Written Testimony

of

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"The Future of Capital Formation"

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Hello and thank you to Chairman Issa, Ranking Member Cummings, and Members of the Committee.

My name is Eric Koester. I am the one of the founders of Zaarly, a location-based, real-time community marketplace launching (crossing fingers) nationwide this month. I greatly appreciate the chance to testify before you today.

As a former startup lawyer turned entrepreneur myself, I've had a unique opportunity to advise, counsel and educate thousands of entrepreneurs and early stage businesses, as well as to live the life of a business owner. Therefore, I have seen the challenges affecting today's entrepreneurs and small businesses first-hand. My testimony today is aimed to highlight specific concerns from the mouths of entrepreneurs that affect the ability of our young companies to hire and increase jobs, to innovate, to compete globally and to grow the broader economy.

Supporting entrepreneurship, startups and small business is about as American as apple pie. But I feel that if we are not careful and cautious, we run the risk of snuffing out our brightest future stars before they have the chance to grow into the next Home Depot, Office Max, Microsoft or Apple.

Today I would like to tell the story of why it is important to act to decrease friction for entrepreneurs and small businesses, to increase liquidity in the private markets, and to regain a leadership position in the support of early-stage businesses. Others on this panel will be better suited to provide information, data, research and analysis on broad market trends, financial markets and public offerings. My purpose it so showcase how regulatory issues impact the business owner or new entrepreneur. These individuals represent the next Facebook, Amgen or Costco, and removing barriers to their success is critical. First, I will quickly share the story of my journey from lawyer to entrepreneur, and offer lessons from the mouths of other entrepreneurs – stories that form the baseline of my support for certain of my key recommendations below. Second, I will share the story of my company Zaarly, which I believe is an example of the importance of decreasing regulatory friction on early stage businesses. Finally, I will discuss several key initiatives that I believe should be enacted, enabled or reformed to spur entrepreneurship, innovation, investment in private companies and the broader growth of our economy.

My Journey: From Lawyer to Entrepreneur

When I was a child, I'd grown up watching my father leave Enron (before its downfall) to start his own business. I was even more fortunate to be able to spend my summers and hours after school helping with tasks and odd jobs around his office. It was those early experience that led me to undertake some consulting work and some web design in high school and college – in what I'd call my earliest "entrepreneurial" activities (save those neighborhood lemonade stands while in grade school).

After college, I took a more traditional route beginning my career at a large public, financial services company before transitioning to a smaller public, biotechnology company. After a few years in 'corporate' America, I returned to school to earn my law degree and became an attorney at a large, five hundred person plus law firm, focusing on corporate and securities law. In spite of working for such a large law firm, I was fortunate to join a practice with a specialization in startups, small businesses, early-stage private companies and entrepreneurs to satisfy my own entrepreneurial leanings. Following nearly five years in the legal trenches advising entrepreneurs and assisting with corporate transactions from formation to equity and debt financings to mergers and acquisitions, I took my first steps into the startup realm by joining one of my clients, a venture-backed company in Seattle, and just five months later I officially took the "leap" to found my own business, Zaarly, which I'll speak about further.

While taking this leap to entrepreneur has been extremely fulfilling and rewarding, owning your own business is a guaranteed way to get more grey hair and less sleep. Founding a business is a difficult and challenging proposition – as the founders have each forgone paychecks and time with our families to hopefully build something great together. The founders of Zaarly are fortunate to each have some savings and to have received investment early in our tenure, but such a leap is not without its share of risk and challenge.

And while we as a society reward the victors of the entrepreneurial 'leap' such as Steve Jobs, Bill Gates, Sam Walton, Richard Branson and T. Boone Pickens, there are countless individuals that will never get rich, will never grace the cover of a magazine, and may actually find financial ruin. Because of the risks these entrepreneurs take and the rewards such risks provide for us as a country and a society – from technology and medicine to safety and convenience – I believe it is important to encourage innovation, calculated risk-taking and broad entrepreneurship.

My journey from lawyer to entrepreneur has taught me that most individuals become entrepreneurs because they believe they can make a difference in the world – which is the very reason I left legal practice to found Zaarly. Our goal is to revolutionize person-to-person commerce and help to connect communities of buyers and sellers living and working next to one another. As we decrease friction in our economy for want-rapreneurs[1] to become entrepreneurs (more funding sources, simplified regulations, etc.), the hope is that more entrepreneurs can begin to revolutionize society themselves.

