



Written Testimony

of

Eric Koester

Founder and Chief Operating Officer, Zaarly

to the

**Committee on Oversight and Government Reform, Sub-Committee on
TARP and Financial**

U.S. House of Representatives

“America’s Innovation Challenge: What Obstacles Do Entrepreneurs Face.”

NOVEMBER 2, 2011

Good morning Chairman McHenry, Ranking Member Quigley and members of the committee. My name is Eric Koester. I am one of the founders and the Chief Operating Officer of Zaarly, a real-time, online community marketplace.

In your invitation letter, you asked me to address the challenges entrepreneurs of today face, specifically around the matter of raising capital. I am grateful for the opportunity to discuss my views this morning.

Introduction

Because of my background, I hope to provide a unique vantage point into the challenges faced by entrepreneurs. During my career as an attorney specializing in advising entrepreneurs, small businesses and startup businesses, I was able to work with hundreds of entrepreneurs across dozens of industries. Then I too followed the allure of the “American Dream” and left the practice of law to launch my own full-time business venture (Zaarly) earlier this year with several close friends and partners.

As a result of these experiences, I have what I hope is some relevant and useful insights into the face of today’s entrepreneur, the challenges that entrepreneurs of today face and the changing landscape for today’s early-stage businesses and business owners. My testimony today will focus on those aspects of the changing landscape and how enhancements in private company financing regulations can not only enhance job growth and spur new business creation, it can also push additional technological innovation.

My testimony will focused on three key areas:

1. Examination of the New Landscape for Entrepreneurs and Small Business Owners
2. Lessons from a fast-growing company, Zaarly
3. How Enhancements to Regulations Can Aid Today’s Entrepreneurs

I also had the privilege to testify before the full Oversight Committee in May 2011 and I am thankful to see the work of this committee has helped to advance many of the reforms discussed during that hearing. During that hearing, my testimony focused on the reduction of regulatory friction for new business ventures and entrepreneurs. Those same beliefs hold true – that the most effective reforms can help entrepreneurs 2.0 (or whatever version today’s entrepreneurs might be appropriately called) more effectively focus on building their businesses.

Why These Reforms Matter

Before becoming a full-time entrepreneur, I was fortunate to work with hundreds of entrepreneurs, small business owners and business founders as their attorney or advisor. Most of those experiences started the same way: ‘I have a great idea... can you tell me how to raise enough money to quit my job and do it.’ For most of these early conversations with an

entrepreneur my answer was consistent: ‘How much have you saved up or how much can your family help you pursue your dream?’ For those of means, the answers were easier than those without.

As the economy worsened in the past three years, startup lawyers began to see more individuals looking to strike out on their own out of necessity after they were unable to find a job. And unfortunately, the answer to my questions above was more often than not: ‘not enough.’

Starting a business is never easy. There are thousands of ways for a new business to misstep – from team dynamics to market forces to inability to find financing. The reforms being discussed by the Oversight Committee will not necessarily make a starting or expanding a business any easier. There are still thousands of ways for a business to fail. However, the reason I believe reforms of regulations around private company fundraising are important are that they provide a new opportunity for these businesses to potentially succeed; to find that source of capital they need to grow; to raise that additional cushion to hire more employees; or to provide a few more months of runway to validate the business model. By providing more avenues to raise these funds, we create the opportunity for more businesses to succeed and that is why I am passionate about the need to expand opportunities by enhancing these regulations.

The current regulatory regime puts unnecessary limits on business owners and investors who want to help those businesses. If a business owner is able to convince 100 neighbors to put in money to open a neighborhood coffee shop, we should not only permit it, we should encourage it. If an entrepreneur can advertise that they are looking for investors on their company’s blog or through social media and use new advertising mediums to find excited partners, then we should facilitate that. And if a business needs thousands of smaller partners to get off the ground to facilitate ownership and partnership, then we should allow it.

Changing Landscape for Entrepreneurs and Business Founders

My time advising entrepreneurs and small business owners has been important in informing my views of the new world faced by the founders of these small firms. And just as important, I’ve been fortunate to learn those lessons firsthand through my own experiences as an entrepreneur with Zaarly and other business ventures. These experience have taught me that the challenges faced by businesses even ten years ago are changing rapidly – and the regulations designed decades ago no longer match the realities for today’s entrepreneur and small business owner.

