

# ARE KOREA INDIVIDUAL INVESTORS IRRATIONAL IN IPO MARKET?: AN EXPLANATION FROM THE WINNER'S CURSE PERSPECTIVE

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## ABSTRACT

*Individual investors are often regarded as irrational sentiment investors whose investment behavior is affected by psychological factors. This study measures the actual investment return of individual investors who participated in IPO stock investment in the Korean market from the short-term and long-term perspective and investigates the relationship with IPO characteristics that affect the investment sentiment of individual investors. Even though the underpricing of IPO stocks on the first day of listing on average reached 31% over the past 13 years, individual investors in the Korean stock market earned very little actual return on IPO stock investment. The market-adjusted return on IPO stock investment on the first day was about -0.5%, and even if they held IPO stocks for one year after listing, it was only 3.4%. The so-called winner's curse, in which individual investors are allocated relatively many overvalued stocks appears to be present in the Korean IPO market. The allocation of IPO stocks by individual investors depends on several factors that reflect individual investors' sentiment, such as past performance of previous IPOs, past industrial returns, institutional investors' investment intent, offering size, an upward revision of the offer price, and issuing firm's financial soundness. It was found that the higher the individual allocation rate, the lower the short-term investment return on the first trading day, confirming the winner's curse risk of individual investors. However, in the long run, a reversal of returns was observed, in which the long-term returns of IPO stocks with high individual allocation rates rose. In order to mitigate the winner's curse risk, it is desirable to reform IPO pricing mechanisms and allocation rules in a way that reduces the asymmetry of information between institutional and individual investors and reflects the subscription demand of individual investors.*

**Keywords:** Individual investor, initial public offering, sentiment, winner's curse, return reversal