When it Mattered

Episode 39: Jared Carmel

Chitra Ragavan:

Jared Carmel thought he was on a surefire path to success when he went to college in 1997 in Buffalo, New York to major in informatics. But by the time he graduated and was ready to hit the ground running in September 2001, the world had changed. Carmel eventually got hired at a boutique investment bank where he earned his chops by wearing lots of hats and learning lots of skills.

Chitra Ragavan:

Hello, everyone. I'm Chitra Ragavan, and this is When it Mattered. This episode is brought to you by Goodstory, and advisory firm helping technology startups find their narrative. My guest today is Jared Carmel, Managing Partner at Manhattan Venture Partners and a pioneer in the development of the secondary market for pre-IBO technology companies.

Chitra Ragavan:

Carmel's primary focus is providing liquidity and diversification for shareholders of illiquid, high-profile, venture backed private companies. Carmel has helped produce nearly two billion of invested capital across more than 30 businesses with over 20 liquidity events including Facebook, Twitter, Pinterest, Lyft, Spotify, Alibaba, DocuSign, and Airbnb. Jared, welcome to the podcast.

Jared Carmel:

Thank you for having me. I'm very excited to be here.

Chitra Ragavan:

You thought you had it all figured out when you went to college back in 1997, but as it often happens life took a twist. What happened to you?

Jared Carmel:

You're right. I did think I had it all figured out. So I started school in 1997, probably one of the best times that the United States has ever seen. By the time I graduated in 2001, the world really took a turn for the worst. Nearly nine months after the tech wreck and about 90 days before September 11, I graduated. Started to look for jobs just like everybody else, and then September 11 occurred. I thought that I'd be working at a large Wall Street investment bank somewhere. And then all of the sudden, post-September 11, there was no jobs anywhere in the world. Ultimately, I think that really formed and helped shape who I've become today, but when you're from New York, from a family who didn't have a lot of connections, it was very hard to figure out where you were going to go from there.

Chitra Ragavan:

So what did you do? How did you cope with that and how did you even look for work?

Jared Carmel:

The first thing I did was try to reach out to friends and family to see if there was anybody with connectivity. My father, as I was sort of indicating before, he was, he had a very small business on Long Island. He had a lighting store. My mother was a guidance counselor at Automotive High School in Brooklyn. So our connectivity was fairly limited. So after working for my father for several months trying to figure out what to do with myself and reaching out to different companies as best as I could, I ended up finding an ad in the New York Times. I'm not sure that people do that anymore, it was actually the paper edition. Circled it with my pen, made a phone call, and after several interviews I ended up working for this boutique investment bank located here in Manhattan.

Chitra Ragavan:

And what were the kinds of things you did and how was that experience?

Jared Carmel:

It was an interesting time in the world because the capital markets shut down for so long, the tech wreck occurred. And it was one of those where I ended up working for a handful of let's call them refugees from bulge bracket investment banks. And by doing that, I got to wear a lot of hats and I would say that ultimately that really helped shape me.

Jared Carmel:

So the diversity that came with coming out of college in that early 2000s, actually allowed me to figure out what I wanted to do and what I liked to do. Mostly while I was there I was working on different types of private equity. So I'm talking about businesses first that maybe went public too prematurely during sort of the boom bust of the first technology wave. Companies that still needed more capital. These were called pipe transactions. That's when you make a private investment into a public equity.

Jared Carmel:

They were interesting companies. There was a lot to do and a lot to learn. What I found was, I really liked learning about these companies. I liked to dive in. And for better or for worse, it allowed me to sort of learn a new story, learn a new opportunity, learn about a new technology, at point in my life where I was still ever curious.

Jared Carmel:

What I found from that was I truly liked the sort of investing in technology space. And if you speak to my mom at some point ever, she'll tell you I was the type of kid that I was taking apart her electronics. So it all sort of makes sense.

Chitra Ragavan:

Yeah, and were you able to put it back together?

Jared Carmel:

Never. Never, that's why I'm not a hardware engineer or software engineer. I was very good at taking it apart and being ever curious, but putting it back together was my shortfall.

Chitra Ragavan:

And you worked on a lot of stuff that wasn't all that sexy, right In this first job? But the failed projects were just as helpful as the successful ones.

