

IPO UNDERPRICING: EVIDENCE FROM MALAYSIA

BY

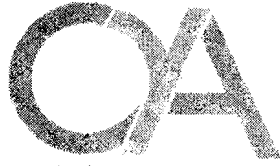
KANNAN SHANMUGAM

Thesis Submitted to the Othman Yeop Abdullah Graduate School of Business,

Universiti Utara Malaysia,

In Fulfillment of the Requirement for the Degree of Master of Science

June 2011



OTHMAN YEOP ABDULLAH
GRADUATE SCHOOL OF BUSINESS
UNIVERSITI UTARA MALAYSIA

Cultivating Perspectives. Building the future. Sharing Solutions

PERAKUAN KERJA KERTAS PROJEK
(*Certification of Project Paper*)

Saya, mengaku bertandatangan, memperakukan bahawa
(*I, the undersigned, certified that*)

KANNAN A/L SHANMUGAM (804262)

Calon untuk Ijazah Sarjana

(*Candidate for the degree of*) **MASTER OF SCIENCE (FINANCE)**

telah mengemukakan kertas projek yang bertajuk

(*has presented his/her project paper of the following title*)

IPO UNDERPRICING: EVIDENCE FROM MALAYSIA

Seperti yang tercatat di muka surat tajuk dan kulit kertas projek
(*as it appears on the title page and front cover of the project paper*)

Bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan dan meliputi bidang ilmu dengan memuaskan.

(*that the project paper acceptable in the form and content and that a satisfactory knowledge of the field is covered by the project paper*).

Nama Penyelia : **ASSOC. PROF. DR. ANGAPPAN S/O REGUPATHI**
(*Name of Supervisor*)

Tandatangan :
(*Signature*)

Tarikh : **13 JUNE 2011**
(*Date*)

PERMISSION TO USE

In presenting this project paper in partial fulfillment of the requirements for a postgraduate degree from Universiti Utara Malaysia, I agree that University Library may make it freely available for inspection. I further agree that permission for copying of this project paper in any manner, in whole or part for scholarly purpose may be granted by my supervisor or in their absence, by the Dean of Graduate School of Business. It is understand that any copying of publication or use of this thesis or parts thereof for financial gain shall not be allowed without my written permission. It is also understand that due recognition shall be given to me and to Universiti Utara Malaysia for any scholarly use which may be made of any material from my project paper.

Request for permission to copy or to make other use of materials in this project paper, in whole or in part should be addressed to:

DEAN

Research and Innovation

Graduate School of Business

Universiti Utara Malaysia

06010 Sintok

Kedah Darul Aman


DECLARATION

I hereby declare that all information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all material and results that are not original to this work.

The author is responsible for the accuracy of all opinion, technical comment, factual report, data figures, illustrations, and photograph in this dissertation. The author full responsibility for the checking whether material submitted is subject to copyright or ownership right. University Utara Malaysia (UUM) does not accept any liability for the accuracy of such comment, report and other technical and factual information and copyright claims.

The author declares that this dissertation is original and his own except those literatures, quotations, explanations and summarizations, which are duly identified and recognized. The author hereby granted the copyright of this dissertation to Graduate School of Business, Universiti Utara Malaysia (UUM) for publishing if necessary.

KANNAN SHAMUGAM

Student Signature: 

804262

Date : 15/6/2024

Othman Yeop Abdullah
Graduate School of Business
Universiti Utara Malaysia
06010 Sintok , Kedah Darul Aman.

HARGA SAHAM MURAH DALAM PENYENERAIAN BARU: BUKTI DARIPADA MALAYSIA

ABSTRAK

Harga saham murah dalam penyenaian baru telah didokumenkan sebagai fenomena anomali oleh pelbagai kajian empirik. Tujuan utama kajian ini adalah untuk mengkaji soalan kajian sama ada beberapa proksi di bawah teori maklumat asimetris khususnya model Sumpahan Pemenang “Winner’s Curse” dan model Isyarat “Signaling” mempengaruhi harga saham murah di pasaran Malaysia. Kajian ini telah menggunakan sampel sebanyak 125 saham penyenaian baru dalam tempoh dari 2005 hingga 2009. Hasil kajiannya menunjukkan bahawa hasil kasar, institusi penanggung kewangan, pegangan dalaman dan modal pasaran didapati signifikan dalam menjelaskan tahap harga saham murah dalam penyenaian baru. Tetapi sebaliknya, keputusan menunjukkan bahawa usia syarikat dan tempoh di antara tarikh prospektus dan tarikh pendaftaran tidak menjelaskan pengaruh ke atas harga saham murah di Malaysia bagi tempoh kajiannya.

