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ABSTRACT

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Competition between investment banks for lead underwriter mandates in IPOs is fierce, but having committed to a particular bank, the power of the issuer is greatly reduced. Although information revelation theories justify giving the underwriters influence over pricing and allocation, this creates the potential for conflicts of interest. In this clinical paper we analyse an interesting innovation that has been used in recent European IPOs whereby issuers separate the preparation and distribution roles of investment banks, and keep competitive pressure on the banks throughout the issue process. These 'competitive IPOs' allow the issuer greater control and facilitate more contingent fee structures that help to mitigate against 'bait and switch.' But unlike more radical departures from traditional bookbuilding – such as auctions – the competitive IPO is an incremental market-based response to potential conflicts of interest that retains many of the advantages of investment banks' active involvement in issues.

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I. Introduction

The bookbuilding approach to conducting IPOs has become the dominant issue method in most countries in recent years. Bookbuilding allows the final offer price to be conditioned on the information received from investors, and enables the investors to be incentivised, through preferential allocation, to produce and reveal that information (see Benveniste and Spindt 1989). However, doubts remain about the operation of bookbuilding in practice, particularly given the reality of investment banks who serve not only the issuers of an IPO but also, on a continuing basis, the investors.

The tendency for IPOs to be underpriced is well established, and modest underpricing need not be against the interests of issuers (see Jenkinson and Ljungqvist, 2001, chapter 3). However, concerns came to a head after the IPO bubble of 1999-2000 when the conflicts of interest facing investment banks were exposed in a series of blatant and damaging revelations and lawsuits. Regulators in the US and the UK acted to address allocation abuses, including laddering, spinning and quid pro quo arrangements.[1] More recently, a growing body of academic research has noted the importance of broking relationships to IPO allocations, including Jenkinson and Jones (2004, 2007), Reuter (2006) and Ritter and Zhang (2006). Some have suggested abandoning the bookbuilding approach altogether in favour of alternative methods, in particular auctions where discretion over allocation would be removed. However, international experience suggests that such deviations from bookbuilding have been limited or short-lived (Sherman (2005), Jagannathan and Sherman (2007)). In this paper we discuss an interesting, and more incremental, innovation to the bookbuilding process that has been used in a number of recent European flotations and which gives issuers greater control. This method has come to be known as the 'competitive IPO'.

In a traditional IPO the lead investment bank is appointed early in the process to help

[1] The NASD issued rule changes in November 2003; see NASD (2003). These built on recommendations by the NYSE/NASD IPO advisory committee (see NYSE/NASD (2003)) and on agreements under the 2003 Global Settlement to outlaw the bookbuilding-related malpractices mentioned above, and to make the bookrunner's allocation decisions more transparent to the issuer. In the UK, the Financial Services Authority (FSA) dealt with issues related to IPO allocations in two consultation papers (see FSA (2003a, c)), whose principal focus was the conflict of interest in investment research. Regarding IPOs, the FSA proposed greater transparency for the issuer in the IPO allocation process as a means of minimizing the misalignment of bookrunner and issuer objectives. On pricing it recommended that banks' compliance departments undertake periodic reviews of IPO pricing, particularly of offerings that rise to a high premium. The link between IPO allocations and brokerage business was also made in connection with another FSA consultation paper, on bundling and soft commissions and an accompanying report (see FSA, 2003b, and OXERA, 2003).

the company prepare for the issue, produce the prospectus, etc. before the marketing and bookbuilding phase begins. This preparation role is combined with the distribution role, whereby the investment bank markets the issue to investors, solicits bids, and advises on the final pricing and allocation. As part of the pitch for the business, rival investment banks typically present their credentials, such as their relevant sectoral experience, access to investors, and also give their views on valuation and pricing of the IPO. However, these views on pricing have no formal status – they are just an initial view presented before any detailed due diligence, and months before the issue will reach the market. This results in the so-called 'bait-and-switch' problem: faced with the non-binding nature of these valuations, investment banks have an incentive to present high valuations when they pitch for the IPO mandate, which are then revised downwards (many months later) when the price is finally set. The issuing firm is likely to choose a bank that produces a relatively high valuation, since in most other respects – such as the ability to guide the firm through the IPO process, access to investors, provision of analyst coverage – the major investment banks differ relatively little. But having chosen an investment bank months before the actual IPO, the issuing firm has little ability to resist a last minute reduction in the offer price by the bank during the distribution phase, nor to force the the bank to raise the price in response to unexpectedly strong demand (see Loughran and Ritter 2002).

In a competitive IPO many of the roles are separated. The advisory mandate is awarded at an early stage in the IPO process, and may be offered on the basis of no participation in the distribution. The adviser helps prepare the company for its IPO, providing advice before launch on the size and target markets for the offering and, after the IPO is launched, on pricing and allocation. The adviser also counsels the issuer on the selection of the bookrunner and the rest of the distribution syndicate. Banks are appointed to distribution roles near the date of the IPO. This means, first, that their views on valuation are better informed and made in light of market conditions at the time of the offering and, second, that it is easier for the issuer to provide incentives for the banks to provide truthful valuations, and to maximize the price. Due diligence and the preparation of the prospectus are carried out by banks, rather than by the adviser. However, banks assigned these tasks must still compete for the bookrunning role.

This disaggregation of the roles of the investment bank raises certain questions. Does the adviser really have to be 'in the market' in order to advise on pricing in the final instance? Does the late appointment of the distribution syndicate merely defer the process of 'bait-and-switch'? And does it create incentives for analysts of aspiring syndicate members to issue

overly-optimistic research, as a way of obtaining a syndicate position for their bank? And can, or should, the distributing banks sell the issue to investors not having conducted much due diligence themselves? Finally, what incentive arrangements are needed to align the issuer's and bookrunner's interests when a number of different contracts are being written?

We address these, and other, questions by exploring in some detail the first instance of a competitive IPO: the €1.4 billion flotation of Pages Jaunes (PJ) in France in July 2004. We then discuss how the technique has evolved in more recent issues, which have taken place mainly in the UK. These UK competitive IPOs led to an investigation by the Financial Services Authority, which we also discuss.[2]

The remainder of the paper is structured as follows. In the next section we review briefly the role of investment banks in traditional IPOs, and review some innovations that have been observed in recent years. We use this as a context for the clinical study of the Pages Jaunes IPO, which we present in section III. We discuss how competitive IPOs developed after the initial Pages Jaunes deal, and the regulatory responses, in section IV. Section V concludes.

II. The role of investment banks in traditional IPOs

The typical timetable for an IPO in the international markets starts with the issuer selecting an investment bank to act as bookrunner for the transaction, either on the basis of an existing relationship or after a 'beauty contest' in which several banks compete. The beauty contest typically takes place at least six months before the IPO itself and may comprise a written proposal and an oral presentation by the banks. Once appointed, the bookrunner carries out a large number of tasks. It co-ordinates due diligence, which is the process of gathering and verifying information for the prospectus. It advises the issuer on the design, size and timing of the offering, including the appointment of other syndicate members. It organizes the marketing of the offering, first in a pre-marketing period, when (in Europe, although not in

[2] The Pages Jaunes deal generated considerable press and practitioner comment, such as "France Telecom is putting potential bookrunners under intense competitive pressure to maximize the valuation of Pages Jaunes, … , by running an auction for a role~~s~~ as bookrunner" (Financial News, 16 June 2004); "The prime reason is control. The objective of creating tension between the various firms is to keep them on a tight leash … and also to result in a more credible pricing range" (International Financing Review, 18 June 2004); and "Only after this were they appointed and all the banks have been warned they could receive no payment if the IPO is launched outside the indicative range. France Telecom used this method as it feared banks could promise inflated prices to gain their mandate only to force the company afterwards to reduce the IPO." (Financial Times, 23 June 2004).

the US) its and the other banks' analysts may set out the case for the shares to investors and then during a one- to two-week roadshow, when the issuer's management visits investors in large groups or in one-on-one meetings. During the roadshow the bookrunner collects bids from investors either directly or via other syndicate members and forms a book of demand.

At the start of the bookbuilding period the bookrunner advises the issuer where to set an indicative price range for the shares, within which the shares will be marketed. At the end of the bookbuilding the bookrunner advises the issuer on the final price for the shares and on which investors should be allocated those shares. In practice the issuer typically delegates the decision on allocations and on pricing to the bookrunner. The bookrunner then acts as stabilizing manager for the shares in the aftermarket, meaning that it may buy shares if the price falls to or below the offer price.

There are a number of other appointments in an IPO syndicate. The global co-ordinator is usually the same bank as the bookrunner but in this role the bank ensures that different parts of an IPO (e.g. the institutional and retail offering or the different regional tranches of an offering) are co-ordinated. The next most senior syndicate positions are joint lead managers (referred to as co-managers in the US), followed by co-lead managers and co-managers ('other syndicate members' in the US).

