**Slides - Module 1 – ch.23 Raising Equity Capital**

**Chapter Outline**

23.1 Equity Financing for Private Companies

23.2 The Initial Public Offering

23.3 IPO Puzzles

23.4 The Seasoned Equity Offering

**23.1 Equity Financing for Private Comp.**

* The initial capital that is required to start a business is usually provided by the entrepreneur.
* Often, a private company must seek outside sources that can provide additional capital for growth.
* It is important to understand how the infusion of outside capital will affect the control of the company.

**23.1 Equity Financing for Private Comp.**

**Sources of funding: Angel Investors**

* Individual Investors who buy equity in small private firms. Angel investors are often rich, successful entrepreneurs themselves who are willing to help new companies get started in exchange for a share of the business.
* The angel investment is usually necessary to kick off the business and the angel market is more well organized these days.
* Angel financing often occurs at such an early stage in the business that it is difficult to assess a value for the firm. Angel investors often circumvent this problem by holding either a convertible note or a SAFE (simple agreement for future equity) rather than equity.
  + Usually, angel investors have a share price discount over new investors.
  + Structuring the deal in this way allows **angels and entrepreneurs to agree on terms without agreeing on a value for the firm**, instead postponing the valuation decision until the firm is more mature and attractive to venture capitalists.

**23.1 Equity Financing for Private Comp.**

**Venture Capital Firm**

A limited partnership that specializes in raising money to invest in the private equity of young firms.

**Venture Capitalists**

One of the general partners who work for and run a venture capital firm.

. . .

VC firms offer limited partners advantages over investing directly in start-ups themselves as angel investors.

* Limited partners are more diversified.
* They also benefit from the expertise of the general partners.
* General partners usually charge substantial fees: over the return they make (carried interest) plus a an annual management fee of about 2% of the fund's committed capital.
* Usually, they demand great control (e.g., board seats).

**23.1 Equity Financing for Private Comp.**

**Private Equity Firms**

* Organized very much like a venture capital firm, but it **invests in the equity of existing privately held firms** rather than start-up companies.
* Private equity firms also might initiate their investment by finding a publicly traded firm and purchasing the outstanding equity, thereby taking the company private in a transaction called a leveraged buyout (LBO).
* In most cases, the private equity firms use debt as well as equity to finance the purchase.
* Private equity firms also charge fees.
* Market value of PE firms greater than VC.

**23.1 Equity Financing for Private Comp.**

**Institutional Investors**

* Institutional investors, such as pension funds, insurance companies, endowments, and foundations, are **active investors in private companies**.
* Institutional investors **may invest directly** in private firms or they **may invest indirectly by becoming limited partners in venture capital firms**.

Ex. Blackrock funds, Vanguard funds.

**23.1 Equity Financing for Private Comp.**

**Corporate Investors**

* A corporation that invests in private companies.
* Also known as corporate partner, strategic partner, and strategic investor.
* Although most other types of investors in private firms are primarily interested in the financial returns of their investments, **corporate investors might invest for corporate strategic objectives**, in addition to the financial returns.

Ex. Google.

**23.1 Equity Financing for Private Comp.**

**Venture capital investing**

When a company founder decides to sell equity to outside investors for the first time, **it is common practice for private companies to issue preferred stock rather than common stock to raise capital**.

**Preferred Stock**

* Preferred stock issued by mature companies usually has a preferential dividend and seniority in any liquidation and sometimes special voting rights.
* Preferred stock issued by young companies has seniority in any liquidation but typically **does not pay regular cash dividends and often contains a right to convert to common stock**.

. . .

**Convertible Preferred Stock**

Preferred stock that gives the owner an option to convert it into common stock on some future date.

**23.1 Equity Financing for Private Comp.**

* Each time the firm raises money is referred to as a funding round, and each round will have its own set of securities with special terms and provisions.
* After a potential initial "seed round," it is common to name the securities alphabetically, starting with Series A, Series B, etc
* Only then, the company has a market value.

**23.1 Equity Financing for Private Comp.**

**Book's example.**

* Real Networks, which was founded by Robert Glaser in 1993, with an investment of approximately 1 million by Glaser.
* In April 1995, Glaser's 1 million initial investment represented 13,713,439 shares of Series A preferred stock, implying an initial price of about $0.07 per share.
* The company's **first round of outside equity funding was Series B preferred stock**. Real Networks sold 2,686,567 shares of Series B preferred stock at 0.67 per share.
* At the price the new shares were sold for, Glaser's shares were worth 9.2 million and represented 83.6% of the outstanding shares.

**23.1 Equity Financing for Private Comp.**

**Pre-Money Valuation**

* At the issuance of new equity, the value of the firm's prior shares outstanding at the price in the funding round
  + 9.2 million in the RealNetworks example

**Post-Money Valuation**

* At the issue of new equity, the value of the whole firm (old plus new shares) at the price at which the new equity sold
  + 11.0 million in the RealNetworks example

**23.1 Equity Financing for Private Comp.**

Over the next few years, Real Networks raised three more rounds of outside equity in addition to the Series B funding round

**23.1 Equity Financing for Private Comp.**

**Problem**

You founded your own firm two years ago. Initially, you contributed 100,000 of your money and, in return, received 1,500,000 shares of stock.

Since then, you have sold an additional 500,000 shares to angel investors.

You are now considering raising even more capital from a venture capitalist. The venture capitalist has agreed to invest 6 million with a post-money valuation of $10 million for the firm.

Assuming that this is the venture capitalist's first investment in your company, **what percentage of the firm will she end up owning? What percentage will you own? What is the value of your shares?**

**23.1 Equity Financing for Private Comp.**

**Solution**

Because the VC will invest 6 million out of the 10 million post-money valuation, her ownership percentage is 60%.

. . .

The pre-money valuation is 10 − 6 = 4 million. As there are 2 million pre-money shares outstanding, this implies a share price of $\frac{4 million}{2 million;shares}=2 ;per;share$

. . .

Thus, the V C will receive 3 million shares for her investment, and after this funding round, there will be a total of 5,000,000 shares outstanding.

. . .

You will own $\frac{1,5000,000}{3,000,000} = 30%$ of the firm and the post-transaction valuation of your shares is $3 million.

**23.1 Equity Financing for Private Comp.**

**Problem**

**Assume**

* You founded your own firm two years ago.
* You initially contributed $50,000 of your money and in return received 1,000,000 shares of stock.
* Since then, you have sold an additional 750,000 shares to angel investors.
* You are now considering raising even more capital from a venture capitalist.
* The venture capitalist would invest $2 million and would receive 2,000,000 newly issued shares.

**What is the post-money valuation? Assuming that this is the venture capitalist's first investment in your company, what percentage of the firm will he end up owning? What percentage will you own? What is the value of your shares?**

**23.1 Equity Financing for Private Comp.**

**Solution**

|  |  |  |
| --- | --- | --- |
| Your shares | 1,000,000 | 26,67% |
| Angel investor's shares | 750,000 | 20,00% |
| Venture capitalist's shares | 2,000,000 | 53,33% |
| Total shares outstanding | 3,750,000 | 100% |

* The venture capitalist is paying $1 per share.
* Thus, the post-money valuation is $3,750,000.
* You will own 26.67% of the firm, and the post-money valuation of your shares is $1,000,000.

