UNIVERSITI PUTRA MALAYSIA

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By

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ABSTRACT

In Malaysia, new issues are reported to be highly underpriced which subsequently led to oversubscription. Since underpricing in the Malaysia capital market has been unique with the regulatory effect (Ariff et.al.), this study extend regulatory intervention effect, namely the New Economic Policy (NEP) in the period of 1970-1990 and Disclosure-Based System from 1st January 1996 on Malaysian IPOs.

Comparison on pre- and post- policy implementation results show that the average market-adjusted return on both short run and long run period are higher in the post-policy period. In the short run, the results of average market-adjusted returns in pre-versus the post- NEP are 52.35 versus 112.01 on first day (t=3.25), 57.63 versus 105.78 on first week (t=2.61), 62.89 versus 106.09 on first month (t=2.24), 46.41 versus 105.06 (t=2.89) on third month and 37.28 versus 106.71(t=3.55) on the sixth month. In the long run, the average market-adjusted returns of pre-versus the post-NEP are 21.19 versus 108.89 (t=9.24) on the first year, -4.79 versus 97.18 (t=6.57) on second year and 6.94 versus 73.41 (t=5.74) on the third year.

Implementation of disclosure-based system has significantly reduced the underpricing. The results of average market-adjusted returns of pre-and post-implementation of the system are 139.65 versus 1.39 on first day (t=11.60), 140.26 versus 1.34 (t=10.56) on first week, 136.08 versus 1.33 (t=10.08) on first month and 147.93 versus 1.69 (t=10.09) on sixth month. Therefore, the study concluded that regulations do have effect on Malaysian IPOs.

ABSTRAK

Di Malaysia, saham terbitan baru seringkali terlebih langan berikutan laporan yang nilai saham terbitan baru melebihi harga yang ditawarkan ("underpricing"). Kesan peraturan di pasaran modal Malaysia adalah unik ke atas harga saham terbitan baru (Ariff et.al.). Oleh demikian, kajian ini akan melanjutkan kesan peraturan Dasar Ekonomi Baru (DEB) dari tahun 1970-1990 dan *Disclosure-Based System* dari 1 Januari 1996 ke atas saham terbitan baru di Malaysia.

Perbandingan keputusan analisis sebelum dan selepas pelaksanaan DEB menujukkan pelaksanaan dasar berkesan ke atas harga saham terbitan baru. Tempoh jangka pendek dari hari pertama ke bulan ke-enam menunjukkan pulangan lebih tinggi selepas pelaksanaan dasar tersebut. Keputusan sebelum berbanding selepas DEB adalah 52.35 berbanding 112.01 pada hari pertama (t=3.25), 57.63 berbanding 105.78 pada minggu pertama (t=2.61), 62.89 berbanding 106.09 pada bulan pertama (t=2.24), 46.41 berbanding 105.06 (t=2.89) pada bulan ketiga dan 37.28 berbanding 106.71 (t=3.55) pada bulan keenam. Di dalam jangka panjang, keputusan pulangan sebelum berbanding selepas DEB adalah 21.19 berbanding 108.89 (t=9.24) pada tahun pertama, -4.79 berbanding 97.18 (t=6.57) pada tahun kedua dan 6.94 berbanding 73.41 (t=5.74) pada tahun ketiga.

Pelaksanaan *Disclosure-Based System* berkesan mengurangkan jurang perbezaan nilai saham terbitan baru berbanding harga yang ditawarkan. Keputusan untuk pulangan bagi jangka sebelum berbanding selepas adalah 139.65 berbanding 1.39 pada hari pertama (t=11.60), 140.26 berbanding 1.34 (t=10.56) pada minggu pertama, 136.08 berbanding 1.33 (t=10.08) pada bulan pertama dan 147.93 berbanding 1.69 (t=10.09) pada bulan keenam. Kesimpulan dari kajian ialah peraturan ke atas pasaran modal mempunyai kesan terhadap saham terbitan baru.

