



Market Structure Issues and Impact On Initial Public Offerings

SEC Advisory Committee on Small and Emerging
Companies

David Weild

June 8, 2012

10:45 AM – 12:30 PM

Securities & Exchange Commission

Washington, DC



David Weild



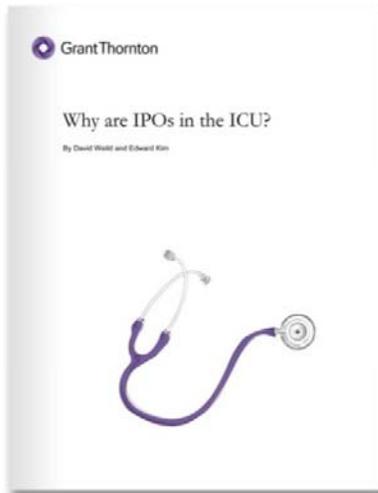
- Leader, **Grant Thornton's** Capital Markets group
- Chairman & CEO, **Capital Markets Advisory Partners**
- Chairman of the Small Business Crisis Task Force for the **International Stock Exchange Executives Emeriti** (non-profit)
- Former vice-chairman and executive vice-president of NASDAQ
- Numerous senior management roles at Prudential Securities, including:
 - President of PrudentialFinancial.com
 - Co-Head of strategy (Banking, research, institutional sales and trading)
 - Head of corporate finance
 - Head of equity capital markets and equity syndicate globally
 - Head of technology investment banking
 - Commitment Committee Member

Some past publications

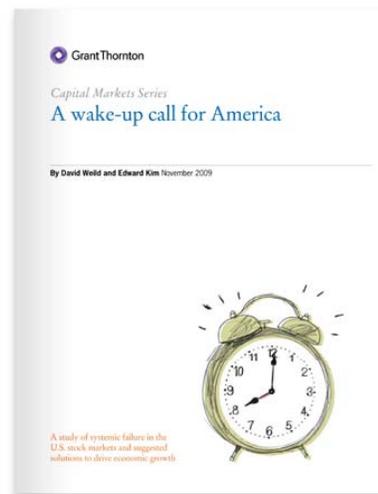
Foundational arguments behind The JOBS Act (But much left to be done!)

- Cited in the IPO Task Force Report to Treasury
- Cited in the Interim Report by The President's Jobs Council

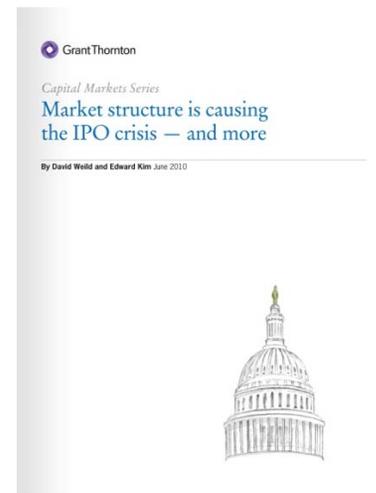
November 2008



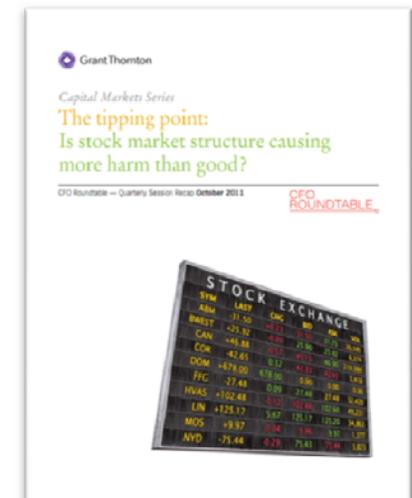
November 2009



June 2010



October 2011



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Market structure concepts (Primer)

Macro (1995 vs. 2012)

- Large cap subsidized small cap vs. No subsidies
- Retail sales vs. Retail PMs
- Broad inst. coverage vs. Narrow
- Profitable aftermarket vs. Unprofitable
- Information additive vs. Information mining (Indexing, Derivatives)
- Fundamental vs. Technical
- Uncorrelated markets vs. Correlated

Micro (General)

- Symmetrical order book (liquid) vs. Asymmetrical (illiquid)
- Quoted vs. Unquoted
- Tick sizes vs. Effective tick sizes

The literature shows that smaller tick sizes hurt liquidity for illiquid stocks

- Illiquid stocks are harmed by smaller tick sizes
- Liquid stocks are helped by smaller tick sizes

-**But, not so fast!** What are *the long-term effects* of smaller tick sizes on the ecosystem?

-**Answer:** They degrade stock market infrastructure, capital formation and undermine the economy.

Quote: Knight Securities, 1997

OHRs and Reg. ATS to harm capital raising

“Remember you are tampering with the most efficient capital raising and job creating mechanism in the world—the NASDAQ Stock Market.”

Walter Raquet, the co-founder of Knight Securities, in a letter dated February 4, **1997** and addressed to the then President of NASDAQ and copied to the SEC Chairman, the SEC Chief Economist and the Chairman of the NASD.

Quote: Bright Trading, 2012

Smaller tick sizes harming liquidity

"I think many of our problems with market liquidity in small and mid-caps can be traced right back to decimalization [Tick sizes]," said Dennis Dick, prop trader at Bright Trading in Detroit. "Where decimalization has helped to reduce spreads in the large-cap space, it has actually harmed liquidity in the small- and mid-cap space."

For blocks, "It's nearly impossible to execute any sizable order without significant price impact," Dick said.

SEC to Examine Tick Size for Small Caps

Traders Magazine Online News, April 17, 2012

John D'Antona Jr.

“Wider Spreads and Fees Could Help Restore Investor Confidence”

