

Global Integration in Primary Equity Markets: The Role of U.S. Banks and U.S. Investors

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We examine the costs and benefits of the global integration of initial public offering (IPO) markets associated with the diffusion of U.S. underwriting methods in the 1990s. Bookbuilding is becoming increasingly popular outside the United States and typically costs twice as much as a fixed-price offer. However, on its own, bookbuilding only leads to lower underpricing when conducted by U.S. banks and/or targeted at U.S. investors. For most issuers, the gains associated with lower underpricing outweighed the additional costs associated with hiring U.S. banks or marketing in the United States. This suggests a quality/price trade-off contrasting with the findings of Chen and Ritter, particularly since non-U.S. issuers raising US\$20 million–US\$80 million also typically pay a 7% spread when U.S. banks and investors are involved.

Traditionally firms going public engaged domestic banks to market their initial public offerings (IPOs) to domestic investors. Both tradition and regulatory guidelines caused share pricing and allocation practices to vary substantially from country to country. In most countries, banks used fixed-price methods whereby shares were priced and then put up for subscription. This contrasts with the bookbuilding approach long used by U.S. banks, which involves canvassing investors prior to finalizing deal terms. Although bookbuilding has the obvious attraction of conditioning the final issue price on

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market demand conditions, fixed-price methods remained predominant outside the U.S. until the 1990s.¹

Triggered in large part by a worldwide privatization movement that forced issuers to seek capital from beyond domestic markets, international marketing efforts and foreign listings became commonplace and the predominance of fixed-price marketing practices diminished. In many instances, U.S. investment banks played a catalytic role in the widespread adoption of bookbuilding practices as the default IPO mechanism. Indeed, by July 1999 we estimate that about 80% of the non-U.S. offerings in our sample were brought to market using bookbuilding methods. In contrast to this enthusiastic reception abroad, U.S. banking practices face increasing criticism at home for favoring institutional investors over retail investors and for the apparent impunity with which banks set fees for their services at 7% of gross proceeds; fees that some observers assert exceed competitive levels.²

Against this backdrop we examine the costs and benefits of the global integration of primary equity markets associated with the diffusion of U.S. underwriting methods. To date, researchers have focused largely on the parallel integration of *secondary* equity markets during the 1980s and 1990s [e.g., Bekaert and Harvey (2000), Henry (2000); also see Karolyi (1998) for a survey of the literature on the initiation of American depository receipt (ADR) programs by firms already listed in their home market]. Stulz (1999) surveys the reasons why secondary market liberalization and integration can reduce companies' cost of capital. Improved corporate governance, better investor protection, higher disclosure requirements, and access to foreign investment banks with the ability to certify the quality of a deal should lower the adverse selection and agency costs of raising outside funds. At the same time, liquidity may increase and trading costs fall due to the greater size and diversity of the shareholder base, a reduction in the opportunities for insider trading, or simply a listing on an exchange with more efficient price discovery. Finally, greater competition among providers of underwriting services should reduce the cost (or improve the quality) of fund-raising.

Our analysis suggests that primary markets warrant similar scrutiny. Relative to secondary markets, primary markets remained segmented until very recently, even in many developed economies. Pagano (1993) argues that underdeveloped secondary markets deter public offerings because issuers cannot internalize the benefits of their marginal contribution to diversification opportunities within the economy at large. In turn, further secondary market development is undermined. The primary market integration that we document, particularly the prominent role of U.S. institutional investors, should diminish the coordination problem Pagano envisions by providing issuers

¹ In some countries, including Belgium, France, the Netherlands, and the United Kingdom, auction-like tender offers are sometimes used.

² See Chen and Ritter (2000). For a contrasting view, see Hansen (2001).

with the option to approach nondomestic (institutional) investors directly. The benefits of doing so are substantial in our data, especially by comparison to the benefits of secondary market integration. Thus our findings suggest a prominent role in what remains a little understood linkage between capital market development and real economic development [see Bekaert, Harvey and Lundblad (2001) and references therein for recent studies of this linkage].

We employ a new dataset containing 2,143 IPOs by issuers from 65 countries outside the United States during the period January 1992 to July 1999. The dataset includes information on underwriting fees, initial returns, syndicate membership, and the markets in which shares are sold and listed. The data permit a detailed examination of the consequences of international marketing, nondomestic listing, the choice of marketing method, and whether transactions are led by domestic banks or the U.S. banks that pioneered the increasingly popular bookbuilding technology. The analysis requires consideration of both the direct costs of conducting IPOs and the indirect costs associated with underpricing.

The direct costs of bookbuilding are, in our sample, around twice as high as in fixed-price offerings. U.S. banks rarely participate in fixed-price offerings. When they lead a bookbuilding effort they charge an average premium of 73 basis points over “domestic” banks. However, in making such comparisons it is important to control for economies of scale in underwriting and whether the issue is listed and/or marketed in the United States. There are significant costs—in excess of 130 basis points—associated with listing in the United States, and in our sample, U.S. banks almost always have a senior position in the underwriting syndicate when a U.S. listing is sought. The additional costs associated with marketing an issue in the United States average around 36 basis points, though U.S. banks do not charge more for marketing in the United States than other banks. Once we control for all these factors, including economies of scale, we still find that U.S. banks charge premia over other banks, averaging 41 basis points. Furthermore, even in IPOs that are neither listed nor marketed in the United States, U.S. banks charge premia, averaging 48 basis points. These findings raise the question why issuers, who clearly have a choice between U.S. banks and local banks, would choose a more expensive service. We investigate the hypothesis that higher direct costs reflect higher-quality services. One dimension of the quality of service is the accuracy with which IPOs are priced.

Perhaps surprisingly, the average underpricing associated with bookbuilding and fixed-price methods is remarkably similar, at around 20%, and in Europe bookbuilt IPOs are in fact *more* underpriced than fixed-price offerings. However, these simple averages do not control for the possibility that issuers choose endogenously among different pricing and distribution methods on the basis of their characteristics. Theoretical work suggests that sectors with high degrees of information asymmetry, such as information technology (IT) or biotechnology, are more likely to benefit from the information

production and revelation often associated with bookbuilding. [Benveniste and Spindt (1989) model bookbuilding as a mechanism designed to induce investors to reveal their private information in return for preferential allocations of underpriced stock. Sherman and Titman (2002) model certain design elements of bookbuilding (such as the size of the investor pool targeted) and link them to issuers' "demand" for information production.] Habib and Ljungqvist (2001) suggest another reason for taking seriously the potential endogeneity of the pricing and distribution method. They argue that reductions in underpricing are worth more to an issuer's owners at the margin, the greater the issue size. As a consequence, we allow for endogeneity by estimating two-stage models that instrument issuer choices.

Finally, we investigate whether the identities of the bank building the book and of the investors targeted affect underpricing. In Benveniste and Spindt's model, the success of bookbuilding depends on repeated interactions between the underwriter and investors and on involving *informed* investors. This leads us to expect that banks which have a higher expected IPO deal flow and which can access high-quality investors are likely to extract more information during bookbuilding per unit of reward, reducing the degree of underpricing [see also Sherman (2000)].

Our empirical results indicate that bookbuilding on its own does not lead to lower underpricing. However, when used in combination with U.S. banks and U.S. investors, bookbuilding can reduce underpricing significantly relative to fixed-price offerings or bookbuilding efforts conducted by "domestic" banks. This is consistent with our prediction: because of their longer bookbuilding experience, U.S. banks are more likely to have access to key institutional investors and may be in a better position to reward investors dynamically for their information revelation.³

The pricing benefits we estimate are large compared to the premia U.S. banks charge for their services. Our results suggest that a switch towards a "cheaper" IPO strategy (replacing U.S. banks and not marketing to U.S. investors) would have made 73% of issuers worse off, in the sense that the resulting increase in underpricing cost would have exceeded the savings on the spread. The median firm switching to the "cheaper" strategy would have suffered a reduction in net proceeds of US\$11.7 million. A switch toward a more "expensive" IPO strategy (including U.S. banks in bookbuildings not already managed by U.S. banks), on the other hand, would have made 62% of issuers *better* off. This illustrates that bookbuilding per se does not reduce underpricing. What appears to matter more is the composition of the syndicate and choice of target market.

Loughran, Ritter, and Rydqvist (1994) offer a bird's-eye perspective on international differences in primary markets by consolidating measures of

³ Moreover, U.S. banks might implicitly "bundle" non-U.S. IPOs with domestic IPOs in the very active U.S. IPO market in ways that non-U.S. banks cannot, thus further strengthening their ability to induce investors to reveal information.

average underpricing calculated in a large number of country-specific studies. Although their approach sheds some light on how initial returns vary conditional on whether information is solicited prior to pricing and whether the underwriter maintains allocation discretion, it does not control for firm-specific, industry-specific, and time-specific effects or the endogeneity of choices regarding the syndicate structure and marketing practices. Thus our study is the first comprehensive and controlled analysis of some key international differences in primary equity markets and provides insight into the likely consequences of market integration. It thus complements Sherman's (1999) account of different IPO mechanisms around the world.

The study also complements recent research on the French experience with IPO auctions and securities auctions generally. Derrien and Womack (2000) suggest that French issuers are better served by the existing auction mechanism (*Offre à Prix Minimal*) than by bookbuilding. Our findings are more nearly consistent with those of Biais and Faugeron-Crouzet (2001), who identify strong parallels between bookbuilding and the French auction mechanism. In practice, the two mechanisms provide for a wide range of discretionary behavior on the part of the underwriter that might be expected to influence investors' incentives. However, our results suggest that to whom and by whom the IPO is marketed probably has considerably more bearing on expected proceeds than subtle differences in the degree of underwriter discretion provided by alternative pricing and allocation mechanisms. This should be of interest to those involved in ongoing experiments with online securities auctions.

Finally, our analysis highlights two methodological concerns relevant to the controversy surrounding the clustering of underwriting spreads around 7% in the United States. First, Chen and Ritter (2000) appeal to the lower average spreads for non-U.S. IPOs to bolster their argument that U.S. spreads exceed competitive levels. As we show, spreads for non-U.S. IPOs were indeed historically lower than in the United States, but largely because of the traditionally widespread use of "low-cost" fixed-price methods. However, our results suggest that many issuing firms would have benefited, on net, from a higher direct-cost bookbuilding effort that might have reduced the indirect cost of underpricing. Second, our analysis suggests that accounting for the endogeneity of the issuing firm's choices regarding marketing methods is important in establishing a link between spreads (price) and underpricing (quality) [see Habib and Ljungqvist (2001) for related evidence from the United States]. Although they do not account for endogeneity, Chen and Ritter suggest that there is no such link in the United States.

The article is organized as follows. In Section 1 we describe our data and sources. In Section 2 we consider the evidence on direct costs. Section 3 turns to the indirect costs associated with underpricing and estimates the impact of the choices facing the firm—in particular, where to market the issue and whether to include a U.S. bank—on underpricing. We also estimate

a switching model to evaluate whether issuers' chosen IPO strategies were optimal. Section 4 contains our conclusions.

1. Sample and Data

1.1 Sources and coverage

The sample is derived from Equityware, a database of international IPOs compiled by a subsidiary of Euromoney Publications plc. The July 1999 CD-ROM contains 2,436 completed equity offerings by non-U.S. issuers between January 1992 and July 1999. We exclude 87 offerings that turn out not to be bona fide IPOs (having been traded previously, sometimes in another country), 181 investment trusts, 3 preference share offerings, and 22 IPOs for which we lack after-market prices. The final sample consists of 2,143 IPOs by issuers from 65 countries.

The sample contains three types of listings: domestic listings (1,595 companies, 74.4% of the sample), dual listings on a domestic and a foreign stock exchange (263 companies, 12.3% of the sample), and foreign-only listings (285 companies, 13.3% of the sample). Companies in the second category most often list at home and in the United States (189 of the 263 companies). Among the 285 companies that do not list at home, 166 list only in the United States, 27 list in the United States and on another foreign market, and 92 list only on a non-U.S. foreign exchange (such as EASDAQ or Germany's Neuer Markt). In the early years (1992–1993), the sample consists entirely of foreign-only and domestic-and-foreign listings, and is therefore incomplete. This reflects Equityware's origins as a database of cross-border IPOs.

