THE BROOKINGS INSTITUTION

CAN AMERICA GET ITS ENTREPRENEURIAL GROOVE BACK?

A DISCUSSION ABOUT PRIVATE CAPITAL'S ROLE IN THE ECONOMY

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**Welcome:**

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**Morning Keynote: Can America Get Its Entrepreneurial Groove Back?**

DAVID BROOKS
Columnist, *The New York Times*

PANEL ONE: THE STATE OF PRIVATE CAPITAL AND ITS FUTURE POTENTIAL

**Moderator:**

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**Panelists:**

MICHAEL KLEIN
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**Moderator:**

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**Moderator:**

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**Panelists:**

CARL SHAPIRO
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**Moderator:**

JOEL KURTZMAN
Chairman, The Kurtzman Group
Senior Fellow, The Milken Institute

**Panelists:**

A.G. LAFLEY
Former Chief Executive Officer, Procter & Gamble
Member, President's Council on Jobs and Competitiveness

RON BLOOM
Former Assistant to the President for Manufacturing Policy

**Closing Keynote: How to Bridge the Cultural Divide Between Entrepreneurs and Policymakers**

KAREN MILLS
Administrator
Small Business Administration

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P R O C E E D I N G S

MR. RICE: This morning we're going to talk about capitalism, free markets and entrepreneurship. The Private Capital Research Institute is pleased to co-sponsor this event with the Brookings. We've been working together for some period of time now on this particular project. And I must say it really is very gratifying to see this turnout this morning. You know, you hold one of these and you wonder whether anybody's going to show up or not.

So -- thank you very much. We appreciate it.

I want to say a couple of words by way of introduction to the Private Capital Research Institute. PCRI was formed to sponsor academic research on private capital. It's the successor to an effort that began in conjunction with the World Economic Forum to study the impact of private equity in a variety of different areas such as employment, capital investment, and creativity. That particular effort was led by Josh Lerner, who will lead the discussion on research this morning.

Josh is, in my opinion, the foremost academic working in this field. And he has felt for some period of time that the databases available for research in this area are inadequate, confused, and confusing. It's almost impossible for policy-makers, legislators, chief executives, or academics to truly analyze the impact of any particular private equity transaction because the gaps in the data are so great. And so the PCRI has undertaken to develop an extensive database, which will be accurate, complete, and unimpeachable.

The work of gathering this data is hard work, because the data is owned by a series of organizations who regard it as very valuable and highly proprietary. But thanks to Josh's efforts and the efforts of the research director, Leslie Jeng, we're making progress. And at some point in time, PCRI is going to have constructed a database, which will permit new insights into the role that private capital plays in our economy.

I think we're all conscious of the fact that we need new insights. Whenever we talk about growth, and debate the questions of growth, the conversation always goes -- almost like a knee jerk -- to public capital, to government intervention. And yet we know that private capital is infinitely more flexible and more creative than public capital is. And so the knee-jerk reaction is one that we simply have to get by.

We are hopeful that the work that's done by the PCRI will introduce a whole series of new thoughts, and may suggest some solutions to the problems that we face today.

Let me close with a note of thanks to Martin and the Brookings. Martin's been an active and good partner in this effort. And the Brookings, of course, is the Brookings -- the finest institution of its kind in the country. And we're very grateful for their support.

Let me now introduce out keynote speaker, the noted columnist David Brooks.

David?

**Morning Keynote: Can America Get Its Entrepreneurial Groove Back?**

MR. BROOKS: I guess lacking as much expertise as anybody else in this room, I thought I would give sort of a background on the values, the environment, and the historical forces that I think shape private capital markets and entrepreneurialism in America.

And the story begins about four or five hundred years ago. The first European settles come to this shore, and see -- they see forest stretching off into infinity, flocks of geese so big it takes them 45 minutes to take off. And they're just stunned by the material abundance of the country.

And they have two simultaneous thoughts. The one is that God's plan for humanity can be completed here. And the second is, they're going to get really rich in the process.

And so this is the essence of American capitalism, the idea that we have a moral materialism. We are materialists working on matter. As the Puritans said, "We have two callings: a rowing for heaven, and a rowing for wealth." And these two things in American culture are intertwined and hard to pull apart.

And this driving moral materialism has given us what America has always been known for, which is energy. We move more often than people in any other country. We switch jobs more often. The job tenure in the U.S., on average, is about seven years, whereas it's 10 years in France, 11 years in Germany and Japan.

We switch religions more often. I recall covering a Democratic presidential field where very single candidate in the primary presidential field had switched religions, switched denominations. Howard Dean switched from, I think, Episcopal to Baptist because he didn't like the Episcopal policy on a bike path in Burlington, Vermont. (Laughter.)

We volunteer more often. Eighty percent of Americans belong to a voluntary organization, compared to 36 percent of Italians and Japanese.

We dine out more often. Fifty-seven percent of Americans eat out in a given week, compared to about 12 percent of the French.

And so we have 5 percent of the world population, roughly 20 to 25 percent of world GDP, three-quarters of the Nobel laureates. Some of the best schools in the world, some of the worst schools in the world. And as Seymour Martin Lipset wrote, "We are an outlier nation because we are driven by a spiritual wind."

And this creates a climate of entrepreneurialism which I think is different -- others have different -- everybody has a spirit of entrepreneurialism in their country. I think you have fewer entrepreneurs in other countries than in this country, where the people think they are creating new futures, when they think their mission -- it's not only to make money, though that's part of it, it's to change the world.

And so this is a cultural underlie that underlies American entrepreneurialism and the capitalists who fund it.

The second thing we have is we have a political system that grew out of this culture, designed to nurture capital formation and capital movement. This political system was pioneered by Alexander Hamilton.

And Hamilton, too, has his own value system. When Hamilton was 10, his father abandoned him. When he was 12, his mother died, in the bed next to him. He was adopted by a cousin, who committed suicide within a year. He was then adopted by his aunt and uncle, who died within a year and a grandmother, who also died within that year.

So between the ages of 10 and 14, Hamilton had lost every single person he loved, except for his brother. And a court actually took away all of his property.

By 17, he was managing a trading firm. By 24, he was George Washington's chief of staff. By 34, he had written the Federalist Papers and was New York's most successful lawyer. By 40, he was stepping down as the most successful Treasury Secretary in American history.

And so he created, and helped create, a system of capitalism, which was designed for poor boys like himself -- people who came from nothing and wanted to succeed. And this involved creating the credit markets, as we know them today. It

involved sometimes using government money to fund manufacturing. It involved using government to break up the oligarchs, like Thomas Jefferson, to create fluid and open capitalism, and fluid and open credit markets.

And so this was the political tradition. We have sort of two parties in this country, but we have three traditions. We have a liberal tradition that believes in using government to enhance equality. We have a conservative tradition that believes in limited government to enhance freedom. But this Hamiltonian tradition is sort of in the middle, and sort of spans both parties -- more or less -- at a given historical moment, that believes in using government in limited, energetic ways, to enhance capitalism and to enhance social mobility.

And this tradition created the early industrial era of Hamilton's day, and then it sort of was embodied by the Whig party, then it was embodied by the early Republican Party with the Homestead Act, or Land Grant legislation, and the Railroad Act, and other pieces of legislation -- which involved using government to enhance the atmosphere for dynamic capital.

And this led to an entirely different political-economic culture than in other countries. In the 19th century, the Europeans spent heavily on their welfare states. We spent heavily on our education systems. And over and over again, we've had the choice between achievement and equality, and Americans have tended to favor achievement. We've had the choice between security and dynamism; we've tended to favor dynamism -- with real human costs.

But the key was -- the key to the value system underlying American capitalism is the balance between moral and the materialism. The key to the Hamiltonian system was the balance between government and private markets, private capital

markets. And it was always achieving that balance, and maintaining that balance, that was the key to the prosperity through the 19th century.

Now I would say over the last few years -- especially in the last three or four years -- we've a bit lost that balance, which explains sort of the crisis of confidence the country is in now. Sixty percent -- or 60 or 70 percent Americans think America is in decline. A tremendous loss of faith in institutions, and especially in the financial markets.

Now, I'd say that loss of faith, and the crisis we now find ourselves in, has a series of deep causes. One of them is a shift in values. From a sense of balance of what to achieve and what not to achieve, I'd say that balance got out of whack over the last 30 years. One of my favorite polling statistics over the last generation or so is this one: Gallup asked high-school seniors in 1950, "Are you a very important person?" And in 1950, 12 percent of high-school seniors said, "Yes, I'm a very important person." They asked that same question in 2005, and it wasn't 12 percent, it was 80 percent who said, "I'm a very important person."

And that's one thing -- I could go on for hours about this, but that was a cultural shift. A cultural shift from a culture of self-effacement that says, "I'm no better than anybody else, but nobody's better than me," of sense of limitation of what you should do, to a culture of self-enhancement, that says, "I am pretty special." We spent a generation telling people, "You're incredibly special," and they believed us. (Laughter.)

And so this shift produced some real-world changes. One, if you think you're pretty special, you're going to spend on yourself as befits your station. And so personal consumption, which is about 60 percent of GDP throughout the 20th century, shoots up to 70 percent starting in 1970. Personal debt, which is about 43 percent of GDP over the course of the 20th century shoots up to 133 percent starting in the 1970s.

Attitudes toward risk -- if you think you're pretty special, you're going to be willing to tolerate huge amounts of risk. And we're seen in the capital markets and in entrepreneurialism, and especially on Wall Street, an incredible risk tolerance over the past 20 or 30 years, which has led to this boom-and-bust psychology, which has a tremendously corrosive effect on the general public.

Another factor that's changed is compensation patterns. Throughout the 20th century there were many companies making a lot of money. Their CEOs could have asked for huge compensation packages. There are many reasons they didn't but one of them was social norms. You just didn't ask for a $20 million a year compensation package, because that would have been shameful. But starting in 1970, compensation packages begin to shoot up because it seems fine, and those norms are eroded.

And then finally: polarization. If you have a modest sense of yourself, you feel, well, I need people to disagree with me, because I need the debate. I rely on the debate, and I rely on the other side. If you think you're pretty special, and you have 100 percent of the truth, than the people who disagree with you are just in the way.

And so I think this shift in culture has contributed to a lot of social problems, including the debt, the boom-and-bust cycle, and the polarization.

The second challenge is what Mancur Olson called "demosclerosis," the rise of institutions which burden, especially, the political system -- the tax code, the regulatory code, the special interest groups like Grover Norquist, which rule out any tax increases for anybody on the Republican side. We've had an agglomeration of these interest groups, which serve as carbuncles on the body politic. And they've just built up slowly over time, but they now impinge anybody in power.

The third challenge is what I think -- and I'm persuaded by this -- the great technological stagnation. Tyler Cowen has written has about this. A number of

people have written about this, the idea that technology, which was improving so quickly during the 20th century, has hit a phase of stagnation -- not forever, but a phase of stagnation. And I highly recommend Cowen's book on this subject. He points out that if you were born in 1900, you were born into horse-and-carriage world. But if you died in 1969, you died in a moonwalking world. That's a huge technological advance over 70 years.

We've now entered a phase where technological advance has slowed down in many fields, with the exception, you would say, of IT and probably robotics. But our kitchens look pretty much the way kitchens looking when we were born. Our energy sources look pretty much the way our energy sources looked when we were born. Our airplanes are pretty much the same as the airplanes we used when we were born. Pharmaceuticals have seen this slow growth of stagnation.

Cowen's argument is we've seized the low hanging fruit, and now we face much tougher challenges. And I observe this myself when I go to NIH and take to the geneticists. You talk to the geneticists and they'll say, "Ten years ago, I really thought we were going to understand these problems in my lifetime. Now we realize they're much more complicated than I thought, and we will not solve them in my lifetime." So there's sort of a double-hump of the learning curve. We climbed to the top, thought it was going to be straight up, but then complexity came in and we were all the way down here again.

And so that's the third challenge. And so it's led to this long economic slowdown.

So I've tried to describe, first, the historical values underlying American capitalism. Second: the political system. And third, the challenge we find ourselves under.

And so the question becomes, is this indeed -- these challenges, is this long-term decline, which will drag American capitalism to a state of stagnation, or is it a recuperation of -- a winter of recuperation? We're just in a down phase, and we're going to come back stronger than ever?

I happen to think we're in a -- well, the majority of Americans clearly think this is the beginning of long, slow decline. That our capitalism is becoming ossified.

I think that's wrong. The America that the founds, our ancestors, came to, the America that Alexis de Tocqueville came to, is still basically the America that we live in today. The values and the culture are the same.

Second, we're in a period of incredible social repair. Government is terrible. But American society is actually in pretty good shape. Crime is down 70 percent. Domestic violence is down 50 percent. Teenage pregnancy is down 30 percent. Teenage suicide is down. Divorce rates are coming down.

And so people -- the younger generation in particular -- has done an incredible job of re-weaving the social fabric. They're an incredibly hardworking, responsible generation -- or we're going to have the biggest mid-life crisis in human history in about 10 years. (Laughter.) But up until then, we're in a period of incredible social repair.

Third -- demographics. I'm going to get the numbers slightly wrong, but by 2050, the average age in China will be about 52, in Japan 52, in the U.S. it will be 38. And so that's the sign of a hopeful country.

We still are a low corruption country. We still are a hardworking country. We still have competitive industries.

But the most vital thing is, is that we still have the ingredients for creativity here. We have the fundamental ingredients for creativity.

And what are those ingredients? Well, it's in the social networks. What is creativity? There's a whole vast body of research on what creativity is. And basically, creativity is not starting and creating something new out of whole cloth. Creativity is taking two discordant idea networks and smashing them together.

So, for example, Picasso took Western art and African masks, and he smashed them together and came out with his art. Steve Jobs took computer geekdom and LSD-India-New Age hippiedom and he smashed them together, and created his creativity.

And so we still have a dynamic culture, which encourages that kind of smashing of idea networks. And that's because, second, what do you need idea networks smashed together? You need what the historians call "verges." Verges are a place where discordant cultures come together. And we still remain a crossroad nation, where people from all over the world come together and share ideas. We have a tremendous tolerance for outsiders. And so we have a tremendous talent for creating hubs. Creativity depends on hubs and social networks.

The most important ingredient to entrepreneurial activity is creating places where people can go, leave, go to again. Howard Gardner of Harvard has a quintessential create person, and the life span of a creative person. And he says this person, she comes from the periphery. She lives off on the edge of society somewhere. She feels alone when she's in her hometown. And she feels herself outgrowing her small circle. So she goes to the big city and finds a lot of people like herself, and forms a group of people with people like herself. She gets involved in a team and they work on a problem.

But then after working the problem with a team for a little while, she has her own independent interests, and she goes off on her own. And she works on this

interest on her own, leaving the team. Then she emerges with some new thing. Then she brings it back to the team. They test it, they work on it, it fails, and they build it.

So it's this process of going to the hub, leaving the hub, going to the hub, leaving the hub. This idea of creative networks -- flexible and rich networks.

These flexible and rich networks don't just happen out of nowhere. You can't just build them with a government program. They depend on incredibly high degrees of social trust. "Spontaneous sociability" is what the sociologists call it. You could be off in Dubai somewhere, and you can build a lot of buildings together, but if you don't have that spontaneous sociability, you're not going to get the networks, you're not going to get the creativity. And this is something we do phenomenally well here naturally.

By contrast, look at Edward Banfield's work on southern Italy. People had tremendous trust for people within their own families. They did not trust people outside the families. So the firms could grow as long as they could employ only family members. They had trouble growing when they stepped outside the family bonds.

But we have that spontaneous sociability. We're incredibly good at creating clusters deep in American culture. We're incredibly good at creating new cities -- a new Mesa, Arizona, a new Silicon Valley. Cities work because they are hubs. They magnify talent. Urban incomes rise faster because productivity of urban workers rises faster than the productivity of rural workers.

People are smarter because they work better in teams. And they work better when those teams are face-to-face. The University of Michigan did these studies where they gave people tests, math tests. Some groups met face-to-face and they were given 10 minutes to do the test. And they could solve the math, no problem. Some groups were given 30 minutes to solve the test, but they had to communicate electronically. They could not solve the problem. Because so much of our

communication is by intonation of voice, by gesture, you need to be there together in the hub. And so you need that physical hub-ness.

And so we have, even despite the crisis, we still have the culture that we inherited from our ancestors, that culture of social trust, spontaneous sociability, of creating hubs. And out of that culture emerges the private capital industry, the venture capital industry, and others like it, which are really good at creating temporary communities.

The most accurate movie about American history is a John Ford movie called *My Darling Clementine*. Most of the westerns -- I think Henry Fonda was in this movie as Wyatt Earp -- most of the westerns are about shootouts, and the lone cowboy off on the range. *My Darling Clementine* is about people coming together out of nowhere and building a community. They put up a church. A barber moves to town. A newspaper is formed. The sheriff comes in and establishes law and order. And so it's not about the lone guy out on the range, it's about community-building -- achieving a purpose and then leaving to build another community. It's that community, leave, build another community.

And that's what the capital industries do. They gather people together and build those communities.

And so to take advantage of the underlying culture, we've obviously got to do two things. We've got to have government policies that will be in accordance with our underlying culture. And now there's a big debate -- which I'm sure others will talk about, with more information than I -- which is how deeply should government get involved?

Now, I have to say, when I interview politicians on this subject, I ask them a trick question. I ask them, "What industries do you think are the real industries of

the future? What's going to really create a lot of jobs in the future?" Now the correct answer, when I ask a politician that question is, "How the hell should I know? I'm a politician?" (Laughter.) And I sometimes get that answer. In this administration some senior people give me a different answer. They name a series of industries they think are going to be the keys to the future. Other people in this industry give me what I think is the right answer, in this administration, give me the right answer. So I think there's a split.

And so the question is, how deeply involved is government going to be in this field? If the zero-yard-line is government should just provide police forces, and the 100-yard-line is government should be picking winners and losers and all that stuff, then me, I'm on our own 40-yard-line. Some people are on the 60-yard-line. Some people are stuck on the 40.

But that seems to me the debate. And it seems to me the lessons of the last few years have underlined the case that all of us who believe in staying on our side of the 50-yard-line has always made -- that government has essential problems in getting too involved in funding private business. There's the epistemological problem -- government just doesn't know enough. None of us know enough. There's a related problem -- the inability to fail productively. Private capital firms can fail productively, learn from that failure, and the market can move forward. Government is terrible at learning from failure.

There's the corruption problem and the regulatory capture problem. There's the politicization of goals. Government necessarily wants to expand the labor force. Most firms are trying to reduce their labor costs.

And so, to me, these are all endemic, and they haven't been solved. And even though we're in a moment when a lot of people are arguing for a more

aggressive industrial policy, I think the fundamental truths still apply. They're embodied not only in Solyndra -- Steve Mufson had an article on a whole series of failures.

But even if you're like me and you think government should only be on the 40-yard-line and below, there's still a ton of stuff to do. Or -- Josh Lerner is here, who calls it "table-setting activity." And there's stuff to do like the Simpson-Bowles, to ensure fiscal future. Stuff to do like tax reform, corporate tax reform. A second generation of human capital policies.

We've done a great job of getting people into college. We've done a terrible job of getting them through college, providing them with the human capital they need to actually get a degree. Basic research. Creating technical universities, like Robert Steel and Mayor Bloomberg are doing up in New York. Fixing patent law. Fixing regulatory processes. Doing infrastructure. Fixing export controls. Creating clustering with zoning and other metropolitan policies. Creating one-stop career centers. You can go to the Kauffman Foundation, or Mackenzie, or Milken, AEI, Manhattan Institute -- there are good ideas, what Lerner would call table-setting ideas, which are just bubbling forth. There's plenty of good stuff to do without having to interfere too severely, crossing the 40-yard-line.

And then the final thing -- I'll just end on this -- is what private capital can do itself. Now, the industry is about to become a pariah. When Mitt Romney's running for president, his time at Bain is about to become a major issue in the campaign. And there's just going to be a wall of crap -- garbage (laughter) -- thrown at the industry.

And, you know, the smart thing probably would be to do a little preemptive publicity to get the news out there of what actually private capital does. The second thing to do is just keep your head down and do your job. But that's just going to be what's coming.

But keeping your head down and doing one's job is probably the right thing, and harkens back to the theme I started with -- the theme of balance.

I do think there's a sense -- one of the reasons the animal spirits are low is because there's a sense we've had this boom-and-bust cycle, and nothing is real. Effort is divorced from award. And to me, doing one's job, and picking entrepreneurs correctly, picking teams correctly, picking companies correctly, is a question of balance.

I'm a huge believer in Jim Collins' finding that the people most likely to succeed, either as entrepreneurs or in any other field of business endeavor, are those who combine these two balanced traits. Collins says they are extreme professional humility combined with intense personal will. And these two things are in tension with each other, but they're both the necessary traits for success in business.

I'm also a big believer in what Sarasvathy found, which is the distinction between people whose minds necessarily flow in corporate direction, and people whose minds necessarily flow in entrepreneurial directions. Sarasvathy says that corporate people do causal reasoning. They define a big goal, and then they march steadily toward that goal entrepreneurs possess what she calls "effectual reasoning." They define very vague goals. And their progress is a series of unpredictable improvisation toward that vague goal.

And finding people of that skill, it's people who have certain mental virtues. The virtues are what the scientists call "meta-cognition," the ability to see what you don't know. So they combine this intense personal drive with modesty bootstraps -- the ability to correct for their own overconfidence. We tend to be incredibly overconfident people. *Time* magazine recently asked Americans, "Are you in the top 1 percent of earners," and 19 percent of Americans are in the top 1 percent of earners. (Laughter.)

And so they correct for things like -- they correct with things like modesty bootstraps. The best one I read was recently, it's called the pre-mortem. Before you make a decision, write a short story about what would happen if that decision went horribly wrong -- which is the thing we tend not to think about before the decision.

They'll be aware of things like the focusing illusion. Nothing is as important as we think it is at the moment we're thinking of it. And so, for example, we think that education is really powerful in shaping inequality in this country. And that's true. Education is the most powerful thing in shaping inequality.

