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Before the U.S. House Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access

Small Business: The Key to Economic Growth

April 27, 2017

10:00 a.m.

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Chairmen Chabot and Brat, Ranking Member Velázquez, and to all of you hard-working members of this Committee, first I'd like to say it is truly an honor to speak before you today on the economy and the impact of small business and entrepreneurship.

My name is Andrew J. Sherman and I am a Partner at Seyfarth Shaw. My practice focuses on issues affecting business growth for companies at all stages. Over the past 32 years, I have counseled thousands of U.S. and international clients from early stage firms to multibillion dollar conglomerates.

This Committee is the guardian and fiduciary of small business and entrepreneurship in our society and the gatekeeper of economic growth. I commend you for your efforts in supporting the Small Business Association (“SBA”), the Small Business Development Center (“SBDC”) network, and (as I will discuss later in my testimony), the Defense of Trade Secrets Act (“DTSA”), and the JOBS Act, which have allowed greater access to crowd funding channels. I have seen first-hand the positive impact of these efforts throughout my career, and especially having served as outside general counsel to the Entrepreneurs’ Organization since 1987, which now comprises more than 12,000 members throughout 160 chapters and whose members employ roughly 2.8 million workers worldwide.

Background

Over the course of my professional career, I have written nearly 30 books on entrepreneurship, the legal and strategic aspects of business growth, franchising, capital formation, the leveraging of intellectual property, mergers and acquisitions, and my latest book, which is on the crisis of disengagement and its impact on the workforce and innovation. I have also served as an Adjunct Professor in the MBA program at the University of Maryland for the past 28 years and at Georgetown University Law School for the past 10 years.

In addition, I was the founder of the Small and Emerging Contractors Advisory Forum (“SECAF”), an organization of small and emerging government contractors in the Washington D.C. region, with over 400 members committed to empowerment and advocacy for the contracting industry. For the past 10 years, I have served as a keynote and workshop speaker at the annual meeting of the SBDC and currently serve on the SBDC Foundation Board of

Directors. In 2001, Fortune Magazine included me in their list of the Top Ten Minds in Small Business and Entrepreneurship. In the 1970's, I dropped out of college to become an entrepreneur and while I have since devoted my career to a life serving and supporting entrepreneurship, both my wife Judy and daughter Jennifer are entrepreneurs and small business owners.

Current Data

Turning to present day trends, 2017 has seen a widespread but tempered increase in confidence among small business owners regarding the economy and overall trends in business investment. Business owner optimism has increased in part due to promises of tax reform, regulatory reform, and the strength of the capital markets. We are all aware that small and emerging businesses are the backbone of our country and a significant engine for the creation of new jobs. According to Small Business Trends, family owned businesses account for 78% of new jobs created in America and a significant portion of our overall GDP. Moreover, an increasing number of millennials are poised to take on management positions and bring a fresh outlook to the workplace. Many small businesses are forecasting significant increases in revenue for 2017 and 2018. In just six months, from July 2016 to January 2017, the concern of economic uncertainty for small businesses declined from 49% to 44%. While these statistics are all good signs for the economy, 70% of small businesses with revenue under \$1 million are still reporting that access to affordable financing is their biggest hurdle to growth.

In my experience as a legal and strategic advisor, there are several factors that support the entrepreneurial eco-system in the United States, as shown in the chart below.

Elements of the Ecosystem Needed for Small Business and Entrepreneurship to Flourish

Overall Societal/Governmental Structure	Accessible and Stable Capital Markets	Enforceable Rule of Law/Court System
Reliable and Fair IP Law to Foster Innovation and Creativity	Culture that Supports Economic Advancement	Business Structures that Limit Personal Liability

Fair and Effective Governance	Human Capital, Culture, and Fair and Flexible L&E Laws	Our Ability to Redefine Ourselves and Engage in Serial Entrepreneurship
Overall Educational Training Systems	Bankruptcy Laws	Access to Global Markets and Trade/Ability to Compete Globally
Access to Mentors and Advisors, Coaches and Resources/Networks	Government/Private R&D Partnerships	University/Private R&D Partnerships
Exit Strategies (M&A, IPO's, ESOP's, etc.)	Estate Planning and Wealth Transfer Laws	Antitrust Laws

