

85 Views | 7 CrossRef citations to date | 0 Altmetric

Original Articles

Offering price clusters and underpricing in the US primary market

Kevin C. H. Chiang * & T. Harikumar

Pages 809-822 | Published online: 11 Oct 2011

Cite this article <https://doi.org/10.1080/0960310042000238903>

Sample our
Economics, Finance,
Business & Industry Journals
>> [Sign in here](#) to start your access
to the latest two volumes for 14 days

Full Article Figures & data References Citations Metrics

Reprints & Permissions [Read this article](#) [Share](#)

We Care About Your Privacy

We and our 880 partners store and access personal data, like browsing data or unique identifiers, on your device. Selecting I Accept enables tracking technologies to support the purposes shown under we and our partners process data to provide. Selecting Reject All or withdrawing your consent will disable them. If trackers are disabled, some content and ads you see may not be as relevant to you. You can resurface this menu to change your choices or withdraw consent at any time by clicking the Show Purposes link on the bottom of the webpage. Your choices will have effect within our Website. For more details, refer to our Privacy Policy. [Here](#)

We and our partners process data to provide:

Use precise geolocation data. Actively scan device

I Accept

Reject All

[Show Purposes](#)

Acknowledgements

We wish to thank Jay R. Ritter for providing the data used in this study and the participants of the seminar at the New Mexico State University.

Notes

A biological rationale for this pricing practice is that consumers have limited memory and tend to store the first digit of a price into memory (Brenner and Brenner, [1982](#)). Thus, costs tend to be priced at odd prices, such as US\$4.99 and US\$99.99, and benefits, e.g., yields and salaries, tend to be priced at whole prices, such as 5.00% and US\$100 000, in retail markets.

The well-documented price clustering in US secondary markets for securities is a result of a variety of economic reasons, including the reduction of negotiation costs (Harris, [1991](#)), implicit collusion among market makers (Dutta and Madhavan, [1997](#)), and explicit collusion among dealers (Christie and Schultz, [1994](#)).

Furthermore, there are differences between the primary and secondary market microstructure in the USA Unlike in the secondary market where minimum tick sizes and spreads are almost always mandated, there are no mandated tick sizes or bid-ask spreads in the primary market. Primary market participants are free to

use odd prices.

Consider a stock with a price of US\$22.5. If the price is rounded to US\$27.5, the potential increase in wealth is 24.44%. If the price is rounded to US\$22.5, the potential decrease in wealth is 11.11%. The potential increase in wealth is 1.69% of the potential decrease in wealth.

Gianfranco Corbelli negotiates with the market.

Arising from the theory and models of price formation in the SDAQ stock market, we propose a structural defence against the incentives to



compete on price (Godek, [1996](#); Huang and Stoll, [1996](#)). As these explanations are tailored to the NASDAQ market, they are not applicable to the IPO market.

In their study of gold price clustering, Ball et al. ([1985](#)) hypothesize that prices tend to cluster if the underlying value of the security is not well known (price resolution hypothesis). Harris ([1991](#)) adapts the price resolution hypothesis to the clustering in the secondary stock market and suggests that traders will use a fine set of prices when the underlying security values are well known, thereby leading to little price clustering. The competition theory of Grossman et al. ([1997](#)) is largely an extension of the negotiation hypothesis.

Although there is currently no theory predicting the shape of the distribution of IPO intrinsic values, except for the truncated component, the distribution of IPO intrinsic values should be somewhat smooth. In other words, a priori, there is no economic reason why a relative high frequency of intrinsic values at $US\$X$ with two relatively low frequencies of intrinsic values at $US\$X - 1$ and $US\$X + 1$. Harris ([1991](#), Fig. 2) supports this presumption, in which the distribution of market prices is a rather smooth, χ^2 -like one.

Harris (1991) documents clusters at whole 5s and 0s in secondary stock markets. These clusters, however, are far less intense than in IPO market.

The Kolm
distribut

To ensur
location,
how the
disappea

When
high as

The find
underpri
need to
Chua, [19](#)
precision



Comparing two

changes in
nsitive to
results of the

nonnormal

ult in less
at investors
(Booth and
her level of

People also read

Recommended articles

Cited by
7

Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research

Help and information

- Help and contact
- Newsroom
- All journals
- Books

Keep up to date

Register to receive personalised research and resources by email

 Sign up

 

 

Copyright

Acc

Registered
5 Howick Pl

