

**Statement  
of  
Dr. Ian Patrick Sobieski, Ph.D.**

**Before The  
United States House of Representatives  
Committee on Small Business**

**May 10, 2006**

**Chairman Manzullo, Ranking Member Velázquez and Members of the Committee:**

**A. Introduction**

Thank you for inviting me to testify regarding the Access to Capital for Entrepreneurs Act of 2006 (“ACE Act”). To provide context for my testimony, I will provide here a brief summary of my background and am attaching a more complete resume for the Committee’s information. My testimony reflects my expertise and knowledge of the private equity market, in particular, the important segment known as angel investing.

**B. Personal Background (gives context to your testimony)**

I am currently the managing director of the Band of Angels. This organization is based in Silicon Valley and is made up of approximately 100 individual members. To become a member one has to be an SEC accredited investor, be an active angel investor, and have been the founder or senior officer of a high tech company earlier in one’s career. Among our membership we have the founders of: Symantec, Logitech, and National Semiconductor and senior executives from: Apple, HP, and Intel. The average Band member is 56 years old and interested in staying involved in high technology enterprises without the need to do so full time. I manage a process at the Band of Angels where we examine 50+ startup companies each month and evaluate them as potential investments. Of these 50, the Band of Angels typically invests in one per month. Last year, the Band invested in 12 startups companies. Entrepreneur Magazine ranks the top 100 sources of capital for startups each year, and each year the Band has been ranked among the top 15.

The Band is usually the first source of capital for the companies we invest in. It is fair to say that, without us, some of the companies we funded would never have otherwise gotten started. Consider then, that in our 11 years of operation, the Band has invested in more than 180 companies which went on to employ more than 3,500 people. Nine of these companies eventually went public; 33 were acquired for a profit to the investors, and more than 60 have gone out of business and were a complete loss. But as a winner or loser, every company that was funded employed people, gave innovation a chance, and let someone try to actualize their dream.

Prior to 1997, when I joined the Band of Angels, I worked at a variety of small startups, the most famous of which was an internet company named Evite.com; later sold to TicketMaster/CitySearch. Earlier, I had a separate career as a scientist. I have a Ph.D. in Aeronautics and Astronautics from Stanford University where my thesis was on the decomposition and optimization of massive design problems into parallel processes. I worked as a research scientist for Kaman Aerospace on a subcontract to the US Army for development of anti-missile systems and held a Secret clearance. My undergraduate alma matter is Virginia Tech where I received a B.S. in Aerospace Engineering and a B.A. in Philosophy. I grew up in Hampton, Virginia and am delighted to be back in my neighborhood to speak with you today.

**C. Statement on Access to Capital for Entrepreneurs Act of 2006 (ACE Act)**

HR 5198, the ACE Act is a simple bill which will create high technology jobs, accelerate innovation, and enhance American competitiveness in the world. The bill is complementary to the government's established support of innovation through SBIR and NIH grants, the SBA, and long-standing efforts to aid in the commercialization of technology from universities. HR 5198's simplicity provides a minimum risk of unintended consequences.

We take for granted now the existence of the venture capital industry as an established source of capital for entrepreneurs wishing to start a venture. But two things may surprise the committee; one is that venture capital, as an industry, is younger than your youngest member. The second is that it is not the primary source of capital for young start ups.

The financial food chain in the United States is ever evolving. In 1860, when Cyrus Field had the dream of laying a telegraph cable across the Atlantic Ocean there was no place else to turn except wealthy individuals. Banks did not make loans of this type, and there was no venture capital industry to support his vision. A hundred years later, when Robert Noyce contemplated leaving Fairchild semiconductor to start Intel, there were still no professional VCs, but the investment banks had developed enough to fund a high risk, technology driven, asset-less, business plan. This success in part catalyzed the formation of the first pure Venture Capital funds in the late 1960s; yet it still took twenty years for this industry to be recognized as a new piece of the financial food chain. Back then, there were a variety of business models for structuring a VC. But by the 1980s, the model had matured and is now standard: a pool of money is committed by investors, professional managers get a fee on this money and deploy it into very high risk ventures. The managers get 20% of the profits and the fund must be wound up in 10 years. The story of venture capital is the story of legal and financial innovation that created a conduit for capital to flow to a riskier class of investments than was previously possible. By 1980, VC was ready to bet on two shaggy haired nerds in their garage: Steve Jobs and Steve Wozniak.

