

Behaviour and Performance of New Issues in Malaysia

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ABSTRAK

Kajian ini melihat kepada gelagat dan prestasi saham-saham terbitan baru di Malaysia dari tahun 1983 hingga 1988. Keputusan menunjukkan bahawa purata pulangan, berdasarkan perbezaan antara harga penutup hari pertama dan harga tawaran, ialah kira-kira 167 peratus. Juga didapati bahawa terbitan baru adalah sangat terlebih langganan. Pulangan selepas hari pertama sehingga setahun selalunya menurun, walaupun ia tidak menunjukkan perbezaan yang ketara berbanding pulangan hari pertama urusaniaga. Tambahan lagi, prestasi terbitan baru adalah agak bebas daripada pergerakan turun-naik pasaran.

ABSTRACT

This study looks at the behaviour and performance of new issues in Malaysia from 1983 to 1988. The results show that the average return, based on the difference between the first day closing price and the offer price, is approximately 167 percent. It is also found that the new issues are overwhelmingly oversubscribed. The returns after the first day and up to one year normally decline, even though they are not significantly different from the returns received on the first day of trading. Furthermore, the performance of new issues is quite independent of the ups and downs of the market.

INTRODUCTION

Every time there is a new issue in Malaysia there seems to be overwhelming support from the public. Firms normally issue new shares as the first step to be listed on the stock exchange as well as expanding their needed capital. From the public viewpoint, they buy new issues because they believe that the new issues are underpriced (Rock 1986). This means that the public perceives the purchase to be a short term investment which guarantees big profits with low or minimum risk (Tinic 1988). With this kind of belief, it is not surprising that every time there is a new issue, the shares are overwhelmingly oversubscribed.

In Malaysia, all new issues are controlled by a governing body called the Capital Issues Committee (CIC) which among others, its function is to examine and to give approval to the proposed public new issues by the public firms and to give approval to the listing request and the public issue's offer price proposed by the

public firms. The offer price is determined by a set of guidelines based on the sector the company is in. However, there seems to be a great disparity between the price offered and the price perceived by the investors in the market.

The purpose of this study is to investigate some characteristics or behavior of new issues in Malaysia from 1983 to 1988. Specifically, it looks at the percentage return on the first day of trading compared to the offer price, excess gain after the first day of trading, and the performance of new issues in relation to the market.

REVIEW OF PREVIOUS STUDIES

Studies on new issues in the US came out with differing results. For example studies performed by SEC (1963), Reilly & Hatfield (1969), McDonald & Fisher (1972), and Logue (1973) found that the initial returns for the new issues were positive. Whereas, the studies of Stigler (1964) and Shaw (1971) showed that the initial returns from the new issues were negative (Ibbotson 1975).

Reilly in a series of studies for new issues in US for the periods 1963-1965 (published in 1969), 1966 (published in 1973), and 1972-1976 (published in 1977) found that the one year returns were positive in the first two studies and negative in the third. The first and second studies' positive returns occurred in a rising market and the third study's decline was in a falling market. Reilly noted that if new issues have betas greater than one, they would lead the market in both directions.

The study of McDonald & Fisher (1972) covers 148 issues in the US for a period from 1969 through March 1970. The results showed that for those investors who were able to acquire the stocks at the offered price obtained an average return of up to 34.6% if the stocks were held for a short term of not more than one month after it is offered. At the end of the first year, the excess return was negative 3.2%. The performance of the same stock using post-offered price as a base showed a higher negative return of negative 18.1% for the first year.

In the UK, Merrett, Home & Newbould (1967) studied 149 offers for sale during 1959 to 1963, and they found that after the initial price rise there was only a small change during the following month. McDonald & Jacquillat (1974) studied 31 French new issues for 1968 to 1971, and they found that the one year gain was a positive 12.6 percent. Shaw (1979) studied 95 Canadian IPOs and found that after one year they averaged just 0.27 percent above their starting point. Finn & Higham (1983) studied 93 Australian new issues between 1966 to 1978 and found little change over the first four months with a negative 11.5 percent return over a year.

