

IPO UNDERPRICING AND AUDIT QUALITY: EVIDENCE FROM THE ALTERNATIVE INVESTMENT MARKET IN THE UK

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Abstract

This paper aims to investigate the relationship between audit quality and IPO underpricing for IPO firms that went public on the Alternative Investment Market (AIM) of the London Stock Exchange in the UK. Prior research has examined this relationship; however, there has been no work investigates this relation for IPO firms that went public on the AIM market. Based on a sample of 413 IPOs, the findings of the current study reassure prior literature that high quality auditors are associated with a lower level of IPO underpricing. The findings show that high quality audit firms help to reduce the level of information asymmetry around the IPO and, therefore, this leads to reduce the level of IPO underpricing. Further, size, liquidity ratio, and high litigation industries are found to contribute the IPO underpricing on the AIM market.

Keywords: Audit Quality, Initial Public Offerings, IPO Underpricing, AIM Market

1. INTRODUCTION

This paper examines whether audit quality impacts the IPO underpricing in the Alternative Investment Market (AIM) in the UK. The IPO underpricing occurs when the offer price is lower the closing price for the stock in the first day of trading. Prior research indicates that information asymmetry between insiders and outsiders significantly contributes to this phenomenon; notably that the IPO issuers tend to leave some money on the table to compensate the investors for the information asymmetry. Thus, prior research has focused on this phenomenon and examined several determinants that are found to play a significant role to increase/decrease the level of IPO underpricing e.g., underwriter reputation and venture capitalist (e.g., Coakley et al. 2009).

In line with this, prior research has examined the impact of audit quality on IPO underpricing and found evidence that IPO firms who appointed high quality auditors (Big 4 audit firms) experience a lower level of IPO underpricing as compared to IPO firms audited by low quality auditors (non-Big 4 audit firms) (e.g., Albring et al. 2007; Chang et al. 2008; Coakley et al. 2009; Akyol et al. 2014; Boulton et al. 2015). On the one hand, IPO firms appoint high quality auditors during the IPO to send a positive signal about the offer to outside investors (Titman and Trueman, 1986). This is due to the fact that high quality auditors are expected to provide high-quality audits to avoid any future litigation risks and to protect their reputation in the capital market (DeAngelo, 1981; Francis and Krishnan, 1999). Khurana and Raman (2004) examined the association between litigation risk, reputation damage, and enhanced audit quality. Their results showed that avoiding litigation risk is the primary

driver for providing high quality audits by more reputable audit firms.

On the other hand, the regulatory environment of the AIM market on the London Stock Exchange is very flexible and mainly designed and structured to fit the needs of small, growing IPO firms that are required to appoint and retain a Nominated Adviser (Nomad), who are private companies that play the role of adviser and regulator for firms on the AIM market. For example, Gerakos et al. (2011) find firms listed on the AIM market have higher levels of information asymmetry, higher failure rates, higher post-listing return underperformance, and lower levels of liquidity. All this in turn would lead to a higher level of information asymmetry between IPOs' managers and outside potential investors and, therefore, a higher level of IPO underpricing. Thus, it is expected that IPO firms who hire high quality auditors during the IPO will experience a lower level of IPO underpricing. This is due to the effective monitoring role of high quality audit firms which helps to reduce the information asymmetry.

Despite the extensive research that has studied the impact of audit quality on IPO underpricing, no research to date has investigated this relationship based on IPOs from the Alternative Investment Market in the UK. Thus, this paper will attempt to fill this gap in the literature by providing new evidence that may open new avenue for future research that focuses on the AIM market in the UK.

By examining these relationships based on a sample of 413 IPO firms that went public on the Alternative Investment Market [AIM] of the London Stock Exchange over the period 1998-2008, the current study provides the first evidence based on AIM IPOs that high quality audit firms are associated with a lower level of IPO underpricing. The AIM market is found to be associated with a higher level of information asymmetry due to the lighter

regulatory environment (e.g., Gerakos et al. 2013). Thus, the presence of high quality auditors is found to reduce the level of information asymmetry and, therefore, the level of IPO underpricing. In addition, the study shows evidence that the IPO underpricing is negatively associated with size and liquidity ratio, and positively with high litigation industries. This evidence suggests that large IPO firms with high level of liquidity experience a lower level of IPO underpricing, while IPO firms that operate in high litigation industry experience a higher level of IPO underpricing.

