

# Competitiveness

Law & Finance  
Harvard Law School  
November 12, 2007



# COMMITTEE ON CAPITAL MARKETS REGULATION



<b>Peter Briger</b>	President, Fortress Investment Group
<b>Peter C. Clapman</b>	President & CEO, Governance for Owners USA Inc
<b>Samuel DiPiazza</b>	Global CEO, PricewaterhouseCoopers
<b>Donald L. Evans</b>	CEO, The Financial Services Forum; former U.S. Secretary of Commerce
<b>Scott C. Evans</b>	Executive Vice President of Asset Management, TIAA-CREF
<b>Robert Glauber</b>	Lecturer on Public Policy, Kennedy School of Government, Harvard University; Former Chairman and CEO NASD
<b>Kenneth Griffin</b>	President & CEO, Citadel Investment Group LLC
<b>Glenn Hubbard</b>	Dean, Columbia Business School; Russell L. Carson Professor of Finance and Economics; (Co-Chair)
<b>Cathy Kinney</b>	President & Co-COO, NYSE
<b>Blythe Masters</b>	Global Head of Currencies and Commodities, JP Morgan Investment Bank - JP Morgan; Vice Chair, SIFMA
<b>Ira M. Millstein</b>	Partner, Weil, Gotshal & Manges
<b>Steve Odland</b>	Chairman & CEO, Office Depot
<b>William Parrett</b>	Senior Partner, Deloitte Touche Tohmatsu
<b>Jeffrey M. Peek</b>	Chairman & CEO, CIT Group Inc.
<b>Robert Pozen</b>	Chairman, MFS Investment Management
<b>Wilbur L. Ross Jr.</b>	Chairman & CEO, WL Ross & Co. LLC
<b>James Rothenberg</b>	Chairman and PEO, Capital Research and Management Co.
<b>Thomas A. Russo</b>	Vice Chairman, Chief Legal Officer, Lehman Brothers
<b>Leonard Schaeffer</b>	Founding Chairman, WellPoint Health Network
<b>Ted Schlein</b>	Managing Partner, Kleiner Perkins Caufield & Byers; Chairman, National Venture Capital Association
<b>Hal S. Scott</b>	Nomura Professor and Director of Program on International Financial Systems, Harvard Law School; (Director)
<b>Paul Singer</b>	General Partner, Elliott Management Corporation
<b>John L. Thornton</b>	Chairman, The Brookings Institution; (Co-Chair)

## Competitiveness Measures: U.S. Public Capital Market Share

<b>Global IPOs*</b>	<b>37% in 2000 to 6.6% in 2006 (value) Only 2 of 10 largest</b>
<b>U.S. IPOs Abroad</b>	<b>0% in 2000 to 6.3% in 2006 (number)</b>
<b>Investment banking revenues (by client location)</b>	<b>54% US in 2001 to 42% US in 2007</b>
<b>Trading Share (NYSE, Nasdaq, AMEX)</b>	<ul style="list-style-type: none"> <li><b>• 58.4% in 2001 to 49% in 2006</b></li> <li><b>• for cross-listings: 12.2% of home in 2001 to 8.7% in 2007</b></li> </ul>
<b>Equity Market Capitalization (public float)</b>	<b>46.9% in 2000 to 36.8% in 2006</b>
<b>U.S. Supply of Worldwide Capital (Citibank 2006)</b>	<b>41% in 1995 to 27.9% in 2006</b>
<b>Public versus Rule 144A</b>	<b>50% in 2000 to 10% in 2006 (value)</b>
<b>Foreign Companies Delistings as % of All Foreign Listings (NYSE)</b>	<b>4.99% in 2001 to 16.4% in 2007 (number) (projection from September data)</b>

\* Foreign company goes public and raises capital in a foreign market

## Faulty Competitiveness Measures

### **U.S. Underwriting Fees**

IPO gross spread of 3.5% on LSE compared to 5.6% on NYSE minor consideration in listing choice; smaller difference for follow-ons (IPOs only 10-15% of stock) and different underwriting process (U.S. bookbuilding)

