



UNIVERSITI PUTRA MALAYSIA

**THE IMPACT OF TYPES OF ISSUES,
SECTORS, LIFESPAN AND DIFFERENT ECONOMIC
PERIODS ON THE SHORT -RUN AND LONG-
RUN PERFORMANCE OF IPOs**

AFIRUDDIN BIN TAPA

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By

AFIRUDDIN BIN TAPA

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in Partial Fulfillment of the Requirements for the Degree of Master of Science

November 2003



To my wife, Nor Azita and daughter, Nur Anis Aishah for their patience, tolerance
and support.



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in partial fulfillment of the requirements for the degree of Master of Science

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This study examines the performance of initial public offerings (IPOs) of 157 KLSE Main Board Companies for the period 1990 to 1999. The performance of the IPOs is analysed based on sample classification of types of issues, sectors in the Kuala Lumpur Stock Exchange (KLSE), the lifespan of a company and different economic conditions. Both the short-run and long-run performances were analysed.

This study documents an average first day initial return of 88.11%. This is consistent with previous studies which reported that most IPOs are generally underpriced on their first day of trading. Furthermore, the evidence shows that the average abnormal returns in the long-run are smaller than those in the short-run.

There is substantial variation in the performance of IPOs across sectors in the Main Board of the KLSE. The Property, Industrial Product and Construction sectors reported the highest initial returns (above 100%).



The finding shows a significant difference in the mean initial returns under different economic conditions. In the hot market, Malaysian IPOs recorded a higher return (127.96%) than in the cold market (27.04%).

With respect to lifespan, the number of years existing does not affect the level of initial return of the IPOs. There is no significant difference in initial returns among three types of issues namely public issues, offer for sale and hybrid of public issues and offer for sale. This finding is inconsistent with the documented evidence in the developed markets.

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

PENCAPAIAN TERBITAN SAHAM BARU: BERDASARKAN KAEDAH TAWARAN, SEKTOR, JANGKA HAYAT SYARIKAT DAN KEADAAN EKONOMI YANG BERBEZA DI DALAM JANGKA PENDEK DAN JANGKA PANJANG.

Oleh

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Penyelidikan ini bertujuan untuk mengkaji pencapaian terbitan saham baru berdasarkan sampel sebanyak 157 buah syarikat yang disenaraikan di Papan Utama Bursa Saham Kuala Lumpur (BSKL) dari tahun 1990 hingga 1999. Pencapaian terbitan saham baru telah diklasifikasikan berdasarkan kaedah tawaran terbitan saham baru, sektor di BSKL, tempoh jangka hayat syarikat sebelum disenaraikan di bursa saham dan keadaan ekonomi yang berbeza. Pencapaian jangka pendek dan jangka panjang terbitan saham baru juga dikaji dalam kajian ini.

Hasil kajian menunjukkan pulangan purata yang diperolehi pada hari pertama penyenaian ialah sebanyak 88.11%. Ini menunjukkan keputusan yang selari dengan keputusan kajian yang lepas di mana saham terbitan baru telah ditawarkan pada harga yang lebih rendah berbanding harga sebenarnya. Kajian ini juga menunjukkan pulangan jangka panjang terbitan saham baru adalah lebih rendah jika dibandingkan dengan pulangan jangka pendek.



Variasi pencapaian terbitan saham baru wujud di antara sektor-sektor di Papan Utama Bursa Saham Kuala Lumpur. Sektor Hartanah, Barangan Industri dan Pembinaan merupakan sektor yang memberi pulangan yang tertinggi (melebihi 100%).

Hasil kajian menunjukkan terdapat perbezaan terhadap pulangan purata pada hari pertama penyenaian berdasarkan keadaan ekonomi yang berbeza. Dalam keadaan ekonomi yang menaik, terbitan saham baru Malaysia merekodkan pulangan yang lebih tinggi (127.96%) berbanding dalam keadaan ekonomi yang menurun (27.04%).

Berdasarkan jangka hayat sesebuah syarikat sebelum disenaraikan di bursa saham, kajian ini mendapati tempoh masa penubuhan sesebuah syarikat tidak mempengaruhi jumlah pulangan pada hari pertama penyenaian terbitan saham baru. Kajian ini juga mendapati tiada sebarang perbezaan terhadap pulangan yang diperolehi secara purata pada hari pertama penyenaian berdasarkan tiga kaedah tawaran semasa penyenaian iaitu saham biasa, tawaran untuk jualan dan gabungan saham (saham biasa dan tawaran untuk jualan). Hasil kajian ini berbeza dengan keputusan kajian bagi pasaran yang sudah membangun.

