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Private Stock Exchanges Help Firms Grow

By Jonathan N. Crawford

New specialty exchanges are cropping up to facilitate the buying and selling of company shares, commodities and more esoteric assets, such as energy credits.

Some aim to provide investment exits for venture capitalists in the face of a sluggish market for initial public offerings (IPOs). Small online private exchanges, such as SharesPost, SecondMarket and XChange, provide a platform for shareholders to sell their stakes and for investors to get equity in firms with good profit prospects but limited likelihood of growing to sufficient size to warrant a public offering.

Other mini-exchanges serve companies' special needs. New Jersey's Flett Exchange, for example, facilitates the sale and purchase of the state's green energy credits. New York-based Parity Energy allows businesses to hedge prices on small volumes of natural gas and crude oil. The Houston Mercantile Exchange does the same for companies that need to buy or sell chemicals, plastics, metals, etc. The trades on these mini-bourses are tracked, cleared and settled by the major exchanges.

In some cases, exchanges dealing with company shares employ a virtual bulletin board where potential buyers and sellers can post offers. Others, such as XChange, use an auction system in which investors compete side by side in a bidding process for the purchase of shares. Firms listed on SharesPost, for example, include LinkedIn, HuffingtonPost and Facebook. The minimum buy is \$25,000. The services are restricted to accredited investors and qualified institutional buyers.

Under certain qualifying circumstances, businesses can use some of the exchanges to raise capital through a closed private stock sale, without incurring the costs and burdens of complying with federal regulations that come with a public issuance.

Online electronic platforms seek to improve upon the traditional way of trading private shares on a secondary market by efficiently matching buyers with sellers and reducing costs, especially legal and transactional fees.

XChange founder and CEO Thomas Foley says he expects the appeal of a private exchange to grow as venture capitalists, private equity investors, angel investors and

employee shareholders seek to liquidate their investments or diversify them at a time when fewer firms are going public and those that do take longer to reach that stage in their lifecycle. “Now is an opportune time [for a private exchange] because there is a crushing need from buyers and sellers. We are solving that need,” he says. Foley expects shares in technology firms to be traded most actively.

But venture capitalist Robert Ackerman, founder and managing director of Allegis Capital in Palo Alto, Calif., who has served as an adviser to private exchanges, believes that the growth will be limited. He says the deals are often between individuals that know and trust each other, so the concept of matching complete strangers in a firm that has not been fully disclosed could deter some from using the service. But XChange, SharesPost and other exchanges try to assuage concerns about deciphering a firm’s value by providing analysis and research.

SecondMarket and SharesPost were fully launched earlier this year, while XChange plans to be completely operational in the fourth quarter. Since SecondMarket started its private company stock trading platform over a year ago, the firm reports nearly 50 trades, totaling about \$100 million in value. Currently, the Web site lists \$50 million in shares for sale. SharesPost reports that seven transactions have been executed, with an aggregate value approaching \$500,000, and that more than \$10 million worth of posts are on the site. XChange says it has completed four transactions.

Since the IPO market slumped, investors have been locked in to their investments longer. The average age of a venture backed company at its initial public offering in the first half of 2009 was nearly 12 years, up from just over eight years in 2005, according to the National Venture Capital Association. What’s more, the number of such firms going public plunged to six last year, down from 86 in 2007. Venture capitalists cite burdensome and costly regulations, including a more competitive landscape plus accounting rules stemming from the Sarbanes-Oxley law, as major deterrents to going public, particularly for small and medium-size firms.