

Initial Public Offerings of Common Stock: The Role of Regional Broker-Dealers in the Capital Formation Process



U.S. Small Business
Administration

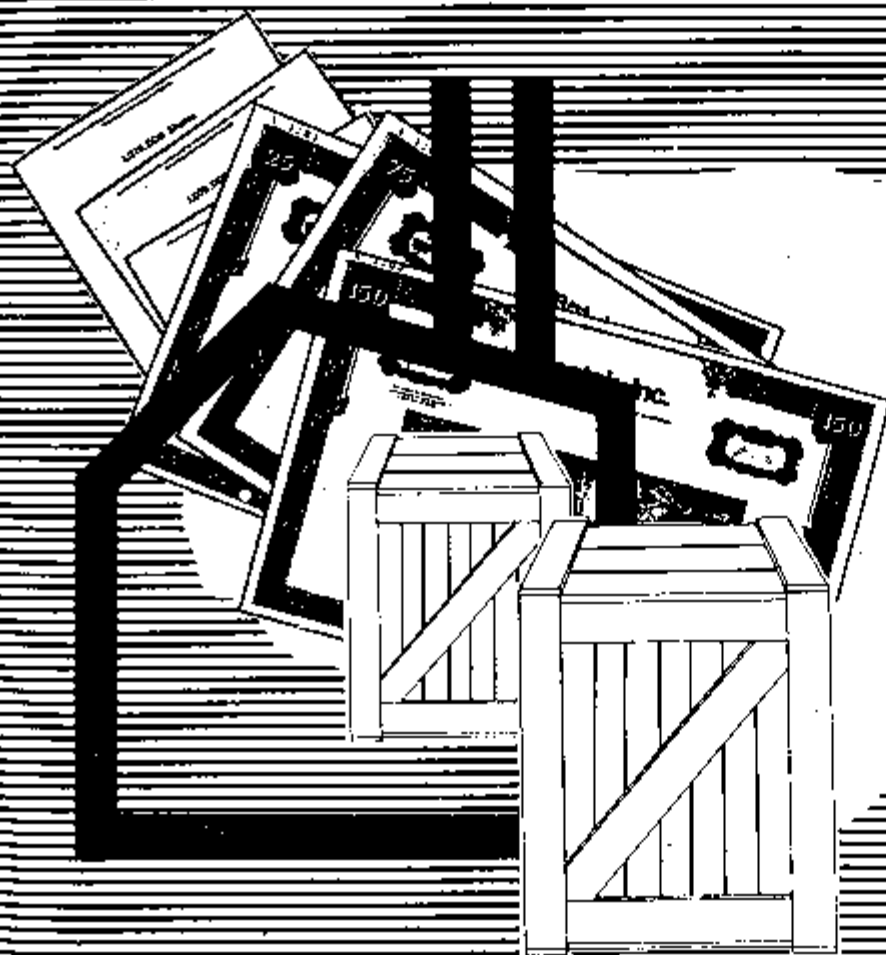
Office of the
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U.S. Securities
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Directorate of
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Policy Research

Phase I
Report

March 1980



INITIAL PUBLIC OFFERINGS OF COMMON STOCK:
THE ROLE OF REGIONAL BROKER-DEALERS IN
THE CAPITAL FORMATION PROCESS

PHASE I

March 1980

This study has been prepared by the Directorate of Economic and Policy Research, U.S. Securities and Exchange Commission, pursuant to an interagency agreement, dated October 1, 1979, between the Commission and the U.S. Small Business Administration. Phase I of the study is limited in scope to certain preliminary elements of the research proposal. A final report encompassing all research elements will be presented upon completion of the project in September 1980. ←

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PREFACE

This report represents Phase I of the Small Business Administration's and the Securities and Exchange Commission's joint research effort to examine the role of regional broker-dealers in the capital formation process.

The research for Phase I of this report was conducted by Joseph A. Meiburger, Jr. and Jeffrey A. Burian of the Commission's staff. Operations research assistance was provided by Charles B. Hallahan and statistical assistance by Phyllis Shumans. Research assistance was provided by Earveta Bizzell, Antonee Black, Andrew Dresner, Harold Ognelodh, Janet Pennington and Christopher Young. Many drafts were ably typed by Ruth Bognovitz. The advice of Professor Alfred E. Osborne, Jr. has been valuable throughout the project. We are extremely grateful to Milton D. Stewart, Jerry Feigen and Robert Berney of the Office of the Chief Counsel for Advocacy of the Small Business Administration for their continued support and assistance.

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8/10/82

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PHASE I REPORT

March 1980

Executive Summary

This Phase I Report presents the initial research findings of a joint project of the Small Business Administration and the Securities and Exchange Commission, pursuant to an interagency agreement, dated October 1, 1979, to examine certain aspects of the capital formation process as it relates to the first offering of a corporation's common stock to the public. This Report examines the period from January 1, 1972 through June 30, 1979 and provides summary information regarding the volume of initial public offerings, certain characteristics of the issuing corporations and the portion of the total volume managed by national broker-dealers and regional broker-dealers in this period. The information in this report appears to fill a gap in the capital formation literature and is intended to provide basic information which may be useful in the continuing policy-oriented discussions of the capital formation issue. Summary financial data regarding managing underwriters is also presented. The principal research findings are:

- Regional broker-dealers managed 78% of the initial public offerings distributed by managing underwriters between January 1, 1972 and June 30, 1979, accounting for 48% of the \$2.9 billion raised in broker-dealer managed initial public offerings in this period.
- Regional underwriters tend to manage the offerings of smaller issuers. Of the initial public offerings of corporations with less than \$10 million in annual revenues, 91% were managed by regional broker-dealers, and 73% of these smaller issuers' gross proceeds was raised in offerings managed by regional broker-dealers.

- The issues managed by national broker-dealers were nearly four times the size of the issues managed by regional underwriters. Thus, national broker-dealers raised 52% of the issuer gross proceeds while managing 22% of the initial public offerings in this period.
- Regional broker-dealers managed 124 of the 155 high technology issues during this period, raising 60% of these issuers' gross proceeds. Since 1976, however, issues managed by national broker-dealers have raised 50% of the gross proceeds raised for high technology enterprises.
- The level of concentration in the initial public offering market has declined since 1972 in spite of the substantial volume decline since that year. In 1972 the largest 10% of the managing underwriters managed 54% of total dollar volume. Since 1977 these percentages have ranged from 34% to 37%.
- The raising of the ceiling for issues exempt under Regulation A to \$1,500,000 in 1978 appears to have resulted in more underwritten offerings of these issues, though the evidence is not conclusive.

Phase II of the project will examine evidence of a relationship between the decline in the volume of initial public offerings and changes in the structure of the securities industry. Further research pursuant to the interagency agreement will examine the Phase I data in detail and extend the analysis of the capital formation role of regional broker-dealers to include their post-initial public offering securities research and marketmaking activities.

U.S. Small Business
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Directorate of Economic
and Policy Research

INTRODUCTION

This Phase I Report presents the initial research findings of a joint project of the Small Business Administration ("SBA") and the Securities and Exchange Commission ("Commission"), pursuant to an interagency agreement, dated October 1, 1979, to examine certain aspects of the capital formation process as it relates to the first offering of a corporation's common stock to the public. 1/ This Report examines the period from January 1, 1972 to June 30, 1979 and provides summary information regarding the volume of initial public offerings ("IPO's") which were managed by national broker-dealers ("National Broker-Dealers") and regional broker-dealers ("Regional Broker-Dealers") in this period. 2/3/ Summary

- 1/ Other aspects of capital formation activity, such as private offerings pursuant to Section 4(2) of the Securities Act of 1933 and Rule 146 promulgated thereunder, are beyond the scope of this Report.
- 2/ An initial public offering is defined, for purposes of this Report, as an offering for cash involving the registration of common stock (or securities units including common stock) with the Commission pursuant to the Securities Act of 1933 by a corporation not subject to the Commission's disclosure requirements pursuant to the Securities Exchange Act of 1934 and the rules promulgated thereunder. For purposes of this Report, the term does not include the offering of debt securities or preferred stock convertible into common stock, or unit offerings which include common stock when the value of the common stock cannot be identified separately. Shares of beneficial interest in real estate investment trusts and investment company shares are also excluded. The term initial public offering also excludes 62 issues aggregating approximately \$220,000,000 for which complete data was not available. Offerings exempt from registration under Regulation A are excluded from the definition of initial public offering but are examined separately in this Report.
- 3/ Regional Broker-Dealers are defined for purposes of this Report as (i) 125 firms which are members of the New York
(Footnote continued)

data regarding managing underwriters ("Managing Underwriters") is also presented. ^{4/} Further research pursuant to the inter-agency agreement will examine this data in detail and extend the analysis of the capital formation role of Regional Broker-Dealers to include their post-offering securities research and marketmaking activities with regard to IPO's.

