**Introduction to IPOs chris**

This element outlines some of the key considerations which a company’s board will take into account when deciding whether to seek a listing on the Official List and admission to trading on the Main Market of the London Stock Exchange (‘**LSE**’).

**Introduction**

Undertaking an initial public offering is a very significant step for a company.  This element will consider some of the key considerations to take into account when embarking on this process.

The term ‘initial public offering’ (‘**IPO**’) denotes a first (‘primary’) offer of shares although you should note that not all IPOs involve a 'public' offering of such shares.

Another term (which some market participants use interchangeably with ‘IPO’) is ‘flotation’.

The UK Listing Rules ('**UKLRs**') and the Prospectus Regulation Rules ('**PRRs**') apply to the listing of 'securities', which includes both equity and debt instruments (in other words, shares and bonds) on the Main Market of the LSE. This knowledge stream covers the listing of equity shares in commercial companies (‘**ESCC**’) category rather than other types of securities.

Unless the context indicates otherwise, references in these materials to admission to the Main Market means both admission to trading on the LSE and admission to the ESCC category of the Official List.

**Introduction**

It is important to understand the nature of and distinctions between **private companies**, **public companies** and **listed companies**.

These will now be considered.

**Private companies**

A private limited company's ability to raise equity finance is heavily restricted by s 755 CA 2006 which prohibits a private company from offering its shares to the public. The definition of 'offer to the public' for these purposes is contained in s 756 CA 2006.

**Public companies**

As the business of a private company gets larger and more successful, its shareholders may decide that the company requires further equity finance. To enable the company to offer new or existing shares to the public at large, private companies often decide to convert the private company into a public company. The procedure that must be followed to convert the company (from 'limited' to a 'plc') is set out in s 90 CA 2006.

**Listed companies [Diagram shows ‘listed companies’ nested within ‘public companies’]**

As many commercial investors want to be able to deal freely in their investments and prefer to invest in a company whose shares are traded on a stock exchange, the third stage of development for some companies, after converting to plc status, is to seek a listing and admission to trading of their shares. Note that it is not the company that is listed, but its shares.

Technically, only companies whose shares are listed on the Official List are 'listed companies' (which will cover companies whose shares are admitted to trading on the Main Market of the LSE but not those on AIM). You may also, however, come across the term used in a wider sense - especially in the press.

A company must be a public company before it applies to have its shares listed or traded. However, not all public companies apply to have their shares listed. You should therefore not assume that a company whose name ends in plc is a listed company.

**Why would a company seek a listing?**

The processes of applying for and maintaining a listing of a company's shares is **complex**, **time-consuming** and **expensive**. There are a number of advantages and disadvantages of applying for, and obtaining, a listing. These can be broadly summarised as follows:

**Advantages**

- Access to capital to fund growth and/or reduce debt

- Providing an exit for existing shareholders and a continuing market for the shares.

- Public profile for the company

- Key staff incentives via options and shares

- Ability to use shares as an acquisition currency

**Disadvantages**

- Burden of disclosure and reporting requirements

- Management time

- Changes to the board

- Cost and fees

- Loss of control

We will consider each of these advantages and disadvantages in turn.

**Advantages**

**Access to capital to fund growth and/or reduce debt**An IPO is a way of gaining an injection of cash into a company. This cash can be used by the company to expand (either through acquisitions of other businesses or organic growth) or to pay off existing debt. Generally, a company will gain many new shareholders as a result of an IPO, and these new shareholders will be a potential source of future funding for the company.

**Providing a market for the shares**One of the main disadvantages of being an unlisted company is the lack of a market in which shareholders can trade their shares. In obtaining admission to trading on the Main Market, shareholders can take advantage of ready-made public markets. For example, as the demand for shares in a company traded on the London Stock Exchange grows, it will be easier for subsequent share issues to be made to raise further finance. The lack of a market for the shares can also be a problem for companies with large numbers of shares held by employees; floating on a market will enable employees to either realise gains by selling their shares at the time of the IPO, or provide an opportunity for them to invest in further shares, perhaps as part of an incentive plan.

**Public profile for the company**

Companies often list to a fanfare of publicity in the business world. Publicity created by an IPO is usually good for business. In addition, the fact that a listed company must keep its investors informed of its financial performance means that its progress can be closely monitored, enabling a company to gain the confidence of its investors.

**Key staff incentives via options and shares**

The tradeable nature of listed company shares makes them a useful tool to incentivise key employees. Shares are often made available to employees through share option schemes which contain bespoke performance measures.

**Ability to use shares as an acquisition currency**

In a similar way, the tradeable nature of listed company shares makes them a viable form of consideration if the listed company undertakes an acquisition.

**Disadvantages**

**Burden of disclosure and reporting requirements**

Companies listed on the Official List must comply with a large number of regulatory requirements.

The UK Listing Rules ('UKLRs'), Prospectus Regulation Rules ('PRRs') and the Disclosure Guidance and Transparency Rules ('DTRs') (together, the 'LPDT Rules'), the Market Abuse Regulation ('MAR') and the London Stock Exchange's Admission and Disclosure Standards must be observed post-listing and failure to comply can lead to penalties, censure or even the suspension of trading and listing of a company's shares.

Example: A company must promptly disclose information on various facts or events that could potentially have an effect on the company's share price. In addition, there are detailed provisions in the UKLRs, the DTRs and MAR on the information that must be contained in the half-yearly results and annual accounts of a listed company and other announcements the listed company is required to make.

**Management time**

The process of listing on the Main Market is a complex and time-consuming task and will involve a significant investment of management time. Company directors can expect to dedicate practically all of their time to an IPO for a number of months. In addition, they need to continue to run the business effectively.

**Changes to the board**

The company will want to ensure that all the directors have appropriate experience and expertise as this will be an important consideration for potential investors. The company's directors are potentially more exposed to the risk of being sued in their personal capacity.

A listed company should also comply with the UK Corporate Governance Code, which stipulates how the board of the company should be constituted. This may result in board changes and new directors being appointed. Finding non-executive directors of the right experience may be difficult and costly.

**Cost and Fees**

The expense involved in floating a company is significant. The various advisers involved will all need to be paid and a substantial proportion of the cash raised through an IPO will be used to meet these costs.

**Loss of control**Although the loss of control is less than in an acquisition, the directors of a listed company must accept that they will be subject to additional influences and pressures on the way that they run the company following an IPO. Institutional investors that have significant shareholdings may be in a position to block resolutions that they do not approve of.   
Listed companies should also follow the guidelines issued by the bodies which represent institutional shareholders, such as the Investment Association ('IA') and the Pre-emption Group ('PEG’). Although such guidelines do not have statutory force, breaching them would risk annoying institutional investors and could thus jeopardise future fundraisings and other corporate activities.

**Summary**

* An IPO is a very significant step for a company to take.
* Only public limited companies may make offers to the public for the purposes of CA 2006.
* Advantages of seeking a listing include access to capital, enhanced profile and an improved market in the company’s shares.
* Disadvantages of seeking a listing include the cost in time and money, greater scrutiny and a wider range of shareholders to keep happy.