IPO UNDERPRICING: EVIDENCE FROM MALAYSIA

ABSTRACT

The underpricing of initial public offerings (IPOs) are anomalies well documented by numerous empirical studies. The aim of this thesis is to examine whether or not a variety of different proxies employed under the asymmetric information theory particularly the Winner's Curse and Signaling models influence underpricing in the Malaysian market. The study used a sample of 125 the Malaysian IPOs in the period between 2005 to 2009. The result shows that gross proceeds, underwriter, insider retention and market capitalization are significant in explaining the degree of underpricing in IPOs. However on other hand, the findings show that age of company and the gap between prospectus and listing dates could not explain the extent of underpricing in Malaysia for the studied period.

ACKNOWLEDGEMENTS

I would like to express my sincere gratitude to all those who have rendered their assistance and encouragement to me in my endeavour to finish this thesis.

First of all, I would like to take this opportunity to wish my sincere thanks to my supervisor Associate Professor Dr. Angappan Regupathi for his continuous valuable guidance, assistance and morale support throughout the thesis. My thanks are also due to Dr. Kamarun Nisham Taufi Mohd for his constructive comments which have improved my thesis.

Many thanks as well to my wife, Suja Sukumaran for her assistance in data collection and always being there for me when I needed her. Finally, I would like to express my special thanks to my parents Mr. Shanmugam and Mdm. Nirmala who have always given me their love, prayer support, continues encouragement and financial support in the entire course of my study.

3.6.1	Sampling	42-44
3.6.2	Data Collection Procedures	44
3.7	Validity and Reliability of Data Analysis	45

CHAPTER FOUR

4.1	Result and Discussion	46
4.2	Descriptive Statistics	46-50
4.3	Pearson's Correlation Matrix	50-52
4.4	Multiple Linear Regression Analysis	52
4.4.1	Model 1: Regression analysis of Underpricing and All Independent Variables	53-54
4.4.2	Model 2: Regression analysis of Underpricing and All Independent Variables Excluding LNMCAP	54-55
4.4.3	Model 3: Regression analysis of Underpricing and All Independent Variables Excluding LNGP	55-56
4.5	Hypotheses Testing	56
4.5.1	Gross Proceeds (LNGP)	57
4.5.2	Underwriter (UW)	58
4.5.3	Age of Company (LNAGE)	59
4.5.4	Gap between Prospectus and Listing Dates (RCPGAP)	60
4.5.5	Insider Retention (RETNT)	61
4.5.6	Market Capitalization (LNMCAP)	62

CHAPTER FIVE

5.1	Summary and Conclusion	63- 67
5.2	Recommendation	68
5.3	Significance of the study	69
5.4	Limitations of the study	70-71

REFERENCES

xi

APPENDICES

LIST OF TABLES

	Page
Table 2.1: Hypotheses and evidence from the Winner's Curse explanation of underpricing	16-17
Table 3.1: Regression Model Variables	33
Table 3.2: IPO listed companies from 2005 to 2009	42
Table 4.1: Descriptive Statistics 1	47
Table 4.2: Descriptive Statistics 2	49
Table 4.3: Underwriters Frequencies	50
Table 4.4: Correlations matrix	51
Table 4.5: Summary for Regression Model 1	53
Table 4.6: ANOVA for Model 1	53
Table 4.7: Coefficients for Model 1 after adjusted for heteroskedasticity	54
Table 4.8: Summary for Regression Model 2	54
Table 4.9: ANOVA for Model 2	54
Table 4.10: Coefficients for Model 2	55
Table 4.11: Summary for Regression Model 3	55
Table 4.12: ANOVA for Model 3	55
Table 4.13: Coefficients for Model 3	56

LIST OF FIGURES

	Page
Figure 3.1: IPOs listed companies according to Industrial Sectors	43
Figure 3.2: IPO listed companies by category for each year from 2005 to 2009	43

CHAPTER ONE

1.1 Background of the Study

Several studies were conducted to explore the phenomenon of IPOs in many major stock exchanges internationally since a few decades ago. Research provides a variety of opinions on and implications of IPO initial return, either overpriced or underpriced, that varies by the market and economic conditions of each country. It may not be surprising to find that IPOs in Malaysia have provided different impacts according to the local economic and market factors at different periods when a few surveys were conducted.

