Testimony before the U.S. House Committee on Financial Services
Subcommittee on Capital Markets

"A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans"

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Chairman Wagner, Ranking Member Sherman, and members of the Committee, thank you for the opportunity to appear before you today as an advocate for the venture ecosystem and the private markets that support it. My name is Henry Ward, and I am the CEO and co-founder of Carta—a privately held financial technology company that sits at the nexus of the innovation economy.

The collapse of Silicon Valley Bank (SVB) has brought into sharp relief the importance of the venture ecosystem and its interconnectedness to the broader economy. Growth-stage companies and the funds that back them create jobs, provide important products and services, and drive the next chapter of innovation and economic growth. Put simply, the venture ecosystem is America's innovation engine, and it is important that we continue to invest in and support the entrepreneurs, investors, and employees that drive it forward.

This hearing is focused on the important goal of modernizing the policy framework to bolster private markets, expand access, and drive equity ownership. Before I discuss the pillars that drive innovation and opportunity, I would like to share my journey in building Carta.

Building Carta

When I started Carta (then known as eShares) a decade ago, tracking equity ownership in private companies was complicated. Unlike the public markets, there was no single source of truth in the private markets—equity ownership was tracked through a fragmented network of law firm spreadsheets and paper certificates. This made it difficult and costly to make more employees owners and to expand investment opportunities to more investors. So Carta set out to build the infrastructure for the private markets.

Carta built a capitalization table and valuations business to make it easier for companies to issue equity to employees and investors. We built a venture capital business that helps form venture funds and provides fund administration and valuations services to them. And we built Carta Liquidity to help make that private equity ownership meaningful by making it liquid. We did this with the goal of creating more owners, enabling employees to participate in the success of the company they help build.

This journey was not easy. I went through 60 “nos” to get people to believe in and invest in us. But in 2013, we opened our doors and onboarded our first customer. We earned $720. As an entrepreneur, you never forget the first time someone paid you for something you built.

We have come a long way. We have grown from a company with seven employees and $720 in revenue to one that employs nearly 2,000 employees and generates over $300 million in revenue.

Today, Carta supports the private market ecosystem at every stage—from idea to IPO. We support more than 35,000 companies and over 2.2 million stakeholders in managing over $2.9 trillion in equity; we provide fund administration services for more than 5,000 funds and special purpose vehicles (SPVs), representing over $110 billion in assets under administration; and to date, Carta Liquidity has helped unlock $13 billion across over 250 secondary transactions.

We are succeeding because of the dedicated employees who share our mission and work tirelessly to achieve it. And we are succeeding because private markets provided us the resources and time to build it.

In building Carta, we came to realize policy is part of that infrastructure. It can drive innovation or bind its growth. It can incentivize entrepreneurship, expand investment, and facilitate the experimentation that leads to new opportunities and outcomes. Policy affects nearly every aspect of the innovation ecosystem. Carta invests in public policy, and I am here today because we want policymakers to continue to shape a framework that supports this ecosystem as an engine of innovation.

Private markets are the engine for innovation and growth

Startups are the engine of our economy, and the private markets are where they build and grow. Some of our most transformative companies—-Apple, Airbnb, Uber—would not exist if the private markets and venture capital did not exist. And these companies operate across sectors. Moderna is a venture-backed company that was instrumental in helping fight COVID-19; Watershed is working to help companies track and control carbon emissions; and there are countless more companies launching every year to build solutions for important global challenges.

Venture capital model

What makes the venture ecosystem so important is not only what it has—and continues to—create, but the structure that drives it. Startups are often unable to access bank loans or traditional financing. Instead they turn to venture capital, which in exchange for equity ownership—and a piece of uncapped potential—provides capital. This private capital enables entrepreneurs to transform a concept into a company.

The venture funding structure is key to innovation. Private markets provide long-term capital with greater risk tolerance. The projects that will drive the next chapter of innovation take time to develop and commercialize. These are the types of initiatives we want as a country. And private market investment, which is patient capital and aligned through the equity ownership model, enables companies to pursue such projects.