Remuneration comes in the form of commissions agreed in advance and paid as a proportion of issue proceeds. The total fees (or gross spread) vary considerably. In the US they stand typically and stubbornly around 7% for issues up to around $100 million, although gross spreads may fall to around 4% for very large offerings (Chen and Ritter 2000). In Europe IPO fees average around 4% for the smallest transactions and around 2% for the largest. Typically the gross spread is broken down into three components, underwriting commission, management commission and selling concession in the proportions 1:1:3. The underwriting and management commissions are paid out in proportion to each bank's underwriting of the whole transaction, although certain mechanisms and practices mean that the more senior syndicate members take a greater share.[3] Selling concession is paid to those syndicate members through whom allocable bids were placed and it may therefore be apportioned differently from the way in which underwriting and management are shared out.

[3] In the case of the management commission, a 'praecipuum' is often retained by the bookrunner and other senior syndicate members before the balance is apportioned to all syndicate members pro rata to their underwriting. In the case of the underwriting commission bookrunners in practice claw back from the pool of underwriting commissions their own costs incurred in preparing for the transaction, including incidental expenses of their own staff, and the remainder is then paid out to all syndicate members (including the bookrunners) proportionately to their underwriting commitments.

In practice the bookrunner tends to receive most or all of the selling concession. This reflects, among other things, investors' perception that the bookrunner, being in charge of allotments, is more likely to allot shares to bids on which it will receive selling concession (see Jenkinson and Jones (2004, 2007)).

Apart from the different nomenclature of European and US syndicates referred to above, the order-taking and remuneration arrangements also differ. In US IPOs institutional orders are received directly by the bookrunner into a 'pot' and do not come via other syndicate members. The bidder is then invited to designate among syndicate members the selling concession on any allocation to that order. It is also customary for a certain fraction of the shares, and thus of the selling concession, to be reserved for each syndicate member (its 'retention') in an amount that varies according to the seniority of that bank. These shares are allocated at the discretion of the syndicate member, often to its retail investors. Retention to some extent counters the tendency, under the 'pot' system, for the great majority of selling concession to accrue to the bookrunner. As a reflection of this, issuers sometimes cap the fraction of the gross spread that the bookrunner may earn to around 80%. 'Fixed economics' is also common in the US, with non-bookrunning managers receiving an agreed percentage of the total gross spread less costs. Chen and Ritter (2000) give a breakdown of remuneration on a typical US IPO, in which the bookrunner earns two-thirds of the available commissions.

Underwriting is typically 'soft' in international IPOs. That is, the underwriting syndicate decides whether to underwrite the issue, and at what price, only after the end of bookbuilding, by which time they know whether the issue size is already covered by investor bids. The underwriting commitment, if taken, then typically lasts between the evening of the last day of bookbuilding and the following morning, when allotments are communicated to investors. Counter-party risk – that bidders will not pay for the shares – endures until settlement date, but in practice bidders do not renege on their bids during this period. As a result, underwriting risk is extremely limited.

Modifications to the traditional bookbuilding technique

Although most IPOs follow the approach outlined above, a few issuers have attempted to modify the way bookbuilding works, in particular by disaggregating roles and altering incentive structures.

First, in some European privatizations the government has appointed separate advisers and bookrunners. For instance, during the UK privatization programme of the late 1980s and

early 1990s the UK Treasury and the company being floated each appointed advisers who normally did not take part in the placement; then, assisted by their adviser, they selected bookrunners and placement syndicates. The French, German and Italian governments did likewise in their privatizations but in these cases advisers were allowed to participate in the placement syndicate. The rationale for this separation between advice and placement was that the adviser could limit the scope for the placement banks to exploit information asymmetries, notably during pricing and allotment. An adviser which is itself experienced in handling IPOs may keep banks 'honest'. A further way in which roles have been disaggregated is for a body other than a bank to run the book of demand. The Task Force on Asset Sales (TFAS) performed this role in a number of Australian privatizations while in France retail demand in public offerings is centralized and allotted by Euronext Paris, the French Stock Exchange.

Second, the temptation to succumb to conflicts of interest may be reduced if there is more than one bookrunner. According to the Dealogic database, the average number of bookrunners in European IPOs during 2007 was 1.3 per transaction, a little higher than the average of 1.2 in 1997. As Hu and Ritter (2008) report, in the last decade the frequency of multiple bookrunners has increased from zero to over 60% of US IPOs. Arguably there is more competition between multiple bookrunners who 'keep one another honest'. On the other hand collusion between them might weaken the issuer's bargaining position further. Academic research gives some insights into these questions although it has tended to focus on the size of the underwriting syndicate as a whole rather than on the number of bookrunners. Corwin and Schultz (2005) find that information production, reflected in price revisions, rises with an increase in co-managers and other syndicate members. Davidson, Xie and Xu (2006) find that the number of co-managers is positively associated with placement risk as proxied, for example, by price uncertainty. On the basis of US IPOs between 2001 and 2005, Hu and Ritter (2008) find that gross spreads do not change with the number of bookrunners, but that underpricing is lower with multiple bookrunners, with the estimated 1% less underpricing per additional bookrunner coming from a combination of a higher filing range and greater responsiveness to positive market conditions.

Third, traditional fee structures incentivize banks to maximize the IPO price because fees are set as a percentage of proceeds. However, other incentives may run counter to this, for example the cost to a bookrunner's reputation of overpricing IPOs (see for example Beatty and Ritter, 1986, and Nanda and Yun, 1997). If the issuer believes that the balance between these incentives favours excessive underpricing, the issuer may alter them. A change that has been observed in some IPOs in recent years, without attracting much academic attention, has

been the setting aside of part of the gross spread as an incentive fee payable at the issuer's discretion. Between 2004 and 2007, according to the Dealogic database, the incentive fee represented, on average, around 6% of the gross spreads in European IPOs, and 27% in those IPOs which had an incentive fee. This portion may, at least in part, be determined by the level of final pricing so that, for example, the underwriters are rewarded for fixing the final price in the upper part of the initial price range. The incentive fee may also include a discretionary element, for example to reward the underwriters' performance in pre-marketing the shares or the issuer's general satisfaction with the handling of the transaction. Other changes to the incentive structure have targeted aspects of IPOs other than underpricing. For example, some issuers have tried to introduce more competition into the selling process by increasing the selling concession as a fraction of the gross spread and/or 'capping' the fraction of the total commission pot that the lead underwriter(s) may earn, thus increasing the incentive for other underwriters to generate demand.

Finally, there have been various attempts over the years in many countries to avoid bookbuilding altogether and use an auction to set prices in IPOs, with pricing and allotment being (largely) algorithmic rather than discretionary, thereby disintermediating investment banks. There is no academic consensus on the relative merits of traditional bookbuilding and auction methods for IPOs. Biais et al. (2002) assume that, in bookbuilding, informed investors and the bookrunner collude to exploit an informational advantage vis-à-vis the issuer. The authors find that the optimal offering method is 'auction-like' and resembles most closely the UK offer by tender and the French *offre à prix minimum*, with shares being sold at a single clearing price and with no bookrunner discretion over pricing and allocations. Sherman (2005) builds a model to compare traditional bookbuilding, discriminatory price auctions and uniform price auctions. She assumes that the number of bidders and the accuracy of their information are endogenous to the transaction, and that there are no agency problems between issuers and underwriters. On the relative merits of these three forms of offering she concludes, 'The ability to control allocations (via book building) yields two advantages: less risk for both issuers and investors, leading to less underpricing even under risk neutrality; and more control over information expenditures, which means more control over either underpricing or aftermarket volatility. These advantages should appeal to all issuers, offering an explanation for the global trends in IPO methods over the last decade'. And Jagannathan and Sherman (2007) note that, although auction methods have been tried in many countries, they have almost all been abandoned.

These various innovations, or wholesale changes, to the bookbuilding approach

provide a useful context for the competitive IPO, which draws on some of these previously observed features. In the next section we present the Pages Jaunes IPO as a clinical study of the original competitive IPO.

III. Pages Jaunes – the first competitive IPO

Background to the Pages Jaunes IPO

The PJ IPO was part of a larger restructuring by its parent company, France Télécom (FT) and formed part of a sequence of transactions designed to reduce FT's leverage and streamline its businesses. In February 2004 FT had announced a buy-back of shares in Wanadoo, its internet service provider subsidiary, a minority of whose shares were listed. PJ, the yellow pages company in the FT group, was 100% owned by Wanadoo at this time. FT did not want to retain 100% of PJ shares after the Wanadoo buy-back and announced that it intended a partial flotation of PJ within twelve months. By July 2004 FT owned 96% of Wanadoo. Simultaneously with the PJ IPO, FT planned a 'squeeze-out' of the remaining public shareholders of Wanadoo on the same terms as those on which the other Wanadoo shares had been bought back, allowing the delisting of Wanadoo.

This sequence of transactions meant that the offer price of the PJ was a sensitive matter for FT. When the buy-back of Wanadoo had been launched, FT had set a value on PJ of €3.96 billion. If the IPO price were markedly lower than this, FT's shareholders would feel that the Wanadoo minorities had been overpaid at their expense. If the IPO price were much higher, FT had committed to pay a supplement to the Wanadoo minority shareholders. Consequently, FT was unusually keen for the IPO to be priced as accurately as possible and avoid any bait and switch issues with the underwriters; it paid close attention to creating the right incentives for the investment banks involved in the issue as it viewed the conventional bookbuilding approach as potentially flawed.