Jared Carmel:

It's like batting practice, right? Before you can go hit grand slam homoe runs you need to strike out a bunch of times. And anybody who hasn't had failure in their life will probably never reach success. So yeah, the businesses that we're looking at, some of them were interesting, some of them were sort of esoteric and boring, but I ultimately at that moment in time found my way into more of the telecom space.

Jared Carmel:

There was a term used that's lesser used today called TMT, right? So technology, media, and telecom. So you used to have analysts or investment bankers who would either cover or invest in technology, media, and telecom. Obviously telecom has changed pretty dramatically, but what I found myself really liking and sort of getting my hands dirty in was on the telecom side. So all the switches and the routers and the fiber and everything that makes our phones run super duper fast today. That groundwork was really laid in the late 90s and early 2000s.

Chitra Ragavan:

And that's the stuff you were focusing on?

Jared Carmel:

Yeah, so I focused on that for a number of years. I found myself evolving and I sort of followed a trend in Silicon Valley where we started to invest in clean and green technology. Which if you asked me was probably the most interesting part of my investment career. Because it felt like we were investing in breakthrough, bleeding edge, amazing types of businesses that ultimately would change the world.

Jared Carmel:

And for better or for worse, it felt like we were investing and doing God's work at the same time. And by the time that those businesses started to ramp up we ended up seeing a lot of political backlash on these companies. But, ultimately, the real problem that I think we bumped into was 2008.

Jared Carmel:

So I was born into a recession out of college, I started to ramp up my career, and then bang. Seven years later, 2008 came. And that wasn't kind to anyone's portfolio, and especially not the venture capital community's portfolio as well.

Chitra Ragavan:

Wow, that's crazy to be bookended by recessions like that just when you're taking off.

Jared Carmel:

Yes. But I will say that the one thing it did teach me and I would say I definitely learned this from my father. I always joke that because watching him sort of go through the trials and tribulations of having a small business, I have a kitchen table MBA, right? And the reality was I watched him go through these ups and downs in his business and the one thing that I learned from him especially, is that you got to keep pressing forward. And the world's going to always knock us down, but as long as you keep getting yourself off the ground and dusting yourself off and keep moving forward, life tends to work out for you.

Chitra Ragavan:

So how did you wind up exploring the secondary market? We should probably explain what that is and where that fits into the venture fund world.

Jared Carmel:

Sure. So it was a little bit by accident. It was one of these things where I felt like in the first 10-ish years of my career opportunity wasn't knocking. And finally it did. And I got to tell you, I feel like I built a door. So ultimately in 2/4 of 2009, I was still licking my wounds from all the clean and green investments that we made. I got a call from a friend of mine who I went to college with. He said, "Hey, I hear you're in the venture capital space. I work at Facebook." And again, just an employee. "I work at Facebook and I'm looking to sell some of my shares."

Jared Carmel:

Now mind you, in 2/4 of 2009, this was about three years before the company was trading on a public exchange so it was still a private business. Now, it was an interesting business. I was the right age for it. I was the ripe old age of 30. I was a user. But what I didn't know at the time was that, based on certain governance within technology companies or private companies, you do have the ability to actually as a vested employee or another type of shareholder to sell your shares to another party.

Jared Carmel:

Typically if I had to sort of distill it. Typically the companies, like Facebook, have something called a Right of First Refusal which I might refer to throughout this conversation as the ROFR. Meaning that they can use their own capital to purchase those shares back from that employee, but usually that employee first has to submit a transfer to the company in order to start that process.

Chitra Ragavan:

And I think it's probably helpful for listeners to understand that while some startups are very open to allowing employees to get that kind of liquidity in the secondary market because they don't plan to go public for a long time, but they want to give employees that opportunity to use that money to buy a house or get married or whatever. So that's the first important thing. There are other companies that don't like to do that. So that's, I think that's important point to make.

Chitra Ragavan:

And secondly, they use this ROFR as a method of controlling the price. So that if the employee is trying to sell the shares at too low a price, then the company can come in and actually buy it at a more competitive price. Correct?

