December 9, 2021

Senator Amy Klobuchar
Chair
Subcommittee on Competition Policy, Antitrust, and Consumer Rights
Committee on the Judiciary

Senator Mike Lee
Ranking Member
Subcommittee on Competition Policy, Antitrust, and Consumer Rights
Committee on the Judiciary

Dear Senator Klobuchar and Senator Lee:

On behalf of our nation's venture capital (VC) investors and the entrepreneurs they support, thank you for the opportunity to provide a statement for the record regarding the subcommittee's hearing on "The Impact of Consolidation and Monopoly Power on American Innovation." We anticipate a topic at the hearing will be the role acquisitions play in the innovation economy. Therefore, this submission will detail the importance of acquisitions to the startup ecosystem and our opposition to the *Platform Competition and Opportunity Act of 2021* (S. 3197).

The *Platform Competition and Opportunity Act* is an effective ban on acquisitions by certain companies. We appreciate that a goal of S. 3197 is to increase competition against incumbent technology platforms. However, we believe S. 3197 will unfortunately harm startup activity in our country. For entrepreneurs, an acquisition of their company is the most common liquidity opportunity and one that motivates many founders to launch new companies. Barring acquisitions of companies by select acquirers would close the door to many opportunities and therefore provide a significant disincentive for new company formation, job creation, and innovation.

Background on VC and the importance of acquisitions

Venture capital is the fuel for high-growth startups that have transformed the world.[1] Recent examples include Moderna and Zoom, and past examples include Genentech, eBay, and SpaceX.

[1] VC funds make equity investments in a company and make 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.

VCs partner with entrepreneurs to build companies. This can include 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, or IPO); 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.[2]

Some have incorrectly argued that acquisitions of VC-backed startups have become more common place in recent years and have used this specious claim to justify restrictions on acquisition activity. In fact, the opposite is true and must be recognized by policymakers. Over the last decade, the average annual ratio of VC-backed acquisitions to IPOs is approximately 13:1.[3] There are less acquisitions today relative to IPOs, with 886 venture-backed companies having been acquired in 2020, whereas 103 went public.[4]

Another common misconception of acquisitions is that large companies perform these transactions to eliminate would-be rivals before they grow to be competitive threats. The experience of the venture industry is the vast majority of acquisitions occur because young, innovative companies improve the underlying product or service of larger companies and deliver benefits to consumers. For this reason, in recent years large technology companies have acquired VC-backed companies in cybersecurity, cloud computing, medical testing, traffic processing, education, and other areas.[5]

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 supporting the pensions, endowments, and foundations that invest their capital in venture funds. In addition, acquisitions allow VCs to raise new investment funds and partner with the next generation of entrepreneurs. This "recycling effect" is one of the key drivers of dynamism in our economy and propels emerging startup ecosystems in places like Minnesota and Utah.

One reason acquisitions are incredibly important to the startup ecosystem is because in recent years it has become challenging for small capitalization companies to go public. The data bears

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[2] "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.

[3] "NVCA Yearbook," National Venture Capital Association (2020) at 37-29, https://nvca.org/wp-content/uploads/2021/03/NVCA-2021-Yearbook.pdf.

[4] Id.

[5] "Startups Will Be Collateral in Lawmakers' Zeal to Attack Big Tech," Jeff Farrah (*Real Clear Policy*), available at https://www.realclearpolicy.com/articles/2021/11/19/startups_will_be_collateral_damage_in_lawmakers_zeal_to_attack_big_tech_804333.html.

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. [6]

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 it had twenty years ago.[7]

Acquisition activity for most of these companies represents their only realistic chance of success. Due in part to these challenges in the public markets, it is emphatically not the case that by making acquisitions harder that companies will simply decide to go public instead. They cannot. Despite this dynamic, S. 3197 would disrupt many of these transactions even though public markets are foreclosed to many startups.

Specific concerns with S. 3197

The *Platform Competition and Opportunity Act* is effectively a ban on acquisitions by companies with a market capitalization of $600 billion or more that have at least 50 million U.S.-based monthly active users or at least 100,000 U.S.-based monthly active business users. Specific concerns with S. 3197 include:

• Had S. 3197 been in place, it likely would have barred the acquisition of at least 140 venture-backed companies in just the last five years.[8] This harsh penalty would be applied without any analysis of the benefits of the acquisition, including to the entrepreneur, consumers, or the startups employees that are often compensated in part with stock that is illiquid until the acquisition occurs.

