

Initial Returns of Shariah versus Non-Shariah IPOs: Are There Any Differences?

(Pulangan Awal Saham TAA Patuh Shariah dan Tidak Patuh Shariah: Adakah Wujud Perbezaan?)

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ABSTRACT

This study examines a sample of 384 initial public offerings (IPOs) issued and listed on Bursa Malaysia from January 1999 to December 2008. The objectives of this study are to examine the difference in initial returns of Shariah versus non-Shariah IPOs and the factors that explain the initial returns of these IPOs. A matched sample of Shariah IPOs, which contains the same number of IPOs and share similar characteristics with the non-Shariah IPOs, is created to ensure a more compatible comparison. The results of the difference tests consistently show that the initial returns of non-Shariah IPOs are not statistically different from those of all and matched sample of Shariah IPOs. The cross-sectional multiple regressions yield results demonstrating that Shariah and non-Shariah IPOs share only one common factor: allocation rate. Other than the sole common factor, the initial returns of non-Shariah IPOs are determined by external factors, namely the reputation of the underwriter and the condition of the market. On the contrary, the initial returns of the Shariah IPOs (all) depend on internal factors, namely the size of the offer; the age of the firm; and the ownership of the top five shareholders. As far as the result of the matched Shariah sample is concerned, none of the other variables are significant in explaining the initial returns.

Keywords: IPO initial return; Shariah IPOs; non-Shariah IPOs; allocation rate; growth motive

ABSTRAK

Kajian ini menguji satu sampel 384 saham tawaran awam awal (TAA) yang diterbitkan dan disenaraikan di Bursa Malaysia dari Januari 1999 hingga Disember 2008. Objektif kajian ini adalah untuk mengkaji pulangan awal saham TAA patuh Shariah berbanding yang tidak patuh Shariah dan juga faktor-faktor yang menjelaskan pulangan awal saham-saham TAA tersebut. Satu sampel padanan bagi saham TAA patuh Shariah yang mengandungi bilangan saham TAA yang sama dan mempunyai ciri-ciri yang sama dengan saham TAA tidak patuh Shariah dibentuk untuk memastikan perbandingan adalah lebih setara. Hasil ujian perbezaan secara konsisten menunjukkan pulangan awal saham tidak patuh Shariah secara statistik tidak berbeza dengan semua dan sampel padanan saham TAA patuh Shariah. Regresi berganda keratan rentas memperoleh hasil yang menunjukkan saham TAA patuh Shariah dan tidak patuh Shariah hanya mempunyai satu faktor lazim, iaitu kadar agihan. Selain faktor lazim tersebut, pulangan awal saham TAA tidak patuh Shariah ditentukan oleh faktor-faktor luaran iaitu reputasi penajajamin dan keadaan pasaran. Sebaliknya, pulangan awal saham TAA patuh Shariah (semua) bergantung kepada faktor-faktor dalaman iaitu saiz tawaran, umur syarikat, dan pemilikan lima pemegang saham terbesar. Manakala bagi sampel padanan saham TAA patuh Shariah pula, pulangan awalnya tidak dipengaruhi oleh mana-mana faktor tersebut.

Kata kunci: Pulangan awal saham TAA; saham TAA patuh Shariah; saham TAA tidak patuh Shariah; kadar agihan; motif pertumbuhan

INTRODUCTION

An initial public offering (IPO) is a major event for companies because it provides access to new external equity capital necessary for future growth; creates a secondary market to improve the liquidity of the shares; improves the visibility of the company in the market; allows firms to restructure to achieve the target capital structure; and creates an effective exit strategy for venture capitalists and/or original owners. Most studies (e.g., Loughran et al. 1994; Reilly & Hatfield 1969; McDonald & Fisher 1972; Ibbotson & Jaffe 1975; Chowdhry & Sherman 1996) that

examine IPOs focus on the puzzlingly abnormal initial returns that are realized by investors at the initial stage of the new shares listing. Also known as underpricing, the significantly abnormal initial return of IPOs occurs when the offer price is set much lower than the price on the first trading day or when the price on the first day of listing increases much higher than the offer price.

Malaysian IPOs have received considerable attention from contemporary researchers (e.g., Dawson 1987; Yong 1991; Wu 1993; Ariff & Shamsheer 1999; Jelic et al. 2001; Abdullah & Mohd 2004; Yong 1991, 1997, 2007). Nevertheless, studies focusing on the Islamic segment of

IPO markets are still limited (Abdul-Rahim & Yong 2008, 2010). The limited attention given to the Islamic segment of the IPO market continues despite the fact that worldwide, investors, regardless of religion or other beliefs, are increasingly concerned and demand investments that are Islamic, ethical, and/or socially responsible. In the context of the Malaysian equity market, Shariah-compliant status appears to be a major concern for the Securities Commission (SC) even though, in reality, Malaysian stock market players and public listed companies (PLC) owners are predominantly non-Muslim entities. In 2004, the SC introduced pre-IPO Shariah-compliant status, a policy that allows IPO issuers to leverage on Shariah-compliant status because their client base can be easily widened to include foreign Muslim investors, particularly from the rich Middle-East countries. In brief, this policy is consistent with the Malaysian vision to be the international hub of the Islamic capital market.

The focus on Shariah-compliant status is also motivated by Moshirian et al. (2009), who, upon finding evidence of varying degree of abnormal performance of IPOs across countries in pan-Asian markets, attribute the variation to unique country-specific features. In the context of the Malaysian IPO market, one of its uniqueness is the Shariah status that some of its IPOs carry. The proposition that Shariah status possesses a certain degree of influence on the initial performance of an IPO initial performance is

based upon the fact that in order to be awarded the Shariah compliance status, IPO issuers are required to undergo an additional screening process certifying whether the core business activities of the companies are permissible (*halal*) and ethical, while the portion of income that stems from prohibited activities and investments is kept within a reasonably tolerable level.

As shown in Figure 1, the majority of public listed companies (PLCs) in Bursa Malaysia are Shariah-compliant and the percentage continues to grow. The significance of Shariah-compliant status is that the status functions as a certification by the market regulator (i.e., the SC in the case of Malaysia)¹ that companies that have undergone and passed the Shariah-compliant screening process generate their incomes from businesses that are free from prohibited (*haram*), unethical or socially irresponsible elements. The screening criteria of Shariah-compliant companies are comprehensive in the sense that the criteria examine companies forelements of certainty, integrity, justice and accountability in addition to the basic *halal* or *haram* rules. Details of the Shariah screening criteria are provided in the Appendix. Throughout the course of the present study, Shariah-compliant IPOs will be interchangeably referred to as Shariah IPOs, whereas IPOs that do not comply with the Shariah screening criteria are interchangeably referred to as non-Shariah or conventional IPOs.

