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THE DECISION OF GOING PUBLIC – WHEN, WHERE AND WHY?

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Abstract
The decisions of the company, in what it concerns financial resources, play a key role in its existence and evolution. Funding through the stock exchange, due to its implications, is especially challenging in the current economic and financial enviroment. By bringing into question the results of relevant studies, we aimed to answer three key questions about the decision of firms to become public: when is the appropriate time, on what market to start selling primary shares and wich are the main implications of this decision? Although a theoretical work, we consider the paper to be of interest due to the whay results of specialized studies were systematized. The overall conclusion is that there are no firm or unanimous answers. Most opinions converge to the idea that the perfect time for a company to become public is when the stock market is growing or marked by optimism. Regarding the question on what market to open to the public investors, most studies recommend international markets due to their size and higher chances of success. However, as any financial decision, the decision to become public involves positive and negative effects. Arguments in favor of the initiative to become public and cons of such an approach are addressed in the same manner, by reference to relevant studies undertaken in the field.

Key words: initial public offer, public company, stock exchange

JEL Classification: *G32, G15, G23*

1. Introduction

The financial resources for current operations or investments has been a key objective in the life of any company. Financing its activity becomes a central point of management's concerns from which it develops a complex network of decisions. Each economy is characterized by a higher or a lower dependence on the banking system or capital market. In an economy largely financed by capital market, the access to information and the large number of investors are prerequisites that allow even young companies to enter the game by issuing new shares, for obtaining their financial resources.

Without denying the importance of funding through the banking system or from own resources, this paper aims to approach the capital market financing. This form of getting resources is considered to have major implications in the life of any company. Under current practice, in order to get to be listed on a stock exchange, the company must conduct an initial public offer of shares, through which it becomes opened to the public investors and is effectively financed. Subsequently, the company may issue additional shares, with the purpose of acquiring new financial resources.

The initiative to open to the public investor is a complex decision, with multiple effects for the company, positive and also negative, as it requires the firm to adopt a certain behavior, often different from the one before the listing decision. When is the right time to become public, on what market to open to the public investors and the main effects of this decision are the questions of the present study. The issue is theoretically addressed by bringing into attention those studies considered to be relevant in finding the required answers.

The decision to become a public company is concretely materialized in initiating and conducting an initial public offer of shares (IPO - *Initial Public Offer*), according to the stock market regulations . The company who wants to finance an investment project or for other activties offers a number of shares for sale to those investors who have sufficient money and want to gain by opening a long position on those stocks or simply to gain from speculation.

2. When to become public?

The right moment when a company decides to obtain financial resources from investors by conducting an initial public offer, is generally related to both firm characteristics and market conditions. Reality confirms

several important aspects. It's hard to test what theory applies to the decision to conduct an IPO, because research is often directed to the companies who already have decided to become public and less on those that could become public but delay this process. Researchers Pagano, Panetta and Zingales (1998) tried a much broader approach on this subject, focusing on Italian firms. According to them, the big companies from industries with a better appreciation of the market are more likely to become public, the first effect being the reduction of the credit cost. Moreover, they concluded that the decision to become public comes after a period of heavy investments and growth, not before.

Investors sentiment plays an important role in the decision to become a public company. When there is a great optimism in the market, issuing new shares becomes appropriate and necessary. Baker and Wurgler (2000) show that, as the issue of shares exceeds the one of bonds, in the coming years there might be lower capital gains. Moreover, Lowry and Schwert (2002) conclude that high capital gains, from the first day of trading the new issued securities through IPO, keep the optimistic feeling and generate other gains, for a period of about 6 months.

Ritter and Welch (2002), however, propose a less rational theory without information asymmetry, which may explain fluctuations in IPO phenomenon: the firm value that entrepreneurs themselves attribute is less dependent on the public value of the market and more related to the personal vision or to daily experience within the company. The value given by the capital market folds faster to the changes or news about the firm, compared with the one given by the entrepreneur. Thus, even if the share price is based on irrational public feelings or the value given by entrepreneurs depends on irrational private feelings, the last ones will be determined to sell the stocks only after the public appreciation generated an increased stock price.

