Business-school research: Where to go for an IPO

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Politicians fret about where firms decide to make their initial public offering (IPO). Whether a firm lists at home or abroad (or if it lists at all) can say much about a country's business environment. At the beginning of this century New York and London were competing for listings on their respective exchanges. But the passage of Sarbanes-Oxley legislation seemingly dissuaded American companies from going public. Now a new working paper from the National Bureau of Economic Research* has examined trends in IPO activity from 89 countries. It describes how firms react to their home countries' weak institutions by listing abroad.

Three business-school professors looked at nearly 30,000 IPOs between 1990 and 2007 (mostly avoiding the current recession). They found that America's share of IPO proceeds fell from 30% in the 1990s to only 21% between 2000 and 2007. The share of money raised by British and Japanese IPOs also fell, while China's rose; in 2006 and 2007, Chinese firms actually raised more money via IPOs than American ones did.

To some degree the difference is due to American IPO values peaking during the tech bubble in the late 1990s. But the main reason is a broadening of the IPO market. Over the study period came an uptick in activity among "global" IPOs—where firms lists twice, once domestically and once in a foreign market. (It is much rarer for firms to list only in a foreign market.) In such cases, the authors found, far more money was raised from the international listing than the home one—90% more in 2007. For firms that could, it made sense to go outside the home market.

The authors also measured the strength of home country institutions, such as protections for minority investors and shareholders, disclosure requirements and regulations against self-dealing. They found a positive correlation between home financial institution strength and domestic IPO activity.

Unsurprisingly, firms from countries with weak institutions preferred to list in a foreign exchange and, in Mr Doidge's words, "borrow" the exchange's domestic regulation. A Chinese firm, for example, might gain credibility from listing in New York and subjecting itself to American disclosure laws (and availing itself of American accounting firms). Firms already in the US, with less to gain from going abroad, are more likely to rely only on a domestic IPO.

As the costs of going global fall it is easier for firms from countries with weak institutions to go public. And so, in turn, the quality of those institutions becomes less important. That is good news for the firms looking for new opportunities, but perhaps less welcome for officials hoping to generate more domestic exchange activity. Reforming institutions is not easy. But it might make more of a difference to IPO decisions than previously thought. Mr Doidge cites Brazil's Bovespa. In 2000 it introduced three different levels, with steadily increasing governance requirements, to allow companies to choose how they wanted to list. It has been thriving.

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