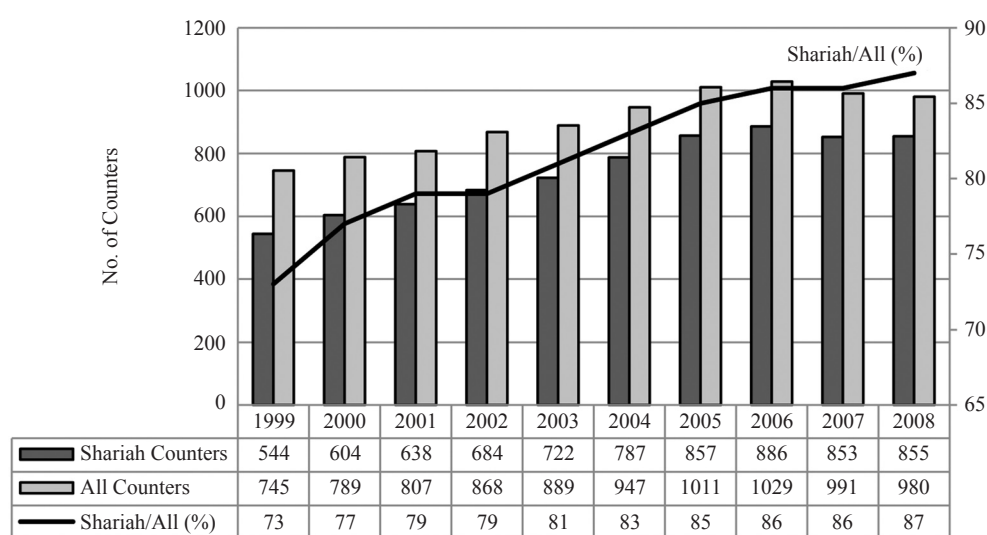


FIGURE 1. Growth in the Islamic segment of the Malaysian equity market

In a nutshell, the process of obtaining the Shariah-compliant status creates a product differentiation between IPOs with Shariah-compliant status and those IPOs without the status. Accordingly, Shariah status is expected to create additional demand because, like other products or services, real or financial investments in entities with Shariah-compliant status are not only meant for the Muslim investors, but for all investors generally. Based upon this argument, the present study proposes that IPOs that carry Shariah-compliant status perform differently from those IPOs that without the status.

In explaining the anomalous initial return of IPOs, many studies forward arguments that revolve around information asymmetry and adverse selection between the issuers (insiders) and investors (outsiders). The present study also proposes that the initial returns of Shariah IPOs are influenced by factors that differ from those that influence the initial returns of their non-Shariah counterparts. In short, the present study expands upon the work pioneered by Abdul-Rahim and Yong (2008, 2010) by imposing a stricter rule for the comparison of the initial returns of Shariah and non-Shariah IPOs.

The remainder of this paper is organized as follows. The next section reviews previous studies on IPO initial performance; the determinant factors of IPO initial performance; and the underlying theories of abnormal behavior in IPO markets. This is followed by a section describing the research methodology employed to test the hypotheses. The last two sections discuss the results; and conclude and explain the implications of the results.

LITERATURE REVIEW

The anomalous initial return of IPOs is widely accepted as a universal phenomenon. One of the most cited studies concerning IPO initial returns is the constantly updated study by Loughran et al. (1994)², which finds that abnormal IPO initial returns exist in all 25 countries selected in the continuous study. The results are consistent with several other pioneer studies that investigate the initial returns of IPOs, including the examination of IPOs in the US by Ibbotson and Jaffe (1975); in the UK by Chowdhry and Sherman (1996); in Singapore by Lee et al. (1999); in Malaysia by Dawson (1987) and Yong (1991, 1997); and in Australia by Finn and Hingham (1988).

Despite the widely accepted anomaly of IPO initial returns, the causes and varying degrees of such anomalies continue to be the substance of debate around the world. One of the most widely cited theoretical explanations for the anomalous initial return phenomenon is the winner's curse hypothesis (Rock 1986), which posits that adverse selection is the main problem that restrains uninformed investors from entering the IPO market. To ensure their IPOs are successful, issuers and underwriters must underprice the new issues to regain or attract the interest of uninformed investors in the IPOs. Other widely accepted theoretical explanations concerning the anomalous initial returns of IPOs include signaling models³ (Leland & Pyle 1977); the faddish behavior of investors⁴ (Aggarwal & Rivoli 1990); and cascades or bandwagon effects in the IPO market⁵ (Welch 1992).

Moshirian et al. (2009) attribute the varying degree of initial returns across countries to the country-specific features. Documenting evidence on the performance of IPOs in pan-Asian markets between 1991 and 2004, the study finds that the initial returns of Malaysian IPOs (61.81%) exceeds those in developed Asian markets, including Hong Kong (21.43%), Japan (34.04%) and Singapore (33.10%). The Malaysian IPO market is known for its uniqueness, which includes the characteristics relating to Shariah status and ownership distribution of IPOs to Bumiputra⁶. Abdul-Rahim and Yong (2008, 2010) examine the role of Shariah status and find that the status does not have a significant influence on the initial returns of IPOs in Malaysia. The results imply that, despite the emphasis and advantages offered by Shariah-compliant status, the status does not appear to contribute to a significant differential between the initial returns of IPOs issued by Shariah-compliant

PLCs and the initial returns of IPOs issued by non-Shariah PLCs.

The findings by Abdul-Rahim and Yong (2008, 2010) are paradoxical because, as explained in the earlier section, carrying a Shariah-compliant status means that the activities of company should be free from any form of prohibited elements, including *riba* or interest-based transactions; unethical elements; and doubtful transactions. In other words, passing the screening process should create a competitive advantage for the issuing companies, which, in turn, should create additional demand for Shariah IPOs. However, a flaw exists in the studies by Abdul-Rahim and Yong (2008, 2010) because comparisons between Shariah and non-Shariah IPOs are made without taking into consideration the difference in sample size and, more importantly, the differences in the characteristics of the two samples being compared.

EXPLANATORY VARIABLES OF IPO INITIAL PERFORMANCE

In examining the initial performance of Shariah versus non-Shariah IPOs and the factors that explain the performance, the present study focuses on three factors that have been neglected or have not received enough attention in previous studies, despite the fact that information on most of these factors is disclosed in the prospectus. Recognizing the significance of such information may help investors to make informed decisions about IPOs. The three factors are allocation rate, operating risk and growth motive.

Allocation Rate Allocation rate provides an estimate of the probability that the investors' subscription is successful based on the rate of IPOs allocated to them. Allocation rate is expected to have a negative relationship with initial returns because, when the probability for investors to win (get the allocation) is high, it demonstrates that the IPOs are not adequately subscribed (demanded) by informed investors. In other words, a low subscription due especially to reluctant participation from informed investors should be taken as a reliable indication that the IPOs are not likely to be of high quality, and, therefore, not likely to generate a high initial return. Amihud et al. (2003) argue that the relationship between the allocation rate to subscribers and the level of IPO initial returns reflects the existence of winner's curse or adverse selection in the IPO market.

