The cost of listing and raising capital: an international perspective

CARE conference

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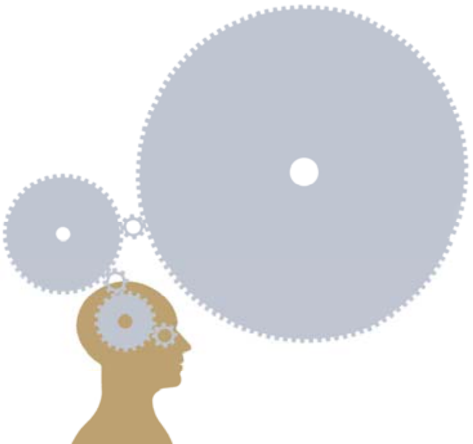
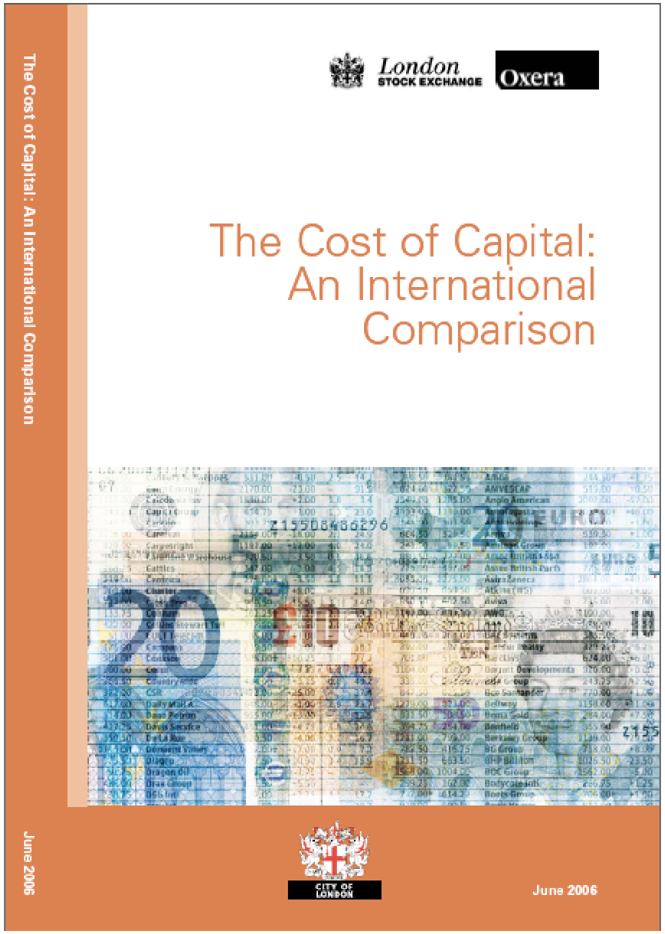


Oxera

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)

