

Lecture 12

Raising Capital 融资

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3 Nov 2025



Financing during a Firm's Life Cycle

- When you have a great idea and start up a company, you need money to grow it. Business large and small have one thing in common: They need long-term capital.
- However, banks will not lend money to start-up companies with no assets or track record. Angel investors (天使投资人) and venture capitalist (风险投资家) can help at the early stage of a company's life.
- As a company grows, it may raise fund from the public with initial public offering (IPO).
- After a company goes public, it can access the capital market using seasoned equity offering (SEO), issue bond, or borrow from banks.

Venture capital (风投)

- VCs are financial intermediaries that raise funds from outside investors
 - Limited partnership: fund manager is the GP. Institutional investors are LP.
 - Angel investors typically invest just their own money.
 - Corporate venture capital (CVC): corporate internal venture capital divisions.
- VCs play an active role in managing the investee companies.
 - Join the board of directors
 - Entrepreneurs are good at products but lack business experience. VCs are good at running business.

VC Exit Strategy

- How VC makes money?
 - VCs seeks to invest in a company at a low price, help it grow up, and cash out or exit at a high price.
 - But, most of the investee companies end up with failure. Their money is burn out. Ten projects, nine failures. Thus, VC investment is very risky.
- Exit strategy
 - Exit priority: Transfer ownership < acquisition < IPO. The selling price is the highest in an IPO.
 - One successful company can cover the loss of nine failures.

Stages of Financing

To avoid of the risk of losing huge amount of money, multiply rounds of financing happens in VC investment. Private equity funds (PE) usually enter in later stage.

- ❑ Seed-money Stage: prove a concept or develop a product. VC invests little in this stage.
- ❑ Start-Up:
- ❑ First-Round Financing: with positive sales
- ❑ Second-Round Financing
- ❑ Third-Round Financing: breakeven
- ❑ Fourth-Round Financing: are likely to go public

Features of VC

- VCs sit in the buy side and receive huge numbers of proposals. Entrepreneurs strive to persuade VCs for their investment.
- Personal contacts are important in gaining access to the VC market.
- VCs are very costly. They demand a large number of equity shares.
- VC typically demands several seats on the board and actively engages in management. They may even remove the founder.
- VC investment are strongly and positively related to economic conditions.

Initial Public Offering (IPO)



- IPO=going public: 首次公开发行, 上市
- A company's first equity issue made available to the public. The firm gets the proceeds but sell part of its shares.
- After IPO, the company's shares is listed in the stock exchanges and traded by public investors.
- The process hinges on investment bank's expertise and reputation.
- The PE ratio is usually higher than 20. Big money involved and very important moment in the life of a firm.

IPO procedures



- Management gets the approval of the board and decide to go public.
- The firm hires one or more investment banks (IB) as the underwriter. The IB conduct due diligence investigation , prepares all the documents required by the regulator (e.g., SEC and **CSRC 证监会**), and files a *registration statement* with the regulator.
- The regulator studies the registration statement during the *waiting period*. The firm may distribute copies of a preliminary **prospectus**. A prospectus discloses detailed information about the IPO firm for investors' evaluation.
- Registration (注册制) vs. Approval system (审核制)

IPO procedures



- The firm prepares and files an *amended* registration statement with the SEC. The IB values the IPO firm and an **offer price range** is given.
- The IB start the **road show** (路演) and **bookbuildin** (询价): contacts his clients and obtain information on their demand for the shares. A final offer price (发行价格) is determined.
- Investors subscribe shares. If the shares are heavily oversubscribed, IB allocate shares and may exercise the **green shoe** (绿鞋) option by over-allocating the shares.
- The shares start trading and IB provides aftermarket price support.

