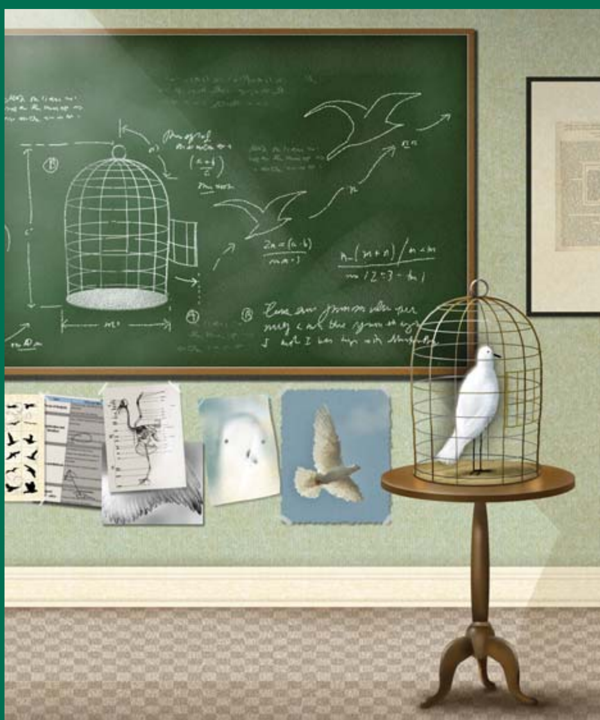
REPORT

No Time Like the Present to Plan an IPO

Prepared Companies Will Be First in the Queue When Markets Recover



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October 2011

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Introduction

One of the early casualties of the financial crisis that began in the autumn of 2007 was the global market for initial public offerings (IPOs). The number of companies making their debut on public stock markets plummeted in 2008, falling even below the depths plumbed during the dot-com bust in the early years of the decade. The average value of IPOs also fell sharply as confidence ebbed and stock prices fell.

The IPO market bottomed out in 2009, as did the global economy and stock markets around the world. Then, the number of IPOs more than doubled in 2010, a recovery that appeared to continue into the first half of 2011. But during the summer months, the continuing failure to resolve the sovereign debt crisis in Europe and growing fears about the strength of the global economic recovery interrupted the upward trend, casting gloom over the prospects for IPOs in the rest of 2011 and into 2012—and perhaps beyond. Companies that were ready to launch their IPOs and private-equity firms that were seeking exits from successful turnarounds were forced to put their plans on hold. Casualties include the flotations of Osram, the lamps and lighting systems manufacturer, by Siemens and of Evonik, the German chemicals maker.

Yet, although the market environment turned hostile to IPOs once again and remains so in the autumn of 2011, now is the time when ambitious companies should be planning their stock market listings. As this report will demonstrate, many months of careful preparations are required to launch a successful IPO. Companies that invest in those preparations during adverse market periods will be first in the queue when prospects improve.

Based on a comprehensive survey of more than 1,000 European IPOs, this report will help companies navigate their way through complex decisions about where and when to make their stock market debut, how much equity to issue, and how to price the offer. It looks at how nearly half the companies in the survey have subsequently returned to the stock markets at least once through a secondary public offering (SPO). And an appendix examines the pros and cons of IPOs and secondary listings on Asian stock exchanges by companies from outside the region.

The report also sets out the extensive preparations needed to ensure that IPOs succeed and that companies perform strongly once they are listed on a stock market. The experience of 2011 has shown that favorable windows of opportunity may not remain open long enough for companies to wait until markets recover to prepare for a listing. While IPOs may have to wait until the gloom hanging over the markets lifts, this is not a time to hunker down.

European IPOs Over the Last Decade

Traces of a Shy and Volatile Creature

The European IPO market is dominated by three large stock exchange groups: the London Stock Exchange, Euronext, and Deutsche Börse. They operate exchanges in seven European countries, which hosted more than 1,500 IPOs between January 2002 and May 2011.

This report draws on the experience of the 1,062 of those IPOs that met two criteria:

- Their shares were still actively traded during the two years after they listed or, for IPOs completed during the last two years, since they were listed.
- Complete and consistent data are available on their stock price performance.

The London Stock Exchange had by far the largest share of the market over the relevant period, with 644 companies raising approximately €77 billion through IPOs. The markets owned by the group, which include the AIM market for growth companies and the Borsa Italiano in Milan, accounted for more than half the number and value of IPOs launched on the markets of the three stock exchange groups during the period we reviewed.

Second was Euronext, part of the NYSE Euronext Group, which operates European stock markets in Paris, Amsterdam, Brussels, and Lisbon. Over the period January 2002 through May 2011, 308 IPOs were launched on its exchanges in Europe by companies that raised approximately €33 billion.

Finally, Deutsche Börse, based in Frankfurt, hosted 110 IPOs worth approximately €20 billion.

The largest IPO by value in the three stock exchange groups over this period was that of Glencore, the Swiss commodity trader that raised just over £6 billion in a dual listing on the London and Hong Kong stock exchanges in May 2011. The average value of an IPO on the exchanges operated by the three European groups between January 2002 and May 2011 was €122 million.

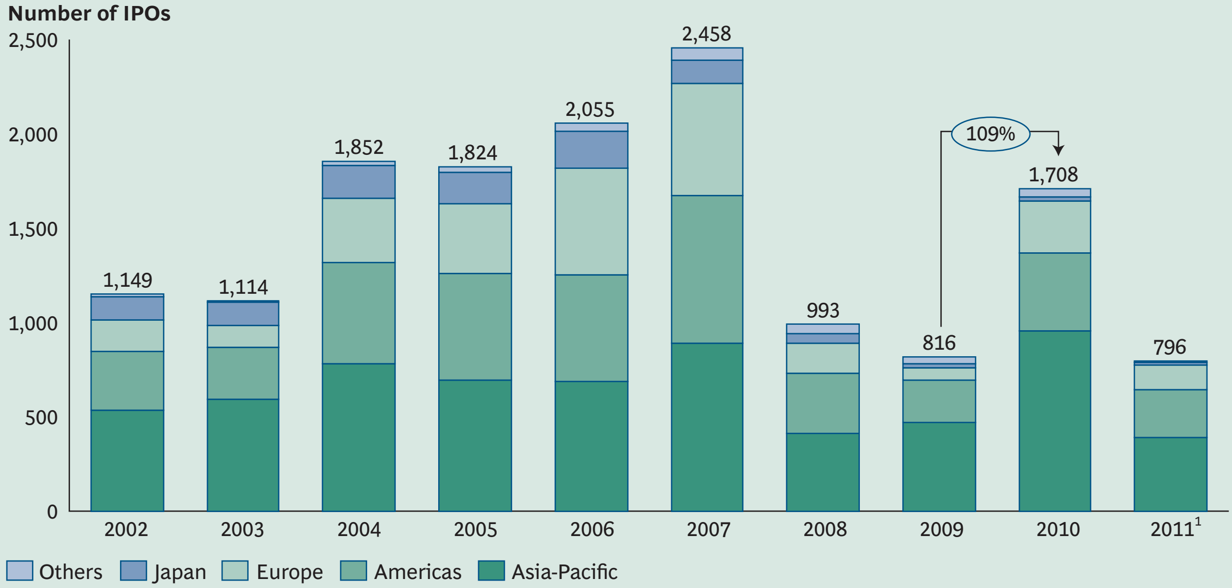
The IPO Market Is Highly Cyclical

As noted above, activity in the global IPO market has been highly cyclical over the past decade. (See Exhibit 1.) The number of IPOs around the world peaked at 2,458 in 2007 shortly before the financial crisis and fell to less than a third of that total two years later as the global economy plunged into a recession. IPO numbers recovered strongly in 2010 to 1,708 but activity fell sharply in mid-2011 amid gloom over the weakness of the global economy and renewed market turbulence caused by the European debt crisis.

