

# Going public—what it means to owners

## Management issue paper

Many companies are now looking to the stock markets as one of the alternatives for raising capital. What does this mean to you if you are a growing company? What reasons prompt a company to go public?

### The up side

The main reason is to raise capital. As your company grows, there are more and bigger opportunities for which debt financing is not always available, or necessarily, the best route. Following a recession, lenders do not quickly part with their funds. However, with the right attributes and growth potential, raising capital from the public market becomes another option. For example, an enterprise that designs, develops and markets innovative products recently went to the public markets to raise capital to help market and distribute their products and to fund new research.

Similarly, one of the largest manufacturers and suppliers of exhaust manifolds for passenger cars and light trucks in North America, entered into an initial public offering (IPO) with the goal of raising funds to repay related-party debt, bank debt and support expansion plans.

Liquidity is another significant reason. You may require liquidity for succession purposes. Family or associates may not have the financial capacity to purchase your shares. Going public can establish or expand a market for your shares. In the public market, shares generally trade at higher values than in private sales.

Employee ownership may be beneficial; in some cases, employees may already own shares. When their shares are publicly traded, they see a market and real value for their shares. Being public makes it easier to set up employee share-purchase plans and stock option plans. When acquiring another business, shares can sometimes be used instead of cash. If your shares are publicly traded, they have a quoted value and provide liquidity to the purchaser.

Once public, raising new capital may be easier. At this stage investors may feel more comfortable with your financial information, and the company's initiatives since its IPO. Positive information also enhances the company's reputation with suppliers, customers and new investors. The previously mentioned manufacturer of exhaust manifolds recently was able to go back to the market for funds to repay debt

and provide capital for expansion and acquisition.

### The not-so-great side

Being a public company has disadvantages that you should consider.

First, going public means just that. You and your company lose the privacy you've enjoyed all these years. One of the more sensitive areas is executive compensation. Each year there are frequent newspaper headlines announcing the remuneration of senior officers of public companies. Also, any information affecting the decision of an investor must be disclosed.

Your flexibility may be reduced. Some decisions will need board of directors approval, and maybe shareholders' approval. Add to that the constant demand from your investors for good performance.

Contrasting the liquidity benefit, principal shareholders usually cannot sell their shares immediately after going public. The security exchanges and underwriters want some commitment from the company's principals that these key leaders will remain through the early years to help make it successful. This commitment usually means that the holdings of the principal shareholders are held in escrow and released over a period of time.

Also, as management of a public company, the securities commissions consider you an "insider" who may have information significant to an investor. Accordingly, insiders cannot trade their shares until that information is available to the public.

### Special costs add up

Initially, and on an on-going basis, going public is expensive. The main cost will be the underwriter's fee. This is a percentage of the offering and usually in the five to 10 per cent range depending on the size of the IPO and other factors. In addition, there are fees for lawyers, accountants, printing, listing and registration and out-of-pocket selling expenses. These costs can range from 1.5 to four per cent and can increase if there is a lot of preparatory work to be done such as reorganizations, tax planning and audits of prior-year financial statements.

You can expect ongoing costs to increase for numerous activities: annual report, board and shareholders meetings, shareholder registration and transfer, and for publishing information for disclosure to shareholders.

Loss of control is usually not an immediate issue with an IPO, since many companies issue less than 50 per cent of their stock. However, over time as you issue more shares for new offerings, acquisitions or other transactions, you may be left with less than 50 per cent of the company.

### Is the time right?

A number of attributes affect the ability of your company to have a successful IPO. These include a good earnings history and asset backing, a solid industry position and growth potential. Accounting and information systems need to provide reliable and timely data for quarterly and annual reporting. The management team should be experienced. Attracting the right members for your senior management and board instills confidence in the company.

You need an appropriate corporate structure. Tax reorganizations and individual tax consequences may have to be considered.

#### Is public for you?

The decision to go public should not be made lightly. It should be the result of a well-thought-out business plan: know where the company is headed and how you expect to get there.

Your Grant Thornton advisers are professionals experienced in this process. It is best to involve them as early as possible. They have a good understanding of your industry and your company, and experience in assisting enterprises make that important going-public decision. They can assist in formulating a comprehensive business plan and with evaluating whether or not your company has those attributes which increase your chances of a successful IPO.

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