

SCR 134

Measure Title: REQUESTING THE CONVENING OF A WORKING GROUP TO INVESTIGATE THE CREATION OF A LOCALLY-FOCUSED, HAWAII-BASED STOCK EXCHANGE.

Report Title: Local Investment Exchange; Economic Development

Description:

Companion:

Package: None

Current Referral: CPN



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Testimony in Support of Senate Concurrent Resolution 134
Hearing before the Committee on Commerce and Consumer Protection
Tuesday, March 29, 2011 – 9:00 a.m.
Conference Room 229, State Capitol
415 South Beretania Street, Honolulu, HI

Dear Chair Baker, Vice-Chair Taniguchi and Committee Members

My name is David Fisher and I am speaking in support of SCR 134.

I am one of the authors of the white paper on developing a local stock exchange and which recommended the creation of the proposed study group. My work is business consulting. I spent 19 years opening and operating the University of Hawaii Small Business Development Center on Maui, which I left in September '09 to form my own private practice. Prior to moving to Hawaii in 1989 I spent nine years doing business consulting and economic development in New York City. A high point for me over the last years was receiving a certificate of appreciation on the State Senate floor in 2006 for receiving the U.S. SBA Financial Services Advocate Award for the State of Hawaii. That helped to encourage me to stick with it, and here I am.

It is important to emphasize that we are not looking at an exchange that would compete with national or international exchanges. We are looking at Hawaii investors investing in Hawaii companies, and then being able to sell their shares at a later time to other Hawaii investors.

There are many benefits that I will attempt to simplify in to three major points:

First of all a local exchange will help Hawaii companies raise equity financing at an affordable cost. The costs of doing a direct public offering using the intra-state exclusions are likely to be dramatically lower than doing a national IPO, which does not make economic sense for all but a handful of large Hawaii companies. Once a company has a base of equity investment, it will be easier to also raise money from banks.

Secondly, a local exchange would encourage and support regular citizens to invest in a broader number of Hawaii companies beyond A&B, Maui Land & Pine, etc. Keep in mind that only 2% of all investors, i.e. qualified investors, were likely to invest in Act 221 companies. By going public on a local basis we would open up the opportunity to invest in Hawaii companies to the rest of the 98% of Hawaii investors. This is important

in that it will engage the broader community in developing our economy while giving the companies, in addition to lower cost financing, investors who will support the company in other ways, whether it be as employees, customers, or suppliers. The public nature of this process will also encourage and help more people to develop skills at entrepreneurial problem solving.

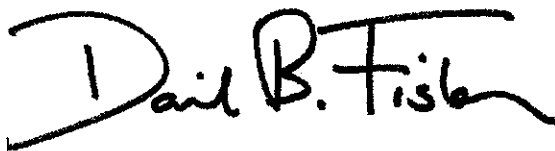
Thirdly, it could allow us to keep our savings, and retirement funds invested in Hawaii. Right now, most investment that does not go in to local real estate goes to Wall Street. I, like most of you have seen 30-40% of my retirement savings disappear over the last two years because of the casino culture that is Wall Street. I would prefer to have a larger proportion of my savings and retirement closer to home.

Over the last twenty years, the idea of even considering "going public" was never a possibility for any of my clients because it was prohibitively expensive and it would give control of the company to people who do not live here and would not have as a high priority the interests of the Hawaii management and stakeholders. Only in the last year have I learned about direct public offerings as a low cost option. We can do direct public offerings right now in Hawaii, but to the best of my knowledge none have taken place. It is not clear to me why this has not happened. Part of it is knowledge. Part may be because private offerings have been more attractive due to Act 221 with its focus on investors who can use tax credits. And finally part of the reason is because business advisers including management consultants, lawyers and accountants have been conditioned to not to investigate the possibility because the costs of the liability insurance.

We have a lot to learn and a lot of assumptions to examine. But I think it will be worth it. Fortunately, we are not alone. There are other communities who have been studying creating local exchanges and there are some operating local exchanges overseas. I recently learned about the Barbados exchange, which has been in existence for twenty years in an island nation one fifth the size of Hawaii.

