What are the critical IPO risks that startups need to consider before going public

With global markets signalling positive recovery, driven by government stimulus programmes, accelerated vaccination rollouts, and improved microeconomic indicators, a large number of companies are going public through Initial Public Offerings (IPO). In fact, according to PwC, with 727 global IPOs[1] and issuance worth $202.9 billion, the first quarter of 2021 was the strongest first quarter for global IPO activity in recent history. This was largely driven by technology and consumer discretion, including e-commerce companies.

Closer home, a number of internet companies such as Zomato, Paytm, Flipkart, Delhivery, PharmEasy, and Nykaa are taking the IPO way, bringing about a paradigm shift in the Indian stock market. Until now, the stock market was mostly dominated by heavy-industry companies, state-owned enterprises and family-owned conglomerates. Now, this number is slated to climb higher with 40-50 digital technology companies going public over the next couple of years.

While IPOs offer an exciting opportunity for businesses to enter the market, they come fraught with risk. The right balance between risk and opportunity is found differently with different types of businesses. Therefore, it is imperative to develop an effective risk management strategy that strikes a perfect balance between the two. Identifying, reassessing, and taking responsibility for the unique set of risks is invariably crucial for start-ups before they embark on their private-to-public transformation.

Risks of Going Public

Going public is a monumental decision for any company as it changes how a company goes about doing business. In addition to business risk on the operational and financial front, there is risk around compliance which includes – regulatory risk, legal risk, code of conduct risk, risk around communication and investor relationship and climate and reputational risk. For example, for a company, a couple of key considerations could be how it is performing on the Environmental, Social, and Governance (ESG) metrics and Task Force on Climate-related Financial (TCFD) disclosures.

Moreover, a company taking the IPO route is most likely to be exposed to risks such as dissatisfied shareholders, confidentiality and trade secret concerns, insider trading by the directors, new stakeholders constantly judging the company's performance, amongst others.

Investor decisions are based on material disclosures made by the company on the Draft Red Herring Prospectus (DRHP). Any misleading or untrue statements in the document present a risk. The complexity increases with multiple parties being involved, such as directors & officers of the company, controlling shareholder, selling shareholder, issuing entity and offering underwriter.

In the current market scenario where a slew of new-age companies are looking at IPOs as part of their growth and expansion strategy, the way of dealing with risk differs vastly from the risks faced by traditional organisations. While mature companies have evolved risk management strategies based on their experience in the field, business goals for start-ups primarily focus on finding funding for their business ideas. The risk assessment needs to be in tandem with laying down realistic financial projections and goals and keeping a close watch on

[1] https://www.pwc.com/gx/en/services/audit-assurance/ipo-centre/global-ipo-watch.html

any regulatory changes that could impact the business.

Undertaking Risk Management

Seeing your company's ticker symbol on a trading screen is a momentous event for all stakeholders involved. However, the journey of taking the company public does not end there. A successful IPO not only opens up new doors of opportunities, but also creates new challenges and risks. Successful organisations understand the significance of risk management. The recent upheaval caused by the pandemic has only enhanced its value, as the perception of strategies employed in managing risk have evolved. Such a scenario requires companies to evaluate all possible measures to mitigate and transfer the risk emanating from listing.

It is in risk transference that insurance can act as a key component for providing necessary monetary safeguards. Insurance can aid in covering liability arising from prospectus alleging misrepresentation, breach of duty, or announcements of the company's plans to go public. In fact, various Indian insurers are offering cover on these lines, with the overall market capacities available in the range of US$150-160 million.

The management must consider transferring the financial impact of this risk and its future ramifications onto risk transfer mechanisms such as IPO Insurance to safeguard their people, profits, and public image. To ensure that companies have the right insurance coverage before launch of IPO, corporates need to evolve their risk profile and exhibit the preparedness before going public.

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