Silicon Valley Bank

A Member of SVB Financial Group

Written Testimony of

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Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee: My name is Mary Dent, and I am the General Counsel for Silicon Valley Bank and its parent, SVB Financial Group. I appreciate the opportunity to testify today on the important topic of how to sustain America's position as a leader in innovation-based economic growth by ensuring that high-growth small businesses have access to the capital they need to thrive.

In my testimony today, I will focus on a small but critically important part of the broader small business landscape: high-growth small businesses. These are the small, young, fast growing companies that aspire to become the future Ciscos, Genentechs, Intels, Googles, Facebooks, and Apples.

High-growth small companies tend to focus on technology markets such as computer hardware and software, the internet, cloud computing, life sciences, medical devices, and clean technology. They typically focus on developing new technologies, new service models, or new business models. They are fundamentally different from other small businesses – the dry cleaners, sandwich shops, hairdressers, and other businesses that make up what we colloquially refer to as Main Street America – which intend to stay small even if they are successful. Both are important, but each is unique.

Why are small, high-growth businesses so important from a policy perspective? Because as a number of studies have demonstrated, they are the principal force behind both gross and net new U.S. job creation.

High-growth small companies, while small in number, have an outsized impact on the U.S. economy. This is best seen by examining the impact of companies that received backing from venture capital investors, as these companies represent a reasonable proxy for the overall high-growth sector. Venture-backed companies consume roughly 0.1-0.2% of U.S. GDP in invested capital annually, but create roughly 11 percent of U.S. private sector employment and 21 percent of annual U.S. GDP – or roughly twelve million jobs and over $3 trillion in annual revenues. They typically outperform the broader economy, in terms of both job growth and revenue growth. They create new, broad-based, long-lasting industries -- from information technology, biotechnology, semiconductors, and online retailing to emerging industries such as clean technology, social media, and cloud computing. They transform how we live, work, and communicate – think mobile banking, Facebook, or the iPad. They help us treat and cure diseases. MRIs, ultrasound diagnostic imaging, angioplasty, and spinal implants, for example, were all developed by venture-backed companies, and more than one in three Americans (or 100 million individuals) have been positively affected by an innovation that was developed and launched by a venture-backed life sciences company during the past 20 years. High-growth, innovative companies also serve as the research and development pipeline for larger companies, and they are our best bet for finding solutions to the issues we confront as a society, from health care to energy.

Since start-ups drive the innovation economy, we believe business leaders and policymakers should view them as the proverbial canary in the coalmine. They can alert us to opportunities that can fuel our economy for decades to come. They can also highlight looming challenges that could stifle growth.

SVB lives in the world of high-growth small businesses. For nearly thirty years, we have focused on helping entrepreneurs succeed. We work almost exclusively with high-growth technology and life science companies and with the investors who finance them.

At our core, we are a commercial bank. We provide a comprehensive suite of financial services to our clients worldwide. We bank nearly half of the high-growth technology companies across the United States and well over half of all U.S. venture capital funds, working through 27 U.S. offices and seven offices in innovation centers outside of the United States.

We often begin working with clients when they are first formed. We are one of the only banks that will lend to venture-backed start-ups before they are profitable – in many instances, even before they are generating revenues. We work hard to be creative, to take a long term view, and to retain a consistent approach to lending, even when events are challenging for our clients. For nearly thirty years, we have proven we can take this approach and also lend safely and soundly.

But we do much more than lend money. Through our exclusive focus on the innovation sector and our extensive knowledge of the clients we serve, SVB provides a level of service and partnership that measurably impacts our clients' success. For example, we hold "Showcase" events, which help our start-up clients gain access to potential investors. We also host "CEO Accelerator" events, which bring start-up CEOs together to allow them to engage with peers, learn from one another, and develop networks and connections that will help them overcome the challenges their company will face as it grows.

We see first-hand the optimism and energy with which entrepreneurs approach the world. We are proud to help these individuals take ideas and transform them into companies that solve real problems and create millions of jobs for this country.

In my testimony today, I will share my perspectives on capital formation and the government's role in promoting investment. I will first describe what we see in bank lending, and then turn to what our clients are experiencing in finding suitable equity financing. Finally, I will touch on the intersection between the decisions you make in Washington and the world of start-up entrepreneurs.