IPO activity on the exchanges operated by the three dominant European groups followed a similar pattern. (See Exhibit 2.) Numbers and values, which had risen steadily after the dot-com bust at the start of the millennium, peaked during the boom years of 2006 and 2007 with 283 IPOs in each of those two years. The total value of IPOs each year also increased, from €2.7 billion in 2002 to more than €35 billion in 2007. Activity then declined sharply to 36 IPOs worth €2.2 billion in 2009 at the depth of the subsequent crisis, before beginning a tentative revival in 2010, when 74 IPOs raised €9.1 billion.

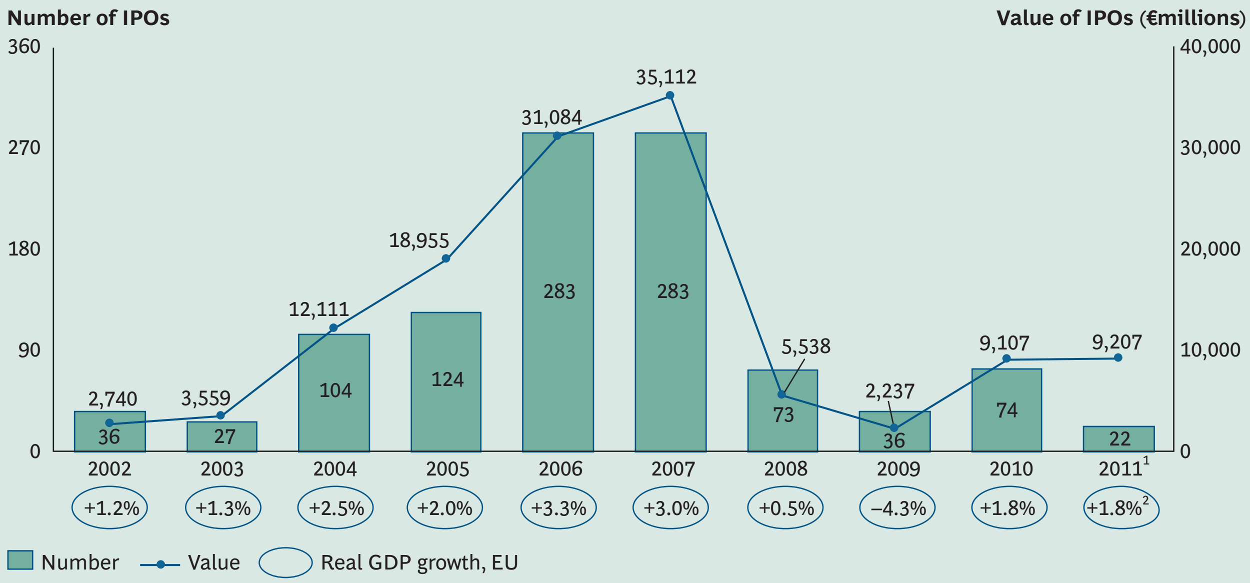
But just as the recovery appeared to be gathering pace, market turmoil again intervened. Many companies that

Exhibit 1. The Recovery in the Global IPO Market Faltered in 2011



Sources: Thomson ONE Banker; BCG analysis.
[1]As of end of May 2011.

Exhibit 2. The Number and Value of European IPOs Tracked the Economic Cycle



Sources: Thomson ONE Banker; Eurostat; BCG analysis.
Note: Our analysis includes IPOs on exchanges owned by the London Stock Exchange, Euronext, and Deutsche Börse only, excluding those where there was no subsequent active trading or where data were insufficient. Constant exchange rate €/$ = 0.691 as of July 5, 2011.
[1]As of end of May 2011.
[2]Forecast.

had begun their IPO preparations in late 2010 and early 2011 were forced to shelve their plans when fears over the global economy grew and Europe's sovereign debt crisis deepened. It was a graphic illustration of the volatility of the IPO market and its impact on even well-advanced plans for stock market listings.

Timing Is All-Important

As Exhibits 1 and 2 show, companies prefer to launch their IPOs during periods of economic strength and financial-market stability. This is not surprising: a company that schedules an IPO during a financial crisis is effectively launching its ship into a severe storm. So, low volatility was a feature of the two IPO booms on the markets of the three dominant European stock-exchange groups in recent years. (See Exhibit 3.) A second characteristic of IPO surges on the European markets was that company valuations were above average at the time.

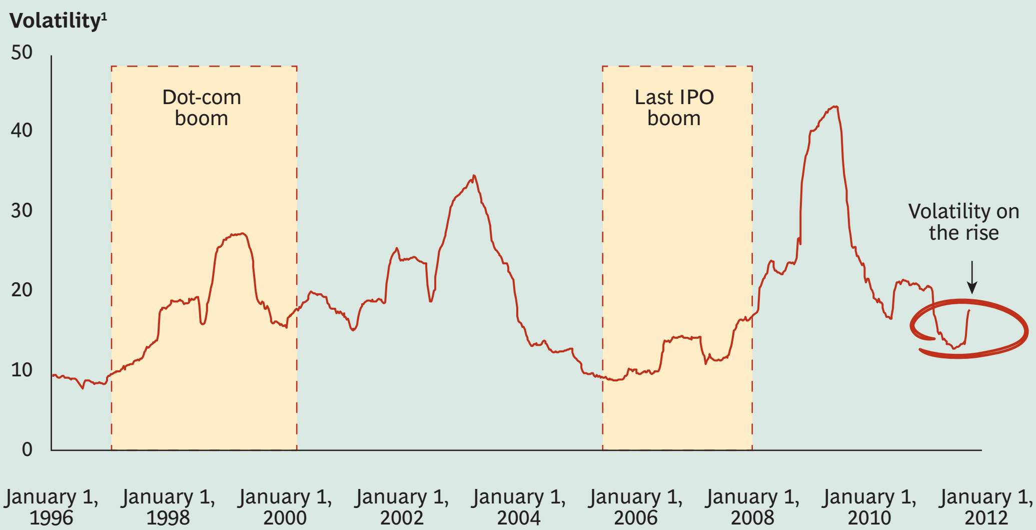
The preference for periods that combine low volatility and high valuations is also hardly surprising: companies want to make their stock market debut at times when they believe they can achieve the highest possible price with the least risk in terms of market turbulence. (For a look at another pattern in timing preference, see the sidebar "The Best Months for an IPO.")

Periods that combine low volatility and high valuations are preferred.

On occasion, though, companies choose to launch their IPOs at less auspicious times. Resolution, a U.K. company focused on restructuring within the insurance industry, raised £660 million through a listing on the London Stock Exchange in December 2008. This was just a few months after the bankruptcy of Lehman Brothers, a time when the number of IPOs had plummeted. But the company could not wait for better conditions to raise capital if it was to take advantage of the availability of distressed financial-services assets. In this case, the timing was good for Resolution's specific situation even though the overall conditions were not ideal for most companies.