**23.1 Equity Financing for Private Comp.**

**Venture Capital Financing Terms**

**Liquidation Preference**: The liquidation preference specifies a minimum amount that must be paid to these security holders---before any payments to common stockholders---in the event of a liquidation, sale, or merger of the company. It is typically set to between 1 and 3 times the value of the initial investment.

. . .

**Seniority**: It is not uncommon for investors in later rounds to demand seniority over investors in earlier rounds, to ensure that they are repaid first. When later round investors accept securities with equal priority, they are said to be pari passu.

. . .

**Anti-Dilution Protection**: If things are not going well and the firm raises new funding at a lower price than in a prior round, it is referred to as a "down round." Anti-dilution protection lowers the price at which investors in earlier rounds can convert their shares to common, effectively increasing their ownership percentage in a down round at the expense of founders and employees.

. . .

**Exit Strategy**: It details how investors will eventually realize the return from their investment

**23.2 The Initial Public Offering**

**Initial Public Offering (IPO)**

The process of selling stock to the public for the first time.

It allows **greater liquidity**, and **better access to capital** at the cost of **more external monitoring** and **more demand for transparency**.

. . .

**Primary Offering**: New shares available in a public offering that raise new capital

**Secondary Offering**: Shares sold by existing shareholders in an equity offering

. . .

**Underwriter**

An investment banking firm that manages a security issuance and designs its structure.

**23.2 The Initial Public Offering**

**Best-Efforts Basis**: For smaller IPOs, a situation in which the underwriter does not guarantee that the stock will be sold, but instead tries to sell the sock for the best possible price. Often such deals have an all-or-none clause: either all of the shares are sold on the IPO or the deal is called off.

. . .

**Firm Commitment**: An agreement between an underwriter and an issuing firm in which the underwriter guarantees that it will sell all of the stock at the offer price. Most common.

. . .

**Auction IPO**: A method of selling new issues directly to the public rather than setting a price itself and then allocating shares to buyers, the underwriter in an auction IPO takes bids from investors and then sets the price that clears the market.

**23.2 The Initial Public Offering**

**Problem**

* Ashton, Inc., is selling 900,000 shares of stock in an **auction IPO**.
* At the end of the bidding period, Ashton's investment bank has received the following bids. **What will be the offer price of the shares?**

. . .

**Solution**: The winning auction price would be 9.25.

**23.2 The Initial Public Offering**

**Lead Underwriter**: The primary investment banking firm responsible for managing a security issuance.

**Syndicate**: A group of underwriters who jointly underwrite and distribute a security issuance.

* Underwriters market the IPO, and they help the company with all the necessary filings.
* More importantly, they actively participate in determining the offer price.
* In many cases, the underwriter will also commit to making a market in the stock after the issue, thereby guaranteeing that the stock will be liquid.

**23.2 The Initial Public Offering**

**Filings**

**Registration Statement**: A legal document that provides financial and other information about a company to investors prior to a security issuance. Company managers work closely with the underwriters to prepare this registration statement.

**Preliminary Prospectus**: Part of the registration statement prepared by a company prior to an IPO that is circulated to investors before the stock is offered.

**Final Prospectus**: Part of the final registration statement prepared by a company prior to an IPO that contains all the details of the offering, including the number of shares offered and the offer price. This document is created only after carefull revision.

**23.2 The Initial Public Offering**

**Valuation**: There are two ways to value a company: a) Compute the present value of the estimated future cash flows, or B) Estimate the value by examining comparables (recent IPOs).

**Road Show**: During an IPO, when a company's senior management and its underwriters travel around promoting the company and explaining their rationale for an offer price to the underwriters' largest customers, mainly institutional investors such as mutual funds and pension funds.

**Book Building**: A process used by underwriters for coming up with an offer price based on customers' expressions of interest. The book-building process provides an early indication of demand for the IPO. If demand appears to be weak in the target price range, the firm may choose to withdraw from the IPO process.

**23.2 The Initial Public Offering**

**Problem**

* RAX House is a private company considering going public. RAX House has assets of 585 million and liabilities of 415 million. The firm's cash flow from operations was 137 million for the previous year.
* After the IPO, RAX House will have 118 million shares outstanding.
* The industry average **cash flow per share multiple is 3.0**, and the **average book value per share is 2.3**. Based on these multiples, **estimate the IPO price.**

. . .

**Solution**

RAX House's book value of equity is $585 - 415 = 170 million$. With 118 million shares outstanding, book value per share is $\frac{170}{118} = 1.44$ per share. Given the industry average of 2.3, the estimated IPO price would be 1.44 × 2.3 = 3.31 per share.

. . .

The firm's cash flow from operations was 137 million, thus cash flow per share is $\frac{137}{118} =1.16$. Given the industry average multiple of 3.0, the estimated IPO price would be 1.16 × 3.0 = 3.48.

**23.2 The Initial Public Offering**

**Spread**: The fee a company pays to its underwriters that is a percentage of the issue price of a share of stock.

* For instance, consider the final offer price is 12.50 per share, and the company paid the underwriters a spread of $0.875 per share, exactly 7% of the issue price.
* The underwriters buy the stock for 11.625 per share and then resold it to their customers for $12.50 per share.

. . .

* When an underwriter provides a **firm commitment**, it is potentially exposing itself to the risk that the banking firm might have to sell the shares at less than the offer price and take a loss.
  + However, research shows that about 75% of IPOs experience an increase in share price on the first day (only 9% experience a decrease).

**23.2 The Initial Public Offering**

**Over-allotment allocation (greenshoe provision)**: In an IPO, an option that allows the underwriter to issue more stock, usually amounting to some % of the original offer size, at the IPO offer price.

. . .

**Lockup**: A restriction that prevents existing shareholders from selling their shares for some period, usually 180 days, after an IPO.

**23.3 IPO Puzzles**

1. On average, IPOs appear to be **underpriced**: The price at the end of trading on the first day is often substantially higher than the IPO price.
2. The number of issues is **highly cyclical**: When times are good, the market is flooded with new issues; when times are bad, the number of issues dries up.
3. The **costs of an IPO are very high**, and it is unclear why firms willingly incur them (source: Berk & DeMarzo).
4. The **long-run performance of a newly public company (three to five years from the date of issue) is poor**. That is, on average, a three- to five-year buy and hold strategy appears to be a bad investment.

**23.3 IPO Puzzles**

**Underpricing**

* Generally, underwriters set the issue price so that the average first-day return is positive.
* Research has found that about 75% of first-day returns are positive. The average first-day return in the United States is 17%.
* The underwriters benefit from the under pricing because it allows them to manage their risk.
* The pre-IPO shareholders bear the cost of underpricing.
* In effect, these owners are selling stock in their firm for less than they could get in the aftermarket.

**23.3 IPO Puzzles**

**Underpricing**

* Although IPO returns are attractive, all investors cannot earn these returns.
* When an IPO goes well, the demand for the stock exceeds the supply.
* Thus the allocation of shares for each investor is rationed.
* When an IPO does not go well, demand at the issue price is weak, so all initial orders are filled completely.
* Thus, the typical investor will have their investment in "good" IPOs rationed while fully investing in "bad" IPOs.

