PERFORMANCE OF NEW STOCK ISSUES ON THE KLSE

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ABSTRACT

This paper investigates the price performance of new issues of common stock at the time of initial listing and during the period following their initial listing on The Kuala Lumpur Stock Exchange during the period January 1980 to December 1989. The results indicate significant returns at the time of initial listing and insignificant returns during the period following their initial listing.

1. INTRODUCTION

During the last decade, there was a large number of new listings on The Kuala Lumpur Stock Exchange (KLSE). Seventy-eight companies had their shares listed during the period January 1980 to December 1989 (Appendix 1).

The objectives of the study are (i) to measure the returns (or issue price discount) achieved by investors from these new shares upon listing; (ii) to measure the change in these share prices for the first week of listing, the first six months of listing and one year of initial listing; and (iii) to see if there is a correlation between oversubscription rate and excess returns upon listing.

The theory of efficient markets suggests that the price of newly-issued stock will quickly adjust to reflect the available set of relevant information. If the efficient market model is applicable to the KLSE market of new common stock issues, subsequent price behaviour should be independent of the initial rate of return at offering.

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It has also been hypothesised that newly listed stocks show a pattern of first rising through the listing and falling thereafter. To analyze stock price movements subsequent to listing, we collected the closing prices for the first week (5 days) of trading, the closing end-of-week prices for the first six months and the prices one year after listing.

2. PRIOR RESEARCH OF NEW ISSUES

A large number of studies on new issues has been carried out on the stock exchanges in the United States, the United Kingdom and Australia. Among those are studies by Reilly and Hatfield (1969), Stoll and Curley (1970), McDonald and Fisher (1972), Ibbotson (1975), Reilly (1977) and Ritter (1984) in the U.S., Davis and Yeomans (1976), Buckland, Herbert and Yeomans (1981) in the U.K., and Finn and Hignam (1988) in Australia. These studies reported that the new issues showed positive initial performance relative to the market from the offering price to the price at the end of the first week or first month on trading.

This positive initial performance, as suggested by the authors, is due to underpricing by underwriters. Underpricing has also been observed in Singapore by Koh and Tee (1985) and Wong and Chiang (1986). Underpricing means the issue price of new shares of stock is lower than the market price when trading begins.

Authors have attempted to explain this underpricing phenomenon. In the U.S., Baron (1982) argued that the discount is due to the superior information of the investment banker who sets the price and distributes the issue. Parson and Raviv (1985) argued that the discount is a result of asymmetric information among investors, and they explained how both seasoned and unseasoned offerings are, on average, underpriced. Rock (1986) proposed that the issuing firm and investors are uncertain about the value of the new issues and that shares must be offered at the discount to guarantee purchase by the uninformed investors.

Finn and Higham (1987) who studied issues on the Sydney Stock Exchange over a period of 12 years, suggested that the joint process of initial issue-cum-listing, the listing requirements and the vesting of allocation rights to issue in the broker plus barriers to entry to stockbroking facilitated underpricing.

The size of underpricing, or issue price discount, varies from one study to another depending on the general state of the market. Among those studies, Ibbotson (1975) found, on average, an 11.4% discount in the offer price of 120 new equity issues in 1960-69 which disappeared within weeks in the aftermarket. Ibbotson and Jaffe (1975) found a 16.8% average excess return relative to the market.

Reilly and Hatfield (1969) found an average of 9.9% price discount based on the performance of 53 new equity issues from 1963-65. This was then confirmed by Reilly (1973, 1977) in his study on 62 new issuance in 1969 and 486 new issues during 1972-75.

Dawson (1985) examined 29 new equity issues offered in 1978-84 and found that these issues were underpriced, on average, by 37.5% from the market price of the first day of trading in Singapore. Koh and Tee (1985) who looked at price performance and risk of 62 new issues during the period 1973-84 showed a 33.8% and 36.5% discount during the first month of trading respectively.

Othman Yong (1991) who studied the new issues in Malaysia from 1983 to 1988 shows that the returns for these investments are high, especially for the first day the average return being approximately 167 percent. The returns after the first day and up to one year decline and are not significantly different from the returns on the first day of trading.

