Comparative IPO Processes in China, Europe, and the USA

Guanyu Long *

Huafu International Department, Affiliated High of South China Normal University, Guangzhou, China

* Corresponding author: longgy.leo2023@gdhfi.com

Abstract. An initial public offering (IPO) is how a private company sells new shares to the public. It is crucial to the development of a company, including raising capital and marketing its name. Based on comparative analysis, this study investigates the efficiency of initial public offering processes (IPO) in the US, Europe, and China. It also presents IPO traits in different countries and offers a graph to showcase the differences.

Keywords: IPO Stages, Book Building, Roadshow, Shareholding Reform.

1. Introduction

The commonly used phrase, “IPO” refers to “initial public offering.” Shares of stock are created in the IPO process and are sold to investors for the first time. This would comprise bonds as well; however, this investigation will focus on stocks only. One might think of the IPO process as the maternity ward for stocks. Investors may include large financial institutions as well as individual investors who may subsequently trade the shares on the stock market. The IPO process is referred to as the “primary market” whereas the subsequent trading of the shares occurs in the “secondary market.”

An IPO is often regarded as a milestone in a company’s development. It provides companies with a pathway to access the capital markets, allowing them to raise funds and pursue better growth opportunities. The IPO process also allows the company to expand its business operations and provide liquidity for its shareholders. Furthermore, the initial public offering process can enhance the company's public presence and brand awareness.

Three key participants are involved in the IPO: the issuing firm, the investment bank, and the investors. The investment bank serves as an underwriter, including assisting the issuing corporation in pricing the shares, locating investors, and writing a prospectus. A prospectus is a document with detailed information regarding the corporation and the nature of the IPO itself.

The issuing firm is the corporation in need of new equity capital. This firm will have hired an investment bank to manage the entire IPO process. Investors are located by the investment bank. This “lead” investment bank will invite other investment banks to form a “syndicate” which will assist in raising the capital.

Typically, small investors are invited to purchase the IPO shares which may later be bought and sold in the secondary market who trade shares in the open markets, and they are usually not so professional. In contrast, large, “institutional,” investors are often involved in “private placements” which do not involve the same IPO process with which this paper deals. Institutional investors will buy large blocks of shares which will not be traded subsequently in the secondary markets.

Due to the Coronavirus epidemic of 2021-2023, the world fell into recession. As a result, the U.S., China, and Europe experienced declines in IPO issuance in 2022-2023. Table 1 (below) presents IPO issuance data for this period [1, 2].

Table 1. IPO Issuance 2021-2023.

	2021	2022	2023
The U. S	1035	181	154
China	611	538	414
Europe	422	102	107

A significant decrease in IPO issuance took place in all three regions after 2021. The decrease was most notable in the U.S.

The 154 IPOs on the US stock market in 2023 represented a 15% decrease compared to the 181 IPOs in 2022, and an 85% decline from the record number of 1,035 IPOs in 2021 [3].

Although the stock market in the U.S. was mature, it was affected profoundly. Therefore, the less developed stock markets in the world would also experience a decline. In China, there were 414 new listings in 2023, indicating a decline of 124 from 2022, and a decrease of 197 from 2021. The decline was not as serious as in the U.S. and it is probably due to the application of a registration-based IPO system which made it easier for the company to go public. In Europe, there were 107 IPOs across Europe in 2023. The numbers of IPOs in 2022 and 2021 were 102 and 422. The energy supply significantly decreased in Europe due to the war, and it raised the cost of operating the companies, which served as a factor that influenced the number of IPOs. The IPOs showed a trend of decline in recent years and the data above shows differences between the scale of decrease of IPOs caused by the specific condition of the regions.

The rest of the paper is organized as follows. Section 2 introduces IPO processes across the three regions. Section 3 compares the steps in IPO and analyzes them. Section 4 concludes and summarizes. Finally, section 5 provides suggestions for future research.

2. Analysis

This section will describe and analyze the IPO process in America, Europe, and China. In addition, a comparison of the IPO processes in these regions will be conducted.

2.1. The IPO Process in the United States

Generally, the IPO process in the United States includes the following six stages.