Creating this study group is the kind of approach that Governor Abercrombie spoke about in his campaign. While the State does not have new money to invest in economic development, we can be innovative by creating public and private partnerships to look at and implement creative ways of encouraging businesses while at the same time protecting consumers. This is what the proposed resolution proposes.

I encourage you to support the resolution.

A handwritten signature in black ink that reads "David B. Fisher". The signature is written in a cursive, flowing style with a large initial "D".

David B. Fisher
Principal



700 Bishop Street, Suite 2000 Honolulu, HI 96813

SCR134: Relating to the Creation of a Locally-focused, Hawaii Based Stock Exchange

DATE: March 29, 2011
TIME: 9:00a.m.
PLACE: Conference Room #229

TO: Senate Committee on Commerce and Consumer Protection
The Honorable Rosalyn Baker, Chair
The Honorable Brian Taniguchi, Vice Chair

FROM: Joe Cooper, CFO
Archinoetics LLC

RE: Testimony In Support to SCR134

Aloha Chair, Vice Chair, and Members of the Committee:

Thank you for the opportunity to testify in support of SCR134. As a member of the Hawaii business community for the past 15 years, I have struggled to raise the working capital needed to grow several businesses. Most recently as the CFO of Archinoetics, a locally founded and owned company, I have been intimately involved in the creation and funding of 2 spin off companies. Both have had to find funding outside of Hawaii, with much of the funding coming from Canada. It would be much more efficient and let us be much closer to our investors if a venue existed in Hawaii to more easily raise money.

In addition to raising capital for growing companies, the creation of a local stock market will also create a new industry that can be targeted to fulfill the goals and mission of Hawaii at large. It will:

- Provide investment opportunities for local investors,
- Require few imported resources,
- Provide a professional workforce who can export their expertise.

Since the creation of a working group is a small step to take with an enormous potential, I enthusiastically support this resolution.

Thank you for the opportunity to testify on this important bill.

Sincerely,

Joe Cooper
CFO
Archinoetics
(808) 741-1684
Joe@archinoetics.com

COMMONWEALTH
GROUP

650 641 1246
www.commonwealthgroup.net

March 28, 2011

Hearing before the Committee on Commerce and Consumer Protection
Tuesday, March 29, 2011 – 9:00 a.m.
Conference Room 229, State Capitol
415 South Beretania Street, Honolulu, HI

Subject: Testimony in Support of Senate Concurrent Resolution 134 (“SCR134”)

Dear Chair Baker, Vice-Chair Taniguchi and Committee Members,

This letter is being submitted in order to provide written testimony in support of SCR134.

My name is Michael Sauvante and I am the Executive Director of Commonwealth Group. Commonwealth Group is principally focused on the study and promotion of socially responsible businesses and financial institutions. One of the areas to which we have dedicated considerable time and resources pertains to local stock exchanges and their impact on, and benefits to, local economies.

Given that focus, we can unequivocally state that we strongly support this proposed legislation and the goals of that legislation.

Here is why:

The real (Main Street) economy is in the worst shape since the Great Depression, despite the rosy picture on Wall Street and on the balance sheets of large companies. The official unemployment rate in the country hovers around 10% with the true effective rate estimated to be 15%-20%. Millions of people have lost their jobs and cannot find new ones or are under-employed in low paying jobs that do not provide a living wage. Washington, Wall Street and big business have no real solutions.

That leaves job creation to the states and the one sector of the economy that historically has been the engine of job creation – small business. Small business has historically been the primary means of job creation in this country, especially when the economy is down.

In times past, small business led the country out of recessions. The SBA’s Office of Advocacy recently revealed that small businesses with less than 20 employees created 98% of net new jobs during the three years after the 2001-2002 recessions, and businesses with less than five employees created 74% of those net new jobs! Those numbers have been reinforced by a recent Kauffman Foundation study entitled “Job Growth in U.S. Driven Entirely by Startups”.¹ However, that is not happening now. According to the Wall Street Journal, startups are not getting investments this time around.² Not only have home equity loans, a common source of startup capital for entrepreneurs,³ become virtually non-existent, but angel investors have abandoned entrepreneurs as well.