3. THE INSTITUTIONAL SETTING

The Kuala Lumpur Stock Exchange (KLSE) was set up as an exchange of its own in July 1973 following the split of the Stock Exchange of Malaysia and Singapore into two exchanges The KLSE and the Stock Exchange of Singapore (SES). At the end of 1973, there were 262 companies listed on KLSE of which 155 were Malaysian incorporated, 69 were Singapore incorporated and the remaining 38 were domiciled in other countries, especially Britain.

By 1984, the number of companies listed reached 282. This increase came only from the Malaysian companies since no new listings were then allowed from foreign companies. The number of British-domiciled companies decreased over the years when many restructured themselves to become Malaysian companies. The number of companies by country of incorporation over the years 1973-1989 can be seen in Table 1.

Malaysian incorporated companies were effectively delisted from the Stock Exchange of Singapore (SES) on 1 January 1990. A similar move was made by Singapore, resulting in the delisting of all their companies on The KLSE on 1 January 1990.

On 11 November 1988, The KLSE launched its Second Board, and by 31 December 1989, two companies were listed on this board. Companies listed on the Second Board are smaller in size and younger in age compared to those on the Main Board.

Table 1

NUMBER OF COMPANIES LISTED ON THE KLSE BY COUNTRY OF INCORPORATION (1973 — 1989)

Year	Malaysian	Singapore	Others	Total
1973	155	69	38	262
1974	163	67	34	264
1975	167	67	34	268
1976	173	64	27	264
1977	177	59	20	256
1978	180	57	16	253
1979	185	57	12	253
1980	182	57	12	250
1981	187	55	11	253
1982	194	57	11	261
1983	204	57	11	271
1984	218	57	8	282
1985	222	57	6	294
1986	227	55	6	288
1987	232	54	5	291
1988	238	53	4	295
1989*	251	53	3	307

* include two Second companies

The main objective of the Second Board is to enable small and medium-sized companies, which are profitable and which have good growth prospects, to raise capital funds to finance their business expansion. The stringent listing requirements of the Main Board and the Capital Issues Committee (CIC) tend to deny smaller companies the opportunity to raise public funds. The Second Board would therefore facilitate and accelerate access to the capital market for these smaller companies.

The KLSE has two listing manuals one for the Main Board and another for the Second Board. The listing requirements for the Second Board are basically the same as those for the Main Board except that the entry requirements are lower and the continuing listing requirements are stricter. The listing requirements will not be discussed here but the various steps involved in the listing process will be briefly outlined.

Before a company's stock can be listed on The KLSE, the company, in accordance with Section 6 of the Securities Industry Act (1983), must submit its application to the CIC. It also submits its Memorandum and Articles of Association for KLSE's approval and files initial listing application and supporting papers with The KLSE.

Upon approval from the CIC and KLSE, the company registers its prospectus with the Registrar of Companies (ROC). It then advertises and issues its prospectus to the public and the offer period opens. The company then announces basis for allotment and issues shares pursuant to the allotment. Shares are then admitted to the official listing. Three market days after certificates have been despatched, shares are traded on The KLSE.

METHODOLOGY

4. DATA COLLECTION

The research covers a period of 10 years, commencing from January 1980 to December 1989. All companies that sought first listing on The KLSE during the time, either through public issue or offer for sale were included in the study. This resulted in 63 issues representing 7 different sectors: industrial & commercial (41), finance (8), property (7), trust (2), plantation (2), second board (2), and hotel (1).

Data concerning the subscription price and oversubscription rate (number of times the shares were being oversubscribed) were gathered to see if there is any correlation between the two variables as being one of the objectives of our study. There were only 44 companies that had the information on oversubscription rate.

In addition, thirteen closing market prices were obtained: the first 5 trading days; month-end prices of the first through sixth months and the twelfth month after trading. In choosing the first month-end price, the month being considered was the month when the initial listing was made if listing fell on the first till the 15th of the month. If, on the other hand, initial listing fell on the 16th onwards, the following month-end would be considered as first month-end. Besides prices, sectoral indices were also obtained. (Industrial index was also used for Trust companies and those listed on the Second Board since there were no established indices for both sectors).

