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Offering Organizational Legitimacy: Foreign Underwriters and Outside Directors in Philippine IPOs

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This study explores the organizational legitimacy offered by underwriters and outside directors on firms going public. Informed by legitimacy theory, certification hypothesis, and resource dependence theory, this study investigates the association of underwriters and outside directors on the level of underpricing. Using a sample of 77 Philippine firms undertaking an initial public offering (IPO) for the 20-year period from 2001 to 2020 and cross-sectional multiple regression, results indicate that the presence of a foreign underwriter and a greater proportion of outside directors on the board reduces the level of underpricing. Their legitimizing presence allows listing firms to potentially maximize their IPO proceeds.

Keywords: Organizational legitimacy, certification hypothesis, resource dependence theory, IPO, underpricing, Philippines

1 Introduction

An initial public offering (IPO) is an important juncture in a firm's existence, representing its transition from being a privately owned to a publicly owned firm. Yet majority of issuers experience underpricing, unable to maximize the proceeds they raised from their listings (Carter & Manaster, 1990; Pollock, 2004). Underpricing, also called initial day returns or first day IPO performance, is the percentage difference between the firm's first trading day closing price and its offer price (e.g., Ibbotson & Ritter, 1995; Loughran & Ritter, 2004). It represents forgone IPO proceeds to the listing firm (Carter & Manaster, 1990; Pollock, 2004) for primary shares and to the selling firm owners for secondary shares.

Underpricing in the United States of America (US) for the 20-year period from 2001 to 2020 and covering 2,258 IPOs averaged 16.7% (Ritter, 2020). Underpricing internationally for various periods from 1971 to 2018 and covering 54 countries ranged from 5.7% (Argentina) to 270.1% (United Arab Emirates) (Loughran et al., 2021). In the Philippines, underpricing was 42.1% for the period from 1989 to 1993 and 32 IPOs (Ybañez, 1993), 22.7% for the period from 1987 to 1997 and 104 IPOs (Sullivan & Unite, 2001), 12.3% for the period from 1998 to 2008 and 22 IPOs (Autore et al., 2014), and 8.4% for the 20-year period from 2001 to 2020 and covering 77 IPOs as this study shows.

Underpricing may be costly to a firm's owners. It is perceived as leaving money on the table, an indirect cost, and a wealth loss for most owners. Also, underpricing persists over time and across markets, and it is often characterized as anomalous, appearing to contradict the efficient markets hypothesis (Agathee et al., 2012; Ljungqvist, 2007).

However, balancing out this view are reasons why underpricing may be acceptable to firm owners and management. One, an IPO creates a market for an otherwise illiquid market for private owners of firm equity, according to Dolvin (2012). He criticizes that underpricing is treated without regard to the share issuance decision and assumes all preexisting firm shares are sold in the IPO—an extremely uncommon event. Hence, he says the indirect costs of an IPO is overstated and the wealth impact on owners is not as extreme. Two, an underpriced IPO can serve as a protective mechanism for management against dilution of their existing shares, according to Taranto (2002). He says managers are willing to underprice IPOs as "they use options and stock grants to protect themselves from the dilution to their existing shares;" plus, "underpricing can have a large positive tax effect for options they hold in addition to making new options more valuable" (Abstract). However, this explanation is improbable in markets with little to no use of options and stock grants, like emerging markets. Third, underpricing may partly be motivated by entrepreneurs' desire for post-IPO control, according to Autore et al. (2014). They say that entrepreneurs are incentivized to use higher levels of underpricing

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to bring in other shareholders and have a more dispersed ownership structure post-IPO. A dispersed ownership base then limits or removes any "risk of entrepreneurs losing control of their enterprises after going public" (Autore et al, 2014, p. 67) especially in an environment absent effective external governance mechanisms often seen in emerging markets. Fourth, high-quality firms underprice at the IPO to obtain a higher price at secondary equity offering, according to Welch (1989). He believes that "low-quality firms must invest in imitation expenses to appear to be high-quality firms" (Abstract), and this imitation is likely discovered between equity offerings.

Irrespective of the view taken on underpricing, there is a large body of evidence indicating that information frictions have a first order effect on underpricing (Ljungqvist, 2007).[1] How then can listing firms reduce these information frictions?

Legitimacy theory posits secondary indicators of quality can be used to compensate for the difficulty of observing the true indicators (Sanders & Boivie, 2004), consequently reducing information frictions. For a listing firm, legitimacy is the perception that its actions are in line with shareholder wealth generation, and its economic potential is accurately reflected in the information it provides potential investors (Cohen & Dean, 2005). Through secondary and potentially symbolic sources of information (Sanders & Boivie, 2004), like the cooptation of external parties, the listing firm can gain and increase perceptions of legitimacy and firm quality. The cooptation of and association with external parties may result in a network of relationships for the listing firm that not only offers it direct access to resources but also provides legitimacy (Certo et al., 2009) through its symbolic endorsements. On the other hand, by choosing to engage with the listing firm, these external parties chose to invest their time and lend their credentials, expertise, and connections to the firm—effectively offering it a level of legitimacy (Chen et al., 2008; Higgins & Gulati, 2003).

Hence, this study argues that firms going public attempt to improve their organizational legitimacy[2] through their chosen affiliations with underwriters and outside directors and in successfully doing so maximize their IPO proceeds and lower any level of underpricing. It explores the underwriters, as well as outside directors and their association with the level of underpricing in the Philippines for the 20-year period from 2001 to 2020. The Philippines, an emerging market, does not have the benefits of a strong and effective legal and governance system, as well as relatively high levels of transparency that developed markets have. The use of legitimacy as the lens for exploring this negative association is supported by the certification hypothesis and resource dependence theory. Results indicate that the presence of a foreign underwriter and a greater proportion of outside directors on the board are significantly negative—reducing the level of underpricing.

This study reconfirms the phenomenon of underpricing but in the lesser studied emerging market institutional context; it adds to the small but growing body of empirical research outside the more studied developed markets, particularly the US. This study also explores the phenomenon of underpricing using the management perspective of legitimacy, a departure from the more often used perspectives of agency and corporate governance (see Appendices A and B). It informs issuers that the likely higher cost of more prestigious underwriters and a greater proportion of outside directors on the board may pay off in terms of their greater legitimizing effect, as measured by lower levels of underpricing. It cautions potential investors, particularly retail investors, to observe particularly the listing firm's choice of underwriters and the proportion of outside directors on the board to guide their investing decisions. Lastly, it highlights to regulators the potential value of greater disclosure of underwriters' activities and performance, as well as details on the outside director so the investing public can judge underwriter prestige and outside director quality, respectively.

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[1] See Ljungqvist (2007) for a review of the theories and empirical evidence explaining the possible reasons for underpricing.

[2] The terms legitimacy and organizational legitimacy are used interchangeably in this study.

2 Literature Review

2.1 Legitimacy

Legitimacy is "the generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). At the level of the organization, organizational legitimacy is the acceptance of an organization by its environment (Dowling & Pfeffer, 1975), "the perceived appropriateness of an organization to a social system" (Deephouse et al., 2016, p. 7).

Organizational legitimacy matters because it "gives an organization the license to operate in a society" (Chung et al., 2016, p. 405) as most stakeholders are likely engaged in social and economic exchanges only with legitimate organizations (Deephouse et al., 2016). Creating a perception of attractiveness, credibility, or legitimacy is important to firms because legitimate organizations are seen as more meaningful, predictable, and trustworthy (Suchman, 1995). Organization must often "create an impression of viability and legitimacy before it will receive support" (Starr & MacMillan, 1990, p. 83).

Suchman (1995, p. 576)[3] approaches organizational legitimacy institutionally, "as a set of constitutive beliefs" or, strategically, as an operational resource. Strategic legitimacy, he elaborates, views legitimacy as a resource that can be extracted from the environment, managed, and even manipulated to achieve organizational goals (Dowling & Pfeffer, 1975). This suggests a "level of managerial control over the legitimation process" (Suchman, 1995, p. 576). He further shows how an organization can actively gain, maintain, and even repair legitimacy, if needed. To gain legitimacy, an organization generally needs to conform to, select, and possibly manipulate its environment (Dowling & Pfeffer, 1975; Suchman, 1995). Empirically, hypotheses have been developed and tested to predict how (strategic) legitimacy affects a variety of performance measures, including IPO values (Cohen & Dean, 2005; Deephouse et al., 2016; Deephouse & Suchman, 2008).