¹ <http://www.kauffman.org/newsroom/u-s-job-growth-driven-entirely-by-startups.aspx>

² *Few Businesses Sprout, With Even Fewer Jobs*

http://online.wsj.com/article/SB10001424052748704648604575621061892216250.html?mod=WSJ_article_related

³ “New Businesses Do More to Fix Economy Than Small Businesses” www.thetakeaway.org/2011/jan/13/money

These wealthier investors (less than 2% of the population) are not investing in small companies (2nd lowest rate in 18 years). This is a major problem because state and federal laws currently force small businesses to rely almost exclusively on those investors (called “accredited investors”) as their primary source of investment.

The other 98% of the population is largely left out because the government has created laws that, although intended to protect small investors, have the effect of legally excluding them, thereby cutting off a huge source of potential capital (literally trillions of potential dollars in aggregate across the country) for small, local companies.

Historically stock exchanges have provided a convenient public meeting place (marketplace) where “public” companies and their investors (both the 2% & the 98%) can meet and where the sale of those companies’ securities (stocks, bonds and other instruments) is facilitated, including both initial offerings and secondary trades. Existing stock markets are geared nearly exclusively to large companies with large public floats (number of shares held by the public) which provide substantial liquidity for shareholders.

In contrast, small public companies typically have very small floats and substantial illiquidity, i.e., few buyers and sellers at any one time. This illiquidity on the national exchanges for small companies creates a high degree of volatility in the price of their shares and easily subjects them to price manipulation.

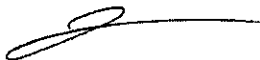
Liquidity is the key driver that underlies a stock exchange and the key benefit that it provides to listing companies and their investors. If we are to provide that benefit to small and medium sized enterprises (SMEs), we must find a way to provide for greater liquidity than the current national exchanges afford.

Matching investors with SMEs needs to be one of the key objectives of states like Hawaii, especially local investors with local companies. If we as a nation are to provide an enhanced capital flow to SMEs, especially of local public investment funds, then a local stock exchange or stock exchange-like environment needs to be provided to perform that function and do so in a fashion that is geared towards, and better serves the needs of SMEs, than that afforded by the national exchanges.

Thus we conclude that it would be very much in the interests of the state of Hawaii and its citizens to move forward with this proposed legislation and join a movement that is gathering momentum across the country. We at the Commonwealth Group are actively involved in an effort to establish such a state based exchange here in California. We know of other efforts throughout the country, several of which are going on behind the scenes, besides those publicly visible.

Finally, we would like to offer our expertise and knowledge in this space, in any manner that may help you in this effort. We wish you success in this important work.

Best regards,



Michael Sauvante
Executive Director
Commonwealth Group, Inc.
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Lompoc, CA 93436
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(650) 641-1246

March 28, 2011

State of Hawaii Senate
Testimony in Support of S.C.R. 134

From

W. Trexler Proffitt Jr.
Assistant Professor of Organization Studies
Business, Organizations, and Society
Franklin & Marshall College
PO Box 3003
Lancaster PA 17604
email: trexler.proffitt@fandm.edu
phone: 717-291-3990
fax: 717-358-4568

Ladies and Gentlemen of the Committee:

My name is W. Trexler Proffitt Jr. and I am a professor of organization studies at Franklin & Marshall College in Lancaster, Pennsylvania. My scholarly credentials in this area qualify me as an expert witness to comment on the establishment of a working group to investigate the desirability of a local exchange within the State of Hawaii. I am writing today in support of S.C.R. 134. Because I am sure you will receive much good background information about local economic development and the importance of small business and small business financing from other sources, I would like to share with you the results of my research on local exchanges.

The founding of local exchanges today is more a matter of desirability than feasibility. Local securities markets are more feasible than they have ever been in recent memory. The issue for policy is whether they are desirable from an economic policy point of view, not whether they are feasible.

