Praexo
technology serving issuers

How could technology improve ways private companies raise capital?

In recent years, the IPO process has been challenged as ever more companies chose to remain private for a longer time. Companies used to stay private between 4 to 6 years then most of them would go public. Nowadays, this pre-IPO period has expanded to 8 or 10 years. We note also fewer companies get listed. There were only 21 IPOs in 2019 on Euronext and Euronext Growth against 42 in 2015 for example.

This creates a new challenge: how do private companies have successfully access to sufficient pool of capital to sustain their growth?

It is a fact, the cookie-cutter and traditional way to raise capital is outdated for many players: first, process has become inefficient and time-consuming. Second, the way the information is transferred is opaque and too often becomes value-destructive for the issuer.

For many years now, a growing number of capital markets experts have been complaining about the standardization of the capital raising processes that have become cumbersome while facingw more volatile markets and increased regulatory oversight. These archaic processes include numerous physical meetings, phone calls,…where countless hours are spent on collecting data, drafting long and outdated presentations (as soon as they go for prints),…It all leads to a slowing down of the process and loss in efficiency. Obviously, they do not fit anymore the new technology possibilities that the world is offering us already.

Likewise, as perfectly observed by Cohen & Dean (2005), any capital raising transaction faces challenges resulting from an asymmetry of information. By nature, this information asymmetry is a central component in private markets (up to IPO included) to the extent that potential investors possess substantially inferior knowledge relative to the owners of the security. As a consequence, investors cannot compare investment opportunities transparently. According to Cohen & Dean, the higher the information asymmetry, the greater the underpricing and post-IPO stock value run-up. In that context, the management has a key role in deal valuation as "*the ability to raise funds is also critical to the long- term success of the firm*". This information asymmetry becomes even more incomprehensible as technology allows to transfer information quicker and more transparently. Digital solutions should support companies' management in better understanding investors' needs and fulfilling more efficiently their requirements that could finally lead to a reduction in this unsettled information asymmetry.

For all these reasons, the technology should definitely be an enabler for building a trustful relationship, accelerating processes and saving money in relation with capital raising transactions.

But more than just tools to remove barriers, are new technologies also becoming a means of raising capital?

Recently, technology has created new formats of financial instruments in the form of the blockchain-based tokens. The development of ICOs (Initial Coin Offerings) and STOs (Security Token Offerings) are examples of new ways of raising funds thanks to technological breakthrough. Tokens in the financial industry have numerous basic benefits: security, transparency, limitless transferability, fractional ownership and a good glimpse on the deal cap table. After the dematerialization of financial instruments and the 2.0 security (end of paper era) that was initiated in the early 80s, tokens could be seen as the next 3.0 security. Many observers believe that tokenization will foster how private companies fund their development and operations. Token adoption can obviously be a catalyst by tearing down some barriers, but it will not be enough. An investment decision will never be driven by the format of the security, the ability to trade 24/24 7/7 or to offload most of the paperwork. Investors must be convinced by the fundamentals of the company and the use of proceeds of the capital raising. In order for more and more fundraising to rely successfully on tokens, one should have to go back to basics: genuine investors targeting and compelling equity story.

The introduction of new technologies is part of humans' life cycle. Considering the fundraising business, it is an enduring task to change all the fund-raising processes, whether it be at the regulatory level or at the industry mindset level. In recent years, crowdfunding, another new way to raise capital, has largely emerged as the practice of funding a project or venture by collecting small amounts of money from a large number of people, typically via the Internet. Over USD$34 billion was raised worldwide by crowdfunding from 2012 to 2015 (according to startups.com). Besides the "marketing" aspects and all the results obtained, crowdfunding is aimed more towards small businesses and it is more dedicated to private individuals and business angels. The choice of crowdfunding relies more on the capital need of the company and its (early) stage of development.

Tokens and crowdfunding show, in their respective fields, a desire to use and adapt technology to make interactions more fluid and direct, as they share the same philosophy. In the same vein, we are witnessing a growing interest for direct listings, such as the Spotify IPO in 2018. Direct fundraising is increasingly popular. Until now reserved for secondary offers, the NYSE is constantly lobbying to convince the SEC to extend the regulation on direct listing to primary offering.

To conclude, technology can help current processes but cannot replace them entirely yet. Pending the massive adoption of new technologies in the financial spheres, the consensus is to couple technological advances with conventional processes in order to make them more transparent and more efficient. Indeed, an investment decision is not based solely on numbers or rational criteria. Technology must therefore come to reinforce current practices and back business decisions. A new era is looming ahead where Blockchain, AI, and machine learning will improve the process while leaving a part of tailor-made input brought by human intelligence. This is why we embrace *Intelligence Augmentation at* Praexo.

Next article will be released end of August: "*Son, What's next in the relationship between Issuers and Investment Bankers?"*

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ABOUT PRAEXO

Praexo is a French Fintech company co-founded in 2019 by a team of investment bankers and IT managers from bulge-bracket investment banks. Praexo intends to introduce data-science and digitalization in capital raising processes in order to help private companies in improving their investment case and how top management interacts with the investors' community. The objective of Praexo is to allow top management to regain ownership in these processes without losing grip to their daily operations.

More information at: www.praexo.com

Contact
Email: contact@praexo.com
Tel. : +33 6 11 635 999