

An Analysis of Aggregate Listing Costs on NASDAQ OMX Helsinki

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<p>The objective of this thesis was to isolate the different costs involved in an Initial Public Offering (IPO) as well as their relative sizes to each other. While general flotation costs have been previously studied and examined, the relative importance of its constituent costs in an IPO remains a point of interest. The markets under specific consideration were the NASDAQ OMX Helsinki Official List and the First North market.</p> <p>The central sections of this paper are the conceptual framework section and the subsequent empirical section. These are somewhat intertwined as necessitated by the topic. The study was conducted via expert interviews, cross-referenced with publicly available academic sources when applicable. Altogether six interviews were carried out, with two interviewees representing the underwriters, legal advisors and external auditors, respectively. Information for the theoretical framework was gathered from the aforementioned academic sources. Up-to-date data and advice was provided by NASDAQ OMX Helsinki.</p> <p>The most significant costs involved in most Finnish market IPOs were confirmed to be the underwriters' premium and the legal and auditing advisory fees, followed by various administrative costs such as registration fees and the fee for the Finnish Financial Supervisory Authority. Thirdly, costs arise from investor relations (IR) and physically publishing the prospectus. Especially marketing, communication and other IR costs can be highly variable, depending on the need to hire an external party to carry out marketing as well as expenditure on the company roadshow preceding the listing.</p> <p>Further points of interest outside the scope of this study would be assessing costs involved in cross listings; seasoned equity offerings; specific costs on other markets; costs arising from multinational IPOs; and specific cost analysis from the standpoint of internal company data.</p>	
<p>Key words Listing, securities, stock exchanges, financing markets, NASDAQ OMX</p>	

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1 Introduction

A public offering is a viable approach in financing a company. An Initial Public Offering (IPO), furthermore, is a fundamental development in the lifecycle of any company. Offering company stock to the public is not only a decision regarding ownership of the firm, but it will also require an extensive preparatory process with strict demands set on corporate governance, past and future fiscal performance, accounting standards and an effective financial disclosures system. After listing, public trading on the company's shares improves its liquidity and increases the availability of equity with better terms than what is available on private equity markets (Mikkola 2007, 3).

The topic for this thesis was suggested by and carried out with the co-operation of NASDAQ OMX Helsinki, with the purpose to map where the aggregate cost for the abovementioned preparatory process leading to an IPO arises. I've used the point between these costs and ongoing costs after the first day of trading as a cut-off point, setting that as the line of demarcation for the scope of the study. Many expenses certainly do not stop immediately after listing, such as carrying on with IFRS (International Financial Reporting Standards) accounting or continuing to follow the disclosures framework laid down during the preparation process. It is still useful to examine costs incurred before the effective trading date as a group of their own, because their nature as preparatory expenses is markedly different from ongoing costs after trading begins – those expenses essentially maintain the infrastructure that the initial listing process established.

Because the listing process is multifaceted and can be fairly complex, it can be difficult for CFOs to budget for it. PricewaterhouseCoopers recently carried out a survey in 2012 asking American financial officers what their expectations for these costs had been and what the subsequent reality of it was: as seen in Figure 1, nearly half of CFOs had underestimated what the cost of going public would be, and over 20 per cent of that figure had severely underestimated the cost. This suggests that the planning and pre-assessment processes were lacking. PwC proposes that a third-party planner would be an effective measure against unforeseen costs – it is conceivable, however, that simply paying more attention to the initial planning phase of the listing process might

be effective against this as long as the company is aware of a significant risk of running with more costs than may initially have been anticipated.

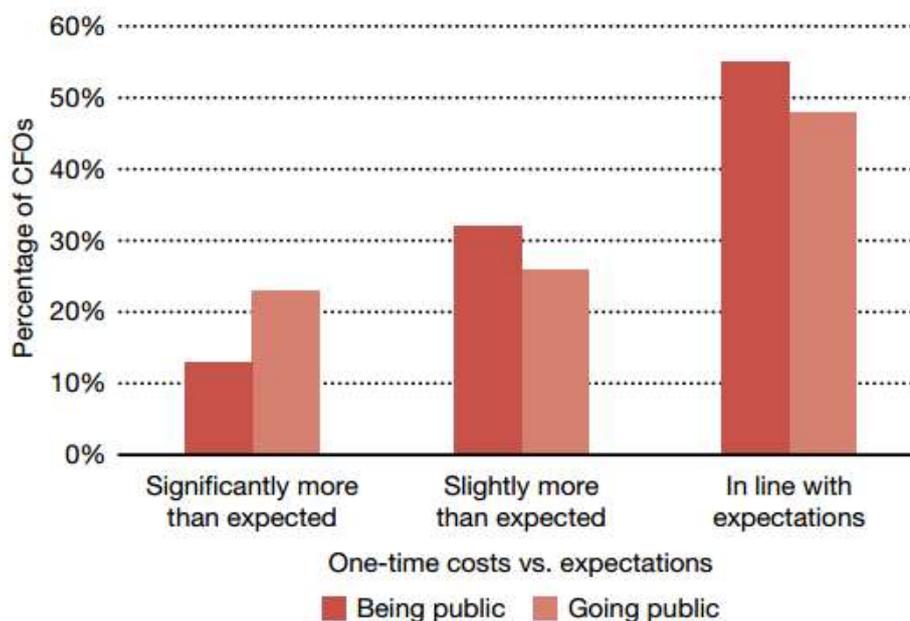


Figure 1. Almost half of CFOs found the one-time costs of going public were higher than they anticipated. Source: PwC 2012.

The process of an initial stock offering and listing has been well documented: there is an abundance of information available for the general steps and checklists that are involved in a listing (e.g. NASDAQ Group 2014, Ernst & Young 2013, PwC 2003, Pörsisäätiö 2012). The fixed costs involved like registration fees and the fee for the Financial Supervisory Authority can be found in an up-to-date form from all the relevant parties themselves.

Information on what the size of other, variable costs during the process incl. underwriting fees and compensation for the legal advisors and IFRS advisors is more scarce, however: under the Finnish Securities Markets Act (746/2012) companies are not required to publish data on specific amounts of money used in projects related to listing, but bulk amounts that are considered relevant information for investors, reported in consolidated income statements. It can be problematic to compile information regarding the different magnitudes of listing project costs because they are dependent on variable factors such as emission size, contracts with the advisors, and whether the company is offering shares on other markets besides Finland. The central purpose this the-

sis is to isolate those factors and examine the importance of each as part of the final, aggregate cost for the listing.

1.1 Objectives and Demarcation

The objective of this thesis is to resolve the following questions: What are the constituent parts of the aggregate costs incurred during the listing process; where do those payments flow; what are their relative sizes; and is it possible to affect them to a significant degree?

The focus of this study is on the main market of NASDAQ OMX Helsinki. Due consideration is also given to the First North market, as it is certainly a potential alternative to the Official List in the Finnish stock exchange. It was best to delineate the thesis specifically to the process of IPOs, however: cross listings and ongoing costs are an area of further interest, but out of the scope of this thesis mainly due to demands on succinctness and accuracy. It is notable that process-related costs, i.e. underwriter, advisory and administrative fees, are therefore in a central position in this body of work – technical indirect costs arising from underpricing or overallotment are not.

