



ELSEVIER

Contents lists available at ScienceDirect

Journal of International Financial Markets, Institutions & Money

journal homepage: www.elsevier.com/locate/intfin



Role of asymmetric information and moral hazard on IPO underpricing and lockup[☆]



Hafiz Hoque*

University of York, The York Management School, Freboys Lane, Yorkshire YO10 5GD, United Kingdom

ARTICLE INFO

Article history:

Received 25 January 2013

Accepted 4 February 2014

Available online 12 February 2014

JEL classification:

G24

G32

Keywords:

Information asymmetry

Moral hazard

Lockups

Underpricing

UK market

ABSTRACT

This paper analyses the role of asymmetric information and moral hazard on IPO underpricing and lockups. I document that high information asymmetry is related to underpricing while the lockup length and lockup expiration return is related to moral hazard. Accordingly, lockup length and underpricing work as substitute signals. These results relate to the UK's unique institutional settings: long and diverse lockups, and a close relationship between the issuing company and the corporate broker. Moreover, director ownership affects lockup length and lockup expiration return in a non-linear fashion.

© 2014 Elsevier B.V. All rights reserved.

1. Introduction

Initial public offerings (IPOs) are subject to asymmetric information and moral hazard problems. Prior work has shown that asymmetric information is mitigated by IPO underpricing (Rock, 1986; Benveniste and Spindt, 1989) and installing lockup contracts on the insiders (Brau et al., 2005). Brav and Gompers (2003) test three explanations for lockups, namely, moral hazard, information asymmetry

[☆] I would like to thank Chen Su, Philip Linsley and the seminar participants at Swansea University for their helpful suggestions. Any remaining errors are my responsibility.

* Tel.: +44 7515890949.

E-mail addresses: hafiz.hoque@york.ac.uk, hafiz.al.asad@hotmail.com

and rent seeking, but find support only for the moral hazard hypothesis. However, [Brau et al. \(2005\)](#) provide support for the moral hazard and information asymmetry hypotheses. Recently, [Yung and Zender \(2010\)](#) bridge the gap between [Brau and Gompers' \(2003\)](#) and [Brau et al.'s \(2005\)](#) studies on lockups by showing that asymmetric information is a dominant consideration for one set of firms, while moral hazard prevails for others. The objective of this paper is to analyse the roles of asymmetric information and moral hazard on IPO underpricing and lockups using unique hand-collected data on IPO lockups from the UK market.

Though all IPOs suffer from moral hazard and information asymmetry problems, in some firms, moral hazard may be dominant, whereas information asymmetry may be dominant in others. While lockups are mechanisms to mitigate information asymmetry or moral hazard, underpricing only alleviates information asymmetry.¹ By comparing high information asymmetry firms (small firms, IPOs underwritten by low-ranked underwriters and Alternative Investment Market [AIM] firms) with high potential for moral hazard firms (high director ownership firms²), I am able to determine if lockups are more closely associated with information asymmetry or moral hazard. At the same time, by comparing high information asymmetry firms and high potential for moral hazard firms (henceforth, high moral hazard firms), I am able to reconfirm that underpricing is related to information asymmetry, not moral hazard.³

This sample polarisation is at the heart of my research design, as it leads to different predictions for the high asymmetric information subsample compared to the high moral hazard subsample. For instance, if information asymmetry drives underpricing⁴ and lockup length in the high asymmetric information subsample, changes in moral hazard in those firms should not affect the underpricing and lockup length. On the other hand, if moral hazard drives lockup length in the high moral hazard subsample, changes in information asymmetry should not affect the lockup length. Examining the high asymmetric information and high moral hazard subsamples should enlighten us as to the role of asymmetric information and moral hazard on IPO underpricing and lockups.

I need an identification strategy to separate out the high asymmetric information subsample and the high moral hazard subsample.⁵ I use following proxies for information asymmetry. I use size as a proxy for information asymmetry by following [Beatty and Ritter \(1986\)](#). Small IPOs are subject to more information asymmetry, while large IPOs are subject to less information asymmetry. The second proxy is underwriter reputation, as in [Carter and Manaster \(1990\)](#), where reputable underwriters mitigate information asymmetry. The third proxy used is the IPO market. AIM is a market for small growth companies, where information asymmetry is high. The ban on insider sells for a certain period of time is frequently alleged to be a necessary commitment device to induce the public to buy shares at the offering which reduces moral hazard. Because insiders have better information about the firm's future prospects, they may try to take advantage of that information at, or soon after, the initial public offering. If insiders knew that the price immediately after the offering was excessively high, they might wish to cash out at a high price. The lockups are likely to act as a commitment device to alleviate the

¹ One of the important assumptions of my analysis is that post-IPO markets are fundamentally accurate, and this is reflected in underpricing. If post-IPO prices are not fundamentally correct, either because they are driven by investor behavioural biases or because there is a systematic mispricing of the IPO firms, then underpricing measures may be severely biased.

² Thanks to an anonymous referee for suggesting that director ownership is a good proxy for moral hazard, and sample bifurcation based on moral hazard could be done using director ownership in the IPO.

³ To the best of my knowledge, no study considers underpricing as a result of the moral hazard problem. The survey evidence is in line with this (see, for example, [Jenkinson and Jungqvist, 2001](#); [Ibbotson et al., 1994](#)). Since underpricing is resolved immediately after the issue, it is difficult to imagine how underpricing can mitigate moral hazard. However, [Brenan and Franks \(1997\)](#) argue that underpricing is a mechanism through which managers can protect their private benefits by allocating shares strategically when raising money through IPOs.

⁴ One should note that asymmetric information is not the only determinant of IPO underpricing. There are other explanations for IPO underpricing: prospect theory ([Loughran and Ritter, 2002](#)), corruption ([Loughran and Ritter, 2004](#)), informational cascades ([Welch, 1992](#)), lawsuit avoidance ([Hughes and Thakor, 1992](#)), signalling ([Allen and Faulhaber, 1988](#)) and IPO as a marketing event ([Chemmanur, 1993](#)). For the analysis of the current paper to be valid, it needs asymmetric information to be one of the determinants of IPO underpricing.

⁵ This does not mean that in the asymmetric information subsample there is no moral hazard problem, or that in the moral hazard subsample there is no information asymmetry. Rather, it means that in the asymmetric information sample, information asymmetry is the dominant problem, and in the moral hazard sample, moral hazard is dominant.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات