Netscape initial public offering essay

This case is about Netscape Initial Public Offering (IPO) in 1995. Netscape had a successful starting in the market mainly because of their strategy of " Give away today and make money tomorrow", which let them capture 75% of the web browser market, making it the most popular browsing software. The successful strategy consists in gaining its large market share by initially giving away its product for free.

Netscape had to create a new industry standard to succeed in the long term, besides make revenues by selling server software to companies that require marketing access to potential consumers, by selling its software packages and through providing servers on the world wide web, consulting, maintenance, and support services. The success of Netscape was reflected in the remarkable faster growth in its full year of revenues. However Netscape was in a risky competitive position.

They were in a very changing market that demanded high investments in Research and Development in order to keep highly standards of innovation. Also new competitors with profitable strategies were entering within the market, which put Netscape pressured to keep as a leader of the market. Netscape had to go public in response to its growing capital needs in 1995. They needed to finance activities to maintain its leadership position in the market. Also they expected high grow in the future, and going public let them to gain visibility and creditability within the industry.

Netscape also could use private equity to finance their capital needs. Which involves direct negotiations with various financial or nonfinancial institutions. In such a case, a company raises money from these various entities, which then own a portion of that company in the form of its privately held shares of stock or other securities convertible into stock.

Private equity has the advantage of a negotiation with fewer parties on the agreement of the terms of the investment in the company. However it usually entails a higher involvement of investor in company’s decisions making process. Another option to finance they could use is a bank loan, which give them the advantages of avoiding ownership dilution. However, taking into account they were projecting losses in the foreseeable future, the probability of obtaining a bank loan is consider low.

Also if they do get bank financing, the interest rate would be very high. Normally a company go public for many different reasons; one of the most common reason is when the equity capital needs of the company increase highly and the opportunity cost of remaining private and compensating investors for the lack of liquidity become too great relative to the lower cost of capital derived from liquid public markets.

In some cases, when the number of the company shareholders raise above a given number, they are obligated to report their financial information; which implies costs to report timely information to investors and regulators, so, if they must incur in these costs anyway, they decide to go public to tap the advantages of going public. Other reason to companies decide to go public is to measure the market value of the company.

Some advantages of going public are the increment of the capital of the issuer, the liquidity of public markets, lower costs of financing and better terms agreement from lenders. Also going public allows the management to retain certain degree of control, allows the company to take better advantage of stock options because compensation, which have the potential to substantially increase in value and liquidity. Thus, generally, going public result may allow the company to attract and maintain better personnel, including high-level executives and officers.

However the disadvantages of going public are the high cost involves: legal and accounting fees, filing fees, travel costs, printing costs and underwriter's expense allowance; Indirect costs (management time invested in the process, and the dilution associated with selling shares at an offering price that is, on average, below the price prevailing in the market shortly after the IPO); Revealing sensitive information (transactions with management, executive compensation and prior violations of securities laws).

Also the pressure to increase current earnings represents a disadvantage on going public. Netscape IPO is characterized as a " hot issue" market because of the high expected returns earned by initial buyers of the shares. Such desirable returns occur as a result of either underpricing or oversubscription of a company's shares. The phenomena of hot issue market is explained by the high demand of the stock, making the price of the IPO increase from 14$ to 28$.

Netscape should be concerned about underpricing because the market was highly increasing and also the competitors were growing as fast as the market did. Volatility and also uncertainty made the stock risky which increase the probability of underprice the stock, as it is the case with many IPOs. As we can see in the exhibit 6 the comparable companies has lower stock price. Netscape weas the leader in the product they were offering and they used this advantage.

However, with new competitor in the market and including the risky position, 28$ could be consider a high price. We value the company using the FCFF method, considering other operating expenses will be decreasing almost 10% annually until 2001 where maintain constant at 20. 9%. We calculate WACC at 11. 81% using Fama French data from 1990-1995. To justify this price they must keep growing at least 42, 6% every year until 2005, assuming grow started al 4% after this year.

It is a hardly grow to achieve, in such a changing and uncertain market. However, while we consider $28 is a high price for the Netscape IPO, considering the potential that investors expected at the time, Netscape recent performance, its leadership in an industry with overall revenues over a billion dollars with a positive outlook, the need for funds for cover capital expenses and indications of a high level of interest in the IPO, we consider Netscape should approve the increase in the IPO.