

# **Lead Through Uncertainty: 3 Key Factors for Tech CEOs to Consider During an IPO**

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## Lead Through Uncertainty: 3 Key Factors for Tech CEOs to Consider During an IPO

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Initiatives: Corporate Development for Tech CEOs

Market conditions have dramatic effects on the initial public offering process. Tech CEOs must ask themselves three basic questions to determine if continuing down the path of an IPO makes sense during uncertain economic conditions.

### Overview

#### Key Findings

- Initial public offerings (IPOs) represent a huge financial investment and time commitment for tech CEOs, posing a risk to the financial health of the company.
- Investors shy away from companies that do not continue to perform during an economic crisis and are not well-positioned to new realities that emerge from economic crises.
- Economic uncertainty could cause the IPO window to close for months and drain considerable cash, making filing for an IPO risky.

#### Recommendations

Tech CEOs focusing on corporate development and looking to refine their IPO exit strategy should:

- Determine the risk of pursuing an IPO by assessing the investment still needed in preparation for operating as a public company.
- Validate visibility for financial projections by assessing the impact of updated market conditions on customers' behavior.
- Determine if there is enough time to safely run an IPO process by assessing the company's cash runway.

## Introduction

IPOs are complicated and require significant strategic and tactical efforts to complete. The process to complete an IPO is significantly impacted by changing market conditions and economic downturns, and disruptive world events can bring additional scrutiny to the process.

**Remember, an IPO is never done until it is done.**

In most instances, a business preparing for an IPO will require many months of preparation, if not a year or longer. Audits, legal issue resolution, investor pitches and internal diligence are completed prior to applying for an IPO, with the timing for these tasks varying depending on the country or stock exchange.

Any market turbulence or economic uncertainty is a major factor that could potentially change the IPO's chances of success by amplifying risks. These types of disruptions tend to dampen investors' enthusiasm for purchasing shares in new listings.

Because new public companies represent unproven entities, growth and earnings predictions are more circumspect. These forecasts are even more risky during market turbulence. Moreover, public market investors who buy IPO shares may have less risk capital available during times of economic uncertainty, versus funds to shore up their portfolios with proven or more profitable companies that are less vulnerable to disruptions. Market conditions are monitored closely by an IPO company's investment bankers, as they recognize that the biggest risk is trying to go public and failing. Assessing the top three considerations for IPO are paramount (see Figure 1).

## Analysis

### Determine the Investment Risk of Pursuing an IPO

Figure 1 provides an overview of the three considerations to assess an IPO.

Figure 1: Top Three Considerations to Assess an IPO

**Top Three Considerations to Assess an IPO**

Source: Gartner  
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**Gartner**

Most tech CEOs know that preparing for an IPO is a major cash and time drain, including selecting legal teams and underwriters, creating a prospectus, running a roadshow, and getting legal and shareholder approvals. In addition, having a couple of years of audited financial statements does not happen overnight and is an essential part of IPO readiness. Furthermore, many tech CEOs are not familiar with the process of operating like a public company after the IPO. It is a challenging dynamic that takes time and upfront investment and comes with additional risks to tech CEOs.

Examples of key business processes that may require significant upfront investment in technology and process development include: compliant internal controls and processes, financial planning and analysis (FP&A), regulatory compliance, integrated risk management, investor relations, audits, and board governance. On top of that, preparing for an IPO may also require lengthy and costly hiring processes for new management, advisors or board members, and filling roles for internal audit, investor relations, risk management and corporate governance. While not a formal requirement pre-IPO, having a CFO and other members on your executive team with public company experience is considered desirable to investors. Additional hires should be considered prior to the IPO to prime the company for public company success.

To ensure these investments allow the company to operate properly, a necessary and costly full audit goes beyond financials and also includes compensation packages, cybersecurity, data security, revenue recognition and securities regulatory compliance.

Furthermore, resolution of all corporate legal disputes, including lawsuits, wrongful terminations, harassment, discrimination, patent filings and collective bargaining agreements, is necessary before embarking on an IPO roadshow. All of these details must be included in disclosure statements for public filings.