I would like to share with you the findings of my feasibility analysis research in the area local securities exchanges. In 2008 I received a grant to produce a feasibility study for a local securities exchange concept from economic agencies associated with the Pennsylvania state government. My collaborating partner has been a local business association, the Susquehanna Sustainable Business Network. In addition, in 2009, I studied a newly founded exchange called InvestBX in the large city of Birmingham, United Kingdom. In 2010, I completed historical research on the economic findings around the impact of exchanges on local economies, and the history of U.S. exchanges. At this time, I am actively working to create a local exchange in my region (provisionally called LanX: Lancaster Sustainable Enterprise Securities Exchange) and to create a nonprofit educational association to help start and support exchanges where appropriate in the U.S. and Canada (provisionally called Focus Local Finance Coalition).

The 2008 study was the first-ever state-funded feasibility research about U.S. local exchanges. I used my local eight-county home region of South Central Pennsylvania as a prototype. This region has about 2.5 million people and more than \$65 billion in GDP. It is centered around four class 3 cities: York, Lancaster, Reading, and Harrisburg.

The conclusions were straightforward: local exchanges, done well, are quite feasible, efficient, and potentially provide great local benefit. They can operate on a relatively modest budget to facilitate financing for small and medium businesses in a way that is complementary to and synergistic with other financing mechanisms.

In addition, local exchanges promise to produce more bang for the buck. They are an efficient capital allocation method that yields more quality jobs growth and other desirable economic development outcomes per dollar spent than either direct government investment (such as Federal stimulus) or less direct forms of government finance (such as SBA loans). The order of magnitude of this improvement is dramatic: the cost of one job created by using a local exchange will average \$10,000 per job in administrative expense. The recent Federal stimulus produced jobs at a rate of \$90,000 per job in administrative expense, according to the Office of Management and Budget. In comparison, local exchanges are cheap! Plus, with a local exchange, the private sector is the primary sector to bear these administrative costs, not the taxpayer.

I would like to share with you some of the research that undergirds this optimistic conclusion. One question was whether the benefits of a local exchange would be significant. The economic literature on this topic suggests that in general, countries, cities and regions that receive a securities exchange (also termed capital market development) generally have subsequent positive economic growth. In other words, the consensus view is that well-functioning capital markets add jobs and facilitate economic investment, which is going to manifest itself in the founding and growth of local small business and working capital for larger, growing businesses.

It is also U.S. policy to encourage capital market development, just in other countries. Since 1945, U.S. foreign policy and international development policy (exemplified by the World Bank and International Monetary Fund) have encouraged (i.e. paid for) the founding of securities exchanges abroad to facilitate economic development in emerging markets. Therefore, the idea that exchanges help with economic development is taken as an article of faith by the U.S. government and the developed world. The academic literature merely confirms this assumption, with the caveat that it is done well and where appropriate.

In addition, I began to survey the history of stock exchanges in U.S. history and was surprised to discover that many cities (and the regions around them) benefited in the past from the establishment of local exchanges for decades after these exchanges were founded. In fact, Hawaii had a local exchange called the Honolulu

Stock Exchange between roughly 1900 and 1972. Although I have not done a case study on that exchange, it would be interesting to do so in the future. Our historical research uncovered no fewer than 36 distinct securities exchanges founded in the United States between 1790 and 1930. In general, a new local exchange, properly focused on developing small and medium size businesses, should provide economic development benefits for at least several decades.

But there was also an interesting puzzle. Beginning in the 1930s, when the Federal Securities and Exchange Commission began regulating exchanges, the dozens of local exchanges around the country began to disappear through consolidation or discontinuation. This consolidation accelerated by mid-20th century to the point that there really are only two exchange operators in the United States today: the New York Stock Exchange and Nasdaq. The next research question then quite logically was whether new exchanges founded in 2011 or later would be desirable given this failure in the past.

On this question, I endeavored to understand the reasons why prior exchanges faltered and whether new ones would suffer the same fate. After all, we would not wish to recreate a poor system that had already self-destructed. Luckily, there are enough differences between the conditions that contributed to the demise of most of the early era local exchanges and the conditions that favor the founding of new ones today. In particular, I would call attention to technology, globalization, and consolidation. I will discuss these in turn.

