# How to Go Public Without Cost

The 1934 Securities Act (US) states that any private company with over 500 public shareholders is public (reporting) company. Frederick Lipman is an experienced securities attorney. In his book, 'Going Public' Lipman observes (Chapter 10) that any public company may sponsor a private company by distributing free stock of the private company to their shareholders. The industry refers to a private company that goes public using this stock distribution strategy as a spinoff.

### Why will Public Companies sponsor spinoffs?

The public company sponsor usually gets 10% of the private company's stock. The public company distributes half this stock (5%) to their shareholders. By regularly paying their shareholders spinoff stock dividends, the public company keeps their shareholders. The public company retains 5% of the private company's stock as a corporate asset. This stock enhances the net worth of the public company. The public company sponsor normally pays the cost of distributing the private company's stock to their shareholders. This makes going public a cost free service for the private company.

### Why should any Private Company go public?

i. Doing private placements is easier for a public company. Your company can more easily convert your stock to cash.

ii. A public company can use its stock to buy corporate assets. By buying cash-producing assets for your company's stock, you in- crease your company's cashflow, without spending your company's money.

iii. When the time comes to sell your public company, the sale price will be your company's share price multiplied by the number of issued shares. The share sale price is usually greater than a sale price based on your company's balance sheet.

iv. Business groups buying recently privatised Foreign Government Industries gain substantial insurance against a future Government nationalisation by becoming a US Public Company.

### How does a spinoff compare with an Initial Public Offering (IPO)?

For an operating company, the average cost of doing an IPO is around $750,000. It takes 18. months. Over half the private companies that decide to go public with an IPO abandon the process before they become a public company.

In a spinoff, the public company sponsor pays your costs. It takes about four months for your private company to become publicly trading. If you do an IPO, you're not required to distribute any free stock to the public. However, most IPO underwriters price the IPO stock at 15% below the net worth of the company. This effectively gives the public shareholders 15% of the private company free.

**Where do spinoffs trade?**

A spinoff is a public company. It will trade over-the-counter (OTC), if it doesn't qualify to trade on a stock exchange. The public companies that regularly sponsor spinoffs, usually arrange to have the new public company trade on the NASD (National Association of Dealers in Securities) Automatic Bulletin Board.

**Why shouldn't a Private Company do a spinoff?**

i. It's rarely cost effective to arrange a PUBLIC financing for a US Public Company. Unless you can arrange a private placement, you must be certain that your broker or consultant has the contacts to fund your spinoff.

ii. The sponsoring company usually wants a seat on your Board of Directors. As Lipman comments, the sponsor can be legally liable for the misdeeds of the spinoff.

iii. It's nearly impossible to find a spinoff-sponsor for a concept company. The potential of legal liability ensures that sponsors want quality operating private companies for this process.

iv. A public company has a responsibility to its shareholders. As a matter of corporate self-interest, the public company must ensure a strong share price. This responsibility adds ongoing costs to any company's operations. Whether your public company trades OTC or on the NYSE (New York Stock Exchange), investor relations will be part of your annual expenditure.

**Why aren't spinoffs popular?**

i. Every industry wants to sell products that make their members the most

money. The spinoff saves you money. But, securities attorneys lose income. US brokerage firms make less money doing private placement than public offerings. Financial printers lose money, etc. It isn't in the industry's best interest to mention a spinoff to the CFO (Chief Financial Officer) of a private company.

ii. Most OTC company insiders want to dump their stock quickly. The stock in a spinoff is restricted stock (subject to SEC Rule 144). Since insiders can get free trading stock by buying a Trading Shell, they avoid spinoffs.

iii. Few public companies will sponsor spinoffs because of the legal liability problem.

Spinoffs work, but they may not work for your company. Discuss this strategy with your attorney and accountant. Seek an opinion from a business consultant or stock broker familiar with spinoffs. Knowing that spinoffs exist means you have half your answer about using a spinoff.