Loughran and Ritter (2001) attest, in a study of interest, that the average age of public firms has remained approximately constant around 7 years, since 1980. As an exception, the Internet era, namely the period 1999 - 2000, when many companies in the field have been the subject of initial public offers of shares, marks an average age of five years, 12 years in 2001. However, without neglecting the actual age of the company, as an important factor in the decision to become public at some point, authors emphasize on a greater extent on market conditions that need to be friendly and proper for the initiative of becoming public.

Supporting the previous idea, researcher Bouis (2009) identifies an interesting behavior of firms that applied for registration in the SEC (Security Exchange Commission) to conduct an IPO but, in reality, they initiated the operation only under high stock prices and low volatility. This behavior proved to be on short term and refers only to the described moment, a different view from other researchers as Boehmer and Ljungqvist (2004) or Busaba (2006) who argue that firms conduct an IPO in highly volatile market conditions.

Interesting results were obtained by researchers Lucas and McDonald (1990) who propose a model with asymmetric information in wich firms postpone the issuance of shares if the market undervalues them. Choe, Masulis and Nanda (1993) develop the mentioned idea and conclude that, in addition, companies do not issue when few good companies do. According to other results, entrepreneurs choose to transform the company into a public one when they consider that the benefits of being a private company are outnumbered by those of opening to public investors, especially when there is sufficient liquidity in the market and share prices are not high [3] .

This correlation between the decision to become public at a certain time and capital market conditions led to the formation of waves, known in the literature as the *IPO waves*. IPO waves are actually time periods when many companies have initiated and conducted initial public offers, as deciding factors considered to be appropriate opening to the public investors. Pastor and Veronesi (2005) concluded, after an analysis of carried out IPOs between 1960 and 2002, that IPO waves are preceded by high capital gains and succeeded by reduced ones or losses.

We observe that most opinions converge to the idea that the decision to become public under information asymmetry becomes appropriate when the market is optimistic and inclined to overvaluate shares as a mean of managers to exploit investors. However, according to the pecking order theory, opening to the public investors for a company appears as a last resort of financing, being preferred self-financing , bank loans and the issue of bonds. Reality has shown that the decision to become a public company is much more complex and harder to fit into a certain theory.

3. On what stock market to become public?

One of the major decisions of the company, that wants to go public, is the choice of the capital market on wich will be selling the new issued shares. From a natural inertia, generally, a new issuer prefers the national market where is already or can be easily known and where it can get a higher value for shares. However, the alternative of listing on a foreign capital market and creating an international shareholding has been an option for companies, with both advantages and disadvantages.

At European level, between 1970 and 1980, companies have expressed an interest in foreign listings, the main targets being stock exchanges from Belgium, Germany, Austria and the UK. However, with the mid '80s, the integration of European stock markets opened the way to another interesting location for listing: the U.S.

stock market, especially the Nasdaq. Without neglecting the additional transaction costs and those of reporting, the listing of a company on a foreign stock exchange is essentially supported by three justifications [2]:

- a financial one - allows an increase of capital by using the resources of a larger investment public and causes a reduction in the cost of capital and an increase in the value of the company;
- a commercial one - facilitates an international increased visibility for the company and allows gaining new customers and suppliers;
- a social one - provides another form of remuneration for employees from foreign subsidiaries.

Listing on a foreign capital market decreases the information asymmetry, once the firm must meet reporting requirements and information. In addition, the company's image to partners and local investors is considerably improved. Chaplinsky and Ramchand (2000) concluded, in a study of interest, that the issuance of shares of American companies in foreign markets are characterized by a decrease of approximately 0.8% of the negative market reaction (the stock price decreases with less than 0.8%, compared with other markets with the same context of negative news), the major benefit being the increased number of potential investors. However, foreign IPOs are rare because sometimes are associated with higher costs and investors prefer local issuers because they can easily communicate and companies managers have the same cultural training.

A study of interest belongs to researchers Hurst and Maula (2007), performed on national and international IPOs conducted, between 1991 and 2001, concluded that the probability of an IPO on a foreign market is even greater as:

- the company is a high – tech one, because the necessary of funds is greater;
- the management team has an international experience;
- the company has offices or branches in other countries;
- in the shareholder company there are foreign entrepreneurs or investors.