5. DATA ANALYSIS

In our analysis, risk was assumed to be constant and thus the data were not adjusted for risk. In finding out the change in price and the excess returns on the selected dates, we adopted a simple model, similar to the one used by Barnes (1978) in his research to find out if there is any significant change in share prices.

First of all, indices for relative price change and relative index change were computed for all companies on each date. KLSE sectoral indices were used here in order to remove the influence of market movements. The difference between both indices computed was then calculated on each date using the following formula:

$$Di = \left(\frac{Pi\,t}{Pi\,t'} - \frac{Ii\,t}{Ii\,t'} \right) \times 100$$

where Di = difference for *ith* company

$Ii\,t$ = KLSE sectoral index on *t*- date

$Ii\,t'$ = KLSE sectoral index on *t*-1 date

$Pi\,t$ = share price of firm on *t*- date

$Pi\,t'$ = share price on *t*-1 date

The average price difference ($\overline{x}_d$) would then be calculated as $\overline{x}_d = \Sigma^n_{i=1} Di/n$ where n = number of companies in the sample. We refer $\overline{x}_d$ as average excess returns where *t* is the first day of listing and *t'* is the last day for subscription.

Average excess returns were calculated for all companies in the sample as a whole and also according to sectors. As for the change in price on subsequent trading days, we did not divide them into sectors since the number of companies in sectors other than industrial and commercial were small. The price change had been observed on a daily basis for the first five days and on a monthly basis for the first six months and one year after the initial listing. We also grouped them together in applying statistical tests.

The data were further analysed to see if the excess returns was significantly large and if there were any significant change in price on the subsequent dates. For these purposes we use the Z-test, and the significant level is set at 5%.

Setting our hypotheses (H_0) to be $\mu = 0$, that is to say that there was no difference between price change and index change, Z-values were calculated as follows:

$$Z = \frac{\bar{x}_d - 0}{\sigma / \sqrt{n}} \qquad \text{where } \sigma = \sqrt{\frac{\Sigma D^2}{n} - \left\{\frac{\Sigma D}{n}\right\}^2}$$

To achieve our final objective, that is to see if there is any correlation between oversubscription rate and excess returns, the data was analysed using Pearson r correlation coefficient.

6. RESULTS

As shown in Table 2, the excess returns ranged from 19.74% (for hotel) to 125% (for industrial and commercial). This test is significant at the 5% level of significance.

It may be argued that excess returns could be affected by the size of the issuing company or the size of the new issue. However, the sample size is too small for conducting any statistical test of significant excess returns.

Table 2

AVERAGE EXCESS RETURNS

Industry	Number of companies	Returns (%)
Industrial & Commercial	41	125.00
Finance	8	117.50
Property	7	114.50
Plantation	2	27.50
Trust	2	23.99
Hotel	1	19.74
Second board	2	56.86
Overall	63	114.60

Table 3 shows the daily percentage change in price, the Z-values and the cumulative percentage change in price after the initial listing. There have been very little changes; the price dropped merely by 0.069% on the second day followed by an increase of 0.237%, 0.196% and 0.080% on the third, fourth and fifth day respectively. The small Z-values indicate that the changes were not significant.

Table 3

DAILY PERCENTAGE CHANGE IN PRICE

Day of listing	Average change (%)	Z-values	Cumulative change (%)
1 to 2	–0.069	–0.118	–0.069
2 to 3	0.237	0.355	0.168
3 to 4	0.196	0.312	0.364
4 to 5	0.080	0.272	0.445

The results of our study on the monthly changes are shown in Table 4. Again, the Z-values of less than 1.96 and greater than –1.96, indicate that the changes were not significant.

Table 4

MONTHLY PERCENTAGE CHANGE IN PRICE

Day of listing	Average change (%)	Z-values	Cumulative change (%)
Day 1 to month-end 1	1.174	0.516	1.174
Month-end 1 to 2	–0.490	–0.410	0.684
Month-end 2 to 3	–0.200	–0.710	0.484
Month-end 3 to 4	1.509	1.091	1.993
Month-end 4 to 5	0.288	0.206	2.281
Month-end 5 to 6	0.711	0.623	2.992
Month-end 6 to 12	5.338	1.530	8.330

As observed in Table 4, the cumulative change up to the twelfth month-end (8.330%) is quite large. We therefore used the Z-test again to compare the price on the first day listed with the prices on each month end observed. The result is as in Table 5.

