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The Long, Slow Death of the IPO

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SecondMarket Founder and CEO Barry Silbert lays out factors preventing companies from going public, and why these issues are exacerbated by aspects of current public markets. Along with citing specific reasons for, and challenges to, going forward with an IPO, Silbert offers an alternative framework for raising capital.

Transcript

So as this market is taking off, I'm getting this question more and more from people and then it's starting to be asked in the press; why go public? And so historically, it's important to know why companies have gone public, there's really kind of four reasons. One is it's to raise capital. It's traditionally been kind of the easiest, most cost-efficient way to raise equity capital for larger companies. Two is liquidity for shareholders. Third it is to have a currency that you can use to buy other companies or to pay your employees and then lastly, it was a branding event. So what's interesting is in the first three, the secondary market, the private market, is now actually starting to address these first three objectives. The fourth one, you know, going public, it used to be the pinnacle of success for companies but today, it's not. Yes, that is Snooki. Ringing the bell of the New York Stock Exchange. Yes.

So what a long way we've come from what this fine institution was originally created to do. But you know, all seriousness, I don't think a lot of people realized that over the past 10 years, the IPO market has been dying a slow, slow death. Now, there's a lot of information on this chart, so I'm going to point on what is important for you to look at. So one is the number of IPOs. So if you look at the chart, the number of IPOs, historically speaking, you look in the '90s, it was averaging 400, 500, 600 IPOs per year. Yet, over the past decade it's now averaging, what, 150 IPOs per year and this was even during come the 2000 to 2007 timeframe when things were pretty healthy in the economy. So that's scary, but also look at the colors on this chart. So the blue are companies that are raising less than $50 million and the orange are ones raising more than $50 million. So what you've seen is in the past, companies, smaller cap companies represented about 80% of the IPO market... ones raising less than $50 million.

Today, it is completely shifted to the opposite. So the companies that are getting public, they're just much larger companies which is really, really bad for us as entrepreneurs. So what happens? I think if you were to kind of look at the causes for this... the death of the IPO, I think you can describe it as it's really kind of the unattended consequences of probably some well intended actions. So the first cause which is surprising to many people started with all of us, all of our parents, all of our friends, moving money away from stock brokers into online trading firms because what used to happen is everybody would have a stock broker and that stock broker will call you up and say, "Hey, I just found this great company. It's named after a fruit, you should buy the stock." And you would say, "OK, good, I'm going to buy that stock." But that just doesn't happen anymore. It's all self-service now. So we lost hundreds of thousands of brokers who used to be pushing smaller cap stocks. Next was decimalization. So what decimalization is, there was a time when stocks were traded in increments of eights and quarters.

And so there was the spread between the bid and the offer. And it was then shifted to decimals like basically pennies. And so while that was really good for us as investors, works with lower transaction fees, it was terrible, terrible for Wall Street and the market bankers. And I know what you're saying, well, it was me, market bankers aren't making us money... not so much

money. The problem is that that money that they were making was being used to pay for research. So what happens is as these banks can't make money trading the stocks anymore, they stop covering the smaller cap companies. Next in 2002, was Sarbanes-Oxley and I think a lot of people think that Sarbanes-Oxley was kind of the cause of all these, it really was probably one of the final nails in the coffin. Sarbanes-Oxley just made it a lot more expensive for companies to go public and be public. And then after that was the research settlements that Spitzer pushed through which essentially eliminated the ability for investment banks to be able to pay the research analysts based on investment banking fees.

So what happened is this... these banks, the research analyst, they couldn't make money anymore from the trading, they couldn't make any money from investment banking so all the resource now is shifted to the very, very large companies which is terrible for small cap companies. And then you had the proliferation of short sellers and then a huge increase in class action lawsuits. So as a result of all of that, it's now taking companies almost 10 years to go public whereas in the past it used to take about half that time like four years, five years. And so think about that for a second, 10 years to go public. That doesn't work for anybody. That doesn't work for venture capitalists. Doesn't work for Angel investors. And most importantly, it doesn't work for employees because no one joins a company with the expectation that they're going to stay at that company for 10 years.