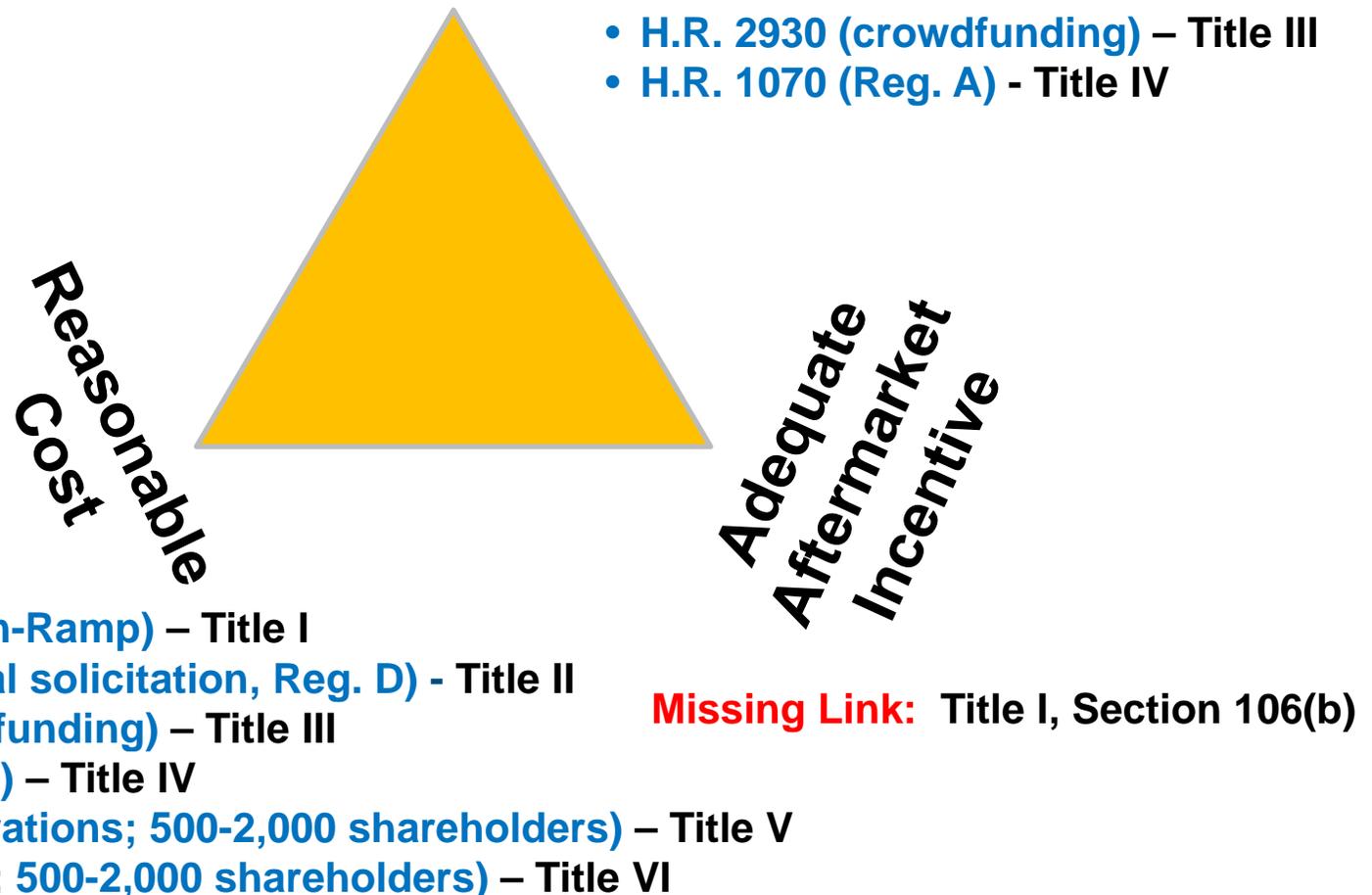
Article: Traders Magazine Online News, June 1, 2012

“**Larry Tabb**, chief executive of the Tabb Group, said dime spreads shouldn't be off the table and considered as well. This, he added, would incentivize brokers to trade and provide research for smaller and new companies. **[Prof. James] Angel** believes issuers, not the regulators, should decide what the spread should be in stocks. But if a company trades better with sub-penny pricing, "Then sub-penny should be permitted."

The JOBS Act put “Cost” over “Aftermarket”

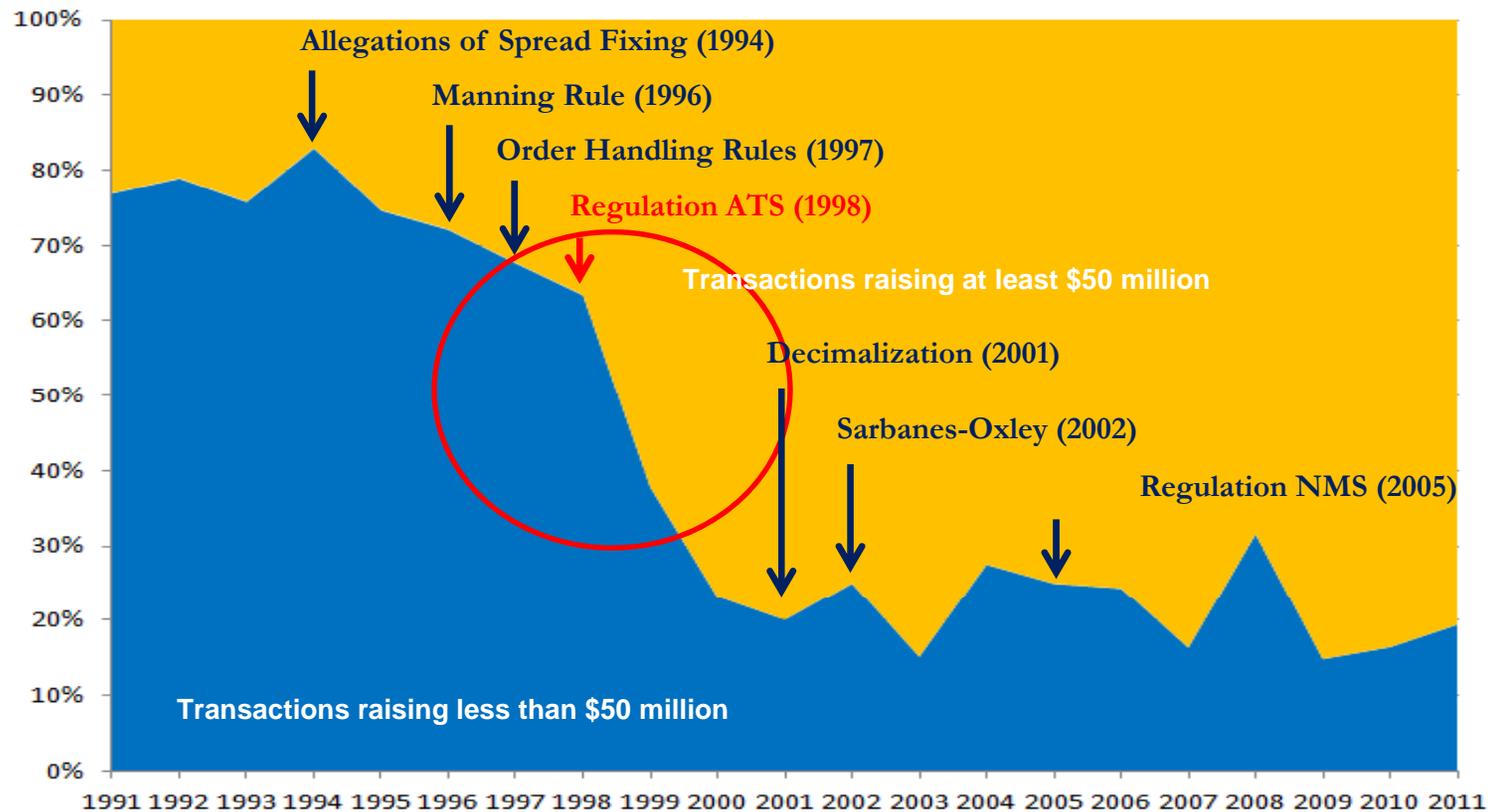
“Aftermarket” support is the biggest obstacle to a resurgence in the IPO market

