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Innovation economy isn't enough for growth

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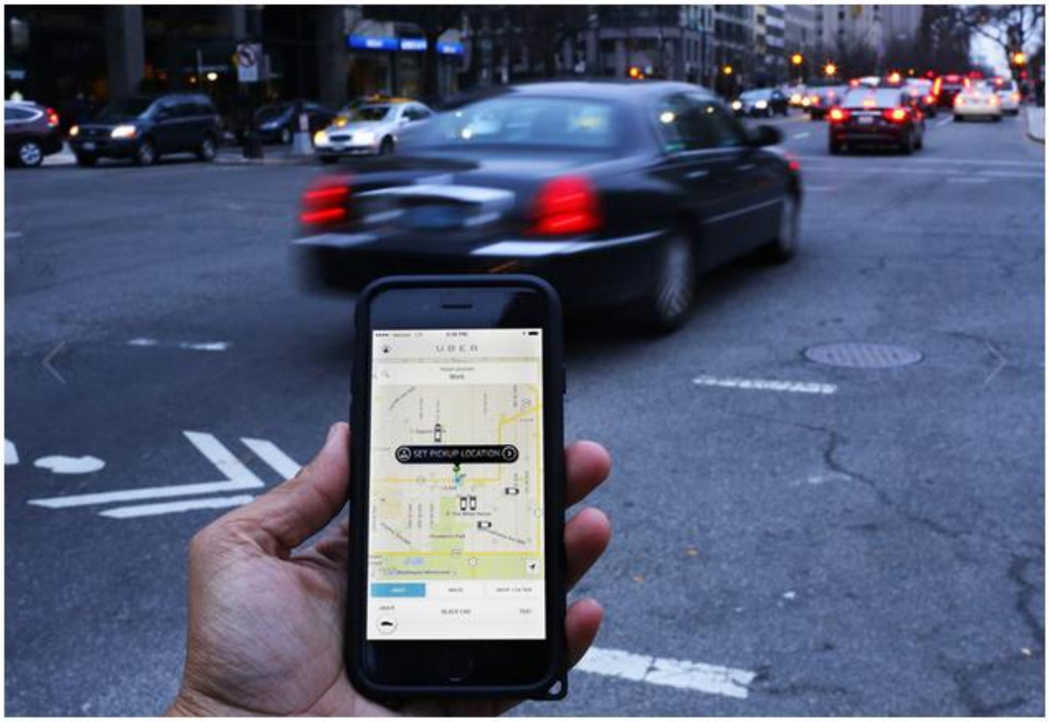

1 of 3 The success of Uber is unique to current trends, where new business formation continues to decline. (ANDREW CABALLERO-REYNOLDS/AFP/Getty Images)

Local merchant banker tells Senate committee that Congress need to act because many startups face difficulties in raising money and new business formation has declined.

Wonder how often members of Congress hear from people who are at the headwaters of where new companies, industries and jobs are being created?

Some members did earlier this month when a group of venture capitalists testified before the Senate Committee on Small Business and Entrepreneurship (Sen. Maria Cantwell serves here). Among them was Joseph Schocken, founder and president of Broadmark Capital, a Seattle merchant bank.

Schocken, a supporter of President Obama, has also acted as an adviser to the administration, especially on the JOBS Act, which passed with bipartisan support in 2012. Among its provisions was equity crowdfunding.

In his testimony this month, Schocken said the environment for new companies remains tough because of banking consolidation and the declining number of venture-capital firms. Most small businesses find it difficult to procure capital, he said.

“We may allow ourselves to be distracted by the flashing success of ‘new economy’ businesses such as Airbnb and Uber,” he said, “but the reality is that over the past five years, we have seen an unprecedented decline in new business formation in the United States. Business deaths now outpace the birth of new businesses, and the startup environment is not thriving.”

He noted that the number of publicly listed companies has declined by 50 percent over the past two decades. Because of consolidation in the financial sector and a big drop in venture-capital firms, “It is more difficult now than it has been in decades to finance and build an early stage company.”

The result is fewer jobs created, increasing income inequality and diminishing options for workers displaced by automation. A few regions profit handsomely, but many parts of the country are left behind.

Schocken said this means trouble in what he calls the American innovation economy, historically “the envy of the world.” He spreads a big tent, from high-growth knowledge companies to small local outfits, even retailers, restaurants and service providers.

The latter group “is always short of capital” and also faces regulations geared for larger companies while lacking lobbyists in Washington, D.C.

Some of Schocken’s suggestions include forming a presidential commission that focuses on improving the innovation economy; encouraging more investment by expanding equity crowdsourcing; and soliciting ideas about making regulations friendlier to small business and entrepreneurs.

My reaction is that we’re paying the price for more than three decades of shifts in the capital markets.

I remember when downtown Denver’s 17th Street was “the Wall Street of the West,” lined with locally headquartered brokerages, investment banks and commercial banks. Although “financial services” remain a big part of Denver, the companies are mostly owned from New York, San Francisco and Charlotte.

This also has been the case in Seattle, of course, but also in any medium-to-large city around the country. A few, such as Seattle and Denver, barely broke stride. But many have been devastated. They didn’t merely lose important headquarters and civic leadership, but the close-in access to capital and executive expertise in these communities.

Worse, consolidation combined with deregulation and other changes altered the fundamental nature of capital markets. Far less attention was given to assembling capital for job-creating enterprises. Far more went to gambling in exotic derivatives or asset bubbles.

A second problem is that the innovation economy, as Schocken catalogs it, is set against itself.

For example, Amazon is a (forgive me) prime example of innovation in the 21st-century digital arena, to the enormous economic benefit of Seattle.

But it has left behind the dead of brick-and-mortar competitors throughout the republic. Many of them were innovators, too, but lacked the commanding market power and tax advantages of Amazon.

And at least Amazon employs some 240,000 people. Many of the sexiest (to investors) companies today have relatively tiny head counts of real, full-time employees with good wages and benefits. For example, the Dollar Shave Club, an online startup being bought by Unilever for $1 billion, employs about 190. It uses Amazon Web Services.

Writing in The New York Times, University of California, Berkeley professor Steven Davidoff Solomon said the deal was cause for every company, even mighty Gillette, to be afraid. Likewise American workers: “Manufacturing now is just as much a line item as is a distribution apparatus.” The razors are made in South Korea.

The problem with “creative destruction,” as economist Joseph Schumpter called the central dynamic of capitalism in the 1940s, is that today the destruction outpaces the creative. For every Dollar Shave Club there are many more entrepreneurs who can’t get capital or neighborhood and downtown retailers savaged by online competition.

This is not an era where the breakthroughs raise many ships, as with railroads, electricity, automobiles and other transformative industries of the past. Now we get gadgets, but many of us can’t get a secure career path or economic opportunity.

So in addition to a 21st-century Glass-Steagall Act that breaks up big banks and casts a wide net to better regulate risky shadow banking, we need incentives to capitalize companies that actually provide American jobs. We need 21st-century antitrust and fair-trade laws that push back against the market power of the big players.

Even that won’t be enough unless enough people realize each purchase is a vote. A vote for the local economy, the neighborhood storekeeper, the company that pays its workers well, that cares about the planet.

Otherwise, we’re being innovated backward, and a cheap list price carries high long-term costs.

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