Jared Carmel:

All of that is correct. What I think we've seen though over the last 10 years is that there's been a greater move towards providing more programmatic liquidity solutions for the employee base. And before I get into there maybe I'll, just like you suggested, let me talk a little bit about the landscape over the last 20 years that really evolved and got us to the point of this active secondary or active private market bid-and-ask system that sort of exists in the ecosystem.

Jared Carmel:

So before 2001, technology companies specifically, the average age at an IPO was three years. Today that number has moved to 11 years. Now, why has this happened? It's simply because of two factors. Number one, more regulation. But number two, is an abundance of private capital which is really driving that change.

Jared Carmel:

What we did recently was we actually did a liquidity study. Meaning that we said, "Okay. Who out there are the natural investors in private technology businesses?" So the ones that pop up simply and easily are venture capital firms or private equity firms. Between the two of them you have nearly a trillion dollars of uninvested capital sitting in these funds dedicated to investing in private technology businesses. On top of that there's untold trillions in mutual funds, sovereign wealth funds, as well as corporate venture capital arms.

Jared Carmel:

And what probably most people don't recognize or realize is that some of the largest investors today in these later stage rounds of these technology businesses are corporate venture capital arms, and sovereign wealth funds, as well as mutual funds. And thus elongating the company's life in the private markets to 11 years. And we think that all this capital that has poured into this asset class has pushed the time of liquidity probably out even further.

Jared Carmel:

Like I said, before 2001 eBay went public at three years, Google at two years, Amazon at three years. And those are examples of how VC-backed companies used to work. So as an employee of one of these companies, you always hear about the founders. But as an employee of one of these companies, after three years of work you were able to cash out or diversify into the public markets. Meaning the company had an IPO, you as a senior engineer or whomever had shares in that company. And outside of making your X amount of dollars per annum, you were able to go out and sell some of those shares into the public markets and buy homes, live a very fruitful life, etc.

Jared Carmel:

Now, there's a real human side to all of this today. If you look at some of the recent IPOs, companies like Uber or DocuSign, or even Facebook or LinkedIn. These companies have stayed private anywhere between eight and 15 years. So ultimately, employees during that time that the company's private have little to no ability to diversify.

Jared Carmel:

Let me explain. If you go to work at a public company today whether it's Apple or Google or whatever, Ford. They're going to issue you stock at some point and eventually you'll be able to sell that onto the New York Stock Exchange. But if start at one of these private companies whether it's today in Airbnb or Turo, Line, DraftKings, whatever. You may start at 24 years old and by the time you're 32 years old, you have significant life changes and different responsibilities. Maybe you want to buy a home, pay your student loans off, have children. And meanwhile, you're working in one of the two most expensive zip codes in the United States, usually either New York or most likely San Francisco, making a modest but good income. But you're the least diversified person in the room.

Jared Carmel:

Meaning that if any of us called our financial advisor today and said, "Hey. I want to put all my money into Apple computer" which is public, right? Which by most... I would say most folks would think that's not a crazy thing to do is invest in a large cap, ever-growing, public technology business. But having 100% of your net worth tied up in there means you're not diversified.

Jared Carmel:

So if you're working at any of the companies that we mentioned while they're private, you're the least diversified person out there. And during that time while the company is private, you don't have the ability to do other things outside of whatever your income allows you to do.

Chitra Ragavan:

Then the other problem is there are restrictions on your ability to sell those shares in the lead-up to a company going public to prevent any kind of insider trading. And then when a company like Uber or Lyft has a value that's overvalued and then that plummets, then the employee doesn't even get that kind of return on their investment at the end of that long period. Right?

Jared Carmel:

That's right. So the means to an end for a lot of these companies is using the public markets as broad-based liquidity mechanisms. And what we have found, especially over the last 12 months is, I would say, a mispricing or maybe even a lack of understanding of the folks who bring companies public. What I call IPO bookrunners, the bulge bracket investment banks who ultimately say to an Uber, "Well, you'd like to go public. Here's where we're going to value the business."