(1) After searching for underwriters, the company enters the first stage of the IPO process, which is holding an all-hands meeting. In an all-hands meeting, an IPO team consisting of underwriters, lawyers, Securities and Exchange Commission (SEC) experts, and certified public accountants will designate duties to each member and develop a schedule for going public.

(2) Due diligence will be started following the all-hands meeting. Due diligence refers to an examination of the operating and financial condition of the company. During the due diligence periods, investment banks, legal advisors, and the company itself will be responsible for gathering information necessary for meeting the security law's requirements. They will also pinpoint any problems the company might face in IPO compliance and reduce post-listing risks.

(3) The corporation and the lead underwriter will compile a "preliminary" prospectus which will be circulated to potential investors. Notably, the preliminary prospectus will not state the price per share. Instead, brokers who are marketing the IPO will quote the expected price range in which the shares are expected to be issued. The brokers will assemble non-binding "indications of interest" from potential shareholders and communicate them to the investment bankers. In this way, the investment bank will be able to gauge the demand for the IPO and ultimately arrive at a final price.

(4) Before the roadshow, according to the Security Act of 1933 regulations, the company should submit an initial registration statement. "Form F-1 is the registration statement form most commonly used by foreign private issuers (certain non-US companies) …" [4]. "S-1 form is the registration statement that the Securities and Exchange Commission (SEC) requires domestic issuers to file in order to publicly offer new securities" [5].

The forms present the usage of capital, the operating condition, the competition, and a brief security prospectus. After registration becomes effective, a revised prospectus will be a final prospectus.

(5) The issuing company will then hold a "road show." A roadshow refers to a series of activities including presentations that are conducted by the company and underwriters. The presentations will be given in several cities to solicit assorted investors whose interests in owning the shares are diverse.

The roadshow provides the company with a chance to show its financial condition, marketing plan, and management experience to engage investors.

(6) Finally, IPO pricing usually happens at the end of trading on the day following the end of the roadshow. The security starts trading on the next morning. The whole process will last for three days to set a final price.

2.2. The IPO Process in Europe

The IPO process in Europe is similar to the one in the US. While Europe consists of many countries, the process is uniformly regulated in the European Union by the European Union Prospectus Regulation. In Europe, the number of stock exchanges is greater than in the US. Each exchange has its unique requirements. The IPO process in Europe can be divided into five stages:

(1) In Europe, which is similar to the United States, it is necessary to find an investment bank before holding a kick-off meeting. During the kick-off stage, an IPO team including the listing company, underwriters, and intermediaries will form and the roles of each member will be defined. The listing candidate will then provide the IPO team with an overview of the company's condition through a management presentation. It aims to inform the IPO team to enable them to prepare for the management of the investors or analyst meetings later.

(2) The company will start its "due diligence" after the kick-off meeting. The risks associated with the business will be investigated to provide financial and business disclosures and ensure the company's compliance with relevant laws.

(3) Pilot fishing meetings are often held 2-3 months before the initial public offering. Pilot fishing can be favorable for all parties. These private meetings between the company's management and several targeted investors provide a chance for the company to receive feedback from investors about their attitude towards the IPO and their interests. According to the feedback, the company can determine when it should go public. On the other hand, if the meetings result in official commitment agreements, contractual orders will be included in a designated part of the prospectus, ensuring pre-established demand from key investors.

(4) With the information they receive, the underwriters can complete a prospectus. The content of the prospectus in Europe is similar to the one in the US. However, a prospectus can be a single document or a tripartite prospectus in Europe. "A tripartite prospectus is composed of three separate documents: a registration document, a security note, and a summary" [6].

Additionally, the submission process for a prospectus is regulated under the European Union Prospectus Regulation.

(5) About two weeks before the IPO date, the subscription, book-building, and roadshow period will start after the publication of the prospectus. Book building aims to set a price for security. "During this period, investors, both institutional and retail, are invited to submit their bids for the shares with the book runners" [7]. After all these works are done, the shares will be issued and traded on the day following the end of roadshows.

