Financing 101: Equity and Initial Public Offerings (IPOs)

In this guide, we will look at the use of equity as a form of debt.

The basics: Equity

Right at the start, we must distinguish between equity financing of publicly listed companies as well as the financing of private companies.

However, both involve the use of shares/stock to raise money for the company.

The nitty gritty: Equity

For private companies, equity financing is where the company seeks investors in their business in return for a share in the business – think of Dragon's Den. The investors in such equity financing are friends, family, venture capitalists or angel investors (these are investors that invest in start-ups).

IPOs

For public companies, the main process by which equity financing occurs is through an IPO. This is the process by which a private company "goes public" and so the public can buy shares in the company. This decision is made usually once a private company reaches a certain maturity in which there is public confidence.

Stock exchanges

As mentioned, an IPO is the process by which a private company "goes public". This is done by listing on a stock exchange e.g. London Stock Exchange.

A stock exchange is a place where you can buy and sell shares in public companies. Stock exchanges themselves are businesses and so charge investors for buying and selling shares – they rely on a stable marketplace to generate income.

This means that stock exchanges want to ensure that traders have access to essential information about the companies they are buying and selling.

Evaluation: Equity

Positives	Negatives
Unlike loans, equity financing is less burdensome as there are **no mandatory interest payments** to keep up with.	Using equity to raise finance leads to a **loss of control** over the business.
Equity financing can help **build business relationships** with investors who may have expert knowledge to grow the business.	IPOs are **long and expensive** processes.
Creditworthiness is not an issue.	IPOs may not succeed due to factors **outside of your control** e.g. pandemic leads to a large shock to business confidence and therefore enough money is not raised. Though note that most share issues are underwritten (essentially insured).
No **collateral/security** is necessary for equity financing.	There is a **potential for conflict since** private investors/partners may not agree on key decisions for the company.
	Though there are no fixed interest payments, public companies will generally need to pay **dividends** to maintain investor confidence in the company.
	Stock exchanges require public companies to give accurate and regular reports on the company including financial information; such **compliance may be undesirable and expensive**. Examples of information are directors' remuneration, disclosure of price sensitive information.