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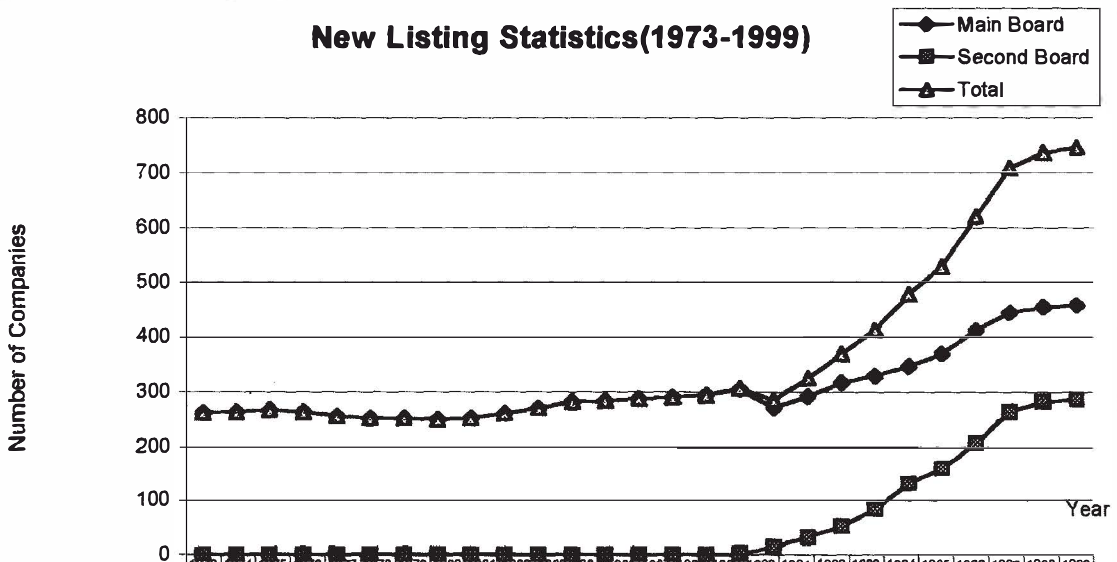
INTRODUCTION

1.0 Overview of the Securities Industry in Malaysia

With over 700 listed companies, the Kuala Lumpur Stock Exchange is by far the largest stock exchange within ASEAN in terms of market capitilisation and has consistently been in the top 15 on a global basis. The number of new issues has been increasing since 1973[1]. The statistics are depicted in Figure 1.

Figure 1 New Listing Statistics



	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Main Board	262	264	268	264	256	253	253	250	253	261	271	282	284	291	295	305	271	292	317	329	347	369	413	444	454	458
Second Boai	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	2	14	32	52	84	131	160	208	264	282	287
Total	262	264	268	264	256	253	253	250	253	261	271	282	284	291	295	307	285	324	369	413	478	529	621	708	736	745

[1] Source: KLSE Homepage as at 22 July 1999.

Approximately RM 170 billion and RM 380 billion will be required to fund the various undertakings by the public and private sectors respectively in the five year period between 1996 and 2000. Should current financing patterns continue, the latter is expected to raise at least 40 per cent of its requirements through the financial markets.[2]

To ensure that this demand is satisfied, a sound domestic investor base must be established in tandem with the implementation of policies to attract and retain foreign funds. A flourishing stock market will provide companies with an excess to a cheaper source of finance, and simultaneously minimise their exposure to interest rate and/or exchange rate fluctuations, which accompany debt financing.

1.1 Category of Listed Securities

Fund raising through the listing of securities on the KLSE comprises, mainly of 3 categories namely:

1. Share capital
2. Fixed income securities
3. Warrants

(1) Share Capital

- Public issue - the most common method of sale of new shares to public. The merchant bankers and one of the two issuing houses either MIDF Consultancy and Corporate Services Sdn Bhd or Malaysia Issuing House Bhd will underwrite. Supply and demand of shares determine the need for balloting process at the issuing house.