2.3. The IPO Process in China

The IPO process in China is similar to the process in the US and Europe, they all include several key steps. The paragraphs below will include a brief introduction to Chinese IPO steps.

(1) Similar to the IPO process in the US and Europe, IPO in China also starts with establishing an IPO team. The IPO team will consist of an investment bank, an accounting firm, and a law firm.

(2) Due diligence takes place after the introduction of intermediaries. The law consultants will help investigate the corporation's compliance with laws; The accountants will investigate the financial condition of the company; The sponsor from the investment bank will look over the business model of the company. These intermediaries will all provide suggestions to help the company achieve the requirement of going public.

(3) "Shareholding Reform", a unique step of IPO in China, usually takes place after due diligence. It refers to the process of transferring a corporation into a qualified stock company. During the process,

the net assets of the company will be converted into shares with the same value. It usually starts with the establishment of a preparation group. The group will involve principles of production, technique, and finance. It is responsible for preparing any necessary documents during the process and reports process to the board of directors. After that, the company will hire intermediaries including accountants and public valuers to determine the value of its assets and complete reports of its operating condition. Sponsors of the process should decide the amount of registered capital and shareholding ratio of each sponsor. Then, the company will apply for establishment approval and convert into a joint-stock limited company.

(4) Before preparing the application materials, the company has to file for guidance registration with the local "Securities Regulatory Bureau". It represents that the intermediaries are advising on the company's IPO process.

(5) Following the guidance registration, the company will start preparing application materials including prospectus drafts. Then, these materials will be delivered to a specific exchange according to the operating conditions of the company. Since the registration-based IPO regime is applied in the Chinese IPO process, the evaluation of materials by the exchange will be the initial review. After that, "China Securities Regulatory Commission" will investigate the materials again and determine whether it allows the company to register.

(6) If the company is allowed to register, it will submit a request to exchange for issuance. A preliminary prospectus will be completed based on a prospectus draft and published on the exchange's website.

(7) Finally, the company will conduct roadshows and set the price of security by online auction and offline inquiry. A final prospectus is only allowed to be published in this period after the registration in CSRC.

3. Comparative Economic Systems

China is a socialist country, while the U.S. and most of the European countries are capitalist. Different economic systems across the three regions lead to distinctions in financial and economic markets.

From 1949 to 1978, China implemented a "command" economic system. This is a system in which the means of production are publicly owned and all economic activity is controlled by the country's government or central authority. The government set the prices of goods. The "Reform and opening up" took place in 1978 at which time a socialist market economy was instituted. "The 'socialist market economy' is a distinct development model, in the sense that it represents communist regimes introducing market reforms" [8]. The Chinese government began this effort first by setting up "Special Economic Zones" to attract foreign investment. The Zones include Hainan, Shantou, Zhuhai, Xiamen, and Shenzhen. After that, more economic interaction between China and foreign markets happened. As a result, the Chinese economy became more open and experienced significant growth as Figure 1 shows [9].

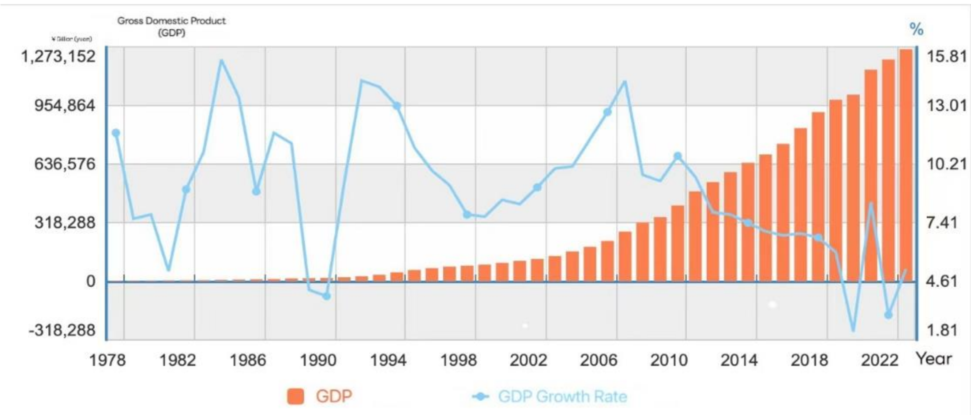

Figure 1. China's GDP: 1978 to 2022

China's total GDP in yuan steadily and constantly increases after 1978, demonstrating significant economic growth. The growth rate fluctuates in these years, with a peak in the 1980s and large variations in the 1990s. After that, the growth rate increases again until a decline that started around 2006, which makes it reach a low point in around 2020. China's GDP shows a trend of slowing growth although it continues to increase.

