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Performance of New Issues: The Malaysian Case

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ABSTRAK

Tujuan kertas ini ialah untuk mengkaji prestasi terbitan saham baru di Malaysia. Prestasi ini dilihat dari segi dua aspek iaitu mengukur sama ada harga saham tersebut terkurang nilai bila diterbitkan dan keduanya sama ada pasaran saham cekap dalam menetapkan harga saham terbitan baru tersebut. Hasil kajian ini menunjukkan bahawa terdapatnya perbezaan harga antara harga tawaran dengan harga yang ditentukan oleh pasaran. Perbezaan harga ini telah mencapai setinggi 400% dan serendah 13%. Walau bagaimanapun pasaran saham di Malaysia menunjukkan kecekapan dalam menentukan harga saham terbitan baru ini kerana tidak ada perubahan yang berkesan atas harga setelah satu tahun saham-saham ini diterbitkan.

ABSTRACT

This paper examines the performance of new issues in Malaysia. Two aspects of performance were examined. Firstly whether there are any underpricing in the pricing of new issues and secondly whether the market is efficient in pricing these shares. The result of this study showed an existence of underpricing as high as 400% and as low as 13%. However, the Malaysian stock market is efficient in the pricing of these new issues. Price of these shares do not experience significant differences from the initial pricing in the opening day within one year after listing.

INTRODUCTION

There are many reasons for companies to issue new shares. In Malaysia it is a common method to seek listing in the Kuala Lumpur Stock Exchange. As a method of financing it is not favourable among companies with new issue making up only 4% of total method of financing (Fauzias and Muhammad 1989). However there has always been keen interest from investors whenever firms issue new shares. New issue are always oversubscribed on average to about 28 times. One of the probable reasons for this overwhelming interest is that new issues are underpriced.

All new issues are controlled by a central body namely the Capital Investment Commitee whose main purpose is to protect the well being of investors. The offering price is determined by a set of guidelines based on the sector the company is in. However there seemed to be a great disparity between the price offered and the price perceived by the investors in the market.

The purpose of this paper is to examine the performance of new issues in Malaysia. This paper will determine whether new issues are underpriced and also to measure the return of these issues within a period of one year. This paper will also determine whether the Kuala Lumpur Stock Market is efficient in pricing these issues. Results of this study should be significant to parties involved in new issues.

Studies on new issues were mainly concentrated in the US market. Mcdonald and Fisher's (1972) study was among the earlier studies which covered new issues offered in the period 1969 to 1970. The results of the study showed that for those investors who were able to acquire the stock 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 -3.2%. The performance of the same stock using post-offered price as a base showed a higher negative return of -18.1% on the first year. The study concluded that the market efficient in adjusting the price of the new issues.

Reilly (1973) examined the short run performance of new issues offered in a rising and declining market in the period 1963 to 1965. New issues provide on the average positive percent changes compared to the index choosen. This return persisted till the first year in a rising market but were negative in the declining market. The performance based on post offered prices showed that new issues offered in the rising market fared better than the ones offered in the declining market.

Attempts were made to examine the reasons for the initial high returns of these new issues. Logue (1973) tested the relevant motives of participants in new issues namely the issuer, the investor and the investment banker and found that current market conditions played a significant role in the performance of new issues. Other significant factors are size of issue and percentage of secondary issues. Factors examined but not significant were underwriter's prestige, debt, non cash compensation and past market conditions.

Van Horne (1970) examined the effect of listing of stock previously traded in the over-the-counter markets (OTC). The listing stocks were thought to benefit in the terms of prestige and free publicity and therefore investors should favour it. Price changes were noted 4 months before listing and 2 months after listing and compared with index changes of the NYSE and the ASE. The study found that on the average stocks experienced an

increase in price prior to listing and dropped after it was listed. However the results showed a significant reduction if transaction cost were taken into consideration. The results also showed that the new issues fared better when compared with the ASE index suggesting that there may be certain biasness in the use of industry averages to compare the performance of the new issue with other group of stocks. When the results were partitioned into rising and declining market, the listing fared better in a rising market. The paper concluded that listing may not be a reasonable factor in the performance of stocks.