1.2 Source Literature

Existing literature on the subject suggests that underwriter and counseling fees form the bulk cost, followed by various administrative and other variable costs. A point of interest will be seeing this applied to the Finnish market.

Reference literature on this topic and tangential subjects is extensive. Ritter is a staple researcher in the field with his studies on U.S. and international IPOs extending from the 1980's to contemporary publications. Presently, Ritter & Welch's 2002 review on IPO activity has been referenced to some extent as well as Loughran & Ritter's 2002 look on underpricing in the section discussing emission pricing. Other academic studies on IPO planning and costs were also sought out: see Clarke & Firenze 2007, Kaserer & Schiereck 2007 or Pajarinen 2011. These were cross-referenced where possible with studies made on the Finnish market: see Ala-Ilomäki 2006, Inkinen 2002, Oravainen 2013, and Tirroniemi 2009. Text books on corporate finance and consulting

agency materials on IPOs were used for framework information. Up-to-date data on the stock exchange was provided by NASDAQ OMX Helsinki.

1.3 Listing Market Developments

The Finnish stock exchange has been described as rather modest in terms of number of listings. Indeed, like Figure 3 suggests, in comparison to the total number of listings since 2000 in the Swedish and Danish markets the amount of listings in the Finnish market has fallen somewhat short, although since 2008 all of the markets have been quieter than previously.

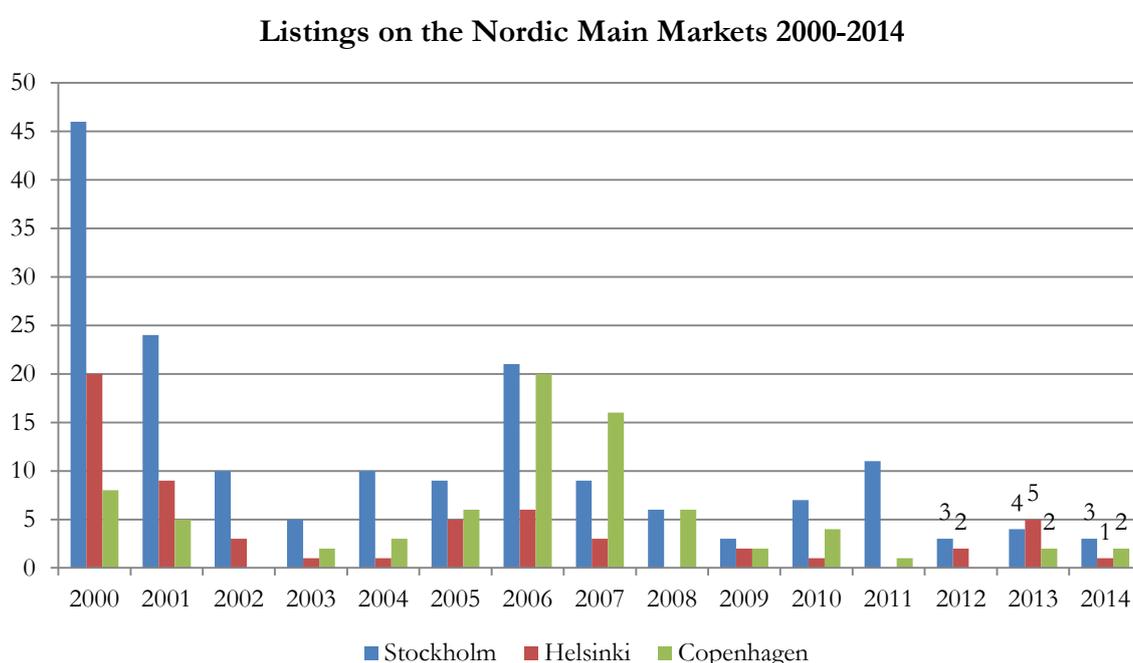


Figure 2. Recent listings on the main market. Data source: NASDAQ OMX Helsinki.

The new listings 2013-2014 on the Official List were those of Valmet Corporation on 2 Jan 2014, resulting from a partial demerger from Metso Oyj; Restamax Plc on 28 Nov 2013; Orava Real Estate Residential Trust Plc on 14 Oct 2013; Caverion Corporation on 1 July 2013, resulting from a partial demerger from YIT; Munksjö Plc on 3 June 2013, resulting from Ahlstrom Corporation’s partial demerger consideration; and the cross listing of Endomines AB on 14 May 2013. Additionally, Soprano Plc recently transitioned from the NASDAQ OMX Helsinki prelist to the Official List on 7 Jan 2014. Of the firms mentioned, Valmet Corporation a large cap company, Caverion Plc

and Munksjö Plc are mid cap and the rest are small cap companies (NASDAQ OMX Helsinki 2014).

In the First North markets, only the Stockholm market has remained somewhat active since 2008, although the effect of the financial crisis was marked there as well. Figure 4 illustrates the number of listings since 2005. Interviewee A commented that in NASDAQ OMX Helsinki the lack of activity may be explained by the riskiness that has been associated with First North – due to the small number of listings, it has not been considered very stable. As more companies make the decision to enter the First North market, it becomes more attractive to others as well (NASDAQ OMX Helsinki 2014).

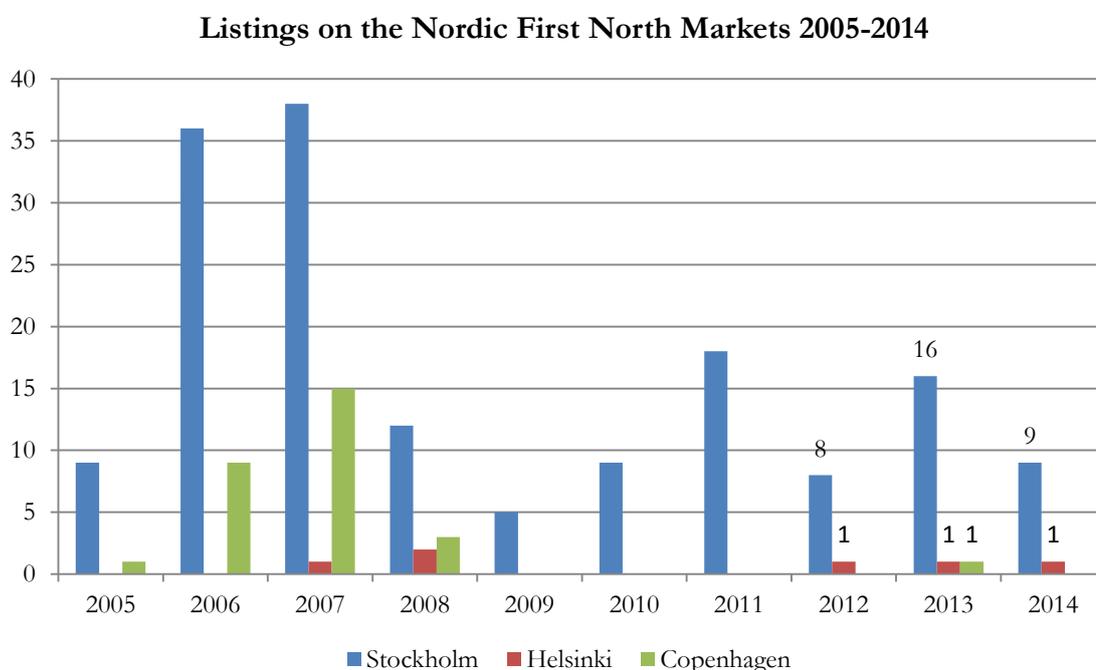


Figure 3. Recent listings on the First North Markets. Data source: NASDAQ OMX Helsinki.