Although the Chinese economy was opened, the government and Communist Party still maintain strong control and influence over many business activities. For example, the government restricts market access for certain industries, including Oil, Tobacco, Electricity, Railroad, and Telecommunication. The prices for important goods like grains and electricity are also restricted. Government control is usually reflected in the many layers of regulatory approvals that businesses are subject to.

Capitalism is an economic system where business ownership and employees are separate. Owners operate the businesses in order to generate surplus profits beyond the basic survival needs. Capitalism was a revolutionary economic system that changed the nature of work, altered the family unit, and affected the government.

Capitalism has greatly transformed the nature of labor.

Capitalism has profoundly changed the activity of work. After capitalism, there are fewer self-employed people and more people working for a wage or salary. Job skills are rendered rapidly obsolete. People's sense of natural time has been supplanted by clock time. Finally, there has been a decline in the percentage of the productive population engaged in producing food [10].

Since the advent of capitalism, family life has changed.

Families are smaller, the household is no longer a production unit, and many households are no longer "families." In addition, people do not stay in the same location as a family as before but move around in response to the dictates of the economy [10].

Capitalism has affected the manner in which people are governed.

Along with capitalism, there has been a growth, generally, of democratic government. Governments have more functions and more direct influence over the lives of their subjects than in the past [10].

The differences between China's and the West's economic systems led to distinct IPO processes across the three regions. The next section discusses the differences.

4. Comparison of IPO Processes

The IPO processes in the three regions are similar, but there are also differences between them. In the table below, IPO processes in the US will be used as a standard to conduct the comparison analysis. Similarities and differences will be explained in the section below.

4.1. Similarities in the IPO Process Across Three Regions

Based on the table above, a comparison reveals three common procedures across the three regions. First, IPO processes in the three regions all start with searching for investment banks. Investment banks play important roles in the IPO process. Their responsibilities include advising, underwriting, pricing, and promoting. The company will select an investment bank as the lead underwriter, and the lead underwriter will establish a syndicate in order to help the company conduct the IPO process.

A "preliminary prospectus" is a necessary component of the IPO process in all three regions. In the United States, the preliminary prospectus, also known as a "red herring," is a legal document, required under the Security Act of 1933, that presents information about the company's operations, management, financial statements, risks, and intended use of the IPO proceeds. In Europe and China, a preliminary prospectus is also required by law. In addition to the issuance of the red herring, company management will visit potential investors, including both retail investors and institutional investors in order to raise funds.

"Book building" is another process shared by the three regions. It is a procedure that allows the underwriter to determine the price at which an initial public offering will be provided. In the process, the lead underwriter will help invite investors, especially institutional investors, and fund managers, to bid, which means they will indicate the number of shares they would like to purchase and the amount they are going to pay for the shares within a specific price range. Subsequently, the underwriter analyzes the information to build the "book", and determines the price for allocating shares to investors, which is also called "Cutoff Price."

4.2. Differences in the IPO Process Across Three Regions

Shareholding Reform is a unique step in Chinese IPO practice. It is a procedure of transforming the form of the company. In China, there are two forms of company: a limited liability company and a joint-stock company. According to Article 2 of the Company Law of the People's Republic of China, A company referred to in this Law means a limited liability company or a joint-stock company established within the territory of the People's Republic of China by this Law [11].

A limited liability company is an economic organization established by contributions of fewer than fifty shareholders. Each shareholder is responsible for the company to the extent of their subscribed capital, and the company bears full responsibility for its debts with all its assets. Compared to a joint-stock company, a limited liability company has a smaller scale of business, as it lacks effective ways to obtain funds. Furthermore, there is no requirement for public disclosure of the company's financial status. In China, only joint-stock companies are allowed to go public. Therefore, companies must conduct Shareholding Reform, which is a process of transforming a limited liability company into a joint-stock company.