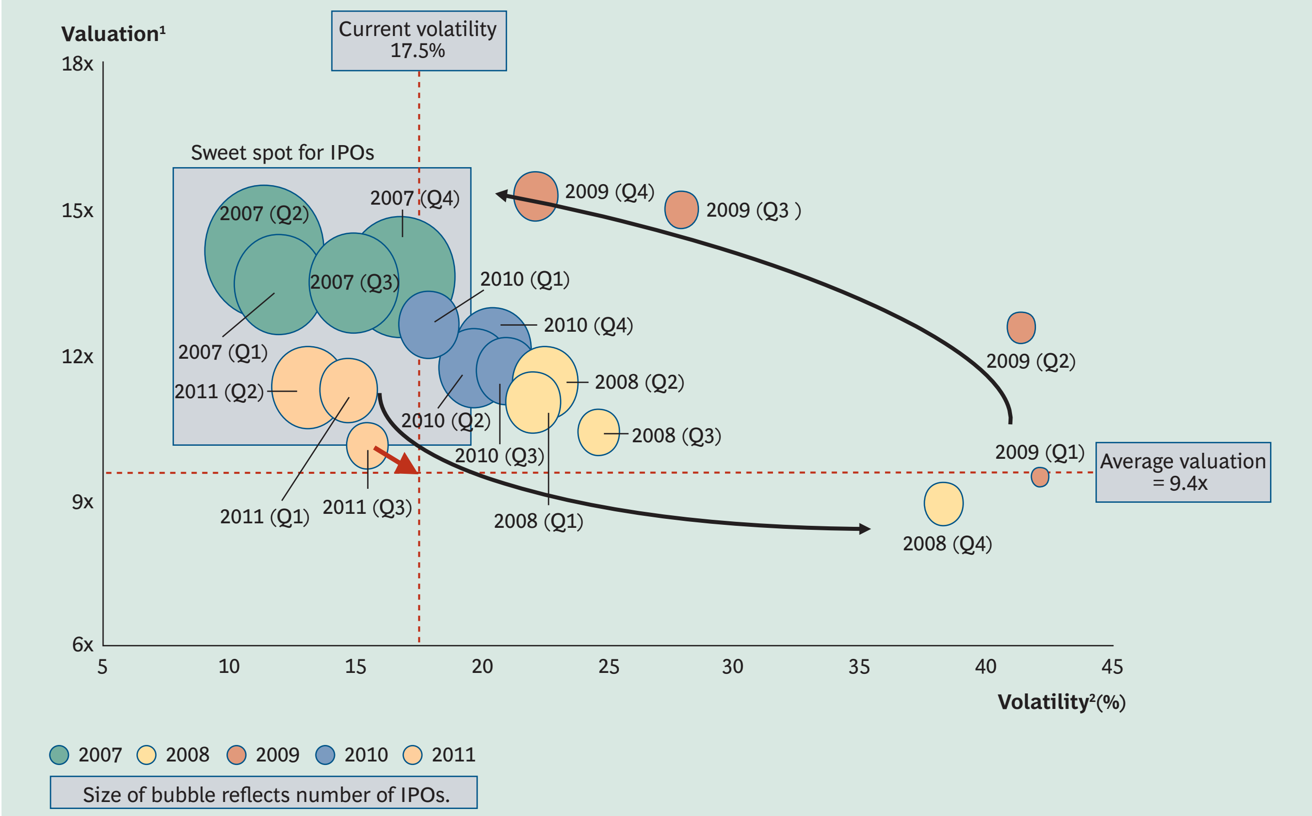
More typically, companies that can choose the timing of their IPOs try to do so when valuations are high and volatility is low. (See Exhibit 4.) The four quarters of 2007, before the financial crisis deepened, were one

Exhibit 3. IPOs Require Stable Markets—Low Volatility Is Important



Sources: Bloomberg; Thomson ONE Banker; BCG analysis.
[1]Average 180 days historical volatility for the Stoxx Euro Index.

Exhibit 4. The European IPO Market Slipped Out of the "Sweet Spot" in the Third Quarter of 2011



Sources: Bloomberg; Thomson ONE Banker; BCG analysis.
Note: Data as of August 24, 2011.
[1]Average forward price-earnings multiple for the Stoxx Euro Index.
[2]Average 180 days historical volatility for the Stoxx Euro Index.

such "sweet spot" when IPO activity boomed. IPO numbers and values collapsed in 2008 and 2009 as valuations fell and volatility increased, and only began to recover in 2010 as markets stabilized.

The first few months of 2011 were well inside the most recent sweet spot, and IPOs continued to be announced. Ahead of Glencore's well-timed offering in May, two large Russian companies launched IPOs in London: HMS Hydraulic Machines & Systems raised $360 million in February, and Etalon, a real estate developer, raised $575 million in April. On Deutsche Börse, engineering group Norma raised €336 million in April, swiftly followed by GSW Immobilien, a German real estate group, which raised €468 million.

The markets slipped out of the sweet spot in the third quarter of 2011.

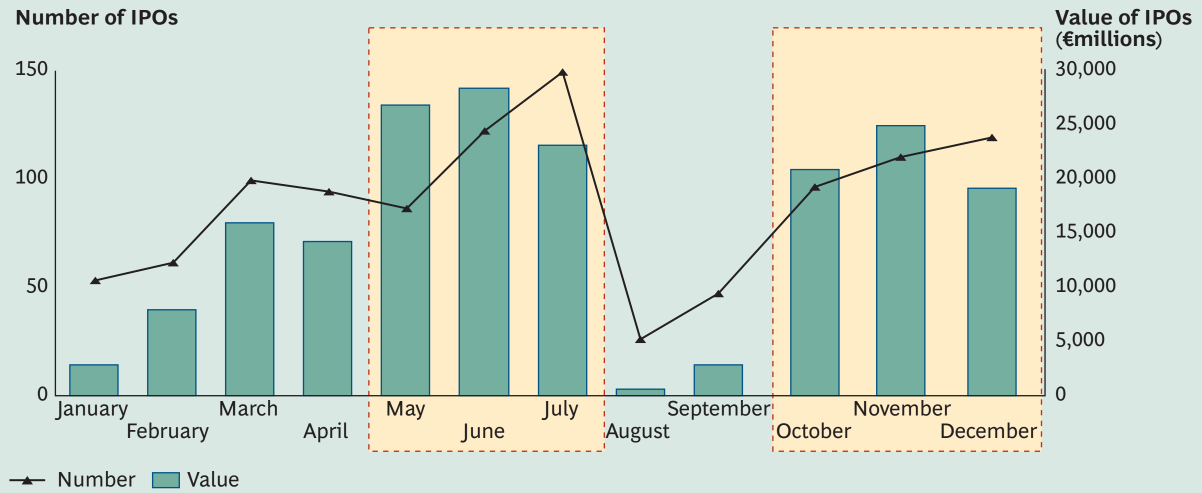
But with renewed turmoil in the markets during the summer, volatility rose and valuations fell, an inauspicious combination that forced companies to cancel their planned IPOs. As Exhibit 4 illustrates, IPO numbers dropped sharply in the third quarter of 2011 as the markets slipped out of the sweet spot.

For companies that are preparing for a listing, the lesson is that the highly desirable sweet spots may suddenly disappear—together with the shy and retiring creature that is the IPO. Preparation during periods when IPOs are in hiding is therefore essential so that they can re-emerge ready for action as soon as the markets recover and enter a new sweet spot.

The Best Months for an IPO

While IPO activity always fluctuates with the economic and financial cycle, another significant timing pattern has been evident since January 2002. European companies are most likely to launch their IPOs between May and July, with October to December being the next most favored months. (See the exhibit below.) Numbers and volumes of IPOs fall sharply during the summer break of August and September, when stock market trading is usually subdued and investors are typically on holiday. Companies are also less likely to launch IPOs in the quiet months of January and February, after the Christmas, New Year, and other winter holidays.

The Two Major IPO Windows Each Year: Before the Summer Break and in the Fall



Sources: Thomson ONE Banker; Thomson Reuters Datastream; BCG analysis.
Note: Constant exchange rate €/$ = 0.691 as of July 5, 2011.

Anatomy of a Successful IPO or SPO

The two key variables in launching a successful initial public offering of stock are the proportion of equity issued and the price. In this chapter, we analyze the experiences of European companies with IPOs between January 2002 and May 2011 to see how they dealt with these issues. We also examine these companies' performance in the two years (where possible) after their IPOs and how those companies that undertook further issues managed their secondary public offerings.

