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What Kinds of Companies Go Public?

What is this research about?

'Going public' is one of the most important events in the life of a firm. By 'going public,' a firm makes it possible for the general public to buy shares, paving the way for future public investment. Not a lot is known, however, about the factors that drive firms to go public. One theory contends that larger, more capital intensive firms – such as auto or oil companies, which need a lot of capital to make their product – are more likely to go public, to draw investors. Other theories suggest that companies with greater shares of the market and less competition are more likely to open themselves up to public investment. It is also argued that firms with greater productivity and growth have a tendency to go public. But there has been little research on the factors that influence a firm's decision to make an Initial Public Offering (IPO) of equity to the general public. Privately held firms are usually not required to report their financial results. As a result, the data needed for this kind of research has not been readily available.

What you need to know:

A firm's productivity and sales growth will peak when the firm goes public. Sales, capital expenditures, and other costs associated with the company's product and market continue to increase after a firm makes its IPO.

What did the researchers do?

Researchers in Boston and Toronto set out to determine how a company's characteristics in the marketplace influence its decision to go public. They also looked at how the process of going public impacts the company's subsequent success in the marketplace. The researchers used the Longitudinal Research Database (LRD) of the US Census bureau, which covers the entire universe of private and public US manufacturing firms. The resulting study is groundbreaking. While previous research looked at specialized and non-US samples to answer this question, this study presents the first large sample analysis in the US and considers the firm's performance for the five years before and after it goes public.

What did the researchers find?

The researchers found the following types of firms that are more likely to go public:

- Firms that are larger in size and have higher sales growth.

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- Firms that have greater productivity and market share than their industry peers, as well as projects that are cheaper for outsiders to evaluate.
- Firms operating in less competitive and more capital intensive industries, with riskier cash flows.
- Firms in industries that have less 'information asymmetry' between insiders and outsiders – in other words, industries whose activities are understood by the general public.

Although previous research had identified that large firms, with higher sales growth, are more likely to go public, the other three types of firms, listed above, represent new findings. The researchers also found that a firm's productivity and sales growth increase in the five years prior to going public, and then decline steadily in the years following (forming an inverted U shape). This drop in productivity may be due to the fact that firms, by going public, tend to enhance the scale of their operations but, as a result, function at less than full efficiency. However, firms going public can potentially avoid this drop in productivity. And sales, capital expenditures, employment, total labor costs, materials costs, and sales and administrative expenses increase consistently in the years before and after the IPO.

How can you use this research?

Companies that are thinking about going public may find this research especially relevant. The findings may help companies to determine the best time to go public.

About the Researchers

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