



UNIVERSITI PUTRA MALAYSIA

**THE PERFORMANCE OF MALAYSIAN INITIAL PUBLIC
OFFERINGS DURING THE FINANCIAL CRISIS OF JULY 1997**

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By

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**Thesis Submitted in Fulfillment of the Requirements for the Degree of Master of
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**THE PERFORMANCE OF MALAYSIAN INTIAL PUBLIC OFFERINGS
DURING THE ECONOMIC CRISIS OF JULY 1997**

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May 2000

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This study examines the performance of IPOs in Malaysia during the economic crisis between July 1997 to September 1999. Using the same methodology as previous studies on IPOs, this study investigates the performance of new issues both in the short run and long run based on a sample of 81 newly listed companies on the KLSE.

The overall results provide evidence consistent with previous studies that most IPOs are, generally, underpriced on their first day of trading. This study documented an average first day return of 37.12 %, a value significantly lower than the earlier studies on the KLSE. Comparing Main Board (MB) and Second Board (SB) IPOs performances, the results indicate that firms listed on the SB provide higher returns than firms listed on MB.

This study documented two important findings when a short run performance (from week one to month six) is analysed. Firstly, when investors are fortunate to be



allocated with new issues at the offering price, they are able to gain some positive returns but at a rate lower than that observed during the first day. Secondly, if they purchased the new issues at the aftermarket price, investors will earn negative returns.

In the long run (12 months), IPOs is an unfavourable investment if the shares are bought at the aftermarket price. This result seems to contradict with findings of previous studies in Malaysia. A strategy of investing IPOs at their offering price and held them for one year would left the investor with some positive returns.



Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

**PENILAIAN PENCAPAIAN SAHAM TERBITAN BARU MALAYSIA SEMASA
KRISIS KEWANGAN JULAI 1997**

Oleh

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Penyelidikan ini bertujuan untuk mengkaji pencapaian terbitan saham baru semasa berlakunya krisis ekonomi di Malaysia pada bulan Julai 1997 sehingga bulan September 1999. Analisa pencapaian saham baru adalah berdasarkan sampel sebanyak 81 buah syarikat yang baru disenaraikan di Bursa Saham Kuala Lumpur (BSKL) dengan menggunakan methodologi yang telah digunakan oleh kajian-kajian sebelum ini.

Hasil kajian menunjukkan keputusan yang selari dengan keputusan kajian yang lepas di mana saham terbitan baru telah ditawarkan pada harga yang lebih rendah daripada harga sebenarnya. Kajian ini juga menunjukkan pulangan yang diperolehi secara purata pada hari pertama penyenaraian ialah sebanyak 37.12% iaitu satu nilai yang lebih rendah berbanding dengan pulangan yang diperolehi daripada kajian-kajian sebelumnya di BSKL. Keputusan perbandingan pulangan di antara Papan Utama dan



Papan Kedua menunjukkan bahawa syarikat yang disenaraikan di Papan Kedua meraih keuntungan yang lebih daripada syarikat yang disenaraikan di Papan Utama.

Dua kesimpulan utama telah diperolehi daripada analisis jangkamasa pendek iaitu di antara minggu pertama sehingga bulan keenam. Kesimpulan pertama ialah apabila pelabur membeli saham pada harga terbitan, mereka akan meraih keuntungan tetapi pada kadar yang berkurangan. Kesimpulan yang kedua pula ialah sekiranya para pelabur membeli pada harga selepas saham tersebut disenaraikan, mereka akan memperolehi pulangan yang negatif.

Bagi jangkamasa panjang (12 bulan), saham terbitan baru merupakan pelaburan yang tidak menguntungkan sekiranya saham dibeli pada harga selepas ianya disenaraikan. Didapati bahawa keputusan kajian ini adalah bercanggah dengan kajian yang telah dibuat sebelumnya di Malaysia. Strategi pelaburan saham baru pada harga yang ditawarkan dan menyimpan saham tersebut sehingga setahun akan memberi sedikit keuntungan kepada para pelabur.