Panel A of Table 1 illustrates Equityware's coverage by year and geographic region (Europe, Asia-Pacific, North and South America, Africa and the Middle East). Two-thirds of sample firms are from Europe and nearly a quarter from Asia-Pacific. Beginning in 1994, Equityware extended coverage beyond cross-border IPOs to domestic-only offerings in east and west Europe, Latin America, Hong Kong, and Singapore, and from 1997 onward to other Asian and African markets. Comprehensive coverage of Japanese domestic IPOs begins in 1998. As a consequence of Equityware's coverage criteria, IPOs in the early sample years are likely to be larger than the local average in many sample countries.⁴ Panel B of Table 1 confirms this: the median offer size drops from US\$61 million in 1992 to US\$32.5 million in 1999 (converted using exchange rates on the pricing day). Some notable countries with large domestic IPO markets (India, Israel, Taiwan, Korea, the "A" share market in China open to Chinese citizens) are not covered. It is unclear whether their inclusion would alter our results, as India largely uses

⁴ We have investigated the robustness of our results to excluding IPOs from 1992–1993 and found that they remained qualitatively unchanged. We therefore use the entire sample in the analyses that follow.

Table 1
Sample distribution and descriptive statistics

	Total sample	1992	1993	1994	1995	1996	1997	1998	1999
Panel A: Sample distribution (number of firms)									
Europe	1,441	16	30	162	134	224	286	342	247
Asia Pacific	491	15	30	48	31	46	143	123	55
North and South America	110	11	25	16	6	11	23	12	6
Africa/Middle East	101	6	9	8	6	19	12	31	10
Total sample	2,143	48	94	234	177	300	464	508	318
Panel B: Descriptive statistics									
Gross proceeds (US\$m)									
Median	33.0	61.0	92.6	46.9	55.4	37.3	26.6	21.0	32.5
Mean	157.1	2061	221.8	173.8	215.6	162.5	145.0	130.7	140.7
Privatization (fraction %)	10.8	37.5	29.8	15.4	16.4	7.7	12.1	5.5	4.4
Listing and marketing (%)									
Listed domestically only	74.4	45.8	39.4	67.5	63.8	71.3	76.3	85.0	83.3
Listings include U.S.	17.8	45.8	50.0	24.8	26.0	21.0	14.9	9.3	9.4
Target market includes U.S.	31.4	64.6	68.1	37.6	44.1	35.0	28.7	18.3	25.2
Marketed abroad	55.8	100.0	98.9	53.0	64.4	51.7	48.7	46.7	62.6
Syndicate (fraction %)									
U.S. bank (senior position)	28.5	52.1	57.4	36.3	36.2	33.7	25.0	17.3	24.5
U.S. bank (junior position)	4.9	18.8	18.1	7.3	10.2	3.7	2.4	2.4	2.8

The 2,143 sample companies went public between January 1992 and July 1999. Panel A gives the sample distribution by region and year. North and South America excludes the United States. For a breakdown of the countries covered, see Table 3. Panel B lists several descriptive statistics, by year. Gross proceeds is expressed in million US\$ converted using exchange rates on the pricing day. "Listings include U.S." refers to IPOs by non-U.S. companies which involve a listing in the United States, either exclusively or in addition to a home-country or other foreign listing. "Target market includes U.S." refers to IPOs which are either SEC registered, mention eligibility under Rule 144A, have a tranche labeled "U.S. tranche" or are listed on a U.S. exchange. U.S. banks are U.S. investment banks such as Goldman, Sachs & Co and Morgan Stanley & Co and any of their overseas offices, excluding the Wall Street offshoots of non-U.S. banks such as CIBC Wood Gundy Securities Inc. and Deutsche Securities Inc. We classify Credit Suisse First Boston as a U.S. bank given its long Wall Street presence, despite its Swiss parentage. "U.S. bank (senior position)" refers to the presence of a U.S. bank in a senior syndicate position, that is, global coordinator, bookrunner, or (co-) lead manager. "U.S. bank (junior position)" refers to the presence of a U.S. bank in a junior syndicate position.

fixed-price offerings, Israel and Taiwan use auctions, and Korea uses book-building. The smaller countries which are not covered in the database are likely to still use fixed-price offerings.

We examine how comprehensive Equityware's coverage is in countries for which it claims coverage by studying Germany and Singapore in detail. From 1994 onward, German coverage is extremely thorough, with only the occasional small IPO on a regional over-the-counter market missing. In Singapore, Equityware captured all but three firms that went public, as well as capturing an additional IPO missing from a list of IPOs provided by the Singapore Stock Exchange. Nonetheless, in some of the smaller non-European markets (Turkey being a good example), Equityware's coverage is less comprehensive.⁵

In addition to information on the countries where sample firms obtained a listing, Equityware reports whether IPOs were marketed abroad. This feature

⁵ We also compared Equityware's coverage to that provided by the Securities Data Company's (SDC) Global New Issues database. In the European markets, SDC covers only about 84% of the IPOs covered by Equityware. SDC frequently misclassifies seasoned offerings as IPOs and double-counts IPOs under different names. In Asia, on the other hand, SDC's coverage begins earlier than Equityware's.

allows us to investigate the effect of involving foreign (usually institutional) investors, and in particular U.S. investors, in the bookbuilding process.⁶ We define IPOs as being marketed in the United States when they are either Securities and Exchange Commission (SEC) registered, mention eligibility under Rule 144A, have a tranche labeled “U.S. tranche,” or when they are to be listed on a U.S. exchange.

1.2 Initial returns

We obtain aftermarket prices from Equityware where available and manually fill gaps using Datastream and a variety of news sources (Nexis-Lexis, Reuters Business Briefing, Bloomberg, and Dow Jones). Where we convert between currencies, we use the exchange rate on the relevant trading day. We measure initial returns over the first week rather than the first day of trading. We do so partly because Equityware’s coverage of seven-day prices is far more comprehensive than its coverage of first-day prices, and partly because some countries impose restrictions on daily price fluctuations, which delay the emergence of an equilibrium price. In France and Japan, for instance, “circuit breakers” prevent post-IPO prices rising by more than a certain percentage per day. In 55 cases, we could not find a 7-day price and instead used the first-day close (33 cases) or the 30-day price reported in Equityware (22 cases). As noted above, we excluded 22 IPOs for which aftermarket prices were unavailable.

We cross-checked all initial returns in excess of $\pm 30\%$ manually using Datastream and the aforementioned news sources, as well as data provided by national stock exchanges. In 12 cases Equityware’s data were wrong, typically as a result of offer prices and seven-day prices being recorded for a different number of shares (e.g., where an ADR contains more than one share) or in different currencies. A small number of the Datastream-generated initial returns turned out to be wrong as a result of partial-paid shares or misplaced decimal points.

1.3 Pricing methods

We distinguish between three principal pricing methods:

- *auction*: where the offer price is set according to either a mandatory or a discretionary clearing rule but allocations to bidders are nondiscretionary, that is, any two bidders with the same bid will receive the same allocation of shares;
- *fixed-price*: where the offer price is set before the issue is marketed to investors, and allocation decisions typically are nondiscretionary;

⁶ SDC’s databases contain no corresponding information. For that reason, we refrain from merging the Equityware and SDC databases. What we thereby lose in coverage, we gain in information on the geography of IPO marketing.

- *bookbuilding*: where the offer price is set after indications of interest are sought from investors, the investment bank is not constrained by a mandatory price rule, and allocation decisions typically are discretionary.

Equityware does not explicitly identify the pricing method used. We manually classify *every* offering in our sample using news sources (Nexis-Lexis, Reuters Business Briefing, Bloomberg, Dow Jones, and the London Stock Exchange's Regulatory News Service) or information from national stock markets and IPO prospectuses contained in Disclosure's Global Access service and Ljungqvist's (1997) database of German IPOs.⁷ Identifying auctions is relatively straightforward since there is little ambiguity in the country-specific terminology used. In our sample, auctions are rarely used: only 52 IPOs were priced in auctions, 34 of which were in France.⁸ This perhaps surprising result reflects how our sample is constructed (e.g., Equityware does not cover Japan during its "auction phase" of 1989–1997) and the apparent preference for fixed-price methods even where auctions were permitted (throughout most of Europe, Asia, and South America), as well as the increasing popularity of bookbuilding methods.

Identifying bookbuilt IPOs is slightly less straightforward than identifying auctions. In some countries, what is regulated is the way securities are offered and distributed to investors, not the way they are priced. For instance, the London Stock Exchange's Yellow Book, which governs London listings, does not contain any reference to "bookbuilding." Therefore, where our sources do not explicitly mention the term "bookbuilding" or its local translation, we classify an offering as using bookbuilding if a reading of the IPO process strongly suggests that the final offer price was set after indications from investors were sought (though not if it was an auction). Bookbuilding efforts can either be aimed entirely at investors whose indications of interest are sought, or they can require some participation by retail investors. In the latter case, it is possible that the retail tranche interferes with the efficiency of the price discovery process. Specifically, where the bookbuilding effort precedes the marketing of a retail tranche, the price has to be finalized earlier [Chowdhry and Sherman (1996)]. Furthermore, in these sequential "hybrids," retail investors can condition their demand on revealed interest in the book, which can cause cascades and thus higher underpricing [Welch (1992)].⁹

⁷ We are grateful to François Derrien for helping to check our French sample.

⁸ In six of these 34 French cases, the auction was subsequently canceled and converted to a fixed-price offering (*Offre à Prix Ferme*).

⁹ Not all hybrids are sequential. In some countries the bookbuilding and public offer periods run simultaneously. In these cases, retail investors usually subscribe at the maximum price in the indicative range and then receive a refund if the final price, as determined by bookbuilding, is lower. In unreported robustness checks, we found no evidence that simultaneous hybrids are associated with significantly different levels of underpricing compared to pure bookbuilding efforts or sequential hybrids, and so we focus on the possible differences between sequential hybrids and other bookbuilding efforts. For a detailed empirical analysis of the effect of differences in bookbuilding procedures on underpricing, see Ljungqvist and Wilhelm (2002).

In total, we classify 1,318 sample IPOs as using bookbuilding, 703 of which were sequential hybrids. The remaining 773 IPOs are fixed-price offerings.

Taking 1994 as perhaps the first representative year in our sample, 46.2% of the IPOs were conducted via bookbuilding methods, rising to 80% during the first seven months of 1999. This pattern is largely a European phenomenon: there the proportion rose from 29.6% in 1994 to 88.7% in 1999. In Asia, in contrast, fixed-price methods remain dominant, especially outside Japan (which switched from auctions to bookbuilding in September 1997).

Bookbuilding involves setting an “indicative” (usually nonbinding) price range as a basis for feedback from potential investors.¹⁰ We collect information on the price range for bookbuilt offerings from Equityware, IPO prospectuses, and news searches. In total, we obtain price ranges for 1,196 of the 1,318 bookbuilt IPOs.

1.4 Underwriting syndicates

Equityware reports the composition of the underwriting syndicate and the capacity in which each participating bank serves. Panel B of Table 1 reveals that the leadership role of U.S. banks has declined somewhat over time in our sample. The fraction of offerings in which a U.S. bank served as global coordinator, bookrunner, or (co-) lead manager (our definition of “senior” syndicate positions) fell from 36.3% in 1994 to 24.5% of the firms floated through the end of July 1999. Mirroring this decline, the rate of U.S. listings fell from 24.8% in 1994 to 9.4% in 1999, while the fraction of sample IPOs marketed to U.S. investors fell from 37.6% to 25.2%.¹¹

After consolidating the regional and overseas offices of each bank and taking into account name changes and acquisitions after they take effect, there are 592 different banks in the sample, 551 of which served at least once in a senior syndicate capacity. Table 2 ranks the 25 most active banks in our sample, judged by their involvement in a senior syndicate position. We also summarize the frequency with which each bank, as a senior syndicate member, marketed an offering to U.S. investors, used bookbuilding methods, or was involved with a privatization. Between them, the top 25 banks were involved in a senior syndicate capacity in 1,056 IPOs, just under half of the total.¹² The next 25 most-active banks (not shown) account for another 274

¹⁰ By indicative price range, we mean a range set by the syndicate banks and disclosed in regulatory filings, preliminary prospectuses, or investor marketing documents. This excludes price indications released by unaffiliated investment banks and quoted in the business press, and press reports of the range of amounts (“\$20m to \$25m”) the issuer plans to raise.

¹¹ There is also a pronounced decline over time in the frequency of privatisations which, in turn, has much to do with the decline in gross proceeds per offering. This is likely a consequence of both sampling bias associated with Equityware’s overrepresentation of privatisations during the early part of the sample period and a time trend in the rate of privatisations.

¹² They were involved in a junior capacity in 975 deals, or after stripping out deals in which another top 25 bank was senior, an additional 70 deals. Hence, at least one top 25 bank serves in a senior or junior capacity in 1,126 (52.5%) of our sample IPOs.