But if we equalized education in this country, we would reduce inequality by less than 15 percent. So there's a zillion other factors, and we should focus on some -- things like path-dependence. We should be aware that every circumstance we're in the middle of existed for some historical reason, but which may not exist for a good reason now.

The Pareto principle -- we tend to be under the illusion that all curves are bell-curves that most people are in the middle. But the Pareto principle holds that 20 percent of the employees do 80 percent of the productivity. That 5 percent of the Twitter users produce like 90 percent of the tweets.

And so we have this illusion that things are always bell-curves. Things are not always bell-curves.

So what these successful entrepreneurs have is this balance, this balance between extreme personal daring, and extreme modesty about what they know -- this epistemological modesty.

And so I've tried to describe very quickly, to lay an underground for all the more substantive discussion to follow, the historical forces facing American entrepreneurialism and American capital markets, the historical structure that Alexander

Hamilton and others have created to give us a superstructure for capital markets. And then the current crisis that we find ourselves in the middle of, which I think has value, values and philosophical basis. And then, finally, just to remind us that we have these underlying strengths -- dynamism, the flexibility, our ability to create spontaneous sociability and networks.

And then, finally, the tasks ahead which, to me, are about government setting the table, staying on this side of the 40-yard-line -- and entrepreneurs creating a more balanced and sustainable system for funding entrepreneurs.

And my basic belief is that we're going to have a very bad 10 years in this city. We're going to have a fiscal crackup at some point. I once asked somebody in this administration, "Do you think we'll avoid a fiscal crisis in the next 10 years?" And he said, "Nah, I don't really see that." And so I said, "Well, how bad will it be? Will it be like Greece? Or will it be like the decline and fall of the Roman Empire?" And he said, "Well, probably a little worse than Greece, not as bad as Rome -- sort of in the middle there." (Laughter.) And I basically agree with that.

But the good news is that we have tremendously strong values, tremendously strong institutions. And we have this ethos of daring, and we have people willing to fund that daring and create the communities that build companies. So we'll be okay after a bad 10 years.

Thank you very much. (Applause.)

SPEAKER: (Inaudible) -- questions?

MR. BROOKS: Okay. Sure.

MR. HEDERMAN: Thank you. Bill Hederman, from Deloitte.

I want to thank you for solving one of the big mysteries I've had for a long time, which was -- as someone who grew up in Brooklyn, how come I can't get a good

pizza outside of New York? Now, I know it's just Italians only trust their family -- (laughter) -- and non-Italians building pizza franchises.

But my question was related to the point you made about shame and corporate executive compensation. That made sense when you said it, but as you went on, I'm going, gee, the entrepreneurs have gone far beyond that compensation.

And I just was wondering if you could speak to that difference?

MR. BROOKS: First, they're probably going to -- well, I won't -- there are probably Chinese firms in China that are making fabulous pizza that are going to take over. (Laughter.) And I should also mention -- you mentioned Brooklyn. There are various strains -- and I'm fascinated by these strains that run through families. If you look at *Who's Who in the 20th Century*, that book in 1950, the number of people who had parents who were missionaries in China is phenomenal. Way disproportionate. You get incredibly driven.

And similarly, if you look at entrepreneurs today, the number of people who could trace their ancestry back to the textile business in Brooklyn, either by one or two generations, is phenomenal -- including Steve Jobs, by the way. The number of entrepreneurs, really big entrepreneurs who had people working in the "schmatta business," as we say in my faith, tradition.

Now, the point about the shame, and why entrepreneurs can earn more -- there is a certain -- I wrote a column about this last week -- certain social status which is peculiar by industry. So if you make a product that's used by yuppies, like the iPhone, you can make a zillion dollars and nobody things the worse of you. If you make a product not used by yuppies, like a turbine, you better not earn too much. And so there's that difference.

But the more serious thing is -- and I think this undergirds a lot of our politics -- there is an equation people have in their head between effort and reward. People think if you took your average Tea Party person, he went to high school; he worked hard when nobody else was. He went to college, maybe he wanted to major in history, but he knew he needed a job so he became an accountant. He bought a house he could afford when people around him were not buying a house they could afford.

All along the road he played by the rules. And he things his effort should be rewarded. And he looks around the society and, because of the bailouts, because of the compensation packages -- especially in finance -- he says, "Those people are not playing by the rules. They're getting bailed out. And I'm paying the bill. There's been a severance of the link between effort and reward. And I want that put back."

And so if you make a zillion dollars, like a Steve Jobs or Bill Gates, but I can see how your compensation is related to effort, then people don't have a problem with that. If you're part of a group of young people on Wall Street who, the compensation happens to reward you for minimal effort, or for average effort, and I don't see the link, then I do have a problem with that.

So it's really establishing that values link, rather than the overall number of your salary. That's the key.

SPEAKER: Well, let me ask you a question.

You mentioned teamwork. Do you think our education system teaches people how to do teamwork?

MR. BROOKS: Ahh -- no. (Laughs.) You know, what teaches people how to do teamwork, it's mom. And this is actually a problem. Scientists can predict at 18 months who's going to graduate from high school. Because what they do is they take a look at infants in a room, they give them what they call the "strange situation test." An

infant goes in a room with mom. Mom leaves the room, stranger comes in, mom comes back into the room. They watch the infant at each of these transition moments.

And about 55 percent of the infants in this country have what they call "secure attachment." And those kids cry a little when mom leaves, but then they settle themselves and they run to greet her when she comes back.

Those kids have in their head a model -- a model for how to build a relationship with mom. And then when they get to school they use that model, how to build a relationship with teacher, how to build a relationship with peers. And they are generally, on average, reasonably good team-builders and members of a group.

Twenty percent of the kids in this country are what they call "avoidingly attached." And those kids, they sent signals to mom but nothing's come back. And so those kids, when they go to teacher -- a teacher described it in one thing I read -- like a sailboat tacking into the wind. Wanting to get close to the teacher, not knowing how. And those kids do much less well in school because they don't know how to build relationships. And even in adulthood, they tend to be more aloof. They have, according to one study, two-thirds fewer friends at age 70.

And then another 20 percent are what they call "have disorganized attachment." Home has been completely chaotic. They're terrible at forming teams.

And so it's not really school's job to make people good at team-building, it's family structure that does it. It's the models laid down in people's head at phenomenally early ages. And I should say nobody's life is determined by 18 months, but these early experiences open up pathways, which can be confirmed or de-confirmed by later experience.

And so one of the problems we face in the country is that 40 percent of kids are born out of wedlock -- 70 percent of African Americans, 65 of Hispanics, about

55 percent of Whites whose parents have high school degrees. And so those people, on average -- again, on average -- are going to be less able team-builders. And that's one of the reasons, by the way, we see the huge social inequality between college-educated and less-college-educated people.

So to me, you know, schools can compensate if they're KIPP Academies. But the underlying social fabric is being eaten away a bit by that problem, which is going to make it hard to build communal teams.

SPEAKER: Do we have time for one more question?

MR. BROOKS: Over there.

SPEAKER: I agree with you that it's difficult for anybody, including government, to pick winners. But how would you assess DARPA, which seems to have been able to pick winners and further certain industries. How would you analyze DARPA?

MR. BROOKS: Well, again, I would go back to my football, which is staying on the 40-yard-line, or the table-setting analogy. And there are many other people in this room -- you should ask this later in the day -- but my impression from the research is that you can create the original idea. You can go up to NIH and show the basic research. But actually bringing that idea to market is probably best done by somebody else because it involves a lot of failures.

Government just doesn't fail well. When things fail they don't die off. And we don't -- the people who tend to go into government are not the people who have that kind of mind-set that I described.

And so DARPA, I think, is an example of a group of people who, A, were outliers within government -- because it's sort of a unique entity -- who experimented and created this thing which was then brought to market by other people. So they set the

table, but I would not say they actually created the companies. And so, in some sense, that's a reasonably good example. NIH is another reasonably good example. Creating a technical university in New York, funding great colleges and great universities, doing the basic research -- those are all fine examples of setting the table.

And you can point to examples where government actually brought something closer to market. And other people in this room have done a lot of work on this. I would say that's by far the exception, and by far overshadowed by the syn-fuels, by the fusion, by all the experiments that government has done that didn't work out.

Anyway, thank you very much.

MR. BAILY: Okay. Thank you. We're going to look now at the state of private capital and its future potential. I'm going to just start us off. I'm then going to hand over to Ronnie Chatterji, who is an Associate Professor at Duke University in the School of Business; done a lot of work on the issues that we're talking about today: venture capital, angel investing and teaches a lot of courses in that area.

I'm very pleased to welcome Michael Klein. He was one of the pioneers within Citi in setting up a private equity group. He's now the managing partner of Invest America. So, let me just start off, and then I will hand off to these folks to talk some more about the issues.

Just to sort of set the stage in the beginning, we've had a real estate fueled bubble, a real estate fueled recovery. We've now sort of got to look somewhere else. I don't think real estate is going to carry us back to the kind of growth rate that we've had in the past that we need to get full employment back

in this economy.

As you see from this chart, investment is growing so businesses are investing, but certainly not at the same level; we don't have the same level of investment. So, we need sort of a shot in the arm, in terms of investment in capital formation to contribute to recovery.

One of the things that characterizes the success of the American economy has been the number of new companies that are formed. There are different ways to measure this. It's a tough thing to measure, but this chart shows how the rate of new private sector establishments are being launched every year from 1993 to 2010, and you can see it goes up and down with the business cycle. It's taken a very big hit in this recession and has not yet really come back. So, that's the second thing we need to get this economy going again, is that entrepreneurship, that ability to form new companies. Many of those will fail, but some will succeed and some will grow and provide a lot of new employment.

So, that's the sort of context in which we want to talk about; the potential role for private capital. Can it help in getting investment going again? Can it help in entrepreneurship, new companies? And there, I think, is where I will turn it over to Ronnie. Thank you.

MR. CHATTERJI: Thanks, Martin. And I'll talk for about 10 minutes and then hand it over to Michael Klein. We were all in the 55 percent of the 18-month olds who were able to work together, so it's been a really great process working with both of them on this project.

So, what we want to do today is facilitate a discussion about the role of private capital in the economy and how it might drive economic growth. And when we think about private capital, there are a few different categories that we're going to discuss today, and these categories aren't necessarily mutually exclusive in all cases.

So when we think about angel investors, we're thinking about wealthy individuals who typically invest their time and money in nacen ventures. Really, it accounts for around $20 billion in 2010; a very small amount of money compared to the rest of the capital structure here, but in many ways, very, very, important to the ecosystem in trying to get entrepreneurs started.

Venture capitalists are much heralded intermediaries who channel investment, private capital to start up companies, and they had $167 billion in what they called dry powder to invest at the beginning of this year.

There's been a lot of talk about corporations, a lot of news coverage on cash-on-hand and why corporations are holding $1.9 trillion on their balance sheets. We're going to talk about that a little bit; private equity and sovereign wealth funds, both imported and financial investors, as well. Michael will talk a little bit more in detail about that.

The big question you want to think about here is -- you know, you look at these sources of capital. What are the challenges in terms of unlocking these and channeling them to productive investments? Martin set the stage by giving us a sense that the last decade was characterized by a booming investment of real estate, and it turned out not to be a sustainable foundation of

growth. What we're trying to do here is think about how you might channel investment from these sources to more productive and sustainable investments.

So, you know, when I worked for Carl Shapiro -- he's here in the audience -- at the Whitehouse, we looked at a lot of the policies around the world to encourage entrepreneurship and innovation. And I think what everyone in this room knows is that other countries are not standing still when it comes to encouraging their entrepreneurial ecosystem. So, if you go to Chile now, they have a program called Startup Chile, which is trying to attract entrepreneurs to locate in Chile. The have programs in China and India to attract returnees, people who have come to the United States and the U.K. to come back to China and India to start new businesses.

There are also concerted efforts to develop intercapital markets. If you read Josh Learner's book, very few of these have actually been successful. Israel is profiled in the book. Start-up Nation might be one example of that.

There have also been efforts to try to revive the small cap IPO market. In London they have the AIM market which has had some limited success, so far. And, as a result of this sort of foreign competition there have been numerous calls to refine U.S. policies in this area. And it really goes to what David Brooks has talked about and Josh Learner has talked about in his book, which is what is the function of government?

On one hand, you have the table-setting approach, which is, you know, low and stable tax rates and effective immigration system that brings high-skilled people here to the United States, strong intellectual property laws, and

developed and robust financial markets. And I use a much less elegant term than Josh to describe the other function. Maybe this is on the 60- or 70-yard line, which is, instead of setting the table, should the government be cooking dinner. All right?

So, on top of the table, you think about the Government providing venture capital, low cost loans. You hear a lot about this with the Department of Energy loan program in particular, but a lot of this is also coming from other countries. If you look at what Chinese banks are doing to support their green energy producers, it's much more in the cooking dinner category than it is setting the table. So definitely an interesting debate that should be had today on what the right role for public policy is. Even if we're between that 40- and 60-yard line that David articulated, what is the proper role for government in trying to harness these sources of private capital?

Let me talk a little bit about the sources in detail. So, if you look at angel investing, typically these wealthy individuals, sometimes they'll be accredited investors by the SEC; sometimes not, you know, only $20 billion. So, you might think this isn't very important as part of the larger picture. But if you look at the amount of ventures they actually touched the best data we have says they touch about 61,000 ventures per year.

To give you a sense of magnitude, there are about 600,000 businesses founded in the U.S. every year. So, 61,000 is a considerable proportion of that; 370,000 jobs attributed to angels. They're also widespread across industries. This is not a narrow phenomenon in one or two industries.

You're looking at healthcare, devices, biotech, software, a wide variety of industrial sectors where angel investors are having an impact.

I think, to Joe's point earlier, and Josh's work on private equity, there's not a lot of good data on angel investing. It really only comes from one source, and we need more rigorous data to figure out how we're going to think about policy in this area. It hasn't stopped 26 states though. They have angel tax credits to incentivize angel investment. And, you know, in our work, in our research, we haven't found any examples of cost benefit analyses on these angel task credits; so, very interesting policies, but really haven't been analyzed to figure out where the bang for the buck is.

The other thing that hits angel investors quite a bit is the accredited investor rules under Dodd-Frank. There were recent changes now that have been rolled back that made it more difficult for angels to qualify as accredited investors and they actually raised a lot of concern about that. So those are the two policy areas, I think, to look at when you're thinking about angels: the tax credit side and the definition of accredited investors.

Now, venture capital is a story that people know a lot better. And instead of putting a lot of words on the slide, I thought I'd show you this chart, which kind of tells you the story of the last generation of venture capital.

So, of course, we had a big boom in the late 1990s with the internet bubble, and people are well familiar with the great companies. It seemed at that time, if you had dot com in your name, you could actually go public and, apparently, people thought you had a reasonable business model. Well, we

found out that wasn't true. And now venture capital, in terms of amount raised, is quite a bit lower than it was and it hasn't recovered to it's pre-2000 level. But there's a question here when you look at this data, and this is where I think the academic research that Josh and other people are doing is really important.

So, if you look at what's challenging in the venture capital market, one thing you'll hear from the VCs is, "Well, the way we make money in venture capital is through exits. We invest in companies and then we have a liquidity event; typically a merger and acquisition or, hopefully, an IPO. And often, it's that one company out of the 10 in the portfolio that goes public that justifies the entire investment."

So, if you look at what happened in U.S. initial public offerings this is actually the real story of venture capital from their perspective. And you look at, again, after a boom in the late 1990s and 2000s, the IPO market hasn't really recovered. And this is something that predates the Obama Administration and begins way back in 2000.

So, one issue for VCs is trying to get a return on their investment. If the IPO market is weak, if not enough companies are going public, then the venture capital business model is threatened and that's causing a lot of interesting changes in the industry and a lot of calls for changes to policy.

So, one of the things that the VCs will often tell you is that there's barriers to going public and they often point to the villain of Sarbanes-Oxley, in particularly, 404(b), which has to do with internal audit controls. Maybe we can talk about this more in detail later, but this is the most frequent refrain that I hear.

If you look at the statistics, the average age at initial public offering has gone to about 10 years as opposed to seven years. Typically, venture capitalists were organized into partnerships that last between, let's say, five and seven years, might be more difficult as these companies get older before they go public and can get liquid.

You know, there is also a lot of policy uncertainty that VCs are facing. One of the things has to do with FDA regulation. If you talk to anyone from the biotech or medical device sector, they'll have a lot of concerns about the FDA process and how quickly they can get products approved.

Essential to their business model is getting products through the pipeline very quickly. In pharma now it takes a long time. Medical devices are often ahead of 510(k) process where you can get products to market much more quickly. That looks like it's going to change. There's a lot of concern around that.

Also, on cleantech and the lack of a price on carbon; without a consistence or policy towards energy, a lot of venture capitalists are unsure about how to invest in this section and it's caused a lot of concern.

And the one you hear most about, which really surprised me, I think, when I went to Silicon Valley and talked to people in North Carolina, is immigration. That often comes before these first two. Venture capitalists, especially, are very concerned about trying to attract the right people to this country and keep them here. So, policies like stapling a green card to people who get PhDs in stem areas, trying to have a startup visa to encourage people

who start companies here that stay here, these are high on the agenda if you talk to a lot of VCs.

One thing is that, you know, not all venture capitalists are actually doing badly. There are a few top firms that are actually doing really, really well. The problem, as it were, is they're actually getting bigger. They're raising larger funds and moving much more towards less risky bigger staged products, so there's a lot of worry that we might see less investment in the early stage capital.

And so, for the Hamiltonian vision that David Brooks articulated, you really need to have providers and capital for those early stage investors, the person with an idea, right? And these guys tend to be moving up more towards the middle range, and that's causing a lot of concern as well.

There is also this issue about how big the venture capital market should be. I showed you that chart about the number of investments and about the value of investments. But Josh Learner, in his work, has actually looked at this and calculated the percentage of VC compared to the public equity market. So, if you look at that, the proportion has actually been quite stable over time. So, we can't look at the size of the venture capital market in isolation; we have to look at it in the context of other capital sources, and that's a really important point to make.

The other point I'll spend a little time on is the cash-on-hand issue. If you read the paper over the last year, you'll see a lot of concern over what do we attribute this corporate cash buildup? Where is this $1.9 trillion coming from and why aren't companies invested? And I would think there's two camps, really,

when you think about the reasons. One camp said it's all about policy on certainty and regulatory overreach. In the way of Dodd-Frank and the Affordable Care Act, companies, as the story goes, are afraid to invest because they don't know what the regulatory environment is going to look like; that's one hypothesis.

On the other side -- and this comes more from folks who subscribe to the Keynesian School of Economics, would say, "It's really about uncertainty about demand. I won't want to invest unless I know there are going to be customers with money in their pockets to buy my products." So there's lots of different ways we can look at this, and this is a great discussion to have.

One way might be a look at which firms are holding the cash and if they are in highly regulated industries. A quick cut of the data suggests it's mostly technology firms that are holding on to the majority of the cash; companies like SISCO and Google and eBay, rather than firms in what we might think of as highly regulated industries; lots of ways to look at this data and think about it.

You also have to look at borrowing costs. Borrowing costs are at an all-time low, so a lot of the cash-on-hand has been stockpiled by borrowing at low rates, and that's another thing that's really driving that up as well.

Now, the cash-on-hand has led to a lot of policy proposals from congress and others out there in the think-tank world in terms of how to harness that cash towards investment. The biggest idea has been around repatriation of foreign earnings. One idea is going to model this after the 2004 American Jobs Act and the Bush Administration and tie repatriation of cash offshore to

productive investments here in the United States. So, this is one creative way to try to channel capital on companies' balance sheets into productive investments.

The 2004 experience was not very encouraging. Most of the money from this ended up going into dividends and shared buy-backs. And so, when you're thinking about policy design you need to make sure you have a mechanism in place to try channeling the investments to productive sources.

Corporate tax reform, again, is going to be a huge issue in this area. Most people agree we need to broaden the base by gaining real loopholes, and also make sure that we lower the rate, and that will be more competitive. Right now we have a 35 percent rate but it's like Swiss cheese where very few companies are actually paying that, so it's a really interesting point to look at how to do that.

The Obama Administration has done things on bonus appreciation, also, 100 percent expensing on capital investments to try and encourage companies to invest some of this capital.

So, private equity I'm going to leave to Michael. He's the expert who's worked in this industry for a long time. I think he's going to talk a lot about some of this controversy about private equities impact on the economy. There are a lot of things being thrown around, a lot of data being thrown around about what PE firms do, what the model is and what the impact is on jobs and productivity. Michael's going to talk a little bit about that. The sovereign wealth fund issue, also, I know Michael will touch on a little bit.

One thing to remember with the Sovereign Wealth Fund is they're

getting a lot of attention recently. It's really the top six funds that hold 75 percent of the assets. And even these top six funds are very diverse in what they invest in. So, thinking about sovereign wealth funds as one thing and one monolithic entity is probably not correct. These funds have very different missions, very different goals and very different restrictions on what they can invest in, also very different rules around transparency, which is one of the things that's been concerning policymakers for a long time.

The other thing, I think, to hit on later in some of these discussions on sovereign wealth funds -- we all remember the Dubai Ports World issue when there was a potential investment and there was a lot of concerns raised about national security.

One of the biggest issues when you have a foreign investment in the United States is what they call CFIUS review to go through this process. And policymakers are often reluctant to approve foreign investments in what we consider critical infrastructure. That's one potential barrier to the deployment of private capital. If sovereign wealth funds have, you know, $4.7 trillion right now under management, they might want to invest in some of these infrastructure projects, but CFIUS review and other issues might make that more difficult. So, we need to think about how to come to common ground on that, as well. I'll let Michael talk about that in more detail.

So what I'll leave you with is this: I think there are a few open questions to consider as we think about whether private capital can lead to sustainable and productive growth. One is that, can it do more? Right now we

think about some of the advantages in private capital as not being sort of straight-jacketed by the quarterly earnings pressure that you often see with public companies. The question is, if you look at angels and VCs and private equities and sovereign wealth funds, can they actually do more than they're doing? What kinds of policy instruments can actually make that happen?

