EQUITY FINANCE: CATALYST FOR SMALL BUSINESS GROWTH

HEARING

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EQUITY FINANCE: CATALYST FOR SMALL BUSINESS GROWTH

THURSDAY, APRIL 19, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX AND CAPITAL ACCESS,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:05 a.m. in room 2360, Rayburn House Office Building, Hon. Mick Mulvaney presiding.

Present: Representatives Mulvaney, Chabot, Schrader, Cicilline, and Chu.

Mr. MULVANEY. If everybody is ready, we will go ahead and get started. Thanks again for coming in today.

As I was just mentioning to Mr. Schrader, I am filling in for Mr. Walsh, who was unexpectedly called back to Illinois. So on his behalf and on Chairman Graves' behalf, thanks very much for coming in today.

All of us in the room today know that small businesses are important to job creation and the economy. But the question is how does a business go from the idea of a business to an engine of job creation? That is one of the things we will be looking at today.

One thing entrepreneurs need to grow a business, obviously, is access to capital. Most businesses begin with an original investment from the entrepreneur or borrowed funds from friends and family, as did the four businesses that I started. In these early growth stages, the future is very uncertain. Entrepreneurs are trying to prove that their idea is viable and can attract customers for their product or their service.

For successful ventures, once the idea shows promise, the entrepreneur will typically need more capital to expand. Because of the high failure rate of new companies, financing from a lending institution can be difficult to come by. So where do entrepreneurs go for this access to capital when they are turned away by a bank? They must rely on outside investors who share in the vision that the entrepreneur has that the new company can and will be successful.

While equity investment can come in many forms, an entrepreneur receives funding in exchange for a stake in the success of a company. While this is a risky proposition for the investor, they are motivated by the belief they can add value to the company and one day profit from the investment.

We are here today to hear from a distinguished panel of witnesses about the current state of entrepreneurial finance and recent legislative changes impacting this environment, and finally, what can be done to focus our efforts as lawmakers on job creation.

With that, I will yield to Mr. Schrader for his opening comments as well.

Mr. SCHRADER. Thank you, Mr. Chairman.

And thank you, panel, for coming all this way to give us your thoughts and advice, which we definitely need.

Today, more than ever, we are relying on America's small businesses to create our jobs, driving the innovation that our country is known for and to unlock new markets. In previous recoveries, it has always been the entrepreneurs that have paved the way. Companies like Microsoft, FedEx, Hewlett-Packard, all those great companies started in someone's basement or garage.

And at this time, we hope that entrepreneurship is again the driving force that gets this economy going again. It takes money to get a business off the ground, as I well knew in my small business; mortgaged basically everything I had to start my business. Probably wasn't the smartest thing I did, but I was successful, thank goodness. It also takes capital to keep the business running.

And under normal circumstances, access to capital has not been a problem. Today, that task has become particularly challenging for small businesses and continues to be a big, big issue for small businesses.

During the hearing, hopefully, we will examine some of the challenges these businesses face. On the positive side, it would appear, now I stand to be corrected, at the same time investment activity in early stage companies, the so-called angel investors, is starting to pick up a little bit and rebound. I would like to hear the extent to which that is and what we can do to actually foster that.

We passed a JOBS Act bill, nice bipartisan bill that hopefully is of some value in getting some of these small businesses off the ground and continue to stay viable going forward. These developments I think are a source of optimism in the current investing climate. Still, there is much more we need to do to get a robust return for our Nation and small business. Although the JOBS Act is still in its infancy, hopefully, it will prove to be of great value. And your suggestions today will hopefully pave the way for the next JOBS Act.

Thank you very much for coming.

Mr. MULVANEY. Very briefly, one logistical matter before we get started. You will see that television screen change here probably in the next 15 or 20 minutes, and we will be called to our first vote series of the day.

Mr. Schrader and I will have to excuse ourselves to go over and vote, hopefully for only a very short period of time. So when we get to that, we will adjourn the meeting for as brief a period of time as possible to allow us to go over and vote.

We will try and find a nice convenient stopping point when we get to that point. Now what I would like to do is introduce the witnesses for the record. And then, after we do that, we will take your testimony, and we will finish with questions at the end.

So we will begin, the first witness today is Ms. Mary Dent, general counsel at the Silicon Valley Bank, located in Palo Alto, California. Silicon Valley Bank provides financing for a wide variety of entrepreneurs, investment funds, and start-up companies. As general counsel, she is responsible for the banks' legal and compliance departments, providing strategic guidance to the company's management team and board of directors.

It is always nice to hear your own bio read back to you, isn't it? We go through it all the time.

Mr. SCHRADER. It is embarrassing.

Mr. MULVANEY. Every time I go through this on my Web site, it gets shorter and shorter. Prior to joining Silicon Valley Bank, Ms. Dent served as general counsel to New Skies Satellites, a global communications firm where she was responsible for the company's regulatory filings related to its IPO.

Ms. Dent, thank you very much for being here today.

Our next witness will be Mr. Jason Best, co-founder of the Startup Exemption. The Startup Exemption has played a key role in developing the framework to change securities laws to make crowdfunding a reality.

Prior to becoming involved in the Startup Exemption, Jason has served in a variety of roles at Medem, Inc.—am I pronouncing that correctly—a technology company that provides communication services to the health care sector.

He has an MBA from the Thunderbird School of Management and an undergraduate degree from William Jewell College.

Thank you again, Mr. Best, as well.

I am also going to introduce Mr. Shipley.

Mr. Shipley, I understand Mr. Chabot is on his way, but we will go ahead and introduce you before he gets here. And I apologize for stepping on his toes.

Mr. Shipley is the founder of Queen City Angels in Cincinnati, Ohio. After being a successful entrepreneur, he founded Queen City Angels, an angel capital investment group with 50 investors which provides financing for seed stage and small high-growth companies. Queen City has invested over $30 million in 52 entrepreneurial companies.

He is testifying on behalf of the Angel Capital Association, a trade association representing more than 7,500 accredited angel investors.

Mr. Shipley, thank you again for being here today and for your testimony.

With that, I will yield to Mr. Schrader for the introduction of our final witness.

Mr. SCHRADER. Thank you again, Mr. Chairman.

I am really pleased to introduce Angela Jackson as co-founder and co-managing director of the Portland Seed Fund, a $3 million private-public seed fund investing in high-growth capital-efficient companies in my State of Oregon.

She brings significant experience securing angel investments in multiple business sectors for the seed fund. She advises hundreds of entrepreneurs and seed stage companies across the broad spectrum of industries at AB Jackson Group.

Also oversees Portland State University's Business Accelerator, which is a really neat deal in our State.

Ms. Jackson is president of the Portland Chapter of the Keiretsu Forum——

Ms. JACKSON. Well done.

Mr. SCHRADER [continuing]. The largest angel network in the world, and was chair of the State's premiere angel investment event, Angel Oregon, in 2010.

She holds a B.A. from Boston University, M.A. from University of Oregon.

Go Ducks.

And thank you for being here today.

I yield back, Mr. Chairman.

Mr. MULVANEY. We are not going to have a quack attack in this meeting, are we? My brother married into a family of Oregon Ducks. It is a disturbing group of people sometimes.

One housekeeping matter. For those of you who haven't testified before, the general rule is that the testimony is supposed to take about 5 minutes. There should be some green, yellow, and red lights that you can see in front of you. While that is the rule, we don't typically enforce it very strictly here. So if you feel the need to go over a few minutes, that is fine. If you get extraordinarily long-winded, and believe us, we know what it is like to be long-winded, you will hear me very quietly tap the gavel. If you could start to wrap up at that time, that would be great.

And what we will do is we will go through as much of your testimony as we can before we have to break, and then Mr. Schrader and I will ask questions after we come back.

STATEMENTS OF MARY DENT, GENERAL COUNSEL, SVB FINANCIAL GROUP, PALO ALTO, CA; JASON W. BEST, CO-FOUNDER, STARTUP EXEMPTION, SAN FRANCISCO, CA; TONY SHIPLEY, FOUNDER AND CHAIRMAN, QUEEN CITY ANGELS, CINCINNATI, OH; AND ANGELA JACKSON, MANAGING DIRECTOR, PORTLAND SEED FUND, PORTLAND, OR

Mr. MULVANEY. So Ms. Dent, with that, please tell us why you are here.

STATEMENT OF MARY DENT

Ms. DENT. Representative Mulvaney and Ranking Member Schrader, thank you very much for having me here today to talk about the very important question of how we make sure that small businesses get the capital they need to thrive.

As you said, my name is Mary Dent, and I am here as general counsel for Silicon Valley Bank. I will focus in particular on a small but critically important part of the overall landscape, which is high-growth, small young businesses.

As you said, we all know why these companies are so important. It is because they are the single best source of job creation we have as a country. High-growth companies create roughly 12 million jobs and more than $3 trillion in annual revenues. They are also helping us solve challenges in fields like health care and energy. And importantly, they serve as the growth pipeline for mature American corporations around the country.

SVB, as its name implies, works pretty much exclusively with these high-growth companies. We work with about half of the venture-backed companies all around the country through 27 different offices, and we are one of the only banks in the United States that will lend to startups before they are profitable.

I will first talk for a minute about what I see in bank lending. I will then touch on what is happening on the venture capital investing side of things and then a bit on the intersection between policy and the world of startups as we see it. So, first, on bank lending, while access to credit does remain an issue in the broader economy, in the sectors that we serve, actually loans are readily available. There are few other sectors today that can deliver the kinds of risk-adjusted returns that banks can get lending to high-growth technology companies, and so competition there is actually fierce.

Even for very early stage companies, on the debt side, we think about the right amount of financing is generally available. The availability of debt does, however, vary by sector. And in clean energy, for example, companies face a very well known what we call valley of death as they try and scale from technology proof to commercial scale production.

Turning to the equity front, we recently did a survey of early stage companies, and their executives said that access to equity funding is their second most significant challenge, right after scaling operations for growth. And we think this reflects a few underlying trends.

On the positive side of things, companies are adopting much more capital-efficient models, which means they just need less money to get started and to begin growing. Venture capital investing levels have largely recovered from the steep falloff we saw during the financial crisis. And other sources of capital, including many of those you are going to hear from today, are providing more and more funding to early stage companies.

Public equity markets are also starting to rebound. And the health of the IPO market, as you understand from your work on the jobs bill, is very important, because traditionally about 90 percent of growth, of job creation by high-growth small companies has occurred after they have gone public.

But the picture isn't universally rosy. While venture investing has recovered, venture fundraising actually has not. In addition, access to capital remains more difficult in capital-intensive, heavily regulated sectors, most notably life sciences and clean technology. This is already affecting the kinds of innovation that is occurring, and it has potentially serious long-term implications for our country.

Turning to the question of the role of policy, we believe that the innovation economy depends first and foremost on the people who build and back high-growth companies. But we also think that policymakers can have a dramatic effect on the overall ecosystem.

To thrive, startups need government leaders who take the long view, who understand the importance of letting people take risks, who base decisions on facts, and who refuse to entrench the status quo. Top of my issues for start-up entrepreneurs include education, access to talent, the regulatory environment, intellectual property protection, health care, and R&D funding.

Like you, Mr. Schrader, I see the recently enacted JOBS Act as a very positive sign, and I commend the House for its leadership and its bipartisan approach to passing this important piece of legislation. I have also been heartened by steps that Members of Congress have taken and are taking to make sure that Dodd-Frank is implemented in a way that doesn't inadvertently stifle the amount of capital flowing to high-growth small businesses.

Looking forward, I hope the House will reauthorize the U.S. Export-Import Bank soon. To give you a sense for this agency's impact on small business, in 2010 just our EX–IM loan commitments helped 75 small businesses generate more than $1.4 billion in sales and support more than 6,000 U.S. jobs.

The United States is lucky. We have a vibrant innovation sector. Other countries are trying desperately to recreate what we are lucky enough to have naturally. All we need to do is avoid stifling it.

I commend this Committee for holding this hearing, and I look forward to working with you to strengthen the vibrant part of our economy that we are here discussing. Thank you for your time, and I am happy to answer any questions you may have.

Mr. MULVANEY. Thanks, Ms. Dent.

Mr. Best.

STATEMENT OF JASON W. BEST

Mr. BEST. Chairman Mulvaney and Ranking Member Schrader and members of the Committee, thank you very much for the opportunity to discuss crowdfunding and how it can function as a part of the solution for the small business funding crisis in the United States.

I would like to begin by thanking the members of this Committee and the House at large for their bipartisan and overwhelming support for the crowdfunding as part of the JOBS Act the President signed on April 5. It was a great testament of the willingness of both parties to work together in support of small business and entrepreneurs, which we all know are America's economic engine.

When entrepreneurs have access to capital to grow their organizations, it translates into new American jobs and American innovation.

My name is Jason Best, and I am an entrepreneur who has been part of the executive management team also of Kinnser Software, that was ranked as one of the 500 fastest growing private companies in the United States both in 2010 and 2011.

I am also co-founder of Startup Exemption. Startup Exemption was formed to advocate for the legalization of equity-based crowdfunding. I and my co-founders, Sherwood Neiss and Zak Cassady-Dorion, saw firsthand the realities of the capital formation crisis in January of 2011. We created a proposal to update securities laws that were written almost 80 years ago to enable crowdfunding to take place in the U.S.

We began working with the House on our ideas. And thanks to the collaborative leadership of the House, the Senate, and the President, crowdfunding has now become law.

Now the SEC has begun its 270-day rulemaking process, and I appreciate the opportunity to share my perspectives on what this means for small business, as well as what I would respectfully suggest that this Committee and the House consider between now and the conclusion of the rulemaking period.