Reilly (1978) made an update on his previous study using data from the period 1972 to 1975. The results still showed that on average new issues provided higher returns within the first week of issues, but mixed results within the month and negative returns within a year. The first year results were however influenced by a declining market. Test using post-offered prices still showed negative results.

A recent study by McConnell and Sanger (1987) covered longer time periods and employed a variety of empirical methodologies. The study used data from the period 1926 to 1982 and found that the market adjusted return were negative. The average raw return however were positive in all 12 months after listing expect for the first month. The study failed to discover a satisfactory reason why the negative results and concluded that the results were not influenced by time periods, outlier observations, original trading place, listing place, issuance of new stock on listing, insider's "dumping" and overreaction of investors.

Dawson (1987) compared the performance of new issues in three 'eastern' markets namely the Hong Kong, Singapore and Malaysian market for the period 1978 to 1984. The study found positive initial return on the three exchanges with the Malaysian market being the highest with an average 166.6%. However subsequent positive returns were no longer available on the Hong Kong and Singapore Exchanges once the stocks were traded. A different pattern was found in the Malaysian exchange as price changes were positive and kept increasing. However the percentage increase is smaller compared to the initial pricing.

In general, the early studies showed that new issues were underpriced and no adequate reasons were found to explain this phenomena. This paper differs from the Dawson (1987) study in two aspects. Firstly this study uses a more recent data and incorporate a longer source period. Secondly, the performance and the efficiency of the market will be determined by using statistical tests.

METHODOLOGY

The data used in this study were new issues offered between 1980 to 1986. There were 43 new issues offered during that period. For each issue, the closing price was taken on the opening day, the 7th day, the first month, the third month, the sixth month and the first year after issue. Similarly, the corresponding Kuala Lumpur Stock Exchange industrial index were also taken on each of these dates for each issue.

The return of the new issue were measured by taking the difference of the closing price at the specific date in question with the offering price and divided by the offering price as shown below.

$$R_{j,t} = [P_{j,t} - P_{j,o}] / P_{j,o},$$

where $R_{j,t}$ is the return of stock j in the period t, $P_{j,t}$ is the price of stock j at the period date t and $P_{j,o}$ is the offering price of stock j. Return were also measured with $P_{j,o}$ using the opening price as to determine the return for investors who were unable to buy the stock when it was offered but bought it on the opening day.

For each stock on the specific period, corresponding market return were determined as follows:

$$R_{m,t} = [I_t - I_p] / I_p,$$

where $R_{m,t}$ is the return of the market, I_t is the index at the period date t as in above and I_p is the index on the opening date. For each stock, the excess return were calculated as follows:

$$D_{j,t} = R_{j,t} - R_{m,t},$$

$$\text{and } \bar{D}_t = 1/N \sum_{i=1}^{n} D_{j,t},$$

where $D_{j,t}$ is the difference of the stock return with the market and N is the number of stock issues used in this study. If there are underpricing in the pricing of new issues, then D_t should be greater than zero.

The following null hypothesis were tested:

1. H_o $\mu_1 = \mu_2 = \ldots\ldots \mu_6$, that is the average excess return are equal
2. H_o $\mu_1 = \mu_i$, that is the average excess return based on the offered price is equal to the average return of the period i.

For the first hypothesis, if the market is efficient in the pricing of new issues, then there should not be any significant difference in the averages. The second hypothesis is to determine whether there are any significant differences between the average return based on the offered price with any of the other period. Again if the market is efficient, there should not be any difference.

The oneway variance analysis was used on the first hypothesis. The null hypothesis will be rejected if observed F is greater than the F-table value at 5% significance level. The Scheffe technique will also be used to determine which averages are significantly different from the initial average return.

The t-test for independent sample as well as the t-test for paired sample were used on the second hypothesis. The null hypothesis will be rejected if observed F is greater than the F table value at 5% significance level.

Further analysis were made by classifying the new issues into groups of return and subjected to the same statistical tests. The purpose is, firstly to examine the performance of the new issues based on the results on the first day and secondly, is to determine whether those issues with high first day return could sustain the same performance throughout the first year. The first group was made up of those issues with excess return between 0 to 50% on the opening day. Excess return 51% to 100% make up the second group, 101% to 200% the third group and more than 201% the fourth group.

