U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
HEARING:
JOBS ACT IMPLEMENTATION UPDATE

TESTIMONY
JEAN PETERS
BOARD MEMBER, ANGEL CAPITAL ASSOCIATION
MANAGING DIRECTOR, GOLDEN SEEDS ANGELS
APRIL 11, 2013

Chairman Schweikert, Ranking Member Clarke and subcommittee members, thank you for inviting the Angel Capital Association to speak on the progress of the JOBS Act.

My name is Jean Peters, and I am a managing director of Golden Seeds, the country's 4th largest angel group. Our 280 members are among the most active angels in the U.S. Collectively, we have funded more than $50 million of equity over the past 8 years in 60 women-led startups. Golden Seeds is a charter member of the Angel Capital Association, on whose behalf I am appearing today.

ACA is the world's leading professional association of accredited investors. We have 200 angel groups from across the continent and their 8,500 individual members.

ACA has watched, waited and worked with the SEC to help promulgate successful rules. We know the process is complex, but recent jobs statistics underscore the need for a fluid flow of angel capital to startups, and we share the subcommittee's concerns over the delay by the SEC in laying out a clear playing field which promotes investment opportunities, protects investors and creates jobs for Americans.

Angels Fund Majority of Early Stage Deals

Let me briefly describe angel investing: Angels are accredited investors whose capital comes from our personal pocketbooks. Most are former entrepreneurs, or were successful in business – and want to help others up that ladder. We invest at the most primal point of capital formation -- small startups with high growth potential.

These companies come out of university research, local business incubators and economic development efforts. They reflect the entrepreneurism that is addressing the business, education and health care challenges we face as a nation today.

ACA also speaks for the 250,000 accredited investors across the country who fund startups each year. And, these are just a subset of the 8 million-plus people who meet the accredited investor definition and could become active.

That is the intent of the JOBS Act – to broadly expand capital access for the startup economy, and to give investors new opportunities to support this growth.

Angels are the only source of capital for most startups, and supply up to 90% of outside equity raised by seed-stage companies after they exhaust any resources from friend and family, according to Kauffman Foundation estimates.

In fact, angel investors fund 20 times the number of seed-stage companies than venture capital. In 2011, angels invested $23 billion dollars in 66,000 early-stage companies, while VCs put a few billion into 1,800 startups, plus $20 billion in 2,000 later stage companies.

Angel-funded companies are in every state and industry sector. They are crucial for job growth. According to Census Bureau data, startups comprise less than 1% of companies, but generate 10% of new jobs in any given year.

Without angel funding, these businesses would simply never get off the ground.

Angel Groups Take Professional Approach

Startup investing is a disciplined and long-term process. Angels bring careful due diligence, negotiations and experience to the table.

We have to: angel capital comes from our own pockets. We are not investing other peoples' money. We invest our own, and more often than not use our successes to fund the next round of startups.

We understand that what we do is highly risky and extremely illiquid. Angels give time and expertise, without compensation, and often without liquidity for 8 to 10 years. We do this to make a return – but also to give back, to keep up with our industry -- and because start-ups value what we do. As a result of the thoughtful work of angel groups, the strong growth in angel financing over the past decade has remained virtually free of fraud or abuse.

Rule 506c will allow issuers to advertise

This brings me to a key part of the JOBS Act – Title Two, which ends to the ban on general solicitation for issuers who sell securities only to accredited investors.

ACA well understands that entrepreneurs have a desperate need for capital. Companies that once could get bank loans, or at least a small business credit card, are now shut out. So, the potential for both crowdfunding and general solicitation to fuel investment is a crucial and exciting development.

We also understand that these new vehicles come with risks for the unwary – just like any other investment, from a public stock to a home mortgage. We appreciate that Congress and the SEC want to safeguard small investors, in particular, from that risk.

But, the proposed rule requires issuers using solicitation to "take reasonable steps to verify" that investors are accredited. This is problematic, because the SEC has not provided clarity on what are "reasonable steps." Instead, the SEC says it will determine whether the test has been met "on a case by case basis."

This leaves both investors and entrepreneurs in a deeply uncertain position.

In a survey of members, ACA identified that angels are likely to not invest if they find a cumbersome, expensive verification process acting as a "gate" against the extraordinary work that angels do. And, many legal experts have advised their clients through alerts not to invest in advertised offerings if there is no safe harbor.

This lack of safe harbors could cause a dramatic slowdown in angel funding – the exact opposite of Congressional intent.

