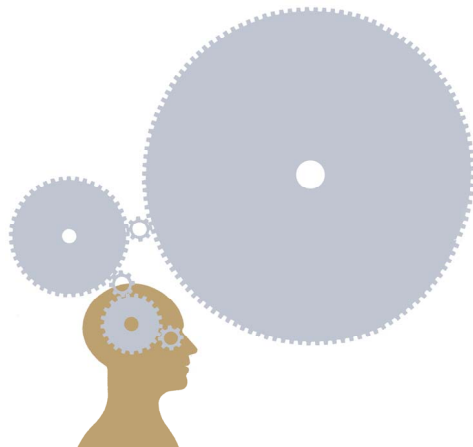


The cost of raising capital: an international comparison

Report prepared for the City of London
and the London Stock Exchange

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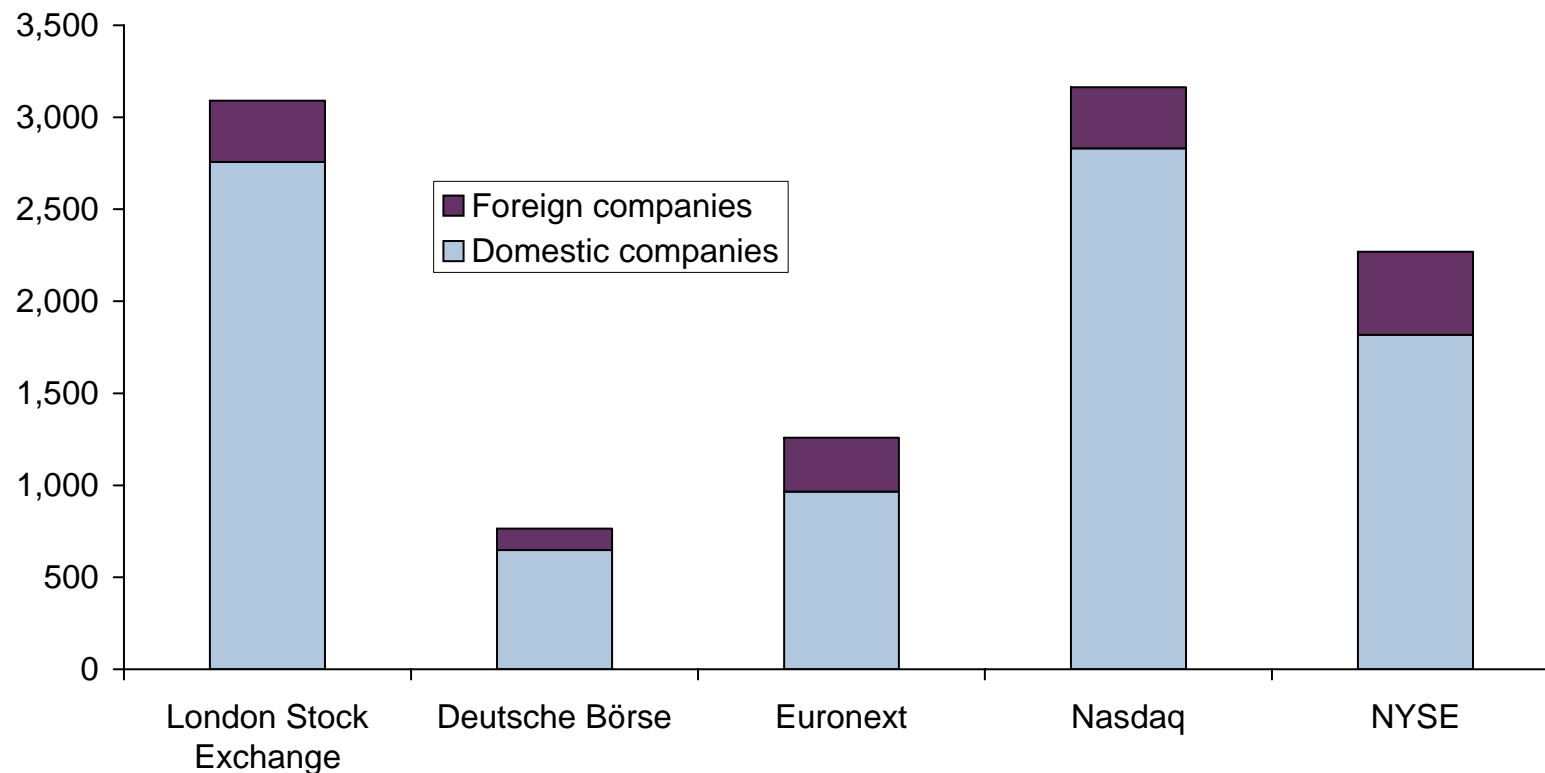
November 27th 2006



Globalisation of capital markets

- traditionally, companies have raised capital in their 'home market'
 - but increasingly they are choosing foreign markets

Domestic and foreign listed firms, end 2005



Overview

- why location of raising capital matters?
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity capital?

