Expanding Antitrust Laws Could Harm U.S. Startup Ecosystem

Venture capital is the fuel for high-growth startups that have transformed the world. Recent examples include Moderna and Zoom, and past examples include Genentech and eBay. VCs partner with entrepreneurs to build companies. This includes incubating a company within a venture firm, investing in a founder with merely an idea and a business plan, or providing capital and expertise to propel a company as it grows.

For venture-backed companies there are effectively three outcomes: standalone company (often via initial public offering); merger or acquisition; or bankruptcy. Company failure is the most common outcome, but the success stories are often hypergrowth companies with a big impact. Many entrepreneurs and their investors begin the company building process with the hope of creating a standalone, public company. However, in most cases an IPO is not possible, and the preferred exit opportunity becomes an acquisition by another company, with **58% of startups expecting to be acquired.**[1] Ultimately, approximately 10 times as many startups are acquired than complete an IPO, with 836 venture-backed companies having been acquired in 2019, whereas 82 went public.[2]

These acquisitions contribute to the health of the startup ecosystem, as entrepreneurs who realize liquidity through the sale of their company regularly go on to found new, innovative companies, and often invest in other startups as angel investors or VCs. Furthermore, acquisitions help power the returns of VC funds, thereby allowing VCs to raise new funds and invest in the next generation of entrepreneurs. This **"recycling effect" is one of the key drivers of dynamism in our economy**.

Acquisitions more common as public markets have become more hostile to smaller companies

Acquisitions of VC-backed companies have always been more common than IPOs but have become more important to the startup ecosystem in recent years as the public markets have become more challenging for small capitalization companies. The data bears out this reality in stark terms. The **number of IPOs per year post-2000 has dropped by more than half** relative to the preceding two decades. Companies going public are older than they used to be—the average age of a company undergoing an IPO in the last decade was around 10.7 years as compared to 7.5 years in the 1980s and 8.5 years in the 1990s. Far fewer small capitalization companies go public: between 1980-2000, companies with less than $50 million in annual sales made up about 50 percent of IPOs; post-2000 that number has dropped to about 35 percent. [3]

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[1] "2020 Global Startup Outlook," Silicon Valley Bank (2020) at 7, available at https://www.svb.com/globalassets/library/uploadedfiles/content/trends_and_insights/reports/startup_outlook_report/suo_global_report_2020-final.pdf.
[2] "NVCA Yearbook," National Venture Capital Association (March 2020) at 22-23, https://nvca.org/wp-content/uploads/2020/03/NVCA-2020-Yearbook_PUBLIC-DATA-PACK.pdf
[3] "Initial Public Offerings: Updated Statistics," Professor Jay Ritter, University of Florida, available at https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

The reality is most young companies cannot realistically achieve the size and scale necessary to survive in the public markets of today. It has become more expensive and significantly more challenging to manage public companies; much of the infrastructure that supported small companies going public has disappeared; and the public markets have unfortunately become more short-term in nature. The frustrating result is that the **U.S. now has roughly *half* the total number of public companies than there were twenty years ago**.[4] Acquisition activity for most of these companies represents their only realistic chance of success.

Expanding antitrust law to restrict acquisitions could chill investment into startups

Recent proposals would modify the existing antitrust rules to place the burden on businesses to prove that an acquisition is pro-competitive, even when the acquiring party does not have a history of anti-competitive acquisitions. These proposals could have a chilling effect on the startup and venture ecosystem, as it may make it harder for startups to be acquired; elongate the timeline for liquidity; and increase the regulatory and legal costs of an acquisition. As a result, U.S. R&D and job creation could be jeopardized. As Patricia Nakache of Trinity Ventures testified before the Senate Judiciary Committee in 2019:

> If the government makes it more challenging for incumbents to acquire these companies, this will have the devastating effect of **making it less attractive to launch a new enterprise and for people like myself to fund and partner with those companies**. The end result will be harm to the American innovation economy."[5]

Background on Venture Capital & its role in economic growth

VC funds make equity investments in a company and makes the **longest-term investment of any asset class**. The company's stock is generally illiquid until a company matures after five to fifteen years and as a result there is little actual value until a company goes public or is acquired.

Startups are responsible for almost all of the net new U.S. jobs created since 1977.[6]
Of the 1,339 U.S. companies that went public between 1974 and 2015, 556 (or 42%) are venture backed. These 556 companies represent 63% of the market capitalization and 85% of total research and development of those 1,339 companies. Those venture-backed companies spent $115 billion in R&D, accounting for 85% of all R&D spending, and created $4.3 trillion dollars in market capitalization – 63% of the total market capitalization of public companies formed since 1974. [7]

Despite the importance of this economic activity, the **U.S. share of global VC has fallen more than 30% (from 84% to 52%) in the last 15 years**.[8] This demonstrates the need for policymakers to carefully consider how changes may impact young, innovative companies.

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[4] *Capital Formation, Smaller Companies, and the Declining Nature of Initial Public Offerings,* Jeffrey M. Solomon, available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/jeffrey-solomon-presentation.pdf.

[5] Testimony of Patricia Nakache before the Senate Judiciary Committee's hearing on *Competition in Digital Technology Markets: Examining Acquisitions of Nascent or Potential Competitors by Digital Platforms*, available at https://nvca.org/wp-content/uploads/2019/09/Testimony-of-Patricia-Nakache-SJC-as-submitted-9-23-19.pdf

[6] "The Importance of Startups in Job Creation and Job Destruction," Kauffman Foundation Research Series: Firm Foundation and Economic Growth," (July 2010) at 2, available at https://www.kauffman.org/wp-content/uploads/2019/12/firm_formation_importance_of_startups.pdf.

[7] "The Economic Impact of Venture Capital: Evidence from Public Companies," Stanford University Graduate School of Business Research Paper No. 15-55 at 5, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841.

[8] NVCA Yearbook at 13.