The latest listings in the NASDAQ OMX Helsinki First North market have been Verkkokauppa.com Oyj on 4 Apr 2014; Taaleritehdas Oyj on 24 Apr 2013; and Siili Solutions Oyj on 15 Oct 2012. Additionally, Cleantech Invest announced their decision to enter the First North market on 5 May – the official issue is planned on 5 June (NASDAQ OMX Helsinki 2014; Cleantech Invest 2014).

Historically, there have clearly been two waves of listings in Finland. The first time that the popularity of listing rose significantly was in the late 1980's. The second prominent

wave of listings was seen in 1997-2000 during a period of economic optimism, until the value of technology-based stocks plummeted around the world (Mikkola 2007, 27). For Finland this type of stock was typical and tech-companies were seeking listing perhaps over-zealously: the stock crash was hard and has subsequently decreased the willingness of going public. Mikkola (2007, 39) also suggested that the lack of an alternative market forum was another reason for the lack of popularity for listing since 2000. The First North market option in Finland has been a positive development in that regard. Its popularity has remained modest, but with altogether six companies currently on the market and one about to enter it, further market interest in the future is possible.

In the wake of the IT-crash of the 1990's, Ritter and Welch (2002, 1802) concluded that companies tend to go public when market conditions are favorable and their condition allows for it. Evidently, the post-2008 economic conditions have certainly not affected companies' willingness to go public in any positive way. It remains to be seen how long it will take for the listing markets to recover.

It should be borne in mind that instead of stock offerings companies may recently have been looking at other options of gathering capital. While the decline in economic growth and sustained uncertainty in the financial market has manifested as an unwillingness to take long-term debts, the issuance of bonds by Finnish companies was, in fact, at a record level in 2012 as the larger companies have diversified their financial structures (Bank of Finland 2013, 19).

2 Methodology

The study was conducted as a qualitative study, with expert interviews being used as the main source of data for the aggregate cost examination. Six advisors were interviewed for the thesis – two representatives for each of the three foremost areas of outside expertise in a listing: the bank; the legal advisors; and the IFRS accounting advisors. Due to the potentially sensitive nature of information relayed on the business practices of competing businesses offering underwriting and advisory services, the interviews were conducted anonymously. All interviewees had broad experience with

listing services and represented companies that have had extensive involvement in both Finnish and international listings.

As this thesis is concerned with the process of listing as a source of expenses, the theoretical framework and the subsequent analysis of costs are somewhat intertwined. They have been separated on the basis that the conceptual framework is largely based on publicly available information on listing and the analysis on the expert interviews.

The main legal sources referenced in this thesis are the Securities Market Act (746/2012) and the related interpretations and additional advice given by the Financial Supervisory Authority, such as its own standard on offering securities and listing (FSA 2013). Finnish national legislature is largely based on the securities markets legislature decreed by the European Union; notably the Markets in Financial Instruments Directive (MiFID). The SMA (748/2012) also requires NASDAQ OMX Helsinki to maintain and publish rules for the stock exchange based on the legislature, kept available to the public (NASDAQ Helsinki 2013). These rules track the SMA very closely, although exchange rules related to stocks have been largely harmonized among the NASDAQ OMX Nordic group, particularly with regard to disclosures policies (Oravainen 2013, 54). Notably, there is also related legislature not directly referenced that the FSA rules lean on, like the Act on Investment Services (747/2012). Several academic papers discussing aspects of listing have also been referenced, as well as material produced by organizations to disseminate data segments related to listing such as Corporate Governance (e.g. Securities Market Association 2010, NASDAQ Nordic 2012). The NASDAQ OMX First North list is exchange regulated and falls under the MiFID as a multilateral trading facility (NASDAQ OMX Helsinki).

3 Public Offering – A Conceptual Framework

3.1 Listing as a Financing Option

Going public becomes topical when a company aims to continue its growth and diversify its base of ownership (PwC 2003). The company is able to gather equity from the public market, strengthening its balance statement, liquidity and even improves its

chances of securing external capital from private institutions (Mikkola 2007, Korkeamäki & Koskinen 2009).

A strong case can be made for the importance of listed companies for the economy. A good part of the biggest Finnish companies are public. Figure 2 below illustrates the central role that listed companies tend to have as a catalyst of economic growth in Finland up to 2007. A notable demarcation after 2007 is the contracted effect of Nokia Corporation in the market, however.

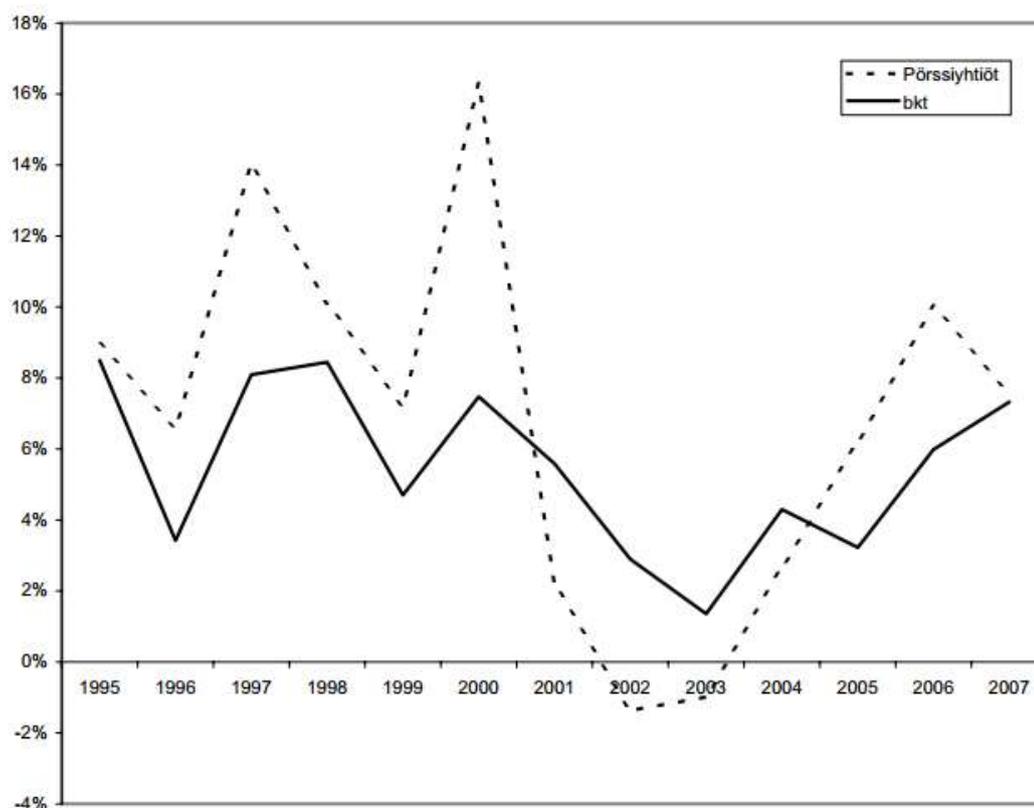


Figure 4. Growth of median revenue in listed companies (dotted line) and the Finnish GDP (solid line) 1995-2007. Source: Korkeamäki & Koskinen 2009.