However, I think you have to return to David Brooks' point about table-setting and cooking dinner. In our efforts to try to harness private capital for the common good, we might actually end up channeling into unproductive investments, wasting money, end up raising the ire of the public in terms of these investments that we make. So, I think the discussion today might want to focus on this, in terms of whether these interventions to channel risky capital into the common good might actually backfire, and how do we achieve that balance; I think that's the key point.

In terms of whether America has lost its entrepreneurial edge, I would just push people here to think about how we measure this. I mean, it's really great to think about big companies and IPOs. How do we want to measure America's entrepreneurial energy? Is it by the number of companies founded? Is it by the number of big billion dollar businesses founded? Is it the number of jobs? I think that that is sort of an important metric to think about when we think about where we're trying to go. We need to have a vision of what we're trying to do with private capital if we're going to know how to get there. I would encourage us to think about these questions as well.

So, why don't I stop here and I'll turn it over to Michael Klein to talk

about some of the other issues at hand here.

MR. KLEIN: Okay. Well, thank you very much, Ron. I think, under the spirit of teamwork, I'm hopeful that you'll see the questions that Ron has posed flowed neatly into some of the answers that we'll attempt to address right now. Let me thank Martin and Joe Rice for inviting me.

As Martin indicated earlier, I spent a large part of my career, probably 10 or 12 years helping to establish a process of, if you will, advising or allocating private equity, the breath of capital from venture capital to late-stage leverage buy-outs into what was a productive force for both investors and for corporates.

I've been a bit removed from that over the past several years as I've spent the bulk of my time working with governments on restructuring activity, which seems to be quite active, in particular, starting with the U.K. bank recapitalization scheme. So, I'm pleased to have a chance to have spent some time reengaging in this sector. And hopefully, today, we'll be able to look at some of the questions that Martin has asked me to address and try to give a sense of perspective.

And really, the questions that have been put forward are the five that are listed here. First and foremost is, is there a shortage of capital today? I think, when one looks at the allocation of capital, you'll have to start with the question of the quantum. Are the markets working to address and migrate that capital to growth? Are there fundamental structural impediments? And I think we will spend a fair bit of time on this question that David Brooks has set forward,

Josh has put forward, in terms of table-setting: where is the Government's role.

Is private capital part of the solution and what actions can be taken? I'm going to start by saying I'm actually quite an optimist here. And I would say, whether it's just returning from trips to Silicon Valley or, frankly, from Houston where Shell gas is changing the industrial competitiveness of the United States. I have a much more optimistic view of the state of the U.S., of the state of private capital and, frankly, this government and corporate and investor balance.

But, since I was coming to Washington, and since I thought I needed greater expertise, I checked the President's State of the Union to take a point of view on what was going on, and I looked -- and as you'll see, I chose not to look directly at the latest State of the Union, although, the first 10 or so points looked remarkably similar.

The unemployment is higher than we'd like. The extension of national insurance coverage, passage of free trade agreements; all this sounds pretty similar to the position we're in today: significant infrastructure investment, focus on balanced budgets, a real focus on exiting government from business enterprises, a new SBA program, $31.5 billion. And if this slide had faded in the way I had anticipated, you would've seen this and seen the last two points and said, "Well, is he a prognosticator or just a real optimist? And that is the largest tax cut in history and a 25 percent growth in GDP."

The point of this slide was to indicate that, actually, virtually all of the policies at the top of the page are policies that you could have read about in

the newspaper over the past several months and associated it with this administration. But, in fact, this State of the Union was from Dwight Eisenhower's State of the Union. And I point it out not because Karen Mills, who's a good friend, will be here with her focus on the SBA, not just because we have a member of the Council of Economic Advisors -- both of which, I remind you, were either started or restarted by Eisenhower -- but also this focus on a dichotomy; removing government from commercial industry, but inserting government in the creation of infrastructure, inserting government into the creation of better business practices, in particular, mentoring and creation of a sustainable small business population that could operate at the same levels as larger businesses. I think that balance is not only critical, but I think that balance will be an important factor in driving success, going forward.

So, as I jump in, I think it's important when we look at this question of where are we vis-à-vis, capital, to remember where we've come from. Pre the crisis, we had unprecedented liquidity.

I point you to just one or two numbers. There's $7 trillion of capital raised annually as of 2007. That's about 20 percent of what was the relevant GDP in those markets. That's an enormous number. Clearly, that fueled the global expansion. It fueled growth of over five percent in 100 countries. It fueled record growth for four out of five years. It took a tremendous number of individuals out of poverty in emerging countries. It created, fundamentally, great stability and low perception of risk in the marketplace.

But I think the area that I would really focus you on is, at every

point of a recession or economic challenge -- whether it was ‘81, whether it was ‘87 to ‘89, whether it was 2001 -- the path out of that recession involved a substantial raising of capital and the substantial uses and deploying of capital. So, the question today is do we actually have enough capital to drive out.

Now, to remember the state of 2007, so we can understand where we are today -- and I view it this way because I think every investor, every corporate CEO, every executive is looking through a window, which is called a financial crisis window. When the August market shivers came, it came largely because of a question was asked, "Are we acting like 2008 again?" We have a commodity price increase deflation. We then have a banking crisis; Europe, not Lehman. Will we have the industrial shut down? This crisis window is the path that we're all living in.

Pre-crisis, we had this degree of stability. We had China in the form of industrial enterprises putting capital into the market. We had metals, mining, oil, gas funds circling into the capital. And at our bottom box, the U.S. and Europe kept pace through financial mechanisms: leveraging of banks, creation of structured vehicles, continued development of financial mechanisms to keep that world spinning. And of course, that world spinning created great liquidity. And then the bubble burst. And when the bubble burst -- and this is a painful reminder, I think, for everyone -- but when the bubble burst just in the '07/'08 period, we had approximately five trillion of capital exit the system.

I put this number out because when you consider the seven trillion being raised per year, five trillion coming out of the system in one fell swoop, it's

really no surprise that we had the shock that we had. We took almost a full year of capital out of the system. It should be no surprise, then, that global trade -- which in 2007, had approached $11 trillion -- dropped by 80 percent in the next year. The world simply ceased. Capital stopped flowing and the world stopped producing.

So, why is that? Well, in part -- and I'll come to private capital in a moment -- but, in part, it's because the financing markets are a continuum. Central banks can create money, but they rely upon a system to extend that money. Universal banks at 15, 20 or 30 percent, 30 times leverage, funding brokerage firms at 30, 40 or 50 times leverage. Funding investor and investor vehicles means you are dramatically multiplying the base capital into the system. And in times of stress, as we saw in the market crisis, the entire middle shuts. And when the entire middle shuts, whether it's interbank lending, whether it's leverage, you essentially have one provider of capital -- that's the central banks -- and you eliminate all of the money multiplier impact; and that's what took place.

Now, the good news is that took place. And the good news is the financial entrances were replaced essentially with the bottom box; central banks, governments. I lived through the U.K. bank recapitalization's scheme and that was an incredibly bold move on behalf of Prime Minister Brown and it was followed up by bold moves around the world, and it's still, frankly, being followed up in Europe as we speak today. But that extra part of the stool, that extra ballast was required. But what it means -- and it is a fair question to ask -- whether it's the 40-yard line, the 60-yard line, tables-setting or dinner-cooking --

you have now governments with a dramatically different seat at the table, by definition, because of the capital provided.

But to the question of, do we have enough capital; actually, we have more capital. The reduction of rates, the creation of new monetary stimulus has actually increased the capital raising since the crisis. We've seen significantly more capital raising. And by the way, to those focused on financial engineering and the perils of which there are, financial engineering and financial technology also continues to grow -- as you can see derivatives of -- continued to grow, despite the crisis.

Now, if you take Mackenzie's data, it isn't just the annual capital that's raising. The overall financial stock has increased and increased substantially since the crisis. And 2010 was the first period where we saw the financial stock grow. Capital is available. And for those companies that can raise it in size, it's at historically low nominal costs and valuations have recovered significantly. And that period of shock which drove risk up three- or four-fold -- as measured by things like the VIX index or spread -- those areas calmed dramatically to a period of greater stability.

The problem, though, is it hasn't flowed evenly. The problem is that the majority of the fixed income that's been raised, which is about half of this capital growth, has been government financing; over 80 percent of the fixed income raised. So 80 percent of the half of the growth has been government financing.

Over 80 percent of the remaining, which is equity, has come from

emerging markets; 60 percent of that's China. And, in fact, what we have with these numbers is a masking in that you've actually seen more growth in areas that have grown and more shrinkage in areas that have shrunk. So, China has seen a $2 trillion growth in fixed income, and financial players in the western markets have seen a $2 trillion shrinkage in the western markets. So, capital in absolute is greater; capital in the places that we are seeking to promote growth is decidedly less.

One statistic that I just found interesting -- if you take out Fannie and Freddie, the actual securitization market which fueled a lot of the U.S. has dropped 83 percent from the crisis to 2010.

Now, where are we? Were we are is that the process of funding is still under stress, and all of the boxes on the left remain in some degree of stress. Central banks in some areas have provided to the limit of what they can do. Banks continue to de-lever. Brokerage firms, in some cases, have been merged, replaced, put out of business, created into holding companies, and the net result is the question that was put forward by Ron. You've got investors that are sitting on significant capital through savings, and you’ve got corporates that are sitting on significant capital. And those two items in this domestic market are quite notable.

I would say that, by the way, the China numbers of 60 percent of the equity of the bulk of the IPOs of $2 trillion worth of debt raised are on top of China increasing the government stimulus from 42 percent of the economy to 53 percent of the economy. So, it is not as if those areas were what was necessary

as much as what was attractive.

So, to the question, is the model broken or is the model able to work? I'd say one of the big problems that we have to recognize is, it isn't just the crisis, but the pre-crisis model. We had a bit of a buy versus build, not just consumption on a personal basis, but on a corporate basis. And the reduction of equity that occurred between 2004 and 2007 in the U.S. and in Europe was a function, if you will, of a buy versus build value equation. It's no surprise that if you've got four or five times the amount of MNA that you have research and development in the United States, you have a fundamental difference where the creation of value from growth is different than the creation of growth for growth. So, this system is a system that underpins part of the question as we seek to readdress and adjust going forward. But, by the way, that's really what private equity was created for.

So, if I go back to my Eisenhower period, the launching of the SBA, the launching of significant changes to investment rules that all occurred in the late 50s to build what became the institutional private equity industry from 1970s onward, this industry has filled gaps that have occurred in virtually every traumatic period or in every period where growth is required. And the spectrum that private equity plays is a spectrum from a very early stage, as Ron described of angle, all the way through until late stage, in terms of restructuring challenging business.

Now, it's a pretty natural model. And while it's fair, as David Brooks has indicated, that this will come under great debate -- in particular, with

Mitt Romney's campaign -- it is a model that is born from a very rational and, I think, very logical and very appropriate approach. And it comes from, in my own view, two distinct processes that were good but not perfect.

The old industrial conglomerates which took the view that I could extend broad-based management across multiple industries worked, but didn't work necessarily to direct incentives of the largest managers to the smallest divisions. And by the same token, mutual funds, which democratized capital, also removed, if you will, some of the direct imposition of owner culture on managed published companies.

I would say, by the way, that we've gone well beyond that with index funds, and we've gone even beyond that today with high frequency trading. And today, 80 percent of the volume that goes through inequity exchanges are high frequency trading or index funds which are not taking any investment decision whatsoever, other than that as arbitrage or computer generated.

So, the need to have better management and owner culture is really where private equity excels. Mark Wiseman is going to speak later and I'm sure he's going to give a great view of this because he's seen it and he's dissected this well. But I break it down into having the ability to bring stronger management teams, have interest aligned, have efficient capital structures and tax strategies, but more importantly, private equity is flexible activist fiduciary capital. They take a long-term view because they have long-term money. They have the ability to take a long-term view. They have visibility across the whole spectrum of opportunities, and they have multiple paths to exit to create value.

It's not simply public company shareholders who can only sell their shares as a vote of exit. They have the ability to merge companies, change management, add on businesses, invest in new plants, invest in new technologies, invest in geographies.

IPO recap; they can go any route because they control that, and as such, they have a control premium. And it is a survival of the fittest industry; make no mistake about it. The statistics show very clearly that the top performers generate all the returns in the industry; all the returns. Josh Learner will discuss that. And in addition to that, if you can't make it past a second successful fund, you're out of the industry. It is a very survival-focused industry.

But, this industry and this model allows for things that can't work in the public dynamic. Joe Rice's firm, CDNR, converting IBM typewriter business -- which, by all rights, could well have gone out of business to Lexmark's printer business -- could not have been done in the public domain, just as -- without speaking with any direct knowledge -- it's impossible or has been impossible for Kodak to change its business model in the very same way. Private models allow for this to have taken place.

Now, in addition to that, we've seen phenomenal -- and by the way, if you haven't been out to Silicon Valley lately, it's another world and you'll feel far better if you go. You can't get into most of the hotels, but if you go, you'll find that it's a much different world; and why?

Now, there's there a study -- there's many studies. This one happens to come from Global Insight, which is a company I'm on the board of --

and I can't speak to the data fully, but I can say that when -- there is a discussion of 4,000 venture-backed companies, three trillion of revenues which is, at this point, 20 percent of the U.S. economy -- revenue growth of nearly twice what was the average company and 12 million jobs created, including venture-backed companies having 50 to 80 percent of some of the highest growth industries. It's a fairly phenomenal track record and it's a fairly encouraging set of statistics; and this is 2008. This isn't the 1998 to 2001 bubble. This isn't the 1984 micro computing. This is late in the dynamic of this definition.

Now, late-stage private equity as well, by the way, will show statistics, and you'll see it from some of the research that Josh had put forward that they create value not simply through what is the perspective of leverage, or the leveraging of the S&P 500, as has been described, or asset stripping. Half of the returns are sales growth. A piece of the return is a reduction of debt and a piece of it is multiple creation. There are multiple studies. This is just one study that was done by BCG.

There are other studies. One study shows very clearly revenues growing, margins growing, and employees -- and in particular, employees were there where industries that required cost-cutting going into the investment. The reallocation of capital into the better sectors within those portfolios drove growth and growth in capital, capital reinvested in expanding these employees. This is, I think David Brooks indicated, is going to be a very hotly debated subject as the ongoing election campaign comes forward. I think more data will come forward and the data will be, I suspect, on both sides.

But the real focus will be driven by what is the perception of private equity, which occurred in 2006 and 2007; very large companies, very large LBOs, a return to what had become the initiation of the LBO industry of RJR Nabisco; a return to the days of very large company transactions. That was a very brief window, but that brief window gave a sense of this buy versus build culture permeating the private capital industry. But I would argue that even before that the battle lines were being drawn; even before that.

The first set of unions in 2006 were raising the question of wages versus profit margins for large companies, even before the large LBOs. From the U.K. and Europe and the U.S., there was a discussion of wealth creation and carried interests and all elements like that, so the battle lines were drawn and the battle lines continued, and this debate is a debate that requires very good analytics. And my perspective, in the data I've seen, show quite clearly value creation, flexibility, long-term investing. Now, by the way, a big part of that is the broken nature of what is the public capital market.

As I said, when 80 percent of investment decisions are not being made for what are direct directed capital allocation, you have a fundamentally different market. Short-termism in the public market makes it that much harder to take actions.

We've seen and saw, during the period of the 1970s onward, an outsourcing of R&D from corporates to the venture capital industry, and this is a part of what has become a continuous path towards public market short-termism.

But let's be clear; private capital is not an eleemosynary set of

institutions; they will follow returns. So, the question of this capital and the capital that's available has been estimated -- the dry powder that Ron's number showed about $1 trillion -- there are estimates that range from 750 to somewhere north of one and a half. It's about 15 years of IPO capital. It's about 15 years at the current pace of IPOs. It's a significant amount of capital. Where that capital is utilized is going to have a massive impact on where growth is found. So, will it be attracted to emerging markets? Will it be attracted to distressed debt? Will it be attracted to growth capital? What will encourage that? What will encourage that is the expectation of returns.

If I have one small comment I would make, it is, though, that private equity -- and this will be a question as part of the image -- has not yet established itself, despite the business model, as having the same sustainability that industrial companies and industrialists had in creating value during economic challenges. You only need to drive to Hershey Pennsylvania or to Midland, Michigan to see the impact that Milton Hershey had in a period of the Depression where one could buy assets cheaply, put labor to work, build both schools and build what were whole communities for that company.

You only need to go to Midland to see the same thing for Dow Chemical where both of the high schools are named either Dow or Chemists, and all of this is based upon the formation of what was local.

Private equity is a global industry, and the question of private equity's impact on society is a local question. And the definition of what is created, in terms of this image, and whether Texas Pacific Group or KKR or

Blackstone can have the same employment standards and training standards and exit standards that GE prides itself is a question that will be raised and will be raised importantly.

Let me close out by saying private equity strategies are being adopted globally. It is one of the great technologies that has been created in the United States and extended. You clearly see, in many countries -- and I would point to Russia in particular. Russia has recently announced and gotten great profile for a $10 billion fund, half from private equity players, half from their own coffers, all focused domestically on creating the economy. The same thing, by the way, is true in other FDI encouragement programs. It's true for U.S. corporations in Saudi.

Despite what is a phenomenal opportunity -- rightfully so, with Shell Gas creating increases in the Gulf Coast -- one of the biggest joint ventures announced in the past several years was announced between Dow Chemical and Saudi or AAMCO in Saudi, with the provision of both capital and energy resources to build a full petro chemical complex, the biggest in the world.

Now, these sovereign wealth funds are not just building at home; they're going abroad. It's inevitable. We have to recognize that these providers of capital, and the state-owned industries that are linked -- it is inevitable that the flow will come.

We have to recognize not that there is an IP question, which there is; not that there are other issues that should be faced, which there are; not that there are transparency questions that shouldn't be raised; of course there are.

But when you have the three biggest banks in China, all being two to three times larger than the biggest banks in the U.S., Europe and the U.K., you recognize that they will go outbound with their companies to expand globally, just as the Japanese banks did going back three decades ago. This degree of inevitability means we have to find processes that are constructive for growth on all sides.

I'm more positive. I think I'm more positive because -- first and foremost, to the questions that were put forward by Martin for me to answer, is there a shortage of capital today? No; I don't believe there is. Are the markets allocating capital to growth? They are, but not necessarily in all the areas we want them to be. Are there structural impediments from the crisis in response? I think there were structural impediments before, and I think those structural impediments are outweighed by the structural benefits of the flexibility of our capital markets and by having great ability and speed to adjust.

Is private capital a part of the solution? It is, has been, was, and for four decades, has been a critical partner to other government solutions. And what actions can be taken? I actually think a lot of the actions are already occurring.

I was fortunate -- and when Karen Mills stands up and speaks, she'll discuss her Startup America program. We were fortunate to create a fund called Invest America which will, on a state-by-state basis, create jobs -- purely a nonprofit partnering with a Michigan-based company, the Michigan State and the SBA to create $150 million focused only on job creation. I think there are very interesting events. I think the development, as I said, of the Shell gas initiative, a

new industrial activity because of pipelines will change as well. I'm more positive.

I think market stability is increasing confidence. I think the most important fact -- and this is -- unfortunately, I'll end -- the opportunities are simply going to become too compelling. Anyone who would have read Warren Buffett's letters over the past couple of decades would have noted a real fear of technology. And waking up this morning or reading your Bloomberg or your Press last night to see an $11 billion investment -- his first or second biggest holding in IBM -- will tell you that sometimes things just become too compelling, and I think that’s what we'll find here in the United States. Thank you very much.

MR. BAILY: We're running right on, sort of, edge of our time, but if there are a couple of questions, maybe we'll feel them. Yes. Okay. But no speeches, please. Have we got a mic there? Is your question directed to one of the -- to Michael?

SPEAKER: Yes. (inaudible)) freelance correspondent, (inaudible). Thank you for your comment. And you are a financial market and you have several box and you say this is a continuum. I will suggest a change (inaudible) to the dynamic equivalent because this is -- (inaudible) between the two box.

And as to the capital; in this globalization stage, the capital can go anywhere. And there's lots of falling capital around the world, and the problem is this; how U.S. are going to capture it? U.S. is very hostile to foreign capital, and how to do about that? Thank you.

MR. BAILY: I guess the question is, is the U.S. hostile and what do we do about it if the U.S. is hostile?

MR. KLEIN: I think that there is -- as I indicated -- and I agree with you that the capital flows to where it's needed and wanted. And there are certainly economies that are focused directly on attracting that capital and using that capital for growth in their own nations. And whether that's concentrated FDI attraction program or it's just the elimination of policies that are restrictive in terms of the flow of people, and there is a significant question that is debated consistently about visa, the ability for those that are trained in this country, whether it's immigration policy or visa policy to stay and work or whether it's the flow of capital, vis-à-vis, CFIUS and others. These are complex issues, no doubt.

I think that they are issues that are front of mind to many in the business community and the investment community as real desires to both attract the people, the talent and the capital. And I think it is a fair statement and I think we do need to recognize private capital as just the tip of this iceberg that there is a competition for capital and resources. And countries today, whether they be developing or developed, are fighting for that access to that capital because, as we saw in just some of these statistics, if you take that capital out, you don't have growth. And I think your comments are fair and spot-on. I think it's understood; complicated, but needs significantly more attention.

MR. MARK: My name is Joncarlo Mark. I recently founded a company called Upwelling Capital Group, after 12 years working with the California Public

Employees Retirement System. I'm pretty excited, because I do have relatives from the "schmatta business," (laughter) -- so I'm hopefully going to be successful with my business.

This is a great panel in that represented on this panel are people from the legal world, labor, Wall Street, and institutional investors.

To my immediate right is Richard Jaffe. He's had a long distinguished career as one of the United States' leading attorneys in the business world. He recently joined the law firm of Duane Morris in Philadelphia, where he practices corporate law, with a focus in the areas of private equity, M&A, divestitures, corporate finance and venture capital. He also is on the executive board of the Association for Corporate Growth, and has played a pretty important role in corporate governance overall. And he chairs an advisory board for corporate governance at the Corporate Governance Center at Drexel University's LeBow School of Business.

Next to him is Heather Slavkin, who is the senior legal and policy advisor for the AFL-CIO's Office of Investment. Ms. Slavkin's work focuses on legal, regulatory and corporate governance issues that impact union and other workers -- worker-based pension, health, and saving funds.