**Winner's Curse**: Refers to a situation in competitive bidding when the high bidder, by virtue of being the high bidder, has very likely overestimated the value of the item being bid on. You "win" (get all the shares you requested) when demand for the shares by others is low and the IPO is more likely to perform poorly.

**23.3 IPO Puzzles**

**Cyclicality and Recent Trends**

* The number of issues is highly cyclical.
* When times are good, the market is flooded with new issues; when times are bad, the number of issues dries up.
* What is surprising is the magnitude of the swings.
* Another striking feature of the data in the following figure is that while the average dollar volume of IPOs since 2000 has been similar to that in the 1990s, the average number of IPOs per year has fallen significantly.

**23.3 IPO Puzzles**

**Costs of an IPO**

* A typical spread is 7% of the issue price.
* By most standards, this fee is large, especially considering the additional cost to the firm associated with underpricing.
* It is puzzling that there seems to be a lack of sensitivity of fees to issue size.
* One possible explanation is that by charging lower fees, an underwriter may risk signaling that it is not the same quality as its higher priced competitors.

**23.3 IPO Puzzles**

**Long-Run Underperformance**

Although shares of IPOs generally perform very well immediately following the public offering, it has been shown that newly listed firms subsequently appear to perform relatively poorly over the following three to five years after their IPOs.

**23.4 The Seasoned Equity Offering**

**Seasoned Equity Offering (SEO)**

* When a public company offers new shares for sale
* Public firms use SEOs to raise additional equity.
* When a firm issues stock using an SEO, it follows many of the same steps as for an IPO.
* The main difference is that a market price for the stock already exists, so the price-setting process is not necessary.

. . .

**Primary Shares**: New shares issued by a company in an equity offering.

**Secondary Shares**: Shares sold by existing shareholders in an equity offering.

**23.4 The Seasoned Equity Offering**

**There are two types of seasoned equity offerings.**

**Cash Offer**: A type of SEO in which a firm offers the new shares to investors at large.

**Rights Offer**: A type of SEO in which a firm offers the new shares only to existing shareholders.

* Rights offers protect existing shareholders from underpricing.

**23.4 The Seasoned Equity Offering**

**Rights offers protect existing shareholders from underpricing.**

* Suppose a firm holds 100 in cash and has 50 shares out. Each share is worth 2.
* It announces a cash offer for 50 shares at 1 per share. Once this offer is complete, the company will have 150 in cash and 100 shares outstanding. The price per share is now 1.50. **The new shareholders therefore receive a 0.50 windfall at the expense of the old shareholders**.
* If it announces a rights offer, shareholders have the right to purchase an additional share for 1. If all shareholders chose to exercise their rights, then after the sale, the value of the firm is 150 with 100 shares outstanding and a price of 1.50 per share. **In this case, however, the 0.50 windfall accrues to existing shareholders, which exactly offsets the drop in the stock price.**
* By using a **rights offering** the firm can continue to issue equity without imposing a loss on its current shareholders.

**23.4 The Seasoned Equity Offering**

**Price Reaction**

* Researchers have found that, on average, the market greets the news of an SEO with a price decline. This is consistent with the adverse selection discussed in Chapter 16.

**Issuance Costs**

* Although not as costly as IPOs, seasoned offerings are still expensive. Underwriting fees amount to 5% of the proceeds of the issue. Rights offers have lower costs than cash offers.

