TESTIMONY OF

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Chairwoman Velazquez, Ranking Member Graves, and all of the members of the Committee, thank you for holding this hearing on business incubators and their role in job creation. I am pleased to discuss how angel investors support innovative start-up companies, some of which work with business incubators and accelerators.

My name is Peter Linder, and I am pleased to represent the Angel Capital Education Foundation, a national source of education and research about angel investing, and the growing community of sophisticated private investors known as “angel investors” who invest money and expertise in high potential start-up companies. I am a long-time angel investor in the Philadelphia area, having invested in 17 start-up companies as an individual and another 14 businesses through the Mid-Atlantic Angel Group Fund, which brings together 90 angel investors to invest in and support promising businesses.

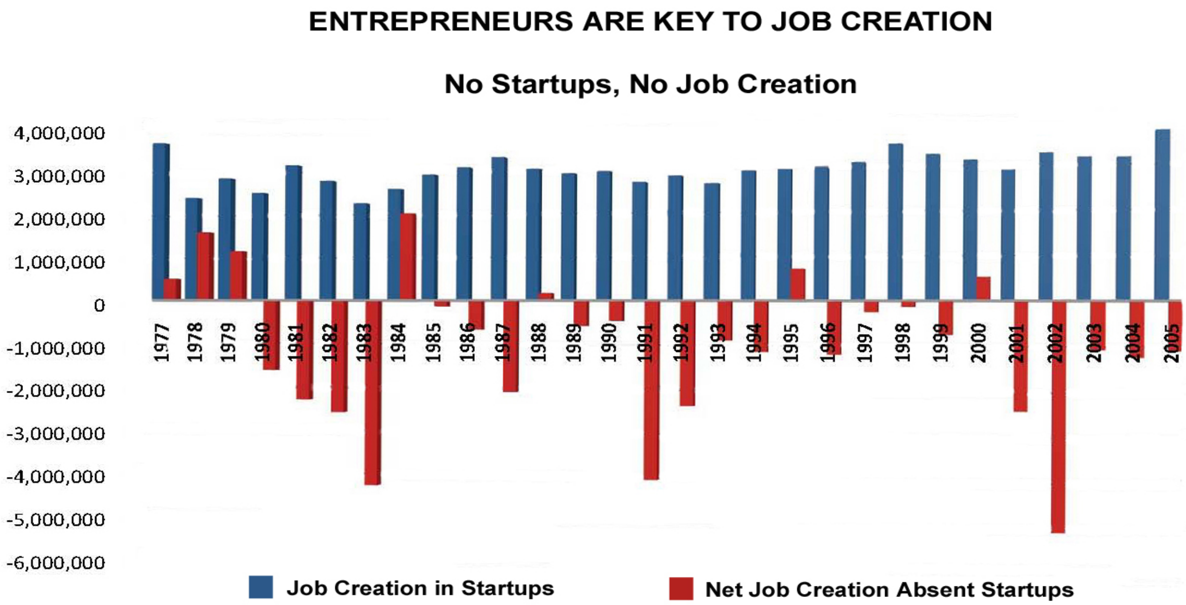
I also a member of ACEF’s sister organization, the Angel Capital Association (ACA) the professional alliance of angel groups in the United States and Canada, with 150 member angel groups in 44 states. More than 6,500 accredited angel investors belong to our member angel groups. ACEF and ACA work together to build the skills of angel investors so that they are better mentor capitalists to start-up companies and to increase the number of angels participating in high quality groups in the United States.

