairman of the subcommittee] presiding.

Chairman PENCE. The hearing of the Subcommittee on Regulatory Reform and Oversight of the Committee on Small Business will come to order.

Our hearing today is about the meteoric rise of Internet-based economy and whether current federal government policies help or hinder small businesses that seek to utilize the Internet as a business strategy. Today's hearing will be the first in a series of hearings that this subcommittee will hold to examine the impact of federal regulatory policies on the ability of small businesses to deploy new technologies, develop new markets and generate economic growth.

The expansion of commerce on the Internet is simply staggering, with numbers that are difficult to comprehend. Internet traffic in 1996, a mere five years ago, but in Internet time almost a generation ago, was doubling every 100 days. Even analysts could not comprehend the growth in usage of the Internet. For example, in 1998, one report estimated that retail transactions on the Internet would reach 7 billion by the year 2000. Most analysts now believe that the estimate was reached in 1998. Just this past Christmas, retail sales of goods on the Internet reached $8.7 billion and the Bureau of the Census estimates that Internet business to consumer retail transactions hit the $20 billion mark in 2000. The use of the Internet by consumers to purchase goods pales in comparisons to estimates of business to business transactions on the Internet. Some analysts predict the value of global transactions on the Internet will exceed $6 trillion.

The growth in commerce and use of the Internet demonstrates that it is the new central business district, the new Main Street, if you will, and the new shopping mall. And just as small businesses play a vital role in the central business districts, on our

Main Streets and in the shopping malls, they also play a key role in the development of commerce on the Internet.

Rather than hire a real estate agent and construction contractor to build a new store, Capital Baby Rentals decided to expand on the new American Main Street and sought the help of another business, Bigstep.com.

However, the Internet is not just the new American business district. Digital convergence enables the Internet to be the next newspaper, the next telephone network and cable system. In my district, LocalWeb4U provides information that individuals currently receive from their local newspapers, broadcast stations and telephone directories. However, because of the ubiquity of the Internet, LocalWeb4U can provide that information not just for Anderson, Indiana but for communities throughout the United States. But we also have iBasis, a company that provides voice over Internet Protocol telephony. In other words, it uses the Internet to provide telephone service and, unlike the telephone company, its customers are not limited by geographic location.

No one can doubt that an Internet-based economy provides significant opportunities for new small businesses, as well as new ways to expand existing small businesses. In fact, three of the businesses testifying here today simply would not exist and did not exist prior to 1995 without the ubiquitous availability of the Internet and the desire of Americans to log on.

Before Congress takes further action to promote expansion of commerce on the Internet or hinder its unbridled growth, it behooves us to understand this new stream of commerce, the problems they face and whether they currently perceive government policies to help or hinder their operation and growth.

The panelists here today will explain how businesses is done on the Internet, how they as small businesses discovered unserved or under served niches to expand their businesses and how this new technology will continue to open new opportunities for the pioneering small businesses. Finally, the panelists will highlight any issues of concern about existing federal policies or changes in federal policies that may help or hinder their businesses. Congress will then have the information it needs to rationally make decisions and ensure federal legislative and regulatory policies are partners in helping small businesses take advantage of this new stream of commerce and not act as a dam to its potential.

Before turning to the ranking member, the distinguished gentleman from Pennsylvania, I would like to take a few moments to mention the superb work done by my predecessor, the gentlewoman from New York, Sue Kelly, who chaired this subcommittee in the last Congress. She demonstrated leadership in this subcommittee in doing oversight of the regulatory problems facing small businesses and she persevered in finally getting the Truth in Regulating Act passed. Her understanding of the regulatory problems faced by small businesses is second to none in this Congress and, as the new chairman of this subcommittee, I hope to follow in her footsteps.

The ranking member not being in attendance, we will recognize our first speaker for the afternoon who is with a company known

as LocalWeb4U and his name is Joe Clark, who is recognized for five minutes.

[Mr. Pence's statement may be found in appendix.]

STATEMENT OF JOSEPH CLARK, CHIEF EXECUTIVE OFFICER, LOCAL WEB4U, ANDERSON, IN

Mr. CLARK. Thank you, Mr. Chairman. It is a huge honor to be able to be here and I greatly appreciate you extending us that privilege. LocalWeb4U was founded on the belief that people need to be heard and to be found, especially on the Internet. LocalWeb4U was established to give individuals, businesses, nonprofit organizations the ability to state their opinion, give dates for events, even brag about their children's accomplishments within a local community.

The sad news is economies of scale have reduced local content providers such as newspapers and radio stations for two-thirds of America so that their voices cannot be heard, the Internet having a virtually unlimited amount of space. It lets you get out into every community of every size without the cost of raw goods and capital expenditure matter.

LocalWeb4U was blessed to create a concept in November of 1999, the peak of the Internet days. It incorporated two days before the largest Nasdaq record reporting in terms of the market. We came to market in a wonderful time and were placed to deal with this economy.

As a certified financial planner, I have looked at my clients who often talk about their new 201(k) versus the 401(k) and they literally feel that they have been cut in half. As a result, LocalWeb4U has had the trials and tribulations and had to tick through periods of time of slow capital infusion.

As all good businesses should, we have listened to the market and we have been forced to go more from a conceptual build up period of time to an immediate let-us-produce-net-revenue type of company. We have changed with the times and I am proud today to tell you that we are here intact and with a strong vision.

There is much talk about the new economy versus the old economy. And, in my opinion, I think you need to understand that the whole world is really changing with new innovations and new technologies.

There is no company that really has a stronghold, whether they are an old company or a new company, on this marketplace. Not Oldsmobile, not Sunbeam, not even Yahoo!. As an example, there were 200 companies in 1920 that produced automobiles, 23 alone in Anderson, Indiana, my hometown. In 1930, we were down to three, Studebaker barely holding on.

During this phase of the economy, the same one that we are in today, there is a mighty shake-out and a race for leadership. This change in corporate profitability and survivability during these economic times forces us to address the taxation of our business economy for one simple reason. The largest barrier to entry for our business was not a failing business model, it was not a mistake in assumptions, but it was a lack of capital. The best way to get capital is to inspire investment.

I believe it is imperative that we create a method so that investors do not pay taxes on growth. As long as the money that they have stays in the market for the development of companies, whether they be new companies or old companies trying to re-tool to stay alive in this great economy. We must give intra-stage investors support in the investment process, not obstacles that they need to overcome. And I realize to some of the people in this room that a 20 percent tax does not seem like a lot of money, but let me remind the committee that a 25 percent reduction in the stock market is titled as a crash.

Mr. Chairman, the only way for people to get money out of one company and to invest in another company is to go through their own little economic crash. I think people forget that regardless of which party you represent, people are scared to death of taxes. That is represented by the fact that 70 percent of all money in qualified plans, in IRAs, stays in the plan until age 70 and a half when the government forces them to pull it out. People cannot bear the loss of their net worth on paper. They cannot bear their own little economic crash.

I dare to wonder how many people would have left the money in some of these high flying Internet stocks last year with several hundred return in one year and not diversified if they had not been trapped by the psychology of the tax code. If people take money out of the market to spend on themselves, if we must tax them, tax them then, but do not stop investors from supporting companies that have the ability to do what it is they need to do.

I think it would be much easier for Congress, it would be much easier for American citizens, if our tax basis was taxed only when all the money left the market. We would not have to deal with the 3 billion shares trading every day and people trying to determine what basis was and it would spur investment based on the company's merits of that day. Do not punish investors and make them stay with their original decision if the market offers a better opportunity.

I do not feel it is the government's place to make sure my business works and survives, but I do look at it this way: I feel it is my best interests to protect my customers, the people that provide my living and buy my product. Investors are one of the IRS's best customers because even if they get it wrong once or twice, they end up staying with it and truly enhance government revenues.

Entrepreneurs live and die by the willingness of investors to bet on their success. Do your best as legislators to encourage investment, to encourage new innovation and to encourage willing compliance to the tax code.

Thank you for this wonderful opportunity. May you be filled with wisdom and God's inspiration to lead our country into the best economic time in history.

Thank you.

[Mr. Clark's statement may be found in appendix.]

Chairman PENCE. Thank you, Mr. Clark. An excellent presentation.

The next witness to testify is Mr. Douglas Mellinger, who is chairman of the National Commission on Entrepreneurship in Washington, D.C.

Mr. Mellinger, you are recognized for five minutes.

STATEMENT OF DOUGLAS MELLINGER, CHAIRMAN, NATIONAL COMMISSION ON ENTREPRENEURSHIP, WASHINGTON, DC

Mr. MELLINGER. Thank you, Mr. Chairman. Thank you for inviting me to testify today. As you said, I am chairman of the National Commission on Entrepreneurship, an organization whose charter is to help government policymakers at the federal, state and local level better understand the needs and interests of entrepreneurs and to elucidate a set of public policies that support a strong entrepreneurial economy.

Over the past few years, we have brought together some of America's top entrepreneurs as commissioners and have gone out across the country to talk to thousands of entrepreneurs and policymakers. We have learned from our research and interviews the opportunities and issues that face entrepreneurs related to infrastructure needs and policy implications. My testimony today reflects some of the highlights of the work that we have done.

While the media likes to write "dotcom, dotgone," the fact is that Internet technologies are revolutionizing how we communicate and transact business. We will look back 20 years from now and realize that we are just now beginning to see the radical change that this technology will have on everybody's lives, both personally and professionally.

Let me give a little bit of my background. I started my first entrepreneurial activities in my early teens before I knew there was such a word as entrepreneur. My first real company was started in college at Syracuse University, which was where I learned the meaning of the word entrepreneur and realized how critical people such as myself were to the economy and to the communities in which we operated.

When I was 25, I started my first technology firm, which I had started with $12,000 in 1989, and built its sales to $85 million in 1998 with about 800 employees. When I started PRT, the venture capital industry was tiny as compared to today. Banks did not want to provide funding and the SBA was of little use due to its focus on small business rather than on entrepreneurship. I was creating a software services business which had as its main assets intellectual capital rather than a manufacturing or retail business with hard assets. We struggled with financing and growth of the business for many years and were fortunate six years later to attract venture capital to fuel our growth.

Today, I am a partner in Interactive Capital, which helps early stage companies and Internet-enabled companies get founded, funded and go through the issues of hiring management teams and accelerating their sales. My two partners and I have been involved with more than 40 companies in our careers and have raised more than $400 million in investment capital to fuel these companies. I live all the issues that you are looking at today, including investment and regulatory infrastructure, labor, globalization, and hope that through my personal experiences and my commission I can give some insight.

Some entrepreneurs think that the government should just get out of the way, but I think it is very naive and reactionary since

they often feel they are all alone with the world on their shoulders. I believe that the government plays a crucial role and can be a positive player or it can be a hindrance, depending on the actions it takes.

I hope that you and your fellow policymakers take the time to understand entrepreneurship, as well as small business, and what the differences are. Before enacting legislation take a moment to understand the impact on entrepreneurs and their companies.

I will focus on a couple of the areas today. The first is human capital. In my experiences are in talking to my colleagues, I know that finding the right employee is the most difficult task. For many Internet entrepreneurs, finding talented engineers is an overriding concern. We also see that finding strong management teams and entry level employees is just as hard. Today, it is a little bit easier than it was three to six months ago, but certainly my belief is that over the next big of years we are going to have as strong an issue in finding people as we have in the past.

There are couple of the areas that I think need to focus on. The first and foremost is that we are not graduating enough science and engineering graduates in the United States today. The K–12 education system is certainly a problem. We need computer literate employees with strong analytical abilities and competencies in the three Rs. We also need employees who understand the free enterprise system. More universities should be offering entrepreneurship programs. And, most importantly, from a technology standpoint, one of our limitations today is getting the engineering talent and for that, we are looking overseas more and more.

Investment capital is a second major issue. Today, the venture capitalists, the large ones, have become very large and there is a gap which I think needs to be addressed between the angel capital at the small end and the large venture capitalists.

Another area of focus is the communications infrastructure. There is not enough broadband access across this country and the costs are sometimes prohibitive.

Regulations, as we look at both H1B filings, business formation, compliance, capital raising and others is a big issue.

Intellectual property, being able to protect the ideas that we have is critical.

And, finally, as we look at Internet taxation, the impact of lifting the moratorium has to be studied.

Finally, a couple of specific recommendations that I have. First, devise incentives that will encourage more students, especially women and minorities, to major in science and engineering. Secondly, explore changing our immigration system to take into account the education and training of our immigrants, rather than focusing primarily on family relationships. And we should also be looking at the student visas and allowing graduates to stay in. Finally, explore options such as enhancing the effectiveness of Section 1202 of the IRS code providing preferential capital gains treatment for individual investments in emerging start-up companies, relaxing the restrictions on the Investment Company Act to allow formation of more professionally managed funds, and, finally, allowing a small portion of 401(k) funds to be invested in venture funds targeted to the capital gap.