Table 2
Most active underwriters

	U.S. bank?	Total number in senior position	Of which ...			Total number in junior position
			Marketed in the U.S.	Bookbuilt	Privatization	
Warburg Dillon Read	No	151	122	139	42	71
Deutsche Bank/ Deutsche Morgan Grenfell	No	143	100	127	26	114
Dresdner Bank/ Dresdner Kleinwort Benson	No	137	74	118	31	111
Merrill Lynch	Yes	126	113	122	33	42
Goldman Sachs	Yes	121	103	117	26	43
CS First Boston	Yes	119	94	113	35	69
Morgan Stanley	Yes	113	105	109	19	43
ABN AMRO	No	96	54	89	29	122
Credit Lyonnais	No	96	48	83	26	92
ING Barings	No	91	54	75	13	87
Banque Paribas	No	86	53	79	22	73
UBS Securities	No	85	58	76	21	72
HSBC Securities	No	80	45	64	22	58
Salomon Brothers/ Salomon Smith Barney	Yes	68	58	62	13	31
Lehman Brothers	Yes	65	61	60	12	26
Nomura Securities	No	54	25	48	13	88
Barclays de Zoete Wedd	No	52	33	37	16	57
Societe Generale	No	51	20	38	12	61
Schroder Securities	No	51	30	45	11	46
DG Bank Deutsche Genossenschaftsbank	No	49	7	45	0	31
Banque Nationale de Paris	No	48	24	38	9	28
County Natwest	No	48	20	28	6	34
JP Morgan Securities	Yes	43	42	42	11	27
Enskilda Securities	No	41	17	26	0	24
Westdeutsche Landesbank/ WestLB Panmure	No	39	10	35	3	27
Top 25		1,056	549	857	150	975
As fraction of category		49.3%	81.7%	64.3%	75.8%	45.5%

The table presents the top 25 banks in our sample by the number of IPOs in which each bank served in a senior syndicate capacity, that is, global coordinator, bookrunner, or (co-) lead manager. We consolidate local offices and keep track of name changes and mergers.

IPOs. The remaining 813 IPOs involved 348 other banks, which served in a senior capacity in 1 to 18 deals.

Between them the top 25 banks account for 81.7% of all sample IPOs that are marketed to U.S. investors. This suggests that the ability to “talk to U.S. investors” is concentrated among a small number of banks. All but 7 (11) of the top 25 (50) banks in the table are “international” rather than U.S. investment banks. These international banks also frequently lead-manage IPOs marketed to U.S. investors, though they typically involve U.S. banks as coleads (515 of the 672 sample offerings marketed in the United States) or junior comanaging syndicate members, possibly to look after U.S. marketing. In 109 cases, syndicates include no U.S. bank at any level, but the lead is invariably a well-established international investment bank with a strong

Wall Street presence, such as Deutsche Morgan Grenfell or Warburg Dillon Read.

The top 25 banks almost always use bookbuilding methods, irrespective of their nationality. In fact, they account for 64.3% and 94.9% of IPOs brought to market via bookbuilding methods by number and by amount raised, respectively. The top 50 banks account for 75% and 96.9%, respectively. Thus bookbuilding technology remains concentrated among a relatively small number of banks. Of the 592 different banks in the sample, only 41 have served 20 or more times in a senior syndicate capacity in a bookbuilding effort.

1.5 Underwriting spreads

Since Equityware reports cross-sectional information for each tranche of a multitranche offering separately, the spread information for multitranche offerings is manually consolidated. To illustrate, where issuers combine an institutional placement with a public offering, spreads are calculated as the weighted average of the placement and public-offer spreads. Where Equityware reports a total-fee figure or a combination of a fixed and a variable fee (common in the United Kingdom), the gross spread is calculated as total-fee paid/gross proceeds.

Spread information for all European and Asian IPOs and for all IPOs due to list in the United States was checked for accuracy against SDC's new issues databases. In the few instances where discrepancies arose, we consulted the prospectuses. In a few cases we used SDC data to fill gaps in Equityware's spread information. In cases where Equityware reports that no spread was disclosed (particularly prevalent in Germany and France), we consulted the issuer's prospectus. In 49 cases, the information was available in the (final) prospectus. In total, we have spread information for 1,647 of the 2,143 IPOs.

1.6 Sample descriptive statistics

Table 3 reports descriptive statistics by country. The busiest IPO markets are in the United Kingdom, Germany, France, Hong Kong, and China. For the sample as a whole, median gross proceeds are about US\$33 million, with a substantially higher mean of US\$157 million. The large difference between the median and the mean reflects, among other things, the importance of privatization IPOs, which are often very large and constitute 10.8% of our sample. Among countries with relatively high IPO volume, median gross proceeds range from less than US\$10 million in Japan, Malaysia, and Singapore to more than US\$75 million in Italy and Mexico.

The exchange(s) on which an issuer lists its shares is a key decision variable and, because most nondomestic listings include a U.S. listing, is closely related to the presence (and status) of U.S. banks in the underwriting syndicates. For example, in Israel, where not a single IPO in our sample is exclusively domestically listed, 82% of the underwriting syndicates include

Table 3
Descriptive statistics: country distribution

	Total no. of obs.	No. of obs w/spread info	Gross proceeds (US\$ m)		Privatization Fraction (%)	Listing and marketing (fraction %)				Syndicate (fraction %)		Gross spread (mean %)	Bookbuilding	
			Median	Mean		Listed domestically only	Listings include U.S.	Target market includes U.S.	Marketed abroad	Using a senior U.S. bank	Using a junior U.S. bank		Fraction (%)	Under pricing (mean %)
Europe	1,441	1,019	149.6	32.0	6.7	81.6	12.1	24.1	51.0	22.6	2.7	3.61	62.4	19.2
France	223	64	142.9	11.5	4.5	89.2	7.6	14.3	35.0	17.0	1.3	4.49	78.5	13.5
Germany	237	174	139.3	34.6	1.3	92.0	5.9	19.0	68.4	13.9	4.2	4.67	91.6	46.5
Italy	62	55	322.6	79.1	12.9	62.9	27.4	45.2	98.4	40.3	1.6	4.34	96.8	7.5
Netherlands	67	62	259.3	69.4	6.0	58.2	32.8	50.7	92.5	50.7	4.5	4.43	95.5	13.6
Sweden	77	28	136.0	38.6	7.8	83.1	9.1	31.2	55.8	15.6	1.3	4.30	46.8	9.1
United Kingdom	450	416	93.8	18.4	0.9	90.0	8.2	15.1	18.0	14.2	0.2	2.49	19.6	15.5
Rest of W Europe	279	183	194.8	52.7	13.6	69.5	16.1	34.8	73.5	34.8	5.0	4.11	77.4	13.6
Rest of E Europe	46	37	136.0	59.9	50.0	39.1	34.8	41.3	93.5	47.8	13.0	4.23	93.5	16.4
Asia Pacific	491	445	178.6	29.6	24.4	74.9	13.2	33.2	55.6	28.3	10.4	3.12	48.5	27.5
China	103	87	121.8	57.9	91.2	43.7	15.5	42.7	100.0	34.0	11.7	3.61	68.9	45.7
Hong Kong	123	121	95.4	18.8	4.0	80.5	13.8	30.1	45.5	26.0	12.2	3.09	34.1	13.8
Japan	42	40	512.7	6.8	0.0	97.6	2.4	11.9	11.9	11.9	21.4	5.33	97.6	53.0
Malaysia	44	44	87.4	3.3	4.5	100.0	0.0	6.8	9.1	6.8	2.3	1.52	4.5	5.9
Singapore	60	56	45.5	8.3	1.7	93.3	5.0	10.0	15.0	11.7	1.7	1.82	10.0	35.5
Rest of Asia/Pacific	119	97	296.6	109.9	16.0	69.7	23.5	57.1	80.7	47.9	10.9	3.30	63.9	20.8
N & S America	110	105	228.1	128.5	9.1	18.2	78.2	86.4	92.7	78.2	9.1	5.16	97.3	5.4
Canada	33	33	195.6	83.4	3.0	30.3	66.7	81.8	100.0	75.8	18.2	6.30	97.0	9.2
Mexico	27	24	193.2	142.5	0.0	11.1	81.5	88.9	88.9	81.5	0.0	4.75	96.3	4.8
Rest of N/S America	50	48	268.3	128.0	18.0	14.0	84.0	88.0	90.0	78.0	8.0	4.57	98.0	3.2
Africa/ Middle East	101	78	83.5	26.4	5.9	30.7	55.4	66.3	85.1	60.4	4.0	5.64	73.3	14.5
Israel	51	45	30.8	21.6	2.0	0.0	82.4	86.3	100.0	82.4	2.0	7.29	88.2	8.9
South Africa	19	13	172.4	3.6	0.0	78.9	15.8	21.1	21.1	15.8	0.0	2.08	21.1	35.5
Rest of Africa/M East	31	20	115.8	45.3	16.1	51.6	35.5	61.3	100.0	51.6	9.7	4.23	80.6	10.9
Total sample	2,143	1,647	157.1	33.0	10.8	74.4	17.8	31.4	55.8	28.5	4.9	3.67	61.5	20.2

We have spread information for 1,647 of the 2,143 sample companies. Underpricing is the percentage return from the (institutional) offer price to the trading price one week after the IPO. All other variables are as defined in Table 1. IPOs by countries not shown are as follows. *Rest of W Europe*: Austria (29), Belgium (54), Denmark (31), Finland (28), Greece (15), Ireland (16), Luxembourg (4), Malta (1), Norway (16), Portugal (15), Spain (31), Switzerland (39). *Rest of E Europe*: Croatia (1), Estonia (1), Hungary (21), Poland (19), Romania (2), Russia (2). *Rest of N/S America*: Argentina (15), Bermuda (8), Brazil (8), Cayman Islands (4), Chile (4), Colombia (2), Dominican Republic (1), Netherlands Antilles (2), Panama (1), Puerto Rico (1), Uruguay (1), Venezuela (3). *Rest of Asia/Pacific*: Australia (21), Indonesia (25), Kazakhstan (1), South Korea (1), New Zealand (6), Pakistan (1), Papua New Guinea (2), the Philippines (26), Taiwan (14), Thailand (22). *Rest of Africa/Middle East*: Bahrain (1), Cyprus (1), Egypt (4), Ghana (1), Kenya (1), Lebanon (3), Liberia (1), Malawi (1), Qatar (1), Turkey (14), Zimbabwe (1).

a U.S. bank in a senior position. By contrast, around 90% of French, German, and U.K. IPOs list only domestically, and less than 20% are led by U.S. banks. This inverse relation is present in each of the four geographic regions reported in Table 3. Where the issuing firm's home country has relatively well-developed capital markets, as in the U.K., Japan, or Singapore, the relative frequency of a U.S. listing is lower. On the other hand, Table 3 also indicates that firms frequently market their offerings in the United States even when they are not seeking a U.S. listing. In Europe, only 12% of sample firms seek a U.S. listing, but 24% include the U.S. as part of their target market. Likewise, although only 13% of sample firms in Asia-Pacific seek a U.S. listing, 33% target U.S. investors. Thus even if an issuing firm is not seeking a U.S. listing, including a U.S. bank in the underwriting syndicate may be beneficial if it improves access to the U.S. (institutional) investor community.

The mean gross spread of 3.67% confirms Chen and Ritter's (2000) claim that spreads are generally lower outside the United States.¹³ But variation across countries is substantial, with mean gross spreads among countries with relatively high IPO volume ranging from a low of 1.52% in Malaysia to a high of 7.29% in Israel. This variation is correlated with variation in the frequency with which bookbuilding methods are used. Among the countries with active primary equity markets, Germany stands out for using bookbuilding in more than 90% of IPOs, whereas 80% of U.K. offerings use fixed-price methods. Indeed, the majority of fixed-price offerings in our sample took place either in the U.K. or in the larger Asian-Pacific markets (with the exception of Japan). The common denominator among these markets is their long-standing adherence to the tenets of British company law [see Loughran, Ritter and Rydqvist (1994) and Sherman (1999) for further institutional details].

The final column of Table 3 reports mean underpricing for each country. Particularly high levels of underpricing are observed in Germany, China, and Japan, and over the sample as a whole, underpricing averages 20.2%.

