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Macro- and microeconomic aspects of going public in the Czech Republic and Poland

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Abstract

The intent of this study is to explore macro- and microeconomic aspects of going public in the Czech Republic and in Poland. There are significant differences in the going public activity on both markets and we firstly aim to determine the influence of GDP growth rates, reference interest rates, industrial production growth rates and a main stock exchange index on numbers of IPOs. Secondly, we survey chief financial officers (CFOs) in the Czech and Polish enterprises to compare practice in the CEE region to findings in previous empirical studies and theoretical approaches in the area of initial public offering motivation.

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1. Introduction

The past decade has witnessed a worldwide rise in the importance of financing corporate growth through ‘Initial Public Offerings’ (IPOs). Under the conditions of developed capital markets the finance theory of going public decision making has been extensively researched. Based on the literature review there are some key macroeconomic and microeconomic aspects that have significant effect on the financing choice of enterprises via IPOs.

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Relations between the number of IPOs and the macroeconomic factors (i.e. external conditions) have been investigated in a limited number of studies. Loughran et al. (1994) investigate the timing of IPOs in fifteen countries in relation to inflation-adjusted stock price indexes and GDP growth rates. The results suggest a positive relationship between the number of IPOs and stock price levels, however no positive correlation with the cycle movements. Rydqvist and Högholm (1995) compare the data for a sample of family-owned enterprises in Sweden (1970–1991) and eleven European countries (1980–1989). They find that “most going public activity took place after an exceptionally sharp stock price increase, and that going public activity is not related to the business cycle”. Ljungqvist (1995) suggests that high number of IPOs is positively correlated with both high stock index levels and good business conditions and tends to follow phases of extensive IPO underpricing. Breinlinger and Glogova (2002) investigate the explanatory power of selected macroeconomic factors influencing IPOs by analysing a data set of annual IPO volumes for six developed continental European countries over a time period of 18 years. The authors followed the question if there are stable indications that IPOs depend on stock index returns for what they termed consolidated periods. The results show that a “logarithmic transformation of IPO volumes (representing authors’ supposition of a nonlinear relationship between IPO volumes and stock index returns) leads to persistently significant estimates for both pooled and individual country regressions”. The hypothesis that percentage changes in savings, GDP growth and interest rates have explanatory power for IPO volumes could not be supported by empirical evidence.

A paper by Ameer (2012) shows a significant negative relationship between the interest rate and the number of IPOs and a significant positive relationship between the industrial production and the number of IPOs in the emerging market of Malaysia. Bilson et al. (2002) find a moderate evidence to support the connection between local macroeconomic factors and stock returns in emerging markets.

Microeconomic studies deal first of all with the motivation of going public. The main factors taking influence on decision to go public in a firm are divided in both academic and professional literature into four groups.

Authors in the first group point out the situation of a firm which needs to obtain external funds to undertake external net present value projects. The primary securities market offers an opportunity to raise capital from a large number of previously unknown investors. As a result, more capital is accumulated than a single investor, or a limited number of investors, would be able or willing to provide. Raising funds through an IPO should be an alternative to borrowing, particularly in companies with high investments (now or in the foreseeable future), high proportion of debt in the capital structure, and high potential for growth (Chemmanur and Fulghiyer, 1999; Ritter and Welch, 2002). Pagano et al. (1998) investigated a comprehensive data set of Italian companies. They conclude that U.S. companies usually undergo a considerable growth process after listing while the decision of Italian independent companies can be interpreted as “an attempt to rebalance their balance sheet after large investments and growth. Brau and Fawcett (2006) investigated 336 nonfinancial U.S. companies that had successfully completed an IPO or attempted and subsequently withdrew an IPO. More than a half of the interviewed CFOs strongly supported the notion that “an IPO serves to create public shares for use in future acquisitions”.

Pagano et al. (1998) followed by Black and Gilson (1998) connect IPOs with another reason. Public trading of shares provides a great advantage to both the issuers, to whom the shares issued provide a long-term source of financing, and to the investors, who can sell the shares purchased at any time on secondary markets and thus recover the desired liquidity, i.e. the money they invested. The short-term financial funds of individual investors are thereby transformed into long-term sources, which then make it possible to implement large-scale investment projects. Raising the stock capital through a public issue also eliminates the difference between the large shareholders, who tend to take a long-term approach to investing, and the small ones, who value liquidity and are therefore inclined to take a short-term view of their investment.

Zingales (1995) and Black and Gilson (1998) argue that going public is the way how the majority shareholder's desire to reduce his stake in the company. Thereby, an IPO allows venture capitalists to cash out and resolves the problem of generational succession in a family-run enterprise. From the shareholder's perspective, the option to cash out his co-ownership by selling the shares of stock at any time on the secondary market is an advantage that imparts a great deal of flexibility to his financial decisions. On the other hand, Brau and Fawcett (2006) findings do not support the public statement of many venture capitalists that an IPO is an integral part of their harvest strategy because “firms with VC presence rank four motivations higher than the opportunity to allow VCs to cash-out”.

The last reason for going public is to gain a non-financial advantage from IPO implementation (Maksimovic and Pichler, 2001; Ježek, 2004). Going public is therefore associated with positive effects in the area of marketing. First of all, an IPO can increase the publicity or reputation of the firm. The prestige can be very advantageous in

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