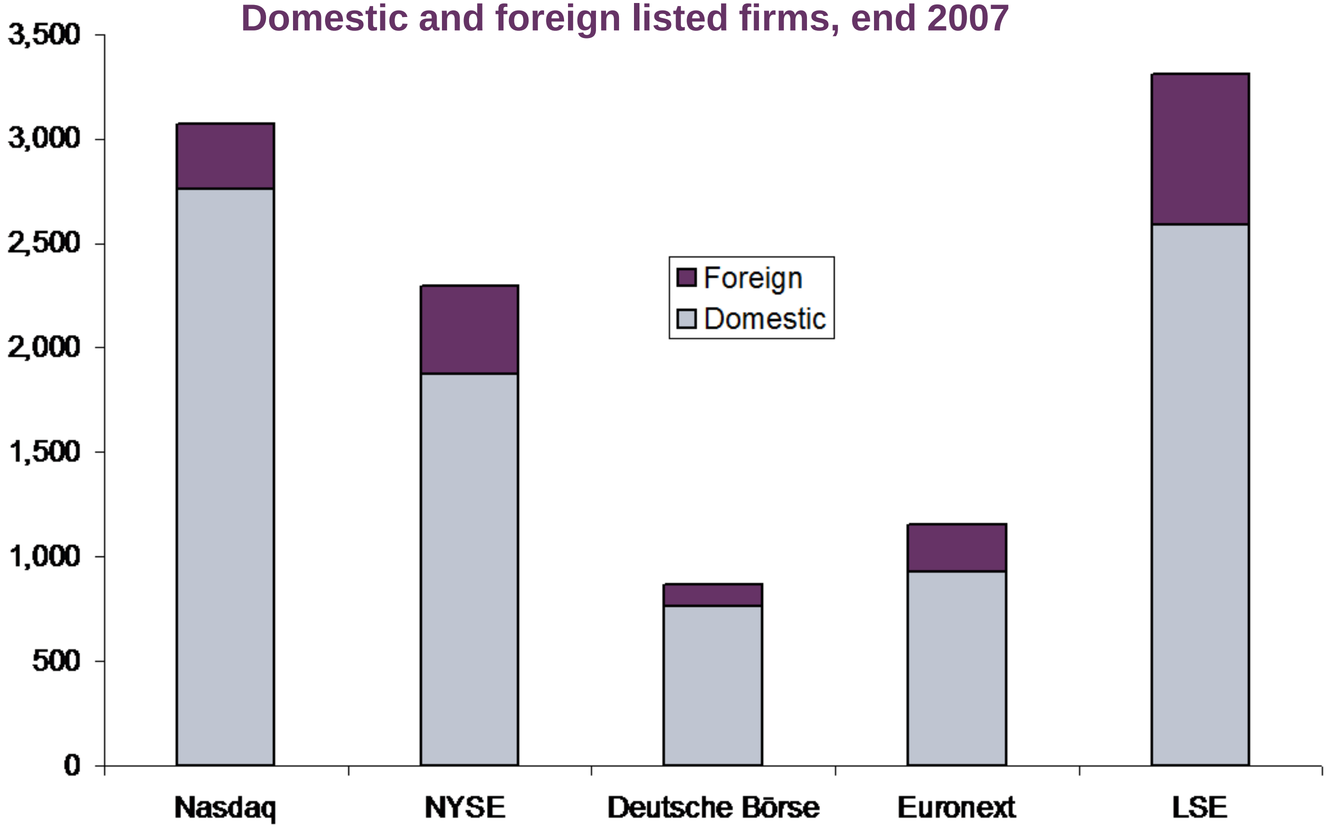
Overview

- 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

Domestic and foreign listed firms, end 2007



Source: World Federation of Exchanges.

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

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

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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	→	price for better quality?
Annual listing fees	→	exchanges, regulatory bodies

Indirect

Trading costs (brokerage fees, bid–ask spreads, etc)	→	intermediaries, exchanges

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Initial costs

Breakdown of direct costs of a ‘typical’ UK IPO

	% of IPO proceeds
Underwriting fees	3–5
Financial adviser costs	1–2
Legal expenses	1–2
Accounting, auditing fees	0.5–1.5
Listing fees	< 0.1
Printing, public relations, etc	< 0.5
Total	**5.5–11**

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

	% of IPO proceeds
Europe	3–4
USA	6.5–7

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

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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

	LSE, Euronext, Deutsche Börse		NYSE and Nasdaq	
Underwriting fees	**Sample size**	**First-day returns (%)**	**Sample size**	**First–day returns (%)**
<1%	2	11.1	–	–
1–2%	11	1.9	2	4.6
2–3%	23	3.12	2	9.0
3–4%	43	7.1	3	0.0
4–5%	12	7.9	16	1.9
5–6%	4	4.1	27	2.1
6–7%	2	10.9	265	6.9
7–8%	–	–	2	–0.2
>8%	–	–	1	–12.0

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)

	Trading costs, Q1 2004–Q4 2005 (bp)		
	Fees and commissions	**Market impact**	**Total trading costs**
LSE (with stamp duty)	40.1	10.1	50.2
LSE (no stamp duty)	15.4	10.1	25.5
Germany	18.1	9.0	27.1
France	18.0	9.1	27.0
Nasdaq	18.8	11.9	30.8
NYSE	16.1	7.4	23.5

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

	Overall country rating
UK	7.39
USA	7.04
Germany	5.23
France	4.05

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?