From the Front lines: Entrepreneurs, Business-owners and Startups

My story is not unique and my time in the entrepreneurial community as an entrepreneur, a startup lawyer, an advisor, and a volunteer has given me a unique window into the minds of others in the entrepreneurial community. Today's entrepreneur, being an owner of a

[1] The phrase "want-rapreneur" is used to describe an individual with substantial interest and initiative in entrepreneurship that has not yet joined or started his or her own venture. Due to factors such as risk-aversion, lack of a team, or other factors, a want-rapreneur is unable or unwilling to become an entrepreneur and either found a business or joins an early-stage venture.

neighborhood bakery, a person listing their crafts on Etsy or eBay, an independent auto mechanic or an owner of a technology-based business like myself, is driven by one overriding fact: Do More Faster. I have recognized this in my brief stint as a full-time entrepreneur, being pushed to build a product faster, scale a marketing team faster, and meet consumer demand faster than ever. But this speed also provides incredible opportunity to fill unmet market needs or to create a new way to do business.

An outstanding example of the "Do More Faster" mantra is a Seattle-based nonprofit, Startup Weekend.[2] Startup Weekend is an organization that aims to provide experiential education for entrepreneurs, offering low-cost educational programs for individuals interested in forming businesses or learning more about entrepreneurship. Startup Weekend's signature 54-hour event allows an entrepreneur to go from idea to prototype in a weekend. This has led to more than 3,000 startups being prototyped in the past 3 years. This organization and its participants showcase the speed of technology and the power of the entrepreneurial ecosystem.

What took eBay nearly ten years to accomplish in size and scope, took Groupon only two years. And while technology has provided newfound speed to market, it has also brought with it the ability of global competition to catch-up to American entrepreneurs at record speed. Fast-growing businesses from Groupon to Twitter to Facebook has each faced new challenges from international copycats, which eBay did not truly face in its early days. Now, an entrepreneur is pushing to 'do more faster' just to prevent competition or copycatting from smart, well-trained and well-funded (often by government funds) entrepreneurs and businesses in nations and cities around the globe. It's no longer a race between businesses with broad ambitions in Boston, Austin, Miami or Los Angeles. Now, it is a race between entrepreneurs in Beijing, Mumbai, London and Sao Paolo.

So just how are today's U.S. entrepreneurs working to 'doing more faster'? There are many ways, from better training, sharing of information and identifying a better workforce. But perhaps above all else is the use of technology. By utilizing technology to sell over the Internet, to save money, to set-up remote offices, to allow home-based workers, or to reach new markets, businesses are quickly able to gain efficiencies. At every turn, business owners and managers are trying to squeeze more out of each hour and each dollar… trying to 'do more faster.' These tools are not only in the hands of U.S. businesses; they are in the hands of everyone with a computer and an Internet connection, making the stakes all the more important.

And while these entrepreneurs continue to try to do more, and do it more quickly to beat international competitors to market, these U.S. entrepreneurs are also faced with externalities that limit their ability to move quickly, to take calculated risks, and to build the next great American businesses. These externalities are what I like to call "friction points." Friction

[2] Eric Koester currently serves as a volunteer advisor to Startup Weekend, a Washington state non-profit company, and serves as the interim general counsel (pro-bono). Eric has no economic or other interests in Startup Weekend.

points are places in business, commerce, regulation and life that slow down a business or a business owner from being able to 'do more faster.' If a machine has obstacles or 'friction points' that slow its operating speed, break its parts, or require maintenance (or worse, the machine to be shut down entirely), we lose efficiency, speed and ultimately dollars. In the same way, friction points from regulations limit efficiency and cost businesses billions annually.

However, I do not suggest that we should scrap all regulations and make America the 'wild west' of capitalism. I agree that regulations are important and serve a key need within our society and the business community. Instead, I suggest that some of the current regulations and regulatory scheme place an unfair and undue burden on the entrepreneurs who least need these friction points. These friction points are discussed in more detail below.

From spending time with entrepreneurs and small business owners, I believe there are a few key lessons from the proverbial "entrepreneurial field."

1. Building a small business is cheaper and easier than ever before.
2. However, building a business is not "cheap" and still takes substantial resources.
3. Raising funds is difficult and identifying prospective investors is extremely distracting to the task of building a business.
4. Removing friction (business, commerce, human capital, regulatory) is crucial to be able to do more with less.

While the earlier example of Startup Weekend producing thousands of new entrepreneurs and startups is a positive one, the challenges set forth above limit the number of these potential businesses that become a full-time priority for these want-rapreneurs. In the U.S., many of the businesses and projects begun at Startup Weekends remain weekend projects or part-time projects because of that hurdle of initial funding and overwhelming regulations. Outside of the U.S., the same startups formed from Startup Weekends abroad are more likely to receive support from governments and business leaders, taking these projects to a full-time business with greater frequency.

