U.S. Securities and Exchange Commission
Office of the Advocate for Small Business Capital Formation

How do startups "exit" or provide liquidity to investors?

Startups and other companies that raise capital via exempt offerings—sometimes referred to as private offerings—issue securities to investors that are often illiquid. Unlike securities of publicly-traded companies, which generally can be freely traded by investors, securities of privately held companies can only be resold to another investor if that resale is registered or meets an exemption, such as through the use of the Rule 144 safe harbor. There are also "exit" events that startups use to provide liquidity to investors, the most common of which are discussed below.

Common "exit" pathways

Public Offering

When a startup reaches a size, scale, and sophistication that would make it attractive to public market investors, it may choose to conduct a public offering and to list its shares for trading on a stock exchange. Public offerings provide capital to holders of a company's equity, including the founders, early employees and investors. Public offering pathways may take the form of an initial public offering (or IPO), merger with a special purpose acquisition company (or SPAC), or a direct listing.

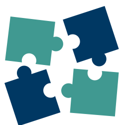
Depending on the public offering pathway and the terms of the offering, some investors' shares may be subject to a "lockup" period that delays when they can sell shares on the public market.

Sale or Acquisition

A startup may elect to sell to another company or investor via an acquisition. The buyer may take over the company—sometimes called the target—using cash, stock, or a combination thereof in exchange for some or all of the company's existing investors' equity. Often key leaders and employees of the startup stay for a period of time after the acquisition as a negotiated part of the transaction.

Merger

Similar to an acquisition, a merger entails the startup being acquired and integrated into the buyer (or a subsidiary of the buyer), which may be a public or private company. The buyer often views the merger with the startup as a more effective way to integrate the start-up's products or services into the buyer's existing business than independently creating it in-house.



Liquidation of Assets

If a startup decides to wind down operations, it will likely sell—or liquidate—its assets at market value and use the revenue to pay off obligations, returning the rest to shareholders in order of liquidation preference.

Have suggestions on additional educational resources? Email smallbusiness@sec.gov.

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