Initial Public Offering is known as IPO which means a company issues shares for the first time on the stock exchange to the public. A unique feature is, when the company does the IPO, the company does not only issue shares on the board of exchange, but also for the first time in its history, the company lists its shares at the bourse (Derrien and Kecskes., 2007).

There are number of factors which have prompted the companies list at the board of the exchange. Firstly, the company can reduce the cost of funding for operations and investment. Furthermore, the exchange bourse creates a special place for investment through IPO to raise capital and to diversify the investment of the existing shareholders of companies in order to increase their capital gains respectively. Indirectly, the situation helps to reduce the company's amount of borrowing from banks (known as a debt), which usually becomes a burden. Next, IPO

The contents of
the thesis is for
internal user
only

REFERENCES

- Aggarwal, Leal and Hernandez (1993). The aftermarket performance of Initial public offerings in Latin America. *Financial Management*, 22, 42-53.
- Ahmad-Zaluki, N.A., Campbell, K., and Goodacre, A. (2009). Earnings management in Malaysian IPOs: the East Asian crisis, ownership control and post-IPO performance. Retrieved 7 February 2011, from <http://ssrn.com/abstract=963085>
- Allen, F. and Faulhaber, G.R. (1989). Signaling by underpricing in the IPO market. *Journal of Financial Economics*, 23, 303-323.
- Balatbat, M. C. A., Taylor, S. L., and Walter, T. S. (2004). Corporate governance, insider ownership and operating performance of Australian initial public offerings. *Journal of Accounting and Finance*, 44, 299-328.
- Baron, D.P. (1982). A model of the demand for investment banking and distribution services for new issues. *Journal of Finance*, 37, 955-976.
- Baron, D.P., and Holmström, B. (1980). The Investment Banking Contract for New Issues under Asymmetric Information: Delegation and the Incentive Problem. *Journal of Finance* 35, 1115-1138.
- Beatty, R.P. and Ritter, J. R. (1986). Investment Banking, Reputation, and the Underpricing of Initial Public Offerings. *Journal of Financial Economics*, 15, 213-232.
- Boudriga, Abdelkader, salma, B., Sarra, Boulila, and Neila. (2009). What determines IPO underpricing ? Evidence from a frontier market. *Munich Personal RePEc Archive*, 1-33. Retrieved 11 November 2010, from <http://mpra.ub.uni-muenchen.de/18069>

- Bozzolan, S. and E. Ipino (2007). Information Asymmetries and IPO Underpricing: The Role of Voluntary Disclosure of Forward-Looking Information in the Prospectus. Working paper, University of Padova and University of Padua, Italy.
- Brau, J. C., and Fawcett, S. E. (2006). Initial Public Offerings: An Analysis of Theory and Practice. *Journal of Finance*, 61(1), 399-436.
- Brau, J.C., Lambson, V. E., and McQueen, G. (2005). Lockups Revisited. *Journal of Financial and Quantitative Analysis*, 40, 519 – 530.
- Bundoo, S. K. (2007). An Analysis of IPOs Underpricing in Mauritius. *African Journal of Accounting, Economics, Finance and Banking Research*, 1 (1), 1-12.
- Carter, R. B., and Manaster, S. (1990). Initial public offering and underwriter reputation. *Journal of Finance*, 45, 1045–1067.
- Carter, R. B., Frederick H. D. and Singh, A. K. (1998). Underwriter reputation, initial returns, and the long-run performance of IPO stocks. *Journal of Finance*, 53, 285-311.
- Carter, R., Dark, F. and Singh, A (1998). Underwriter reputation, initial returns, and the long-run performance of IPO stocks. *The Journal of Finance*, 5, 285-311.
- Carter, R.B. and Manaster, S. (1990). Initial Public offerings and Underwriter Reputation. *Journal of Finance*, 45, 1045-1067.

