International Review of Law and Economics 29 (2009) 260–271

Contents lists available at ScienceDirect

International Review of Law and Economics

Why are the French so different from the Germans? Underpricing of IPOs on the Euro New Markets

Marc Goergen[a], Arif Khurshed[b,*], Luc Renneboog[c]

[a] Cardiff Business School and European Corporate Governance Institute (ECGI), Cardiff University, Aberconway Building, Colum Drive, Cardiff, CF10 3EU, United Kingdom
[b] Manchester Business School, University of Manchester, Oxford Road, Manchester M15 6PB, United Kingdom
[c] Tilburg University and ECGI, PO Box 90153, 5000 LE Tilburg, The Netherlands

ARTICLE INFO

JEL classification:
G14
G24

Keywords:
IPOs
Underpricing
Venture capital
High technology
European New Markets
Lock-up agreements

ABSTRACT

We study the underpricing of firms listed on the two largest EuroNM stock exchanges, the *Neuer Markt* of Germany and the *Nouveau Marché* of France. We find that the high underpricing in these two markets – contrary to the evidence on the US – is not driven by insiders' selling behaviour. However, the large underpricing is caused by the high degree of riskiness of the issuing firms and by the partial adjustment phenomenon of offer prices to compensate institutional investors for the truthful revelation of their demand for the shares. For France, lock-up agreements act as substitutes to underpricing, but not so for Germany. We also explore the reasons for the large difference in underpricing between the German and the French IPOs: German firms are more underpriced because they are riskier, have larger price revisions, have less stringent VC lock-up contracts, and go public mostly during the hot issue period when the general level of underpricing in all IPO markets is substantially higher.

1. Introduction

In an initial public offering (IPO), a firm offers its shares to the public for the first time via a listing on a stock exchange. One of the interesting features of IPOs is that shares usually trade on the first day of listing at a price which is higher than the offer price. This anomaly is termed underpricing. Traditionally, for the stock markets of the developed world, the level of underpricing averaged between 10 and 15%. However, the recent literature on firms that were floated during the dot com bubble years of 1999 and 2000 documents that underpricing reached astronomical levels of more than 70% in the US markets (Ljungqvist & Wilhelm, 2003). Further, the IPOs of internet firms yielded first-day returns exceeding 96% during this period (Ofek & Richardson, 2003). Relatively high underpricing was also observed on a number of European markets (Ritter, 2003). In particular, Goergen, Khurshed, McCahery, and Renneboog (2003) find that during the period of 1996–2000, IPOs on the newly formed stock markets of Europe were underpriced by more than 30% on their first day of trading.

This paper focuses on the reasons for the high underpricing of firms listed on the new stock markets of Europe (EuroNMs). Studying underpricing of IPOs on the EuroNMs is interesting for at least two reasons. First, being new stock markets, largely developed along the lines of NASDAQ, the EuroNMs are likely to provide interesting insights into their listing activity and post-IPO performance. Second, IPOs on the EuroNMs are different from those on the other, established primary markets of their country: the majority of these firms are relatively young, are from high tech industries, have a shorter trading record, and face stricter listing requirements such as lock-up agreements.[1] They are also frequently venture-capital financed and often have over-allotment options.

The IPOs on the German and French EuroNMs,[2] which are the focus of this study, attracted more than 90% of all the EuroNM IPOs. Our results show underpricing in the German *Neuer Markt* of about 53% during the period of 1997–2000. This is about five times the past level of underpricing reported by Ljungqvist (1997)

* Corresponding author at: Division of Accounting and Finance, Manchester Business School, University of Manchester, Manchester M13 9PL, UK.
E-mail addresses: GoergenM@cardiff.ac.uk (M. Goergen), Arif.khurshed@mbs.ac.uk (A. Khurshed), Luc.Renneboog@uvt.nl (L. Renneboog).

0144-8188/$ – see front matter © 2009 Elsevier Inc. All rights reserved.
doi:10.1016/j.irle.2009.02.006

[1] Lock-up agreements are agreements which prevent the incumbent shareholders from selling further shares during a certain period after the IPO. See Goergen et al. (2006) for an overview of the regulation on lock-ups across Europe and the US.

[2] The first EuroNM was created in 1996 in France (the *Nouveau Marché*) and later encompassed its German (*Neuer Markt*), Dutch (NMAX), Belgian (EuroNM Belgium) and Italian (*Nuovo Mercato*) equivalents, which were all placed under the umbrella of EuroNM.

for Germany. In comparison, during the period of 1996–2000, the underpricing in the French *Nouveau Marché* amounted to 21%, about twice the past level (Derrien & Womack, 2003). Interestingly, we find that neither the selling behaviour of insiders in the IPO nor the involvement of venture capitalists has any impact on underpricing. In addition, price revisions during the offer process occur more frequently in Germany and are larger than those in France. This suggests that the German investors were more forthcoming with information about the potential demand for shares enabling the investment banks to set more accurate prices and/or were overoptimistic about their national IPO market. For France, lock-up agreements are a substitute for underpricing. The more stringent the lock-up, the smaller is the level of underpricing. In some firms, the underwriters are also shareholders in the firms they are taking public. For Germany, this leads to higher underpricing whereas for France it has the opposite effect.

Finally, we study some of the reasons behind the large differences in underpricing between the two markets. We find that German IPOs are more underpriced because they are riskier, provide a larger compensation for the truthful revelation of information by potential investors, have less stringent VC lock-up contracts and mostly come to the market during the hot issue period when the average underpricing in all IPO markets is substantially higher.

