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# Informational Asymmetries and the Demand for IPOs: An Explanation of Underpricing

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# INFORMATIONAL ASYMMETRIES AND THE DEMAND FOR IPOs: AN EXPLANATION OF UNDERPRICING

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There exists large informational asymmetries in the stock market, particularly in the primary market where initial public offerings are made. This paper examines the large initial gains observed in a previous study and explains them using game theory. The process of bringing an IPO to the market involves the issuing firm, the investment bank and the investors. This paper will discuss the strategic relationships that exist between these entities and why each either accepts a smaller gain or demands a risk premium based on the level of uncertainty they face. Accompanying the economic theories discussing these relationships are case studies displaying examples of underpricing in the process of bringing an initial public offering to the market.