Also in terms of benefiting employees and revitalizing the economy listed companies have outperformed their unlisted peers – looking at historical data, listed companies have consistently paid out higher wages and spent more on investments during recessions (Korkeamäki & Koskinen 2009, 18). A well-functioning stock market is also important in securing equity for companies that are growth-oriented, relatively risky and carry out much research & development activities (Korkeamäki & Koskinen 2009, 12).

In most cases, raising equity capital and creating a public market for company shares might be said to be the central motivation for going public (Ritter & Welch 2002, 1796). As far as formal theories on that decision go, two main types can be distinguished: life cycle theories and market-timing theories. As mentioned in the previous chapter, these two elements both contribute to the decision. By going public the company may also facilitate the acquisition of the company for a higher price than what would be otherwise possible in a direct sale. Alternatively, the entrepreneurs running the business may often regain a measure of control from venture capitalists in strongly venture capital backed companies (Ritter & Welch 2002, 1796-99).

It may become optimal to go public after a certain point in a company's growth has been reached. IPOs allow for the dispersion of ownership and attract public-market investors who allow for a higher price to be paid than pre-IPO venture capital investors. A high public price may on the one hand attract product competition, but on the other, increase faith in the company from investors and creditors alike and further increase growth potential. Again, an allusion to the internet-era boom may be made: in the late 1990's the aggressive expansion strategies of tech companies could be interpreted as an attempt to pre-empt the other companies in the field (Ritter & Welch 2002, 1798).

Based on an asymmetric information model, i.e. an uneven distribution of information possessed by the parties, firms can be seen postponing their listing if the company is currently undervalued by a pessimistic market until it is more favorable. It has also been suggested that companies sometimes actively avoid equity issuing if there are no other high quality firms in the field issuing any stock (Ritter & Welch 2002, 1799).

3.2 On Pricing Equity Offerings

Equity offerings and their pricing have been extensively studied since the 1960's. As Mikkola (2007, 3-4) points out, this interest is not very surprising considering the high potential for inflated profits associated with many public offerings. There is a general trend of underpricing stock offerings all over the world. An equity offering is considered to be underpriced, when the initial listing price is smaller than the price at the end of the first trading day. Ala-Ilomäki (2006, 4-6) notes that such a difference cannot be

considered a compensation of systematic or liquidity risk taken by the investors because those risks still exist at the end of the trading day – the listing price is, therefore, not dictated by the usual rules of supply and demand but by other principles used in setting the listing prices.

Numerous theories and hypotheses surrounding the anomaly have been suggested, often based on different degrees of information asymmetry, although there does not seem to be conclusive evidence for it (Ala-Ilomäki 2006, 85-89; Inkinen 2002; Ritter & Welch 2002, 1822). Besides information asymmetry, Mikkola (2007, 4) and Ala-Ilomäki (2006, 25-35) list several additional theories based on other factors such as the main dealer's fee, attracting analysts' attention, and book building, although these were not found to be any more or any less convincing as a cluster than theories based on asymmetrical information. As a case in point, Boyle, Stover & Carter (2009; 3, 16) refer to Healy & Palepu's (2001) summarization of literature in support for information asymmetry and proceed to lean on e.g. Welch & Ritter (2002) in concluding that, in fact, there is no substantial evidence for asymmetrical information being the main reason for underpricing.

Loughran and Ritter (2002, 22-23) argue that “higher valuations have resulted in issuers being more complacent about leaving more money on the table. This, combined with the desire of underwriters to leave money on the table and receive indirect compensation from buy-side clients eager to receive IPO allocations in return, results in greater underpricing. This accounts for most of the increase in underpricing over time.” They go on to state that while during the 1980's boom information asymmetry may have been the main reason for underpricing, agency problems have since been a more important reason for underpricing. While research on the topic may not be conclusive, it should be kept in mind that while underpricing a stock may attract investors, the potential cost in equity is borne by the issuer.

3.3 Requirements for Listing

Finnish national legislature on securities markets is largely based on the securities markets legislature given by the European Union; mainly the Markets in Financial Instruments Directive (MiFID). The Finnish Securities Markets Act (746/2012) and relevant supplements decree the prerequisites for an IPO, excluding due diligence procedures

based on generally accepted market practice. The FSA lists key areas of regulation that concern issuers of securities in the Finnish market. These are prospectuses; insider issues; disclosure obligations; flagging; supervision of financial reporting; and supervision of mandatory bids and takeover bid procedures. As a rule, generally accepted marketplace rules must be followed (FSA 2014). All applications to trade on the regulated market will also be evaluated by a listing committee at the stock exchange and applicant companies must be compliant with the rules of the marketplace (NASDAQ OMX Helsinki 2013).

3.3.1 Due Diligence

Due diligence (DD) refers to the processes investigating a company's affairs in preparation of a potential transaction, in this case the IPO. It is also a way for the external parties to demonstrate that proper and reliable measures were taken in conducting the due diligence processes and as such forms one of the most central parts of an IPO. While there are no specific legal requirements set for due diligence, it will take up a significant portion of any public offering – interviewee F (Lawyer (Partner), Mergers & Acquisitions, Capital Markets) noted that if viewed from a documentation perspective, it may form as much as a third of the overall advisory costs for the company due to cross-checking and time taken drafting the related texts. There was a fair consensus among the interviewees about this matter – possible specific expenditure is discussed in section 4 with the constituent parts of the overall costs.

Clarke and Firenze (2007, 3-4) make the following classifications for IPO due diligence: Background DD; business DD; financial DD; accounting DD; legal DD; and corporate governance DD if applicable.

The above may already illustrate how taxing this process may get. Background DD encompasses an initial investigation into the company, including analyst reports or past legal filings. The formal IPO DD -process begins with business DD, whereby the underwriter or legal counsel may engage in discussions with the company management and business partners or suppliers. Financial DD will include inspection of the company's financial status by the investment bankers and legal counsel – pro forma financial statements, past and current budgets, credit and loan status will all be closely reviewed.

Accounting DD includes examining the required IFRS financial statements for the prospectus, accounting practices, internal controls and the comfort letter provided by the external auditors that the financial statements are in proper order. Legal DD is related to the aforementioned areas, referring to the generally document-intensive nature of the DD process as well as looking over existing business contracts, loans and any other agreements that may be material to the IPO. In Clarke & Firenze's classification corporate governance DD refers to the Sarbanes-Oxley Act in United States legislature, but in Finnish terms ensuring compliance with the Corporate Governance Code is still a notable measure (Clarke & Firenze 2007, 4-9).