Jared Carmel:

And that system at which they actually bring companies public, to me is broken. They value the company at a certain price. They allow a big chunk of that company to be sold to investors and those investors don't have to hold onto that business for any significant period of time. Whereas all the private investors as well as the employees and founders and all the shareholders, during that first six months post IPO, cannot sell a single share. But yet the folks buying it at the IPO are fluid and liquid, and they're able to buy and sell at will. And if you misprice a business to the upside. Let's use Uber as an example. And that stock goes down 10, 20, 30, 40% there's nothing you can do as a private shareholder. And we also saw the same problem with some of the IPO bookrunners not properly pricing businesses that they didn't really understand or were less consumer facing. Companies like Zoom, amongst others, they were mispriced to the downside.

Jared Carmel:

The idea of a public market is to get companies to equilibrium. Meaning they go out at a fair market value and they start trading appropriately. And that's the antithesis of what we've seen over the last nine months to a year. So part of what we do is ultimately that. Help provide diversification to the unknown.

Chitra Ragavan:

How much of this problem of overvaluing or undervaluing a company by these bookrunners has to do with the fact that these companies remain private for so long that they don't need to expose their books. And that's probably a factor in why they want to stay private as long as they do because if you want to go public then you're exposing your books and your accounting and then people know what the real health of the company is.

Jared Carmel:

It's not even just about the health of the company, but you hit that nail right on the head. It's a very expensive proposition to be public and you have to deal with quarterly and annual results. And it's to nobody's surprise that there's such thing as an activist investor. So like a Carl Icahn as an example, is an activist investor. And a lot of times activist investors, they only care about the quarterly results. Whereas private investors look forward to the future and they value you on where you're going to be years from now, not where you're going to be tomorrow.

Jared Carmel:

So having to deal with the sort of ups and downs of the public market and the employee morale that's associated with if you end up dropping pretty precipitously, like we've seen with companies like Uber and the like, can be quite difficult for those businesses and running a business.

Chitra Ragavan:

So overall, who would you say this trend has benefited the most, the founders and the employers, or the employees? This trend towards staying private longer and longer and then this opening up of the secondary market.

Jared Carmel:

Well I think who's benefited the most are these new crossover investors. It gave them the ability to participate and almost create their own walled garden around companies. Meaning that if companies used to go public in three years backed by traditional venture capitalists and now a company is five years old, before this there was no ability for a mutual fund or a hedge fund or a corporate VC or a sovereign wealth fund to invest in these companies.

Jared Carmel:

Now, it also obviously helps the overall startup ecosystem because it allows companies to build themselves to a point of being an excellent business. Not a good business, right? An excellent business. The idea is we have enough capital to pivot. To make bad decisions privately, right? And not to have to deal with those activist investors. It gives us the ability to grow and actually create a business without having to deal with the scrutiny that usually comes with being a public business.

Chitra Ragavan:

So timing everything in starting a new company and it seems like your timing was absolutely perfect when you started to look at this very niche market when no one else was, when you set up Manhattan Venture Partners.

Jared Carmel:

It's one of those where sometimes it's better to be lucky than good. And this might be one of those moments where we saw an opportunity, we looked at it, but the one thing that we found was and our concern at the time was that there was no true ecosystem for this business. What we learned was regulation didn't allow for traditional venture capitalists to own a lot of secondaries within their portfolio.

Jared Carmel:

So today the Securities and Exchange Commission has something called the private company exemption and that allows a VC fund to have 80% of their fund in venture capital. Once they get under that 80% mark, then they have to be regulated. Meaning that that 20 plus percent could be another opportunity. It could be secondaries. It could be public markets. It could be cryptocurrency. Heck, it could be gold or wine, who knows where they're putting that 20%, but once that 20% grows to 21% you have to start actually, you have to get what's called a registered investment advisor license. You have to start dealing with the accounting rules and the disclosures of a registered business.

Jared Carmel:

So in the end, what we found was we had to build out an entire ecosystem. So the first thing we did was we created a broker-dealer, become a registered investment advisor so that we can invest in more of these secondaries. And now mind you, the idea of secondaries is not an uncommon concept. The idea of secondaries had been around for a long time, but usually companies who would invest in secondaries were buying, I would say, later stage what's called limited partner interest, from venture funds. Meaning that they would go in there and provide liquidity to the investor base within the venture fund and buy a diversified basket.