Dawson (1987) compared the performance of new issue in markets of Hong Kong, Singapore and Malaysia for a period from 1978 to 1983. The study found positive initial returns on the three markets with the Malaysian market (using 21 new issues) being the highest with an average of 166.7 percent. However, subsequent positive returns were no longer available on the Hong Kong and Singapore markets on the secondary market. With the Malaysian stocks, the price

changes were still positive and kept increasing eventhough at a smaller rate compared to the initial pricing.

Attempts were made to find out the reasons for the initial high returns of these new issues. Logue (1973), for example found that the prevailing market conditions at the time of issuance played a significant role in the performance of new issues. Other factors were the size of issues and the percentage of secondary issues. Rock (1986) and Ibbotson (1975) offered the reason that the public perceives the new issues to be underpriced.

DATA AND METHODOLOGY

The information on the companies which issued new shares was obtained from various issues of *Investors Digest*, a monthly publication of the Kuala Lumpur Stock Exchange (KLSE). In addition to the information on the names of the companies which issue new shares, *Investors Digest* also provides other information such as the last day of application, date of listing, par value, offer price and oversubscription ratio. Closing prices on selected period were gathered from the *Business Times*, a daily business newspaper. Between January 1983 and early 1988 there were 33 companies which issued new shares:

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|--|----------------------------------|
| 1. C.I. Holding Bhd | 18. Kian Joo Can Factory |
| 2. Perusahaan Pelangi Bhd. | 19. Dayapi Industries |
| 3. Malaysian Borneo Finance | 20. Pilecon Engineering |
| 4. Amalgated Industrial Steel | 21. Granite Industries |
| 5. D & C bank | 22. Hong Kong Tin Corp. |
| 6. Time Engineering | 23. Lam Soon Huat Development |
| 7. Malaysian Pacific Industries | 24. Malaysian Airline |
| 8. Antah Holding | 25. Maruichi Malaysia Steel Tube |
| 9. Renong | 26. OYL Industries |
| 10. Sungai Way Holdings | 27. Malaysia British Assurance |
| 11. Malaysian Aica | 28. MISC |
| 12. Cement Industries of Malaysia | 29. Dreamland Holding |
| 13. Indris Hydraulic | 30. Sports Toto |
| 14. Kumpulan Emas | 31. Southern Bank |
| 15. Malaysian General Investment Corp. | 32. Mun Loong |
| 16. Sitt Tatt | 33. Sistem Television Malaysia |
| 17. Muda Holding | |

Data on offer price, first day closing price, closing price after one week trading opens, closing price after one month trading opens, and closing price after one year of public listing were gathered for analysis. Return for period i was calculated based on the percentage difference between the closing price on period i and the offer price, that is,

$$r_i = \frac{P_i - P_{offer}}{P_{offer}} \times 100\% \quad (1)$$

where r_i is the return for period i
 p_i is the closing price for time i
 and P_{offer} is the offer price

Cash dividends were not included in the the stocks' return. This exclusion is somewhat in line with the exclusion of cash dividends in the computation of the KLSE Industrial index, since a comparison with this index is also made later. Furthermore, this approach was taken by an earlier study by Dawson (1987).

As noted by various earlier researchers (such as MacDonald & Fisher 1972; Jacquillat, McDonald & Rolfo 1978; Block & Stanley 1980; Finn & Higham 1983; Neuberger & LaChapelle 1983), the usual market model cannot be used to estimate risk because of the absence of an historical time series of returns for new shares prior to their listing. Another approach, Ibbotson's return across time and securities (RATS) model (1975) was found to have risk adjustment using RATS did not have much effect on the results by several earlier studies such as Ibbotson (1975), Ibbotson & Jaffe (1975), Jacquillat, McDonald & Rolfo (1978), and Block & Stanley (1980). Dawson (1987) took an approach of assigning beta to these new issues to be equivalent to one based on the studies by Bear & Cutley (1975) and Buckland, Herbert & Yeomens (1976) which concluded that there was no evidence that the betas attached to new equities are significantly different from unity. As a result, the excess returns earned by an investor are taken to be

$$ER_{i,t} = R_{i,t} - R_{m,t} \quad (2)$$

where $ER_{i,t}$ is the excess percentage rate of return for security i for time period t , $R_{i,t}$ is the percentage return on security i for time period t , and $R_{m,t}$ is the percentage return on the market over time period t . Subsequently, the excess return for the total portfolio of securities for time period t was taken to be

$$ER_t = \sum_{i=1}^N ER_{i,t} / N \quad (3)$$

where N is the number of securities in the portfolio.

