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Initial Public Offer (IPO) Mispricing, Asymmetric Information and IFRS Adoption in Nigeria

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Abstract: *The study investigates the effect of adoption of IFRS and asymmetric information on IPO mispricing in Nigeria. 38 IPOs are included in the study between 2001 and 2016 and panel data regression particularly the random effect model is used to test the influence of the IFRS and asymmetric information on IPO mispricing in the Nigeria Stock exchange NSE. The results indicate that asymmetric information and IFRS adoption have significant impacts on IPO mispricing in the Nigeria Stock Exchange .however information on the following variables; firm value, firm age, offer price, subscription level and numbers of shares are the most important for IPOs mispricing in the NSE .It can be implied from the findings that there is the need to place more emphasizes on the reduction of the flow of asymmetric information especially on the aforementioned variables that increases the mispricing of the IPOs. The study has brought into perspective the influence of IFRS and asymmetric information on IPO mispricing. This has not been done on Nigeria Stock Exchange before.*

Keywords: Initial Public Offers IPOs, Asymmetric Information, International Financial Reporting Standards IFRS.

JEL Classification: G11, G14, G15.

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INTRODUCTION

The relevance of financial reports in dissemination of asymmetric information that are relevant for pricing of securities have been enjoying patronage of financial researchers over the years. The reason behind this is that increasing number of the public are now developing more interest in making speculative dealings in the financial market especially across developing countries including Nigeria (Aboody & Lev, 2000).

Nigeria experienced a downward trend of equities listed on the exchanges consequent upon the global market meltdown in 2007. It appears the capital markets are yet to fully recover from the aftermath of the experience thus casting doubt on the hope for speedy market recovery. Even after the global financial crises, the functions of capital markets in sub Saharan Africa have increasingly come into question and many allegations have been trailing the activities of these stock markets. For instance, there are claims that stock market prices were being manipulated in Nigeria Stock Exchange NSE. Other claims contend that players on the exchange focus on gains of listed shares of IPOs and that, to a large extent, these gains could not have been made possible without information asymmetry (Jog & McConomy, 2014).

Many more challenges observed on the stock markets include the unusual quiet- investor strike whose effect is visible in the sliding movement of equities listed on the exchange and the unrealistic pricing of equities which is occasioned by information asymmetry (La Porta *et al.*, 2002). According to Jog & McConomy (2014). There seems to be a consensus of opinion that, something is wrong with IPOs across the globe and that the problem appears deep-seated and critical even in some developed economies in Europe. Investors were reported to be fed up with paying too much for IPOs and in consequence have led to protest from some investors on the prevalence of mispricing of IPOs in the NSE (Security Exchange Commission SEC, 2015).

Extant literature revealed that shares of firms floating IPOs have never been listed before and the only information available to regulators, issuing companies and investors are those contained in the company's financial reports and prospectuses (Kanagaretnam *et al.*, 2011). The usefulness of financial information so provided in these documents is enhanced in comparability, verifiability, timeliness and clarity. Therefore, in order for accounting information to meet the needs of its users, financial statements should meet some basic characteristics and these are relevance and faithful presentation (Kanagaretnam *et al.*, 2011).

(Hong *et al.*, 2014) Adoption of IFRS in the European Union (EU) has made the standards' the most broadly received financial accounting model in the world. Furthermore, IFRS adoption predicts improved accounting quality of firms that got listed after IFRS

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adoption based on the assumption that, IPOs firms would have fulfilled the requirements of the global standards prior to listing thus reducing insiders' ability to benefit from private information. It therefore behoves current and potential investor as well as the standard setters to understand the implications of IFRS on accounting variables (Nanda & Wysocki, 2011). However, the outcome of studies in respect of IFRS adoption and the difference it has made in the quality of accounting information in Nigeria appear scanty thereby revealing research gaps in literature.

IPOs have been widely studied in literature (Ibbotson, 1975; & Loughran *et al.,* 1994) but the significant discovery in these studies since 1970 has been the incidence of abnormality in IPOs pricing. IPOs mispricing can be in the form of under-pricing or over-pricing but the persistence of equity mispricing in our capital markets had continued to compel additional research works. Research efforts made by scholars on IPOs mispricing revealed that, the steps involved in determining a right price for equity shares of firms going public for the first time is critical, complex and laden with information asymmetry (Lowry el al., 2010). As a consequence, the process of share price determination has been classified as one of the most difficult decisions a firm planning to go public must make (Kleeburg, 2005).