Table 4 reports the sample distribution by industry. The largest sector in our sample is IT (hardware and software), accounting for about 14% of the IPOs. The remainder of the sample is spread widely across a range of industries. Privatizations are concentrated in four sectors: energy/utilities; oil, coal, and gas; banking and financial services; and telecommunications. Bookbuilding efforts are most common among companies in the energy/utilities, telecommunications, and IT sectors, and least common among construction, hotels and leisure, and real estate companies. To the extent that valuation is more uncertain in the IT industry than in construction, the patterns in

¹³ The proceeds-weighted spread averages 3.30%, somewhat lower than the equally weighted average, indicating economies of scale.

Table 4
Descriptive statistics: industry distribution

Industry	Total no. of obs.	No. of obs w/spread info	Gross proceeds (US\$ m)		Privatization Fraction (%)	Listing and marketing (fraction %)				Syndicate (fraction %)		Gross spread (mean %)	Bookbuilding	
			Median	Mean		Listed domestically only	Listings include U.S.	Target market includes U.S.	Marketed abroad	Using a senior U.S. bank	Using a junior U.S. bank		Fraction (%)	Under pricing (mean %)
IT	296	214	41.1	20.1	0.7	76.0	18.9	26.0	54.4	24.7	2.0	4.65	72.6	33.0
Retailing/ Consumer Goods	147	118	100.6	28.4	2.7	85.0	12.2	26.5	42.2	26.5	8.2	3.17	52.4	16.3
Electronics/ Electrical Goods	139	103	47.2	23.3	4.3	79.1	12.9	21.6	48.2	20.1	2.2	3.88	61.9	17.6
Manufacturing	128	95	57.3	28.7	12.5	80.5	11.7	20.3	54.7	16.4	3.9	3.55	53.9	17.7
Telecoms	128	107	820.7	147.4	19.5	42.2	49.2	66.4	82.8	66.4	3.1	4.03	78.1	22.0
Food & Drink	102	71	60.6	30.1	5.9	85.3	8.8	24.5	57.8	22.5	9.8	3.42	67.6	12.1
Healthcare/ Pharmaceuticals	95	68	66.0	29.7	7.4	71.6	23.2	32.6	52.6	28.4	6.3	4.52	56.8	14.1
Media & Publishing	87	72	115.6	30.4	3.4	78.2	16.1	25.3	48.3	25.3	1.1	3.78	58.6	36.5
Banking & Financial Svcs	85	62	293.4	69.5	23.5	64.7	21.2	40.0	68.2	40.0	4.7	3.30	65.9	24.2
Hotels & Leisure	82	62	85.3	19.5	4.9	93.9	3.7	8.5	32.9	9.8	1.2	2.96	45.1	31.1
Consultancies/ Services	81	60	38.2	14.1	0.0	91.4	4.9	9.9	33.3	7.4	0.0	3.18	51.9	18.8
Real Estate	76	54	102.6	53.1	6.6	86.8	6.6	31.6	52.6	23.7	7.9	2.85	44.7	9.7
Engineering	73	58	142.3	46.5	15.1	65.8	23.3	38.4	57.5	30.1	4.1	3.66	56.2	11.6
Construction	67	57	119.9	25.0	13.4	80.6	10.4	28.4	44.8	22.4	11.9	2.56	44.8	6.1
Automotive	51	41	146.0	34.3	15.7	74.5	13.7	29.4	64.7	19.6	3.9	3.44	58.8	19.3
Transport & Shipping	50	42	55.0	32.1	14.0	68.0	16.0	34.0	52.0	24.0	12.0	3.40	48.0	17.2
Oil, Coal & Gas	48	38	300.5	81.8	22.9	58.3	39.6	54.2	66.7	50.0	0.0	4.17	64.6	13.2
Textiles & Clothing	45	33	51.2	26.9	11.1	77.8	6.7	20.0	57.8	17.8	8.9	3.16	64.4	20.5
Forest Products/ Packaging	37	30	104.1	33.9	5.4	78.4	18.9	32.4	59.5	27.0	8.1	3.63	64.9	12.6
Energy/Utilities	32	29	406.7	193.9	56.3	53.1	31.3	65.6	81.3	62.5	6.3	3.59	81.3	20.8
Other (23 classifications)	294	233	215.4	59.0	21.4	68.0	20.1	39.8	64.6	36.1	6.1	3.59	65.6	17.3
Total sample	2,143	1,647	157.1	33.0	10.8	74.4	17.8	31.4	55.8	28.5	4.9	3.67	61.5	20.2

IPOs are classified by the primary industry code assigned by Equityware. Equityware uses a total of 43 industry codes. This table shows the same information as Table 3 individually for the 20 industries with the most observations, and for the remaining firms as a group. All variables are as defined in Tables 1 and 3. *Other industries* are Insurance (31), Industrials & Conglomerates (29), Rubber & Plastics (26), Chemicals (25), Biotechnology (23), Iron & Steel (21), Metals & Ores (20), Airlines (18), Glass & Ceramics (18), Mining (15), Luxury goods (12), Agribusiness (10), Aerospace (9), Financial corporate (8), Railways (6), Public Works/Public Services (6), Leasing companies (4), Investment Companies (4), Education (3), Tobacco (3), Local authority (1), Financial Trading & Dealing (1), and unclassified (1).

bookbuilding use are to be expected. The most “domestic” industries, in terms of both listings and marketing and inclusion of U.S. banks in senior syndicate functions, are hotels and leisure, consultancies, retailers, and manufacturing companies, while the sectors dominated by privatizations are most likely to involve foreign listings or marketing drives and to hire U.S. banks. Underpricing, shown in the last column, varies considerably by industry, with industries that are likely to be characterized by greater valuation uncertainty (IT, media and publishing) being prone to much greater underpricing than more stable and mature industries (construction, real estate).

2. Direct Costs

2.1 Fixed-price versus bookbuilding methods

Table 5 reports on a country-by-country basis the average direct cost, or gross spread, incurred by issuing firms using either fixed-price or bookbuilding methods. We focus on the direct costs associated with employing the investment banking syndicate rather than the total IPO costs incurred by the

Table 5
Gross spreads on bookbuildings and fixed-price offers

	Bookbuildings		Fixed-price offerings		<i>t</i> -test of difference in means
	No. of obs. w/spread info	Gross spread (mean %)	No. of obs. w/spread info	Gross spread (mean %)	
Europe	645	4.43	370	2.19	−22.53***
France	64	4.49			
Germany	164	4.70	10	4.09	−1.56
Italy	53	4.37	2	3.50	−1.15
Netherlands	60	4.46	2	3.55	−0.84
Sweden	25	4.46	2	2.93	−1.69
United Kingdom	83	4.42	333	2.01	−12.76***
Rest of W Europe	161	4.17	19	3.66	−1.32
Rest of E Europe	35	4.18	2	5.13	0.83
Asia Pacific	214	4.10	225	2.21	−14.41***
China	60	3.80	27	3.30	−1.40
Hong Kong	42	4.09	79	2.50	−6.34***
Japan	39	5.38			
Malaysia	2	3.00	40	1.47	−4.22***
Singapore	5	5.07	50	1.51	−9.58***
Rest of Asia/Pacific	66	3.57	29	2.65	−3.11*
N & S America	103	5.17	1	5.00	
Canada	32	6.34	1	5.00	
Mexico	24	4.75			
Rest of N/S America	47	4.58			
Africa/Middle East	64	6.37	13	2.19	−6.07***
Israel	42	7.44	3	5.17	−2.05*
South Africa	3	4.67	10	1.30	−5.01***
Rest of Africa/M East	19	4.27			
Total sample	1,025	4.55	610	2.20	−28.88***

Spread information is available for 1,025 bookbuilding efforts and 610 fixed-price IPOs. Because of the small number, we drop the 12 auction IPOs for which spread information is available. Their average spread is 2.98%.

***, **, * Significant at 0.1%, 1%, and 5% (two-sided), respectively.

issuing firm, as it is difficult to obtain consistent information on other IPO expenses (such as the costs of conducting a road show, advertising, or management time). In every country in the table, fixed-price IPOs involve lower fees. For the whole sample, bookbuilding efforts are charged a mean gross spread of 4.55% of proceeds versus 2.20% for fixed-price deals. Of course, these figures are simple (equally weighted) averages and do not control for economies of scale usually associated with conducting an IPO.

2.2 How expensive are U.S. banks?

As a general rule, U.S. banks are not active in (cheaper) fixed-price offers—the sample for which we have spread data contains only 30 such cases—so to see whether they charge more than non-U.S. banks we focus on bookbuilt IPOs. Table 6 reports the results of three univariate analyses of gross spreads for bookbuilding efforts. The first block of the table splits the sample according to whether a U.S. bank served in a senior syndicate position. Syndicates led by U.S. banks generally charge higher spreads than syndicates led by non-U.S. banks. The premia charged average 73 basis points (4.89% versus 4.16%) for the sample as a whole, which is significant at the 0.1% level. In Europe, premia average 47 basis points, ranging from 226 basis points in the United Kingdom to −32 basis points in Germany. For Asian-Pacific, North/South American, and African/Middle Eastern countries, premia average 31 basis points, 81 basis points, and 284 basis points, respectively. At first sight therefore, U.S. banks appear to charge higher fees even when we filter out the effects of fixed-price offerings.

There are several possible, not necessarily mutually exclusive explanations for these premia. First, because U.S. banks lead-managed all but 19 of the bookbuilt IPOs that listed in the United States, the premia could reflect the greater complexity of listing in the United States. Second, U.S. banks might charge issuers for access to their established networks of U.S. (institutional) investors whose information might be valuable in determining the offer price via bookbuilding. Third, U.S. banks might possess superior valuation technology (in the form of sectoral expertise or analysts). The second and third blocks in Table 6 look at particular subsamples of the data in an attempt to shed light on these hypotheses.

The second block concentrates on the 604 bookbuilt, U.S.-marketed IPOs for which we have spread information. The majority (491) were led by U.S. banks. Splitting these U.S. bank-led bookbuildings into the 355 IPOs which were to be listed in the United States and the 136 which were only marketed in the United States reveals a substantial cost increase of 208 basis points (5.60% versus 3.52%) associated with U.S. listings. This difference is highly statistically significant for the sample as a whole and in every region except North/South America (*t*-tests not shown). This is consistent with the hypothesis that U.S. banks charge a premium for facilitating access to U.S. capital markets.

Table 6
Gross spreads on bookbuilt IPOs: the influence of U.S. banks and marketing to U.S. investors

	Marketed to U.S. investors											Not marketed to U.S. investors					
	Use U.S. bank in senior position?					U.S. bank in senior position				No U.S. bank in senior position		<i>t</i> -test of difference in means (not listed in U.S.)	U.S. bank in senior position		No U.S. bank in senior position		
	Yes		No		<i>t</i> -test of difference in means	Listed in U.S.		Not listed in U.S.		No U.S. bank in senior position			U.S. bank in senior position		No U.S. bank in senior position		
	No. of obs. w/spread info	Gross spread (mean %)	No. of obs. w/spread info	Gross spread (mean %)		No. of obs. w/spread info	Gross spread (mean %)	No. of obs. w/spread info	Gross spread (mean %)	No. of obs. w/spread info	Gross spread (mean %)		No. of obs. w/spread info	Gross spread (mean %)	No. of obs. w/spread info	Gross spread (mean %)	<i>t</i> -test of difference in means
Europe	294	4.68	351	4.21	−3.81***	169	5.30	78	3.77	67	4.13	1.85[‡]	47	3.96	284	4.23	1.15
France	32	4.63	32	4.36		17	5.61	11	3.21	3	2.90		4	4.36	29	4.51	
Germany	31	4.44	133	4.76		12	4.94	10	3.74	20	4.68		9	4.56	114	4.78	
Italy	25	4.63	28	4.14		17	5.07	6	3.60	4	3.63		2	4.08	24	4.22	
Netherlands	34	5.05	26	3.69		22	5.79	6	4.25	5	3.42		6	3.14	20	3.75	
Sweden	12	4.89	13	4.07		7	5.42	4	4.44	7	4.26		1	3.00	6	3.85	
United Kingdom	56	5.16	27	2.90		37	5.97	17	3.59	4	4.31		2	3.48	23	2.65	
Rest of W Europe	85	4.46	76	3.85		44	4.93	23	4.04	19	4.03		18	3.83	57	3.79	
Rest of E Europe	19	4.03	16	4.35		13	4.03	1	2.25	5	3.89		5	4.40	11	4.56	
Asia Pacific	117	4.24	96	3.93	−1.32	58	5.49	51	3.04	29	2.95	−0.49	8	2.82	67	4.36	2.82**
China	33	4.03	26	3.39		16	5.45	14	2.92	10	3.08		4	3.02	16	3.59	
Hong Kong	29	4.87	14	2.68		16	6.46	9	2.61	8	2.81		3	2.50	6	2.50	
Japan	4	4.43	35	5.48		1	2.73	3	5.00						35	5.48	
Malaysia	1	3.00	1	3.00				1	3.00	1	3.00						
Singapore	4	5.69	1	2.57		3	6.84	1	2.25						1	2.57	
Rest of Asia/Pacific	46	3.87	19	2.85		22	4.77	23	3.05	10	2.93		1	3.00	9	2.78	
N & S America	85	5.31	18	4.50	−1.93[‡]	77	5.38	5	4.65	11	4.84	0.26	3	4.53	7	3.96	−0.50
Canada	25	6.51	7	5.75		20	6.92	3	4.75	3	6.33		2	5.00	4	5.31	
Mexico	21	4.77	3	4.67		19	4.80	2	4.50	3	4.67						
Rest of N/S America	39	4.84	8	3.35		38	4.87			5	4.05		1	3.60	3	2.17	
Africa/Middle East	54	6.81	10	3.97	−4.17***	51	7.02	2	3.18	6	4.50	0.91	1	3.50	4	3.18	
Israel	39	7.59	3	5.58		39	7.59			2	7.01				1	2.72	
South Africa	2	5.25	1	3.50		2	5.25			1	3.50						
Rest of Africa/M East	13	4.74	6	3.25		10	5.17	2	3.18	3	3.17		1	3.50	3	3.33	
Total sample	550	4.89	475	4.16	−6.87***	355	5.60	136	3.52	113	4.03	2.62**	59	3.83	362	4.24	1.97*

This table uses the 1,025 IPOs for which spread information is available and which are classified as bookbuildings; see also Table 5.