To be certain, some projects and companies will fall short and fail. That is the nature of building something—it is hard. It also creates uncertainty and volatility. These long-term projects do not often provide signal each day, much less financial results. Companies incorporate milestones and accountability, ship items quickly to gain market feedback, and adapt. They do everything possible to make progress and realize success, but it is not always a straight line. It took Carta nearly two years to build our venture fund business. During that time we saw it falter and flounder, but today it is a key driver of our growth. The private market regulatory framework allows innovators to focus on reaching their destination, and we should support this goal.

Public market dynamics

Private markets are unique in supporting this long-term funding dynamic amidst uncertainty. This is less true in our public markets today. There are a number of reasons a company may decide not to go public, including increased regulatory burdens and higher costs. Additionally, despite the allure of broader liquidity in public markets, for some companies, the stock can be thinly traded and the issuer can actually struggle with sufficient liquidity. These are serious hurdles.

But another issue, and perhaps the bigger issue, is a duration-of-capital problem. The typical duration in venture capital investment is ten years because it takes time to build and scale. Public markets, which operate on a quarter-to-quarter basis, do not have the patience to see these projects through. Even though large public companies have more resources, they are not optimized to solve niche problems or those that do not yield financial results quickly.

To succeed in the public markets, companies need a predictable, highly repeatable business model. If management makes a prediction and does not execute against that prediction, the public markets are hostile—they punish volatility. Innovation is premised on building something new, which is unpredictable. That process requires learning, iterating, and improving. Companies that are still in the building stage and have volatility in growing their businesses—companies like Carta—would not flourish under the current public market structure. Not only will the company not flourish, but neither will the ideas and innovations they are attempting to bring to market.

Despite that, the public markets are critical: they enable companies to raise capital, access liquidity, and create more investment opportunities for retail investors—these are worthy goals. But the solution to increasing the number of public companies should not come at the expense of successful private companies, the private markets, and ultimately, American innovation. The answer to creating more public companies is not to make private markets more hostile, but to make private markets work better. Doing so makes it easier to start and grow companies, creating a bigger pipeline of companies that can go public. Forcing companies to go public before they are ready is not good for the company, it is not good for the investor, and it is not good for the broader economy and U.S. competitiveness.

<u>Capital access drives the innovation engine</u>

To build and thrive, companies need capital. Private market capital has grown exponentially over the past decade. This growth, however, has not been uniform: the majority of capital raised is concentrated in a handful of places, namely Silicon Valley, New York, and Boston. To put a finer point on it, according to Carta data, in 2022, seven of the top 15 counties by total invested capital were in California, and companies in the San Francisco area raised nearly half of the combined total of every other U.S. county.[1] venture-backed jobs, on the other hand, are more broadly distributed, with 63% outside the top three states.[2]

Capital has become more mobile, but proximity still matters. For the earliest stages, investors tend to fund companies in their region: the average distance between the lead seed investor and portfolio company headquarters is less than 100 miles.[3] There are innovators with transformative ideas across the country, but they may lack connections to networks of potential investors, or the available capital options may be too expensive or not optimal for the business model. Women and minority entrepreneurs also face more challenges in attracting startup capital. For example, women-backed startups received just over two percent of venture-backed investments in 2022[4] despite the fact nearly half of new businesses were run by women.[5] Black founders received around one percent of venture capital dollars over the last year.[6]

These funding disparities have become more challenging as economic conditions have tightened. Funding rounds are lower, take longer, and are gravitating back to traditional