Thank you very much.

[Mr. Mellinger's statement may be found in appendix.]

Chairman PENCE. Thank you, Mr. Mellinger.

The chair now recognizes Mr. Joshua Engel, who is general counsel for BigStep.Com and comes to us from San Francisco, California.

STATEMENT OF JOSHUA ENGEL, GENERAL COUNSEL, BIGSTEP.COM, SAN FRANCISCO, CA

Mr. ENGEL. Good afternoon. First of all, thank you very much for inviting BigStep to testify today on behalf of our customers. Our customers are small businesses from around the country.

We at BigStep recognize, as I am sure all the members of this committee do as well, that small businesses are a critical piece of the business ecosystem. They are the nucleus of virtually all corporate geneses. They fill local and specialized places around the globe and often fill critical gaps in rural communities through their focus on services. In fact, this coveted role in our national fabric is recognized by reputation. Fully 85 percent of all Americans recognize small businesses as a positive influence on American life. We also share that belief.

In July of 1998, BigStep was founded with a simple premise. We wanted to help level the playing field for small businesses using the Internet. We wanted to give them power and tools to compete with the big boys on line: websites, e-mail, marketing tools and e-commerce tools.

Today, nearly three years later, we are succeeding. With over 300,000 members, BigStep is helping small businesses do on line what they do best off line: build businesses based on unique products and services, building meaningful, personal relationships with customers and providing enhanced value.

While we are proud to serve the small businesses, we cannot support them alone in their success. As the power of the Internet and broadband access and universally acceptable e-commerce becomes a reality, these businesses that fuel our economy will need greater advocates.

There are two particular areas of concern where we believe small businesses can benefit from your support. First, is taxes. We have already heard mention of that day. By their very nature, small businesses are challenged with juggling several duties, making time their most precious commodity. The complexity of small business taxation, particularly for home-based businesses, is challenging enough. What we hear over and over again from our 300,000 members is that on-line commerce tax management is a huge challenge.

Just handling sales taxes today over the Internet is extraordinarily complex. If the tax moratorium were lifted and electronic commerce were conceptually opened and new taxation at all levels of government, small businesses will spend an enormous amount of time trying to figure out how much tax they owe and to whom do they pay it.

This is time that would be much better spent running their small businesses.

As you mentioned in your opening statement, access to technology is also an incredibly important issue. Most analysts agree that an internet presence and tools to communicate with customers via the Internet are critical to business success.

One very interesting fact is this. The research firm IDC has found that businesses without any kind of Internet presence average—and this is small businesses up to 100—average 1.74 million in total revenue per year. That number increases to 2.07 million for small businesses with some kind of Internet presence and that number jumps to 2.15 million per year for small businesses with at least a home page. So I think the message there is clear that the Internet can work for small businesses.

Indeed, every member of Congress has both e-mail and a website and nearly 100 percent of the Fortune 1000 have websites and they have broadband access.

As recently as last month, the research firm IDB found that over 20 million small businesses do not even have websites. This disparity in access and deployment often has as much to do with a lack of time and resources as it does to access to the offering. However, access that is affected by regulatory controls does have a real impact on small business capabilities.

In particular, broadband access is a crucial hurdle for small business success on line. As I mentioned earlier, time is the most precious resource to a small business. Using applications like BigStep, with transaction tools and other e-business management services, these things become incredibly valuable when used over broadband connections. With high speed lines, small businesses can truly compete with the large corporations who have had this access for years and continue to provide over 50 percent of Americans their jobs.

Finally, small businesses need a friend. They do not have organizations like the ITAA as a support system. If we are indeed moving toward an economic slowdown, we need to show small businesses that we understand their integral role in today's economy. We need to help them flourish and not be stifled by the perplexity involved with more taxation or lack of access to technology.

Thank you very much.

[Mr. Engel's statement may be found in appendix.]

Chairman PENCE. Thank you, Mr. Engel.

The chair recognizes Ragan Hughs, who is co-owner of Capital Baby Rental in Falls Church, Virginia, for five minutes.

STATEMENT OF RAGAN HUGHS, CO-OWNER, CAPITAL BABY RENTAL, FALLS CHURCH, VA

Ms. HUGHS. Thank you very much, Mr. Chairman. I would like to express my gratitude for being invited to speak. I am not a large company, I am actually a small business owner, so I am speaking to you from the people would be most directly affected by action of the committee.

Mr. Engel told you about the two areas of concern to the small business market. As a small business owner doing business both on and off the Internet, the issues of equal access to the Internet and to new Internet technologies as well as the moratorium on Internet taxation are extremely important to me and my businesses.

As you said, I am a co-owner of Capital Baby Rental, which is a baby equipment rental company meeting the needs of business and leisure travelers to the Washington, D.C. area. My experience with Capital Baby Rental demonstrates the importance of equal access to the Internet and to new Internet technology.

The company itself is a brick and mortar business. We make physical deliveries and pickups of our equipment at the customer's location. However, the Internet is extremely important to the success of our business. Approximately 80 percent of our customers come to us via our website. Since most people making a trip use the Internet in some form or fashion for research and planning, our Internet presence is absolutely critical to us to reach international and domestic consumers traveling to the D.C. area with small children before they absolutely arrive to get them in that planning stage.

To use traditional methods of advertising to reach potential customers would be absolutely outrageously expensive and completely prohibitive. Using the Internet, however, we have been able to expand our reach considerably for very little cost. Using services like BigStep which are free to the Internet consumer, it is amazing what you can do.

Having an informational website where a potential customer can learn about Capital Baby Rentals, who we are, what we do, what services we provide, what costs are going to be incurred, has become a major part of our marketing plan. Without our website, we would be limited to serving the needs of local residents and last minute travelers and true success just would not be possible.

I also operate ThePartyBug.com which I wholly own, which is a party supplies company that is solely an Internet-based business. ThePartyBug.com markets, promotes and sells all of its products on line. The most important issue to us without question is the issue of Internet taxation, the state imposition and collection of sales and use taxes on e-commerce transactions.

Currently, when an on-line sale takes place, we collect sales tax when the items are being shipped to the state in which we have a physical location. Therefore, we are taxed exactly the same, no different, no more, no less, than a brick and mortar store. If a small business owner were operating on the Internet also had to collect and report sales tax for several other states and localities, it would make it almost impossible for them to do business. Should the moratorium be lifted, the confusion that would ensue would be outrageous.

By nature, Internet transactions actually take place in several different locations. For example, a web business' physical location may be in D.C., but the site is hosted in California, the traffic from that site is routed to several different servers in several different states, the consumer is located in Nebraska. Which state has the right to impose its taxes? Are several or, even worse, all of these states, going to be permitted to impose sales taxes on this one transaction? If this is the case, e-commerce will soon become a thing of the past. Merchants who either cannot or will not keep up with the different regulations will close their Internet businesses. Further, consumers who do not want to pay the excessive taxes would most likely choose to shop only at brick and mortar stores.

I feel that the current e-commerce taxation is much more than sufficient.

The Internet has opened up several doors for up and coming entrepreneurs like myself and as we move to the next phase of the Internet age, I would like to hold onto the hope that the World Wide Web will continue to make business easier, not more complicated.

Thank you very much.

Chairman PENCE. The chair also will recognize Jonathan Draluck, who is Vice President for Legal Affairs of iBasis and comes to us today from Burlington, Massachusetts, recognized for five minutes. Thank you.

STATEMENT OF JONATHAN DRALUCK, VICE PRESIDENT FOR LEGAL AFFAIRS, iBASIS, BURLINGTON, MA

Mr. DRALUCK. Thank you, Mr. Chairman, for the invitation to address the issue that this subcommittee has correctly identified as critical to the success of Internet-based businesses, that is, an environment free from legal barriers.

My name is Jonathan Draluck. I represent iBasis. It is a company that has succeeded in large part due to Congress' resolve to keep businesses that provide Internet-based services as free as possible from burdensome regulatory oversight.

Please allow me to share with you briefly what iBasis is and what we hope to become. Our core business is wholesale Internet telephone service. We carry the long haul portion of international telephone calls over the public Internet. We provide this service to over 100 telephone carriers around the world, including nearly all of the big U.S. long distance carriers that you are familiar with.

We began our operations in a basement in suburban Boston three years ago. We now carry millions of ordinary phone traffic minutes every day, using more than 426 Internet telephony facilities in 46 countries. And, today, if you dial an international long distance call using your regular long distance carrier, the odds are up to one and three that for any of 15 countries you may be trying to reach, including China and Russia, that your call is being carried by iBasis.

Our global network operates using Internet protocols which, like the Internet itself, are more efficient, versatile and scalable than the transport offered by traditional networks. Because of this, we are uniquely well suited to provide innovative web-based voice applications over our network. For instance, our Speech Solutions business based in Northern Virginia developed speech-driven applications that are available to anyone with a phone. Some of you may have already used a speech-recognition application such as that employed by major U.S. airlines. The service enables customers to dial in to a number and using spoken command make a flight reservation without ever using a touch tone.

Think of speaking into your mobile phone anywhere in the world and having the answer you seek spoken back to you, but never speaking to a person. That is the potential of the iBasis network.

The Internet's open protocols offer a lot more. We take for granted the use of the Internet. We all log on and surf, but if you think about it, there are only 300 million PCs in the world, that as com-

pared with 2 billion telephones. So the idea is to leverage the phone and leverage the power of the Internet. For instance, unified communications which we offer lets you hear and respond with your voice to your e-mail or your voice mail from any phone. We also see a world in which ordinary Internet content is accessible over the phone with what we call Global Spoken Web. It is a worldwide infrastructure of interconnected voice enabled websites that respond to spoken requests.

Finally, we offer our global IP voice infrastructure as an incubator for other small developers for new applications we can barely imagine now. In this way, we hope to bridge the digital divide by becoming an Internet access device and developing applications for it that are navigated by human voice.

A key driver in these kinds of applications is deregulation. On the U.S. front, therefore, iBasis urges the U.S. Government to maintain its current hands-off policy to regulating the Internet. In other words, let us keep the status quo and I will tell you the three issues that we are following.

First is international settlement regimes, which historically have maintained a balance of payments for terminating international telephone traffic between any two countries. The international settlement regime is rapidly becoming a relic of the monopoly era on competitive routes, though some countries that continue to have monopolies are persisting in imposing some form of settlements on international Internet traffic.

So iBasis encourages Congress to send a signal that it opposes such efforts by some foreign regulators. The absence of such charges has resulted in dramatic increase in international long distance traffic and a commensurate decrease in rates and has benefitted consumers worldwide.

Second, unlike in the U.S., where Internet services are not subject to licensing or tariffing requirements, some foreign governments erect obstacles to market entry. We attempt and are often successful in negotiating with the regulatory organ in these countries, but in some cases, countries impose all sorts of obstacles that prove insurmountable.

There are also significant delays and obstacles in getting local telephone numbering resources and international codes for signalling and set up. The U.S. Government and in particular Departments of State and Commerce have been an enormous source of support. They have carried our torch and that of others at the ITU, which is an international organization laden with monopolist regulators who still do not see the benefits of competition, innovation and technological change.

We are concerned about access charges for the same reason in this country because it requires higher communication services costs for consumers and it is a subsidy that is a relic of the traditional telephone network era.

We are hoping to deliver the new, more dynamic flexible and efficient voice services of the 21st century all over the world. We are giving a voice to the Internet, but we need this committee's voice to speak together with ours to help maintain the deregulatory momentum that preserves our invaluable freedom to innovate.

Thank you very much for your time and for your efforts on behalf of small business.

[Mr. Draluck's statement may be found in appendix.]

Chairman PENCE. Thank you, Mr. Draluck.

The chair as our last witness recognizes Mr. Robert McCord, President and CEO of Eastern Technology Council, and I do so on behalf of the ranking minority member, who was detained but who I know would want you to feel very welcome as a fellow citizen of Philadelphia. I bring greetings on behalf of the Honorable Robert Brady and welcome Mr. McCord of Eastern Technology Counsel in Philadelphia for five minutes of testimony.

STATEMENT OF ROBERT MCCORD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, EASTERN TECHNOLOGY COUNCIL

Mr. MCCORD. Thanks so much. It is a real pleasure to get to be here and an honor to meet you and spend time with you. With the chair's permission, of course, I would like to submit my written testimony as my official testimony and just speak extemporaneously and be open for questions.