Standard Disclosure



Small IPO gutted before Sarbanes-Oxley

Earlier Version From *Why are IPOs in the ICU?* (November 2008)



Sources: Grant Thornton LLP, Capital Markets Advisory Partners and Dealogic.
Data includes corporate IPOs as of Dec. 31, 2001, excluding funds, REITs, SPACs and partnerships

*March 16, 2011; House Financial Services Committee "Hearing on Legislative Proposals to Promote Job Growth, Capital Formation and Market Certainty"

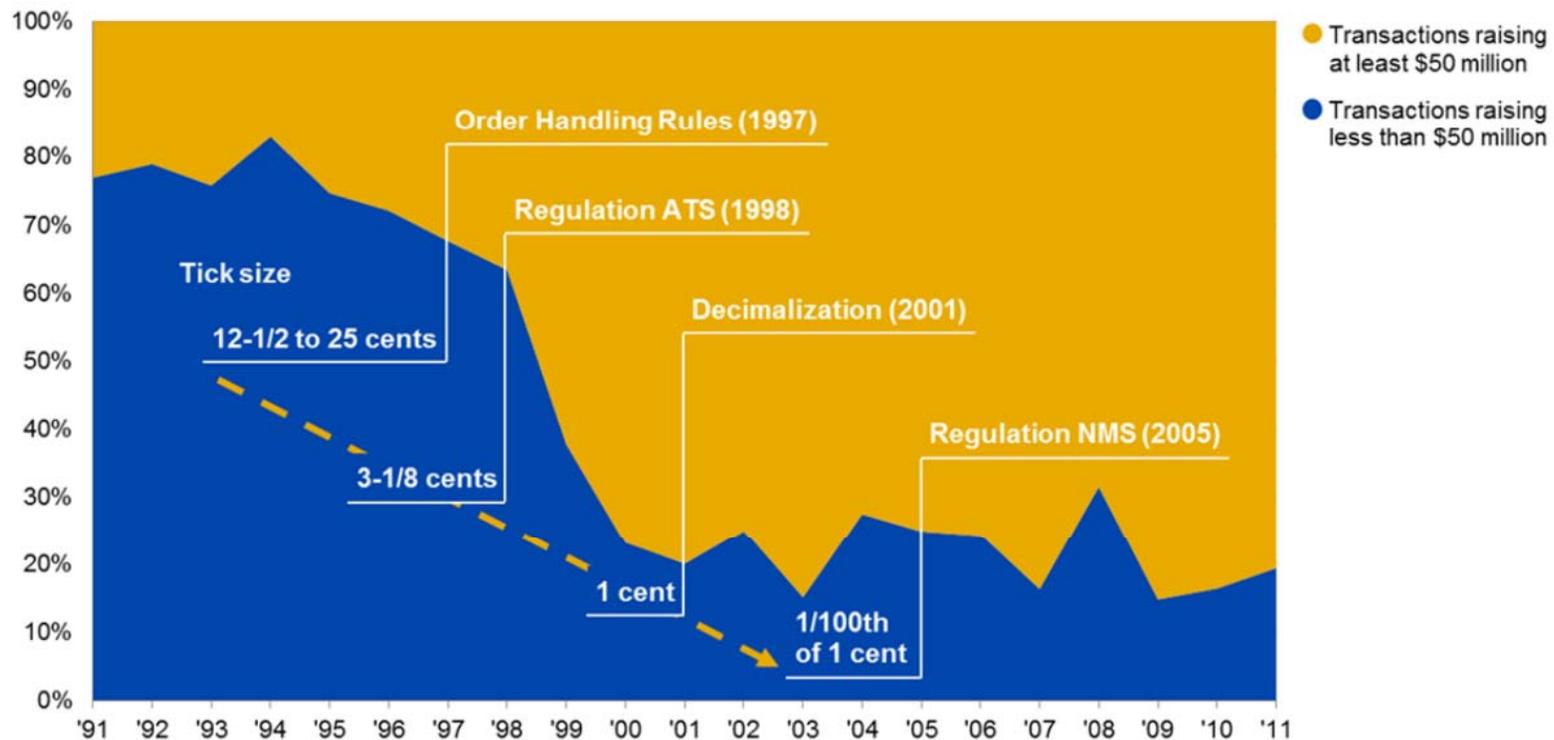
statement by David Weild

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Essential to increase "Effective" tick sizes

Title 1, Section 106(b): Tick Sizes

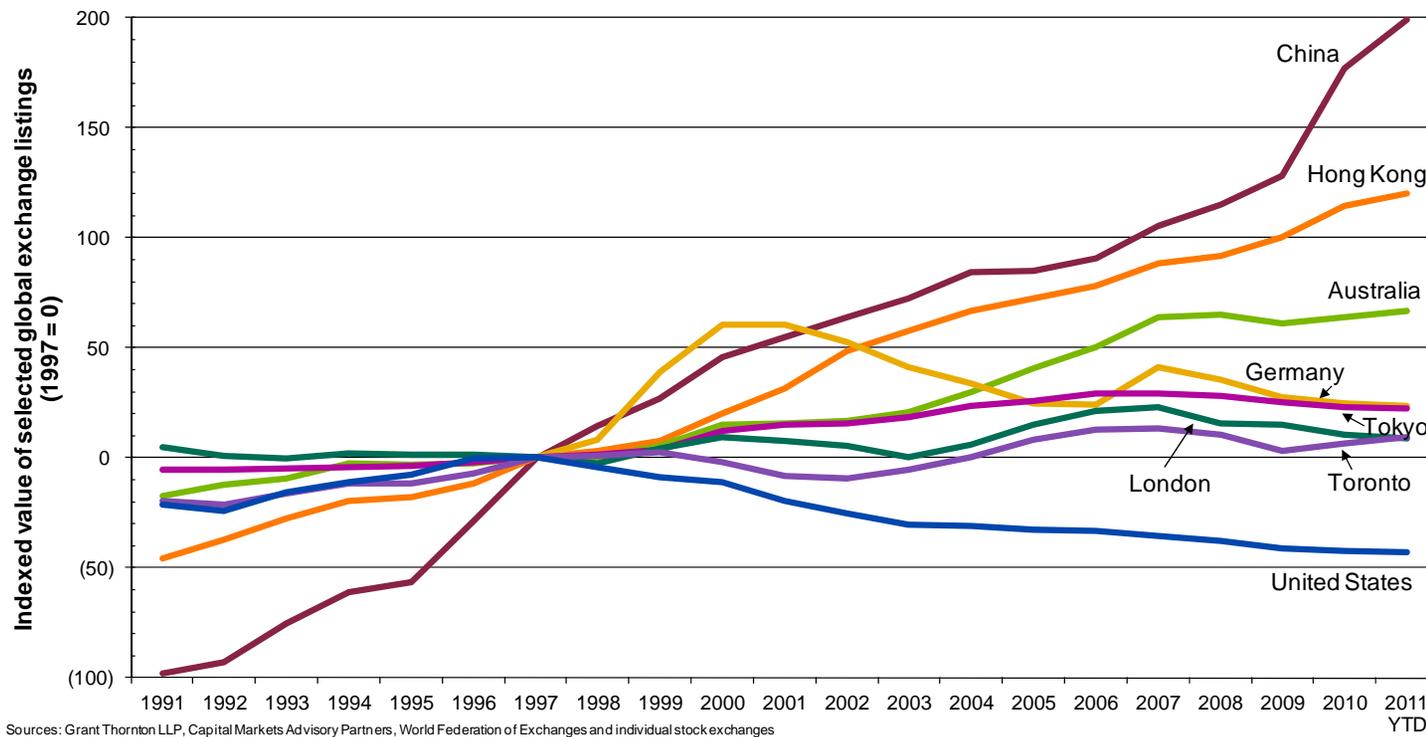
Smaller tick sizes undermined U.S. small-company IPOs