1. Traditional Tools Updated with Modern Technology

Early exchanges became redundant because of technology but that trend cuts both ways. Beginning in the late 19th century, trades in St. Louis or Pittsburgh could be done in New York as well with the advent of the telegraph and telephone. In addition, local exchanges competed quite directly with New York exchanges to list the securities of the largest and most widely-held corporations. Accordingly, direct competition for the same “big fish” led to a price war and New York won it. By 1950, it was clear that any company that wanted to raise capital should do so on Wall Street, not Main Street.

But times have changed once again. The internet technology available today has democratized the process of listing and trading securities once again, opening up new niches. It is once again because of technology possible to take listing and trading out of Wall Street and to relocalize it in areas that need more responsive local financial institutions. An exchange can now operate in a relatively low cost virtual space that is basically off-the-shelf. This was not true ten or even five years ago but has made exchanges very low cost to create today.

2. Globalization and Relocalization

As capital markets have become detached from place and people, there is a new trend towards reconnecting with the local economy and reacquiring community and community values. People are starting to realize a balance between global

connections and local community is highly desirable. This suggests that there is today stronger demand than ever for increased local investment alternatives, coupled with a willingness on the part of investors to prioritize investing locally as one of their core investment objectives. In our work with local investors, we have found a strong craving for local investments suggesting that there may be significant demand for such opportunities. This trend might not have been apparent in the past but the recent financial crisis has focused new light on the possibilities.

Consolidation and Niche Space

With the consolidation of the many local exchanges of the past into just two major exchange organizations today, a niche space has arisen in the “equity gap” that affects small and medium businesses. This equity gap is created by the larger national exchanges by their preference for listing only larger firms. Smaller firms have much less access to the same sorts of financing as Wal-Mart or Starbucks, in part because the large exchanges really would prefer not to deal with firms with capitalization lower than \$100 million. The presence of this niche suggests that small and medium firms up to that level would benefit from more local financing options. In particular, firms that were able to connect meaningfully to their local community would have the best chance of being valued correctly.

It seems safe to say that new local exchanges can serve a wide market niche up to about \$25 million in market capitalization with no direct competition with national exchanges. This is important because local exchanges then perform a “farm team” role of validating and supporting small and medium firm growth, such that firms might eventually migrate to the national exchanges later on. So long as new small and medium firms keep entering the exchange locally, graduation to the “big leagues” is not a threat at all. National exchanges can keep doing what they are doing, and they will get a new source of growing firms coming from the farm teams around the country.

In addition, it is important to understand that local exchanges do not have to operate the way the big exchanges do, or past exchanges did. In our work, we have calculated that an exchange that attempts to list local securities issues ranging in value from \$500,000 to \$5 million will be able to support itself primarily with very reasonable listing fees paid by the firm issuing securities. Consider this scenario: if the exchange can list at least five local firms per year, averaging \$2 million per issue, producing fees averaging \$150,000 per listing, then this produces \$750,000 per year, the amount it would cost to operate the exchange. While the scenario can be adapted to any local market with different expectations, we find this a reassuring and reasonable budget to consider.

So what is left to prevent local exchanges from popping up all over? Regulatory uncertainty remains the foremost concern of firm owners and investors alike. This is where a working group can add the most value. It is quite essential that this niche space below \$25 million in capitalization attain a regulatory home that is both respectful and thoughtful of the rules that govern the big exchanges and large firms,

but also imposes relatively lower costs on in-state small and medium firms and in-state exchanges. This is where I think a working group is a fantastic solution and I support its creation wholeheartedly. Please let me know if I can help.

Sincerely,
W. Trexler Proffitt Jr.

Testimony for CPN 3/29/2011 9:00:00 AM SCR134

Conference room: 229
Testifier position: support
Testifier will be present: No
Submitted by: Bill Spencer, President
Organization: Hawaii Venture Capital Association
Address:
Phone:
E-mail: bspencer@hawaii.rr.com
Submitted on: 3/28/2011

Comments:

Dear Chair Baker and Committee Members:

It has been the mission of the Hawaii Venture Capital Association since its formation in 1988 to support capital formation for Hawaii entrepreneurs and their companies. Hawaii is starved for investment capital for new businesses, especially those in the high technology sectors. Since the sunset of Act 221, there are no viable options for entrepreneurs to raise capital. Our State's venture capital companies are few and far between and most institutional investors including the Employee Retirement System prefer to put their venture investment capital with top tier venture firms on the mainland.

