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Coming to America: IPOs from emerging market issuers ☆

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Abstract

We compare the issue costs of 299 companies from emerging and developed market countries making initial public offerings (IPOs) in the United States between 1991 and 2001. Our results indicate that IPOs from emerging markets experience the same costs on average as IPOs from developed market countries. Although there is a large gap between the country risk ratings of the emerging and developed market countries, IPO issuers from emerging markets appear to bridge that gap by being large issuers in their respective home countries, listing more frequently on the NYSE, and having a greater proportion of activity in manufacture and infrastructure segments, and a lower proportion in high-tech segments. These issues occur following periods of strong U.S. and home market equity performance which helps to alleviate country risk. In comparison to their developed market peers, emerging market issuers are a select group of higher-quality firms.
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1. Introduction

Since 1990, a number of companies from emerging countries have gone public — raising equity for the first time anywhere — by issuing in the United States. The sheer volume of these initial public offers (IPOs) invites an examination of foreign entry into U.S. capital markets: Is entry frictionless for all foreign entrants, or do the U.S. equity markets impose barriers to entrants from emerging market countries in the form of higher issue costs or entry requirements? While the entry of foreign issuers into the U.S. equity market has garnered research attention, no study has examined the characteristics and costs of firms from emerging markets raising capital for the first time in the U.S. as compared to those from developed countries. Studies to date have examined the effect of a U.S. listing or a U.S. capital-raising event on an international firm's stock returns (e.g., Foerster and Karolyi, 1999; Karolyi, 1998; Miller, 1999; Errunza and Miller, 2000). These studies have compared the costs and benefits of foreign firms raising capital in the U.S. relative to raising capital in their home markets.[3] Bruner et al. (2004) (BCR) compared the costs and benefits of foreign firms' going public in the U.S. to domestic U.S. firms going public. They found that foreign issuers experience equivalent issue costs compared to U.S. IPO issuers. Though this might seem consistent with the ideal of a frictionless market for global capital, BCR found that foreign issuers were of higher quality than U.S. domestic issuers on a number of dimensions, suggesting highly selective entry into U.S. capital markets.

In this regard, issuers from emerging markets merit particular attention. A combination of information asymmetry (e.g., perhaps due to greater cultural differences or less analyst following) and higher country risk (observed in higher volatilities and yield premiums for emerging market securities) are at least two explanations why U.S. investors might discriminate among issuers from emerging and developed markets. Merton (1987) argues that markets can be segmented by information if investors purchase only the securities of firms they know. If firms from emerging markets are less well known to U.S. investors, all else equal, theory would suggest they face increased capital raising costs. Forty-six percent of the foreign U.S. IPOs originate from emerging market countries that are associated with high country risk. High country risk is symptomatic of differences in language, culture, and institutions that contribute to a lack of familiarity on the part of U.S. investors (see Coval and Moskowitz, 2001; Grinblatt and Keloharju, 2001; Sarkissian and Schill, 2004). Further, the same factors could also hinder the efforts of emerging market IPO issuers to generate institutional following and comparable analyst coverage relative to developed market IPOs.

The extent to which emerging market IPO issuers are less well known and possibly face higher issue costs relative to developed market IPO issuers is the central focus of our investigation. Are the entrants from emerging markets different from those from developed markets? In particular, is it more costly for emerging market issuers to enter the U.S.? This study extends findings of Bruner et al. (2004) in at least two dimensions. First, it profiles the emerging market IPO issues and issuers — these have not previously been described in the literature and offer important insights on the "carriage trade" of the U.S. equity markets in financing emerging market firms. Second, it compares the costs of equity issuance between samples of emerging market and developed market issuers. In equilibrium, emerging market firms will come to the U.S. only if the costs of issuing in the U.S. are equal to or less than the

[3] The studies examining listings typically find that the shares of international firms trading in their home market experience positive valuation effects as a result of a U.S. listing. The positive valuation effect is consistent with Lins et al. (2005) finding that after U.S. listing, firms improve their access to capital.

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