March 20, 2023

The Honorable Isabella Casillas Guzman
Administrator
U.S. Small Business Administration
409 3rd St, SW
Washington, DC 20416

Dear Administrator Guzman,

On behalf of our nation's venture capital (VC) investors and the entrepreneurs they support, I write to thank you for your hard work on the Small Business Investment Company Investment Diversification and Growth rulemaking. In addition, I write to request that the final rule clarify the waiver of affiliation rules generally available to small business investment companies (SBICs) also will be made available to accrual SBICs.

This critical rulemaking will expand the opportunity to participate in technology-related economic activity to more communities across the country and dramatically increase government access to many of the world's leading frontier technologies. Due to longer time horizons, larger risk appetite and shared ownership structure, equity investment is often critical to financing the commercialization of frontier technology. Yet because the existing SBA affiliation rules often capture even minority investments and therefore prohibit eligibility from certain federal programs, the rules drive an unintentional wedge between some of America's most innovative small businesses and various government agencies in need of their products to best accomplish their missions.

A waiver from affiliation rules for accrual SBICS is central to maximizing the positive impact of this rulemaking for the frontier technologies outlined by the Department of Defense's Office of Strategic Capital and the key technology focus areas as designated by the CHIPS and Science Act. We applaud the Small Business Administration (SBA) for prioritizing technology, innovation, and human capital as the cornerstones of economic growth and competitiveness. By increasing access to many of the world's best technologies, this rulemaking will advance a range of critical policy goals including job creation, national security, energy, health care, and economic growth.

Venture Capital's Role in Technology Commercialization

Commercializing frontier technologies is a high-risk and long-term commitment demanding expertise in a range of fields, including science, engineering, business management, and finance. Research suggests that the results of far less than half of academic medical technology studies can be

confirmed in industrial settings.[1] Even if the science holds up under more rigorous industrial standards, there are still a host of other challenges that will cause many VC-backed companies focused on commercializing technology to ultimately fail. These include market shifts, challenges with scaling, or competition with incumbent companies.

The VC community is uniquely suited to finance frontier technology commercialization due to its longer time horizons and equity-based financial model. Venture capitalists create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations and others with their talent and expertise to make high-risk, long-term equity investments into innovative young companies. Venture capital has the longest asset holding periods of any investment class. The standard VC partnership agreement lasts for ten years with extensions that in practice mean the partnerships generally run even longer.

VC-backed companies are generally nascent entities that use equity investment provided by VC funds to conduct research, expand workforces, build out new facilities, and focus on growth activities that create long-term value. A recent survey of VC-backed companies by NVCA showed that "four out of five respondents spend at least 70 percent of their budgets on two activities, wages and compensation and research and development (R&D)."[2] The survey also found that nearly one in five VC-backed companies spend at least 85 percent of their budget on R&D.

VC-backed companies are also able to attract some of the best technological talent in the world through widespread use of equity compensation. By sharing ownership of the company with their workforces, these companies draw motivated workers willing to bet on themselves.

In addition to patient working capital, VCs work alongside their portfolio companies to mentor the executive teams, offer strategic advice (often from seats on the company's board), and serve as critical resources bridging the divide between the lab and market. A VC's participation often serves as a conduit to further growth capital opportunities and resources needed to scale, a key factor for expanding innovation opportunity to new regions and building local ecosystems.

In some instances, VCs will even work directly with universities to license technologies, re-run experiments, pull complementary technologies together, recruit the founding team, and essentially build the company from scratch. An illustration of this model is the founding of vaccine maker Moderna. Journalist Dan Primack of Axios observed of the company's founding: "Moderna wasn't just a VC-backed startup. It was a VC-*created* startup, inside an incubator program run by Cambridge, Mass.-based Flagship Pioneering. It didn't even have a name for the initial nine months of its life, just a project number."[3] This is exemplary of the power of venture capital and the central importance of the equity investment model to frontier technology.