Another important difference is underpricing in the IPO processes in China. "Underpricing" is the process of issuing a new security at a price lower than its intrinsic value. While underpricing is not unusual in the US and Europe, it is usually caused by information asymmetry, agency conflicts, publicity, or legal issues.

Asymmetric information models assume that one of these parties knows more than the others and that the resulting information frictions give rise to underpricing in equilibrium [12].

Agency conflict also encourages the company to apply underpricing during the IPO process.

An agency conflict occurs when there is a conflict between the interest of the agency itself and its customer. In an IPO, this happens because although underpricing will cost the company a lot, it's beneficial for the investors and underwriters [13].

Publicity is another factor that incentivizes the company to practice underpricing.

Underpricing for publicity means that the company deliberately issues its security at a lower price in order to attract investors' attention when the price of the security rises significantly after issuing [13].

Companies engage in underpricing as a way of risk management.

Underpricing sometimes takes place because the company wants to avoid being accused. If there is overpricing of the security, when the price of security decreases, investors may be unsatisfied and charge the company for undisclosure of the worries of future growth [13].

China is also affected by the four factors cited. However, regulation also plays an important role in IPO underpricing in China. An "IPO Authorized System" is instituted which regulates a company's IPO application and must be approved by the CSRC. In the past, the CSRC required that the price-to-earnings (P/E) ratio may not exceed 23 times.

It is difficult to pinpoint what the major causes of this difference between China and the US are. The most likely explanation is that the interference of the CSRC in China causes relatively high IPO underpricing in China [14].

Therefore, the IPO underpricing in China presents the investor with greater price appreciation potential in the secondary market than his counterparts in the U.S. and Europe.

Many Chinese investors are attracted to IPOs due to underpricing and the associated profit potential. To participate in the new shares' subscription, investors must qualify by having an account with an average daily stock market value higher than 10,000 yuan over the last 20 trading days before the subscription date. Subscriptions are then allocated by a quota managed by the government. In the U.S., it is the brokers who determine which investors can purchase the new shares and the allocations are limited accordingly [15].

Table 2 (below) summarizes the similarities and differences of the IPO processes in the three regions discussed.

Table 2. Comparative IPO Stages

	USA	Europe	China
Number of IPO Stages	6	5	7
1. Arrangement with investment bankers	Negotiated	Negotiated	Negotiated
2. Kick-Off Meetings	Hold	Hold	Hold
3. Due Diligence	Required	Required	Required
4. Preliminary Prospectus	Required	Required	Required
5. S-1/F-1 Form	Required	Not Required	Not Required
6. Roadshow	Hold	Hold	Hold
7. Shareholding Reform	Not Required	Not Required	Required

5. Conclusion

This research has identified six stages in the U.S. IPO process. The process is regulated by the Security Act of 1933. In Europe, the IPO process follows an almost identical sequence of stages. They are governed by the European Union Prospectus Regulation. In China, the process includes a unique step called “Shareholding Reform.” The main purpose of the reform is to convert a limited liability company into a joint-stock company. Across the three regions, S-1/F-1 Forms are required only in the U.S.

Despite the differences, the IPO process in all three regions starts with identifying a lead underwriter followed by distributing a prospectus and book building. It is important to note that this research did not discuss the differences between the processes in the U.S. and Europe but presented the distinctions between China and the other regions. The Shareholding Reform and the underpricing are unique to China the result of which provides the IPO investor with outsized upside potential does not present in the U.S. and Europe.

This research does not compare the efficiency of conducting IPO processes in the three regions due to the lack of access to related information. The time required for completing an IPO is critical to a company’s development since the longer the preparation period, the more resources it requires to spend on the process. Similarly, research about which region is more bureaucratic is also important, because a more complex procedure may lead to a higher cost of preparing. Therefore, it is necessary to figure out where it will take a shorter time to conduct the process, and which region is more bureaucratic.

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