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IPO COSTS ON THE POLISH CAPITAL MARKET

Annotation. The effectiveness of IPO processes is a frequent research subject for finance scholars. This article examines the cost of such processes on the Warsaw Stock Exchange in 2008–2017 based on a sample of 136 companies. Research results indicate that IPO costs for transactions worth up to PLN 50m are significantly higher than for the remaining transactions and decline as the value of the IPO increases. At the same time, poor state of the WSE related to the absence of new capital and the loss of trust among investors due to events related to failure to comply with corporate governance mean that it may be difficult to see the return of a larger number of IPOs and the amount of equity raised in the upcoming years.

Key words: IPO, cost of IPO, stock exchange

Introduction

A company's decision to list on the public markets is one of the most critical in its history. It requires a precise analysis of all the benefits, but also the related costs and obligations. The main motive behind the IPO process is the desire to raise equity for the company as a result of a stock issue. In many instances it is also an opportunity for a divestment by existing shareholders. Both opportunities are associated with the necessity to incur costs of the entire stock listing process.

The purpose of this article is to assess changes at the level of direct Initial Public Offering costs on the main market of the Warsaw Stock Exchange. Moreover, the article poses the following research hypothesis: IPO costs on the Warsaw Stock Exchange are the highest for transactions worth up to PLN 50m and differ significantly compared to larger-sized transactions. It will be possible to reach the goal and verify the hypothesis made by analyzing the direct Warsaw Stock Exchange IPO costs of 136 companies which conducted this process in the 2008–2017 timeframe.

Theoretical aspects of IPO costs

The key moment in a company's life cycle is to go public: to launch an Initial Public Offering (IPO). While the benefits are clear, the IPO decision itself is always costly, financially and organisationally (Helbing et al., 2019). The motives behind the decision to list are the subject of numerous scholarly research studies (Pagano et all, 1998, Szyszka 2014). For the issuer, aside from benefits arising from being a public company, conducting an Initial Public Offering through a public subscription is tied to the necessity of pay for certain expenses. These are partially obligatory and partially depend on the decisions of company authorities and in that sense are optional. The first cost category includes above all court fees, tax and notary fees paid by the company in connection with the process of registering the increase of company's initial capital. Fees collected by the KNF, KDPW and the WSE for registration and identification activities related to shares subject to the public subscription are also obligatory. The company also has to pay the costs of mandating a brokerage house as the entity which offers the shares during the IPO process, as well as an auditor to examine its financial statements. It is not mandatory in a legal sense but worth considering hiring a legal advisor for the IPO process, a financial advisor, a PR agency and occasionally also other types of advisors, which naturally leads to the increase of the costs of a stock issue (Puławski, 2013).

Source literature includes cost classification proposed by Ritter, who distinguishes three cost categories: a) costs of underestimating the issuing price, b) the gross underwriter spread, c) other expenses, i.e. the expenses of legal advisory services, audit and those related to the printing of the issuing prospectus [Ritter 1987]. Non-financial costs such as increased oversight, or scrutiny, for instance, can act as a significant deterrent to the filing of IPOs (Bessler et al., 2017).

For the purpose of empirical studies, IPO costs are classified as direct and indirect. According to the Polish law, direct costs of the public offering have to be made public in a current report that contains the information about the number of shares in the offering, issuing price, amount raised, the figure and type of offering costs which include a) the cost of preparing and conducting the offering, b) underwriter fees, c) cost of the issuing prospectus, including advisory costs, d) cost of promoting the offering. Additionally, the issuer should publish the information on how these costs are accounted for in their books and how they are shown in the financial statement.

In turn, indirect costs are the opportunity costs of the vendor or the issuer of stock in a situation when the stock price on the first day of trading is higher than the issuing price, or the sale price. Underestimating price of the shares offered is common on the financial markets and serves as something of an incentive to purchase shares in the public offering. Indirect costs also include the costs of time spent by managers to prepare the company for the stock market debut, which are difficult to estimate. Examples include time spent to prepare the issuing prospectus, investor meetings or the participation in promotional activities. In the context of IPO costs, it is worth to refer to studies (Signori, 2018), which indicate that in the 2008-2018 timeframe, 15 % of all companies conducting an IPO in Europe were zero-revenue companies. That is certainly an interesting segment of companies for an analysis of the cost of capital they raise in an IPO since their valuation is not based on traditional metrics.

Source literature, particularly studies by Polish scholars, devotes a significant amount of space to the impact of the crisis on the number of IPOs held, as well as their expenses. For instance, [Wawryszuk-Misztal 2015] has shown in her study that the financial crisis has a negative impact on the amount raised from the share issues and on the relations between the expected and actual amounts raised. Moreover, the number and value of IPOs on the financial markets is shown to be significantly smaller in periods of crisis. [Henry, Gregoriou 2014].