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CHAPTER I

INTRODUCTION

1.1 The importance and the development of Capital Market

Over the centuries, capital market plays an important role for the economic development of a country. This is because capital market provides unparalleled access to the medium and long-term funds for economic growth.

In order to finance or expand their operations, business firms need extra capital that is beyond their capacity. Similarly, government who wants to meet their budget deficits must borrow large amount of money. There are basically two ways for a company or government can raise capital to finance its business. One way is through debt financing which is borrowing money from financial institutions or issuing bonds. Another way is through equity financing which is selling the company shares.

When a company sells stock, the company is actually selling parts of itself, giving up some of the ownership. However, with debt financing, the company gives up no ownership, but has an obligation to pay back the bank. If they issued bonds, they have an obligation to pay interest on the bonds and eventually the face value of the bonds when the bonds mature. However, equity



is a cheaper way to raise funds compared to debt financing. Both of these financing sources are raised in capital market.

Capital market exists so that both businesses and government can obtain the needed funds by selling securities. In the same time, investors with excess funds can invest in the capital market by buying those securities. This shows that capital market acts as financial intermediaries between those who wants to earn extra returns and willing to take some risk by investing and those who need funds to meet their enterprise requirements.

Capital market are absolutely vital for proper functioning of capital economies as they acts like a role of the commercial banks by channelling funds from savers to borrowers. Furthermore, they play an important role by providing and allocating the funds to those who can use them optimally and indirectly develop the nation's economy.

Funds that are raised in any capital market in the world are in the form of debt and equity. In Malaysia, funds are sources from public and private debts and equities. Bank Negara Malaysia (Money and Banking in Malaysia 1959 – 1989) refers capital market as the 'market in the longer term financial assets, comprising all public and private debt instruments with maturity exceeding one year, corporate stocks and shares for which they are no fixed maturity period and commodity futures'.



Due to growing demand by both public and private sectors, capital market in Malaysia has shown remarkable growth as observed in the amount of funds raised over the decades. In 1970, net funds raised in the market were estimated at RM 405 million. Ten years later, it has increased to RM 2.5 billion and in 1990 the funds has reached to RM 14.7 billion. Until 1989, net funds raised by public sector were larger than that of private sector. Starting 1990, however, the situation was reversed. The funds raised in the private sector far-outpaced funds raised by the public sector. This was in line with the policy adopted since mid-1980s to down size government operations and to accelerate the private sector's role as the main engine growth in the economy.

Table 1 presents the distribution fund raised in capital market during 1996 to 1999. The results indicate that in year 1996, the funds stood at RM 31.8 billion and further increase to RM 33.5 billion in 1997. This is because during period between 1990 to middle 1997, Malaysian economy grew at an average of 8%. This has encouraged rapid developments in shares and other financial markets, which in turn has increased liquidity. Many companies take the opportunity to go for listing in the Kuala Lumpur Stock Exchange (KLSE) during these encouraging periods. Hence, the fast developments especially in shares have permitted capital market to raise more funds for public and private sector investment needs. As shown by Table 1, the biggest contributions in the equity market were from public offerings and rights issue. However, the funds received from equity market especially new issues floated on the KLSE decline significantly to RM 1.8 billion in 1998 and RM 6.1 billion in 1999 due to



the effects of the economic crisis. This indicates to us that new issues depend on the climate of the economy.