The paper is structured as follows. Section 2 reviews prior literature and discusses the hypotheses. Section 3 presents sample selection and research methodology. Section 4 discusses descriptive statistics and OLS regressions results. Section 5 presents conclusion.

2. THEORETICAL FRAMEWORK, LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Audit quality and IPO underpricing

The IPO event is found to experience a high level of information asymmetry since this event is the first stage in the firm life cycle as a public firms and, therefore, pre the IPO event there was no information available to the public about the firm and its operations (e.g., Ritter and Welch, 2002; Bruton et al., 2009). Thus, IPO firms tend to appoint high quality auditors during the IPO to send a certification signal about the quality of the IPO firms to outside investors (Titman and Trueman, 1986). Such a positive signal would contribute to the success of the IPO event by marketing and selling the offer.

In line with the above view, prior research has found evidence that hiring high quality auditors leads to reduce the level of information asymmetry and, therefore, the level of IPO underpricing. For example, Chang et al (2008) examine the impact of audit quality on IPO underpricing using an Australian sample of 692 IPOs over the period 1996-2003. They find IPO firms that audited by high quality auditors (Big Four) experience a lower level of IPO underpricing, suggesting that hiring high quality auditors send a positive signal to the investors. Chang et al (2008) also find that high quality auditors (Big Four) earn higher audit fees as compared to low quality audit firms.

Focusing on accounting conservative, Boulton et al. (2015) has examined whether accounting conservative is associated with IPO underpricing based on a sample of 10,103 IPOs from 36 countries over the period 1998-2008. They find that IPO firms experience a lower level of IPO underpricing in countries where the incremental speed of bad news recognition is greater than incremental speed of good news recognition (the principle of conservatism). Boulton et al. (2015) indicate that accounting conservatism help to mitigate managerial opportunism and accounting measures bias and this, in turn, leads to reduce information asymmetry. They find that the documented associations between accounting conservative and IPO underpricing is stronger for countries where the rule of law is promoted. This evidence is in line with information asymmetry hypothesis and its impact on IPO underpricing.

Meanwhile Akyol et al. (2014) has investigated the relationship between corporate governance and IPO underpricing in the European markets. Specially, Akyol et al. (2014) has examined whether the adoption of corporate governance codes in Europe is associated with IPO underpricing. By examine a sample of 3677 European IPOs over the period 1998-2012, they find evidence that IPO underpricing is declined after the adoption of corporate governance codes. Their results suggest that the enhancing on the corporate governance codes in the European countries has led to increase transparency and decrease the level of information asymmetry. Akyol et al. (2014) created a control IPOs sample that went public through an exchange-regulated markets and are exempted from applying the Member State corporate governance codes.

In contrast with prior research, Albring et al (2007) focus on non-Big 5 audit firms and investigate the relationship between IPO underpricing, audit quality, and auditor compensation using a US sample that consists of 166 IPOs during the period from 1990 to 1998. They use factor analysis and construct a continuous variable to measure auditor reputation for those non-Big 5 audit firms. Albring et al (2007) find evidence that the proxy of audit quality is positively associated with auditors' compensation and negatively associated with IPO underpricing. Their evidence shows that the quality of audit firms (even for non-Big audit firms) is very important factor in the IPO process to send a positive signal about the offer to outsiders (e.g., investors). By examining UK data, Coakley et al (2009) examine the nature and causes of IPO underpricing based on a UK sample of 591 IPOs that went public on the London Stock Exchange over the period 1985-2003. They find the bubble period (1998-2000) has different characteristics as compared to the rest of the sample. Coakley et al (2009) show evidence that venture capitalists and prestigious underwriters play a significant certification role, but not for the bubble period. Further, they find evidence that the combination of venture capitalists and prestigious underwriters are associated with a higher level of IPO underpricing during the bubble period (1998-2000), and this evidence in turn, is inconsistent with prior literature concerning the spinning hypothesis.

In line with above discussion, it is expected that the presence of high quality audit firms will be associated with a lower level of IPO underpricing. However, whether this argument can be extended to the UK market, namely the Alternative Investment Market, this is something has not been examined before. This paper aims to answer this question. Thus, the one main hypothesis for this paper is as follows:

H1: IPO firms on the Alternative Investment Market that appoint high quality audit firms are expected to experience a lower level of IPO underpricing.