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Glossary of Terms

IPOs	-	Initial Public Offerings
KLSE	-	Kuala Lumpur Stock Exchange
SC	-	Securities Commission
MITI	-	Ministry of International Trade and Industry
MAIR	-	Market Adjusted Initial Return
CI	-	Composite Index



Chapter 1

Introduction

1.1 Background of the Study

The performance of Initial Public Offerings (IPOs) has been a long standing issue among academicians, practitioners and researchers due to its strategic impact on investment decision. Extensive literature has been documented to understand the price behaviour of these offerings both in developed and developing markets. Generally, the findings of previous literature showed that IPOs recorded substantial gains on the first day of trading and provided excess return to the investors who initially subscribed the offers and then sold them immediately in the market.

Underpricing for new issues is a well-known phenomenon both in the developed and the developing markets such as Malaysia. This study aims at examining the primary market price performance of the underpricing of new issues or Initial Public Offerings (IPOs) in the Main Board of Kuala Lumpur Stock Exchange, during the period of 1990 to 1999. It focuses on four main areas of interest. Firstly, it studies into the performance of IPOs based on three types of issues: Public Issues, Offer for Sale and Hybrid of Public Issues and Offer for Sale. Secondly, focuses on the performance of IPOs based on the sectors in the KLSE namely, Finance, Consumer Products, Construction, Property, Trading and Services, Plantation, Technology and Industrial Product. Thirdly, it examines the

performance of IPOs based on their lifespan for a particular company before they are listed to ascertain whether their lifespan has any impact on the initial return of IPOs. Finally, the study examines the performance of IPOs under two different economic conditions namely hot and cold markets.

Numerous studies on similar issue have concluded that there are several explanations for the underpricing of IPOs. According to Rock (1986) and Beatty and Ritter (1986) underpricing of IPOs is the result of a winner's curse to uninformed investors caused by asymmetric information between the informed and the uninformed investors¹. The informed investors are assumed to have access to private information about the true value of new issues. Therefore, they will only subscribe to a new issue if the after-market price is expected to exceed the offer price. The uninformed investors on the other hand are assumed to subscribe to all new issues indiscriminately, and they will end up purchasing the overpriced or underpriced IPOs. Naturally, in order to avoid the uncertainty in the new issues the uninformed investors tend to stay out of the new issues market. However, in order to ensure that the offering is fully subscribed, the new issue has to be underpriced to entice the uninformed investors into the market.

Nevertheless, Allen and Faulhaber (1989) argued that asymmetric information causes quality firms to signal their quality by underpricing. In doing so, they expect to raise capital under better terms in the future. Further explanation was offered by Tinic (1988), who argued that underpricing occurs because the issuing

¹ Informed investors consist of investment bankers and the issuing companies, while uninformed investors are generally the individual investors subscribing to the IPOs.

firms want to avoid lawsuits by unhappy investors who are less likely to file lawsuits when new issues are underpriced.

1.2 The Needs and Importance of IPOs

In order to raise funds for business operations or expansions, companies have several mechanisms such as loans, retained earnings and new issues to choose from. Some companies prefer to raise funds by offering new issues in the stock exchange. Among the commonly cited reasons why companies seek listing on the stock exchange are as follows: (i) to raise funds for business operations and expansions, (ii) to obtain listing and quotation on the KLSE, (iii) to give an opportunity for the general public, employees and directors to participate in company's growth and (iv) to comply with the National Development Policy (NDP) by providing an opportunity for Bumiputra investors and institutions approved by Ministry of International Trade and Industry (MITI) to participate in the equity of the company

1.3 The IPO Process in Malaysia

The process of initial public offering is generally the same in any primary market. In Malaysia, any public company, fulfilling the requirements may apply for listing by (i) Public Issue of new shares, (ii) Offer for Sale of existing shares, (iii) Placements, and (iv) Tenders. However, most IPOs involve only public issues and offer for sale. Among the important pre-listing requirements are minimum paid-up capital of RM 60 million (RM 40 million for Second Board), aggregate profit of RM 25 million in the last 3 to 5 years, good financial liquidity, and settlement of all debts owing to the directors. Once a company fulfills the basic requirements, a merchant bank (or a syndicate of merchant banks) will be appointed as the issue's adviser-cum-underwriter. The adviser-cum-underwriter exercises due-diligence analysis of the issues, forecasts the company's profitability, prepares the proposal, and lodges application for listing (with all the facts and figures) with the Securities Commission (SC).²

After taking into consideration the management team; product lines; conflict of interest between directors, underwriters, and other shareholders; business risks and overall contribution to national economic growth, the Securities Commissions determines the suitability of listing based on the facts and figures provided in the application. Once the Securities Commissions is satisfied with the requirements, an offer price is determined and official approval is given to the company for the floatation of the shares.