**True or False Questions – Module 1 – ch23.**

1. **Question:** New issues are highly cyclical. **Answer:** T **Feedback:** The sentence is TRUE. Companies tend to go public during bull markets when investor sentiment is high and valuations are favorable, leading to periods of high IPO activity followed by lulls.
2. **Question:** The 'fees' paid to underwriters are a significant part of the transaction costs of an IPO. **Answer:** T **Feedback:** The sentence is TRUE. The underwriting spread, which is the difference between the price investors pay and the amount the company receives, is typically the largest single expense in an IPO.
3. **Question:** The 'lock-up' period prevents company insiders from selling their shares in the secondary market for a certain time after the IPO. **Answer:** T **Feedback:** The sentence is TRUE. This is a contractual agreement designed to prevent a sudden sell-off by insiders, which could depress the stock price and signal a lack of confidence shortly after the offering.
4. **Question:** Investors in an IPO are guaranteed to receive shares at the offering price. **Answer:** F **Feedback:** The sentence is FALSE. Investors in an IPO are not guaranteed to receive shares at the offering price; allocation depends on demand, and the market price can fluctuate immediately after listing.
5. **Question:** One of the disadvantages of being a public company is the increased reporting and regulatory compliance requirements. **Answer:** T **Feedback:** The sentence is TRUE. Public companies face stringent regulations from bodies like the CVM or SEC, requiring costly and time-consuming periodic financial reporting and disclosures.
6. **Question:** A controlling shareholder completely loses control of the company after an IPO. **Answer:** F **Feedback:** The sentence is FALSE. A controlling shareholder does not necessarily lose complete control; mechanisms like dual-class share structures can help them retain significant influence.
7. **Question:** The Dutch auction method allows investors to bid for shares in an IPO, determining the final offer price. **Answer:** T **Feedback:** The sentence is TRUE. In a Dutch auction, the final price is set at the highest price at which all offered shares can be sold, allowing for a market-driven price discovery process.
8. **Question:** The secondary market involves the trading of existing shares among investors. **Answer:** T **Feedback:** The sentence is TRUE. After a security is issued in the primary market (e.g., IPO), all subsequent trading of that security occurs in the secondary market between investors.
9. **Question:** A cash offer occurs when new shares are offered only to existing shareholders. **Answer:** F **Feedback:** The sentence is FALSE. A cash offer typically involves selling new shares to the general public or institutional investors, not exclusively to existing shareholders (that would be a rights offer).
10. **Question:** The 'quiet period' restricts communication from the company and underwriters to the public during the IPO process. **Answer:** T **Feedback:** The sentence is TRUE. This regulation aims to prevent the company from providing information that is not included in the official prospectus, ensuring all investors have access to the same data.
11. **Question:** An IPO prospectus is a confidential document only accessible to investment banks. **Answer:** F **Feedback:** The sentence is FALSE. An IPO prospectus is a public document filed with regulatory bodies (like the SEC or CVM) and made available to potential investors.
12. **Question:** The transaction costs of an IPO are usually low. **Answer:** F **Feedback:** The sentence is FALSE. The transaction costs of an IPO, including underwriting fees, legal fees, and administrative expenses, are typically substantial, often a significant percentage of the capital raised.
13. **Question:** The stock price reaction to an SEO is positive on average. **Answer:** F **Feedback:** The sentence is FALSE. The stock price reaction to an SEO (Seasoned Equity Offering) is, on average, negative, as it often signals potential dilution or a need for capital that can be interpreted negatively by the market.
14. **Question:** The two advantages of going public are greater liquidity and better access to capital. **Answer:** T **Feedback:** The sentence is TRUE. Going public allows shares to be traded easily on an exchange (liquidity) and enables the company to raise large sums of money from a broad base of investors (access to capital).
15. **Question:** Market conditions, such as interest rates and general investor sentiment, affect the decision to conduct an IPO. **Answer:** T **Feedback:** The sentence is TRUE. Favorable market conditions can lead to higher valuations and greater investor demand, making the timing of an IPO a critical strategic decision.
16. **Question:** IPOs eliminate financial risk for company founders and early investors. **Answer:** F **Feedback:** The sentence is FALSE. While IPOs offer an exit strategy and liquidity, they do not eliminate financial risk; the market value of shares can fluctuate post-IPO, and founders/early investors remain exposed to market conditions.
17. **Question:** A seasoned equity offering (SEO) does not affect the price of existing shares in the market. **Answer:** F **Feedback:** The sentence is FALSE. An SEO can affect the price of existing shares, often leading to dilution and a potential downward pressure on the stock price.
18. **Question:** A roadshow is a series of presentations made by company executives to potential investors. **Answer:** T **Feedback:** The sentence is TRUE. During the roadshow, management travels to meet with large institutional investors to market the IPO and generate interest (build the book).
19. **Question:** A company's corporate governance tends to become more complex after an IPO due to new regulatory requirements. **Answer:** T **Feedback:** The sentence is TRUE. Public companies must establish independent boards of directors, audit committees, and comply with numerous regulations designed to protect public shareholders.
20. **Question:** The primary market is where investors buy and sell shares of companies already listed on the stock exchange. **Answer:** F **Feedback:** The sentence is FALSE. The primary market is where newly issued securities are sold for the first time (e.g., in an IPO), while existing shares are traded in the secondary market.
21. **Question:** A 'greenshoe option' (over-allotment option) is used by underwriters to sell fewer shares than initially planned. **Answer:** F **Feedback:** The sentence is FALSE. A greenshoe option allows underwriters to sell *more* shares than initially planned to cover over-allotments and stabilize the stock price, not fewer.
22. **Question:** The underwriter's reputation has no significant impact on the success of an IPO. **Answer:** F **Feedback:** The sentence is FALSE. The underwriter's reputation can significantly impact the success of an IPO, as reputable underwriters often attract more investor interest and lend credibility to the offering.
23. **Question:** The process of selling stock to the public for the first time is called a seasoned equity offering (SEO). **Answer:** F **Feedback:** The sentence is FALSE. The process of selling stock to the public for the first time is called an Initial Public Offering (IPO); a seasoned equity offering (SEO) occurs when a company already publicly traded issues additional shares.
24. **Question:** Due diligence is a critical process in an IPO to verify the company's financial and legal information. **Answer:** T **Feedback:** The sentence is TRUE. Underwriters and their legal teams conduct a thorough investigation to ensure the information presented in the prospectus is accurate and complete, reducing risks for investors.
25. **Question:** A privately held company can raise equity capital by selling shares publicly without conducting an IPO. **Answer:** F **Feedback:** The sentence is FALSE. A privately held company must conduct an IPO (or a direct listing) to sell its shares publicly on a stock exchange.
26. **Question:** Greenshoe stabilization is an activity that underwriters can undertake to prevent sharp drops in the price of newly issued shares. **Answer:** F **Feedback:** The sentence is FALSE. Underwriters can use mechanisms like the greenshoe option to sell more shares in the open market if the demand is higher.
27. **Question:** The CVM requires full disclosure of financials and risks in an IPO prospectus. **Answer:** T **Feedback:** The sentence is TRUE. The goal of this regulation is to provide potential investors with sufficient and transparent information to make an informed investment decision.
28. **Question:** Syndication is the formation of a group of investment banks to manage a large IPO. **Answer:** T **Feedback:** The sentence is TRUE. A syndicate is formed to share the risk and workload of underwriting and distributing the shares of a large offering.
29. **Question:** A seasoned equity offering (SEO) is the sale of stock by a company that is already publicly traded. **Answer:** T **Feedback:** The sentence is TRUE. This is the correct definition of an SEO, which is used by public companies to raise additional equity capital after their initial IPO.
30. **Question:** The 'bookbuilding' process completely eliminates the risk of 'underpricing' or 'overpricing' in an IPO. **Answer:** F **Feedback:** The sentence is FALSE. While bookbuilding helps in price discovery, it does not completely eliminate the risk of underpricing (leaving money on the table) or overpricing (leading to a weak aftermarket performance).
31. **Question:** The 'underwriter's spread' represents the company's net profit after the IPO. **Answer:** F **Feedback:** The sentence is FALSE. The underwriter's spread is the difference between the price paid by investors and the price received by the issuing company, representing the underwriters' compensation for managing the IPO.
32. **Question:** Regulatory filings must be submitted before an IPO. **Answer:** T **Feedback:** The sentence is TRUE. Companies must file a registration statement (like a Form S-1 in the U.S. or similar documents with the CVM in Brazil) for regulatory review and approval before they can sell shares to the public.
33. **Question:** Underwriting is the process by which investment banks guarantee the sale of shares in an IPO. **Answer:** T **Feedback:** The sentence is TRUE. In a "firm commitment" underwriting, the investment bank purchases the shares from the company and assumes the risk of reselling them to the public.
34. **Question:** Venture capital investors are typically the main target audience in a rights offer. **Answer:** F **Feedback:** The sentence is FALSE. Venture capital investors are typically involved in private equity financing of young, growing companies, while a rights offer targets existing shareholders.
35. **Question:** An IPO guarantees that the company will achieve its long-term financial goals. **Answer:** F **Feedback:** The sentence is FALSE. An IPO provides capital and visibility but does not guarantee the achievement of long-term financial goals, which depend on various factors including management, market conditions, and competition.
