UNDERPRICING IN THE MALAYSIAN IPO MARKET DURING 2009-2014

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Introduction
IPO is a mechanism by which a private company garners capital by issuing shares to the public for the first time and in the process while becoming a public firm. IPOs help firms to generate huge capital which in turn facilitates the expansion of the firm.

Empirical studies have documented that around the world IPOs are getting listed with significant premium to issue price. Due to which, investors earn an abnormally high return on the day of listing.

The purpose of this paper is to determine the extent of underpricing that exists in the Malaysian market. Data regarding all IPOs listed in Malaysian stock market from 2009 to 2014 is used for making this evaluation.

Extant Literature
In this section, literature, which details about theories stating the causes of underpricing in IPOs and the global presence of underpricing, has been dealt with.

Chemmanur (1993), Kim et al (1995), Vong (2006) and Agarwal et al. (2008) have mentioned underpricing of IPOs and have also analysed the reasons of this. Reber and Fong (2006) have studied the impact of various factors like underwriter certification, subscription levels of shares on offer, equity market conditions and industry sector on the underpricing of IPOs. They came up with the finding that subscription levels of shares on offer have the most important impact on underpricing. Khurshed et al. (2008) have proved that retail and non-institutional investors follow the institutional investors' subscription patterns when bidding for shares.

The presence of underpricing around the world has also been extensively studied. Sullivan and Unite (1999) have analysed underpricing with respect to Philippines. They discovered that underpricing of Philippine IPOs is considerably less when compared to other emerging market countries and less than other Pacific-Rim countries. Omran (2005) studied underpricing in the Egyptian market and found that the initial excess returns are determined by ex-ante uncertainty and oversubscription. Vong and Trigueiros (2010a) based on their study of the Hong Kong market mentions that underwriter’s reputation has the most significant effect on underpricing. Other notable studies are by Alvarez and Gonzalez (2005) devoted to the Spanish stock market, Kooli et al. (2006) devoted to Canada, Datar and Mao (2006) devoted to China, Aggarwal et al. (2008) examining the Hong Kong stock market, Dash (2015), Dash and Sundarka (2015) and Gaur and Dash (2015) devoted to the Indian stock market.

Theories Explaining Unerpricing of IPOs
Various theories and possible explanations for underpricing has been put forward by eminent authors, which are detailed as follows.
**Information Asymmetry model**

Baron and Holmstrom (1980) put forward the argument that underpricing is due to the information asymmetry between the security issuer and the investment banker about market conditions. Rock (1986) states that there exists a set of investors who are more informed than the firm and all other investors. Due to which, if an IPO is issued at the expected price, these group of investors will outrun others while investing in good IPOs and will withdraw from the market in case of bad IPOs. This will create a scenario wherein uninformed investors will lose interest to invest in IPOs and will eventually defeat the firm’s purpose of generating capital from the market. To avoid such a situation and to ensure that the uninformed investors also purchase the IPOs, firms prefer to underprice their new issues. Study by Vong and Trigueiros (2010b) provide empirical evidence for this theory.

**Information generation cost theory**

Chemmanur (1993) has stated that underpricing results from insider’s inducing information production in order to obtain a more precise valuation of their firm in the secondary market. Outsiders, who do not have detailed information regarding a firm, will incur a cost to generate information regarding a firm. For a high valued firm, its true value will be reflected in the stock price only if information generation is done by the outsiders. So the high value firms will provide a discount to the actual price to promote information generation by outsiders. Datar and Mao (2006) have also suggested that firms deliberately underprice to encourage a wider subscription.

**Institutional explanation and deliberate underpricing**

Ruud (1993) and Taranto (2003) have suggested that firms deliberately underprice the security to avoid the risk of future litigation. Potential litigation costs motivate the entrepreneur to underprice the IPO in a tradeoff between the litigation cost and the up-front opportunity loss of underpricing. Recently Zhu (2009) has reiterated the relation between underpricing and litigation risk.

**Behavioural model**

According to this model, the price of IPOs goes above its fundamental value due to the over enthusiastic investors. Empirical evidence supporting behavioural imperfection theory includes Welch (1992), Loughran and Ritter (2002) and Ljungqvist and Wilhelm (2003).