Crowdfunding will enable organizations to use SEC-regulated Web sites to raise modest amounts of capital from large numbers of regular Americans. In exchange for that capital, these small businesses will issue equity or debt securities. If we think of the Internet as Web 1.0 and then the rise of social networks, like Facebook and Twitter, as Web 2.0, this legislation really creates Web 3.0. Web 3.0 is where the social Web meets capital formation. Finally, we are able to harness the power of social networks as well as communities of geography and communities of interest to build businesses that create jobs and innovation.

I live in San Francisco, California, where venture capital and angel investors are plentiful. The same can be said of places like Austin, Texas, and New York City. How will this crowdfunding benefit companies in these places? It really is looking at providing them with another option for some early stage businesses who need to establish proof points with professional investors that the management team can execute and there are markets for its goods and services.

Mr. Chairman, I believe that companies may use crowdfunding as an onramp to professional capital and investment from angels and VCs.

But what about places like Natchitoches, Louisiana, where I grew up, or Arnold, Nebraska, where my family first settled in this country? There are great ideas, talented entrepreneurs, and hard-working small business people in towns like these all across the country, and many of these individuals have no access to venture capital or even bank loans. Many Main Street businesses may never fit the typical venture-backed business model, but may be really good investments for individuals in those communities. Now, crowdfunding can provide these businesses and entrepreneurs the chance to raise capital from their own communities. Soon the dry cleaner could crowdfund to add much needed equipment or a restaurant could open a second location. While crowdfunding alone cannot solve all capital formation challenges, it may provide benefits to many businesses.

Mr. Chairman, there is still a great deal of work to do in the 256 days remaining in this rulemaking process. As the President noted during his signing ceremony, the crowdfunding industry has formed the Crowdfunding Leadership Group. I was meeting with this group yesterday in fact. This group's goal is to collaborate with the SEC during the rulemaking period as it seeks to provide oversight, education, and investor protection for the industry. These 14 crowdfunding companies and industry experts that created this group have already begun their work. And as a board member of this group, I ask for this Committee's help in ensuring the SEC can complete its work within the 270 days mandated by the legislation of the JOBS Act.

The crowdfunding industry has committed to do all it can to create an orderly market with investor protection, investor education, transparency, and data flows that can demonstrate that the market can create jobs, innovation, and successful companies. Please help us as we collaborate with the SEC to create rules that will enable this industry to thrive.

Thank you, Mr. Chairman and this Committee, and I look forward to your questions.

Mr. MULVANEY. Thank you, Mr. Best.

If you can give me just a second to go over a couple housekeeping things with Mr. Schrader.

At this point, with Mr. Schrader's approval, I would like to yield a few minutes to Mr. Chabot for an opening statement.

Mr. CHABOT. Thank you. I will be very brief. I just wanted to welcome and thank Tony Shipley, who is from my district, from my city, Cincinnati. And Cincinnati is known as the Queen City. And they are the Queen City Angels. And they have invested I believe in 52 entrepreneurial companies now, have raised about $30 million, and have I believe about 50 investors in your company.

And Tony Shipley is testifying on behalf of the of the Angel Capital Association, which is a trade association representing more than 7,500 accredited angel investors. And I know we have got a vote, so I don't know if we want to get his testimony in before.

If so, I will yield at this point.

Mr. MULVANEY. Actually, I think we have just enough time for that.

Mr. Shipley, if you would present your testimony. And then, after that, we will adjourn for a brief time.

Mr. CHABOT. So, welcome to Washington. You have 5 minutes.

STATEMENT OF TONY SHIPLEY

Mr. SHIPLEY. That is what I was told.

Thank you very much.

Chairman Mulvaney, Ranking Member Schrader, Member Chabot, and all the other members of the Subcommittee, thank you for holding this hearing on equity finance as a catalyst for small business growth.

The capital that equity investors provide, both financial and intellectual, is important for the successful creation and growth of innovative entrepreneurial companies. My name is Tony Shipley, and I am a co-founder of the Queen City Angels, a Cincinnati, Ohio, group of 50 angel investors that have invested more than $30 million of our own money in 52 entrepreneurial companies in 11 years.

We make multiple investments in these small businesses to support their development, and as such, we have made a total of 115 investments in our portfolio companies. Our money has leveraged an additional $60 million in direct co-investments in our companies and $120 million in follow-on venture capital.

I am pleased to represent the Angel Capital Association, a growing community of sophisticated private investors known as angel investors, who invest money and expertise in high potential startup companies. The Angel Capital Association, ACA, is the professional alliance of angel groups in the United States and Canada, and includes 165 member angel groups in 44 States and another 20 affiliated organizations.

The Angel Capital Association has about 350 angel groups in its database, located in every State, compared to about 100 groups 10 years ago. The new HALO Report from the Angel Resource Institute, Silicon Valley Bank, and CB Insights describe the investments angel groups made in 2011: Median round size of $700,000; 58 percent of investments were in health care/life sciences and Internet/IT sectors; two-thirds of the investment rounds were syndicated, often with multiple angel groups; and investments were distributed throughout the country. Two-thirds of the deals were outside of the traditional equity centers California and Boston.

Queen City Angels' experience fits within these national statistics. From conversations with my colleagues in Cincinnati and across the country, my angel journey has a lot in common with many active angels, including past entrepreneurial experience and interests, investing for more than financial returns, connecting with other smart investors, becoming part of a start-up ecosystem, and providing continuing support to entrepreneurs and start-up companies.

Angel groups like Queen City Angels actively work to market and brand themselves so that entrepreneurs can find us. We work with many organizations to conduct initiatives, such as monthly mentoring sessions and incubators, and conduct an annual 2-day entrepreneurial boot camp to prepare entrepreneurs who are making effective presentations to investors, judging business plan competitions, participating in regional venture forums, and many other events.

I recommend a few things to help strengthened the environment for starting and growing businesses, including leverage the large number of Baby Boomers. In addition to their equity capital, they can bring many of the skills, experience, and mentoring needed by startups and early stage companies to help them be successful in shorter periods of time without making many of the costly mistakes that startups tend to make; leverage private investments to get companies out of the capital gap that was testified to a moment ago, the valley of death; ensure enough angel capital to support new ideas.

The Angel Capital Association calls your attention to a few public policy issues to ensure the health of these investors. Reinstate the 100 percent tax exemption on gains in qualified small business stock; consider tax credits for angel investments in qualified entrepreneurial companies; and develop education, training, and awareness programs for investors and entrepreneurs.

Thank you for this opportunity to describe the unique role and significant impact that angel investors have in our economy supporting the innovative startups that create important jobs in our country. I would be happy to answer any questions you may have and for the Angel Capital Association to provide you with additional information where and when you need it.

Thank you.

Mr. MULVANEY. Thank you, Mr. Shipley.

And Ms. Jackson, with our apologies, I think we are going to draw a temporary close right now.

Mr. Schrader and I and Mr. Chabot need to run over. So what we will do, three votes, gentlemen, best guess 30 minutes? We are going to shoot to be back here as close to 11 o'clock as we possibly can. So as soon as everybody is back in the room, we will get right back to it and wrap up this afternoon.

Thank you very much. We will see you in a little bit.

[Recess.]

Mr. MULVANEY. If it is all right with everybody else, we have got one more witness to testify, and we have got some questions.

We also welcome Ms. Chu from California.

And so, Ms. Jackson, when we were so rudely interrupted, it was your turn. So fire away, and then we will move to the questions.

STATEMENT OF ANGELA JACKSON

Ms. JACKSON. Thank you very much.

Thank you, Chair Mulvaney, Ranking Member Schrader, members of the Committee.

As you know, I am Angela Jackson, and I am delighted to be presenting my testimony here today.

I am fortunate to be involved in the entrepreneurial ecosystem from several angles, one as fund manager of a professionally managed seed fund, called the Portland Seed Fund; one as a chapter president of an angel group of private citizens getting together to invest angel capital; and third, as the director of the Portland State University Business Accelerator, which is a facility housing 25 to 30 fast high-growth technology, biotech, and clean-tech companies.

In addition, I grew up in a serial entrepreneur household. And much like Mr. Schrader, got to witness my father betting the last $2,000, $3,000 on starting a company, which fortunately one day did have a nice exit and generate a lot of jobs and economic activity. I got to go to college off the earnings for one.

Like my father, many entrepreneurs do choose to bootstrap their companies. And in that case, they trade sort of a slower level of growth—this was a 20-year overnight success—for the faster, explosive growth that you might achieve by seeking venture or angel capital, where you can accelerate that growth.

So I look forward to answering questions later. I thought it would be helpful to talk about some things that are going on in Portland, Oregon, which is a real entrepreneurial destination. We are actually having entrepreneurs start to move to Portland to build their companies because of the quality of life, the access to tech talent, and the cost of living vis-a-vis other communities where they might like to be.

So, from my vantage point, things are looking good and getting better. Investors are coming back into the game, startups are creating companies. So from the Portland Seed Fund standpoint, my partner, Jim Huston, and I raised $3 million in a hybrid public and private fund; $3 million doesn't sound like a lot by anyone's measure. But what we do is invest initially very small amounts of capital, $25,000 to start, in who we see as the highest potential, high-growth, capital-efficient companies that we can find in Oregon. We do these in classes or cadres of eight at a time. And with the capital comes strings attached in the form of mentorship, intensive connections and investor introductions, as well as introduction to the ABCs of running a business. Very often these seed stage entrepreneurs come at it from the standpoint of the product, but they don't understand the other nine-tenths of what building and running a successful business encompasses. And we expose them to that.

To date—this is quite new—we kicked off the fund with our first investments last July, eight at a time, and we did a second class just in early March. So 17 total investments to date. Those companies, even after we just invested an initial $25,000, have created 60 jobs and have gone on to raise over $4 million in follow-on priced capital.

So we are very proud of the progress to date. But I also want to point out and set expectations, we are playing at a high-risk, high-failure rate asset class, the seed and angel class, and we know that failure is a key part of the game. And we do expect failures.

So we call this the catalyst and the crucible. The discipline around what we do at the seed fund is we think what makes the difference in accelerating these company's success.

We take a similar approach at the Portland State University Business Accelerator. But the types of businesses that we serve are a little different, and they have a longer time to market. Bioscience cannot be a $25,000 overnight success, for example. So, instead, we help these companies access larger formal rounds of capital. And we are proud to report that those companies were the subject of a Portland Business Journal lead article last November, something along the lines of, What is in the water at 2828 Southwest Corbett? These companies have attracted $128 million in private capital to Oregon, which is kind of a cash-starved venture State, through their great work. And that was over a 5-year period. These companies are hiring rapidly. These 25 to 30 companies have 15 open positions today. So these are in fact job-creating companies.

The third hat I wear is with the Keiretsu Forum, the angel group. And this is actually a global angel group, but I participate in the Northwest Circuit, which encompasses 240 members. Those 240 members last year invested $24 million of their own capital in 36 companies, to grow them and to expect a return. I would sort of tap groups like Keiretsu Forum as a logical partner with the new crowdfunding legislation to put a face in a room to create an online-offline experience to vet out some of the deals, the due diligence, and the deal screening that will be a necessary part of crowdfunding, which we are excited about, by the way.

If there were, if I could wave a magic wand and ask for a couple of things, I am seeing that—first of all, we are supportive of the crowdfunding legislation. We also know, we are cautiously optimistic, we know that the devil will be in the details of rulemaking. So we are hopeful that that process will go well. But it is early to tell. We are probably more excited about the easing of the non-solicitation ban in the short term anyway from Reg D, which will make it easier for the already in place angel infrastructure to advertise, attract, and recruit new members, who, by the Keiretsu example, you can see are ready and willing to put, you know, funds into good companies.

In the yet-to-do column, increased incentives to angel investors who are putting risk capital into place to grow the economy would be a top priority as well as easing the friction through the Tax Code to startup companies, who are struggling to create these jobs. And I know you are well aware of many proposals. I am not going to suggest or back a specific one.

A couple of other potential upstream choke points to be aware of. I am not experiencing the easing of lending with the small companies that I work with yet. I would like to see some provision where the top performers, as vetted by groups like mine, can access loan capital earlier in the form of working capital and inventory financing. These are huge potential choke points to the growth that they could put on. And they are still, in my experience, struggling to get those loans. And I am happy to talk to anyone who knows a way around that.

And lastly, we are seeing a choke point of talent actually. So the training, and whether we are training organically here or recruiting highly skilled tech workers to fill out these jobs that are becoming available, this is the new choke point that I am seeing in the job-creating companies.

So, with that, I am looking forward to your questions. Thank you.

Mr. MULVANEY. Thank you, Ms. Jackson.

Thanks to all the witnesses.

As is my custom, I usually defer to the ranking member.

So, Mr. Schrader, you are recognized for as much time as you will consume.

Mr. SCHRADER. Thank you, Mr. Chair.

Appreciate everyone for coming. Both the chair and I were kind of anxious to hear your testimony and learn how we can continue to help this critical part of our economy develop and grow.

I guess I would start with Ms. Jackson, if that is all right. Elaborate maybe a little bit on your last two points about the choke points. And maybe Ms. Dent could chime in also about—I agree, in my State at least, the small, small businesses are still having a lot of trouble with the credit. The middle stage and larger businesses I think are in much better shape. So, you know, a little bit on what some of the solutions are that you think.

And Ms. Dent, if you could follow up on that.

Ms. JACKSON. Sure. Understanding bank underwriting, that is not my sweet spot. But what I can report is when we put in the hours and—you know, we are professional fund managers; we are able to select top performing companies and surround them with everything they could possibly get and need to ensure their success. And again, there will still be failures. But there are companies that will fail first because of lack of access of that next year capital and not for any other factor. If there is a way to achieve some sort of seal of approval or some sort of loan guarantee that those particular hotshot companies could achieve some, you know, kind of line of credit—again, it is not for every company. It is not for small business, Main Street America; this is a different type of company I am talking about——

Mr. SCHRADER. Are you familiar with the new market venture programs SBA has? Are they too cumbersome, too whatever? What is the deal?