注册制 vs. 审核制



中国证券监督管理委员会
CHINA SECURITIES REGULATORY COMMISSION

繁體 | English | 移动端 | 微博 | 微信 | 无障碍

建制度、不干预、零容忍

首页
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当前位置: 首页 > 新闻发布 > 证监会要闻

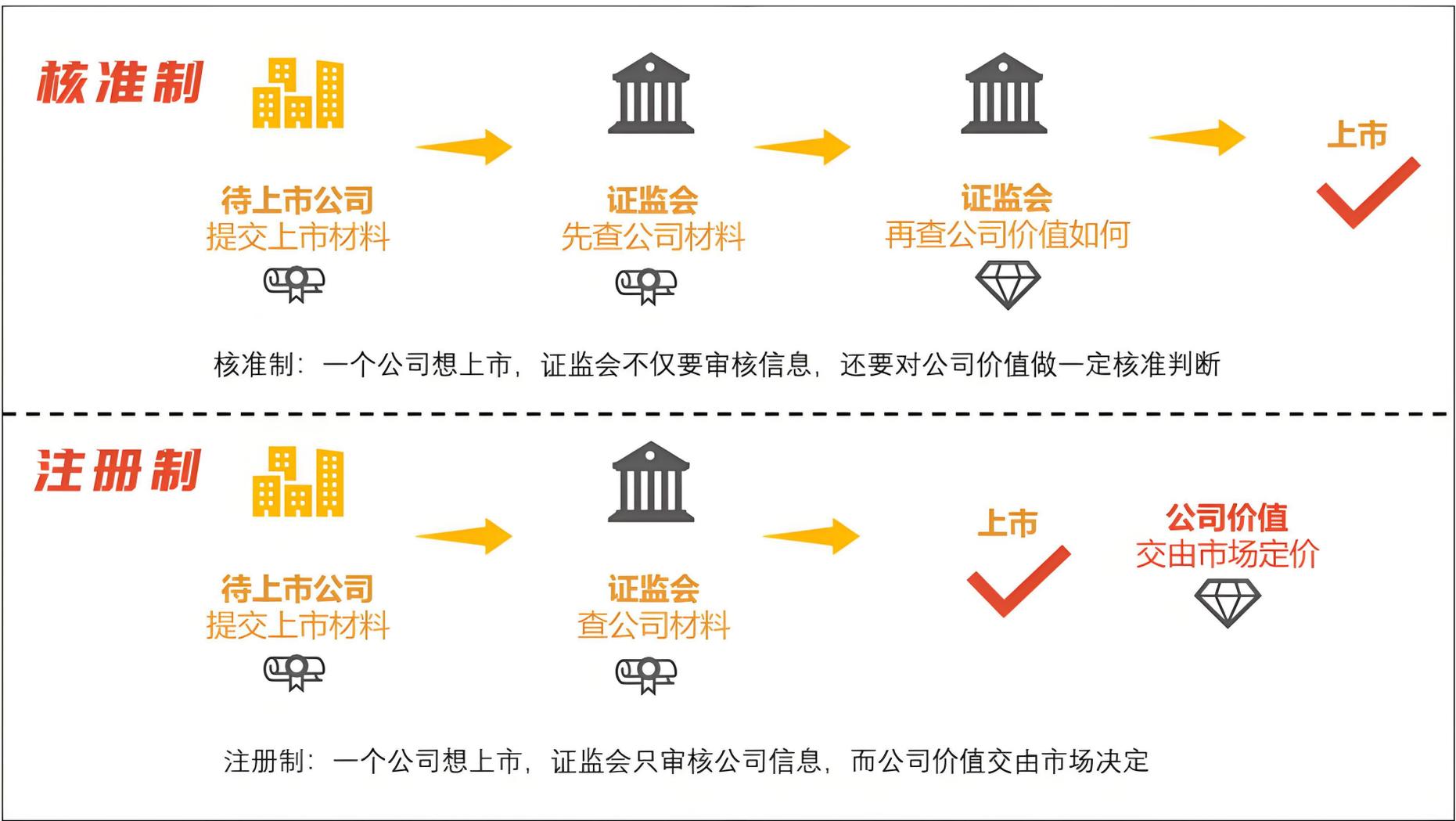
全面实行股票发行注册制制度规则发布实施

日期: 2023-02-17 来源: 证监会

【字号: 大 中 小】     +

2023年2月17日，中国证监会发布全面实行股票发行注册制相关制度规则，自公布之日起施行。证券交易所、全国股转公司、中国结算、中证金融、证券业协会配套制度规则同步发布实施。