Despite the efforts of scholars to address the challenge posed by information inequality in capital markets, the problem remains unresolved and as a result, the problem of information inequality and negative choice has remained a global challenge for decades. However, recent rigorous explorations to address this epoch-making challenge are IASB's bold move to replace IFRS with local standards. Adoption of IFRS reduces the problem of data inequality and negative selection compared to local standards. Numerous studies have been conducted worldwide to contribute to the growing literature on the impact of IFRS adoption on data inequality in IPO pricing (Dorsman *et al.,* 2010; Horton *et al.,* 2012; Roberto, 2013; & Hong *et al.,* 2014).

Despite the abundance of these studies globally, empirical literature on IPO, information asymmetric and the effect of IFRS appears not to have been given priority in many developing countries like Nigeria. This study will contribute to the existing literature by investigating the pre and post IFRS adoption, the influence of information asymmetric and the general implication for the IPO pricing in the Nigeria stock market. The remaining part of the paper is discussed under the literature, methodology, results and discussion and the conclusions.

LITERATURE REVIEW

Some researcher mentioned in their studies about initial public offers and information asymmetry in the context of IFRS adoption. However, the major difference among the studies are their focus and the case studies utilized. The following are some of the recent studies.

Nanda & Wysocki (2011) explored accuracy of valuing IPOs under different accounting principles namely, U.S. GAAP and IF'RS and found that valuation of IPOs is more accurate under IFRS regime. The study tested two groups of public firms in U.S. and E.U. that adopted GAAP and IFRS from 2006 to 2014 and found absolute error which measure the tendency of existence of mispricing stood at 72.4% and 66.72% for the U.S. and E.U. public firms respectively. The results thus suggest that IFRS adoption works better than GAAP adoption in valuing IPOs.

Li-fang-Huang (2015) investigated the effect of the adoption of IFRS on the IPOs in Taiwan's capital market from 2009 to 2013 and found a significant decrease in level of under-pricing after IFRS adoption. A summary of the few studies reviewed out of others that might be in print and otherwise, revealed that most of these studies were carried out in matured stock exchanges (Li-fang-Huang, 2015; Suh *et al.,* 2015; Shih-Han Chuang, 2014; Roberto, 2013; Hung *et al.,* 2013; & Dorsman *et al.,* 2010). All of these studies except one (Roberto, 2013) lend support to the expectations of the Board upon adoption of IFRS. The proponents of IFRS had earlier predicted that adoption of the global standards will reduce information asymmetry in the equity issuance process and in turn helps firms raise capital at a lower cost. The outcome of the study carried out by Roberto (2013) documented that adoption of IFRS does not reduce asymmetry information among investors in Europe.

Olowolaju & Ogunsan (2016) investigated value of accounting information in the determination of shares prices of quoted Nigerian deposit money banks. The study used a sample of 12 listed money deposit banks to assess the value relevance of accounting information on shares prices of listed banks in Nigeria. The study revealed that the contribution of dividend per share is significantly more than earnings per share to the determination of shares of the selected money deposit banks investigated.

Umoren & Enang (2015) assessed IFRS Adoption and value Relevance of Financial Statements of Nigerian Listed Banks. The sample comprises of twelve listed banks in Nigeria. Descriptive statistics and least square regression were conducted to analyse accounting quality. The result indicates that the equity value and earnings of banks are relatively value relevant to share prices under the previous Nigerian SAS.

Onalo *et al.* (2014) investigated International Financial Reporting Standards and the quality of banks financial statement information: Evidence from an emerging market Nigeria. Twenty Nigeria banks

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covering a period of six years was investigated Result suggest that IFRS adoption is associated with minimal earnings management and timely recognition of losses?

Okoye & Raymong (2014) assessed the effect of IFRS on stock market performance of banks with a view to measure whether investors' expectation is satisfactory is becomes necessary. The population consists of fourteen banks quoted in Nigerian Stock Exchange. Stratified Random sampling method was adopted and seven years (2006-2012) annual accounts of these banks covered both SAS and IFRS. Findings showed that most of the banks could not generate sufficient interest earnings to cover their interest obligations thereby unable to satisfy investor's expectation, hence the assessment of stock market performance of banks therefore can be used to measure whether investors expectation is satisfactory or not.