As you noted, I have the pleasure of serving as president and CEO of the Eastern Technology Council which has 1300 member companies, dues paying member companies, many of which are venture capital firms and many of which are technology oriented leaders nationally. I am also joined today by my colleague Donna Gentile O'Donnell, who is a strong civil, political and business leader in her own right and is the managing director of our Philadelphia office.

I am out in the suburbs in what is called the Route 202 Corridor, recently labeled as one of the three hot new areas nationally to develop tech companies. And Donna, in addition to heading up all of our city-based activities and a close colleague and a close friend of your colleague, she also heads up all of our bio-pharma activities and one of the things that I would very much like to emphasize is that much of the Internet-oriented wealth creation that will flow into America over the next few years will have to do with the convergence of biotechnology, the pharmaceutical industry and the IT industry.

Indeed, if Donna is successful in the development of various projects related to the human genome project and also specifically in recruiting the Wellcome Trust, the largest single funder of human genome research in the world to have some sort of an operations in North American, specifically in the United States, that single project is likely to mint more Internet-oriented wealth creation than any 50 publicly traded Internet companies are today. That is a matter of scale.

And then, of course, you also are able to create real human progress in a lot of these cases, thanks to leadership from the pharmaceutical sector. So I hope you will recognize that convergence and invite your direct questions to Donna or to me and, of course, we are informally available to you because we are a hop, skip and a jump away. We can commute down here by train.

Informally, I would just want to highlight for you, first of all, I would want to associate us with the remarks made across the table here. I believe that Ms. Hughs made a terrific point, that there is

serious peril out there if we do over-regulate, over-tax, complicate the lives of a lot of these really inspiring early stage company entrepreneurs like her.

There is a real hazard here. It is not the go-go, late 1990s any more. It is harder to get these companies started and funded and it is very important that we not hurt these companies, indeed, that we look for ways to help them.

Furthermore, Mr. Mellinger's remarks were a great sort of laundry list of specific actions that I hope this subcommittee will embrace and we would be eager to help. And in terms of the spirit of things going on, I think you have a reputation as somebody who is likely to emerge as a young leader in Congress, I would hope to highlight for you that in terms of the new, new economy, it is a time for reconsideration, it is a time for activism, and it is also time for immigration.

In terms of reconsideration, in general, the era of hype is out. Hype is out and margins and profitability are in. Part of what that creates, candidly, is opportunity for leaders from regions like yours and mine. Companies with many more mature companies and lower cost factors.

Companies that do have bricks and not just clicks to offer because you are going to get much more mature business leaders looking to use the Internet to lower costs or increase revenues and if it does not do one of those two things, they are not interested in it. It is not the Internet for its own sake.

The era of sort of 24-year-old with little more than an ego, a business plan and a tricycle being heavily funded is going away. And that will create tons of opportunities for low-cost platforms that show open affection for these early stage entrepreneurs especially if they bolt into more mature companies.

Secondly, I mentioned activism by intent. While we want to be very careful about regulation and preserving an era of deregulation, and I had the great honor of working for a variety of members of Congress who were avid about deregulation, including of the aviation industry and the trucking industry and so on, I was honored to get to work a bit for Bob Walker in a bipartisan setting when I was staff director of the Congressional Clearinghouse on the Future and Bob Walker, a conservative Republican, was very good at highlighting the need to have real activism at the federal level on behalf of science and technology, that this is one of those areas where you have a massive, if you will, externality, an external good is created.

And with funds drying up for what we call pre-product, pre-revenue companies, having federal and local governments take a look at ways to play here with relatively small but very meaningful amounts of money could be huge. In Pennsylvania, we have the Ben Franklin Partnership that was created by Governor Thornburg. There are tons of other examples.

And, finally, on immigration, we do hope that you will help us get more aggressive on the H1B visas. It is one reason that I was hoping to speak with our great leader from Philadelphia because in particular leaders who are close to labor I believe should be brought to think more creatively about this.

We have had tens upon tens of millions immigrate from Central Europe, Eastern Europe, Ireland, Great Britain in the 19th and 20th century to be an aggressive importer of brilliant, talented, skilled labor. It could make a big difference in the early 21st century.

Chairman PENCE. Thank you, Mr. McCord.

[Mr. McCord's statement may be found in appendix.]

Chairman PENCE. I want to thank the panel for a very exceptional and informative presentation. I will recognize him in a moment, but I do want to acknowledge the presence of my colleague and a genuine young leader in the U.S. Congress, Mr. Toomey from Pennsylvania, who I will recognize in a moment to participate in questions.

We appreciate you being here.

Also a subcommittee chairman on the Small Business Committee.

A few questions, if I may. There have been several common denominator themes that I have heard from the witnesses and I want to get a sense from each of you about the role and the threat of Internet taxation. I think Ms. Hughs raised that issue in the most practical way.

But before that, Mr. Clark, you in your presentation talked about creating incentives to investment. You as not only a constituent of mine, but a successful entrepreneur, attracting investment capital. Others have talked about attracting investment capital.

As this committee moves foreword and makes an effort particularly to promote incentives for investment, I wondered if you might give more detail to the idea that you introduced of having a similar profusion in the new technologies area that we have that allows people to roll over their capital gains on the sale of a house toward the purchase of a new home. Is that what you were referring to? And briefly describe how we would do that in Internet investment.

Mr. CLARK. Very similar. And it is not—I do not think you should necessarily have to limit it just to the Internet side. And he mentioned the 1232. Section 1045 of the tax code is there that allows you if you have a qualified business interest stock, it has to be a qualified interest, which means you had to currently have purchased it at the very beginning stages, something that moms and pops and certainly those of us in Indiana are rarely eligible to participate because of other securities rules and regulations, rarely do we ever get to see them.

We need to figure out a way to allow the average American investor the opportunity to help build companies, whether they are old companies that are trying to re-tool to become part of this new economy as they watch the manufacturing jobs leave, or whether it is new companies that are coming along, where people want to invest. We need to give them ways to encourage it and when you look in a market and you realize you are going to lose 25 percent of your wealth when you count estate taxes, it is very difficult to sell, to go from one company to another.

And I believe that there are—very similar to the stock exchange on section 1031 as we transfer property there is no limitation there to the amount of money that you can have little or big. And it would be a very easy process.

As a financial planner, the most trying time I see all year long in my client's face is not just having to pay Uncle Sam on April 15th, but it is sitting down with years and years of tax returns and trying to figure out really what their tax basis is. They try to be honest. They try to do the right thing. Many of them are in my church. And it is a challenging day.

I have to believe with trading 3 billion shares of stock every single day on the United States markets that it is tedious and expensive for the IRS.

Senator John Breaux from Louisiana pointed out that 90 percent of the money that comes from federal estate tax is used to operate the system. I have never heard the percentage quoted for capital gains tax, but I have to believe it is a very expensive process for the IRS to really mandate and watch.

If we could figure out how to let people put money in, they would have to keep track of it one time, and allow them to go and invest in companies big and small that are right for that time and right for that economy and have the merits and deserving of the investment without regard to taxation, I think you would see a lot of the littler investors able to help promote companies like my own.

Chairman PENCE. Mr. Mellinger, you talked about devising incentives during your testimony. What specific incentives would you like to see this committee promote to encourage investment capital in high technology?

Mr. MELLINGER. Well, there are a couple of things I think that could be looked at. One, from a standpoint of individuals investing, is the change in ERISA regulations, specifically the prudent man rule, which enabled public pension funds to invest a portion of their money in risk capital.

And really the result of that, which I do not think was the main intention at the time that the legislation was enacted, was what we know of today as the venture capital industry. While it was a small, small industry before that, the amount of public pension funds that came into the venture industry was enormous.

As we look at it today, one of the biggest pools of money is out there is the 401(k) fund. A lot of people would love to be able to invest in private companies but do not have the ability to today, I think looking at enabling some small portion of 401(k) assets to be allocated towards riskier investments is something that would be a very interesting area and create a whole new class of capital that could come in to the market.

And I would hope that that would be looking at more than the capital gap. Because right now, one of the biggest problems we face as we help young companies is the first couple hundred thousand dollars that might be invested in a company while funds coming from the angels, friends, families, and people like that is great, but it is harder today than ever to raise these funds because of what has happened in the public market.

So, as Joe said, we should be able to give people more incentives around this capital gains issue and be able to, as we talked about, to provide the Section 1202 preferential capital gains treatment for individual investments. We very much support looking at both these ideas.

The last issue I would raise, and I do not have a specific recommendation on how to do it, but we should support the people that have organized loosely—some more officially, but into these angel networks.

I think we need to encourage people to invest. The biggest thing that we have found with the National Commission that has been troublesome is looking at a map of the United States and seeing where all the venture capital has been invested and then taking that next step which is where all the angel capital has been invested. And then very much match each other, more then two-thirds of all venture capital that has gone into five states in the United States.

Investments are not being shared equally across this country. What has happened is that successful companies that have cashed out through either selling the companies or IPOs, and have become angel investors. Lo and behold, they are right in the areas where those first companies started. And so we see more concentration happening over time, not something that is spreading out. And I think that the more we can do to encourage people across the country to invest and build companies the better.

Chairman PENCE. Mr. Engel, you talked about the mission of your company was to level the playing field for small businesses and I commend you for that. In the public policy realm, are there specific instances where in the high tech area you think we in Congress and on this committee could pursue that goal?

Mr. ENGEL. Absolutely. In fact, I will stick to the two points that I raised in my statement. The first is anything you can do to keep the tax system as simple as possible for small businesses like Ragan the better. Again, if the moratorium is lifted in October, who knows what may come out of that as local and state jurisdictions from around the country start to say, hey, I want a piece of the pie, too? And the second is an overall point of increasing just access to technology, broadband especially, the services such as BigStep but there are a ton of others out there that can help a small business actually level the playing field and really that was our mission. Big businesses have money, they have staff and they a lot of time have technical expertise. They will have a whole IT department just to get themselves up on the web.

Ragan does that all herself. So a broadband access helps her do those things and to get on the web and really establish her Internet presence in order to help her business.

So I will stick with those two and anything that this committee can do, that would be great.

Chairman PENCE. Thank you.

Ms. Hughs, you focused on Internet taxation at a very practical level. If the moratorium was lifted, do you believe that the Capital Baby Rental could survive? Would you have the capability of complying with the wide range of taxes or would you see that as a threat to your business survival?

Ms. HUGHS. Well, I think that was what was interesting about me being selected to come before you today. Since I have two different businesses that do totally different things with the Internet, a business like Capital Baby Rentals is not going to be affected by the taxation moratorium unless there are new taxes that are going

to be imposed on Internet access because we are not actually selling anything on the Internet; it is just an informational site where people can find out and then call us, fax us, e-mail us to set up a reservation. The transaction does not occur over the Internet.

But for businesses like ThePartyBug, it would just devastate it. It is very difficult for a small business owner who is wearing a million and fifty different hats to be an expert in everything. We do not have a general counsel and an IT department and we have to do all these things by ourselves, so that is a barrier right there. And if more tax regulations were imposed upon us, it would just be completely prohibitive to most small business owners doing business on the Internet to continue doing that.

In addition to the fact that I just basically do not think it is fair. I hear brick and mortar saying, oh, well, you guys get so many breaks, but it is actually not true. For instance, I am in D.C. and if somebody has to have something shipped to the District, I collect the sales tax on that and then I report that to the District of Columbia.

So I am not doing any different than the Gap down the street, so I do not feel that we should have to be double taxed or consumers should have to be penalized because they want to purchase something over the Internet when it is a huge convenience, saves time, allows access to things that people with disabilities and what not cannot access going to regular stores sometimes. So I do not think that that would be very good at all.

Chairman PENCE. Mr. Draluck, your business is very fascinating to me and represents one of those new uses of the Internet in terms of communications technology. The international settlement regimes that are in place now, do you believe that they need to be modified, set aside? I understand from your testimony that they are a barrier, but what do you see that this Congress and this committee should do to address that somewhat antiquated means of distributing resources in the telephone business?

Mr. DRALUCK. It is a prime example of a system of subsidies that really affects innovation and development in every telecom sector, both locally and internationally. On the one hand, a pitch about taking one's small business international which iBasis has done, and that is that the kind of forward thinking discussion that is taking place here today does not occur in many of the countries that iBasis serves and, as a result, we are faced with all sorts of obstacles.

The settlements in particular, many countries that have signed the WTO have simply dropped settlement charges. Many lesser developed countries that might have one monopoly carrier see settlement charges as an enormous source of revenue because when calls are terminated into the country they collect.

Now, one way that iBasis has worked to get around this actually to work with monopolist carriers. That allows regulators in the distant countries to get a taste of what technological innovation can bring to consumers in that country and understand—or let us say begin to understand how the competitive force operates.