注册制 vs. 审核制



Stock Exchanges in China



主板， 1990年成立， Many large state companies (SOEs),



主板， 1991年成立， Non-SOEs, firm size is relatively smaller. Chinex (创业板) is included



科创板， 2019年成立， Designed for high-tech companies



新三板， 2015年成立， Over-the-counter (OTC) market



新三板精选层， 2021年11月15日开始交易

多层次资本市场体系

我国的资本市场



Stock Exchanges in China

项目	主板	创业板	科创板	北交所	新三板
板块	上海/深圳证券交易所	深圳证券交易所	上海证券交易所	北京证券交易所	全国中小企业股份转让系统
成立时间	1990年	2009年10月	2019年6月	2021年11月	2012年
定位	大中型成熟企业	成长型创新创业企业	高新技术企业和战略性新兴产业企业	专业化、精细化、特色化、新颖化的中小企业	创新型、创业型、成长型中小企业
发展阶段	成熟期	成长期	成长期	成长期	初创与成长期

Why do companies go public?



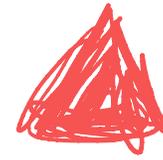
- **Financing:** Firm has access to the capital market and can obtain money with low cost to expand the business.
- **Wealth effect:** The owner's personal wealth is expanded significantly. Usually PE ratio > 20 . It means you suddenly get the lump sum of total 20 years' earnings.
- **Exit:** Shareholders (founders, PEs or VCs) can sell the shares in the secondary market and cash out.
- **Reputation:** Catch more attention from the public; Have greater bargaining power against suppliers and customers.

When do companies go public?

- Stock market condition: Firms tend to do the IPO in the boom market.
- Business life cycle: Firms tend to go public when they are mature, with low growth rate.



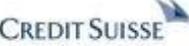
Investment Bank (投资银行)



- IBs are not commercial banks. They do not attract deposits from the public nor lend to others.
- IBs are specialized in advising and marketing public offerings of stocks or bonds, and are called “underwriters”
- IBs provide services such as research, valuation, marketing plan, IPO, SEO, bond issuance, Merger and acquisition, and restructuring.
- Reputation is the life of IBs. The Wall Street often provides rankings of IBs.

