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Going Public -- The Right Way

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The initial public offering, or IPO, is a watershed event in the life of a company, and today's capital markets makes this possibility a potential reality for more software companies than ever before. Although few corporate events can create the euphoria or match the satisfaction associated with a successful IPO, going public is also a complex, demanding, time-consuming and expensive process. The consequences of the decision to go public are enormous. This article is in no sense a legal road map to the IPO. Its aim is to merely set forth six principles that, if observed, are likely to significantly increase the probability of achieving a successful IPO.

1. Approach the IPO as a beginning, not an end.

An IPO is not an isolated, transitory event. A critical mistake, too often made by the management of private companies, is to think of the IPO as an end in itself. It is not. Going public carries with it consequences that endure for years beyond the actual date of the IPO, such as the liability of directors and certain officers for any material omission or misstatement in the company's IPO prospectus. Being a public company carries with it a set of new and extensive demands, disclosures and burdens, including making periodic public disclosures of financial and other information. While the management of private companies are generally accountable only to creditors and a few significant stockholders, the management of public companies operate in a "fishbowl," accountable to literally thousands of public stockholders. Moreover, a public company's constituency also includes Wall Street securities analysts and institutional money managers who can be an extremely unforgiving audience if management fails to deliver on anticipated quarterly or annual results. Managing expectations on Wall Street thus becomes a necessary and often tricky new management challenge following an IPO. If liquidity is the primary motivation for an IPO, alternatives to an IPO, such as a sale or merger, warrant careful consideration. Be certain that you understand and prepare for your company's public life.

2. Beware the premature IPO.

Management must resist the temptation to go public too soon. All too often, unsophisticated or poorly advised companies in very early stages of development fall prey to the siren song of investment banking firms promising liquidity for management and access to desperately needed capital. In many cases, however, such promises turn out to be illusory as onerous underwriting terms, unwieldy capital structures, poor after-market support and thin trading volumes create an undercapitalized company with an illiquid stock, making subsequent financings even more difficult and expensive. As a rule of thumb, an IPO should not be undertaken unless management has the management information systems in place to confidently forecast revenues and earnings at least six months following the anticipated closing date of the IPO. Moreover, an IPO should not be undertaken as a financing alternative of last resort, after efforts to obtain private equity such as venture capital have failed.

3. Select the right investment banker.

Ultimately, the success or failure of the IPO will depend on the ability of the company's investment bankers to successfully market the company's securities, especially in turbulent financial markets. Selection criteria for investment bankers should include, among other things, reputation, industry expertise, strength of industry analysts, distribution channels, aftermarket price performance and post-offering services. Aftermarket performance is an especially important criteria for management because they are often required to wait until a "secondary offering," 12 to 24 months following the IPO, to sell their shares to the public. It is also important for management to be comfortable with the investment bankers that would be assigned to the company and the level of attention their deal would receive from the investment bank's sales force.

4. Choose your law and accounting firms carefully.

The difference between a smoothly run IPO and an IPO which becomes bogged down, perhaps missing a crucial market window, can often be attributed to the strength of the company's lawyers and accountants. The company's law firm quarterbacks the entire IPO process and should be experienced with both IPOs and public company representation. In many cases, the law firm that has served the company well as a private company may not be nearly so well suited to handle the company's needs in the IPO and beyond. A vast amount of work involving a large number of people (including company management, the board of directors, stockholders, lawyers, accountants, investment bankers and their lawyers, printers and the Securities and Exchange Commission, among others) whose work must be finely orchestrated, is required to achieve a successful IPO. Without appropriate leadership, the IPO process will flounder, leading to delays in meeting demanding schedules, frustration and added expense, or worse. Company counsel must demonstrate initiative and leadership to move the process forward briskly to a successful conclusion. The company's accountants must also be familiar with the IPO process and the accounting requirements imposed upon public companies. Each relationship, from law firm to accounting firm, should be examined for quality of fit and the professionals' ability to meet the many challenges inherent in the IPO and the company's subsequent public existence. Do not underestimate the value of choosing the right partners.

5. Prepare early and set appropriate expectations.

The secret of a successful IPO lies in good preparation and a realistic understanding of the process by all concerned. Myriad matters demand advance preparation. For some items, such as pricing of stock options, preparation should begin at least a year before the anticipated IPO date. Other matters to consider before an IPO include the timing of option exercises by officers, loans to officers, the need or desire to reincorporate in a more favorable jurisdiction, adoption of protective or anti-takeover provisions, and the confidential treatment of certain agreements between the company and third parties. Knowledgeable and experienced counsel should guide the company well in advance of the formal kick off of the IPO process. All too often, company participants in the IPO have significant misconceptions about the process. The professionals involved—especially the lawyers—must educate their clients regarding the nature and aims of the IPO. Unfortunately, such education occurs all too often under battle conditions, with consequent dissatisfaction, frayed nerves, lost tempers, needless delays and unnecessary additional expense. An IPO is one of the company's most important events. Make sure that all those involved understand it intimately.

6. Understand the risks.

From a legal perspective, few—if any—corporate events involve more potential liability than an IPO. All too familiar is the scenario of an IPO followed sometime later by a quarterly financial shortfall followed by a plaintiff's class-action securities-fraud lawsuit. Irrespective of whether those named as defendants—the list always includes the chief executive officer and chief financial officer, all directors and the investment bankers—are actually liable, such lawsuits are demoralizing, distracting and expensive. The company's IPO prospectus should tell the company's story well, but it must do more. It must adequately and completely convey the risks associated with an investment in the company. Hope for the upside, but plan for the downside when writing the IPO prospectus. You'll never regret it. SDP

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