FINDINGS

The average excess return of new issues based on the offered price is shown in Table 1. The average excess return on the first opening day was 140.5%. The maximum return achieved among the new issues was 425% and the minimum 13%. The price of these new issues continued to increase considerably till the first year to produce a return of up to 151.6%, meaning that the price of new issue on average continue to increase in price.

However there were no indications that the increase was significantly different from the opening price. Therefore, the null hypothesis that there are no difference in return between the initial return and other period is accepted. This goes to show that once the new issues were priced on the opening day, it is generally maintained at least throughout the first year after listing. The Scheffe technique also confirmed this result.

Table 2 shows the performance of the new issues using the opening price as a base. As expected the return were considerably smaller with only 2.90% within the first week. The performance improved at the end of the first year to register a return of 10.9%. These returns however were significantly different from the opening return, which reinforced the result in Table 1.

Grouping the shares into groups of returns resulted in 26% of the shares made up the first group, 26% in the second group, 26% in the third group and 22% in the fourth group.

TABLE 1 Average excess return on new issues for the period 1980 to 1986

	Initial	1st week	1st month	3rd month	6th month	1st year
Excess return	1 405	1 425	1 436	1 468	1 497	1 516
Std Deviation	1 035	0 956	0 993	0.987	1 044	1 235
Median	1 000	1 110	1 120	1 250	1 090	1 150
Skewness	0 996	1 085	0 818	0 511	0 712	1 427
Independent t-value		−0.09	−0 14	−0 29	−0 41	−0 45
(p-prob)		(0 927)*	(0 889)*	(0 775)*	(0 685)*	(0 654)*
Pairwise t-value		−0 42	−0 46	−0 62	−0 70	−0 63
(p-prob)		(0 677)	(0 648)	(0 536)	(0 491)	(0 535)
Oneway F-value	0 0732	Mean Squares				
(p-prob)	(0 9962)	Between groups 0 08 Within groups 1 0934				

* Denotes pooled variance

TABLE 2 Average excess return on new issues at post offered prices

	Initial	1st week	1st month	3rd month	6th month	1st year
Excess return	1 405	0 029	0 033	0 061	0 090	0 109
Std Deviation	1 035	0 148	0 157	0 256	0 325	0 457
Median	1 000	0 020	0 020	0 050	0 070	0 060
Skewness	0 996	1 021	0 179	0 818	1 059	2 034
% negative return		44	44	37	42	42
Independent t-value		8 63	8 59	8 27	7 95	7 51
(p-prob)		(0 000)	(0 000)	(0 000)	(0 000)	(0 000)
Pairwise t-value		8 23	8 31	7 79	7 45	7 15
(p-prob)		(0 000)	(0 000)	(0 000)	(0 000)	(0 000)
Oneway F-value	51 7918	Mean squares				
(P-prob)	(0 000)	Between groups 12 927 Within groups 2496				

* Denotes pooled variance

The performance of the new issues according to these groups is shown in Table 3. As can be seen, generally all groups offer positive excess returns. However the trend is not consistent between the four groups. For the first group, the highest return of 59% were registered in the sixth month, significant differences from the opening were also registered within the first week and the first month using the pairwise t-test. The correlation coefficient between the initial return and the first week return is 0.703 and with the first month return is 0.719 indicating that the pairwise test is a better measure. For this group there is indication of a slight increase in price till the first month after issue. After the third month there seemed to be no difference in the return compared to the initial return.

The performance of the second and third group were considerably better. Both group shows an increasing trend till the first year. However all satistical test showed no significant differences. The fourth group on the other hand could not sustain the high opening day performance. It showed a decreasing trend. Again no statistical significant difference was registered.

Table 4 shows the performance of the group using the opening price. Group one provide a better performance compared to other groups. Within the third month the excess return was 15.5% and within the year with 9.4%. The oneway variance statistical test showed that there are no significant difference between the initial return and the other periods, suggesting that there may be an adjustment in prices during the first year. This result seem to confirm the result in table 3 for group 1.

