Statement of Scott Kupor
Managing Partner, Andreessen Horowitz
Chair-elect, National Venture Capital Association
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"Searching for Capital: How Venture Capitalists and Angel Investors Fund Entrepreneurs and Startup Companies"

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Chairman Vitter, Ranking Member Shaheen, thank you for the opportunity to testify before the Small Business Committee today. My name is Scott Kupor and I serve as Managing Partner of Andreessen Horowitz, a $6 billion venture capital firm that has invested in many early-stage technology companies, such as Facebook, Lyft, Magic Leap, Oculus, Pinterest, and Twitter. I am here today in my capacity as Chair-elect of the National Venture Capital Association (NVCA).

The Story of Venture Capital

The story of venture capital is really a subset of the story of entrepreneurship. As VCs, we raise investment funds from a broad range of institutional investors – endowments, foundations, pension plans, etc. and seek to invest in great entrepreneurs with breakthrough ideas. Venture capitalists invest anywhere from the very early stage, where the startup has little more than an idea and a couple of people, to growth-stage startups, where there is some revenue coming in and the focus is on effectively scaling the business. A company leaves the venture ecosystem generally by an initial public offering (IPO), a merger or acquisition, or bankruptcy.

There is often a misconception that venture capitalists are like any other investment fund manager in that they find promising investments and write checks. But writing the check is the easy part; the hard work begins when we roll up our sleeves and work with our startups to help entrepreneurs turn their ideas into successful companies. For example, we often work with our companies to help them identify talented employees and executives to bring into the company or to identify existing companies who can serve as live customer test sites for their products.

The reality is that those who are successful in our field don't just *pick* winners. We work actively with our investments to help them throughout the company-building lifecycle over a long period of time. We will support our portfolio companies with multiple investment rounds generally spanning five to ten years, or longer. We serve on the boards of many of our portfolio companies, provide strategic advice, open our contact lists, and generally do whatever we can to help our companies succeed. We hope all of our companies succeed against huge risks and grow into successful companies, but the majority fail. As this committee appreciates, entrepreneurship is inherently a risky endeavor.

Whether to undertake the challenge of founding a company is an incredibly difficult decision. As a society, we hope these men and women will leave their jobs and dedicate their lives to an endeavor. But they must make this choice knowing that it is more likely than not to fail, potentially leaving them without an income or benefits, and an uncertain future.

Much of the success of a country's entrepreneurial ecosystem is determined by an appetite for risk, which is largely a combination of the policy environment and cultural norms. It must be acceptable both financially and culturally to try and fail. And the rewards for success must be significant enough to make taking such huge risks worthwhile, particularly in light of the high failure rates of startup-up companies.

Benefits of Venture Capital

Through public policy and cultural norms, the United States has fostered a strong appetite for risk, and the benefits have been tremendous. According to a 2015 study by Ilya Strebulaev of Stanford University and Will Gornall of the University of British Columbia, 42 percent of all U.S. company initial public offerings (IPOs) since 1974 were venture-backed.[1] Collectively, those venture-backed companies have invested $115 billion in research and development (R&D), accounting for 85 percent of all R&D spending, and created $4.3 trillion dollars in market capitalization, 63 percent of the total market capitalization of public companies formed since 1974. Specific to the impact on the American workforce, a 2010 study from the Kauffman Foundation found that young startups, most venture-backed, were responsible for almost all the 25 million net jobs created since 1977.[2]

It is quite clear that the American economy is dependent on the economic activity that comes from young firms scaling into successful companies. The rapid hiring, the innovative product, the increasing sales and distribution needs, and the downstream effects all serve to push the U.S. economy forward. The American economy needs more of this activity to help deal with many of the challenges we see today.

Challenges to American Leadership

As recently as 1990, more than 90 percent of global venture capital was invested in American entrepreneurs.[3] The story of modern venture capital began in America and, as a country, the U.S. was the predominant funder of most startup ventures. But other countries see the benefits to the American economy that innovative entrepreneurship has brought. These countries are now racing to compete with us and are using a number of different policy mechanisms to do so.

The share of global venture capital invested in the U.S. has fallen from 90 percent to 54 percent in only 20 years.[4] China has attracted nearly $20 billion in investment this year and is now the second largest destination in the world for venture capital. The European Union received $12.8

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[1] "The Economic Impact of Venture Capital: Evidence from Public Companies," Stanford University Graduate School of Business Research Paper No. 15-55, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841.
[2] "The Importance of Startups in Job Creation and Job Destruction," Kauffman Foundation Research Series: Firm Foundation and Economic Growth," (July 2010), *available at* http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2010/07/firm_formation_importance_of_startups.pdf.
[3] Data compiled jointly by Thompson Reuters and the National Venture Capital Association.
[4] Id.

billion in venture capital investment. And in three of the last four years, at least half of the top ten largest venture investments in the world have occurred outside the U.S.

