

# Examining pairing mechanisms between underwriters and IPO firms in a nascent stock market

January 31 2022

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In both mature and burgeoning markets, underwriters who have a high reputation will prevail, as they get to choose their clients. The question

becomes: Who might they choose?

According to a new study titled "Who do you take to tango? Examining pairing mechanisms between underwriters and initial public offering firms in a nascent stock [market](#)," high-reputation underwriters' client-picking behaviors differ in a nascent stock market than in a mature one. Previous research established that in mature markets, high-reputation underwriters are primarily paired with high-quality IPO firms. In a nascent capital market, however, high-reputation underwriters work with IPO firms of varying qualities—good and bad ones, including those who "cooked" their accounting books in order to meet public listing standards.

Why would high-reputation underwriters ever choose to work with low-quality IPO firms if their reputation is at stake? The authors find that money plays an important role in the pairing between underwriters and IPO firms in a nascent market. That is, high-reputation underwriters charge higher fees than their low-reputation counterparts do, whereas low-quality IPO firms pay higher fees than those high-quality ones. The authors argue that because a nascent stock market typically starts with weak regulations, the financial and reputational penalties for underwriters taking on low-quality clients are not well defined, giving underwriters incentives to put short-term financial gains (high fees) ahead of long-term reputation concerns.

"We contribute to the IPO literature by going beyond the well-accepted assumption that high-reputation underwriters are paired with high-quality IPO firms and by proposing an alternative pairing mechanism in a nascent stock market: the pricing mechanism," the authors write. "By focusing on a nascent [stock](#) market, our study provides a glimpse into how underwriters and IPO firms are paired before an efficient contract, which best serves IPOs, has emerged in a capital market."

After regulations get more stringent, the pricing mechanism falls apart. The study finds that after stronger regulations are introduced into a nascent market—and a few cases demonstrate that underwriters do get panelized for endorsing low-quality firms—the overall quality of IPO firms improves. More important, underwriters' client-picking behaviors adapt, as well. High-reputation underwriters become more likely to work with IPO firms with high quality instead of those who are willing to pay hefty fees.

This study offers important insights on behaviors at all levels of market maturity, be they quite germane or well-established, and holds implications for any [financial institution](#) looking to play the market.

**More information:** Yan Anthea Zhang et al, Who do you take to tango? Examining pairing mechanisms between underwriters and initial public offering firms in a nascent stock market, *Strategic Entrepreneurship Journal* (2021). DOI: [10.1002/sej.1414](https://doi.org/10.1002/sej.1414)

Provided by Strategic Management Society

Citation: Examining pairing mechanisms between underwriters and IPO firms in a nascent stock market (2022, January 31) retrieved 19 April 2024 from <https://phys.org/news/2022-01-pairing-mechanisms-underwriters-ipo-firms.html>

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