FT also felt justified in imposing its own structure on the Pages Jaunes IPO. In 2003 FT had launched a €15 bn rights issue. Just before launch the four appointed banks revised the terms on which they were prepared to underwrite the shares. In response FT altered the process by inviting these four banks together with a further seventeen banks to bid for a role in the issue on the basis of price and size of underwriting commitment. As a result the issue was fully underwritten at fees and at a discount to the existing FT price which were both

narrower than what had been proposed by the original four banks.[4]

France Télécom's critique of traditional IPOs

FT set out to avoid what it considered defects in the traditional IPO structure. These defects, mentioned in documents of theirs and of their adviser, Dresdner Kleinwort Wasserstein (DrKW), are underpricing, 'bait and switch' and the allotment of shares to undesirable investors, notably hedge funds. These are, of course, questions that have concerned academics, regulators, and many other issuers, although the way of addressing them was innovative.

Both FT and DrKW felt that IPOs are apt to be excessively underpriced. In a paper on 13 May 2004, DrKW remarked that, in a traditional IPO, pricing is 'not optimized,' and that the objective should be to optimize [the] IPO price and distribution through a price discovery process.' FT claimed that banks, once mandated, propose price ranges that are 'too low, leaving value on the table for investors'.

'Bait and switch' involves banks allegedly exaggerating the achievable IPO price when pitching to be appointed to lead an IPO and then revising it downward near the time of the IPO. FT's post-mortem states, 'Often the value suggested for marketing is lower than the original value advertised by the bookrunners to win the mandate;' and FT refers to a temptation for banks to submit price ranges that are 'excessively high in an attempt to be appointed'.

DrKW also mentions, in its post-mortem of the IPO, the allocation of shares in traditional IPOs against the best interests of the issuer, notably to hedge funds, talking critically about the '[d]eal allocated in priority to hedge funds.' John St John, who managed the transaction at DrKW, told the authors that, in traditional IPOs, the list of potential investors to be contacted is drawn up by the banks already appointed as bookrunner. They may bias the list to their own clients so that, however objective the allocation process might be among bidders on that list, the process favours the customers of a small number of banks

[4] Further context for the FT decision was the June 2004 €1.6 billion IPO of Deutsche Postbank, which highlighted what an uncertain business IPO pricing could be. The price range of that transaction had had to be reduced after the very low internal valuation by one of the lead underwriters, Deutsche Bank, had reached the public domain. Deutsche Postbank's CEO Klaus Zumwinkel had announced during the transaction that the original price-range would stand and suffered a climb-down when it did not. The Financial Times noted (9 July 2004) that "France Telecom's novel approach to the initial public offering of Pages Jaunes, … seems to have succeeded in its aim of avoiding the embarrassment Deutsche Post suffered over PostBank. To avoid overoptimistic pricing, investment bankers were told their fees would not be paid if they predicted the wrong price."

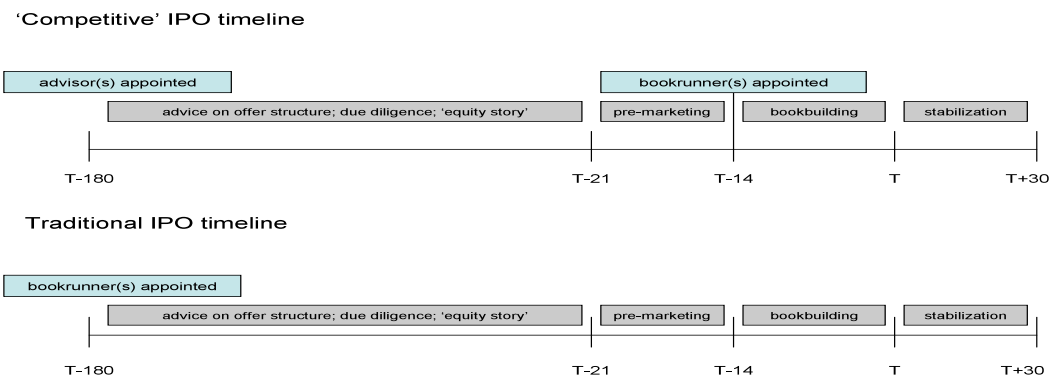
and competition for shares is reduced. FT does not mention this in its critique of traditional IPOs, although a private equity vendor, which subsequently used competitive IPOs, did so in communication with the authors.

As for the underlying causes of these defects, FT points to the early appointment of the bookrunner(s) and the abuse by the latter of asymmetric information. FT states in its own post-mortem, 'By appointing at the outset the same institution for preparation and placement, it is not unusual for the institution, once appointed, to take advantage of its position to revise down the initial price range.' FT noted that the selection process is usually six months before IPO launch and sometimes one to two years. Since lead underwriters are appointed well before key pricing decisions, real competition between underwriters remains untapped. DrKW in its post-mortem claimed that, in a traditional IPO, the 'bookrunner's conflicts of interest [are] not monitored'. It also maintained that the 'negotiation of price range and final pricing [are] based on asymmetric information with no guarantee on IPO final pricing.'

Banks appointed to the IPO

FT's appointment of banks to the PJ IPO reflects its assessment of the underlying defects of the traditional IPO model. It attempted to reduce the banks' scope to abuse asymmetric information by making bookrunner appointments late and by assigning some of the bookrunner's traditional roles to advisers, as the timelines below show for a 'competitive' and a traditional IPO.

Schematic timelines for 'competitive' and traditional IPOs showing the main appointments and phases in the transaction



Three appointments were made well in advance of the transaction. Morgan Stanley was engaged as lead adviser to PJ on the deal. Calyon was appointed by PJ to organize the French retail offering. Both these banks were responsible for carrying out due diligence. DrKW was appointed as adviser to FT via the latter's subsidiary Wanadoo. However, a critical feature of the deal was that none of these banks was promised any role in the underwriting syndicate; the formation of the syndicate was completely separated from the advisory roles. The bookrunner role was divided between five banks which were to be appointed after the pre-marketing period, along with four joint lead managers. In the event Morgan Stanley and Calyon were appointed bookrunners and DrKW was made a co-lead manager.

The early appointments of Morgan Stanley and Calyon meant that due diligence could be completed by the time the bookrunners were selected. A potential problem was that the bookrunners, once appointed, might be unwilling to accept underwriting risk on the basis of due diligence done by other parties. However, the appointed bookrunners knew that due diligence had been carried out by banks which were competing for a bookrunner roles, even if they might not be appointed. FT also mitigated this problem by arranging for the bookrunners, after their appointment, to participate in this process beyond the 'bring-down' due diligence in which syndicate members normally participate. In the event Morgan Stanley and Calyon, as bookrunners, bore the risk of their due diligence work along with the other appointees and their presence in the bookrunner group may have comforted the other bookrunners.

The early appointment of DrKW allowed FT to make decisions regarding deal structure and preparation with a party whose remuneration was set regardless of their advice. These decisions concerned the design of the deal, the appointment of banks and commissions.

Designing the deal

FT and DrKW considered a number of alternative structures for the IPO. Common to them all, however, was the appointment of the entire syndicate, including the bookrunner(s), after pre-marketing. In a document dated 13 May called 'Structuring the Transaction' DrKW proposed inviting 12-15 banks to take part in pre-marketing, and selecting from among them only after pre-marketing had ended. DrKW suggested as selection criteria the scale and quality of the banks' pre-marketing efforts and their assessment of, and commitment to, an achievable price range. In a document of 31 May DrKW gave more details. Around 15 banks

would be invited to a beauty parade and to submit written proposals with their views on the transaction. Some eight banks would be short-listed and invited to pre-market the IPO. Each would be prescribed the responsibility to pre-market to a list of institutions. After pre-marketing the banks would propose a price range within a narrow band and 2 or 3 bookrunners would be selected on the basis of this and of the perceived quality of their pre-marketing efforts.

The other short-listed banks would be appointed to non-bookrunning joint lead roles. FT and DrKW would then determine the price range. As for fees, banks would receive most of their reward if the final price were set within the range they had indicated, although at this stage the basis for calculating this element was not stated. DrKW only recommended that there should be a base fee of around 2%, split in the traditional manner (1:1:3 between underwriting, management and selling) and that it would be reduced if pricing were at or near the bottom of the indicated range. An entirely discretionary fee of around 0.75% would also be paid to some or all syndicate members to reward marketing performance. DrKW's fee proposal was explained in a document dated 18 May in terms of previous European IPOs; in this paper they regressed gross fees against offer size, to show that gross fees of just under 3% corresponded to the size of the planned PJ offer.

Two other structural considerations pre-occupied FT and DrKW at this stage: (i) whether to ask the banks to hard underwrite the IPO (in contrast to the soft underwriting in the traditional IPO structure) and (ii) how to co-ordinate the institutional and retail offerings. In their document of 13 May, DrKW contemplated asking the banks, after pre-marketing, to commit to a hard underwriting; that is, to underwrite IPO from the start of bookbuilding at a fixed price. The amount and price level of a bank's underwriting commitment would be among the factors taken into account in appointing senior syndicate positions. Underwriting amounts would be the subject of a modified auction: a single underwriting price would be set in light of the banks' bids for underwriting, though not necessarily the highest possible price.