Suchman (1995) further identifies three types and effectively provides the bases for evaluating legitimacy. Legitimacy can be judged on whether the organization engages in activities that: (1) are "the right thing to do," socially correct, and desirable (moral or normative legitimacy); (2) "make sense," are "necessary or inevitable based on some taken-for-granted cultural account" (cognitive legitimacy); and (3) benefit the evaluator (pragmatic legitimacy) (Deephouse et al., 2016; Deephouse & Suchman, 2008; Suchman, 1995. p. 582). Under pragmatic legitimacy, Suchman (1995) further elaborates that audiences may support the organization because they believe it provides them specific favorable exchanges (exchange legitimacy), responds to their larger interests (influence exchange), and/or personifies idealized characteristics they value, e.g., honesty and trustworthy (dispositional legitimacy).

Lastly, Deephouse et al. (2016) and Deephouse and Suchman (2008) identify that legitimacy can emanate both from internal or external audiences, and it is ultimately based on who has the collective authority over legitimation in a particular setting. Media, society-at-large, and interorganizational relations (connected to legitimate others) are the frequently mentioned sources of legitimacy according to them.

2.2 Initial Public Offering

An IPO is a process by which a privately owned firm for the first time raises capital in the equity market (Carter & Manaster, 1990) and subsequently becomes a publicly traded firm. The process is long and complex (Daily et al., 2003) and fraught with risk and uncertainty (Deeds et al., 2004). During and after the IPO process, the firm must address a broader set of external stakeholders, including institutional investors and analysts who need to be convinced of the legitimacy and potential of the firm (Deeds et al., 2004).

Going public offers several benefits, as well as costs, to the firm as summarized by Certo et al. (2009) and Ibbotson and Ritter (1995). According to them, it offers the firm: (1) access to financial resources to fund its growth and/or to settle its obligations; and (2) post-IPO, greater visibility, perceived

[3] See Suchman's (1995) seminal article for further details on the theory.

legitimacy, and access to additional capital at more favorable terms (and possibly access to other resources as well). However, they also caution that going public: (1) has substantial initial, upfront costs, such as management time, dilution, legal, underwriting, and auditing fees; (2) "increases financial and operational scrutiny of the business" from an expanded investor base and the stock exchange (Certo, 2009, p. 1341); and (3) requires the firm to "demonstrate that they can cope effectively with the pressures of public trading" (Certo, 2009, p. 1341).

There are three agency issues in an IPO context that Ibbotson and Ritter (1995) and Certo et al. (2009) also point out, with the first issue clearly having an impact on the issue's valuation and any subsequent underpricing. One is information asymmetry resulting from current firm owners possessing superior information compared to potential investors. Information asymmetry increases uncertainty and complicates firm valuation, but it can be mitigated through increased communications (e.g., company prospectus, investor road shows, and media/press releases) (Certo et al., 2009). Two is adverse selection resulting from the firm (and its underwriters) "exercising discretion in determining the timing, pricing as well as the allocation of shares" (Certo et al., 2009, p. 1343). Three is moral hazard resulting from the managers' and/or owners' action which may be opportunistic in nature for personal gains.

Possibly the most important measure of an IPO's success is the amount of capital raised (Deeds et al., 2004). However, the information asymmetry and uncertainty surrounding an IPO give rise to underpricing. The greater the uncertainty (Pollock, 2004) and the higher the information asymmetry (Cohen & Dean, 2005), the greater the underpricing. Aside from increased communications, the association and cooptation by the listing firm of prestigious others, and their reciprocal endorsement, reveal information that may lessen uncertainty (Titman & Trueman, 1986), gain for and signal legitimacy of the firm, and hence reduce the level of underpricing.

2.3 Legitimacy for Listing Firms

Undertaking an IPO exposes the listing firm to intense public scrutiny and serves as a decisive test of its legitimacy. Potential investors want to determine the firm's quality at the time of the IPO given how research has shown the tendency of firms to underperform or fail in the years post-IPO, as emphasized by Certo (2003). Hence, he posits that by demonstrating organizational legitimacy, managers may raise more capital and have better stock performance. However, "the uncertainty and information asymmetry surrounding IPO firms makes it difficult for potential investors to discern organizational legitimacy and hence potential firm quality" (Lester et al., 2006, p. 4). Also, there is a challenge in building legitimacy, of "convincing preexisting entities to lend support when none previously existed" (Lester et al., 2006, p. 4).

Legitimacy affects market access (Deephouse & Suchman, 2008). Hence, in the pre-IPO phase, the firm must actively build legitimacy in preparation for going public. Legitimacy, under these circumstances, is viewed as strategic—an operational resource to create the impression of a credible organization to mold the external audiences' perception of the firm (Suchman, 1995; Tornikoski & Newbert, 2007). Legitimacy is specifically the perception that the listing firm's actions are in line with shareholder wealth generation, and its economic potential is accurately reflected in the information it provides potential investors (Cohen & Dean, 2005).

The listing firm aims to gain pragmatic legitimacy through conformity (Suchman, 1995). First, it meets the needs of the various audiences of the IPO, such as the potential investors and the stock exchange, and markets to them. It conforms to their demands by sharing the firm's established record of performance and by lauding the credentials of its management and board through a comprehensive prospectus, investors' road shows, and media/press releases (Certo et al., 2009). Second, it coopts external parties, through associations and certifications/endorsements, "character references" to effectively vouch for its untested reliability (Starr & MacMillan, 1990; Suchman, 1995). It conforms, to name a few, by inviting "valuable" outsiders to its board, aligning, or even partnering with certain suppliers or buyers, as well as affiliating with certain underwriters, law firms, and auditors. The latter affiliations are termed professional legitimacy—legitimacy that is conferred by virtue of their "collective authority" (Deephouse & Suchman, 2008; Suchman, 1995).

Empirical studies on pragmatic legitimacy gained through the cooptation of external parties have explored the relationship of IPO valuation and/or underpricing and the: (1) presence and/or prestige

of underwriters (see Appendix A), among others; and (2) presence, prestige, and/or the proportion of nonexecutive, outside directors on the board (see Appendix B). According to the certification hypothesis, a relationship with a prestigious underwriter (and other professional entities) may provide the firm the necessary endorsement critical for IPO success, as the reputational capital of the underwriter guarantees the IPO quality (Booth & Smith, 1986; Carter & Manaster, 1990). According to the resource dependence theory of Pfeffer and Salancik (1978), certain benefits accrue to firms through their outside board members—advice and expertise, access to resources, and legitimacy. Outside directors may provide the firm the resource of "legitimacy," together with other resources, through their work experiences, expertise, affiliations, and/or prestige that they harness for the firm (Hillman et al., 2000; Pfeffer & Salancik, 1978).

Potential investors may be more willing to invest in the firm, and on better terms, than if the firm lacked such indicators of worthiness (Chen et al., 2008). Potential investors may be further reassured because these associated parties: (1) "are expected to have superior abilities to make judgments about the firms with which they affiliate," especially given their limited time (Pollock et al., 2010, p. 9); (2) value their reputation and "status highly and will guard carefully against tarnishing it," or even facing legal issues by avoiding association with questionable firms (Ljungqvist, 2007; Michaely & Shaw, 1994; Pollock et al., 2010, p. 9); and (3) "may provide substantive resources that will enhance the firm's functioning" (Pollock et al., 2010, p. 7), such as abundant social and human capital, and maybe even financial capital.

3 Institutional Context: The Philippines

The Philippine Stock Exchange (PSE), established in 1927, is one of the oldest stock exchanges in Asia. Despite its age, the Philippine stock market has remained concentrated and small, with low liquidity over the years, as characterized by Ho and Odhiambo (2014).

As to concentration, they indicate that, like most East Asian countries, a few large firms account for a good portion of both the market's capitalization and trading volumes. The top 10 listed firms accounted for 38% of market capitalization and 46% of trading volume in 2013, which is already an improvement from 57% and 53%, respectively, in 1999. Additionally, ownership of publicly traded firms, like seen in many other markets except for the Anglo-Saxon markets, is concentrated (Lizares, 2022). It is not helped by the relatively low minimum public ownership (MPO) requirement of 20%; this is already a doubling from the prior 10% MPO requirement level, but it only applies to public firms that have listed after December 2017 (PSE, 2020).

As to size, the Philippine stock market is small in terms of market capitalization and number of listed firms when compared to its neighboring ASEAN countries (see Table 1). The slow increase in number of listed firms seen in Table 3, coupled with Table 4 which details the IPO for the 20-year period from 2001 to 2020, indicates the volatility of capital raising activities in the Philippines. The activity usually follows the prevailing market conditions, with IPOs insignificant during downturns.