3. DATA AND RESEARCH METHODS

3.1. Sample construction

The sample of this study consists of 413 IPO firms on the Alternative Investment Market (AIM) of the London Stock Exchange covering the period from

1998 to 2008. Consistent with prior research (e.g., Chen et al. 2005; Morsfield and Tan, 2006) financial and insurance IPO firms are excluded from the sample due to the differences in their financial reporting process. Several databases have been used to collect the required data to conduct the analysis e.g., closing and opening prices for the offer from the London Stock Exchange website, financial data from Thomson One Banker database, while data concerning audit quality are collected from Fame database and the IPOs' prospectuses.

3.2. Variable measurement

3.2.1. Measuring audit quality and IPO underpricing

In this study, audit firm is considered as high quality auditor if it is one of the big 4 audit firm (PWC, Deloitte, EY and KPMG) over the study period. For example, if a company went public in 2005 on the Alternative Investment Market and its auditor at the time of the IPO (2005) was one of the big 4 audit firms, then the IPO firms are considered to be audited by high quality auditors. I therefore follow prior research and construct a dummy variable that equals to 1 if the IPO audited by Big N audit firms, and zero otherwise. While the IPO underpricing is calculated as the difference between the offer price and the closing price for the IPO stock in the first day of trading. Underpricing = [(first-day market closing price divided by the offer price) - 1].

3.2.2. Ordinary Least Square (OLS) - audit quality and IPO underpricing

To examine whether audit quality is associated with IPO underpricing, I follow Chang et al. (2008) and estimate the following OLS regression for the whole IPOs sample:

$$\begin{aligned} \text{UnderPrice}_{it} = & \alpha_0 + \beta_1 \text{Big4} + \beta_2 \text{Ln}(\text{age}) + \\ & \beta_3 \text{Ln}(1+\text{assets}) + \beta_4 \text{Ln}(\text{Proceeds}) + \beta_5 1/\text{Price} + \\ & \beta_6 \text{Current} + \beta_7 \text{Litigation} + \beta_8 \text{ROA} + \beta_9 \text{Loss} + \\ & \beta_{10} \text{RetOwn} + \beta_{11} \text{Prestige} + \beta_{12} \text{VC} + \text{IND} + \text{Year} + \varepsilon_{it} \end{aligned} \quad (1)$$

Where (UnderPrice_{it}) is IPO underpricing calculated as the first-day market closing price divided by the offer price minus 1, while (Big4) is a dummy variable that equals to 1 if the IPO audited by Big N audit firms, and zero otherwise. A positive (negative) coefficient of [Big4] implies that the quality of audit firms is negatively (positively) associated with IPO underpricing.

I also follow prior research (Beatty, 1989; Willenborg and McKeown, 2001; Albring et al. 2007; Chang et al. 2008; Coakley et al. 2009; Akyol et al. 2014; Alhadab, 2015; Alhadab et al. 2015; Boulton et al. 2015) and add several control variables into the model that are found to significant determinants of IPO underpricing. These control variables are as follows: IPO firm age [$\text{Ln}(1+\text{age})$] which is calculated as the natural logarithm of 1+IPO firm age, firm age as the difference between the founding date and the date of the IPO; company size [$\text{Ln}(\text{assets})$] calculated as the natural logarithm of total assets during the IPO; issue size [$\text{Ln}(\text{Proceeds})$] calculated as the natural logarithm of IPO proceeds; ($1/\text{Price}$) is the reciprocal of IPO offer price, which added to control

for the differences in stock prices; (Current) is the current ratio that is calculated as current assets divided by current liabilities, this is to control for the liquidity; (Litigation) is a dummy variable that equals 1 if the IPO firm operate in a high litigation industry and zero otherwise, added into the model to control for the risk profile; (ROA) is return on assets and (Loss) are added to control for the profitability, (Loss) is a dummy variable that equals 1 if the firms reported loss during the IPO year, and zero otherwise; (RetOwn) is the percentage of retained ownership by insiders; (Prestige) is a dummy variable equalling 1 if the IPO firms have high profile underwriters and zero otherwise; while (VC) is a dummy variable that equals 1 if the IPO firms backed by venture capitalists and zero otherwise.⁴ Finally, I control for industry (IND) and year (Year) effects.