36. **Question:** A 'rights offer' is the sale of new shares to the general public in the market. **Answer:** F **Feedback:** The sentence is FALSE. A rights offer is a sale of new shares offered specifically to existing shareholders, giving them the "right" to purchase new shares to maintain their proportional ownership.
37. **Question:** Underwriters face no risk during an IPO, so that a greenshoe provision is usually not necessary. **Answer:** F **Feedback:** The sentence is FALSE. Underwriters do face risk during an IPO, especially if they guarantee to sell shares at a set price (firm commitment). A greenshoe provision is used to mitigate this risk by allowing them to stabilize the stock price.
38. **Question:** A private company goes public to facilitate future acquisitions or mergers by using its stock as currency. **Answer:** T **Feedback:** The sentence is TRUE. Having publicly traded stock provides a valuable currency that can be used to acquire other companies, which is often more flexible than using cash.
39. **Question:** The liquidity of a private company's shares is typically higher than that of a publicly traded company. **Answer:** F **Feedback:** The sentence is FALSE. The liquidity of a private company's shares is typically much lower than that of a publicly traded company, as there is no organized market for their frequent trading.
40. **Question:** The main motivation for a company to conduct an IPO is usually access to much larger capital and greater liquidity for its shares. **Answer:** T **Feedback:** The sentence is TRUE. These are the primary strategic benefits that drive a company to undertake the complex and costly process of going public.
41. **Question:** The transaction costs of an IPO are generally insignificant compared to the total value raised. **Answer:** F **Feedback:** The sentence is FALSE. The transaction costs of an IPO are typically significant, representing a considerable percentage of the gross proceeds raised.
42. **Question:** A 'cash offer' always ensures that shares are sold to existing shareholders. **Answer:** F **Feedback:** The sentence is FALSE. A cash offer is a type of seasoned equity offering where shares are sold to the general public or institutional investors, not exclusively to existing shareholders.
43. **Question:** The primary market involves the buying and selling of existing shares among investors. **Answer:** F **Feedback:** The sentence is FALSE. The primary market is where new securities are first sold to investors by the issuer; the secondary market is where existing securities are traded among investors.
44. **Question:** CVM (Comissão de Valores Mobiliários) is the regulatory body in Brazil responsible for overseeing the capital market, including IPOs. **Answer:** T **Feedback:** The sentence is TRUE. The CVM plays a role similar to the SEC in the United States, regulating the issuance and trading of securities to protect investors.
45. **Question:** Institutional investors, like big Banks, who buy equity in small private firms are called angel investors. **Answer:** F **Feedback:** The sentence is FALSE. Institutional investors who buy equity in small private firms are typically called venture capitalists or private equity firms; angel investors are usually wealthy individuals who provide seed funding.
46. **Question:** The goal of an IPO for early investors (private equity, venture capital) is often to monetize their investment. **Answer:** T **Feedback:** The sentence is TRUE. An IPO provides a clear path to liquidity (an "exit"), allowing early-stage investors to sell their shares and realize the returns on their initial investment.
47. **Question:** A company that is already publicly traded is prohibited from conducting seasoned equity offerings (SEO). **Answer:** F **Feedback:** The sentence is FALSE. A company that is already publicly traded can and often does conduct seasoned equity offerings (SEOs) to raise additional capital after its IPO.
48. **Question:** Stock price volatility is common in the first few months after an IPO. **Answer:** T **Feedback:** The sentence is TRUE. Due to uncertainty, speculation, and the expiration of lock-up periods, newly listed stocks often experience significant price swings.
49. **Question:** A 'dual-class share structure' allows founders to maintain disproportionate voting power. **Answer:** T **Feedback:** The sentence is TRUE. This structure creates different classes of stock, with one class (typically held by founders) having more votes per share than the class sold to the public.
50. **Question:** A company's decision to go public is generally a long-term strategic decision. **Answer:** T **Feedback:** The sentence is TRUE. It involves fundamental changes to the company's structure, governance, and obligations, and is not undertaken lightly as a short-term tactic.
51. **Question:** In a greenshoe option, underwriters buy shares back from the market to stabilize the stock price. **Answer:** F **Feedback:** The sentence is FALSE. In a greenshoe option, underwriters sell additional shares to cover over-allotments and can buy shares back from the market only if the price falls below the offer price to stabilize it, but their primary function is to manage over-allotment.
52. **Question:** An SEO (Seasoned Equity Offering) can be a primary offering (new shares) or a secondary offering (shares from existing shareholders). **Answer:** T **Feedback:** The sentence is TRUE. A primary offering raises new capital for the company, while a secondary offering allows existing large shareholders to sell their shares to the public.
53. **Question:** The stock price of a newly public company is always stable in the first year post-IPO. **Answer:** F **Feedback:** The sentence is FALSE. The stock price of a newly public company is often highly volatile in the first year post-IPO, subject to market fluctuations, earnings reports, and analyst coverage.
54. **Question:** Market capitalization is a measure of a company's value, calculated by multiplying its stock price by the number of outstanding shares. **Answer:** T **Feedback:** The sentence is TRUE. This is the standard formula for calculating a public company's total market value and is a key metric used by investors.
55. **Question:** A 'preliminary prospectus' guarantees that all information contained within is final and complete. **Answer:** F **Feedback:** The sentence is FALSE. A preliminary prospectus is an initial draft and states that the information is not yet final or complete, as it awaits regulatory approval and final pricing.
56. **Question:** Liquidity risk is one of the major concerns for investors in newly public companies. **Answer:** T **Feedback:** The sentence is TRUE. Although public, a newly listed stock may initially have a low trading volume (float), making it difficult to buy or sell large quantities without affecting the price.
57. **Question:** IPOs are underpriced on average. **Answer:** T **Feedback:** The sentence is TRUE. This is a well-documented phenomenon where the offering price is often lower than the price at which the stock first trades in the secondary market, resulting in a positive first-day return.
58. **Question:** IPOs are always a cheaper method of raising capital than bank loans. **Answer:** F **Feedback:** The sentence is FALSE. IPOs typically involve higher transaction costs (underwriting fees, legal, accounting) compared to traditional bank loans, making them often a more expensive way to raise capital in terms of direct costs.
59. **Question:** An underwriter is an investment bank that manages the IPO process and helps the company sell its stock. **Answer:** T **Feedback:** The sentence is TRUE. The underwriter acts as a crucial intermediary between the issuing company and the investing public.
60. **Question:** Before an IPO, the company prepares the final registration statement and final prospectus containing all the details of the IPO, including the number of shares offered and the offer price. **Answer:** T **Feedback:** The sentence is TRUE. These final documents are legally required and must be approved by the regulatory authority before the IPO can proceed.
61. **Question:** Bookbuilding is a process where underwriters collect indications of interest from investors to help price the IPO. **Answer:** T **Feedback:** The sentence is TRUE. By gauging demand from institutional investors at different price points, underwriters can determine an offering price that is likely to be well-received by the market.
62. **Question:** The final offer price of an IPO is always determined exclusively by the issuing company. **Answer:** F **Feedback:** The sentence is FALSE. The final offer price of an IPO is typically determined through negotiation between the issuing company and the lead underwriters, often informed by the bookbuilding process and market conditions.
63. **Question:** An 'over-allotment option' can only be exercised if the stock price falls after the IPO. **Answer:** F **Feedback:** The sentence is FALSE. An over-allotment option (greenshoe) is typically exercised by underwriters if the stock price rises above the offering price in the aftermarket, allowing them to cover their short position.
64. **Question:** Quiet period is a term used to describe the period after an IPO when company executives cannot communicate with the public. **Answer:** F **Feedback:** The sentence is FALSE. The quiet period generally refers to the time *before* and *immediately after* an IPO when the company and underwriters are restricted from making public statements that could improperly influence the market for the new shares.
65. **Question:** An IPO always increases the wealth of existing shareholders. **Answer:** F **Feedback:** The sentence is FALSE. While IPOs often provide liquidity and can increase wealth, they do not always guarantee an increase in wealth for existing shareholders, as the stock price can fall below the offering price or even its pre-IPO valuation.
66. **Question:** IPO allocation refers to the process of distributing shares to interested investors. **Answer:** T **Feedback:** The sentence is TRUE. After the IPO is priced, the underwriters allocate the shares to the investors who participated in the bookbuilding process.
67. **Question:** The lock-up period for insiders typically lasts for a short duration, usually a week. **Answer:** F **Feedback:** The sentence is FALSE. The lock-up period for insiders typically lasts for a longer duration, commonly 90 to 180 days (3 to 6 months), to prevent an immediate flood of shares onto the market.
68. **Question:** The volatility of newly issued stock prices is always lower in developed markets than in emerging markets. **Answer:** F **Feedback:** The sentence is FALSE. While developed markets might have more stable overall conditions, the volatility of newly issued stock prices in IPOs can be high in any market, regardless of development status, due to novelty and speculative interest.