Next to her is Harry Wilson, who is chairman and CEO of MAEVA Advisors, a turnaround and restructuring company. Harry has played a wide variety of roles at four highly distinguished firms, including Goldman Sachs, Clayton Dubilier, the Blackstone Group, and Silver Point. In 2009 Harry agreed to serve as the sole Republican member of the President's Auto Task Force,

which is the group responsible for overhauling GM and Chrysler. And in 2010 Harry also ran as the Republican candidate for the New York comptroller position.

Next to Harry is Mark Wiseman. Mark Wiseman is the executive vice president of investments at the Canadian Pension Plan Investment Board, which might be the most important institutional investor in the world at this point in time. And he's responsible for all the investment activities of CPP's Investment Board, including public market investments, private investments, real estate and infrastructure. Prior to joining CPP, Mark was head of private equity with Ontario Teachers. And mark was also the former chairman of the Institutional Limited Partners Association, a role that he graciously handed to me -- by vote -- in 2007.

So, what's great about this morning is we've had a really great overview of some of the issues that are going on in the private capital world. One point that I would like to emphasize from an institutional standpoint is the reason why you've seen these numbers -- a trillion dollars of dry powder, globally, $500 billion of U.S.-oriented private capital that's sitting in dry powder -- is because the institutional investor community globally has seen the importance -- first and foremost from a returns standpoint -- of private equity.

And just to give you some evidence of this, when I joined CalPERS in 1999, the allocation of private equity was roughly 4 percent. Today that allocation is 14 percent. The program has grown from $10 billion to $50 billion in total exposure. That's the market value, plus the unfunded.

In 1999 CPP didn't even exist -- right, Mark? And today what's the size of CPP's total program in private group?

MR. WISEMAN: Private capital would be -- not including real estate -- $38 billion invested. Private equity would comprise $22 billion of that 38 invested.

MR. MARK: So, to echo Michael's comments about the flow of capital, CPP didn't exist 12 years ago. Today they have a staff of 140 people just focused on private investing -- correct?

And you can see the ramp from CalPERS and other institutions, because in a world where a lot of public institutions, a lot of public pension plans are underfunded, all roads point to private capital, private equity, where the returns, if done properly, generate a return in excess of what they can get in the public markets.

So I do believe that you'll continue to see this flow. A lot of the capital's been committed. It's sitting there. So we have -- there is a tremendous amount of capital available.

But I think what I'd like to do with this panel is really talk more granular, from "we know the money's out there," to getting to some evidence of how that capital is being put to work. And one point that Michael made earlier today is when people hear about private equity, a lot of times they think of the big, bulge bracket firms that have gotten a lot of attention on their highly levered deals. But the reality is that -- a recent article came out in PitchBook, which is an aggregator of private equity industry information -- that of that $450, $500 billion

of dry powder, 90 percent of that is committed to firms that operate in the middle market. So these are firms that most of the people in this audience probably haven't heard of. Richard, in his role with the ACG represents many of these firms.

So I'm going to turn it over to you, Richard. If you'll just give a brief background of ACG, and what their role is, and what they're seeing in the market.

MR. JAFFE: Great. So, although I'm a full-time lawyer, my partners sometimes think I'm a full-time ACG member.

ACG is an organization of about 14,000 members, with 54 chapters. It's a global organization that focuses on the middle market. And we had a mission that about a year ago was three paragraphs. And we had a strategic planning process we undertook. And our mission now is driving middle market growth. And that's the focus of ACG.

Its members are professionals in private equity funds, banks, corporations, and their supported by advisors like lawyers -- you always need lawyers -- (laughter) -- accountants, and investment bankers. And we accomplish our goals by providing content education for our members. And we also provide opportunities for our members to get together to develop relationships. Because if you're in this business, it's a relationship business. And our focus is -- as Joncarlo said -- on the middle market, where we think there's an enormous amount of activity.

Just to give you an example, about two years ago I was talking to Andrew Ross Sorkin. He was on his book tour for *Too Big to Fail*. And he writes an online daily column and deal book. And it focuses on KKR and Blackstone, and the larger funds. And I said to him, "Andrew -- why aren't you writing about the middle market? That's really where a vast amount of activity is occurring." And he looked at me and he said, "Richard -- it's not sexy." (Laughter) And that's right -- it's not.

But it is Middle-America. And we're finding the funds that I work with are very, very active in growing the middle market, the small or medium-sized companies.

There's also an issue of, ASo what's the middle market?@ And you can talk to anyone on this panel and we'll give you different definitions. But it's principally companies with operating profits or (inaudible) $20 million or less. It's companies with revenues of $10 million to a billion. It's total enterprise value of $25 to $200 million.

So it's a huge number of companies across the country. And that's what private equity is focused on, in middle market.

MR. MARK: And what do the private equity sponsors bring to the table that is different than what a KKO or a Blackstone is bringing to the table with the companies they invest in?

MR. JAFFE: Well, the companies are different. I think that's really the differentiation. It's companies that need more guidance. And I think Michael Klein really articulated -- he kind of eviscerated what I was going to say,

but I'll reiterate it -- it's, they bring capital, which is really important. But it's more, it's guidance, and it's more disciplined, and it's opening up the networks that they have so that they can help to build and take companies that really need this kind of discipline and molding, and control that growth, and help them grow.

And there are numerous examples. And I think that's one of the things we're trying to accomplish at ACG, is getting those companies, examples, out there to really educate the public.

MR. MARK: So there are two forms of private capital we were talking about earlier today. One was that held with the private equity firms, but also the corporations and the trillion dollars -- this elusive capital sitting on these balance sheets.

And I'll turn it over to Harry. Harry, what are the hurdles that are out there that are creating barriers for that capital to flow freely into the market?

MR. WILSON: Sure. Well, I think there -- you know, there's a lot of discussion in the political debate currently about tax policy and the like, and regulatory policy. And I think that's part of it. But I think it's much broader than that, much less partisan than that -- which is, you know, I think the fundamental problem for private capital today is the absence of aggregate demand. And when you talk to portfolio companies or investors or consumers, that's a fundamental challenge -- driven by, I think, an abundance of excess leverage in the consumer space, whether it's at the household level in the housing sector, or at the consumer level.

And as a result, demand -- consumer demand -- is not strong enough to drive, you know, a greater supply of product, and therefore a greater basis for investment. And so I think you've got this kind of fundamental problem.

And then you've got the second issue which, when paired with the weakness of aggregate demand, is, I think, you know, very near fatal -- which is the uncertainty, both on the fiscal side and the regulatory side, that comes out of Washington.

And I see the combination of those two things really creates a very uncertain environment. And when you think about long-term investments particularly, which I think we need more of in the economy, it's particularly, you know, negative.

MR. MARK: Go ahead, Mark.

MR. WISEMAN: Yeah -- can I jump in on that a little bit? Because I want to -- it picks up on a point more broadly, as a global institutional investor, and Michael's answer to the question earlier, in his talk.

I think the world -- and not just the United States -- is facing an increasing problem of what I can see -- if you want to take it up to a global level -- of what I refer to as "capital protectionism." And, you know, we worry a lot, in terms of the impact on the global economy of trade protectionism. And you have a body you can go to, the WTO, and a bunch of treaties and other things, to complain about trade protectionism.

But capital protectionism and limitations on the free flow of capital to its most efficient use are growing -- whether it's CFIUS in the United States,

Foreign Investment Review in Australia, various tax rules -- and, in fact, other regulations. And Wall Street can look at the U.S. -- the problem is global. In fact, China, as many of you know, is one of the most difficult countries to invest in, with foreign exchange rules. Even if you invest in the public market in China you require something called a "qualified foreign institutional investor license," which I have no idea how to get one, but we've been trying for two-and-a-half years. (Laughter)

And this limitation on the free flow of capital, I believe, is having all kinds -- causing all kinds of dislocations in global markets. And for us, we're an exporter of capital. So we're interested in moving our capital. We have to move our capital outside of our domestic market, because we're $160 billion. Canada represents 2 to 2-1/2 percent of global capital markets. We don't want to own Canada. (Laughter)

So, for us, there's a real opportunity to attract global capital, but exactly the opposite is taking place. And just to use the CFIUS example, we were actually the first -- as far as I know, the first application through CFIUS when we bought Puget Energy in early 2009. And, you know, the U.S. regulators kept telling us, "Well, you guys aren't the target of this. We're not really worried about long-term Canadian capital buying a U.S. utility." But, in fact, it put us at a strong disadvantage against domestic buyers who, quite frankly, didn't exist. Because if you were the seller of that company, you either had to wait for us, even for a 30-day regulatory process, or have certainty of closing with a domestic buyer.

By the way, we went through the process. We got very quick approval. And we have invested a billion dollars into Washington State to build the wind-power project at lower Snake River. A billion dollars, and I don't know how many jobs that's created.

But quite frankly, but for the fact that we were willing to subject ourselves to this process -- which we weren't the target of -- you know, that money would have gone elsewhere. So it's a massive problem.

And it's not just a U.S. problem, quite frankly. It's a problem -- you know, the potash deal in Canada -- for those of you who followed that -- that was turned down by the Canadian government? So I'm not blaming the U.S. here. In fact, the U.S. is one of the better places to put capital. But if we don't globally start looking at protectionism against the free flow of capital the way that we look at trade protectionism as being a huge impediment to economic growth, we're going to be in big trouble.

MR. MARK: Heather, what's the AFL-CIO's perspective on private capital? And how are you trying to balance the needs of your members with this flow of capital into the market?

MS. SLAVKIN: Sure. It's a good question.

And, you know, coming into this panel I tried to come up with the best and most succinct way to answer it, given the fact that we represent more than 55 different labor unions, in almost as many different industries. And we're looking out for their interests, not just as employees of companies that may be

purchased by private equity funds, but also as beneficiaries of pension funds who are oftentimes investors in the private equity funds.

And so I've spoken with our affiliates in various industries to try to get a sense of how they feel about this. And, you know, I talked about one prominent person who makes investment decisions and said, you know, "What do you think of the future role of private equity?" And his immediate response was, "There's no role for private equity in helping to rebuild the economy unless they adjust their fee structure."

But I spoke with other unions who have had more positive experiences with private equity. For example, I spoke with the hotel workers union, who see that the Blackstone purchase of Hilton has provided some opportunities for them. And at the same time, the hotel workers have had problems with casinos that were bought by private equity funds, and trying to deal with over-leverage.

And so I think a lot of the time it depends on the perspective of the particular private equity fund going into a business. And what we are really looking for is private equity firms that see the workers as an asset, and see them as partners. Because these are people that oftentimes have been working for a company, that know the business better than the private equity fund coming in to purchase the company, and hope to stay there for a long time into the future. And if the private equity firm looks at their employees as partners in this project, then the workers can help as an asset, and to provide some additional expertise.

On the other hand, if the workers are seen as the enemy, it can cause some major headaches. It can become a big expense for the private equity fund.

MR. MARK: Harry, you've had some experience, through the Task Force and some other investments. Can you talk a little bit about that partnership between labor and private capital.

MR. WILSON: Absolutely. I was going to pick up on Heather's point, which I think is excellent -- and I think totally misunderstood by most people in the business sector, including myself until a few years ago.

And I say that because, yes, I come at it from a career of private capital, but the last few years working intensively with a number of labor unions starting with the UAW, and more recently the Teamsters. And I think there's such an understanding gap between a lot of folks in the private capital space and the folks on the labor side. And they come at it from a perspective expectations of, you know, acrimony, hostility, et cetera, as opposed to really a partnership approach.

And what we try to do -- both in our work with Ron Bloom on the Task Force, with the UAW and General Motors and Chrysler, and what I've tried to do on a couple of transactions since then, is really create a partnership between the union -- the employees -- and management, through equity ownership, board representation, and, you know, shared governance.

And there are a couple things associated with that. One, it's very German model. Those of you familiar with the German corporate structure, it's

much more common over there. And I think, frankly, it's worked quite well in a number of instances. But what it does is allows for a, you know, greater sharing of ideas, greater, you know, collaboration, a realization of kind of where the kind of shared incentives are. Sure, at some level, there's a zero-sum game between costs and margins. But at another level there's a lot more to be gained by growth. And if you saw Michael Klein's chart from the last presentation, half the returns for private capital deals that were cited on that one slide were driven by sales growth, and a relatively small percentage was driven by margin enhancement.

So this concept of kind of working together as more of a partnership is very valuable.

If you talk to Bob King at the UAW he would say -- and Al Mulally of Ford would agree -- that a lot of the improvements in the new Taurus were driven by improvements that were identified on the factory floor, pointed out by factory workers on the factory floor, and bubbled up to top management, and resulted in design improvements that both improved the cost of the Taurus, improved fuel efficiency, and improved the margins. So that's like a real-world example of how this can be a very fruitful partnership -- if people can get past the kind of preconceived notions that are often false.

MR. MARK: Richard, you and I talked about regulation, and your role in advocating for your members -- private equity firms and the corporations you represent.

What are the two or three things that you are educating people on constantly to help improve the environment for the ACG members?

MR. JAFFE: So, one of the principal things that ACG is doing, we've actually partnered with Private Capital Research, and Josh Lerner, to create a data base of growth stories, principally to help the legislators and shapers of policy to understand how private capital works. And, again, I have to refer to Michael's slide. It's not just investing, growing and selling, recapping. It's what private capital and what private equity managers do once they have an interest in a company.

And that's really the important thing. It's that kind of growth. And it's not trying to create a barrier or eliminate -- or crush the expenses and improve margins. It's to grow the company, to grow the top line. So that's one of the things that we do.

The other thing is, Dodd-Frank was enacted, and it was designed to identify and deal with systemic abuses. And there are those abuses.

But it also casts a very wide net, and it included private equity funds for registration as investment advisors. And what's interesting is it excluded venture capital funds. And I'm still trying to determine the difference between the structure of a private equity fund and a venture fund. I mean, they're structured the same way. It's not that private equity funds invest in securities. They don't manage capital, they call capital. And when it's called, they then invest it. So, the registration as investment advisors didn't seem to me to really add anything, and didn't seem to be meaningful.

As part of this, there was a Form PF, which would have required, in its proposed form, the reporting on a quarterly basis of a variety of information which would have been costly and burdensome, and taken away from the focus of the private equity fund's managers in helping to build the companies.

There was a coalition of groups -- including ACG -- that was able to work the regulators to the final form of Form PF as much less onerous. And it requires now, instead of a quarterly, an annual report.

So the bottom line is, we seek to influence that by educating the policy-makers and shapers.

MR. MARK: Besides Cash for Clunkers II, Harry, anything else the government can do? (Laughter) To free up some more of this capital? Or your perspective on just the environment, in general, in Washington. Is it a leadership hole, or something, that's perhaps being an impediment here to the flow of capital?

MR. WILSON: Sure. So -- for the record, I was opposed to Cash for Clunkers I, and I would be opposed to Cash for Clunkers II.

But I think in terms of, you know, the leadership vacuum and deficit that we see in Washington on both sides of the aisle -- with all due respect to those who are part of that -- you know, I think the frustration a lot of us have in the private sector is when you look at the -- I think the biggest challenge facing our country is our fiscal gap, particularly over the long term.

There are some really commonsense solutions. You know, Simpson-Bowles, Domenici-Rivlin, that are bipartisan, that address our long-term

problems, and create both financial stability to avoid the fate of Europe, and real clarity and certainty. And with a handful of exceptions on both sides of the aisle, very few people in Congress have seen the ability to embrace that -- or in the White House, for that matter.

And so I think, to me -- and I think to many people in the business sector -- is having clarity and certainty and a solution on our fiscal deficit is the primary problem. And I think most people have given up hope that they'll see anything of consequence before the election.

MR. MARK: Mark, one of the things that CPP is involved with, as well as CalPERS, and a lot of the other large institutional investors, is the U.N. Principles of Responsible Investing.

Can you talk a little bit about that? And why that's important for CPP? And then I'll turn it over to Heather to talk about labor's role in the UNPRI, as well.

MR. WISEMAN: Sure. The UNPRI, we're a signatory to the UNPRI. And we do look extensively across, not just private investments -- actually, a lot of this activity takes place in our public market side of our business, as well.

And we take a particular view towards that ESG factors -- meaning "environmental, social, and government" factors -- when we invest.

We look at it from not a policy point of view. We look at it from an investment point of view. We are a long-term investor. We're investing our assets for the next 75 years and beyond.

And we believe that as a long-run investor -- not an organization that's going to be trading out of investments on a daily basis, or can trade out of investments on a daily basis -- we believe that in the long run companies and enterprises that pay attention to ESG factors will become more valuable in the long run.

And that's one of the things about being a long-term investor that is -- we can make a difference in terms of the way that we invest. And for us it is all about maximizing long-term return.

And so to take a simple example -- and this, by the way, is one of the reasons that we think disclosure -- so we're a signatory to the Carbon Disclosure Project -- it's one of the reasons we think disclosure is so important, because it can help us make better investment decisions.

So let's take a view of carbon. If one believes that in the long run carbon will be taxed, or the emission of carbon will be taxed or regulated in some way shape or form, it then follows that companies that do a better job controlling carbon emissions will be more valuable. And particularly if they can do that efficiently. And so we have our ESG folks actually sitting inside our fundamental research teams. And they're looking, so that we can put those types of factors into our investment decision-making, so that we can pick those firms that we believe will be more valuable in the long run.

We don't screen stocks. We don't choose to make investments for any public policy reason. That we can leave to the politicians to make public policy. We're all about maximizing long-term return. And we think companies

that manage environmental risks well, that manage their workforces well, and that have good governance practices will be more valuable in the long run.

And that's why long-term capital that's provided by institutions like ours can take a very, very different view of investing. And we're not the guys -- back to Michael Klein's comment -- we're not the guys flipping stocks nine times a day. We're investors. And there aren't enough of us left.

MR. MARK: Heather, a big part of ESG has to do with how you treat your workforce. What specifically are the key things that you'd like to see private equity firms consider as they put their capital to work as it relates to your members, and labor in general?

MS. SLAVKIN: Wow, that's a big question.

You know, I think I touched on earlier the importance of looking at your employees as partners, and seeing them as a resource when you go into a firm. In addition, there are the interests of pension beneficiaries, and the interest of the trustees of the pension funds in ensuring that they have the information, the transparency, necessary to make informed investment decisions. So, you know, labor is looking at investing and at private capital from both perspectives.

And I wanted to actually build on the UNPRI conversation, and talk for a second about something that the AFL-CIO's been involved in, trying to be a bit more proactive, actually, in terms of investing in a responsible way.

And one of the things that we've done recently is we've partnered with the Clinton Global Initiative, and with the Center for American Progress, and American Federation of Teachers, and committed to working to get workers'

capital up to $10 billion in workers' capital deployed in energy-efficient investment strategies to put people back to work in America, and to help improve and clean up the environment. And we've actually already gotten a billion dollars in commitments from CalPERS and CalSTERS. And my colleagues are working hard to try to get up to that $10 billion mark as quickly as possible.

So we're really looking for more proactive ways to try to push to create jobs, and create a cleaner environment.

MR. WISEMAN: I think it's an important contrast. Because there is a difference in what you're saying and what we're saying. And I think it's important to understand it's a distinction.

You know, personally, I like the idea of there being a cleaner environment. But for my beneficiaries, 17 million of them, if we can get to that end through making better investment decisions, that's great. But we're not -- and we can't be -- in the role of making those policy decisions.

So we're looking for undervalued companies. And if that movement exists that says companies that are good in terms of managing their environmental exposures will be more valuable, that we'll take into consideration.

But that's the real locus of the debate, I think, between public policy and investing. And it's one of the things, interestingly, in the U.S. that I think there's much more of a struggle with than there is north of the border, where our mandate is clearly an investment mandate. We see that as having a good end, but to me, it makes it less confusing in terms of how we think about deploying our capital.

MR. WILSON: If I can jump in -- isn't a key distinction there one of fiduciary responsibility? Your fiduciary responsibility is to maximize --

MR. WISEMAN: Absolutely.

MR. WILSON: -- returns for your beneficiaries.

Your fiduciary responsibility is broader.

MS. SLAVKIN: (Inaudible)

MR. WILSON: You want to do that, but you also have a broader mission to your members, to your 55 member unions.

And that's, I think -- to tie it back to private capital -- that's one of the great things about private capital, because the fiduciary responsibility is so much clearer than you have in, say, a public company. And I think that's something that I think is really kind of a bedrock issue for everybody on this panel, but also everybody in this room, is how do you make sure that that fiduciary responsibility is both aligned with the organization's goals, as well as kind of, ultimately, you know, kind of more beneficial on a broader basis.

MR. MARK: And when it comes to reputation issues of private equity, Harry, what do you think needs to occur for there to be an enhanced image? I mean, clearly, it sounds like capital is flowing, jobs are being created. How come it just seems that the image is so down in the industry? And what needs to happen to change that?

MR. WILSON: Sure. I think it's a couple things. And this is -- again, I'm having the benefit of having spent most of my career there, but having now a different perspective, is that most people in business, in general, and

particularly in private capital, shy away from the media. Do not want to be in the press, do not want to be covered. If they're covered, it's for a, you know, ostentatious birthday party or something that they'd rather people not know about, other than the guests.

And so it is a real mentality -- I remember in the first 15 years of my career, the only appropriate answer to the press was always "No comment." And for good reasons. But as a result, that kind of mentality means that you don't trumpet the good things about the industry.

And there are a lot of great stories. Lex Smart, from CDNR, is a fantastic story that a lot of people don't fully appreciate. Steve Klinsky, New Mountain, talks about the 8,000 net jobs his firm has created, and they're tenured -- net jobs, net of all reductions and restructurings. And those are great stories that don't get out there very much.

And so the sexy narrative is the $15 billion deal, and all the things that go along with that. The really interesting part of the industry is the part that leads to, you know, job creation and real enhancements at the company level. And sometimes those are efficiencies, because companies that are not efficient die over time. But a lot of times they're growth and improvements.

So I think one is a PR strategy, I think is important. I think secondly there are -- you know, I think the industry does have some marginal players. And I think the press for higher returns among institutional investors has led towards an over-allocation to private equity.