Jared Carmel:

But now that we saw these companies stay private for such a long period of time, we looked at the entire venture community and said, "Okay. What's left in these portfolios that are doing super well, makes up most of their returns?" And we started to invest in those businesses. So not just helping the employees with their liquidity, but also helping the VCs with their liquidity.

Jared Carmel:

So we had to create an entire ecosystem around this in order to facilitate all of this broad based liquidity that we found was necessary in order to keep the private markets moving efficiently.

Chitra Ragavan:

And you've had a piece of some of the biggest of companies in the tech space. What's that been like and what have you learned? Looking at Airbnb or Facebook or Lyft and, I mean, your portfolio is quite extraordinary. What have been some of the key lessons learned from looking at this landscape of tech companies and how they've evolved?

Jared Carmel:

Sure. We use a sports term internally called "buzzer beating." Right? It's a basketball term when the game's about to end and you're taking a shot maybe from half court. Meaning that what we don't want to do is buzzer beat. It might be so interesting to hear, and I'm making this part up, "Airbnb's going public this year." Once you hear that it seems that your first inkling is, "Oh, I need another bigger piece for so on or so forth."

Jared Carmel:

Well what we found is as companies get to the later stages or latest stages of their life, there ends up being sort of a convergence in pricing. Either to the last round of funding that might have happened in year or two or three before. Or ultimately crossing that line and actually being valued at a much greater price.

Jared Carmel:

So what we've learned through sort of trial and error is that we have to take a real sort of wait and see approach. Meaning that we want to invest in companies that have somewhere between 12 and 48 months to liquidity. So what we've learned the hard way was if you hear an announcement of X, Y, Z company having an IPO this year, probably stay away. At least for us as principal investors because we do principal investing through our fund.

Chitra Ragavan:

And where do you see this going? If companies are staying private longer and longer does that eventually mean that tech startups will essentially walk away from any kind of public funding, IPO, or? Where's this all going?

Jared Carmel:

I think that the public markets are here to stay. I just think we're starting to see sort of the winds of change start to sort of blow through both New York and Silicon Valley. And that is alternative methods to reach the public markets. Not every business in the world needs to have the big fanfare that comes with having a traditional Initial Public Offering or an IPO.

Jared Carmel:

For the audience I'll explain this sort of briefly and again, I'll try to distill it appropriately. Which is, if you decide you want to have an IPO you usually work with a large investment bank on Wall Street. Who comes in and says, "Here's exactly what we're going to do for you. We're going to raise you hundreds of millions, if not billions, of dollars worth of cash. And then after you do a roadshow and travel around the world with us and meet the potential investors, we're going to work with one of the exchanges like the New York Stock Exchange or the NASDAQ. And then ultimately we're going to take your company and we'll have shares traded on one of these exchanges and people can buy and sell those shares. All of yourself, and all of your employees, and your investors, have a lockup period for six months and when that lockup expires, you can sell your shares."

Jared Carmel:

That's how it works today. What we saw with one of our portfolio companies, Spotify, was they decided to do something called a direct listing. It's the first time that something like this was done. So think of it as an Initial Public without the Offering. So the IP of the IPO. Meaning they took their business, they dropped the entire business on the New York Stock Exchange with little to no volatility and no problems. But behind the scenes what people didn't know was leading up to that direct listing, the company worked and did hundreds of transactions behind the scenes allowing their shareholders, whether you were an employee or an investor in the company, to sell their shares. And we participated in nearly 300 individual transactions from the summer of 2016 all the way through their direct listing which I believe was June of 2018. And over that sort of year and a half time frame, like I said we did nearly 300 transactions as small as five or ten thousand dollars for an employee at that company. As large as 100 million dollars from a corporate venture capital arm.

Jared Carmel:

And ultimately we got that business to a point of what I like to call equilibrium. Meaning all the sellers were gone in the business, all that was left in that company were either buyers or holders of that stock. The company didn't need money and didn't want money. So they took their entire business, they dropped it on the New York Stock Exchange. Day one, all the shares were free trading meaning there was no longer that lockup that I spoke about before and anyone could buy and sell their shares day one. And what that did was is that used the public markets as a clearing house. As opposed to a method at which one would use to create liquidity and or investment into a company.