3.3.2 The Prospectus

Any party seeking to admit securities to trading on a regulated market is obligated to publish a prospectus. Before publication, it will be approved by the FSA. Altogether there are three different possibilities related to prospectuses when listing: it will either be an EU directive, as prepared by the Prospectus Directive; a national prospectus, if certain conditions are met; or a prospectus is not required at all, if other conditions are met (FSA 2014).

Commonly, an EU prospectus will be published: this is always a requirement if the equity offering will be on a regulated market, e.g. the NASDAQ OMX Nordic Official Lists, or the total consideration of the offer over 12 months is at least €5 million. A nationally qualified prospectus is a technical possibility if the total consideration of the offering over 12 month is less than €5 million and will not be offered on a regulated market (FSA 2014).

The possibility of not publishing a prospectus is offered, when at least one of the following conditions is met as defined by the FSA and not to be offered the stock exchange:

- The total consideration of the offer over 12 months is less than €1.5 million.
- The offer is addressed only to qualified investors.
- The offer is addressed to fewer than 150 investors.

- The total consideration per investor or denomination per unit is at least €100,000.

A prospectus as defined by the Securities Market Act can also be replaced with a readily available company description compliant with market place rules if the total consideration of the securities is under €5 million and admission is applied for the securities to be traded on the Finnish NASDAQ OMX First North market (FSA 2014).

3.3.3 Disclosure Obligations

The SMA requires issuers on regulated markets to publish all information and decisions materially important to the issuer's securities. With listing, this means obligation pertains to the aforementioned prospectus as well as obligation to publish material information periodically. This data includes interim reports, financial statement releases, full financial statements and management reports. The third type of disclosure required is significant information that pertains to corporate restructuring and future performance of the company. This includes profit warnings if the company's profits or financial position otherwise seems likely to change better or for worse from the earlier reports. These changes are to be reported without undue delay after the change in forecasts becomes likely to happen (FSA 2014).

Notably, the Securities Market Act no longer requires companies to assess future prospects in the interim or annual financial statements, but likely prospects are instead to be presented in the management reports under provision of the Accounting Act (1336/1997). It is still allowed, however, to publish these prospects in the interim reports, annual financial reports or include this reflection in reports pertaining to significant business acquisitions. Assessment of future prospects means consideration of future company performance related to underlying assumptions: while it is subject to appropriate diligence and must be well founded, the FSA differentiates it from profit forecasts whereby the company prepares the forecast in line with the reporting principles of its financial statements, so that the two are comparable by investors (FSA 2014).

Listed companies are also asked to provide information on corporate restructuring actions such as business acquisitions, reorientation of business activities, mergers, demergers, downsizing, liquidation or bankruptcy. In case of external actions such as acquisitions, essential information includes the principal terms and conditions in the action. The FSA also recommends that the company disclose its assessment of the impact of the restructuring on the company's performance, if possible. The dissemination of restructuring information is meant to ensure that investors are able to assess the profitability of these actions on a case-by-case basis and their effect on the company securities (FSA 2014).

The Transparency Directive requires companies to disseminate the aforementioned information as full, unedited text in a timely manner. It must be made available to the media, the FSA and the regulated market (FSA 2014).

3.3.4 Financial Reporting

International Financial Reporting Standards, or the IFRSs, were adopted for use in the European Union since the beginning of 2005, including Finnish listed companies. Since 2007 this supervision has been extended to issuers of bonds and notes as well. The aim of adopting the IFRS has been to promote dissemination of transparent and easily understandable financial information to the market so as to facilitate investors' decision making (FSA, 2014).

Under the Accounting Act (1336/1997), Finnish companies offering equity in a regulated market are required to follow IFRS accounting standards. Listed companies' financial statements must also be periodically published and made available for the media, the FSA and the regulated market under the Securities Market Act (746/2012). In terms of representing financial information, the IFRS has been a significant change.

The traditional Finnish Accounting principles have been based on expenditure-revenue principles formulated by professor of accounting Martti Saario, stressing prudence and historical costs. Finnish accounting legislation was based on these principles 1973-1997, after which it was taken to a more international direction with the incorporation of European Union accounting principles in 1992 and 1997. The most important func-

tion of financial reporting before the official introduction of IFRS in the 2000's was the calculation of profits, while the balance sheet functioned as a storing place for capitalized costs and valuation questions have not played an important role (Pajunen 2010, 3-5).

IFRS principles, in contrast, do emphasize valuation aspects and stress the importance of the equity market – the most important characteristic is the further emphasis on the perspective of the investor and the need to disseminate information to the stock market (Oravainen 2010, 82).

3.3.5 Corporate Governance

The Financial Supervisory Authority and the Rules of the Exchange require that listed companies comply with the Finnish Corporate Governance Code kept by the Securities Market Association, listing corporate governance principles and practices that aim to keep Finnish companies up to date on high international standards on governance principles. The code lists practices related to general meetings to shareholders, the board, board committees, the managing director and other executives, remuneration in the company, internal controls, insider information administration and information distribution. Notably, the code has been prepared on the so-called Comply-or-Explain principle: this means that if a company chooses to not implement one or more of the recommendations in the code, it is obligated to disclose the reason for the departure in its management statement (Securities Market Assn. 2010, 6).

The FSA further recommends that the listing company and the underwriter prepare for the listing by preparing a due diligence -checklist or an equivalent related to the governing principles of the company so as to ensure it is prepared for the listing in terms of proper governance. It presents an example scheme for carrying out this supervision. Governance principles; management accounting; budgeting and forecasting measures; risks and risk management; and company personnel should all be individually evaluated. The assessor, form of documentation and notable information for each segment should also be summarized (FSA 2013).

3.4 Listing as a Chronological Process

This section relies on both academic sources as well as the interviews conducted for the thesis. It appears there is no single, correct way of representing a company's path to its first public equity offering – the length, complexity and number of simultaneous processes varies from business to business. There are some generally shared common factors, however, and these may be represented in a fairly simple roadmap form as in Figure 4 to illustrate the rough phases involved.

There was a fairly good consensus among the interviewees that a listing process generally takes somewhere between 6 and 9 months from the first talks to the effective listing date, depending on the complexity of the company listing. It was suggested by interviewee A (Associate Director, Corporate Finance) and comments were made by others to the same effect.



Figure 4. Timeline of the IPO process. Source: PwC 2012.

Figure 4 is a generalization of the process, but it does help in visualizing it: even before the company begins negotiations with third parties vis-à-vis the prospectus, IFRS-conversion and other considerations that need to be carried out before official listing, an initial phase of pre-planning is advisable in order to identify possible problem areas or measures that may be undertaken before the process.

Interviewee D (IFRS Expert, Accounting) suggested complying with IFRS as far as possible beforehand: some of the principles that are optional under Finnish Accounting Standards are mandatory under IFRS, such as activating significant research and development costs in the financial statement. His opinion was that in

general the process becomes incrementally easier and therefore shorter by the amount of measures that the company is able to carry out by itself before experts step in to check the work and give their comfort letters. In terms of accounting, this will be facilitated if the company already has some familiarity with IFRS practices even if they are not being followed as of yet.