The effective registration statements filed by IPO issuers with the Commission, Form SR and Form 10-K have been used as the source documents to identify IPO's and underwriting volume, and

(Footnote continued)

Stock Exchange ("NYSE") and classified in certain categories developed jointly by the Commission staff and the Securities Industry Association ("SEC-SIA Categories") in 1979; (ii) all members (114 firms) of the National Association of Securities Dealers, Inc. ("NASD") which are not NYSE Members and are headquartered outside New York City; (iii) 45 New York City based Firms which are NASD members but are not NYSE members; and (iv) certain NYSE Members (6 firms) which are not classified in the Regional Broker-Dealer SEC-SIA Categories but which, in the judgment of the Commission staff, are Regional Broker-Dealers. Specifically, these SEC-SIA Categories are: Small Regional Firms, Medium Regional Firms, Large Regional Firms, Small New York City Based Firms, and Large New York City Based Firms. See SIA Trends, June 26, 1979, Appendix I.

National Broker-Dealers are defined for purposes of this Report as (i) 43 NYSE Members who are classified as National Full Line Firms, Large Investment Banking Houses or Institutional Firms according to the SEC-SIA Categories; and (ii) two NYSE Member firms and one NASD member firm that are not classified in the National Broker-Dealer SEC-SIA Categories but which, in the judgment of the Commission staff, are National Broker-Dealers.

^{4/} The term "Managing Underwriter" for purposes of this Report is defined as a broker-dealer which is designated as manager in the IPO registration statement. Such term includes both a broker-dealer acting as an underwriter in a firm commitment underwriting, as well as a broker-dealer acting in an agency capacity in a best efforts distribution.

thus the relative importance, of National Broker-Dealer and Regional Broker-Dealer firms as Managing Underwriters of IPO's. 5/6/ In this Report, if an IPO has more than one Managing Underwriter, the lead Managing Underwriter ("Lead Managing Underwriter") has been treated as the only Managing Underwriter. 7/ The Financial and Operational Combined Uniform Single Report ("FOCUS Report"), which each broker-dealer is required to file quarterly with the Commission, is this Report's source document for financial data concerning Managing Underwriters. 8/

- 5/ Form SR is a form IPO issuers are required to file with the Commission within 10 days after the end of the first 3-month period following the effective date of the IPO, reporting sales of the registered securities and the application of the proceeds of such sales. Form 10-K is an annual reporting form which issuers subject to the disclosure requirements of the Securities Exchange Act of 1934 are required to file with the Commission.
- 6/ The role of Managing Underwriters in securities syndicates is discussed in Samuel L. Hayes, III, "Investment Banking: Power Structure in Flux," Harvard Business Review (March-April 1971), pp. 136-152. See also Samuel L. Hayes, III, "Evolving Competition in Investment Banking," Working Paper, Graduate School of Business Administration Harvard University, Boston, Massachusetts (October 16, 1978).
- 7/ When an issue is co-managed, the Lead Managing Underwriter is assumed to be the Managing Underwriter listed first in the underwriting syndicate in the registration statement. In future research, multiple Managing Underwriters will each be given partial credit as Managing Underwriters and the members of the syndicate will be examined so that the syndicates themselves can be characterized as being national or regional.
- 8/ Broker-dealers provide certain quarterly income statement and balance sheet information as a part of the FOCUS Report. See Securities Exchange Act Release No. 11935 (December 7, 1975).

The Volume of IPO's

As Table 1 indicates, the volume of IPO's has declined dramatically since 1972. While a decline in the number of IPO's might be expected when market conditions in general deteriorate, as they did in 1973 and 1974, the recovery since 1974 in the common stock offerings of corporations already publicly held has not been accompanied by a corresponding recovery in IPO's. The data presented in Table 1 served as a stimulus for the initiation of this Report.

Recent Commission Actions

The Commission recently made two changes in its registration requirements which may facilitate capital formation for small businesses, consistent with the protection of investors. First, the Commission adopted a simplified registration form, Form S-18, in April 1979. ^{9/} Second, in September 1978 the Commission increased the aggregate offering price of securities which may be sold under Regulation A during any 12-month period from \$500,000 to \$1,500,000. ^{10/} In addition, the Commission

^{9/} Securities Act Release No. 6049 (April 3, 1979). See also U.S. Securities and Exchange Commission (Directorate of Economic and Policy Research) Form S-18: A Monitoring Report on Its Use in 1979 (March 1980). This Report indicates that all 23 broker-dealer managed IPO's on Form S-18 in 1979 were managed by Regional Broker-Dealers.

^{10/} Securities Act Release No. 5977 (September 11, 1978). This amendment followed legislation raising the aggregate amount of exempt offerings specified in Section 3b of the Securities Act of 1933 to \$2,000,000.

Table 1

COMMON STOCK OFFERINGS BY PUBLICLY HELD
CORPORATIONS AND BY IPO ISSUERS
1972-1979

(Millions of Dollars)

Year	Publicly Held Corporations <u>1/2/</u>	Index (1972=100)	IPO Offerings <u>2/3/</u>	Index (1972=100)
1972	\$10,707	100	\$2,051	100
1973	7,643	71	295	14
1974	3,976	37	42	1
1975	7,413	69	38	2
1976	8,305	78	128	6
1977	8,047	75	99	5
1978	7,956	74	177	9
1979 (6 mos.)	3,977	74	179	9
Totals	\$58,024		\$3,009	

1/ Amount of securities offered for sale, including IPO offering volume and offerings of closed-end investment companies.

2/ Includes both primary and secondary portions of offerings.

3/ Actual amount sold.

Source: IPO Registration Statements, Form SR, Form 10-K,
SEC Statistical Bulletin
Directorate of Economic and Policy Research
Securities and Exchange Commission

adopted an amendment to Regulation A permitting the use of a preliminary offering circular prior to the date on which the securities may be sold in an offering which is to be sold by or through one or more broker-dealers registered under Section 15 of the Securities Exchange Act of 1934. 11/ These changes may make participation in Regulation A offerings more attractive to broker-dealers.

Structure of the Report

This Phase I Report is organized into four chapters. Chapter 1 reviews certain prior research concerning small business capital formation. Chapter 2 presents statistical data describing certain specified characteristics of IPO issuers. Chapter 2 also identifies the number of issues and dollar volume managed by Regional Broker-Dealers and National Broker-Dealers and, in addition, provides data pertaining to the issuers using the Regulation A exemption. Summary financial data for various groups of Managing Underwriters is presented in Chapter 3, with the Managing Underwriters of Regulation A offerings described separately. Chapter 4 concludes this Phase I Report with a description of planned future research of the project.

11/ Securities Act Release No. 6075 (June 1, 1979).

Chapter 1

A REVIEW OF PRIOR RESEARCH

This chapter reviews published research studies of the problems of small business capital formation, particularly several recent, public policy-oriented, studies. The purpose of this Chapter is to place into a larger context the data presented in the following two Chapters. The information presented in this Phase I Report appears to fill an existing gap in the literature, since the size and business activity of IPO issuers and the role of Regional Broker-Dealers as Managing Underwriters appears to have been examined only on a limited basis.

The Commission twice extensively examined IPO's in the 1960's. 12/ Eight separate studies of flotation costs have also been published by the Commission, the earliest comparing the costs of flotation for small issues before and after the enactment of the Securities Act of 1933. 13/

12/ See Securities and Exchange Commission, Report of the Special Study of Securities Markets of the Securities and Exchange Commission, April 3, 1963. Chapter IV, pp. 481-739, examines primary and secondary distributions to the public. See also Securities and Exchange Commission, Institutional Investor Study Report of the Securities and Exchange Commission, March 10, 1971. Chapter XIV, pp. 2333-2529, analyzes institutional participation in new equity financings.

13/ See Securities and Exchange Commission, Cost of Flotation for Small Issues, 1925-1929 and 1935-1938 (May 1940).

The Research Bibliography contained herein enumerates published works in the academic literature which describe the underwriting process and empirical studies of the number and value of new issues and the costs of entering the capital markets. This literature, however, examines the efficiency of the securities markets, rather than the characteristics of IPO issuers or Managing Underwriters. The academic literature, which is of greater relevance to future research elements, will be reviewed as applicable in the Phase II Report.

The Small Business Life Cycle

Analysis of the size and business activity of IPO issuers is also nearly absent in the literature. 14/ The SBA published a generic description of a high-technology IPO issuer as part of its 1977 review of small business capital formation. 15/

The SBA Report views a growing and successful company as progressing through a number of life cycle phases. In the initial research and development phase, lasting perhaps three years, the enterprise usually has no revenue and is financed by the initial capital of the group of founding entrepreneurs.

14/ Two periodicals attempting to fill this gap include Venture Capital, Capital Publishing Corporation (Boston, Massachusetts) and Going Public: The Initial Public Offering Reporter, Howard & Company (Philadelphia, Pennsylvania).

15/ See Small Business Administration, Report of the SBA Task Force on Venture and Equity Capital for Small Business ("SBA Report"), January 1977, pp. 4-8.

