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The alternative financing choices facing lebanese enterprises : being public or staying private

George El Kazzi

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Université de Lille

**Ecole doctorale des sciences économiques, sociales, de l'aménagement
et du management.**

Institut d'Administration des Entreprises.

**Laboratoire : Recherche Interdisciplinaire en Management et en
Économie.**

Thèse préparée et soutenue publiquement par

George El Kazzi

le 18/11/2022

pour obtenir le grade de Docteur en Sciences de Gestion

**LES CHOIX DE FINANCEMENT ALTERNATIFS AUXQUELS SONT
CONFRONTÉES LES ENTREPRISES LIBANAISES :
ÊTRE PUBLIQUE OU RESTER PRIVÉ**

Jury

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**THE ALTERNATIVE FINANCING CHOICES FACING LEBANESE
ENTERPRISES: BEING PUBLIC OR STAYING PRIVATE**

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The Alternative Financing Choices Facing Lebanese Enterprises: Being Public or Staying Private

Abstract

Lebanese firms, categorized as family or closely held businesses, are often facing the challenge of whether to go public or continue in their familiar existing status away from the capital markets. An extended review of literature was conducted to set up the study followed by a historical overview of the Lebanese financial system to set up the case. The overview showed a unique aspect of concentration at the financing level in the hands of commercial banks on one hand and the underdevelopment of the capital market, on the other. After a long halt during the civil war period, several attempts were made by the central bank to revive the capital market including the latest attempt to privatise the Beirut Stock Market, but it seems that a structural change is needed in the governance of the Lebanese firms.

The study also shows that the Lebanese firms follow a modified Pecking Order Theory (POT) where the sequence of internal to external financing is clear but does not reach the capital market due to its underdevelopment. Furthermore, the size and age of the firms do not support the POT prediction but instead, the Lebanese firms tend to exhaust the internal sources of financing before accessing short term external sources. As firms move forward in their business cycle, the need for long term financing becomes imminent. Hence the direct and indirect costs were investigated and a roadmap was drawn showing approximate costs figures ranging between \$60,000 and \$150,000 depending on the size and number of shares. Once public, firms face the increased costs of being listed, the burden of the minority shareholders, the low turnover of shares and the fading away of the need for financing which was the main reason of becoming public. Therefore, the exit is simply by going back private or just delisting and specially in the case of small capitalization firms, whereby, management can start to accommodate more time and effort to concentrate on running and growing a successful business instead of meeting regulatory requirements.

Résumé

Les entreprises libanaises, classées comme entreprises familiales ou à capital fermé, sont souvent confrontées au défi de devenir publiques ou de continuer dans leur statut existant loin des marchés des capitaux. Une revue de littérature approfondie a été menée pour établir l'étude suivie d'un aperçu historique du système financier libanais. L'aperçu a montré un aspect unique de concentration au niveau du financement entre les mains des banques commerciales d'une part et le sous-développement du marché des capitaux, d'autre part. Après un long arrêt pendant la période de la guerre civile, plusieurs tentatives de relancement du marché des capitaux ont été faites par la banque centrale, y compris la dernière tentative de privatisation de la Bourse de Beyrouth, mais il semble qu'un changement structurel est nécessaire dans la gouvernance des entreprises libanaises.

L'étude montre également que les entreprises libanaises suivent une théorie modifiée de l'ordre hiérarchique (TOH) où la séquence de financement de l'interne à l'externe est claire mais n'atteint pas le marché des capitaux en raison de son sous-développement. De plus, la taille et l'âge des entreprises ne supportent pas la prédiction du TOH mais au lieu de cela, les entreprises libanaises ont tendance à épuiser les sources internes de financement avant d'accéder à des sources externes à court terme. À mesure que les entreprises progressent dans leur cycle économique, le besoin de financement à long terme devient imminent. Par conséquent, les coûts directs et indirects ont été étudiés et une feuille de route a été établie indiquant des coûts approximatifs compris entre \$60 000 et \$150 000 selon la taille et le nombre d'actions. Une fois cotées en bourse, les entreprises sont confrontées à l'augmentation des coûts d'inscription, à la charge des actionnaires minoritaires, à la faible rotation des actions et à la disparition du besoin de financement qui était la principale raison de leur introduction en bourse. Par conséquent, la sortie de la bourse consiste simplement à redevenir privée ou simplement à se retirer de la cote et, en particulier dans le cas des entreprises à petite capitalisation, la direction peut commencer à consacrer plus de temps et d'efforts pour se concentrer sur la gestion et la croissance de leur entreprise au lieu de respecter les exigences réglementaires.

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Introduction

The Lebanese firms, in the traditional status as closely held businesses, are always trying to figure out whether to go public ¹or continue in their existing structure away from the capital markets. In this context, we draw on different factors and theories of why firms go public, why they go back private and how they weigh the costs and benefits of becoming public, staying public or going private. However, going public is a complex decision influenced by many factors of which we pinpoint the costs and benefits. Many of the factors that drive a firm to go private are the opposite of initial public offering (IPO) reasons, in specific, the importance of information and liquidity consideration and the importance of capital accessibility and control. The theories of going public are reversible into the prospect of going back private. They explain why firms go public and accordingly pave the way to know why they go back private.

Holmstrom and Tirole (1993) and Bolton and Von Thadden (1998) suggest that going public will put companies under monitoring of outsiders such as investment banks, auditors, analysts and investors which might in turn enhance the value of the firm. A company must design its sale of new shares based on its forward-looking view regarding the ownership structure. Ruback (1995), Barclay and Holderness (1989) state that most new investors will remain relatively small and passive holders of shares while other large block holders of shares will be active players in the management team or the monitoring units of the current management. Companies might decide to issue stocks and go public in an effort to finance an investment opportunity (ies). Aslan (2011) stated that firms with high investment-financing needs, lower information production costs and high industry market-to-book ratios are more likely to go public.

The Pecking Order Theory states that firms prefer internal to external funds (Myers & Majluf, 1984). Firms seek debt funding first, and when restrictions limit its availability, equity is issued to fill the gaps needed, and in the cases of surplus conditions, the theory states that debt can be redeemed to bypass the information asymmetry issues (Myers, 2001) and if managers have better information than investors, it is better to issue debt than equity (Myers and Majluf, 1984, Kester 1986). Firms that go public tend to increase investment, improve liquidity and reduce leverage in the first five years after IPO. From another point of view, firms with availability of internal equity

¹ Public: refers to public traded company

financing and lower marginal borrowing costs are more unlikely to go public. Ellul and Pagano (2006) concluded that secondary market liquidity influences the cost of equity capital for firms that decide to go public.

In general, firms face imminent funding issues around the possible and available sources of financing. These sources are ubiquitous ranging from internal sources to external sources and from traditional bank facilities to more complicated capital market securities.

The internal sources are displayed in the retained earnings which are considered in the corporate finance theories as auto-financing or simply personal and individual injection of money. The external sources can be divided into private equity, at the narrow level, and traditional collateralized bank loans, on one hand, and capital market securities such as bonds and equities.

Going further in time and the length of operation, some firms will find themselves with a depletion of the available and relatively easy accessed sources of funds. With less free assets to be locked as mortgage against bank loans, large firms, in general, and SME, in specific, will face the need to seek alternative sources of financing from the capital markets.

Even though, debt can be considered as cheaper and more tax efficient, firms look at the possibility of reducing their debt burden or, simply stated, their current and short-term obligations. In the question of cheaper and more cost-efficient source of funding, firm must look into the different costs embedded in the decision to go public, in general, and the specific costs inherent in each step in the road map to get from a status of a privately owned to a publicly traded firm.

The drawbacks of asymmetric information in the context of initial public offerings (IPOs) has been the subject of many documented literatures and multiple theories were presented to support its resulting underpricing phenomenon. Some authors tried to explain the underpricing such as Rock's (1986) winner's curse model, the ex-ante uncertainty theory developed by Ritter (1984) and Beatty and Ritter (1986), and the signalling model developed and discussed by Allen and Faulhaber (1989), Grinblatt and Hwang (1989) and Welch (1989). Others tried to present solutions to undermine the effect of asymmetric information such as (Barry et al., 1990; Megginson and Weiss, 1991) who found in the private equity (PE) backing a possible way out to reduce its the effect by stressing on the signalling effect on one hand and some authors presented the certification role as a possible explanation but not with concrete results, but rather differing views as found in (Lin and Smith, 1998; Smart and Zutter, 2000; Francis and Hasan, 2001; Schertler, 2002; Franzke, 2003; Coakley et al.,2009).

Costs of going public are important in the decision, but given the nature and the characteristics of the Lebanese companies, it is always difficult to have access to the exact figures related to the costs of getting listed and even the costs of being listed, especially that the capital markets are underdeveloped with very low activity. Costs and benefits considerations make it clearer to understand why firms go public, stay public and at times go back private.

Furthermore, during the past two decades the markets witnessed a growing popularity of share repurchases and a decreasing popularity for dividends payments and it was shown by Grullon (2000) that in 1998 the total amount of share buybacks exceeded the total dividends for industrial firms. Early studies such as Vermaelen (1981) show that stock prices react positively to any declaration of share repurchase programs suggesting that the market perceives repurchase announcements as excellent news from different perspectives, mainly because they signal that the managers of the company believe that the stock is undervalued and is committed to reduce any potential agency problems on one hand and that the tax burden of the firm and its shareholders decreases at the margin and provides more liquidity to the stock.

Over the past 20 years, the Lebanese capital market did not witness any activity pertaining to listing nor delisting of companies. The delisting or going back private is considered by the business world as an exit strategy and should be examined to shed the light on a back door to provide a possible medium to long term solution to an enterprise that can be caught in the middle of the capital market with overwhelming legal and regulatory requirements.

Compared to going public, the decision to go back private or delist is given less attention in the corporate finance literature even though it represents an important step in the life of a firm. Going private, privatization or simply delisting can happen voluntarily by the firm or involuntarily (Macey et al. 2008). The voluntary delisting transaction or going private is a choice by investors or management to pull out of the public market and try to concentrate the ownership of the firm in the hands of fewer parties. Whereas, the involuntary delisting, it is a fate imposed upon the firm by the regulatory authorities² for breaching any rule or requirements or resulting from a case of financial distress or simply resulting from a merger or acquisition that led to the dissolution of the

² Every Exchange is free to set its own listing requirements so they will all differ. Most of them will include factors like the market capitalization of the company and minimum turnover and most exchanges will also automatically delist stocks after they've reached the status of penny stocks with value of less than a 1 USD dollar or its equivalent.

firm. Sanger and Peterson (1990) studied the reasons for delisting firms on NYSE and AMEX and found that the failure to meet minimum net income, minimum number of shareholders and minimum market value among the most important reason for involuntary delisting.

How are the Lebanese firms confronted with short term financing from the commercial banks and how they are striving for a long-term source of financing to fund their long term needs for investment and growth? This concern must be addressed by looking at the corporate structure and behaviour of the Lebanese firms on one hand and the possible costs related to the move towards the long-term source of financing from the capital market.

The research paper tries to answer some of the important questions pertaining to the structure of the Lebanese firms, how and why they choose their sources of financing and the costs they will have to face once they decide to go forward with their long term needs and financing from the capital markets. In order to understand this duality between the actual situation and the needs of firms, it is important to investigate the main features of the BSE and to explore the following important questions. We start by does the corporate governance and structure of the Lebanese firms justify their choice of the sources of financing and do Lebanese firms follow the POT in their quest and priorities for the sources of financing? And then we should get to whether the costs of going public and staying public present themselves as a hurdle in front of the decision to go public and staying public and how important are the direct and indirect costs? The final step examines the trending question of once public, what are the chances that a firm will decide to go back private, why and what are the different scenarios that drive a company to become a privately-owned firm again after being public?

In this quest, we developed the following hypotheses:

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding, which will be discussed and validated in chapter two and three.

H2: The Lebanese firms follow a modified POT due to their peculiar corporate structure and the status of the capital markets, which will be discussed and validated in chapter three.

H3: The direct and indirect costs are important variables in the decision to go public, which will be discussed and validated in chapter four.

H4: A publicly traded firm might decide to go back private once the need for long term financing fades away and once the costs become irrelevant, which will be discussed and validated in chapter five.

The purpose of this study revolves around the explanation of the corporate structure of the Lebanese firms and the financial system and how they dictate upon the firms their current choice of financing and the introduces the need to switch to a longer-term funding source such as a developed capital market. Furthermore, it highlights the importance of the direct and indirect costs as variables that a firm must consider before taking the decision to join the publicly listed status. In addition, as firms move forward and when the costs become an obstacle in front of acceptable profitability, the choice of being a privately-run firm again present itself as a choice to alleviate these costs or it might ultimately be a destiny for relatively small cap firms.

However, to test the hypotheses, the thesis methodology is characterized by a process of data collection based on several techniques ranging from first hand surveys to secondary data collection. A questionnaire was distributed and feedback was received from around 161 firms in an effort to investigate the corporate structure of the Lebanese firms and their behaviour and perception of the BSE. A time series data was collected and studies to extract some possible relation between the sources of financing and the different status of the Lebanese firms. In addition, secondary data was collected in order to investigate the latest trend in corporate finance world and in specific the tendency to go back private away from the publicly traded cloud.

This research follows conventional methodologies and is structured as follows:

Chapter One, introduces a review of literature that highlights the importance of going public for firms as an alternative source of financing and the cost inherent in such a decision. It tackles the different factors that might affect an IPO decision starting with the ownership structure that is translated through the alignment of interest on one hand and the trade-off between management autonomy and cost considerations on the other. It also talks about corporate governance versus investors protection aspects. The concept of valuation and pricing environment are discussed with a reflection on liquidity and firm specific characteristics. Many researches were visited to reflect upon the benefits and the drawbacks and costs of going public and being a publicly traded company and highlight also some of the reasons to stay private. This chapter discusses the literature covering

the POT and how it explains the behaviour of the enterprises in their quest and search for financing and the hierarchy they follow in doing so.

Chapter Two takes us into a historical overview of the Lebanese financial system and capital markets. It covers the period from the establishment of the Beirut Stock Exchange in 1920 till 2019 just at the threshold of the latest and ongoing financial crisis. The chapter walks us through the two phases in the history of the BSE, before 1983, the date of closing down of the BSE and after 1996 the date of reopening of the capital market. The chapter discusses the characteristics and operational specificities of the BSE when it comes to market participants and trading platform on one hand, and the regulatory changes and macroeconomic and financial variables, on the other. It also introduces the need for the capital markets in a country that lacks long term sources of financing.

Chapter Three, presents an attempt to discuss and examine the relevance of the Pecking Order Theory and its possible application in the context of the Lebanese firms' decisions to provide financing and funding for their current needs and their long-term prospects of growth and expansion. After introducing the SMEs and their importance in the Lebanese economy, the researcher exposed the business and financing constraints that these SMEs face and the researcher found that their corporate structure as SMEs operated as closely held or family businesses follow the first stages of the POT but stops short of going public due to the underdevelopment of the Lebanese capital markets. Using empirical data, the Lebanese firms did not support the effect of the size and the age and these two variables could not explain the choice of external financing. The firms of different size and maturity levels depend on commercial banks' loans and credit from suppliers in the absence of developed capital markets.

Chapter Four, comes to back up and support the views of the going public decisions as opposed to the privatization decision. This deliberation discusses the costs of going public and staying public as depicted in many markets across different development stages and structures. The case of Lebanon was presented with a roadmap for enterprises, interested to go public, to highlight and pinpoint the different embedded costs of the process of going public and being publicly listed firm. Several field researches were conducted with management of listed firms and with officials from the Beirut Stock Market itself. Financial statements and notes to the financial statements were examined to collect the direct and indirect costs inherent in the public listing life of an enterprise. A roadmap was drawn to facilitate the firms' decision to go public or simply stay private. Worth

to know that the capital markets in Lebanon are found in an environment that lacks transparency and clarity.

Chapter Five, introduces a new trend in the corporate finance world where a number of publicly traded companies try to go back private in an effort to overcome regulatory stringent requirements of transparency and loss of control on one hand, and a need for closer and less costly corporate decision-making capabilities away from the capital markets radar that affects their growth potentials negatively on the other. Since the Lebanese capital market did not witness any delisting or going back private occurrence over its latest history, this trend was highlighted by an empirical study and discussion over a period of 20 years. Data were collected from Bloomberg and Reuters, in addition to data from AMF to display the delisting trend in relevant markets. Furthermore, data on delisted firms were collected to display the reasons behind the decision to go back private after being public.

In summary, this research constitutes a first attempt by any scholar to dissect the Lebanese corporate structure, to describe its corporate finance skeleton to shed the light on the structure of the financial system and to try to open the door for a future change in the financial philosophy, mainly away from the traditional short-term banking cloud to a long-term perspective that will ultimately lead to the development of the Lebanese capital markets. This might eventually facilitate the futures growth prospects and might ultimately help overcome and bypass the traditional banking sector financing that proved to be fragile over the most recent years.

Chapter One: Literature Review

Going public has attracted a lot of attention in the finance world due to the strategic importance of the decision to go public or stay private. Researcher from different markets and different management styles, Anglo-American, European and Asian have touched upon the subject from many aspects. There are those who approached it from an ownership perspective, be it corporate governance or legal status and structure, from funding perspective, be it pricing and valuation or simply source of financing, from firm perspective, be it size or credit status. Others just revealed the benefits and the costs inherent in the context of entering the transparent life of being publicly traded, be it the availability of alternative sources of financing or just the costs and expenses to be endured during that journey of becoming and being publicly traded.

I. Introduction

Going public or staying private is seen as the choice of main owners of private firms to balance the costs against the benefits of an IPO. Loss of pecuniary control can be seen as the main reason to stay private. On the other hand, major shareholders cherish liquidity while block holders look for diversification. Amihud et al. (2005) suggest that IPOs increase firm value by making its shares more liquid. Being a public company increases liquidity and benefits from external monitoring and adds more stock price information to help management. Bancel (2009) realized in their survey that UK executives see stock liquidity as the main reason for IPO.

Going public provides inflow of capital and improves the reputation and social capital by increasing its visibility, prestige and perceived trustworthiness. IPO will reinforce the network of relationships that offer access to external resources, complementary skills and investment opportunities. Once public, companies find themselves under scrutiny and monitoring from outside parties which might be an incentive to enrich the value of the firm Holmstrom and Tirole (1993) and Bolton and Von Thadden (1998). Furthermore, a firm must structure its issue of new shares based on its ownership structure whereby new investors shall continue relatively small and passive owners of shares and large block holders of shares will be the main decision makers or the monitoring units of the current management, Ruback (1995). Hence, firms might refer to the issue of stocks with the intention to finance an investment opportunity (ies). As stated by Aslan (2011),

firms with high investment-financing needs and in an industry with high market-to-book ratios are more likely to go public. They also found that firms that go public tend to increase investment, improve liquidity and reduce leverage in the first five years after IPO. From another point of view, firms with availability of internal equity financing and lower marginal borrowing costs are more unlikely to go public. Ellul and Pagano (2006) concluded that secondary market liquidity influences the cost of equity capital for firms that decide to go public.

Loans from commercial banks and private equity placements can provide the needed funds for growth and to fund investment opportunities. This source varies according to the structure of the capital market of the country and the development of its financial system. In most underdeveloped economies, the banking sector presents itself as a major partner and the main provider of funds to SMEs in the absence of a well-developed capital market.

Aslan (2011) found that capital investment and profitability increase substantially after IPO for UK firms whereas, Pagano et al. (1998), in their study of Italian IPOs stated that investments by firms actually decline after an IPO, and as such the decision to go public boils down to being a strategic market timing rather than investment funding decision (Ritter 1991). This idea was also reversed by Brau et al. (2006) and Bancel et al. (2008) surveys of European CFOs who stressed on the investment financing as the main decision for going public in addition to the potential use of stock-based acquisition as an attractive reason to go public as well.

Mello and Parsons (1998) suggest financing through IPO to be done over stages, starting with an IPO for small investors, then selling controlling block, at a discount, and then a contingent sale of additional shares. IPO should be viewed as selling financing prospects and not as selling control. Mikkelsen et al. (1995) proved that large blocks remain untouched during IPO, and Holderness et al. (1988) and Rydqvist et al. (1994) and Holgholm (1994) showed evidences of control turnover after IPOs. Zingales (1995) and Stoughton et al. (1998) in their papers suggest proceeding with the sale of a company in stages to facilitate the transfer of corporate control, where starting sales to passive investors and later on to controlling blocks leads most of the time to maximization of revenue to the seller. Zingales goes even further to separate controlling right from cash flow rights. Selling controlling blocks can bring in benefits to all shareholders, since the investors, benefitting from discounted prices, have higher valuation for the stock and accordingly raise market value of the firm. Shares should be offered first to small passive investors and use the outstanding price per share to offer to investors seeking controlling block. A process to follow over time rather than a

single event and it depends on subsequent financing needs. Hence, each sale results and terms should be interrelated with prior and post sales results and terms. Thus, reducing the sale to active investors with low valuations for the company raises the price that the seller can charge to active investors with high valuations.

Active investors play a monitoring role that raises the value of all shares and improves the efficiency of the market for corporate control. Faced with such high level of market monitoring and pressure to meet analysts' expectation, IPO firms are also faced with challenges related to their product market, existing competition and technological considerations. Moreover, investors might change their sentiments regarding certain product lines or technologies which in turn might affect the issuing company's ability to finance new growth opportunities.

Family owners' intent to retain large percentage of shares in the long run is an indicator of the level of confidence in their own company.

Once public, the issuing firm will undergo several structural changes (Jain et al. (2000)). These changes revolve from ownership structure to governance in addition to changes in access to external financing. Mikkelson et al. (1997) noted the reason to go public, in the offering prospectus, standing at 85% to use the proceeds to raise working capital, 58% to retire debt, and 64% to finance capital expenditures, and found that offering by young firms are frequently intended to raise capital rather than repay debt or to discharge holding of existing stockholders.

From a wider spectrum, financial development will help in boosting the economy by enhancing savings and channelling those savings into real investments leading to factor accumulation and as such provide directives for entrepreneurs to forward their capital toward more productive segments of the economy and hence alleviate resource allocation (Beck et.al 2000). Moreover, King and Levine (1993) showed that countries with larger initial capital markets grow faster in the future. Wurgler (2000) found that financially developed economies are better situated to allocate investment into industries with growth opportunities and Morck et al. (2000) found that the stock markets in developed economies are better at displaying firms' specific information and as such lead to better resource allocation.

II. Ownership Structure

Ownership structure is divided into two types, public ownership and private ownership. Public ownership is characterized by dispersed ownership and control among different shareholders through listed and traded shares and many transparency requirements and relative corporate governance arrangements. Private ownership, on the other hand, is characterized by concentrated ownership and control without any imposed market requirements. Management, under the public structure, may find it difficult to act at its own discretion due to special governance imposed by investors to deal with agency problems and to limit management own profit seeking (Boot et al. 2003). This bi-lateral behaviour can be assigned to non-homogeneous priorities, overconfidence or different philosophies on the part of management and investors alike and will lead ultimately to disagreement.

Private firm owners and managers control the percentage of the firm to be sold, it is argued that ownership concentration and retained ownership are at the heart of the inherent risk of the IPO and hence can seriously affect the performance of IPO firm.

Initial Public Offering of the company's common stock is associated with large and remarkable changes at the level of ownership of the company's equity. Accordingly, managers' and stockholders' interests decrease as new entrants make the ownership more disperse and less concentrated. Jensen and Mekling (1976) referred to increasing agency costs that results from the smaller insiders' ownership as an explanation for the poor post-listing share performance. They said that the more the stake sold by insiders the more they are prone to seek personal benefits at the expense of other minority shareholders. Morck et al. (1988) and Mikkelson and Partch (1985) show that low ownership is associated with low measures of corporate value; and Wruck (1989) found increase in share value associated with increases in ownership concentration. In turn, Gorton and Schmit (1999) found that higher ownership by large shareholders is associated with higher valuation of corporate assets in Germany.

The entrepreneur will, most of the time, raise the amount needed externally with minimum number of new shares, in a move to retain the largest stake in the company (Chemmanur and Fulgheri 1999). Jain and Kini (1994) argue that IPOs cause dilution of stock ownership and higher conflict of interest among managers and shareholders and accordingly an increased agency costs and a decrease in post IPO operating performance which is relatively smaller for firms with high retained managerial ownership.

Mikkelson et al. (1997) found that operating performance decline more in the first five years of public trading when current holders sell shares in the secondary sales offering and this results from the decision of insiders to sell shares after encouraging performance and usually precede a major decline in performance. Moreover, Mikkelson et al. (1997) found no association between performance and different measures of equity ownership by officers and directors. Even though the stake of the latter decreases, it does remain within acceptable ranges to justify alignment of interest with other stakeholders. A steeper decrease in stake reduces the managers' incentives to avoid risky investments and hence adds value to the company. Mikkelson et al. (1997) found that in five years after the IPO, officers and directors stake fall even further which might lead to misalignment of interest with other stakeholders and this can be explained partially by market agents such as threats of a takeover and monitoring by outsiders.

Ahmad-Zaluki et al. (2010), in a study of Malaysian market, highlighted the feature of high level of ownership concentration, mostly family ownership, and the higher level of post-IPO involvement which can reduce short term incentives and the requirement of prospectus earnings forecasts discourages managers from unrealistic optimism around a profit guarantee, this profit guarantee was later removed in April 1999 due difficulty of compliance (Wan-Hussin et al. 2003). Moreover, owners may accept reduced IPO proceeds to ensure the retention of post-IPO control of the company, and they had to deal with a three-years share moratorium that required them to maintain at least 45% of the issued shares for one year after the listing and then they can dispose of 15 % per year. This requirement provided good support for the stock price post-IPO if the owners actually have the intention to sell after this lock-up period. Owners of high-quality companies usually signal quality by underpricing IPO shares. They retain a large equity stake and benefit from selling shares at higher prices in the aftermarket. (Spiess 1997, and Espenlaub 1998.) Contrary to the above, in a closely held ownership economy, owners of IPO firms fear the loss of control as a result of the transfer of ownership (Nagata and Hachiya 2006). To overcome this new situation, IPO firms tend to allocate shares to small investors in order to reduce the threat of takeover and the tight monitoring by large block investors. (Brennan 1997, Pham 2003, Alavi 2008). Therefore, income reducing earnings management will be the best way out to decrease the offer price and ensure oversubscription and relatively high initial return and makes it easier to allocate shares to a larger base of small investors and this can be very clearly supported in the application and acceptance section of the prospectus. Looking at this contrast in decision regarding

the ownership retention and earning management, owners must decide on whether they are willing to sacrifice short-term wealth over post-IPO control of the company.

Moreover, a family or entrepreneur may see it fit to retain control of the firm because of the fact that the family's reputation is required to attract outside financing specially when the legal protection of the outside investor is poor (La Porta, 1999). Contrary to this opinion, Bennedsen and Wolfenzon (2000) went all the way to require more dissipation of control which might put restrictions on expropriation and lead to more distribution of dividends and hence more wealth to the entrepreneur.

It is argued that the entrepreneur can still maintain concentrated ownership in the firm by simply issuing shares with limited voting rights, or issuing cross-shareholdings between a group of firms in order to render the problem of gaining control of the firm out of reach.

Bebchuk et al. (2000) introduced a new concept known as controlling-minority structure (CMS) where control is exercised by the minority shareholder and it combines both previous known structures of dispersed ownership (DO) where an insider with a small fraction of shares controls the firms and controlled structure (CS) where a majority shareholder controls the firm and is shielded from the market for corporate control. This structure, familiar in countries known for its family-controlled businesses, separates control from cash flow right in three different arrangements known as the stock pyramids, the cross-ownership and the dual class equity.

The stock pyramid structure is displayed as a controlling minority holding controlling stake in a holding company, minimum of 50%, and the holding company in turn holds controlling stake in an operating company. As such, the further down the pyramid we go, the lower the stake needed to control an operating company, since a minority controller with four levels pyramid needs only 6.25% to control the operating company (Bebchuk et.al. 2000) and this method for focussed control is also highlighted by LaPorta et.al. (1999).

On the other hand, in the cross-ownership structure the voting rights will remain distributed among the whole group instead of being concentrated within a single company and respective companies are related by horizontal cross-holding of shares.

In the dual class equity structure, the controller of the firm is assigned with all the shares with voting rights and the remaining shares are distributed to the public. This structure manifests itself in the examples of the Swedish companies Electrolux (home appliances manufacturer) with 95%

voting rights held by only 7% shareholders and Ericsson (telecom) where 40% of votes are held by only 4% of shareholders (Bebchuk et.al. 2000).

Therefore, CMS structure finds it hard to control agency costs since controllers do face neither proxy fights nor hostile takeover and controller holds only a small percentage of the firm in spite of being in control. In addition, another structure, the leveraged controlling-shareholder (LCS) came to give cash flow rights to debt holders and the controller maintains all voting rights (Bebchuk et.al. 2000). It is also argued that greater concentration of cash flow rights produces a positive effect on corporate valuation as officers work for the best interest of shareholders (Jensen and Meckling 1976).

Bharath and Dittmar (2006) argue that high ownership concentration leads to weak investor recognition and decreases the benefits of being public which in turn push firms into going private as better option. Bruton et al. (2006) added that, with the different agency conflicts, public market investors will tend to price-protect themselves by lowering IPO valuations.

A. Alignment of interest vs. entrenchment hypothesis

Jensen et al. (1976) first introduced the “Alignment of Interest” hypothesis predicting that firm value and operating performance increase as management ownership rises especially if we take into consideration owner-managers inclination towards existing and additional privileges or more into value maximizing behaviour.

Kenneth et al. (2004), in a study of the Thai IPO firms termed the fact that “Alignment of Interest” exists when low and high management ownership levels in a firm are positively related to changes in performance of the firm, while negative relationship that is represented by intermediate level of ownership by management and change in performance is a sign of “Entrenchment” where management feels protected from market discipline Morck et al. (1988) and Short (1999).

La Porta et al. (1999) stressed on the importance of ownership structure in emerging markets relative to developed ones. Hence the existence of high degrees of information asymmetry among managers and outside shareholders in emerging markets which put high importance on the need for the alignment of interest between managers and shareholders knowing that most of the time the owner and the managers are almost the same person. Fam (1993) stated that high degree of asymmetry of information creates a plausible atmosphere for managers to prefer more non-value

maximizing behaviour. Therefore, the more owner-managers own after IPO, the more the value maximizing effort they perform. Jain et al. (1994) and Jensen et al. (1976) stresses on the fact that the more shares the original owners retain, the better the firm performance due to the decrease in agency costs.

Based on findings of Morck et al. (1988), Kenneth et al. (2004) found that increases in managerial ownership are associated with better performance within both the 0-31% and 71-100% ownership ranges and negatively with 31-71% ranges representing the “Entrenchment” threshold as compared to Morck et al. 5-25% range for US firms and Short (1999) range of 16-42% for UK firms.

Weisbach (1988) introduced managerial entrenchment as a situation where managers enjoy so much power in the company that they start pursuing their own interest rather that of the shareholders. Morck et al. (1988) suggested that entrenchment is most likely to take place whenever management feels protected from market discipline and here wider base of ownership for larger and more established firms makes it more difficult to exert control by outsiders than smaller IPO firms where outsiders will be more likely striving to apply such control and influence. Berger et al. (1997) saw entrenchment as a state where managers fail to be disciplined with all existing forms of control including monitoring, threat of dismissal and performance based incentives. Furthermore, corporate governance mechanism might not function efficiently in concentrated ownership firms in the presence of entrenched managers (Zakaria 2014).

Kole et al. (1995) pointed out the fact that larger firms have more dispersed ownership and hence more difficult for outsiders to exert control as opposed to small IPO firms where investors are looking for more influence and control, through more insider ownership, due to large variability in its future potential and its relatively high risk. The decrease in inside ownership explains partly the post IPO decline in firm performance due to an increase in agency costs. Jain (1994) argued that IPOs cause dilution of stock ownership and hence increase agency costs which may be reduced if only the original entrepreneurs and management retain a higher portion of the firm after IPO.

Demsetz (1985) and Renneboog (1998) suggested that riskier firms and accordingly IPOs require higher level of inside ownership to make sure that incentives are aligned which also a requirement for the entrenchment to happen. In other words, once public, less than 100% ownership has the potential to lead to lower performance under both hypotheses.

The idea of ownership was tackled from a different perspective such as ownership effect on performance by Demsetz (1985), McConnell et al. (1990), Morck et al. (1988) and Short (1999) and Kenneth et al. (2004) worked on changes in ownership and its effect on changes in performance.

To conclude, going public leads in general to separation of corporate control and stock ownership leading consequently to an increase in information asymmetry. This fact is present on a larger scale in emerging market and leads to a contraction in operating performance following an IPO and requires the alignment of management incentives with the shareholders' interest to moderate somehow the agency costs as pointed out by Jensen et al. (1976).

B. Trade-off between management autonomy and cost of capital

Dispersed ownership in the public equity markets increases secondary market liquidity which is beneficial towards reducing the cost of securing additional capital to finance investment opportunities. Once the loss of independency in the management decision making outweigh the reduced cost of capital, the benefits will turn into an impediment and firms would tend to go private.

For publicly traded companies, corporate governance sets the path for the management to follow in its firm maximizing decisions and lays down acceptable elbow room for manoeuvrability of management within investors' acceptable boundaries (Boot et al. 2003). In this context, management will seek autonomy that facilitates and speeds up decision making for the best interest of the company, whereas investors will find themselves forced to require a higher cost of capital in order to forfeit that right in favour of management, whom they think will tend to take decision more or less firm value reducing. Therefore, a trade-off between governance structure and cost of capital would be reached in a way to accommodate both concerned parties, management and investors, requirements and the best interest of the firm. This trade-off boils down from the financial market regulations and is market determined and not privately negotiated. By selling cash flow rights to dispersed shareholders, the initial owners will try to reach an ownership structure that maximizes the total proceeds for the IPO and at the same time maintain control over the final decisions (Pagano et al. 1998).

Accordingly, investors, who now benefit from market liquidity to cash in their holdings, will most probably require a lower cost of capital. Hence, being a publicly traded company entails some strict corporate governance structure, hand in hand with lower cost of capital than privately owned

companies. On the other hand, when corporate governance is extremely lenient and allows management significant autonomy, investors in the public markets tend to require higher returns on their capital pushing firms into preferring private ownership.

Looking at it differently, when the manager raises equity privately from a single investor, he can usually patch up the most favourable level of autonomy contractually specifying accordingly the investor's rights and the following reporting structure and delegation of responsibilities between the manager and the investor. Here, the manager's expertise will play an important role in determining the relatively smaller share percentage to be sold to secure the same amount of funding maintaining as such higher managerial autonomy (Boot et al. 2003).

C. Corporate governance and investor protection

Corporate governance refers to some internal means ranging from effectiveness of the board to compensation at the executives' level and/or external means such as takeovers and shareholders' activism that are planned to bring together both interests of shareholders and managers. In addition, corporate governance is viewed by many as insurance or a protection tool for outside investors against unforeseen acts of expropriation and similar mean activities by managers and controlling shareholders which fall most of the times against the best interest of these minorities. These acts by management can extend from selling assets under their control to firms they own at below market price to simply stealing profits from the company.

At times, shareholders and managers might find it costly to fire the managers in spite of the fact that they do not agree with their decisions and would rather sell out their interest in the firm, knowing that this situation will get even more difficult whenever the CEO is himself the chairman of the board which renders the issue of firing him very difficult task (Zakaria 2014).

Looking at it differently, these expropriation acts can also be presented by employing and appointing unqualified family members in managerial positions and overpaying existing executives (La Porta et al. 1999). Jensen and Meckling (1976) described the agency problem as a way for managers to use profits of the company for their own benefits rather than the benefits of investors and stricter corporate governance leads to lower agency costs and makes the firm better off as the agency costs are absorbed by the entrepreneur. Therefore, some essential elements of corporate governance and finance are the laws and quality of their enforcements by the regulators and courts that provide protection to the rights of the outside investors. These can be revealed in

adequate voting rights of shareholders and effective liquidation rights of creditors which encourage investors to finance companies; otherwise, investors will be reluctant to invest and corporate governance will fail to provide protection to investors. Jensen and Meckling (1976) pinpointed the sequence and the importance of the legal system by stating that the statutory law sets the bounds on contracts, the police powers to enforce the performance of contracts, and the courts to establish precedents which form the body of common law. Insiders will try to expropriate by setting up intermediary firms to which they can channel profit, but as the laws that protect outsiders become more effective, managers will be left with only the option of paying/distributing more dividends out to shareholders and accordingly end up attracting more external financing (La Porta et al. 1999). Brycz et al. (2017) proposed that, in order to maximize the amount of capital raised through an IPO, firms should maximize the percentage increase in shareholders' equity against the fraction of ownership sold during the IPO.

All outside investors, controlling and non-controlling, small and large, shareholders and creditors need to have their rights protected, which is the determinant of financial markets development rather than the size of specific institutions. The shareholders' rights might consist of voting for directors, participation in shareholders' meetings, and subscription to new shares issues. Whereas creditors' rights revolve around bankruptcy and foreclosure on collateral and seniority claim on assets in addition to stock exchange regulations regarding transparency and disclosure. Hence, countries with more laws and regulations to protect investors have better and more developed capital markets and when investors find themselves protected from any future expropriation by insiders, they tend to invest and pay more for securities that are easily issued by entrepreneurs.

According to La Porta (1999), countries with common law system, such as England, USA, Canada, and many countries in South East Asia, have the strongest protection for outside investors, the German civil law comes next and the French civil law, applicable in France, Spain and most of their previous colonies, presents the weakest protection to outside investors. From a different aspect, the German and Scandinavian legal origin countries rank first in terms of the quality of enforcement and the French legal origin countries have the worst quality of enforcement. As such, common law, in general, presents itself as a better and more protective in favour of outsiders than the civil law. Hence, companies under common law are more likely to finance investment by issuing equity as opposed to firms under civil law favour financing through debt rather than equity because investors are relatively less protected.

Auditors and underwriters play an important role in narrowing information asymmetry between company managers or owners and potential investors. Auditors play this role by signalling the reliability of the financial data provided to the investors in the prospectus, and underwriters play this role by approving the quality of the issue. Aharony et al. (1993) stressed on the importance of the high-quality auditors and underwriters in providing accurate data in a move to avoid possible future litigation and reputational damage. Investment organizations and regulatory bodies typically suggest that effective corporate governance includes a board consisting of a majority of outside directors, and in specific non-executive and unaffiliated directors. These directors to be considered as unaffiliated should have no relation whatsoever with advisors, suppliers or creditors of the firm. Arthur et al. (1993) and Brickley et al. (1997) saw in the dual leadership structure both costs and benefits that could create a potential for rivalry between CEO and the chairperson and thus hindering accountability for the poor performance of the firm. Bruton et al. (2006), in turn, stressed the fact that founders-managers who end up holding a significant part of the IPO shares may be compelled to abuse public investors creating thus an additional principal-principal goal incompatibility on top of the usual agency problem. In the same context, high concentration of retained ownership can form a means that mitigates the different risks inherent in multiple agency divergence. On one hand, the large blocks of shares retained by initial investors might comfort the public investors and reduce the risk of adverse selection, especially during the period of lock-up. Furthermore, this concentration of ownership will also reduce the costs of policy coordination due to the existence of small number of investors and helps in alignment of objectives among all parties concerned and present itself an important governance parameter that boost the performance of IPO firms without the need to suffer any discounts or underpricing of IPO shares (Jensen and Meckling, 1976 and Bruton et al. 2006)

Reforms of corporate governance will always face some objections from the existing families, the insiders, who control the large corporations and see a threat to their control and to their expropriation opportunities as they monopolize the credit market and enjoy the political influence that comes with it.

The German government pushed ahead with its corporate governance reforms by creating the Neuer Markt for new companies and mandating that new companies wishing to list must comply with international accounting standards and follow stricter disclosure requirements than existing

firms which in turn was guaranteed by heavily regulated financial intermediaries and eventually gave a boost for more initial public offering in the country.

Hoskinson et al. (2004) differentiates between common law countries, such as U.K., where investors who are protected by law, can easily take more risk and are better situated to sue the board of a company in courts, it was proven that they are not trying to maximize firm profitability. On the other side, in civil law countries, such as France, investors rely more on relationship governance.

In conclusion, better investor safety goes hand in hand with effective corporate governance which is reflected in wider financial markets, more scattered ownership and efficient allocation of capital (La Porta et al. 2000).

But again, the corporate governance regime will ultimately reflect the policymaker's desire to encourage greater investor participation and lower cost of capital through more restrictive requirements or his desire to attract more firms to go public through more lenient requirements.

III. Valuation

At the core of the decision to go public, the company seeking a source of funding must make sure that it is getting what it is aspiring for in terms of monetary values and not only in shareholders' protection and control. The right valuation accordingly to planned future growth scenarios will be crucial in the decision to go public or to stay private and seek different source of funding. Several factors play an important role in the expected proceeds from the IPO and in specific the method used in the calculation of the value of the company, the underwriter investors base and the trading venue and its development.

A. Pricing

Before going public through an IPO, companies need to find the price range for which its stock will have to be offered to the public. Underwriters will work on different valuation methods and then decide which price to adopt. These valuation methods range from the dividend discount model (DDM), the discounted free cash flow method (DFCF), to several comparable valuation approaches.

Alford (1992), Kaplan and Ruback (1995), Kim and Ritter (1999), Gilson et al. (2000) and Berkman et al. (2000) studies the pricing of IPOs based on comparable valuation, such as the P/E valuation, and discounted cash flow model and concluded that they both lead to almost the same

results and when using DDM model the results tend always to underestimate the value of the shares.

More companies will go public when outside valuations are high or have increased. Dow and Gorton (1997), Habib and Ljungqvist (1998) and Maug (2001) contend that IPOs help entrepreneurs use their shares to deduce investors valuations of their firm and help them in some post IPO decisions such as management's incentive compensation.

Hot market IPOs take advantage of irrational investors and reflects greater optimism. In hot market offering prices are closer to their true valuations. Ritter (1984) talks about waves in IPOs that affected by what he calls "hot issue markets" that affects the timing to go public for some industries that witness a better investment opportunity that might help in increasing fund-raising capabilities. Loughran et al. (1994) found that it is investors' preference and high valuation for some firms especially during period of relatively high market prices. Some good macroeconomic circumstances will affect positively the cash flows of many firms that are positively correlated when it comes to firm profitability. Bruton, G. et al. 2006, stated that overly optimistic estimates of the revenue of the firm are one way to inflate value of the firm and as such increase the managers' reward from IPO.

Habib and Ljungqvist (2000) illustrated the cases of U.S. and Canada where issuing firms go for one of two options: the best-effort offering which is relatively less costly but leads to high level of underpricing or the firm commitment book-building which is costly but presents lower underpricing. Moreover, they found that firm commitment is more convenient to large issues where the benefits outweigh the inherent costs.

Busaba and Chang (2002) found that book building pricing method decreases adverse selection by simply requiring more information, Biais et al. (2002) concluded also that the discretion used in book-building by the underwriters leads to better outcomes for issuers relative to auction mechanism, and Ritter (2003) points out that fixed price and auction mechanism are declining while book building method of allocation is increasing. Moreover, Ritter (2003) saw bookbuilding procedure dissimilarity between the US who starts the process by setting a file price range with a \$2 difference and then the offer price is set based on demand from the road show outcome with a +/- 20 % from the most recent price range, while the German set the price range after the book-building procedure with a €2 difference (Ljungqvist et al. 2003) and the IPO is usually priced at the highest side of the range.

Benveniste et al. (2003) saw information spill over from larger frequency of IPOs leading to better appetite and more price acceptance of investors and hence affects positively the offer price of a current IPO. This, in turn, is manifested in Pagano et al. (1998) who stated that the original issuers factor in the liquidity benefits of going public and the potential opportunities for diversification when pricing the issue.

In addition, there is a growing trend in the US and Europe to allow and encourage small unprofitable companies with little history to go public. Examples of which are London Stock Exchange AIM, Deutsche Borse OMX, Borsa Italiana Alternative Capital markets and the Euronext NV's Alternext that focus on listing of younger growth companies.

When a company goes public, it usually starts a marketing campaign known as a "road show" weeks prior to the IPO. The company's top executives and representatives from the investment banker perform presentations to institutional investors. At the end of the road show, the underwriters solicit potential investors to confirm how many shares, if any, they want to buy, and at what price. The underwriter and issuing firm then agree on an offer price. This road show presents a high-stress period for the issuing firm's executives because if an unexpected failure didn't get the deal through, the company and selling shareholders will receive no money, and the existing shareholders continue to hold shares in a private company with no liquid market in which to sell their shares.

If the IPO goes ahead as scheduled, all investors who stated that they are willing to pay a price above the offer price receive shares, with no discretion about who receives the shares or most of the issue will go to institutional investors and around 20% will go to the general public.

Almost all IPOs are sold using a procedure known as bookbuilding, in which, if there is excess demand at the offer price, the underwriters are allowed to use discretion for allocating shares.

With bookbuilding, the incentives of the issuers and underwriters are misaligned. Underwriters receive compensation from two sources—the fees paid by issuers and extra commissions paid by some mutual funds and hedge funds, known as "soft dollars". Because the underwriters know that they will receive this indirect soft dollar income only if they allocate underpriced IPOs to these clients, they have an incentive to recommend a lower offer price than would be in the best interest of the issuing companies. In other words, with book-building, underwriters receive compensation from both direct and indirect sources. The conflict of interest that results hurts issuing firms, adding to the costs of going public.

B. Underpricing

The IPO underpricing occurrence entails large initial day returns when measured as the difference between the offer price and the market price at the end of the first day of trading (Ritter 1991). Furthermore, the 'lemons problem' emanating from the adverse selection on the average quality of IPO firms leads to underpricing or stated differently an information-based discounting of IPOs (Akerlof, 1970, Leland 1977). Asymmetric information, among informed and uninformed investors on one hand and issuers and investment banks on the other, is also presented as a reason behind underpricing as pronounced by Baron (1982), Rock (1986) and Welch (1989).

Usually companies, when going public, offer their shares at a price which is below market clearing price in an effort to reward new investors with a good return as measured by the difference between the offer price and first day closing price. Berk (2007) defined underpricing as a higher closing than offering price on the listing date. Ritter (1984) and Welch (1989) found an average initial return of 22% on IPOs of US firms, and Buckland et al. (1981) found similar results on the London Stock Exchange. Ritter (2003) in his survey of international studies, that covered four decades and 38 countries, reported an average first-day return ranging from 5.4% in Denmark to around 257% in China, with a median of 20.7% which implies that a large portion of the proceeds from the IPO are denied to the issuing company, which is also known as “Money left on the table”. He added also that the owner wants to maximize the value of the company and avoid risk of leaving money on the table on one hand, and the investment bank looks at a good deal for the investors on the other, the compromise, to both parties, leads eventually to under-pricing of the issue.

Habib and Ljungqvist (2000) clarified that initial owners spend more on promotions in a move to decrease as much as possible any under-pricing that will reduce their proceeds from the IPO process and hurt their interests. This promotion can take the form of recruiting reputable auditors, lawyers and underwriters and the costs of road shows. Therefore, they have to bargain a trade-off between acceptable level of under-pricing and expenses on promotions especially when the size of the issue is large and they stand to lose more. Their market study revealed the fact that Malaysian owners sell 58 times more of their equity than Chinese owners, which explains the 6% underpricing witnessed by Malaysian issues compared to 42% for Chinese issues. Booth and Chua (1996) stated that under-pricing tend to attract a number of potential investors, with high information collection cost, by widening the pool of dispersed shareholders and raising the valuation of the firm through the creation of liquidity in the aftermarket. This liquidity from

the additional investors' participation will match up to any incurred information collection cost and as such higher under-pricing leads to more liquidity. Rational investors expect managerial efforts to drop after the decrease in the equity stake of entrepreneurs and hence the price they are willing to pay for an IPO depends largely on the percentage retained by initial owners.

Ellul and Pagano (2006) came to contradict this finding by stating that greater liquidity calls for lower underpricing and that this relationship is stronger whenever initial investors turn out to be flippers who are just looking to sell their holdings after the first couple of days following the increase in the share price to reflect the true value of the firm. They also found that older and bigger companies tend to fare well with less underpricing based on their low risk feature.

Brennan (1997) revealed that underpricing is affected by the owners' strategic decision to influence share dispersion and accordingly ownership structure and corporate control. Moreover, Ljungqvist and Jenkinson (2001) and Krigman et al. (1999) found in underwriter reputation and size a good reason behind underpricing as a mean used by the underwriter to attract long term investors.

A weak issuer would rely on discounts to attract uninformed investors and consequently grants informed investors a very large gains opportunity. As such, when faced with strong issues, underpricing causes rationing due to very high demand and hence small allocation. Rock (1986) in his model, stated that underpricing is important to attract uninformed investors with the presence of adverse selection due to the existence of informed investors participating in the course of issue. Some writers explained this phenomenon as a kind of double pricing that the issuing company must pay in terms of cost of the services rendered by the underwriter on one hand and opportunity cost of underpricing. S. Hauser et al. (2006) reject the fact that underpricing and rationing are signs of due competition and efficiency in the market and reflects on two different pricing mechanisms that can lead to or away from this mispricing. They stressed on an investor-driven auction pricing system that leads eventually to a clearing price with only a minimum price to rely on, unlike the book-building that negotiates both pricing and share allocation. This system reduced the average return in first day trading, increased the costs charged by the underwriter to compensate for the relatively higher risk of under-subscribed offers and increased the return to uninformed investors at the expense of informed ones which at the end resulted in better priced issues based on actual IPO factors and that is a sign of an efficient market for the IPO market. George Akerlof (1970) introduced the concept of adverse selection and Berk (2007) asserts by concluding that the seller

is motivated to sell only when the product is of low quality and when they are hiding some of the information from investors. Accordingly, adverse selection is at the heart of the fact that informed investor can differentiate between under and over-priced issues unlike uninformed ones and this led to the explanation of the Lemon Problem.

Kimbrot (2005), in her study of the Chinese IPO market, argued that managers have incentives to underprice to compensate for higher agency costs emanating from remaining state ownership, regulatory and political factors. Ross (1977) introduced the signalling theory that relates directly to the asymmetric information and hence some investors with higher information might act according to their informational advantage. Here a signal can be looked at as credible information relayed to uninformed investors from the informed investors (Copeland et al. 2005). Welch (1989) saw that issuers may signal their quality by relying on underpricing at IPO, selling accordingly small percentage of the firm, and then they will depend on seasoned equity offering based on market determined fair equilibrium price to collect high proceed from the sale, and as such that model of underpricing reveals the potential of better performance for underpriced firms relative to others who do not.

Moreover, Ljungqvist et al. (2003) suggested that underpricing will be larger for IPOs issued through book-building method than through fixed price method due to the high cost of information needed and Benveniste et al. (2003) went to prove that underpricing will be the lowest whenever the market witnesses more frequency of IPOs.

Boulton et al. (2010) put forward some hypotheses to explain the underpricing phenomenon, stating that the underpricing is higher in countries with strong corporate governance system that protects external investors and firms that underpriced are known to have more widespread ownership after IPO.

Finally, it has been argued that younger and smaller firms are relatively riskier and hence are more prone to underpricing in their IPO issuance (Ritter, 1984, 1991, Megginson and Weiss 1991).

C. Underperformance of new issues

Firms, issuing equity, tend to make excess inventory investments and capital expenditure and witness relatively high sales growth with low levels of cash collection rates (Liu and Forster, 2014). Sometimes, the IPO decisions falls within a wave that follows a period of relatively higher industry-wide returns and the post-IPO operating performance results from managers' decisions

prior to and after the IPO that usually revolve and affect variables such as capital expenditures, cash sales and operating cash flows. Accordingly, underperformance is mostly the result of market participants' over optimism or the fact that they were fooled by pre-IPO information (Ritter 1991) and a rapid increase in capital expenditure and sales subsequent to IPO will lead to lower stock returns (Loughran and Ritter 1997).

Koh et al. (1989), Aggarwal et al. (1994), Higham (1988), Keloharju (1993), Loughran et al. (1995) and Stoughton et al. (1998) investigated the underpricing and post issue performance in several Asian and Latin American Countries and the US and ended up with almost similar outcomes but at differing degrees. Long run underperformance was also documented by Boutro et al. 2007 and Zaremba and Okon 2016. Furthermore, Liao et al. (2015) found that earnings management during lock up period is associated with operating underperformance patterns after lock up expiration.

Pettway et al. (1996, 2003) found a decrease in first day returns of the Japanese IPOs from 70% to 12% during the period 1981-1996 following the introduction of market effect on the investor-driven fixed pricing system. Biais et al. (2002) studied the French “offre à prix minimal (OPM)” which rendered a 15% return on average during 1983-96 period being reasonable under official supervision. Derrien and Womack (2003) studied two other French “offre à prix ferme (OPF)” and “placement garanti (PG)” to show that OPM is a more competitive mechanism.

Jain and Kini (1994) found that firms showed a decline in post-issue operating performance when measured by operating return over assets relative to pre-IPO figures and this decline in neither a by-product of decrease in sales nor a decrease in capital expenditure and this decrease is even smoother when the IPO's initial owners retain a higher percentage of the new public firm. They stated also that investors usually value firms based on earning growth expectations which, most of the time, are not sustained after the IPO. Differently, the reduction in management ownership, once public, leads to increased agency problem when conflict of interest become a disputing issue between initial owners and new shareholders. This will push management into more perquisite consumption such as non-value maximizing projects (Jain and Kini 1994).

From another perspective, the efforts of window-dressing prior to IPO, which tend to overstate the performance of the going public firm, will eventually lead to a reduced post-IPO performance reflecting the actual status of the firm. Moreover, while preparing the firm for the IPO, figures related to assets are usually reported at their fair value and sometimes inflated as opposed to private firms that try to always hide the true value from the taxation authorities. And since the going public

decision is usually timed to correspond with period of exceptional levels of performance, post IPO performance figures will reflect the fact that these levels cannot be maintained for a long period of time.

In the long run, IPO underperform due to risk mismanagement, bad luck and over-optimism. The high transaction costs of raising external equity capital in an IPO as documented in Ritter (1987) and Barry et al. (1990) are partly offset by low returns during optimistic periods of investors.

Mikkelsen et al. (1997) suggested that firm age and size can have a huge impact on the post IPO performance. They stated that older and larger firms tend to show better performance than relatively newer and smaller firms. Moreover, Kenneth et al. (2004) found also that, if capable of maintaining capital expenditure, growing firms perform better after IPO but does not fully explain the post-IPO operating performance. Operating performance peaks in the year prior to the IPO and declines thereafter accompanied by an increase in capital expenditures and sales.

Boulton et al (2010) stated that post-IPO firm valuations are higher in countries with strong corporate governance and the empirical results showed that underpricing is higher for smaller IPOs, book building IPOs and IPOs with higher volatility. They also found that after a state of high returns in the market, IPOs show higher underpricing as well as in countries where more restrictions are imposed on commercial banks regarding their ability to invest in equity markets. Underpricing is conceived to be higher when private benefits are higher and when investor protections are higher as well. The private benefits, on the other hand, are well observed in countries with less developed capital markets and where ownership concentration is remarkable.

Lastly, Zaremba and Szyszka (2016), in their study of CEE countries, found that the impact of age on the stock returns is evident among smallest and oldest stocks and that, after controlling for size and book-to-market ratio effect, IPO firms didn't perform worse than similar non-issuing firms. Further to above, Paul McGuinness (2016), in his study of Chinese firms going public on the Hong Kong market, highlighted the mix of state backed and privately-owned issuers where strategic political importance has a positive impact on post-IPO returns, and state support helps in maintaining stable sales turnover and earnings. He, further, stressed on the "Cascades" idea of Welch (1992) where subscribers to an IPO boosts their demand for the share issue depending on a perception of higher demand rather than the fundamentals of the issuing firms which later on align with the fair fundamentals and hence lead to underperformance. Moreover, McGuinness explained this behaviour by stressing on Shiller's (1990) "impresario hypothesis" where underwriters might

exploit investors' perception and encourage queuing effects which further overstate their perception of market demand.

D. Information and liquidity consideration

Firms face the choice between private and public financing that revolves around availability of information and at which costs this information is accessible by potential investors. Subrahmanyam and Titman 1999, talked about serendipity where investors stumble, by chance and at no cost, on important information that is relevant to a specific stock or company which explains different interpretations by different investors. Moreover, when a small number of firms and participants exist in the market, this will lead to the availability of less accurate public information which in turn reduces the benefits of being public and the availability of the information, aside with a large number of participants, constitutes a key aspect of a liquid market which is further enhanced by the large number of investors with serendipitous and low-cost information and hence the efficiency in these markets. As such, this information gathered by many investors present itself as a good market signal that would not have been available if the company was financed through private equity.

Lowering the requirements to become active investors and facilitating the transmission of low-cost information through the reduction of the brokerage commissions and enhancing the disclosure requirements, enough to uncover reliable information about a firm, will have the effect of snowball that encourages more firms to go public and sets the ground for markets to become more liquid and more efficient (Subrahmanyam and Titman 1999). Mandatory financial and accounting information has large impact on the valuation of the issued shares and its success as found by Brycz (2017) and that the success of the issue is signalled and determined, better, by the pre-IPO ROE, which is based on net income, rather than ROA, which is based on operating profit (Teoh et al. 1998).

Furthermore, when the stock price conveys accurately the information about the future of the firm, the share price is more valuable and respective managers are pushed more into taking better investment decisions (Holmstrom and Tirole 1993).

Investors are usually less informed than the issuers regarding the true value of the issuing company and hence they are concerned about their investment righteousness, affecting therefore the share price of the company both at its initial offering or its secondary offering. Chemmanur et al. (2005)

said that firms facing less information asymmetry and with projects that are easy to evaluate by investors are more likely to go public.

In addition, we must look at the development of the financial markets on one hand, and on the actions taken by the government to enhance economic efficiency on the other. As such, the liberalization of the stock markets throws in a wider choice for investors to benefit from and accordingly diversify their portfolio which improves stock prices by increasing the informational efficiency and the liquidity of the market (Henry 1997 and Stulz, 1997).

Ellul and Pagano (2006) stated that the expected level of liquidity and its variability affect the issue price in addition to the adverse selection and relative fundamental risk. They found that the more liquid the secondary market is expected to be, the less the underpricing of the primary issue and as such the more difficult this expectation the more the expected return required by the initial investors. They also found that seasoned equity issues are more liquid than IPO shares due to the uncertainty feature associated with the initial offering where investors not knowing the extent of liquidity of the aftermarket, tend to require a higher liquidity premium which will be translated into underpricing of the issue. Whenever visibility starts to decrease and information asymmetry begins to increase, public firms will tend to go private in a move to escape the adverse selection costs.

Moreover, according to Ellul and Pagano (2006), once the initial owners realize the low quality of their company, they tend to sell a larger stake which can be attributed to the presence of asymmetric information in the public offering procedure.

Bhide 1993, argued that the dispersed ownership of publicly traded firms conveys with its liquidity benefits to investors. Zingales (1995) and Mello and Parsons (2000) emphasized the importance of liquidity in establishing a market price relative to the value of the firm.

Booth and Chua 1996 stated that the ability of a firm to list its shares on major exchanges provides liquidity to the firm's stock by allowing the possibility of large trading volume which can be reached through a large number of stocks that corresponds to large companies. It is also known that the stock price is very volatile following an IPO implying that information that was missed during the underwriting period is reflected in the current price and this post-IPO stock performance will affect at a later stage the cost of raising additional funds and accordingly the subsequent investment decisions and choices (Jegadeesh et al. 1994).

E. Certification role versus monitoring role

Booth and Smith (1986) introduced the certification hypothesis that explains why respectable intermediaries are needed to certify to potential investors that an IPO is not overpriced. Therefore, it is argued that underwriters stand ready to pay the extra cost of certification stranded by the benefit of reducing the underpricing effect on one hand and increasing the proceed from the IPO issue on the other.

Jensen and Meckling (1976) discussed the increase in transparency and market scrutiny after IPO and their role in improving corporate governance and in imposing discipline on managers and allowing stock-based incentives for managers and employees to align their interests with those of shareholders.

Pagano and Roell (1998) argued that the larger the number of owners of a company, the greater the tendency to increase the monitoring and the costs of this process push the firms into going public. Once public, firms come under more pressure on management to perform and the market steps in as a reference for managers in their efforts towards more value creation.

Bancel and Mittoo (2009) came across evidence suggesting that the value of external monitoring depends on firm size and on owners' willingness to depart from the business with small firms since external monitoring is costly especially for high tech companies. Moreover, they found that European CFOs see external monitoring as a major benefit of IPO as opposed to U.S. CFOs who perceive it as a major cost.

Sun et al. (2010) hypothesized that a negative relation exists between underwriter reputation and earning management before an IPO, which presents a certification role, and the positive relation between underwriter reputation and firm operating performance, after IPO, presents a monitoring role. The certification role has a restraining effect on earning and in order to uphold their reputation, underwriters have strong inclination to keep providing monitoring services to the IPO firms. Furthermore, the certification is required to ensure the fairness of the offer price as dictated by the regulatory bodies and to mitigate risk of asymmetries of information and adverse selection pitfalls. Moreover, high prestige investment bankers might have rigorous standards and requirements for certification and hence produce better-quality information about the targeted firm. IPO firms as such can relay favourable information about their firm by selecting reputable underwriters that will fully price the issue at hand and decrease accordingly the level of underpricing (Chemmanur and Fulghieri 1994). Block and Hoff (1999) revealed that underwriters

are better suited to perform due diligence research to assert proper information disclosure by issuers and prevent possible legal liabilities. The issuers depend on the reputation of the underwriter in their choice of the investment banker based on its history in effective pricing and marketing as well as its post-issue price stability, market timing, analyst coverage and the ability to assist in future restructuring and secondary stock issuance. Ritter (2003) in turn stated the importance of favourable analyst coverage and found that investment bankers compete for deals by committing to have high coverage of a stock and issue positive recommendations. Krigman et al. (2001) further explained that underwriters with strong analysts can charge high fees and leave more money on the table.

Moreover, Mazouz et al. (2012) found that reputable underwriters support IPO prices after listing in cold market and during weak demand in a move to protect their reputation and offer the respective shares at prices closer to their true value reducing as such underpricing and prevent investors from participating in overpriced IPO on one hand and benefit issuers on the other by lowering the money left on the table and improves its own profitability. Accordingly, stabilization is a kind of insurance that IPOs start and trade at or above their offer prices Schultz and Zaman (1994) and Aggarwal (2000) showed that the lead underwriter is usually the main market maker in the first few weeks following an IPO, and as such stabilization stand as a substitute for underpricing in compensating uninformed investors from the costs of adverse selection (Chowdhry and Nanda 1996). Furthermore, stabilization improves benefits of the issuer by decreasing the total money left on the table since shares are offered at higher prices than otherwise indicated by pre-market demand.

Issuers usually put up with high costs of bookbuilding and with its built-in conflict of interest because they focus on hiring an underwriter that has an influential analyst who will cover the firm, most commonly with a “buy” rating, making the company’s stock appealing to potential investors.

The investment bankers have an incentive to underprice the offering more than necessary and charge a healthy commission, paid to themselves, to make it appear as though this is normal resulting in money being left on the table for the filing company, while the underwriters enjoy a healthy profit. (Loughran and Ritter 2002).

IV. Firm Characteristics

Observing many companies that went public, several characteristics surface and distinguish these firms and provides some differentiation and probably lay the ground for some of the requirements to make it out there in the world of being a publicly traded company. The following does not present a pre-requisite to be public but set the base for thinking of the move into the status of being a listed company.

A. Timing of decision to IPO

"Getting to initial public offering is like getting a license to drive" (Irvin, 2016). Jaffe (1970) and Ritter (1984) saw the IPOs coming in waves and that managers tend to time their IPOs with the market to benefit from windows of opportunity that will get them a relatively higher price for their issue. These opportunities can present themselves in the overall stock market (Lucas et al. 1990, Ritter et al. 2002), in the specific industry level (Pagano et al. 1998), and the IPO market in general (Lowry et al. 2002), similarly, Brau et al. 2006, saw stock markets and industry levels as prime determinants regarding the timing of going public decision.

Chemmanur et al. (2005) said that firms will IPO at the peak of their productivity cycle, going public in the early stages of its life is not optimal due to the high cost associated with the going public process, rather they should wait until the benefits of the IPO outweigh its costs and the firm as such tries to increase its scale of operations. Furthermore, Rajan and Servaes (1997) tested the 'window of opportunity' theory and Ritter (1991) came to testify that firms time their IPOs at instances where other firms are believed to be overvalued and take advantage of favourable markets to capture attractive stock prices. He also pointed at times of high profitability of a firm that might be mistaken by investors for being permanent and hence the overvaluation of the respective shares. This so called 'hot issue anomaly' was supported by Choe et al. (1993) and Lerner (1994) who found an increase in raising money in bull markets and when the stocks in a specific industry are bullish.

Boot et al. 2003, on the other hand, stated that for the bull market to attract firms to go public, it should be accompanied with an atmosphere of lax corporate governance and stated that the effect of bull market on firms going public will be weaker with stringent public market corporate governance. Meluzin and Zinecker (2014) found positive relationship between the number of IPOs and the stock price levels and no correlation with the business cycle movements. Rydqvist and Hogholm (1995) found also that most going public activity during 1970-1991 in Sweden and 1980-

1989 in Europe took place just after sharp stock price increases. Ljungqvist (1995) in turn stated that high number of IPOs was spotted just after high stock index levels and good business conditions.

Moreover, Aussenegg et al. (2003) reported more IPOs during 1999 and 2000 on Frankfurt's Neuer Markt compared to an average of less than one IPO per year during the period from 1961-1982 according to Stehle et al. (2000) which suggest also that in the decision to go public, the market timing is somewhat more important than the life-cycle considerations.

B. Product market

Chemmanur et al. (2005) revealed the fact that going public helps the firm in satisfying current capital needs and facilitates the future access to additional future financing through secondary stock offering or any other types of securities. They also found that a firm's product market characteristics and in specific its market share, competition, capital intensity and cash flow riskiness play an important role in its decision to go public. Furthermore, firms operating in less competitive and more capital-intensive industries are more likely to go public. In turn, the total factor productivity (TFP) and sales growth display an inverted U-shaped pattern where these factors tend to increase in the few years preceding the IPO reaching a peak in the IPO year before starting to decline in the years subsequent to the IPO, this phenomenon can simply be explained by the fact that firms tend to increase its scale of operations around the IPO by making use of the external financing raise through the IPO (Clementi 2002).

Jain et al. (2008) discovered that increased diversification by US IPO firms is positively related to the probability of survival and the time-to-failure. They found that the risk of failure declines by 18.4% for each newly introduced line of business. The firms with concentrated product lines face high price competition from rivals in the market and as such face high risk of early failure as reported also by Lerner (1995). Accordingly, diversification presents itself as a cushion for IPO firms against uncertainties veiled in price competition, product demand and capital markets.

In the literature on corporate diversification (Lang et al., 1994; Berger et al., 1995; Comment et al., 1995; and Barnes et al., 2006) documented negative relation between diversification and value-based measures with less concrete results in the case of accounting-based measures. Some document this relation being negative, others like Capozza et al. (2001) found a high level of cash

flow for focused and established firms that is usually offset by high administrative and interest expenses and this relation is completely different when it comes to new and smaller IPO firms.

The IPO process is usually pursued to finance some technological breakthrough which might not be up to the expectations of the company on one hand, or fought by rivals through competing new technology (Maksimovic et al. 2001) or aggressive pricing behaviour (Lerner 1995), as such undiversified IPO firms will suffer high risk of failure specially in period of tight financing.

Deeds et al. (1997) studied the impact of variables that are specific mainly the location of the firm, the quality of R&D staff, the number of products developments and patents held.

As such, diversification is seen as a factor reducing the variability of cash flows and inherent risk and permits IPO firms an opportunity to take longer time to adjust to the structural changes of being public and improve new products and technology that are more feasible and profitable. Diversification across product lines provides synergy for firms by facilitating the allocation of cash to negative cash flow lines from the profitable ones. This assumption is revoked by Rajan et al. (2000) and Scharfstein et al. (2000) who saw a relatively higher degree of misallocation of capital across business lines.

Campbell 1979, Yosha 1995, Maksimovic and Pichler 2001 saw the disclosure requirements imposed on listed companies as a danger to the competitive advantage of the firm. Pagano (1998) saw in the loss of confidentiality a problem to the high-technology firms affecting the competitive edge of their R&D efforts.

However, firms belonging to industries with large technological uncertainty and where the industry is witnessing strong and rapid evolution in investors' sentiments, tend to go public at an earlier stage of their life (Chemmanur and Fulgheri 1999) and Fischer (2000) saw a greater tendency to go public for companies in relatively high-risk sectors.

C. Firm size

Chemmanur and Fulgheri (1999) saw lower share price resulting from information production costs which renders younger and smaller firms less likely to go public since they are known to present larger asymmetric information- based discounts and this was later endorsed by Bancel (2009). But this assumption is opposed by the fact that younger firms generate more technological innovations that boost growth option and hence are better suitable to go public. However, the wider

the track record of an aging firm put it at an advantage for assimilating external financing through public issue rather than private one.

Mikkelson et al. (1997) examined US firms going public during the years 1980-1983 and found that changes in operating performance after going public are mostly explained by the size and age of the firms suggesting that large and older firms tend to have better performance relative to small and young firms resulting from low sales volume, relatively high initial operating costs and mostly aggressive pricing strategies. Balatbat et al. (2004) in their study of Australian IPOs concluded that the use of debt finance, relative to equity, increases as business mature and grow and capital expenditure, relative to assets, declines as opposed to US firms reported by Mikkelson et al. (1997). From a different angle, young firms that are characterized by difficulty in the dissemination of information will find themselves obliged to rely on private venture capital rather than the public market and firms with larger capital requirements technology risk inherent in its operations tend to go for public equity financing (Chemmanur and Fulgheri 1999).

Pagano et al. (1998) found that the average age of Italian firms going public during the period from 1982-1991 stood at 33.4 years compared to 11 years for U.S. firms and they also stressed on the fact that the lack of enforcement of minority property rights makes it difficult for small and young firms to attain outside investors' trust. Maksimovic and Pichler (2001) found also that IPO firms tend to be industry leaders rather than followers and hence value more the capital raise benefits of going public. Furthermore, Bhattacharya and Ritter (1984) realized that raising capital in the equity market by going public permits a firm that is an industry leader to raise external capital at cheaper rate than private financing at the expense of releasing confidential information to its competitors. Boot et al. (2003) stated that as business design or technology becomes more familiar to investors and managers, more firms following that design or technology will go public, which again confirms that the percentage of publicly traded firms will be larger in older and more well-established industries. For example, before 1990, Europe saw much older firms going public relative to the US, where Vandemaele (2003) reported an average age of 28 years for firms going public on the French Second Marché during 1984-1995 and 13 years for European IPOs from 1995-2001 compared to an average age of seven years for US IPOs from 1980-2000 according to Loughran and Ritter (2002) and seven years for US IPOs from 1996-2000 as well according to Ljungqvist et al. (2003).

From an opposite spectrum, Brycz (2017) found that size can be an important factor in determining the success of an issue, where investors looking for more potential return from companies with growth potential will shy away from large companies that are at the top of their life cycle, because their growth potential is limited. Chemmanur et al. (2005) also found that firms which are larger in size and that have higher sales growth are more likely to go public.

D. Credit constraint and activity

Rajan (1992) discussed the fact that firms going public will have more financial flexibility which enhances their bargaining power with bankers and financial creditors and reduces thus their respective cost of credit. Bancel and Mittoo (2004) reported feedback on financial flexibility to be the most important component of a company's debt policy. Moreover, Brycz et al. (2017) introduced a different concept where they saw higher debt as a positive signal that reflects the market trust and analysis done which might strengthen the financial position of the issuing firm and promises a successful share issue. Bancel and Mittoo (2009) found that family-controlled firms see the IPO as a strong bargaining power with creditors without undermining control of the firm.

V. Benefits of IPO

Bancel and Mittoo, 2009, in a survey of 78 European CFOs from 12 European countries concluded that enhanced visibility and prestige, and financing for growth are the most important benefits of an IPO. Large firms see external monitoring as the most important while small firms want to raise capital to finance growth, and family-controlled firms see it as a bargaining power with creditors while maintaining control. Moreover, firms under English system perceive share liquidity as the most important while Italian firms look for reduced cost of capital in IPO. Moreover, the IPO of a firm facilitates any subsequent public offering, be it in the form of equity or any other type of securities.

A. Financing growth

Ritter and Welsh (2002) and Kim and Weisbach (2005) argued and proved that most firms go public mainly to raise new capital for growth and European firms usually do it by releasing relatively larger fraction of the firm's existing shares. When we try to break down some of the

reasons for going public, we come across some of the benefits of raising external financing that are represented in a dominant motive of financing growth since firms will start finding it difficult to generate enough internal funding (Pagano and Roell, 1998) and which in turn secures cheap direct financing away from bank loans and participating venture capitalists, Diamond (1991).

Mikkelsen et al. (1997) saw an increase in assets following an IPO in the US markets and suggested that firms mainly raise equity to finance growth, and Kim and Weisbach (2005) differentiated between primary issues intended toward capital expenditures and secondary issues that are mainly intended towards providing liquidity for firm's directors, but these reasons are not exclusive and can be observable for any of the above-mentioned objectives. They also affirmed that primary offerings most of the time coincide with an increase in inventory, property, plant and equipment and R&D expenditures in the first four years following an IPO.

Bancel and Mittoo (2009) found, in their study of European firms going public, that firms that raise capital for growth through IPO have higher annual average growth rate, larger market capitalization and larger number of employees relative to non-capital raising firms. Kenny et al. (2012) reported an increase in employment and remarkable revenue growth in their study of US IPOs during the period from 1996-2010 and concluded that the newly employed labour force would have been doing nothing else than their current job and that the capital raise through the IPO would not have been used to create alternative jobs.

Furthermore, going public will minimize the cost of capital and accordingly maximizes the value of the firm. Hence, as the cost of capital increases in the public market place, firms tend to go private to overcome this relatively high burden.

Moreover, Wiklund and Shepherd (2003) talked about entrepreneurial orientation that is characterized by the willingness to be innovative, pro-active and to take risks. They found that recent IPO firms possess that entrepreneurial orientation which enhances the relationship between performance and resources and as such lead to growth.

B. Financing alternatives

Companies, in their best state, depend on internal sources of fund, such as retained earnings, to finance their investment projects. Others depend on external sources, such as equity and debt markets, especially in the Anglo-American system as opposed to European system that depends more on the internal sources and the private markets. If the firm expects to face more investments

opportunities after the initial investment and undermines the availability and cost of capital in the private markets, then the choice for public source of financing will become imminent (Boot et al. 2003).

Rajan (1992) argued that going public improves financial flexibility and bargaining power with bankers and other creditors which ultimately decreases cost of credit. Pagano et al. (1998) found that companies witness a decrease in the costs of bank credit after IPO which arises from the improved public information associated with the security listing requirements and/or from their newly created stronger bargaining power represented by the availability of a wider source of capital. As such, IPO firms tend to borrow from a wider array of banks and diminish the concentration of their borrowing.

The choice of external sources also revolves around two alternatives, public money or private financiers, the decision on which is based, in turn, on the cost of funds and the investment opportunity. Here, the entrepreneur must weigh in the bargaining power of private financiers or a small group of investors before taking the decision on the source of external financing and these private financiers must be compensated with higher returns for the concentrated risk they are assuming in a single company (Chemmanur and Fulghieri, 1999).

In addition, the original owner must consider the need to relay any decision to a large number of investors as opposed to small private investors. The larger the investors' base the better the investors are diversified when it comes to the ownership of a stock of an individual firm, hence the benefit of public issue.

Kim et al. (1988) shows evidence that issuers benefit from differences in borrowing costs that arise between the domestic and Eurobond markets.

Moreover, companies with larger international presence are better equipped to secure financing from GDRs market (Global Depository Receipt) rather than seeking equity and private financing such as the case for domestic companies.

There are debates over relative importance of banks and capital markets for financial development and if they are considered as substitutes. Bank-centered economies such as Germany and Japan versus market-centered economies such as the United States and United Kingdom are the focus of many studies regarding which one will help in boosting growth of the economy. Some findings are wavering once we see that Germany has banks that can support firms through debt and equity holdings with relatively underdeveloped stock market. Japan brags about its developed banking

and strong stock markets with large number of listed firms. France resides with underdeveloped credit and stock markets and Italy falls back with largely underdeveloped financial markets (La Porta et.al. 2000). Moreover, the countries with the biggest stock markets show the largest debt to GDP ratios which contradicts with the notion of substitutions between debt and equity financing (La Porta et.al. 1997).

The riskier the firm, the greater are the costs that are sustained if a small number of residual claimants bear most of the residual risk. As such, an increase in the company's risk and complexity of its operations increases the likelihood that a controlling family may exit from its ownership.

