The cost of listing and raising capital: an international perspective

CARE conference

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Oxera (2006) report for LSE and City of London

- independent report
- comparison of costs of listing and raising capital
  - the London Stock Exchange (LSE)
  - Euronext, Deutsche Börse
  - NYSE, Nasdaq
- the costs of raising debt
- significant data collection, primary analysis
Developments since

- since 2006, some significant market developments
  - regulatory changes
  - consolidation of exchanges
  - credit crunch and volatility in markets
  ⇒ particularly relevant time to review costs of raising capital

- new academic literature
  - determinants of listing choices
  - competitiveness of US capital market
    - impact of Sarbanes-Oxley Act (SOx)
Overview

- why location of raising capital matters
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity?
- what are some of the relevant developments?
Globalisation of capital markets

- firms can increasingly choose foreign markets for raising capital

Financial centres are increasingly competing

- competitiveness of the exchange matters, but
  - the costs of financial intermediation and the wider regulatory environment are also important

**Exchange factors**
- size of market
- liquidity
- analyst coverage
- ‘be with your peers’
- etc

**Country factors**
- accounting standards
- legal variables
- cultural similarities
- etc

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**Government**
**Financial regulator**
**Exchange**
**Intermediaries**
Why is this important?

- access to capital, lower cost of equity, better investor recognition and publicity

- benefits to firms
  - improved competitiveness
  - higher fixed investment and R&D spend

- increased international competitiveness of countries, higher GDP, etc
Overview

- why location of raising capital matters
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity?
- what are some of the relevant developments?
What costs are incurred by firms?

Costs at IPO stage

Direct costs
- underwriting fees
- professional fees
- initial listing fees
- other direct IPO costs

Indirect costs
- IPO price discounts

Ongoing costs

Direct costs
- regulation, corporate governance, professional fees
- annual listing fees

Indirect costs
- trading costs

Cost of equity capital
Main costs incurred at the time of IPO

Direct:
- Underwriting fees
  - investment banks
- Professional fees
  - legal advisers, auditors and reporting accountants
- Initial listing fees
  - exchanges, regulatory bodies

Indirect:
- IPO underpricing
  - ‘money left on the table’, or good publicity?
Main costs incurred following the IPO

Ongoing costs affect initial valuations
- net present value discounted into IPO prices

Direct
- Regulatory and corporate governance standards
- Annual listing fees

Indirect
- Trading costs (brokerage fees, bid–ask spreads, etc)

price for better quality?
exchanges, regulatory bodies
intermediaries, exchanges
Overview

- why location of raising capital matters
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity?
- what are some of the relevant developments?
## Initial costs
Breakdown of direct costs of a ‘typical’ UK IPO

<table>
<thead>
<tr>
<th>% of IPO proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwriting fees</td>
</tr>
<tr>
<td>Financial adviser costs</td>
</tr>
<tr>
<td>Legal expenses</td>
</tr>
<tr>
<td>Accounting, auditing fees</td>
</tr>
<tr>
<td>Listing fees</td>
</tr>
<tr>
<td>Printing, public relations, etc</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Notes: Based on interviews with companies having gone through IPO process. Assumes that around £20m of new funds is raised. Source: Oxera (2006), op. cit.
Initial costs
Underwriting fees and IPO underpricing

Underwriting fees are considerably lower in Europe

<table>
<thead>
<tr>
<th></th>
<th>% of IPO proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>3–4</td>
</tr>
<tr>
<td>USA</td>
<td>6.5–7</td>
</tr>
</tbody>
</table>

Source: Bloomberg and Oxera calculations.

Significant initial underpricing in all markets
- academic studies show first-day returns of 10–15%
- no systematic differences across countries over time
How can differences in underwriting fees persist?

- significant clustering in the US markets
  - 265 issues from total of 318 fall into 6–7% band

- no evidence that higher fees improve quality
  - no systematic relationship between underwriting fee and IPO underpricing

<table>
<thead>
<tr>
<th>Underwriting fees</th>
<th>Sample size</th>
<th>First-day returns (%)</th>
<th>Sample size</th>
<th>First–day returns (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1%</td>
<td>2</td>
<td>11.1</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>1–2%</td>
<td>11</td>
<td>1.9</td>
<td>2</td>
<td>4.6</td>
</tr>
<tr>
<td>2–3%</td>
<td>23</td>
<td>3.12</td>
<td>2</td>
<td>9.0</td>
</tr>
<tr>
<td>3–4%</td>
<td>43</td>
<td>7.1</td>
<td>3</td>
<td>0.0</td>
</tr>
<tr>
<td>4–5%</td>
<td>12</td>
<td>7.9</td>
<td>16</td>
<td>1.9</td>
</tr>
<tr>
<td>5–6%</td>
<td>4</td>
<td>4.1</td>
<td>27</td>
<td>2.1</td>
</tr>
<tr>
<td>6–7%</td>
<td>2</td>
<td>10.9</td>
<td>265</td>
<td>6.9</td>
</tr>
<tr>
<td>7–8%</td>
<td>–</td>
<td>–</td>
<td>2</td>
<td>–0.2</td>
</tr>
<tr>
<td>&gt;8%</td>
<td>–</td>
<td>–</td>
<td>1</td>
<td>–12.0</td>
</tr>
</tbody>
</table>

Source: Bloomberg and Oxera calculations.
Other initial costs

- legal, accounting and advisory fees
  - Oxera survey suggests fees of around 3–6% for issuers in the UK
  - internationally?