To be clear, global competitiveness in entrepreneurship is not something to be afraid of or shy away from. This innovation arms race is a virtuous competition where the byproducts are new technologies that improve the way we live, new jobs and economic opportunities, greater productivity to offset the aging workforce challenges facing most industrialized nations, and greater growth for all competitors. But we must recognize that this competition is happening and engage before we cede too much ground.

While these countries have aggressively changed their policies to encourage entrepreneurship and attract venture investment, America has become complacent. If I could leave Congress with one message it would be this: please understand that innovative entrepreneurship is now a global game. It is time to prioritize policies that support the American entrepreneurial ecosystem.

Proposals to Maintain American Leadership

As our country fights to maintain its preeminence in entrepreneurship, I would like to offer several areas on which Congress could focus to support the American entrepreneurial ecosystem.

First, we need a tax policy that encourages new company formation. All across the world, countries are using tax policy to compete for venture capital investment. To provide a few examples, just this spring Australia passed a suite of significant tax incentives for venture capital investment. Great Britain created the seed enterprise investment scheme in 2012. Both of these laws provide both income and capital gains tax relief for startup investment. Canada has a refundable R&D credit which provides critical capital to early stage startups. Meanwhile, here in America one common theme shared by Democratic and Republican tax reform plans is that both ignore new company creation as a priority.

I strongly suggest that Congress protect what's working in the tax code for the ecosystem: that is a policy which has encouraged patient investment and rewarded risk, and make improvements where tax rules hurt or ignore startups. Too often beneficial tax policy ignores startups as is largely the case with our R&D credit, or tax rules are written to crack down on some unrelated evil but which end up hurting startups. An excellent example of this are the Section 382 Net Operating Loss rules which were created so large companies could not buy dying firms in order to use the losses to shield their income from tax, but which can now hurt startups being acquired or sometimes even come into play in fundraising rounds. It is a strange irony that a law passed to prevent tax arbitrage by large corporations taking advantage of dying firms now impacts young startups trying to grow.

I was encouraged by the tax bill that passed in December which made permanent needed improvements to the tax incentive for investment in certain early stage companies and for the first time allowed a small subset of startups to offset payroll taxes with their accumulated R&D credits. This was a good start and I encourage Congress to build on this momentum and think more boldly about how to create a tax code that understands innovative entrepreneurship.

Second, we need to re-energize the IPO market. The sad reality is that today's public markets are no longer welcoming to innovative small-capitalization companies. It used to be that companies would IPO to access the capital needed to help scale their businesses. It is now more often the case that a company only has a chance to go public once they have found that capital to scale somewhere else.

There are myriad reasons why companies are waiting longer and going public less frequently than before, but the reality is that in the United States we are averaging less than half the number of IPOs per year since 2000 than we did in the previous several decades. Meanwhile, in the first half of 2016, roughly half of the world's 437 IPOs took place in the Asia Pacific region and China is turning out twice as many IPOs as anywhere else on the planet.[5] A consequence is that we now have half the number of public companies than we did twenty years ago.[6] This troubling trend has a significant impact on the U.S. job market as well. A 2011 report by the IPO Task Force on the status of the U.S. IPO market cited research that found "up to 22 million jobs may have been lost because of our broken IPO market."[7]

Some market observers blame the regulatory environment and many blame different market structure issues. But one thing we should all be able to agree on is prioritizing efforts to make the U.S. capital markets more hospitable to innovative startups. The JOBS Act was an excellent start and one of the most pro-startup pieces of legislation passed in years. I encourage Congress to build on this success and continue efforts to reopen the public markets to innovative startups. The JOBS Act did a great job of making the process of going public easier, but it did not solve many of the capital markets structure issues that make it difficult particularly for small cap companies to trade in the public markets.

Third, we need to encourage more talented individuals to found their own companies or work in startups. A recent Silicon Valley Bank survey found that access to talent is the top policy issue facing startups. An emphasis on STEM education and training will pay positive dividends over the long run. In addition, I have seen several proposals to allow individuals to defer student loans while trying their hand at entrepreneurship. This strikes me as an excellent idea.