Raising Capital

Capital is the lifeblood of a growing business. The only way to take any business to the next level is to gather the funds needed to fuel growth. Small businesses find that this is the most difficult hurdle to overcome. Stringent regulatory requirements have made it more difficult for banking institutions to offer loans to small business. Moreover, while cycles of the economic downturn put a dent in everyone’s pocketbook, for smaller and entrepreneurial companies it robbed them of the critical fuel they needed to keep the engines of the economy moving forward. Main Street often recovers much slower than Wall Street. Payrolls are slashed, creativity is halted, inventories are reduced, capital investment decisions are delayed, and workforce motivation is virtually nonexistent. If entrepreneurial leaders refrain from making new hiring, growth, or capital investment decisions because they are concerned with what new crisis, burdensome regulation, budget deficit, tax hike, or economic downturn may await them, then we face a very slow journey to a complete and widespread economic recovery and our job creating engine will stall.

Reducing Regulation

Streamlining agencies’ approval processes at the state and federal level, while still maintaining comprehensive business guidelines, will help businesses open their doors faster and with lower

ongoing compliance costs. The current trend to better define the true cost of regulation and its impact on smaller companies, as well as pressure on agencies to publish clearer regulations so that small businesses can understand guidelines, rules and regulations without having to involve lawyers, accountants and other business counselors must continue to be the focus of this Committee.

Narrowing the Innovation and Productivity Gap

We have reached a point where, for both big companies and small ones, over 85% of the assets driving shareholder value and economic growth are intangible, taking the form of innovation, intellectual property, and intrapreneurship (Ocean Tomo, Baruch Lev). These assets include brands, systems, processes, channels, best practices, social media, customer recognition and loyalty, know how, relationships, and related strategic intangible assets. Yet, the latest State of the American Workforce study published in December of 2016 observes that less than 5% of employees surveyed describe themselves as “highly engaged.” These are the most creative, innovative, and productive employees in our workforce and surely overall. If we can’t engage more workers in the short-term, and sustain them in the long-term, then entrepreneurship as a driver of economic growth and our ability to compete in the global marketplace are severely in jeopardy.

In spite of the potential value of corporate innovation contributing to improved organizational performance, many small as well as established companies overlook the critical importance of engaging their workforce, and thus fail to encourage entrepreneurial behavior or implement effective rewards and incentives. Executives tend to be more concerned about the images of chaos that innovation can portray. In addition, there are often structural impediments in place, most of these being the product of bureaucratic routines and red tape policies that have outlived their usefulness, as well as politics, cronyism, and silo’s that stand in the way of meaningful collaboration. Effective managerial efforts are essential to developing an engaged culture that is capable of cultivating employees’ interest in and commitment to effective entrepreneurial behavior and the innovation that can result from it.

There are a multitude of studies that emphasize the connection between truly engaged workers and better customer service, higher levels of creativity and productivity, higher sales margins,

higher quality products, increased attention to safety, and lower turnover rates. However, what businesses have also recognized, and research has supported, is that innovation within a company is one of the primary drivers of company success, determined through growth. The more interesting element of this equation is where that innovation comes from: engaged employees. A Gallup Management Journal study found that employees who were “engaged” indicated they “strongly agreed with the statement that their current job ‘brings out [their most creative ideas.]’” The reverse was true for those who indicated they were actively disengaged—in other words, the disengaged individuals in the survey were the least likely to find that their current job incited creativity.

For decades, workers at companies of all sizes and in all industries were expected to know their jobs, do their work, keep their heads down, and only “bother” management with questions to avert a crisis. If a problem arises, know how and when to solve it, and don’t interfere with the supervisor’s valuable time. That mantra needs to shift if we are going to improve engagement in a way to drive more innovation and shareholder value. Employees at all levels need to feel liberated to ask the “Whys?” and the “What ifs?” They need to be able to ask (without retribution or punishment) “Why am I doing my job the way I am doing it?” “Is there a better way?” “What would it take to change and why?” People are likely to be more engaged when they are empowered to think for themselves and permitted to question the “status quo”—within reason—without the fear of retribution. Empowering workers in this way not only permits the workforce to begin organizing its thinking around the unknowns instead of the knowns, which will inspire greater creativity, innovation, and productivity, but it also demonstrates humility by the leadership team as they acknowledge that they do not have all of the answers and become more accepting of innovation at all levels. Fostering curiosity and inspiring and rewarding creativity is surely an effective elixir and a cure for our nation’s current level of disengagement and complacency.