According to the SBA Report, if the enterprise is well conceived it may approach breakeven operations at the end of its early growth phase, perhaps seven years after its start-up, with revenue in the neighborhood of \$2-\$10 million and cumulative private capital commitments of perhaps \$2-\$2.5 million. At this stage of accelerating growth, the firm's continuing need for risk capital may exhaust the resources of the entrepreneurs, venture capitalists and other private investors. The firm's future, however, may appear encouraging enough to attract capital from a new group of investors -- the general public. A securities brokerage firm often enters the picture at this point as a financial intermediary to distribute an IPO for the corporation. It has been asserted that Regional Broker-Dealers have traditionally dominated the capital raising effort for small businesses. 16/

For the economy as a whole, depreciation of assets, retention of after-tax profits, and issuance of new debt securities are each substantially more important sources of capital than the sale of new equity securities. 17/ For small and growing

16/ See NASD Report of the Joint Industry/Government Committee on Small Business Financing ("NASD Report"), May 22, 1979, Preface, p.1 and Chapter 7.

17/ Compare, for example, capital recovery via depreciation in the Senate Committee's Twenty-Ninth Annual Report, March 7, 1979, p. 62, with corporate after-tax profits, in Business Conditions Digest, Department of Commerce, monthly, Series 16, with gross proceeds from corporate debt and common stock offerings, in Statistical Bulletin, Securities and Exchange Commission, monthly, Series M-140 and M-170.

businesses, however, these sources are often unavailable or insufficient and periodic infusions of risk capital are usually required if the enterprise is to succeed. 18/ To the extent public equity financing is not available to small business, the growth of these firms, the jobs they create through their growth, as well as the innovation they stimulate in their industries and in the economy as a whole, may be inhibited. 19/

Examinations of Small Business Capital Formation

Given a description of the small business life cycle, the role of IPO's in the continued growth of these firms can be perceived. The SBA Report represented the first of a number of major policy-oriented examinations of the issues involved in small business capital formation. 20/ For example, the Subcommittee on Capital, Investment and Business Opportunities of the House Committee on Small Business examined these issues in mid-1977. 21/ In February 1978, the

18/ SBA Report, p. 6.

19/ The importance of small businesses as a source of innovation and employment growth in the economy is discussed by Edwin Zschau, before the Senate Select Committee on Small Business ("Senate Committee"), Capital Formation Hearings, February 8, 1978, p. 5.

20/ See particularly SBA Report, p. 15.

21/ See U.S. House of Representatives, Committee on Small Business, Subcommittee on Capital, Investment and Business Opportunities, Small Business Access to Equity and Venture Capital, May 12 and 18, 1977 and July 16, 1977.

Senate Committee began a series of hearings on small business capital formation. 22/

The Commission held 21 days of hearings (the "SEC Hearings") in six cities during the Spring of 1978 to examine the relationship between small business and Federal securities regulation. 23/ The NASD report was published in May 1979 and examined, among other policy problems, the decline in new issues in conjunction with the contraction in the broker-dealer community.

Testimony to the Senate Committee identified the nation's overall economic difficulties, a discouraging national tax policy regarding high risk investments, the growing institutionalization of the market, the development of investment alternatives to IPO's and the availability of alternatives to an IPO for issuers in a difficult market environment as five major factors contributing to the decline in the volume of IPO's since 1972.

Chairman Harold M. Williams of the Commission testified before the Senate Committee on September 21, 1978 on a number of issues, including the first factor, and stated that a

22/ See Senate Committee Capital Formation Hearings ("Senate Hearings"), Parts 1-4, February 8 and 10, 1978, May 15, 1978, September 21, 1978 and May 22, 1979.

23/ See Securities and Exchange Commission, Small Business Hearings and Proposed Form S-18, Commission File No. S7-734. See also Securities Act Release Nos. 5914 and 5915, March 15, 1978.

healthy and more predictably optimistic economy would tend to alleviate the capital formation problems caused by the small number of IPO's. 24/

Tax policy was identified as a second influential factor with regard to the IPO market by a variety of witnesses at the Senate Hearings. 25/ The 1969 increase in the capital gains tax rate was believed to have been a particularly important factor discouraging the growth of relatively risky venture capital investment. 26/

A third possible explanation for the low IPO volume identified at the Senate Hearings was the declining number of individual investors and the correspondingly greater dominance of the financial markets by institutions. 27/ This trend, coupled with fiduciary responsibilities under the Employee Retirement Income Security Act of 1974 ("ERISA"), tends to discourage institutional investors from taking positions in

24/ Senate Hearings, September 21, 1978, p. 606.

25/ See for example, the testimony of E. F. Heizer, Senate Hearings, September 21, 1978, p. 653. See also the testimony of John C. Whitehead, Senior Partner, Goldman Sachs & Co., Senate Hearings, February 10, 1978, p. 113.

26/ With the passage of the Revenue Act of 1978 (Public Law No. 95600), the effective maximum capital gains tax rate was reduced from 49% to 28%.

27/ See for example, the Senate Committee testimony of Chairman Williams, September 21, 1978 and John C Whitehead, Senior Partner, Goldman Sachs & Co., February 10, 1978, See also NASD Report, Chapter 7.

higher risk securities, and may have caused a relative shift in investor demand toward debt securities and more seasoned equity investments. 28/

The NASD Report, which was presented at the Senate Hearings, cited the introduction of new investment products as a fourth factor discouraging growth in the volume of IPO's. 29/ Exchange-listed stock options, as well as commodities and financial futures contracts, may be viewed as attractive alternatives to the purchase of new issues. The NASD Report suggested that these alternatives have tended to drain speculative investor funds from the IPO market. 30/

A fifth possible explanation for the decline in IPO volume is that to some extent acquisitions are now supplanting IPO's for smaller issuers. 31/ Acquisition by a large

28/ See Senate Committee testimony of Dan W. Lufkin, February 10, 1978, p. 136.

29/ NASD Report, p. 38.

30/ Ibid. In contrast, a Chicago Board Options Exchange ("CBOE") Study found the IPO market was already deteriorating in April 1973 when options trading began on the CBOE. See Sidney M. Robbins, Robert B. Stobaugh, Francis L. Sterling and Thomas H. Howe, The Impact of Exchange Traded Options on the Market for New Issues of Common Stock of Small Companies, Management Analysis Center, Cambridge, Massachusetts, June 10, 1977.

31/ See particularly, the opening statement of Senator Gaylord Nelson before the Senate Committee, February 8, 1978.

corporation may be a more attractive alternative to entrepreneurs and venture capitalists than the issuance of shares to the public at prices which could reasonably be expected in the current market environment. 32/

Possible Securities Industry Structural Barriers
to Small Business Capital Formation

Part of the explanation for the divergent pattern in Table 1 between IPO volume and the offerings of publicly held corporations, however, may be rooted in certain structural changes which have occurred during the decade of the 1970's in the securities industry. Few appraisals of the role of Regional Broker-Dealers in the securities industry have been published in recent years and these studies provide conflicting perspectives. The substantial decline in the number of smaller securities firms has been identified as an important factor contributing to the reduced IPO volume by a variety of commentators. 33/ As measured by the number of firms, the

32/ NASD Report, p. 3.

33/ See for example, testimony by John Whitehead, Senior Partner, Goldman, Sachs & Co. and Thomas I. Unterberg, General Partner, L. F. Rothschild, Unterberg Towbin, before the Senate Committee, February 10, 1978, and September 21, 1978, respectively. It is anticipated that the Phase II Report will examine in greater detail the interrelationships between the contraction in the securities industry and IPO activity.

(Footnote continued)

securities industry contracted substantially in the 1970's. The number of brokers registered with the NASD fell from 4,470 in 1970, to 2,813 in 1978, a decline of 37%. 34/ Changes in industry structure may have had an adverse effect on a particular aspect of industry performance -- the underwriting of IPO's. 35/

Besides possible securities industry structural barriers, other commentators have suggested that the costs of registering an IPO, particularly the legal, accounting and printing costs, may have risen in recent years and could be raising the size of the minimum feasible offering, creating a cost barrier

(Footnoted continued)

It is interesting to note that in the Commission's Staff Report on the Securities Industry in 1978 ("Staff Report"), the Commission indicated that the medium-sized group of regional firms headquartered outside New York City and the group of larger New York City based regional firms were both more profitable than either the National Full Line Firms or the Large Investment Banking Houses (as these groups are defined by the SEC-SIA Categories). The Staff Report also found, however, that in 1978 regional firms which are not NYSE members were notably less profitable than the NYSE member firms.

34/ See NASD Annual Reports, 1970-1979. Other measures of industry size indicate a less substantial contraction. The number of branch offices and registered representatives of NASD member firms, for example, each declined 9% from 1970 to 1978.

35/ See Samuel L. Hayes, III, "The Transformation of Investment Banking", Harvard Business Review (January-February 1979). See also NASD Report, pp. 39-43.

to capital formation for smaller issuers. 36/ The NASD Report also documents a 91% increase in average registration costs of firm commitment IPO's from 1972 to 1978. 37/ Increasing IPO costs may thus represent a second possible structural barrier to small business capital formation. 38/ The effects of government regulations on the ability of small businesses to raise capital has also been studied. For example, David Barnes has examined the cost of complying with federal and various state government new issue registration requirements and concluded that when these costs of registration are added to the underwriting expenses, a significant percentage of the capital derived from an offering may be lost to the issuer. 39/

36/ See particularly the testimony of William R. Hambrecht, General Partner, Hambrecht and Quist, before the Senate Committee, September 21, 1978.

37/ NASD Report, p. 44.