Sellers Stay Committed

Whatever the temptation to stage a "hit and run" job when launching an IPO, companies typically issue less than half their shares when making stock market debuts. On average, the companies listing on the stock exchanges operated by the three dominant European groups between January 2002 and May 2011 issued 35 percent of their equity.[1] Thus, the original investors remain as stable anchor investors, at least until any future secondary offering is made. (See "Going for Growth Through SPOs," below.)

Companies in some industries issued a higher-than-average proportion of their equity. At the top end on this measure was the financial services industry, where companies typically issued nearly half their shares (48 percent) in an IPO, followed by retailers (43 percent) and travel and leisure companies (41 percent). At the bottom end, banks and telecommunications companies issued just over a quarter of their shares on average (26 percent).

Approximately one-third of the companies launched their IPOs to allow investors to "cash out" by selling some or all of their stake, with little or no new capital being raised. For example, France Télécom raised €1.4 billion to invest in its Internet and wireless units by selling almost 37 percent of the shares of PagesJaunes, the French yellow-pages business, through an IPO on Euronext Paris in July 2004. The U.K. financial advisor Hargreaves Lansdown sold a quarter of its shares in an IPO on the London Stock Exchange in May 2007, raising a gross amount of £190 million for the two founders and other shareholders.

But just over two-thirds of the companies (68 percent) used their IPOs to raise capital, typically to repay debt or to invest in growth. Those that raised capital did so by issuing more than half of their equity (58 percent) in the IPO. Most of the proceeds were used to provide funds for the company (83 percent of the shares issued), while only a small proportion (17 percent) was sold to allow existing investors to cash out. (See Exhibit 5.)

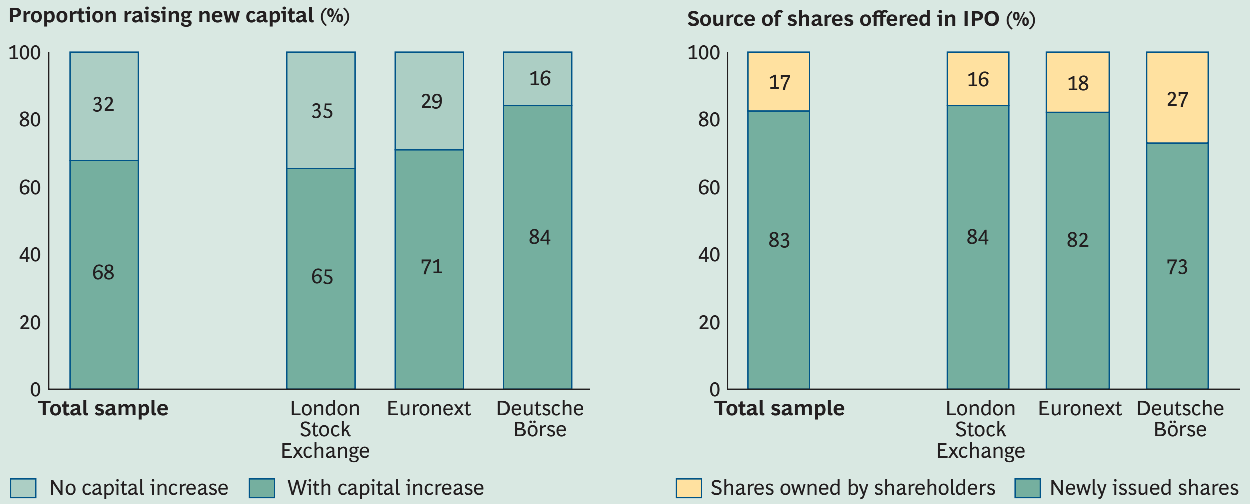
The substantial increase in share capital when an IPO was used in order to raise capital suggests that the companies involved made their stock market debut because they needed to raise financing for significant investment opportunities.

Pricing to Attract Investors

Pricing an IPO is always a complex issue. The objective is to set an offer price that is low enough to attract buyers but high enough to maximize the value of the IPO to the company in the long run.

1. Shares offered in the IPO as a percentage of the number of shares outstanding after the listing.

Exhibit 5. Two-Thirds of IPOs Raised New Capital—Providing an Exit Option for Shareholders Was Secondary



Sources: Thomson ONE Banker; BCG analysis.
Note: Numbers show the increase in the number of shares as a percentage of the shares outstanding after the listing. Data on shares outstanding before/after IPOs that raise new capital are not available for the whole sample (n=223).

Investors see risks in buying shares offered in IPOs, so they are more likely to buy them if they expect the stock price to rise after listing. The company issuing the shares will also prefer to see the price rise at least modestly above the offer price—a falling price could reflect badly on the company and make it harder to raise further capital with a later secondary offering. However, if the price is set too low, the share price could leap after the IPO, giving the buyers a very large profit. In the latter case, the company might feel it has sold its shares too cheap—and if it was raising capital through the IPO, it could have raised more if it had not underpriced the shares more than was necessary to attract buyers.

Underpricing is therefore a necessity, but choosing the right price to make the IPO a success without giving away too much is often difficult. For example, several academic studies have found that companies in U.S. IPOs have seen jumps in their stock price on the first trading day averaging about 20 percent in recent decades—and much more during stock market bubbles.[2] In the dot-com boom of the late 1990s, investors were so desperate to buy shares in "new economy" technology companies that Netscape's stock price more than doubled on the first day of trading, for example. Recently, the share price of LinkedIn, the U.S. business-focused social-networking group, rose 109 percent on the first day of trading after its IPO, in May 2011, fueling concerns about a new tech bubble.

The process of marketing an IPO is intended to find the optimal level of underpricing. The company will typically propose an offer price at a discount of between 5 percent and 15 percent of the fair-market trading value. The lower end of the price range is chosen to engage the attention of investors and the higher end to maximize the valuation of the company. The final offer price will normally be fixed between these two points, depending on investor interest, developments in the company's business, and market conditions during the book-building period. The overall aim is to create a solid base of investors committed to the company over the long term, with steady and reasonable price increases after the IPO to maintain their confidence.

For the European IPOs analyzed for this report, first-day gains on IPO stocks between January 2002 and May

2. Jay R. Ritter and Ivo Welch, "A Review of IPO Activity, Pricing, and Allocations," *The Journal of Finance,* 57(4), 2002; Alexander Höllbacher, "Das Underpricing-Phänomen und die Sekundärmarktperformance von Initial Public Offerings (IPOs) am deutschen Kapitalmarkt—Eine empirische Studie für den Zeitraum, 1983–2009," *Corporate Finance,* 3, 2011.

2011 were much lower than U.S. levels. Underpricing of European IPOs averaged 8.3 percent over that period, which was in line with discount levels found in other studies of European IPOs over longer periods.[3] It was greatest on the London Stock Exchange markets, where stock prices jumped by an average of 10.5 percent on the first day of trading after an IPO. This compared with 4.9 percent on the Euronext exchanges and 5.2 percent on Deutsche Börse. (See Exhibit 6.)

Underpricing is usually greater when the IPO market is booming.

The degree of underpricing is usually greater when the IPO market is booming; such times tend to attract IPOs by new or less conventional companies that investors find more difficult to value. First-day gains averaged a low of 4.6 percent in 2002 after the dot-com bubble burst and climbed to a peak of 11.5 percent in 2005 as the stock markets recovered, before falling to 4.2 percent in 2009 at the depth of the economic crisis. Underpricing climbed slightly to 4.8 percent in 2010 when markets picked up again, but fell back to a very low 1.7 percent in the first half of 2011 as the sovereign debt crisis worsened and fears about the global recovery began to emerge.

Finally, levels of underpricing are greater in some industries than others. Hot sectors in Europe have included telecommunications, where stock prices have risen on average by almost 33 percent on the first day of trading after an IPO. Again, these fast-moving and innovation-driven companies can be hard to value but attractive to investors—often leading to big gains for those who buy stock at the offer price.

