

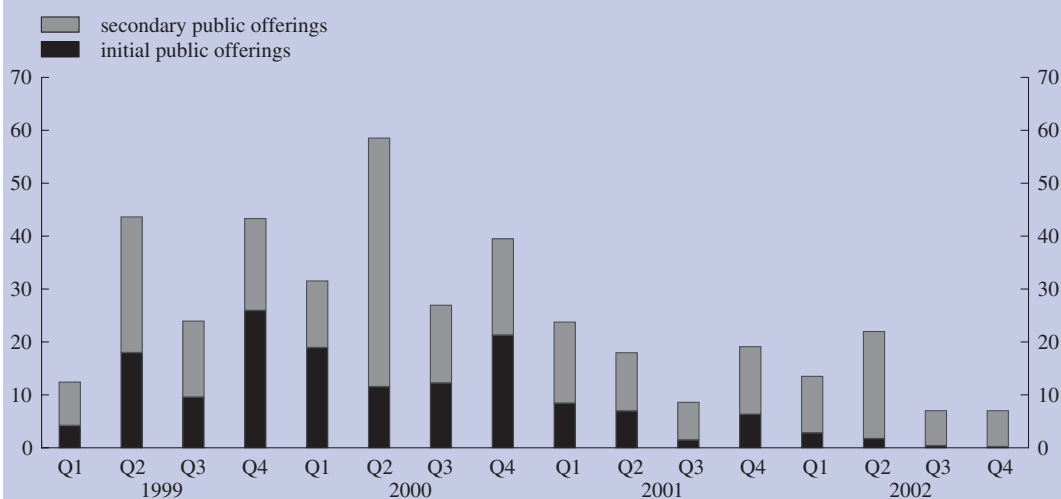
Box 3

Recent trends in equity issuance in the euro area

During the stock market boom of the late 1990s and early 2000, corporations in the euro area raised significant amounts of equity capital either in the form of initial public offerings (IPOs) or secondary public offerings (SPOs). Since then corporations have become increasingly reluctant and/or have found it more difficult to issue equity capital on public stock exchanges (see Chart A). This box examines some of the factors characterising the market for equity capital in the euro area and provides some explanations for the current low level of activity.

Chart A: Gross issuance of equity capital in the euro area

(EUR billions)



Source: Bondware.

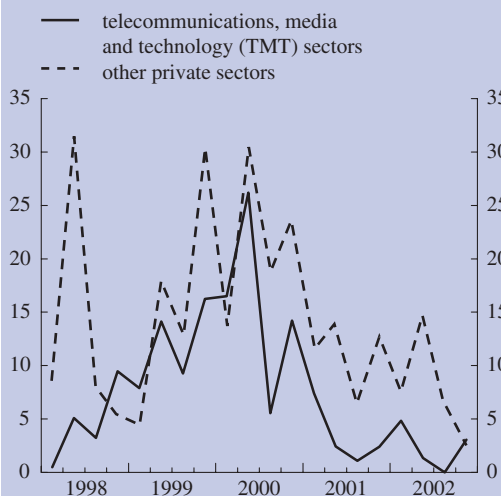
According to Bondware, a private financial data provider, in 2002 the value of total gross issuance of equity was at its lowest level since 1996 and only accounted for around 45% of the annual average for the preceding four years. The downward trend has been particularly marked with regard to IPOs, which virtually dried up in the second half of 2002 and, for the year as a whole, only amounted to 13% of the annual average since 1999. In the fourth quarter of 2002 only eight IPOs were registered in the euro area, with a total value of just €170 million. This should be compared with a quarterly average over the last four years of 49 IPOs and a value of €9.4 billion. Moreover, the evidence recorded so far, although anecdotal, suggests that the low level of activity on the equity markets has continued, and may even have declined further, in early 2003.