38/ The costs of registration were discussed extensively at the SEC Hearings, in the context of consideration of Form S-18. See for example, testimony of Joseph Sciarrino, Technical Director of the Financial Executives Institute, comment letter (June 6, 1978). See also John L. Blumlein, Testimony at Small Business Hearings (April 20, 1978), Los Angeles, California

39/ See David Barnes, "The One-Two Combination: Will Federal and State Securities Regulation Knock Out Small Business?", Tulsa Law Journal, Vol. 14 (1978), p. 136.

This review of prior research indicates a paucity of basic information regarding the characteristics of IPO issuers and the types of Managing Underwriters which distribute these offerings. The information presented in Chapters 2 and 3 of this Report is designed to partially fill this gap and expand the empirical foundation of the continuing capital formation policy debate.

Chapter 2

TRANSACTION AND ISSUER PROFILE

From January 1972 through June 1979, 726 corporations raised \$3 billion through IPO's. 40/ Regional Broker-Dealers, acting as Managing Underwriters, raised \$1.4 billion of this total. This Chapter examines the yearly volume of IPO's and stratifies the IPO's based on the issuer's size (in annual revenues), issuer's line of business, type of offering and characterization of Managing Underwriter. By analyzing data concerning Managing Underwriters, this Chapter documents the role of Regional Broker-Dealers in the capital formation process.

Introductory Concepts

This section presents the analytical concepts used in this Chapter and defines certain terms utilized in connection with the examination of IPO's.

40/ Of the 814 successful IPO's during this period, this analysis excludes 22 closed-end investment company offerings, four unit offerings of debt securities and common stock in which the value attributable to the common stock portion could not be determined and 62 IPO's for which complete information was not available. National Broker-Dealers were Managing Underwriters for 98% of this volume of closed-end investment company offerings and unit offerings. The 62 IPO's with incomplete data totalled approximately \$220 million. Of this dollar volume, approximately 60% (48 issues) represent transactions managed by Regional Broker-Dealers.

When an IPO is underwritten on a firm commitment basis, ("firm commitment IPO"), the group of broker-dealers which have joined together in the underwriting syndicate purchase the entire issue from the issuer on the date of the offering, and bear the risk that the issue will not be distributed successfully. When a broker-dealer manages an issue on a best efforts basis as agent for the issuer, the issuer bears the risk of an unsuccessful offering and the broker-dealer or syndicate makes no commitment to purchase the issue in advance. 41/

Firm commitment IPO's frequently have both primary and secondary portions and feature over-allotment options. Shares sold on behalf of the issuer itself represent the primary portion of the offering and the secondary portion consists of the shares sold on behalf of the existing shareholders for their own account. In approximately 86% of the firm commitment IPO's, the underwriters have over-allotment options which enable them, for a specified time, to purchase a limited quantity of additional shares from either the issuer or the selling shareholders at a set price for the purpose of meeting over-allotments

41/ Firm commitment and best efforts distribution agreements are described in Louis Loss, Securities Regulation, Vol. 1 (1961), pp. 163-172.

of shares to investors. These over-allotment options, if applicable to a specific offering, are assumed to be exercised in this analysis. 42/

For the best efforts issues and for the issues distributed to investors without the utilization of a broker-dealer intermediary, the actual shares sold and gross proceeds have been used in this analysis.

In this Phase I Report, the Managing Underwriters have been credited with all of the IPO volume for the issues they managed. 43/ This procedure tends to understate the importance of Regional Broker-Dealers as IPO Managing Underwriters, since National Broker-Dealers are often the Lead Managing Underwriters for IPO's co-managed by National and Regional Broker-Dealers.

42/ To examine the impact of the alternative assumption that over-allotment options are not exercised, a randomly selected sample of 10% of the firm commitment IPO's was chosen and the offering size without assuming exercise of over-allotment options was calculated. These results indicate that if over-allotments were excluded, the primary portion of IPO's would decline approximately 6%, while the secondary portion would be reduced 14%. Such options were granted in 86% of the sample issues: 56% by the issuer alone, 15% by the selling shareholders alone and 15% by both parties jointly.

43/ Ninety-six of the 706 issues (excluding IPO's with incomplete data and those not utilizing a broker-dealer intermediary) were co-managed. In the Phase II Report the co-managed issues will be allocated equally to each of the co-managers and the composition of the syndicates will also be examined.

The definition of issuers engaged in high technology manufacturing ("High Technology Issuers") used in this Report includes manufacturers of the following types of products:

Basic and specialty chemicals, plastics and synthetics
Drugs
Solar energy equipment
Specialized industrial and electrical machinery
Data processing and office equipment
Electronics and communication equipment
Defense equipment
Scientific and medical instruments
Optical, ophthalmic and photographic equipment 44/

44/ Each issuer provides a narrative description of its line of business as a part of its registration statement. The High Technology Issuers include all issuers in the following 3-digit Standard Industrial Classification ("SIC") Codes: 281, 283, 289, 355, 357, 366, 369, 372, 381, 383, and 384. Issuers in SIC Code 343 include conventional plumbing and heating equipment manufacturers, as well as solar energy equipment manufacturers. These issuers were reviewed individually and only solar energy issuers were classified as High Technology Issuers. A description of the types of activity included in each SIC category can be found in the Standard Industrial Classification Manual, Office of Management and Budget, Executive Office of the President, 1972. The Commission also publishes a Directory of Companies Required to File Annual Reports with the Securities and Exchange Commission, which lists publicly held corporations by 3-digit SIC Code. The definition of High Technology Issuers as utilized in this Report is closely related to the definition developed by Charles River Associates, An Analysis of Venture Capital Market Imperfections, prepared for the U.S. Department of Commerce, National Bureau of Standards, Experimental Technology Incentives Program (February 1976) p. S-4.

Finally, Start-up Issuers, as the term is defined in this Report, includes issuers with less than \$50,000 in revenues and less than 5 years elapsing between the year of incorporation and the effective date of the issuer's IPO. ^{45/}

IPO Volume: National and Regional Broker-Dealers

As Table 2 indicates, Regional Broker-Dealers managed 78% of the IPO's distributed by Managing Underwriters between January 1, 1972 and June 30, 1979, accounting for 48% of the \$2,915,202 raised in broker-dealer managed IPO's during this period. Seventeen percent of these IPO's were distributed on a best efforts basis, with all such issues being managed by Regional Broker-Dealers.

The important role of Regional Broker-Dealers as Managing Underwriters of IPO's during poor market conditions is illustrated by the data in Tables 2 and 3. Table 5 presents the average IPO offering size by year; the two years (1974 and 1977) with the lowest average IPO offering size were dominated, in terms of dollar volume, by Regional Broker-Dealers, while the two years (1975 and 1976) with unusually large IPO offerings were dominated by National Broker-Dealers. The annual volume figures in Table 5 suggest a measure of improvement

^{45/} The 5-year parameter was chosen because it represents the midpoint of the research and development phase plus the start-up phase of the SBA's small business life cycle. See SBA Report, p. 6.

Table 2
 IPO'S DISTRIBUTED BY NATIONAL AND REGIONAL BROKER-DEALERS
 PRIMARY AND SECONDARY PORTION
 1972-1979

(Thousands of Dollars)

Year of Offering	Issues Underwritten on a Firm Commitment Basis 1/				Issues Distributed on a Best Efforts Basis 2/				Total				Annual Total	
	National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Broker-Dealer Manager		Regional Broker-Dealer Manager		No. of Issues	Dollar Volume
	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	Issues	Dollar
1972	106 22%	\$1,025,987 52%	335 70%	\$919,196 47%	-	-	40 8%	\$28,735 1%	106 22%	\$1,025,987 52%	375 78%	\$947,931 48%	481 100%	\$1,973,918 100%
1973	19 23%	\$150,796 52%	50 60%	\$129,434 44%	-	-	14 17%	\$10,714 4%	19 23%	\$150,796 52%	64 77%	\$140,148 48%	83 100%	\$290,944 100%
1974	1 8%	\$15,013 40%	6 50%	\$18,304 49%	-	-	5 42%	\$4,152 11%	1 8%	\$15,013 40%	11 92%	\$22,456 60%	12 100%	\$37,469 100%
1975	2 33%	\$27,284 80%	-	-	-	-	4 67%	\$6,701 20%	2 33%	\$27,284 80%	4 67%	\$6,701 20%	6 100%	\$33,985 100%
1976	10 48%	\$90,176 71%	7 33%	\$34,649 27%	-	-	4 19%	\$2,277 2%	10 48%	\$90,176 71%	11 52%	\$36,926 29%	21 100%	\$127,102 100%
1977	4 12%	\$30,754 32%	13 39%	\$49,157 51%	-	-	16 49%	\$16,167 17%	4 12%	\$30,754 32%	29 88%	\$65,324 68%	33 100%	\$96,078 100%
1978	7 17%	\$95,140 54%	12 29%	\$56,143 32%	-	-	22 54%	\$25,674 14%	7 17%	\$95,140 54%	34 83%	\$81,817 46%	41 100%	\$176,957 100%
1979 (6 mos.)	8 28%	\$95,620 53%	9 31%	\$62,389 35%	-	-	12 41%	\$20,740 12%	8 28%	\$95,620 53%	21 72%	\$83,129 47%	29 100%	\$178,749 100%
Total	157 22%	\$1,530,770 52%	432 61%	\$1,269,272 44%	-	-	117 17%	\$115,160 4%	157 22%	\$1,530,770 52%	549 78%	\$1,384,432 48%	706 100%	\$2,915,202 100%

1/ Dollar volume assumes full exercise of over-allotment options.

