The Impact on IPO Performance of More Stringent Listing Rules with a Pre-listing Earnings Requirement: Evidence from Hong Kong

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Summary
This study considers the impact of a change to listing rules covering IPO performance in the Hong Kong stock market. The change, introduced in 1994, imposed a three-year pre-listing earning requirement on new issues. The objective of this research is to screen out a subset of poor IPO performers. We find there is no significant difference in performance between IPOs before and after the regulatory change. We further divide our sample of IPOs registered before the regulatory change into two sub-samples: those that did and those that did not fulfil the earnings requirement. The result shows that there is no significant difference in performance between the two IPO sub-samples. This implies that the existence of pre-listing earnings does not guarantee good long-term IPO performance and the pre-listing earnings of new issues is not an effective screen for ‘bad’ IPO performers. This study further analyzes the rationale for rule change in the context of recent developments in the Hong Kong stock market and concludes that the rule change is part of the reform programme aimed at introducing a second board market for small companies and at attracting more China-related listings to the main board.