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Green energy companies: Stock performance and IPO returns

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ABSTRACT

This study aims at investigating the performance of energy companies at IPO and highlighting the differences in underpricing and stock return trends of green energy companies compared to non-green ones. We select all energy stock IPOs between 2000 and 2014 on the main European markets and evaluate first day and long run performance to shed light on the differences of the two groups of firms. As further refinement, we evaluate the determinants of short and long term performance. Evidence shows that green companies have a lower underpricing, which nevertheless disappears after few days of trading and when controlling for underpricing determinants. In the long run, performances of green and non-green are similar and empirical results show that the traditional risk factors explain return dynamics.

To the best of our knowledge, this is the first paper to analyse the underpricing and stock performance of green energy companies.

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1. Introduction

Underpricing is a common phenomenon for companies newly listed on stock exchanges that have a high positive return due to the difference between the offer price and the first trading day price (Ibbotson and Ritter, 1995). The issue has received a relevant attention by the theoretical and empirical literature (Ritter and Welch, 2002; Loughran and Ritter, 2004; Chambers and Dimson, 2009). The empirical investigations nevertheless provide contrasting evidence (Daily et al., 2003) and underline that the degree of underpricing is determined by various firm, market and country specific factors, such as firm age, size, the bull or bear market and the existence of market bubbles at IPO, as well as the overall economic conditions (Engelen and van Essen, 2010) which are all able to influence asymmetries of information and uncertainty at IPO. In fact, despite there are different theories explaining underpricing, most of them state that this phenomenon is related to asymmetries of information (Ibbotson and Ritter, 1995; Engelen and van Essen, 2010; Banerjee et al., 2011). Hence if a company is more difficult to evaluate, because it is younger, smaller or produces less established products or services, it might be more subject to asymmetries of information, both concerning the company and the business, and, as a consequence, suffer a higher underpricing at IPO.

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This study evaluates the underpricing at IPO and the performance in the long run for a sample of firms operating in the energy industry that listed between 2000 and 2014. We investigate the role of green energy companies and start-ups in the market of IPOs.

Our results show a statistical significant difference in the behaviour of green and non-green companies. Both groups of firms exhibit underpricing for the first day and for the first week of trading, but green show a lower performance than other companies. When controlling for other firm and market specific factors and the economic cycle, differences between the two disappear. In the long run, green energy companies show a lower performance, but again, when testing for the determinants of stock returns, these seem to be affected by the market return and size effect, rather than being green or not green.

To the best of our knowledge, this is the first paper to analyse the underpricing and long run performance of green energy companies and start-ups. This research contributes to the literature providing further insight on the underpricing phenomenon for the energy industry, with special attention to the green companies. Additionally, we provide specific new evidence on the stock performance of energy companies, both green and traditional.

Section 2 discusses the theoretical framework and the empirical evidence provided in the literature; Section 3 describes the data and the methodology; Section 4 presents the results and the last section concludes.

2. *Theoretical and empirical framework*

When firms go public for the first time, on average their offering price at the time of IPO is below the price prevailing on the first trading day (or days) (Ibbotson and Ritter, 1995). This means that the offer price was set below the "fair" price for the company; in other words, the issue is underpriced. This effect of underpricing can persist over time for few days or weeks of trading (Ibbotson and Ritter, 1995).

The rationale for underpricing has to be found in the asymmetries of information characterising the new debuting firms. Several theories have discussed the origin of underpricing and, among the others, we just cite some of the most relevant. The "winner's curse hypothesis" (Rock, 1986) that states that when there are two types of investors, one of which has incomplete information about the firm, the offering price has to be set at a lower level in order to compensate for the incomplete information. The "costly information hypothesis" by Benveniste and Spindt (1989) maintains that investment banks underprice the issue in order to get private information from investors in the pre-offer period. The "cascade hypothesis" by Welch (1992), stems from the hypothesis that markets are subject to cascades, and hence investors have to be induced to buy, underpricing the offer, in order to induce other investors to buy.

Several factors can influence the extent of underpricing at IPO. Among these, the literature has identified those firm, market and country characteristics that appear to impact the most. Firm age and size can influence the level of asymmetries of information and, as a consequence, underpricing. The younger and the smaller are the firms, the higher is the degree of potential undisclosed information (Megginson and Weiss, 1991; Daily et al., 2003; Hoque, 2014). The more difficult is to evaluate the business of the company, the higher will be the underpricing: among the others, high tech or innovative companies will experience higher initial returns (Walker et al., 2015). Nevertheless, asymmetric information can be softened by the presence of a reputable underwriter or by the VC backing, as the latter act to signal the quality of the company issuing the stocks on the market (Gompers, 1996; Jain and Kini, 2000; Daily et al., 2003; Belghitar and Dixon, 2012; Anderloni and Tanda, 2015).

With reference to long run performance, the literature finds that IPOs tend to underperform other more mature stocks in the long run (Ibbotson and Ritter, 1995). The evidence on green energy companies is limited, while a strand of literature analyses green or social responsible companies in its widest sense. Green companies might underperform other companies if the cost of investing in new technologies translates into lower profits and hence lower expected stock returns (Brammer and Brooks Pavelin, 2006; Cai and He, 2014). Other studies find that green companies do not underperform other companies and have similar or higher returns (Cohen et al., 1997; Guenster et al., 2010; Heinkel et al., 2001; Belghitar et al., 2014), especially in the long run, as the intangible asset of being green and sustainable displays its effects only after few years (Cai and He, 2014). A strand of literature also analyses the type of investors backing green energy companies. As sustainability becomes a more urgent issue, some investors might find investments in green energy a suitable manner to employ their capital satisfying their investment objectives (for a recent discussion, see Kaminker and Stewart, 2012). The role for private investors increases as public funds become lower and the financing gap widens and private capital have indeed started to flow into this industry lately (BNEF, 2012 BNEF, 2016). This holds not only for Socially Responsible Funds, but also for pension funds and insurances. Nevertheless, according to OECD estimates, just a very small portion of funds from this investors is allocated to green energy projects (Kaminker and Stewart, 2012).

In this study, we focus on green energy companies, which produce and distribute alternative energy. This might imply the implementation of new technologies which are not widespread in the market and hence might involve higher initial costs and higher continuous research and development costs than traditional energy producers, that include both oil and gas firms and traditional electricity producers.

3. Data and methodology

We select all the Initial Public Offers (IPOs) concluded between 2000 and 2014 on the main European stock exchanges by European companies operating in the energy industry. The IPOs are individuated through Bloomberg, which is also the source

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