The IFRS-conversion process was considered as one of the most bureaucratically taxing parts of the listing sub-projects by interviewee E (Lawyer (Partner), Mergers & Acquisitions, Capital Markets), surmising that it is in practice one of the things that are and should be started as early as possible in the listing process. This observation was substantiated by interviewees' C (IFRS Director) and D descriptions of the process. Interviewee C estimated that the conversion process tends to take 3 to 6 months – a significant proportion of any listing. Interviewee D described the conversion process in detail as beginning straight after the initial company kick-off, followed by checking what measures need to be taken for the conversion, after which several sub-processes in different departments in the company are begun to convert their accounting principles, ending with finalization of the gathered information.

As the official process of transforming the company into a public company is being kicked into gear and initial negotiations with the underwriter and advisors has been completed, the legal advisors preferably begin their work with due diligence -interviews for different parties (interviewee E). For legal advisors, the listing process consists largely of ensuring due diligence measures, incl. comfort letters affirming the correctness of information and proper measures undertaken in reporting is, as well drafting and checking the prospectus for listing.

The interviewees tended to agree that the timetable for the entire process should be agreed upon in the start of the process – interviewee D went on to note that the time reserved for the listing preparation also shouldn't be too long. Reserving an unnecessarily long time for the process will inflate the costs for the company, but it could potentially complicate the listing even further if new market information or restructuring actions come up, reflecting into listing process by necessary revisions of the financial statement and prospectus.

4 Constituent Parts of the Aggregate Cost

The following sections will concern the information given by the interviewees in relation to the listing process. All the interviewees were presented with questions posed in Appendix 1. All of those interviewed were specialists in the main advisory areas of the listing process, namely financial, legal and IFRS consultation, and as such had expert insight on the thesis research questions. The sections will be interspersed with academic sources where it is appropriate to explain, add to or reflect on the questions.

The expenses are represented according to their sources so as to emphasize where they arise during the process. One rougher way of grouping direct expenses is into two main classes and further two sub-classes, i.e. expenses preceding and following the formal registration as a listed company, and one-time vs. incremental expenses related to them (PwC 2012). The sub-classes might then be expressed as costs directly applicable to either the offering or conversion to a public company, vs. costs that keep running during the processes before and after formal listing. While both the costs of transforming into a public company and continuing existence as one are important in gaining a comprehensive understanding of the cost of an IPO, it should also be borne in mind that the effective date of the first trading day is not a specific cut-off or starting point for running expenditure.

4.1 Preparing for the Listing and Prospectus

Based on total IPO proceeds, the largest expense will rather invariably result from the underwriter's fee, which was also a consensus view among the interviewees. Legal fees and the external auditor's fee follow behind, although both may subject to significant variability based on different factors involving the IPO. Especially legal fees will multiply in case of an international listing.

Data from the United States market illustrates the degrees of relative costs, although it should be borne in mind that they are not directly applicable to Finnish markets. Kaserer and Schiereck (2007) divided costs into direct flotation costs and indirect costs arising from underpricing, looking into differences between markets – they found that while there were some statistically significant differences between markets in direct

costs, they were comparable in scope. Figure 5 below illustrates that costs were consistently ordered so that the underwriter’s fee was followed by legal and auditing costs, respectively, followed by assorted administrative costs. Findings in this paper are comparable in terms of relative cost size.

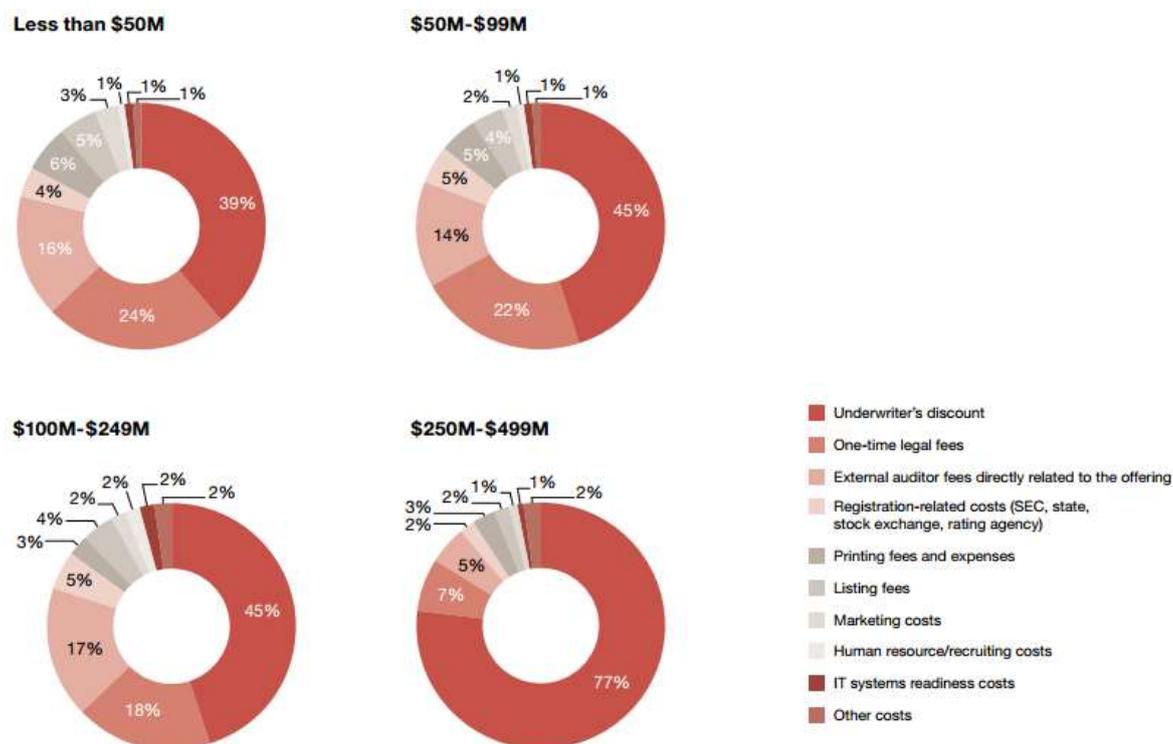


Figure 5. Proportion of one-time costs directly related to going public based on IPO proceeds. U.S. market. Source: PwC 2012.

4.1.1 Underwriter’s Fees

The underwriting bank gives procedural and financial advice to the preparing company and oversees stock buying and reselling. The lead manager is in charge of the company’s listing process and is responsible for making sure that it is in a suitable financial condition for public trading (Brealey, Myers & Marcus 2012, 427; PwC 2002, 11). This highlights the importance of due diligence processes as part of the costs, because the underwriter and advisors seek to minimize their risk by making sure due diligence is carried out reliably (Interviewee B; Director, Corporate Finance).

The underwriting agreement details the responsibilities and specific role of the underwriting bank. This may be a firm commitment whereby the underwriter buys part of

the shares in the listing and resells them to public, earning a fee through the sales spread. In a riskier case the agreement is written on a best efforts basis, in which case the underwriter does not guarantee the sale of the entire issue but as much of it as possible. Other, rarer alternatives are a standby agreement in which the lead manager buys remaining stock not sold and an all-or-none emission in which the issuance may be canceled if all stock is not sold (Brealey, Myers & Marcus 2012, 427; Mikkola 2002, 23).