Reduction in Costs of New Business Formation. Technology has helped reduce the cost of starting a business today. This is not to imply that today’s entrepreneur has it easy (starting a restaurant still requires money for the lease, the equipment, the inventory and the advertising). However, technology has helped reduce certain costs such as bookkeeping, advertising, data storage, equipment rental and general administration. For today’s technology-heavy businesses, this can be understood simply by looking at the reduction in the cost of storing data. In 1980, the average hard disk cost to store just one gigabyte of data (the

amount we routinely store or send today for a single photo) was \$3 million. By 1990, that cost had fallen to \$8,000, by 2000, \$30 and today less than 8 cents. This means that today's businesses don't necessarily need millions of dollars to start and succeed. However, it does not mean that there are not costs to start a business – especially in the new information economy.

Explosion of the Freelance Economy. Today one of ten workers is not an employee of the company they work for – they represent independent contractors, freelancers and individual entrepreneurs that can help businesses be more efficient and effective.¹ And this trend is only expected to continue with common freelance professions such as graphics designers, software developers, photographers, writers and artists all expected to see their ranks grow by ten percent by 2018.² These individuals are themselves businesses who may need small amounts of money to start, grow or expand.

Emergence of International Competition (even earlier). Groupon and Living Social, online group buying and coupon sites, have each become success stories in relatively short periods of time. Those businesses also quickly found out how fast international competitors can emerge, with the “Groupon-of-fill-in-the-blank-country” popping up almost as quickly as Groupon or Living Social were able to grow their businesses domestically. Today's ‘flat’ world has created competition from not only across the street, but also from across the world.

Challenges to obtain Bank Loans. In years past, business owners would go to their local bank to obtain a loan to start their business. Today, fewer banks are lending to small businesses and more early stage businesses do not have the right profile to obtain bank loans. That means that banks no longer represent an option for today's technology-based or freelance-based businesses – the very heart of businesses that are growing the fastest.

What do these changes mean for today's business owner or entrepreneur? It means that raising capital to start or expand the business may not follow the traditional paths from just a few years ago. Further, these changes mean that to keep up with the world, we need to continue to think progressively about supporting new innovation and new opportunities for business growth.

The Story and Lessons of Zaarly

Entrepreneurship spurs job creation. Data from academic research confirms the importance of young companies in job creation (Kauffman research notes that companies less than five years old contribute two-thirds of new job growth). And anecdotal evidence shows that new companies such as Zaarly, Groupon, Facebook and others drive new job creation – in fact, Zaarly has added more than thirty (30) new jobs to the U.S. economy in just under eight months since being founded in a weekend.

¹ www.navigateeconomics.com

² www.bls.gov/oco/ocos090.htm

Zaarly is a marketplace that connects people buy and sell with people nearby. In just 5 months, Zaarly has had nearly \$8 million of requests of all types posted – people looking to find a plumber, people wanting to buy a used lawn mower, people hoping to find a cleaning person, or people hoping to buy tickets to the big game. In many cases, these requests are for services or goods that may never have been bought or sold without our platform. And as a result, we've seen people in local communities keep million of dollars in their community. Today, Zaarly provides a way for a stay-at-home mom to make extra money with her part-time cleaning business; an opportunity for a student to earn money editing term papers; and a source of new leads and business for the local small business owner.

The reasons for Zaarly's rapid growth are many. But two things in particular stand out: 1. Zaarly was able to convince smart, savvy investors to invest in the company early in our lifecycle; and 2. The Zaarly marketplace helps other individuals and businesses, specifically freelancers, entrepreneurs and business owners that are looking to make money in their local markets.

Zaarly was fortunate to receive funding early in its life cycle to help the business hire employees and grow. Additionally, Zaarly has grown because we provide a marketplace for individuals looking to save money by finding a good or service locally or looking to make additional money in their own community. We are most proud of the fact that Zaarly not only contributes to local economies but it spurs job creation of news businesses serving these local economies. We are seeing businesses utilizing Zaarly in places from Nashville to Kansas City to Seattle to Boston.