ACA recommends that the final rule ensure that startups *and* accredited investors can act with confidence. At last fall's SEC Forum on Small Business Capital Formation, the advisory group unanimously recommended that "membership in a reputable angel group" be made a safe harbor. We encourage the SEC to take this approach, and suggest that the professionalism of ACA membership serve as a benchmark standard.

We recommend additional safe harbors, including a detailed self-certification questionnaire that would give further assurance – an approach ACA already employs.

Conclusion

Angels have a long history of adhering to disciplined due diligence, deal screening, term sheets and corporate governance. As more accredited investors come into this class, ACA will play an expanding role in helping high-growth startups and investors intelligently and successfully come together.

ACA will continue to provide adult supervision in this shifting landscape of social media, general solicitation, and the nascent conduit of crowdfunding.

We will be there when companies that are crowd-funded need additional capital.

We will continue to be the primary sorting mechanism for those startups that are most promising.

We will help ensure that companies seeking funding are legitimate, appropriately structured, managed and valued.

Angel groups can provide a substantial barrier to the types of hazards that might face accredited investors – and others trying to sift through advertising or crowdfunding to identify great entrepreneurs and startups.

And that will mean that the innovation now bubbling up in every congressional district and job-seeking community will stand a far better chance of success for the entrepreneur, for its employees, and for the investor willing to take that risk.

Thank you very much.

SUPPLEMENTAL INFORMATION FROM THE ANGEL CAPITAL ASSOCIATION

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
HEARING:
JOBS ACT IMPLEMENTATION UPDATE
APRIL 11, 2013

National Angel Investing Landscape

Angel investors are high-net-worth individuals as defined by the Securities and Exchange Commission, who provide money for start-up firms with growth potential. Many angels started, built and sold their own companies and are now in a position to invest their money and equally important, their time and expertise, in new 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% of the outside equity raised by start-ups after the capital resources of founders, friends, and family are exhausted. These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

The University of New Hampshire's Center for Venture Research estimates that angels invested $22.5 billion in 66,230 companies in 2011.

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. ACA estimates there are more than 350 angel groups, located in every state, more than a three-fold increase from about 100 groups ten years ago.

The HALO Report, the leading assessment of angel investing nationwide, describes the investments angel groups made in 2011:

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

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. 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.

For example, Golden Seeds, which has 280 members from more than two dozen states, has invested in technology, life sciences, retail and other sectors in companies including:

- Cognition Therapeutics, a Pennsylvania-based novel drug discovery company developing a potential cure for Alzheimer's
- Crimson Hexagon, a Boston-based company that provides social media monitoring and analytics
- Flixmaster, a Colorado-based company that provides a technology platform for dynamic video editing

Risk and Angel Investment

Returns to Angel Investors in Groups, the first ever dataset and analysis of angel group returns, confirmed what many investors thought about their success:

- 52% of all exit returns less than the capital the angel had invested in the venture (with 35% of all exits losing all of the money invested)
- 7% of the exits achieved returns of more than ten times the money invested, accounting for 75% of the total investment dollar returns
- 31% of the exits returned the investment between 1 and 5 times the investment.

The study, which looked at 1,137 exits from angel investors connected to angel groups in many areas of the United States, also provided data to support that best practices in angel investment lead to better results for investors and the entrepreneurs they invest in. This includes matching investor expertise with the company, mentoring and monitoring of company progress, and conducting due diligence in reviewing investment opportunities.

It is conventional wisdom that small business is responsible for the majority of net new job creation in the country in any given year. A growing body of focused research, using the Census Bureau's *Business Dynamics Statistics* database, dramatically illustrates that it is a smaller subset of dynamic, high-growth startups that make up the vast majority of that job growth

- According to a Kaufman study, these so-called "gazelle" firms (ages three to five years) comprise less than 1% of all companies, yet generate 10% of all new jobs in any given year.
- A similar study from the National Bureau of Economic Research using the same database, found that, after controlling for age of a small business, startups account for almost 20% of gross job creation in any given year.

These are exactly the businesses that angel investors – and mostly only angel investors -- invest in. The true shift in job creation has moved away from publicly-traded companies to the realm of startups that are funded almost entirely by private capital.

Sources

- www.sec.gov/answers/accred.htm
- Ewing Marion Kauffman Foundation, *Why Entrepreneurs Need Angels – and How Angels are Improving*, Kauffman Thoughtbook, 2005.
- www.angelresourceinstitute.org/halo-report, Angel Resource Institute, Silicon Valley Bank, and CB Insights
- 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.
- Robert Wiltbank, Willamette University, and Warren Boeker, University of Washington, *Returns to Angel Investors in Groups* (published by the Kauffman Foundation, 2007.