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Initial Public Offerings: Daily Returns, Offering Types and the Price Effect

Initial public offerings (IPOs) generate abnormally high returns immediately following their issuance. An examination of daily returns for 649 firms that went public between 1975 and 1982 reveals how these returns are distributed across time (from the day of issuance through the 190 aftermarket trading days); across initial offering price categories; and across types of offerings.

The sample's mean return on the initial day was a statistically significant 21.65 per cent; the first day of aftermarket trading also experienced a significant positive abnormal return. The entire aftermarket period had a cumulative return of 17.99 per cent, suggesting that significant abnormal returns continued beyond the initial offering day.

While the initial day's abnormal return was positive across all price groups, it was much greater for the IPOs originally priced at $1.00 or less than for any other group. The lowest priced IPOs also accounted for most of the sample's abnormal returns over the aftermarket trading period.

The initial and aftermarket performances of firms using firm commitment offerings closely approximated the performances of the entire sample (as 88.4 per cent of the IPOs sampled used this form). The best efforts offerings, however, outperformed the firm commitment offerings both on the offering day and over the aftermarket trading period. These higher returns are attributable, again, to the returns on stocks priced at $1.00 or less; over 70 per cent of the best efforts offerings fell into this price category.

THAT INITIAL PUBLIC OFFERINGS (IPOs) generate abnormally high returns during the period immediately following their issuance has been well documented by previous studies.[1] As these studies observed only cumulative one-week or one-month initial returns, however, we do not know if abnormal returns occur entirely on the first trading day or if they are spread over several trading days. Nor has prior research addressed the question of why IPOs alternate between "hot" and "cold" periods. That is, during hot markets, such as those of 1968–69, 1971–72 and 1980–81, both the number of IPOs and the initial returns increase substantially; activity and returns decline substantially during cold markets.

This article examines daily returns for 649 firms that went public between 1975 and 1982.[2] We observe daily returns from the initial offering day through 190 days of aftermarket trading to determine whether abnormal IPO returns occur immediately after issuance or continue beyond the offering day. We also categorize IPOs by original issue price to see if high abnormal returns are largely concentrated in a particular price group. Many small companies take advantage of the hot-issue markets to go

1. Footnotes appear at end of article.

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