² Applications may also need to be submitted to the Ministry of International Trade and Industry (MITI) and Foreign Investment Committee (FIC) to obtain official clearance in specific cases.

After obtaining approval for the IPOs the underwriter/issuer makes a press announcement, indicating the approved offer price, and takes the necessary action to float the company shares. The underwriter/issuer also prepares the final prospectus for submission to the Securities Commissions and KLSE, and concentrates on other conditions, subject to the requirements by the Securities Commissions. Public investors are normally invited to apply for new shares a few months before listing. The investors lodge their applications along with full payment. Generally, during good market conditions large over-subscription is common and balloting takes place on the basis agreed by the underwriter, issuer, and the Securities Commissions. The successful applicants are allotted³ shares on or before the listing day, while refund cheques are sent to the unsuccessful and partially successful applicants, usually one week before the listing.

³ Under the Malaysian law, at least 30 percent of the total issuing shares must be set aside for Bumiputera investors (Malay and indigenous people), the first ballot is conducted for this 30 percent of shares. The unsuccessful Bumiputera applications are included in the second balloting for the remaining 70 percent of shares, which are balloted among all the Malaysian citizens including Bumiputeras.



1.4 Methods of New Issues

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

1) Public Issues

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

2) Offer for Sale

Offer for Sale is an invitation to the public to buy the shares of new issue from the issuing house to whom the issues has been sold outright by the company concerned. The document whereby the invitation is made is deemed to be a prospectus issued by the company and is subject to all the requirements of the Companies Act. The issuing house, which is sponsoring the offer, may be remunerated, wholly or in part, by the difference between the price, which the company and/ or the vendors receive, and the price at which the shares are offered to the public. In other words, Offer for Sale can be considered as a block of shares belonging to the existing shareholders that is offered for sale to the public.

3) Hybrid of Public Issues and Offer for Sale.

This type of issue is a combination of Public Issue and Offer for Sale. The company uses both types of issues in order to be listed in the stock exchange. Funds raised from Public Issues normally goes to the company and funds raised from Offer for Sale goes to the existing shareholders.

4) Private Placements

This is the selling of shares by a company to a predetermined buyer, often without any intermediary of a stockbroker. Shares are not generally offered to the public but are placed to a group of large institutional investors. 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 are only permitted in limited cases.

5) Special Issues

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

For the purpose of this study, only performance of new issues arising from method 1 (Public Issues), 2 (Offer for Sale) and 3 (Hybrid of Public Issues and

Offer for Sale) will be analysed because most of the companies in the KLSE float their shares via these three methods.

1.5 Listing Requirements

New issues can be listed either on the Main Board or the Second Board based on the listing requirements. Generally the companies must have a good track record and healthy financial conditions. The Second Board companies are relatively smaller than the Main Board companies. Table 1.0 illustrates the main differences of listing requirements between the Main Board and the Second Board companies.

Table 1.0 KLSE Listing Requirements

Requirements	Main Board		Second Board	
Minimum paid-up capital	60 million		40 million	
Profit track record of 3 or 5 financial years	An aggregate after-tax profit of not less than RM 30 million, the minimum after-tax profit for the most recent year should be RM8 million.		An aggregate after-tax profit of not less than RM 12 million, the minimum after-tax profit for the most recent year should be RM4 million.	
Profit Track Record	Option 1	Option 2	Option 1	Option 2
Profit record	3 years	5 years	3 years	5 years
Aggregate after-tax profit	RM 30 mil	RM30 mil	RM12 mil	RM 12 mil
Min after-tax profit for the most recent years	RM8 mil	RM8 mil	RM4 mil	RM4 mil
Prospectus	Must advertise the full prospectus		Advertise only a summary of the prospectus	

Source: KLSE Information Book