Table 1 : Funds Raised in Malaysia Capital Market

| Sector | 1996 | 1997 | 1998 | 1999p |
|------------------------------------------------|------------|------------|------------|------------|
| | RM Million | RM Million | RM Million | RM Million |
| <u>BY PUBLIC SECTOR</u> | | | | |
| <i>Debts Securities</i> | | | | |
| Malaysian Government Securities (MGS) | 6,000.00 | 3,000.00 | 14,950.00 | 10,000.00 |
| Khazanah Bonds (KB) | | 794.40 | 2,731.90 | 2,598.20 |
| Government Investment Issues (GH) | | | | 2,000.00 |
| Malaysian Savings Bonds (MSB) | | | | 377.20 |
| <i>New issues of Debt Securities</i> | 6,000.00 | 3,794.40 | 17,681.90 | 14,975.40 |
| <i>Less : Redemption</i> | | | | |
| MGS | 3,809.00 | 3,648.00 | 6,200.00 | 6,676.00 |
| KB | | | | |
| GH | 900.00 | 1,400.00 | 750.00 | 2,000.00 |
| MSB | 34.00 | 154.80 | 928.20 | 2.10 |
| <i>Less : Government Holdings</i> | (74.10) | (1.20) | | |
| <i>Net Funds Raised by Public Sector</i> | 1,331.10 | (1,407.20) | 9,803.70 | 6,297.30 |
| <u>BY PRIVATE SECTORS</u> | | | | |
| <i>Shares / Warrants</i> | | | | |
| <i>Ordinary shares</i> | | | | |
| Initial Public Offerings | 4,099.20 | 4,781.00 | 684.60 | 999.50 |
| Right Issues | 5,268.50 | 8,524.90 | 722.00 | 4,346.90 |
| Private Placements / Restricted Offer for Sale | 4,554.40 | 3,233.60 | 320.10 | 518.60 |
| Special Issues | 2,002.30 | 1,818.80 | 61.00 | 208.00 |
| <i>Warrants</i> | | | | 13.50 |
| <i>New Issues of Shares / Warrants</i> | 15,924.40 | 18,358.30 | 1,787.70 | 6,086.50 |
| <i>Debt Securities</i> | | | | |
| Straight Bonds | 2,675.40 | 4,209.00 | 10,238.00 | 9,570.00 |
| Bonds with Warrants | 5,563.70 | 2,950.30 | 150.00 | 555.00 |
| Convertible Bonds | 1,794.60 | 2,018.90 | 98.80 | 1,269.20 |
| Islamic Bonds | 2,350.00 | 5,249.70 | 345.00 | 1,734.00 |
| Cagamas Bonds | 4,665.00 | 5,169.00 | 3,320.00 | 4,425.00 |
| <i>New Issues of Debts Securities</i> | 17,048.70 | 19,596.90 | 14,151.80 | 17,553.20 |
| <i>Less : Redemption</i> | | | | |
| Private Debts Securities | 1,765.00 | 1,368.50 | 2,964.40 | 6,279.50 |
| Cagamas Bonds | 750.00 | 1,640.00 | 5,012.00 | 6,470.00 |
| <i>Net Issues of Debts Securities</i> | 14,533.70 | 16,588.40 | 6,175.40 | 4,803.70 |
| <i>New Funds Raised by Private Sectors</i> | 30,458.10 | 34,946.70 | 7,963.10 | 10,890.20 |
| <i>Net Funds Raised in the Capital Market</i> | 31,789.20 | 33,539.50 | 17,766.80 | 17,187.50 |

p = Preliminary Data

Sources: Bank Negara Malaysia , <http://bnm.gov.my/>



1.2 Methods of New Issues

New issues are the sale of company shares or equity to the investors. New issues market consists of offer of shares to the public from private firms and government-linked privatised companies floated in the KLSE. Basically, there are several types of new issues in Malaysia as stated below.

1) Public Issue

This is the most common method of issuing new shares. The Company will create new issues for sale to the public. To be listed on the Exchange, the company must first obtain approval from the Securities Commission (SC). The issue must be underwritten, normally by merchant bankers and one of the two issuing houses.

2) Offer for Sale

This is another way of getting the company listed where a block of shares belonging to the existing shareholders is offered for sale to the public. Similarly, the listing need to be approved by the SC and must be underwritten.

3) Private Placements

The selling of shares by a company to a predetermined buyer, often without the intermediary of a stockbroker. Shares are not generally offered to the public but are placed to a group of large investing institutions. Essentially, it allows the directors of a company to influence the selection of its shareholders. In Malaysia, they account to only 5-10 percent of funds raised in the stock market and permitted in limited cases only.