- initial listing fees negligible for most firms
  - admission fees of less than 0.05% of value

- firms pay significant attention
  - high visibility, and easy to assess?
Ongoing costs
Trading costs in secondary markets (I)

- both implicit and explicit costs matter
  - Domowitz and Steil (2001) estimate that a 10% increase in total trading costs would raise the cost of equity by 1.4–1.7%

Increase in trading costs from 20bp to 24bp

Increase in cost of equity: from 10% to 10.34%

- cross-country evidence, however, is not conclusive …
Ongoing costs
Trading costs in secondary markets (II)

<table>
<thead>
<tr>
<th></th>
<th>Fees and commissions</th>
<th>Market impact</th>
<th>Total trading costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>LSE (with stamp duty)</td>
<td>40.1</td>
<td>10.1</td>
<td>50.2</td>
</tr>
<tr>
<td>LSE (no stamp duty)</td>
<td>15.4</td>
<td>10.1</td>
<td>25.5</td>
</tr>
<tr>
<td>Germany</td>
<td>18.1</td>
<td>9.0</td>
<td>27.1</td>
</tr>
<tr>
<td>France</td>
<td>18.0</td>
<td>9.1</td>
<td>27.0</td>
</tr>
<tr>
<td>Nasdaq</td>
<td>18.8</td>
<td>11.9</td>
<td>30.8</td>
</tr>
<tr>
<td>NYSE</td>
<td>16.1</td>
<td>7.4</td>
<td>23.5</td>
</tr>
</tbody>
</table>

Source: Elkins/McSherry.

NYSE appears most attractive
- followed by LSE (excluding stamp duty)
- stamp duty affects only UK registered companies

- need for better data and analysis of liquidity of markets
Ongoing costs
Corporate governance and regulatory frameworks (I)

- impact on the cost of raising equity capital can be positive and negative
  - compliance with better frameworks signals quality and is valued by investors
  - stricter standards impose greater compliance costs

- rankings suggest differences in corporate (and country) governance standards

<table>
<thead>
<tr>
<th>Overall country rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK</strong></td>
</tr>
<tr>
<td><strong>USA</strong></td>
</tr>
<tr>
<td><strong>Germany</strong></td>
</tr>
<tr>
<td><strong>France</strong></td>
</tr>
</tbody>
</table>

Notes: Global governance ratings from Governance Metrics International (2005), using scale from 1 (lowest) to 8 (highest).
Ongoing costs
Corporate governance and regulatory frameworks (II)

- concerns about US rules-based approach and strict enforcement
  - versus European principles-based ‘comply-or-explain’

- SOx has increased cost of US listing
  - may have improved governance standards in USA
  - what is evidence that SOx has delivered benefits beyond those that apply under the UK regime?

⇒ Loss in competitive position of US capital markets?
Mixed findings in the recent academic literature

- positive correlation between the level of corporate governance and valuations/cost of capital

- negative stock-price reactions to SOx-related events for some, but not all, firms

- increase in number of firms going ‘dark’, but mainly firms with weak standards (ie, SOx works)

- drop in global IPOs in USA most likely to be due to increased costs of listing (and catch-up of EU markets)
  - Zingales (2007)

- cross-listing premium for a US listing unchanged since SOx (and no similar premium for London listing)
  - Doidge, Karolyi and Stulz (2007)
What else is driving location choices?

- industry affiliation
- country of domicile
- ownership, control
- analyst coverage
- pool of equity capital
- openness, integration
- required returns at IPO
- …?
Origin of international IPOs in Europe (2007, by value)

- 126 international IPOs (total value €21.4m)
  - 64 on LSE’s AIM and 33 on LSE’s Main market
  - all Russian IPOs on LSE—clustering effects?

Origin of international IPOs in the USA (2007, by number)

- 50 international IPOs (total value of €8.8m)
  - increase from 2006, but still less than Europe
  - again clustering effects?

Private-equity-backed IPOs

Number of IPOs

Market value at issue (£m)

PE-backed IPOs constitute a considerable proportion of IPOs

Notes: Total number and market value of IPOs between 1998 and 2004.

1. How do markets compare for different types of IPO?
2. How do markets compare for different types of equity?
Overview

- why location of raising capital matters
- how to compare attractiveness of financial centres?
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- what are some of the relevant developments?
How is the landscape changing?

- growth in domestic IPOs in China and other markets
  - will the flow to European and US capital markets continue?

- decoupling of listings and liquidity
  - are listing locations becoming less important?

- transatlantic consolidation of exchanges
  - will this have any effect on the cost of raising capital and the relative attractiveness of markets?
Growth outside Europe and USA

- IPOs on Chinese exchanges nearly doubled by value and volume in 2007
  - exceed IPO volumes in the USA
  - nearly reaching total IPO value in Europe

Source: PWC (2007), 'IPO Watch: Europe'.
Liquidity is decoupling from listing location

- regulatory changes
  - Reg NMS in the USA
  - MiFID and Code of Conduct in Europe

- increased competition among trading platforms
  - liquidity is not exclusively tied to the listing location

- so far the main effects are observed in the USA
  - but Europe is likely to follow suit
Liquidity is decoupling from listing location: an illustration

- in the USA, liquidity is not exclusively tied to the listing location

Notes: Shows matched market share of Nasdaq in securities listed on NASDAQ and NYSE. Matched market share represents total share volume of NASDAQ or NYSE-listed securities that are executed on NASDAQ as a percentage of total consolidated NASDAQ or NYSE market volume.
Source: NASDAQ.
Transatlantic consolidation of exchanges

- transatlantic mergers
  - NYSE and Euronext
  - NASDAQ and OMX

- possible implications
  - further integration of pools of equity capital?
  - positive impact on liquidity?
  - facilitating regulatory convergence?

- too early to assess
What can we conclude?

- capital-raising decisions play a pivotal role in firms’ strategies
  - lowering financing costs can provide firms with a competitive edge
- firms can increasingly choose between markets …
- … and there are differences in the cost of raising capital that can be achieved in different markets
- markets are changing
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