In my opinion, there are a handful -- you know, Michael Klein's point about the top performers generate all the returns in the industry is basically true. And so there are a handful of firms that have demonstrated for many, many years that they're outstanding. And those firms should manage large amounts of capital. And there are a lot of firms that have, frankly, not done very well, and don't justify the fee stream.

It's hard to outperform the market, a relatively efficient market, on a 2&20 structure. Some people can. Not many. And the rest shouldn't be in the industry, in my opinion.

And so, kind of a rationalization of the industry -- which I think is happening now because of the over commitments of institutional investors to private equity -- will be an important part of, you know, the industry improving and growing again.

MR. MARK: We have a few minutes left. Can we take a few questions from the audience?

Anybody have any questions?

MR. LITAN: Hi. This is Bob Litan. I'll be on the next panel.

But actually, let me pick up on your point that you were just making about relatively few PE firms are successful, and most of them aren't. That's certainly our foundation's experience. We've put a lot of money into private equity, and also venture capital.

But your numbers imply a dramatic reallocation of money. I mean, if institutional money is going to go away from the losers, where's it going to go? Into direct investing? Into other kinds of vehicles?

But let's just be clear -- you're talking about a huge movement, potentially, of funds out of this industry.

MR. WILSON: Yes -- great question. And I'll answer it very specifically.

As Joncarlo said in the beginning, I ran for New York State Comptroller last year, narrowly unsuccessfully. But I mention that because the State Comptroller is the sole trustee of $130 billion pension fund -- at the time. And one thing I pointed out was that the fund pays -- the fund, for long periods of time, has underperformed its indices. Not even risk-adjusting, it's underperformed its indices, largely because of fees. It pays about -- and I'm going to get these numbers a little bit wrong since it's been a year ago -- but I think it's about $300 million in fees overall.

Now, my recommended strategy was to allocate the vast majority of its capital into passively-managed products, and allocate to a handful of, relatively smaller number, of outstanding performers, who do have higher fee structures but can beat the market on an after-fee basis which, of course, is the only way to look at it. And allocate to those.

Now, that does mean, you know, a lot less capital in private capital, more successful firms doing better. But it also implies a much lower fee structure. And when we did the numbers, that $300 million goes down to like $25

or $30 million. And so it becomes a lot easier to outperform the index when you're not being dragged down by $275 million in fees.

MR. WISEMAN: Or there's another path. And the other path is the one that we've taken -- and for some of the same reasons.

And the other path is saying, "We will hire top managers. But where we can build internal excellence, we will bring it in-house." So -- and we will hire our own teams, and pay them commensurate to what they could make, and incent them the way that they would be incented in the private market. And we'll capture, essentially, the spread, to the benefit of our pensioners.

So let's take infrastructure as an example. Our infrastructure program. Let's use round numbers, just to make the math easy.

Our infrastructure program is just about in excess of $10 billion invested capital. Let's say we could go out an really negotiate well with some infrastructure funds. Instead of paying 2&20, because we're so large, we could pay 1&10. Well, 1 percent management fee is $100 million on $10 billion. And let's assume it returns 10 percent a year, and you pay 10 percent of that profit to the manager, that's another hundred million.

So outsourcing our infrastructure program would cost us $200 million a year. And that would be good negotiation to get there -- in fee and carried interest.

Now, we determined we could actually do just as well hiring a team ourselves. And so we have an internal direct infrastructure investment team. We have about 35 investment professionals located in Toronto and the

U.K. Our total cost, including compensation, incentive, keeping the lights on, travel, et cetera, for that team -- it's a lot, it's a lot. It's about $30 million to run that internal team. And we're paying our top investors, you know, commensurate wages with what they would make working in a fund.

But that $170-ish million per annum is captured to the benefit of our beneficiaries.

That takes a very different governance model, though -- a very different governance model than exists for most institutional investors. Because we have to be nimble, and we have to be able to go in and compete with those funds for talent and for investments. But that's the path that we've taken.

So I think you're right, but there's two ways to get to that end.

MR. WILSON: If I could just -- really quickly on that, too, which I think is a huge point. I totally agree with you -- it's a -- I was approaching it very much from a U.S. mentality, which is you cannot pay people a lot of money, because people will kick and scream. And that is a huge problem. And so you either hire people internally and pay them for performance, or you pay big fees, or you pay in a passively-managed strategy.

But, you know, New York State, for example, doesn't have the capacity to pay people significant amounts of money to attract that kind of talent in the way that your fund can.

MR. WISEMAN: Yes, and I mean, I find it ironic that, you know, that socialist place up north of the 49th parallel (laughter) is kind of, you know, more capitalistic in terms of the way we manage our money than Wall Street.

So, I think you're right. It's just there's another way to get there. Whether the U.S. plans can get there from the right governance perspective to achieve that is another question.

MR. WILSON: I've said for awhile, stop worrying about the Chinese and start worrying about the Canadians. (Laughter)

MR. MARK: Do we have any other questions?

MR. KENNEDY: Hi. Joe Kennedy. I've got a question for Ms. Slavkin.

Did I understand you right -- did I understand you to say that in some cases the trustees of union pensions should accept a lower rate of return in order for job creation -- in return for greater job creation?

MS. SLAVKIN: That wouldn't be in compliance with their fiduciary duty to their trustees. So that's not at all what I mean.

I'm looking at it from the perspective of someone who works for the AFL-CIO and is not a trustee of a pension fund. And so I'm looking out for the interests of my members -- both as workers and employees of companies that are potentially going to be purchased by private equity funds, and as beneficiaries of pension funds who are looking to maximize their returns to provide for their retirement.

MR. MARK: So one of the things that was alluded to in a couple of the earlier talks was the sort of deleterious effects of the sort of boom-bust cycles that's frequently characterized private capital markets. And certainly, the

empirical evidence suggests, for instance, productivity gains on private equity-backed firms are considerably less during deals which are done during booms.

Similarly, if you look at the job creation and destruction, the job destruction is much greater in public-private deals which, as Michael showed, are concentrated at the tops of these booms, as well.

Yet, in some sense, you say, who's to blame on this? Is it the private equity guys for trying to go and raise big funds? Or is it the limited partners for getting so excited and exuberant, and sort of jumping in at the tops of the markets, and sort of throwing all sorts of money during these periods?

Do you see any sort of signs and progress that, you know, due to hard experience, or just generally more sophistication, that that sort of boom-bust cycle can be sort of tamed in private capital markets?

MR. WISEMAN: Who gets to answer that one? (Laughter)

MR. JAFFE: The next panel.

MR. WILSON: I'll speak a little bit to it. And I'm sure my fellow panelists will jump in.

But, you know, the fundamental problem -- it's a little bit of a tragedy of the (inaudible) issue, and I actually will put the blame primarily on the limited partners. Because if you can raise the money and get paid a lot for it, why not? Why are we blaming people from taking advantage of market conditions?

And the fundamental problem is -- and it is as institutional investors increasingly have to search for return, and search for lead -- particularly

when there's a deficit in their asset-liability mix, and they need a higher return -- you know, they end up chasing the same types of things, whether it's an individual investment, or an investment in a fund, in essentially bidding up the price, or bidding down the return.

And there is a great difficulty, first of all, in getting some degree of coordination between those folks in order to exercise the market power, essentially. And there's another issue called collusion, that is illegal. (Laughter)

And so, you know, it's a market like any other market, where there is supply and demand. And the supply -- to your point earlier, and to Michael's point -- the supply of really good managers is narrow. And it's not that hard to figure out who the good managers are in private markets, because there's a great degree of persistency. So you just have to look at the track record.

And if you picked the top quartile funds last time around and just did that, and said "That's the sole basis of my investment decision," you'd probably be okay. So it's not that complicated a process to get to. So those top funds attract investment, and then can command -- and they'll pick up, the fund managers will pick up, you know, as much of that arbitrage as they can -- or capture as much of that gain as they can.

So, you know, it's the nature of the way that that market works. And, you know, bad on, you know, limited partners for continuing to overpay. And, in my view, how can you blame the GPs for capturing value when they're trying to capture as much value as they can when they create it.

So that's my view.

MR. WISEMAN: There's another real technical issue that came up in >06 and >07, when you saw the flow of capital so much, and that was the equity market was on a tear, so there was a desire for LPs to actually get to their allocation targets. And when their denominator of the overall assets grew so much, there was push to continue to commit more and more and more -- which is actually the absolute worst time to be committing extra amounts of capital when the equity market is very rich.

But it's a very difficult thing for a staffer at a public pension plan to say, "Guess what -- so-and-so's coming back to market. They've generated 20 percent gross return, and they're 15 percent net returns for us over 10, 15 years. I don't think we should commit capital to them because, you know, it's a rich market." It's a very tough decision.

But I think there's a lot of lessons learned from last year, is that there's much more collaboration internally, so that the CIO now is saying, okay, where across the realm of opportunity should I be putting in a new dollar of capital?

MR. LERNER: I think we will commence the proceedings. We've been given the daunting topic of dealing with research insights regarding what we're casting as a fairly broad net around private capital, entrepreneurship, and innovation, and choosing whichever topics we want to particularly dig into ourselves. But while we have a daunting topic, we have a team here of people who are well up to the job in terms of putting us in a great position to talk about these things.

Sitting over here is Bob Litan, who is the vice president of research and policy at the Kauffman Foundation, which sort of understates his role as the critical intellectual venture capitalist in terms of seeding entrepreneurship research across this great land in terms of business schools, law schools, economics departments, and the like. It's hard to imagine very many people have had as profound a role in terms of shaping the intellectual discussion around entrepreneurship in the last two decades. In addition, among many other accolades, roles, and so forth, he still serves as a senior fellow at The Brookings Institution.

And then sitting next to him is Carl Shapiro. Carl is the Transamerica professor of business strategy at the Haas School at Berkeley, as well as professor of economics in Berkeley Econ Department, where he's been for many years. At the moment, though, he's on leave steering the U.S. economy through his seat on the Council of Economic Advisers. Prior to this he was the deputy assistant attorney general for economics in the Antitrust Division at Justice. And again, both these people have many glamorous things that we could talk about for a long time, but in the interest of time I propose we just plunge into things.

We've proposed a little mode where each of our distinguished panelists are going to take a few minutes to share a few thoughts. I'll then pepper them with a few questions of my own, as well as a few editorial comments, and then we'll throw it open for a few questions in the remaining moments until Carl has to go off and save the free world. (Laughter)

So with that, Bob, do you want to take?

MR. LITAN: Yeah, I'll begin. Actually, there's one other point you didn't have in your notes and introduction. We actually wrote a paper together once.

MR. LERNER: Wow, I didn't know that.

MR. LITAN: Oh, yes.

MR. LERNER: Little-known fact. (Laughter) Little-read paper.

MR. LITAN: No, we did a survey at Antitrust Enforcement in the 1990s, because we both served at the Justice Department. Actually, Carl is serving in the second -- well, you served a second stint in the same job. I think other than Jack Lew, probably the only person in the government who has had the same job twice.

MR. LERNER: Gene Sperling.

MR. LITAN: Oh, Gene Sperling, that's true. That's three. Okay, there's a pattern. Okay.

So in any event, I thought I would tackle just several issues. Let me step back before we talk about finance to talk about, I think, an emerging confusion between what we think of as new and small businesses. And the confusion in part was generated, embarrassingly enough, by a paper that was published by Brookings here, in the last Brookings papers on economic activity. There was a joint paper that was done by Eric Hurst and Ben Pugsley that looked at small business, and it got a lot of publicity and I've seen a number of columns on this that have taken off from the paper, I think wrongly attributing some of the

findings of the paper.

And the paper shows that most small business owners -- this will not surprise you -- have no intention of growing beyond their lifestyle. So, therefore, no need for capital nor do they introduce new products. And the implication that I've seen from a number of commentators from this paper is, well, we don't have to worry about small business. If we're going to get our mojo back, we're going to have to rely on big business. And I wrote a column on this I think last week on CNBC's website that says that those commentators who were drawing that conclusion from that paper were missing an important fact, which has grown out of research that's been funded by our foundation and also research that we've conducted ourselves.

John Haltiwanger at Maryland, along with Ron Jarmin and other people, have sensed this and shown us some papers, and also I've done some papers with people at Kauffman that show the same thing. And that is that if you control for the size of business, size does not matter in terms of job creation, it's the age of business that counts. So all the action in generating jobs over the last 30 years until the recession is all in new business, it's not in small business. And so, that's the reason we're here.

Martin showed a chart at the beginning that had from BLS those numbers of new businesses going down. That's the problem, is that we've had a decline in new business formation that actually predated the recession, that got a lot worse in the recession. And then another chart they did not show but we have in the paper in Kauffman that shows the number of jobs per startup has also been

falling, and that's been true for about 10 years and that's probably due to technology. But nonetheless, you put those two trends together and that's one of the reasons why we're having a hard time digging ourselves out of this slump when we come to jobs. That's point one.

Point two is we get to the issue in the Hurst and Pugsley paper, it talks about small business not wanting to innovate. That's true, because really when you talk -- if you look at the economic research, if you look at people like Will Bommel, Drucker, Schumpeter, other people that have written about the "entrepreneurship" in the economy, the definition of an entrepreneur is somebody who undertakes something new. And so almost by definition most small businesses are not what we would categorize as entrepreneurs because they're not doing something new, they're just simply replicating.

And in fact, if you look at the major disruptive innovations that contribute to our daily wellbeing -- things like the airplane, the car, personal computer, Internet search, I always say air-conditioning -- if you look at all those innovations, they were all brought to us by entrepreneurs, not by big firms. And that's because entrepreneurs who have no vested stake in the status quo are more likely to do disruptive innovation than existing firms. There are exceptions, of course. Honda and Toyota introducing the hybrid car would be a radical innovation, I would say, but that's going to be the exception that proves the rule.

So let's get to the important fact, and that really our challenge in our economy is to finance new businesses, okay? So now let's go to another chart that was up there. I think this was Ronnie's chart, and a lot of people have

been talking about all this capital that's sloshing around the economy, billions and trillions of dollars. But the fact is very little of that capital is devoted to seed investment in starting new companies. Even venture capital, which had like a $20 billion entry and was sort of a pipsqueak in that chart, a small fraction of venture capital goes to financing the seed rounds of new companies. And in fact, these seeds have shied away from the seed capital financing since the Internet bust.

So on the surface you would say -- oh, by the way, there's one other factoid that I want to give you that also looks bad. We have a paper on our Kauffman website that I think is eventually going to be published in a journal. Alicia Robb, who works for us, along with David Robinson at Duke have published a paper that looks at the 2004 cohort of firms that we have been tracking longitudinally. And it turns out, contrary to popular perception, that bank financing, at least as of that cohort that they looked at, bank financing turns out to be a lot more to startups than people think. It's the most important source of funds, even more important than DCs and more important than friends and family or angel investors. And that's because most people start their business -- or at least until the recession they were starting their business with their credit cards, their home equity loans, and perhaps some straight business loans. And so the crunch in bank lending since the recession, which is a combination in decline in demand and also regulatory stringency, that bank lending crunch would be another source of worry when it comes to new business formation.

So on the surface it would seem that if private capital is

withdrawing from new firms, that we should really worry. And so people will say, well, the government should step up and fill the void. I mean, it's sort of the natural reaction, and we'll hear from Karen Mills to see what her answer is, I guess, in an hour. I just want to give you a couple perspectives on that and then I'll quit.

Number one, it's important to distinguish the type of company, the startup, when we talk about this apparent shortage of capital because if we're looking at IT companies or anybody that's doing, you know, a web-based business, it turns out you don't need much capital because of cloud computing. You can rent the cloud, essentially you can rent an IT department. You don't have to recreate an IT department. You can rent a web designer, you know, you can hire programmers to do something cheap. And so the entry barriers for anything related to IT have gone down dramatically, and so the fact that there isn't as much capital around for those companies doesn't matter.

And even so, there's plenty of capital for those companies because replacing the seeds, increasingly, have been the so-called super angels. There's an outfit called Angel's List in California which has, you know, roughly 600 to 800 of the top angel investors in the country and they're putting money into these companies. And there's outfits like Y Combinator that are basically *American Idol*-kind of companies that bring together superstars based on their business plans, put them together in a hothouse environment, and then funds their companies. I think Y Combinator initially was giving like $15,000 or $20,000 per company. They're up to like $250,000 now.

So if you're in the IT space, capital is not a problem. If there's any market imperfection at all it would be in long-life startups. It would be in clean tech, in drug development, medical devices, anything that's going to be a long-term payoff, all right? And it's unclear there whether there's a capital shortage, but I will give you the following statistic. I went to the NBCA website and it turns out that of all the VC money now that's being invested in the last 2 years, 15 percent is in clean energy or in bio, and the only industry that has a larger share of VC is software, which is 20 percent. So even though the total number is down, the share of VC going to these long-life investments still is rather significant.

Nonetheless, I think we do have a problem financing these long-life businesses. Many of them come to us and complain there's a shortage of money, and so what's the answer to that? And my answer really goes back to a reference to Josh's work, which is setting the table for cooking the meal. Cooking the meal would by more Solyndra-kind of deals, which let's be honest, are off the table now, all right? A, for obvious political reasons and, B, because of the budget deficit. So, I don't think we're going to see many more government guarantee kind of operations.

I would prefer more setting the table kind of policies. Therefore, we at Kauffman have supported the idea of having a capital gains exemption for investments made in startups as long as the money is held for five years. This has been an Obama Administration proposal that we would like to see made permanent, and so that's the setting the table kind of proposal that doesn't pick winners and losers, and basically levels the playing field, but encourages more

investment in seed-stage companies.

I'll make a final point and then I'll quit. Let's get to the growth stage, which is now a company, let's say, is past the seed. It's growing rapidly, and now it's making the decision of whether to go to IPO or not. And then there was a chart earlier this morning -- I think it was Ronnie again had that IPO chart, right? -- 5- to 600 IPOs in the '90s down to like 100 IPOs a year now, right? And there have been a lot of villains, and he showed you all the villains inside. It's Sarbanes-Oxley, regulatory uncertainty, blah, blah, blah.

I'm going to throw one villain that's not on the chart that Harold Bradley, our chief investment officer, and I have been writing about for the last year. It's a hypothesis. We haven't found the smoking gun, but I think we've found a lot of smoke, and in response to our writings we're getting a lot of people who are writing to us and confirming the following thought.

We think that ETFs belong on that list as a source or as an additional factor that may be depressing companies from going public, and I'll tell you why. You know, an ETF is a strange day-traded fund, it's not like a mutual fund. We have to wait at the end of the day to value the company. ETF is like a stock, you can trade it all throughout the day. Half the trading on the market appears to be high-frequency, and a lot of the high-frequency trading is in ETFs.

And what ETFs have allowed is, they've allowed -- essentially, they've lowered the transactions cost of buying the whole market or sections of the market all at once. And in particular, if you look at small cap ETFs, like the Russell 2000 and other comparable ETFs, what they are doing is the volume in

the small cap ETF swamps the volume in the individual stocks so the ETF is basically the tail wagging the stock dog. And so, that's not true for S&P ETFs, where the trading in and out of Microsoft and Dell is clearly going to be driving the ETF price, but it's not true in small cap ETFs.

So one of the reasons we think you're seeing so much volatility in small cap prices is because the in and out movement of the ETF. And if you're a company that's thinking about going public, you may not realize a lot of volatility that may happen to you once you go public is because through no fault of your own, you may get lumped in to an ETF and you'll have no control over your stock price because your stock price is going to be driven by the ETF, not by your own performance.

And so we've suggested a couple of very radical ideas, and I'll just leave it there and then I'll quit. And that is, one idea is you can ban small cap ETFs. That would be an extreme solution. A second idea would be you could make ETF sponsors pay small companies for the right to put their company in your ETF. I mean, the fact of the matter is, why should some third party essentially expropriate the value of a company who has a right in their shares and take them and put them in ETF and basically put them in this ETF ocean and this little company is the small boat that's bobbing around the ocean?

So, I throw that in there as an additional thing to think about and I'll quit there and look forward to Q&A.

MR. SHAPIRO: Well, it's a pleasure to be here. Unlike Josh and Bob, I'm not somebody who has done years of research on private equity in

particular, but I do come from a tradition of academic, and as an antitrust person of -- and being at Berkeley now in the Bay Area of paying a lot of attention to disruptive innovation, disruptive entrance a la Schumpeter going back many years.

Now, where I sit on the Council of Economic Advisers, I'm really a user of this research. And one reason I wanted to spend the morning here was to hear the broader thinking from people who came before. So, let me put a little broader context of sort of how the administration sees some of these things.

We've put forward an innovation strategy and we've had a couple of rounds of documents. The most recent one was earlier this year. Actually, Ronnie Chatterji, who spoke earlier, was a senior economist at the CEA and was involved in this. And so, the vision or the structure is a pyramid. The base of the pyramid is building blocks: education, infrastructure, R&D, some of the things -- public goods type of things that really we need the government to do off in the federal government, including sort of IT ecosystem under there. That's the lower level, and that kind of legal -- of course, rule of law, some basic things like that.

The middle level, market-based innovation, that's more what we're talking about here, some of the structures to make sure capital markets are working well, that innovative firms are not blocked from the market, and other intellectual property policy and the like. And then on top of that, our national priorities that we might choose -- health, IT or clean energy, which in terms of what David Brooks decided, we can think of sort of starting from the goal line there -- and it's of a different analogy, obviously, than the pyramid, and how far

do we go?

And the other analogy we've heard is table setting versus cooking the meal. I guess I'm kind of in the middle there. I feel like the government, we can kind of provide a very nice ambiance for the meal, okay? (Laughter) So, a little more than just setting the table, but, you know, so that people would enjoy the meal.

MR. LERNER: You're at the 50-yard line?

MR. SHAPIRO: I don't really know. I don't want to position myself vis-à-vis David Brooks. That seems like a losing proposition, actually.

I will say where I would differ from him -- it was a wonderful talk, actually -- is on sort of the -- I don't think we're in a lull in terms of innovation. I mean, we're obviously -- the recovery is not what we'd like it to be. Unemployment is too high and all that. But, you know, you talk about people doing whether it's robotics or clean energy, biotech, you know, a lot of the health sciences, maybe if we -- and I just had the pleasure of being at the awarding of the National Medals of Science and Technology, and it's so inspiring, you know. And you could see the young people, and the President just hosted some of the science winners. So, I just -- there I would differ from him. I'm not going to go into the end zone, but I'll stay somewhere in the middle of the field here.