Typical to most emerging market countries, companies are mainly owned, managed and controlled by individuals, families and their partners and bank loans and public stock offerings are the primary sources of capital. As such, firms frequently go public when they think that they can grow faster with external financing. Facing underdeveloped market structure and a high degree of information asymmetry brings out the importance of ownership structure in setting firm performance in emerging markets relative to developed ones.

Merton (1987) stressed on investor recognition that might improve firm value and as such decrease cost of capital resulting from improved visibility of public firms. Bancel (2009) supports this view and emphasize that IPO tend to lower cost of financing especially when funds are used to reduce leverage which in turn enhances power of balance with creditors.

Equity financing is crucial for the expansion of new firms whose assets are solely presented by their growth opportunities. For these companies, private equity financing can still put some restrictions on personal initiatives and as such they are only left with public equity financing in the presence of well-developed stock market. This context gives a way for diversification for investors in the equity market, an exit choice for initial holders of equity and allows firms to better time their issue with favourable sentiments towards their industry (LaPorta et.al. 2000).

C. Financing constraint and investment decision

Firms face a choice between private and public financing when confronted with the IPO potential ability to overcome some borrowing constraints that keep the production at a sub-optimal level and assist the entrepreneur in unloading part of the risk to risk neutral investors (Clementi, G. 2002).

Pagano (1998) displayed the access to new source of financing as the most beneficial reason for going public. They also found that concentrated ownership of private firms leads to over-monitoring which renders the decisions regarding any possible capital investment very difficult and costly, and accordingly makes going public a way out to decrease this high cost by raising fund from multiple owners.

High growth firms usually present large current and future investments opportunities that require public equity capital in order to sustain their financing needs away from other sources that are hindered by the large leverage situation that characterizes their financial position. Becoming public will, accordingly, improve visibility and open up the door for long term borrowing possibilities in the bond markets.

Ritter et al. (2002) also mentioned going public as a mean to finance growth by raising capital in the public market. Moreover, Brau et al. (2006) and Bancel et al. (2009), in their surveys of European CFOs, highlighted the ability to finance investment opportunities as one of the advantages of going public and a mean to overcome equity investment constraints and high costs of borrowing.

Firms with high levels of leverage find it difficult to raise additional debt due to the fact that their creditors and all creditors in general can clearly identify the sources of risks they present. High leverage pushes away potential investors and makes it more difficult to go public. Helwege and Packer (2001) said that highly leveraged companies would rather stay private and was supported with this idea by Fischer (2000) who even went to find that leverage reduces the likelihood of going public in Germany. The same was observed of U.S. markets with Busaba et al. (2001). Look at it differently, the available information tends to help in getting more loans at more competitive rates, as such, Myers (1977) suggested that firms with high leverage should more prone to go public.

Firms with high levels of bank financing usually suffer from larger performance decline when they become public firms. Mikkleson et al. (1997) displayed the fact that growing firms with less bank loans seem to outperform other firms and according to K.A. et al. (2004) firms using less debt will experience a better transition regarding performance which can be explained by the fact that moving away from debt or bank financing, firms are becoming less conservative, and this confirmed by Anderson and Makhija (1999) in their study on Japanese firms becoming less reliant on bank financing.

Kenneth et al. (2004), while studying ownership effect, found that firms with high levels of bank financing suffer a larger drop in performance when they become public. Weinstein and Yafeh (1998) and Morck et al. (2000) argue that banks encourage firms to pursue activities that generate significant cash flow before and after IPO in order to secure enough liquidity to meet the bank's short-term loans which again is a sign of conservatism that contributes to any lower performance after IPO.

In emerging markets where companies are usually owned and managed by individuals and families, firms usually believe that they can grow faster with external financing when faced with bank loans as the primary source of financing. Rajan (1992) and Pagano (1998) and Mikkleson et al. (1997) insisted on the fact that growing firms with less bank loans fare better than other firms. Anderson and Makhija (1999) in their study of Japanese firms argued that firms with less bank debt will do better after going public since by moving away from bank financing they are becoming less conservative and hence face less decline in performance post-IPO. Banks used to put some constraints on the activities of firms in a move to secure enough cash flow to pay for the debt.

Cooley et al. (2001) and Cabral et al. (2003) concluded that financing constraints tend to lower survival probabilities and lead to higher exit among small firms that went public in the first place to finance their negative cash flows and are suddenly faced with capital market slowdown. Here, rivals take the opportunity to cut their prices during weak capital markets which in turn undermines the economic viability of IPO firms (Bolton et al. 1990; and Lerner 1995).

Jain et al. (2008) indicated that diversification and capital expenditures intensity are positively related to operating performance and suggested that pre-issue commitment from the part of management to R&D spending and the development of diversified product lines improve the IPO issuing firm likelihood to survive for longer periods. Guo et al. (2006) documented positive relationship between R&D investment at the time of IPO and the initial returns and long-term performance of US IPO firms. Ravenscraft and Scherer (1982) found evidence of four to six-year lag in seeing the effect of R&D investment and profitability. This correlation can go back to the fact that capital markets may be relatively more inclined to finance R&D intensive companies over capital intensive ones.

Moreover, Jain et al. (2008) study results showed that issuing firms that invest below industry norms in R&D face one and a half times more risks of failure in the short post-IPO period.

Whereas, Kothari et al. (2002), Eberhart et al. (2004) and Anagnostopoulou et al. (2006) concluded that the benefits of investments in R&D are more uncertain than capital investments.

Hirschey et al. (1985) and Chan et al. (1990) reported that advertising and R&D expenditures presented positive impact on the market value of firms and capital investment had positive effect on stock returns. In addition, Blose et al. (1997) and Vogt (1997) saw excess stock return facing a simple announcement of an increase in capital investment. Chung et al. (1998) saw advances in stock prices when firms had valuable investment opportunities relative to the capital spending and negative effect as a result of overinvestment according to Titman et al. (2004).

Moreover, Amir et al. (2007) found proof indicating that R&D led to variability in earning for R&D intensive industries that are usually undervalued by investors and Chan et al. (1990) found value enhancing features of R&D expenditure in high growth high technology industries which is usually a characteristic of most IPO issuers. In turn, Eberhart et al. (2004) saw R&D expenditure positively affecting stock return of US seasoned firms, and explaining cross-sectional variation in UK stock return according to Al-Horani et al. (2003), while Anagnostopoulou et al. (2006) couldn't relate R&D investment with growth in sales and earnings of UK firms.

Looked at it differently, Holmstrom & Costa (1986) and Meulbroek et al. (1990) saw the long term expected payoff, resulting from high level of investment in R&D by IPO firm, as a way for managers to entrench themselves or to try to hide their poor ability.

On the other hand, investment in assets will have direct impact on product development, gains in market share, cost structure and brand development as well and these investment choices present their effect on post-issue performance in a two-years period, Kanatas et al. (2004) who also found that higher advertising expenditures expands investors' base and accordingly lower cost of capital. Therefore, the investment policies can support the IPO firms in early post- IPO stages, when they are the most vulnerable to failure and impact the survival time by providing sufficient time for the IPO firms to adjust to the newly shaped structural changes.

Moreover, Brau et al. (2003) contend that publicly traded shares might be used as currency in mergers and acquisition deals in the pursuit of growth. This was supported by Kumar et al. (2008) who stressed on the motivational importance of growth for post-listing acquisitions for foreign firms raising capital in the US markets which brings us to conclude that growth opportunities prompt firms to go public and increase their asset size after IPO.

D. Exit strategy

Ahmad-Zaluki et al. (2010) stated that owners may sell their company looking for diversification and/or personal liquidity whenever their wealth is concentrated in a family-controlled business. Pagano (1993) stressed that owners tend to diversify their portfolio by taking their company public and having the chance to divest by selling part of their equity stakes in the company. This is also emphasized by Mello and Parsons (1998) stating that IPO can be seen as a vehicle to create a liquid secondary market for the firm's shares and Black and Gilson (1998) as an opportunity for original owners to cash out their investments and selling cash flow rights in the company at first and then selling controlling rights (Zingales 1995).

Chemmanur and Fulghieri (1999) and Pagano (1993) made it clear that original owners/entrepreneurs will be reluctant to cash out by going public in the absence of good investment opportunities or alternatives.

Usually, venture capital and private equity firms are mandated by contracts to exit their portfolio companies within ten to twelve years of their investment, and accordingly find themselves obliged to sell out or take the company public which is called according to Gompers and Lerner (1999) as the "venture capital cycle".

Benninga et al. (2003) shows that entrepreneurs issue shares when the cash flows of their firms are relatively high which is usually in periods of high stock prices which can be explained by the fact that cash flows are usually cross-sectionally correlated within industries. Moreover, they state that firm value is a convex function of its cash flows that increases with cash flow above a certain critical level and decreases below this critical level leading to reprivatisation.

Nahata (2008) showed that going public is largely affected by the backing of Venture Capital (VC) firms and focuses on VC exits in IPO. Krishnan et.al. (2009) found that the relatively wider network of relationships of reputable VCs allow them to be better situated to select the right strong market conditions to time their portfolio IPO exits procedures. But it argued that in the hot market periods, when investors show more optimism towards most industries, VCs tend to lower their standards and accordingly we see more and more companies going public.

Brau et al. (2003) suggested that IPO would create public shares that can be used as a monetary tool in the acquisition of other firms or being acquired by other firms.

Moreover, investors once faced with liquidity shock, they try to sell their assets to raise cash, hence when they own shares in a firm and try to sell the shares in the market. Investors are assumed to

be able to sell their shares always at the market-clearing price and as such avoid selling personal property to meet their need for cash as in the case of private ownership in a firm.

E. Publicity

Merton (1987) assumed that investors tend to invest only in firms they know about and the increase in investor recognition and shareholder base lowers cost of equity and increases firm's value. Being listed in the stock market, the company will make costless information available to its customers, suppliers and employees and this information serves as an efficient input to its valuation Subramanyam and Titman (1999). Stoughton et al. (2001) in turn said that the company will be capable of charging higher prices for its products once the consumers get to know about the quality of these products from the stock market and thus, the benefit of listed stocks will be relatively higher for firms with larger customer base (Helwege and Parker, 2001). Maksimovic and Pichler (2001) argued, in turn, that the higher disclosure requirements for exchange listing and public trading of stock increases the confidence and trust of investors, creditors, customers and suppliers in the firm. Furthermore, Bancel and Mittoo (2009) saw IPO acting as advertising for the company and increases its reputation and in turns helps in reducing the cost of financing and help promoting its reputation among businesses and its good reputation as an employer.

VI. Why Stay Private? And Costs of Going Public

Most European CFOs see the IPO as a stage in the life of the firm and ascertain that benefits outweigh the costs (Bancel and Mittoo, 2009). The costs are widespread and range from administrative and managerial reasons such as agency concerns to some direct and indirect monetary costs. These costs differ also in time of occurrence, whether at the time of the IPO itself or when the company is a publicly traded going concern.

A. Adverse selection

Original owners and insiders of a firm command more information about their company than outsiders. This asymmetry of information is decisive to the possibility and the probability of success of any public stock issuance process. With this fact in mind, investors tend to pay less for IPO shares. Chemmanur and Fulgheri (1999) predicted that the price of an IPO share would be lower if offered to the public rather than to a small private equity group or venture capitalists.

Moreover, smaller and younger firms, that are less visible with short track records to depend on, are more affected by adverse selection and hence find it difficult to go public and list their shares. The opposite is true for larger firms with longer track records and more visibility (DeAlbornoz and Pope 2004).

Diamond (1991) found high profitability as a factor that can assist in reflecting the quality of a company and hence help in overcoming adverse selection hurdles.

From a different angle, market governance systems cannot be tailored for individual firms needs and as the disparity widens between governance needs of firms and of market, firms usually tend to favour private ownership sparing as such liquidity inherent in the markets. (Boot et al. 2003).

B. Loss of Confidentiality

Campbell (1979) was the first to introduce the loss on confidentiality as a deterrent to going public. Firms going public will incur some costs as they have to disclose sensitive information about their products that may be valuable to their competitors especially in sectors and industries characterized by rapid technological change Maksimovic and Pichler (2001).

Firms in the technological and R&D intensive sector find it difficult to reveal their marketing plans and their break through development projects and hence are more reluctant to go public due to transparency requirements (Pagano et al. 1998).

Furthermore, publicly traded companies reveal greater transparency of their account to tax authorities, which was turned into an incentive by the Italian government back in 1994 when it passed a law lowering the corporate tax rate for newly public firms encouraging as such firm to go public and report relatively higher earnings (Giudici and Paleari, 2003).

C. Costs associated with public status

The IPO process entails many costs that are divided between direct and indirect costs. The direct costs reside in the underwriting and registration fees, whereas the indirect costs revolve around higher disclosure requirements and loss of confidentiality. Most of these costs are usually included clearly in the listing prospectus and some costs are less explicit and clear, especially when they are related to labour hour needed to meet compliance requirements. Public firms are under the

scrutiny of meeting lots of expenses ranging from listing venue and compliance fees to advertising and potential secondary stock offering.

1. Direct Costs

The direct costs of listing revolve around underwriting fees, professional fees, initial listing costs, compliance costs and advertising costs.

The investment bankers provide and certify the information about the firms that they underwrite in return for fees that represent part of the floatation costs. Torstila (2001, 2003) and Ljungqvist et al. (2003) found that fees charged by underwriters are lower in Europe relative to the US and they are higher for book-building rather than auction or fixed price offers.

The average of the total IPO floatation costs of the gross offering proceeds, over the period 1999 to 2006, was around 8.7% and 11.7% in Frankfurt and London respectively for equity offering and around 0.5% for debt offering (Kaserer and Schiereck 2006).

Furthermore, the gross spread is higher whenever the book-runner is an American underwriter who is more willing to revise the offer price higher in face of high demand for the new share. Chen and Ritter (2000) reported that after 1994, the majority of average size IPOs, in Europe, had a gross margin of 7% irrespective of the risk and the value of the proceeds and Ljungqvist (2003) revealed some trade-off between the gross spread and the level of underpricing. Krigman et al. (2001) showed that underwriters with top rated analysts can charge high gross spreads and still enjoy high market share for IPO underwriting.

Moreover, direct costs include, aside from underwriting fees, any fees paid to the exchange and any advertising and publicity costs and expenses incurred in the process of meeting corporate governance rules and disclosure requirements. The admission fees, even though they are relatively small, are related to the firm market capitalization in general.

The huge costs that worry most of the CFOs are presented in professional fees or non-underwriting fees such as banking, lawyers, auditors and accountants' fees that can add up to almost 9 % of the total funds being raised (Bancel and Mittoo, 2009) with an increasing trend from 1999-2006 period with 2.5% and 4.5% in Frankfurt and London respectively (Kaserer and Schiereck, 2006). This is partly due to high costs of complying with listing rules and disclosure requirements imposed by the SEC or the European financial markets law that can go as far as publishing quarterly reports

and high investor relation standards. These legal fees include the preparation of the offering document as well as the review of and advice regarding contracts directly related to the offering. The Sarbanes-Oxley act, of 2002, lead to significant changes of corporate governance rules and public accounting practices in the U.S, which in turn lead to a diminishing role of the U.S. equity markets potential. Moreover, before listing, a firm must look into its own incorporation status and its relative governing rules, the financial market rules and the stock market rules. In addition to the year-end audit required by the SEC, a firm will need to hire an auditor to issue a comfort letter to the underwriters, to review the registration statement, to audit the financial statements included in the offering document, and to review all documents related to the offering. Most auditing fees related to an IPO, can vary depending on the complexity of the offering.

In addition to hiring an external auditor, most companies must hire an IPO consultant to help with IPO preparation and execution. They can assist in several ways, including the following:

- Acting as business advisors both to executives and to the audit committee.
- Assisting in the filing of the registration statement and giving advice related to the financial statements.
- Ensuring the pre-IPO period's financial information is completed.
- Providing an independent assessment of IPO readiness and aiding in any necessary improvements in preparation for going public.

Ritter (2003) added that most traded public firms pay for insurance known as D&O (directors and officers) insurance to reduce the impact in case of being sued and which is related to company specific risks. Other costs that firms must take into consideration include public relations costs and the need to change accounting systems, in addition to management time and other opportunity costs.

Moreover, a firm must invest in a new financial reporting system prior to the IPO and start hiring and structuring a new board of directors since as a public company, the Board of Directors takes on many new and significant tasks such as identifying and managing risks in addition to setting new corporate governance rules which are essential to the long-term success of the company.

Once public, most of the exchanges impose some annual fees and firms must respect the transparency requirements that put on some additional costs related to auditing fees and costs of formulating and distributing information about the company. These costs are generally fixed in

nature and are not related to the size of the company and accordingly can be detrimental to small firms in their decision to go public (Pagano and Roell, 1998 and Pagano et al. 1998).

Furthermore, gross returns to investors usually comprise trading costs that can be split into explicit and implicit costs. The explicit costs revolve around brokerage commissions and fees, whereas the implicit costs are manifested in the Bid-Ask spread. Kaserer and Schiereck (2006) in turn showed that an increase in the liquidity of a stock leads to a remarkable reduction in these trading costs.

In a study done by PwC, they benchmarked the costs of managing a public company and found that “financial reporting, regulatory compliance, and incremental auditing costs together accounted for an estimated 52 percent of the total incremental ongoing costs directly associated with being public.”

Though some of the cost of a new financial reporting system may have already been incurred prior to the IPO, it is likely that the company might not be fully integrated into the new system by the time the IPO is complete. These post-IPO costs might include professional accounting advisory fees for implementing internal controls into the new reporting system and IT advisory fees for the installation, implementation and testing of the system.

Although the fulfilment and administration of employee compensation plans is a recurring cost, the creation of stock-based compensation plans should be a one-time cost. A good deal of the work and costs may have been incurred in pre-IPO phase, but according to KPMG discussions “newly public companies can approach aligning and optimizing the people costs within a new public entity with...delivering value to shareholders” through a “total rewards strategy” that will “[serve] the needs of all stakeholders.”

2. Indirect Costs

In the restructuring topics are the formation of an internal legal department, a tax department, an investor relations department, an internal audit department and audit committee, the implementation of new reporting and accounting systems, setting new employee benefit scheme, and the creation and documentation of internal controls.

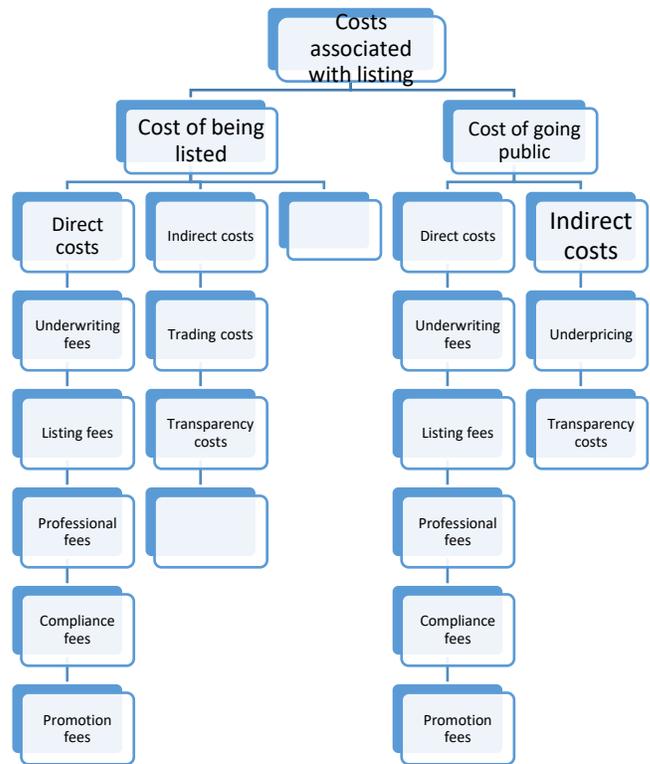
Moreover, due to the adverse selection and moral hazard issues, IPO firms are inclined to offer their security at a discount, a trend known as underpricing. Underpricing is factored in as an important indirect cost to be accounted for when going public and which usually affected by the listing location on one hand and the market sentiment on the other. According to Oxera (2006),

the average underpricing at the LSE and at the Deutsche Borse were 10.7% and 6.9% respectively during the period of study from 2003 till 2005 and these levels change from period to period depending on the economic and financial situation in the listing country.

Furthermore, firms might abstain from going public as a result of tough disclosure requirements which will reduce the informational advantage the company might enjoy against its competitors.

Trading costs are presented as an indicator of market liquidity. The trading volume (TVO) is usually calculated as numbers of shares traded multiplied by closing price per day. The higher the TVO the more the liquidity in the market and as such the lower the trading costs Kaserer and Schiereck (2006). Furthermore, a zero-trade-ratio (ZTR) is estimated as the number of days without any trading over a certain number of observation days. A liquidity problem is signalled whenever a market reveals a high percentage of ZTR relative to another market. Moreover, the bid-ask spread which represents an implicit trading cost is inversely correlated with trading volume and tend to become wider with less trading volume and less liquidity in the market.

Figure 1: Costs Associated with IPO



Source: Christensen, C, 2018.

VII. Concluding notes

The choice of going public or staying private hits, at a first instance, the ownership structure as the firm raises funds externally. The degree of autonomy of the managers revolves around the independence and control preferences on one side and the decision-making ability with respect to firm value maximization on the other.

The corporate governance arrangement will play an important role in paving the way for more independence with private ownership and greater liquidity and lower cost of capital with public ownership. Furthermore, the decision to go public with different types of securities, debt or equity, revolves around the following key observations or characteristics:

- 1- Smaller and younger firms are less likely to go public
- 2- Companies operating in industries characterized by less information asymmetry and higher stock market liquidity are more likely to go public.
- 3- Firm in industries that facilitate the valuation of firms and with relatively easier and more efficient projects are more likely to go public.
- 4- Firms operating in the high-tech industry where confidentiality is of utmost importance are less likely to go public.
- 5- More capital-intensive firms with greater cash flow risks are more likely to go public.
- 6- Firms with larger market share are more likely to go public.
- 7- Firms with higher levels of growth in output and capital expenditures are more likely to go public

The following chapters will introduce the BSE through a historical overview of the different stages in the life of this market in an effort to magnify the potential of the market and the underdevelopment that it suffers from. We will also shed the light on the Lebanese businesses in terms of their structure and corporate governance and their ultimate choice of sources of financing and the most convenient source of such financing. We will see how the Lebanese firms following a modified Pecking Order Theory fall short of going public and accessing the capital market in their quest for long term sources of financing. The underdevelopment of the capital markets is the main reason for the reluctance of the firms to approach this market or even to look for prospects of long-term funds.

In their pursuit of funding, the Lebanese enterprises should reflect on the costs inherent in the process of going public and the aftermath of being a publicly traded company. The direct and

indirect costs can at times be a hurdle facing the firms that intend to go public and can at times be the reason for success and growth or the destruction of the firms if not accounted for or not budgeting properly before taking the action to go public and accessing this important source of funding. Further examination will be presented and supported with empirical studies on the dynamics and potential long-term future of publicly traded firms and the possibilities of recourse to being private again as highlighted in the example drawn from the European markets and in specific the case of France's Euronext-Paris.

Chapter Two: Historical Overview of the Lebanese Financial Markets: 1920-2019

Post-colonial and an independent country, Lebanon had to establish itself in an arena of multiple cultural surrounding with ongoing intentions to get a hold of its unique geo-political stronghold. A merchant economy with a strong and robust banking sector, Lebanon tried always to benefit from its wide Diaspora and domestic strong will to pin itself on the regional and world financial map. With one of the oldest stock markets, in the region, established back in 1920, and one of the highly regulated banking sectors, Lebanon established itself as a strong financial hub that attracted investors looking for opportunities and decent returns. The devastating civil war of 1975, that lasted 15 years, and the services-oriented economy pulled out its stock market activities and shifted all potential money inflows into the banking sector that became a unique landmark relative to the distinct and difficult macroeconomic characteristics of the economy.

Since 1996, several attempts were made to revive the capital markets but the Lebanese mentality of the family business and the stacked sense of legacy building and inter-generation inheritance always stood as cornerstone in the face of all potential efforts. With the intention of a trustworthy and resilient central bank, the capital market might gain its chance to complement the banking sector and provide new and more affordable means for the existing companies and the SMEs, in specific, to have access to new sources of financing whether be it through debt issuance or equity funding.

Comparable analysis is conducted to weigh in the Lebanese capital market relative to other markets in the region and globally. Lebanon falls among the resource-poor and labour-abundant economies and its stock market (BSE) is considered one of the smallest, in terms of number of listed companies with only 10 listed firms and a total market capitalization of around \$9.6 billion as at end of 2018 representing around 17% of GDP with a promising future potential for growth.

In addition, recent introduction and aspiration of the market were tackled such as the start-up financing program by the central bank of Lebanon (Article 331) and the latest privatization of the national stock market and work is in progress to introduce a new sophisticated electronic trading platform in cooperation with the Athens stock market can pave the way toward the revival of the

capital market. The SME sector that portrays the majority of the firms should be able to benefit from the new platform by relying on new innovative securities that renders long term financing more accessible than the traditional short-term banking loans.

With one of the largest gold reserves in the region and a unique system of pegged exchange rate, the economy is under constant pressure from a large deficit in the balance of trade and a decrease in the inflows from expatriates. Accordingly, all efforts to embellish the going public scenario are reaching a deadlock and firms are shying away from the capital markets due to the blurry vision of the future of the political economy and the financial distress as shown in the hard-hit balance of payments figures.

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding, which will be discussed and validated in chapter two and three.

I. Introduction

For any country, having companies go public is good for the economy because the capital market activities are linked with economic growth, they provide investment opportunities, they help in reducing information costs, they are the catalyst that stimulate investment banking and securities trading, and last but not least, capital markets are a sign of a healthy regulatory system.

Healthy capital markets provide benefits to a variety of participants that includes not just investors but also corporations and governments. Capital, raised through equity and debt, can be used to help grow businesses, finance investments in new expansionary plans, equipment and technology and provide funding to supportive infrastructure projects. This will help in job creation and induce flow of money into the economy. Moreover, businesses and individuals can invest in securities to generate and grow wealth.

IPOs raise capital for the companies that go public; IPOs are a mean for the shareholders of private companies to convert their stock to cash. When companies go public, their shares become widely owned by the public which creates opportunities for investments, and hence the company will have to follow a new disclosure regime imposed by the regulatory authorities and the stock exchanges making transparency of information at the core of its operations.

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding, which will be discussed and validated in chapter two and three. By reflecting upon the low turnover in the BSE and the limited number of firms listed on the BSE and the still ongoing efforts by the Central bank of Lebanon (BDL) and the Capital Market Authority (CMA) to introduce new trading platform and new trading rules and regulations, the researcher will validate the first hypothesis and prove the current status quo of underdevelopment of the Lebanese capital market and the specific the Beirut Stock Exchange (BSE).

The chapter tries to shed some light on the post-colonial period and the post-independence chapter in the history of the Lebanese economy. Lebanon is a country governed by feudal mentality that rendered the establishment of large firms difficult. The divided sense of belonging surrounding its culture and the overall disputed structural backbone of the economy imposed itself in the form of a services-oriented economy. Services that tried to attract resources from the new-found neighbouring states through an entrenched banking system on one side and a supply of repatriation through a concretized labour force migration.

A resourceful private sector supported by a laissez-faire state run mentality, helped the country maintain an all-time deficit in the current account and a surplus in the overall balance of payments. A surplus based on a sustainable inflow of funds which contributed to the inefficiency in the efforts to move forward in the development of forward-looking intentions, but rather a full dependency on the outside soft-landing resources.

A market round-up will highlight the different historical chapters in the life of the capital market since its inception in 1920 till the current period. Economic and financial variables will be tackled, descriptive in times and analytical in other times.

The chapter will try to put to light the existing organizational structure of the stock market and the planned new configuration of a developed capital market. A comparative analysis with some of the world and the regional capital markets was due in order to diagnose the weaknesses, learn from the success stories and set a solid foundation to embark on new promising capital markets.

The section on comparable analysis is a good reference for people looking to know more about the different capital markets, their histories, their characteristics and their relative sizes and activities.

Interested scholars can find it easy as a reference whenever they are trying to study a specific market and cannot probably get needed information related to market listing requirements, regulations and capitalization in one unique place.

One note to add regarding the scholarly writing on Beirut Stock Exchange is that since the BSE is very small relative to the neighbouring countries, the historical financial culture of the economy that is dependent on the banking system and the engraved family business mentality among market participants, all these factors add up together and make it very scarce to find any literature on this capital market on one hand and the loss of most of the data on the BSE due to the fact that all the offices and archives have caught fire during the civil war and barely any data could be retrieved. An exception can be found in few writings available in the library of the American University of Beirut and that are represented in some bachelor degree and few graduate degree projects of old students. When compared together, these projects display uncommon data base depending on the sources that were used back then.

The following data are retrieved from the Central Bank data, World Bank and IMF data and a collection of data gathered by Dr. Tahseen Douweik, who managed, in 2010, to go through the burned and destroyed papers/documents/archives and data base of the BSE and gathered some valuable data from Syria and France dating back to the period of the French mandate and the period of cooperation between Lebanon and Syria. He agreed to share with the researcher/author of this work only a few but very rare and limited data pertaining to the history of the BSE. He was referred to the researcher/author of this work by the administration and management of the BSE and the collected figures were later confirmed by the said administration.

II. Historical Overview: 1920-2019

A better understanding of the capital markets in Lebanon should start by shedding the light on the geopolitical scene that imposed the structural guidelines of the economy and set the allocation of available resources from the Ottoman ruling period to the French mandate reaching the post-independence era. Afterward, the rules and regulations pertaining to the proper functioning of the BSE are presented chronologically to show the serious attempts of the regulatory bodies to set the ground for an efficient market and their quest to provide more transparency and incentives for the different participants to join the market. Furthermore, the original set up is described and the

market highlights presented in an explanatory diffusion to spot some comparability with other developing and developed markets in a move to introduce ways that can help in getting with the potential of the Lebanese markets. This market is, thus, dissected by walking through different economic and financial variables that are at the essence of the lagging nature of the Lebanese capital market compared to its regional counterparties.

I- Introduction to the Geopolitical Scene

France which was known for its good educational and commercial relationship with the Levant had to decide, after the First World War whether to give Lebanon its independent identity or to keep it under Syrian umbrella. It was on 19 November 1919 when the French Prime Minister, Georges Clemenceau, under pressure from the Lebanese nationalist at the Versailles peace conference, gave the Maronite Patriarch, Mgr. Pierre-Elias Hayek the promise of an enlarged independent mutasarrifiya³ under French protection, and accordingly, France proclaimed Greater Lebanon (Le Grand Liban) in 1920 as a foothold for France in the Middle East against any European competition or any uprising from the neighbouring Arab countries (Chaitani Y. 2007). Mount Lebanon was joined by Sidon and Tyre in the south, the Beqaa in the east and Tripoli in the north and port city of Beirut forming the Greater Lebanon with a mix of Christian Maronite and Muslim Sunnite and Shiite who later joined forces and marched for their independence from the French mandate in 1945.

Lebanon, with its front on the Mediterranean Sea, became a country dependent on tourism, trade and transit and embraced most of the European cultures and languages and in specific the French language which it inherited from the French mandate. With time, Beirut became the main political, administrative, economic and cultural centre of the French mandated territories, enjoying its status as the seat of the High Commission (Chaitani, 2007).

Moreover, Lebanon favoured the import-oriented economy to satisfy its population's and its tourists' needs and desires since it was in no condition equipped nor ready to produce anything after the independence (Kubursi, 1999). The country had no natural resources to depend on, nor the culture to manufacture⁴. This inefficiency in production turned into a strong point in trade and

³ Mutasarrifiya is an Arabic word used during the ottoman empire to denote a division under the control of one ottoman delegate

⁴ The Lebanese have been known as the descendent of the Phoenicians who were traders in nature.

in the tourism sector which attracted foreign funds into the economy and as such followed a liberal financial system unlike Syria which was a producing country who opted for more protection both on the tariffs side as well as on the financial side.

France inherited, in addition to formal legal structures in 1920, the structures in the Syrian society⁵ as they were articulated at the end of the Ottoman times, and as such, the social, economic and governmental organisations with whom the French dealt were products of the late Ottoman period. These organizations witnessed some transformations by opening up to the new European culture and accordingly moved away from the traditional artisanal handicraft to new products from the industrialized Europe and replaced part of the agricultural production with new commercial crops and lost much of its importance in the 19th century as a result of the competition of cheap European machine-made products. (Chaitani, 2007)

The “social question” in Syria during the French Mandate (1920-1946) was always subordinated to the “national question”, (Schad, 2005). However, one division of Syrian society, the artisanal and labouring segments, pressed for acknowledgement of their rights during the 1920s and 1930s and in specific, higher wages, better working conditions, and the right to strike. Artisans and factory workers ⁶began to organize themselves ⁷and to ask for amelioration of their situation. The labour force increased their violence in 1930s with a series of strikes, corresponding with a major political and economic crisis in the Levant area and endangered the ability to maintain order and challenged the preservation of French authority (Gebhardt, 2005). The French, accordingly, attempted to channel artisanal/working class grievances through officially controlled “professional associations” (Schad, 2005). Facing this new happening, Syrian elites accepted the corporatist bargain offered by the French, and agreed to close government supervision of their organizations in return for access to power and a representational monopoly, but the artisans and the workers continued their quest for autonomy until they gained a generous labour law at independence.

In 1935 a new law of occupational associations (Legislative Decree 152 of 18 September 1935), was introduced under High Commissioner Damien de Martel in addition to the reforms of the

⁵ The Ottoman established a hierarchical social structure with the Sultan and his officials at the top, the nobles who administered the day-to-day business of the empire and who were in charge in local cities and villages came next, and at the bottom of the social structure were the peasants who worked on the farms or were employed by traders.

⁶ In Syria, people working in art-craft and labor force were mainly working in industries and agriculture.

⁷ Labor force of different sectors started to form groups to revolt against their working and compensation situations.

chambers of commerce, industry, and agriculture which accepted the Mandatory's corporatist agenda at that time. The law regulated the creation of "professional associations"⁸. "They were to be associations of the practitioners of the same "craft" or of similar crafts of a given district (art. 3). There could be only one association for any trade in a district, and no association could extend its activity beyond its own province (art. 4). Membership was restricted to practitioners of the same trade in an attempt to exclude the notables and members of the liberal professions who had assumed leadership of many workers' organizations. The law said that the goal of the associations was to « assure the study and the defence of the occupational interests of their adherents » and expressly forbade « all political activity, all participation in demonstrations or meetings of a political character » (art. 2). Such activity figured among the grounds for dissolution of an association (art. 31)" (Schad, 2005).

Massignon (Massignon, 1953) found in Damascus in the late 1920s that, of the 114 existing corporations, only 36 had adopted formal written statutes and registered with the municipality as required by the law. A similar situation was manifested in the other Syrian provinces with, for example, the Aleppo weavers' guild (representing the most important trade of the city) lacking written rules or any legal status as late as 1936–37 (Ministère des Affaires Etrangères, 1938).

Between 1943 and 1950 the Syro-Lebanese bilateral relations consisted mainly of cooperation at the level of the Customs Directorate, which compelled them to seek agreement on tariffs and quotas and other factors governing their foreign trade. The economic unity included joint customs, a unified currency and tax system, free movement of capital and persons and unrestricted freedom of work in both countries. After the independence, each side began to follow a separate monetary and fiscal policy. Consequently, unable to come to terms, Damascus utilised numerous means of economic pressures, such as frequent border closures and food blockades to enforce an agreement (Chaitani, 2007). After the official economic break up of Syria and Lebanon in 1950, the long-established system of laissez-faire which was a distinct character of Lebanon's post-WWII political economy and that gave rise to the concept of a 'Merchant Republic during the period 1948-1958 (Gates, 1998 and Menassa, 1991) largely set Lebanon apart from regional trends of the development of political economies in the Arab world.

⁸ Arabic, niqâbât al-Hiraf wa al-mihan

Lebanon was known for its traditional economic factors and in specific constantly generating a surplus, as a by-product of the ability of the economy to expand its productive capacity and at the same time enjoy a high investment to GDP ratio of 20% during the period from 1950 till the break of the civil war in 1978 (Saidi, 1986).

On the other hand, two separate exchange control systems, one for Syria and one for Lebanon were introduced in 1948 and the Syrian currency was fixed at 0.4563 SL (Syrian Lira) to the USD, whereas the Lebanese currency was left to float based on market forces.

In the long-run, laissez-faire measures according to Menassa (Menassa, 1991) would solve the problem of hard currency and gold reserves. “These measures included abolishing foreign exchange control and gold flow restrictions, liberalizing legislation to repatriate capital in all its forms, and even authorizing the opening of bank accounts in gold and foreign currency denominations”. Actually, these were the measures that were implemented between 1948 and 1952⁹ and formed the basis of the ‘Merchant Republic’

The Banque de Syrie et du Liban (BSL), which replaced the Banque Imperiale Ottomane, took measures and decisions to cover the Lebanese Lira with Gold holdings, which led to capital flight from Syria, with gold smuggled into Lebanon and large number of Lebanese rushing to exchange uncovered Syrian Liras for Lebanese ones. Damascus called on Beirut to fix the exchange rate to avoid further depreciation of the Syrian Lira but no action was taken. But rather, the Lebanese signed in 1948 a monetary accord with France which placed the two countries, Syria and Lebanon, in a quick confrontation, with the BSL playing an active role in accelerating the crash. During that period, until the official signing of the Franco-Lebanese treaty that took place on February 6, confidence in the Syrian currency fell, and Syrian merchants started looking to exchange it for gold in Beirut.

BSL had to rely on the expertise of his General Director René Busson, whose role, as a guardian of the interests of French capital and the mediator of Lebanon and Syria’s monetary policy, showed clearly the difficult relationship between the new national governments and the state-linked

⁹ International financial statistics published by IMF and UN monthly bulletin of statistics, 1944 to 1950 custom receipt were divided 56% for Syria and 44% for Lebanon

institutions that were still tied to the previous colonial power. Busson shared his economic vision with the Lebanese ruling elites and became the single most powerful financial figure until his resignation in 1951 leaving the floor for the U.S. official to foster the decline of French influence in Lebanon and worked on making Lebanon's Ministry of Finance more autonomous vis à vis the, then, French controlled unregulated BSL¹⁰.

Therefore, after the independence and without guarantees from France, long-term currency stability and financial independence could only be maintained by a strong economy that would generate its own gold and hard currency reserves through a positive balance of payments. The fragile Lebanese economy required a strong belief in the future potential of the national economy and the adoption of important steps to develop its infrastructure and productive sectors (Collelo, 1987).

At that period of time, the industrial sector was classified under the following industries: Foodstuffs and beverages; Textiles; Footwear and wearing apparel; Furniture, fixtures and manufacturing; Printing and publishing; Chemicals and chemical products; Metal and machinery manufacturing; and Non-metallic minerals products (Badre and Nasr, 1953).

According to United Nations statistics during 1950-1956, the national income of Lebanon increased by 50% and the imports increased by 75% but the balance of payments showed favorable results due to foreign inflows of funds and remittances into the Lebanese Banking sector from the neighboring Gulf countries and which was clear from the appreciation of the currency from USD/LBP 3.44 in 1950 to USD/LBP 3.15 in 1956 and the increase in the gold reserves from around \$20 million in 1950 to more than \$74 million in 1956.

During the above-mentioned period, the BSL followed an unprecedented policy of gold purchases increasing gold reserves to nearly 100 per cent of note cover which supported further the full liberalization of the Lebanese economy and the success of the laissez-faire 'Merchant Republic'. Figure 2-1 highlights the increase in Gold reserves during the period from 1939 till 1956.

¹⁰From Ottoman to French with no specific rules from the Lebanese government until 1967 Code of Money and Credit

Figure 2: Gold Reserves in Lebanon (1939-1956)

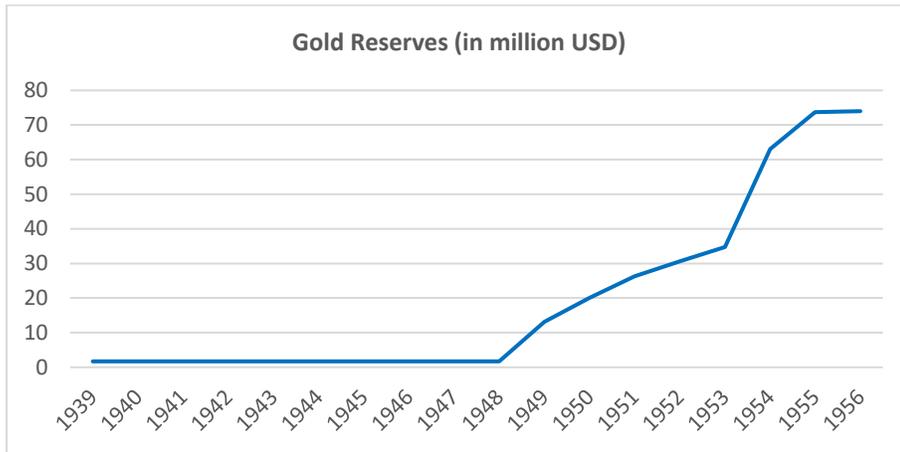


Figure 2-1 depicts how Lebanon started to pile up his Gold reserves after the break-up of the Syro-Lebanese economic ties.

Source: <https://data.worldbank.org/country/Lebanon>, personal compilation.

In March 1950, the Lebanese-Syrian customs union was cut¹¹ which resulted in tension and pressure on the relatively small Lebanese economy. According to Eyal Zisser in his "Lebanon: The Challenge of Independence" attributed the dissolution of the Syro-Lebanese customs union in 1950 to the rise of military power in Syria which caused great and irreversible damage to the Syro-Lebanese relations. At that point in time, with no manufacturing nor oil nor commodities to depend upon, the Lebanese economy, with less than 1.5 million inhabitants (United Nations statistics 1956), was expected to collapse or to surrender to Syrian terms on customs. On the political side, Lebanese Muslims were pushing for a unity with Syria (Chaitani, 2007) which could have caused the disappearance of Lebanon from the regional map; this fact has rendered the investment and development of the economy very risky under such environment of uncertainty.

In effect, Syria intervened very directly in what appeared to be an internal civil dis-agreement in Lebanon. Muslim Lebanese were determined to overthrow the system of confessional government that had been established during the French Mandate. The system was established on the premise

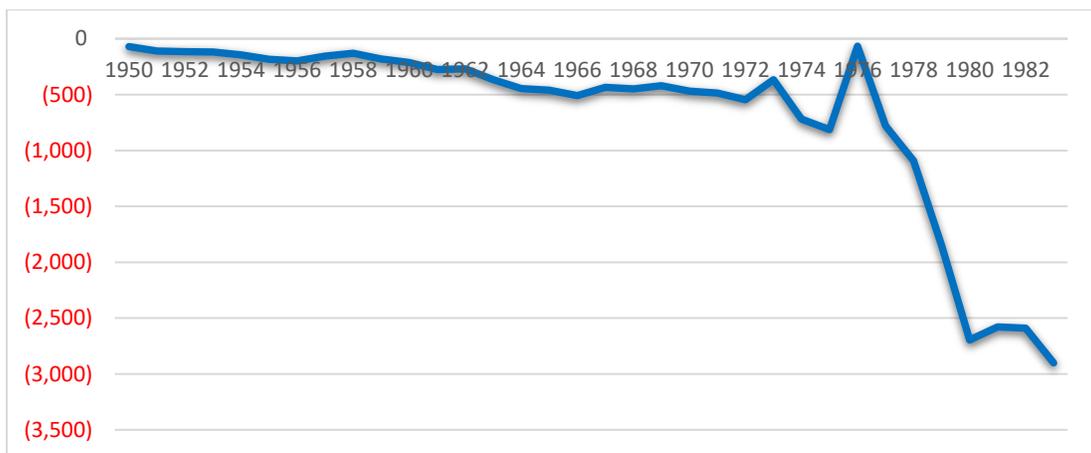
¹¹ See "Legislative decree number 2 issued on 23 March 1950: Establishment of Directorate for the Lebanese Customs" and "Decree number 1560 issued on 3 April 1950: Organization of the DLC"

that the majority of the population was Christian – based on a survey ¹²which the Muslims proclaimed to be inaccurate. (Chaitani, 2007).

Moreover, the negative balance of trade was very common for a country where exports constituted on average around 47% of imports during the period from 1936 till 1947 dropping thereafter to an average of 25% between 1948 and 1955 (UN Statistical yearbook,1956)

This trade deficit as shown in the graph 2-A-2 is an ongoing trend in the Lebanese economy since the breakup of Lebanese-Syrian customs union in 1950 till 1983 the day of closure of the stock market with the exception of some improvement in 1974-1975 before the start of the Lebanese civil war.

Figure 3: Trade Balance (1950-1983)



Graph 2-A-2 pinpoints the deterioration of the trade balance after the eruption of the civil war in 1975.

Source: United Nations Statistical Yearbook 1951, eighth issue, Department of Economic and Social Affairs, New York

When Lebanon tried to join the International Monetary Fund (IMF) in 1946, IMF officials decided to construct a statistical data of the Lebanese economy and complained of its unavailability. Until the Syro-Lebanese customs union split in 1950, this segregation of data was almost impossible with the absence of reliable Lebanese data separate from those of Syria. In addition, during the first two years of Lebanon’s IMF membership from 1946 until 1948, data was also missing

¹² Last national census has been conducted in 1932, before the founding of the modern Lebanese State claiming that Christians and Muslims constitute 58.7% and 40% respectively. Statistics Lebanon stated in its 2012 survey a decrease in Christians count to 40.4% and the last CIA World Factbook brought that figure down to 36.2% in 2017.

regarding the currency system, whose management was vital to the regulation of the international financial system overseen by the IMF. Moreover, Lebanese representatives were unable to provide statistics on balance of payments, trade, nor on banking as requested by the IMF. (IMF, 1950).

From another look at the region, and in the wake of the 1956 Suez Crisis, the Christian leader of Lebanon, President Camille Chamoun, was sharply criticized by Gamal Abdel Nasser, President of Egypt, and the Lebanese Muslims for maintaining diplomatic ties with the involved Western powers. Tensions escalated with the creation of the United Arab Republic, a union between Egypt and Syria and led by Nasser, as Chamoun refused to join despite pressure from Lebanese Muslims. Aware of the recent overthrow of the pro-Western king of Iraq and threatened by civil war, Chamoun asked for help. President Eisenhower authorized Operation Blue Bat on July 15, 1958 and U.S. troops landed on the beaches of Beirut and remained in the city until October.

Furthermore, the development of an oil economy in the Gulf region which generated an inflow of hot capital to the international markets including nearby Beirut and the shift during the 1960s to planned economies in the neighbouring Arab countries such as Egypt and Syria and the nationalization schemes channelled more free-enterprise capital into Lebanon's liberal economy. Domestically, Lebanon's laissez-faire policy of free trade, deregulation of currency exchange, unrestricted capital flow, and total absence of any banking regulation led to this unforeseen growth and the banking regulations presented in the form of the Banking Secrecy Law of 1956 was additionally a key driving force.¹³ Raymond Edde, a member of the parliament who gained credit as a driving force behind the passage of bank secrecy law, said "The aim behind the legislation was to "render Lebanon a refuge for foreign capital and Lebanese expatriate moneys".

Another feature of the Lebanese economy is that it was a young and growing population known for being highly educated, well trained, and motivated with the highest adult literacy rate in the region of about 73.5 % (UN Statistical yearbook 1980)

From another perspective, looking at the root of the Lebanese economic strength that the country was built on, Lebanon was known to derive roughly 20 per cent of its GDP from expatriate worker

¹³ With code of Money and Credit and establishment of the Central Bank (BDL) , the government decided to turn its efforts into banking to attract money from flourishing Gulf countries.

remittances¹⁴. These remittances are diffused among recipients in the economy which, in a way, influenced the government spending decisions, diverting them away from essential public goods, and relieved any potential political pressure arising from excessive unemployment. Remittances helped in improving financial intermediation, but they also assisted in depressing growth in the long term by providing the necessary foreign exchange cushion that can shield countries from economic crises and thereby weakening the incentives for economic reform (Rajan and Subramanian, 2011).

II- BSE- Rules and Regulations

Beirut Stock Exchange (BSE) was established back in July 1920 by a decree of the French Commissioner, Colonel Nigier, by order number 1509, as a public institution, and is the oldest stock exchange in the region after Alexandria Stock Exchange that was officially established in 1883 and Cairo Stock Exchange in 1903

The regulations governing the operation were amended to reflect the development of the market in the 1950's and the organizational law of 1954 issued by the Parliament was later amended in 1957 and called for the establishment of a disciplinary council and regulated the status of all parties operating in the BSE. And in June 1959 some modifications were introduced to regulate the role of the brokers which subjected their acceptance to some strict requirement such as training, education, examination and financial backing. The current law was amended in August 1961 and later on in August 1967 by decree no. 29 when the government was given the right to regulate.

In 1969 a presidential decree cancelled all prior legal provisions governing BSE and regulated all aspect of BSE under Law of October 1969 which defined members of the Beirut Stock Market to be Lebanese commercial banks and companies with minimum capital of LBP 500,000. This law was amended by Decree 1509 of October 1978 (Official gazette 1978) and Decree no. 120 of September 1983 which came to specify that raw materials, gold, foreign currencies and financial instruments can be traded in the Beirut Stock Market and prevented the commercial banks from

¹⁴ Latest figures show that remittances were 275 times the tourism and 924 times the FDI receipts reaching 14% of GDP in 2001 (Saradar 2003)

acting as brokers in the Beirut Stock Exchange and later decree 30 of March 1985 and decree 4729 of 1988 and decree 7667 of 1995 which set the new by-laws of BSE.

Decree number 4808 of 1982 set the internal law of the Bourse of which the minimum capital required was fixed at LBP 500,000, and Decree number 120 of September 16, 1983, which consisted of five chapters and thirty three articles, came to determine the Stock Exchange management and trading procedures and specify the legal framework by stressing on Law dated September 3, 1956 regarding the professional secrecy and legislative decree No. 30 dated 23/3/1985 that established the BSE committee which is comprised of a Chairman, a Vice-Chairman, and 8 members appointed, for a four-year tenure, by a cabinet decree promulgated upon the proposal of the Minister of Finance. The committee enjoys the authority and powers entrusted by the code of commerce to the Board of Directors in joint-stock companies and shall draw up the Stock Exchange by-laws and draft the Staff Regulation and ultimately propose relative legislative and regulatory texts (BSE-bylaws).

It wasn't until 1994 that the Lebanese government decided to revive the BSE and appointed a new administrative committee to pave the way for the re-launching of the BSE along new rules and regulations, as per decree 7667 of December 1995, and an updated trading mechanism which is described in the below section on trading mechanism.

In August 2011, the Capital Market Authority was established (Law No. 161) to regulate and supervise the activities of capital markets in Lebanon and to create adequate legal framework to help in the development of the Lebanese financial markets.

In September 2017, the Lebanese Council of Ministers approved the formation of the Beirut Stock Exchange (BSE) SAL, a joint stock company that will replace the current BSE. The share capital of the new bourse, fixed at LBP 100 million divided into 100 thousand shares with a nominal value LBP 1,000 per share, will be first owned by the state and at a later stage will be offered to the private sector within a period of one year, renewable for another year.

Table 1: Legal Window on the History of Beirut Stock Exchange

<u>Decree/Law/Order</u>	<u>Date</u>	<u>Issuer</u>	<u>Subject</u>
Order number 1509	July 1920	French Commissioner	Beirut Stock Exchange (BSE) was established
Law of 1954	1954	Parliament	Organizational law
Banking Secrecy Law	September 3, 1956	Presidential decree	Professional secrecy
Law of 1957 which amended Law of 1954	1957	Parliament	Establishment of a disciplinary council and regulated the status of all parties operating in the
Several Decrees / Section 4 of 7667	June 1959 / December 1995	Presidential decree Ministry of Finance	Regulated the role of the brokers
August 1961 and later on in August 1967 by decree no. 29	1961 & 1967	Ministry of Finance	The government was given the right to regulate.
Law of October 1969	October 1969	Presidential decree Ministry of Finance	Cancelled all prior legal provisions governing BSE and regulated all aspect of BSE under Law of
Decree 1509	October 1978	Ministry of Finance	
Decree number 4808 of 1982	1982	Ministry of Finance	Set the internal law of the Bourse of which the minimum capital required was fixed at LBP 500,000
Decree no. 120	September 16, 1983	President of the Republic Ministry of Finance	Specify that raw materials, gold, foreign currencies and financial instruments can be traded in the Beirut
Legislative decree No. 30	March 23, 1985	Ministry of Finance	Established the BSE committee which is comprised of a Chairman, a Vice-Chairman, and 8
Law No. 418	15/5/1995	Parliament	The agent is every corporate body entitled by the BSE committee to mediate in sale and
Decree 7667	December 04, 1995	President of the Republic Ministry of Finance	Set the new by-laws of BSE

Law No. 161	August 2011	Lebanese Council of Ministers	Capital Market Authority was established
Series 7000	August 27, 2015	CMA¹⁵	Draft Regulation on Listing Rules
Series 4000	Nov 10, 2016	CMA	Business Conduct Regulations
Series 3000	Nov 10, 2016	CMA	Market Conduct Regulations
Series 2000	January 19, 2017	CMA	Licensing & Regulations
Series 6000	August 7, 2017	CMA	Regulations on Offers of Securities
Decree 1404	September 2017	Lebanese Council of Ministers	Approved the formation of the Beirut Stock Exchange (BSE) SAL
RFP	December 2018	CMA	Establishment and licensing of an Electronic Trading Platform (ETP)
Bidding for ETP	June 19, 2019	CMA	Consortium approved for the ETP

Source: Compilation of Laws from website of BSE and CMA.

III- Organizational Set Up

The BSE¹⁶ was composed of members, subscribers and brokers. All the banks operating in Lebanon were members as well as all joint stock companies with capital exceeding 500,000 LBP¹⁷. The subscribers were the foreign exchange and gold dealers in addition to the brokerage houses, both local and foreign, and all financial institutions whose capital is less than 500,000 LBP. The BSE had 15 brokers who abided by strict regulations regarding code of conduct and qualifications.

¹⁵ CMA: Capital Market Authority, the regulatory body of the capital market in Lebanon.

¹⁶ BSE still follows the same regulatory framework and amended as per the paragraphs that follow.

¹⁷ Amended as per article 106 of decree 7667 of 1995 to the equivalent of at least US\$ 3 million in Lebanese pounds

The BSE was administered under the State control by a committee headed by a chairman and 5 members appointed by a presidential decree upon the recommendation of the Minister of Finance and for a 4-year term; in addition to two members representing the banks and two members representing the joint stock companies and one member representing the brokers. The government appoints also a representative in the capacity of oversight and control over the activities of the BSE. (Decree No. 4808 mentioned above).

1. Types of Markets

The BSE encompasses three types of markets:

- 1- The Official market intended for companies incorporated for more than three years with a capital equivalent to USD three million at least, having distributed a minimum of 25 per cent of their share capital to the public and which is being held by 50 shareholders at least (As per Provisions Applying to the Official Market- Article 106).
- 2- The Junior market intended for newly established companies with a capital equivalent to USD one million at least, having distributed a minimum of 25 per cent of their share capital to the public and which is being held by 50 shareholders at least. (As per Provisions Applying to the Secondary Market- Article 111). This market used to facilitate trading of closed end funds but with more reliance on marketing of open-end funds, this market became very marginal in its daily activity.
- 3- Over the Counter market intended for Lebanese companies with a capital equivalent to at least USD 100.000. The shares of such companies are traded without being listed on the Beirut Stock Exchange. (As per Provisions Applying to the Market of Securities not listed on the Stock Exchange- Article 113). This market is very marginal and barely witnessed any activity.

It is worth mentioning that in the Decree No. 4808 of January 1982 article 69 imposed a fee of 2 per mil (0.2%) of capital on each company that qualifies to list its shares on the Bourse, but refuses to do so and this applies for each month lateness in listing on the Bourse. Article 70 allowed the listing of bonds of public institutions and of companies provided the government owns shares in them and bonds of companies whose shares are already listed in the Bourse.

Table 2: Listing Requirements on BSE

Market	Capital	Minimum Floating	Number of Shareholders	Period of Incorporation
Official	\$ 3 Million	25% of Shares	50 or more	3 years
Junior	\$ 1 Million	25% of Shares	50 or more	n/a
OTC	\$ 100,000	n/a	n/a	n/a

Source: Beirut Stock Exchange and CMA

2. How to Get Listed

The issuer wishing to price its securities in either the official or the junior market¹⁸, and fulfilling the conditions of admission in either of these two markets should present the following documents and information:

1. An application for admission duly prepared in accordance with the rules determined by the committee.
2. A certified copy of the application for registration in the commercial register.
3. A certified copy of the certificate of registration in the commercial register¹⁹.
4. A certified copy of the establishment by-laws and all their amendments, which should include an explicit text providing for the pricing of the issuer's securities in the Stock Exchange.
5. An official and recent commercial circular²⁰.
6. All the copies of the minutes of the general meetings and the board of directors registered in the commercial register for the last three years, or for the period between the date of incorporation and the date of the submitting of the application.
7. A detailed statement describing the nature, kind and value of the securities in the application.

¹⁸ Mis-interpreted during translation as "secondary market". Secondary market is a market where any previously issued security is traded. In the case of Lebanon, it refers to the junior market.

¹⁹ A commercial register entails the name of the company and of the partners with their shares ownership

²⁰ A commercial circular declares that the company has a number in the registration records of the Ministry of Trade and Commerce

Table 3: Current Listed Companies

Name	Date of Listing	Latest Market Capitalization (Billion USD)	Industry
1- Bank Audi	1997	1.958	Banking
2- Bank of Beirut	1997	0.39	Banking
3- Bank BEMO	1999	0.08	Banking
4- BLC Bank	1997	0.066	Banking
5- BLOM Bank	2006	1.988	Banking
6- Byblos Bank	1998	0.774	Banking
7- S.L. Des Ciments Blancs	1997	0.325	Industrial
8- HOLCIM	1997	0.302	Industrial
9- RasamnyYounes Motor Co	1999	0.035	Trading
10-Solidere	1997	1.167	Real Estate

Source: Beirut Stock Exchange reports as at end of 2018.

8. All of the balance sheets, profit and loss accounts, inventories, and consolidated final accounts in the event the issuer has subsidiary companies. This is in addition to the reports of the board of directors and the auditors for the last three years, or the period between the date of incorporation and the date of submitting the application.

9. A general descriptive statement of the issuer's activity and markets.

10. A General statement on the issuer's subsidiary companies when they exist, specifying the proportion of the capital owned by the issuer and determining their main activities.

11. A letter by virtue of which the applicant is committed to the contents of article 91 of the BSE's By-Laws.

3. Trading Mechanism

The BSE has a very tight trading schedule which is highlighted as follows: Pre-Opening: From 9:00 AM until 9:30 AM using a regular fixing system of trading, opening: At 9:30 AM, Trading session: From 9:30 AM until 12:30 PM based on a continuous trading system, and Closing: At 12:30 PM.

The Beirut Stock Exchange adopted the pricing system known as the “Fixing System”, using the Stock Exchange computerized trading system in 1996 and then moved to a combination of fixing and continuous in 2001 until it adopted the Euronext TAK continuous trading system in 2003 (Sadek, PC). In the beginning of 2005, there were only 13 approved brokers on the Beirut Stock Exchange. These brokers are the only entities allowed to carry transactions on the BSE. Every broker has a seat. In case the broker has a representative, the latter should bear at all times a tag mentioning that he represents the broker and he must be directly accepted and approved by the Exchange officials. Currently, a new updated trading system is under way to and it is scheduled to replace the outdated trading system in 2019 and this new trading system represents the new revised version of the Euronext system (Sadek, PC).

Table 4: Current List of Brokers

1- Arab Finance Corporation	8- Fidus
2- Audi Investment Bank	9- F.F.A. (Private Bank)
3- Bank of Beirut Invest	10- Fransa Invest Bank
4- BLOM Invest Bank	11- FNB Capital
5- Byblos Invest Bank	12- LCB Finance
6- Cedrus Invest Bank	13- LibanoFrancaise Finance
7- Credit Investment Bank	14- Mediterranée Investment Bank

Source: Beirut Stock Exchange and CMA publications end of 2018

4. Annual Fees and Membership Fees

Brokers and Issuers admitted to the Beirut Stock Exchange shall pay an annual fee for the first twelve-month period set as follows:

Brokers: The equivalent of US\$ 10,000 in Lebanese pounds.

Issuers: The equivalent of US\$ 10,000 in Lebanese pounds.

And as of the second year of their admission the following annual fees:

Brokers: The equivalent of US\$ 2,000 in Lebanese pounds

Issuers: Half per mil (0.05%) of the relative stock market capitalization for every category of securities listed on the official or junior Stock Exchange market as per Article 196 of decree 7667 of 1995. "Stock capitalization is the average trading price in the last month prior to the due annual fee, multiplied by the number of securities accepted for trading". (Beirut Stock Exchange (BSE), official website)

According to article 3 of Decree 7667 of 1995: "Shall be considered a BSE member every joint-stock company with a capital of more than 500 thousand Lebanese pounds". Every member in the Stock Exchange shall pay an annual membership fee equivalent to the counter value of US\$ 100 in Lebanese pounds. Only members and authorized brokers are allowed to trade and operate in the "Corbeille" which is the trading floor of the BSE.

5. Commissions Due on Transactions

The following commissions shall be paid on each buying or selling transactions carried out in any of the official or secondary markets:

- 4‰ on transactions of up to US\$ 100,000 or its equivalent
- 2.5‰ on transactions ranging from US\$ 100,001 to US\$ 1,000,000 or its equivalent.
- 1‰ on transactions ranging from US\$ 1,000,001 to US\$ 5,000,000 or its equivalent.
- 1/10,000 on transactions exceeding US\$ 5,000,000 or its equivalent.

The commission should not be less than US\$ 10 or its equivalent in Lebanese pounds whatever the value of the transaction.

The above commission should be doubled (as a penalty) on each direct transaction carried out outside the Stock Exchange.

Every buying or selling transaction carried out on the over the counter (OTC) market²¹, bears a commission of 7.5 per mill.

Commissions mentioned above are distributed as follows:

24 per cent to the Beirut Stock Exchange

12 per cent to Midclear

64 per cent to the Broker

6. Settlement

The clearing and settlement of financial instruments executed in the Beirut Stock Exchange is carried out through Midclear -custodian and clearing centre of financial instruments for Lebanon and the Middle East. The Central Bank of Lebanon established MIDCLEAR (Middle East Depository and Clearing Company) in June 1994 and owns 99,79 % of its Capital. As per law No.139 enacted by Parliament in October 1999, Midclear became the Central Depository for Lebanon. In April 2001 law No. 308 appointed Midclear as the central registrar for all Lebanese Banks shares. (www.midclear.com.lb).

As per Article 173 of the internal rules and regulations, payment and delivery operations are interrelated and simultaneous, and are settled on a delivery versus payment basis (DVP), where transactions are settled three working days after the trade date (T+3), except for the corrective transactions that are carried out by the Beirut Stock Exchange, in case of deficiency by a broker which shall be completed in one day (T+1).

The transfer of ownership for traded securities is conducted via book entry based on daily files submitted by the Beirut Stock Exchange to Midclear by the end of each trading session.

All cash clearing takes place at the Central Bank of Lebanon. Therefore, authorized brokers are asked to open, in addition to the "securities" accounts with Midclear, a "cash" account with the Central Bank, to be used only for operations related to financial instruments' transactions. The balances of these accounts are transmitted by the Central Bank to Midclear on a daily basis for validation.

²¹ Over the counter in this context means electronic listing with no specific market maker or physical trading location

Whenever a transaction is confirmed in the Beirut Stock Exchange, it becomes final and irrevocable. Therefore, brokers are deemed to be debtor of the amount representing the price of securities in case they enter a purchasing order in the BSE trading system, and debtor of securities that form the subject matter in case they enter a selling order in the system. In the event that provisions in securities or in cash are insufficient, Midclear informs Beirut Stock Exchange, who takes the appropriate action by forcing the failing member to either make a buy-in (in case of securities deficiency) or a sell-out (in case of cash deficiency).

IV-BSE Market Highlights (1920-1983)

The period was chosen to reflect the start and the activity of the Beirut Stock Exchange from the French mandate till the full closure of the exchange due to the eruption of the civil war.

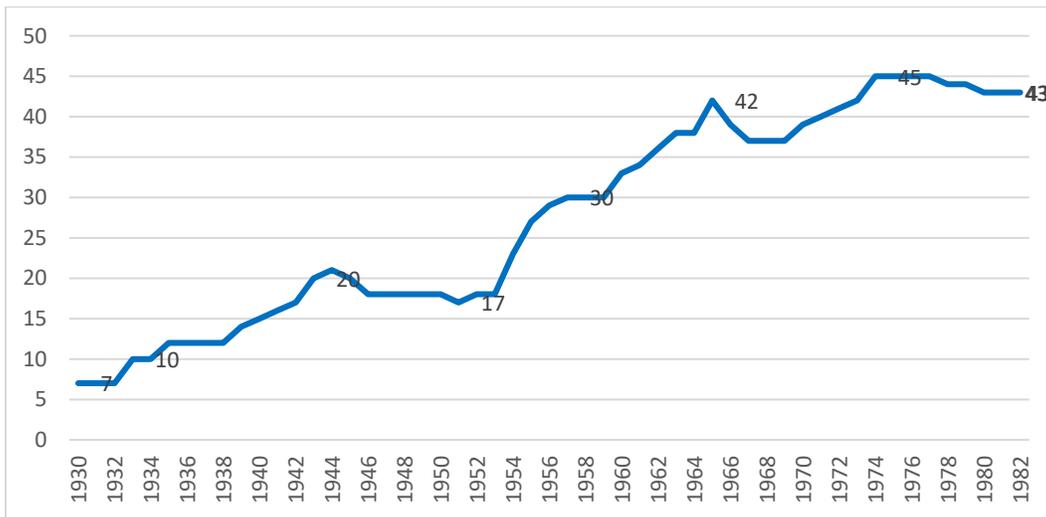
BSE started with nine companies, two old firms from the Ottoman times, five were French and two of Lebanese origin. The companies were:

- 1- Compagnie du Port, des Quais et Entrepot de Beyrouth (Ottoman turned French in 1926)
- 2- Société du Chemin de Fer de Damas, Hamah et Prolongement (Ottoman)
- 3- Ciment Libanais (Lebanon)
- 4- Electricité Kadisha (Lebanon)
- 5- La Banque du Syrie et du Liban (France)
- 6- Radio Orient (France)
- 7- Electricité d'Alp (France)
- 8- Société Foncière du Levant (France)
- 9- Compagnie Générale du Levant (France)

The last five companies were also listed on Paris Bourse which generally reflects their French origin. Trading was very shallow due to minority control of the market and it was limited to gold and foreign currencies and then expanded in early 30s to include shares of private companies that operated some public services in Lebanon, and these shares were listed on both BSE and Bourse of Paris (Zouheiry and Samad 1995). But by 1939, the French authority took the decision to delist its companies from the international market in a move to limit German control over these companies and this had an almost detrimental effect on the BSE.

When the state of Israel was created in 1948, Lebanon became the natural Mediterranean outlet for the Arab world. For instance, the Iraqi Petroleum Company pipeline to its original western terminal at Haifa ceased to be used after 1948 and, instead, the outlet switched to Tripoli, north of Lebanon which contributed to fast development of the economy in addition to the obvious lack of intervention by the government which followed a simple laissez-faire strategy in its policies. Following World War II, and during the period of the 1950s and 1960s, some of the Arab neighbouring countries, in specific Egypt, Iraq and Syria were confronted with the inception of new socialist movements and the trend to nationalize most of the big companies in the region. Lebanon benefited from its banking secrecy law of 1956 and its financial system, that facilitated the free movement of capital and the free foreign exchange trading activities, to attract foreign investors to come and invest in Lebanon and as such, the BSE had around 33 and 42 listed firms in 1960 and 1965 respectively due to the remarkable activities that the economy witnessed. The progress and evolution of the number of listed firms is shown in Figure 3-1 below:

Figure 4: Evolution of Listed Companies on the BSE (1920-1982)

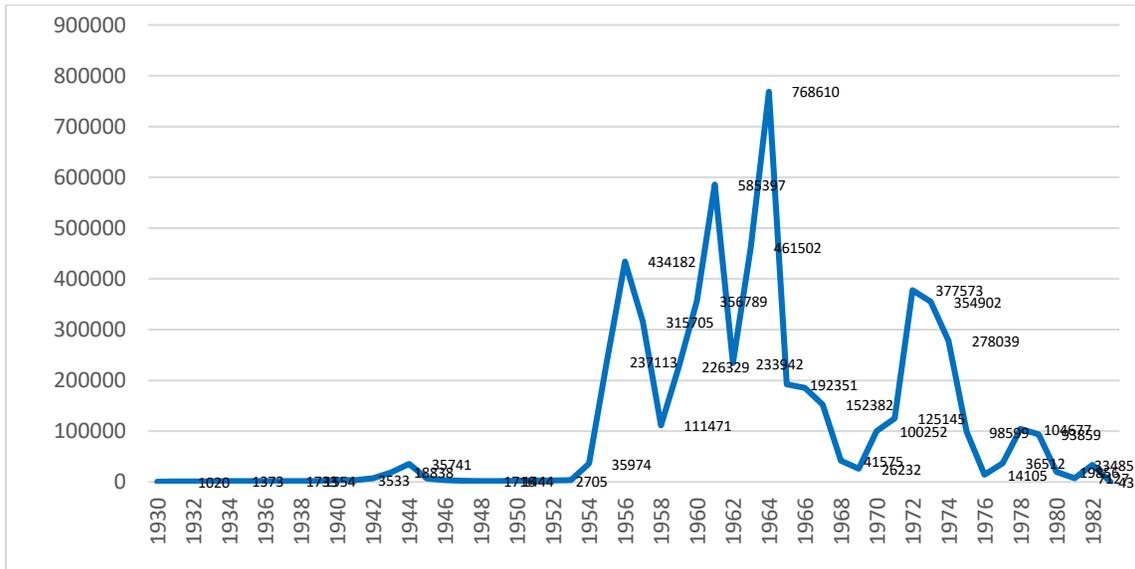


Source: Dr. Tahseen Doueik, Thesis data and confirmed against data retrieved from AUB Jaffet Library.

The BSE witnessed a decline in 1965 as a result of six month of civil war that disrupted all aspects of the economy and then regained its recent development afterward.

BSE reached a peak in trading activity in 1964 due to some speculative trading in shares of “Mechref” and “Companie Libanaise de Petrole” (Tukan, 1986) and dropped again in 1965 and 1967 due to INTRA ²²crisis, which was unable to raise sufficient liquidities at a time of above normal withdrawals and it stopped payments on October 14, 1966 which wrecked the Lebanese economy as it accounted for 15% of total bank deposits and 38% of deposits of Lebanese owned banks. The collapse of Intra Bank was behind the imposition of the new banking regulations on the Lebanese banking sector. Therefore, the BSE reached a trough in 1969 decreasing by around 97% from 1964 figure of 81 million LBP to a mere 2 million LBP which corresponds to a decrease from US\$ 26.3 million in 1964 to a circa US\$ 0.6 million in 1969 in current dollar terms.

Figure 5: Evolution of Number of Shares Traded on BSE (1930-1982)

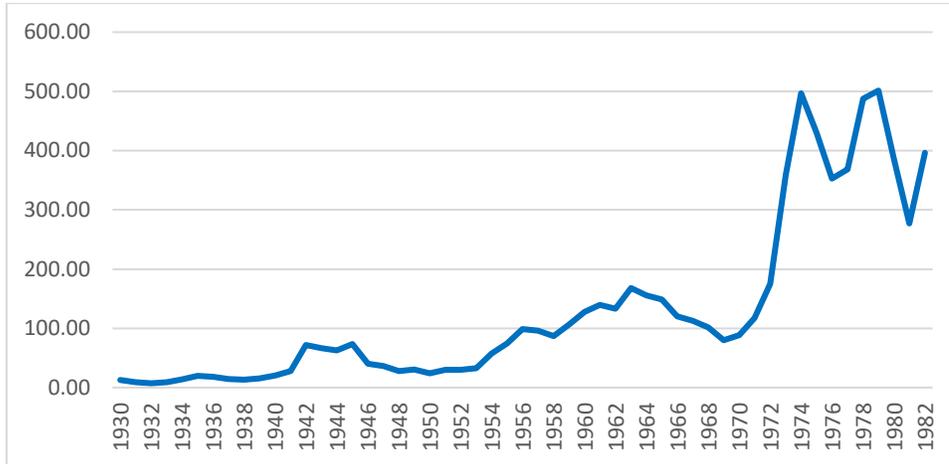


Source: Dr.Tahseen Doueik, Thesis collected data. Number of shares traded increased during the mid-1950s to the mid of the 1960s which corresponds with the increase of cash inflows from the Gulf area and the same is observed at the eve of the civil war in 1974-75.

And the market capitalization followed the same pattern as the number of listed companies and witnessed an increase in the first part of the 1960s before dropping later and picking up again in 1970 before dropping back in late 1982 and closing down in 1983 as shown in Figure 7.

²² Bank INTRA was founded in 1951 and opened branches all over the Middle East, Africa, Europe and the Americas.

Figure 6: Evolution of Market Capitalization (1930-1982)



Source: Dr. Tahseen Doueik, Thesis collected data (figures in million USD, current dollar terms)

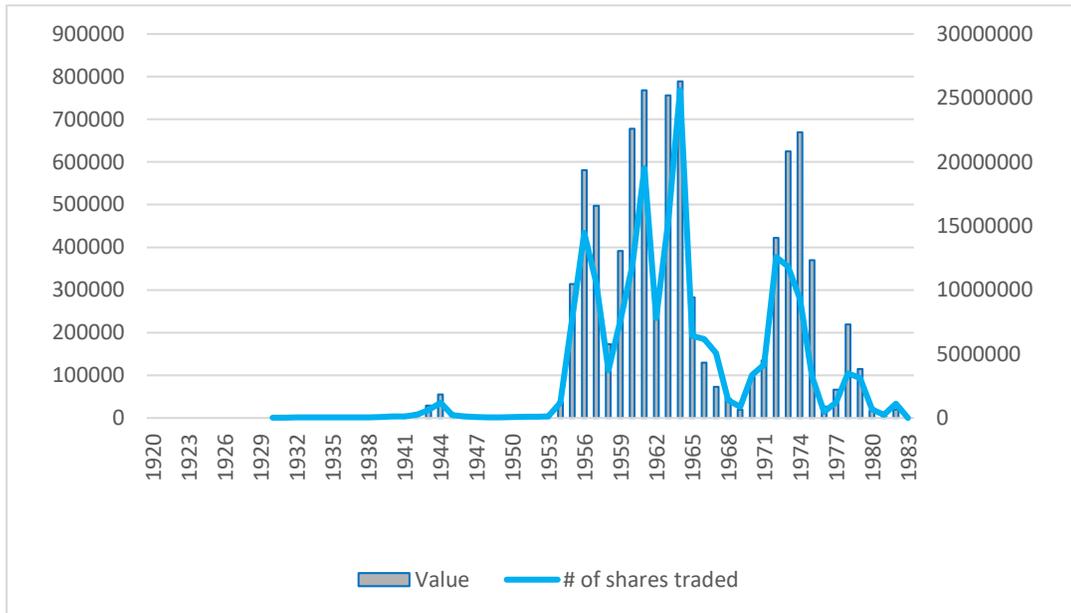
A new Central Bank was established in 1964 and the commercial banks might be said to have consolidated their position since then. The total number of commercial banks operating in Lebanon reached a peak in the period of 1967-1968 with a total of 88 banks registered with the Central Bank with a total of 232 branches among them. The INTRA crash forced the Central Bank into action. New control measures were necessary for the advantage of the banking sector. The Central Bank was concerned to maintain a very close supervision on liquidity ratios within individual banks. From 1968 onwards, all banks had to submit a brief statement of their liquidity position to the Central Bank each month and more detailed statements have to be submitted every quarter. Moreover, in 1969 the Central Bank required all commercial banks to deposit 5% of their total deposits with the Central Bank in Lebanese pounds as legal reserve requirements. This measure had a two-sided effect. It put some pressure on local banks to increase their liquidity and forced many foreign banks to convert foreign currency holdings into Lebanese pounds to meet the 5% requirement. The high demand for the local currency and the supply of foreign currency and in specific US dollars had the effect of reducing the speculative pressure on the Lebanese pound

which was gradually depreciating in late 1969 and early 1970 from 3.13 to 3.25 to the dollar respectively.²³

Most of the Gulf countries and the Lebanese working abroad in the Gulf in specific were trying to escape the relatively unsecure economic and political regimes in the area and found in the Lebanese banking system a refuge along the attractive banking secrecy law in Lebanon. With this capital inflow creating high liquidity levels coupled with low interest rates levels at times when deposits in the banking sector increased by a CAGR of 36% during the period 1971-1975 and interest rates stood at an average of 3.58% in the 1972 period (Central Bank of Lebanon- Data Series), investors were, as such, looking for an opportunity to gain a higher return on their money, accordingly, the market, facing an influx of money from investors, witnessed an upswing during the period starting in 1958 to reach a peak in number of 768,710 shares traded in 1964 with a value of 81 million LBP and again from 1970-1973 reaching a peak of 377,573 shares traded in 1972 and a peak value of 52.3 million LBP in 1973 but this trend did not last long and started to decline, by the end of 1974, in terms of activity in the number of shares traded and their respective values, and endured harsh times towards the end of 1974 and into 1975 as shown in Figure 8 as result of the up rise of the civil war and the insecure and uncertain economic situations.

