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Executive Summary: ***Why don't U.S. issuers demand European fees for IPOs?***

It was a decade ago that academics showed IPO issuers in the United States almost always pay exactly seven percent of the proceeds to the underwriting syndicate when offerings have proceeds of between $20m and $80m. This prompted a Department of Justice investigation and a class-action anti-trust lawsuit was also launched against 32 investment banks. However, the investigation was subsequently dropped for a lack of evidence of explicit collusion, and the lawsuit was ultimately settled privately. But ten years ago, there was no representative and comparable sample of IPOs from another market. The passage of time and the integration of markets have changed this: not only can we assess whether the "7% solution" still stands in the U.S., but for the first time we are now also able to compare the U.S. and European markets, like-for-like, and reopen the debate on IPO fees.

The method of conducting IPOs in the U.S. was, for many years, unique. Unlike elsewhere, U.S. offerings have for decades been managed using the "bookbuilding" method, whereby investment banks canvass legally non-binding but nonetheless serious indications of interest from a wide network of institutional investors in advance of the offering. IPOs in Europe, by contrast, used the less time-consuming and, in terms of direct costs, cheaper fixed price method or tender/auction process. This difference was cited by industry participants as the reason why gross spreads – the proportion of proceeds earned by the investment bank – were lower in Europe than in the U.S.

In recent times, however, all this has changed: for the past decade, with the exception of some very small offerings and some periods when certain countries have experimented with auctions, the vast majority of European IPOs have used bookbuilding.

We are able to use our dataset, which covers ten years of data from 1998 to 2007, to match with a dataset of U.S. IPOs drawn from the same period using standard sources. Furthermore, with the international integration of capital markets, leading investment banks compete for IPO business on both sides of the Atlantic. In this paper we are able to compare how a given bank charges for its (almost identical) services at home and abroad. With accurate IPO data available from these once distinct but now comparable markets, we are able to measure – and shed light on – the disparities between them.

Our main findings are as follows. First, we find that the "7% solution" has become even more pronounced in the U.S.: 95.4 percent of small-to-medium sized IPOs report fees of exactly 7 percent fees over the period 1998-2007. The comparable figure over the decade from 1989-1998 (from previous research), was 84 percent. Second, the "7% solution" applied to larger U.S. offerings in 1998-2007 than in the decade before. Whereas previously there were virtually no IPOs over $150m with a 7% spread, we find 77 percent of offerings between

$100 m and $250m charge exactly 7%. Third, European IPO spreads do not cluster, and only 1 percent experience fees as high as 7 percent. Fees for small-to-medium sized IPOs average just over 4%. Indeed, European IPOs are always cheaper: we find there is a "3 wedge" between European and U.S. IPOs after controlling for size, issue characteristics, syndicate structure and time or country effects. Fourth, whilst spreads are lower for the larger offerings in both regions, our multivariate analysis indicates that fees for the larger U.S. IPOs have tended to increase in our sample period, while European IPOs have been getting cheaper. Finally, we find that the same investment banks charge significantly lower fees for conducting IPOs in Europe than for similar IPOs they underwrite in the U.S.

The economic significance of this difference in fees is considerable. From 1998-2007 the U.S. companies in our sample raised $412 billion via IPOs. Our best estimates suggest that had these IPOs been conducted at European fee levels the savings to U.S. issuers over the period would have totalled $11.4 billion – or over $1 billion per year.

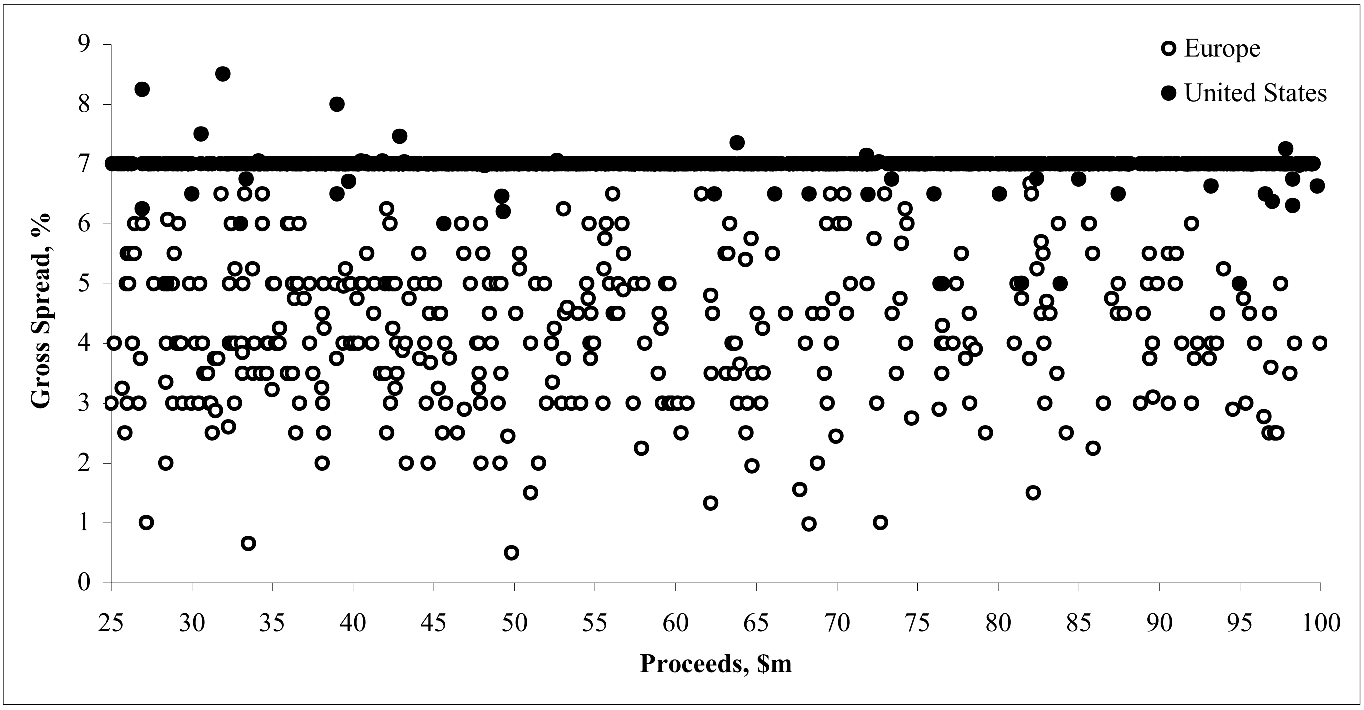
Searching for explanations, the fact that the same investment banks set fees at around a 50% discount in Europe relative to the U.S., suggests that it cannot be the structure of the banks themselves that causes the price discrepancy. Although we would not characterise the U.S. IPO market as uncompetitive, we show it is substantially less competitive than Europe using standard measures. There have clearly been some entrants into the U.S. market. WR Hambrecht have been offering their auction-based Open IPO method for some years, which has considerably lower fees, but they have attracted only a tiny fraction of the market. So, despite some competitive pressure, the U.S. market remains relatively concentrated in terms of the number of investment banks, with few deviations observed from standard bookbuilding techniques.

