LOS ANGELES AND SAN FRANCISCO

Daily Journal

www.dailyjournal.com

WEDNESDAY, MARCH 1, 2017

PERSPECTIVE

MONEY MATTERS

Renewed focus on routes to going public

By Jeff Steiner and Sean Sullivan

The results of the 2016 election have renewed focus on the consideration of changes to the way in which U.S. companies go public. Politicians, investment banks and capital markets lawyers are actively discussing proposals designed to ease disclosure obligations and streamline the process of companies making their initial public offerings in U.S. markets. Republican control of Congress and the White House increases the likelihood that a follow-up to the Jumpstart Our Business Startups (JOBS) Act of 2012 will be forthcoming.

While proposed changes to the IPO process has garnered press attention in recent weeks, data suggests that companies may not be as excited as politicians, investment banks and attorneys about going public in the first place. In fact, companies, for a number of reasons, are staying private for longer than before. For example, according to data collected and analyzed by University of Florida Professor Jay Ritter, the average age of a U.S. technology company that went public in 1999 was four years. By 2014, the average age of a U.S. technology company going public had risen to 11 years.

The trend of companies staying private longer can also be seen in the number of private companies with valuations over $1 billion; according to Bloomberg, the number of unicorns rose from 13 in 2012 to 40 in 2014. And looking at a longer time period, the trend is also exhibited in the number of companies going public — the number of IPOs per year has dropped dramatically from an average of 436 in the 1990s to 120 in 2015, according to research conducted by Ritter.

Historically, chief executive officers have looked to IPOs as not only a way to raise funds and provide liquidity to existing investors, but also as broader validation that the company has "made it." However, a paradigm shift in the way that leaders of start-up and larger private companies think about going public has led to the leadership of many private companies making the strategic decision to remain private longer than historical averages or indefinitely. For a number of reasons, remaining private has become viewed as a status symbol in itself. In fact, in an online survey of chief executive officers conducted by Fortune magazine, 77 percent agreed with the statement that their company would be easier to manage if it were a private company rather than a public company.

There are myriad reasons that companies have tended to remain private for longer or indefinitely, and the individual profile of each company — the need to raise capital, the sustainability of growth and the desire for liquidity by existing investors — results in a different analysis for each. One of the primary reasons that many large companies elect to "stay private" is a desire to invest in longer-term initiatives without the short-term pressure of quarterly earnings report and Wall Street analyst expectations.

Private companies have observed not only the grueling pace of quarterly public reporting cycles, but also that many companies that have gone public have performed poorly in the public markets. For example, the negative results of missing earnings guidance or Wall Street analyst expectations as a public company create a tension for managers who seek to build long-term value in a business, especially when initiatives or plans are at odds with measures that could be taken the enhance short-term performance.

From a business management perspective, the increased public disclosure demands of going public and being a reporting company also can be a disincentive. Potential public disclosures regarding broader topics, such as intellectual property and executive compensation, as well as more specific areas, such as single source suppliers and customer concentration, are understandably unattractive to companies used to sharing information with a relatively small set of investors.

The availability of capital in equity financing rounds for private companies has been increasing in recent years. While some industry observers think that the levels of private financing may be approaching an unsustainable level, these private financing rounds, often with large amounts of capital investors, have been the lifeblood for unicorns and smaller startups in the technology industry and the broader market. As long as these funds are available, the draw of public market money will be tempered. Sustained low interest rates, for those businesses willing to take on debt, have also created an alternative financing source that is attractive to a subset of private companies in selected industries.

In addition, while the JOBS Act was well known for creating an "onramp" for small companies to go public, the JOBS Act also made amendments to the Securities Exchange Act of 1934, as amended, raising the cap on holders of record from 500 to 2,000 (with not more than 500 persons who are not "accredited investors" for non-bank companies) and the exclusion of securities held by persons who were issued securities exempt from the Securities Act of 1933, as amended, pursuant to employee compensation plans. These changes increased the ability of companies to remain private for significantly longer periods of time (or indefinitely) without tripping the shareholder cap, which was sometimes a de facto trigger forcing private companies to enter registration with the SEC to go public.

The rise of private markets to provide liquidity to existing investors has further allowed companies to avoid some of the pressure from those investors to go public, since a limited market is available for the shares of some companies. In addition, some venture investors that invest in early rounds of private companies are simply selling their stake to other, often larger, venture funds or to private equity investors. By taking away some of the pressure on companies to provide a path to the public markets, these alternative liquidity paths reinforce other trends that have led to decreased activity in the IPO market.

IPOs remain a key defining moment for many companies, and there is no doubt that some number of companies will continue to go public each year. The trends to watch over the next few years is how company management teams and boards of directors evaluate IPOs versus other financing options, the broader considerations of operating a company publicly vs. privately, and how IPOs can be used a strategic tool to accelerate growth, rather than simply a "next step."

.

Jeff Steiner, *counsel in the Washington, D.C. office of Gibson, Dunn & Crutcher and a co-leader of the firm's Derivatives team, is a former special counsel at the U.S. Commodity Futures Trading Commission.*

Sean Sullivan, *a senior associate in the San Francisco office of the firm, focuses on capital markets transactions, mergers and acquisitions and securities regulation.*

STEINER

SULLIVAN