69. **Question:** The aftermarket performance of an IPO is often unpredictable and subject to market conditions (but many IPOs have a positive first-day return). **Answer:** T **Feedback:** The sentence is TRUE. While many IPOs are underpriced leading to a first-day "pop," their long-term performance is uncertain and depends on the company's execution and the broader market environment.
70. **Question:** IPO pricing is a delicate balance between maximizing capital raised and ensuring good performance in the secondary market. **Answer:** T **Feedback:** The sentence is TRUE. If the price is too high, the stock may perform poorly. If it's too low (underpriced), the company "leaves money on the table."
71. **Question:** Investment banks play a crucial role in pricing and marketing new stock issues. **Answer:** T **Feedback:** The sentence is TRUE. This is their primary function as underwriters: they use their expertise and network to value the company, market the issue, and distribute the shares.
72. **Question:** The 'roadshow' phase in an IPO aims to generate demand and educate potential investors about the company. **Answer:** T **Feedback:** The sentence is TRUE. It is a critical marketing effort where management presents the company's story to institutional investors to build the "book" of orders for the stock.
73. **Question:** The issuing company receives all the money from a secondary market stock sale. **Answer:** F **Feedback:** The sentence is FALSE. The issuing company does not receive money from a secondary market stock sale; the proceeds go to the selling shareholder, as it involves trading existing shares among investors.
74. **Question:** 'Analyst coverage' generally increases after an IPO, which can enhance the company's visibility. **Answer:** T **Feedback:** The sentence is TRUE. After a company goes public, analysts from investment banks begin to cover the stock, providing research and recommendations that increase its exposure to investors.
75. **Question:** Underwriters in an IPO often form a syndicate to share the responsibility of selling the new issue. **Answer:** T **Feedback:** The sentence is TRUE. Forming a syndicate allows investment banks to distribute a large offering more widely and share the financial risk associated with the deal.
76. **Question:** Regulatory requirements for public companies are generally more stringent than for private companies. **Answer:** T **Feedback:** The sentence is TRUE. Public companies are subject to extensive disclosure and governance rules to protect public investors, which do not apply to private firms.
77. **Question:** Listing on a stock exchange is optional for companies conducting an IPO. **Answer:** F **Feedback:** The sentence is FALSE. Listing on a stock exchange is not optional for companies conducting an IPO, as it is the primary venue for public trading and liquidity for the shares.
78. **Question:** A 'Dutch auction' in an IPO favors investors who pay the highest prices for the shares. **Answer:** F **Feedback:** The sentence is FALSE. In a Dutch auction, all winning bidders pay the same price, which is the lowest successful bid, not necessarily the highest price they were willing to pay.
79. **Question:** Bookbuilding is a common method used by underwriters to determine the IPO price. **Answer:** T **Feedback:** The sentence is TRUE. It has become the dominant method for pricing IPOs globally because it allows underwriters to gauge real-time market demand.
80. **Question:** A dual-class share structure allows company founders to maintain control even after going public. **Answer:** T **Feedback:** The sentence is TRUE. By holding shares with superior voting rights, founders can retain control over strategic decisions even with a minority of the total equity.
81. **Question:** By going public, companies give their private equity investors the ability to diversify. **Answer:** T **Feedback:** The sentence is TRUE. An IPO converts illiquid, concentrated holdings into publicly traded shares that early investors can sell, allowing them to reinvest the capital into other assets and diversify their portfolios.
82. **Question:** CVM does not require companies to disclose their financial results after the IPO, only before. **Answer:** F **Feedback:** The sentence is FALSE. CVM (and other regulatory bodies like the SEC) requires public companies to continuously disclose their financial results and other material information *after* the IPO.
83. **Question:** The main goal of 'underpricing' in an IPO is to create positive sentiment and attract investors to the secondary market. **Answer:** T **Feedback:** The sentence is TRUE. A positive first-day return (the "pop") generates good publicity and can create sustained buying interest in the aftermarket.
84. **Question:** Retail investors are always the first to receive share allocations in high-demand IPOs. **Answer:** F **Feedback:** The sentence is FALSE. In high-demand IPOs, institutional investors and preferred clients of the underwriting banks often receive priority in share allocations over retail investors.
85. **Question:** A common practice of early investors in private companies is to stay for a long time, i.e., years after the company's IPO. **Answer:** F **Feedback:** The sentence is FALSE. A common practice for early investors (like venture capitalists) is to exit their investment (sell their shares) within a few years after the IPO, as it provides liquidity for their prior investment.
86. **Question:** A company must always conduct an IPO to raise equity capital. **Answer:** F **Feedback:** The sentence is FALSE. A company does not always have to conduct an IPO to raise equity capital; it can also do so through private placements, venture capital, angel investors, or debt financing.
87. **Question:** A rights offer occurs when new shares are sold to investors at large. **Answer:** F **Feedback:** The sentence is FALSE. A rights offer involves selling new shares exclusively to existing shareholders, giving them the option to buy more shares to maintain their proportional ownership.
88. **Question:** The main disadvantage of going public is the complete elimination of financial risks for the company. **Answer:** F **Feedback:** The sentence is FALSE. Going public does not eliminate financial risks; instead, it introduces new ones such as market volatility, increased regulatory scrutiny, and public pressure on performance.
89. **Question:** Lock-up periods restrict company insiders from selling their shares immediately after an IPO. **Answer:** T **Feedback:** The sentence is TRUE. This is a standard feature of IPOs designed to promote price stability in the aftermarket by preventing an immediate and large supply of shares from insiders.
90. **Question:** Share dilution occurs when new shares are issued, reducing the ownership percentage of existing shareholders. **Answer:** T **Feedback:** The sentence is TRUE. When a company issues new equity, the total number of shares increases, causing the ownership stake of existing shareholders to decrease proportionally unless they participate in the new offering.
91. **Question:** Venture capitalists typically do not seek board representation, as their primary interest is solely financial returns. **Answer:** F **Feedback:** The sentence is FALSE. Venture capitalists often demand board seats and significant control rights to protect their investment and guide the company's strategic direction.
92. **Question:** A Simple Agreement for Future Equity (SAFE) is a debt instrument that always requires regular interest payments before conversion to equity. **Answer:** F **Feedback:** The sentence is FALSE. A SAFE is an investment contract, not a debt instrument, and it typically does not accrue interest or require regular payments; its purpose is to convert into equity at a future financing round.
93. **Question:** Private equity firms primarily focus on investing in early-stage startup companies, similar to angel investors. **Answer:** F **Feedback:** The sentence is FALSE. Private equity firms primarily invest in existing, more mature privately held firms or take publicly traded companies private through leveraged buyouts (LBOs), differing from the early-stage focus of angel investors or venture capitalists.
94. **Question:** The main purpose of a stock exchange listing after an IPO is to directly provide additional capital to the issuing company through continuous share sales. **Answer:** F **Feedback:** The sentence is FALSE. While an IPO raises capital for the issuing company, the main purpose of a stock exchange listing is to provide a public market for the *secondary trading* of existing shares among investors, offering liquidity to shareholders.
95. **Question:** The 'Winner's Curse' in IPOs suggests that investors who receive full allocation of shares are typically the most informed and will consistently achieve the highest returns. **Answer:** F **Feedback:** The sentence is FALSE. The 'Winner's Curse' indicates that investors who receive full allocation often do so because demand from others was low, implying they may have overestimated the value of the shares, leading to poorer performance.
96. **Question:** In a liquidation scenario, common stockholders always receive payment before holders of preferred stock with liquidation preference. **Answer:** F **Feedback:** The sentence is FALSE. Holders of preferred stock with liquidation preference are typically paid a minimum amount before any payments are distributed to common stockholders in a liquidation event.
97. **Question:** A "seed round" of funding, typically led by angel investors, always involves the issuance of common stock with full voting rights. **Answer:** F **Feedback:** The sentence is FALSE. A seed round, especially with angel investors, often involves convertible notes or SAFEs (Simple Agreements for Future Equity) rather than immediate common stock, or preferred stock without full voting rights.
98. **Question:** Private equity firms typically hold their portfolio company investments for very short periods, usually less than one year, to maximize quick returns. **Answer:** F **Feedback:** The sentence is FALSE. Private equity firms typically hold their investments for medium to long terms (e.g., 3-7 years) to implement operational improvements and achieve significant value creation before exiting.
99. **Question:** Venture capital firms prefer to invest in mature companies with established revenue streams and low growth potential, as these present less risk. **Answer:** F **Feedback:** The sentence is FALSE. Venture capital firms specifically target early-stage, high-growth potential companies, even if they are pre-revenue, seeking significant returns on innovative but higher-risk ventures.
100. **Question:** Corporate investors, such as large companies, invest in private firms solely for financial returns, with no interest in strategic objectives. **Answer:** F **Feedback:** The sentence is FALSE. While corporate investors seek financial returns, they often invest in private companies for corporate strategic objectives (e.g., access to new technology, markets, or talent), in addition to or sometimes even prioritized over purely financial returns.