Jared Carmel:

And we expect to see more of that. There is rumors about several companies doing it. Slack did it recently as well and there's a handful of other companies if you look at the news that are looking at doing these alternative ways of going public. One of them is another portfolio company of ours that most people know, a company called DraftKings. DraftKings is working with what's called SPAC, right? A Special Acquisition Corporation and what that SPAC is is it's a shell company that in this case holds hundreds of millions of dollars and they're acquiring DraftKings into that SPAC. It's a go-to-public strategy where they don't have to do that enormous roadshow, they don't need to run around the world sort of shaking hands and meeting everybody because they have one large investor who believes in the company and they'll back themselves into the public markets without that roadshow and without that fanfare.

Jared Carmel:

So we're starting to see more and more of this happen on a regular basis which means there is a need for liquidity that will continue to happen in the private markets. And I think as companies continue to stay private for a long time, we'll see a really big sort of uptick in the way that they think about their existing shareholders and their existing employees and what they can do for them.

Chitra Ragavan:

You have been through 9/11, you've been through the 2008 recession, you've been through tech wrecks of all kinds, and now of course we are confronting this unprecedented crisis with coronavirus. How is that affecting the technology space and the VC space and also the secondary markets?

Jared Carmel:

Sure. So if we did this conversation three months ago, if we had this conversation nine months ago, if we had this conversation a year ago, I would have told you there's a wall of worry that I am seeing. And maybe I'm Chicken Little. "The sky is falling, the sky is falling, the sky is falling." Right? But I've lived through two recessions as you've mentioned. I've come out stronger each time, but when I look at the landscape, we've seen a few things. And I'll throw two points out there before we move on to everything. Which is the average bear market in the United States meaning the average recession, lasts about 18 months. The average bull market lasts about seven years. We're in year 11 of what is now going to go down as being probably the oldest bull market in history.

Jared Carmel:

So here we are at the sort of oldest bull market in history and if you look at the macro landscape of the world, it's pretty scary out there. I mean, not only are we in an election year, right? You have Brexit. You had, before corona, the Hong Kong protests. You have central banking ammunition meaning that they don't have a lot of rates to cut. You have earnings not coming out great from businesses. You have an economic slow down or recession that's looming. You have global bond yields that are flattening. You have debt, both owned by businesses and governments alike, starting to stockpile. And then you have the trade war with China.

Jared Carmel:

And ultimately this wall of worry is what keeps my up at night because ultimately I'm investing in growth businesses in the private markets. And not to be too self-serving, but we're on our fourth fund. And when we launched this fund about a year ago we were very specific with our investors. This is what we're seeing and what our goal is to sort of keep power dry in order to sort of take advantage of changes that might come in this space.

Chitra Ragavan:

So what would you say is the biggest challenge with the coronavirus and where is it coming from?

Jared Carmel:

So I don't have a biology degree. This is not my space. Although, what I think coronavirus is to the global markets, it's not really the straw that breaks the camel's back but it's the magnifying glass that sets that straw on the camel's back on fire. If you ask me again three months ago or nine months ago what my biggest concern is, it's actually Italy and the European Union as a whole.

Jared Carmel:

Italy has almost 135% debt to GDP. Before corona, this was all before corona, they're the fourth largest holder of debt in the world behind the United States, Japan, and China. And their economy is nowhere as large as those three. There's 60 million people of which 9% are unemployed. And one of their main industries is tourism. They're a service economy. So I think that corona might be the magnifying class that sort of sets this all on fire simply because Italy was my largest concern and obviously Italy looks like they're going to be, they're being hit by the coronavirus the hardest right now.

Jared Carmel:

And if tourism and service is their largest parts of their GDP, or one of the largest parts of their GDP, I think they're going to have a very difficult time recovering. And this can create a contagion throughout the entire European Union. A few years ago we were all talking about Greece, but Italy's GDP is almost ten times the size of Greece. So if this contagion through Italy failing is as big as it possibly could be, then we're talking about the European Union being affected dramatically and as a whole it's a fairly big economy. It will affect the rest of the world.

Chitra Ragavan:

So if the economy slides into a global recession what's going to happen in Silicon Valley and LA and New York and all these hubs for technology startups? And more importantly, to shareholders if they start to lose their jobs, employees?