Group two and three showed better results within the first year, with 12.6% and 19.8% respectively. However on checking the raw results, this performance could be influenced by some stocks in the group with extremaly high returns, reaching as high as 208% within the first year. The results were significantly different from the initial price. The performance of the fourth group were smaller as expected, with lowest return as early as the first week and within the first year only provide a 1% return.

CONCLUSION AND IMPLICATIONS

In general, underpricing exists in the issues of new shares in the Kuala Lumpur Stock Exchange. Investors who are fortunate to acquire these shares at the offered price is guaranteed a positive high return, as high as 400%. No knowledge of investment techniques are needed to decide whether an investment should be made on the new offerings.

Once these new shares were priced by the market on the opening day, it is generally maintained within the year. Investors could obtain positive returns if they sell their shares any time within the year. This result is

TABLE 3. Average excess return on new issues according to return groups

	Initial	1st week	1st month	3rd month	6th month	1st year
Group 1						
Excess return	0.363	0.539	0.490	0.585	0.590	0.551
Std. Deviation	0.149	0.318	0.263	0.438	0.410	0.491
Median	0.430	0.490	0.500	0.540	0.590	0.780
Skewness	−0.851	0.466	−0.349	0.606	−0.571	−0.728
Independent t-value		−1.67	−1.40	−1.59	−1.73	−1.22
(p-prob)		(0.117)	(0.178)*	(0.137)	(0.109)	(0.247)
Pairwise t-value		−2.46	−2.25	−2.11	−2.03	−1.33
(p-prob)		(0.034)	(0.048)	(0.061)	(0.069)	(0.214)
Oneway F-value	0.5995	Mean squares				
(P-prob)	(0.7004)	Between groups 0.0792 Within groups 0.1322				
Group 2						
Excess return	0.881	0.985	0.936	0.975	1.189	1.235
Std. Deviation	0.117	0.357	0.350	0.477	0.823	0.787
Median	0.900	1.050	0.950	0.930	1.040	1.120
Skewness	−0.519	0.702	0.067	0.541	1.626	1.299
Independent t-value		−0.91	−0.50	−0.64	−1.23	−1.48
(p-prob)		(0.378)	(0.628)	(0.536)	(0.246)	(0.169)
Pairwise t-value		−1.11	−0.64	−0.68	−1.25	−1.51
(p-prob)		(0.293)	(0.537)	(0.509)	(0.241)	(0.162)
Oneway F-value	0.7638	Mean squares				
(P-prob)	(0.5795)	Between groups 0.2277 Within groups 0.2981				
Group 3						
Excess return	1.565	1.524	1.595	1.691	1.746	1.923
Std. Deviation	0.350	0.433	0.539	0.794	0.804	1.475
Median	1.650	1.560	1.470	1.550	1.870	1.870
Skewness	−0.145	−0.320	0.171	0.475	0.064	1.945
Independent t-value		0.25	−0.15	−0.48	−0.68	−0.78
(p-prob)		(0.806)*	(0.878)*	(0.639)	(0.505)	(0.451)
Pairwise t-value		0.59	−0.21	−0.51	−0.69	−0.75
(p-prob)		(0.568)	(0.838)	(0.621)	(0.507)	(0.469)
Oneway F-value	0.3515	Mean squares				
(P-prob)	(0.8793)	Between groups 0.2375 Within groups 0.6756				
Group 4						
Excess return	2.952	2.775	2.850	2.735	2.557	2.438
Std. Deviation	0.686	0.756	0.640	0.536	0.991	1.167
Median	2.755	2.555	2.895	2.750	2.575	2.065
Skewness	0.861	1.528	0.500	−0.310	−0.089	0.461
Independent t-value		0.55	0.34	0.79	1.04	1.20
(p-prob)		(0.590)*	(0.735)*	(0.441)*	(0.314)*	(0.245)*
Pairwise t-value		1.56	0.46	0.77	1.07	1.16
(p-prob)		(0.154)	(0.652)	(0.459)	(0.313)	(0.276)
Oneway F-value	0.5291	Mean squares				
(P-prob)	(0.7532)	Between groups 0.3601 Within groups 0.6805				

