Some See Google Dutch Auction in 2004
Sun December 21, 2003 08:03 PM ET

By Steve James
NEW YORK (Reuters) - With no initial public offerings on the calendar for the rest of the year, talk has turned to 2004 and increasing speculation over an anticipated Google offering.

When the Internet search engine company finally does go public, perhaps sometime in the first half of next year, some are suggesting the expected $16 billion offering might be made in a "Dutch auction," as opposed to the traditional Wall Street route through investment bank underwriters.

In spite of several published reports that it might chose the auction route, Google has said only that the company had no public announcement about its plans.

Opinion is divided over the possibility of a Google IPO auction.

In a Dutch auction, or uniform-price auction successful bidders pay only the price of the lowest accepted bid. The concept has not been generally embraced by Wall Street traditionalists, who prefer the status quo that allows for underpricing in which quick profits can be made when the share price rises on the first day of trading.

Yet as Wall Street has come under increasing scrutiny amid accounting scandals, insider-trading and conflicts of interest, auctions are gaining support as an alternative to the "old boy's network" of Wall Street as a more equitable way for firms to raise capital, and allow many people to invest rather than a favored few.

ARBITRARY PRICING, PREFERENTIAL ALLOCATION

The San Francisco firm of W.R. Hambrecht, a leader in Dutch auctions, has completed several Dutch Auction IPO's since 1999, including Salon.com, Peet's Coffee and Tea and Ravenswood Winery. Hambrecht views this as a viable alternative to Wall Street's traditional handling of IPOs..

"The traditional system has two problems: arbitrary pricing, and preferential allocation," said Clay Corbus, head of investment banking for Hambrecht.

"The investment bank says 'this is the price' and then distributes shares to special clients. It is not in the best interests of the (IPO) company.

"The current system favors traders instead of investors. Potential investors, who want to own shares, are shut out, it's an insider's game," said Corbus.

He said the historical reasons for underpricing are sound since it encourages investors to buy more shares in the after-market. "But in the late 90s that discount became institutionalized," said Corbus.

"There was a big hangover from '99 and 2000 and people realized they got caught up in the euphoria. They lost sight of what an IPO is. It's capital-raising not a marketing event."

He said auctions were a way of ensuring transparency. "Everybody is on a level playing field. When you get away from that there is a potential for corruption."

In contrast, Bruce Foerster of South Beach Capital in Miami, is not a fan of Dutch auctions. "What's wrong with Wall Street favoring its best customers?"

"Companies have been going public in the manner of today since the 30's, it's worked pretty well since every free market in the world emulates the way we raise equity capital.

"But a notion developed in the late 90's that companies were leaving money on the table (underpricing)."

At that time, he said, dot-com companies were opening at big premiums above the IPO price. "You don't see a lot of deals open at monstrous premiums today but who is being harmed?"

CONFLICT OF INTEREST

There is a historical role for middlemen, dating from Marco Polo, he said. "Conflict of interest won't go away so the investment banker is in the middle to ameliorate conflicts."

Timothy Pollock, a business professor at the University of Maryland sees advantages and drawbacks to auctions.

"The advantage for a company (going public) is that it can typically get a higher price, because the bidding occurs before the final price is set," Pollock said, "The price is bid up until the allocation is filled that means less underpricing or 'money left on the table'."

Pollock also noted that shares are more widely held by a pool of investors if a company is worried about control. "In an auction it's more egalitarian," he said.

As for disadvantages? "If an IPO doesn't have a bump in the stock price on the first day, it's widely perceived as being a failure," Pollock said.

"Lots of offerings have a first day jump and it brings publicity to a firm. So you could think of the money left on the table as an advertising expense."

He said studies have shown that underpriced IPOs are more likely to have second offerings, get more analyst coverage and are more likely to survive five years.

Professor Dan Dalton, dean of the Kelley School of Business at Indiana University said: "At best, an auction will raise more money for the company, but not necessarily for investors.

"A Dutch auction will get you closer, more quickly to what the market believes the price should be," he said.