DrKW's advice was that, by leaving appointments until after pre-marketing and by making a hard underwriting a possibility, the quality of the feedback of aspiring banks would be improved. In a more detailed discussion paper of 27 May on the subject DrKW noted that the completion of the transaction and the price were uncertain without hard underwriting. At the same time they claimed that a hard underwritten offering gave little prospect of pricing above the underwritten level. The reason is not stated in their document but a widely held view among investment bankers is that risk mitigation becomes paramount for underwriters in a hard underwritten transaction and that banks prefer to forgo fees by pricing low rather than

increasing the risk of undersubscription by aiming for a high price. DrKW also mentioned the danger that banks would collude to reduce the level at which they were prepared to underwrite, although they downplayed this risk given the short length of time the banks would be appointed. In the event DrKW recommended at this stage that FT should leave the decision about hard underwriting until after pre-marketing. Then FT could ask banks both to bid for a hard underwritten transaction and to propose an indicative range for a soft underwriting.

FT could thus defer a decision on hard underwriting until it knew at what level this would be available. In any event the fees would incentivize banks to take on large underwriting commitments. In a document dated 18 May DrKW envisaged, on top of a ca 2% base fee, a 0.5% increment for banks whose underwriting commitment and allocation were above €300 million and a 0.25% fee for those who underwrote more than €300 but were allocated less. DrKW also suggested in their 13 May document a mechanism whereby FT would be prepared to adjust the underwriting level under a 'market adjustment clause', even after the banks had committed to it, in light of exceptional market conditions, but this idea was not developed in later material. However, by 31 May DrKW was merely proposing that banks should be invited to offer hard underwriting if they wished and in the event the IPO did not include hard underwriting at all.

The other structural consideration was the interaction between the institutional and retail offerings. In one scenario an institutional bookbuilt offering would be priced and allocated first, and a retail offering would follow at the lower of the institutional price and of the market price prevailing at the pricing date. Another timetable had the two offerings running according to the same timetable with the retail offering priced at a pre-set discount to the institutional price. In each of these scenarios the institutional bookbuilding would be kept to 2/3 days and orders submitted before then would be held over until the books opened. The retail tranche would be conducted by a retail co-ordinator which would not necessarily be one of the institutional bookrunnners. DrKW rejected consecutive institutional and retail offerings on two grounds. First, this would mean that there would be no competition or 'demand tension' between the offerings, i.e. that the two constituencies would not be able to bid against each other for stock. Second, the institutional offering would have to be sized and allocated in ignorance of retail demand, and the sizes of the two tranches could not be adjusted in response to demand.

Pre-marketing and senior appointments

The timetable for the PJ IPO is presented in Figure 1, which is based on the post-mortem of the transaction as presented to FT by DrKW. This timetable broadly accords with DrKW's pre-deal recommendations. Twenty-three banks were sent a request for proposal (RFP) to participate in the transaction. Of the 21 which did so, nine were selected, on the basis of a five-page written proposal, to conduct pre-marketing and the rest eliminated. The nine were each given 40 institutions to which they had exclusive responsibility to pre-market, although not exclusive access. Each bank provided written pre-marketing feedback to FT and DrKW so that, if there were discrepancies, DrKW could contact institutions directly to verify their views. The banks were told that a selection would be made from among them for senior appointments as a result of their pre-marketing performance. This performance was measured through their qualitative feedback from pre-marketing and from their response to an 'Invitation to Bid'. This required banks to propose a price range within a band no wider than 10%. The nine were sent documentation relating to the transaction, notably the draft prospectus, and were involved in due diligence at this stage, so that any queries could be addressed before the final appointments were made. Banks were given one day (from Friday 18 June to Saturday) to respond. By Sunday they were told the outcome; a final due diligence session was held for the appointees, and the responsibility for the offering handed to them. The roadshow began on Tuesday, 22 June. The rest of the timetable was in line with that of a traditional IPO: the roadshow ran from the 22 June to 6 July. The shares were priced and allotted on Wednesday, 7 July and trading began the following day.

Appointment of banks

The nine banks invited to pre-market the offering were: ABN AMRO Rothschild, BNP Paribas, CALYON, Citigroup, Goldman Sachs, Lazard-IXIS, Lehman Brothers, Morgan Stanley and Société Générale. In the event, the following five were appointed as joint bookrunners and joint global co-ordinators: ABN AMRO Rothschild, BNP Paribas, CALYON, Lehman Brothers and Morgan Stanley; the others were appointed to the lesser role of joint lead-managers. DrKW were appointed as co-lead manager; this enabled FT to pay DrKW for their advice out of the fees due to the underwriting syndicate and to avoid incurring a separate advisory fee. The selection of the five bookrunners was made on the basis outlined above, and their suggested price ranges were taken into account. The (anonymized) banks' ranges are shown in Figure 2. The ranges of banks 1, 5, 7 and 9 were removed and the

indicative range was set around those of the remaining banks, which were selected as bookrunners. The decision to remove the highest and lowest ranges was driven by FT's desire for high but accurate pricing. According to DrKW, FT chose the banks whose valuation ranges were 'most aggressive and realistic'. Their assessment of what was realistic was informed by the feedback on investors' valuations from pre-marketing. The pre-marketing feedback is summarized in Figure 3.

Investors' indications of valuation were concentrated between Euro 3.5 and Euro 4.0 billion. DrKW explained the chosen price range of Euro 3.617-4.166 billion as being intended, at the lower end, 'to lock-in most investors in the bookbuilding process and gain momentum' and, at the higher end, 'to leave significant upside above Pages Jaunes' reference value' (for the buy-back of the Wanadoo minorities) of Euro 3.958 billion. The final price was fixed in the event almost exactly at this level, at a value of Euro 3.946 billion.

Bearing in mind FT's desire to avoid being the victim of 'bait-and-switch' as described above it is instructive to compare the price ranges of the nine short-listed banks with the valuations they indicated when they were among the 23 banks that had been invited to make a preliminary proposal. The chart in Figure 4 shows this comparison. On average the mid-point of the price ranges decreased by 3.1% between these two stages and the decrease was 9.2% in the most extreme case. During the same period the CAC 40 index rose 0.50% and the DJ Euro Telecoms Stoxx index rose 0.85%. Of course, if banks are asked to value a company months in advance of an IPO and then just before the IPO itself, the valuation would be likely to change to reflect their greater information about the company and the market. In this case, however, the time-lapse was under two weeks and seven out of nine banks lowered their valuations. This comparison, at least, is consistent with a policy of 'bait-and-switch' by the banks.

Syndicate economics

FT's fee structure was very heavily performance-driven. A base fee of 1.75% was split 1:1:3 between underwriting, management and selling respectively. This fee was originally to be payable only if the final price was fixed within the range of the bank concerned. The fee was designed like this to 'encourage banks to submit realistic marketing price range' (DrKW presentation, 10 June 2004). In the final analysis, however, the basis for payment was altered so that a bank received this fee only if the price was set within the chosen bookbuilding range selected, not that proposed by each bank. Kaïs Ben Hamida, who was responsible for the

transaction at FT, acknowledged that this might undermine the strategy to incentivize accurate price ranges in a repeated game setting, but stated that this was more of a problem for DrKW – as architects of the IPO procedure – than FT, who were not planning future IPOs. In the event, the final issue price was not outside the ranges of any of the banks, and the base fee was paid in full.

There was an additional incentive fee of 1%; half of this was payable automatically if the price was set in the top third of the range and half would be at FT's discretion. In the event the price was not set in the upper third, but FT allowed the fees to be paid based on a linear reward scheme (rather than the binary scheme originally proposed). The other 50% was to be paid according to the 'value added' of the syndicate members. FT reported that, for the syndicate as a whole, 92% of this part of the incentive fee was paid.

We do not have access to the actual payment of fees to the underwriters. We can piece together some aspects of the institutional offering, to which these fee arrangements applied. The institutional offering of 40 million shares (or Euro 576 million pre-greenshoe) was underwritten in the following percentages:

Table 1: Breakdown of underwriting commitments between the underwriters of the Pages Jaunes IPO

ABN AMRO Rothschild	15.00%	Lazard-IXIS	5.25%
BNP Paribas	15.00%	Citigroup	5.25%
CALYON	15.00%	Goldman Sachs	5.25%
Lehman Brothers	15.00%	Société Générale	5.25%
Morgan Stanley	15.00%	DrKW	4.00%

Note that DrKW, the adviser, was included in the syndicate with 4% of the underwriting and in this way they were paid for their advisory work in the deal. These percentages were applied to the underwriting and management portions of the base fee, that is 40% of 1.5% of proceeds. The remaining 60% of this fee represented selling concession, which was paid out proportionately to the shares allocated through each bank. As we have just seen, the base fee was paid out in full, as was 92% of the incentive fee. We also understand that the bookrunners' share of the selling concession was capped at 2/3 of the total selling concession to incentivize non-bookrunners' selling efforts.