Jared Carmel:

Sure. It's hard to tell how it's going to affect these businesses at a whole, right? Many of these companies sort of will continue to do very, very well. We've seen traditional venture capitalists launch large funds to take advantage of late stage and growth stage investing, which my guess is they'll be supporting a lot of their later stage businesses with the billions and billions of dollars that they raised.

Jared Carmel:

But the one thing that's different right now that we've never seen before in the history of venture capital or private investing, is these large cap private technology companies. These unicorns as the media likes to call them. These multi billion dollar private businesses. In many cases, most of them are very well capitalized to the tune of hundreds of millions if not billions of dollars. But what we expect to happen when a recession does hit, is what we've been seeing over the last week or two. The stock market comes down pretty dramatically.

Jared Carmel:

Which means the multiples that the private companies are trading at today, compared to the multiples in the public markets, will get skewed. So meaning that the companies and the private markets may ultimately be overvalued. Therefore, fundamentally the valuations should go down to stay with the market. But since they have all this cash and they have nothing but time, they could stay private through that 18-month recession. But what we have seen time and time again from public markets, and I imagine these large cap private businesses will do the same, is during times of recession is they lower their operating expenses.

Jared Carmel:

But how do you do that? Well, you get rid of moonshot projects you're working on. You get rid of nonessential personnel. And ultimately when you're getting rid of nonessential personnel, and I'm sorry to put it in that term, is you're basically cutting your workforce. We could call it nice words like being laid off or being fired or whatever it is. These companies, these private technology businesses, have tens of thousands if not hundreds of thousands of employees who are working to grow the company.

Jared Carmel:

So here's the problem. The first thing is if you're at a public company like an Apple or if you're at an Amazon or if you're at a Ford, and you get laid off you might cash in some of your shares into the public exchanges. Take some money out, be able to continue to live your life, collect unemployment, etc. but there's a real challenge in the private markets today. And I don't foresee this going away anytime soon and I'm not sure who else is looking at this the same way we are. Which is if you leave one of these private businesses, okay? And you end up having 90 days to exercise those stock options, assuming your stock options are vested. So whether you're in the C- suite, whether you were an assistant, whether you were an engineer, once you leave that business whether it's on your own accord by quitting or being let go or fired or the like. You have 90 days to exercise those vested options.

Jared Carmel:

So what does that mean? Well first thing you need to do is you need to pay for those options. So if you have enough money put away, then great. But if you're at a 50 billion dollar or 10 billion dollar private company and you have, God bless you, 20 million dollars worth of options it might cost you millions of dollars just to exercise those options. Meaning you have to come out of pocket for millions.

Jared Carmel:

and if you are using the same example of 24 to 32, making $100,000 a year, living in San Francisco which is the second most expensive zip code in the world, you may not have that sort of money put away. The second challenge is once you do get that money to exercise those options, the way IRS tax code works today is you actually owe Uncle Sam income tax upon exercising those options. In some cases, many of the companies we work with actually hold back those income tax because they pay it on your behalf because you were an employee and they have fear that they will be held liable if you do not pay your taxes on it.

Jared Carmel:

So if you had 20 million dollars worth of stock options, you cash those in. It might cost you, I don't know. a million dollars to exercise, but now you have a six million dollar tax bill. So a total of seven million dollars due immediately. Trying getting a loan on private securities from a bank and if you don't have real collateral to cover that several million dollars that is needed in order to affect a proper transaction with the company to own the shares that you've worked so hard for, they end up expiring worthless and it becomes a really difficult situation.

Jared Carmel:

So to me, my biggest concern for existing shareholders of these private venture backed companies, especially ones that have issued lots of stock options to their employees is what's the plan when the world changes and you have to lay these people off? You're not going to come out of your own bank accounts in order to help them with those stock options. And again, after 90 days those shares expire worthless.

Chitra Ragavan:

Yeah, and the irony of it is that the draw for a lot of these young employees is the... They come in at low salaries because they're being given high amounts of stocks, but it's great if that all works out and the economy is good and you get out and you can exercise those options and you can cash them in. But if you're coming in on a relatively low salary and not saving much, and then you have to cough up these taxes you're in a no-win situation if, when things go bad.