And as a result of our ability to raise funds, in less than eight months, Zaarly has been able to add these thirty jobs and to help local individuals earn money in their own neighborhoods. Examples like Zaarly showcase the importance of maximizing the opportunities for smart entrepreneurs to raise funds – and why we should reduce hurdles by expanding the current regulatory regime to allow for more investors, to open doors for crowd funding and to permit broader fundraising solicitation. Today, an individual who has some graphics design training can utilize a platform like Zaarly to find clients and by finding new ways for them to raise funding, we can help them expand their business and add additional jobs to the economy.

As the U.S. works to retain its leadership status in the innovation economy, so too must our government continue to push innovative reforms in the funding environment that can continue to inspire the next generation of businesses.

Importance of Regulatory Reforms

Many of us were enthralled with the breakout movie hit *The Social Network*, which told the story of the founding of Facebook. Facebook was started in a college dormitory at Harvard by a smart young man, Mark Zuckerberg. Facebook also had the fortune to have received a few thousand dollars from a family friend to get the business started. And while the dollar amount may not have been significant, the question remains about what could have been without those funds. What if Mark Zuckerberg hadn't had that money so readily available? What if Mark Zuckerberg had started Facebook at a community college and needed a few

thousand dollars to get it started? Innovation comes from unlikely sources and while we cannot ensure this innovation turns into Facebook, we can make sure that these entrepreneurs have the most opportunity to succeed possible.

I support regulatory reforms that allow for the broad use of crowdfunding and similar tools for businesses to raise up to \$5 million, that eliminate the rules restricting general solicitation and that align with the currently proposed revision of accredited investor rules and the expansion of shareholder caps. Ultimately, I believe these reforms will open up new channels to fundraising. However, the efforts to expand options for new ventures to raise funds are not completed by these reforms. Instead, the efforts to provide channels for businesses to raise funds from existing sources such as banks or sophisticated investors and new sources such as community members or neighbors must continue to be examined. It may be one of these channels that will provide the necessary funding for the next Zaarly, Amgen, or Facebook or it may be a channel that we have not yet thought about.

Does this expansion induce new risk to investors? As we expand opportunities for businesses to leverage solicitation mediums online, as we permit crowd funding, as we expand the number of investors, and as we permit more individuals to participate in funding private companies, how do we continue to protect the investors? I believe the answer is no. In fact, I believe that today's investors will have more protections than ever before simply by trusting the market to utilize the very tool that has helped lead to the explosion of new businesses: the Internet.

Today, individuals have their reputation, their experience and their backgrounds on display every day all across the Internet. If you want to learn about anyone, simply use a search engine to find articles, credit scores, social networks and more with a click of the mouse. This explosion of data also provides new insights by these potential investors into the individuals and the company they are investing in. You can quickly discover prior job references online (through a tool like LinkedIn), find common connections (through a tool like Facebook), read articles by or about the business (through tools such as search engines) and ask a broader community for feedback on any person or business (through tools such as Quora or Twitter). The expansion of tools to discover information about any person or business, and the ability to discover "reputation" quickly and easily, puts investors in an incredible position to protect themselves.

As platforms for crowdfunding, online solicitation of investors, and business tracking grow, those very platforms can leverage all this available online data to provide more information to prospective investors than ever before. These tools will reward individuals and businesses that build strong reputations for openness and collaboration, rather than hide behind secrecy and opacity. Investors will invest in companies through platforms that help them to identify, sort and separate the best businesses from those that are not a good fit. And self-interested investors will utilize platforms that provide the best protections.

There will of course be situations where unscrupulous individuals can beat the system and will defraud people. That has happened from the dawn of time and no regulatory scheme can

fully protect investors. However, by empowering new platforms and individuals in these areas, we should expect even greater innovations to occur.

Conclusion

In conclusion, I want express my sincere gratitude to Chairman McHenry, Ranking Member Quigley and members of the committee for your time today. Spurring innovation, small business growth and creation and expansion of fundraising opportunities for new entities is without question a key aspect to job creation in America. You could even argue that these regulations will play the key role in new venture creation and will ultimately lead to the creation of millions of jobs from more Zaarlys, Facebooks, Home Depots, and Amgens, as well as the thousands of neighborhood and community businesses.

