MARKET MICRO-STRUCTURE STUDY FOR THE EXCESSIVE UNDERPRICING IN THE MALAYSIAN NEW ISSUES MARKET

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Introduction

Initial Public Offers or more commonly known as IPOs are unseasoned common stocks offered to investing public for subscription. In Malaysia it is a common method for a company to seek listing on the Kuala Lumpur Stock Exchange to generate new funds through sale of new shares for purpose of business expansion or debt retirement program. While there are abundant empirical evidence evaluating the performances of Malaysians IPOs, this study takes a slightly different approach by (i) examining the performances of Main vs Second Boards IPOs as well as Private vs Government-linked IPOs and (ii) covering longer study horizons in order to achieve the following objectives: (a) to measure short and long term levels of underpricing between main and second boards and extending the analysis by investigating the level of underpricing between private versus government-linked IPOs. (b) evaluating signalling characteristics of Malaysian IPOs and (c) investigating auditor firms reputation hypothesis in relation to level of underpricing.

Materials and Methods

Data and other relevant materials were sourced from the Kuala Lumpur Stock Exchange regular publications such as Daily Dairy, Investors Digest and Annual Company Handbook. For each new issue, information on the offer and closing prices of daily, weekly and monthly intervals of trading were extracted. Both market adjusted and risk adjusted returns were consistently used to evaluate the short and long term performances of Malaysian IPOs. Subsequently the Hwang Ginbatt signalling model were operationalised to suit the Malaysian context in order to assess whether IPOs are used as a signal of quality of superior prospects of firms in the near future. Grinbatt and Hwang developed a two signals model to explain the information asymmetry between firm which has better knowledge about the true value, and outside investors who are generally uninformed. Following this, the auditor reputation model were subsequently tested to determine the extent to which firms with superior prospects as proposed by Hwang-Grinbatt model are captured/reflected in the proforma financial statement vetted through by auditors.

Results and Discussion

No reasons cited in the literature can fully explain this huge underpricing (160% in 1980's and 110% in 1990's), though the economic policy of equitable distribution of wealth and demand pressure hypothesis seem most plausible reasons for this peculiar phenomenon. The deliberate attempts to underprice is consistent with the government's policy of speeding up the privatisation program and ensuring the success of the program in general and the listing of selected government-based firms in particular. This creates demand pressure effect as unsuccessful investors will resort to the secondary market in the hope of acquiring some shares and earn quick profits. Possible tests carried out in evaluating signalling qualities of new issues to potential investors reveal that of all the suggested determinants, the ex-ante risk factor seems to better explain the level of underpricing. A comparative analysis of government based IPOs (GLIPOs) against private issues indicate that GLIPOs generally generate relatively lower underpricing compared to private issues. A test on the possibility of auditors playing a major role in determining the level of underpricing suggests that Malaysian investors have homogenous expectations with regard to services rendered by auditors irrespective of whether they are from big six (now big five) or non big six category. These findings are inconsistent with those in the developed stock markets where investors have more confidence in large audit firms.

Conclusions

Malaysian IPOs are, average, substantially underpriced compared to underpricing in other emerging and developed markets. Though the level of underpricing has subsided from over 160% in early 1980s to about 110% in 1990's, the underpricing remains sustainable to 70% average even after 36 months of listing. This may lead to the conclusion that KLSE is informationally inefficient in pricing new issues though we strongly feel this inefficiency has to do with the methods of setting the offer price by the regulatory authority.

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