***, **, *, † Significant at 0.1%, 1%, 5%, and 10% (two-sided), respectively.

Do they charge an independent premium for access to their U.S. investor networks? The average spread that U.S. banks charge in the 136 issues marketed but not listed in the United States is in fact 51 basis points *lower* than the average spread charged in the 113 IPOs marketed in the United States by non-U.S. banks (3.52% versus 4.03%). This difference is significant at the 1% level and widens to 69 basis points when we weight spreads by the proceeds raised. However, it is a fragile result driven by Germany. Here U.S. banks appear to have competed aggressively on fees and Germany is also the one country in which domestic banks have retained the largest share of U.S.-marketed IPOs. Excluding Germany, average spreads cease to be significantly different across banks when marketing to U.S. investors. As we shall see in the next section, this result continues to hold when we control for economies of scale in underwriting and other possible influences on costs. As we argued in Section 1.4, most of the non-U.S. banks that market IPOs to U.S. investors do have an established Wall Street presence. It is perhaps not surprising therefore that these “international” investment banks have similar fee structures to those of U.S. banks. Their investor networks surely are close substitutes for U.S. bank networks.

Do U.S. banks charge a premium in “domestic” deals? The third block of Table 6 concentrates on the 421 IPOs not marketed in the United States, which were largely sold domestically. Of these, only 59 were led by U.S. banks, and in these offerings, spreads averaged 3.83%. Syndicates without U.S. banks in a senior position charged 41 basis points *more* on average. This apparent premium is significant at the 5% level and is robust to proceeds weighting. However, a simple comparison of means fails to control for other influences on spreads, such as differences in size. The 59 “domestic” IPOs lead-managed by U.S. banks are almost six times larger (averaging US\$319 million) than IPOs led by non-U.S. banks (averaging US\$57 million). Given economies of scale in underwriting, it is unclear whether U.S. banks charge less or more in these deals. We return to this question later when we estimate cost regressions controlling explicitly for offer size.

2.3 The 7% solution?

Do U.S. banks charge less for their services outside the United States than they do in domestic U.S. IPOs? On average U.S. banks charge 5% in international IPOs marketed to U.S. investors—the category of offering in our sample that is perhaps closest to a domestic U.S. IPO. This certainly *appears* considerably lower than the average 7% spread most medium-sized U.S. IPOs pay [see Chen and Ritter (2000)]. However, international IPOs led by U.S. banks are not medium-sized: the average issue size is US\$471.3 million. If we concentrate on the 104 IPOs in our sample which fulfill Chen and Ritter’s size criterion (US\$20 million–US\$80 million), we find that U.S. banks charge 6.4% on average in U.S.-marketed deals, with a median of 7%, and 56% of issuers paying exactly 7%. These results look similar to Chen and

Ritter's and raise the interesting question of why foreign companies apparently voluntarily pay U.S. banks what Chen and Ritter argue are inflated fees.

2.4 Cost functions for bookbuilding and fixed-price offers

The univariate analysis suggests gross spreads are influenced by a variety of factors including the use of bookbuilding practices, the cost of listing and marketing in the United States, possibly the presence of a U.S. bank, and country-specific regulatory and competitive circumstances. U.S. banks are most active in IPOs marketed and/or listed in the United States. Much of the premium they demand can be traced to U.S. listings; there is no evidence that U.S. banks charge a premium for access to their U.S. investor networks, as non-U.S. banks charge just as much when marketing to U.S. investors. When the target market does not include U.S. investors, U.S. banks are rarely given senior syndicate positions, and they charge fees that appear lower than those of domestic banks.

This univariate analysis does not, however, shed light on the marginal contributions to the spread of these choices. We provide a more detailed characterization of the determinants of gross spreads by regressing spreads on

- a measure of the size of the offering, to control for the possibility that substantial fixed costs in securities underwriting result in economies of scale;
- a dummy variable indicating whether a U.S. bank serves in a senior syndicate position;
- a dummy variable for bookbuilding efforts;
- a dummy variable indicating whether the issue is marketed to U.S. investors;
- a dummy variable for companies that are to be listed on a U.S. exchange;
- a dummy variable for privatizations; and
- a set of country, year, and industry dummy variables.

Like Dunbar (2000), we include both the level and the natural log of gross proceeds (in million U.S. dollars) to allow for nonlinearities in the relation between spread and size. We also control separately for privatizations. Jones et al. (1999) speculate that governments deliberately underprice privatization offerings (by more than do private issuers) which has the effect of reducing syndicates' underwriting risk and thus, potentially, underwriting fees.

The regression results are reported in Table 7 [standard errors, adjusted for heteroscedasticity using White's (1980) correction, are reported beneath the coefficients]. Regression R1 is estimated over the sample as a whole and thus assumes that U.S. and non-U.S. banks have the same cost (or at least pricing) functions.¹⁴ The regression exhibits considerable explanatory

¹⁴ We estimated (but do not report) separate cost functions for U.S. and non-U.S. bank-led offerings. We found evidence of greater economies of scale in spreads charged by U.S. banks, largely because U.S. banks tend to underwrite the larger offerings in our sample. All other inferences reported in this section were unaffected.

Table 7
The determinants of the gross spread

	Dependent variable: gross spread (%)			
	Whole sample			Bookbuildings, not marketed in the U.S.
	R1: OLS	R2: Heckman	R3: OLS	R4: OLS
Constant	3.844*** <i>0.196</i>	3.401*** <i>0.841</i>	3.833*** <i>0.198</i>	5.551*** <i>0.340</i>
Proceeds (in US\$ m)	-0.0001*** <i>0.00004</i>	-0.0002*** <i>0.00004</i>	-0.0002*** <i>0.00004</i>	0.0005* <i>0.0002</i>
Log proceeds (in US\$ m)	-0.427*** <i>0.035</i>	-0.392*** <i>0.080</i>	-0.412*** <i>0.035</i>	-0.419*** <i>0.074</i>
Dummy: U.S. bank in senior position	0.620*** <i>0.100</i>	0.686*** <i>0.155</i>		0.475** <i>0.173</i>
Dummy: bookbuilding	1.325*** <i>0.126</i>	1.302*** <i>0.133</i>	1.297*** <i>0.128</i>	
Interaction: bookbuilding*U.S. bank			0.408*** <i>0.168</i>	
Dummy: marketed in the U.S.	0.364*** <i>0.098</i>	0.469*** <i>0.213</i>	0.361*** <i>0.115</i>	
Interaction: U.S. marketing*U.S. bank			0.147 <i>0.200</i>	
Dummy: listed in the U.S.	1.318*** <i>0.109</i>	1.395*** <i>0.170</i>	1.342*** <i>0.116</i>	
Dummy: privatization	-0.366** <i>0.121</i>	-0.378*** <i>0.122</i>	-0.361*** <i>0.122</i>	-0.144 <i>0.287</i>
Country dummies	✓	✓	✓	✓
Year dummies	✓	✓	✓	✓
Industry dummies	✓	✓	✓	✓
Adjusted R^2	64.4%	—	64.1%	30.1%
No. of observations	1,647	2,143	1,647	421
F -test: all coefficients = 0	76.0***	—	73.1***	14.3***
Wald test of indep. eqns. ($p = 0$)	—	0.26	—	—

The dependent variable is the gross spread, in percent. Proceeds are converted into U.S. dollars using exchange rates on the pricing date. See notes to Table 1 for the definition of the variables. All regressions except R2 are estimated using OLS. Regression R2 allows for nonrandom sample selection and possible resulting bias in the coefficients estimated in regression R1, by estimating R1 conditional on a selection probability model (Heckman 1979) using maximum likelihood. The selection probability model (results not shown) relates the probability of spread information being available for a particular sample IPO to its country of origin, year of issue, the size of the offering (level and log), and dummies for U.S. listings, marketing in the U.S., U.S. banks serving in senior positions, the use of bookbuilding, and privatizations. To ensure the model is identified, it also includes a dummy for offerings which are purely primary (raise new equity only). White (1980) heteroscedasticity-consistent standard errors are in italics under the coefficient estimates. Instead of using dummies for all the 65 countries and 44 industries in the sample, some of which have only a few IPOs, we use dummies only where we have at least 25 observations per country or industry. Most of the industry dummies are significant, perhaps indicating industry-specific differences in underwriting risk. For instance, IT IPOs face higher-than-average spreads, financial, construction and retailing companies lower ones. The year dummies after 1994 are negative and significant, indicating a downward time trend in gross spreads since the early 1990s. The country dummies for the United Kingdom, Singapore, and Malaysia are significant and negative. They are significant and positive for Germany, Sweden, Italy, Japan, Canada, and Israel.

***, **, * Significant at 0.1%, 1%, and 5% (two-sided for coefficient estimates), respectively.

power with an adjusted R^2 of 64.4%.¹⁵ The negative coefficients estimated for the level and log of proceeds are consistent with the presence of scale economies in IPO underwriting. Controlling for offer size, the marginal cost of engaging a U.S. bank in a senior capacity is about 62 basis points and

¹⁵ Most of the explanatory power comes from the four dummies for bookbuilt offers and for U.S. banks, listings, and marketing: a regression with just these four variables has an adjusted R^2 of 43.7%. In contrast, a regression with just proceeds and log proceeds has an adjusted R^2 of 1.7%.

is statistically significant ($p < 0.1\%$). Bookbuilding costs an estimated 133 basis points more than a fixed-price offering ($p < 0.1\%$). The U.S. marketing and U.S. listing coefficients are both positive and statistically significant ($p < 0.1\%$). Since all offerings listed in the United States are also marketed to U.S. investors, the two coefficients have to be interpreted jointly. Listing in the United States increases the spread by 132 basis points for the listing itself (perhaps reflecting banks' greater costs involved in due diligence and SEC registration) and another 36 basis points for marketing to U.S. investors. This implies that listing in the United States costs an additional 168 basis points on average, compared to listing domestically (or in another non-U.S. market). Offerings marketed to U.S. investors that are not listed in the United States are charged only the extra 36 basis points. These results are consistent with U.S. banks charging higher fees in part because they often lead-manage a different type of IPO—those that seek a U.S. stock market listing.

