

ESG Ratings and Underpricing on Emerging Markets Case of European IPOs between 2014 and 2023

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Abstract

Given the increasing salience of Environmental, Social, and Governance (ESG) criteria in investment decisions, this study investigates the extent to which pre-Initial Public Offering (IPO) ESG ratings function as a mechanism to reduce information asymmetry and, consequently, influence the phenomenon of IPO underpricing. The analysis is focused on a sample of IPOs within developed and emerging European markets. An Ordinary Least Squares (OLS) regression analysis is employed to empirically examine the relationship between the RepRisk rating (as a proxy for corporate sustainability performance) and the Initial Return (IR) as the measure for underpricing. The sample comprises 1,927 European IPOs executed between 2014 and 2023. Model robustness is ensured through the inclusion of control variables covering firm, offer, and market characteristics. The results demonstrate a conditional influence of the ESG rating on underpricing. For the overall sample, no significant effect of the RepRisk rating on underpricing was identified. However, a sub-analysis of rated companies during the period prior to the COVID-19 pandemic (2014-2019) revealed a negatively significant correlation between the ESG rating and underpricing. This finding supports the hypothesis that higher ESG transparency mitigates information asymmetry. Conversely, for IPOs originating from European emerging markets, no significant influence of the ESG rating could be established. The findings suggest that the role of ESG ratings in alleviating IPO underpricing is highly dependent on the observation period and the specific submarket. The assumption that ESG activities universally contribute to greater market certainty during times of crisis could not be confirmed. Future research should address the heterogeneity of European regulatory frameworks and incorporate ratings from multiple agencies to enhance the generalizability of these conclusions.

Keywords

Emerging Markets, ESG, European Markets, IPO, Underpricing.