Ms. JACKSON. In my experience, again, I work with hundreds of entrepreneurs, I have yet to meet one who has successfully accessed those programs.

Mr. SCHRADER. That is telling.

Ms. JACKSON. It is not to say that they aren't elsewhere, but in my experience in Oregon, that is true.

Mr. SCHRADER. Ms. Dent, any comments?

Ms. DENT. Sure. I think there are probably at least two things going on. One is, by definition, we see the companies that we see, and there are relatively small lenders who will lend to these very small startups. So some of it may be an information flow thing. If the companies can't find their way to one of the handful of people who is open to lending to very early stage companies, by definition, we will believe everybody is getting the credit they need, and they won't be getting the credit they need. So I am happy to introduce you; we do have an office in Portland, and I am happy to introduce you to my colleagues there and let them continue the conversation.

Ms. JACKSON. I know your colleagues. They are lovely people. Thank you.

Ms. DENT. The second is, frankly, harder to solve. And that is that lenders have relatively little upside; they earn interest, and they really can't therefore take the downside risk that an equity investor can and often chooses to take.

In addition, under the banking regulations you have to have one or two sources of repayment. That doesn't mean potential repayment, that means accounts receivable, cash on hand, or something else that you can count on as a source of repayment. And if you don't have that, you actually have to treat the loan as a loss. It doesn't matter if you remain optimistic that it will be recovered, but you have to take it out of income in this period and then hold it basically in a separate account. And then when you recover that, that flows back in. But it does impose a rigidity on what banks can do on potential they believe in, potential they see and they share with the investors. A belief that the company will perform well and will be able to pay, that is not enough for a bank to be able to lend. They really need to see the actual source of repayment. And there usually have to be at least two sources of repayment.

And that is a basic gap between I think the desire for credit, the realistic and reasonable desire for credit on the part of the entrepreneurs in these startups and the legitimate views of the lenders looking at the credit from a credit perspective.

Mr. SCHRADER. So then a question for the whole panel I guess is, I agree, banks never lent me money unless I really didn't need it. And that is not a slam on the banks; it is just the real world. Because like you said, they have to have some sort of asset. And when I started, I didn't have a whole heck of a lot.

So what do you use to guide your decisions? You know, obviously, you have more flexibility as angel investors. How do you decide which is a better risk than another? Because eventually, you do want to make some money on your investment at some point in time. So what are some of the things you look for to guide your decisions?

Ms. DENT. There are probably two big differences between Silicon Valley Bank and most banks. One is that we will lend against the probability of the next round of financing as a source of repayment; that when we are in conversations with the investors and we know that they are backing a company and we know that when that company reaches the next round, they will be there. In the near term, the company usually has cash because equity goes into companies in chunks. So they sort of get a load of cash, we can lend against that cash. As they use that cash and develop their product or service, as it gets closer to the point where they are going to need to raise another round, then we can engage more with the investors. And it is our focus on the ecosystem and our deep relationships that let us have all the conversations we need to have to go figure out, is this company going to get that next round, in which case we can hang in there with them, or not going to, in which case we would work with the management to wind down the company because it is approaching that end point. And it is better to do it gracefully if they are not going to make it.

I think the second difference that we believe really differentiates ourselves comes later. It is after you get the credit, so you get past that initial gate, what happens when you hit the inevitable bumps in the road? And I think we believe, again, because we focus on the sector and we work so much with entrepreneurs, that we are better able to understand what is really going on and not react too strongly to things that happen, and sort of hang in there and figure out, again, we have an obligation to the Federal Government and to our shareholders to continue to be safe, sound lenders. But the more you understand, the more you can differentiate real risk from perceived risk and hang in there where it may look like there is a risk, but you understand the facts, and it actually is a risk that is manageable and can you stay with the management team and let them work through that risk.

Mr. SCHRADER. Very good.

Mr. Best. We will just go right down the road. Comment?

Mr. BEST. I guess we definitely see, in my work with Kinnser Software in the last 4 years, we spent a lot in Austin, Texas, and certainly a lot of venture capital there. But from a small business lending perspective, definitely a very challenging environment still.

I think Mr. Shipley has made an investment in a company that is part of the leadership group, this crowdfunding leadership group that we are working on on the debt side, SoMoLend, and he may have some more specific comments about them. But certainly this crowdfunding on the debt side, the opportunity there really is in the research work that that platform has done, the typical amount of money that a small—a Main Street business needs is around $20,000 to $25,000. So it is a fairly small amount. It is an amount of money that could certainly be crowdfunded effectively for Main Street businesses. So I think whether that is on the equity side or the debt side, I think there is a lot of opportunity there.

Mr. SCHRADER. Very good.

Mr. Shipley.

Mr. SHIPLEY. Yes, just a couple of follow-on comments.

Mr. Best talked about the company that we have invested in, which is SoMoLend. And it is a part of this crowdfunding. In fact, the lady who started that business is going to be working with the SEC and the committee that they are putting together to finalize the regulations on this. So we are really interested in what will come out of that.

And as Ms. Jackson pointed out, I think the devil will be in the details. So it is going to be very interesting to see how that shakes out at the end of the day. And I think the question is, is it going to be more appropriate, "it" meaning crowdfunding, for those companies that are more lifestyle oriented, or will it also apply to companies that are venture oriented, that can actually get organized angel rounds of capital or VC rounds of capital. So I think we are going to shake that out over this next several month period.

There is another company in Cincinnati that we are affiliated with. One of our angel members started a company called the Business Backer. And it is exactly for those companies who need—maybe it is a pizza parlor and, they need a $25,000 loan that they can't go through the bank and get because they don't have the collateral to support the loan. And as long as they have a revenue stream, they can get a loan from this organization. And the way the loan is repaid is on every revenue transaction they take a little piece of that revenue and repay the loan. So over a several month period, and generally a 9-month period, they have repaid that loan. So it is one way to fund these companies who need these small amounts of capital.

Another concept that one of our ACA members is working on is this idea of revenue funding. And it is a higher level of activity that I have talked about with the Business Backer. And a gentleman that is looking at all of the ins and outs of how you would do revenue funding, in fact he is Rob Wiltbank. I am sure you know Rob.

Ms. JACKSON. Yes.

Mr. SHIPLEY. I think that is a very interesting concept, because there are a lot of companies that are never going to be the strategic kind of companies where venture debt or recognized angels or VC money will come to the table. But they can be very nice $5 million, $10 million, $15 million kinds of companies, and they may need a half a million or a million dollars, and they could raise this through revenue funding. It is the same concept where the people lending will take money back on the revenue stream until they have gotten the returns that they expect to get. If it is a 2× return or a 3× return, once that happens, there could be some follow-on warrants that you retain some small equity sliver in the company. But it is another way for those more lifestyle kinds of companies can actually get the revenue—or the funding that they need to grow their business. So I think that as a pretty nice concept.

And Rob Wiltbank is doing a lot of work around standard term sheets, standard documentation that these kinds of companies would sign and put in place for that kind of funding. So we are really looking forward to see what comes out of that.

Ms. JACKSON. Thanks.

I would agree with Mr. Shipley; that is a really interesting and important new trend. And Professor Rob Wiltbank and also Thomas Thurston, both in Oregon, are taking a leadership role on defining what those types of deals would look like.

The type of investor that that might attract is a little different than a pure angel investor, who sometimes is going for more of a home run return. So I think what is important here is there is a role for everyone to play.

And to Ms. Dent's point, absolutely, we understand there is certain regulatory issues and covenants. But there is an opportunity for somebody to lend money—and I don't know who it is—to lend money quickly to the right types of companies, and they will get a nice return. Now, who that is I think, you know, bears some discussion. But it is an interesting topic for filling in the gaps.

We need to create this seamless capital ecosystem. And I think we are doing a really good job now on a seed level, where 3 years ago, that was seen as the area of greatest paucity. Now, I almost think we might be—I hate to say we are over-allocated on the seed side, but I promise you companies will get funded that probably don't deserve to be because there is a lot of seed capital out there right now.

I think the next place we need to turn our sites is just upstream of that, so the real top performers get the capital they need to continue.

Another issue I just want to mention, loan versus equity. Professional investors don't want to come into a deal that is over-allocated to other investors. And so everyone has a role to play. Can grants, can loans create a nondilutive sort of capital influx into the company at the key moments? If that can, it is a better deal for the investor. You can have an easier time attracting upstream institutional financing. So these are all things to consider at the early stage.

Mr. SCHRADER. Last question for me, Ms. Jackson, and anyone else who wants to comment. You talked about the talent pool choke point. Could you elaborate a little bit on that?

Ms. JACKSON. Absolutely. So, in Oregon, we are benefitting from an extreme talent choke point in Silicon Valley right now and a lot of competition for individual developers and teams. Some people say acquisitions are happening just to acquire tech teams. So there is a dearth of that top talent.

Now, in Oregon we have a lot of that talent. It has also become very competitive for that talent. But we have the advantage of you can build in scale a company and hire top talent for less than you can in those talent pools.

But if a company is scaled, you know, to take the next step and has 50 open key positions, it is a choke point. So how do we address that through training and acquiring by any means the appropriate talent to keep our businesses growing?

Mr. SCHRADER. Very good.

Ms. DENT. If I might briefly add, we do an annual survey of very early stage start-up companies. And we have just gotten the results back. We will be releasing it in a few weeks. But there were a number of findings from that that speak to your question. One, the biggest challenge they see is scaling operations for growth, which, based on our conversations with them, we do think is directly tied back to talent. Two, only one in five believe that the higher education system is training people with the skills they are going to need. And three, on a more optimistic note, I think there are emerging sectors with enormous potential. We talk a lot about regaining manufacturing in the United States. There are huge sectors that require new skills where the fight is not going to be based on the lowest cost producer; it is going to be the highest skill force. And so there is an opportunity, if we address this and start really getting our educational institutions, mostly at the higher ed level and then percolating down to earlier education, training people with the skills they need, I think that the opportunity for the U.S. economy is really enormous.

Mr. BEST. Just to echo that, one of the things I heard a couple weeks ago is there is now a vocational school in Massachusetts that is offering a vocational degree in development, software development. And so to begin—and so in addition to the traditional vocational education programs that occur today, to add an information technology track, the ability to train people to write code in Java and Ruby and these other languages that are desperately needed. Having spent a lot of time in Austin and in San Francisco, there are so many open positions now for developers. And so, especially in States like where I am from, Louisiana, or in other places where there are not a lot of—where you can develop software and you don't have to be physically in the same place as the company, a lot of virtual workers that could be in South Carolina, or Oregon, or other places, there is an opportunity to create these kind of vocational education programs that could make a huge difference in local economies and also to stop the gap we have right now in these technical positions.

Mr. MULVANEY. Thank you, folks.

Thank you, Mr. Schrader.

At this time, I yield to Ms. Chu for any questions she might have.

Ms. CHU. Thank you.

A very important point of the Community Reinvestment Act is that it brings lending investments and services to low- and moderate-income neighborhoods that are traditionally underserved by lending institutions. And we have a situation here where historically minority-owned businesses have not taken advantage of equity financing. In fact, it is estimated that of the total amount of equity capital invested in the United States, minority businesses receive 1 to 2 percent.

So how can we work together to help underserved entrepreneurs learn more about equity financing and start to utilize equity financing? Do you have any policies with regard to diversity in lending and helping these underserved small business communities through equity financing? For everybody on the panel, if you have any thoughts on that.

Mr. BEST. At the Startup Exemption, the organization that worked on the crowdfunding portion of the JOBS Act, one of our early supporters actually was Whoopi Goldberg, because she really believed that it was an opportunity to bring financing on an equity basis to underserved communities. So in her neighborhood in New York City, the ability to allow women entrepreneurs the ability to get microfinance and community-based lending, community-based equity investments to those people who are able to build businesses.

You know, so I think that is one of the opportunities that is there. I think that providing education programs and providing, you know, through the SBA or other touch points where we could reach out to those communities and explain the opportunities for crowdfunding, for crowd lending, I think would be really powerful.

Ms. DENT. I have a couple of thoughts. One is there are programs for kids that are really interesting. There is one at the high school where my kids attend. It is a very mixed high school with a very high dropout rate. And it is a program called BUILD. And they spend the first 3 years working with the kids to develop little micro businesses, maybe making a cover for a cell phone or something like that. And local entrepreneurs and VCs from the area coach the kids. They build the business. They sell their products. They make a few hundred dollars. And then, during their senior year, they still work with them, but they use all those skills they have developed over the prior 3 years to help them select a college and get a college application. And they have a wonderful success rate with the kids, and the kids learn entrepreneurism. And they also increase dramatically their chances of going to college. It as relatively young program, but at least the data they have so far shows that the chance they stay in college and finish college also seems to be higher. So I think programs to teach entrepreneurship to kids and give them the skills and the aspirations is part of it.

The second, there is a program in San Francisco called Astia that works with women entrepreneurs, because actually funding for women entrepreneurs is also surprisingly less prevalent than for companies led by men. And they do a lot of coaching of very early stage companies to help them get ready, develop their business model, develop their staffing plans, their marketing plans, their pitches so that they get ready and are more successful when they go to seek institutional investments from venture funds or others. And I think that kind of—it really takes I think a lot of mentoring. And that kind of program might also be helpful.

And the third is a little bit more to a legislative fix. The Community Reinvestment Act was enacted a long time ago, where banking was much more physically based. And it has moved to a more virtual system. Silicon Valley Bank, for example, exists in 27 different offices all over the country, but we only have four—five branches, and they are all in California, in Napa Valley and in Silicon Valley. All of the other offices don't count as branches. So, from a Community Reinvestment Act perspective, they are irrelevant. And I think if you stepped back and realized that so much of banking is now virtual and rethought about Community Reinvestment Act in terms of, how do you get pools of capital into the communities that need them, and that may or may not be a strict geographic tie between a bank that physically sits in a location with a branch and the community that physically surrounds that branch, that might be a really interesting way to go.