Growth Motive The present study also examines the motivation behind the issuers' decisions to issue IPOs by calculating the percentage of the proceeds from IPOs that is allocated for growth. The percentage of proceeds utilized for growth, or growth motive, is expected to send a signal about the future prospect of the companies. The importance of growth motive is documented in various studies that explore the issues of growth in IPOs (e.g., Chung et al. 2005; Leone et al. 2007; Chahine et al. 2007). Chung et al. (2005) test the relationship between initial returns and growth opportunities and find that the relationship is consistently positive. Chahine et al. (2007) discover that

growth opportunities have a positive relationship with investment in R&D activities. This finding implies that if an insufficient amount of the IPO proceeds are allocated to finance growth, company growth will slow down which eventually results in decreases in the firms' value. Leone et al. (2007) find that the relationships between R&D and growth opportunities vary due to differences in the national systems of corporate governance; and firm size.

Operating Risk One of the listing requirements of Bursa Malaysia mandates issuing firms to demonstrate a good track record of profitability. Zheng and Stangeland (2005) find that initial returns have a positive relationship with growth rates in sales and EBITDA (earnings before interest, taxes and depreciation). Meanwhile, Shen et al. (2008) discover the price of IPOs increases tremendously due to misperceptions concerning earnings and find that a positive relationship exists between initial returns and discretionary earnings. The present study uses the standard deviation of EBITDA prior to IPO to measure the operating risk of the issuing firms. Based upon the risk-return trade-off theory, the higher the operating risk, the higher the initial returns.

Control Variables In addition to the three factors, the present study recognizes other factors that are found to be significant in explaining the initial returns of IPOs: the reputation of underwriters (Jelic et al. 2001; Abdullah & Mohd 2004); firm size (Abdul-Rahim & Yong 2008; Abdullah & Mohd 2004; Yong 1996, 2008); firm age (McDonald & Fisher 1972); offer size (Abdul-Rahim & Yong 2008, 2010); ownership of top 5 shareholders (Abdullah & Mohd 2004); and market conditions (Afirudin 2004; Ritter 1984).

RESEARCH METHODOLOGY

The present study employs a data set of fixed-priced IPOs issued from January 1999 until December 2008 and listed on either the Main Board, the Second Board or the MESDAQ of Bursa Malaysia (previously known as the Kuala Lumpur Stock Exchange). On 25 March 2008, the Main and Second Boards were merged to form the Main Market, while the MESDAQ was converted to the ACE market. The year 1999 is selected as the starting point to minimize the adverse effects of the 1997/98 Asian financial crisis on the analysis. Although similar effects are expected to be found during the 2007/08 US sub-prime crisis, the Malaysian market was not adversely affected to the extent that it was affected by the 1997/98 Asian financial crisis. As reported in Table 1, a total of 426 new issues are found during the 10-year study period.

SAMPLE AND MATCHED SAMPLE

Similar to Abdul-Rahim and Yong (2008, 2010) and Yong (2007), the present study selects a sample of IPOs that are offered as public issue; offer for sale; private placement; and hybrid of the aforementioned forms. The selection criteria essentially exclude special purpose IPOs, such as restricted offers for sale; restricted public issues; restricted offers for sale to eligible employees; restricted offers for sale to Bumiputra investors; special and restricted issues to Bumiputra investors; tender offers; and special issues. Special purposes IPOs are rare and including them may lead to a less meaningful outcome (Abdul-Rahim & Yong 2008; Yong 2007). IPOs issued under REITS category are also excluded due to the differing format of financial statement presentation. Based upon these selection criteria, the present study examines a final sample 384 IPOs.

TABLE 1. Distribution of IPOs population and sample by year of listing, 1999 to 2008

Listing Year	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	Total
IPO population	19	38	20	51	58	72	79	40	26	23	426
Dropped cases	0	5	4	6	3	2	7	6	4	5	42
Sample IPOs	19	33	16	45	55	70	72	34	22	18	384
Shariah IPOs	14	32	15	41	50	66	63	31	20	15	347
Non-Shariah IPOs	5	1	1	4	5	4	9	3	2	3	37
Matched Sample IPOs	5	1	1	4	5	4	9	3	2	3	37

Note: The percentage of IPOs that are Shariah-compliant is consistent with the percentage of PLCs with Shariah-compliant status (Figure 1).

The main objective of the present study is to test whether the performance of Shariah IPOs differs from that of the non-Shariah IPOs. As noted above, similar studies by Abdul-Rahim and Yong (2008, 2010) find no difference between Shariah and non-Shariah IPOs. The present study expands upon the works of Abdul-Rahim & Yong (2008, 2010) by examining whether or not the lack of difference is due to the incompatibility of the groups being compared. Table 1 demonstrates that the total number of Shariah IPOs is nearly 10 times greater than non-Shariah IPOs. Therefore, the present study proposes

that the difference between Shariah and non-Shariah IPOs can be examined more appropriately by creating a matched sample of Shariah IPOs that is of equal size and shares similar characteristics with those of non-Shariah IPOs. The characteristics used to select and construct the matched sample of 37 Shariah IPOs are as follows: (i) the year of the IPO issuance; (ii) the board on which the IPOs are seeking listing; (iii) the sector of the issuing firm's core business; (iv) the offer size of the IPOs; and (v) the operating risk of the IPOs.

Data for this study are gathered from various sources, including OSIRIS; Investors Digest (one of Bursa Malaysia publications terminated in mid-2004); the websites of Bursa Malaysia and the Malaysian Issuing House (MIH); the prospectuses of the IPOs; and the annual reports of the issuing firms.

INITIAL PERFORMANCE

The initial performance of IPOs, which is the variable to be explained in this study, is measured using the initial returns of the IPOs. The two methods most commonly used for calculating initial returns are based upon the opening price on the first day of trading; and the closing price on the first day of trading (e.g., Agarwal et al. 2008; Ritter 1998; Dawson 1987; Yong 1991). To conserve space, the present study employs only the formulation based upon opening price. The preference for opening price over closing price is based upon the argument that the price that prevails at the opening of the listing day is subject to less trading noises than the price that prevails at the closing of the listing day. The formulation for the initial return ($IPORTN$) is as follows:

$$IPORTN_i = \left(\frac{P_i^{OPEN}}{P_i^{OFFER}} - 1 \right) \times 100 \quad (1)$$

where P_i^{OPEN} is the opening price on the listing day and P_i^{OFFER} is the offer price of the i th IPO.

EXPLANATORY VARIABLES

When examining the factors that explain the initial returns of Shariah versus non-Shariah IPOs, the present study focuses on eight explanatory factors: allocation rate; operating risk; growth motive; firm size; firm age; offer size; underwriter reputation; and market condition.