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[1] Carta, State of Private Markets: Q4 and 2022 in review (Feb. 2023), *available at* https://carta.com/blog/state-of-private-markets-q4-2022/#industry-data.
[2] Gregory W. Brown, et al., An Analysis of Employment Dynamics at Venture-Backed Companies Between 1990-2020 (2022), *available at* https://nvca.org/wp-content/uploads/2022/02/Employment-Dynamics-at-Venture-Backed-Companies_FINAL.pdf.
[3] U.S. Securities and Exchange Commission, Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2022, *available at* https://www.sec.gov/files/2022-oasb-annual-report.pdf.
[4] Pitchbook, US VC female founders dashboard (Apr. 2023), *available at* https://pitchbook.com/news/articles/the-vc-female-founders-dashboard.
[5] World Economic Forum, Here's what women's entrepreneurship looks like around the world, July 2022), *available at* https://www.weforum.org/agenda/2022/07/women-entrepreneurs-gusto-gender/.
[6] *See* BLCK VC, State of Black Venture (2023), *available at* https://www.blckvc.org/sbvr2023.

geographic hubs.[7] These regressions may be further exacerbated by SVB's failure, as it displaces a financial pillar of the ecosystem and also, as the Committee knows, has cascading effects to other banks, lenders, and capital allocators.

The venture ecosystem is the engine of America; it should not be limited to coastal regions. It should be accessible to more. Policies that help drive capital to emerging ecosystems, broaden local networks, and promote increased opportunities for underrepresented founders and capital allocators will help create more economic opportunity and a more inclusive ecosystem.

Carta supports policy proposals that:

> *Empower emerging fund managers.* Emerging managers play a key role supporting startups across the country, particularly for companies seeking smaller, early-stage financing. These smaller funds are more likely to participate in earlier rounds and invest in a more diverse pool of entrepreneurs located in their geographic area, which are also likely to be run by women and people of color. Venture funds are generally limited to making direct investments in private companies, but modest improvements can be made to help drive more capital into the ecosystem in more regions. Policy changes that could help incentivize established venture funds to invest in regional funds could help unlock a significant source of capital for growing entrepreneurial ecosystems. Further, permitting investments acquired through secondaries could help provide more liquidity for founders, employees, and early-stage investors to exit and redeploy capital, and provide an avenue for new investors to gain exposure to startups that have shown maturation and scale.
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> Additionally, expanding the size and investor limits for venture capital funds could help smaller funds reach more investors with smaller check sizes, developing more localized networks.
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> *Preserve the ability for communities to support their innovators.* Particularly at the earliest stages, many founders turn to their local communities for support to get their ideas off the ground. Policy should bolster these local funding networks, rather than constrain them. Recently, there has been discussion around increasing the 40-year old accredited investor financial thresholds to reflect inflation. Financial means are not a proxy for investor savvy, but in today's regulatory regime, they are the standard. Significant increases to these thresholds could have a detrimental impact on funds and founders trying to raise capital, particularly in lower cost of living areas, and particularly among minority communities.

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[7] *See* Pitchbook, NVCA Venture Monitor Q1 2023, *available at* https://files.pitchbook.com/website/files/pdf/Q1_2023_PitchBook-NVCA_Venture_Monitor.pdf;

Increasing access to opportunity

A policy framework that expands investment opportunities will not only drive innovation, but also wealth creation for more people. However, in the private markets, these opportunities are largely reserved for institutional or wealthy investors. Most individuals are generally prohibited from participating in the private markets by narrow accreditation standards largely based on wealth and income thresholds.

The United States is built on the premise that the only barrier to opportunity is one's willingness to work for it. This country does not preclude opportunities based on circumstance or socioeconomic background. Through work and determination, anyone has the opportunity to do almost anything—go to college, build a company, even run for president—except for when it comes to investing in the private markets. With few exceptions, unless an individual investor is wealthy, this country's most innovative and transformative companies are off limits.

This is particularly important because it means the public markets are often the only available option for investing. As the number of public companies has declined, so has the number of investment opportunities. Consequently, most investors are unable to take advantage of diversification options. Under the current framework, these investors are also missing out on the growth curve, as companies that do go public are waiting to do so later in their lifecycle and at a flatter growth trajectory. Limited alpha and limited opportunities are not ideal outcomes.

Democratizing access to private market investment opportunities while preserving important investor protections and the character of the ecosystem can broaden economic opportunity.