Mr. SHIPLEY. Just a couple of other comments. I absolutely agree, pushing entrepreneurship down to the lowest level we can to get kids interested in it is—that is a longer-term program, but I absolutely endorse that.

You know, kids these days have their heroes. And most of them that they think are rock stars or sports figures and people like that, movie stars. But most of them don't have rock star heroes that are entrepreneurs. And so one of the programs we are looking at in Cincinnati is how do we take our entrepreneurs and really elevate them to that rock star status and give them special privileges in the city so that we become a magnet so that people who want to be entrepreneurs come into our city because we treat entrepreneurs in a special way? And of course, sports stars are really treated in a special way. So why don't we do that same thing with entrepreneurs?

And one other idea, this lady I mentioned that started this crowdfunding company also has a venture called Bad Girl Ventures. And it is for women who want to start basically small businesses, and they need $5,000 or $10,000 or $15,000 to allow them to start the business. I don't know a lot of details about how it operates, but she has had a successful—or a number of classes of women who have gone through their program and then have started their own lifestyle kind of business. So that would be something to look into.

Ms. JACKSON. These are wonderful ideas being shared by my fellow panelists.

I just want to point out a trend that I think is exactly the opportunity you point out and that crowdfunding is serving so well, and that is just the democratization of information and entrepreneurship. Literally, anyone can be an entrepreneur today. The costs of entry have come down so far. Anyone can study and learn how to write—can create a mobile app, get it out on the marketplace very quickly. So anyone can be an entrepreneur for very little capital.

With that democratization of entry comes more competition. And people actually need to get better at what they do to stand out above the other entrants. And that is where I think it gets trickier. You can get a lot of people to play, but how do you nurture them so they can actually succeed? And, you know, I maybe have more questions on that than answers at this point, but there are some great programs.

The other point is just to keep in mind, we are at the point now where over half the world's population is under 25. And the acquisition in the news lately is Instagram and a billion dollar market cap by 15 people. I am not sure of any other example of a per-headcount market cap like that in 3 years. And these are all, you know, young people. But if you go upstream, the fish that acquired Instagram was created by someone at the time who was under 25. So how do we really bring not just access to create a company, but that velocity education to scale a company quickly? Because as these two examples have pointed out, they can create a lot of economic value in a short time.

Ms. CHU. Thank you.

Mr. MULVANEY. Thank you, Ms. Chu.

I have a couple of general questions to begin with, and then I will have some final questions for you as individuals. But one of the things several of you mentioned in your testimony was the recent JOBS Act that we passed. And I know the parts that I liked, and I know the parts that my colleagues across the aisle liked, but I would be curious to know the parts of the bill that stood out as being particularly helpful to each of you. And then perhaps as a follow-up to that, things that you would have liked to have seen in that bill that were missing if we decide to take it up again in sort of a 2.0 version next section.

So I will start down here, Ms. Dent, with you. If there is anything about that bill that particularly stood out to you, let's hear about it.

Ms. DENT. We probably knew best the IPO onramp provisions. We had worked on and off with that committee over the course of last year developing the recommendations. And we see the impact that the lack of IPO—or maybe better said, the unpredictability about whether an IPO will be a possibility. It takes about 2 years to get ready for one. And so it is not a question of whether you can pull it off when you are ready; it is a question of do you devote the resources to try to get ready and the costs, millions of dollars of costs, away from all the other things you could use that money and your time to do. So we think that providing a more predictable path, scaling those requirements is really, really important. The other piece that we had worked on, the other pieces we had worked on were, what if you don't want to go public? What if you still are the right size to be a private company, and so the Reg A, the Reg D and the shareholder limit provisions, we think in some ways the bill was strong because it addressed both halves, from the earliest stage to the latest stage, to give people different options. I forget who it was who said, there is no single answer; it is a mosaic.

In response to your other question, I guess I don't have a version 2.0. What I loved about the IPO act was it avoided the desire to solve all problems. And it said, let's going something done. So I think it is great if you are looking to 2.0, but I think what you really should be commended for is being willing to do 1.0, get it done, move it forward, pass something and then keep moving forward.

Mr. BEST. Obviously, for us, for Startup Exemption and myself, it would be the crowdfunding act that was part of the JOBS Act, and the opportunity to raise—for regular Americans to make investments in their communities and with ideas—entrepreneurs they believe in and ideas that they love. For a while now, the donation-based crowdfunding space has been in act. So companies, like Kickstarter and Indiegogo, where you can go and contribute in sort of the PBS model of, I would like to donate money to an artist or a filmmaker or a band, and in return for that, I get a prize. And typically that is the movie or the CD or whatever it is that that artist is creating. There will be more money that is donated through those platforms this year than the NEA will distribute this year. So well over $100 million. And that has all been delivered with virtually no fraud. And so it is a real huge opportunity.

To give you a sense of the scale of what crowdfunding could become from an equity or debt perspective, I think it is a data point to look at. So I think that is one of the things that we are really thrilled about. And again, from the opportunity to say let's get something done, let's put a stake in the ground and move forward, we were so grateful for that, for taking, you know, for really moving forward with a new idea in this way in a really rapid and meaningful way. And we appreciate that so much.

From a 2.0 perspective, I think that I would like to ask for the opportunity to continue to engage with you, Mr. Chairman, and this Committee during the SEC rulemaking process. Because that is where we are really going to need support in making sure that we create a process that does protect investors really well but also doesn't create so much friction on the process of making these small investments, these modest investments, that it kills the market. So it really is going to be that delicate balance, because so much of—a few data points about what is happening today on those donation-based platforms. Only about 40 percent of those, of projects that are posted on those platforms that say, please, we would like to—please, fund my idea, only 40 percent actually reach their funding goals. So what that says is the crowd is doing a pretty good job of vetting the ideas that they think are good ones and bad ones.

My guess would be that as we look at the equity side, that those numbers may be even a little smaller than that, as people really are looking at, what are my returns, and really taking a very close look at those things. So making sure—and also typically these investments will be made by people you know. And so your first-degree connections on LinkedIn, or your second-degree connections, or third-degree connections, people who know you or know people who know you. What we see on these donation-based platforms today is you have to get to a tipping point of about 30 percent of your funding goal being reached by people that know you or know of you before strangers will invest in you. I think that also will be true with equity-based or debt-based crowdfunding as well.

And so really allowing this market that is very delicate from a social interaction perspective to take place, I think there is a way to do it and ensure—create some prudent investor protections. But just making sure that we can work with the SEC effectively to do it in a way that doesn't restrict the market so much that it kills that market dynamic. So thank you.

Mr. MULVANEY. Thank you, Mr. Best.

Mr. SHIPLEY. The other panel members are much more expert in the JOBS Act than I am. But certainly we—and we have never had a company that has gone through an IPO. But certainly with the modifications made that would allow some of our companies to perhaps go through that process much quicker and for less cost, we like that feature of the bill.

On a personal basis, I like the idea that companies that previously couldn't get access to appropriate amounts of funding to start their companies, because I think there has been comments made on that, it could be more lifestyle kinds of companies, they may never be an organized angel or a venture capital kind of opportunity, but they are companies that if you can put a half a million bucks or a million dollars a year into those companies, they can be very significant lifestyle companies.

And I like to tell the story of when I was a part of a CEO group of about 15 members, and we had low-tech, no-tech, and high-tech folks in the group, but the most successful company in the group was a lifestyle business. It was $250 million in annual revenue. He wouldn't tell us the profits that he made, but I am sure they were much more significant than the profits we ever made. But that was considered to be a lifestyle company. So the fact that we could get more of those kinds of companies, and probably 80 or 90 percent of the companies that we have in the country today are lifestyle kinds of companies. So to be able to give them funding to them get the traction that they need in the marketplace I think is pretty significant.

Mr. MULVANEY. Ms. Jackson.

Ms. JACKSON. Thank you.

Again, supportive and complimentary that this exciting new form of crowdfunding can be passed this quickly and soon will be available to the market.

A couple of concerns, and they have yet to—we have yet to know if they will be concerns, but this is an area for possible future work. As a large number of investors relates to converting into follow-on rounds, there may be the need for some changes in regulation on some upstream funding to accommodate the crowdfunded investor invested companies. Again, it is too early, I think, to know whether that is going to be an issue.

Mr. MULVANEY. And that sort of transitions into my next question. Maybe it is you, maybe it is Mr. Best, anybody else.

You mentioned something that was of interest to me. I am not a new-tech kind of person. The companies I have started have always been old-tech, very old-school, boring companies. But you mentioned the restaurant in Louisiana. Maybe now there is the opportunity for them to use this crowdfunding. Why don't you walk through how you would like to see that work? Ideally, how would it work if you are a small business owner of a restaurant in Lafayette, Louisiana, and you want to do this? And then I would like your input into what needs to happen during this rulemaking process that we are in the middle of right now to get to that ideal outcome.

Mr. BEST. So, in the best-case scenario, I am a restaurant owner, I want to add a second location. I would go to a Web site that would be what we call it a funding platform, a place where all of these transactions will take place. I as a business owner and equity—investment seeker would then put in a lot of information about myself and my business. My Social Security number, and my business information, and my sources and uses of cash, and some pro forma kind of business statements, accounting statements so that I am able to explain fully to my potential investors what I am going to be doing with that money and how I am going to be utilizing it. There will be a video there, like there are on a lot of these sites today, letting you sort of get a chance to virtually interact with this entrepreneur.

And then I would then go out to my social network, both physically in the community, and I love the idea Ms. Jackson has of creating a physical space for this to take place as well as an online space, but also through my virtual community of saying, you know, to my customers and my friends and my relatives and say, please, invest, I want to add a second location. That money would come in over some period of time. Let's say, you know, typically, we would say between 60 and 90 days would be a typical window you would want to leave this open for. And then, once the funding goal was reached, because the legislation requires, obviously, there to be a 100 percent of the funding goal to be reached, if I reach that goal, then the cash call occurs and I am able to then receive that money and then continue to communicate through this funding portal with my investors. And so there would be, you know, standards required for this restaurant owner to be able to then say on a quarterly basis.

Mr. MULVANEY. Tell me what those are. Now we have moved into what has to be done during the rulemaking. So give me the standards. Tell me the type of things that when the SEC calls my office and says, what happened at the hearing today, what is your input, what am I supposed to tell them? What do we want to focus on as we go through this rulemaking process?

Mr. BEST. You want to provide the same type of quarterly reporting that would be expected from a bank loan or an investor. Just, you know, provide that basic level of information on——

Mr. MULVANEY. Does it have to be audited?

Mr. BEST. The legislation—I think it depends on the level. I think that below a half-million dollars, it basically should be just a signature of the CEO. Above a half-million dollars, what we have called for is not fully audited, but that it would be certified by a CPA. Reviewed and certified by a CPA.

Mr. MULVANEY. Now tell me, you mentioned something else, about it is not the charitable, but the other type——

Mr. BEST. Donation based?

Mr. MULVANEY. Exactly. And you mentioned something very interesting to me, which is that it is almost completely fraud free. How is that happening?

Mr. BEST. I think it is just the power of the social Web I guess is one way to say it. And I guess what that means is it is, to use a term Ms. Dent used, it is an optimistic way of moving into this sort of arena, where I say I really want—because people make donations for a number of reasons. They do it because they want the perk that comes along with what you get. Like if you give me $50, I give you my CD of my band. They do it because they believe in the individual and want to help out. They want to be a micro patron of the arts. Or they just believe in the cause or the idea, or want to be part of something bigger than themselves. I may never be in a band—I will never be in band—but I might want to support someone who is. And so those are the things that, reasons that people would donate.

I think that when you add the equity return piece to it, I think all those things still exist. But you are adding also to it the desire to be part of something bigger that may have a financial return for you.

Mr. MULVANEY. And do you think that the risk for fraud would be higher or lower? Because you have just described essentially the old-fashioned charitable—you are right, you are a micro patron of the arts, which is a slightly different calculus that you go through versus investing in that restaurant. Do you think when we switch over into that return on equity, that the risk of fraud goes up, goes down, or stays about the same?

Mr. BEST. I think it stays about the same. I mean, there may be some—it is totally hard to predict because it is kind of a whole new area. But I don't see it being orders of magnitude different than what we are seeing today with the donation-based platforms. Because I think that the main reason is the disinfectant quality of social media, the ability—the power of sunlight, if you will. If I am signing into these platforms, both as an investor and as an entrepreneur, and I am signing in with my online identity, and all of my network is there, it is really hard to hide. Because in the past, the fraud that took place was I knocked on a door, or I made a phone call, or I sent you a one-to-one communication email that said, you know, I got this great idea. This is you putting yourself out in front of the entire Web, with all of your social connectivity watching. And there will be online rating systems, just like there are on Amazon or on the other Web sites.

Mr. MULVANEY. So it sounds like there is a strong argument for a fairly light hand when it comes to prophylactic fraud prevention. Because it is people that you know, because of the forums that you are moving in, that I guess you are trying to—I am trying to make an argument for you that the SEC and whoever else gets involved in rulemaking should not go too heavy on trying to anticipate fraud and hope that perhaps the market will insulate itself against that to begin with. Okay. That is great.

Ms. Dent, very quickly, and I don't want to have a hearing and mention the words IPO and not have somebody saying something about Sarbanes-Oxley. So you win by default, because I have got my angel investor, my crowdfunder, and you are the closest we get to IPOs. And you actually mentioned it a couple times. Is it working? We all know that formation of public entities is at an all time low. I think it was you who mentioned, I think accurately, that it is when that company gets over that hump and becomes public that we see the dramatic increase in jobs because the access to capital allows the company to grow so dramatically. So how are we doing on IPOs, and if you have some suggestions on fixes to Sarbanes-Oxley, would there be any? And what would they be if there are?

