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Going public – the initial public offering

An initial public offering (an IPO) is the first sale of a privately held company's shares to the general public. While an IPO often provides the company with a higher valuation and greater access to capital, and the company's shareholders with liquidity, the company also subjects itself to the rules and regulations of the Securities and Exchange Commission and the stock exchange on which the company's shares are listed. This article provides a high level introduction to the process of completing an IPO, and the pros and cons of being a public company.

The IPO process

From start to finish, the IPO process generally takes from four to six months. Prior to starting the actual IPO process, companies generally spend a number of months preparing for the IPO. Among other matters, during the pre-IPO period, companies may recruit additional senior management and board members, enhance the company's financial infrastructure to be public company ready, focus more intensely on the projections of the company's future financial results and interview investment banks to act as underwriters and help guide the company through the IPO process.

Just prior to the start of the formal IPO process, the company typically makes the final selection of the investment bank or banks for the offering. After the lead underwriters are chosen, the company and the underwriters, with the help of each of their legal counsel, will hold an organizational meeting to start the IPO process and begin the drafting of a document called a prospectus. The prospectus, which becomes part of a registration statement, the document that is ultimately filed with the SEC, provides investors with information about the company, including a description of the company's business, senior management, and outstanding litigation, the risks an investor faces when investing in the company, the company's financial statements, and a list of the company's principal shareholders and their respective holdings in the company, among other things.

Once complete, the registration statement is filed with the SEC. The SEC reviews the registration statement and provides comments, to which the company must respond and, where necessary, revise the registration statement. This comment and response process continues until the SEC notifies the company that it has no further comments. Most companies qualify as an "emerging growth company" under the JOBS Act and, as a result, are able to conduct the SEC review process confidentially.

During the comment process the company selects the exchange on which its shares will be listed (such as NYSE or Nasdaq), establishes board committees to satisfy the requirements of the Sarbanes-Oxley Act and applicable stock exchange (and, if necessary, adds additional directors), further develops its internal financial control structure and engages a transfer agent. Towards the end of the comment process, the registration statement is updated to include the specific proposed terms of the offering, including the number of shares to be sold and the price per share. If the SEC review process has been done confidentially, the company must make a public filing of the registration statement at least fifteen days prior to launching the public offering.

Following the conclusion of the comment process with the SEC, the company will commence a roadshow that lasts anywhere from ten days to two weeks. During the roadshow, the underwriters and the company's management visit with numerous investors around the country (and, on some deals, internationally) to present the company's story and generate interest in the company's shares. At the end of the roadshow, assuming the underwriters have a sufficient number of buyers at a satisfactory price, the offering is "priced" and the company agrees to sell a specified number of shares to the underwriters at an agreed

upon price, all pursuant to the terms of an underwriting agreement. The IPO is typically closed (*ie*, the shares are issued and sold to the underwriters and the underwriters pay the company for the shares) three business days later.

Pros of being a public company

Going public provides the company and its shareholders with many benefits, including:

- An IPO can result in a substantial infusion of cash, which can be used to fund acquisitions or expansion plans, increase research and development or pay off existing debt.
- The company will have easier access to the equity and debt capital markets, which could provide the company with access to amounts of capital that the company would not otherwise have.
- The company will be able to use its publicly traded stock as an additional form of currency (in addition to cash) in mergers and acquisitions, allowing it to reserve its cash for other uses.
- Publicly traded stock also enables the company's employees to have greater liquidity from stock options and other stock-based awards.
- After the expiration of a lock-up period, which is a period of time following the IPO during which all or substantially all of the company shareholders are prohibited from selling their stock (generally 180 days following the closing of the IPO), the shareholders will be able to sell their shares in the public markets, allowing them to recognize instant liquidity in addition to possibly diversifying their investment holdings for estate or other planning purposes. Sales by officers and directors are subject to certain regulatory restrictions in additional to practical limitations associated to market reactions to insider sales.

Cons of being a public company

Becoming a public company also has certain downsides, including:

- Public disclosure requirements, and shareholders' reaction to those disclosures, increase the pressure on the company's management, particularly with respect to quarterly reporting of financial results.
- Companies generally provide quarterly or annual earnings, revenue or other financial guidance. Failure to meet the guidance may result in a drop in the company's stock price. Even if the company exceeds its financial guidance, the share price may still drop because the company did not exceed the estimate by a sufficient margin. This may result in management focusing on the short rather than the long term.
- Ongoing SEC periodic reporting requirements, including quarterly and annual reports, mean additional ongoing costs and expenses and may distract the company's management team from running the business.
- The IPO is generally not an immediate liquidity event for the company's shareholders due to the lock-up period.
- Simply because a company's stock is listed does not necessarily mean that a shareholder will be able to readily buy and sell his or her shares. Lack of analyst coverage or limited selling can lead to a thinly traded stock, which may make it difficult to sell at an acceptable price or at volume.
- The Sarbanes-Oxley Act and SEC and exchange regulations impose corporate governance and other requirements on the company which are sometimes burdensome.

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