Financial centres are increasingly competing

- competitiveness of the exchange matters, but
 - the costs of financial intermediation and 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

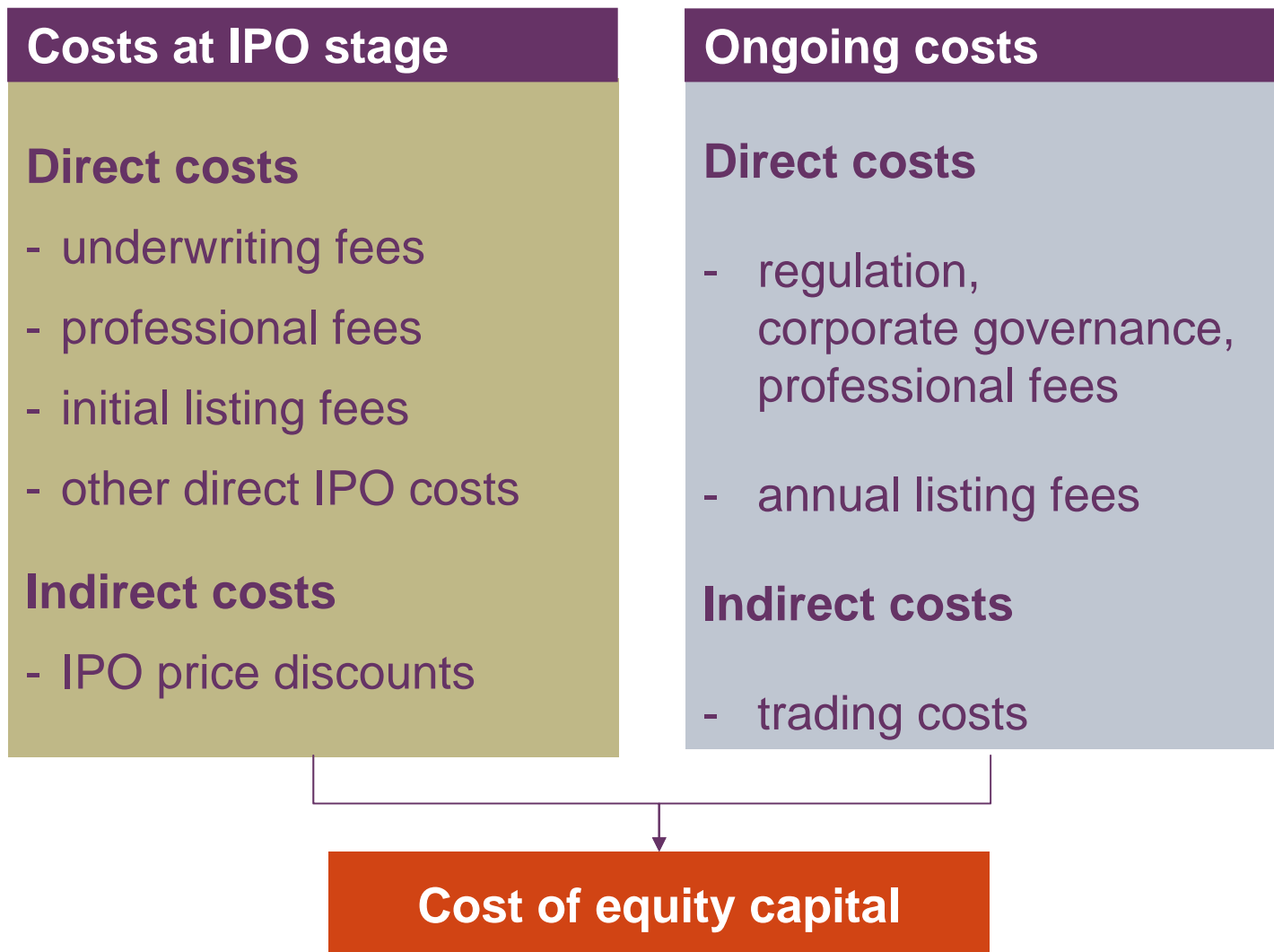
Why is this important?