4) Special Issue

Only Bumiputra institutions and individuals are eligible for this issue. A listed company would give a special issue of shares, at a price lower than the market price to Bumiputra. The SC sanctions the price of share while the allotment of these shares decided by Ministry of International Trade and Industry (MITI)

5) Restriction Issue

Shares given to shareholders/directors etc within the groups

6) Right Issue

This issue of new shares to existing shareholding for cash, issued at discount to the market price of existing shares. The issue is made to the existing shareholders in proportion to their holdings of old shares as against to the public at large as the latter would affect existing equity holders. Shareholder may either take up the new shares offered or dispose of the right to apply to another person.

7) Bonus Issue

Also referred to as scrip issue or capitalisation issue, because bonus issue only represents an adjustment to the accounts of a company as no additional capital is raised in the exercise.

8) Issue of Share arising from the Conversion

This is an additional issue of shares to holders of another classes of shares or holders of loan capital with conversion rights into ordinary share. The date and rate of conversion into ordinary shares are determined by the company and stated in the trust deed.



9) Issue of Shares arising from Employee Share Option Scheme (ESOS)

Some companies have share option schemes for their employees, which give the employee the option to take up a certain number of shares in the company within a specified period.

10) Issue of Shares for Merger, Take-overs and Acquisitions

When a company, say ABC acquires assets from another company, say XYZ, company ABC will often issue new share in exchange for the asset or the share capital of company XYZ. In these cases, a cash element may or may not be involved. The SC must first approve the value of share as well as the exchange ratio.

(Sources: Investors Digest, Mid-April, 1999, pp: 23-24)

Note:

For the purpose of this study however, only new issues arising from method 1 and 2 are included. Reasons being most listed companies float their shares via the first two methods.

1.3 Initial public offerings (IPOs)

One of the most attractive and puzzling areas of research in finance is initial public offering (IPOs). For decades, researchers are puzzled by the empirical results associated with IPOs. Ever since Ibbotson (1975) documented that the large short run returns of new issues, a number of research has been carried out in the United States and other parts of the world to investigate the phenomenon.



Almost all the empirical studies indicate that IPOs generate large positive abnormal initial return, in other words new issues appear to be underpriced. Loughran, Ritter and Rydqvist (1994) documented that underpricing generally occurs in virtually all the IPO markets around the world. While the initial underpricing of new issues is confirmed internationally, the international evidence of long run returns is not conclusive. Recent studies in the U.S. by Aggarwal and Rivoli (1990) and Ritter (1991) suggest that the existence of underpricing in the short run may be overpricing in the long run. Ritter (1991) shows that new issues in US significantly underperform in the three years subsequent to listing. In contrast, studies in Singapore markets suggest that there is persistence initial underpricing in the long run. In Malaysia, almost all of the studies agreed that new issues were underpriced both in short and long run. However, the percentage of underpricing in the long run reduced over time consistent with the fad hypothesis proposed by Aggarwal and Rivoli (1990).

1.4 The Objective of IPOs

There are a number of reasons why the companies seek to take initial public offerings as stated in their prospectuses. However, the main purposes are summarised as

- i) To raise funds for business operations and expansions
- ii) To obtain listing and quotation on the KLSE
- iii) To give the opportunity for general public, employee and directors to participate in the company growth



- iv) To comply with the National Development Policy (NDP) by providing an opportunity for Bumiputra investors and institutions approved by MITI to participate in the equity of the company

1.5 Pricing of IPOs

Basically, new shares will either be offered to the public by tender offer or at fixed prices. Tender offer is where no issue price is set in advance. The price of share is determined through the market forces between demand and supply and also the psychological pressure the issuers and their agents can exert.

In contrast, a fixed price is where the price of the issue is set in advance usually as stated in the prospectus. The price is based on the evaluation by the issuers, its advisors and the underwriter. The price is estimated based on several factors. In Malaysia, this method is commonly used to price an IPO.

To determine the issue price, the seller and its agent must evaluate from both quantitative and qualitative aspects. The first part in estimation of the pricing of securities to be issued or offered for sale, is comparing the company with others companies in the same industries. This is to weigh the company's financial position and projection against comparable companies within similar industries.