This all represents considerable investment of time and capital.

Pushing through an IPO during an economic crisis adds substantial risk to the process. Forgoing the investments to operate like a public company can lead to disastrous results from problems such as revenue recognition, poor earnings guidance or data breaches. Therefore, it is recommended not to take a company public without making these investments in technology, people and processes.

If the company still has to make considerable investments to prepare for an IPO, this represents a tremendous amount of risk. The tech CEO should take extra care in determining if an IPO strategy is worth the upfront costs and financial risk to the company and its shareholders.

**If market conditions make investing in the technology, people and processes to operate like a public company now too arduous, it is not a good idea to pursue an IPO.**

## Validate Visibility for Financial Projections

Investors are not forgiving to companies that cannot correctly forecast their financials. This is especially true with newly public companies.

Market downturns are sometimes accompanied by fundamental changes in customer behavior, which could be permanent. After an initial market shock and the market is still in decline, customers facing cash-flow challenges aggressively reduce spending to conserve cash. In addition, customers also look for new ways to operate more efficiently to consume less cash, changing their fundamental behaviors in how they do business. These activities put into question whether your product or solution is still relevant. These new realities create new risks for companies looking to go public. This could mean that sales processes could lengthen and projects can get postponed or even canceled.

Financial projections under these conditions can be difficult. In the middle of market uncertainty, giving financial guidance becomes dramatically more difficult, especially for a new management team. During the economic crisis in 2020 caused by COVID-19, public companies were pulling financial guidance in record numbers, again underpinning the risk faced by being public.

**If market conditions make giving financial guidance to investors too difficult, it is not a good idea to pursue a public offering.**

Missing your numbers as a public company can be devastating. Therefore, if you are able to get the IPO out, the market could still turn on the company stock if retail investor sentiment changes due to continued economic uncertainty, and investors do not feel the company's story is compelling and the company is properly prepared.

## Determine If There Is Enough Time and Capital to Safely Run an IPO Process

Turbulent markets can take a turn for the worse, causing underwriters to rethink the timing of the stock offering. Sometimes this means market conditions pushing back the window for an IPO by months.

Companies that are burning cash and have less than nine months' runway run the risk that the IPO window doesn't reopen before they run out of cash. Therefore, pursuing an IPO can be very risky during market uncertainty following an economic shock.

A tech CEO can expect the IPO process to take nine months or longer to complete. In the intervening time, the IPO window could close, meaning underwriters have determined that investors are too spooked by market conditions to subscribe to an IPO. In this case, the IPO would need to be postponed until market conditions improve, investors return to the market and the IPO window is back open. IPO markets can remain closed for months.

Complicating the situation is the “quiet period,” a regulatory requirement that, after the initial prospectus filing, the company’s management, business development or marketing teams cannot share opinions or information about the company that is not in the initial registration. The purpose of the quiet period is to ensure all investors have access to the same information at the same time. In the U.S., this requirement stretches from the time a company files the registration with regulators through the 40 days after the stock starts trading.

If the IPO postponement is longer than the company’s financial runway, the company will need additional financing. However, the company cannot raise bridge financing and continue down the IPO process, because the company will be forced to pull the IPO registration in order to comply with the quiet period requirements. In extreme cases, the company may need to find a buyer quickly (likely at suboptimal pricing) or file for bankruptcy.

**If economic uncertainty means IPO markets could remain closed for longer than the cash runway, it is not a good time to pursue an IPO.**

## Evidence

Gartner Analysis of S&P 500 Company Earnings Shows 70% Have Revised or Withdrawn Their Earnings Guidance Due to COVID-19, Gartner.

Roadmap for an IPO: A Guide to Going Public, PwC.

Going Public: The Pre-IPO Timeline, Financial Executives International.

IPO Process, Corporate Finance Institute.

Timeline Schedule for a Reg A+ IPO to the Nasdaq or NYSE, Manhattan Street Capital.

## Document Revision History

3 Key Tech CEO Considerations for IPOs in Times of Economic Crisis and Uncertainty – 30 October 2020

## Recommended by the Authors

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