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[1] *Raise Standards for Preclinical Cancer Research*, available at https://www.nature.com/articles/483531a#Tab1

[2] *Venture Capital at Work*, NVCA, available at Venture Capital Investment at Work - National Venture Capital Association - NVCA

[3] *The Company Leading the Race to a Coronavirus Vaccine*, available at https://www.axios.com/moderna-coronavirus-vaccine-trial-78e06a4e-e7ed-42e9-a769-7055030fe3a1.html

Economic Impact of Venture Capital Activity

Venture-backed companies constitute approximately 50 percent of companies that go public each year, including 40 percent of climate technology companies,[4] and are responsible for developing around half of new FDA-approved drugs.[5] Public companies originally built with venture capital financing account for an astounding 92 percent of R&D spending undertaken by all public companies founded within the last fifty years.[6]

In addition to innovation and economic growth, venture capital has a massive impact on the U.S. workforce. Recent research found that employment at VC-backed companies between 1990 and 2020 grew 960 percent, whereas total private sector employment during that same period grew only 40 percent. These jobs are distributed broadly across the entire U.S. with 62.5 percent of jobs at VC-backed companies located outside the states of California, Massachusetts, and New York.[7]

This data illustrates a fundamental trend in the modern economy: the path to greater economic opportunity for American workers runs through technological progress and long-term investment. America is the global leader in innovation—a critical component in a globally competitive economy—in large part because of venture capital. This is where the modern venture capital model was created and the home of so many innovative companies built in the post-war era. As we can see from regional and international disparities in venture capital activity, if venture capital does not exist to support an entrepreneurial ecosystem, no other investment class, nor government spending, can fill this gap.

But this leadership should not be taken for granted in the global race for innovation. In fact, the share of global venture capital investment into U.S. companies has dropped from 90 percent from as recently as the 1990s to just 49 percent last year.[8] In an increasingly competitive world, the United States must prioritize greater scientific discovery and patient capital investment to maintain our leadership edge.

SBA Affiliation Rules and the Equity Investment Model

There are essentially three ways a new company can be financed, the first two of which can do so with relatively quick paths to revenue and that can post suitable collateral, and the last which is more suited to the high-risk and longer-term horizons necessary to build frontier technologies:

- Individual founder wealth;

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

[5] *Trends in Healthcare Investments and Exits 2019*, Silicon Valley Bank, available at https://www.svb.com/globalassets/library/managedassets/pdfs/healthcare-report-2019-midyear.pdf

[6] *The Economic Impact of Venture Capital: Evidence from Public Companies (July 2021)*, Professors Will Gornall and Ilya Strebulaev, available at The Economic Impact of Venture Capital: Evidence from Public Companies by Will Gornall, Ilya A. Strebulaev :: SSRN

[7] *An Analysis of Employment Dynamics at Venture-Backed Companies Between 1990 and 2020*, NVCA, Venture Forward, and the University of North Carolina Kenan Institute of Private Enterprise (February 2022), available at https://nvca.org/wp-content/uploads/2022/02/Employment-Dynamics-at-Venture-Backed-Companies_FINAL.pdf

[8] Source: NVCA 2022 Yearbook, Data Provided by Pitchbook.

- Debt financing;
- Equity financing;

The nature of the frontier technology commercialization process typically requires substantial amounts of capital to finance high-risk research projects for long term horizons with little to no revenues or collateral. These factors make equity investment far more prominent in financing breakthrough innovation than debt instruments. Looking back through recent history of innovation in the post-war economy, examples that illustrate this fit include semiconductors (Intel), biotechnology (Genentech), the personal computer (Apple), internet (Microsoft, Amazon, Alphabet), and of course coronavirus vaccines (Moderna, BioNTech). Venture capital investment is flowing into every single key technology area defined by the CHIPS and Science Act and every dual-use critical technology area as defined by the Department of Defense Office of Strategic Capital (OSC).[9]

Unfortunately, because SBA affiliation rules are incredibly complex and can be triggered by minority equity investments, government programs that incorporate affiliation rules discourage the participation of equity-financed small businesses. This is the case even if many of these companies might be in the best position to support the goals of the program. If the SBA wants to prioritize the acceleration of frontier technology innovation in the United States through creation of this new SBIC license, the agency must clarify that the general waiver to affiliation rules that is already provided to licensed SBICs will be available to accrual debenture SBICs as well.

This clarification will enable more companies financed with equity investment to compete in government innovation and procurement programs, a dramatic reform that will increase the success rate of government programs, bring better technology to the American warfighter, and improve our leadership position in every single critical technology area policymakers are targeting.

Conclusion

We appreciate the tremendous potential of your rulemaking to expand economic opportunity, improve our global competitiveness and national security, and accelerate the energy transition. To maximize the potential of this critical rule change, we ask that the final rule clarify that companies financed by accrual SBICs receive the same waiver from affiliation rules currently available to other SBICs. We hope these comments are helpful to your efforts and are pleased to continue to offer our support and assistance as you finalize this important rulemaking.

Sincerely,

Bobby Franklin
President and CEO

[9] USD(R&E) Strategic Vision and Critical Technology Areas – DoD Research & Engineering, OUSD(R&E) (cto.mil)