

New SEC Group Debates Easier Path to IPO

A newly formed committee to address capital raising for growth companies looks at less-costly ways to get public and be public, as well as some IPO alternatives.

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The Securities and Exchange Commission's new advisory committee on small and emerging companies held its first meeting on Monday — an all-day event that covered a number of important topics, but with no signs of consensus in any one particular direction.

The [group was formed this past summer](#) in response to concerns that [the IPO process is too high a hurdle](#) for growth companies, that Sarbanes-Oxley compliance may be too costly for them, and that smaller companies need broader means for raising capital from private investors. The biggest issue the group confronts: coming up with alternatives that lift the burden on companies while still offering investor protections the SEC would deem adequate.

The committee's 19 members, including three finance executives, had varying opinions on some of the major agenda item; namely, whether or not it was possible to make it easier for smaller companies to go public, and what the rules should be for start-ups trying to raise initial rounds through [alternative mechanisms like crowd-funding](#). With the members were two committee observers from the SEC's division of corporation finance, director Meredith Cross and deputy director for legal and regulatory policy Lona Nallengara. SEC chairman Mary Schapiro also attended a portion of the meeting, explaining she had planned to be there for the full day but was called away to help the SEC handle lawsuits related to MF Global's bankruptcy.

The idea of an ["IPO Lite"](#) is one of the more alluring options the committee is considering. Currently, the SEC's Regulation A process allows for something like this in that companies can register their shares without going through the whole IPO process and producing a full set of audited financial statements. However, Reg A is rarely used because companies can only raise up to \$5 million and must still comply with a variety of state securities laws. In the Monday meeting, SEC officials probed the group on how Reg A might be more useful, and what other models the committee might follow to make going public less costly for small companies.

If the Reg A cap were [raised to \\$50 million](#), as is currently being considered in Congress, and if the state compliance burden were reduced, the process "would be worth looking into for my company," said Kathleen A. McGowan, vice president of finance for Tobira Therapeutics in Manalapan, New Jersey. Tobira is a venture-backed biopharmaceutical company focusing on HIV treatments that raised a B round of funding in September 2010. Since the company already has annual audits, "we have a lot of the structure and processes in place to validate any reporting," she said, adding that reporting requirements still "should be minimal" in order to maintain focus on the core business.

Indeed, some investors seemed very open to something less than a full-blown SEC reporting regime from the companies in which they invest. "Why couldn't the SEC come up with a one-page reporting [format] that a company could post on the web that everyone can see?" asked Milton Chang, managing director of Incubic Venture Fund in Menlo Park, California. Companies "don't have to make a jillion dollars," he added, but rather show consistent profitable growth.

On the flip side, Richard L. Leza, chairman of Exar, suggested the cost of complying with reporting structures like Sarbanes-Oxley might not be as great as some people suggest, particularly as corporate executives learn the process over time. Exar, a Nasdaq-traded company with close to \$150 million in revenue, saw its audit and compliance costs double [from \\$1.5 million to \\$3 million](#) when it initially began hewing to Sarbox rules. Now, after several years of compliance, [the costs are back down to \\$1.5 million](#), Leza said. (In fact, Exar's most recent proxy shows that [audit fees fell from \\$1.3 million in 2010 to \\$895,000 in 2011.](#))

And McGladrey and Pullen partner Joseph (Leroy) Dennis winced at the idea of the SEC being involved with less robust processes for going public. "The SEC is part of the brand of the U.S. capital markets, and it's a good brand. If you dilute that brand, it hurts our capital markets in total," said Dennis.

Frustration with some of the current SEC rules came out when the [topic of crowd-funding](#) was discussed. While most crowd-funding raises are now outside the purview of the SEC since they involve a company offering a product rather than securities in exchange for money, some companies would like to raise more money through such platforms and offer debt or equity. While that is technically possible now, investor-protection laws often hamstring them. The rules limit how and to whom the deals can be marketed, making it difficult for companies to reach a critical mass.

Many suggested that SEC attempts to confine the marketing of such deals to the traditional “family and friends” is unrealistic in the world of Facebook “friends” and other widespread web-based connections. “The SEC cannot lock down everything,” said Shannon L. Greene, CFO of Tandy Leather Factory in Fort Worth, Texas, a small-cap company traded on Nasdaq. “If someone wants to put something stupid out there, you can’t protect every \$100 investor, no matter how many tens of thousands there are. Some of the onus on investor protection has to be on the individual investor.”

Meanwhile, Paul Maeder, general partner with Highland Venture Partners in the Boston area, pooh-poohed the whole notion of crowd-funding. “What problem are you trying to solve?” he shot at SEC officials, suggesting that qualified investors such as his firm are very easy to find. “If you don’t have an angel network, it’s because you don’t know how to use a browser, which arguably means you shouldn’t start a business,” he said. For small companies, he argued, “access to capital is not a problem at all.”

But access to capital often varies greatly by region, other panelists countered, and asking a large group of people for investments doesn’t always mean a company is too weak to get funded by traditional means. Said the Small Business Administration’s special adviser for innovation, Sean Greene: “There are a lot of smart, interesting people looking at this, not just people with wacky ideas.”

The next steps largely revolve around defining the mission and the audience for the committee’s inquiry, questions that SEC staff readily admitted they were still trying to answer. In addition to future meetings of this committee, the SEC also plans to host its annual forum on small-business capital formation on November 17 at its Washington, D.C., headquarters.