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Bachelor Thesis

The Short-Run Performance of IPOs in Switzerland from 1997 to 2011

Underpricing and Empirical Evaluation of Selected Explanations Theories

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Executive Summary

The first hypothesis tested in this study is whether publicly traded stocks from IPO companies at the SPI outperform chosen benchmarks in the short run. Thus, the study aims to find evidence that the Swiss IPO market is inefficient in the definition of Fama (1970) for the analyzed time period from 1997 to 2011. Fama (1970) defines that prices in efficient markets must always fully reflect all available information. However, the underpricing phenomenon contradicts this definition.

The initial IPO return is measured from the issue price to the closing price at the first trading day, as it is documented e.g. in Ritter (1991). Hence, the amount of underpricing results by subtracting the corresponding benchmark return from the initial return. The STOXX Sector indices are used as benchmark to adjust the short-run performance of 113 Swiss IPOs at the SPI.

The findings in this study suggest that adjusted returns are significantly positive on average up to six months after the IPO. The study has shown an adjusted initial return of 10.92% on average and 8.43% without two extreme outliers. The performance does not differ to a large extent for the sample periods of one day, one week, one month and six months. The adjusted return in the one-year period was noticeably lower than in the other sample periods.

This study provides evidence that the Swiss IPO market is inefficient in the short-run due to the definition of Fama (1970) for the analyzed time period from 1997 to 2011. Thus, hypothesis 1 is not rejected for the primary market.

Furthermore, the present study performed a more detailed analysis categorizing adjusted returns by the industry, year of issuance, listing agent and the age of the issuing company.

The three in detail analyzed industry sectors Financials, Industrials and Health Care all show significant adjusted initial returns. A remarkable result is the low short-run performance of the most frequent IPO sector Financials (N=38) in all sample periods, e.g. 5.69% adjusted initial return. The Technology industry (N=9) reached the greatest adjusted initial return (18.08%) in this study. Companies in the Financials and Technology industries tend to be younger at the time of going public.

The greatest IPO activity (N=21) and highest adjusted initial return (18.74%) was in 2000. This study found that issuing activity and underpricing tend to have a positive relation.

Surprisingly, the average underpricing level of IPOs listed by Credit Suisse and UBS, which are considered to be the most reputable among all listing agents in Switzerland, were greater than those of listings from other market players (except from Bank Vontobel). In addition, UBS and CS tend to list more established companies.

Finally, a positive relation between the age of the issuing company and underpricing could not be found for the analyzed sample period.

The second hypothesis in this study was to determine whether the degree of IPO underpricing in Switzerland could be explained to some extent with proxies for the overall macroeconomic climate in Switzerland, the market development prior to the IPO, the learning effect from IPO issuing activity, the reputation of listing agents, and the ex-ante uncertainty about the market value of IPO stock.

A multiple regression analysis with adjusted initial return as the dependent variable was performed in order to discuss this hypothesis. The results of two approaches with recoding and removing outliers have been computed. These scenarios substantially improved the consistency of OLS assumptions and model fit. Five theories have been introduced in order to discuss hypothesis 2.

One of the more significant findings to emerge from this study is that the standard deviation of the daily returns during the first 20 trading days, which is one of two proxies for ex-ante uncertainty about the market price of IPO stock, predicted underpricing significantly in both scenarios. This indicates that underpricing increases with greater ex-ante uncertainty about the market value of new issues.

The second proxy for ex-ante uncertainty, which was the age of the issuing company, failed to predict underpricing, even though the years of operating history is supposed to be an adequate proxy for ex-ante uncertainty according to Ritter (1984).

A model presented by Carter & Manaster (1990) predicts the amount of underpricing as a decreasing function of the underwriting investment bank’s reputation. The only result that was consistent with the reputation of the investment banks theory was that Credit Suisse and UBS tend to list more established companies.

Also no significant evidence was found for the lack of experience theory for the investigated sample period. Kunz & Aggarwal (1994) state that underpricing decreases with the experience of investment banks, which are able to profit from a learning effect in the course of time, if IPO activity increases. This study found a non-significant negative coefficient in the scenario with recoded outliers. However, there is some tendency for decreasing initial returns in the course of time if several studies about short-run underpricing in Switzerland with different sample periods are compared.

Ritter (1984) argues that given the institutional lag hypothesis, underpricing results if the time period between the day of determining the issue price and the first trading day is long and the market rises during this time period. The relevance of the institutional lag hypothesis is supported by the current findings. A statistical significant relation is present especially if outliers are excluded.

The last theory tested in this study is the hot market theory described by Uhlir (1989). Investors show an excessive demand for IPOs and are willing to take more risk than they usually do in hot market periods. Tietze (2004) concludes that underpricing results as soon as the secondary market meets the excess demand. In this thesis, the investor sentiment approximates market climate in order to achieve a macroeconomic perspective on IPO underpricing. A statistical significant positive relation to the degree of underpricing resulted using the scenario with recoded outliers.

In both investigated scenarios, recoding and removing outliers, the regression model has the best explaining power if the variable company age and the variable approximating the lack of experience theory are excluded. The best model with recoded outliers has an adjusted R^2 of 21.5% and 18.5% without outliers.