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What you should know before you think IPO

Everyone wants to do an IPO.

The guy who does mobile shoe shines in the lobby of my building is a great guy, has excellent top line growth, a fantastic cloth snap, has now renamed his company e-shine and wants to go public. I ask him why he'd want to do that and wreck a good thing. Public shareholders are a royal pain, I tell him.

Expert Opinion

RICK RICKERTSEN

"I've got more in sales than half these companies, and I have profits," he says. "Besides, I want to make mega-bucks and appear on CNN-FN."

I like this guy so I tell him the truth: The IPO may look glamorous but it's not, and it's not for everybody. As an investor in several public companies and chairman of a public software company, I've seen the dark side. In fact, there are so many negatives to going public I regularly counsel people to think very carefully before taking the plunge. My rule, in general, is don't do it unless it's absolutely necessary to executing your business plan.

Consider these negatives:

■ **Contrary to public perception, you don't get lots of cash.** The central misconception about the IPO is that you make big bucks. This is just not correct. You have the potential to make big bucks. You have paper gains. But potential and paper do not buy houses on the Cote D'Azur. In fact, if you are the CEO or a senior manager, your underwriters normally will not let you sell a single share in the IPO. They say that management selling sends a "negative signal to the market." And they're right. Your institutional investors, in fact, feel the same way. Every time you try to sell a few shares they may send your stock lower or, at a minimum, call to ask why you're doing it. You may be able to sell 15 percent to 25 percent of your position over three or four years, but that's it. So long as you're public and have not been acquired, you have to hold your stake. In fact, the IPO is ultimately a mediocre path to liquidity.

■ **No more secrets.** There's massive public disclosure associated with your IPO. All your competitors will know exactly what your margins are and, worse, all of your employees and neighbors will know exactly how much money you make, how much stock you own, how many options you have and how big your last raise and bonus were. It's a forensic study, and you'd better be ready. Have you been in litigation in the past five years? Disclose it. Sold stock on the cheap to your brother? Get it out there. The only thing the SEC doesn't require you to disclose is your shoe size.

■ **Time drain.** The large legal, accounting and underwriting costs of completing an IPO are the least of the challenges. It takes two to three months, nearly full time, to complete the deal. Worse than that, if you're the CEO or CFO, you'll probably spend one-third of your time after the IPO is completed tending to your institutional investors. These folks, your new best friends and stockholders, are very high maintenance and require major coddling. You don't return their call, they sell your stock. You used to run the business full-time, but now you do that part-time and schmooze investors part-time. And that's if things are going well. When things are going badly, you'll be talking to them all the time.

■ **Live (or die) by the numbers.** Life in the public market revolves around meeting quarter-to-quarter analyst projections. Instead of making the best long-term decisions for the business, you do what it takes to make your numbers. If the analysts have your third quarter earnings target at 17 cents per share, you had better show up with 18 or better, or these people who were once your best pals start heading for the door, not returning your calls and sending your stock in a downward spiral. You've entered the sad, dark world of what analysts kindly call "broken stocks." This means you're probably trading at half your real underlying value (Lord help you if you're a single-digit or penny stock) and have probably a year to get out of the penalty box. Some companies never get out.

■ **The broken stock bonus: shareholder litigation.** When you went public, you thought, "This is a great country. Only in America." And you're right. But there's something else you find only in America — the plaintiffs' bar. This is a friendly group of lawyers whose goal in life is to prey on almost any public company whose stock goes down precipitously. You've missed your numbers, your shareholders and employees hate you, and now you (personally, I might add) and your company are being sued. These law firms monitor big stock drops. When they see one, they contact shareholders and convince them they should be outraged by what you've done to them. They change a few names in the last lawsuit they filed, hit the print button and presto, instant litigation. They allege $30 million in damages, but because you're scared to death to go to court because you never know what a jury could do, you settle the thing for $3 million. It's legal extortion, and it happens very day. I hope you have directors' and officers' insurance.

To be fair, there are some potential benefits to going public. For example, there are cases when the public market is paying much more to value companies than anyone else would. Such is the case in today's tech world. If this valuation gap is big enough, perhaps it makes sense to accept the hassles associated with being public. Others see a public stock as a great currency for financing future acquisitions.

Public stock options also are a good way to attract and retain employees, and are almost required in today's tech recruiting environment. (You can, however, still provide stock options in a private company environment and retain good people.)

And finally, over many years, you will be able to sell a meaningful portion of your equity position, which is harder to accomplish in a private company unless you sell the entire thing.

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