The Impact of COVID-19 on the Global IPO Marketplace

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As aptly stated by George Soros, "Markets are constantly in a state of uncertainty and flux and money is made by discounting the obvious and betting on the unexpected."

The COVID-19 global pandemic has played a significant role in various industries across the globe, including the world financial marketplace. Uncertainty was fully present in the first quarter of 2020 and investors were weary to back new players that sought public financing by way of initial public offerings (IPOs). However, as the pandemic raged on and world health experts learned more about COVID-19, investors gradually embraced the chaos caused by uncertainty and the global IPO market rebounded to finish 2020 with a record number of filings. This article explains that, although the global IPO market was directly affected by the uncertainty caused by the COVID-19 pandemic, the IPO market, similar to other financial market sectors, rallied by the close of 2020, leading to the busiest IPO market since the tech boom of 1999. This article will also address the 2021 forecast for IPO filings and the ever increasing need for directors and officers liability insurance.

What Is an IPO?

As a preliminary matter, IPO stands for Initial Public Offering and is the process of how a privately held company offers shares to the public and begins trading on a stock exchange, like the New York Stock Exchange or the Nasdaq.[i] Companies that enter the IPO process have historically been start-ups in the tech industry or other high-growth fields funded by venture capitalists, but IPOs can also be utilized by more mature companies that are held by private equity firms looking to cash out.[ii]

One key benefit of going public is that the existing shareholders of a company can monetize their existing stake in the company. This is often seen as a way to reward stakeholders, such as employees, founders or early investors who own company stock but cannot cash in on the stock until it starts trading publicly.[iii]

However, publically traded companies also face many drawbacks, such as additional compliance measures, recurring listing fees and answering to public shareholders.[iv]

Uncertainty and the Impact on the 2020 IPO Market

In the first quarter of 2020, the coronavirus pandemic led to great uncertainty across all sectors, including healthcare, technology, real estate and finance.[v] This uncertainty triggered investor panic, leading to a large stock sell-off prior to the March, 2020 market correction.[vi] As stated by Scott Rostan, the founder and CEO of Training The Street Corporation, "Volatility in the stock market is kryptonite to the IPO Market because you can't get a sense of where to price the stock."[vii] Stock market declines during the first quarter of 2020 were triggered by the uncertainty caused by the pandemic, including the length of region-wide lockdowns, the rising death toll and COVID-19's impact on the world markets.[viii] Investors' risk tolerance quickly decreased to a point that left markets at a standstill.[ix] This risk aversion directly impacted the IPO market since newer companies with minimal financial historical data had an almost impossible time obtaining investors to offer financial backing. The lack of financial track record, coupled with the uncertainty of long-term financial effects of the pandemic, made the investment riskier than many investors were willing to take.[x]

The pandemic, as it raged forward from the first to second quarter of 2020 with no end in sight, slowed the issuance of IPOs and affected the IPO share price.[xi] This caused many high-profile companies that were scheduled to enter the public market in early 2020 to delay and take a breather in the hope for market stabilization. As noted by Jim DeLoach, the managing director of Protiviti, a global consulting firm, this delay in entering the public market was understandable since historical trends prove that IPO activity generally accelerates in a rising market, when investor demand is high.[xii] However, when demand slows, especially in a down market, investors are historically more cautious and more risk averse. The COVID-19 pandemic caused a bear market, especially in the first half of 2020.[xiii]

Embracing the Chaos Caused by Uncertainty

However, as the COVID-19 pandemic continued throughout 2020, even as the infection rate and the death toll rose, investors either gained back confidence in the financial markets due to increasing certainty in the market outlook and the hope for the COVID-19 vaccine, or they simply embraced the chaos of uncertainty. These companies were able to develop a readiness plan for their IPO rollout, which took into consideration legal challenges and disclosures about non-financial reporting matters, such as cybersecurity, and risk factors on emerging issues, including the ongoing impact of the COVID-19 pandemic.[xiv] Companies poised to enter the public market also had to determine whether they had the operational resiliency and technical expertise to navigate the public IPO transition, which includes establishing strong internal managers in key positions, such as finance, legal and internal audit.[xv] Companies that stood ready at the starting line and began operating internally as a public company well before the IPO rollout were ready to pounce on the opportunity to enter the public market. Although these companies took a major risk in terms of timing, this risk paid dividends for certain companies.

