



Business Insurance: Underwriting Considerations for IPO's and "Start-Ups"

An initial public offering (IPO) is a company's first sale of stock to the public. Typically, an IPO involves the sale of stock of a young and little-known company. Occasionally, well-known and well-established firms do "go public." Reasons that companies "go public" include:

- to raise money
- to increase their financial base, liquidity, prestige, and ability to attract management
- to realize planned expansions
- to make acquisitions

A "start-up" company is a company less than 1 year old with no established track record. These are usually small companies that can take on the form of a sole proprietorship, partnership, or corporation.

These situations challenge the Underwriting arena with questions of financial justification and business stability. Concerns are:

Management - What are the qualifications, background and experience of the people managing the operations (i.e. their resumes). Ownership is another important consideration. An outline of the percentage of ownership of all owners and degree of active involvement in the operation of the business is essential (i.e. CEO, Board of Directors member, investor with no active involvement, etc.).

Financial Data - While this may be minimal, it is helpful to know where the initial capitalization to begin operation was derived. For example, knowing the capitalization is coming from a well-regarded firm specializing in venture capital investment might be interpreted more favorably. Further, the pro-forma, which demonstrates the financial expectations/rewards of a well-executed business plan, can help the underwriter determine the appropriate amount of coverage given the expectations of yet unrealized business success.

Speculation – Here, questions are asked regarding the likelihood of a business being successful. Is this a unique business that has wide spread public appeal or is the market already well represented by companies providing the same or similar products and/or services? The "Business Plan", which outlines the actions/steps to be taken to achieve the desired outcome, often times helps the underwriter in making this determination. The business plan, often required by investors, is an excellent source of market, organizational and financial data.

Valuation - This addresses the "market value" of the business. What would it sell for on the open market? This can be different than the "book value" of the business. It must be based on a realistic and credible method of valuation which takes into consideration such things as similar businesses that have recently been purchased/sold. This can be challenging when it involves valuing intangible assets.

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An informational cover letter outlining the above items is of considerable help in providing justification for the various forms/types of business coverage needed for a start up company or a company just now offering its stock to the public. The more information given to the underwriter in understanding/justifying the need and demonstrating how the amount was determined will be valuable. This information is very similar to that given to the venture capital group when they made their decision to participate.

The following list gives document resources that establish the need/purpose of coverage:

- Cover Letter
- Financial Statements (balance sheet & income/expense reports)
- Tax Returns
- Legal Documents
- Trust Agreements
- Business Plans
- Pro-forma's
- Contracts-Buy/Sell
- Third Party Documents
- Internet Data

While not all of the above may exist in every business situation, if available to the underwriter, they can expedite the evaluation/assessment process.

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