

## **O'Brien: Time to stop blaming Sarbanes-Oxley for IPO troubles**

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If you're going to fix something, it helps to know why it's broken.

Even before the financial crisis knee-capped the stock markets, the IPO engine that drove much of the valley's innovation economy was sputtering. Except for a couple of quarters in 2006 and 2007, tech IPOs had failed to return to the levels seen in the 1990s.

Instead of opening up a reasoned dialogue on this topic, much of the venture capital industry has had an unhealthy fixation on a single scapegoat: Sarbanes-Oxley.

To hear VCs tell it, the corporate reform measure passed in 2002 had made IPOs too expensive. Sarbanes-Oxley was driving U.S. companies to go public on foreign stock exchanges. And the law, known colloquially as SOX, was killing innovation.

Nope. Nope. And nope.

The conventional wisdom that the valley has embraced about SOX's impact is simply wrong, and the attempts to demonize it for the vanishing IPO have been wasted energy. The good news is that a number of players across the innovation economy have begun to realize that, and they're at last opening a more reasonable, productive dialogue about how we can reboot the IPO.

This new tone was capped by a study of the IPO market released late last month by the National Venture Capital Association. I disagree with some of the remedies proposed. (Tax breaks for IPOs? No thanks.) But the report's analysis of the causes behind the disappearance of IPOs is nuanced and complex, and it offers several useful solutions.

One item that was noticeably absent from the NVCA: Yet another request for "reform" of SOX.

"We had a great debate about that," said **Dixon Doll, chairman of the NVCA**. "We decided we were not going to whine about Sarbanes-Oxley."

Bravo.

VCS are understandably nervous about the plunge in venture-backed IPOs. According to the NVCA report, from 1990 to 2000, there were 1,776 IPOs. From 2001 to 2008, there were 392. There are now too many venture capital firms to be sustained by the trend of lower IPO activity. A reckoning is coming.

But VCS' response has been to blame everyone but themselves for this state of affairs. The most convenient scapegoat was the Sarbanes-Oxley reform passed in the wake of an era of dot-com excess and corporate scandals involving Enron and WorldCom.

That led to a commonly peddled myth that U.S. companies were fleeing to foreign (and less regulated) stock exchanges for their IPOs.

Foreign exchanges

So what really happened?

It's true that SOX prompted stock exchanges in London, Toronto and Singapore to come calling. And some U.S. companies decided to take a look.

"That opened the door for other venues to attract U.S. companies," said Bob McCooley, a senior vice president at Nasdaq. "In general, what they found, though, is that those exchanges weren't able to deliver the goods."

The one market that did at first glance seem to be getting some traction with U.S.-based companies was the London Stock Exchange's Alternative Investment Market. AIM was a junior market that offered smaller companies a place to go public with limited rules. In 2005, 19 U.S.-based companies went public on AIM, and by the end of 2006, there were 36 U.S. companies trading on the market.

But an analysis by the London Times a couple of years ago came to a pretty clear conclusion about the quality of these companies: "Nearly two-thirds of companies based in the United States that have listed on the Alternative Investment Market over the past five years have lost money for investors." In other words, London was getting our undesirables.

Care to guess what the talk surrounding AIM is these days? The need for more regulation.

"The punch line is that today, most exchanges are raising their corporate governance standards," McCooley said.

'Well washed'

If you think that's funny, just listen to what Bill Smith of Renaissance Capital, which researches the IPO market, has to say. Smith said he'd been a vocal critic of SOX, but he acknowledged that the handful of companies that have pulled off IPOs this year had told him that the regulations were helping them with investors.

"In this type of environment, when people are looking for transparency and liquidity right now, they know that any company going public is a pretty well washed company because of Sarbanes-Oxley," Smith said. "And that gives some comfort to some investors."

Let's be clear about one thing: Yes, SOX does raise costs, by requiring companies to spend more on accounting and legal fees. The real question is whether those costs are worth it?

The answer: Yes.

But if SOX is not the problem, then what?

The report from the NVCA offers several more compelling answers. For instance, the report notes the disappearance of many of the boutique investment banks that championed the technology industry in the 1990s and offers way to encourage the creation of new ones. (Opportunity alert for all you unemployed investment bankers!) The report also notes that startups employ the largest and most expensive accounting firms. The NVCA plans to engage these big firms in rethinking their high fee structures for small companies while also pushing startups to consider smaller, competitive accountants.

My one strong area of disagreement is the NVCA's recommendation that the capital gains tax on IPOs be lowered from 15 percent to 10 percent. Not only can we not afford such tax cuts at the moment, this is the sort of solution that seems more focused on boosting the quantity of IPOs, rather than quality.

The bar should be high for any company considering a public offering of stock. In the long run, that's the best way to reward the truly deserving innovations and keep Silicon Valley's economy healthy.

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