

DOCTORAL THESIS

A study on the impact of unconventional monetary policy regime on money left on the table and net underpricing cost for Hong Kong initial public offerings

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ABSTRACT

This study provides a test of the proposition that a unique agency cost (induced by windfall interest earnings) has a significant impact on both the money left on the table and underpricing costs of initial public offerings (IPOs) of China-related enterprises (H-shares and Red-chips). This arises from the advanced payment, non-discretionary allocation mechanism adopted by HKEx. The agency cost stems from an asymmetry in the accounting treatment of the reporting of interest income (if any) generated from the public subscribers' application fund, and the often significant, but unreported, underpricing cost. This important point appears to have been first pointed out by Ritter and Welch (2002). For Chinese state enterprises the manager who is overseeing the listing process has little (if any) incentive to maximize the offer price or new equity capital from an IPO but may benefit directly and/or indirectly from the significant interest earnings that can be generated from public subscribers' monies. This occurs when the controlling shareholder (the State) is either uninformed about the true value of the firm and/or due to other considerations allows the manager to offer a deeply discounted offer price. The deep discount raises the public subscription rate and increases the interest income from the application funds. Using the prolonged zero interest rate regime following the bankruptcy of Lehman, the study finds strong support for the proposition and shows that H-shares and Red-chips have offered significantly less money on the table and hence incurred substantially lower underpricing costs relative to Other categories of shares. This is in marked contrast to the pre-global financial crisis period when there were significant interest rates on deposits. The study contributes to the literature on the differential concerns of managers and owners in the IPO process.

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