²³ Banks had to convert their foreign currency into local currency which created supply of USD and a demand for the domestic currency the LBP and as such eased down the pressure on the LBP.

Figure 7: Traded Values vs Traded Volumes



Source: Dr. Tahseen Doueik, Thesis collected data.

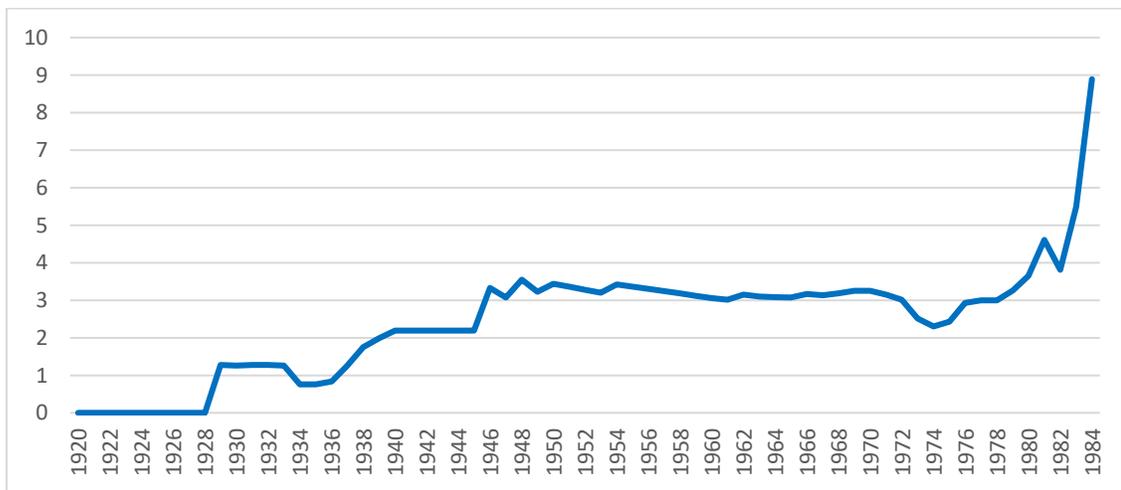
The trading activities fell sharply as the fear injected into the market from the INTRA crisis lead investors to hoard onto their cash away from any investment. But then again, investors saw some optimism in the early 1970s before faltering again with start of the civil war until the market reached a halt in 1983.

In 1975, with the onset of the civil war in Lebanon, BSE activity retreated and reached a halt in 1983. Knowing that after November 1976 the market opened and closed on various occasions interrupted by troubles which continued to disturb the economic and political situation in the country. Banca di Roma, even, offered to carry out the trading transactions at its premises in a move to boost confidence again in the trading activity, and BSE resumed its activities in March 1979, with large trading volume from people selling their shares fearing an escalation in the Israeli-Lebanese conflict, to stop again in April 1981 when fighting broke out again in Beirut. Activity was resumed in 1982 to stop again due to the Israeli invasion in the summer of that year. It then opened for business in September 1983 to stop once more and for good this time in October 1983. During that period and just before the closing of the stock market, some of the known companies that were listed are: Ocal, Bonjus, Soliver, Ciments Libanais, Naas, Eternit, ABC, El Bared

electricity, Zahle electricity, Sodeco, Regie, Casino du Liban, Telepherique, Lecico, Uniceramic, and Kadisha (Tukan, 1986).

It is worth noting that the laissez-faire decision and the merchant economy adopted in Lebanon put some pressure on the foreign exchange market during the period from 1920 till 1983, and witnessed couple of bumps represented by a small depreciation after the second world war in 1944 which brought it from a steady USD/LBP 2.19 to USD/LBP 2.55 in 1948 and another large depreciation at the inception of the civil war in Lebanon from USD/LBP 2.3 in 1974 to a USD/LBP 5.49 and USD/LBP 8.89 in 1983 and 1984 respectively, and representing a 58% and 74% depreciation respectively.

Figure 8: USD/LBP Exchange Rate (1920-1983)



Source: Personal compilation from multiple publications from AUB Jaffet Library and from Dr. Tahseen Doueik.

V- Market Variables (1996- 2019)

It wasn't until 1994 that the Lebanese government decided to revive the BSE and an updated trading mechanism which consisted of an electronic trading system, an automated order, based on price fixing to replace the old OTC voice brokers. And the launching was live on the 22nd of January 1996 and it was located in Sadat Towers in Hamra street in Beirut.

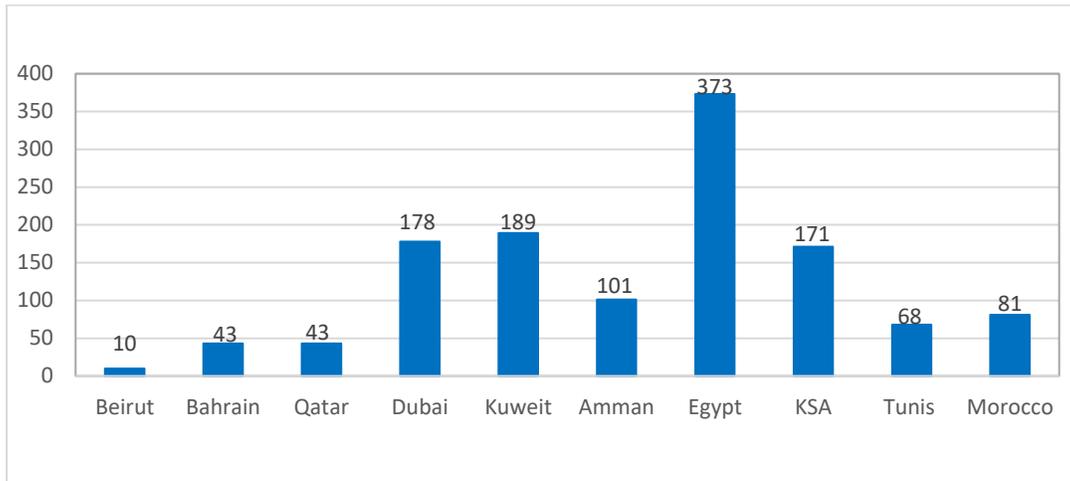
In June 1999, the Bourse of Paris helped the BSE adopt a state of art electronic trading system, the NSC-UNIX-EURONEXT, which allows continuous trading (BSE website). And in a transitory move to cope with the new situation, the BSE started using a combined continuous-fixing system by October 20th, 2000. In that same year, the BSE introduced new amendment to its bylaws to allow the listing of GDR (Global Depository Receipt), investment funds shares, preferred stocks and priority shares (BSE website).

In 2002, BSE moved to the Lazariéh building in Down Town Beirut, and on the 7th of July 2003, launched a new trading system designed by the European capital markets software “Atos Euronext” market solutions that was branded NSC-Unix-EURONEXT. (BSE) that was later updated in 2009 to its 3rd version that was based on the new PAM V3+, the same trading platform used in EURONEXT and in NYSE.

By the end of 2006, the BSE initiated the new Remote Trading System, allowing brokers to trade from their offices, and then approved the use of E-trading via the internet on February 13th 2008 through authorized brokers (Sadek, PC).

BSE’s market capitalization has widened dramatically by 295.46% over the 1997-2017 period, from \$2.68 billion to just over \$11.4 billion but it remains one of the smallest stock exchanges in the Middle East and North Africa (MENA) region, with the number of listed companies increasing from 8 in 1997 to 16 in 2006, before dropping to 10 companies in the year 2010 and remained at this level till 2017. The following Figure 10 compares Stock Exchanges in the region to Beirut Stock Exchange which reflects to a certain point the immature stock market of the Lebanese economy and the fact that the Capital market contributes very little to the financing of the economy and does not represent, in any way, a risk to financial stability (IMF and World Bank mission, 2015).

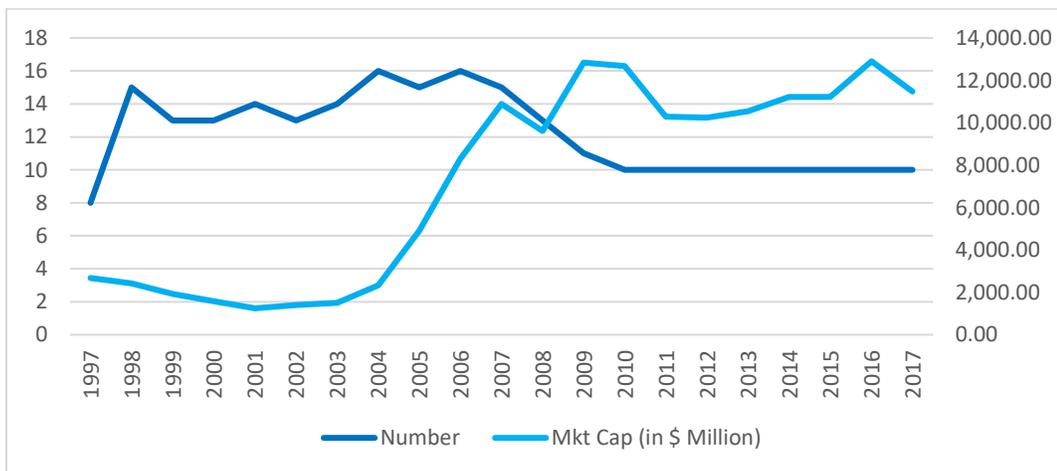
Figure 9: Number of Listed Companies on selected MENA Exchanges



Source: Personal compilation from Exchanges' official websites.

The increase in BSE market capitalization was a result of more share issuance by the existing companies rather by the introduction of new companies as shown in figure 11. This move to issue more shares resulted from the decision imposed by the Central Bank on the Lebanese banks to increase their capital base, and since around 50% of the listed firms are banks, this explains the increase in market capitalization during the period 2009-2010.

Figure 10: Market Capitalization vs Number of Listed Firms



Source: BSE reports available on its website from 1997-2017.

In August 2011, the government issued Law 161 which established the Capital Market Authority (CMA) and set the rules and regulations of this regulatory and supervisory body that will be headed by the governor of the Central Bank.

In March 2014, the BSE signed an agreement with Euronext, a wholly owned subsidiary of Intercontinental Exchange Group (NYSE: ICE), for the implementation of a new trading application platform that supports the expected growth in equity listing and the introduction of new asset classes to the Lebanese markets and in specific tradable derivatives²⁴ (Sadek, PC).

On Monday May 12, 2014, Mr. Riad Salameh, Governor of the Central Bank and president of the Lebanese Capital Markets Authority signed a cooperation agreement with Mr. Gérard Rameix, president of the AMF (Autorité des Marchés Financiers), the authority in charge of capital markets' regulation in France, this agreement will reinforce the cooperation between both authorities, which will be able to share helpful information for a better management of capital markets, better monitoring of the transactions executed on both markets and implementation of relevant rules and regulations.

In September 2017, the Lebanese Council of Ministers approved the formation of the Beirut Stock Exchange (BSE) SAL, a joint stock company that will replace the current BSE. The share capital of the new bourse, fixed at LBP 100 million divided into 100 thousand shares with a nominal value LBP 1,000 per share, will be first owned by the state and at a later stage will be offered to the private sector. All rights and obligations of the present bourse will be transferred to the new company. The first Board of Directors of the newly established bourse that will be in charge, until the shares of the Beirut Stock Exchange company are sold to the private sector, will comprise seven members; two from the existing board of the exchange, three executive boards from the Capital Market Authority (CMA) and two members from the Ministry of Finance (Sadek, PC). The process of this structural implementation is still awaiting the adequate political and economic situation up to the moment of this writing.

The following presents a brief description and analysis that highlight some macroeconomic and financial vulnerability that characterize the Lebanese economy. The banking sector stands out as

²⁴ Derivatives are still not traded on the BSE as at mid-2019.

a resilient sector aside with the Central bank foreign reserves holdings that project confidence into the financial system and promote confidence through the different policy measures undertaken to back up the government missteps and mitigate any potential risks that might face the fragile economy.

The subsequent parts will expose the trade balance that started to show deficits at an increasing stamina after the eruption of the war back in 1975 reaching alarming levels in the most recent years. On the other hand, the banking deposits stood as an appealing sector that attracted deposits from Lebanese expatriates and regional well-off individuals as well. Despite the efforts of the central bank, the monetary and capital authorities, the Beirut Stock Exchange showed very shy and slow improvement in its capitalization representing barely 20% of GDP. Furthermore, a look at the increase in GDP after 1990 reveals a high dependence on government spending with no amelioration in revenue generation which reflected in the budget deficit figures that kept on deteriorating throughout the 1990 till present times. The balance of payments, in turn, climbed to record highs in the period 2007-2008 to fall back in 2009 with no sign of improvements due to the increase in the trade deficit on one hand and the relative decrease in the capital inflows, mainly from the expatriate working in the gulf area.

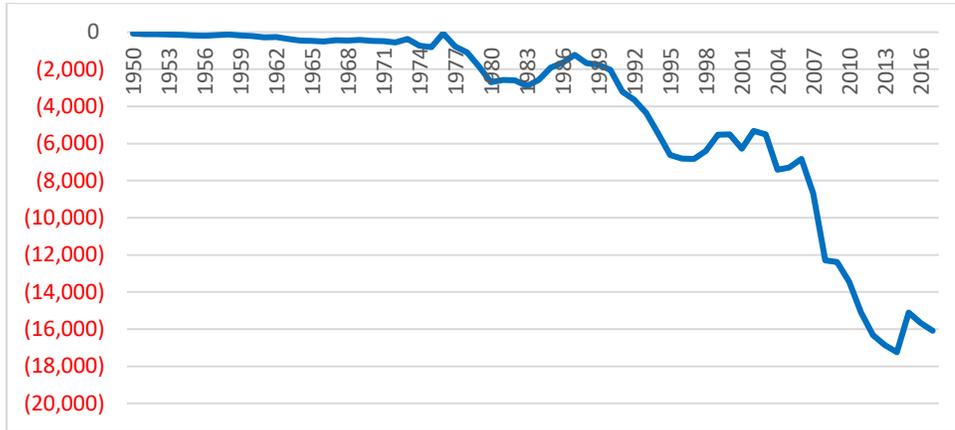
With all the deterioration in most of the economic variables, the central bank managed to maintain sustainable levels of foreign currency reserves and accordingly a stable exchange rate at levels set in 1997 and maintained throughout the recent history of the Lebanese economy supported by the presence of one of the largest gold reserves levels in the region.

1. Trade Balance

A sustained trade deficit could have adverse effects on a country's stock market. If a country imports more goods than it exports for a continued period of time, it is basically going into debt. Over time, investors will realize the decline in expenditure on domestically produced goods, which will hurt domestic companies and their stock prices. Therefore, investors will realize less and less investment opportunities locally and begin to invest in foreign stock markets, as potentials in these markets will be much higher. This will lower demand in the domestic stock market, causing it to decline. Accordingly, the effect of the historical and continuous deficit witnessed in the trade balance, which is obvious from the figure 12, had always contributed to the weak trend of investing in the BSE and the missing attractiveness of new companies to list their shares in the market,

establishing as such a disequilibrium on both the supply side and the demand side of the capital market in Lebanon.

Figure 11: Trade Balance (in million USD)



Source: World Bank and IMF working papers

2. Banks Deposits

Deposit and equity markets are not completely segmented and households increasing biased allocation toward bank deposits drains stock market funding. The negative relationship between deposit growth and stock returns in Lebanon is apparent clearly in the deposit steady growth rate relative to a very volatile stock market growth rate as depicted in Figure 13 and which reflects the large swings in the market growth rates depending on economic variables on one hand and on regulatory requirements on the other. The banking sector in Lebanon stood as the recipient of much of the oil income from the Arabian Peninsula. On June 7, 1937, the Lebanese pound became the only legal tender in Lebanon and the public authorities agreed to maintain its parity against the French currency at 20 francs per each LBP.

It is worth mentioning that in 1941, the allied forces occupied Syria and Lebanon and a monetary agreement was concluded between the British Government and General De Gaulle, in which the official rate of the French franc was set against the sterling (£1 = 8,125831 FRF), with freedom of conversion between both currencies. Consequently, the Syrian and the Lebanese currencies became pegged to both the sterling and the franc.

It was important to breakdown the time frame of the comparison of the growth in deposits versus the market capitalization in order to highlight the different historical development in the Lebanese financial sector.

The sharp percentage decrease in the market capitalization in the early 1980s reflect the fact of the closure of the BSE, and the percentage decrease in deposits witnessed in the late 1980s resulted from the huge depreciation of the domestic currency before witnessing the dollarization of the deposits in the banking sector. Looking at the subsequent figures, figure 12 highlights the early period of the independence from 1942 till 1956 where data reflected the start of the growth in deposits versus the market capitalization of the BSE. Figure 13 covers the period from 1964 till 1982 which is characterized by a remarkable growth in the early 1970s followed by a sudden decrease as a result of the outbreak of the civil war in 1975 and a large volatility in early 1980s that led ultimately to halt of the stock market operations. The market reopened in 1996 and witnessed a big jump in market capitalization as a result of the decision by the central bank that prompted commercial bank to enhance their capital adequacy ratio by increasing their capital positions. In the meantime, deposits continued their steady growth until 2015 when the first signs of pull back started to appear and the banking system began witnessing a leakage in deposits that led to negative numbers in 2017 and 2019 as shown in figure 14.

Figure 12: Growth in Bank Deposits vs Market Capitalization

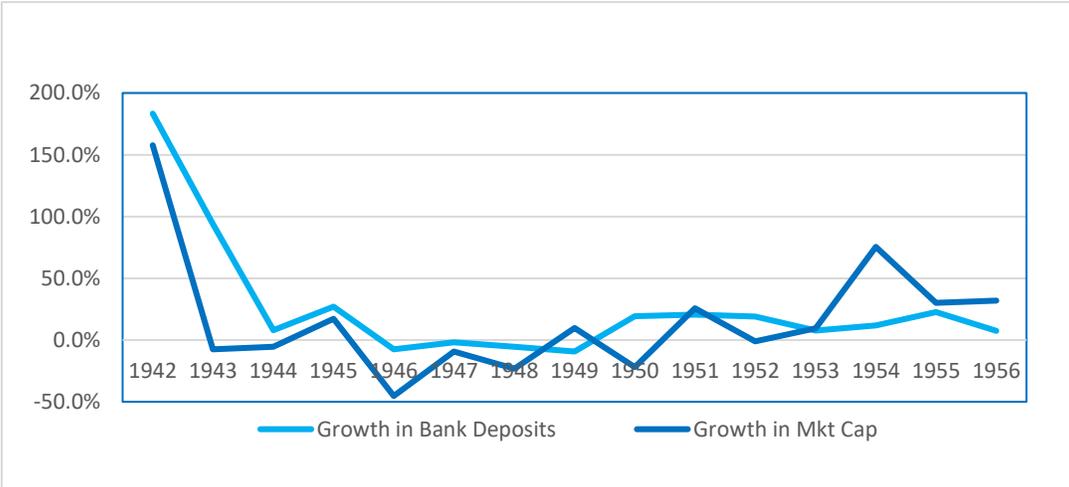


Figure 14: Growth in Bank Deposits vs Market Capitalization (1963-1982)

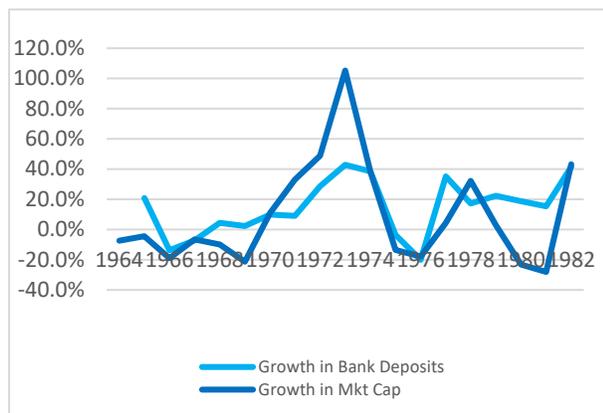
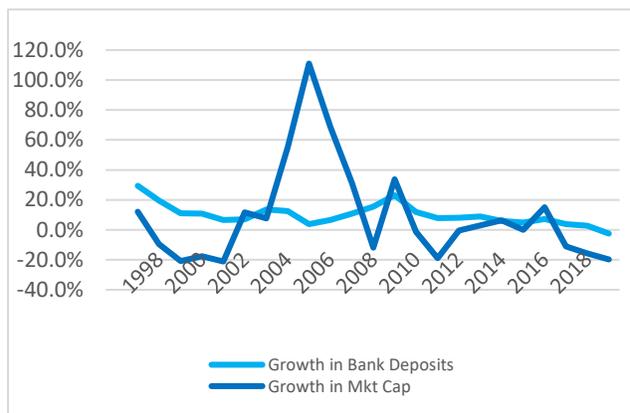


Figure 13: Growth in Bank Deposits vs Market Capitalization (1996-2019)

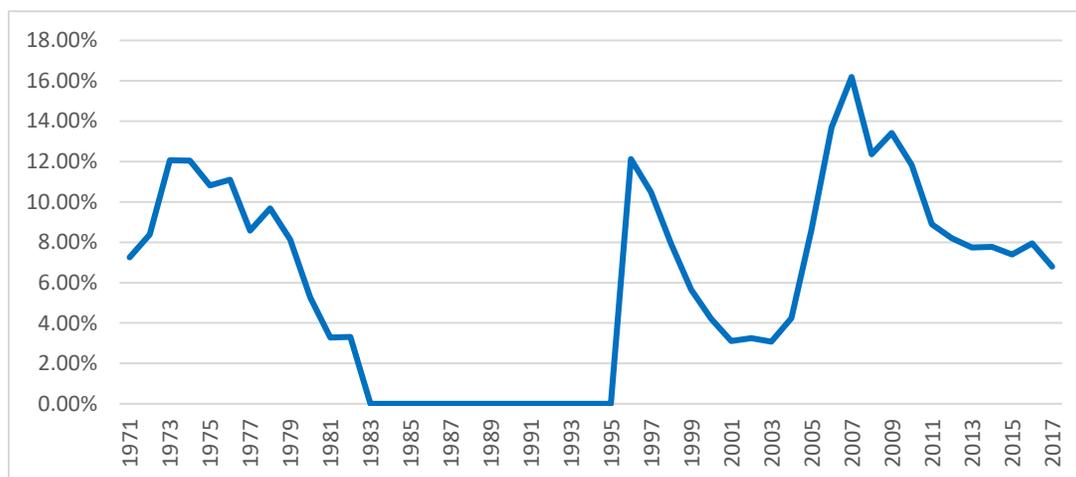


Source: Personal Compilation based on data from the Central Bank and the BSE

A study on the Lebanese financial sectors conducted by Tukan in 1986 showed a negative relationship between volume of transactions and interest rates on call saving accounts which explains the fact that deposits represent a major competitor to the stock exchange market cause people and investors tend to shift their money into bank deposit when interest rates are high knowing that these deposits entail lower risk as well (Alam and SalahUddin, 2009). Moreover, the relative size of the stock market to the total value of the deposits in the banking sectors shows the larger reliance of the market participants on the banking sector in its investments and financing sources rather on the stock market. The deposits in the banking sector grew remarkably throughout the years which reflect the sentiment of safety and peace of mind that people associated with their money deposited in a bank.

After the separation of the trade agreement between Lebanon and Syria in 1950 and the adoption of the banking secrecy law in 1956, deposits started growing at an average of 14.8% during the 1950s and into the 1960s and then accelerated at an average of 36.7% in the early part of 1970 before dropping with the start of the civil war. During the period from 1991 till 2000, deposits grew at an average of 24.2% reaching \$37.6 billion, and manifested a growth during the last 10 years at an average of 9.9 % from 2007 till 2017 reaching around \$168.7 billion as at end 2017.

Figure 15: Market Capitalization as a percentage of Deposits



Source: Compilation from data retrieved from Central Bank of Lebanon and BSE websites.

Figure 16 shows that the percentage of the market capitalization over deposits in the banking sector has always been low relative to the deposits at an average of 8.33% before its closure in 1983 with a peak of 12% in 1973-1974 period and still hovers at around and average of 8.41% since its reopening in 1996 till 2017 with a peak of 16% in 2007-2008 period.

3. BSE Market Capitalization

In November 2005, the Bank for International Settlements (BIS)²⁵ announced the “International Conversions of Capital Measurements and Standards” related to Basel agreement, which prompted the international financial community to abide by the Basel II standards. Consequently, the Central Bank of Lebanon (Banque Du Liban-BDL) called for the immediate implementation of the new requirements by banks operating in Lebanon. As such, some banks resorted to issuing common and preferred shares to increase their capital base and meet the newly imposed capital adequacy threshold of 8%; which explains the substantial increase in BSE’s market capitalization during the

²⁵ The BIS is owned by 60 central banks, representing countries from around the world that together account for about 95% of world GDP. Its head office is in Basel, Switzerland and its mission is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.

2004-2007 period (Figure 4-8), knowing that listed banking stocks constitute the largest stake in terms of volume and value on the Beirut Stock Exchange.

Moreover, the Central Bank of Lebanon, with its prudent measures, spared the Lebanese economy from the repercussion of the 2008 financial crisis and rather helped in the GDP growth that averaged circa 9 % per annum over the period 2007-2010 and which in turn pushed the BSE market capitalization to its record high of \$12.84 billion as at end 2009 which then retreated to \$10.29 billion in 2011 as a result of the outbreak of the Arab Spring.

In the context banking prudence and regulation, some of the measures that were applied by the Central Bank of Lebanon include the regulation of banks' dealings with derivatives and structured products, which require prior approval from the BDL's Central Council, and forbidding banks from making subprime investments, both domestically and overseas²⁶ (Basic circular No 66 of December 24, 1999 and Basic circular No 81 of February 21, 2001). Banks are also prohibited from carrying out for their own account any derivatives operation, except for hedging purposes. Moreover, banks were required to abide by international banking and accounting standards regarding capitalization requirements (Basic circular No 44 of March 25, 1998- Basic circular no. 104 of April 1, 2006). The average capital adequacy ratio of banks in Lebanon exceeded 12% in 2009 with banks fully abiding by Basle II standards.

In addition, the Central Bank required banks to maintain adequate liquidity levels by keeping at least 30% of their assets in cash²⁷.

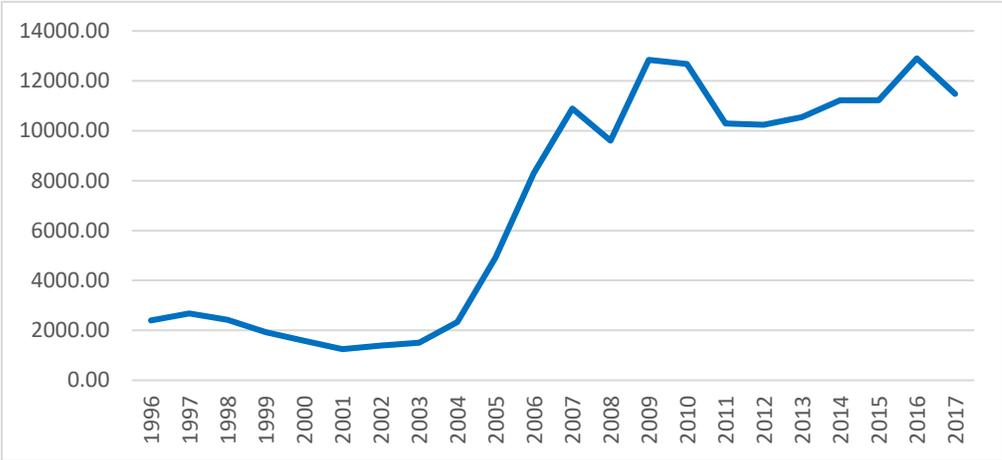
Therefore, BDL regulation that required banks to maintain a minimum capital adequacy ratio of 10.5% by the year 2013, 11.5% by 2014, and 12% by end of 2015, according to the Basel III pillars, put more pressure on banks to increase their capital, in addition to the increase in market capitalization which had to be sustained also by banks trying to finance their expansion across borders by issuing additional common and preferred shares and this helped maintain market capitalization at around \$11 billion in spite of the devastation in neighbouring Syria bringing the GDP growth rate from an average of 13% during the period from 2006 till 2011 down to an average of 4.4% during the period from 2011 till 2017. Figures 16 and 17 show the increase in BSE market

²⁶ Basic circular No 72 of October 18, 2000- Basic circular no 84 of June 2, 2001- Basic circular No 86 of September 20, 2001.

²⁷ The Lebanese economy is known to be dollarized up to 67% and the same applies to the liabilities and assets of the banking sector.

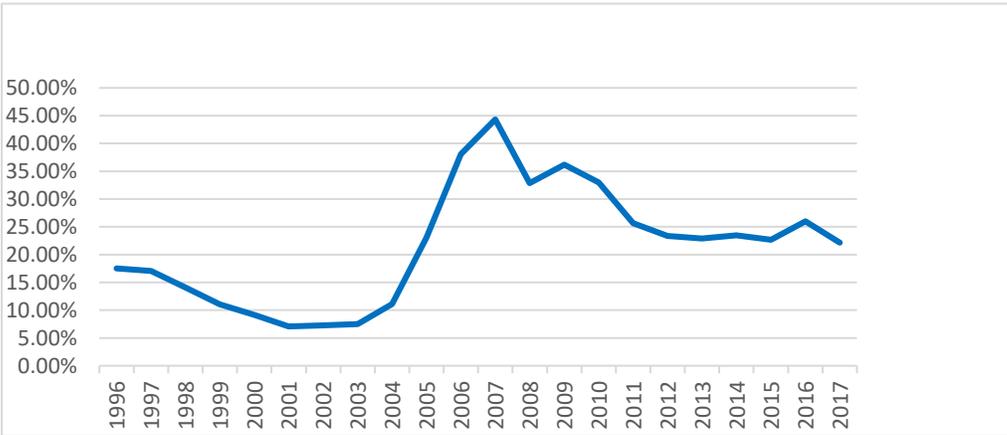
capitalization resulting from the legally required capital increase of commercial banks and in spite of this fact, the market capitalization stands at barely 20% of GDP which is a sign that the Lebanese capital market remains under-developed relative to other markets in the region and internationally.

Figure 16: BSE Market Capitalization



Source: BSE reports (in Million USD)

Figure 17: Market Capitalization as percentage of GDP

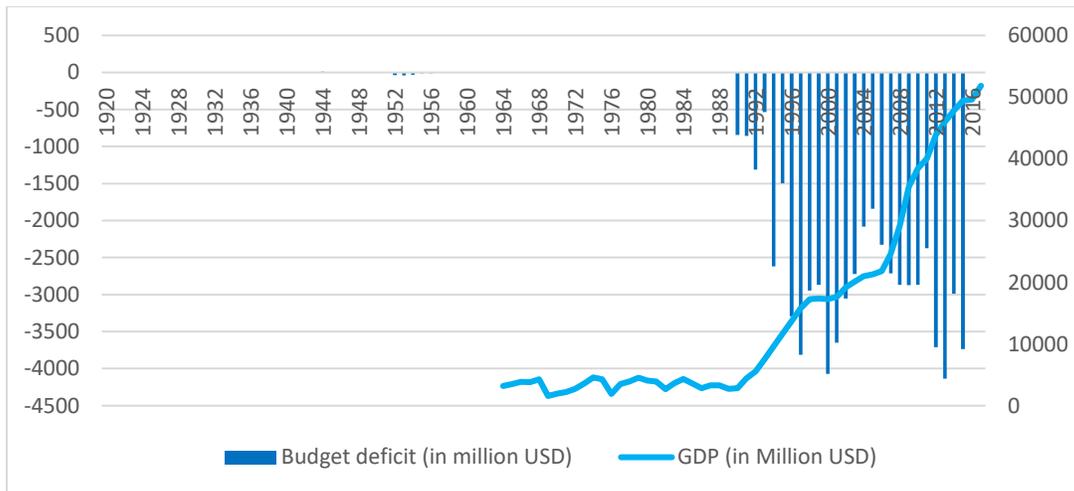


Source: Compiled from BSE and BDL reports.

4. Budget Balance

The Lebanese government has always faced large budget deficits due to the low revenue collection relative to its high expenditures which are concentrated on mainly on financing the public sector and the government owned public services companies such as the electricity company. For example, at the end of 1996, the commercial banks holding of treasury securities reached \$7.7 billion which is almost seven times larger than the private sector loans of \$1.01 billion. This situation led to crowding out the private sector away from development projects at the expense of financing government expenditures. Treasury securities paid 24% interest at the time, and the central bank's efforts to support the domestic currency were translated in appreciation of the currency which in turn became very lucrative to the commercial banks to invest in and reap huge returns from a riskless investment opportunity. Figure 18 shows the expansion of the GDP over the past 10 years coupled with an increase in the budget deficit.

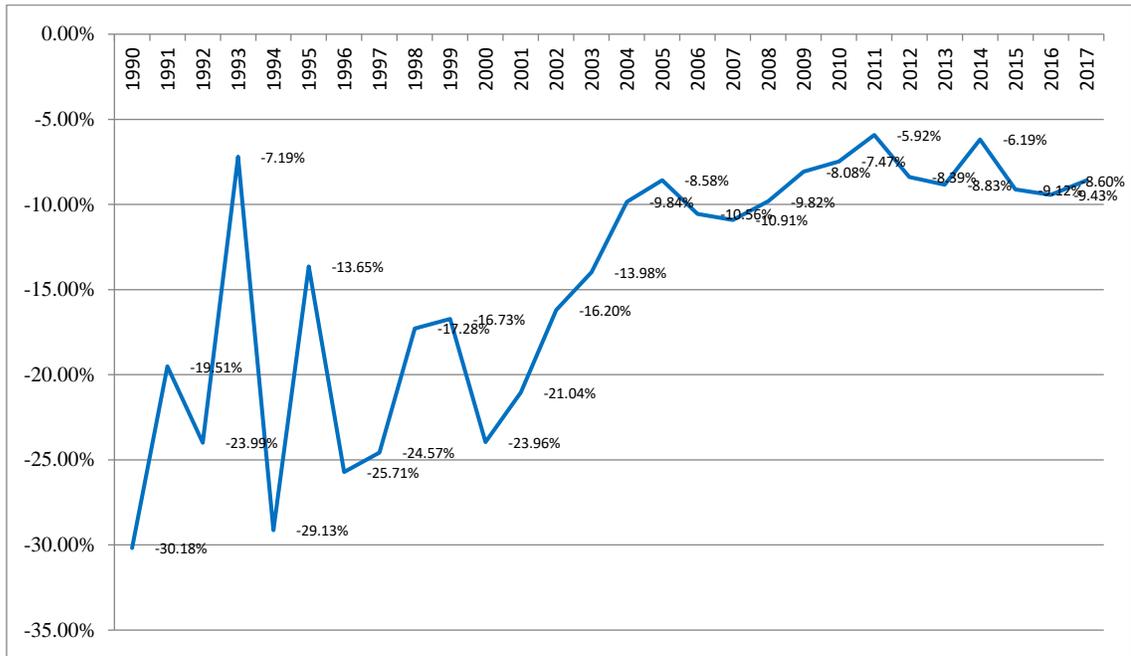
Figure 18: GDP vs Budget Deficit



Source: IMF working papers

Figure 19, below, depicts an improvement in the ratio of the budget deficit to the GDP level decreasing from around 24% in 2000 to a mere 8.6% in 2017 which is a by-product of an increase in the GDP levels rather an improvement in the deficit itself as it is shown in the following section on GDP.

Figure 19: Budget Deficit as percentage of GDP



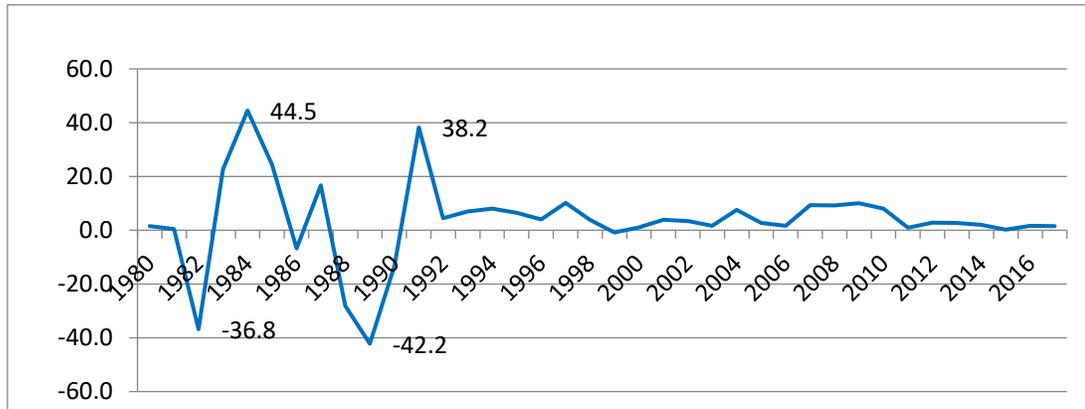
Source: Compilation from data collected from BDL and Ministry of Finance websites.

5. GDP

According to data collected by the International Monetary Fund (IMF) for the period extending from 1980 till 2017, Lebanon witnessed an average of 3.54% growth in real GDP throughout the 38 years under study, with the largest negative growth witnessed during the years 1982 and 1989 with -36.8% and -42.2% respectively and the largest positive growth during the years 1984 and 1991 with 44.5% and 38.2% respectively.

Aside from these major deviations in 1982-84 and 1989-91 intervals that witnessed major events in the economy, Lebanon managed to maintain a relatively steady growth in its GDP in real terms until the Syrian crisis in 2011 as depicted in Figure 20 below. Lebanon witnessed a CAGR in percentage GDP growth of 11% during the period extending from 1990-1995 just to drop to 2% during late 1990s and early 2000s and to jump again during 2005-2010 to 9% before dropping to 2% between 2010 and 2015 period (IMF, WB, IMF World Economic Outlook Database April 2018). During the recent history, Lebanon's standard deviation (volatility) of real GDP growth, from 1992-2017, marked a 3.3% increase compared to 1.4% in France and Belgium and around 4.5% in Greece and Turkey which reveals the similarity of the Lebanese economic situation to the two latter examples and the possibility of expecting a downturn in the overall situation.

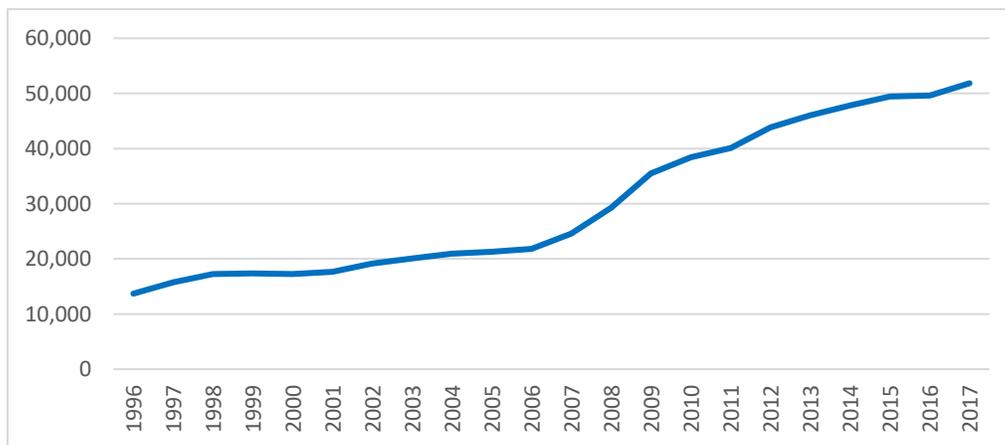
Figure 20: Real GDP Growth Rate



Source: IMF, Country data

Since the reopening of the Beirut stock exchange, the economy has witnessed an average increase in its GDP of around 6.70% during the period from 1996 till 2017. This improvement in the GDP was reflected in a booming banking sector rather than in the stock market due to the nature of the Lebanese economy that favours bank deposits over investment account. Figure 21 shows the relatively strong increase in the GDP.

Figure 21: GDP (in million USD)



Source: BDL, World Bank

It is worth mentioning that Lebanon's GDP per capita in 2017 was only 30% more than that in 1980, whereas growth in Singapore and Korea reached 400% and 700% respectively (World Bank, 2018).

6. Balance of Payments (BOP)

According to IMF reports, the balance of payments statistics (BOP) in Lebanon are weak. The data reflect deficiencies in the current account, the capital account (grants), and the financial account, and the coverage of foreign direct investment (FDI) transactions remains limited as well.

Lebanon, known for being an import-oriented country, has always enjoyed a positive balance of payments. The deficit on the balance of trade, which is a permanent feature of the Lebanese economy since its independence, has been usually met by a surplus on the services and capital accounts in the balance of payments. Despite the conflict in the 1970s, the balance of payments was generally in surplus. It showed minor deficits in 1979, 1983, 1984 and 1986, but larger deficits occurred in 1989 and 1990 (Kasparian, 2008). Capital inflows and remittances of Lebanese working abroad went down tremendously as a result of the Gulf war and Lebanon lost some of the sources of financing after the Palestine Liberation Organization (PLO) was forced to leave Beirut in 1982. Accordingly, the balance of payments recorded a deficit starting in 1983 and continued until 1991. The balance of payments recorded a surplus exceeding one billion dollars in 1991 after the signing of the Taef Accord in late 1989²⁸ and as a result of large capital inflows generated by regaining confidence in the country on one side, and a high return on financial investments, mainly treasury bills, with three-month TBs paying 14.50%, on the other (Ministry of Finance).

The balance of payments registered a surplus of U.S. \$54 million and U.S. \$1,170 million in 1992 and 1993 respectively. The trend continued in the following years. However, the balance of payments registered a deficit of U.S. \$488 million in 1998 following the appointment of the Al Hoss Government and a reduction in the amount of foreign transfers.

In 2000, the balance of payments recorded a deficit of U.S. \$289 million due to increased capital outflows resulting from losses incurred by investors in international equity markets, increased fuel prices, a reduction in additional external borrowings and the doubling of payments on external public debt.

In 2003, the balance of payments results showed a significant influx of transfers to Lebanon and the BOP recorded strong surpluses during this period due to increasing oil revenues.

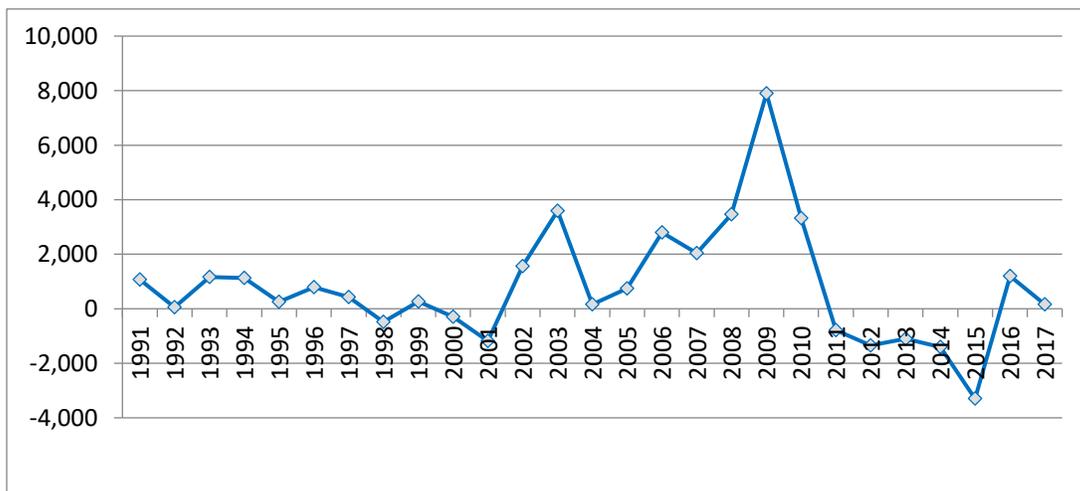
²⁸ The Taef accord is the National Reconciliation Accord or Document of National Accord) that was reached to provide "the basis for the ending of the civil war and the return to political normalcy in Lebanon in 1989.

In 2004, despite large transfer volumes, the balance of payments surplus was small given a big increase in imports and minor subscriptions to euro bonds. From 2005, the balance of payments surplus resulted from the resumption of direct investments, particularly in the real estate sector, and in 2008, 2009, and 2010, a significant increase in transfers were translated in large surpluses. Capital outflows that affect negatively the BOP were represented, aside from imports payments, by residents' investments abroad. Net residents' investments were concentrated in four countries, the United States, France, the United Kingdom and Germany and this accounted for around 78.1% of the total in 2004 and 69.0% in 2005.

American equity securities remained in the first rank for the fifth consecutive year since 2000, followed by French equity securities for the fourth consecutive year. On the other hand, equity securities issued by United Arab Emirates to the third place in 2005, thus becoming ahead of British equity securities.

By the end of 2016, BDL's swap operation with the Ministry of Finance sent the BOP into its first surplus in the last five years. Moreover, and in spite of Eurobond issue early 2017, the Lebanese Prime Minister Resignation Crisis boosted significantly the demand on the dollar and pressed some depositors to transfer part of their savings out of the country reducing thus the Balance of Payment figure for 2017 as shown in figure 22.

Figure 22: Balance of Payments



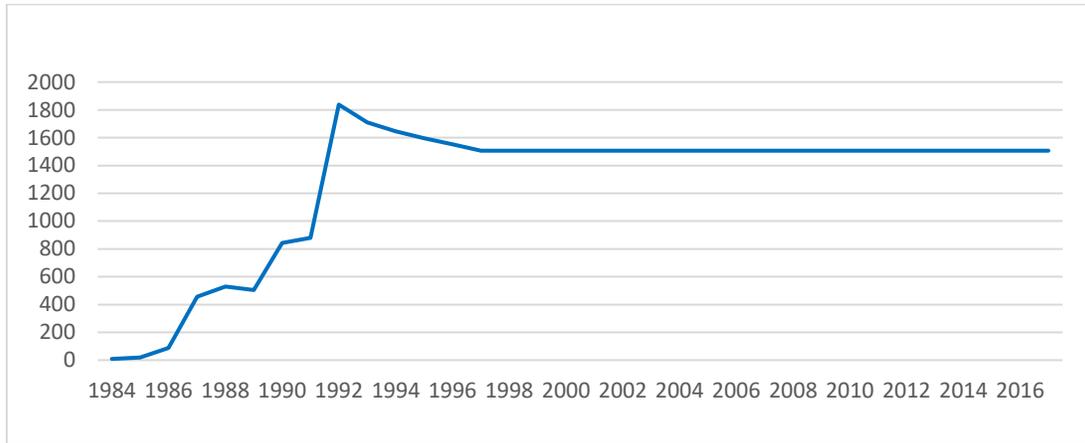
Source: Ministry of Finance, Central Bank of Lebanon, estimates of IMF and World Bank.

The negative figures in 2014 and 2015 resulted from deterioration in the current account that was not compensated by any foreign inflow of funds.

7. Foreign exchange

The period from 1984 saw the era of the depreciation of the Lebanese currency reaching an all time low in 1992 before the intervention of the Central bank of Lebanon to assimilate the pressure on the domestic currency and starting the supportive intervention to bring the currency back up to a steady controllable and sustainable mid-rate level of USD/LBP 1507.5 in 1997.

Figure 23: USD/LBP (1984-2017)



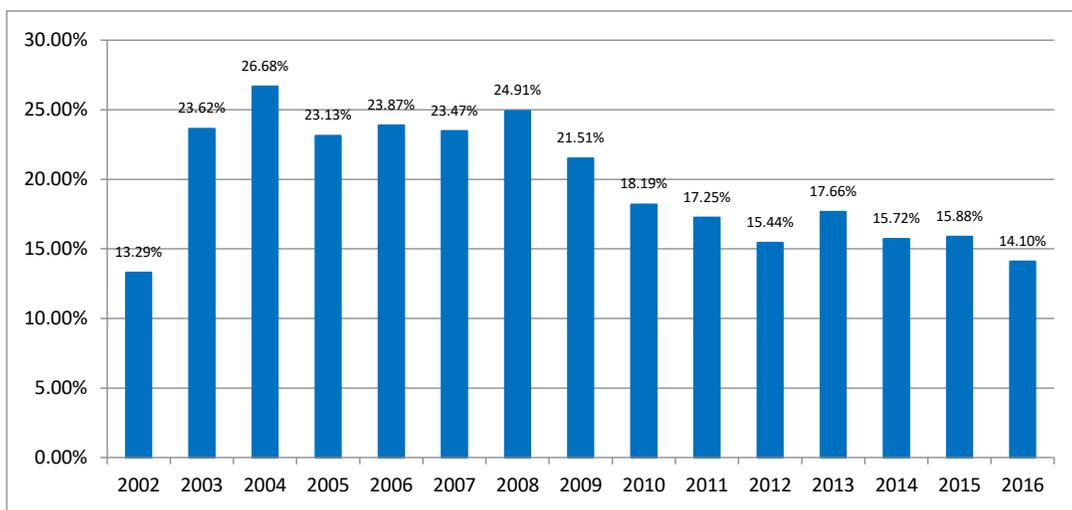
Source: Central Bank of Lebanon

If we look at the foreign exchange market throughout the history of Lebanon, we can clearly spot the vulnerability of the domestic currency to shocks that hit the economy and rendered the investment opportunity in the stock market and the economy as a whole a rather risky decision, especially with the long-term characteristics of such investments. Figure 23 is a reflection on the importance of maintaining a relatively steady currency in an import-oriented economy with scarce natural resources and more dependence on foreign products in a way to boost and maintain the standard of living and the purchasing power of the citizens. Historically, the exchange rate was maintained stable with the support of the French authorities and the effort of the bank of Syria and Lebanon and later faced a massive drop after the Israeli invasion of 1982 and stretched into the devastating years of unrest of 1988 through 1992 before reaching a stabilizing level again under the effort of the Central Bank of Lebanon.

8. Foreign currency reserves

Ever since the establishment of the independent Central Bank of Lebanon, the Lebanese economy depended on its citizens who are working outside Lebanon, in specific in the gulf area, to repatriate their savings back to their home land. Figure 24 below depicts the remittances of Lebanese expatriates as a percentage of GDP with an average of around CAGR 19.65% over the past 14 years as compared to a Global average of 0.76% for the same period according to the IMF and an average in the MENA region of 1.75% in 2016 according to the World Bank.

Figure 24: Remittances as percentage of GDP



Source: World bank 2016, and IMF

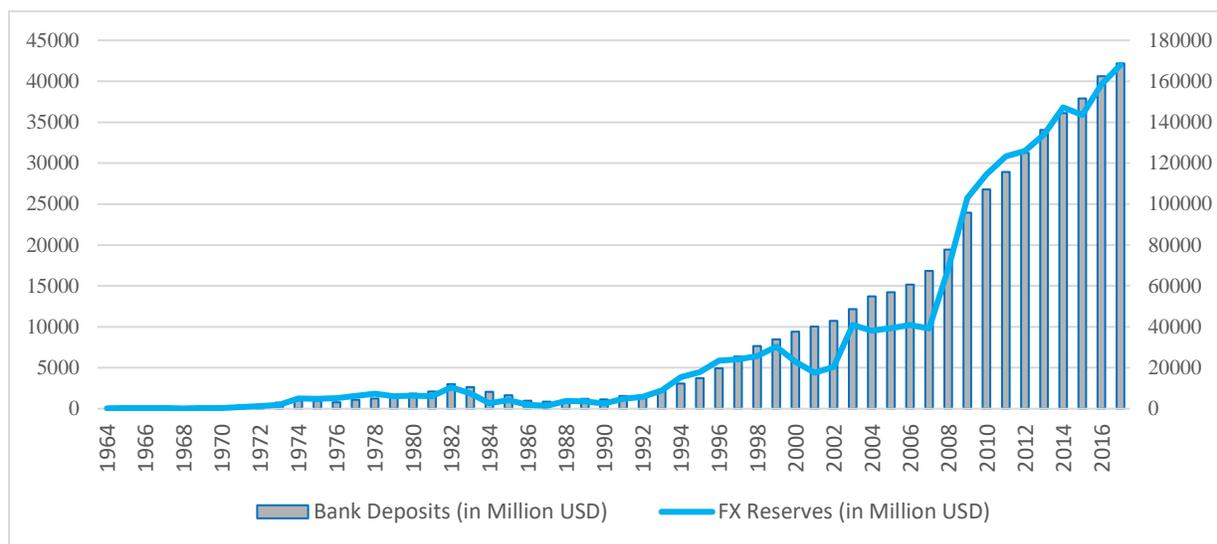
The large inflow of money helped build the foreign currency reserves of the central bank and stood ready to defend the domestic currency in the face of any trouble. The first remarkable build up with an increase of 164% was seen in the period of 1973 to 1974, when the foreign currency reserves shot up from \$ 478 million to \$1261 at current market prices. This level was maintained relatively steady until reaching its best year in 1982 with \$ 2598 million before starting a drop throughout the 1980s till 1991. Afterwards, Lebanon started its pace towards regular accumulation of foreign exchange as the most suitable mean to support and face any attempt of speculation against the domestic currency and the economy as a whole.

Moreover, the imposition of legal reserve requirement of 15% on foreign currency deposits in the commercial banks (Basic decision 7926, circular 86 of 20-09-2001) participated in pushing the central bank reserves even further up since these reserves must be deposited as term deposits in the central bank adding to the portfolio of the central bank in foreign currencies. Figure 25 shows

the positive relationship between the foreign currency reserves of the central bank and the deposits in the banking sector as a whole.

Moreover, Lebanon underwent several international meetings intended to support the programs to rebuild the economy. Some of the most important in chronological order are highlighted: “Friends of Lebanon” was held in Washington and secured \$3.2 billion in loans and grants in 1996; then, Paris I, which took place in February 23, 2001 and managed to raise around 500 million Euros. It was followed by Paris II, in 23 November 2002, which raised around 4.2 billion Euros.

Figure 25: BDL Reserves vs Banks' Deposits



Source: Central Bank of Lebanon Reports.

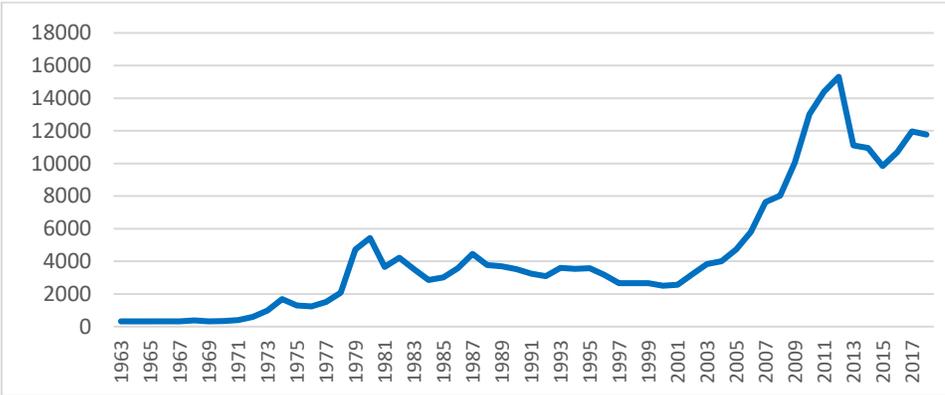
Then came the Stockholm conference that managed to secure US\$980 million, but only around US\$ 650 were dispatched. These conferences were followed by Paris III conference on 25 January 2007, but none of its promised funds arrived to Lebanon due to non-compliance of the Lebanese government with the requirements imposed by international community during the conference.

9. Central Bank's Gold Reserves Holdings

Since 1939, Lebanon started purchasing Gold with \$1.7 million (at current prices) bought and maintained through 1948. Afterward, Lebanon decided to increase its holdings of gold and reached \$73.7 million in 1955. The independent central bank was created in 1963 with around \$324 million in gold holdings. During the term of president Chamoun in 1958, a presidential decree was issued to prevent the sale of gold under any circumstances and Gold holding of 9.22 million ounces is

maintained until current days and it cannot sell it unless it is authorized to do so by a legislative text enacted by the Parliament. With this gold reserves on hand, Lebanon ranks second in the world in terms of gold reserves per capita and 18th in the world in terms of Gold reserves holdings. The below Figure 26 highlights the Central bank holdings of Gold and its fluctuation based on the fluctuation in the price of Gold only and not its quantity.

Figure 26: Gold Reserves Holdings of BDL (in millions of USD)



Source: Central bank of Lebanon reports.

After looking at some of the structural characteristics of the Lebanese economy, one must look around for some comparative analysis with the surrounding capital markets in the Gulf and the MENA region, in a move to shed the light on the similarities that might pave the way for the future prospects and the possibilities that faces this country.

10. Relative comparison

It is crucial to compare Beirut Stock Exchange to some of the exchanges to pinpoint the relative size, strength and weaknesses of the BSE. For this, we started with the market capitalization relative to GDP which is an indication of the relative size of the stock exchange to the economy.

The World Bank classifies countries in the Middle East, North Africa and Central Africa that satisfy some requirements to be considered as emerging economies into three groups: Lebanon along with Egypt, Jordan, Morocco, Tunisia, Gaza and Djibouti as resource-poor, labour-abundant economies; Algeria, Iran, Iraq, Syria and Yemen as resource-rich, labour-abundant economies; and Bahrain, Kuwait, Libya, Oman, Qatar, Saudi Arabia and the United Arab Emirates as resource-rich, labour-importing economies (World Bank reports).

The capital markets in the Middle East and North Africa region are considered as less developed than other emerging markets. During the 1990 period, some privatizations of the public institutions were initiated, but at a slow pace. This was associated to a lack of political will and some aversion by interest groups. Moreover, the participation of governments in economic activities and the weak job creation in the private sector, represented barriers to a quick privatization process.

From a different perspective, most Gulf countries-imposed barriers and restrictions on foreign investments in domestic equities, inhibiting deeper capital market integration.

Nowadays, the demand for shares in Gulf stock markets increased and their respective economies are growing due to the removal of controls associated with the economic reform and foreigners are now able to invest directly in most of the Gulf stock markets.

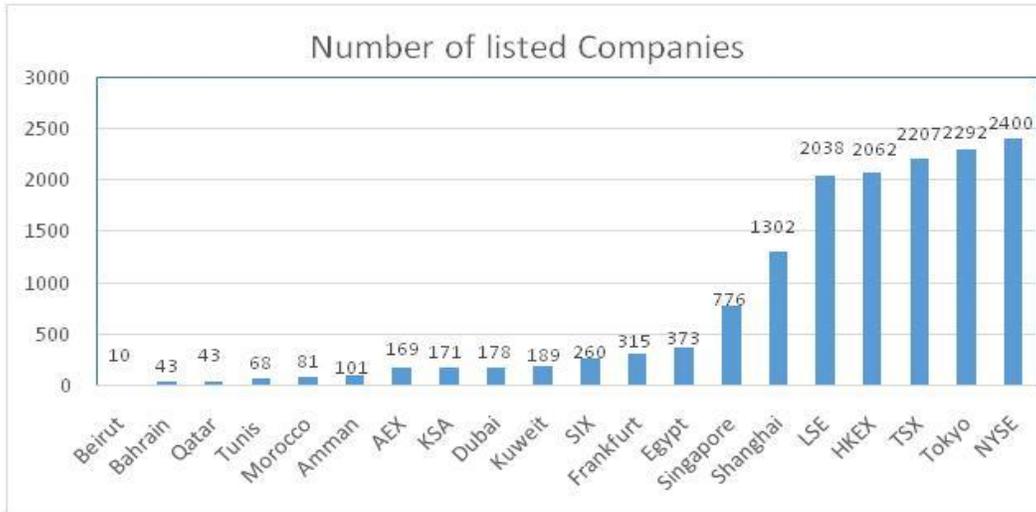
It is worth noting that there was a move towards a US dollar peg in a way to boost the stability of the Gulf countries' exchange rate which remained relatively stable since 1979 for most of the countries in the Gulf region.

After going through most of the markets in the Gulf and the MENA region, the author reached a handful of markets based on the potential similarities and possible duplicability of some of these active markets. In order to set the sequence or the selection of markets to introduce first, no priorities nor size differences were followed, only alphabetical order and random selection of markets that are thought to be comparable to Beirut Stock Exchange geographically, culturally and exemplary to be followed.

A quick and general view on the achievements of the markets in the nearby Arab and Gulf area revealed low correlation in the activities of such markets and showed that some indices of Arab Stock Exchanges denominated in local currencies increased in 2018 compared with 2017. Qatar Stock Exchange marked the highest increase by 20.8% trailed by Tunis stock exchange with 15.8% and Abu Dhabi Securities Exchange with 11.7%, whereas Saudi Stock Exchange, Damascus Securities Exchange and Bahrain Bourse increased by 8.3%, 3.5% and 0.4% respectively. On the other hand, Palestine Exchange, Casablanca Stock Exchange, Amman Stock Exchange, Iraq Stock Exchange, the Egyptian Exchange, Beirut Stock Exchange, Muscat Securities Market, Kuwait Stock Exchange and Dubai Financial Market declined by an average of 13.86% compared with

2017. In the Far East, the market is much more active and deeper with large number of listed companies that represent a relatively larger sizes as shown in the high market capitalizations.

Figure 27: Number of Listed Firms on Selected Markets



Source: Personal compilation from official markets websites.

Moreover, Lebanon underwent several international meetings intended to support the programs to rebuild the economy. Some of the most important in chronological order are highlighted: “Friends of Lebanon” was held in Washington and secured \$3.2 billion in loans and grants in 1996; then, Paris I, which took place in February 23, 2001 and managed to raise around 500 million Euros. It was followed by Paris II, in 23 November 2002, which raised around 4.2 billion Euros.

Browsing into the above-mentioned markets, one can see clearly that most of the countries around the world have reformed or started the reform of their markets by working on laws and regulations to remove capital controls and other barriers to entry in a step to attract foreign capitals.

Moreover, a basic requirement for a company to be listed is the percentage float of the total capital of the issuing company which revolve around 20% to 30% in all of the cases in addition to minimum specified number of shareholders which is very important to reflect the ownership dispersion and the move away from ownership concentration of the old system of family businesses. This ownership diversification dictates certain corporate governance rules and more transparency in the ongoing operation of the business.

The Market Capitalization to GDP ratio, which became to be known as the Buffett Indicator²⁹, measures the total value of all publicly traded stock in a country divided by that country's Gross Domestic Product (GDP). It is a way to assess whether the stock market is overvalued or undervalued, compared to a historical average for a certain country (CFI and Guru focus). The question to ask here is what should the average ratio be? The ratio is affected by developments in Initial Public Offerings (IPOs) on one hand, and the percentage of companies that are publicly traded as compared to the ones that are private on the other. The Market Capitalization to GDP ratio reflects how big is the market relative to the size of the domestic economy as presented by the GDP.

Since the stock prices reflect the expected earnings of companies³⁰ and the GDP denotes the consolidated revenue in the economy³¹, this ratio shows an estimate of whether the two are moving in tandem. A ratio above 100% shows overvaluation and one below 50% shows that the market may be undervalued. The World Bank releases data annually on the Stock Market Capitalization to GDP for World which was 55.2% at the end of 2015 and edged up to 87.55 percent in 2017 with the highest value being in Hong Kong at 1274.13 percent and the lowest in Vietnam at 5.16 percent (datacatalog.worldbank.org/stock-market-capitalization-GDP).

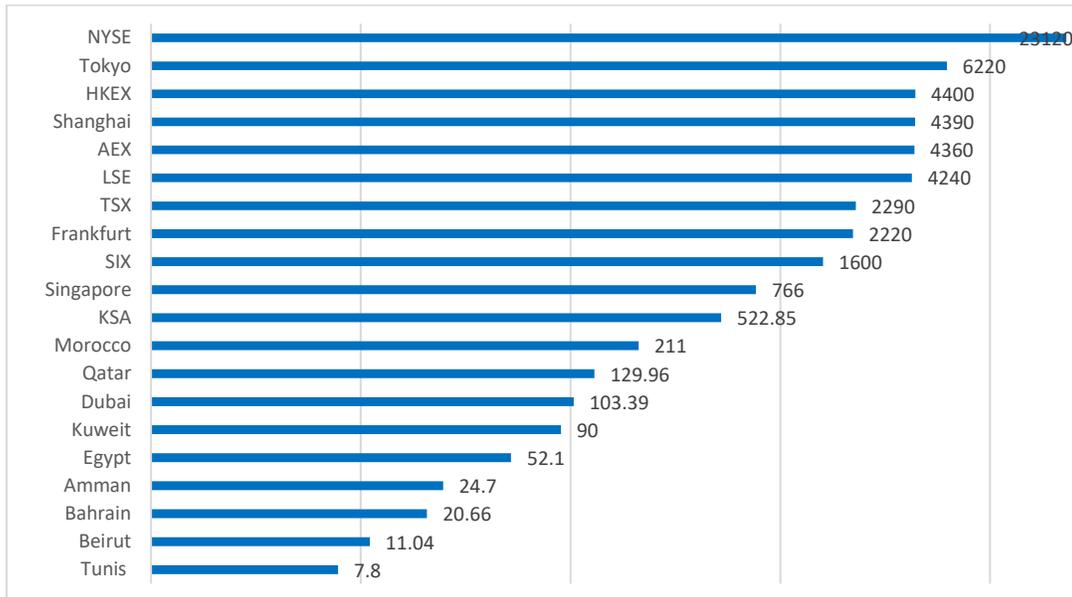
Looking at figure 28, the observer can see a market capitalization crossing the \$103.39 billion in Dubai and increasing to cross the \$1.6 Trillion in Switzerland to move further up the scale to cross the \$4 trillion in London and reaching 5 digits figures in New York which reflects the large size of the companies listed in these respective markets. On the side of the spectrum, markets with relatively smaller companies or lesser number of listed companies is evident in countries such as Egypt, Jordan, Bahrain, Lebanon and Tunis.

²⁹ It refers to Warren Buffet's favourite market indicator that can predict the market collapse.

³⁰ There are many contradicting views on the relationship between earnings and stock prices. The most followed study dates back to M. J. Gordon, 1959 and supported by Campbell and Shiller, 1988.

³¹ As opposed to GNP that includes foreign investment revenues of residents as well.

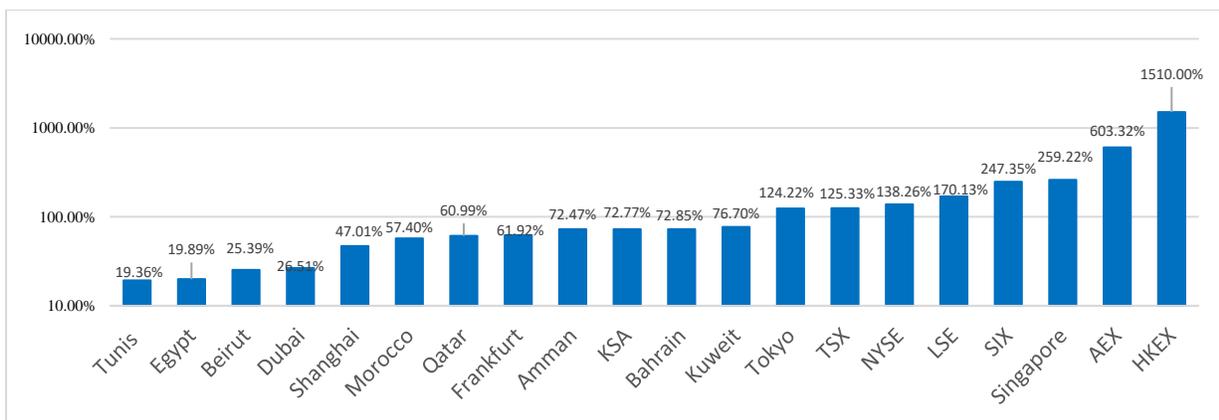
Figure 28: Market Capitalization of a Sample of Selected Markets



Source: [datacatalog.worldbank.org/stock-market capitalization](http://datacatalog.worldbank.org/stock-market-capitalization)

Looking at the ratio of market capitalization to GDP, (figure 29), it is also evident where we have more room and more potential for development in the markets at levels below the threshold of 87% that was calculated by the World Bank.

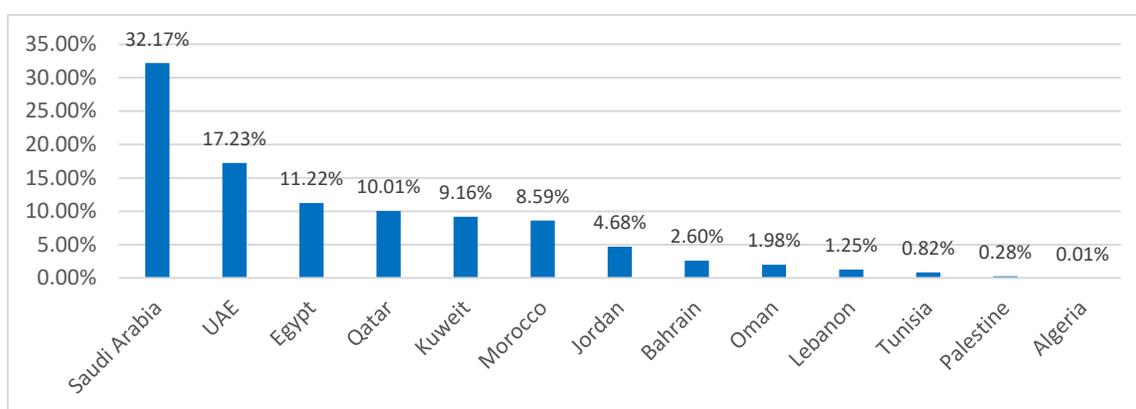
Figure 29: Market Capitalization to GDP of a Sample of Selected Markets



Source: [datacatalog.worldbank.org/stock-market capitalization-GDP](http://datacatalog.worldbank.org/stock-market-capitalization-GDP)

Most of the markets in the Gulf area fall below that level as a result of their relatively high GDP level being mainly oil producing countries. As for the rest of the Arab countries in the Middle East area, it is rather the lower number of the listed companies that characterizes their economies and that lead to the relatively low ratios reaching 25.39 % in Lebanon and the lowest in Tunis with 19.36%. In figure 30, we can clearly see the dominance of the relative share of market capitalization in the Arab Countries that is controlled by most of the Gulf countries and in specific Saudi Arabia with 32.17% of the total shares followed by United Arab Emirates and we have lagging behind at the other side of the spectrum Lebanon, Tunis, Palestine and Algeria.

Figure 30: Relative Market Capitalization in the Arab Countries



Source: Arab Monetary Fund (2008). (In most MENA countries, stock markets are characterized by the concentration of ownership and the limited role of market forces). The graph reflects the percentage of each market of the overall Arab markets.

VI- Recent Introductions to the BSE

After the successful introduction of the housing loan program at subsidized interest rates and the education loan program at zero interest rate, the central bank of Lebanon found the need to boost and support the technology sector and in specific the knowledge economy by providing an innovative tool for the commercial banks to participate in start-ups and growing companies. For the first time in Lebanon, the commercial banks were allowed to invest directly or indirectly in companies with amounts secured from the central bank with the provisions to pay it back with a profit-sharing scheme that was considered creative in the Lebanese financial sector and in the commercial banking sector in specific.

1. Article 331 by the Central Bank of Lebanon

The Central Bank of Lebanon (BDL) issued on August 22, 2013 an intermediate circular No. 331 addressed to Banks and Financial Institutions. Intermediate circular 331 came to amend prior circular No 23 related to basic decision No. 6116 of March 7, 1996 relative to facilities that may be granted by BDL to Banks and Financial Institutions.

Accordingly, banks operating in Lebanon may obtain an interest-free credit facility contracted for a maximum period of seven years in return for their participation, at their full responsibility, in the capital of companies, as per to the following requirements:

- * Facilities shall be received by a bank for its participation in a company, upon BDL Central Council approval, provided that the company is a Lebanese joint-stock company with nominal shares.
- * The facilities can be used to support a new start-up company, to fund an incubator and accelerator³² whose role revolves around the support of start-up companies in Lebanon, or a venture capital company investing in potential growth and profit-making companies.
- *The target company shall not be a financial company or an offshore company.
- * The target company's shareholders shall not be governed, whether directly or indirectly, by the provisions of Article 158 of the Code of Commerce³³ and by Article 152, Paragraph 4 of the Code of Money and Credit³⁴. The beneficiary bank shall make sure, at its own responsibility, to comply with this provision.
- * The concerned bank undertakes to transfer its shares in the capital of the company, within a period of not more than seven years to the respective owners/shareholders.
- * The financed project should target the knowledge economy and support the creative intellectual skills.

³² The Incubators and Accelerators offer the start-ups administrative support, networking, mentoring, training, and know-how, in addition to a range of support resources and services

³³ Article 158 of the Code of Commerce restricts and regulates any agreement between the company and one of its Board of Directors

³⁴ Article 152 forbids banks from granting, either directly or indirectly, credits to members of its Board of Directors or to persons in charge of its management, to its principal shareholders and to relatives of such persons.

- * Several banks may participate in the capital of a single company after receiving the respective approval from the BDL.
- * The participation of bank(s) shall be restricted to 80% of the capital of a single target company and should include assistance toward the development of the company's business and support toward its continuous growth and good governance.
- * Participations of banks are restricted to maximum 4% of any bank's tier one capital as defined in circular No. 43 related to basic decision 6938 of 25 March 1998 and distributed among a minimum number of 10 benefiting companies. In other words, a maximum of 10% of the mentioned amount can be allocated to one single company, i.e. minimum 10 companies or a maximum of 20% can be allocated to a single venture capital fund, i.e. minimum 5 VCs, (BDL, PC July 2019)
- * The concerned banks shall invest the amount of the facilities granted by BDL in Treasury securities subscribed to in the primary market and the margin realized thereto shall be calculated in a way that guarantees a coverage amounting to 75% of its participation in the company.
- * The amount of granted facilities shall be determined in a way that the net yield on the facilities invested by the benefiting bank shall be equivalent to 75% of the value of its participation in the Company.
- * The banks were later required by the Central Bank of Lebanon to make a provision with the remaining balance of 25% in order to be able to face any future potential risk of shortage in meeting the required paybacks.
- * The Project Portfolio Management (PPM) is divided into an investment period of four (4) years that might be extended for one year and an exist period of three (3) years that might be extended for one (1) year and exceptionally for another one year (R. Semaan, PC 2019).
- * The VC funds studied the feasibility of each company they invested in and pre-arranged the exit strategy with each respective company. Some of these strategies were performance based, some depended on a put option, some relied on a pre-set price, but most of the exits

that were presented to the BDL with the respective feasibility studies referred to a trade sale at the end of the confinement period (J.Ezzeddine July 16 and R. Semaan July 31, 2019, PC)

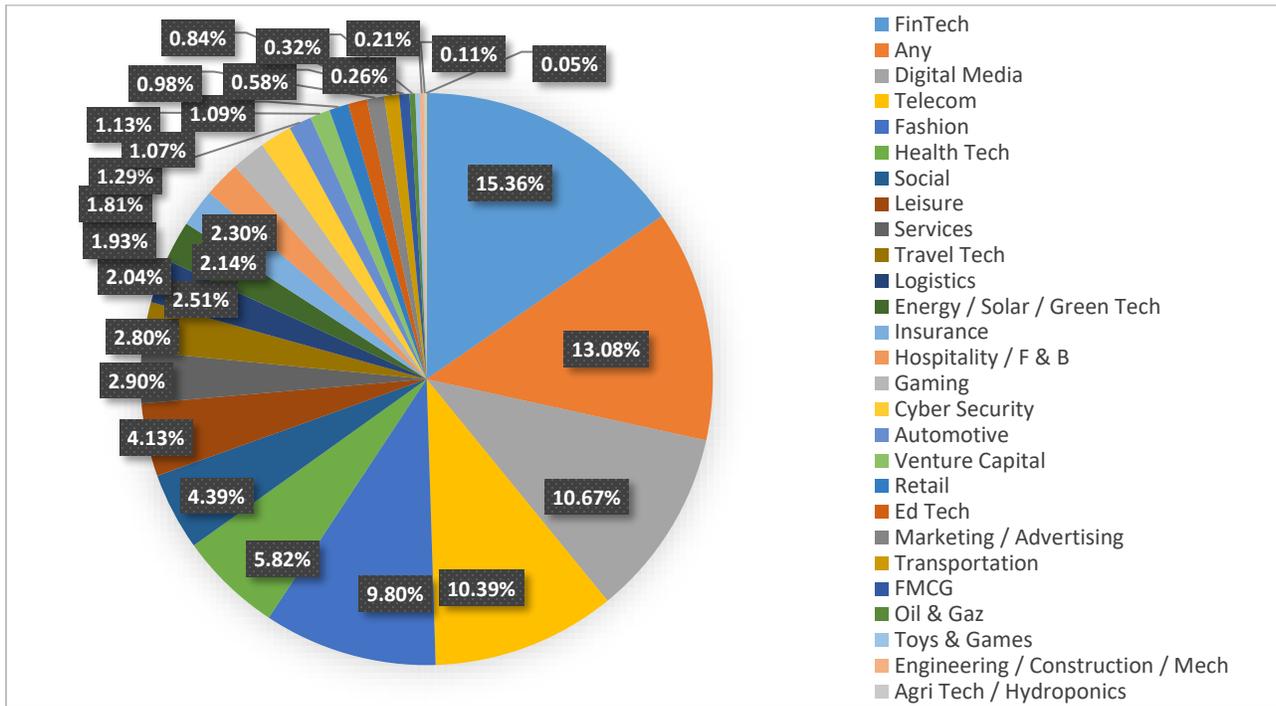
* The amount of the facilities granted to finance the participation of a bank in a company shall be automatically reimbursed at their maturity date, upon the discount of bonds invested therein, or upon the transfer of the shares held by the said bank in the company's capital.