$\Rightarrow$ Loss in competitive position of US capital markets?

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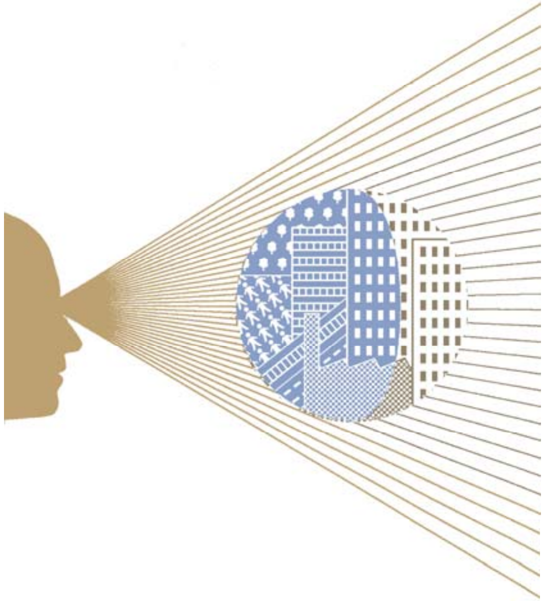
Mixed findings in the recent academic literature

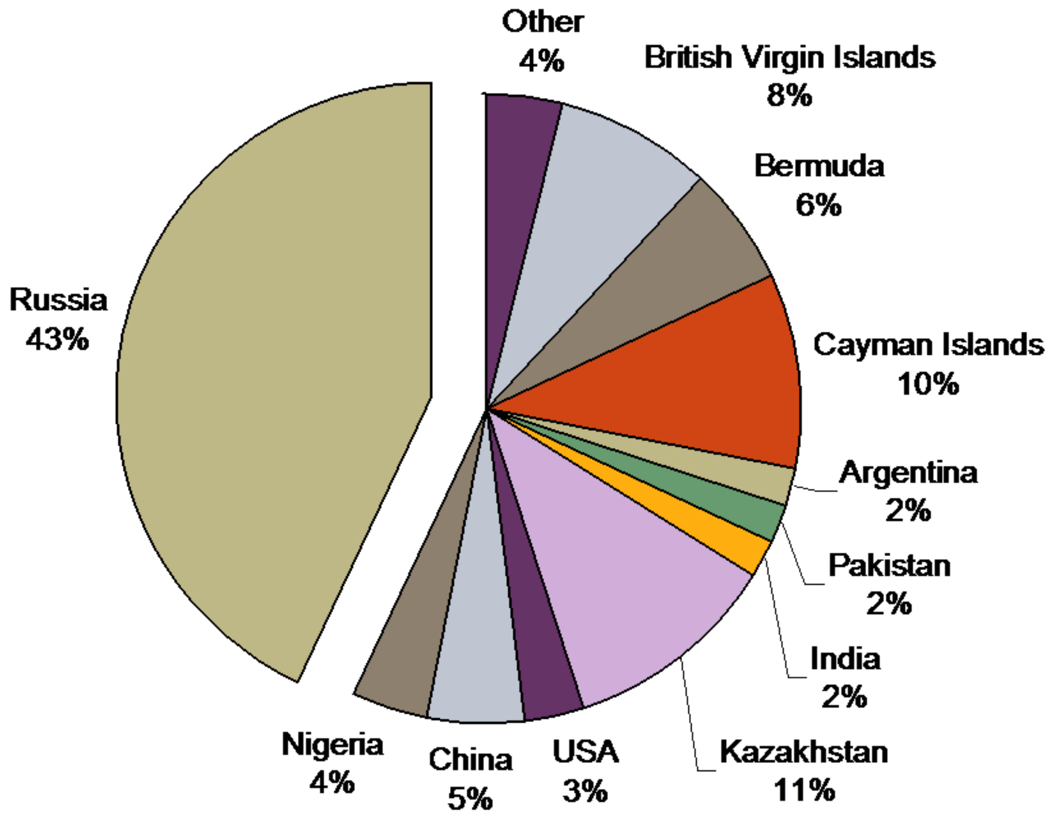
- positive correlation between the level of corporate governance and valuations/cost of capital
  - Hail and Leuz (2006), Bruno and Claessens (2007)
- negative stock-price reactions to SOx-related events for some, but not all, firms
  - Akhigbe and Martin (2006), Zhang (2007)
- increase in number of firms going ‘dark’, but mainly firms with weak standards (ie, SOx works)
  - Leuz and Wang (2007)
- 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
- … ?



