Hallmark Capital, a New York-based investment bank, speaks on the subject of going public.

IPO: Dream come true or nightmare?

Picture this: You're flush with success. Your sales have doubled from five years ago. Two new divisions are expanding your company from its original market niche, a new product is performing way beyond expectations, and your name is drawing increasing respect within your industry. A well-known investment bank is wooing you with the seductive idea of going public – dangling promises that you'll get rich beyond your wildest dreams, and offering a valuation of your firm that is so unbelievably flattering it must be true.

Don't worry about a thing, the bank says. It will handle everything for your initial public offering (IPO): just sign on the dotted line, and it will even raise the bridge funds to pay deal expenses, which can run as high as 20% of an offering as small as $5 million.

Going public is the next step a fast-growing firm takes, right? Think again. You may be in for the roller-coaster ride of your life, from which it may be difficult, if not impossible, to recover.

Some IPOs die in infancy. Owners may sign a commitment letter with great expectations and, two weeks before the effective date, the deal falls through. Perhaps the underwriter fails to drum up enough interest from company investors – or else investors want to pay share prices embarrassingly lower than the rates that company executives envision. Or the volatile IPO market softens and then closes up.

Even if your company makes it past the IPO effective date, consider that statistics indicate that the average IPO stock price will fall within the first six months; even worse, many firms are vulnerable to downward stock price pressures for up to two years after going public. This may inhibit a firm's ability to raise capital or make it a tempting takeover target at a fire-sale price.

Before a privately held company considers an IPO, it must set strategy. As the head of a publicly traded entity, you are suddenly forced to shift your focus to the interest of public shareholders, the scrutiny of security analysts and the interests of underwriters. So beware of:

■ **The ongoing expense of being public.** An IPO requires public disclosure and your company must adhere to the regulatory reporting requirements issued and overseen by the Securities and Exchange Commission (SEC). Meeting these filing requirements adds ongoing corporate costs in the form of audits, legal filings, quarterly financial reporting, regular board and shareholder meetings, etc.

■ **Loss of confidentiality.** Because of strict SEC disclosure requirements, detailed and often highly confidential information about your operations and current financial results can now be examined by your competitors, suppliers, potential customers and the media. You will now have to publicly disclose, for example, lawsuits, contingent liabilities, details about any acquisitions, etc.

■ **Loss of operating flexibility**. The SEC requires public companies to publish quarterly financial results on a timely basis; this means that you will be subject to the scrutiny of shareholders, professional analysts and financial institutions that will expect quarterly revenue and earnings growth, or a detailed explanation of why you "failed to properly manage the company." Suddenly, you many find yourself unable or unwilling to implement strategic operating plans that have a negative impact on short-term results, even though they may be beneficial – or even crucial – to the long-term success of the company.

■ **The myth of shareholder liquidity.** Unless your company is very big and generates substantial investment interest, chances are your stock will be thinly traded. Moreover, the SEC often restricts key shareholders' ability to trade shares or engage in certain activities for a period of up to three years. This can be ample time for the stock price to plummet, either for legitimate reasons like adverse financial results, or sometimes just due to current overall market conditions unrelated to your company's operations.

■ **Being public can sometimes be detrimental to your ability to raise additional capital**. While it is theoretically easier to raise capital because your public status gives you access to a specific group of lenders that are only allowed to lend to public companies, the opposite can also be true. If your company is experiencing financial difficulties, bad news will travel fast through the tight-knit financial community. If you are private, on the other hand, you might work out with a private lender an acceptable arrangement that won't embarrass you or it because the deal is kept confidential.

■ **Exposure to uninvited raiders or troublesome shareholders.** As a public company, anyone can buy your stock, including competitors, raiders or other unwanted shareholders. Underwriters generally float between 20% and 45% of a company's shares in an IPO, and while this is less than controlling interest in the company, in the wrong hands, it could wreak havoc. If your stock price falls – even temporarily or for unexpected reasons – an unfriendly investor might scoop up your company for as little as 20 cents on the dollar.

■ **Your time and attention will be devoured during the IPO process.** According to CEOs in the INC. 100 Fastest Growing Companies, they spend an average of 33 hours a week for an average of 4-1/2 months on their offerings. Lawyers, underwriters, industry analysts and accountants – they will monopolize your time, which is diverted from customers and competitors.

Some Alternatives to IPOs.

Before making your decision about going through with an IPO, thoroughly check out all your financial options, bearing in mind the relative risks and rewards of alternative methods of raising capital. Among these other options are:

Private placement of debt and/or equity. This involves approaching a limited number of financial institutions that are selected with care and pre-screened for specific interest. You don't expose your financial condition to the world, and you maintain more control, flexibility and negotiating power if anything goes wrong.

Sale to a friendly company. Selling your business to another company with deep pockets to finance your growth may be the best strategic way to raise capital. This is true regardless of whether your goal is to retire to the beach with a wad of money in your pocket – or stay to operate the company for the next 15 years with a substantial ownership position (thus keeping operating control and increasing the value of your stock for future cashing out). A strong "financial angel" who respects your talents and wants your company to succeed will generally give you a lot of leeway to run it the way you choose.

In many cases, there are solid advantages to being a public company. Key reasons are the ability to raise equity funds directly from the public, access to additional and potentially less expensive sources of capital for future financings, and a potential source of future liquidity for shareholders.

The bottom line: Don't fall too readily for the siren call of the words "going public." An IPO is not for everyone. Whether an IPO is a nightmare – or a dream come true, earning handsome returns – depends on you personal and corporate goals, your attitude toward risk and confidentiality, and timing. It may be better to wait until your company is bigger and more stable, thereby maximizing your value by applying a high multiple to a stronger bottom line.