

Statement of Barry Eggers
Partner, Lightspeed Venture Partners
Board Member, National Venture Capital Association
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“Legislative Proposals to Help Fuel Capital and Growth on Main Street”

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Chairman Huizenga and Ranking Member Maloney, thank you for the opportunity to testify today on the important subject of capital markets reform and encouraging more U.S. public companies. My name is Barry Eggers, and I am a Founding Partner at Lightspeed Venture Partners, a venture capital (VC) firm that invests in, and works closely with, cutting-edge technology startups in areas such as information technology, data analytics, cloud computing, storage, networking, ecommerce and consumer marketplaces. I am here in my capacity as a board member of the National Venture Capital Association.

Let me begin by explaining why venture capitalists care about policy issues pertaining to our public capital markets. There are three main ways that venture capitalists exit an investment: 1) a merger/acquisition 2) an initial public offering (IPO) or 3) a business failure. While the vast majority of venture capital investments are in private emerging growth companies (EGCs), recent research has shown that nearly half of all companies that have gone public since 1979 have been backed by venture capital¹. We sit on the boards and provide advice and counsel to many of the companies who consider going public. Generally once they go public they exit the VC ecosystem. But the ability and attractiveness of becoming a public company is a critical issue for the growth of our portfolio companies while we are involved with them.

To provide a little background on venture capital, we are investors in the nation’s startups. At Lightspeed for instance, we invest early in a company’s life, often when there are a few founders trying to build out a new concept. We work with these entrepreneurs to grow the company into a successful enterprise, including providing mentorship and strategic advice, helping them hire new employees, introducing them to potential customers, and providing additional rounds of financing to fuel continued growth. This work typically takes a lot of patience over a long time horizon. At Lightspeed, the average time to IPO from first investment is roughly eight years.

I’ve been a venture capitalist for over two decades, and in the technology ecosystem for over 30 years. I have witnessed firsthand the increasing willingness among founders and CEOs of private EGCs to sell their companies instead of taking them public. When I first got started in the business, the goal of most entrepreneurs was an IPO, and many companies were successful in that endeavor – such as Maker Communications, a company I invested in that went public in 1999. Maker had quarterly revenue of \$3 million prior to their IPO. They had raised \$24 million from venture capital firms and then raised \$44 million in their IPO, which valued them at \$230 million. Twenty years later, an IPO is rarely a goal for an EGC. Many view the public markets as hostile to innovative small-capitalization companies and would rather have the certainty of a trade sale than deal with the challenges, complexities, and costs of running a public company. And for those that do go public, they often do so only when they’ve grown to a size that can

¹ <https://www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy>

better bear the burdens that come with being public – such as Nimble Storage, another company I invested in which went public in December 2013 – and is representative of the first batch of EGCs to go public under the 2012 Jobs Act. Nimble had quarterly revenue of \$33 million prior to their IPO. They had raised around \$100 million in venture capital and raised \$168 million in their IPO, which valued them at \$1.5 billion.

The data here is rather stark. Since 2000, the U.S. is averaging less than half the number of IPOs per year than in either the 1980s or 1990s². A consequence is that the U.S. now has about half the number of public companies than twenty years ago³. My firm, Lightspeed, has one of the strongest track records of IPOs since 2016. We have had seven portfolio companies go public over the last two and a half years. But that is still less than 5 percent of the 145 active companies in our portfolio.

Challenges Facing EGCs

Avoiding the public markets has unfortunately become a prevalent view among many EGC executives. It is a far less attractive proposition to run a public company now, and as a result, many choose to forego this option altogether. As an example, AppDynamics, previously a Lightspeed portfolio company, faced this choice and decided to sell rather than become public. At the time, AppDynamics was a growing company that had actually gone through all the work to prepare for an IPO and had successfully completed their IPO roadshow. The day before they were scheduled to go public, they decided instead to sell to Cisco Systems. Mergers and acquisitions are certainly a healthy economic activity, but my point with AppDynamics was that even a healthy company with a bright future can look at the public markets these days and decide it is not worth the uncertainty. As a result, there is one less independent, high growth public company which creates jobs and becomes an acquirer of small companies.

The myriad issues that discourage EGCs from going public can be grouped into three broad categories: 1) the increased cost and complexity of running a public company 2) the collapse of market making infrastructure, including research coverage for EGCs and 3) the challenges presented by a culture of short-termism. In each category, since the turn of the millennium, policy changes and industry trends have conspired to increase the challenges facing small public companies. For example:

- Sarbanes-Oxley significantly increased the costs of operating a public company;
- The Global Settlement in 2003 disrupted the economics of research coverage for smaller companies;
- The rise of activist investors and manipulative shorting have made it more difficult for innovative companies to access capital in the public markets for longer-term projects.

