

# Is going public the right answer for your company?

Going public can be a defining moment for an organization, accelerating its growth potential and strengthening its reputation.

Companies like Visa, Apple and Google have flourished since completing their IPOs. Global IPO volumes reflect the market's continued enthusiasm: in 2017, proceeds reached \$141 billion — which was 33% greater than 2016 levels.<sup>1</sup>

However, going public may not be the right answer for every business. Public companies<sup>2</sup> must deal with investor pressure to meet growth expectations, heightened legal risk, competition for talent with specialized skills, and increased compliance and reporting requirements in a burdensome regulatory environment. A public company also needs to register the offering and sale of its securities with the SEC.

Before deciding whether or not to take your company public, it is important to consider both the benefits and the potential drawbacks. There may be other, better ways to accomplish your company's objectives.

## Why go public?

Going public has long been considered a landmark for a successful organization. There are plenty of reasons why achieving listed status may be the right move for your company.

### Raise additional capital

Your company may be able to raise substantially more capital by going public than it can accumulate through other means, such as debt financing or tapping into private equity.

### Improve your financial position

A public offering can boost your company's net worth and/or reduce your company's debt-to-equity ratio.

### Create a currency

Once public, it may be somewhat easier to raise additional capital as needed in the future. Moreover, having publicly traded shares creates a currency that can be used to acquire other businesses and compensate key personnel, in lieu of paying cash.

### Provide liquidity for existing shareholders

Going public enables existing shareholders to monetize their holdings. And, unlike a complete sale of the company, going public allows existing investors to retain some upside potential in the business if they so desire.

### Raise company profile

A public company — and its owners — can enjoy a certain cachet that is not often available to private competitors. Plus, being a public company can heighten name and brand recognition, generating more interest from potential customers, investors and employees.

### Benefit from analyst coverage

Buy-side analysts from major financial institutions will begin benchmarking your performance against a peer group once you go public, highlighting your strengths and recommending areas for improvement.

<sup>1</sup> Source: <http://www.renaissancecapital.com/Review/Renaissance-Capital-2017-Global-Annual-Review.pdf>.

<sup>2</sup> For purposes of this publication, we use the words "public company" to mean an entity whose shares are available to public shareholders, is listed on a national exchange and is subject to U.S. SEC regulations.

## Why going public might not be the right answer for your company.

Going public can also have its downsides. As the CFO of an emerging tech company recently commented, achieving listed status means “we’ll have pressure to hit our targets every quarter, our compliance costs will increase, and we’ll have significant legal exposure.”

Factors to consider about whether to go public include:

### **Sensitive information will become available to the public**

Material agreements with customers, suppliers and employees must be made publicly available on a timely basis — and therefore will be open to scrutiny by regulators, investors, suppliers and competitors.

### **Pressure to meet or exceed analyst expectations**

The urge to meet — and beat — quarterly analyst expectations may encourage short-term decision-making at the expense of the company’s longer-term goals. Even worse, this pressure can trickle down, making a company vulnerable to misconduct by employees who feel they have to hit their numbers.

### **Increased legal risk**

A public company — as well as its officers and directors — can be exposed to nuisance lawsuits when the entity fails to meet analyst estimates or to complete a major transaction, such as an acquisition. Even if the claims have no merit, defending against these actions can be time-consuming and expensive.

### **Possible loss of control**

If a sufficiently large percentage of company shares is sold to the public, the original shareholders may lose control of the company. A public company is also vulnerable to hostile takeovers or involvement by activist investors.

### **Increased time demands**

A typical IPO takes several months to complete. There will be frequent meetings with underwriters, lawyers and accountants. In addition, management will participate in a road show — presenting the organization to the investment community to build excitement around the offering. These activities take a lot of time and distract management from otherwise running and growing the business.

### **Expense of going public**

The underwriters’ commission is typically 5–7% of the total offering proceeds and additional fees will have to be paid to attorneys, accountants and printers.

### **Costly to maintain public company status**

Once public, there are significant ongoing costs to comply with federal securities laws and exchange listing requirements. A public company may need to hire additional accounting, tax, legal and investor relations resources; recruit and compensate non-executive/independent board directors; and pay director and officer liability insurance premiums.

### **Increased reporting and compliance requirements**

A public company must file periodic reports with the SEC. Public companies are also required to maintain a system of internal controls, which is periodically evaluated and, in certain cases, audited by an independent accountant. Additionally, CEOs and CFOs must provide quarterly certifications as to the completeness and accuracy of the materials filed with the SEC. The penalties for a false certification are up to 20 years in prison and/or up to a \$5 million fine.

## What are some alternatives to going public?

A company may be able to achieve some of the benefits of going public through other mechanisms. However, even these alternative strategies have their pluses and minuses.

Alternate strategy	Description	Advantages	Disadvantages
<b>Exempt offerings</b>	Offerings that meet certain criteria and are exempt from SEC registration, such as smaller offerings under Regulation A and Regulation D, Rule 144A private placements (including both equity and debt offerings), and others.	<p>Access to the capital markets without having to bear the costs of SEC registration and ongoing periodic filings.</p> <p>The Jumpstart Our Business Startups (JOBS) Act has removed some of the traditional roadblocks to executing exempt offerings.</p>	<p>In most cases, a company can raise more capital through an IPO than an exempt offering.</p> <p>In many types of exempt offerings, securities may only be sold to qualified buyers, limiting the pool of potential investors.</p>
<b>Crowdfunding</b>	An emerging means of raising capital by obtaining a series of smaller investments from a large number of people, typically through the use of social media sites.	<p>Enables entrepreneurial companies to raise capital that traditional investors or lenders are not willing to provide.</p> <p>Can be less costly than obtaining financing through other means.</p>	<p>Capital raised each year through crowdfunding is limited to \$1,070,000 (subject to periodic inflation adjustments) in a 12-month period.</p> <p>Additionally, individual investors are limited in the amounts they are allowed to invest in all crowdfunding offerings over the course of a 12-month period.</p>
<b>Secondary market transactions</b>	Private transactions that allow investors/ employees to liquidate their stock holdings to qualified investors.	Enables original shareholders or option holders to monetize some/all of their holdings.	<p>This alternative is available only to certain well-known private companies.</p> <p>Not a means to raise capital for the business itself.</p>
<b>Debt financing</b>	Involves borrowing money from a financial institution or via a private financing.	<p>With debt financing, the equity owners' interests in the company are not diluted.</p> <p>The after-tax cost of borrowing funds can be less than issuing equity securities, mainly because interest expense is deductible.</p>	<p>Debt financing imposes an obligation on a company to make periodic payments of principal and interest.</p> <p>This type of financing can constrain future growth if a company becomes "too leveraged."</p>

## Is going public right for your company?

There are no easy answers. Every business will have to reach its own conclusion, in consultation with its financial, legal and accounting advisers.

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