Sources: Grant Thornton LLP, Capital Markets Advisory Partners, Dealogic
Data includes corporate IPOs as of Dec. 31, 2011, excluding funds, REITs, SPACs and LPs

U.S. lost listed companies every year since 1997

Earlier Version From *A wake up call for America* (November 2009)

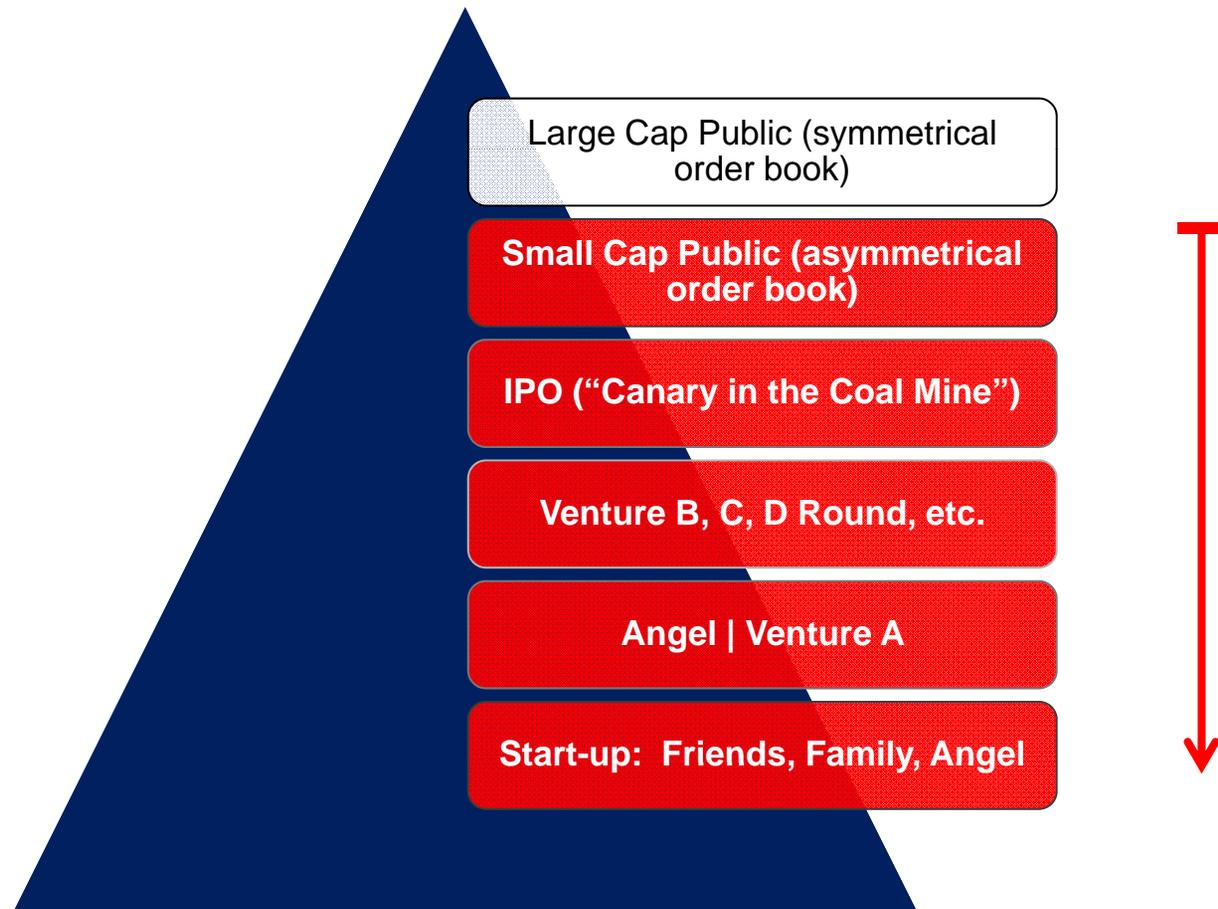


*March 16, 2011; House Financial Services Committee "Hearing on Legislative Proposals to Promote Job Growth, Capital Formation and Market Certainty"