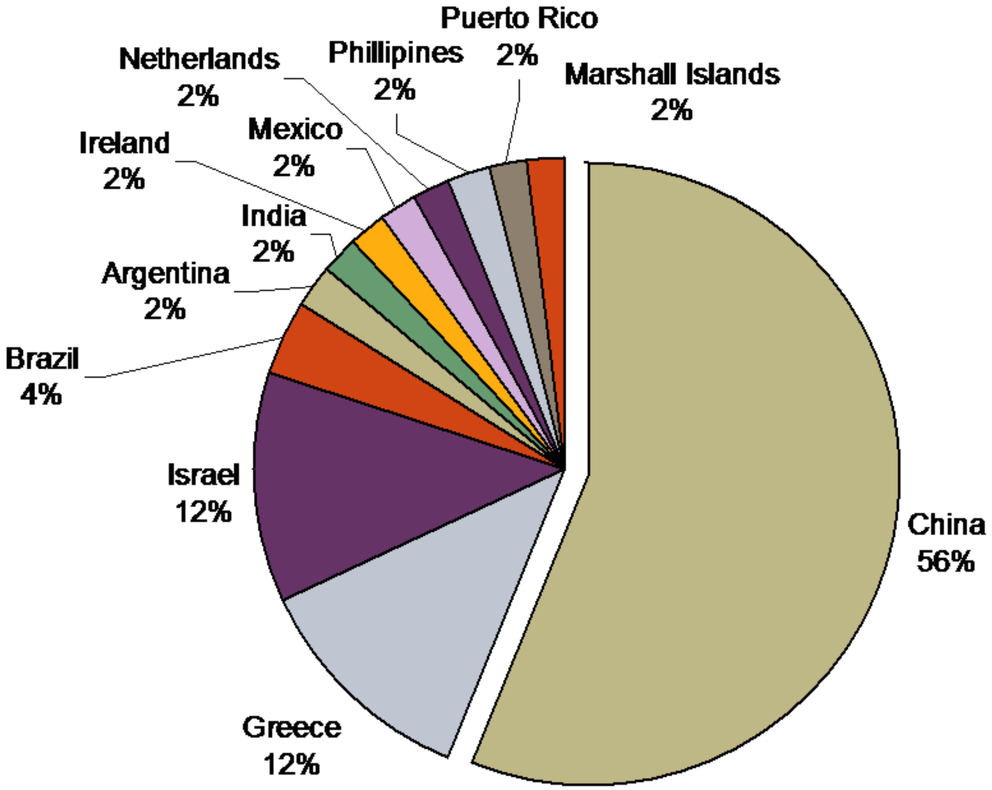
Origin of international IPOs in Europe
(2007, by value)



- 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?

