Research And Analysis of IPO underpricing In the Market with Chinese Characteristics

Qingqiao Liu [1], Hang Su [2, *], Manni Yang [3]

[1] Chongqing No.1 International Studies School, Chongqing, China

[2] NFLS British Columbia Academy, Nanjing, China

[3] Tongsheng Lake Senior High School, Changsha, Hunan, China

* Corresponding author: Amanda.Su25@nflsbca.com

Abstract. This paper mainly introduces and popularizes science about IPO underpricing and discusses the characteristics and future development direction of China's securities market. This paper introduces the opinions of domestic and foreign scholars on the IPO underpricing phenomenon from different angles. Finally, through the analysis and summary of resources integration, this paper discusses how to deal with the new strategy of high underpricing rate, and further expounds the future direction of national efforts in the stock exchange market. This paper finds that there is a significant IPO price suppression phenomenon in China's A-share market, which is the IPO issue price of the stock is significantly lower than its listing price. This paper points out the negative impact of IPO price suppression on the effective operation of the securities market, and deeply analyzes the reasons for the existence of IPO price suppression in China.

Keywords: IPO underpricing, stocks, market h.

1. Introduction

An Initial Public offering (IPO) is the first time a company or company sells its shares to the public. IPO underpricing is a phenomenon in which a new issue is priced significantly below the market value of the new issue. When underpricing occurs, existing shareholders may suffer losses because the issuer sells the shares at a discount to their own value, while new shareholders are able to earn a higher return on the shares they buy. His performance is that on the first day of the issue of new shares, he obtained an excess rate of return and obtained significant profits.

There is a serious phenomenon of IPO underpricing in China's securities market. The existence of high IPO underpricing rate means that the pricing efficiency of China's primary stock market is low, resulting in a stable excess return rate for investors in the primary market. A large number of investors in the secondary market therefore transfer funds to the primary market, resulting in the listing price of new shares being higher than their intrinsic value. The long-term underperformance of listed companies' shares. On the other hand, a large number of investors in the secondary market have moved to the primary market, resulting in a low IPO winning rate, which will lead to a large amount of capital constraints. At present, a large number of studies have shown that IPO underpricing will make investors unable to identify stocks with investment prospects, which is not conducive to the development of China's capital market and national economy.

In recent years, due to the changes and development of China's stock market listing approval system, IPO underpricing has become a hot topic in the current society. With the state vigorously support and develop the securities market, how to deal with the increasingly high underpricing rate has become a new development direction.

2. Literature Review

2.1. Information Economics

2.1.1. Analysis of IPO underpricing reasons

From the perspective of information economics, the investment bank buyout hypothesis proposed by Baron (1980) holds that since stock issuers tend to give the pricing right of new shares to investment banks with information advantages when issuing shares, investment banks tend to price new shares below their value [1]. This is because the issuing bank has the following two advantages: one is to reduce the risk of investment banks in underwriting or underwriting stocks; the other is to provide investors with an excess rate of return by issuing at a discount, which is conducive to establishing a good relationship with investors. However, this theory does not take into account that in the IPO process, when the issuing company is aware of this situation, it will negotiate with the issuing bank, ask for an increase in the company's price, and share some benefits with the issuing bank to achieve a win-win situation. Moreover, because investment banks are in a monopoly position, they issue discounts on IPOs for a long time, so that all customers, investors and regulators think that the phenomenon of IPO discounts is very normal. The theory has a certain explanatory power, but the theory still does not take into account the investors of the 1PO process. Moreover, after the company detects this situation, it will negotiate with the investment bank to determine the price according to the actual value of the company, and it is possible to promise to distribute some of the benefits to the investment bank, so as to achieve a win-win situation between the two.

2.1.2. The Winner's curse hypothesis

It is also known as Rock (1986) model theory [2]. The dominant Rock winner's curse hypothesis holds that market information is asymmetrical and there are informed investors and uninformed investors. Investors who have information can use their information advantage to buy stocks with investment value, but investors who do not have information may buy stocks of inferior companies with no investment value. Uninformed investors buy low-quality stocks, realize the "winner's curse," and withdraw from the market. Such uninformed retail investors play an important role in the stock market, and stock issuers need to attract uninformed investors to invest. If the price of a new issue is similar to the normal price, uninformed investors will not enter the new issue market and many new issues will fail. Therefore, the price of a new issue needs to be lower than the normal price to attract uninformed investors to maintain purchasing power in the primary market.

2.1.3. Signal hypothesis theory

Investors do not know the true value of the company; investors can only use the average valuation of all businesses to evaluate. Good companies need to signal their value to investors if they want to be known. Therefore, high-quality companies usually adopt low pricing of new shares in the IPO and retain a high proportion of shares to pass on the intrinsic value of the company. After investors understand the real value of the company, they issue shares at a high price to make up for the loss of 1PO underpricing. Therefore, the issue price of new shares must be lower than the normal price to ensure that uninformed investors stay in the primary market to buy stocks. (If the issue price of new shares is not lower than the normal price, those without information will not enter the new stock market, and many new shares will fail.