[2] "Securities Regulation in Malaysia ", Low Chee Keong, Malayan Law Journal(1997)

- Offer for sale - It involves sale of a block of shares belong to the existing shareholders to public, with the offer price, underwriting and balloting process similar to public issue.
- Special issue - National Development Policy that set minimum 35% Bumiputera equity participation promotes the listed company. Company gives special issue at lower than market price. Securities Commission determines the price while MITI determines the share allotment.
- Bonus issue - also known as scrip issue or capitalisation issue which only involves adjustment company account without any capital raised. Reserves may increased due to higher value of fixed asset revaluation or retain earnings. The reserves may be converted to issued capital through bonus issue such as 1 for 4 bonus issue where shareholders receive one new share free for every 4 existing shares they own, but the value of the share will eventually drop by 20% of its original value.
- Rights issue - new shares issued at the discount to market price to current shareholders. It is to avoid new issue to public as it may affect current shareholders. Moreover, shareholders may dispose their rights to another person.
- Private placement - shares are offered to predetermined buyer of large investing institutions without the stockbroker intermediary. It is the means of going public or to raise additional capital in the case of a listed company.
- Restricted issue - only the shareholders or directors and others within the group received the shares.
- Issue of shares for acquisitions, takeovers, mergers - exchange for assets of another company through issuing shares. It is faster and more economical than issuing new

capital for cash that is later for operation extension. However, the current shareholders holdings will be diluted.

- Issue of shares arising from conversion - company determine the date and rate stated in trust deed of conversion of other classes of shares o holders of loan capital into ordinary shares.
- Issue of shares arising from Employee Share Option Scheme (ESOS) - benefits the employee with option in a specify period to take up the shares.

(2) Fixed income securities enable creditors or the holders the right on the interest and loan repayment under the terms of securities issued. A debenture is a long-term loan secured against the company asset. While debenture stocks are issues at fixed interest stock Both rights are specified under the trust deed. Loan stocks have higher return as increase in interest payable parallel with its higher risk of unsecured.

(3) Warrants are mainly the transferable subscription rights (TSRs) and call warrants. The TSRs is when the company issue the warrants whereby within specify period and price holders of the right of no obligation, to buy a fixed number of shares. It expired within 5 years while it attached to the loan stock issued. Call warrants is similar to TSRs but the warrants are now issued by third parties based on the existing shares. It has no more than 2 years maturity date and subjects to SC guideline for the issue of call warrants.

1.2 Authority in New Listings

The main rules and regulations governing the listing of new issues in Kuala Lumpur Stock Exchange (KLSE) are (1) Companies Act, 1965 (2) Securities Industries Act, 1983 (3) Capital Issues Committee (CIC) guidelines, currently the Malaysian Securities Commission (MSC) guidelines and (4) the KLSE Listing Requirements. In the Companies Act, 1965, when company seeks to list has more than 50 shareholders it must be converted to public limited. The Act also encounters conditions pertaining to the issue of prospectus. The Securities Act, 1973 implemented was to prevent unfair trading practices such s insider trading, speculation, market manipulation and share rigging. In addition, the Act regulates the licensing of share dealers, basically the stockbroking firms and investment bankers and their underwriting commitments. The Security Industry Act, 1983 replaced the 1973 Act with the intention to have tighter control to prevent fraudulent trading and market rigging transactions.

On 1st January 1996, the MSC guidelines replaced the CIC guidelines. Among the recent guidelines for company seek listing with placing of shares to public are on

- Public issue where new shares are offered to public through prospectus invitation.
- Offer for sale where the existing shareholders are offering to sell part of equity to public, resulting in no change of total units of issued and paid-up capital of company.
- Private placement where institutions investors such as pension funds, insurance companies and investment trusts are allocated shares by investment banker (this method is not popular in Malaysia).