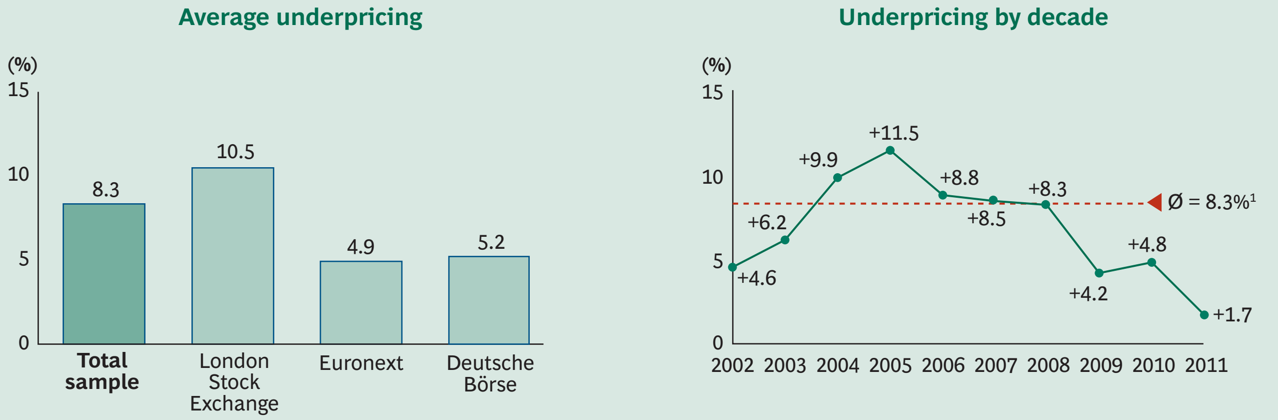
Building In Long-Term Success

Even if stock prices rise on the first day of trading after an IPO, that is not the end of the story. Companies whose stock falls in price over the following days and weeks are often rated as underperformers. If the stock falls below the offer price in the period after the IPO, it can take many months to recover.

For companies that made their debut on markets operated by the three dominant European stock-exchange groups between January 2002 and May 2011, stock prices continued to rise on average over the months after the first day of trading. One year later, their stock prices were still 10 percent on average above the offer price; by the second anniversary, however, their price had

3. Höllbacher, "Das Underpricing-Phänomen."

Exhibit 6. Underpricing Rose When Markets Were Buoyant



Sources: Thomson ONE Banker; Thomson Reuters Datastream; BCG analysis.
Note: Underpricing is defined as the percentage difference between the first trading day and the first available stock price. First trading day as provided in Thomson ONE Banker IPO database; owing to some inconsistencies between first trading day and first available stock price, some corrections were applied to the data sample.
[1]Volume-related average.

dropped to 3.9 percent below the offer price. (See Exhibit 7.)

In fact, much of the early gains was due to underpricing. If the price at the close of the first day of trading is used as the base point, returns over the first year averaged only 2 percent. After two years, the stock price had on average fallen 11.4 percent below the price at the close of the first day.

Empirical studies in many parts of the world have shown that after their IPOs, companies underperform the market and similar seasoned companies over the longer term.[4] This phenomenon can also be seen in the stock performance of companies that launched IPOs on the European markets over the period reviewed for this report. One year after their debut, their stock prices had underperformed their sectors by 4.5 percent on average and their market's main index by 5.4 percent. After two years, they were lagging behind their sectors by 11.8 percent and their market by 14.6 percent.

In other words, European IPO stocks are no different from those elsewhere in underperforming their peers and their markets. One possible explanation for this underperformance is that successful IPOs encourage less well prepared companies to seek listings, reducing the average performance of IPO companies. Another is that the investors who buy the initial shares in an IPO are more optimistic than those buying later, who pay lower prices when investing in the company.

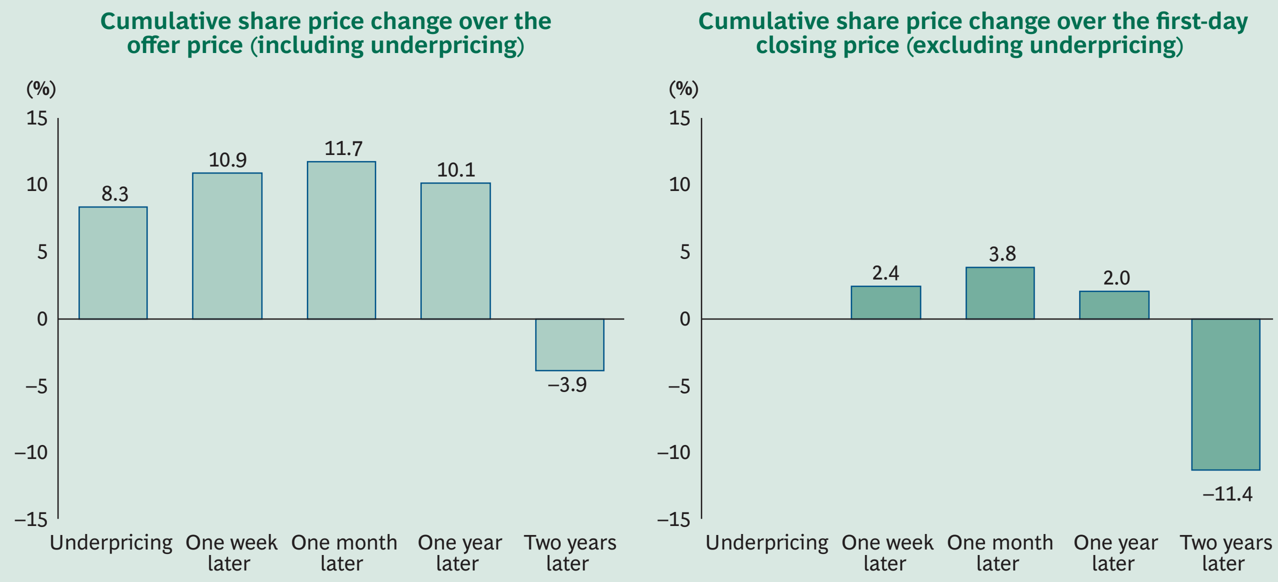
Overall, therefore, timing remains the key. Well-prepared companies that pick the optimal times to launch their IPOs can improve their medium-term performance prospects. They may also produce superior returns if they launch their IPOs ahead of the crowd: the early bird gets the worm—one other reason to be ready to fly when the window of opportunity for IPOs opens.

Going for Growth Through SPOs

One of the attractions of an IPO is that it can make it easier to raise equity capital in the years that follow through an SPO—especially if the company has proved to be a good investment. An SPO also offers another opportunity for the original owners of the company to cash out.

4. Ritter and Welch, "A Review of IPO Activity."

Exhibit 7. Share Performance After IPOs Was Strongly Driven by Initial Underpricing



Sources: Thomson ONE Banker; Thomson Reuters Datastream; BCG analysis.

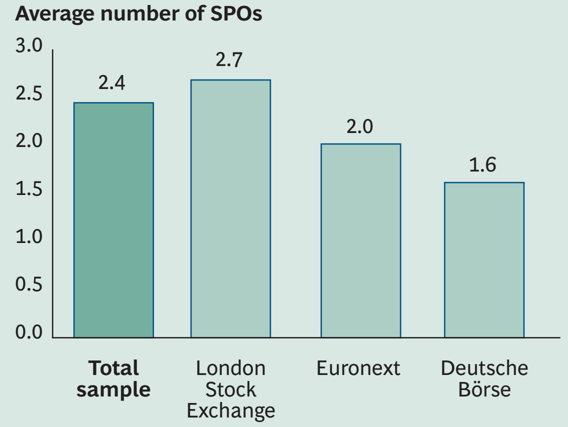
Almost half the companies (46 percent) that launched an IPO on the stock exchanges of the three European groups during our review period subsequently sold additional shares. In a small minority of the first SPOs after an IPO, this was simply because investors in the company wanted to cash out. But in 94 percent of the SPOs, the companies raised further capital.

