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What Makes an IPO Compelling?

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At a recent preparation meeting for an Initial Public Offering (IPO), a question which I've heard repeatedly at such meetings was posed to the company's managing director: "So, what's your narrative that makes this IPO compelling?"

His answer: "Don't worry, we have an interesting company story, our financials are strong, and, therefore, our IPO will be highly sought after."

The managing director missed the point.

Yes, investors want to know all the company's history, its products and services, the people involved, and how strong the financials are. However, the key question on their minds is what makes this IPO stand apart from so many others?

In my experience, this question can be split in two: What is the company's long term strategy? What makes the IPO special?

The answers to these questions form the critical driver for the IPO. Specifically, they are likely to influence the price earnings ratio, the type of investors the company will attract and even how the stock price may behave post-listing.

LONG TERM STRATEGY

From the point of view of an IPO, the company's long-term strategy requires a clear articulation of its mission, vision and value proposition.

The mission is a statement of the company's *raison d'etre*. For example, Harley-Davidson's mission statement is simply: "We fulfil dreams through the experience of motorcycling."

A vision paints an ideal image of the future. It's a mental picture of a new order. It presents fresh ideas that inspire and energise a commitment to change in key people in the company. For example, Amazon's vision is: "To be Earth's most customer-centric company."

When a company decides to take a growth path that's different from its historical evolution, a clearly articulated vision can be the foundation of a strategy for radical change.

Finally, a clear long-term value proposition states how the company will survive competition, while keeping customers loyal. The important question is: What value do we provide to our stakeholders, and how do we do it better than our competitors?

MAKING THE IPO SPECIAL

To make the IPO special, the company needs to focus on its distinctive competency, i.e. its unique offering in a ferociously competitive marketplace.

Specifically, the business idea found within the product or service needs to fill a void in the marketplace. If no one else is doing what the company is doing (or doing it the way the company is doing it), then there can be real magic in the IPO.

This prompts an obvious follow-up question: what if competitors catch on? It will be helpful here to demonstrate barriers to entry (such as copyrights, patents, relationships, etc) or the ability to quickly scale up the business to dominate that particular market segment.

An example of a company that achieved this is Starburst Holdings. The first of its kind in Singapore, the company designs, fabricates, commissions and maintains high quality military training facilities in Asia and the Middle East. The distinctive competency of Starburst is its proprietary design methods and its engineering processes which allow its products and services to be scalable.

Starburst listed on Catalist in July 2014. Its IPO offer price was 31 cents and it was 9.5 times oversubscribed. The counter closed at 42 cents on the first day and 56 cents one month after its IPO. While the share price of a company is not necessarily a reflection of its performance or prospects, it does to a large extent reflect the market's confidence level in the company's business model.

STANDING OUT THROUGH GOOD GOVERNANCE

But beyond corporate uniqueness (especially post-IPO), investors want specifics. How are risks managed? How might investor interests be better protected?

Here, good governance is the touchstone. Without question, it draws faithful investors. It is one of the strongest platforms from which any company can launch an IPO. In fact, a 2001 study of 1,500 US firms by the National Bureau of Economic Research of Cambridge, Massachusetts, *Corporate Governance and Equity Prices*, concluded that corporate governance has a striking direct relationship with stock returns.

Achieving good governance, of course, has its challenges. The firm should present a board of high quality directors.

A company can signal its governance intent by appointing independent directors beyond the prescribed minimum. Additionally, it can emphasise the diversity of its directors so that its board comprises individuals from different backgrounds who can work constructively together to take the company forward.

Meanwhile, investor interests are best served by management identifying risks and installing stringent internal control measures. By the same token, how the board discloses its interests and practices in the IPO is an indication of how future public disclosures will be made.

Just as previous articles in this series have highlighted, good corporate governance can indeed enhance a company's valuation and its corporate reputation. ■