statement by David Weild

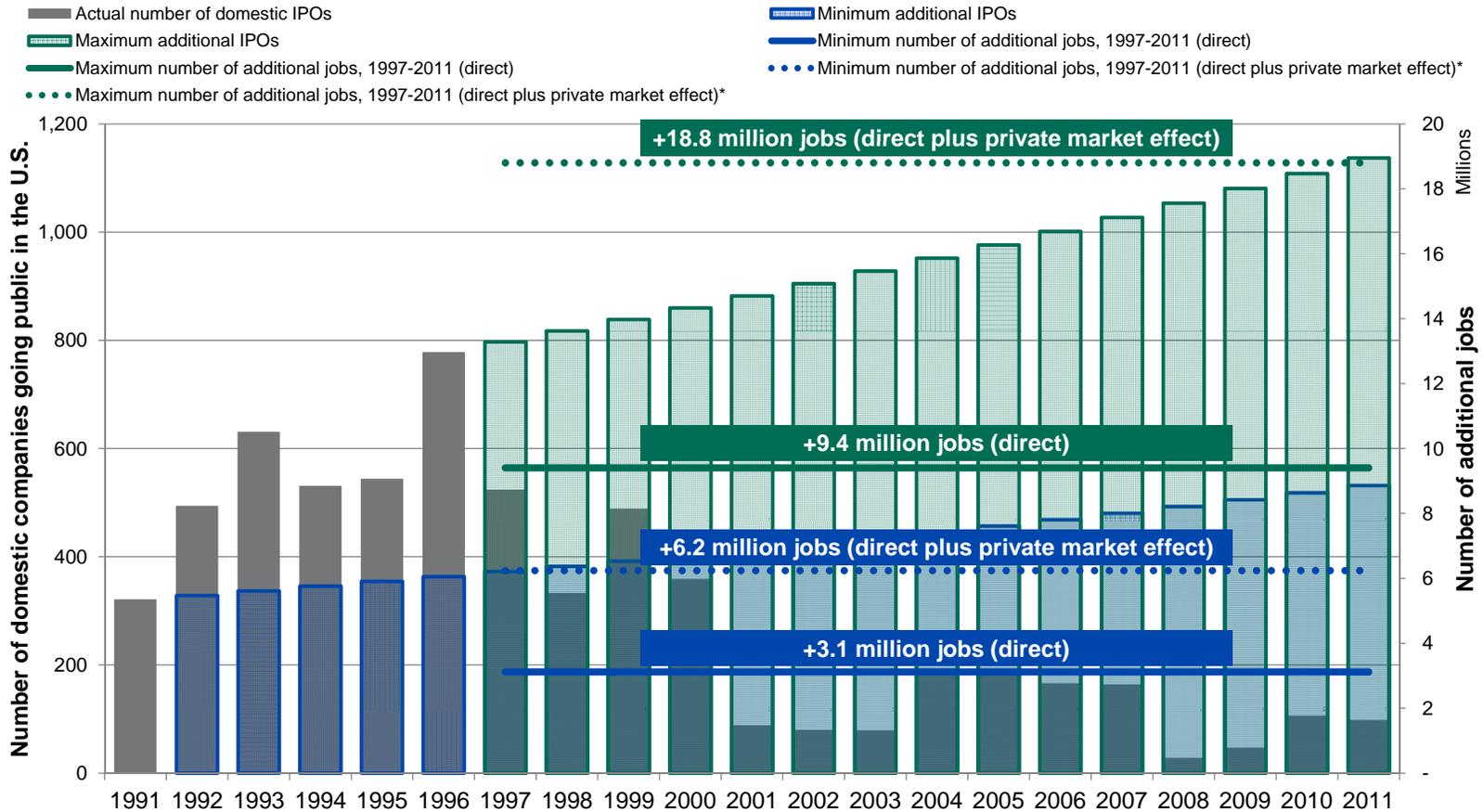
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Erosion of small cap support creates a “Domino Effect” that rips through the IPO venture and start-up markets.



Major contributor to unemployment

Earlier Version From *A wake up call for America* (November 2009)



*Best estimate of the multiplier effect in the private market of more companies going public.

Sources: Grant Thornton LLP, Dealogic and the U.S. Department of Commerce Bureau of Economic Analysis

Data include domestic corporate companies going public in the U.S. as of December 31, 2011, excluding funds, REITs and other trusts, SPACs and LPs. Assumes an annual growth rate of 2.57% (U.S. real GDP growth from 1991-2011) and 822 jobs created on average post-IPO (see "Post-IPO Employment and Revenue Growth for U.S. IPOs," *Kauffman Foundation*).

IPO aftermarket profitability eroded

So IPO focus is shifted on the offering itself to the exclusion of the aftermarket

IPO Economics: Pre- & Post-decimalization

	1997	2007
Deal Size	\$ 25,000,000	\$ 25,000,000
Number of Managers	2	5
Bookrunner / Senior Manager's Revenue		
Transaction	\$ 840,000	\$ 560,000
Aftermarket	\$ 1,680,000	\$ (56,000)
Total Revenue	\$ 2,520,000	\$ 504,000
Deal Size Needed in 2007 to Achieve Economics Equivalent to 1997		\$ 125,000,000

Source: Capital Markets Advisory Partners LLC and Grant Thornton LLP

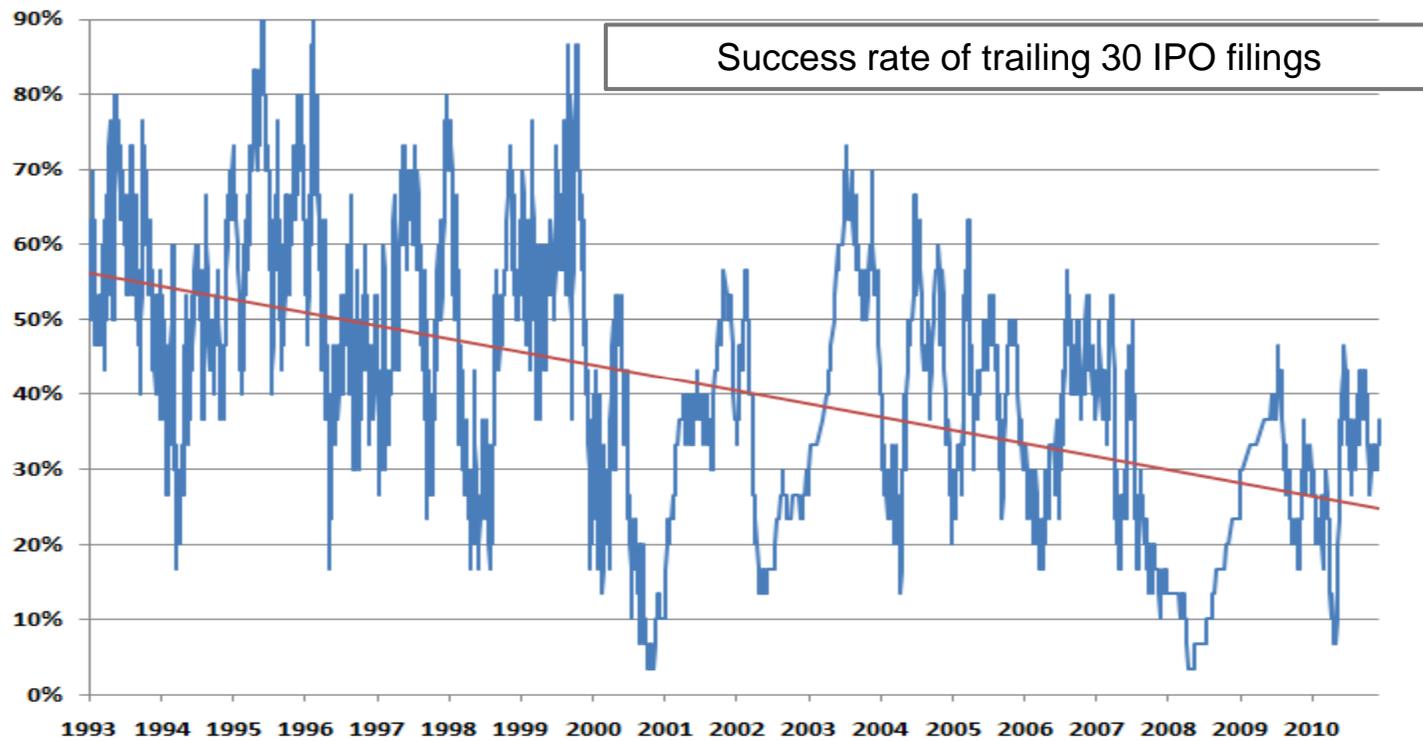
Source: Capital Markets Advisory Partners

Tick sizes and electronic execution undermined the sub \$2 billion market cap market and associated ecosystem.