Source: PWC (2007), 'IPO Watch: Europe'.

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



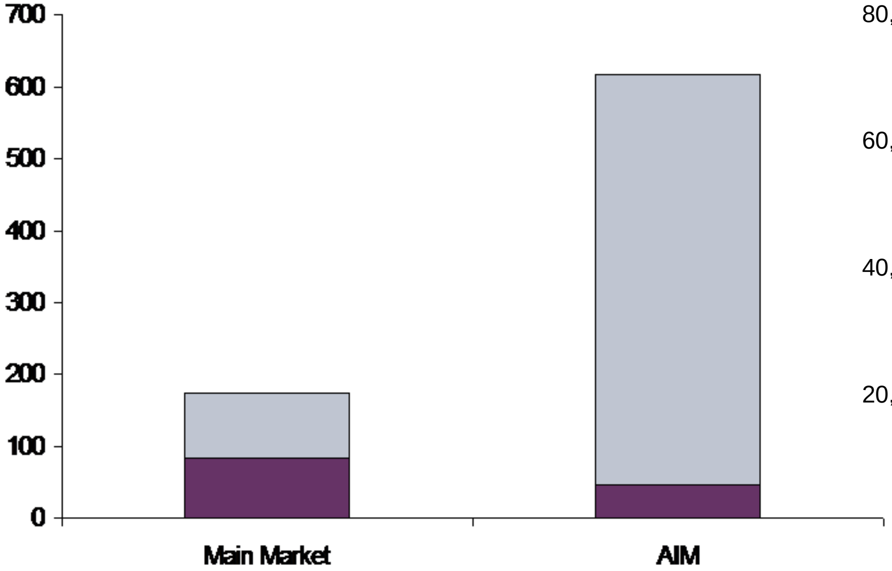
- 50 international IPOs (total value of €8.8m)
  - increase from 2006, but still less than Europe
  - again clustering effects?

Source: PWC (2007), 'IPO Watch: Europe'.

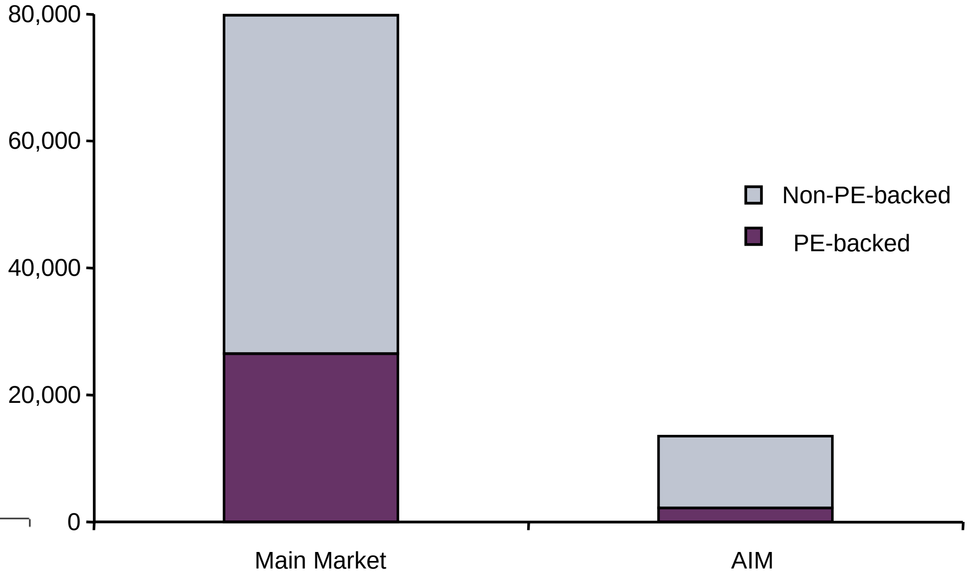
Private-equity-backed IPOs

PE-backed IPOs constitute a considerable proportion of IPOs

Number of IPOs



Market value at issue (£m)



Notes: Total number and market value of IPOs between 1998 and 2004.
Source: Oxera (2006), 'The London Markets and Private Equity-backed IPOs', report prepared for BVCA and LSE.