- Chamber.D., and Dimson, E. (2009). IPO Underpricing over the Very Long Run. *Journal of Finance*, 64(3), 1407-1443.
- Chemmanur, T.J. (1993). The pricing of initial public offerings: A dynamic model with information production. *Journal of Finance*, 48, 285-304.
- Chowdhry, B., and Sherman, A. (1996). International differences in oversubscription and underpricing of IPOs. *Journal of Corporate Finance*, 2, 359-81.
- Clarkson, P. M. and Merkley, J. (1994). Ex Ante Uncertainty and the Underpricing of Initial Public Offerings: Further Canadian Evidence. *Canadian Journal of Administrative Sciences*, 2(1), 54-67.
- Clarkson, P. M., and Simunic, D. (1994). The association between audit quality, retained ownership, and firm-specific risk in U.S. and Canadian IPO markets. *Journal of Accounting and Economics*, 17, 207-228.
- Cliff, M. T., and Denis, D. J. (2004). Do initial Public Offering firms purchase analyst coverage with Underpricing?. *Journal of Finance*, 59(6), 2871-2901.
- Dawson, S. M. (1987). Secondary stock market performance of initial public offers, Hong Kong, Singapore and Malaysia: 1978-1987. *Journal of Business Finance & Accounting*, 14, 67-76.
- Derrien, F., & Kecskes, A. (2007). The Initial Public Offerings of Listed Firms. *Journal of Finance*, 6(1), 447-479.
- Downes, D. H., and Heinkel, R. (1982). Signaling and the valuation of unseasoned new issues. *Journal of Finance*, 37, 1-10.
- Fennee, C. and Chin, H. P. (2009). The Time Series Behaviour of Volume, Initial Return and Economic Condition of the Malaysian IPO Market. *International Review of Business Research Papers*, 5(4), 409-417.

- Firth, M. and Liao-Tan, C. K. (1998). Auditor quality, signalling, and the valuation of initial public offerings. *Journal of Business Finance and Accounting*, 25, 145-165.
- Grinblatt, M., and C.Y.Hwang. (1989). Singnalling and the Pricing of New Issues. *Journal of Finance*, 44(2), 393-420.
- Hanley, K. W. (1993). Underpricing of initial public offerings and the partial adjustment phenomenon. *Journal of Financial Economics*, 34, 231-250.
- Harris, R.A., (1933). Are-analysis of the 1928 new issue boom. *Economic Journal* 43, 453-459.
- Hensler, D. A., Rutherford, R. C., and Springer, T. M. (1997). The survival of initial public offerings in the aftermarket. *Journal of Financial Research*, 20, 93-110.
- How, J., Jelic, R., Saadouni, B. and Verhoeven, P. (2007). Share allocations and performance of KLSE second board IPOs. *Pacific-Basin Finance Journal*, 15, 292-314.
- Hwang, Y. S. (1999). The Price behaviour of Initial Public Offerings on the Taiwan stock exchange. *Applied Financial Economics*, 9, 201 - 208.
- Ibbotson, R. G. (1975). Price performance of common stock new issues. *Journal of Financial economics*, 2, 235-272.
- Jain, B. A. and Kini, O. (2000). Does the presence of venture capitalists improve the survival profile of IPO firms?. *Journal of Business Finance and Accounting*, 27, 1139-1176.

- Johnson, J., and Miller, R. (1988). Investment banker prestige and the under-pricing of initial public offerings. *Financial management* 17, 17-29.
- Koh, F. and Walter., T. S. (1989). A Direct Test of Rock's Model of the Pricing of Unseasoned Issues. *Journal of Financial Economics* 23, 251-272.
- Lee, P. J., Taylor, S. L. and Walter, T. S. (1996a). Expected and realised returns for Singaporean IPOs: Initial and long-run analysis. *Pacific-Basin Finance Journal* 4, 153-180.
- Lee, P. J., Taylor, S. L., and Walter, T. S. (1996b). Australian IPO pricing in the short and long run. *Journal of Banking and Finance* 20, 1189-1210.
- Leland, H. E., and Pyle, D. H. (1977). Informational asymmetries, financial structure, and financial intermediation. *Journal of Finance* 32, 371-387.
- Ljungqvist, A. (2006). IPO Underpricing: A Survey. Handbook in Corporate Finance Empirical: *Corporate Finance, A*. Chapter 7.
- Loughran, T., Ritter, J. R. and Rydqvist, K. (2008). Initial public offerings: International insights. Retrieved 13 November 2010, from <http://bear.cba.ufl.edu/ritter/Int2008.pdf>.
- Loughran, T., Ritter, J.R., and Rydqvist, K. (1994). Initial public offerings: international insights. *Pacific-Basin Finance Journal*, 2, 165-99.
- Loughran, Tim, and Ritter, J. R (2004). Why has IPO underpricing changed over time? *Financial Management*, 33, 5-37.
- Lowry, M. B., Officer, M. C., and Schwert, G. W. (2006). The variability of IPO initial returns. Working paper No. FR 06-06, Simon School.