- Introduction where shares are not offered or placed to public. The company eligible for introduction when its shareholding spread requirements and compliance of National Development Policy of 30% bumiputera equity participation. The shareholding spreading is to promote liquidity with the adequate free float of shares in the open market.

- The most significant areas in the MSC recent guidelines is the disclosure-based system. Table 1 shows the MSC's Plan for moving towards the disclosure-based system. Based on the disclosure-based system, the issuer and investment banker solely determined the offer price of a listing application. Thus, the implementation of the programme involves the revision of relevant laws to various parties such as mentioned in Table 1. Company financial track record, its position in the industry and prospects shall determine the price. The new rules was hoped to be market driven and create higher standard of accountability. On 21 June 1996, New Straits Times published that MSC indicated the following

" investors should be mindful that the premium on listing for these offers would be necessarily lower than those under the old formula. In addition, there could never be any guarantee that the after-market performance of these securities will always be better than the prices offered at the IPO stage, it said....to clarify recent press comments on the pricing of shares under an IPO exercise"

Table 1

MSC's Plan for moving towards the Disclosure-Based System[3]

" This involves moving away from the current system in which the commission determines the viability of a proposal to one where the investor makes the decision based on available material information. The main objectives of the programme are to:

1. Facilitate a shift to market-based pricing on primary offerings of securities
2. Remove any barriers to the competitiveness of Malaysian corporations inherent in the present system
3. Inculcate higher standards of disclosure and accountability to investors by corporations

Implementation of this programme involves:

(i) a revision of relevant laws to
 -impose an obligation on offerors of securities to provide full, accurate and non-misleading information to investors
 -make intermediaries responsible for their recommendations
 -make advisers responsible to investors for information on corporations
 -confer rights of recourse to investors who have suffered loss as a result of misleading or deceptive information

(ii) developing appropriate criteria for the type of information to be released and the method of disclosure

(iii) Instilling awareness among all participants in the primary and secondary Markets of their respective roles and responsibilities under the new regulatory system. "

[3] Source: Malaysian Securities commission's Business Plan 1995-1997 Booklet (p 10).

The KLSE listing requirements are on the qualifying for company seeks listing. Among the recent listing requirements are as follows

Table 2

Listing Requirement[4]

Main Board	**Option 1**	**Option 2**
Profit record	3 years	5 years
Aggregate after-tax profit	RM 30 m	RM 30 m
Minimum after-tax profit per year	-	-
Minimum after-tax profit for most recent year	RM 8 m	RM 8 m
Second Board	**Option 1**	**Option 2**
Profit record	3 years	5 years
Aggregate after-tax profit	RM 12 m	RM 12 m
Minimum after-tax profit per year	-	-
Minimum after-tax profit for most recent year	RM 4 m	RM 4m

1.3 Advantages and Disadvantages of going public

1.3.1 Advantages

Distinct advantages when companies seek listing in public exchanges. Issuing or floating securities to raise capital enables the company to refinance expansion and to obtain wider pool of funds at a lower cost. The fund generated will be an introductory to longer term push for expansion before issuance of rights and debts. Also, it allows the acquisition of

[4] Source: KLSE Homepage as at 22 July 1999.

assets through the exchanges of shares that will minimize the outflow of cash from the company and enhanced the corporate profile. The quality of its management and technical expertise is improved with the establishment of employee share ownership schemes.

1.3.2 Disadvantages

The disadvantages are the preparation cost in the initial public offering process, time consuming and expensive as the burden of continuous reporting under the securities law. With the implementation of disclosure-based system, requirement on disclosure of previous proprietary heighten the competition.

1.4 Primary Market and Secondary Market

Primary markets allow corporations, government units and others to raise needed funds for expansion of their capital base. Once the assets or securities are sold in the primary market, they begin trading in the secondary market. Primary markets are distinguished by the flow of funds between the market participants. Instead of trading between investors as in the secondary markets, participants in the primary market buy their assets directly from the source of the asset.