It is imperative that we make efforts to offer more tools to both small and large businesses to allow them to compete more effectively on a national and global business platform. Congressional initiatives, such as last year’s DTSA and the 2013 America Invents Act (AIA) amendments to our nation’s patent law systems, help provide entrepreneurs with a competitive edge. In order to keep our nation’s job-creating engine well lubricated and running smoothly this

Committee should also explain similar regulations to address new technologies such as automation and robotics, copyright reform to keep up with developments in publishing and regulation, tax reform to encourage entrepreneurship and intrapreneurship, and patent troll legislation. This Committee must delve further into the root causes of the barriers that stand in the way of innovation, productivity, creativity and profitability, and be a catalyst for change and a champion and defender of those willing to undertake economic risks.

Common Barriers to Innovation

- Aversion to risk
- Politics (turfmanship)
- Red tape
- Pressure to live quarter to quarter (for public companies)
- Disconnect between innovation projects and overall strategic goals
- Communication silos
- Demand is unclear; Limited insights and inputs from customers
- Inadequate measurement tools & weak selection criteria
- Not enough ideas/creative focus within teams
- Lack of reward systems to motivate and encourage innovation
- Organizational chart: wrong people in the wrong jobs
- Time management constraints
- Lack of systems (how and where to start), focus, or resources
- Closed-mindedness
- Burn-out and Complacency
- Not Invented Here (NIH) syndrome
- Poor planning (or a lack of planning)
- Overly short-term investment horizons (public companies living in a fishbowl quarter to quarter)
- Inventor's syndrome (a better mousetrap vs. market/margin focused)
- Loss of touch with the needs and values of the end user/customer
- Inadequate skills (poor recruiting) or resources (weak capital structure)

Suggestions for Further Policy Research

We are living in a time of constant change and uncertainty. To protect and preserve the role of small businesses and entrepreneurs as drivers of economic growth and creators of new jobs, I respectfully suggest that this Committee consider the following areas for additional research and possible legislation or programming:

- Impact of Automation, Artificial Intelligence and Robotics on Small Business Job Creation, Retention, and Transformation
- Training, Education, and Incentives to Improve our Nation's Level of Employee Engagement
- Foster Access to the Capital Markets (Especially the Debt Markets by Allowing Smaller Companies to Pledge Intangible Assets as Collateral for Loans)
- Examine Intellectual Property Laws to Ensure Fair and Legitimate Opportunities to Harvest Intangible Assets and Restrict Patent Trolling
- Tax Reforms that Reward Measured Business Risks, Entrepreneurial Growth, and Exits to Foster Greater Wealth Creation
- Regulatory Reform to Unburden Small and Growing Business from the Costs that Prevent them from Being Competitive in a Global Marketplace (Consider Carrots v Sticks, Self-Regulatory Bodies, and Peer-Reviews, etc.)
- Replacing Certain Welfare Programs with Job Training and Mandatory Educational Programs to Keep our Workforce Relevant and Productive (Federal and State Welfare Programs Should Not be more Lucrative than Engaged Career Paths)

Summary

I have no doubt that dozens of very well-trained minds from academia, trade associations, research organizations, to industry leaders have previously appeared before this Committee. My perspectives are from the trenches and based on my experiences in working with thousands of entrepreneurs and small business owners over 32 years as a legal and strategic advisor. Our entrepreneurial ecosystem is one of the primary assets we all share as a nation in remaining competitive in a global marketplace. The role of our government is to allow it to flourish through the undue burden of regulation, to support it with creative initiatives that will fuel economic growth and new jobs, and to celebrate it by recognizing the day-to-day efforts of our nation's entrepreneurs and small business owners, who, like those who defend our county and those who serve as our emergency responders and educators, are our truest American heroes.