So our strong position is that this committee and Congress overall recognize that these kinds of issues over which you are grappling are issues in their infancy overseas and the FCC has taken

a big stand to disallow carriers in this country from paying settlement charges over a certain amount and that rate is constantly coming down and it is almost a fiction that they are strangled, but being disallowed to pay those fees because there is a balance of payments, it forces other countries to reduce the collection.

So if we can get the message internationally that that kind of subsidy that is not market driven will not lead to development, then that would be quite an important message and we are grateful for that.

Chairman PENCE. I am going to come back to Mr. McCord before I close, but I do want to acknowledge and recognize for any questions he might have the gentleman from Pennsylvania, my colleague, Mr. Toomey.

Mr. TOOMEY. Thank you, Chairman. I would like to start by saluting you for having this hearing. I for one think that the development and, probably more precisely, the deployment of new technologies, to put it very broadly, has been the great driving force behind the growth in productivity and the boom in our economy over recent years. And I think it is not a coincidence that as a general matter the technology sectors, if you will, of our economy have tended to be the least regulated and the most successful and innovative at the same time. I think there is a good reason for that.

I have just really one area that I would like to discuss a little bit in particular with Mr. Clark, if I could. In your testimony, you pointed out a couple of things. One is the well known fact that the capital gains tax has a tendency to lock investments in in ways that are not necessarily rational for the investor otherwise, not as productive for the economy as they could be if investors were not locked in, and you point out that that kind of mentality that is a creation of the tax code could in fact contribute to things like excessive share prices when there is a run up and perhaps contributed to the speculative bubble that we saw recently.

But you make an interesting point also, and I think you are talking about a capital gains tax, although perhaps you would broaden that to include other multiple layers of taxation on savings like the double taxation of dividend income, for instance, but you make the point that the capital gains tax in particular hinders the capital formation for new companies and I think that is an important observation. And while for new companies and for some others there might be a strong case to be made for allowing people to roll into other investments, I prefer abolition of the capital gains tax all together.

Mr. CLARK. Amen.

Mr. TOOMEY. It is just simply an irrational tax. But could you explain a little bit more how you would foresee a greater opportunity to build capital in new companies, in start-up, in inherently more risky ventures in the absence of a capital gains tax, if you believe that would be the case?

Mr. CLARK. Sure. I think there are two things that we have to understand and one is that we have left an economy, what we call the extension of maturity phase, where there is no question that the companies that have strong loyalty, the GMs, the Fords, the Chryslers, they are not going out of business and so you can tax

at will and it is not a matter of somebody pulling their money out of GM to go to another company or not.

When you go back to the entrepreneurial phase or the shake-out, you have people literally trapped. I mean, literally. Psychologically, they are trapped when they look at seeing how much of their wealth is going to leave if they go into another company.

I think it would be very, very simple to develop a method, if you will, to say, okay, this is the amount of money that we have that we have put in, whether it be on a monthly basis or whether it be in lump sums, over a period of time, this is the amount of money that we have invested in the United States stock market in these particular type of companies.

And I do not believe even though we are here for the Internet today, I do not think it is just Internet. I think it is about companies that are really trying to use new technologies and new innovations that are really trying to drive our country to the next level, that are trying to take our economy where it has to be. And you figure out how to define what those companies are and label them as such and they can go freely from one company's investment to another without having to have any regard to a capital gains tax until they take the money out to go spend, to buy a Harley-Davidson or do something else that fuels the economy.

Mr. TOOMEY. Mr. McCord, I would be happy to hear your thoughts on this, but I wanted to just respond briefly.

My reservation about creating a category of investments is that we then bias investors in favor of those at the exclusion of others and I question—well, I do not question, I doubt strongly whether the government has the wisdom to know which ones the economy——

Mr. CLARK. I agree. I have the same problem with the government investing the Social Security money that way because we are picking out some companies versus others.

Mr. TOOMEY. Right.

Mr. CLARK. And so I agree. I am with you. Abolish the capital gains tax all together. I am telling you, the next level of my company, to get to the next step, I need $1.4 million and if you change the capital gains rules, I can have it in two days. And if you do not, I get to go back home and go through the same struggle that I did to raise the first million and a half.

Mr. TOOMEY. Thanks.

Mr. McCord? Did you have something?

Mr. MCCORD. Yes. First of all, it is a great honor finally to meet you in person. Even though you served your share of time at the Evil Empire of Harvard Business school, if I remember correctly.

Mr. TOOMEY. Undergrad.

Mr. MCCORD. Oh, okay. Well, then we have that in common. I am a Wharton partisan.

I did want to be responsive on this and also echo the 401(k) idea which I think is a brilliant one and I had not heard before. Having staff members of Congress, you know, you always do kind of mine for the gold of actual new ideas.

Just trying to be responsive a little bit here, I think a blended average of what the two of you are talking about, without pretending that I am an expert in the Byzantine ways of the tax code,

might be the most productive. Otherwise, you run into a watch out what you wish for, you may get it.

If you eliminate the inheritance tax and then you have a bunch of—you know, you are self-made, you made a lot of money, now you are a public servant. Your kids did not make a lot of money, they inherit it tax-free because you paid taxes on it. Okay. Now, they put it in the stock market. Now, they have a smart dad, he went to Harvard, et cetera, they get 11 percent a year on it. They may never in their lives pay a dollar in taxes if there is no capital gains tax cut.

Now, I just want you to ponder that for a second. Conversely, the next time we are trying to float a bond for Lehigh Valley to have fat pipes so that the less affluent can get the same level of service as Alargco, we have no tax tool whatsoever because tax-free is meaningless if we have no capital gains.

Conversely, if you have patient treatment where you say if all you are doing is moving your money from one field to another but keeping it in the equity markets, you are not out there buying SUVs or, you know, third homes or whatever. That is a big deal. And I do think in general we have problems with the capital gains tax cut.

To your point, I mean, you have probably read about Safeguard and some of those fiascos. A lot of that stuff, a lot of the margin purchasing that was done, was done specifically to avoid capital gains tax cuts because they figured their cost of capital was 7 percent instead of 40 percent.

So I understand these are challenging problems, but in a hierarchy, at the same moment that you are going after the inheritance tax, I would say something that you might want more promptly to put on your to do list to allow on a voluntary basis the small fry who are with 401(k) plans to allow them the freedom to put up to 1 percent of their 401(k), because the vast majority of people moving towards retirement are not part of these SURS, PSRS, CALPERS. We are speaking in code, but these are the largest pension fund funders because they are state-run pension funds.

If you allowed the average 401(k) for the average risk affectionate true entrepreneur to say, hey, heck, I will put 1 percent into private equity funds, you would really turbo charge a lot of the venture money out there and I think have a big net benefit in a very timely fashion because there is a fright—I mean, all respect to angel groups aside, those tend to be a long run for a short throw.

You get 20 rich guys sitting around Lehigh, they get together because they want to get together with other rich guys, they kick tires for a few weeks and then they squawk to put 10 grand into a company. A 401(k), now, that is a real turbo charger.

So just trying to parse this out and give you a flavor for what you might want to put on your to do list, I wanted to be responsive in real time to your thought.

Mr. TOOMEY. Thank you.

I will yield the balance of my time, Mr. Chairman.

Chairman PENCE. Thank you, Mr. Toomey. Thank you again for participating in the hearing as a leader in the Congress on economic issues and as a subcommittee chairman. You have greatly

enhanced the value of this hearing. I know we and the witnesses appreciate your participation.

Let me just close, if I may, by thanking each one of you. I can expect that testifying before a congressional hearing is a harrowing experience. Many of you traveled far distances to be here and may well have enjoyed a sleepless night last night thinking about your presentation.

Let me say that you were none worse for the wear today, that each of your presentations were not only eloquent and well executed, but, as I hope you could tell from my questions and Mr. Toomey's questions, quite well informative and very helpful to us as we begin this process of really using this subcommittee as a driving force for small business entrepreneurism and policies in Congress that will promote that.

Let me close by saying as someone who built my own small business starting in my basement of my home and working in the communications area that I am a bit envious of each one of you.

Now sitting in the stolid chambers of Congress, I some days pine for the rugged world of entrepreneurism and I hope each one of you know that this chair admires you as the new Edisons, the new Fords, and as genuine pioneers in an economy that our children and grand children will know nothing different than.

Each one of you are the first ones into the wilderness, really paving a way for what I think is the real key to the United States of America remaining the dominant force on the world economic scene.

So I congratulate you for your courage. I congratulate you for your testimony and I thank you for being here today.

With that, this hearing is adjourned.

[Whereupon, at 3:17 p.m., the Subcommittee was adjourned.]

MIKE PENCE, INDIANA
CHAIRMAN

ROBERT BRADY, PENNSYLVANIA
RANKING MINORITY MEMBER

Congress of the United States
House of Representatives
107th Congress
Committee on Small Business
Subcommittee on Regulatory Reform
and Oversight
2361 Rayburn House Office Building
Washington, DC 20515–6315

Statement of Mike Pence
Chairman
Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
United States House of Representatives
Washington, DC
April 3, 2001

Our hearing today is about the meteoric rise of the Internet-based economy and whether current federal government policies help or hinder the small businesses that seek to utilize the Internet as a business strategy. Today's hearing will be the first in a series of hearings that this Subcommittee will hold to examine the impact of federal regulatory policies on the ability of small businesses to deploy new technologies, develop new markets, and generate economic growth.

The expansion of commerce on the Internet is simply staggering with numbers that are difficult to comprehend. Internet traffic in 1996, a mere five years ago, but in Internet time almost a generation ago, was doubling every 100 days. Even analysts could not comprehend the growth in usage of the Internet. For example, in 1998, one report estimated that retail transactions on the Internet would reach $7 billion by 2000. Most analysts now believe that the estimate was reached in 1998. Just this past Christmas, retail sales of goods on the Internet reached $8.7 billion and the Bureau of the Census estimates that Internet business-to-consumer retail transactions hit the $20 billion mark in 2000. The use of the Internet by consumers to purchase goods pales in

comparison to estimates of business-to-business transactions on the Internet. Some analysts predict that value of global transactions on the Internet will exceed $6 trillion.

The growth in commerce and use of the Internet demonstrates that it is the new central business district, the new "Main Street", and the new shopping mall. And just as small businesses play a vital role in the central business districts, on our Main Streets, and in our shopping malls, they also play a key role in the development of commerce on the Internet. Rather than hire a real estate agent and construction contractor to build a new store, Capital Baby Rentals, decided to expand on the new American "Main Street" and sought the help of another business, BigStep.Com.

However, the Internet is not just the new American business district. Digital convergence enables the Internet to be the next newspaper, telephone network, and cable system. In my district, LocalWeb4U provides information that individuals currently receive from their local newspapers, broadcast stations, and telephone directories. However, because of the ubiquity of the Internet, LocalWeb4U can provide that information, not just for Anderson, IN, but for communities throughout the United States. We also have iBasis, a company that provides voice over Internet Protocol telephony. In other words, it uses the Internet to provide telephone service and, unlike the local telephone company, its customers are not limited by geographic location.

No one can doubt that an Internet-based economy provides significant opportunities for new small businesses, as well as new ways to expand existing small businesses. In fact, three of the businesses testifying here simply would not exist, and did not exist prior to 1995, without the ubiquitous availability of the Internet and the desire of Americans to "log-on."

Before Congress takes further action to promote expansion of commerce on the Internet or hinder its unbridled growth, it behooves us to understand this new stream of commerce, the

problems they face, and whether they currently perceive government policies to help or hinder their operation and growth.

The panelists here today will explain how business is done on the Internet, how they, as small businesses, discovered unserved or underserved niches to expand their businesses, and how this new technology will continue to open new opportunities for the pioneering small businesses. Finally, the panelists will highlight any issues of concern about existing federal policies or changes in federal policies that may help or hinder their businesses. Congress will then have the information it needs to rationally make decisions and ensure federal legislative and regulatory policies are partners in helping small businesses take advantage of this new stream of commerce; not act as a dam to its potential.

I will now recognize the ranking member, the distinguished gentleman form Pennsylvania, for whatever statement he may wish to make.

Statement by Rep. Robert A. Brady, Ranking Democratic Member
Subcommittee on Regulatory Reform and Oversight
Hearing on Internet Entrepreneurship
April 3, 2001

Thank you Chairman Pence. I think today's hearing will be very interesting and helpful for understanding the hurdles that small businesses are facing when it comes to the internet.