Since corporations and government units do not sell new securities daily, monthly or even annually, they usually rely on the expertise of the investment banker when selling securities. Therefore, one of the most active participants in the primary market is the investment banker. The investment banker acts as a middleman in the process of raising funds and, in most cases, takes a risk by underwriting an issue of securities. The investment banker may sell the issue on a best-efforts basis or underwriting. In best-efforts basis, the issuing firm assumes the risk and simply takes back any securities not sold after a fixed period. In underwriting, it refers to the guarantee of the investment banking firm gives the selling firm to purchase its securities at a fixed price thereby eliminating the risk of not selling the whole issue of securities and having less cash than desired.

1.5 Definitions of Initial Public Offer

Malaysian laws define sale of expanded authorised shares of a company as new issues. In Malaysia, there are two types of primary market issues of common stock which are unseasoned and seasoned offerings. Initial public offer or IPO can be consider as new issue of shares, which is the sale of ordinary shares to the public out of previously closely-held authorised shares of a firm. IPOs are also known as unseasoned offerings. Companies offer seasoned new issues which are companies already floated shares or equity in the capital market. In the stock exchange, listed firms also raised about 5-10% of funds through private placements of shares. They are permitted in limited cases and these are not IPOs.

1.6 Listing Procedures for Initial Public Offering

New issues are subjected to public scrutiny by the investment bankers, that is, any one of the merchant bankers in Malaysia, the Securities Commission (Capital Issues Committee &the Foreign Issues Committee prior to March 1993), the Registrar of Companies and the Kuala Lumpur Stock Exchange (KLSE). Applications of IPOs in Malaysia must be open to the public. In the event of oversubscription, SC and KLSE regulate the allocation through public lottery. An auditor is appointed to oversee share allocation. Rules forbid self-listing in the Malaysian primary market. Regulators approve the sale of new shares of any kind with elaborate care. Consequently, in large placement, the approval process may take up to a year. In Malaysia, as an emerging market, the average time for approval is estimated at about 4-6 months.

To get listed, firstly, company will submit the application to the SC as Section 32 of Securities Commission Act 1993 mandates that all proposals for the listing of securities on the KLSE must be approved by SC. Later, the company will get KLSE approval through the submission of the Memorandum of Association and Articles of Association. As an addition and complement to common law and statutory obligations of publicly listed company, KLSE Listing Requirements require the company to submit the Initial Listing Application and supporting documents which depend on types of securities, listing on Main or Second Board of the KLSE. SC and KLSE shall approve the listing. Company is obliged to continue supplement the disclosure requirements of Company Act 1965 whereby if not comply, company may liable to removal from official list. A final copy of prospectus is filed with Registrar of Company and KLSE, followed by advertising and issuing prospectus[5] to the public. Issuing houses that are MIDF Consultancy and Corporate Services Sdn Bhd and Malaysia Issuing House Sdn Bhd will do the allotment and balloting in the event of oversubscription. After allotment, shares are issued and admitted to KLSE Official List. After three days upon Central Depository confirmation on securities accounts of successful applicants have been duly credited, shares are traded on KLSE.

1.6.1 Floatation Team

- Merchant bankers - the key role in listing process. It prepares the feasibility of floatation, advise on size and issue price, method and timing of floatation all of which adhere to regulatory requirements. Underwriting is an onerous duty when SC only entertain the merchant bank applications.
- Auditor or reporting accountant - provide an independent business review and confidential report to be referred by merchant banker on the suitability of listing. Based on professional duty, it is to provide the profit and cashflow forecasts in submissions to get SC approval.
- Tax advisors - often also the auditor who is to maximize the shareholders wealth when they keep the tax bill down with consideration on income tax implication of company financial results.
- Legal counsel - the principal functions include preparing the legal document prior to listing transaction. Among which are the sales & purchase agreement, underwriting

[5] The prospectus information is in the appendix.