The rest of the paper is organised as follows. Section 2 briefly discusses the creation (and demise) of the French and German EuroNM markets and compares the characteristics of the two markets. Section 3 reviews the current literature on underpricing on the European New Markets. Section 4 then discusses the determinants of underpricing and formulates the hypotheses, while Section 5 specifies the data sources and describes the sample. Section 6 documents the underpricing in the two EuroNMs and relates it to the IPO characteristics. Section 7 discusses the results and Section 8 concludes.

2. The rise and fall of the EuroNMs

The European New Markets (EuroNMs) were launched in 1996/1997 in order to facilitate the financing of innovative companies with a potential for high growth. Given that these firms were young and had no or little trading record, they were usually not able to meet the listing requirements of the primary markets. The French New Market (*Nouveau Marché*) was created first and commenced operating on 14 February 1996. At the end of 2000, the total market capitalization of the 158 companies listed on the *Nouveau Marché* amounted to nearly €14 billion. The fact that some of its entry requirements were less strict was compensated by other stricter requirements (see Goergen et al., 2003). For example there was no requirement in terms of past profitability, but there was a minimum lock-up period of 6 months (covering 100% of shares held by the insiders immediately after the IPO) or 1 year (covering 80% of the insiders' shares) as compared to a 6-month lock-up for all shareholders in the *Neuer Markt*.

As a consequence of the increasing demand for equity investments in Germany, the Deutsche Börse established the *Neuer Markt* on 10 March 1997. The number of firms seeking a *Neuer Markt* listing took off with 11 flotations in 1997 and rose to a spectacular 143 in 2000. By the end of 2000, 325 companies were listed with a market capitalization in excess of €50 billion.

On 25 March 1997, the Amsterdam Exchanges created a New Market segment: the New Market of the Amsterdam Exchanges (NMAXs). This initiative was soon followed by the Brussels Stock Exchange which created EuroNM Brussels on 11 April 1997. However, in comparison to their French and German counterparts, the EuroNMs of Amsterdam and Brussels have only known a modest success. The total number of IPOs on the Dutch and Belgian markets was 16 and 14, respectively. The youngest EuroNM was the Milanese *Nuovo Mercato* (later renamed MTAX) which started with the IPO of Opengate SpA, an Italian IT services group on 17 June 1999 and is operated by Borsa Italiana. Whilst today the *Nuovo Mercato* has only 39 listed companies, it includes Tiscali, one of Europe's largest internet service providers.

Initially, the five EuroNMs experienced a spectacular success with more than 430 companies listed by the end of year 2000. The total amount of capital raised on the EuroNMs exceeded €23.5 billion, and the total market capitalization was in excess of €234 billion (Goergen et al., 2003). The market performance has also been impressive with the official EuroNM All-share Index rising by 561% between the start of 1998 and March 2000, just prior to the bursting of the 'internet bubble'. However, because of difficulties of harmonizing the different sets of listing rules, the existence of different national regulators and inefficient cross-border trading, the EuroNMs dissolved their partnership in December 2000. Consequently, the five EuroNMs went separate ways: the German *Neuer Markt* and the Italian *Nuovo Mercato* went their own ways whereas EuroNext was formed by the merger of the Amsterdam Exchanges (which included the Dutch EuroNM), Brussels Stock Exchange (which included the Belgian EuroNM) and the Paris Bourse (which included the French EuroNM). Since the dissolution of the EuroNMs, the New Markets have suffered particularly badly from the decline in technology stocks with losses on some markets exceeding 80%. Since 2001, there have been fewer than 20 IPOs on the New Markets down from more than 200 in 2000. After a series of insider trading and price manipulation scandals, Deutsche Börse AG absorbed the *Neuer Markt* on 5th June 2003. Of all the members of EuroNM network, *Neuer Markt* was the only exchange that was based on private law. As a result of this it was felt that the regulation was difficult to enforce.

The listing and disclosure requirements on the *Neuer Markt* and the *Nouveau Marché* were very similar. For example, for both markets the issuer was required to have at least €1.5 m of equity capital outstanding. Both markets demanded that the minimum number of shares issued be at least 100,000 and the minimum market capitalization be at least €5 m. Further, for both markets, the issuers were asked to have a minimum free float of 20% and at least half of the shares offered in the IPO had to be primary shares. Both markets required issuers to adopt the US-GAAP accounting standards and report quarterly accounts. However, in contrast to the *Neuer Markt* which had a 6-month lock-up period covering all pre-IPO shareholders,[3] the *Nouveau Marché* locked up 80% of the insiders' shares (typically the directors and founders) for a period of 12 months or 100% of their shares for 6 months.

3. Literature review

The second half of the 1990s experienced the busiest IPO market in European history. This was also the period of the birth of the EuroNMs. Goergen et al. (2003) study the underpricing of firms listed on all the EuroNMs. They find that underpricing in the different EuroNM markets was quite high and quite varied. For Germany, average underpricing was around 54% whereas for France it was around 25%. The Belgian and Italian IPOs had substantially lower underpricing with 10 and 19%, respectively. Conversely, IPOs on the

[3] For Germany, in addition to the 6-month lock-up, there is a 12-month tax lock-up period and a 2-year lock-up period for stock option plans. We are grateful to one of the referees for pointing this out. In what follows, we concentrate on the 6-month lock-up because it is directly comparable to the type of lockups that exist in France.