Companies on average returned to the market for their first secondary offering approximately 18 months after the IPO at the London Stock Exchange and about 21 months after their IPO at Euronext and Deutsche Börse. They raised an average of €72 million by selling 23 percent of their equity through these SPOs. The largest SPO in the markets operated by the three European stock-exchange groups was the €3.7 billion raised in December 2007 by the French government through the sale of a 2.5 percent stake in EDF, the energy group, on Euronext Paris.

When companies launched their SPOs, the price of their stock was 7 percent above the IPO offer price on average. The average price of the stock issued through the first secondary offering was 3.9 percent below the closing price on the day before the SPO was launched—a lower average discount than at the IPO.

Finally, the first secondary offering often was not the last. The companies that launched IPOs in the markets of the three European stock-exchange groups between January 2002 and May 2011 returned to the market on almost two and a half occasions on average during that period. (See Exhibit 8.)

Exhibit 8. Companies Returned to the Market 2.4 Times After Their IPOs Within the Last Ten Years



Sources: Thomson ONE Banker; Thomson Reuters Datastream; BCG IPO Research Center.

Planning for the Recovery

As this report demonstrates, companies planning an IPO must navigate their way through complex decisions about the timing, scale, and pricing of the offer. But empirical studies show that even companies that make these decisions carefully tend to underperform after their IPOs, relative to their competitors and their stock markets. However, companies planning an IPO can separate themselves from the pack by avoiding some of the pitfalls that produce these disappointing average results.

In particular, they can improve their post-IPO prospects by adopting strategies that will ensure that they prosper in the public company environment and by making careful preparations well ahead of the event. This is a lengthy process involving some fundamental changes to the organization that can comfortably be undertaken during periods when the markets are unfavorable to IPOs. The company's leading executives—particularly the chief financial officer—must also prepare for a significant expansion of their roles.

Learning to look at the business through a capital market lens should be the guiding principle in this process. (See Exhibit 9.) The three key elements that investors demand from publicly listed companies are a compelling story, convincing financial data, and an organization that has

Exhibit 9. The Key Elements of IPO Readiness

Topic	Detailed requirements	Complete?
A Strategy	Consistent and credible corporate strategy?	✓ / ✗
	Growing sales and profitability support the credibility of the strategy?	✓ / ✗
	Comparative competitive strengths clearly identified and reflected in business plan?	✓ / ✗
	Internationalization addressed in strategy?	✓ / ✗
	Competitive capital-market position attained versus peers?	✓ / ✗
B Financials	Ready to produce accurate and timely financial reports (for example, international accounting standards)?	✓ / ✗
	Budgeting, forecasting, and controlling capabilities in place?	✓ / ✗
	Balance sheet "cleaned up" and understandable to potential investors?	✓ / ✗
	Requisites for timely quarterly reporting, segment reporting?	✓ / ✗
	Consistent, like-for-like financials prepared (historic, forward-looking)?	✓ / ✗
C Organization and capabilities	Corporate communications and investor relations team in place?	✓ / ✗
	New organizational units and processes set up (for example, accounting)?	✓ / ✗
	IPO-relevant functions/operations adjusted?	✓ / ✗
	Stock options in compensation, governance codes acknowledged?	✓ / ✗
	Management aware of responsibilities (for example, special restrictions on communication, sale of stock)?	✓ / ✗

Source: BCG project experience.

prepared itself to meet the obligations of a listed public company.

A Compelling Story

Investors are looking for a clear strategy based on competitive advantage in the market, along with growing profitability that can be sustained through quantifiable targets for sales growth, convincing efficiency improvements, or both. They also value consistency—sudden changes in the story arouse suspicion. Elaborating a strategy takes time and requires a dialogue between the management, the board, and other relevant parties.

Investors are looking for a clear strategy based on competitive advantage.

Companies from some industries will be unfamiliar to the investing community, which will need to be convinced of an IPO's potential well ahead of investing. For example, the success of the partial privatization of Fraport, Germany's largest airport operator, through an IPO in 2001 depended on demonstrating that there would be no conflicts of interest between private investors and the remaining public-sector shareholders. And when Bayer spun off Lanxess through an IPO in 2005, potential investors had to be convinced of the global growth potential of the previously unpopular rubber-product sector. (A more detailed example is provided in the sidebar below.)

Companies planning IPOs need to demonstrate that they have made every effort to make their business model as resilient as possible—particularly at times of market turbulence such as the present. While it is impossible to eradicate risk or eliminate exposure to volatility, resilience means reducing the impact of both when they are not inherent elements of the business model.

Convincing Financial Data

The second key element in a successful IPO is a set of data that demonstrate the potential of the newly listed company. One component is consistent, like-for-like figures covering at least the three years running up to the IPO. Another is a cleaned-up balance sheet that investors can understand.

Providing a transparent view of the operating results for recent years can be particularly complicated with IPOs of businesses carved out of larger companies. There may be limited data for the carved-out business, particularly if there have been recent organizational changes to create it. Operating results can also be distorted by significant accountancy issues such as the allocation of purchase

Case Study: Turning a Midsize Business into a Growth Story

Norma Group is a global market leader in engineered joining technology (EJT) and serves global industries such as aviation, commercial and passenger vehicles, agriculture, irrigation, oil and gas, and infrastructure. Norma supplies fastening and conveyance systems for engine application areas such as emission control, cooling systems, air intake and induction, ancillary systems, and infrastructure as well as for nonengine contexts such as plumbing and drainage. The company's IPO, in April 2011—the biggest in Germany in a year—attracted considerable investor interest even though the company was a leader in a low-visibility, highly fragmented market.

Ahead of the IPO, BCG helped develop a sound equity story, carrying out the first global market study of EJT in order to demonstrate Norma Group's potential. It identified growing demand across eight major industries, with trends such as tighter emission standards giving Norma an enviable position as the largest supplier of mission-critical, high-tech but low-unit-value components. BCG also reviewed the company's strategy and business plan to ensure that both were robust and communicable to investors.

Despite the difficult market environment after the March 2011 earthquake in Japan, demand for Norma Group shares was high, especially from institutional investors. Positioned as a growth story in sectors requiring highly specialized products, Norma Group went public with an offer price that was in the middle of the book-building range in an IPO oversubscribed several times.

prices to the business, which is often the case for IPOs of companies owned by private-equity firms.

In such circumstances, it is vital to start demonstrating a track record well ahead of time. For the Lanxess IPO, Bayer used the preparatory period to build a solid record of improving performance, getting rid of nonperforming businesses and making progress toward clear short-term and long-term targets in the overall strategy.

An Organization Ready for the Stock Market

A publicly listed company needs to create business functions that are often unnecessary in private companies. These include units for financial reporting, investor relations, and corporate communications with the markets.

Managers must also be trained in the responsibilities of running a public company and motivated by appropriate incentives such as stock options. Organizing the alignment of management and shareholders is of critical importance and can take a long time.

Investors reward a transparent and robust organizational structure that features clear lines of responsibility and adequate performance measures. But transforming an organization is not an easy feat and needs to begin well ahead of an IPO. This is especially the case in IPOs of government enterprises that have previously not been operated as commercial organizations.