At this time I would like to introduce a witness that I have invited from Philadelphia, Mr. Rob McCord. Mr. McCord is the president and CEO of the of Eastern Technology Council. The Council provides information, support, contacts and capital to many Pennsylvania-based Internet and information technology businesses. It has a membership base of over 1200 member companies. Mr. McCord is a venture capitalist directly involved with the start up and development of more than 50 information technology based companies.

He is accompanied today by Ms. Donna Gentile O'Donnell. She is the Managing Director Ms. O'Donnell directs the Council's efforts in the business areas of life sciences and pharmaceuticals. and I greatly appreciate their participation today. Both Ms. O'Donnell and Mr. McCord are on the front lines of growth related issues affecting small businesses.

Mr. Chairman studies show the Internet is growing at a rate of about 40 percent to 50 percent annually. In 1983, there were 562 computers connected to the internet. Today, there are more than 72 million. It took 38 years for the telephone to penetrate 30 percent of U.S. households; television took 17 years; and personal computers took 13 years. But it took less than 7 years for the Internet to reach 30 percent of U.S. households.

As the growth of the Internet economy continues its rapid rise, we must address the growing concerns of entrepreneurs and small businesses attempting to participate in the revolutionary development of the Internet business highway. Laws and regulations should be balanced. We must make sure that businesses have the tools to succeed, but me must also make sure that consumers' rights are protected.

Mr. Chairman, I hope this hearing will give us a better understanding of some concerns that small businesses face involving the internet. I look forward to listening to the testimony of this panel.

Joseph A. Clark, CFP, RFC
CEO LocalWeb4U, Inc
April 3, 2001

Good afternoon. Thank you for allowing me to participate in this hearing. I pray that your ears be opened to new ideas and that your wisdom then be expressed in legislation to help Americans both rich and poor to take advantage of this new economy.

This past year I have been afforded many first hand observations that have proved valuable to my clients and to my investors. I feel very blessed to be a part of this Country in this very exciting time.

Let me first explain the situation of LocalWeb4u. Our company was founded on the belief that people need to be able to ***be heard*** and to ***be found***. We chose to use the Internet as the medium to allow for that transfer of information.

Let us first understand the speed at which the Internet has grown. It took 46 years for electricity to make it into 30% of American homes, 38 years for the telephones, 17 years for TV's, but the Internet did it in seven years. There are over 2 billion pages of information on the Internet with over 3.2 million pages added every day. The technology has grown so fast that it never really had time to experience a childhood. As individuals, we never had time to ask how this powerful technology could help our businesses or schools or churches. In short, the Internet grew so fast that it is hard to find the business next door or the church down the street. We need to be able to ***be found*** on the Internet.

Demographically we spend 80% of our time and 70% of our money within 20 miles of home but the Internet has tried to take everything global. The original concept of gathering information from anywhere in the world was amazing. But the idea that you need to look through useless matches from some other place, perhaps even some other country, to find the business you are looking for down the street is less than humorous.

The cost of doing business today coupled with the focus on strong and immediate returns has created many shortcomings across our country. The media world is no different. Economies of scale dictate that revenue is spent and money invested where the largest rate of return is possible. Today, one third of our country lives in larger metropolitan areas. These folks do indeed have local television stations, local newspapers, and local radio stations. Capital investment is provided because potential return exists due to the mass of population and these areas to some extent can have their interest voiced.

The remaining two thirds of America live in tier two cities where they may have a newspaper that appears local but many of the stories say Associated Press behind them. They are merely a regurgitation of national information. The radio stations are now being broadcast by satellite from some other area to again reduce cost. Obviously television tries to reach some of this audience with the occasional news story but their primary interests lie in the area most likely to gain attention – the larger city where they are located. Essentially, if there is not maximum potential return on investment, no capitol will be provided, and there will be no media outlet or voice. Communities of all sizes need to be able to ***be heard.***

Localweb4u was established to use the infrastructure already in place via the Internet to give individuals, businesses, and non-profit organizations the ability to state their opinions, give dates for events, and even brag about their children accomplishments within their local community. The Internet has a virtually unlimited amount of space so the messages can get out in every community regardless of size without the cost of raw goods and capital expenditure.

The two principle entrepreneurs originally funded Localweb4u from inception in November of 1999 through September of 2000. Since October of 2000, over 25 different Angel investors have invested over $1.5 million to help drive our company to communities across the country. We feel very blessed to have had their support and faith in a time where very few companies where able to get a dime to build a new company.

The stock market has taken its toll on Americans in all directions. As a Certified Financial Planner, I have heard many clients talk about their new 201k versus the old 401k. They feel that they have been cut in half. As a result, Localweb4u is running out of the money required to maintain our momentum. In the over all scheme of things $1.4 million isn't a lot of money but it is the difference between what our company needs to operate until it can cash flow on its own versus fading away as a great concept that just didn't make it.

The last three weeks has brought about the lay off of over 70 hard working individuals in a city still trying to recover from the downsizing of the auto motive industry. Localweb4u is important to non-profits and businesses across this country. It is important to the investors who were willing to step up and says yes to invest in a company in the mid west. It is important to a community that must move in the direction of the new economy.

We have listened to the market as any business should and we have refocused our attention on helping companies and associations communicate with their members. We have done what was required to be successful and to be profitable. We are proud to tell you that with many trials and tribulations LocalWeb4U remains intact and strong.

I want to spend my time today sharing with you as a professional manager of other peoples money, as a CEO of a technology based company, and as an American willing to invest in the future of our country.

I have been asked what barriers to entry exist in the new economy that are created by the government or at least what opportunities are not supported by the government.

My professional opinion is that we do a great job offering people the opportunity to start businesses and to take a hold of the American Dream. I feel that we do little to keep those businesses running long term and little to help them to profitability. I realize there is a great question as to whether or not it is the job of the government to facilitate business growth. I would however, contend that it is definitely the job of the government to not hinder economic growth.

Part of being an entrepreneur is being willing to accept calculated risk and we understand that. Part of being a legislator is understanding the challenges required to keep people employed and making money so they can pay their bills and their taxes. I feel very strongly that we need to examine our laws and belief system to understand this new economy and then we must take action - yesterday! New times mean new answers and new solutions. We must revamp our traditional thoughts about a lot of things.

There is much talk about new economy versus old economy. Most of the discussion boils around the question is it an old manufacturing company that has been around for years or is it a new company with technology and a young work force.

In my opinion, the new economy is about understanding the whole world is changing with all the new inventions and applications for technology. There is NO Company that has a strong hold on the market neither as an old company nor as a new company - Not Oldsmobile, not Sunbeam, not even Yahoo! Every company has to be able to grasp the new technologies and the new desires of individuals today. The new economy means delivering value to the needs of people in today's market. It is all about adaptation not about long standing company loyalty.

As an example, in 1920 there were 200 companies that produced cars, 23 alone form my home city of Anderson, Indiana. In 1930 there were three and Studebaker that was barely holding on. During this phase of the economy – the same that we are in today – there was a mighty shake out and race for leadership. Once that leadership is established, those surviving companies will have a profit base which can be taxed and depended upon to put money in the coffers to pay for military, social programs, and the like.

There is no loyalty in this economy for particular companies. There is a very high demand for better, faster, and more value – not just a cheaper – solutions and products.

This change in corporate profitability and survivability forces us to address the taxation of our business economy. Under our current tax structure, we not only reduce opportunity for investment but we jump the gun on the taxing structure. Our current system forces investors to make a choice in a company and doesn't allow them to diversify their holdings without losing one fifth of their gain. I realize that 20% doesn't sound like much to some of you but let's be aware that a 25% drop in the market is titled as a crash! The only way for a person to take money from one company and go to another is to go through their own little economic crash!

It is imperative at this time that we create a method for investors to not pay capital gains taxes on growth as long as the money stays in the development of companies. In other words, they should be able to invest in my company and when they feel appropriate, be able to sell the investment and take the gain to invest in other companies if they so desire. They cannot fear a personal economic crash in their holdings or they won't take the money out to reinvest.

It takes a different type of investor to invest in new companies versus companies that have been around for many years. We have to give these early stage investors support in their investments not hindrances.

Please understand that people are scared of taxes regardless of which political party they favor. This is illustrated by the fact that 70% of qualified money stays in accounts until US Tax Code mandates the individuals start withdrawing money at age 70 ½. I have seen people go without things they want and sometime things they need because they cannot bear to lose those high percentages of their net worth to the taxman. People will always respond to fear before opportunity. The fear of losing 20% is enough to keep investment down.

The same holds true of investors. They cannot bear to rebalances their investments especially if the stock had massive short-term growth and the taxation was centered on ordinary income rates. I dare to wonder how many people would have left their money in some of the high flying internet stocks that grew several hundred percent and added to Alan Greenspans bubble if they didn't feel trapped by the psychology of the tax code.

If people take money out of the market to spend on themselves, if we must tax them on gains at all, then tax them then. Do not penalize people for being diligent enough to rebalance their portfolios. Do not stop them from investing in the best concepts and the newest technology.

We must do everything we can in this economic time to inspire investment. We must give our citizens the opportunity and the ability to find good concepts with good revenue potential and allow them to invest. Please examine the capital gains tax code and rethink this issue. Think about it for a second. It would be much easier for Americans to keep track of their basis and much easier for the IRS to track basis if taxation only existed on money that came out – perhaps under the LIFO method. The countless hours spent every year by honest Americans trying to determine long-term basis is enormous. I must imagine the task quite tedious for the IRS considering we trade almost 3 billion shares of stock everyday. If the bureaucracy was reduced, the taxes may very well be the same net number but investment of companies would be spurred. Economic growth would be enhanced.

A suggestion might be in allowing investors a full deduction on any loss taken on a company less than five years old whether it is publicly traded or not. There is a great deal of what is commonly referred to as old money that would come to the table if this were to be possible.

Another issue is simple understanding in terms of government support. It is not right to drag the private sector into this issue but public money should be available for all types of companies. Currently, the process of getting an SBA loan is a tedious and painful process. If you are a typical part of the technology sector, your time and energy will be flat out wasted.

Unlike a business that has to buy equipment that could be resold, or even the purchase of another asset that could be collateralized, the technology sector is based primarily on human capital. The computers are pennies on the dollar compared to our nations best asset – that of our highly trained and highly motivated workforce. There is no help in funding from the SBA regarding companies that present no collateral protection. For us, the time invested was minimal but wasted nonetheless.

I don't feel that it is the governments place to make sure my business works and survives. But think of it this way. I do feel that it is in my best interest to protect my customers. The people that buy my product and provide my living. Entrepreneurs are one of the IRS' best customers because even if they get it wrong once or twice, they end up hitting home runs that truly enhance government revenues. Do your best as legislators to encourage investment, to encourage new innovations, and to encourage willing compliance to the tax code.

Thank you for this wonderful opportunity. May you be filled with wisdom and with God's inspiration to lead our Country into the best economic time in history.

Joseph A. Clark, CFP, RFC
CEO LocalWeb4U, Inc
Chairman of The Financial Enhancement Group

NATIONAL COMMISSION ON ENTREPRENEURSHIP

Statement of

Doug Mellinger
Chairman
National Commission on Entrepreneurship

Before the

Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
U.S. House of Representatives

April 3, 2001

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Mr. Chairman and Members of the Subcommittee, thank you for inviting me to testify today. I am here as Chairman of the National Commission on Entrepreneurship (www.ncoe.org), an organization created to help government policy makers at the federal, state, and local level better understand the needs and interests of entrepreneurs and to develop a set of public policies that support a strong entrepreneurial economy. We were established by the Kauffman Center for Entrepreneurial Leadership, part of the Kansas City-based Ewing Marion Kauffman Foundation (www.entreworld.org).

Over the past few years, we have brought together some of America's top entrepreneurs as Commissioners and have gone out across the country to talk to thousands of entrepreneurs and policy makers. We have learned from our research and interviews the opportunities and issues that face entrepreneurs related to infrastructure needs and policy implications. My testimony reflects some of the highlights from the Commissions work as it pertains to Internet Entrepreneurship.

Today's Entrepreneurial Landscape

While the media likes to write "Dotcom, dotgone," Internet technologies will continute to revolutionize how we communicate and transact business. Twenty years from now, we will look back and realize that we are just now beginning to see the radical change that this technology will have on everyone's lives both personally and professionally.

There are many historical precedents for this revolution. The National Commission on Entrepreneurship will soon be releasing a report that looks at the origins of America's largest corporations. Many people forget that Eastman Kodak, IBM, JP Morgan, Boeing and most other large companies were entrepreneurial startups at one point. If you look at the Fortune 200 in 1997, only 3 of these firms were not traceable to entrepreneurs.