I am passionate about the entrepreneurial ecosystem as a member of the ecosystem and as a concerned citizen. The opportunity to assemble a panel of outstanding thought-leaders to discuss how to spur job growth, increase innovation and increase competitiveness is a crucial point of discussion. I thank this committee for its efforts to find ways to spur job creation, innovation and global competitiveness. With a continued eye on innovation, we can help America play a leadership role for the future.

Thank you.

Eric A. Koester

Founder & Chief Operating Officer Zaarly, Inc.

Eric Koester is the Founder and COO of Zaarly, a real-time online marketplace.



Eric previously served as VP Operations & General Counsel at Appature Inc., a cloud-based relationship marketing software company. Prior to joining Appature, Eric was a corporate and securities attorney for Cooley LLP where he represented public and private technology, energy and life sciences companies, venture capital firms and investment banks in a wide range of transactions, including public offerings, mergers and acquisitions, securities issuances, technology licensing transactions, corporate partnerships, commercial agreements and venture capital financings. Before joining Cooley, Eric was the Financial Reporting Manager at Ventana Medical Systems, a leading diagnostics company acquired by Roche, and began his career in Morgan Stanley's financial

advisory services group. Eric has also founded and operated several technology and consulting businesses during his career.

Eric's current venture Zaarly, is based in San Francisco and is backed by investors including Ashton Kutcher, Felicis Ventures, Bill Lee, Naval Ravikant, Lightbank, SV Angel, Paul Buchheit and Thrive Capital. Eric and his co-founders conceived of and built the prototype for Zaarly in February 2011 at Startup Weekend Los Angeles, a 54-hour event aimed at entrepreneurs and technologists. Less than 30 days after being founded, the Zaarly team had built its initial version of the application, secured financing, and ran a successful "market experiment" at the South by Southwest Interactive (SXSWi) Conference in Austin, Texas, where Zaarly processed over \$10,000 in transactions in less than 48 hours, and launched the product nationwide in May 2011 with nearly \$8 million in requests on the site since then. The business has been profiled in publications such as *The Wall Street Journal*, *The Huffington Post*, *The New York Times* and *TechCrunch*.

Zaarly helps people get what they want, when they want it from people around them. The platform puts buyers at the center of transactions by allowing them to make requests for the things they need from people in their own communities. When a buyer posts a request to Zaarly --- whether for food delivery, the latest tech gadget or reservations at the hottest restaurant in town --- people in their community who have what they are looking for can provide it. This two-way, community-powered process provides convenience and flexibility to buyers while allowing sellers to make money fulfilling requests from the people around them.

Eric is a well-known author for private companies and entrepreneurs, including the books *Green Entrepreneur Handbook* (2010) and *What Every Engineer Should Know About Starting a High-Tech Business Venture* (2009). He is a frequent speaker at conferences on the topics of small businesses and startup companies, green businesses and technology law. Eric was

named one of the 40 under 40 by the Washington Business Journal; the Technology Hire of the Year by TechFlash (Seattle) in 2010; the Best Service Provider to Startups by Seattle 2.0 in 2010; and the Outstanding Young Lawyer for the state of Washington in 2009. Eric holds a JD from The George Washington University School of Law, a BA in Business Administration from Marquette University and is a certified public accountant in the State of Washington. Eric is married to Allison Koester, a professor of Accounting at Georgetown University.

**Committee on Oversight and Government Reform
Witness Disclosure Requirement – “Truth in Testimony”
Required by House Rule XI, Clause 2(g)(5)**

Name: ERIC A. KOESTER, Esq.

- 1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2008. Include the source and amount of each grant or contract.**

None.

- 2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.**

None. I am testifying on my own behalf. I am a founder and the chief operating officer of Zaarly, Inc., a privately held company.

- 3. Please list any federal grants or contracts (including subgrants and subcontracts) received since October 1, 2008, by the entity(ies) you listed above. Include the source and amount of each grant or contract.**

None.

I certify that the above information is true and correct.

Signature:

A handwritten signature in black ink that reads "Eric Koester". The signature is written in a cursive style with a horizontal line extending from the end of the name.

Date: November 1, 2011