Table 5

CHANGE IN PRICE FROM INITIAL LISTING

Month-end compared	Z-values
1	0.516
2	0.369
3	0.486
4	0.904
5	0.891
6	1.454
12	1.684

The small Z-values in Table 5 also indicate that there were no significant difference in price between the initial listing and the following months, up to one year. We can therefore conclude that the after-market returns of new issues after the initial listing were small and insignificant. This finding is similar to most of that found in the U.S., and some other countries stated in the literature review.

It is consistent with the efficient market hypothesis, which implies that one will make no abnormal returns if he participates in the market on the first day of listing and thereafter.

The result of the analysis for correlation between the oversubscription rate and excess returns shows a correlation coefficient, r = 0.6383. This means that there is a significant correlation between the number of times shares were oversub-scribed and the excess returns.

7. CONCLUSION

Based on the findings of this study, we can conclude that there is no significant change in prices after the shares were listed on the exchange. Though the returns are high on the first day of trading, they are small and insignificant after that. Price changes in the first week of trading, the first six months and one year after listing were small and insignificant. This finding is similar to most of that found on the other exchanges as observed from other research. It is consistent with the efficient market hyphothesis which implies that one will not make an abnormal return if he participates in the market on the first day of listing and thereafter.

This study also analyses if there is any relationship between the number of times shares were oversubscribed and their excess returns for 44 new equity issues. It is found that there is a significant positive relationship between the two variables. Shares obtaining high over-subscription rate tend to obtain high excess returns. This is probably due to the large spread between the highest and lowest values of the variables. The range for the oversubscription rate was from 0.38 to 132.40 and the excess returns percentage ranges from 2% to 372%.

Although our findings have furnished evidence on the performance of new stock issues after their listing on The KLSE until one year later, they do not explain the factors that might influence the size of the excess returns. The correlation coefficient only expresses the extent to which the two variables are related and does not establish any causal link between them. Future studies could focus on this matter in attempting to clarify the initial performance of new issues upon listing.

APPENDIX 1

1980
Jacks International
Industrial Oxygen Incorporated Bhd
Cold Storage (M) Bhd

1981
Palmco Holdings Bhd
Malaysian Oxygen Bhd
United Estate Projects Bhd
IGB Corporation Bhd (Ipoh Garden)
Timah Langat Bhd

1982
Rothmans Industries Ltd
Multi-Purpose Holdings Bhd
Chocolate Products (M) Bhd
Lion Corporation
Federal Flour Mills
Asiatic Development
Rasa Sayang Beach Hotels
Harrisons Malaysian Plantations
Petaling Garden

1983
Amalgamated Steel Mills
CI Holdings
Perusahaan Pelangi
MBf Corporation
Amalgamated Industrial Steel
D&C Bank
Time Engineering
Malaysian Pacific Industries
Antah Holdings
Mulpha Int. Trading

1984
Renong Bhd
Sungai Way Holdings
Malaysia Aica Bhd
Gopeng Bhd
Cement Industries of Malaysia
Idris Hydraulic
British-American
Kumpulan Emas
Malaysian General Investment Corp
Sitt Tatt Bhd
Muda Holdings
Kian Joo Can Factory
Dayapi Industries
Pilecon Engineering

1985
Metroplex
Granite Industries
Hong Kong Tin Corporation
Lam Soon Huat
Malaysian Airline System

1986
Mechmar Bestobell
Maruichi
OYL
IJM Engineering

1987
Malaysia British Assurance
Rothmans of Pall Mall
MISC
Dreamland
Pengkalen Holdings
Sports Toto
Southern Bank

1988
Mun Loong
Tradewinds
Sistem Televisyen Malaysia
KFC Holdings
Arab-Malaysian Merchant Bank
Rashid Hussain
Cement Manufacturing Sarawak

Bank of Commerce
UMW Holdings

1989
Kretam Holdings
Nanyang Press
Kamunting Corp
Arab-Malaysian First Property Trust
Goh Ban Huat
Malaysian Helicopter Services
Resorts World
Lim Kim Hai Holdings
Kumpulan Guthrie
Autoways Holdings
First Malaysia Property Trust
Nestle

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