**Ownership Retention Theory**

Underpricing has also been theorized as a means for the original owners to retain control (Brennan and Franks, 1995; Booth and Chua, 1995; Zingales, 1995; Pagano et al.,1998). These theories hypothesize that underpricing will attract a large array of bidders, such that, the issue can be sold to a disperse group that will not threaten the original owner’s control interests.

**Data Source and Sample Selection**

The sample data for this study is collected from the ShareInvestor database. Data regarding the listing day price of IPOs has been selected from the website of Malaysian stock exchange www.bursamalaysia.com. Other sites like www.cimbsecurities.com and www.malaysiastock.biz has been used to collect information regarding
subscription rate and size of the IPO. To ensure the validity of the sample data, the figures has been cross checked with available prospectus of IPOs.

The sample data contains all IPOs issued between January 2009 and December 2014 at the Malaysian stock exchange. 120 IPOs are issued during this period. 6 IPOs have been excluded due to non-availability of offer price. So a total of 114 IPOs are selected for the sample, which includes 95% of the total population. FTSE Bursa Malaysia KLCI Index, has been used as the market index in the study.

Methodology for Computation of Underpricing

The degree of underpricing in the Malaysian IPO market is calculated based on the Market adjusted abnormal returns (MAAR). MAAR means the extent to which the return of the IPO is above the market return. The following formula is used to calculate the underpricing for each IPO

$$MAAR_{il} = \frac{([1+R_{il}]/[1+R_{im}]) - 1)*100, \quad (1)$$

where MAAR_{il} = Market Adjusted Abnormal Return for stock i on the listing day.

$$R_{il} = (P_{il} - P_{io})/P_{io}, \quad (2)$$

where R_{il} is the percentage change in the list price of IPO with respect to the offer price; P_{il} - closing price of the IPO on the listing day; P_{io} - offer price for the IPO.

$$R_{im} = (P_{im} - P_{ic})/P_{ic}, \quad (3)$$

where Rim is the is the percentage change in the closing market index on the listing day to the closing market index on the date of closure of issue; Pim – closing price of market index on the listing day; Pic – closing price of market index on the date of closure of issue.

The average underpricing for all IPOs together is calculated by

$$(\sum_{i=1}^{n} MAAR_{il})/n,$$ where n is the total no of IPOs in the sample.

The above method is consistent with the methodology used by Sullivan and Unite (1999) and Sohail and Nasr (2007).

Descriptive Statistics

The return for each IPO has been calculated as shown in Table 1.

<table>
<thead>
<tr>
<th>Table 1. Computation of Market Adjusted Abnormal Return (Underpricing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computation of Underpricing for Kronologi Asia Berhad</td>
</tr>
<tr>
<td>Issue price (MYR)</td>
</tr>
<tr>
<td>Issue open date</td>
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<tr>
<td>Issue close date</td>
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<tr>
<td>Market Index as on issue close date</td>
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<tr>
<td>List price (close) (MYR)</td>
</tr>
<tr>
<td>Date of listing</td>
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<tr>
<td>Market Index on list date</td>
</tr>
<tr>
<td>IPO returns (Ri )Raw return in %</td>
</tr>
<tr>
<td>Market Index Return (Rm) in %</td>
</tr>
<tr>
<td>Underpricing/Market adjusted abnormal return (%)</td>
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</tbody>
</table>
The important characteristics of the 114 IPOs are given in Table 2.

### Table 2. Descriptive Statistics of 114 IPOs in Malaysian Stock Market

<table>
<thead>
<tr>
<th>Term</th>
<th>Mean</th>
<th>Median</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underpricing (in %)</td>
<td>23.45</td>
<td>19.03</td>
<td>309.9</td>
<td>-40.82</td>
<td>37.51</td>
</tr>
<tr>
<td>Over-subscription ratio (times)</td>
<td>34.67</td>
<td>30.28</td>
<td>388.42</td>
<td>0.94</td>
<td>54.32</td>
</tr>
<tr>
<td>Offer size (in million ringitts)</td>
<td>192.36</td>
<td>187.28</td>
<td>12500</td>
<td>2.1</td>
<td>872.62</td>
</tr>
</tbody>
</table>