**Numeric Questions – Module 1 – ch23.**

**Post-money valuation and ownership**

You founded your company with **0.055 million** and received **1 million shares**.  
You later sold **0.75 million shares** to angel investors.  
Now a VC wants to invest **3 million** in exchange for **2 million shares**.

Parte superior do formulário

**1. What is the post-money valuation (in million)?**

Parte inferior do formulário

✅ Post-money = (Total shares) × (Price per share)  
= (3.75) × (1.5) = **5.625 million**

Parte superior do formulário

**2. What percentage of the firm will the VC own?**

Parte inferior do formulário

✅ VC Ownership = 2 / (3.75) × 100 = **53.333%**

Parte superior do formulário

**3. What is the value of your shares (in million)?**

Parte inferior do formulário

✅ Value = 1 × 1.5 = **1.5 million**

**Capital raised and founder dilution**

A company raised capital in three rounds (values in millions USD):

Series A: Pre = 3.368, Post = 6.287

Series B: Pre = 38.243, Post = 77.473

Series C: Pre = 132.115, Post = 184.012

Parte superior do formulário

**1. How much did the company raise in Series A?**

Parte inferior do formulário

✅ Raised = Post - Pre = 6.287 - 3.368 = **2.919 million**

Parte superior do formulário

**2. How much did the company raise in Series B?**

Parte inferior do formulário

✅ Raised = Post - Pre = 77.473 - 38.243 = **39.23 million**

Parte superior do formulário

**3. How much did the company raise in Series C?**

Parte inferior do formulário

✅ Raised = Post - Pre = 184.012 - 132.115 = **51.897 million**

Parte superior do formulário

**4. What % of shares did founders keep after Series A?**

Parte inferior do formulário

✅ % kept = Pre / Post = 3.368 / 6.287 = **53.571%**

Parte superior do formulário

**5. What % of shares did founders keep after Series B?**

Parte inferior do formulário

✅ % kept = A × B = (53.571%) × (49.363%) = **26.444%**

Parte superior do formulário

**6. What % of shares did founders keep after Series C?**

Parte inferior do formulário

✅ % kept = A × B × C = (53.571%) × … = **18.986%**

**Post-money valuation and VC ownership**

You founded a firm three years ago. You started with $0.293 million, which gave you 1.308 million shares. You later sold 1.146 million shares to angel investors. Now, a VC firm wants to invest $5.574 million in exchange for 2.804 million new shares.

Parte superior do formulário

**1. What is the post-money valuation (in million)?**

Parte inferior do formulário

✅ Post-money = Total shares × Price per share = (5.258) × (1.988) = **10.452 million**

Parte superior do formulário

**2. What percentage of the firm will the VC own?**

Parte inferior do formulário

✅ VC Ownership = 2.804 / (5.258) × 100 = **53.328%**

**Valuation and Ownership After Equity Issuance**

Erica owns all **4 million shares** of her company, CoralTech. A new partner is offering to invest **1.631 million** in exchange for **1.5 million shares**.

Parte superior do formulário

**1. What is the post-money valuation (in million)?**

Parte inferior do formulário

✅ Post-money = (5.5) shares × $1.087 (1.631/ 1.5) = **5.978 million**

Parte superior do formulário

**2. What percentage of the company will the new partner own?**

Parte inferior do formulário

✅ Partner Ownership = 1.5 / 5.5 × 100 = **27.273%**

**Ownership After Two Funding Rounds**

After a Series A round, the founders owned **63.3%** of BetaVision.  
Then, Series B investors contributed **4.04 million** and received **27.9%** of the company.

Parte superior do formulário

**1. What is the founders’ final ownership (%)?**

Parte inferior do formulário

✅ Founders’ final ownership = (1 - 27.9%) × 63.3% = **45.6%**

Parte superior do formulário

**2. What is the Series A investors’ final ownership (%)?**

Parte inferior do formulário

✅ Series A ownership = (1 - 27.9%) × 36.7% = **26.5%**

**Convertible Note with Discount**

**Context:**  
Yara invested in a startup using a convertible note of **$1.501 million**, with a **20% discount**.  
When the company raised Series A at **$1.32 per share**, her note converted at the discounted price.

Parte superior do formulário

**1. How many shares did Yara receive upon conversion?**

Parte inferior do formulário

✅ Shares = Note / Discounted Price = 1.501 million / 1.056 = **1.421 million shares**

**Multiple Choice Questions – Module 1 – ch23.**

Parte superior do formulário

**Which of the following best describes a venture capital firm?**

 A. A partnership that raises money to invest in young private firms  
 B. A federal agency funding infrastructure projects  
 C. A firm that exclusively invests in publicly traded companies  
 D. A group of angel investors funding IPOs  
 E. A commercial bank offering debt financing

Parte inferior do formulário

✅ Correct: A. A venture capital firm is a limited partnership that raises capital to invest in private startups.

**What is the primary feature of an IPO?**

 A. The issuance of bonds by a private company  
 B. The buyback of shares by the firm  
 C. The first time a company offers shares to the public  
 D. The distribution of dividends to shareholders  
 E. The offering of preferred stock to employees

Parte inferior do formulário

✅ Correct: C. An IPO is the first time a company sells equity shares to the public.