2.2. Behavioral Economics

2.2.1. The hypothesis of equity diversification

The equity diversification hypothesis holds that a certain amount of liquidity needs to be maintained after the new stock is listed to help its price discovery, and liquidity needs to be achieved through the trading of a large number of investors. The issuer's intention to lower the issue price of new shares is to cause the phenomenon of excessive demand for new shares, so that the company has a large number of minority shareholders. This kind of scattered equity will greatly increase the company's liquidity, which can reduce the pressure on the company's management outside the company [3].

2.2.2. Speculative-bubble hypothesis

This hypothesis holds that the excessive rate of return on IPOs is caused by speculators' desire to be speculative. Because IPOs are oversubscribed by investors, it is not easy for many speculators to subscribe for IPOs with stock prices. Once the IPO is listed, the speculative factor will push the price of 1PO to a price that exceeds its intrinsic value.

2.2.3. The hypothesis of following the trend

WELH explains this phenomenon from the perspective of investor psychology. Investors generally have a strong crowd mentality. When making investment decisions, they often observe the behavior of other investors and make similar behavior decisions. When the price of 1PO is too high, once investors are not enthusiastic about buying stocks, other investors in the market who intend to buy will also change their behavior, which will lead to the failure of the company's listing. In order to avoid this, issuers will attract the first investors and induce other investors through low prices [4].

3. IPO Underpricing Phenomenon and Harm Analysis

Since 2013, China has clearly proposed and implemented the reform of the stock issuance registration system, which has developed in a balanced manner in the aspects of system construction, market ecology, service entity ability, establishment of a multi-level capital market system and legal protection, and the securities trading market has become increasingly mature. But at the same time of pushing to the secondary market, the phenomenon of IPO high underpricing emerged endlessly, which seriously damaged the interests of enterprises, and reduced the financing and resource allocation ability of the stock market.

3.1. IPO Underpricing in The Chinese Market

When companies go public, the shares they sell in the initial public offering (IPO) are often priced too low, causing the stock price to rise sharply on the first day of trading. In the 1990s, China's low discount averaged more than 20%, which meant that the company left a considerable amount of money on the negotiating table.

Under the background of "full circulation" stock exchange, the pricing of initial public offering is obviously lower than the initial market price in Chinese market, which has caused a great impact on the market. When underpricing occurs, existing shareholders may suffer losses because the issuer sells the shares at a discount to their value, while new shareholders are able to earn a higher return on the shares they buy. The reasons for the phenomenon of underpricing are mainly divided into two parts: 1. In China's immature securities market environment, the price of new shares has obvious defects, and there is still a lot of room for improvement compared with European and American countries. 2. In the secondary market, enterprises have excessive speculation and speculation, and the IPO price does not depend on investors, which leads to excessive speculative atmosphere in the Chinese market and high underpricing rate.

There is also abundant research on the phenomenon of IPO underpricing in China. Many scholars have analyzed the characteristics of the Chinese market and the causes of underpricing from different angles. For example, Sun Yanan (2007) took the new shares listed from September 2006 to December 2011 as a sample to make an in-depth study on the impact of institutional changes in China's listing approval system on IPO underpricing.

3.2. Serious Consequences of Excessive Speculation In The Market

Under the current situation of the market with high underpricing rate, many companies issue unit prices much lower than the estimated price after being approved for listing, leading to their financing failure and bankruptcy. At the same time, under the competitive market, the interests of some small and medium-sized investors and retail investors have been seriously damaged, 90% of the shareholders who participate in the new share purchase are in a state of loss, the reason is that the new share pricing ability of the investment bank has never been truly tested by the market, so the competitiveness is lack after entering the international market. What is more worrying is that a large number of financial fraud or poor performance of the company after landing in the securities market, so that the cornerstone of the market has been seriously eroded, but also to the market's ability to allocate resources has brought a great impact. In addition, China's IPO high underpricing rate caused A large number of short-term liquidities freeze in the A-share market. The high underpricing rate consumes a lot of stock market funds, and the funds applied for new shares are more than ten times the funds raised by new shares, which affects other stocks in the stock market to obtain short-term financial support, and these funds often continue to allocate stocks after unfreezing, and some stock prices will change [5]. Meanwhile, the high price suppression rate of China's IPO has caused heavy losses to some new stock investors in the A-share market. The high discount rate of China's IPO means that the market price of some new stocks is greatly increased. In fact, the long-term performance of many new stocks is not good. Between 2011 and 2014, more than 100 new shares broke. Table 4 lists the ten stocks with the worst performance compared with the issue price as of March 7, 2014, in 2011-2014. Huarui Wind Power, which ranked the bottom one, closed 79.4% lower than its issue price on March 7, 2014. Considering the increase on the first day of stock listing, Huarui Wind Power has caused great losses to a large number of investors in three years [6]. Next, we'll explain the results through different perspectives:

Listed companies can quickly raise the funds needed for the development of enterprises. At the same time, public display value and quality to the market can be trusted and supported by the majority of investors, which is more conducive to long-term development. At the same time, the lower price can attract more investors, so that the company's equity can be dispersed as much as possible to ensure the founder's absolute control over the company [7]. The right. However, if the lower issue price is lower than the reasonable range, the company will miss part of the funds it should raise, causing economic losses. In addition, the unreasonable expansion of listed companies with excessive funds will change the company structure and have a negative impact on long-term development.