The proposed local stock exchange would offer a viable alternative to companies seeking expansion capital from local investors. We need to invest in our own backyard and support local entrepreneurs with investment, or else they will leave Hawaii for the mainland, denying our citizens of quality jobs and tax revenues from a diversified economy.

I strongly encourage you to undertake the recommendation in this resolution, SCR134.

Sincerely,

Bill Spencer
President
Hawaii Venture Capital Association
808-225-3579

acceptable.

Testimony for CPN 3/29/2011 9:00:00 AM SCR134

Conference room: 229
Testifier position: support
Testifier will be present: Yes
Submitted by: Virendra Nath
Organization: Individual
Address:
Phone:
E-mail: vnath@accessasia.com
Submitted on: 3/28/2011

Comments:

A white paper on the need for a local stock exchange and its benefits and limits can be found at: www.HiLocalExchange.org.

There is a lot of investment money in Hawaii and there are lots of capable entrepreneurs in Hawaii. They don't each other and there are no established methods to build trust. These barriers - incomplete information and trust limits - are not new. These barriers were overcome with the establishment of local stock exchanges over 500 years ago.

The SEC has several exemptions in place to allow smaller local companies to raise money from local and accredited investors. These exemptions will reduce the cost of listing in the HI local stock exchange.

Since Hawaii is a small market, a local stock exchange is not expected to be a profitable entity. However, I believe that it can sustain itself without ongoing grant funds.

If the exchange ever does make money, the additional money should be used as grant money for UH and community college students who are participating in business plan competitions and the like.

There has been much rhetoric on the national stage about the limited benefit of governmental regulations. I believe that building a public/private partnership is crucial to the success of the stock exchange. Government regulations will ensure that the trust barrier is removed; government participation in the establishment of the stock exchange will allow smooth implementation of the SEC exemptions.

Testimony for CPN 3/29/2011 9:00:00 AM SCR134

Conference room: 229

Testifier position: support

Testifier will be present: No

Submitted by: Howard Mendelsohn

Organization: Individual

Address:

Phone:

E-mail: howardm@avitarpartners.com

Submitted on: 3/28/2011

Comments:

I have been a financial consultant for several young companies in Hawaii and formerly Chief Financial Officer and VP Finance for several publically traded Companies on the Mainland. I recognize the economic power and huge benefit in terms of access to capital and liquidity to shareholders (increased liquidity leads to higher value) that stock markets and marketplaces can bring. I strongly urge the State of Hawaii to evaluate the benefits and costs of establishing a local exchange to bring island based businesses together with island based investors and provide a new vibrant access to information to both.

Testimony for CPN 3/29/2011 9:00:00 AM SCR134

Conference room: 229

Testifier position: support

Testifier will be present: No

Submitted by: Bill Staley

Organization: Individual

Address:

Phone:

E-mail: ws9811@earthlink.net

Submitted on: 3/27/2011

Comments:

I appreciate the struggle to diversify Hawaii's economy and support SCR134 as a means of doing this. This can be a vehicle to new opportunities. It merits the Senate's consideration and approval.

Thank You,
Bill Staley
Maui

Testimony for CPN 3/29/2011 9:00:00 AM SCR134

Conference room: 229

Testifier position: support

Testifier will be present: No

Submitted by: amy cortese

Organization: Individual

Address:

Phone:

E-mail: amycortese@nyc.rr.com

Submitted on: 3/28/2011

Comments:

I am a journalist that has just finished writing a book about local investing (Locavesting, Wiley & Sons, June 2011). In the course of my research, I have become convinced that local stock exchanges are a valuable tool for facilitating the flow of capital to productive, local use, rather than to speculation and trading. Local exchanges, like the ones that once dotted the nation, can address a desire on the part of many investors to support local enterprises while providing necessary liquidity. Local exchanges, in my view, are a linchpin for many local investment strategies that currently suffer from a lack of liquidity. I support the efforts of Hawaii and other regions to develop local markets.