Start-up Companies, Job Creation, and Angel Investors

Innovative high-growth, start-up companies are critical for job growth and economic vitality in any year, and are even more so during an economic recession. A 2009 Census Bureau study[1] funded by the Kauffman Foundation found that start-up companies create new jobs at a higher rate than all employers as

[1] John Haltiwanger, University of Maryland, Ron Jarmin, U.S. Bureau of the Census, Javier Miranda, U.S. Bureau of the Census, *Business Dynamics Statistics: An Overview*, 2009.

a whole – in other words, if you excluded the jobs from new firms in normal years, overall employment in the country would decrease. The chart below, from the Census Bureau and Kauffman Foundation, illustrates the importance of new companies (those in operation for five years or less) to net job creation in the United States over a 25 year period:



While angel investors supported only some of these companies, ACEF believes that angel investors were an important element to the growth of early-stage firms. Angel-backed companies have been some of the most prolific job creators and innovators in recent times: Google, Yahoo, Amazon, Facebook, Costco, and PayPal are just a few examples of these businesses. Without the angel investors who helped these companies get started, these businesses might not be around today. Many of these promising firms need capital, mentoring and other support to hire new people and develop new innovations. Angel investors are the source of capital for an estimated 50,000 companies every year. The Center for Venture Research estimates that angels invested $19.2 billion in 55,480 companies in 2008.[2]

Angel investors are high-net-worth individuals who provide money for start-up firms with growth potential. Many of them started, built and sold their own companies and are now in a position to invest not only their money by their time in new businesses. The nation's leading expert on entrepreneurship and founder of ACEF, the Ewing Marion Kauffman Foundation, estimates that angel investors may be responsible for up to 90 percent of the outside equity raised by start-ups after the capital resources of their

[2] Jeffrey Sohl, Center for Venture Research, University of New Hampshire, *The Angel Investor Market in 2007: Mixed Signs of Growth*, 2008.

founders, friends, and family are exhausted.[3] These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

The best angels provide more than capital to small businesses. These "mentor capitalists" give back to the entrepreneurial economy by making high risk investments directly in early-stage companies in their communities and using their entrepreneurial experience to mentor the companies as they grow. Many top angels got into this type of investment as a way to support their communities – by investing in local companies and providing them with mentoring and connections, they can help create jobs in their towns.

One way in which angel investors are becoming better resources for entrepreneurs is through the formation of angel groups, in which angel investors join together to invest in these companies, share best practices, and bring the power of the group to help make the start-ups successful. There are currently just over 300 angel groups in the United States, with at least one organization in almost every state in the country.[4] These groups add efficiency to capital raising for small businesses because they can be easily located by entrepreneurs, lead to larger investments as individual angels combine their capital with other investors, and provide better feedback as angels work together to evaluate investment opportunities.

Investors, Incubators and Accelerators are Part of Ecosystem for Entrepreneurs

I know from my investment and mentoring activity in Pennsylvania that the entrepreneurs that will create the jobs, innovations, and companies of our future need support from a large community of experts and organizations. Not only are the services and facilities of incubators and private accelerators helpful to the startup and growth of these small businesses, but they also need to connect with a number of experts from the private sector:

- Angel investors, who might invest in them, but who can provide mentoring and coaching from a perspective of having started and grown companies of their own in the past
- Attorneys, accountants, and other private experts who can guide new entrepreneurs through many key business processes and issues
- Successful entrepreneurs and corporate leaders interested in mentoring start-ups
- Venture capitalists, which invest in some of the most successful companies when they have passed the start-up stage and are ready for expansive growth.

[3] Marianne Hudson, Ewing Marion Kauffman Foundation, *Why Entrepreneurs Need Angels – and How Angels are Improving*, Kauffman Thoughtbook, 2005.
[4] Angel Capital Education Foundation database - www.angelcapitaleducation.org/dir_resources/directory.aspx, 2009.

In my opinion, the very best acceleration programs have been successful because they have attracted and partnered with some of the most experienced private investors, entrepreneurs and business experts to provide education, mentoring and coaching to their client businesses on a regular basis. These programs have understood that true experience in building businesses and expertise in the same industries is critical for helping new entrepreneurs think strategically, locate new customers and partners, gain credibility, and avoid problems that can literally kill new businesses.

When you have the combination of incubation and support from the private sector, there are some excellent examples of growing companies and jobs in Pennsylvania:

- In Pittsburgh, Carnegie Speech, a developer of spoken language assessment and training software, was incubated at the Language Technology Institute at Carnegie Mellon University. My angel fund, the Mid-Atlantic Angel Group Fund, made two investments in the company. I am personally active with the company, providing business advice and attending Board meetings. Carnegie Speech is a healthy business that currently employs 17 people (and growing).

