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Factors affecting investment bank initial public offering market share[☆]

Craig G. Dunbar*

Richard Ivey School of Business, University of Western Ontario, London, Ont., Canada N6A 3K7

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Abstract

This paper examines the effect of several factors on the market share of investment banks that act as book managers in initial public offerings (IPOs) between 1984 and 1995. For established banks, IPO first-day returns, one-year abnormal performance, abnormal compensation, industry specialization, analyst reputation, and association with withdrawn offers have a significant impact on changes in market share. These factors have a more significant effect on market share changes in low-volume IPO markets. These factors have a less significant effect on market share, statistically and economically, for less established banks, consistent with the notion that less reputation is placed at risk. © 2000 Elsevier Science S.A. All rights reserved.

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* Tel.: 519-661-3716; fax: 519-661-3959.

E-mail address: cdunbar@ivey.uwo.ca (C.G. Dunbar)

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1. Introduction

Corporate finance activities, including the issuance of securities, provide significant revenues for investment banks. The Securities Industry Association (1997), for example, reports that NYSE securities firms received over $11 billion in underwriting fees in 1996 amounting to approximately 10% of total revenues for these firms. Investment banks compete aggressively for new underwriting business. This behavior is particularly true in the market for initial public offerings (IPOs), since underwriting fees as a percentage of proceeds raised are greater for IPOs than for seasoned equity or debt offerings. Also, the investment bank in an initial public offering is commonly retained to underwrite a firm's subsequent security offerings (see James, 1992). An issuer's choice of investment bank is argued to depend on a number of qualitative and quantitative factors, such as the 'quality of the bank's people' (Eccles and Crane, 1988, p. 110), the pricing and performance of past deals underwritten by the bank and the bank's research capability.[1] This paper examines the relation between several quantifiable factors and an investment bank's ability to generate underwriting business, as proxied by changes to its IPO market share.

A study of market share changes has two advantages. First, Eccles and Crane (1988) note that market share is highly correlated with investment bank profitability. Identification of the relative importance of quantifiable factors in explaining market share changes should, therefore, have practical significance. Second, market share is commonly used in the academic literature as a proxy for investment bank reputation (Megginson and Weiss, 1991; Dunbar, 1998). Banks are credible third party information producers because they lose economic rents from future issues if their information is inaccurate and can expect to gain rents from future issuers if their information is accurate. Market share changes are a reasonable proxy for changes to expected future economic rents.[2] A study of market share changes, therefore, also provides insights into how reputation evolves.

[1] Smith (Wall Street Journal, February 1, 1996, p. C1) discusses the role of such factors in AT&T's selection of a lead bank to underwrite the IPO of Lucent Technology. Siconfoli (Wall Street Journal, December 19, 1996, p. C1) discusses the importance of IPO pricing and investment bank research in underwriter selection. Raghavan (Wall Street Journal, March 25, 1997, p. C1) also discusses the importance of research in attracting underwriting business. Soja (1992) presents a detailed examination of the factors used by EASAL Corporation in selecting an investment bank to take it public.

[2] Investment bank reputation is argued to play an important role in resolving information frictions in the new issues market for IPOs (see, for example, Booth and Smith, 1986; Beatty and Ritter, 1986; Benveniste and Spindt, 1989; Carter and Manaster, 1990; Chemmanur and Fulghieri, 1994).