* Denotes pooled variance

TABLE 4. Average excess return on new issues at post offered prices according to return groups

	Initial	1st week	1st month	3rd month	6th month	1st year
Group 1						
Excess return	0.363	0.121	0.094	0.155	0.145	0.094
Std. Deviation	0.149	0.164	0.142	0.239	0.284	0.347
Median	0.430	0.050	0.050	0.110	0.280	0.150
Skewness	−0.851	0.454	0.011	0.360	−0.540	−0.661
% negative return		18	18	18	27	36
Independent t-value		3.62	4.34	2.46	2.25	2.36
(p-prob)		(0.002)*	(0.000)*	(0.023)*	(0.036)*	(0.034)
Pairwise t-value		4.17	4.76	3.19	2.28	2.31
(p-prob)		(0.002)	(0.001)	(0.010)	(0.046)	(0.043)
Oneway F-value	2.0829	Mean squares				
(P-prob)	(0.0800)	Between groups 0.1136 Within groups 0.0546				
Group 2						
Excess return	0.881	0.047	0.010	0.033	0.128	0.126
Std. Deviation	0.117	0.172	0.155	0.243	0.429	0.426
Median	0.900	0.030	0.020	0.020	0.040	0.030
Skewness	−0.519	1.167	0.059	0.621	1.705	1.179
% negative return		36	45	36	45	36
Independent t-value		3.28	14.88	10.44	5.62	5.66
(p-prob)		(0.000)*	(0.000)*	(0.000)	(0.000)	(0.000)
Pairwise t-value		15.28	18.95	11.06	5.68	5.95
(p-prob)		(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Oneway F-value	15.0726	Mean squares				
(P-prob)	(0.0000)	Between groups 1.2353 Within groups 0.0820				
Group 3						
Excess return	1.565	−0.017	0.025	0.063	0.077	0.198
Std. Deviation	0.350	0.102	0.180	0.324	0.356	0.681
Median	1.650	0.020	−0.010	0.060	0.120	0.060
Skewness	−0.145	−0.728	0.555	1.389	0.671	0.463
% negative return		45	64	45	45	36
Independent t-value		14.41	12.99	10.46	9.89	5.93
(p-prob)		(0.000)	(0.000)	(0.000)*	(0.000)	(0.000)
Pairwise t-value		14.88	12.05	9.37	8.50	5.26
(p-prob)		(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Oneway F-value	29.0313	Mean squares				
(P-prob)	(0.000)	Between groups 4.1615 Within groups 0.1433				
Group 4						
Excess return	2.952	−0.043	0.001	−0.014	−0.001	0.010
Std. Deviation	0.686	0.090	0.155	0.205	0.210	0.318
Median	2.755	−0.050	−0.010	0.005	0.030	−0.140
Skewness	0.861	1.423	0.233	0.171	0.346	0.426
% negative return		80	50	50	50	60
Independent t-value		13.70	13.28	13.11	13.03	12.31
(p-prob)		(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Pairwise t-value		13.34	11.94	11.13	11.36	10.85
(p-prob)		(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Oneway F-value	127.2814	Mean squares				
(P-prob)	(0.000)	Between groups 14.6199 Within groups 0.1149				

* Denotes pooled variance

consistent regardless whether the amount of increase registered at the opening day is high or low. We can say that the market is efficient in determining the price of these new issues.

As stated ealier new issues are normally oversubscribed. Small investors are chosen through balloting and large investors will be party fulfilled. Investors who were not successful in their bid for the shares could still obtain some positive returns up to 20% if held for one year after issue. However investors should pay attention to issues that register small increase in the opening day. These shares generally offer better return six months after issue. Caution should be exercised on new issues with high opening price compared to the price offered as their performance were not impressive.

The results of this study is consistent with ealier studies on new issues, in respects that they are underpriced and that the market is efficient in pricing these new shares once it is opened to the market. However, there seemed to be extraodinary high amount of underpricing in the KLSE compared to other markets. Further research on this phenomena could be done to ascertain as to why this difference exists. Certain issues like firm's fundamental condition and market influences could be examined to explain why certain issues were highly underpriced compared to others.

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