State of the Warsaw Stock Exchange

The last few years have been difficult for the capital market in Poland. First, in 2013 was the de facto dismantling of the Open Pension Funds (OFE), reducing considerably the amount of available capital. The OFE funds were a stable supply-side factor providing the equity, particularly equity needed for IPOs. It is enough to note that thanks to access to capital, the Warsaw bourse attracted the attention of companies from the Central European region, with companies from Ukraine accounting for the majority. A special WIG-Ukraina index was created to promote investments into companies from that region. Unfortunately, discontinuation of OFE capital has halted the development of the domestic market. The second big blow for the capital market in Poland were the various events related to the failure to observe corporate governance rules. The biggest of its kind was the default of debt collection firm GetBack, whose consequences for the market have already started to generate coverage in academic works in Poland [Rogowski, Gemra, 2018]. Confidence in the capital market suffered as a result of the above events, impacting the level of investor interest in the Warsaw Stock Exchange. Data which reflects the state of each bourse are the statistics of the number of IPOs and the value of capital raised by companies. Figure 1 shows the data with the number of IPOs.

Considering the above data from Fig. 1, note several aspects. First, the number of IPOs is visibly lower since the appearance of the financial crisis in 2009. It is also worth noting that after 2009, the number of IPOs once again returned to pre-crisis level, evidence of WSE's good condition at the time. Meanwhile after 2012, the number of IPOs became visibly lower. Of course there were outliers and the best statistics were observed in 2017, but the number of IPOs declined compared to the previous years. The situation was the worst in 2017. The chart ends that year, but considering the events of 2018 and 2019, no visible improvement is seen.

Besides the number of IPOs, one should look at the value of all the transactions, shown on Fig. 2.

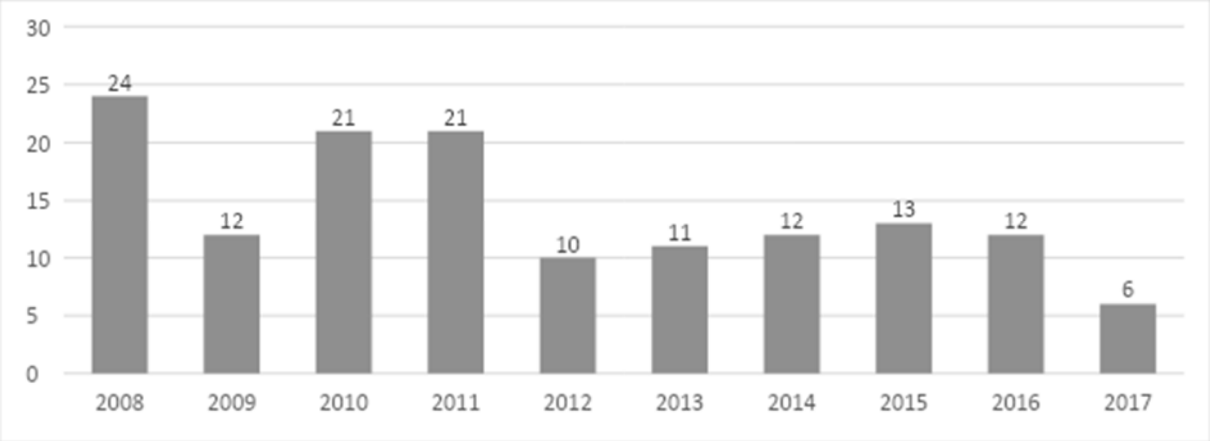

Fig. 1. Number of IPOs on the Warsaw Stock Exchange in 2008–2017

Source: proprietary research.

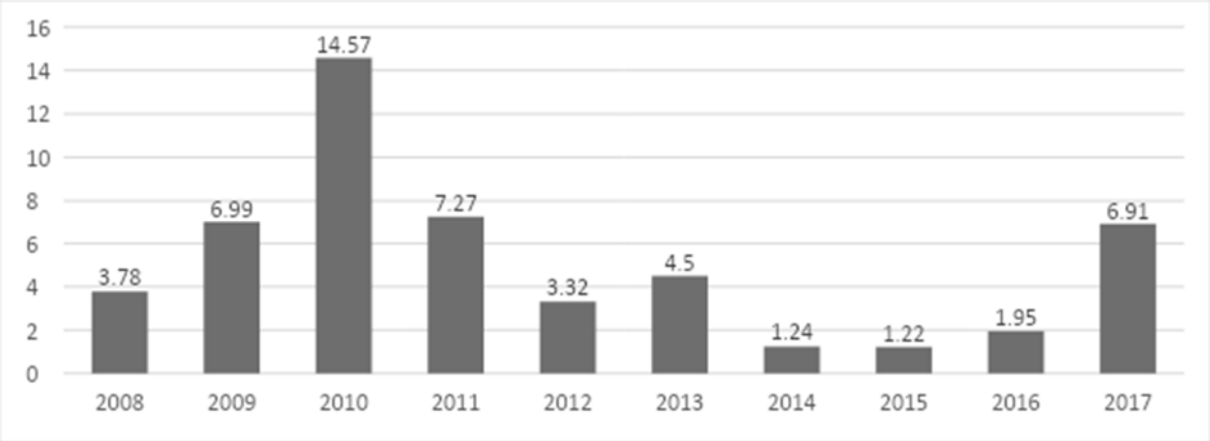

Fig. 2. Value of IPOs on the WSE in 2008–2017

Source: proprietary research.

