



April 21, 2022

Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Department of Justice, Antitrust Division
950 Pennsylvania Avenue, NW
Washington, D.C. 20530

Re: Response to Request for Information on Merger Enforcement

The National Venture Capital Association (NVCA) unites the U.S. venture ecosystem to support the formation of high-growth companies and ensure the United States remains the most competitive in the world for entrepreneurs. We convene venture investors and entrepreneurs to shape public policy priorities, develop new industry initiatives, provide premier research, and organize professional development opportunities.

NVCA appreciates the opportunity to respond to this Request for Information (RFI) from the Federal Trade Commission (FTC) and Department of Justice (DOJ) on merger enforcement. Our industry is concerned that proposals to restrict acquisitions focus on the impact these changes would have on large companies and often minimize the positive impact acquisitions have on entrepreneurs, startup employees, and early investors who partner with founders to create American companies. Our comments provide our perspective in this discussion, and we hope the DOJ and FTC will engage with our industry and the entrepreneurs we support as policy changes are contemplated.

Background on venture capital and its economic impact

Venture capitalists are committed to funding America's most innovative entrepreneurs, working closely with them to transform breakthrough ideas into emerging growth companies that drive U.S. job creation and economic growth.¹

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, SpaceX, 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.

¹ For additional information on how venture capital partners with entrepreneurs, please see "What is Venture Capital," available here: <https://nvca.org/about-us/what-is-vc/>.

New research finds that employment at VC-backed companies grows at roughly 8 times the pace of employment at non-VC-backed companies, and VC-backed jobs are distributed broadly across our country, with 62.5 percent of VC-backed jobs outside the states of California, Massachusetts, and New York.² This 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.

A recent survey of companies backed by venture capital showed that four out of five respondents spent at least 70 percent of their total expenses on two activities: wages and compensation, and research and development. This statistic highlights the extent to which venture capital finances job creation and innovation despite the inherent risks in funding companies expected to operate in revenue loss positions for years.³

Professor Illya Strebulaev of Stanford University and Will Gornall of the University of British Columbia conducted ground-breaking research into the importance of venture capital to the U.S. economy. Their research reveals that of the 1,339 companies that went public between 1974 and 2015, 42 percent can trace their roots to venture capital. Those venture-backed companies account for an astounding 85 percent of all research and development spending by companies that have gone public since 1974.⁴

Importance of acquisitions to the startup ecosystem

For venture-backed companies there are effectively three possible outcomes: public company (often via initial public offering, or IPO); merger or acquisition; or bankruptcy. Company failure is the most common outcome, as entrepreneurship is an inherently difficult endeavor. 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 percent of startups expecting to be acquired.⁵

Acquisitions have played a major role in the entrepreneurial ecosystem since the inception of the venture capital industry. Relative to IPOs, acquisitions are *not* more common today than they have been in past years. This is despite the fact that the largest companies in the U.S. are technology companies that presumably are motivated to acquire other technology companies to improve the underlying business of the acquirer. Over the last decade, the average annual ratio of

² “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

³ “Venture Capital Investment at Work,” American Startups and Job Growth Coalition (April 2021), available at: <https://nvca.org/venture-capital-investment-at-work/>.

⁴ “How Much Does Venture Capital Drive the U.S. Economy?,” Stanford Graduate School of Business (October 2015), available at: <https://www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy>.

⁵ “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.

VC-backed acquisitions to IPOs is approximately 12 to 1.⁶ There are less acquisitions today relative to IPOs, with 1,357 venture-backed companies having been acquired in 2021, whereas 181 went public – a 7.5 to 1 ratio of acquisitions to IPOs.⁷ In 2020, the acquisition to IPO ratio was 8.6 to 1, with 886 companies having been acquired and 103 having gone public.⁸

An unfortunate misunderstanding is that acquisitions play a negative role from a competition perspective. The reality is that acquisitions contribute to the health of the startup ecosystem. Entrepreneurs who realize liquidity through the sale of their company regularly go on to found new, innovative companies, hence the term ‘serial entrepreneur’. Entrepreneurs who have sold their company often use those proceeds to invest in other startups as angel investors or VCs. Many of the world’s most successful venture investors are former entrepreneurs who sold their company and use that knowledge to coach the next generation of entrepreneurs on how to successfully build a company. Furthermore, acquisitions help power the financial returns of VC funds, thereby allowing VCs to raise new funds and invest in the next generation of entrepreneurs. The returns of venture capital funds allow the limited partners in funds – be they pensions, endowments, or foundations—to meet their goals and support their constituencies.

Collectively, the above dynamic is termed the “recycling effect” and is one of the key drivers of dynamism in our economy and a critical aspect of successful entrepreneurial ecosystems around the world.

Public policy pressure on acquisitions comes at a particularly troubling time for the entrepreneurial ecosystem because the other positive outcome for a company – an IPO—has come under significant pressure in recent years. The unfortunate reality is 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 55 percent of IPOs; post-2000 that number has dropped to about 36 percent.⁹

Many entrepreneurs and their investors want to see their companies go public, but the fact is that 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

⁶ “NVCA Yearbook,” National Venture Capital Association (March 2022) at 36-38, available at <https://nvca.org/wp-content/uploads/2022/03/NVCA-2022-Yearbook-Final.pdf>.