Our research has found that most of America's greatest companies were started during revolutionary business times such as the start of the agrarian age in the early 1800's, the rapid industrialization of the late 1800's and early 1900's, and the information age which began in the 1960's. During these periods, innovation peaks, fundamental business models are transformed, and whole new industries emerge. Our survey of the 1997 Fortune 200 shows this succinctly. Approximately 50% of the companies were founded during the agrarian age or the beginning of the industrial revolution when transportation and manufacturing took off. Roughly 35%

of the companies were founded during the information age and only 15% were founded during the intervening decades between the 1920's and the 1960's.

Internet entrepreneurship is all about how major industries such as telecommunications, wireless, and information technology, will transform business models and produce tomorrow's Fortune 200. Internet entrepreneurship is tapping another interesting trend that we have uncovered in our historical studies: CEOs of major corporations are becoming younger. In 1917, entrepreneurs who began at an average age of 40. In 1997, the average age for these entrepreneurs had dropped to 26.5 years. With the Internet, we are seeing the entrepreneurial activity beginning in college and even earlier. This is an incredible phenomenon that will give these very young entrepreneurs more years to start and run these and many other companies.

Entrepreneurship is critical to our nation's economic health. New, fast growing companies – about 350,000 out of the nation's six million businesses with employees – created about 2/3 of new jobs. Small entrepreneurs lead the way in developing ideas; they are responsible for more than half of all innovations – 67 percent of inventions and 95 percent of radical innovations since World War II. According to the Global Entrepreneurship Monitor, which compared entrepreneurship in 21 countries, the differential in national economic growth rates is due to the impact of entrepreneurial activity. *Global Entrepreneurship Monitor: 2000 Executive Report, Kansas City, MO. Kauffman Center for Entrepreneurial Leadership, January, 2001.*

I have been involved with the subject of entrepreneurship for a very long time – an entrepreneur since my teens as well as head of a couple of global organizations for collegiate and young entrepreneurs. I have had the privilege of lecturing around the world on the subject and most recently chairing the National Commission on Entrepreneurship. I could not be happier that you have decided to focus on this issue today. I can not think of a more important topic for discussion within our government than the continuation of the great economic boom that we have been enjoying for the past decade.

Let me give you a little of my background. I started my first entrepreneurial activities in my early teens before I knew there was such a word as an entrepreneur. My first real company was started in college at Syracuse University, which was where I learned the meaning of the word "entrepreneur," and realized how critical people such as myself were to the economy and to the communities in which we operated. We create jobs, produce innovation and provide the money to fuel the economy and ultimately enable government and non-profits to have money to pay for various social, health and environmental issues.

When I was 25, I started my first technology firm. I started with $12,000 in 1989 and built its sales to $85 million in 1998 with about 800 employees. When I started PRT Group Inc., the venture capital industry was tiny when compared to today, banks did not want to provide funding, and the SBA was of little use due to its focus on small business rather than entrepreneurship. I was creating a software service business, which had intellectual capital as its main asset—as opposed to a manufacturing or retail business with hard assets. We struggled with financing the growth of the business for many years and were fortunate six years later to attract venture capital to fuel our growth. Today, I am a partner in Interactive Capital Partners which helps early stage technology and internet enabled companies get founded, funded, and go through the issues of hiring management teams and accelerate their sales. My partners and I have been involved with more than 40 companies in our careers and have raised more than $400 million in investment capital to fuel these companies. I have lived all the issues that you are looking at today including investment, regulatory, infrastructure, labor and globalization as examples and look forward to sharing my personal experiences as well as my Commission experiences.

KEY FACTORS IN INTERNET ENTREPRENEURSHIP

I will now outline some of the areas where I think you might focus your attention as you look for ways that the government can play a positive role in creating an environment for entrepreneurs and internet-enabled companies to flourish. Some entrepreneurs think that the government should just get out of our way, but I think that is very naïve and reactionary since they often feel that they are all alone with the world on their shoulders. The government plays a crucial role in my opinion and can be a positive player or can really be a hindrance depending on the actions it takes. I hope that you and your fellow policy makers take the time to understand the differences between Internet entrepreneurship and traditional small business and, before enacting legislation, take a moment to understand the impact on entrepreneurs and their companies.

The following are the areas that are of significant importance for the success of technology and Internet enabled companies.

Human Capital. First, and foremost for Internet companies, is the "human capital" issue. Human capital is a new and fashionable phrase but imbedded within it are myriad problems that entrepreneurs trying to break into the Internet space confront each day. From my experiences and talking to my colleagues, I know that finding the right employees is a most difficult task. For many Internet entrepreneurs, finding talented engineers is an overriding concern. The issue of finding the right employees doesn't stop with the much publicized technology skill sets. Entrepreneurs are face challenges today in finding competent management and entry-level employees. While these problems are less intense today due to the

slowdown in the economy, they will return and will intensify over time, not subside. Policymakers face some mighty and wide-ranging problems in addressing these concerns. Here are just a few that I see.

Statistics show that at this time of unprecedented opportunity for scientists and engineers, enrollment in university science and engineering schools is dropping. From 1985 to 1995, the number of students obtaining a science degree dropped more than 5 percent and those receiving an engineering degree fell more than four percent. Demand for these talented individuals is growing both at home and abroad, and overseas companies and universities are doing a better job of training new scientists and engineers. In the decade ending in the late 90's, the United States saw the number of computer science degree candidates drop by 50% while India saw its numbers climb to twice the number of United States graduates.

K-12 education continues to be a major problem. Entrepreneurs rely on a growing workforce to meet the needs of their growing businesses. They need employees who are ready to work and have basic English, math and analytical skills. Also, entrepreneurs believe that training in basic economics – the fundamentals of a capitalist society – belongs in the educational system before college.

While more colleges and universities than ever have started degree programs in entrepreneurship, from a handful in the 1980s to more than 125 today, our schools are still falling short in teaching students about entrepreneurship as a career option. Some organizations, like the Kauffman Foundation and the National Foundation for Teaching Entrepreneurship (NFTE), are very active—and successful—in furthering entrepreneurship education before students make a career choice, our schools need to develop a systematic approach rather than relying on piecemeal interventions of private organizations.

We also need to rework our immigration policy. While everyone agrees that we need to nurture more homegrown engineers, increasing graduates in science, engineering and math, this will not happen overnight. The H1B visa program has helped many technology businesses staff up, but it is by far an imperfect solution. The H1B quota is low and, for the past several years, only Congressional efforts to raise the limits have provided entrepreneurs with relief. For entrepreneurs just starting out and in need of hiring some very skilled technical workers, negotiating the H1B visa process can be daunting. When I had my software company, we dealt with this problem on a daily basis. We ended up hiring employees from 19 countries. Due to the H1B problem, we were also forced to build development centers in Barbados and India. It was a very expensive and complex process to bring in the labor we needed and we were forced to move some of our business offshore to handle the growth needs of our company to serve our clients.

I wish there were ample prospects for us to choose from in the United States, but we are not graduating enough students who are capable and interested in technology as a career as compared to India, China, Russia, Ireland, Israel, Philippines, Brazil and others who see technology careers as their salvation. My personal belief is that having these bright individuals in this country is a very positive thing and will lead to many of them starting businesses. We have seen phenomenon with the Indian and Chinese nationals who have built many of the most well known technology firms in this country after coming here for university and economic opportunities. We are the entrepreneurial capital of the world and should encourage others to come here to start their businesses rather than force them to go home.

Investment Capital. Entrepreneurs are always in need of capital – and often they need "smart" capital – especially as they enter their high growth stages. There is a "gap" in the business financing system. When companies are started, most of the money comes from personal saving, friends, family and individual angel investors. Many of these early stage investments range from a few hundred thousand dollars to a few million dollars.

While there is an unprecedented amount of money being managed and invested by venture capitalists, they have become almost too successful and are today managing enormous funds. This success has caused the better funds to focus on larger-scale investments. The average venture investment in 1999 was $13 million. There are very few quality venture firms that are investing in early stage companies, which has caused the angel investors to have to invest far more than just a few years ago. And, as venture capital firms spend most of their time taking care of their existing portfolio, they are less willing to provide new investments in early stage firms.

The other problem with venture capital is that it is so geographically concentrated. Last year, there was $104 billion invested, but roughly 2/3 of this investment was concentrated in five states. Angel investing is also similarly concentrated due to the fact that many of the angel investors have come out of the companies that were originally financed by venture capital firms. We must find ways to broaden the investment pool or else we will continue to see that most of the country does not feel the economic benefits of our strong entrepreneurial economy.

Entrepreneurs now have to look to other sources of financing and they are relying more and more on angels, who are few in number and hard to find in all but a very few communities. Angels are wealthy investors, often cashed out executives of successful companies who both want to reap the benefits of investing and, equally important, want to stay involved in their field of expertise. Angels, either individually or as part of investment clubs, typically make smaller, seed capital investments in young companies. They then work with those companies to develop

better products and management teams that will permit them to survive. The relationships between Internet companies and angel investors are complicated; angels provide advice or customer lists or serve on the boards of directors – they have a stake beyond that of percentage owner. Angels introduce entrepreneurs to venture capitalists and, it is often their recommendation and support that makes the deals viable. Venture capital, if available at all, is much further down the road now than it was a year or two ago. Therefore, we must find ways to encourage more investment by angel investors as well as the creation of early stage investment firms.

A recent forum for start up Internet businesses in Washington, DC, titled "I'm OK, You're OK...But We're Not Investing" drives home this point. Venture capital firms now are concerned with nurturing the large investments they made in the last few years and are only looking for the groundbreaking technologies that offer "disruptive change" to markets. While they are still open to a great new idea, they are investing later in the game. Angels are playing a bigger role than ever.

Policymakers should look at ways to expand angel investor pools or, at a minimum, make sure they do not hinder angel investing in growth businesses.

OTHER ISSUES

Mr. Chairman, I have only briefly addressed two areas of special concern to entrepreneurs trying to start and grow their businesses but it is important to recognize that public policy in many areas has a profound effect on entrepreneurs and they abilities to succeed. Some of the other areas of concern that we hear about most from the entrepreneurs, especially technology and internet-enabled businesses are:

- Communications infrastructure – There is not enough broadband access in this country or the costs/time for installation is prohibitive for early stage companies.
- Transportation – Traffic, access, cost for land and air travel are becoming a problem for many employers both from an operating basis as well as the ability to attract quality employees.
- Regulations – Whether it is the business formation process, H1B filings, compliance filings, capital raising (i.e. blue sky laws) or general corporate legal issues, the costs for legal preparation and management of the aftermath is prohibitively expensive due to our litigious society and the complexity built into the system today.
- Intellectual property – Entrepreneurs need to be able to protect their innovations within this country and abroad. Too much has been invested and is at stake for these entrepreneurs, their companies and investors as well as this country. We must make it easier to protect

innovation and defend against unlawful use especially from foreign competitors who do not have similar laws as the US.

- Taxation – The general taxation system should be as simple as possible, but the bigger question facing Internet enabled companies today is how to manage sales tax if the moratorium is lifted. If and when this does change, policy makers need to look closely at the impact to early stage companies regarding implementation of systems to track and pay those taxes. It will not be trivial and will probably force many companies out of business initially due to their inability to collect taxes.
- Professional services – For technology and Internet enabled businesses to succeed, we need qualified professional services firms such as legal, accounting, bankers and others to succeed. Many areas do not have enough people with knowledge of the ways in which the new economy is working or are experienced in capital raising or intellectual property protection to service these new businesses correctly.

RECOMMENDATIONS

In addition to these general points, I would urge the Subcommittee to consider the following specific recommendations:

• Devise incentives that will encourage more students—especially women and minorities – to major in science and engineering.

• Explore changing our immigration system to take into account the education and training of immigrants rather than focusing exclusively on family relationships to close the skills gap. Or, look at permitting those holding student visas to apply for citizenship once they receive their degrees from accredited institutions of higher learning. While these issues may seem to be less pressing during this period of slower growth, they may very well take center stage in the near future.

• Explore various options for addressing the capital gap. Some potential ideas include: 1) enhancing the effectiveness of Section 1202 of the Internal Revenue Code, providing preferential capital gains treatment for individual investments in emerging and start-up companies, 2) relaxing the restrictions of the Investment Company Act, to allow the formation of more professionally managed funds targeted to the capital gap, and 3) allowing a small portion of 401(k) funds (5% or less) to be invested in funds targeted to the capital gap.

I appreciate your holding this hearing. I think that it will shed light on what policymakers can do to assist Internet entrepreneurs in meeting the challenges of starting and maintaining fast growing businesses. I am happy to answer any questions you may have.