Many of the policy changes were well intentioned attempts to solve for separate policy issues. Similarly, industry trends may have good intentions at their core, perhaps seeking to impose discipline on public companies or force more accountability to shareholders, for instance. Unfortunately, time and again the EGC IPO ecosystem becomes collateral damage to these

² *Initial Public Offerings: Updated Statistics*. Jay Ritter, University of Florida, March 8, 2016

³ Jay Ritter, University of Florida, Number of Listed Firms in the U.S. 1980-2015, by quarter.

objectives. And as these challenges continued to pile up, they have made the decision to go public harder for entrepreneurs to justify.

Consequences of Fewer Companies

I believe there are two significant consequences arising from the lack of IPOs and the decline in U.S. public companies: a decline in job creation and a loss of investment opportunities for retail investors. Every time a company chooses to sell itself rather than go public, there is a negative impact on the U.S. jobs market in terms of reduced potential new job creation and often there are job reductions once the companies fully merge. Research indicates that 92 percent of job creation happens at companies once they go public⁴. And data provided by Professor Jay Ritter, a professor at the University of Florida who has been a prominent voice on the IPO market, posits that this lack of IPOs has cost the economy on average about two million new jobs a year. From what I've seen, many of these jobs can be the type that support middle class families and don't necessarily require college degrees. I am thinking for instance about human resources or administration jobs, which often disappear after a merger.

The lack of IPOs has also had an impact on middle class retirement savings and retail investor portfolios. To provide a few examples of the growth in value of venture-backed companies if one bought into their IPO, Microsoft which went public at a \$350 million dollar market capitalization is now worth more than \$500 billion. Genentech raised \$35 million in their revolutionary 1980 IPO and was acquired at a valuation of \$106 billion in 2009. Amazon's market capitalization has increased by a factor of 1,100 from their \$440 million market capitalization at IPO. Yes, IPOs are risky to invest in, but they have also provided a fantastic opportunity for wealth creation to main street investors.

Jumpstart Our Business Startups (JOBS) Act

The JOBS Act was a terrific start to tackling this difficult challenge. And I have seen it used first hand. In particular, the provisions allowing for EGCs to file with the SEC and to test the waters with prospective investors confidentially have made it easier to go public without harming investor protection. And in my view, the creation of the Emerging Growth Company construct was one of the most creative pro-growth policies in recent memory. EGC status allows companies that are under \$1 billion in annual revenues and who are either private or public for less than five years to access a scaled disclosure and regulatory regime.

Expanding the On-Ramp

The joint report endorsed by NVCA, [*Expanding the On-Ramp*](#), offers a blueprint for building off the success of the JOBS act and making it more attractive to be a public company. One aspect that struck me was the breadth of viewpoints that were brought to bear in the coalition which came together to compile this report. From company operators to those whose job it is to facilitate public offerings, exchanges, and investors such as myself, the report leans on the experience of industry participants who have seen this challenge from a broad cross-section of perspectives. While I may not be an expert on market structure, I do understand how challenges with liquidity can impact the decision of one of my portfolio company CEO's decision to take their company public. This is a complex and multi-faceted challenge, and so needs a comprehensive effort.

⁴ https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf

In particular, I view the enhancements to EGC status as a positive move to improve the experience for companies going into the public markets. Removing the phaseout of EGC status for large accelerated filers will provide more certainty for companies that the benefits of EGC status will be there unless they cross a more predictable revenue or time threshold. The problem that the current large accelerated filer phaseout presents is that the definition is based on public float, which is a function of stock price and can be quite variable. For instance, looking at the history of the companies that Lightspeed has been involved with which went public since 2016, there was an average difference of about 68 percent between the high price and the low price in the first six months of trading post-IPO. And even if the company crosses the \$700 million public float threshold for one day, they lose EGC status permanently. As a result, this company would then be responsible for an audit of internal financial controls immediately, an expensive surprise indeed and one that can call into question the certainty of EGC benefits.

I applaud the Committee for your work on allowing any investment into an EGC to be considered a qualifying investment for purposes of the VC exemption definition from the Registered Investment Advisor (RIA) regulatory regime. Congress created both the EGC definition and the VC exemption for similar purposes, namely a favorable capital formation regulatory environment for growing companies. That secondary share purchases of EGCs are currently non-qualifying is becoming an increasing challenge for VC funds that are forced to choose between continuing to follow their companies along the growth trajectory and risk the significant expense and difficulty of registration or passing on further capital formation opportunities for certain portfolio companies. Neither outcome is positive.

I understand that rebuilding the research coverage and market making infrastructure is a difficult undertaking, but it's absolutely critical to solving this challenge. And so a study of pre-IPO research coverage seems to be a good place to start. I hope this work can be done expeditiously so we can begin to implement policy reforms that will encourage the research coverage EGCs desperately need to have success going public.

Conclusion

I am excited to see the Congress take such a deep and thoughtful look at an issue that is fundamental to our country's future. As a venture capitalist, I have spent my career building the next generation of America's companies. I believe that if we can encourage more of these companies to go public in the next decade, we will improve access to economic opportunity in the country, as well as our economic competitiveness.

Again, thank you for providing me the opportunity to testify today on this critical topic. I'm happy to answer any questions.