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IPO or divestiture:

Making informed decisions

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To divest or go public. It is a simple proposition with complex considerations. No doubt, pursuing an initial public offering (IPO) is a viable option for private equity (PE) funds looking to raise cash from a portfolio asset they are not ready to part ways with, but like any major portfolio decision, it pays to go in with eyes wide open.

Taking the IPO journey has its merits. Current market conditions are making it more difficult for funds to operate on a debt leverage model approach at the same levels of return. As such, going public may be a mechanism to extract capital from the asset while maintaining ownership.

The true cost of going public

Even still, going public is not a panacea for difficult times. As anyone who has ventured down the IPO path can attest, it only means trading one set of challenges for another. Whether raising a million dollars or a billion, going public means becoming beholden to new rules, processes, public shareholders and regulators. This can be unfamiliar territory for funds that are used to working in a more autonomous environment and selling acquisitions when the numbers deem it best.

The cost of going public must also be weighed when deciding between an IPO or divestiture. Between lawyers, underwriters, bankers, and auditors, the IPO experience can add up fast. The primary reason for listing deferrals and cancellations is the unprecedented and unexpected costs imposed on the organization. And it is not simply the logistical price of going public that warrants consideration, but the cost of public readiness and the maintenance of continuous disclosure.

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Economy of scale

It is one thing to say your organization wants to be public and another to be ready for the costs, compliance, and public scrutiny that entails. The massive shift in the reporting environment alone can be a significant challenge for the under-prepared, as it demands significant financial reporting capabilities, controls, IT infrastructure, human resource considerations and governance that simply cannot be established overnight.

Smaller companies may feel more nimble and flexible to tackle this transition, but being operationally simple does not necessarily translate into a smooth IPO transition. Big or small, there is a relative baseline that all organizations need to adapt to and absorb.

That is not to say the IPO route is to be avoided, only that it takes considerable preparation and an honest evaluation of your business' ability to maneuver the challenges therein.

Preparing for the IPO journey begins by conducting an assessment of the company to gauge the organization's current state. Education about being a public company is key prior to becoming one. How strong is your finance department? What are its current reporting capabilities? Is your IT infrastructure scalable? Do you have the right team? Do you have all the committees in place to support your governance structure? Once you assess your capabilities, you can determine if the organization needs to go public and set realistic timelines (and budgets) for transformation.

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Critical to that assessment is clarifying your long-term goals. If the plan is to sell the acquisition shortly down the road, divestment may be the strategy of choice. De-listing a public company is an equally costly and onerous experience, and it can be more difficult to pivot strategies when held accountable by public stakeholders.

Under a microscope

Ultimately, PE funds are used to living in a world where they buy, transform and resell for a significant profit. All that shifts when there is public interest and those decisions are being held accountable by the marketplace; public scrutiny can naturally dilute the returns on two companies with identical operations other than stakeholders.

And so we come back to the original question: to divest or go public? To cut the cord or take a risk for big returns? Both options have their advantages and both require a well-executed plan. Organizations must not only determine the right approach for them but take an honest look internally to ensure they are rightly prepared to take it.

And when you are ready
Let's do this.

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