Allocation rate ($ALLOCT$), which is adopted from Amihud et al. (2003), is calculated as follows:

$$ALLOCT_i = \log \left(\frac{\left(\frac{1}{OSR_i} \right) + \alpha}{1 - \left(\frac{1}{OSR_i} \right) + \alpha} \right) \quad (2)$$

where α is $0.5/N$; N is the sample size; and OSR is the oversubscription ratio, which represents the ratio of units subscribed to units offered. $ALLOCT$ represents the allocation rate that the subscribers are likely to receive of their order on an IPO. Item α is added in Equation (2) so that $ALLOCT$ must be positive, but is, at most, equal to 1 ($0 < ALLOCT \leq 1.0$). Note that if $ALLOCT$ equals 1, the investors are allocated with all the IPOs for which they subscribe. As explained by Amihud et al. (2003), undersubscribed IPOs will be absorbed by underwriters or else the IPO fails. In the sample of IPOs examined in the present, 6 such cases of IPOs that fail to get full subscription exist and the $ALLOCT$ values for these IPOs are accordingly equal to 1.0.

The growth motive ($GROWTH$) of the IPOs is measured as the percentage of proceeds utilized for growth activities, including allocation for working capital; R&D expenditure; and capital expenditure. Operating risk ($OPERISK$) is measured using the standard deviation of EBITDA over the three years prior to the IPO, as represented in the following formulation:

$$OPERISK = \text{Ln} \left\{ \left[\frac{1}{2} \sum_{t=-3}^{-1} (EBITDA_t - \overline{EBITDA})^2 \right]^{1/2} \right\} \quad (3)$$

The firm's size ($COSIZE$) is measured based upon total assets, which is transformed into the natural log to standardize the data. Meanwhile, the offer size ($OFSIZE$) is measured by multiplying the number of shares offered by the offer price ($NOSIX \times P^{OFFER}$) and then transformed using the natural log. The firm's age (AGE) is defined as the number of years that the issuing companies have been in business (i.e., from the incorporation of the firm through the listing year of the firm's IPOs). Ownership structure, specifically concentrated ownership, is defined as the total ownership of the top five shareholders of the issuing companies ($OWNER5$), which is calculated as follows:

$$OWNER5_i = \frac{\sum_{s=1}^5 \text{shares}_{s,i}}{NOSH_i} \quad (4)$$

where $\text{shares}_{s,i}$ = number of shares of major shareholder $s = 1, \dots, 5$ of the i th firm; and $NOSH_i$ = total number of shares outstanding.

The reputation of underwriter ($DUNDWTR$) takes a value of 1 if the main underwriter of the IPO is one of the five 'reputable' underwriters and 0 if otherwise. The present study uses Bursa Malaysia's list of reputable investment bankers in 2007 and 2008 to identify reputable underwriters, which includes CIMB Investment Bank Berhad; HWANGDBS Investment Bank Berhad; AMINVESTMENT Bank Berhad; KENANGA Investment Bank Berhad; and OSK Investment Bank Berhad.

Market condition is also represented by a dummy variable ($DMKT$), which takes a value of 1 if the market is in "hot" condition and 0 if otherwise. The present study follows Afirudin (2004) in defining a hot market as one when the volume of offering and number of new listings are high. For this study period, the market condition during a 4-year period (i.e., from 2002 to 2005) is considered hot, while the market is cold during the remaining 6 years (1999 to 2001; and 2006 to 2008).

MODEL SPECIFICATION

The econometric equation that represents the regression of initial returns on allocation rate, growth motive, operating risk and the six control variables defined in the earlier section is represented as follows:

$$IPORTN_i = \alpha + \beta_1 ALLOCT_i + \beta_2 OPERISK_i + \beta_3 GROWTH_i + \beta_j \sum_{j=1}^J CV_{j,i} + \varepsilon_i \quad (5)$$

where α = constant term,
 β = coefficient estimates of the respective explanatory variables,
 $IPORTN_i$ = initial return of the i th IPO,
 $ALLOCT$ = allocation rate,
 CV = controlled variables,
 j = $AGE, COSIZE, OFSIZE, DUNDWTR, OWNERSHIP$, and $DMKT$,
 AGE = age (in years) of the IPO firm at the time of the IPO,
 $COSIZE$ = size of the IPO firm,
 $GROWTH$ = growth motive behind the IPO issuance,
 $OSIZE$ = size of the IPO issue,
 $D_{UNDEWTR}$ = dummy variable for underwriter reputation,
 $OWNERSHIP$ = ownership of the top 5 shareholders of the IPO firm,
 D_{MKT} = dummy variable for market condition,
 $OPERISK$ = operating risk, and
 ε = error term.

Equation (5) is run using cross-sectional multiple regressions. Before reporting the regression results, econometric issues, such as multicollinearity, autocorrelation, and heteroskedasticity, are tested and corrected (if any) to ensure the estimated coefficients are reliable to provide a basis for meaningful interpretation.

RESULTS OF THE STUDY

Table 2 summarizes the profiles of the 384 selected IPOs that are issued and listed between January 1999 and

December 2008. The Shariah IPOs are offered at a price that is approximately 20 percent lower than the non-Shariah IPOs. Relative to the non-Shariah IPOs, the Shariah IPOs are also trading at lower opening and closing prices on the day of listing. Furthermore, the gaps between the opening and closing prices for Shariah IPOs are found to be greater than for non-Shariah IPOs, indicating that investors have more divergent opinions concerning the value of Shariah IPOs than the value of non-Shariah IPOs.

A higher oversubscription ratio (OSR) for the Shariah IPOs indicates that these IPOs are more demanded relative to the non-Shariah IPOs. This finding is consistent with the argument that Shariah IPOs are gaining popularity compared to their non-Shariah counterparts. Muslim investors may contribute to the higher demand for Shariah IPOs since such investors are typically more attracted to investments that comply with Shariah rules. The higher OSR could also be attributed to the smaller supply of Shariah IPOs. Note that the offer size of the Shariah IPOs (RM49,087,003) is, on average, much smaller than that of the non-Shariah IPOs (RM130,559,047). In other words, the demand for IPOs is similar in both Shariah and non-Shariah IPOs (constant numerator), but the OSR of Shariah IPOs is higher due to the smaller supply of such IPOs (smaller denominator).

Of the total proceeds that are raised from the IPOs, only slightly more than half (57%) are allocated for growth purposes. This finding is consistent with Jelic et al. (2001), who find that only 56 percent of companies allocate proceeds from IPOs to growth or expansion activities. Jelic et al. (2001) use a sample of 182 Malaysian IPOs listed on the Main Board of Bursa Malaysia between 1980 and 1995. Shariah IPO issuers, especially the matched Shariah IPO issuers respectively allocate 62 percent and 73 percent for growth purposes. The aforementioned percentages are high in relation to the non-Shariah IPO issuers, which only allocate 42 percent of IPO proceeds for the growth purposes.