2/ Dollar volume represents actual amount sold.

Note: Percentages represent portions of annual totals.

Source: IPO Registration Statements, Form SR, Form 10-K
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

Table 3
 IPO'S DISTRIBUTED BY NATIONAL AND REGIONAL BROKER-DEALERS
 PRIMARY PORTION
 1972-1979

(Thousands of Dollars)

Year of Offering	Issues Underwritten on a Firm Commitment Basis 1/				Issues Distributed on a Best Efforts Basis 2/				Total				Annual Total	
	National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Manager Broker-Dealer		Regional Manager Broker-Dealer		No. of Issues	Dollar Volume
	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume		
1972	106 22%	\$626,792 46%	315 70%	\$703,380 52%	-	-	40 8%	\$27,349 2%	106 22%	\$626,792 46%	375 78%	\$730,729 54%	481 100%	\$1,357,521 100%
1973	19 23%	\$89,815 43%	50 60%	\$108,915 52%	-	-	14 17%	\$10,387 5%	19 23%	\$89,815 43%	64 77%	\$119,302 57%	83 100%	209,117 100%
1974	1 8%	\$2,888 14%	6 50%	\$14,266 67%	-	-	5 42%	\$4,152 19%	1 8%	\$2,888 14%	11 92%	\$18,418 86%	12 100%	\$21,306 100%
1975	2 33%	\$14,088 68%	-	-	-	-	4 67%	\$6,701 32%	2 33%	\$14,088 68%	4 67%	\$6,701 32%	6 100%	\$20,789 100%
1976	10 48%	\$59,712 71%	7 33%	\$22,335 26%	-	-	4 19%	\$2,277 3%	10 48%	\$59,712 71%	11 52%	\$24,612 29%	21 100%	\$84,324 100%
1977	4 12%	\$17,823 27%	13 39%	\$33,110 49%	-	-	16 49%	\$16,167 24%	4 12%	\$17,823 27%	29 88%	\$49,277 73%	33 100%	\$67,100 100%
1978	7 17%	\$72,316 51%	12 29%	\$43,280 31%	-	-	22 54%	\$25,674 18%	7 17%	\$72,316 51%	34 83%	\$68,954 49%	41 100%	\$141,270 100%
1979 (6 mos.)	8 28%	\$57,671 42%	9 31%	\$59,533 43%	-	-	12 41%	\$20,740 15%	8 28%	\$57,671 42%	21 72%	\$80,273 58%	29 100%	\$137,944 100%
Total	157 22%	\$941,105 46%	432 61%	\$984,819 48%	-	-	117 17%	\$113,447 6%	157 22%	\$941,105 46%	549 78%	\$1,098,266 54%	706 100%	\$2,039,371 100%

1/ Dollar volume assumes full exercise of over-allotment options.

2/ Dollar volume represents actual amount sold.

Note: Percentages represent portions of annual totals.

Source: IPO Registration Statements, Form SR, Form 10-K
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

Table 4
 IPO's DISTRIBUTED BY NATIONAL AND REGIONAL BROKER-DEALERS
 SECONDARY PORTION
 1972-1979

(Thousands of Dollars)

Year of Offering	Issues Underwritten on a Firm Commitment Basis 1/				Issues Distributed on a Best Efforts Basis 2/				Total				Annual Total	
	National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Broker-Dealer Manager		Regional Broker-Dealer Manager		National Broker-Dealer Manager		Regional Broker-Dealer Manager		No. of Issues	Dollar Volume
	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume		
1972	78 35%	\$399,195 65%	146 64%	\$215,816 35%	- -	- -	2 1%	\$1,386 *	78 35%	\$399,195 65%	148 65%	\$217,202 35%	226 100%	\$616,397 100%
1973	12 41%	\$60,981 75%	15 52%	\$20,519 25%	- -	- -	2 7%	\$327 *	12 41%	\$60,981 75%	17 59%	\$20,846 25%	29 100%	\$81,827 100%
1974	1 25%	\$12,125 75%	3 75%	\$4,038 25%	- -	- -	- -	- -	1 25%	\$12,125 75%	3 75%	\$4,038 25%	4 100%	\$16,163 100%
1975	2 100%	\$13,196 100%	- -	- -	- -	- -	- -	- -	2 100%	\$13,196 100%	- -	- -	2 100%	\$13,196 100%
1976	9 64%	\$30,464 71%	5 36%	\$12,314 29%	- -	- -	- -	- -	9 64%	\$30,464 71%	5 36%	\$12,314 29%	14 100%	\$42,778 100%
1977	4 50%	\$12,931 45%	4 50%	\$16,047 55%	- -	- -	- -	- -	4 50%	\$12,931 45%	4 50%	\$16,047 55%	8 100%	\$28,978 100%
1978	6 55%	\$22,824 64%	5 45%	\$12,863 36%	- -	- -	- -	- -	6 55%	\$22,824 64%	5 45%	\$12,863 36%	11 100%	\$35,687 100%
1979 (6 mos.)	7 78%	\$37,949 93%	2 22%	\$2,856 7%	- -	- -	- -	- -	7 78%	\$37,949 93%	2 22%	\$2,856 7%	9 100%	\$40,805 100%
Total	119 38%	\$589,665 65%	180 61%	\$284,453 35%	- -	- -	4 1%	\$1,713 *	119 39%	\$589,665 67%	184 61%	\$286,166 33%	303 100%	\$875,831 100%

* = Less than .5%

1/ Dollar volume assumes full exercise of over-allotment options.

2/ Dollar volume represents actual amount sold.

Note: Percentages represent portions of annual totals.

Source: IPO Registration Statements, Form SR, Form 10-K
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

Table 5

ANNUAL IPO VOLUME AND AVERAGE OFFERING SIZE
BY TYPE OF MANAGING UNDERWRITER
1972-1979

(Millions of Dollars)

Year	Number of Issues	Gross Proceeds ^{1/}	Average Offering Size ^{1/}		
			National Managing Underwriter	Regional Managing Underwriter	All Issues
1972	481	\$1,974	\$ 9.7	\$ 2.5	\$ 4.1
1973	83	291	7.9	2.2	3.5
1974	12	37	15.0	2.0	3.1
1975	6	34	13.5	1.8	5.7
1976	21	127	9.0	3.4	6.0
1977	33	96	7.8	2.2	2.9
1978	41	177	13.6	2.4	4.3
1979 (6 mos.)	29	179	12.0	4.0	6.2
1972-1979 Total/Average	706	\$2,415	\$ 9.8	\$ 2.5	\$ 4.1

^{1/} Includes both primary and secondary portions of IPO's.

Source: IPO Registration Statements, Form SR, Form 10-K
Directorate of Economic and Policy Research
Securities and Exchange Commission

in the IPO market since 1978, an improvement which confirms a recent Wall Street Journal article. 46/

As Table 5 indicates, since 1977 the average IPO issue size has increased 114%, from \$2,900,000 to \$6,200,000. Comparison over a longer period, however, weakens the interpretation that IPO's are increasing in size, since the average IPO offering size in 1978 was only slightly higher than the average IPO size in 1972.

IPO Profile: Revenues of Issuer

Table 6 presents the average and median revenue of IPO issuers by year of offering. 47/ IPO issuers in 1979 were 18% larger in terms of revenues than their 1972 counterparts, but smaller in real terms, if changes in prices over the time period were to be considered. Table 6 also highlights the substantially larger IPO issuers which were able to avail themselves of the public market in the 1975-1976 period.

46/ See Vasil Pappas, "Demand For New Stock Issues During '79 Was Greater Than in Previous Six Years", Wall Street Journal, January 22, 1980, p. 36.

47/ Issuer revenue data is for the full calendar year prior to the date of the issuer's IPO. For issuers with less than a full calendar year of corporate history, annual revenues figures were estimated by extrapolating the partial year figures contained in the registration statement, assuming the rate of increase in revenues to be zero.

Table 6

AVERAGE REVENUES OF IPO ISSUERS
1972-1979

(Millions of Dollars)

<u>Year</u>	<u>Average Revenues of Issuers</u> <u>1/</u>
1972	\$ 11.8 (5.2)
1973	13.4 (3.0)
1974	9.3 (1.8)
1975	52.3 (11.4)
1976	29.4 (12.5)
1977	13.4 (7.8)
1978	15.7 (8.8)
1979 (6 mos.)	13.9 (13.7)
1972-1979 Mean	\$ 12.9 (5.1)

1/ Excludes Start-Up Issuers.

Note: Median figures in parentheses.