Outcome of the IPO

The IPO was twice subscribed at the final offering price, with the retail offering 1.1 times subscribed and the institutional offering 2.9 times subscribed at their respective issue prices of Euro 14.1 and 14.4 per share. The greenshoe option of 15% of the base offering was exercised in full and an 'extension clause', up to a maximum of 19% of the base offering was exercised for 2%. The growth of demand during the bookbuilding period is shown in Figure 5.

Kaïs Ben Hamida suggested that there are three broad phases to the bookbuilding – getting the book covered, raising the quality of investors in the book and then reducing price sensitivity by getting investors to raise or remove their limits. The chart in Figure 6 shows the price sensitivity of institutional and retail demand. Each bar shows the total demand at each price (in increments of 0.1 and 0.2 Euros), broken down by the 'quality' of bidder, ranging from 'super tier one' investors to retail investors. Bookrunners had been asked to rank investors by quality before the bookbuilding had begun and FT had determined final quality categories with the involvement of their own investor relations department, which was aware of investors' holdings of FT's own shares and inferred from this those investors' propensity to be long-term holders of PJ shares. Hedge funds were assigned to the bottom two quality categories, tiers three and four. FT was keen to allocate to investors which had proven to be long-term investors in FT.

Above each bar is the percentage of total demand represented by the top three categories of institutional bidder (super tier one, tier one and tier two). The horizontal dotted lines show the maximum and minimum issue size. The maximum issue size assumes both that a 19% 'extension clause' and the greenshoe 15% option are exercised. Total demand shown is highly price sensitive between Euro 14.0 and Euro 14.6 per share; in fact it more than halves between these prices. Institutional price sensitivity was far sharper than retail price sensitivity: demand from the former declined by 68% as the price rose from Euro 14.0 to 14.6 per share, while the latter declined by only 4%. Price sensitivity and institutional quality did not correspond fully: super tier one declined by 79% between these prices, tier one by 55%, tier two by 74%, tier three by 70% and tier four by 48%. We do not have details of the allocation by investor quality. However, at the institutional price of Euro 14.4 per share demand from super tier one and tiers one and two covered the institutional offering (pre-greenshoe) of 44 million shares 1.6 times, so allocations could have been made without placing shares with the two lowest tiers of investor, which were the categories that included hedge funds. Allocations in the institutional offering were broken down by investor type and geographically as shown

in Figure 7.

The PJ shares, priced at Euro 14.4 per share for institutions (and Euro 14.1 for retail investors), closed at €14.15, down 1.7% from the institutional price on the first day, and just above the retail price, and then performed broadly in line with other European stocks in the sector. Over the following six months it slightly underperformed Yell but outperformed SEAT, the two shares most commonly cited as comparables by investors during pre-marketing. It also traded in line with the index of European telecoms operators (see Figure 8).

Appraisal of the Pages Jaunes IPO

The only reservation FT expressed about the structure of the IPO is that institutions were called by too many banks during pre-marketing: Kaïs Ben Hamida told the authors that the number of banks allowed to contact each institutions should have been restricted to three including the bank with responsibility to do so. Otherwise, as FT states in its own post-mortem on the transaction, it felt that it had achieved its objectives thanks to four structural innovations. First, by separating the preparation and documentation phase from the placement phase it reduced banks' scope to abuse information asymmetries. Second, the syndicate selection was in two competitive stages. Third, the second of these stages occurred after pre-marketing partly on the basis of their indicated price ranges. And fourth, the fees were linked to the accuracy of these price ranges and the ability of the syndicate to achieve pricing high with the chosen range.

In fact not all of these were innovations but there were three novel features of the Pages Jaunes IPO: first, the late appointment of banks to the bookrunner roles that had not been assigned to other parties; second, the fact that FT took the disaggregation of bookrunner roles further than ever before; and third, the link between banks' indicative price ranges and their fees. The first of these novelties partly necessitated the second because, if bookrunners were to be appointed late, other parties had to be engaged earlier to carry out some of the preparatory work. Together these two features allowed FT more control over the offering and a longer period during which it received advice from unconflicted parties. However, the third novelty was needed if the issuer was to prevent the banks from engaging in 'bait-and-switch'.

The comparison in Figure 4, above, between banks' initial indicative ranges and the ranges in the invitation to bid illustrates the phenomenon. The late appointment of banks and the splitting of roles, alone, did not remove the danger of 'bait-and-switch' because banks might always suggest a high indicative price range after pre-marketing in order to win the

bookrunning role and then fix the final price low within that range. The linkage between each bank's indicated range and the final price was a mechanism to ensure that bait-and-switch was not merely delayed until later in the IPO process. As for FT's other concerns, underpricing and misallocation, the PJ structure certainly allowed FT to address them, but not in a completely innovative way. The incentive fee which was offered for pricing in the top third of the indicative range was no novelty (see section II above), although at 40%, the percentage of the total fees represented by the incentive fee was high by market standards. And the presence of an adviser to assist the issuer in interpreting pre-marketing feedback and in pricing and allotting the shares – in short, in mitigating the bookrunner's potential to abuse asymmetric information - has a number of precedents, as we have seen.

IV Competitive IPOs – developments since Pages Jaunes

Interviewed after the PJ IPO, Kaïs Ben Hamida stated, "Is this the new way of doing IPOs? Pages Jaunes was a specific situation with a specific asset. It was not a complicated technology company, it was easy to understand, it had stable, diversified cash flows, there were recently listed comparables, and it didn't require a long roadshow. The IPO process we put in place was tailor-made for Pages Jaunes. Could this structure be replicated? That will depend on the circumstances and the deal. The key, as always, will be to have the right process to achieve the right objectives for the right project. That's what we tried to do with Pages Jaunes and I think we succeeded."

A number of other IPOs have been dubbed 'competitive' and have followed PJ in splitting the traditional roles to some extent. The transactions are summarized in Table 2. None of these IPOs followed Pages Jaunes in all the respects described above, nor do we have the same level of detail as we do for PJ. However, in these transactions some of the preparatory work, including documentation, was carried out by parties not (yet) appointed as bookrunners. Furthermore the bookrunning roles were awarded either just after pre-marketing or, if they were appointed before pre-marketing, it was only after the aspirant banks had conducted private soundings with selected institutions. For example, in the Inmarsat IPO, DrKW was appointed as adviser and JP Morgan Cazenove and Morgan Stanley were appointed as joint sponsors, in which role they prepared documentation. DrKW did not participate in the placement of the IPO and they were paid a partly fixed, partly discretionary fee. JP Morgan Cazenove and Morgan Stanley were allowed to compete for bookrunning roles and in the event were, with Lehman Brothers and Merrill Lynch, appointed bookrunners. Only one other

bank was eliminated, after allegedly refusing a subordinate role. In Inmarsat the appointments were made before pre-marketing, but after competing banks had been allowed to conduct discreet soundings with three investors each in a process dubbed 'pilot-fishing'.

Table 2: Summary data for 'competitive IPOs' since Pages Jaunes

This columns in this table show (1) the name of the issuer, (2) the month and year of issue, (3) the number of bookrunners, (4) the offer size in € million, (5) the incentive fee as a percentage of the total fee (i.e. of the gross spread), (6) the price range per share expressed in the currency of issuer, (7) the final price and (8) the percentage gain or fall from the issue price at the end of the first day's trading

Issuer	Date	# of book-runners	Offer size (€m)	Incentive fee	Price range	Final price	First-day close
Inmarsat	Jun 05	4	597	71%	215-245p	245p	+17.6%
Eutelsat	Oct 05	5			*IPO delayed*		
Telenet	Oct 05	4	922	67%	Eu21-25.5	Eu21	-9.1%
EFG	Oct 05	3	904	67%	Sfr34-41	Sfr38	+4.2%
Hogg Robinson	Sep 06	4	364	43%	£0.9-1.2[5]	£0.9	+6.7%

None of these competitive IPOs linked banks' commissions directly to their pre-marketing ranges as PJ had done. In Inmarsat, for example, there were three fee elements, totalling 3.25-3.50% of proceeds. These were: (i) a base fee of 1% paid as long as the IPO took place; (ii) a price-based incentive fee, which was 0% if the final price was at or below the bottom of the indicative range and rose to 1% if pricing was at the top of the range; and (iii) a fully discretionary fee of 1.25-1.5% based on three performance criteria: performance against allocated accounts, cooperation with other banks in the process, and investor feedback on the banks.

It is noticeable that in all competitive IPOs the incentive fee represented a large fraction of the total fees, ranging from 40% of total commission in Pages Jaunes to 71% in Inmarsat (and what would have been 80% in the withdrawn Eutelsat IPO). This compares with an average incentive fee of around 6% of total fees for European IPOs during 2004-2007.

As the table above shows, competitive IPOs have had mixed success. Inmarsat and EFG were priced at the top of their indicative ranges and their first-day closes were above the offering price. Telenet, by contrast, was priced at the bottom its range and fell sharply in the

[5] IPO was reduced from an original range of £1.4-£2.2 per share.

aftermarket. The first day's drop of 9% was followed by a further 5% drop on the second day of trading. The Eutelsat IPO was withdrawn and relaunched a few months after the first attempt, this time as a traditional IPO. The Hogg Robinson IPO saw the original indicative price range reduced and it was priced at the bottom of this lower band.

