Chapter 5

Conclusion

Investors in the market can be differentiated by their level of informed investor. Informed investors should invest and trade based on information acquiring from the market. Merton (1987) proposes that institutional investors trade only the subset of available risky assets with which he or she is familiar. In the Thai stock market, Bailey and Jagtiani (1994) find that information availability and foreign investor familiarity generate price premiums in Alien Board. These papers suggest that information acquisition and dissemination are major determinant in explaining prices or returns in the stock market.

This study measures the information acquisition ability among investor groups during the offering period of common stocks. The newly issued stocks are used because there is little information about previous returns, risks and liquidity. Information acquisition ability, therefore, is important in this environment. Consequently, investors are apparently diverged into sub groups based on their information acquisition ability. In this study, the information acquisition ability is investigated both in primary and secondary markets by observing the relationship between investor holding or trading and the anomaly of IPOs (short-run underpricing and long-run underperformance).

Lack of previous returns and risks data on IPO firms also increases the importance of information disseminated to market during issuing period. This study also investigates the quality and predictability of the information disseminated during offering period of IPOs. Specifically, the study examines the accuracy of earnings forecast made by financial analysts on IPO stocks and find whether it has relationship with the aftermarket performance of IPOs.

This study composes of three major objectives. The first one aims to test the relationship between level of subscription or allocation from each group of investor in the primary market and the degree of underpricing. The second objective examines the relationship between investors trading in the secondary market and the aftermarket

performance of IPO firms. Finally, the third objective is to investigate the quality of information produced by financial analyst subsequent to the offering date.

Data used in testing hypothesis in the primary market (*H1*) are the IPOs which have available data reported in the "Selling Report". Form 81-1 (b) of Selling Report summarizes the results of selling the new issued stock to each group of investor in the primary market. In the Selling Report, most of the data report similar number of share subscribed and number of shares allocated to investors. According to this form, investors are classified into 4 groups: - local individual, local institution, foreign individual and foreign institution investors. From the Rock (1986) and Carter and Manaster (1990), the models imply that number of informed investor is an increasing function with degree of underpricing. Foreign investors and local institutional investors are hypothesized, in this study, to be positively correlated with degree of underpricing according to Rock (1986) and Carter and Manaster (1990) models.

Data in the secondary market are the daily volume and percentage of trading by each group of investor on IPOs that issue common stocks in 1996. 39 IPOs are used to find different ability among investor groups in selecting the IPOs regarding its future performance. Hypothesis is that informed investors have the ability to select the IPOs, which their future performance is good relative to other IPOs. Foreign and institutional investors are expected to exhibit superior investors compared to individual investors since they are claimed to dominate other participants in this market (Khantavit (1996)). In the third test, the earnings forecast data are obtained from the I/B/E/S database.

In section I of Chapter 4, initial returns of IPOs are examined. The results show that on average the first-day initial returns of 292 IPOs during 1987-1997 are positive by 46.73%. Energy sector has the highest initial returns and Banking sector has the lowest initial returns. These results are consistent with the finding of Ritter (1984) who find that, in the U.S. stock market, the oil sector exhibit the highest initial returns. The variation of initial returns across industrial sectors supports the incomplete spanning of IPOs in the secondary market which proposed by Mauer and Senbet (1992). When investor in the primary market is decomposed, it is found that Local individual investors are major investors in the primary market (63.6%) and foreign investors are the minor investors (10.5%). The result also shows that foreign

investors are interested in the new (small number of ages) firms and large size offering while local individual investors tend to be interested in small size and old firms. Hypothesis of positive relationship between informed investor and underpricing (*H1*) is tested by examining the correlation between level of subscription from each investor group and initial returns, investigating the cross-tabulation between level of investor subscription and underpricing and performing the regression analysis. Results from the three methods consistently suggest that local individual investors are least informed investors. Foreign investor and local institutional investors are informed investors relative to local individual investors since the level of subscription are positive correlate with initial returns of IPOs. The result supports the model of Rock (1986) and Carter and Manaster (1990).

In the secondary market, this study explores the performance of IPOs in the secondary market. Performances of newly issued stocks in the secondary market are measured using the cumulative adjusted returns (CARs) and the 3-years buy-and hold-returns (WR). Alternative benchmarks are used for robustness check. They are industry- and size-match firm, the SET index, the industry index and constructed size-match portfolio both equally weighted and value weighted.

Results from secondary market reveal that the 3-year cumulative adjusted average returns (CARs) are negative using the SET index, the industry index and constructed size-match portfolio as benchmarks. Using SET index benchmark, the 3-year CARs are -55.30%. The result of underperformance is confirmed when alternative 3-year buy- and hold- method is used. The results reject the overreaction hypothesis since the level of underperformance is not correlated with the initial returns of IPOs.

The hypothesis that investors are not equal in their ability to acquire information in the secondary market is also evidenced (H2 and H3). The level of subscription from foreign investors is positively correlated with the aftermarket performance of IPOs while this relationship is not found for local individual investors and institutional investors. Further investigation shows that foreign investors and local institutional investors are not captured by long-run underperformance of IPOs Specifically, the portfolio which report positive changes in the cumulative net investment (CNI) during the first 21 days exhibits positive cumulative adjusted

returns (CARs) using SET index as benchmark. And, portfolios which report negative CNI during the first 21-day express negative CARs. The results are reversed for the customer portfolio.

In conclusion, results from both primary market and secondary market support argument claimed that foreign investors and institutional investors are better informed investors relative to individual investors.

In the topic of information dissemination, the results show that error in earnings forecast is very high for this market and display systematic bias in the forecast value. Specifically, financial analysts are overoptimistic in forecasting the EPS of IPOs firms. This result is similar to Rajan and Servaes (1997). The result also indicates that the revision of EPS forecast in one year is a valuable information to market since the relationship between the revision and aftermarket performance is significantly positive.

The results from this study suggest that policy maker should concern about information provided during issuing period to individual investors since they are investor group who generally losses in the market. It should be noted that foreign investor is the group whose investment show positive relationship with returns of IPO stocks. However, this result can not be concluded that foreign investor is the group who capture profit on the IPO stocks since the study does not have data to elaborate buying or selling in the secondary market by these investors.

This study can be further expanded for further research in many areas. For example, level of disclosure of information across firms should be investigated its relationship with level of subscription and level of trading from each group of investor. International investigation of the relationship between performance of firms and level of trading from each group of investors is essential to check the validity of the argument conjecturing superior ability of informed investors.

It is also interesting to examine change in ownership structure during the issuing period. Then, this issue can be hypothesized to correlate with firm value, level of subscription and level of trading by each group of investor.

Finally, data on daily volume trading by each investor group on each stock should be examined to see whether there is opportunity to exploit profit from herding strategy or not. Currently, the data are not publicly published to prevent any abnormal profit deducted from the data. This policy may prevent efficiency of information produced by market participants and should be revised to promote more market efficiency.