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A review of IPO research in Asia: What's next?

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Abstract

This paper examines the current status of research on IPOs in general, with special focus on Asian IPOs. As in the case of U.S. IPOs, most past studies on Asian IPOs deal with the issue of under-pricing in IPOs and the factors, usually unique to Asian IPOs, that can explain the levels of the IPO under-pricing. Studies on long-term IPO performances are also carried out with results not always consistent with long-term underperformance observed in the U.S. In general, research on Asian IPOs is still quite preliminary with many IPO phenomena discovered in the U.S. are not fully investigated. This paper also suggests some possible areas of IPO research in the future.

JEL classification: G12; G14; G24; G32
Keywords: Initial public offering; Asian IPOs; Under-pricing; Capital market

1. Introduction

In general, the IPO literature documents that there are positive initial returns (usually measured as percentage change from offer price of IPO to the closing price on the first day of trading) both in the U.S. and international markets. This gives rise to a phenomenon referred to as the *IPO puzzle* or specifically the *under-pricing of IPOs* puzzle. When after-market returns (usually for a period that varies from 1 month to 5 years) are measured, the abnormal returns generally become insignificant or negative. The short-run and long-run performances of IPOs are also the most frequently research topic on Asian IPOs.

This paper is designed to review the status of research in Asian IPOs, with specific focus on short-term under-pricing and long-run performance of IPOs. The rest of the paper is organized as follows. Section 2 discusses the short-term under-pricing of Asian IPOs, while Section 3 discusses the after-market and long-term performances of Asian IPOs. Section 4 presents the explanations

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for the under-pricing phenomenon. Section 5 continues with explanations for the long-term under-performance. Section 6 discusses issues relevant to Asian IPOs. Section 7 touches on other relevant issues. Section 8 concludes the paper, and suggests future areas of research on Asian IPOs.

2. Short-term under-pricing of Asian IPOs

The existence of under-pricing phenomenon for U.S. IPOs is well documented in the literature. A comprehensive review can be found in Ibbotson and Ritter (1995) and Ritter (2003). A comparative study by Jenkinson (1990) examines the performance of IPOs in Japan as well as IPOs in the U.S. and the U.K., and concludes that IPOs in these countries are systematically priced at a discount relative to their subsequent trading price; in the U.S. the discount is around 10% while in the U.K., it is around 7%. In contrast, the Japanese IPOs rise in price, on average, by nearly 55% after 1 week. Hamao et al. (2000) find that Japanese IPOs in which the lead venture capitalist is also the lead underwriter have higher first-day returns than other venture capital-backed IPOs.

Loughran et al. (1994) provide a comprehensive survey of the companies going public in 25 countries, including 7 Asian countries (with an average initial return of 17.6% for Hong Kong; 32.5% for Japan; 78.1% for Korea; 80.3% for Malaysia; 27.0% for Singapore; 45.0% for Taiwan; and 58.1% for Thailand). They also suggest that the move by East Asian countries to reduce regulatory interference in the setting of offer prices should result in less under-pricing of IPOs in the 1990s compared to the 1980s. Ritter (2003) reports the extent of under-pricing in 38 countries, including 11 Asian countries (with an average initial return of 256.9% for China; 15.9% for Hong Kong; 35.3% for India; 15.1% for Indonesia; 28.4% for Japan; 74.3% for Korea; 104.1% for Malaysia; 22.7% for the Philippines; 31.4% for Singapore; 31.1% for Taiwan; and 46.7% for Thailand). In general, Ritter reports that the average initial returns of Asian IPOs are significantly higher than the average initial return of U.S. IPOs.

Dawson (1987) reports the market-adjusted average initial returns for 21 IPOs in Hong Kong (13.8%), 39 IPOs in Singapore (39.4%), and 21 IPOs in Malaysia (166.6%) for the period 1978–1983. Yong (1997) reports an average initial return of 75.0% for 224 Malaysian IPOs for the period 1990–1994. Sullivan and Unite (2001) report an average initial return of 22.7% for 104 Philippine IPOs for the period 1987–1997. Wethyavivorn and Koo-Smith (1991) find an average initial return of 58.1% for 32 Thai firms for the period 1988–1989. Chi and Padgett (2005), using 668 IPOs for the period January 1996–December 2000, find that the average under-pricing of Chinese IPOs is 129.2%. Other studies on individual countries in Asia include McGuinness (1992) for Hong Kong; Kim and Lee (1990), Lim (1992) and Kim et al. (1993) for Korea; Mok and Hui (1998) and Su and Fleisher (1999) for China; Hwang and Jayaraman (1993), Pettway and Kaneko (1996) and Cai and Wei (1997) for Japan; Paudyal et al. (1998) and Jelic et al. (2001) for Malaysia; and Koh and Walter (1989) and Lee et al. (1996) for Singapore.

In a related issue, Cliff and Denis (2005) examine the relation between IPO under-pricing and the post-IPO analyst coverage. They find that there is a significant positive relation between under-pricing analyst coverage by the lead underwriter, which is consistent with the hypothesis that under-pricing is, in part, compensation for expected post-IPO analyst coverage. This kind of research can still be carried out in Asia.

3. After-market and long-term performances of Asian IPOs

Ritter (1991) shows that IPOs in the U.S. under-perform other firms of the same size (based on market capitalization) by an average of 3.8% during the 5 years after the first day of trading. When