Debt Financing for High-growth Technology Companies

While access to credit remains an issue in the broader economy, in the markets we serve loans are readily accessible. In the words of one of my colleagues, "there's never been more competition" to lend to high-growth companies. With few other sectors providing comparably attractive risk-adjusted returns, banks are competing aggressively on deals. For credit-worthy companies of the type we serve, there is no shortage of credit.

Our performance in 2011 gives a sense for the level of activity we are seeing in the sectors we serve. During 2011, we increased the total amount of loans outstanding to the highest level ever in our nearly 30-year history. Despite the very low interest rate environment, our earnings hit a record high and were 81 percent higher than in 2010. Though the U.S. and world economies sometimes seemed on the verge of falling back into a recession, the tech sector performed well, and banks responded by lending actively to tech companies.

As you might expect, the level of competition and the availability of credit varies depending on how advanced the company is. The "younger" the company (in terms of revenues and profitability), the fewer the financing options. Even for very early stage companies, however, we think that between banks like Silicon Valley Bank and specialty venture lending funds, the right amount of debt financing is generally available.

For many entrepreneurs, we know it may not feel that way. That's because debt financing isn't well suited to taking on the kinds of risks that equity is meant to handle. In essence, the key difference between providers of debt and providers of equity is that debt needs to be paid back. Because debt has limited upside, lenders must be extremely vigilant in managing downside credit risk. Before making a loan, they need to be reasonably confident that one or two defined sources of repayment exist or will exist. Equity investors, in contrast, enjoy unlimited upside and can make higher risk investments across a portfolio, using the gains from a small number of highly successful "winners" to offset some meaningful losses. Financial metrics such as balance sheet liquidity, cash flows, continued future funding by investors, and the like provide a foundation for debt. Upside and opportunity, in contrast, serve as the foundation for equity investments.

Start-ups may not fully understand what kinds of risks debt providers can take on, and what kinds of risk they can't. They are also typically understandably optimistic about their future prospects. As a result, they may underestimate repayment risk and perceive a shortfall in available financing when, in fact, debt providers are providing the level of credit that is responsible given the borrower's overall risk profile and stage of growth.

The availability of financing also varies by sector. For clean energy companies, for example, there is a well-recognized and long-standing lack of credit to finance initial commercial-scale facilities – or, in other words, to move from technological feasibility to full commercial production. These are commonly referred to as "valleys of death," and while policymakers have made several attempts to solve the problem, to date these programs have not succeeded in closing the gap. This has a real impact on the long-term growth prospects for companies in this sector and for America's competitiveness in new forms of energy generation.

Equity Investments in High-growth Companies

There are a number of interesting trends on the equity front. A few weeks ago, Silicon Valley Bank completed a survey of early stage technology start-ups. At the macro level, entrepreneurs still see the availability of equity financing as a significant advantage for the United States over other countries. At the individual company level, however, more than one in three start-up entrepreneurs saw access to equity financing as one of their greatest challenges, and fewer than one in three saw it as an opportunity to drive growth for their company. In fact, the executives we surveyed said access to equity financing is their second most pressing challenge, after scaling operations for growth.

We believe this reflects a few underlying trends – some positive, some not.

One, companies are adopting much more capital efficient models. That means they need less capital to grow. In the software sector, for example, entrepreneurs can use cloud-based services as the platform upon which to offer their applications. That means they don't need to buy servers and other infrastructure, and can get their company to the point of earning revenues with a lot less money.

Two, venture capital investing levels have largely recovered from the steep falloff they experienced during the financial crisis. According to data from the National Venture Capital Association/PWC MoneyTree, during 2011 venture capital funds invested $28.4 billion in 3,673 deals, a 22 percent increase in dollars and a four percent increase in the number of deals over 2010. The amount of venture dollars invested during 2011 represented the third highest annual investment total in the past ten years, according to the same source.

In addition to venture capital funds, other sources of capital are more and more active in financing early stage companies.

On one end of the spectrum, so-called "angel" investors are playing an increasingly important role in driving entrepreneurship. According to a study of investing trends by angel investment groups released earlier this year by the Angel Resource Institute, Silicon Valley Bank, and CB

Insights, the size of median angel group rounds grew to $700,000 in 2011, an increase of 40 percent over 2010. Nearly 60 percent of angel group investments were in healthcare and Internet companies, with 60 percent of the healthcare deals targeting medical device and equipment companies. Many deals were syndicated among investors, providing companies seeking larger investments access to the additional capital they need to fund their early stage businesses. And angel investors were investing across the country, with 79 percent of 2011 investments and 70% of 2011 invested dollars going to companies outside of California.

