The Pros and Cons of Going Public

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There's no question that the allure of an initial public offering (or IPO) for CEOs and CFOs can be strong. Going public may represent the chance to cash in on a lifetime of hard work spent building a company, or to raise a large amount of capital to fund business growth and expansion.

But the lure of an IPO can just as easily be a siren song. While most of the large corporations in the U.S. probably wouldn't be where they are if they hadn't gone public, many other companies have experienced first-hand the potential drawbacks of an IPO.

Clearly, there are pros and cons to taking your company public. For every IPO success story like Apple or Microsoft, there are other stories of businesses that failed to thrive (or even survive) in the challenging environment and under the intense scrutiny faced by public companies.

Potential Benefits of Going Public
Let's look at the pros of going public first. The primary potential benefits of an IPO may include:

Potentially large financial rewards for owners. Successful IPOs can make business owners millionaires literally overnight, at least on paper.

The ability to raise large amounts of growth capital quickly. Similarly, millions of dollars of equity financing can also be raised overnight—money that can be used to fund growth initiatives like launching new products and markets, hiring more employees, investing in research and development, and funding capital expenditures.

Direct access to capital markets. This may enable companies to raise additional capital in a secondary stock offering. An IPO may also enable a company to acquire other businesses using stock, instead of cash.

A valuable employee retention and recruiting tool. Stock options and grants are an attractive carrot that can help attract talented executives and keep them on board once they've joined your company.

A liquid market for selling ownership shares. Illiquidity is one challenge owners of closely held businesses face when they are ready to exit their business and/or retire. But a ready market exists for owners of public companies to easily sell their shares.

More liquidity for your estate. This may help heirs deal with the challenges of paying estate taxes after an owner's death.

Potential Drawbacks of Going Public
However, it's also important to be aware of the cons of going public. Three of the biggest potential drawbacks of an IPO are:

1. High cost — An IPO is generally a very expensive method of raising capital. These expenses take several forms, not the least of which is the large amount of equity that will be given up when shares are sold to the public. There are also hefty fees involved, as well as the ongoing costs of public reporting and maintaining requirements for public companies that are set forth by the Securities and Exchange Commission (SEC).

2. Less control — As a public company, you will have much less freedom to make your own business decisions and run the company in your own way. Instead, you will answer to a whole new set of stakeholders, including your public shareholders, institutional investors, a board of directors, brokerage firms, and the financial press.

3. Pressure to meet investor expectations — Shareholders and the investment community (sometimes referred to as the "Street") will have certain performance expectations for your company. And as a public company, you will be required to communicate with these audiences on a regular basis about everything going on at your company (especially everything that's financial related) and the decisions you and your board of directors make. Sometimes, these pressures may force you to make decisions for short-term reasons that you don't necessarily believe are in the long-term best interests of your company.

One highly publicized recent example of what was widely considered to be an unsuccessful IPO is Facebook, which became the biggest Internet IPO ever when it went public on May 18 of this year. When Facebook's shares soared from an opening price of $38 to $45 on its first trading day, the company's market capitalization reached $104 billion. But by the end of August, the share price had dropped all the way down to $18—a fall in value of more than 50 percent.

Concluding Thoughts
The going public decision is one of the biggest that Los Angeles and Southern California CEOs and CFOs may have to make if their companies reach a certain size and want to continue growing. The assistance and guidance of an outsourced CFO services provider can be invaluable in this decision-making process. In our next article, we'll look at some of the factors involved in making the going public decision.

About CFO Edge
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