This is a simple, but troubling example that highlights the fact that the U.S. cannot rest of its past successes and an ecosystem without a bridge from idea/prototype to a true business. In the earliest days businesses may only need relatively small dollar amounts (oftentimes measured in thousands of dollars) to transition from a weekend project to a true entrepreneurial venture. However, the high compliance costs of such raising small dollar amounts cause these projects to languish.

With new firms (those in business less than five years) accounting for the vast majority of job creation in the U.S., it is without question important to our economic future to remove friction points and encourage today's risk-takers to build tomorrow's anchor businesses. This means continuing to reward risk, support failure and encourage innovation. As a society, our regulations are meant to protect all parties and to continue the practices that initially placed the U.S. at the center of the innovation economy.

The Story of Zaarly: Why "Fast" is the New Black

The story of Zaarly offers an important case study into the importance of removing barriers and friction points, and why smart regulations can encourage innovation and spur innovation.

It is somewhat difficult to believe, but eleven short weeks ago, Zaarly did not exist. It did not exist as a company, as a team of employees or even as a "fully baked" idea. However, in the past 11 weeks, a small and dedicated team has been able to build a robust technology product, raise funding from angel investors, open two offices, hire a nearly a dozen employees, retain numerous contractors, file for several patents and trademarks and ready a marketing and roll-out strategy. It is our hope that with some luck and the support of consumers that we can build the next great electronic commerce company in the vein of Amazon, eBay or Groupon.

We at Zaarly are one of the fortunate early-stage companies – a by-product of an interesting idea, good timing and an experienced team. But were it not for that idea, timing and team, our company might not be preparing for a nationwide launch. Today, we have engaged in substantial job creation, innovation development and some very broad ambitions, all of which are supported by some very forward-thinking investors and a dedicated team. The specific reasons behind the speed and early-success of Zaarly can be debated extensively, but it is without question that the ability to understand the formation, founding and funding process allowed our team to move with deft speed and to "Do More Faster." We are fortunate to know accredited investors, to be able to avoid any sort of general solicitation, to be able to limit our shareholder base, and to know to bypass funding sources that won't pass muster. However, this process and knowledge is not possible for most companies and even for those that have this good fortune, it is by no means easy and takes a team with dozens of companies to their credit and hundreds of advisory experiences.

It is unfortunate, but there are dozens and dozens of ways an entrepreneur can hit friction points in the current regulatory scheme. This is why I respectfully urge the parties gathered here to take actions to eliminate such friction – and to make it so that any business can move fast, even without the experience of dozens of startups and a securities lawyer on the team. Zaarly was just one of fifteen companies that was "founded" over a weekend in February at a Startup Weekend held in Los Angeles. But the reality is that many more of those entrepreneurs and businesses *could* or *should* be full-time endeavors for the individuals that founded them three months ago.

The story of Zaarly highlights the following important lessons:

1. Regulatory Schemes are complicated for early stage businesses
2. Sufficient funding sources are crucial to speed
3. There are dozens and dozens of ways to trip up a business along the way through the founding, formation and funding path
4. Alternative funding sources without high operational costs are crucial for encouraging want-rapreneurs to become true entrepreneurs.

Again, I do not intend to state that we should make it riskless to undertake any entrepreneurial venture nor do I say that we should not put in place certain protections for parties working with or investing in early-stage businesses. However, I posture it is incredibly important for the country to focus on obstacles that prevent individuals from beginning or joining true entrepreneurial ventures.

Leverage Your Best Assets: Unfair Advantages

The final and perhaps most important piece of this testimony is to provide recommendations based on personal experiences in the startup ecosystem. The U.S. entrepreneurial ecosystem has been the envy of the world and therefore other countries have done a great deal of research and investigation into how to spur innovation in their countries. We in the U.S. have the distinct advantage of a population that fosters and encourages innovation, risk-taking and entrepreneurial behaviors. And, as a result, it is crucial to utilize these "unfair advantages" to hold a leadership position in the world of innovation.

While these unfair advantages are clearly the first step towards new job creation, innovation development and economic competitiveness, it is also in our interest to eliminate barriers that slow the effectiveness of this unfair advantage in fostering innovation.

I respectfully submit that with the changes in the business culture encouraging business and entrepreneurs to "do more faster", it is even more important today to identify ways to regain competitive excellence in support for early stage businesses. And, given the experience of Zaarly, a business able to utilize nearly forty years of experience in the startup ecosystem to move quickly, build a team and product, and launch a consumer product, it is clear that the more we can eliminate common points of friction, the better for our broader innovation economy.