According to the authors Ding, Nowak and Zhang (2010), a company chooses a foreign market, to list, in order to signal an important step in the implementation of long-term growth strategy. In particular, the signaling is made in two essential directions: for the national business environment in which it activates and for the international investment environement. Choosing between the national capital market and the international one becomes like choosing between financial benefits in the short term and strategical ones in the long term. In another view, the decision to become a public company is actually a simple option wich depends on the decision makers perceptions between risks and opportunities [30].

Any initial public offer of shares is normal to continue, in a short time, with the listing of the company on the stock exchange, since this approach enables investors to get out of that position, by subsequent sell of securities or allocation rights, if it is the case.

4. Arguments in favor of the decision to become a public company

A relevant study belonging to researchers Smith and Chun (2003), conducted on Korean firms, concludes that there is uniformity in the companies decision to become public. Korean companies do not go public to finance fixed assets but to take advantage of opportunities arising at a certain time, to rebalance their portfolios or even to finance the takeovers of other companies. However, a systematization of the main arguments in favor of the decision to become a public company is possible and useful.

Once the process of listing has been completed and assuming that the company is able to promote its own *interests, the advantages of such an approach are not few:*

- *the ability of the company to procure the necessary cash resources from investors;*
- *it is provided a better dispersion of shares;*
- *the company enjoys advertising and gains reputation;*
- *the company is given a different value – the market value;*
- *there is a technical win;*
- *the self-responsibility to do performance;*
- *a continuous posibility to test the market feeling*.

The first advantage, of course, is the possibility of the company *to procure the necessary cash resources* from investors, wich most times are considerable sums of money. Google's initial public offer, held in 2004, meant the sale of 20 million shares at a unit price of $ 85, approximately $ 1.7 billion for the company. This form of loan is the subject of an interesting discussion if we refer by comparison to the bank loans. In both cases it starts from the study of the company, as an entity who is profitable and also solvent, in which investors or the bank invest money and have the belief that it will be able to remunerate all of them, at a certain time, through dividends (for investors) or interest (for banks). However, in the case of financing through the capital market, the company is not contractually bound as it is in the relation with the bank, to repay the full credit and the interest.

In addition, as argued by researchers Fulghieri and Chemmanur (1999), through IPO it *is ensured a better dispersion of shares*. In the early years of a company, this will choose to be private but, after it grows enough, it

can choose to become public, in order to benefit of investors cash resources, who seek public companies to diversify their portfolios. On the other hand, long-term investors or speculators, once they gave up money to get the shares offered through the IPO, they can immediately close that position only in relation with another buyer investor.

The first flow of financial resources, most often of a considerable volume, is achieved from investors to the issuer of shares. Once the money arrived at the company, this may use them for the development of productive investment, refurbishment, opening new outlets, payment of debts. This moment actually represents the financing of the company: when the primary offer of shares is exchanged for all the money provided by investors.

Inevitably, after the company enters the stock exchange game, it must comply with all the defined rules, one of the most important being *the transparency*. Transparency, as an obligation imposed by the capital market authority and and also as an ideology of an entire economic and financial system, based on fairness and proper information, materializes in publishing all data and information needed by investors, in order to know the evolution of the company. The increase in the liquidity of shares, by promoting a transparent and cooperative relation with potential investors, is a good premise for a favorable development of the company and also an advantage offered by the stock market.

From this game of information, the company wins another important advantage: *advertising and reputation*. An enterprise listed on a stock exchange, whose name appears on the daily trading reports or is the subject of some news and investment advices, is automatically promoted and supported in the view of commercial partners, customers and future creditors. In this respect, Maksimovic and Pichler (2001) conclude that a good stock price can positively influence the image of the company and its products, can increase the credibility of the firm in relation with other investors, customers, creditors, suppliers. Moreover, a company, that becomes the first public one in the branch it activates, gets the advantage of the first step.

Given that today advertising costs, financing through capital market provides an opportunity for the company to save and redirect a relatively large amount of financial resources to meet other pressing needs. In this direction, is oriented the study of Henry (2008), about the importance of company's presence, by listing on a stock exchange, within the media. The study assumes that the press articles related to the financial results of listed companies fulfill two objectives: information and promotion. The main conclusion is that all appearances of the company in articles and news, related to its financial performances, influences investors who react by selling or buying the shares. But, of course, unusual gains obtained by positive news articles about the profitability of the firm, grow to a certain point, after that the market reaction is diminished, despite other unexpected incomes reported by the company.

