DICHOTOMY OF CHINESE DOMESTIC AND OVERSEAS IPOS

Congsheng Wu
School of Business
University of Bridgeport, Bridgeport, CT

Abstract

Due to regulatory constraints, many Chinese companies pursue overseas listings in Hong Kong and the U.S. over being listed in the domestic market. Some of them have, often after many years, eventually returned to the mainland by offering A-shares to domestic investors. This unique feature of cross-listed Chinese stocks provides a natural experiment field to test conventional IPO theories, which suggest less underpricing in homebound IPOs. Using a sample of Chinese IPOs made from 1990 to 2007, we find that substantial underpricing still prevails in homecoming IPOs by those already listed abroad, with an average first-day return of 96.38%. After control for firm size and potential self-selection bias, these IPOs do not differ on the first day of trading than purely domestic offerings. The hot short-run performance in their A-share debuts is in sharp contrast to what they experienced in their overseas listings: The mean first-day return is merely 5.75% for their ADRs and 11.55% for their Hong Kong IPOs.

Homecoming vs. Pure Domestic IPOs

IPO theories suggest that homecoming IPOs should experience lower first-day returns because

1. With a HK or US listing, they have less uncertainty
2. Their H-share and ADR prices are directly observable
3. They return from overseas markets with more stringent standards of accounting, disclosure, and corporate governance

The purpose of this study is to test this hypothesis using Chinese domestic and overseas IPOs.

Data and Sample

Three sets of samples are used

1. Chinese domestic A-share IPOs
2. H-share IPOs by Chinese companies
3. ADR-type IPOs by Chinese companies

First-Day Returns of Chinese Domestic A-Share IPOs:

Mean = 230.8% and Median = 119.6%

Shanghai and NYSE Dual Listed Firms

Mean ADR first-day return = 5.75%

Shanghai and NYSE Dual Listed Firms

Mean ADR first-day return = 5.75%

Panel A: All 51 A-H Cross-Listings

First-day return (H-share IPOs) First-day return (A-share IPOs) Univariate test in the difference

Mean 11.55% 96.38% t-test: ***
Median 13.54% 76.87% Mann-Whitney test: p-value = 0.001
Meanness -3.32% 0%
Maximum 208.00% 148.89%
Standard deviation 35.21% 73.46%

Panel B: Three Simultaneous A-H Cross-Listings

Company Industrial and Commercial Bank of China China LTEC China Railway Group

First-day return (H-share IPOs) First-day return (A-share IPOs)

Shanghai and NYSE Dual Listed Firms

Mean ADR first-day return = 5.75%

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Mean ADR first-day return = 5.75%

Conclusion

Significant underpricing still prevails for A-share IPOs by Chinese companies returning from Hong Kong or the U.S. The mean first-day return of the homecoming IPOs is 96.38%. After control for firm size and other factors, the A-share IPOs by those already listed abroad do not appear to differ on the first day of trading than domestic offerings that are not cross-listed. The result is inconsistent with traditional IPO theories which suggest less underpricing for homecoming IPOs.

In sum, there exists a stark discrepancy in first-day performance between domestically and overseas listed Chinese IPOs, even by the same companies. Our results are consistent with the notion that cross-listed Chinese IPOs behave more like American or Hong Kong IPOs when listed in the two markets, but more like Chinese IPOs when return to China.

Regression Model

First-Day Return = α + γ * Cross-Listing + β1 * Log(Sales) + β2 * State_Ownership + β3 * P/E + ε

Where Cross-Listing is an indicator variable that takes the value of one for the 51 homecoming IPOs from Hong Kong or the U.S. and zero for all others.

Sales = the annual sales (in yuan millions) in the IPO year

State_Ownership = the post-IPO state ownership P/E = the price/earnings multiple

More complicated model to correct for self-selection bias is also used. But the results are robust.

Regression Results

The following table presents the OLS regression results. The dependent variable is the first-day return. The coefficient estimate on the Cross-Listing dummy represents the difference in first-day return between homecoming and pure domestic IPOs. The result in the last regression indicate no significant difference between the two types of IPOs.

<table>
<thead>
<tr>
<th>IPO Year</th>
<th>Alpha</th>
<th>Beta1</th>
<th>Beta2</th>
<th>Beta3</th>
<th>T-Value</th>
<th>P-Value</th>
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<tr>
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</tr>
</tbody>
</table>

An Illustration: PetroChina IPOs

Shanghai and Hong Kong Cross-Listed Chinese Firms

51 Chinese firms are A-H cross-listed. When these companies listed their shares in HK, the average IPO first-day return is only 11.55%. But when they return to the mainland for their A-share IPO debuts, the average initial return is 96.38%.

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