I would also like to echo what you said, Bob, about the importance of young firms. That's something I think we really appreciate, actually. Ronnie, again, we worked on this together, the importance of young, high-growth firms and distinguishing them from small business -- from the broader set of small

businesses. Not to say, you know, one is more important than the other. I mean, there are so many jobs in small business, but I think our focus here today, at least, is more on sort of the high-growth, entrepreneurial firms and getting capital -- making sure they have access to capital. And I'm sure we're going to hear from -- you know, I see Karen Mills here. We'll hear from her about the wonderful efforts SBA is doing in that regard.

A little more context, then I'll just say a few things about administration initiatives, but not so much SBA because Karen will. Look, we really do see that right now in the short-term -- if we think sort of short term versus some of these longer-term structural issues, you know, we see it as aggregate demand is the fundamental problem, you know, from a macro point of view. And Martin, you know, sort of alluded to that at least or mentioned that. And I think you mentioned, you know, the housing, we can't count on residential investment. We were over investing in housing versus other things. So, that's a painful de-leveraging process.

So when we think about job creation -- which we think about every minute, okay, all the time -- you know, that of course goes to, well, who is going to create the jobs? Businesses are going to create the jobs or people are going to create their own businesses and their own jobs. I'm waiting for my son to do that right now, by the way, because he just got out of college. And so, you know, we have that sort of macro policy, fiscal policy debate on the one side. What do we need the government to do to help grow aggregate demand and get us out from a situation where we're so much under potential output?

But in that context, what are we also doing to make sure that small businesses and growing businesses have access to capital and the tools they need, because they are so important for job creation. And the Kauffman Foundation's work, the Haltmeier work you mentioned, too, is very influential, actually. I've read that, we've learned that other people in the CEA -- that is kind of -- that's sunk in, okay, let's put it that way. So, that's a good example of actually how the research really matters in terms of the way the policy issues are framed in the White House.

MR. LITAN: You should come to our trustees meeting and say that.

MR. SHAPIRO: Okay. Well, I think it's really true.

So then the bridge between the aggregate demand and need to boost that versus looking to the private sector to make these investments, the American Jobs Act, which the President has sent forward and we're continuing to push for, has a number of elements in that area. So one that's maybe less well-known, in the Pathways Back to Work part, which is -- you would think it's including an extended unemployment insurance. It has provisions so that people who start their own companies can continue to receive some unemployment benefits, okay? So it has provisions for training and helping people to be entrepreneurs, okay? So, that sort of framework is part of what's in there.

We also have got various, you know, tax cuts and extenders into 2012, such as the bonus depreciation for investment and payroll tax cuts for small businesses. All of those should help.

I think the more specific policies that are a little closer to our topic here today are -- and I think you mentioned, actually -- the 100 percent exclusion for capital gains tax for capital gains that are realized based on the sale of qualified small business stock that's held for at least 5 years. And that seems right in the line of sort of private equity, angel investors. We've already had that, we want to continue that policy. And from my point of view, it would be very interesting to hear how much that matters, for which sort of investments that matters. You know, not everybody is signing up necessarily on that policy, so, it's good for us to have evidence and learn what the effect is.

Obviously, it has a budget cost. Anything with a budget cost we need to justify and explain there's a good return on that, so that would be one example. The making permanent and expanding the R&E tax credit would be another example which would be particularly important for innovative, high-growth small firms.

Let me just list a few other things relating to access to capital that are, I think, pretty much closely related, all of which we've called for and all of which actually have considerable bipartisan support. And in fact, I just got an e-mail this morning as I was sitting here that the Senate Banking Committee is planning a hearing on some of these issues coming up. A number of them have also been taken up in the House. So, one strives to find these bipartisan areas. There are not as many as one would like. But actually, access to capital for small, high-growth firms is generally in that area, and I think that's why the work that folks here are doing can really get picked up and it doesn't have to run into

partisan gridlock.

So, crowd funding is one of them, okay? Which, you know, I don't know if it's going to be huge in comparison with the tens and hundreds of billions of dollars, you know, that we were looking at in some of the slides here, but particularly someone from the Bay Area, sort of with a tech orientation, it seems very appealing. So, this is basically to give a limited exemption from SEC registration requirements for companies that can raise up to a million dollars -- at least that's our proposal. Individuals can put in up to about $10,000, and we can have a holding period so you would avoid sort of people who are just flipping these and turning these.

And it's pretty appealing in a number of respects. We've indicated our support for it along the lines of seed capital that's already given some special treatment by the SEC. And to the House (inaudible) this is -- I think also has an interest in Congress.

Second one along the same lines is to expand the limit for Regulation A, many public offerings. Right now, it's $5 million; I think it's been that way for quite a while. And this, to raise it up to $50 million. This gives basically an exemption from SEC registration requirements, simplified financial disclosure, and basically would allow companies to get access to capital in that way and grow larger in the process of that. Very few companies took advantage of this provision last year, and that could well be because the limit is so small.

A third area is to have an on ramp for Sarbanes-Oxley compliance to make it basically lighter compliance as companies -- they can go public and

then get larger and have proportional responsiveness requirements imposed on them. Right now there's a market cap limit of $75 million. This has to do with the audit of 404(b), especially costly. CEA has looked at this, I think Ronnie did some work on this, actually, when we had you with us. Compliance costs, you know, can be 2-1/2-, $3 million a year for an average company, just for the external part of the auditing.

So we're looking at working with the SEC to have some more proportionate sort of on ramp so that as companies got larger they -- but beyond the $75 million they could gradually take on more responsibilities. Again, while they're young, okay? The notion is based on age rather than just size.

So in the end -- Josh is looking at me. I will wrap up here and we'll go into questions. Certainly where I come from is to be agnostic about various forms of capital funding, okay? The basic story about private capital being patient, being more hands-on, we've heard that from several people this morning. That's very appealing to me. I mean, you go back -- and I'm a student of Alfred Chandler and Burl and Means and the growth of the modern corporation, and there's clearly an important role there, okay? Of course, there's an important role for traditional, you know, large, publicly-traded companies with diffuse ownership. So we're trying to put in place the suitable ambiance for all of these meals to be eaten.

MR. LERNER: Right. Well, thanks so much, guys. All right, you have to be at the White House at 12, right? So maybe we'll do five minutes of questions and we take, maybe, eight.

MR. SHAPIRO: Yeah, or 10.

MR. LERNER: What do you think? All right, 10 it is. All right, so I'm going to start with the first question. You highlighted one thing that we don't know, which is sort of how effective tax policies -- you know, in terms of capital gains or R&D are in terms of really stimulating stuff. Do you in your, you know, sort of day-to-day interactions -- are there other things that sort of really stand out in terms of things you like relative to this whole realm of entrepreneurial finance, private capital, whatever you'd like to have more evidence or information on that would be helpful in terms of guiding your choices?

MR. SHAPIRO: Well, I think generally all the things that involve tax credits. I mean, there's a rigorous -- you know, whether it's OMB or Treasury or CEA we're like, all right, we've got to explain why we're spending tax credits money, you know? Turns out we got long-term fiscal issues. We can't just throw around money, okay?

So even the R&E tax credit, okay, as an example, I mean, as an economist I'm naturally disposed to that because there are positive spillovers associated with R&D and so forth, but do we know what that does in terms of how companies actually spend? You know, what about if we're going, you know -- other benefits and investments in small business or preferred or, let's say, national priorities, what's the return on those investments, historically? You've looked at this a little bit. Doesn't look so great, necessarily, from all of your work. So, I think that's very relevant.

So, there's a couple examples.

MR. LERNER: Bob, what do you see as the sort of big gaps from where you're sitting, as I said, as the intellectual venture capitalist? Where are there holes in the portfolio?

MR. LITAN: Okay, so far we've been talking about -- or at least a lot of the papers that we've funded have talked about jobs without distinguishing what the jobs pay. And so, I think the next frontier of research, especially given all the angst about income and equality and opportunity and all that, is to focus on the kinds of jobs that are being created.

MR. LERNER: Yeah.

MR. LITAN: And in particular, is there anything we can do to both promote new job formation and at the same time narrow income inequalities?

Now, when I was a research assistant here many years ago, I was Art Okun's research assistant on the famous paper called, "Upward Mobility in a High Pressure Economy." And at that time, the sort of standard view was if you had lots of aggregate demand push and the economy was growing strong, we would narrow income differentials and you'd have lots of upward mobility. And right now, we are in a demand low, and the big question that we don't know is whether Art's research would hold up today as we expand. And that's just a -- you know, we take it on faith as economists that once we get down to 6 percent unemployment at some point that these differentials will narrow. But on the other hand, in a society we've got 30 percent dropout rates and all the problems we have in our K-12 education system and so forth, it is not a certainty that more jobs will necessarily lead to a narrowing of the income differentials. I think that is

the next frontier.

MR. SHAPIRO: I would just pick up on that and say, you know, one of the big issues we naturally face thinking about jobs and Okun's Law, actually, is if companies -- even if companies start up and they're successful as they scale, what sort of jobs will that create, okay? I mean, some of the most profitable companies -- and there's a lot of fixed costs, whether it's content or software -- they don't necessarily create that many jobs, even though they are very successful. And if they scale, are they going to do it in the United States in terms of the employment or abroad?

So, in that sense, at least right now, we sure care about that as well as the ROI on those investments.

MR. LERNER: Yeah. I guess one challenge is just the way that Census actually compiles data. Where, you know, so often certainly much of the research that's been done on these questions has used the Census data where they'll have the aggregate payroll, but the fact that there are 150 people collectively making $1 million doesn't really tell you a lot of what you really want to know to answer, you know, some of the critical questions there in terms of stuff.

So, we throw it open to questions? Yeah, all right. A quick question?

MR. CHIN: Yeah, Chow Chin, freelance correspondent based in Maryland.

Dr. Shapiro, first thank you for your service in the President's

Council. I would like to ask you a question I did not have a chance to ask last panel, and I would like to take advantage of your current position to ask.

Mr. Michael Klein pointed out that the company profit share and the company wage share are in a different direction. One is going up and the other one is going down. How do you manage in this situation better?

Thank you.

MR. SHAPIRO: Well, corporate profits are at record highs. And I think as, again, maybe Ronnie or somebody else pointed out, there's a lot of money on quarter balance sheets, basically. What did you say, $1.9 trillion, was that the figure you cited? So, one thing that tells us, the access to capital is not the problem. And, in fact, Mr. Klein said there's plenty of capital around for larger firms.

We still worry, you know, and have to pay careful attention to access to capital for smaller firms and the evidence we have from the Fed's senior loan officer and other sources indicate there's been a -- the loan standards went much, much tighter during 2008, 2009, and then they've eased off again. But that's something we have to worry about.

But it goes back then to interest rates are low, all this capital is looking for a good place to invest, and if we need to get demand up in order for that investment to be profitable, and then that will hopefully create jobs and will get a broad-based resurgence and prosperity resulting from that.

MR. KENNEDY: Hi, Joe Kennedy. A lot of discussion is being focused on sort of the supply side of innovation, tax incentives and other things.

And I'm just wondering, maybe it would be more productive to focus on the demand side, on the areas where we would like to see innovation and growth. Energy, education, health care are not the type of dynamic, competitive choice field markets as IT are. And wouldn't it be better, maybe, to focus on government and other policies that would free up those markets to more innovation and more competitiveness and make it easier for outside entrants to enter with disruptive technologies?

MR. SHAPIRO: Well, let me take a crack at that and then maybe Bob. So, you know, you should hear Aneesh Chopra. He's the current chief technology officer of the United States. He's wonderful, I get to work with him pretty often. He's very energetic. And one of the things he's really pushing, and others, is that some of these areas where the government -- or the government is buying a lot of the services, and I don't just mean the federal government. State or local government are where we don't see as much innovation. Educational technology, health, IT, some areas we're trying to kind of standardize and move forward.

So I think when the government is on the demand side -- I mean, educational technology is a great example. It's very Balkanized. We don't seem to be getting scale economies, it's sort of sluggish in terms of adopting new technologies. That's a real challenge. It's a challenge for the CTO, it's a challenge for our chief information officer, so we can do learning.

One of the things in the Affordable Care Act is to try to do a lot of experimentation in the health care sector so that we can see what works and

hopefully save money there by rewarding the business models as well as technologies that are more successful. So, I think that's a big area of demand pull where the government could do better.

MR. LITAN: So I'll just add to that. I don't know whether this is demand or supply, but we're coming out with a paper, Kauffman is, in January called, "License to Grow." It's a survey of a lot of the fields that you talk about where we have state and local licensing provisions for people to go in, whether it's education or doctors or lawyers. There's a book here that was published at Brookings that Cliff Winston and Bob Crandall did on licensing lawyers. You can just go down the list --

MR. LERNER: In Florida, it's dog walkers have to get licensed, right?

MR. LITAN: Dog walkers, et cetera. In fact, there's an index of the share of population, which now has to be licensed to do something, and it's gone straight up. And it gets at your issue. And so all these things are not at the federal level. These are state and local things that need to be done and are better addressed, obviously, to legislatures there, national government association. But we think they're huge opportunities for unleashing a lot of creativity if we got rid of a lot of these licensing restrictions.

MR. SHAPIRO: And one example where we were able to push a little bit in that direction is for veterans, actually, coming back who had training maybe as medics in the military, come back and try to ease the way that they can get civilian jobs and reduce the licensing barriers they would face when they

actually have, you know, good training and experience, but there can still be delays because of these obstacles.

MR. LITAN: Right.

MR. LERNER: Okay. I think we can go on for hours entertaining ourselves, but the show must go on. So with that, I will end by very much thanking our panelists for sharing their perspectives. (Applause)

So, let me -- we're doing a little software upgrade here. I'll just tell you I have the honor of introducing Karen Mills. She is, as you all know, the administrator of the Small Business Administration.

Prior to running SBA, she served as the president of a private equity group called MMP Group, and prior that, the director -- founding partner and director of Solera Capital, whose primary focus was in investing in women-owned businesses.

She's got many honors including her alma mater and my employer, Harvard Business School. So, assuming the technology is ready --

MR. LERNER: It's not.

MR. LERNER: It's not. Okay.

MR. LERNER: We had this earlier problem, but we have a back-up plan.

MR. LERNER: We've got a back-up plan. This reminds me of some of the technological difficulties we encountered in our day. Our previous dean at Harvard Business School didn't like to invest in computers. He used to be a forest ranger, so we kept on upgrading the software, layer after layer, until

one time trying to do an Excel spreadsheet and the little old IBM XD that we had caught fire, started smoking. (Laughter)

In any case, this looks more promising. In fact, it looks really good.

Without further ado, thanks again.

MR. KURTZMAN: Good morning. I'm Joel Kurtzman, senior fellow at the Milken Institute and at Wharton, and I'd like to welcome everyone to this panel, which is on innovation and how we can get it going more quickly for the country for growth.

One of the disclosures I wanted to make, though, at the beginning, I just heard here, is that neither of my co-panelists are economists. So, that will give us a different perspective. However, we do have the opportunity, in some ways, to do kind of some real world tests of the statements, figures, and assumptions that were made by the economists and I would like to introduce my two panelists, and that is -- now, you have bios, so this will be just very short, and we have Ron Bloom, who was the President's czar -- I don't know whether that's a technical term or title, but -- for manufacturing, and he has recently taken on the small challenge of the Post Office. Now, Post Office, innovation panel, you draw your own conclusions.

And we have A.G. Lafley,who was the chairman and CEO of P&G and is now a partner at Clayton, Dubilier & Rice, a private equity firm, and has made the transition, in a sense, from the operating world where the innovations

actually have to get put into the pipeline and conceived and developed and made, to more on the financial side.

So, what I'd like to start with, because innovation has come up a lot in terms of the whole day that we've had discussion is, how -- let's have a common definition of innovation. What do we mean by innovation? Ron?

MR. BLOOM: Well, I'm, again, not an economist so I can sort of say anything I want. I mean, I think innovation is relevant to a purpose, so innovation as -- we could describe it as doing things differently than we've done them before, but the purpose of innovation, the challenge we face, is obviously the fact that we are not creating good jobs. We don't have enough jobs, and we're not creating -- and the jobs we're creating are not good jobs.

So, I think the relevant question is, is innovation going to help us with that problem? So, the definition seems only relevant if it's to a purpose and I think the purpose, the reason why anyone gathers at this, is not to have innovation in the abstract, it's because we believe that by doing things differently we can create more wealth and that is the key to obviously what we want our economy to do for its citizens.

MR. KURTZMAN: Okay, so we're talking about innovation as a wealth creation tool. A.G.?

MR. LAFLEY: Well, I'm about as practical an operating manager as you're going to see probably, Ron and I, this morning. I think innovation has to create a customer or a more loyal customer. No customer, no innovation, no business. I think it has to create some value for that customer and ultimately has

to create some value for that business. And if it does create value, I agree with Ron, it should result in employment.

MR. KURTZMAN: Good. So, we have some agreement on innovation. In very practical terms it's different from invention, it's different from creativity and so forth, it's practical, and we could, by the way, have an entire panel, I think, just on questions raised by Brooks in his panel, but one of the things he said, and I'd like to explore it a little, is that there's kind of a dearth of innovation right now, that we've kind of hit a wall, the low-hanging fruit has been picked except in few areas, IT and so forth, as he mentioned, we're running out of things to innovate around.

Is that true? Would you agree with that, Ron?

MR. BLOOM: Well, I would not agree with that. I think there's a huge amount of innovation going on out in the economy. You know, one of the things I did in the Administration is hang around the car business a little bit. You know, in 1956 the Ford Motor Company went public. At the time it went public it was a 50-year old company. Nobody in the prior 40 years -- so, if we take from Ford in '56 and go back sometime into the '30s, nobody started a car company in America. So there were no OE car producers that survived, and the Ford IPO is not the creation of a new company.

Last year Tesla went public. Last year a company that was formed a few years earlier had the temerity to believe that it could get into the OE car business, a business that most people would have said 10 years ago was closed. You can't start a new car company in America. That's preposterous.

There are dozens of people out there in America today who have that same temerity, who have that same audacity, that they can form car companies. Some of them -- none of them have gone public yet, and maybe they will and maybe they won't. My guess is most of them will fail, that is the nature of innovation and change. Some will be bought by a big company as happened when the car business was sort of first formed in America 100 years ago. But there are people out there in a little space I know a little bit about who have this audacious notion that they can form an OE carmaker.

So, I think there's a lot, a lot of innovation going on out there and I think it's fair to observe that the context into which innovation is occurring today and into which this challenge of creating good jobs is occurring is a different context than it was 10 or 15 years ago.

The basic rules of the -- the basic context of where the global economy is, the role that America plays in the global economy, this terrible overhang of deleveraging and lack of aggregate demand, these are all very important factors and so I don't want to wish away the seriousness of the problem, but I don't think we have lost in America the desire of people to start new companies.

MR. KURTZMAN: A.G.?

MR. LAFLEY: I couldn't agree more. I come from the non-innovative, large cap part of the world that doesn't create jobs: 33 years at P&G, 10 years as a director at GE, so we're talking about Fortune 25 companies here. The company I joined in 1977 did $5 billion in sales. The company I left in 2010

did $80 billion in sales. Yes, we made some acquisitions, but most of that was organic growth. You can do the math on the growth rate.

The company I joined originally employed 6,000; the company I left employed over 130,000. And that doesn't count our network of satellite suppliers and customers.

Both GE and P&G are spending more on R&D than they ever have in their history. I've seen more interesting and new material science, more interesting and new energy technology and energy sources, more interesting and new chemistry and biochemistry, and I'm a medieval and renaissance history major, so that should frighten you. But it's just not my experience.

I guess the other thing I would say, I'm also a bit of an historian and my recollection is in the doldrums of the '70s, the stagflation and -- we had at least two recessions, as I recall, in the '70s, another big recession in the early '80s. That's actually when a lot of the most innovative companies in America were created. And I was telling Ron earlier, I suspect we can't see a lot of innovation that's going on in garages and around America.

And I guess the last thing I would say, I don't think there's an issue with money. I accept the fact, and I've heard that small entrepreneurs and small businesses struggle a bit more and I understand that, but I think the capital is there. I think we just have to funnel it to those innovators.

I think the big opportunity is creating the associations, the connections, and the collaboration that really unleashes disruptive innovation, because a lot of disruptive innovation comes around the edges of established

industries, it comes around the edges of existing technologies.

If you go into a hospital today, the pathology department is completely separate from the scanning or radiation or MRI department. Okay? Great diagnosis is going to come from a combination of the two disciplines and the two sciences.

So, there's a lot of opportunity in finding ways to make the human connections and social connections, which, as I said, tend to be associative, connective, and collaborative, that are going to unleash a lot of the innovation that I think is there and ready to go, or at least ready to be unleashed.

MR. KURTZMAN: It's kind of an American catechism, so to speak, to say that large companies are not the innovators. And you've just shown that, in fact, they can be.

Ron, you've just come out of working to transform an industry that has been considered to have lost its innovative capacity, but can large institutions, can large companies innovate? Can they become -- can they launch new products in the way that they could when they were brand new and young?

MR. BLOOM: Well, Exhibit A says they can, but let me talk about the car business and make another point. You know, I think there's an artificial distinction we make a lot of times, at least, again, my field has been manufacturing, so let me talk specifically about that. We talk a lot about small business and large business and in our sort of mythology, small business, good; big business, not so good; small business, innovative; big business, not so innovative.

In manufacturing I think there's a much deeper connection -- and, again, I'm not going to speak about service companies, it's just not something I know as much about -- but most small manufacturing companies sell to big manufacturing companies. That is most of their customers. So, the innovation that is occurring in a lot of these manufacturing sectors is collaborative between small companies and large companies, and that kind of relationship is a very important relationship.

And one of the things, I think, that has occurred in the car business in the U.S., which is a good development, is the car companies, the OEs have opened up in a much better way their relationship with their supply base.