Source: IPO Registration Statements
Directorate of Economic and Policy Research
Securities and Exchange Commission

An examination of the revenue and the volume of the IPO primary portions, as shown in Table 7, indicates, as would be expected, that smaller issuers engage in smaller offerings and that Regional Broker-Dealers dominate the underwriting activity of smaller firms. Table 7 also shows that best efforts IPO offerings are concentrated among smaller issuers. Of the \$3 billion raised by the IPO issuers during 1972-1979, only \$115 million was raised on a best efforts basis.

IPO Profile: Issuer's Line of Business

As Table 8 indicates, 46% of the IPO issuers during the 1972-1979 period were engaged in manufacturing, and within this group, Regional Broker-Dealers were Managing Underwriters in 73% of the issues, representing 53% of the manufacturing issuers' IPO gross proceeds. ^{48/} In addition, Regional Broker-Dealers were Managing Underwriters in 79% of the IPOs by High Technology Issuers. As Table 9 indicates, Regional Broker-Dealers greatly outnumbered National Broker-Dealers as Managing Underwriters for IPO's of High Technology Issuers during 1972-1979. Finally, it is noted, Table 8 indicates that within certain issuer line of business categories (i.e., National Resources), the difference in size of IPO issues managed by National and Regional Broker-Dealers can be extreme.

^{48/} The various lines of business in Table 8 reflect major divisions in the Federal government's standard industrial classifications.

Table 7

IPO's DISTRIBUTED BY NATIONAL AND REGIONAL BROKER-DEALERS
PRIMARY PORTION BY REVENUES OF ISSUER
1972-1979

(Thousands of Dollars)

Revenues of Issuer 1/	Issues Underwritten on a Firm Commitment Basis 2/				Issues Distributed on a Best Efforts Basis 3/				Total				Total by Revenue of Issuer	
	National Broker- Dealer Manager		Regional Broker- Dealer Manager		National Broker- Dealer Manager		Regional Broker- Dealer Manager		National Broker- Dealer Manager		Regional Broker- Dealer Manager		No. of Issues	Dollar Volume
	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume		
No Sales	2 2%	\$48,000 24%	34 38%	\$99,814 50%	- -	- -	54 60%	\$52,659 26%	2 2%	\$48,000 24%	88 98%	\$152,473 76%	90 100%	\$200,473 100%
Below \$50,000	2 8%	\$11,430 25%	14 56%	\$22,918 50%	- -	- -	9 36%	\$11,692 25%	2 8%	\$11,430 25%	23 92%	\$34,610 75%	25 100%	\$46,040 100%
\$50,000 to \$999,999	4 4%	\$27,500 17%	73 64%	\$108,561 65%	- -	- -	37 32%	\$30,372 18%	4 4%	\$27,500 17%	110 96%	\$138,933 83%	114 100%	\$166,433 100%
\$1,000,000 to \$4,999,999	17 10%	\$131,158 31%	141 82%	\$283,698 66%	- -	- -	14 8%	\$15,023 3%	17 10%	\$131,158 31%	155 90%	\$298,721 69%	172 100%	\$429,879 100%
\$5,000,000 to 9,999,999	17 19%	\$78,748 31%	72 79%	\$177,272 69%	- -	- -	2 2%	\$1,266 *	17 19%	\$78,748 31%	74 81%	\$178,538 69%	91 100%	\$257,286 100%
\$10,000,000 to \$24,999,99	58 44%	\$217,734 51%	74 56%	\$206,782 49%	- -	- -	- -	- -	58 44%	\$217,734 51%	74 56%	\$206,782 49%	132 100%	\$424,516 100%
Over \$25,000,000	57 69%	\$426,535 83%	24 30%	\$85,774 17%	- -	- -	1 1%	\$2,435 *	57 69%	\$426,535 83%	25 31%	\$88,209 17%	82 100%	\$514,097 100%
Total	157 22%	\$941,105 46%	432 61%	\$984,819 48%	- -	- -	117 17%	\$113,447 6%	157 22%	\$941,105 46%	549 78%	\$1,098,266 54%	706 100%	\$2,039,371 100%

* = Less than .5%

1/ Revenue figures represent annual totals for the full calendar year prior to the year of the effective date of the IPO. For issuers with less than one full calendar year of revenues in the year prior to the effective date of the offering, partial year figures were extrapolated to develop an annual revenues estimate, assuming the growth rate of revenues to be zero.

2/ Dollar volume assumes full exercise of over-allotment options covering shares available from the issuer.

3/ Dollar volume represents actual amount sold.

Note: Percentages represent portions of annual totals.

Source: IPO Registration Statements, Form SR, Form 10-K
Directorate of Economic and Policy Research
Securities and Exchange Commission

Table 8

IPO's DISTRIBUTED BY NATIONAL AND REGIONAL UNDERWRITERS
PRIMARY PORTION BY ISSUER'S LINE OF BUSINESS
1972-1979

(Thousands of Dollars)

Issuer's Line of Business	Issues Underwritten on a Firm Commitment Basis 1/				Issues Distributed on a Best Efforts Basis 2/				Total				Total by Line of Business	
	National Broker- Dealer Manager		Regional Broker- Dealer Manager		National Broker- Dealer Manager		Regional Broker- Dealer Manager		National Broker- Dealer Manager		Regional Broker- Dealer Manager		No. of Issues	Dollar Volume
	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume	No. of Issues	Dollar Volume		
Agriculture, Forestry and Fisheries	2 20%	\$7,620 38%	3 30%	\$6,121 30%	-	-	5 50%	\$6,375 32%	2 20%	\$7,620 38%	8 80%	\$12,496 62%	10 100%	\$20,116 100%
Natural Resources	7 16%	\$75,413 58%	15 34%	\$11,338 24%	-	-	22 50%	\$24,201 18%	7 16%	\$75,413 58%	37 84%	\$55,541 42%	44 100%	\$130,954 100%
Construction	3 21%	\$17,995 44%	9 64%	\$22,029 53%	-	-	2 14%	\$1,088 3%	3 21%	\$17,995 44%	11 78%	\$23,117 56%	14 100%	\$41,112 100%
High Technology Manufacturing	32 21%	\$163,982 41%	98 63%	\$220,629 54%	-	-	25 16%	\$19,812 5%	32 21%	\$163,982 41%	123 79%	\$240,441 59%	155 100%	\$404,423 100%
Other Manufacturing	55 32%	\$234,585 53%	96 56%	\$182,993 42%	-	-	20 12%	\$20,989 5%	55 32%	\$234,585 53%	116 68%	\$203,982 47%	171 100%	\$438,567 100%
Transportation, Communication and Utility Services	8 40%	108,215 84%	9 45%	\$18,877 15%	-	-	3 15%	\$1,953 1%	8 40%	\$108,215 84%	12 60%	\$20,790 16%	20 100%	\$129,005 100%
Wholesale and Retail Trade	26 19%	\$150,980 40%	98 71%	\$209,471 56%	-	-	14 10%	\$15,023 4%	26 19%	\$150,980 40%	112 81%	\$224,494 60%	138 100%	\$375,474 100%
Finance, Insurance, Real Estate	14 18%	\$141,674 45%	49 63%	\$156,551 50%	-	-	15 19%	\$15,105 5%	14 18%	\$141,674 45%	64 82%	\$171,656 55%	78 100%	\$313,330 100%
Services	10 13%	\$40,641 22%	55 72%	\$136,850 73%	-	-	11 15%	\$8,899 5%	10 13%	\$40,641 22%	66 87%	\$145,749 78%	76 100%	\$186,390 100%
Total	157 22%	\$941,105 46%	432 61%	\$984,819 48%	-	-	117 17%	\$113,447 6%	157 22%	\$941,105 46%	549 78%	\$1,098,266 54%	706 100%	\$2,039,371 100%

1/ Dollar volume assumes full exercise of over-allotment options covering shares available from the issuer.

2/ Dollar volume represents actual amount sold.

Note: Percentages represent portions of annual totals.

Source: IPO Registration Statements, Form SH, Form 10-K
Directorate of Economic and Policy Research
Securities and Exchange Commission

Table 9

HIGH TECHNOLOGY ISSUER IPO's
ANNUAL PRIMARY PORTION DISTRIBUTED BY NATIONAL AND REGIONAL UNDERWRITERS
1972-1979

(Thousands of Dollars)

<u>Year of Offering</u>	<u>Average Offering Size</u> ^{1/}	<u>National Broker-Dealers</u> ^{2/}		<u>Regional Broker-Dealers</u> ^{2/}		<u>Total Dollar Volume</u> ^{1/}
		<u>No. of Issues</u>	<u>Dollar Volume</u>	<u>No. of Issues</u>	<u>Dollar Volume</u>	
1972	\$2,104	16	\$64,917	73	\$122,374	\$187,291
1973	2,325	3	17,540	18	31,286	48,826
1974	2,000	-	-	2	4,000	4,000
1975	-	-	-	-	-	-
1976	5,579	5	25,753	1	7,718	33,471
1977	3,132	1	5,500	8	22,688	28,188
1978	3,756	4	35,934	15	35,430	71,364
1979 (6 mos.)	3,476	3	14,338	6	16,945	31,283
1972-1979 Total/Average	\$2,609	32	\$163,982	123	\$240,441	\$404,423

^{1/} Includes primary portion of issue only.