Spreads for privatization offerings are 37 basis points lower than for private-sector offerings ($p < 1\%$), consistent with Jones et al.'s claim. The industry dummy coefficients, not reported in the table, are generally statistically significant and have intuitive signs. IT-related IPOs have above-average spreads, while IPOs by banks, construction companies, or retailers have below-average spreads. This suggests industry-specific differences in underwriting risk or valuation uncertainty. There is also a negative time trend in gross spreads since the early 1990s, as evidenced by statistically significant negative coefficients for the year dummies after 1994. Coefficients estimated for the country dummies for "Anglo" capital markets (the United Kingdom, Singapore, and Malaysia) are significant and negative. In contrast, the coefficients are significant and positive for Germany, Sweden, Italy, Japan, Canada, and Israel.¹⁶

Recalling that we have spread information for only 1,647 of the 2,143 IPOs, we investigate the possibility that our results are spuriously driven by an unobserved but nonrandom selection criterion. To test (and if necessary correct) for selection bias, we estimate a maximum-likelihood version of a Heckman (1979) selection model of regression R1, where the spread is observed if $\gamma\mathbf{Z} + \varepsilon > 0$. $\mathbf{Z}$ is a matrix of variables which determines whether the spread is observed, γ is a vector of coefficients to be estimated, and $\varepsilon \sim N(0,1)$ will be correlated with the error of regression R1 if selection is nonrandom. We use all right-hand side variables from regression R1 to form $\mathbf{Z}$. To ensure the model is identified, we also include a dummy equaling one where the IPO consists purely of primary (new) shares. The results, reported in column R2, indicate that selection appears to be random: we cannot reject the null hypothesis that the spread regression R1 and the selection

¹⁶ Exclusion of the industry, year, and country controls (not reported) suggests that the regression fit is not spurious. Although adjusted R^2 declines to 54.2%, the remaining coefficient estimates are quite stable (although the estimate of the marginal cost of bookbuilding rises to 227 basis points). Specifically, cross-sectional variation in gross spreads still shows evidence of scale economies in underwriting, and the premia for marketing to U.S. investors, listing in the United States, and engaging a U.S. bank in a senior capacity remain highly significant.

equation are uncorrelated. As a consequence, the selection-adjusted coefficient estimates are not significantly different from the simple coefficients of regression R1.

Regression R1 showed that U.S. banks charge an average premium of 62 basis points compared to syndicates led by non-U.S. banks. To see what drives this premium, regression R3 replaces the dummy for IPOs led by U.S. banks in regression R1 with two interaction terms. The first equals one if a U.S. bank markets an IPO to U.S. investors, the second equals one if a U.S. bank conducts a bookbuilding. These interaction terms provide estimates of the premium over non-U.S. banks that U.S. banks charge for marketing in the United States and for bookbuilding. The interaction coefficients show that the average U.S. bank premium of 62 basis points is not driven by a U.S. marketing effect: U.S. banks charge only an insignificant 15 basis points more than non-U.S. banks when marketing in the United States. But U.S. banks charge a statistically significant premium of 41 basis points for bookbuilding.¹⁷

Regression R3 controls for scale economies and cost differences associated with marketing and listing in the United States. It therefore qualifies our earlier finding in Table 6 that U.S. banks appear not to charge more than non-U.S. banks when not marketing to U.S. investors. Specifically, the apparent discount arising from U.S. banks charging average spreads of 3.83% compared to the non-U.S. banks' 4.24% (see Table 6) becomes a 41 basis point premium when controlling for differences in offer size. We confirm this by running a simple version of regression R1 restricted to the subsample of bookbuildings not marketed in the United States (this corresponds to the comparison of means in the last block of Table 6). The estimate for the U.S. bank dummy in regression R4 indicates that U.S. banks charge 48 basis points more than non-U.S. banks, even when the U.S. banks do not provide access to U.S. capital markets or U.S. investors. This raises the question of why companies *choose* to hire more expensive U.S. banks in what are effectively domestic offerings. A possible answer is that U.S. banks possess superior valuation technology or certification ability [Titman and Trueman (1986)], in which case their degree of underpricing should be lower in domestic deals.

3. The Indirect Cost of Underpricing

The gross spread evidence suggests that despite the ready availability of lower-cost alternatives, some non-U.S. issuers willingly bear the higher cost of engaging a U.S. bank. Presumably this reflects an expectation that U.S. banks deliver a higher-quality bundle of services. In this section we examine

¹⁷ The two estimates sum only to $41 + 15 = 56$ basis points, short of the 62 basis points premium U.S. banks charge on average. The discrepancy arises because regression R3 does not separately control for the (rare) fixed-price offerings in which U.S. banks are involved or for the 52 auction-IPOs.

one quality dimension of this bundle, the pricing of the offering. A widely cited benefit of bookbuilding is that it allows the offer price to be conditioned on information about market demand conditions, and hence should result in more accurate pricing. So we begin by comparing the underpricing of bookbuilt and fixed-price offers.

Average underpricing for the 773 fixed-price issues is 19.1%, but this masks significant variation across the various geographical regions.¹⁸ Average underpricing is 16.1% in Europe (standard deviation 38%), 24.3% in Asia-Pacific (standard deviation 62%), and 29.9% in Africa and the Middle East (standard deviation 84%). The average underpricing among the 1,318 bookbuilding efforts of 21.2% is actually higher than that of fixed-price offers, though not significantly so.¹⁹ Again, there are large geographical differences. European bookbuilding efforts—with average underpricing of 21.4% (standard deviation 49%)—are in fact significantly more underpriced on average than fixed-price offers. A similar picture emerges in the Asian markets, where bookbuilt IPOs are underpriced by 30.9% (standard deviation 78%) on average (which is not significantly greater than the 24.3% mean for fixed-price offerings). On the other hand, African/Middle Eastern bookbuildings are less underpriced than fixed-price offerings in the region, with underpricing averaging only 9.9% (standard deviation 21%).

3.1 A multivariate underpricing model

Univariate comparisons of average underpricing fail to control for issuer choices regarding its bank and syndicate structure, the marketing method and target market, and the myriad other factors that might influence the initial price run-up. For example, Hanley (1993) provides empirical support for Benveniste and Spindt's (1989) prediction that underpricing will be greater for deals drawing strong interest from institutional investors during the bookbuilding effort. Jones et al. (1999) show that privatization IPOs are considerably more underpriced than private-sector IPOs, perhaps reflecting political motives. The existing literature also suggests that underpricing run-ups are directly related to uncertainty regarding the issuing firm's prospects. Following Hanley, we proxy for offerings drawing strong (weak) interest by computing the price revision between the midpoint of the initial price range and the offer price. We also distinguish between pure bookbuilding efforts and those which involve a public offer tranche after the issue has been priced (sequential hybrids). The latter are expected to be more underpriced, *ceteris paribus*, due to the delay between pricing and trading and the possibility of cascades.

¹⁸ Average underpricing for the 52 auction IPOs is 9.3%. This is not statistically different from the average underpricing experienced in bookbuilding or fixed-price offerings.

¹⁹ If weighted by gross proceeds, underpricing averages 13.2% in fixed-price and 10.4% in bookbuilt offerings.

The size and breadth of our database, coupled with the relatively weak reporting standards maintained in many sample countries, limit our ability to control for other influences as fully as we might like. However, if ex ante valuation uncertainty is similar within industries, industry effects provide some control for cross-sectional variation in ex ante uncertainty. Country dummies can serve a similar function by controlling for differences in “IPO microstructure” or the degree of informational asymmetries among different groups of IPO investors.²⁰ Finally, year dummies can control for the well-known, but largely unexplained, time variation in underpricing. Thus we estimate a multivariate regression of the following form:²¹

$$\begin{aligned} \text{UNDERPRICING} = & \beta_0 + \beta_1 \text{D_Bookbuilding} + \beta_2 \text{D_USbank} \\ & + \beta_3 \text{D_MarketUS} + \beta_4 \text{D_privatization} \\ & + \beta_5 \text{price revision} + \beta_6 \text{hybrid} \\ & + \text{country/industry/year controls} + \varepsilon. \end{aligned} \quad (1)$$

The first column of Table 8 shows the results of a least-squares estimation of Model 1. Relative to previous attempts to explain cross-sectional variation in initial returns, the adjusted R^2 of 10.5% for the regression indicates a good fit, in particular in view of the substantial heterogeneity across countries (a Wald test indicates that the country dummies are jointly significant at $p < 0.1\%$, and these alone account for about half the overall R^2). Bookbuilding alone does not lead to significantly less underpricing, nor are hybrid bookbuilding efforts more underpriced than pure ones. However, the negative coefficients estimated for the other two choice dummies indicate that underpricing is reduced by 5.4 percentage points when engaging a U.S. bank ($p = 2.3\%$) and 13.3 percentage points after marketing to U.S. investors ($p < 0.1\%$).

Consistent with Hanley’s (1993) findings, underpricing is more pronounced among firms subject to substantial positive price revisions in the aftermath of the bank’s marketing effort. Privatizations are discounted an additional 13.7 percentage points ($p < 1\%$). The joint significance (Wald test: $p < 1\%$) of the industry effects (not shown) indicates that the dummies help filter the effects of variation in ex ante uncertainty. For example, construction companies are significantly less underpriced than average, whereas media and publishing, IT, and telecommunications companies are significantly more

²⁰ Chowdhry and Sherman (1996) predict that fixed-price offerings may be more underpriced than bookbuilding efforts in countries where issuers are allowed to earn interest on the subscription funds and so may deliberately lower the offer price to generate greater oversubscription. We do not have data on oversubscription ratios and so cannot control for this possible effect. As a crude robustness check, we estimated our models with a dummy for IPOs in which issuers were allowed to earn interest, but found no effect.

²¹ We do not include a dummy for listings in the United States because it was not associated with lower underpricing in the simple ordinary least squares (OLS) regression. This changes when the choice to list in the United States is treated as endogenous. However, U.S. listings and U.S. marketing result in similar reductions in underpricing, so to avoid clutter we do not distinguish between them.

Table 8
OLS and two-stage least squares underpricing regressions

	Whole sample				Bookbuildings		Domestic		
	Model 1 OLS	Model 2 OLS	Model 3 Multinomial logit 2SLS		Model 4 OLS	Model 5 Bivariate probit 2SLS	Model 6 Treatments		
Stage 1:			Multinomial logit			Bivariate probit	MLE		
			Bookbuilding and U.S. . . .			U.S. bank	Marketed		
			1. bank ×	2. bank ✓	3. bank ×	4. bank ✓	in senior	to U.S.	
			investors ×	investors ×	investors ✓	investors ✓	position?	investors?	
Constant			−1.584*** <i>0.458</i>	−5.991*** <i>0.928</i>	−7.079*** <i>0.924</i>	−6.273*** <i>0.602</i>	−2.399*** <i>0.329</i>	−2.559*** <i>0.288</i>	−3.665*** <i>0.526</i>
Proceeds (in US\$ m)			−0.003** <i>0.001</i>	−0.0008* <i>0.0004</i>	−0.006*** <i>0.002</i>	−0.0006*** <i>0.0001</i>	0.0009* <i>0.0004</i>	−0.0001† <i>0.00006</i>	0.0009 <i>0.0006</i>
Log proceeds (in US\$ m)			0.758*** <i>0.099</i>	1.448*** <i>0.165</i>	1.925*** <i>0.207</i>	1.838*** <i>0.106</i>	0.542*** <i>0.063</i>	0.618*** <i>0.047</i>	0.519*** <i>0.115</i>
Dummy: privatization			0.200 <i>0.312</i>	−0.300 <i>0.478</i>	−0.271 <i>0.368</i>	−1.244*** <i>0.304</i>	−0.461** <i>0.153</i>	−0.410** <i>0.146</i>	0.331 <i>0.347</i>
Country/year/industry dummies			✓	✓	✓	✓	✓	✓	✓
			Pseudo- R^2 : 44.5% LR test (χ^2): 2,569.9***			Bivariate? (χ^2): 168.0*** $\rho = 78.4\%^{***}$	Independent? $\rho = 21.1\%$		
Stage 2:			OLS with IV			OLS with IV	MLE		
Constant	0.323*** <i>0.059</i>	0.312*** <i>0.059</i>	0.434*** <i>0.088</i>		0.290*** <i>0.072</i>	0.397*** <i>0.099</i>	0.461*** <i>0.126</i>		
Dummy: bookbuilding (all)	0.042 <i>0.042</i>								
Dummy: hybrid bookbuilding	−0.027 <i>0.032</i>							−0.082 <i>0.055</i>	
Dummy: U.S. bank (senior)	−0.054* <i>0.024</i>							−0.338** <i>0.114</i>	
Dummy: marketed to U.S. investors	−0.133*** <i>0.029</i>								