Competitive IPOs have proven to be highly controversial. A large number of banks have been willing to participate in competitive IPOs. Permira, the private equity firm, used this structure as vendor in both the Inmarsat and Hogg Robinson transactions. However, the structure has drawn criticism from both market participants and regulators. Market participants have argued that the competitive format makes banks less, not more, honest in their dealings with the issuer. They point out that, if banks are advising on market conditions while they are competing for bookrunner roles, they are likely to be over-optimistic towards the issuer. In a report in Euroweek of 3 March 2006 one banker is quoted as saying, "If you compete, you're incentivised to make the world seem a pretty place. In a process like this, the tough messages don't get delivered and bookrunners keep blowing smoke in the client's face." In the same article Louise Wilson, head of equity syndicate at UBS, says: "An IPO is arguably the most important event in a company's history and this process treats it like a commodity." These comments suggest that 'bait-and-switch' is still a feature of competitive IPOs, but that it is merely deferred until a later stage of the offering than under a traditional timetable. Thus, while traditional 'bait-and-switch' might result in a disappointingly low price range for the issuer, the outcome here is an unachievably high price range and a final price which is in the lower part, or outside, this range.

Both market participants and the UK regulator, the Financial Services Authority, have highlighted a related point, the possibility that the competitive structure encourages competing banks to write biased research. In the November 2005 issue of its newsletter *List!* the FSA notes that in a competitive IPO banks are appointed at just the time when their analysts are preparing research. The FSA expressed concern that competing firms might find it difficult to resist the pressure to inflate valuations in their research when they are under pressure to compete for mandates. The FSA's rules, referred to in the newsletter, make it incumbent on firms not misleadingly to hold out 'conflicted' research as objective. The FSA's concern was that the temptation to do so might be greater given the pressures that competitive IPOs place on banks. The FSA did not, in this newsletter, oppose competitive IPOs, but used it to remind firms of the appropriate regulatory standards for managing conflicts given the exceptional pressures of competitive IPOs.

V Conclusions

The three novelties of Pages Jaunes – bookrunner appointments after pre-marketing, radical disaggregation of roles, and the link between indicative ranges and final pricing – went together. Some roles had to be disaggregated if others were to be awarded late, and the link between price range and final price was needed to avoid 'bait-and-switch' merely being delayed. The competitive IPOs since PJ have retained the first two of these innovations but not the third. Although not strictly speaking an innovation, both Pages Jaunes and other competitive IPOs made heavier use of incentive fees than was the case in 'non-competitive' IPOs, notably to reward pricing in the upper end of the bookbuilding range.

In the Pages Jaunes IPO, for reasons peculiar to the transaction, an accurate price was sought as opposed to a high price. However, the linkage of banks' commissions to their indicative ranges could be applied in IPOs where a high offer price is the objective in a price-maximizing variant of the structure. The advantage of this would be that banks would need to propose as high an indicative price range as possible in order to be considered for appointment, but only as long as this was justified by their pre-marketing feedback. If they suggested a range that was too high, they would earn low or zero fees. With these incentives in place a bank would rationally suggest the highest indicative range which its own placement power justified. The different price ranges of the banks would thus correspond to their own perceived placement power, which would be a useful selection criterion for the issuer.

However, these incentive arrangements may be disturbed by two factors. First, when more than one bookrunner is appointed, a bank with weak placement may free-ride on the superior placement power of another bookrunner, so that the final price is still set within the inflated indicative range of the weak bank. Second, the arrangements rely on the issuer carrying out his or her threat to withhold fees if a bank's price range is not achieved. As the PJ offering showed, the issuer may have relatively weak incentives – other than the cash savings – from seeing through this threat unless he or she has more IPOs to come, thereby making each IPO part of a repeated game. As this was not the case with PJ, FT undermined the effectiveness of the threat for future issuers that use a similar arrangement.

In the absence of an explicit link between the banks' suggested bookbuilding range and fees, there is a risk that bookrunners fail to maximize this range. If bookrunners are appointed before pre-marketing and are then incentivized to set the final price as high within this range as possible, the temptation is to set an over-pessimistic indicative range in the first place. However, even in Inmarsat and other competitive IPOs in which appointments were

made before pre-marketing, banks were appointed partly on the strength of their indicative ranges and their proposals were informed by discreet soundings ('pilot-fishing'). Thus the combination of an incentive to propose a high indicative range and an incentive to price high within that range may indirectly match the direct incentive in PJ between proposed bookbuilding range and final pricing.

The innovations in the PJ IPO were designed to reverse the information asymmetries typically found in IPOs by making the issuer, rather than the bookrunner, better informed about the transaction, at least at the pre-marketing stage, and reducing the scope for the bookrunner to abuse his position. This abuse was graphically exemplified by alleged malpractice in IPOs during the period up to 2002 brought to light in the US, resulting in the Global Settlement of April 2003. Regulators addressed the issue in the US and the UK, as can be seen in rule changes by the NASD and the UK FSA. Academic research has also focussed increasingly on the scope for bookrunners to exploit conflicts of interests in their management of IPOs. However, issuers themselves have at the same time been attempting to introduce more certainty into the IPO process. Their attempts have taken a number of forms. Google used an auction for its IPO in 2004. Other attempts have involved hard underwritten IPOs, such as the £672 million flotation for RHM in July 2005; and 'decoupling', whereby a long marketing period is following by a short bookbuilding, intended to increase pricing accuracy and used for example in the Euro 45 million IPO for SAF in April 2006.

Competitive IPOs should be seen as one of a number of market-based solutions to the problems of IPO pricing and of information asymmetries between issuer and bookrunner. They represent an attempt to create a contract between issuer and bookrunner(s) that is optimal in two respects: first, in generating the information prior to the IPO that is necessary to determine a fair price, and, second, in incentivizing the bookrunner(s) to set the price as close to this level as possible. In Pages Jaunes the first of these objectives was served by having the banks compete for the bookrunner role partly on the basis of their pre-marketing efforts. As for the second objective, the price-maximizing variant of the Pages Jaunes structure would mean that banks were appointed partly according to how high their indicative range was and rewarded for their ability to achieve this level. As we have seen, competitive IPOs since Pages Jaunes have not explicitly linked fees to the level of each bank's pre-marketing range in this way. However, as long as banks are appointed partly on the strength of their proposed bookbuilding range and then rewarded for pricing high in that range, a similar incentive effect may be achieved.

All competitive IPOs have included an incentive fee that represents a large fraction of

total commissions, ranging from 40% of total commissions in Pages Jaunes to 71% in Inmarsat (compared to around 6% on average for other European IPOs in the same period). In these cases the incentive fee paid out increased when pricing was in the upper end of the bookbuilding range. This too can be seen as an incentive to price near fair value. However, if this is not combined with an incentive to propose a high bookbuilding range, the banks may be encouraged to set a low range so as to fix the price high within it. A more direct way to incentivize price maximization would be to make part of the incentive fee inversely proportional to underpricing (as measured by the difference between offer price and the first day's close, for example). However, we are not aware of any IPOs, competitive or otherwise, which have been remunerated in this way.

Competitive IPOs show issuers thinking about how to resolve the conflicts of interest that have been noted by regulators and academics alike. The late appointment of bookrunners, the radical disaggregation of roles, and heavy fee incentive for pricing high within the range, all represent efforts to optimize the contract between issuer and bookrunner. The attempts to promote effort and honesty by bookrunners attest to the fact that the conflicts of interest paradigm is now shaping market practice.

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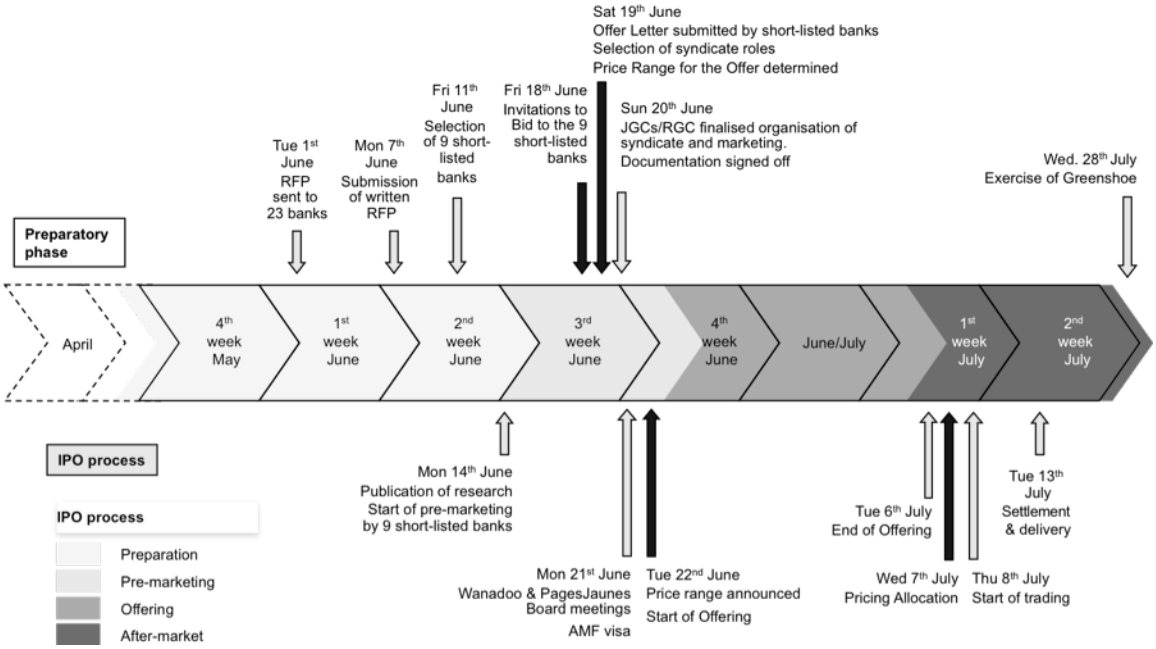
Figure 1