- Md Hamid Uddin, (2008). An Empirical Examination of Intended and Unintended IPO Underpricing in Singapore and Malaysia. *International Research Journal of Finance and Economics*, 20, 55-74.
- Megginson, W. L., and Kathleen, A. W. (1991). Venture capitalist certification in initial public offerings. *Journal of Finance*, 46, 879-903.
- Megginson, W.L and Tian, L. (2006). Extreme Underpricing: Determinants of Chinese IPO initial returns. Working paper, Peking University and the University of Oklahoma, Oklahoma.
- Miller, R. E. and Reilly, F. K. (1987). An examination of mispricing, returns, uncertainty, for initial public offerings. *Financial Management*, 16, 33-38.
- Mok H.M.K., and Y.V. Hui (1998). Underpricing and aftermarket performance of IPO's in Shanghai, China. *Pacific-Basin Finance Journal*, 6, 453-474.
- Muhammad Khalid, S., and Abdul Reheman. (2009). Determinants of Unde-Pricing of IPOs regarding Financial & Non-Financial Firms in Pakistan. *European Journal of Economics, Finance and Administrative Sciences*, 15, 62-73.
- Paudyal, K., Saadouni, B. and Briston, R.J. (1998). Privatisation initial public offering in Malaysia: Initial premium and long-term performance. *Pacific-Basin Finance Journal*, 6, 427-451.
- Reber, B., Berry, B., and Toms, S. (2005). Firm resources and quality signaling: evidence from UK initial public offerings. *Applied Financial Economics*, 15(8), 575-586.

- Ritter, J. R., and Welch, I. (2002). A review of IPO activity, pricing, and allocations. *Journal of Finance* 57, 1795–1828.
- Ritter, J.R. (1998). Initial public offerings. *Contemporary Finance Digest*, 2(1), 5-30.
- Rock, K. (1986). Why New Issues Are Underpriced. *Journal of Financial Economics* 15, 187-212.
- Ruud, J. S. (1993). Underwriter price support and the IPO underpricing puzzle. *Journal of Financial Economics*, 34, 135–151.
- Ruzita Abdul Rahim and Othman, Y. (2010). Initial returns of Malaysian IPOs and Shari'a-compliant status. *Journal of Islamic Accounting and Business Research*, 1(1), 60-74.
- Sherman, A. E. and Chowdhry., B. (1996). The Winner's Curse and international Methods of Allocating Initial Public Offerings. *Pacific-Basin Finance Journal*, 4(1), 15-30.
- Su, D., and Fleisher, B.M. (1999). An empirical investigation of underpricing in Chinese IPOs. *Pacific-Basin Finance Journal*, 7, 173-202.
- Uddin, M. H., 2001. An Investigation on Initial Public Offers in Malaysia. PhD thesis, National University of Singapore, Singapore.
- Wan Nordin, W. H. (2005). The Effect of Owners' Participation and Lockup on IPO underpricing In Malaysia. *Asian Academy of Management Journal*, 10(1), 19–36.

- Wan-Hussin, W. N. (2006). IPO Valuation, investors protection and deregulation: Evidence from Bursa Malaysia. Retrieved 20 October 2010, from <http://www.ssrn.com/906973>.
- Yong, O and Isa, Z. (2003). Initial performance of new issues of shares in Malaysia. *Applied Economic*, 35, 919-930.
- Yong, O. (1991). Performance of new issues of securities in Malaysia. *The Malaysian Accountant*, June, 3-6.
- Yong, O. (2007a). A review of IPO research in Asia: what's next?. *Pacific-Basin Finance Journal*, 15, 253-275.
- Yong, O. (2007b). Investor demand, size effect and performance of Malaysian initial public offerings: evidence from post-1997 financial crisis. *Jurnal Pengurusan*, 26, 25-47.