The crisis period starting in 2009 on the Polish market was not worst time to conduct an IPO. However, if we analyze the data in greater detail it is all due to a single transaction worth nearly PLN 6bn, i.e. the privatization of PGE energy group. The year 2010 was a record one, but that was also due to privatization transactions, this time those of PZU, Tauron and the listing of the WSE itself. The year 2011 marked the privatization of JSW mining group, i.e. a transaction worth PLN 5.37bn. Finally, 2012 WSE saw the debut of Alior Bank. The transaction, worth over PLN 2bn, was one of the first from the private sector to have such a strong impact on IPO volumes. As late as 2013 Energa and PKP Cargo debuted on the WSE with a combined volume of PLN 3.83bn as the last privatization projects. After 2013, the IPO volume collapsed. Only in 2017 the listing of telco Play, Dino grocery chain and GetBack have visibly improved the image of the IPO market.

To summarize the assessment of Initial Public Offerings on the WSE it should be noted that the situation over the past few years is deteriorating. The only exception was the year 2017, but after that period there are no signs indicating that the situation is even going to stabilize. Things are getting worse. On the one hand, this is due to the lack of access to capital and on the other to the end of privatization process of state-owned companies from Poland. Previously, there was the Civic Shareholding program dedicated to individual investors, which stimulated this investor category and encouraged it to invest on the WSE. However, in 2013 the program was shut down.

Costs by company size - research results

Data for 2008–2017 period was analyzed in order to examine IPO costs on the Polish capital markets. A total of 142 IPOs took place over this time period. Companies which list on the stock exchange in Poland are required to publish a current report summarizing the offering, including its costs. The costs are split into the following categories: cost of preparing and conducting the offering, underwriter fees, cost of issuing prospectus and the offering's promotional costs. Unfortunately, not all companies publish such data and some, even when they do publish them, will not break the data down into individual components. Consequently, the study covered 136 companies which did publish the above data.

Referring once again to cost components it is worth noting that the first category listed above is the brokerage house fee. This fee is usually variable, depending on the amount of equity raised. Underwriters are very rare in Poland, hence usually there are no associated costs. On the other hand costs related to the issuing prospectus, a mandatory document essential for the execution of the entire process, include the fees of a legal advisor. The last category is advertising for the offering and usually that budget is allocated to a PR advisor who coordinates the entire advertising campaign. Aside from brokerage fees, which are usually paid on a success fee basis, the remaining costs are fixed and obligatory. Thus, if the amount of capital raised is much smaller than expected, fixed costs become more material.

Fig. 3 shows the average cost of raising capital for companies on the Polish market.