### **“In Play” (E&Y)**

Assumes no UK AIM listings would qualify in US (\$50 million plus do, over 25% of AIM in 2005), that US cannot get Chinese listings (does get some) and does not count Rule 144As

### **Number of Foreign IPOs in U.S. (Thomson)**

Absolute number does not give market share

### **Types of Firms That Listed in Past Continue to Do So Today (DKS 2007)**

Irrelevant since U.S. is not getting foreign listings now; compare AIM's increase from 220 in 2005 to 329 (as of September 2007)

## “Maybe” Competitiveness Measures

### **U.S. Cross-Listing Premium** (market/book)

- Academic studies come to different results—many methodological issues
- What difference does the premium make if few foreign firms come to get it?

## Listing Premium Findings

**Doidge, Karolyi, Stulz  
(2007)**

1993-2005, average 17% premium over London Main Market non-cross listed firms: problems of (1) limited universe of potential cross-listers and (2) other foreign exchanges have even higher premium (AIM 27% in 2005)

**Litvak (2007); Zingales  
(2007); Piotroski and  
Srinivasan (2007)**

Listing Premium decreases post-Sox for developed country firms (with better markets and corporate governance), particularly small ones (where more SOX cost impact)

## **Impact on U.S. of Loss of Competitiveness of Capital Markets**

- **Less attractive public market leads to less U.S. capital formation, e.g. less venture capital investment**
- **Fewer investment choices for US retail investors who are shut out of private markets and are not familiar with foreign markets**
- **The securities industry is a key component of the U.S. economy, contributing 1.3% of GDP in 2005**
- **There is a vast economic literature showing that a thriving financial sector is an important requirement for economic growth**

## Why Have U.S. Public Markets Lost Competitiveness?

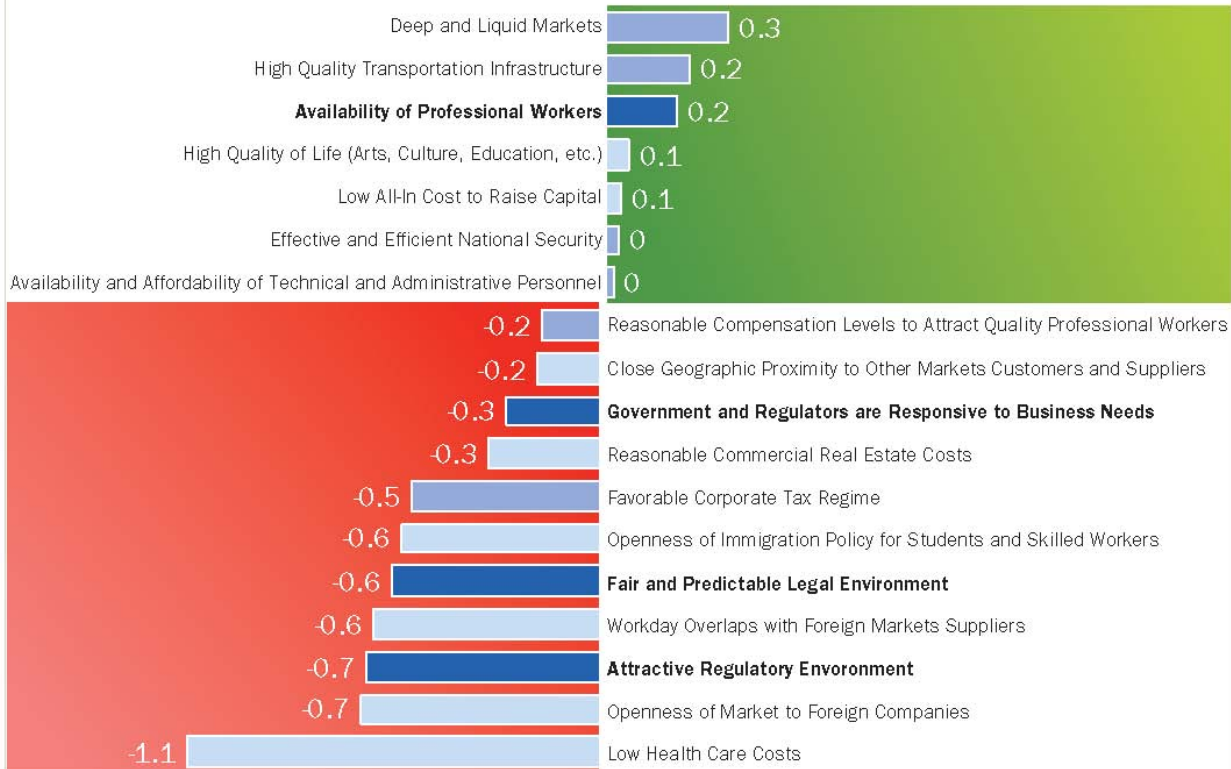
- **Better foreign markets, more liquid and better regulated**
- **More money outside U.S., less need to come**
- **Better private markets: VC private acquisition exits exceed IPOs from 2001-2005 (\$95 billion to \$12 billion); developing secondary market (GS TRuE, Portal)**
- **Higher regulatory and litigation costs in U.S. :  
Only cause we can do something about**