METHODOLOGY

Research Design

The research design adopted for the work was ex-po facto research design. Prior studies, carried out in developed economies. Like those of Roberto, (2013); Hao (2011) made use of this research design and so it is considered appropriate for a study of this nature. The study made use of secondary data extracted from IPO prospectuses and annual financial reports of the firms' concerned while the historical stock and market data

$$IR = \beta_0 + \beta_1 IFRS + \beta_2 EPS + \beta_3 BVPS + \beta_4 RET + \beta_5 OP + \beta_6 FV + \beta_7 FA + \beta_8 NOS + \beta_9 EP + \beta_{10} SL + \beta_{11} FLP + \beta_{12} MI + \varepsilon \ldots\ldots\ldots\ldots\ldots (1)$$

Where:

IR[1] = IPO pricing, IFRS= is represented by dummy variables with "0" for pre IFRS adoption and "1" for post IFRS adoption. EPS = Earnings per Share of each firm, BVPS= Book value per share of each firm, RET= Retained Equity by pre-IPO owner, OP= offer price, FV=Firm value, FA= Firm age, NOS=Numbers of share offered, UP=uses of proceeds, SL subscription level, FLP= Flipping ratio, MI=market index and E is the error term.

Estimating techniques

Panel data analysis is used to examine the effects of asymmetric information and IFRS adoption on the initial public offers in the NSE. There are two major methods of panel data analysis namely; fixed and random effects. The two will be estimated and HAUSMAN test will be conducted to choose the one that is appropriate for the data set in the study.

The Fixed Effect Model

were obtained from the websites of selected Nigeria capital market and their respective regulatory agencies as well as the various publications of the African Capital Exchanges Association (ASEA). This approach provided the opportunity of extracting the needed data from relevant documents to proxy our variables.

Sample

With special reference to the time frame of adoption of IFRS only the listed IPOs between 2001 and 2016 which is the scope of our study are used for the analysis. In all there are 36 IPOs listed between these periods and they shall be the focus of this study.

Model Specification

The prediction that 1FRS adoption has not significantly reduced the level of information asymmetry in the prices of selected Nigerian IPOs is investigated in this study. Asymmetric information supporters debate that information scarcity about the company going to the public for the first lime breeds the usual uncertainty that surrounds IPO floatation and in consequence creates difficulty in ascertaining the true price of the securities. However, leveraging on the studies of La Porta *et al.* (2002) among others a model that expresses the IPO mispricing as a function of some variables that represents asymmetric information is specified for the study. In addition, a dummy variable is added to depict periods of pre and post IFRS adoption in Nigeria to capture the influence of IFRS adoption in the nodel.

The term "fixed-effect" is due to the fact that although the intercept may differ among firms, each firm's does not vary overtime, that is time-variant. This is the major assumption under this model i.e. while the intercept are cross-sectional variant, they are time-variant. The model to be estimated under fixed effect is

$$Y_{it} = \beta_i + \sum_{i=2}^{k} \beta_i X_{ijt} + \eth t + \infty_i + E_{it} \text{ -----} (2)$$

Random Effect Model

The major difference between this and fixed effect is the treatment of the random variables called the error term or the unobserved variables. These unobserved variables according to the random effect are treated as being drawn randomly from a given distribution. This may well be the case if the individual observations constitute a random sample from a given population. The random effect equation is

$$Y_{it} = \beta_i + \sum_{j=2}^{k} \beta_i X_{ijt} + \eth_i + \infty_i + E_{it} = \beta_i + \sum_{j=2}^{k} \beta_i X_{ijt} + \eth_i + \mu_{it} \text{ ----(3)}$$

Where $\mu it = \infty i_{+ Eit}$

The unobserved effect has been dealt with by subsuming it into the disturbance term.

Panel Regression Coefficients

[1] IR is the IPO mispricing which is measured as the natural logarithm of the ratio of closing share price at the end of the first day of trading and offer price (Reber & Fong, 2006)

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Each coefficient multiplies the corresponding variable in forming the best prediction of the dependent variable. The coefficient measures the contribution of its independent variable to the prediction. The coefficient of the panel is the constant or intercept in the regression, it is the base level of the prediction when all of the other independent variables are zero. The other coefficients are interpreted as the slope of the relation between the corresponding independent variable and the dependent variable.

Standard Errors

These measure the statistical reliability of the regression coefficients--the larger the standard error, the more statistical noise infects the coefficient. According to regression theory, there are about 2 chances in 3 that the true regression coefficient lies within one standard error of the reported coefficient, and 95 chances out of 100 that it lies within two standard errors, (Lipsey & Crystal, 1995).

Panel T-Statistic

This is a test statistic for the hypothesis that a coefficient has a particular value. The t-statistic to test if a coefficient is zero (that is, if the variable does not belong in the regression) is the ratio of the coefficient to its standard error and this is the t-statistic reported by E-views. If the t-statistic exceeds one in magnitude it is at least two-thirds likely that the true value of the coefficient is not zero, and if the t-statistic exceeds two in magnitude it is at least 95 percent likely that the coefficient is not zero, (Hazewinkel, 2001).