Table 1. Size of ASEAN-5 Stock Markets

	Market capitalization (USD million)		Number of listed domestic companies	
	2010	2020	2010	2020
Indonesia	360,388	496,086	420	713
Malaysia	408,689	436,538	948	927
Philippines	157,321	272,790	251	268
Singapore	647,226	652,615	461	459
Thailand	277,732	543,165	541	743

Source: World Bank (n.d.)

As to liquidity, Ho and Odhiambo (2014) compare the Philippine stock market turnover ratio (total value of traded shares divided by market capitalization) and traded ratio (total value of traded shares divided by GDP) against the ASEAN-5. For the period from 1990 to 2014, the Philippines is the least liquid, ranking lowest on both ratios among the ASEAN-5. They attribute this low liquidity to high transaction costs, friction cost, and the limited size and diversity of the investor base. Despite the almost tripling of the investor base to 1.397 million investor accounts in 2020, up from 0.499 million

accounts in 2010 (PSE, 2011, 2021–b), this still represents a little over 1% of the Philippine population. Of the total investor accounts in 2020, 1.5% are owned by foreigners (versus similar levels in 2010), and 2.1% are owned by institutions (versus 4.5% in 2010). Despite the low number of foreign (often institutional) accounts, foreign trade amounts to approximately half of the total trade of the PSE for the 20-year period from 2001 to 2020. In fact, Antonio and Abola (2006) indicate the heavy reliance of the Philippine equity market on foreign capital as a challenge.

Aquino (2006, Abstract), meanwhile, identifies the Philippine stock market as weak-form efficient. Using an event study perspective, he examines major events that can affect share prices and can cause large price movements. His results show the "fairly rapid absorption by the market of information, except in cases of extreme stress caused by political and economic shocks." His study also shows that "factors other than information about fundamentals appear to have causes major share price movements."

3.1 Relevant Listing Requirements

The PSE's Consolidated Listing and Disclosure Rules (PSE, 2021–a) documents the listing requirements, rules, and processes. Discussed in this section are the rules relevant to this study's purpose—PSE Board, underwriters, and board of directors.

As to the PSE Board, the PSE had three listing boards prior to 2013, the First, Second, and SME Boards. However, in June 2013, it consolidated the First and Second Boards into the Main Board, and the SME Board was expanded to target not just small and medium but also emerging enterprises (PSE, 2014). For the Main Board, the changes were as follows: (1) minimum required authorized capital stock: the First and Second Boards required PHP400 million and PHP100 million, respectively, while the Main Board now required PHP500 million; and (2) minimum track record of profitable operations prior to listing: the First Board required at least three years which the Main Board maintained, while the Second Board required just one year (PSE, 2014). For the SME Board, the changes were as follows: (1) minimum required authorized capital stock increased from PHP20 million to PHP100 million; and (2) from just one-year operating history prior to their application for listing to at least three years of operating history, positive earnings for two of the last three years, positive stockholders' equity for the fiscal year prior to listing, and earnings before interest, taxes, depreciation, and amortization (EBITDA) of at least PHP15 million for the last three years (PSE, 2014). There are further amendments to the Main and SME Board listing rules that took effect after February 2021, outside of this study's sample period.

As to the underwriter, the PSE defines them as "a duly licensed and authorized investment house or universal bank which undertakes and guarantees the distribution of securities to the public" (PSE, 2021–a, p. II–9). The underwriter serves as an intermediary between the firm issuing shares and the investors buying shares. The underwriter helps the firm prepare for the IPO, draft a prospectus, and take the offering on a road show to create interest among potential institutional investors. It is precisely for the protection of the investing public that the Omnibus Rules and Regulations for Investment Houses and Universal Banks Registered as Underwriters of Securities (SEC, 2002) requires that the underwriter exercise due diligence investigation on the issuer and issue, as well as holds them liable for damages suffered by the investing public if the underwriter is proven to have not fulfilled this role thoroughly.

After the road show, the underwriter and the firm determine the final IPO price based on the orders received during the road show. Then, the underwriting syndicate allocates the shares to the investor based on the following rules: (1) up to 60% of the offered shares to institutional investors, both domestic and foreign; (2) at least 10% to local small investors; and (3) the remaining 30%, the underwriters can distribute to their clients/public, including institutional investors and high net worth individuals; or the stockbroker/dealers can subscribe for their dealer accounts, provided they sell the shares to their customers during the offer period (PSE, 2021–b). Foreign underwriters are required, and may even lead the underwriting syndicates, when a portion of the IPO shares is offered to foreign institutional investors. The final role of the underwriter is to provide pricing support on the first day of trading and for a period thereafter.

As to the board of directors, like the underwriters, they are responsible for the veracity of the information on all IPO firm's listing application and documents submitted to the PSE, especially the

IPO prospectus (PSE, 2021–b). Unlike the Code of Corporate Governance, revised over the years since its first introduction in 2002, the listing rules only comments on the board size (minimum of seven directors). It is silent on the number and or percentage of independent (and outside) directors on the board as well as the separation of the Chairman and Chief Executive Officer roles. Once publicly traded, however, the firm is subjected to the corporate governance code especially after 2017 when the Code of Corporate Governance for Publicly Listed Companies (SEC, 2016) took effect. The firm must annually file a corporate governance report and disclose which provisions they are compliant with and which they are not and explain the reason for this noncompliance.

4 Hypothesis

4.1 Underwriter and Certification Hypothesis

For a firm going public, a relationship with a prestigious underwriter provides the firm legitimacy (Certo et al., 2009)—the necessary endorsement critical for IPO success (Booth & Smith, 1986; Carter & Manaster, 1990). The certification hypothesis, which supports this endorsement, originates "from the literature on the use of reputational capital to guarantee product quality" (Booth & Smith, 1986, Abstract). Its use has been extended to the IPO market where the reputation capital of the underwriter, information producers of IPOs, guarantees the IPO quality. Assuming the underwriter has vetted the listing firm, its mere involvement then may provide a positive signal for potential investors (Titman & Trueman, 1986).

According to Booth and Smith (1986), the basic problem in issuing equity is informational asymmetry or the potential opportunism by insiders who possess superior knowledge. Hence, to reduce this asymmetry, as well as any uncertainty in the IPO process, they say an issuer "leases" the underwriter's brand name by engaging it to "certify that the issue price reflects inside information" about the firm's future earnings prospects (p. 263). They hypothesize that the degree of underpricing is "inversely related to the completeness of the certification effort and positively related to the potential impact of adverse inside information" (p. 277).

According to Carter and Manaster (1990, p. 1046), to reduce information asymmetry, "low risk firms attempt to reveal their low risk characteristic to the market," "by selecting an underwriter with high prestige." Similarly, they point out that high prestige underwriters are more likely to underwrite lower risk IPOs to build their reputation, to maintain their high prestige, and possibly to protect the value of other current and future IPO activities with the issuer and other firms. Corollary, high prestige underwriters are unlikely to undertake speculative issues due to the legal liabilities and potential loss of reputational capital associated with such deals (Beatty & Ritter, 1986; Higgins & Gulati, 2003). Furthermore, since "underwriters are compensated based on a percentage of the proceeds they raise for the issuer," they may be further incentivized to price closer to the listing firm's fair value and limit any underpricing (Jones, & us Swaleheen, 2010, p. 292).

Conceptually, a negative association then is expected between prestigious underwriters, who confer legitimacy through certification, and the level of underpricing.

Empirically, the relationship is mixed, particularly in the much-studied US market (e.g., Beatty & Ritter, 1986; Beatty & Welch, 1996; Loughran & Ritter, 2004). In the 1970s and 1980s, the presence of a high-quality underwriter is the single most important determinant of the lower level of underpricing in the US (Beatty & Welch, 1996). This relationship shifts in the 1990s and onwards possibly due to: (1) underwriters weakening their criteria for IPO selection; and (2) issuers increasing willingness to accept underpricing in exchange for other benefits, such as influential analysts' coverage of their stock post-IPO and allocation of future hot IPOs to the personal broker account of the executives of the issuing firms (Loughran & Ritter, 2004). Another possible explanation offered by Habib and Ljungqvist (2001) for this shift is an endogeneity bias when regressing underpricing on underwriter choice. They view that the issuer and underwriter mutually optimize their choice to associate with each other, instead of the conventional view of a one-sided choice with either the issuer or the underwriter doing the choosing. Ljungqvist (2007) elaborates on this, explaining that the issuer likely (and partly) bases the choice on the underpricing it expects to suffer. He says an issuer that is straightforward to value expects lower underpricing, and hence "has little to gain from the greater certification ability" of a top underwriter, while a high risk, difficult to value issuer "expects significant level of underpricing in the

absence of a prestigious underwriter" (p. 389). (See Appendix A for empirical studies exploring the association between underwriter reputation and underpricing.)