The company's presence as an active player in the capital market through its shares, as a main emblem, generates another major advantage: to the company is being offered a new value, different from the one given by accounting information, a new value provided by the market, by those who invest their money – *the market value*.

The practical importance of this notion is relevant especially when there are events such as mergers, acquisitions or other such operations that put an emphasis on the real and actual value given by the partners of the company, by the environment where it activates and by the market, in general. Zingales (1995) argues, in a study of interest, that it is technically easier for a public company to be acquired by another company but, in addition, it gains an advantage: to its share is being assigned a better price, given that investors are unlikely to be pressed by the purchaser.

We believe that a company's shares, which are frequently traded on a stock market and there is always interest in purchasing them, attract by their liquidity new investors. In a favorable environment of development and good prospects related to that company, its market value is more likely to increase. By default, the company's image improves, managers are watched as fair and competent decision makers, all these being strengths in dealing with suppliers, government and lending institutions.

Of a great interest is *the technical gain* obtained from this relation: the company, as an entity listed on the capital market, must accept to collaborate with other institutions involved in the trading activity. While it may keep an own record of its shareholders, given the continuous trading operations, it certainly would not reflect reality in proper time. Capital market institutions, responsable with shareholders records in real time, ensure the transfer of property quickly and at a reduced cost.

All these advantages, briefly presented, have been extensively publicized in an attempt to attract companies to capital markets, as a source of funding. But, they are necessary in our attempt to introduce the idea of another advantage, a more complex one and manifested only in terms of responsibility and economic integrity. An organization that has entered the capital market scene, as an issuer of securities, automatically undertakes to provide investors with the opportunity to place their trust and financial resources in an effective and efficient framework, with the hope of future benefits.

In our opinion, this *self-responsibility to make performance* and to keep up with the competition, in a fairly manner, is an excellent premise for the development of the company. Although it occurs in an almost

unseen manner at first, this self-responsibility can be easily transferred to the employees. Their involvement in the ownership of the company, by offering shares as prizes or other forms of remuneration, transforms ordinary employees in shareholders, with more or less shares, depending on their performance and position. Thus, they become aware of the importance to provide a quality work, in order to allow the growth of the company.

Additionally, the presence of the company on the stock exchange, as a listed company, *allows to continously test the market pulse*. Excepting those situations of crisis, when good news lose their normal impact of growth and appreciation of stock prices, the shares of a profitable and performant company are an object of interest for investors, as a recognition of their value. In this regard, Schultz (2000), Subrahmanyam and Titman (1999) point out that, if the market provides information about the growth and opportunities through the stock price, companies respond by specific decisions. These few considerations make the financing through capital market a necessity and also a challenge, a smart way to diversify the financing sources.

If listing on a stock exchange allows all these advantages in the existence of a company, then we can say that it becomes more than necessary, because the awareness of the need for performance and then implementing the strategy in this regard represent the economic engine of the entire productive system, with great repercussions on national welfare.

5. Ideas against the decision to become a public company

Of course, in this relation enterprise – stock exchange may appear elements of risk or disadvantages, such as:

- *the fear or unwillingness to enable undesirable investors to entry into the company's shareholding;*
- *the transparency required by the capital market, the disclosure and reporting requirements;*
- *the costs implied by this initiative;*
- *an increased attention to shareholders expectations.*

The fear or the refusal to enable other unwanted investors to entry into the company's shareholding is a reason for not seeking funding through capital market and, therefore, not listing on a stock exchange . Thus, Boot, Gopalan and Thake (2006) argue that the fear of losing the autonomy in decision makes many entrepreneurs-managers to avoid opening to the public investors. The authors insist not on the information asymmetry or on the agency costs, as main causes for this behavior, but on the simple divergence of views. What the manager may decide, at some point, can be assimilated by investors as an unapropriate initiative for the company.