* The concerned bank must pay to BDL 50% of the profits that may be realized through the sale of the company's shares and through the distribution of any dividends by the said company.

* Any bank that violates the provisions of this Article shall immediately reimburse the amount of facilities granted by BDL or pay an interest amounting to 15% of the value of these facilities, accrued from their granting date until their effective settlement or until the detection of the violation, as decided by BDL.

With the exception of three (3) banks, all commercial banks in Lebanon who benefited from circular 331 opted for the alternative of providing the funds received from BDL to special venture capital funds (VC) who had the expertise and the know-how to evaluate the start-ups in the knowledge economy. The choice of the funds, by each bank, was based in first place on the expertise and know-how of the fund manager and the corporate governance in effect in the fund. The banks looked at the availability of an investment committee and the respective advisors and the decision-making process and the size of the fund on one hand and the type of the board members and their independence on the other (R. Semaan, PC 2019). According to the Central Bank of Lebanon, the total amount disbursed to support the promising start-ups reached around \$ 335 million distributed among 171 individual beneficiaries. In a look at the breakdown of the beneficiaries of article 331, the BDL divided the beneficiaries into different industries as shown in (figure 31). The FinTech tops the list with around 15.36% of the amounts disbursed, followed by the Digital Media and Telecom with 10.67% and 10.39% respectively, while the Agritech and the HR-business environment ranked last in the list with 0.11% and 0.05% respectively.

Figure 31: Article 331- Industry Distribution

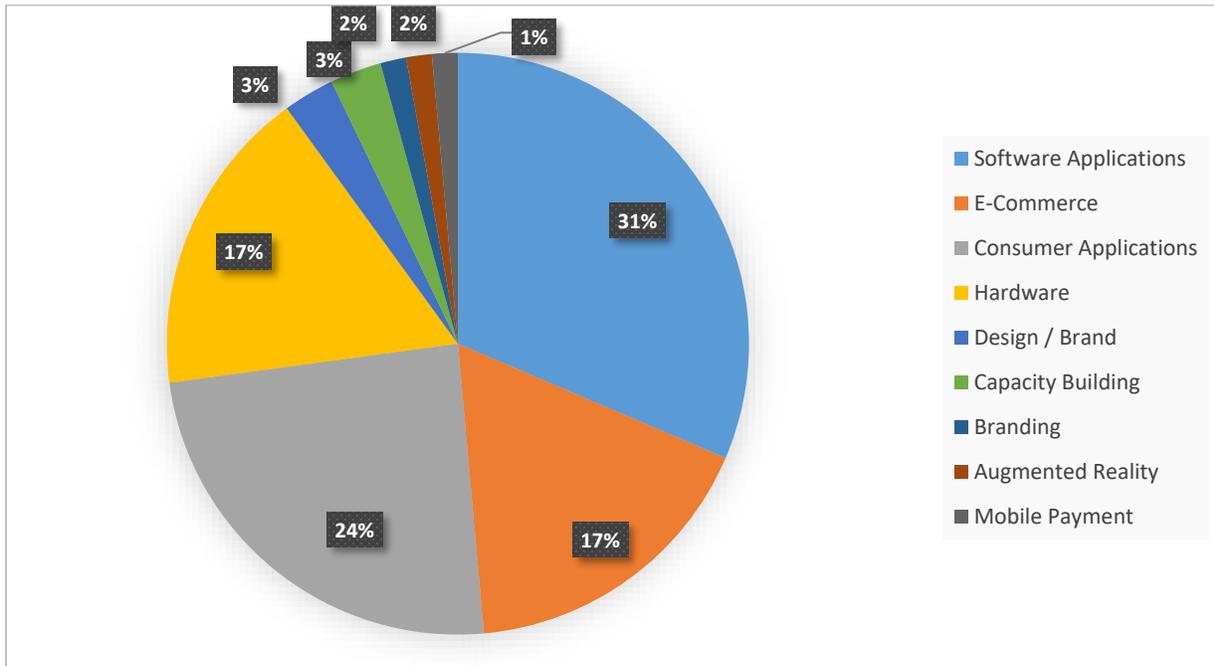


Source: BDL- Real Estate & Financial Assets Department, PC

On top of that, a sector distribution shows an additional \$ 180 million divided among software applications, consumer applications, e-commerce, and hardware topping the list with 31%, 24%, 17% and 17% respectively as shown in (figure 32). The average amount granted per individual start-up was around \$1,650,000 with a median of \$ 3,080,000.

With the prevailing economic turmoil due to the uprise of the October 17th revolution, most of the beneficiaries of article 331 started asking for extensions of the period of repayment based on the tremendous fall in turnover figures and the difficulty of finding the proper exit strategy. Start-ups with international exposure are performing relatively better but the hard-hit domestic operation is preventing them as well from any profitable exit and accordingly, article 331 successful story has to wait couple of months of years before reaching its happy endings.

Figure 32: Article 331- Sector Distribution



Source: BDL- Real Estate & Financial Assets Department, PC

2. Venture Capital Participation/ Financing

Barry et al. (1990) showed that venture capital backing influence investors' valuation of companies and presents a quality signal since they join the firm long before the IPO and hence their influence leads to lower underpricing. Jain and Kini (1995) found that venture capitalist-backed IPO firms showed relatively higher post-issue operating performance compared to non-venture capital-backed IPO firms. In addition, Krishnan et al. (2009) studied the effect of Venture Capital (VC) firms' reputation on the long run performance of IPO firms. This reputation is dependent on the IPO market share measured by prior successful IPOs during the last 3 years prior to the IPO year. This measure is computed as dollar market share of all VC backed IPOs in the preceding 3 years. They found that, more often, the lead VC tend to hold issuer shares and maintain board seats during the post-IPO period providing as such more support and guidance and affecting the post-IPO firm performance. This reaction is better understood in the context of loss of control by the VCs once their ownership is redeemed for common shares as a replacement for the existing ownership and controlling position. Nahata (2008) in its cumulative IPO market share, extending back to 1993

till date of going public, found positive relation between VC reputation and potential future IPO. Sorensen (2007) came to support this outcome by pinpointing that the reputable VCs tend to be more selective regarding their portfolio firms hence the higher success rate and the better performance observed. The VC's wealth will be concentrated in the firm's equity which again requires larger return on investment for the degree of risk assumed in this venture.

The VCs enjoys dual role as principals and agents. Their short term needs to reach satisfactory results for their investors with a proper exit strategy presents its agent role, whereas, their need to build their long-term reputation, in order to attract new funds in the future, ascertain their principal role. This contrasts with Business Angels (BA) who present more patient behaviour in the sense that they are not urged to exit quickly and hence they represent their own principal. Moreover, venture capitalists specialize in specific industries and help the firms in their management responsibilities and are able to provide valuable services in the form of third-party monitoring by preventing the investment in non-value maximizing activities and hence reducing cash flow difficulties (Jain and Kini, 1995).

The VC reputation was previously studied by Gompers (1996) based on VC firm age, by LEE and Wahal (2004) based on age and number or frequency of IPOs, by Gompers and Lerner (1999) based on capital under management, but Krishnan et.al. (2009) found the IPO market share to better reflect the long-term performance of VC backed IPO firms and that reputable VCs tend to excel in the market for firm with high R&D expense and CAPEX ratios. This success, in turn, attracts new entrepreneurs with potential business venture to this reputable VC and facilitates recurrent and higher future funding opportunities. Moreover, VCs with better reputation tend to discourage window dressing by relatively poor future prospects' companies in a way to maintain their future potential and credibility.

Arthurs et al. 2008, on the other hand, points out the opportunity costs borne by the VCs upon monitoring the floatation of their previous ventures as opposed to finding financing and funds for a new venture which will be translated into lower post-IPO performance. Furthermore, operating performance, witnessed smaller declines from the year prior to going public to the year following the public issue, but this is not evident in longer period post IPO.

Business Angels (BA) alternatively, are wealthy and successful individuals interested in long term ventures, hence the lesser need to sell the shares and more forward-looking objectives in the

management of the IPO scenario. Their commitment entails building a trust relationship with management and ensuring the good performance of the venture, mainly by retaining larger stake after IPO and bearing monitoring costs which ultimately mitigates agency costs and relieves public investors from any future conflicts (Politis, 2008). Hence, both VCs and BAs focus on creating value for the venture firms, but after the IPO, VCs focus will shift towards their own investors while BAs focus will remain on their IPO venture.

3. How to quit the 331

It has been always difficult to provide investors with viable exit strategies or options knowing their expectations and commitments to return capital over a time scale that is predetermined and short term in nature. Legal considerations and bureaucracy have to be accounted for when facing the decision of going all the way to public listing or just staying private and referring to public borrowing from the local markets. Moreover, the nature of the business dictates the choice since people usually like to invest their money in what they know and feel comfortable with. Sometimes, firms might be at a stage where they need additional financing, but existing investors, like venture capital firms or private banks, who have vested their money for six or seven years want to exit with no intention or ability of additional financing in the said company. As such, the company might structure a private placement by raising money from investors who usually invest in IPOs or public companies. This way, the company can work on its capital structure through the conversion of its shares into common shares and grasping the opportunity of relieving its balance sheet from any partnership or long-term loan that it might have from private or governmental entities.

Furthermore, with a low to moderate cash burn rate, the company can still attract external sources of financing while still being able to afford relatively low cost of capital. The cash burn rate is the rate at which a company is exhausting its financial resources and the rate at which a new company is spending its venture capital to finance overhead before generating positive cash flow from operations; it is a measure of negative cash flow. Burn rate is usually quoted in terms of cash spent per month.

When the funding requirements are relatively huge, internal sources of funding such as retained earnings would not be adequate and external sources such as equity or debt financing would be a better choice. Moreover, internal sources might limit the business growth opportunities while

external sources would help in its expansion. So, the possibility of public listing without the need of floatation would enable the company to generate funds that are needed to proceed with its strategic goals. But here again, most companies are relatively too small to attract external investors and only larger companies will benefit from their competitive size advantage to attract external investors in their quest for the proper exit strategy.

The company must always remember that the exit strategy that depends on external funding must be carefully planned and protected by an appropriate lock-up³⁵ period to promote credibility on the public market and show commitment towards external investors by the existing shareholders, as such, the management team/owners must discuss with the existing investors/lenders the optimal exit strategy as early as possible to avoid any last minutes unexpected surprises.

According to Mr Paul Chucrallah (PC 2019), Managing Director at Berytech Fund II³⁶, several scenarios were laid down during the negotiations period with the beneficiaries of circular 331. The business lines that were supported by the fund revolved around knowledge economy as circular 331 stipulated and in specific Information & Communication Technology and Digital Content, where the fund invested 20% to 40% into the capital of the target firm with participation ranging from \$150,000 to \$ 5 million depending on the target firm's potential. The possible exit strategies laid down ranged from:

1- A full buy back by the founder for the fund's share in the company based on a model formula to be applicable and calculated at the time of exit and based on the specific situation and feasibility of the proposal.

2- A treasury share buy-back where the firm, as an independent entity, buys the shares held by the fund and keep them on its book as treasury shares, as such, the original owner, who used to own 80%-85% of the 100% of the total shares of the company, owns now 80%-85% of the 90% of the total public shares, this anti-dilution strategy will enhance the position of the original owner.

³⁵ Lock up period is a contractual restriction preventing insiders who acquired shares of a company's stock before it went public from selling the stock for a stated *period* of time after it goes public.

³⁶ Berytech Fund II is a \$ 51 million Beirut-based Venture Capital Fund that received its funding mainly from major banks in Lebanon under the Circular 331 issued by the Central Bank of Lebanon.

3- A part of the overall merger and acquisition strategy (M&A), trade sale is when the firm is sells its product to a bigger and larger company and hence the purchased firm becomes a “subsidiary” of the purchaser.

4- Acquihire is when a large company acquires a relatively smaller firm or a start up mainly for the know-how and expertise of its staff, rather than for the products or services it supplies. The acquihire is usually done in order to sign in a talented engineering and product design team, especially when the small firm reaches a point in time where it becomes difficult to continue as a going concern. Moreover, this type of acquisitions, might stipulate the sale of the whole company and to keep the original owners to run and manage the company with minimum lock up period of 2 years after the acquisition.

5- Full scale acquisition. Worth mentioning here is that while mergers are generally friendly business transactions that result in the joining of two business entities together, acquisitions are generally more hostile in nature and may entail the dismissal of employees, owners, or other assets that the acquirer deems necessary.

6- Default represents the hardest of the exits, but it is part of the venture business risk that has to be factored in and calculated from the beginning of the business agreement.

7- Going public as an exit strategy is considered the ultimate scenario for a successful business, but it all depends on the capital market requirements and relative costs.

Therefore, Mr. Chucrallah stressed on the fact that any exit strategy cannot be decided and agreed upon from the start of the business venture, but rather it has to be planned and the general possibilities laid down and model agreed upon and the exit strategy will only be decided on the date of the exit and based on the firm's situation and the economic conditions prevailing at that time. Furthermore, he clarified that any deal that will be executed and set forth from the beginning of a venture deal regarding the exit strategy with predetermined and fixed outcome will be more like a loan agreement and should not be considered under the umbrella of circular 331 nor the venture capital funds business model.

According to Mr Joseph Aziz (PC Oct 15, 2019), who supports Investment Managers in due diligence and portfolio management at Cedar Mundi³⁷, several scenarios were discussed during the prospecting and contractual period with the beneficiaries of circular 331. The sectors that were supported by the fund revolved around knowledge economy as circular 331 stipulated and the current 10 firms in the portfolio of Cedar Mundi cover digital media, health tech, eCommerce, foodtech, and traveltech and the fund opted for an investment ranging from 10% to 25% in the capital of the prospective firms with participation ranging from \$1 million to \$ 3 million depending on the target firm's potential. The funding might start exceptionally with smaller amounts that will be increased later on to reach the minimum funding amount of \$ 1 million, once certain pre-determined KPIs³⁸ are met. The exit strategy that was discussed as the best option was the potential for a full-scale acquisition by a bigger company at a feasible price that will be deemed acceptable by all concerned parties. Therefore, the fate of the owners, the management and the employees will be taken care of on a case by case basis and depending on the possible negotiations between the acquirer and the acquired firm.

With the current situation of the capital market and with no specific pre-set or predetermined listing requirements in sight, the IPO exit option was never discussed nor proposed at this point in time. The fund dates back to 2016 and accordingly, being new in the market for start-ups, no beneficiary firm is showing any sign of probable risk of default.

Lastly, Mr. Aziz set forward some needed flexibility in article 331 when it comes to investment and operation of the target start-ups outside the domestic economy and the stringent red flags imposed by the central bank.

The Leap Ventures, a MENA focused venture capital fund was launched in 2015 at the ArabNet conference as a result of Lebanon's Central Bank Circular 331 initiative. "The fund's mission was to invest in the Lebanese knowledge economy start-ups through their growth phase up to large exit" according to its managing partner Mr. Henri Asseily. The Leap Ventures fund is headed by four of Lebanon's most seasoned entrepreneurs and angel investors in the tech sector with plans to invest on average \$3 million up to \$7 million in no more than 3 companies per year and for a 5-

³⁷ Cedar Mundi is \$ 44 million Beirut-based Venture Capital Fund with 25 % funding from Kuweiti IFA (international financial advisors) holding. It received its local funding from 11 major Lebanese banks under the umbrella of Circular 331 issued by the Central Bank of Lebanon.

³⁸ KPI: key performance indicator is a type of performance measurement.

year period securing as such large exits for the target companies. Leap Ventures aims at firms with a validated product and with a good penetration in a local market, known as series B, and tries to expand them into a regional or global dimension to become large enough to reach a proper exit strategy or grow to entail a second and bigger round of investment.

Mr. Asseily added “everybody was interested in doing seed funding, and barely series A”, stressing on the fact that in order to get an exit, market participants are needed at every single level of a company’s life cycle in order to push it forward. He also clarified that the average successful start-up in the U.S. is worth around \$243 million on exit with an average investment of \$41 million, which means the investment is one-sixth of the exit. Hence, he estimated that the MENA start-ups should expect a minimum of a \$30 million exit therefore requiring a minimum investment of \$5 million, therefore, Mr. Asseily asserted that if the market does not provide the required series B growth funding, it will be hard to get to an adequate exit (Wamda.com, 2015)

4. Electronic Trading Platform (ETP)

The Capital Market Authority of Lebanon (CMA) issued in December 2018 an RFP for the establishment and licensing of an Electronic Trading Platform (ETP). The CMA was trying to help provide a solution for some of the recent difficulties and troubles faced by Lebanese companies on one hand and the hurdles facing new start-ups on the other. Current and original owners of historical and established companies are looking for an exit or a way out of their businesses specially that they are now run by third generation that has different aspirations and different views regarding these businesses. Some companies are looking for cheaper sources of funding outside of the commercial banking atmosphere which is characterized by a high degree of indebtedness of the private sector (Zebian, PC). New start-ups are looking additional funding for expansionary purposes on one hand and for VCs exit strategies on the other, and this program might be the main exit route for start-ups that benefited from the circular 331. The system will be based on the Nominated advisor concept known as NOMAD that provides control, supervision and follow up for the start-ups (Safieddine, PC).

A new version of the electronic trading system, which is currently used by the EURONEXT, is going through some adjustments to be operational in the Amman Stock Exchange, Muscat Securities Market, Tunis Stock Exchange and Beirut Stock Exchange. This new upgraded version supports international features that aim to develop the trading operations and enhance the technical

infrastructure and improve the capacity of the electronic trading system (ETS), in addition, to the possibility of supporting new financial instruments.

The ETP will target different types of securities that are not targeted by the BSE and securities that can be dually listed on both existing markets. The ETP differs in that it provides access to domestic and international investors and the Lebanese Diaspora remotely and in a completely electronic mean. This new platform will ensure that an active financial market attracts the needed liquidity for the growth of different economic sectors, and provides a window to new sources of funding for SMEs and other firms operating in Lebanon (Safieddine, TV interview).

The ETP is intended for, but not restricted to, the following types of securities:

- * Government debt whether it is domestic currency treasury securities or foreign currency Eurobonds; this will provide better liquidity and transparency for this important product.
- * Listing of new companies whether it is equity or debt listing; this will introduce cheaper sources of funds and new ownership structure for the Lebanese companies and enhances visibility for the listed companies and attracts new investors.
- * Securitization and factoring will be introduced as different liquidity solutions for companies and new products for investors who are looking to diversify away from equity holdings and still enjoy the benefits of secondary markets liquidity.
- * Different types of derivatives can be introduced such as futures and options on commodities and foreign exchange.
- * Foreign exchange trading will be facilitated with the presence of market makers.
- * Potential for trading on different geographical locations linked through the ATHEX trading platform.

The consortium formed of Bank Audi Group³⁹ and ATHEX Group⁴⁰ won the bid on the 19 of June 2019 and will be responsible for the establishment and operation of the ETP on one hand and on working with the CMA to attract new equity listing and new securities listing on the other. The

³⁹ Bank Audi is a leading bank with presence in 11 countries across MENA region and Europe.

⁴⁰ The Athens stock exchange runs also the exchanges in Cyprus, Kuwait and Greece

platform is estimated to be up and running by the first quarter of 2020 (F. Safieddine, CMA, TV interview).

The consortium is expected to work on new capacity building schemes for corporations and prepare them to be IPO ready in terms of their financial structure's readiness and investors' attractiveness equally. For this Bank Audi and ATHEX intend to follow the Greek success story Roots program. Roots works with potential companies to communicate effectively and successfully their business proposal to investors and alleviate their chances to get the needed funding from the capital markets through the most appropriate tools.

Moreover, the ETP will operate according to international standards which facilitate the access and the inclusion of many foreign market members who are already using the same platform, ATHEX. The advantages of using the same platform will be translated through lower costs, better coverage of companies by specialists and wider and more differentiated access to funds and revenue generation environment. Furthermore, the platform will facilitate the access of retail investors with relatively small investable amounts and will create a liquid secondary market through the pledge to provide market making facility by the consortium.

VII- Summary and concluding remarks

The period from 1920 till 1975, the date of the breakout of the Lebanese civil war, was characterized by the absence of formal data on the Lebanese economy and only a handful of researchers and academics wrote on the capital market and its development. Information was found through stringent and deep research that had to be conducted going through multiple writing by the World bank, the UN and special reports collected from the Ministry of Foreign Affairs during the French mandate. Moreover, the period of the civil war marked the destruction of most of the official government offices and with it most of the data, pertaining to the financial and economic sector, was either burned and/or destroyed beyond any possibility of retrieval. This in turn posed a remarkable difficulty in collecting respective information to support the descriptive nature of some of the chapters of this work and in specific the historical data on the exchange rates, the banking sector and the public sector alike.

From the Ottoman rule, to the French mandate in 1920, Lebanon went through different economic statuses dictated by the forces of order until its independence in 1945. What was once an economy dependent on the Syrian economy, enjoyed at last, its independence and was engraved as the

“Merchant Republic”, an economy based on commerce and trade, that set Lebanon on the international trade map, away from the neighbouring countries. Lebanon’s elite group of economists paved the ground for a new independent Central Bank and a unique banking system characterized by its secrecy law that attracted the high net worth individuals from the oil rich Gulf region. Its capital market is the oldest in the region and was established in 1920 to host the French companies that were active in the country and the then mutually owned Syro-Lebanese firms. With the independence came the breakdown of the Syro-Lebanese economic ties and the introduction of more domestic companies on the floor of the Beirut Stock exchange within the context of a fully-fledged domestic currency, the Lebanese Pound and which also witnessed the gradual delisting of the French firms.

Over the years, the Lebanese economy went through vicious cycles, driven by a highly volatile economy reliant on expatriates and diaspora capital inflows rather than the productive sectors, and high levels of corruption and very hard fiscal challenges driving an unfavourable business environment. Despite witnessing intermittent periods of economic prosperity, the economic growth has been highly volatile. This volatility is influenced by the economy’s reliance on capital inflows that were channelled into the real estate, the banking sector, in terms of deposits, and the consumption sectors away from any productive use such as capital expenditure, in the industrial sector intended for future potential benefits. These inflows have been geographically concentrated in the GCC (Gulf Cooperation Council), which further influenced their volatility on one hand, and the critical reliance on external factors to boost the growth of the economy as a whole on the other. The standard deviation (volatility) of real GDP growth from 1992-2017, marked a level of 3.3% compared to 1.4% in France and Belgium and around 4.5% in Greece and Turkey which again reveals the similarity of the Lebanese economic situation to the latter examples and the possibility of expecting a downturn in the overall situation. With a growing public debt burden, standing at around 150% of GDP, Lebanon has the third highest debt to GDP ratio in the world, driven by continuous budget deficits by successive governments.

In an import oriented economy with scarce natural resources and more dependence on foreign products to boost and maintain the standard of living and the purchasing power of the citizens, the central bank (BDL) opted for pegged exchange rate in 1997 that is still maintained up to recent days, in spite of the continuous pressure from the government deficit that is pressuring the

sustainability of the foreign currency reserves that the central bank is trying to maintain dearly along with one of the largest gold reserves in the area under a unique system of pegged exchange rate. The balance of payment is, additionally, under constant pressure from a large deficit in the balance of trade and a decrease in the inflows from expats, whether directed to their family members or their personal saving or investment accounts.

Countries in the Middle East, North Africa and Central Africa are classified into three groups depending on availability of resources and labour abundance. Lebanon is among the resource-poor and labour-abundant economies and as such a comparative analysis was conducted to differentiate and distinguish among the stock markets of the region, on one hand, and the stock markets from selected developed countries of the world. The Beirut Stock Exchange is one of the smallest, in terms of number of listed companies, with only 10 listed firms with a total market capitalization of around \$9.6 billion as at end of 2018 representing almost 17% of GDP and paving the way for more potential for growth in the future.

Despite the stringent compliance requirements, ranging from Sarbanes Oxley to the MiFiD, most of the exchanges of the world are opting for more lenient and flexible listing requirements in a move to attract more of the SMEs that are gaining in market share and presence on all levels of the economy. This, in turn, has moved the world to become more of a global financial village with converging rules and regulations.

And in the absence of any serious measures or long-term planning capabilities of the government, the central bank found itself as the sole player in the market with the responsibility to boost the economy and provide all the necessary support for the productive sectors. From that stance, and in a country that lacks the existence of any natural resources, the BDL issued article 331, back in 2013, in a move to launch the technology sector in Lebanon by introducing monetary incentives for the commercial banking sector to provide direct financial and managerial support for start-ups in the knowledge economy. Furthermore, a new law privatized the national stock market and work is in progress to introduce a new sophisticated electronic trading platform in cooperation with the Athens stock market. This platform should help the narrowly controlled domestic firms to enlarge their financing sources by looking at the public market for longer term funding away from the traditional banking sources. This will enable the capital markets to develop and expand through growing capital demand and its early stages of development should concentrate on what is known,

in the financial world, as fast track state-owned enterprises listing and through debt markets, both sovereign and corporate.

The financial authorities should start working to create an official market for domestic securities, encompassing both debt and equity securities in a move to take advantage of Lebanon's cultural and legislative situation to attract international issuers and investors. The newly introduced exchange traded platform should be managed to offer sustainable financial instruments in addition to the opportunity brought forward in favour of existing family businesses. The SME sector that characterizes the majority of the businesses in the country should look at ways to benefit from the new platform in look into innovative securities that facilitates getting the appropriate long-term financing needs away from the traditional short-term banking loans.

As such, it is important to look at the structure of the Lebanese firms in order to check the readiness of the firms and the suitability of a capital market to provide and meet the financing requirements of the Lebanese business sector. The history and the management culture of the entrepreneurs/managers play an important role in the decision and the choice of the sources of financing, add to it the age and the size of the enterprises and their market behaviour.

Chapter Three: The Relationship Between the Pecking Order Theory and the Size, Age and Ownership Structure: An Empirical study of the Lebanese Enterprises.

The present work studies the applicability of the Pecking Order Theory in the case of Lebanese firms. Using empirical data, the results show that a modified Pecking Order is applicable, where firms depend in large part on internal funding and external funding is limited to short term loans from the traditional banking sector and to some degree trade financing from suppliers. Firms prefer to retain funds for future financing needs away from long term debt and equity financing. The behaviour of the Lebanese firms seems not to support the effect of the size and age on the choice of external financing and cannot be explained by these two variables the private ownership of the Lebanese firms provides management and owners a unique autonomy at the expense of a wide choice of sources of financing. The managerial autonomy and the limited and short-term tenor of the sources of funding come to describe the status quo of the Lebanese firms in the absence of an active capital market.

Firms of different sizes and maturity levels follow the same patterns in the choice of financing, where bank loans and credit from suppliers present the preferred choices of external source and equity is still a remote alternative.

I. Introduction

Corporate finance theories state that management should identify the most suitable capital structure that maximizes the firm value and may choose from many alternative sources of financing and may resort to external funding. The trade-off theory (TOT) sets the choice to allocate a firm's resources on the tax benefits of debt and hence a desired optimal debt ratio. The Pecking order theory (POT), on the other hand, concentrate on the fact that firms try to avoid external financing as long as they have ample internal financing and shun from equity financing whenever debt financing is in sight, hence, the POT sequential choice over funding sources. Debt maybe seen as

a cash flow commitment irrespective of the use of the funds and equity financing, though less stringent on the cash flow, leads to dilution of ownership and control.

The TOT theory is best suited in the literature of Modigliani and Miller (1958) where they assumed that capital markets are perfect and that taxes, agency costs and transaction costs are non-existent. Modigliani and Miller (1963) came to include taxation and the interest tax deductibility of debt with the accompanying benefit of using debt over equity and the positive effect of leverage in situation of relatively high tax rates (Miller, 1977). Jensen & Meckling, (1976) stated that the agency cost, emanating from the principal (owners) and the agent (managers) affect directly the choice of financing. The precedence of creditors over owners in instances of bankruptcy is at the core of the conflict of interest among them and hence the choice of the optimal debt ratio that will minimize the agency cost. In most SMEs, managers and owners are usually the same, accordingly the agency cost is reduced, but still show up due to conflicts between lenders and owners resulting from lack of information transparency (Cieply, 1997).

Myers and Majluf (1984) developed Pecking Order Theory (POT) stemming from the asymmetry of information between internal stakeholders and external providers of the firm. They revealed the fact that owners/managers try to minimize this asymmetry of information through their preference in their choice of financing on internal financing rather than external financing. The POT, hence, assumes a hierarchy in firms' sources of financing starting with self-financing, relatively low risk debt issuance, risky debt issuance and equity issuance as a last resort.

In spite of extensive amount of theoretical and empirical studies on this subject, there is no consensus in the literature on the magnitude to which POT is able to explain the financing behaviour of firms, as suggested by Shyam-Sunder and Myers (1999), and the predictive power of this hypothesis has not been evidenced to be completely comprehensive to alternative explanations (de Jong et al., 2011; Leary and Roberts, 2010; Fama and French, 2005; Frank and Goyal, 2003). Ang (1991) and Holmes and Kent (1991) pointed out that POT applies to SMEs as they tend to reveal their inclinations toward internal financing rather than external financing and they prefer debt over equity. SMEs do not target an optimal financial structure and they might wish to borrow when their funding needs exceed their available internal cash flow, even though this tends to affect their credit relationship. The costs are minimal in case of internal funds, and relatively higher for

new equity issuance and debt costs lie in between. The objective of SMEs managers/owners is to maximize their own wealth, while maintaining control over decision making. Therefore, they tend to prioritize internal funds for financing and in cases of deficient internal of cash flows, they favour debt rather than increasing their capital.

According to Myers & Majluf, (1984), the POT asserts that firms prefer internal to external funds and they seek debt funding first and they shift to equity when faced with limited credit availability. Moreover, when companies enjoy surplus conditions, the theory states that debt will be repaid in order to circumvent the information asymmetry hitches (Myers, 2001). On the other hand, it is argued that if managers have better information than investors, it is better to issue debt than equity (Myers and Majluf, 1984, Kester 1986).

Private ownership is characterized as an operation without market listing with concentration of ownership and control lying in the hands of small number of investors, the owners/managers of the firm. Insider investors tend to limit the use of equity in order to retain control of the firm (Hutchinson, 1995). As such, firms tend to depend more on debt than equity for their external financing needs and thus, most of the firms follow a modified POT with threshold drawn on the edge of the equity capital markets. Mackie Mason (1990) asks the question; “Do firms care who provides their financing?” His result revealed the importance of asymmetric information in pushing firms to care about the provider of funds (public or private debt) since the nature of the fund providers requires different access to information about the firm and the ability to monitor its behaviour.

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding, which will be discussed and validated in chapter two and three.

H2: The Lebanese firms follow a modified POT due to their peculiar corporate structure and the status of the capital markets, which will be discussed and validated in chapter three.

In this chapter, we study the choice of financing of the Lebanese firms. The structure of the firms in Lebanon is dominated by closely run businesses that are managed by second and third

generation owners who prefer to depend mainly on internal sources of financing to fund their working capital needs and their capital expenditure requirements. The study did not concentrate on the family business status, but rather on the behaviour of the Lebanese firms in general and their behaviour and their financing decisions and preferences. To track the financing hierarchy of firms, the Pecking Order Theory has been tested across a sample of 161 enterprises in a daring quest to check the validity of the POT in explaining the financing behaviour of the Lebanese enterprises with possible outcomes and recommendations for a smoother and cheaper funding alternative. We reached 560 firms and obtained 161 responses to our questionnaire. We present nine characteristics (age, size, revenue domestic and international, debt level, internal funding, external funding (suppliers' credit and bank credit), sources of long term and short-term financing, initial public offering (IPO) likelihood, and ultimate owner (s)) that describe the firms in our sample.

Firms showed alternative source of capital with mean percentage ranked from high to low. The choice of Internal funding ranked first with a mean of 58.76% followed by commercial banks (23.83%) and credit from suppliers (17.4%), while other sources of funds such as private equity/venture capital (PE/VC) (~ 1.5%) and new equity (0% in the last 25 years) are relatively irrelevant. This finding implies that firms behave in a way that can be explained by the pecking order theory.

To the best of our knowledge, this is the first study to investigate the relevance of the Pecking Order Theory in the Lebanese firms' context. The following text attempts to assess the likelihood of following the Pecking Order Theory in the Lebanese firms financing decisions and the applicability of such a theory on the choice of funding at different stages of the life of the enterprise in Lebanon. We start by a definition and a characterization of the SMEs environment and then placing the Lebanese enterprises in this context. The POT testing starts with a literature review in section two, data and methodology have been explained in section three. Empirical evidences have been discussed in the fourth section. The last section enumerates the concluding observations and paves the way for future research.

II. SMEs, Definition and Characteristics

Small and Medium Enterprises (SMEs) are considered an important source of employment and income, competition and innovation. They fuel the entrepreneurial culture and skills and contribute

to a better income distribution than large firms because they are more scattered across geographical areas (Panitchpakdi, 2006). SMEs are viewed as a bridge between the informal economy of family enterprises and the formal corporate sector. A report from Oliver Wyman (2014) has estimated that “successful SME capital markets can add up to 0.1% to 0.2% uplift in the contribution of SMEs to overall GDP each year, while supporting the creation of hundreds of thousands of new jobs globally” (p. 8).

The size and the definition of firms can be determined based on the country, on the number of employees, on annual sales turnover, on assets value or a combination of any of the aforementioned. This definition can be different from one industry to another depending on how the respective authorities see it fit leading as such to no universal agreement on what qualifies as SME. Having a standard SME definition makes collecting data and analysing statistical information about businesses easier.

Tables 5 and 6 illustrate comparable tables regarding employment and turnover of the SMEs sector's definitions in some of the countries in order to pinpoint the relative importance of the SMEs sector in Lebanon. Most of the definitions converge when it comes to what can be considered as micro, small, medium and large enterprise in terms of number of employees with the exception of china where the size of the enterprises is relatively large compared to other countries and as such the definition of SMEs differs accordingly.

Table 5: SME Definition by Employment Size (ES)

	Micro	Small	Medium	Large
Lebanon	<10	<50	<100	
European Union	<10	<50	<250	>250
United States	<10	<50	<500	
China	<100	<300	<1000	>1000
Japan		5< ES < 20	100< ES <300	
Canada	5	50< ES <100	<500	>500
UAE	9< ES <9	35< ES <100	75< ES <250	
KSA	<2	3 <ES <49	50< ES <200	

Sources: Compilation from SMEs country reports, OECD

Table 6: SME Definition by Turnover Size (TS)

	Micro	Small	Medium	Large
Lebanon	<LBP500m	<LBP5B	<LBP25B	>LBP25B
European Union	<€2m	<€10m	<€50m	>€50m
United States			\$7< >\$27m \$7 < TS< \$27m	
China	<RMB 100m	<RMB 300m	<RMB 400m	>RMB 400m
Japan		N/A	¥50< TS <300m	
Canada		N/A		
UAE	AED9<TS <10m	AED50< TS<100m	<AED250m	
KSA	<\$27,000	\$27000< >\$1.3m	\$1.3m<TS <\$13.3m	

Sources: Compilation from SMEs country reports, OECD

In the U.S. as shown in Table 5, SMEs in the manufacturing sector are defined as having less than 500 employees that differs from the definition in the wholesale trades where it is less than 100 employees (NAICS⁴¹). Canada, in turn, uses the 500 employees' threshold to differentiate between large and medium enterprises with small firms revolving around the 50-100 employees based on whether the firm is a goods-producing or service-based business (Key Small Business Statistics, 2021). The European Union, on the other hand, adopts the 250 employees cut off to differentiate medium from large firms with 50 and 10 head count for the small and micro definition, respectively as per the European Commission, (User Guide to the SME Definition, 2020). United Kingdom follows the EU definitions and China breaks down the SME definitions by sectors and industry

⁴¹ NAICS: The North American Industry Classification System.

types and revolves around 300 to 1000 headcount average with 100 to 400 m RMB average revenue.

A. SMEs Business Constraints

The International Finance Corporation (IFC) showed, in a 2010 study, that in emerging economies, the majority of firms fall under the micro segment with around 65% to 75% of total enterprises with small and medium firms representing 20% and 5%-10%, respectively with large corporation trailing behind at 1%. Furthermore, the Asian Development Bank (ADB), in its 2014 publication, showed that SMEs constitute an average of 62% of national employment and around 42% of Gross National Product (GDP) of Asia and Pacific countries compared to 33% in developing and 45% in high-income OECD countries (OECD, 2014).

The development of feasible and capable SMEs is deterred by numerous constraints that may differ from region to region, between rural and urban areas, between sectors, or among individual enterprises within a sector. However, there are some constraints that are common to all SMEs.

The lack of clear policy and legal framework presented an obstacle facing the development of the SME sector across countries. SMEs find the processes and bureaucratic procedures for registration, licensing and permits difficult and demanding which in turn results in high cost of compliance and low productivity. This fact is aggravated by the complicated tax administration and corruption resulting from weak governance, weak contract enforcement and lengthy court proceedings. The aforementioned in turn renders the costs of starting and operating very high and as such pushes the majority of SMEs into working in the informal sector, outside the scope of the government reach (ADB, 2018). Moreover, the absence and weakness of financial infrastructure and markets, as identified by the Asian Development Bank, lead to another obstacle facing SMEs. Making things worse, these are capped by the SMEs' lack of access to business development services in the form of capacity building, adequate business training, advice, access to markets and enhancement of competitiveness and profitability. Furthermore, some important variables like insufficient capital, competition, anti-entrepreneurial culture and technological barrier/backwardness affect the potential growth of SMEs. Hence, SMEs need to plan, design and implement strategic training programs in order to provide them with adequate entrepreneurial knowledge, skills and attitude.

B. SMEs Financing Constraints

SMEs are directed towards narrow debt financing and shareholders' loans as the sole source of capital financing when faced with existing taxation policies and granted subsidies. This creates a capital mismatch between volume and type of collateralized debt on one hand, and possible long-term free unconstrained equity financing. Moreover, the aforementioned aggravates by the lack of financial instruments and professional investment banks to lead the underwriting process leading to equity financing. From the legal perspective, frail creditor protection with low recovery rate and long court procedure lead to the imposition of detrimental collateral requirements.

SMEs also face restricted access to bank credit creating as such a large credit gap that results from the inadequate financial documentation and collateral requirements on one side and the relatively high and detrimental interest rates and the time-consuming loan approval procedures. According to the World Bank (2013), 20% of SMEs in the Middle East region have a loan or line of credit contributing accordingly to only 10% of their capital expenditures which in turn put limits on firms' working capital and restricting their expansion.

Equity financing presents itself as a good choice for an entrepreneur with a promising business and facing the unlikelihood of having sufficient collateral to justify a loan. This path can also be appealing whenever a business is looking for investors to share the risk and help the business grow by relying on the relative expertise and available business networks.

Hughes (1993) notes the following smaller businesses' characteristics depicted in Table 7.

Table 7: Smaller businesses' characteristics

- | |
|---|
| <ul style="list-style-type: none">(a) lower fixed to total assets ratios;(b) a higher proportion of trade debt in total assets;(c) a much higher proportion of current liabilities to total assets with much greater reliance on short term bank loans to finance their assets;(d) are heavily reliant on retained profits to fund investment flows;(e) obtain the vast majority of additional finance from banks with equity being less important; and(f) are financially riskier, as reflected in their relatively high debt-equity ratio and in their higher failure rates. |
|---|

Source: Hughes, 1993

The facts depicted in Table 7 can also be explained by the Pecking Order Hypothesis (POH), or simply Pecking Order Theory (POT), of Myers and Majluf (1984), known as ‘large firm analysis’. The POT affirms that facing a state of asymmetric information, firms will opt for finance sources in a particular order that minimizes ownership dilution which entails that internal sources (trade debt and retained profits) are utilized first, followed by bank debt and then outside equity. Hence, one should expect that smaller firms have higher dependence on bank and trade debt than large, in their earlier stage of financial evolution. As such, they would rely on retained profits as the main source of new equity, with new owners only adopted as a last resort, in line with Hughes’ evidence. Furthermore, the high proportion of short-term bank debt is likely to reflect small firms’ lower growth potential, as the ability to raise external equity depends on the capital gain expected for the outside investor. Hence, debt in the form of overdraft facilities is solely requested to cover working capital needs. Generally, small firms do not wish to grow beyond the level of survival in their chosen industry and may grow to the level needed to maintain the managers' lifestyle (Cressy et al., 1996). The financial constraints are also viewed as a supply constraint in the form of bank credit rationing and demand constraints in the form of abstention of owners to relinquish and give up control and hence renounce to ask for funds for growth but rather go for debt financing.

III. SMEs in Lebanon

Lebanon is a small country with a small economy and a GDP that does not exceed \$60 billion and accordingly the enterprises are relatively small and characterized by being family owned and closely held with limited number of employees. Some firms that went international in their operations might at some point be able to employ a larger number of employees just to cater for this international presence and meet any production requirements.

A. Definition

Lebanon lacks a formal definition for small and medium enterprises and according to recent study approached to Ministry of Economy and Trade (MoET), (Lebanon SME Strategy, 2020), and after collection of information on the nature of SMEs, a proposed definition revolves around a combination of annual turnover and number of employees in the following context:

- Micro: Less than LBP 500 million and less than 10 employees
- Small: Less than LBP 5 billion and less than 50 employees
- Medium: Less than 25 billion and Less than 100 employees

With this definition in mind, SMEs in Lebanon represent around 95% of the overall enterprises in the economy with the highest concentration being in Beirut (the Capital) and Mount Lebanon followed by the Beka'a (Eastern Lebanon), the South and the North regions.

The Central Bank of Lebanon (BDL) defines SMEs as enterprises with less than LBP 15 billion in annual turnover (Lebanon SME Strategy, 2020) and Kafalat (p.11) defines SMEs as having less than 40 employees. As for the Ministry of Finance, an enterprise must meet both turnover and employee threshold to be considered in a particular category, for example, a medium enterprise should have between 50 and 100 employees, and an annual turnover between 5 and 25 billion LBP (Finance.gov.lb).

The challenges faced by the SMEs in Lebanon are looked at from multiple aspects ranging from culture to capital requirements to legal and industry requirements and finally to national level comprising labour and financial markets.

From the cultural side, the owner manager mentality is difficult to change and shows limited eagerness and willingness to introduce a well-defined level of corporate governance that can be freely implemented. This inherited culture with its valuable extended control causes the owners to keep their capital base closed to outside opportunities. Moreover, Lebanese business owners often assign high importance to unrestricted control over their companies at the expense of neglecting the potential for higher profits and the possibility of finding the probably cheaper and most efficient form of financing from the stock market. As such, many SMEs keep their capital base closed to outsiders and prefer to remain closely-run businesses rather than publicly-owned corporations.

B. Type of incorporation

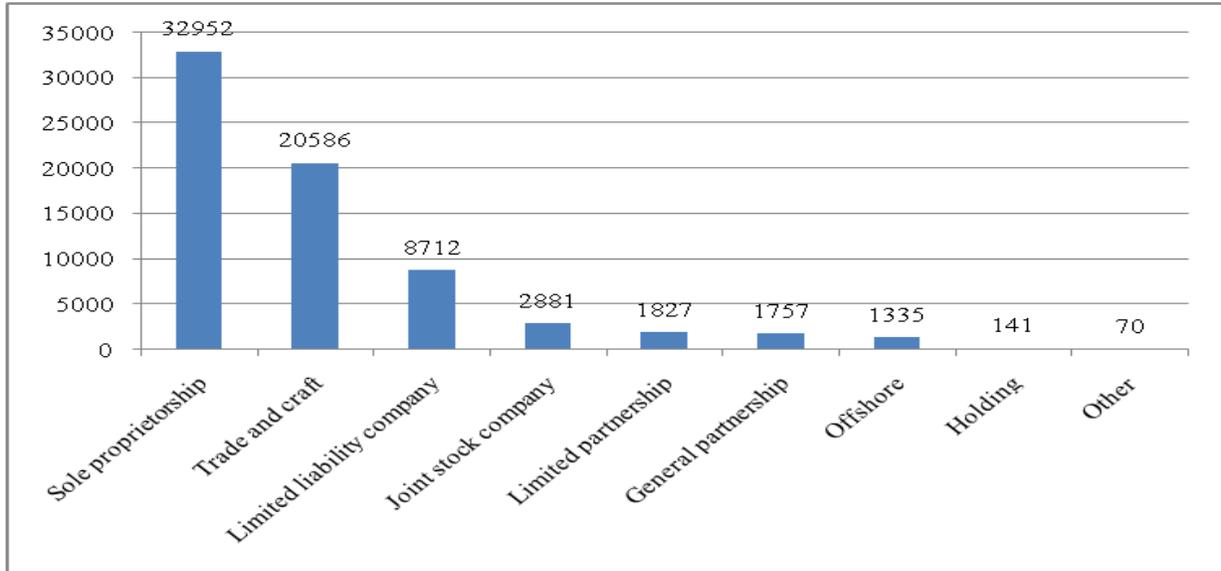
Table 8 shows a breakdown of the different types of legal incorporation of business entities in Lebanon. Moreover, Figures 1 and 2 show a breakdown of the business entities in Lebanon based on different types of legal incorporation out of around 70,260 entities collected data by the United Nations mission to Lebanon (2014).

Table 8: Types of Legal Incorporation

Type	Decree/Law	Ownership	Capital	BOD	Special
Joint Stock Company	Decree-Law No 304 of January 24, 1942 and its amendments	negotiable instruments referred to as 'shares'	<ul style="list-style-type: none"> Capital: minimum of LBP 30,000,000 divided into negotiable instruments, the shares Shareholders: minimum of 3 	Board of Directors: 3 to 12 members	All board members must own a minimum number of shares
Limited Liability Company	Decree-Law No 35 of August 5, 1967 and its amendments		<p>* Capital: minimum of LBP 5,000,000 composed of social parts</p> <p>* At least three partners, may range between three and twenty partners</p>	managed by one or more managers who may not be partners	
Holding Company	A special type of Joint Stock Company * Decree Law No 45 of June 24, 1983, & its amendments	negotiable instruments referred to as 'shares'	<ul style="list-style-type: none"> Capital: minimum of LBP 30,000,000 Shareholders: minimum of 3 	Board of Directors: 3 to 12 members	
Offshore Company	A special type of Joint Stock Company * Decree Law No 46 of June 24,	negotiable instruments referred to as 'shares'	<ul style="list-style-type: none"> Capital: minimum of LBP 30,000,000 Shareholders: minimum of 3 	Board of Directors: 3 to 12 members	can operate only in the Lebanese free zones or abroad

	1983, & its amendments			
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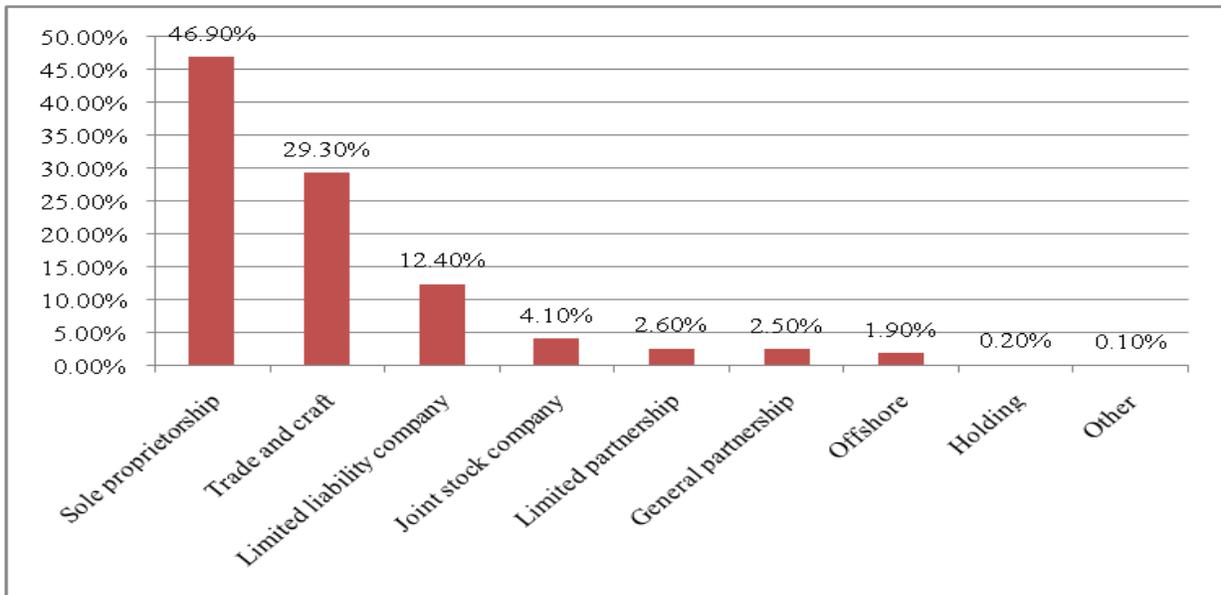
Figure 33: Number of Firms as Per Type of Incorporation



Source: Chamber of Commerce Industry and Agriculture of Beirut and Mount Lebanon, 2014

Source: Inference from UNDP Project for Lebanon, 2014.

Figure 34: Percentage of Firms as Per Type of Incorporation



Source: Inference from UNDP Project for Lebanon, 2014.

C. Landscape

According to the GEM (Global Entrepreneurship Monitor) Lebanon National Report 2018, Lebanon ranked fourth globally (among 49 world economies), and first within MENA, in terms of the level of Total Early Stage Entrepreneurial Activity. In 1971, 72.7 percent of all establishments employed less than 5 workers, compared with 24.6 percent which employed between 9 and 25 workers, and 2.7 percent with more than 25 workers (UNDP, 1997). Nowadays, 73 percent of all establishments employed less than 10 workers, compared with 20 percent which employed less than 50 workers, and 3.5 percent with more than 100 workers and another 3.5% with more than 100 workers (MoET, 2014). SMEs comprise over 95% of total businesses in the economy with more than 50% of the registered employees and roughly 90% of the total workforce in Lebanon with 80% concentrated in the area of Mount Lebanon and greater Beirut. (UNDP, 2014). Furthermore, the majority of the enterprises are found to be concentrated in the wholesale, retail trade and repairs sectors, followed by manufacturing and real estate, renting and business activities come in the third place in terms of total turnovers (UNDP, 2014).

D. Financing and Support Atmosphere

Table 9 introduces some of the existing and the most important companies that provide support to the SME sector in Lebanon. They are selected based on the fund they provide and the stage at which they intervene to provide the necessary support to the SMEs, whether it is at the financial level or at the management level. Each of the SME financing entity is unique in terms of the sectors and industries that they cover, the level of financing that they provide and the stage of financing needed that they provide. Some of them prefer to stay as a business angel, some of them will provide venture capital and some of them will help in seed financing and crowd funding.

Table 9: SME Financing Companies in Lebanon

<p>Berytech Fund II is a 51 million US Dollar Beirut-based Venture Capital Fund. The funds were received from major banks in Lebanon under the Circular 331 issued by the Central Bank. The Fund's objective is to invest in small and medium-sized Lebanese enterprises with high growth potential, high human added value and that fall in the scope of the knowledge economy.</p>
<p>Founded in 2005, the EuroMena Funds (part of the Capital Trust Group) is one of the MEA region's leading private equity firms specialized in emerging markets with a track record of successful investments. With over a decade of experience in the MEA region, the EuroMena Funds has invested more than \$350 million dollars across three private equity funds</p>
<p>LIBANK is a hub for high net worth individuals, families, and institutions that seek exposure to quality advice, deposits, custody, and asset allocation. LIBANK's presence is concentrated in Beirut and London, with an international client base across the Middle East, the UK, Europe, and Latin America.</p>
<p>Cedar Mundi aims to build a corporate driven innovation network advocating Lebanon as a tech hub for best-in-class start-ups under the guidance of the Banque du Liban and to provide them with the ultimate support in growing and expanding into international markets.</p>
<p>Lucid Investment Bank SAL is regulated by the Central Bank of Lebanon under license #142. Lucid was previously regulated as a Financial Institution in Lebanon since 2012. Originally, it was established in 2003 as a specialized corporate financial advisory firm offering high-end financial advisory. Lucid's mission is to guide high net worth investors and their subsidiaries to growth through its combined private banking and investment banking platform.</p>
<p>The iSME Programme is a US\$ 30 million initiative funded by the Government of Lebanon through a loan from the World Bank. The programme aims to encourage the equity investment market to increase early stage investment finance for financially viable, new, and existing innovative firms. The iSME fund will only make equity investments in companies alongside an approved investor who is also providing new equity. The iSME facility can provide second and third round of co-equity financing with an approved Investor Partner</p>
<p>Phoenician Funds, founded in 2015, is at the heart of thriving capitals of digital innovation and start-up ecosystems in the Middle East and North Africa Region. The team includes seasoned advisors, devoted problem solvers and serial entrepreneurs, who share a passion for technology and proactively seek opportunities in sectors that are ripe for disruption. The team actively supports founders to co-shape successful ventures in the early stages of investment, and create value across the investment life-cycle. Phoenician Funds provides strategic guidance, market access and insights, linkages to proprietary networks as well as proven execution capabilities to drive long-term success of our portfolio companies.</p>
<p>B&Y invests in visionary and high-impact founders aiming to create new markets or transform existing ones. B&Y believes that success comes from building strong and supportive relationships with the entrepreneurs we back. B&Y's team has a history of success as both investors and</p>

founders and can provide value to our portfolio companies through resources, mentorship and an extensive global network of connections. B&Y invests in start-ups across 2 stages: seed and growth.
Insure and Match Capital (IM Capital) provides Matching Capital, Equity Guarantee, and Support Programs to a broad range of qualified early-stage business and investors in Lebanon. IM Capital provides Qualified Investors (angels and institutions) with a partial guarantee on investments in Early-Stage Businesses and on Venture Capital Syndicated Pooled Investments, thus mitigating associated risks and encouraging increased capitalization.
Leap Ventures is a tech-focused entrepreneur-led venture capital firm that operates in MENA and Europe. At Leap, we seek to actively partner with entrepreneurs with innovative ideas in order to quickly accelerate and scale their vision and operations globally. Leap's value-add platform and extensive international network provide entrepreneurs with the tools to sharpen their technology edge, develop their customer base, recruit top talent, and structure their operations in order to heighten their ability to face hyper growth.
MEVP is a Middle East-focused venture capital firm that invests in the early and growth stages of innovative companies run by talented entrepreneurs primarily, but not exclusively, in the Middle East Region with a focus on the GCC and Levant countries. The MEVP group operates from a number of jurisdictions including Dubai and Beirut.
Zoomaal is a crowd-funding platform that supports creative projects in the Arab world to get funding for their work. Using crowd funding to collect the funds, project owners no longer have to get loans or provide equity to fund their projects. In addition to the funding, projects get a lot of exposure throughout the process. Project owners, backers and sponsoring companies benefit from crowd funding. Individuals who back projects will benefit from the rewards that offered by project owners.

Source: Ministry of Economy and Trade, Lebanon, 2018

Most of the support to SMEs comes in the form of financing solutions for new production capacity or maintaining current production and some loan guarantees supported by the European Union, in addition to management support, mentorship and training services. These services are provided by some local and international entities as per Table 5 that sheds the light on some of the most prominent supporters of the different SME sectors in Lebanon.

Moreover, seed, venture capital and private equity for start-ups and SMEs are also available through the above-mentioned network of companies. As such, SMEs face the choice of an equity financing solution depending on several factors including the type of the business and respective sector and the value of the required investment. In addition, the Central Bank of Lebanon (BDL) issued Circular 331* in August 2013, introducing a new financing scheme that encourages and allows banks to invest in the capital of start-ups, accelerators and incubators. Banks wishing to finance such companies will benefit from interest free loans from the Central Bank.

Furthermore, a new Capital Market law was passed and a new Capital Market Authority was established in 2011 to facilitate the SMEs access to fresh capital to proceed with their evolution and growth and encouraged also by the government through tax incentives on dividends (50% reduction) and income tax breaks (2 years if 40% of shares are listed) when listing. Despite these efforts, Lebanese capital markets did not take off and remain largely burgeoning today.

IV. The Pecking Order Theory (POT) and its Application to Lebanon?

Donaldson (1961) is credited as the first who advocated the Pecking Order Theory. POT outlines the most selected financing hierarchy – internal funds, debt and equity. Generally, firms prefer internal funds to external funds and debt issues to equity (Myers, 1984; Serrasqueiro & Caetano, 2015). The Pecking Order Theory states that there is an order of preference for the firm regarding the capital sources when funding is needed. The firm will seek to satisfy funding needs in the following order: internal funds and then external funds in the form of debt first and equity last.

Shyam-Sunder and Myers (1999) stated that, in a simple Pecking Order Theory, firms will issue debt, only, when the internal cash flows are not plenty enough for the firm's investments and dividend obligations; external equity is, therefore, issued as a last resort. Myers and Majluf (1984) clarify that there are costs related to equity issuance such as transaction costs and cost of asymmetric information, which leads to this hierarchy in the choice of the sources of financing. They indicated that it is better to issue safe securities than risky securities and in the same context, when managers have private information about the value of a firm, investors will, ultimately, discount the price that they are willing to pay for equity due to adverse selection (Berk, 2007). Once the managers think that outside investors will under-price the equity of the firm, they will follow this source of financing hierarchy. Therefore, managers prefer to fund investments by using internal finance like retained earnings, then debt and as a last resort issue equity (Myers, 1984). Lemmon (2010) amended the model of Shyam-Sunder and Myers (1999) and disclosed that it is important to control for debt capacity. They established that firms prefer debt to equity when external financing is necessary.

If external finance is required, firms usually issue the safest security first. As such, they will start referring to debt and credit from suppliers, then fixed income securities such as short-term papers or long-term bonds, and ultimately, they might depend on equity as a last resort. Facing the

presence of two equity sources, internal at the core of the Pecking order, and the other external, at the bottom of the Pecking order, and with no specified ratios, firms work around their debt ratio based on the emerging need and urgent requirement for external finance. Firms prefer to retain earnings or internal cash flows because their first priority is to fund all projects. Where funds are inadequate, debt is preferred because it is relatively a cheaper source of finance. The last resort is Equity (Myers, 2001; Briozzo et.al., 2016).

Firms prefer internal finance, but with the variations in profitability and investment opportunities, the internally generated cash flow may exceed and sometimes fall short of the needed funding and hence present the case for external financing. Accordingly, if external financing is required, firms usually issue the safest security first. With that in mind, they start with debt, then bonds and ultimately, they might refer to equity as a last resort. Many proponents of “managerial capitalism” have inferred that firms' reliance on internal financing is a result of the separation of ownership and control where managers evade relying on external financing because it would subject them to the discipline of the capital market (Myers, 1984).

Pecking Order Theory, modified by Stewart Myers and Nicolas Majluf in 1984, states that managers follow a hierarchy when considering sources of financing. According to the pecking order theory, there are three factors that the theory is based on and that are considered by firms when raising capital. Internal funds are cheapest to use (no issuance costs) and require no private information release. Debt financing is cheaper than equity financing. An argument could be made for internal financing to avoid issue costs, and if external finance is needed, for debt to avoid the higher costs of equity. Nevertheless, issue costs in themselves do not seem large enough to override the costs and benefits of leverage emphasized in the static trade-off story⁴² (Kraus, 1973).

In the case of closely held companies and due to the concentrated ownership structure and the substantial degree of control over the firm by each shareholder (Mayer and Alexander, 1991), the cost of issuing equity, and in specific the cost of giving up control over the firm, is higher for closely held companies than it is for listed companies (Brav, 2009). In addition, private firms show a relatively higher information asymmetry among the insiders and the outsiders when raising

⁴² The static tradeoff theory of optimal capital structure assumes that firms balance the marginal present values of interest tax shields against the costs of financial distress.

capital compared to public firms. Hence, non-listed companies are less likely to raise capital externally and in order to avoid high agency costs accompanying the equity issue, private firms choose internally generated finance over external one.

Therefore, POT suggests that the firm will first use internal funds. Hence, more profitable companies will have less use of external sources of capital and may have lower debt ratios. Once the internal funds are exhausted, then the firm will refer to issue debt, with no specific levels identified by the theory, until it has reached its debt capacity, and only at that point will the firm decide to refer to issue new equity.

On the other hand, managers tend to know more about the future performance of the firm than lenders and investors. Because of this asymmetric information, investors may make inferences about the value of the firm based on the external source of capital the firm chooses to raise. Company's choice of finance, therefore, sends some signals in the market. If a company is capable of financing itself internally, this is considered a strong signal. It actually shows that the company has adequate reserves to handle its funding needs. Moreover, if the company issues debt, it indicates that management is confident and it can meet its fixed payments. But if the company finances its needs with stock offering, this relays a negative signal to the market and here the company that issues new stock is generally perceived to have a relatively overvalued stock and the management is looking to generate financing by diluting shares in the company.

According to Harris and Raviv (1991), and in the context of the pecking order theory, firms present greater asymmetric information problems in the absence of tangible assets that can serve, obviously, as collateral. Accordingly, collateral is associated with an increase in leverage. On the other hand, large firms are more diversified. They enjoy better reputations in the debt markets, and present lower information costs when borrowing. Therefore, large firms expect to have more debt as part of their capital structures.

Furthermore, according to the pecking order theory, large firms face less adverse selection problems and therefore issuing equity is easier (Frank and Goyal, 2003). Following Frank and Goyal (2003), there is more support for the pecking order expectation for small firms.

POT states also that firms prefer to issue debt rather than equity if there is insufficient internal finance and equity is raised as a last resort. Blanco et al. (2007) found evidence of a Pecking Order in financing closely held firms, where debt instead of new equity is preferred whenever additional

external financing is pursued. Furthermore, POT predicts that high growth firms typically with large financing needs will end up with high debt ratios because of a manager's reluctance to issue equity. This suggests that short-term debt is exhausted before the firm issues long-term debt.

Looking at another aspect, Ezeoha and Botha (2012) demonstrate that there is a theoretical uncertainty in the relationship between age and debt financing and few studies indicate a positive correlation between age and debt financing. Investigating the life cycle of small business firms, Berger and Udell (1998) indicate that as firms grow they tend to rely more on debt and relatively younger firms use less debt. Old and profitable firms benefit from the availability of more internal funds than debt (Booth, Aivazian, Demirguc-Kunt, & Maksimovic, 2001) and they have more cash funds available. This category of firms prefers internal to external funds in their financing needs. They, as such, follow the pecking order more than young firms (Bulan and Yan, 2009). This can be explained by the fact that these old firms enjoy better credit relationship with their lenders which, in turn, decreases their cost of debt (Bernasconi, Marenzi, & Pagani, 2005), whereas young firms, they endure more financial constraints (Carpenter & Rondi, 2000). With their good reputation, older firms present less adverse selections and moral hazard problems (Petersen & Rajan, 1994).

In the context, small firms, who face limited access to the capital markets, were found to use more trade credit when credit from financial institutions is inaccessible. Suppliers, in their quest for business, lend to these stressed firms with blatant information about the buyers and the ability to easily liquidate assets (Peterson, 1997). "Trade credit is a legally binding agreement between two business partners in which the buyer can purchase goods or services on account and pay the supplier at a later date, i.e. a short-term loan to a buyer provided by a supplier" (Cuñat and Garcia-Appendini, 2012). Hence, short-term debt positively influences trade credit. Specifically, as trade credit seems to complement existing short-term debt, it might replace long-term debt. The importance of trade credit is highlighted by Kohler et al. (2000) stating that 55 per cent of the total short-term credit received by UK firms during the 1983-1995 period was in the form of trade credit.

As mentioned, a common challenge for SMEs, especially small and young ones, is access to external financing in terms of bank loans (Peel et al., 2000; Wilson and Summers, 2002; Danielson and Scott, 2004). As such, to overcome problems linked to credit rationing, trade credit is regarded as an important short-term financing instrument for SMEs (Cassia and Vismara, 2009; Gama et al., 2010; Garcia-Teruel and Martinez-Solano, 2010). In addition, in spite of the fact that many Swedish companies are financed

mainly with bank loans (safeguarded by collateral), SMEs are encouraged to use trade credit as an alternative source of financing because such source rarely involve any demand for collateral (Yazdanfar, 2012). Bougheas et al. (2009) describe the demand for trade credit by stating the difficulty of accessing bank credit and refers to the pecking-order theory to state that firms' incentives to use trade credit depend on the accessibility and costs of alternative sources of financing (Petersen and Rajan, 1997).

Consistent with the pecking-order theory, internal source of financing, in the form of generated profit, is usually preferred to external financing (Myers and Majluf, 1984). Nevertheless, trade credit can be a means for a leading buyer to obtain preferential price discrimination. According to Schwartz (1974) financially constrained firms tend to use trade credit as an alternative to bank loans and Mateut et al. (2006) stated that firms with difficulties obtaining bank loans will increase their use of trade credit. In line with the Pecking Order Theory, Petersen and Rajan (1997) suggested that firms that are able to generate capital internally are likely to decrease their demand for trade credit, and Niskanen and Niskanen (2006) found that firms with strong internal financing are likely to exclude trade credit. As such, the trade credit level is negatively related to firm age. On the other hand, since previous results are inconsistent, most studies demonstrate that firms tend to request more trade credit when access to bank loans is insufficient. Therefore, trade credit may be considered as an important source of short-term debt and an alternative to other financing sources (Petersen and Rajan, 1997; Deloof and Jegers, 1999; Kohler et al., 2000; Atanasova, 2007; Bougheas et al., 2009; Garcia-Teruel and Martinez-Solano, 2010).

On another note, the family/private businesses face fewer obligations to provide any information to the financial market due to the uniqueness of their source of financing which is present in the credit system/commercial banking. As such, in the case of the closely held businesses, the information is held by banks, which highlights the effects of the financial structure of the country and the corporate status on the relations between the family/private businesses and the banking system. Such relationship is characterized by the existence of the founder-entrepreneur, at the core of the decision making and when it comes to succession, it is, as such, imperative that the control is passed on to the heir who is supposed to contribute to the route of value creation. According to Campanella (2013), the governance and the legal aspects and size of the company affect the closely held or family firms' performances. More specifically, the generational aspect represented by the founder-entrepreneur affects the financial and economic trends of more developed companies and

these firms' solvency depends mainly on the governance structure, the duration and the status of the company, and in specific the effect of the owner's presence and the impact on the credit rating of these family firms.

The literature detailing empirical evidence of the pecking order theory of the Lebanese economy is not yet available in any aspect. This study primarily focuses on internal financing and debt, since access to equity financing is limited and will be highlighted, separately, based on owners'/managers' feedbacks regarding the domestic capital markets. To the best of the researcher's knowledge, the current study is the first of its kind that examines and compares the new parameters of the pecking order theory for firms in Lebanon.

Since 1996, Lebanon has made significant efforts to expand its financial system. The Lebanese financial system consists mainly of debt markets with complete absence of equity markets. The corporate financing in Lebanon is mostly covered by debts in the form of borrowings from banks and some financial institutions

Most Lebanese companies would explicitly rule out the sale of common equity under any circumstances, and it shows clearly that the majority of these businesses had not opted for such a sale in the past 25 years and have no intention of doing so in the foreseeable future. Management favoured internal generation as a source of new funds even to the complete elimination of external funds except for sporadic inevitable need for funds and in specific the short run revolving needs.

The heavy reliance on internal finance and debt is obvious from the collected data. For most empirical data collected, firms depended on internally generated cash in most of the cases to cover their capital expenditure and working capital needs with only few cases of external financing through fixed loan, credit from suppliers and overdraft facilities from commercial banks. The majority of required external financing came from borrowing and equity issuance was never the case. Therefore, looking at the statistics, one would find that the pecking order idea is entirely plausible, as far as the hierarchy in the choice of sources of financing but without the last choice of stock issuance.

Lebanese firms give more preference to short-term debts than long-term debts and they usually rely more on short-term debts to finance the short-term needs than on long-term debts to finance fixed investments. One can clearly notice that the capital markets are not, in any way, the driver of the economy in Lebanon and bank loans are the major source for financing the deficits.

Aside from the information asymmetry, the Lebanese capital markets are shallow and relatively inefficient and illiquid with very few listed companies and participants. In view of this scenario, firms in Lebanon have only one primary source of debt, i.e., short-term debt. The reason is because Lebanese firms use less amounts of long-term debts in their capital structure and in view of the only and single source of debt, they maintain low level of debt. As such, firms do not rely at all on equity financing and present full reliance on debt funds.

Hence, testing the Pecking order model is done for different firm sizes, where firms sizes are based on total number of employees since it is very difficult to have access to the balance sheets of the firms under study.

The findings reflect on the idea that the environment in which a firm operates has large influence on its financial decisions and as such the pecking order theory can explain Lebanese firms' financing decisions. The study supports the pecking order theory due to Lebanon's dominated bank financing. The Lebanese firms follow a probable "new pecking order" which includes retained earnings, short-term and long-term debts without any reference to equity.

A. Research Objective

This chapter's study examines the Lebanese firms' adherence to the pecking order theory in providing for their financing needs. It also examines the extent of closely-run businesses reaction to the issuance of shares and abstention from going public.

B. Research Question

The research question related to the Pecking Order Theory is as follows:

Does the Pecking Order Theory provide an explanation for the financing behaviour in less developed countries such as Lebanon, where much of the firms fall under the SME categorization?

The first question relates to the effect of size and age in explaining the sources of financing and the choice among internal and external sources. The second question checks a possible relation among the different external sources of financing ranging from bank loans to credit from suppliers in the Lebanese firms' structure and the sequence and importance of the available sources.

C. Research Methodology

The chapter's study is quantitative in nature, deductive and uses a positivist strategy. According to Hejase & Hejase (2013), "Positivism is when the researcher assumes the role of an objective analyst, is independent, and neither affects nor is affected by the subject of the research" (p. 77). Primary data collected is analysed using correlation followed by regression analysis to detect possible relations and examines the effects of the age and size of the firm on the debt level, the preference in the case of internal and external sources of financing and the ultimate owners' reaction towards the capital markets and the choice of the sources of financing.

D. Sampling and Sample Selection

This study provides insights into the financing practices of the Lebanese firms characterized by being closely run with minor outside ownership. It mainly focusses on dataset that have been collected from firms that are registered as joint stock companies (JSC), the type of companies that are allowed to float according to the Lebanese capital markets regulations.

Therefore, data for this study were gathered using a survey questionnaire from Lebanese firms which are not listed on the Beirut Stock Exchange (BSE) due to the very low and static number of listed companies. The selection of firms was based on their legal status as "Joint Stock Company"⁴³ and chosen from among a cluster of privately-owned companies. Since in the last observed 20 years in the Lebanese economy, equity issues were known to be zero, as such the financing deficit must be equal to the debt issue as stipulated in the debt ratios of the respondents.

Lists of firms from different industry officials were obtained and then, depending on responses on the questionnaire, the data were collected from these different companies. Ministry of Economy and Trade was the source of the secondary data that were missing from the questionnaires. The researcher excluded the banking and financial firms such as commercial banks from the study, because they represent an important factor in the POT's external sources of financing. Moreover, more firms were omitted whenever there are missing values of any variable. In total, the final

⁴³ In order for firms to be listed on the Beirut Stock Exchange these must have the legal status of Joint Stock Company or SAL, in French, for Société Anonyme Libanaise. The majority of the firms in Lebanon have the status of Limited Liability Company, LLC or SARL, in French, for Société à Responsabilité Limitée.

sample size was 163 firms. Of course, the low number, 163 firms, is relatively a small sample from the set of 2881 firms registered as JSC⁴⁴, it is therefore important to understand whether the pecking order theory is broadly applicable in the Lebanese financial system.

According to Myers (2001), a major advantage of the pecking order is that it explains why the greater part of external financing takes the form of debt. Over time, the internal cash flow declines in relative importance as a source of financing and firms are better positioned to benefit from external debt from banks on one hand and suppliers on the other.

E. Questionnaire Design

A questionnaire was used and structured in a way to contain multiple choice questions, two different attitude scales, closed questions and open-ended questions. The drawback from such type of research was that they had a rather low response rate and target firms were reluctant to disclose of any information. The questionnaires were administered in a number of different ways such as; email attachments, handed out personally or administered through the help of common acquaintances.

The questionnaires represent a good medium to collect information from a large number of firms, where the managers may not have enough time to schedule an interview. The questionnaire enables a responsible person to take his/her time, think about it and ultimately come back to the questionnaire later. The respondents were given subtle time to state their own point of views or reactions without thinking about the potential reaction of the researcher. Joint stock companies (having the right to list their shares on the BSE), were the target for the administration of the questionnaire. The study excluded other legal forms of companies even if they have the intention to, later on, list their shares, but this process requires some legal procedures that can be often time consuming.

Some questionnaires were missing some data, accordingly the researcher had to go through all available industry specific publication in an effort to fill the gap or the missing data where possible. Furthermore, the respondents opted for the confidentiality of the information due to the sensitive nature of the information and the possible conflict with their published figures. This is a known

⁴⁴ JSCs represent 4.10% of the overall number of firms in Lebanon.

characteristic in most less developed countries where firms tend to conceal information from the public on one hand and from the fiscal authorities on the other. A characteristic also known or referred to as lack of transparency or simply a disguised attempt at tax evasion.

F. Ethical Considerations

Respondents were given the full freedom to participate based on their willingness and time and no personal data were involved. All respondents were promised confidentiality and were informed that such information is solely for research purposes.

G. Data Analysis

Collected primary data were analysed using descriptive statistics and inferential analysis. According to Hejase & Hejase (2013), “descriptive statistics deals with describing a collection of data by condensing the amounts of data into simple representative numerical quantities or plots that can provide a better understanding of the collected data” (H & H, p. 272). Consequently, this research used frequencies and percentages depicted in tables and figures. The collected data were analysed using SPSS. Moreover, inferential analysis used correlation among different variables and then a linear regression was performed in order to assess the relationship behaviour of the relevant variables. The variance inflation factors (VIF) was then used to make sure that the independent variables are not explaining the same variance in the decision to get financing and that they are not overlapping. If the variables do overlap they might inflate the R^2 , and any value in the VIF which is higher than 10 indicates that the respective variable is redundant with other variables and should be removed.