However, the empirical findings of the effect of the underwriter's reputation on the level of underpricing in developed markets may not be completely applicable to emerging markets given the differences in their institutional contexts. But this is difficult to confirm with certainty given the paucity of studies in emerging markets. Emerging markets' "capital and stock markets are relatively less efficient and incomplete than their developed counterparts" and its information asymmetry considerably higher (Eldomiaty, 2008, p. 26). Also, emerging market investors, particularly retail investors, are less knowledgeable and have less information on the new stock issues. Consequently, the certification role of underwriters may continue to be more valuable and prevail in emerging markets. Recent studies in Malaysia (Sundarasen et al., 2018; Tong & Ahmad, 2015) and China (Hu et al., 2021) confirm this negative relationship in an emerging market context.

Because of the legitimacy offered by the certification of a prestigious underwriter, the greater informational asymmetry in emerging markets, and the negative relationship of underwriter reputation and level of underpricing seen in recent emerging market studies, this study hypothesizes:

H1: The presence of a prestigious underwriter lowers the level of underpricing.

4.2 Outside Board Directors and Resource Dependence Theory

A firm is an open system, dependent on contingencies in the external environment, according to the resource dependence theory of Pfeffer and Salancik (1978). They propose that firms can minimize environmental dependencies through their choice of their board of directors, among other actions.[4] Board members, according to them, offer several benefits to the firm, such as advice and counsel, channels of information flow, preferential access to resources, and legitimacy.

The firm's board composition choice is not the outcome of a random choice but rather "rational organizational responses to the conditions of the external environment" (Pfeffer, 1972, p. 226). Moreover, there are certain points in a firm's life, like when it goes public, where the board of directors and the resources they bring are most critical and beneficial (Hillman et al., 2009). Certo (2003) argues that prestigious boards may enhance organizational legitimacy and subsequent IPO performance; and although he bases his study on the signaling theory, his findings clearly also support the resource dependence theory.

Firms who can attract and coopt powerful members of the community onto their boards are able to acquire critical resources from their environment, of which legitimacy is one of them (Provan et al., 1980). Firms may invite to their board executives from important suppliers or major customers to gain their support, or from banks to maintain sources of funding, or even former government officials if the firm is dependent on government business to gain contacts and signal legitimacy (Davis & Cobb, 2010). Hillman et al. (2000) offer a taxonomy of the resource dependence roles of directors—business experts, support specialists, and community influential—and elaborate how each brings the legitimacy resource to the firm, primarily through their (prestigious, symbolically valuable) work experiences, affiliations, expertise, and influence.

Conceptually, a negative association then is expected between the proportion of outside directors on the board, who confer legitimacy through resource dependence, and the level of underpricing.

Empirically, the relationship is mixed, irrespective of the institutional context (developed or emerging market), the theory underpinning the study (resource dependence or otherwise), and the definition of (the proportion of) outside directors on the board. The definition is dichotomized into two: (1) all outside (nonexecutive) directors; and (2) just independent, outside directors. (See Appendix B for empirical studies exploring the association between the proportion of outside directors and underpricing.)

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[4] The four other actions are: (1) mergers/vertical integration; (2) joint ventures and other interorganizational relationships; (3) political action; and (4) executive succession (Pfeffer & Salancik, 1978).

Inconsequential of the type of outside director, the outwardly oriented resource dependence theory views outside directors as bearers of critical resources to the firm. This resource includes legitimacy through their work experience, affiliations, expertise, and influence. Independent directors are differentiated from other outside directors not by the critical resource they bring to the firm but by their lack of significant (pecuniary) relationships with the firms' management and owners;[5] this perspective has a strong agency theory flavor to it. In an emerging market where wealth and firm ownership are concentrated and business interests and board membership are interlocked, an outside director, independent or not, brings critical resources to the firm.

Despite the legitimacy offered by outside directors through the resource dependence theory, the mixed empirical support on the relationship of the proportion of outside directors on the board and level of underpricing compel this study to offer alternative hypotheses:

H2A: The greater the proportion of outside directors on the board, the lower the level of underpricing.

H2B: The lower the proportion of outside directors on the board, the lower the level of underpricing.

5 Methodology

5.1 Sample

This study's sample covers the 77 firms that are publicly listed in the PSE, either in the Main/First, or in the Second, or in the SME Board for the 20-year period from January 1, 2001 to December 31, 2020. This sample equals the population of IPOs in the PSE for this period.

Data for this study came primarily from the listing firms' prospectus available in their respective websites, Bloomberg and Eikon, and, if not available from any of these sources, purchased from the PSE Library. The first day closing price came from Eikon, online stock market databases, and, if not available from these sources, online news articles reporting on the firms' first trading day activity.

5.2 Variables

Table 2 details this study's variables, resulting from the review of literature. The dependent variable *Underpricing* represents forgone IPO proceeds to the issuing firm (Carter & Manaster, 1990; Pollock 2004).

The two independent variables represent organizational legitimacy: (1) the presence of a foreign underwriter in the underwriting syndicate (*Foreign Underwriter*) to proxy for prestigious underwriter given the absence of any such measure in the Philippines; and (2) the proportion of outside directors on the board measured as all outsider directors (*Prop. of OD on Board*) or just independent directors (*Prop. of ID on Board*) (Alvarez-Otero & Lopez-Iturriaga, 2018). This study hypothesizes that the presence of a foreign underwriter serves the necessary endorsement critical for IPO success because of the market they serve, the foreign institutional investors. Some studies have shown that foreign institutional investors exhibit superior performance over domestic institutional investors, and likely over retail investors, on account of their investment experience and expertise (Neupane et al., 2016). Also, institutional investors are better equipped than individual investors (Abrahamson & De Ridder, 2015) likely to determine a firm's fair valuation. However, it is argued that in this IPO context, foreign institutional investors may demand from the foreign underwriter more information, possibly even access to firm's top management and board of directors, to overcome home informational advantage of domestic institutional investors.

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[5] The typical criteria for an independent director are a combination of several of these criteria. He/she: (1) is not a member nor immediately related to a member of the firm's management; (2) is not an employee of the firm nor a firm in the group; (3) receives only directorship fees and no other compensation from the firm or its group; (4) has no material business relations with the firm or its group; (5) is not an employee of the external auditor of the firm nor a firm in the group; (6) is within the maximum tenure of a director; and (7) is not a representative of a significant shareholder (IOSCO, 2007, pp. 34–38).

Lastly, three control variables, *Firm Growth*, *CEO Experience*, and *PSE Board*, have been chosen from the review of literature and among several other variables tested. These variables have shown to be the most relevant in the model's fit. *Firm Growth*, a measure of firm quality, is expected to have a positive relationship with underpricing (Pollock et al., 2010; Zheng & Stangeland, 2007). Zheng and Stangeland (2007, p. 2) explain that "firms with the most favorable prospects find it optimal to signal their type by underpricing their initial issue, because they can expect to recoup the cost of underpricing in subsequent seasoned issues." *CEO Experience* and *PSE Board* are expected to have negative relationships with *Underpricing*. *PSE Board* is specifically included to control for listing effects, since firms listed in the Main/First Board are more established firms than their counterparts in the SME/Second Board; and hence, the level of underpricing may be relatively lower.