Table 2 shows that underpricing exists in the Malaysian stock market during the study period. The market is showing an average underpricing of 23.45%, with a minimum of -40.82% and a maximum of 309.9%. This average underpricing is considerably lower than the figures of 80.3% reported by Isa (1993) for 132 Malaysian firms from 1980 to 1991, 72.85% by Yong (1997) and 94.91% reported by Yong and Isa (2003) regarding the Malaysian IPO market. The offer price is higher than the listing day price for 15 IPOs indicating overpricing. Thus overpricing is present in 13.16% of all the IPOs. The underpricing increases to 31.3%, when the cases of overpricing are not taken into consideration. Large differences between the maximum and minimum values are observed. This points to wide variation in the underpricing. Datar and Mao (2006) report average initial returns of 388.0% for 226 Chinese firms going public from 1990 to 1996, Dhatt et al. (1993) find average initial returns of 78.1% for 347 Korean firms from 1980 to 1990 and Wethyavivorn and Koo-smith (1991) find average initial returns of 58.1% for 32 Thai firms from 1988 to 1989. Rakibul (2014) observes that average underpricing for IPOs in Bangladesh during the period 2003 to 2013 is 214.6%. Compared to these, the average underpricing of the Malaysian stock market is substantially low during the period of study.

On average, the IPOs are oversubscribed by 34.67 times. The median value is 30.28 with a standard deviation of 54.32. The mean subscription rate is higher than the median showing that a large number of IPOs are subscribed at a higher price. Wide fluctuations in the subscription rate are evident from the high difference between the maximum and minimum values. The average over-subscription ratio is lower than 46 times, found in the study by Dawson (1987) regarding Malaysian IPO market. However, it is higher than 32.3 times by Yong (1997) and 22.06 times by Yong (2007) regarding Malaysian bourses.

Offer size is considered to be one of the major determinants of underpricing. The risk associated with a firm and the corresponding underpricing decreases with increase in the offer size of the firm according to Lougrhan and Ritter (1995). The average offer size of IPOs in the Malaysian market is 192.36 million ringitts. This is a comparatively higher value for offer size according to international standards. This may be one of the reasons for the comparatively low underpricing present in the Malaysian stock market.

### Conclusions and Implications

This paper examines the existence of underpricing with respect to the Malaysian market. 114 IPOs issued during the period 2009 to 2014 are analysed for the purpose. The study provides fresh evidence to the underpricing anomaly. It reveals that the IPOs are underpriced at an average of 23.45% at the list price. The average underpricing is very low in comparison with the underpricing figures in other countries. The reason may be the high average offer size of the IPOs, due to which the risk associated with
the firm is reduced.

The underpricing showed huge fluctuations with the maximum value at 309.9% and minimum at -40.82%, resulting in a range of 350.72%. The data disclosed the presence of overpricing in 13.16% of all the IPOs. The average underpricing showed a nominal increase of 7.85%, when the overpricing cases were avoided.

The average subscription rate for IPOs is 34.67, but subscription rate also shows huge variations in a range of 387.48. The offer size is comparatively higher at 192.36 million ringitts. This data also shows an extremely wide range equivalent to 12448 millions. The higher offer size can be one of the reasons for the comparatively lower value of underpricing.

The results also provide valuable information for the investors. The investors who are purchasing the IPOs stand to make an average profit of around 23% by the listing day. The chance for an investor, purchasing an IPO, to make a loss within the listing day, are very minimal at 13%. This fresh evidence proves that IPOs still continue to be a profit generating option for investors in the short term.

References


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**Abstract**

The paper analyses the extent of underpricing that exists in the Malaysian IPO market. 114 IPOs issued during 2009 to 2014 at Malaysian market has been used for the study. The findings of this study substantiate the presence of underpricing in Malaysian IPO market. The empirical results suggest that the investors, who put their money in IPOs, are earning an average of 23.45% return on the listing day. However, the extent of underpricing that exists in the Malaysian market is very small compared to other markets around the world.

**Keywords:** underpricing, initial public offer, market adjusted abnormal return