4. RESULTS

4.1. Descriptive statistics

Table 1 provides descriptive statistics of main variables for 413 IPOs over the period 1998-2008. Table 1 shows that the average IPOs underpricing is 16.4%, the median is 0.07% million, the standard deviation is 0.504, while the minimum is -35%, and the maximum 500.8%. This large difference between the minimum and maximum values suggests that the data has some outliers and, therefore, this issue should be addressed in the analysis. Further, Table 1 shows that for the IPOs sample that approximately 58% operate in high litigation industries, 53% reported losses during the IPO year, 66% of the total shares are owned by insiders, 38% audited by high quality auditors (Bin N), 14% have prestigious underwriters, and 18% backed by venture capitalists.

Table 2 provides descriptive statistics for the IPOs sample that audited by high quality auditors (Big N). Table 2 approximately shows that 11% is average IPOs underpricing, 60% operate in high litigation industries, 53% reported losses during the IPO year, 61% of the total shares are owned by insiders, 25% have prestigious underwriters, and 22% backed by venture capitalists. While Table 3 provides descriptive statistics for IPOs sample that audited by low quality auditors (non-Big N) and shows for the total IPO sample that 19% is average IPOs underpricing, 57% operate in high litigation industries, 54% reported losses during the IPO year, 69% of the total shares are owned by insiders, 9% have prestigious underwriters, and 16% backed by venture capitalists.

Overall, Tables 2 and 3 provide preliminary evidence that IPOs audited by high quality auditors (Big N) share different characteristics as compared to IPOs audited by low quality auditors. For example, IPOs audited by high quality auditors have a lower level of IPOs underpricing and are associated with more prestigious underwriters and venture capitalists. These financial intermediaries are found to play a significant role to reduce information asymmetry and, therefore, the IPO underpricing (e.g., Lee and Masulis, 2010). Table 1 provides descriptive

⁴ My definition of prestigious underwriters as similar to Derrien and Keckes (2007), while venture capitalist are those investors who hold more than 3% of a firm's shares and included in the list of the British Venture Capitalist Association.

statistics for the IPOs sample. All variables are previously defined. Table 2 provides descriptive statistics for the IPOs audited by Big N (high quality audit firms). All variables are previously defined.

Table 1. Descriptive statistics for the whole IPOs sample over the period 1998-2008

	<i>N</i>	<i>Mean</i>	<i>Median</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
UnderPrice	411	0.164	.0705	0.504	-0.350	5.800
Big N	413	0.337	0	0.473	0	1
Ln(1+age)	413	1.005	0.583	0.895	0.059	3.285
Ln(assets)	413	1.012	1.046	1.662	-2.617	5.535
Ln(Proceeds)	413	1.522	1.609	1.283	-1.967	5.964
1/Price	413	5.169	1.429	11.947	0.274	100
Current	412	5.209	1.913	16.961	0.045	301.728
Litigation	413	0.579	1	0.494	0	1
ROA	413	-1.273	-0.024	4.782	-59.396	2.184
Loss	413	0.533	1	0.499	0	1
RetOwn	413	0.663	0.702	0.227	-1.151	0.993
Prestige	413	0.143	0	0.350	0	1
VC	413	0.182	0	0.386	0	1

Table 2. Descriptive statistics for IPOs sample that audited by Big N over the period 1998-2008

	<i>N</i>	<i>Mean</i>	<i>Median</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
UnderPrice	139	0.106	.054	0.224	-0.350	1.763
Ln(1+age)	139	1.036	0.625	0.970	0.059	3.285
Ln(assets)	139	1.608	1.736	1.580	-1.609	5.534
Ln(Proceeds)	139	2.129	2.079	1.214	-1.432	5.964
1/Price	139	1.718	1	1.738	0.274	10.000
Current	138	6.627	1.784	26.471	0.195	301.728
Litigation	139	0.604	1	0.491	0.000	1.000
ROA	139	-1.161	-0.023	3.361	-25.193	0.798
Loss	139	0.525	1	0.501	0.000	1.000
RetOwn	139	0.610	0.686	0.280	-1.151	0.993
Prestige	139	0.245	0	0.431	0.000	1.000
VC	139	0.223	0	0.418	0.000	1.000

Table 3. Descriptive statistics for IPOs sample that audited by non-Big N over the period 1998-2008