Probability

The last column shows the probability of drawing a t-statistic of the magnitude of the one just to the left from a t distribution. With this information, you can tell at a glance if you reject or accept the hypothesis that the true coefficient is zero. Normally, a probability lowers than .05 is taken as strong evidence of rejection of that Null hypothesis, (Lipsey & Crystal, 1995).

The test statistics is stated as follows:

- $H_0: \beta_i = 0$ $(Null\ Hypothesis)$: Adoption of IFRS and asymmetric information do not have significant impact of IPOs
- $H_1: \beta_i = 0$ $(Alternative\ Hypothesis)$: Adoption of IFRS and asymmetric information have significant impact of IPOs

β_i is the panel regression coefficients which is tested for significance. The probability of each of the coefficient is compared to 5% level since the hypothesis is tested using 95% confidence interval.

Decision Rule

If the Probability of the β_i is greater than 5% then, the null hypothesis is accepted while the alternative hypothesis is rejected. Hence, we conclude that the variable with the parameter β_i is not statistically significant. The reverse is the case when the β_i is less than 5%.

Sources of data

Data for this study are sourced from the website of the Nigerian stock exchange NSE as well as the fact book the NSE and we focused on years between 2001 through 2016

RESULTS AND DISCUSSIONS

Pool regression analysis

The essence of pool regression analysis is to verify if there will be need to use panel data analysis for the estimation of the equation 1. Panel data application might not be necessary if there is no problem of cross-sectional dependence. In other words if the estimated pool regression model does not have specific effect then pool regression will suffice for the analysis but if otherwise then, panel data analysis is more suitable to be used for the estimation. One of the sort comings of the pool regression is the problems of heterogeneity which is not present in the panel data.

Table 1: Pool Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.218017	1.204037	4.333769	0.0000
IFRS	1.074939	0.334741	3.211252	0.0015
LnEPS	0.176263	2.016142	0.087426	0.9304
LnBVPS	1.345195	0.983401	1.367901	0.1723
LnRET	0.456117	1.202625	0.379268	0.7047
LnOP	-0.072625	0.037788	-1.921929	0.0555
LnFV	0.152519	0.036314	4.200016	0.0000
LnFA	109.2378	23.90106	4.570416	0.0000
LnNOS	6.974960	2.632319	2.649740	0.0085
LnUP	-1.219992	0.485574	-2.512473	0.0125
LnSL	-0.911334	12.70625	-0.071723	0.9429
LnFLP	156.4866	125.4973	1.246932	0.2133
LnMI	1.278918	2.356460	0.542729	0.5877
R-squared	0.725868	Mean dependent var		7.965009

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F-statistic	8.434804	Durbin-Watson stat	0.216122
Prob(F-statistic)	0.000000		

Source: Author's computation

The results on table are an indication that four of the variables that are used to capture asymmetric information have significant impact on IPO mispricing. This is shown from the probabilities of the t statistics of each of the independent variables in the estimated model, which are significant at 5% level. Adoption of IFRS particularly showed significant impact IPO mispricing as well. Notwithstanding, this approach of pool regression might not be sufficient to explain the relationship between the independent variables and the dependent variable because the results are prone to specific effects/heterogeneity influence which might undermine the reliability of the parameter estimates in the estimated model. Consequently, cross-sectional dependence test is conducted to ascertain if there is presence of specific effect in the result. The result of the cross-sectional dependence test is presented in Table 2.

Table 2: Cross-Sectional Dependence Test (Pool-Ability Test)
Null hypothesis: No cross-section dependence (correlation) in residuals

Test	Statistic	d.f.	Prob.
Breusch-Pagan LM	292.6937	105	0.0000
Pesaran scaled LM	11.91700		0.0000
Pesaran CD	-0.100446		0.9200

Source: Author's computation

The results from table 2 show that the null hypothesis is rejected and the alternative hypothesis that there is cross-sectional dependence in the estimated panel model is accepted. The implication of this result is that it is not appropriate to pool the data. Therefore, the pool regression results are not reliable for the purposes of forecasting and empirical inferences. Consequently, panel model approach is used to reduce the problem of cross-sectional dependence. The results of panel estimation are presented as follows:

Panel data estimation

Following the results of the pool regression, it is obvious that there will be need for panel data estimation in other to get rid of the problem of cross-sectional dependence. Both fixed and random effects are used in this study to be able to ascertain the level of consistency in the panel results as well as investigating the approach that is more suitable for the nature of our data. The HAUSMAN test is first conducted, this will enable us know if it is fixed or random effect result that will be presented and interpreted.

