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INITIAL PUBLIC OFFERINGS (IPOs)

An article entitled "The Market's Problems with the Pricing of Initial Public Offerings," authored by Roger G. Ibbotson, et al and published in the Spring 1994 issue of the *Journal of Applied Corporate Finance*, confirms and quantifies what has been known about IPOs for decades by those familiar with that market. In short, collectively, over time, IPOs are not a very good way to invest.

One finding of the authors' research was that the total return on IPOs over the first three years after coming to market was only about half (55%) that of the returns of similar firms listed on the New York Stock Exchange over the same period of time. Furthermore, the tendency to underperform lasted for a full five years, and was much more pronounced for younger and smaller companies than for older and larger ones.

A second problem is one of "adverse selection" known as "the winner's curse." Because of their great demand, investors can receive only a fraction of their requests for the more desirable IPOs and these are the IPOs that are more apt to perform better than the average IPO in the marketplace. However, investors will be allocated all that they request of the less desirable IPOs. Unfortunately, these new issues are just the ones that are apt to underperform even the average IPO after coming to market.

Given that IPOs are collectively underperformers to begin with, and that, because of the nature of supply and demand for IPOs, participants in that market are further burdened with larger allocations of bad IPOs than they are blessed with good ones, the odds of success for the investor in this sector are relatively low.

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