Panel A: Overview of the Pages Jaunes IPO process



Panel B: Overview of syndicate selection process and price range setting

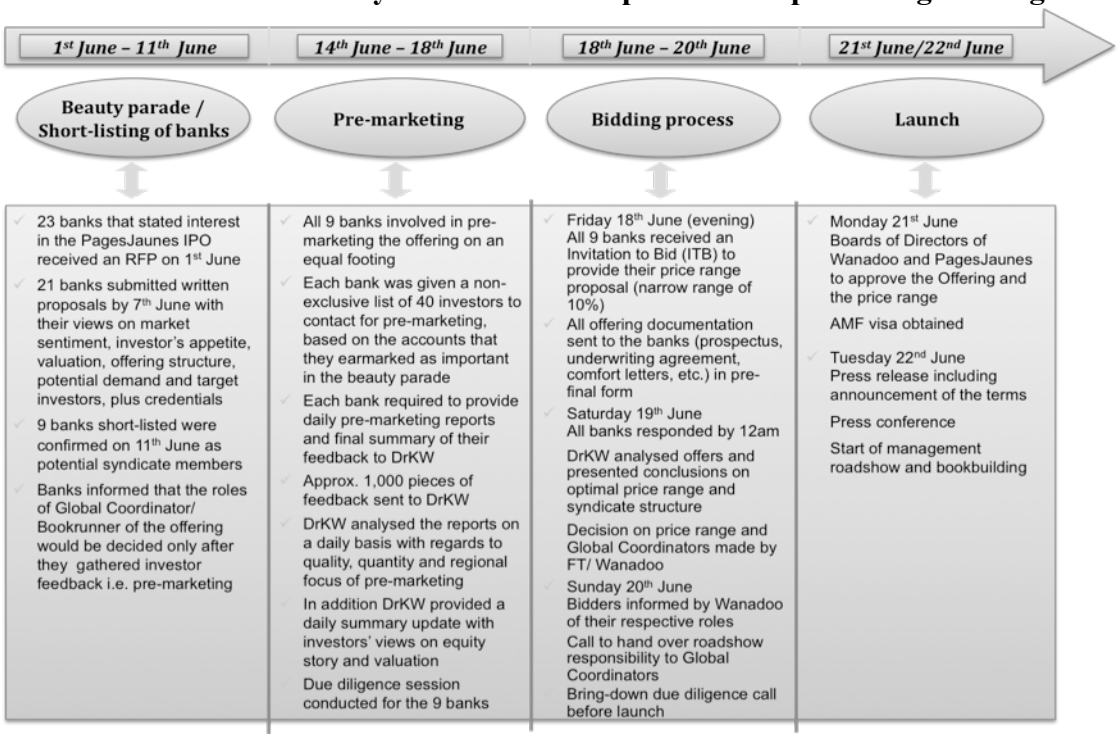


Figure 2: Invitation to Bid (ITB) price ranges suggested by the potential underwriters

This figure shows indicative price ranges in € proposed by each of nine (anonymized) banks as part of the selection process for the appointment of underwriters to the Pages Jaunes IPO. The indicative price range eventually chosen for the IPO and the final institutional issue price are also marked

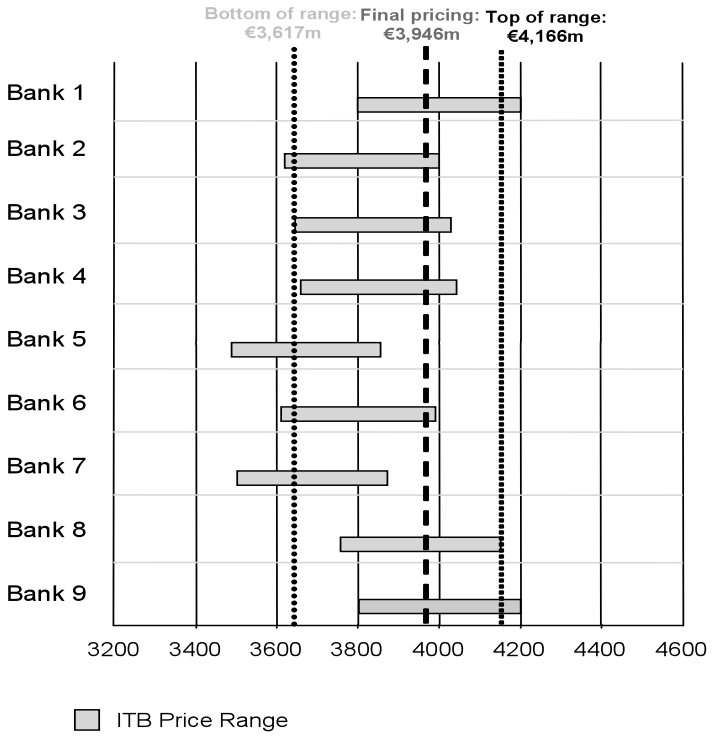


Figure 3: Summary of pre-marketing feedback on valuation

This figure shows the number of responses from investors giving their view of the valuation of Pages Jaunes. The top and bottom bars show the number of investors who indicated that they valued Pages Jaunes at a premium or discount to its peer group respectively; the other bars show the responses in valuation bands of €0.5bn

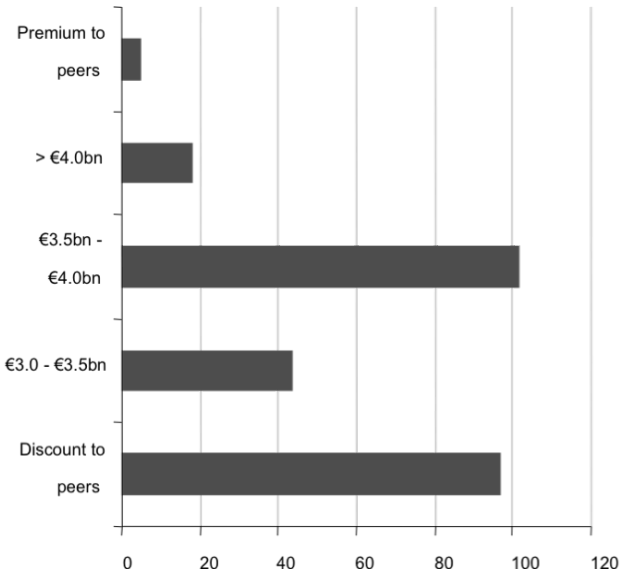


Figure 4: Comparison of banks' valuations at the beauty contest with their suggested bookbuilding ranges

This figure provides a comparison of the mid-point valuations of Pages Jaunes by each of nine (anonymized) banks on 7 June 2004 and on 19 June 2004. Positive numbers indicate a rise and negative numbers a fall in the mid-point of the valuation between these dates

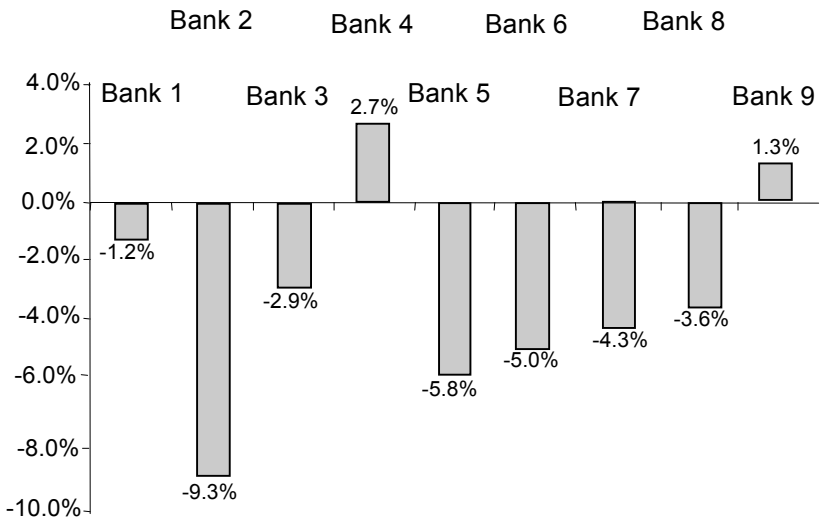


Figure 5: Development of demand during the bookbuilding

This figure shows the cumulative development of demand at all prices during the bookbuilding period of the Pages Jaunes IPO in millions of shares, broken down between French institutions, international (non-French) institutions and retail investors. The issue size was 88m shares (101m including the shares available under the greenshoe option).