The extent to which companies turn to the stock markets to obtain funding for their activities is determined by a confluence of factors. First of all, the capital demand of firms is closely linked to economic activity. Hence, when the economy is booming there are plenty of investment opportunities and thus there is a great need to raise capital (either in the form of equity or through other sources of finance). Seen in this light, the subdued economic growth in 2001 and 2002 is likely to have contributed to the decrease in issuance activity on the equity market. Secondly, the cost of equity capital, estimated as the return demanded by investors to bear the risk of an equity investment, plays an important role in determining issuance activity.¹ When the cost of raising equity capital is high, the amount of shares offered to the public is likely to be low. The significant decline in stock prices and the low level of interest rates observed in the last three years, resulting in a higher cost of equity, may therefore have reduced many companies' interest in obtaining finance via the public stock

¹ See the box entitled "Activity in the euro area initial public offering market" on page 34 of the December 2002 Monthly Bulletin.

Chart B: Gross issuance of equity in the euro area by sector

(EUR billions)



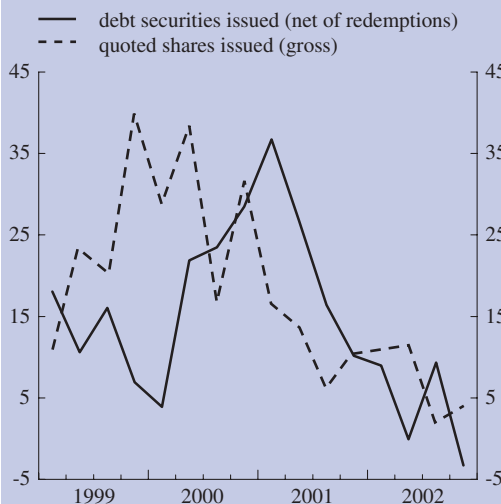
Source: Bondware.

which began in 2000, and, partly as a result of this, the gross issuance of TMT-related stocks declined sharply in 2001 and 2002. Yet, while the TMT sectors may have been the driving force behind both the boom and the subsequent slowdown in IPO activity, quoted share issuance by other sectors also declined substantially in recent years. In the fourth quarter of 2002 gross issuance by non-TMT sectors in terms of value amounted to just 20% of the quarterly average of the last four years.

As regards non-financial corporations, the slowdown in equity issuance activity in 2001 and 2002 was accompanied by a broadly similar decline in debt securities issuance (see Chart C). In the last quarter of 2002

Chart C: Securities issued by non-financial corporations

(EUR billions)



Sources: Bondware and ECB.

Note: Debt securities issues are net of redemptions, while quoted share issuance is shown in gross amounts.

markets. Thirdly, problems of asymmetrical information about the “true value” of firms might amplify the swings in IPO (and SPO) activity. In periods of widespread uncertainty about the correct valuation of firms, investors may be reluctant to buy equity. 2002 was a year of high uncertainty on the stock markets owing, among other things, to the continued concerns about accounting standards and corporate earnings statements. This is likely to have adversely affected the number of investors interested in financing share issuance.

Turning to the sectoral composition, public offerings in the euro area in the late 1990s and in 2000 were very much influenced by telecommunications, media and technology (TMT) companies which, at times, accounted for more than half of the value of all quoted shares issued (see Chart B). The TMT sectors were especially affected by the stock market correction,

net issuance of debt securities by non-financial corporations was -€3.3 billion compared with +€14.7 billion on average per quarter in the preceding four years, while gross issuance of quoted shares by this sector in the fourth quarter of 2002 had fallen to €4 billion, which was significantly lower than the four-year average of €18 billion per quarter. These declines in securities financing partly point to lower capital demand following the economic slowdown. The worsening of capital market sentiment in recent years may also have induced companies to rely increasingly on other sources of finance, such as private equity and internal financing. Furthermore, additional funding may have been obtained through special purpose vehicles (SPVs) and other non-monetary financial intermediaries. Indeed, by contrast with non-financial corporations, issuance of debt securities by non-monetary financial institutions remained strong throughout 2002, which may in part reflect the fact that many companies increasingly tend to use SPVs to issue debt.