



June 3, 2022

Ranking Member Patrick J. Toomey
U.S. Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ranking Member Toomey and Members of the Committee,

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues. We appreciate the opportunity to provide input on the recently released JOBS 4.0 draft and to highlight feedback of a number of startups in our network on the capital formation priorities deserving of congressional attention.

It has been 10 years since the historic bipartisan passage and adoption of the Jumpstart Our Business Startups (JOBS) Act and we have seen a number of positive changes in the startup ecosystem as a result of the legislation. It made going public easier for those companies wishing to pursue that path, enabled startups to raise funds through new pathways like Regulation A+ and through general solicitation under Regulation D, and created a market for non-accredited investors to participate in the ecosystem through the creation of Regulation Crowdfunding. As we said on the fourth anniversary of the legislation, now that we have a chance to see the effects of the bill, “policymakers should evaluate the impact of the Act and remain open to modifications and improvements to the existing framework that could further enhance capital formation options for entrepreneurs and startups.”¹ We are pleased members of the committee are committed to pursuing this overview.

On the whole, we welcome the efforts of committee Republicans to further boost access to capital for small businesses and create opportunities for a broader universe of investors. While much of the conversation around startup activity—and understandably many of the proposals in the package—is centered around several innovation hubs that have historically seen high levels of startup formation and growth, policymakers should focus on targeted legislative proposals to innovators, founders, and investors outside traditional startup hubs. One founder mentioned, “[t]his bill seems to be written from the perspective of major startup hubs where venture capital is fairly established. These provisions will still help, but from what I see, most startup communities are still a very far cry from

¹ Emma Peck, “Four Years of the JOBS Act: Examining its Impact and Looking Forward” (April 14, 2016), <https://www.engine.is/news/issues/tax-and-finance/four-years-of-the-jobs-act-examining-its-impact-and-looking-forward/6718?rq=jumpstart>.

having a distinction from \$10 million to \$20 million matter. The big gap for broad enhancement of dealflow is in seed funding < \$1 million; in many communities it's < \$250 thousand.”²

Still, a number of provisions also stand out as exciting opportunities for the innovation community. The Expanding American Entrepreneurship Act, for example, would help to diversify the pool of investors eligible to invest in new businesses by reforming 3(c)(1) funds. By boosting the number of possible investors and raising the fund cap, more individuals would have the opportunity to participate at lower investment levels, which could lead to investment in more diverse entrepreneurs and investment by a more diverse pool of accredited investors.³ While this provision as written would be welcome, it could be improved upon by further raising the fund cap. Stephanie Roulic of Startup Boston, a startup support organization based in Boston, Massachusetts, told us, “I do believe the cap level should be higher. A \$50 million fund and 500 investors is still very low by modern fund standards, but it is a tremendous step forward. I do feel that, as a society, we can do better. However, this is a great first step in truly helping accredited women investors and investors of color participate in funds.”⁴

Engine and many of the founders in our network are similarly encouraged by efforts to expand the definition of accredited investor. One founder told us, “[t]his is by far the most important thing in this document. Changing this would be HUGE for truly allowing anyone to invest without arduous hoops for businesses and investors.”⁵ He did indicate, however, that policymakers should consider as a rework, “bump[ing] this up to 20 or 25% and/or include[ing] a secondary test for net worth that could allow individuals to make larger investments (e.g 10% of net worth).”⁶ And some founders did mention concern with the examination process. Yasmin Mattox, founder and CEO of Rochester, New York-based Arkatecht, a startup that creates professional development tools for working parents, expressed concern about the content and presentation of the exam and suggested making sure it’s in “layman's terms and easily accessible and understandable to virtually anyone.”⁷ Eric Parker of theClubhou.se, an Augusta, Georgia-based startup support organization that includes a coworking space and accelerator, highlighted that net worth will vary dramatically across geographic locations, arguing, “that the person making \$150k in middle America has a much higher proportion of disposable income. If the exam is required, accreditation should scale based on cost of living in your region.”⁸ Engine has repeatedly called for an expansion to the definition, particularly to boost diversity amongst investors and, subsequently, amongst startups receiving funding.⁹ Only 1.3 percent

² Engine, What Startups are Saying About the JOBS 4.0 Draft, <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/629a299aff12856973b9a17c/1654270362843/Startup+Feedback+JOBS+4.0+.pdf>.

³ John Dearie, JOBS Act of 2022 Will Help Diversify American Entrepreneurship (April 29, 2022), <https://thehill.com/blogs/congress-blog/3472209-jobs-act-of-2022-will-help-diversify-american-entrepreneurship/>.