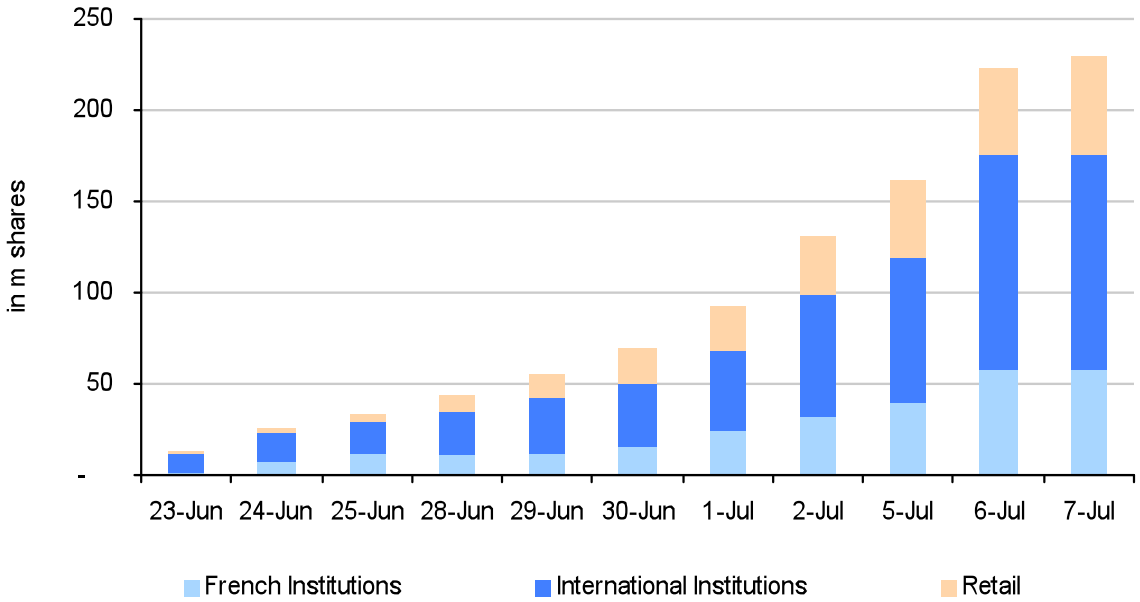


Figure 6: Price sensitivity of demand

This figure shows the detailed breakdown of total demand for the Pages Jaunes IPO at the end of the bookbuilding period. The bars show the total demand at each price in increments of € 0.2. Within each bar demand is broken down among investors by quality category, with the highest quality shown at the bottom of each bar ('Super Tier 1') and the lowest quality at the top (retail). Above each bar are shown the total demand at that price and the percentage of that demand coming from the three highest quality categories ('Super Tier 1', 'Tier 1' and 'Tier 2'). The issue size (including and excluding all the shares available under the greenshoe option) is also marked.

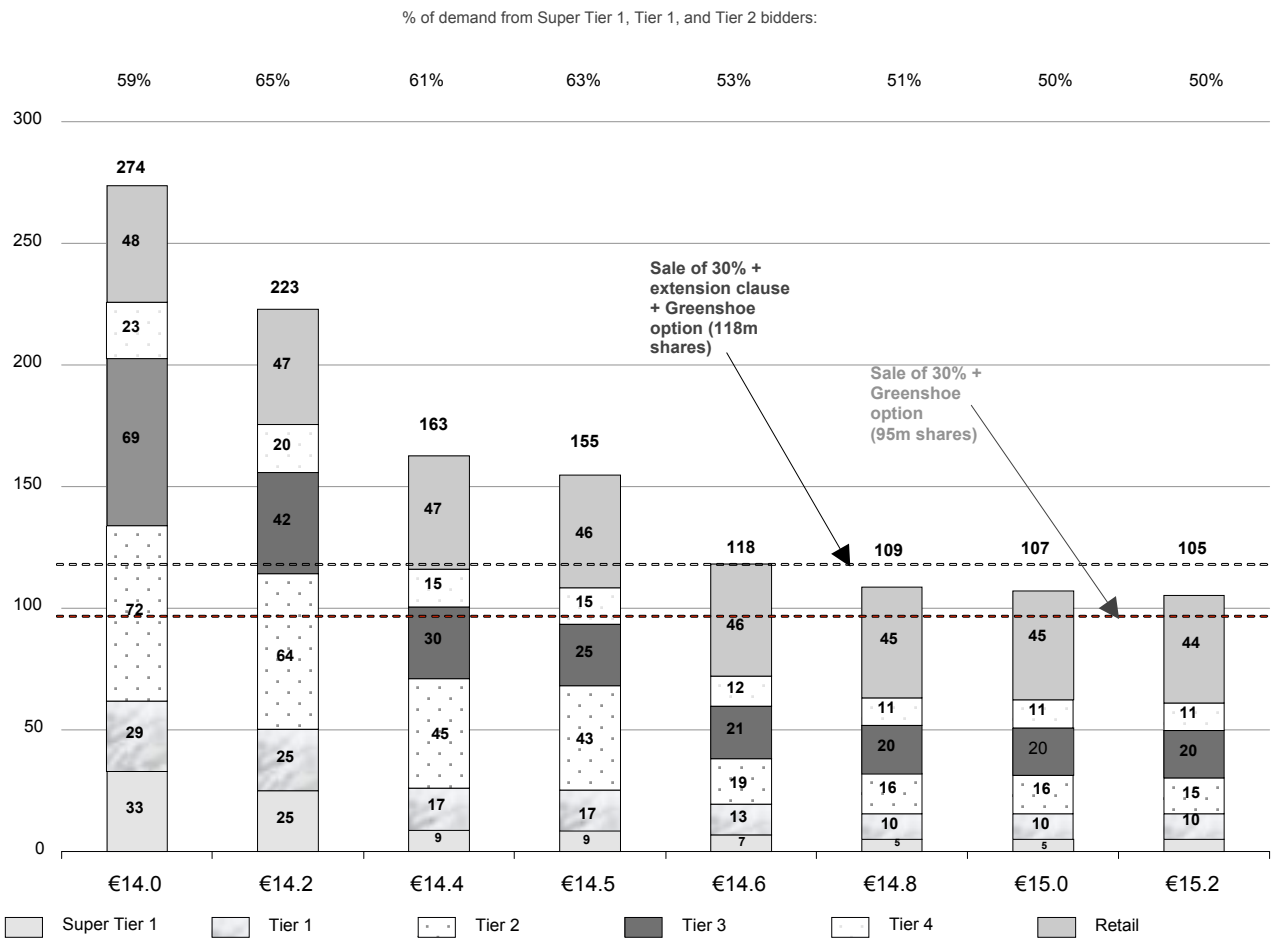
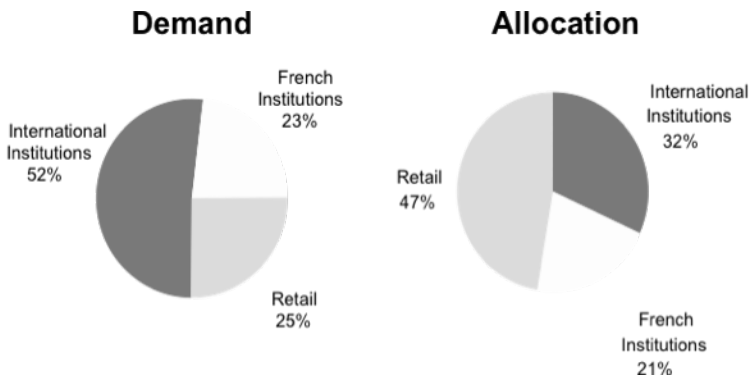


Figure 7: Breakdown of demand by investor type and by region

Panel A: Global split by type of investor



Panel B: Institutional tranche - geographical split

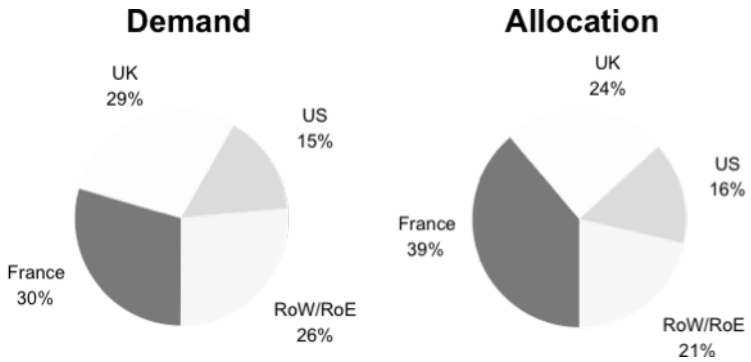


Figure 8: Aftermarket performance of Pages Jaunes

This figures shows the Pages Jaunes share price from the start of trading on 8 July 2004 for the next seven months, as well as the share price of Seat Pagine Gialle and Yell Group over the same period rebased to Pages Jaunes' institutional issue price.