

Competitive Effects of IPOs: Evidence from Chinese Listing Suspensions

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ABFER Annual Conference 2021

Corporate Finance

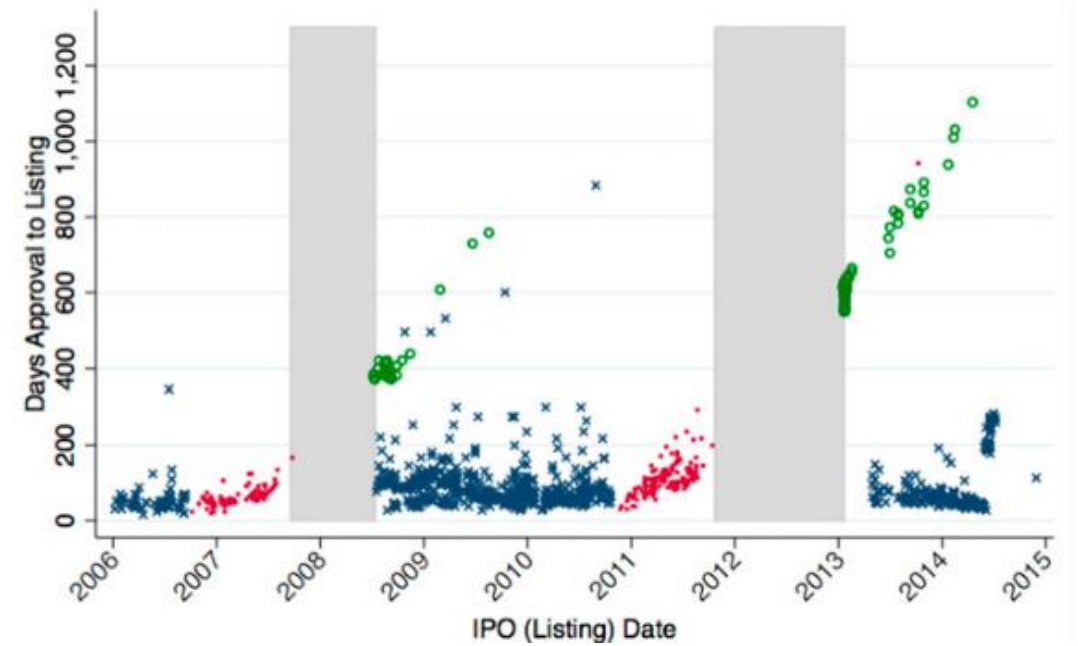
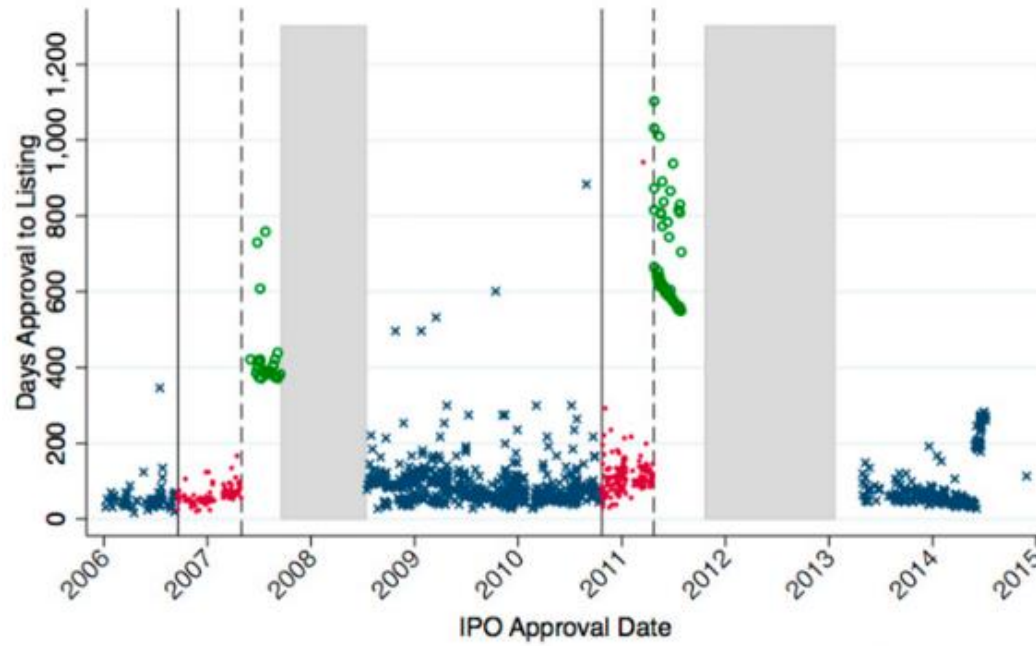
June 3, 2021

Summary

- Question: How IPOs affect already listed firms?
- Theories and prior research suggest adverse impact through two competition channels:
 1. Direct competition
 2. Asset space competition
- Conventional approach of examining listed firms' returns and performances around IPOs or IPO withdrawals is subject to endogeneity concerns:
 - “Who”: selection of firms into IPOs or IPO withdrawals
 - “When”: opportunistic market timing of equity issuances

Setting: Blanket suspension of already approved IPOs in China

- Firms need CSRC (China's SEC) approval for IPO. Getting the approval is a lengthy process that can take years.
- Blanket suspension of IPOs force already approved IPOs to delay.