TABLE 2. Profiles of Malaysian IPOs, 1999-2008

Items	Whole	Shariah	Non-Shariah	Matched Shariah
Offer Price (RM)	1.11	1.08	1.34	1.37
Opening Price (RM)	1.44	1.41	1.70	1.65
Closing Price (RM)	1.42	1.40	1.66	1.65
Over-Subscription Ratio (times)	31.40	32.50	21.16	25.32
IPOs with Reputable Underwriter	52.34%	51.87%	56.76%	48.65%
Offer Size (RM'000)	56,937.17	49,087.00	130,559.05	159,557.38
Total Proceeds (RM'000)	39,360.35	32,617.36	102,598.63	76,402.07
Proceeds For Growth (RM]000)	22,428.05	20,208.76	43,241.43	56,095.34
Proceeds to Offer Size (%)	69.13	66.45	78.58	47.88
Growth to Proceeds (%)	56.98	61.96	42.15	73.42
Total Asset (RM'000)	218,378.55	194,576.46	441,603.61	496,180.03
Average EBITDA (RM'000)a	19,184.39	18,256.59	27,885.69	31,800.12
Standard Deviation of EBITDA	18,604.19	19,409.65	7,825.73	10,382.09
Firm's Age (Year)	4.70	4.57	5.92	5.81
Top 5 Ownership (%)	59.21	59.21	59.29	64.72
Number of IPOs, N	384	37	347	37

Note: ^a The average values are calculated over a three-year period prior to listing.

Non-Shariah IPOs are larger than Shariah IPOs in regards to total assets and offer size by 2.27 times and 2.66 times, respectively. The differences reduce significantly when Shariah IPOs are represented by the matched Shariah sample. Nonetheless, investors of Shariah IPOs should probably be concerned with the lower profitability (EBITDA) and more so with the nearly 3 times greater variability of EBITDA compared to those reported by non-Shariah firms. Again, the differences between Shariah and non-Shariah IPOs reduce substantially once the comparison is performed in a more compatible manner (i.e., by comparison against the matched Shariah sample). Little difference is found between the IPO firms in relation to age and ownership concentration, although the results concerning the latter indicates that the ownerships of Malaysian firms are highly concentrated (OWNER5 ~ 60%) to five major shareholders.

INITIAL RETURNS OF SHARIAH VERSUS NON-SHARIAH IPOs

Table 4 reports the descriptive statistics of the IPO initial returns over the 10-year study period for the whole sample, which includes Shariah IPOs; non-Shariah IPOs; and matched Shariah of IPOs. The initial returns, based upon closing price, are also reported for reference purposes. On average, the initial return for the whole sample of 384 IPOs is 31.65 percent. Previous studies (e.g., Dawson 1987; Yong 1991; Ku Ismail et al. 1993) on Malaysian IPOs report initial returns that are consistently higher than 100 percent for earlier periods, which span from 1978 until 1989. In later periods, from 1990 to 1995, Yong et al. (2001) report an average initial return of 81 percent. The declining trend of initial returns of Malaysian IPOs continues in more recent years. For instance, for the period from 1999 to 2007, initial returns decline to 32 percent (Abdul-Rahim & Yong 2008), which is also consistent with the findings reported concerning IPOs in the present study.

TABLE 3. Descriptive statistics of IPO initial returns

Statistics	Whole		Shariah		Non-Shariah		Matched Shariah	
	IR ^{OPEN}	IR ^{CLOSE}	IR ^{OPEN}	IR ^{CLOSE}	IR ^{OPEN}	IR ^{CLOSE}	IR ^{OPEN}	IR ^{CLOSE}
Mean	31.65	30.21	32.17	30.77	26.76	24.87	21.07	19.44
Median	20	18.13	20	18.46	18.67	17.8	10	9.68
Minimum	-68.13	-70.7	-67.27	-66.67	-68.13	-70.7	-16.28	-29.09
Maximum	275	263.64	275	263.64	190	184	102.7	150
Std.Dev.	43.27	48.92	43.2	49.41	44.22	44.28	28.81	32.76
Skewness	1.51	1.72	1.5	1.74	1.61	1.4	1.17	1.97
Kurtosis	6.96	7.32	6.93	7.29	7.4	7.06	3.57	8.15
J-Bera	396.48	488.50	353.76	440.09	45.74	37.49	8.94	64.77
Test of Difference								
Category			t-test	MW			t-test	MW
Non-Shariah			0.722 (0.471)	5952.5 (0.467)			-0.656 (0.514)	617 (0.465)

Notes: Jarque-Bera statistics are all significant at the 1% level, indicating that the initial returns of the sample IPOs are not normally distributed. Non-normal distribution is, however, considered a stylized fact for financial data (Bali & Cakici 2004). MW refers to non-parametric Mann-Whitney U test. In tests of differences, figures in parenthesis represent the *p*-value. Tests of differences are done on IR^{OPEN} only.

The Shariah IPOs report initial returns (32.2%) that are very similar to the whole sample. This finding is somewhat expected because most (about 90%) of the IPOs carry Shariah status. The results concerning the initial returns of Shariah IPOs in the present study is consistent with that documented in Abdul-Rahim and Yong (2008, 2010). The initial returns of Shariah IPOs are higher than that of the non-Shariah group (26.8%), although the standard deviations of these initial returns are similar. However, when the characteristics of the sub-samples are considered by comparing the non-Shariah IPOs with the Shariah matched IPOs, the non-Shariah IPOs appear to perform better. However, the standard deviation of the initial returns is much smaller for the matched Shariah than non-Shariah IPOs. Overall, the results indicate that although the initial returns for matched Shariah IPOs are slightly lower, the variations among IPOs are smaller, which allows the performances of these IPOs to be more

easily predicted. However, despite the seemingly different initial returns between Shariah (all and matched sample) and non-Shariah IPOs, the results of the independent t-test and Mann-Whitney U test in Table 4 consistently demonstrate that no statistical differences exist between the two IPO groups.

The pattern of yearly initial returns, which are based upon offer-to-open prices, is illustrated in Figure 2. For the whole sample, the highest average initial returns are reported in 2000 (63.3 percent). Good performance is also reported in 2003 and 2004, with reported initial returns of 45.6 percent and 40.9 percent, respectively. Shariah IPOs also report the highest average initial returns during these periods: 64.2 percent in 2000; 47.1 percent in 2003; and 38.5 percent in 2004. This similarity can also be linked to the composition of Malaysian IPOs, where most firms are Shariah compliant. Non-Shariah IPOs are slightly different in regards to their bullish years. The highest initial returns

are reported in 2004 (80.42%), followed by 52.78 percent in 2002. The matched Shariah IPOs show a hybrid feature between the non-Shariah and the Shariah IPOs in general. Like non-Shariah IPOs, the matched Shariah IPOs report the highest initial return reported in 2004, but report the second highest initial returns in 2003 in a fashion similar

to Shariah IPOs generally. Interestingly, the results for the matched sample suggest that Shariah IPOs that have similar characteristics to non-Shariah IPOs do not appear to offer initial returns which are similar to either their non-Shariah counterparts or the remaining Shariah IPOs.