	<i>N</i>	<i>Mean</i>	<i>Median</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
UnderPrice	272	0.193	0.077	0.597	-0.253	5.800
Ln(1+age)	274	0.989	0.580	0.857	0.059	3.285
Ln(assets)	274	0.710	0.703	1.624	-2.617	4.831
Ln(Proceeds)	274	1.214	1.216	1.208	-1.966	4.001
1/Price	274	6.919	1.694	14.309	0.323	100.000
Current	274	4.495	1.956	8.943	0.045	93.338
Litigation	274	0.566	1.000	0.497	0.000	1.000
ROA	274	-1.330	-0.025	5.366	-59.396	2.184
Loss	274	0.536	1.000	0.500	0.000	1.000
RetOwn	274	0.690	.7137038	0.190	0.000	0.986
Prestige	274	0.091	0.000	0.288	0.000	1.000
VC	274	0.161	0.000	0.368	0.000	1.000

Table 3 provides descriptive statistics for the IPOs audited by non-Big N (low quality audit firms). All variables are previously defined.

Table 4 presents the correlation matrix for all the variables that are included in the regression models. Table 4 reveals that IPO underpricing (*UnderPrice*) is negatively associated with the size [*Ln(assets)*]. This suggests that large IPO firms experience a lower level of IPOs underpricing, due to the fact that large IPO firms can afford to appoint more reputable financial institutions such as high

quality auditors, prestigious underwriters, and venture capitalists who help to reduce information asymmetry between insiders and investors.

In line with this view, Table 4 provides preliminary evidence that high quality auditors (Big N) is positively associated with prestigious underwriters and size, and that the presence of prestigious underwriters is positively associated with the presence of venture capitalists. Table 4 presents Pearson correlation matrix for all the variables. All variables are previously defined.

Table 4. Correlations matrix for all variables

	UnderPrice	Big N	Ln(1+age)	Ln(assets)	Ln(Proceeds)	1/Price	Current	Litigation	ROA	Loss	RetOwn	Prestige	VC
UnderPrice	1												
Big N	-0.084	1											
Ln(1+age)	0.006	0.025	1										
Ln(assets)	-0.159**	0.257***	0.183***	1									
Ln(Proceeds)	-0.081	0.350***	0.033	0.482***	1								
1/Price	0.056	-0.209***	-0.050	-0.239***	-0.332***	1							
Current	-0.036	0.058	-0.075	-0.136**	0.179***	-0.046	1						
Litigation	-0.003	0.044	0.028	-0.129**	-0.042	-0.060	-0.018	1					
ROA	-0.057	0.016	0.135**	0.374***	-0.005	-0.003	-0.048	-0.061	1				
Loss	0.060	-0.010	-0.186***	-0.383***	-0.124*	0.191***	0.064	-0.031	-0.289***	1			
RetOwn	0.021	-0.175***	0.024	-0.251***	-0.544***	0.034	-0.136**	0.128**	-0.031	0.083	1		
Prestige	-0.008	0.208***	-0.020	0.024	0.259***	-0.134**	0.077	0.026	-0.001	0.018	-0.100*	1	
VC	-0.063	0.081	-0.057	0.064	0.044	-0.073	0.105*	0.028	0.086	0.054	-0.112*	0.133**	1

Note: *, **, *** Denote 0.1, 0.05, and 0.01 significance levels, respectively

4.2. Ordinary Least Square (OLS) results –audit quality and IPO underpricing

Table 5 reports the results for the analysis whether audit quality impacts the IPOs underpricing in the Alternative Investment Market (AIM) in the UK. I find positive and statistically significant coefficients on Big N in Models 1 and 2, suggesting that high quality auditors are associated with a lower level of IPOs underpricing. Specifically, the results show negative coefficients of -0.044 (p<0.05) and -0.043 (p<0.05) on Big N in the models 1 and 2, respectively. This negative relationship between audit quality and IPO

underpricing is disappeared when more determinants (control variables) are added into the model. However, it is worth noting that the sign of the coefficient on Big N is negative in all models even if the coefficients are not statistically significant. For example, Table 5 shows negative coefficients on Big N of -0.023 (Model 3), -0.019 (Model 4), -0.021 (Model 5), and -0.008 (Model 6). These results confirm that investors consider appointing high quality auditors as a positive signal about the offering and, this in turn, is reflected by the lower level of IPO underpricing.

