

# Does the IPO Market Shun Smaller Companies?

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*Venture capitalists want to widen the playing field for the underwriters.*

**SURGING SHARE PRICES HAVE** spurred more initial public offerings for technology companies, but not nearly as many as there could be if private companies used a broader selection of underwriters to hawk them. The largest trade association for venture capitalists intends to do something about that.

"This is going to be a holy war in Silicon Valley," says former National Venture Capital Association Chairman Dixon Doll, a primary architect of a plan to diversify the types of investment banks young companies use.

The NVCA's program asks members, among other things, to consider using investment banks other than Wall Street giants such as Goldman Sachs, Morgan Stanley and Credit Suisse. Instead, the association advocates using midsize boutiques that specialize in growth and emerging markets as lead or co-lead underwriters.

Many of these firms, including former tech specialists such as Hambrecht & Quist and Robertson Stephens, flourished before the Internet bubble. The NVCA says, to the chagrin of some of its most powerful members, that venture capitalists and their portfolio companies have allowed the bigger banks a near oligopolistic hold on tech IPOs. That has stymied the market, says the group, because the big firms generally require more size and financial strength than is actually required to go public.

"There's a lot of conventional wisdom in the industry that says if you're not strong enough to go public with Goldman [Sachs] or Morgan [Stanley], you shouldn't go public," says Doll, who considers the logic flawed.

**DOLL THINKS TOO MANY** of his colleagues choose these firms by default. "The average venture capitalist and private-company CEO don't have a clue as to how to hire investment-banking services for an IPO," says Doll, who is co-founder of Menlo Park-based DCM, a venture-capital firm. The NVCA's plan will offer guidance on accounting, law, regulation and the role of money managers to help VCs prepare their companies for offerings.

The VC outfits, except the biggest and best-known firms, are so out of practice that they defer to Goldman, Morgan and other bigs. "There have been so few deals that there isn't any experience in the marketplace anymore," Doll added.

## Running With the Big Dogs

So far in 2009, tech-company IPOs have been underwritten almost exclusively by Wall Street's largest investment banks.

Company	Deal Amount (mil)	Lead Managers
DigitalGlobe	\$279	JPMorgan, Morgan Stanley
SolarWinds	151	Goldman Sachs, JPMorgan, Morgan Stanley
Bridgepoint Education	142	Credit Suisse, JPMorgan
Changyou.com ADR	120	Credit Suisse, Merrill Lynch
Rosetta Stone	113	Morgan Stanley, William Blair
LogMeIn	107	JPMorgan, Barclays Capital
Medidata	88	Citi, Credit Suisse
OpenTable	60	Merrill Lynch

Sources: Bloomberg, company reports

The severe recession exacerbated an already moribund tech IPO market. Only six technology companies went public in 2008, compared to a yearly average of 53 from 2004 to 2007. That post-Internet pace paled in comparison to an annual average of 130 tech IPOs between 1991 and 1998, according to Jefferies. (The dot-com boom and bust years of 1999-2003 were omitted from the list. Deals ranged from 381 in 1999 to 22 in 2003). What's more, the size of the deals has been growing.

The objective is to get back to late-80s, mid-90s practices, allowing more start-ups access to capital so they can remain independent and create more opportunities for venture capitalists to cash out. In recent years, VC firms have become too

dependent on mergers and acquisitions as the exit strategy of choice, says Paul Deninger, vice chairman at midsize banker Jefferies. In fact, most tech start-ups are "built for acquisition," as opposed to being built to become the next publicly held Microsoft or Oracle, Deninger says. Most neither have the proper accounting structure nor comply with the Sarbanes-Oxley requirements to sell stock. Last year, despite the credit crisis, there were 1,998 mergers and takeovers of VC-backed companies in the tech, media and telecom sectors, compared with 2,123 deals in 2007.

**THAT TREND CREATES AN** even greater need for a vibrant tech IPO market, Deninger argues. But it is up to the venture capitalists to "heal thyself," he says, because they are responsible for allowing the large firms to dominate by not using midsize firms such as Piper Jaffray, William Blair, or Jefferies.

Deninger says the post-bubble Valley has become elitist, overly cautious and too brand conscious. In their desire to be better known and more popular with entrepreneurs, too many VC firms insist on "name-brand" bankers. "They've become brand bigots," he says.

The big firms disagree and argue privately that the IPO slowdown is due to the economy. The big firms also say their institutional clients are so big they can invest only in offerings with the highest market valuations.

Deninger agrees that institutions demand larger-cap offerings, which is why he urges issuers to use midsize firms that can tap thousands of funds under the 100 largest institutional firms. "Mega-banks optimize stock allocations to benefit their large institutional clients, not the companies issuing the stock," Deninger says.

The bigger banks also argue that there aren't as many "quality" companies to take public because too much capital is chasing too few new ideas. Many private companies can't meet the 20-to-25-times price/earnings multiples and \$20 million in annual revenue minimums underwriters demand. Goldman Sachs and Morgan Stanley wouldn't comment.

Ironically, the tech IPO market is re-awakening just as the NVCA prepares to roll out its initiative. Deninger and Doll hope that doesn't derail their efforts. They say the tech-offerings market is perking up due to pent-up supply and a slightly stronger economy, not because the structural underpinnings have improved.

"It's just the best companies in the queue that are getting out," Deninger says.