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

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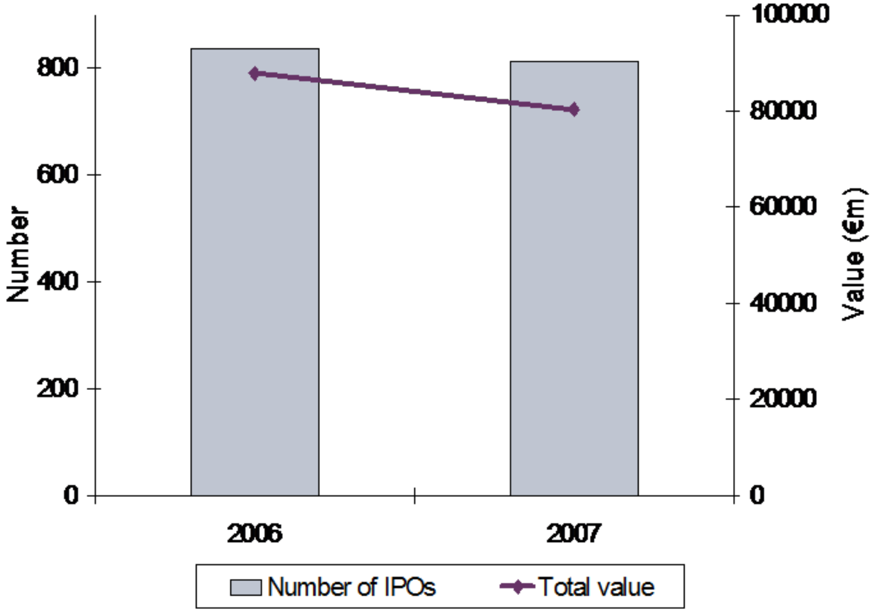
How is the landscape changing?

- 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?