The transparency required by the capital market, the disclosure and reporting requirements may be other potential problems in financing through the capital market. According to the principle of transparency, the company that became opened must comply with reporting requirements imposed by the capital market institutions. Pagano, Panetta and Zingales (1998) draw attention, in their study, upon the danger imposed by these requirements of transparency, given that a company is required to disseminate information that may be crucial in the fight with competition. From the perspective of mandatory transmission of these documents in proper time and in the requested format, the new issuer entered in the stock exchange game might perceive these requirements as an impediment or an overload of bureaucratic activities, essentially unproductive.

Another problem of the initiative for the company to become public, through an initial public offer of shares, refers to *the costs* of this decision, which may affect the company's performance. Thus, one of the reasons behind the massive delisting initiatives from the U.S. stock exchange was the high costs imposed to firms by implementing the requirements of Serbanes - Oxley Act [22]. In response to financial scandals such as Enron, WorldCom, Tyco and Adelphia, the Congress introduced the 2002 Serbanes - Oxley Act, in order to protect investors from possible abuses of corporations. Section 404 became, with 15 November 2004, a major point of discussion among participants to stock exchange activity and not only. According to this section, the annual report of each company must contain the internal control department conlusions and complete financial and accounting information. In essence, the act transfers the responsibility to provide accurate and real information to the management team.

By default, internal audit costs substantially grew between $ 500.000 and $ 5 million [28], which led many companies to opt for delisting, not being able to comply with the new requirements. Another option that companies chose, in response to high costs imposed by the Serbanes – Oxley Act, was to become *opaque* (a procedure known as *to go dark*). The obligation to publish quarterly or annual reports disappears, internal auditing is not required anymore but, once *the go dark procedure* is announced, the impact on the capital market is a negative one, the stock price decreases, the company does not have unlimited access to the stock exchange and banking partners react with a plus of prudence in lending.

Once the company becomes a public one, it must pay attention and respond to shareholders expectations, especially to those of institutional investors wich prefer dividends and are interested in obtaining also capital gains in the short term. Moreover, in the company, the power of control is diluted because shareholders must

approve major changes in the company (issuing new shares , mergers, etc.). Even when the shareholders approval is not explicitly required, the company must consider their desire, in order to limit negative effects on its stock price.

The reality is often contradictory to the rules of ethics and professionalism. Researcher Gomes (2000) argues, in a study of interest, that managers who are shareholders want the company to go public just to share the risk with other potential investors. However, investors remain aware of the fact that managers can still enjoy harnessing their opportunities and the exploitation of small shareholders, despite promoting a protective reputation of the management team.

Finally, a recent study concludes that the company's decision to become public influences its process of innovation as this initiative changes the nature of adopted projects, because it promotes greater caution and that may cause the departure from the firm of important inventors [4]. However, all negative considerations deserve to be weighed against the positive ones that financing through the stock exchange implies on enterprises development, in terms of economic growth.

6. Conclusions

As stated in the introduction of the paper, we considered IPOs as the particular way for the company to become public, by listing on a stock exchange. The attention focused on these operations, extensively studied in the literature. The decision of a company to conduct an initial public offer for the sale of shares, at some point identified as appropriate, undoubtedly marks some important changes for the company. Using relevant research results, we tried to capture the main issues raised by such a decision of the company to finance using the stock market and opening to the public investors: when, on what market and why?

If some studies insisted upon the importance of the national market as a reliable source of capital funds, on wich the issuer is known and works in the same cultural framework with potential investors, other studies promote the benefits of listing on a foreign market, with greater investment power. The perfect moment is also intensively discussed in the literature. However, most studies identified a strong link between the volume of IPOs and market optimism. In other words, the company wants to go public when the market reacts positively and the economic environment is a growth marked one.

A particular attention we offered to the consequences of the initiative to become public for a company, identified both positive and negative. If these advantages are actually transposing in reasons to go public and finance through the stock exchange, ideas against this initiative accentuates the main concerns of the companies that causes postponement or cancellation of such initiatives.

In conclusion, financing through capital market provides both advantages and disadvantages for the company, but any economic decision when is adopted involves simultaneously good prospects and risks. It is however recognized the key role the stock market plays in a capitalist economy, being actually the place with a total freedom of choice.

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