Table 2. Study Variables and Measures

Variable	Definition
Dependent Variable	
Underpricing	Continuous measure; percentage difference between the firm's first trading day closing price and its offer price (e.g., Ibbotson & Ritter, 1995; Loughran & Ritter, 2004) $U = \frac{P_{c-} P_O}{P_c}$ where U is equal to *Underpricing*, P_c the first day closing price, and P_O the firm's offering price
Independent Variables	
1. Foreign Underwriter	Binary measure: 0–None; 1–Present (e.g., Alvarez-Otero & Lopez-Iturriaga, 2018; Kenourgios et al., 2007; Kim et al., 1995)
2. Prop. of OD on Board	Continuous measure; total number of outside directors divided by total number of directors on the board (e.g., Anand & Singh, 2019; Filatotchev & Bishop, 2002)
3. Prop. of ID on Board	Continuous measure; total number of independent directors divided by total number of directors on the board (e.g., Arora & Singh, 2020; Lin & Chuang, 2011)
Control Variables	
1. Firm Growth	Continuous measure; annual sales or revenue growth of the two reported years prior to listing (e.g., Pollock et al. 2010)
2. CEO Experience	Binary measure; 0–If the CEO has no prior CEO experience; 1–Otherwise (e.g., Lester et al., 2006)
3. PSE Board	Binary measure: 0–If the firm is listing in the SME or Second Board; 1– Otherwise (Main or First Board) (e. g. Alvarez-Otero & Lopez-Iturriaga, 2018; Sundarasen et al., 2018)

5.3 Model

This study uses a cross-sectional, multiple regression analysis to test its hypotheses. The model is specified as follows:

$$Underpricing = \beta_0 + \beta_1 Underwriter + \beta_2 Prop.of\ OD\ in\ Board\ (or\ Prop.of\ ID\ in\ Board) + \beta_3 Firm\ Growth + \beta_4 CEO\ Experience + \beta_5 PSE\ Board + \mu_i$$

where u_i is the error term.

6 Results

6.1 Descriptive and Correlation Results

Tables 3 to 6 describe this study's sample, while Table 7 shows the correlation of this study's variables.

Table 3 shows annually the number of IPO and gross amount raised by PSE Board and in aggregate, as well as the mean underpricing. Of the 77 IPOs and PHP270.9 trillion gross amount raised in the process, 73% of the IPOs and 98% of the gross amount raised are in the Main Board. On average there are three to four IPOs per year, with a maximum of nine in 2007 and a low of just one in 2004, 2009,

and 2018. Annual level of underpricing ranges from -6.2% to 29.2% and has a mean of 8.4% over the 20-year sample period.

Table 3. Annual IPO by Number and Amount* (PHP million) by PSE Board and Annual Underpricing

Year	Main/First Board		Second Board		SME Board		Total		Mean, % Under-pricing
	# of IPO	Gross amount raised	# of IPO	Gross amount raised	# of IPO	Gross amount raised	# of IPO	Gross amount raised	
2001	1	147.4	1	87.6	1	7.0	3	242.0	18.2
2002	3	2,519.8	2	128.2			5	2,648.0	1.3
2003			2	160.8	2	35.0	4	195.8	2.8
2004	1	1,011.3					1	1,011.3	0.0
2005	2	28,750.0					2	28,750.0	1.3
2006	2	16,695.7	2	330.5			4	17,026.2	14.5
2007	8	14,368.9	1	580.5			9	14,949.4	7.3
2008	2	3,998.2					2	3,998.2	-6.2**
2009					1	20.0	1	20.0	3.0
2010	2	27,897.2	1	191.0			3	28,088.1	4.9
2011	3	10,084.4	2	99.0			5	10,183.4	0.2
2012	4	24,161.0	1	270.1			5	24,431.1	11.6
2013	8	40,572.0					8	40,572.0	1.6
2014	3	10,662.4			2	2,525.1	5	13,187.6	23.4
2015	3	4,990.2			1	207.4	4	5,197.7	29.2
2016	4	4,223.8					4	4,223.8	15.2
2017	4	22,901.8					4	22,901.8	2.5
2018	1	8,150.1					1	8,150.1	-1.7**
2019	3	17,834.0			1	384.8	4	18,218.8	9.5
2020	2	25,288.6			1	1,594.9	3	26,883.5	11.0
Mean									8.4
Total	56	264,256.8	12	1,847.5	9	4,774.3	77	270,878.7	
% of total	73	98	16	1	12	2	100	100	

* Both primary and secondary offering

** Of the two IPOs in 2008, Pepsi Cola Products, Philippines, Inc., was the only one overpriced, i.e., first trading day closing price was lower than offer price, while the only IPO in 2018 was D. M. Wencesclao Associates, Inc.

Tables 4 and 5 further describe this study's sample. Table 4 indicates the mean, standard deviation, minimum level and maximum of level of underpricing, the proportion of outside and inside directors on the board, firm size and age, and total sales and sales growth prior to IPO. (See Appendix C for annual details on the mean, minimum, and maximum of firm size and age, as well as sales growth prior to IPO.) Table 5 shows the sample's industry breakdown, indicating that most IPOs are from the Industrial and Service sectors.

Table 4. Profile of the Sample

	Mean	Standard Deviation	Minimum	Maximum
Underpricing (%)	8.4	19.8	-69.8	50.0
Prop. of OD on Board (%)	64.9	18.4	14.3	92.9
Prop. of ID on Board (%)	25.2	12.1	0	87.5
Firm size pre-IPO, Total assets (PHP million)	14,852.1	24,930.8	.04	109,530.5
Firm age at IPO (Years)	15	13	0	57
Total sales pre-IPO (PHP million)	3517.9	6445.8	0	28750.0
Sales growth pre-IPO (%)	40.8	133.9	-83.6	1,141.1

Table 5. Industry Breakdown of the Sample

Sector	Total IPO	% of Total
Financials	10	13.0
Holding Firms	4	5.2
Industrial	25	32.5
Mining and Oil	3	3.9
Property	6	7.8
Services	21	27.3
SME	8	10.4

Table 6 details the number of IPO by PSE Board and type of underwriter and the resulting level of underpricing per category. Of the 77 IPOs, 49 (63.6%) firms limited their offerings to domestic investors as indicated in the Only Domestic Underwriter column, with SME firms limited to only domestic investors. Foreign underwriters participated only in 28 IPOs (36.4%) as indicated in the With Foreign Underwriter column. The level of underpricing averaged 11.7% without a foreign underwriter and just 2.6% with a foreign underwriter. The level of underpricing differed across PSE Board by a little over 1%.

Table 6. IPO by PSE Board, Type of Underwriter, and Average Underpricing

	Only Domestic Underwriter[6]	With Foreign Underwriter[7]	Total
SME Board, # of IPO*	21	0	21
Underpricing (%)	9.4	0.0	9.4
Main Board, # of IPO	28	28	56
Underpricing (%)	13.5	2.6	8.1
Total # of IPO (%)	49 (63.6)	28 (36.4)	77 (100.0)
Underpricing (%)	11.7	2.6	8.4

* Includes listings in the Second Board

Table 7 contains the correlation results of this study's variables. Given the data values are a mix of continuous and binary measures, different correlations are computed—Pearson correlation between continuous measures, point biserial correlation between a binary measure and a continuous measure, and tetrachoric correlation between binary measures. *Underpricing* reflects significant correlation with *Foreign Underwriter* ($r=-0.222$, $p<0.10$), *Prop. of OD on Board* ($r=-0.288$, $p<0.05$), and *Firm Growth* ($r=-0.206$, $p<0.10$). *Foreign Underwriter* and *Prop. of OD on Board* are also positively correlated ($r=0.213$, $p<0.10$). *Prop. of ID on Board* and *CEO Experience* are also positively correlated ($r=0.214$, $p<0.10$). Lastly, *Foreign Underwriter* and *PSE Board* are perfectly and positively correlated ($r=1.000$, $p<0.10$). This is unsurprising since only firms listed in the Main Board can potentially sell their shares to foreign institutional investors, the only time foreign underwriters can participate in an underwriting syndicate.

[6] There are two types of domestic underwriters: (1) independent investment house, not connected to a universal bank; and (2) investment bank, connected to a larger banking group. For the first type, one of the more active investment houses for the period 2001 to 2020 was Abacus Capital & Investment Corp.—solely underwriting 10 (13%) of the issue for the period 2001 to 2020. For the second type, the three most active investment banks for the same period, who undertook issues solo or as part of an underwriter syndicate, were: (1) BDO Capital & Investment Corp. with 27 (35%); (2) First Metro Investment Corp. with 13 (17%); and (3) BPI Capital Corp. with 11 (14%).

[7] For foreign underwriters, who were part of an underwriting syndicate, UBS AG was the most active with 13 issues—17% of all 77 IPOs and 46% of all 28 IPOs with foreign underwriters. The two next active ones were: (1) Deutsche Bank with 6 (8% and 21%); and (2) JP Morgan with 5 (6% and 18%).