In case of an international or otherwise large IPO, an underwriting syndicate may be formed whereby a lead firm forms a team of investment banks that may share the responsibility for the stock issue (Bodie, Kane & Marcus 2002, 65). A syndicate is better placed to market the issue than a single underwriter, but as the involved parties increase, so do their commissions and advisory costs (Interviewee B). As these costs are all carried by the issuing company, this may multiply flotation costs – the underwriters must assess whether the size of the issue is sizeable enough.

In practice there is significant variance in the fees that may be agreed upon with the underwriting bank arising from different company risk profiles. According to interviewee A, possible fees for the underwriter in a smaller IPO is on the order of a few per cent, whereas in the case of larger equity offerings it may be as small as 0.5-2 per cent. There is some leeway for alternative pricing, however – depending on the case, it may be agreed upon that the underwriter receives a certain fixed fee, whereby the percentage fee of the proceedings is smaller. The underwriter aims to screen the company holistically before a decision is made to proceed with an IPO: the company must be reasonably stable and there have to be good prospects for expansion. Interviewee B agreed: because the banks undertake IPO commission based on a percentage fee, their compensation may be anywhere from approximately €300 000 to €200 million in a very large international IPO. In proportion to other costs it will always form a bulk cost in an initial listing also because the underwriter has a responsible and therefore risky position in any primary listing.

4.1.2 Legal Fees

The underwriter and issuing company require fairly wide-ranging legal consultancy and documentation drafting. From the beginning to the end of the listing process the

responsibilities of the legal counsel include due diligence considerations including interviews and addressing issues like material contracts, past litigation and intellectual property issues, as well as otherwise drafting the prospectus and other documents like the listing application for the stock exchange listing committee. The lawyers will also be involved in the discussions between parties such as the underwriting agreement meetings.

Both interviewees E and F, representing the legal counsel expertise, agreed that the prospectus is in the center of the required work in preparing for the listing. As noted by interviewee E, the investors' decision to buy stock in the company must be based on information that can be found in the prospectus. While the Securities Market Act (746/2012) and relevant European legislature that it is based on is strict to begin with, interviewee E also remarked that the work involved with the prospectus will vary depending on how complicated describing the company is. The company also needs to have a clear strategic view on its equity story beforehand so it can be integrated to the prospectus in a timely manner.

Cross-checking the advisors' work also increases the amount of legal work required: interviewee C (IFRS Director) added that the comfort letters issued by the auditors also have to be examined by the lawyers. This practice of issuing affirmations comes from the legislative tradition but has spread to the European markets as well.

As mentioned in section 3.3.1, interviewee F (Lawyer (Partner), Mergers & Acquisitions, Capital Markets) estimated that from a documentation perspective due diligence may take as much as a third of the entire flotation cost. His estimate for efficient legal counsel working hours for a domestic IPO may be in the order of 1000 hours. Interviewee B (Director, Corporate Finance) commented on due diligence costs independently as well, estimating that these kinds of "reliability costs" may run anywhere between €100 000 and €1 million in a moderately sized IPO. Interviewee A also suggested a rough figure of €300 000 involved in IPO due diligence, corroborating the previous estimations.

Notably, however, if a company decides to enlist on the First North market and the total value of securities offered does not exceed €5 million, publishing a prospectus is not mandatory. Instead, a company description compliant with the First North rules is sufficient (FSA 2014). Both interviewees E and F noted that the cost savings may be significant if this option is taken, due to the lighter nature of the company description in comparison to a mandated prospectus, as well as the possibility to eschew the IFRS-conversion in favour of standard Finnish accounting practices.

4.1.3 IFRS-conversion and External Auditors' Fees

Converting from Finnish Accounting Standards to the International Financial Accounting Standards was considered the most bureaucratically complex part of the listing process. Interviewees C and D, representing the IFRS expertise in the interviews, and interviewee E from legal counsel, noted independently that along with the prospectus the IFRS conversion should be begun as soon as the going-public process is begun. Interviewee D remarked that while there are always baseline actions that must be carried out in the conversion, its complexity and therefore final cost will be affected by the nature and scope of the company's business. Besides there simply being more data, more difficult questions like valuation of immaterial assets and handling of securities in the financial statement will have an effect on the final cost of the conversion.

As noted in section 3.3.4 the required IFRS principles have a marked effect on how the company looks financially. As a pinpoint example of this Restamax Plc, listed on NASDAQ OMX Helsinki Official List on 28 Nov 2013, noted on its prospectus that it had been compensated in 2011 for one of its burned-down restaurants – there was a profit and loss effect of €2,5 million based on IFRS principles vs. an effect of €1,3 million based on Finnish Accounting Standards (Restamax Plc 2013, 50).

Interviewees C and D described the conversion process in detail. According to interviewee C the conversion may be completed in a space of three months, but usually lasts closer to six. The role of the external auditor is essentially in helping the accountancy in the company to carry out the conversion and preparing the finalized financial statements in IFRS form, from the preceding three years required for the prospectus. As the company accountants carry out converting the needed data into IFRS, it is ex-

amined and signed off by the external auditor in a comfort letter. There may be several comfort letters involved, the process of drafting each requiring more work by the auditors and legal counsel. On this note, interviewee A estimated that the costs tied to comfort letters may be between €80 000 and €200 000 in a conversion process.

The costs involved in IFRS conversion may be affected by a number of factors described in the interviews. Interviewee D noted that the company may, in fact, expedite the process somewhat by complying with IFRS principles as well as possible beforehand – for instance, the activation of research and development costs to the financial statement is mandatory under IFRS but optional under FAS. The interviewees agreed that if a company decides to list on the First North market, it may save in auditing expenses as IFRS compliance is not mandatory – however, this savings cost is fairly marginal compared to the final size of the emission dictated by the underwriter and the company.

A number of complicating factors to the process were also discussed. In the case that the listing company does not have the required operative data for the past three years, the auditors may forecast future profits and losses. This is not an easy process and presents a certain liability to the forecaster as well, increasing the auditors' fee. Additional expense will also be present if there are acquisitions or other major financial changes during the actual listing process, necessitating a review of the changes and their addition to the prospectus, also requiring a renewed comfort letter. If the audit of financial statements is carried out by the external advisor, an added pro forma statement will also be drafted, increasing costs.

Interviewees C and D agreed that some attention should also be given to the company accountants learning and carrying out the IFRS principles – it should be assessed whether there is a need for an additional employee dedicated to IFRS accounting or whether the existing department is able sustain the change. If additional personnel is employed, questions about IFRS expertise should be assessed with care as new persons should be intimately familiar with IFRS practices.

4.2 Other Expenditures

The assorted costs related to listing include dues paid to various market entities, registration fees and other external agencies employed to assist in the listing process. The Financial Supervisory, book-entry account held by Euroclear and the officially appointed mechanism filing information system at the stock exchange are regulated. Additional fees will be charged by the marketplace and other parties employed at the company's discretion like the prospectus publisher and marketing firm.

4.2.1 Assorted Fees and Registrations

Additional expenses are incurred by the company in paying various registration, annual and administrative fees. These include marketplace fees on the First North market or Official List; fee for the supervisory authority; and registration and annual fees for the book-entry account.