Interaction terms: Bookbuilding and U.S. ...						
1. ... bank ×, investors ×		0.052	−0.063			
		<i>0.036</i>	<i>0.103</i>			
2. ... bank ✓, investors ×		−0.089 [†]	−0.312	−0.137**	−0.016	
		<i>0.047</i>	<i>0.256</i>	<i>0.050</i>	<i>0.292</i>	
3. ... bank ×, investors ✓		−0.139***	−0.434**	−0.189***	−0.503*	
		<i>0.034</i>	<i>0.168</i>	<i>0.041</i>	<i>0.247</i>	
4. ... bank ✓, investors ✓		−0.149***	−0.343***	−0.197***	−0.416***	
		<i>0.029</i>	<i>0.067</i>	<i>0.036</i>	<i>0.093</i>	
Interaction term: hybrid bookbuilding × 4.		0.063*	0.128***	0.065*	0.118***	
		<i>0.029</i>	<i>0.040</i>	<i>0.029</i>	<i>0.037</i>	
Dummy: privatization	0.137**	0.123**	0.139**	0.064	0.066	0.061
	<i>0.045</i>	<i>0.044</i>	<i>0.046</i>	<i>0.048</i>	<i>0.049</i>	<i>0.095</i>
Price revision	0.551*	0.533*	0.584*	0.516*	0.572*	1.546***
	<i>0.251</i>	<i>0.249</i>	<i>0.282</i>	<i>0.252</i>	<i>0.281</i>	<i>0.412</i>
Country/year/industry dummies	✓	✓	✓	✓	✓	✓
Adjusted R ²	10.5%	10.4%	10.7%	11.7%	11.7%	—
No. of observations	2,143	2,143	2,143	1,318	1,318	687

The dependent variable in all OLS regressions and in the second stages of the 2SLS regressions is underpricing, the percentage return from the (institutional) offer price to the trading price one week after the IPO. Price revision is the percentage change between the midpoint of the initial price range and the offer price. Hybrids refer to bookbuilt offerings in which a public offer follows the pricing of the bookbuilding exercise. White (1980) heteroscedasticity-consistent standard errors are reported in italics under the coefficient estimates. Model 1 estimates an OLS regression of underpricing on the full set of explanatory variables. Model 2 replaces the dummies for bookbuilding, choice of U.S. bank, and marketing to U.S. investors in Model 1 with four interaction terms equal to one if a bookbuilding involves, 1. neither a U.S. bank nor U.S. investors, 2. a U.S. bank but no U.S. investors, 3. U.S. investors but no U.S. bank, and 4. both a U.S. bank and U.S. investors. The regression constant captures fixed-price (and auction) offerings. Model 3 allows for the possible endogeneity of the choice between fixed-price offerings and the four alternatives 1–4 in Model 2 using a two-stage methodology to obtain consistent estimates. Stage 1 estimates a multinomial logit of the probability of a firm choosing any of alternatives 1–4 rather than a fixed-price offering. The explanatory variables are the level and natural log of gross proceeds (in million US\$), a dummy equal to one for privatizations, and a full set of country, year and industry dummies. Stage 2 uses the predicted probabilities from stage 1 as instrumental variables for alternatives 1–4 in a least-squares regression with underpricing as the dependent variable. Model 4 reestimates Model 2 for the subsample of bookbuildings. Model 5 again allows for the endogeneity of the choice variables using two-stage estimates. Stage 1 estimates a bivariate probit which allows for the interdependence of a firm's choice of hiring a U.S. bank and having its IPO marketed to U.S. investors. Stage 2 uses the predicted probabilities from stage 1 as instrumental variables for alternatives 2–4 in an OLS regression with underpricing as the dependent variable. Model 6 is a full maximum-likelihood treatment effects model (Maddala [1983, pp. 117–122]), estimated over the subsample of bookbuildings which are not marketed in the U.S.

***, **, *, [†] Significant at 0.1%, 1%, 5%, or 10% (two-sided), respectively.

underpriced than average. The year dummies also account for a statistically significant fraction of the cross-sectional variation in underpricing ($p < 0.1\%$).

Model 1 treats the choice variables separately and thus ignores the fact that issuers can choose among different combinations of bookbuilding, U.S. bank involvement, and marketing to U.S. investors. In Model 2 we use four interaction terms and the regression constant to allow issuers to choose among five alternative IPO strategies:

- | | | | |
|------------------------|---|---|----|
| bookbuilding involving | { | 1. neither a U.S. bank nor U.S. investors | or |
| | | 2. a U.S. bank but no U.S. investors | |
| | | 3. U.S. investors but no U.S. bank | |
| | | 4. both a U.S. bank and U.S. investors | |
5. a fixed-price offering (captured via the constant).²²

Whether a hybrid bookbuilding offer is sequential or simultaneous is largely not a matter of choice, but regulation. We thus treat the dummy for sequential hybrids as exogenous. Since we are interested in whether these hybrids reduce the efficiency of price discovery compared to other bookbuilding efforts, we need to interact the hybrid dummy with the four bookbuilding effects captured via strategies 1–4 above. Doing so, we find that only the interaction term involving strategy 4 is ever significant. We therefore report results using that interaction term only.

The least-squares results for Model 2, reported in column 2 of Table 8, help explain why the bookbuilding dummy in Model 1 was insignificant. Bookbuilding efforts are associated with lower underpricing than fixed-price offerings, but only if they include either a U.S. bank ($p = 5.9\%$), U.S. investors ($p < 0.1\%$), or both ($p < 0.1\%$). The effects are large, ranging from reductions of 8.9 percentage points when using a U.S. bank to 14.9 percentage points when marketing to U.S. investors (these effects are not significantly different from each other). Bookbuilding efforts which involve neither a U.S. bank nor market to U.S. investors do not significantly reduce underpricing relative to fixed-price offerings. The positive interaction term of 0.063 ($p = 3.1\%$) suggests that sequential hybrids reduce the beneficial effect that marketing to U.S. investors with a U.S. bank has on underpricing. Specifically, while sequential hybrids experience underpricing reductions of 8.6 percentage points when hiring a U.S. bank and marketing to U.S. investors ($= -0.149 + 0.063$, significant at $p = 1.6\%$), other bookbuilt offers experience underpricing reductions of 14.9 percentage points. As predicted, this suggests that the sequential nature of these hybrids interferes with the efficiency of price discovery.

²² As noted earlier, fixed-price offers rarely employ a U.S. bank and are equally rarely marketed in the United States. Hence they can be thought of as a “plain vanilla” benchmark against which the other IPO strategies can be judged. For the purpose of generating the interaction terms, we treat the 52 auctions as though they were fixed-price offerings. Including auctions among bookbuilt IPOs instead or controlling for them separately does not change our results.

3.2 Controlling for endogeneity

Both Model 1 and Model 2 are estimated on the implicit assumption that the three choice variables are exogenous. However, this is unlikely to be the case. Habib and Ljungqvist (2001) model issuers' IPO design choices assuming they aim to maximize net IPO proceeds. Using U.S. data they show that issuers spend more on promoting their IPOs when the marginal benefit of lower underpricing is large. Moreover, they document that failing to account for the endogeneity of promotion choices and underpricing leads to spurious empirical results (such as the spurious finding that higher-quality banks appear to underprice *more* during the 1990s). In our context, OLS estimates for the coefficients of endogenous choice dummies are likely to be inconsistent. If serious, bias will lead to understatement of the effect on underpricing of bookbuilding, choice of U.S. bank, and marketing to U.S. investors. The threat of understatement arises because companies that otherwise would be heavily discounted have the most to gain from taking costly actions to reduce underpricing, all else being equal.

To derive consistent estimates of the effect of the choice variables we employ two-stage least-squares in Model 3. In the first stage we estimate a multinomial logit of the probability of a firm choosing one of our four alternatives over a fixed-price offering. The second stage uses the predicted probabilities from the first stage to instrument the endogenous choice variables. Following Habib and Ljungqvist (2001), we assume in the first stage that issuers aim to minimize underpricing subject to the constraint that doing so is costly. For instance, say U.S. banks are better at pricing IPOs but also charge more for their services. Then we expect only those issuers to hire U.S. banks for whom the reduction in underpricing outweighs the increase in fees. The same applies to the choice whether to market to U.S. investors. The marginal benefit of these choices depends on the size of the offering: hiring a more expensive U.S. bank makes most sense in larger issues where underpricing translates into larger reductions in issuers' wealth. Issuers who float little equity have less to gain from more accurate pricing and should thus be less inclined to spend much when going public; issuers who float a lot stand to gain much more. Therefore a key determinant of the IPO choices we investigate is offer size.²³ We capture this by including the level and natural log of gross proceeds (in million US\$) in the first-stage multinomial logit. We also separately control for privatizations, given that political or domestic considerations may cause their objective function to differ from that of private-sector issuers. Finally, we include a full set of country, year, and industry dummies.²⁴

²³ Clearly offer size is not exogenous in the strict sense, as it is itself determined by factors such as financing constraints and the desire to diversify the portfolios of the existing owners. However, in the context of the models we construct, it can reasonably be regarded as exogenous with respect to underpricing. For U.S. evidence in favor of treating it as exogenous, see Habib and Ljungqvist (2001).

²⁴ Country dummies help control for local conditions, in particular where regulations limit firms' choices regarding how an IPO is conducted. Time dummies help control for the evolution of choice over time. For instance,

The multinomial logit estimates are reported in the upper half of Table 8. The pseudo- R^2 of 44.5% and the significant likelihood-ratio test indicate considerable explanatory power. The coefficients for the log of gross proceeds are consistently positive, indicating that larger issuers are less likely to use fixed-price offerings. The negative coefficients for the level of proceeds are consistent with diminishing returns. Comparing the size coefficients across the four bookbuilding choices, we find that as issues become larger, they are incrementally more likely to add a U.S. bank or marketing to U.S. investors to their bookbuilding effort. Indeed, compared to domestic bookbuildings with domestic banks, the coefficients on offer size are significantly larger when either U.S. banks or U.S. investors, or both, are involved. The insignificant privatization dummy indicates that privatizations are as likely to involve fixed-price as bookbuilding efforts if U.S. banks and investors are not included. They are, however, significantly less likely to use bookbuilding involving both U.S. banks and U.S. investors ($p < 1\%$) after controlling for size. The industry dummies (not reported) show that companies in the IT, media, electronics, and drug industries are significantly more likely to be bookbuilt and are incrementally more likely to employ a U.S. bank in a senior syndicate role and/or market to U.S. investors. The reverse is true for hotels and leisure and real estate companies. This is consistent with the hypothesis that more risky companies, or those whose value is more difficult to determine, tend to choose more expensive marketing techniques.

The second stage of Model 3 uses the predicted probabilities from the first stage as instrumental variables for alternatives 1–4 in a least-squares regression with underpricing as the dependent variable. Comparison of the least-squares estimates in Model 2 and the 2SLS estimates in Model 3 suggests significant bias introduced by the failure to treat issuers' choices as endogenous. Compared to Model 2, the coefficients on bookbuilding efforts involving U.S. banks or U.S. investors, or both, become larger in magnitude, significantly so when involving U.S. investors. The estimates indicate that bookbuilding efforts led by U.S. banks but not marketed in the United States still reduce underpricing, but the standard error quintuples, causing significance to be lost. This combination of choices is relatively rare in our data. The reduction in underpricing from marketing to U.S. investors in the absence of a U.S. bank triples. However, bearing in mind that this is another low-probability choice, the economic magnitude of the effect is more moderate: an increase in the likelihood of this choice from the 1st quartile to the 3rd quartile reduces underpricing from 22.6% to 19.6%, holding all other covariates at their sample means. Finally, using a U.S. bank to market the

in the early years of our sample, hiring a U.S. bank was not always possible in every country. Industry dummies help control for valuation uncertainty if uncertainty over the "true" value of companies differs systematically across industries. The option value of employing "superior" issue methods, which should result in lower underpricing, would clearly increase in uncertainty. For instance, biotech companies have more to gain from information production.

offering to U.S. investors continues to reduce underpricing significantly compared to a fixed-price offering. The reduction in underpricing ranges from 21.5 percentage points for sequential hybrids ($= -0.343 + 0.128$, significant at $p < 1\%$) to 34.3 percentage points ($p < 0.1\%$) for the other bookbuilding efforts. Bookbuilding without U.S. banks or U.S. investors still exerts little influence on underpricing.

3.3 Underpricing in bookbuilding efforts

In this section we concentrate on companies that choose to conduct a bookbuilding effort and model the effect on underpricing of their remaining two choices: whether to hire a U.S. bank and/or market to U.S. investors. Model 4 reestimates Model 2 in the subsample of bookbuildings, including the interaction terms for choices 2–4 above; choice 1, bookbuildings without U.S. banks and investors, is captured in the regression constant. Model 4 is estimated using OLS and thus makes no attempt to endogenize the choice variables. As in Model 2, the interaction terms are negative and significant, indicating that issuers can reduce underpricing in bookbuildings by hiring a U.S. bank, marketing to U.S. investors, or both. The effect of these three choices is similar in magnitude so it appears not to matter which combination issuers choose. However, the fact that U.S. banks can reduce underpricing even when they do not market to their U.S. investors suggests that U.S. banks may be better at bookbuilding per se than “local” banks which have adopted the practice.