- access to capital, lower cost of equity, better investor recognition and publicity
- significant benefits to firms
 - improved competitiveness
 - higher fixed investment and R&D spend
- increased competitiveness of countries internationally, and higher GDP growth

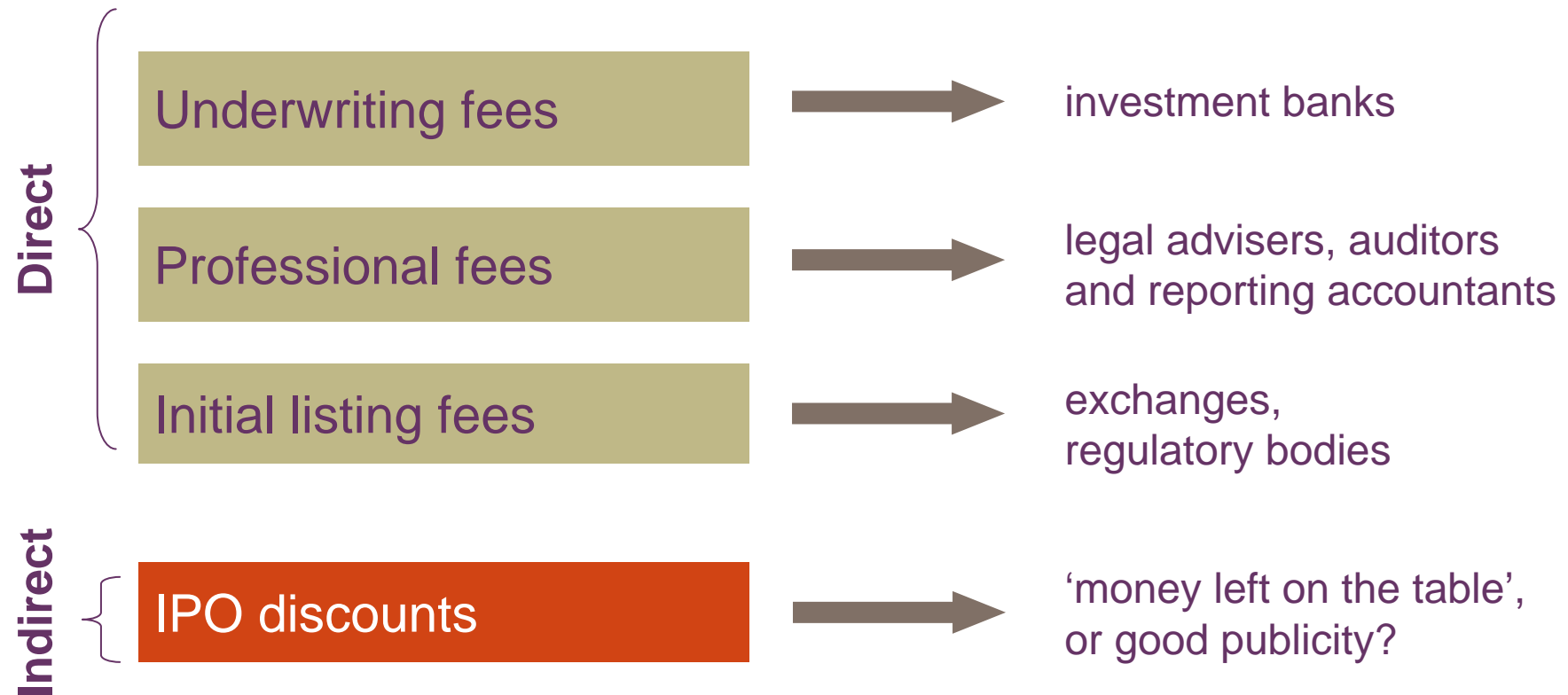
Overview

- why location of raising capital matters?
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity capital?

What costs are incurred by firms?