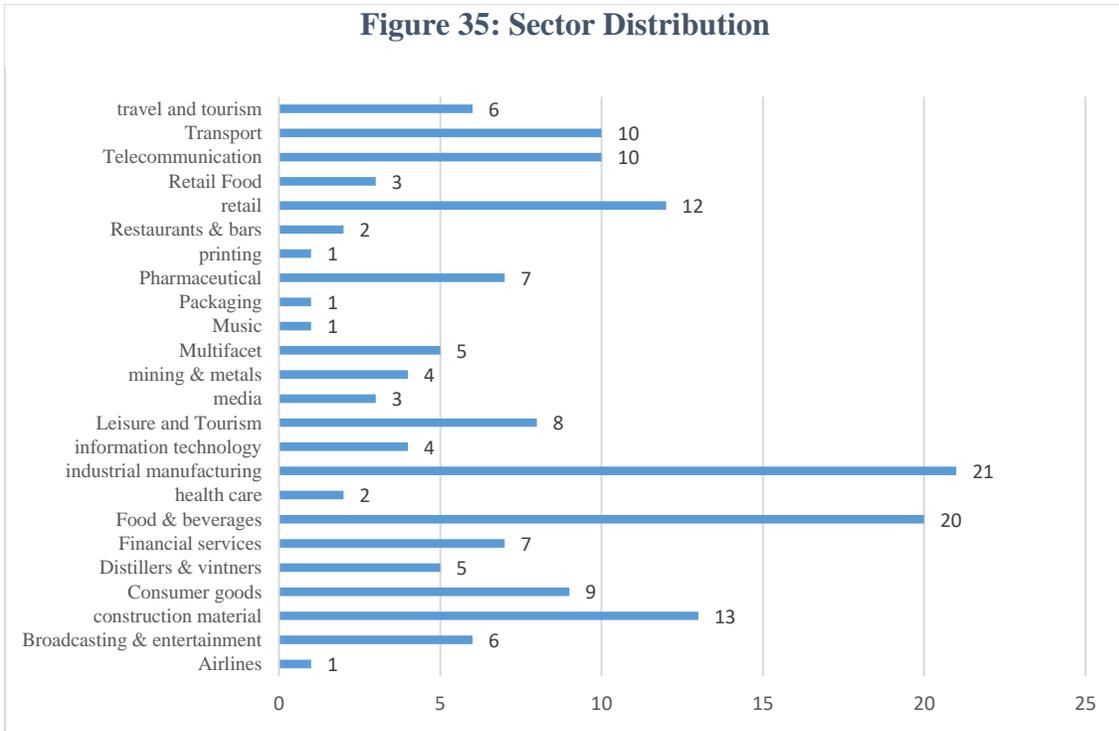
H. Results and Findings

When analysing the collected information, the firms were grouped into several categories based on different characteristics ranging from demographic, size (as in the number of employees), age and industry type.

1- Demographic Review of the Collected Data

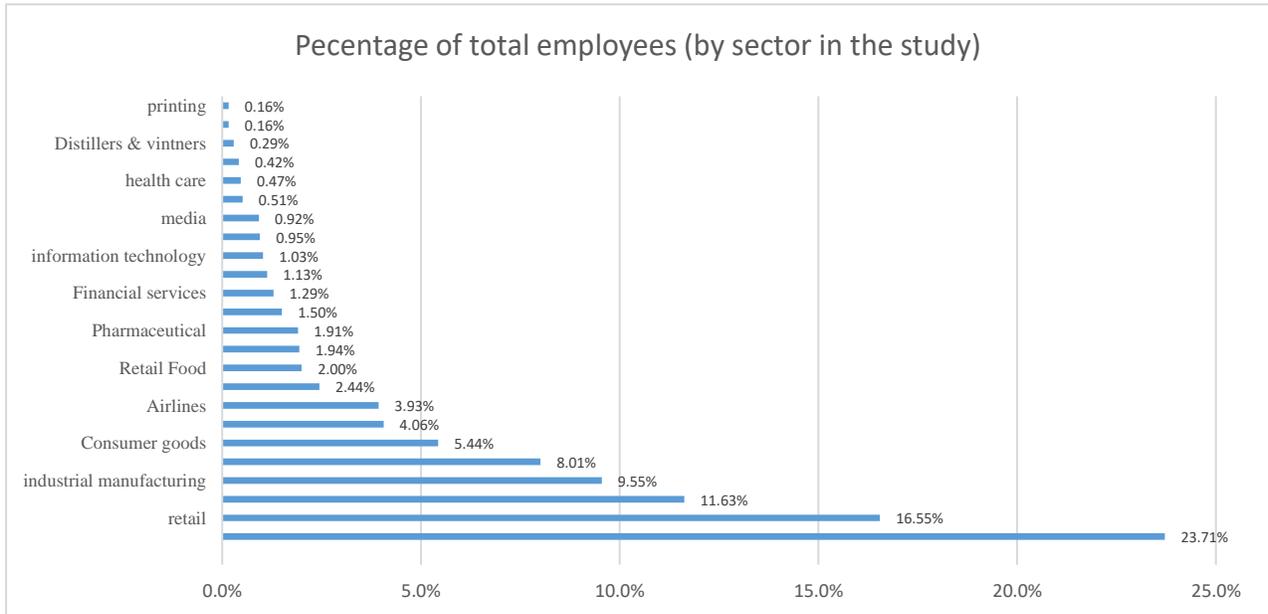
The respondents were grouped into 24 sectors based on MoET⁴⁵ distribution as shown in Figure 35. Moreover, reflecting on the most prevalent base for the classifications of firms, in terms of size, depends on the number of employees, total assets and total revenues and since it was a difficult to collect data on the total assets and total revenues of firms operating in Lebanon, the researcher used the total number of employees as the variable in the classification of the size of the companies. Accordingly, the firms showed the following concentration as per the sector distribution mentioned before. Figure 36 reveals that the majority of the employment is in the large multifaceted holding companies with 23.71% followed by the retail sector, food & beverages, industrial manufacturing and construction with 16.55%, 11.63%, 9.55% and 8.01%, respectively. The aforementioned reflect more labour-intensive sectors, while the printing, music and distillers ranking lowest with 0.16%, 0.16% and 0.29%, respectively as a result of either low number of respondents or the fact that the majority of workers are seasonal workers and not full-time employees like in the distiller's sector. To further check for the labour intensity and the importance of the employment as a factor in the determination of the size of the firms, the average number of employees per company per sector was calculated (Figure37) which also justified the reasoning of high average number of employees presented in the multifaceted firms followed by airline, retail, restaurants & bars, retail food, construction material, consumer goods and F&B sectors. If any, the results present additional justification to the choice of the employment level as a mean of classification of firm size.

⁴⁵ MoET: Ministry of Economy and Trade



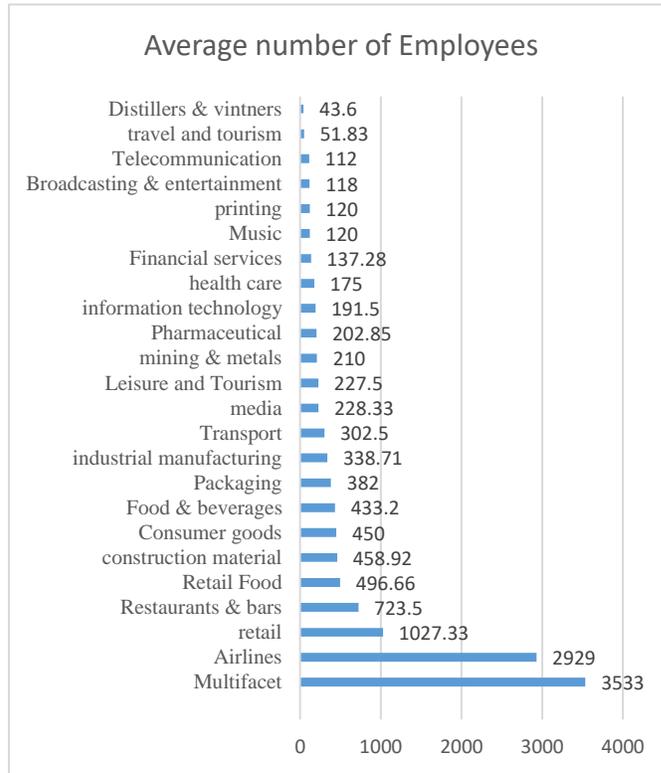
Personal data compilation, 2020

Figure 36: Percentage of Total Employees



Personal data compilation, 2020

Figure 37: Average Number of Employees



Personal data compilation, 2020

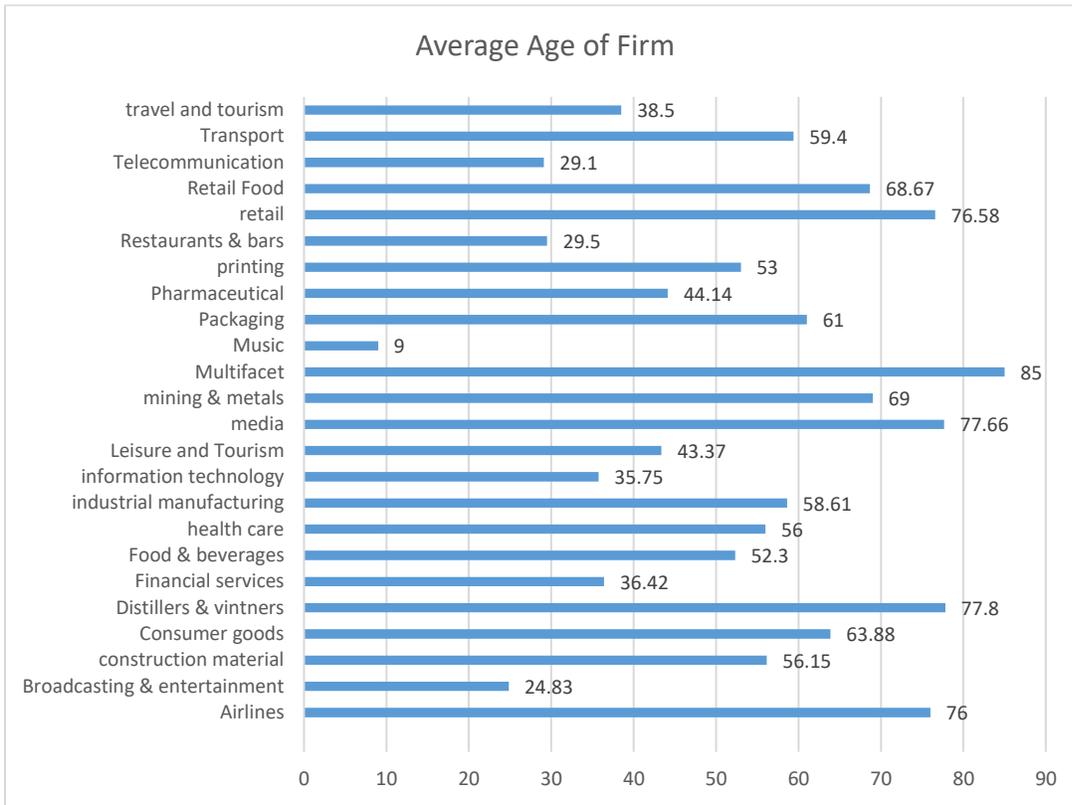
Moreover, the age of the respondent firms showed a mean age of 54 years and a median of 51 years with the oldest firm dating back 164 years and the youngest 9 years. The average age of the firms varied among the different sectors reflecting the historical nature of the economy. (Figure 38) depicts the existence of the businesses that control the Lebanese markets since the old times with little possibility for new firms to penetrate such entangled markets.

In the data collection process, the researcher came across an important aspect that can be an important target of future study regarding the status of the Lebanese firms and their concentration in being closely run businesses. It is worth mentioning that the breakdown into family and non-family businesses (Figure 39) shows that 72.67% of the firms are established and still follow the pattern of family businesses versus 27.33% for non-family businesses, respectively. Out of the family firms, 29.06% are run and managed by 1st generation owners/managers, 46.15% by 2nd generation, 20.51% by 3rd generation and 4.27% are managed by 4th generation, respectively.

These figures again emphasize the high concentration of the second generation running the firms that almost complements the previous results of an average age of 54 years for firms under study. The average amount of debt for Lebanese firms ranges from 22% to 23% of assets. For SMEs in G7 countries, it ranges from 23% for Canada to 43% for France. The composition of current liabilities is dominated by bank loans around 24% and trade credits around 17%, while other liabilities represent about 10% of total assets. Banks provide 5% to 6% of common-size debt and total aggregate loans account for 20% to 23% of financing for Lebanese companies. This is nearly identical to Berger and Udell (1998) who found that banks account for 25% of US small business financing. Trade credits of 15% to 17% of funding are only slightly larger than the 15% number reported by Berger and Udell (1998) for the US.

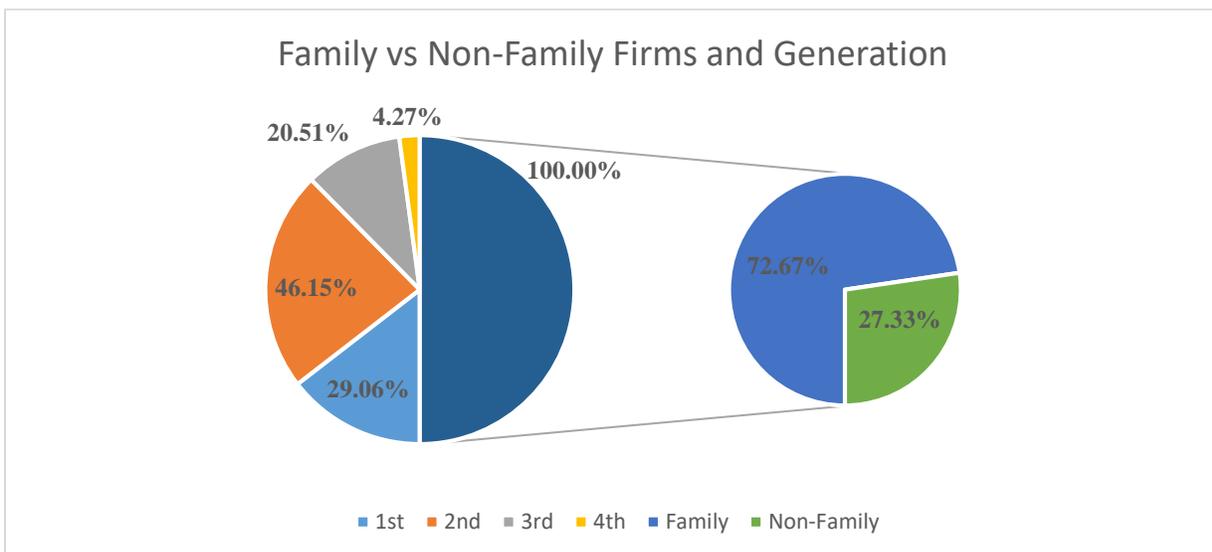
In summary, banks provide an average of 24% of the financing for Lebanese firms, trade credits from suppliers constitute an average of about 17%, which leaves an average of 59% to be accounted for from other different providers of credit and mainly from internal and personal funding. The managers' sentiments toward joining or not joining the capital market through access to the BSE is highlighted in the separate table 10.

Figure 38: Average Age of Firms



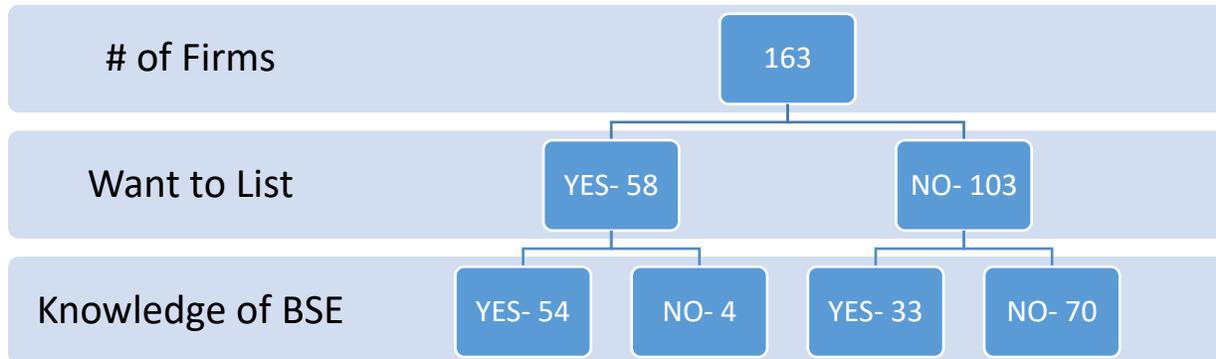
Personal data compilation, 2020

Figure 39: Business Structure



Personal data compilation, 2020

Table 10: Listing Intent & Knowledge of BSE



Personal data compilation, 2020

2- Regression Analysis

The researcher used linear regression to determine the relationship between various measures of leverage- and firm-specific variables, such as size and age. Reflecting on the importance of the closely run status in the Lebanese enterprises structure, this study will try to identify the possible effects of different sources of financing resulting from this closely run status. Therefore, and before the regression, we started with a test of Pearson Correlation on SPSS to test for possible correlations among the size, the age and the debt ratio. It is expected that a growing firm will not be able to fill its financial needs with internally generated funds, thus the pecking order theory implies an increase in the debt level.

The next step was to assess the effect of the age of the firm, which is calculated starting from the date of its establishing, on different variables. Results show a non-statistically significant effect on the international and the domestic revenue and the debt from banks, whereas the internal funding, the overall debt ratio and the credit from suppliers were statistically significant.

Nevertheless, when looking at the coefficient of determination, the variance of the studied dependent variables with the age of the respective firms depicts no major explanation that can set a guideline for the source of funding nor financing. The age of the firm is, hence, a factor that does not have any direct effect on the sources of financing but more logically it is the type of the business.

Table 11: Correlation between age, size and debt ratio

Correlations

		Debt Ratio (T)	Age	Employee
Debt Ratio (T)	Pearson Correlation	1	.242**	.246**
	Sig. (2-tailed)		.002	.002
	N	162	162	162
Age	Pearson Correlation	.242**	1	.081
	Sig. (2-tailed)	.002		.303
	N	162	162	162
Employee	Pearson Correlation	.246**	.081	1
	Sig. (2-tailed)	.002	.303	
	N	162	162	162

** . Correlation is significant at the 0.01 level (2-tailed).

The results show a 0.242 and 0.246 correlation for both age and size respectively with the debt ratio which is relatively low but significant at 0.01 level. This comes in support of Ezeoha and Botha (2012) who demonstrated that there is a theoretical uncertainty in the relationship between age and debt financing and few studies indicate a positive correlation between age and debt financing. On the other hand, the results refute Berger and Udell (1998) who indicated that as firms grow they tend to rely more on debt and relatively younger firms use less debt and Bernasconi, Marenzi, & Pagani, (2005) who found that old firms enjoy better credit relationship with their lenders which might lead to reduction of their cost of debt and the idea that the cost of issuing debt is much higher for small firms than large firms (Titman and Wissels, 1988).

Booth, Aivazian, Demirguc-Kunt, & Maksimovic, (2001) stated that old and profitable firms benefit from the availability of more internal funds than debt, therefore, the correlation is tested again by replacing debt ratio with internal funding that showed a negative but very low correlation between internal funding and the age and size of the sample even with significance at the 0.05 level with correlation of -0.155 and -0.188 for age and size respectively. The results simply emphasize the fact that as firms grow older and bigger they depend less on the internal funding and direct their choices toward external sources which reveals the findings of Bulan and Yan, 2009. This also comes to support the idea that small firms have less access to external funds than

do large firms (Bernanke, 1983) and as such the pecking order is a more profound description of the financing decisions of small firms.

Table 12: Correlation between Age, Size and Internal Funding

Correlations		Age	Employee	% Internal Funding
Age	Pearson Correlation	1	.081	-.155*
	Sig. (2-tailed)		.303	.050
	N	162	162	162
Employee	Pearson Correlation	.081	1	-.188*
	Sig. (2-tailed)	.303		.016
	N	162	162	162
% Internal Funding	Pearson Correlation	-.155*	-.188*	1
	Sig. (2-tailed)	.050	.016	
	N	162	162	162

*. Correlation is significant at the 0.05 level (2-tailed).

The correlation is then tested between size, age and the debt from banks and then with the credits from suppliers as a source of external funding.

The results came to negate the effect of age on the choice of loans from banks with a very low correlation of 0.064 and a low correlation of 0.201 with the credit from suppliers but significant at the 0.05 level which is the same as the correlation between size and the loan from banks. This test revealed also a positive correlation of 0.551 between loans from banks and the credits from suppliers at the 0.01 significance level. This also stresses the fact that once firms move toward external financing, their credit worthiness will be interpreted positively by both banks and suppliers which comes in tandem with Bernasconi, Marenzi, & Pagani, (2005).

Table 13: Correlation between Age, Size, Debt from banks & Credit from Suppliers

Correlations

		Age	Employee	% Debt from Banks	% credit from suppliers
Age	Pearson Correlation	1	.081	.064	.201*
	Sig. (2-tailed)		.303	.418	.010
	N	162	162	162	162
Employee	Pearson Correlation	.081	1	.201*	.134
	Sig. (2-tailed)	.303		.010	.088
	N	162	162	162	162
% Debt from Banks	Pearson Correlation	.064	.201*	1	.551**
	Sig. (2-tailed)	.418	.010		.000
	N	162	162	162	162
% credit from suppliers	Pearson Correlation	.201*	.134	.551**	1
	Sig. (2-tailed)	.010	.088	.000	
	N	162	162	162	162

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

As such, the behaviour of the Lebanese firms seems not to support the effect of the size and age on the choice of external financing which cannot be explained by these two variables that show low correlation with the different source of financing.

The researcher studied the specific relation between the debt and the traditional sources of financing in isolation from any other factor; and re-looked only at the relation between the debt from banks and credit from suppliers together with the debt ratio. A first regression is conducted to test the impact on total debt by the debt/loans from banks and the credits from creditors/suppliers and ultimately the debt ratio (DR) in the current year and it was manifested in the following equation:

$$DR = 3.475 + 0.508 CFS + 0.451 DFB$$

Where: CFS stands for credit from suppliers and DFB stands for debt from banks showing a positive and statistically significant relation between debt ratio and the credit from suppliers and the debt from banks. On the other hand, the coefficients showing 76.1% and 73.1% of the change in the debt ratio being explained by the debt from banks and credit from suppliers comes with no

surprise since the debt of firms is often short term from banks and suppliers with no dependency on the capital markets.

Furthermore, the internal funding was correlated with the external funding from banks and suppliers and the following respective correlations reflect an expected negative relation of -0.867 with loan from banks and a -0.894 with credit from suppliers. The results come, as such, to confirm the choice of internal source and the move towards the external sources comes as a substitute rather than a complement which can be explained by the POT as an alternative choice of financing. The correlation between the bank loans and the credits from suppliers of 0.551 at the 0.01 significance level comes also to support the context of the external sources once the firm turns to outside financing choices.

Moreover, the effects on the debt ratio are studied and no significant relation appeared with the international revenue nor the domestic revenue. This clearly shows no effect from whether the firm operates domestically or if it had any international presence.

Looking back at the open-end questions in the questionnaire, the respondents' answers showed a 35% / 65% intent to list / no intent to list results that mirrors the closed ownership nature of the Lebanese firms. This outcome required clarification and support from the answers on the reasons for not wanting to list on the BSE. Table 4 ranks the reasons for not listing on the BSE with the lack of participants as the main reason with 37.2% of the answers followed by their preference for bank loans with 20% and the inclination to maintain a closed operation with 13.3%, the illiquid characteristics of the BSE with 11.4% and the reluctance to publish the financial statements with 10.5% and finally the lack of knowledge of the BSE with 7.6%.

Table 14: Reason for not Listing

Reasons	Percent
Insufficient Participants	37.2
Prefer Bank Financing	20.0
Maintain Ownership in the Family	13.3
Illiquid Market	11.4
Publishing of Financial Statements	10.5
No Knowledge about it	7.6
Total	100.0

From the above analysis, one can infer that the Lebanese firms, which are in the majority structured as closely run businesses, present in one way or another a clear personification of a Pecking Order or a rather modified Pecking Order in their choice of sources of financing. The old firms that started with their internal funding sources are in a better credit situation that enables them to seek external financing in the form of commercial banks loans and credit from suppliers. Moreover, these old firms are longing to have access to the capital market to fill their needs for financing. On the other hand, the small number of participants and the very low liquidity of the Beirut Stock Exchange, rendered their last resort to external sources through the capital markets a need that is not achievable, at least in the short term.

The Pecking Order Theory manifests itself in the first two stages of financing, i.e., through the internal source and then through the safest short-term external source being the loans from the banking sector and credit from suppliers. This comes in line with Demirgüç-Kunt and Maksimovic (1996) who stated that, in most developing countries, the stock market is not fully developed and as such, firms rely more on debt financing.

In the hope of future development of the capital markets, in specific the BSE, Lebanese firms long for the ultimate long-term source of financing be it debt or equity.

3- Concluding remarks and Implication

The study concluded that as firms grow older and bigger they depend less on the internal funding and direct their choices toward external sources, but the behaviour of the Lebanese firms seems not to support the effect of the size and age on the choice of external financing and cannot be explained by these two variables. The outcome of the study showed a positive relation between the closely run business and the internal funding stressing on the importance of self-financing in the Lebanese firms' structure. Furthermore, the concentration of ownership in the Lebanese firms is manifested in their more dependence on self-financing and little dependence on external financing even at the level of credit from suppliers.

The data, also, showed no effect on the financing decision from neither domestic nor international presence. Nevertheless, the debt ratio was clearly explained by the debt from banks and credit from suppliers that is often short-term in nature and showed no dependency on the capital markets.

Moreover, the age of the firm appeared as a factor that does not have any direct effect on the sources of financing but more logically, it was the type of the business. However, the age of the firm had a more convincing effect whenever the firm opted for the internal financing as a more convenient source. From that perspective, as firms chose to finance their funding needs internally from operation, they moved away from borrowing irrespective of whether it is short- or long-term. Therefore, no firm specific factor affected the debt from banks but rather the type of business and the operational needs.

The Lebanese firms seem to have adequate amounts of internal cash flows to finance their investment needs. Among external financing, the equity and bond markets in Lebanon are inefficient with very limited role. Accordingly, Lebanese firms considered only debts as their major source to finance their deficits. If one reflects just on the debt amounts, it is clear that firms preferred more short-term debts in their capital structure because of their specific financing options and the relatively favourable interest rates offered by existing commercial banks. Despite the debt issues, Lebanese firms kept themselves in safe zones.

Firms in Lebanon should decide on more long-term debts in their capital structure, which might help in reducing their liquidity risks and they should start thinking of incorporating equity financing in order to balance their capital structure. The decision should revolve around the fact that the costs are minimal in case of internal funds, and relatively higher for new equity issuance and debt costs lie in between. Lebanese firms should weight in the costs of listing in their decision on a new capital structure, a structure that might involve the capital market where long-term source of financing are nested.

From the banks' perspective, Lebanese firms demonstrate an important liquidity risks because they do not have significant reliance on other sources of financing and in specific long-term debts and equities. In line with Kopyakova (2017), it is clear that closely held firms tend to have more leverage and prefer short-term liabilities. Thus, we can conclude that the pecking order seems to be a better fit for the preferences of owners of Lebanese firms, it also reveals one of the theory's main mechanisms, the preference for control. Finally, the results show a preference for bank loans when external financing is required. Taken together, it seems that the ultimate owner who values control over efficiency (Thomsen & Pedersen, 2000), seems to be a usable illustration in the context of the Lebanese economy.

4- Future research

Future studies may consider adding the financing cost aspect in a way to generate a more impressive analysis of firms' adherence to the pecking order theory. However, inference regarding the extent to which Lebanese firms are following the Pecking Order is complicated by the missing actual level of debt capacity of the firms in the data and the weak form state of the Beirut Stock Exchange. One cannot distinguish whether firms are following the Pecking Order or whether firms are constrained by their financing choices. In the recent context of financial crisis and the excessive reliance on short term debts from banks, it is critical to highlight the aspect of the concentration of the sources of financing available to the Lebanese firms, in the form of traditional banking loans, and the weakness inherent in the funding decisions. The closely run business structure that characterizes the Lebanese firms should be studied closed to identify the effect of such a status on the decision to go for external sources of financing or just stick to the internal ones with minor back up from the traditional banking system and the credit from suppliers. The state of the firms and the economy might open the door for the need to find new sources of funding, probably through the capital markets.

Chapter Four: The Cost of Going Public and Being a Publicly Listed Company: The Case of Beirut Stock Exchange

Most companies face some funding issues that mainly revolve around the sources of financing. These sources are widespread ranging from internal sources to external sources and from traditional bank loans to capital market securities. The internal sources secured in the form of retained earnings are usually backed up by external sources from traditional bank loans and ultimately the capital market. As firms move forward in their business cycle, the need for more external sources is imminent and maintaining adequate debt level is a requirement and hence the need to find more convenient sources from the capital markets. In this quest, firms must weigh in the indirect cost summarized in the context of underpricing and the multi-sectional direct costs of going public and staying public. This chapter highlights these different direct costs with an emphasis on an explicit and inferred example from Beirut Stock Exchange, the BSE, and a display of tentative and possible costs to be considered by the Lebanese enterprises in their pre and post budgeted decision of becoming a publicly listed company.

The IPO is generally a costly exercise both at the time of listing as well as over the long run because of the additional disclosure required to maintain a listing and keep new shareholders informed of new corporate developments. At this point, investor relations embrace a high level of transparency to the benefits of customers, suppliers and competitors alike, in addition to a significant commitment from the management in terms of adequate time and resources to face the expectations of the markets. Furthermore, the floatation can often incentivise unwelcomed shareholders and sooner or later leads to loss of control over the business away from the grasp of the original shareholders resulting from a mere dilution of existing ownership.

I. Introduction

In general, firms face imminent funding issues around the possible and available sources of financing. These sources are ubiquitous ranging from internal sources to external sources and from traditional bank facilities to more complicated capital market securities.

The internal sources are displayed in the retained earnings which are considered in the corporate finance theories as auto-financing or simply personal and individual injection of money. The external sources can be divided into private equity, at the narrow level, and traditional collateralized bank loans, on one hand, and capital market securities such as bonds and equities.

Going further in time and the length of operation, some firms will find themselves with a depletion of the available and relatively easy accessed sources of funds. With less free assets to be locked as mortgage against bank loans, large firms, in general, and SME, in specific, will face the need to seek alternative sources of financing from the capital markets.

Even though, debt can be considered as cheaper and more tax efficient, firms look at the possibility of reducing their debt burden or, simply stated, their current and short-term obligations. In the question of cheaper and more cost-efficient source of funding, firm must look into the different costs embedded in the decision to go public, in general, and the specific costs inherent in each step in the road map to get from a status of a privately owned to a publicly traded firm.

The drawbacks of asymmetric information in the context of initial public offerings (IPOs) has been the subject of many documented literatures and multiple theories were presented to support its resulting underpricing phenomenon. Some authors tried to explain the underpricing such as Rock's (1986) winner's curse model, the ex-ante uncertainty theory developed by Ritter (1984) and Beatty and Ritter (1986), and the signalling model developed and discussed by Allen and Faulhaber (1989), Grinblatt and Hwang (1989) and Welch (1989). Others tried to present solutions to undermine the effect of asymmetric information such as (Barry et al., 1990; Megginson and Weiss, 1991) who found in the private equity (PE) backing a possible way out to reduce its the effect by stressing on the signalling effect on one hand and some authors presented the certification role as a possible explanation but not with concrete results, but rather differing views as found in (Lin and Smith, 1998; Smart and Zutter, 2000; Francis and Hasan, 2001; Schertler, 2002; Franzke, 2003; Coakley et al.,2009).

Whenever a company is putting together the idea of going public, they should factor in an array of expenses. Their IPO budget should account for multiple expenses against their expected proceeds

from the planned issue. The net proceeds might step away from the financial plan if a proper roadmap, that encompasses all possible expenses, is not set forth with the help of professional people. The choice of advisors and consultants, by itself, entails an expenditure that should not be undermined due to its crucial role in keeping up with the budgeted plan and its significance in getting the utmost from such an important decision in the life of a company. The disbursements start at an early stage with the preparation of the company to be IPO ready legally, structurally and organizationally. The costs borne by the "to be public company" involve some outlays that are direct and indirect in nature. The direct costs cover the investment bank responsibilities from underwriting to listing going through legal, audit, roadshow, registration and printing materials. As for the indirect costs, they stress on some structural and compliance attributes. Furthermore, these costs are also segregated into one time or recurring costs when the company is looked at as a publicly listed going concern. In its quest to get the best out a public offer, the issuer company must contemplate the choice of the investment bank whose reputation will have a blasting effect on the success or the failure of the issue. The contract signed with the investment bank must tackle each and every detail of the issue in order to set a clear roadmap to follow and an accurate budget to respect and maintain.

The process of going public is a very demanding task and deserves careful planning and consideration few years prior to the intended filing date. Due to the complicated nature of filing with the proper regulatory authorities as a public company, the process can become very expensive. Many companies seek the benefits of going public but they tend to underestimate the substantial costs involved in the process of becoming public and the ongoing costs of being a public company. Therefore, the benefit of going public should be weighed against the initial and ongoing cost of being public. Further, the actual time needed to get the approval, registration and liquidity, and the respective costs of each step of the process may vary depending on each particular company's situation and in specific on the accounting readiness, the underwriter experience, the management team professionalism and the choice of the proper legal consultants and advisers, the size of the company and the monetary value of the offering and lastly the market conditions and regulatory environment.

A thorough study of the costs is an important step to lay the ground for the existing board, management, employees and other stakeholders in order to know what to expect and to present the

appropriate move toward the proper implementation of a well-structured timeline and a more detailed budget.

The going public process involves, among other steps, an assessment of the readiness of the company to be a publicly listed company, the preparation of the prospectus, the registration with the proper authorities, the preparation and audit of the financial statements and the underwriting and relative advisory services.

Once public, the firm must comply with new financial reporting requirements, new corporate governance procedures, internal controls, taxation and legal requirements, in addition to a totally different look at media campaigns and investor relations, treasury and risk management processes. Going public is a complex decision influenced by many factors of which we pinpoint the costs and benefits. Costs of going public are important in the decision, but given the nature and the characteristics of the Lebanese listed companies, it is difficult to have access to the exact costs of getting listed and being listed.

IPO firms have the autonomy to make the most efficient decisions regarding the contract that decreases their costs of going public. Logue and Lindvall (1974) reported that if insiders are willing to sell more shares, they may have a better bargaining power in pushing for relatively lower floatation costs. On the other hand, Dunbar (1995) confirms this argument and reveals that the proportion of current shares sold in the IPO can prompt a positive signal to the market. The reason being that if insiders are selling a portion of their holdings then this implies that either they are ready to give up some of their shares in a move to expand the number of investors holding the company's stocks, or that the firm is not reliant on a relatively small number of existing shareholders.

Torstila (2003), in a study on Asian Pacific, European and North American markets, found that IPOs were charged by investment banks with gross spreads that revolve around 2.5% in Hong Kong, India and Singapore, 2% in Malaysia, and 2.5% to 4% in Germany, France and Belgium. On the other hand, Ljungqvist et al. (2000) reported an average gross spread of 4.6 percent for book-building efforts and 2.2 percent for fixed price offerings in 61 markets outside the US market. European IPO fees are almost three percentage points lower than the U.S. and are more variable (Abrahamson et al. 2011), Meoli et al. (2012) show that the underwriter compensation in Europe depend on a flat fee and an underwriting commission on which some determinants result in having

different effect and earlier, Torstila (2001) and Ritter (2003) showed a remarkable difference in fees charges between US and Europe. On LSE, the total costs of going public are 25.61% (as a percentage of gross proceeds) of which 3% represents commission for underwriting services/advice that a broker delivers at the time of listing, Kostas (2014).

Hansen (2001) refuted the possibility of collusion on the part of US underwriters and stated competition and quality as a probable reason for the deviation from the European fees level.

On the other hand, Liu & Ritter (2011) found some convergence in the fees resulting from moves toward more non-price competition away from price competition among underwriters.

Like the 7% gross spread, the standard contract of 20% management fee, 20% underwriting fee, and 60% selling concession has become more common in recent years, Ritter (1998). As the offering size increases, the percentage of the total spread paid as selling concessions increases accordingly. This simply reflects the benefits of economies of scale in managing and underwriting an IPO, Torstila (2001, 2003).

Al Zamel (2016) stated that the IPO spread, in the AIM in England, is in the range of 4% - 6.43% and a median of 5%, which contradicts with earlier US studies by Chen and Ritter (2000) and Abrahamson et al. (2011) who reported a gross spread of 7% for most of the US IPOs. Al Zamel, also, explains this difference by referring to economies of scale and clarifies that the spread decreases when the proceed increases, large issues often cost less in terms of percentage of proceeds. On the other hand, Chen and Ritter explained the 7% as a result of collusion among investment banks, whereas, Hansen (2001) blamed this 7% on the behaviour of underwriters.

On another note, Ritter (1987) stated that most IPOs in the US are structured as firm commitment rather than best efforts and that the cost of going public, including investment banking fees and underpricing, is more efficient under firm commitment. He explained this finding in the context of economies of scales and larger book values reported by institutional investors. He further finds that firm commitment offerings are usually adopted by prestigious underwriters and Beatty (1996) stated that more prestigious underwriters charge higher fees due to their reputation.

A PWC study back in 2017 stated that an IPO timeline stretches from 12 to 18 months of preparation prior to the IPO process and needs 6 to 9 months for the execution of the IPO and requires an ongoing follow up post-IPO.

The push for lowering the burden of going public is a question of policy and regional and international competition. Some of the concern is that the regulation makes going public very expensive, driving IPO activity and firms listing and trading to overseas markets or to become out of scope for expanding firms. Furthermore, it hinders investment banking activity and trading, reduces the business for local investment banks and securities dealers, and eliminates investment opportunities for investors.

In 2012, the JOBS Act was introduced as a way to help growing companies benefit from going public at relatively lower costs, but Eberhart (2016) found little cost reduction for these new companies and more awareness when it comes to setting the proper costs for such an endeavour.

The idea is different in Europe since every stock exchange provides the issuing company with different listing options depending on its status. For example, the ‘Main Market’ in London is designed for large companies, the ‘Parallel Market’ helps companies with middle and small capitalizations and the ‘New Market’ for potential growth companies. But some markets do not provide this variety in terms of listing availability, the Stockholm stock exchange, the Vienna stock exchange and the Warsaw stock exchange never catered for growth companies separately, and the Swiss exchange and the Deutsche Börse stopped the support of these growth companies. Furthermore, in the case of the LSE and Euronext Amsterdam, their Main Markets accept all firms, independent of size considerations, except when capitalization surpasses £ 700,000 at the LSE and shareholders’ equity is over € 5 million on Euronext Amsterdam (Gajewski and Gresse, 2006)⁴⁶.

Therefore, the costs of going public vary generally depending on various factors such as the difficulty of the IPO structure, the company size and the offering proceeds, not to forget the company’s preparation and readiness to function as a public company. Accordingly, working on rather appropriate anticipations and drawing a clear plan can help facilitate the budgeting process, on one hand, and help in making the figures more precise and aid in restraining surprises that emanates as the company moves into the public markets, on the other. This will also provide management with precious time to develop the systems, the oversight mechanisms and operational methods to support the requirements of being a public company.

⁴⁶ Jean-Francois Gajewski and Carole Gresse (2006) studied in details the characteristics of the 15 European markets and presented valuable information on listing requirements, different pricing strategies used and market performance during the period from 1995-2004.

H3: The direct and indirect costs are important variables in the decision to go public, which will be discussed and validated in chapter four.

To underline the originality of this paper, we will try to highlight the different steps needed to become a publicly traded company and the respective inherent costs. As far as we know, there is no study nor a clear-cut explanation on the specific costs of going public for Lebanese firms that are considering the potential of going public. Furthermore, there has been no IPO over the last 20 years and as such, any available information or guidelines are scattered and not updated with a lack of regulatory guidelines that sets forth a detailed roadmap that facilitates the going public process that Lebanese firms must consider before planning or even thinking of going public.

Chapter four starts with preparing the company to be IPO ready, engaging in the underwriting process with what it entails in regulatory, financial and compliance requirements and relative costs. Some general guidelines were consulted from different parts of the world and different markets such as the American and the English markets. Then, we tried to assign outlays needed after being a publicly listed company with all the compliance and exchange listing requirements.

As such, the chapter's general research questions to be answered are displayed in the following:

- 1- How much does it cost to go public and stay public?
- 2- Is it time consuming to go public?
- 3- Does it require any restructuring of the company to be IPO ready?
- 4- What are the costs of going public and staying public on the BSE?

II. Ground Setting for an IPO

Pre-IPO set up

Once a firm decides to embark on the long way of becoming a publicly listed company, it must take the time to embellish its image to become an attractive asset for investors. Accordingly, being prepared for the coming IPO reflects the seriousness of the company in doing business and helps in projecting a positive mind set with respect to potential future investors. This effort should be directed towards three main pillars revolving around achieving a critical mass, expand the high

growth segments and pick the right independent board. First, to attract the attention of institutional investors, a company must have a market capitalization of a certain minimum prerequisite amount, depending on the financial centre of incorporation, in order to create an active market for the stock and as such drive up the stock price. This can be achieved through increased revenues or through quicker moves like undergoing acquisition in the years leading to the IPO. Second, investors are looking to see high degree of growth in fields where other publicly traded companies have recorded high P/E multiples⁴⁷. Here, management team should know the figures of P/E for all competing companies in its market segment and as such allocate funds to those areas of their business which can provide helpful base when the company goes public. Third, investors seek board members who are independent from management team. Even though it can be done at short notice before the IPO, but it is better if the company selects these members ahead of time, enough to give them the opportunity to react and cope with the business operations.

The costs associated with the IPO process can be divided into costs related to the preparation of the offering and costs related to the offering itself. The pre-IPO organizational costs comprise among others the costs of valuation reports, the costs related to required legal restructuring, taxation and audit costs and these costs are usually expensed as incurred (GAAP). On the other hand, the costs related directly to the offering comprise among others underwriting fees, external audits and financial reporting compliance costs, registration and legal fees, printing and road show costs and many other miscellaneous costs. These costs are usually charged against the IPO gross proceeds and present a discount of around 7% of the gross proceeds raised⁴⁸. Moreover, the IPO costs vary among different sectors depending on the size, the complexity, the legal and regulatory requirements and the geographical distribution of the company's operations.

In a move to shed some light on the going public process in the USA and its respective costs the following were observed in different articles and briefed in the below paragraphs.

⁴⁷ The price-to-earnings ratio (P/E ratio) is the ratio of the current price per share relative to its per-share earnings (EPS). A high P/E ratio indicates that investors expect higher earnings.

⁴⁸ According to study by PwC and conducted by Oxford Economics on 315 companies that completed an IPO in the US from 2015 till June 2017, the average IPO cost ranged between \$7.3 million for proceeds raised up to \$100 million and \$ 70.3 million for proceeds raised above \$1 billion.

A. Corporate charter

The company must start with a review of its initial corporate and capital structure to see if it complies with the requirements to become a public company and if it will require any recapitalization or any changes to its articles of incorporation or corporate charter. To that end, the company must start by building the management team and draw its corporate governance policies. The firm must also perform a thorough due diligence of capital structure before going public and this should be done at a point in time where the number of investors and owners is still under control and before attracting new shareholders which, then, can become very difficult and costly. Moreover, during this section of the timeline, the company must look into different functional areas and assess the gaps, if any, for the company to be publicly ready. Starting on the capital side, the company must see into the proper valuation of the firm and the capital that it needs to raise. The new governance requirements should be studied and accordingly the company must draft the new leadership and governance rules to follow; in specific, management roles, responsibilities and reporting hierarchy. Alongside, the proper capital structure should be determined with the potential alternative sources of financing. The management of the IPO proceeds should be set in place with the respective risk management tools and the disclosure requirements should set the skeleton for the proper accounting, financial and budgeting processes. Compliance requirements will set the frame for the internal audit and control procedures that should also be drawn and the corresponding tax plan adhered to as per the respective jurisdiction.

Therefore, the company should be ready for the IPO along with some restructuring concerns such as developing departments within the company to handle effectively all matters related to legal, taxation, investors' relation, audit, reporting and accounting, internal control and company by-laws (Christensen, 2018).

With above in check, the going public firm stands a big chance of meeting planned costs and meeting the budgeted monetary values within the pre-drawn timeframe once it is scheduled under the umbrella of a customary project management process and lead and managed by a qualified team member.

As such, this process takes couple of weeks to 3 months to be completed. (Nead, 2014 and KPMG, 2015)

B. Registration statement

After the due diligence and enough research on the readiness of the market, the firm management should decide on the type of security to issue, the number of securities to be issued and the respective price per share and the exchange where listing will happen if the firm is faced with more than one choice. The firm should start working on an elaborate marketing plan during the pre-prospectus period which should mainly include:

- A definition of the target market and the proper identification of the potential buyers of the relative stock and stressing on their characteristics with respect to whether they should be institutional or retail in nature, speculators or established investors, regional or national)
- The choice of the investor relations firm to help develop and implement the marketing plans
- Set up meetings with the target investment community and the financial media to develop contacts and communicate company activities
- work on updating the company's proper website that will meet the needs of the investors

In order to speed up the process of issuing the shares and allowing the public to trade in these shares, the company must speed up the preparation and submission of the registration statement. The registration statement provides the investors with an understanding of the securities offered and the profitability of the company. It encompasses the prospectus and any additional information that is material to the investors to know about.

The company must prepare the road show⁴⁹ presentation, meet with the analysts, plan its public communication and inform the management team on public reporting requirements. The company must submit information on how it is planning to use the collected proceeds from the issuance of the shares, provide a detailed description of the current business and provide a short prospectus of the planned security itself and its class and its offering price methodology⁵⁰. This process is usually accompanied by a financial audit report. The actual timeframe will largely depend on the actual state of the financial books and records. If the firm is organized and generates internally its income statements, balance sheets and statements of cash flow the auditing process

⁴⁹ A road show involves members of the investment firm who are underwriting or issuing the IPO for which they travel around the country presenting the investment opportunity.

⁵⁰ Form S-1 requires companies to provide information on the planned use of capital proceeds, detail the current business model and competition and provide a brief prospectus of the planned security itself and the offering price methodology

will go smoothly. In most of the cases, the audit report is drawn in 2-3 weeks and the registration will take around 2-4 months. (Nead, 2014)

A prospectus must include all the information that may be relevant to a reasonable investor considering the purchase of the securities offered under the prospectus. Usually a prospectus highlights the issues with respect to the board size, independence, age, leverage, underwriter, terms of the IPO securities (Abdul Rashid et al. 2012), the shares lockup, earning forecast (Clarkson et al. 1992), and all aspects of the company business, finance and management (Lowry and Shu, 2002).

Bhabra and Pettway (2003) in their study on IPOs from 1987 till 1991 found that information collected from prospectuses is not indicative of the one-year stock return but rather give guidance as to the survival or failure once compared to subsequent equity offerings. Further studies by Balakrishman and Bartov (2011) suggest that analysts cannot fully induce the qualitative earning information reflected in the prospectus's risk factors section due to pre-existing prejudice that leads to downside earning risk information and in turn displays and explains up to a certain degree the post-IPO underperformance. Drake and Velsuypens (1993) went to discuss the lawsuit avoidance hypothesis that presented underpricing as a probable safety net to avoid legal liabilities under federal securities law for mis-statements in the offering prospectus or registration statement. Table 15 enumerate some of the main information that a prospectus should contain:

Table 15: Prospectus (sample topics)

A description of the issuer's business activities.
The outstanding securities.
The offered securities and the rights attached to it.
The offering procedures.
Information regarding the company's directors and officers.
Certain corporate governance issues.
Information regarding the 5% or more shareholders and the shareholders' agreements among them.
Description of the remuneration of the chief executive officer and directors of the company.
The use of proceeds and expenses of the issue
Lock-up agreements.

Source: Personal collection.

The prospectus should also contain the issuer's financial statements and a management discussion and analysis.

The description of the business activities is the main chapter in the prospectus and reveals information on the following issues as elaborated in table 16 below:

Table 16: Prospectus' Description of Business Activity

Economic environment	Research and development
Equipment	Products and services
Financing	Environmental issues
Material agreements	Material legal proceedings
Strategy	Risk factors
Regulatory environment	Customers
Suppliers	Marketing
Employees	Backlog
Competition	Capitalization and indebtedness

Source: Personal collection.

The prospectus is usually drafted by the issuer's external lawyers after they conduct a due-diligence process, with input from the issuer. If there are underwriters that will be signing the prospectus, the underwriters' legal advisors check the prospectus and conduct independent legal and financial due-diligence.

The following parties have statutory liability for a prospectus:

- The issuer or offering party
- The issuer's directors.
- The issuer's chief executive officer.
- The issuer's controlling shareholders (even if they do not sell shares under the prospectus).
- The underwriters (if any).

These individuals are all liable to the buyers and sellers of the securities covered by the prospectus for damages incurred to them as a result of misleading information in the prospectus, including a

failure to disclose any material information. The underwriter activities are most likely to be concerned with production and marketing and sales efforts exerted on their behalf.

C. Affiliate filing

In addition to the registration statement, all officers, directors and shareholders with 10% or more of the companies' shares must file, at their own responsibility, a special form on insiders' ownership. But, to ease the process, companies usually handle this registration and count as part of the overall registration statement costs. The stock exchange, where the listing is decided upon, will look at different aspects, including the number of shareholders, amount of capital invested and the relationship among all shareholders. Michel et al. (2014) presented the choice of public float level as a trade-off between incentives to insiders and power given to outsiders and that determines the relation between public float and long-run returns. Furthermore, one of the main issues is to ensure that no individual or group controls the 'public-float'. Therefore, the company in this registration signals that it is abiding by some corporate governance guidelines related to transparency and that covers minority and controlling interest in the company. Accordingly, the time needed to complete this registration or affiliate filing procedure is not included in the company's general IPO process time frame.

D. Private placement

The private placements of equity are usually short-term in nature and they result from a more rigorous analysis that contains governance guidelines and are transparent to outside investors. This disclosure projects the firm's future prospects because they represent reputable investors' decision, endorsing as such the issuing firm, especially in the case of young firms, less capitalized firms, and firms that have received recently funding from experienced investors. These participating investors take advantage of private placements since they get to purchase the shares at a discount and earn normal returns and both announcement and long-term abnormal returns are significantly higher when the shares are placed with affiliated investors (Janney and Folta, 2006).

The issuing company will have to expense a large amount of money in the process of the preparation for the going public event. Along the way, the company might rely on some conventional actions such as a private placement in order to collect some funding that should assist in covering part of the costs of legal advice, registration and financial audit.

The private placement requires a communication letter to be addressed to potential investors and which shall include the company's business plan as to the expected corporate structure, the expected potential performance and the use of the proceeds. As such, a private placement memorandum (PPM)⁵¹ will have to be drawn by a legal counsel and takes 2-3 weeks (Nead, 2014).

E. Registration for quotation

Once the registration becomes effective, a market maker or a broker-dealer, who represents the company, must file a form that governs the submission and publication of quotations for certain equity securities through a legal counsel. This form is submitted to the proper financial regulatory authority and the process extends over couple of months depending on subsequent amendment requested by the said authorities.

F. Ticker and CUSIP collection

After the registration and the filing with the respective regulatory authority, a ticker is issued along with the respective CUSIP⁵² and the company must file for eligibility for a securities' depository and clearing firm⁵³ through its broker-dealer and this process takes 2-4 weeks to be completed (Nead, 2014). On the other hand, a listing on a European stock exchange from scratch could take as little as 6 weeks (Big Ben Venture).

Accordingly, the company should choose wisely how to hire a knowledgeable, experienced and qualified professional advisor in order to maintain all stakeholders who are involved in the going-public transaction on track and on budget. In its decision regarding the choice of the professional counsel, the firm must weigh both the costs that it is willing to incur against the time it takes to accomplish all these tasks and finalize the registration and the going public process. As such, the right PCAOB⁵⁴ audit can play an important role in minimizing the cost and time to reach the final public stage which can range between 6-12 months (Nead, 2014).

⁵¹ A private placement memorandum (PPM) is a legal document provided to potential investors when selling a security in a business. It is sometimes referred to as an offering document.

⁵² CUSIP is an acronym that refers to Committee on Uniform Security Identification Procedures and refers to a nine-digit, alphanumeric CUSIP number that is used to identify securities.

⁵³ DTC is the largest securities depository in the world and holds over thirty-five trillion dollars, worth of securities on deposit.

⁵⁴ The Public Company Accounting Oversight Board (PCAOB) is a private-sector, nonprofit corporation created by the Sarbanes–Oxley Act of 2002 to oversee the audits of public companies and other issuers in order to protect the

III. IPO and Costs Breakdown

The following will cover three main topics: first, the necessary services to plan for during the IPO process, and their relative costs; second, the structural changes that must be made before and after an IPO, and their relative costs; and third, how a company should account for the respective costs. The costs of going public can be looked at differently and can be divided into four different types; Pre-IPO direct and indirect costs, post-IPO one-time and recurring costs. The specific costs in each of these four categories are listed in the following figure 35 and will be discussed in details throughout the course of writing this article.

The costs are divided into gross fees and brokerage fees. The gross fees are usually charged to the issuer and any other selling shareholder and calculated as a percentage of the issue size and deducted from the proceeds realized in the IPO. They can also be in the form of brokerage fees that are charged to investors as a percentage of the value of the stock allocated to each of them in the IPO (Espinasse, 2014). In addition to the gross fees, firms are often charged with fees to cover documentation and advisory expenses and they range in the couple of hundred thousand US dollars for the bank acting in its capacity as sponsoring bank. The IPO fees charged vary from market to market and they depend in most of the cases on the size of the transaction. They were recently falling in Europe except on the AIM in the UK and other secondary boards, where they remain relatively high due to the small size of the IPOs on the said platform. In most of the Asian markets, they range about 2% to 3% of the issue proceeds, whereas they remain high in the US, reaching often 6.5% to 7%.

Negotiation is part of the game, but firms usually prefer to pay relatively higher fees in order to capture the full attention and dedication of the lead bank and they put in some additional variable fees that are linked to the performance of the lead bank and its delivery of its promises in the deal.

A. Pre-IPO Direct Costs

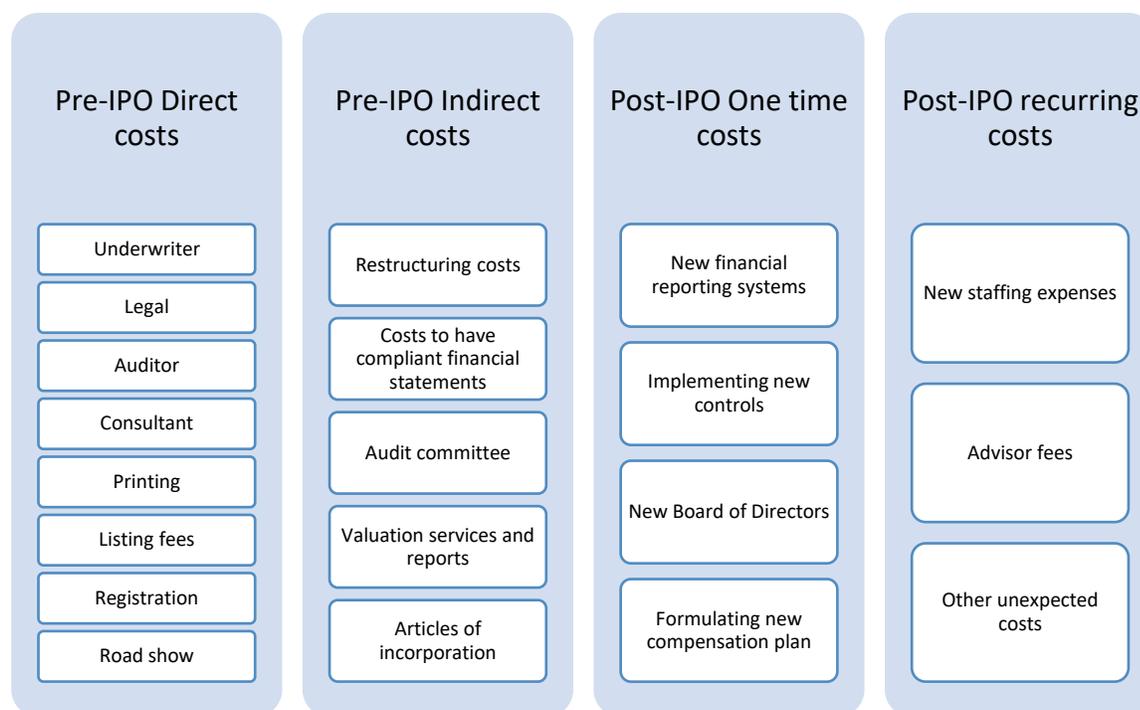
In the financial world of capital markets, undergoing an initial public offering (IPO) involves sizeable direct and indirect costs. The gross spreads, which are the fees paid to investment banks for supplying the underwriting services and accepting the relevant issue risk, represent the most important element of the direct costs, whereas, the most important element of indirect costs is

interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports.

represented in the value of underpricing of the new issue. The pre-IPO direct costs are comprised of the following task as per the breakdown of table 17.

The gross spread or the gross fees of the equity capital market transactions are usually split into three major components, management commission (20%), underwriting commission (20%) and selling commission (60%). The management commission is paid to compensate for the dedication of the resources and underwriting is often paid on fixed amount underwritten, the sales commission, on the other hand, is paid for actually selling the securities offering to investors and it is dependent of the book of orders of each participating bank (Espinasse, 2014).

Table 17: IPO Costs Breakdown



Source: Christensen, C, 2018.

1. Underwriting

Going public is a complicated process and the services of underwriters are requested for their experience and skills in valuing/pricing, marketing (Merton 1987), administration (Booth and Smith 1986), monitoring (Easterbrook, 1984 and Hansen & Torregrosa, 1992) and research. Different studies have looked into the relation between underwriters' reputation and IPO initial

returns and found a negative relationship where reputable underwriters are associated with lower IPO underpricing (Beatty & Ritter, 1986; Johnson & Miller, 1988; Kim et al. 1995; Carter et al. 1998; Aggarwal & Conroy, 2000; Kirkulak & Davis, 2005; Kenourgios et al. 2007). Despite their costs, issuing firms use reputable underwriters to market their credibility, and these underwriters, in turn, market low risk firms to sustain their reputation and ultimately send a positive sign to investors regarding the current and future value of the issuing firm. Lee (2010) stressed on the underwriters' important role in timing the offer based on their expertise in the financial markets and their know-how when it comes to the issuer's industry performance. The more reputable the underwriter is, the more its competitive advantage with respect to collection of information and the better their ability to time an issue to correspond with higher industry valuation of comparable stocks in the market.

Underwriters with a good reputation are paid more for taking companies public and are expected to provide a better service. Underwriters provide a list of different services to the firms that they take public which will lead to different gross spreads charged. The investment banks usually ask for higher fees when they are required to provide some additional services such as price stabilization and liquidity support. Based on the declarations reported in the prospectus of Italian IPOs, the availability of underwriters to stabilize the price increases the spread costs (Signori et al. 2012). As such the underwriter's remuneration can be spread over three important variables: (1) nature of the firm, (2) the underwriter's characteristics, and (3) the IPO deal. First, the nature of the company going public affects the level of fees in such a way that larger firms pay relatively less as a percentage of the gross proceeds. Second, the reputation of the underwriter and its perceived quality and bargaining power in addition to its ranking and international standing tend to be a factor to raise the fees (Fang 2005, and Signori et al. 2012). Third, the services and commitment required from the underwriter in addition to the scope and level of these services play a decisive role in setting the structure of the fees. Signori et al. (2012) confirmed the existence of an average of three percent gap in underwriting fees between US and Europe which, according to Abrahamson et al. (2011), is justified by higher marketing costs, legal expenses and litigation exposure of US underwriters.

An important signal sent out by a firm when going public is when it hires a reputable underwriter (Beatty & Ritter, 1986; Booth & Smith, 1986). Many studies show that reputable underwriters reduce underpricing and present a positive effect on the long-run performance of the IPO, and this

confirms the relevance of underwriters as an attractive signal for potential investors (Bansal & Khanna, 2013; Bruton et al. 2009; Carter et al. 1998).

The underwriting fees of companies undergoing initial public offering (IPO) process amount to an average of 5.4 to 5.6 percent of gross proceeds of the IPO offerings back in 2017 (Szmigiera, 2019 and PwC 2017), with a 4% and 7% representing upper and lower limits respectively (Christensen, 2018). In some older studies, Ritter (1987) examined IPOs from 1977 to 1982 in the United States and found that the direct investment banking fees, taking into consideration the size of the public offer, are relatively similar in magnitude among underwriting contracts. Furthermore, Chen and Ritter (2000) revealed that around 90 percent of average size public offers in the United States, during the period of 1985-1998, were billed with gross spreads of around 7%, which the authors assigned as the "7% solution" due to insufficient competition among underwriters during that period of time and according to Abrahamson et al. (2011) this high fee rate is still prevailing even with new entrant into the underwriting market. Torstila (2001) went even further to show that the spreads in most European countries do not even cluster and cannot be grouped at any level but rather vary from country to country and Torstila (2003) stated that this spread is lower in Europe by around 300 to 400 basis points. Furthermore, these upfront costs of an IPO can be significant with underwriters' commissions typically standing 4%–7% of the proceeds of an IPO according to TORYS⁵⁵, Canada-Toronto.

The underwriting fees to be charged are also a function of the issuing method used (Ljungqvist et al., 2000). Book-building is a method that is followed more frequently with the assistance of an analyst whose role is to provide a recommendation that might be more appealing to potential investors. The book-building method depends on the demand and supply for the issued stock and as such the underwriter is prompt to refer to underpricing of the shares in question in order to sell them and get his commission accordingly. On the other hand, the auction method provides usually a more accurate and fair pricing for the issued stock depending on the positive effects created from the road show (Ritter, 2014).

The price received for the offer will be determined by the track record of the company, its future potential and the respective listing market and agreed upon by the company and the underwriter. Firth and Liao-Tan (1998) showed that even if the firm is audited by a reputable auditor, the underwriter might underprice the issue to avoid holding back unsubscribed issues which will

⁵⁵ Torsys LLP is a respected international Canadian business law firm.

confront them with adverse positions that can even reach losses. Furthermore, Sherman and Titman (2002) stated that underwriters' discretion is an important tool used to grant advantage to the issuing company, because when the underwriters use their discretion to package the IPOs, problems emanating from the asymmetric information are reduced (Ritter & Welch, 2002) and as such cause lower initial returns on IPOs.

Kostas (2014) mentioned issuing warrants to the underwriter by some cash constrained firms in what he called a non-cash compensation. The issuer will, accordingly, decrease its costs of going public and leaves the opportunity to the underwriter to time his exercise of the warrants and who in turn work on lessening the underpricing of the issue in order to benefit from the exercise of these warrants. (Kostas, 2014). The reputable underwriters usually benefit from the advantages of issuing these warrants that provide, in a way, some certification that the offer is not overpriced. The total costs the US IPO firms incur during the flotation stand at 28.9% with warrant issue and almost double at 43.96% without the warrants. Dunbar (1995).

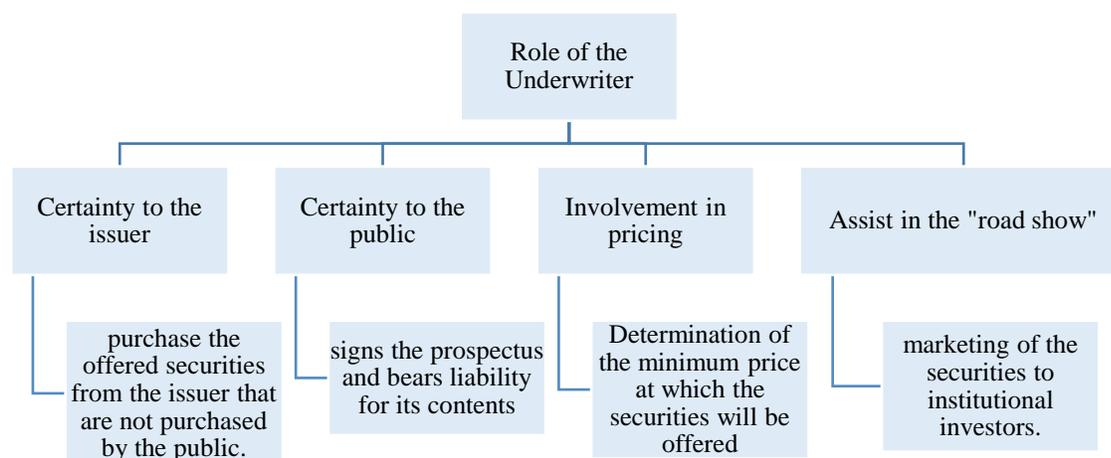
In contrast to the above, reputable underwriters are often linked to higher levels of underpricing probably in times of changes in the economic conditions and emphasis on more analyst coverage which relates also to higher media attention and increased publicity in the market for the respective stock (Chemmanur & Fulghieri, 1994; Beatty & Welch, 1996; Bates & Dunbar, 2002; Loughran & Ritter, 2002 and Liu & Ritter, 2011). Moreover, issuing firms and underwriters might set the price of an IPO below the true market value to protect against any future litigation by investors and to protect uninformed investors from negative initial returns if the IPOs are overpriced.

Furthermore, it is crucial for the underwriter to assign a professional market analyst with proper experience in the industry of the issuing firm and with previous market coverage of similar firms within the industry at the local and international level. This analyst coverage will help in pulling the attention of investors and provides confidence to the market participants on one hand, and assures the issuing firm's original owners of receiving an equitable price for the shares they are offering to the market on the other.

The underwriting service is usually divided among a syndicate of banks whose size depends largely on the size of the issue. The underwriter who can pull together a strong underwriting syndicate will facilitate the sale and distribution of the offering. The underwriting fees are,

accordingly, distributed to book-runners⁵⁶ (80% to 90%) and the co-managers⁵⁷ (10% to 20%), (PwC 2017). Wang and Zhou (2013) in their study of the Chinese IPO market found that lower spreads are associated with large competition among underwriters⁵⁸ on one hand and significantly affected by the issue proceeds, the number of book-runners, and the book-runner reputation on the other.

Table 18: Breakdown of Major Services Provided by Underwriters



Source: CFI, personal compilation

2. Legal

The legal costs cover almost each and every aspect of the offering process. They encompass drafting of the registration statement to counselling needed for the due diligence and advice on the prospectus and the disclosure requirements. The respective legal counsel should have strong expertise in the laws and regulations concerning public company disclosure and corporate governance requirements. This will enable the legal counsel to help the company make decisions before and during the IPO that will benefit the company during its public company life. The legal counsel will ultimately advise the company on the establishment of the corporate governance structure, policies and procedures so that the company can operate effectively and in compliance

⁵⁶ The book-runners manage the order book for the company's securities once the IPO is placed into the market

⁵⁷ The co-managers generally pick up research coverage on the stock and provide aftermarket support.

⁵⁸ Torstila (2001) stressed on the high competition among investment banks to underwrite privatization IPO (government entity being privatized) in the European markets.

with relevant governance laws, regulations and stock exchange rules after the IPO (PerkinsCoie, 2016). The costs vary depending on the complexity of the offering, the structure of the company and the restructuring needed to meet the legal requirements for listing. The legal fees range from \$175,000 for small deals to \$ 1,800,000 for deals exceeding \$ 1 billion (PwC 2017).

3. Auditors

When a firm goes public, it has inside information regarding the company's expected future growth which is not readily available to the potential investors. This asymmetric information problem leads to a demand for an auditor's credibility to affirm firm value on one hand and to minimize monitoring costs on the other (Sundarassen et al. 2017). Their findings also show that both auditors' and underwriters' reputations play an important role in decreasing asymmetric information and indicates firm value to potential investors. On one hand, the reputation of auditors shows a positive relationship, while the reputation of underwriters shows a negative relationship but the latter has a more prevailing role in supporting investors in their investment decision. Hogan (1997) in a study of a sample of US IPOs in 1990, confirmed on previous studies by Beatty (1989) and showed that firms choose one of the big 6 auditors to benefit from lower underpricing knowing the accompanying higher compensation costs. Furthermore, in the presence of asymmetric information, potential investors in the going public situation are relying on auditors and underwriters for various signals of firm quality (Wang and Wilkins, 2007; Sundarassen et al. 2017). Many studies have asserted that engaging reputable auditing firms to perform the audits plays an important role in sending signals of firm quality (Beatty, 1989; Brau & Johnson, 2009). As such, the auditor's attestation of the relative financial information minimizes asymmetric information between investors and owners and accordingly reduces the cost of initial underpricing of the securities that are usually borne by the owners. In Australia, IPO firms voluntarily providing an earning's forecast within the offer document are considerably more likely to use a high-quality auditor, stressing on the fact that the signalling role of auditor attestation is at least partially dependent on the extent of voluntary, audited disclosures (Lee et al. 2003). Fan and Wong (2004) stated that firms suffering from agency problems rooted in their ownership structures tend to employ one of the Big 5 auditors and as such receive lower share price discounts resulting from the agency conflicts and usually raise equity capital more frequently. They also found that agency problems are factored into the auditors' fees structure and audit report decisions. At the time of the

IPO, there is relatively a lack of information that can facilitate the setting of equity values which suggests that the information presented by external experts like auditors and underwriters is rather important. The pre-IPO opinions of larger auditors are more predictive of post-IPO stock delisting and for these larger auditors the presence of a pre-IPO going-concern opinion is correlated with first-year stock returns and the larger auditors, themselves, are more inclined to provide such opinions to their distressed clients (Weber and Willenborg, 2003).

Fees are incurred for performing of audits of financial statements that are required to be added to the listing or offering document and for the auditors' review of the related documents. The external auditor is set to review and give advice on the registration statement in addition to issuing of a comfort letter⁵⁹. In the USA, these costs vary from \$20,000 to \$400,000 for deals size from \$100 million to more than \$1 billion respectively with a maximum upper limit that can reach \$ 7 million for a deal exceeding \$ 1 billion (PwC 2017). Hence, audit quality plays a crucial role as auditors provide extra credibility to the financial disclosures (Hayes et al. 2005). Independent audits enhance the credibility of corporate financial reports and help investors to make rational decisions in the capital market. The critical use of the auditing functions depend in the first place on the quality of audits as displayed by the independence and expertise of auditors (Lin et al. 2008). Therefore, the utilization of reputable auditors and underwriters is a form of signal regarding the level of quality of a firm and enhance the subsequent sale of shares (Francis & Wilson, 1988) and may affect the share prices eventually (Albring et al. 2007). This idea is also concurred by Wang and Wilkins (2007), who revealed that the IPOs that were audited by the Big-6 audit firms stand to face less underpricing compared to the IPOs that were audited by non-Big firms. Furthermore, the SEC experience for non-national firms is associated with higher audit fees, suggesting this experience is perceived to be valuable because the choice of audit firm is important since the auditor reputation influence the pricing of the offering (Albring et al. 2007).

Additionally, LI Ming-hui in a study of 179 Chinese IPO firms revealed that among all the variables related to corporate agency conflict such as size, growth, leverage, ownership and independence of the board, only the size of the firm had a positive effect on the choice of big auditing firms while ownership had only a downside U shape, and no relations were found regarding growth and leverage and the choice of auditors and new issuers of securities have more

⁵⁹ A comfort letter is a document prepared by an accounting firm assuring the financial soundness or backing of a company.

tendency to choose a high-quality auditor and retain a lower percentage of ownership as the firm-specific riskiness of future cash flows increases (Peter et al. 1994).

4. Consultant

Most of the going public companies need the services of a consultant in this domain to act as business advisor to the executives and auditors; to help in the filing of registration documents and assist in the readiness for the IPO. Most firms that are less visible and have inexperienced management tend to hire Investor Relations (IR) consultants prior to the issue date. These consultants help, also, in the creation of positive vibes (Chahine, 2019). The credibility and success of consultants are based on their independence and their ability to deliver objective and unbiased advice (Espinasse, 2014). Based on the simplicity of the company, these consultancy cost can reach \$0.5 million. Furthermore, investment bankers have a significant association with deal completion time and their skills and connections are important channels through which bankers are associated with deal performance (Ertugrul and Krishnan, 2011). These consultants are usually former equity capital markets investment bankers or financiers who have, throughout experience, focused on the execution of equity corporate finance transactions, and as such enjoy considerable experience of what an IPO entails and they have extensive understanding of the requirements of an IPO. Small IPO firms usually do not have a well exposed investors' relation departments and accordingly, they are more likely to rely on external IR consultants.

Chahine et al. 2019. Found that when firms have inexperienced management and low visibility, they require investor relation consultants to help them enhance their publicity prior to an IPO offer. As a result, the issue shows higher underpricing with lower long-run returns and insider such as venture capitalists depend on these consultants to benefit from possible higher first-day returns.

5. Printing

The printing costs relates to all documents needed for the proper filing with the respective authorities and the road show materials and other distribution expenses. There are firms that specialize in arranging the prospectus and the revision of the documents and the submission of these documents to the proper authorities, all with strict confidence and secrecy. The printing costs cover also the preparation and distribution of marketing materials and the SEC filing and other papers that might be requested or needed by management. The costs range from \$10,000 to

\$350,000 for deals size ranging from \$100 million to more than \$1 billion respectively with a maximum upper limit that can reach up to \$2 million for a deal exceeding \$ 1 billion (PwC 2017).

6. Listing fees

An actively traded stock exchange is crucial for the liquidity of the issued stock and helps in increasing the profile and visibility of the company. The listing fees represent the costs paid to the exchanges for listing services. There are usually flat amounts to be paid in addition to a cost that depends on the number of shares outstanding and is paid initially with the listing and annually thereafter. Some trading venues charge the listing fees as a percentage of market capitalization of the listed firm, which makes it a variable yearly fee to be paid. An additional fee is also required to be paid to FINRA⁶⁰ in the US as part of the listing costs of an IPO offering. MiFID⁶¹ and EMIR⁶² enact the regulations that increase transparency of EU's financial markets and are enforced by ESMA⁶³. In NYSE, an application fee of \$50,000 is required in addition to a \$0.004 per share capped at \$270,000 plus a onetime fee of \$50,000, whereas on the NASDAQ it ranges between \$ 50,000 for companies with less than 15 million shares and \$75,000 for companies with more than 15 million shares. As such, initial listing fees constitute a trivial amount of the total cost of raising equity on almost all exchanges, in general less than 0.1% of the amount issued and the annual fees paid to maintain a listing are also considered minor compared with other costs.

7. Registration

Before a company's securities can begin to trade on a securities exchange it must register that class of securities. By registering securities, a company becomes subject to the periodic and current reporting requirements and, as a result, becomes a reporting company⁶⁴. The registration should provide some important information regarding the description of the company's properties and business and the security to be offered for sale; some information about the management of the company and some certified financial statements. The financial regulatory authorities in each

⁶⁰ FINRA is the main organization that monitors and regulates U.S. stockbrokers and brokerage firms in the USA.

⁶¹ MiFID: Market for Financial Institution Directive

⁶² EMIR: European Markets Infrastructure Regulations

⁶³ ESMA: European Securities and Markets Authority

⁶⁴ Registration with the Sec in the US or ESMA in Europe

country require some registration fees to be paid in order to file the shares on a pre-determined exchange. This registration depends on the number of shares to be issued and the final launching price. The securities in question may not be sold nor any offer accepted before the completion of the registration.

8. Transfer Agent

A transfer agent helps in the issuance of shares and makes sure that the IPO proceeds smoothly. With the existing complex regulatory environment, a transfer agent must be carefully chosen based on his experience reliability, reputation and responsiveness. All companies with publicly traded securities refer to a transfer agent, who is also a share registry, to follow up and keep track of the different shareholders and bondholders as ownership of respective securities exchanges hands in the markets. It can be a trust company or a bank.⁶⁵ The most important in market share in the USA are Compushare / BNY Mellon and American Transfer and Trust (AST) and Clearstream / Euroclear in Europe.

9. Road show

An IPO is often marketed shortly before the publication of the prospectus by a "road show", during which the issuer, together with the underwriters or distributors, present the company to institutional investors. The roadshow presentations is usually designed to capture audiences' overall insights of a CEO and is directly associated with pricing of the IPO and gives guidance as to the proposed price and the offer price (Blankespoor et al. 2017). The pre-IPO road show must contain enough information about the company to induce the investors. Companies are usually given the opportunity to test their message in front of investors to see its effects and the process is often handled in a one-week and commonly referred to as "test the waters"⁶⁶ meetings. During the road show, a team from top management and the investment bank share the company's presentation with investors in one-on-ones and in large and small group meetings during a period ranging between 8–9 days. Blankespoor et al. (2017) showed that the high perception of

⁶⁵ The transfer agent has also the responsibility of overseeing the mailing of monthly investment statements to investors and mutual fund shareholders.

⁶⁶ It's a series of one-on-one meetings with potential investors in order to refine the message inherent in the road show and provide feedback regarding the company's story.

management by potential investors is mostly linked to high-quality underwriters and accordingly reflected in their assessments of firm value.

Usually the road show video would have been released to the general investor audience on the first day of the road show, accordingly, most of the audience would have seen the video and they move directly to questions that will help them determine whether they want to invest in the company or not. The target audience of the road show revolves usually around institutional investors on one hand and anyone who might be interested in the company from fund managers to analysts on the other.

The roadshow has been dominant in China's IPO to compensate for the incomplete information between the issuer and the investor and as such the quality of the letter of intent is usually presented as a discrete signal to set the issuer's equilibrium signal and the investor's buy action. The issuer put forth a letter of intent to uplift its quality and if it is considered by the investor as high-quality, the basis of purchase is that the opportunity cost is less than the expectation on the intrinsic value of the issued stock, otherwise the investor will refuse to purchase on the condition that the opportunity cost surpasses the valuation of intrinsic value (Zhao and Li, 2016).