Big Investment Banks

World's Largest Investment Banks

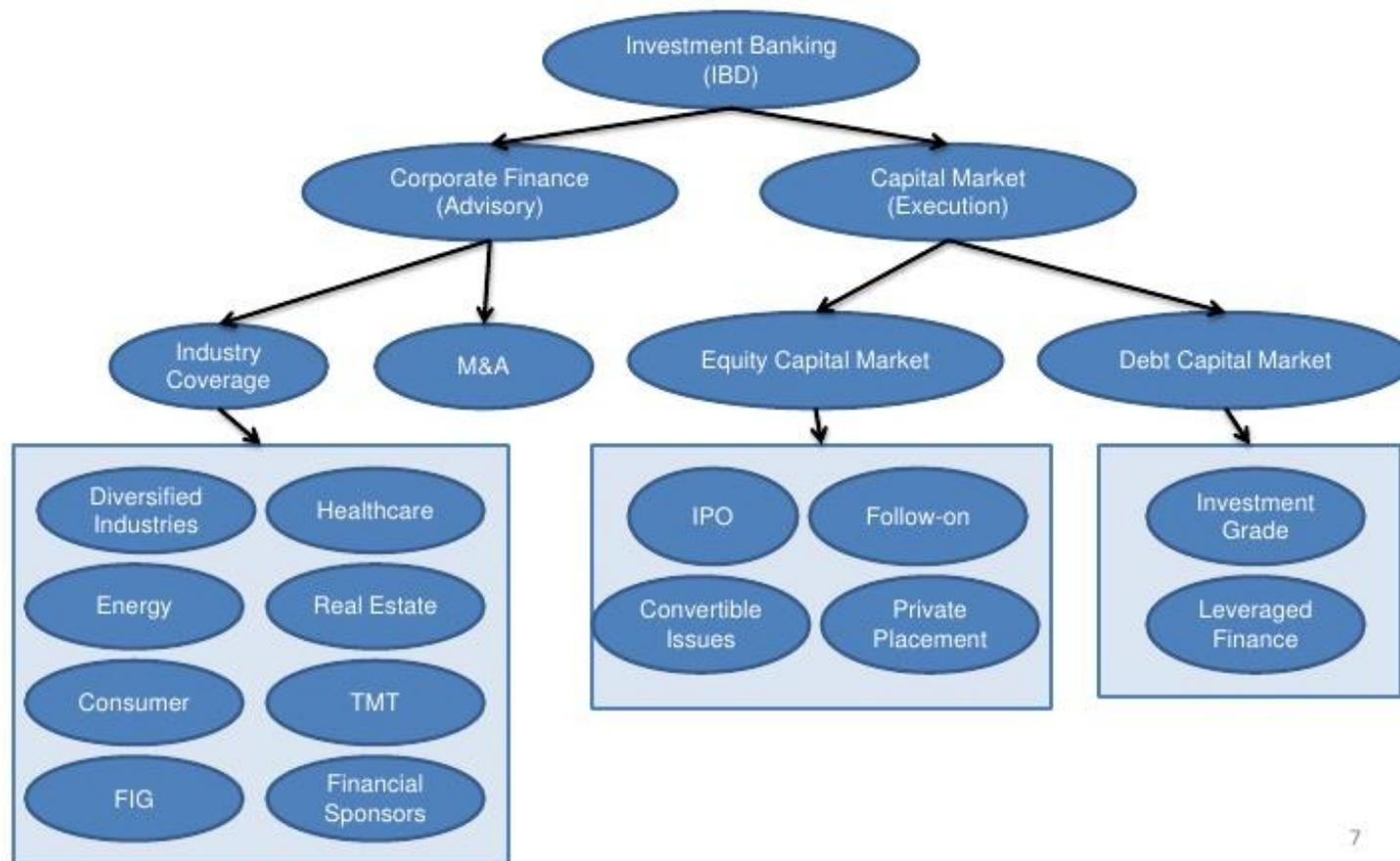
Rank	Name	Founded	Country
1:	JP Morgan & Co 	2000	US
2:	BoA Merrill Lynch 	2009	US
3:	Goldman Sachs 	1869	US
4:	Morgan Stanley 	1935	US
5:	Citigroup 	1812	US
6:	Deutsche Bank 	1870	Germany
7:	Credit Suisse 	1856	Switzerland
8:	Barclays 	1690	UK
9:	Wells Fargo 	1852	US
10:	UBS 	1854	Switzerland

2020年券商投行总承销排名

机构名称	收入 (亿元)	市场份额 (%)	排名变化
中信证券	29.05	11.00	0
中信建投	27.45	10.40	0
中金公司	22.38	8.48	0
海通证券	17.53	6.64	9
华泰联合	15.78	5.98	5
国泰君安	14.98	5.67	1
民生证券	10.94	4.14	5
招商证券	10.71	4.06	-2
国金证券	10.35	3.92	6
东兴证券	8.03	3.04	-1
光大证券	7.86	2.98	7
兴业证券	6.66	2.52	15
国信证券	5.92	2.24	-8

Business of Investment Bank

Investment Banking (IBD)



Three basic methods of underwriting

- **Firm commitment:** the investment banks buy the securities at a discounted price and accept the risk of not being able to sell them. This is the main issuing method in the real world.
- **Best effort:** The underwriters does not purchase the shares. Instead, they merely act as an agent, receiving a commission for each share sold.
- **Dutch auction:** The underwriter does not set a price for the security sold. The offer price is determined from submitted bids. This method is popular in bond markets.

