IPOs give tech companies instant wealth but lots of headaches

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With Groupon Inc.'s high-flying IPO earlier this month and Zynga Inc. poised to go public, Silicon Valley is once again atwitter (if you will) about its favorite obsession: the initial public stock offering.

But while a robust stock market debut is a badge of honor, the wealth it creates can lead to newfound distractions for employees, veterans of the process say. Obsessed workers watching the stock price minute by minute lose focus. Sudden multimillionaires splurge on new cars and houses, creating envy among those who have worked just as hard but joined the company at the wrong time. Employees who have cashed in start to check out, fueling resentment in co-workers who have to pick up the slack.

In short, it's a recipe for disaster for a company culture that's already under stress from the new attention that going public attracts.

Those who have been through the process say it's crucial to have experienced hands at the helm. Phil Fernandez, for instance, has been a top executive at two valley tech companies that have gone public, and he's making plans to take his current startup, San Mateo, Calif., enterprise software maker Marketo, public sometime next year.

He speaks soberly of the hazards awaiting Facebook CEO Mark Zuckerberg, Zynga CEO Mark Pincus and others when he says:

"It can be a tremendously distracting thing."

Fernandez is the former president and chief operating officer of Epiphany, a San Mateo software company that during the dot-com zenith of 1999 went public in spectacular fashion. "It was one of those ridiculous cases where the company ran to a $9 billion market cap and created tremendous paper wealth," he said. "A number of people walked out with $50 million or $100 million. And it created some big divisions between them and the ones who weren't able to cash out before the bubble crashed."

Much of the tumult an IPO creates has to do with the so-called "lockup period" that keeps company insiders from selling stock within the first six months after going public. Epiphany's shares, for instance, made their debut at $16 apiece in September 1999. By March 2000, they topped $211. But within weeks, as Wall Street began to question soaring dot-com valuations, Epiphany's stock plunged - while many employees, other than the earliest hires, were still not vested in their shares.

"It did create a lot of bad feelings," Fernandez said. Fixation on the share price, he said, became "a pervasive element of that culture."

Now consider the more recent example of Pandora Media, which in the five months since going public at $16 a share has seen its stock price swing from $9 to $26; it closed Wednesday at $12.16.

"We've really tried to teach people that investors will set the price every nanosecond, and it's not something for us to focus on," said Chief Executive Joe Kennedy - who, like Fernandez, has ridden the IPO roller coaster before. In summer 1999, he had just joined E-Loan as vice president of marketing when the company went public at $16 a share. The stock hit $63 a week after its IPO, making Kennedy (and plenty of others) millionaires on paper; a month later, it was down to $21.

"It reinforced for me that an IPO is just another step in a company's life," he said recently. But "for people who have never been through an IPO, there's a tremendous focus on that day, almost as a goal in and of itself."

So to keep Pandora's 400 employees from being swept up by the adrenaline rush of going public, Kennedy repeated the mantra, "We're going back to work tomorrow morning." When he flew home to the San Francisco Bay Area from New York the night of the IPO, he made a point of flying coach.

Lise Buyer, a former investment banker who guided Google through its watershed IPO and now counsels companies on the process of going public, agrees that the people at the top of the organization chart can set a pivotal tone after a stock debut. "If they handle it graciously," she said, "the organization tends to handle it graciously."

To that end, she says Google co-founders Sergey Brin and Larry Page "were very clear that if you wanted to buy a fancy car, don't bring it into the company parking lot. It was recognition that you had people who were worth eight figures, and people on the same teams who'd only been there for months."

Employees at Facebook and Zynga privately say they're trying to borrow from Google's example, which also included an education program to help employees understand issues like estate planning, philanthropy and the tax implications of stock options.

Zynga even included the potential fallout among the risk factors laid out in its IPO filing: "We expect that this offering will create disparities in wealth among our employees, which may harm our culture," it states. The company also noted that the IPO will make some of those workers wealthy beyond their wildest dreams, "which may reduce their motivation to continue to work for us."

Indeed, keeping millionaire techies focused once they no longer need to work is another challenge a CEO faces post-IPO. Valley insiders wryly refer to the trend as "resting and vesting," and Buyer notes that it's sometimes necessary to move such people out of the company.

"It's a tightrope," she said. "Some of those folks are responsible for getting the company where it is after a lot of 20-hour days. But once a company's public, it has to be conscious of costs, because everybody's watching."

Such outside scrutiny also means companies must educate their people about disclosure. A few careless words to a friend about proprietary financial data can sock an employee with insider-trading allegations.

Although Kennedy said he has tried to keep his employees in the loop just as he did when Pandora was private, Fernandez and others say it's often tough for a CEO to maintain the same level of openness after an IPO.

Fernandez has begun informal workshops to walk his employees through these kinds of issues. Going public, he said, "is exciting, and I'd be lying to not share that excitement. But then I say, 'Let me tell you some of the bad stuff. If we get distracted, we can blow it.' "

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