Table 7. Correlation Results

	1	2	3	4	5	6	7
1. Underpricing	1.000						
2. Foreign Underwriter	-0.222*	1.000					
3. Prop. of OD on Board	-0.288**	0.213*	1.000				
4. Prop. of ID on Board	-0.094	-0.047	0.584	1.000			
5. Firm Growth	0.206*	-0.113	-0.074	0.101	1.000		
6. CEO Experience	0.123	0.157	-0.094	0.214*	0.103	1.000	
7. PSE Board	-0.029	1.000*	0.137	0.003	0.026	-0.133	1.000

* p<0.10, ** p<0.05, *** p<0.01

6.2 Regression Results

Table 8 contains the results of the four regressions models, containing: (1) only the control variables (excluding *PSE Board*); (2) all variables, and measuring the proportion of all outside directors on the board as *Prop. of OD on Board*; (3) all variables, and measuring the proportion of all outside directors on the board as *Prop. of ID on Board*; and (4) all variables, and controlling for listing effects (including *PSE Board*).

Table 8. Regression Results

	(1)	(2)	(3)	(4)
	Only Control Variable	All variables (Prop. of OD on Board)	All Variable (Prop. of ID on Board)	All Variables for PSE Board (OD)
Firm Growth	0.029***	0.024**	0.027***	0.022**
	(0.009)	(0.010)	(0.009)	(0.010)
CEO Experience	0.041	0.040	0.063	0.046
	(0.045)	(0.046)	(0.045)	(0.048)
Foreign Underwriter		-0.068*	-0.092**	-0.089**
		(0.036)	(0.040)	(0.043)
Prop. of OD on Board		-0.248*		-0.252*
		(0.139)		(0.139)
Prop. of ID on Board			-0.258	
			(0.190)	
PSE Board				0.048
				(0.067)
Constant	0.052	0.240**	0.140**	0.213
	(0.033)	(0.119)	(0.060)	(0.142)
Adjusted R-squared	0.028	0.101	0.074	0.099
No. of Observations	77	77	77	77
F Statistic	6.638	4.669	7.4221	4.554
p-value	0.000	0.000	0.000	0.000

Note: standard errors in parentheses
* p<0.10, ** p<0.05, *** p<0.01

Table 8 offers several interesting insights. The addition of the independent variables, *Foreign Underwriter* and *Prop. of OD on Board,* in regressions 2 and 4 increases the explanation in the variance for *Underwriting* significantly (+0.07 for R-squared). Further, both independent variables are significantly negative for regressions 2 and 4, like their correlation results.

The negative significant relationship of the presence of prestigious underwriters (*Foreign Underwriter*) and level of underpricing supports H1 (β=-0.069, p<0.10 for regression 2; β=-0.092, p<0.05 for regression 3; and β=-0.089, p<0.05 for regression 4). This supports the legitimacy offered by the certification of a prestigious (foreign) underwriter and echoes the results of Booth and Smith (1986) and Sundarasen et al. (2018), to name a few (see Appendix A). But this contradicts the results of Sullivan and Unite (2001) who have a different definition of foreign underwriter, as well as a different sample time frame. A foreign underwriter for them must be the lead underwriter, while for

this study the foreign underwriter just has to be part of the underwriting syndicate, even if it is in a subordinated role. Their study's time frame is from 1987 to 1997, while for this study it is from 2001 to 2020; and Loughran and Ritter (2004) have shown that the relationship between underwriter and underpricing may shift over time.

The negative relationship of the proportion of outside board directors for both measures (regressions 2 and 3) and the level of underpricing partially supports H2A. The relationship is only significant when it is measured as *Prop. of OD on Board* (β=-0.248, $p<0.10$ for regression 2 and β=-0.252, $p<0.10$ for regression 4), replicating the results of Filatotchev and Bishop (2002) (see Appendix B). It is not significant when it is measured as *Prop. of ID on Board,* replicating results of other studies (e.g., Alvarez-Otero & Lopez-Iturriaga, 2018; Chen & Yang, 2013; Teti & Montefusco, 2021) (see Appendix B). Only partial support is found for legitimacy offered by outside directors through the resource dependence theory. Perhaps the much lower level of *Prop. of ID on Board* (mean = 25.2%), which is two and a half times smaller than the *Prop. of OD on Board* (mean = 64.9%), is inadequate to offer the critical resources posited by the resource dependence theory.

Only the control variable of *Firm Growth* is in line with the hypothesized relationship with *Underpricing*. *CEO Experience* and *PSE Board* (only appearing in regression 4) are contrary to the negative hypothesized relationship with *Underpricing*. *Firm Growth*, like its correlation results, indicates that the greater the sales growth, the higher the level of underpricing. As Zheng and Stangeland (2007, p. 2) explain, "firms with the most favorable prospects find it optimal to signal their type by underpricing their initial issue, because they can expect to recoup the cost of underpricing in subsequent seasoned issues." Lastly, controlling for listing effects, *PSE Board* is not significant, and its inclusion marginally reduces the explanation in the variance for *Underwriting* from regression 2.

Given the lack of significance of *PSE Board*, a regression is run just for the Main Board, the only subsample with foreign underwriters. Note, however, this reduces the sample size to just 56, and the number of variables must be reduced to reflect this smaller sample size. Using different combinations of this study's variables, only *Foreign Underwriter* and *Firm Growth* maintain their initial negative significant relationship. *Prop. of OD on Board* remains negative but is no longer significant.[8]

7 Discussion

This study explores the association of underwriters and outside directors on the level of underpricing in the PSE for the 20-year period from 2001 to 2020. It uses the concepts of legitimacy, certification, and resource dependence to explain the association. Results indicate that the presence of a foreign underwriter and a greater proportion of outside directors on the board are significantly negative, reducing the level of underpricing.

Organizational legitimacy matters for a listing firm because it provides it the license to operate (Chung et al., 2016) in the stock market and provides comfort to potential investors to engage in economic exchanges (Deephouse et al., 2016) with the firm. In its run up to its public listing, the firm uses legitimacy as a resource to extract from the environment and manage accordingly (strategic legitimacy), to address agency issues plaguing it, and to simultaneously create a perception of attractiveness and credibility (Suchman, 1995). The outcome of the firm's legitimation process can possibly be measured by more capital raised and better stock performance (Certo, 2003).

To help "potential investors discern organizational legitimacy and hence potential firm quality" (Lester et al., 2006, p. 4), the listing firm conforms (pragmatic legitimacy) by meeting the needs of the various stakeholders of the IPO and marketing to them (e.g., comprehensive firm prospectus, investor road show, and media/press releases) and by coopting certain stakeholders. The firm seeks affiliations that impart certifications/endorsements, vouching for its untested reliability (Starr & MacMillan, 1990; Suchman, 1995); and two externally validated symbols of credibility that confer legitimacy are underwriters (via certification hypothesis) and outside directors (via resource dependence theory). By choosing to engage with the listing firm, these two parties chose to invest their time, and lend their

[8] Results are available upon request to the author.

credentials, expertise, and connections to the firm, and effectively offer it a level of legitimacy (Chen et al., 2008; Higgins & Gulati, 2003).

Regression results show that the certification hypothesis is in effect, with the endorsement of a prestigious underwriter significantly reducing the level of underpricing. This is in line with the results of prior studies (e.g., Booth & Smith, 1986; Sundarasen et al., 2018). It can be interpreted that the underwriter certifies that the issue price reflects inside information about the firm's future earnings prospects (Booth & Smith, 1986). This study measures prestigious underwriter by the presence of a foreign underwriter in the underwriting syndicate. The information quality and quantity demand of foreign institutional investors, as well as the markets these foreign underwriters serve, may signify the completeness of the certification efforts of the underwriter (Booth & Smith, 1986).

Also, regression results partially show resource dependence at work. Legitimacy offered by a greater proportion of outside directors on the board significantly reduces the level of underpricing only when it is measured as the proportion of all outside directors, and not when it is measured with the narrower proportion of only independent directors on the board. Outside board members offer several benefits to the listing firm, such as advice and counsel, channels of information flow, preferential access to resources, and legitimacy (Pfeffer & Salancik, 1978). The outwardly oriented resource dependence theory views outside directors as bearers of critical resources to the firm and makes no distinction of the type of outside directors, which agency theory and governance literature do. In an emerging market where wealth and firm ownership are concentrated and business interests and board membership are interlocking, an outside director, independent or not, brings critical resources to the firm, including legitimacy through their work experience, affiliations, expertise, and influence.

Underwriters and outside board directors effectively are believed to possess superior abilities in making judgments about the firms they choose to associate with, especially given their limited time (Pollock et al., 2010). Also, they value their reputation and status highly and carefully guard against tarnishing it, or even facing legal issues, by aligning themselves with questionable firms (Ljungqvist, 2007; Michaely & Shaw, 1994; Pollock et al., 2010). (Note, however, there is no known legal case lodged against an underwriter or outside director in the Philippines.) Lastly, they "may provide substantive resources that will enhance the firm's functioning" (Pollock et al., 2010, p. 7), such as abundant social and human capital, and maybe even financial capital.