In this study, no assumption is made regarding the betas of the new equities because of the controversies regarding betas mentioned in the previous paragraph. In fact, there is no evidence to believe that the betas for new equities in Malaysia are one. On the other hand, the return based on the percentage difference between the closing price of the first day of trading and the offer price is used as the basis of comparison. This means that, the excess returns are determined based on the

significant difference between return on day 1, calculated using the formula given in equation (1), and the return for any period i . In a way, this approach can tell the investor whether or not there is still excess gain to be expected after the first day of trading up to 1 year period.

Annual percentage changes in the KLSE industrial Index were also used for the purpose of looking at the overall trend in the market. No formal comparison or computation of excess returns as used by Dawson (1987) using formulas (2) and (3) is used in this study. We are only interested in knowing whether or not an upward market has any effect on the performance of the new issues.

RESULTS AND DISCUSSION

Table 1 shows the summary of statistics on selected variables, namely, oversubscription ratio (number of times), and returns for periods day 1, week 1, month 1, and year 1. As shown in Table 1, the average oversubscription ratio is 45.91 times, with a range from 1.2 to 132.4 times. It should be noted here that the company which has the highest oversubscription ratio is the Dreamland Holding which issued its new share in April 1987. On the other hand, the company which has the lowest oversubscription ratio is the MISC which issued its new shares in January 1987. In general, the oversubscription ratios show that the overwhelming support or demand is something that the companies which issues new shares can always count on the investors in Malaysia.

TABLE 1. Summary of statistics on oversubscription ratio and returns for selected periods

	Mean	Median	Mode	Std. Dev	Skew-ness	Kurt-osis	Range	
							Min	Max
Over-subscription ratio (times)	45.911	42.100	1.200	27.395	1.085	1.916	1.200	132.400
Returns (%):								
Day 1	167.437	168.182	100.000	96.177	0.497	-0.343	13.000	380.000
Week 1	162.434	144.286	108.333	94.672	0.562	-0.490	17.000	370.000
Month 1	163.258	142.857	268.000	101.681	0.516	-0.571	-1.000	400.000
Year 1	153.602	132.308	-12.000	122.834	0.994	0.572	-12.000	453.333

Note: 14 of the 33 stocks have 50 cents par value, the rest have \$1 par value.

In terms of the returns on the first day of trading, the average return that can be expected is 167.4%. This average is very close to the finding of the study by Dawson (1987) who found an average of 166.7% for the new issues in Malaysia. However,

the average return decreases to 162.3% after 1 week, up to 163.26% after 1 month and down to 153.60 percent after 1 year. In terms of range of returns, the spread is the largest for the 1 year period with a range of negative 12 percent to positive 453 percent. However the potential return after 1 year of 453 percent is not significantly different from the highest return after 1 day of 380 percent.

Table 2 shows the returns according to the percentage changes in KLSE industrial index according to year. Also it shows the average return after day 1 and after 1 year for all the stocks listed in each of these years.

TABLE 2. Percentage change in KLSE Industrial Index and average return of new issues according to year

Year	Change in KLSE Industrial	Average Return After One Day Trading	Average Return After 1 Year	Excess Returns After 1 Year	Excess Return Compa- red to Market
	(1)	(2)	(3)	(4)=(3)-(2)	(5)=(4)-(1)
1983	+39.798%	222.643%	211.769%	- 10.874%	- 50.672%
1984	- 23.746	138.946	144.555	+ 5.609	+29.355
1985	- 21.247	176.345	94.073	- 82.272	- 61.025
1986 *	+21.484	57.500	99.500	+42.000	+20.516
1987	+ 1.399	197.002	157.410	- 39.592	- 40.991
1988	+28.371	135.795	138.865	+ 3.070	- 25.301
Overall average	+ 7.676%	154.705%	141.029%	- 13.677%	- 21.353%