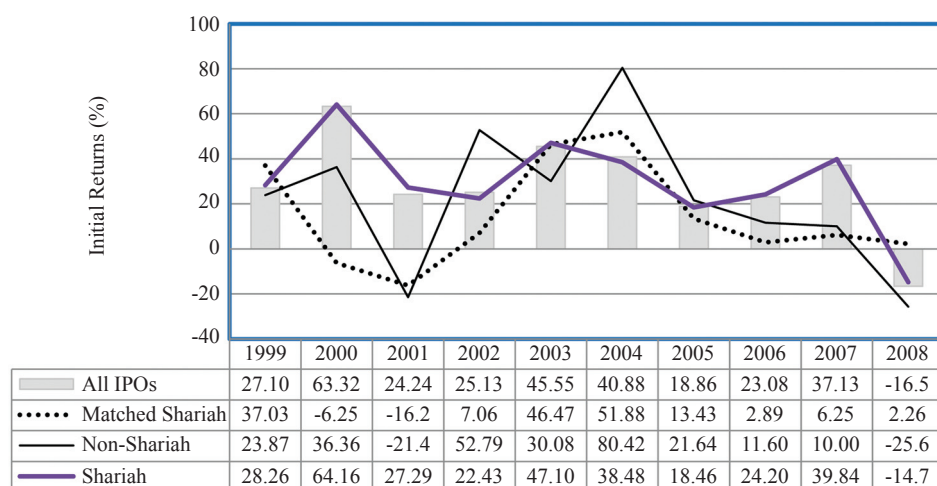


FIGURE 2. Trend of IPO initial returns, 1999-2008

DOES SHARIAH STATUS INFLUENCE IPO INITIAL RETURNS?

Before proceeding to the analysis concerning determinants of initial returns, the present study performs a cross-sectional multiple regression analysis, which adds a dummy variable (DSHARIAH) representing IPOs with Shariah status in Equation (5). The results are expected to strengthen those of the difference tests, which may not be powerful enough to address such an important issue because the tests do not consider the influence of other variables. This additional analysis is also important because it allows the present study to re-examine a question that remains unanswered by the examinations

performed by Abdul-Rahim and Yong (2008, 2010), who claim Shariah status plays no particular role in the Malaysian IPO market because it does not alter the patterns in the initial returns of new shares despite the emphasis on the Shariah investment. The results of the present analysis, as reported in Table 4, show that the DSHARIAH is positive, but insignificant, in influencing initial returns. Results concerning other determinants, which will be discussed in later section, are also not influenced by the incorporation of DSHARIAH in the model. These results lend strong support to the aforementioned claim by Abdul-Rahim and Yong (2008, 2010).

TABLE 4. Results of regression on the whole IPO sample with and without the Shariah dummy variable

Variables	Without DSHARIAH		With DSHARIAH	
	Coefficient	t-statistics	Coefficient	t-statistics
ALLOCT _j	-26.3144	-4.4790***	-26.2991	-4.4858***
GROWTH	2.9402	0.4150	2.8626	0.3974
OPERISK	-0.8168	-0.4614	-0.8413	-0.4706
DSHARIAH			1.2816	0.17133
Control Variables (CV) OFERSIZE	-7.6350	-2.3183**	-7.6034	-2.3071**
AGE	4.5770	2.1189**	4.5970	2.1182**
COSIZE	2.8512	0.7471	2.8934	0.7519
OWNER5	-0.3081	-1.9173*	-0.3086	-1.9065*
DWRITER	-4.4301	-1.0720	-4.3994	-1.0549
DMKT	-0.5699	-0.0856	-0.6121	-0.0915
INTERCEPT	116.7600	3.1543***	114.8650	2.9765***
Adjusted R-Squared	0.1491		0.1469	
F-Statistics	8.4555***		7.5936***	
Probability	0.000		0.000	
Durbin-Watson stat.	1.4465		1.4464	
VIF range	1.033-3.699		1.033-3.715	

Notes: Autocorrelation and heteroskedasticity are determined through the Breusch-Godfrey Lagrange multiplier test and corrected with a Newey-West Covariance estimator. The adjusted values are highlighted by symbol #. *, ** and *** denote significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

RESULTS OF CORRELATION ANALYSIS

The correlations in Table 5 provide the pairwise relationships between initial returns and each of the explanatory variables. The relationships between independent variables, in the meantime, can be used to detect multicollinearity problems that may affect the regression results, but the results are not reported here to conserve space. As later confirmed with the variance inflation factor (VIF) values, none of the independent variables are correlated at levels that indicate the existence of multicollinearity problems in the regression models. The correlations indicated by the results presented in Table 5 suggest that the initial returns of non-Shariah, Shariah and matched Shariah IPOs are each related to a different set of variables. The variables that are significantly related to the initial returns of the whole sample and Shariah IPOs are allocation rate (ALLOCT); operating risk (OPERISK); the size of the IPO offer (OFSIZE); firm age (AGE); firm size (COSIZE); and ownership structure (OWNER5). The similarities between the relationships in the whole sample and Shariah IPOs are more likely due

to the fact that the majority of newly listed companies hold Shariah status (~90%). This set of variables is almost completely different from the set of variables for non-Shariah compliant IPOs. The initial returns of non-Shariah IPOs are significantly correlated to allocation rate (ALLOCT) and market condition (DMKT). Meanwhile, the initial returns of the matched Shariah IPOs are significantly correlated to allocation rate (ALLOCT) and the size of the IPO offer (OFSIZE). Overall, regardless of categorizations, only allocation rate (ALLOCT) is consistently significantly correlated to initial returns. The negative correlation between ALLOCT and initial returns can be taken as preliminary support for the winner's curse hypothesis. The hypothesis suggests that when the allocation rate is high, IPOs are typically overpriced and allocation is high because institutional investors are more likely to avoid these IPOs. Not having the same information as informed investors, uninformed investors place their subscriptions and win the allocations. When the new issues start trading, the fair price is revealed and turns out to be lower than the offer price. To summarize, the higher the allocation rate, the lower the initial returns.

TABLE 5. Correlations between initial returns and explanatory variables

Variables	Whole	Non-Shariah Initial Returns	Shariah (IPORTN ^{OPEN})	Matched Sample
IPORTNCLOSE	0.8149**	0.9016**	0.8070**	0.7574**
ALLOCT	-0.3563**	-0.4618**	-0.3437**	-0.5635**
GROWTH	0.027	-0.0078	0.0293	0.0453
OPERISK	-0.1197**	-0.004	-0.1314*	-0.1232
OFSIZE	-0.1888**	-0.0864	-0.2016**	-0.3657*
AGE	0.0973*	0.0481	0.1069*	0.0097
COSIZE	-0.1285**	-0.0104	-0.1394**	-0.2946
OWNER5	-0.1289**	0.036	-0.1466**	-0.0229
DWRITER	-0.0621	-0.0174	-0.0658	0.2098
DMKT	0.0069	0.3651*	-0.0137	0.174

Notes: Asterisks ** and * denote correlations that are significant at the 0.01 level and 0.05 level (2-tailed), respectively.