Carta supports policy proposals that:

> *Modernize the accredited investor definition.* The accredited investor standard determines access to private market investment opportunities primarily based on personal wealth and income. Financial metrics, however, do not necessarily equate financial sophistication. Limiting access to investment opportunities and the potential for diversification to the economically privileged is not a desired outcome. In fact, it is discriminatory. It is important for individuals to understand the risks of investing and their ability to withstand loss with respect to any investment—public, private, real estate, crypto—and I believe education is a necessary component. But the government should not deny an individual access to opportunity on the basis of their financial status.
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> The SEC expanded the accredited investor definition to include sophistication on-ramps for certain credentialed investment professionals. This important step untethered the designation from wealth-based means for the first time. More can be done, however, to expand additional pathways for individuals to qualify as accredited through nonfinancial means, including by expanding the list of

professional designations, certifications, and education requirements to qualify and through sophistication tests.

Permit structured access to private market investments. Another path to increasing access to private market investment opportunities is through professionally managed funds. Giving retail investors access to the private markets through pooled investment vehicles provides a number of important protections. These funds are managed by sophisticated individuals who are regulated and owe fiduciary duties to their investors. Investors would also be able to achieve greater portfolio diversification and would benefit from investing alongside institutional investors and their diligence.

Clarify the ability to invest in private funds through retirement accounts. Another way to expand participation in private markets is through retirement funds. On a risk-adjusted basis, private companies do better than public companies,[8] which is why you see such big investments and high returns in private equity and venture capital. Private market investments, however, are less liquid and can be locked up for years. Pairing longer duration capital—such as that in retirement accounts—with longer-term investments addresses the liquidity mismatch. Too often, this is backward in the retirement space. Professionally managed retirement plans, such as 401(k) investments, also include the benefits of a regulated fiduciary and diversification.

Ownership drives innovation

Carta's founding mission is to create more owners, and equity ownership is at the core of the private markets. In this testimony, I outlined the importance of expanding investor access to ensure more people could become owners in private companies, whether through modernizing the accredited investor definition, structured access, or retirement accounts. This will give more investors access to growth-stage potential that increases their wealth. And importantly, their investments will expand the pool of capital for innovative companies and entrepreneurs.

For Carta, ownership is also about employee ownership. We strive to incentivize and make it easier for employers to issue equity to more employees. Ownership is a critical component to wealth creation, driving economic opportunity, and narrowing the wealth gap. It also aligns incentives across the enterprise, creating accountability and commitment to these longer-term projects that drive innovation and a company's success. Ownership enables employees to benefit from the upside they helped create.

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[8] *See* Cambridge Associates, US PE/VC Benchmark Commentary: First Half 2022 (Jan. 2023), *available at* https://www.cambridgeassociates.com/insight/us-pe-vc-benchmark-commentary-first-half-2022/; McKinsey & Co., Private Markets Rally to New Heights, McKinsey Global Private Markets Review 2022 (Mar. 2022), *available at* https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2022/mckinseys-private-markets-annual-review-private-markets-rally-to-new-heights-vf.pdf.

Carta is filled with employees who have contributed to Carta's growth and who benefit from the financial appreciation of their equity stakes in our company. They use this money to buy first homes, support their families, invest in other companies, and in their own futures. This drives the innovation cycle forward. And Carta is just one of the many companies whose employees benefit from that ownership.

For these reasons, employee ownership is critical to the employee, the company, and the broader community. Carta is working with partners in the private market ecosystem to expand the employee ownership model beyond venture-backed startups. We hope to shift employee equity ownership from being a perk to being an expectation.

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Thank you for the opportunity to tell Carta's story and advocate for the innovation ecosystem. Carta is proud to provide the infrastructure to support our innovators: the founders, investors, and employees who drive the innovation economy. Policy is part of that infrastructure—it affects nearly every aspect of the ecosystem and can drive innovation or bind its growth. This is why it is so important to make sure we have the right framework in place to ensure American innovation remains at the forefront, and that the American economy maintains its competitive edge. I appreciate all the work that Congress is doing on that front, and we want to work with you to do that.

I look forward to your questions