After the JOBS Act: The Impact on Private Companies

It's been three years since the Jumpstart Our Business Startups Act—better known as the JOBS Act—was signed into law. The legislation was designed to spur business growth by enhancing access to capital for both private and public companies.

For a perspective on the act's impact, KPMG recently spoke with Kate Mitchell, partner and cofounder at Scale Venture Partners, a firm that invests in early-revenue technology companies, and director of Silicon Valley Bank. She also sits on the board of the National Venture Capital Association, and chaired that board when the JOBS Act was being drafted.

Following are edited excerpts from our interview.

KPMG: Do you think the JOBS Act is working as expected?

Kate Mitchell: Generally, the goals were to increase access to capital for small companies. For the section addressing IPOs by emerging growth companies, the objective was to encourage entrepreneurs to be well prepared for capital investment and to encourage effective communication with investors. Entrepreneurs should be enthusiastic about taking their company public, and those offerings should also serve public investors well. The costs of a public offering can be managed and predictable, and even more so after the JOBS Act; however, the reputational risk of a failed offering is high.

Kate Mitchell, partner and cofounder, Scale Venture Partners

I think the JOBS Act has helped reopen the public equity option for young (and old) private companies alike. Provisions in the JOBS Act related to initial public offerings—confidential drafting and the opportunity for dialogue with institutional investors, the "test-the-waters" provision—were designed to increase the number of companies willing to consider public financing and investors' comfort in investing behind them.

KPMG: From your perspective, what were the concerns that brought about this section of the Act?

Mitchell: We were in a period where, at least for technology start-ups, it was really about building for an acquisition. And companies that are designed to be sold usually end up with relatively modest exits. And there really weren't a lot of acquirers out there. The M&A game (in Silicon Valley) ended up with a concentrated set of buyers and entrepreneurs selling out early. Steve Jobs famously asked, "Why is everybody looking for an exit?" His response was that they should be building a company that outlives them.

Now, I can't fly in or out of entrepreneurial and venture capital centers around the country without meeting a CEO who hasn't taken advantage of provisions in the JOBS Act.

KPMG: How do you believe private capital markets have responded to the shifting landscape?

Mitchell: The markets themselves always drive the appetite for both private and public investing alike and I think we've seen that play out over the last few years. The JOBS Act was designed to improve deal flow and access to capital in both private and public markets.

But you still have to deliver value to your shareholders and meet their expectations. Business fundamentals and growth opportunities will always dominate who can raise capital. No regulatory changes can take care of that.

KPMG: Where are you and your companies seeing the greatest value in the IPO section of the JOBS Act?

Mitchell: The confidential filing provision. With only 20–25% of filed S-1s actually resulting in an IPO, there is significant reputational risk in releasing a non-vetted S-1 filing. There's no feedback from the SEC or any indication of institutional investor appetite, yet your data is public. You don't know how the conversation will go. Your company can get picked apart, for whatever reason, and you can't respond. It is likely to hurt employee morale and raise customer concerns unnecessarily if an IPO is delayed or canceled.

Before the confidential filing provision, there was all of the cost and none of the benefit in starting the drafting process. Having access to feedback from the SEC and investors in private is very valuable. The back-and-forth is eventually disclosed before the IPO—none of the conversation is ever kept from investors. And the SEC and the issuer still get the benefit of an open comment period as well.

KPMG: What about the rest of the Act?

Mitchell: Other parts of the JOBS Act—general solicitation for private offerings, Regulation A+ for small issuers, and platform funding, otherwise known as crowdfunding—are all part of the capital arc that can be used by an emerging growth company over the course of its lifecycle. Each financing options demands a thoughtful approach across the continuum.

It's too early to tell with Regulation A+, but I'm pleasantly surprised that there has been as much interest as there is. Generally, the JOBS Act has helped to democratize access and put a broader set of tools in people's hands. Which tools will fit which companies and which markets is still being discovered. And remember, there's still a cash glut in some sectors of venture capital and private equity, so we will likely learn even more about its impact in leaner times.

Ultimately, these financing options raise the interest in IPOs. And I think more companies are actually raising more capital because they can build a company large enough to eventually go public. The capital landscape is also developing into more of a subway map than a linear set of financing options. Companies may use different tools over time as they grow.

Debt and product crowdfunding are great because they don't dilute equity. With these options available to entrepreneurial businesses throughout the country, particularly in smaller markets without a startup investing culture or local sources of capital, they provide a high quality alternative for entrepreneurs. To have competitive sources of capital available, crowdfunding also helps keeps all of us in the venture capital community on our best behavior.

KPMG: Have you noticed a change in governance and board composition for start-ups and entrepreneur-led companies?

Mitchell: We're definitely seeing better and stronger governance early on. It's a good trend—for companies to realize the value of a board and, particularly, independent directors. When you just have management teams and investors talking, it's often a zero-sum conversation. Outside directors help ensure that the entrepreneur is focused on how best to create value for all the shareholders and is aware of alternative financing. An independent director provides objective balance to a board.

Of course, everybody on the board should be working on behalf of all the shareholders. But when venture investors can control terms of the next capital infusion, independents help ensure that the board is doing its job. When we invest in early-stage companies, we actually make an independent director a requirement for a Series A or Series B investment.

We've also witnessed the strengthening of angel investing communities—often comprised of experienced general business operators—realizing the value they can bring as directors for private companies. It's not just experience with pre-IPO startups or hyper-growth technology companies that can help a company.

For potential private company directors, association and nonprofit boards are a great place to hone their skills. The pattern recognition and experience with oversight and its challenges is highly valuable. Across the board, one of the biggest skills to develop is asking good questions.

KPMG: How do you expect these governance shifts to impact companies?

Mitchell: Governance has a direct impact on a company's controls. Clearly, it behooves even an early-stage company to have quality internal controls. But it's amazing how much control structures and processes (if followed) can improve any sale or financing. If you don't have controls buttoned up, you're going to see a discount to your acquisition price due to uncertainty on the part of the buyers.

Even if control weaknesses are perceived (and not real), it can become a factor in investment and merger negotiations. You can't even argue the materiality of the point if you've been called out. The leverage is on the other side of the table.

KPMG: Any final thoughts?

Mitchell: The IPO pipeline has definitely improved and it's not just the well-known, high-growth companies. Startups are interested and enthusiastic about going public. It's become cool again. That's better for jobs and it's better for the business ecosystem. And the dialogue between issuers and investors is very healthy.

About KPMG's Private Markets Group

KPMG's Private Markets Group (PMG) has the knowledge and insight to help private companies address complex marketplace challenges and drive growth in today's global economy. Focused on serving privately-held entities, including private equity- and venture capital-backed companies, our global network of professionals offers integrated audit, tax and advisory services tailored to meet the needs of private enterprises. By providing industry perspectives and proactive guidance, our PMG teams help private companies achieve their strategic objectives throughout each stage of the business life cycle.

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