May 1, 2020

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

The Honorable Jovita Carranza
Administrator
U.S. Small Business Administration
409 3rd Street S.W.
Washington, D.C. 20416

Dear Secretary Mnuchin and Administrator Carranza:

Thank you for your tireless leadership during these challenging times, including your leadership of the Paycheck Protection Program (PPP). The startup ecosystem is deeply committed to supporting efforts to fight COVID-19, as well as leading the economic recovery through the development of high-growth companies that create jobs, innovation, and increase our global competitiveness. Venture-backed companies are currently working on a range of products to support the fight against COVID-19. Examples include a cell therapy designed to remove the virus from infected cells; an antibody designed to activate virus-killing cells in the body and prevent COVID-19 from spreading in patients; and an at-home test kit to deliver results in minutes.

As you know, PPP was created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act to help small businesses impacted by the economic crisis caused by the COVID-19 pandemic. This program offers loans up to $10 million to small businesses that certify that the loan is necessary to support ongoing operations. Loans can be forgiven based upon the number of employees retained and wages preserved.

As revenues drop and long-term investment capital dries up in this crisis, thousands of startups face significant layoffs and potential closure. These companies clearly fit the eligibility of PPP, and some of them have accessed the program. Despite this, in the last few weeks, more than 300

U.S. startups have laid off more than 30,000 employees.[1] Sadly, this is just the tip of the iceberg, as some have estimated that 80 percent of startups will cut up to one-half of their employees over the next two to four quarters. To put this into context, U.S. venture-backed startups employ about 2.27 million workers, and these high-quality jobs often support many more in ancillary support and service industries. We anticipate that sources of capital will continue to dry up as the crisis deepens, which will lead to the loss of many high-growth companies and lost jobs.

Many of these companies have received venture capital (VC) financing and have questioned how recent guidance from the Treasury Department and Small Business Administration impacts their ability to use PPP. Specifically, Treasury and SBA recently released FAQs #31 and #39 directing companies to take into account "their ability to access other sources of liquidity sufficient to support their ongoing operations that is not significantly detrimental to the business."[2] At the same time, FAQ #31 reiterates that in the CARES Act, Congress "suspend[ed] the ordinary requirement that borrowers must be unable to obtain credit elsewhere [.]"[3]

Entrepreneurs now fear a mistaken assumption that just because their company has venture capital involvement, the company may be treated as having an ability to access liquidity to sustain current operations, even though in reality that is not the case. The vagueness of FAQ #31 has already caused many entrepreneurs to fear that access to liquidity may be interpreted in an overly broad manner, which could render companies retroactively ineligible and subject to penalties. I am writing to provide some perspective on how venture capital may be deployed in a crisis, and in particular the limitations on the ability of this capital to be used to sustain ongoing operations.

At the beginning of 2020, the venture capital industry had about $120 billion in capital available to deploy to startups. Our industry is grateful that this capital has been raised so it can support the startup ecosystem. But make no mistake, that figure is deceiving for several reasons. This capital is *often not available* to support ongoing operations in the startup ecosystem during this downturn, and *far from enough* even if there were no constraints on deployment. It is critical to understand the following points:

- VCs must allocate capital not only to support existing portfolio companies but also to finance new companies. A large portion of the capital available is already reserved for the next generation of companies. Even if possible, to cut into this capital now and divert it to existing companies will create a significant setback to future economic growth that will be critical to our national economic recovery.

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[1] *Startup Ecosystem Faces Capital Crunch over Coming Months,* National Venture Capital Association (April 27, 2020), *available at* https://nvca.org/wp-content/uploads/2020/04/Startup-Ecosystem-Faces-Capital-Crunch-over-Coming-Months-5.pdf.

[2] Treasury Department and Small Business Administration, Paycheck Protection Program Loans, Frequently Asked Questions (FAQs), https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf

[3] Id.

•In addition to future companies, the capital available to venture funds is meant to be deployed over several years and often in order to finance various growth milestones, such as development of a manufacturing facility, a clinical trial, or hiring a salesforce. Venture capital investment is not meant to be (nor should it be) used simply to backfill a drop in revenues or for workforce preservation. To do so would undermine our future economic growth. After all, VCs are fiduciaries of the limited partners (LPs) that invest in venture funds. These LPs include pensions, endowments, and foundations, and each of them relies upon the returns of the fund to meet future commitments, such as the retirement plans of their workers. Therefore, VCs must deploy capital in a manner that creates growth and long-term value, or risk poor returns that will create a long-term access to capital challenge in the U.S. startup ecosystem, thus weakening our country's competitiveness. Further, if funds are deployed in a manner contrary to investor agreements, they may find themselves in conflict with their own sources of capital.

•Even if VCs could deploy the $120 billion to startups today, it would not be nearly enough to offset the coming capital crunch in the startup ecosystem. To put this into context, U.S. venture funds raised $50 billion last year, while $133 billion was deployed in the U.S. startup ecosystem. This is clearly a massive gap and is largely due to increased participation by nontraditional investors (e.g. asset managers) that historically flee the startup ecosystem and high-risk illiquid investment in general during economic downturns.

•Startups sell equity to receive venture capital financing and there are often reasons the company cannot or should not sell additional equity. One reason is that VCs are generally limited in the percentage a fund is permitted to dedicate to a given portfolio company.

•Future fundraising for venture capital funds is likely to see a drastic drop. A recent example is what occurred during the 2008 financial crisis, when VC fundraising fell by nearly 60% from 2008 to 2009.

•Many of the LPs in venture funds have significant economic and health challenges of their own, which may lead some to not meet the capital commitments they have made to the venture fund.[4] Thus, the capital reportedly available to venture investors may not actually be available when the capital needs to be deployed to a startup.

For the above reasons, it is not feasible for all U.S. startups to rely on venture capital investors to cover revenue shortfalls and sustain ongoing operations of the company. Many startups will not be able to access capital and therefore will either fail or drastically reduce employee levels. Given venture capitalists' deep commitment to the startup team, we find this incredibly regrettable, but it is a reality.

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[4] It is important to understand that the capital available to deploy to startups is only capital *committed* to the venture funds. It is not the case that the venture funds currently hold this capital. Therefore, it is conceivable that some LPs may default on their commitment due to their own economic circumstances.,

For many startups, PPP has truly been a lifeline that has enabled these companies to sustain operations and retain American workers during these difficult times. We have been grateful for the support of many Members of Congress who have encouraged inclusion of startups in PPP.[5] We hope this letter demonstrates that startups that have accessed venture capital may still reasonably find it necessary to access PPP to sustain ongoing operations and maintain their workforce through these uncertain times. After all, this capital may be the only way that many impacted startups will sustain the operations that advance American scientific and technological leadership.

Sincerely,

Bobby Franklin
President and CEO

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[5] To date, 91 Members of Congress have signaled their support for allowing startups to access PPP. A collection of those letters can be found here: https://nvca.org/nvca-response-to-covid-19/#toggle-id-1