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IPO vs. Staying Private: Pros & Cons of Each Model

By Amy Fontinelle

If you own a successful private company and you want to grow, you might be thinking about going public. It can be a great way to raise money, increase your company's profile and feel like you've really made it. But it's expensive and time consuming to become and remain publicly traded, and you lose some control of the business. Let's take a closer look at these and other pros and cons of going public vs. staying private.

IPO PROS

The biggest motivation to conduct an initial public offering (IPO) is typically financial.

"Going public gets you cash – and usually lots of it," says Eric Chen, an associate professor of business administration at the University of Saint Joseph in West Hartford, Conn., where he teaches finance, strategy and law classes. In his previous career in corporate finance and equity research, he says he led or participated in taking more than 25 companies public. "Where you might have been cash-constrained before, you're now flush with capital that you're supposed to invest in the company in order to make it grow exponentially," he says. (See IPO Basics: What Is an IPO?)

In addition, you can also use your company stock as currency, Chen says. It's worth something because people can buy and sell it on a public exchange. You can use it to acquire other companies to grow faster, to take out competitors or to strengthen your market position through synergy.

There is also a certain perceived legitimacy in being public, Chen says. "People will know about you. Being public will make it easier for you to do business with others. Securing financing will also be easier," he says, since the money companies raise from going public usually shores up the balance sheet. Potential investors and business partners may feel more comfortable working with you since your company information will be filed with the Securities and Exchange Commission (SEC) and available for all to see.

In addition to increasing perceptions of your company's legitimacy, "there is just a perceived cool factor about going public, ringing the bell, and trading on the stock market—it's like a rite of passage," says Jeremy S. Office, founder and principal of Maclendon Wealth Management and cofounder and managing partner of venture fund SJO Worldwide, both in Delray Beach, Fla.

STAYING PRIVATE PROS

Going public may help you grow your balance sheet, smooth business transactions, make it easier to take over competitors and make you stand up a little straighter, but there are many pros to remaining private. You report to a finite group of investors, Office says, and while your pool of potential investors is smaller, since they have to be accredited, "right now there is a record amount of capital going to early-stage companies." (See The Risks And Rewards Of Investing In Startups and The Rise of Corporate Venture Capital.)

Staying private means you can choose exactly who invests in your company, and it's not as if you can't decide to go public later. But as long as you remain private, you don't have to alter your company's focus or strategy to meet Wall Street's expectations, Office says (see Keeping Control of Your Business after the IPO).

Going public is also a huge risk. "What if the IPO is a failure? The IPO flop can end your business," Office says. A benefit of staying private is that you don't subject your company to that risk. If you're in a position where you're so successful that going public is even a consideration, you might actually be better off leaving things as they are. (See The Biggest IPO Flops and IPO Flippers And The Companies Who Hate Them.)

"If you're not big enough, don't even think about it," Chen says. "The markets are littered with small companies who really didn't have enough to sustain a public offering." Depending on the industry you're in, this can happen to companies that post several hundred million in annual sales, he says. You need to have a strong following so the company's stock will trade properly. "Many of these situations end up as "penny stocks" and face delisting from the exchange," he says. (See The Dirt On Delisted Stocks and The Lowdown On Penny Stocks.)

A major benefit of staying private, in other words, is that you limit your downside risk. You can keep doing what you're doing to earn the profits that have made your business as strong as it already is. You don't have to answer to thousands of outside stockholders or risk losing control of your company (see Why Public Companies Go Private).

IPO CONS

While the prestige and the cash are tempting reasons to go public, the expensive and time-consuming process and requirements for holding an IPO and being publicly traded are significant drawbacks.

"Going public, even under the reduced reporting requirements of the JOBS Act, can be an expensive exercise," says Helen Adams, San Diego area managing partner of Haskell & White, one of the largest independently owned accounting, auditing and tax consulting firms in Southern California. "There are specific SEC financial statement filing requirements on a quarterly and annual basis, and many periodic legal reporting requirements, including those for material transactions and for stock trading by senior executives and board members," she says.

Chen also adds that going public itself is an expensive process. "You have to pay for road shows, and your senior management is going to spend lots of time prepping for the offering instead of focusing on the business."

In short, you're going to spend more money as a public company than a private one, Chen says. "If you're the size of GE, you can afford the extra costs of being public," he says. But if you're small, you might find that your bottom line gets chewed up by costs you didn't consider carefully.

Another drawback is that while going public might be a boon to your company's bottom line, it won't necessarily line your own pockets because founders may not be able to sell their shares.

"Don't expect to get your money out anytime soon," Chen says. "Your shares are going to be subject to lock-up provisions for at least six months." (See What is an IPO lock-up period and how long is it?)

The reasons for this are largely based on investor psychology. "Think about a situation where Facebook is going public, and Mark Zuckerberg is selling his own shares into the offering," Chen says. Investors will think, "What does he know that the public doesn't? Is he looking to dump shares on bad news?" This doesn't mean you won't eventually be able to sell your holdings, but it does mean you will likely have to wait.

STAYING PRIVATE CONS

As a private company, you may not be able to attract top talent through benefits like stock incentives, says Mike Ser, an active trader, trading coach and entrepreneur with more than 16 years of trading experience. He is the co-founder, along with Andy Man, of Ser Man Traders, a training program for professional traders. Another con is that as a private company, you can't use your stock as currency to acquire your competitors or other companies. "If you're a private company, it's more of a challenge as you either have to have cash or borrow debt to acquire companies," he says.

Staying private also limits liquidity for existing investors. They can't easily sell their stake in the company by going to a public exchange. For a well-known, top-performing, venture-capital backed company, it might not be so hard to find a buyer, but in the case of a lesser-known company, the only potential buyers might be other existing owners. Selling shares in the secondary market is often challenging, especially since prospective buyers have to be accredited investors. (See How can I sell private company stock?)

You may still have investors to answer to as a private company, just not as many as with a public company. The investors you do have might hold a significant stake in your company and be vocal about how they think you should run the business. You might not have as much control as you'd like, even if your company remains private. At the same time, relying on private investors may not allow you to raise the funding you need, and you may not be able to find enough private investors who are interested in your company (see Why Companies Stay Private and Looking for Profit in Privately Held Companies).

THE BOTTOM LINE

Going public isn't always the best choice for your business. It will no doubt be fun to brag about it to everyone you know, but it might not be as lucrative as you think, given the costs of the IPO itself and the increased financial reporting requirements. You'll lose some control over the company to shareholders who want a say in the business and to the ongoing need to keep both your company's performance and the public's perception high so the stock price doesn't tank.

If you choose to remain private, it doesn't necessarily mean your company isn't successful enough to go public. It might just mean that you're wise enough to make the choice that's best for your business, even if it's not a glamorous choice (see When Does an IPO Make Sense for Your Business?).