^{2/} Assumes full exercise of over-allotment options covering shares available from issuer for firm commitment offerings and includes actual amount sold for best efforts offerings.

Source: IPO Registration Statements, Form SR, Form 10-K
Directorate of Economic and Policy Research
Securities and Exchange Commission

IPO Issuers Using the Regulation A Exemption

In September 1978 the Commission increased the maximum dollar amount of securities which could be sold to investors within a twelve-month period pursuant to the Regulation A exemption from registration from \$500,000 to \$1,500,000. 49/ This section reviews the experience of issuers with this change by comparing IPO's sold during two three-month periods; one before (first quarter 1978) and one after (fourth quarter 1978) the change in the Regulation A ceiling. 50/

In the first three months of 1978, the Regulation A exemption was used 22 times to raise \$4,554,000 by IPO issuers. During the fourth quarter of 1978, after the Regulation A ceiling increase, 22 IPO issuers raised \$10,846,000 pursuant

49/ The Commission is authorized under Section 3(b) of the Securities Act of 1933 to exempt any class of securities from registration if it finds that registration is not necessary in the public interest and for the protection of investors by reason of the small amount involved or because of the limited character of the public offering, but such exemptions may not be extended to issues offered to the public in aggregate amounts exceeding \$2,000,000. Regulation A permits the corporate issuer to file a notification and an offering circular with the Commission's various regional offices and does not require audited financial statements. See Securities Act Release No. 5977 (September 11, 1978).

50/ The first quarter of 1978 precedes the date of passage by Congress of Public Law No. 95-283 (May 21, 1978), which amended Section 36 of the Securities Act by raising the maximum dollar amount which the Commission can exempt under that Section.

to Regulation A. ^{51/} IPO's pursuant to Regulation A were 2.4 times as large in the fourth quarter of 1978 under the higher ceiling.

IPO issuers who used the Regulation A exemption appear to differ in important respects from other IPO issuers. Table 10 presents the type of corporations that used Regulation A Offerings in the first and fourth quarters of 1978. Such issuers are primarily engaged in the service industries, particularly entertainment and leisure services, and to a lesser extent in manufacturing and wholesale and retail trade. Only five IPO's using Regulation A were High Technology Issuers. Over half of the Regulation A users examined during these periods were Start-Up Issuers. Broadway theatrical productions accounted for most of the start-up ventures in the service industries for the two periods examined.

Issues Without Managing Underwriters

Table 11 presents data concerning 20 IPO's which were underwritten during 1972-1979 without a broker-dealer serving as a financial intermediary. Eight issuers sold their entire IPO offerings in this fashion, but five of these eight were registered broker-dealers selling equity in themselves to the public. With the exception of these issuers, which routinely

^{51/} This analysis excludes 13 Regulation A offerings for which complete data was not available.

Table 10
REGULATION A OFFERINGS
ISSUER BUSINESS ACTIVITY AND FINANCIAL DATA

(Thousands of dollars)

Issuer's Line of Business	Number of Offerings	Average Offering Size ^{1/}	Issuer Financial Data ^{2/}		
			Average Total Revenue	Average Net Income	Average Total Assets
Agriculture, Forestry and Fisheries	- [-]	\$ - (-)	\$ - (-)	\$ - (-)	\$ - (-)
Natural Resources	4 (1)	500 (500)	1,896 (293)	127 (-)	95 (53)
Construction	- [-]	- (-)	- (-)	- (-)	- (-)
High Technology Manufacturing	5 (5)	336 (300)	- (-)	- (-)	- (-)
Other Manufacturing	9 (6)	223 (120)	1,865 (2,442)	-120 (154)	1,525 (1,088)
Transportation, Communication, and Utility Services	3 (2)	217 (111)	2,608 (2,608)	494 (494)	9,684 (9,684)
Wholesale and Retail Trade	7 (1)	381 (151)	9,780 (5,761)	-59 (58)	10,827 (3,929)
Finance, Insurance, and Real Estate	5 (2)	261 (289)	140 (140)	74 (24)	131 (181)
Services	11 (6)	463 (420)	12,186 (15,147)	748 (597)	11,740 (10,965)
Totals/Averages	44 (23)	\$ 450 (304)	\$ 6,689 (3,213)	\$ 197 (85)	\$ 9,628 (1,976)
Jan.-Mar. 1978 Issuers	22 (12)	\$ 207 (139)	\$ 5,058 (2,512)	\$ 41 (60)	\$ 4,436 (2,864)
Oct.-Dec. 1978 Issuers	22 (11)	\$ 493 (500)	\$ 8,023 (2,608)	\$ 326 (104)	\$ 13,868 (1,098)

^{1/} Based on actual amount sold.

^{2/} Start-up issuers are excluded. One bank is also excluded in the calculation of average and median issuer financial data.

Note: Start-up issuers in each line of business category are classified in brackets. Median figures are in parentheses.

Source: Regulation A Offering Circulars
Directorate of Economic and Policy Research
Securities and Exchange Commission

Table 11

IPO's DISTRIBUTED WITHOUT BROKER-DEALER INTERMEDIATION
GROSS PROCEEDS
1972-1979

(Millions of Dollars)

<u>Year</u>	<u>Number of Issues</u>	<u>Gross Proceeds</u> <u>1/2/</u>
1972	10	\$ 76.5
1973	1	3.7
1974	4	4.6
1975	2	4.1
1976	1	1.0
1977	2	2.6
1978	-	-
1979 (6 mos.)	-	-
Totals	20	\$ 92.5

1/ Includes actual amount sold.

2/ Includes both primary and secondary portions of IPO's.

Source: IPO Registration Statements, Form SR, Form 10-K
Directorate of Economic and Policy Research
Securities and Exchange Commission

have access to investors and to the industry's distribution system, successful IPO issues without Managing Underwriters were rare. Eighty-seven percent of the gross proceeds raised in this fashion were raised in 1972 and 1973.

Chapter 3

MANAGING UNDERWRITER PROFILE

This Chapter provides a summary profile of the broker-dealers who were Managing Underwriters of the previously examined IPOs. This profile compares two types of National Broker-Dealers -- Large Investment Banking Houses and National Full Line Firms -- with two types of Regional Brokers-Dealers -- regional NYSE members and regional non-NYSE member NASD firms. 52/ As the previous chapter demonstrated, Regional Broker-Dealers play a leading role as IPO Managing Underwriters; their importance as municipal revenue bond underwriters has been documented in an earlier Commission study. 53/

Comparative Financial Analysis

Data concerning two groups of National and two groups of Regional Broker-Dealers are presented in Tables 12 and 13. The four groups vary dramatically in size. The National Full Line Firms averaged \$362,700,000 in 1978 total revenues (40% higher

52/ The designations of Large Investment Banking House and National Full Line firm are derived from the SEC-SIA Categories. The group of regional NYSE members includes members in the five SEC-SIA Categories identified on page 2 above. The group of regional non-NYSE NASD members was developed by the Commission staff for this Report to include non-NYSE members which are similar to the regional NYSE members.

53/ Bank Participation in Municipal Revenue Bond Underwriting, Securities and Exchange Commission (Directorate of Economic Research), October 19, 1979.

Table 12
 INITIAL OFFERING MANAGING UNDERWRITERS
 1977 SUMMARY FINANCIAL DATA

(Thousands of Dollars)

	<u>National Broker-Dealers</u>		<u>Regional Broker-Dealers</u>	
	<u>National Full Line Firms</u>	<u>Large Investment Banking Houses</u>	<u>Regional NYSE Members</u>	<u>Regional Non-NYSE NASDAQ Members</u>
<u>Income Statement</u>				
Securities Commissions	43%	23%	52%	24%
Trading and Investment Profits	15%	14%	15%	32%
Net Revenue from Underwriting and Selling Groups 1/	12%	16%	12%	11%
Commodities Revenue	7%	1%	*	1%
Other Securities Related Revenue	18%	9%	16%	23%
All Other Revenue	5%	17%	5%	9%
Average Total Revenue	\$222,375	\$116,767	\$10,235	\$ 417
Pre-tax Profit Margin	5%	9%	5%	12%
<u>Balance Sheet (December 31, 1977)</u>				
<u>Assets</u>				
Cash	3%	*	2%	3%
Receivables	62%	25%	68%	18%
Long Positions in Securities and Commodities	18%	46%	16%	54%
Securities purchased under agreement to resell	10%	26%	5%	18%
Other Assets	6%	3%	9%	7%
Average Total Assets	\$1,039,050	\$1,566,460	\$32,075	\$2,645
<u>Liabilities and Capital</u>				
Total Liabilities excluding subordinated debt	89%	95%	84%	84%
Total Capital	11%	5%	16%	16%
<u>Capital Structure</u>				
Subordinated debt	\$21,283	\$13,867	\$1,293	\$ 39
Equity capital	\$92,442	\$67,508	\$2,888	\$ 389
Average Total Capital	\$113,725	\$81,375	\$5,182	\$ 428

* - Less than .5%

1/ Registered broker-dealers report underwriting revenue net of related underwriting expenses.

Note: Classification of broker-dealers is based on SEC-SIA Categories.