Small capitalization companies and capital formation			
	Before 1997	After 2001	% change
Tick sizes	\$0.25 per share	\$0.01 per share	-96%
Investment banks (acting as bookrunner)	167 (1994)	39 (2006)	-77%
Small company IPOs	2,990 (1991-1997)	233 (2001-2007)	-92%

IPO success rates (Systemic failure)

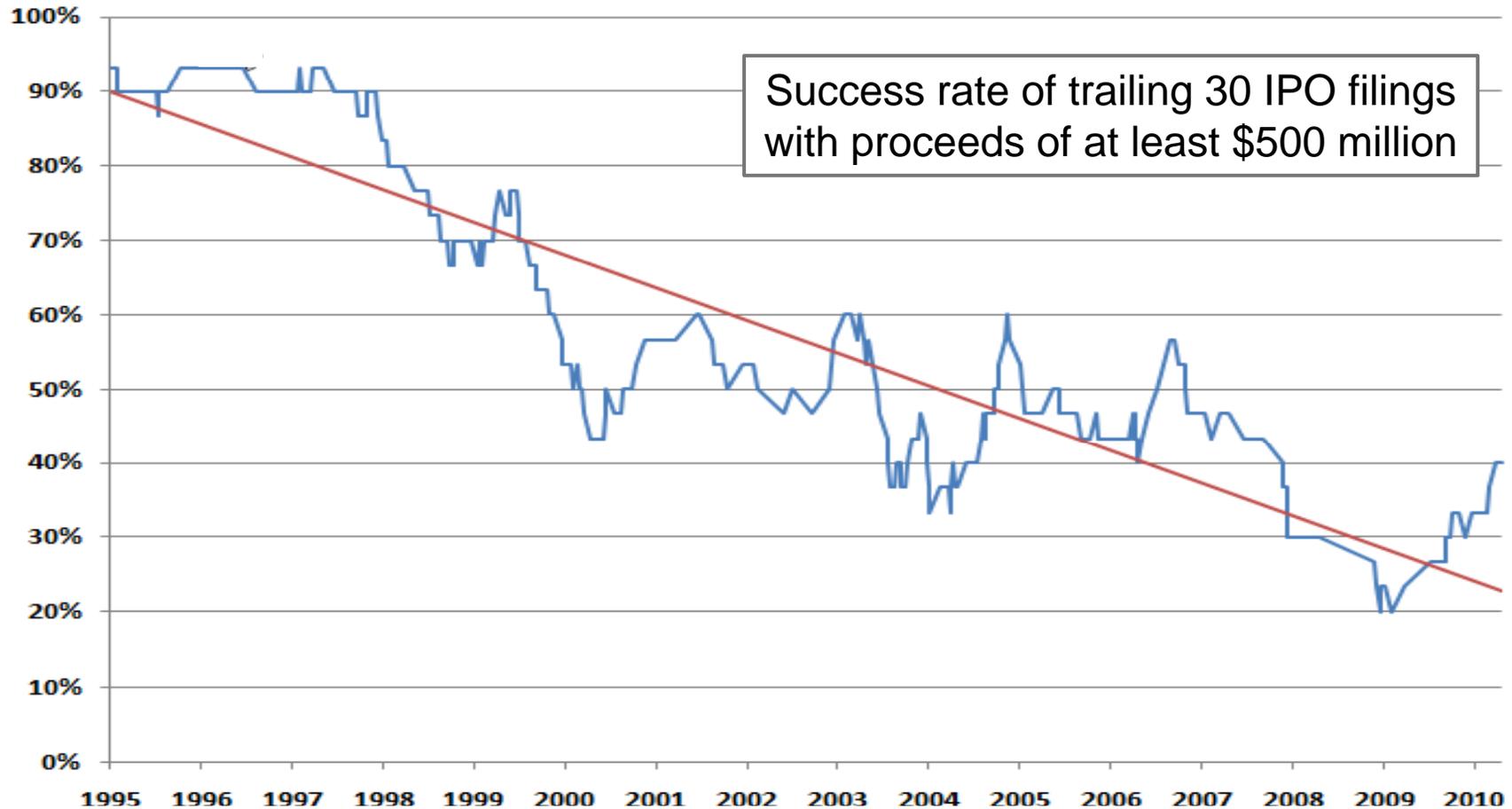
Steady declines (Unpublished data)



Source: Capital Markets Advisory Partners, LLC, All rights reserved
Includes only corporate issuers. Excludes funds, MLPs, SPACs and REITs.