⁴ Engine, *supra* note 2.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ Nathan Lindfors, Policymakers Should Expand the Pool of Startup Investors, Not Narrow It (March 10, 2022), <https://engineadvocacyfoundation.medium.com/policymakers-should-expand-the-pool-of-startup-investors-not-narrow-it-b8854a7770f6>.

of angel investors are Black and only 2.3 percent are Hispanic—and current financial thresholds are in part responsible for these disparities in investment opportunities.¹⁰

Founders also provided feedback on efforts to study the capital needs of rural communities. While we frequently highlight the racial and gender diversity amongst startup founders, there is also a great deal of geographic diversity within the U.S. startup ecosystem. According to Mattox of Arkatecht, while they aren't a rural startup, they are rural-adjacent, and “[f]rom what we've heard, there is an issue of access to networking opportunities,” and “[v]irtual networking events through SBA and its partners can help rectify this situation.”¹¹ She goes on to explain that “[s]hining a light on opportunities for innovation in the tech space in a manner that uplifts rural communities could be leveraged in a number of ways. Challenges posed by SBA to bring these rural startups into the fold in terms of connectivity and a spotlight on often ‘invisible or overlooked’ rural issues could be powerful and timely given forecasted impacts of the pandemic on supply chain issues related to agribusiness, food, and manufacturing facilities.”¹²

Additional changes at the SBA could help make the agency's resources available to more startups in geographically diverse locations across the country. Andrew Prystai of Event Vesta, an event promotion and discovery platform located in Omaha, Nebraska agrees that change is needed at the SBA—stating, “I believe the issue overall is access to capital, as SBA can't make loans to asset lite businesses like ours. . . I do think almost anything here (whether loosening restrictions on small grants from the SBA, providing working capital to potential investors, or setting up tax credits for angel investments) would help.”¹³

Startups also highlighted other areas the committee should consider in thinking about capital formation and ways to support the startup ecosystem. While the first section of the draft is focused on encouraging more companies to IPO, the draft fails to consider that, while an IPO is a desired outcome for some startups, a far greater percentage pursue mergers and acquisitions as the best exit option. According to a recent Engine report, “[a]n analysis of the approximately 12,000 startup exits from Aug 2002 to March 2020 revealed that 35 percent of startups failed and shutdown, 61 percent were acquired, and four percent underwent an IPO.”¹⁴ Further, “[i]n a 2020 survey, 58 percent of startup founders said acquisition was “the realistic long goal” for their company.”¹⁵ Therefore, emphasizing IPO as the primary startup exit, without also helping to facilitate mergers and acquisitions—or at least working to preserve existing mechanisms for mergers and acquisitions, which have come under increased scrutiny from policymakers—fails to take into account the realistic goals of many startup founders.

¹⁰ *Id.*

¹¹ Engine, *supra* note 2.

¹² *Id.*

¹³ *Id.*

¹⁴ See Engine's Comments to the Federal Trade Commission, available at:

<https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/626090a94d6c20727c338d01/1650495664536/Merger+Guidelines+RFI+Submission+042122.pdf>.

¹⁵ *Id.*

In comments to the Federal Trade Commission, Engine notes “[a]ll successful exits—by either IPO or acquisition—provide incentives to innovate, create a return on investment, and promote investment in new startups as capital and talent tend to remain in the ecosystem. However, acquisitions are more accessible for startups at all stages of development, and startup acquisitions share a stronger, more positive relationship with startup investment.”¹⁶ Preston James, founder and CEO of DivInc, an Austin, Texas based non-profit that works to support underrepresented entrepreneurs, echoed the need for a focus on M&A, stating, “I would also recommend that with the same focus on IPOs, they facilitate or develop mechanisms that enable more merger and acquisition of private startup companies that will not IPO. I would also recommend that there is a target percentage of merger and acquisitions that we want to facilitate. I think we can put incentives in place that encourage merger and acquisition or at least support merger and acquisition in a favorable way for companies.”¹⁷

The most consistent feedback we received from founders on the JOBS 4.0 draft pertained to the need for equity throughout and a focus on lifting up diverse founders, including women founders and founders of color. Doing so would improve startup outcomes, including access to capital. Engine has repeatedly called on policymakers to address barriers in capital access faced by underrepresented founders.¹⁸ And diminished access to capital is felt by these founders on multiple levels—from oft cited barriers to obtaining venture capital, to reduced opportunity for friends and family rounds, to difficulty obtaining bank loans. Founders in our network expressed a desire to see an understanding of the barriers underrepresented founders face baked into the draft legislation, including solutions specifically tailored to improving capital access for founders in these communities.

James of DivInc told us, “[t]he access to capital [section] should address various stages as opposed to a broad stroke to provide access to capital. [Otherwise] it's not going to be equitable in any way shape or form.”¹⁹ He explained that the three early stages of funding—personal/friends and family, pre-seed, and seed rounds—“are underfunded in the market, especially for underrepresented founder groups” and the SEC has the opportunity to better support underrepresented founders in earlier stages.²⁰ He goes on to explain, “[i]t is estimated that 70% of underrepresented founded ventures are at the seed stage or earlier. By partnering with entrepreneur support organizations (accelerators, etc.), the SEC can provide greater and more targeted access to capital at these early stages.”²¹ And that with greater support for underrepresented founders at earlier stages, “we build a stronger pipeline of employer based tech companies that can potentially go public or experience an exit via a merger/acquisition.”²² James indicated the SEC should support “pre-seed focused funds,

¹⁶ *Id.*

¹⁷ Engine, *supra* note 2.