Underwriters, the low sale price of new shares makes the sale of new shares smoother and reduces the risk of underwriters, so as to obtain as many underwriting profits as possible. At the same time, with the accumulation of the number of successful underwritings by underwriting companies, the trust of investors has been greatly increased to a certain extent. On the contrary, if all new shares can be issued smoothly, the underwriter's new stock pricing ability has never been really tested by the market, and it is difficult to be competitive.

For investors, a lower issue price can expand the return on investment. However, the high first-day yield tempts the majority of investors to seek short-term benefits and play games with gambling psychology, which is not conducive to the formation of rational investment concepts.

In the capital market, due to the low price of new shares, a large number of unqualified companies such as property fraud can also land in the securities market one after another, causing the cornerstone of the securities market to be seriously eroded, which is not conducive to long-term stable development. Because the purchase of new shares can get a very high yield [8].

As a result, a large amount of funds has been hoarded in the primary market for short-term operations such as new stock purchase for a long time, which not only leads to fund imbalance in the primary and secondary markets, which is not conducive to the resource allocation efficiency of China's stock market, but also easy to cause abnormal fluctuations in the entire securities market, which directly endangers the healthy development of China's securities market and increases me. Systematic risks of the national financial system [9].

3.3. Changes In the System of New Stock Issuance in China's Stock Market

The approval system is a fully planned distribution model, mainly for the selection and recommendation of enterprises, which is later decided by local or competent government agencies.

The scale of shares issued by enterprises is determined according to the plan. The issuance review is directly approved by the CSRC, and there are more administrative interventions in the method of stock issuance and the pricing of stock issuance [10].

The approval system is an intermediate form of the transition from the approval system to the registration system. It is a system in which market participants perform their respective duties. The implementation of the approval system is to clarify the respective responsibilities and risks of issuers, directors, supervisors, lawyers, accountants and other intermediaries, investors and regulators, so as to achieve the relationship between market participants and regulators. Comply with each other, perform their respective duties, and form a complete securities issuance supervision system that conforms to the principle of marketization [11].

The regulatory department of the issuance system commonly adopted in the mature capital market depends not only on whether the listed company is in line with the industrial policy, but also on the profitability and development prospects of the enterprise [12].

4. Conclusion

The analysis of IPO underpricing phenomenon is a problem that cannot be ignored under current economic conditions. Foreign scholars have conducted research for nearly half a century and formed a series of effective results. In the buyer monopoly hypothesis of investment banks, investment banks with information advantages will underprice IPO to reduce underwriting risks and increase returns. The winner's curse hypothesis also refers to the impact of information asymmetry, in which uninformed investors, as important players in the stock market, buy inferior stocks and exit the market. In order to attract these investors, they have to reduce the price of new shares to below their value. It can be seen that the information gap and asymmetry make some people who have information like a fish in water, obtain huge benefits, and also contribute to the IPO price suppression [13]. The domestic capital market started late, and there are few theoretical hypotheses compared with foreign countries. In recent years, Chinese scholars have conducted multi-dimensional and multi-angle discussion and research on the direction of IPO underpricing in the market with Chinese characteristics, including "the reasons for the phenomenon of Chinese market underpricing" and "the serious consequences caused by excessive market speculation". However, due to the immature securities environment and excessive speculation of enterprises in China, the issue price of new shares is defective, and the underpricing rate continues to rise, causing damage and bankruptcy of small and medium-sized enterprises [14].

Based on the special operation mechanism of China's stock market, the crux of the serious ipo underpricing problem in the Chinese market needs to be found in the future, and a reliable basis for the formulation of future policies of the regulatory authority should be provided. In addition, the fundamental institutional issues of share separation and government control should be studied and solved in the future, otherwise any local reform measures such as the approval system will only be on paper. Secondly, the long-term development of GEM and the specific factors affecting the underpricing of GEM in the medium and long term still need continuous attention. The academic community has studied the direct relationship between the formation mechanism of IPO underpricing and IPO underpricing, but more studies and empirical evidence are needed on the regulatory relationship between institutional investors and the underpricing of the reputation of brokerages [15].

Authors Contribution

All the authors contributed equally and their names were listed in alphabetical order.

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