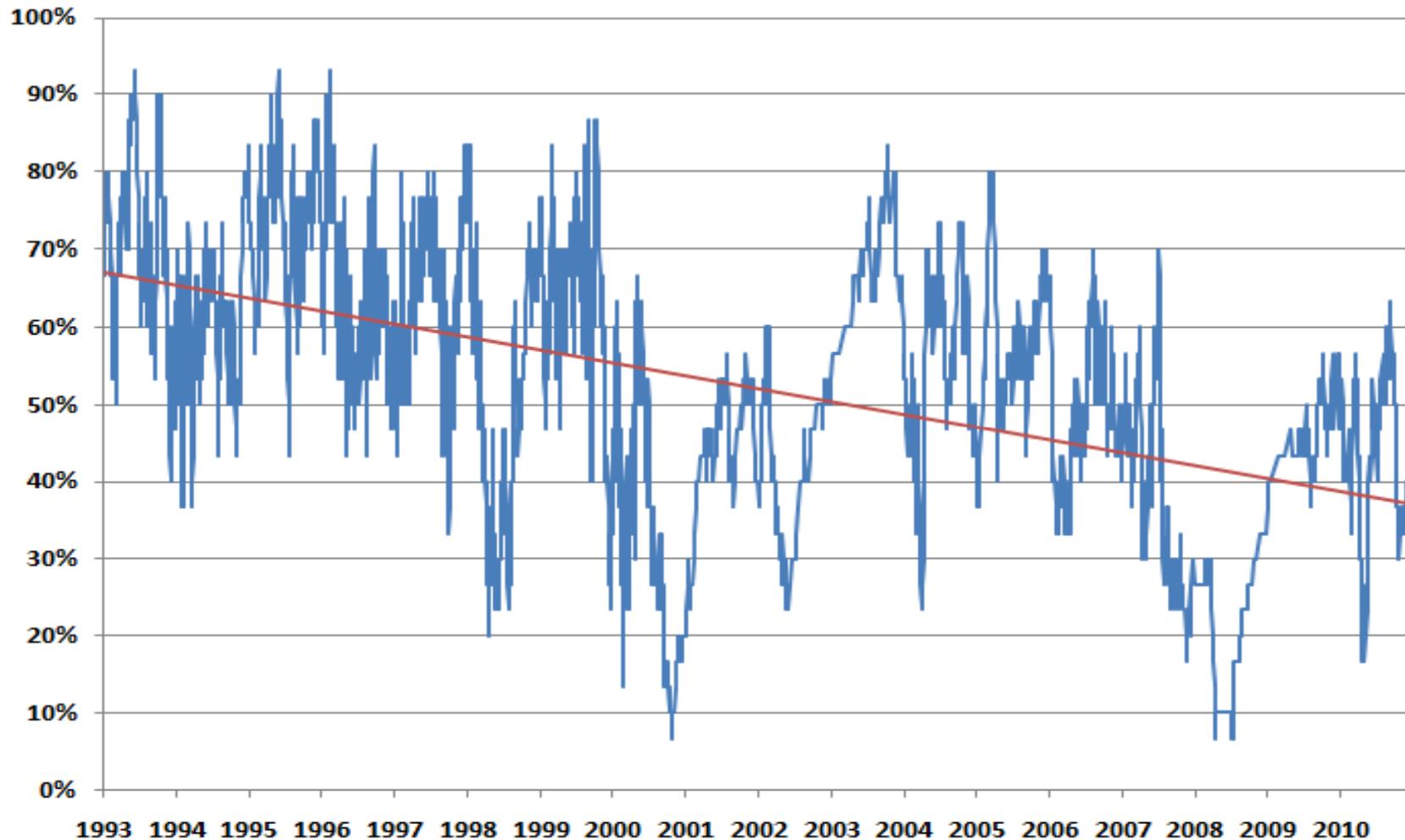
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IPOs > \$500 million have demonstrated the steepest decline of all



Source: Capital Markets Advisory Partners, LLC, All rights reserved
Includes only corporate issuers. Excludes funds, MLPs, SPACs and REITs.

IPOs that are trading at or above issue price 30 days after pricing—trailing 30 filings



Source: Capital Markets Advisory Partners, LLC, All rights reserved
Includes only corporate issuers. Excludes funds, MLPs, SPACs and REITs.

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Shift away from fundamental investing

Winners and Losers as we migrated from high cost/high touch to low cost/low touch stock markets

Winners		Losers	
<ul style="list-style-type: none"> • Speculators • Big investment banks • Hedge funds • Day traders • Electronic trading • Volatility 	<ul style="list-style-type: none"> • Trading-oriented institutions • Dark pools • Big company acquirers • Asia 	<ul style="list-style-type: none"> • Small companies • Entrepreneurs • Private enterprise • Small investment banks • Venture capital • Market-makers • Stockbrokers (advice) • New issue distribution 	<ul style="list-style-type: none"> • Equity research • IPOs • Institutional liquidity in small cap stocks • Transparency in small cap stocks • Long-term investors • The United States

Only 6.6% of listed company market value is for companies under \$2 billion in market value



Sources: Grant Thornton LLP, Capital Markets Advisory Partners, Capital IQ

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Tick Sizes: How do we pay for the "Ecosystem?"

Importance of "Tick sizes," Commissions and Trading Spreads

Economic infrastructure supporting U.S. capital markets

Stakeholders:

- **Roads** — Trade execution venues, such as NYSE, NASDAQ, Direct Edge, Liquidnet
- **On-ramps** — Investment banks
- **Bridges** — Market-makers (firms ready to buy/sell stocks continually) committing capital
- **Tunnels** — Analyst and broker support to investors

Economic incentives:

- **Tolls** — Tick sizes and commissions that support the market's operations and upkeep

Microsoft IPO: \$58,695,000 March 13, 1986

Underwriter Table from Final Prospectus **116 Underwriters (p. 1 of 3)**

<u>Underwriter</u>	<u>Number of Shares</u>	<u>Underwriter</u>	<u>Number of Shares</u>
Goldman, Sachs & Co.....	440,500	Kleinwort, Benson Incorporated.....	15,000
Alex. Brown & Sons Incorporated.....	440,500	Ladenburg, Thalmann & Co. Inc.....	15,000
ABD Securities Corporation.....	15,000	Cyrus J. Lawrence Incorporated.....	6,000
Advest, Inc.....	15,000	Lazard Frères & Co.....	42,000
Allen & Company Incorporated.....	15,000	Legg Mason Wood Walker Incorporated.....	15,000
Arnhold and S. Bleichroeder, Inc.....	15,000	McDonald & Company.....	15,000
Robert W. Baird & Co. Incorporated.....	15,000	Merrill Lynch, Pierce, Fenner & Smith Incorporated.....	42,000
Baker, Watts & Co.....	6,000	Montgomery Securities.....	42,000
Banque de Neuflyze, Schlumber, Mallet.....	15,000	Moore & Schley Capital Corporation.....	6,000
Barclays Merchant Bank Limited.....	6,000	Morgan Grenfell & Co. Limited.....	15,000
Bateman Eichler, Hill Richards Incorporated.....	15,000	Morgan Keegan & Company, Inc.....	6,000
Bear, Stearns & Co. Inc.....	42,000	Morgan Stanley & Co. Incorporated.....	42,000
Sanford C. Bernstein & Co., Inc.....	15,000	Moseley, Hallgarten, Estabrook & Weeden Inc.....	15,000
Birr, Wilson & Co., Inc.....	6,000	Needham & Company, Inc.....	6,000
William Blair & Company.....	15,000	Neuberger & Berman.....	6,000
Blunt Ellis & Loewi Incorporated.....	15,000	W. H. Newbold's Son & Co., Inc.....	6,000
Boettcher & Company, Inc.....	15,000	Newhard, Cook & Co. Incorporated.....	6,000
J. C. Bradford & Co., Incorporated.....	15,000	The Nikko Securities Co. International, Inc.....	6,000
Brean Murray, Foster Securities Inc.....	6,000	Nomura Securities International, Inc.....	6,000
Butcher & Singer Inc.....	15,000	The Ohio Company.....	15,000
Cable, Howse & Ragen.....	42,000	Oppenheimer & Co., Inc.....	15,000
Carolina Securities Corporation.....	6,000	PaineWebber Incorporated.....	42,000

Source: Microsoft IPO Final Prospectus, Capital Markets Advisory Partners, LLC.