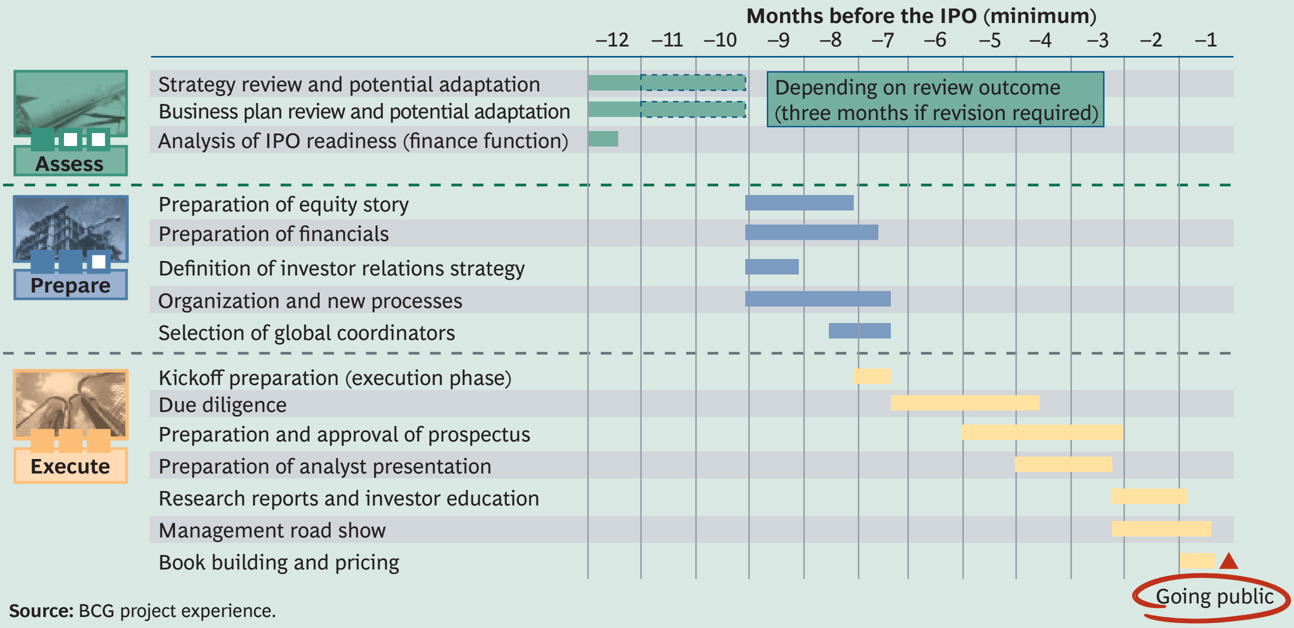
Be Ready to Fly

The timing of an IPO remains a critical issue for companies. The performance of newly launched stocks is significantly better if they are issued in quarters when shares are rising in the company's industry and in the overall market, when market volatility is low, and when valuations are attractive. The prospects for IPOs on these criteria turned negative in the third quarter of 2011, and the outlook for 2012 is also uncertain.

However, companies planning an IPO should not delay their preparations while they wait for an improving outlook. The volatility in markets over the last four years, particularly in the summer of 2011, has demonstrated that the windows of opportunity for IPOs can all too easily slam shut without warning. Companies that were still preparing for their public debut after the markets had picked up in 2010 were forced to postpone their plans when turmoil returned to the markets.

Preparations for an IPO typically take a minimum of between 9 and 12 months. (See Exhibit 10.) Ambitious companies planning an IPO should have done most—if not all—of the work by the time the market begins to recover. The success of an IPO may depend on being ready to seize the opportunities as soon as they materialize.

Exhibit 10. IPO Preparation Typically Takes At Least 9 to 12 Months



Source: BCG project experience.

Appendix

Is an IPO or a Secondary Listing in Asia Worth Considering?

Hong Kong became the world's largest IPO market by value in 2009 with public offerings that raised US$32 billion, and it held its lead in 2010 with offerings worth US$58 billion. (See Exhibit 1.) The Hong Kong Stock Exchange (HKEx) has been targeting foreign companies for IPOs and secondary listings since 2007, easing its secondary listing requirements in 2009 to attract some high-profile companies. Foreign companies can list on the Hong Kong exchange in one of two ways:

- *An IPO to Raise Fresh Capital.* This approach requires full observance of the HKEx listing and compliance rules. Glencore's London IPO, which occurred in May 2011, was accompanied by a Hong Kong IPO designed to raise 20 percent of its US$10 billion target. In June 2011, Samsonite, the luggage manufacturer, raised US$1.25 billion in an IPO in Hong Kong only, while Prada, the Italian fashion house, similarly raised US$2.1 billion in the same month.

- *A Secondary Listing (Also Known as a Cross-Listing) That Raises No Fresh Capital.* The introduction of existing shares to the HKEx avoids the need for public float procedures and imposes less onerous reporting obligations. Prudential, the U.K. insurance group, launched a secondary listing in Hong Kong in May 2010, followed by Brazilian mining giant Vale in December 2010 and Kazakhmys, the Kazakh copper miner, in July 2011.

The attractions of Hong Kong include access to investors in mainland China and other Asian countries; capital markets in this region have been more buoyant since the economic crisis than those in the West. Companies listing in Asia hope that the broader investor base increases liquidity and improves access to capital and that listing in a fast-growing market will raise credibility among investors generally and lead to a higher valuation.

Cross-listings have been used to achieve similar objectives for decades. New York, London, and Frankfurt were popular choices for secondary listings in the 1990s, and there was a short-lived surge in Tokyo during Japan's economic boom in the 1980s. However, many companies delisted in New York recently after finding that the costs and increasing regulation involved in secondary listings there did not produce the expected benefits. The number of secondary listings in Europe declined for similar reasons after the bursting of the dot-com bubble in 2000. (See Exhibit 2.)

Do Cross-Listings Improve Liquidity?

Studies of cross-listings by European companies on other European stock exchanges or in the U.S. have found that they initially increased trading activity, enhanced liquidity, and led to tighter bid-ask spreads.[1] In most cases, however, these gains quickly melted away when trading in the stocks flowed back to the exchanges in their home countries. The exceptions were export-led high-tech companies that retained higher foreign-trading volumes—they continued to benefit from improved liquidity.

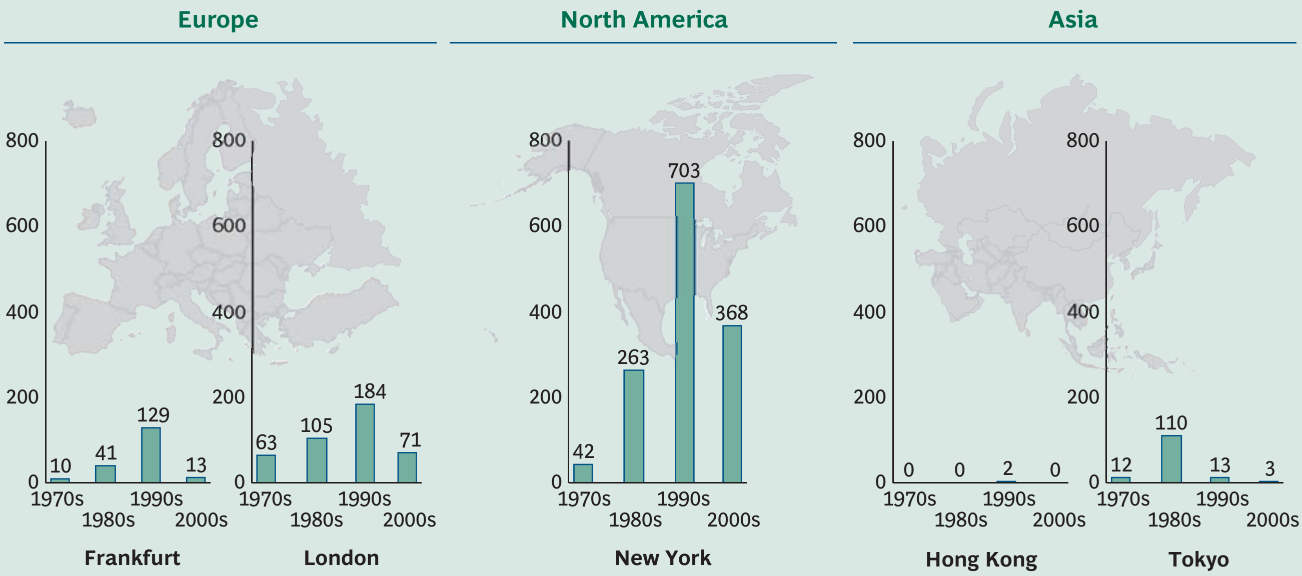
Typical of these diminishing returns was the experience of DaimlerChrysler, which started to cross-list on the New York Stock Exchange (NYSE) in 1998. Daimler delisted

1. G. Andrew Karolyi, "DaimlerChrysler AG, the First Truly Global Share," *Journal of Corporate Finance,* 9, 2003; Michael Halling, Marco Pagano, Otto Randl, and Josef Zechner, "Where Is the Market? Evidence from Cross-Listings in the United States," *Review of Financial Studies,* 21(2), 2008.