- In Wilkes-Barre, a two-person Internet company, PepperJam, began in the local incubator, and then a group local angels provided them seed money and helped them secure a line of credit at a local bank. The company grew to 96 employees and was listed as one of the 500 fastest growing companies by Inc magazine. PepperJam was recently acquired by a public company.

- Morphotek, a Philadelphia company that develops therapeutic antibodies for the treatment of cancer began at the University City Science Center Incubator, receiving capital from Ben Franklin Technology Partners and angel investors. The company now employs 130 people and is building a 60,000 square foot manufacturing plant. Another angel backed company in the same incubator has grown to 40 people and went public a few years after the angel investment.

- Orasure, an Allentown medical device company, got its start in the TechVentures Incubator. More than $1.5 million in angel investment led to a venture capital round and Orasure subsequently merged with a public company, which now employs 250 people.

While companies started in incubators are a small portion of all angel-funded companies, angel investors appreciate the support those new ventures receive so that they are ready for early-state equity capital. We will have a good example of the combination of this ecosystem on April 5 and 6th in Philadelphia when the Private Investors Forum hold the Annual Angel Venture Fair. This event brings together angels and prospective angels from across the region to learn about the latest best practices in angel investing but will also include presentations by 55 entrepreneurs seeking funding, with several companies coming from incubators.

Angels Provide Money, but More than Money

Each of the examples of company support and job growth is repeated across the United States every year with different partners of local entrepreneurial support ecosystems. Angels and angel groups provide important financial capital for the promising start-ups, but I want to highlight the intellectual capital provided by these investors as this support was a key reason for the job growth and success of many firms.

From a personal standpoint, I have used my own background to help the companies I have invested in. Of the 31 angel investments I have been involved in, I have served on the Board of Directors of seven of the companies. The CEOs of these companies appreciate the fact that I have been through their issues and where they would like to grow their businesses because I founded and grew two companies (ETHIX, a managed care company that grew to $50 million in revenues and 250 employees, and American Interactive, which specialized in hospital laboratory data processing services).

In these seven companies in which I served on the Boards, I would work with the CEO and his or her team usually once or twice a month over a three to five-year time period. We tackled many problems and issues, from detailed planning for future investments, to auditing and accounting, to cash shortages when sales were slower than forecasted, to ensuring the right leadership was on board to help the company continue to grow.

The Kauffman Foundation and many experts hear regularly from entrepreneurs that the “mentor capital” or “intellectual capital” was as important, if not more, than the equity investment to their success. Here is an example from a California life science company that received investments from angel groups in Nevada and Arizona, particularly related to their angel mentor:

A member of the angel group brought a wealth of relevant expertise to the table, with more than 25 years of experience in the biotech industry, and as an FDA regulatory and compliance specialist in medical devices and pharmaceuticals. She chaired the company's Scientific Advisory Board. "She was one of the keys to all of this. As a young company, having her background, credibility, and connections helped a lot in seeking additional angel investors. And, she is instrumental in our pursuit of FDA approval of our product."

Angels are Different than Venture Capitalists

Because angels are not as well known as other types of investors, I also want to clarify some differences between angel investing and venture capital. While angel investors and venture capital firms (VCs) are complementary, there are several things about angel investors that make them quite different:

- In general, angels invest in start-up and early stage companies, while VCs provide "growth capital" for companies that are further along in their development. Individual angels are investing $10,000 to $200,000 per company, with angel groups making average investments of $281,000 per company in 2008.[5] This compares to average VC investment of more than $7 million for the last several years.[6]

- Angels, by definition, risk their own personal capital in companies. Given a 2007 academic study in which some of the most skilled and active angel investors lost money in 52 percent of all of their investments, angels take incredible risks in backing start-up companies.[7]

- The estimated overall sizes of the angel and VC markets are roughly the same - $20-$30 billion per year – but the number of companies they invest in is different by a factor of 15. In 2008, VCs made 3,800 investments, while angel investors made an estimated 55,480 investments.[8] And while more than two-thirds of all VC investments were in California, Boston, and New York, and half of all states had only one or no VC deals, angel investments happened in every American state.