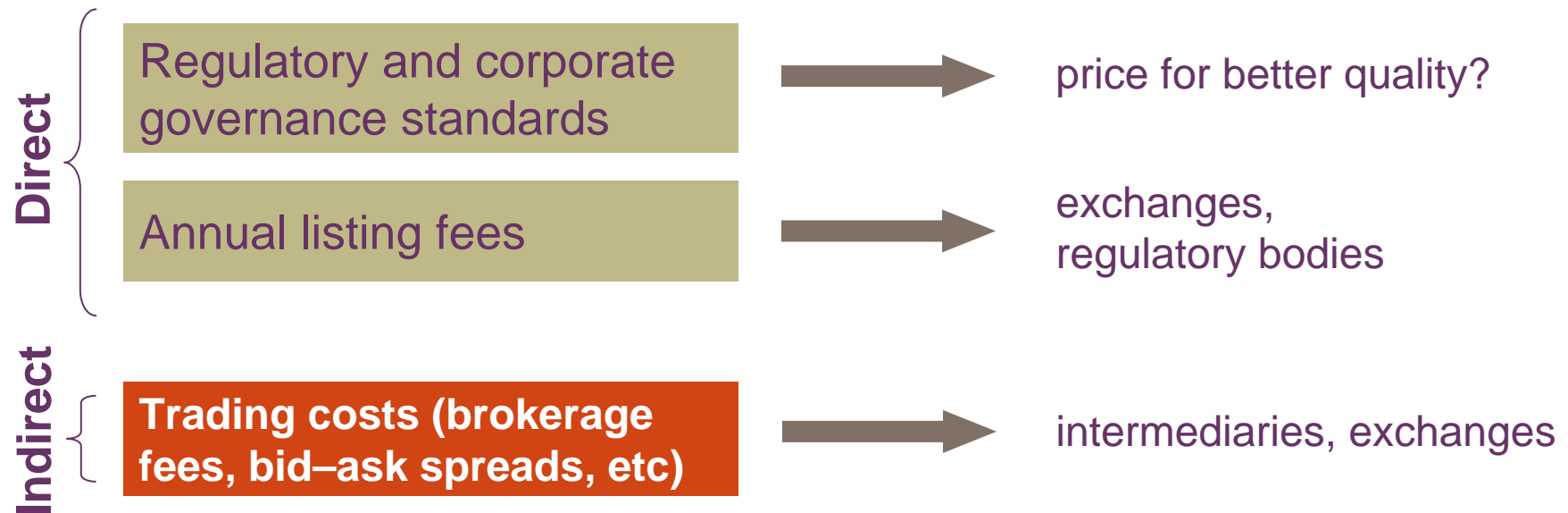
Main costs incurred at the time of IPO



Main costs incurred following the IPO

Ongoing costs affect initial valuations

- net present value discounted into IPO prices



Overview

- why location of raising capital matters?
- how to compare attractiveness of financial centres?
- how attractive are different markets for raising equity capital?

Summary of main findings

How do markets compare?

Underwriting fees	UK, France and Germany similar, and lower fees than on NYSE and Nasdaq
Initial discounting	Significant costs, but no consistent cross-country differences across time
Professional fees and other direct costs	Significant costs, but international data not available
Corporate governance and regulation	UK generally ranked as leading country. Sarbanes-Oxley.
Trading costs and liquidity	Some indication of cross-country differences, but comprehensive data not available
Listing fees	Negligible costs

Initial costs

Underwriting fees and IPO discounting

Underwriting fees are considerably lower in Europe

	(%)
Europe	3–4
USA	6.5–7

Source: Bloomberg and Oxera calculations.

Significant initial discounting

- academic studies show discounting of 10–20%
- 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 discounts

Underwriting fees	LSE, Euronext, Deutsche Börse		NYSE and Nasdaq	
	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)

- can have significant impact on firms' share prices
 - Oxera (2001) estimates that 0.5% stamp duty abolition in the UK could result in an increase in share prices of around 10%
- 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
UK (no stamp duty)	15.4	10.1	25.5
UK (stamp duty)	40.1	10.1	50.2
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.

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
- UK is ranked as leading country in terms of corporate governance

	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)

Sarbanes–Oxley has increased cost of US listing

- may have improved governance standards in USA
- but no evidence that Sarbanes–Oxley delivers benefits beyond those that apply under the UK regime

⇒ Relative decline in competitive position of US markets

What else is driving location choices?

Industry affiliation

Required returns at IPO

Country of domicile

?

Scope for further research

- is clustering of companies from the same country important?
- how does type of firm matter?

What can we conclude?

- capital-raising decisions play a pivotal role in firms' strategies
 - lowering financing costs can provide firms with a competitive edge
- on the evidence of this report, firms are actively choosing between markets...
- ...and there are differences in the cost of capital that can be achieved in different markets
- but capital markets are changing
 - FSAP and further integration of European markets
 - capital markets initiatives in the USA

Summary of empirical evidence

	Overall evidence	Impact on total receipts
Underwriting fees	Consistently higher in the USA than in Europe	Around 3–4% (Europe) or 6.5–7% (USA) of receipts
Initial discounting	Levels differ across countries and over time, but no consistent picture	Constitutes as much as 10–20% of receipts
Professional fees and other direct costs	Potentially significant, but no international evidence is available	Constitute around 3–6% of total receipts for a 'typical' UK IPO
Corporate governance and regulation	UK generally ranked as leading country. Sarbanes–Oxley in the USA	Significant, but what monetary value?
Trading costs and liquidity	Potentially significant, but cross-country comparisons not conclusive	Significant, but depend on firm's characteristics
Listing fees	Depends on company size, but negligible relative to value of companies	Negligible—in general less than 0.1% of receipts



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