7.1 Contributions

This study adds theoretically and practically to the body of research on underpricing. Theoretically, this study offers another emerging market institutional context that reconfirms the phenomenon of underpricing. Though the study of underpricing may be considered mature, the vast majority of work has been in developed markets, particularly the US, with established legal and governance systems and relatively high levels of transparency. Also, it studies underpricing using the management lens of legitimacy, certification, and resource dependence rather than the more commonly used economic lens of information asymmetry, agency, and signaling (see Appendices A and B). Further, it updates the prior exploration of underpricing in the Philippines (Sullivan & Unite, 2001; Ybañez, 1993).

Practically, this study offers insights to issuers, potential (retail) investors, and regulators. Issuers who wish to maximize their IPO proceeds must manage carefully the run up to listing to increase their organizational legitimacy. Once again, their choice of underwriters and outside directors matter. The likely higher cost of more prestigious underwriters and a greater proportion of outside directors on the board may pay back in terms of their greater legitimizing effect that translates to higher IPO proceeds and lower levels of underpricing. Additionally, this expanded, more prestigious IPO network of relationships may provide direct access to other resources, such as bankers, suppliers, etc. Meanwhile, investors, particularly retail investors who lack the experience and expertise of institutional investors, must pay attention to the chosen underwriters and the proportion of outside directors on the board to guide their investing decisions.

Lastly, regulators may consider increasing the disclosure demands of domestic underwriters (e.g., number of IPOs conducted for the year, amounts raised, performance of their IPOs, etc.) so the investing public can judge underwriter prestige, given its important legitimizing effect. Similarly, given the legitimizing effects of outside directors, regulators may consider demanding listing firms to: (1)

comply fully (versus just comply or explain) with the Code of Corporate Governance Code for Publicly Listed Companies (SEC, 2016) at the very least with the requirement of a majority of outside directors on the board as pre-IPO requirements; and (2) classify further outside directors;[9] both actions increase the investing public's information to judge outside directors' quality. Of the 12 IPO from 2017 onwards, one-third or four firms do not have majority of outside directors on the board as indicated in their prospectuses.

7.2 Limitations

This study, lastly, is limited by its sample size, theories, variables, measures, and analytical methodology chosen to inform this study—all of which offer avenues for future research. This study's variables of underpricing, underwriter, and outside directors are informed by the concepts of legitimacy, certification, and resource dependence and limited by the sample size. Other measures of IPO performance besides underpricing and beyond the first day of trading can be examined, such as price to book value (Brogi et al., 2020) and IPO price premium (Certo et al., 2009; Lester et al., 2006).

Further, informed potentially by other theories, several other exploratory variables are available to study this rich area of IPO performance—sample size permitting. The following suggestions are not meant to be exhaustive. First, governance variables (e.g., Brogi et al., 2020), such as board size, composition, leadership, and diversity, can be explored to explain underpricing, and the exploration can be informed by concepts of information asymmetry, signaling, agency, and stewardship. Second, external macro and micro (industry) variables, such as state of the economy or market at the time of the IPO (e.g., Allen & Faulhaber, 1989; Brogi et al., 2020; Pollock 2004), can be investigated to explain underpricing, and concepts of signaling and rationing can be used in the process (Allen & Faulhaber, 1989). Third, the ownership profile of the firm (i.e., founder, manager, and public) (Certo et al., 2001) and level of ownership concentration (e.g., Alvarez-Otero & Lopez-Iturriaga, 2018), together with the concepts of principal-agent and principal-principal (Lin & Chuang, 2011), can be considered to explain underpricing. Fourth, behavioral finance, such as investor interest (e.g., share turnover on first day of offering), time of year issued (e.g., January effect), and moment of entry (e.g., hot market), offers another set of variables to explore underpricing, like Zarzecki and Woloszyn's (2016) study of the Polish stock market. Fifth, the issuing firm's attributes and the deal offer's characteristics (e.g., equity retained, process, lock-in, and fees) can be explored to study underpricing, like the exhaustive study of Reber and Vencappa (2016).

Other, more nuanced measures of underwriter's reputation beyond a binary measure, as this study uses, can be an area of further exploration. A continuous measure can be constructed based on the relative market share of domestic underwriters for all type of issuance, not just equity given its paucity in the Philippine market. This can serve as a proxy measure for an underwriter's reputations (Megginson & Weiss, 1991; Sundarasen et al., 2018; Tong & Ahmad, 2015).

Also, the use of cross-sectional regressions can only ascertain the association of the chosen variables but not the causal mechanism. The use of more qualitative research techniques, such as case analysis, may offer insights on the causal mechanism and even other insights beyond said association. There are several interesting case explorations coming out of this paper (see Table 3): (1) the single IPO issuances of 2004, 2009, and 2018 have very different underpricing outcomes; and (2) the significant underpricing occurring for the period from 2014 to 2016. More detailed exploration of the IPO issuance (e.g., its ownership structure, management team) and its environment (e.g., industry presence and outlook, economic and market prevailing conditions and forecast) may surface interesting themes unique to emerging markets. Additionally, exploring the endogeneity of the choice of underwriter can be explored using instrumental variable regressions (Habib & Ljungqvist, 2001; Jones & us Swaleheen, 2010).

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[9] Outside directors are often further classified as directors who are: (1) independent; (2) related to, representatives of significant shareholders; or (3) others, such as lead, alternate, nominee, or professional director (IOSCO, 2007; OECD, 2021).

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Appendix A
Empirical Studies on Underwriter Reputation and Underpricing

Author (Year)	Country	Period	Sample Size	Theories and Concepts	Results
Negative, significant relationship					
Beatty & Ritter (1986)	US	1977–1982	1028	Information asymmetry, reputational capital	An underwriter does not behave opportunistically (i.e., price other than the underpricing equilibrium) and forfeit reputational capital.
Booth & Smith (1986)	US	1971–1982	964	Information asymmetry, reputational capital	An underwriter serves a certification role, mitigating the issue of asymmetric information between insiders and outsiders.
Carter & Manaster (1990)	US	1979–1983	501	Information asymmetry, reputational capital	Prestigious underwriters, to maintain their reputation, associate with lower risk offerings.
Hu et al. (2021)	China (Growth Enterprise Market)	2009–2012	328	Information asymmetry, reputational capital	Prestigious underwriters reduce IPO underpricing by minimizing information asymmetry and selecting high-quality firms to underwrite.
Kenourgios et al. (2007)	Greece	1997–2002	169	Role of prestigious underwriter	They offer international support for Beatty and Ritter (1986).
Michaely and Shaw (1994)	US	1984–1988	947	Adverse selection, reputational capital, signaling	Underwriter's reputation "resolves some of the uncertainty about the quality of the IPO. The better the investment banker's reputation, the less risky the issue is, and the lower the required initial day return" (p. 298).
Sundarasen et al. (2018)	Malaysia	2005–2012	228	Information asymmetry, signaling role of reputation	"Underwriter's reputation plays a significant role in reducing asymmetric information and signals the firm value to the investors" (Abstract).
Tong & Ahmad (2015)	Malaysia	2002–2008	322	Signaling role of reputation	Underwriter's reputation can signal to the investors the post listing performance of the IPO.
Positive, significant relationship					
Alvarez-Otero & Lopez-Iturriaga (2018)	Spain	1998–2013	72	Information asymmetry, signaling reputation, institutional, alignment/ entrenchment	There may be lower informational asymmetries in the Spanish capital market compared to the Anglo-American markets.
Beatty & Welch (1996)	US	1992–1994	960	Reputational capital	The relationship reversed from their previous negative relationship from studies in the 1980s, likely due to differences in the economic environment.
Dimovski et al. (2011)	Australia	1994–2004	380	Reputational capital	They offer international support for Loughran and Ritter (2004).
Jones & us Swaleheen (2010)	US	1980–2003	6320	Reputational capital	The relationship is significantly negative for the period from 1980 to 1991 and significantly positive for the period from 1992 to 2003 when the underwriter's reputation is treated as an exogenous variable. It is significantly positive for the period from 1980 to 2003 when endogenizing the underwriter's reputation based on the characteristics of the listing firm.
Kirkulak & Davis (2005)	Japan	1998–2002	687	Reputational capital	The relationship is significantly positive when there is high demand for the IPO, likely indicating prestigious underwriters

