Access to Capital

What is access to capital?

- The average startup launches with just $78,000 in outside funding. Studies show that 57 percent of startups have to rely on personal loans and credit cards for seed funding. Only **2 percent of startups ever receive venture capital and 75 percent of that funding goes to startups in just three states.** In order to promote the growth of new startup ecosystems, policymakers need to craft rules that help support entrepreneurs who don't live near the coasts.

Why does it matter to startups?

Accessing capital is always top of mind for startups. If entrepreneurs are forced to take on credit card debt or turn to family members for seed funding, many innovative companies will simply never get off the ground, and only wealthy founders will find startup success. Crowdfunding offered a solution for many startups. After the Jumpstart Our Business Startups (JOBS) Act—signed into law in 2012 and fully implemented in 2016—legalized equity crowdfunding, more than 1,000 companies in all 50 states and over 80 industries have filed with the SEC to raise money on online platforms.

Where are we now?

While there is a robust venture capital market in the U.S., many startups don't have access to institutional investors on the coasts, and government policies meant to curb investment fraud inadvertently make it virtually impossible for the average investor to support the startup ecosystem. Under current law, it can be incredibly expensive and complicated for startups to raise funds, and they are limited to seeking capital from wealthy investors. To help grow the startup ecosystem throughout the country, policymakers should focus on creating rules that make it easy and inexpensive for entrepreneurs to find investors.

Crowdfunding

In 2016, the SEC implemented Regulation Crowdfunding ("Reg CF"), a securities registration exemption that allows startups to raise capital from small retail investors over the Internet. Reg CF was a monumental shift in capital access policy, opening up early stage capital markets to a whole new range of startups and investors. But, problems with the underlying rules have limited Reg CF's impact on startup activity.

The SEC caps the amount a startup can crowdfund to $1.07 million, an arbitrary limit that does not reflect the true fundraising potential of most startups. Because it can be very costly for an entrepreneur to solicit funds through an equity crowdfunding platform, the fundraising cap limits the range of companies that can afford to use the so-called Reg CF to raise seed capital. To help open up the crowdfunding market, the SEC should raise this funding limit to at least $20 million. A higher limit will make equity crowdfunding more cost-effective for a wider range of entrepreneurs and will open up new investment opportunities to everyday Americans.

Accredited Investors

To protect small investors from potentially ruinous losses in the private capital markets, U.S. law prevents all but the wealthiest investors from participating in most types of early-stage investments. Generally speaking, startups can only seek investment from qualified "accredited investors"—individuals with an annual income of more than $200,000 or $1 million in assets other than their home or coupled with $300,000 combined annual income. This greatly limits the amount of capital available for early-stage entrepreneurs and prevents most Americans from participating in the startup ecosystem.

Fortunately, policymakers are recognizing that the traditional accredited investor rules present problems for the tech economy. The House recently passed legislation, S.488 the JOBS and Investor Confidence Act ("JOBS Act 3.0") that makes a range of changes to capital formation laws, including updating defination of "accredited investor." While the bill maintains the current income and asset qualifications in their current form, it would create a new pathway for individuals with adequate investing or startup knowledge to qualify as an accredited investor. Allowing sophisticated investors to support early-stage companies regardless of their annual income will help increase the pool of capital available for startups while minimizing the risk to unwary investors.

Questions?
Contact Engine's Executive Director, Evan Engstrom, at evan@engine.is