There was a long period of time where there was a much more confrontational relationship between the OE customer, if you will, and his or her supplier. I think you're seeing a lot of collaboration and cooperation between the large and the small company and that's where the innovation is going to occur because I think there are -- I think there is a recognition, while there can be good innovation with a big company, and I think you see these companies reinventing themselves, it is true that the guys in the garage can offer an element which is harder to do in a big company.

Bigger companies find it hard, unless they really are exclusively focused on this problem, to kind of eat their young and so I think these problems have been documented. And so that's why that relationship between the OE and the supplier net is actually quite important. And I'm not sure there's a huge

amount for the government to do, per se, in that area, but creating the -- setting the table, whatever phrase we want to use, for that kind of collaboration, innovation, I think, is at least in manufacturing where you will see a lot of very important innovation.

MR. KURTZMAN: You agree, A.G.?

MR. LAFLEY: Totally agree. And I think it's collaboration up and down the value chain and it's collaboration horizontally across adjacencies. In 2000, only about 10 percent of the new products and services we would bring to market in a given year had one or more external partners. We set a goal of getting that to half. We thought it was a stretch goal. I think in 2007 or '08, half -- more than half of all the new products had one or more external partners. A big chunk of them were suppliers --

MR. KURTZMAN: Yeah, describe what that means in terms --

MR. LAFLEY: Well, what that means is that we were doing 90 percent of our innovation in-house, on our own. Okay? And suppliers were providing materials and packaging and things like that, and then after that, you know, we'd be co-creating a polymer, a chemical polymer together, we'd be co-creating a new formula together, we'd be co-creating a new manufacturing process together. Okay?

But it wasn't just the supply chain. You know, we opened up to university research labs, university scientists, we opened up to government research centers, we've done a number of things with Los Alamos, we work with international, you know, research labs. We've actually -- I mean, there's a young

Korean, literally, in a garage that we've done a couple of things with, you know, but we find each other on the Internet because we put out problems or issues of interest on the Internet and that's how we connect.

MR. KURTZMAN: Crowd sourcing type of --

MR. LAFLEY: All kinds of networks. Some are science and engineering networks, they're probably pretty obvious. Some are we literally pay bounties, you know, we have a technical problem that we're trying to solve and if you, you know, if you look like a likely partner to solve it, you know, we'll get together.

Let me comment on the other part because I think I have an insight from experience there. If you really think about innovation, it's a process and it starts with an ideation or a kernel of a technology or something that's, you know, very early in the formative stage, and somehow, someway it's got to be conceptualized and, I would argue, rapidly prototyped and put in front of a customer. And then if there's interest, it's got to be developed, which is all the feasibility issues, can we make it? Can we deliver it? Can we do it in a way that creates value? Then it's got to be qualified and then it's got to be commercialized.

But companies like P&G are really good at developing, qualifying, and commercializing. Frankly, we're not better at creating and we've had to teach ourselves rapid, low-cost prototyping because we tended to be the high-cost spread in prototyping and it took too long. So, my view of the world is, there's a huge opportunity for us to provide complementary capabilities, okay,

that can help accelerate, you know, accelerate entrepreneurs and innovators.

We introduced the only probiotic that you ingest by taking a tablet -- or actually it's a pill, it's a capsule -- everyday. Our partner was a small entrepreneur, okay, in Ireland.

We're running a company -- we're actually joint venturing a company called MDBIP. It's a, you know, I would call it a concierge alternative to family practice where doctors, instead of taking 1,500 to 2,000 patients, take 400 patients and they give you much better care and service, including an annual physical, nutritional help, you know, physical training help if you want it, all that kind of stuff.

But the point I'm trying to make is lots of our, I think, most interesting ideas and some with the potential to become, you know, new spaces, new industries, you know, came from this sort of, you know, marriage or at least dating of an entrepreneur who's got an idea but needs some capability we have. And the capability isn't money, the capability isn't capital, the capability is, you know, something that we can do to help him or her advance the ball along.

So, I think if you think about it as that funnel, there is actually a role for different players, you know, in the private economy. And I'm with Ron, I don't think, you know, at least a company the scale of GE and P&G, we don't need, you know, we don't need government subsidy. We need simpler regulation, you know. We need transparency, you know. We need rules that stick, but we don't need the incentives. The incentives, you know, there are certain parts of the economy, early stage, where I think the incentives are of

more value.

MR. KURTZMAN: Well, let me ask you on that point, Ron, the automobile industry is still standing thanks to your work, in very large part, and I guess in a way you took on the role of private equity firm when you did that. You had government funding, you had authority, you had to change a culture as well in the companies that you worked with. How did that operate within the context of government? Were you able to do it successfully? Did you have a lot of headwinds from your counterparts and so forth?

MR. BLOOM: Well, the first thing I would say, as a broad matter of sort of public policy, what we did in the car business is not, in my opinion, a model of how the government ought to act in the private economy.

You know, we arrived in February of 2009. The economy was in free fall, all three companies were on the verge of liquidation, and a judgment was made that -- and I don't use this in kind of a technical term, but a judgment was made that the collapse of the car business posed systemic risk to the overall manufacturing economy. And so extraordinary times justify extraordinary measures, and so we did an intervention in the car business that is not, I think, a model as to how government ought to behave in the private economy.

But that said, it's an interesting little story and it does point out, I think, some of both the opportunity and the limits. I think your characterization of our work is, in fact, reasonable. We had a little skunkworks sort of inside the Treasury Department. Because of the odd way that the TARP was created we were given enormous freedom to kind of do the right thing and had, you know,

support at the very top of the House, from the Secretary of the Treasury, the director of the NEC and the President of the United States, who said, do the right thing.

We were private equity in the sense that we were told to treat this as a commercial problem and to act like this was kind of -- we were the stewards of the taxpayers' money, and how do you fix this thing? I'll make two points. One is we were not told to target a return. We were told to fix a company and obviously private equity has a different mandate. They have a pile of money and they pick and choose their investments and they decide whether or not the particular opportunity provides an appropriate return for the beneficiaries they're ultimately speaking for.

That was not the mandate here. While Chrysler had a flavor of that in the sense of do it, don't do it, the mandate was to try to fix this industry. So, what I like to say is, our return analysis was just, we kind of took a -- we just kind of moved a decimal point over. So, we weren't trying to hit a particular return, we were trying to hit the best return that was available in the context of fixing the companies.

So, that's one thing, I think, that's important. And, again, it was a very odd set of circumstances and the degrees of freedom we were given are not the degrees of freedom the government normally has, which I think is among many reasons why it's not a model.

But the second thing is, and here, again, I think this goes to the nature of the different actors in the kind of private equity drama, while we were

exceedingly interventionist during the restructuring and without apology, you know, as stewards for the taxpayers, involved ourselves in a number of key decisions that were made, although we did not take over the running of the company, that was left to the management. But immediately upon the conclusion of the restructuring a very conscious decision was made to step back and to essentially give the oversight of the company, instead of to the government, to a group of independent men and women who were set up to be on the boards of directors of these companies. And, again, that was a very conscious decision that had to do with the fact that while the intervention itself was justified, this level of intervention into the private economy is not a good model as to how we behaved and so there was a big step back.

MR. BLOOM: I think the relevance of that is, is that financial engineering, which is largely what can be done in a restructuring, was a critical part of fixing these companies. They were badly over-levered. Their cost structures were hopelessly out of whack. But the hard work of fixing companies, the culture change, which is ultimately the thing that really decides whether or not a company can go from a wealth destroyer to a wealth creator, was not our job. Our job was to find men and women who would supervise the management, be very active as a board of directors needs to be in supervising the management and making sure that they effectuated the culture change, but that was really, again, not a role that we felt government should play and we very consciously didn't play it.

MR. KURTZMAN: Let me ask you, A.G., so you ran one of the

most iconic, largest companies in the country, in the world. And now you're in private equity. Is you thinking different as a private equity investor than as an operator? Are there changes as you look back when you were running P&G that if you looked at as a private equity investor you might have made differently? People talk about freedoms. Do private equity firms have more freedom to experiment, innovate, and so forth?

MR. LAFLEY: I guess the first thing I would say is Joe and Don, I think, want me to think like an operator. That's why I'm on board. So my primary responsibility at Clayton Dubilier -- and, frankly, their business model, their strategy and their business model, is I would call it two in a box. There's the financial leader and there's the operating leader. And from the time we're vetting the options for investment through the decision to make the acquisition through the operation for a period of usually five to seven years, through the exit, they're side by side and we try to generate 75 percent or so of the ultimate value creation from improvements in strategy and operations. So I think my role, my primary role, is the same.

There is a difference in time horizon. There is a difference in urgency. You know, at P&G we used to sort of pride ourselves in taking the very long-term view. Unfortunately, the law requires we report financial results on a quarterly basis in the United States of America, but, you know, we tried to, you know, minimize that and literally focus on decades at a time.

I think in the private equity game more of the value creation has been generated by the capital structure, the improvements in business focus and

operations, and we're just beginning to learn that one of the big drivers is revenue growth, organic growth, or organic or inorganic if acquisition is the route. And we can get a little bit more the value creation in that area, so I think that's going to be interesting and maybe one of the reasons why I'm aboard.

And I guess the last point I would make is if you're really in an innovation game, you know, the capital has to be patient. There was a question of the earlier panel and I wonder whether the fundamental issue is too much of the capital isn't patient, okay, or patient enough.

And the other thing I would say, and actually this is just reaffirming something Ron said, this is an incredibly risky business. You know, in my simple industry of household products and personal care products, 85 percent of all new products fail. They're not around. They're not in retail distribution three years later. There's a museum in upstate New York full of failed P&G products, okay? (Laughter) No, they just -- it is a risky business, okay? So you're taking on risk and you're taking time horizons.

We were in the pharmaceuticals business. It could easily take us 15 years to come up with a new chemical compound for postmenopausal osteoporosis as we did. In some of our more capital-intensive paper businesses the cycle was easily a decade. You know, we worked for a decade on a totally new chemistry and technology for feminine protection. In the color cosmetics business, if I had the wrong lip color for the spring season, I was dead. (Laughter) So, you know, and we could all talk about whether that's innovation or not, but I don't want to go down that road. (Laughter)

But for the most part, the innovation cycle is longer and, for the most part -- I'm not saying private equity isn't, doesn't take risk. We do take risk. We work real hard to squeeze a lot of the risk out and it's a lower risk profile if we do it right than the risk profile that we take on some major new technologies and major innovations.

MR. BLOOM: Let me add something about -- and we had some discussion earlier about the different private equity, the mid-market versus the larger firms. And I think it might be interesting to sort of think about it this way: that the mid-market private equity firm is largely replacing another private owner. It might be a man and woman who started the family. It might be a family who's into the second generation, who wants to get liquidity. But generally speaking, in the size of the company that was identified, the alternative to private equity is not public capital markets. The alternative is some other form of private capital. And so we can compare those two forms of ownership and ask kind of what they bring to the party and what their aspirations are and whose time horizon is shorter, whose time horizon is longer. And I would argue, again, I'm sort of with Carl, I'm a bit agnostic on this. I think it's just good to see the distinction that if a family owns a business, it can be that their horizon is extremely long because a person can start it and tend to give it to their children, and so have sort of an infinite horizon. On the other hand, they may be less interested in innovation because a lot of what a small company is doing is simply making the money to support the lifestyle of owners. And so the idea of trying to be disruptive and take huge risks in a family business can be less than a private equity firm would

do. So I think we can kind of compare and contrast in the mid-market.

When the alternative is the public capital markets I think, again, you have this odd dichotomy, which is the owners of the public company have a way shorter time horizon, by and large, than private equity, whether they're day traders or hedge funds or mutual funds. Their time horizon is exceedingly short. But because of the agency effect a management can have a lot of freedom, if you will, to have a longer time horizon. Now, what they do with that is not -- sometimes it is to build great companies and to take a very long time horizon and sometimes it's to try to maximize value very, very quickly to realize on stock options. So there's not -- again, there's not one behavior that exists. But I think it's important when we talk about private capital to distinguish because these are alternative forms of ownership and so the question is what is it an alternative to? And I think, again, I'm agnostic as to whether any of those four -- that 2-by-2 matrix produces necessarily better results, but the compare and contrast between the two of them is quite different.

MR. LAFLEY: I think the key -- if I could just (inaudible) it because I think this is a very interesting discussion, the key is strategic alignment. We were fortunate, we were a public company, but half of our ownership, maybe a bit more, was individuals, okay? A big chunk of it was P&G retirees and every one of those 130,000. Okay. And we were lucky to have big holders like Warren Buffett and (inaudible) who had long time horizons, so we weren't, you know, buffeted too much by the hedge funds and the ones that wanted to churn. And they also knew we were the wrong industry and the wrong company to try to

push volatility in any way, although there's been volatility (inaudible).

MR. KURTZMAN: And they didn't want to mess with you anyway. (Laughter)

MR. LAFLEY: Well, no, no. Actually that's -- yeah, that's another discussion. (Laughter) They have different ways of messing with you.

The other point, though, that I think builds on Ron's comments is that I think there's been a lot of -- you know, this is the whole point, it's about getting the right owner matched up with the right strategy. A lot of medium- to large-sized private equity has done well with carve-outs. Carve-outs are, frankly, the divisions that we didn't run as well. And the part of your question that I didn't answer is we got better at divesting, but we never divested soon enough. And we got better at partnering with private equity, but I don't think we were as good partners with private equity as we could have been because they were just businesses that we had that were, in the end, not strategic for us, where were not a strong enough player, not a leading player, that could be run better by private equity than we could run them.

MR. KURTZMAN: So the point of this panel is how do we accelerate innovation? How do we get more of it? And given what you've said so far and what's been discussed, how are we going to accelerate the innovation process and, in essence, make it more democratic, get more of it out there into the marketplace, more companies affected? Ron?

MR. BLOOM: Well, let me say, you know, till a couple of months ago, I worked here full time and so I can't resist doing at least a little bit of politics

when I'm here. Look, I think we can have a good debate. We don't have to have it right now, but we can have a good debate about everyone's favorite, you know, company that begins with an S that's in the solar panel business. And we can have a good debate about what the proper role for government is in that part of Carl Shapiro's pyramid. I would observe that there shouldn't be, and yet there is, a debate about the bottom of the pyramid. So I would argue that there are things the government -- are pretty obvious that the government can and should do that are our political system is not permitting the government to do.

And again, obviously I work for the Obama Administration, so I'm somewhat partisan on this, but let me just step back and say it's a failure and others can assign the blame. But the fact that the government can borrow money essentially for free and isn't investing in infrastructure, which pays dividends both socially as well as greasing the wheels of commerce for business, as well as putting the people who are hardest hit by the recession back to work, on and on and on, the fact that we can't find a political solution to invest in infrastructure, we can't even find the political will to invest in infrastructure when the particular proposition in front is to do it in partnership with the private sector. So even when we put forward the notion of an infrastructure bank which says, look, the government shouldn't do all this, there's a lot of capital on the sidelines, everyone's favorite story. Let's find a way to have the government be the instigator, but let's have these deals be rooted in private participation. Let's do what the rest of the world does and look creatively at private capital coming into infrastructure. We can't even have that discussion.

We can't have a -- right now we can't even seem to agree to continue the payroll tax cut. We can't have a discussion about making permanent the R&D tax credit, which, again, one can debate exactly it's positive spillover effects, but it's hard to imagine that given the totality of our economy that whatever negative repercussions aren't outweighed by this as a way to spur innovation. Will it exactly have the impact we want? The economists can debate that, but it can't be that controversial an idea.

So here we have two ideas -- to invest in infrastructure and to make the R&D tax credit permanent -- and our political system doesn't permit us to have a rational discussion about how to do that. So I think that it goes back to where we were at the beginning. There's a lot of good stuff happening out in America. There are people, as I said, from my little world trying to invent OE car companies. There is a lot of people who believe still that they can come to America and change the world by building a great company. I think the challenge we face is our political system is not up to the challenge of setting the table properly. And again, I obviously have somewhat partisan view about the relative allocation of blame, but even if your view were the alternative to that, I hope we could all agree that the fact that it's not getting done is an important retardant to why we're not getting more output.

MR. KURTZMAN: So you're saying that essentially government is inhibiting innovation right now?

MR. BLOOM: I think government isn't doing -- again, long before you get to the discussion of whether we should do more Solyndras, long before

you get to that discussion, we ought to be able to agree we should be doing infrastructure, and we can't even get to that. So yes, I think the failure of the political system to rally around what I would think of, and I think 80 percent of policy people would say is a pretty commonsense thing you ought to do in a time of slack demand and low interest rates, investing in infrastructure can't be a very controversial decision and we can't seem to come to that.

MR. KURTZMAN: A.G., how do we get more innovation?

MR. LAFLEY: We've never met and we're in incredible agreement here.

MR. BLOOM: Scary.

MR. LAFLEY: I think there are -- but I would say it this way: We need to be -- we need goal and strategic clarity; we need to be brutal on competitive advantage and where we really stand, really, really stand, okay, for innovation leadership.

So what do I mean by "goal and strategic clarity?" We don't have an energy strategy. You know, is energy independence most important? Is energy affordability most important? Is some environmental aspect of energy -- but if we were just crystal clear. You know, my hypothesis, energy independence is most important. We have the technology that can take just about any energy source, put it through just about any kind of energy plant and distribute it, okay, so it's not a huge technology problem. But I would argue we don't have a strategy. And, oh, by the way, we haven't had a strategy, you know, in my -- the lifetime I can remember, since the '60s and '70s. So I do think one of the roles of

government is to be crystal clear on the goal and strategy.

Competitive disadvantages. You could make a case that our country has a major primary and secondary education competitive disadvantage. The point about not very much innovation in education came up earlier. There is some innovation. Some of these charter school programs, Teach for America, are doing a hell of a job. But for some reason, we can't get the innovation spread. It's spreading at the rate of pioneers crossing Oklahoma in 1907. (Laughter)

And I would argue we have some government competitive disadvantages. I like the rule of law. I much prefer a capitalistic democracy, but we have some disadvantages and the government has to take a hard look at what they are and they've got to straighten them out because they put us at this disadvantage when we're competing for innovation and we're competing in a very competitive global world.

MR. KURTZMAN: Thank you. Do we have time for a couple of questions?

SPEAKER: Well, maybe. Yeah, a couple minutes.

MR. KURTZMAN: Okay, a couple of minutes of questions. There's one in the back there.

MR. WHITE: So the word "ambiance" was used earlier.

MR. KURTZMAN: You want to identify yourself, please?

MR. WHITE: I'm sorry, yeah, Dan White (phonetic) and, like Rich, with ACG. The word "ambiance" was mentioned earlier. Within the confines of a

large organization, you know, a public corporation, government, how do you create an ambiance within the organization that promotes innovation? Do you set up a skunkworks? Do you buy it? How do you promote it?

MR. LAFLEY: Within a GE or a P&G?

MR. WHITE: Also within the government. I mean, everybody talks about --

MR. LAFLEY: Oh, within the government, yeah.

MR. WHITE: Or, no, but also within the confines of a corporation.

MR. LAFLEY: Yeah, okay.

MR. KURTZMAN: By "ambiance," you're talking about table setting, meal, cooking --

MR. WHITE: A culture that promotes --

MR. KURTZMAN: -- and now candles.

MR. WHITE: -- innovation.

MR. KURTZMAN: Okay.

MR. LAFLEY: Ronnie and I actually spent some fair amount of -- you know, I have to confess, I served on the Innovation Committee of the President's Job Council, so I have a bit of a stake in this and an oar in the water, but, hey, listen, at my company we had to declare very clearly what the strategy was and what role innovation played in the business model. It drove all of our organic revenue growth and a significant part of our margin improvement. Okay? Most importantly, it was the single best way to attract new customers, okay, and to convert current customers into ever more loyal customers. Okay, that was the

most important.

So once we understood that, then we got crystal clear about which specific technologies. We picked 8 initially, 11 ultimately at the end of the day that we were going to be world-class in because they drove our household care and personal care product industries that we wanted to be the leaders in. And then we organized for it and then we worked like heck on the culture because we had to turn from being incredibly internally focused to being all of a sudden far more connected, far more collaborative. And that's going to be a 100-year process, right? The company's 175 years old. It's got the culture it had when I picked it up at 165 years. We made some progress, but it's going to have to continue on that course.

I don't think it's that different from the government. The only challenge the government has is less time to govern, right? You know, we could get into -- we have a system where, you know, representatives are elected every two years, the President's elected every four years. Unfortunately, the campaign cycle is longer than the governance cycle, which makes absolutely no sense to me. You know, we used to start at the time of the conventions, right, in late August, and then the campaign would basically be September and October, and we'd vote in November. You know, when did governance end and campaigning begin in this cycle?

So, I mean, I think conceptually it's not difficult. Practically it is a bear. It is a bear because we've evolved to the situation that we're in. We didn't just, you know, drop into the situation.

MR. BLOOM: I'll say one final comment, say one thing about the government as innovator and one barrier that I think -- I know that the administration has worked a lot on, but, again, I don't think this is a partisan point, I think this is a learning point. And it goes back to something A.G. said about sort of looking around the world and saying what we -- our basic frame in America rule of law, capitalist democracy, is obviously something we treasure and want to guard zealously. But I think the ability of government to learn from business is something we don't do very well in America. And partly it's simply the nature of kind of who goes into government versus who goes into business. There's not a lot of interplay back and forth.

Most businesspeople are aghast at the notion of going to serve in government because of the level of kind of invasiveness to your personal life and a whole lot of other reasons. But when you have companies that are as successful as some American companies are at doing innovation, that is something that the government can learn a lot from. But part of our problem is we're stuck in a relationship between government and business.

And by the way, I don't think this is a Democratic or a Republican problem. I think this is an American government problem as to how we kind of think about business and how we think about our relationship. And to bring companies in and try to learn from them would all of a sudden mean, you know, you were in bed with companies, that's not the way the world is -- that's not the way the rest of the world is working. The way the rest of the world is working is government and business are in a constant dialogue about how they can serve

each other and do better together. That's just not been the nature of our discussion in America, and I think the innovation is just one example of that, but it's a good example where a whole lot of learning could take place between that would benefit both.