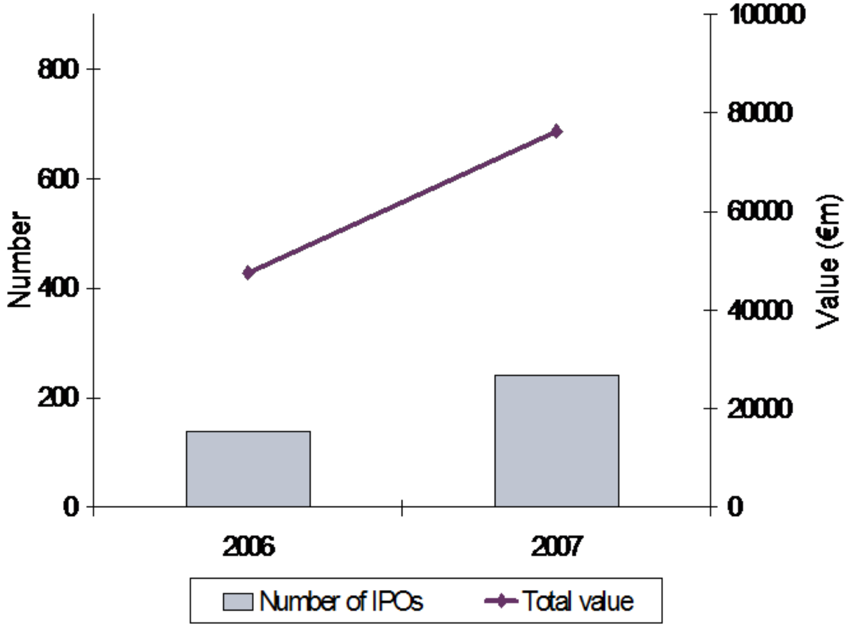
Growth outside Europe and USA

- 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

Europe



China



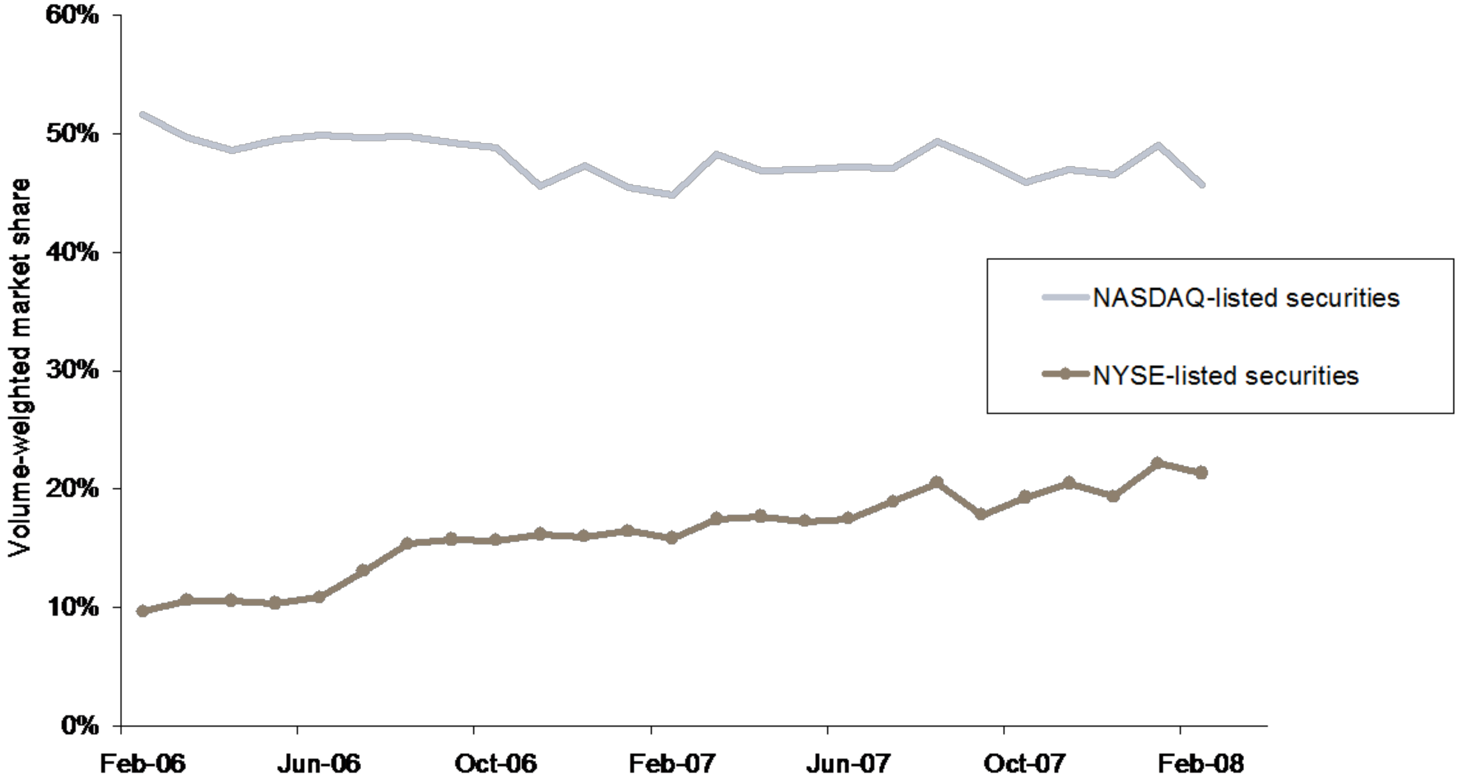
Source: PWC (2007), 'IPO Watch: Europe'.

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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