At the other end of the spectrum, established corporations are once again increasingly active in financing start-up companies. Corporate venture arms invested nearly $2.3 billion in high-growth companies last year, up from $2.0 billion in 2010 and significantly higher than the $1.4 billion they invested in 2009, according to data from the National Venture Capital Association/PWC MoneyTree report. Increasingly, we are seeing a diverse array of large corporations actively participating in the start-up ecosystem, as growth once again becomes a top priority for CEOs and corporations recognize the critical role outside innovation needs to play in achieving that growth. Among those expanding venture investing are Citigroup, BMW, General Mills, Comcast, and Dell, to name just a few.

While early-stage companies may be better able to "bootstrap" or rely on angel investors to get started, as they grow they need larger amounts of capital to expand. Public equity markets are an important source of that growth capital. There's good news on that front as well: after a long dry period, the market for initial public offerings, or IPOs, is slowly rebounding. Already, the number of venture-backed IPOs in the first quarter of 2012 hit its highest number in five years, both in terms of number of IPOs and dollars raised, according to data from the National Venture Capital Association/Thomson Reuters.

IPOs are a very important source of capital to fund longer-term expansion by more mature companies. They give companies the option of growing organically, rather than selling themselves to a larger company. This is very important, because it promotes healthy competition and helps ensure that our economy retains an array of companies of different sizes. In addition, since over 90 percent of venture-backed companies' job creation historically has happened post-IPO, promoting companies' ability to turn to public markets to fund their growth is very important to the country as a whole. That's why we supported the recently-enacted JOBS Act, which will make it more feasible for good, high-growth companies to go public by providing an "on ramp" to come into compliance with some regulations. We commend the House of Representatives for leading the effort to pass this legislation, acting decisively and in a bi-partisan way to solve a very real problem.

But while the picture has many bright spots, it isn't universally rosy.

While venture *investing* has recovered, venture *fundraising* has not. During 2011, venture funds did not raise enough capital to replenish what they invested. This implies that the current level of venture investing is not sustainable unless the fundraising environment improves.

In addition, access to capital remains more difficult for more capital intensive ventures in more heavily regulated sectors, where the time required to succeed and the levels of regulatory and market uncertainty are high. This is most notable in the life science and cleantech sectors, both of which are very important to our broader economy because they offer enormous potential for growth and because we need innovation to help us provide affordable, effective health care to all Americans and develop stable, affordable, long term sources of energy.

In life sciences, early-stage venture investments have migrated away from high-risk "swing for the fences" deals to lower risk "singles and doubles." Start-ups are more likely to focus on developing a single product, and less likely to try to build a deeper portfolio of products. Overall, venture fundraising in the life sciences sector is down significantly, leaving funds with limited "dry powder" to support existing companies and fund new start-ups. Health care reform, downward pressure on insurance reimbursement rates, challenges in the FDA approval process, and difficulties securing rights to reimbursement have all meaningfully increased uncertainty and the cost and time it takes to succeed. The medical device tax imposed in the health care law – which applies to revenues, not profits – will dampen top-line growth if it goes into effect as scheduled next year.

In cleantech, the pool of sophisticated investors has narrowed very significantly, leaving only a handful of firms that are able to deploy large amounts of capital. These firms have largely made their bets in higher risk areas, particularly energy generation. As a result, funding in these areas is largely focused on follow-on financings for existing companies, while new start-ups are primarily being funded in areas such as energy efficiency, energy storage, and advanced materials. Corporate investors are an increasingly important part of the overall landscape, providing funding and helping companies develop and execute on strategies to grow to commercial scale and work with – or compete against – competitors in global markets, particularly China. The political winds have shifted over the past few years, and the lack of a consistent, forward-looking energy policy is depriving would-be entrepreneurs and investors with a long term view of the overall landscape for the sector.

The Role of Policy in the Innovation Ecosystem

One of the start-ups that participated in our recent "Startup Outlook 2012" survey said, "Executives who suggest that government should not get involved are naive. Government is involved. The challenge is getting government to refine its involvement so that it is a net positive, not a net negative, to the entrepreneurial ecosystem."

I couldn't agree more.

Public policies can positively influence private sector behavior. However, they can also set up barriers that impede risk-taking and stifle innovation.