Exhibit 1. Hong Kong Became the Biggest IPO Market by Value in 2009 and 2010

Sources: PricewaterhouseCoopers IPO Watch 2010; BCG analysis.

Exhibit 2. Cross-Listings in Europe and North America Have Been Declining in Number



Source: BCG analysis.

from the NYSE in July 2010, having found that international investors primarily traded its shares in Germany and through electronic trading platforms. Deutsche Telekom, insurance giant Allianz, power group E.ON, and pharmaceutical group Bayer have all made similar decisions, citing diminishing liquidity and cost as the main factors.

By contrast, SAP is an example of an export-led, high-tech company that has maintained its NYSE listing. The German software group, a market leader in the U.S., has repeatedly said it has no intention of delisting in New York.

Companies that recently listed in Hong Kong have yet to experience increased liquidity. A mere 0.2 percent of Prudential's shares are traded on the HKEx, while less than 0.1 percent of global trading in Vale shares has been transacted in Hong Kong.

Do Cross-Listings Expand the Investor Base?

A 2006 study of Canadian companies cross-listed in the U.S. found that the practice led to increased investor recognition and raised the percentage of these companies' equity held by U.S. investors. Those companies that achieved this wider investor base enjoyed a permanent increase in their valuations.[2]

However, today's information systems allow institutional investors to collect extensive information on foreign companies at the click of a button. In addition, trading is now largely conducted via electronic platforms that allow for easy and cost-efficient transactions across markets, reducing the need for companies to list on an exchange close to investors in order to attract them. The experience of German companies such as Allianz, Bayer, and SAP was that while cross-listing on the NYSE initially attracted new U.S. shareholders, large U.S. investors primarily hold and trade the shares of all three companies on Xetra, Deutsche Börse's electronic trading platform.

Do Cross-Listings Improve Company Credibility or Company Valuations?

Empirical studies have found mixed evidence on the impact of cross-listings on company valuations.[3] If there is a premium, it is mainly restricted to companies that have secondary listings on exchanges that insist on higher standards of corporate governance than those in their home markets.

On this basis, there may be some premium for companies from less well regulated markets listing in New York, London, and Frankfurt—or even in Hong Kong, which is regarded as a well-regulated market. But there are unlikely to be similar benefits for companies already listed in a well-regulated market. And a cross-listing in a less prestigious market might destroy value.

Among foreign companies that recently cross-listed in Hong Kong, their shares experienced no discernible boost following the announcement that they were listing there. Indeed, the abnormal returns were negative on the day of the announcement of secondary listings for Vale, Prudential, and Kazakhmys.[4] The Prada and Samsonite listings in June 2011—seen by some observers as gimmicks or marketing ploys—were both judged to have failed to attract retail investors in Hong Kong, despite offer prices at the low end of guidance.

The attractions of Hong Kong have also weakened recently. The region's equity market underperformed its peers in the first half of 2011, amid concerns over the quality of accounting and auditing standards among mainland Chinese companies. In June 2011, the HKEx saw its first IPO cancellation, and another five were called off before the end of the month.

2. Michael R. King and Dan Segal, "The Long-Term Effects of Cross-Listing, Investor Recognition, and Ownership Structure on Valuation," Bank of Canada Working Paper No. 06-44, 2006.

3. Craig Doidge, G. Andrew Karolyi, and René M. Stulz, "The U.S. Left Behind: The Rise of IPO Activity Around the World," NBER Working Paper No. 16916, 2011; Juan Carlos Gozzi, Ross Levine, and Sergio L. Schmukler, "Patterns of International Capital Raisings," The World Bank Policy Research Working Paper Series No. 4687, 2008; and Nicola Cetorelly and Stavros Peristiani, "Firm Value and Cross-Listings: the Impact of Stock Market Prestige," Federal Reserve Bank Staff Report No.474, 2010.

4. Standard event-study analysis measures cumulative abnormal returns net of market returns in the period from three days before to three days after the date of the initial announcement, following the most commonly used approach. See Stephen J. Brown and Jerold B. Warner, "Using Daily Stock Returns: The Case of Event Studies," *Journal of Financial Economics,* 14(1), 1985. Share data from the companies' primary listing markets were used, together with the relevant stock market indices (São Paulo/MSCI Emerging Markets Latin America for Vale, and London/FTSE 100 for Prudential and Kazakhmys).

Overall, Very Limited Benefits—If Any

The experience of IPOs and secondary listings in Hong Kong suggests that they are unlikely to be reasonable options unless the company is based in a poorly regulated market. Cross-listings do not significantly improve liquidity in the longer term, and large institutional investors increasingly use online trading platforms that obviate the need to expand the investor base by cross-listing. Meanwhile, hopes of higher valuations have ebbed—for the time being, at least—as Asian stock markets have lost momentum in 2011.

There is some evidence that companies from less well regulated markets that list on exchanges with high regulatory standards may improve their valuations. However, this is unlikely to apply to cross-listings in Asia by companies listed on markets covered by the three large European stock-exchange groups.

For Further Reading

The Boston Consulting Group publishes other reports and articles on corporate development topics that may be of interest to senior executives. Recent examples include:

The 2011 Value Creators Report—Risky Business: Value Creation in a Volatile Economy
A report by The Boston Consulting Group, September 2011

Collateral Damage—Stop Kicking the Can Down the Road: The Price of Not Addressing the Root Causes of the Crisis
A Focus by The Boston Consulting Group, August 2011

All That Cash: The BCG 2011 Investor Survey
An article by The Boston Consulting Group, May 2011

The Debt Monster
A Focus by The Boston Consulting Group, May 2011

The Art of Planning
A Focus by The Boston Consulting Group, April 2011

Does Practice Make Perfect? How the Top Serial Acquirers Create Value
A Focus by The Boston Consulting Group and the Leipzig Graduate School of Management (HHL), April 2011

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A White Paper by The Boston Consulting Group, March 2011

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An article by The Boston Consulting Group, February 2011

2011 BCG Global Challengers: Companies on the Move
A report by The Boston Consulting Group, January 2011

M&A: Back to the New Reality—A Survey of European Companies' Merger and Acquisition Plans for 2011
A White Paper by The Boston Consulting Group and the IESE Business School of the University of Navarra, November 2010

Accelerating Out of the Great Recession: Seize the Opportunities in M&A
A report by The Boston Consulting Group, June 2010

The Art of And: Growing While Cutting Costs
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Strategic Optimism: How to Shape the Future in Times of Crisis
BCG Perspectives, April 2010

Be Daring When Others Are Fearful: Seizing M&A Opportunities While They Last
A report by The Boston Consulting Group, September 2009

The Return of the Strategist: Creating Value with M&A in Downturns
A report by The Boston Consulting Group, May 2008

Note to the Reader

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