Source: FOCUS Reports
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

Table 13
 INITIAL OFFERING MANAGING UNDERWRITERS
 1978 SUMMARY FINANCIAL DATA

(Thousands of Dollars)

	National Broker Dealers		Regional Broker-Dealers	
	National Full Line Firms	Large Investment Banking Houses	Regional NYSE Members	Regional Non-NYSE NASDAQ Members
<u>Income Statement</u>				
Securities Commissions	43%	24%	53%	28%
Trading and Investment Profits	15%	31%	13%	29%
Net Revenue from Underwriting and Selling Groups 1/	9%	13%	10%	11%
Commodities Revenue	7%	2%	1	1%
Other Securities Related Revenue	21%	11%	18%	22%
All Other Revenue	5%	21%	5%	9%
Average Total Revenue	\$352,700	\$169,010	\$13,800	\$ 497
Pre-tax Profit Margin	7%	8%	8%	5%
<u>Balance Sheet (December 31, 1978)</u>				
<u>Assets</u>				
Cash	3%	*	2%	3%
Receivables	53%	24%	69%	28%
Long Positions in Securities and Commodities	19%	38%	15%	35%
Securities purchased under agreement to resell	20%	35%	1%	25%
Other Assets	5%	3%	13%	9%
Average Total Assets	\$1,673,600	\$2,211,800	\$38,200	\$2,392
<u>Liabilities and Capital</u>				
Total Liabilities excluding subordinated debt	91%	95%	84%	79%
Total Capital	9%	5%	16%	21%
<u>Capital Structure</u>				
Subordinated debt	\$29,140	\$23,780	\$1,500	\$ 41
Equity capital	\$124,440	\$81,170	\$4,700	\$ 453
Average Total Capital	\$153,580	\$104,950	\$6,200	\$ 494

* = Less than .5%

1/ Registered broker-dealers report underwriting revenue net of related underwriting expenses.

Note: Classification of broker-dealers is based on the SEC-SIA Categories.

Source: FOCUS Reports
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

than in 1977), while the Large Investment Banking Houses averaged \$169,000,000 (45% above 1977). The regional categories of firms were significantly smaller than the National Broker-Dealers. The NYSE member Regional Broker-Dealers averaged \$13,800,000 in 1978 total revenue (35% above 1977), while the non-NYSE NASD member Regional Broker-Dealers generated an average of \$497,000 in total annual revenue in 1978, 16% higher than in the previous year but substantially below the revenue growth of the other three categories of IPO Managing Underwriters.

Securities commissions are a larger source of revenue for the NYSE member Regional Broker-Dealers than for the other three broker-dealer groupings, while trading profits are a smaller revenue source for the NYSE member Regional Broker-Dealers and for the National Full-Line Firms. The receivables and long positions in securities on the balance sheet also reflect the relatively smaller role trading activities play in the total operations of the National Full Line and NYSE member Regional Broker-Dealers.

While the four groups of firms differ substantially in size, their pre-tax profit margins are quite similar, and in fact, the Commission's most recent analysis of the securities industry reported evidence that smaller broker-dealers were often more profitable than their larger competitors in 1978. 54/

54/ See, Staff Report, Appendix Table A-1.

A comparison of the balance sheet data for the four groups of IPO managers indicates that capital is a larger portion of the balance sheet for the smaller regional firms and subordinated debt is also a smaller portion of total capital. 55/

The Concentration of IPO Volume

As Table 14 indicates, the revenues the securities industry generates from IPO's represent only a small portion of overall underwriting revenue and a much smaller portion of a broker-dealer's aggregate total revenues. The IPO revenue data presented in Table 14 represents the underwriting discounts and commissions the securities industry has received from this aspect of its capital formation activity. This data excludes other compensation which a managing underwriter may receive in addition to underwriting discounts and commissions, such as finders fees and payment for accountable or non-accountable expenses.

Even though IPO volume shrank dramatically after 1972, suggesting the possibility that the remaining volume would become more concentrated in the hands of certain Managing Underwriters, the data set forth in Table 15 raises interesting questions concerning concentration.

55/ Debt which is subordinated to the claims of a broker-dealer's customers qualifies as capital in the computation of the broker-dealer's net capital pursuant to the Commission's net capital rule (Rule 15c3-1).

Table 14

IPO UNDERWRITING REVENUES AND
THE SECURITIES INDUSTRY
1972-1979

(Thousands of Dollars)

<u>Year</u>	<u>IPO Underwriting Revenues</u> 1/	<u>Percent of Total Underwriting Revenues</u> 2/	<u>Percent of Total Broker-Dealer Revenues</u>
1972	\$154,143	16.4%	2.20%
1973	21,677	4.3	.39
1974	3,092	.6	.06
1975	2,958	.3	.04
1976	9,179	1.0	.10
1977	8,598	.9	.10
1978	13,992	1.5	.12
1979 (6 mos.)	13,642	1.4	.10

1/ IPO revenues consist of underwriter discounts and commissions, including those attributable to over-allotments on firm commitment issues and actual shares sold for issues managed on a best efforts basis. Other cash compensation including finders' fees and payments for accountable and non-accountable expenses are excluded.

2/ Total underwriting revenue is reported net of related expenses on the FOCUS Report. Percentages based on data comparable to IPO underwriting revenues would be slightly lower.

Source: IPO Registration Statements, Form SR,
Form 10-K, FOCUS Reports
Directorate of Economic and Policy Research
Securities and Exchange Commission

Table 15

CONCENTRATION OF IPO MANAGING UNDERWRITERS
 BASED ON GROSS PROCEEDS OF IPO OFFERING
 1972-1979

(Millions of Dollars)

Year of Offering	All Managing Underwriters			Top 10 Percent of Managing Underwriters			Percent of Total IPO Dollar Volume Managed By Top 10 Percent of Managing Underwriters
	Number of Managing Underwriters	Number of IPO Issues Managed	Total IPO Dollar Volume	Number of Managing Underwriters 1/	Number of IPO Issues Managed	Total IPO Dollar Volume	
1972	263	481	\$ 1,974	26	110	\$ 1,062	54%
1973	76	83	291	8	10	131	45
1974	12	12	37	1	1	15	41
1975	6	6	34	1	1	21	62
1976	16	21	127	2	3	36	28
1977	28	33	96	3	3	33	34
1978	29	41	177	3	4	65	37
1979 (6 mos.)	22	29	179	2	4	63	35
Total/Average	452	706	\$ 2,915	46	136	\$ 1,426	49%

1/ Managing underwriters comprising this group were selected on the basis of dollar volume managed, including both primary and secondary portions.

Source: IPO Registration Statements
 Directorate of Economic and Policy Research
 Securities and Exchange Commission

IPO volume was most concentrated in the hands of the largest 10% of the managing underwriters in 1972; 26 managers of 110 issues controlled 54% of the IPO volume. Such percentage has ranged between 34% and 37% since 1977. 1974 and 1975, when only one broker-dealer comprised the largest 10% of the Managing Underwriters, may represent unreliable observations on the level of concentration.

Chapter 4

FUTURE RESEARCH ACTIVITY

Subsequent research conducted as Phase II of the study will examine the marketmaking and research support Regional Broker-Dealer firms provide in connection with IPO's. Also, the issuer and broker-dealer profiles set forth in this Phase I Report will be developed in greater detail. It is anticipated that survey questionnaires will be employed as well as interviews with securities markets participants and analyses of the Commission's data bases.

Regional Broker-Dealer Marketmaking

The extent of marketmaking activity which Regional Broker-Dealers undertake in connection with IPO issues will be examined on a quarterly basis from the time the IPO is distributed to the public until December 31, 1979, or until the issue is listed on either the American Stock Exchange or on the NYSE. This research will examine the hypothesis that Managing Underwriters play a leading role as marketmakers in IPO's, once the issues are distributed. Historical marketmaking information generated by the National Association of Securities Dealers Automated Quotation System will be the primary information source for this aspect of the study, as well as data from the National Quotations Bureau. It is anticipated that this research will be supplemented by interviews with industry participants.

Regional Broker-Dealer Research

In 1976, a survey by the Financial Analysts Federation of securities research directors in brokerage firms and institutional investors found that 78% of these firms excluded from close continuing financial analysis companies with market capitalizations below \$50,000,000. In fact, 54% of the respondents limited themselves to firms with over \$100 million in aggregate market value. 56/

The principal exception to this pattern appears to be Regional Broker-Dealers. Future research for this project will attempt to specify with precision the role of Regional Broker-Dealers in providing such research support to smaller issuers by utilizing interview, survey questionnaire and existing data base analysis methodologies.

Issuer and Regional Broker-Dealer Profiles

The descriptive profiles of issuers and Managing Underwriters provided in this Phase I Report will be developed in greater detail in future research. For example, information will be segmented by size of issue and data will be gathered

56/ The survey results were reported in the Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission, Vol. 1, pp. 41-42, November 3, 1977. The NASD Report (Chapter 4) also indicates that a significant portion of the institutional investors surveyed by the NASD have an investment policy which limits investments to issues with a minimum market capitalization of \$50 million.

on the structure of underwriting syndicates. The effect of the decline in the number of broker-dealers on the industry's capital and ability to underwrite IPO's will be examined.

A final Report for the project will be prepared for release to the public in September 1980.