Therefore, the investment would have worked on refining the story to highlight all the historical successes of the company, the challenges and the values the company creates for its customers and its vision for the future in addition to the competitive positioning, the financials and culture of the company and off course a possible sales price for the stock. The roadshow should not be the restatement of firms' public news, but rather it should supply more detailed information and interaction with small investors (Wang, 2018). Even though the IPO roadshow is devised to be the first public disclosure of listing firms, it has now turned to be more of an acting scene, the activity, words and appearance of managers present one of the most imminent pricing factors. Furthermore, since the internet has become an important communication platform, the public firms should pay more attention on the non-formal disclosure channel, such as roadshows and stockholder meeting, when it comes to communicating additional information, because now the channel of disclosure has expanded to online news conference, interviews with managers and managers' social network away from traditional news report and announcements in newspapers (Wang, 2018). In his study of IPO roadshows of China's, A-share market he showed that managers' mood that is reflected in their oral recommendation of IPO roadshow had an elusive effect on investors' decisions. The minimum tender price of the securities is often determined based on the responses of the potential

investors and usually it is not permitted to fix a maximum price. Jenkinson and Jones (2009) showed how, during the roadshow, institutional investors assess the IPO and the kind of information they provide to the investment banking syndicate among which is the brokerage relationships with the book-runner which are believed to be the most important factors influencing any IPO allocation.

The CFO should stand ready to answer any question about the company reflecting, as such, confidence in the future opportunities and potentials of the company. Therefore, the road show costs revolve around cost of transportation and hotels stays and presentation venue, in other words the costs depend on how far the company decides to go with road show and the area to be covered.

B. Post-IPO Direct Costs

The post-IPO direct costs are comprised of the following:

A publicly listed company must consider a bundle of costs to maintain its shares trading in the market and the exchange venue where it is listed. Some of these costs are mandatory and some of them are optional. The mandatory costs revolve around exchange and regulatory requirements, compliance and transparency requirements, and audit and legal requirements. DeAngelo et al. (1984) put forward the argument related to the size effect, where he said that larger firms tend to be more capable of amortizing these costs unlike smaller firms who might reach a point in time and be forced to leave the public market once these costs become detrimental to their operations.

1. Listing fees

Most exchanges charge some annual sustaining fees based on market capitalization of the listed company and additional listing fees for any additional securities listed including securities resulting from private placement grouped under financing fees, filing fees that cover transactions such as stock option plans, shares split, warrants and convertible debt, and any new classes of shares. Some of the exchanges are much lenient in their requirements and charge only an annual flat fee. Most of the exchange use electronic systems for filing such EDGAR⁶⁷ in the USA,

⁶⁷ Electronic Data Gathering, Analysis and Retrieval (EDGAR) is the electronic filing system created by the Securities and Exchange Commission to increase the efficiency and accessibility of corporate filings.

SEDAR⁶⁸ in Canada and the Exchange Reporting System (ERS) in Germany⁶⁹. In Canada, the Toronto stock exchange has the minimum annual sustaining fee as \$12,500 up to a maximum of \$110,000 and it depends on market capitalization.

2. Legal

A financial lawyer is necessary to help the publicly listed company in compliance with applicable rules and regulations pertaining to securities and the stock exchange in general. He can assume the role of a consultant in all matters related to mergers and acquisitions, financing decisions, disclosure concerns and many other corporate actions. In this capacity, he assists in the preparations of press releases and information needed for shareholders' meetings, attends board meeting and drafts board resolutions and minutes of meetings, and presents the company in any communications with exchanges and the regulatory authorities. The costs of such services are based on a monthly all-in charge or broken down into hourly charges. Example of which can include press release fees set at minimum of C\$ 2,500 per year in Canada.

3. Transfer Agent

The transfer agent is the registrar and the custodian of all shares issued within a jurisdiction. His role includes execution of any amendment to the capital structure of a company, issuance of certificates and managing mailing to shareholders regarding any meeting, changes to capital structure and dividend decisions and payments. The transfer agent's costs depend on the number of shareholders, the frequency of dividend payments and the listing exchange. Basic annual fees for transfer agents typically range between \$3,000 and \$6,000 in Canada.

4. Auditors

The exchanges require audited financial statements to be submitted on regular intervals. The fees paid, for such services, depend on how structured is the company's data and on how much it has grown and on the amount of information provided to the auditor to perform his duties at the best

⁶⁸ The System for Electronic Document Analysis and Retrieval (SEDAR) is an electronic filing system that allows listed companies to report their securities-related information with the authorities concerned with securities regulation in Canada.

⁶⁹ ERS is used for forwarding annual financial reports, annual financial statements and management reports, calendars of company events, brief company profiles, key financial figures and ratings to Deutsche Börse.

of his capabilities. Some exchanges require audited and unaudited financial statements and accordingly the auditor will charge differently for each type depending on whether he will prepare both or only the audited ones.

Furthermore, results indicate that firms that pay a premium for their registration audit face lower initial returns for their investors confirming as such the inverse relation between the initial public offering initial return and the auditor reputation (Beatty, 1989).

Chen et al. (2005) in their study of the relationship between audit quality, as a function of size and industry specialization and earnings management as a function of unexpected accruals in the cases of Taiwanese IPO firms found that the big five auditors are related to less earnings management in the IPO year in Taiwan which reflects that higher quality auditors constrain earnings management for Taiwan IPO firms and provide more precise information. The same was revealed by Xian and Lijie (2006) when they showed that higher quality auditors constrain earnings management for Chinese IPO firms.

5. New financial reporting system and new control system

Once public, investors and regulators expect to have extensive information about the company. The financial adviser or consultant must help the offering company with the preparation of the pro-forma financial statements that are required by the regulatory authorities and should handle any comments and follow up with the SEC. As such a new reporting system is in demand depending on the existing system's deviation from the public companies applicable accounting standards. The financial reporting should be commensurate with the exchange requirements and at the same time provide enough information to investors and market analysts equally. Moreover, new control and additional auditing procedures are required by the regulatory authorities that necessitate additional risks on the auditors and as such are compensated by higher fees. Accordingly, these costs associated with auditing and financial reporting constitute around 50% of the costs of being a publicly traded company (PWC, 2017). Moreover, as part of the requirements, MD&A⁷⁰ should be prepared quarterly and annually to discuss some of financial and non-financial information which should be adequate and reliable at all times.

⁷⁰ The management discussion and analysis (MD&A) section provides commentary on financial statements, systems and controls, compliance with laws and regulations, and actions planned or taken to address any challenges the company is facing. Management also discusses the upcoming year by outlining future goals and approaches to new projects (Investopedia).

Regulatory compliance represents one of the major hurdles facing the decision to go public. A public company should comply with regulations imposed by all the financial markets' concerned regulators extending from the SEC and Sarbanes-Oxley (SOX)⁷¹ in the United States to EU regulators to the public company accounting oversight board (PCAOB) to respective governments and listing exchanges' rules and regulations.

According to a study published by Protivi in 2016, one third of organizations pay around \$500,000 per year and one half reach the threshold of \$1 million per year with some large firms in the real estate and telecommunication sectors spending around \$2 million per year on meeting SOX compliance requirements. According to most literature about the subject, it is those compliance costs that are holding back companies from going public and shrinking the capital markets in general.

Furthermore, a public company is accountable toward its investors, shareholders and the public in general. The company must, accordingly, bear the costs of maintaining, at all times, a transparent and accurate communication with all its stakeholders. All companies should arrange for a press release for every major change that happens in the company and that should be notified to the respective exchange and to the respective stakeholders. This diffusion of information can be charged at a flat rate or at any other exchange suitable charge.

6. New board of directors and new compensation plan

A joint stock company that can list its shares in the markets must maintain some minimum board members count and work on a compensation plan that will retain its key employees and management team. New board member might be needed with special expertise to help in hiring and training of new senior employees in order to ensure proper succession planning, to identify and manage new confronted risks and to draw compliant corporate governance rules (PWC, 2017). Some companies work on their employments and compensations based on tax-driven incentives, but once public, the company must disclose all direct and indirect compensations provided to some executive officers and directors for services they provide to the company and the decision process related to such disbursements. Pergola and Joseph (2011) found that both independent and insider board members become entrenched, therefore impacting reported earnings quality and the strength

⁷¹ The Sarbanes-Oxley act and its stringent compliance requirements imposed on publicly traded listed companies is accused as being the reason holding back firms from going public and of squeezing the whole capital markets.

of the governance structure which questions the motivations and the behaviour of board members and the impact of stock ownership on their actions.

A study by Ernest & Young (EY) back in 2011 revealed an important cost related to being a public traded company and which is associated with the high compensation paid to officers and directors post-IPO and in specific the investors relations new function and which comes to add to the costs incurred as result of hiring different types of advisers. These costs cover the increase in the board size which is witnessed through the addition of new members to the existing boards. In the same study, EY found around \$1 million in annual costs spent on advisors in addition to the costs paid to help in the IPO process. Moreover, the new public company had to contract with investor-relation firms, auditing firms and attorneys' firms.

7. New staff

All the above introduced functions that come with the public territory must be staffed with adequate personnel and the cost thereof including the costs of additional board members and audit personnel must be included in the recurring budget expenses of the public company which can at times reach around \$ 1 million in the US.

This staffing needed must cover many functions that include hiring, training and retaining, and especially in the department that are considered crucial to the process of going public such as finance, accounting and legal.

Needless to forget that all the previously mentioned prerequisite and post requisite should be managed through a well-developed IT system that can differentiate and analyse each and every function with its relative costs separately and with the utmost level of cyber security and support. The information system should also be flexible to accommodate for any new developments in accounting standards and regulatory requirements.

8. Advisor fees

The going public process is considered a major transformational decision for a company and the costs associated with it can be detrimental. Hence, most companies depend on external financial and capital markets advisors to provide them with the proper assessment of their readiness to go public and help them predict and prepare for the IPO process. Nevertheless, these services will still be required after going public in order to anticipate and mitigate any unexpected costs (PwC

2017). The reputation of the nominated advisor (Nomad) to the IPO company has a significant impact on IPO survival as seen on the AIM⁷² in London (Eспенlaub et al. 2012).

The role of the advisor can be combined with the legal role to cover guidelines and advices on investor relations which are important for any publicly traded company to attract new investment and maintain it while meeting full disclosure requirements at the same time. In one of the largest markets, the broker who provides advice to a company to list on AIM receives a commission that is divided into two main parts (London Stock Exchange, 2007b, p. 34). The first is the commission, which is calculated as a percentage of the proceeds of the flotation, and is paid in return for securing investors in the new shares and buyers for shares offered during the IPO. The second part is the retainer fee, which is paid annually to maintain the advisor on an ongoing basis, post-listing. (Dimitris, 2014).

9. Market makers

In the absence of high frequency traders, designated market makers present themselves as a solution to bypass the transfer of asymmetric information costs across traders into an increase in social welfare by encouraging the narrowing down of spreads and giving more incentives for more traders to become better informed and accordingly pave the way for faster and better price valuation by market participants (Bessembinder et al. 2011).

Moreover, a publicly traded company might require the services of a market maker to develop and improve the liquidity of its shares by making available a continuous market to both buyers and sellers of the respective company's stocks. Illiquidity associated with secondary markets can at time deter firms from going public on one hand and investors from soliciting trade in such markets on the other. As long as the firm is able to capture a higher IPO price and all the expected benefits from improved secondary market liquidity including the value-maximizing of the firm, a designation of a market maker provides some social welfare and in a way a solution to any probable market failure (Bessembinder et al. 2013). To overcome market irregularities, a going public firm can contract with a designated market maker to enhance and provide liquidity to its stock specially when the firm is a new comer, small or in its growth stage (Bessembinder et al. 2015).

⁷² AIM: Alternative Investment Market was established back in 1995 and designed to attract smaller, growing companies that could not meet the listing rules of the London Stock Exchange (LSE).

This service comes at a cost that is usually set at a flat monthly rate depending on the type of the industry or sector of the issuer and the specific financial market depth⁷³. The aftermarket trading of underwriters and unaffiliated market makers in the three-month period after an IPO displayed a dominant market making role of the lead underwriter as he takes influential inventory positions in the aftermarket trading. The lead underwriter, hence, engages in stabilization activity when needed, and depends on the overallotment⁷⁴ option to manage his inventory risk. Therefore, compensation to the underwriter arises primarily from fees, but aftermarket trading generates positive profits, which are directly related to the degree of underpricing (Ellis et al. 2002).

On the other hand, Bradley, et al. (2011) in their study of Chinese IPOs, where trades are order-driven without the intervention of any market makers nor any allowable price support, they found that large trades characterize the first day of trading and then small trades interpose the following days where aggressive buy orders relates to positive imbalances and sell orders relates to negative imbalances, and both converge somehow to provide the needed market liquidity and accordingly the sought after fast price discovery and price equilibrium. According to KPMG-Canada, the costs of an IPO range between seven to 10 percent of the amount of the funds being raised and they include the underwriters' commission, the accounting, tax, legal, translation, marketing and other costs that cover filing fees and listing fees, directors' fees, travel expenses and any needed environmental or engineering reports.

In order to have an approximate idea regarding the distribution of the costs of going public process, the researcher summarized the previous literature and findings in Figure 3 below which was extracted from PWC Statista study of the US market in 2012 and based on IPO with less than \$ 50 million in proceeds. It is clear that underwriting, in all its terms and conditions as pertaining to relative valuation, roadshow activity and preparation of the issue constitutes the major costs to be considered with 39% of the total costs, followed by legal actions related to the firm's legal status and all other regulatory requirements with 24% and by compliance methodology and auditors' readiness, internally and externally standing at 16% of total costs. When the issue reaches \$500 million, the underwriting share climbs to around 77% of the total costs and both the legal and the auditors' parts drop from a total of around 40% to around 12%. This change in weights goes back

⁷³ Market depth refers to the number of active participants in the market, in other words it shows the number of open buy and sell orders for a security at different prices. It is also sometimes known as the order book since it shows pending orders for a security or currency.

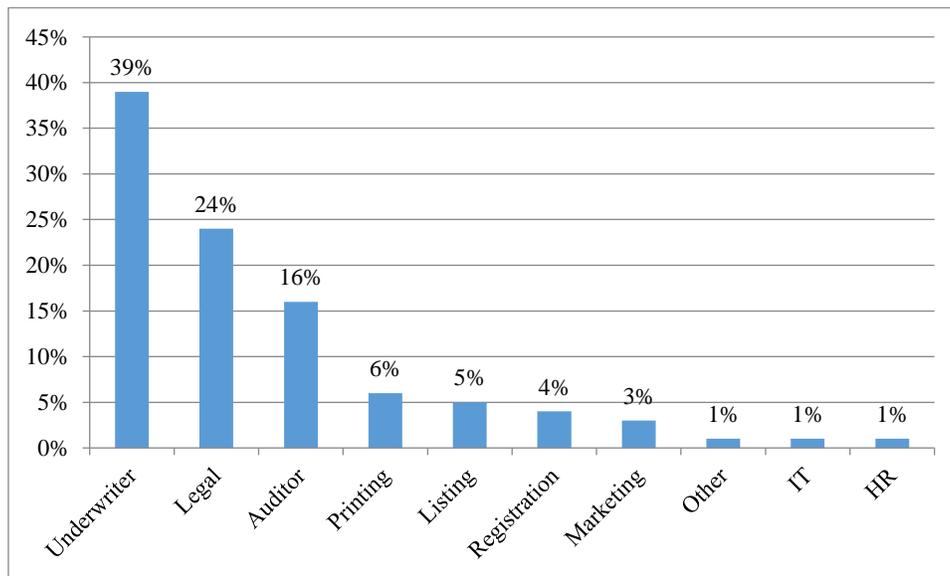
⁷⁴ An overallotment option allows underwriters to issue as many as 15% more shares than originally planned.

to the hardship associated with underwriting a large issue and almost the same absolute dollar costs associated with the legal and auditors' procedures that benefit from the effect of economies of scale.

The printing of all the materials that come along with the whole course of action from the first intention to finally becoming a publicly traded company occupied the fourth place with around 6% of the costs, followed by the listing fees and the registration fees with 5% and 4% respectively. Nevertheless, the costs expensed on the marketing and sales of the securities in question, the IT upgrade and enhancements and the disbursements needed for the additional personnel required to fulfill the new public status should be carefully accounted for in the preliminary study of the going public process.

Figure 3 is not conclusive, but rather, it draws the attention to the important factors that should be researched and included in the budget preparation. The prevailing private owners are expected to be able to afford such a move before embarking on this time-consuming adventure into the world of the publicly traded companies and they should consider the possibility of not being able to go through with the aforementioned process as a normal outcome of being transparent and true with oneself and with the future of their company.

Figure 40: Costs of Going Public as a Percentage of Total IPO Costs



Source: PWC, Statista 2018, Personal Compilation

10. Accounting Considerations

Though several costs of an IPO fall into only one of two categories, either they are expensed or charged against issuance proceeds, many costs will need to be allocated between the two methods. Examples of costs that fall under each of these scenarios are listed below.

Offering costs that are “directly attributable” to the offering of equity securities may be deferred and charged against the gross proceeds of the offering as a reduction of paid in capital. These include the underwriter discount, legal fees, accounting (external auditor, financial reporting advisor), printing, registration, exchange listing fees, Blue Sky filing fees⁷⁵, FINRA fees and other miscellaneous costs, such as road-show travel costs.

In other words, costs to be netted against gross proceeds are comprised of the following functions: Underwriter Fees, Road-Show Costs, Printer Costs and other miscellaneous costs.

Incremental organizational costs that are non-recurring include the cost of valuation reports, tax and legal entity restructuring in anticipation of the IPO, additional audit costs, and other pre-IPO organizational tasks.

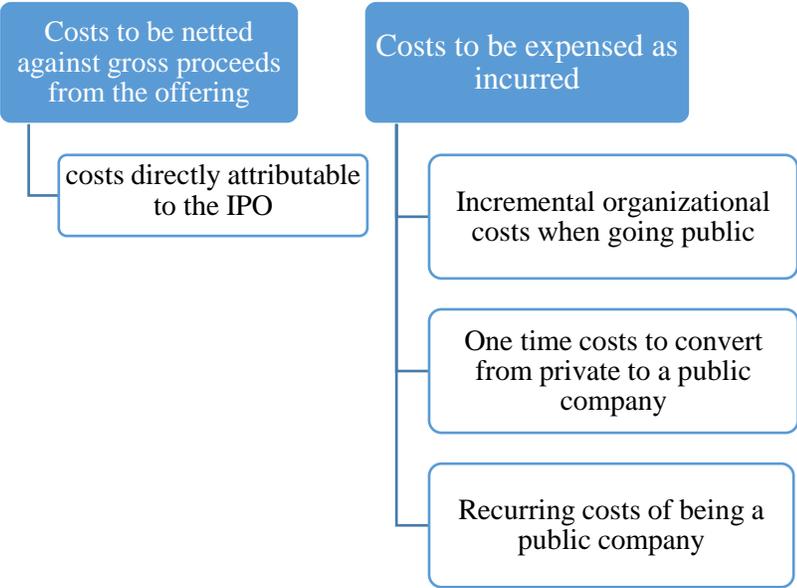
The costs to be expensed as incurred are comprised of the Listing Fees, the Restructuring Costs, the Costs of New Board of Directors and the Costs of Compliance. Hence, some costs need to be allocated between both methods such as the Legal Fees, the Auditor Fees and the Advisory Fees. Moreover, in an article on technical update (2014) published by the IFRS standard setting department in Hong Kong, it has been clearly outlined that the costs pertaining to any issue of new securities that does not provide any new funding to the company but only listing of existing shares would not be considered as assets and hence should be expensed during the year on the profit & loss statement.

The FASB's Accounting Standards Codification (“ASC”) separates the guidance for the costs discussed above into two different sections; ASC 340-10-S99-1 (SAB Topic 5.A) that covers the actual expenses of the offering, while ASC 720-15 covers only those costs that qualify as start-up costs. ASC 340-10-S99-1 states that “specific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and charged against the gross proceeds of the offering.” In contrast, the remaining costs fall under the guidance found in ASC 720-15, and must be expensed as incurred.

⁷⁵ Blue Sky filing fees in the USA are applicable in specific states and jurisdictions irrespective of other fees.

The International Financial Reporting Interpretation Committee (IFRIC) issued on September 2008 an agenda decision on IAS 32 (IAS 32.38) regarding the transaction costs to be deducted from equity and said that judgment is needed to decide on which costs are directly attributable to issuing new equity security and that are related strictly to this activity. It should be differentiated between incremental costs and ongoing cost when it comes to costs allocation, such as payroll costs of permanent employees that should have been paid irrespective of whether an act of going public is taking place or not. Furthermore, activities that do not involve using new equity are not equity related and as such cannot be deducted from equity (IAS32.37).

Table 19: Costs to be netted against Costs to be expensed (incurred)



Source: Christensen, C, 2018.

Therefore, IFRIC asked companies to clarify and differentiate activities related to issuing new equity and activities related to listing new equity and recognize the former costs in equity and the latter costs in profit and loss statements (IAS 32.38).

Table 20: Cost Recognition

Cost	ASC 340-10-S99-1	ASC 720-15	IAS 32.37	IAS 32.38
Underwriting	X			X
Road show	X			X
Printing	X			X
Listing		X	X	X
Restructuring		X	X	
Compliance		X	X	
Legal	X	X	X	X
Auditing	X	X	X	X
Advisory	X	X	X	X

Source: IFRS Interpretation Committee, Standard Setting Department 2014, personal compilation
Table 20 differentiates among cost recognition based on FASB's Accounting Standards Codification (ASC) and IFRS's International Accounting Standards (IAS).

IV. Concluding thoughts

The task of going public is significant and justifies an equally significant summation of relative costs. The information presented here will help determine an approximate dollar figure to use as management weighs the pros and cons of taking the company public. Once the owners decide to file for an IPO, knowing and anticipating the costs will help ensure the long-term success of the company in the months and years ahead. The financial regulations are being updated regularly to provide more protection to investors and to try to manage the risks that the markets are facing with the continuous introduction of new financial products. As such, these costs are likely to rise significantly in the near future. Since the costs of going public are considered to be relatively high for SMEs and Emerging Growth Companies, the management of these companies may be forced to choose whether to go public or to seek other sources of financing.

Going public entails costs that are directly related to the process itself and some costs that are indirect and result from the new public status of the firm. The direct costs cover all disbursements related to the listing decision, and in specific the underwriting fees paid to the lead investment bank, fees paid to lawyers and auditors, initial listing fees paid to the listing venue or the exchange in addition to all the stringent disclosure, compliance and regulatory costs over and above the

administrative and marketing expenses incurred during the whole journey to become a publicly traded company and to maintain that status over the life of the going concern.

As for the indirect costs, they encompass the charges that are not expensed directly by the firm, but rather they result in some forgone opportunity cost presented in the form of lower proceeds at the time of issuance and loss of confidentiality and higher trading costs at the level of being a publicly traded company. In Ernst & Young's experience, the total cost of an IPO transaction, including listing fees and business advisor fees, typically runs in the hundreds of thousands of dollars and can exceed US\$1 million, depending on a company's specific situation and the selected stock exchange.

In breaking down the direct costs among different scales and procedures, pre and post IPO, the listing venue presents itself as an important factor in determining the viability and the feasibility of these costs and plays an important role in the decision of whether to go public or stay private. In their choice of the exchange, firms seek visibility to customers and suppliers on one hand and the existence of comparable companies on the market before deciding on the most suitable listing venue. For a listing exchange, the stricter and the more rigid the compliance and regulatory requirements and the higher and the more complicated the listing fees, the more it becomes detrimental and financially stressful the decision of a firm to go public. Firms looking to raise funding and maintain a liquid market will eventually shy away from these exchanges and focus on the ones that provide relatively cheaper and competitive initial and on-going costs for the firm in specific and their investors in general.

On another note, the cost is not by itself the most important factor to consider when searching for an exchange, but rather the institutional investors' quality and their knowledge and understanding of the business of the listing firm. Furthermore, it is important to look for peer companies that are listed on the target exchange and the possibility of attracting analysts' coverage and interested researchers which enhances also the perceptibility by concerned suppliers and customers alike. Hence, the importance of the choice of the exchange as strategic decision that need to be studied thoroughly by the listing firm and its consultants.

Before going public, firms need to make an estimation regarding the impact of the listing decision on the cost of capital. Firms must also emphasize on the impact of the cost of going and being public on the decision of accessing financing needed through the public spectrum or through other traditional sources such as borrowing from banks.

Furthermore, as international competition becomes more intense, competitive and efficient trading exchanges, surrounded with comprehensive regulatory settings, are more in demand. Accordingly, capital markets authorities should strive to set up and promote broader, more transparent and better competitive markets, in a move to attract more firms into the long-term capital market financing environment away from the more traditional routes of short-term funding.

Therefore, looking back at the costs' figures discussed above, interested companies, looking for the public status, shouldn't be scared or derailed from the IPO idea. Every company has some unique attributes and should try to benefit from the possibilities of increased efficiencies, and should do its proper due diligence to get the right people in the right place in the hierarchical organization of the company. Moreover, utmost attention should also be given to the selection of the most suitable advisers with adequate expertise in their specific line of business which will, in the end, help in controlling these costs and keep them within planned budget.

Table 21: Major Exchanges and Costs of Listing

MAJOR EXCHANGES AND COSTS OF LISTING							# of listed Firms
Established	Annual Fees			Membership Fees			
	Brokers	1st year	2nd year and on				
Beirut Stock Exchange	1920		\$10,000	USD 100			10
		2nd year and on	\$2,000				
		1st year	\$10,000				
		2nd year and on	0.5 per mil of capitalization				
Bahrain Bourse	1987	Individual / Corporate / Transfer Agent			1 per mil of share K (min BD 5000, max BD 15,000)		43
		Once (BD)	500 / 1000 / 500		1 per mil of share K on 1st 10 million (min BD 30,000)		
		Yearly (BD)	250 / 500 / 1000		0.5 per mil of share K : 10 <50 million		
					0.25 per mil of share K above 50 m (max BD 20,000)		
Qatar	2009	QR 5000			1 per mil of share K (max QR 100,000)		43
		3 per thousand of capital (max QR 300,000)					
Dubai Financial Market	2000	K < 500 million: AED 30,000			K < 500 million: AED 30,000		178
		500 mil < K < 2 bil: AED 50,000			500 mil < K < 2 bil: AED 50,000		
		K > 2 bil : AED 100,000			K > 2 bil : AED 100,000		
		Brokers: AED 20 mio bank guarantee			Brokers: AED 20 mio bank guarantee		
Kuwait Stock Exchange	1952	0.075% of paid up capital					187
		minimum KD 2,500					
		Maximum KD 7,000					
Amman Stock Exchange	1999	4 % for equity	Maximum JOD 3,000		500 JOD		101
		1 % for bonds	Maximum JOD 1,000		Brokers JOD 200,000 once		
The Egyptian Exchange Cairo 1903	Alexandria 1883 / Cairo 1903	2 per mill of K (max EP 500,000)					373
Saudi Stock Exchange	2007	SR 30,000			SR 60,000		171
		SR 3,650	Trading Workstation		SR 11,700 Trading Workstation		
Tunis Stock Exchange	1969				Issuer: SR 50,000		68
Casablanca Stock Exchange	1929	up 150,000,000 MD	2400MD			0.10%	81
		150,000,001 < 400,000,000	4800MD				
		400,000,001 < 2,000,000,000	24000MD				
		2,000,000,001 < 6,500,000,000	48,000MD				
		> 6,500,000,000	120,000MD				
Euronext	2000	# of shares up 2,500,000	2940EUR	2,500,001 < 5,000,000	up 10,000,000	max 10000EUR	882
		3990EUR	5,000,001 < 10,000,000	9240EUR	10,000,001 < 50,000,000	max 55000EUR	
		14910EUR	50,000,001 < 100,000,000	19530EUR	> 100,000,000	max 215000EUR	
		24150EUR	Cap > 150,000,000	€10/mil above 150Mio + above	1,000,000,001 < 2,500,000,000	max 365000EUR	
					> 2,500,000,000	max 665000EUR	
						max 2000000EUR	
Frankfurt Stock Exchange	1585	eur 12,500 + eur 0.1 per 1 mio capitalization			eur 10,000	admission eur 3000	200

	Established	Annual Fees	Membership Fees	# of listed Firms
Singapore Stock Exchange	1973 1999	<p>SS 25 per 1 million of mkt value min SS 10,000- max SS 25,000</p>	<p>SS 100 per 1 million of mkt value min SS 25,000- max SS 100,000</p>	776
Tokyo Stock Exchange	1878	<p>TDNet usage YEN 120,000 ¥5 billion - 720,000 5<>25 - 1,440,000 25<>50 - 2,160,000 50<>250 - 2,880,000 250<>500 - 3,600,000 >500 - 4,320,000</p>	<p>examination fees YEN 4,000,000 listing fees YEN 12,000,000</p>	2292
London Stock Exchange	1571	<p>Minimum £7,400 plus £30 per £1 million of Market Capitalization</p>	<p>Market Capitalization £0-£5 million £10,000 £500 million £209,650 AIM £150 per million minimum £10,000 £250 million £84,800 £110 per million</p>	2038
Hong Kong Stock Exchange	1891	<p>200 million to over 5000 145,000 to 1,188,000</p>	<p>Initial 100 to over 500 150,000 to 650,000</p>	2062
Shanghai Stock Exchange	1860	<p>RMB 50,000 < 200 million RMB 80,000 200 <> 400 million RMB 100,000 400 <> 600 million RMB 120,000 600 <> 800 million RMB 150,000 > 800 million</p>	<p>RMB 300,000 < 200 million RMB 450,000 200 <> 400 million RMB 550,000 400 <> 600 million RMB 600,000 600 <> 800 million RMB 650,000 > 800 million</p>	1302
New York Stock Exchange	1792	<p>< 50 million shares \$ 35,000 50 <> 75 million shares \$ 45,000 > 75 million shares \$ 50,000</p>	<p>25000 app fees 0.004/share + 50000 min 150000 <> 295000 max Additional issue up to 75 million 0.0048 75 mio <> 300 mio 0.0038 > 300 mio 0.019 max 500,000 per year</p>	2800
Toronto Stock Exchange	1861	<p>Market Capitalization CS 0-5 million CS 5,200 5 <> 100 million CS 5,300 + 100 per million 100 <> 440 million CS 16,750 + 100 per million > 440 million CS 51,000 + 100 per million</p>	<p>Application CS 2,500 < CS 6 million CS 7,500 + 0.5% of value of shares > CS 6 million CS 30,000 + 0.1% of value of shares</p>	3985 3154

V. Model for Listing on BSE

According to the BSE Listed Company manual, a company must begin by paying a \$10,000 Initial Listing fee that will be applied toward other listing fees. The BSE has stipulated that for first time issuers, there is a listing fee of \$10,000 and a subsequent annual listing fee equal to 0.05% of the relative stock market capitalization.

The Beirut Stock Exchange (BSE) emphasizes the liquidity of the securities therefore a minimum public-float value of \$ 5 million and a rate of 25% are required, in addition to a minimum dissemination of public holdings to 50 shareholders excluding the directors and/or senior management who hold 5% or more of the shares and their respective families. Lock-up rules apply to shares held by the controller, director and member of senior management, prior to the listing, for a period of six (6) months from the date of listing of the securities and they are prohibited from selling any of their ownership before getting the relevant approval from the CMA.

Companies interested in an IPO must comply with the criteria set forth under the official market:

- Official. Companies must comply with the following criteria:
 - Capital (BSE page) : \$ 3 million;
 - Minimum portion of public float : 25%
 - Period of activity : 36 months;
 - Value of the public float which is the total value of the new issue to the public underlying the listing application: minimum \$ 5 million.
 - The securities must be transferable and tradable.
 - The securities must be registered with and settled through Midclear, in book entry form only.

As for the remaining two alternatives, the BSE states the requirements hereunder, but at the present trading days, these two markets are almost non-existent.

- Junior market. Companies must comply with the following criteria:
 - Capital : \$ 1 million;
 - minimum portion of public float : 25%;
 - period of activity : n/a;
- Over-The-Counter market. Companies must comply with the following criteria:
 - Capital : \$ 100,000;
 - minimum portion of public float : n/a;
 - period of activity : n/a;

In addition to the above and under the first alternative and second alternative, a minimum dissemination threshold is applicable, in a way that on the time of listing, the shares must be held by at least 50 different holders. This threshold does not apply to the third alternative.

An IPO is typically structured as an offering for subscription of new shares (raising or obtaining cash for the issuer). The vast majority of IPOs are offering to the general public, on equal terms to all, at a pre-determined offer price, and they mostly structured as a public sale by a controlling shareholder, who is usually offering to sell his/her shares to the public.

One advantage for public companies is the ability to raise large amounts of capital from the public within a relatively short time, therefore, the Beirut Stock Exchange (BSE) rules and regulations specify the timetable of offerings.

What are the main steps for a company applying for a primary listing of its shares?

Procedure for a primary listing

A company seeking to list its shares for trading on the Beirut Stock Exchange's (BSE) for the first time needs to obtain two main approvals:

- The approval of the Capital Market Authority (CMA) for the publication of a prospectus, which will be given within 4 weeks of the application for public offer of securities.
- The BSE approval for the listing.

An issuer must appoint a financial advisor to advise it on the offer of securities and check the compliance with the regulations before filing the application for approval of the public offer. Furthermore, before filing the first draft prospectus with the CMA and the BSE, the company should prepare itself for the new and major regulatory changes that will result from its new status as a publicly listed company. This preparatory work can include:

- Going through the articles of association and perform the due amendments and changes
- Discussing with the main shareholders all agreements among them and look into adjusting the employment agreement of the key officers, if need be.
- Establishing if necessary, all required compensation for any harm or loss and/or security against any legal liability for any responsibility assumed by the directors and officers of the company.

Simultaneously, the company's lawyers should conduct all legal due diligence that are needed in the process of the preparation of the draft prospectus and as the company officers and its

respective auditors convert the company's financial statements to the format applicable to listed companies and which is required by the regulatory authorities.

The first draft of the prospectus must be signed by the issuer and approved by its board of directors. It is filed with the CMA and the BSE together with an application form and the payment of an application fee.

After the filing of the first draft, the CMA and the BSE each provide comments to the draft. The CMA comments to the first draft, as well as to the accompanying financial statements, at the CMA's discretion. Comments are often provided also by the BSE, which focus on the parts of the prospectus relating to the offering process and the description of the securities. Following the comments and discussion process, subsequent drafts are filed, until the draft is for the full satisfaction of the CMA and the BSE and they are both ready to provide the relative authorizations required for the publication of the prospectus.

In the meantime, the issuer and the advisor are permitted to solicit investment interests or “indications of interest” from their relative investors by approaching them and using the said prospectus, provided that it is stamped as “DRAFT ONLY” in red ink and with the following statement “the CMA has not approved the prospectus for this public offer of securities. The securities may not be sold to subscribers until the CMA approves the prospectus for the prospectus for the offer”⁷⁶.

Lawyers and financial advisors, usually, play an important and key role in the IPO process. Their main roles include, but is not restricted to:

- Legal due diligence.
- Advising the issuer regarding the legal reorganization process.
- Drafting the prospectus and negotiating with the proper authorities until reaching the final prospectus.
- Communication with the Capital Market Authority (CMA) and Beirut Stock Exchange (BSE) to obtain the required approvals.

⁷⁶ SERIES 6000: Offers of securities, published by the CMA. It elaborates the full scale procedures and regulations pertaining to the offering of new securities.

The auditors also play an important role in the preparation of the financial statements in a format and subject to International Financial Reporting Standards (IFRS) applicable to public companies. Since some values in the financial statements are based on appraisal, according to the IFRS, appraisers are often needed in an offering process.

More generally, it is usual to depend on the services of underwriters in IPOs. The underwriter's important role is to advise the issuer on the structure and pricing of the offering and to support the issuer in the marketing and sales of the securities to investors. They are required to sign the prospectus if their services stipulate a “firm commitment” which sets forth their willingness to purchase the securities that are left not sold to the public. But again, their services might only entail the distribution of the securities on a “best efforts” basis, with no explicit commitment. Moreover, the underwriters frequently provide the services of their own lawyers, accountants and finance people to conduct due diligence examinations.

Additionally, many issuers engage the services of financial advisers and investor relations or public relations firms. When looking at the time frame of the IPO process, the majority of this time is spent in the first part that includes the groundwork of the first draft of the prospectus and the preparation of the financial statements in accordance with International Financial Reporting Standards and the Capital Market Authority (CMA) regulations. The second part entails all the communication with the CMA, from the date of filing of the first draft until the receipt of the final permission to publish the prospectus, which revolves around two to three months including the pre-set four (4) weeks for the CMA discretionary study, comments and approval.

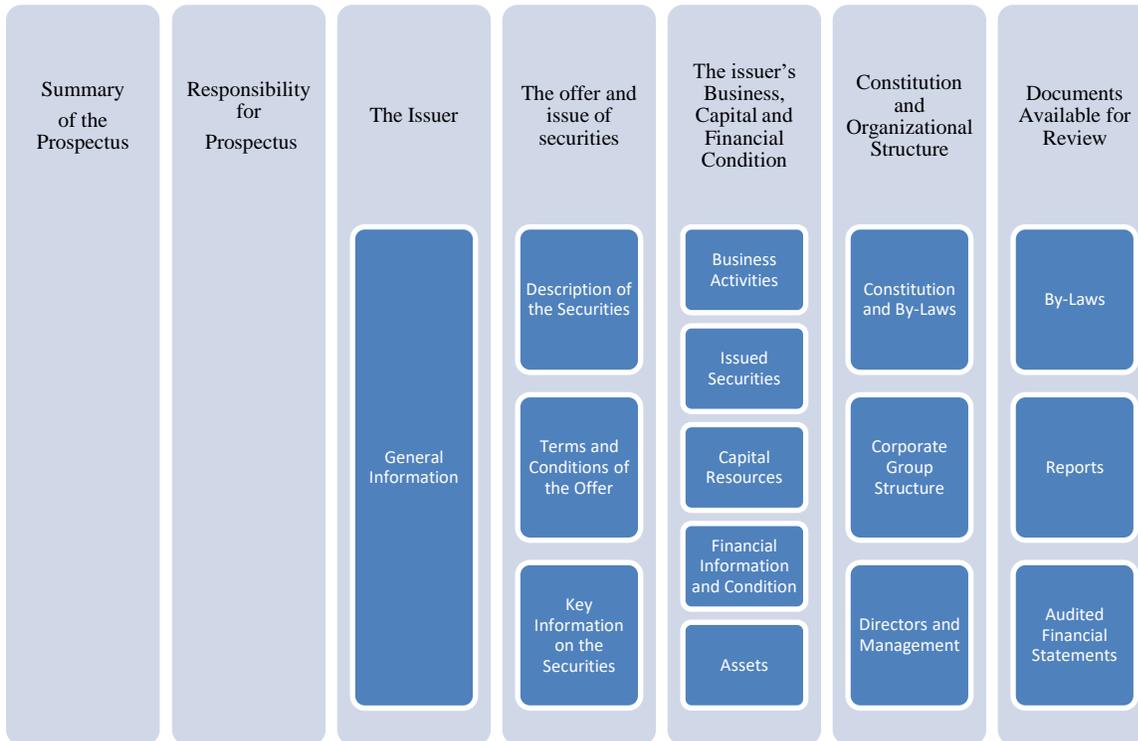
The table 6 below pinpoint the main topics that have to be included in the prospectus according to the series 6000 issued by the CMA and pertaining to the “offering of securities”.

Table 22: Breakdown of Topics and Steps needed to Publish the Prospectus

Article	6204	6205	6206	6207	6208	6209
Topic	Prospectus Requirements	Liability for Prospectus	Approval of the prospectus by the Authorities	Powers of the Authority	Supplementary prospectus	Publication of the Prospectus

Source: CMA, Series 6000, personal compilation

Table 23: Requirements to be Included in an Acceptable Prospectus



Source: CMA, Series 6000 and Series 7000, personal compilation

What are the main areas of continuing obligations applicable to listed companies and the legislation that applies?

Listed companies are subject to on-going reporting obligations primarily as follows:

- Publication of annual audited financial statements and reviewed quarterly financial statements, accompanied by management discussion and analysis reports.
- Publication of a comprehensive annual report regarding the company's business covering most of the issues covered in a prospectus.
- Publication of immediate reports regarding certain events set out in the securities regulations (appointment and termination of office of directors and officers, transactions with controlling shareholders, issuance of shares and changes in the holdings of major shareholders), as well as with respect to any material or extraordinary event, promptly following the occurrence of the event.

The following paragraph shed the light on some short and quick recommendations to the CMA to proceed with the development of the Lebanese capital market in light of their continuous effort to boost this market and bring it to new heights.

The CMA is in the process of preparing and finalizing the live launching of the ETP in an effort to encourage companies and SMEs in specific that are interested in raising significant amounts of capital, away from the banking facilities, to undertake public offerings and list on the BSE.

The capital market should be present to complement the initial stage financing that is provided by crowd funding and venture capital to start-ups whose long-term financing need is met in this capital market at a later stage.

The CMA shall work on facilitating and encouraging the listed companies' exposure to foreign investors.

Privatizations, where shares are offered to the public by the government, should be a goal of the proper authorities to kick-start the capital market with enough publicity and promotion to attract the private sector participants: investors and fund-raising units alike.

Entrepreneurs of target IPO companies should, for example, enjoy certain tax benefits regarding the tax treatment of stock options they hold in the respective target company.

The CMA should work closely on the scope of qualified investors, in a way to broaden that perspective and attract more investors into the capital market and provide it with enough depth to attract in turn the IPOs.

The CMA shall work on introducing new and different indexes to cover the scope of the new comers to the market. It should also outline a number of incentives and benefits that can be granted to target IPO companies and stress on the waiver, for example, of the three years' financial statements to qualify.

Cost of Being Listed on BSE

The Lebanese capital market did not witness any IPO listing for the past twenty years or so and the tendency to list is rather weak considering the dominance of the banking sector and the business ownership mentality of owners/managers and the unwillingness to recede control to any outside party. According to Dr. Osseiran (PC, 2019), the Lebanese firms are reluctant to list on the Beirut Stock Exchange because they cannot see the added benefit of listing in a thinly traded market. The investment banks in Lebanon play a narrow role in the IPO process based on the fact that the underwriting services are not needed at this point in time and specially within the current market

structure. Adequate pricing is not available and comparative analysis is almost non-existent because the sectors listed in the BSE are limited to banking in large part, one real estate company, one car agency and two cement companies. As such, the only service that can be provided, if any, is the possibility of listing on the official market the shares of companies whose shares are already listed on the OTC market. Besides that, it is very rare and remotely possible, the potential for a company to list its shares in an IPO with the goal of raising capital for the purpose of expansion or growth.

Therefore, one cannot estimate the cost of going public due to the lack of the underwriting services which represent the largest part of the cost inherent in the going public decision. The only costs that can be accounted for will be a relatively representative labour hour and legal costs associated with the process of moving a firm's shares from the OTC to the official market. Accordingly, the remaining costs to evaluate are the costs of being public and meeting the reporting, disclosure, governance and compliance requirements. Here, again, it is difficult to reach this cost accounting procedure because most of the listed companies are banks and they fall under much stringent requirements from the central bank of Lebanon and hence, being listed or not, the commercial bank must meet these requirements equally.

As for circular 331 and possible exit strategies, Dr. Osseiran sees the acquisition of the start-up by a larger company as a better and more efficient solution when compared to going public as an exit strategy for principal owners and private investors. This is mainly due to the stringent governance, financial and reporting requirements imposed by the stock exchange on listed companies. From a different perspective, he contemplated this possible solution based on the lack of accurate pricing in the market that he mentioned before and showed potential hope of reversal of this scenario with the establishment of the electronic trading platform (ETP) with its new rules and regulation and flexible requirements, but he thinks that the market needs more time to cope with this trend.

At the same time, the poor state of the BSE related to the absence of new capital and the loss of trust among investors due to latest financial and economic events mean that it may be difficult to see any IPO activity and subsequently any attempt at equity raising in the upcoming years.

A. Questionnaire Design

The questionnaire was structured based on the cost breakdown in figure 1, the ten companies whose shares are listed on the Beirut Stock Exchange were approached individually with the assurance of full professionalism in using the data provided by them and with full objectivity when

displaying their feedbacks and it was made clear that the main purpose of the study is to evaluate how much does it cost to be listed on the Beirut Stock Exchange with no specific prejudgments. It was made clear that the aim is to try to segregate the costs that are borne by companies that are already listed on the BSE and to provide some basic guidelines for new comers to the public listed world and what they should include and consider in the feasibility of going public or staying private on the BSE. The researcher depended on open questions in order to leave the freedom for the responsible persons (respondent) to add what they think is worth mentioning and what they prefer to keep for themselves outside of the publicly available information. This approach was important after several discussions with the in charge of the listed firms, on one hand, and people responsible from the CMA and the banking community on the other.

Despite the fact that the firms are listed and they are somehow bound by transparency and disclosure rules, the mentality of keeping specific and detailed information away from the public still dominates over the public status as understood in most American, European, Gulf and Middle Eastern capital markets. The Lebanese listed firms provide, regularly, the CMA with the requested information at the time of release of their financial statements and the respective quarterly reports, but they abstain from providing the general public with information that they believe is confidential and should they do so, they reveal only general information and when it comes to actual figures and statistical data they stick to broad guidelines with no specific nor accurate data. This conclusion was reached during and after the communication process that took place with top management officers and that lasted and consumed a long time with so many repetitive contacts and reminders.

The data that were difficult to retrieve from the direct contacts with the respective firms' officers was secured by contacting the relevant regulatory authorities and in specific the BSE, CMA and MIDCLEAR. Here again, approximate data was provided with a request to forward a commitment to maintain confidentiality and professionalism in the context of publishing the available data.

The approach, accordingly, had to be straight forward and specific in order to provide proper guidance as to what should be covered and mentioned in the respondents' feedback without any need to go into the specificities of each firm. The following questions were presented to the respondents of the listed firms and discussed based on the purpose of the study and the need to clarify and differentiate the costs to be borne and the charges to be accounted for in the preliminary feasibility study of going public or staying private. As mentioned before, the study revolved around

the costs of being public since there is no regular nor foreseeable listing taking place and as such there is no way that a financial institution can depend on comparable and peers study to benchmark the process of going public and accordingly forecasting the costs of doing so. Therefore, the study covered what can be accessed in terms of being public rather than going public. The costs and charges incurred that need to be highlighted are requested and analysed on annual basis and the results are detailed in the following section under the heading of each question respectively.

The costs incurred that need to be highlighted are on annual basis:

- 1- Annual listing fees and MIDCLEAR fees
- 2- Auditing fees and audit committee cost
- 3- Financial and regulatory reporting costs
- 4- Compliance costs
- 5- Investors relation, advertising and publication costs
- 6- Legal fees related to the fact of being listed
- 7- Number of board members (internal and independent) and approximate yearly total costs
- 8- Costs incurred for dedicated staff
- 9- Advisory and consultancy costs, if any
- 10- Cost of internal control systems (IT enhancements)

B. Cost Accounting of Firms Listed on BSE

The data collected from the 10 listed companies on the BSE are grouped together under each question in order to treat all possible answers received from the respondents. Accordingly, the reader can have a wider and a more global look at the potential costs and fees incurred and that are customary for publicly listed firms. Since the majority of the listed firms are commercial banks, and since this sector is one of the most regulated sectors in the economy, this explains why the bulk of the answers and discussions revolve around the banking sector and the Central Bank rules and regulations.

1. Annual listing fees and MIDCLEAR fees:

According to the Laws & Regulation - By Laws of the Beirut Stock Exchange, under section VII, chapter one under article 195, it was set that the annual listing fees, on the BSE, is fixed at \$10,000 for the first 12 months of being listed and then in the subsequent years, it is set at 0.05% of the relative stock market capitalization for every category of securities listed on the official or junior

Stock Exchange market as per Article 196 of decree 7667 of 1995. For the sake of calculation, "Stock capitalization is the average trading price in the last month prior to the due annual fee, multiplied by the number of securities accepted for trading". This annual fee should not, at any time, be less than \$ 2,000 nor should it exceed \$ 10,000 or its equivalent in Lebanese Pounds. (Beirut Stock Exchange (BSE), official website). Furthermore, and according to article 3 of Decree 7667 of 1995: "Shall be considered a BSE member every joint-stock company with a capital of more than 500 thousand Lebanese pounds" as such, every member in the Stock Exchange stands to pay an annual membership fee equivalent to the counter value of US\$ 100 in Lebanese pounds. The MIDCLEAR fees are divided into a one-time fixed registration fee of \$ 3,000 and a subsequent yearly membership fee of \$1,500. In its capacity as custodian, an additional safekeeping fee is applicable based on market capitalization and the value of the portfolio held by each member. These fees are calculated based on the daily closing price and then used to construct the average monthly values of portfolios and charged monthly on the account of each respective member. Since the information regarding such portfolios is rather private and classified and cannot be declared to the public and especially in the case of commercial banks, the researcher opted for an example on the calculation of the safekeeping fees based on an assumed portfolio of \$ 5.5 billion held by a member of MIDCLEAR and according to a pre-defined incremental schedule posted on MIDCLEAR page. Table 24 below highlights the calculation example of safekeeping fees collected by MIDCLEAR. Worth mentioning that the figures are just a simulation to reflect on the approximate costs of portfolio safekeeping at MIDCLEAR and are only charged on monthly basis.

Table 24: Example of Calculation of Safekeeping Fees on MIDCLEAR

Example on Safekeeping fees			
Portfolio		\$ 5,500,000,000	
USD	USD	per mil	Fees
5,500,000,000	10,000,000	0.180	1,800
5,490,000,000	90,000,000	0.130	11,700
5,400,000,000	1,400,000,000	0.125	175,000
4,000,000,000	1,500,000,000	0.122	183,000
2,500,000,000	2,000,000,000	0.121	242,000
500,000,000		0.117	58,500
Total Safekeeping Fees			\$672,000

Source: MIDCLEAR, personal compilation and calculation

As for the registrar fee, it entails all the buy and sell orders and the respective change of ownerships among investors- holders of securities. In other words, it is responsible for recordkeeping of shareholders. The registrar double checks and verifies at any point in time, the shareholders who own the stock and the number of shares owned by each investor. Among the respondents, only SOLIDERE has set up a registrars' department in-house, accordingly, some dedicated internal staff manage the register of the company's stock and the company owes no registrar fees to MIDCLEAR.

Back in April 2001, the Lebanese Parliament enacted the Law number 308 which stipulates, in its Article one, that all bank shares shall be registered and the respective securities REGISTER shall be managed by MIDCLEAR SAL. The registrar function encompasses, among others, change of ownership as a result of buy/sell orders, inheritance or will, pledging and un-pledging of shares, freeze of shares for guarantee purposes, statement of ownership of nominal shares, and attendance list for general assembly meetings.

After approaching MIDCLEAR regarding the costs charged for the registrar services, it was made clear that the figures cannot be revealed due to its proprietorship nature and that member banks must give their consent to disclose such information. Accordingly, all member listed banks were approached and they all abstained from disclosing this "classified" information regarding the cost borne for the registrar services provided by MIDCLEAR. Therefore, the researcher had to refer to the page of MIDCLEAR in order to conclude the method of calculation of the registrar fees. The simulation was done on the last couple of years using data from the BSE website, under yearly reports - historical data, regarding the number of shares listed and the market capitalization of each listed company. These latter figures were again confirmed from the annual reports issued by each respective listed bank, and the nominal or par value of the shares were respectively collected.

The formula and the percentage used were retrieved from MIDCLEAR fees page. The registrar fees are divided between fees charged on the total market value of the listed shares and the total nominal value of the unlisted shares. Among the 10 listed companies, only Bank of Beirut, BLC bank and BEMO bank had unlisted shares in the percentage of 63.02%, 66.75% and 17.10% respectively. Table 25 below highlights an exercise whereby the researcher tried to calculate the approximate fees charges for registrar services on each listed company with the exception of SOLIDERE. Instead of using monthly averages to calculate the fees, the figures for December 2018, end of year, were used, as an approximation of each company's respective registrar fees.

The market value was retrieved from the annual reports and used in the calculation of the registrar fees for the listed shares and the nominal or par value was retrieved from the proper annual reports of the three companies (BOB, BLC and BEMO) who had unlisted shares and used in the calculation of the registrar fees on unlisted shares accordingly.

Table 25: Simulation of the Registrar Fees for Each of the Listed Companies

Figures calculated as at End 2018							
Registrar							
Bank	Price per Common share	Number of shares listed	Number of shares not listed	Market Capitalization	0.4 per mil on the average <u>market value</u> of the listed portion	0.1 per mil on the average <u>nominal value</u> of the non-listed portion	Total Registrar fees
AUDI	4.90	525,674,000		2,878,030,000	1,151,212		\$ 1,151,212
BLOM	9.25	288,896,010		2,676,722,000	1,070,689		\$ 1,070,689
BYBLOS	1.37	570,824,118		1,012,937,000	405,175		\$ 405,175
BOB (1)	18.80	42,948,417	35,440,514	925,725,000	370,290	3,520	\$ 373,810
BLC (2)	0.93	72,396,843	142,600,751	196,331,000	78,532	9,507	\$ 88,039
BEMO (3)	1.57	51,750,000	39,073,920	114,343,000	45,737	2,615	\$ 48,353
RYMCO (4)	3.28	10,920,000		35,818,000	14,327		\$ 14,327
CIMENT BLANC	2.55	9,000,000		22,950,000	9,180		\$ 9,180
HOLCIM	15.50	19,516,040		302,499,000	121,000		\$ 121,000
SOLIDERE	7.00	165,000,000		1,167,350,000	N/A		N/A
Total		1,756,925,428	217,115,185	9,332,705,000			\$ 3,281,784
Figures calculated as at End 2017							
Registrar							
Bank	Price per Common share	Number of shares listed	Number of shares not listed	Market Capitalization (all issued shares common and preferred)	0.4 per mil on the average <u>market value</u> of the listed portion	0.1 per mil on the average <u>nominal value</u> of the non-listed portion	Total Registrar fees
AUDI	5.75	527,174,000		3,749,000,000	1,499,600		\$ 1,499,600
BLOM	11.64	288,896,010		3,441,000,000	1,376,400		\$ 1,376,400
BYBLOS	1.60	570,824,118		1,412,000,000	564,800		\$ 564,800
BOB (1)	18.80	39,898,000	30,242,102	880,000,000	352,000	3,004	\$ 355,004
BLC (2)	0.93	72,683,333	134,632,200	231,061,000	92,424	8,975	\$ 101,400
BEMO (3)	1.30	51,750,000	39,073,920	103,000,000	41,200	2,615	\$ 43,815
RYMCO (4)	3.25	10,920,000		35,000,000	14,000		\$ 14,000
CIMENT BLANC	2.25	9,000,000		20,000,000	8,000		\$ 8,000
HOLCIM	14.46	19,516,040		282,000,000	112,800		\$ 112,800
SOLIDERE	8.01	165,000,000		1,320,000,000	N/A		N/A
Total		1,755,661,501	203,948,222	11,473,061,000			\$ 4,075,819
Figures calculated as at End 2016							
Registrar							
Bank	Price per Common share	Number of shares listed	Number of shares not listed	Market Capitalization (all issued shares common and preferred)	0.4 per mil on the average <u>market value</u> of the listed portion	0.1 per mil on the average <u>nominal value</u> of the non-listed portion (5)	Total Registrar fees
AUDI	6.80	523,424,000		3,882,000,000	1,552,800		\$ 1,552,800
BLOM	10.60	308,896,010		3,294,000,000	1,317,600		\$ 1,317,600
BYBLOS	1.70	570,824,118		1,474,000,000	589,600		\$ 589,600
BOB (1)	18.80	39,898,000	30,242,102	887,000,000	354,800	3,004	\$ 357,804
BLC (2)	0.99	72,683,333	134,632,200	235,000,000	94,000	8,975	\$ 102,975
BEMO (3)	1.70	51,750,000	39,073,920	122,000,000	48,800	2,615	\$ 51,415
RYMCO (4)	3.25	10,920,000		35,000,000	14,000		\$ 14,000
CIMENT BLANC	1.57	9,000,000		25,000,000	10,000		\$ 10,000
HOLCIM	11.75	19,516,040		229,000,000	91,600		\$ 91,600
SOLIDERE	10.38	165,000,000		1,721,000,000	N/A		N/A
Total		1,771,911,501	203,948,222	11,904,000,000			\$ 4,087,795
(1)	BOB has 36.98% of its common shares listed						
(2)	BLC has 33.25% of its common shares listed						
(3)	BEMO has 82.9% of its common shares listed						
(4)	100% of Class B shares (representing 40% of the total capital of the company)						
(5)	Nominal value of unlisted shares was retrieved from annual reports						
N.B.: Last updated on March 20,2020							

Source: MIDCLEAR, personal compilation and calculation

Table 26 below elaborates the tariffs and costs charged by MIDCLEAR on all members, listed companies.

Table 26: MIDCLEAR Fees

MIDCLEAR Fees	One Time	Annual
Registration Fees	\$3,000	
Membership Fees		\$1,500
Safekeeping Fees		0.18 per mil on lower end < \$ 10 million and 0.117 on higher end > \$ 5 billion
Custody Fees		Min \$60
Registrar Fees		0.4 per mil on the average market value of the listed portion 0.1 per mil on the nominal value of the not listed portion
Corporate Actions Fees - Dividend distribution		Issuer: 1 per mill calculated on the total amount distributed. Member: \$ 10 < X < \$ 300
Service Transactions Fees		Average \$1.25 / request
Reporting and Inquiry Fees		Audit Confirmation \$ 5 \$ 5 per Inquiry Online Reporting Fee \$ 125
Communication Fees		\$ 10 / request

Safekeeping: The daily market values are used to calculate an average value for the month which will be charged according to a pre-specified table.

MIDCLEAR charges a penalty fee of USD 100.- for every 15 days delay for failing to report the resolutions taken at the General Assembly.

Source: MIDCLEAR, personal compilation

It is worth mentioning that the Central Bank issued an intermediary circular 532 (decision 13129) on November 4th, 2019 requiring Lebanese banks not to distribute dividends from the profits of the financial year 2019 and rather increase the regulatory capital by 20% of the Common Equity Tier 1 capital as at 31 December 2018 through cash contribution in US Dollars. This decision, accordingly, affected the fees paid on corporate actions to MIDCLEAR.

2. Auditing fees and audit committee cost:

All listed companies are stipulated by law to publish their audited financial statements. According to their statutory legal status, commercial banks operating in Lebanon, are bound by the rules and regulations imposed on them by the Central Bank of Lebanon, whereby, they have to publish their audited financial statement regularly, irrespective of whether they listed on the BSE or not. Other listed firms consider this task as part of their routine tasks and accordingly they do not account for it separately and some of the non-bank companies did not deal with the hassle of establishing an audit committee. As for the commercial banks, they established an audit committee to help out in the dynamic requirements that are imposed and amended continuously by the Central Bank. Here again, no specific costs nor additional costs were incurred by the listed banks since the set-up of the audit and control system falls under their statutory framework.

Accordingly, several prominent auditing firms were approached in order to get an approximate cost to be charged on listed firms for the auditing services. These services include the audit process and the review report and/or the management report where applicable, not to forget the important weight assigned to the application of IFRS and IAS in the preparation of the reports, and especially amid the recent financial and economic situation in the country. The fees charged depend on the numbers of branches to be audited and the respective regulatory reports that have to be issued. Financial institutions and in specific commercial banks, are known to have plenty of branches, on one hand, and they are bound by their statutory rules and regulations to submit special reports to the Central Bank, on the other.

Therefore, the audit fees are usually comprehensive of all audit processes and the special reports to be submitted to the respective authorities and they range between \$250,000 and \$350,000 in the case of banks and commensurate with the number of branches and between \$20,000 and \$35,000 for other businesses depending on the available number of branches and the management requirements and the complexity of the group organizational structure. Worth mentioning that it is mandatory to employ the services of two (2) audit companies for each commercial bank, which brings the costs up to double the figures mentioned above.

3. Financial and regulatory reporting costs:

Most business entities prepare financial reports for their own use in the management decision making, planning and forecasting and risk management. Some firms publish summary of their

financial situations and some publish detailed information and incur the additional costs. Once listed on the BSE, each company must publish an audited annual report respecting all regulatory accounting standards and following a pre-determined format and topics to be covered including all financial statements from balance sheet to profit & loss to cash flow to changes in owners' equity and a special section explaining risk management where applicable and in specific credit risk, liquidity risk, market risk, interest rate risk and currency risk, in addition to capital risk management and any off-balance sheet activities. Commercial banks that are listed in Lebanon follow the Central Bank requirements when it comes to preparing their annual reports irrespective of whether they are listed or not listed. The requirements are detailed in basic circular 6574 dated 24/4/1997 which stipulated that all commercial banks operating in Lebanon shall publish their financial statements regularly on annual basis and all commercial banks whose shares are listed on Beirut Stock Exchange shall publish these audited statements on quarterly basis. The said basic circular was amended by intermediate circulars on November 1st, 2019⁷⁷ and again on 20th of January 2020⁷⁸ as a consequence of the latest up-rise of October 17th, 2019 and stipulated that commercial banks whose shares are listed on the BSE shall postpone publishing their quarterly financial statements, effective from the 3rd quarter of 2019 and publish them once and all together at the same date of publishing their audited 2019 financial results during the third quarter of 2020. These regulatory requirements imposed on commercial banks by the Central Bank are prepared and made available to the public under "annual reports".

4. Compliance costs:

The compliance segment of the operation must cover subjects under the general guidelines of: Legal compliance, Tax compliance, CMA compliance, BSE compliance, KYC compliance and any additional compliance directives in effect by the regulatory authorities. Most of the firms left this task to be performed by the legal department with no need to appoint a dedicated unit. As for the commercial banks, they are also required by the Central Bank to establish a Compliance Department that shall be comprised of a Legal Compliance Unit which will handle the identification and prevention of legal risks, and that must formulate the required measures to

⁷⁷ Circular number 531

⁷⁸ Circular number 540

mitigate these risks, in addition to an AML/CFT⁷⁹ Compliance Unit, as per circular 128 under decision 11323 issued in January 12th, 2013. Furthermore, banks established anti-bribery and corruption (ABC) compliance, sanctions compliance and FATCA/CRS Compliance in order to stand out and be compliant with any domestic and international compliance requirements. Here again, the listed commercial banks could not assign a specific cost to compliance, as a result of being listed, since it is part of their legal statutes, under the Central Bank supervision, and not because they are publicly listed companies. Some companies incur cost for compliance that revolve around some KYCs and does not surpass the threshold of \$50,000 per year.

5. Investor relation, advertising and publication costs:

Some firms work around their investor relations and incur costs based on their Corporate Social Responsibility (CSR) and settle with minimum publications. The respondents concentrated on the fact that most publications, and in specific the financial reports, are posted online with no major or considerable cost to be borne for printing and distributing these reports. From the regulatory point of view, all listed companies must secure the approval of the CMA before taking or engaging in any action related to a press release, management or board member's interview, publication or advertising. In addition, they are required to post and make available all the above-mentioned releases on the BSE page and on the company's proper page as well, and this should be done before or at the time of the said release or publication, otherwise they will be fined by the CMA. This requirement is imposed and is meant to protect investors and to secure equal, equitable and timely access to information by all relative shareholders.

6. Legal fees related to the fact of being listed:

Most firms do not have any cost accounting for dedicated personnel in the legal department. All the legal costs incurred are related to compliance and follow up with the CMA and the BDL regulations and continuous circulars and requirements imposed on the listed firms in specific and the banking sector in general. For commercial banks and most of the listed firms, the fact of being listed did not provoke any additional legal aspect that can cause them to incur costs other than the one resulting from compliance requirements.

⁷⁹ AML/CFT: Anti-Money Laundering/Combating the Financing of Terrorism

Before being listed a company must change its legal status from LLC or SARL into JSC or SAL according to the Lebanese Code of Commerce and accordingly, each company must set aside 10% of its annual net profits to a reserve account until this reserve reaches one third of the company's capital. This reserve, as such, is not available to be distributed.

7. Number of board members (internal and independent):

Most of the firms abstained from mentioning the yearly compensation of the Board members, but the listed commercial banks are bound according to BDL Basic Circular no. 118, issued in July 2008⁸⁰ to establish the board of directors of internal / executive and non-executive, and external / independent members and in the notes to the yearly financial statements, the remuneration for salaries, bonuses and attendance fees should be clearly identified and explained.

Furthermore, the law as per legislative decree no. 304 dated 24/12/1942 was amended by law no. 126 dated 1/4/2019 and entered into force on 1/7/2019. The law has amended the Lebanese Code of Commerce to meet local and international standards. The amendments introduced new legal concepts as a result of the development of business in Lebanon. The Lebanese Code of Commerce Article 100 covered electronic publication of financial reports by (JSC - SAL) whereby the name, the form of company, the capital and the paid capital shall be added to the company's electronic documents. Article 101 covers the annual disclosures whereby the (JSC - SAL) Companies shall publish their financial statements, board members' names and external auditors annually in the official gazette and 2 newspapers. Additionally, and in the context of total transparency, the law stipulated on the members of the board of directors the obligation to publish before the trade register or by an electronic way, the obligatory declaration and periodical reports.

⁸⁰ Article 1 of BDL Circular No. 118: A Board of Directors' non-executive member is a Board member who has no administrative function in the concerned bank and is entrusted with nonexecutive duties at this bank and/or any of its branches or affiliates in Lebanon or abroad. A Board of Directors' independent member is a Board member who meets the following conditions: - Is a non-executive Board member - Is not one of the major shareholders who own, directly or indirectly, more than 5% of the bank total shares or voting rights pertaining to these shares, whichever bigger - Is independent from any person in the Senior Management of the concerned bank or from its major shareholders, so that no business relationship binds him/her to any of them, whether presently or during the two years preceding his/her appointment as a Board member - Is not related by kinship, up to the fourth degree, to any of the major shareholders - Is not one of the Bank's debtors

After analysing the annual reports, and based on the above regulations, the researcher managed to retrieve the approximate costs paid to the board of directors under the “attendance fees” that are usually paid for each time the board is summoned and meets during the year. For commercial banks, the fees range from around \$700,000 to almost \$ 3.5 million depending on the number of the board members and the number of meetings held throughout the year. As for the other listed companies, the figure is rather much cheaper and it ranges around \$100,000 to couple of hundred thousand dollars.

8. Costs incurred for dedicated staff:

Firms did not hire any new or additional personnel but rather opted for rotation and transfer of existing employees. On a need to go basis, employees from the finance and/or accounting department(s) were assigned to a special unit entrusted with the task of preparing and publishing financial reports. Commercial banks, on the other hand, were under the scrutiny of having dedicated staff to prepare and communicate with the Banking Control Commission of Lebanon (BCCL), the supervisor body of the Central Bank, due to the dynamic aspect of the rules and regulations that are continuously amended and imposed by the BDL. As such, they believe that no staff were, specifically, dedicated to meet the requirements of being listed. Therefore, when they answered with the nominal costs for dedicated staff, they were only accommodating for the compliance and the general reporting staff.

1- Advisory and consultancy costs, if any:

No specific services, only internal knowhow. The advisory and consultancy services are mostly needed at the time of the initial public offering and become relatively minor once the company is public and already able to manage its way around in the publicly listed world.

2- Cost of internal control systems (IT enhancements):

The IT systems are updated on regular basis to keep up with the market development. The cost depends on whether the company opt for an in-house development of their systems or they refer to a third party for this service. The information system used should be able to provide instantaneous and accurate reports to management to help them in their decision making, on one hand, and to generate the detailed financial statements to the regulatory authorities in the proper required format. The respondents did not specify any determined cost but rather highlighted the fact that it all depend on the upgrade needed and the complexity of the business structure.

The following table 27 highlights the overall findings of the study done on the costs of being public in Lebanon. The data collected from the respondents and the figures that were approximated through the different exercise calculations are all included to give a general perspective as to what it costs to be listed on the BSE and which might provide a door as to where the work should be done to attract new listing to the market and provide more incentive and attraction for companies to list.

C. Concluding Remarks

In the question of cheaper and more cost-efficient source of funding, firm must look into the different costs embedded in the decision to go public, in general, and the specific costs inherent in each step in the road map to get from a status of a privately owned to a publicly traded -firms. Many companies seek the benefits of going public but they tend to underestimate the substantial costs involved in the process of becoming public and the ongoing costs of being a public company. Therefore, the benefit of going public should be weighed against the initial and ongoing cost of being public. The explicit and implicit costs spread out from the actual time needed to get the approval, registration and liquidity and thus, the respective costs of each step of the process may vary depending on each particular company's situation starting with the underwriter experience, the management team professionalism and the choice of the legal consultants and advisers, the size of the company and the market conditions and regulatory environment.

Costs of going public are important in the decision, but given the nature and the characteristics of the Lebanese listed companies, it is difficult to have access to the exact costs of getting listed and being listed. With a minimum public float of 25%, firms must decide carefully on the capital needed to be raised from the IPO. One cannot estimate the cost of going public due to the lack of the underwriting services which represent the largest part of the cost inherent in the going public decision. With annual listing fees fixed at \$3000 per year and an additional minimum amount of \$1500 per year representing safekeeping and custodian fees paid to Midclear and around \$20,000 for auditing services, firms with an intention to go public must weigh in the benefits from such listing against the cost of listing and the ongoing costs of being listed.

Table 27 Costs Breakdown for Being Listed on the BSE (Approximation)

	LaforgeHolcim	Société Libanaise des Ciments Blancs	SOLDIERE	RYMCO	AUD bank	BLOM bank	BEMO Bank	BYBLOS bank	Bank of Beirut	BLC bank	
Annual Listing Fees	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	\$10,100	
Midlevel Annual Registration	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	
Midlevel monthly Fees (annualized)	\$216,720 (1)	\$9,180	Maintain own registrar \$200,000	\$14,327	\$1,151,212	\$1,070,689	\$47,402	\$465,175	\$436,918	\$91,794	
Auditing (5), Audit Committee and Financial Reporting	\$75,600	\$20,000 < X < \$30,000	\$200,000	\$20,000 < X < \$30,000	\$250,000 < X < \$450,000 multiplied by 2	\$250,000 < X < \$450,000 multiplied by 2	\$250,000 < X < \$450,000 multiplied by 2	\$930,000	\$250,000 < X < \$450,000 multiplied by 2	\$250,000 < X < \$450,000 multiplied by 2	
	Part of Accounting duties	Part of Accounting duties	\$50,000 cost of REVIEW by Auditors								
Compliance costs	Part of Legal and HR Deps	Part of Legal and HR Deps	\$50,000	Part of Legal and HR Deps							
Investors Relations and Advertising costs	N/A	N/A	very limited after delisting from London	N/A	N/A	N/A	25000(2)	N/A	N/A	N/A	
Publications costs	LBP 2,220,000		Electronic	Electronic	Electronic	Electronic		Electronic	Electronic	Electronic	
Legal fees	No specific costs	No specific costs	No specific costs	No specific costs	N/A	N/A	20000(2)	\$1,665,333	N/A	N/A	
Board members (3)	5 members / shareholders	3 members / shareholders	12 members / 3 internal / 9 external	6 members / 3 internal / 3 external	9 members / 4 internal / 5 external	15 members / 10 internal / 5 external	5 members / 8 internal / 4 external	10 members / 2 internal / 8 external	12 members / 6 internal / 6 external	11 members / 4 internal / 7 external	
Remuneration (4)			\$180,000		\$2,433,333	\$2,433,333		\$688,667			
* 2019			\$240,000	\$88,440	\$2,933,333	\$1,615,333		\$893,333		\$1,699,985	
* 2018					\$3,500,667	\$1,442,667		\$786,667		\$2,667,436	
* 2017			2 needed only at the time of preparing and filing financial statements	N/A	N/A	N/A	25000(2)	N/A	N/A	N/A	
Dedicated Staff	N/A	N/A									
Consultant and advisors	N/A	N/A	N/A	N/A	N/A	N/A	25000(2)	N/A	N/A	N/A	
Cost of internal control system (IT)	Standard procedure not related to being listed	Standard procedure not related to being listed	Standard procedure not related to being listed	Standard procedure not related to being listed	Imposed by the Central Bank to meet statutory requirements	Imposed by the Central Bank to meet statutory requirements	Imposed by the Central Bank to meet statutory requirements	Imposed by the Central Bank to meet statutory requirements	Imposed by the Central Bank to meet statutory requirements	Imposed by the Central Bank to meet statutory requirements	
(1)	Figure supplied by Holcim (Laforge) for 2019										
(2)	Figure supplied by BEMO bank for 2019										
(3) & (4)	Retrieved from respective Annual Reports										
(5)	Figures of Audit costs were approximation from 2 prominent auditing firms in the country (personal communication)										

Source: Personal communication and compilation, 2020

Source: Personal Compilation

Chapter Five: Privatization after Being Public: The French Experience.

Since its reopening in 1996, the Beirut Stock Exchange did not witness any incident of delisting or going back private. In order to elaborate on the phenomena of delisting, the French capital market was chosen as a study field for the subject matter. Over the past twenty years, the French stock market, Euronext – Paris, witnessed a lot of changes in its regulatory framework and faced new strategic decisions taken by firms when it comes to stay listed as a public company or just delist⁸¹ and go back to being private again. The author collected data from the Bloomberg terminal from 2000 till 2019 and tried to analyse and differentiate among the reasons why companies decide to delist from the Euronext-Paris. A further attempt was made by retrieving data from the Euronext website and in specific the fact book from 2013 till 2019, where the prior years' fact books were difficult to be accessed due to non-availability on the mentioned website. A look deeper into delisted firms' decisions to go back private was performed on individual delisted companies' official publications and announcements, and the general reasons were mainly concentrated on the high cost of being listed and specially the dual listing costs, the need to overcome the burden of the minority shareholders, the low turnover of shares and the fading away of the reason for being listed in the first place which is simply set forward as the need for financing.

⁸¹ “Getting delisted” is the term for “radiation du marché” in French.

I- Introduction

Over the past 30 years, the Lebanese capital market did not witness any activity pertaining to listing nor delisting of companies. The delisting or going back private is considered by the business world as an exit strategy and should be examined to shed the light on a back door to provide a possible medium to long term solution to an enterprise that can be caught in the middle of the capital market with overwhelming legal and regulatory requirements. As such, in order for the researcher to explore the different dimensions of going back private, the French market was chosen. The choice landed on the French market due to the similarity in the start-up structure with the Lebanese enterprises, on one hand and the recently witnessed “radiation de la bourse” or simply the delisting from the Paris stock exchange, from the other.

The stock market growth attracted a lot of capital to be invested in securities. However, as this money became increasingly tied, sooner or later, opportunities had to be created to release it. Going back to being private had to follow different paths ranging from delisting to going dark or simply a partial or complete share repurchase. Why do firms go back private after being public? An important question that requires explanation as it became a trend over the last two decades. What does it mean to go private and what are the factors that induce and stimulate publicly traded firms to go back private again? Several studies hinted on the stringent requirements imposed on public companies ranging from detailed reporting, to tough corporate governance measures, to control issues and reaching out to market determined strategies over management own visions and achievements of goals. Privatization is presented in the context of trade-off between autonomy and cost of funds on one hand and between short term profitability and long-term growth and sustainability. Going private can be done over stages starting with partial shares buy back, where some findings indicated that firms are gradually substituting shares repurchases for dividends, or a complete privatization and delisting and to lesser degree going dark. Even though IPOs continue to influence the news, many small investors are now beginning to find the large opportunities available in delisting, which are the opposite types of IPO transactions. Moreover, going private depends on the structure of the economy, whether we are under an Anglo-Saxon or a European system, as such different approaches and different drivers are encountered.

H4: A publicly traded firm might decide to go back private once the need for long term financing fades away and once the costs become irrelevant, which will be discussed and validated in chapter five.

Publicly traded companies assess a priori their decision to go private based on the costs that they will have to incur and the benefits that they will pull out of the new private company. Being a publicly traded company entices the following attractive elements that include among others higher stock liquidity, easier and cheaper access to capital and financial markets and a risk sharing potential with the general public investors. These costs and benefits range from being in kind to being related to management controls, vision and growth oriented strategic issues. Going private entails some new debt burden and may lead to an increase in the cost of debt and at the same time can bring with it some tax benefits of new borrowing and a more relaxed and freer and innovative management decisions.