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Testimony for the Subcommittee on Regulatory Reform and Oversight of the Committee on Small Business of the United States House of Representatives

Josh Engel, General Counsel Bigstep.com
April 3, 2001

Good afternoon. I'd like to thank Chairman Pence, Ranking Member Brady and the esteemed members of the Subcommittee for inviting Bigstep to testify today on behalf of our customers; small businesses across the Country.

We at Bigstep recognize, as I'm sure do all members of this committee, that small businesses are a critical piece of the business ecosystem. They are at the nucleus of virtually all corporate geneses (no Fortune 500 started as a Fortune 500). They fill local and specialized niches around the globe and often fill critical gaps in rural communities through their focus on services.

In fact, this coveted role in our national fabric is recognized by reputation. 85% of all Americans recognize small businesses as a positive influence on American Life (NFIB). We share that belief.

In July of 1998, Bigstep was founded with a simple promise: to help level the playing field for Small Businesses using the Internet. We wanted to give them the power and tools to compete with "the big boys" online. Websites, email, marketing tools, and e-commerce.

Today, nearly three years later, we're succeeding. With over 300,000 members, Bigstep is helping small businesses do online what they do best offline: build businesses based on unique products or services, building meaningful, personal relationships with customers and providing enhanced value.

While we are proud to serve small businesses, we cannot support them alone in their success. As the power of the Internet, broadband access, and universally acceptable e-commerce becomes a reality, these businesses that fuel our economy will need greater advocates.

There are two particular areas of concern where we believe small businesses can benefit from the support of the Federal government.

Taxes

By their very nature, small businesses are challenged with juggling several duties, making time a precious commodity. The complexity of small business taxation, particularly home-based businesses, is challenging enough. What we hear over and over again from our 300,000 members is that online commerce tax management is a huge challenge.

Just handling sales taxes today over the Internet is extraordinarily complex. If the tax moratorium were lifted and electronic commerce were conceptually open to new taxation at all levels of government, small businesses will spend an enormous amount of time trying to figure out how much tax they have to pay to whom – this is time that would be better spent running their small businesses.

Access to Technology

Most analysts agree that an Internet presence and tools to communicate with customers via the Internet are critical to business success. Indeed, every member of Congress has both email and a website. And of course today, nearly 100% of the Fortune 1000 companies have websites, and broadband access. Yet as recently as last month, the research firm IDC found that over 20 million small businesses (5m small businesses and 15m home-based businesses) don't have web sites.

This disparity in access and deployment often has as much to do with the lack of time and resources as it does access to the offering. However, access that is affected by regulatory controls does have a real impact on small business capabilities.

In particular, broadband access is a crucial hurdle for small business success online. As I mentioned earlier, time is the most precious resource to a small business. Using applications like Bigstep, transaction tools, and e-business management services become increasingly valuable when used over broadband connections. With high-speed lines, small businesses can truly compete with the large corporations who have had this access for years.

Without this broadband access, which is woefully behind in most rural and small business areas across the country, small businesses will never be able to compete with large businesses. Again, we will find "the little guy" being left behind, with no advocate strong enough to stand up to big business with this group of employers that give over 50% of Americans their jobs.

Conclusion

Small businesses need a friend. They don't have organizations like the RIAA as a support system. As we move towards an economic slowdown, we need to show small businesses that we understand their integral role in today's economy. We need to help them flourish in a free market economy, not be stifled by the perplexity involved with more taxation or lack of access to technology that's become expected for conducting business today.

We are at a crossroads. In one direction small businesses will be asked to struggle through a quagmire of taxation, navigate through a thicket of regulation, and jump over hurdles to access the latest technology. In the other direction we can commit our support for a group that defies categorization and thus often defies organized representation. The small businesses of America need a friend, and need that level of representation from this body to help them grow, prosper and do what they do best: serve the unique needs of our people, drive the creative engine of innovation, and generate more jobs than any other sector*.

Today, we have the ability to support the needs of small businesses as they once again play catch up to the big boys, and struggle to get access to this technology, protect themselves from nexus taxation, and learn from us and one another how to best use this newfound technological power.

In closing, I believe a statistic tells well the disparity small businesses face without proper access to the world of the Internet. The average annual income of a small business utilizing the Internet is $3.0 million per year compared with an average of $1.9 million for small businesses in general (IDC, April 2000). We at Bigstep hope you will continue to assist small businesses to compete with equal footing by utilizing technology that has become essential to doing business in today's Marketplace.

*A report by the Small Business Administration (December 2000) states that an estimated 5.5 million small businesses in America employ more than half the country's private workforce, create three of every four new jobs and generate a majority of American innovations. SBA also claims that small businesses represent over 99 percent of all employees.

Testimony for the Subcommittee on Regulatory Reform and Oversight of the Committee on Small Business of the United States House of Representatives

Ragan Hughs, Entrepreneur
April 3, 2001

Good afternoon Chairman Pence, Ranking Member Brady and members of the Subcommittee. I am grateful for the opportunity to talk to you today about my businesses and how the decisions you and your fellow legislators may make in the future will directly impact me.

Josh told you about two areas of concern to the small business market. As a small-business owner doing business both on and off the Internet, the issues of equal access to the Internet and to new Internet technologies, as well as, the moratorium on Internet taxation are very important to me.

Equal Access to Technology

I am co-owner of Capital Baby Rentals, a baby equipment rental company meeting the needs of business and leisure travelers to the Washington, DC area. My experience with Capital Baby Rentals demonstrates the importance of equal access to the Internet and new Internet technologies.

The company is a brick and mortar business making physical deliveries and pickups of our equipment at the consumer's location. However, the Internet is extremely important to the success of our business; approximately 80 percent of our customers come to us by

way of my Website. Since most people making a trip use the Internet in some form or fashion for research and planning, our Internet presence is critical for us to reach international and domestic consumers travelling to the DC area with small children before they arrive.

To use traditional methods of advertising to reach these potential customers would be outrageously expensive. Using the Internet, however, we have been able to expand our reach considerably and for very little costs. Having an informational website where potential customers can learn about Capital Baby Rentals, who we are and what we do, has become a major part of our marketing plan. Without our web site, we would be limited to serving the needs of local residents and last minute travelers and true success would not be possible.

Internet Taxation

I also operate ThePartyBug.com, a party supplies company that is solely an Internet-based business. ThePartyBug.com markets, promotes, and sells all its products online. The most important issue to us, without question, is the issue of state imposition and collection of sales and use taxes on e-commerce transactions. Currently, when an online sale takes place, we collect sales tax when the items are being shipped to the state in which we have a physical location. Therefore we are taxed exactly the same as if we were a brick and mortar store. If small business owners operating on the Internet also had to collect and report taxes for several other states and localities, it would make it

almost impossible for them to do business. Should the moratorium be lifted, the level of confusion that will ensue will be outrageous. By nature, Internet transactions actually take place in several different locations. For example a web businesses physical location may be in DC, but the site is hosted in California, the traffic from the site is routed through several different servers in several different states. The customer is located in Nebraska. Which state has the right to impose its taxes? Are several or even worse, all of the states going to be permitted to impose sales taxes on the one transaction? If this is the case, then e-commerce will soon become a thing of the past, as merchants, who either can't or won't keep up with the states different regulations close their Internet businesses. Further, consumers who don't want to pay excessive taxes would most likely choose to only shop at traditional brick and mortar stores. I feel that the current e-commerce taxation system is sufficient.

The Internet has opened up several doors for up and coming entrepreneurs like myself. As we move into the next phase of this "Internet Age," I'd like to hold onto the hope that the World Wide Web will continue to make business easier—not more complicated.

Thank you.

Bigstep.com

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BIGSTEP.COM FACT SHEET

THE COMPANY AT A GLANCE

- Bigstep is an online service center for small businesses
- Headquartered in San Francisco, CA
- **More than 300,000 members** as of January 1, 2001
- Founded in July 1998
- 110 employees
- Privately held and funded by Worldview Technology Partners, InterWest Partners, Cardservice International, Compaq Computers, Office Depot, U.S. Venture Partners, Mayfield Fund, The Washington Post Company, Angel Investors, LP, Partech International, Draper Richards, Argus Capital, Staenberg Private Capital and private investors.

BIGSTEP.COM BUSINESS MODEL

Bigstep.com's business model aligns with the company's goal of helping small businesses and be successful online. The company generates revenue through the retention and expansion of its highly loyal member base and the members' adoption of fee-based and value-added services. Premium services account for 80% of Bigsteps's revenues. The remaining 20 percent of revenue comes from sponsorships on the Bigstep.com corporate site – all sponsorships come from companies offering products and services relevant to the people who operate small businesses. Bigstep.com does not place advertisements on its customers' Web sites.

BIGSTEP.COM PARTNERS

Bigstep.com selects partners that produce the highest quality, top-tier products that add value to our business, our members and their businesses.

Business Partners

- AllBusiness.com, AOL, Driveway, eWork Exchange, Guru.com, iNiku.com, Keen.com, McAfee.com, MegaPath Networks, mondus.com, Respond.com, Sales.com, salesforce.com and SCORE

Technology partners

- AboveNet, ATG, CSI, ClearCommerce Hosting Engine, Macromedia, Mapquest.com, MyPoints, Network Solutions, Oracle, Sun, Portal, Acclaim Technologies

BIGSTEP.COM MILESTONES

- Preview version launched July 4, 1999
- Raised $51 million in series D funding, March 2000, over $65 million raised to date
- 100,000 customers, July 2000
- Leading ASP with more than 40 business service partners by August 2000
- Lucy Reid joined Bigstep.com as CEO, September 2000
- 300,000 customers, January 2001
- Raised nearly $5 million in debt financing, February 2001
    - Underwritten by Comdisco, Phoenix Leasing and Pentech

MANAGEMENT TEAM

- Lucile (Lucy) Reid, President & CEO
- Andrew Beebe, Co-founder and Chairman
- Josh Jacobs, Co-founder and VP, Sales and Marketing
- Monica Keenan Laurence, VP, Customer Support
- Lynda Kim, VP, Finance
- Anthony J. "Chip" Pessa, EVP, Product Development
- George Peterson, VP, Network Operations
- David Rich, VP, Marketing
- Bud Rosenthal, Co-founder and VP, Business Development

BOARD OF DIRECTORS

- Marc Friend, U.S. Venture Partners
- Allen Morgan, Mayfield Fund
- Nicolas ElBaze, Partech International
- Ralph Terkowitz, The Washington Post Company
- Andrew Beebe, Bigstep.com
- Lucile Reid, Bigstep.com

AWARDS

- *PC Magazine* list of the "Top 100 Web sites," Quarter 1, 2001
- *PC Magazine* "The Best of 2000" in Web development category, December 2000
- *PC Magazine's* list of the "Top 100 Web sites for 2000," December 2000
- *PC Magazine* Editors' Choice Award, 1999 and 2000
- *PC Computing* MVP Finalist award, 1999
- *Home Office Computing*'s 100 Gold Award, 1999
- *Computer Currents*' Annual Reader's Choice Award, 1999
- Top 50 Private Companies, *Red Herring,* 1999
- *Red Herring* Top 10 Companies to Watch, 1999
- Debutante, PC Forum, 1999
- *USA Today* "Hot Site Award," 1999

CONTACT INFORMATION

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TESTIMONY BEFORE

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
107th CONGRESS
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
2561 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-6315

April 3, 2001
Cannon House Office Building
Room 311
2:00 p.m.

by

Jonathan D. Draluck[1]
Vice President Business Affairs & General Counsel
iBasis, Inc.
20 Second Avenue
Burlington, Massachusetts 01803
(781) 505-7500
jdraluck@ibasis.net

Mr. Chairman, Honorable Members of Congress:

Thank you very much for the kind invitation to address the issue that this subcommittee has correctly identified as critical to success of Internet-based businesses: an environment free from legal and regulatory barriers. My name is Jonathan Draluck, I'm the Vice President of Business Affairs and General Counsel of iBasis, Incorporated. iBasis is a company that has succeeded in large part due to Congress's resolve to keep

[1] In accordance with Rule XI clause 2(g)(4) of the Rules of the House of Representatives, I attest that neither I nor iBasis, Inc., the entity that I am representing at the above-captioned hearing, has received any federal grant, contract, or subcontract, this year or during the preceding two years.

businesses that provide Internet-based services as free as possible from burdensome regulatory oversight.

Please allow me to share with you briefly what iBasis is and what we hope to become.