MR. KURTZMAN: Well, we're going to have to leave it at that. Thank you, Ron. Thank you, A.G.

(Applause)

MS. MILLS: That was impressively done. Thank you very much.

Well, thank you for the kind introduction and I am quite delighted to be here. The first thing I have to say is happy National Entrepreneurship Week and National Entrepreneurship Month. The President proclaimed this National Entrepreneurship Month, but -- is Bob still here? Bob Litan? -- yup, you, at Kauffman, have declared this and led the charge and really initiated National Entrepreneurship Week, so thank you.

I come, as Josh was saying, from the private sector, so -- and from the world that has been discussed this morning, and I'm particularly glad to be here at Brookings because it was through Brookings that I started my slippery slope into the current job. I was involved in the great state of Maine, where I live, in some economic development and job creation clusters, and Brookings came and I ended up writing a paper on clusters for Brookings, came on the transition team, and now have the great pleasure of leading the Small Business Administration.

I want to talk today about three things: the sort of subtitle -- the

title here is “Entrepreneurship and Creating Small Business Jobs,” the subtitle is “Where have the jobs gone and how are we going to get them back?” And I want to tell you a little bit about some of the specifics we’ve been able to do at the SBA, articulating some of this public-private partnerships that were discussed today, and then most importantly, going forward, what are these strategies? What are the strategies for being on the 40-yard line, working in partnership between the federal government and the private sector, particularly in this industry, so that we can do more job creation and drive more entrepreneurship and more innovation?

So, first, the facts about small business. Half of the people who work for this company -- for this country, work in this country, own or work for a small business. So, half the jobs are either people who are involved in running and owning the business or working for the business, and 65 percent of the net job creation comes from small business.

Now, about 28 million, this number goes up and down, small business, only about 6 million of them actually have employees. So, we’re going to talk about the force of small business, both the high-growth entrepreneur sector and the Main Street small businesses and what they have experienced in this economic downturn.

If you look at what happened in the recession, small businesses just got crushed and they haven’t recovered yet, so the red line is the small businesses, 62 percent of the net job loss came from the small businesses, and things have gotten better but they started dipping back down, particularly in the

summer, with that lack of business confidence -- there was a crisis of confidence really across the country in the middle of the summer and small businesses really have yet to recover.

If you look at where in the small business world those job losses came, 32 percent of them came from the smallest businesses. If you look at the whole dip was about 7.7 million jobs, 137 down to about 130 million jobs, and 2.5 million of those came from small employers, 1 to 19 employees.

So, these are both new and starting businesses, growth businesses, and, importantly, they're also Main Street small businesses and we know that these are the firms that really drive job creation.

And one last major chart on the macro picture, these are births and deaths, so this underlines some of the points that were made earlier. There's a big gap, an unusually big gap, that occurred in births and deaths. Failures just accelerated and births just stopped. Now, the two -- the gap is getting back together, but there's still a gap and we are not at the level of new business creation that we need to be. And that's really illustrated by this, one of, I think, the most powerful charts on small business job creation. We are down 100,000 new starts. Our economy, day-in, day-out, year-in, year-out, in the past, even in recessions, has created about 600,000 new businesses every year. And now we're down to 500,000.

So, this has the impact -- I know there's a lot of talk about is it new firms, is it young firms, is it entrepreneurs -- but we know that this number, according to McKinsey, and I think the team that did this actually was here in the

room, this drop in 100,000 new starts is likely to have accounted for about 1.8 million of the 7 million gap -- 1.8 million.

So, why are these new firms not starting? Maybe the failures are tapering off, but we're not starting the new firms.

So, switching gears for a second, with that background, what's the SBA's role? What does an agency like the Small Business Administration do in this environment? We came in in October 2008, we had seen just a credit crunch. We come in around the beginning of 2009 and what do we do? It's our job to fill the gap, particularly in capital, and many of you probably don't know what the SBA does. We have a portfolio of $90 billion of loan guaranties and we are partnered with about 5,000 of the 7,000 banks that are out there. We tend -- we usually are guaranteeing these loans as opposed to making them directly, so, public-private partnership, big public-private partnership.

And we have a big role in the area of private capital. We run about 150 Small Business Investment Companies, SBIC, we have about a $3 billion annual authority to put money into those SBICs and right now we have about $11 billion outstanding capital in those companies. They perform very well and provide a pretty good return for taxpayers. They are zero subsidy. Zero subsidy, so no current cost to taxpayers because, of course, the companies do well and pay for the losses.

So, this brings us to what have we been doing with this portfolio at the SBA? And coming back to the current crisis, when the recession hit in October 2008, the credit markets, for small businesses, just froze. You can see

that right here we're still down $100 billion in credit to small business.

Small businesses were lucky if they were able to keep their lines of credit. I was traveling all around the country. They'd say, I need a loan to save my business. Good businesses had their credit lines pulled. And if you look at what was happening in the credit standards, they were tightening for a very long period of time. This is the net percent of credit officers that said that they were tightening that quarter.

So, they're tightening, tightening -- 75 percent of them said they were tightening at some point. Now it's gone positive, that means a net 9 percent say they're loosening. But that means there's a lot still tightening and only a net 9 percent are loosening.

So, we are working very hard on this. I am partnered with the FDIC. Sheila Bair and I spend a lot of time on this issue and with the Fed trying to tell banks that the credit standards that were set on small business, the guidance, needs to be executed at the regional levels, that it can't -- the pendulum can't swing so far that good credits are not getting funded.

What did we do at the SBA at this period of time? Well, we stepped into the gap because, remember, we give a guaranty, a government guaranty, which helps a bank make a loan that they would not otherwise have made. If you're a small business and you can get credit from the marketplace, then the market is working. Why should taxpayers subsidize your business? But if you're a good business and you cannot get credit elsewhere, that's where the SBA steps in.

Well, I'm pleased to give you our report card because we just had the biggest year ever in SBA history, we had a record year. We did $30 billion in loan guaranties in this fiscal year just ended and you can see in the background that gray line is our actual monthly volumes. It goes up and down, up and down because the first thing that happened is we're in 2008, credit markets drop in '09, the bottom just falls out, we come in with the Recovery Act, we raise our guaranties to 90 percent, we reduce and eliminate the fees, and our volume comes roaring back. So, this is a great example about being on the 40-yard line, as I heard was discussed earlier. We were there with a government guaranty program, pretty good bang for the taxpayer buck, only cost us about $1 billion+ to do $30 billion in loan guaranties, and 5 times Congress came back and renewed this program, 5 times, ending in the Small Business Jobs Act about a year ago last fall, and we had the biggest quarter ever and were able to really deliver this record year.

So, we're very happy that we're on track now to be above the levels of credit delivery that we were even in 2008.

Another area -- and I'll come back to where the gaps still are, but I just want to move to an area of great interest in this room, which is, so what's happening in the more patient capital, the earlier stage capital? Nothing good. Nothing good for our small businesses. There was a decline in venture capital fundraising, there was a decline in the amount of capital going out. Fundraising is down 131 percent. It's down $17 billion. And venture capital investments into companies, down 31 percent. So, all of that patient capital disappears and the

valley of death gets wider.

So, as the federal partners, what do we do about it? Well, remember our Small Business Investment Companies. What we did is ramp up that program. We have $3 billion of authorization and less than a third of it was being used every year. What we did in this last year was significantly increase our commitments through our SBICs, both the money into the SBICs and the money out of those SBICs into the marketplace. And this is -- the $26 billion is a record year for us. You can see how much is us and how much is the private commitment.

So, once again, an operating public-private partnership, these are investment funds run by investment professionals, so government is not making the decisions, but we are providing the support so that we get more funding out into these marketplaces.

How are we able to do that? Well, we did what everybody has been asking us to do in this Administration and the President has committed to do, we reduced the complexity without creating more risk. We took our licensing times down almost 15 months to 5-1/2 months and we licensed 22 new funds and we have very high applications from women-run funds and minority-run funds.

So, that's what's going on in the SBA of today, in answer to the gap.

So, then the question is, well, what are we going to do next? What are we going to do going forward? Because the problem is not solved.

And this is where I want to come down to talking about three kinds of small business. We used to talk about two, but I've added some thoughts about supply chain, and you heard some great discussion about supply chain just in the previous panel, but we're going to talk about Main Street small business, what they're facing, we're going to talk about high growth-high impact small business that many of you fund, and we're going to talk about small businesses, particularly manufacturing businesses, in the supply chain.

First off, what's happening on Main Street? And the answer is, there's still a gap. Even though we are back up above our 2009 levels, there is a gap in small-dollar loans, under $250,000, particularly under $150,000, and there is a gap in underserved markets. So, even though minority-owned businesses are growing faster than ever, as are women-owned businesses, we are not getting the capital into these markets and they're not getting access and opportunity, and therefore, unemployment rates are high. Some of these are Main Street businesses -- restaurant opens, restaurant closes, failure rate; new restaurant doesn't open, new dry cleaner doesn't open, auto dealer, not open in some of these underserved communities. So, we've really got some work to do.

What are we doing? Well, there's a series of things that we're doing that involve more dollars and more doors. We've got a whole scheme of things but I'll just talk about a couple. We simplified our programs for small dollar loans. Too much paperwork, right? Too much cost to make a small dollar loan. We took our paperwork down.

I actually had this conversation. I delivered over at the White

House, because they had a question on this, the stack of paper that was required before our change and the stack of paper that was required after our change. We're trying to use more of the bank's own paperwork and allow us less complexity, more streamlining, without increasing the risk.

We're also strengthening our micro loans, and then I particularly want to talk about this last thing. Just recently the Vice President and I went and announced that 13 of the largest banks, including Bank of America, Wells Fargo, JPMorgan Chase, have committed an additional incremental $20 billion into these markets, small business loans with particular emphasis on small loans in underserved communities. And that's another public-private partnership that is going to drive more capital where it needs to be.

And if you look at the whole range of equity, we are operating -- and we're not the only ones. Down at the bottom you'll see we have a great partnership with Tom Vilsack, the Secretary of Agriculture, using all of the rural development loan programs in the same context, but all the way from equity in our SBICs through the micro lenders, CDFIs is a Treasury program where we are now allowing them access to our 7A loan product. So, partnerships all across the federal government on access to capital and partnerships with the private sector as well.

So, that's the theme for us going forward and the idea is to make this network more seamless and easier to navigate for this small business and for the entrepreneur.

What else are we doing? Well, the second group I want to talk

about are the high growth entrepreneurs, the ones that, by a lot of arguments, create lots of the jobs, maybe all the jobs. What are we doing for them? Well, there's a problem because entrepreneurship rates are down, and I think once again this is Kauffman data, but it's not a good trend. If you think that entrepreneurship is one of America's greatest assets, what are we going to do with this trend? We have to make sure that more people get access and opportunity to start their own business all across all of the various entrepreneurial groups in America, and so we have a series of things that we're doing.

Many of you heard about Startup America. Startup America is a partnership with Steve Case and a whole set of private companies who are going to try to work on many of these parts of entrepreneurship.

I like to divide -- we divide things into three buckets at the SBA around access to capital, around counseling and mentoring that we think is equally important to giving somebody the capital is giving them the advice to accelerate their business, and then this third area you just heard talked about, what are we doing to drive innovation all across the administration? You heard quite a bit about that.

But I'll just point out a couple of these things. Michael Klein talked this morning about the SBIC Impact Fund and he helped us with Dow and we were able to partner with Dow in Michigan and the State of Michigan, the pension fund there, and create an impact fund just for an area which had been very hard hit, but has a lot of potential for entrepreneurial companies.

We also -- you heard about the crowd funding and many other

things we're doing on access to capital with the SEC. We are working across the Administration on allowing small businesses to raise money in a broader way, to relax some of the SEC regulations and make them appropriate to small business, and Mary Schapiro has been a very good partner to small business in that endeavor.

On the counseling side, we are very excited about something called an entrepreneurial mentor core that we've been piloting, and this has to do with the fact that, as once again shown by Kauffman folks, accelerating entrepreneurs with networks, with advice, with mentorship, is equally as important as the capital, and we are looking to expand that once again with private sector partners. There are many, many folks between Goldman Sachs and Blackstone and others who have stepped into this space, all the partners in Startup America are very interested, and we are trying to orchestrate this network. We actually funded the first piece of it in clean tech.

And then we have a whole series of things that we are doing -- oh, I want to mention student loan deferment. You may have heard the President talk and Arnie Duncan talk about what we are doing on student loans. Well, it turns out that the income-based deferment on student loans applies to budding entrepreneurs.

So, this is something, once again, we can do without new congressional authority or money, it's within the current authority. But we are promoting to young entrepreneurs that they can defer their student loans under this arrangement if they decide to become entrepreneurs and they're, of course,

not getting a lot of income at the time.

We have a whole series of things we do around innovation. We run the SBIR program. Many successful companies have come out of that program. Actually, 25 percent of *R&D Magazine's* top 100 innovations were SBIR funded. It's $2.5 billion. So, how do we make this more accessible? Well, the first thing we did is we created a website where you can go to one place and get 11 agency solicitations. That wasn't hard but hadn't been done before, so all across these various activities we are working to deliver more access and more opportunity to money that already is in the system, that doesn't add to the federal budget, and that drives innovation.

Patent reform, as you know, just passed and this federal lab commercialization is something being driven by the Department of Commerce and Energy. There's enormous innovation in the federal labs and this is a whole set of programs to help pull it out.

So, I think one of the things we talked about in these public-private partnerships, all of these either involve or have the potential to increasingly involve a public-private partnership with, you know, the federal government squarely participating because we can bring enormous activity and enormous leverage just within these current program and still remain, as I said, on the 40-yard line, but driving down the field.

The last area I want to talk about is supply chain. Now, we've kind of added this as another kind of small business and you heard why earlier, but one of the reasons I like it is I come from a manufacturing heritage. That's really,

you know, most of the businesses I bought for all those years were plastic injection molders and metal stamping and food processors and I'm a big believer in American manufacturing. And as I go all around the country, I see that we have opportunity in small manufacturing, but it needs some help right now.

You can see the hit that manufacturing took, 2.7 million jobs lost, but, you know, we're starting to add jobs in manufacturing, so we're on a good trend, and the question is, how can we accelerate that trend? The reason we want to, it's not just because I love manufacturing. It's because the multiplier on manufacturing, as you see from the first bar in he bar chart, is the highest. Every dollar that you invest in manufacturing has the highest multiplier in terms of benefit for the economy.

So, we have put it in our head to do a series of things to help small manufacturers, particularly if they get into supply chains, because we know when they get into the supply chain they get more sales and more profits and hire more people.

So, these are a series of things that we are doing around small business and supply chain. We have a new financing product. I did say I was the only person, I thought, who was an SBA administrator who had ever had an asset-based loan, and we have just redesigned our asset-based lending product to have significantly less paperwork and be able to fund lots of these small manufacturers.

We also are partnered with the Department of Labor and the White House in something called Skills for America's Future, which is training for

manufacturing. And I was out with the National Association of Manufacturers, so this is really a bipartisan effort, in Minnesota, to kick off the Skills program for precision manufacturing. We have all of these C&C machines, we don't have C&C operators. So, we need to make sure we build those skills.

And then we have a whole set of revenue generating and I will tell you my absolute favorite. How many of you know that the President announced about two months ago that the federal government is going to pay all of its small business contractors in 15 days? Right? And I say this sometimes to a bunch of folks who are not small business-oriented and then say it to a crowd of small business people, the small business people all just break out and go wild because they know, you know. And others say, well, they were going to get it in 30 days, what's the big deal if they get it in 15? This is a permanent infusion of working capital and cash into a small business and they all know it.

So, this actually has gone out to the agencies and they have until this month to figure out how they're going to pay their small businesses in 15 days. Once again, this is the kind of thing that we can do right at this moment to do what is absolutely the most important -- there's $100 billion of small business contracts every year. They're all going to get paid in 15 days, not 30 days.

So, these are the kinds of things that -- and this is -- I have to tell you, this is the President's -- one of the President's favorites and he can explain to you why it's good for small business and the cash flow.

We have some other things as well, including a big focus on small business exports that's been accelerating, and a very strong public-private

partnership led by IBM on a portal to connect suppliers to some of the largest companies. And it's been Citigroup, IBM, Pfizer, Bank of America all signed up to do some of their purchases through this portal.

So, this is another way we can drive revenue into the hands of small businesses.

So, just to conclude a little bit, these are the gross jobs numbers. The small business ones look kind of like this. They don't have that little red bump, but they lag, the data lags. That's something we could do, we could get data sooner on small business. But we still have not created enough jobs, still are in this area where we have to push on every lever that we have. And we're not going to wait for Congress. We're going to move ahead with the budgets we have, with the authority that we have, to drive capital, to drive tools, to drive help into the hands of these small businesses.

I was in Pittsburgh with the Jobs Council and with the President recently and he talked about entrepreneurship and he said, "The story of America's success is written by American entrepreneurs, men and women who took a chance on a dream and turned that dream into a business and somehow changed the world." This is right after Steve Jobs died.

You know, I'm somebody who grew up in a family of entrepreneurs. My grandfather came to this country, started a business. I grew up with that notion that what you do is you come here and you build a business, and that those are the dreams that we have to support, even as we come out of one the toughest recessions that this country has ever seen. So, it's up to you

and to me and to all of us in these public-private partnerships to make sure that these dreams can come true and that we can build a prosperous and entrepreneurial America.

Thanks very much. (Applause)

MR. LERNER: Thanks so much. Do we have time? I think we have five minutes or so for some questions?

MS. MILLS: Absolutely. I'd be happy to take some questions. I'm going from here to film a promo for Small Business Saturday, which means I get to go shopping. I hope all of you will take a moment to consider where you will shop on the Saturday after Thanksgiving and maybe find a small business in your town and help them with some revenue.

MR. LERNER: So, let me start with the first question. People are either bashful or still processing all the information that you're getting.

How much do you see there being, essentially, a model in all the kind of activity in terms of incubator -- we talked earlier about why combinator, incubators, seed venture funds and so forth, which is clearly very narrowly focused today on Silicon Valley and social media companies. Is there, though, some sort of learning that we can take out of this that might in some way be able to be harnessed to help the greater mass of small businesses out there in the U.S. more generally beyond the sort of narrow confines of Silicon Valley and social media?

MS. MILLS: Right. Well, we love -- you know, I love Silicon Valley, but I almost never go there, and, you know, I go to Memphis and to Ohio

and to Minnesota and to Pennsylvania, West Virginia, and you know what I find is incredibly interesting innovation and entrepreneurial companies.

And unfortunately, what, all 90 percent of the venture capital goes to 3 states? So, we have to, and this is classically a gap, and I say to the folks who say, what's the role of government? I say, to fill the gap. And we have some tools, but they aren't actually enough. And so one of the things that we are working very hard on is to take this model that you just described and see how we can take the incredible energy in these accelerators and the capital that people like Starbucks want to put out, and the success of the micro loan programs and the state run programs, and create more of a continuum, because right now the hardest thing for the small business owner is to find their way. They just can't navigate. They're so busy, you know, trying to stay alive and trying to take that next step, and very often they don't have a road map. So, we need to get them the road map, the business plan, the counseling, the advice, the network, and those are different for a Main Street business than for a high growth business.

So, we've come to, I think, that point where we've identified a lot of models. We do things that we can do like convene, and I'm looking forward to convening all the top accelerators and many of the folks that you saw. We try to weave them together to give them access to programs we know that work. So, one of the things we learned is don't reinvent the infrastructure. Don't invent a brand new program. Build on one that's successful now. So, we took our 7A program and under it we put community advantage allowing CDFIs access to 7A

loans. We take our micro loan program and got more intermediaries into it.

So, more simplicity, more streamlining, building on those things that work, I think answers the question of what's the role of government is to come in and provide access and opportunity and the ability to navigate.

MS. NGUYEN: I'm Genie Nguyen with Voice of Vietnamese Americans. I work with many Asian Americans Chamber of Commerce, and I actually have two questions. First, many ethic minorities, especially women, are trying to establish -- save their current business, but they don't know enough about your programs.

I sit in different classes held by Fairfax County Small Business for Women and they taught us to go on the Net and borrow money from -- there's a network on the Net and they charge like 35 to 45 percent interest rate on it, and these women don't know any better. They don't require credit or anything and they just go in and apply and they get the money, but very high risk. So, I think there's a need to reach out there to these people who have limited knowledge of your program.

MR. LERNER: So, the real question is about the education and --

MS. NGUYEN: The education.

MR. LERNER: -- just the skill levels are so disparate in terms of stuff.

MS. NGUYEN: Right. And then the second part of it is, I have my husband, who is in an engineering network for Quest Diagnostics and recently they cut half of the staff, not (inaudible), so because they wanted to save their

money and half of the jobs are being cut. So, how do you save the current business, the current jobs, while you're trying to build the new ones?

MS. MILLS: Right. So, the first piece of this is really, I think, one of our greatest challenges, which is the entrepreneurial fabric of this country is increasingly diverse and the traditional pathways are very, very limited, as we talked about, so we need to be in every community and people in the Hispanic community, in the Asian-American Chamber have said to me they have business opportunities, particularly on the mom-and-pop side, but sometimes on the high-growth side. We need to have a door in that community that they can walk through and have that door, whether it's a community development financial institution, a micro lender, have that door open to the next door. And that's what we're working on.

And it's complicated because there are many, many, many diverse pieces of this, but what everybody has realized in this recession is that this group has to have access and opportunities, so we are doing it by redesigning our website, SBA.gov, so you can put in, I'm a woman-owned business, I'm a veteran-owned business, I want to export, and we will help you navigate to the federal government program that has that activity.

We're doing it even further with a one portal platform called Business USA, which is going to be up in under 90 days and we're doing it on the ground, by link leverage and aligning both private sector partners, chambers, and our program.

But my biggest challenge is, nobody knows, and if they think

about the SBA they think about the SBA of three or four or five or eight years ago, which was too much paperwork, too much time. And we have transformed it. We now approve loans in 10 days. So, how do we make sure that nobody is going on and accessing inappropriate capital when perhaps they would be eligible for one of our programs?

MR. LERNER: Right. So, thank you very much for taking the time out.

MS. MILLS: Thank you. Really appreciate it. (Applause)

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