In the beginning, a literature review will be presented to highlight some going public factors and their reversibility leading to the decision to go private and we will try to differentiate between two foundation of delisting under the Anglo-Saxon and the Continental European countries. Liquidity and dispersed control feature some intriguing factors that will lead after an extensive confrontation with market participants to a tendency to weigh the benefits of more efficient control insulated from market-imposed control mechanism at the expense of relinquishing any market provision of liquidity once this liquidity turns into a straitjacket that hinders the movement of management and owners of a publicly traded company. Furthermore, being public might undervalue a publicly listed company, probably as a result of miscalculated decisions or due to different expectations with misalignment of time frames and target outcome. In addition, a relatively narrower dispersion of ownership and more control concentration into the hands of large-scale individual investors and big funds might as well speed up the quest of original owners and management into privatization away from coercion that might hinder their attempt to grow within the original spirit of the company. Bharath and Dittmar (2006) introduced some debatable factors and yet adequate as to the different reasons that drive public companies into privatization. They brought forward these factors from multiple literatures to highlight the need to go private such as the adverse selection, the duplicative monitoring and cost of information, the opportune information, the cost of capital

and a multitude of management constraints and market sought liquidity and exposure to investors radars.

We will then try to define the going private transactions and the reasons and the decision base that will lead a company into privatization. Furthermore, advantages and drawbacks will be tackled with an emphasis on the newly created matrix related to investors, shareholders and employees alike in the context of the newly imposed borrowing arrangements and new corporate governance. At the same time, it is important to look into the perspective drawn by management team when it comes to the choice of ownership structure and their respective role as a manager or an owner investor and its implications.

Furthermore, during the past two decades the markets witnessed a growing popularity of share repurchases and a decreasing popularity for dividends payments and it was shown by Grullon (2000) that in 1998 the total amount of share buybacks exceeded the total dividends for industrial firms. Early studies such as Vermaelen (1981) show that stock prices react positively to any declaration of share repurchase programs suggesting that the market perceives repurchase announcements as excellent news from different perspectives, mainly because they signal that the managers of the company believe that the stock is undervalued and is committed to reduce any potential agency problems on one hand and that the tax burden of the firm and its shareholders decreases at the margin and provides more liquidity to the stock.

II- Literature review

Compared to going public, the decision to go back private or delist is given less attention in the corporate finance literature even though it represents an important step in the life of a firm. Going private, privatization or simply delisting can happen voluntarily by the firm or involuntarily (Macey et al. 2008). The voluntary delisting transaction or going private is a choice by investors or management to pull out of the public market and try to concentrate the ownership of the firm in the hands of fewer parties. Whereas, the involuntary delisting, it is a fate imposed upon the firm by the regulatory authorities⁸² for breaching any rule or requirements or resulting from a case of

⁸² Every Exchange is free to set its own listing requirements so they will all differ. Most of them will include factors like the market capitalization of the company and minimum turnover and most exchanges will also automatically delist stocks after they've reached the status of penny stocks with value of less than a 1 USD dollar or its equivalent.

financial distress or simply resulting from a merger or acquisition that led to the dissolution of the firm. Sanger and Peterson (1990) studied the reasons for delisting firms on NYSE and AMEX and found that the failure to meet minimum net income, minimum number of shareholders and minimum market value among the most important reason for involuntary delisting. Chen and Schoderbek (1999) found that 31% of firms delisted on AMEX during 1981 and 1992 violated the stock market accounting directives on multiple occasion in the five-year period preceding the delisting, and accordingly the authors stressed on the importance of the auditors' opinion in the decision to delist a firm from the market or not.

Going public is often viewed as a representation of a growth stage of the firm, but it is still unclear why a firm might decide to exit the public market and in which surrounding conditions. Some traditional motivations to go public are presented in the quest for more liquidity, better access to the financial markets and the larger risk distribution among a wider shareholders'/investors' base. Once these motivations fade away, a firm might elect to leave from the public market.

The development of the U.S. junk bond market in the 1980s introduced the publicly traded companies to the leverage buyouts (LBOs) phenomenon that was used by some of them to go back private, the UK followed suit in 1990s and Europe saw one of the largest trends of privatization during 1995-2005 period. A going private transaction usually takes the form of an LBO, where the listed firm gets acquired by some private equity investors using borrowing and then gets delisted. According to the Securities Data Company (SDC), the U.S. financial markets experienced more than 900 delisting since 1996.

Lehn and Poulsen (1989) and Kaplan (1989a, 1989b and 1991) revealed that the tax benefits and the reduced agency problems were some benefits derived from the LBO led privatization transactions in the 1980s. Kaplan found that an important factor in the decision to delist a firm emanates from the agency problem and the need to ease down the conflicts of interest between shareholders and managers and work on better alignment of the incentives of both parties through going private move with an LBO being the catalyst of this scenario. In this context, going back private unifies again the control and the ownership of a firm within the hand of few investors who in turn are better positioned to provide more incentives for managers to act in their best interests. Furthermore, the relatively high leverage resulting from the LBO tends to reduce unnecessary leakage from the free cash flow and put more constraints on managers due to the much-needed cash flow to pay back the new debt burden.

DeAngelo et al. (1984) studied the motivations behind the going private transactions and their effects on the minority shareholders. They found that going private generates benefits by eliminating the listing costs on one hand and by improving the incentives for managers as a result of a new structure of ownership on the other.

The way to look at the going private scenario or just delisting should be channelled through the unique characteristics of the two opposing camps: The Anglo-Saxon and the Continental European. The first one is distinguished by low ownership concentration where the privatization is based on LBO and the latter is defined by a large shareholders base (Faccio and Lang, 2002) and where the privatization happens on what is known as Buy-out Offer and Squeeze-Out (BOSO)⁸³. Under the BOSO process, the controlling shareholders, with the minimum 90% majority voting right⁸⁴, choose to buy out the minority shareholders and as such seals the capital of the firm and it becomes private (Venturuzzo, 2010). Therefore, within the above description, a difference has to be cleared and it is that in the Anglo-Saxon system a private equity usually initiates the move whereas under the European system it is usually a family member or a close corporation who initiates the move towards privatization.

To get to know the reasons for going private, it is necessary to look at the reasons to go public and try to see if the opposite is true and may lead a company to forgo its public status and go back private. Fama and French (2004), in their study of US firm who underwent an IPO between 1980-2001 period, found that two of every five new IPO firms were delisted for poor performance within 10 years.

In this context, we should confront the benefit of the availability of more liquidity to the shareholders and the company alike against the loss of control and the limited manoeuvrability in decision making. It was expressed clearly that the more liquidity is available in the market, the more prone are the owners and investors of a company to go public and in this accept the diversification of ownership and the forgone control in decision making. Amihud and Mendelson (1998) and Boot et al. (2006) found that the liquidity of a company's shares is a primary benefit sought from going public and as such once this benefit worsens, the company will be better off

⁸³ In France, around 85% of the going private transactions that happened during 1997-2006 followed the BOSO system.

⁸⁴ European Directive on Takeover Bids.

private again. Accordingly, once the management starts to sense a decrease in liquidity and a reduction in the availability of capital in the market, they develop a sentiment of resentment and begin their quest to going private away from possible market constraints. Furthermore, DeAngelo et al. (1984) pushed forward the increase in listing costs against the decrease in listing benefits as reason for companies to go back private. In their turn, Martinez and Serve (2011) saw the going private decision being made when the listing costs exceed the benefits of being public, where either the benefits decrease and/or the costs increase relative to an acceptable threshold.

Bharath and Dittmar (2006) saw that a decrease in analysts' following and reviews is a sign of the imminent liquidity squeeze that will direct management into going private decision. This lack of analysts' coverage pushes the cost of information production to levels that deter investors from approaching the stock of the company and hence turns the relative stock into the low liquidity mode and pushes as such the company to go private. This undervaluation is a by-product of asymmetric information among owners, managers and the investing public and presents itself as an opportunity costs that the public company has to face and the most feasible way to get around it is by going private. Whenever the management of the company realizes the undervaluation of its stock in the market, they might decide to get out of the market for their own sake and for the sake of forgone opportunity in favour of their company (Kim and Lyn, 1991).

Moreover, if the company has a concentrated ownership and mutual funds and less institutional owners, the going private process resulting from the low liquidity levels will be accelerate even more. Bharath and Dittmar (2006) also found that companies that are financially constrained prefer to stay public and benefit from what the market can offer in terms of financing and that firms that are out of the market for corporate acquisition tend to prefer to go private in a move to have better control over their decisions. In other words, going private can be clearly expected as result of the subsequent changes and more precisely reductions and decreases in some basic factors and in specific information, liquidity, access to capital and control.

Furthermore, adverse selection is one of the most detrimental factors for young and small companies that lack enough market visibility and as such the less the availability and the more the cost of information, the more likely the firm is to go private where adverse selection will be reduced to be a minor issue. The high cost resulting from the duplication of information production as seen by Chammanur and Fulghieri (1999) will be diluted within the market by participants' actions in price determination and information dissemination. Whenever the stock of the company

does not reflect the respective value of the company and when the market is not relaying the right image about the company, the latter will find itself in better position as a private company rather than a public one. This is also confirmed by Merton (1987) where he stressed on the lack of investors recognition and the relative ownership concentration as being a reason behind the going private decision.

Kim and Weisbach (2008) saw in going public an opportunity for high growth firms to have access to equity capital to finance their investment opportunities. As such, once a public company faces a shortage of investment opportunities and low growth potentials, it is better off becoming private rather than staying public since they have less need for capital (Kim and Lyn, 1991 and Martinez and Serve, 2011). Accordingly, as the cost of funds from the public markets is cheaper than from private sources, the company is better off as a public company, but once the costs start to increase due to an increase in information production, companies go private looking for the cheaper choice. Being public puts the company as a target for the suppliers of funds who try to compete over the best deal (Roell, 1996) and a company with financial constraint is better to stay public rather than go private.

Amihud and Mendelson (1988) stressed on the importance of liquidity in the going public decision whereas Bolton and von Thadden stressed on the trade-off between liquidity and control in the IPO decision. Zingales (1995) saw in the IPO a liquidity feature as a by-product of the market set price of the stock of the company. As such, in times of market troubles, the shortage of liquidity sends the companies to look for a way to go private. He also saw the IPO as a mean to set the right price for the takeover of the company. And if the company is not there in the public market looking for the elusive corporate control it is as well better off going back private and if it is benefiting from its stock price in any deal it might as well go private to cut down on costs of being public with no benefits accruing thereof (Braun and Fawcett, 2006). In his turn, Jensen (1986) studied the going private decision and found that an LBO transaction will lead to efficiency since it puts management and the company on equal wave length in the presence of high debt repayments and align management incentives with higher equity positions.

Weir et al. (2005), in their study of the characteristics of firms going back private relative to those that stayed public, realized that the firms that delisted during the period from 1998 to 2001 were younger, smaller and with lower growth potentials when using the Q ratios⁸⁵. Thomsen and Vinten

⁸⁵ The Q ratio is the ratio of a firm's market value of equity plus total debt minus cash to the book value of assets.

(2007), in their study of delisted European companies between 1995 and 2005, found that most delisted firms were slow growing, undervalued and illiquid compared to other public traded firms. The same was confirmed by Boucly et al. (2011) regarding French firms that were delisted during 1994-2004 period. Furthermore, Croci and Del Giudice (2011) found that the post-delisting operating performance of family firms was far better than firms that were delisted by new owners. Bharath and Dittmar (2010) also found a relationship between an increasing yield curve and the potential to go private and saw that public firms will be more inclined to take on additional debt and go private as an escape from possible risk of default that might affect negatively on the publicly traded firms. Moreover, the large supply of bank loans is absorbed as cheap source of financing and hence encourages more going private transactions on one hand, and the existence of a hot stock market can also be seen as a source of encouragement for equity financed acquisitions and the resulting privatization.

With the emergence and implementation of modern forms of economic organization in the nineteenth and twentieth centuries, the classic entrepreneur in large companies had to be replaced more and more by the shareholders. The separation between decision-making authority and risk-taking has become the leading model of success in most companies (Fama and Jensen, 1983 and Berle and Means, 1932). The main reason for removing the entrepreneur as a decision maker and enforcing the manager is the benefit that can be retrieved in a constantly differentiating modern world through the availability of specific information. Instead of having all decisions taken by one person, the decisions that have relevant specific knowledge are made in an organizational atmosphere (Fama and Jensen, 1983 and Berle and Means, 1932) and the separation of decision and control or responsibility and property enables an efficient organization of economic processes. Furthermore, Jensen and Meckling (1976) see, in their fundamental paper on principal-agent theory, the agency problem as the core question of the corporation. The agency theory depicts problems that occur in the interaction of two or more parties, each pursuing different goals and sharing the work. As the assumptions of individual benefit maximization, opportunism and limited rationality described above apply, the case of a division of labour between contracting authority and contractor, concerning the analysis of the contract between the two parties, is appropriately described: "We define an agency relationship as a contract under which one or more persons (the principal (s)) engage another person (the agent) to perform their duties. If both parties

to the relationship are utility maximizers, there is good reason that the agent does not always act in the best interests of the principal” (Jensen and Meckling, 1976).

From another angle, Boot et.al (2003) described public ownership as a market-imposed discipline, general enough not to meet a firm's specific requirements, whereas private ownership accommodates particular needs and is monitored as per the required intensity and quality. Hence, corporate governance structure can be customized to private firms' specific characteristics rather than a market-based governance structure that controls management actions by imposing specific disclosure requirements on one hand and limits decision taking capabilities of management in a move to dilute and absorb possible agency problems on the other. But, managers are supposed to maximize firm value in a way that may disagree with investors' philosophies (Mullainathan and Shleifer, 2002). This disagreement can be a question of priorities (Allen and Gale, 1999), or a question of overconfidence by either party (Daniel et.al, 1998).

There is a remarkable difference between the corporate governance in Continental Europe and in the Anglo-Saxon countries which is manifested in the high ownership concentration in Europe that in turn explains the relatively low agency cost resulting from a situation of closer control and monitoring by the majority shareholders (Faccio and Lang, 2002, Weir et al. 2005 and Renneboog et al. 2007).

When it comes to value enhancing decisions by management, autonomy is a must away from investors' interventions: this intervention can be reduced at the expense of increasing the cost of capital that can be the by-product of lesser number of investors but with a larger individual position. Accordingly, looking at the broad picture of going public or staying private, one must weigh the perceived value of management autonomy with the acceptable level of cost of capital. Here again, private firms can find the most convenient allocation of management autonomy for the best interest of the company and the level of cost of capital that best suits the growth potential of the company. The public firms, on the other hand, are known to make available more funds and at lower costs but at the expense of strict and rigid governance structure.

Therefore, when a market-based governance structure is willing to provide management with more manoeuvrability, investors will require a higher cost of capital to compensate for the risk they believe they are assuming and as such, the cost of capital will become detrimental and the company will find itself better under private ownership structure. At the same time, if the market-based

governance structure is strict and strangles the management, the firm will opt for the private ownership to escape the harsh and continuous interference by investors.

But if a private firm is owned by numerous shareholders, this may lead to tiresome monitoring and as the number of owners increase firms may opt out of private into public status. The opposite presents itself as a recall of additional monitoring by going private and reducing the number of shareholders/owners (Pagano and Roell (1998).

Jensen (1986) tried to put forward the LBO as a solution to the conflict of interests between owners and managers and referred to the idea of incentive realignment hypothesis of Kaplan (1989) to highlight the importance of the presence of a subtle capital base to the benefit of more efficient understanding among controlling party and ownership party under the Anglo-Saxon system. On the other hand, in Continental Europe, Weir et al. (2005) and Renneboog et al. (2007) observed more ownership concentration and hence predicted better monitoring and accordingly reduced the effect of Kaplan's realignment hypothesis and stressed rather on the quality of monitoring. They also depicted that the more monitored the company is, the less the value creation that can be extracted from it and the less attractive it is for private equity investors and the more control is pulled by the shareholder with the largest ownership position. Therefore, in Continental Europe, the control hypothesis sets itself as a better explanation for the going private transaction and the BOSO strategy presents itself as an explanatory comment on the conflict between majority and minority shareholders (Crocì and Del Giudice, 2011).

Coffee (1991) and Bhide (1993) contest the liquidity advantage of public firms which is confirmed by the large number of shareholders who sacrifice the freedom of management decision as opposed to private firms who grab onto owner/management freedom in decision making, but with the sacrifice of liquidity of ownership. In turn, Bolton and Von Thadden (1998) presented the limited degree of ownership through block shareholdings as a possible midway solution that can combine liquidity of ownership with some acceptable control over management decision making. Whereas, Zingales (1995) saw the potential bargaining power of initial owner to be affected by various ownership structures when they are dominated by different type of commitments.

One note is that delisting can be done on a mandatory basis⁸⁶ by the Exchange or on a voluntary basis by the company itself.

The following table 28 highlights some of the most important factors that can induce a public company to go back private, the authors who tackled the issue and introduced relative models, the effect that each factor can have on the privatization decision and an additional short analysis or insights as presented in the study done by Bharath and Dittmar (2006) on US firms that went private during the period from 1980 till 2004.

In the following section, we will try to find enriching answers to some of the informative and intriguing questions in the going private world of finance. Some questions relate to reason for going private, others relate to advantages and drawback of going private and others relate to what happens to investors, employees and shareholders.

⁸⁶ Forced Delisting occurs when a company is forced to delist itself from an exchange.

Table 28: Why a Public Firm Would Go Private?

	Driving Force	Models	Effect on the going private decision	Insights
INFORMATION	Adverse selection	Leland and Pyle (1977)	As information asymmetry increases, more firms go private	Smaller and younger firms go private
	Duplicative monitoring	Chemmanur and Fulghieri (1999)	If information gathering costs increases, more firms go private	Firms with less analysts' coverage go private
	Serendipitous information production	Subramanyam and Titman (1999)	If serendipitous information gathering costs increase, more firms go private	
	Investor recognition	Merton (1987)	Low diffuse ownership or less recognition suggests more firms opt to be private.	Firms with ownership concentration are more likely to go private
ACCESS TO CAPITAL	Cost of capital	Modigliani & Miller (1966) Scott (1976)	As cost of capital increases in public	Dividend payers are less likely to go private
	Overcoming financial constraints		Lack of large investments, financial constraints in public markets lead more firms to go private.	Financially constrained firms are more likely to go private
CONTROL CONSIDERATION	Benefit of corporate control	Zingales (1995) Mello & Parsons (1998)	Facilitate control transfers increase in public markets	Firms with less mergers and low market to book are more likely to go private
		Brau et.al. (2003) Brau et.al. (2006)	Stock as a currency for future acquisitions Managerial autonomy	
LIQUIDITY	Benefit of liquidity	Zingales (1995) Mello & Parsons (1998) Bolton and von Thadden (1996) Boot et.al. (2006)	Establish market price of the firm Liquidity benefits Managerial autonomy	

Source: Bharath and Dittmar, 2006.

III- General Landscape for Going Back Private

Bharath and Dittmar (2010) tracked U.S. firms, during the period of 1980-2004, from their IPO and tried to see how the costs and benefits of being public push the firms to decide to go private instead of staying public. They first realized that whenever the cost of the loss of control in decision making exceeds the benefits of liquidity, firms will leave the public markets and go private. DeAngelo et al. (1984) pinpointed the gains from reducing the listing costs and the new ownership structure that improves managers' incentives after becoming private again. Martinez and Serve (2011) in turn, stressed on the fact that whenever the costs of listing start to outweigh the benefit of being public, it is time for the firm to go private.

Moreover, the less coverage the firm has from analysts, the less its shares are held by institutional investors, the more concentrated the ownership of its shares lead these firms into going private again away from the public markets. Charitou et al. (2007) and Marosi and Massoud (2007) displayed the fact that companies with outside directors and greater insider ownership and less institutional investors are more likely to go private. It is also stated that the more illiquid the shares and the less these shares turnover is, the more the tendency of the firms to become private again and this decision to go back to being private was realized over an average of 13 years after becoming public, Bharath and Dittmar (2006).

Lehn and Poulsen (1989) show that mitigating agency conflicts is one reason for companies to go private, in addition to tax benefits and incentives inherent in the going private decision using leverage buyouts. Furthermore, they found that firms that go private have more free cash flow and may benefit by reducing potential agency problems and reducing the risk of wasting of the cash flow. The Free Cash Flow hypothesis states that the new debt burden imposed by the LBO will reduce the waste of FCF by the managers because it is needed to repay the debt (Jensen, 1987).

Whenever visibility starts to decrease and information asymmetry begins to increase, public firms will tend to go private in a move to escape the adverse selection costs. Mehran and Peristiani (2009) defined the financial visibility by market participants as an important gauge to test the level of righteous information that reaches the market and its consequence in attracting analysts to provide monitoring for the company on one hand and liquidity for its shares on the other.

More investors tend to collect information about an investable public firm leading to an increase in the aggregate costs of this information. The availability of a public price provides more information and reduces these costs which put forward the benefits of selling the shares to a large

investor or VC. Accordingly, if liquidity is lacking and rendering information production costs detrimental, firms tend to go private to avoid mispricing of the true value of the firm. As the costs of producing serendipitous information increase, firms tend to go back private again. It is argued that high ownership concentration may lead to lower investor recognition and hence decreases the benefits of being public and pushes firms into going private as better option. Despite the run-up in equity prices, public investors often undervalue companies they don't understand. As Josh Harris, the cofounder of Apollo Global Management puts it, "That is creating a very fertile hunting ground for private equity."

Hence, as the cost of capital increases in the public market place, firms tend to go private to overcome this relatively high burden.

Firms that do not have adequate information production are relatively financially constrained and prefer to be private. Despite the run-up in equity prices, public investors often undervalue companies they don't understand. As Josh Harris, the cofounder of Apollo Global Management puts it "That is creating a very fertile hunting ground for private equity."

To summarize, most companies going private or newly privatized firms display one or more of the following characteristics:

- * Firms going private have relatively less analysts following and more informed trading with more concentrated ownership and less institutional ownership and fewer funds holding the stock.
- * Private firms have lower capital expenditures and hence fewer growth opportunities and less need for capital.
- * Firms tend to go private when they do not benefit from a liquid publicly traded stock, meaning that their stock is illiquid or they have less stock turnover.
- * The market to book value ratio is significantly lower at the time they go private.

Private ownership accommodates precise contracting with monitoring customized to the needs of the firm. Unlike publicly owned firms that follow a market-imposed discipline that is imposed on all public firms alike.

Moreover, the private ownership helps manager to achieve the desired trade-off between governance structure and cost of capital through private contracting with few large investors.

When corporate governance is extremely lenient and allows management significant autonomy, investors in the public markets tend to require higher returns on their capital pushing firms into

preferring private ownership which in turn helps in eliminating the conflicts between insiders and outsiders.

Kaplan 1989, Muscarella and Vetsuypens 1990 and Smith 1990 document that superior performance of firms that make the transition from public to private ownership through LBOs or management buyouts MBOs. A common argument to explain the operating efficiency gains is related to the reduced conflict of interest between managers and owners in a closely held firm.

What Does "Going Private" Mean?

Generally, a "going private transaction" is the exchange of cash for the shares of a company's existing public shareholders in a way that the company's shareholder base will be sufficiently reduced to permit the company to decide to terminate its public company status (Foley & Lardner, 2005). In other words, going private is a series of transactions that convert a publicly traded company into a private entity whose shareholders are no longer capable of trading their stocks in the open public markets.

A going private transaction is usually initiated by a controlling shareholder or a group of shareholders that either constitutes a majority or a control position in the company. Senior management often comprises such a buyout group which turns the going private transactions look like a management buyout. Shah and Thakor (1988) showed that the publicly traded eminence allows the controlling shareholder, who enjoys superior access to information about the degree of risk of the firm's assets and returns, to benefit from risk sharing with the minority shareholders, and once that possibility is reduced, going back private will be presented as the choice to consider.

A publicly held company may decide to deregister a class of its equity securities, either because those securities are no longer widely held or because they are delisted from an exchange which is known as "going private."

A publicly held company may deregister its equity securities when they are held by less than the minimum number of shareholders required by the listing exchange. Based on the facts and circumstances, the company may no longer be required to file periodic reports with the regulatory authorities once the number of shareholders of record falls below the ore-requisite thresholds.

A company usually goes private when its stakeholders or owners decide that there are no more benefits to be gained from being a public company. Privatization will usually take place when a company's management wants to buy out the public shareholders and take the company private

and this is known as a management buyout, or when a company or an individual makes a tender offer to buy the majority or all of the stock of the target company.

A company might go private in so many ways. A management buyout or MBO that requires that the company management putting together an array of resources ranging from personal resources to private equity financing to seller financing in order to acquire all or certain parts of the business. An MBO has both advantages and disadvantages. Advantages mainly include existing managers' know-how and understanding of the business they are taking over. Whereas, the disadvantages include, among others, managers transition from an employee to an owner status which demands a completely different mindset change from managerial to entrepreneurial in nature.

Another approach to go private is a leveraged buyout (or LBO) where acquirers use an amount of borrowed fund to meet the cost requirements of the acquisition. LBOs are usually done on relatively larger entities where the assets of the company being acquired and assets of the acquiring company are used as guarantee or collateral against the loan. As such and LBO will help companies undergo large acquisitions without having to commit a lot of capital.

Different types of transactions can lead a company into going private, such as:

- - Another company or individual makes a tender offer to buy all or most of the company's publicly held shares or "cram down" transaction⁸⁷.
- - The company merges with or sells all of the company's assets to another company
- - A self-tender by the company for its own shares where the company declares a reverse stock split that reduces the number of shareholders of record⁸⁸. In this situation, the company typically gives each shareholder a single new share in exchange for a block of 10, 50 or even 500 shares of the old existing shares. If a shareholder does not have sufficient number of old shares to exchange for the new ones, the company will usually pay the shareholder cash instead of issuing a new share, and as such the number of shareholders will be reduced.

Which form to choose for a going private transaction case depends usually on the structure of the company and its shareholder base, who is participating in the transaction and the source of financing for the transaction which almost require some degree of outside financing and each form

⁸⁷ A "cram down" is a buyout of the unaffiliated public shareholders that is initiated by an existing controlling shareholder.

⁸⁸ Squeezing out smaller shareholders

has different implications when it comes to considerations of costs, timing, disclosures requirements and legal standards.

- These transactions listed above will mostly result in a company's publicly held securities becoming delisted from the relative securities exchange.

While most of the rules and regulations of exchanges don't stand against companies going private but, they require companies to provide some specific information to shareholders about the transaction that caused the company to go private. Further and to protect shareholders, some regulators have adopted corporate takeover statutes that provide shareholders with dissenter's rights. Dissenters' rights are part of a corporate law that gives a corporation's shareholders the right to receive a cash payment for the fair value of their shares in an acquisition or merger they did not consent to. If the majority shareholders approve the merger or acquisition, the process advances and these *dissenting* shareholders are not obliged to accept shares in the surviving or successor company.

These statutes provide shareholders the opportunity to sell their shares on the terms offered, to challenge the transaction in court, or to hold on to the shares. Once the transaction is concluded, remaining shareholders may find it very difficult to sell their retained shares because of a limited trading market.

Moreover, and in contrast with the going public transaction, the process of "going dark" is not a transaction in itself. It is a filing with the respective authorities where a public company with fewer than the minimum required number of shareholders on record but that is still able to meet certain other eligibility requirements under the relative rules of the exchange may suspend its obligation to make public filings. Here, the company does not buy out its existing shareholders but rather it only does not file any disclosure document with the regulatory authorities or distribute any disclosure document to its shareholders. "Turn the lights back on" is a scenario subsequent to going dark and it happens when the number of record holders of the company's stock once again exceed the applicable minimum required threshold used to deregister as a public company. This situation happened with a so-called "broker kick-out." A broker kick-out occurs when a street or nominee holder determines it no longer wants to serve in that position and kicks the shares out to its customers. This, in turn, causes those customers to change from beneficial holders to record holders, thus increasing the number of record holders. Going dark is all about becoming outside

of the radar of the market transparency requirements. Going dark is mainly attributable to the Sarbanes-Oxley Act and its increased compliance costs and when governance and investor protection are weak, controlling insiders usually decide to take their firms dark in a move to protect private control benefits and reduce outside intriguing observation or examination (Leuz et. al, 2008). Engel et al. (2007) in their study during the period of the enactment of SOX, found that smaller firms and less liquid firms stand to bear very high costs as a result of SOX, and firms upon taking the decision to go private witnessed an increase in their stock prices because the market participants expected a saving in expenses that could have resulted from SOX implementation. SOX came as a reaction to the failures of Enron and Worldcom in 2001-2002, SOX required all publicly traded companies to implement and execute internal control and requires the implementation, documentation, and testing of internal controls over financial reporting at all levels of the organization.

Nevertheless, most companies prefer to go private instead of going dark for two important reasons. First, the going private transaction facilitates the defense against any lawsuit that might be brought by the minority shareholders claiming a violation of the directors' fiduciary duty, since they receive cash for their shares. Whereas, when a company goes dark, its shareholders receive no cash in spite of the benefits accrued from a reduction in the compliance costs that they were subjected to.

A. Decision to Go Private

A "take-private" transaction means that a large private equity group purchases the stock of a publicly traded corporation. Because most public companies are large in size, it is normally not practical or feasible for an acquiring company to finance the purchase alone. Accordingly, the acquiring private-equity group needs to secure financing from an investment bank or related lender that can provide an amount of fund to help finance the deal and the newly acquired company's cash flow can be used to pay off the debt that was taken to proceed with the acquisition.

Investment banks and senior management usually build relationships with private equity firms in order to search partnership and transaction opportunities. Acquirers typically pay between 20% and 40% as premium over the current stock price which can represent a lucrative incentive for CEOs and other managers of public companies. Many stockholders of public companies are also

short-term institutional and retail investors who see a low-risk mode of securing returns and realizing a premium from a take private transaction.

Fiduciary duty

The fiduciary obligations of directors in a going dark context are not entirely clear. Some cases indicate that there is no affirmative fiduciary duty to provide or maintain a market in a company's stock and others see a continuous risk that a shareholder challenges the company going dark as a breach of fiduciary duty because as a shareholder he always assumes the presence of a liquid market in the stock and the directors never disclosed any information to the contrary. Some studies (Bradshaw, G. 2015) see the continuous trading of the stock on the Pink Sheets, as a risk reduction of such a breach of fiduciary duty.

Business judgment rule

Generally, actions taken by a company's board of directors are protected by the "business judgment rule" which is the assumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the company's best interest. This rule protects corporate directors from liability for unprofitable or undesirable corporate transactions if the decisions approving such transactions were made in good faith, with due care, and within the directors' authority (US Legal definitions). However, when directors represent the shareholders as members of the board of directors and are members of the buyout group, the business judgment rule no longer applies due to the involvement of self-interest or self-dealing.

There are many reasons to go private which can be related to a strategic decision for an existing public company. A public company may consider a going-private transaction in light of the strict corporate governance regime and scrutiny of accounting and executive compensation policies and practices that apply to publicly listed companies.

A US private company that does not have any publicly traded equity or debt securities is exempt from complying with the corporate governance rules in the Sarbanes-Oxley Act and all related SEC and stock exchange rules.

Some of the reasons for a company to go private and/or go dark include the following:

* Eliminate the significant costs of being a public company⁸⁹. Trading volumes on the exchange it wants to delist from are not sufficient to justify the listing fees. As a result, deregistering can save a company a lot of money and reward shareholders with a higher net income and earnings per share (EPS).

* Realize the full value of a company in a situation where the company is undervalued in the market. In this context, Boucly et al. (2011) studied 830 French firms that were delisted between the years 1994-2004 and found that smaller and undervalued firms are considered targets for LBOs. So, the best opportunities are found in companies that voluntarily delist to go private and cash out their shareholders. This happens typically when management is confident that the company is undervalued or could save substantial money by operating as a private enterprise.

* Reduce or eliminate the obligation to disclose important and sensitive information to competitors

* Looking for more flexibility in their corporate governance

* Going-private transactions can help avoid the risk of activist investors looking to replace directors or execute other corporate governance or strategic changes.

* Be able to focus more on core business rather than working to meet market expectations

* More concentration of and control over the shareholders' base

* Escaping the burdensome rules imposed by SOX reforms, in the case of US firms, the FSL⁹⁰ in the case of France, or the Code of Best Practice in the UK.

* Providing liquidity to minority shareholders without brokerage fees

* Furthermore, from a management perspective the question of why would anyone want to take a company private? Can be answered by the following:

* Freedom from interference and greater control

* Managers see going private as an opportunity to get rich

* Gloomy market conditions

* Managers' freedom from shareholder lawsuits- case of the US

Last but not least, there reasons that qualify as last resorts such as:

* The company is being liquidated, the owners might choose to liquidate a subsidiary and transfer all the assets to the parent company and have only the parent company listed on the exchange.

⁸⁹ Direct costs that include annual listing fees and trading costs and indirect costs that include audit, publication and compliance.

⁹⁰ FSL: Financial Security Law

* The company declares a Bankruptcy when a company defaults on paying its debt and file for bankruptcy protection.

A company undertaking a going private transaction must consider taking several actions within the regulatory procedures governing such a move including:

- The directors should be obtaining independent legal guidance and background information before any action or transaction.
- A special committee of independent directors should handle all the negotiations and evaluations and independent valuation, fairness opinion to establish a fair minority share price
- Duly documenting all meetings, negotiations, discussions, and actions of the board, the special committee, and other involved parties, this documentation will have to be disclosed to the proper authorities for ant future dispute.
- The directors should release promptly the information to the public to address disclosure obligations while also "window shopping" the proposal
- Respecting the proper vote required by law

B. Alternatives When Going Private

Looking at the supply of funds in the world, one can clearly see a huge increase in the availability of funds from emerging and high performing countries such as China, India, Indonesia and Nigeria that the former Fed chairman Ben Bernanke calls "the global savings glut". Some private equity and venture capital firms hold more money than they know what to do with. Their "dry powder", the funds committed by investors but not yet invested, reached record high levels.

Furthermore, private companies that need capital face an attractive alternative to giving up equity by borrowing money at the lowest rates ever thanks to the savings glut on one hand and the easy money policies across most of the world's economies. Smaller companies, probably, have to pay more, but their rates are still at historical low levels, not to forget that in most countries, interest payments are tax-deductible.

Now combine the huge supply of funds with low interest rates on borrowing you will get the most convincing reason why companies are becoming less eager to need more capital but rather they can easily borrow money at the lowest possible cost and at the same time maintain their high ownership levels.

Alternatively, finance literature saw in share buybacks a possible back door to leave the market. With time, money gets stuck the stock markets, so opportunities had to be created to release it. The repurchase of shares or the acquisition of treasury shares is one of the key instruments to achieve this freedom (Grullon, 2000). Share buybacks were allowed for some time and gained economic relevance since the beginning of the 1980s. They play an important role in the changes that the distribution policy of stock corporations has experienced over the past 30 years (Skinner, 2008). In Germany, share buybacks due to a liberalization of laws since 1998 are on the agenda of most annual general meetings. For example, Daimler AG has implemented a resolution of the Annual Shareholders' Meeting on repurchasing shares in 2007, acquiring and redeeming its own shares with a value of € 6.2 billion by the beginning of April 2008 Daimler AG (2008a).

The motives and drivers of share buybacks are highly pertinent and highly controversial. In the US, since the emergence of share buybacks, a brisk financial and corporate science debate has developed over what can be the justifications and effects of this instrument. It is, therefore important to look into the price effects of buybacks, their motives and the repurchase methods. A lot of conflicting results surface which does not allow a consistent picture of the idea behind share buybacks. An attempt to structure the different motives from the point of view of the principal-agent relationship and the respective motives of management to carry out a share repurchase and the potential effects on the shareholders⁹¹. A combination of individual motives presents itself and defines the share buyback as a mixture of distribution, remuneration policy, capital structure and financing of a company which in turn imposes a look at the price effect or the repurchase procedure and an overview of the relevant drivers of the share repurchase.

For this, the new institutional economics theory divides the relationship into three directions starting with property rights theory, principal agent theory and last transaction cost economics. The property rights theory portrays institutions and explains the handling of rights of action and disposition in the context of the law and economy between different economic actors (Picot / Dietl / Franck, 2005). The principal-agent theory describes specific transactions in the relationship between the manager and the owner and therefore helps in the analysis of the exchange process between shareholders and managers. Transaction cost theory, on the other hand, does not place rights of disposal over resources in the center, but the interaction in general transactions

⁹¹ Following a share repurchase, there are now fewer remaining shares, those shares will experience increased earnings per share.

among individual economic agents and the costs of these transactions. Furthermore, the basic assumptions of these economic theories interlink and focus on the smallest unit of investigation being always the individual who acts and the second assumption turns to that individual who seeks benefit maximization and what he pursues may be different, depending on how his preferences are organized. However, a person will behave always in a way that optimizes his or her benefit based on his personal goals. Therefore, the individual benefit maximization is complemented by opportunism when he goes further to accept the harm of others to maximize his own benefits. And the third assumption is that a man's knowledge and information processing capacities are limited which leads to the realization that decisions can only be optimal from the point of view of the individual, but not from an objective-rational perspective. These three assumptions are generally used when trying to understand the managers and the shareholders and their interactions, especially when deciding on share buybacks.

The knowledge of the managers and the costs of gathering information which happen everywhere give one party advantage over the other. This might lead to more efficient organization in the company by separating decision and control if the management is given a capacity that it is intended to be exploited in the best interests of the shareholders through the specific information advantage. Therefore, in order to maximize their own benefit, managers can take advantage of their specific knowledge advantage (information asymmetry) over others who have delegated the decision-making powers over their assets, such as the shareholders. As Jensen and Meckling (1976) put it "... the heart of principal-agent theory is the trade-off between (a) the cost of measuring behaviour and (b) the cost of measuring outcomes and transferring risk to the agent.". This will undermine the prosperity-maximizing economic configuration, because the approaches for monitoring and controlling the management must be used and the resulting total costs (agency costs) are on the part of the management and the signalling costs (Vermaelen, 1981, 1984) of its quality and trust worthiness, as such the Principal/shareholders will face the control and monitoring costs of the agent/manager and the resulting welfare loss by not reaching a prosperity-maximizing favourable solution (Jensen and Meckling, 1976). Therefore, the relevance of the moral hazard problem in the relationship and the interaction between management and shareholders, many corporate policy decisions such as the repurchase of shares must be made jointly by both parties.

Brealey et al. (2006) put it briefly in their book on corporate finance: “Investors cannot read minds, but they can learn from managers' actions” See also Picot et al. (2005) and Eisenhardt (1989). Furthermore, the key buyback motives will be presented in order to try to better understand the different factors and aspects that could influence share buybacks (Grullon and Ikenberry, 2000). Based on some existing literature, there are some major differences between the US stock market and the German one and which is clear in that the US stocks have been characterized by free float, while the European markets were dominated by large investors. This difference, in turn, allows more functionality transfer from market to market in spite of the cultural and legal divergence (Picot et al. 2005).

After the exposure of the German companies to large competition from the US and UK firms in 1990, and following the EC Capital Directives⁹² and adoption in Germany of the Law on Control and Transparency in the Corporate Division (KonTraG) came the liberalization of the repurchase of shares specifically in Germany with the addition of the decision # 71 (1) No. 8 to the Stock Corporation Act⁹³, which is followed today by the majority of share buybacks. Thus, the possibility of repurchase of shares needs a fundamental license, even though it is constrained by a small number of key requirements. On the other hand, in the US, the share buyback has been permitted and the US experienced the first wave of share buy-backs between 1954 and 1963, when the post-war economic boom produced large cash surpluses (Fama, 1980). The popularity of the share buyback started in the early 1980s. From 1977 to 1987, dividend payments by US companies rose by 61.3%, while the volume of money distributed to shareholders via share buybacks rose by 824% during the same period. This huge increase in share buybacks compared to dividend payments can be explained as having fiscal reasons for replacing the traditional dividend pay-out instrument with the repurchase of own shares (Bartov, E. et al. 1998). Moreover, some refer to other motives, such as trying to prevent and protect against attempts of takeovers.

In the 1990s, the trend moved towards more share buybacks with few dividends being paid. On average, dividends increased by only 6.3% annually, from 1980 to 2000 for all US companies, while share buybacks increased by 26.1% annually (Grullon and Michaely, 2002). One important step was taken from 1983 to 1984, when the total volume of share buybacks jumped from \$ 7.7

⁹² The EC second capital directive of 1976 created regulations at the European level to liberalize share buy-backs to standardize capital markets

⁹³ Aktiengesetz (1965) paragraph 1 that intended to prevent severe damage to the firm and to distribute shares to employees.

billion to \$ 27.4 billion which was due to the introduction of Rule 10b-18⁹⁴ by the US Securities and Exchange Commission (SEC) in 1982 which created much greater legal certainty for repurchasing companies that could be exposed to suspected illegal price manipulation. Therefore, share repurchases substituted dividends as a significant type of pay-out for U.S. corporations and Grullon and Michaely (2002) found that smaller and younger firms have a more propensity to use repurchase as a preferred form of cash pay-out. Nevertheless, large firms maintained their dividends payment strategies, but they started to show a bigger tendency to release cash payments through repurchases. Some results suggest that before 1983, regulatory constraints inhibited firms from aggressively repurchasing shares and in the 21st century, share buybacks on the US capital market outpaced the total volume of dividend payments (Grullon and Michaely, 2002).

Management of companies are usually entitled to buy back shares of up to a predetermined percentage of the outstanding share capital with a resolution of the Annual General Meeting and they are entrusted with the final decision on the timing, amount and use of funds. The redemption of the shares that are normally bought back and the resulting decrease in capital does not require any additional authorization, once the process is approved at the Annual General Meeting. Even though a stock buyback is considered a way for a company to re-invest in itself, there are many distinct types of share buybacks that must be differentiated before any action is taken in order to understand the possible results of each action; The repurchase can be carried out through the stock exchange as a public repurchase tender offer (Vermaelen, 1984) to all shareholders, and the privately negotiated repurchase of selected shares by the concerned parties.

The most common process is the open-market repurchase (Porter et al. 2000), in which the company repurchases its shares either itself or under the direction of a credit institution. In this case, a distinction must be made between a fixed price tender offer⁹⁵, a Dutch auction tender offer (Comment and Jarrell, 1991)⁹⁶ and the issuance of transferable put rights⁹⁷. The rarest form is the

⁹⁴ Rule 10B-18 is a Securities and Exchange Commission (SEC) rule that provides a safe harbor, or reduces liability, for companies and their affiliated purchasers when the company or affiliates repurchase the company's shares of common stock.

⁹⁵ Fixed-price tender offer is when a company offers to repurchase a specific number of shares at a given price before a given date.

⁹⁶ Dutch auction share repurchases is where shareholders can choose to tender their stock at any price within the stated range. The purchase price is the lowest price that allows the firm to buy the number of shares sought in the offer, and the firm pays that price to all investors who tendered at or below that price.

⁹⁷ Repurchase 'put' rights are a stock option granted by a corporation to its shareholders that allows those shareholders to sell their shares back to the corporation at a fixed price within a fixed time period.

privately negotiated repurchase⁹⁸, since the potential for manipulation is significant here and there are some strict legal requirements that must be met (Terberger / Wettberg (2005). More than 95% of the buyback transactions since 1990 have been carried out in this way (Schremper, 2002). The advantage here is that equal treatment principles are adhered to because the selling shareholder does not know whether he has sold to the company or to another investor in the stock exchange. It also gives the company's management the flexibility in terms of timing and amount of actual repurchase and minimizes the transaction costs. Market conditions such as a price decline or increase can be rapidly reacted to by the short-term and quick decisions and the market usually perceives a buyback as a positive indicator and as such the share price shoots up following a buyback.

Signalling the undervaluation of a company's share is considered the most important motive for share buybacks and provides the most widely used explanatory approach to price effects through share buybacks (Williams, 1988, Brealey et al. 2006). In anonymous surveys of CFOs in the US about their motivation to buy back shares, the most common reason given is that they seek to recover undervalued stocks from the capital market (Skinner, 2008). In principle, by announcing and executing a share buyback, different signals will be sent to the capital markets and the shareholders. The most common motive for this is that the buyback seeks to counter investors' perceived undervaluation of the stock price through underestimated future cash flows and overestimated risks. When the company buys its own shares back, it reflects confidence in its shares, showing outside investors that it sees the share as a good future investment opportunity. As such, the company repurchases from the capital markets the shares that investors have priced incorrectly and projects accordingly some credibility to their actions mainly through the buyback volume, the premium offered over and above the current price and the share of capital or profit sharing provided by the management. Management is the main driving force and the decisive force behind share buybacks and the repurchase method is an important factor because any fixed price premium increases the credibility of the signal. Furthermore, the credibility of a share buyback to signal undervaluation is drastically influenced by this factor, and is considered only effective if management (insiders) do not sell their shares, because the managers involved in the buyback and who do not sell their personal holding of shares as part of this repurchase are probably bidding on

⁹⁸ In private negotiations, the share repurchase is negotiated between the company and an individual shareholder.

rising prices and hence the signal should be absorbed as a credible move by the capital markets participants.

C. Advantages of Privatization

Going private, or privatization, frees up management's time and effort to concentrate more on running and growing a successful business and as such senior management team can focus more on improving the business's competitive positioning in the marketplace.

The private-equity firms who step in to assist a public company go back private have segmented exit framework for their investments and their investment horizon ranges between four and eight years (Bain, 2016). During this period of time, management of the target firm shifts their concentration from meeting market's quarterly earnings expectations and requirements and focuses more on activities to build long-term shareholder wealth. Accordingly, managers might choose to retain the sales staff and get rid of underperformers and with the additional time and money these private companies now enjoy after being freed of reporting obligations, they can benefit and use that extra time and money in implementing some process-improvement initiative throughout the organization which can bring in more efficiency and profitability.

In an informal online survey, Fortune asked CEOs, "Do you agree or disagree with the following: It would be easier to manage my company if it were a private company rather than a public company." With only preliminary results so far, the message is clear: 77% agreed with the statement.

Moreover, private ownership can be attractive to managers on a totally different aspect which is 'pay'. For public companies, top executive pay is publicly reported and usually executives don't like the attention. Boards, on the other hand, hesitate to assume incentive pay plans that would reward CEOs enormously if they deliver impressive results from fear of how it would look to the public arena. The story is completely different at private companies, where pay plans might provide a CEO with higher rewards if he or she is willing to assume more risks.

According to market intelligence, the top target location for going private deals is the USA and China comes in at second place, with UK following during the period of 2013 through September 2018. In these locations, it was seen that after going private, average target's EBITDA values increased compared to when those companies were public. In the US, the growth stood at 56% and in China and UK it witnessed a 10% and 38% respectively.

A PE firm can bring along some managerial wisdom that many companies lack. Consider Tibco Software, one of those smallish software outfits that went from public to private after an activist demanded changes in response to weak results. Tibco sold to Vista Equity Partners, and founder Vivek Ranadivé ceded the CEO role to COO Murray Rode. “What surprised me most was the nature of the relationship with our private equity investors,” Rode says. “When you’re aligned with such a firm as theirs, it’s a bit like a golfer having a swing coach. Even if you’re a good golfer, it helps to have a swing coach who says do this, not that. Vista has a well-developed process of sharing best practices from its portfolio software companies to help your business. It spans a range of functional areas—from sales to product management to HR to M&A and leadership development.”

A survey by consultants McKinsey on the difference between public boards and private equity-led boards concluded that:

- Public boards can be slower to react when change is needed, and their voice on everything but the CEO succession tends to be more advisory than directive.
- Public company boards focused more on budgetary control, the delivery of short-term accounting profits, and avoiding surprises for investors
- Our respondents felt that private equity boards were much more effective at managing stakeholders, largely as a result of structural differences between the two models.
- The burden of investor management is much less onerous for private equity boards and the quality of the dialogue much better.

D. Drawbacks of Privatization

If a public company takes advantage of its status by using its stock as an acquisition currency or to access capital markets, or relies on the prestige of being public, then going private may not make good business sense. But, if the company is not regularly raising funds in the capital markets or making acquisitions with its stock as currency, then the benefits to the company of going private and/or dark may outweigh the costs of being public.

The following potential reasons against going private or going dark should be noted:

- Potential liability to officers and directors associated with "interested" nature of transaction
- Significant increase in debt on balance sheet if "self-funded"

- Increased difficulty in raising equity capital in future, potentially limiting a company's ability to grow via acquisition
- Reduced liquidity and overall financial flexibility
- Reduced attractiveness of equity-based incentives available to offer to executives and key employees or to use as money or payment in acquisitions
- Potential loss of prestige from no longer being a public company
- Possibility of high transactions costs for fairness opinion, legal costs and other accounting and printing costs, in addition to price paid to minority shareholders to buy them out.

In other words, a private equity firm that steps in with more borrowing and adds some heavy leverage to an existing public company can critically damage the organization if it faces some adverse economic conditions or some deterioration in its relative industry. The newly privatized company might face difficulty servicing its debts, and it will become harder to raise additional funds needed for expansion. In its quest to differentiate its products and services and its attempt to meet and overcome competition, some capital expenditures and research and development investments are needed to secure the long-term success of the company. Therefore, high levels of debt can hinder the competitive advantage of the newly privatized company. In other words, going private can backfire because when a company takes on debt to buy out public shareholders, this debt burden might weigh down on the company's ability to grow or meet its obligations. Management could fail in its efforts to turn the company on a growth path due some business downturns and it has no assurance that any change in its strategy will be better for a company's growth potential.

Moreover, private companies' shares don't trade on public exchanges and this affects the liquidity of the shares held by investors. These private investors might find buyers for their portion of the equity stake in the company depending on the willingness of the firm to buy out investors who want to sell on one hand and on some privacy covenants that specify exit dates and hence make it challenging to sell the investment on the other.

IV- Stakeholders' Fate When a Company Goes Private

Stakeholders stand to benefit from a going private transaction in different magnitude and multiple ways. Depending on the status: shareholders, employees and other related parties will see a gain or a positive window that offer them an incentive or a motive to support such a move and forego

some existing dissatisfaction and discontent that they might be enduring with the publicly listed status quo of their respective company.

A. What Do Investors Need to Know?

If you own a stock that's later on delisted from the stock exchange on which it had been trading, you might think this a bad thing, but there are some circumstances in which a delisting⁹⁹ might not indicate a problem.

For shareholders of a public company a buyout might be seen as an appealing move because the buyout offers usually push the company shares upward as would-be buyers must offer a premium to persuade shareholders to sell.

From an opposite view, when public shareholders sell their shares, they no longer have the opportunity to participate in any future gains. Furthermore, if the deal price happens to be below the price they paid for the shares, the buyout transaction would pen down your losses with no window to wait for and ride out of this realized loss. An individual investor might be having limited powers against a buyer who gets a majority of the shareholders to accept the offered price and as such you would be forced to sell your shares at the agreed upon price.

One should look also at investors who are not shareholders of a public company who might hear some rumours that the company is being taken private which might give them an incentive to buy the stock before the transaction happens in spite of the fact that most of the rumours do not materialize.

B. What Happens to Employees When a Company Goes Private?

Going private may substantially reduce the attractiveness of stock-based incentive plans, which are often used for executives and other key employees. In cases where the going-private transactions is led by private equity, a major concern for the acquirer is the continuity of management since the sponsors usually does not have the time, the resources nor the expertise to operate the acquired business. Accordingly, the principal executive compensation question in a private equity transaction is to ensure that equity-based and other compensation have been conveniently structured to provide an incentive to management to increase the company's value and remain with the company following the closing. One must also note that ongoing employee

⁹⁹ Before 2009, delisting in France was not enough to consider a company private but rather it should be declassified from the category of publicly-held to private company.

benefit protections and some other compensation arrangements such as salaries and annual cash bonus opportunities will factor into the negotiation with management and employees of the target company.

One more important issue to private equity firms regarding the continuity of management and the structure of their equity and compensation-based incentives is that there is usually a strain between the time when the board of directors will permit senior management to negotiate these arrangements with the potential private equity buyer and when the private equity buyer wishes to tackle such arrangements and confirm them with the senior management and the private equity sponsors must also be aware of tax issues relating to these management and employee compensations, which are relevant to structuring management's investment and post-closing incentives.

C. What Happens to Shareholders When a Company Goes Private?

The different stakeholders must weigh in the advantages and disadvantages of privatization and must look at going private as an attractive and viable alternative for some public companies. Being acquired or taken out of the public world can create significant financial gain for the shareholders and CEOs, at the same time, the reduced regulatory and reporting requirements can free up time and money to focus on long-term goals. Furthermore, as long as debt levels are at acceptable levels and the company continues to grow its free cash flow, management will be better situated to operate and run the private company free from any compliance requirements and market imposed short-term earnings management and will work to provide long-term benefits to the company and its private shareholders.

In a nutshell, benefits of tax-deductible interest payments, higher depreciation expenses associated with the going private transactions will accrue to the shareholders as a result of financing the privatization (Lehn & Poulsen, 1989 and Shleifer & Vishny, 1986). Furthermore, most management led transactions can be attributed to some information asymmetry on behalf of management and going private can also assist in mitigating any agency problem arising and resulting from withholding excess cash rather than distribution of such liquid assets among investors and owners alike (Jensen and Meckling, 1976). This conflict is rather more obvious in companies that enjoy large amount of free cash flow with low growth prospects and as such management will face a dilemma of unnecessary and unfeasible expenditures on one hand and the

option of going back private by paying high premium to existing bought out shareholders on the other.

In some cases, a company's managers might decide to take their company private to escape the pressures of activist shareholders and to avoid any risk of being sued by these public shareholders.

D. What Happens to Debt When a Company Goes Private?

Most private equity transactions involving the acquisition of a private or public company are generally structured as leveraged buyouts (LBOs) in which part of the purchase price is paid with the proceeds of new debt that is usually secured by assets of the target company and serviced from the company's cash flows. Private equity buyouts are arranged through senior bank debt, in the form of a senior syndicated¹⁰⁰ and secured revolving credit facility and senior secured term loans. Accordingly, the private equity sponsor must assess the schedule in which and the cost at which existing indebtedness may be repaid or refinanced and if it contains any provision that might restrict or forbid the transaction and hence evaluate the cost of the current indebtedness compared with acquisition-related indebtedness.

In recent years, private equity funds are using full equity backstop commitments that provide the target company with the assurance that it is capable of fully funding the purchase price using sponsor equity if debt financing is not obtained from third-party lenders by the time of the transaction's closing date. Therefore, the private equity sponsor's purchase proposal relative to other bidders seeking debt financing from third-party lenders gains more approval and better appeal to the target firm.

Before the decision to go private, the company should consider the effect of the transaction on the company's balance sheet. If the company uses too much debt to finance the transaction and becomes too leveraged, it might be difficult to operate from a cash flow perspective on an ongoing basis due to the newly created debt burden.

Some observers argue that "if debt is kept at acceptable levels, going private frees up management's time and energy from short-term earnings and share price obsession and regulatory compliance to focus 100 percent on trying to create a long-term future for a company and its future stakeholders"(McSherry, M. 2013).

¹⁰⁰ A syndicated loan is when a broad array of financial institutions extends the loan jointly on the same loan terms and with different duties and sign the same loan agreement.

V. Characterization of Firms Going Back Private

The dual role played by banks as lenders and underwriters of securities leads most of the time to IPO withdrawals under the pressure from banks who override their capital market role for the sake of their bank lending capacity. Better deals are presented to client firms with narrower spreads and cheaper fees do not pull the firms away from dropping their IPO in favour of traditional bank financing. Moreover, firms looking for external financing, plan ahead the minimum expected proceeds from a potential IPO that will at least meet their aspiration and the opportunity cost of foregoing some ownership privileges. If the minimum reserve price is not met through a normal auction, the company owners see themselves out of the IPO and withdraw their offer accordingly. With the new financial innovations and the new schemes that can bring a lot of good to companies, private firm owners looking for an exit strategy might opt for the dual tracking scheme whereby they arrange simultaneously an IPO registration and secret acquisition deal. Once they reach their best aspirations, they do not hesitate to withdraw their IPO in favour of being acquired by a public company at a convenient monetary deal. Helbing, Pia. (2019) revealed in her study that the IPO withdrawal is seen in many countries with different settings and reasons which are not fully covered or discovered yet, but one thing that might justify any IPO withdrawal decision has to do with agency conflict.

Furthermore, a study on the relation between in the aggregate supply of bank loans and its influence on the supply of new equity capital showed that a shock in the lending standards proclaimed a relatively strong reaction from IPO-firms that are largely reliant on external capital and hence increased the number of IPO withdrawals (Bergbrant et al. 2017). This feedback implies that the credit conditions present an important catalyst for a subtle IPO market. Furthermore, Bayesian inference procedure generated strong evidence that some incidences of withdrawal affect the subsequent performance of a firm (Chen et al. 2010).

Revoking the United States' Glass Steagall¹⁰¹ act back in 1999 facilitated the dual role that banks can play in the financial scene. On one hand, the banks provide credit facilities to the deficit units or the companies facing difficulty and shortage of liquidity, and participate as underwriter to these deficit units in their quest for financing through the capital markets on the other. The phenomenon increases the likelihood that companies may withdraw their IPO offer before it is executed. The banks lost their motivation to sell their clients securities in the capital market and give their lending

¹⁰¹ Glass-Steagall act separated underwriting from lending activities by banks.

relationship with the respective client. So, when the securities are not sold, the fund seeking company finds itself cornered by the only available source for financing represented by the commercial bank (Chen et al. 2015). Despite the economies of scope when it comes to information collection by the commercial bank¹⁰², the potential issuer will incur significant costs in the process of registration leading to final listing, and as such the company is more prone to withdraw its public offer.

This relaxation in the segregation of duties led to the creation of larger financial intermediaries that are worthy of being called universal banks that provide both credit and underwriting services to their clients. Drucker and Puri (2005) claimed that two years after the removal of Glass Steagall act, banks managed to underwrite more than 20% of new seasonal equity offers for their clients' companies and benefited these clients from either a lower fee for the underwriting service and /or a discount yield spread on their loan facilities (Kanas and Qi, 2003). This saving resulted from the lower inherent risk due to the ability of banks to lock in future borrowing facility.

Drucker and Puri (2005) also touched on the advantages to both the issuer and the universal bank. The issuer will enjoy lower underwriting fees and/ or discounts¹⁰³ and the universal bank/ underwriter will benefit from additional business from the issuer. Furthermore, Yasuda (2005) revealed higher probability of issuing debt securities by the underwriting bank in response to existing borrowing relationship with the client.

Vithanage et al. 2016 in their paper on the role of multiple lead underwriters (MLU) in pricing of IPOs stated that MLU backed IPOs presented an offer price that is very close to the intrinsic value of the issuing company. Hence the market saw lower initial returns with less variability and better long run performance. As such, IPOs with MLUs showed better chances of stronger market for secondary offering on one hand and less probability of IPO withdrawal on the other.

With the dual role of underwriter and lender, the bank might be more inclined to assist their low-quality clients in issuing securities for the sake of repaying back their outstanding loans to the said bank (Puri 1996 and Kanas & Qi, 1998, 2003) and this idea was later refuted by Mehran and Stulz (2007) for inconclusive results and Puri (1994, 1999) found no conclusive evidence on the low-quality securities that are underwritten by universal banks. Therefore, a security that is

¹⁰² Banks are seen as the ultimate producer of information due its lending relationship with their clients.

¹⁰³ Kanas and Qi, 1998 and Puri, 1996 touched upon the benefits of passing on the cost saving from the bank to the issuing client.

underwritten by a concurrent lending and underwriting bank will mostly be withdrawn and rarely sold when compared to securities underwritten by independent underwriters (Chen et al. 2015). But Laux and Walz (2009) looked at the concurrent lending/underwriting relationship from a positive perspective stating that once the securities are issued, the issuing company will have a better financial position and as such its risk of default on any outstanding loan will be reduced and accordingly the successful selling of securities will bring benefit to the lending bank.

In case of withdrawal, the ability to lock in the future business of its clients plays an important role in listing costs recovery by a universal bank, as opposed to an independent underwriter who bears tremendous costs in case the securities of its client are not sold or the issue is fully withdrawn from the public listing scene. The bank will always manage to recover the costs from future borrowing needs of its clients and as such reduces the risk inherent in the underwriting role and presents a lesser incentive to perform a greater effort to sell the securities of its client (Kanas and Qi, 2003). From a different perspective, a dual tracking scenario is observed when a company is preparing to go public through an IPO and at the same time looking for a parallel deal and being the subject of an acquisition by another market player. Once the acquisition deal is reached at the most appropriate terms of the target company, it will relinquish its decision to go public and withdraws its IPO offer (Lian and Wang, 2007). They also found that the target companies are usually acquired at a relatively 58% premium when compared to non-dual tracking companies. Furthermore, they explained this additional acquisition premium as a by-product of better and more robust company valuation resulting from the IPO registration and consequent information transmission. One might also structure this premium on enhanced bargaining power of the target firm or on larger synergistic benefits, but the idea of higher and more informed valuation stands to outweigh the two other reasons for the acquisition premium according to Lian and Wang (2007). So, this lower valuation uncertainty contributes to the additional premium paid for the acquisition and as a result of abiding by the registration requirements regarding disclosure and transparency.

Chen et al. (2015) found that the withdrawal frequency of IPOs is double the usual possibilities of withdrawal when the issuing company is, at the same time, a client on the credit side and a client on the underwriting side. On a different note, usually the costs borne by the issuer are relatively huge and accordingly, the decision to withdraw has to weigh the forgone costs of listing against the spread reduction and the future availability of bank loan facilities.

Once withdrawn, a company can attempt a second IPO with different underwriter, and the chances of success, here, are higher and depend on market conditions and underwriter reputation on one hand, and the issuer's better bargaining power, on the other, and this usually results from the ability to withdraw the offer at any time and hence commands a lower risk of underpricing (Dunbar and Forester, 2008 and Busaba et al. 2001). Moreover, Busaba (2006) stated that withdrawing when the market is weak has the effect of increasing the expected proceed from the second attempt at going public. Looking at it from a different point of view, data collected suggest that a company is better off issuing its IPO, the first time, at lower price rather than withdrawing the offer and reintroducing it again at a later point in time (Boeh, and Dunbar, 2014).

Looking at data collected in the United States by Chen et al. (2015) during the period extending from 1995 to 2013, they found that the rate of withdrawal was 3.85% of total filed public listings in 1995 and reached their peaks in 2001 and 2003 with 39.62% and 38.24% respectively, to drop back again to 4.85% in 2013. Over the whole study period, total withdrawals represented 15% of total filed public listings and withdrawals of IPOs with concurrent lending represented around 26.6% of total withdrawals.

A large proportion of IPOs tend to be withdrawn during their initial book-building phase once the underwriter and the issuing company realize that the security to be issued will not reach their minimum valuation offer price. In the book-building process, the investment bank tries to approach investors to evaluate their intentions to invest in the issue at hand and accordingly set the final offer price (Ljungqvist et al. 2003). Some markets require a reservation price to be announced in the prospectus and revealed in the roadshow while some other markets leave the reservation price to be decided upon and reached at the time of the issue (Brisley and Busaba, 2007). The non-disclosure of the reservation price might at times create uncertainty for investors and as such they will be reluctant to show their true intentions and interests in the security to be issued. The auction gives the issuer the right to withdraw the public offer from sale whenever they realize that the auction resulting offer price does not coincide with their minimum reservation price. Dunbar and Forester (2008) found that 20% of the IPOs filed with the SEC between the years 1985 and 2000 were cancelled and withdrawn just at the time when the shares were prepared for the issuance¹⁰⁴.

¹⁰⁴ In 2001, Rule 477 facilitated immediate effect of withdrawal of an IPO offer and Rule 155 allowed financing through private equity just after withdrawal of an IPO offer.

In the United States, the reservation price is kept secret, whereas in many countries, it is required to announce the reservation price before starting the bidding. For example, the reservation price is posted in the case of internet auctions (Lucking-Reiley, 2000), but it is not posted in the case of timber in south of France¹⁰⁵ (Elyakime et al., 1994). Investors who have collected all the needed information to evaluate a company look at the reservation price as just a confirmation on the intention of the issuer to leave an offer price behind if it does meet its expectations (Vincent, 1995). Furthermore, an announcement of a reservation price tends to improve the IPO proceeds if it is set high enough relative to investors valuation and would reduce the IPO proceeds if it is set too low relative to investors' valuation (Brisley and Busaba, 2007).

Horstmann and LaCasse (1997) formulated a strategic move to withdraw an offer immediately when the bids are low and wait for a second opportune time to reintroduce the offer, as such they believe that investors will have time to re-evaluate the asset on hand and bids its price up, most probably, to the undisclosed reservation price. But this strategic move was marginalized by Dunbar and Forester (2007) when they stated that only 9% of withdrawn offer are reintroduced to the market at a later point in time. Additional results from Lian and Wang (2009) suggest that the withdrawal event conveys some negative information that is later incorporated into a lower offer valuation for the second time IPOs, and at that instance, switching investment banks might just help in mitigating, but not eliminating all together the perceived higher risk of the second-time offerings by potential investors.

Even though an IPO withdrawal is presented as a backup that can be used to stop selling the firm at an unfeasible price, it usually burdens the market with negative public signal of possible hidden information that are unexpectedly released during the book-building phase. With all the efforts done by investment banks to make sure to keep the demand schedule collected in the book-building process out of reach, investors remain confused and alerted with respect to the size and effect of the negative information (Lian and Wang, 2009). Furthermore, Dunbar and Forester (2008) revealed some evidence showing that withdrawal is a risk factor that is priced in for second-time IPO issuers. Accordingly, second-time IPOs sell at a large discount relative to comparable first-time IPOs despite switching investment banks. Around 78% of second-time IPOs switch to different underwriters on their second attempt (Dunbar and Forester, 2008).

¹⁰⁵ In France, Offre à Prix Minimal (OPM) is the norm followed in primary markets, the same is applicable for Japan.

Exploring the possible exit strategies, investors are faced with the choice of selling their shares in an IPO or simply selling the firm to another company through a merger or an acquisition. Brau et al. (2003) stated that the decision to go with the IPO is more suitable for companies that enjoy high growth potential and more capital constraint with easier possibility of valuation and a ready and suitable IPO environment. Stated differently, private firms with valuation difficulties tend to follow the dual tracking path in a move to reduce their valuation uncertainty despite of the expenses incurred with the IPO registration. Busaba et al. (2001) saw in the IPO withdrawal a window for the private company to test investors' sentiments and true valuation through the book-building exercise.

The company following a dual tracking scenario never reveals its intention to get acquired or its decision to withdraw from the IPO market until it reaches its optimal target price, accordingly, one will never be able to spot such a firm or differentiate it from any other ordinary IPO firm. What is of interest in this process and that cannot be hidden are the high expenses incurred for the registration covering items such as registration fees, legal and audit and printing, in addition to time and effort spent to prepare the company to go IPO. These additional costs are accepted within the expectation of being able to be acquired at a higher premium than a normal path of takeover.

In addition to the above strategic reasons, Latham and Braun, (2010) presented a relationship between CEOs' equity participation and the decision to IPO and stated that a public offering probability of IPO cancellation in weak capital markets tends to increase as CEOs hold too little or too much ownership. Research showed that a large number of IPOs were withdrawn from registration during 1999 and 2004 period. Out of 588 IPOs that have withdrawn, 13% returned for a second successful IPO, 36% were able to raise capital privately and 42% went through M&A and 11% filed for bankruptcy.

Helbing et al. (2019) in their study of European IPO market between 2001 and 2015 found that IPO withdrawal is a characteristic inherent in the capital markets and the presence of venture capital or private capital aside with some pessimistic news tends to increase the probability that an IPO might be withdrawn before reaching the market. They discovered also that CEO duality¹⁰⁶ or

¹⁰⁶ CEO duality refers to the situation where the CEO also holds the position of the chairman of the board.

even the intent to decrease the leverage of the issuer might play a role in opting out of the IPO offer (Busaba et al. 2001). A low level of corporate governance which stumbles across severe agency problem and a sense of loss of adequate control can pull back owner of a private company away from IPO and tempt them to withdraw their IPO offer.

Some of the authors who discussed the issues of IPO withdrawal or sometimes referred to as IPO cancellation presented several reasons for withdrawal. The most prominent ones are highlighted in table 2 below. Some of the reasons are related to market conditions and others to company specific situation such as leverage position or weak stock performance at the time of the issuance or just the inability to sell the shares at a convenient price. Companies would decide to cancel the issuance or just postpone it and wait for more opportune time to capture the benefits of going public.

Table 29: List of Authors Who Discussed IPO Withdrawal

<i>Author</i>	<i>Possible reason to withdraw</i>
Brau & Fawcett (2006), Chloe et al. (1993), Jensen & Pugh (1995)	Unfavorable market and industry conditions
Busaba et al. (2001)	Level of debt
Dunbar & Foerster (2008)	Issuer size, use of the proceeds to repay debt
Clarke et al. (2001)	Market capitalization, market-to-book ratio
Frijns et al. (2006), Mikkelsen & Patch (2001)	Stock price performance
Shangguan & Vasudevan (2008)	Negative returns around announcement date Issuer unable to sell their securities at the offer price

Source: Chen et al. 2010.

VI. The French Delisting Experiences (2000-2019)

Many researchers tried to study the delisting of firms from the French market and in specific the “voluntary delisting” that is usually taken at the own discretion of the company due to many reasons ranging from cost-cutting to strategic in nature. From 1997 till 2006, 10 years of being listed and getting delisted according to the Association des Marchés Financiers (AMF) (Martinez

and Serve, 2010), the majority of firms that left the public arena used a special mechanism known as: buyout offer with squeeze-out (BOSO) in an effort to better handle the future of the concerned firms. Under the BOSO process, the controlling shareholders, with the minimum 90% majority voting right¹⁰⁷, choose to buy out the minority shareholders and as such seals the capital of the firm and it becomes private (Ventoruzzo, 2010). Further study goes through a different segment extending from 2006 till 2010 with Anne Demartini from the department of studies at the AMF, where she noticed a decrease in the delisting during the period under study, with the lowest figures witnessed in 2008-2009. Demartini also stressed on the effects of dual listing and the judicial liquidation as the most important reasons for delisting during that period followed by corporate actions in the context of mergers and acquisitions.

Kim and Weisbach (2008) saw in going public an opportunity for high growth firms to have access to equity capital to finance their investment opportunities. As such, once a public company faces a shortage of investment opportunities and low growth potentials, it is better off becoming private rather than staying public since they have less need for capital (Kim and Lyn, 1991 and Martinez and Serve, 2011). Accordingly, as the cost of funds from the public markets is cheaper than from private sources, the company is better off as a public company, but once the costs start to increase due to an increase in information production, companies go private looking for the cheaper choice.

The following script goes further in time covering the period from 2000 till 2019 (20 years) in the life span of the French market as it changed and evolved to become known today through three different markets: Euronext, Euronext Growth and Euronext Access. To have a comprehensive view for this long period and to tackle the most important reasons to quit the public status, we consulted the Bloomberg terminal, the World Federation of Exchanges (WFE), the Euronext and Reuters Thomson.

Over the study horizon of 20 years, around 2226 firms left the market according to Bloomberg terminal data with reasons varying among almost sixteen (16) different standard terminologies and descriptions used by Bloomberg as they collected the data to be posted and used as reference for the market and the regulators equally. The World Federation of Exchanges, in turn, provides data on the number of firms that get delisted on different markets with no mentioning of the reason

¹⁰⁷ European Directive on Takeover Bids.

behind such a delisting and this source was used also to retrieve the number of firms that were listed over the study period to reflect upon the changes in the number listings and trend in the French stock market. As for the Euronext, they publish yearly fact book that describes the whole year in question from the trading volume to market capitalization to new listing and delisting. After accounting for the data pertaining to Brussels, Amsterdam, Dublin and Lisbon, the researcher managed to compile data related to delisting in France over the period ranging from 2013 till 2019 (7 years) and the total number of firms in question totalled around 368 companies with many reasons displayed for delisting. These reasons were summed up in twelve different categories according to the AMF terminology and descriptions, which in turn gives a thorough look at the trend in the French market.

The delisting of firms that were quoted on the regulated markets in France has been stable and relatively at low levels throughout the period under study, with some exception or interruptions that took place in 2005 and 2010 that were driven by regulatory changes that prompted listed firms to take adequate decision regarding their status of staying listed or just dropping out of the quoted markets. Looking back at the reasons behind the delisting, one can infer few requirements in support of these decisions against the advantages of staying listed. The majority of the firms that opted to quit the listed status are represented in the small capitalization firms that are burdened by the high cost of being listed and foreign firms that are looking to concentrate their listing in one venue or one market (reduce cross-listing costs) where liquidity of their stock and benefits of being listed is more efficient.

Since February 2005, the organization of the bourse of Paris of the following markets (premier, second and nouveau) has been reformed to reflect the registration of all quoted firms onto a new list called the “Eurolist of Euronext”. The creation of this new list led to the dismantling of the old system and the introduction of a new market system where firms are categorized based on their capitalization and grouped alphabetically as A, B and C. A entails firms with market capitalization above 1 billion Euros, B handles firms between €150 million and 1 billion, C for firms of less than €150 million in capitalization and the Alternext market for firms that cannot meet listing requirements (Euronext, FAQ, 2017)

According to Euronext, during the period from 1996 till 2010, the delisted firms were witnessed highly in the Eurolist (C) followed by foreign firms, with 40% and 32% respectively of the total

number of firms delisted (Demartini, 2010). With the economic downturn of the subprime crisis from 2007 till 2009, around 220 firms delisted, averaging 73 firms per year, due to various reasons ranging from corporate decisions related to mergers and acquisitions, bankruptcy and cancellation of listing¹⁰⁸. Further delisting was observed during 2010 with around 115 firms delisted due to the aforementioned reasons, and at the heart of it lies the NYSE Euronext-Paris decision to increase listing fees and trading commissions with a free option for firms to opt out of the market without any prior requirements before July of that same year. This decision prompted around 40 firms to benefit from such an offer and decided to delist from the market. Appendix 3 lists the 40 firms that were delisted at the option of NYSE Euronext-Paris.

Therefore, one should look even further into different changes and amendments of some rules and regulations in effect over the period in question and investigate the results pertaining to each and every new amendment. The European directives¹⁰⁹ of 2004 (Delaux 2004), for example, pushed some firms into delisting due to the imposition of some demanding rules and regulations that inflated the cost of compliance and being listed during that period and that witnessed a relative increase in the number of firms that opted out of the market as seen in the jump in the 2005 figures.

With the introduction of a unified order book by Euronext in 2009, firms started losing interest in the benefits of cross listing since all the trading will be executed based on the reference market only and the costs of cross listing outweigh, at that point in time, the benefits of additional visibility and public promotion. Foreign firms were the first to delist their shares due to lack of liquidity in the French market and retained their listing in the markets where they see an opportunity for better visibility and liquidity for their respective shares. Accordingly, a steadily declining volumes of trading and liquidity prompted companies to rethink their perception regarding foreign cross-listing and what was considered as efficient several years ago might have become no longer efficient and hence opened the door for a wave of future foreign cross-delisting with investors' preference going for the most liquid trading place.

¹⁰⁸ Cancellation of listing refers to both voluntary and involuntary delisting

¹⁰⁹ "Ordonnance n°2004-1382 du 20 décembre 2004": adapting legislative provisions relating to company accounting to Community provisions in the field of accounting regulations.

Furthermore, the law no. 2009-1674 of December 2009 (Legifrance) relative to the exemptions of corporate tax on Quoted Real Estate Firms that are listed in Euronext Paris has been expanded and amended to apply to all Real Estate Firms whose shares are listed on any market within the European Union. This decision, in turn, impelled most of the Real Estate Firms to delist from Paris and to stick to their reference market listing.

The 2007-2009 financial crisis had its effect also on the decision to delist from the Euronext market where the firms with the longest period of being listed (more than 20 years) represented around 57% of the number of firms that delisted during that period followed by firms that were listed for a period between 10 and 20 years and firm listed between 5 and 10 years with 17% and 9% respectively (Euronext-Paris and AMF, 2010)

Moreover, the number of firms that were delisted as a result of corporate activities related to mergers and acquisition dropped tremendously from an average of 34 firms per year during the 2000-2008 period to an average of 14 firms per year over the 2009-2019 period, this drop was mainly due to the large restructuring that firms witnessed during the subprime crisis period which led to either merger or acquisition on one hand or to a complete overall reorganization that was witnessed towards the end of 2008.

It is worth mentioning that voluntary delisting is usually exercised by the majority shareholders or the controlling parties for strategic purposes related to reorganization of the entity or the holding group, protection against the dissemination of critical information to competitors, and the need for some major investments in R & D that will have negative effect on the company's profitability in the short run. Furthermore, the voluntary delisting can be a reaction to lack of liquidity in the respective market where the stock is listed or to the high cost to being listed which in turn can be traced back to some imperfection in the market. In this context, weak trading levels will eventually lead to low liquidity, high volatility in market values, and ultimate undervaluation of the stock in question (Pietrancosta, 2014).

Furthermore, in the absence of promising and feasible projects, firms find themselves reluctant to reach for the capital market for any medium- or long-term funding and as such the quest or the need for local and domestic investors' funds is no longer in demand and refuted the reason for being listed.

