Initial Public Offerings

An initial public offering (IPO), otherwise known as stock market launch, is a public offering in which shares of a company are sold to investors.

Initial public offerings can be used to raise new capital for companies to gain more funding to monetize the investments of shareholders

Initial Public Offerings are a featured topic in the economics segment of the UPSC Exams, hence the details of this article will be useful for candidates attempting the exam this year.

History of Initial Public Offerings

The earliest form of a company which put public shares to trade can be traced to the *publicani* during the Roman Republic (later the Roman Empire). Like modern stock companies, the *publicani* were akin to legal bodies of modern day financial institutions who owned shares

The Dutch are credited as the forerunner of the modern financial system which gave IPOs its current forms. The first known recorded instance of an IPO took place in March 1602 when the Dutch East India Company offered its shares in order to raise new fundings.

The Dutch East Indian Company, henceforth became the first company to issue bonds and shares of stock to the general public, becoming officially the first publicly traded company to be listed on an official stock exchange.

How does an Initial Public Offerings work?

Before an IPO a company is a private entity not subject to trade in a stock market. The private company at first consists of a small number of shareholders like the founders, family and some professional investors

When the company reaches a stage in its growth where it believes it can stand the rigorous regulations of a financial authority (In India's case the SEBI), it will begin to advertise its interest in going public, as in being listed in a stock exchange.

The steps of issuing an IPO can be condensed into the following:

1. Underwriters present proposals and valuations discussing their services, the best type of security to issue, offering price, amount of shares, and estimated time frame for the market offering.
2. The company chooses its underwriters and formally agrees to underwriting terms through an underwriting agreement.

3. Form a board of directors.
4. Ensure processes for reporting auditable financial and accounting information every quarter.
5. The company issues its shares on an IPO date.
6. Some post-IPO provisions may be instituted.

An IPO is a crucial step for a rising company as it is a gateway to raise additional fundings. This allows the company to grow beyond its initial setup and additionally leads to better transparency and credibility that can be a factor in attracting new investors and when seeking to borrow more funds in the future.

An initial public offering of a company is priced to underwrite due diligence. When a company is listed publicly, the previous shares that were privately owned would be publicly traded and the existing private shareholders's shares would be equal to public shares.

Advantages and Disadvantages of an IPO

Advantages and disadvantages of an IPO is listed out below:

Advantages:

- Increasing and diversifying equity base
- Cheaper avenues of raising capital
- More exposure, prestige and enhanced public image
- Ability to attract and hire better employees and the management to oversee them through liquidity participation
- To enable acquisitions
- Creating multiple financing opportunity through equity, convertible debt etc

Disadvantages:

- Rise in marketing and accounting costs that will munt as time goes on
- It is necessary to disclose sensitive financial and business information.
- More effort and attention is required of the management to ensure an IPO goes smoothly.
- Chances of additional funding might not be acquired in case the company does not perform well
- Public disclosure of information might be exploited by competitors or even customers
- The initial shareholders may lose independence as new ones will come in through the ability to buy new shares.
- The company will be exposed to risk of litigation, private securities and other forms of derivative actions.