Table 5. The relationship between audit quality and IPO underpricing in the AIM market over the period 1998-2008

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	UnderPrice	UnderPrice	UnderPrice	UnderPrice	UnderPrice	UnderPrice
Constant	0.129*** (8.445)	0.140*** (8.029)	0.148*** (7.957)	0.155*** (7.586)	0.219*** (3.123)	0.062 (0.674)
Big N	-0.044** (-2.085)	-0.043** (-2.052)	-0.023 (-1.206)	-0.019 (-0.914)	-0.021 (-0.940)	-0.008 (-0.344)
Ln(1+age)		-0.011 (-0.825)	-0.003 (-0.254)	-0.004 (-0.280)	-0.003 (-0.224)	-0.006 (-0.429)
Ln(assets)			-0.022*** (-2.850)	-0.020** (-2.137)	-0.022** (-1.983)	-0.018* (-1.655)
Ln(Proceeds)				-0.007 (-0.716)	-0.008 (-0.567)	-0.014 (-0.951)
1/Price					0.000 (0.283)	0.001 (0.995)
Current					-0.001* (-1.883)	-0.001* (-1.839)
Litigation					-0.008 (-0.338)	0.156** (2.068)
ROA					-0.001 (-0.320)	-0.001 (-0.280)
Loss					-0.003 (-0.155)	-0.008 (-0.312)
RetOwn					-0.072 (-1.058)	-0.081 (-1.345)
Prestige					0.020 (0.590)	0.001 (0.022)
VC					-0.028 (-1.358)	-0.026 (-1.086)
Industry dummies						Yes
Year dummies						Yes
N	411	411	411	411	410	410
Adj. R-squared	0.006	0.005	0.027	0.025	0.021	0.047

Note: *, **, *** Denote significance at the 10 percent, 5 percent, and 1 percent levels, respectively. Robust t-statistics appear in parentheses

Table 5 also reports the results for the other determinants of IPOs underpricing and shows evidence the size and liquidity ratio are negatively associated with IPO underpricing. Table 5 (Model 6) report negative coefficients of -0.018 ($p < 0.10$) on size [$\ln(\text{assets})$] and -0.001 ($p < 0.10$) on liquidity ratio (*Current*). Further, an analysis of Tables 5 (Model 6) reveals that IPO underpricing is positively associated with risky industries where the coefficient of *Litigation* is found to be negative and statistically significant [-0.156 ($p < 0.05$)]. This result indicates that IPO firms which operate in a high litigation industry experience a higher level of IPO underpricing. It seems that IPO issuers attempt to compensate investors for risk taking by leaving some money on the tables (the concept of IPO underpricing).

Overall, the results reported in Table 5 confirm the main hypothesis of this study that high quality auditors (big N) reduce the level of IPO underpricing in the Alternative Investment Market (AIM) of the London Stock Exchange in the UK. High quality auditors help to reduce the level of information asymmetry about the IPO offerings and, this in turn, lead to reduce the level of IPO underpricing. Table 5 reports the results of regressions of audit quality and IPO underpricing for IPO firms that went public on the AIM market over the period 1998-2008.

5. CONCLUSIONS

This paper examines whether audit quality impacts IPO underpricing in the Alternative Investment Market (AIM) of the London Stock Exchange. Despite the fact that prior research has examined the association between audit quality and IPO underpricing (e.g., Albring et al. 2007; Akyol et al. 2014; Boulton et al. 2015), the current study is the first to examine this association based on IPOs that went public on the AIM market. The AIM market has attracted many national and international IPOs over the last three decades, notably this market was mainly designed to fit the needs of small and young IPO firms.

The findings of this study show evidence that IPO firms audited by high quality audit firms experience a lower level of IPO underpricing, suggesting that high quality auditors play a determinant role to reduce the level of information asymmetry about the offering. This evidence is in line with prior research that finds hiring high quality auditors send a positive signal about the offer to outside investors (e.g., Titman and Trueman, 1986.) and that audit quality is associated with IPO underpricing (e.g., Chang et al. 2008). In addition, this study investigates other determinants of IPO underpricing and finds evidence that size, liquidity ratio, and high litigation industries are associated with IPO underpricing. Specifically, large firms that have a high level of liquidity are found to experience a lower level of IPO underpricing, while IPO firms that operate in high litigation industries experience a higher level of IPO underpricing.

The findings of this study provide important implications for policy makers, AIM regulators, investment banks, audit firms, and other interested parties. For example, regulators should reform the IPO market by taking further steps that help to reduce the level of information asymmetry which is

found to lead to many associated problems e.g., agency conflict, earnings management, IPO underpricing, etc.

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