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How does national culture influence IPO underpricing?

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ABSTRACT

In this paper we examine how national culture affects the international underpricing of initial public offerings (IPOs). We hypothesize that cultural norms and beliefs informally influence human perceptions, such as risk tolerance, motivations, and perceived options, and thus affect behavior. Using a large dataset of 19,420 IPOs listed in 44 countries, we find strong evidence that issuing firms located in countries with a higher degree of uncertainty avoidance tend to experience a lower level of underpricing. In contrast, issuing firms in countries characterized by higher collectivism, masculinity, and power distance scores tend to experience a greater level of underpricing. Our results are robust to controlling for a country's legal system, investor protection, private control benefits, regulations in bank ownership, tax advantages, and stock market performance and with respect to alternative culture proxies and subsamples. Our findings highlight the importance of national culture in explaining international IPO underpricing.

1. Introduction

Every year, companies going public leave substantial amounts of money "on the table" as a result of underpricing. This empirical regularity has attracted much attention in the financial economics literature leading to a wealth of theoretical and empirical studies trying to uncover its roots. In their seminal paper, Loughran et al. (1994) report a substantial variation in country-level underpricing of initial public offerings (IPOs) ranging from 4.2% to 80.3%. Little is known, however, about what explain such differences in international IPO underpricing because the bulk of the IPO literature has focused on single-country setting and in particular the U.S. context. To help fill this gap, we examine whether national culture plays a role in explaining firm-level differences in the international IPO underpricing.

With the rising interest in culture analyses in recent years, the concept of a national culture has been widely adopted in finance literature. Growing research has focused on cultural influences not only on corporate financial decisions, such as mergers and acquisitions (Ahern et al., 2015), capital structure (Chui et al., 2002; Griffin et al., 2013), dividend policy (Fidrmuc and Jacob, 2010),

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cash holdings, and the financial reporting environment (Hope, 2003; Han et al., 2010), but also on the form of a country's financial systems (Kwok and Tadesse, 2006) and its international investment strategies (Chui et al., 2010). This paper seeks to extend the literature on the important role that national culture plays in finance by exploring whether national culture can influence the level of IPO underpricing.

Consistent with our hypotheses (discussed in Section 2), and using Hofstede's cultural measures, we find strong evidence that culture plays an important role in the explanation of international IPO underpricing. In particular, we show that IPOs in countries with high uncertainty avoidance scores tend to experience a lower level of underpricing, whereas IPOs in countries with higher collectivism, masculinity, and power distance tend to experience a higher level of underpricing. Our results are robust to controlling for various determinants of international IPO underpricing, including a country's legal system, investor protection, private control benefits, regulations in bank ownership, tax advantage, and stock market performance and with respect to alternative culture proxies and sub-period samples.

In additional analyses, we examine whether the documented effect of national culture on IPO underpricing varies across a set of moderating variables. Our findings suggest that the effect of national culture on IPO underpricing is moderated by the offer size, the presence of venture capitalist, the proportion of shares held by underwriter(s), whether the IPO firm operates in the high-tech industry, and the quality of country-level governance.

This paper contributes to the literature in several ways. First, we add to the growing, yet limited, streak of studies explaining international IPO underpricing (Loughran et al., 1994; Engelen and van Essen, 2010; Banerjee et al., 2016; Boulton et al., 2010, 2011, 2017). Using 2920 IPOs across 21 countries from 2000 to 2005, Engelen and van Essen (2010) find that the quality of a country's legal framework, as measured by its level of investor protection, the overall quality of its legal system and its level of legal enforcement are negatively related to the level of underpricing. In the same vein, Boulton et al. (2010) examine 4462 IPOs across 29 countries and find that underpricing is higher in countries with corporate governance that strengthens the position of investors relative to insiders. More recently, Boulton et al. (2017) document lower underpricing in countries where public firms practice more accounting conservatism. Boulton et al. (2017) argue that this negative association is due to conservatism lessening the impact of information asymmetries between issuing firms and investors. Our paper adds to this literature by exploring the role of national culture as another factor that can explain the substantial differences in international underpricing of IPOs, documented by Loughran et al. (1994).

Second, we contribute to the large literature on the determinants of IPO underpricing.[2] A number of these studies have investigated the different theories that attempt to explain the underpricing of IPOs. The main focus of those competing explanations falls into two categories, namely, behavioral and informational asymmetry explanations. For instance, lawsuit avoidance theory (Hughes and Thakor, 1992) suggests that issuing firms are motivated to underprice in an attempt to avoid being sued later. Utilizing prospect theory of Kahneman and Tversky (1979), Loughran and Ritter (2002) point out that entrepreneurs are more tolerant of excessive underpricing if they simultaneously learn about a higher than expected post-market valuation. Because human perceptions and behaviors are developed and determined by their cultural norms and beliefs (Markus and Kitayama, 1991), the present paper adds to the stream of literature stressing on the behavioral explanation of IPO underpricing.

Third, we contribute to the growing literature on the role of national culture in corporate financial policies and decision making (e.g., Chui et al., 2002; Li et al., 2011; Griffin et al., 2013; Zheng et al., 2013; Ahern et al., 2015). To the best of our knowledge, this is the first study to examine how national culture influences the level of international IPO underpricing. Prior studies have documented that underpricing is determined by several factors including the issuing firms' motivation to underprice, the choice of underwriters, as well as agency and asymmetric information problems with underwriters and investors. We argue that the issuing firms' subjective perceptions, which mainly depend on their country's cultural beliefs and norms, play an important role in shaping the magnitude of a firm's IPO underpricing, choice of underwriters, and conflicts of interest with underwriters and investors.

The remainder of this paper is organized as follows. Section 2 discusses the role of national culture in explaining IPO underpricing and develops hypotheses for the empirical analysis. Section 3 describes the data and variables used in our empirical analysis. Section 4 investigates the relation between national culture and IPO underpricing. Robustness checks on the basis of additional country-level governance qualities, alternative cultural measures, and subsamples are presented in Section 5. Section 6 concludes the paper.

2. Hypothesis development

Hofstede's five cultural dimensions have been largely adopted in the international business literature (e.g., Kwok and Tadesse, 2006; Chui and Kwok, 2008; Chui et al., 2010; Han et al., 2010). On the basis of a survey sample of IBM employees in the 1970s, Hofstede (2001) first categorized national culture into four dimensions: (i) uncertainty avoidance, (ii) collectivism, (iii) masculinity, and (iv) power distance. In particular, the dimension of uncertainty avoidance measures the level of acceptance of uncertainty and ambiguity within a society. A country with a high uncertainty avoidance score is risk averse. In contrast, the dimension of collectivism focuses on the degree to which a society reinforces individual versus collective achievement and interpersonal relations. A country with a high collectivism score has strong relations between individuals and relies on collective responsibility. The dimension of masculinity captures the degree of gender differences within a society. A high masculinity score indicates that males in that country dominate society and have much more control and power in it than females. Similarly, the dimension of power distance

[2] See for instance, Hughes and Thakor (1992), Drake and Vetsuypens (1993), Stoughton and Zechner (1998), Ritter and Welch (2002), Cooney et al. (2001), Field and Karpoff (2002), Lowry and Shu (2002), Loughran and Ritter (2004), Gao et al. (2013), Butler et al. (2014), Fung et al. (2014), Bouzouita et al. (2015), Banerjee et al. (2016), Boeh and Dunbar (2016), Nielsson and Wójcik (2016) and Chang et al. (2017).