According to information gathered from the Euronext- Paris and the AMF, firms that opted for voluntary delisting from the Euronext – Paris were mostly medium firms in the industrial sectors and that pride with a relatively stable shareholders base. In addition, a recent trend has been noticed with the increase in the delisting of foreign firm who opted also to maintain their listing in their main listing venue and away from the French market to the extent that the share of listing of foreign firms went down in the Paris market from 21% back in 1995 to almost 9% in the Euronext – Paris in 2010 (Bondain, 2019). Most of these foreign firms identified their reasons for the delisting as being due to low turnover and the high and detrimental cost to maintain their dual listing in the recent internationalization and dematerialization of exchanges which rendered such dual listing non-feasible anymore. In 2017, at least 33 companies left the French market while only 14 were newly listed, according to Denis Cosnard of le Monde magazine in his article dated February 2018. As for Hervé Rousseau, he wrote in an article in le Figaro in January 2020 : “Le nombre de sociétés cotées en Bourse fond comme neige au soleil. Tandis que les introductions en Bourse se font plus rares, de nombreuses sociétés sont rayées de la cote.”

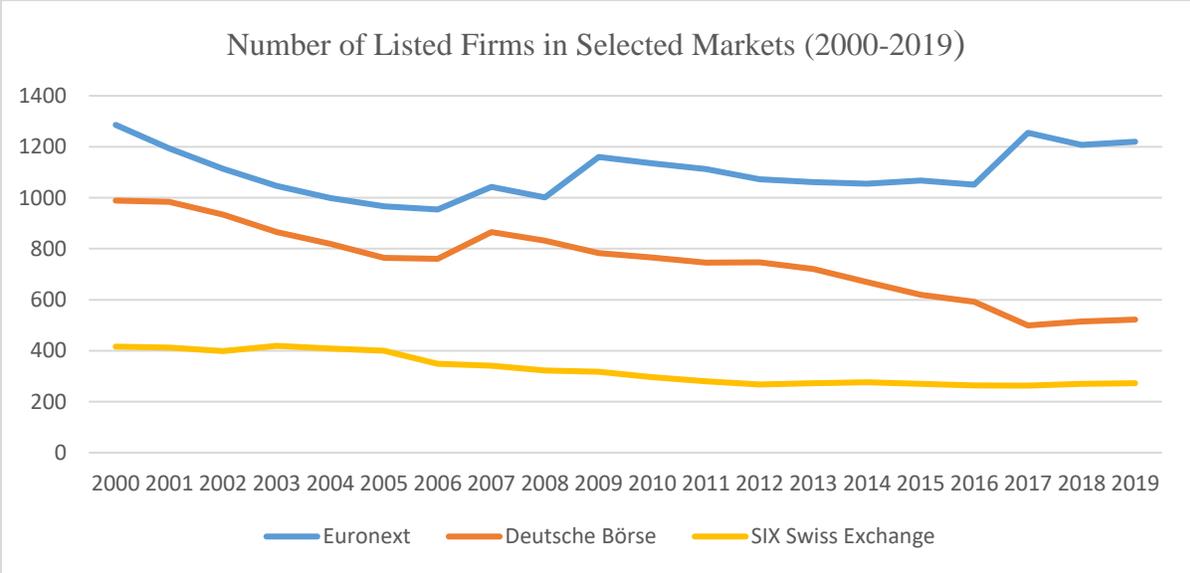
With effect from 22 May 2019, the “Loi Pacte” has witnessed some amendment in the context of reducing the threshold for applying for delisting through “OPA” from 95% to 90%. This new rule was enacted in a move to give an incentive for firms to list their shares by going public, knowing that their exit strategy has become easier (Benhamou, 2019). According to the new rule, once the initiator holds less than 50% of the capital and wants to delist he can simply acquire 90% of the capital and proceed with voluntary delisting. But if the initiator holds more than 50%, the decision to delist remains within the threshold of the old rule of 95% (Pasquette, 2018).

Empirical Data

In order to investigate further the trend in the French capital market and the framework of delisting over the last twenty years and in an effort to highlight the trend in the listing and delisting of firms on the Euronext Paris, data was retrieved from the World Federation of Exchange (WFE), Bloomberg terminal, Euronext official page and Reuters Thomson terminal. The figures that are collected had to be investigated on different levels because the Euronext-Paris is confused sometimes with the French market in general. The French market is comprised of the Euronext, the Alternext newly named Growth market and the Free market newly named Access market.

First of all, it is worth starting our discussion by a simple straight comparison of the evolution of the Euronext over the last 20 years versus some of the important neighbouring and similar European countries like Germany and Switzerland. Figure 1 delineate the corporate trend where the capital markets in Europe witnessed a contraction in the number of new listings and more and more instances of withdrawal from the market. This is obvious in the period from 2000 toward 2007, a small jump from 2007 till 2010 and then a continuous decrease towards 2019 with the exception of Euronext that was boosted with the introduction of more markets into its structure. The German and the Swiss markets lost around 47% and 33% respectively in terms of the number of listed firms over the past twenty years.

Figure 41: Comparison of Listed Firms in Selected Markets (2000-2019)



Source: The Federation of European Securities Exchanges AISBL (FESE)

1. World Federation of Exchange (WFE)

According the WFE annual statistics guide, from 2001 onward, the figures displayed for Euronext includes Netherlands, France, Belgium and Portugal.

The figures show that the number of listed firms decreased from the year 2000 towards the year 2016 before taking a small leap in 2017 and then maintained its previous level in 2018. It is also

worth mentioning that the figures cover only Euronext without taking into consideration Alternext and Free market respective data. Figure 42 below depicts the trend of the listed companies on the Euronext-Paris after accounting for the delisted companies during that same period. According to the data collected, the French market witnessed a decrease in the number of listed companies netting around 685 companies which represents an average of 40 companies per year from the 2000 till 2018. This result backs up our view on the recent trend of increasing delisting of companies in spite of the new listings. This is the net result of a decline in the number of new listings and a large number of companies that have left the stock market through delistings.

The collected data from the WFE displays only the number of firms that are listed on the Euronext-Paris and the number of firms that are delisted with no section or availability of information that states the reason for such a delisting and when comparing directly with the data retrieved later from the Euronext, we observed that some data are in conformity for some years and we observed some undermining of these numbers for some of the recent years.

Figure 42: Number of Firms Listed on the Euronext-Paris (2000-2018)



Source: World Federation of Exchange, personal compilation.

Figure 43 below displays, in turn, a comparison of the number of listing between the Euronext and the Euronext- Paris. The relatively small difference between the two figures depicts the important size of the French market when compared to the rest of the markets that comprise the data of the overall Euronext. The number of listed companies on the Euronext is composed of all aggregate companies that listed on the Euronext, the Alternext and the Free market.

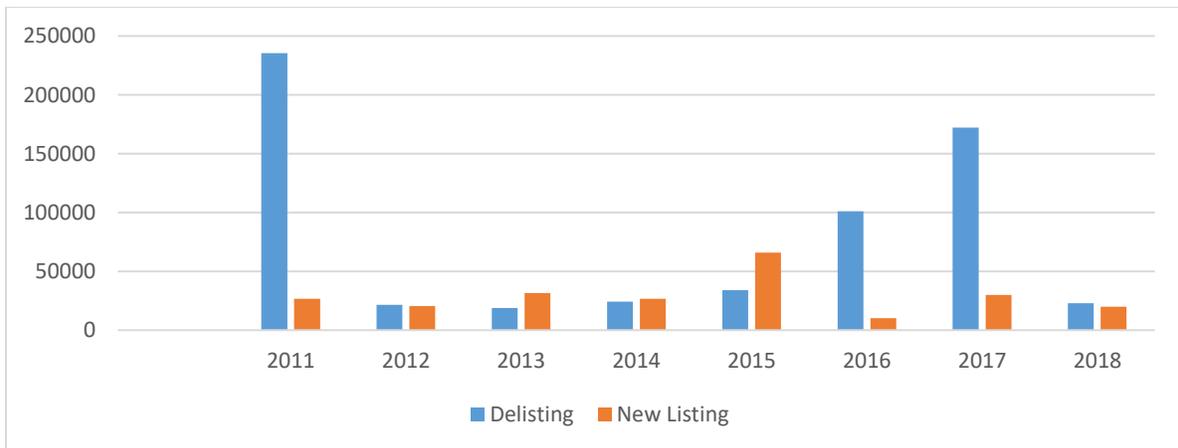
Figure 43: Number of Firms Listed on the Euronext and Euronext-Paris (2000-2018)



Source: World Federation of Exchange, personal compilation

In Figure 44 below, the WFE contained data on the market capitalization of firms that are listed and delisted from the Euronext in all its markets and revealed only the figures for a period of eight years extending from 2011 till 2018.

Figure 44: Market Capitalization of Firms Listed vs Delisted on the Euronext (2011-2018)



Source: World Federation of Exchange, personal compilation

As depicted, in 2011, the market capitalization of the delisted firms reached around € 235,408 million with around 60 firms delisted which can be traced back to the delisting of large firms during that year. and again, that trend was obvious in the delisting of 45 firms in 2016 and 50 firms in 2017 with a total market capitalization of €101,116 million and €172,073 million respectively.

2. Bloomberg data

The researcher tried to retrieve respective data from Bloomberg terminal which incorporates the reasons for delisting according to its own definitions. After analyzing the data retrieved from Bloomberg for the period ranging from 2000 till 2019, the author observed some concentration in the reasons for delisting that differs from year to year and the following presents an abstract of these observations that are shown in the Figure 5. The reasons are broken down as mergers and acquisition, bankruptcy, cancellation of listing, company's request and others.

Regarding “mergers and acquisition”, this reason witnessed a peak yearly average of 35.5 firms during the period of 2000-2005 and a low yearly average level standing at 14.3 firms during the period from 2010-2019 with an overall yearly average of 23.2 firms during the period under study ranging from 2000 till 2019.

As for “bankruptcy”, this reason for delisting witnessed a peak yearly average of 8.7 firms during the period of 2010-2019 and a low yearly average level standing at 5 firms during the period from 2000-2005 with an overall yearly average of 7.7 firms during the period under study.

The reason of “cancellation of listing”, in turn, witnessed a peak yearly average of 36 firms during the period of 2005-2010 and a low yearly average level standing at 12.3 firms during the period from 2000-2005 with an overall yearly average of 19.9 firms during the period under study.

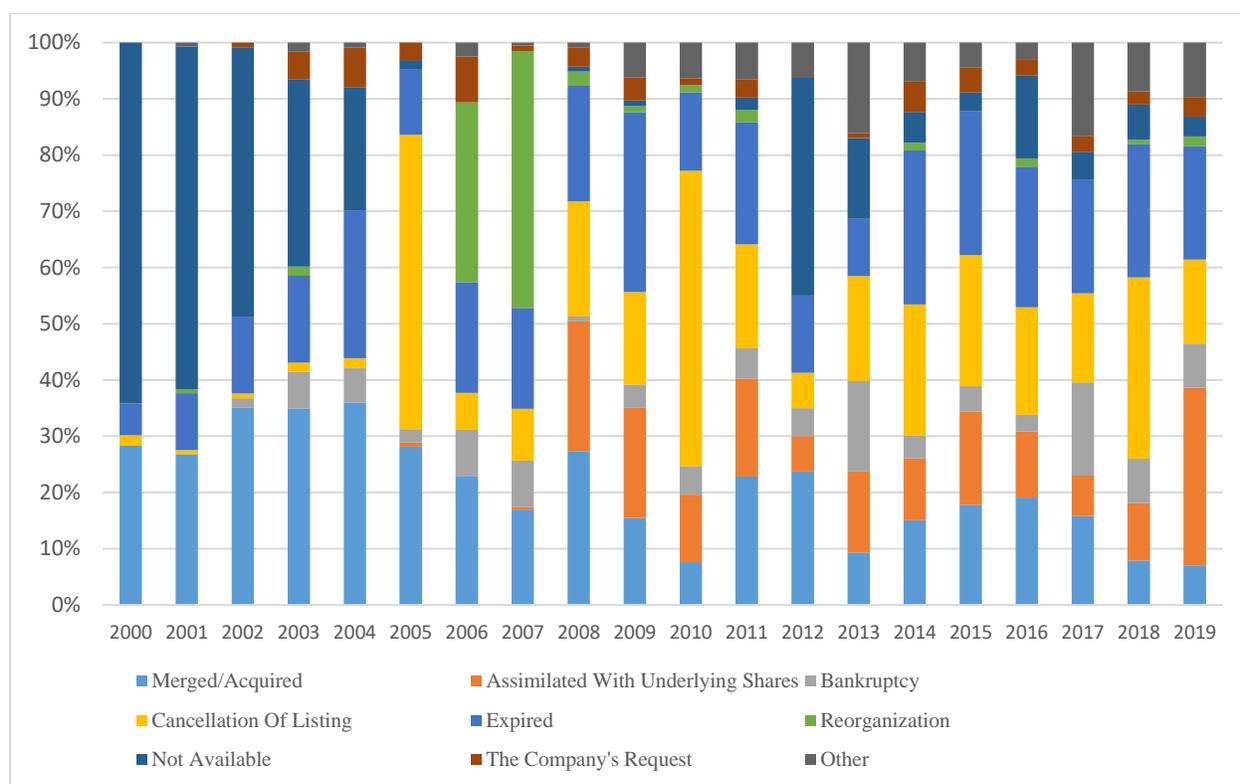
Delisting for the reason of “reorganization” witnessed a peak yearly average of 26.8 firms during the period of 2005-2010 and a low yearly average level standing at 1.5 firms during the period from 2000-2005 with an overall yearly average of 9 firms during the period under study and a peak of 89 firms in 2007.

According to the data retrieved from Bloomberg, the number of delisted firms during the period extending from 2000 till 2019 summed up to 2226 firms after accounting for duplicates and repetitions. There was no mentioning of whether the firms delisted were doing so voluntarily or involuntarily. Therefore, the researcher had to go and look for publications and many different announcements by individual firms that might help in determining the reasons for such delisting.

A sample of delisted companies with reason being “Cancellation of Listing” and “The Company Request” were checked and the different publications found in the period surrounding the date of announcement of delisting and the effective delisting dates were grouped into four main reasons.

Low Trading Volume, High Costs and Administrative Requirements were grouped as one category of delisting reasons and constituted around 60% of the observations. This reason was adopted by most large international and local firms seeking to reduce the redundant and unjustifiable costs of being listed on the French market, on one hand, and looking after their investors best interests when it comes to liquidity and trading volume. Some examples of these large firms are found in the decisions of Philp Morris, Procter & Gamble, Nestle, Eli Lilly, Abbvie Inc., Bike Expand, Cesam, Flip Technology, Arcoa and much more.

Figure 45: Bloomberg Breakdown of Reasons for Delisting (2000-2019)



Source: Bloomberg, personal compilation

Offre Publique de Retrait (OPR) and Offre Publique d'Achat (OPA) were grouped together since they lead eventually to the voluntary delisting of the companies after being bought out by the majority shareholders or acquired by another company. This reason reflects the corporate actions that are witnessed in the French market by firms looking to capitalize on the efficiency and the advantages of synergy in their management culture. A relatively impressive 20% was observed under this delisting reason and this section denotes some major companies like Access Industries, Agrivolt, Valtech, Acino Holding, Afone Participation, AES Chemunex and many others.

The remaining two reasons that were retrieved from the publications of delisted firms revolve around the “Listing on another market” where firms decided to concentrate their public presence in only one trading venue where their stock experiences a relatively higher turnover and better liquidity, and the “Non-Compliance” which is the main reason for the obligatory or involuntary delisting that is imposed on firms by the trading venue and the financial market regulatory authorities. Both reasons account for around 8% of the delisted companies and they entail important entities like Velcan Holding, ABO Group, Vestasia Ltd just to name a few.

3. Euronext data

In order to have a look from a different perspective, the researcher collected data from the Euronext page under the section of the resources/statistics and in specific the Euronext fact book. After browsing the page, only the fact book for years extending from 2012 till 2019 were retrieved and emails were sent to the StatEurope@euronext.com in an effort to find an access to the missing years from 2000 till 2011. Reply was received and analysed as per the following Table 30 that depicts the trend from 2000 till 2011 with delisting reasons from different markets and which witnessed many segmentations in the data according to the evolution of the French market and the many developments that happened and the changes in the structure of the said market.

The market delisting data in 2000 covered three market: the “Premier Marché”, for large companies with more 1 million euro in market capitalization, the “Second Marché”, which was intended for SMEs and later stopped in 2005, and the “Nouveau Marché” which targeted the French start-ups.

Later in 2005, the data on the three markets was grouped in one category the “Eurolist” and then in 2008 the name of the category was changed to “Euronext” with the same general delisting reasons still adopted. In 2010 and 2011 only the number of delisting was available with no specific reason being set forth except the nationality and the ICB classification¹¹⁰.

¹¹⁰ Industry Classification Benchmark (ICB) is a globally utilized standard for the categorization and comparison of companies by industry and sector.

Table 30: Reason for Delisting from the Euronext (2000-2011)

		2000	2001	2002	2003	2004	Eurolist	2005	2006	2007	Euronext	2008	2009	2010	2011
Intra-Group	Premier Marché	19	10	12	11	13	Intra-Group	4	6	10	Intra-Group	4	6		
	Second Marché	7	9	9	4	6									
	Nouveau Marché		1	1	1	1									
Merger & Acquisition	Premier Marché	9	8	7	3	7	M & A	25	18	10	M & A	13	3		
	Second Marché	14	8	12	4	4									
	Nouveau Marché	2	1	5	3	1									
P-to-P (OPR)	Premier Marché		2	1	1		P-to-P (OPR)	2	2	4	P-to-P (OPR)	12	6		
	Second Marché	5	3	5	6	4									
	Nouveau Marché				3										
Others	Premier Marché	3	6	3	1		Others	8	6	6	Others	4	4		
	Second Marché	8	2	5	4	4									
	Nouveau Marché	3	2	7	7	6									
Total		70	52	67	48	46	Total	39	32	30	Total	33	19	30	34

Source: StatEurope@euronext.com, Personal communication and compilation

Reasons for Delisting based on different cases :

- Intra-Group consists of Parent company absorption of a Subsidiary

- M&A also refers to Industrial Operations or Corporate Actions

- Public-to-Private refers generally to 'Offre Publique de Retrait' effected by Majority Shareholders buying Minority Shareholders

- Others refers mainly to Judiciary Liquidation, Transfer to other markets , etc.

During the period from 2000 till 2011, the highest number of delisting was witnessed in the year 2000 with 70 delistings mainly due the Intra-group in the premier marché with 19 cases and the M&A proceedings presenting 14 cases of delisting in the second marché. Looking further, over the first ten years of the study, from 2000 till 2009, M&A represented an average of around 36%/Yr. of all the delistings with the highest number of cases seen in 2005 with 64.1% of the delistings. Then we have the Intra-group with an average of 29.1%/Yr. with the highest number witnessed in 2004 with 43.5%. The Others, the judiciary liquidation etc., make up an average of 20.1%/Yr. with the highest number spotted in 2003 with 25% of the cases, while the P-to-P (OPR) added up to an average of 14.8%/Yr. with the highest number identified in 2008 with 36.4% of all incidents o delistings. Table 31 below shows the breakdown of the percentages of delisting reasons over the period 2000-2009.

Table 31: Percentage Distribution of Reasons for Delisting (2000-2009)

Reason	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Average
Intra-Group	37.1%	38.5%	32.8%	33.3%	43.5%	10.3%	18.8%	33.3%	12.1%	31.6%	29.1%
M & A	35.7%	32.7%	35.8%	20.8%	26.1%	64.1%	56.3%	33.3%	39.4%	15.8%	36.0%
P-to-P (OPR)	7.1%	9.6%	9.0%	20.8%	8.7%	5.1%	6.3%	13.3%	36.4%	31.6%	14.8%
Others	20.0%	19.2%	22.4%	25.0%	21.7%	20.5%	18.8%	20.0%	12.1%	21.1%	20.1%
Total	1	1	1	1	1	1	1	1	1	1	100.0%

Source: Euronext, personal compilation

In the relative fact book, one can find many statistical figures pertaining to the primary market, new listings, delistings, ranking of largest capitalization, secondary market, most active securities and plenty more on derivatives trading and European Exchange Traded Products (ETPs). The data collected covered all actions on the stock markets of Brussels, Amsterdam, Dublin, Lisbon and Paris. The delistings were retrieved and among the three different market segments, only the stocks related to Paris are filtered and separated to form the base of the study in question. The three markets under review are the Euronext, Euronext growth¹¹¹ (previously Alternext) and Euronext Access¹¹² (previously Free Market). Table 32 below shows that the Euronext has different categorizations for the reasons for being delisted from the stock market. These reasons range from company's request to bankruptcy to M&A to squeeze out¹¹³ to voluntary and compulsory liquidation and to the non-adherence to the harmonized rulebook¹¹⁴ of the market.

Over the past seven years from 2012 till 2019, the French market witnessed around 414 delistings with the largest number being in the years 2017 and 2018 with 73 and 72 delistings respectively. Going deeper in the specific reasons, it shows that these latter years witnessed the highest number of delistings due to bankruptcy with 20 firms and non-compliance with 21 firms leaving the Euronext Access market in 2017 and 2018 respectively. Nineteen additional firms left the Euronext due to squeeze out during 2017.

¹¹¹ Euronext Growth is an equity trading market that was opened May 17, 2005 for SMEs

¹¹² As of 19 June 2017, Free Market became Euronext Access.

¹¹³ A squeeze-out is an action undertaken by a company's majority shareholders to force minority shareholders to sell their stakes in the company in order to gain complete control of the firm.

¹¹⁴ Harmonized rule book of Euronext: chapter six relates to admission to trading and continuing obligations of issuers (rule 6905- removal)

Table 32: Reason for Delisting from the Euronext (2012-2019)

Reason for Delisting	Market	2012	2013	2014	2015	2016	2017	2018	2019	Total
At the request of the Company	Euronext				1	1	1		1	4
	Euronext growth (previously Alternext)				1		1			2
	Euronext Access (previously Free Market)				1	1		5	5	12
Bankruptcy	Euronext	2	1	3	5	1	5			17
	Euronext growth (previously Alternext)			3	1	5	6	1		16
	Euronext Access (previously Free Market)			7	7	10	20	1		45
Final liquidation payment	Euronext									0
	Euronext growth (previously Alternext)									0
	Euronext Access (previously Free Market)							1		1
Following recommended cash offer	Euronext	5								5
	Euronext growth (previously Alternext)	1								1
	Euronext Access (previously Free Market)						4	3		7
Merger & Acquisition	Euronext	3	2	3	5	1	2	3	1	20
	Euronext growth (previously Alternext)		1				1			2
	Euronext Access (previously Free Market)		1	1	3		1			6
Sales facility	Euronext	2	2	2	2	3	2	3	4	20
	Euronext growth (previously Alternext)									0
	Euronext Access (previously Free Market)							1		1
Squeeze out	Euronext	16	12	14	10	11	19	8	9	99
	Euronext growth (previously Alternext)	4	4	3	5	7	4	4	3	34
	Euronext Access (previously Free Market)		1	3	11		1	1		17
Voluntary liquidation	Euronext		1							1
	Euronext growth (previously Alternext)									0
	Euronext Access (previously Free Market)		2		1	2	1	9	4	19
Compulsory liquidation	Euronext	3						1	4	8
	Euronext growth (previously Alternext)	8						2	3	13
	Euronext Access (previously Free Market)		8					5	5	18
In application of provision 6905/1 and 6905/3 of the harmonized rulebook and article 7.3 (vi) of the Alternext Rules and article 2 of the euronext access rules	Euronext				1			2		3
	Euronext growth (previously Alternext)			2						2
	Euronext Access (previously Free Market)		10					21		31
Dissolution	Euronext		1				1			2
	Euronext growth (previously Alternext)									0
	Euronext Access (previously Free Market)				1					1
Other	Euronext	2								2
	Euronext growth (previously Alternext)									0
	Euronext Access (previously Free Market)						4	1		5
Total		46	46	41	55	42	73	72	39	414

Source: <https://live.euronext.com/fr/resources/statistics/factbook>, Personal compilation

Harmonized rule book of Euronext: chapter six relates to admission to trading and continuing obligations of issuers (rule 6905- removal)

Article 7.3 (vi) of the Alternext Rules: remove the Securities of the relevant Issuer from the Euronext Growth Market in accordance with Chapter 5 (removal) of these Rules.

On the other hand, one of the highest figures for firms being forced out of the Euronext Access due to non-compliance with the harmonized rulebook and in specific provisions 6905/1 and 6905/3 marked the year 2018 that witnessed 20 delistings due to non-compliance versus 35 delistings in 2019 (marchelibre, 2018). Appendix 4 lists the companies that were delisted from the Euronext due to non-compliance to different reporting standards imposed on all listed companies during 2018.

Overall, the last eight years witnessed the largest delisting reason being the squeeze out in the Euronext with 99 firms and a total of 150 delistings, followed by bankruptcies in the Euronext Access with 45 firms and a total of 78 delistings, the compulsory liquidation in the third place with a total of 39 delistings followed by non-compliance to the harmonized rule book in the Euronext Access market with 31 firms and a total of 36 delistings. According to the Euronext definitions and descriptions of reasons for delisting, the reason mentioned as voluntary delisting, it

encompasses the “Offre publique de retrait suivie d'un retrait obligatoire” (OPRO) which is based on the amended “Loi Pacte” and the ability of firms that capture 90% of the voting right to buy out the remaining shareholders (minorities) and ask for delisting from the market consequently. The researcher managed to retrieve data on the “OPRO” specifically and compiled them in the below table 5 that highlights the period from 1998 till 2008 inclusive.

Table 33: Voluntary Delisting from Euronext due to OPRO

Reason	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
OPRO	129	198	216	152	171	155	155	132	91	11	32

Source: <http://archivesbdif.amf-france.org/metadonnees>, personal compilation

After removing different reasons such as “Offre Publique d’Achat” and other compulsory reasons, the remaining available figures depict a decrease in the number of delisting due to OPRO from 2005 onward with a peak year standing at 216 OPROs witnessed during the year 2000 followed by 2002 with 171 OPROs and 2003 and 2004 with 155 OPROs during each. Moreover, 2007 and 2008 presented the lowest years with only 11 and 32 OPROs respectively, which can be mainly attributed to the financial crisis that the whole witnessed during that period of time.

Overlooking the reasons for delisting and reflecting on table 34, one cannot but realize the large number of firms that were delisted from the Euronext Access (previously Free Market) standing at 163 during the period under study followed by Euronext and Euronext growth (previously Alternext) with 148 firms and 57 firms respectively.

Table 34: Delisting from the three French Markets (2013-2019)

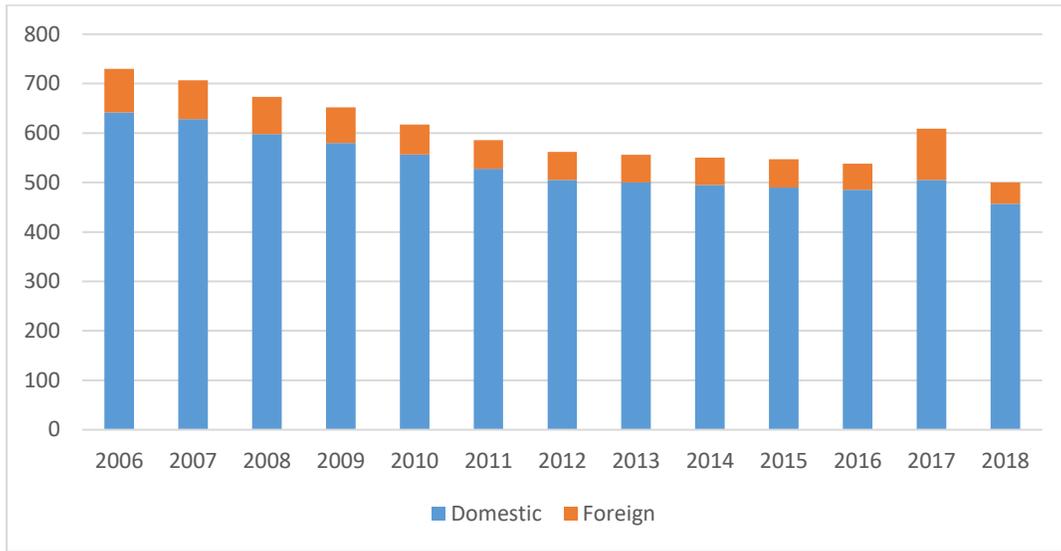
	2013	2014	2015	2016	2017	2018	2019	Total
Euronext	19	22	24	17	30	17	19	148
Euronext growth (previously Alternext)	5	8	7	12	12	7	6	57
Euronext Access (previously Free Market)	22	11	24	13	31	48	14	163
Total								368

Source: Euronext-fact book, Personal compilation

With the implementation of the “Loi Pacte” in the summer of 2019, more companies with important names in the French market took cost cutting decision and left the Euronext-Paris market due to number of reasons and in specific the low market turnover of their shares which mostly emanates from low analyst coverage on one hand and lack of interest of investors in the French firms’ shares, on the other. Moreover, the need to overcome the burden of the minorities shareholders has been made reachable, achievable and easier with the new threshold of 90% as amended by the “Loi Pacte” that took effect on May 22nd, 2019. The delisting was not only a move by large cap firms, but it was a step taken even by smaller firms looking to reduce the relatively detrimental cost borne from being listed on the French trading venue. Appendix 5 depicts the ten (10) most important firms that were delisted from- the Euronext, Appendix 6 from the Euronext-Access and Appendix 7 from the Euronext Growth- during 2019 and they are ranked in terms of market capitalization just to reflect and emphasize on the diversity of the firms delisted from the French market. This diversity reveals the important need to reduce the costs of being listed for both large and small companies alike.

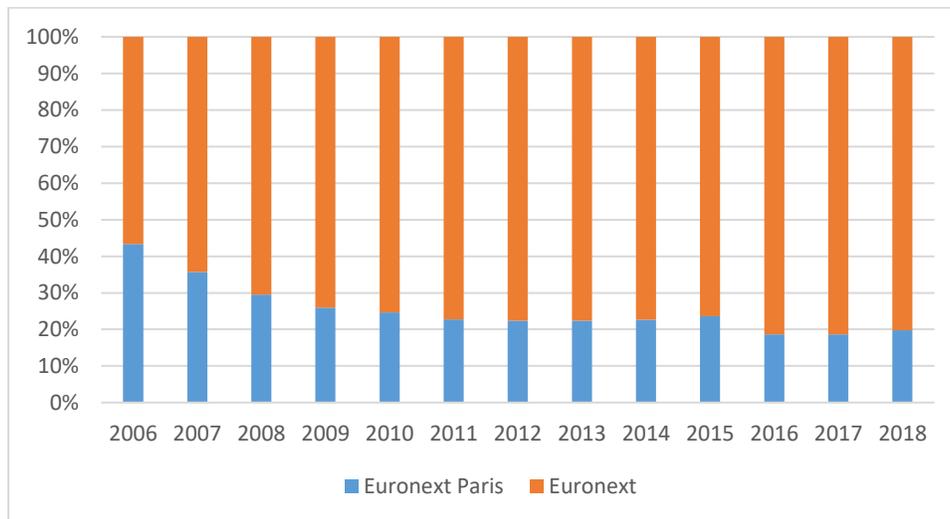
Moreover, figure 6 below shows the decrease in the number of domestic firms and foreign firms that are listed on the Euronext Paris over the period extending from 2006, the start of the NYSE-Euronext, till 2018, the last published year, with a larger share of decrease witnessed in the number of domestic firms. Figure 46, on the other hand, compares the number of listed companies on the Euronext –Paris with the number of listed companies on the Euronext with all its three segments. The number of companies listed on the French market constituted around 76% of the total Euronext listed companies back in 2006. This number plummeted to less than 25% in 2018 which reflect the decrease in the number of listed firms on the NYSE Euronext and the large migration to the Euronext Access and Growth markets on one hand, and the addition of more and more European markets to the Euronext.

Figure 46: Domestic vs Foreign Firms listed on the Euronext Paris



Source: https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=181.SEE.A.FR.ENP0.LSD.X.Q

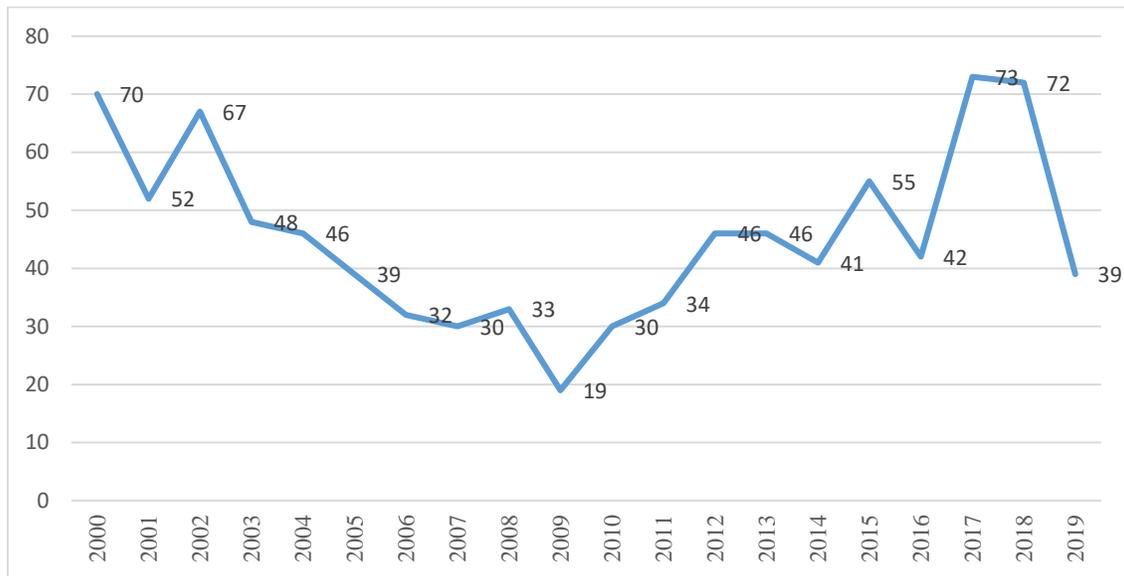
Figure 47: Number of Listed Companies on Euronext vs NYSE-Euronext Paris



Source: https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=181.SEE.A.X0.ENX0.LST.E.Q

The final round-up of the delisted firms for the period under study ranging from 2000 till 2019 according to the data retrieved from the Euronext is presented in the below figure 8.

Figure 48: Number of Firms Delisted from the French market (2000-2019)



Source: Euronext, Personal compilation

As spotted in figure 8, the delisting in the French market witnessed a decrease from the year 2000 towards the 2009 with some upticks' exceptions seen in 2002 and some minor changes in 2007-2008 period and then picked up its pace towards 2017 with a huge increase of around 31 firms leaving the market during that year before stabilizing back to its yearly average in 2019.

Further data collection was sought from Thomson Reuters in order to have a more thorough understanding and analysis of the delisting phenomena in the French market. The country data base could only have access to data extending as far back as 10 years and accordingly, we used the matrix from January 2011 till June 2020 with many attempts to go back farther in time but without any success after numerous attempts. Furthermore, the reasons for the delisting were not accessible, but the market capitalization was rather manageable and the researcher opted for this variable to try to, at least, fill the gap of the missing delisting reasons.

After filtering down the delisting actions on the Euronext to only the firms that were listed on the Euronext-Paris, we found around 652 delisting during the period in question with different market capitalization. The market capitalization displayed a median of \$2,421 million and a mean of \$18,689 million with a maximum value standing at \$942,043 million and a minimum value of \$0.18 million. Figure 2.3 show the progress in delisting and the average market capitalization of companies that are delisted during the period extending from 2011 till June 2020.

Figure 49: Market Capitalization of Delisted Companies (2011- 2020)



Source: Reuters-Thomson, personal compilation.

The observed high figure for 2014 refers to the delisting of some large companies such as Ricoh Company Ltd, a Japanese Electronics Company and Weatherford International Ltd, one of the largest multinational oilfield service companies.

On the other hand, if we try to breakdown the years, from 2011 till June 2020, we realize that different years had different effect on the delisting, whether it is from the capitalization perspective or the number of firms and this breakdown is shown in the following Table 2.6 that outlines the different market capitalization during the years in question and the total de-listings that happened respectively in the French market.

Table 35: Market Capitalization of De-listings from 2010-2020 (in \$ Million)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	Jun-20
Market capitalization	691,051	1,202,186	1,240,250	2,148,625	1,124,390	1,048,385	1,139,062	999,672	916,020	1,319,491
Number of de-listings	48	75	67	76	70	68	81	73	61	33
Average Market Capitalization	14,397	16,029	18,511	28,271	16,063	15,417	14,062	13,694	15,017	39,985

Source: Reuters-Thomson, personal compilation.

VII. Concluding Remarks

The chapter tried to shed the light on the trending phenomenon of going back private or delisting from the public market. Continental Europe and the Anglo-Saxon countries face an increasing number of firms going private and present different approach to understand the reason for this move.

A "take-private" transaction requires the action of a large private equity group to purchase the stock of a publicly traded corporation. This move can be executed by the owners or some other private investors. The result will be a narrower shareholders base with fewer owners leading to a subsequent delisting decision. Private companies benefit again from closer and quicker decision making and more hands on and direct access to operational efficiency.

The delisting can be voluntary to overcome listing costs and benefit from enhanced cash flow, to bypass agency cost and align owners and managers' goals, or simply because the incentives of more liquidity and market power just faded away. The delisting can also result from involuntary situations that necessitated the delisting by the regulatory authorities such as the violation of the stock exchange requirements or simply non-compliance with specific accounting standards. Most of the instances of delisting were associated with cases of poor performance in the period prior to the delisting and lack of growth potential.

Furthermore, regulatory constraints are present and are imposed on issuers in the form of requirements related to the need to increase market transparency for the best interests of investors. Most of the instances of delisting were associated with cases of poor performance in the period prior to the delisting and lack of growth potential.

On the other hand, the need to address group restructuring in order to combine the business activities and management of subsidiaries within the group through mergers and/or reworking of parent-subsidiary relations is there also as an important reason leading to delisting. Not to forget the poor liquidity and low valuation of SMEs, which once associated with poor performance on the stock exchange, inaccurately mirror the activities of most SMEs and ultimately do not constitute any interest for analysts and other institutional investors who always demonstrate some kind of lack of interest in the securities of French SMEs.

The French market participants, like in most markets, weight in on the advantages and the disadvantages of being publicly listed and are lured by the private equity funds that attract them

away from the stringent financial and regulatory requirements. Furthermore, the evolution of the French market and the multitude of layers and divisions within the market requires thorough and in-depth research and study in order to understand the trends and the potentials for a promising future of the capital markets at the large cap and SMEs level.

UK and US saw a deep market for LBOs and more BOSOs in Continental Europe. Both strategies depend on multiple variables including ownership concentration and respective agency costs, corporate governance in effect and listing costs versus benefit of being public. These private equity buyouts are usually structured through senior debt and the company should consider the effect of such transaction on the company's balance sheet before the decision to go private. With debt at acceptable levels and equity under full control, the management can now concentrate on enhancing operational efficiency away from the burdens of market regulations and the accompanying disclosure costs.

Conclusion

The paper is an attempt to introduce the pros and cons of going public against the decision to stay private. The study of the Lebanese capital and financial market was important in order to set the ground for understanding the need for such market and the potential to benefit from if any. A breakdown of the survey done among firms showed that 72.67% of the firms are established as family run businesses and 27.33% as non-family businesses. Out of the family firms, 1st generation owners/managers controlled and managed 29.06% and 46.15% of respondent were run by 2nd generation, 20.51% by 3rd generation and 4.27% are managed by 4th generation, respectively

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding.

Chapter two discussed and presented a dynamic and elaborate view on the different stages of the BSE and showed that the Beirut Stock Exchange is one of the smallest, in terms of number of listed companies, with only 10 listed firms and a total market capitalization of around \$9.6 billion as at end of 2018 which represented circa 17% of GDP. The comparative figures along with the efforts of the BDL and the recently introduced CMA to change the legal status of the BSE from a government owned institution to a privately-owned institution could not add any new participants nor increase the turnover of this shallow capital market. The banking sector, on the other hand, stood as the recipient of much of the oil income from the Gulf countries and flourished and grew to become the main contributor to the economy, and with large increases in the deposits, the commercial banks became the sole supplier of fund to the economy, its private sector as well as its public sector. The funding, as such, was short term and always backed by adequate collateral which in turn haunted the borrowing firms and restricted their source of financing to the short-term facilities provided by the commercial banks.

H1: The underdevelopment of the BSE pushes the Lebanese firms into short term funding.

H2: The Lebanese firms follow a modified POT due to their peculiar corporate structure and the status of the capital markets.

In studying the alternative that Lebanese enterprises face when it comes to finding the most suitable funding sources, the researcher found that they follow a modified Pecking Order (POT) which limits the funding sources short of issuing equity shares. This fact is understandable in a country with very weak and almost non-existent capital market.

With 163 respondents, the researcher found that 72.67% of the firms are structured in the pattern of family businesses versus 27.33% for non-family businesses with an important observation that the Lebanese firms are presented as closely held businesses with very few shareholders running and managing the entities. The results showed that banks provide roughly 24% of the financing for these Lebanese firms with trade credits from suppliers standing at around 17%, which leaves around 59% of funding to come from other different providers of credit and mainly from internal and personal funding. The study in chapter three started with a test of Pearson Correlation on SPSS to test for possible correlations among the size, the age and the debt ratio. It is expected that a growing firm will not be able to fill its financial needs internally, hence the pecking order theory implies an increase in the debt level.

The age of the firms was calculated based on the year of establishment and the number of employees was used as a reflection and approximation of the size of the firms. The resulting coefficient of determination, the variance of the studied dependent variables with the age of the respective firms could not explain the choice of the sources of funding nor financing. Hence, the age of the firm does not have any direct effect on the sources of financing but more logically it is the type of the business. Booth, Aivazian, Demirguc-Kunt, & Maksimovic, (2001) stated that internal funds are more readily available for old and profitable firms, therefore, the correlation is tested again by replacing debt ratio with internal funding that showed a negative but very low correlation between internal funding and the age and size of the sample even with significance at the 0.05 level with correlation of -0.155 and -0.188 for age and size respectively. Therefore, the results showed that older and bigger firms depend less on the internal sources of funding and try to access external sources which supports the findings of Bulan and Yan, 2009. This also comes to support the idea of Bernanke (1983) who stated that small firms have less access to external funds than large firms and therefore, the pecking order can probably more accurately describe the financing decisions of small firms.

In addition, the study showed a positive correlation of 0.551 between bank loans and credits from suppliers at the 0.01 significance level. This finding clarifies the fact that as firms consult with external financing, their credit worthiness will be interpreted positively by both banks and suppliers which comes in tandem with Bernasconi, Marenzi, & Pagani, (2005). A study on the relation between the debt from banks and credit from suppliers with the debt ratio was performed and the following equation:

$$DR= 3.475 + 0.508 CFS + 0.451 DFB$$

Where, CFS is credit from suppliers and DFB is debt from banks show a positive and statistically significant relation between debt ratio and the credit from suppliers and the debt from banks. Hence, the coefficients showing 76.1% and 73.1% of the change in the debt ratio are explained by the debts from banks and credits from suppliers since firms usually borrow short term from banks and suppliers with no reliance on the capital markets. Further results came to confirm the choice of the external sources as a substitute of internal source and not a complement, which can be explained by the POT as an alternative choice of financing. An open-end questionnaire revealed that 65% of the firms have no intention to list on the BSE, where 37% see the BSE as shallow with very low number of participants, 20% prefer bank loans and around 13% cherish their closed ownership status.

Therefore, the Lebanese firms that are structured as closely run businesses exhibit a modified Pecking Order in their choice of sources of financing. The old firms start with internal funding and then they tend to seek external financing from commercial banks and from suppliers.

In the absence of an active capital market, the Lebanese firms relied mainly on the debt markets. The corporate financing in Lebanon is mostly covered by debts in the form of borrowings from banks and some credit from suppliers. To investigate whether firms follow the pecking order theory, I focused on the behavior of private, unlisted, firms in Lebanon. I found that internal funding is the source of choice followed by commercial banks and credit from suppliers, while other sources of funds, such as private equity from the public, were absent in the past 25 years. In summary, banks provide an average of 24% of the financing for Lebanese firms, credits from suppliers stand at an average of 17%, which leaves an average of 59% to be accounted for from different providers of funding mainly from internal and personal funding. This observation can be explained by the pecking order theory.

The results came, as such, to confirm the choice of internal source and the move towards the external sources comes as a substitute rather than a complement which can be explained by the POT as an alternative choice of financing. The Lebanese firms seem to have adequate amounts of internal cash flows to finance their investment needs. Among external financing, the equity and bond markets in Lebanon are inefficient with very limited role. Accordingly, Lebanese firms considered only debts as their major source to finance their deficits. The short-term nature of

private firms' loans reveals the dependence on external funding from commercial banks. On the other hand, the Lebanese firms seems not to support the effect of the size and age on the choice of external financing which cannot be explained by these two variables that show low correlation. Firms start with their internal funding sources which later pushes them to seek external financing in the form of commercial banks loans and credit from suppliers. Once the internal sources have been depleted, firms will be under the scrutiny of going public based on the expected and perceived costs of doing so and being public ultimately. The Lebanese economy relies heavily on inflows directed towards the real estate, the banking sector and the consumption sectors away from investment opportunity in the industrial sector intended to boost future potential benefits.

The study showed that large and old firms able situated to benefit from external sources of financing due to availability of adequate cash flows and the disposal of reliable assets that can be used as collateral for such external sources of financing. Moreover, the Lebanese firms showed no aspect of a solid relationship between size and age and the choice of financing, but rather it is the underdevelopment of the capital market that put forward the restrictions on these sources and imposed indirectly the tenor and the choice of the sources of financing. From another perspective, the concentration of ownership dictated upon the firms the reliance on self-financing away from the possible external sources. Furthermore, the short-term debts emanated from the banking sector and the credit from suppliers with a complete absence of the capital markets.

With enough cash flows generated internally, the Lebanese firms found themselves with a preference toward short term sources of financing form the commercial banks to fund their short-term working capital needs and as such they depend on their proper fund for any investment opportunity.

H3: The direct and indirect costs are important variables in the decision to go public.

In order to facilitate the decision to go public, the researcher tried to shed the light on the cost of going public and being a publicly listed company in Lebanon with emphasis on Beirut Stock Exchange (BSE) rules and regulations. Since most of the listed firm are commercial banks that are bound by secrecy law, I had to rely on publicly available data in the website of the said banks and on personal communication with bank managers, Midclear and the capital market authority

(CMA). A road map was introduced and a simulation was formulated to assist the potential enterprises wishing to go public.

Before going public firms must look into the different costs embedded in the decision to go public, in general, and the specific costs associated with move from a status of a privately owned to a publicly traded -firms. Many companies seek the benefits of going public but they tend to underestimate the substantial costs involved in the process of becoming public and the ongoing costs of being a public company. Therefore, the benefit of going public should be weighed against the initial and ongoing cost of being public. The explicit and implicit costs spread out from the actual time needed to get the approval, registration and liquidity and thus, the respective costs of each step of the process may vary depending on each particular company's situation starting with the underwriter experience, the management team professionalism and the choice of the legal consultants and advisers, the size of the company and the market conditions and regulatory environment.

Costs of going public are important in the decision, but given the nature and the characteristics of the Lebanese listed companies, it is difficult to have access to the exact costs of getting listed and being listed. With a minimum public float of 25%, firms must decide carefully on the capital needed to be raised from the IPO. One cannot estimate the cost of going public due to the lack of the underwriting services which represent the largest part of the cost inherent in the going public decision. With annual listing fees is fixed at \$10,000 for the first year of being listed and then set at 0.05% of the relative stock market capitalization in the subsequent years, in addition to a fixed cost of \$3000 per year and an additional minimum amount of \$ 1500 per year representing safekeeping and custodian fees paid to Midclear and around \$20,000 for auditing services, firms with the intention to go public must weigh in the benefits from such listing against the cost of listing and the ongoing costs of being listed.

As a publicly traded entity, companies must comply with very demanding accounting measures related to the posting and accounting for the costs and expenses. Some costs must be netted against gross proceeds such as the Underwriter Fees, Road-Show Costs, Printer Costs and other miscellaneous costs. Some costs must be expensed as incurred such as the Listing Fees, the Restructuring Costs, the Costs of New Board of Directors and the Costs of Compliance. Hence,

some costs must be allocated between both methods such as the Legal Fees, the Auditor Fees and the Advisory Fees.

With the prerequisites to be IPO ready and the responsibility to meet the legal, statutory and financial requirements, companies cannot but be aware of the time frame needed and the important budget required to be allocated to the whole process of going public and maintaining that status of a publicly traded company.

H4: A publicly traded firm might decide to go back private once the need for long term financing fades away and once the costs become irrelevant.

Nevertheless, the stock market growth attracted a lot of capital to be invested in securities. But, as this money became scarce, new opportunities had to be created to attract it. Otherwise, going back to being private is presented as an ultimate choice that ranges from delisting to going dark or simply a partial or complete share repurchase. “Why do firms go back private after being public?” is an important question that requires a thorough study as it became a trend over the past two decades. What does it mean to go private and what are the factors that entice the publicly traded firms to go back private again? This alternative should be set forth, probably as an exit strategy for firms should the decision to go public fail to meet their strategic objectives of growth and expected profitability. With the existing shallow Beirut Stock Exchange (BSE) the very low number of participants and the lack of corporate actions that describes the status quo of the Lebanese capital market, the researcher had to look for more active markets such as the Paris Stock Exchange to explain this corporate action and to shed the light on the possible reasons and the reversibility of any going public decision.

Over the past 3 decades, the Lebanese capital market witnessed no major move towards privatization with an almost ineffective and inactive capital market. The lack for delisting prompted the researcher to refer to a more active market such as the Paris stock Exchange or simply Euronext-Paris. For this, the Association des Marchés Financiers (AMF), Bloomberg terminal, the World Federation of Exchanges (WFE), the Euronext and Reuters Thomson were consulted to highlight the importance of such a corporate move. The data collected helped reach a clear-cut answer as to why firms do go back private. Going back private frees up management's time and effort to concentrate more on running and growing a successful business. From a different

perspective, if the company is not regularly raising funds in the capital markets or making acquisitions with its stock as currency, then the benefits to the company of going private and/or dark may outweigh the costs of being public. The delisting happens usually in two distinct forms. A voluntary delisting is a choice by investors or management to pull out of the public market in order to concentrate the ownership of the firm in the hands of fewer stockholders. Whereas, the involuntary delisting happens when an enterprise breaches some of the applicable rules and get delisted by the regulatory authorities or simply gets to this point as a result of a corporate action known as merger or acquisition that led to the dissolution of the firm.

Over the study horizon of 20 years, around 2226 firms left the French market according to Bloomberg terminal data with reasons varying among almost sixteen (16) different standard terminologies. The majority of the firms that opted to quit the listed status are represented in the small capitalization firms that are burdened by the high cost of being listed and foreign firms that are looking to concentrate their listing in one venue or one market (reduce cross-listing costs) where liquidity of their stock and benefits of being listed is more efficient. Worth mentioning that with the introduction of a unified order book by Euronext in 2009, firms started losing interest in the benefits of cross listing since all the trading will be done based on the reference market only and the costs of cross listing outweigh, at that point in time, the benefits of additional visibility and public promotion. One can see delisting as a reaction to the lack of liquidity in the respective market where the stock is listed or to the high cost to being listed. A recent trend revolved around the increase in the delisting of foreign firm who delisted from Euronext Paris and preferred to maintain only one venue listing in their main market as such, the listing of foreign firms decreased in France from 21% back in 1995 to almost 9% in the Euronext – Paris in 2010 (Bondain, 2019).

As a conclusion, the delisting can be voluntary to overcome listing costs and benefit from enhanced cash flow, to bypass agency cost and align owners and managers' goals, or simply because the incentives of more liquidity and market power just faded away. The delisting can also result from involuntary situations that necessitated the delisting by the regulatory authorities such as the violation of the stock exchange requirements or simply non-compliance with specific accounting standards. Most of the instances of delisting were associated with cases of poor performance in the period prior to the delisting and lack of growth potential. Furthermore, regulatory constraints are present and are imposed on issuers in the form of requirements related to the need to increase

market transparency for the best interests of investors. Not to forget that the poor liquidity and low valuation of SMEs once associated with poor performance on the stock exchange are behind the lack of interest of analysts and other institutional investors in the securities issued by French SMEs.

Future research

The financial authorities should introduce both debt and equity securities in the same capital market. This move must start with debt securities whose valuation is easier and the time need to convince management to move to the external sources is much acceptable and falls within the sequence of priorities and preferences of sources of financing. Afterward, once the financial public builds the habits of participating in the capital market, the equity securities should be introduced taking advantage of Lebanon's cultural and legislative situation to attract domestic and international issuers and investors alike. New financial instruments must be introduced benefiting from the recent exchange traded platform in compatibility with the managerial and structural mind of a closely held business that is looking forward for long term and sustainable sources of funding. The SME sector that characterizes the majority of the businesses in the country should look at ways to benefit from the new platform and look into innovative securities that facilitates getting the appropriate long-term financing needs away from the traditional short-term banking loans.

With the above in mind, the researcher envisions the need to test whether the pecking order is more explanatory for small firms, supporting the supposition that small firms are more likely to follow the pecking order because they find it difficult to have access to external sources of financing. Credit rationing as such might be the reason for the choice facing SMEs rather than an issue related to Pecking Order Theory (POT).

In the new era of technology, financial markets operate in an extremely complex environment, influenced by diverse factors and ever-changing technologies. Big data, driverless cars, climate change, crypto-currencies, smart grids, and shifting geopolitical powers, are becoming our day-to-day reality and every developing and growing country must find its most convenient passport to join this fast track or will be left behind. "Automation enhances and enables us to do different things and to do them better; AI will allow financial institutions to reduce cost focus, and funnel

resources to adding value in servicing the customer” according to Nasir Zubairi, CEO of Luxembourg House of Financial Technology.

The findings come as a first attempt to study the funding behavior for Lebanese firms and are distinguished by characterizing the first study of this kind that has not been performed so far in the literature of the Lebanese economy. Consequently, the study opens the door for further studies that might assist in changing the capital structure of the Lebanese firms and put them face to face with a requirement for adequate capital markets.

Ultimately, the listing intent remained a subjective decision on the part of the managers/owners and on how they perceive the BSE and its characteristics in terms of liquidity and depth. The listing intent is triggered by the sentiments toward the benefits of the BSE and its functionality.

LES CHOIX DE FINANCEMENT ALTERNATIFS AUXQUELS SONT CONFRONTÉES LES ENTREPRISES LIBANAISES :

ÊTRE PUBLIQUE OU RESTER PRIVÉ

(Résumé)

Ce document présente les avantages et les inconvénients de devenir public contre la décision de rester privé dans le but de mettre en évidence les alternatives auxquelles les entreprises libanaises sont confrontées dans leur quête de sources de financement. Le chercheur a découvert qu'ils suivaient un ordre hiérarchique modifié (POT) qui repose principalement sur le financement interne et dette externe et manque l'émission d'actions en raison du sous-développement des marchés des capitaux. Les entreprises privées libanaises non cotées ne supportent pas l'effet de la taille et de l'âge sur le choix du financement. Une fois les sources internes épuisées, les entreprises seront soumises à un examen minutieux pour devenir publiques en fonction des coûts attendus et perçus de le faire et être finalement publiques.

Afin de faciliter la décision d'entrer en bourse, le chercheur a tenté de clarifier le coût de l'introduction en bourse et d'être une société cotée en bourse au Liban en mettant l'accent sur les règles et réglementations de la Bourse de Beyrouth (BSE). Une feuille de route a été introduite avec une simulation pour aider les entreprises potentielles, souhaitant d'entrer en bourse, à peser les avantages d'une telle cotation par rapport au coût de la cotation et aux coûts permanents de l'inscription.

Redevenir privé est présenté comme une ultime stratégie de sortie. Redevenir privé libère du temps et des efforts pour que la direction se concentre davantage sur la gestion et la croissance d'une entreprise prospère. Sur l'horizon d'étude de 20 ans, environ 2226 entreprises ont quitté le marché français, principalement des entreprises de petite capitalisation qui sont grevées par le coût élevé de la cotation et des entreprises étrangères qui cherchent à réduire les coûts de cotation croisée. Qu'elle soit volontaire ou involontaire, la radiation était associée à de mauvaises performances et à un manque de potentiel de croissance. Par ailleurs, les contraintes réglementaires, la faible liquidité et la faible valorisation parfois associée à de mauvaises performances boursières sont à l'origine du désintérêt des analystes et autres investisseurs institutionnels pour les titres émis par les entreprises françaises.

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Appendix 1: Trading Time of Stock Markets of the World

Exchange	Country	Est Date	Trading time
Hamburg Stock Exchange/Xetra	Germany	1558	09:00 - 17:30
London Stock Exchange	United Kingdom	1571	08:00 - 16:30
Frankfurt Stock Exchange	Germany	1585	08:00 - 20:00
Euronext/Amsterdam	Netherland	1602	09:00 - 17:30
Euronext Lisbon	Portugal	1769	08:00 - 16:30
Wiener Börse	Austria	1771	08:55 - 17:35
New York Stock Exchange	America	1792	09:30 - 16:00
Irish Stock Exchange	Ireland	1793	08:00 - 16:30
Brussels Stock Exchange	Belgium	1801	09:00 - 17:40
Borsa Italiana	Italy	1808	09:00 - 17:30
Nasdaq Copenhagen	Denmark	1808	09:00 - 17:00
Oslo Stock Exchange	Norway	1819	09:00 - 16:30
Euronext/Paris	France	1826	09:00 - 17:30
Bolsa de Madrid	Spain	1831	09:00 - 17:30
Madrid Stock Exchange	Spain	1831	09:00 - 17:30
Buenos Aires Stock Exchange	Argentina	1854	11:00 - 17:00
Bolsa de Valores de Lima	Peru	1860	09:30 - 17:00
Stockholm Stock Exchange	Sweden	1863	09:00 - 17:30
Budapest Stock Exchange	Hungary	1864	09:00 - 17:00
Borsa Istanbul	Turkey	1866	09:00 - 18:00
Prague Stock Exchange	Czech Republic	1872	09:00 - 16:30
Bombay Stock Exchange	India	1875	09:55 - 15:30
Athens Stock Exchange	Greece	1876	10:00 - 17:20
Tokyo Stock Exchange	Japan	1878	09:30 - 15:30
Bucharest Stock Exchange	Romania	1882	09:45 - 18:00
Egyptian Exchange	Egypt	1883	10:30 - 14:30
Johannesburg Stock Exchange Limit	South Africa	1887	09:00 - 17:00
BM&FBovespa Stock Exchange	Brazil	1890	10:00 - 5:30
Hong Kong Stock Exchange	Hong Kong	1891	09:30 - 16:00
BolsaComercio De Chile	Chile	1893	09:30 - 16:00
Helsinki Stock Exchange	Finland	1912	10:00 - 18:30
Jakarta Stock Exchange	Indonesia	1912	08:30 - 17:00
Beirut Stock Exchange	Lebanon	1920	09:30 - 12:00
Bolsa de Valores de Colombia	Colombia	1928	09:00 - 17:00
Luxembourg Stock Exchange	Luxembourg	1928	09:00 - 17:35
Casablanca Stock Exchange	Morocco	1929	09:30 - 15:30
Bolsa de Valores de Caracas	Venezuela	1947	09:00 - 13:00
Pakistan Stock Exchange Limited	Pakistan	1947	09:32 - 15:30
Osaka Securities Exchange	Japan	1949	16:30 - 19:00

Tel Aviv Stock Exchange	Israel	1953	09:00 to 17:30
Nairobi Securities Exchange	Kenya	1954	09:30 - 15:00
The Nigerian Stock Exchange	Nigeria	1960	10:30 - 16:00
Khartoum Stock Exchange	Sudan	1962	1 Hour per day
Iran Stock Exchange	Iran	1967	09:00 - 12:00
NASDAQ	America	1971	09:30 - 16:00
BRVM	Cote d' Ivoire	1973	09:00 - 15:00
Singapore Exchange	Singapore	1973	09:00 - 17:00
Thailand Stock Exchange	Thailand	1975	09:30 - 16:30
Bolsa Boliviana de Valores	Bolivia	1976	10:15 - 13:15
Iceland Stock Exchange	Iceland	1985	09.30-15:30
Australian Securities Exchange	Australia	1987	10:00 to 16:00
Ghana Stock Exchange	Ghana	1989	09:00 - 17:00
Stock Exchange of Mauritius	Mauritius	1989	09:00 - 16:00
Swaziland Stock Exchange	Swaziland	1989	12:00 to 12:30
Shanghai Stock Market	China	1990	09:30 - 15:00
Shenzhen Stock Exchange	China	1990	09:30 - 15:00
Mongolia Stock Exchange	Mongolia	1991	10:00 to 1:00
Warsaw Stock Exchange	Poland	1991	09:00 - 17:00
Zagreb Stock Exchange	Croatia	1991	09:00 - 16:00
Deutsche Börse	Germany	1992	08:00 - 20:00
National Stock Exchange of India	India	1992	09:00 - 17:00
Kazakhstan Stock Exchange JSC	Kazakhstan	1993	09:00 - 18:00
Mexican Stock Market	Mexico	1993	09:00 - 15:00
Montenegro Stock Exchange	Montenegro	1993	10:30 to 15:30
Royal Securities Exchange of Bhutan	Bhutan	1993	10:15 to 13:00
Zimbabwe Stock Market	Zimbabwe	1993	09:00 - 12:00
Lusaka Stock Exchange	Zambia	1994	08:00 - 17:00
Botswana Stock Exchange	Botswana	1995	10:00 to 14:00
Chittagong Stock Exchange	Bangladesh	1995	10:30 to 14:30
Qatar Stock Exchange	Qatar	1995	09:30 - 13:15
SIX Swiss Exchange	Switzerland	1995	09:00 - 17:30
Dar Es Salam Stock Exchange	Tanzania	1996	10:00 - 15:00
Malawi Stock Exchange	Malawi	1996	10:30 - 12:00
Algiers Stock Exchange	Algeria	1997	09:30 to 11:15
Uganda Security Exchange	Uganda	1997	10:00 - 12:00
Bolsa de Valores de Cabo Verde	Cape Verde	1998	09:30 - 14:00
Hanoi Stock Exchange	Vietnam	1998	09:00 - 15:00
Maputo Stock Exchange	Mozambique	1999	09:00 - 12:00
Abu Dhabi Securities Exchange	Abu Dhabi	2000	10:00 - 14:00
Borse Dubai	U. A. E	2000	10:00 - 14:00

Dubai Financial Market	U. A. E	2000	10:00 - 14:00
Euronext	Europe	2000	09:00 - 17:30
Ho Chi Minh City Stock Exchange	Vietnam	2000	09:00 - 15:00
Vadodara Stock Exchange	India	2000	09:00 - 15:30
Armenian Stock Exchange	Armenia	2001	11:00 - 15:00
Douala Stock Exchange	Cameroon	2001	08:00 - 16:30
New Zealand Stock Exchange	New Zealand	2002	10:00 - 16:45
Belgrade Stock Exchange	Serbia	2003	09:00 - 14:00
Guyana Stock Exchange	Guyana	2003	Once a week
Nasdaq Nordic	Sweden	2003	09:30 - 16:00
Namibian Stock Exchange	Namibia	2004	09:00 - 17:00
Korea Exchange	South Korea	2005	09:00 - 15:30
Bangalore Stock Exchange	India	2006	09:00 - 17:00
Libyan Stock Market	Libya	2007	10:00 - 17:00
PFTS Ukraine Stock Exchange	Ukraine	2008	10:00 - 17:15
TMX Group Limited	Canada	2008	09:30 - 16:00
Mercado Integrado Latino americano	Chile, Colombia, Mexico, Peru	2010	09:00 - 17:00
Cambodia Stock Exchange	Cambodia	2011	09:00 - 11:30
Moscow Exchange	Russia	2011	09:30 - 16:00
Somalia Stock Exchange	Somalia	2012	10:00 - 13:00
Japan Exchange Group	Japan	2013	09:00 - 15:00
Rwanda Stock Exchange	Rwanda	2013	09:00 - 12:00
Seychelles Securities Exchange	Seychelles	2013	10:00 - 16:00
Yangon Stock Exchange	Myanmar	2015	09:30 - 13:00

Source: Collection from Individual Stock Exchanges websites

Appendix 2: Short list of ETPs of the World

Platform Name	Description	Trading method	Eligible participants	Establishment
Algomi	Through their Honeycomb, Synchronicity and Algomi ALFA technology, Algomi creates a bond information network that enables all market participants to securely make valuable financial trading connections.	Sourcing, aggregation and/or matching detection platform	Dealers, institutional investors	Founded in 2012, Algomi is headquartered in London with offices in New York and Hong Kong
AxeTrader	AxeTrader provides banks, broker-dealers and buy-side firms with a complete picture of fixed income liquidity	Sourcing, aggregation and/or matching detection platform	Dealers, institutional investors	Founded in 2008, headquartered in London with offices in Germany, Australia and Singapore
BGC Trader	BGC provides electronic trading services for various financial products through BGC Trader. Products supported include government and corporate bond markets.	D2D	Dealers	Founded in 2011, Headquartered in London and New York, with offices in dozens of major markets across the globe.
Bloomberg BBX	Bloomberg Bond Cross (BBX) allows buy-side and sell-side participants to access European bond market liquidity.	A2A	Dealers, institutional and retail investors	Headquartered in New York, with operations in 185 locations around the world. Bloomberg Fixed Income Trading (FIT) is the world's largest and most widely used
Bondpoint	Virtu BondPoint delivers centralized liquidity and automated, cost-efficient trade execution services for fixed income securities.	D2C	Dealers, institutional and retail investors	ICE Founded in 2000 with market infrastructure in all major trading centers
BrokerTec	BrokerTec is an anonymous dealer-to-dealer electronic trading platform for the fixed income markets, providing innovative technology solutions across a wide range of products.	D2D	Dealers	CME Founded in 2000 with market infrastructure in all major trading centers
BrokerTec Direct	BrokerTec Direct offers a disclosed trading execution platform. It is a dealer-to-client platform that offers relationship-based electronic trading for fixed income instruments.	D2C	Dealers, institutional investors	November 2, 2018, CME Group completed the acquisition of NEX, creating a global markets company across futures, cash and OTC
CanDeal	CanDeal has assembled Canada's deepest liquidity pool for Canadian debt securities.	D2C	Dealers, institutional investors	Founded in 2001 as a Canadian online exchange for Canadian dollar debt securities

CastleOak DirectPool	The DirectPool platform from CastleOak connects price-makers and price-takers and optimizes the price and minimizes the leakage of information.	D2C	Dealers, institutional investors	N.Y.-based, launched in 2017 in cooperation with Bloomberg the DirectPool™ as a platform for electronic trading in corporate bonds
Clarity BidRate	The Clarity BidRate alternative trading system creates an opportunity in the variable-rate securities market that is designed to level the playing field for issuers, investors, banks and broker-dealers.	A2A	Dealers, institutional investors	Founded in 2013, Clarity is a Division of Arbor Research & Trading, LLC .
Dealerweb	Tradeweb's Dealerweb offers liquidity solutions for traders in the interdealer broker marketplace.	D2D	Dealers	Founded in 2008 Tradeweb is the exclusive source for U.S. Treasury pricing for the Reuters Capital Markets 19901
EMBonds	An electronic trading venue dedicated to the emerging market fixed-income space, with a central clearing counterparty. The platform has a global client base ranging from hedge funds to specialist emerging market banks.	A2A	Dealers, institutional investors	Founded in 2013 and launched in 2015, Emerging Markets Bond Exchange Limited is based in London
Euronext Synapse	Euronext signed a partnership with Algomi. Combining Euronext's experience and Algomi's innovation technology.	D2D	Dealers	Founded in 2017
HSBC Credit Place	The platform displays streamed prices from various sourced. Trading execution does not take place on the platform but outside through existing channels.	D2C and C2C	Dealers, institutional investors	Launched in 2014. London based
ITG POSIT FI	POSIT was launched in 1987 as a point-in-time electronic crossing network. POSIT FI is a block crossing mechanism for U.S. corporate bonds.	A2A	Dealers, institutional investors	Launched in 2014. London based
LiquidityChain	LiquidityChain provides an information and crossing network that searches and mines client IOIs (Indication of Interest) to a pairing engine.	Sourcing, aggregation and/or matching detection platform	Institutional investors	Launched in 2017. London based
LiquidityEdge Direct	LiquidityEdge is a trading venue that facilitates genuine liquidity for US Treasuries.	A2A	Dealers, institutional investors	Launched in 2017. New York based

MarketAxess	MarketAxess' electronic trading platform enables institutional investors and broker-dealers to efficiently trade corporate bonds and other types of fixed-income securities.	A2A	Dealers, institutional investors	Founded in 2000 in New York
MTS Bonds.com	MTS Bonds.com, previously known as BondsPro, is an electronic trading platform that supports USD and a wide range of non-USD denominated corporate bonds and emerging market debt.	A2A	Dealers, institutional investors	Launched in Italy in 1988
MTS BondVision	MTS BondVision is a regulated and secure multi-dealer-to-client trading platform for government bonds and credit that connects investors to dealers across Europe and the US.	D2C	Dealers, institutional investors	Launched in Europe in 2001 and later merged with EuroMTS
Neptun	Neptune delivers bond market data from sell-side banks to buy-side clients.	Sourcing, aggregation and/or matching detection platform	Dealers, institutional investors	
OpenBondX	OpenBondX operates an all-to-all trading platform for trading US treasuries and corporate bonds.	A2A	Dealers, institutional investors	
OpenDoor Trading	OpenDoor is an all-to-all session-based trading platform and fills the liquidity vacuum for Off-the-Run US Treasuries and TIPS.	A2A	Dealers, institutional investors	
Saxo Digital Bond Offering	Saxo Bank's digital bond trading solution gives investors direct access to a universe of over 5'000 bonds.	D2C	Institutional and retail investors	
SGX's Bond Pro platform	Singapore Exchange (SGX) has launched an over-the-counter (OTC) trading platform dedicated to Asian bonds.	D2D, D2C	Dealers, institutional investors	
Spain SENAF	SENAF is the Bolsa de Madrid's (BME) electronic trading platform for Spanish Public Debt, reverse repos and specific securities registered on AIAF.	D2D	Dealers	
Tradeweb Direct	A electronic fixed income marketplace for financial advisors, registered investment advisors, traders, and buy-side investors.	D2C	Dealers, institutional investors	

Source: Description from company websites and brian.mattmann@hslu.ch

Appendix 3: List of The Firms Delisted Due to NYSE Euronext-Paris Decision of 2010

Company name	Denomination	Symbol	ISIN
ACCESS2NET	ACCESS2NET	MLACC	FR0004167062
ADMEA	ADMEA	MLADM	FR0010002196
SOCOPI	SOCOPI	MLSOO	FR0000076457
CHATENET (AUTOMOBILES)	AUTO.CHATENET	MLAUT	FR0000073991
BIKE EXPAND	BIKE EXPAND	MLBIK	FR0010536060
CALYSTENE	CALYSTENE	MLCAL	FR0000076275
CARTOPLAST	CARTOPLAST	MLCAR	FR0000073074
CESAM(EDIT.SCOLAIRES APPRENT.)	CESAM	MLCES	FR0000062838
RHONE-ALPES(CIE DE DIST.AUTOM.)	CODARALP	MLCOA	FR0000185605
C.T.A.HOLDING	CTA HOLDING	MLCTA	FR0000054066
EASYTHERM	EASY THERM	MLTHE	FR0010550137
EUREXIA	EUREXIA	MLERX	FR0000039778
FINANCIAL S.A.	FINANCIAL	MLFIN	FR0010147595
FINATECH ENTREPRISES	FINATECH ENTREPR.	MLMAX	FR0000077174
FLE	FLE	MLFLE	FR0000078396
FLIP TECHNOLOGY	FLIP TECHNOLOGY	MLFLI	FR0000073934
GAYPLANET	GAYPLANET	MLGAY	FR0004177731
Generale De Protection Europe Holding	GLE PROTECT.EUROPE	MLGPE	FR0005038288
GLOBAL TECHNOLOGIES	GLOBAL TECHNO.	MLITS	FR0010613968
FRUCTA PARTNER (GROUPE)	GPE FRUCTA PARTNER	MLGFP	FR0000053118
HOLY-DIS	HOLY-DIS	MLHOD	FR0004169704
INFORMATIS TECHNOLOGY SYSTEM	INFORMATIS TECHN.	MLINF	FR0000077463
JLMD ECOLOGIC GROUP	JLMD ECOLOGIC GRP.	MLJLM	FR0010315622
LOCATION CONS.AUTO.-LCA FRANCE	LOC.CONS.AUTO.LCA	MLLCA	FR0000035677
METAPHORA	METAPHORA	MLMET	FR0000076531
MON PLUS BEAU JOUR	MON PLUS BEAU JOUR	MLPBJ	FR0010435107
NEWTECH INTERACTIVE	NEWTECH INTERACT.	MLNEW	FR0000037400
NICOMATIC	NICOMATIC	MLNCO	FR0000039034
PARTICIPATIONS FIN.INDL.COMLES	PART.FIN.INDL.COML	MLPFI	FR0006822284
PROMENS SA	PROMENS	MLPLA	FR0000061327
SKINETHIC	SKINETHIC	MLSKI	FR0010098376
SOBELEC	SOBELEC	MLSOB	FR0000054520
SOCOM	SOCOM	MLSOC	FR0010221168
ARCOA	ARCOA	MLARC	FR0004063295
TECHNI BUREAU	TECHNI BUREAU	MLTEB	FR0000078453
TELEMEDIA GROUP	TELEMEDIA GROUP	MLTEL	FR0000076416
TEMERIS	TEMERIS	MLAST	FR0000064933
WILLEME(ETS)	WILLEME	MLWIL	FR0006460721
PARTICIPEX-PART.DEV.ENT.REGION	PARTICIPEX	MLPAR	FR0000063380
Société LEXBASE	LEXBASE	MLLEX	FR0004165694

Source: 2010-2020, Boursier.com

Appendix 4: Companies Delisted from Euronext-Paris Due to Non-Compliance in 2018

Company name	Ticker
CTA Holding	MLCTA
Consort Nt	MLCNT
WT	MLWTT
Part.Indles Mini.	MLHOP
Body One	MLONE
Financier Croi Inv	MLFCI
JSA Technology	MLJSA
Caire	MLAAE
Novae Aerospace	MLNOT
Galeo	MLGAL
Afrique Telecom	MLAFT
Novaday	MLLED
Jane France	MLJAN
USG	MLUSG
Point Parfums	MLPPF
Valoneo	MLVAL
Steam France	MLSTM
Courbet	MLCOU
Courbet Am.	CRBT
Thermes De Saujon	MLTDS

Source: *Marchelibre.com*

Appendix 5: Market capitalization of Top Ten companies delisted on Euronext as of end 2019 (millions of euros)

Trading venue	Company	Market capitalization
Euronext	Lilly and Co	94,612
Euronext	Procter & Gamble	24,898
Euronext	Coca-Cola	23,810
Euronext	Brockfield Asset Mgt	19,318
Euronext	Vale	13,305
Euronext	RTL Group	7,426
Euronext	Hexcel	6,452
Euronext	Gemalto	4,780
Euronext	Beni Stabili	1,496
Euronext	Green Reit Plc	1,336

Source: *AMF, personal compilation*

Appendix 6: Market Capitalization of Top Ten companies delisted on Euronext - Access as of end 2019 (millions of euros)

Trading venue	Company	Market capitalization
Euronext-Access	Swissfintecinvest	180.56
Euronext-Access	Quadpack Industries	136.21
Euronext-Access	Cogifrance	109.68
Euronext-Access	DWC3.0	46.98
Euronext-Access	Securinfor	32.2
Euronext-Access	Transinsular	29.41
Euronext-Access	Debflex	18.07
Euronext-Access	MNR Group	16.45
Euronext-Access	C.T.A. Holding	10.49
Euronext-Access	Raphael Michel SA	7.8

Source: AMF, personal compilation

Appendix 7: Market Capitalization of Top Ten companies delisted on Euronext - Growth as of end 2019 (millions of euros)

Trading venue	Company	Market capitalization
Euronext- Growth	Falcon Oil & Gas	138.44
Euronext- Growth	Scisys Group	87.91
Euronext- Growth	Keyyo	66.64
Euronext- Growth	Gan Plc	49.42
Euronext- Growth	Millet Innovation	38.5
Euronext- Growth	Oceasoft	10.53
Euronext- Growth	ISA	5.98
Euronext- Growth	Dolphin Integrat.	4.92
Euronext- Growth	Holosfind	3.22
Euronext- Growth	Technofirst	0.34

Source: AMF, personal compilation

Euronext Growth replaced Euronext-Alternext on 19 June 2017. It is a segment of Euronext intended for SMEs to get financing.