Ms. DENT. I think for growing companies the two most important things are they have scarce resources, so you really want to make sure—it is not a question of I wouldn't say get rid of Sarbanes-Oxley across the board. Personally, there are things I would get rid of about it. But it is really scaling to the level of risk. And so I think what the JOBS bill did, for example, which is reduce the number of years of audited financial statements you have to provide when you go public, and remove the audit, the external auditor attestation around the 404 controls, those were both steps in the right direction. Because for a smaller company, those don't add almost any value to investors, and yet they add a lot of costs. And that cost is coming out of somewhere else, hiring an engineer or expanding into a new market.

So I think continuing to really look at what have we learned from Sarbanes-Oxley for a larger, more complicated institution that it may be that the costs are justified, but I think as you go down the curve, it gets into a much bigger question.

I think a second thing that really came out during the debate over the JOBS Act is, do people understand small business? I think there is still in Washington policy circles a view that small business is really, really small. And the reality is that for these technology companies, you can get pretty big in terms of revenue and still be investing everything you have got in new products and not profitable.

Mr. MULVANEY. I can assure you we don't understand small business. Right now, the current debate right now was a small business tax reduction that could go to companies that have several tens of billions of dollars in revenues. But go ahead.

Ms. DENT. Oh, really. That is probably a whole different problem. But I think the tendency is sometimes to cut off small business at a very low level. So I think Sarbanes-Oxley had a $75 million threshold. And that is just not really that relevant. I think something that slides is more relevant than saying small ends at a certain end point.

And then the third I would say, which arguably is the most important, which is predictability; that in a sense what people need to know is what they have to do. And they can cope with any reality. Different things will happen. And so, for example, there are some things that won't happen if the cost of doing them is higher. And that is a loss to our country. But at least with predictability, you can start to make investments that make sense. And I think that is what we are seeing play out right now in life sciences; there is so much unpredictability. The cost of getting through the regulatory process has increased so dramatically—and I recognize this isn't Sarbanes-Oxley, but it is that same theme of, how much do we require companies to spend on extra levels of protection? And are we really sure that we are getting extra levels of protection that warrant that additional investment, recognizing that it is coming out of somewhere else? And I think those are the questions I would really recommend this committee look at, because my guess is there is still more movement to scale 404, other parts of Sarbanes-Oxley and regulation more generally back, so that it hits companies with a responsible level of regulation.

Mr. MULVANEY. One last question for Ms. Dent. You mentioned earlier that you all have the ability to lend against the likelihood of the next round of equity funding or next round of funding. Is that a choice that you make, or is there something specific to your bank that you have done that you can do that, or is it something all banks could do if they chose to do it?

Ms. DENT. All banks could do it if they chose do it. It does take very deep relationships and a very deep understanding of how companies grow in order to do it well.

Mr. MULVANEY. So that is not our problem or our issue. That flexibility exists in the marketplace already. Some choose to do it; some banks choose not do it.

Ms. DENT. Yes.

Mr. MULVANEY. Mr. Shipley, before we wrap up, and I am trying to wrap up here by noon, you had three recommendations. And I want to make sure I got all three of them, because I am pretty sure I missed one. You talked briefly about your 100 percent exemption suggestion. The last one was develop education and training. And then I didn't even get notes on the second one. So if you could maybe walk me through those for the record, that would be helpful, sir.

Mr. SHIPLEY. Sure. These are recommendations that are generally approved by the Angel Capital Association, with our public policy group that we have as part of ACA. First one was reinstate the 100 percent tax exemption on gains of qualified small business stock. And I think a number of organized angel groups saw a dramatic increase in investments that they were willing to make. I think they felt like they were on the clock, so they were pushing investments into that time period. So we think if you made this a permanent part of the bill, that we would get more investments in companies because people would be—the idea in angel investing or venture investing or basically any kind of investing is to have greed overcome fear, and so if we think we can get enough return so that we are willing to make the investment in a company, and this is one way to help people step up to the plate and make that investment.

The second point there, consider tax credits for angel investments. There has been a very successful program in our State and other States that are using investor tax credits.

Mr. MULVANEY. We just passed a bill in South Carolina this week I think.

Mr. SHIPLEY. Is that right?

Mr. MULVANEY. Yeah.

Mr. SHIPLEY. In Ohio, we give a 25 percent tax credit. And we have had literally hundreds of millions of dollars invested in companies over the period of time that this has been in play.

I know, in the State of Wisconsin, which is part of the testimony, you can see the impact that it has had on both job creation and on amounts of money that angels have invested in companies. And I think, from my perspective, we view it as a way to derisk the investment in some ways. Because as we have all talked about the kinds of investments that we make, the failure rate is going to be about 50 percent. These are stats that have been generated through studies that the ACA has done, where we surveyed literally hundreds and hundreds of deals that angels had invested in. And 52 percent was the number that came back. So we invest in 10 deals; five of them we expect to write those off. So I think some people—they are going to invest in the deal not because there is a tax credit, but it is a little more icing on the cake. And if it is a failure, then we have got some of the money back by virtue of the tax credit. So I think that has been very important in our State.

And the third point was then developing educational tools, training, and awareness programs for both investors and entrepreneurs. I think a lot of the panel members have talked about those issues. But certainly from an investor standpoint, to have more accredited investors who understand the process of angel investing. When we first started, we actually created a one-day boot camp to teach prospective angel investors what it means to make an angel investment. So the ACA now offers those kinds of programs, which I think are invaluable, so that you teach people not only the process, but the fact that it is a high risk that you are taking. And so they understand that risk profile before they start writing checks. You don't want an angel investor to write one or two checks, see those investments go south, and then declare that angel investing is not worth it. You have to understand that risk profile.

Mr. MULVANEY. Thank you, Mr. Shipley.

Last question, and it is to you, Ms. Jackson. You mentioned a suggestion, an idea you had about at some point companies that you term “vetted companies”, companies that sort of received a seal of approval at some level of early equity financing, would have better access to debt. And I am just wondering if you have any suggestions on how the government could help that happen. Are there regulations that need to change? Are there specific things we need to do in order to encourage that type of behavior?

Ms. JACKSON. I will use a community bank as an example. We have use run into lots of cases where there is a desire to support a specific company with a loan product but the inability to overcome, you know, some of the regulations in order to do so. Again, I am not an expert in banking, so I don’t want to go too deep on what specifically. But what I do see is an opportunity to have another couple of conversations to put people together.

I think it is because of the failure rate; I understand why people don’t want to loan money to this risk pool. But if we have a known behavior of selecting, nurturing, vetting, you know, the least likely to fail, then is there something that we could do to get them a loan product? And is there any regulation that could be eased to make the community banks, for example, comfortable doing that?

Ms. DENT. Might I also offer one suggestion?

Mr. MULVANEY. Please.

Ms. DENT. There is a provision in the Dodd-Frank Act called the Volcker rule that says that banks—it was intended to deal with very high risky activities, proprietary trading and investing in hedge funds in particular, private equity funds as well. And one of the issues before the regulators right now is, will it apply to venture funds? And that includes both venture equity funds as well as venture funds that provide credit, debt. And if it is applied broadly to all those funds, banks will no longer be able to sponsor or invest in venture debt funds.

I think they are an incredibly important part of this overall ecosystem because they aren’t regulated banks; they do have more flexibility to come up with some hybrid solutions that I think are more likely to be able to address the opportunity Ms. Jackson says. But if Volcker is applied broadly and all bank capital is legally prohibited from going into those funds, arguably the investors who are most able to understand and back those funds are now locked out of that.

And so I would encourage the committee to join with other Members, there have been a lot of Members of Congress who have gone on the record saying that the Volcker rule should not dry up equity going into venture generally. And I think that is an important thing, because it will affect the very people who are most likely to solve the gap you are talking about.

Mr. MULVANEY. Thank you, Ms. Dent.

Thank you to everybody. I really appreciate you all taking the time to do this. I know that sometimes it seems that you spend all this time to come all this distance, as many of you have, and then you get maybe 5 minutes to ask questions—or give your testimony and then get a chance to just do a couple of questions. And I can’t overestimate for you the importance of what it is that you all do when you come and do this. What we are helping to do here is drive the debate.

Inevitably, something that you said today, all of which goes in our permanent record, will end up being discussed in a trade association paper someplace. And then it turns into a discussion at the next symposium. And then it turns into something that somebody brings through an association to their Member of Congress. And that is how we drive the debate. And I have seen that firsthand.

I know then that at some times, you think it is a complete waste of time to come out here and talk for 5 minutes and travel for 3 days to do it, but I can assure it is not. The opportunities we get to get your ideas on Sarbanes-Oxley and the Volcker rule, the trends about the donative funding or whatever, I can't remember the term, and then the experiences with the fraud especially, it has been very helpful. And we certainly do appreciate your input into the process.

With that, since there is no objection, because there is nobody else here but me to object, I will allow members to submit questions for 5 days after the hearing.

And with that, we will stand adjourned. I thank you for your time.

[Whereupon, at 12:04 p.m., the subcommittee was adjourned.]

Silicon Valley Bank

A Member of SVB Financial Group

Written Testimony of

Mary Dent

General Counsel, Silicon Valley Bank

U.S. House of Representatives

Committee on Small Business

Subcommittee on Economic Growth, Tax and Capital Access

Hearing on Access to Capital for Small Business

April 19, 2012

Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee: My name is Mary Dent, and I am the General Counsel for Silicon Valley Bank and its parent, SVB Financial Group. I appreciate the opportunity to testify today on the important topic of how to sustain America's position as a leader in innovation-based economic growth by ensuring that high-growth small businesses have access to the capital they need to thrive.

In my testimony today, I will focus on a small but critically important part of the broader small business landscape: high-growth small businesses. These are the small, young, fast growing companies that aspire to become the future Ciscos, Genentechs, Intels, Googles, Facebooks, and Apples.

High-growth small companies tend to focus on technology markets such as computer hardware and software, the internet, cloud computing, life sciences, medical devices, and clean technology. They typically focus on developing new technologies, new service models, or new business models. They are fundamentally different from other small businesses – the dry cleaners, sandwich shops, hairdressers, and other businesses that make up what we colloquially refer to as Main Street America – which intend to stay small even if they are successful. Both are important, but each is unique.

Why are small, high-growth businesses so important from a policy perspective? Because as a number of studies have demonstrated, they are the principal force behind both gross and net new U.S. job creation.

High-growth small companies, while small in number, have an outsized impact on the U.S. economy. This is best seen by examining the impact of companies that received backing from venture capital investors, as these companies represent a reasonable proxy for the overall high-growth sector. Venture-backed companies consume roughly 0.1-0.2% of U.S. GDP in invested capital annually, but create roughly 11 percent of U.S. private sector employment and 21 percent of annual U.S. GDP – or roughly twelve million jobs and over $3 trillion in annual revenues. They typically outperform the broader economy, in terms of both job growth and revenue growth. They create new, broad-based, long-lasting industries -- from information technology, biotechnology, semiconductors, and online retailing to emerging industries such as clean technology, social media, and cloud computing. They transform how we live, work, and communicate – think mobile banking, Facebook, or the iPad. They help us treat and cure diseases. MRIs, ultrasound diagnostic imaging, angioplasty, and spinal implants, for example, were all developed by venture-backed companies, and more than one in three Americans (or 100 million individuals) have been positively affected by an innovation that was developed and launched by a venture-backed life sciences company during the past 20 years. High-growth, innovative companies also serve as the research and development pipeline for larger companies, and they are our best bet for finding solutions to the issues we confront as a society, from health care to energy.

Since start-ups drive the innovation economy, we believe business leaders and policymakers should view them as the proverbial canary in the coalmine. They can alert us to opportunities that can fuel our economy for decades to come. They can also highlight looming challenges that could stifle growth.

SVB lives in the world of high-growth small businesses. For nearly thirty years, we have focused on helping entrepreneurs succeed. We work almost exclusively with high-growth technology and life science companies and with the investors who finance them.

At our core, we are a commercial bank. We provide a comprehensive suite of financial services to our clients worldwide. We bank nearly half of the high-growth technology companies across the United States and well over half of all U.S. venture capital funds, working through 27 U.S. offices and seven offices in innovation centers outside of the United States.

We often begin working with clients when they are first formed. We are one of the only banks that will lend to venture-backed start-ups before they are profitable – in many instances, even before they are generating revenues. We work hard to be creative, to take a long term view, and to retain a consistent approach to lending, even when events are challenging for our clients. For nearly thirty years, we have proven we can take this approach and also lend safely and soundly.

But we do much more than lend money. Through our exclusive focus on the innovation sector and our extensive knowledge of the clients we serve, SVB provides a level of service and partnership that measurably impacts our clients' success. For example, we hold "Showcase" events, which help our start-up clients gain access to potential investors. We also host "CEO Accelerator" events, which bring start-up CEOs together to allow them to engage with peers, learn from one another, and develop networks and connections that will help them overcome the challenges their company will face as it grows.

We see first-hand the optimism and energy with which entrepreneurs approach the world. We are proud to help these individuals take ideas and transform them into companies that solve real problems and create millions of jobs for this country.

In my testimony today, I will share my perspectives on capital formation and the government's role in promoting investment. I will first describe what we see in bank lending, and then turn to what our clients are experiencing in finding suitable equity financing. Finally, I will touch on the intersection between the decisions you make in Washington and the world of start-up entrepreneurs.

Debt Financing for High-growth Technology Companies

While access to credit remains an issue in the broader economy, in the markets we serve loans are readily accessible. In the words of one of my colleagues, "there's never been more competition" to lend to high-growth companies. With few other sectors providing comparably attractive risk-adjusted returns, banks are competing aggressively on deals. For credit-worthy companies of the type we serve, there is no shortage of credit.