Source: Figures 2 & 3 from Cong & Howell (Management Science, 2021)

Summary (continued)

- Paper focuses on one-day return on the day of IPO suspension announcement
- Estimation exploits the variation in listed firms' exposure to suspension due to the industry composition of postponed firms
 1. Direct competition: value share of postponed firms in the industry
 2. Asset space competition: historical covariance with synthetic listed firms in the same industry mix of postponed firms
- Paper finds support for both channels
- Stronger effects for weaker listed firms → consistent with competition

Big picture

- Access to finance remains challenging in emerging markets.
- In China: long queue of IPO applications. No approved IPO firm decides to withdraw the IPO even during long suspension. → IPOs are highly valuable for firms. Opportunistic IPO timing is less of an issue in general.
- The adverse effect of IPOs on already listed firms can be generalized to other EMs. The effect can be weaker in developed economies where firms have better access to finance.
- In terms of welfare implications, the competition can be viewed as leveling the playing field for firms with and without access to the public financial markets.

Empirical setting and competition channels

IPO suspension setting has clear advantages:

- Using already approved and eventual successful IPOs sidesteps selection issues
- Imposed delay in listing is plausibly exogenous to firm & industry dynamics

How does the actual listing affect the two competition channels?

- Direct competition: Listing increases competition that is *already intense*.
- Asset space competition: Listing is necessary for this competition to take place.

Listing in China has requirements on profit, cash flow, and net asset

		Main Board / SME Board
Business integrity		In the last 3 years, no major adverse changes have occurred in the main business, directors and senior managers
Finance and accounting		Requirements on net asset, cash flow, revenue, and net income
	Profit	In the last 3 fiscal years, the company has made continuous profits and accumulated net profits exceeds 30 million RMB
	Cash flow	In the last 3 fiscal years, the cumulative net cash flow from operating activities exceeds 50 million RMB, or the accumulated total operating revenue exceeds 300 million RMB
	Net asset	Intangible assets account for no more than 20% of net assets at the end of the latest period. There is no undistributed deficit at the end of the latest period.

Source: Shanghai Stock Exchange (<http://english.sse.com.cn/start/listing/overview/>)

Potential channels of direct competition

Given that unlisted firms need to be profitable to seek IPO, product market competition between IPO queue firms & listed firms is presumably already quite intense.

How would the actual IPO increase this competition?

- Loosening of financial constraints
- Certification:
 - Underwriters, law firms, auditors
 - CSRC
 - IPO performance
- Visibility

Additional tests for direct competition

- Loosening of financial constraints
 - *Measure the extent of financial constraints faced by postponed firms from their IPO prospectuses and pre-IPO financial statements → listed firms competing with more financially constrained postponed firms should be better off*
 - *Do listed firms take advantage of the halt and do SEOs?*
- Certification from IPO performance
 - *Examine heterogeneous effects w.r.t. P/E at issuance and first day return of the delayed IPOs*
- Visibility
 - *Measure the visibility increase due to IPO using online search index*

Asset space competition

- Assumption: Markets are incomplete (likely to hold up in the Chinese setting)
- Key is to identify stocks that would be affected by the market completion from the IPOs
- Measure based on covariance corresponds to mean-variance optimization. However, this measure also uses industry affiliations which may pick up direct competition.
 - *How correlated is this with the direct competition measures?*
 - *Construct the alternative measure by dropping all firms in the same industry*
 - *Explore other aspects of asset space competition*

Additional tests for asset space competition

- Local bias in portfolio choices

➤ *Construct synthetic portfolio based on headquarter locations.*

- Institutional ownership

➤ *Differentiate stocks by level & type of institutional ownerships. For instance, some mutual funds have proportionately higher investments on IPO stocks. Stocks held by these funds have higher exposure to IPOs.*

Additional suggestions for the outcome variable

- Paper currently focuses on one-day return on the IPO suspension day
- Examine cumulative abnormal return for the longer window, e.g., $[T-10, T+10]$
 - Unexpected suspension → Pre-suspension return should be insignificant.
 - Is there any drift in the days beyond the suspension day?
- Examine the operating performance of listed firms → shed more light on the direct competition
- Examine the trading behaviors, institutional ownership of listed firms → shed more light on the asset space competition

Concluding remarks

- Access to finance is important. Paper contributes to the IPO literature and also sheds light on the access to finance in emerging markets.
- IPO suspension in China provides a clean setting. Competition dynamics do interact with the setting.
- More analyses will further solidify the competition channels.
- Overall, this paper is a pleasure to read. I look forward to reading the new version.