• S. 3197 would disproportionately impact startups in emerging ecosystems. In recent years, startup and venture capital activity has seen impressive growth in the middle of the country, thereby spreading entrepreneurial activity into new pockets.[9] But because companies in these regions do not tend to grow large enough to go onto the public markets, acquisitions are the far more common exit opportunity for entrepreneurs. S. 3197 would endanger the recent growth in

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[6]"Initial Public Offerings: Updated Statistics," Professor Jay Ritter, University of Florida, available at https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

[7] *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.

[8] Source: Pitchbook data. This estimate assumes the companies subject to S. 3197 are Alphabet, Amazon, Apple, Meta, and Microsoft.

[9] "How Policymakers Can Capitalize on Two Geographical Trends in the Startup Ecosystem," Jeff Farrah (NVCA), *available* at *https://nvca.org/how-policymakers-can-capitalize-on-two-geographical-trends-in-the-startup-ecosystem/*.

emerging ecosystems by closing off potential acquirers of startups and disincentivize investment in new companies in these regions.

• S. 3197 would make it harder for startups to be acquired by reducing the number of potential acquirers. The impact of this is considerable: fewer potential acquirers would mean a reduced sales price for the company due to less bidders, resulting in less profitability for the entrepreneurs. This reduced profitability will make new company formation less attractive than it currently is relative to other opportunities, thereby negatively impacting employment, wages, and innovation.

• An unintended consequence of this dynamic is that many startup founders are former employees at large technology companies, and if entrepreneurship is less attractive then these individuals are less likely to leave their positions at established companies and strike out as entrepreneurs, thereby strengthening the hand of the very companies that S. 3197 is designed to curtail.

• Three-time entrepreneur Bettina Hein, a witness at the subcommittee hearing, has elaborated on how S. 3197 will backfire:

> By dramatically raising the regulatory hurdles and compliance costs of acquisitions, the act would benefit large incumbent companies that have money and teams of lawyers to navigate the new legal landscape. Smaller companies would be shut out. In this way—ironically—the bill would likely deepen and widen the competitive moat protecting large incumbent companies from smaller, more innovative challengers.[10]

Indeed, today large companies are skilled at using regulatory uncertainty as a justification for a lower acquisition price. For example, larger companies often cite uncertainty over the tax assets and intellectual property of a startup as a reason for a lower purchase price. A complex analysis of S. 3197's exclusions (discussed below) threatens to be the next frontier in how larger companies use regulatory bodies to their benefit against smaller companies.

• S. 3197 is effectively a ban on acquisitions by certain companies because its exclusions are so challenging to meet. For example, one exclusion is that the acquiree does not "compete with the covered platform or with the covered platform operator for the sale or provision of *any product or service*."[11] The companies subject to S. 3197 are large, multi-faceted enterprises that arguably "compete" with vast amounts of smaller companies outside the core business of the acquirer, thereby nullifying this exception. Another exclusion is that the acquiree does not "constitute nascent or potential competition to the covered platform [.]"[12] In most cases, this is impossible to determine, especially for the government which is not a market participant and therefore does not have the relevant experience or expertise to make judgment calls on which companies may compete years down the road. Ultimately, the exclusions within S. 3197 are not exclusions at all,

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[10] "Lawmakers Plan to Tank the Startup Economy, Bettina Hein (*Wall Street Journal*), *available at* https://www.wsj.com/articles/lawmakers-plan-to-tank-the-startup-economy-acquisition-antitrust-ipo-11634592207.
[11] *See Platform Competition and Opportunity Act of 2021*, section 2 (b)(3)(a) (emphasis added)
[12] *See Platform Competition and Opportunity Act of 2021*, section 2 (b)(3)(b)

which makes the bill an effective ban on acquisitions without any analysis of the competitive effects of the transaction.

• Because S. 3197 bars the purchase of "the whole or *any part of the stock or other share capital*," the bill goes beyond restricting acquisitions and appears to bar even minority, non-controlling investments into startups by certain companies. Corporate Venture Capital (CVC) is the practice of investments by existing corporate entities into startup companies. CVC activity has been a growing and important source of capital for startups in recent years. In addition to providing capital to startups, CVCs also serve as important business partners as the new company scales. But S. 3197 would cut off this source of capital even though an acquisition has not occurred.

We hope this submission has provided the subcommittee with a better understanding of the role acquisitions play in the U.S. innovation economy. Our startup ecosystem is the envy of the world in significant part due to sound policy determinations. For the United States to remain the global leader in this space, policymakers must not harm the entrepreneurial ecosystem as they address other marketplace issues. The venture industry stands ready to partner with policymakers to make our country the best place in the world to launch and scale a high-growth company.

Sincerely,

Bobby Franklin
President & CEO

CC: Chair Dick Durbin
Ranking Member Chuck Grassley