Our performance in 2011 gives a sense for the level of activity we are seeing in the sectors we serve. During 2011, we increased the total amount of loans outstanding to the highest level ever in our nearly 30-year history. Despite the very low interest rate environment, our earnings hit a record high and were 81 percent higher than in 2010. Though the U.S. and world economies sometimes seemed on the verge of falling back into a recession, the tech sector performed well, and banks responded by lending actively to tech companies.

As you might expect, the level of competition and the availability of credit varies depending on how advanced the company is. The "younger" the company (in terms of revenues and profitability), the fewer the financing options. Even for very early stage companies, however, we think that between banks like Silicon Valley Bank and specialty venture lending funds, the right amount of debt financing is generally available.

For many entrepreneurs, we know it may not feel that way. That's because debt financing isn't well suited to taking on the kinds of risks that equity is meant to handle. In essence, the key difference between providers of debt and providers of equity is that debt needs to be paid back. Because debt has limited upside, lenders must be extremely vigilant in managing downside credit risk. Before making a loan, they need to be reasonably confident that one or two defined sources of repayment exist or will exist. Equity investors, in contrast, enjoy unlimited upside and can make higher risk investments across a portfolio, using the gains from a small number of highly successful "winners" to offset some meaningful losses. Financial metrics such as balance sheet liquidity, cash flows, continued future funding by investors, and the like provide a foundation for debt. Upside and opportunity, in contrast, serve as the foundation for equity investments.

Start-ups may not fully understand what kinds of risks debt providers can take on, and what kinds of risk they can't. They are also typically understandably optimistic about their future prospects. As a result, they may underestimate repayment risk and perceive a shortfall in available financing when, in fact, debt providers are providing the level of credit that is responsible given the borrower's overall risk profile and stage of growth.

The availability of financing also varies by sector. For clean energy companies, for example, there is a well-recognized and long-standing lack of credit to finance initial commercial-scale facilities – or, in other words, to move from technological feasibility to full commercial production. These are commonly referred to as "valleys of death," and while policymakers have made several attempts to solve the problem, to date these programs have not succeeded in closing the gap. This has a real impact on the long-term growth prospects for companies in this sector and for America's competitiveness in new forms of energy generation.

Equity Investments in High-growth Companies

There are a number of interesting trends on the equity front. A few weeks ago, Silicon Valley Bank completed a survey of early stage technology start-ups. At the macro level, entrepreneurs still see the availability of equity financing as a significant advantage for the United States over other countries. At the individual company level, however, more than one in three start-up entrepreneurs saw access to equity financing as one of their greatest challenges, and fewer than one in three saw it as an opportunity to drive growth for their company. In fact, the executives we surveyed said access to equity financing is their second most pressing challenge, after scaling operations for growth.

We believe this reflects a few underlying trends – some positive, some not.

One, companies are adopting much more capital efficient models. That means they need less capital to grow. In the software sector, for example, entrepreneurs can use cloud-based services as the platform upon which to offer their applications. That means they don't need to buy servers and other infrastructure, and can get their company to the point of earning revenues with a lot less money.

Two, venture capital investing levels have largely recovered from the steep falloff they experienced during the financial crisis. According to data from the National Venture Capital Association/PWC MoneyTree, during 2011 venture capital funds invested $28.4 billion in 3,673 deals, a 22 percent increase in dollars and a four percent increase in the number of deals over 2010. The amount of venture dollars invested during 2011 represented the third highest annual investment total in the past ten years, according to the same source.

In addition to venture capital funds, other sources of capital are more and more active in financing early stage companies.

On one end of the spectrum, so-called "angel" investors are playing an increasingly important role in driving entrepreneurship. According to a study of investing trends by angel investment groups released earlier this year by the Angel Resource Institute, Silicon Valley Bank, and CB

Insights, the size of median angel group rounds grew to $700,000 in 2011, an increase of 40 percent over 2010. Nearly 60 percent of angel group investments were in healthcare and Internet companies, with 60 percent of the healthcare deals targeting medical device and equipment companies. Many deals were syndicated among investors, providing companies seeking larger investments access to the additional capital they need to fund their early stage businesses. And angel investors were investing across the country, with 79 percent of 2011 investments and 70% of 2011 invested dollars going to companies outside of California.

At the other end of the spectrum, established corporations are once again increasingly active in financing start-up companies. Corporate venture arms invested nearly $2.3 billion in high-growth companies last year, up from $2.0 billion in 2010 and significantly higher than the $1.4 billion they invested in 2009, according to data from the National Venture Capital Association/PWC MoneyTree report. Increasingly, we are seeing a diverse array of large corporations actively participating in the start-up ecosystem, as growth once again becomes a top priority for CEOs and corporations recognize the critical role outside innovation needs to play in achieving that growth. Among those expanding venture investing are Citigroup, BMW, General Mills, Comcast, and Dell, to name just a few.

While early-stage companies may be better able to "bootstrap" or rely on angel investors to get started, as they grow they need larger amounts of capital to expand. Public equity markets are an important source of that growth capital. There's good news on that front as well: after a long dry period, the market for initial public offerings, or IPOs, is slowly rebounding. Already, the number of venture-backed IPOs in the first quarter of 2012 hit its highest number in five years, both in terms of number of IPOs and dollars raised, according to data from the National Venture Capital Association/Thomson Reuters.

IPOs are a very important source of capital to fund longer-term expansion by more mature companies. They give companies the option of growing organically, rather than selling themselves to a larger company. This is very important, because it promotes healthy competition and helps ensure that our economy retains an array of companies of different sizes. In addition, since over 90 percent of venture-backed companies' job creation historically has happened post-IPO, promoting companies' ability to turn to public markets to fund their growth is very important to the country as a whole. That's why we supported the recently-enacted JOBS Act, which will make it more feasible for good, high-growth companies to go public by providing an "on ramp" to come into compliance with some regulations. We commend the House of Representatives for leading the effort to pass this legislation, acting decisively and in a bi-partisan way to solve a very real problem.

But while the picture has many bright spots, it isn't universally rosy.

While venture *investing* has recovered, venture *fundraising* has not. During 2011, venture funds did not raise enough capital to replenish what they invested. This implies that the current level of venture investing is not sustainable unless the fundraising environment improves.

In addition, access to capital remains more difficult for more capital intensive ventures in more heavily regulated sectors, where the time required to succeed and the levels of regulatory and market uncertainty are high. This is most notable in the life science and cleantech sectors, both of which are very important to our broader economy because they offer enormous potential for growth and because we need innovation to help us provide affordable, effective health care to all Americans and develop stable, affordable, long term sources of energy.

In life sciences, early-stage venture investments have migrated away from high-risk "swing for the fences" deals to lower risk "singles and doubles." Start-ups are more likely to focus on developing a single product, and less likely to try to build a deeper portfolio of products. Overall, venture fundraising in the life sciences sector is down significantly, leaving funds with limited "dry powder" to support existing companies and fund new start-ups. Health care reform, downward pressure on insurance reimbursement rates, challenges in the FDA approval process, and difficulties securing rights to reimbursement have all meaningfully increased uncertainty and the cost and time it takes to succeed. The medical device tax imposed in the health care law – which applies to revenues, not profits – will dampen top-line growth if it goes into effect as scheduled next year.

In cleantech, the pool of sophisticated investors has narrowed very significantly, leaving only a handful of firms that are able to deploy large amounts of capital. These firms have largely made their bets in higher risk areas, particularly energy generation. As a result, funding in these areas is largely focused on follow-on financings for existing companies, while new start-ups are primarily being funded in areas such as energy efficiency, energy storage, and advanced materials. Corporate investors are an increasingly important part of the overall landscape, providing funding and helping companies develop and execute on strategies to grow to commercial scale and work with – or compete against – competitors in global markets, particularly China. The political winds have shifted over the past few years, and the lack of a consistent, forward-looking energy policy is depriving would-be entrepreneurs and investors with a long term view of the overall landscape for the sector.

The Role of Policy in the Innovation Ecosystem

One of the start-ups that participated in our recent "Startup Outlook 2012" survey said, "Executives who suggest that government should not get involved are naive. Government is involved. The challenge is getting government to refine its involvement so that it is a net positive, not a net negative, to the entrepreneurial ecosystem."

I couldn't agree more.

Public policies can positively influence private sector behavior. However, they can also set up barriers that impede risk-taking and stifle innovation.

While the health of the U.S. innovation economy depends first and foremost on the inventors, entrepreneurs, and investors who build companies, policymakers have a dramatic impact on the overall system within which innovation occurs. Continued robust innovation-based economic growth therefore depends to a significant extent on forward-thinking government leaders who understand that we need a carefully calibrated regulatory system, access to capital, a highly skilled workforce, a legal system that protects intellectual property, and stable investments in infrastructure, research, and education. It is crucial that policymakers understand the importance of allowing people to take risks, and that they base decisions on facts, take the time to understand how technologies work and how rapidly they change, and reject policies that merely entrench the status quo.

When it comes to entrepreneurs and their ideas, there's a lot of good news. Silicon Valley Bank's recent survey showed that start-ups are performing well and remain optimistic about the future. The vast majority expect to hire employees in the coming year. New sectors are emerging that have the potential for truly amazing growth. And entrepreneurs continue to believe the United States is an appealing place for business because of our focus on innovation and our entrepreneurial mindset.

The network of policies that support the innovation economy, however, is beginning to fray. Our recent survey showed that respondents this year are less positive about the quality of U.S. higher education, and more positive about the quality of foreign countries' higher education, than they were a year ago. Fewer than one in three start-up executives believes the U.S. higher education system is preparing workers with the skills their businesses need. More than one in three says the regulatory environment presents a challenge to their ability to grow. Start-ups don't think policymakers made progress on their top policy priority from our 2011 survey, intellectual property protection, and actually lost ground on the next three – controlling health care costs, improving the regulatory environment, and implementing health care reform.

The recently-enacted JOBS Act offers promise that Congress can begin to confront the issues facing small, high-growth companies in a targeted, timely, and bi-partisan way. I have also been heartened by the actions members of the House and Senate have taken to ensure the agencies implementing the Dodd-Frank Act take the time they need to adopt well-reasoned rules grounded in the facts, and to provide needed context to the agencies. For example, the Dodd-Frank Act included a provision commonly referred to as the Volcker Rule. It was intended to get banks out of activities Congress deemed too risky and too volatile for banks – specifically, engaging in proprietary trading and sponsoring and investing in hedge funds and private equity funds. Yet because of how it was written, the Volcker Rule could be read in a way that would stifle the amount of debt and equity flowing into start-up companies. Approximately 45 members of Congress have gone on the record to make clear this is not what they intended, and not what they want. The agencies have not yet adopted final rules, and we encourage members of this Committee to continue to urge the agencies to avoid rules that artificially and unnecessarily limit banks' ability to support small, growing companies by sponsoring and investing in long-term venture capital funds.

Looking forward, the House is expected to take up the reauthorization of the U.S. Export-Import Bank in the reasonably near future. We participate actively in the bank's working capital guarantee program, and believe the basic structure of the Export-Import Bank's guarantee program is effective by ensuring that lenders create credit risk only when they share "skin in the game." The loans we are able to make as a result of this program fuel our clients' export sales, jobs, and shareholder value. In 2010, for example, our Export-Import Bank loan commitments helped 75 small business clients generate more than $1.4 billion in U.S. export sales to 30 different countries and support nearly 6,400 new and existing U.S. jobs.

More generally, we believe this Committee can help continue to lay the foundation for well considered, productive policies by holding hearings such as this one. The technology sector is continually evolving in ways that will create new opportunities that we, as a country, can exploit to create jobs, promote our global competitiveness, and increase economic growth. We encourage you to look to the future and to actively solicit the views of high-growth young companies on the issues they face, such as R&D funding, access to capital, access to talent, and the impact of the regulatory environment. We also encourage you to help policymakers once again embrace appropriate risk-taking. It is vitally important that our economy, our political system, and our regulatory systems don't become hostile to risk, because without risk, there is no reward.

In closing, I commend this committee for focusing on the important questions of whether young companies can obtain the capital they need and how policy decisions affect small businesses' access to capital. The United Sates is lucky: we have a vibrant innovation sector, and all we need to do is avoid stifling it. Other countries around the world are trying to replicate what we already have, with some success. If we take the right steps, we can remain a leader in the innovation economy. If we don't, we will feel the repercussions throughout the economy for years to come.

It's a privilege to be here today and I thank this committee for taking the time to hear our perspectives and working to strengthen this vibrant part of our economy.

Thank you for your time.

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"Equity Finance: Catalyst for Small Business Growth"

Testimony of
Jason W. Best
Co-Founder
Startup Exemption
San Francisco, CA

April 19, 2012

Before the

Subcommittee on Economic Growth, Tax
and Capital Access
Committee on Small Business
United States House of Representatives

The Honorable Joe Walsh, Chairman
The Honorable Kurt Schrader, Ranking Member

Testimony – House Small Business Committee
10:00am, April 19, 2012
Jason W. Best
Co-Founder
Startup Exemption

Chairman Walsh, Ranking Member Schrader and members of the committee, thank you very much for the opportunity to discuss crowdfunding and how it can function as a part of the solution to the small business funding crisis in the United States.

I'd like to begin by thanking the members of this committee and the House at large, for their bipartisan and overwhelming support for crowdfunding as part of the JOBS Act that The President signed on April 5th. It was a great testament to the willingness of both parties to work together in support of small businesses and entrepreneurs, which we all know are America's economic engine. When entrepreneurs have access to capital to grow their organizations, it translates into new American jobs and American innovation.