Table 3: HAUSMAN Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	24.302898	11	0.9602

Source: Authors' Computation

From the HAUSMAN test revealed that the chi square probability is not significant at 5% level. This is an indication that the null hypothesis is accepted and the alternative hypothesis is rejected. The implication of the results is that random effect is more preferable for this study hence we go ahead to interpret the results of the random effects.

Table 4: Random Effects Panel Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.865097	1.479456	2.612513	0.0094
IFRS	0.840251	0.207946	4.040727	0.0001
LnEPS	0.445685	1.150729	0.387306	0.6988
LnBVPS	0.126302	0.695810	0.181517	0.8561
LnRET	0.701780	0.769426	0.912083	0.3624
LnOP	0.233939	0.045031	5.195008	0.0000
LnFV	8.481937	4.008208	2.116142	0.0350
LnFA	0.651456	0.016103	5.449239	0.0000
LnNOS	0.861489	0.214353	4.019019	0.0001
LnUP	-0.308038	0.445223	-0.691874	0.4895
LnSL	3.015228	0.327388	6.957761	0.0000
LnFLP	0.398743	0.457279	0.441624	0.6591
LnMI	0.028833	0.142407	0.202471	0.8397

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Effects Specification			
		S.D.	Rho
Cross-section random		2.920131	0.8822
Idiosyncratic random		1.066944	0.1178
Weighted Statistics			
R-squared	0.783202	Mean dependent var	0.618587
Adjusted R-squared	0.661867	S.D. dependent var	1.321490
S.E. of regression	1.055649	Sum squared resid	354.3779
F-statistic	17.96057	Durbin-Watson stat	1.779937
Prob(F-statistic)	0.000000		
Unweighted Statistics			
R-squared	-0.088648	Mean dependent var	7.965009
Sum squared resid	1675.984	Durbin-Watson stat	1.764913

Source: Authors' Computation

The random effect results presented in table 4 is an indication that IFRS adoption is among the variables that have significant effect on IPOs mispricing in the NSE. The coefficient is from the estimated random effect model is 0.840251 with probability of 0.001. This shows that the coefficient passed the test of statistical significance hence we can concluded that adoption of IFRS affects the IPOs mispricing in the NSE during the period under study. The result is similar to the findings of (Hong *et al.,* 2014).

Secondly among the variables used to proxy asymmetric information, it was discovered that four of the variables have significant impacts on IPO mispricing in the NSE. Offer price has a coefficient of 0.233939 with probability of 0.0000. This shows that the price of the offer significantly affect mispricing of IPOs in the NSE. It implies that information of the offer price can cause mispricing of IPOs. Again, information of the frim value is another important variable that affects IPO mispricing. The estimated random effect model shows that the coefficient of FV is 8.481937 and it is significant at 5% with the probability of 0.03. Consequently it shows that information of the value of firm can significantly determine the mispricing of IPOs.

In addition firm age FA and number of shares NOS are also shown to have significant impact of mispricing of IPOs. Both of them have coefficients of 0.651456 and 0.816489 respectively. The probabilities are also less than 0.05 thus showing that both of them are important determinants of IPOs in the NSE. The result is also similar to the findings of (Reber & Fong, 2006).

Subscription level is another variable with significant impact on IPO mispricing. With a coefficient of 3.015228 and probability of 0.000 it is obvious from the estimated random effect equation that the level of subscription witnessed by IPOs is important determinants of it mispricing. (Hong *et al.,* 2014) also found the same result from their study. However, other variables such as earnings per share, book value per share, retained Equity by pre-IPO owner, uses of proceeds, flipping ratio and market index are not important factors that affect IPOs mispricing in the NSE.

CONCLUSIONS

Considering the analysis in this study, it is obvious that adoption of IFRS is very important in determining the mispricing of IPOs in the NSE. Authors in the past have emphasised that some information that are useful for investors decision are mandatory in IFRS and therefore it adoption is very important of mispricing of IPOs. Nigeria as a country adopted IFRS fully in 2005 and this year marked the implementation of disclosure of some important information in the financial reports of firms in Nigeria. This study have shown that the inclusion of this information has significant implication on the mispricing of IPOs in the NSE.

It can also be confused from this study that asymmetric information is an important factors affecting IPO mispricing in the NSE. However, since there are various information that are available in the financial reports, this study has shown that information of the following variables are very germane to IPOs mispricing in the NSE; offer price, numbers of shares, firm age, firm value and subscription levels. The implication is that any asymmetric information that involve any of these aforementioned variables will significantly affect mispricing of IPOs in the NSE.

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