¹⁸ E.g. see Engine’s response to the U.S. Patent and Trademark Office, available at: <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60366ecbd288114c62743c45/1614180046522/Engine+USPTO+diversity+comments.pdf>; Engine, *Making the Startup Ecosystem More Equitable* (Nov. 2021), <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/6193d03ac7eb9c40442a6740/1637077051416/Making+the+Startup+Ecosystem+More+Equitable+11.15.pdf>.

¹⁹ Engine, *supra* note 2.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

invest with accelerators, or in equity crowdfunding platforms focused at this early stage,” including through support of organizations like DivInc.²³ These organizations, like DivInc, serve dozens of companies and set them up for success by preparing them for growth. Finally, he also mentioned that the SEC could further support underrepresented founders and boost capital access by enabling more people, particularly BIPOC people and women, to become venture capitalists through training or partnerships with support organizations, as well as investing in “BIPOC emerging fund managers who focus on various stages of investment with a target of ensuring that 50% of the new funds are led by people of color and women.”²⁴

Other founders, like Renee King, Founder and CEO of New York, New York-based crowdfunding platform Fund Black Founders, spoke to us about crowdfunding and how to boost its viability as an option for founders. She told us that the SEC needs to “think about education—educating the public about what the SEC does around all of this. You need to empower local people that can speak to communities directly—putting something on a website isn’t going to empower an under-resourced person, for example, someone without broadband, to access any of this.”²⁵ King stressed that navigators would be helpful because educational resources need to come from the SEC, as the agency “restricts how much education [crowdfunding portals are] permitted to provide.”²⁶ She further tells us that there “is still a barrier to being able to run an equity crowdfunding campaign. There are security law-related costs, getting certified, and what is quietly happening is the bigger platforms are shifting more towards unicorn-possibility businesses and not bringing on the ones that aren’t that,” leaving some startups left out of the funding tool.²⁷

Mattox of Arkatecht also stressed the need for equitable access in crowdfunding. Regarding the Improving Crowdfunding Opportunities Act, she states, “[t]he viability of this improvement will in great part rest on whether information is marketed to communities typically crowded out of/unaware of Reg CF opportunities. Vehicles exist for this already under economic development programs. There are opportunities for partnerships with online banking services that cater to low to moderate income and working class communities who can invest using a graduated approach to help build community and generational wealth.”²⁸

Other feedback we received from startups involved policymaking perhaps outside the purview of the committee but still equally important to capital access and breaking down barriers to the innovation ecosystem. Jeff Wigh from Overland Park, Kansas-based connected gaming startup, Bryght Labs indicated a federal angel investor tax credit would be helpful, building off of the tax credit available to startups in Kansas.²⁹ Andrew Prystai concurred, arguing that a federal angel tax credit would be even more beneficial than what is available at the state level, “just for the simple fact that the federal taxes are so much higher proportionally.”³⁰ He goes on to explain that “Nebraska’s Angel Tax Credit

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

was creating a 4X dollar for dollar economic return for every dollar that was counted for a credit,” and that a federal counterpart might include an application to be a startup, be claimed on tax returns retroactively, and prioritize individual investors as opposed to focusing mostly on venture capital firms.³¹

Founders also touched on other policy areas that inhibit startup formation and growth. Policymakers could consider dismantling roadblocks to entrepreneurship, including exorbitant healthcare costs and the student loan debt crisis. On the latter, policymakers should consider targeted relief for startup founders³² (or early-stage employees), possibly through a format similar to public service loan forgiveness.³³ Finally, Prystai of Event Vesta also told us policymakers should think about creating new programs, perhaps similar to Nebraska’s Prototype Grant Program,³⁴ which “matches 2 grant dollars to 1 ‘investment’ dollar” and allows startups to “dramatically increase their product budget without being diluted.”³⁵ The program also requires the funds to be spent within the state, which helps to boost local job creation as opposed to offshoring positions.³⁶

Engine commends the committee on their effort to pursue a bipartisan approach to boosting capital access for startups. This initial draft is a substantive step. As policymakers continue to think about how to encourage capital formation, we encourage you to look to suggestions and feedback from founders and investors in the startup ecosystem, including those within these comments. We also encourage you to consider the broad diversity of the U.S. innovation ecosystem and the differing needs of underrepresented founders when advancing legislation. As always, Engine is happy to serve as a resource to the committee on the needs of the startup ecosystem, including by facilitating conversations with startups in our network.

³¹ *Id.* Mr. Prystai has a number of proposals for what would constitute a successful federal angel tax credit, which Engine is happy to share with the committee or other interested members.

³² *Id.*

³³ *Id.*

³⁴ See information on the Prototype Grants, available at: <https://opportunity.nebraska.gov/programs/business/nif-prototype-grants/>

³⁵ Engine, *supra* note 2.

³⁶ *Id.*