My name is Jason Best and I am an entrepreneur who has been part of the executive management team of Kinnser Software that has been ranked as one of the 500 fastest growing private companies in the US in 2010 and 2011. I am also co-founder of Startup Exemption. Startup Exemption was formed to advocate for the legalization of equity-based crowdfunding. I and my co-founders Sherwood Neiss and Zak Cassady-Dorion saw first hand the realities of the capital formation crisis and in January 2011, we created a proposal to update securities laws that were written almost 80 years ago, to enable crowdfunding to take place. We began working with the House on our ideas, and thanks to the collaborative leadership of the House, Senate and The President, crowdfunding has become law.

Now the SEC has begun its 270-day rulemaking process and I appreciate the opportunity to share my perspective on what this means for the small business community and what I would respectfully suggest this committee, and the House, consider between now and the conclusion of this rulemaking period.

Crowdfunding will enable organizations to use SEC regulated Web sites to raise modest amounts of capital from large numbers of regular Americans. In exchange for that capital, these small businesses will issue equity or debt securities. If we think of the Internet as Web 1.0, and the rise of Social networks like Facebook and twitter as Web 2.0, this legislation creates Web 3.0. Web 3.0 is when the social Web meets capital formation. Finally, we are able to harness the power of social networks, communities of geography and communities of interest to build businesses that create jobs and innovation.

I live in San Francisco, California where venture capital and angel investors are plentiful. The same can be said for places like Austin Texas or New York City. How will crowdfunding benefit companies in these places? Crowdfunding will become an option for some early stage businesses that need to establish "proof points" with professional investors that the management team can execute and that there are markets for its goods or services. Mr. Chairman, we believe that companies may use crowdfunding as an "onramp to professional investment" from angel investors and VCs.

But what about places like Natchitoches, Louisiana where I grew up or Arnold, Nebraska where my family first settled in this country? There are great ideas, talented entrepreneurs and hard working small businesspeople in towns like these all across the country. Many of these individuals have no access to venture capital or even bank loans. Many main street businesses may never fit into the typical venture-backed business model but may be good investments for individuals in that community. Now, crowdfunding can provide these businesses and entrepreneurs to chance to raise capital from their communities. Soon a dry cleaner could crowdfund to add much needed equipment, or a restaurant, to open a second location. While crowdfunding alone cannot solve all capital formation challenges, it may provide benefits to many businesses.

But Mr. Chairman, there is still a great deal of work to do over the next 256 days of rulemaking at the SEC. As The President noted during his signing ceremony, the crowdfunding industry has come together to explore the creation of a Self Regulating Organization. This group's goal is to collaborate with the SEC in providing oversight, education and investor protection for the industry. The fourteen crowdfunding companies and industry experts that created this group have already begun this work. Mr. Chairman, as the interim spokesperson for this group, I ask for this committee's help in ensuring the SEC can complete its work within the 270 days called for by the JOBS Act. The crowdfunding industry has committed to do all it can to create an orderly market with investor protection, investor education, transparency and data to demonstrate that this market can and will create jobs, innovation and successful companies. Please help us as we collaborate with the SEC to create rules that enable this industry to thrive.

Thank you Mr. Chairman and I look forward to questions from this committee.

TESTIMONY OF
TONY SHIPLEY
FOUNDER AND CHAIRMAN
QUEEN CITY ANGELS
MEMBER, ANGEL CAPITAL ASSOCIATION

SUB-COMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

APRIL 19, 2012

Chairman Walsh, ranking member Schrader, and all of the other members of the sub-committee, thank you for holding this hearing on equity finance as a catalyst for small business growth. The capital that equity investors provide – both financial and intellectual – is important for the successful creation and growth of innovative, entrepreneurial companies.

My name is Tony Shipley, and I am a co-founder of the Queen City Angels, a Cincinnati, OH group of 50 angel investors that have invested over $30 million of our own money in 52 entrepreneurial companies in eleven years. We make multiple investments in these small businesses to support their development, and as such, we have made a total of 115 investments in our portfolio companies. Our money has leveraged an additional $60 million in directed co-investments in our companies and $120 million in follow-on venture capital.

I am pleased to represent the Angel Capital Association and growing community of sophisticated private investors known as "angel investors" who invest money and expertise in high potential start-up companies. The Angel Capital Association (ACA) is the professional alliance of angel groups in the United States and Canada, and includes 165 member angel groups in 44 states, and another 20 affiliated organizations. More than 7,500 accredited angel investors belong to our member angel groups. ACA is focused on building the skills of angel investors so that they are better mentor capitalists to start-up companies and on increasing the number of angels participating in high quality groups.

National Angel Investing Landscape and Impact

Angel investors are high-net-worth individuals[1] as defined by the Securities and Exchange Commission who provide money for start-up firms with growth potential. Many of them started, built and sold their own companies and are now in a position to invest their money and equally important, their time, in new

[1] www.sec.gov/answers/accred.htm

or early stage businesses. The nation's leading expert on entrepreneurship, the Ewing Marion Kauffman Foundation, estimates that angel investors may be responsible for up to 90 percent of the outside equity raised by start-ups after the capital resources of their founders, friends, and family are exhausted.[2] These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

The size of the angel investing market is not known, but the Center for Venture Research estimates that angels invested $22.5 billion in 66,000 companies in 2011, a 12 percent increase over 2010. One of the trends in the field over the last decade is the growth of angel groups, in which investors join together to invest in and mentor companies, pooling their capital to make larger investments and developing best practices for investing and mentoring. The Angel Capital Association has about 350 angel groups in its data base, located in every state, compared to about 100 groups ten years ago. The new HALO Report[3], from the Angel Resource Institute, Silicon Valley Bank, and CB Insights, describes the investments angel groups made in 2011:

- Median round size of $700,000;
- 58 percent of investments were in healthcare/life sciences and Internet/IT sectors;
- Two-thirds of the investment rounds were syndicated, often with multiple angel groups; and,
- Investments were distributed throughout the country – two-thirds of the deals were outside of traditional equity centers California and Boston.

Queen City Angels' experience fits within these national statistics. About 80 percent of our investments are in life sciences and technology, with the remainder in a variety of areas, such as consumer products, manufacturing, and nanotechnology. We generally invest $500,000 to $1 million in a company, and syndicate with other investors most of the time for larger rounds.

Angel investors are proud to be an important resource for the startup companies that have created the large majority of net new jobs in the United States over a 25 year period[4]. Angel-backed companies have been some of the most prolific job creators and innovators in recent times: Google, Facebook, and Starbucks are just a few examples. Thousands more companies supported by angel groups and individual angels are less known, but significant in the innovative products and jobs they have created. Queen City Angels has been part of some of these:

[2] Marianne Hudson, Ewing Marion Kauffman Foundation, *Why Entrepreneurs Need Angels – and How Angels are Improving*, Kauffman Thoughtbook, 2005.
[3] www.angelresourceinstitute.org/halo-report
[4] John Haltiwanger, University of Maryland, Ron Jarmin, U.S. Bureau of the Census, and Javier Miranda, U.S. Bureau of the Census, *Business Dynamics Statistics: An Overview*, 2009.

- AssureRx Health is a personalized medicine company dedicated to helping physicians determine the right drug for individual patients suffering from neuropsychiatric and other disorders. Queen City Angels co-led the initial investment in this innovative company and were joined by other investment groups in subsequent rounds of equity capital. AssureRx Health is also creating high paying jobs as evidenced by the growth from one initial startup employee to more than 70 employees today By the end of this year, the firm expects its employee base to be in the range of 100 to 125 and by the end of 2013, they expect to employ 250 people.

- Bioformix develops sustainable polymer platforms, with a focus on high performance adhesives, sealants, inks and coatings. The company's products polymerize with little to no energy at high speeds that can outperform current products. Bioformix started in 2010 with a couple of employees and has grown to 24 employees today. According to the company's business plan, they expect to double employment over the next two years.

An Angel Investor's Journey

ACA has been asked how accredited investors get involved in angel investing and what our experience is like. This is especially true given the risky nature of this kind of equity investment, in which sophisticated investors lose money in more than half of their investments[5]. From conversations with my colleagues in Cincinnati and across the country, my angel journey has a lot in common with many active angel investors:

- Entrepreneurial experience or interest – I was part of the team that founded and grew two companies, after which I founded a mechanical engineering/machinery monitoring software company that grew from two people to 380 and from startup to $60 million in revenue. The company was sold to Rockwell Automation in 2000 after which I was ready for a "second act" and became interested in using my experience as an entrepreneur to invest in promising startup companies. My cohorts in Queen City Angels either had similar experiences or they were in large corporations or professional fields like medicine, but all have an interest in supporting entrepreneurs and mentoring.

- Angels invest for more than financial returns – I love angel investing because I have many opportunities to meet exciting and passionate people with amazing energy and great ideas that can

[5] Robert Wiltbank, Willamette University, and Warren Boeker, University of Washington, *Returns to Angel Investors in Groups* (published by the Ewing Marion Kauffman Foundation), 2007.

change markets. It is particularly motivating and gratifying to support the next generation in the start-up arena. Like many investors in our space, angel investing gives me the opportunity to give back to my community as companies and jobs are created through my investments and mentoring of entrepreneurs.

- Connect with other smart investors – Early on, I discovered it was better to make angel investments with other people. We founded the Queen City Angels in 2000 in part because there was a market need in Cincinnati (more on this later), but have really found that angel groups have great benefits for entrepreneurs and investors. The angel group has people with varied backgrounds, giving us a better chance of evaluating companies and helping our portfolio companies become more successful in growing because we have the right skills among our member angels to mentor them or serve on their boards. We also need to connect with venture capitalists, who can provide the expansion capital that many of our portfolio companies need.

- Active learning – I have built my skills as an angel investor over time through experience and from learning from my colleagues in Ohio and elsewhere. The Angel Capital Association has also helped us develop best practices for selecting investments and how to help our entrepreneurs take their businesses to the next level of success.

- Be part of startup ecosystem – It is also important to regularly network with the professionals and organizations in the community to find and educate entrepreneurs. Queen City Angels gets much of its deal flow from referrals from the Cincinnati startup infrastructure, and that has increased as we have put more of our time in connecting with other community leaders and professionals.

- Angels need to provide continuing support – Not only have I found that in many cases I need to make more than one financial investment in a company, but that an angel's time and expertise might be more critical to their success. Angels serve on boards of directors, provide mentoring and connections on everything from sales strategies to technology issues, and some even become part of the companies' leadership. For instance, I am currently the interim CEO of a health information technology company, helping the 50-employee company release a new product.

How Angels and Entrepreneurs Connect

Angel groups like Queen City Angels actively work to market and brand themselves so that entrepreneurs can find us. Of course we have a Web site, but more importantly we create networks that bring the entrepreneurs that have the potential of being equity funded to our doorstep. Our network or ecosystem includes a number of experts from the private sector, universities, and economic development:

- Attorneys, accountants, and other private experts who can guide new entrepreneurs through many key business processes and issues;
- Successful entrepreneurs and corporate leaders interested in mentoring start-ups;
- Venture capitalists, which invest in some of the most successful companies when they have passed the start-up stage and are ready for expansive growth capital; and,
- Accelerators, incubators, and entrepreneurial support organizations who work with a variety of entrepreneurs.

We work with many of these organizations conducting initiatives such as monthly mentoring sessions in incubators, and an annual two-day entrepreneur boot camp to prepare entrepreneurs for making effective presentations to investors; judging business plan competitions; participating in regional venture forums, university entrepreneurship events, and many other events. The networking element of these activities is important; however, our work also focuses on helping more entrepreneurs understand whether equity capital is the right route for them, and if it is, the efforts needed to help them become more "investor ready."

How do entrepreneurs get to pitch their investment opportunities to angel groups like ours? Most groups have a way to accept executive summaries through a Web site or email. We publish the criteria for the kinds of companies we're interested in and also provide a framework for the executive summary, and then screen submissions to ensure the companies fit the criteria. Our group has nine criteria[6], with ability to grow to $10 million in a reasonable time, a strong management team, location within 150 miles of Cincinnati, and a credible exit strategy, among others. Our screening committee meets with each of the companies and either recommends them to present to the whole angel group or provides written feedback to companies that are not selected.

[6] www.qca.com/how.html

Entrepreneurs that pitch to the full Queen City Angels and receive enough interest from member angels then go through due diligence and if that is successful, investment documents are negotiated, and one or more of our members join their board to assist the company with strategic and growth issues.

Helping Entrepreneurs through a Capital Gap

As I mentioned earlier, we started Queen City Angels in 2000 because there was a gap in Cincinnati's continuum of capital during that period. Entrepreneurs could get small amounts of money from friends, family, and individual angels or they could get several million or more from venture capitalists. There was a capital gap – sometimes called the "Valley of Death" – between the $10,000s or $100,000s from small investors and the millions from venture capitalists. Entrepreneurs that couldn't find an investor for their next round had to close their companies. Cincinnati isn't unusual with this gap in the United States.

Queen City Angels and other angel groups help back-fill some of this gap in Cincinnati and Ohio, first by pooling our individual capital in one angel group, then by making additional and larger investments in our portfolio companies, and also by syndicating investments with other organized angel groups. It used to be that angel investors would make one or two investments before venture capitalists would invest in a "Series A" round. Now angel groups sometimes need to make four or five rounds of investment before the entrepreneurial businesses are "VC ready."

Angel groups and other syndicated investors in some cases can keep up with the need for larger and larger rounds, but most angels and organizations have some limit on how much they can invest. This struggle is particularly true with life science and clean energy companies, in which angel rounds might be $2 to $5 million or more, but these firms need several millions of additional capital before VCs are comfortable investing in them. Cincinnati's corporate and business community has recognized this issue and is currently raising a $50 million fund of funds to invest in angel funds and venture capital firms to make investments in promising businesses that are caught in this capital gap.