As before, the binary variables—if endogenous—will be inconsistently estimated by OLS. To correct for this, we use probit two-stage least squares [see Maddala (1983, p. 240)]. The first stage involves a bivariate probit model of the choices of whether to hire a U.S. bank and whether to market to U.S. investors. We model these choices as functions of offer size, a dummy for privatizations, and a set of country, industry, and year dummies. The second-stage underpricing regressions use the predicted probabilities from the first stage as instruments for the observed choices. We use a bivariate probit in the first stage rather than a multinomial logit, because the former can explicitly allow for the interdependence between the choice variables by capturing the fact that issuers are more likely to be marketed to U.S. investors if they have hired a U.S. bank.²⁵

The results of estimating Model 5 are reported in the penultimate column of Table 8. The hypothesis that the two choice variables in the first stage are interrelated cannot be rejected (as indicated by the significant chi-square test), which confirms the need to model them jointly. An estimate of the extent of interrelatedness is provided by ρ , the correlation coefficient of the joint distribution of the underlying latent variables generating the two binary choice

²⁵ This advantage implies that it would be desirable to replace the multinomial first stage of Model 3 with a multivariate probit to allow for the interdependence of the three choice variables. Unfortunately multivariate probits have extremely nonlinear likelihood functions, and we failed to achieve convergence.

variables. The likelihood ratio test shows that our 78.4% estimate for ρ is significant at the 0.1% level. The determinants of the choices in the first stage mirror the findings in Model 3. Larger issuers are significantly more likely to hire U.S. banks and be marketed to U.S. investors, while privatizations are less likely to do so.

Using the predicted (joint) probabilities from the first stage to instrument the interaction variables in the second stage, we find one main difference between Models 4 and 5: the negative effect on underpricing of U.S. bank backing when the IPO is not marketed to U.S. investors ceases to be significant when we allow for the endogeneity and interdependence of the two choices. Otherwise the results are similar, though the magnitude of the individual effects are larger when we account for endogeneity, as was also the case in Model 3, which uses the entire sample. The effect of employing a U.S. bank and marketing to U.S. investors doubles in Model 5 compared to the simple least-squares estimate in Model 4. This choice now reduces underpricing by 30 percentage points for sequential hybrids and 42 percentage points for other bookbuilding efforts compared to bookbuilding efforts led by a non-U.S. bank and not involving U.S. investors. These effects may seem large, but they are in line with a univariate comparison of average underpricing. Bookbuilt IPOs involving neither U.S. investors nor U.S. banks are underpriced by 32.4% on average, against 11.5% for bookbuilt IPOs involving both U.S. investors and U.S. banks.

Finally, the spread regression R4 in Table 7 shows that U.S. banks charge a 48 basis point premium when they do not provide access to U.S. capital markets or U.S. investors. Do they deliver a corresponding reduction in underpricing? Model 6 in Table 8 estimates a maximum-likelihood “treatment effects” model [Maddala (1983, pp. 117–122)] in the bookbuilding subsample of deals not marketed in the United States. The maximum likelihood estimation simultaneously estimates the determinants of the probability of hiring a U.S. bank and the effect on initial returns of choosing a U.S. bank.²⁶ The estimated effect is large. Choosing a U.S. bank to lead-manage a “domestic” offering reduces underpricing by close to 34 percentage points ($p < 1\%$).²⁷ This suggests U.S. banks can reduce underpricing not only by virtue of their privileged access to U.S. investors, but also for some other reason: perhaps they possess superior valuation technology or can more easily certify the issue’s quality.

3.4 The role of U.S. investors

Our empirical results suggest that marketing to U.S. investors can substantially reduce underpricing. Within the framework of Benveniste and

²⁶ This is the maximum-likelihood version of the Heckman two-step estimator.

²⁷ Controlling for endogeneity makes a large difference here: the OLS estimate of the effect of U.S. bank backing is “only” 13.3 percentage points ($p = 2.5\%$). The test statistic for $\rho = 0$ clearly indicates that the selection equation and the underpricing regression are not independent.

Spindt's (1989) model of bookbuilding, this implies that U.S. investors are better at evaluating IPOs than are domestic investors. Of course, the U.S. investors that are targeted in international IPOs are very likely to be institutions rather than retail investors, so an alternative hypothesis is possible: what if our U.S. marketing effect is really an institutional investor effect? In that case, underpricing should decrease the more is sold to institutions generally, irrespective of the institutions' geographic location. While we do not have data on institutional allocations, we know if an IPO was marketed outside its home country. If marketing to institutions is the driving force, foreign marketing should be just as effective as marketing in the United States. However, when we replace the U.S. marketing dummy with a foreign marketing dummy in the Table 8 regressions, it is never significant. Moreover, the U.S. bank effect becomes larger in magnitude (more negative), indicating that omitting U.S. marketing forces the effect of U.S. marketing into the U.S. bank variable. Similarly, when we include both a U.S. and a foreign marketing dummy (the former being a subset of the latter), it is only the U.S. dummy that is ever significant. These results suggest that investors located in London, Zurich, and other non-U.S. financial centers are not a perfect substitute for U.S. investors in reducing underpricing.

To further support our argument that issuers stand to benefit from involving U.S. investors, we relate underpricing to the percentage of the offer that is placed in the United States. For 1,600 of the 2,143 IPOs, we know whether shares were placed in the United States, and if so how many. Since this is a choice variable, we estimate a 2SLS model with offer size (level and log) as instruments. The results (not reported) show that increasing U.S. allocations by 1% reduces underpricing by 2.4% ($p < 0.1\%$), which strongly suggests that U.S. investors play a special role in evaluating international IPOs.

Our findings suggest that benefits to primary market integration are primarily associated with access to U.S. institutional investors. On the one hand, this is surprising given the highly developed state of many non-U.S. financial centers. On the other, even the more sophisticated capital markets outside the U.S. have only recently begun to develop the institutional infrastructure for early stage equity investment and the relationships that link key intermediaries in the venture capital and private equity markets to the primary and secondary markets. For example, as recently as 1998 only 10.2% of the €14.5 billion private equity investment in Europe funded startups. More than 80% of private equity investment continued the tradition of funding buyouts and business expansions [*The Economist*, January 15, 2000]. If non-U.S. markets continue their convergence toward the U.S. model in both the private and public equity markets, we might expect the relative importance of U.S. investors to diminish.

3.5 The total cost of IPOs

Our regression results suggest that issuers can reduce underpricing substantially by choosing among different IPO strategies. The marginal benefit of

combining bookbuilding with U.S. banks and U.S. investors appears considerable, but we know from Section 2 that such IPO strategies lead to higher costs too. The magnitude of the effects estimated in our underpricing regressions suggests that the net benefit is almost certainly positive, but the estimated coefficients are not directly comparable. In this section we ask whether issuing firms would have been better off choosing a different IPO strategy in terms of the trade-off between underpricing and gross spreads.

To answer this question we borrow the econometric intuition behind Lee's (1978) two-stage switching model.²⁸ Specifically we

- use the second-stage coefficient estimates from Model 3 in Table 8 to predict what underpricing would have been had issuers chosen differently (note that the 2SLS estimates of Model 3 are adjusted for self-selection; our predictions would otherwise be biased);
- calculate the implied change in the offer price and gross proceeds;
- use the coefficient estimates from regression R1 in Table 7 to predict the spread the switching firms would have paid, taking into account their new choices as well as changes in offer size given changes in offer prices; and
- calculate the change in net proceeds (after underwriting costs) associated with the alternative choice.

Switching regressions usually model the choice between two alternatives. In our case, we have many more. To keep things simple we continue to concentrate on the five alternatives analyzed in our underpricing regressions (see p. 90). We investigate two illustrative switches. The first supposes that all bookbuilding efforts continue to be bookbuilding efforts but that any firm employing a U.S. bank switches to using a local bank and that any firm being marketed in the United States chooses not to involve U.S. investors. This leaves two types of offerings: fixed-price IPOs and bookbuilt offerings without the participation of U.S. banks or U.S. investors. The consequence of this switch would be to increase the underpricing of the 702 switching firms from 11.4% on average to 32.7%, which in turn would reduce median gross proceeds substantially, by 14.7%.²⁹ On the fee side, dropping U.S. banks and U.S. investors would reduce the average spread among the switchers from 4.73% to 3.11%. The change in net proceeds would have made 73% of the switchers worse off, with the median switcher suffering a reduction in net proceeds of US\$11.7 million. On balance, therefore, the great majority of switchers would have been ill-advised to conduct a "domestic" bookbuilding instead.

²⁸ Applications in finance include Smith (1987) on the choice between competitive and negotiated underwriting and Madhavan and Cheng (1997) on the choice in block trades between upstairs and downstairs markets.

²⁹ The change in gross proceeds is calculated as implied over actual gross proceeds, minus one. The implied gross proceeds is the number of shares actually sold times the implied offer price given the switch. The implied offer price is calculated as the aftermarket price (assumed unaffected) divided by one plus the predicted underpricing given the switch.

The second switch supposes that any bookbuilding effort not already led by a U.S. bank hires a U.S. bank. This would reduce average underpricing among the 744 companies concerned from 28.5% to 7.7%, leading to a median rise in gross proceeds of 7.8%. The average spread would increase from 4.15% to 4.69%, reflecting the premium U.S. banks charge. The change in net proceeds would have made 62% of the switchers better off, with the median switcher enjoying an increase in net proceeds of US\$2 million had it hired a U.S. bank. Half of the companies that could have benefited from hiring a U.S. bank according to our estimates are in Germany, France, the United Kingdom, Italy, and Belgium—countries where U.S. banks have not won much market share.

The results of the second switching model indicate that a substantial number of issuers could have reduced the amount of money “left on the table,” net of underwriting fees, by hiring U.S. banks whose greater experience and better investor networks generate keener offer prices.

4. Conclusion

We set out to consider the consequences of global integration on primary equity markets and the role played by U.S. banks and U.S. investors. One question that we address is whether the worldwide introduction of bookbuilding methods during the 1990s has promoted efficiency in the primary equity markets. If we define efficiency from the perspective of the issuing firm, the answer appears to be a qualified “yes.” Compared to fixed-price offerings, bookbuilding efforts—though more expensive—produce far less underpricing, but only in combination with U.S. banks and U.S. investors. Of interest is that it seems sufficient to merely market—not list—in the United States. Primary market integration appears important relative to structural and integration considerations at the secondary market level. U.S. banks clearly benefit from their access to U.S. investors, but we also find evidence that U.S. banks deliver reductions in underpricing, even in bookbuilding efforts that are not marketed to U.S. investors. For the moment, at least, U.S. banks appear to retain some advantage in the bookbuilding technology they brought to non-U.S. markets during the last decade or so.

We leave for future research what this advantage may be. Curiously we observe that non-U.S. banks almost never set the final offer price outside the indicative price range established prior to a bookbuilding effort, and instead price at the upper bound in almost half their offerings. U.S. banks, on the other hand, are many times more likely to price outside the range.³⁰ If bookbuilding is an exercise in information production for the purpose of establishing an offer price that more nearly reflects market demand conditions,

³⁰ It is not the case that U.S. banks simply set narrower price ranges than non-U.S. banks and are therefore more likely to have to price outside the range. Nor do we find support for the hypothesis that U.S. banks just “happened” to lead-manage offerings which turned out to be “hot.”

any constraint on the offer price might be expected to diminish its efficiency. Since we can find few obvious regulatory reasons³¹ for the difference in behavior of U.S. and non-U.S. banks, we leave for future research why it is so pronounced, what impact it may have, and whether continued market integration will diminish it in the future.

Our conclusion that the diffusion of U.S. banking practices has been to the benefit of issuing firms should not be interpreted to suggest that we have no reservations regarding bookbuilding methods. Rather we contend that they represent perhaps one of many possible second-best responses to the informational frictions present in taking companies public in a world of relatively primitive information and communications technologies. As the marginal cost of communicating with virtually any interested party at one time and in one (virtual) place plummets, it may be possible to approximate the benefits of the bookbuilding approach with an electronic auction similar to that being promoted by W. R. Hambrecht and Co. In addition to reducing direct costs, a shift from the extraordinary discretion bookbuilding methods rely on to a rules-based system might also promote confidence in the integrity of the primary markets.

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³¹ Regulatory constraints certainly exist in the case of hybrid bookbuilding offers in some countries (e.g., Italy, Hong Kong, Hungary, Spain, and Turkey). In Finland and France, pricing above the range is costly, but not prohibited.

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