Economics Department
PhD Program

IPOs-UNDERPRICING AND CORPORATE GOVERNANCE

Evidence from some Selected Emerging Markets

Presented by

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A thesis submitted to the Faculty of Economics and Political Science, Economics Department

In Partial Fulfilment of the Requirements for the Degree of Doctor of Science in Economics

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Abstract

Student Name: Bosy "Ahmed Gamal Eldin" Fathy Ahmed.

Title of the thesis: IPOs-Underpricing and Corporate Governance: Evidence from Some Selected Emerging Markets.

Degree: PhD in Economics.

Initial public offerings (IPO) tend to generate first-day abnormal returns compared to the rest of the market, and thus creating the well-documented IPO underpricing phenomenon. This thesis employs both the ordinary least squares (OLS) method and the quantile regression (QR) technique to investigate the relevance of information asymmetry theories, behavioural models and institutional explanations to cross-section variation of IPOs' first-day returns in a sample of 710 issues across seven emerging markets between 2013 and 2017. Determinants of IPO underpricing include firm, issue, market, and country-specific variables. Understanding influences of IPO underpricing across countries and firms has important implications for issuing companies, investors, and policymakers. Underpricing varies across the employed countries with a positive average of 78%, with $238 billion money left on the table. According to the OLS results, independent variables explain 26% of the variation of IPOs' first-day returns. Findings show that employing QR is crucial given the non-normality of the data and because each quantile is associated with a different effect of explanatory variables. Findings reveal the importance of country-specific variables (e.g., corruption control and the protection of private property) in explaining variation of cross-sectional IPO underpricing and, hence, confirming the institutional explanations of underpricing. The pre-IPO market sentiment significantly affects IPOs' first-day returns, confirming the investor sentiment hypothesis. The certification hypothesis, suggesting that employing prestigious underwriters are associated with smaller levels of underpricing, is not validated. Moreover, the ex-ante uncertainty hypothesis holds true, to some extent, in explaining underpricing in the employed sample.

Keywords: Initial public offering, Underpricing, Corporate governance, Information asymmetry, Quantile regression, Emerging market.

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Summary

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Initial public offering (IPO) tends to have a substantial initial first-day return compared to the rest of the market, creating the well-documented IPOs underpricing phenomenon. The total amount of money left on the table was estimated to be $172.08 billion over the period 1980 -2019. Therefore, exploring influences of IPO underpricing across markets and firms has important implications for issuers, investors, and policymakers. Theories explaining IPO underpricing are asymmetric information; institutional reasons; control and ownership consideration and behavioural theories. According to empirical finance literature, determinants of IPO underpricing are grouped under four categories. These categories are firm-specific, issue-specific, market-specific, and country (institution)-specific determinants. Company-specific determinants include, inter alia, board size, board independence, and ownership concentration as firm-level corporate governance (CG) variables. Effective CG can manage agency problems through internal monitoring and signalling the firm's quality to external parties, mitigating the magnitude of underpricing. IPO-specific characteristics include underwriter reputation where prestigious underwriters can reduce IPO underpricing according to the certification hypothesis. Market return (a proxy for investor sentiment) is a key market-specific variable. Country-specific determinants, largely neglected by literature, include legal framework quality and contract enforcement. Thus, the overall quality of the institutional settings, i.e., the country-level CG, is expected to mitigate the underpricing level. The thesis hypothesizes that cross-sectional variation of initial returns for 710 IPOs in seven emerging markets, namely, China, Egypt, India, Indonesia, Malaysia, Thailand, and Turkey through 2013 and 2017 could be explained in terms of firms, issue, market, and country-specific variables. It employs the ordinary least squares (OLS) method and the quantile regression (QR) technique to investigate the relevance of information asymmetry theories, behavioural models, and institutional explanations to IPO underpricing in the sample under investigation.

The thesis includes four chapters. Chapter one addresses theories explaining the decision of going public, benefits and costs of going public, highlighting IPOs procedures in the selected markets. Chapter two introduces theories explaining IPO underpricing and empirical literature. Chapter three covers the CG mechanisms and their linkages to IPOs underpricing. Chapter four models the relationship between IPOs underpricing and key explanatory variables. Moreover, it discusses empirical findings, policy implications, limitations, and area for further research.

Results reveal that using QR is important given the non-normality of the data and because each quantile is associated with a different effect of independent variables. Firm-level GC play a slight role in explaining variation of cross-sectional IPO underpricing whereas country-level CG are significant in explaining it and, hence, supporting institutional explanations of IPO underpricing. Thus, policymakers should take the required procedures to combat corruption, enhance the protection of private property and strengthen legal rights with the aim of lowering the costs of going public for domestic firms. The pre-IPO market sentiment significantly influences IPOs' first-day returns. Thus, firms can time their issuing through going public during hot periods rather than during cold periods. The certification hypothesis is not supported. Moreover, the ex-ante uncertainty hypothesis holds true, to some extent, in explaining underpricing in the employed sample.

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