I respectfully encourage several approaches to reform and modify existing policies to better support entrepreneurs, small businesses and startups. I group these approaches into three broad categories, with a fourth important category to encourage innovation that may be outside the scope or the purpose of this hearing (but still of key importance):

1. Private Company Fundraising and Financing Regulations

In general, I respectfully request that regulations governing private company financing be thoroughly examined with an eye to decrease the regulatory scope, simplify procedures, and ensure that the cost-benefit of regulations for raising funding for small investments be met. Investors continue to be in the best position to protect themselves in their investment decisions. This may include contractual requirements for audits of financial statements, seats on a board of directors, or the receipt of regular financial statements.

More specifically, I encourage the removal of the Ban on General Solicitations, which limits the ability of private businesses to locate and identify prospective investors. In addition, I encourage the creation of regulations to extend/expand the concept of accredited investors to individuals that are deemed to be sophisticated based on their knowledge, experience, education or training, thereby allowing these individuals to participate in the private company investment market.

2. Private Market Regulations

For many fast-growing private companies, there are two traditional paths to providing for liquidity of their stock for investors: a sale of the company or an offering on the public markets. Yet with the increasing costs of public company compliance and offerings, a third approach has developed that now offers shareholders and employees limited liquidity while reducing some of the burden on these fast-growing businesses: private markets.

For later-stage businesses, these private markets offer an alternative to a sale of the company or a public offering to provide liquidity to investors and employees. At the same time, this provides a greater sense of visibility and market pricing into the valuation of a business. This alternative option has an added benefit for early-stage businesses – it provides confidence for early stage investors that more than a single path to an exit event exists. Now, investors have the option of public or private offerings and a merger or acquisition event.

As a result, I respectfully urge the creation of more flexible rules and regulations to permit businesses to remain private companies, while allowing for the additional liquidity these private market provide. This includes modifications to the 499 shareholder threshold rules and the related solicitation regulations.

3. Community-Funding Opportunities

Today's businesses are looking for funding from new sources (community-powered investment, angel investors, alternative loan structures, revenue-factoring, etc.) Dozens of organizations are powering microloans, crowd sourced social entrepreneurship and group-powered projects, most of which remain focused on international entrepreneurs or for non-profit aims. Yet the reality is that these structures provide a unique and powerful solution for current funding shortfalls affecting today's small businesses and startup companies. Imagine a day when a community can come together and fund community-centered businesses through microloans, micro-investments or crowd-sourced funding. It is important for the continual protection of investors, but we should take lessons from organizations using microlending and crowd sourced funding to alleviate poverty in other nations to also spur private investment in community-organizations.

I respectfully encourage the investigation of regulations to permit groups of individuals, businesses and organizations to make investments in private companies, small businesses and startups.

4. Immigration Reform

As an entrepreneur and supporter of the entrepreneurial eco-system, I also urge the Congressional leadership here to consider the importance of immigration reform in the long-term success of this sector. While not directly related to the hearing at hand, I urge a strong examination and consideration of two key programs which directly support and benefit the startup ecosystem:

a. Expansion of visa programs for individuals intending to work at early-stage businesses. Talent remains at a premium and there is a clear shortfall of citizens and foreign residents with the technical and scientific skills required to build businesses required in the innovation economy.
b. Startup Visa. Proposed legislation described as a "Startup Visa" to provide a mechanism for foreign individuals starting qualified businesses in the United States to remain here so long as they meet certain pre-set criteria. This legislation will encourage investment in foreign talent intending to build businesses in the U.S. that increase jobs and build long-term economic value.

While I recognize immigration reform is outside the scope of this specific hearing, I believe talent is one of the most important resources required for building a successful business. America continues to serve as a location where individuals from the world-over hope to come and participate in the entrepreneurial ecosystem. We should leverage this fact to help support existing businesses as well as new businesses that can or will be formed by these foreign entrepreneurs.

Conclusion

In conclusion, I want express my sincere gratitude to Chairman Issa, Ranking Member Cummings, and each of the members of the Committee for your time today. 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'd also like to thank the SEC and fellow George Washington University Law School Alum Chair Schapiro for her time today, and for the Commission's consideration of these rule changes. Each of us wants to find ways to spur job creation, innovation and global competitiveness. And such changes require a balanced approach. However, I believe that some simple changes can return us to balance between investor protection and spurring innovation. We must remodel outdated rules and regulations to spur the creation of and investment into today's small businesses and startups that will be tomorrow's economic "anchor tenants."

Thank you.

Eric A. Koester

Founder & Chief Operating Officer
Zaarly, Inc.

Eric Koester is the Founder and COO of Zaarly, a location-based, real-time commerce platform launching nationwide in May 2011.

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. 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 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.

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:

Eric Koester

Date: May 8, 2011