While the health of the U.S. innovation economy depends first and foremost on the inventors, entrepreneurs, and investors who build companies, policymakers have a dramatic impact on the overall system within which innovation occurs. Continued robust innovation-based economic growth therefore depends to a significant extent on forward-thinking government leaders who understand that we need a carefully calibrated regulatory system, access to capital, a highly skilled workforce, a legal system that protects intellectual property, and stable investments in infrastructure, research, and education. It is crucial that policymakers understand the importance of allowing people to take risks, and that they base decisions on facts, take the time to understand how technologies work and how rapidly they change, and reject policies that merely entrench the status quo.

When it comes to entrepreneurs and their ideas, there's a lot of good news. Silicon Valley Bank's recent survey showed that start-ups are performing well and remain optimistic about the future. The vast majority expect to hire employees in the coming year. New sectors are emerging that have the potential for truly amazing growth. And entrepreneurs continue to believe the United States is an appealing place for business because of our focus on innovation and our entrepreneurial mindset.

The network of policies that support the innovation economy, however, is beginning to fray. Our recent survey showed that respondents this year are less positive about the quality of U.S. higher education, and more positive about the quality of foreign countries' higher education, than they were a year ago. Fewer than one in three start-up executives believes the U.S. higher education system is preparing workers with the skills their businesses need. More than one in three says the regulatory environment presents a challenge to their ability to grow. Start-ups don't think policymakers made progress on their top policy priority from our 2011 survey, intellectual property protection, and actually lost ground on the next three – controlling health care costs, improving the regulatory environment, and implementing health care reform.

The recently-enacted JOBS Act offers promise that Congress can begin to confront the issues facing small, high-growth companies in a targeted, timely, and bi-partisan way. I have also been heartened by the actions members of the House and Senate have taken to ensure the agencies implementing the Dodd-Frank Act take the time they need to adopt well-reasoned rules grounded in the facts, and to provide needed context to the agencies. For example, the Dodd-Frank Act included a provision commonly referred to as the Volcker Rule. It was intended to get banks out of activities Congress deemed too risky and too volatile for banks – specifically, engaging in proprietary trading and sponsoring and investing in hedge funds and private equity funds. Yet because of how it was written, the Volcker Rule could be read in a way that would stifle the amount of debt and equity flowing into start-up companies. Approximately 45 members of Congress have gone on the record to make clear this is not what they intended, and not what they want. The agencies have not yet adopted final rules, and we encourage members of this Committee to continue to urge the agencies to avoid rules that artificially and unnecessarily limit banks' ability to support small, growing companies by sponsoring and investing in long-term venture capital funds.

Looking forward, the House is expected to take up the reauthorization of the U.S. Export-Import Bank in the reasonably near future. We participate actively in the bank's working capital guarantee program, and believe the basic structure of the Export-Import Bank's guarantee program is effective by ensuring that lenders create credit risk only when they share "skin in the game." The loans we are able to make as a result of this program fuel our clients' export sales, jobs, and shareholder value. In 2010, for example, our Export-Import Bank loan commitments helped 75 small business clients generate more than $1.4 billion in U.S. export sales to 30 different countries and support nearly 6,400 new and existing U.S. jobs.

More generally, we believe this Committee can help continue to lay the foundation for well considered, productive policies by holding hearings such as this one. The technology sector is continually evolving in ways that will create new opportunities that we, as a country, can exploit to create jobs, promote our global competitiveness, and increase economic growth. We encourage you to look to the future and to actively solicit the views of high-growth young companies on the issues they face, such as R&D funding, access to capital, access to talent, and the impact of the regulatory environment. We also encourage you to help policymakers once again embrace appropriate risk-taking. It is vitally important that our economy, our political system, and our regulatory systems don't become hostile to risk, because without risk, there is no reward.

In closing, I commend this committee for focusing on the important questions of whether young companies can obtain the capital they need and how policy decisions affect small businesses' access to capital. The United Sates is lucky: we have a vibrant innovation sector, and all we need to do is avoid stifling it. Other countries around the world are trying to replicate what we already have, with some success. If we take the right steps, we can remain a leader in the innovation economy. If we don’t, we will feel the repercussions throughout the economy for years to come.

It’s a privilege to be here today and I thank this committee for taking the time to hear our perspectives and working to strengthen this vibrant part of our economy.

Thank you for your time.

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