DETERMINANTS OF IPO INITIAL RETURNS

The second part of the present study focuses on the determinants of the initial returns of the Shariah IPOs, which are analyzed by running the cross-sectional multiple regression analyses of Equation (5). Before the regression results are discussed, it is important to report that the variance inflation factors (VIF) of each variable in the regression analyses are always lower than 10, which indicates that the results can be considered free from multicollinearity problems (Kleinbaum et al. 1998). The results of the Breusch-Godfrey Lagrange Multiplier tests for identifying autocorrelation and heteroskedasticity problems in each model are also reported. Whenever the standard regression analyses detect the presence of autocorrelation and heteroskedasticity issues, the problems are treated with the Newey–West covariance estimator so

that the regression results are more precise in estimating the coefficients.

Within the scope of determinants examined in this study, the results in Table 6 may be summarized as follows. The initial returns of non-Shariah IPOs are significantly explained by ALLOCT, DWRITER and DMKT. The initial returns of Shariah IPOs are also explained by ALLOCT, but that is the only similarity between the two groups. Unlike the initial returns of non-Shariah IPOs, the initial returns of the Shariah IPOs are also explained by OFSIZE, AGE and OWNER5. Based upon the results thus far, this study finds evidence that supports the findings of Abdul-Rahim and Yong (2008, 2010) that the initial returns of IPOs are not influenced by Shariah status. However, the findings of present study go further and determine that the initial returns of Shariah and non-Shariah IPOs are apparently influenced by a different set of factors with only one

TABLE 6. Results of multiple regression analyses on whole sample and sub-samples of IPOs

Variables	Whole	Shariah	Non-Shariah	Matched Shariah
ALLOCT	-26.3144 (-4.4790) ***	-24.7268 (-3.8843) ***	-38.5908 (-2.55688) **	-31.2333 (-2.6114) **
GROWTH	2.9402 (0.4150)	4.9684 (0.6344)	8.3863 (0.3754)	7.4969 (0.4628)
OPERISK	-0.8168 (-0.4614)	-0.4952 (-0.2452)	-1.3374 (-0.1922)	-1.1927 (-0.2778)
Control Variables				
OFSIZE	-7.6350 (-2.3183) **	-7.8452 (-2.0771) **	-7.2944 (-0.5864)	-10.9028 (-1.4507)
AGE	4.5770 (2.1189) **	5.2606 (2.0505) **	4.6918 (0.5643)	4.9352 (1.0310)
COSIZE	2.8512 (0.7471)	1.6781 (0.4243)	10.3459 (0.8032)	7.9832 (1.1028)
OWNERS5	-0.3081 (-1.9173) *	-0.3750 (-2.1390) **	0.5643 (0.7549)	-0.5414 (-1.0643)
DWRITER	-4.4301 (-1.0720)	-3.3945 (-0.8268)	-35.6577 (-2.0762) **	5.8916 (0.5801)
DMKT	-0.5699 (-0.0856)	-2.1074 (-0.3080)	34.8151 (2.0024) **	-1.7789 (-0.1470)
INTERCEPT	116.7600 (3.1543) ***	135.6579 (3.0744) ***	-48.1682 (-0.3938)	110.4845 (1.2895)
Adjusted R-Squared	0.1491	0.1470	0.1950	0.2117
F-Statistics	8.4555 ***	7.6261 ***	1.9691 *	2.0744 *
Probability	0.000	0.000	0.0839	0.0691
Durbin-Watson stat.	1.4465	1.4607	2.2947	1.5121
VIF range	1.033-3.699	1.030-3.420	1.377-6.754	1.204-5.696

Notes: Autocorrelation and heteroskedasticity in the analysis are identified through the Breusch-Godfrey Lagrange multiplier test and corrected with a Newey-West covariance estimator. The adjusted values are highlighted by symbol #. ***, ** and * denote significance at the 1%, 5% and 10% levels, respectively.

common variable (ALLOCT). A possible explanation for the difference is that the previous studies (Abdul-Rahim & Yong 2008, 2010) do not incorporate some of the variables considered in the present study. Next, in confirming whether or not the difference in the determinant factors of initial returns between the two groups are influenced by the differences in the characteristics of the issuing firms, the results for the matched sample of Shariah IPOs are examined. The results confirm earlier findings regarding the role of ALLOCT as the sole common factor in the two groups of IPOs. ALLOCT is the only determinant of initial returns among the matched Shariah IPOs.

CONCLUSION AND IMPLICATIONS

The present study examines a sample of 384 IPOs that are issued and listed on Bursa Malaysia during a period spanning from January 1999 to December 2008. The sample IPOs are segregated according to their Shariah compliance status. Since Shariah IPOs constitute the majority of the IPOs in the Malaysian market, a comparison with the non-Shariah IPOs might not be compatible. Accordingly, a matched sample of Shariah IPOs that

contains the same number of IPOs and share similar characteristics with the non-Shariah IPOs is created. The comparison between non-Shariah IPOs and Shariah IPOs (all or matched sample) yield results that demonstrate these groups share only one common factor (i.e., ALLOCT). Therefore, it may be surmised that the two groups are determined by different factors. The results suggest that the initial returns of non-Shariah IPOs are also determined by the reputation of the underwriter and the condition of the market. On the contrary, the initial returns of the Shariah IPOs (all) depends on the size of the offer; the age of the issuer; and the total ownership of the top five shareholders. As far as the result of the matched Shariah sample is concerned, none of the other variables are significant in explaining the initial returns.

Overall, allocation rate (ALLOCT) is the only factor that consistently matters in predicting initial returns of IPOs. The negative impact of ALLOCT on the initial returns of IPOs, regardless of Shariah status, suggests that IPOs that are lowly demanded, and fully award investors' subscriptions as a result, have a greater tendency to offer lower initial returns. As suggested by Amihud et al. (2003), the negative ALLOCT-initial returns relationship indicates the existence of winner's curse in the Malaysian

IPO market, which is consistent with the findings of Yong (2009). The higher the allocation rate of the IPOs that the investors (especially uninformed investors) win, the more likely that they win cursed IPOs (i.e., IPOs that provide lower initial returns). In other words, the uninformed investors are cursed because they win IPOs that are overpriced.

The results of the present study are expected to guide investors and market regulators in formulating their respective strategies. Once the distinctive features of Shariah versus non-Shariah IPOs are established, investors and fund managers should be more confident and receptive to factors that are statistically proven to exert significant influence over the initial returns of the IPOs. The results of the present study reveal that the initial returns of Shariah IPOs are influenced by different factors than those that influence the initial returns of non-Shariah IPOs. Muslim investors should pay more attention to internal factors, particularly the size of the offer; the age of the company; and the ownership concentration of the company. Meanwhile, investors of non-Shariah IPOs should pay closer attention to external factors, such as the reputation of the lead underwriter and the condition of the market.