**.**

Parte superior do formulário

**Why might a firm choose a rights offering over a cash offering in an SEO?**

 A. To reduce underwriting fees to zero  
 B. To avoid diluting current shareholders  
 C. To raise debt instead of equity  
 D. To eliminate voting rights of new investors  
 E. To bypass SEC registration requirements

Parte inferior do formulário

✅ Correct: B. Rights offerings give current shareholders the opportunity to maintain their ownership percentage.

**.**

Parte superior do formulário

**Which of the following refers to a right that gives investors priority in liquidation?**

 A. Preferred dividend  
 B. Voting right  
 C. Liquidation preference  
 D. Capital gains clause  
 E. Redemption option

Parte inferior do formulário

✅ Correct: C. Liquidation preference ensures investors are repaid before common shareholders in case of company sale or bankruptcy.

**.**

Parte superior do formulário

**What is the purpose of a road show in the IPO process?**

 A. To generate interest among institutional investors  
 B. To set a fixed offer price based on accounting rules  
 C. To file the final prospectus  
 D. To launch the rights offering  
 E. To announce dividends before the IPO

Parte inferior do formulário

✅ Correct: A. The road show is a marketing campaign to build demand and gather pricing information.

**.**

Parte superior do formulário

**What is a common motivation for a company to go public?**

 A. To reduce disclosure requirements  
 B. To limit liquidity for shareholders  
 C. To eliminate the need for external funding  
 D. To gain access to public capital markets  
 E. To exit the business entirely

Parte inferior do formulário

✅ Correct: D. Companies often go public to access capital from public markets and fund future growth.

**.**

Parte superior do formulário

**Which of the following is a disadvantage of going public?**

 A. Increased access to funding  
 B. Enhanced public visibility  
 C. Improved liquidity for shareholders  
 D. Ability to use shares for acquisitions  
 E. Higher compliance and reporting costs

Parte inferior do formulário

✅ Correct: E. Public companies face higher regulatory burdens and disclosure obligations.

**.**

Parte superior do formulário

**What does underpricing in an IPO refer to?**

 A. Selling shares only to insiders  
 B. Offering shares below the market value at IPO  
 C. Issuing shares at par value only  
 D. Discounting shares during a buyback  
 E. Selling shares without a prospectus

Parte inferior do formulário

✅ Correct: B. Underpricing means the IPO share price is set below expected market value, often leading to a first-day stock price increase.

**.**

Parte superior do formulário

**Which entity typically underwrites an IPO?**

 A. The Securities and Exchange Commission  
 B. A venture capital fund  
 C. An investment bank  
 D. The company’s board of directors  
 E. The company’s legal team

Parte inferior do formulário

✅ Correct: C. Investment banks serve as underwriters, pricing and distributing IPO shares.

**.**

Parte superior do formulário

**What is a typical role of a lead underwriter in an IPO?**

 A. Writing the company’s business plan  
 B. Issuing loans to retail investors  
 C. Conducting the company’s internal audit  
 D. Coordinating the IPO process and allocating shares  
 E. Approving IPOs on behalf of the government

Parte inferior do formulário

✅ Correct: D. The lead underwriter manages the offering, coordinates marketing, and distributes shares to investors.

**Open Questions – Module 1 – ch23.**

**Q1. Explain the main differences between angel investors, venture capital funds, and private equity firms.**

**Ideal answer feedback:**

* **Clear, distinct definitions**:
  + *Angel investors*: High-net-worth individuals investing their own money in early-stage startups, often providing mentorship and networking.
  + *Venture capital funds*: Structured funds pooling institutional and high-net-worth capital to invest in high-growth startups, typically in early growth stages.
  + *Private equity firms*: Funds investing in more mature companies, often acquiring controlling stakes and pursuing operational restructuring to enhance value.
* **Key differences**:
  + Investment stage (angel = seed; VC = early growth; PE = maturity).
  + Source of funds (own capital vs. pooled capital from investors/partners).
  + Objectives, time horizon, and governance involvement.
* **Course connection**: Relate differences to risk–return profiles and governance structures.

**Q2. What is IPO underpricing, and why does it occur? Who benefits and who loses from this phenomenon?**

**Ideal answer feedback:**

* **Technical definition**: Underpricing occurs when the IPO offer price is set below the first-day closing market price.
* **Causes**:
  + Information asymmetry between issuers and investors.
  + Incentives to ensure the IPO’s success (oversubscription).
  + Compensation for institutional anchor investors’ risk.
  + “Leaving money on the table” to create market buzz and liquidity.
* **Winners**: Investors allocated shares at the offer price (gain immediate first-day returns).
* **Losers**: The issuing company (raises less capital than possible) and existing shareholders (suffer greater dilution).
* **Critical discussion**: Recognize that underpricing may have strategic value in certain contexts (e.g., publicity, stabilizing post-IPO trading).

**Q3. Compare an Initial Public Offering (IPO) to a Seasoned Equity Offering (SEO). Discuss their pricing process, expected market reactions, and main types of SEO.**

**Ideal answer feedback:**

* **Definitions**:
  + IPO: First sale of shares to the public.
  + SEO: Additional issuance of shares by an already public company.
* **Pricing process differences**:
  + IPO → roadshow, bookbuilding, high uncertainty, higher asymmetry of information.
  + SEO → price anchored to existing market price, lower uncertainty.
* **Market reactions**:
  + IPO → potential for underpricing.
  + SEO → often negative reaction due to signaling of potential overvaluation or urgent need for capital.
* **Types of SEO**:
  + Primary offering (new shares, funds to the company).
  + Secondary offering (existing shareholders sell shares).
  + Combined offering (mix of both).
* **Practical connection**: Cite real-world cases or empirical evidence on average returns post-IPO vs. post-SEO.

**Q4. As the founder of a startup negotiating with a venture capital fund, what are the key terms you should consider in the funding agreement? Why are these terms important?**

**Ideal answer feedback:**

* **Key terms**:
  + Pre-money and post-money valuation.
  + Ownership percentage given up.
  + Liquidation preference clauses.
  + Governance rights (board seats, veto rights).
  + Anti-dilution protection clauses.
  + Founder vesting schedules.
  + Exit rights (tag-along, drag-along).
  + Covenants (operational obligations and restrictions).
* **Importance**: These terms determine control, alignment of incentives, protection against dilution, and payout structure in liquidity events.
* **Strategic perspective**: Link to future funding rounds and potential conflicts between founders and investors.

**Q5. What are the main benefits and costs of going public through an IPO from the perspective of the company?**

**Ideal answer feedback:**

* **Benefits**:
  + Access to growth capital.
  + Liquidity for existing shareholders.
  + Enhanced brand visibility and credibility.
  + Shares as currency for acquisitions.
* **Costs/downsides**:
  + Direct costs (underwriting, compliance, auditing).
  + Disclosure requirements (loss of strategic privacy).
  + Short-term performance pressures from the market.
  + Exposure to hostile takeovers.
* **Critical discussion**: Evaluate when the trade-off between benefits and costs justifies going public.