The Pros and Cons of Floating

Chris Searle, Corporate Finance Partner for professional services firm BDO, discusses the opportunities and obstacles of an IPO on the AIM market

The UK has the most developed public equity capital markets in Europe and, in AIM, the most successful junior stock market in the world.

Undertaking a flotation of your company may seem the best way to raise capital and enhance its profile, but often it's not that simple. Before taking the decision to float, you need to carefully assess the advantages and disadvantages.

Your final decision should be based on discussions with your directors, shareholders and advisors.

So, what are the principal advantages and disadvantages of a flotation AIM?

Advantages

The new shares your company issues in the flotation can finance organic growth and enable it to grow faster.

Being quoted places a market value on your shares, so if you want to grow by acquisition, you can issue new shares to the vendors of target companies instead of using cash or borrowings. This can also help 'tie in' the owners of the acquired company should you consider them important to its success. This may be of particular importance to a business focused on people.

You and your fellow shareholders may be able to realise part, or all, of your existing investment in the company and establish a market value for your retained shareholdings.

However, you should note that if you are to have an ongoing management role in the company after its flotation, it is unlikely that you will be allowed >

to sell more than a small proportion of your shares, if any. You will also have to agree not to sell any further shares during a period of between six months and two years after the flotation. If you do want to sell all your shares, you should consider a trade sale instead.

The status of your company will be enhanced in the eyes of your customers, suppliers, the financial community and the media. This will give your products or services a higher profile and improve your credit rating. Some customers prefer buying from a public company and this intangible benefit is often overlooked.

A flotation enables you to motivate management and employees with more attractive share participation schemes. Management and employees will be able to see the market price for their shares and options on a daily basis and will be able to sell their shares more easily than if the company was private.

Disadvantages

Once your company is quoted, it will be subject to public scrutiny. In addition, the need for accountability to outside shareholders means you must distinguish more precisely between company and private assets. You must also expect and accept criticism when the company has a bad year.

Your vulnerability to an unwelcome takeover bid increases according to the percentage of the company's share capital in public hands. If another company can buy 51 per cent of your issued share capital, it will be able to take control of your company.

A flotation may not necessarily increase the marketability of your company's

> *“Expect and accept criticism when the company has a bad year”*

shares. This is particularly the case for small companies where trading can be 'thin' and, in many instances, effectively only undertaken on a matched bargain basis. This means that even the purchase or sale of a small number of shares can cause big swings in the share price.

As well as the significant financial cost, you should not underestimate the hidden cost of the extensive time that your company's management will have to devote to the flotation – time that could otherwise be spent running and developing the business.

However, this will only last for the duration of the flotation, say two or three months, and there are ways around it if your management team is big enough. For example, a small team could be assigned to project manage the flotation. This is therefore more of an issue for companies with smaller management teams.

Your company's costs will increase because of the need to strengthen its reporting function and because you will have to appoint non-executive directors.

Quoted companies have to release their results every six months and even between these dates, they must keep the market informed of anything that may affect the price of their shares.

You will also be expected to have robust and reliable accounting and an internal control system in place prior to flotation.

There will be increased pressure on your company's directors, especially concerning profit levels and dividends expected by outside investors. Unwelcome or unexpected news can cause a sharp reduction in your share price – and it may take a long time for it to recover.

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These are just some of the factors that should shape your final decision. A flotation certainly widens the future options available to your business – for instance, in terms of how to fund growth and acquisitions. But you need to weigh those benefits against the time management will need to commit to the flotation and the subsequent market and regulatory pressures. ■

Thinking about floating on AIM?
Read Chris Searle's next article
A Guide to Listing on AIM

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