⁷ Id.

⁸ Id.

⁹ “Initial Public Offerings: Updated Statistics,” Professor Jay Ritter, University of Florida, available at <https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf>.

companies than there were twenty years ago.¹⁰ Acquisition activity for most of these companies represents their only realistic chance of success. For that reason, our industry is concerned about proposals that would make acquisitions more challenging.

Effects on entrepreneurship from acquisition restrictions

The venture capital industry is concerned about the knock-on effects of making acquisitions more challenging. NVCA board member Patricia Nakache of Trinity Ventures testified before the Senate Judiciary Committee in 2019. She stated:

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.”¹¹

Policymakers must understand that acquisition restrictions do not only impact the company making the acquisition; these restrictions necessarily impact the company on the other side of the table that sees an acquisition as the best opportunity for the company founders, company employees who are often compensated by equity in the enterprise, and the investors whose fund returns are helping foundations, pensions, and endowments to meet their goals and obligations.

Professor Daniel Sokol of the University of Southern California and Professor Gary Dushnitsky of London Business School have elaborated on these concerns:

Without the ability to exit as well as having that ability reduced by having one major off-ramp closed off (i.e. acquisition), neither founders nor investors will be able to reap the gains of the appreciation in the valuation of the business. And without appropriate incentives to form new businesses. . .the incentives for founding and growing a business lessen. Increasing difficulty in entrepreneurial exists for founders and investors makes future investment in such ventures less likely, since founders and investors cannot reap the rewards of a timely exit at acceptable valuations.¹²

The impact acquisition restrictions may have on young companies should be taken seriously given the role new company formation plays in our economy. The Kauffman Foundation has written that “[n]ew and young companies are the primary source of job creation in the American economy.”¹³ To keep this vibrant component of the U.S. economy moving forward,

¹⁰ “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>.

¹¹ 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>

¹² See Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and Investments That Fund It, available at <https://nvca.org/wp-content/uploads/2021/06/Mergers-Antitrust-and-the-Interplay-of-Entrepreneurial-Activity-and-the-Investments-That-Fund-It.pdf>.

¹³ See “The Importance of Young Firms for Economic Growth, available at https://www.kauffman.org/wp-content/uploads/2019/12/entrepreneurship_policy_digest_september2014.pdf.

policymakers must not unduly restrict acquisition activity that is an important driving element of the entrepreneurial ecosystem.

Potential and Nascent Competition

The RFI asks for information regarding “Potential and Nascent Competition” in question 7. In recent years, policymakers have focused on acquisitions of nascent competitors as a reason to change acquisition standards. Our industry is uniquely positioned to offer a perspective on this topic given venture capitalists are in the business of creating, funding, and partnering with nascent competitors to incumbents.

We urge the agencies to exercise caution in characterizing or quantifying whether a company constitutes nascent competition. Such an assessment is fraught with uncertainty and therefore the opportunity for a false positive is significant. Consider that venture capital investors are in the business of assessing whether young companies have the prospects for building a successful company. The capital, reputation, and careers of these individuals are on the line as investors determine whether these nascent companies will one day compete against larger players already in the marketplace. Despite experience and training as investors, venture capital investors ‘get it wrong’ more often than they ‘get it right’ when it comes to assessing which companies will be market winners. Since this is the case for professional investors, then surely agency personnel will struggle considerably to accurately assess the future competitive prospects of a company.

The result of a false positive could be to block an acquisition that would have considerable negative ramifications for an entrepreneur. Further, expanding acquisition review standards in this manner would have a chilling effect across the startup ecosystem by dimming the chance of a key liquidity event for founders and aspiring entrepreneurs.

Many have speculated about the intentions of larger companies purchasing smaller competitors and have over relied on anecdotal evidence without examining market dynamics. Professors Sokol and Dushnitsky addressed the commercial motivations for a larger firm’s acquiring a smaller firm:

The primary motivation is that the nascent firm will allow the acquiring firm to create efficiencies that otherwise would not be possible merely by utilizing various strategies short of a merger, such as bilateral contracts (integration via contract), strategic alliances, or joint ventures. Because the target firm is often a strategic complement to the acquiring firm, the merger may lead to reduced transaction costs and asymmetric risk. The merger may also enable learning by doing, encourage knowledge transfers, reduce information leakages, improve investment coordination, or create R&D synergies.¹⁴

The venture industry finds the above comments from Professors Sokol and Dushnitsky to be consistent with our experience in the marketplace.

¹⁴ See Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and Investments That Fund It, available at <https://nvca.org/wp-content/uploads/2021/06/Mergers-Antitrust-and-the-Interplay-of-Entrepreneurial-Activity-and-the-Investments-That-Fund-It.pdf>.

Conclusion

The venture capital industry thanks DOJ and FTC for taking into account our views. We hope that the opinions expressed in this filing serve to offer a unique perspective as the agencies contemplate changes to the Merger Guidelines.