From Table 2, it is clear that the average return after one day of trading as compared to the offer price, is always positive, and always greater than the annual change in the KLSE industrial index. The average returns after 1 year show an average which is lower than the average of the 1 day average returns, even though the year average returns are higher in years 1984, 1986 and 1988. The upward market in 1983, 1986 and 1988 is not totally reflected as a positive excess returns after 1 year as shown in column 4 of Table 2.

If we run a simple Spearman rank correlation test between change in KLSE industrial index and the excess returns after 1 year (column 4), we will find a nonsignificant correlation between the two variables ($r_s = -0.486$; not significant at 5% level with $n=6$). In fact a Spearman rank correlation between the average return after one day of trading and the change in KLSE industrial also shows a nonsignificant correlation ($r_s = 0.413$; not significant at 5 percent level with $n=6$). This means that the performances of new issues are not exactly influenced by the trend in the market place. It should be cautioned here that this comparison is not quite accurate

because of the differences in actual periods involved. However, it can at least give some indication on the overall trend in the market and the direction in the movement of the new issues for the year concerned.

Table 3 shows the results of pairwise t-test among return after day 1, return after week 1, return after month 1, and return after year 1. As can be seen none of the t-values show significant difference (as shown by the P-values) among these variables at the 5 percent level. What it means is, there is no excess gain to be received if an investor holds on his new shares after day 1 up to year 1. It is better for that investor to dispose of his ownership at the end of trading day 1 and start looking for other types of investment.

TABLE 3. Results of pairwise t-test among selected periods' returns

Pair	t-value	p-value
<i>Returns for period of</i>		
Day 1 versus week 1	0.9000	0.3760
Day 1 versus month 1	0.4800	0.6330
Day 1 versus year 1	0.7100	0.4830
Week 1 versus month 1	-0.1400	0.8870
Week 1 versus year 1	0.5200	0.6090
Month 1 versus year 1	0.6000	0.5500

Note: As noted by the P-values, none of the pairs show significant difference at the 5 percent level.

CONCLUSIONS AND IMPLICATIONS

Based on the findings of this study, we can conclude that returns for investment in new issues in Malaysia are high, especially for the first day of trading. Subsequent periods' returns are not that much different from the first day's return. This explains why many people in Malaysia are very fond of the new issues. In fact, some of them regard new issues as a type of lottery which guarantees a high return without having to worry about losing the original "bet" or investment. However, it should be understood that the probability of getting any new issue is in the neighborhood of 2 to 3 percent. This means that the chances of 'winning' the new issue are largely dependent on "luck".

The very high returns on the first day of trading imply that the new issues are largely very much underpriced. Furthermore, insignificant price movements in subsequent periods after the first day of trading indicate that the participants in the market place were not overreacted to the price of the new issue. Those in the authority should not worry about increasing the offer price for the fear of undersubscription because the past experiences have shown otherwise.

In this study, it is shown that the movement in the market place has little effect

on the behavior of the new issues in the primary or in the secondary market. The movement in the new issues is independent of the movement of the overall market. Therefore, it seems "useless" or inappropriate to compare the return of the new issues with that of the market as employed by some studies in the past. In fact, we should treat the discussion or research on the new issues (at least up to one year period) as a separate matter, i.e. not in the same manner we treat the already seasoned or existing stocks, at least in the Malaysian case. In addition, to assign a beta of one to new issues is not quite acceptable since the movement in the new issues is not in the same direction with the market. The performance of the market should be used only as a guideline in making decision as to whether to invest in seasoned stocks or to invest in new issues.

The notion of whether or not a new issue market is an efficient market is hard to ascertain. The insignificant differences between the returns between the returns of the first day of trading and subsequent periods cannot be used as a basis for saying that the secondary market for the new issues is efficient. One thing is for sure, the best time to sell your newly gotten new issue is on its first day of trading because that is the time you receive your highest return.

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