A WORD FROM DELOITTE

Is it Groundhog Day for capital markets—will the IPO see its shadow?

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From boom to bust and today's market: The IPO recovery and how we can avoid history repeating itself

Ask anyone who was around in the heyday of the 1990s about the dot-com boom and their expression will simultaneously be one of both excitement and utter disappointment. It was the best of times; it was the worst of times. It's been said that, back then, all you needed to go public was an idea written on a napkin. Now, following the post-COVID-19 boom and bust, it appears the IPO market is once again beginning to thaw, albeit slowly, leading some to believe an IPO recovery may be on the horizon. Is AI the new catalyst for the next IPO gold rush? And if it is, how do we avoid history repeating itself?

To answer these questions and more, Heather Gates offers insight into the similarities and differences among the booms, busts, and recoveries of past IPO markets, the current IPO market—and, more importantly, how we can avoid making the same mistakes all over again.

Will AI be the spark that sets off the next IPO boom?

Recent IPOs suggest that the IPO market may remain in hiding for the foreseeable future. Even with the hope around AI as the second coming of the internet, we have yet to see any real influx of AI-inspired IPOs. Rather, we are seeing AI as simply a catalyst for established companies to continue to build new momentum. Of course, it's early days, but by looking to the past, we can better prepare ourselves for the day when IPOs come back out into the light.

Comparing data from previous booms

The parallels between the 90s dot-com boom and the COVID-19-era IPO surge are intriguing. Both were viewed as unprecedented periods, and each were followed by steep declines.[1] The scale of overvaluation in the 90s and the valuations of companies in 2021 and 2022 are similar: In both instances, a multitude of unicorn companies with valuations of more than a billion dollars entered the market.

According to Forbes, "There were 5,934 IPOs between 2000 and 2022. The lowest number of IPOs in a single year was in 2009, with a mere 62. Yet, interestingly during an overall decline, 2021 holds the all-time record for IPOs with 1,033, beating the previous record of 480 in 2020; however, there were only 181 IPOs on the US stock market in 2022."[2] Based on historical data, one can deduce that such an unprecedented period was unsustainable and led to necessary corrections and market recalibrations.

What have we learned?

What lessons from past booms could help the world of finance sidestep another catastrophic bust? The cyclical nature of markets is not new to experienced observers. As I see it, a significant portion of companies raised staggering amounts of capital at incredible valuations in 2021 and 2022. Of these, probably one-third have experienced a down round, where they raised less capital than in their initial rounds. While others may have refrained from raising capital again, and still do, it appears others have yet to adjust their valuations to the "new norm" levels.

History teaches us no boom lasts indefinitely. Eventually, markets normalize, often with bouts of volatility and temporary slowdowns in IPO activity. Interest rates play a crucial role in shaping investor sentiment—higher rates mean a higher cost to borrow for companies, driving down future earnings—and, in turn, IPO activity, because the cost of debt increases as interest rates increase. Consider that from 1990 to 1999, interest rates fluctuated between 8.0% to 5.5%, respectively.[3]

1: "The Current IPO Market: Factors in Its Decline and Reversing the Trend," Forbes, Giri Devanur, February 1, 2023.
2: Ibid.
3: "Federal Funds Rate History 1990 to 2023," Forbes Advisor, Taylor Tepper, October 17, 2023.

The settling of interest rates at a predictable level could significantly impact market stability. The uncertainty stemming from fluctuations in the Federal Reserve's interest rate policies often reduce transaction volumes. Clarity and stability in this area are perceived as being crucial for sustaining the thawing IPO market.

Why this time could be different

Another observation is that in contrast to the recovery following the 90s, the present IPO market has rebounded more rapidly. In my opinion, the diversification of industries and sectors may play a pivotal role. As I see it, unlike the 90s, where the majority of IPOs centered on the internet, the current market showcases variety across various sectors. In this era, when one industry faces challenges, others often thrive. It could be argued that the fundamental dynamics of venture capital investment, with some repetition of valuation creep, have shifted toward a more diversified portfolio of investments. While AI on the surface appears to be a singular subject, its impact is being made across many industries.

In my view, we no longer categorize companies around their internet or technology capabilities as we did in the 90s. The proliferation of the internet, software, and other technologies across all business types enables us to look at them as tech-enabled rather than strictly internet-based. Outside of "core" technology companies, the recategorization reflects the underlying nature of the business, thus enabling it to align with the appropriate regulatory standards—think of fintech as an example. I believe there are also fewer look-alike companies versus during the dot-com boom when there might be several IPOs offering the same product or service. Today's companies, though alike in their use of tech tools, are innovating in visibly different ways.

Current trends can also impact success or failure. While some of the trends are beyond the control of companies looking to go public, not all of them are. A firm grasp of changes in access to capital, as well as investors' appetite for IPOs, evolving regulations, and in-house capabilities when it comes to handling financial and regulatory matters, can all contribute to the success of any company undertaking an IPO.

Steps to consider for IPO success

Sustaining success in this evolving IPO landscape requires at least a few key elements, not the least of which are profitability or a clear strategy for getting there, and an understanding of what is expected of a public company from a reporting standpoint. To see a more complete list, we recommend taking a look at last quarter's article, Venture Capital Chronicles of 2023.

It's vital to plan ahead and engage financial service specialists early in the process. Drawing lessons from the past and anticipating market dynamics can help guide companies on their path to an IPO. Deloitte's IPO services are designed to advise companies around the world as they navigate the IPO process. The critical period begins six to 18 months prior to listing and lasts until the six months post-IPO and beyond. My team of Deloitte specialists can provide advice and recommendations before, during, and after the IPO, with services ranging from an audit, rounding out gaps identified via an IPO readiness assessment, and project management office services, to technical accounting and Securities and Exchange Commission (SEC) reporting services.

As the IPO market continues to evolve, embracing change, diversifying investments, and adhering to regulatory standards will be pivotal. The potential for another opening of the IPO window looms, and with prudent preparation, the market can aim for sustainable growth, free from the shadows of its past.