## Exhibit 3

### AMONG HIGH IMPORTANCE FACTORS, NEW YORK EXCELS IN TALENT BUT UNDERPERFORMS IN LEGAL AND REGULATORY

Performance gap, rating scale

**Importance\***  
■ High  
■ Medium  
■ Low



\* High importance factors were rated between 5.5-6.0 on a 7-point scale; medium between 5.0-5.4; low were less than 5.0

Source: McKinsey Financial Services Senior Executive Survey

## Key U.S. Legal and Regulatory Differences with Europe: Capital Markets

- **Securities class actions (U.S. D&O insurance 6x that of Europe)**
- **Higher level of disclosure requirements (gap closing)**
- **GAAP reconciliation for foreign companies (Roadmap 2009)**
- **More rigid corporate governance requirements (not comply or explain), particularly SOX 404 (part of SOX not copied)**
- **More focus and higher priority on retail investor protection (to exclusion of competitiveness, efficiency)**
- **More intense regulatory enforcement (less prudential, more rule-based)**
- **More fragmented regulatory structure**
- **Fewer shareholder rights, e.g. plurality voting, no voting on poison pills, less access to proxy**

## Committee Recommendations for U.S. Public Equity Market (32)

- **Grand Bargain:** Increase shareholder rights and decrease regulatory and litigation costs. With increased shareholder control of management , there is less need for regulation and enforcement (32 specific recommendations)

## Shareholder Litigation

- **Total class action settlements reached a high of \$17 billion in 2006 and still rising in 2007 (filings dropped in 2006 but are rising again in 2007)**
- **Shareholders get 3% of losses, lawyers get 25-30%; institutions often pay themselves**
- **The only justification for securities class actions is deterrence—the idea is that the prospect of large losses deters wrongdoing. But**
  - Did Bernie Ebbers really care that WorldCom would pay billions in class action settlements if his frauds were discovered?
  - D&O insurance shelters personal liability (Enron and WorldCom director liability highly unusual)
  - SEC and NASD fines of \$3.8 billion in 2006 (plus criminal and States)
  - The biggest deterrent is the market reaction to wrongdoing: average 41% fall in share price with wrongdoing announcement
- **Shareholders of individual companies should be free to decide what remedies they want, e.g. by amending their corporate charters to provide for arbitration without class actions or non-jury trials**

## Conclusions

- The U.S. public capital markets are becoming less competitive
- This is important to the strength of the U.S. economy not Wall Street (securities firms do not care where they make money)
- U.S. should play to its strengths (rule of law, liquidity and people) and correct its weaknesses (lack of shareholder rights, costly litigation and regulation)
- Bipartisan support exists for this approach, e.g. Schumer

**This is ultimately about whether the U.S. can adapt to the reality of a global capital market (and world) where it must compete to survive**