Why do IPOs leave money on the table for investors on the first day of trading? A theoretical review

Wasantha Perera* & Nada Kulendran*

*Department of Finance, Faculty of Management Studies and Commerce, University of Sri Jayewardenepura, Nugegoda, Sri Lanka. *School of Accounting and Finance, College of Business Victoria University, Melbourne, Australia.

Abstract

To find out the possible theoretical reasons for leaving money on the table, this study reviews the literature on the short-run market performance of IPOs. Leaving money on the table is measured by the difference between the closing price on the first day of trading and the issue price, multiplied by the number of shares issued. The main cause for leaving money on the table is short-run underpricing which rewards positive financial returns for initial investors at the very first day of trading. The short-run underpricing is a universally accepted phenomenon. The theoretical reasons for underpricing vary according to the markets, models and sample periods. The academic researchers have more emphasized on asymmetric information theories to explain the theoretical reasons for short-run underpricing phenomenon. The theoretical explanation also links with the uncertainty and the information asymmetry among the issuer, the underwriter and the investor. The issuer, underwriter (investment banker) and investor are major players in the IPO process. However, there is no single dominant theoretical reason for short-run underpricing. Further studies focus more on the behavioural finance approach to find out the real reasons for underpricing, which is complete dearth of literature on the short-run market performance of IPOs.

Keywords: IPO, Leaving money on the table, Positive returns, Asymmetric information theories

1. Introduction

Leaving money on the table is defined as the first trading day returns earned by initial IPO investors in monetary terms. It is measured by the difference between the closing price on the first day of trading and the issue price (PRICE), multiplied by the number of shares issued (Ritter, 2014). Leaving money on the table mainly comes through the short-run under-pricing which provides positive financial returns for initial