Ideas for Strengthening the Entrepreneurial Funding Ecosystem

As I think about the importance of angel investors to innovative entrepreneurs and also new developments to early-stage investing, such as accelerators and equity crowdfunding, I recommend a few things to help strengthen the environment for starting and growing businesses:

- **Leverage the large number of baby boomers** - In the US, we are now witnessing the greatest ever expansion of "senior citizens" in the history of our country by virtue of "baby boomers" reaching retirement age. These people live longer than previous generations or senior citizens, are healthier, have money to invest and want to be actively involvement in meaningful activities. In addition to their equity capital, they can bring many of the skills, experience and mentoring needed by startups and early stage companies to help them be successful in shorter periods of time without making many of the costly mistakes that startups tend to make. This is a resource the government can tap into and perhaps work with ACA and the Angel Resource Institute to educate this population (see below for more information) on the opportunities (and risks) present in angel investing. For states such as Ohio, participating in organized angel groups and becoming active in the entrepreneurial space could be a method to help the state retain these people as residents rather than lose them to warm climate areas.

- **Leverage private investments to get companies out of the capital gap** – Policy makers should investigate ways to address the "Valley of Death" so that more innovative companies can access the capital they need to progress from angel financing to venture capital investment. Perhaps there are tax policies to encourage more private investment in this gap or we can learn from some initiatives by the private sector, state governments, or other countries. For instance, Ohio invests in angel groups and venture capital through its Third Frontier program[7] and Scotland pioneered a government fund that automatically co-invests with qualified investors to spur growth of high impact companies at a low overhead and bureaucratic cost.

- **Ensure enough angel capital to support new ideas** – In the last few years more changes may have occurred in the early-stage capital environment in this country than ever before. Startup accelerators, in which innovators receive concentrated mentoring and seed financing, appear to be increasing the number of promising ideas that will need to be funded. The same may be true as equity crowdfunding, a part of the JOBS Act that recently became law, gets started later this year. Tax incentives, such as those recommended by the Angel Capital Association, may help increase the pool of capital to finance all deserving ideas and business models, at a variety of stages and investment sizes.

- **Allow entrepreneurial immigrants to stay in the United States**– Too often, smart people visiting from other countries have to return to their home countries because of American immigration laws.

[7] http://thirdfrontier.com/

Not only does this country lose their great ideas and the jobs that could be created by their businesses, but we also see venture capitalists following them to those countries with their investment.

- **More effective use of the US tax code** – As long as we pay estate taxes, we could consider the exclusion of returns made from angel (and other early stage) investments from estate taxes. This idea would require more study; however, it could be a method to further jumpstart the investments made in startups and early stage companies.

Because of their importance to start-up entrepreneurial businesses and the fact that new firms create most of the net new jobs in the United States, the Angel Capital Association calls your attention to a few public policy issues to ensure the health of these investors:

- **Reinstate the 100% tax exemption on gains in Qualified Small Business Stock -** The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 included a provision that provides a 100 percent exemption for gains made in Qualified Small Business Stock for investments made before December 31, 2011. The exemption has expired and ACA recommends that this exemption be made permanent. When the 100 percent exemption was first announced in another bill in September 2010, it caught the attention of angel investors. ACA found several examples investments that happened more quickly because of the new exemption. While the Qualified Small Business Stock program has been around for some time, the program was not well known or used by private angel investors until the 100 percent exemption became law.

- **Consider tax credits for angel investments in qualified entrepreneurial companies** – In the current economic times, Congress may also want to complement a lower capital gains tax for successful early-stage investments with a tax credit for investments in innovative small businesses. Federal ordinary income tax credits for angel investments in small business start-ups could improve the flow of angel capital to small businesses in communities throughout the country. ACA is aware of three bills being drafted on this issue at this time and appreciates the work done by Members of Congress to date on this subject.

  A 2012 study of Wisconsin's angel tax credit program and related initiatives found that the state's initiatives helped angel investments in Wisconsin small businesses by 22 percent in 2011 over 2010, with 900 jobs supported in 2010. Since 2003, angel group investments have increased their investment from $1.74 million to $61.1 million, a 35-fold increase.[8]

- **Develop education, training and awareness programs for investors and entrepreneurs –** America's entrepreneurial community is best served by having investors who have a good understanding of the best practices of equity investment and more entrepreneurs who are prepared for the funding process. Even entrepreneurs who have received equity investment have much to learn when they become investors. Without some education, investors stand to lose their money in this kind of investment. Perhaps more importantly, entrepreneurs have a lower chance of success when they are linked to unsophisticated investors. There are many stories of good entrepreneurs who went out of business because their investments were structured incorrectly and they therefore could not attract a next round of capital.

  As more people become involved as equity investors, particularly through the crowdfunding provisions of the recent JOBS Act, and perhaps through policies that encourage more angel investment, ACA recommends that the federal government promotes strong education programs for new investors and also that entrepreneurial training programs include more high quality information on equity financing for entrepreneurs. The Angel Resource Institute, a non-partisan charitable organization, provides high quality education for angel investors, potential angels, university leaders, and support organizations that help small businesses that need equity investment. An outside evaluation of these education programs found that they increased the number of accredited investors who made angel investments and increased their confidence in making good investments because they had a better understanding of best practices for evaluating investment opportunities and working with entrepreneurs.

Summary and Final Thoughts

Thank you for this opportunity to describe the unique role and significant impact that angel investors have in our economy, supporting the innovative start-ups that create important jobs in this country. We like being part of the ecosystem of support for these companies, along with incubators, accelerators, and many private partners.

As the Sub- Committee and Committee consider plans for catalyzing new jobs across the country, we hope that the contributions of angel investors and other private sector experts to the survival and growth

[8] Wisconsin Portfolio 2012, a collaborative effort of the Wisconsin Department of Financial Institutions, Wisconsin Economic Development Corporation, Wisconsin Angel Network, and Wisconsin Technology Council.

of promising new companies will be recognized. Angel investors are passionate about helping build great new companies in our communities. Many angel investors enjoy being part of the entrepreneurial ecosystem, along with business incubators, accelerators, attorneys, accountants, venture capitalists and other private experts who can guide new entrepreneurs through many key business processes and issues.

We also encourage you to let entrepreneurs in your districts know that angel groups are interested in learning more about angel investment to link to every known angel group on the Angel Resource Institute Web site, www.angelresourceinstitute.org, and to review the "Info for Entrepreneurs" section to learn more about the angel investment process.

I would be happy to answer any questions you have and for the Angel Capital Association to provide you with additional information when you need it.

"Equity Finance: Catalyst for Small Business Growth"
April 19, 2012

Testimony of:
Angela Jackson
Co-Founder and co-Managing Director, Portland Seed Fund
Director, Portland State University Business Accelerator
Portland, Oregon

Before the:
Committee on Small Business,
Subcommittee on
Economic Growth, Tax and Capital Access

Chairman Walsh, Ranking Member Schrader, and members of the Committee: Thank you for inviting me to present my testimony today. My name is Angela Jackson, and I am fortunate to be involved in the entrepreneurial ecosystem in a few ways- as co-Founder and Managing Director of Portland Seed Fund; Director of Portland State University's Business Accelerator, and as the local chapter president of the Keiretsu Forum, a global angel network. Over the past decade, I have placed seed or angel investments in more than 50 companies and have advised hundreds more on their growth and financing plans. Nearly all of these companies have contemplated whether to sell equity in their company as a means of raising capital. In the end, some opt to bootstrap their company, trading outside investment for slower, organic growth. There are good reasons to raise, and not to raise, capital, through equity financing, and I am pleased for the opportunity to talk about it here today.

While few would argue that certain economic indicators are slow to rebound, I can report from the startup trenches that this leading edge of the economy is robust, growing and creating jobs, thanks in part to increased access to seed and venture capital in recent months. I'd like to shed a light on the trends we are seeing take shape in Portland, Oregon.

PORTLAND SEED FUND

As co-founder and Managing Director for Portland Seed Fund, I, along with my partner Jim Huston, began devising a strategy in 2010 to grow the local economy by sourcing, nurturing and funding capital-efficient, scalable companies with high growth potential - a handful at a time. We believed that by following the discipline of angel investing plus formalized coaching, we could generate superior economic growth by building a business rigor in those companies that would not exist if those entrepreneurs were left on their own. Our model was not brand new. We watched and learned from predecessors Y Combinator and Techstars operating in other cities, noting their ability to invest very small amounts of capital to achieve order-of-magnitude superior returns to those experienced by the venture asset class over the same time. We applied certain aspects of the model, such as a heavy emphasis on mentoring, but also made Portland Seed Fund our own, injecting follow-on capital into the model for top performers, and recruiting both private angel investors and public entities to invest in our $3 Million fund.

To date we have graduated our first class of eight companies, who since July 2011 has created 60 jobs, despite that our initial investment in each is barely enough to sustain one job. Half of those quickly secured follow-on investment from other angels or institutional venture capital, despite the fact that many were so early they were not even incorporated as businesses when we took them into the program.

We have since invested in our second class of nine companies, which will graduate at Investor Demo Day on June 6. Our capital-efficient, scalable selection screen means we don't invest in retail or service-heavy models. We are software/mobile dominant in our selections, but by no means exclusive. To that point, we have two consumer product investments, each which leverages a local economic cluster – green building and apparel.

Our "catalyst and crucible" approach means that yes, our money has strings attached. With investment we require full participation in our intensive 90-day bootcamp. For the entrepreneur, the mix of peer group learning, access to a great mentor/investor network, subject matter teachings, one-on-one weekly meetings with fund managers and the publicity/credibility that comes with being a Portland Seed Fund company are far more valuable than the $25,000. For fund managers, there is no better due diligence than what we call experiential due diligence – our hundreds of hours in the trenches with these companies during those 90 days. We quickly learn each entrepreneur's appetite for the 24-7 focus a growth company demands, who has resilience when things go wrong (which they will – this is often the only thing we are sure of). We also get a read on which entrepreneurs are natural born leaders, which can be developed, and who may need to get out of the way of their own success. In short, we leave the 90-day bootcamp with a keen sense of trajectory of each company and a unique position to influence it.

While it is too early in the Portland Seed Fund life cycle to measure success through liquidity events, the indicators we are seeing at this stage are very positive, as measured by hiring, revenue, market prognosis and capital attracted. $4+ million in additional capital has been placed in our companies alongside our initial $500,000 outlay, with more to come. We will begin raising Portland Seed Fund II in Fall 2012.
www.portlandseedfund.com

PORTLAND STATE UNIVERSITY (PSU) BUSINESS ACCELERATOR

What's in the water at 2828 SW Corbett? A Portland Business Journal reporter posed this question to me last November after he pulled all the Regulation D filings in Oregon for a story on venture capital financing trends in the state. His investigative work revealed that the 25-30 resident bioscience, tech and cleantech companies at the PSU Accelerator were the most successful attractors of private venture capital to the State over the past three years.

In fact, Accelerator companies over the past five years have attracted $128 Million of mostly out-of-state funds to Oregon at a time when we lacked a strong native venture capital infrastructure. Funds are put to work immediately with hiring, and the high-performance startups at the Accelerator tend to create higher-paying jobs such as software developers and lab personnel, with the obvious and immediate benefits to the local economy and the taxpayer. As I write, with a national unemployment rate of 8.2%, our Accelerator companies have posted two years of double digit employment growth and as I write there are 15 unfilled positions posted on our website, http://psba.pdx.edu.

KEIRETSU FORUM

Keiretsu Forum is the world's largest angel investment network with 23 chapters on three continents. Today, the global membership is 800+ accredited investors, and this organization is uniquely poised to lead the implementation of crowdfunding-related reforms nationally, with already-in-place infrastructure for quality deal screening and due diligence by its members, no matter how geographically dispersed. I am president of the Portland chapter, which is part of a Northwest circuit of four chapters, including Seattle and Kirkland, Washington and Boise, Idaho. In 2011, 240 member angels at those four chapters alone invested $24 Million in 36 companies. This is an astonishingly important source of private capital fueling the startup economy. Deals range from technology, consumer product and life sciences to real estate investment and hard lending. http://k4northwest.com/

SUMMARY AND RECOMMENDATIONS

The critical role that startup companies and their investors play in creating wealth and growing the economy – in down times as well as boom times – has been well documented. Private investors are back in the game and active at the seed, angel and venture stages. Recent passage of the JOBS Act is likely to help small companies attract new investors through crowdfunding, but until rulemaking is complete it is too early to know the real impact of this legislation. More material and immediate is the easing of the non-solicitation ban in Regulation D, making it easier in future for angel groups to market, attract and retain a base of accredited angel investors who will (see Keiretsu example above) continue to pour much-needed capital startup companies. True to the risk profile of young companies, many of those will fail – but some will succeed, and succeed big.

With the JOBs Act passed, opportunity still remains on the Federal level to both reduce friction for emerging startups and increase incentives to angel investors who put risk capital to work stimulating the economy. There are a number of proposals to amend the tax code to reward investors through tax credits and/or capital gains treatment that could be effective, fair and compelling. Similarly, the tax code provides a way to reward the job creating companies themselves with tax cuts and/or deductions.

Finally, from my vantage point at the leading edge of the startup economy, there are two potential upstream choke points that we need to address in order to continue the progress we have made at the seed and angel stages. First, we need to ensure that loans are available to promising companies who need working capital and/or inventory financing. While banks today are proclaiming their increased lending to small businesses, I see little evidence of it. The lending standards for a portion of commercial loans must be significantly streamlined for the most promising early stage companies. Second, there is a shortage of highly-skilled technical talent to fill the growing number of positions open in the software/mobile economy. We need to both increase resources to expand training programs here and enhance our means to attract this talent from abroad through appropriate immigrant visas.

I look forward to taking your questions.

angela@portlandseedfund.com
twitter @ABJackson
@PSUAccelerator
@pdxseedfund

Portland Seed Fund office: 503-419-3007
PSU Accelerator office: 503-725-2312