We also need an immigration policy that encourages immigrant entrepreneurs to work at and start new companies here in the United States, not overseas. Talented entrepreneurs and early employees are critical to the success of startups. In fact, many venture capitalists worry less about the proposed product and invest based upon their view of the quality of the team. There is a global search for talent and the United States is holding itself back by not moving on immigration reform. In our own portfolio, for example, the CEO and founder of one of our companies fled communist Romania by literally swimming across the Danube River. He landed in the U.S. in NYC and employed himself as a taxi driver for several years before starting his

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[5] "Tons of Companies Are Going Public (Just Not in the U.S.), Forbes (July 2016), *available at* http://www.forbes.com/sites/laurengensler/2016/07/06/tons-of-companies-are-going-public-just-not-in-the-u-s/#66eb1faa77db.
[6] "The U.S. Listing Gap," Craig Doidge, G. Andrew Karolyi, Rene M. Stulz, NBER Working Paper No. 21181 (May 2015), *available at* http://www.nber.org/papers/w21181.
[7] "Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth," IPO Task Force (October 2011), *available at* https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

first software company that was ultimately sold to SAP. He then moved out to the Bay Area where we had the opportunity to fund his most recent endeavor.

One particularly helpful reform is the Startup Visa that is included in the *Startup Act* (S. 181) by Senators Moran and Warner. This proposal would create a new visa category for 75,000 qualified entrepreneurs who create a new business, employ at least 2 full-time employees, and invest or raise at least $100,000 in the business. Another great idea would be to provide legal status to immigrants who graduate with advance degrees from American universities. Allowing these talented immigrants to help entrepreneurs build the next generation of American companies is a win for everybody.

Fourth, we must do our best to modernize our rules and regulations to the realities of the modern entrepreneurial economy, and perhaps even more important, avoid regulatory burdens that will stifle innovation. While at the local level, the recent saga that forced Uber and Lyft out of the city of Austin, Texas is instructive. Both ride sharing companies were delivering tremendous value to Austin residents, but challenges in the regulatory environment forced both companies to cease operating in the city. There is so much promise in the ability of technology to deliver society shaping change, but these efforts are fragile and can be significantly impacted unless the private sector and the regulatory agencies work effectively together. At the federal level, I encourage you to be particularly mindful about how mandates affect small, disruptive industries. Large incumbents are skilled at navigating the morass of federal rules, but onerous requirements can be the death knell for otherwise nimble startups.

I commend Congress for its willingness to hold hearings and commit to better understand the on-demand economy. This approach will lead to better public policy outcomes over the long run.

Fifth, we need a government procurement policy that allows our country to benefit from the wonderful innovation taking place in the entrepreneurial ecosystem. Despite the fact that many young startups are developing technologies that can be useful for the federal government, it can be difficult for these companies to efficiently navigate the federal procurement process. Changing this reality would benefit our nation's warfighter, the taxpayer, and the entrepreneurial ecosystem. I have been impressed with Defense Secretary Carter's efforts to bridge this divide, including opening the Defense Innovation Unit Experimental (DIUX) in Silicon Valley. I hope Congress will support these efforts and encourage greater engagement.

One particular area where the government and Silicon Valley could more effectively partner is cybersecurity. Every week we seem to be hearing of a new attack that compromises massive amounts of sensitive information. Fortunately, venture capitalists are working to build incredible new companies to combat this threat. Since 2010, 351 cybersecurity companies received approximately $9 billion in venture funding. Venture investment in cybersecurity companies hit a six-year high in 2015 when venture investors deployed $3 billion to 144 companies. Easing procurement burdens for startups so the government can gain access to the best cybersecurity tools the world has to offer would be of significant value to our nation's security.

Sixth, and finally, we need to reemphasize our commitment to funding basic research and technology commercialization programs. From the computer revolution to biotechnology and the creation of the Internet, federal investment in basic research has been a critical component of American innovation in the modern economy. Federal commitments to basic research can start a virtuous process where new technologies become startups backed by significant private risk investment from venture capitalists and grow into successful companies. This process fuels innovative breakthroughs that drive economic growth and create millions of American jobs. In addition, as this committee knows well, commercialization programs like the SBIR and STTR are vital tools in ensuring those basic research dollars can create that virtuous impact.

Conclusion

The science and technology behind most inventive startups is very complex, but the policy formula is not. But it does require prioritizing many policies for which there is not a strong collective voice in Washington. It requires doing away with the idea of a quick fix, thinking bigger, and allowing good policies the time to succeed. And it requires avoiding self-inflicted wounds.

We in the venture community lost a true American hero recently when World War Two veteran and venture capital pioneer David Morganthaler passed recently. Part of his legacy of achievement serves as an excellent example of how much promise a robust entrepreneurial ecosystem holds for the country. Before David got to work on the issue, regulations prohibited pension funds from investing in venture capital. He and a small group came to Washington in the 1970's and successfully lobbied Congress and the Department of Labor to change this rule. The result was an innovation boom funded by hundreds of billions worth of investment capital made available to American entrepreneurs, and huge returns for these pension funds from such successes as Google, Oracle and Facebook, along with so many others. He will be missed but his legacy shows the tremendous value to the country of prioritizing policies that support the entrepreneurial ecosystem.

Thank you to the committee for your interest in this important topic. I stand ready to answer any questions.