The Financial Supervisory Authority covers its activities by levying the companies it supervises. A set supervision fee for a company domiciled in Finland is set at €15 500 unless the market is considered liquid for the company's shares in which the case the fee is raised to €31 500 (FSA 2010). The FSA divides its costs into supervision and processing fees on an actionable basis as based on the Act on the Supervision Fees of the Financial Supervisory Authority (No. 879). The processing fees are based on specific actions undertaken by the FSA (FSA 2014a).

Euroclear Finland is responsible for keeping the book-entry system for securities. As detailed in its price list for companies and institutions, the annual safekeeping fee is 0,004 per cent of the total value of book entries plus the value-added tax for that sum, currently 24 per cent (Euroclear Finland 2014).

NASDAQ OMX Helsinki charges various fees from its clients to finance its operations. The registration fee to the Official List charged at initial listing is set at €40 000. Ongoing costs charged quarterly are based on the market value of the listed company at the start of each quarter, varying from 0,002223 per cent of market value for companies at the smallest range and 0,000042 per cent at the largest market values. Finnish

issuers filing regulated information with the officially appointed mechanism are charged €1 600 initially and €1 000 annually. NASDAQ OMX Helsinki also offers specialist services if consulting is needed – their fees are listed as hourly rates from €180 for a specialist to €460 for training, but these are seldom charged from the company. Fees for First North companies are listed separately. Application fee for shares is €5 400, with ongoing quarterly fixed fees paid by quarter based on company market value, varying from €1 400 to €9 200 (NASDAQ OMX Helsinki).

NASDAQ OMX Helsinki handling fees for changing listed shares vary from €400 for minor changes or an adding listed option rights to €7 500 for delisting a share from the Official List. Other matters presented to the listing committee, Board of Directors or the CEO of NASDAQ OMX Helsinki is set at €2 000, €5 000 or €10 000 based on the extent of the matter but is not part of ordinary expenses.

4.2.2 Public Relations Expenditure and Publishing

Quantifying public relations and publishing expenditure is difficult because the need for these services is entirely based on company need and its specific situation. If much of the issue is intended for domestic institutional investors, these costs may be modest, but in the other end of the spectrum an international listing aimed at private investors would require a much greater investment. Interviewee A estimated that fairly typical marketing costs to be €30 000 – €100 000 including management roadshow costs. The general conception among interviewees was that marketing costs may be inflated by the company themselves but it is usually fairly clear based on individual business situations how much it should be. Based on these estimations marketing costs may run on a similar relative value to overall expenses as registration costs.

Publishing costs were estimated to be on par with singular registration costs, amounting to a fairly marginal cost. Physical publishing is not needed on a very extensive scale because all the necessary information will be provided and kept up to date electronically. A possible if unlikely extra cost on publishing arises if an error discovered in the prospectus and a republishing is required.

5 Results and Discussion

The direct costs involved in a public listing were confirmed to be the underwriter's premium and total cost for the hourly fees charged by legal counsel and external auditors. Registration and marketing fees altogether form a smaller part of the overall cost. A notable result of the cost examination from a company's perspective is that if an underwriter considers it eligible for listing, some baseline direct costs will always be carried: risk management is a key issue in the listing process for all parties.

It appears that only a marginal benefit can be achieved by asking for bids among underwriters and advisors – the underwriter will always assess eligibility and potential emission size on a case by case basis and different investment banks have differing criteria for approved listings. In all cases, however, the company will bear the cost of the underwriter agreement whose contents will be determined on the basis of risk taken by the investment bank.

Cost consideration for legal counsel and external auditors is similar. The expense for both may be considered from a risk management and expertise basis. Price for counsel cannot be driven below a level generally accepted by popular market parties, because plausible deniability for all external participants must be maintained – using a non-experienced party for due diligence considerations may be questioned if any claims arise after the listing. In other words, if claims of any misconduct arise, the underwriter or company is not justified in using an advisory body that was not generally approved in the market. From an expertise standpoint, newcomers to the market may not have the required resources to carry out the needed duties. IFRS expertise, for instance, is concentrated on the Big Four auditing companies.

Registration costs tend to be fixed costs with some additional procedural costs like the supervisory authority's processing fees. Affecting this part of expenditures is not possible but they always form a small portion of the overall cost. These dues include the publishing cost, which may be negotiated. In the category of assorted costs, the variability of marketing and investor relations costs in general was greatest.

The First North market option is less capital intensive than listing on the main market, but has been considered a riskier option in Finland. In comparison, the Swedish First North market has been fairly popular – if the Finnish First North option is adopted by a greater number of companies, its attraction as an alternative will consequently be increased. Savings associated with First North arise from the possibility that an EU prospectus can be eschewed if the offering is smaller than €5 million, the IFRS principles are not a requirement, the combined effect of which expedites the market entrance process. Costs involved with legal counsel and external auditing are consequently reduced as well.

In entering the NASDAQ OMX Helsinki Official List, conducting a pre-IPO study can be a good way to prepare for the listing process – interviewee A suggested that company lawyers may carry this out. Other options are hiring a consulting firm for this purpose or dedicating internal company resources for it. While incurring some additional costs in the beginning, pre-planning may facilitate the consequent listing process in terms of streamlining it as well as possible.

5.1 Personal Remarks

The interviews were mostly conducted in February and March - the writing process was concentrated in April and the beginning of May. In retrospect the writing process could have been begun in March for the theoretical framework section so as to spread the process more evenly.

An initially unexpected problem arose with the legal documents and standards related to listing: as the new Securities Market Act is fairly recent, there is no official translation of the act or the related standards given by the Financial Supervisory Authority. It also quickly became apparent that there is some scarcity for raw Finnish IPO data: most of the publicly available, large-scale studies on IPOs are concentrated on the U.S. market which has some different rules for listing than the European market.

5.2 Avenues for Further Study

The topic merits extensive research and is likely to continue inspiring new studies. Certainly other avenues of examination might include cross-listing and bond issuance questions as a cost analysis study; other markets, such as the United Kingdom with some of its unique features on regulation; ongoing costs after listing on the short- and long-term; in-depth analysis of a specific parts of the aggregate cost; and a comprehensive study on First North Markets.

If sufficient resources are available, conducting an IPO study from the standpoint of internal company procedures would be rewarding information for the prospective new companies. This would require a strict observance of confidentiality and a broad access to internal company data, however.

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7 Appendices

7.1 Appendix 1. Questions posed for the interviewees

Questions and main themes discussed with each interviewee

1. Procedural: Please describe your role as an underwriter/financial expert/legal advisor/IFRS-specialist during a company listing
 - a. How does the project advance chronologically?
 - b. How is Your role positioned with regard to the prospectus production and due diligence, company personnel training, and IFRS-conversion?

2. Project costs: What is your conception of the scale of expenses that come with an IPO preparation? How about the scale that is involved in Your area of specialization?
 - a. What are the different expenses during the listing process that are related to Your area of specialization?
 - b. How significant are the costs incurred in Your area of specialization in relation to the overall cost of the listing process?
 - c. How about in relation to the other expenses incurred that You are not involved with? How would you gauge their significance?

3. Process management: In Your experience,
 - a. Are there specific difficulties that could be avoided before the process is begun, or during the process?
 - b. Is there room for saving on some part of the project?