Our core business is wholesale Internet telephone service. We carry the long-haul portion of international telephone calls over the public Internet. We provide this service to over 100 telephone carriers around the world, including nearly all of the big U.S. international long distance phone companies with whom you are familiar. We began our operations in a basement in Burlington, Massachusetts, three years ago, and now carry millions of minutes of ordinary phone traffic around the world, every day, using our more than 426 Internet telephony facilities spread across more than 46 countries. We have come a long way in a short span of time. Consider, for instance, that only three years ago, many "experts" insisted that Internet Telephony would be confined to niche markets of computer hobbyists. Today, if you dial an international long-distance call using your regular long distance carrier, the odds are up to 1 in 3 that for any of 15 countries you may be trying to reach, including China and Russia, that your call is being carried by iBasis.

Our global communications network operates using Internet Protocols – which, like the Internet itself, are more efficient, versatile and scalable than the transport offered by traditional circuit-switched networks operated by incumbent carriers. Because of this,

we are uniquely well-suited to provide innovative web-based voice applications over our network and make these new services available worldwide.

For instance, our Speech Solutions line of business, based in Reston, Virginia, develops speech-driven applications for corporations and carriers that are available to anyone with a phone, whether mobile or fixed, anywhere in the world. Some of you have probably already used a speech-recognition application, such as that employed by major US airlines or financial institutions. This service enables customers to dial-in to a number and, using spoken commands, make a flight reservation or modify a 401(k) allocation, without touching their phone's keypad. Think of speaking into your mobile phone and asking an Internet-based application or service for information and then having the answer you seek spoken to you over your mobile phone, regardless of where in the world you're located. Now you understand the potential of the iBasis Network. We believe that the next Internet revolution will be driven by the human voice.

Using the Internet and its universal, open protocols to provide voice services allows the phone to offer all of us much more than Alexander Graham Bell could have ever imagined. Unified communications, for example, lets you hear and respond with your voice to your email and voicemail from your phone. And this is just the beginning. We see a world in which we will all be able to access ordinary Internet content over the phone through what we call the Global Spoken Web, a worldwide infrastructure comprising hundreds of interconnected voice-enabled web sites, sometimes called voice portals, that will respond to spoken requests.

I'm sure we can agree that the Internet has had profound effects on our lives – effects that were unforeseeable only a few years back. Nearly all of us have witnessed these changes using browser software on PCs. There are an estimated 300-400 million PCs worldwide. On the other hand, there are nearly 2 billion phones in the world. Using the services we provide, any phone – from a black phone built in 1920 to the latest miniature mobile – can help bridge the digital divide by becoming an Internet-access device – with the human voice directing the navigation. In addition to the work we're doing on our own, we also offer our global IP voice infrastructure as an incubator hosting environment for small developers seeking to create new applications – many of which we cannot even imagine today.

A key driver of the explosive growth in new communications services is deregulation. On the U.S. front, therefore, iBasis urges the United States government to maintain its current "hands-off" approach to regulation of the Internet. In other words, let's keep the status quo. We're following three issues.

First, international settlement regimes, which historically have maintained a balance of payments for terminating international telephone traffic between any two countries. The international settlement regime is rapidly becoming a relic of the monopoly era on competitive routes, though some countries that continue to have monopolies or have limited competition are attempting to impose some form of settlements on international Internet traffic. iBasis encourages Congress to send a clear

signal that it opposes efforts by some foreign regulators and monopoly phone carriers abroad to subject Internet traffic to the settlements process. This will enable private companies to develop innovative, flexible and pro-competitive compensation mechanisms that better suit the Internet environment, without government or regulatory intervention. The absence of such charges has resulted in a dramatic increase in long distance traffic and a similar decrease in rates that benefit consumers worldwide.

Second, unlike in the U.S., where Internet services are not subject to licensing or tariffing requirements, some foreign governments erect obstacles to market entry. We attempt and are often successful in negotiating with the regulatory organs in these countries, but in some cases, these government-imposed obstacles prove insurmountable. Our service is illegal in some countries, because of fears that we could potentially compete with state-owned carriers – even though we're willing to provide services to those carriers, as we do in a number of single-provider countries. Other countries require companies such as iBasis to comply with onerous information requests before granting operating permits, and impose arbitrary requirements relating to foreign ownership, and the incorporation of subsidiaries (which, by the way, are often required to hold board meetings locally as well as hire local accountants.) There are also, on occasion, significant delays and other obstacles in getting local telephone numbering resources and international codes for call signaling and set-up.

iBasis commends efforts by the Departments of State and Commerce as well as the FCC at the recent ITU World Telecommunications Policy Forum on Internet

Telephony to combat entry barriers and the imposition of subsidies, such as settlements on Internet traffic. The ITU is dominated by incumbent telecom companies, who are trying to protect their market dominance, as well as by regulators, not all of whom understand the enormous benefits that our services can deliver their nations, in terms of better communications and faster technological and economic growth. The U.S. Government, therefore, should continue its efforts to prevent the ITU from gaining oversight that could lead to a stranglehold over the Internet.

Finally, we are concerned about access charges that local telephone companies charge traditional long distance companies. The FCC has authority to impose access charges on other services, such as Internet access or Voice-over-Internet Protocol. To date, the FCC has not done so. Any such charges would resurrect a legacy of the telecommunications-monopoly era and would result in less innovation and higher communications services costs for consumers.

iBasis is helping to deliver the new, more dynamic, flexible and efficient voice services of the 21st century, all over the world – from Beijing to Boston, from Harare to Helsinki, from Moscow to Melbourne. We are giving a voice to the Internet, but we need your voices to speak together with ours to help maintain the deregulatory momentum that preserves our invaluable freedom to innovate. A freedom we cannot take for granted.

Thank you very much for your time and for all of your efforts on behalf of small businesses like ours.

Prepared Testimony Rob McCord
President and CEO
Eastern Technology Council
Wayne, Pennsylvania

My name is Rob McCord. I am President and CEO of the Eastern Technology Council and a Managing Director of Pennsylvania Early Stage Partners. The Eastern Technology Council is a corporate consortium that provides business development services for more than 1300 mid-Atlantic-based member companies, and Pennsylvania Early Stage Partners is a family of venture funds that provides early-stage venture financing for young technology-driven firms. I am joined by Donna Gentile O'Donnell, the Managing Director of the Technology Council's Philadelphia Office. Ms. Gentile O'Donnell directs the Council's efforts in life sciences and all ventures related to biotechnology and the pharmaceutical industry.

The Eastern Technology Council is currently developing programs to attract foreign talent, retain regional graduates, and promote and advertise Greater Philadelphia as a national technology player.

The Eastern Technology Council is a membership association that is thriving today because of successes in a wide array of efforts to help the leaders of technology-oriented companies raise capital and locate valuable contacts and information. Our organization searches to find and execute innovative programs that help our member companies, and as a venture capitalist, I work to find, invest in, develop, and sell companies that provide valuable and commercially viable technology products and services. Ms. Gentile O'Donnell and I are eager to help this subcommittee develop cost-effective tactics that will help spur the growth of young Internet-oriented companies.

By design, I offer only limited and informal testimony and hope, primarily, to offer our help, and secondarily, to answer any questions you might have.

Greater Philadelphia

Of course, the country has already seen too many venture-backed companies fail to focus on the needs for positive cash-flow and sustainable profits. Yet these failures create opportunities.

One positive output of recent shake-outs is that many older companies will now drive new uses of the Internet (for specific and productive applications), and new Internet-oriented ventures could and should develop in areas with much lower costs than those posed by Silicon Valley or Silicon Alley. Another positive development flows from the increased use of the Internet in the pursuits of pharmaceutical companies (e.g. in breathtakingly quick research and development programs). Both of these developments throw opportunity toward Greater Philadelphia.

Indeed, leaders of the Eastern Technology Council were delighted recently to see Greater Philadelphia highlighted as one of the best new "hot" places in the country in which to develop "tech" Companies (in the Internet-oriented Industry Standard magazine and other media outlets).

The region qualified with a wide variety of features, including: relatively low costs, a critical mass of existing tech-oriented companies in both "biopharma" and "IT," strong educational institutions, a high quality of life, and close proximity to millions of eastern-corridor based customers.

Immigration/H1B Visas

Please note that even a severe recession would not end the shortage of "human capital" in Internet-related fields. In Greater Philadelphia and throughout the country, it is difficult to overemphasize the importance of highly skilled workers. Technology companies look for very specific skills and need rapidly; that is, they often lack the time to "manufacture" (or train) a worker up to the adequate level of skill. In Greater Philadelphia, the gap between the number of available information technology workers and the number of open IT positions is widening. The supply of graduates is not keeping pace with demand[1]. In the Philadelphia region, the data-intensive services cluster gained about 7,300 net new jobs each year, while regional institutions graduated only 3,300 students from computer and information sciences programs.

One way employers are looking to fill demand is to look overseas. Although the American Competitiveness and Workforce Improvement Act of 1998 increased H1-B visas from 65,000 to 107,500 for fiscal year 2001, the demand gap continues to grow. Companies continue to claim that towards the end of the fiscal year, the visa caps have been reached, forcing delay or missed opportunities for the companies to hire the skills they need to grow. In addition to increasing the number of H-1B visas, the Act also imposed additional requirements on H-1B employers. The regulations and visa processes themselves place an undue burden on companies trying to hire for very specific talents. In 2002, the Act will return the visa cap back to 65,000. The Technology Council would be delighted to help Congress recraft HI-B policy in a fashion that is acutely sensitive both to the needs of organized Labor and to the needs of company leaders who lack the time needed (usually decades) to train people with some of the world's scarcest skills. We should be able to take advantage of the USA's role as the world's most attractive economy without hurting any U.S. citizens.

Brain Drain and Brain Gain

Today, business leaders throughout Greater Philadelphia are concerned that too many qualified graduates are unaware of the region's "hot" technology jobs and relocating to other parts of the country. Many successful entrepreneurs are finding that it is more difficult to find qualified people than it is to find money. Analysts still forecast a 7,000 percent increase in U.S. e-commerce and mobile-commerce over the next five years. The Philadelphia region is already experiencing tremendous growth in the information technology and biotechnology sectors. The area's competitive advantage will correlate to its ability to develop, attract, and retain technology-oriented workers and graduates.

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[1] Pennsylvania Economy League. (2000). Workforce 2000: An annual report on Greater Philadelphia's Labor Market.

Working with recruiters and leaders from colleges and universities throughout Greater Philadelphia, the Technology Council is developing programs to provide scholarships and regional signing bonuses, leads and introductions. These initiatives will help area technology-oriented companies attract and retain invaluable professionals. The Technology Council is also supporting a "brain gain" initiative organized by the Pennsylvania Economy League and involving the region's leading universities. Led by the University of Pennsylvania's John Fry, participants in this initiative will work to increase the total number of students who flow through the Greater Philadelphia region (higher volume should lead to higher total "brain gains"). In addition to this work, we would welcome opportunities to work with Congress to ensure that, in general, throughout the USA, foreigners who come to the US for advanced education in technical fields gain more opportunities to stay in our country and create wealth for the nation that helped subsidize their training.

Alternative Minimum Tax

The alternative minimum tax is an extra tax some people have to pay on top of the regular income tax. The original idea behind this tax was to prevent people with very high incomes from using special tax benefits to pay little or no tax. But, the AMT reaches more people each year, including some people who do not have very high incomes or special tax benefits.

The AMT increasingly catches both entrepreneurs and technology executives by unfairly taxing even a minimal exercise of stock options. With the recent stock market volatility, there are many cases where the AMT puts executives in a cash crisis by taxing the gains recognized on exercises when a stock is high, even when those gains have decreased or become losses by year's end. The existence of the AMT tends to encourage executives to "flip" options to avoid the tax risk, rather than exercising and holding the options. These practices further increase technology stock volatility. Again, we would welcome opportunities to help you address these unintended consequences.

Pooling of Interests

There have been numerous proposals over the past few years to eliminate "pooling of interests" treatment of mergers. This elimination would make accounting for mergers more onerous, and would potentially dampen the willingness of large corporations to acquire emerging companies. This lessened liquidity decreases the incentive of investors to back these highly-risky new entrepreneurial ventures. Please carefully consider this potential danger.

Venture Capital

Venture capital continues to fuel economic development. Note, even when a company fails, the venture-backed, technology-oriented entrepreneurs involved in the start-up gain scarce skills and often build enduring attachments to their community. To spread the wealth that will continue to

flow from technology-oriented entrepreneurship, we should do a better job of spreading the supply of venture capital (i.e. avoid warehousing 60% of it in northern California).

In the coming months, funding for "pre-revenue" companies is likely to be especially scarce. Excellent models for public programs that fund these kinds of companies do exist: witness Pennsylvania's own, very successful Ben Franklin Program. We would welcome opportunities to advise you on further development of these kinds of invaluable initiatives.

Thank you for providing this opportunity.