Regardless of the Shariah status of the IPOs, investors must be wary of the allocation rate of the IPOs. The higher the allocation that one receives, the greater the chance of receiving an overpriced IPO. The findings provide evidence of winner's curse, which implies that the Malaysian IPO market continues to experience high information asymmetry. The winner's curse phenomenon is somewhat alarming because it appears to be driven by the speculative behavior of investors who enter the IPO market and exit at the first available opportunity. This behavior is reflected by the fact that investors are not paying attention to company fundamentals that are disclosed in the prospectus (Daily et al. 2005). Investors are neither influenced by the manner in which companies use IPO proceeds, nor are they influenced by how the companies have performed in the past.

The market regulator might interpret the indifference in the initial performances of Shariah versus non-Shariah IPOs as implying a lacking in the Shariah screening criteria adopted by the SAC. As detailed in the Appendix, the SAC places great emphasis on the permissibility (*halal* or *haram*) of the businesses of the companies, while somewhat neglecting the other elements of Islamic investment, such as *gharar* (uncertainty) and *maisir* (gambling). International Shariah equity screening standards, particularly those of the Council of Islamic Fiqhi Association, evaluate the companies' financial management. Two of the prudent financial management measurements are debt ratio and accounts receivable over total asset ratio (ARTA ratio). In capital structure literature, the gearing ratio is commonly associated with the riskiness of the companies, while the ARTA ratio measures the extent to which the assets owned by companies actually exist and are available to investors.

The present study also proposes that the indifference in the initial returns of the Shariah versus non-Shariah IPOs is due to the manner the SAC publishes the Shariah-compliant status under a blanket (i.e., without awarding any specific rating based upon how well the companies comply with the screening criteria). The blanket labeling is less informative because nearly all Malaysian listed companies (Figure 1) have attained Shariah-compliant status. As an analogy, without any specific rating (AAA, BB and etc.) given to bond instruments, investors have difficulty in differentiating the riskiness and credibility of one bond in relation to another. Therefore, the present study proposes that the specific characteristics of Shariah-compliant stocks need to be examined to determine the rating of the stocks based upon the degree of compliance with Shariah rules. A similar proposition has been forwarded by Mohamad Akram (2006), the former Executive Director of International Shariah Research Academy for Islamic Finance (ISRA), who stresses the need to examine the Shariah-compliant companies not only based upon their income, but also based upon their total debt; cash and interest bearing securities; and account receivables.

ACKNOWLEDGEMENT

The authors wish to acknowledge that this study is part of a larger research project on Shariah IPOs funded by the Ministry of Higher Education under the Fundamental Research Grant Scheme (UKM-TOPDOWN-EP-05-FRGS0002-2011).

ENDNOTES

- 1 The development of the Malaysian Islamic equity market began with the establishment of an informal group called the Islamic Instruments Study Group (IISG) by the SC in 1994, whose main function is to advise market participants on matters pertaining to issues in the Islamic capital market. On 16 May 1996, the SC established the Shariah Advisory Council (SAC), which is comprised of panels consisting of muftis, Islamic finance experts, Islamic scholars and scholars of various disciplines. One of the functions of the SAC is to formulate the screening criteria for assessing and awarding Shariah compliance status to financial instruments that are registered with the SC.
- 2 The paper is last updated on December 22, 2011.
- 3 The signaling model applies when asymmetric information exists between investors (outsiders) and the issuers (insiders). Any action taken by the issuers, including financial decisions, will be translated into a certain signal which the investors rely upon to predict the company's performance.
- 4 Faddish behavior refers to an overreaction by investors that leads to an overvaluation in early aftermarket trading.
- 5 A cascade in the IPO market is a situation where potential investors ignore their private information, but instead imitate earlier investors in making purchasing decisions. The cascade effect is also known as the bandwagon effect.

- ⁶ In 1976, the government of Malaysia implemented a public policy requiring at least 30 percent of IPO share ownership distribution to be reserved for Bumiputra (the indigenous population). The minimum Bumiputra ownership requirement can be fulfilled via ownership of companies; mutual funds; or on an individual investor basis. Abdullah and Mohd (2004) examine the Bumiputra ownership policy as a potential factor that influences the performance of Malaysian IPOs. In contrast to the argument put forth by Moshirian et al. (2009) and the empirical evidence by Ariff and Shamser (1999), the findings of Abdullah and Mohd (2004) reveal that Bumiputra ownership allocation reduces underpricing.

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APPENDIX

SCREENING CRITERIA OF THE SHARIAH ADVISORY COUNCIL

The Shariah screening process of the Shariah Advisory Council (SAC) of the Securities Commission (SC) places emphasis on the main activities and the sources of income of the listed companies. The SC collects information on the position of the companies from various sources, such as the companies' annual financial reports and their responses to the SC's standard survey forms. The SC can also request additional information and data directly from the respective companies. The SAC applies standard criteria, which focus upon the activities of the companies applying for the Shariah-compliant status. The SAC will not grant the Shariah-compliant status to companies that are involved in the following prohibited (*haram*) activities¹:

- a. Financial services based on interest (*riba*);
- b. Gambling;
- c. Manufacture or sale of non-halal products or related products;
- d. Conventional insurance;
- e. Entertainment activities which are not permissible according to the Shariah;
- f. Manufacture or sale of tobacco-based products or related products;
- g. Stock broking or share trading in non-Shariah compliant securities; and
- h. Other activities considered non-permissible according to Shariah.



CONSOLIDATED INFORMATION ON

Turnover (TO) and profit before tax (PBT) of non-approved activities

Statement of Position (SOP) of non approved activities

Interest income

Dividend received from investment in non-approved securities



TO AND PBT CONTRIBUTION

TO and PBT of non-permissible activities vs group's TO and PBT

SOP of non-permissible activities vs group's PBT

Interest income vs group's TO

Dividend received from investment in non-approved securities vs group's PBT



COMPARISON AGAINST BENCHMARK

5 percent - contribution from clearly prohibited activities such as interest, pork, gambling and even manufacturing of condoms.

10 percent - contribution from activities of *umum balwa* like interest from conventional banks or revenue from tobacco-related products.

20 percent - contribution from rental payment from premise for gambling and liquor selling.

25 percent - contribution from activities that are generally *halal* and *umum balwa* but tainted with other prohibited elements such as in hoteling, brokerage houses and airlines.

Notes: Non-approved securities are securities that do not comply with Shariah rules.

Sources: Resolutions of the Securities Commission Shariah Advisory Council ([http://www.mifc.com/sift_09/content/othpub/8ICMbook2\(6\).pdf](http://www.mifc.com/sift_09/content/othpub/8ICMbook2(6).pdf)) Mohamad Akram (2006)

FIGURE A. SAC's quantitative screening criteria for mixed business companies

It is also important to note that the SAC reserves the right to evaluate the mixed companies based on their image (i.e., how these companies are perceived by others) in a separate qualitative evaluation in cases that involve companies that are notorious for engaging in the following

activities: (i) serving alcoholic drinks in public transport; (ii) running a pork-based business; (iii) selling alcoholic drinks in restaurants; (iv) takeovers of casino companies; (v) advertising alcoholic drinks; and (vi) holding equity interest in other listed companies that are not Shariah-compliant.

¹ Securities Commission website <http://www.sc.com>.