At the close of the 2020 fiscal year, shares of companies that went public via IPO in 2020 had surged 75%, according to a Reuters analysis.[xvi] This surge was in part brought on by the expectations that companies will benefit from low interest rates, eventual economic recovery and the COVID-19 vaccine rollout.[xvii] Companies that cashed in on the 2020 IPO surge included Palantir Technologies (PLTR), which had an annual return of 301%, Snowflake (SNOW), seeing a return of 153% and XPeng (XPEV), which saw an unprecedented return of 328%.[xviii]

Public markets rewarded company growth over profitability in 2020. This was fully evident in the technology sector, which was quiet during the first half of last year, but was highly volatile during the last two quarters.[xix] There were 65 technology based IPOs in 2020. Additionally, the healthcare industry saw increased momentum in the latter part of the year, producing 102 IPOs.[xx] A majority of the success in the healthcare sector was attributed to the biotech industry, which saw an unprecedented surge in deals in 2020.[xxi] The uncertainty caused by the COVID-19 pandemic made the public realize the importance of biotechnology and advancements made through biotech research.[xxii] Ironically, the uncertainty caused by the COVID-19 pandemic in the first two quarters of 2020 fueled the surge in top performing biotech IPOs in the final two quarters of last year.[xxiii]

Analysts expect that the technology and healthcare IPO sectors will continue to dominate the market in 2021. With the steady rollout of COVID-19 vaccinations, more players will enter the market to seize on the unprecedented volatility.[xxiv]

IPO Market Volatility and the Need for D&O Insurance

With the many benefits provided to a company by public trading, drawbacks are inevitably present. Becoming a public company includes greater access to capital markets and increased financial capital to develop the future of the business.[xxv] However, an IPO also creates additional risks, including the risk of a lawsuit brought by investors following the IPO. Two main types of lawsuits that new companies face are stock drop litigation and breach of fiduciary duty lawsuits.[xxvi] Lawsuits are commonly filed against new IPO companies when the share price falls below the offer price. As markets become volatile and the share prices of new issuances fluctuate, the probability of a shareholder lawsuit increases.[xxvii]

Based on this inherent risk, newly public companies should secure a tailored directors and officers (D&O) liability insurance policy either before, during or after the issuance of an IPO. D&O insurance is designed to protect a company, board members and executive officers from having to pay for their own defense or settlements when they face a lawsuit.[xxviii] A company will start preparing for an IPO more than a year in advance of the IPO launch, and in that time, a great deal of effort goes into fully drafting, reviewing and finalizing the SEC filing forms, such as the S-1, and other materials that are shared with investors. Throughout this pre-IPO process, the risk of a shareholder lawsuit remains.[xxix]

Company management can subject the company to liability if certain risks are understated on the S-1 or if omissions or misstatements are made by management during the roadshow, which is a series of presentations made by a company in various locations leading up to an IPO.[xxx] All of these issues can lead to a post-IPO lawsuit by shareholders, making the need for D&O coverage imperative.

Final Thoughts

As the COVID-19 pandemic rages on, uncertainty is still present in the world financial marketplace. The uncertainty that crippled the global economy in the first half of 2020 fueled the unprecedented gains in both the technology and healthcare sectors in the latter half of of the year. As investors embraced the chaos caused by the uncertainty of current world events, the global IPO market made a robust rebound to finish 2020 and continues its momentum into 2021.

With a record number of IPO filings, unprecedented industry trends in the financial markets and unfathomable market volatility, the risk of a shareholder lawsuit has increased exponentially. The need for D&O insurance coverage, especially in today's uncertain climate, is necessary in order to protect company management from personal exposure connected to representations made throughout the IPO launch.

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