Ensuring Angel Investment Stays Healthy

Because of their importance to start-up entrepreneurial businesses and the fact that new firms create most of the net new jobs in the United States, the Angel Capital Association calls your attention to a few public policy issues to ensure the health of these investors:

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[5] Angel Capital Association, *ACA Angel Group Confidence Report*, 2008.
[6] PricewaterhouseCoopers MoneyTree Survey, 2006-2009.
[7] Robert Wiltbank, Willamette University, and Warren Boeker, University of Washington, *Returns to Angel Investors in Groups (published by the Ewing Marion Kauffman Foundation)*, 2007.
[8] PricewaterhouseCoopers MoneyTree Survey, 2006-2009 and Jeffrey Sohl, Center for Venture Research, University of New Hampshire, *The Angel Investor Market in 2007: Mixed Signs of Growth*, 2008.

- **Eliminate threats to angel investment in 2010 Senate Financial Reform Bill** – This lengthy piece of legislation introduced by Sen. Christopher Dodd on March 15th – Restoring American Financial Stability Act of 2010 – includes two short sections that could threaten the size of the angel investor pool and complicate the ability for entrepreneurs to attract angel investment from multiple states. The bill calls for increases in requirements to be an accredited investor, which could significantly reduce the number of angel investors. Decreasing the number of angel investors during the economic recession would reduce access to capital for small businesses. In addition, it opens the door for elimination of federal regulation of accredited investor rules to states, potentially meaning different rules for different states, and increasing the level of difficulty for entrepreneurs to syndicate their deals to investors from different states. This would be unfortunate, just as one of the biggest trends in the field is for multiple angel groups in a region to invest in an entrepreneurial company that needs $1.5 to $2.5 million to grow.

- **Minimize capital gains tax rates** – Most ACA member angels tell us that the 15 percent capital gains rate for their successful investments has been one of the most important reasons for the increase in angel investments in the last six years. These capital gains rates have rewarded risky angel investments, but also put more attention on strong investment processes to ensure that the companies receiving the investment had the best chance of success. Any significant increase in capital gains rates will contribute to decreases in this type of risky investment.

- **Consider tax credits for angel investments in qualified entrepreneurial companies** – In the current economic times, Congress may also want to complement a lower capital gains tax for successful early-stage investments with a tax credit for investments in innovative small businesses. Federal ordinary income tax credits for angel investments in small business start-ups could improve the flow of angel capital to small businesses in communities throughout the country. ACA is aware of three bills being drafted on this issue at this time and appreciates the work done by Members of Congress to date on this subject.

Summary and Final Thoughts

Thank you for this opportunity to describe the unique role and significant impact that angel investors have in our economy, supporting the innovative start-ups that create important jobs in this country. We like being part of the ecosystem of support for these companies, along with incubators, accelerators, and many private partners.

As the Committee considers plans for catalyzing new jobs across the country, we hope that the contributions of angel investors and other private sector experts to the survival and growth of promising new companies will be recognized. Angel investors are passionate about helping build great new companies in our communities. Many angel investors enjoy being part of the entrepreneurial ecosystem, along with business incubators, accelerators, attorneys, accountants, venture capitalists and other private experts who can guide new entrepreneurs through many key business processes and issues.

We also encourage you to let entrepreneurs in your districts who are interested in learning more about angel investment to link to every known angel group on the Angel Capital Education Foundation Web site, www.angelcapitaleducation.org, and to review the "Info for Entrepreneurs" section to learn more about the angel investment process. ACEF and ACA also have resources for investors interested in learning more about becoming angel investors and/or in building their capabilities.

I would be happy to answer any questions you have and for the Angel Capital Education Foundation to provide you with additional information when you need it.