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Microsoft IPO: \$58,695,000 March 13, 1986

Underwriter Table from Final Prospectus **116 underwriters (p. 2 of 3)**

Cazenove Inc.....	6,000	Parker/Hunter Incorporated.....	6,000
The Chicago Corporation.....	6,000	Pictet & Cie.....	6,000
Cowen & Co.....	15,000	Piper, Jaffray & Hopwood Incorporated.....	15,000
Credit Commercial de France.....	15,000	Prescott, Ball & Turben, Inc.....	15,000
Dain Bosworth Incorporated.....	15,000	Prudential-Bache Securities Inc.....	42,000
Daiwa Securities America Inc.....	6,000	Rauscher Pierce Refsnes, Inc.....	15,000
D.A. Davidson & Co. Incorporated.....	6,000	Raymond, James & Associates, Inc.....	6,000
Deutsche Bank Capital Corporation.....	15,000	Robertson, Colman & Stephens.....	42,000
R. G. Dickinson & Co.....	6,000	The Robinson-Humphrey Company, Inc.....	15,000
Dillon, Read & Co. Inc.....	42,000	Rotan Mosle Inc.....	15,000
Doft & Co., Inc.....	6,000	Rothschild Inc.....	15,000
Donaldson, Lufkin & Jenrette Securities Corporation.....	42,000	L. F. Rothschild, Unterberg, Towbin, Inc.....	42,000
Drexel Burnham Lambert Incorporated.....	42,000	R. Rowland & Co., Incorporated.....	6,000
Eberstadt Fleming Inc.....	15,000	Sal. Oppenheim Jr. & Cie.....	6,000
A. G. Edwards & Sons, Inc.....	15,000	Salomon Brothers Inc.....	42,000
Eppler, Guerin & Turner, Inc.....	15,000	J. Henry Schroder Wagg & Co. Limited.....	15,000
EuroPartners Securities Corporation.....	15,000	Seidler Amdec Securities Inc.....	6,000
First Albany Corporation.....	6,000	Shearson Lehman Brothers Inc.....	42,000
The First Boston Corporation.....	42,000	Sogen Securities Corporation.....	15,000
First Manhattan Co.....	6,000	Stephens Inc.....	15,000
First Southwest Company.....	15,000	Stifel, Nicolaus & Company, Incorporated.....	15,000
Furman Selz Mager Dietz & Birney Incorporated.....	15,000	Sutro & Co. Incorporated.....	15,000

Source: Microsoft IPO Final Prospectus, Capital Markets Advisory Partners, LLC.

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Microsoft IPO: \$58,695,000 March 13, 1986

Underwriter Table from Final Prospectus **116 underwriters (p. 3 of 3)**

Furman Selz Mager Dietz & Birney Incorporated.....	15,000	Sutro & Co. Incorporated.....	15,000
Gruntal & Co., Incorporated.....	15,000	Swergold, Chefitz & Sinsabaugh, Inc.....	6,000
Hambrecht & Quist Incorporated.....	42,000	Swiss Bank Corporation International Securities Inc.....	15,000
Hill Samuel & Co. Limited.....	15,000	Thomson McKinnon Securities Inc.....	15,000
J. J. B. Hilliard, W. L. Lyons, Inc.....	6,000	Tucker, Anthony & R. L. Day, Inc.....	15,000
Hoare Govett Limited.....	6,000	UBS Securities Inc.....	15,000
Howard, Weil, Labouisse, Friedrichs Incorporated.....	15,000	Underwood, Neuhaus & Co. Incorporated.....	15,000
E. F. Hutton & Company Inc.....	42,000	Vereins-und Westbank A.G.....	6,000
Interstate Securities Corporation.....	15,000	Wedbush, Noble, Cooke, Inc.....	6,000
Investment Corporation of Virginia.....	6,000	Wertheim & Co., Inc.....	42,000
Janney Montgomery Scott Inc.....	15,000	Wheat, First Securities, Inc.....	15,000
Johnson, Lane, Space, Smith & Co., Inc.....	6,000	Dean Witter Reynolds Inc.....	42,000
Johnston, Lemon & Co. Incorporated.....	6,000	Yamaichi International (America), Inc.....	6,000
Josephthal & Co. Incorporated.....	15,000	Total.....	<u>2,795,000</u>
Kidder, Peabody & Co. Incorporated.....	42,000		

Source: Microsoft IPO Final Prospectus, Capital Markets Advisory Partners, LLC.

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LinkedIn IPO: \$352,800,000 May 18, 2011

Underwriter Table from Final Prospectus **5 underwriters**

	<u>Number of Shares</u>
Morgan Stanley & Co. Incorporated	3,684,800
Merrill Lynch, Pierce, Fenner & Smith Incorporated	1,411,200
J.P. Morgan Securities LLC	1,411,200
Allen & Company LLC	940,800
UBS Securities LLC	392,000
Total:	<u><u>7,840,000</u></u>

The Issuer (Job Creators) Bill of Rights

June 5, 2012 – NIRI (Clear support from 200+ audience of IR professionals)

We call on the SEC and Congress to provide Issuers (Job Creators) with:

1. **Equal Standing** (Issuers must have equal input to the trade execution community on market structure)
2. **Representation** (A standing issuer advisory council to the SEC made up of issuers and issuer advocates)
3. **Transparency , Timeliness & Completeness** (Issuers deserve real-time trading and ownership data – All Long and Short activity)
4. **Choice in Market Structure** (No more one-size-fits all market structure)
5. **Market Structures that Encourage Fundamental Investment Strategies Over Trading Strategies**

SEC should allow issuers to choose their own tick sizes from 1 cent to 25 cents!¹

- Mass customization of micromarkets
- Gives managements a voice and a seat at the table
- Management will need to respond to market forces (investor pressures, investment bank pressures)
- Enables expansion of research, sales and trading support to more small companies
 - increased visibility of small, unknown brands to investors
 - growth in small IPOs
 - support of large IPOs in the aftermarket
 - growth in the economy
 - management will become engaged in the market structure debate

1. SEC need to control rebates and executions within the spread to keep volume from migrating to dark pools and siphoning off revenue intended to fund the "value components" of research, sales support and capital commitment.

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- International scope and standards adherence
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- Demonstrated capital markets experience
- Global IPO readiness capabilities



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- History of innovation and entrepreneurship in capital markets
 - Principals invented/created:
 - Market Intelligence Desk (NASDAQ)
 - Capped-Jump Ball Pots (Prudential Securities)
 - Accelerated Book Build Transactions (Prudential Securities – ROCS)
 - Incentive Underwriting Structures (Prudential Securities – Closed-end funds)
 - First Algorithmic Allocation Systems (Prudential Securities – CAMP)
- We make issuers the best they can be in capital markets



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- Small Business Crisis Task Force
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