Author (Year)	Country	Period	Sample Size	Theories and Concepts	Results
					favor investors (not the issuer) when pricing the issue. It is significantly negative when there is low demand for the IPO, likely indicating prestigious underwriters are more concerned with firm specific risks.
Liu & Ritter (2011)	US	1980–1989 1990–2008	2006 5273	Certification, differentiated underwriting services and localized oligopolies	The relationship is significantly negative, supporting the certification hypothesis. It is significantly positive, supporting the local oligopolies theory. Underwriters compete less on gross spread and more on nonprice dimensions, and issuers are willing to pay for these services with greater underpricing.
Loughran & Ritter (2004)	US	1980–1989 1990–2000	1752 4032	Certification, changing risk composition, realignment of incentives, changing issuer objective function	The relationship is significantly negative, supporting the certification hypothesis. It is significantly positive, indicating prestigious underwriters may have relaxed their underwriting standards and may be more willing to underwrite younger, more uncertain, and unproven new issues. Also, issuers may be more willing to engage underwriters who underprice in exchange for influential analyst coverage and allocation of hot IPOs to the personal brokerage accounts of the issuer's executives.
		2001–2003	206		There is no significant relationship (positively signed).
Sullivan & Unite (2001)	Philippines	1987–1997	104	Certification, conflicts of interest	The relationship is significantly positive if the underwriter is related to the listing firm or is foreign, and significantly negative otherwise.
No significant relationship					
au Abdullah, & Mohd (2004)	Malaysia	1992–1998	70	Information asymmetry, reputational capital, signaling	There is no support that the choice of underwriter provides signals about a firm's IPO (negatively signed).
Kim et al. (1995)	South Korea	1985–1990	260	Information asymmetry, signaling	There is no support that the underwriter's quality lessens ex-ante uncertainty unresolved by the prospectus nor does it signal favorable private information (negatively signed).
Pinheiro et al. (2016)	US	1991–2000	2754	Industry influence	Underpricing is fully explained by the firms' characteristics and strategic behavior, and is not associated with top underwriting.

Source: Literature review

Appendix B
Empirical Studies on Proportion of Outside Directors and Underpricing

Author (Year)	Country	Period	Sample Size	Theories and Concepts	Results
Negative, significant relationship					
Chahine & Filatotchev (2008)	France	1996–2000	140	Informational asymmetry, agency, signaling	Board independence, measured as the percentage of independent (external) directors on the board, alleviates agency problems between the IPO firm and investors, thus reducing underpricing.
Filatotchev & Bishop (2002)	United Kingdom	1999–2000	251	Agency, upper echelon, signaling	"Investor's attribute high quality to firms with a larger proportion of nonexecutive directors" (p. 949) on the board and the presence of nonexecutive directors "may have been strategically used to attract financial resources during the initial floatation" (p. 952).
González et al. (2019)	Latin America	1990–2004	396	Information asymmetry, signaling	Board independence, measured as the number of independent directors divided by the number of dependent directors, negatively impacts underpricing.
Lin & Chuang (2011)	Taiwan	2000–2005	525	Agency (principal-principal), institutional theory	The proportion of independent directors on the board may be effective at mitigating principal-principal conflicts, as well as balancing and weakening controlling shareholders and/or family members, thus reducing underpricing.
Positive, significant relationship					
Arora & Singh (2020)	India	2012–2017	200	Information asymmetry, agency, resource dependence, signaling	The percentage of independent directors on the board in SMEs undertaking an IPO "signals good quality to investors, thereby evoking positive reaction on the first day of trading" (p. 517).
Certo et al. (2001)	US	1990–1998	748	Signaling	Several possible explanations are offered for the positive relationship of underpricing and the proportion of independent directors on the board, which are contrary to predictions: (1) "independent board members serve to benefit the underwriters' clients, not firm owners;" (2) underwriters believe that a growth oriented firm, such as the listing firm, is "better served by directors familiar with the firm and its growth opportunities, than by independent directors;" and/or (3) corollary, "effective oversight of firm management may be less critical" in the growth stage and, hence, less meaningful as a signal (p. 45).
Darmadi & Gunawan (2013)	Indonesia	2003–2011	101	Information asymmetry, signaling, agency	Several possible explanations are offered for the positive relationship of underpricing and the proportion of independent directors on the board, which are contrary to the predictions. Independent directors: (1) fail to mitigate information asymmetry, possibly because they are influenced by insiders or management; and/or (2) act as a signal of the firm's quality to investors, as well as the firm's intent to fulfill capital market requirements and to protect the interests of minority shareholders.

Author (Year)	Country	Period	Sample Size	Theories and Concepts	Results
No significant relationship					
Alvarez-Otero & Lopez-Iturriaga (2018)	Spain	1998–2013	72	Information asymmetry, signaling reputation, institutional, alignment/ entrenchment	There is no support that board independence, measured as both the proportion of independent and the proportion of nonexecutive directors on the board, enhances information exchange outside the firm (both are negatively signed).
Anand & Singh (2019)	India	2003–2017	471	Information asymmetry, agency (principal-principal), resource dependence	There is no support that board independence, measured as the proportion of outside directors on the board, acts as an important information signal for investors (negatively signed).
Chen & Yang (2013)	China (Second board)	2009–2012	355	Agency	There is no support for the relationship of underpricing and board independence (negatively signed), measured as the fraction of independent director on the board, possibly because investors participating in the IPO: (1) have a short investment horizon and care less about governance mechanisms; and/or (2) trust that the strict rules governing firms listed on this board can sufficiently protect them.
Hearn (2012)	Sub-Sahara Africa excluding South Africa	2000–2009	172	Agency, signaling	The relationship of board independence, measured as the proportion of nonexecutive directors to their executive counterpart, to underpricing is inconclusive.
Li & Naughton (2007	China	1999–2001	314	Agency	There is no support that the country's new policy of requiring that at least one-third of the board be outside directors has a clear impact on the IPOs' short-term performance (positively signed).
Teti & Montefusco (2021)	Italy	2000–2016	128	Information asymmetry, signaling, agency (principal-principal)	There is no support that board independence, measured as the percentage of independent director on the board, can attenuate principal-principal conflict (positively signed).
Yatim (2011)	Malaysia	1999–2008	385	Information asymmetry, signaling, resource dependence	There is no support for the relationship of underpricing and board independence, measured as the percentage of nonexecutive on the board (negatively signed), possibly because investors believe that an IPO/growth-oriented firm is better served by executive directors and managers who are familiar with the firm and its growth opportunities, than by nonexecutive directors.

Source: Literature review

Appendix C
Annual Profile of the Sample (PHP million)

	Firm size pre-IPO, Total asset (Million)			Firm age at IPO (Years)			Sales growth pre-IPO (%)		
Year	Mean	Min	Max	Mean	Min	Max	Mean	Min	Max
2001	170.1	42.0	386.2	9	5	15	40.3	29.6	51.6
2002	16,306.8	0.04	77,379.9	13	1	34	20.0	-20.0	44.9
2003	120.8	26.3	219.7	14	3	37	96.6	7.9	292.9
2004	43,895.9	43,895.9	43,895.9	9	9	9	0.3	0.3	0.3
2005	61,133.7	12,736.9	109,530.5	27	8	45	22.2	11.3	33.1
2006	38,582.3	457.6	83,401.0	12	3	30	1.8	-19.2	20.1
2007	4,164.1	394.9	12,345.3	15	0	57	31.7	-10.9	119.7
2008	14,696.7	6,785.3	22,608.0	10	1	19	13.2	8.8	17.5
2009	24.8	24.8	24.8	9	9	9	29.4	29.4	29.4
2010	17,402.8	528.6	35,323.0	10	2	22	5.0	-19.6	18.4
2011	2,749.6	52.9	10,123.7	6	0	13	55.3	20.7	91.4
2012	35,200.4	125.5	96,006.6	15	0	41	244.5	11.3	1,141.1
2013	21,316.8	351.0	64,947.4	17	10	25	22.0	3.3	82.6
2014	5,086.8	182.1	11,877.9	10	1	27	10.6	-83.6	85.3
2015	3,205.2	480.2	8,084.0	15	6	26	8.6	-1.8	18.7
2016	24,887.5	1,787.1	66,219.0	34	1	57	6.6	-24.6	22.8
2017	3,064.2	5,346.9	27,568.8	12	2	22	21.0	6.3	40.9
2018	29,050.6	29,050.6	29,050.6	53	53	53	38.1	38.1	38.1
2019	4,298.7	433.5	8,215.4	8	4	14	23.5	1.5	46.9
2020	8,299.4	914.6	11,991.7	13	11	14	58.3	18.8	80.8