But Venture Capital is not the final solution, or even the first rung, of the financial food chain. I personally know an investor who turned Jobs and Wozniak down for seed funding because he couldn't abide the fact they were not wearing shoes when they pitched him for an investment. Aside from personal proclivities, Venture Capital does not, and structurally can not, provide the capital needs of all the entrepreneurs starting companies. Venture funds are managed for 10 years and thus shy away from investments that may take longer than that to achieve liquidity. The size of the venture funds demand that the average investment size be on the order of a few million dollars. But many companies need a few hundred thousand dollars first, to prove they are worthy for the multi-million dollar investment. Where do these entrepreneurs turn?

Angels are the answer. They always have been the source of seed capital. Angels invest in risky businesses just like VCs, but unlike VCs they invest their own money, have a longer time horizon, and, because they generally have less money than VCs, they invest in much smaller amounts. Angels fill an incredibly important role; they provide the seed

capital to entrepreneurs to get them proved out for later venture financing. They are the first rung on the ladder. VCs really would suffer greatly if angels were not around to give rise to the companies they invest in. The vast majority, nearly 100%, of all companies take money from angels.

This activity is not so well known because individuals act on their own, often do just a few deals, and do not become “branded” the way top VC firms do; with the brand outliving generations of individual partners. But the Angel contribution is enormous.

And so this then comes to the affect of the bill being reviewed by this committee. HR 5198 would essentially lower the investment hurdle for angels to invest in startup companies. As with anything, whenever you make something more cost effective, you get more of it. The consequence of HR 5198 is simple, more angel money will flow into startups, more startups will get started, consequently more jobs will be created, and more ideas will have a chance of success or failure in the marketplace.

What is wonderful about HR 5198 is its simplicity and alignment with the way angels actually operate. Angel investing is an individual activity. The emergence of groups is still nascent and forming. Even for angels who belong to one of the well established angel groups, most investments are made by individuals on their own behalf. The tax credit is an immediate and easily understandable incentive to make these kinds of investments.

Critically, HR 5198 also does not limit the amount of money that can be invested in an entity. Rather, a limit is placed on the individual or fund investor in an annual period. Again, the limitation included in the bill mirrors the way investors act in the angel market. If a lesser incentive was proposed, little or no additional investment would occur. HR 5198 is also broad in scope in terms of the type of small businesses that are qualified investments for the tax credit. It uses SBA’s size standards as a guide while excluding lifestyle and certain other businesses. Any further narrowing of the qualified small businesses would undercut the creation of many high growth, small businesses.

Ultimately, I view HR 5198 as a proposition to accredited investors that if you invest 4 dollars in a high risk start up, the government will cut your taxes by 1 dollar. Compare this 3x leverage on the government’s dollar to the 0.5x leverage in the SBA’s, recently suspended, SBIC program that loans money to venture capital firms (2 dollars of government money for 1 dollar of VC money). Consider also that the angel has a choice between spending his dollars on buying a second home or car or some other luxury good, or investing his dollars into a company that will in turn produce goods, hire employees, and give someone a chance to actualize their dream. Which is the incentive the committee would like to foster?

Consider, a few statistics cited by Carl Schramm, CEO of the Kauffman Foundation at the recent ACEF Angel Capital Summit in New York City, which I will paraphrase: The statistics say that a 21 year old college graduate today will be as likely to start a company in his life as it is that he or she will get married or will become a parent. Today more than

20% of people either work for an entrepreneur or as an entrepreneur in a company that is less than 5 years old. The average 30 year old will have worked for 4 employers before he is 30 (compare this to the fact that in 1960 the average American would work for 4 employers in his whole life). It is clear that small startups are an incredibly important part of the American jobs and innovation economy. Now, speaking for myself, in light of these facts, policies that enhance the creation of such small companies will have net beneficial affects in creating jobs, employment security, fostering of innovation, and maintaining American leadership in innovation.

I know angels, they are individual human beings, and they will look at the credit and realize an immediate benefit for their angel activity. Unlike alternative measures, HR 5198 does not create additional bureaucratic mechanisms. Rather, it focuses directly on the proper tax incentive needed by angel investors and funds. There will be more angel investments made if this tax credit exists. There will be more companies getting the funding they need to start, there will thus be more jobs, and, some of those companies will turn into the next Google or Apple. Which ones? We don't know. The vast majority will fail, but, if the committee wants to increase the odds for it happening, it will support and advance HR 5198.