IPO underpricing (IPO折价)



- The IPO firm wants the offer price to be high while the underwriter want it to be low. The final price is determined through negotiation between the underwriter and the firm.
- Assume the first-day close price is the fair price for the stock, underpricing or initial return is defined as:

$$\text{Underpricing} = \frac{\text{First - day close price} - \text{Offer price}}{\text{offer price}}$$

- Underpricing is a benefit to new shareholders but a cost to shareholders since shares are sold at price lower than its fair value.

Alibaba's IPO

Alibaba went public in New York Stock Exchange (NYSE) on 19 September 2014. The initial price range is \$66 to 68 and the final offer price is set at \$68. On the first-trading day, it opens at \$92.7 and closes at \$93.89.

- What do the relationship between the offer price and the original price range tell us?

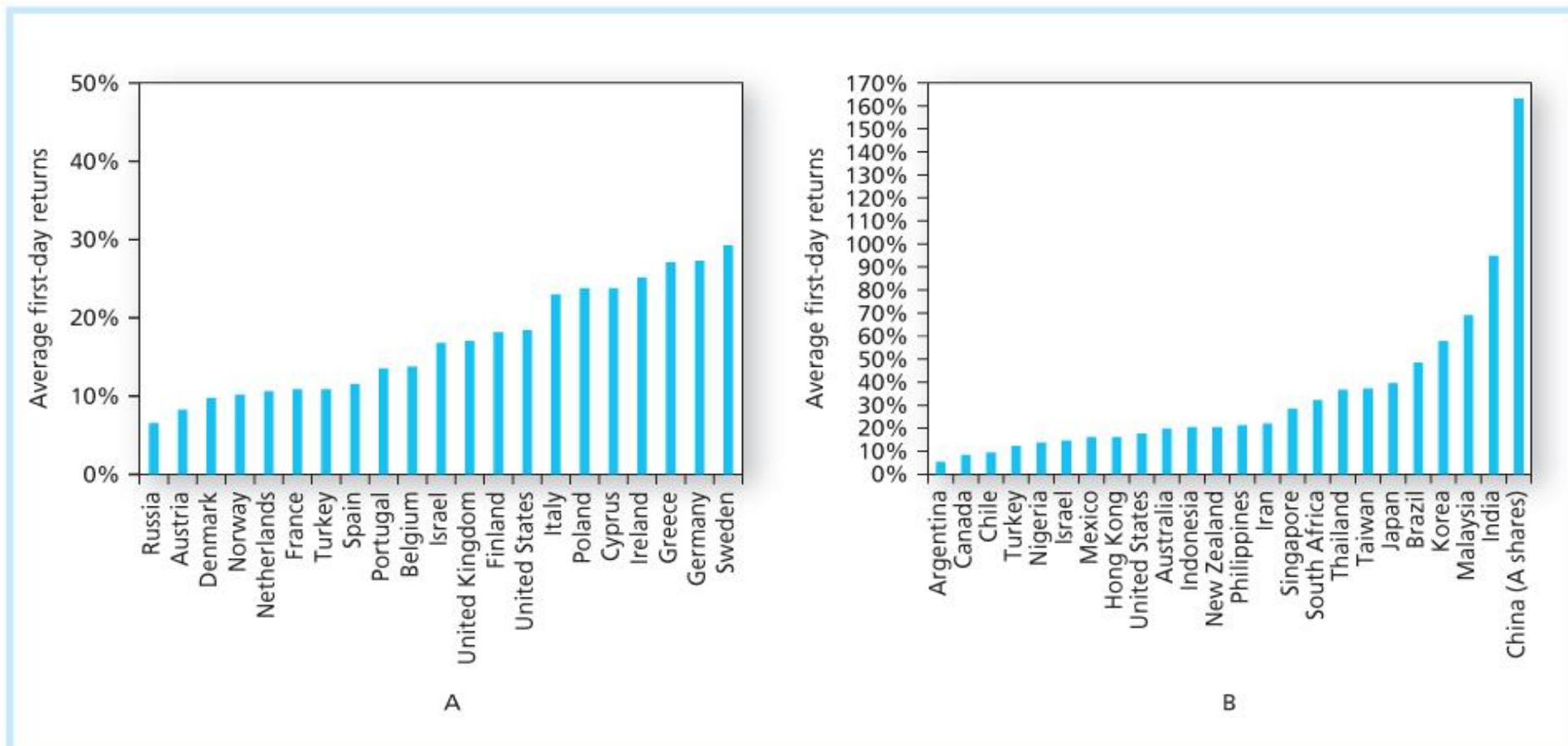
It tells us in the book building, its shares are highly demanded.