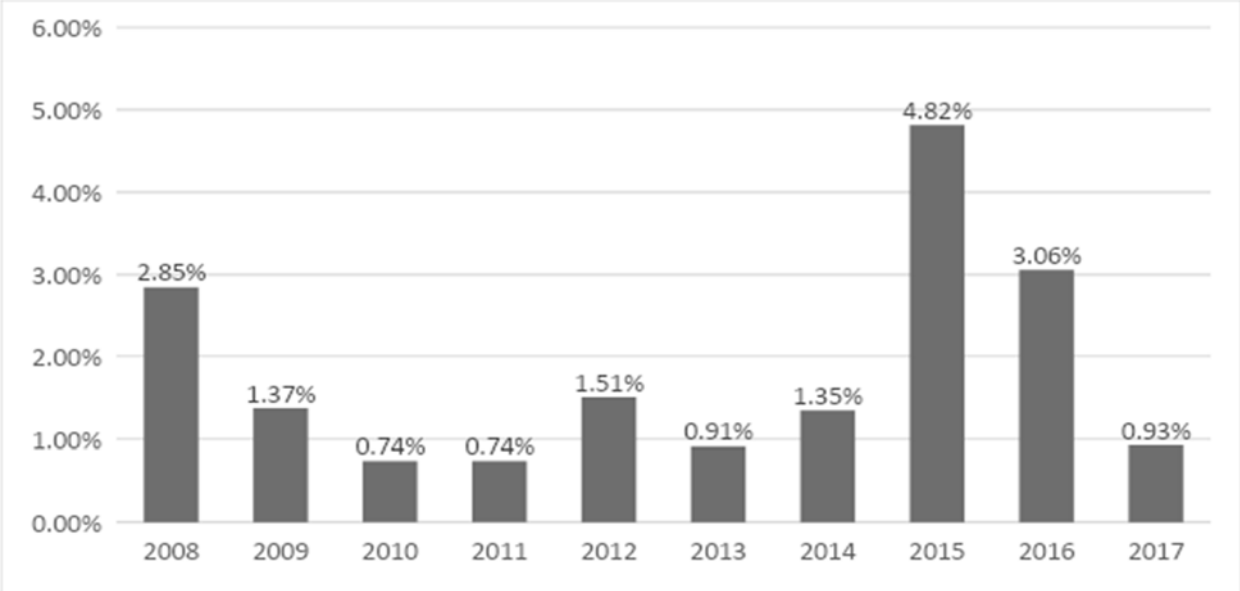

Fig. 3. Average cost of raising capital through stock issuance in 2008–2017

Source: proprietary research.

When analyzing the chart note that the smaller the transaction the greater the costs. If we look at each year holistically, it is variable costs related to the brokerage fee that differ in particular depending on transaction size. With bigger transactions, nominal brokerage fee becomes significant enough that in percentage points that value is lower than in the case of smaller transactions. Moreover, when analyzing expenses, particularly in those years when large transactions took place, it must be noted that these are relatively low values in relation to the transactions**.**

Let us look then at companies which held the highest- and lowest-cost IPOs. The data is shown in table 1.

The companies in question, those which paid the most for the capital raised, have simply made unsuccessful deals. An earlier part of this article mentioned that some IPO-related costs are fixed and obligatory, thus with a low value of equity raised we saw extremely expensive

processes. Companies nonetheless decided to list on the WSE. On the opposite pole are large companies which raised equity from share issues in a very effective manner. The cheapest capital raise was made by a private company which manages Dino supermarkets.

In connection with the previous data, companies holding IPOs in Poland were divided into three categories, depending on transaction values. The first category are companies which executed transactions worth up to PLN 50m. There were 66 such companies. The second category are those with transactions in the PLN 50m – 250m range, with 46 companies. The last group are companies whose offerings exceeded PLN 250m – there were 24 such companies. The data is shown in table 2.

Table 1

Companies with the highest and lowest IPO costs

Company name	IPO value	Total IPO costs	Cost of capital, %
NANOGROUP	4 180 000	1 179 122	28.21
Towarzystwo Finansowe SKOK	4 165 159	1 460 000	35.05
GPM Vindexus	1 751 628	858 210	48.99
Anti	731 304	518 420	70.89
IZNS Iława	135 151	444 519	329.00
DINO POLSKA	1 654 978 000	3 720 000	0.22
JSW	5 371 482 656	13 774 727	0.26
PZU	8 068 542 813	25 611 049	0.32
ATM Systemy Informatyczne	96 309 862	347 293	0.36
SOLAR Company	156 000 000	595 427	0.38

Source: proprietary research.

Table 2

Cost of IPO by value

	Total amount raised	Number of companies	IPO cost, %
<50 PLN m	1 355 766 159	66	6.89
From 50 to 250 m	4 969 312 040	46	2.59
Over 250	44 582 635 286	24	0.91

Source: proprietary research.

Analysis shows that IPO cost for transactions worth up to PLN 50 m is over 2.5x higher than for transactions worth PLN 50 m to PLN 250 m. The difference between small transactions and those over PLN 250 m is even larger. It means that it is possible to validate positively the hypothesis made in the text which says that IPO costs on the Warsaw Stock Exchange are the highest for transactions worth up to PLN 50 m and differ significantly compared to higher value transactions. The differences are material and significant.

Conclusion

Analysis presented in the article indicates that the recent years have been difficult for the WSE, as shown by the declining number of IPOs and deal volumes. Furthermore, the hypothesis made in the article has been validated. IPO costs for transactions of up to PLN 50 m are significantly higher than for larger transactions. This implies several conclusions. First, for smaller companies, the cost of raising capital and conducting an IPO may be relatively high, moreover it goes up as the amount

of capital raised declines. Due to increasingly lower demand on the WSE, quite often not all shares offered as part of the IPO are sold. Since some of the costs are fixed, they account for an increasingly large part of the entire process. Secondly, because of lower investor propensity to participate in IPOs, it is difficult to place large transactions on the Polish market. Over the past five years only in 2017 transactions worth close to PLN 1bn were made, thanks to Dino, Play and GetBack. One can then expect smaller transactions, where the cost is high. Perhaps a hypothesis should be made that IPO costs for small companies in Poland are high and that scares away these companies from the stock exchange while worsening the situation on the capital market. One potential solution would be to develop the alternative NewConnect market and encourage some of the companies which are considering listing on WSE's main board to list there.

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