Even if competition is part of the answer, some argue that other differences between the two markets can explain the 3% wedge. We explore five of these favoured explanations: legal costs, retail offerings, litigation risk, sell-side analysts, and the possibility that narrower underpricing might offset higher fees. However, we find no evidence that these explanations can materially explain the difference in fees. Indeed, regarding the latter issue, we find that European IPOs are underpriced less than U.S. IPOs.

We offer no definitive answer to the question posed in the title. Given that cost, or quality, differences cannot explain the differences in fees charged by the same investment banks for conducting IPOs in the U.S. and Europe, the only remaining explanation is the nature of competition. We conclude that, despite entry into both markets, strategic pricing occurs in the U.S. but not in Europe. The evidence in this paper may help to strengthen the negotiating position of U.S. issuers when awarding future bookrunner mandates.

United States vs. European Gross Spreads, $25m-$100m offerings, 1998-2007

Sample contains 1013 U.S. and 375 European IPOs with proceeds of ≥ $25m < $100m, spanning 1998-2007 where gross spread and underpricing data are available. The sample excludes closed-end funds, SPACs, REITs, ADR/GDR-only or unit offerings and auction and fixed price IPOs. Spread refers to the gross spread, calculated as a percentage of proceeds as disclosed by the underwriting syndicate. Proceeds exclude any over-allotment options and are reported in 2007 U.S. dollars, calculated using the U.S. GDP deflator.



Top Ten Bookrunners by Proceeds for United States and European IPO samples

Sample contains 1931 U.S. and 914 European IPOs, spanning 1998-2007 where gross spread and underpricing data are available. IPO proceeds exclude any over-allotment options and are reported in 2007 U.S. dollars, calculated using the U.S. GDP deflator. The sample excludes IPOs where the proceeds are less than $25m. All closed-end funds, SPACs, REITs, ADR/GDR-only or unit offerings and auction and fixed price IPOs are also excluded. Spread refers to the gross spread, calculated as a percentage of proceeds as disclosed by the underwriting syndicate. In this table we sum the total proceeds according to the bookrunner(s) for U.S. and European IPOs. Where there are multiple bookrunners we divide the proceeds equally between the bookrunners. For the purposes of this table we include the deals transacted by bookrunners that were acquired during the sample period into the total for the parent investment bank in the relevant market (e.g. Citigroup includes Salomon Smith Barney and Salomon Brothers). The reported average spread is the simple (unweighted) average across all the IPOs conducted by each investment bank in each region.

	United States				Europe			
Rank	Bookrunner	Total Proceeds ($m)	% U.S. Proceeds	Average Spread (%)	Bookrunner	Total Proceeds ($m)	% European Proceeds	Average Spread (%)
1	Goldman Sachs	78,139	19.0	6.45	Goldman Sachs	41,568	10.0	3.50
2	Morgan Stanley	71,106	17.2	6.45	Merrill Lynch	40,838	9.8	2.81
3	Merrill Lynch	44,875	10.9	6.52	Morgan Stanley	38,807	9.3	3.48
4	Citigroup	41,354	10.0	6.42	UBS	37,332	8.9	3.08
5	Credit Suisse	41,115	10.0	6.63	Credit Suisse	30,360	7.3	3.65
6	Lehman Brothers	25,686	6.2	6.61	Deutsche Bank	26,778	6.4	3.70
7	JP Morgan	18,245	4.4	6.48	Citigroup	18,167	4.4	3.30
8	Deutsche Bank	11,523	2.8	6.79	JP Morgan	17,809	4.3	2.87
9	UBS	11,362	2.8	6.69	Mediobanca	15,300	3.7	3.42
10	DLJ	9,496	2.3	6.83	ABN AMRO	10,729	2.6	3.26