- What is the initial return?

$$\text{Initial return} = (93.89 - 68) / 68 = 38\%$$

IPO underpricing around the world

- Almost all capital markets in the world experience positive IPO initial return, creating the famous **underpricing puzzle**.



IPO underpricing puzzle

- Underpricing puzzle: why we observe positive initial returns around the world?
- A few explanations:
 - Winner's curse: You lose share allocation for good IPO because too many subscribe it. You win the share allocation for bad IPO because others who have better information avoid it. To attract the average investor, underwriter underprice issues.
 - Information asymmetry: To induce institutional investors to reveal their information on the value of the IPO in the bookbuilding, underwriters underprice issues.

Seasoned Equity Offering

- Seasoned equity offering (SEO): a new issue when the company's securities have already been publicly traded.
- The investment bank also participates in the SEO. But the process is much easier than IPO, since there is a trading price out there.
- Contrary to an average positive initial return of IPO, when a firm announces new issue of common stock, the price drops on average.

Why price drops upon SEO announcement?

- **Managerial Information:** Since the managers are the insiders, perhaps they are selling new stock because they think it is overpriced. Recall pecking order in capital structure.
- **Debt Capacity:** If the market infers that the managers are issuing new equity to reduce their debt-equity ratio due to the specter of financial distress, the stock price will fall.

Cost of new issues

- Direct cost
 - Gross spread, or underwriting discount (about 7% of the total money raised)
 - Filing and legal fee

- Indirect expenses
 - SEO price drop
 - Ownership dilution
 - IPO Underpricing
 - **Green Shoe** option: Underwriters buy additional shares to cover over-allotment. This is a cost to firm since underwriter will buy shares only when the offer price is below the first-day close price.

Debt vs. Equity

● Debt

- ❑ Not an ownership interest
- ❑ Creditors do not have voting rights
- ❑ Interest is considered a cost of doing business and is tax deductible
- ❑ Creditors have legal recourse if interest or principal payments are missed
- ❑ Excess debt can lead to financial distress and bankruptcy

● Equity

- ❑ Ownership interest
- ❑ Common stockholders vote for the board of directors and other issues
- ❑ Dividends are not considered a cost of doing business and are not tax deductible
- ❑ Dividends are not a liability of the firm, and stockholders have no legal recourse if dividends are not paid
- ❑ An all-equity firm cannot go bankrupt

Bank Loans

- **Lines of Credit:** Provide a maximum amount the bank is willing to lend. The borrower can draw down money anytime within a specific period. It is similar to personal credit card.
- **Term loan:** a loan issued by a bank for a fixed amount and fixed repayment schedule with either a fixed or floating interest rate.
- **Syndicated loan(辛迪加):** When lending amount is large, several banks form as a syndicate and provide capital together for the borrower. The lead bank is responsible for the negotiation and monitoring.

Bank Loan vs. Bond

- Bank loans are also called private debt while bond is public debt, since the investors of loans are banks, not public investors. Bond is direct financing while loan is indirect financing.
- Remember public issuance has much higher requirements. Not many firms can access to the public bond market. The interest rate on loans is usually **higher** than public bond.
- The maturity of a bank loan is much shorter than bond, usually less than 5 years. Most of loans are secured with collateral and banks can monitor the borrower stronger than public investors.

Financing during a Firm's Life Cycle

