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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:

- <u>Entrepreneurial experience or interest</u> – 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.

- <u>Angels invest for more than financial returns</u> – 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.