Jared Carmel:

That's exactly right. It could be a very scary time if you don't have a rich uncle somewhere to help you out.

Chitra Ragavan:

And I think it's also led to some new startups that are supporting these engineers and employees who, by loaning them money against their shares. And I think that's turning into another little cottage industry that could become very lucrative over time.

Jared Carmel:

I agree. I mean, you're starting to see that now. I don't disagree, I think that's a really interesting business as well. The question is if you come from an equity based society, meaning a startup then they've been funded and so on, how much debt do you really want to accrue? It'll be interesting to see how it all plays out in the end. Not just on the side of the shareholder who are taking out those loans, but those who are providing those loans because it could be a much longer proposition than they expected.

Chitra Ragavan:

So when you're looking ahead to the next year or two years, what are the markers you're looking for? What are the things that you'll be keeping a keen eye on to see where this is all going?

Jared Carmel:

Obviously the coronavirus is really scary right now, but I also think that's going to probably pass at some point in the near future. I think what we need to continue to look out for are the larger macro signals. I think we have a tendency here in the United States to just pay attention to what's being fed to us and it seems as though on the political front. I think we need to continue to look outward and see what's happening with the rest of the world.

Jared Carmel:

And how the rest of the world is behaving because ultimately we are at this interesting sort of inflection point where we're becoming a global village, whether people like it or not. And when you see rises of populism in first, second, and third world countries all simultaneously, it's sort of dictating where our future is going to go.

Jared Carmel:

So I think I would say keep an eye on the European Union. Especially what's happening not just with corona in Italy, but the Italian fiscal policy. Keep an eye on the central banking system. There's almost little to no ammo left here in the U.S. and there's little to no ammo left around the rest of the world.

Jared Carmel:

But the reality is, I think the one piece of good news because I don't want to just be a bad news sort of guy, is the one piece of good news is we live in great times. The technology that we're using today has been changing our lives for the better. It will continue to do so. But also see on an economic front that probably the dollar is the cleanest dirty shirt in the pile and we'll continue to see money flow into the dollar as a safe haven. So ultimately, as far as living in the U.S. and working in the U.S. although we'll go through some trials and tribulations likely, I think that ultimately we'll continue to be supported by the rest of the world who is almost addicted to U.S. support.

Chitra Ragavan:

Looking back at the college graduate that you were confronting the aftermath of the 9/11 attacks and not being able to find a job and everything that you've been through and what we are now confronting today, what are your closing thoughts on what you've learned in the years between all of these crises that would be helpful to others?

Jared Carmel:

Well, I will say this. It was not really my goal to start a company, but there weren't other places that I worked that necessarily shared my values and vision. I was in sort of the beginning of a trend of folks wanting to be entrepreneurs. I think you have to do it. Work hard, read a lot, ultimately in the end be a leader and make your own decisions. Don't allow other external factors media or otherwise change your vision or goal just because you're being force fed that.

Jared Carmel:

And have resilience because the reality is this has been 11 great years and I think there was a Mike Tyson quote that says, "Everybody has a plan until they get punched in the mouth." And the reality is everybody's going to get punched in the mouth a lot over their lives. As long as you're resilient and you keep getting up off the ground, ultimately in the end you'll find your success.

Chitra Ragavan:

Jared, thank you so much for joining me today. It's been a great conversation.

Jared Carmel:

Well thank you so much for having me. This was a lot of fun.

Chitra Ragavan:

Jared Carmel is the Managing Partner at Manhattan Venture Partners and a pioneer in the development of the secondary market for pre-IPO technology companies. This is When it Mattered. I'm Chitra Ragavan.

Chitra Ragavan:

Thanks for listening to When it Mattered. Don't forget to subscribe to the show on Apple podcasts or your preferred podcast platform. And if you like the show, please rate it five stars, leave a review, and do recommend it to your friends, family, and colleagues.

Chitra Ragavan:

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Chitra Ragavan:

Our producer is Jeremy Corr, Founder and CEO of Executive Podcasting Solutions. Our theme song is composed by Jack Yagerline. Join us next week for another edition of When it Mattered. I'll see you then.